ANZ

CAPITAL MARKETS IN PAKISTAN: RESOURCE MOBILIZATION FOR HOUSING FINANCE COMPANIES

STUDY CONDUCTED FOR

SHELTER RESOURCE MOBILIZATION PROGRAM

USAID

BY

ANZ GRINDLAYS BANK

PAKISTAN

December, 1992

ANZ

TABLE OF CONTENTS

ANZ

ANNEXURES

This report has been prepared by Adil Ahmad, Azam Mashadi, Nadeem Anwar, Syed Hussain Shirazie, Syed Tariq Husain and Shahid H. Kardar (Consultant).

ANZ

ACRONYMS

"ADB"	Asian Development Bank
"ADBP"	Agricultural Development Bank of Pakistan
"BEL"	Bankers Equity Limited
"CCI"	Controller of Capital Issues
"CLA"	Corporate Law Authority
"DBCs"	Dollar Bearer Certificates
"DFI"	Development Finance Institutions
"DSCs"	Defence Saving Certificates
"FIBs"	Federal Investment Bonds
"FEBCs"	Foreign Exchange Bearer Certificates
"HBFC"	House Building Finance Corporation
"ICP"	Investment Corporation of Pakistan
"IDB"	Islamic Development Bank
"IDBP"	Industrial Development Bank of Pakistan
"ISE"	Islamabad Stock Exchange
"IFC"	International Finance Corporation
"KSE"	Karachi Stock Exchange
"LIBOR"	London Interbank Offer Rate
"LSE"	Lahore Stock Exchange
"MNCs"	Multinational Companies
"NBFIs"	Non-Bank Financial Institutions
"NCB"	Nationalised Commercial Banks
"NDFC"	National Development Finance Corporation
"NDLC"	National Development Leasing Corporation
"NIT"	National Investment Trust

ANZ

"PICIC"	Pakistan Industrial Credit & Investment Corporation
"PNSC"	Pakistan National Shipping Corporation
"PRs"	Prudential Regulations
"PTC"	Pakistan Telecommunication Corporation
"SLIC"	State Life Insurance Corporation
"SBFC"	Small Business Finance Corporation
"SBP"	State Bank of Pakistan
"SOEs"	State Owned Enterprises
"SRMP"	Shelter Resource Mobilization Program
"TBs"	Treasury Bills
"USAID"	United States Agency for International Development
"WAPDA"	Water & Power Development Authority

1. EXECUTIVE SUMMARY

√

ANZ

A. INTRODUCTION

1.01 This study on capital markets was commissioned by USAID. The report provides a brief historical review of the domestic financial sector and the institutional framework prior to the recent reforms undertaken by the Government of Pakistan to develop this sector. It evaluates the reforms and the manner in which these measures are influencing the growth of capital markets. It discusses the policy, legal, fiscal and institutional factors that constrain the development of these markets and the implications of these and other constraints on the expansion of the housing finance sector. The final chapter is devoted to the formulation of proposals that will facilitate the evolution, and thereafter efficient functioning of capital markets in general and the housing finance sector in particular.

B. DOMESTIC SAVINGS AND THE FINANCIAL SECTOR

1.02 Pakistan's national savings rate at barely above 13% of GNP is rather low, both in absolute terms and relative to other similarly placed countries.

1.03 The government has been a net dissaver for many years. The gap between revenues and expenditures has expanded steadily causing the fiscal deficit to rise from around 5% of GDP in the early 1980s to just below 8% of GDP in 1991-92. The long term environment for growth is threatened by these large and growing deficits.

1.04 Financial and capital market development is important for the overall mobilization of savings and for the allocation of resources required for complementing and supporting the funding needs of productive activities, including housing finance.

1.05 Despite the relatively low per capita income and the low rate of national savings the financial sector is quite large, dynamic and diverse compared with other countries at a similar stage of development.

C. BACKGROUND TO THE FINANCIAL SECTOR REFORMS

1.06 Prior to the May 1991 financial reforms there was an elaborate system of regulations governing the financial system in general and the banking sector in particular. The flow and level of credit to different sectors of the economy was administered by the government.

1.07 Under the financial regime of ceilings the banking sector provided the government captive funds at low interest rates for financing its expenditures. Whereas one portion of government debt was provided by the banking sector at around 6%, much below market rates of interest, another portion was provided by the public directly through government saving schemes that carried high interest rates - 14% to 16%.

1.08 The banks had little motivation to mobilize deposits. The government, therefore, decided to facilitate the development of a structure that would be less centred on credit ceilings and provide the financial institutions with an incentive to play a more active role in mobilizing savings.

D. FINANCIAL SECTOR REFORMS

1.09 The key measures that lie at the heart of the financial sector reform programme are:

(a) improvement of the competitive environment in which banks operate through privatisation and greater reliance on market forces;

(b) liberalisation of exchange controls;

(c) the deregulation of the structure of interest rates and a gradual dismantling of the system of directed credit;

(d) permission for foreign ownership of equity; and

(e) improved bank supervision.

1.10 Also, to improve the capital base, for ensuring safety and security, and to maintain the operationality of financial institutions, well-designed, stringent prudential capital adequacy standards have been introduced.

E. IMPACT OF LIBERALISATION ON THE FINANCIAL SECTOR

1.11 The timing of the liberalisation measures happily coincided with a growth in the overall size of the market. As a result new entrants had a relatively easy entry into the market.

1.12 Since June, 1991, deposits have increased by 32.5% (a growth of 23% on an annualized basis). The growth in bank deposits can be attributed to the following factors.

a) The government's reform programme as a result of which there has been an increase in foreign currency deposits by US$ 1.4 billion between May 1991 and November 1992.

b) The establishment of new commercial banks has resulted in concerted deposit mobilisation drives by these institutions.

c) The stock market boom brought money into the banking system for participation in equity investments.

d) The deficit financing undertaken by the government (money supply grew by around 18% between 1990 and 1991 and at 20.6% during 1991-92 and the first five months of 1992-93) also brought about an increase in monetary savings.

e) The significant slump in the property market, mainly as a result of the collapse of the cooperatives in the Punjab.

f) The switching of corporate, pension and provident funds from National Savings Schemes (NSSs) into banks following the government's decision to prohibit, first the corporate sector, and now pension and provident funds from investing in NSSs.

1.13 However, the financial sector reforms are too recent to enable a more robust analysis of their impact. Also, this period has coincided with changes in government policy in the other sectors that are impacting upon the growth of the financial sector.

1.14 Some of the events are too recent and the basis for drawing conclusions too fragile to infer that this growth in deposits is of a permanent nature. For instance, a fair proportion of these deposits may well represent money that has been "parked temporarily" in search of more attractive investment opportunities - for instance, in traditional investments like real estate. Factors like the low rate of return on bank deposits compared with the returns on instruments like Treasury Bills (TBs) and Federal Investment Bonds (FIBs) and the current rate of inflation (even if we accept the officially accepted rate of 10%) seem to support this view.

1.15 Nevertheless, savers are at least, 250 to 300 basis points better off (for instance since privatisation MCB have raised the return on PLS accounts by 1%). Interest rates would have, perhaps, risen even further had this period not coincided with the occurrence of other events (referred to above) that induced a flow of capital into the financial sector, in particular into the commercial banking system.

1.16 The noteworthy aspect of the execution of the programme has been the flexibility shown in implementation.

F. THE EFFECT OF THE REFORMS ON THE STOCK MARKET

1.17 The economic reforms introduced by the government had an immediate impact on the stock market. They changed the perception of investors and served as the ignition point for an increase in investment and economic activity. The new KSE share price index soared to 1680 until a correction pushed it back to its current level of around 1230, while the State Bank General Index of Share Prices rose by 93.2% during 1991-92 compared with an increase of 38.2% in the preceding year. Market capitalization has increased from Rs. 52 billion in 1989 to Rs. 200 billion in December, 1992.

1.18 The traded number of shares increased from 361 million to 725 million while the value of traded shares rose from Rs. 27.9 billion to Rs. 85.8 billion. In 1991 the average daily turnover was 2.4 million. By 1992 the daily turnover had increased to 3 million, with a substantial proportion of trading accounted for by foreign investors.

1.19 The potential of the stock market to serve as an instrument for raising long term funds has not been fully exploited. There is evidence of its capacity to absorb large offerings. Between April 1991 and September 1992 capital of Rs. 22 billion was raised through the Karachi Stock Exchange through new flotations, rights issues and bonus shares, over and above the Rs. 4.5 billion raised (in cash terms) through privatisation.

G. GROWTH IN GOVERNMENT DEBT

1.20 One major area of concern is the huge and burgeoning government debt and the impact it is having on the financial markets in general and the interest rate structure in particular.

1.21 The government's domestic debt has increased from Rs. 58.1 billion in 1980-81 to over Rs. 500 billion in 1991-92, growing at a galloping rate of almost 22% per annum and as a percentage of the GDP from 20.9% to 42.4%.

1.22 During the first five months of the current fiscal year (1992-93) the government's borrowings from the banking system for budgetary purposes has already exceeded the target for the entire year.

H. NEW DEBT INSTRUMENTS

1.23 Since March, 1991 the government has been auctioning two debt instruments, which have the crucial capability of liquidity:

a) Treasury bills - TBs - (a floating debt instrument).

b) The Federal Investment Bonds - FIBs - (a permanent debt instrument) that are available for 3, 5 and 10 year periods.

1.24 The TBs are zero coupon instruments of 6 month maturity and can be discounted with the State Bank. Rates on TBs have been growing steadily, increasing from 8.55% to 13.2% (as contrasted with 13% on a 3 year FIB).

1.25 The FIBs are fixed income securities, paid half yearly, carrying a rate dependent upon the maturity period; 13% for 3 years, 14% for 4 years and 15% for a 5 year maturity period respectively. Federal Investment Bond auctions have been more predictable than Treasury Bill auctions.

1.26 As part of the reform measures the State Bank has established the Subsidiary General Ledger Account (SGLA), a book-based system for settling secondary market deals. The establishment of a book-based system at the State Bank has improved the security and efficiency of the system.

1.27 A strong secondary market for T.Bills has developed, but only between banks.

1.28 The development of the secondary market will to a large extent depend on the attitude of the government towards the development of financial markets. The perception of the Ministry of Finance is that the major players in the market are colluding to drive rates to unreasonably high interest levels. This attitude has tended to thwart the development of the secondary market.

I. CONSTRAINTS TO DEVELOPMENT OF CAPITAL MARKETS

I.1 Policy Constraints

1.29 A stable macro-economic environment is critical for the successful implementation of financial reforms. Inflation reduces reliability of prices as a factor of information. Long term investments are viewed as risky. Considerable efforts and resources are required to overcome or adjust to price distortions. Thus, a high degree of price stability is essential for the success of the liberalisation programme, especially because financial markets in Pakistan today are not only shallow but have not fully recovered from the financial wounds inflicted upon them by the recent scandals involving the cooperative societies. The government, therefore, needs to take urgent measures to keep inflation under control if the liberalization measures are to achieve the objectives associated with their initiation, the most important of which will revolve around the reduction of its budgetary deficit.

1.30 Investors find it difficult to operate in a system in which there are frequent changes in policies. Continuity of policies is critical for introducing the stability that will attract serious investors. Long term reforms announced in advance enhance the government's credibility and also give affected institutions time to adjust.

1.31 The financial sector is still characterised by uncertainty caused by frequent changes in government policies. For instance, in January 1992, the government ostensibly dismantled the structure of credit ceilings and introduced the concept of a 65% credit/deposit ratio. However, after the banks had expanded their deposit base by US$ 700 million the State Bank imposed a 3% exchange cover risk on the plea that the banks could afford to pay it. Later on the credit deposit ratio for private sector lending was reduced to 30% on local currency deposits and 40% on foreign currency deposits. The State Bank has now intimated that from April, 1993 a uniform credit deposit ratio will be applicable.

1.32 Till the fiscal year 1992-93, the government had permitted the private sector to set up Modarabas which were to be exempt from income tax. The imposition, in 1992-93, of an income tax at the rate of 25% on all modarabas in existence for more than

3 years provides another example of the government backtracking and introducing a levy (without giving adequate notice to modarabas already in existence).

1.33 Finally, during the last 2-3 years the government first withdrew the exemption from taxation of dividend incomes and then raised the taxation rate each year.

I.2 Fiscal Treatment of Different Financial Instruments

1.34 A major impediment faced by the private sector in mobilizing resources is the inconsistency of tax treatment on the profits of various instruments. Fiscal concessions have been granted to incomes earned by funds invested in specific instruments. For example, Special Saving Certificates (SSCs) and earlier issues of WAPDA bearer bonds are exempt from income tax.

I.3 Constraints to Development of Secondary Markets for Government Debt

1.35 A big constraint to the trading of TBs and FIBs is the imposition of the withholding tax. TBs and FIBs are sold cum-interest and the holder of the instrument on maturity is liable to pay the withholding tax on the entire return. This adversely affects the market for instruments the maturities of which are close to the interest payment date.

1.36 At the same time that it has been issuing Federal Investment Bonds (which in themselves are fairly attractive instruments) the government is negatively impacting upon their marketability by permitting the issue of other government guaranteed paper which has vastly superior qualities in that it is bearer and exempt from Zakat.

1.37 The current policy of the State Bank is to do Repo at 15%. The fact that the State Bank is always willing to do Repo and that this rate is fixed, and does not adjust to market conditions at different moments in time during the year, it is negatively impacting upon the development of a secondary market.

I.4 Incentives to Invest in Real Estate versus Financial Assets

1.38 In Pakistan the incentives to invest in financial assets are lower than the incentives to invest in other assets, in particular urban land.

1.39 The legal and fiscal instruments and the institutional arrangements that enable or facilitate speculation in land for long periods include the following:

a) The low non-utilization charges levied by development authorities for leaving land vacant.

b) The property tax structure that enables vacant land to virtually escape property tax.

c) The absence of a capital gains tax.

d) Land can be transferred through powers of attorney. A property may exchange hands several time, without each transaction being legally liable for taxes (stamp duty and registration fees) which become payable only on the execution of a lease or a sale.

e) Under Muslim Personal Law there is no statutory requirement to register an oral gift.

f) The legal system permits ownership of land in fictitious names, in the name of a person other than the real owner, i.e., holding it 'benami'.

I.5 Business Culture and Legal Constraints

1.40 The legal system is inadequate and slow in enforcing contractual obligations. The inability to enforce contracts through legal channels is one of the root causes of the inefficiency in the Pakistani economy. It has to be made more responsive to the needs of financial liberalisation. This will require a supportive legal, administrative and regulatory structure for protecting depositors of private banks and an adequate bankruptcy law for enforcing foreclosures.

I.6 Multiple Regulatory Agencies

1.41 Capital markets are currently being regulated by various government agencies, including the Ministry of Finance, the State Bank of Pakistan, the Corporate Law Authority, the Religious Board, the Internal Finance Wing of the Ministry of Finance and the Controller of Capital Issues. The existence of multiple regulators hinders the smooth functioning of capital markets.

1.42 It would be desirable to confer onto the Corporate Law Authority or some similar agency the right to deal with all capital market issues.

J. POTENTIAL NEW INSTRUMENTS - COMMERCIAL PAPER

1.43 There is little incentive for top tier companies to float commercial paper because they have good access to bank credit. In fact, the top tier of the prime corporations, can borrow at rates (10% to 11%) which are even lower than the (credit) risk free rates being offered on government securities. Also the existence of some instruments like SSCs and the ready availability of government T-Bills and FIBs backed by government guarantees make it difficult for private companies to issue their own paper.

1.44 Stamp duty at 3.5% in Sindh - it varies between provinces - on private sector marketable securities inhibits the development of a market for commercial paper.

1.45 The regulations governing the operations of provident and pension funds do not permit them to invest in corporate debt.

1.46 The Islamic mode of finance impedes development of financial markets. Problems are encountered in even issuing convertible bonds because they carry a fixed interest rate.

1.47 The State Bank has also imposed several restrictions that make public issues of commercial paper more difficult. Specifically, private sector companies cannot issue securities in bearer form, placing them at a competitive disadvantage vis-a-vis public sector institutions, which have been allowed to issue bearer securities for the past several years. Furthermore, banks are not permitted to provide bank guarantees on any security issue by a private sector firm.

K. FACTORS CONSTRAINING GROWTH OF HOUSING FINANCE

K.1 Cost of Funds

1.48 Existing financial institutions have alternative options for advancing credit that reduce the attraction for housing loans. In a market starved for funds the banks are not under any pressure to venture into activities other than those they have performed traditionally. Not only are they earning risk free yield on long term government bonds of 15%, the interest rates on most corporate credit is 16% - 18%. In other words, there is a huge demand for credit against which 'better quality' collateral is being offered (than would be provided by an individual seeking a housing loan). The banking sector can hardly be expected to show a great deal of enthusiasm for extending housing loans that would invariably be much smaller in size, and yet require the devotion of more administrative resources (in terms of personnel and costs). The willingness of commercial banks to venture into housing finance type activities will be adversely affected even further with the recent decision of the State Bank to raise the reserve requirement from 40% to 45% of deposits.

1.49 The financial institutions would broaden their base of operations into relatively riskier areas only if the profit margins were higher, which would mean an interest rate of at least 20%.

1.50 Only a small segment of the population would be able to service debts for new housing at rates of interest exceeding 20%, unless the banks express willingness to extend considerably smaller home improvement loans.

1.51 For new special purpose housing finance companies the biggest problem would be deposit mobilization. In the present financial environment, where interest rates would be pegged to rates being offered on government securities, the high cost of funds would inevitably push up the on-lending rates to levels even more formidable than the ones indicated earlier above, making the debt servicing costs of new housing prohibitive for the middle and a substantial proportion of the upper income groups.

K.2 The Taxation Issues Hindering Development of a Housing Finance Market

1.52 In the case of self occupied property the government does not permit the tax payer to set off the expenditure on debt servicing (the financial charges component) against his other income.

1.53 According to income tax experts housing finance companies (HFCs) could become liable for the 2.5% turnover tax.

1.54 Some tax practitioners also argue that the nature of the mortgage agreement could potentially lead to the company having to pay property tax at rates applicable to rented out properties, at 25% of the "annual rent".

K.3 Problems of Foreclosure

1.55 A large problem in developing housing finance in Pakistan is the difficulty of enforcing foreclosure laws in the event of a default. The procedural complications encountered by financial institutions in cashing a collateral, particularly of immovable property, is a deterrent holding back the private sector from venturing into housing finance activities.

1.56 However, the relatively successful performance of Banking Tribunals provides some basis for optimism that the formidable challenge of foreclosure can be addressed through an appropriate strengthening of the legal framework and the judicial machinery, by developing strong credit appraisal procedures and by strengthening institutional capacities.

K.4 Cost of Registering Property Related Transactions

1.57 Another important factor that will hinder the growth of housing finance will be the high cost of registering property related transactions. The costs in urban areas in

Sindh include a 1% registration fees, a 8.5% provincial stamp duty, a 2.5% property transfer fee charged by local government, a 5% capital value tax (CVT) on certain categories of residential plots exceeding 240 sq.yds., other charges (professional charges, brokerage fees and court fees). In the case of a loan, there is a 1% charge for registration of the mortgage documents, a 3% stamp duty for a non-bank financial institution (the stamp duty is 1% in the case of a banking company) plus charges for fire insurance and professional input.

L. RECOMMENDATIONS

1.58 Some policy, legal and institutional reforms are critical for creating the enabling environment for the long term development of capital markets in general and the housing finance sector in particular. A more detailed and focused effort would be required to draw up precise proposals taking into consideration their wider implications and their inter-sectoral linkages and, on the other hand, some of the relevant changes would be politically and practically difficult to introduce in the foreseeable future. We mention these issues as some of them seem critical to the development of a housing finance industry.

1.59 Such a package of reforms would broadly cover the following areas:

a) Measures to bring down the government's budget deficit, touching 8% of the GDP.

b) Granting of greater autonomy to the State Bank to pursue a consistent monetary policy without interference from higher levels of government.

c) More effective foreclosure mechanisms through appropriate amendments in the legislative framework, procedural changes and strengthening of the judicial machinery.

d) Development of a well trained supervisory staff at the State Bank to ensure that the rapidly expanding financial institutions comply with the new prudential regulations.

e) Development of an Apex institution for the regulation of the securities market.

L.1 Measures that can be Implemented in the Short Term

L.1.1 Housing Finance Policy

1.60 The government should allow the deduction, against the taxable income of a tax payer, the interest element of a housing loan - placing an upper limit on the value of the loan.

1.61 Some of the instruments that could reduce the cost of funds for housing finance that the government should consider are:

a) Fiscal incentives, for instance, concessions in income tax for a specific period, for those providing housing finance.

b) Permission to HFCs to have access to passbook saving accounts, as is the case in almost every developed country. Passbook savings can serve as a growing source of capital for mortgage lending.

c) The treatment of housing finance companies (HFCs) as commercial banks for purposes of inter-bank borrowing. The cost of funds can be lowered by allowing HFCs access to interbank funds, particularly because these companies will be undercapitalized in their early years of operation. There is a critical need to provide them with short term funds to meet liquidity needs and provide for stable cash management. Access to passbook savings [(b) above] will be a longer term source of funds and it will take HFCs several years to build up this deposit base.

d) Lowering of the costs of registering property related transactions (registration fees, stamp duty, capital value tax, etc.) and mortgage documentation. These issues are beyond the scope of this study but are critical to the development of the housing finance industry.

L.1.2 Policies Regarding Capital Market Securities

1.62 For fixed interest securities held by banks the Government of Pakistan must initiate a system of regular auctions reasonably interspaced in time to give the secondary market time to develop.

1.63 During the last 18 months there have been 84 issues of FIBs (28 for each period of maturity). The crowding of issues has given rise to a fairly complicated secondary market. The market could be simplified considerably if there was only one issue per annum.

1.64 The government should have a uniform policy for all securities in respect of the liability for Zakat and for wealth tax and income tax (withholding tax) purposes.

1.65 The private sector, like public sector corporations, should be permitted to issue bearer certificates (commercial paper) and domestic banks should be allowed to guarantee paper issued by the private sector.

1.66 To facilitate the development of a market for commercial paper the Federal Government should persuade the Provincial Governments to reconsider the high rate of stamp duty and the stage at which it is to be levied. Currently duty at 3.5% is payable both at the time of issue of paper and at all subsequent transfers.

1.67 Underwriting is a requirement for public issues; it gives the market liquidity. No restrictions on the amount of issue or fees should be placed.

1.68 A separate study needs to be conducted for identifying proposals for developing secondary markets.

1.69 A study also needs to be undertaken to develop proposals for reducing multiplicity of regulations and regulatory bodies.

L.2 Recommendations that can be Undertaken in the Medium Term

L.2.1 Access to Pension/Provident Funds

1.70 Pensions/provident funds should be allowed to operate in the equities market. This will give the market both depth and liquidity.

L.2.2 Supervision and Monitoring of Financial Institutions

1.71 After the recent reforms controlling money supply has become a more sophisticated exercise, reinforcing the importance of well trained staff responsible for performing the regulatory functions. Added to this is the onerous responsibility of having to regulate almost 110 financial institutions. The State Bank, therefore, needs internal reforms, qualified and suitably trained staff to ensure compliance with sound business practices and enable streamlining of the various departments to make them more efficient and productive.

1.72 In view of the history of financial scams in the country and the recent proliferation of new financial institutions there is a need for establishing deposit insurance schemes.

L.3 Proposals that can be Implemented in the Long Term

L.3.1 Capital Adequacy Ratios

1.73 The capital adequacy ratios of banks should be based on Bank for International Settlements (BIS) guidelines where capital adequacy is a function of risk weighted assets rather than of the gearing ratio.

L.3.2 Private Sector Involvement in Policy Formulation

1.74 In view of the problems encountered by different players in the market (including the government) in interpreting and implementing different policy changes the government should involve the private sector in formulating policies, making legislative changes and in devising implementation mechanisms and instruments.

1.75 However, the financial systems will function effectively only if the private sector also responds positively to government initiatives in this direction. Currently, entrepreneurs do not collaborate with each other to develop codes of behaviour and standards for self regulation. An institutional structure for disciplining and publicly reprimanding those abusing the freedoms and not rectifying their operational practices will help marginalize those not complying with the ground rules. The private sector will have to fulfil these obligations itself and not rely primarily on the government to perform these functions.

L.3.3 Other Stock Market REforms

1.76 There are an equal number of stock market reforms which are addressed in detail in the Section on Recommendation (Section 13). They are listed here and cover the following issues:

- Fraud prevention and detection
- Insider trading
- Capital base
- More players
- Retail market constraints
- Complaint registration
- Share transfer
- Settlement

2. SCOPE OF STUDY AND METHODOLOGY

A. INTRODUCTION

2.01 This section of the report introduces the objectives of the assignment, describes the methodology adopted for conducting the study and identifies the limitations of the study.

2.02 This study was commissioned by the USAID. The aim of the study is to develop an understanding of the developments taking place in domestic capital markets and the policy, procedural, institutional and legal constraints being faced by the different players that are active in the market. The report reviews recent developments in the domestic financial structure, in the light of the financial reforms introduced by the Government of Pakistan, and makes an assessment of their likely impact on the evolution and growth of capital markets in general and the supply and demand for housing finance in particular.

2.03 It examines the structure of capital markets, the institutional arrangements, the activities of the key parties - the State Bank, the commercial banks, the institutional investors, the stock exchanges, the investment finance companies, the modarabas, etc., and the rules and regulations governing their operations. It examines the legal, fiscal and regulatory framework governing the market for government debt, equities and other securities and how they impact upon the development of capital markets. It assesses the supply, demand and ownership pattern of securities and analyses the underwriting procedures, the financing patterns and the costs of public issues. It also briefly looks at matters connected with the pricing of new public issues and government regulations requiring large companies to go public.

2.04 The findings of this report are based upon the results of extensive interviews and a review of available data and policy documentation. Whatever factual and anecdotal information was available has been incorporated and subjected to an examination in this report.

B. METHODOLOGY

2.05 The following methodology was adopted to satisfy the objectives of the study:

a) A review was undertaken of the financial reforms that have been introduced.

b) An evaluation was carried out of the capital markets, the institutional arrangements (both in the public and private sectors) and the more important financial instruments being introduced by the govemment and the private sector to mobilize savings.

c) A critical aspect of the study included extensive interviews of a representative sample of bankers (in commercial banks and DFIs), institutional investors, stock brokers, and relevant officials of the State Bank (Annexure-3) - the key players - on the manner of functioning of capital markets.

C. LIMITATIONS OF STUDY

2.06 As the introduction of the package of financial reforms was introduced, and the initiation of the process of capital market development based on market signals took place only recently, much of the assessment of their likely impact on the volume of savings or the financialisation of savings is analytical, but not irrefutable evidence, particularly in view of the fact that this period has coincided with the large devaluation of the property market and the similar large swings in the stock market - alternative investment opportunities.

2.07 Before forming definite conclusions at the macro level the reader would be well-advised to place the responses of the different actors in this sector in their proper perspective. Respondents demonstrated obvious and understandable biases in their answers, thereby casting doubts on the accuracy of the replies. For instance, due consideration must be given to the human urge to overstate one's own performance, to state what they perceive to be in their own interest and, where results are unsatisfactory, to pin the blame upon others and claim that the role and attitude of others must change before the level of efficiency of the system can be raised. Bankers and stock brokers, therefore, exaggerate their own efficiency, the unhelpful attitude of the bureaucracy and the lack of information, while the government is understandably reluctant to accept some of the procedural and policy weaknesses of the programme. Therefore, wherever possible, we have presented both points of view to provide as comprehensive and as objective a picture as was possible for us to do within the narrow time frame available for completing the study.

ANZ

3. THE MACRO ENVIRONMENT AND THE FINANCIAL SECTOR

A. INTRODUCTION

3.01 Since the mid sixties Pakistan has been registering an annual growth rate of 2.5% in per capita GNP compared with an average of just under 1.9% in the case of other developing countries, excluding China. The high growth rates have been achieved through a heavy dependence on external capital inflows - there has been a gap of 5 to 6 percentage points between gross domestic investment as a percentage of GDP and domestic savings as a percentage of GDP - and by running down the already limited physical and social infrastructure.

B. DOMESTIC SAVINGS

3.02 Pakistan's savings rate is rather low, both in absolute terms and relative to other similarly placed countries. Pakistan's domestic savings rate has remained below 10% for most of its history - and between 6.5% to 8.5% since the 1970s - compared with the rate in excess of 20% for most low and lower middle income countries.

3.03 The national savings rate at around 14% of GNP has, however, been perceptibly higher than the domestic savings rate on account of the substantial inflows of workers' remittances. However, despite the additionality of remittances the national savings rate is rather low in comparison with the gross investment rates required for sustaining future growth.

3.04 A comprehensive picture of households savings is not available because details of household wealth of non-financial assets are not available and these constitute the bulk of household wealth. The most important component of financial assets are deposits.

3.05 The government has been a net dissaver for years. The gap between revenues and expenditures has expanded over the years, causing the fiscal deficit to rise from around 5% of GDP in the early 1980s to just under 8% of GDP in 1991-92. The long term environment for growth and the ability of the government to support development is threatened by these large and growing deficits.

C. THE FINANCIAL SECTOR

3.06 Financial and capital market development is important for the overall mobilization of savings and for the allocation of resources required for complementing and supporting the funding needs of productive activities, including an important sub-sector of the financial sector, housing finance. In this the role of financial intermediaries is simply the mobilization of savings of the community and passing them on to potential investors by adopting prudent norms of lending.

3.07 Despite the relatively low per capita income and the low rate of national savings the financial sector is quite large, dynamic and diverse in comparison with other countries at a similar stage of development.

