

INTERVIEW SECTION



Ashraf Mahmood Wathra Governor, State Bank of Pakistan

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ICMAP: Please tell us briefly about the core functions of State Bank of Pakistan (SBP) and its contributory role towards achieving sustainable economic growth in Pakistan?

AMW: Unlike central banks of developed nations, SBP performs not only the traditional functions regulation and supervision of the financial system, lender of the last resort, conduct of monetary policy, management of foreign exchange reserves, issuance and distribution of currency but it also performs non-traditional development functions like broadening the access and usage of the financial system through promotion of microfinance, Small Medium Enterprises (SME) finance, Islamic banking, agricultural finance. In the context of discharging its fiduciary responsibilities, SBP employs strategic planning as a major management device in identifying priorities, developing actions and delivering outcomes. Currently we are implementing our Strategic Plan 2016-20,

known as SBP Vision 2020, which contains clear strategic imperatives around which SBP activities are being organized.

In terms of some key achievements under Vision 2020, Pakistan became the first major country in the South Asian region to have an independent Monetary Policy Committee after requisite amendments in the SBP Act, 1956. SBP has also progressed towards further improving the depth and efficiency of the money, debt and foreign exchange markets in Pakistan. SBP is developing comprehensive financial stability framework, deposit insurance scheme, crisis management framework along with supporting legal and regulatory structures. With a view to promote financial inclusion, SBP has developed a broader National Financial Inclusion Strategy (NFIS) in consultation with all stakeholders. In terms of outcomes of SBP policies, it is quite encouraging to note that the macroeconomic indicators are continuously improving. In FY16, the average annual headline CPI inflation was



observed to be declining to a historic low of 2.9 percent, the real GDP growing by 4.7 percent, the highest level in the last eight years and foreign exchange reserves touching an all time high of USD 23.1 billion. The credit to private sector almost doubled and the net Foreign Direct Investment has also increased in FY16.

ICMAP: What is SBP's policy towards SME-financing? Could you please share some statistics with regard to bank's lending to the private sector, especially SMEs during last few years?

AMW: SBP policy is geared towards increasing access to finance for SMEs through various initiatives like creation of enabling regulatory framework, building a better financial infrastructure and market interaction and capacity development. SME financing has been given due importance in SBP Vision 2020 and NFIS.

As a result of SBP measures, outstanding SME financing of the banks and Development Finance Institutions (DFIs) increased from Rs 260 billion as of Sep-2015 to Rs. 325 billion as of Sep-2016, showing a commendable rise of 25 percent on Y-o-Y basis. Moreover, the share of SME lending as percentage of total bank credit to private sector also increased from 5.54 percent to 8.25 percent on Y-o-Y basis during the same period. Now let me give you the summary of SBP initiatives undertaken for facilitating SMEs access to finance.

Provision of enabling regulatory environment for SME financing is core activity of SBP and various initiatives undertaken by us during last few years have resulted into upward trend in SME financing. Separate prudential regulations for small enterprises and for medium enterprises were issued in May 2013. Moreover, SBP has allocated SME finance targets for banks and DFIs, in the light of which outstanding SME portfolio is expected to grow to around Rs 390 billion as of Dec 31, 2016. To tackle the issue of collaterals of SMEs, SBP is facilitating government of Pakistan in

establishment of electronic secured transactions registry which will enable collateral deficient enterprises to get finance from banking sector through registration of charge on their movable assets with the registry. In this regard, good news is that Financial Institutions (Secured Transactions) Act 2016 has been passed by the Parliament, based on which electronic registry is being established.

In addition to above, SBP is facilitating market through refinance schemes for SMEs, particularly for modernization of SMEs, for storage of agri produce and for renewable energy projects. A Credit Guarantee Scheme for Small and Rural Enterprises has also been introduced under which credit risk coverage of up to 40% is provided to banks for extending loans to small and rural enterprises, which otherwise could face challenges in accessing finance from the formal sector.

