ADB

Completion Report

Project Number: 33271
Loan Numbers: 1955/1956/1957
December 2008

Pakistan: Financial (Nonbank) Markets and Governance Program; Strengthening Pension, Insurance and Savings Systems; Strengthening Regulation, Enforcement, and Governance of Nonbank Financial Markets

Asian Development Bank

CURRENCY EQUIVALENTS

Currency Unit – Pakistan rupee/s

		At Appraisal	At Program Completion
		13 August 2002	3 October 2008
PRe1.00	=	$0.0166	$0. 1740
$1.00	=	PRs60.15	PRs60.54

ABBREVIATIONS

ADB	–	Asian Development Bank
AETP	–	Accelerating Economic Transformation Program
CDC	–	Central Depository Company
CDNS	–	Central Directorate of National Savings
CFS	–	Continuous funding system
CMDP	–	Capital Market Development Program
DFI	–	development finance institution
EA	–	executing agency
EOBI	–	Employees’ Old-Age Benefits Institution
FMGP	–	Financial (Nonbank) Markets and Governance Program
GDP	–	gross domestic product
IA	–	implementing agency
ICAP	–	Institute of Chartered Accountants of Pakistan
IDBP	–	Industrial Development Bank of Pakistan
IFRS	–	International Financial Reporting Standards
IPO	–	initial public offering
KSE	–	Karachi Stock Exchange
LIBOR	–	London interbank offered rate
LSE	–	Lahore Stock Exchange
MOC	–	Ministry of Commerce
MOF	–	Ministry of Finance
NBFI	–	nonbank financial institution
NBFS	–	nonbank financial sector
NCCPL	–	National Clearing Company of Pakistan Limited
NICL	–	National Insurance Company Limited
NSS	–	National Savings Scheme
OTC	–	over the counter
PCR	–	program completion report
PIB	–	Pakistan investment bond
PRCL	–	Pakistan Reinsurance Company Limited
PRG	–	political risk guarantee
SBP	–	State Bank of Pakistan
SECP	–	Securities and Exchange Commission of Pakistan
SGCMRP	–	Second Generation of Capital Market Reform Program
SLIC	–	State Life Insurance Corporation
SOE	–	state-owned enterprise
TA	–	technical assistance
TA1	–	TA Loan to Strengthen Pension, Insurance and Savings Systems

TA2	–	TA Loan to Strengthen Regulation, Enforcement and Governance of Nonbank Financial Markets
TFC	–	term finance certificate

NOTES

(i) The fiscal year (FY) of the Government ends on 30 June.

(ii) In this report, "$" refers to US dollars.

(iii) For an explanation of rating descriptions used in ADB evaluation reports, see: ADB. 2006. *Guidelines for Preparing Performance Evaluation Reports for Public Sector Operations.* Manila.

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CONTENTS

BASIC DATA

A. Loan Identification

1.	Country	Pakistan
2.	Loan Numbers	1955-PAK, 1956-PAK, 1957-PAK
3.	Program Titles	Financial (Nonbank) Markets and Governance Program (FMGP); Strengthening Pension, Insurance and Savings Systems (SPISS); Strengthening Regulation, Enforcement, and Governance of Nonbank Financial Markets (SREGNFM)
4.	Borrower	Islamic Republic of Pakistan
5.	Executing Agency	Ministry of Finance
6.	Amount of Loans	$260,000,000 SDR2,268,000 SDR2,268,000
7.	Program Completion Report Number	PCR:PAK 1096

B. Loan Data

1.	Appraisal	
	– Date Started	13 August 2002
	– Date Completed	25 August 2002
2.	Loan Negotiations	
	– Date Started	7 October 2002
	– Date Completed	9 October 2002
3.	Date of Board Approval	5 December 2002
4.	Date of Loan Agreement	3 March 2003
5.	Date of Loan Effectiveness	
	– In Loan Agreement	3 June 2003
	– Actual	22 April 2003
	– Number of Extensions	0
6.	Closing Date	
	– In Loan Agreement	
	• FMGP	30 June 2006
	• SPISS	30 June 2005
	• SREGNFM	30 June 2005
	– Actual	
	• FMGP	17 May 2007
	• SPISS	24 January 2008
	• SREGNFM	10 September 2007
	– Number of Extensions	
	• FMGP	1
	• SPISS	4
	• SREGNFM	1
7.	Terms of Loan	
	– Interest Rate	London interbank offered rate (LIBOR)-based
	• FMGP	
	• SPISS	
	• SREGNFM	

– Maturity (number of years)

- FMGP 15
- SPISS 32
- SREGNFM 32

– Grace Period (number of years)

- FMGP 3
- SPISS 8
- SREGNFM 8

8. Disbursements

a. Dates

i. FMGP

Initial Disbursement	Final Disbursement	Time Interval
2 May 2003	19 September 2005	28 months
Effective Date	**Original Closing Date**	**Time Interval**
22 April 2003	30 June 2006	38 months

ii. SPISS

Initial Disbursement	Final Disbursement	Time Interval
16 December 2005	24 January 2008	25 months
Effective Date	**Original Closing Date**	**Time Interval**
22 April 2003	30 June 2005	26 months

iii. SREGNFM

Initial Disbursement	Final Disbursement	Time Interval
10 November 2004	10 September 2007	34 months
Effective Date	**Original Closing Date**	**Time Interval**
22 April 2003	30 June 2005	26 months

b. Amount

i. FMGP

Category or Subloan	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
1	**$260,000,000**		**$77,400,000**		**$182,600,000**	
Total	**$260,000,000**		**$77,400,000**		**$182,600,000**	

ii. SPISS

Category or Subloan	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
1	**SDR2,268,000**		**SDR1,263,008**		**SDR1,004,992**	
Total	**SDR2,268,000**		**SDR1,263,008**		**SDR1,004,992**	

iii. SREGNFM

Category or Subloan	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
1	**SDR2,268,000**		**SDR834,770**		**SDR1,433,230**	
Total	**SDR2,268,000**		**SDR834,770**		**SDR1,433,230**	

C. Program Data

1. Program Cost ($)

Cost	Appraisal Estimate	First Tranche	Second Tranche	Actual
FMGP [a,b]				
Foreign Exchange Cost	260,000,000	100,000,000	80,000,000	180,000,000
Local Currency Cost	0	0	0	0
Total	**260,000,000**	**100,000,000**	**80,000,000**	**180,000,000**
SPISS				
Foreign Exchange Cost	2,390,000	0	0	1,915,111
Local Currency Cost	2,110,000	0	0	271,188
Total	**4,500,000**	**0**	**0**	**2,186,299**
SREGNFM				
Foreign Exchange Cost	2,365,000	0	0	2,128,264
Local Currency Cost	2,035,000	0	0	53,623
Total	**4,400,000**			**2,181,887**

TA = technical assistance.
[a] The amount of $77,400,000 was cancelled.
[b] Total amount disbursed was $182,600,000, which is the total tranche amount of $180,000,000 and a front-end fee of $2,600,000 (1% of loan amount).

2. Financing Plan ($)

Cost	Appraisal Estimate	Actual
FMGP		
Implementation Costs		
Borrower Financed	0	0
ADB Financed	260,000,000	182,600,000
Other External Financing	0	0
Total	260,000,000	182,600,000
SPISS		
Implementation Costs		
Borrower Financed	1,500,000	271,188
ADB Financed	3,000,000	1,915,111
Other External Financing		
Total	**4,500,000**	**2,186,299**
IDC Costs		
Borrower Financed	0	0
ADB Financed	100,000	6,394
Other External Financing	0	0
SREGNFM		
Implementation Costs		
Borrower Financed	1,400,000	0
ADB Financed	3,000,000	2,181,887
Other External Financing	0	0
Total	**4,400,000**	**2,181,887**
IDC Costs		
Borrower Financed	0	0
ADB Financed	100,000	29,625
Other External Financing	0	0

ADB = Asian Development Bank, IDC = interest during construction.

3. Cost Breakdown by Program Component (US$)

Component	Appraisal Estimate	Actual
FMGP [a]		
SPISS		
Consulting Requirement	1,849,929	1,908,717
Equipment	304,521	0
Studies/Training	304,521	0
Unallocated	456,110	0
SREGNFM		
Consulting Requirement	1,809,684	1,689,073
Equipment	304,521	366,165
Studies/Training	405,133	43,401
Unallocated	401,109	0

TA = technical assistance.
[a] No cost breakdown by program component

4. Program Schedule

Item	Appraisal Estimate	Actual
FMGP [a]		
SPISS		
Date of Contract with Consultants	22 April 2003 [b]	
1. Aries Group Ltd (Package A)		22 November 2005
2. Aries Group Ltd. (Package B)		22 November 2005
3. Sidat Hyder Morshed Associates (PVT) Ltd		10 November 2005
Other milestones		
1. Cancellation of Undisbursed Balance		24 January 2008
2. Extension of Loan Closing Date		
1st		30 June 2007
2nd		30 September 2007
3rd		31 October 2007
4th		31 December 2007
SREGNFM		
Date of Contract with Consultants	22 April 2003 [b]	
1. International Securities Consultancy		12 October 2004
2. DWP Technologies (PVT) Ltd		13 February 2007
3. Securities and Exchange Commission of Pakistan		06 September 2006
Other milestones		
1. Cancellation of Undisbursed balance		10 September 2007
2. Extension of Loan Closing Date		
1st		30 June 2007

[a] No program schedule

[b] As the RRP has no procurement plan.

5. Program Performance Report Ratings

i. FMGP

Implementation Period	Ratings: Development Objectives	Ratings: Implementation Progress
31 December 2002	Satisfactory	Satisfactory
31 January–31 December 2003	Satisfactory	Satisfactory
31 January –31 December 2004	Satisfactory	Satisfactory
31 January 2005–31 March 2005	Satisfactory	Satisfactory
30 April 2005–30 June 2005	Satisfactory	Partly Satisfactory
31 July 2005–30 September 2005	Satisfactory	Partly Satisfactory
31 October 2005–31 December 2005	Satisfactory	Satisfactory
31 January 2006–31 March 2006	Satisfactory	Satisfactory
30 April 2006–30 June 2006	Satisfactory	Partly Satisfactory
31 July 2006–30 September 2006	Satisfactory	Partly Satisfactory
31 October 2006–30 November 2006	Satisfactory	Partly Satisfactory
1 January 2007–31 December 2007	Satisfactory	Partly Satisfactory

ii. SPISS

Implementation Period	Ratings	
	Development Objectives	**Implementation Progress**
31 December 2002	Satisfactory	Satisfactory
31 January–31 December 2003	Satisfactory	Satisfactory
31 January 2004–31 December 2004	Satisfactory	Satisfactory
31 January 2005– 31 December 2005	Satisfactory	Satisfactory
31 January 2006– 31 December 2006	Satisfactory	Satisfactory
31 January 2007–31 December 2007	Satisfactory	Satisfactory
31 January–31 October 2008	Satisfactory	Satisfactory

iii. SREGNFM

Implementation Period	Ratings	
	Development Objectives	**Implementation Progress**
31 December 2002	Satisfactory	Satisfactory
31 January–31 December 2003	Satisfactory	Satisfactory
31 January 2004–31 December 2004	Satisfactory	Satisfactory
31 January 2005–31 December 2005	Satisfactory	Satisfactory
31 January 2006–31 December 2006	Satisfactory	Satisfactory
31 January 2007–31 March 2007	Satisfactory	Unsatisfactory
30 April 2007–30 June 2007	Satisfactory	Unsatisfactory
31 July 2007–30 September 2007	Satisfactory	Unsatisfactory
31 October 2007–31 December 2007	Satisfactory	Unsatisfactory

D. Data on Asian Development Bank Missions

Name of Mission	Date	No. of Persons	No. of Person-Days	Specialization of Members[a]
Fact-Finding	6–24 May 2002	3	19	a,g,h
Pre-Appraisal	13–25 August 2002	5	13	a,c,g,h
Review Mission	21 April–8 May 2003	2	18	a
Consultation Mission	23–30 April 2004	1	4	a
Review Mission	10–23 June 2004	3	14	a,b
Review Mission	16–27 August 2004	3	12	a,f
Review Mission	1–6 November 2004	6	1	a
Review Mission	28 June–5 July 2005	5	8	a,f,g
Review Mission	9–17 May 2006	2	9	a,f
Review Mission	15–26 January 2007	3	12	a,f,h
Program Completion Review[b]				

[a] a = project officer, b = project analyst, c = senior counsel, d = financial analyst, e = social development specialist, f = Pakistan Resident Mission staff, g = Office of Cofinancing Office staff, h = consultant.
[b] The Project Completion Review Mission was conducted by a staff consultant from 27 October to 29 November 2008.

I. PROGRAM DESCRIPTION

1. On 5 December 2002, the Asian Development Bank (ADB) approved the Financial (Nonbank) Markets and Governance Program (FMGP or the Program). The FMGP includes a (i) program loan for $260 million from ADB's ordinary capital resources;[1] (ii) two technical assistance (TA) loans[2] of $3 million equivalent each—one to strengthen pension, insurance, and savings systems (TA1) and the other to strengthen regulation, enforcement, and governance of nonbank financial markets (TA2); and (iii) two political risk guarantees (PRGs) with counter-indemnity by the Islamic Republic of Pakistan (Pakistan)—one to enhance Pakistan's integration into international capital markets (up to $25 million) and one to improve access to cover for selected political violence-related risks (up to $175 million).

2. The overall goal of the FMGP was to facilitate economic growth and poverty reduction through more efficient financial intermediation and enhanced social protection. The Program intended to achieve this objective by developing the nonbank financial sector (NBFS). The FMGP reform agenda built upon successful completion of the Capital Market Development Program (CMDP)[3] and supported the Government's ongoing financial sector reform efforts. The FMGP had the following key objectives: (i) position Pakistan as a credible financial market for investors by improving investor confidence through better governance, transparency, and risk management; (ii) broaden and increase market depth by strengthening secondary market activity and encouraging safe, efficient investments by pension funds and the insurance industry; and (iii) diversify bank intermediation and reduce financial sector and fiscal vulnerabilities.[4] This program completion report provides an overview and a preliminary evaluation of initial impacts and benefits of the FMCP.

II. EVALUATION OF DESIGN AND IMPLEMENTATION

A. Relevance of Design and Formulation

3. The FMGP was formulated in close consultation with the Government and reflected the Government's priority to stimulate investment and savings by addressing investor concerns and ensuring that the benefits, in terms of new employment opportunities and more effective social sector spending, trickle down to the poor. These priorities and the Government's related development agenda were incorporated into ADB's country strategy and program for 2002–2004, which focused on poverty reduction through private sector-led pro-poor economic growth, social sector development, and improved governance.[5] Within this agenda, the financial sector was viewed as having an important role to play in increasing resource mobilization, improving the efficiency of resource allocation, enhancing access to financial products and services, contributing to the sustainability of social safety nets, and safeguarding economic stability.

