

## Development Finance Institutions

# 6.1

*Asset base of Development Finance Institutions (DFIs) contracted substantially owing to decrease in investments in government securities which had posted strong growth in last year on the back of borrowings from financial institutions. The advances portfolio recorded subdued growth. However, the overall asset mix remained concentrated in government securities. Earnings remained healthy, mainly supported by substantial increase in non-interest income, particularly from dividend earnings while net interest income remained steady due to pressure on net interest margin in the backdrop of falling interest rates. Solvency indicator i.e., CAR improved on the back of healthy earnings and remained well above the regulatory requirement.*





## 6.1 Development Finance Institutions

*Asset base of DFIs contracted due to a fall in investments...*

After a strong investment-led growth of 63.3 percent in last year, the asset base of DFIs contracted by 15.3 percent during CY24 (Table 6.1.1). The contraction was mainly driven by a fall in investments.

Though investments, which mainly comprise of government securities, witnessed a significant decline of 18.6 percent during the year under review, they remained the major part of the asset base with 83 percent share – staying well above the historical average of last five years (75.9 percent).

The advances, which constitute only 9.7 percent of asset base, grew by a meager 1.5 percent in CY24 (0.1 percent growth in CY23). Within advances, private sector advances, which constitute around 95 percent of DFIs' advances in CY24, declined by 0.7 percent, while domestic public sector exposure rose by 81.2 percent and supported the growth in total advances.

Key Variables and Financial Soundness Indicators Table 6.1.1

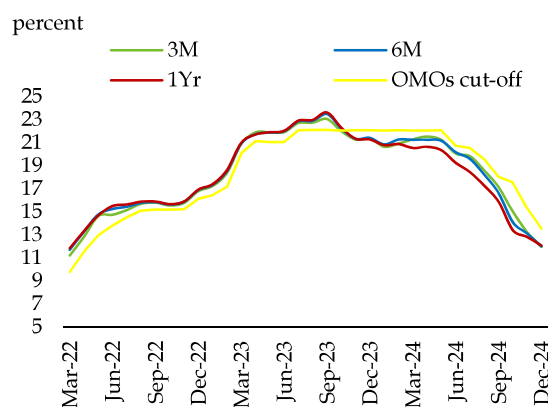
	CY20	CY21	CY22	CY23	CY24
<b>billion Rupees</b>					
Investments (net)	287	338	1,168	2,025	1,648
Advances (net)	111	140	188	188	191
Total Assets	439	539	1,430	2,338	1,979
Borrowings	261	348	1,223	2,117	1,652
Deposits	27	34	38	45	78
Equity	132	136	145	144	191
NPLs	15.8	14.5	14.6	15.1	16.8
<b>percent</b>					
CAR	43.1	38.7	36.5	43.3	52.5
NPLs to Advances	12.8	9.5	7.3	7.4	8.0
Net NPLs to Net Advances	3.1	1.6	0.9	-1.2	1.9
ROA (After Tax)	3.3	2.4	1.6	0.9	1.2
ROE (After Tax)	10.7	8.9	10.1	13.3	17.1
Cost to Income Ratio	25.2	32.5	26.9	24.0	20.6
Liquid Assets to Short-term Liabilities	97.5	98.0	98.2	95.9	110.1
Advances to Deposits	405.1	412.6	493.4	417.7	243.6

Source: State Bank of Pakistan

*Investments moderated on the back of government securities....*

Investment portfolio recorded a broad-based decline, as government securities, investments in shares and TFCs recorded decline in CY24. The decline in investments was mainly driven by government securities, which constitute around 97 percent of total investments. These securities contracted by 19.2 percent in CY24. The reduction was in contrast to a strong 82.1 percent growth in last year – mainly funded by borrowing from open market operations (OMOs) and financial institutions, in an environment marked by rising interest rate. This incentivized the DFIs to substantially increase their portfolio of government securities. During the year under review, declining yields on treasuries vis-à-vis relative steady cost of funds induced DFIs to reduce investments (Figure 6.1.1).