Further, SBP supervises Prime Minister Youth Business Loans Scheme (PMYBL) and closely monitors performance of banks under this Scheme. Eighteen banks are working as PMYBL executing agencies. As of November 30, 2016, a total of 11,025 beneficiaries have been disbursed an amount of Rs. 11,384 million. During 2016, automated PMYBL Central Portal for data reporting by Executing Agencies has also been launched by

SBP to prevent the occurrence of multiple financing by same individual from different banks.

ICMAP: The current account deficit during July-Nov of FY 2016-17 has reached to negative US\$ 2.6 billion from US\$ 1.36 billion during same period last year. What are the main reasons of this burgeoning deficit?

AMW: During Jul-Nov FY17, the current account deficit widened due to a rise in imports of machinery, mostly for power and construction projects under the CPEC; the decline in exports; the absence of CSF inflows; and a marginal drop in workers' remittances. However, this increase in the current account deficit does not raise concerns for many reasons. First of all, the workers' remittances, which recorded some

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slowdown in the first quarter of FY17, have already started showing a rising trend in recent months. Encouragingly, this trend is likely to gain further momentum. Secondly, exports have also recorded an increase for the second consecutive month in November 2016, and its outlook is positive. Thirdly, the increase in imports is attributed to capital goods, as we are now in a growth phase after achieving stabilization. More importantly, the financial inflows from China are available to fund these additional imports. Finally, CPEC-related projects are also expected to improve Pakistan's soft image and turn it into a lucrative market for foreign investments from other countries.

ICMAP: The Pakistani industry is faced with acute energy shortage which has led to declining production and exports. What the government should do to improve the industrial production capacity?

AMW: We know that the acute energy shortage in the past had caused significant losses to our industrial production and the export sector. The situation however has improved considerably in recent years; not only the overall availability of energy has increased, the industrial sector has also adapted to past energy shortfalls by shifting their reliance to alternate energy sources. The business environment has become more conducive due to better security situation, and the falling prices of key raw materials in the global market. On the policy front, SBP has been maintaining a historically low interest rate. In addition, the government has already allowed several fiscal incentives in the last federal budget, besides announcing Drug Pricing Policy in 2015 and Automotive Development Policy in 2016. Last but not the least, the initiation of several infrastructure projects under China Pakistan Economic Corridor (CPEC) has provided impetus to a number of construction-related industries.

The domestic industrial sector is already responding to these positive developments. For example, a number of firms in

cement and steel manufacturing are already gearing up for expansion in their production capacities. In addition, several foreign companies, particularly in the automobile sector, are keen on partnering with local investors to launch projects in the country.

While the capacity expansion in manufacturing is a welcome development, we need a more focused strategy to shift our industrial base from low value to high value products. In this context, the expected relocation of traditional industries from China provides Pakistan an excellent opportunity to transform and upgrade its industrial sector. For this to happen, there is a need for a close collaboration between provinces and the federal government, as investment and industrial policies are now the provincial matters following the 18th amendment.

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ICMAP: Being the regulator of Islamic Banks in Pakistan, could you please briefly outline the major initiatives taken by the SBP for the growth and development of Islamic banking and finance industry?

AMW: Since the re-launch of Islamic banking as a parallel banking system in 2001, SBP has not only been developing and strengthening the regulatory framework to match the local and global dynamics but has also been working extensively to overcome the challenges which may otherwise

adversely affect the sustainability and growth of the industry. SBP has put in place a comprehensive Shariah Governance framework which aims at institutionalizing Shariah compliance at the level of Islamic banking institutions (IBIs). SBP also keeps track of international best practices and reviews standards issued by various international standard setting bodies like Islamic Financial Services Board, Accounting and Auditing Organization for Islamic Financial Institutions and International Islamic Financial Markets on an ongoing basis for their possible adoption or adaptation in the local market. Keeping in view the importance of Shariah harmonization, SBP has also notified permissible Islamic modes of finance, their



Shariah essentials and model agreements as part of regulatory framework.