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[1] ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan to the Islamic Republic of Pakistan for Financial (Nonbank) Markets and Governance Program* Manila. (Loan 1955-PAK).

[2] ADB. 2002. *Technical Assistance Loan to the Islamic Republic of Pakistan for Loan for Strengthening Pension, Insurance and Savings Systems*. Manila (Loan 1956-PAK; TA1); and ADB. 2002. *Technical Loan Assistance to the Islamic Republic of Pakistan for Strengthening Regulation, Enforcement and Governance of Nonbank Financial Markets* (Loan 1957-PAK; TA2).

[3] ADB. 2002. *Program Completion Report on the Capital Market Development in Islamic Republic of Pakistan.* Manila. The CMDP was approved on 6 November 1997 for $250 million and implemented over 4 years.

[4] ADB. 2002. *Report and Recommendation of the President on Proposed Loans and Guarantees for Financial (Nonbank) Markets and Governance Program.* Manila.

[5] ADB. 2002. *Country Strategy and Program 2002–2004: Pakistan.* Manila.

4. The FMGP was designed as a comprehensive effort that focused on almost all aspects of NBFS development in Pakistan, and built on and expanded long-standing ADB initiatives in the capital market.[6] Program objectives were to be achieved through policy, governance, institutional, and operational reform. The Program covered equity markets, debt and money markets, contractual savings, and other nonbank financial institutions (NBFIs) and services. It recognized that while most of the key regulatory and technological infrastructure has been put in place, investment has not followed. To attract and retain investment, the FMGP included reforms on both the supply (new products) and demand (institutional investors) sides, supported by an improved investment climate. The program design, based on extensive discussions with the Government and other key stakeholders, and supported by ADB TA, was relevant.

B. Program Outputs

5. The FMGP included five key outputs, with 42 policy conditions (with 97 sub-conditions) to be released in two tranches. The first tranche had 24 conditions (40 sub-conditions) and the second tranche had 18 conditions (57 sub-conditions), including an incentive tranche. Policy actions under the Program and their implementation status are in Appendix 1.

1. Improvement of Fiscal, Interest Rate, and Investment Policy Environment

6. To strengthen demand for financial instruments, reforms focused on continued rationalization of the tax treatment for financial instruments. While good progress was made, momentum in several areas was not sustained after the first tranche. For example, to address the high cost of issuing corporate debt, the FMGP included an action to reduce stamp duties on corporate paper to internationally competitive rates. However, such reduction required provincial government support, which did not materialize during the Program. Under a follow-on capital market development program (Second Generation of Capital Market Reform Program or the SGCMRP),[7] the provincial government in Islamabad Capital Territory reduced stamp duties on corporate bonds.

7. To promote longer-term savings and discourage speculation, a second tranche condition required the capital gains tax exemption to be extended for investments held for more than 6 months. While amendments to the Finance Act 2004 extended this exemption to June 2007 regardless of the holding period, a capital value tax was imposed to discourage speculative transactions—undermining the policy objective. Under the SGCMRP, the Government agreed to introduce a withholding tax on securities market turnover, which is easier to levy and more feasible under Pakistan's conditions than capital gains taxation on income from short-term investment in shares. ADB continues to engage in policy dialogue with the Government to address the Government's concerns with short-term speculative trading in a manner that does not discourage long-term investment.

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[6] This included economic and sector work, and operational programs and advisory TA to develop the capital market and supportive institutions, including regulatory bodies. The first phase of capital market reforms was implemented successfully over 1997–2000 under the CMDP, and was carried out under a difficult economic environment. The main achievement of the CMDP was the establishment of a more independent and effective regulator, improvements in market infrastructure, improvements in investor protection, and development of the primary corporate debt market. This program established a good basis for further market development. See ADB. 2002. *Project Completion Report on the Capital Market Development Program Loan and Capacity Building of the Securities Market in Pakistan.* Manila. The CMDP also included policy reforms in the insurance sector.

[7] ADB. 2007. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Loan and Technical Assistance Grant to the Islamic Republic of Pakistan for the Second Generation of Capital Market Reform Program*. Manila (Loan 2340, for $400 million).

8. Another second tranche action that was not fully met required the National Savings Scheme (NSS) and the Central Directorate of National Savings (CDNS) to improve their governance structure and administration to enhance their efficiency and effectiveness. With support under TA1, the Government announced the transformation of CDNS into a commercial entity and prepared the draft Savings Act, 2004. However, privatization of CDNS requires presidential approval. Under TA1, consultants recommended options for transition of the NSS into a fully funded system, which the Government is still reviewing and no decision has been made. Under TA1, consultants assisted the Government to develop a software solution to computerize collections, which was supposed to be implemented during the second tranche. Additional time was needed to pilot test and roll out the new system.

2. Improvements in Governance, Transparency, and Investor Protection

9. Reforms to enhance investor confidence built on earlier reforms under the CMDP and helped to raise governance standards, improve transparency in information disclosure, and improve enforcement. With the help of TA2, good progress was made by the SECP in terms of preparing draft legislation and adopting new regulations.[8] However, the FMGP envisioned the adoption of a new legal framework for the NBFS, which depended on enactment of laws by parliament. This was outside the control of implementing agencies (IAs). ADB continues to engage in policy dialogue with the Government to clarify the status of these reforms and to address new development challenges and market risks. Ongoing initiatives in this area have been included in the SGCMRP and the recently approved Accelerating Economic Transformation Program (AETP).[9]

10. Good progress was made in improving governance of the Securities and Exchange Commission of Pakistan (SECP), which recruited 63 new staff with expertise in accounting, law, and information technology. A new unit for monitoring and inspection of NBFIs was established with 27 authorized positions, of which 23 are new positions. A unique identification number for every person who holds shares and trades on the market was also introduced—providing a powerful tool for detecting market abuse. SECP's monitoring of trading in real time using state-of-the-art technology and prohibition on insider trading has also been strengthened. Stock exchanges plan to adopt similar technology to replace the manual system for detecting market abuse. However, outstanding vacancies in SECP's board have undermined its governance reforms. SECP's board comprises seven commissioners, four of whom should be from the private sector. These positions are currently vacant—the board currently has only three commissioners, including the chairman.

11. Under the FMGP, corporate governance standards for market participants have improved. A new Code of Corporate Governance was adopted and it applies to both listed companies and non-listed financial institutions, including development finance institutions (DFIs) and non-listed insurance companies (State Life Insurance Corporation or SLIC, National Insurance Company Limited or NICL, and Pakistan Reinsurance Company Limited or PRCL). Improved enforcement mechanisms for companies found in violation of the code have also been put into place and are being implemented. SECP has imposed fines and sanctions on companies for failing to hold general meetings, circulate quarterly accounts in a timely manner, present true and fair financial statements, and maintain proper records. SECP has also imposed

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[8] In addition, as envisioned under the Program, the Securities and Exchange Commission of Pakistan (SECP) did not prepare amendments to the Companies Ordinance to transfer selected powers of high courts over companies, based on the need for additional consultations with new stakeholders.

[9] ADB. 2008. *Report and Recommendation of the President to the Board of Directors on a Proposed Program Cluster and Loans for Subprogram 1 to Pakistan for Accelerating Economic Transformation* (Loan 2446, for $500 million).

fines against auditors for failing to state material facts about companies' affairs or providing untrue statements in the audit report. Stock exchanges now require listed companies to disclose in their annual report that they comply with the code or state the reasons for noncompliance.[10] Karachi Stock Exchange (KSE) has also set up a board committee on corporate governance and a unit in the Company Affairs Department to monitor compliance with the code.

12. To improve quality of information disclosure, SECP and the Institute of Chartered Accountants of Pakistan (ICAP) have adopted new requirements and procedures under which the accounts of listed companies are to be certified and audited under international standards. ICAP also adopted a code of ethics based on international standards for the accounting and auditing industries. SECP worked with the stock exchanges to ensure that ICAP is monitoring and enforcing ICAP member compliance with these new requirements.

13. To improve governance of stock exchanges and promote greater efficiency and effectiveness of the local capital market, the FMGP included demutualization of the three stock exchanges. However, this has been delayed based on the need for additional consultation to build stronger ownership of reforms. Notwithstanding, during the FMGP, the Islamabad Stock Exchange (ISE) and the Lahore Stock Exchange (LSE) submitted a plan for integration and demutualization to SECP, including implementation steps and a time frame. KSE submitted a separate plan to SECP. With support under TA2, SECP worked closely with the stock exchanges to develop a framework under draft legislation for regulating demutualized stock exchanges, which was approved by the Cabinet and sent to Parliament for approval. TA2 also helped SECP prepare guidelines for market operations in a demutualized environment. To enhance market efficiency, SECP adopted an enabling framework for an over-the-counter market and for dispute resolution between brokers and investors, and developed and implemented a number of capacity building initiatives.

14. With support under TA2, good progress was made to improve the risk management practices of securities market intermediaries. SECP, in cooperation with the stock exchanges and the State Bank of Pakistan (SBP), adopted and began implementing an action plan aimed at phasing out carryover transactions (*badla* financing), which included the adoption of regulations and a system for margin financing to replace *badla.*[11] To promote margin financing, SECP and SBP established a committee comprised of representatives from SECP, SBP, stock exchanges, banks, and brokers, to suggest ways to improve operational interface among banks, brokers and clients and enhance investor awareness on margin financing. Based on the committee recommendations, SECP issued a regulation to enable the creation of a continuous funding system (CFS). The CFS regulation set a cap on the amount of margin financing and included rules regarding the duration of the margin period and type of securities suitable for margin financing. Recently the CFS Mark II facility was developed. Currently there are 71 scrips available for CFS and the funding cap is set at PRs, 55 billion for KSE, PRs 10 billion for the LSE, and PRs 5 billion for the ISE. This facility enables brokers to profit both from leveraging their exposure to the market by using it as a source of funds for rolling over settlement until the 23rd business day after execution of the trade, and earning high returns by making funds available through the facility to finance transactions of brokers and clients who are accessing

[10] The Corporate Governance Code is currently under review to update it and bring it into closer alignment with international best practices. Listed companies continue to have a high concentration of ownership and a low level of free float, which is compounded by the buy and hold investment strategy pursued by local institutional investors.

[11] *Badla* is an informal source of financing for short-term trade related transactions based on the sale and repurchase of an asset that serves as collateral. It allows trades to be carried forward. Settlement of trades can be extended indefinitely, delaying delivery to the individual investor. This can result in settlement failures. See ADB. 2008. *Special Evaluation Study on ADB Assistance for Domestic Capital Market Development*. Manila. In contrast, in margin financing, a client pays only part of the amount due from him toward his purchase obligations

the facility. However, settlement can be extended indefinitely by continuing to roll over the financing through the CFS — raising risk concerns.[12] The CFS Mark II is administered by the National Clearing Company of Pakistan Limited (NCCPL) and provides greater transparency, has an elaborate risk management system that has stood up well to declining market conditions, and enables banks and NBFIs to participate directly as financiers.[13]

15. SECP effectively coordinated the development of an enabling framework for the establishment of a derivatives market. The National Commodity Exchange Limited issued operational rules in March 2005 and put in place trading, clearing and settlement, and risk management systems. KSE also launched a new index futures contract—the KSE-Futures.

16. Since January 2004, all securities in the Central Depository Company of Pakistan Limited (CDC) have been cleared through the NCCPL with a fully automated pay and collect system; and online linkages between selling banks, NCCPL, and CDC. NCCPL has been posting information on its website regarding the daily value and volume of settlement of each security since January 2005. In addition, each client is required to use a unique global identification number that provides a traceable link between every order entered into the stock exchange trading system and the person on whose behalf the order was placed. As a result of these reforms, which effectively move to a dematerialized model for the transfer of securities, the majority of companies have joined CDC and 98% of securities traded on stock exchanges are settled through CDC. This is a significant achievement.

17. SECP and CDC successfully implemented reforms to enable the development of stock lending and borrowing. SECP issued stock lending and borrowing regulations, and CDC begun implementing an action plan to set up a stock lending and borrowing facility.

18. To raise the professionalism of market participants, the Pakistan Institute of Corporate Capital Markets was established and a chief executive was recruited under the FMGP. The Institute conducts various licensing examinations leading to certifications for different segments of the capital market and also provides a platform for research and development, exchange of ideas, and consulting services on capital market issues. SECP also held seminars and workshops to support enhanced corporate governance for directors, senior management, market participants, and investors. SECP has also worked closely with the stock exchanges and other training providers that promote capital market development and investor education. Other market institutions are also providing training in the area of accounting and analysis and margin finance.

19. While these reforms have helped to improve investor confidence, the current economic and political situation in Pakistan, combined with the global credit crisis, have resulted in a significant outflow of foreign portfolio investment. The KSE-100 index has dropped by more than 40% and market capitalization has fallen to $37 billion (from $70 billion). To arrest the sudden decline in share trading prices, the KSE has imposed a price floor on all stocks, which has resulted in historic lows in trading volume.

[12] This could allow speculation in a boom market with cheap funding to finance such speculation.

[13] Broker participation in CFS continues to impede market development—it facilitates market manipulation, discourages new listings, and makes the market unattractive to investors. The overexposure to the market by some brokers and their clients, and the possibility of their failure to meet mark-to-market margin calls in the CFS Mk II are said to have contributed to KSE's decision to impose a floor on the exchange.

3. Increase in the Supply of Financial Instruments and Improvements in Market Infrastructure

20. Good progress was made in increasing the supply of investment products, with a focus on new capital market issues, introducing new financial instruments, and increasing secondary market activity and liquidity. To improve the supply of equity issues through privatization, the Privatisation Commission has successfully floated the shares of 10 state-owned enterprises (SOEs) in five sectors (oil and gas, power, manufacturing, banking, and transport) since FY2003, which exceeded the policy action objective of floating five SOEs in three sectors. As a result, market capitalization of KSE increased by about 35%. Shares floated included Attock Refinery Limited, Oil & Gas Development Company Ltd, Sui Southern Gas Company Limited, Pakistan Petroleum Limited, Kot Addu Power Company Limited, D.G. Khan Cement Company Limited, Habib Bank Limited, United Bank Limited, National Bank of Pakistan, and Pakistan International Airlines.[14]

21. To improve activity in the secondary debt market, SBP developed a benchmark government bond yield curve by issuing bonds for 3, 5, 19, 15, 20 and 30-year periods. SBP also introduced a system for primary dealers, under which they are appointed every year to function as market makers in government securities. For FY2008, there are nine designated primary dealers, including an investment bank and eight commercial banks.[15] In February 2004, SBP instructed banks and DFIs to use the Karachi Inter-Bank Offered Rate as a benchmark rate for pricing Pakistan rupee loans, term finance certificates, and commercial paper. To stabilize yields and improve secondary market activities, the Pakistan investment bond (PIB) auction calendar is announced regularly, and has been held quarterly since 2005. However, issuance of wholesale securities remains unpredictable. While treasury bills are issued fortnightly, an issuance calendar for PIBs with tenors of 3–30 years was introduced only during the current fiscal year. In treasury bill and PIB auctions, bid acceptance is yield-driven as opposed to volume-driven. The full announced volume of PIBs of each tenor is rarely issued at each auction. SBP also applies cutoff yields in treasury bill auctions to prevent the clearing yield from exceeding SBP's discount rate. To enhance transparency and information disclosure, government bond price and yield information has been posted on SBP's website since November 2004. To widen the scope of potential investors to provident and gratuity funds, SECP issued guidelines for issuance and investment in commercial paper in September 2004. SBP issued similar guidelines for banks and DFIs.

