



## **OXFORD ANALYTICA**

**PAKISTAN**

**MONETARY TRANSPARENCY**

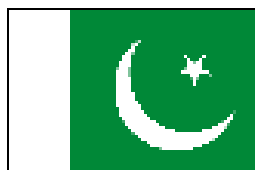
**Country Report 2006**

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# PAKISTAN



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2006	2005	2004	2003
Clarity of roles	•••	•••	•••	•••
Open decision process	•••	•••	•••	••
Availability of information	•••	•••	•••	••
Central bank accountability	•••	•••	•••	•••
<b>Score</b>	<b>3.00</b>	<b>3.00</b>	<b>3.00</b>	<b>2.50</b>

## OUTLOOK & COMMENTARY

The first-ever female governor of the State Bank of Pakistan (SBP) took up her position in January 2006. Dr Shamshad Akhtar has since pushed through huge restructuring within the bank, creating four separate departments, including one focusing on Monetary Policy.

A Monetary Policy Committee with a remit to set interest rates has also been created out of the former Monetary and Exchange Rate Committee, and is headed by the governor herself. At this stage, however, the committee's transparency has not improved, with no advance meeting calendar and no public statements following its meeting. There are also some worries that the SBP does not have the capacity to make a success of the restructuring. Although the SBP currently has adequate standards of transparency, it remains to be seen whether these will improve further in the coming years.

Pakistan is close to subscribing to the IMF's Special Data Dissemination Standard as most data is now compliant. Only quarterly data for GDP and wages need further work. A draft Banking Act is being submitted to the legislature in order to enhance the SBP's supervision of the banking sector, something which is much needed in Pakistan.

## EXECUTIVE SUMMARY

### 3.00 Enacted

The State Bank of Pakistan (SBP) has undergone significant change in 2006. On 2 January 2006, Dr Shamshad Akhtar -- who previously worked for the Asian Development Bank and the World Bank -- took up her position as the SBP's first-ever female governor. Her work so far has been impressive, and despite some reservations regarding her experience in monetary policy, she has gained credibility in the markets.

Since her appointment, she has tightened monetary policy and undertaken an ambitious restructuring within the SBP, setting up four clusters -- a Banking cluster, a Monetary Policy and Research cluster, a Financial Markets and Reserve Management cluster, and a Corporate Services cluster -- to improve coordination between different sections of the Bank. However, there are some concerns that there is not sufficient capacity within the bank to make the restructuring successful.

This year, the Monetary and Exchange Rate Policy Committee became the Monetary Policy Committee (MPC) in September 2006 with a remit to set interest rates, and is now headed by the governor herself. However, although a press statement is released following MPC meetings, there are no publicly available minutes or summary following the meeting.

Pakistan is a member of the General Data Dissemination Standard (GDDS). It is now close to subscribing to the IMF Special Data Dissemination Standard (SDDS), but quarterly GDP and wage data must be improved first. The SBP has also been improving data standards through the Data Warehouse Project and, as a result, banks now provide financial accounts and data to the SBP on a weekly, monthly and quarterly basis. However, the quality of some of the data provided is dubious due to the lack of IT infrastructure in some banks' branches. The second stage of the project, which neared completion during 2006, will release monitoring data for non-banking financial institutions.

Pakistan's overall score is unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES OF CENTRAL BANKS

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### The objectives and institutional framework of monetary policy

#### Central bank objectives and responsibilities

The institutional framework for monetary policy in Pakistan is set out in the State Bank of Pakistan Act of 1956 and its subsequent amendments.<sup>1</sup> The Act stipulates that the Central Board of Directors of the State Bank of Pakistan (SBP) shall 'secure monetary stability and the soundness of the financial system'.<sup>2</sup> However, the Act currently has twin objectives: price stability and growth. It does not define 'monetary stability' with precision, although Sections 9(a) and (b) do set out monetary policy formulation and objectives. These ambiguities have allowed the government to adopt different monetary policy frameworks at different times. To improve transparency, the IMF has recommended to the Pakistani authorities that the SBP Act be amended to define the term more clearly and to establish a hierarchy of multiple objectives of monetary policy.<sup>3</sup> The SBP is currently working to amend the Act to reflect the bank's role in the foreign exchange market, as well as to clarify monetary policy.<sup>4</sup>

The SBP is charged with approving the aggregate credit requirements of public finance bodies and the private sector, advising the federal government on the impact of monetary policy on the economy, managing foreign exchange, and reporting to the parliament on the state of the economy.<sup>5</sup>