Secondary Market Yields and Cut-off rate on OMOs Injection Figure 6.1.1



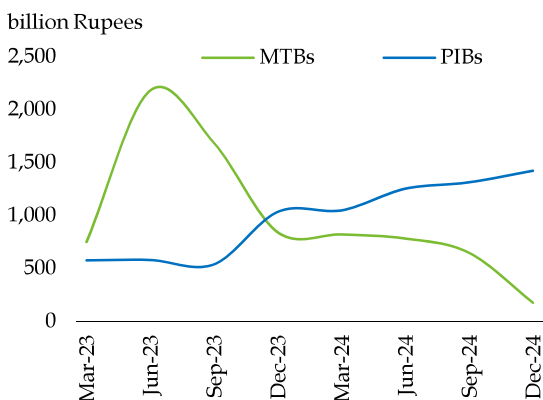
Source: MUFAP and State Bank of Pakistan

Within government securities, DFIs reduced short term MTBs while longer tenor PIBs rose during CY24. On the other hand, investments in equity stock, which is a small fraction of overall investments (0.6 percent) dropped by 41.3 percent to Rs 10 billion, as the institutions capitalized on the booming stock market to book gains on sale of quoted shares during the year.

*The composition of investment in government securities changed in favor of PIBs ....*

Investment in MTBs significantly contracted by 79.4 percent to Rs 173 billion in CY24. However, DFIs increased their investments in PIBs by Rs 389 billion to reach Rs 1,422 billion by the end of CY24, which suggests institutions preferred to lock funds in longer term securities amid the declining interest rates. However, within PIBs, DFIs preferred to invest in floating rate instruments that have relatively lower sensitivity to changes in interest rates. This was reflected in the rising share of floating rate government securities in Fair Value Through Other Comprehensive Income (FVOCI), commonly known as available for sale (AFS), category and Fair Value Through Profit and Loss (FVTPL), generally known as held for trading (HFT), category (Figure 6.1.2).<sup>1</sup>

Stock of MTBs and PIBs Figure 6.1.2



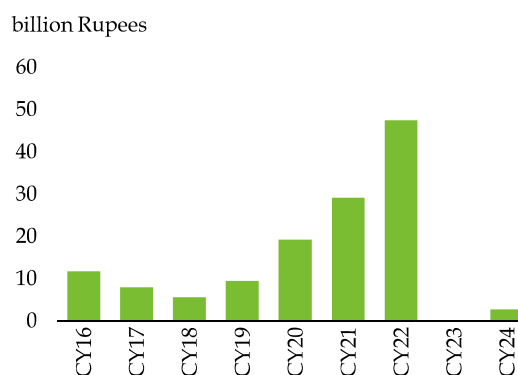
Source: State Bank of Pakistan

*Advances growth recovered modestly....*

The advances growth, though meager, was relatively better at 1.5 percent in CY24 compared to 0.1 percent in CY23 (Figure 6.1.3). The uptick in advances pushed their share in the overall asset base to 9.7 percent in CY24 from 8.0 percent in CY23. Corporate sector remained the main user of financing, largely for fixed

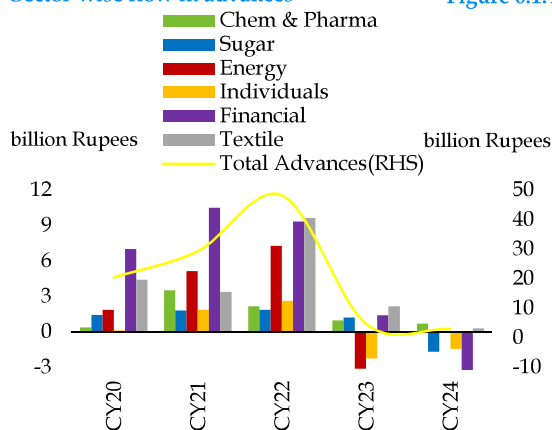
investment purposes followed by working capital requirements. The increase in advances was primarily due to financing availed by public sector, as advances of private sector declined in CY24. Sector wise data reveals that within the private sector advances, only agri-businesses and auto financing (such as for commercial vehicles) rose, however, the net retirements in other sectors such as cement and sugar dragged the overall private advances during CY24. The increase in public sector advances was channeled to housing finance by a single DFI (Figure 6.1.4).

Yearly flow of Advances (Net) Figure 6.1.3



Source: State Bank of Pakistan

Sector-wise flow in advances Figure 6.1.4



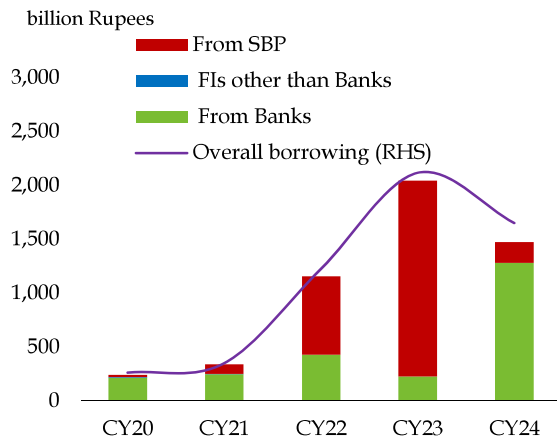
Source: State Bank of Pakistan

<sup>1</sup> The combined share of FVOCI and FVTPL in total government securities is 88.9 percent at end CY24 as compared to 53.3 percent at end CY23.

