

Implementing
regulatory
reform

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An overview of Financial Sector Reforms in Pakistan



Presentation Outline

- 1. Introduction**
- 2. Regulatory framework in Pakistan**
- 3. Financial Market Reforms Programme**
- 4. Corporate Governance/Investment Climate**
- 5. Key Issues**
- 6. Conclusion**

Introduction

1. Financial liberalisation in Pakistan
2. High growth period (political context)
3. Macro-economic reforms in place but problems in second generation of reforms
4. Regulatory structure in place and financial market has expanded
5. Pakistan has not really achieved the desired outcomes in terms of FDI, outreach of financial services and capital formation
6. Issues related to independence and capacity of the regulator

- The Commercial Banks along with a few NBFIs are supervised by the State Bank of Pakistan (SBP) through its Prudential Regulations.
- The Stock Market, Specialised Companies, Modarabas, and Insurance Companies are regulated by the Securities and Exchange Commission of Pakistan (SECP)

- **SECP established in 1999 under SECP Ordinance**
- **A Collegiate Body with and Oversight Board**
- **Chairman Appointed for Three Years**
- **Ministry of Finance Acts as the Administrative Ministry**

- Commercial Banks
- Development Financing Institutions
- Foreign Banks
- Non Bank Financing Institutions (NBFIs)
- Leasing, Investment Banks, Housing Finance, Asset Management Companies, Venture Capital etc.
- Stock market
- Insurance companies
- Now, micro-finance institutions (MFIs)