4. Increase in Demand for Financial Instruments through Development of Contractual Savings and Institutional Investment

22. This component sought to improve the policy, governance, and supply side; and provide the foundation for growth of institutional investors in Pakistan. While reforms to increase the role of private pension schemes have been successfully implemented and are ongoing, reforms relating to public pensions and the state-owned insurance industry have lagged based on lack of consensus among key stakeholders to increase private sector participation in these institutions. Under TA1, consultants reviewed the overall pension system in Pakistan and recommended to Ministry of Finance (MOF) and the Pay and Pension Committee to consider a shift toward a multi-layered pension approach providing pensions for the whole society, combining a basic citizen's pension with the existing defined benefit and defined contribution pensions. With respect to the Employees' Old-Age Benefits Institution (EOBI), a large government institutional investor, TA1 consultant recommendations included the need to

[14] In January 2007, the second offer for sale of shares of Oil & Gas Development Company Ltd. was made—the off-loading of these shares resulted in an increase in market capitalization of more than 40%.
[15] http://www.sbp.org.pk//FSCD/2008/C9.htm

outsource investment management to the private sector with well-defined guidelines and controls, improve administrative procedures, and align its performance structure to enable the recruitment and retention of professionals with relevant experience. Reforms within SLIC have been very challenging to implement based on weaknesses in the Insurance Ordinance—this assigns a number of regulatory functions to the Ministry of Commerce (MOC), which has a conflict of interest as both the operator of an SOE and the regulator. TA1 consultants recommended that SLIC strengthen its investment management, international administrative processes, and field office operations.

5. Strengthen Financial Services and Institutions

23. Progress under this component of the FMGP was mixed and generally poor. It sought to strengthen the NBFS by improving the regulatory framework through consolidation of this highly fragmented subsector, and through the development of new financial products. While SECP drafted prudential regulations for NBFIs, concerns arose regarding SECP's legal mandate to regulate the NBFS. These regulations were not adopted during the Program, but SECP's legal mandate was clarified under the SGCMRP and the regulations were adopted.

24. Actions promoting the reduction of government dominance in DFIs and the insurance sector were not completed. While the Government was able to restructure the Industrial Development Bank of Pakistan (IDBP), a DFI, into a public limited company in preparation for privatization under the first tranche of the FMGP, IDBP was not privatized under the second tranche. SBP has adopted a plan for privatizing IDBP, but market conditions for privatization have not been favorable.

25. Reform of public sector insurance has also been very slow. While the compulsory cession to PRCL was eliminated in December 2004, and PRCL subsequently submitted a plan to MOC to phase out first refusal cession entitlement, NICL's monopoly has not been reduced. MOC has agreed to transfer NCIL's commercial operations to Alpha Insurance Company Ltd. SLIC continues to retain a monopoly in the life insurance, although its market share has decreased from 81% in 2002 to 71% in 2006.[16] While the cabinet has approved an initial public offering of SLIC shares (10%), divestment has to be carefully planned, given SLIC's dominant market position and hidden reserves. TA1 consultants conducted a valuation of SLIC's hidden reserves and recommended privatization modalities. They also prepared a detailed proposal and draft action plan to convert SLIC into a company and remove government guarantees for SLIC's liabilities under the Life Insurance Nationalization Order, and draft new legislation or amendments to existing legislation, as needed. Based on report recommendations, MOF and MOC adopted a time-bound action plan for restructuring and corporatizing SLIC.[17] Under this plan, MOC plans on registering SLIC as a company and publicly offering 10% of its shares. MOC is waiting for the market to stabilize before proceeding with this sale.

C. Program Costs

26. ADB supported the Program with a $260 million loan from its ordinary capital resources. The loan was intended to finance the costs of structural reforms initiated under the Program including (i) revenue shortfalls caused by harmonization of tax structures, selected tax

[16] State Bank of Pakistan. Financial Stability Review. 2006.

[17] ADB. 2002. *Technical Assistance to the Islamic Republic of Pakistan for Enhancing Access to Comprehensive Insurance Cover After September 11*. Manila (TA 4033-PAK) outlined an approach for transferring public sector insurance entities' business to the private sector. Report recommendations were shared with MOC, SECP, and MOF. This TA also outlined a reform proposal for Postal Life Insurance, which was presented to the Ministry of Communications.

incentives, and adjustment in interest rate structures; and (ii) restructuring and development of government-owned institutions.

27. Two TA loans for a total of $6 million equivalent were provided for capacity building associated with the Program from ADB's Special Funds resources. TA1 was provided by ADB for $3 million equivalent (SDR2,268,000) to improve Pakistan's pension system and strengthen the capacity of key government institutions in the mobilization and management of contractual savings. TA2 was financed in the amount of $3 million equivalent to support the sound and sustainable development of the NBFS, application of proper risk management practices, and protection of investors and policyholders.

D. Disbursements

28. Loan proceeds were withdrawn in accordance with ADB's standard disbursement procedures and used exclusively to finance the full foreign exchange costs of items produced in and procured from ADB member countries, other than those specified in the negative list. Goods imported from the Hong Kong made up the largest share of imports, followed by USA, and Pakistan. Appendix 8 provides the list of contracts awarded to member countries under TA1 and TA2.

E. Program Schedule

29. The loans became effective on 22 April 2003. The first tranche of the program loan ($100 million) was released on 2 May 2003. The second tranche was scheduled to be released in two installments. The incentive tranche of $80 million was released on 19 September 2005, almost 2 years after the originally scheduled release date. The final release ($80 million) was cancelled due to lack of progress particularly in the insurance sector and policy actions were incorporated into the SGCMRP. Implementation of TA2 was delayed based on the absence of an SECP chairperson for more than 8 months—delaying consultant mobilization for 18 months from the originally targeted date. The TA closing date was thus extended by 24 months to 30 June 2007. Implementation of TA1 was delayed based on difficulty obtaining agreement from institutions involved in the reform initiatives. The contracts were awarded to two international consultancy firms in November 2005 and the TA closing date was extended by 30 months to 31 December 2007.

F. Implementation Arrangements

30. Overall, implementation arrangements were partly satisfactory. MOF acted as the Executing Agency (EA) for the FMGP. It coordinated and monitored the Program and administered the utilization of loan proceeds. Support to MOF was provided by SECP on matters relating to implementation of all conditions and program components within its regulatory and development mandate. MOF and SECP agreed to ensure effective coordination through existing mechanisms with other concerned agencies, including MOC, Ministry of Labor, Privatisation Commission, SBP, and the private sector as appropriate. However, delays in appointing a new SECP chairperson slowed down program implementation and coordination with other concerned agencies was not effective on a number of conditions.

G. Conditions and Covenants

31. The Program included 42 policy actions (97 sub-conditions), of which 24 (40 sub-conditions) were complied with at the time of loan approval by ADB's Board of Directors. A total of 18 policy actions were specified as conditions for second tranche release. To provide an

incentive for early compliance with the second tranche, an incentive release under the second tranche could be made as soon as any nine of the release conditions were met. In September 2005, the incentive tranche was released against the fulfillment of nine conditions (26 sub-conditions). Significant delays arose in connection with fulfillment of the remaining tranche with nine policy conditions (31 sub-conditions). Several conditions depended on actions outside of the control of the EA and IA, such as legislation, or required further consultation to develop stronger consensus among key stakeholders (demutualization, public pension system), and detracted from other significant reform achievements under the Program. Unfortunately, this essential consensus was found lacking. In view of the difficulties experienced, the Government asked ADB to cancel the remaining tranche. It was agreed that a more carefully targeted approach was needed. ADB later processed the SGCMRP to target reforms within the control of SECP.

32. Preparation of quarterly progress reports were not in line with the stipulated program covenants, and the Borrower did not submit a program completion report until the finalization of ADB's Program completion report. Most of the reporting was done directly by SECP with respect to actions under its purview. MOF collaborated with ADB review missions and, together with the IAs, provided all necessary data—including an updated assessment of compliance with the second tranche release conditions and a final assessment of the Program. Reports by SECP were generally provided on time, and the Program was implemented with oversight from ADB staff that made frequent visits and maintained policy dialogue throughout implementation.

H. Related Technical Assistance

33. TA1 sought to strengthen the policy framework for pensions as well as the institutional capacity of key government institutions involved in the management of pensions, insurance, and savings. The loan included five components: (i) establishment of an overall framework for pension provision, (ii) financial assessment of the civil and military pension scheme, (iii) institutional reform and strengthening of EOBI, (iv) capacity building for investment management in SLIC, and (v) institutional reform and strengthening of CDNS. TA1 was executed by MOF and implemented in coordination with other ministries, including MOC and the Ministry of Labor. The cost of the TA was estimated to be $4.5 million equivalent. Agreement on the scope of the three TA components required lengthy coordination since the components involved a number of institutions and addressed fundamental sector and institutional reforms. The delay in the bidding process resulted in delayed mobilization of consultants.

34. TA2 was aimed at strengthening standards and enforcement capacity for corporate governance, transparency of information disclosure, and sustainable risk management to improve protection of investors and policyholders. It included four components: (i) further improvement of legal and regulatory frameworks; (ii) capacity building of SECP, with particular attention to the enlarged mandate for regulation and supervision of NBFIs, insurance, and pensions; (iii) support for the restructuring of stock exchanges; and (iv) establishment of sustainable mechanisms for skills development and training. SECP was the IA.

I. Consultant Recruitment and Procurement

35. Under TA1, an international and a national firm were contracted in accordance with *ADB's Guidelines on the Use of Consultants* by ADB and the Borrower (ADB Guidelines) to provide consulting services for 91 person-months. The $3 million equivalent did not include any procurement of hardware or software. Recruitment of the consultants was delayed for 31 months because of difficulties in coordination among several agencies. Consultants did not start

work until November 2005, which required extension of the closing date by 30 months to 31 December 2007.

36. Under TA2, an international consulting firm and a national firm were contracted under ADB Guidelines to provide consulting services for 88 person-months. Of the $3 million equivalent, $0.37 million was allocated for procurement of hardware and software for SECP. The term of the IA (SECP) chairperson expired on February 2003 and the new chairperson did not assume office until November 2003. This delayed the bidding process and consultants under the loan did not start work until October 2004. Related reform outputs were thus delayed by 18 months. Delayed implementation required an extension of the closing date by 24 months to 30 June 2007.

J. Performance of Consultants

37. **TA1**. The performance of the consultants was satisfactory. Good efforts were made by the experts to consult the IAs. The consultants possessed the capacity to provide solid technical advice as well as flexibility to meet the client's needs. The training provided by the experts to develop broader understanding of best practices in development of sustainable and inclusive pension, insurance, and savings schemes clarified policy options and actions needed to address current gaps and viability concerns.

38. **TA2**. The performance of the consultants was satisfactory. Good efforts were made by the experts to consult SECP. Overall, the consultants possessed the capacity to provide solid technical advice as well as flexibility to meet the client's needs. The capacity building provided to SECP staff helped increase knowledge in the regulation and supervision of capital markets, NBFIs, insurance, and pensions—with a focus on enforcement and supervision. Capacity building was supported by comprehensive training provided by the experts.[18]

K. Performance of the Borrower and the Executing Agency

39. MOF was proactive in the process of implementing reforms. Meetings were regularly held at MOF for reviewing and monitoring the progress of implementation and for resolving outstanding issues. MOF showed commitment to policy reforms and senior officials were generally available for policy discussions with ADB staff. MOF also met loan administration requirements and its performance was satisfactory. In more politically sensitive areas of reform involving different government authorities, MOF's role was limited to that of a mediator. Further, MOF has continued to suffer from low technical capacity in capital market and NBFS reforms, not commensurate with the role it has assumed in policy oversight at SECP, for instance. Significant capacity building is needed to enable MOF to be more proactive on the policy front. However, the absence of strong government leadership in a number of key policy reform areas (public pensions, insurance) slowed down the pace of reform momentum, release of the incentive tranche, and cancellation of the final tranche.

40. While SECP provided quality support to MOF, the absence of a chairperson during program implementation delayed reform implementation. SECP effectively liaised with the three

[18] Training was provided in the following areas: market intermediaries (qualifications), professional development, capital market operations, electronic market surveillance, reinsurance, financial reporting, insurance regulation, index futures contracts, derivatives, on-site inspections, life and nonlife insurance, mutual funds and pension funds, life insurance basics, fixed income markets, money market instruments and trading, insurance regulation, investment banking, clearing and settlement (risks), insurance accounting, leasing, margin financing, securities borrowing and lending, voluntary pension systems, internet trading, and capital adequacy—which was useful in building the regulatory capacity of staff.

stock exchanges in executing structural reforms, and coordinated effectively with other stakeholders in the capital market for implementing difficult policy actions. However, with regard to demutualization, additional time was needed to build consensus. There remains sufficient scope for institutional strengthening of SECP to reflect its broadened mandate (insurance, pension, and NBFI sectors). SECP's commitment to the Program was instrumental in maintaining the momentum of reforms during the 4 years of program implementation. This is reflected in the follow-up SGCMRP. Support given by other IAs was more limited. Overall, however, the Government's performance was partly satisfactory, as commitment for reforms declined over time in NBFS reforms.

L. Performance of the Asian Development Bank

41. ADB's performance during the Program was partly satisfactory, although ADB staff overseeing the Program provided regular monitoring of program actions. From 2003, seven review missions were fielded totaling 110 person-days. Each visit closely monitored the status of program implementation, identifying impediments and engaging government counterparts in intensive discussion on measures to resolve them within the given time frame. Through program implementation, ADB established a close working relationship with key program counterparts. ADB responses to the Government were generally timely, and approvals and disbursements were undertaken promptly. Significant efforts were made to support capacity building of SECP, an integral component of the Program, by administering TA2 flexibly. ADB staff played a crucial role in advancing policy dialogue, and supported implementation of several reform components. However, given the broad and complex agenda of reforms under the Program and ADB resource constraints, additional technical inputs could have further facilitated resolution of sensitive and multifaceted policy issues.