On 2 January 2006, Dr Shamshad Akhtar took up her position as governor of the SBP. She is the SBP's first-ever female governor, and was the only external candidate for the position. Prior to joining the SBP, she worked for over ten years for the Asian Development Bank and before that, the World Bank. With such experience, she was a strong candidate, although there are some worries that she does not have enough experience of setting monetary policy. Since her appointment, Dr Akhtar has undertaken an ambitious restructuring within the bank, setting up four departments to improve coordination between different sections of the bank. A Banking Cluster, a Monetary Policy Cluster, a Financial Markets and Reserve Management Cluster, and a Corporate Services Cluster have thus been created. In particular, the Monetary Policy Cluster is responsible for economic analysis, the setting of monetary policy, research, as well as the statistics and data warehouse department. In general, commentators report that they are impressed with the work she has done so far, in particular her successful tightening of monetary policy in order to address inflation and the external current account deficit, although there are some concerns that the SBP lacks sufficient capacity to make the restructuring successful.<sup>6</sup>

The SBP set up a separate department in 2002 for the development of the Islamic banking sector, receiving training from Malaysia and running a course last year on Islamic banking to meet the growing demand for sharia banking services. There were 70 Islamic banking branches by the end of 2005 and sharia-compliant instruments are being developed. The SBP is currently trying to ensure that it has a strong regulatory framework; reporting on its activities in Islamic banking can be found in both the *Financial Sector Assessment* and the annual *Banking System Review*, both of which are published regularly and are available on the SBP website.<sup>7</sup> The SBP has also published a book entitled *Islamic Banking and Finance: Theory and Practice* on its website.<sup>8</sup>

## **Operational autonomy**

In February 1994, the SBP was granted full autonomy to regulate and supervise monetary and credit mechanisms. Three amendment ordinances to the SBP Act in January 1997 gave the SBP the authority to regulate the banking sector, to independently conduct monetary policy, and to set limits on government borrowings from the SBP. The Monetary and Fiscal Policies Coordination Board (MFPCB) manages and harmonises monetary, fiscal, and exchange rate policies to “ensure consistency among macroeconomic targets of growth, inflation and fiscal, monetary, and external accounts.”<sup>9</sup> The National Credit Consultative Council (NCCC) has an advisory role, and makes recommendations for the Annual Credit Plan, which determines the credit requirements for both the public and private sector. These recommendations go to the Board of Directors for final approval. However, the NCCC is in the process of being restructured and will soon be replaced by the Private Sector Credit Advisory Council (PSCAC).<sup>10</sup>

SBP officials have stated that in carrying out the assigned functions of coordinating fiscal, monetary and exchange rate policies, the MFPCB does not take any measures that adversely affect the autonomy of the SBP as provided in the SBP Act. Commentators have asserted that the stature of the central bank is growing among government institutions, as is its institutional competence.<sup>11</sup> The SBP Act gives the bank sufficient autonomy to conduct monetary policy and regulate the banking sector, and the government does not interfere with the workings of the bank. Neither is there any clause in the law which explicitly permits the government to interfere.<sup>12</sup>

The SBP Act grants the Federal Government the power to declare the SBP ‘superseded’ if, in its judgement, it fails to carry out its legal obligations.<sup>13</sup> The government may then delegate the authority of the SBP’s Central Board of Directors to another agency, and must submit a full report to parliament on the grounds for its decision as soon as possible. The decision must also be reported in the Official Gazette. However, the specific conditions under which the government is authorised to override SBP decisions and replace the Central Board of Directors with an agency chosen arbitrarily by the government are not stipulated in the legislation. This is a significant obstacle to the transparency of the monetary policy process and a potential threat to the operational autonomy of the central bank. The IMF has raised this concern with the Pakistani authorities and has recommended that these conditions be specified in legislation.<sup>14</sup>

## **Institutional relationship between monetary and fiscal operations**

### **Lending to government**

Information on the volume of government borrowing from the SBP is provided in the table of cumulative money flows produced for the SBP’s *Quarterly Reports*. It is also available separately in the form of a weekly and monthly survey on the SBP website.<sup>15</sup> The SBP is allowed, within certain limits, to purchase and sell government (both federal and provincial) securities, on the recommendation of the Central Board of Directors.<sup>16</sup>

The SBP is authorised to provide advances to the federal, provincial, and local governments, either through government securities or loans.<sup>17</sup> The advance to federal government provided against government securities is for six months at market-determined interest rates (the latest weighted average yield on the six-month T-Bill auctioned to the primary dealers). The information is available on the SBP website (domestic debt figures) and is also discussed in other publications such as its annual and quarterly reports.<sup>18</sup> Further details of government borrowing are now published by the SBP.<sup>19</sup> Other advances, like ways and means and overdrafts, are provided to fill very short-term mismatches, and these are a negligible ratio of total advances (usually less than 1%).<sup>20</sup>

### **Central bank involvement in the rest of the economy**

The SBP is prohibited, under the terms of the SBP Act, from participation in trade or commercial activities. Nor can it own property -- other than its own infrastructure -- or make unsecured loans.<sup>21</sup>

SBP officials are prohibited from sitting on the boards of commercial entities. Though SBP holds share capital in some entities on behalf of the Government of Pakistan, it does not influence the decision making in such institutions.<sup>22</sup>

Regarding procurement in the private sector for its services, the SBP created a spin-off subsidiary (SBP Services) that performs many of the support services for the SBP, such as currency printing and publications.