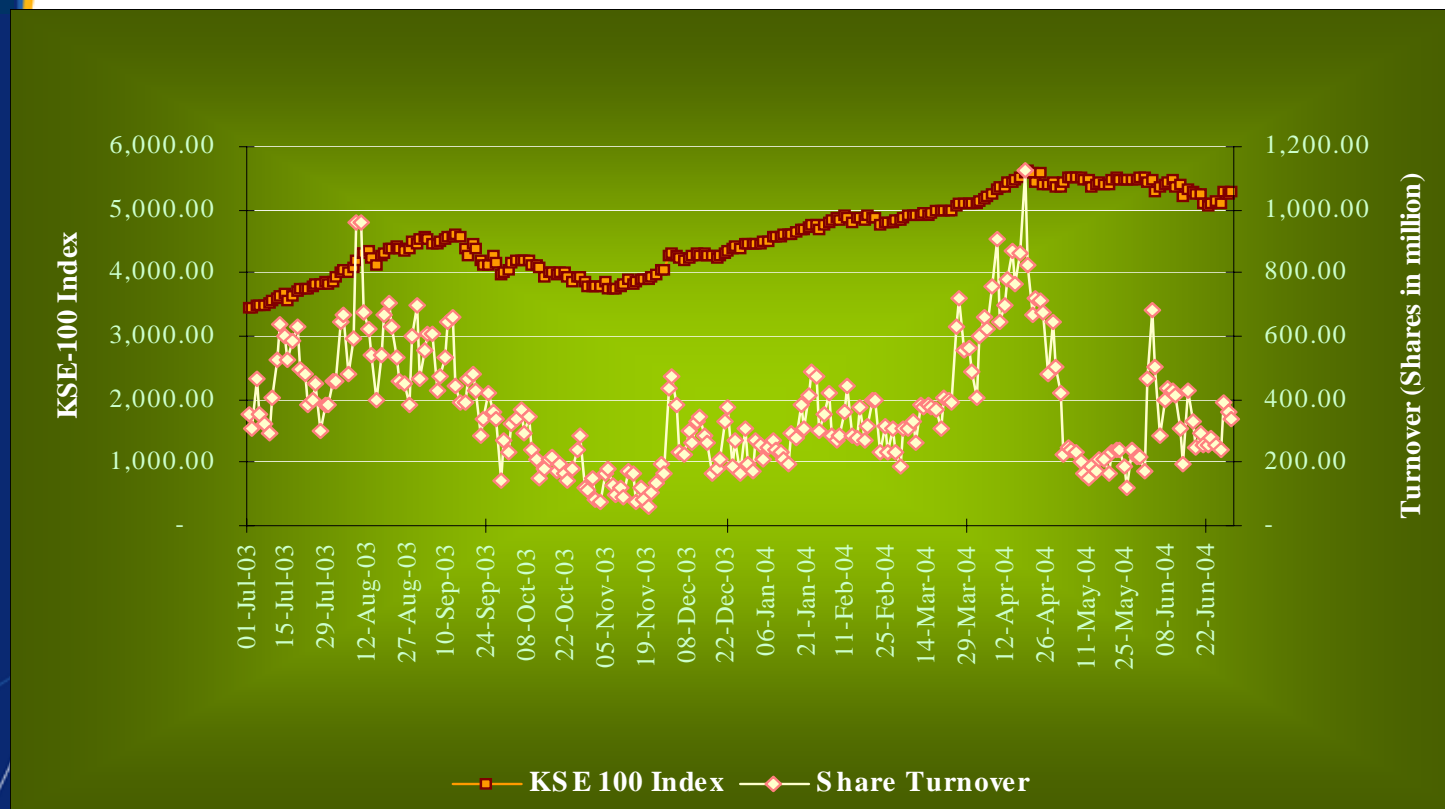
Financial Market reforms: Objectives

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1. To improve market stability and governance
2. To enhance access and availability of financial services
3. To improve market's ability to act as an efficient agent for capital formation

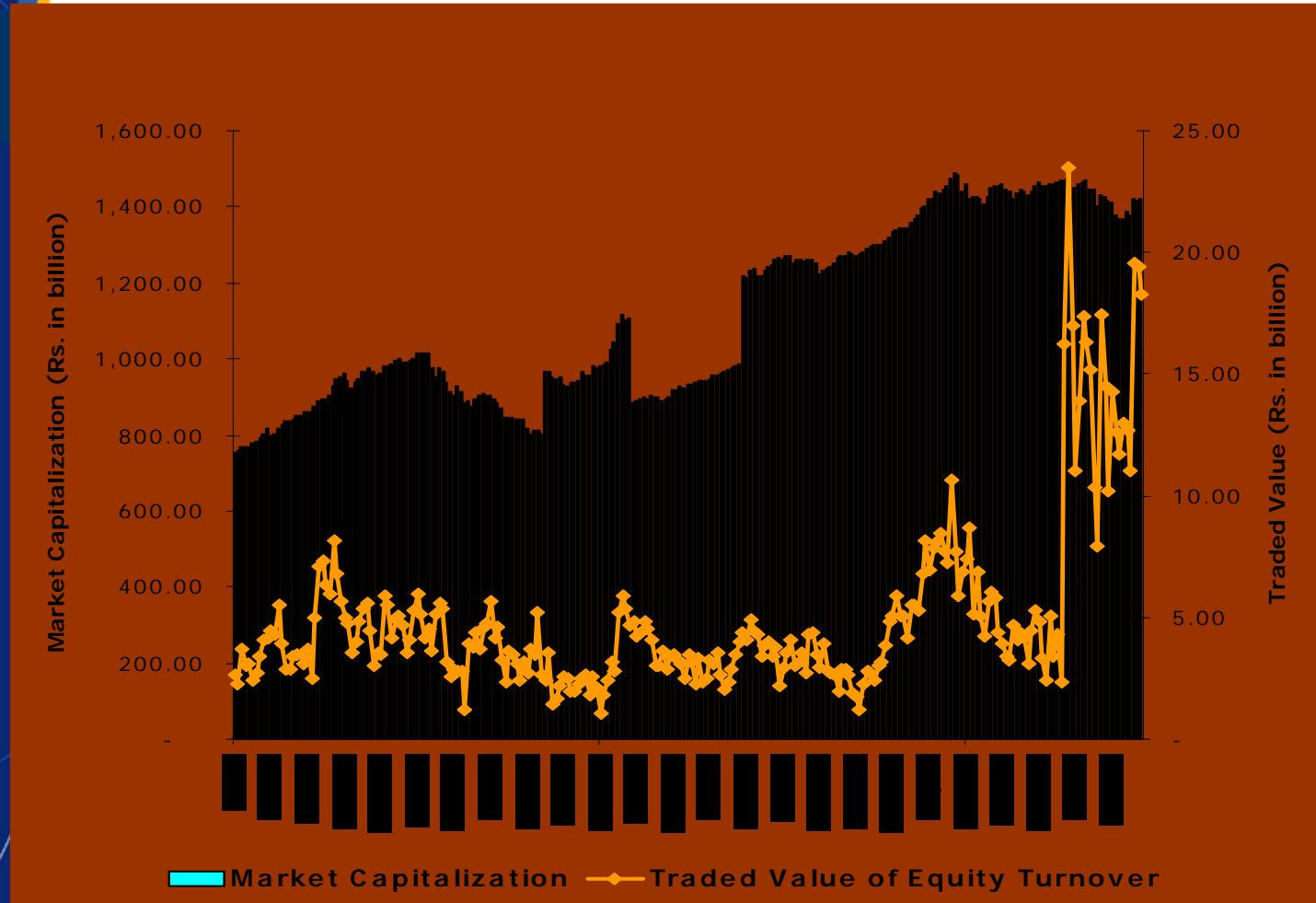
KSE-100 Index and Turnover at KSE (July 2003 – June 2004)