3.08 This study, therefore, reviews the scenario developing in the financial markets by examining the financial instruments and interest rate structures that were in place before the financial sector reforms of 1991 (Sections 5 and 6), the reforms introduced by the government to improve the efficiency of financial markets (Section 8), the size and nature of government debt and its impact on the interest rate structure and the environment for the development of the housing finance sector (Section 10), the policy, legal, fiscal, institutional and other constraints to the development of capital markets in general and the housing finance sector in particular (Sections 11 and 12).

ANZ

4. INTRODUCTION TO INSTITUTIONS OPERATING IN THE FINANCIAL SECTOR

A. INTRODUCTION

4.01 This section introduces the different institutions operating in the domestic financial sector and the variety of roles they perform in the sector. The recent proliferation in the variety of financial institutions in the marketplace makes it important to review the status and role of each type of institution.

4.02 As the financial sector in Pakistan has evolved, the government has created a framework for specialised institutions, each designed to meet the needs of a specific financial service. The increasingly complex nature of finance has increased the variety of institutions. These include commercial banks, investment finance companies, development finance institutions, leasing companies, modarabas, stock brokers and housing finance companies. As a result the financial sector today comprises 4 NCBs, 2 provincial government banks, 2 privatised commercial banks, 9 new private commercial banks, 22 foreign banks, 15 leasing companies, 39 modarabas (mutual fund companies), 9 private investment banks, 11 DFIs while letters of intent have been granted to 8 housing finance companies (see Annexure-2 for complete list of names). Each type of institution addresses the needs of a specific segment of the market.

4.02 These financial institutions can be essentially classified into two broad categories, banking companies and non-bank financial institutions, with both being controlled primarily by the central bank, the State Bank of Pakistan. They are also regulated, depending upon the nature of the institution, by the Corporate Law Authority, the Ministry of Finance and the Religious Board. The roles of these institutions are described below:

B. BANKING COMPANIES

4.03 Banking in Pakistan is basically conducted by the 37 scheduled banks. In addition to these, 2 provincial government banks and the DFIs conduct core banking activities. Core banking activities are mobilizing deposits, lending funds and conducting trade related activities.

4.04 The commercial banks play an especially important role in mobilising deposits from the public. In addition, they are involved in helping companies meet their working capital requirements, providing a conduit for overseas Pakistanis to remit foreign currency home, and for financing foreign trade.

4.05 Three NCBs and the 2 previously nationalized banks have traditionally controlled in excess of 80% of banking sector activities. However, their market share has been declining over the last 5 years and this rate of decrease in market share is expected to accelerate with the induction of the new private banks.

4.06 The three nationalised commercial banks in Pakistan, Habib Bank Limited, United Bank Limited, and National Bank of Pakistan have a very large branch network that facilitates deposit mobilisation. While these institutions play an important role in financing short-term credit requirements, their success in raising deposits ensures that they have a significant surplus of funds that can be on lent or invested in government securities. Two NCBs have been privatised since 1990. Muslim Commercial Bank was sold by auction/negotiation, while Allied Bank was sold to its employees.

4.07 The foreign banks in Pakistan are branch operations; they are not separate legal entities. They are primarily niche players and have been successful because of their superior management skills and better access to international financial markets.

4.08 According to most respondents almost 80% of foreign currency deposits are with foreign banks, partly because of their marketing efforts and partly because of their credibility as international banks.

4.09 As one of the measures (see Section 9) to induce competition into the financial sector, the government recently allowed several financially sound groups to set up new commercial banks and 9 such institutions have been established.

C. NON-BANK FINANCIAL INSTITUTIONS

4.10 Development Finance Institutions (DFIs) play a crucial role in providing term finance for industrial and agricultural ventures. They are the most important source of long term project finance in the country. They maintain a close relationship with different aid-giving agencies, often acting as the primary channel for disbursement of foreign aid to the private sector. These DFIs primarily focus on providing long term debt to companies. They can, therefore, be differentiated from the government-owned mutual funds and unit trusts, which focus on equity investments in companies. The complete list appears in Annexure-2.

C.1 DFIs

4.11 Pakistan has also entered into joint venture DFIs with Kuwait (Pakistan Kuwait Investment Company), with Libya (Pak-Libya Holding Company Limited) and with Saudi Arabia (Saudi-Pak Industrial and Agricultural Investment Company LImited). These companies are owned jointly by the governments of the two countries, and work to provide project finance to various ventures. Currently, however, their level of activity is fairly limited.

C.2 Leasing Companies

4.12 Leasing companies are a relatively new phenomenon in Pakistan, dating to the late 1980s. Because of the financial structure of leases, leasing to finance assets has become popular. It is especially advantageous for companies to execute leasing agreements if they are liable for current taxes. In addition, the desire to find new sources of capital has caused many companies to turn to leasing as a means to finance growth without using normal overdraft facilities. Besides traditional leasing companies, modarabas (described below) have also become very important players in the leasing industry.

C.3 Modarabas

4.13 As part of the effort to Islamise the economy in the 1980s, the government laid the framework for the establishment of modarabas in Pakistan. A modaraba is conceptually similar to a close-ended fund where a management company provides expertise while investors provide capital. Modarabas were especially popular with sponsors because they had the advantage of being exempt from income tax. This exemption has now been withdrawn for modarabas that became operational more than three years ago. Modarabas established less than three years ago will remain tax-free for three years from inception. Modarabas can only engage in activities that are approved by the Religious Board as being Islamic.

C.4 Investment Banks

4.14 The government has recently outlined procedures for the establishment of investment banks and some of these have already been established.

C.5 Housing Finance Institutions

4.15 Historically, there has only been one housing finance institution in Pakistan, which is government-owned. In recent years, however, there has been increased interest in the field, and the government has recently given approval to 8 new companies to enter the field. One is already in operation while 3 are expected to commence operations during 1993.

D. MUTUAL FUNDS

4.16 There are two large government organisations that provide mutual fund services in Pakistan. These organisations place funds in publicly traded stocks, as long term investments or for short term trading. In addition, some modarabas and other companies have now started participating in the market for equities.

4.17 National Investment (Unit) Trust is an open-ended mutual fund. It has the option to purchase 15 per cent of all new public share issues from the issuers. A unique characteristic of its Unit is that it does not reflect current market equity prices. NIT has a huge portfolio of shares and has appointed at least one director on the boards of many companies. The Investment Corporation of Pakistan (ICP) manages 21 close-ended mutual funds. In addition, ICP underwrites new share issues and promotes awareness about the stock market.

E. STOCK EXCHANGE

4.18 The Karachi Stock Exchange was established in 1949, and currently enjoys a market capitalization of around Rs. 200 billion. While stock brokers have been established for many years, the recent reforms have contributed to the increased interest in the stock market. Professional standards have risen and information technology has recently been introduced (see detailed discussion in Section-7).

F. STATE BANK OF PAKISTAN

4.19 The key official institution is the State Bank of Pakistan. The State Bank of Pakistan is regulated by the State Bank of Pakistan Act, 1955. This Act outlines the role and responsibilities of the State Bank as the nation's central bank. The State Bank has two primary functions. It controls the money supply and the foreign exchange reserves and protects interests of depositors in financial institutions. It issues currency, acts as banker for the federal government, advises the government on economic, financial and banking issues, is the banker for the various banking institutions, controls credit policy, and regulates foreign exchange transactions.

ANZ

5. FINANCIAL INSTRUMENTS AVAILABLE TILL THE 1991 REFORMS

A. INTRODUCTION

5.01 This chapter provides a brief introduction to the various financial instruments available for investment prior to the financial reforms in 1991.

B. COMPOSITION OF PRIVATE FINANCIAL SAVINGS

5.02 It is estimated that the corporate sector in Pakistan is responsible for around 12% to 15% of private savings,[1] the household sector providing the balance.

5.03 According to one study on earnings of companies registered on the Karachi Stock Exchange, small firms retain almost all their profits for financing operations and expansion of production facilities compared with 85% savings by large companies, i.e., for every unit increase in profits these firms save 85% of it.[2] This is because corporate sector clients have better access to the banking sector and other sources of finance.

5.04 Enumerated below are the various instruments which were available to investors before the 1991 reforms; most of these are still available.

C. INVESTMENTS AVAILABLE TO THE GENERAL PUBLIC

C.1 Bank Deposits

5.05 The total bank deposits as at June 30, 1992 were Rs. 416.7 billion, made up of Rs. 310.3 billion in the form of time deposits while Rs. 106.4 billion comprised demand deposits. It is interesting to note that demand deposits make up almost 26% of the total deposits. This provides one explanation of the low cost of funds available to commercial banks. Local currency bank deposits are maintained on a profit and loss sharing (PLS) basis. The rates of return on PLS deposits are announced every six months by the scheduled banks. The tables provided in Annexures 3 and 4 show the growth in deposits of banks between 1986 and 1991 as well as the rates of return that were availed on these deposits. The weighted average rates of return on saving deposits were around 7.5% in 1990 and 8.5% in 1991, while the yield on 6 months to less than 2 year fixed deposits ranged between 8.6% and 11.7% during the same period. Between 1986 and 1991 deposits with scheduled banks increased at around 12.8% per annum. Of all deposits held by banks the share of foreign banks is 13%.

C.2 National Savings Schemes

5.06 Several instruments were also launched by the government through the Central Directorate of National Savings, to cater to the various needs of individual investors. These are listed below:

5.07 The instruments under this scheme can be purchased from banks, post offices and national savings centres. The total amount held in the National Saving Schemes as of March 31, 1992 was approximately Rs. 165 billion. The main instruments available under these schemes were as follows:

a) Defence Savings Certificates (DSCs)
b) Khas Deposit Certificates (KDCs)
c) Special Savings Certificates (SSCs)

These are described below and Annexure-10 provides a profile of these securities:

a) Defence Saving Certificate

This is a tax exempt registered security with a ten year maturity period. It is issued at par. The compounded rate of return for a ten year holding period is around 16%.

b) Khas Deposit Certificate

This was a registered security which was issued at par with a three year maturity and six monthly coupon payments of 15% for the first 2.5 years and 17% in the last six months. This was discontinued in 1990.

c) Special Savings Certificate

This security with a three year maturity period is exempt from income tax. The rate of return is 11.5% for bearer and 12.5% for registered certificates.

D. OTHER SCHEMES

5.08 Several other schemes have been launched by the State Bank and other government institutions, as given below:

a) Foreign Exchange Bearer Certificates (FEBCs)
b) WAPDA Bonds
c) National Investment Trust Units (NIT Units)
d) Special National Fund Bonds
e) National Prize Bonds
f) Civil Aviation Authority Bonds

These are briefly described below and Annexure-10 provides a profile of these securities:

a) Foreign Exchange Bearer Certificates

These certificates of a three year maturity period are available in bearer form. The holder has an option to convert to foreign currency. The return accrues at a yearly rate of 14%, 15% and 16% respectively. The profit is payable on encashment.

b) WAPDA Bonds

These are government guaranteed issues and are traded in the market, with maturities ranging from 5 to 10 years and rates of return varying from 12.5% to 15%, payable six monthly. The profit on the first three issues of these bonds were exempt from income tax.

c) National Investment Trust Units

These units are issued by a closed-end mutual fund and are available in both bearer and registered form. The recent annual dividends was 18%. It, however, is subject to a withholding tax of 10%.

d) Special National Fund Bonds

These are non-negotiable, tax free, zero coupon, five year bonds that pay a rate of return of 9%.

e) National Prize Bond

Prize bonds are issued by the government, via the commercial banks, to the general public. The prize money offers the opportunity of high returns to speculative investors.

f) Civil Aviation Authority Bonds

These government guaranteed tax free bearer bonds are issued by the Civil Aviation Authority and have a maturity period of 5 years. The bonds pay a return of 15.5% per annum. The profit is paid every 6 months.

E. INSTRUMENTS AVAILABLE OUTSIDE CEILING (BANKS)

E.1 Federal/Provincial Government Loans

5.09 The government has been raising debt by issuing long term Federal and Provincial Government bonds. The total Federal Government Bonds as on 30th June, 1991 were Rs. 8.674 billion. The outstanding balances of the Provincial Governments' Loans as on 30th June, 1991 was as follows:

	Rs. in Millions
Government of Punjab	503.9
Government of Sindh	1,723.7
Government of NWFP	730.8
Government of Baluchistan	1,015.2
Total:	3,973.6

E.2 Treasury Bills (3 months)

5.10 The main financial instrument that banks could earlier buy was the three months Treasury Bill yielding a return of just under 6%; which were included in the reserve requirement of banks. These bills could be discounted at 6.06% by the State Bank. These Treasury Bills were available at all times, from the issuer. This scheme was discontinued in March, 1991.

E.3 Treasury Bills (Auction)

5.11 The government used to issue Treasury Bills through an auction system and these bills were investments outside ceiling. The rates on these Treasury Bills were regulated at approximately 6.5%. The disadvantage of these Treasury Bills, compared to the 3 month Treasury Bills, was that this investment did not qualify for the reserve requirement.

----

1. Estimated from reported private and corporate savings in Pakistan from the Economic Survey, State Bank Annual Report and Balance Sheet Analysis of Companies Listed on the Stock Exchange.
2. The Determinants of Corporate Savings in Pakistan: A Case Study of Companies registered with the Karachi Stock Exchange, Applied Economics Research Centre, Univ. of Karachi, Sept. 1990.

ANZ

6. INTEREST RATES STRUCTURE

A. INTRODUCTION

6.01 This chapter briefly introduces the interest rate structures on bank deposits, government securities and on different categories of borrowings.

B. LOCAL CURRENCY DEPOSITS

6.02 In 1985 the State Bank legislated to bring all returns on local currency deposits onto a profit and loss sharing basis, with profits being declared every 6 months on a provisional basis in advance.

6.03 Over a 10 year period the weighted average rate of return has ranged from a minimum of 6.98% (in 1987) to a maximum of 7.64% (in 1983). The comparative figure for 1991 is estimated at 8.5%.

6.04 On term deposits the rates have not been overly impressive either. In fact, a lot of scheduled banks do not even offer term deposits for more than one year. The term deposits are briefly analysed below (see details in Annexure 4).

Table-1

Term Depo	≤6mo	≤1yr	≤2yr	≤3yr	≤4yr	≤5yr	≥5yr	Total
Minimum	7.24	9.84	7.29	8.13	8.21	10.50	11.52	5.95
Maximum	10.25	11.72	11.01	11.65	12.02	13.04	14.75	9.82
Average	8.83	9.48	9.20	10.38	11.18	12.14	12.45	-

The above rates clearly depict that the term rates have been grossly inadequate in terms of a normal yield curve. On the shorter end of the spectrum the customers would be better off keeping the funds in saving accounts where the mark up difference is normal, yet there are liquidity advantages. For the longer term investors government securities are more attractive because they not only offer a far superior return on a post-tax basis in some cases there is also an incentive to whiten black money.

6.05 Over the four years to 1990 deposits of scheduled banks grew from Rs. 178 billion to approximately Rs. 300 billion, i.e., at a rate of 13.5% per annum. The growth in deposits after 1990 has been phenomenal, largely because of government policies (see Sections 8 and 9). The increase during 1991 alone was Rs. 78 billion, a growth of 26% over 1990.

C. FOREIGN CURRENCY DEPOSITS

6.06 Prior to May 1991, the foreign currency deposits could only be maintained by non-resident Pakistanis. The Economic Reforms of 1991 now also permit resident Pakistanis to hold foreign currency deposits. The current yield on deposits offers an attractive spread over LIBID for different currencies. Details of this scheme and its impact on the deposit base of banks has been discussed in later sections of this report.

D. GOVERNMENT SECURITIES

6.07 In the pre-reform period interest rates on a variety of government securities, including the National Savings Schemes, ranged from 11.5% per annum to around 16% per annum depending on the maturity of such securities.

E. CORPORATE PAPER

6.08 With a few exceptions, like the Civil Aviation Authority and WAPDA Bear Bonds, corporate paper has not been issued in Pakistan. A market for corporate debt does not exist at this time.

F. CEILING FUNDS

F.1 Introduction to Ceilings

6.09 In the financial market "ceiling" is a specific term which denotes funds that can be used by banks at their discretion for any purpose specified in the Banking Companies Ordinance. Ceilings are used as an instrument of monetary control by the State Bank to check credit expansion and thereby the inflationary pressure in the economy. Normally these funds are used by banks for lending purposes. These funds can be transacted among scheduled banks on a weekly basis.

6.10 The ceiling market rates are strictly a function of the supply and demand for ceiling funds and ceiling normally follows a seasonal trend. In the cotton season, for example, approximately November to February, the demand for ceiling normally outstrips supply and ceiling becomes quite expensive; it has been as high as 25% on occasions.

F.2 Ceilings and Credit Deposit Ratios

6.11 Ceilings of banks are currently governed by a formula issued by the State Bank. The State Bank uses these ceilings to monitor the credit that should be available to the market. This ceiling for private sector lending is specifically calculated for each bank. It is a factor of 30% local currency deposits and 40% foreign currency deposit holdings. From April 1993 a uniform credit deposit ratio will be introduced for the purposes of calculating ceilings. However, the details of the formula are not available at present.

6.12 These ceilings have an important bearing on the potential availability of investible funds for the private sector in general and the housing finance sector in particular. Assuming that deposits are equally divided between local and foreign currency deposits, then the overall ceiling would be around 35%. The current statutory reserve requirement under State Bank Regulations is 45% of total deposits while the balance of 20% is used for commodity operations, state sector and priority lending. The bulk of the 35% ceiling funds that are available for lending to the private sector (i.e., between 65% to 70%) go to prime customers. The balance of around 30% is potentially available for lending to other sectors. The housing finance sector will have to compete for funds from this pool. The problems that it will encounter in competing with other sectors and alternative investment opportunities are discussed at length in Section-12.

6.13 The main uses of ceilings are described below.

F.3 Running Finance

6.14 For running finance purposes, banks currently make funds available to customers at interest rates ranging from 12% to 20%.

F.4 Term Loans

6.15 For term loans, banks have recently lent funds at interest rates ranging from 13% to 20%.

F.5 Other Advances

6.16 The category covers other investments of ceiling funds which could either be short term or long term in nature. On the short term uses the banks could buy equities. The longer term uses of funds can include fixed asset purchases. Ceiling is also available for specific purposes and specific rules apply in such cases.

G. THE INTER-BANK MARKET RATES

6.17 The Inter-bank Market operates for the following five categories:

a) Call or overnight
b) Ceilings
c) Repos
d) Securities
e) Rupee-US$ transactions between banks

G.1 Call or Overnight Rate

6.18 The call market borrowing is an overnight inter-bank market which falls outside ceiling. It is available only to scheduled banks with a few concessionary exceptions given to some non-banking financial institutions, for example PICIC. This is clean lending on an overnight basis strictly within the interbank market. Technically, only the banks that are subject to ceiling constraints can access the call market. If this were not the case then arbitrage possibilities would exist. The call rate fluctuates with the demand and supply of call funds in the market. It can be as low as 1/2% or as high as the SBP repo rate.

6.19 The call or inter-bank overnight borrowing is transacted at varying rates depending on demand and supply for funds. From 1981 up to the pre-reform period of 1991, it ranged from 5.5% to 8% (see Annexure-5). The highest level of this rate was, understandably, the State Bank discount rate.

6.20 Since the reforms in 1991, the call rates have varied between 1% to 14%, as the State Bank discount/repo rate (see end of chapter) increased from 6.06% to 14% during this period; it has now been raised to 15%. These variations reflect, on the one hand, liquidity levels at various times and, on the other hand, indicate how liquidity management is that much more difficult in the post-reform period.

G.2 Ceiling

6.21 Ceilings are also traded between banks. In the ceiling market, banks having ceiling in excess of their lending needs can lend their unused ceiling to other banks at the prevailing ceiling rate. In this way, banks can meet their additional lending needs from the ceiling market. The end of the week figures should reconcile with the State Bank. Because ceilings have more uses than call funds, the ceiling rate is invariably higher than the call market rate.

G.3 Repos and Securities

6.22 To manage their short term liquidity requirements banks can resort to repurchase agreements with other financial institutions, which means selling the security and simultaneously buying it back at a marked-up price on a specified date. The SBP also provides Repo facility at 15%. For this reason the call money market cannot exceed this benchmark. Alternatively, the bank, in the absence of the Repo facility can, to raise funds, liquidate the securities held by them.

G.4 Rupee-US $ Transactions

6.23 The US dollar rupee rate is managed by the State Bank and is fixed at the start of any given day. The Rs./US $ dealing in the local market can only be done between the various treasury departments of banks as well as authorized foreign exchange brokerage houses.

6.24 Keeping in view the fluctuations/volatility in the international markets, the SBP allows a certain margin to cater to the volatility in the US $/Rs. rate. The uniqueness of this market is that the rates are quoted to the customer in the morning and remain fixed throughout the day, irrespective of the movements in international markets.

7. THE STOCK MARKET

ANZ

A. INTRODUCTION

7.01 This chapter examines the historical role of the stock market, the regulatory framework governing the operations of stock markets, the pattern of ownership of corporate equity and the historical performance of the corporate sector in terms of yields on securities.

B. HISTORICAL ROLE

7.02 At present, there are three stock exchanges in Pakistan, one each in Karachi, Lahore and Islamabad. The Karachi Stock Exchange (KSE) opened in 1948, the Lahore Stock Exchange (LSE) in 1970 and the Islamabad Stock Exchange (ISE) only recently in 1992. The KSE is, however, the only actively traded equity market accounting for 90% of the total volume. As of November, 1992, there were [illegible] companies listed on the KSE (having increased from 362 in 1985) while 522 companies were listed on the LSE; the biggest increase in listed companies has been witnessed in the cotton textiles sector. The aggregate market capitalization at the KSE is approximately Rs. 200 billion, having grown by 426% since 1986.

7.03 The membership of KSE is current around 200; new members are required to purchase an existing seat. The current base of active members is around 130, with trading being dominated by 15 to 20 members. In June, 1990, the constitution of the KSE was amended to permit corporate membership. Corporate members are required to have a minimum paid up capital of Rs. 20 million.

C. REGULATORY FRAMEWORK

7.04 The regulatory framework for the stock and capital markets has evolved over a period of time. The governing legislation is the Securities and Exchange Ordinance, 1969 and the Rules made thereunder. The KSE regulates and organises the conduct of its members and establishes standards for listing and dealing in securities. It also operates the clearing house and supervises settlements.

7.05 The KSE itself and its members are regulated by the Corporate Law Authority (CLA), an authority constituted under the Companies Ordinance, 1984. New issues are subject to the approval of the Controller of Capital Issues (CCI) under the Capital Issues (Continuance of Control) Act, 1947, and to regulation under the Monopolies and Restrictive Trade Practices Ordinance, 1970.

7.06 The KSE is managed by a board of directors consisting of 16 persons and a president, 14 of whom are elected by the members and two of whom are nominated by the National Investment (Unit) Trust Limited (NIT) and the Investment Corporation of Pakistan (ICP) respectively.

7.07 In the case of a public issue of shares by a new company without foreign participation at least one-half of the equity has to be raised from the general public. Where a company has foreign partnership at least one-half of the capital to be owned by domestic investors has to be issued to the general public.

D. DOMESTIC INSTITUTIONAL INVESTORS

7.08 This section summarizes the stock market activities of the major institutional investors.

7.09 The NIT is an open-ended mutual fund established by the Government of Pakistan for the benefit of small investors in Pakistan. The NIT is active on the KSE and purchases and sells shares on a regular basis.

7.10 Under the Islamization policy NIT cannot invest in securities offering a fixed return, e.g., TBs and FIBs, and hence has ben a stabilising force in the equities market. The income of NIT was exempt from tax till the fiscal year 1992-93.

7.11 It is a condition of every consent issued by the CCI to a company seeking public participation in its equity that it gives to NIT the right of first refusal to 15% (till recently it was 20%) of the capital to be issued to the general public.

7.12 Although NIT has a preferential right to acquire 15% of the shares floated by a new company, it is not bound to accept every offer made to it. This apparent benefit has two caveats attached to it:

a) They cannot have any transactions in these shares for two years and, therefore, cannot disinvest if the company is performing poorly.

b) Political pressure is applied on them to pick up shares and support the market when it is depressed. It was asked to perform this role during the recent market down turn. During the period August-October, 1992, it invested Rs. 10 million per day. Through this action they appear to have bailed out well connected speculators and brokers who would have otherwise suffered heavily on account of poor investment decisions.

7.13 Another financial institution established by the Government of Pakistan that trades extensively in shares is the Investment Corporation of Pakistan (ICP). It has, since its inception, sponsored the listing on the KSE of 21 closed-ended mutual funds. The pre-emptive rights of the NIT over new issues are not available to the ICP. As a financial institution, the ICP has played a significant role in the underwriting of public flotations and in establishing underwriting syndicates.

7.14 The State Life Insurance Corporation (SLIC) has a portfolio consisting of shares of 206 companies. It holds 33% shares of PICIC and 30% equity of the Karachi Electric Supply Corporation. It currently holds 3.1% of the total market capitalization of KSE. SLIC's maximum exposure in the case of new companies is limited to 2.5% of lower of the equity of the new company or its own portfolio.

7.15 General insurance companies are, however, subject to fewer restrictions. For instance, they are free to choose their own portfolio of investment and can invest in any paper that can be transacted upon in the stock market. However, a new condition that might be enforced upon them (presently under discussion) would be a restriction on the maximum permissible holding to the lower of 2.5% of the equity of the new company or 2.5% of the insurance company's portfolio. For example, Adamjee Insurance Company, the largest general insurance company in Pakistan, holds equity in 200 companies.

7.16 General insurance companies prefer investments in equities because for the purposes of the solvency requirement test, their investments are valued at market prices.

E. OWNERSHIP PATTERN OF SECURITIES

7.17 Anecdotal evidence and the assessment of major investors suggest that the shareholding pattern of a typical company listed on the stock exchange is as follows:

Sponsors	60 - 65%
Institutional investors	25%
Individual investors	10%

It is, however, estimated that scrips of around 100 companies have good availability and widely dispersed ownership.

7.18 The turnover on the KSE has been dominated by individual rather than institutional investors. The average daily turnover in 1986 was half a million shares, growing to over one million in 1990.[1] In recent months it has occasionally touched the 5 million mark. At present, approximately 300 equities, out of a total of 623, are traded on an average day. Amongst these, trading in most shares is in insignificant volumes. Trading in the shares of 10 companies is estimated to account for over 30 per cent of turnover in terms of value.

F. CORPORATE SECTOR PERFORMANCE

F.1 Yield

7.19 According to one institutional investor their yield on investments in the stock market averages 8% before tax -in cash terms and by recording bonus shares at face value. In his assessment, if capital gains are also taken into account the yield would be around 15% before tax.

F.2 Capitalization

7.20 The State Bank of Pakistan share index doubled between June, 1991 and June 1992 while market capitalization increased two times. The average rate of return for investors during the preceding five years was around 17.25%, excluding returns arising from dividends and bonus shares. Returns in the shape of cash and stock dividends can be approximately 3% to 5% on well constructed portfolios It, therefore, appears that even disregarding the exceptional increase in the index after the recent reforms the yields from judicious investments in the stock market can be quite attractive.

F.3 Earnings

7.21 As regards earnings per share (EPS) of profit making companies listed on the KSE the average EPS (simple average of all sectors excluding transportation - where EPS fell from 78.1 to 1.1 - and not weighted average) in 1990, of 4.1 fell slightly to 4.0 in 1991.[2] Furthermore, the rise in prices in 1991 was not fully backed by corporate earnings figures of 1991. This led to unrealistic P/E ratios for some scrips. The correction process lasted all throughout the first half of 1992, and is still continuing in certain sectors. The yield for new investors in existing shares has declined significantly because of a low market float. Currently the only motivation appears to be the exemption of capital gains from taxation.

G. INVESTOR PERCEPTION

7.22 The small investors have generally preferred investment in scrips of foreign multinationals (MNCs). The reasons range from high cash and stock dividend payments to greater confidence and credibility in the information disclosed by these companies and to the management of these companies by professionals. This is reflected in the very high P/E ratios for MNCs, for some these exceed 50.

7.23 A select few domestic groups have also figured prominently in the stock market activities of investors. They have successfully exploited investor confidence (based on past performance) in them, over the last 2 years, and have raised substantial sums of money from the market.

7.24 After the recent steep decline in the stock market (from a high of 1700 to an index of around 1230 today) the small investor has become more wary in his investment decisions.

----

1. The Karachi Stock Exchange Report, 1990-91.
2. First Inter Fund Modaraba Stock Scanner Special Report, 1992 First Half Review and Future Outlook.

ANZ

8. RECENT REFORM MEASURES INTRODUCED BY THE GOVERNMENT

A. INTRODUCTION

8.01 Since November, 1990, the present government has been attempting to bring about a metamorphosis in Pakistan's economy. Substantial changes are being introduced and major innovations have been made in the prevailing systems. It is implementing a series of policy measures aimed at reforming the economic, commercial and financial structures. The basic thrust of these reforms is privatisation, deregulation and the liberalisation of the environment for savings and investment and a regime of controls established by the government to regulate economic activity. The arrangements are supposed to reward efficiency and make economic management more transparent and less discretionary. For a detailed description of the various reform measures introduced by the government the interested reader is referred to Annexure-7. This section only describes the financial sector reforms and discusses the background to their introduction.

B. BRIEF HISTORICAL BACKGROUND OF GOVERNMENT'S MONETARY CONTROL POLICY

8.02 Till the recent reforms credit was essentially earmarked for different sectors of the economy through credit ceilings. But this strategy was only a part of the overall structure established to maintain direct monetary controls. The overall allocation of credit to the private sector was also affected by the public sector demand for domestic credit.