We have most recently allowed delinking of KIBOR benchmark rate for pricing under financing provided on the basis of participatory (Musharakah & Mudarabah) and Wakalah (Agency) modes by IBIs. We also expect that this will not only help in addressing perception related issues of users of Islamic banking services but will also encourage IBIs to capitalize on modes other than popular ones i.e. Murabaha and Ijarah.

SBP has also started carrying out Shariah compliant Open Market Operations through sale and purchase of Sovereign Ijarah Sukuk. This tool is helpful for SBP in transmission of its monetary policy in more effective manner and also for the Islamic banking industry in managing their liquidity.

Continued growth momentum witnessed by this industry during the last decade was possible because of focused efforts of both industry players and regulator alike as outlined in the blue print drawn in second five-year Strategic Plan of Islamic banking industry 2014-18, we developed in consultation with the stakeholders.

Moreover, SBP with the support of government of Pakistan and Department for International Development, U.K. has established Centers of Excellence in Islamic Finance Education (CEIFEs) in well reputed universities i.e. Institute of Business Administration (IBA), Lahore University of Management Sciences (LUMS) and Institute of Management Sciences (IMSciences) in three different cities. The centers are likely to be instrumental in enhancing capacity building for Islamic banking industry and also in producing useful research work to facilitate Shariah compliant financial innovations.

ICMAP: What do you think are the main challenges faced by the Islamic banking industry in Pakistan? What role SBP is playing in helping the industry to meet these challenges.

AMW: Islamic banking is a developing sector, this sector faces a number of challenges. At present, one of the significant challenges of Islamic banking is lack of liquidity management instruments. There is dire need of regular supply of sovereign domestic Sukuk. In this regard, SBP and Islamic banking industry are actively exploring the feasibility of various Sukuk structures.

As the industry is growing rapidly, so is the need for quality human resource and public awareness, and SBP is fully aware of the importance of this challenge. Towards this front, SBP frequently conducts and supports holding of seminars, conferences, targeted programmes and focused discussions for business community, academia, bankers, policy makers, Shariah scholars and public in general. The training arm of SBP i.e. National Institute of Banking and Finance has been successfully running series of specialized short to medium term certificate courses. Support from international organizations like Islamic Research and Training Institute and Islamic Financial Services Board is also being leveraged for this purpose. We have also started holding Islamic banking training programs for students of Madaris to meet the current and future needs of industry of Shariah scholars having basic understanding of banking and finance. The CEIFEs established

at IBA, LUMS and IMSciences are also expected to make major contributions for capacity building in the days to come.

In the last decade, Islamic banking industry has made substantial growth yet I would like to mention that this rapid growth and enhanced outreach needs to be complemented with innovation in product development to meet the dynamic needs of the market. In this regard, the industry must increasingly invest on research initiatives; on their own and also in collaborations with CEIFEs and other universities.

Despite challenges faced by the industry, we are very optimistic about the future of Islamic banking in Pakistan especially given the resolve of the present government which is complimenting the regulator's efforts. Government's commitment towards the sustainable growth of this industry is evident from the premise that in 2013 it constituted a national level Steering Committee to develop concrete recommendations for the promotion of Islamic banking in the country. The Steering Committee has submitted its comprehensive recommendations while to execute these recommendations an Implementation Committee has been formed.

ICMAP: Does the State Bank encourage Islamic banks to utilize their surplus equity to fund infrastructure development projects in Pakistan, especially in context of CPEC?

AMW: It is believed that the distinction Islamic banks can make, is through their direct linkage with the real economy. A number of Islamic financing modes are considered relatively better fit for designing products for financing infrastructure and industrial development projects. SBP has always encouraged IBIs to capitalize on their innate strength of financing such transactions especially given their ample liquidity position. The US \$ 51 billion worth of domestic infrastructure projects conceived in connection with CPEC open-up huge potential market for Islamic banking industry. Islamic banking industry has been represented at various forums related to CPEC.