### **Central bank profit allocation**

The SBP Act established an Industrial Credit Fund, an Export Credit Fund, a Rural Credit Fund, a Loan Guarantee Fund and a Housing Credit Fund, all of which are financed in part by a share of the SBP's operating profits.<sup>23</sup> The Federal Government may also decree that a part of the SBP's profits be allocated to a Reserve Fund, before any residual (after depreciation and provision for bad debt) is distributed as a dividend to the SBP's shareholders (i.e. the federal government) or directly transferred to the government.<sup>24</sup> Details are provided in the Annual Report.<sup>25</sup>

### **Agency roles performed by the central bank on behalf of the government**

The agency roles entrusted to the SBP on behalf of the government include acting as banker to the government; performing the role of a fiscal agent -- including the responsibility for conducting short- and long-term government paper auctions --, and managing the external debt (external debt is managed by the Economic Affairs Division/Debt Management Office). In addition, the SBP is also responsible for maintaining all federal government accounts, and making local and foreign currency payments on behalf of the federal government from its various accounts or liquid reserves.<sup>26</sup>

The SBP is entrusted with the management of the public debt and with issuing any new loans.<sup>27</sup> Although the Ministry of Finance (MoF) monitors the government's external accounts, it does not have any significant role in either the primary or secondary markets of treasury bills. Clearance and settlement of government securities is performed exclusively by the SBP. The general debt management framework is outlined in the Debt Management Committee Report of the MoF.

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

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### The framework, instruments, and targets of monetary policy

#### Framework and monetary targets

The objectives of monetary policy in Pakistan are price stability and economic growth. The money supply, measured by M2, is used as an intermediate target of monetary policy, inflation being the ultimate target. Monetary targets are drawn up by the Central Board of the SBP, with significant input from the NCCC and the MFPCB, in accordance with the annual National Credit Plan. The Credit Plan estimates private sector credit requirements in the economy keeping in view the overall safe limits of monetary expansion determined by the SBP's Board of Directors.

A key responsibility of the SBP is to maintain the external value of the currency. The Foreign Exchange Act of 1947 lays out the measures to be taken in order to regulate foreign exchange reserves. Pakistan operates a market-determined floating exchange rate regime, and all surrender requirements of foreign exchange receipts have been abolished. However, the SBP is required to prevent major fluctuations in the value of the rupee in order to maintain the competitiveness of Pakistani exports and to ensure the stability of the foreign exchange market.<sup>28</sup>

#### Monetary instruments

The SBP's monetary operations, as well as updated lists of counterparties (such as primary dealers), are detailed in publicly available circulars. Monetary policy is conducted through open market operations, via regular auctions of T-Bills and the long-term Pakistan Investment Bond (PIB),<sup>29</sup> as well as the use of discount rate and cash/liquidity asset requirements on commercial banks. Although the MoF communicates the targets for the T-Bill auctions, the SBP sets the final target after accounting for the liquidity position of commercial banks and upcoming developments in the money market. The central task of monetary policy in the recent past has been to sterilise substantial foreign currency inflows.

### The monetary policy-making body

#### Monetary board

The primary governing body of the SBP is the Central Board of Directors. The details underlying the appointment of its members and the terms of office are formalised in legislation.<sup>30</sup> The Central Board comprises the governor of the SBP, representatives from the MoF, and directors from each province, all nominated by the Federal Government.

In addition to the Central Board of Directors, there are several consultative bodies that play a coordination role in monetary policy. These are the Monetary and Fiscal Policies Coordination Board (MFPCB), the National Credit Consultative Council (NCCC), and the SBP's Monetary Policy Committee (MPC), which, until September 2006 was the Monetary Policy and Exchange Committee. As part of this transformation, two more members will soon be appointed to the MPC, which is now headed by the governor herself rather than by the deputy governor. By November 2006 it had held two meetings, but it plans to hold meetings at least every six weeks. Minutes of the

meetings are circulated among members, but are not released to the public. However, press statements containing decisions of the MPC are released following each meeting.<sup>31</sup>