8.03 In addition to the two types of Treasury Bills discussed in Section-5, the banks could hold one other instrument, albeit in relatively small quantities, the Federal and Provincial Government Loans. These were long term government paper that were attractive because the coupon rate was approximately 10% to 11.75% at a time when securities held with non-ceiling funds were barely yielding 6%. Hence, there was substantial demand for such paper but not enough was put out by the governments to satisfy the demand. Banks could also hold Bearer National Fund Bonds and Government Treasury Deposit Receipts.

8.04 The government supplemented its resources by borrowing from non-bank institutions and the public at interest rates ranging from 9% (on 90-day treasury deposit receipts) to 15% on the 3 year Khas Deposit Certificates.

8.05 The result of this system of securities was that a market for tradeable securities was not developed. The money market (the market for short term funds) essentially comprised the following:

a) Short term call (inter-bank) trading between banks and some NBFIs; and

b) The trading of ceilings between scheduled banks.

The banks were, however, unable to use this market to manage their reserve related requirements in an efficient manner.

C. BACKGROUND TO THE FINANCIAL SECTOR REFORMS

8.06 As discussed above, prior to the financial reforms innovation there was an elaborate system of regulations governing the financial system in general and the banking sector in particular. The flow and level of credit to different sectors of the economy was administered by the government. These ceilings were referred to as credit ceilings. The credit ceilings consisted of general purpose and priority lending.

8.07 Under the financial regime of ceilings the banking sector provided the government captive funds at low interest rates for financing its expenditures. The banks were forced to acquire government securities that offered low yields Whereas one portion of government debt was provided by the banking sector at below market rates of interest another portion was provided by the public directly through government saving schemes that carried high interest rates - 14% to 16%.

8.08 The nationalised commercial banks were (and are) lumbered with a huge portfolio of non-performing loans that were advanced under political pressure. The negative aspects of this factor were compounded by the weak legal and institutional arrangements and mechanisms for enforcing recovery.

8.09 In view of the above, the banks had little motivation to mobilize deposits and there was reason for doubting the financial sector's ability to mobilize savings for facilitating growth in a more sophisticated economic environment. There was increasing recognition that the banking system (through which a large part of savings are channelled) had become highly fragile and that this would eventually reduce its role in the area of development and investment. It was acknowledged, therefore, that the financial systems had to be made efficient by changing the structural pattern. A structure had to be evolved which would be less centred on credit ceilings and entail a diversification of instruments. This could be achieved by forcing the financial institutions into playing a more active role in mobilizing savings.

8.10 In recognition of the above weaknesses the government set about the task of addressing these structural weaknesses through institutional and policy reforms. Consequently, it has initiated radical and far reaching reforms. It has embarked upon a programme aimed at the enlargement of the financial sector and a gradual loosening up of its hold on the economy by creating an economic system more responsive to market signals. A number of measures have been taken to facilitate the liberalization of the financial sector, to foster the growth of the financial system and to open up the financial markets to new forces by allowing the private sector to play a more positive role in mobilizing domestic resources.

D. FINANCIAL SECTOR REFORMS

8.11 The key measures that lie at the heart of the financial sector reform programme are:

(a) improvement of the competitive environment in which banks operate through privatisation and greater reliance on market forces;
(b) liberalisation of exchange controls;
(c) the deregulation of the structure of interest rates and a gradual dismantling of the system of directed credit;
(d) permission for foreign ownership of equity; and
(e) improved bank supervision.

8.12 The government has committed itself to structural reforms aimed at making the sector more responsive to market stimuli and ensuring improvements in the efficiency and the financial viability of the banking system. As a first step to the introduction of a market-driven pricing system for government debt, an auction system has been introduced for government securities. The commercial banks are the linchpin of this system as they play the role of primary dealers (see detailed discussion in Sections 9 and 10).

8.13 Credit ceilings have been relaxed considerably. The long term strategy of the government is to eventually eliminate all ceilings on lending to the private sector and to do away with directed credit schemes and credit availability at concessional interest rates. This will make the market more efficient in allocation of credit in an integrated money market in which the private and public sectors compete fairly for available funds.

8.14 For tackling the problems posed by directed and subsidized credit, the government raised the interest rates for most concessional schemes and reduced the shares of different loan categories in the incremental credit provided to the private sector.

8.15 To promote competitiveness in the financial system the government has allowed the establishment of new private commercial and investment banks and leasing companies. The environment has changed radically with the granting of unprecedented freedom on operational matters.

8.16 In response to this freer environment, new institutions and instruments are being set up to cater for special and more sophisticated requirements of industry, trade and commerce, leasing arrangements, merchant banking services, modarabas, mutual funds.

E. REGULATORY ENVIRONMENT UNDER FINANCIAL SECTOR REFORMS

8.17 Up to the end of the 1960s banking was characterised by the interlocking ownerships of financial, commercial and industrial interests. This resulted in the concentration of formal credit in a few hands. Even today some of the private banks and most of the modarabas are either controlled or closely associated with large family-run industrial groups. The banks or modarabas serve, either directly or indirectly (one group financing the other and vice versa), as financing instruments for other group operations.

8.18 It was, therefore, felt that the institutional and legal framework for a regulatory environment needed to be improved in respect of matters concerning conflict of interest and the security and safety of deposits, through a gradual and phased liberalization so as not to jeopardize the process. The State Bank has already taken some steps in this direction (see Section 8.F below). To improve the capital base to ensure safety and security and to maintain the operationality of financial institutions, well-designed, stringent prudential capital adequacy standards have been introduced. The attempt of the regulatory framework is to prevent the system from breaking down and thereby damaging public confidence in it.

F. PRUDENTIAL REQUIREMENTS

8.19 The capital adequacy requirements of the State Bank's Prudential Regulations (PRs) [Annexure-8] introduced in 1991 have been widely welcomed as a step in the right direction. There are essentially two types of Prudential Regulations affecting the institutions in the financial sector. One set pertains to commercial banks and the other governs the activities of the non-banking financial institutions.

8.20 It is recognized that whereas frauds occur the world over, the bulk of them are sui generis because they are carried out by ingenious individuals by violating established regulations and procedures. Widespread fraudulent practices can be minimised through a well designed system and PRs are supposed to play this role. They have been designed to ensure security and safety of deposits within a financial sector that has the operational flexibility and functional autonomy required for enhancing efficiency and productivity.

8.21 It is recognized that the State Bank has put in place a set of very good Prudential REgulations (PRs). What is not yet in place, and is critically needed, is a well trained and motivated supervisory staff capable of monitoring the operations of financial institutions to ensure that they are complying with the PRs.

ANZ

8.22 The problems faced by different financial institutions in conforming to these regulations and guidelines are described briefly in Section-11.

ANZ

9. OPERATIONS OF THE FINANCIAL MARKETS AFTER REFORMS

ANZ

A. INTRODUCTION

9.01 This section examines the operations of the financial and stock markets after the introduction of the recent reform measures.

B. IMPACT OF LIBERALISATION ON THE FINANCIAL SECTOR

9.02 The timing of the liberalisation measures happily coincided with a growth in the overall size of the market. As a result new entrants had a relatively easy entry into the market.

9.03 In a sense the new market entrants were fortunate from a staffing point of view in that their entry happened at the same time as BCCI ceased operations worldwide. Hence a fairly substantial pool of trained bankers were available to assist in a smooth entry.

9.04 Most market participants did not expect the interest rates to rise in the short term. It was felt that the activities of the new banks would not be significant enough to have an impact on the market.

9.05 However, the market expected that, in the longer term, as competition heated up, it would eventually lead to competition on a price basis and that market spreads would begin to squeeze as deposit rates increased and lending rates stayed constant.

9.06 To date the experience has been that the commercial banks have been steadily growing with the growth of the market; it is only very recently that they have started making themselves felt. Most of the new banks have concentrated on specific market niches initially for their business, and are now competing by offering better service.

9.07 It is also expected that the new banks will market new deposits more aggressively than the older local or the foreign banks. This should have a favourable impact on the market, as the overall quantum of deposits in the official economy would continue to grow.

9.08 This liberalization has also encouraged the establishment of new privately operated housing finance institutions and the legal framework that will govern their operations. As mentioned earlier one private housing company has started operations whereas another three are expected to commence commercial activity during 1993.

C. GROWTH IN BANK DEPOSITS

9.09 Since June, 1991, deposits have increased by 32.5% (a growth of 23% on an annualized basis). The extraordinary growth in deposits in the past one year can generally be attributed to the government's reform programme. The confidence reposed in the programme and the flexibility introduced by the government has brought money into the banking system that in the past was floating in the parallel system. More specifically, the increase can be attributed to the following factors:

a) The increase in foreign currency deposits by US$ 1.4 billion between May 1991 and November 1992, substantially because of the government's exchange reforms and the marketing efforts of foreign banks and partly because of the diversion of home remittances into foreign currency accounts. Today foreign currency deposits are estimated to be US$ 2.7 billion.

b) The growth in the economy and the resulting trend growth in deposits.

c) The deficit financing undertaken by the government. It has created additional money which it has pumped into the system (money supply increased by around 18% between 1990 and 1991 and at 20.6% in 1991-92 and thereafter). This monetisation of the deficit has also brought about an increase in monetary savings. This is the link between government deficits and the savings of households in financial assets.

d) The stock market boom brought money into the banking system for participation in equity investments. Some of this money came back into the system following the recent sharp decline in stock prices.

e) The significant slump in the property market, mainly as a result of the collapse of the cooperatives in the Punjab.

f) The collapse of the cooperatives in the Punjab followed by the closure of the BCCI resulted in flow of funds into the formal, well established banking system.

g) The switching of corporate, pension and provident funds from National Savings Schemes (NSSs) into banks following the government's decision to prohibit, first the corporate sector, and now pension and provident funds from investing in NSSs.

h) The establishment of new commercial banks has resulted in concerted deposit mobilisation drives by these institutions.

9.10 However, on the one hand, the financial sector reforms are too recent to enable a more robust analysis of their impact and, on the other hand, this period has coincided with changes in government policy in the other sectors that are impacting upon the growth of the financial sector, e.g., the occurrence of events like the collapse of the cooperatives, BCCI and the property market and the resulting diversion of funds from other investments or instruments into the formal banking systems. Consequently, it is difficult to segregate or assess the impact of these factors on bank deposits. Some of the events are too recent and the basis for drawing conclusions too fragile to infer that this growth in deposits is of a permanent nature, thereby signifying a degree of success of the government's financial sector reforms. For instance, a fair proportion of these deposits may well represent money that has been "parked temporarily" in search of more attractive investment opportunities - for instance, in traditional investments like real estate. Factors like the low rate of return on bank deposits compared with the returns on instruments like TBs and FIBs and the current rate of inflation (even if we accept the officially accepted rate), 10%, seem to support this view.

9.11 Nevertheless, savers are at least, 250 to 300 basis points better off (for instance since privatisation MCB have raised the return on PLS accounts by 1%), partly because of intensified competition between banks for deposits, the establishment of a host of different types of financial institutions (private commercial banks, privatized NCBs, modarabas, investment finance companies, etc.) and the introduction of the foreign currency deposit schemes and, to a limited extent, the introduction of high yielding TBs and FIBs. Interest rates would have, perhaps, risen even further had this period not coincided with the occurrence of other events (see discussion earlier above) that induced a flow of capital into the financial sector, in particular into the commercial banking system.

D. ADJUSTMENT TO CHANGING CONDITIONS

9.12 The financial market found its feet quickly because of the following reasons:

a) The State Bank of Pakistan was quite open in its communication with the market and did a lot to promote awareness, especially among bigger and slower participants, who were generally the local banks.

b) Although the 5 larger local banks had the predominant market share (approximately 85% of the deposit market), the 21 foreign banks operating then, being smaller and having a greater level ot awareness, quickly learnt the nature of the market and helped spread the awareness throughout the market.

c) The general spirit of reform was contagious and the momentum of the reforms was powerful enough to sweep the whole market along without any major resistance to the changes that were being brought about by the reform.

9.13 The market did not take too much time getting used to the concept of an auction market, liquidity management, and the concept of repurchase agreements. Although it is taking time to get used to the vagaries of inconsistent government policies and the concept of interest rate movement risk, there has, by and large, been a fairly rapid transformation of the market profile after the reforms.

9.14 The transition was no less easy for the government. Initially prodded into action by the financial assistance that was promised by the World Bank and the IMF for the financial sector reforms, it moved very rapidly into what was a rather new field. By and large the Ministry of Finance and the State Bank have performed creditably in pushing the changes through and subsequently streamlining the process.

E. THE EFFECT OF THE REFORMS ON THE STOCK MARKET

9.15 The economic reforms introduced by the government had an immediate impact on the stock market. They changed the perception of investors and served as the ignition point for an increase in investment and economic activity. The new KSE share price index (a basket of hundred stocks, created in 1991 with a base of 1000) soared to 1680 early this year until a correction pushed it back and is currently around 1230; the State Bank General Index of Share Prices grew by 93.2% during 1991-92 compared with an increase of 38.2% in the preceding year. The market capitalization of stocks listed on KSE more than trebled between April and December, 1991.

9.16 The traded number of stocks increased from 361 million to 725 million during 1991-92 while the value of traded shares rose from Rs. 27.9 billion to RS. 85.8 billion. In 1991 the average daily turnover was 2.4 million. By 1992 the daily turnover had increased to 3 million with a substantial proportion of trading accounted for by foreign investors (see below). Market capitalization has increased from Rs. 52 billion in 1989 to Rs. 200 billion currently. The number of shareholders has also increased from 250,000 to one million indicating the widening of the culture of equity.

9.17 The PE ratios were as low as 6 in 1990 and blue chip shares looked rather attractive. Their attractiveness also grew with the government's decision to first lower interest on the savings certificates issued by it and to later impose a 10% withholding tax on interest incomes.

9.18 In April 1991, Citi Corp set up a US $ 22.6 million closed-end Pakistan fund which was listed on the Hong Kong Stock Exchange. Then Credit Lyonnais also established a US $ 25 millions open-ended growth fund and a US $ 10 million special situation fund for investment in unlisted equities while Asian Development Bank is in the process of setting up a US $ 60 million closed-end fund in association with Solomon

Brothers. However, institutional investors are loosing interest in country funds because the reforms now permit them to deal directly with brokers rather than through fund managers.

9.19 The privatisation of state enterprises has also served as a catalyst for the stock markets. The biggest public flotation of unlisted state enterprises after privatisation was the Muslim Commercial Bank's issue of RS. 850 million in mid-1991 which was over-subscribed about 7 times.

9.20 Due to the earlier law which required shares to be only issued at par, new issues in 1991 were generally well received by investors. On the average they were over-subscribed 7 times (see Annexure-6 for sector-wise subscriptions in 1991 and 1992).

9.21 The recent amendment passed by CLA in 1992, allowing companies to offer shares above the par value, attracted many well established companies to raise capital at high premiums. Subsequently, companies also tried to cash in on this opportunity. However, for them, the results have not been encouraging.

9.22 With the introduction of the State Bank's prudential guidelines, credit to the corporate sector has become more restricted. As a result, the traditional undercapitalized corporate sector's reliance on the equity markets has increased. This trend was in evidence throughout 1992. Most dividend declarations by established concerns have included right issues at substantial premiums.

9.23 The market for public debt is, however, relatively undeveloped. Although a number of federal and provincial debt securities are listed, little trade is seen on the stock markets since most institutional investors and banks either hold such securities until maturity, or trade them off-market.

9.24 Originally the market was based on payout ratios. The foreign investors brought in the concept of P/E ratios, but the market overlooked the fact that P/E ratios have to have a logical link with interest rates. It was, therefore, just a matter of time before the bullish phase came to an end. Also, major fluctuations in the share prices of a handful of companies, e.g., ICI, Gatron, Indus Motors, Fauji Fertilizer, the new private banks, etc., influenced the stock market index significantly. Most of the players in the stock market interviewed for the study, however, argued that the market is now settling at levels that can be sustained. There may be good reasons to take an optimistic view of the basic outlook for securities. However, a reasonable certainty in conclusion can only come after the market is firmly set on its upward journey.

F. UNDERWRITING OF PUBLIC ISSUES

9.25 The major costs involved with flotation are the underwriting fees, brokerage charges, fees of bankers to the issue, etc., which, on the average, account for around 4% of a fully subscribed issue. In the case of under-subscription, the costs are increased to the extent of take-up fees payable to the underwriters. The CLA has currently set take-up fees at a maximum of 2.5% of the under-subscribed amount. In other words, in the case of an under-subscribed offer the maximum cost of an under-written flotation borne by the sponsors is 6.5% of the issue.

9.26 Recently sponsors of large established groups have preferred to underwrite their own public offerings to reflect confidence in the issue, to maintain control and to save on flotation costs.

9.27 With shares being offered at premiums, the underwriting risk has considerably increased, while the upper limit for underwriting fee continues to be 2.5%. After big failures of premium issues in the market, the underwriters have become apprehensive of large flotations as fees are not commensurate with the risk being taken.

G. POTENTIAL OF STOCK MARKET

9.28 Although the market is to some extent thin and volatile, the extent to which realistically priced public flotations by reputable industrial and commercial groups are over-subscribed is not only a testimony to the ability of the market to finance privatization through the stock exchange but also provides evidence on the latent demand for good quality scrips. This is particularly so now that the rules on foreign exchange holdings and foreign investment on the stock exchange have been considerably relaxed and the new Prudential Regulations are forcing companies to increase their capital base and raise finances from equity markets.

9.29 The potential of the stock market to serve as an instrument for raising long term funds has not been fully exploited. There is evidence of its capacity to absorb large offerings. Between April 1991 and September 1992 capital of Rs. 22 billion was raised through the Karachi Stock Exchange through new flotations, rights issues and bonus shares, over and above the Rs. 4.5 billion raised (in cash terms) through privatisation. Recent data, therefore, suggests that the stock market can absorb between Rs. 5 to Rs. 10 billion per annum, which, based on international experience, appears to be achievable as it represents around 5% of the present levels of capitalization of the market.

H. PRIVATE PLACEMENTS

H.1 Equity Placements

9.30 As capital markets became more volatile, foreign institutional investors became more interested in the potential offered by tax free capital gains. Their appetite has increased for larger blocks of stocks which offer liquidity at the time of redemption.

9.31 The sponsors of new companies also tend to prefer private placement of equities as it assures considerably smaller and more manageable public flotations. Also, foreign institutional investors are not particularly keen to occupy a place on the company's board.

9.32 The privatisation of state enterprises fuelled this idea further as larger blocks were made available without threatening the management control of new owners. Unlisted companies, in particular, provided a potential for capturing large tax free capital gains at the time of flotation. One such example is the privatisation of D.G. Khan Cement Company in which a group of foreign institutional investors collectively bought equity of over Rs. 500 million. The issue was eventually under-subscribed because of generally depressed market conditions when the shares were floated.

9.33 Private placements will increasingly become the more favourable route as large public sector enterprises, such as Water and Power Development Authority, Pakistan Telecommunication Corporation, Pakistan International Airlines, etc., are privatised.

H.2 Corporate Debt Placements

9.34 Corporate debt is also being placed privately to a limited extent. However, this market is currently restricted to financial institutions. Corporate debt instruments such as Term Finance Certificate (TFCs) are sold to a syndicate of banks and other financial institutions for their own accounts.

10. INVESTMENT IN GOVERNMENT DEBT

A. INTRODUCTION

10.01 This section will describe, briefly, the history and composition of government debt and discuss fixed interest securities that banks are today permitted to hold outside their State Bank imposed ceilings, i.e., Treasury Bills (TBs) and Federal Investment Bonds (FIBs).

B. GROWTH IN AND COMPOSITION OF GOVERNMENT DEBT

10.02 The government's domestic debt has increased from Rs. 58.1 billion in 1980-81 to over Rs. 500 billion in 1991-92, growing at a galloping rate of almost 22% per annum and as a percentage of the GDP from 20.9% to 42.4%.

10.03 The broad composition of this debt has also changed the share of the permanent debt component having risen from 23.8% to 40.1% (the biggest increase being in the new instrument of FIBs - see details below) while that of the floating debt dropped sharply from 54.5% to 32%. Further details of these broad categories are provided in Annexure-9.

Table-2

	Percentage Share of Total Debt	
	1980-81 (%)	1991-92 (%)
Permanent debt	23.7	40.1
Floating debt	54.5	32.0
Unfunded debt	21.8	27.9

10.04 During the first five months of the current fiscal year (1992-93) the government's borrowings from the banking system for budgetary purposes has already exceeded the target for the entire year.

C. INTRODUCTION OF A MARKET ORIENTED SYSTEM

10.05 In 1991 the government initiated radical and far reaching reforms primarily aimed at creating an economic system more responsive to market signals. Under these reforms the thrust in the financial sector is greater reliance on market forces with the government's role being limited to macro policy planning and control.

10.06 To rationalise the interest rate structure the following reforms were made:

a) The interest rates on concessional, special purpose, finance schemes were raised, although they are still below market rates.

b) The method of calculating credit ceilings was changed.

c) The structure of National Savings Schemes was revamped, particularly by prohibiting corporate entities and later pension and provident funds from investing in these schemes.

d) A system of public auctioning of government bonds and securities was instituted.

D. NEW DEBT INSTRUMENTS

10.07 Since March, 1991 the government has been auctioning two debt instruments, which have the crucial capability of liquidity:

a) Treasury bills (a floating debt instrument).

b) The Federal Investment Bonds (a permanent debt instrument) that are available for 3, 5 and 10 year periods.

10.08 The TBs are zero coupon instruments of 6 month maturity and can be discounted with the State Bank. They are treated as money market instruments. Their liquidity derives from their short term maturity period.

10.09 The FIBs are fixed income securities, paid half yearly, carrying a rate dependent upon the maturity period; 13% for 3 years, 14% for 4 years and 15% for a 5 year maturity period respectively. They are not redeemable before maturity. The interest earned is liable to a withholding tax deducted at source. For individuals, 30% is deducted from T-bills while 10% is deducted from the income derived from the FIBs. For corporations and local banks the withholding rate on profit is 30% while for foreign banks it is 65%.

10.10 Auctions for treasury bills are supposed to be held every fortnight while FIB auctions are held once a month.

10.11 The government's decision to change its debt instruments from the on-tap variety to non-redeemable ones means that it does not have to make arrangements for the early encashment of these securities. This has improved the Government of Pakistan's cash flow management. The government's decision to phase out the National Savings Schemes (precise cut off dates are not available) will improve it even further. It will then have no debt that will be redeemable before maturity.

10.12 Six-months T-bills and the 3 year FIBs are viewed as liquid instruments by the financial institutions and are being used in inter-bank trading.

10.13 The auction process was accompanied by the inevitable raising of the discount rate at the State Bank of Pakistan discount window, gradually from 6.06% to 15%. During this process the discount window was closed and in its place a repo window was opened at the State Bank. This in itself has been a very positive development for the market from the point of view of liquidity management.

10.14 As part of the reform measures the State Bank established the Subsidiary General Ledger Account (SGLA), a book-based system for settling secondary market deals. The establishment of a book-based system at the State Bank has improved the security and efficiency of the system, as physical movement and handling of securities is no longer required.

E. THE FUNCTIONING OF THE AUCTION MARKET FOR GOVERNMENT DEBT

E.1 Treasury Bills

10.15 The auctioning process, which started in March, 1991 is successfully underway and understood by the market; during 1991-92 the government raised Rs. 766 billion through TBs. Unfortunately, the State Bank has, at times, not adhered to the tender amount that it has specified in the tender notice. Had it done so it would have served as a good indicator to market players in deciding where to pitch their bids. In the absence of this indicator, the only three factors that are available to the market in deciding where to pitch their bids are:

a) the amount of liquidity available to the bidder;
b) the amount of liquidity available in the market; and
c) the trend of previous cutoff yields in the most recent few auctions.

10.16 Rates on TBs have been growing steadily, increasing from 8.55% (at the first auction) to 13.2% (as contrasted with 13% on a 3 year FIB). The State Bank has recently been attempting to push the rates back down, presumably with the objective of achieving a more appropriate yield curve. It is applying pressure on the rates by occasionally rejecting all the bids in an auction. As there are no other immediate avenues for investment the market becomes awash with liquidity. The funds then stay idle in a bank's account at the State Bank; there have been many occasions this year when the call rates (overnight) have stayed close to 0%. The State Bank has been exploiting this situation and doing short term reverse repos (buy/sells) at 1%.

E.2 Federal Investment Bonds

10.17 Federal Investment Bond auctions have been more predictable than Treasury Bill auctions; Rs. 44.8 billion was raised by the government through FIBs during 1991-92. The State Bank has at least been consistent in picking up all bids at par or at a premium. On two occasions for 3 year bonds, on two occasions for 5 year bonds and thirteen occasions on 10 year bonds, bids have been accepted at a discount. The lowest price accepted to date in each of the three maturities being Rs. 92.90, Rs. 97.60, and Rs. 95.00 respectively. Obviously, any price discount will increase the yield for the investors.

10.18 The more recent trend has been to accept par bids. This practice is in line with the attempts (referred to above) to reduce the yields on money market instruments.

F. THE DEVELOPMENT OF A SECONDARY MARKET FOR GOVERNMENT DEBT

10.19 A strong secondary market for T.Bills has developed, but only between banks, with a limited number of major players.

10.20 The constraints to the development of a secondary market for government debt have been covered in considerable detail in Section 11. However, it would not be amiss to re-emphasise at this point that the development of the secondary market will to a large extent depend on the attitude of the governmant towards the development of financial markets. The perception of the Ministry of Finance is that the major players in the market are colluding to drive rates to unreasonably high interest levels. This attitude has tended to thwart the development of the secondary market.

10.21 A case in point was when the State Bank, through its BCD circular 2 of May 16, 1991, restricted banks from holding more than 15% of their deposits in government paper with a maturity of more than 1 year. This effectively covered Federal Investment Bonds and Government loans and the objective stated for this action was to force banks to sell and thereby promote a secondary market. The result of this action was predictably the opposite of the objective that was stated in that confidence in the securities and in the government's policies was adversely affected and some banks incurred significant capital losses as a result of the forced sales.

10.22 The effects of the above action soon led to a reversal of the 15% limitation. However, the effect on the market was far more deep rooted and in an attempt to make Federal Investment Bonds attractive again the prices were dropped to substantial discounts but even then the interest could not be rekindled to previous levels. Banks also learnt to only hold the bonds at levels required for their own portfolios, losing interest in holding a trading portfolio.

11. CONSTRAINTS TO DEVELOPMENT OF CAPITAL MARKETS

A. INTRODUCTION

11.01 This section discusses the policy, procedural and legislative constraints to the development of capital markets and the secondary market for government debt and examines the capacity limitations of the official institutions to regulate and supervise the operations of these markets.

B. POLICY CONSTRAINTS

11.02 This section deals with the problems posed by sequencing of reforms and the constraints imposed by policy inconsistencies.

B.1 Timing and Pace of Policy Reforms

11.03 A stable macro-economic environment is critical for the successful implementation of financial reforms. Inflation reduces reliability of prices as a factor of information. Real returns fall, thereby affecting profitability of financial institutions. Long term investments are viewed as risky. Considerable efforts and resources are required to overcome or adjust to price distortions. Thus, a high degree of price stability is essential for the success of the liberalisation programme, especially because financial markets in Pakistan today are not only shallow but have not fully recovered from the financial wounds inflicted upon them by the recent scandals involving the cooperative societies. One frequently hears about South Korea's financial liberalisation. What is, however, not realised is that South Korea had a highly regulated financial system till early 1980s. Even today there is preferential access to credit for specific groups of borrowers. Reforms were undertaken only after macro-economic stability was achieved. The inflation rate was barely 3 per cent and fiscal and current account deficits had been taken care of. These conditions do not exist in Pakistan. The government, therefore, needs to take urgent measures to keep inflation under control if the liberalization measures are to achieve the objectives associated with their initiation, the most important of which will revolve around the reduction of its budgetary deficit.

11.04 There is a lot of volatility in money markets, partly because of uncertainty associated with uncharted territory (with the market undergoing a massive structural change) and partly because the entire economic and financial environment is moved by short term considerations; even the annual budget is characterised by 2 mini-budgets. Furthermore, these fluctuations are becoming more pronounced because of the government's ad-hoc policies and its requirements for financing various schemes like the self employment and credit for taxi cabs schemes.

11.05 The noteworthy aspect of the execution of the programme has been the flexibility shown in implementation. For instance, some sort of ceilings (which had till then served as the primary instrument for executing the government's monetary policy) have been maintained. Moreover, bankers are becoming familiar with concepts of Repos and secondary markets and some private banks are managing to tap deposits that others were unable to. In the same vein, PRs are introducing discipline in accounting systems and contributing to the improvement in the quality of lending while the State Bank is becoming more sophisticated in its operations through practical experience.

B.2 Policy Consistency

11.06 Investors find it difficult to operate in a system in which there are frequent changes in policies. It needs no emphasizing that an uncertain political and economic environment discourages investors. Continuity of policies is critical for introducing the stability that will attract serious investors. Long term reforms announced in advance enhance the government's credibility and also give affected institutions time to adjust.

