

COUNTRY REPORT ISLAMIC REPUBLIC OF PAKISTAN- 2014

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COUNTRY REPORT
ISLAMIC REPUBLIC OF PAKISTAN
PAKISTAN ECONOMY:

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Global economic growth during the outgoing year has witnessed some continuing signs of improvement with a pickup in high income economies along with some improvement in developing countries.

The **China–Pakistan Economic Corridor (CPEC)** is a development megaproject which aims to connect Gwadar Port in southwestern Pakistan to China's northwestern autonomous region of Xinjiang, via a network of highways, railways and pipelines to transport oil and gas. The economic corridor is considered central to China–Pakistan relations and will run about 3,000 km from Gwadar to Kashgar. Overall construction costs are estimated at \$46 billion, with the entire project expected to be completed in several years. The Corridor is an extension of China's proposed 21st century Silk Road initiative. According to a Firstpost report, "this is the biggest overseas investment by China announced yet and the corridor is expected to be operational within three years and will be a strategic gamechanger in the region, which would go a long way in making Pakistan a richer and stronger entity than ever before."

Other than transport infrastructure, the economic corridor will provide Pakistan with telecommunications and energy infrastructure. The project also aims to improve intelligence sharing between the countries. China and Pakistan hope the massive investment plan will transform Pakistan into a regional economic hub as well as further boost the growing ties between Pakistan and China

Major trading partners of Pakistan are growing with better outlook, which will certainly have positive impact on the economy of Pakistan and provides an opportunity to uplift socioeconomic condition of common man in the country.

Major success of the outgoing fiscal year includes: picking up economic growth, inflation contained at lowest level, improvement in tax collection, reduction in fiscal deficit, worker remittances touches new height, successful launching of Sukuk, foreign exchange reserves significantly increased and stock market created new history.

The GDP growth accelerates to 4.24 percent in 2014-15 against the growth of 4.03 percent recorded in the same period last year. The growth momentum is broad based, as all sectors namely agriculture, industry and services have supported economic growth. However, the economic growth is underpinned by low international oil prices and expected uptick in economic growth in advanced economies.

The Services sector has witnessed a growth rate of 4.95 percent as compared to 4.37 percent last year.

Present government has launched comprehensive plans to create investment friendly environment and to attract foreign investors in the country. As is evident, the capital market has reached to new height and emitting positive signals for restoring the investor's confidence. Government policies narrow the budget deficit, rebuild depleted exchange reserves and raised the growth modestly despite large energy crisis, law and order situation

The government is also aiming to explore new markets to export its manpower as well as incentives for the remittances to further enhance its growth. The available data suggest inflow of the remittances for the period of July April 2014-15 stood at \$ 14969.66 million compared to \$ 12897.91 million during the corresponding period last year, which is 16.06 percent higher over the previous period.

During the current fiscal year, SBP reduced the policy rate by a cumulative 300 bps to 7.0 percent w.e.f 25th May, 2015 which is the lowest rate in last 42 years reflecting improved macroeconomic conditions towards the end of fiscal year 2014-15.

Significant development in the Capital Market have been witnessed. Pakistan ranked third in calendar year 2014 amongst the top ten best performing markets in the world. The performance of the stock market during current fiscal year can be attributed to a number of positive factors including a stable macroeconomic environment, relative stable exchange rate, acceleration in the privatization process, downward inflationary trend, prudent monetary policies and strengthened economic growth.

Market capitalization as on 22nd July 2015 stood at PKRs.7,732.87 billion.

During the period July 2014 to December 2014, five debt securities were issued which include two domestic Sukuk amounting to PKRs. 26 billion, one international Sukuk of PKRs. 100 billion (US\$ one billion) and two Privately placed Term Finance Certificates amounting PKRs. 6 billion.

The SECP has issued Sukuk Regulation, 2015 under Section 506-A of the Companies Ordinance, 1984 which require appointment of Shariah Advisor and Investment Agent. An efficient, broad-based and well-regulated Sukuk market will greatly help in the development of capital market. The purpose of making the Sukuk regulations is to facilitate the issuers for fund raising from the capital market.