The MFPCB manages and harmonises monetary and exchange rate policies, as well as fiscal policy. Its task is to ensure consistency among macroeconomic targets of growth, inflation and fiscal, monetary, and external accounts. The board includes the SBP governor and officials from the Ministries of Finance and Commerce, and the Planning Commission. It meets on a quarterly basis to review the consistency of macroeconomic policies and to revise limits and targets set at the time of the formulation of the budget, keeping in view the latest developments in the economy. The responsibilities and membership of the MFPCB are specified in legislation,<sup>32</sup> but as it is not a policy-making body, there is very little information publicly available regarding its operations, and it does not have a formal decision-making or voting structure. However, the SBP's new governor is currently trying to increase the transparency of the MFPCB.<sup>33</sup>

The NCCC, established in 1972, formulates the annual National Credit Plan, which sets a monetary target for the private sector. The NCCC includes the SBP governor, representatives from major ministries (Agriculture, Commerce, Finance and Industry), representatives from the provincial governments, and private sector representatives drawn from the domestic chambers of commerce, primary dealers, and the Pakistan Bankers' Association (PBA), among others. NCCC meetings are normally held twice a year in January and July. There is no pre-announced schedule. After each meeting, a press release is issued outlining any major decisions taken, along with broad estimates of credit to the private sector. However, the new governor wants to convert the NCCC into a private sector advisory committee.<sup>34</sup>

## Public statements on monetary policy

### Periodic publications

The SBP's publications programme, both in terms of paper publications and information provided on the SBP website, provides timely and comprehensive data on the SBP's activities. The SBP publishes an *Annual Report* (which contains a *Review of the Economy* and an *Annual Performance Review*), *Quarterly Reports*, and a *Monetary Policy Statement*. The twice-yearly *Monetary Policy Statement* includes a review of the macroeconomic outlook and the SBP's monetary policy stance, as well as information on monetary and credit trends for the preceding year. Content has improved during 2006 to include greater detail on trends and policies in the fiscal year just ended, together with challenges for the coming fiscal year.<sup>35</sup> The SBP Board of Directors is obliged to submit a *Quarterly Report* to parliament on the state of the economy with reference to macroeconomic performance, a range of relevant monetary data, and economic analysis of leading issues affecting monetary policy, exchange rates and price developments.<sup>36</sup> All reports can be found on the SBP website.<sup>37</sup>

Other publicly available publications include the monthly *Statistical Bulletin*, a summary weekly *Statement of Affairs* (listing assets and liabilities), a monthly *Export Receipts*, a bimonthly *Pakistan's Balance of Payments*, and an annual *Banking Statistics of Pakistan*.<sup>38</sup> In addition, the SBP publishes an *Inflation Monitor*, the *Quarterly Performance Review of the Banking System* and an annual *Pakistan Financial Sector Assessment* and a *Banking System Review*. Publications on Islamic banking are also included on the SBP's website. The SBP also discloses a summary of its balance sheet every week, and a detailed, audited balance sheet consistent with internationally accepted accounting principles is included in the *Annual Report*.

### Public hearings

There are indications that the scope and intensity of SBP consultations with key stakeholders on monetary policy issues are increasing. The number of central bank meetings with private sector participants has increased

substantially in recent years. The Central Board meetings are now held in different cities, and the SBP has made efforts to consult a wider audience in the financial community, including depositors, borrowers, industry trade groups and other key stakeholders.<sup>39</sup>

A series of formal and informal meetings are held between the SBP and selected private sector representatives, who are invited to provide feedback on proposed changes to prudential regulations. However, there are no public announcements of these meetings, nor are any minutes published. The Pakistan Bankers' Association meets quarterly with SBP officials to discuss monetary regulations and conditions in the market. In addition, changes in monetary management are discussed and disclosed to the market via the SBP's network of primary dealers on a monthly basis.

Currently, the SBP seeks stakeholders' feedback before taking important policy decisions. The SBP places all draft prudential regulations/guidelines and other policy documents on its website for comments and suggestions from the stakeholders before final issuance.<sup>40</sup> Annual Financial Sector Assessments (FSA) are disseminated on the SBP website to generate private-sector feedback. These documents are drafted in tandem with an advisory committee of public and private sector stakeholders. In 2006, the SBP circulated its Draft Guidelines for Islamic Microfinancing, inviting comments from key stakeholders.