11.07 The financial sector is still characterised by uncertainty caused by frequent changes in government policies, some not necessarily consistent with the government's stated objectives for the sector. Some of the measures introduced have created doubts about the government's ability to maintain policy consistency. For instance, in January 1992, the government ostensibly dismantled the structure of credit ceilings and introduced the concept of a 65% credit/deposit ratio, which was to be effective from July, 1992. This gave the banks, in particular the foreign banks, the incentive to mobilize foreign currency deposits. However, after they had expanded their deposit base by US$ 700 million the State Bank imposed a 3% exchange cover risk on the plea that the banks could afford to pay it, in view of the large spreads that they were maintaining. Later on the credit deposit ratio for private sector lending was reduced to 30% on local currency deposits and 40% on foreign currency deposits. The State Bank has now intimated that from July, 1993 a uniform credit deposit ratio will be applicable. It has, however, not quantified the ratio.

11.08 The initial issues of Federal Investment Bonds explicitly specified that although the profits on Federal Investment Bonds would be subject to income tax, withholding tax would not be levied on the profits. Subsequently, this stance was changed and the State Bank started deducting withholding tax. These changes took place without any verbal or written communication from the State Bank.

11.09 Till the fiscal year 1992-93, the government had permitted the private sector to set up Modarabas which were to be exempt from income tax. The imposition, this year, of an income tax at the rate of 25% on all modarabas in existence for more than 3 years provides another example of the government backtracking and introducing a levy (without giving adequate notice to modarabas already in existence) which had not been taken into consideration at the time of setting up a modaraba or when subscriptions were invited.

11.10 Again, during the last 2-3 years the government first withdrew the exemption from taxation of dividend incomes and then raised the taxation rate each year. Dividend income was exempt from taxation till 1988-89. In 1989-90, Rs. 15,000 were exempted and the balance was taxed at 7.5%. In 1990-91, the exemption limit was lowered to Rs. 10,000 and the tax on the balance income was raised to 10%. From 1992-93 all dividend income has become taxable at a flat rate of 10%.

C. FISCAL TREATMENT OF DIFFERENT FINANCIAL INSTRUMENTS

11.11 A major impediment in the development of capital markets is the inconsistency of tax treatment on the profits of various instruments. This inconsistency encompasses not only the overall tax treatment but also the withholding tax, with different tax payers liable to different withholding tax rates.

11.12 For achieving the objectives of financial reforms, in particular the development of a broad based capital market, income and wealth tax policies in respect of investments and income from these investment also require rationalisation. Despite recent fiscal changes the investment rate structure continues to be distorted because of the tax exemptions granted on incomes from SSCs, DSCs and foreign currency accounts (these holdings are also exempt from wealth tax). Such measures do not bring about an increase in financial savings, they merely lead to a switching of savings from one financial asset to another. For stimulating savings in financial instruments the government should either exempt net financial savings from taxation (such a move would discourage consumption without fragmenting financial markets) or tax incomes from all sources.

11.13 The biggest constraint to resource mobilisation by private sector institutions is the fiscal concessions granted to the incomes earned by funds invested in specific instruments. For example, Special Saving Certificates (SSCs) and earlier issues of WAPDA bearer bonds are exempt from income tax.

D. CONSTRAINTS TO DEVELOPMENT OF SECONDARY MARKETS FOR GOVT. DEBT

11.14 Some of the short comings that have already been discussed in the above paragraphs exemplify the constraints to the development of the Secondary Markets for Government Debt. However, the primary factor distorting the smooth functioning of the Secondary Market appears to be the lack of trust between the key players in the market. The Ministry of Finance (acting through the State Bank of Pakistan) suspects that the Primary Dealers are colluding and 'fixing' the interest rate whereas the dealers contend that the government is hindering the functioning of the market.

11.15 The government has not displayed consistency in accepting/rejecting bids. At times, it has rejected bids without either assigning, or indicating through its actions, the reasons for rejection. Market players are, therefore, unable to read the signals being sent out by the government. For instance, if the government were to reject a bid on the grounds that the average cut off was too high it could accept one of the bids whose cut off rate it found acceptable, thereby giving an indication of the acceptable cut off rate. To date, however, it has not done so. The following recent example highlights the nature of the problem that this inconsistency creates. The government rejected all bids the settlement of which would have taken place on November 11, 1992. It, however, accepted the bids at the next auction, November 21, 1992, at rates above the rate at which it had rejected the earlier bid. This erratic behaviour has also adversely affected market liquidity.

11.16 As mentioned earlier, Treasury Bills and FIBs are relatively liquid in the inter-bank market. A major impediment in the trading of TBs and FIBs is the imposition of the withholding tax. Treasury bills and Federal Investment Bonds are sold cum-interest and, on maturity, the holder of the instrument on maturity is liable to pay the withholding tax on the entire return. This adversely affects the market for instruments the maturities of which are close to the interest payment date.

11.17 The absence of instruments in the market other than Treasury Bills and Federal Investment Bonds effectively means that the banks are totally captive on the government for using all of their funds, except those funds which have been designated as ceiling funds. The authorities may be of the opinion that the interest rates that they are offering are the market interest rates. However, because of the lack of depth in instruments these interest rates may or may not bear any resemblance to actual interest rates as they prevail in the economy.

11.18 The auction process has evolved into an almost monthly process. For Treasury Bills this is understandable, but in the case of Federal Investment Bonds the auctions are too frequent to encourage the development of secondary markets.

11.19 The other uncertainty that banks are faced with is the date of future auctions. The future auction dates can at best be "guestimated" narrowing the market of potential institutional investors. This inhibits trading in the secondary market.

11.20 The gap of 2 to 4 days between the bid and the acceptance of bids is too long because during this period all activity in the market, apart from covering of short positions or investing of long positions, comes to a halt. The main reason for the above delay is that the SBP acts as a post office for the Ministry of Finance and the bids are sent to Islamabad for the final decision. Considering that, on average, the Treasury Bill and the Federal Investment Bond auctions each take place on a monthly basis, the Inter-bank market effectively stops functioning for about 5 working days every month.

11.21 Another reason why the secondary market has not developed is that the government has been raising funds, as indicated earlier above, without adhering to a fixed debt management policy. At the same time that it has been issuing Federal Investment Bonds (which in themselves are fairly attractive instruments) the government is negatively impacting upon their marketability by permitting the issue of other government guaranteed paper which has vastly superior qualities in that it is bearer and exempt from Zakat. The competing instruments then tend to restrict the attractiveness of Federal Investment Bonds and consequently the secondary markets.

11.22 The current policy of the State Bank is to do Repo at 15%. The ostensible objective is to force banks to concentrate on "cash management". However, the fact that the State Bank is always willing to do Repo and that this rate is fixed, and does not adjust to market conditions at different moments in time, it is negatively impacting upon the development of a secondary market.

11.23 The State Bank's requirements in respect of returns are too detailed and cumbersome. It demands a great deal of information in the form of returns. This acts as a deterrent to the development of a secondary market. In addition to the numerous detailed returns that are required to be filed on a regular basis, it is common for the State Bank to ask for supplemental information.The vast amount of paper work is a disincentive to dealing in Federal Investment Bonds.

11.24 The transparency of the entire system is essential for the proper functioning of the market. Since all bids are opened publicly, the bid amounts are known. Thus, it is possible to assess the effect on interest rates, which makes for a reasonably efficient market. It has, however, recently come to light that the State Bank has taken up Treasury Bills from the Ministry of Finance that had not been offered to the market and the State Bank had then repo'd the Treasury Bills into the market. Consequently, the bulk of the market was not aware of the existence of these bills, nor of the amount that was issued or the amount that was repo'd. The lack of transparency in the case of such transactions is detrimental to the development of the market and should, in principle, be discouraged.

11.25 Finally, the development of secondary markets will take time as primary markets themselves are in the early phases of their development.

E. INCENTIVES TO INVEST IN REAL ESTATE VERSUS FINANCIAL ASSETS

11.26 In Pakistan the incentives to invest in financial assets are lower than the incentives to invest in other assets, in particular urban land. The social and cultural values that shape the demand for land and the existing statutory, economic and financial environment all reinforce the desire to invest in land.

11.27 Historically, such an investment has offered the best after-tax rate of return, even though transactions in shares are exempt from capital gains taxation, dividend income is still taxed lightly and a number of financial instruments are bearer in nature (the identity of the holder is not revealed) and the withholding tax rate of 10% on interest income is not prohibitive. In view of the high return and the highly liquid characteristics of property it is a more attractive investment than a financial asset. It also serves as a security in times of unforeseen hardships. Although the market for real estate has taken a nose dive leading to the diversion of funds into other channels (like the stock market) and, following the collapse of the cooperatives, into other financial instruments (resulting in the financialisation of savings) the long term environment for investment in hand has not substantially altered.

11.28 The legal and fiscal instruments and institutional arrangements that enable or facilitate speculation in land for long periods include the following:

a) The non-utilization charges levied by development authorities for leaving land vacant continue to be maintained at a low level. This penalty is not effective in discouraging speculation in land.

b) The property tax structure enables vacant land to virtually escape property tax.

c) The provincial governments abolished capital gains tax in 1986.

d) Land can be transferred through an agreement to sell coupled with powers of attorney. About 6 to 8 years ago, 15-20% of the documents registered comprised of powers of attorney now as much as 40% to 50% of transactions in land are through powers of attorney.[1] A property may exchange hands several time, without each transaction being legally liable for taxes (stamp duty and registration fees) which become payable only on the execution of a lease or a sale.

e) Under Muslim Personal Law there is no statutory requirement to register an oral gift, even when reduced in writing on a stamp paper (usually of Rs. 50 only).

f) The legal system permits ownership of land in fictitious names, in the name of a person other than the real owner, i.e., holding it 'benami', enabling the hoarding of black money in land on which high rates of tax free returns can be earned.

F. <u>POTENTIAL NEW INSTRUMENTS - COMMERCIAL PAPER</u>

11.29 Large corporations with a good performance record (e.g., banks and multinationals) can, theoretically, issue their own commercial paper directly, i.e., without the involvement of banks in the capacity of intermediaries. The maturity of this paper could even be rolled over for better known companies. The government has taken an active interest in the development of commercial paper and has liberalised many of the rules pertaining to these securities. However, public issues of these instruments have not occurred for several reasons, discussed in detail below.

11.30 Most of the institutional investors interviewed for the study were of the opinion that other than the better known multinationals only a dozen or so companies have enough market credibility to issue their own commercial paper. This statement runs contrary to the fact that most of these institutional investors have diversified portfolios and hold equity in over 200 enterprises. In our view, therefore, a larger number of companies have the potential to issue commercial paper. In particular, the sub-sectors of textile and sugar, have a large base and can use the market to satisfy their seasonal demand for credit by floating commercial paper. There are, however, some constraints to the development of such a market. These are identified below:

a) There is little incentive for top tier companies to float commercial paper because they have good access to bank credit. In fact, the top tier of the prime corporations, can borrow at rates (10% to 11%) which are even lower than the (credit) risk free rates being offered on government securities. Also the existence of some instruments like SSCs, etc., (see Section 11.D) and the ready availability of government T-Bills and FIBs backed by government guarantees make it difficult for private companies to issue their own paper. These companies would not be able to match the attractive features of government paper like its high risk free return, its tax exempt status (as in the case of SSCs and DSCs), its bearer nature in most cases or the facility in the case of instruments to convert into foreign currency at the official exchange rate without any restrictions.

b) Stamp duty at 3.5% in Sindh - it varies between provinces - on private sector marketable securities transferrable by endorsement or delivery inhibits the development of a market for commercial paper.

c) There is no credit rating system for assessing the credit worthiness of issuers of instruments, although the State Bank has now established a Credit Bureau which maintains information on borrowers that have loans in excess of Rs. 1 million.

d) The charters or rules and regulations governing provident and pension funds do not permit them to invest in corporate debt.

e) The Islamic mode of finance impedes development of financial markets. Problems are encountered in even issuing convertible bonds because they carry a fixed interest rate. However, it is also true that banks have also not put in a great deal of effort in developing alternative instruments, primarily because it would tend to cannibalise the banks' own core business.

11.31 The State Bank has also imposed several restrictions that make public issues of commercial paper more difficult. Specifically, private sector companies cannot issue securities in bearer form, placing them at a competitive disadvantage vis-a-vis public sector institutions, which have been allowed to issue bearer securities for the past several years. Furthermore, banks are not permitted to provide bank guarantees on any security issue by a private sector firm. This makes it particularly hard for all but the best-known companies to raise any money through the issue of securities. In addition, the State Bank restricts the ability of various entities, primarily foreign banks and companies, to hold instruments issued by private sector firms. The State Bank has recently clarified that foreign banks may trade in such instruments. However, the matter has still not been settled as several issues pertaining to their right to hold such securities remain unresolved. The imposition of these restrictions has made the issue of redeemable capital securities by the private sector rather difficult. As a result there has been little operational activity in this area.

G. BUSINESS CULTURE AND LEGAL CONSTRAINTS

11.32 In Pakistan business is generally carried out with people with whom prior trust has been developed. This severely reduces the scope for business and curbs the entry of newcomers.

11.33 The legal system is inadequate and slow in enforcing contractual obligations. It has to be made more responsive to the needs of financial liberalisation. This will require a supportive legal, administrative and regulatory structure for protecting depositors of private banks and an adequate bankruptcy law for enforcing foreclosures. The inability to enforce contracts through legal channels is one of the root causes of the inefficiency in the Pakistani economy. The legal and institutional arrangements the government devises to tackle these fundamental issues will be critical for the pattern and pace of growth for the Pakistani economy.

11.34 A study of the weaknesses and strengths of legal systems and the efficacy of the judicial machinery in enforcing contracts and foreclosure laws would be required for preparing proposals in this regard.

H. OPERATIONAL PROBLEMS POSED BY THE STATE BANK'S PRUDENTIAL REGULATIONS

11.35 Respondents highlighted the following operational difficulties posed by the Prudential Regulations that can frustrate the development of capital markets.

a) The PRs restrict the activities of banks by limiting overall exposure to ten times the paid capital, even when there are counter guarantees from foreign banks. As a result of this decision Letter of Credit confirmation will cost the government more (as it will lose access to credit) in cases of Letter of Credits opened by the NCBs as these will have to be confirmed by a foreign bank.

b) Some bankers argued that under the PRs capital, rather than assets, serves as the benchmark for the extent of capital adequacy whereas capital adequacy should be a function of the risk profile of assets rather than the gearing ratio.

c) The foreign banks also argue that for determining the capital adequacy requirement the capital of their parents in other countries should also be taken into consideration, as this will enable them to expand their operations. The State Bank's view, however, is that the insistence on using the capital invested locally for determining the capital adequacy requirement is a treatment that is accorded in other countries as well. It should not be expected to take into consideration the capital of these banks invested in other countries as this capital might be constrained. Therefore, it is fair for the State Bank to demand that the activities of foreign banks should be governed by their capital invested in Pakistan.

d) The demand that the return on deposits should be uniform for the same maturity period is an anti-saving clause. The banks should not be prevented from offering a higher return on a larger deposit. A strict implementation of this condition will also encourage corruption as savings will be routed through quoted companies to which this restriction does not apply. For housing finance companies, in particular, this requirement is a great disincentive. Furthermore, this clause cannot be applied in the case of modarabas (they cannot take deposits) and leasing companies (they are not allowed to take deposits for 2 years).

e) There is a limit on lending against shares to 50%, if Market Price is greater than 2 times par value of future. This requirement is stunting investment growth by adversely affecting the market for equities.

I. LEGISLATIVE CONSTRAINTS - ISLAMISATION OF ECONOMY

11.36 A potential problem area for the entire financial system is the extent to which the decision of the Federal Shariat Court on the Islamic interpretation of interest (that it amounts to usury) will be followed.

11.37 The decision of the Shariat Court declaring interest and all fixed pre-determined rates of return as un-Islamic will play an important role in the structure of interest rates and the functioning of capital markets. Many feel that the imposition of such a ruling will undermine the development of financial markets, particularly because foreign investors will be turned away. The government has gone into appeal in the Supreme Court against this ruling and is pleading for a more practical interpretation of interest under Islamic laws.

J. OTHER INSTITUTIONAL CONSTRAINTS

11.38 Financial markets tend to be fragile and susceptible to manipulation and unsound practices. An important pre-requisite of smooth transition from a regulated to a deregulated system is the institutional capability and integrity of the domestic financial sector. Fair trading, diligence and information disclosure are the basic pillars of a dependable financial structure. Flow of reliable and detailed information to investors is the sine qua non of a successful financial market. However, it is interesting to note that hardly any of the institutional investors interviewed placed much reliance or faith in the financial results declared by private sector companies while taking a decision to invest in the equity of a company.

11.39 The State Bank has not been given the freedom by the Ministry of Finance to play the role that is generally assigned to such institutions.

11.40 The State Bank and the Capital Law Authority (CLA) have started making efforts to enforce the various regulations governing the operations of the financial institutions. These institutions, mainly because of lack of institutional capacity, face difficulties in enforcing these regulations pertaining to disclosures, ensuring compliance with accounting standards and legal requirements, and levying penalties in case of non-compliance. The early indications are, however, encouraging. Much, however, needs to be done to strengthen them for timely action.

11.41 One of the complaints made by some respondents was that the CLA/CCI do not discuss and approve concepts and ideas. They prefer to deal with issues/problems on a case by case basis.

K. MULTIPLE REGULATORY AGENCIES

11.42 Capital markets are currently being regulated by various government agencies, including the Ministry of Finance, the State Bank of Pakistan, the Corporate Law Authority, and the Controller of Capital Issues. The existence of multiple regulators hinders the smooth functioning of capital markets.

11.43 The Corporate Law Authority was initially established to handle legal matters pertaining to companies. However, many such issues are still being handled by other regulatory agencies. This makes the streamlining of efforts particularly cumbersome. For instance, flotations of commercial paper are subjected to several approval processes. Such agencies as the Controller of Capital Issues, the Corporate Law Authority, the State Bank and the Stock Exchanges are involved in various aspects of the approval and flotation process, making this process rather long winded and cumbersome. The general response of companies has been to avoid issuing these securities.

11.44 As for Housing Finance Companies, their operations are not only governed by the Prudential Guidelines but also by guidelines issued by the Internal Finance Wing of the Ministry of Finance. Some institutions, such as modarabas, are subject to even greater regulation. Modaraba activities are also scrutinised by the Religious Board. In other words, the monitoring systems are currently too fragmented.

11.45 It would be desirable to confer onto the Corporate Law Authority or some similar agency the right to deal with all capital markets issues. In the United States, for example, all issues pertaining to the functioning of the securities market are handled by the Securities and Exchange Commission (SEC). Because this regulation is the primary work of the SEC, it can ensure that the application of rules balances the requirements of a dynamic marketplace with the need to protect investors from unscrupulous parties.

11.46 The need to create a one-window operation is highlighted by the fact that the current set up has slowed down the reform effort. Even in a situation where the government has, as a matter of policy, pursued the development of a new financial product, the regulatory structure has proved so cumbersome that efforts were unsuccessful (see Section 11.F).

L. POLITICAL CONSTRAINTS

11.47 The biggest question mark relates to the political will and determination to proceed against all those responsible for perpetrating business and financial frauds.

M. CONSTRAINTS ON THE OPERATIONS OF STOCK MARKETS

11.48 This section briefly examines, for the stock market separately, the policy, legal and institutional constraints to the development of these markets.

11.49 The limited supply of shares in the market has been influenced by the following factors:

a) The liberal debt equity ratio requirement has enabled companies to meet their long term needs for funds by borrowings rather than by issuing shares.

b) Family owned companies are reluctant to dilute their shareholding for fear of loss of control.

c) The procedures for issuing rights shares is less cumbersome and cheaper than a public offering for new shares.

d) Small sized public offerings can turn out to be rather expensive in relative cost terms.

11.50 The bulk of the shares being tightly held lack liquidity. Less than 10% shares are traded on the exchange. Corporate disclosures are poor, profits are understated and accounting treatments are non-standardised.

11.51 Trading activity tends to be concentrated in a few shares, highlighting the narrow base and the shallow character of the market. Adverse movements in the prices of these scripts and a poor performance can seriously impact upon the operations of the market.

11.52 In view of the thin markets for shares of well run companies, their prices tend to be volatile. Market volatility is enhanced by the high degree of speculation in some shares, because the system allows share buying for a 14 day period without any payment or margin deposits. It is believed that over 90% of the trading is speculative in nature as investors have no intention in taking delivery.

11.53 Speculation is also fuelled by the policy of large institutions to hold large blocks of shares, by the pricing policy of new shares and by the quality of the settlement procedures.

11.54 Presently, returns on short term, fixed return and larger risk-free instruments, offered through the national savings schemes, tend to be higher than on many equities, thereby reducing the attractiveness of shares. Although share prices may have grown in line with that of alternative investments, dividend yields have not kept pace.

11.55 Settlement processes are affected by:

a) the procedures for the matching of transactions;
b) the recording of the settlement; and
c) the physical delivery of the scrips.

Because of problems posed by the requirement of physical delivery of shares, time limits for effecting share transfers, etc., the market suffers from further illiquidity, fuelling speculation.

11.56 Legally companies have 45 days to effect a share transfer in their books. However, the entire process of buying a scrip and ensuring its registration with Registrar of Companies is currently taking as much as 90 days.

11.57 The infrastructural facilities of the stock exchange have not kept pace with the growth in trading volumes. There are long delays in share allotments, payments and deliveries. The different aspects of the system of settlements - matching of transactions, procedures for recording settlement and physical delivery of shares are incapable of tackling the huge trading volumes.

11.58 The stock exchange is characterised by an under-capitalised jobbing system, poor liquidity, insider trading and inefficient settlement systems.

11.59 The development of the market has been difficult because of the lack of confidence of investors in it. Almost 40% to 50% of the transactions are not reported by the market information facility (FASCOM)[2] as they are not routed through the clearing house.

11.60 It is common for brokers to quote to their client the highest price for purchases and the lowest for sales of a particular stock recorded during the day. In a market where the range can vary significantly, the brokers can dishonestly exploit the situation and make a lot of money.

11.61 Insider trading is common and there are hardly any penalties against such an activity. In fact, as the stock brokers themselves are active traders in securities, they do not make any serious attempt to check the practice of insider trading.

11.62 Stock exchange brokers, however, challenge the widely held perception that the market is manipulated by cartels. They argue that a Rs. 200 billion market cannot be manipulated (unless they have institutional support) and whenever some speculators have tried to do so they have paid a rather heavy penalty.

11.63 A change is, however, discernible and positive attempts are being made to educate investors through provision of information. The stock exchange has been computerised to improve the quality and timeliness of information available to investors.

11.64 The Karachi Stock Exchange is constructing a new building with modern facilities.

11.65 Also, a large central depository is being established to facilitate the handling of large volumes by doing away with physical delivery.

----

1. See, "A Study on Land Tenure in the Punjab", by Fazle Ghani Khan & Co., Advocates, for the Shelter for Low Income Communities Project administered by the World Bank, July 1991 and a study on "Land Recording Systems in Karachi", by Shahid Kardar and Makhdoom Ali Khan for the World Bank, July 1991.
2. Efficiency Enhancement Study of the Karachi Stock Exchange (Guarantee) Limited, Report prepared by First International Investment Bank Limited for USAID, July, 1992.

ANZ

12. IMPLICATIONS FOR HOUSING FINANCE INSTITUTIONS

A. INTRODUCTION

12.01 As home ownership is the most important objective for social and economic stability the flow of housing finance makes up a significant share of the entire financial system in developed countries. Savings for housing is perhaps the single largest source of funds for the financial system. In the UK, the household sector's holding in financial assets in Building Societies was 32.1%, of total financial saving in 1989. In the US, outstanding debt for residential accommodation was US $ 2.2 trillion. The level of mortgage debt as a percentage of GDP was 58.3% in UK, 45.2% in USA and 25.1% in Japan.[1]

12.02 Furthermore, in the UK, the share of Building Societies in the household sector's holding of financial assets is 32% compared with 20.5% of that of the commercial banks. Again, in the US, of the total savings of US $ 2.7 trillion, the savings and loan associations hold 35% (US$ 940 billion) while commercial banks hold 50%.[2] In other words, in developed economies institutions dealing with housing finance hold a high proportion of household savings.

12.03 In Pakistan housing finance can acquire a more prominent status in the financial system provided there is an improvement in the economic, social and legal environment for housing finance (see discussion below). This section, therefore, examines the implications of the constraints to the growth of capital markets (Section 11) and of the other factors on the development of housing finance institutions.

B. COST OF FUNDS

12.04 An important factor that hinders the development of housing finance is alternative investment opportunities. Existing financial institutions have alternative options for advancing credit that reduce the attraction for housing loans. In a market starved for funds the banks are not under any pressure to venture into activities other than those they have performed traditionally. Not only is there a huge demand for credit against which 'better quality' collateral is being offered (than would be provided by an individual seeking a housing loan) the government, in view of its massive sized deficit, is offering risk-free returns of between 13% - 15%. The competition is also not exacting enough to compel these institutions to look for other areas in which to invest. The banking sector can hardly be expected to show a great deal of enthusiasm for extending housing loans that would invariably be much smaller in size, and yet require the devotion of more administrative resources (in terms of personnel and costs), considering that they are not organisationally equipped to extend their activities into the sector of housing finance.

12.05 The financial institutions would broaden their base of operations into relatively riskier areas only if the profit margins were higher, which would mean an interest rate of at least 20% (excluding the 1% excise duty payable on capital loans), in view of the risk free yield on long term government bonds of 15%, the interest rates of 16% - 18% being earned on most corporate credit and the relatively small administrative costs of handling these large value transactions (for a brief discussion on how finance to the housing sector has to compete with other sectors and clients under a regime of ceilings, the reader is referred to Section 6.E). In particular, the burgeoning budget deficit of the government has been placing a huge demand for funds from the financial system, setting a benchmark for the price of credit in the financial system. The willingness of commercial banks to venture into housing finance type activities will be adversely affected even further with the recent decision of the State Bank to raise the reserve requirement from 40% to 45% of deposits.

12.06 Only a small segment of the population would be able to service debts for new housing at rates of interest exceeding 20%, unless the banks express willingness to extend considerably smaller home improvement loans. It is, therefore, not quite clear if in the current environment, in particular the prevailing cost of funds, housing finance is commercially viable.

12.07 As for new special purpose companies set up to deal with housing finance their biggest problem would be deposit mobilization. Without a widely acknowledged track record (not being subsidiaries of well established financial institutions) they will have to pay higher rates of return to attract term deposits; they are, in any case, not allowed to take saving account deposits. In the present financial environment, where interest rates would be pegged to rates being offered on government securities, the high cost of funds would inevitably push up the on lending rates to levels even more formidable than the ones indicated earlier above, making the debt servicing costs of new housing prohibitive for the middle and a substantial proportion of the upper income groups.

12.08 The discussion above highlights that ways and instruments have to be found for lowering the cost of funds. One way of reducing the cost of credit for housing finance would be to induce commercial banks (who have to pay a lower price for mobilizing deposits) to extend finance for housing related activity. As they have more attractive alternative investment opportunities (see argument above) their interest can be stimulated through fiscal incentives. Attempts to reduce the cost of capital through implicit or indirect subsidies should be avoided as they will not only introduce distortions in the financial markets, the benefits will also be appropriated by the more privileged segments of society. This system of concessional financing is currently being followed, and rather unsuccessfully, by the HBFC. Not only will it be difficult to sustain this level of subsidy, it also lacks transparency; neither can the beneficiaries be identified nor can the subsidies that they have availed be costed readily.

12.09 On the subject of what was likely to happen to the interest rate structure and the levels of interest rates if the financial sector were to be fully deregulated (thereby reducing the cost of funds for say, housing finance companies) we got two broad, although contradictory, responses from the individuals interviewed for the study. One school of thought argued that the interest rates in the formal banking system would rise and the existing gap between the "Badla" rate and the interest rate of the formal sector would narrow. The other group argued, equally persuasively, that the rates are artificially high currently because of the segmentation in the market. Opening up the system and making it primarily, if not only, responsive to market signals would bring down the level of interest rates prevailing in the formal sector. Both schools of thought, however, do concede that the eventual outcome, in particular the level at which interest rates will settle, will be heavily influenced by the rate of inflation, the size of the government's overall budgetary deficit and its appetite for funds for financing this shortfall.

C. THE TAXATION ISSUES HINDERING DEVELOPMENT OF A HOUSING FINANCE MARKET

12.10 In the case of self occupied property the government does not permit the tax payer to set off the expenditure on debt servicing (the financial charges component) against his other income.

12.11 According to income tax experts housing finance companies (HFCs) could also become liable to the 2.5% turnover tax. In view of the fact that the mortgaged property would be registered in the name of the company the tax authorities may deem their business to be property trade for income tax purposes even if under the approved charter they are specifically prohibited from trading in property.

12.12 Furthermore, according to some tax practitioners, the nature of the mortgage agreement (under which the property would be in the name of the company) is such that the occupant of the house could be deemed to be a tenant. Such an interpretation could potentially lead to the company being liable for property tax at rates applicable to rented out properties, at 25% of the "annual rent".

12.13 The government needs to clarify that for HFCs the laws would not be interpreted in this manner. In the case of property tax collected by the provincial governments for distribution to local governments it will be particularly difficult for the federal government, and perhaps even provincial governments, to make any commitments.

D. PROBLEMS OF FORECLOSURE

12.14 A large problem in developing housing finance in Pakistan is the difficulty of enforcing foreclosure laws in the event of a default. The procedural complications encountered by financial institutions in cashing a collateral, particularly of immovable property, is a deterrent holding back the private sector from venturing into housing finance activities. The legislation is oppressive and the procedures tedious, time consuming and heart breaking. As a result, the judicial system fails to resolve disputes in an efficient, effective and timely manner. Even in rent related cases where a separate Rent Control Ordinance has been ostensibly promulgated and Rent Controllers with special jurisdiction established to simplify and expedite justice in rent/ejectment cases, it takes 2-4 years to get the decision of a court. Moreover, even when the court finally passes an order it becomes difficult to execute the decision.