M. Political Risk Guarantees

42. The PRGs were included in the FMGP to strengthen confidence for overseas investors by helping to mitigate political risks, including terrorism. The PRGs guarantee repatriation of proceeds from investments in debt instruments, including listed corporate bonds, corporate commercial paper, and government paper; and guarantee payment of a certain amount to a guaranteed party in case terrorism or other political violent risk occurs. The PRGs also create cross-border political risk-taking capacity, focusing on currency inconvertibility and transfer risk; and enable vital investments and infrastructure projects in Pakistan to be insured comprehensively and maintain their financial sustainability. The ADB guarantee facility enables individual PRGs to be issued on a case-by-case basis, and pricing will be market-based. Notwithstanding the strong interest in this product during FMGP processing, the PRG facility was not utilized during the Program. After the FMGP was approved, there was no marketing of the PRG facility by ADB. Demand for this product appeared to have declined based on a decrease in country risk after Program approval, as evidenced by increased flows of investment, including the funding of infrastructure projects.

III. EVALUATION OF PERFORMANCE

A. Relevance

43. The FMGP is rated partly relevant. While the program design was consistent with the Government's development strategy, ADB's lending strategy for Pakistan, and ADB's strategic objectives in Pakistan at the time of loan approval, the scope was too broad and related policy actions were too ambitious. In addition, the Program design was too rigid in some areas (legislation) and not sufficiently forward-looking (e.g., did not envision the emergence of new

risks arising from the growth in financial conglomerates). The Program also lacked strong leadership to reconcile diverse interests. A greater impact could have been achieved through stronger analyses of supply and demand issues, and a more selective focus on a few core areas and key principles (versus specific actions that could more easily be reversed or undermined).

B. Effectiveness in Achieving Outcome

44. The FMGP was designed prior to the adoption of the new results-based framework at ADB, along with the design and monitoring framework template. Thus, the Program framework included many objectives versus a concrete outcome. Many of these objectives were achieved (Appendixes 3, 5, and 5). However, given the need for additional consensus among key stakeholders and the absence of strong leadership, reforms in the area of contractual savings and institutional investment, with the exception of private pension funds, require additional time to build much-needed consensus before implementing.

45. During Program implementation and at present, political and macroeconomic developments affect Pakistan's stock market, undermining investor confidence. Notwithstanding, with the exception of the need to more effectively address emerging new regulatory and supervisory issues arising from the increase in financial conglomeration and increased deposit taking activities of NBFIs, Pakistan has achieved good progress in achieving reforms under the five key outputs. Under FMGP, the Government adopted an enabling framework for the NBFS that incorporates international best practice standards (International Organization of Securities Commissions Principles and Standards), established new market institutions and products, and implemented best practice principles (dematerialization of securities and real time gross settlement). Progress in other areas continues to be undermined by government changes; political resistance (lack of sustained leadership); public debt issuance policies and practices; capacity constraints among regulators, intermediaries, and consumers (investor education); staff turnover at SECP; and ongoing investment climate constraints (contract enforcement, debt recovery). Overll, FMGP was partly effective in achieving its outcomes.

C. Efficiency in Achieving Outcome and Outputs

46. The FMGP had too many conditions and sub-conditions, and lacked clear focus. Resources were thus spread too thin. Policy actions involved too many government agencies, some of which required additional time to understand the policy options and develop stronger ownership and consensus among key stakeholders, lacked sufficient leadership or commitment, and/or lacked sufficient authority to meet a number of key conditions.

47. The FMGP required substantial ADB staff resources to make adjustments and fine-tune the policy actions during implementation. Many of the risks identified at the time of Program formulation materialized (absorptive capacity, commitment of key stakeholders, strong and sustained government leadership), and overcoming them proved more difficult than assumed. The Program's design resulted in it being inefficient towards achieving its outcome.

D. Preliminary Assessment of Sustainability

48. The sustainability of Program reforms, as originally designed with complex, multiple components with a range of nested conditions in view of limited capacity and commitment for reforms, is rated less likely based on the lack of (i) strong commitment to greater private sector participation in key financial institutions (through divestment in SOEs), and (ii) reform in public pensions and the state-dominated insurance sector, and in government and stock exchange

commitment to improve the effectiveness and efficiency, including the fairness of secondary trading markets. The sustainability of other FMGP reforms related to the capital market is more likely based on the Government's strong commitment, which continues under the SGCMRP.[19] Based on the increase in financial conglomeration, a more effective legal, regulatory, and supervisory framework for the financial sector depends on more effective coordination between SECP and SBP.

E. Impact

49. The FMGP was categorized environmental category B and has not had a direct environmental impact. Indirect environmental and sociocultural impacts through economic growth and poverty reduction are positive.

IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

A. Overall Assessment

50. The FMGP is rated partly successful (Appendix 6). The Program successfully built upon earlier capital market reform initiatives under the CMDP, and touched on integral components of the NBFS. However, the focus was too broad and a number of key actions, primarily in the area of contractual savings and institutional investors, were not implemented successfully. Except for SECP, the role and involvement of key agencies in implementation was not sufficient. With respect to policy actions overseen by SECP, the Program produced good results. In addition, the Program design did not enable ADB to address the emergence of new risks and related regulatory gaps, resulting in a fragmented legal, regulatory, and supervisory structure for the financial sector and related investor protection concerns.

51. The release of the incentive sub-tranche (9 conditions and 26 sub-conditions) was delayed by about 2 years. The remaining tranche (9 policy conditions and 31 sub-conditions) was cancelled and FMGP capital market-related reforms were incorporated into the SGCMRP (footnote 8). DB agreed with the Government to pursue contractual savings reform initiatives under a subsequent and dedicated reform initiative, after building adequate consensus. While the TA loans helped improve capacity, with respect to TA1, strong vested interests and lack of leadership undermined the impact.

B. Lessons

52. Policy lending programs in the financial sector should be linked to overall economic development and private sector financing needs. It should focus on implementing best practice principles within the country context, and on what is achievable and can be sustained—based on government capacity and commitment and ADB resources (funding and staff). The policy reform agenda should be focused on a few key areas that can result in a tangible impact. The need for strong ownership of program reform activities, especially in politically sensitive areas, is

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[19] The SGCMRP continues to support capital market reforms under the FMGP agenda: development of institutional investors to facilitate long-term capital formation, with a focus on further development of an enabling environment for private pension plans—including additional privatization of SOEs to increase the scope of investments and reduce the Government's role in finance sector intermediation (privatization of the largest remaining state-owned mutual fund); and improve the efficiency of securities markets through development of the corporate bond market. The SGCMRP also includes reforms to strengthen the governance of SECP and the enabling legal and regulatory environment for NBFIs. However, a number of actions under this component need to be reconciled with conflicting proposals from SBP regarding consolidated supervision, regulation of financial conglomerates, and regulation of NBFIs engaged in deposit-taking. ADB can help facilitate consensus on the way forward in terms of the regulatory architecture for Pakistan's financial market, which is increasingly moving toward financial conglomeration.

crucial and depends on extensive and in-depth discussions with government officials and other key stakeholders—preceded by capacity building initiatives—at the time of program design and throughout implementation. In view of the general operating and administrative conditions in Pakistan, frequent consultations are needed to proactively address and reconcile and resolve divergent approaches and emerging issues and concerns. Reform programs should be able to respond to market developments effectively. A more flexible program structure over a longer period, combined with sufficient TA support to address capacity constraints, would enable greater flexibility within the context of agreed focused principles and objectives.

53. It might be more effective to choose a few areas where agreement can be reached on core principles and related actions, demonstrate concrete benefits from reform implementation, and then build on successes. For example, protection of minority shareholders is a key objective of securities regulation that everyone can agree on. Reaching agreement on a menu of options to facilitate such protection, while clarifying that the cost of such measures is less than the benefits in terms of market development, will help develop stronger ownership and sustainability. Where taking criminal enforcement actions is difficult based on broader rule of law constraints, the Government could focus on preventive measures (investor education, reporting and record keeping, monitoring through e-filing and inspections, more effective use of information technology to monitor compliance and inform investors, etc.) and administrative sanctions/complaint mechanisms that are within the control of IAs.

54. Although many of the basic concepts and frameworks to enable development of the NBFS have been put in place, additional work is needed to ensure that the NBFS is able to develop and function effectively as a medium for channeling risk and term funds efficiently to the economy.

55. The PRG is a useful tool to help absorb country risk, including political risks, and encourage investment. However, there needs to be a clear demand for this instrument and it needs to be marketed effectively by ADB after loan approval. The Government has no incentive to market the PRG (effectively insure against itself). The facility is complex but very useful in transferring risk and lowering the cost of funding. However, the product will not sell itself. ADB should explore options for creating awareness of this product more effectively among potential investors.

C. Recommendations

1. Program Related

56. The focus of ADB interventions should be more focused and within the context of a comprehensive longer-term government strategy to develop the financial sector—prepared and monitored in close consultation with key stakeholders. Strong leadership and commitment is needed to ensure that consensus can be reached and momentum retained. The framework for coordination among financial sector regulators needs to be institutionalized. The strategy should be based on principles that can be codified into legislation versus a list of actions whose implementation may be impeded by changes in the Government. This simplifies the dialogue and gives the country a menu of reform options to pursue based on the country context. The strategy should clarify government commitment to develop the financial sector, including the need for a capital market as a key component of economic development.

57. ADB-supported actions should be based on detailed analysis, including supply and demand, commitment for reforms based on wide consultation with key stakeholders, and linked to policy dialogue in the real sector (link to financing needs). To address absorptive capacity

constraints, a common constraint in the region, ADB should develop regional training initiatives (including information sharing) that would also facilitate greater regional cooperation. Program interventions that support bond market development need to address related risks (debt management, debt recovery, property rights, contract enforcement) among others more effectively.

58. Future interventions need to reflect more effectively the capacity of the Government and ADB (including resources) to implement. Reforms should be targeted, and strategy and time frames for implementation should be realistic. Support for enabling frameworks needs to be complemented by support for implementation, along with a monitoring framework, to clarify the impact of such reforms on the real sector.

59. **Further Action or Follow-Up.** The SGCMRP will continue to support reforms in the capital market. Ongoing TA for SBP[20] and new TA under the AETP (footnote 9) will support reforms in the banking sector. To develop a more comprehensive approach to financial sector development, this work needs to be coordinated closely. TA resources should be used to help facilitate development of a framework for a comprehensive financial sector strategy by SECP, SBP, and other key stakeholders.

60. **Timing of the Program Performance Evaluation Report**. To assess the impact of the Program on the overall performance of the NBFS, and independently on its components, it is proposed that a program performance audit report or the PCR validation report be prepared in 2-3 years. The Program should be viewed in the context of a long-term process and its impact assessed within the framework of such process, rather than against targeted performance standards.

2. General

61. **Assessment of Implementation Process.** In the design and implementation phase, close collaboration is needed among financial sector regulators and market operators to retain momentum. Market operators need to have a good understanding of reforms required and the benefits of such reforms. Market supervisors should assess and develop a credible framework for implementation prior to adopting reform initiatives, including monitoring and enforcement. Capacity building needs to keep pace with policy reforms.

[20] ADB. 2007. *Technical Assistance to the Islamic Republic of Pakistan for Support to Governance Reforms in Pakistan.* Manila.

STATUS OF POLICY REFORMS UNDER THE FINANCIAL MARKETS AND GOVERNANCE PROGRAM

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
1. Rationalize tax treatment for financial instruments	Further rationalize tax treatment for financial instruments. **Partially complied with**	
• Apply uniform income tax and move toward uniform withholding tax treatment on interest income from all savings and debt instruments	**Not complied with.** Rationationalize stamp duties. Federal and provincial governments to clarify stamp duties on convertible bonds and securitized debt to avoid double levying; lower stamp duties for corporate paper to internationally competitive rates. Investment banks not to be taxed on profits distributed on portfolio management.	Under the Second Generational Capital Market Reform Program (SGCMRP) the Government reduced stamp duties on corporate bonds in Islamabad Capital Territory.
• Eliminate tax on bonus shares from listed companies		
• Eliminate tax discrimination among institutional investors and multiple taxation for investment through collective investment schedules. Undertake to rationalize tax treatment to allow mutual funds to retain capital gains, for consolidation of their financial position and growth of net asset value	Equal withholding treatment on interest income from all savings and debt instruments by including appropriate measures in Finance Act, 2003, or other legislation.	
• Eliminate tax discrimination of insurance companies, provide for equal tax treatment of dividend income, Central Board of Revenue and Securities and Exchange Board of Pakistan (SECP) and insurance industry to initiate study to capture income of insurance companies	Implement recommendation of study on income tax treatment of insurance companies.	
2. Adjust fiscal measures to promote long-term capital formation		
• Allow income tax deduction for contributions to SECP-approved annuity schemes of life insurance companies up to PRs100,000 per annum or 5% of income to promote old age protection and life insurance	**Not complied with.** Extend capital gains tax exemption beyond 2004 only for investments held more than 6 months through the Finance Act, 2004, or other legislation.	Under SGCMRP, the Government extended capital gains tax treatment throughout program period and introduced a withholding tax on securities market turnover to address the turnover issue.
• Allow income tax deduction up to PRs100,000 per annum for markup (interest) payments on housing loans and to promote housing	Exempt from income tax new voluntary contributions by individuals to approved private provident fund and pension schemes up to PRs100,000 and provide that	

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
finance and mortgage markets	annuities from these investments be made taxable as income through the Finance Act, 2003, or other legislation. Allow tax deductibility for transfer of profit to special reserves through the Finance Act, 2003, or other legislation. Review and rationalize incentive structure for venture capital companies.	
3. Adjust NSS rates to more market-based benchmark mechanism. Further refine adjustment mechanism for NSS rates (for new investments) to better align this to an accepted benchmark (such as the yield curve). Reduce yield for early redemption through higher encashment premiums.	**Not complied with.** Improve governance structure and administration of National Savings System (NSS)/CDNS. Based on recommendation of TA1,[1] move NSS toward a funded system invested in government securities. TA1 recommendations included the need to move NSS to a funded system. The Government has not made a decision on the recommendation. Action also recommended computerizing collections under a time frame developed under the TA1. **Not complied with.** Computerize collections following a time frame developed under TA1. Consultants developed a software solution. Software is expected to be pilot tested at 27 sites by mid-2007 and rolled out system-wide in 2008.	
4. Rationalize investment eligibility criteria for securities. Redefine statutory liquidity requirements eligibility of various instruments for financial institutions to ensure level playing field. Undertake to remove special privileges for NIT/ICP on privatization. Allow approved mutual funds and investment schemes to qualify for investments by charitable trust, welfare, or providence fund institutions.		
5. Remove distortions in foreign exchange transfer for reinsurance. Remove bar on remission abroad of life		

[1] ADB. 2002. *Technical Assistance Loan to the Islamic Republic of Pakistan for Loan for Strengthening Pension, Insurance and Savings Systems*. Manila (Loan 1956-PAK).