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KSE Market Capitalization and Traded Value (July 2003–June 2004)

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Financial Market reforms: Achievements

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- Establishment of new regulatory set-up
- Transformation from public to private sector ownership
- Large number of entities and instruments
- Level playing field for market participants
- New laws and regulations for insurance and asset management companies
- Improved risk management at the stock exchanges

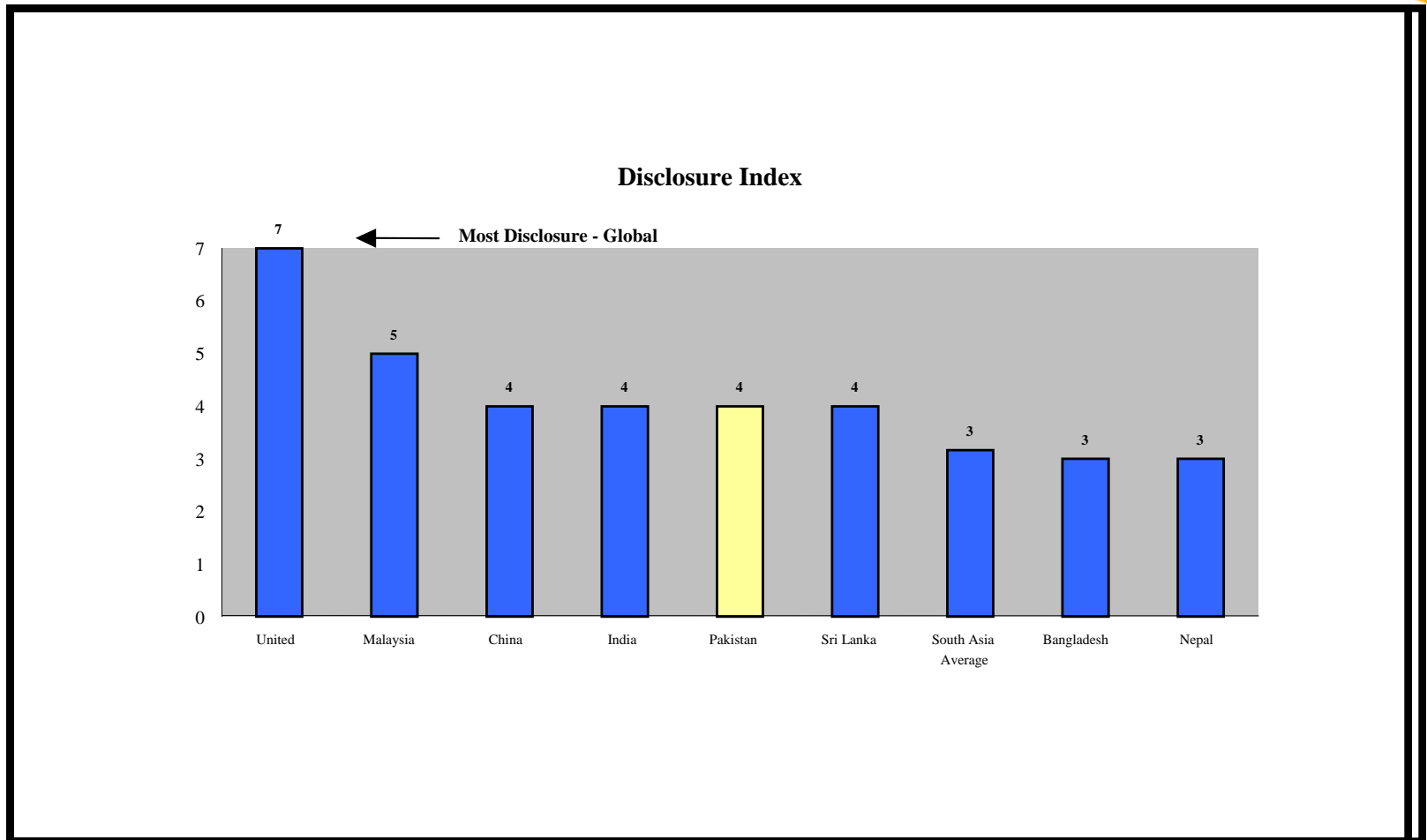
Financial Market reforms: Achievements Contd....