New IPOs at Stock Exchange:

During the year 2014-15 9 Initial Public Offerings (IPOs) were made through Karachi Stock Exchange. The aggregate paid-up capital of these IPOs was PKRs.38,140 million.

FINANCIAL SECTOR:

Pakistan's financial sector consists of the following types of entities:

- i. Scheduled Banks
- ii. Development Finance Institutions (DFIs)
- iii. Micro-finance Institutions (MFIs)
- iv. Non-Banking Finance Companies (NBFCs)
- v. Modarabas

Scheduled Banks, DFIs and MFIs are regulated by State Bank of Pakistan whereas NBFCs and Modarabas are under the regulatory ambit of Securities and Exchange Commission of Pakistan. The NBFCs includes Assets Management Companies (AMCs), Pension Fund Managers, Real Estate Investment Trust (REIT) Management Companies, Private Equity Fund Managers,

Investment Advisors (IAs) Leasing Companies, Housing Finance Companies and Investment Finance Companies i.e. Investment banks engaged in Investment Finance Services (IFS).

LEASING SECTOR - A BRIEF:

The leasing sector in Pakistan has a brief but eventful history. The leasing activity, in the organized sector, started in the mid-eighties with the establishment of first leasing company in 1984. The growth of the leasing industry in Pakistan initially lacked the momentum mainly due to lack of general awareness regarding its nature and benefits but subsequently the number of companies increased. From 1984 to 1989 only nine companies were incorporated while the total number of companies incorporated raised to 35 till 1999 and in 2003 one leasing company was incorporated, hence the highest number of leasing companies were 36 with a minimum capital of PKRs.100 million.

The minimum capital requirement was raised to PKRs.700 million by the Regulator. However, in the NBF Reform Committee Report issued in 2012 it was suggested to segregate the NBFC Sector into two clusters i.e. Deposit Taking NBFCs and Non-Deposit Taking NBFCs and separate capital requirements have been suggested.

Due to merger and acquisition the number of leasing companies have been reduced to 9 as on December, 2012. In the year 2014, after a gap of number of years, a leasing company was established by the Sindh Government with a paid up capital of PKRs. One billion which depicts that still the leasing sector has great potential and more companies may enter the sector.

The leasing sector in general has experienced commendable growth over the years and has adequately proved to be an alternative source of finance. In case of an expected economic revival, the leasing sector is likely to regain its initial momentum particularly in the backdrop of Islamisation of the economy due to its inherent potential of being in close conformity to one of the permissible modes of financing under Sharia.

Leasing sector in Pakistan is a major component of Non-Banking Financial Institution (NBFI) segment and has played a vital role in expanding economic growth and containing poverty. Broadly speaking, leasing is an institutional arrangement that channels resources to small and medium size enterprises to fund their business needs.

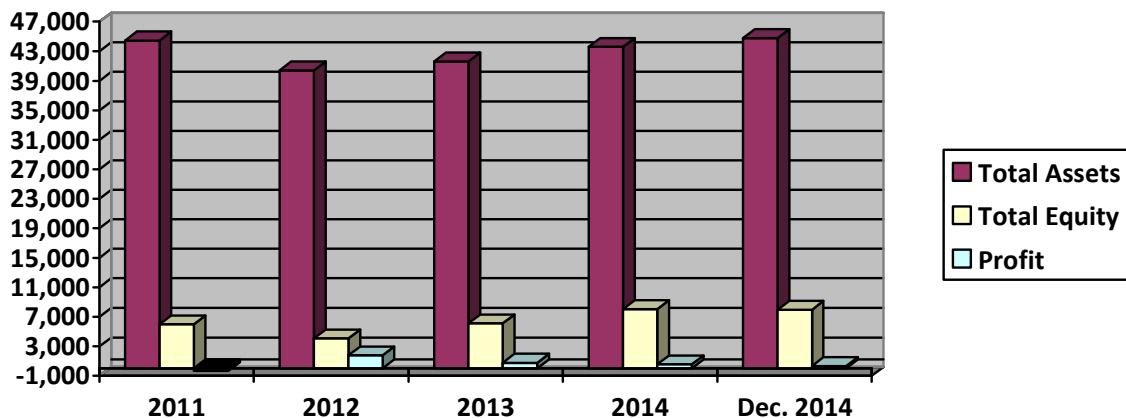
Leasing model world wide has faced competition with banks and has succeeded with strong foundation focusing on SMEs financing. Leasing has played a major role in the economic growth of the countries by providing access to financing to entities that otherwise borrowed at very high rates from the informal sector. The primary idea of leasing was asset based financing.