### **Regulations on data reporting by financial institutions to the central bank**

Regulations on data reporting by financial institutions are set out in the SBP Act and the 1962 'Banking Companies Ordinance' (BCO), which give the central bank full authority to supervise and regulate banks and financial institutions.<sup>41</sup> The SBP Act requires corporations with which the SBP has transactions, including all domestic financial institutions, to furnish the SBP with returns, and it sets out the provisions for enforcing this practice.<sup>42</sup> A draft Banking Act is currently being submitted to the legislature, which would replace the existing Banking Companies Ordinance of 1962, and should provide for the improvement of the SBP's supervision of the banking sector.<sup>43</sup>

The SBP has drafted prudential regulations for banks and Development Finance Institutions for different categories of customers, such as corporate, commercial, consumers and agriculture.<sup>44</sup> Two departments of the SBP are charged with supervision of the financial sector. Off-site management is the responsibility of the Off-site Supervision and Enforcement Department, while the Banking Inspection Department takes charge of on-site monitoring. The SBP reports that its on-site examination capabilities have been "substantially augmented to bring them at par with the expected international standards."<sup>45</sup> This sentiment has been echoed across the private sector. The SBP inspection staff are considered well-qualified and professional, and the inspection reports themselves are thought of as balanced, constructive and informed.<sup>46</sup>

Overall banking supervision is felt to be improving, although there is still a long way to go, and some commentators say that non-bank financial institutions (which fall under the purview of the Securities and Exchange Commission of Pakistan, SECP) need their regulatory frameworks to be improved.<sup>47</sup> In January 2004, the central bank adopted a risk-based system of monitoring, surveillance, and supervision of banks and development finance institutions. This system has improved the quality of the SBP's surveillance and regulation activities.<sup>48</sup> The SECP has put in place a new system of monitoring, supervision, and surveillance to strengthen supervision in the financial sector.<sup>49</sup> There are also areas of less than full compliance with supervisory standards that relate to legal provisions regarding the independence of the regulator, arrangements for consolidated supervision, and provisions for country risk. The IMF has stated that this does not currently pose a major risk to the stability of the financial system, since compliance is high with the principles dealing with prudential regulation.

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY



#### Release of central bank data

The SBP currently publishes a wide range of macroeconomic and monetary data on a frequent basis, as well as timely publishing of its *Quarterly* and *Annual Reports*. In addition, Pakistan joined the General Data Dissemination System (GDDS) of the IMF in November 2003. Consequently, most key SBP data meet IMF standards; the SBP is close to subscribing to the IMF Special Data Dissemination Standard (SDDS), but needs to improve quarterly GDP data first.<sup>50</sup>

The SBP has been improving data standards on foreign liabilities, credit to the private sector, methodology, the balance of payments, the international investment position, and international reserves through the Data Warehouse Project.<sup>51</sup> The first stage of this project was completed in 2005, and banks now provide weekly returns, audited accounts, and quarterly and final balance sheets to the SBP. A monthly monetary survey is now also published on the website. Sometimes data provided by banks is provisional due to the lack of IT infrastructure at the branch level of banks. However, the SBP has issued guidelines to banks for improving and removing deficiencies. The second stage of the Data Warehouse project is to release monitoring data for non-banking financial institutions, and this should be completed by the end of 2006.<sup>52</sup>

The SBP has improved the timeliness of the monthly data on the net external position, domestic credit, and broad and narrow money, and these meet IMF standards. According to Pakistan's posting on the GDDS Bulletin Board, monthly data on the country's net external position, monetary base, domestic credit, and broad money indicators are published with a timeliness of 30 days. Interest rate data, including short- and long-term government security rates, are published daily.<sup>53</sup>

The Monetary Survey is compiled in accordance with the analytical framework of the IMF's *Monetary and Financial Statistics Manual*. It is produced by consolidating the balance sheets of the SBP and the deposit money banks or scheduled banks. The assets and liabilities of non-bank financial institutions such as *modarabas*, discount houses and venture capital companies, are not incorporated. Foreign positions are distinguished from domestic positions on the basis of residency, in accordance with the IMF's *BPM5*.

#### The central bank balance sheet

The SBP publishes a detailed balance sheet along with profit and loss accounts on a yearly basis in the *Annual Report*. Information on market transactions such as T-Bill auctions and foreign exchange activities is also made available through newspapers and the SBP's publications. In addition, a summary balance sheet is released weekly. The SBP prepares its balance sheet according to International Accounting Standards (IAS). Weekly reports are included in the *Statement of Affairs*.<sup>54</sup>

Market transactions or monetary operations are reported the same day. All information is available online. Aggregate amounts of monetary operations, with the exception of swaps, can be found in the *Annual Report*. The foreign exchange position of the SBP can be found on the SBP website, where the SBP publishes both its own reserves and those of domestic banks. Information on contingent liabilities is available in the *Annual Report*, published online.<sup>55</sup>

## **Lender of last resort**

The SBP acts as a lender of last resort to banks, investment banks and brokerage houses (if primary dealers) in Pakistan, providing a discount window facility to meet temporary liquidity shortages.<sup>56</sup> The SBP is also empowered to provide emergency financial support to those banks that may need such aid.