### Borrowing declined in line with the significant fall in investments...

Borrowing has remained the major source of funding for DFIs in recent years, as the sector cannot raise checking deposits from public. It may be recalled that DFIs' investments rose significantly during CY22 and CY23, which were mainly funded by additional borrowings. However, DFIs observed negative net interest income during H1CY24, on the back of higher fall in yields compared to funding costs which remained relatively sticky (**Figure 6.1.1**). This development induced a fall in investments and an associated decline in borrowings during CY24. Borrowing contracted by 22.0 percent or Rs 466 billion in CY24 (73.1 percent or Rs 894 billion increase in CY23). DFIs, however, changed the mix of their borrowings by raising funding from banks and retiring the borrowing from SBP (**Figure 6.1.5**).

**Composition of Borrowings** Figure 6.1.5

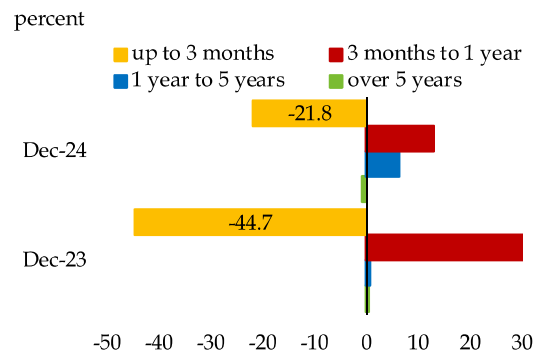


Source: State Bank of Pakistan

### Maturity mismatch declined with retirements of short term borrowings...

The maturity-wise analysis of rate sensitive assets (RSA) and liabilities (RSL) indicates that gap between the two has contracted by the end of CY24. The improvement was particularly visible in combined up to 1-year time bands (**Figure 6.1.6**). This was in line with the fall in short term borrowings.

**Gap of Rate Sensitive Assets (RSA) and Liabilities (RSL) as Percent of Total Assets** Figure 6.1.6



Source: State Bank of Pakistan

### Most of the earning assets have shorter repricing maturities ...

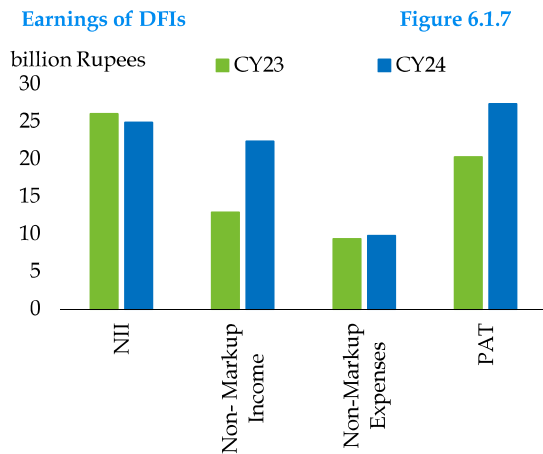
A major portion of earning assets had relatively shorter maturity at end CY24. The investments, which form major part of the asset mix i.e., 47.0 percent were repricing within three months, whereas, 41.0 percent were repricing in three months to one year. On the other hand, 56.5 percent of advances were repricing within three months and 14.8 percent in three months to one year.

### Earnings remained healthy on the back of significant non-interest income ...

After-tax profit of DFIs increased by 34.7 percent to Rs 27 billion in CY24 (Rs 20 billion in CY23), owing to significant growth in non-interest earnings. Dividend income posted a notable growth of 79.8 percent, rising to Rs 18 billion (Rs 10 billion in CY23). Main driver of the growth in dividend income was the stake of a DFI in a leading Islamic bank – the DFI contributed 94.1 percent in total dividend income of the sector. With a slight contraction, net interest income remained more or less stable at Rs 25 billion in CY24 (Rs 26 billion in CY23). A major drag on net interest income stemmed from contraction in net interest margin, as falling interest rates translated into relatively higher decrease in return on earnings assets vis-à-vis the decrease in cost of funds. Besides, a contraction in assets

in CY24 also contributed in lower net interest income in CY24 compared to last year.

On the other hand, non-interest expenses grew at a slower pace of 4.5 percent to Rs 10 billion in CY24 (**Figure 6.1.7**). The falling inflation helped in stagnation in admin cost at around Rs 9 billion in CY24 (also Rs 9 billion in CY23).