12.15 For a detailed exposition on how delays are caused by defects in procedural regulations, overworked and understaffed courts, reluctance of courts to compel compliance with statutory time limits, ancient and archaic office management methods and systems used by court registries, the system of granting appeals liberally, corruption, the failure of the courts to award reasonable costs to the winning side and thereby discourage frivolous litigation, failure to develop alternative dispute resolution techniques, the litigious nature of Pakistanis and the use of courts by government to secure its own ends, etc., the reader is advised to read Makhdoom Ali Khan, et.al, "Land Tenure in the Punjab", a study carried out for the Shelter for Low Income Communities Project being administered by the World Bank.

12.16 However, the relatively successful performance of Banking Tribunals (Section-12.E below) provides some basis for optimism and hope that the formidable challenge of foreclosure can be addressed through an appropriate strengthening of the legal framework and the judicial machinery.

E. LEGAL AND INSTITUTIONAL FORECLOSURE ARRANGEMENTS

12.17 Depending upon the nature of the financial charges levied under the borrowing agreement the government has established separate institutional arrangements and procedures for adjudicating cases relating to banking:

a) Legal procedures pertaining to interest based loans.
b) The legal procedures and institutional arrangements in respect of loans advanced under the mark up system.

12.18 Interest based loans below Rs. 1 million fall within the jurisdiction of banking courts whereas cases in respect of loans above Rs. 1 million have to be decided by the High Court. Cases of loans based on mark ups are handled by the Banking Tribunals. Between 80% to 85% of cases pending with the judicial machinery are with the Banking Tribunals, i.e., only 15% to 20% of legal cases relate to interest

ANZ

based loans.

12.19 The Banking Tribunals were first set up around the end of 1982. However, they were unable to function effectively. Problems were faced in satisfying the quorum requirement of 3 judges. The law was finally amended in 1988-89 which now only requires one judge (a retired judge of the High Court) to act as the Tribunal. Approximately 2,000 to 2,500 cases are being filed annually with the Karachi based Banking Tribunals. According to a newspaper report around 2,000 cases are pending before the Karachi based tribunals.[3]

12.20 All cases classified under the first category have to follow the code of civil procedure. The procedures in the Banking/High Court suffer from most of the problems encountered in civil suits. The courts grant adjournments liberally, lawyers are major impediments to speedy justice, the judges also have other responsibilities to fulfil, and the ability of the judges, particularly in the case of a banking court, is questionable. The judge of a Banking Court can be a district judge with 10 to 15 years experience of civil suits. Most of them, however, have limited experience of commercial litigation. In many cases it takes at least 5-6 years to get a decree from these courts.

12.21 The situation, in terms of the time taken by the courts to arrive at a decision, is substantially better in the case of Banking Tribunals. According to two respondents interviewed for this study, the decision period is between 6 months to one year, and that the oldest case pending with the Tribunals in Karachi was registered in 198[illegible]. Also, according to the above referred press report (see Para 12.16) around 2,500 cases have been disposed of in four months by all the banking tribunals in the country.

12.22 It is not, however, clear if the Banking Tribunals have ever assisted the HBFC to foreclose on a housing loan.

F. OTHER FACTORS CONSTRAINING DEVELOPMENT OF HOUSING FINANCE INSTITUTIONS

12.23 The most important factor hindering the growth of housing finance is the high cost of registering property related transactions. The costs in urban areas in Sindh include a 1% registration fees, a 8.5% provincial stamp duty, a 2.5% property transfer fee charged by local government, a 5% capital value tax (CVT) on residential plots exceeding 240 sq.yds.,[*] (see end of chapter) other charges (professional charges, brokerage fees and court fees) and, in the case of a loan, there is a 1% charge for registration of the mortgage documents, a 3% stamp duty for a non-bank financial institution (the stamp duty is 1% in the case of a banking company) plus charges for fire insurance and professional input. In the case of an equitable mortgage, however, in which title deeds are deposited with the financial institutions, there are no charges pertaining to registration and stamp duty. In view of these additional costs and the advantage, in the Pakistan business environment, of holding original title documents both the customers and the banks prefer equitable mortgages. However, for strengthening their legal position of first right over the property some banks register a small percentage of the value of the mortgage. In the event of a fraud, their legal status is ranked higher than those who have not registered the mortgage deed.

G. CONCLUSIONS ON CONSTRAINTS TO THE DEVELOPMENT OF HOUSING FINANCE INDUSTRY

12.24 The discussion above has attempted to show that the development of a housing finance market is not only dependent upon alternative investment opportunities, the cost of funds and the establishment of an appropriate legal structure and supportive institutional arrangements for foreclosure but is also inextricably linked with the government's strategy on deficit reduction. Moreover, social values and behaviour and the legal system positively encourage litigation, occupation and control over someone else's property and political intervention on behalf of defaulters.

H. LESSONS FROM THE INDIAN EXPERIENCE

12.25 The success of the Housing Development Finance Corporation Limited (HDFC) in India is commonly presented as an example to be emulated. Details on the reasons for its success are not available. However, two factors appear to have been critical in the success of the HDFC:

a) For the bulk of the loans the up-front deposit paid, or the investment already made, by the borrower covers between 60% - 70% of the value of the property. The borrower is, therefore, apprehensive of losing a valuable property in the event of default.

b) The social behaviour tends to be more responsible. This factor and community pressure play a critical role in keeping the default rate low.

c) HDFC has developed a robust and thorough credit appraisal programme. Applications are carefully considered and credit is only given to solid applicants.

d) Around 60% of HDFC's loans are still given to employees of large business clients who deduct the monthly mortgage payments from the employees salary and remit them to HDFC.

e) HDFC has developed organised and efficient loan recovery mechanisms. It has only initiated 15 foreclosure actions over the last 14 years and yet enjoys a recovery rate of 98%.

12.26 In Pakistan the factors discussed above can be resolved by revamping the legal structure, by developing strong credit appraisal procedures by strengthening institutional capacities and by enforcing relevant legislation, creating an environment which emits a clear signal that the government and the courts mean business, that defaulters will not be able to escape the penalties laid out in the law.

I. PROBLEMS OF MATCHING IN HOUSING FINANCE

12.27 It is generally believed that as housing finance is a long term investment the resources for financing such operations should also be long term in nature, i.e., housing finance institutions should not venture into the market for short term credit for financing their operations. Although the concerns regarding cost of capital - the mix of deposits, equity and long term financing - are well placed, they exaggerate the dilemma of resource mobilization. The role of all financial intermediaries is to raise funds for onward lending, taking into consideration liquidity requirements. How well they cover these risks, barring, of course, unforeseen events, will determine the efficiency with which they manage their operations. In a primarily stable economy, in which inflation rates are moderate, saving deposits can be a very stable resource base for housing finance institutions. Admittedly, however, in Pakistan there are fears that the underlying inflationary pressures could destabilise an already delicate macro-economic environment.

12.28 In the UK the bulk of the resource base of Building Societies comprises saving deposits, with over 80% of the accounts either on call or on short notice.[4] In the case of the HDFC, India, 7.2% of the funds employed represented equity, 5-10 year bonds made up 11.4% of total funds while deposits (the bulk of which have a maturity period greater than 1 year) contributed 33.4% of funds available. In Pakistan, however, housing finance companies are neither allowed to take saving account deposits nor are they permitted access to the inter-bank market for funds.

12.29 It is also widely believed that households should be made to save for a house before being regarded as eligible for housing finance. According to one study 45% of the savings accounts of Building Societies in the UK had balances of £100 and below which represented about 0.3% of total saving account deposits. In contrast, 8% of the accounts had balances in excess of £10,000 representing 67% of these deposits, i.e, the bulk of the systems' resource base, was provided by large deposits.[5] Also, most of these balances were held by elderly people reinforcing the life cycle hypothesis of savings that young people tend to be debtors and become savers later on in life.

----

1. Mentioned in the Chairman's statement to the Annual Report of the Housing Development Finance Corporation Limited, 1991-92.
2. See Chairman's statement to the 1990-91 Annual Report of the HDFC, 1990-91.
3. Dawn Economic and Business Review, September 13-19, 1992.
4. See Chairman's statement to the 1990-91 Annual Report of the HDFC, 1990-91.
5. See Chairman's statement to the 1990-91 Annual Report of the HDFC, 1990-91.

* The 5% CVT is payable by non-tax payers on all transactions in respect of residential plots exceeding 240 sq.yds., while tax payers are required to pay the CVT on residential plots with an area of more than 240 sq.yds. allotted by a Development Authority. On commercial plots of any size a 5% CVT is payable by both tax and non-tax payers.

13. RECOMMENDATIONS

ANZ

A. INTRODUCTION AND SCOPE OF RECOMMENDATIONS

13.01 Some policy, legal and institutional reforms are critical for creating the enabling environment for the long term development of capital markets in general and the housing finance sector in particular. It would be beyond the scope of this study to make specific recommendations in this regard because, on the one hand, a more detailed and focused effort would be required to draw up precise proposals taking into consideration their wider implications and their inter-sectoral linkages and, on the other hand, some of the relevant changes would be politically and practically difficult to introduce in the foreseeable future. We mention these issues as some of them seem critical to the development of a housing finance industry.

13.02 Such a package of reforms would broadly cover the following areas:

a) National Budget Deficit

Measures to bring down the government's budget deficit, touching 8% of the GDP. By soaking up the liquidity in the financial system the government is raising the level of interest rates in the economy, captivating the majority of scheduled bank deposits at artificial interest rates, crowding out the private sector and thwarting the development of vibrant capital markets.

b) Monetary Policy

Granting of greater autonomy to the State Bank to pursue a consistent monetary policy without interference from higher levels of government.

c) Open Market Operations

Making capital markets more efficient by a phased movement towards open market operations.

d) In our interviews with various institutional groups the issue of foreclosure was mentioned by several of them. More effective foreclosure mechanisms through appropriate amendments in the legislative framework, procedural changes and strengthening of the judicial machinery.

e) Development of a well trained supervisory staff at the State Bank to ensure compliance with new PRs by the rapidly expanding group of financial institutions. The financial sector cannot afford a cooperative society type scandal at this critical stage of its development.

f) Development of a secondary market for a wide range of financial instruments.

g) Development of an Apex institution for regulating the securities markets.

13.03 Organization of Recommendations

The rest of this section will be devoted to a series of specific recommendations which taken together can help stabilize the system and provide the basis for the functioning and improvement of capital markets. Finally, we have attempted to link the needed reforms with suggestions on how reforms in the capital markets can assist the development of the new housing finance industry so that it can attract capital for mortgage lending purposes during its formative years. These policy, legislative, procedural and institutional strengthening proposals have been classified into those that can be initiated in the short term (less than 2 years), those that will require a medium timeframe, 3 to 5 years, for implementation and those that can, realistically, only be executed in the long term.

B. MEASURES THAT CAN BE IMPLEMENTED IN THE SHORT TERM

13.04 This section proposes policy and institutional strengthening measures that require only procedural changes or minor legislative modifications (enabling legislation) that can be implemented in the short-term, 1-2 years.

B.1 Policy Proposals

13.05 Tax Deduction

The government should allow the deduction, against the taxable income of a tax payer, the interest element of a housing loan - placing an upper limit on the value of the loan. This measure can play a critical role in facilitating the development of a market for housing finance.

13.06 Housing Finance Policy

Some of the instruments that could reduce the cost of funds for housing finance that the government should consider are:

a) Fiscal incentives, for instance, concessions in income tax for a specific period, for those providing housing finance.

b) Permission to HFCs to take saving account deposits; presently they are only allowed to take term deposits (see Section-12.I on Problems of Matching in Housing Finance).

Almost every developed country in the world allows Building Societies and Savings and Loan institutions access to passbook savings accounts. This is a source of clients for the housing finance companies in that passbook savers can demonstrate their ability to set aside certain amounts of capital at regular intervals. Passbook savings accounts can serve as a vehicle to float various land and home purchase schemes. And most importantly, passbook savings can serve as a growing source of capital for mortgage lending.

c) The treatment of housing finance companies (HFCs) as commercial banks for purposes of inter-bank borrowing.

d) Taxation and stamp duty impediments and cost of registering property related transactions are major problems for registering land and mortgage documentation that are hindering the development of a housing finance market (Para 13.28). These issues are beyond the scope of this study but are critical if the housing finance industry is to flourish in Pakistan.

e) Housing finance companies have no "Bank of Last Resort" and will be undercapitalized in their early years of operation. There is a critical need to provide these companies with short term funds to meet liquidity needs and provide for stable cash management. Access to passbook savings will be a longer term source of funds as it will take the HFCs several years to build up this deposit base. In their first years of operation they will need access to Interbank funds or some other source of short term funding to provide a smooth efficient operation. While the current market extends only to seven days, we believe, if HFCs were players in the market longer term agreements would emerge. There is a need for more players in the Interfund market and giving access to HFCs would be a logical step towards the needed expansion.

13.07 Directed Credit

The strategy pertaining to directed credit needs to be further developed to (i) eventually lead to the elimination of credit ceilings; and (ii) phasing out of credit lines to specialized financial institutions like the Agricultural Development Bank, House Building Finance Corporation, Industrial Development Bank, etc.; to encourage them to mobilize additional resources from their own efforts for their lending activities.

B.2 Policies Regarding Capital Market Securities

13.08 Fixed Interest Securities

For fixed interest securities held by banks the Government of Pakistan must initiate a system of regular auctions reasonably interspaced in time to give the secondary market time to develop.

13.09 Fewer Securities Issues

During the last 18 months there have been 84 issues of FIBs (28 for each period of maturity). The crowding of issues has given rise to a fairly complicated secondary market. The market could be simplified considerably if there was only one issue per annum. Any auction during the year would then open up the issue resulting in the settlement amount being the price tendered plus the accrued interest up to the settlement date. The local market is sophisticated enough to understand and calculate the accrued interest on settlement.

13.10 Securities Taxation Policy

The State Bank should have a uniform policy for all securities in respect of the liability for Zakat and for wealth tax and income tax (withholding tax) purposes.

13.11 Bearer Certificates

The private sector, like public sector corporations, should be permitted to issue bearer certificates (commercial paper) and domestic banks should be allowed to guarantee paper issued by the private sector.

13.12 Stamp Duty Relief

To facilitate the development of a market for commercial paper the Federal Government should persuade the Provincial Governments to reconsider the high rate of stamp duty and the stage at which it is to be levied. Currently duty at 3.5% is payable both at the time of issue of paper and at all subsequent transfers.

13.13 Securities Underwriting

Underwriting is a requirement for public issues; it gives the market liquidity. No restrictions on the amount of issue or fees should be placed. The government should allow the market to determine these factors, in particular the risk/reward. If the reward is not linked to the risk there will be little motivation to move out of a low risk environment. This requirement will result in the growth of a security market biased in favour of large and better known names.

13.14 Secondary Securities Market

There is a need to develop secondary markets further so that the market provides the liquidity rather than the State Bank's discount/repo window. A separate study needs to be conducted for identifying proposals for developing secondary markets.

13.15 Securities Apex Institution

A study needs to be undertaken to develop proposals for reducing multiplicity of regulations and regulatory bodies. For instance, by making one body responsible for handling all legal issues pertaining to the securities markets, the Government of Pakistan would be taking a significant step in ensuring that efforts to streamline the regulatory structure are not misdirected. All expertise in corporate law would be available at one place.

B.3 Institutional Strengthening

13.16 Access to Listed Companies Records

Better availability of, and access to, the records of listed companies should be the right of all potential investors, the public at large. One method for ensuring transparency and fairplay would be greater public awareness. The better the access of the public to information about these companies the lesser the likelihood of abuse. There is, therefore, an urgent need to widely disseminate information on the status of listed companies and ensure that legal requirements on timely disclosure of material information are met.

13.17 Better Enforcement

Heavy penalties should be devised and strictly enforced against those found guilty of negligence, misreporting, concealing information and certifying information that they knew or should have known was incorrect (also see Section 13.C.2).

13.18 Credit Rating Agency

To enable investors to properly evaluate the credit-worthiness of potential issuers, it is important that a feasibility study for setting up a rating agency be conducted. Without an impartial mechanism to ascertain the credit-worthiness of issuers, the public will be unable to make informed investment decisions. This will result in an increase in information search costs, causing firms to pay higher rates than would otherwise be the case. We have been given to understand that there has been some effort by the International Finance Corporation (IFC) to lay the groundwork for a rating agency, but so far there has been no definite progress.

C. RECOMMENDATIONS THAT CAN BE UNDERTAKEN IN THE MEDIUM TERM

13.19 This section is devoted to recommendations for making improvements in the policy, institutional and administrative framework that can be undertaken in the medium term (3-5 years).

C.1 Policy Proposals

13.20 Access to Pension/Provident Funds

Pensions/provident funds should be allowed to operate in the equities market. This will give the market both depth and liquidity. Therefore, specific recommendations - legal, procedural and institutional - need to be developed on the manner in which these funds should be authorized to function in the market for equities.

13.21 Stop Concessionary Financing

Concessional financing (e.g., export refinance, LMM financing) provided by the government should be phased out. This sort of financing skews the term structure of interest rates, and makes development of an efficient capital market difficult. Fiscal incentives to support such activities would serve as a better alternative.

13.22 Deposit Insurance Schemes

Having introduced the framework for credit and risk exposure through the Prudential Regulations there is a need to set up deposit insurance schemes to instill confidence in the safety of savings with banks. This is particularly important in view of the history of financial scams and the recent proliferation of financial institutions.

C.2 Institutional Strengthening Proposals

13.23 Monetary management is not just a question of the right mix of policies but also depends upon institutional capacities. One of the lessons of financial disasters is that competitive financial markets, although efficient at mobilising and allocating funds and managing risks, make costly mistakes. The regulators, therefore, will have to continually strive for an appropriate balance between stimulating competition and checking fraud and instability. In this regard the PRs have a critical role to play. The regulations, however, cannot promote a safe, stable and efficient system unless these are effectively enforced by well trained staff.

13.24 After the recent reforms enterprises can now borrow abroad freely. This implies that the supply of credit does not only come from the domestic banking system. Controlling money supply has, therefore, become a more sophisticated exercise reinforcing the importance of well trained staff responsible for performing the regulatory functions.

13.25 Supervision of Monitoring of Financial Institutions

The State Bank needs internal reforms, qualified and suitably trained staff to ensure compliance with sound business practices and enable streamlining of the various departments to make them more efficient and productive and to make staff aware of modern commercial banking practices. With the onerous responsibility of having to regulate over 110 financial institutions the State Bank will have to make strenuous efforts to improve its data bases and the quality of staff through formal training and cross training programmes with commercial banks. This is so because, on the one hand, a number of new financial institutions are being created in the private sector and, on the other hand, the introduction of new complicated financial instruments is making it difficult for regulators to assess the riskiness of the bank's balance sheet and determine capital adequacy rules. In this regard the State Bank's decision to allow external auditors to review the operations of financial institutions on a selective basis is a laudable step.

13.26 State Bank Disclosure

An important reform measure that can facilitate the State Bank in fulfilling its supervisory role and in promoting financial stability is wider disclosure of information relating to banking, for example bad debts and deposit composition.

D. PROPOSALS THAT CAN BE IMPLEMENTED IN THE LONG TERM

13.27 This section sets out recommendations that, in our opinion, can only be fully instituted and activated in the long term (more than 5 years).

13.28 Tax, Stamp Duty and Costs of Registration - Housing Finance

Issues concerning costs of registering property related transactions and potential costs in the shape of property, capital value and other taxes that become liable on land registration and mortgage documentation are problems that will have to be sorted out if the housing finance industry is to flourish in Pakistan.

13.29 Capital Adequacy Ratios

The capital adequacy ratios of banks should be based on Bank for International Settlements (BIS) guidelines where capital adequacy is a function of risk weighted assets rather than of the gearing ratio.

13.30 Private Sector Involvement in Policy Formation

In view of the problems encountered by different players in the market (including the government) in interpreting and implementing different policy changes the government should involve the private sector in formulating policies, making legislative changes and in devising implementation mechanisms and instruments. For this to happen the government will have to recognize that the formal participation of the private sector is necessary for both formulating policies (including a regulatory framework) and for devising the institutional arrangements and mechanisms for implementing them. In the light of the above discussion it is, therefore, proposed that a detailed study be carried out on mechanisms for making government policies operational and for submitting proposals on institutional arrangements aimed at formalizing the private sector's involvement in policy making.

13.31 Self Regulation

However, the financial systems will function effectively only if the private sector also responds positively to government initiatives in this direction. Industrialists, stock brokers, and professionals, like auditors, are adept at protecting and promoting either their individual or trade interests. They do not collaborate with each other to develop codes of behaviour and standards for self regulation. An institutional structure for disciplining and publicly reprimanding those abusing the freedoms and not rectifying their operational practices will help marginalize those not complying with the ground rules. For instance, the stock exchange must exercise self-regulation while the government maintains a vigilant eye against frauds, unfair practices, concealment of information and misrepresentations through inadequate disclosures. The private sector will have to fulfil these obligations itself and not rely primarily on the government to perform these functions.

13.32 Foreign Investment

Similarly, for attracting foreign investment the government can at best create a conducive environment. The private sector will have to do the marketing effort and invite foreign expertise and investors to enter into joint venture arrangements.

D.2 Institutional Strengthening

13.33 Fraud Prevention and Detection

Efficient supervision which provides for redressal and minimising the risk of frauds is also essential for attracting foreign investors. For instance, the office of the CLA had been created to control and regulate the corporate sectors activities and to safeguard the interests of the minority shareholders. It, however, has difficulty in protecting the rights of minority shareholders. How can minority holders exercise their rights and check the malpractices of the management? It is not clear if the solution lies in giving the latter representation on the Board. If this proposal can be justified, how and what mechanism could achieve such an objective? It could perhaps be achieved by reducing the maximum holding of the sponsors.

13.34 Insider Trading

Despite widespread rumours of manipulation, insider trading, and malpractices, no concrete action has been taken to either confirm or dispel these rumours. For example, problems arising out of over trading are only attended to without appropriate corrective measures being undertaken. To perform the role envisaged the CLA has to be fully equipped, in terms of qualified personnel and adequate funding, to deal effectively with such violations.

E. RECOMMENDATIONS ON THE STOCK MARKET

13.35 Capital Base of Brokers

The basic requirements of a good trading system for servicing customers are information, transparency, liquidity, efficiency, and reliability. The present position is that there has been a tremendous increase in transaction volumes and there is greater volatility in the stock market. In view of the changed circumstances it appears that some stock brokers do not have an adequate capital base. Thus, the capital base of some members has to be enhanced.

13.36 More Players

For the long term development of the market and because of the huge growth in the volume of transactions, a larger body of transactors is required, who should perceive the market to be operating in an orderly fashion and ensure that trade practices are open and fair.

13.37 Retail Market Constraints

The retail customer lacks information. The problem is not just poor disclosure but also lack of infrastructure in the market to service retail customers, for example, through computerisation of settlements.

13.38 Complaint Registration

There is also a need for setting up a system at the stock exchange for registering complaints and settling grievances.

13.39 Share Transfer

To improve the functioning of the market the system of transferring share deeds needs to be simplified and the time period for companies to make the transfer related entries in their books and records needs to be reduced. We recommend that a study be undertaken on the manner in which this procedure can be simplified and the process telescoped in time.

13.40 Settlement

The settlement procedures have to change to enable the market to function smoothly, particularly after this rapid growth in trading volumes.

13.41 Apex Institution

Further to our proposal (Para 13.15) on the need for making just one organisation responsible for handling legal aspects of issues of securities, we recommend that the government should review the model of the "Securities and Exchange Commission" of USA and examine the viability of, and the legal and procedural mechanisms for, setting up such an institution.

ANZ

ANNEXURE - 1

INDIVIDUALS MET

ANZ

INDIVIDUALS MET

ANZ Grindlays Bank
Senior Management

Mr. Ashraf Janjua
Deputy Governor
State Bank of Pakistan

Mr. A.K.M. Sayeed
Executive Vice President
National Investment Trust

Mr. Arif-ul-Islam
Executive Vice President (Investment Banking Group)
Muslim Commercial Bank

Mr. Athar Naseem
Deputy Managing Director
First Interfund Modaraba

Mr. Aneeq Khawar
Chief Executive
Citi Housing Finance Co.

Mr. Frederick Piechoczek
Chief Executive
First International Investment Bank Limited

Mr. Farrukh Khan
Chief Executive
BMA Capital Management

Mr. Jacques Broquet
Manager Merchant Banking
Banque Indosuez

Mr. Khalil Hassan
Chairman
Vital Capital Markets

Mr. Mohammed Choudry
Managing Director
Adamjee Insurance Company Ltd

Mr. Munawar Chaudary
Senior Executive Vice President
Investment Corporation of Pakistan

ANZ

Mr Mudassar Malik
Director
BMA Capital Management

Mr. Nader Morshed
Executive Vice President/Chief Economist
National Development Finance Corporation

Mr. Nasir Bokhari
Chief Executive
Khadim Ali Shah Bokhari & Co.

Mr. Nesar Ahmad
Chief Executive
Crescent Investment Bank Limited

Mr. Nusrat Yar Ahmed
Chief Executive
Vital Capital Markets

Mr. Rauf Qadri
Chief Executive
First Interfund Modaraba

Mr. Salim Rathod
Senior Vice President
Pakistan Industrial Credit & Investment Corporation

Mr. Shezad Naqvi
Vice President (Investment Banking Group)
Citibank

Mr. Syed Ali Reza
Vice President & Country Manager
Bank of America

ANNEXURE - 2

LIST OF FINANCIAL INSTITUTIONS

ANZ

FOREIGN BANKS

1 ANZ Grindlays Bank p.l.c.
2 Standard Chartered Bank
3 Deutsche Bank (Asia)
4 ABN – AMRO bank (Fomerly Algemene Bank)
5 American Express
6 Al – Baraka Bank
7 Indo-Suez French Bank
8 Rupali Bank
9 Hongkong & Shanghai Banking Corporation
10 International Finance Investment & Commerce Bank Ltd
11 Habib Bank AG Zurich
12 Societe Generale
13 Pan African Bank Ltd
14 Bank of America
15 Bank Of Tokyo
16 Citibank
17 Chase Manhattan Bank
18 Bank of Oman
19 Middle East Bank
20 Emirate Bank International Ltd
21 Doha Bank
22 Faysal Islamic Bank of Bahrain

NATIONALIZED BANKS

1 National Bank of Pakistan
2 Habib Bank Limited
3 United Bank Limited
4 First Women Bank Limited

DEVELOPMENT FINANCE INSTITUTIONS

1 Agricultural Development Bank of Pakistan
2 Industrial Development Bank of Pakistan
3 Bankers Equity Limited
4 Pakistan Industrial Credit & Investment Corporation
5 National Development Finance Corporation
6 Small Business Finance Corporation
7 Pak Lybia Holding Company
8 Pak Kawait Investment Company
9 Rural Development Finance Corporation
10 Youth Investment Promotion Society
11 Saudi Pak Investment Company

Contd..

PROVINCIAL BANKS

1 Bank of Punjab
2 Bank of Khyber

PRIVATE BANKS

1 Muslim Commercial Bank
2 Allied Bank Limited
3 Mehran Bank
4 Union Bank
5 Soneri Bank
6 Prime Commercial Bank
7 Indus Bank
8 Bolan Bank
9 Metropolitan Bank Limited
10 Askari Bank
11 Bank Commerce Al-Habib

INVESTMENT FINANCE COMPANIES

1 Al-Towfeek Investment Bank
2 Atlas BOT Bank
3 Crescent Investment Bank
4 First International Investment Bank
5 Fidelity Investment Bank
6 Security Investment Bank
7 Prudential Investment Bank
8 Islamic Investment Bank
9 Asset Investment Bank Limited

LEASING COMPANIES

1 Asian Leasing
2 Atlas BOT Lease
3 Credit & Leasing Corp.
4 Dadabhoy Leasing
5 English Leasing
6 First Leasing Corp.
7 Ghemni Leasing
8 International Multi Leasing
9 National Assets Leasing Corporation
10 National Development Leasing Corporation
11 Orix Leasing
12 Pak.Ind. & Comm.
13 Pakistan Industrial Leasing Corporation of Pakistan
14 Standard Chartered Mercantile Leasing
15 Trust Leasing Corporation

ANZ

Contd..

MODARABAS

1 Al Ata Leasing Mod.
2 Al-Noor Mod.
3 Al-Zamin Leasing Mod.
4 B.F Mod.
5 B.R.R. Capital I Mod.
6 B.R.R. Capital II Mod.
7 1st Confidence Mod.
8 1st Constellation Mod.
9 1st Crescent Mod.
10 1st D.G. Mod.
11 1st Elite Cap Mod.
12 1st Equity Mod.
13 1st Grindlays Mod.
14 1st Habib Bank Mod.
15 1st Habib Mod.
16 1st Hajvery Mod.
17 1st Interfund Mod.
18 1st Mehran Mod.
19 1st National Mod.
20 1st Nishat Mod.
21 1st Pak Mod.
22 1st Premier Mod.
23 1st Professional Mod.
24 1st Providence Mod.
25 1st Prudential Mod.
26 Punjab Bank Modaraba
27 1st Sanaullah Mod.
28 1st Tawakkal Mod.
29 1st Tri-Star Mod.
30 1st UDL Mod.
31 Indust. Capital Mod.
32 L.T.V. Catital Mod.
33 Mod-Al-Mali
34 Mod Al-Tijarat
35 Schon Mod.
36 Second Prudential Mod.
37 Third Prudential Mod.
38 Trust Mod.
39 Unicap Mod.