## **Public information services**

Both the External Relations Department and the Publications Department handle all requests for information, from both the press and the general public. The SBP publishes a large volume of information on its website, all of which is available in English, and increasingly in Urdu. Monetary data, such as the position of foreign exchange reserves, auctions of government Treasury Bills, and monetary developments are published both as press communiqués and online. In addition, all the governor's speeches and press releases are reproduced in their entirety. The Banking Policy Department and the Exchange Policy Department have help desks with electronic query forms.<sup>57</sup> The External Relations Department has also appointed a Chief Spokesman for the SBP.

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK



### Accountability before a designated public authority

The governor and other high-ranking officials of the SBP appear before the Economic Coordination Committee of the Cabinet (ECCC) and make periodic appearances in parliament, although there is no formal legal requirement for them to do so. The SBP is required to answer any questions from parliamentary members or committees, and unofficial SBP policy requires a written response to any query from the general public. The SBP is also subject to reviews conducted by the Senate Banking Committee and National Assembly Banking Committee.

The SBP Act requires the Central Board of Directors of the SBP to submit a *Quarterly Report* to parliament on the state of the economy with special reference to economic growth, the money supply, credit, balance of payments, and price developments.<sup>58</sup> In a 2004 review, the IMF concluded that the SBP follows all good practices on accountability and assurances of integrity of its staff.<sup>59</sup>

### Financial statement

#### Audited financial statement

Public disclosure of audited financial statements of the SBP's operations is required by the SBP Act.<sup>60</sup> The SBP publishes its balance sheet in its *Annual Report*. The SBP's statements include the balance sheet and profit and loss account, which contain information on the operating expenses and revenues, as well as the dividend accrued to the Government of Pakistan, and the balance transferred to the government. This is audited externally by two independent, private sector auditing firms. The *Report of the Auditors* is appended to the *Annual Report*, and is undertaken in accordance with International Auditing Standards.<sup>61</sup>

Under the SBP Act, the SBP must hold an annual shareholders meeting, where the shareholders present are entitled to discuss the annual accounts, the report of the Central Board on the working of the SBP throughout the year, and the auditors' report on the annual balance sheet and accounts.<sup>62</sup> All operating expenses and revenues of the SBP are detailed in the *Annual Report*.

#### External and internal audit

The SBP Act requires the appointment annually of at least two auditors whose remuneration is fixed at the annual general meeting. Somewhat problematically, the auditors may be shareholders, although officers of the SBP are disqualified. Any auditor can be re-elected with no legal limits on the number of renewals.<sup>63</sup> The accounts for 2005-06 were audited by two accounting firms – KPMG Tasseer Hadi and M.Yousef Adil Saleem &Co. The report is published in the SBP's Annual Report 2005-06 Volume II.<sup>64</sup>

The SBP has an Internal Audit and Compliance Department that is charged with ensuring that the departments at the Central Directorate and all branch offices comply with rules and regulations issued by the central bank.<sup>65</sup> Internal auditing has been strengthened by new management of the department, which reports directly to the governor of the

SBP. In the past three years, the department has inspected both regional offices and departments at the SBP Secretariat.

The Internal Audit and Compliance Department is responsible for addressing non-compliance with regulatory requirements, for identifying problems and proposing resolutions, and for investigation of financial mismanagement. The department can assign compliance responsibilities to directors of the departments concerned, chief managers of offices, and the governor.<sup>66</sup>

Subject to meeting all other pertinent statutory requirements, the federal government may at any time appoint the Auditor General or other auditors of its choice to examine and report on the accounts of the SBP.<sup>67</sup>

According to the SBP Act, every auditor will be supplied with a copy of the annual balance sheet and will be given complete access to the SBP's books and other documents. The auditors will report, as appropriate, to the shareholders or the federal government.<sup>68</sup>

## **Conduct of officials**

Detailed rules for appointment, terms of office, and criteria for removal of the head and members of the governing body of the SBP are specified in the SBP Act.<sup>69</sup> The SBP has a formal code of conduct for employees, which is available on its website. This code -- the State Bank of Pakistan Staff Regulations 2001 -- includes regulations on recruitment, promotion, staff loan policy, discipline (including provisions relating to political participation, speculation in financial markets, and confidentiality), punishment and appeal.

Legal protection for actions taken by SBP employees in the conduct of their official duties, provided such actions have been taken in good faith, is provided in the Banking Companies Ordinance, 1962 (section 94). The scope of legal protection has been further broadened through amendment to the SBP Staff Regulations, whereby it is the responsibility of the SBP to provide for the legal costs of staff that encounter litigation resulting from the performance of official duties.<sup>70</sup>

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Pakistan between 5 and 9 November 2006.