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
insurance for accidental death risk.		
6. Clarify responsibilities and strengthen coordination for financial sector policy formulation and regulation. Improve coordination of government ministries and regulator for financial sector (NBFIs, insurance, and pensions)		
• Review and streamline policy and regulatory responsibilities and improve coordination of government ministries and regulator for financial sector (including NBFIs, insurance, and pension). Further reduce direct government involvement in regulatory and operational matters, including delegation of regulatory powers for insurance to SECP.	**Not complied with.** Improve legal framework for financial transactions and corporate affairs. Based on TA2[2] recommendations, develop and bring into force laws and regulations for enhanced transparency in financial transactions and corporate affairs, which may include new legislation for anti-money laundering and corporate insolvency; amend the Companies Ordinance to improve governance stands, the Trust Act for modern investment needs, the SECP Act, the Securities and Exchange Ordinance, the Central Depository Act, and other laws identified under TA2; and transfer selected powers of the high court in relation to implementation of the Companies Ordinance. The Companies Ordinance has been amended to strengthen disclosure of related party transactions for listed companies. Additional amendments to Companies Ordinance were drafted. The Government later established working group to draft new Company Law. Central Depository Act was amended. SECP has started drafting a new securities law and a new financial services commission law, but did not submit these amendments to MOF during the Program. Amendments have been made to Securities and Exchange Ordinance through the Finance Companies Act, 2006, providing a legal basis for demutualization. SECP drafted amendments to	SGCMRP supports preparation of new legislation to replace the Securities and Exchange Ordinance, and to enable establishment of an integrated nonbank financial sector regulator, the Financial Services Commission (FSC) of Pakistan. Subsequent changes were made to the Securities and Exchange Ordinance, which raised concerns regarding the governance framework for SECP. Release of the first tranche of SGCMRP was delayed until this issue was sorted out (almost a year). In addition, SBP raised concerns with the FSC legislation, which included provisions that appeared to conflict with proposed amendments to the Banking Companies Ordinance (specifically, SBP's views on consolidated supervision) and did not appear to address the risks posed by the rise in financial conglomerates or the deposit-taking activities of NBFIs. Thus, SECP drafts, including draft FSC Law, need to be reconciled with SBP drafts. The AETP includes actions relating to consolidated supervision. Anti-money laundering (AML) was subsequently adopted. The AETP includes AML reform actions. ADB is also providing TA to support Government build capacity in AML. A copy of the draft Corporate Rehabilitation Act has been submitted to MOF.

[2] ADB. 2002. *Technical Loan Assistance to the Islamic Republic of Pakistan for Strengthening Regulation, Enforcement and Governance of Nonbank Financial Markets* (Loan 1957-PAK).

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	Insurance Ordinance. Amendments to Trust Ordinance also drafted. On transfer of selected powers of high courts in relation to companies, SECP has not yet prepared such amendments. Additional consultations needed in this area (and in developing new company law versus specific amendments).	
• Appoint full-time government actuary (at market salary) to provide advice to the Government on actuarial matters, which may include public pensions, insurance, and risk management.		
7. Enhance mandate and governance structure of SECP, including structure of commission and policy board; assign SECP with power over private pensions; review selected powers for high courts in relation to implementation of Companies Ordinance for possible transfer to SECP.	Enhance SECP capacity for market surveillance, and regulation and supervision of NBFIs. SECP to recruit further market professionals with industry knowledge, and upgrade surveillance systems and procedures for off-site inspection. During the Program, SECP recruited 63 officers with expertise in chartered accountancy, business administration, law, and information technology. New staff includes professionals with industry knowledge including market surveillance, inspection and broker registration, commodity exchange, NBFI regulation, and monitoring and inspection. SECP also engaged an experienced consultant for non-life insurance business. In mid-2006, a unit for monitoring and inspection was set up in Karachi. Of 27 staff authorized to work in this unit, 24 will be new recruits. SECP established separate wing for on-site inspection, monitoring, and enforcement of NBFIs in 2003; and developed an inspection program in 2005. SECP conducted inspection of books and records of selected brokers at all exchanges, enforced actions against insider trading, and investigated price manipulation. SECP improved off-site surveillance through online connectivity with KSE. The monitoring and inspection unit in Karachi is responsible for on-site inspection; headquarters staff in Islamabad is responsible for off-site	SGCMRP supports reforms to enhance market supervision and enforcement, improve SECP's governance structure, and clarify and strengthen SECP powers over NBFCs and private pensions.

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	inspection.	
8. Improve corporate governance standards • SECP to develop and introduce corporate governance code for corporate sector, financial intermediaries, and related professions.	SECP to devise effective enforcement mechanisms, including adequate enforcement powers and sanctions, and monitor adherence to corporate governance code based on TA2. SECP has imposed fines and sanctions on companies for failure to hold general meetings, circulate quarterly accounts in a timely manner, present true and fair financial statements, and maintain proper records. SECP imposed fines against auditors failing to state material facts about companies' affairs or providing untrue statements in audit report. KSE set up a board committee on a code of corporate governance and a unit in the Company Affairs Department to monitor compliance with the code, which was covered under the listing regulations. Under TA2, the consultant recommended legal amendments to strengthen enforcement power of SECP. SECP to ensure that stock exchanges delist noncompliant companies from main board. The Government to amend legislation as required to extend application of relevant provisions of corporate governance code to companies beyond listed companies. A number of companies were delisted from main board because of violations of listing regulations. In addition, five companies that failed to join central depository system (during 2002–2004) were delisted. Amendments to Securities and Exchange Ordinance, 1969—through Finance Act, 2003—provide rules for divestment from delisted firms. Listed and nonlisted banks and DFIs adopted code of corporate governance. Nonlisted insurance companies (including state-owned SLIC, NICL, and PRCL) are under the code applicable to insurance companies notified on 21 January 2003.	

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• Stock exchanges to update listing regulations to apply corporate governance code to listed companies and start enforcement through delisting of noncompliant companies.		
• Update corporate governance provisions in Companies Ordinance.		
9. Improve information disclosure standards and transparency in market transactions. Require quarterly reporting by listed companies of accounts and encourage financial projections in offer documents; make price relevant information available simultaneously and in a timely manner to all interested parties, including the public.	Improve quality in information disclosure. SECP, in coordination with ICAP and other professional groups, to strengthen professional standards for accounting and auditing firms providing services to listed companies; develop statutory code of conduct for accounting and auditing firms providing services to listed firms; and enhance disclosure of corporate financial information. Listed companies are subject to international accounting standards (IAS), and auditors are subject to international standards of auditing. SECP, ICAP, and Stock Exchanges enforced a review of ICAP to ensure that ICAP conducts audits of members to guarantee compliance with these standards and other relevant laws and regulations. The auditing firm must be rated satisfactory by ICAP to qualify as an auditing firm for listed companies. As a self-regulatory organization, ICAP takes disciplinary action against its members. ICAP adopted the code of ethics of the International Federation of Accountants (IFAC). All ICAP members, including auditors of listed companies, are required under the Chartered Accountants Ordinance, to follow IFAC code. All international accounting standards (IAS) have been adopted except three: IAS 15 (information reflecting the effects of changing prices) and IAS 29 (financial reporting in hyper-inflationary economies) are irrelevant in Pakistan; and IAS 41 (agriculture accounting) is being customized for Pakistan. Since July 2004, the fourth schedule of the Companies Ordinance requires disclosure and presentation of financial statements	IFRS 2, 3, 5, and 6 are required to be followed with respect to accounts and preparation of balance sheets and profit and loss accounts of listed companies. SECP monitors compliance with international accounting standards through regular review of the annual and quarterly financial statements of listed companies, NBFIs, and insurance companies, published and filed with SECP. When identifying disclosure deficiencies or other noncompliance with these standards, SECP imposes fines and penalties on the preparers and auditors. Over the last few years, SECP has penalized several companies and nearly 25 auditor firms. SECP also refers the cases of defaulting auditors to ICAP for further disciplinary action through its investigation committee.

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	of listed companies and their subsidiaries according to IAS.	
10. Improve governance of stock exchanges and other capital market intermediaries	Further reform of stock exchanges	SGCMRP includes actions to ensure that the new Securities Law and FSC Law provide the FSC with the authority to require a unified national market system in securities and an inter-market surveillance committee.
• Revise stock exchange board constituents and nomination/selection process	**Partially complied.** SECP and stock exchanges to develop comprehensive plan to encourage stock exchange demutualization and integration, to facilitate establishment of electronic communication networks and alternative trading systems for establishment of a national market. SECP to issue guidelines and regulations for operation of demutualized and new markets. Boards of Islamabad Stock Exchange and Lahore Stock Exchange submitted an action plan for integration and demutualization of the two exchanges in April 2005. KSE submitted a separate demutualization plan.	SGCMRP includes action to ensure that Securities Law grants SECP authority to require a unified national market system. SECP will also require stock exchanges to establish an inter-market surveillance system. Cabinet has approved demutualization plan prepared by SECP and sent draft legislation to Parliament for approval.
• Initiate structural reforms for stock exchanges, including dialogue with SECP on different models for demutualization /integration of stock exchanges.	SECP to work with exchange for OTC market to (i) introduce a unified trading system as well as an electronic system for second tier board that includes requirements governing minimum capital size, issue/offer size, and disclosure norms; (ii) in coordination with the stock exchanges, set up a mechanism for screening companies prior to all IPOs; (iii) require participants to make continuous offers to buy and sell new issues at the OTC market (market making) to ensure liquidity; (iv) adopt code of ethics for companies' auditors and brokers; and (v) promote trading of debt securities on OTC market. SECP issued OTC market regulations in December 2002 and the regulations were amended in December 2004. The exchanges have electronic trading, clearing and settlement, and risk management systems in place for the second board. SECP simplified listing criteria and exempted companies for listing and trading fees for 1 year. KSE increased paid-up capital requirements for securities to be listed on the first board from PRs50 million to PRs200 million. Integration	

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
	of the second board has not taken place, since no companies have listed on this board. OTC market regulations include provisions for minimum issue/offer size, disclosure norms, compliance requirements, screening, and market making mechanism. Securities Market Division of SECP, in coordination with stock exchanges, is responsible for review and approval of prospectus and offer for sale documents, which need to meet terms and conditions specified by SECP. Market making has been compulsory for a minimum specified period, as provided in clause 8 of OTC regulations. Companies listed on the second board need to follow a less stringent code of governance compared with the first board. The code of ethics for brokers applies to brokers in both markets. Auditors of companies listed on OTC board need to follow IFAC guidelines on code of ethics, as adopted by ICAP. Guidelines for the issue of TFCs to the public require that TFCs should be listed on at least one exchange. On 28 September 2004, SECP required listing at the OTC board for any new TFCs offered to the public.	
• SECP to request stock exchanges to regulate proprietary trading of brokers and separate investor accounts from broker accounts. In furtherance thereof, SECP to encourage opening of investors accounts with depository		
11. Strengthen prudential and risk management standards for nonbank financial intermediaries	Further improve efficiency in trading and operational risk management practices.	SGCMRP supports reforms to strengthen prudential regulation.
• For capital market intermediaries, introduce capital adequacy and issue guidelines for broker licensing, increase minimum capital	SECP and stock exchanges to review existing system of *badla* trading (informal financing mechanism to purchase securities based upon sale and repurchase of securities that serves as collateral- allows	Reforms included banning of in-house *badla*, strengthening of margin deposits with pre-trade margin verification instituted at the exchanges, and position limits defined for brokers in futures market and CFS.

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requirements for brokers and fixed exposure limits, review margin requirements for the futures and cash market operations, with segregation of trading and clearinghouse members, and review minimum capital requirements for clearinghouse members.	settlement of trades to be indefinitely carried forward and raises settlement risks) and its impact on market distortions and volatility, develop time-bound action plan to replace this system with margin trading, promote establishment of institutions for stock lending, and adopt regulations. SECP implemented a plan to phase out carryover trade of *badla* financing. In 2005, it was replaced with the continuous funding system. SECP approved margin financing regulations on 23 September 2004. SBP issued regulations for financing to brokers by banks/DFIs on 3 July 2004. Stock exchanges published investor guides that cover margin trading and financing. KSE prepared a manual on margin financing, practices, and conventions for its members. Public understanding of margin financing is being promoted by SECP, stock exchanges, and Central Depository Company (CDC. SECP issued stock lending and borrowing regulations on 9 December 2004. In March 2005, CDC prepared a plan to establish a stock lending and borrowing facility. Stock exchanges to regulate proprietary trading of brokers and separate investor accounts from broker accounts. SECP issued regulations for proprietary trading in October 2004. These regulations require separate accounts for brokers and investors. CDC has separate accounts for brokers and investors. SECP to coordinate development of the derivatives market and issue guidelines for internet/web-based trading in capital market instruments, considering recommendations of TA2. In September 2004, SECP upgraded eligibility criteria for companies to be traded on the futures market and 30 stocks were approved as underlying stocks for futures contracts. To strengthen risk management, stock exchanges introduced in March 2005	CFS was introduced as an interim measure to replace *badla* financing in order to enhance the level of liquidity in the market, while alternative modes of leverage financing are being developed, which includes margin financing and futures markets. Recently, CFS Mk II has been proposed to cover market risks adequately. CFS cap has been enhanced to PRs55 billion for KSE, PRs10 billion for LSE, and PRs5 billion for ISE; and CFS number of scrips has been increased to 71. Stock lending and borrowing facility is operational and available through brokers in the market, with custodial services being performed by CDC. In March 2005, rules for regulating the business of a commodities exchange were adopted. Commodities futures are currently traded on the National Commodities Exchange, Ltd.