PROPOSED HOUSING FINANCE COMPANIES

1 Citibank Housing Finance Corporation
2 Jaffar Bros. Housing Finance Corporation
3 Interfund Housing Finance Corporation
4 International Housing Finance Corporation
5 Empire Housing Finance Corporation
6 National Housing Finance Corportation
7 Olympic Housing Finance Corporation
8 21st Century Housing Finance

ANZ

Contd..

MUTUAL FUNDS

1 National Investment (Unit) Trust
2 Investment Corporation of Pakistan
3 Equity Participation Fund

DISCOUNTING COMPANY

1 Prudential Discount & Guarantee House Ltd

HOUSE BUILDING FINANCE INSTITUTIONS

1 House Building Finance Corporation

ANZ

ANNEXURE - 3

BANK DEPOSITS AND ADVANCES

CUSTOMERS DEPOSITS

Following are year end figures of customer deposits with scheduled banks:

(Rupees in Millions)

CATEGORY	1986	1987	1988	1989	1990P	1991P	*1992P
FIXED	57,842.3	67,951.3	75,093.9	77,899.1	100,990.2	127,244.9	137,068.6
CURRENT	33,081.0	41,079.1	40,583.5	55,868.9	61,959.7	78,067.5	88,984.2
SAVING	77,670.8	88,624.8	94,027.9	107,384.1	124,957.9	157,443.5	173,195.3
CALL	3,462.5	2,591.2	2,749.1	2,799.4	3,470.4	4,372.6	4,790.1
OTHER	5,902.6	5,888.1	6,247.1	8,471.9	8,567.8	10,795.2	12,663.9
TOTAL	177,959.2	206,134.5	218,701.5	252,423.4	299,946.0	377,923.7	416,702.1

CUSTOMERS ADVANCES

Over the years scheduled bank advances have been as follows:

(Rupees in Millions)

ADVANCES	1986	1987	1988	1989	1990P	1991P	*1992P
TOTAL	147,551.4	152,852.2	168,705.2	196,797.4	219,068.1	250,622.3	280,351.1

P Provisional figures
* As of 30th June 1992

(Source:-- Bulletin, State Bank of Pakistan, November 1992 issue)

ANZ

ANNEXURE – 4

RATES OF RETURN ON DEPOSITS

ANZ

From Janruary 1985, the State Bank of Pakistan decided that banks and financial institutions receiving PLS deposits shall declare rates of profit on various types of PLS deposits on a half yearly basis for the half year ending 30th June and the half year ending 31st December each year after obtaining clearance from the State Bank in regards to the rates of profit proposed to be declared.

While distributing non-interest income in the manner spelt out therein, the following weightages will be given to the PLS deposits, PLS borrowing and equity:-

Type of Maturity		Weightage to be given
A.	<u>DEPOSITS</u>	
I.	Special notice <u>deposits</u>	
i)	Withdrawn at 7 to 29 day's notice:	0.65
ii)	Withdrawn at notice of 30 days or over:	0.75
II.	Savings accounts:	1.00
III.	PLS Call deposits from other banks:	Weightages as agreed to by the Banks concerned.
IV.	Term deposits:	
i)	For terms upto and inclusive of 6 months:	1.00 + 0.05 for each each month of the term of the deposit.
ii)	For terms in excess	1.3 for the first six

ii)	For terms in excess of 6 months:	1.3 for the first six months plus 0.01 for each subsequent month of the term of the deposit, subject to maximum of 2.08.
b.	PLS BORROWINGS:	Borrowings of various maturities will be given weightages as for term deposits of corresponding maturities.
c.	EQUITY:	Not exceeding 5 as may be determined by the concerned banks.

The amount of non-interest income distributable on PLS deposits of each type/maturity will be converted into an annual percentages rate of profit and the rate rounded off to the nearest one-tenth of a percentage point.

Weighted Average Rates of Return on Deposits

(in per cent per annum)

					FIXED DEPOSITS				
END-JUNE	Current Deposits	Call Deposits	Other Deposit Accounts	Saving Deposits	Less Than 6 Months	Upto 6 Months	For 6 Months & over but less than 1 year	over 6 Months to 1 year	For 1 year and over but less than 2 years
1978	0.09	5.01	3.17	7.59	–	8.66	–	9.95	–
1979	0.15	5.41	2.98	7.57	–	8.94	–	10.09	–
1980	0.10	5.73	3.47	7.58	–	8.89	–	10.15	–
1981	0.04	5.33	3.79	7.57	–	9.39	–	10.43	–
1982	0.02	5.82	4.00	7.60	9.61	–	9.84	–	10.38
1983	–	6.26	4.51	7.64	9.19	–	9.91	–	10.49
1984	–	5.51	4.69	7.61	9.29	–	9.93	–	10.53
1985	–	5.40	3.79	7.63	8.79	–	9.69	–	10.38
1986	–	4.44	3.90	7.61	7.89	–	9.04	–	9.41
1987	–	4.96	2.53	6.98	7.69	–	7.38	–	8.39
1988	–	3.19	2.65	7.30	7.24	–	8.24	–	8.11
1889	–	3.73	2.63	7.16	9.78	–	9.40	–	7.29
1990	–	2.31	4.21	7.45	8.59	–	10.65	–	8.38
1991P	–	3.75	4.03	8.50	10.25	–	11.72	–	11.01

(Source:– Economic Survey 1991–92 issue, Government of Pakistan)

Contd

Weighted Average Rates of Return on Deposits

(in per cent per annum)

			FIXED DEPOSITS					
END–JUNE	Over 1 year to 2 years	For over 2 years and over but less three years	Over 2 years to 3 years	For 3 years & over but less than 4 years	Over 3 years	For 4 years & over but less than 5 years	For 5 years & over	Total Deposits
1978	10.24	–	10.72	–	11.50	–	–	6.23
1979	10.52	–	10.93	–	11.70	–	–	6.11
1980	10.41	–	11.06	–	11.82	–	–	6.18
1981	10.48	–	11.19	–	12.03	–	–	5.95
1982	–	11.06	–	12.02	–	12.31	12.37	6.05
1983	–	10.76	–	11.84	–	12.39	12.44	6.24
1984	–	11.10	–	11.79	–	12.54	12.47	6.39
1985	–	10.95	–	11.58	–	12.40	12.41	5.76
1986	–	10.53	–	11.38	–	11.91	12.03	8.80 *
1987	–	10.10	–	11.72	–	11.98	12.20	7.87 *
1988	–	10.58	–	11.31	–	10.50	12.08	7.67 *
1989	–	8.13	–	10.12	–	11.75	12.25	7.95 *
1990	–	8.92	–	8.21	–	12.59	11.52	8.23 *
1991P	–	11.65	–	11.80	–	13.04	14.75	9.82 *

P = Provisional.

* = As from 1st July,1985, all deposits except deposits from foreign constituents and un–matured term deposits were converted from interest basis to profit & loss sharing basis. Weighted average rates of interest on deposits from September, 1985 onwards are, therefore, not comparable with either years.

SCHEDULE BANK DEPOSITS
Rates of Return on
DEPOSITS

(All Figures are %)

For 1 year and over but less than 2 years	For two years and over but less than 3 years	For 3 years and over but less than 4 years	For 4 years and over but less than 5 years	For 5 years and over	WEIGHTED AVERAGE RATE OF RETURN ON TOTAL DEPOSITS	END OF PERIOD
6.08	10.10	11.72	11.98	12.20	7.87	June 1987
8.11	10.58	11.31	10.50	12.08	7.67	June 1988
7.29	8.13	10.12	11.75	12.25	7.95	June 1989
8.38	8.92	8.21	12.59	11.52	8.23	June 1990
11.01	11.65	11.80	13.04	14.75	9.82	June 1991

(Source:– Annual Report State Bank of Pakistan, 1990–91 issue)

112

ANZ

RETURNS ON PLS INVESTMENTS

(January – June, 1992)

(Per Cent)

BANKS	NOTICE DEPOSIT (days) 7 to 29	30 & above	Saving Account	PLS Call Deposit	TERM DEPOSIT 1 Month	2 Months	3 Months	4 Months	6 Months	8 Months	1 Yr.	1½ Yr.	2 Yrs.	3 Yrs.	4 Yrs.	5 Yrs.
Allied Bank Limited	5.6	6.4	7.8	—	—	—	8.6	—	9.7	—	10.1	—	11.0	11.9	12.8	13.7
ADBP	—	—	4.60	—	—	—	5.30	—	6.00	—	6.20	—	6.80	7.30	7.90	8.40
Askari Comm. Bank	6.2	7.5	7.8	—	9.7	—	10.0	—	10.5	—	11.2	—	12.0	12.5	—	14.4
Bank Comm. Al-Habib	6.50	7.50	8.50	—	8.50	—	9.00	—	10.00	—	11.00	—	—	—	—	—
Bolan Bank Limited	5.9	7.1	—	—	—	—	9.2	—	10.1	—	11.0	—	—	12.5	—	—
Bank of Punjab Limited	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Cres Bank	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
First Women Bank Ltd.	5.1	5.9	7.8	—	—	—	9.0	—	10.1	—	10.6	—	11.6	12.5	—	14.4
Habib Bank Limited	5.10	5.90	7.80	—	—	—	9.00	—	10.20	—	10.70	—	11.60	12.50	13.50	14.40
Indus Bank Limited	7.00	8.00	9.00	—	10.50	10.70	11.00	—	11.50	—	12.00	—	—	—	—	—
IDBP	5.1	[illegible]	8.0	—	8.4	—	9.2	—	10.4	—	10.8	—	11.8	12.8	13.7	14.7
Mehran Bank Limited	6.50	7.50	10.00	—	—	—	11.50	—	13.00	—	13.60	—	14.90	16.20	—	18.40
Muslim Comm. Bank	5.20	6.00	8.00	—	—	—	9.1	—	10.3	—	10.8	—	11.8	12.7	13.7	14.6
National Bank of Pak.	5.8	6.7	7.8	—	—	—	8.8	—	10.1	—	10.6	—	11.5	12.4	13.4	14.3
P.I.C.I.C.	—	—	—	—	8.00	—	10.75	—	12.00	—	13.00	—	13.50	14.00	14.50	15.00
Soneri Bank Limited	6.00	7.00	8.50	—	9.50	—	9.50	—	10.00	—	11.00	—	12.00	—	—	—
United Bank Limited	5.30	6.10	6.60	—	—	—	9.10	—	10.30	—	10.70	—	11.70	12.50	13.50	14.50
FOREIGN BANKS																
ABN-Amro Bank	5.74	6.35	7.12	—	—	—	7.50	—	8.49	—	10.02	—	—	—	—	—
American Express Bank	4.5	5.3	7.1	—	—	—	6.0	—	8.0	—	8.3	—	—	—	—	—
ANZ Grindlays Bank	6.5	7.5	7.7	—	—	—	8.9	—	10.0	—	10.5	—	—	—	—	—
B.C.C.I.	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Banque Indosuez	5.20	6.00	7.20	—	—	—	—	—	8.50	—	9.00	—	—	—	—	—
Bank of Oman	6.10	7.10	8.50	—	—	—	10.40	—	10.50	—	10.70	—	—	11.80	—	13.50
Chase Manhattan Bank	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Deutsche Bank	5.1	5.9	7.9	—	—	—	6.7	—	8.0	—	8.4	—	—	—	—	—
Doha Bank	6.20	7.10	9.50	—	9.90	—	10.90	—	12.30	—	12.90	—	—	—	—	—
Emirates B.I.L.	6.5	7.5	8.8	—	9.3	9.5	9.7	9.8	11.3	12.0	13.0	—	—	—	—	—
Faysal Islamic B.	6.0	7.5	9.2	—	9.3	9.8	10.6	—	12.0	—	12.2	—	—	—	—	—
H.B. A.G. Zurich	6.7	7.8	9.2	—	9.2	—	10.0	—	11.0	—	11.9	—	—	—	—	—
Hong Kong Bank	6.6	7.6	7.8	—	—	—	9.0	—	10.1	—	10.6	—	—	—	—	—
I.F.I. & C. Bank	6.5	7.5	10.0	—	10.5	—	11.5	—	13.0	—	13.5	—	—	—	—	—
Middle East Bank	6.2	8.0	—	—	9.5	9.7	10.0	—	10.5	—	11.0	—	—	—	—	—
Pan African Bank	7.0	8.6	10.7	—	10.8	—	12.4	—	14.0	—	—	—	—	—	—	—
Rupali Bank	5.8	6.8	9.0	4.1	9.5	—	10.4	—	11.7	—	12.3	—	—	—	—	—
Standard Chart. Bank	5.5	6.5	7.1	—	—	—	7.6	—	8.6	—	9.0	9.4	9.8	—	—	—
Societe Generale (The French and International Bank)	—	5.2	—	—	—	—	8.0	—	—	—	—	—	—	—	—	
Union Bank	6.6	7.6	8.6	—	8.6	—	9.0	—	10.1	—	11.0	12.1	12.5		14.3	
ABN-AMRO Bank Foreign Currency Accounts:																
US dollar (6.11.92)							4.1250		4.1250		4.5625					
Deutsche mark (5.11.92)							9.5000		9.1250		8.6250					
Japanese yen (6.11.92)							4.3125		4.1875		4.3125					
Pound sterling (5.11.92)							8.1250		7.6250		7.4375					

F. I. B. Rates: ASK. — BID. —

Source : Business Recorder
12th December, 1992

ANZ

ANNEXURE - 5

CALL MONEY RATES

CALL MONEY RATE

PERIOD	1981–82	1982–83	1983–84	1984–85	1985–86	1986–87	1987–88	1988–89	1989–90	1990–91
July	9.75	9.75	6.50	10.63	8.50	6.50	6.25	6.38	6.25	7.50
August	9.50	9.25	7.63	10.25	7.75	6.25	6.25	6.38	6.25	7.50
September	9.38	9.13	9.00	10.38	9.75	6.25	6.25	6.38	6.25	7.00
October	9.13	9.00	9.00	9.00	6.50	6.25	6.25	6.38	6.25	6.75
November	10.00	8.13	6.13	8.00	6.50	6.13	6.25	6.38	6.25	7.25
December	10.00	8.38	8.88	9.38	6.63	6.25	6.25	6.25	6.50	8.00
Janruary	10.25	10.13	6.88	7.63	6.75	6.25	6.25	6.38	7.13	8.13
February	10.25	9.75	7.00	10.50	6.75	6.25	6.25	6.38	7.13	7.25
March	9.88	9.00	8.75	9.00	7.00	6.25	6.25	6.38	7.13	8.75
April	10.25	7.25	9.38	7.50	6.88	6.25	6.25	6.25	7.38	5.50
May	9.75	7.00	8.25	8.25	7.00	6.25	6.38	6.25	7.50	5.71
June	10.13	7.50	9.75	9.00	7.13	6.25	6.38	6.25	7.25	5.64

(Source:– Economic Survey 1991–92)

ANNEXURE – 6

KARACHI STOCK EXCHANGE SECTOR–WISE SUBSCRIPTIONS IN 1991 & 1992

THE KARACHI STOCK EXCHANGE (GUARANTEE) LIMITED

NEW ISSUE DURING THE YEAR JAN.1991 – DEC. 1991

(Rupees in million)

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUB. AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL.	PREMIUM	TOTAL	SUBCRIP RECD FRM G. PUBLIC	SUBCRIP RECD FRM N.I.T	TOTAL SUBCRIP
SECTOR : Mutual Funds										
1	Twentieth ICP	50.000	0.000	50.000	–	0.000	–	86.090	–	86.090
2	Prud:StockFund	35.000	0.000	35.000	10.000	0.000	10.000	129.310	–	129.310
SECTOR : Modarabas										
3	Ist Const: Mod	20.000	0.000	20.000	5.000	0.000	5.000	331.095	–	331.095
4	Ist Cresent Mod	40.000	0.000	40.000	10.000	0.000	10.000	265.869	10.000	275.869
5	Ist D.G Mod	20.000	0.000	20.000	5.000	0.000	5.000	562.182	5.000	567.182
6	Ist Habib Bank	112.000	0.000	112.000	28.000	0.000	28.000	97.069	28.000	125.069
7	Ist Hajvery	60.000	0.000	60.000	15.000	0.000	15.000	116.060	3.750	119.810
8	Ist Interfund	14.500	0.000	14.500	3.500	0.000	3.500	272.745	0.000	272.745
9	Ist Pak Mod	40.000	0.000	40.000	10.000	0.000	10.000	347.466	0.000	347.466
10	Ist Premier	10.000	0.000	10.000	2.500	0.000	2.500	299.605	0.000	299.605
11	Ist Professional	20.000	0.000	20.000	5.000	0.000	5.000	345.245	5.000	350.245
12	Ist Providence	20.000	0.000	20.000	5.000	0.000	5.000	204.415	5.000	209.415
13	Ist UDL Mod	40.000	0.000	40.000	10.000	0.000	10.000	547.510	10.000	557.510
14	Ind. Cap Mod	30.000	0.000	30.000	7.500	0.000	7.500	321.740	7.500	329.240
15	Mod Al Tijarah	24.000	0.000	24.000	6.000	0.000	6.000	252.737	6.000	258.737
16	3rd Prudential	80.000	0.000	80.000	20.000	0.000	20.000	539.302	10.000	549.302
17	Trust Mod	60.000	0.000	60.000	15.000	0.000	15.000	505.055	15.000	520.055
18	Uni Cap Mod	40.000	0.000	40.000	10.000	0.000	10.000	276.355	10.000	286.355
SECTOR : Leasing Co.										
19	Int. Multi Leasing	20.000	0.000	20.000	5.000	0.000	5.000	155.535	5.000	160.535
20	Nat. Assets Leasing	20.000	0.000	20.000	5.000	0.000	5.000	261.850	5.000	266.850
21	Standard Chartered	14.000	0.000	14.000	3.500	0.000	3.500	448.432	3.500	451.932
SECTOR : Investment Co. & Banks										
22	Atlas BOT Bank	16.000	0.000	16.000	4.000	0.000	4.000	266.507	4.000	270.507
23	Bank Of Punjab	40.000	0.000	40.000	–	0.000	–	196.568	–	196.568
24	K.A.S.B. & Co.	10.000	21.500	31.500	0.000	0.000	0.000	220.591	0.000	220.591

Contd.. NEW ISSUE DURING THE YEAR JAN.1991 – DEC. 1991

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUB. AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL.	PREMIUM	TOTAL	SUBCRIP RECD FRM G. PUBLIC	SUBCRIP RECD FRM N.I.T	TOTAL SUBCRIP.
51	Hamid Tex.	53.085	0.000	53.085	13.273	0.000	13.273	3.640	–	3.640
SECTOR : Synthetic & Rayon										
52	Dewan Salman Fibre	90.000	0.000	90.000	26.500	0.000	26.500	375.905	26.500	402.405
SECTOR : Sugar & Allied Ind.										
53	Ansari Sugar Mills	58.545	0.000	58.545	14.640	0.000	14.640	73.185	–	73.185
54	Chashma Sugar	76.512	0.000	76.512	19.128	0.000	19.128	93.218	19.128	112.346
SECTOR : Cables & Electrical Goods										
55	Auvitronics	10.000	0.000	10.000	2.500	0.000	2.500	148.053	3.250	151.303
SECTOR : Paper & Board										
56	Cherat Paper Sack	13.600	0.000	13.600	3.400	0.000	3.400	238.220	3.400	241.620
57	Central Forest	12.000	0.000	12.000	3.000	0.000	3.000	22.645	3.000	25.645
SECTOR : Vanaspati & Allied Ind.										
58	Al–Hussany Ind.	10.000	0.000	10.000	2.500	0.000	2.500	46.230	1.250	47.480
59	Sarhad Ghee	10.560	0.000	10.560	2.640	0.000	2.640	350.290	2.640	352.930
SECTOR : Leather & Tanneries										
60	Pak Leather	13.600	0.000	13.600	3.400	0.000	3.400	354.550	3.400	357.950
SECTOR : Miscellaneous										
61	Mandviwalla Mauser	29.422	0.000	29.422	7.355	0.000	7.355	74.335	–	74.335
62	Mineral Grinding	12.000	0.000	12.000	3.000	0.000	3.000	48.343	–	48.343
SECTOR : Chemical & Pharmaceutical										
63	Fauji Fertilizer	80.000	40.000	120.000	0.000	0.000	0.000	1,043.870	0.000	1,043.870
	TOTAL			2,179.865			489.823			16,079.159

Source:– Karachi Stock Exchange
Khadim Ali Shah Bukhari & Co.

* A subsidary Co. of Modern Textile Mills
** " " " " Fateh Textile Mills

THE KARACHI STOCK EXCHANGE (GUARANTEE) LIMITED

NEW ISSUE DURING THE YEAR JAN. 1992 – AUG.1992 (Rupees in million)

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUBL AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL.	PREMIUM	TOTAL	SUBSCRIP RECD. FRM G. PUBL	SUBSCRIP RECD FRM N.I.T.	TOTAL SUBSCRIP
SECTOR : Modarabas										
1	Ist Elite Mod	40.000	0.000	40.000	10.000	0.000	10.000	336.565	10.000	346.565
2	Ist Equity Mod	80.000	0.000	80.000	20.000	0.000	20.000	248.710	20.000	268.710
3	Ist Nishat Mod	40.000	0.000	40.000	10.000	0.000	10.000	466.943	10.000	476.943
4	Schon Mod	60.000	0.000	80.000	20.000	0.000	20.000	512.219	10.000	522.219
5	Alzamin Lease Mod	59.500	0.000	59.500	10.500	0.000	10.500	139.720	10.500	150.220
SECTOR : Leasing Companies										
6	First Leasing	52.000	0.000	52.000	13.000	0.000	13.000	943.950	13.000	956.950
7	Ghemni Leasing	20.000	0.000	20.000	0.000	0.000	0.000	490.705	0.000	490.705
8	Al-Ata Leasing	29.750	0.000	29.750	5.250	0.000	5.250	13.905	5.250	19.155
9	Dadabhoy Leasing	28.000	0.000	28.000	7.000	0.000	7.000	37.510	7.000	44.510
10	English Leasing	32.000	0.000	32.000	8.000	0.000	8.000	585.125	8.000	593.125
11	Trust Leasing	42.500	0.000	42.500	7.500	0.000	7.500	735.785	7.500	743.285
SECTOR : Investment Companies & Banks										
12	Bolan Bank	120.000	0.000	120.000	30.000	0.000	30.000	560.808	15.000	575.808
13	Bank Com. Al.H	120.000	0.000	120.000	30.000	0.000	30.000	1,001.884	30.000	1,031.884
14	Indus Bank	120.000	0.000	120.000	30.000	0.000	30.000	482.983	15.000	497.983
15	Mehran Bank	120.000	120.000	240.000	30.000	0.000	30.000	2,124.398	15.000	2,139.398
16	Prime Comm.Bank	120.000	0.000	120.000	30.000	30.000	60.000	983.770	30.000	1,013.770
17	Prudential Disc & G	30.000	0.000	30.000	0.000	0.000	0.000	111.310	0.000	111.310
18	Security Inv.Bank	40.000	0.000	40.000	10.000	0.000	10.000	534.155	10.000	544.155
19	Union Bank	120.000	0.000	120.000	30.000	0.000	30.000	861.471	30.000	891.471
20	Al-Towfeeq Bank	43.400	0.000	43.400	10.850	0.000	10.850	541.096	10.850	551.946
21	Askari Comm. Bank	120.000	0.000	120.000	30.000	0.000	30.000	2,073.280	30.000	2,103.280
22	M.C.B	114.025	662.515	776.540	0.000	0.000	0.000	4,712.632	0.000	4,712.632
23	Soneri Bank	120.000	0.000	120.000	30.000	0.000	30.000	2,141.491	30.000	2,171.491
24	Fidelity Invest. Bank	40.000	0.000	40.000	10.000	0.000	10.000	554.545	10.000	564.545

Contd..

NEW ISSUE DURING THE YEAR JAN. 1992 – AUG.1992

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUBL AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL.	PREMIUM	TOTAL	SUBSCRIP RECD. FRM G. PUBL	SUBSCRIP RECD FRM N.I.T	TOTAL SUBSCRIP
SECTOR : Textile Spinning										
25	Faisal Spinn.	47.000	19.320	66.320	3.000	4.830	7.830	555.650	4.449	560.099
26	J.A. Tex	38.772	0.000	38.772	9.694	0.000	9.694	67.659	4.847	72.506
27	Ruby Tex	28.000	0.000	28.000	7.000	0.000	7.000	75.791	7.000	82.791
28	Shahpur Tex	33.288	0.000	33.288	8.322	0.000	8.322	374.752	8.322	383.074
29	Ahmad Hassan	33.600	0.000	33.600	8.400	0.000	8.400	390.810	8.400	399.210
30	Ahmed Oriental	30.360	0.000	30.360	7.590	0.000	7.590	36.970	1.898	38.868
31	Al-Azhar Tex	34.202	0.000	34.202	8.550	0.000	8.550	18.905	2.000	20.905
32	Awan Tex	34.656	0.000	34.656	8.664	0.000	8.664	7.415	4.332	11.747
33	Dar-es-Salam	32.000	0.000	32.000	8.000	0.000	8.000	36.190	4.000	40.190
34	Maqbool Tex	33.600	0.000	33.600	8.400	0.000	8.400	713.070	8.400	721.470
35	Sargodha Spinn.	41.600	0.000	41.600	10.400	0.000	10.400	730.614	10.400	741.014
36	Sunrays Tex	24.000	0.000	24.000	6.000	0.000	6.000	23.460	1.500	24.960
37	Zahoor Cotton	39.440	0.000	39.440	9.860	0.000	9.860	881.309	9.860	891.169
38	Accord Textile	37.200	0.000	37.200	9.300	0.000	9.300	18.075	9.300	27.375
39	Aisha Cotton	48.000	0.000	48.000	12.000	0.000	12.000	70.000	12.000	82.000
40	Idrees Textile	60.160	0.000	60.160	15.040	0.000	15.040	51.530	3.760	55.290
41	Saif Textile	31.957	22.370	54.327	6.251	4.376	10.627	353.551	10.626	364.177
SECTOR : Textile Weaving										
42	Ayaz Tex Al	34.137	0.000	34.137	8.534	0.000	8.534	14.752	0.000	14.752
43	Shahtaj Tex	23.200	0.000	23.200	5.800	0.000	5.800	622.595	5.800	628.395
44	Sunrise Tex	43.024	0.000	43.024	10.756	0.000	10.756	159.461	5.378	164.839
45	Amazai Textile	16.884	0.000	16.884	4.221	0.000	4.221	3.035	0.422	3.457
46	Koohin. Looms	34.647	0.000	34.647	8.660	0.000	8.660	251.527	2.165	253.692
47	Sunshine Cloth	40.000	0.000	40.000	10.000	0.000	10.000	125.405	10.000	135.405
48	Crown Textile	25.799	0.000	25.799	6.449	0.000	6.449	5.315	6.449	11.764
49	Ghani Textile	20.000	0.000	20.000	5.000	0.000	5.000	44.255	1.250	45.505
50	Nishat Fabrics	56.000	11.200	67.200	14.000	2.800	16.800	940.687	16.800	957.487
51	Reliance Weaving	44.000	0.000	44.000	11.000	0.000	11.000	118.255	5.500	123.755

Contd..

NEW ISSUE DURING THE YEAR JAN. 1992 – AUG.1992

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUBL AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL	PREMIUM	TOTAL	SUBSCRIP RECD. FRM G. PUBL	SUBSCRIP RECD FRM N.I.T	TOTAL SUBSCRIP.
SECTOR : Textile Composite										
52	Schon Textile	20.000	0.000	20.000	5.000	0.000	5.000	667.240	5.000	672.240
53	MARR Fabrics	9.600	0.000	9.600	2.400	0.000	2.400	9.840	2.400	12.240
SECTOR : Woollen										
54	Bannu Woolen	7.344	5.508	12.852	1.250	0.938	2.188	239.214	2.187	241.401
SECTOR : Synthetic & Rayon										
55	Tawakkal polyester	40.000	0.000	40.000	10.000	0.000	10.000	155.381	0.000	155.381
56	Gatron	111.508	223.016	334.524	22.876	45.752	68.628	4,951.029	68.628	5,019.657
57	Tri–star	47.264	0.000	47.264	11.816	0.000	11.816	954.190	5.908	960.098
58	Kashmir Ploytec	28.400	0.000	28.400	7.100	0.000	7.100	49.870	3.550	53.420
SECTOR : Cement										
59	DadaBhoy	106.317	0.000	106.317	26.579	0.000	26.579	149.425	0.000	149.425
60	D.G. Khan Cement	194.990	0.000	194.990	34.410	0.000	34.410	68.142	17.205	85.347
61	Pioneer Cement	213.945	0.000	213.945	37.755	0.000	37.755	123.512	0.000	123.512
SECTOR : Engineering										
62	Multipole Ind	24.000	0.000	24.000	6.000	0.000	6.000	30.345	0.000	30.345
SECTOR : Auto Allied & Engineering										
63	Indus Motors	167.025	167.025	334.050	29.475	29.475	58.950	1,997.950	58.950	2,056.900
SECTOR : Cables & Electrical Goods										
64	Casspak Ind	8.800	0.000	8.800	2.200	0.000	2.200	25.910	1.100	27.010
65	Myfio Video Ind.	8.500	0.000	8.500	1 500	0.000	1.500	2.325	0.000	2.325
SECTOR : Chemical & Pharmaceuticals										
66	Ravi Resins	18.320	0.000	18.320	4.580	0.000	4.580	70.750	4.580	75.330

Contd..