### Ministry of Finance

#### 5 November 2006

Dr Ashfaque Hassan Khan	Economic Advisor	Ministry of Finance
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### State Bank of Pakistan

#### 9 November 2006

Mr Riaz Riazuddin	Economic Advisor	SBP
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## ADDITIONAL INTERVIEWS

#### 5 November 2006

Dr Faisal Bari	Assistant Professor	Lahore University of Management Sciences
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#### 6 November 2006

Henri Lorie	Senior Resident Representative	IMF
Riaz Hassan Naqui	Former Chairman	Central Board of Revenue

#### 7 November 2006

Sakib Sherani	Chief Economist	ABN Amro
Muhammad Yunis Khan	Auditor General of Pakistan	Supreme Audit Institution
Muhammad Tahir	Director General	PIFRA
Dr Khurum	Director	PIFRA
Riaz Hussain Naqvi	Former Chairman	Central Board of Revenue
Abdullah Yussuf	Chairman	Central Board of Revenue

#### 8 November 2006

John Wall	Country Director	World Bank
Hanid Mukhtar	Senior Economist	World Bank
Manuela Ferro	Lead Country Economist	World Bank
Peter Fedon	Country Director	Asian Development Bank
Sandra Nicoll	Senior Governance Specialist	Asian Development Bank

#### 9 November 2006

Aalishaan Zaidi	Country Distribution Manager	Standard Chartered
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## NOTES

- <sup>1</sup> The State Bank of Pakistan (SBP) Act of 1956 is available on the SBP website: [www.sbp.org.pk](http://www.sbp.org.pk).
- <sup>2</sup> SBP Act 1956, Article 9A
- <sup>3</sup> 'Pakistan: Financial System Stability Assessment', IMF, July 2004, pp. 45-46.
- <sup>4</sup> Interviews in Pakistan, 7-10 November 2005, and 5-9 November 2006.
- <sup>5</sup> SBP Act 1956, Article 9A.
- <sup>6</sup> SBP Press releases: 'Dr Shamshad Akhtar takes over as Governor of the State Bank of Pakistan', 2 January 2006: [www.sbp.org.pk/press/2006/02-Jan-06.pdf](http://www.sbp.org.pk/press/2006/02-Jan-06.pdf) and 'Reorganisation of the State Bank of Pakistan': 7 September 2006: <http://www.sbp.org.pk/press/2006/SBP-%20Reorganization-8-09-06.pdf>, and interviews in Pakistan, 5-9 November 2006.
- <sup>7</sup> Interviews in Pakistan, 7-10 November 2005.
- <sup>8</sup> See *Islamic Banking and Finance: Theory and Practice*: [www.sbp.org.pk/publications/islamic/book1/index.htm](http://www.sbp.org.pk/publications/islamic/book1/index.htm)
- <sup>9</sup> SBP Act 1956, Article 9B, 2(a)-(b).
- <sup>10</sup> Written correspondence with the SPB, 19 December 2006.
- <sup>11</sup> Interviews in Pakistan, 27 September - 1 October 2004.
- <sup>12</sup> Interviews in Pakistan, 27 September - 1 October 2004, and SBP Act Section 46-B
- <sup>13</sup> SBP Act 1956, Article 52.
- <sup>14</sup> 'Pakistan: Financial System Stability Assessment', IMF, July 2004, p.47.
- <sup>15</sup> [www.sbp.org.pk/ecodata/gborrow.pdf](http://www.sbp.org.pk/ecodata/gborrow.pdf)
- <sup>16</sup> SBP Act 1956, Article 10(a)-(b).
- <sup>17</sup> SBP Act 1956, Article 17.5.
- <sup>18</sup> Interviews in Pakistan, 27 September - 1 October 2004.
- <sup>19</sup> Available at: [www.sbp.org.pk/ecodata/gborrow.pdf](http://www.sbp.org.pk/ecodata/gborrow.pdf)
- <sup>20</sup> Interviews in Pakistan, 27 September - 1 October 2004.
- <sup>21</sup> SBP Act 1956, Article 20.
- <sup>22</sup> Interviews in Pakistan, 5-9 November 2006.
- <sup>23</sup> SBP Act 1956, Articles 17(a)-(e).
- <sup>24</sup> SBP Act 1956, Articles 41 and 42.
- <sup>25</sup> [www.sbp.org.pk/reports/annual/arFY02/chap13.pdf](http://www.sbp.org.pk/reports/annual/arFY02/chap13.pdf).
- <sup>26</sup> SBP Act 1956, the Foreign Exchange Regulation Act (1947), and the Public Debt Act (1944).
- <sup>27</sup> SBP Act 1956, Article 21.2(a).
- <sup>28</sup> [www.sbp.org.pk/about/core\\_functions/index.htm](http://www.sbp.org.pk/about/core_functions/index.htm)
- <sup>29</sup> The PIB is available in tenures of three, five, and ten years.
- <sup>30</sup> SBP Act 1956, Articles 10, 13, 14 and 15.
- <sup>31</sup> Interviews in Pakistan, 5-9 November 2006 and SBP Reorganisation: [www.sbp.org.pk/press/2006/SBP-%20Reorganization-8-09-06.pdf](http://www.sbp.org.pk/press/2006/SBP-%20Reorganization-8-09-06.pdf)
- <sup>32</sup> SBP Act 1956, Article 9B(f).
- <sup>33</sup> Interviews in Pakistan, 7-10 November 2005, and 5-9 November 2006.
- <sup>34</sup> Interviews in Pakistan, 5-9 November 2006.
- <sup>35</sup> See SBP Monetary Policy Statements: [www.sbp.org.pk/m\\_policy/index.asp](http://www.sbp.org.pk/m_policy/index.asp)
- <sup>36</sup> SBP Act 1956, Article 9A(f).
- <sup>37</sup> [www.sbp.org.pk/publications/index.asp](http://www.sbp.org.pk/publications/index.asp)
- <sup>38</sup> [www.sbp.org.pk/reports/stat\\_reviews/index.htm](http://www.sbp.org.pk/reports/stat_reviews/index.htm)
- <sup>39</sup> Interviews in Pakistan, 15-17 October 2002.
- <sup>40</sup> Interviews in Pakistan, 27 September - 1 October 2004.
- <sup>41</sup> This legislation is available on the SBP website.
- <sup>42</sup> SBP Act 1956, Articles 36 and 38.
- <sup>43</sup> Interviews in Pakistan, 5-9 November 2006, and *Draft Banking Act, 2006*: [www.sbp.org.pk/about/act/Draft.pdf](http://www.sbp.org.pk/about/act/Draft.pdf)
- <sup>44</sup> Interviews in Pakistan, 5-9 November 2006.
- <sup>45</sup> Ishrat Husain, 'Regulatory Strategy of the State Bank of Pakistan,' address delivered at the 18<sup>th</sup> Annual General Conference of the Pakistan Society of Development Economics, Islamabad, 15 January 2003, *BIS Review* 3/2003.
- <sup>46</sup> Interviews in Pakistan, 15-17 October 2002, and: [www.sbp.org.pk/about/ordinance/supervision.htm](http://www.sbp.org.pk/about/ordinance/supervision.htm)
- <sup>47</sup> Interviews in Pakistan, 5-9 November 2006.