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	the following measures in the futures market: (i) the position limit for a contract on a single stock has to be 1% of free float of each stock, (ii) the total exposure limit of a member equals 10 times the net capital of the member, (iii) an increase in the percentage of margin deposit, and (iv) the collection of margin deposit against exposures must exceed PRs200 million in cash. As of January 2007, no stock index futures are trading at KSE. The Securities and Exchange Ordinance, 1969, and the Securities and Exchange Act, 1997, were amended by the Finance Act, 2003, to regulate a commodity exchange and empower SECP to supervise its activities. The National Commodity Exchange Ltd was granted permission in 2002 to establish electronic trading, clearing and settlement, and risk management systems; and started mock trading for members on 13 July 2004. Commodity Exchange and Futures contract rules have been finalized and the Futures Trading Act was submitted to MOF in December 2005. As of January 2007, the Futures Trading Act was still under consideration by MOF. Amendments to the Securities and Exchange Ordinance, 1969, are expected to take place through the Finance Act, 2007, to provide regulations for the Futures Exchange. SECP issued internet trading guidelines in March 2005. SECP to coordinate improvements in clearing and settlement infrastructure, including work with the National Clearing Company of Pakistan Limited (NCCPL) to upgrade clearinghouse information and provide real-time information on client exposure with different brokers, issue rules for the NCCPL, and encourage dematerialization of securities. Since January 2004, clearing of all securities on the CDC is made through NCC. The automated pay and collection system provides for	

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
	online access to settling banks, NCC, and CDC. Clearing and settlement of futures market transactions has been made through NCC since June 2004 and margin financing transactions through NCC since December 2004. Since January 2005, the NCC website posts daily information on the value and volume of settlement and comparative ratios. On 9 December 2004, SECP informed stock exchanges that brokers should create a client identification number for each customer. On 1 August 2006, the unique global identification number was made effective. The number provides a traceable ink between every order entered at the trading system of the exchange and the person on whose behalf the order is placed. On 14 March 2005, CDC submitted a plan to provide real-time information on client exposure by different brokers by 30 November 2005. Real-time information on client exposure with different brokers is expected to take effect in March 2007. Clearing companies' registration and regulation rules were notified on 1 June 2005. As of January 2007, 495 of 652 companies had joined CDC and 98% of securities traded in the stock exchanges were settled through CDC.	
• For the insurance industry, introduce mandatory rating for insurance companies of claims payment capacity, limit exposure for illiquid assets relative to total assets in insurance to 25% for non-life and 10% for life insurance companies, enforce capital and solvency requirements (in particular for non-life business) to support industry consolidation and strengthening, phase out the quota share compulsory cession to PRCL.		

FMGP Policy Condition and/or First Tranche[a]	Second Tranche	Status
12. Improve dispute resolution mechanisms between brokers and investors. Stock exchanges to issue regulations.	Develop professional standards, qualifications, and continued education. SECP and private sector to establish an institute for corporate governance or similar and development continued education programs with established institutions based on recommendations under TA2. SECP and professional bodies to enhance their public education programs and encourage professional qualifications for stock brokers, investment analysts, fund managers, insurance agents, and other relevant professionals. The Pakistan Institute of Capital Markets was registered as a not-for-profit company under the Companies Act in December 2004. A chief executive officer was recruited in mid-2006. The Institute is planning on conducting various licensing examinations leading to certifications for different segments of the capital markets. SECP issued the Insurance and Promoters Guide (August 2003), Manual of Corporate Governance (January 2004), Directors and Secretaries Guide (March 2004), Guide on Accounts and Accounting Reference Dates (July 2004), and Single Member Companies Guide (December 2004). SECP has held seminars and workshops on strengthening corporate governance, and on the responsibility of directors and senior management to educate market participants and investors. SEC and the stock exchanges have regularly held seminars, workshops, and training programs on capital market development issues. ISE has conducted information sessions on stock market activities and functions, and has introduced an investor hotline to respond to investor queries. LSE and KSE have started investor education programs. SECP and CDC held forums in Sialkot, Peshawar, and Hyderabad to educate small investors about stock markets. The Pakistan Society of Investment Professionals has coordinated with the Association	All stock exchanges have arbitration committees that investigate complaints between investors and members. SECP has established a vigilance cell through which grievances and complaints can be redressed. SGCMRP includes policy reforms to support enhanced capacity of market participants and related TA to help implement recommendations under TA2. Consultants not yet recruited. SECP asked ADB to defer pending changes in senior management of SECP. Recently, SECP held seminars on the provision of online services to the corporate sector, lawyers, and public; and on the e-services project that provides information on incorporation and statutory returns online. A series of road shows has also been arranged to educate small investors about investment in stock markets. The Institute has launched an “Analyst Certification Program” in collaboration with the Certified Financial Analysts Institute in the United States and the Certified Financial Analysts Association in Pakistan for individuals providing investment advice.

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	of Investment Management and Research Professionals to provide examinations for chartered financial analysts. NCC provided training on facilitating margin financing transactions through broker-to-broker module in NCC.	
13. Introduce new market for smaller and less frequently traded companies. SECP/Exchanges to set up a second tier board/OTC quote-driven market to attract smaller companies and new IPOs. Announce listing requirement.	Improve supply of equity issues through privatization. Government to float/offload shares in at least five SOEs on a stock exchange from any three sectors. During FY2003–FY2006, the Privatization Commission floated shares of 10 SOEs in five sectors. In January 2007, the second offer for sale of the shares of Oil and Gas Development Co. Ltd. was made. Off-loading of these shares resulted in an increase of market capitalization of more than 40%.	OTC market developed and incentives provided to promote listings in this market. SGCMRP continues to support privatization to increase the supply of equity issues. No privatizations were carried out through stock exchanges in 2008.
14. Introduce financial hedging instruments and markets	Improve secondary debt market activity.	
• SECP/Exchanges to introduce instruments for hedging. Review and update regulations to facilitate trading in futures. Deepen futures market by adding further scrips.	SECP and SBP to facilitate and promote active market making in corporate debt securities, PIBs ; improve clearing and settlement and information disclosure on market activity, including pricing; and introduce a designated market maker system. Government to adhere to Treasury Bill targets and borrowing plan. SBP developed a benchmark government bond yield curve by issuing PIBs for 3, 5, 10, 15, 20, and 30-year maturities. The PIB market faced a severe liquidity crunch and the demand for PIBs has remained low from 2005. Guidelines for the issue of TFCs to the public encourage issuers to appoint market makers for trading TFCs. To enhance transparency and information disclosure, price and yield information on government bonds has been posted on the SBP website since November 2004. Beginning in February 2004, SBP instructed banks and DFIs to use the Karachi Inter-Bank Offered Rate as a benchmark rate for pricing Pakistan	Development of corporate debt market is a key component of SGCMRP, which includes further reforms to develop the benchmark yield curve. Demand for PIBs has remained low based on the lack of liquidity in the secondary market and the opening of NSS to the corporate sector.

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	rupee loans, TFCs, and commercial papers. Automation and implementation of the real-time gross settlement system is under way. SBP is expected to implement the system soon. The number of primary dealers has increased from 7 in 2001 to 14 in 2006. Introduction of the primary dealer system has helped make the bidding process more competitive. In particular, the average bid spread in 6-month T-bills auctions has declined substantially from 147 basis points during FY1995–FY2000 to only 66 basis points during FY2001–FY2006.	 Real time gross settlement (RTGS reforms included under the AETP. Currently, there are nine designated primary dealers.
• SECP to initiate concept paper for the development of interest rate swaps.		
15. Develop money markets. SBP/SECP to initiate introduction and development of commercial paper market, including identification of key issues.	SBP/SECP to issue guidelines for commercial paper that permit investments by banks and pension/ provident funds in CP. Based on TA2 recommendations, take appropriate steps for promoting discount houses. SECP issued guidelines for issuance of and investment in commercial paper in October 2002 and revised them in September 2004. The guidelines permit provident funds and gratuity funds to invest in commercial papers. SBP issued guidelines on investments and dealings in commercial papers by banks and DFIs in August 2003. The guidelines for issue of commercial paper, revised in September 2004, encourage commercial paper issuers to appoint dealers, and advise issuing and paying agents to buy commercial papers from sellers and resell to investors. The requirement for standby facilities was removed to facilitate commercial paper issuance. Consultants under TA2 recommended that it was premature to set up discount houses. A working group comprising SEC, SBP, and industry stakeholders was established to review impediments to the corporate debt and money markets, and has submitted its recommendations to SECP/SBP for consideration.	Development of the corporate debt market is a key component of the SGCMRP.

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16. Promote bond market (PIBs and TFCs)		
• Review operations of existing primary deals for improving secondary market operations in PIBs, including minimum turnover commitment and two-way quotes, and allowing independent securities firms as primary dealers for PIBs.		SGCMRP includes development of the corporate bond market as a key component. Conditions include publication of guidelines for the creation of a limited secondary market among qualified institutional buyers of corporate bonds issued through private placement.
• SBP to introduce PIB jumbo issues to reduce fragmentation of issues and improve liquidity.		
• SBP/SECP/Exchanges to improve dissemination of information on secondary market trading on fixed income securities. SBP to provide to the public information on secondary market trading in government securities (website).		
17. Upgrade regulation for mutual funds. Amend investment advisors' rules to allow closed end mutual funds to be established under the Trust Act. Integrate investment advisers rules and asset management rules within framework of the proposed new NBFI rules.		
18. Clarify and streamline regulatory responsibilities for pensions. Assign explicit regulatory responsibility for private pensions to SECP.	Promote private pensions. Taking into account TA1 and TA2 recommendations, Government to develop and introduce legal, regulatory, and tax framework for private pension plans; and standardize relevant accounting and information disclosure standards. On 15 March 2003, SECP was given the power to regulate pensions. Voluntary private pension scheme rules were notified on 27 January 2005 and the tax framework for the scheme was established by amending the Income Tax Ordinance through the Finance Act, 2005. In January 2007, SECP issued licenses to four fund managers to offer voluntary private pension scheme products.	Development of private pension funds is a core component of the SGCMRP. As of January 2007, four pension fund managers have been registered with SECP.

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	The scheme's rules require IAS for accounting and information disclosure.	
	Improve operational efficiency of large government-controlled institutions (EOBI, SLIC). **Not complied with.** Government to review and amend EOBI Act; outsource investment management to private sector with well-defined guidelines and controls; improve administrative processes;, and review and align performance structures to enable the recruitment and retention of professionals with relevant expertise; and for SLIC to strengthen investment management, internal administrative processes, and field office operations. A TA consultant reviewed and helped draft amendments to EOBI Act. However, amendments have not yet been submitted by the Ministry of Labor to Cabinet. EOBI proposed setting up a subsidiary wholly owned by EOBI to manage its investments rather than to outsource to the private sector. EOBI worked with TA1 consultants on improving human resource management to establish performance structures that would enable EOBI to recruit and retain professionals with relevant experience. An action plan has not yet been submitted. A draft final report and proposed action pan to strengthen investment management, internal administrative processes, and field operations, was submitted to SLIC and MOF in December 2006.	More time is required for the Government and other stakeholders to build broad consensus on structural reforms in this area. EOBI has followed through with some of the consultants' recommendations: (i) making the EOBI Act applicable to enterprises with five or more workers; and (ii) making the EOBI Act applicable to banks and NBFIs through the Finance Companies Act, 2008; and withdrawal of the exemption of the carpet industry from the EOBI.
19. Liberalize investment restrictions for institutional investors. Lower the mandatory requirement for insurance companies and pension and provident funds to invest in government securities; and allow investments in listed securities, rated corporate debt, and mutual funds up to 60% of investible funds.		

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20. Promote corporate and financial restructuring and consolidation. Encourage mergers and restructuring of financial institutions by allowing tax deduction of merger costs, and carry forward for losses for merged entities. For financial institutions that carry on different businesses, the business losses of the merged entity as well as the cost of the merger will be allowed as a deductible expense to the surviving entity to encourage consolidation in the financial sector.	Strengthen regulatory framework and supervision for NBFIs. **Partially complied with.** SECP to improve rules and regulations for NBFIs and the insurance industry based on experience in implementation and recommendations under TA2. SECP adopted insurance rules in December 2002. Rules for NBFCs were adopted in April 2003. Basic prudential requirements for NBFCs were adopted in January 2004. However, they were not in line with international best practice. SECP adopted amendments to these rules and submitted them to Ministry of Law, Justice and Human Rights in January 2007 for clearance. The ministry has not cleared amendments on the ground that SECP does not have a sufficient legal mandate to enforce prudential requirements.	SGCMRP included an action to amend the Companies Ordinance through the Finance Bill, 2007, to strengthen SECP's legal mandate with respect to its powers, functions, and responsibilities over NBFIs. Some overlap with the AETP with respect to NBFIs engaged in deposit taking activities. The SBP and SECP positions need to be reconciled to ensure that risks, including regulatory arbitrage, are effectively addressed. SGCMRP TA also includes support for drafting legislation. SECP has asked ADB to defer mobilization of consultants in this area.
21. Reduce government dominance and dispose of DFIs through sale or merger. Restructure IDBP, including finalization of draft legal documents for conversion into a public limited company under the Companies Ordinance; initiate transfer of nonperforming loans to CIRC, make substantive progress in audit for FY2002, and reduce staff strengthen through voluntary retirement scheme.	Sell IDBP to the private sector or liquidate. **Not complied with.**	SBP is in the process of preparing a plan for privatization of IDBP.
22. Improve governance of government-controlled insurance companies. Board of SLIC, PRCL, and NICL to adopt corporate governance codes.	Reduce public sector involvement in commercial insurance operations. **Not complied with.** Government to reduce monopolies accorded to NICL; eliminate compulsory cession and initiate gradual elimination in a phased manner of first refusal; convert SLIC into a public limited company; remove government guarantee for contractual entitlements from new business by	More time is needed for the Government to build broad consensus on these reforms.

[3] ADB. 2002. *Technical Assistance to the Islamic Republic of Pakistan for Enhancing Access to Comprehensive Insurance Cover After September 11*. Manila (TA 4033-PAK).

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	SLIC; implement options for return of commercial insurance operations, (including SLIC, NICL, and Alpha Insurance) to the private sector; and consider and initiate implementation of feasible options for regularizing the position of Postal Life as a life insurance company under the Insurance Ordinance, 2000. PRCL was eliminated on 1 January 2005. Gradual elimination of the right of "first refusal" cession entitlement of PRCL was notified in October 2006. With regard to NLIC, MOC agreed to limit its insurance operations to sensitive assets and develop an action plan to transfer nonsensitive assets. However, no such action plan was submitted or implemented. No actions have been taken to convert State Life Insurance to a public limited company and discontinue the government guarantee for contractual entitlements from new business of SLIC. Reports outlining options for transferring commercial business of public sector insurance companies to the private sector were presented to MOC in February and October 2005. However, no strategy or action plan was developed. Cabinet approved an IPO of 10% of the shares of SLIC but no steps have been taken to initiate the privatization. While MOC has claimed to have requested the privatization committee to privatize Alfa Insurance, the privatization committee clarified that it has not been authorized to do so. A proposal for reform of postal services, including Postal Life, was submitted to the minister of Communications in 2004. In 2005, detailed recommendations were prepared with TA assistance[3] regarding corporatization of Postal Life Insurance. No decision has been taken toward regularizing the position of Post life Insurance as a life insurance company under the Insurance Ordinance.	
23. Open general insurance market for public sector property and activities. Initiate removal of		

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NICL's monopoly on public property business by gradually allowing private sector participation in underwriting of commercial public sector business.		
24. Enhance risk retention capacity for noncommercial risks and strengthen reinsurance. Develop and agree on a concept for sustainable reinsurance arrangements for cover of terrorism-related and other noncommercial risks.		

[a] All first tranche conditions were complied with.