NEW ISSUE DURING THE YEAR JAN. 1992 – AUG.1992

SR. NO.	NAME OF COMPANY	CAP. OFRD TO G. PUBL AT PAR VAL.	PREMIUM	TOTAL	CAP. OFRD TO N.I.T AT PAR VAL	PREMIUM	TOTAL	SUBSCRIP RECD. FRM G. PUBL	SUBSCRIP RECD FRM N.I.T	TOTAL SUBSCRIP
SECTOR : Leather & Tanneries										
67	Fateh Industries	--	0.000	--	--	0.000	--	--	0.000	--
SECTOR : Food & allied										
68	Baker Food	13.000	0.000	13.000	3.250	0.000	3.250	96.720	0.000	96.720
SECTOR : Glass & Ceramics										
69	Frontier Ceramics	30.965	0.000	30.965	7.741	0.000	7.741	27.767	0.770	28.537
SECTOR : Sugar & Allied Industries										
70	Al-Abbas Sugar	86.812	0.000	86.812	17.361	0.000	17.361	101.078	17.361	118.439
71	J.W.D. Sugar	87.456	0.000	87.456	15.430	0.000	15.430	8.985	15.430	24.415
72	Tandiawala	70.728	0.000	70.728	17.682	0.000	17.682	45.236	17.682	62.918
SECTOR : Fuel & Energy										
73	Nishat Tek	40.000	20.000	60.000	10.000	5.000	15.000	999.457	15.000	1,014.457
74	Sui Northern Gas	85.451	1,536.186	1,621.637	0.000	0.000	0.000	390.789	0.000	390.789
SECTOR : Vanasoati & Allied										
75	Muslim Ghee	11.050	0.000	11.050	1.950	0.000	1.950	4.400	0.000	4.400
SECTOR : Insurance										
76	Delta	10.000	0.000	10.000	0.000	0.000	0.000	59.490	0.000	59.490
	TOTAL			6,925.316			1,012.517			39,842.752

Source:– Karachi Stock Exchange
Khadim Ali Shah Bukhari & Co.

ANZ

ANNEXURE - 7

RECENT REFORM MEASURES INTRODUCED BY THE GOVERNMENT (OTHER THAN FINANCIAL)

ANZ

Annexure-7

OTHER REFORM MEASURES INTRODUCED BY GOVERNMENT

These can be broadly classified and described as below:

A. DEREGULATION AND PRIVATISATION

The measures announced to date include the following:

a) All investment and import licensing requirements have been discontinued.

b) Two banks (with another one in the process of being privatised) and 100 State Owned Manufacturing Enterprises (SOEs) have been or are in the process of being privatised. Approximately half of the SOEs have already been transferred to private managements. Also, plans are being formulated to divest the government's holding in WAPDA, PTC, Pakistan National Shipping Corporation, etc.

c) To assist the export sector, import duties and sales taxes on equipment for manufacturing exportable products have either been reduced or withdrawn altogether. To improve competitiveness and productivity tariff barriers are being lowered and foreign trading companies have been granted permission to export products from Pakistan.

d) It is no longer necessary to obtain approvals for setting up companies in sub-sectors of industry in which investment permission is no longer required.

e) The equity ceiling for going public has been raised from Rs. 50 million to Rs. 100 million.

f) The reform programme is also meant to attract foreign investment and skills. Foreign ownership is no longer discriminated against, companies can now be fully owned by foreigners. Foreign investment is only restricted in four areas (arms, printing of currency, mint, and alcoholic beverages), in which, for security and social reasons, even the entry of domestic entrepreneurs is subject to approval.

The objectives of the proposed changes are to eliminate bureaucratic interference in economic activity and raise domestic saving levels and economic growth by improving the environment for savings, by creating a better climate for private investment and by inducing competitiveness in the system. The private sector is, thus, being encouraged to raise its saving and investment levels, with the government performing the critical task of maintaining macro-economic stability.

The success of the underlying objectives aimed at stimulating investment and national growth hinges crucially on the private sector's response to these incentives and liberalisation measures.

A distinctive feature of Pakistan's far reaching reforms has been the lively pace at which they have been put into effect. Also whereas other countries introduced reforms when their economies were not functioning well economically, Pakistan initiated its reforms in an economy that was already clocking up growth rates in excess of 6%.

B. EXCHANGE AND PAYMENT REFORMS

Prior to February 1991, only non-resident Pakistanis and overseas workers were permitted to operate foreign exchange accounts in Pakistan. Moreover, the transactions in these accounts were subject to a variety of restrictions. Now residents of Pakistan can also maintain foreign currency accounts in domestic commercial banks, transfer their holdings freely abroad (there are no restrictions on remittances) as well as receive foreign exchange in these accounts - facilities already available to non-residents. The foreign currency accounts can be fed by currency notes, travellers cheques, FEBCs and remittances from abroad, with no questions asked about the source. Foreign currency accounts are not subject to income tax, wealth tax or Zakat. Rupee loans can also be obtained against the security of these deposits. The deposits can be maintained in US dollars, Pounds Sterling, Deutsche Marks or Yen for periods up to 36 months.

The government has also issued foreign currency bearer certificates. The Dollar Bearer Certificates (DBCs) are denominated in US dollars with a maturity of one year. FCBCs are 3 year bearer certificates denominated in US Dollars, Yen, Deutsche Marks and Sterling. They do not carry any exchange risk. The yield on these certificates is set by the State Bank -currently it is a spread of 1/4% over LIBID.

Foreigners can hold 100% equity in new ventures, buy equity into any manufacturing venture on a repatriable basis and remit dividends. Regulations concerning profit repatriations, technical fees and royalty charges have been removed. Only in the case of banks, insurance companies, airlines and shipping companies are permissions required for profit repatriations.

Restrictions on foreign currency loans and direct foreign investment in the stock exchange have also been withdrawn. Foreign banks can now underwrite up to 30% of any public issue.

Foreign exchange regulations governing the transfer of shares from a resident to a non-resident are administered by the State Bank of Pakistan under the Foreign Exchange Regulation Act of 1947. Until recently the issue or transfer of shares in Pakistani companies to residents abroad required the specific consent of the relevant authorities.

Overseas Pakistanis and foreign investors can now purchase shares listed on a stock exchange against foreign exchange and transfer capital and dividends without having to obtain prior permission.

The transfer of shares between two non-residents is now permitted, provided the consideration is paid in foreign exchange. In the case of any off-market purchase of quoted shares, shares can be transferred between non-residents provided the consideration is not less than the quoted price on the date of the transactions. The exemption from the requirement to obtain exchange control consent only applies to the acquisition of shares (Section 6.09), and to units in the National Investment (Unit) Trust Limited and government securities. It does not apply to the acquisition of existing shares in unlisted companies. In such cases specific consent would be required for each investment.

From the above it should be obvious that many regulations that restricted capital movements have either been removed or eased. Furthermore, the access of foreign companies to domestic, and that of domestic companies to foreign credit has been liberalized.

The private sector is free to negotiate terms and conditions of foreign currency loans for investment in a new enterprise or for extending existing production facilities; the only requirement is that the loan repayment period should not be less than 3 years.

Foreign owned companies are also free to negotiate terms and conditions for loans and technology transfer, without the intervention of the government. There are no ceilings on interest rates and amortization period. Foreign companies will also no longer be subject to limits on domestic borrowings, provided 50% of the output is exported. In other cases, they will be allowed to borrow rupees equal to their equity.

According to a press statement by the Finance Minister, the removal of restrictions on foreign equity participation has brought in foreign involvement of US$ 360 million in around 15 months. Foreign investors are showing interest in coming to Pakistan.

ANZ

C. LEGAL PROTECTION TO REFORM MEASURES

For building public confidence in these measures it was felt that the government's assurance through appropriate legislation, specifically on capital repatriation, immunity from scrutiny and irreversibility of the process would be required at an early stage. Following the BCCI scandal and the collapse of many private domestic finance companies and cooperatives, protection was also required in the current environment characterised by a declining confidence in financial markets.

To allay these fears a Presidential Ordinance was issued on August 11, 1991 to provide guarantees to holders of foreign currency accounts. It legally commits that:

a) foreign exchange accounts will be exempt from income and wealth tax and Zakat;

b) that the tax authorities will not make any enquiries about the source of the foreign currency in these accounts;

c) banks will maintain absolute confidentiality and secrecy in the opening, maintenance and operation of these accounts, and will not provide information to any authority;

d) any incentive given to encourage investments will not be altered or repudiated in a way that will harm investments; and

e) domestic or foreign owned investments will not be nationalised.

We understand that this Ordinance has now been passed by Parliament.

To facilitate the privatisation process the Transfer of Managed Establishments Order, 1991 was issued. Although, the process has also been granted legal cover through the Protection of Economic Reforms Ordinance, 1992, it has not yet been promulgated by Parliament.

ANZ

ANNEXURE - 8 A

PRUDENTIAL REGULATIONS (COMMERCIAL BANKS)

/ilo

ANNEXURE - 8(A)

STATE BANK OF PAKISTAN
BANKING CONTROL DEPARTMENT
CENTRAL DIRECTORATE
KARACHI.

BCD Circular No.15

29th August,1992

All Scheduled Banks.

Dear Sirs,

PRUDENTIAL REGULATIONS

Please refer to BCD Circulars Nos.1,6,7 & 11 of 1992 on the captioned subject.

2. The updated version of the existing Prudential Regulations consolidating therein all the amendments issued from time to time has been prepared and issued herewith for ease of reference.

3. Please acknowledge receipt.

Yours faithfully,

(R. A. CHUGHTAI)
Director

1. **LIMIT OF BANK'S EXPOSURE TO A SINGLE PERSON.**

The total outstanding financing facilities by a banking company to any single person shall not at any point of time exceed 30 per cent of the bank's unimpaired capital and reserves subject to the condition that the maximum outstanding against fund based financing facilities do not exceed 20% of the unimpaired capital and reserves. In the case of branches of foreign banks operating in Pakistan, the maximum exposure limit of 30% shall be calculated on the basis of their assigned capital maintained under Section 13(3) of the Banking Companies Ordinance, 1962 free of all losses and provisions, provided that maximum exposure on the basis of fund-based facilities shall be 20% of the capital maintained under Section 13(3) of the Banking Companies Ordinance, 1962, or Rs.12 million which-ever is higher.

2. No bank shall provide any accommodation fund based or otherwise to any member of its Board of Directors, its Chief Executive and its shareholders holding 5(five) per cent or more of the share capital of the bank, including their spouses, parents, and children or to firm and companies in which they are interested as partners, directors or shareholders holding 5(five) per cent or more of the share capital of that concern.

3. The term 'person' shall include any individual, XX association or body of individuals, firm, or company whether incorporated or not and any other juridical person.

BEST AVAILABLE COPY

guarantees.

(j) In arriving at per party exposure, 80% of

(a) deposits of the party with the bank under lien and

(b) face value of FIBs lodged by the party as collateral shall be deducted.

BUT SHALL NOT INCLUDE:

(i) Loans and advances given to the Federal or Provincial Government or any of their agencies under the commodity operations programme of the government.

(ii) Loans and advances (including bills purchased and discounted given to Federal/Provincial Government, or guaranteed by the Federal Government.

(iii) Pre-shipment/post-shipment credit provided to finance exports of goods covered by letters of credit/firm contracts.

(iv) Letters of credit established for the import of plant and machinery.

(v) Obligations under letters of credit and Letters of guarantee to the extent of the cash margin retained by the bank.

(vi) Letters of credit which do not create any obligation on the part of the bank to make payments on account of imports.

BEST AVAILABLE COPY

dation shall mean and include :

(a) any form of loans and advances or credit facilities including bills purchased and discounted;

(b) any loans and advances, or bills purchased or discounted extended to another person on the guarantee of the person;

(c) subscription to or investment in shares, Participation Term Certificates, Term Finance Certificates or any other commercial paper by whatever name called (at book value) issued or guaranteed by the person;

(d) any financing obligation undertaken on behalf of the person under a letter of credit including a stand-by letter of credit, or similar instrument;

(e) loan repayment guarantees issued on behalf of the person;

(f) any obligations undertaken on behalf of the person under any other guarantee;

(g) acceptance/endorsements made on account; and

(h) any other liability assumed on behalf of the client to advance funds pursuant to a contractual commitment.

(i) In arriving at exposure per person weightage of 50% shall be given to -

(a) documentary credits opened by banks; and

BEST AVAILABLE COPY

facilities provided to banks.

5. Banks are directed to complete the regularisation of their port-folios in accordance with the above regulations latest by 30.6.1993.

REGULATION - II

LIMIT ON BANK'S EXPOSURE AGAINST CONTINGENT LIABILITIES.

1. Contingent liabilities of a bank shall not exceed at any point of time 10 times of its paid up capital and general reserves free of losses. In case of branches of foreign banks operating in Pakistan, capital will mean capital maintained under Section 13(3) of the Banking Companies Ordinance, 1962. Following shall not constitute contingent liabilities for the purpose of this regulation..

   (a) Bills for collection and

   (b) Forward foreign exchange contracts, Weightage of 50% shall be given to bid/mobilisation advance/performance bonds.

2. Exposure limit on contingent liabilities shall come into effect on 1st July, 1993.

REGULATION-III.

LIMIT ON BANK'S EXPOSURE AGAINST UNSECURED ADVANCES.

1. Banks may grant financing facilities on unsecured basis upto a maximum of Rs.50,000/- to any one borrower for agricultural, commercial and industrial purposes, provided the aggregate exposure of the bank against all its unsecured

exceed the amount of the bank's capital (free of all losses) and general reserves.

2. Banks shall regularise their existing exposure against unsecured advance latest by 30.6.1993.

REGULATION-IV

LINKAGE BETWEEN A BORROWER'S EQUITY AND TOTAL BORROWING FROM BANKS.

1. While granting any accommodation, banks shall ensure that the total accommodation availed by any borrower from banks/financial institutions does not exceed 10 times of the capital and reserves (free of losses) of the borrower as disclosed in its Audited Accounts. Every bank shall, as a matter of rule, obtain copy of accounts relating to the business of each of its borrower for analysis and record in the following manner :(For the purpose of this regulation, accommodation shall have the same meaning as in Regulation I above).

a) Where the bank's exposure does not exceed Rs.2 million.	Accounts duly signed by the borrower.
b) Where the exposure exceeds Rs. 2 million but does not exceed Rs.10 million.	Accounts duly signed by the borrower and countersigned by the Internal Auditor of the bank or a Chartered Accountant.
c) Where the exposure exceeds Rs.10 million.	Accounts duly audited by the practising Chartered Accountant.

d) The regulation shall not apply to loans not exceeding Rs.500,000/- per borrower.

2. (a) 'Banks shall strictly observe the regulation when sanctioning fresh/additional credit facilities. Following relaxation is hereby granted upto 30.6.1996 for renewing existing facilities :-

Total accommodation availed by a borrower from banks/financial institutions may exceed 10 times of the capital and reserves (free of losses) of the borrower provided the borrower injects additional equity during each year (92-93, 93-94, 94-95 & 95-96), an amount equal to 1/4th of the difference between the equity prescribed by this Regulation and the existing equity.

EXAMPLE

i.	Limit proposed to be renewed.	100
ii.	Prescribed Equity (i) ÷ 10.	10
iii.	Actual Equity (say).	6
iv.	Difference between the prescribed equity and the existing equity (ii) - (iii)	4
v.	Additional equity required to be injected in 92 - 93 (iv) ÷4	1

(b) Export finance and finance provided to ginning and rice husking factories and finance provided on the basis of lien on foreign currency deposits shall be excluded from the borrowings when determining linkage between equity and borrowing for the purpose of this Regulation. The borrowers availing this relaxation shall plough back 20% of the net profit each year until such time that they are able to borrow without this

BEST AVAILABLE COPY

loans shall be counted as equity.

REGULATION - V

MAINTENANCE OF DEBT-EQUITY RATIO

(1) Banks shall ensure that :-

(a) Current asset to current liability ratio of the borrower does not fall below the minimum indicated hereunder :-

i)	Upto 31.12.1992.	0.7 : 1
ii)	From 1.1.93 to 30.6.1993	0.8 : 1
iii)	From 1.7.1993 to 31.12.1993	0.9 : 1
iv)	From 1.1.1994	1 : 1

Current maturities of long term debt not yet due for payment may be excluded from the current liabilities for the purpose of calculating these ratios.

(b) Fresh/additional accommodation in the form of long term debts shall be provided on the basis of a debt equity ratio not exceeding 60:40. The position of existing facilities may be regularised by 30.6.1996. The borrowers shall inject during each year (92-93, 93-94, 94-95 & 95-96) an amount equal to 1/4th of the difference between the required equity and the existing equity. Provided that where a different debt equity ratio has been laid down by the Government the ratio laid down by Government shall apply.

FINANCING FACILITIES AGAINST SHARES.

1. No bank shall provide unsecured credit to finance subscription towards floatations of share capital of public limited companies.

2. No bank shall allow financing facilities whether fund-based or non-fund based against the shares of companies not listed on the stock exchange.

3. 'Facilities against the shares of listed companies shall be subject to the following minimum margins :-

   (a) Where the market value does not exceed the preceding 12 months average market value. 20%

   (b) Where market value exceeds the preceding 12 months average market value but does not exceed twice the preceding 12 months average market value. 40%

   (c) Where the market value exceeds twice the preceding 12 months average market value. 50%

4. The regulation will come into force with immediate effect. The prescribed margin requirement may be completed before the close of the financial year ending 31.12.1992.

BEST AVAILABLE COPY

115

REGULATION-VII.

DEALING WITH DIRECTORS, MAJOR SHARE-HOLDERS AND EMPLOYEES OF THE BANKS

Banks shall not without the prior approval in writing of the State Bank of Pakistan enter into leasing, renting and sale/purchase of any kind with their directors, officers, employees or persons who either individually or in concert with family members beneficially own 10 per cent or more of the equity of the bank.

2 The regulation will come into force with immediate effect.

Contd..P/10..

. CLASSIFICATION AND PROVISIONING FOR LOSS AND OTHER ASSETS.

Every bank shall observe prudential guidelines given hereunder in the matter of classification of its assets and provisioning thereagainst :

1) Guidelines for Classification of Short Term Facilities.

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
1.	2.	3.	4.
OAEM(other Assets Especially mentioned)	Where mark-up/ interest or principal is overdue (Past due) by 90 days from the due date.	Unrealised mark up/ interest to be put in Suspense Account and not to be credited to Income Account.	Provision of 2% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
Substandard.	Where mark-up/ interest or principal is over due by 180 days or more from the due date.	As above.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
Doubtful.	Where mark-up/ interest or principal is over due by one year or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
Loss.	a)Where mark-up/ interest or principal is overdue beyond two years from the due date.	As above.	Provision of 100% of the outstanding balances of principal.
	b)Where Trade Bills (import, export or inland bills) are not paid/adjusted within 180 days of the due date.	As above.	As above.

/other ts Espe- ily attended).	Where instalments of principal or interest/mark up is overdue (past due) by 180 days or more from the due date.	Unrealised mark-up/ interest to be put in Suspense Account and not to be credited to Income Account.	Provis... the difference ... sulting from the outstanding balance of principal less/assets realisable without recourse to a Court of Law. /the amount of liquid
2. Substandard.	Where instalment of principal or interest/ mark-up is overdue by one year or more.	As above.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.-
3. Doubtful.	Where instalment of principal or interest/mark-up is overdue by two years or more.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
4. Loss.	Where instalment of principal or interest/ mark-up is overdue by three years or more.	As above.	Provisions of 100% of the outstanding balance of principal.

The regulation will come into force with effect from 30.12.1992.

REGULATION-IX

MANAGEMENT.

1. No member of the Board of Directors of a banking company holding 5 per cent or more of the paid-up capital of the banking company either individually or in concert with family members or concerns/ companies in which he/she has the controlling interest, shall be appointed in the bank in any capacity save as the chief executive of the bank (which should not exceed one in any case) and that no payment shall be made or perquisites

BEST AVAILABLE COPY

travelling and [illegible],
meetings of the Board of Directors or its Committees. Provided further that not more than 25% of the total directors can be paid executives of the bank

2. The regulation shall come into force with immediate effect in respect of all banks other than banks owned, controlled and managed by the Government.

REGULATION-X.

BANK CHARGES.

1. All commercial banks shall be free to determine the rates of charges in respect of various services that they may provide to their constituents.

2. It shall be mandatory for each commercial bank to fix its rates of charges on half-yearly basis in advance for the half year January-June and July-December. Each bank shall get its schedule of charges printed and so notified as to be available to its constituents at least 7 days before the commencement of the half year during which the rates shall remain in force at all places of business. The bank shall be required to provide a copy of the printed schedule of charges to the Banking Control Department of State Bank of Pakistan before the commencement of the related half year.

3. The regulation shall come into force with immediate effect.

OPENING OF ACCOUNTS.

Banks shall make all reasonable efforts to determine the true identity of every would-be account holder. Towards this end, banks shall institute effective procedure and methods for obtaining proper identification from new customers.

REGULATION-XII.

PREVENTION OF CRIMINAL USE OF BANKING CHANNELS FOR THE PURPOSE OF MONEY-LAUNDERING AND OTHER UNLAWFUL TRADES.

1. The following guidelines are issued to safeguard banks against their involvement in money-laundering activities, and other unlawful trades. These will add to or reinforce the precautions, banks may have been taking in this regard:

   a) Before extending banking services, bank shall make reasonable efforts to determine the true identity of customer. Particular care should be taken to identify ownership of all accounts and those using safe-custody facilities. Effective procedures should be instituted for obtaining identification from new customers. An explicit policy should be devised to ensure that significant business transactions are not conducted with customers who fail to provide evidence of their identity.

   b) Banks shall ensure that banking business is conducted in conformity with high ethical standards and that banking laws and regulations are adhered to. It is accepted that banks normally do not have effective means of

BEST AVAILABLE COPY

art of wrongful activity. ...

tional context it may be difficult to ensure that cross border transactions on behalf of customers are in compliance with the regulations of another country. Nevertheless banks should not set out to offer services or provide active assistance in transactions which in their opinion are associated with money derived from illegal activities.

c) Specific procedures be established for ascertaining customer status and his source of earnings, for monitoring of accounts on a regular basis, for checking identities and benafides of remitters and beneficiaries, for retaining internal record of transactions for future reference. The transactions which are out of character with the normal operation of the account involving heavy deposits/withdrawal/ transfers should be viewed with suspicion and properly investigaged.

d) For an effective implementation of Banks' policy and procedures, suitable training be imparted to members of staff and they be informed of their responsibility in this regard.

e) Banks may make arrangements for setting up an internal audit system in order to establish an effective means of testing/checking compliance with the Bank Policy and procedures established by it.

necessary instructions for guidance and implementation by staff members.

REGULATION-XIII.

SERVICE CHARGE ON PLS DEPOSIT ACCOUNTS.

1. No bank shall levy any charge, in any form, on the credit balances held by it on PLS basis in customers deposit accounts.

2. The regulation shall come into force with immediate effect.

REGULATION-XIV.

PAYMENT OF DIVIDEND.

1. No bank shall pay any dividend on its shares unless and until:

a) All its capitalized expenses (including preliminary expenses, organisation expenses, share selling commission/brokerage, amount of losses incurred and any other item of expenditure not represented by tangible assets) have been completely written off; &

b) All bad and doubtful debts and other classified assets have been fully and duly provided for in accordance with the prudential regulations of and to the satisfaction of the State Bank of Pakistan.

2. The regulation shall come into force with immediate effect.

BEST AVAILABLE COPY

REGULATION-XV.

UNDERTAKING OF CASH PAYMENTS OUTSIDE THE BANK'S AUTHORISED PLACE OF BUSINESS

1. The banks are prohibited from undertaking any business of cash payments at any place other than the authorised place of business except through the installation of Automated Teller Machines (ATM).

REGULATION-XVI.

WINDOW DRESSING.

1. All banks are directed to refrain from adopting any measures or practices whereby they would either artificially or temporarily show an ostensibly improved position of banks accounts as given in their Balance Sheets and Profit and Loss Accounts specially in relation to its deposits and profit. Particular care shall be taken in showing inter-branch and inter-bank accounts accurately and strictly according to their true nature.

REGULATION-XVII.

Banks are directed not to issue any guarantee or letter of comfort nor assume any obligation whatsoever in respect of deposits, sale of investment certificates, issue of commercial papers, or borrowings of any non bank financial institution. In other words, banks shall not assume any obligation on behalf of any financial institution including investment banks, leasing companies, modarabas and development finance institutions, etc. in respect of any resources mobilised by them.

Some of the banks are providing fund management facility(PMF) to their clients. In all such cases of fund management, banks must have a written contract with the persons on whose behalf fund management is being undertaken which agreement must, inter alia, clearly state that the bank assumes no liability of any kind on account of such funds. Such funds shall not form part of bank's time and demand liabilities.

The above Prudential Regulations are issued under the powers vested in State Bank under the Banking Companies Ordinance, 1962. All banks are mandated to observe, in letter and spirit, the prudential regulations as issued by the State Bank failing which they shall render themselves liable to penalties as prescribed.

ANZ

ANNEXURE – 8 B

PRUDENTIAL REGULATIONS
(NON–BANK FINANCIAL INSTITUTIONS)

ANNEXURE - 8(B)

STATE BANK OF PAKISTAN
NBFIs REGULATION & SUPERVISION DEPARTMENT
CENTRAL DIRECTORATE
P.O.BOX No.4456
KARACHI

NBFIs Circular No.1 5th December,1991

Chief Executives of
DFIs, Investment Banks,
Leasing Companies, Modarabas and
Housing Finance Companies.

Dear Sir

As you are aware, the Government has, through an amendment in the Banking Companies Ordinance,1962 assigned the responsibility of supervising the business of NBFIs to the State Bank of Pakistan. The State Bank has, accordingly, framed Rules of Business for NBFIs. These appear in paragraph II below. These rules will come into force with effect from 1st January,1992. The rules will govern the business of NBFIs which they are permitted to undertake under the relevant Laws, SROs, Notifications, Government Consent, Charters etc. The rules should not be construed as permission to undertake business which you are not authorised to do. All transactions taking place on or after 1st January, 1992 shall be in conformity with these rules. It should be ensured that undertaking of business on or after 1st January,1992 does not result in violation of these rules. Business undertaken prior to 1st January,1992 shall be regularised within reasonable time. Process of regularisation may be taken in hand immediately and completed as early as possible. The State Bank will monitor the progress of regularisation through quarterly progress reports.

II. RULES OF BUSINESS

A. DEFINITIONS:

For the purposes of these regulations:-

a) "NBFI" means a Non-Bank Financial Institution and includes a DFI, Modaraba, Leasing Company, Housing Finance Company and Investment Bank.

b) "Exposure" would include fund and non-fund based facilities.

c) "Principal Lines of Business" would mean:

   i) For a leasing company, the leasing business.

   ii) For a Development Finance Institution, fixed investment financing and other lines of businesses declared by the DFI in order of priority.

   iii) For an Investment Bank, lines of businesses declared by the Investment Bank in order of priority

   iv) For Housing Finance Companies, the financing of housing.

   v) For a Modaraba lines of business declared by the Modaraba in order of priority or as specified by Registrar Modaraba.

d) "Facilities to Small Entrepreneurs" would mean:

   i) Facilities allowed by the NBFI for genuine business purpose upto Rs. 300,000.

   ii) Facilities allowed to Industrial Units, including cottage industries, which have fixed assets (excluding land and buildings) the original value of which does not exceed Rs. 20,000,000/-

e) "Major Shareholder" would mean any person holding 5% or more of the share capital.

f) "Person" includes an individual, a Hindu undivided family, a firm, an association or body of individuals whether incorporated or not, a company and every other juridical person.

g) "Records" include ledgers, day books, cash books and all other manuals or magnetic records used in the business of the NBFI.

h) "Documents" include vouchers, bills, promissory notes, securities for leases/ advances and claims by or against the company and other documents supporting entries in the books of the NBFI.

i) "Equity" includes Share Capital and Reserves.

j) "Facilities" would include fund based and non-fund based facilities.

k) "Lease Key Money" means lease security deposit.

B. R U L E S

Limits On Exposure

1) Liabilities, excluding contingent liabilities, of a NBFI for the first two years of its operations shall not exceed seven times of its equity. In the subsequent years the liabilities shall not exceed ten times of the equity of the NBFI.

2) Contingent Liabilities of a NBFI for the first two years of its operations shall not exceed seven times its equity. In the subsequent years the contingent liabilities shall not exceed ten times of the equity of the NBFI.

Creation & Building Up Of Reserve.

3) Every NBFI shall create reserve fund to which shall be credited:

a) An amount not less than 20% of its after tax profits till such time the reserve fund equals the amount of the paid up capital.

b) Thereafter a sum not less than 5% of its after tax profits.
Stock dividends shall be treated as appropriation for the purpose.

<u>Deposit Insurance</u>

4) When Deposit Insurance arrangements are in place every NBFI shall arrange full insurance cover for its deposits/COIs etc. upto Rs. 100,000/-

<u>Return On Deposits</u>

5) Every NBFI shall allow a rate of return to all its depositors/COI holders on uniform basis i.e. rate of return shall be the same for the same maturity period irrespective of amount. Deposits etc. of Listed Companies, recognised charitable trusts and statutory bodies shall be exempt.

<u>Maintenance Of Liquidity Against Certain Liabilities</u>

6) Not less than 15% of the NBFI's liabilities shall be invested in Government Securities. For this purpose liabilities shall not include NBFI's equity and its borrowings from Financial Institutions and Lease Key Money. In the case of Modarabas if the Religious Board does not permit investment in Government securities e.g. Federal Investment Bonds (FIBs) they will comply with this regulation by investing in NIT Units.