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- <sup>48</sup> ‘State Bank to introduce new system of surveillance, monitoring, and supervision of banks/DFIs’, SBP press release, 9 January 2004.
- <sup>49</sup> Interviews in Pakistan, 7-10 November 2005.
- <sup>50</sup> Interviews in Pakistan, 5-9 November 2006.
- <sup>51</sup> [dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum1](http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum1)
- <sup>52</sup> Interviews in Pakistan, 5-9 November 2006.
- <sup>53</sup> [dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum2](http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorysummreport/?strcode=PAK&strcat=Sum2)
- <sup>54</sup> [www.sbp.org.pk/publications/statements/index.htm](http://www.sbp.org.pk/publications/statements/index.htm)
- <sup>55</sup> Interviews in Pakistan, 7-10 November 2005; <http://www.sbp.org.pk/reports/annual/index.htm>
- <sup>56</sup> A description of the SBP’s LOLR function is available on the SBP website, in ‘Core Functions of SBP’.
- <sup>57</sup> [www.sbp.org.pk/bpd/helpdesk.asp](http://www.sbp.org.pk/bpd/helpdesk.asp)
- <sup>58</sup> SBP Act 1956, Article 9A (f).
- <sup>59</sup> ‘Pakistan: Financial System Stability Assessment’, IMF, July 2004, p.47.
- <sup>60</sup> SBP Act 1956, Article 40.
- <sup>61</sup> SBP Act 1956, Article 45.
- <sup>62</sup> SBP Act 1956, Article 16.1-2.
- <sup>63</sup> SBP Act 1956, Article 43.
- <sup>64</sup> State Bank of Pakistan, *Annual Report, 2005-06, Volume II*: [www.sbp.org.pk/reports/annual/arfy06/vol2/index.htm](http://www.sbp.org.pk/reports/annual/arfy06/vol2/index.htm)
- <sup>65</sup> [www.sbp.org.pk/departments/audit.htm](http://www.sbp.org.pk/departments/audit.htm)
- <sup>66</sup> [www.sbp.org.pk/departments/audit.htm](http://www.sbp.org.pk/departments/audit.htm)
- <sup>67</sup> SBP Act, Article 44.
- <sup>68</sup> SBP Act, Article 45.
- <sup>69</sup> SBP Act 1956, Articles 10-15.
- <sup>70</sup> Interviews in Pakistan, 27 September - 1 October 2004. See also: Banking Systems Review, December 2003, at: [www.sbp.org.pk/publications/index.asp](http://www.sbp.org.pk/publications/index.asp)