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- Improved governance of stock exchanges
- Introduction of new Settlement system
- Demutualisation of stock exchanges on the cards
- Consolidation of specialised companies
- Growth in the mutual fund industry
- Emphasis on credit rating and information dissemination
- Code of Corporate Governance introduced

Benchmarking—Corporate Governance Pakistan—Compared to Global Best / Selected Other Countries

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Investment Climate Indicators 2004

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PAKISTAN		REGION: South Asia	
Economic Characteristics		Entry Regulations	
Income per capita	470	Number of procedures	11
Population	148,400,000	Time (days)	24
		Cost (% of income per capita)	36.0
		Minimum capital (% of income per capita)	0.0
Labor Regulations		Credit Markets	
Difficulty of hiring index	78	Cost to create collateral (% of income per capita)	11.5
Rigidity of hours index	40	Legal rights of borrowers and lenders	4
Difficulty of firing index	30	Credit information index	4
Rigidity of employment index	49	Public registry coverage (borrowers/1000 adults)	2
Firing costs (weeks)	90	Private bureau coverage (borrowers/1000 adults)	3
Contract Enforcement		Bankruptcy	
Number of procedures	46	Time of insolvency (years)	2.8
Time (days)	395	Cost of insolvency (% of estate)	4.0
Cost (% of debt)	35.2	Recovery rate (cents on the dollar)	38.1
Registering property		Protecting investors	
Number of procedures	5	Disclosure Index	4
Time (days)	49		
Cost (% of property value)	4.2		

- Low level of capital formation (high level of secondary market trading, low interest rates, companies not interested in new equity issues)
- Market failures (Agriculture, SME sectors)
- Focus on entities not outreach
- How independent is the Regulator?

- Weak supervisory capacity
- Political risks (exchange risk, directed credit, interest rate regime, focus on growth)
- Single vs multiple regulators
- Weak self regulatory organisations
- Regional market integration

- Generally encouraging outcomes against objectives
- Market has not acted as a true economic agent
- Market failures due to weak supporting structure (information asymmetry, legal system etc.)
- Need to review the policy focus from entities to outcomes

Conclusions

- Political economy factors (political will, crony alliances, policy inconsistency)
- Inequitable treatment of SOE (Others!)
- How realistic is it to ensure regulatory independence in an imperfect institutional environment?