<u>Obtaining Of Audited Accounts From Borrowers.</u>

7) Every NBFI shall regularly obtain accounts from every borrower in the following manner and keep the same on its record:-

a) Exposure not exceeding Rs. Two million.	Accounts to be signed by the borrower.
b) Exposure exceeding Rs. Two million but not exceeding Rs. Ten million.	Accounts to be signed by the borrower and counter-signed by the Internal Audit Officer of the NBFI or a practising Chartered Accountant.
c) Exposure exceeding Rs. Ten million.	Accounts to be audited & signed by a practising Chartered Accountant.

Maintenance Of Debt Equity Ratio.

8) While granting a credit facility every NBFI shall ensure that the total long term debt-equity ratio of the borrower does not exceed 60:40 except in cases where the Government Schemes provide for a different debt-equity ratio in which case the one fixed by the Government shall apply. It should also be ensured that current liabilities of the borrower do not exceed his current assets.

Limit On NBFI's Exposure

9) Total exposure of a NBFI to a single borrowing entity or group shall not exceed 20% of its equity. In the case of listed companies exposure shall not exceed 20% of total assets of the NBFI.

Margin Against Facilities.

10) Following minimum margins shall be maintained against various facilities:-

i) Guarantees:

All guarantees except those specified below, will be backed by 100% realisable securities.

a) For issue of performance bonds, 100% cover of realisable securities may be waived by the NBFIs at their own discretion subject to minimum compulsory realisable security cover equivalent to 20% of the amount of the performance bond.

b) For issue of guarantees in respect of mobilisation advance, 100% cover of realisable securities may be waived by the NBFIs at their own discretion subject to the following conditions:-

i) Guarantees issued should contain a clause that the mobilisation advance shall be released by the beneficiary through the guarantor NBFI only; and

120

ii) At the time of issuing such a guarantee the construction company should sign an agreement with the NBFI that releases out of mobilisation advance would be covered by them by realisable assets.

c) For bid bonds issued on behalf of domestic consultancy firms bidding for International contracts where the consultancy fees are to be received in foreign exchange the requirement of 100% cover by realisable securities may be waived at the discretion of the NBFIs.

d) Relaxation provided in (c) above, would also be admissible to all suppliers of goods and services bidding against International Tenders.

ii) Advances Against Shares.

No NBFI shall allow facilities against its own shares or shares of its associated companies or shares of companies not listed on the Stock Exchange. Facilities against shares of other listed companies would be subject to the following margins:-

a)	Where market value does not exceed the face value	20%
b)	Where market value exceeds the face value but does not exceed twice the face value.	40%
c)	Where market value exceeds twice the face value.	50%

d) No NBFI shall hold shares in any Company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves which-ever is less.

iii) Deposit Certificates.

These will be subject to a margin of 20%

iv) Facilities Against Stocks

Raw Cotton	25%
Cotton Yarn.	25%
Edible oil	25%
Sugar (To Sugar Mills)	25%
Industrial Raw Material:	
-Imported	25%
-Indigenous	30%
Other stocks	25%

Facilities To Small Entrepreneurs

11) At least 5% of the credit facilities shall be to small entrepreneurs. In the case of Housing Finance Companies at least 5% facilities shall be in the form of facilities not exceeding Rs. 125,000 per borrower.

Focussing Attention On Principal Lines Of Business.

12. Every NBFI shall hold not less than seventy per cent of its assets in the form of its principal lines of business.

Restrictions On Certain Types Of Transactions

13)(i) NBFIs shall not provide any accommodation fund based or otherwise, to their Directors, Chief Executives and major shareholders including their spouses, parents and children or to firms & companies in which they are interested as partners, directors or major shareholders. Facilities allowed by the NBFIs to their Chief Executives as part of their remuneration will be exempt.

(ii) No NBFI shall allow unsecured facilities or facilities secured only by guarantees. Facilities provided against bank guarantees, the end use of which will be verified by the NBFI to be productive will be exempt.

(iii) No NBFI shall allow facilities for speculative purposes.

(iv) NBFIs shall not without the approval in writing of the State Bank of Pakistan enter into leasing, granting, purchasing or selling transactions with their directors, officers, employees or persons who either individually or in concert with close relatives beneficially own ten per cent or more either of the equity or other securities with voting rights of the transacting NBFI.

(v) No NBFI shall hold, deal or trade in real estate except that in use of the NBFI itself. In the case of Housing Finance Companies property acquired from a borrower in consequence of his failing to meet his obligations to Housing Finance Company would be exempt from this regulation.

Provisioning For Non-Performing Assets

14) Every NBFI shall follow prudential guidelines in the matter of classification of its assets and provisioning there against. These are given hereunder:-

i) GUIDELINES FOR CLASSIFICATION OF SHORT TERM FACILITIES.

CLASSIFICATION 1	DETERMINANT 2	TREATMENT OF INCOME 3	PROVISIONS TO BE MADE 4
OAEM (Other Assets Especially Mentioned)	Where mark-up/interest or principal is overdue (Past due) by 90 days from the due date.	Unrealised mark-up/interest to be put in Suspense Account and not to be credited to Income Account.	Provision of 2% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
Substandard	Where mark-up/interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
Doubtful	Where mark-up/interest or principal is overdue by one year or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.

1	2	3	4
4. Loss.	a) Where mark-up/ interest or principal is overdue beyond two years from the due date.	As above.	Provision of 100% of the outstanding balance of principal.
	b) Where Trade Bills (Import, export or inland bills) are not paid/adjusted within 180 days of the due date.	As above.	As above.

Liquid asset means realisable amount of bank deposits, certificates of deposits, government securities, shares of listed companies, NIT Units, Certificates of Mutual funds, inventories pledged to the bank with possession with 'perfected lien' duly supported with flawless documentation.

ii) GUIDELINES FOR CLASSIFICATION OF LONG TERM FACILITIES.

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
1. OAEM (Other Assets Especially mentioned)	Where instalments of principal or interest/ mark up is overdue (past due) by 180 days or more from the due date.	Unrealised mark up/ interest to be put in Suspense Account and not to be credited to Income Account.	Provision of 2% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
2. Substandard	Where instalment of principal or interest/ mark-up is overdue by one year or more.	As above.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
3. Doubtful	Where instalment of principal or interest/ mark-up is overdue by two years or more.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law.
4. Loss.	Where instalment of principal or interest/ mark-up is overdue by three years or more.	As above.	Provision of 100% of the outstanding balance of principal.

Liquid asset means realisable amount of bank deposits, certificates of deposits, government securities, shares of listed companies, NIT Units, Certificates of Mutual funds, inventories pledged to the bank with possession with 'perfected lien' duly supported with flawless

Submission of Statistical Returns.

15. (15) Every HFI shall submit returns prescribed below as per prescribed format attached.

	Title of Returns.	Periodicity	Period for submission
1	Weekly statement of affairs (as per HFIs' own format) as on week ended Thursday the ____ of ____ 1992.	To be submitted weekly	Within four days of the date to which the return relates.
2.	Statement showing liquidity position.	Weekly	Within four days of the date to which the return relates.
3.	Statement showing equity and liability.	Monthly	Within seven days of the date to which the return relates.
4.	Statement showing equity and contingent liability.	-do-	-do-
5.	Distribution of deposits/CDIs by maturity.	Quarterly	Within fifteen days of the date to which the return relates.
6.	Distribution of deposits by number of accounts.	-do-	-do-
7.	Statement showing sources of borrowings and their maturity.	-do-	-do-
8.	Ratewise analysis of borrowings.	-do-	-do-
9.	Ratewise analysis of advances.	-do-	-do-
10.	Constituent wise break up of advances.	-do-	-do-
11.	Statement of advances to small borrowers.	-do-	-do-
12.	Sector/Industry-wise statement of advances.	-do-	-do-
12.A	Foreign & local currency loan Sector/Industry-wise statement of advances.	-do-	-do-
13.	Statement showing rescheduling of financial assistance.	-do-	-do-

BEST AVAILABLE DOCUMENT

14.	Classification of advances by security pledged	Quarterly	Within fifteen days of the date to which the return relates.
15.	Statement of disbursements made.	-do-	-do-
15.A	Statement showing disbursement of foreign & local currency loan made.		
16.	Statement of defaults against contingent liabilities.	-do-	-do-
17.	Statement showing typewise break-up of contingent liabilities.	-do-	-do-
18.	Statement of recovery.	-do-	-do-
18.A	Statement showing recovery of foreign and local currency loan.	-do-	-do-
19.	Rate of return on various types of deposits/COIs.	Half yearly	-do-
20.	Statement showing position of classified short term facilities to Public Sector.	Annually	-do-
20.A	Statement showing position of classified short term facilities to Private Sector.	-do-	-do-
20.B	Statement showing position of classified long term facilities to Public Sector.	-do-	-do-
20.C	Statement showing position of classified long term facilities to Private Sector.	-do-	-do-

Removal Of Records.

16) No HBFI shall remove from Pakistan and State of Azad Jammu and Kashmir to a place outside Pakistan and State of Azad Jammu and Kashmir any of its records or documents relating to its business without the prior permission in writing of State Bank of Pakistan. The records taken out of Pakistan and State of Azad Jammu and Kashmir by the officers of the organisation in the discharge of their official duties will be exempt.

Audit & Submission Of Accounts

17) Every HBFI shall submit duly audited accounts to the State Bank of Pakistan within a period of four months after the end of its accounting year and shall comply with the following conditions with respect to the appointment of auditors:-

a). A person shall not be qualified for appointment as an auditor unless he is a Chartered Accountant within the meaning of Chartered Accountants Ordinance,1961 (X of 1961).

b) An auditor shall hold office for a period of not less than three consecutive years and shall not be removed from the office before the expiry of that period except with the prior approval of the State Bank of Pakistan. In view of the provision of appointing auditors with the approval of Registrar Modarabas, this provision shall not apply to Modarabas.

c) The SBP may from time to time lay down guidelines for the audit, and the auditors shall be bound to follow these guidelines.

The SBP may require special audit of any HBFI in addition to regular inspection by the SBP, at any time and may appoint special auditors. The cost of such audit shall be borne by the HBFI.

Restriction On Election & Appointment

18) No person shall be elected or appointed as a director, an officer or an employee of a NBFI who;

a) has been convicted of an offence involving fraud, breach of trust or moral turpitude, or

b) has been adjudged an insolvent or has suspended payment of his debts or has compounded with his creditors.

Places Of Business

19) No NBFI shall open further places of business without the prior permission in writing of the State Bank of Pakistan.

Code Of Conduct

20) Every NBFI shall become a member of an association constituted in consultation with the State Bank of Pakistan. Such Association shall frame a code of conduct for their members and ensure compliance therewith.

Internal Audit

21) All NBFIs shall have an Internal Audit Department. The Head of this Department will report to the Chief Executive Officer directly. He will be, inter alia, responsible for compliance with these regulations.

III. Please acknowledge receipt.

Yours faithfully,

(I.A. FAROOQ)
Director

Copy to:

1. Corporate Law Authority.
2. Investment Wing, Ministry of Finance.
3. Internal Finance Wing, Ministry of Finance.
4. Director, Banking Control Department, SBP:CO;

ANZ

ANNEXURE – 9

DOMESTIC DEBT

BEST AVAILABLE DOCUMENT

1541

ANZ

DOMESTIC DEBT OUTSTANDING

(Rupees in Million)

DEBT CATEGORIES	1988-89	1989-90	1990-91
A.Permanent Debt	**78,709**	**98,602**	**156,843**
1. Market Loans	21,358	21,345	21,014
2. Federal Invest. Bonds	4,548	5,148	8,674
3. Income Tax Bonds	23	22	22
4. Govt. Bonds (under land reform Act,1977)	54	54	54
5. Special Govt. Bonds for SIIC	6,198	6,910	7,304
6. Bearer National Fund Bonds	18,089	32,536	43,905
7. Foreign Exchange Bearer Certificates	5,920	7,748	9,277
8. Special National Fund Bonds	8	5	2
9. (a) Federal Investment Bonds(Registered)	–	–	34,938
(b) Federal Investment Bonds (Bearer)	–	–	314
(c) Federal Investment Bonds on Tap	–	–	3,482
10. Prize Bonds	22,511	24,834	27,857
B.Floating Debt	**135,238**	**144,978**	**150,928**
1. Treasury Bills (3 months)	57,538	58,713	13
2. Government Treasury Deposit Receipts	17,051	16,070	5,318
3. Market Treasury Bills	–	600	–
4. Adhoc Treasury Bills	60,649	69,595	69,541
5. Treasury Bills (auctioned)	–	–	45,556
6. Treasury Bills (Purchased by S.B.P.)	–	–	30,500
C.Unfunded Debt	**113,040**	**130,601**	**132,551**
1. Defence Saving Certificates	25,373	35,156	41,893
2. National Deposit Certificates/Accounts	3,837	4,162	3,142
3. Khas Deposit Certificates/Accounts	80,930	79,023	48,834
4. Special Saving Certificates(Registered)	–	6,546	24,881
5. Special Saving Certificates(Bearer)	–	454	1,860
6. Special Saving Accounts	–	1,721	6,588
7. Premium Saving Certificates	–	(–)4	(–)4
8. Saving Accounts	2,900	3,543	5,357
TOTAL (A+B+C)	326,987	374,181	440,322

(Source: State Bank Economic Survey 1991 issue)

BEST AVAILABLE DOCUMENT

PERMENANT DEBT OUTSTANDING
Federal Government

(Rs. in millions)

At The End Of	Special National Fund Bonds	Foreign Exchange Bearer Certificates	Bearer National Fund Bonds	Bearer National Fund Bonds Rollover	Govt. Bonds to Public Sector	Federal Investment Bonds	Bearer Federal Investment Bonds	U.S Dollar Bearer Certificates	Foreign Currency Bearer Certificates
1991									
April	2.40	9,183.99	43,958.78	–	7,925.78	15,511.30	313.66	5.28	–
May	2.40	9,243.60	43,940.27	–	7,925.87	29,731.93	313.66	313.61	–
June	2.40	9,277.19	43,904.63	–	7,925.87	38,420.18	313.66	584.23	–
July	2.40	8,738.87	43,820.42	–	7,925.87	38,420.18	313.66	1128	–
Aug	2.40	8,378.84	43,815.25	–	7,925.87	39,250.02	313.66	1,501.04	–
Sept	2.40	8,258.67	43,810.43	–	7,925.87	46,940.11	313.66	1,606.85	–
Oct	2.40	8,023.90	43,556.97	–	7,925.87	56,334.26	313.66	1,697.18	–
Nov	2.40	8,085.84	35,406.42	–	7,925.87	63,274.31	313.66	1,859.90	–
Dec	2.00	7,961.96	24,471.68	4,252.20	7,925.87	69,643.26	313.66	1,926.20	–
1992									
Jan	1.50	7,906.16	24,066.09	4,760.09	7,925.87	76,233.42	313.66	1,926.19	–
Feb	1.50	8,005.36	18,347.12	5,397.37	7,925.87	78,127.93	213.66	1,992.46	–
March	1.50	7,991.12	18,317.49	5,470.59	7,925.87	78,614.45	213.66	1,975.81	–
April	1.50	8,084.50	18,227.50	5,471.53	7,925.87	79,386.44	213.58	2,210.29	348.84
May	1.50	8,037.62	18,227.50	6,838.42	7,925.87	83,223.75	213.58	2,435.32	454.28
June	1.50	8,500.43	18,227.50		7,925.87	83,223.75	213.58	2,197.45	535.97
July	1.50	8,871.21	16,855.40	6,842.09	7,925.87	85,745.89	213.56	2,089.91	726.51
Aug.	1.50	9,300.00	90,621.47	6,842.09	7,925.87	90,621.47	213.58	1,744.00	889.30

(Source:– Bulletin State Bank of Pakistan, September 1992, issue)

BILLS AND TREASURY DEPOSIT RECEIPTS

(Rupees In Millions)

PERIOD	RETURN PERCENT PER ANNUM						OUTSTANDING BALANCES					
			Govt. Treasury Deposit Receipts				Govt. Treasury Deposit Receipts					
	Govt. of Pakistan Market Treasury Bills	Govt. of Pakistan Treasury Bills (Auctioned)	ON TAP	Normal 3 Months	Normal 6 Months	Normal 1 Year	ON TAP	Normal 3 Months	Normal 6 Months	Normal 1 Year	Govt. of Pakistan Market Treasury Bills	Govt. of Pakistan Treasury Bills (Auctioned)
1990												
Jun.	–	–	6.00	7.75	8.50	9.00	58,713.30	2,152.70	11,431.70	496.60	600.00	–
Dec.	–	–	6.00	7.75	8.50	9.00	53,843.90	2,265.20	13,625.00	3,338.60	–	–
1991												
Jun.	–	–	6.00	7.75	8.50	9.00	13.00	–	2,341.10	2,977.20	–	45,555.90
Dec.	–	14,813.60	6.00	7.75	8.50	9.00	13.00	–	36.00	129.40	–	31,948.90
1992											–	
Jun.	–	6,715.10	6.00	7.75	8.50	9.00	13.00	–	36.00	–	–	44,303.10
1991												
Aug.	–	2,000.00	6.00	7.75	8.50	9.00	13.00	–	396.70	2,443.30	–	51,959.70
Sept.	–	6,673.00	6.00	7.75	8.50	9.00	13.00	–	193.40	2,311.10	–	51,701.70
Oct.	–	7,271.00	6.00	7.75	8.50	9.00	13.00	–	179.80	2,059.50	–	44,565.70
Nov.	–	4,798.30	6.00	7.75	8.50	9.00	13.60	–	36.00	738.10	–	40,047.40
Dec.	–	14,813.60	6.00	7.75	8.50	9.00	13.00	–	36.00	129.40	–	31,948.90
1992												
Jan.	–	11,225.80	6.00	7.75	8.50	9.00	13.00	–	36.00	91.00	–	38,583.10
Feb.	–	7,178.00	6.00	7.75	8.50	9.00	13.00	–	36.00	88.00	–	37,828.10
Mar.	–	7,178.00	6.00	7.75	8.50	9.00	13.00	–	36.00	88.00	–	37,828.10
Apr.	–	135.00	6.00	7.75	8.50	9.00	13.00	–	36.00	–	–	38,018.10
May	–	280.00	6.00	7.75	8.50	9.00	13.00	–	36.00	–	–	42,858.10
Jun.	–	6,715.10	6.00	7.75	8.50	9.00	13.00	–	36.00	–	–	44,303.10
Jul.	–	17,860.00	6.00	7.75	8.50	9.00	13.00	–	36.00	–	–	61,963.30
Aug.	–	6,423.00	6.00	7.75	8.50	9.00	13.00	–	25.70	–	–	64,512.30

(Source:– Bulletin State Bank of Pakistan, September 1992, issue)

GOVERNMENT TREASURY

(Rupees in Millions)

PERIOD	ISSUES: Government Treasury Deposit Receipts: ON TAP	Normal: 3 Months	Normal: 6 Months	Normal: 1 Year	Govt. of Pakistan Market Treasury Bills	Govt. of Pakistan Treasury Bills (Auctioned)	DISCHARGES: Government Treasury Deposit Receipts: ON TAP	Normal: 3 Months	Normal: 6 Months	Normal: 1 Year
1990										
Jun.	21,646.10	1,151.70	4,210.00	43.50	–	–	51,216.50	1,182.10	1,790.50	–
Dec.	20,193.00	1,409.50	1,776.20	578.80	–	–	27,214.40	2,441.10	4,211.30	–
1991										
Jun.	–	–	–	–	–	14,813.60	–	0.90	3,416.80	136.70
Dec.	–	–	–	–	–	6,715.10	–	–	–	608.80
1992										
Jun.	–	–	–	–	–	8,160.10	–	–	–	–
1991										
Aug.	–	–	–	–	–	7,178.00	–	–	610.50	62.30
Sept.	–	–	–	–	–	6,415.00	–	–	203.30	132.20
Oct.	–	–	–	–	–	135.00	–	–	13.60	251.60
Nov.	–	–	–	–	–	280.00	–	–	143.80	1,321.40
Dec.	–	–	–	–	–	6,715.10	–	–	–	608.80
1992										
Jan.	–	–	–	–	–	17,860.00	–	–	–	38.40
Feb.	–	–	–	–	–	6,423.00	–	–	–	–
Mar.	–	–	–	–	–	2,500.00	–	–	–	–
Apr.	–	–	–	–	–	4,240.00	–	–	–	–
May	–	–	–	–	–	5,120.00	–	–	–	–
Jun.	–	–	–	–	–	8,160.10	–	–	–	–
Jul.	–	–	–	–	–	35,520.20	–	–	–	–
Aug.	–	–	–	–	–	8,972.00	–	–	10.30	–

(Source:– Bulletin State Bank of Pakistan, September 1992, issue)

PERMENANT DEBT OUTSTANDING
Federal Government

(Rs. in millions)

At The End Of	Special National Fund Bonds	Foreign Exchange Bearer Certificates	Bearer National Fund Bonds	Bearer National Fund Bonds Rollover	Govt. Bonds to Public Sector	Federal Investment Bonds	Bearer Federal Investment Bonds	U.S Dollar Bearer Certificates	Foreign Currency Bearer Certificates
1991									
April	2.40	9,183.99	43,958.78	–	7,925.78	15,511.30	313.66	5.28	–
May	2.40	9,243.60	43,940.27	–	7,925.87	29,731.93	313.66	313.61	–
June	2.40	9,277.19	43,904.63	–	7,925.87	38,420.18	313.66	584.23	–
July	2.40	8,738.87	43,820.42	–	7,925.87	38,420.18	313.66	1128	–
Aug	2.40	8,378.84	43,815.25	–	7,925.87	39,250.02	313.66	1,501.04	–
Sept	2.40	8,258.67	43,810.43	–	7,925.87	46,940.11	313.66	1,606.85	–
Oct	2.40	8,023.90	43,556.97	–	7,925.87	56,334.26	313.66	1,697.18	–
Nov	2.40	8,085.84	35,406.42	–	7,925.87	63,274.31	313.66	1,859.90	–
Dec	2.00	7,961.96	24,471.68	4,252.20	7,925.87	69,643.26	313.66	1,926.20	–
1992									
Jan	1.50	7,906.16	24,066.09	4,760.09	7,925.87	76,233.42	313.66	1,926.19	–
Feb	1.50	8,005.36	18,347.12	5,397.37	7,925.87	78,127.93	213.66	1,992.46	–
March	1.50	7,991.12	18,317.49	5,470.59	7,925.87	78,614.45	213.66	1,975.81	–
April	1.50	8,084.50	18,227.50	5,471.53	7,925.87	79,386.44	213.58	2,210.29	348.84
May	1.50	8,037.62	18,227.50	6,838.42	7,925.87	83,223.75	213.58	2,435.32	454.28
June	1.50	8,500.43	18,227.50		7,925.87	83,223.75	213.58	2,197.45	535.97
July	1.50	8,871.21	16,855.40	6,842.09	7,925.87	85,745.89	213.56	2,089.91	726.51
Aug.	1.50	9,300.00	90,621.47	6,842.09	7,925.87	90,621.47	213.58	1,744.00	889.30

(Source:– Bulletin State Bank of Pakistan, September 1992, issue)

NATIONAL SAVING SCHEMES

(Rupees in Millions)

Name of Scheme	1990 – 91 (Jul–Mar) Gross	Net	1991 – 92 (Jul–Mar) Gross	Net	Outstanding as on 31–3–1992
1. Defence Saving Certificates	7,057.826	5,041.919	7,146.629	4,072.386	45,998.959
2. National Deposit Certificates	30.458	(575.841)	19.265	(549.918)	4,140.126
3. Khas Deposit Certificates	365.939	(12,508.197)	218.249	(2,532.257)	16,125.275
4. Premium Saving Certificates	–	(0.144)	–	(0.005)	(4.297)
5. Special Saving Certificates (Regd.)	15,823.391	13,430.813	18,648.476	13,189.188	38,065.794
6. Special Saving Certificates (Bearer)	1,097.194	848.344	1,653.486	960.109	2,819.839
7. Khas Deposit Account	3,443.561	(10,318.232)	2,046.408	(9,233.157)	10,928.791
8. National Deposit Accounts	0.261	(244.260)	0.154	(41.868)	(1,585.830)
9. Saving Account	6,621.121	839.189	9,179.266	157.639	4,849.081
10.Special Savings Account	4,684.430	3,823.700	5,526.499	3,772.719	10,369.370
11.Mahana Amdani Account	144.202	111.556	175.260	138.581	803.470
12.Special Savings Account (old)	–	–	–	–	0.821
13.Prize Bond	8,834.650	2,422.752	8,280.731	1,103.440	28,995.924
14.Postal Life Insurance	508.173	396.476	448.669	401.927	3,462.780
Grand Total	48,611.206	3,268.075	55,345.092	1,438.714	164,970.103

Note:Figures in brackets represent negative sign

(Source:– Economic Survey 1991–92)

ANZ

ANNEXURE – 10

PROFILE OF FIXED INCOME GOVERNMENT SECURITIES

LIST OF SECURITIES REPRESENTING RUPEE GOVERNMENT DEBT

S/N	INSTRUMENTS	AMT. IN ISSUE AS AT 31/12/91 (Rs.in Millions)	MATURITY	RETURN	PROFIT PAYMENT	ISSUED AT	FISCAL FEATURES
1	Federal Investment Bonds	69,643.26	3 YEARS 5 YEARS 10 YEARS	13.00% 14.00% 15.00%	6 MONTHLY	AUCTION	TAX AT SOURCE ZAKAT VOLUNTARY REGISTERED
2	Treasury Bills	31,948.90	6 MONTHS	12.32% (WT.AVERAGE OF LAST AUCTION)	PAYMENT AT RATE ON MATURITY	DISCOUNT	TAX AT SOURCE ZAKAT VOLUNTARY REGISTERED
3	Foreign Exchange Bearer Certificates	7,961.96	3 YEARS	1 YR 14.50% 2 YRs 14.46% 3 YRs 14.98% (COMPOUNDED)	PAYMENT ON ENCASHMENT	PAR	TAX FREE ZAKAT VOLUNTARY CONVERTIBLE TO FOREIGN CURRENCY BEARER
4	National Investment Trust Units	* 14,486.00	N/A	DIV. 18.00% (1992 YIELD)	ANNUAL DIVIDEND	SALES PRICE SET BY N.I.T	TAX AT SOURCE ZAKAT APPLICABLE REGD./BEARER
5	Special Saving Certificates	2,220.00	3 YEARS	1st YR 11.50% 2ND YR 11.50% 3RD YR 14.00% (NOMINAL RATES)	6 MONTHLY	PAR	ZAKAT APPLICABLE TAX FREE BEARER
6	Special Saving Certificates	33,426.00	3 YEARS	1st YR 12.50% 2ND YR 12.50% 3RD YR 15.00% (NOMINAL RATES)	6 MONTHLY	PAR	ZAKAT APPLICABLE TAX FREE REGISTERED
7	Defence Saving Certificates	44,559.00	10 YEARS	1 YRs 12.00% 2 YRs 11.80% 3 YRs 11.87% 4 YRs 11.94% 5 YRs 12.10% 6 YRs 13.78% 7 YRs 13.99% 8 YRs 14.48% 9 YRs 15.12% 10 YRs 15.50% (COMPOUNDED)	PAYMENT ON ENCASHMENT	PAR	ZAKAT APPLICABLE TAX FREE (Rs. 426/– PER 100 INVEST. PAID AFTER 10 YEARS) REGISTERED

LIST OF SECURITIES REPRESENTING GOVERNMENT RUPEE CORPORATE DEBT

S/N	INSTRUMENTS	NATURE	TENURE	RETURN	PROFIT PAYMENT	ISSUED AT	FISCAL FEATURES
1	Wapda Bearer Bonds(1st Issue)	Bearer	5 YEARS	13.50%	6 MONTHLY	PAR	TAX FREE ZAKAT EXEMPT
2	Wapda Bearer Bonds(2nd Issue)	Bearer/Regd	5 YEARS	13.50%	6 MONTHLY	PAR	TAX FREE ZAKAT VOLUNTARY
3	Wapda Bearer Bonds(3rd Issue)	Bearer/Regd	10 YEARS	12.50%	6 MONTHLY	PAR	TAX FREE ZAKAT VOLUNTARY
4	Wapda Bearer Bonds(4th Issue)	Registered	10 YEARS	15.00%	6 MONTHLY	PAR	TAX AT SOURCE ZAKAT VOLUNTARY
5	Civil Aviation Authority Bonds	Bearer	5 YEARS	12.50%	6 MONTHLY	PAR	TAX FREE ZAKAT VOLUNTARY

GOVERNMENT ISSUED FOREIGN CURRENCY CERTIFICATES

S/N	INSTRUMENTS	NATURE	TENURE	DENOMINATION	RETURN	PROFIT PAYMENT	ISSUED AT	FISCAL FEATURES
1	DOLLAR BEARER CERTIFICATES	Bearer	1 YEAR	U.S.DOLLARS	0.25% OVER 12 MONTH LIBOR	PAYMENT ON MATURITY	PAR	TAX FREE ZAKAT VOLUNTARY
2	FOREIGN CURRENCY BEARER CERTIFICATES	Bearer	5 YEARS	USD D.MARKS P.STERLING J.YEN	8.00% ** 9.50% ** 9.25% ** 6.25% **	6 MONTHLY	PAR	TAX FREE ZAKAT VOLUNTARY

* Value of 1.013 million units outstanding at market price of Rs. 14.30 / units as on 30/06/91.

** Rates for the month of December 1992.

Compiled by ANZ Grindlays Bank