Reform of Pakistan’s Banking Industry

ZAKIR MAHMOOD
President & CEO
Habib Bank Ltd
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Pakistan has been on a restructuring & reform drive of the financial sector supported by the World Bank (banking sector) and ADB (capital markets)

Market Liberalization was phase 1 – liberalization of capital markets, financial sector (new entrants)

Enhanced pace in the last 2 1/2 years

Shift in emphasis to structural reforms

Banking sector is one area where the greatest progress has been made – and is now ready for expeditious privatization
Banking Reforms – Vision

VISION

- A market oriented, predominantly private system that operates under a strong regulatory framework, is supported by an effective legal & judicial system & intermediates resources in response to price signals

OBJECTIVES

- To achieve a sound banking sector that can provide financial services needed by the economy efficiently
- To improve the environment for and the ability of bank owners, bank regulators, the markets and banking courts
- Privatization is a means to an end
Banking Reforms in Pakistan

Banking Reforms; new programs initiated in 1997, 1999 and in 2001

Aimed at

- Strengthening the Regulator
- Providing Effective Legal Framework
- Enhancing Competitiveness
- Improving Governance at NCBs
The Problems - Pre-Reform

- **Limited Competition:** NCBs Banks accounted for over 60% assets

- **High Non Performing Loans:** Over 30% of Advances Non Performing

- **High cost base:** due to excess staff, highly inefficient operations

- **Low level of Financial Intermediation:** 26% Currency/Monetary Assets
Reforms...

Strengthening the Regulator

- **SBP given autonomy** through change in law
- **Hiring of professionals** at entry and middle management levels
- **Training of staff** in banking supervision - locally and internationally
- Steps taken towards **automation** & networking - linking with banking sector
- **Shift to market based** monetary and credit management systems
- **Introduction of risk based systems** for monitoring
Effective Legal Framework

- **Banking Ordinance 1962 strengthened**
- **Unified system of banking courts** introduced
- **Legislation on disposal of non-performing loans/assets** - Loan Recovery Act, 1997 replaced by The Financial Institutions (Recovery of Finances) Ordinance, 2001
- **Improved recoveries** through courts - new banking court system processed 22k out of 55k loan default cases
Governance/Restructuring of NCBs

- **Management/governance structure** revised & made autonomous through change in law
- **Independent Boards** selected from private sector
- **New professional management** from private sector
- **Credit policies & procedures** introduced
- **Aggressive loan recovery drive**
  - Total cash recoveries of Rs.130bn since 1997
- **NCBs made competitive & efficient by**
  - Removal of surplus/non-productive staff - over 30,000
  - Closure of non-profitable branches - over 1,200
Enhancing Competition

Removing Market Distortions

- **Liquidity** reserve requirement revised
- **Mandatory & concessionary credits** being phased out
- Discretionary **Open Market Operations**
- **Tax rates** and structure revised from 58% to 50%
- **Liberalization** of branch opening and closing policies
- **Rationalization** of National Savings Scheme rates
- **FX market** liberalization
- Settlement of **tax refunds**
Banks now ready for Privatization

Measures taken to aid privatization

- **Market oriented** regulatory environment
- **Improved Legal Framework**
- **Operational restructuring** – Staff reduction, branch closures
- **Non Performing Loans** – increased provisioning, CIRC established to assist in recoveries
- **Financial Restructuring** – Balance Sheets repaired, recapitalized

- **Reduction of implicit & explicit taxes on banks**
  - Reduced liquidity and cash reserve requirement
  - Future provision deductible from taxable income
  - Reduced income tax rate from 58% to 50%
Actions taken to restructure HBL (1)

BUSINESS

• Functionality & Specialization introduced

* Business Lines established - Corporate & Investment Banking, Retail Banking, Treasury Operations, & International Banking

* Support Functions - Global Operations, Credit Policy, Asset Remedial Management, IT, Financial Control & Corporate Planning, Human Resources & Audit
Actions taken to restructure HBL (2)

**ORGANIZATIONAL**

- Independent Board of Directors from private sector
- Upgraded quality of staff
  - Hired Professional Management & specialists at all levels
  - Recruitment of MBA’s
- Staff reduction from 30,000 to 19,000
- Unprofitable branches closed - from 2000 to 1468

**FINANCIAL**

- Deficit in Balance sheet - loan losses, operational and employee pension fund shortfall – addressed. $ 1 Bn of charges to balance sheet
- Bank recapitalized by Government
- NPLs adequately provisioned
Actions taken to restructure HBL (3)

➢ Improvements in Operating efficiency
  * Process re-engineering
  * Centralization – back-office functions
  * Technology upgrade
    - 325 branches automated – 70% of business volume
    - All customer records centrally computerized
    - 66 ATMs across Pakistan, 100 branches interconnected
      on-line banking introduced

➢ Fully Documented Procedures and Policies
  * Credit
  * Treasury
  * Accounting
  * Administration
  * Audit
HBL - Balance Sheet growth

DEPOSITS CAGR
1997-2001 = 8% pa

ADVANCES CAGR
1997-2001 = 9% pa
Improved Balance Sheet Quality

• 58% NPLs covered by cash provisions of Rs32.3bn
• 100% of net outstanding balance covered by forced sale value of collateral independently valued as per central bank regulations
Net Revenue Trends

Rs bn

'97  '98  '99  '00  '01

REVENUE CAGR
1997-2001 = 15.8%
Profitability Trends

Return to sustained profitability
Y2000-2001