PERFORMANCE OF THE LEASING SECTOR:

During the year ended 30th June, 2014 the Leasing sector and investment banks booked a profit of PKRs.546 million as compared to a loss of PKRs.768 million during the corresponding period last year. The total Assets size increased to PKRs.43,574 million as compared to PKRs.41,600 million. The total Equity increased to PKRs.8,028 million

A comparative Position of Leasing Companies and Investment Banks for the last four years are given hereunder:-

| | 2011 | 2012 | 2013 | 2014 | Dec. 2014 |
|------------------|--------|--------|--------|--------|-----------|
| No. of Companies | 13 | 12 | 12 | 13 | 13 |
| Total Assets | 44,461 | 40,420 | 41,600 | 43,574 | 44,777 |
| Total Equity | 5,969 | 4,042 | 6,087 | 8,026 | 7,941 |
| Profit | (348) | 1,772 | 758 | 546 | 322 |



REGULATORY FRAMEWORK:

The regulatory framework of NBFC Sector under purview of the Securities and Exchange Commission of Pakistan comprises of:

- i. Companies Ordinance, 1984
- ii. NBFCs (Establishment and Regulation) Rules, 2003
- iii. NBFCs and Notified Entities Regulations, 2008
- iv. Private Equity and Venture Capital Fund Regulations, 2008
- v. REIT Regulations, 2008

Recently the Securities & Exchange Commission of Pakistan issued proposed amendments in NBFC Regulations, 2008 and NBFC Rules, 2003 and invited the stakeholders and general public to offer their comments and suggestions for the improvement of both the NBFC Regulations and NBFC Rules. NBFI & Modaraba Association of Pakistan after concurrence with the members, sent their recommendations to the Securities & Exchange Commission of Pakistan for consideration and finalization.

Pakistan's financial sector is banking centric with the NBF Sector accounting for only 4.9% (excluding insurance sector) of the financial sector's total assets. This dependence on the banking sector makes our financial system vulnerable to risks through lack of diversification and also restricts the scope of product innovation. A strong NBF Sector would not only promote savings by offering different assets classes to the investors but will also provide alternative fund raising opportunities to the participants of financial system.

SMEs IN PAKISTAN:

Leasing is the most effective module for meeting the funding needs of small and medium enterprises. Historically most of the leasing business in Pakistan has remained dedicated to the

SMEs but has never been recognized as an effective driver in the policies formulated by the Government and Central Bank for the growth of SME Sector. For the growth of the SME Sector, measures should be taken by the Government and Central Bank to make this sector successful.

Islamic Finance

Some of the leasing companies have diversified their business avenues to the Islamic modes of financing. ORIX Leasing Pakistan Limited and Pak-Gulf Leasing Company Limited have opened windows for undertaking Islamic modes of financing. ORIX Leasing is offering Ijarah and Diminishing Musharaka as its core products to the rapidly growing clientele of Shariah Compliant financial products.

MODARABA SECTOR – A BRIEF

The concept of Modaraba as a Shariah compliant mode of financing was evolved and introduced as an institutional framework in Pakistan with proper legislation, regulatory and monitoring structure and operating guidelines as back as in 1980. This privilege of translating the concept into an institutional and properly regulated structure is unique to Pakistan. In fact, the Modarabas, as Islamic financial institutions are the fore-runners of Islamic banking and mutual funds in Pakistan.

The Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 was promulgated in June, 1980. Initially the Modarabas were also regulated by the Central Bank like other financial institutions. Later on, the responsibility was entrusted to the securities & Exchange Commission of Pakistan. The office of the Registrar Modaraba, being a part of SECP, monitors and controls the sector through Rules, Regulations and Guidelines. The Modarabas are subjected to reporting requirement, prudential disciplines and on site audit like the rest of financial institutions. A properly constituted Religious Board approves and guide the functional integrity of the Modaraba for Shariah Compliance. No Modaraba can undertake any modes of business or execute any form of agreements other than those which are specifically approved by the Religious Board.