ADB = Asian Development Bank; AETP = Accelerating Economic Transformation Program; CDC = Central Depository Company; CDNS = Central Directorate of National Savings; CFS = continuous funding system; DFI = development finance institution; EA = executing agency; EOBI = Employees' Old-Age Benefits Institution; FMGP = Financial Markets and Governance Program; IA = implementing agency; IAS = International Accounting Standards; ICAP = Institute of Chartered Accountants of Pakistan; IDBP = Industrial Development Bank of Pakistan; IFAC = International Federation of Accountants; IFRS = International Financial Reporting Standards; IPO = initial public offering; ISE = Islamabad Stock Exchange; KSE = Karachi Stock Exchange; LSE = Lahore Stock Exchange; MOC = Ministry of Commerce; MOF = Ministry of Finance; NBFC = nonbank finance company; NBFI = nonbank financial institution; NCCPL = National Clearing Company of Pakistan Limited; NICL = National Insurance Company Limited; NSS = National Savings Scheme; OTC = over the counter; PIB = Pakistan investment bond; PRCL = Pakistan Reinsurance Company Limited; SBP = State Bank of Pakistan; SECP = Securities and Exchange Commission of Pakistan; SGCMRP = Second Generation of Capital Market Reform Program; SLIC = State Life Insurance Corporation; SOE = state-owned enterprise; TA = technical assistance; TA1 = Technical Assistance Loan 1956-PAK: for Strengthening Pension, Insurance and Savings System; TA2 = Technical Assistance Loan 1957-PAK for Strengthening Regulation, Enforcement, and Governance of Nonbank Financial Markets; TFC = term finance certificate.

IMPLEMENTATION STATUS OF VARIOUS COMPONENTS

Table A2.1: Technical Assistance Loan 1956-PAK: Strengthening Pension, Insurance and Savings Systems

Subcomponent	Implementation Status
Establishment of an overall framework for pension provision	Implemented
Financial assessment of the civil and military pension scheme	Implemented. The implicit pension debt for the federal and provincial civil service, as well as the military, has been estimated based on a limited data sample.
Institutional reforms and strengthening of the Employee's Old-Age Benefits Institution	Partially implemented. Recommendations developed but computerization delayed based on need to convert paper files into an online system.
Capacity building for investment management in the State Life Insurance Corporation	Implemented.
Institutional reform and strengthening of the Central Directorate of National Savings (CDNS). Financial restructuring of the State Life Insurance Corporation (SLIC).	Institutional reforms and strengthening of the CDNS implemented. Financial Restructuring of SLIC not implemented.

CDNS= Central Directorate of National Savings; SLIC= State Life Insurance Corporation.
Source: ADB.

Table A2.2: Technical Assistance Loan 1957-PAK: Strengthening Regulation, Enforcement, and Governance of Nonbank Financial Markets

Subcomponent	Implementation Status
Further improvement of the legal and regulatory framework	Implemented
Support for the development of non-bank financial institutions (NBFIs) and the capital market, including restructuring of stock exchanges	Implemented by stock exchanges have not yet been demutualized. Government and stock exchanges have agreed on a demutualization framework. Enabling legislation has been sent to Parliament.
Capacity building of Securities and Exchange Commission of Pakistan (SECP) with particular attention to its enlarged mandate for regulation and supervision of capital market, NBFIs, insurance, and pensions	Implemented
Establishment of sustainable mechanisms for skills development and training	Implemented.

NBFI= nonbank financial institution; SECP= Securities and Exchange Commission of Pakistan.
Source: ADB.

PROGRAM FRAMEWORK

Design Summary	Performance Indicators and/or Targets	Monitoring Mechanisms	Assumptions and Risks
Goal Contribute to poverty reduction and facilitate private sector-led economic growth through productivity improvement and more efficient financial intermediation as well as enhanced social protection.	Increase monetary assets to GDP ratio Increase investment and savings rate Increase corporate securities issuance Increase market capitalization and trading volume Increase insurance and pension assets–GDP ratio Increase international portfolio investment	Economic and financial sector statistics Annual reports of SECP and SBP	Assumptions: Political and macroeconomic stability Sustained strong commitment of the Government to financial sector reforms Credible implementation of reforms under the FMGP increase investor confidence Acceptance of new financial instruments by the market Sufficient skills developed to market and manage new instruments
Purpose and/or Objectives 1. Strengthen investor confidence through improved governance, transparency, and investor protection 2. Increase depth and diversity of financial intermediation through new capital market issues for savings and investment 3. Increase operational efficiencies and risk management of intermediaries 4. Reduce financial sector vulnerabilities 5. Strengthen fiscal position and sustainability	Number and quality of new standards issued and amendments to rules and regulations Number of enforcement actions by SECP Compliance of intermediaries with solvency margins and capital requirements Number of new securities issues Number and turnover of actively traded stocks and TFCs Transaction costs in capital markets Spreads for bid/offer quotes Foreign portfolio investment Ease of access to nonbank savings products Consolidation of DFIs through closure or mergers Establishment of specialist reinsurance company	SECP and SBP statistics and reporting by stock exchanges Circulars/directives issued by SECP/SBP Annual report by SECP/SBP Periodic progress reports by MOF ADB review missions and feedback from market participants	Assumptions: Strong leadership, independence, and capacity of SECP; SECP able to recruit and retain competent staff. Government support for legislative reforms and increased private sector participation, including privatization of state-owned institutions. Stock exchanges committed to reforms and demutualization Overseas investors willing to invest in Pakistan's capital markets Stability of the Pakistan rupee No foreign exchange restrictions on convertibility and transfers

Design Summary	Performance Indicators and/or Targets	Monitoring Mechanisms	Assumptions and Risks
Outputs			
1. Conducive fiscal and policy framework	Tax rates for financial instruments and investors streamlined	Annual government budget announcement and notification of tax-related statutory rules and orders	SECP has adequate capacity for regulation and enforcement
	Reduction in National Savings Scheme interest rates relative to other (riskier) investments	FMGP website (maintained by SECP)	Willingness by issuers and investors to develop new products and markets
2. Effective regulatory and governance framework with enforcement mechanisms	Legislative and regulatory framework updated	SECP/SBP statistics	SBP to disclose price information on secondary market trading in government instruments, and promote development of money and bond markets
3. Transparent and competitive financial markets	Information and price disclosure to public	SECP/SBP annual report	Willingness of international investors to accept ADB guarantees
	Reduction in issuance and transaction costs	Progress reports by MOF	Documentary ease of use for the PRG facilities
	Public availability of real-time pricing information at affordable cost (e.g., through the internet)	Report by facility agents on PRG utilization	
	Liquidity and volume of secondary market trading	ADB review missions	
	Number of retail outlets and internet-based providers offering investment products		
4. Improved access and variety of saving and investment instruments	Availability and use of hedging instruments (futures, swaps and options)		
	Use of money market instruments		
5. Efficient and effective institutional investors	Growth in life insurance and pension funds		
6. Enhanced and more sustainable social safety nets	Number of unit and policy holders		
7. Reduced government involvement in financial operations of NBFIs, including insurance and pensions	Ownership and nomination of outside directors by Government in SLIC, NICL, EOBI, and other NBFIs		
8. Fewer but financially sound NBFIs	Merger and closures of NBFIs		
9. Improved skills base of market participants	Professional standards established and continued education programs in place; number of participants and graduates		

Design Summary	Performance Indicators and/or Targets	Monitoring Mechanisms	Assumptions and Risks
10. Increased international interest and investment in Pakistan's capital markets	Foreign portfolio investments and underwriting of new issues		
11. Access to reinsurance for noncommercial risks	Policies written, premium level, and income from terrorism insurance		
Inputs and Activities			
1. $260 million funding by ADB to finance adjustment costs	Compliance with policy matrix	Regular progress reports, statistics and review missions	Assumptions: Adequate and timely provision of skilled staff and facilities Project ownership by SECP, SBP, government ministries, and private sector
2. $3 million TA loan for strengthening regulation, enforcement, and governance of financial markets	Advice to SECP to review, draft, and administer policies, rules, regulations, and procedures for introduction/utilization of new instruments, investors, and markets		
3. $3 million TA loan for strengthening pension, insurance, and savings systems	Advice to government-owned savings institutions and pension schemes to improve policies and operations Training of key staff Organization of stakeholder workshops		
4. Provision of up to $25 million PRG facility by ADB and $125 million guarantees to cover transfer and convertibility risk of international investors	Appointment of facility agent and conclusions of legal documentation as well as pricing structure		
5. Provision of $175 million PRG facility to ensure access to elected violence-related insurance that is not commercially available	Number and amount of PRGs issued for investment cover	Follow-up and facilitation by ADB staff and private sector parties	Continued and consistent government and private sector support
6. Continued dialogue with stakeholders to promote new financial instruments and markets effectively.	Number of workshops and seminars conducted and attended; number of comments via internet on SECP website		

ADB = Asian Development Bank, DFI = development finance institution, EOBI = Employees' Old-Age Benefits Institution, FMGP = Financial (Nonbank) Markets and Governance Program, GDP = gross domestic product, MOF = Ministry of Finance, NBFI = nonbank financial institution, NICL = National Insurance Company Limited, NSS = National Savings Scheme, PRG = political risk guarantee, SBP = State Bank of Pakistan, SECP = Securities and Exchange Commission of Pakistan, SLIC = State Life Insurance Corporation, TA = technical assistance, TFC = term finance certificate.

STRUCTURE OF THE PAKISTAN FINANCIAL SECTOR
(2005-2007)

Item	2005 Number	2005 Assets (PRs billion)	2005 (% of total)	2006 Number	2006 Assets (PRs billion)	2006 (% of total)	2007 Number	2007 Assets (PRs billion)	2007 (% of total)
Financial Sector (percent of GDP at market prices		4,142	100		4,999	100		5,392	100
Regulated by the State Bank of Pakistan									
Banking system	39	3,659	88.3	39	4,282	85.7	40	4,884	90.6
Commercial banks	35	3,546	85.6	35	4,162	83.3	36	4,769	88.4
Public sector commercial banks	4	724	17.5	4	836	16.7	4	934	17.3
Local private banks	20	2,483	60	24	3,102	62.1	26	3,666	68
Foreign banks	11	339	8.2	7	224	4.5	6	169	3.1
Specialized banks	4	113	2.7	4	120	2.4	4	115	2.1
Development Finance Institutions	5	128	3.1	5	117	2.3	6	23	.4
Microfinance Banks	6	8	.2	6	10	.2	6	11	.2
Regulated by the Securities and Exchange Commission of Pakistan									
Nonbank finance companies		129	3.1	79	326	6.6	117	449	8.3
Leasing companies		54	1.3	18	72	1.4	16	69	1.3
Investment banks		51	1.2	9	57	1.1	9	49	.9
Discount houses		2	0	2	3	.1	2	2	0
Housing finance companies		19	.5	2	19	.4	2	19	.4
Venture capital companies		4	.1	0	0	0	1	0	0
Mutual funds				48	177	3.5	87	310	5.7
Modarabas		22	.5	23	23	.5	22	25	.5
Pension funds									
Insurance companies	51	196	4.7	58	239	4.8			
General insurance companies	46	54	1.3	49	74	1.5			
Life insurance companies	5	142	3.4	5	165	3.3			

[a] Consolidates operations of foreign branches of domestic banks.
GDP = gross domestic product.
Sources: Securities and Exchange Commission of Pakistan; State Bank of Pakistan.

CURRENT STATUS OF CAPITAL MARKET: CAPITAL MARKET INDICATORS

Item	Dec 2001	Dec 2003	Dec 2004	Dec 2005	Dec 2006	Dec 2007	End June 2008/KSE
No of listed companies	747	701	661	661	651	630	629
Listed Capital (PR Billion)	235.683	313.267	405.646	470.427	515.030	671.269	713.077
Market Capitalization (PR Billion)	296.143	951.446	1,723.454	2,746.559	2,766.584	4,329.910	3,301.908
Companies listed during the year	3	6	17	19	9	14	5
Capital listed during the year	2.885	4.563	66.837	30.090	14.790	57.240	11.352
New debt instruments listed	5	6	5	8	3	3	6
Listed Capital of debt instruments	5.658	2.749	4.775	10.900	3.400	6.500	21.000
Fund mobilized during year	8.886	7.312	86.344	51.896	31.241	64.524	42.896
Share turnover (billions)	23.070	76.380	85.640	91.450	63.047	65.957	32.464
Average daily turnover (billions)	0.097	0.308	0.344	0.366	0.262	0.268	0.217
KSE-100 Index High	1,550.42	4,604.02	6,218.40	10,303.13	12,273.77	14,814.25	15,676.34
KSE-100 Index Low	1,075.16	2,356.48	4,473.03	6,220.28	8,766.98	10,066.32	10,212.92
KSE-100 Index Year end	1,273.07	4,471.60	6,218.40	9,556.61	10,512.48	14,075.83	12,289.03

KSE = Karachi Stock Exchange.
Source: KSE annual reports.

ASSESSMENT OF OVERALL PROGRAM PERFORMANCE

Criterion	Weight (%)	Definition under ADB Guidelines	Rating Description	Rating Value	FMGP Rating	Score
1. Relevance	20	Relevance is the consistency of a project's impact and outcome with the government's development strategy for the country, and the Asian Development Bank's strategic objectives at the time of approval and evaluation and the adequacy of the design.	Highly relevant Relevant Partly relevant Irrelevant	3 2 1 0	1	0.2
2. Effectiveness	30	Effectiveness describes the extent to which the outcome, as specified in the design and monitoring framework, either as agreed at approval or as subsequently modified, has been achieved.	Highly effective Effective Less effective Ineffective	3 2 1 0	1	0.3
3. Efficiency	30	Efficiency describes, ex post, how economically resources have been converted to results, using the economic internal rate of return, or cost-effectiveness, of the investment or other indicators as a measure and the resilience to risk of the net benefit flows over time.	Highly efficient Efficient Less efficient Inefficient	3 2 1 0	1	0.3
4. Sustainability	20	Sustainability considers the likelihood that human, institutional, financial, and other resources are sufficient to maintain the outcome over its economic life.	Most likely Likely Less likely Unlikely	3 2 1 0	1	0.2
Overall Assessment (weighted average of above criteria)	Highly successful: Overall weighted average is greater than or equal to 2.7. Successful: Overall weighted average is greater than or equal to 1.6 and less than 2.7. Partly Successful: Overall weighted average is greater than or equal to 0.8 and less than 1.6. Unsuccessful: Overall weighted average is less than 0.8.				Total	1.0

FMGP = Financial (Nonbank) Markets and Governance Program.
Performance rating follows the ADB *Guidelines for Preparing Performance Evaluation Reports for Public Sector Operations*. January 2006.