Government of Pakistan has shown interest in Sukuk issuance for meeting various developmental and infrastructure needs of the country particularly those related to CPEC projects. It is high time for the Islamic banking industry to aggressively take steps to capitalize on potential gains from this big opportunity.

ICMAP: The Islamic Finance industry lacks professionals and desired skills. How ICMA Pakistan can help the SBP in meeting this shortage of specialized HR for Islamic finance industry?

AMW: Capacity constraints of the industry, mainly in view of its potential growth is one of the significant challenges confronting the industry in times to come. The industry particularly lacks behind in terms of having sufficient number of professionals like accountants, lawyers and Shariah scholars having adequate understanding and knowledge of Islamic financial system. ICMA can play its role in not only acquainting their students with concepts of Islamic banking but also equipping them with knowledge about Islamic banking products and operations. As ICMA has already launched a diploma in Islamic finance; we look forward to seeing a dedicated course of Islamic banking and finance in its flagship program. SBP has been supporting academic institutes across Pakistan for designing and conducting training programs and



awareness sessions. We would also be happy to collaborate with ICMA and other stakeholders for initiatives which could positively contribute towards the growth of the industry.

ICMAP: How do you see the role of Management Accountants in bringing operational efficiency in Pakistani banks and also cost effectiveness in financial products offered to customers?

AMW: With an ascend of stringent regulatory regimes (post-crises), traditional Cost & Management Accounting techniques like cutting costs, optimal controls & efficiencies, effectiveness in product designing etc. have largely been superseded by stringent regulatory standards and the resulting risk-based approaches, regulatory risk limiting, balancing risk and performance in ever-accelerating technologically and managerially complex financial industry. Whereas, management accounting methodologies and approaches couldn't be thrived accordingly. However, recently the advancement in management accounting techniques like total quality management, implementation of robust internal controls, a supporting risk management roles such quantifying objectives and outcomes of events, performance measurement methodologies, effective costing of risk management processes, designing of optimal controls to minimize costs of financial products & services etc. are now accepted key developed technical expertise of the management accountants. While banking industry seems to be interested in employing these techniques to gain competitive advantage and to comply regulations.

Therefore, I see a major role of Management Accountants in financial services but there is a need to create awareness in the industry regarding the potentially value adding roles of Cost & Management Accountants.

ICMAP: In what specific areas, do you think SBP and ICMAP Pakistan can work together for the betterment of national economy, especially in advisory roles at different regulatory institutions?

AMW: I believe that ICMAP is already playing very important role in betterment of economy by providing quality financial and business knowledge to our professionals and business leaders of the future. ICMAP also provides valuable suggestions and feedback to the government on budget,

taxation and other important macroeconomic issues. However, there is always room for more collaboration for national cause. ICMAP may take initiatives to provide training seminars to professionals and SBP officials on latest topics of interest like international accounting standards, Shariah standards and corporate governance. Further, on the initiative of ICMAP, the Securities & Exchange Commission of Pakistan has introduced cost audit rules in some industries; however, this initiative needs to be further expanded to other industries to increase their efficiency and competitiveness. ICMAP can also assist in further enhancing the cost effectiveness of financial services

provided by our banks in order to become more beneficial for customers. SBP already has a collaborative arrangement with Institute of Chartered Accountants of Pakistan and inclusion of ICMAP in the forum can be considered. SBP always encourages collaborative arrangements with professional bodies and concrete proposals forwarded by ICMAP for the benefit of economy in general and financial sector in particular will be welcomed.

The interview ended with a vote of thanks to Mr. Ashraf Mahmood Wathra, Governor, State Bank of Pakistan, who spared his valuable time and gave his candid views exclusively for this Journal - Editor

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