The Modaraba Sector being the pioneer in providing Islamic financial services in Pakistan is the most important segment of the financial sector. However, the immense potential of Modaraba concept has not been fully utilized primarily due to lack of awareness on the part of the investors ad lack of enthusiasm by most of the market operators.

SHARIAH COMPLIANCE

Inspite of all these efforts, Modaraba Sector could not get the status of a Shariah Compliant Entity and still there were reservations to Islamic Banks about the integrity of the Modarabas. Islamic Banks were reluctant to extend any facility to the modarabas on the plea that their day to day transactions are not transparent and according to the Shariah principles.

The Registrar Modaraba in collaboration with the NBFI & Modaraba Association issued Guidelines on “Shariah Compliance & Shariah Audit Mechanism” (SCSAM) in the year 2012 and implemented effectively. These Guidelines improved the quality of existing compliance and eliminate the risk of any inadvertent violation of Shariah principles by the modarabas. It was an

important step towards the enhancement of the image of Modarabas as a responsible component of Islamic Financial Industry.

REGULATORY FRAMEWORK

The regulatory framework of Modaraba Sector under purview of the Securities and Exchange Commission of Pakistan comprises of:

- i. Companies Ordinance, 1984
- ii. Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980.
- iii. Modaraba Rules, 1981
- iv. Prudential Regulations for Modarabas.
- v. Shariah Compliance & Shariah Audit Mechanism (SCSAM) Guidelines issued by SECP.

Recently the Securities & Exchange Commission of Pakistan issued proposed recommendations in Modaraba Regulations, 2015 and invited the stakeholders and general public to offer their comments and suggestions for the improvement in the Modaraba Regulations, 2015. NBFI & Modaraba Association of Pakistan after concurrence with the members, sent their recommendations to the Securities & Exchange Commission of Pakistan for consideration and finalization.

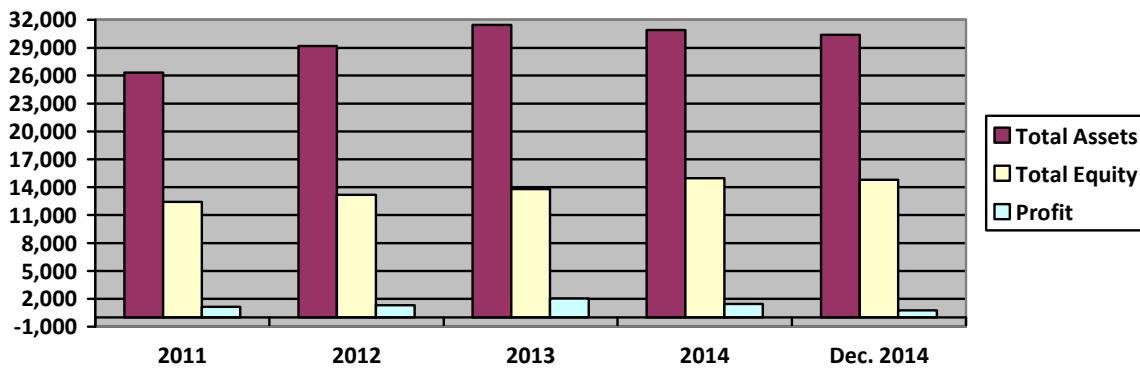
PERFORMANCE OF MODARABA SECTOR

Modaraba sector in Pakistan is consistently performing well and during the year ended 30th June, 2014 booked a profit of PKRs.1,545 million as compared to a profit of PKRs.2,035 million. The total equity stood at PKRs.14,488 million as compared to PKRs.13,824 million last year. Total assets stood at PKRs.30,212 million from PKRs.31,434 million.

Out of 25 modarabas 20 declared profit and 17 announced cash dividend ranging from 1. 5% to 50%. The total distribution of profit to the Certificate holders was over PKRs.1.0 billion. The sector is playing significant role in the promotion of Islamic finance within the country and over the years has emerged as major sector within the segment of non-banking financial institutions.