STATUS OF COMPLIANCE WITH LOAN COVENANTS

Covenant	Reference in Loan Agreement	Status of Compliance
Loan 1955		
The Borrower shall cause the Project to be carried with due diligence and efficiency in conformity with sound administrative, financial, capital markets practices	(LA, Section 4.01(a)).	Complied with.
The Borrower shall make available, promptly as needed, the funds, facilities, services, and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Program and for the operation and maintenance of the Program facilities.	(LA, Section 4.02)	Complied with.
The Borrower shall ensure that the activities of the departments and agencies with respect to the carrying out of the Program and operation of the Program facilities are conducted and coordinated in accordance with sound administrative policies and procedures.	(LA, Section 4.03)	Partially complied with.
The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and to indicate the progress of the Program.	(LA, Section 4.04 (a)	Complied with.
The Borrower shall (a) ensure that the policies adopted and actions taken as described in the Policy Letter prior to the date of this Loan Agreement continue in effect for the duration of the Program period and subsequently, and (b) promptly adopt the other policies and take the other actions indicated in the Program as specified in the Policy Letter, including the Policy Matrix, and ensure that such policies and actions continue in effect during and after the Program period.	(LA Sched 5, para 1)	Partially complied with.
MOF shall be the Program Executing Agency and shall appoint a Program Director who shall facilitate overall implementation of the Program, administer the utilization of loan proceeds and ensure compliance with all policy related conditions. SECP shall be the Implementing Agency and shall have full responsibility for implementation of all conditions and program components within its regulatory and development mandate. MOF and SECP agencies, including Ministry of Commerce, Ministry of Labor, Privatization Commission, SBP and the private sector as appropriate. SECP shall facilitate wide stakeholder	(LA Sched 5, para 2)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
consultation and update the public on implementation progress through an electronic webpage for the program within SECP's website http://wwww.secp.gov.pk		
The Borrower shall keep ADB informed of, and the Borrower and ADB shall from time to time exchange views on the progress made in carrying out the Program	(LA Sched 5, para 3)	Complied with.
The Borrower shall continue timely policy dialogue with ADB on problems and constraints encountered during implementation of the Program and on desirable changes to overcome or mitigate such problems and constraints, and on further reforms to strengthen the financial (non-bank) markets	(LA Sched 5, para 4)	Complied with.
The Borrower shall keep ADB informed of the outcome of policy discussion with other multilateral and bilateral aid agencies that have implications for the implementation of the Program and shall provide ADB with an opportunity to comment on any resulting policy discussions.	(LA Sched 5, para 5)	Complied with.
The Borrower shall (i) maintain a conducive macroeconomic environment for financial market development: (ii) maintain its commitment to the principles of good governance of the financial sector and not impose any laws, rules, regulations or administrative measures that undermine the autonomy and effectiveness of the SECP and its capacity to attract, retain and develop qualified staff; and (iii) ensure continuation of the fiscal measures taken in coordination with ADB and the International Monetary Fund beyond the program period.	(LA Sched 5, para 6)	Partially complied with.
The Program Executing Agency shall assist ADB by providing relevant data and information I such detail as ADB may reasonably request.	(LA Sched 5, para 8)	Complied with.
The Borrower shall implement a Program performance management system for monitoring of the Program during and after implementation in accordance with a schedule and terms of reference to be mutually agreed upon by the Borrower and ADB.	(LA Sched 5, para 9)	Complied with.
The Borrower shall prepare quarterly progress reports as well as an annual report on Program implementation for submission to ADB. The Borrower shall ensure that SECP shall also update regularly the Program website for transparency in implementation and information of the	(LA Sched 5, para 10)	Partially complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
public. The MOF, in cooperation with SECP, and jointly with ADB shall conduct at least semi-annual reviews to evaluate compliance with the conditions and advise the Borrower on actions required to keep program implementation on course.		
The Borrower shall ensure that the counterpart funds to be generated out of the loan proceeds shall be used to finance the cost of structural adjustment, including the establishment of funds and facilities under the Program and shall, in particular, provide necessary budget appropriations in support of priority programs and projects implemented by SECP satisfactory to ADB for this purpose.	(LA Sched 5, para 11)	Complied with.
Loan 1956		
The Borrower shall cause the Project to be carried out with due diligence and efficiency and in conformity with sound administrative, financial, capital markets, pension and insurance practices.	(LA Section 4 (a)	Partially complied with.
The Borrower shall make available to MOC, MOF, MOL, SECP, EOBI, CDNS and SLIC, promptly as needed, the funds, facilities, services and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Project and for the operation and maintenance of the Project facilities.	(LA Section 4.02)	Complied with.
In the carrying out of the Project, the Borrower shall cause, through the Implementing Agencies, competent and qualified consultants and contractors, acceptable to the Borrower and the Bank, to be employed to an extent and upon terms and conditions satisfactory to the Borrower and the Bank.	(LA Section 4.03 (a)	Complied with.
The Borrower shall, through the Implementing Agencies, cause the Project to be carried out in accordance with plans, specifications and work schedules acceptable to the Borrower and the Bank. The Borrower shall, through the Implementing Agencies furnish, or cause to be furnished, to the Bank, promptly after their preparation, such plans,, specifications and work schedules, and any material modifications subsequently made therein, in such detail as the Bank shall reasonably request.	(LA Section 4.03 (b)	Complied with.
The Borrower shall ensure that the activities of MOC, MOF, MOL, SECP, EOBI, CDNS, SLIC and its other its departments and	(LA Section 4.04)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
agencies with respect to the carrying out of the Project and operation of the Project facilities are conducted and coordinated in accordance with sound administrative policies and procedures.		
The Borrower, through the, Implementing Agencies, shall make arrangements satisfactory to the Bank for insurance of equipment to be financed out of the proceeds of the Loan to such extent and against such risks and in such amounts as shall be consistent with sound practice.	(LA Section 4.05 (a)	Complied with.
Without limiting the generality of the foregoing, the Borrower undertakes to insure, or cause to be insured, through the Implementing Agencies, the goods to be imported for the Project and to be financed out of the proceeds of the Loan against hazards incident to the acquisition, transportation and delivery thereof to the place of use or installation, and for such insurance any indemnity shall be payable in a currency freely usable to replace or repair such goods.	(LA Section 4.05 (b)	Complied with.
The Borrower shall maintain, or cause to be maintained, through the Implementing Agencies, records and accounts adequate to identify the goods and services and other items of expenditure financed out of the proceeds of the Loan, to disclose the use thereof in the Project, to record the progress of the Project (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, the operations and financial condition of the agencies of the Borrower responsible for the carrying out of the Project and operation of the Project facilities, or any part thereof.	(LA Section 4.06 (a)	Complied with.
The Borrower, through the Implementing Agencies, shall (i) maintain, or cause to be maintained, separate accounts for the Project; (ii) have such accounts and related financial statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to the Bank; (iii) furnish to the Bank, as soon as available but in any event not later than six months after the end of each related fiscal year, certified copies of	(LA Section 4.06 (b)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the Loan proceeds and compliance with the covenants of this Loan Agreement as well as on the use of the procedures for imprest account/statement of expenditures), all in the English language; and (iv) furnish to the Bank such other information concerning such accounts and financial statements and the audit thereof as the Bank shall from time to time reasonably request.		
The Borrower, through the Implementing Agencies, shall enable the Bank, upon the Bank's request, to discuss the Borrower's financial statements for the Project and its financial affairs related to the Project from time to time with the Borrower's auditors, and shall authorize and require any representative of such auditors to participate in any such discussions requested by the Bank, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower shall otherwise agree.	(LA Section 4.06 (c)	Complied with.
The Borrower, through the Implementing Agencies, shall furnish, or cause to be furnished to the Bank all such reports and information as the Bank shall reasonably request concerning (i) the Loan, and the expenditure of the _proceeds and maintenance of the service thereof; (ii) the goods and services and other items of expenditure financed out of the proceeds of the Loan; (iii) the Project; (iv) the administration, operations and financial condition of the agencies of the Borrower responsible for the carrying out of the Project and operation of the Project facilities, or any part thereof; (v) financial and economic conditions in the territory of the Borrower and the international balance-of-payments position of the Borrower; and (vi) any other matters relating to the purposes of the Loan.	(LA Section 4.07 (a)	Complied with.
Promptly after physical completion of the Project, but in any event not later than three (3) months thereafter or such later date as may be agreed for this purpose between the	(LA Section 4.07 (c)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
Borrower and the Bank, the Borrower, through the Implementing Agencies, shall prepare and furnish to the Bank a report, in such form and in such detail as the Bank shall reasonably request, on the execution and initial operation of the Project, including its cost, the performance by the Borrower of its obligations under this Loan Agreement and the accomplishment of the purposes of the Loan.		
The Borrower, through the Implementing Agencies, shall enable the Bank's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.	(LA Section 4.08)	Complied with.
The Borrower, through the Implementing Agencies, shall ensure that the Project facilities are operated, maintained and repaired in accordance with sound administrative, financial, engineering, environmental, and maintenance and operational practices.	(LA Section 4.09)	Complied with.
The MOF shall be the Executing Agency for the Project and shall ensure coordination and communication among the Implementing Agencies and EOBI, SLIC, CDNS and SECP.	(LA Sched 6 para 1)	Complied with.
Each Implementing Agency shall establish and maintain separate accounts for each Component of the Project for which it is responsible in accordance with accounting procedures acceptable to the Bank. The accounts of each Implementing Agency and the Project shall be audited annually by independent auditors in accordance with auditing standards acceptable to the Bank. Certified copies of the audited accounts and financial statements and the report of the auditors shall be submitted to the Bank in English within 6 months after the end of each fiscal year.	(LA Sched 6 para 4)	Complied with.
Each Implementing Agency shall ensure that the consultants for each Component of the Project for which it is responsible prepare an inception report on their respective Components within four weeks of the commencement of their services, providing a time-bound work program. In addition to any	(LA Sched 6 para 5)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
full report required at the end of each individual sub-component, each Implementing Agency shall ensure that the consultants and the Implementing Agency shall submit quarterly progress reports. The final report for each Component shall be submitted within three months of the end. of the Component or the Project, whichever is earlier, and shall incorporate comments received from the Borrower and the Bank.		
A comprehensive midterm review shall be undertaken jointly by the Bank, each Implementing Agency and the consultants nine months after project inception to review all aspects of project implementation.	(LA Sched 6 para 6)	Complied with.
Loan 1957		
The Borrower shall cause SECP to carry out the Project with due diligence and efficiency and in conformity with sound administrative, environmental, financial and capital markets practices.	(LA Section 4.01 (a)	Complied with.
The Borrower shall make available to SECP, promptly as. needed, and on terms and conditions acceptable to the Bank, the funds, facilities, services and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Project.	(LA Section 4.02)	Complied with.
The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Project and operation of the Project facilities are conducted and coordinated in accordance with sound administrative policies and procedures.	(LA Section 4.03)	Complied with.
The Borrower shall furnish, or cause to be furnished, to the Bank all such reports and information as the Bank shall reasonably request concerning (i) the Loan, and the expenditure of the proceeds and maintenance of the service thereof; (ii) the goods and services and other items of expenditure financed out of the proceeds of the Loan; (iii) the Project; (iv) the administration, operations and financial condition of SECP and any other agencies of the Borrower responsible for the carrying out of the Project and operation of the Project facilities, or any part thereof; (v)	(LA Section 4.04)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
financial and economic conditions in the territory of the Borrower and the international balance-of-payments position of the Borrower; and (vi) any other matters relating to the purposes of the Loan.		
The Borrower shall enable the Bank's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.	(LA Section 4.05)	Complied with.
The Borrower shall take all action which shall be necessary on its part to enable SECP to perform its obligations under the Project Agreement, and shall not take or permit any action which would interfere with the performance of such obligations.	(LA Section 4.06)	Partially complied with.
It is the mutual intention of the Borrower and the Bank that no other external debt owed a creditor other than the Bank shall have any priority over the Loan by way of a lien on the assets of the Borrower. To that end, the Borrower undertakes (i) that, except as the Bank may otherwise agree, if any lien shall be-created on any assets of the Borrower as security for any external debt, such lien will ipso facto equally and ratably secure the payment of the principal of, and interest charge and any other charge on, the Loan; and (ii) that the Borrower, in creating or permitting the creation of any such lien, will make express provision to that effect.	(LA Section 4.07)	Complied with.
The Borrower shall cause SECP to be the Project Executing Agency and coordinate activities relating to implementation for the Project.	(LA Sched 6 para 1)	Complied with.
SECP shall closely coordinate with other stakeholders, including from the private sector, involved in the .implementation of the TA to ensure the relevance of the Project to development and improved governance of the Borrower's financial (non-bank) markets.	(LA Sched 6 para 2)	Partially complied with.
SECP shall establish and maintain separate accounts for the project in accordance with accounting procedures acceptable to the Bank. The accounts of SECP and the Project shall be audited annually by independent auditors in accordance with auditing standards acceptable to the Bank.	(LA Sched 6 para 4)	Complied with.

Covenant	Reference in Loan Agreement	Status of Compliance
Certified copies of the audited accounts and financial		
The SECP shall ensure that the consultants for the Project prepare an inception report on their respective components within four weeks of the commencement of their services, providing a time-bound work program. In addition to any full report-required at the end of each individual component, SECP shall ensure that the consultants and SECP shall submit quarterly progress reports. The final report shall be submitted within three months of the end of the Project and shall incorporate comments received from the Borrower and the Bank.	(LA Sched 6 para 5)	Complied with.
A comprehensive midterm review shall be undertaken jointly by the Bank, SECP and the consultants nine months after project inception to review all aspects of project implementation.	(LA Sched 6 para 6)	Complied with.
The Borrower, through SECP, shall monitor and evaluate the Project during and after implementation in accordance with a schedule and terms of reference to be mutually agreed upon by the Borrower, SECP and the Bank.	(LA Sched 6 para 7)	Complied with.

ADB = Asian Development Bank; CDNS = Central Directorate of National Savings; EOBI = Employees' Old-Age Benefits Institution; LA = Loan Agreement; MOC = Ministry of Commerce; MOF = Ministry of Finance; MOL = Ministry of Labor; SBP = State Bank of Pakistan; SECP = Securities and Exchange Commission of Pakistan; SLIC = State Life Insurance Corporation.
Sources: ADB Staff.

LIST OF CONTRACTS AWARDED TO ASIAN DEVELOPMENT BANK MEMBER COUNTRIES

Table A8.1: Loan 1956-PAK: Strengthening Pension, Insurance and Savings Systems

Country	Amount	%
Aries Group Ltd, USA	1.84	79
Sidat Hyder Morshed Associates (PVT) Ltd, Pakistan	.48	21
Total	**2.32**	**100**

Sources: ADB Staff.

Table A8.2: Loan 1957-PAK: Strengthening Regulation, Enforcement, and Governance of Nonbank Financial Markets

Country	Amount	%
International Securities Consultancy, Hong Kong	2.69	85
DWP Technologies (PVT) Ltd	.37	15
Total	**2.53**	**100**

Sources: ADB Staff.