A comparative Position for the last four years are given hereunder:-

| | 2011 | 2012 | 2013 | 2014 | Dec. 2014 |
|------------------|--------|--------|--------|--------|-----------|
| No. of Companies | 26 | 24 | 24 | 25 | 23 |
| Total Assets | 26,343 | 29,195 | 31,434 | 30,896 | 30,389 |
| Total Equity | 12,422 | 13,186 | 13,824 | 14,996 | 14,784 |
| Profit | 1,128 | 1,311 | 2,035 | 1,458 | 754 |



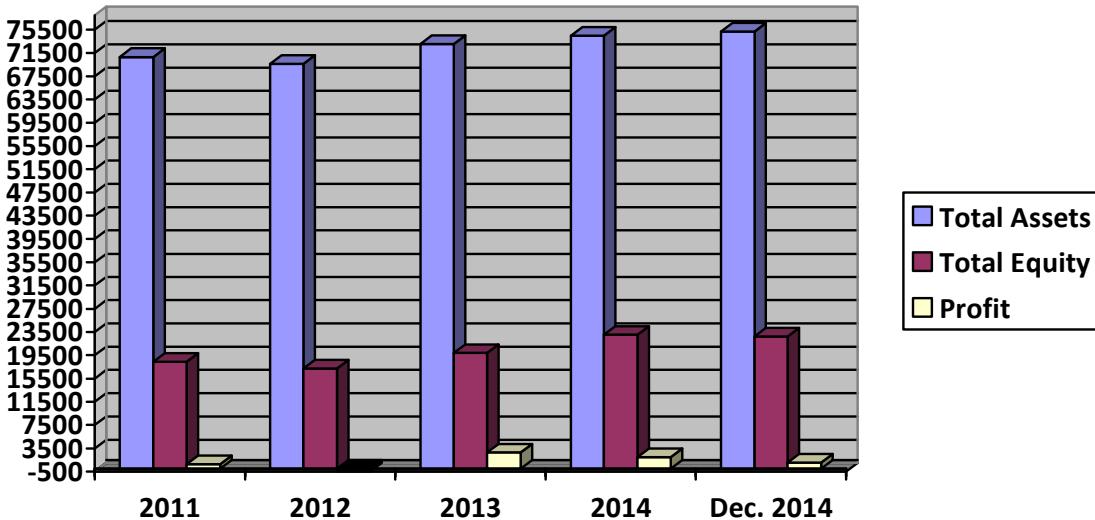
NBFI & MODARABA ASSOCIATION OF PAKISTAN

NBFI & Modaraba Association of Pakistan consists of 38 members including 25 Modarabas, 10 Leasing Companies and 3 Investment Banks. These sectors are vibrant and progressive components of the financial industry of Pakistan. The Association provides a platform to interact with each other in order to deal with the sectors' issues and formulate strategies for its consolidation and growth in the context of market challenges and opportunities. It also maintains an active coordination with the regulatory authorities to achieve a consultative and supportive regulatory environment.

The Association is continuously putting hard efforts for the promotion of the NBFI & Modaraba Sector and broadening the base of the Association.

The performance of the members during the period ended 30th June 2014 were significant as evident from the following comparative position given below:

| | 2011 | 2012 | 2013 | 2014 | Dec. 2014 |
|------------------|--------|--------|--------|--------|-----------|
| No. of Companies | 39 | 36 | 36 | 38 | 36 |
| Total Assets | 70,804 | 69,615 | 73,034 | 74,470 | 75,166 |
| Total Equity | 18,391 | 17,228 | 19,911 | 23,022 | 22,725 |
| Profit / (Loss) | 779 | (461) | 2,793 | 2,004 | 1,076 |



During the year the Association has been involved in preparing recommendations to the Proposed Amendments in NBFC Regulations, 2008, NBFC Rules, 2003 and Modaraba Regulations, 2015 issued by SECP for the comments/suggestions of the stakeholders and general public. The NBFI & Modaraba Association of Pakistan after concurrence with the members, finalized the recommendation and submitted to SECP for their consideration.