Source: State Bank of Pakistan

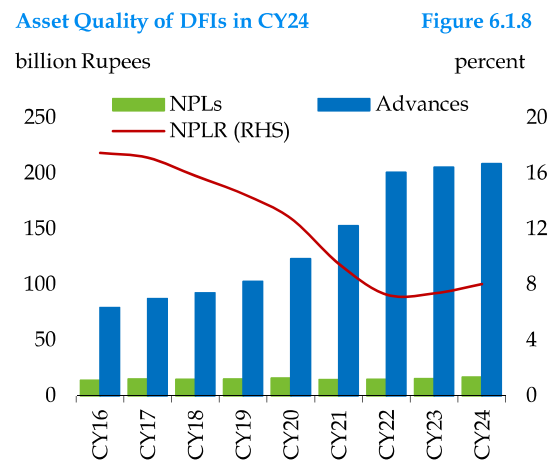
*ROA and ROE improved owing to noteworthy growth in earnings ...*

With a healthy growth in profitability and a decline in asset base, the after tax return on assets (ROA) increased to 1.2 percent during CY24 (0.9 percent in CY23). Likewise, return on equity (ROE) improved to 17.1 percent during CY24 (13.3 percent in preceding year) due to growth in income and a modest uptick in equity.

*Asset quality indicators showed slight deterioration in CY24, though remaining in comfortable range...*

Over the recent years, infection ratio of the DFI sector has shown improvement on the back of growth in advances, better credit risk management and better recoveries against NPLs.<sup>2</sup> However, NPL to advances ratio slightly deteriorated to 8.0 percent by end CY24 from 7.4 percent in CY23 (**Figure 6.1.8**). Gross NPLs rose by Rs 2 billion, higher than last year. The

provisioning coverage also dropped to 78.6 percent during CY24 (114.8 percent last year). Accordingly, net NPLs to net loans and capital impairment ratios deteriorated in CY24 to 1.9 percent (-1.2 percent in CY23) and 1.9 percent (-1.6 percent in CY23), respectively.



Source: State Bank of Pakistan

Nevertheless, these ratios remained in comfortable range, and relative to the amount of loan loss provision and capital, the risk to solvency of DFIs remained muted.

*CAR of the DFIs sector improved on the back of healthy earnings...*

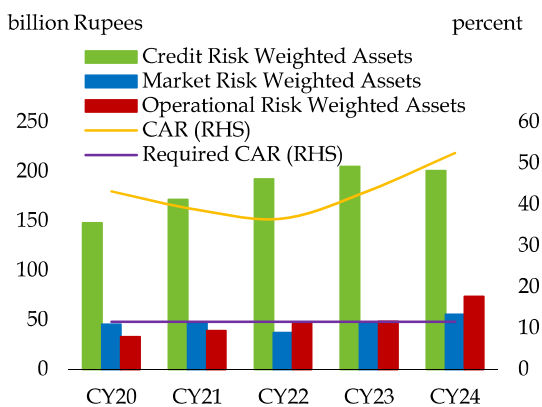
The aggregate CAR of DFIs has historically remained well above the required benchmark due to strong capital base coupled with the fact that the asset base is mainly comprised of investment in risk-free government securities while share of lending remains low. During the year under review, CAR further improved to 52.5 percent (43.3 percent at end CY23). The CAR ratio remained considerably higher than the regulatory requirement of 11.5 percent.

The improvement in CAR emanated from significantly higher growth (32.8 percent) in regulatory capital vis-à-vis risk-weighted assets, on the back of healthy earnings and revaluation surpluses. Accordingly, both major components

<sup>2</sup> Recoveries against NPLs stand at Rs 1 billion in CY24, higher than Rs 198 million in CY23.

of capital, Tier-I and Tier-II, grew during CY24. Besides, the addition of one new DFI that has strong capital base, also boosted the aggregate CAR of the sector. Total risk weighted assets (TRWAs), however, recorded lower growth of 9.7 percent in CY24 compared to capital, which translated into improvement in the CAR ratio. Detailed analysis of DFIs' regulatory capital requirement shows the credit risk which forms the major part, i.e., 68 percent of the total capital requirement, slightly contracted during CY24 (Figure 6.1.9).

CAR and Risk Weighted Assets of DFIs Figure 6.1.9



Source: State Bank of Pakistan

However, market risk weighted assets increased by 17.4 percent due to transfer of some investment portfolio from banking book to trading book.<sup>3</sup> Operational RWAs surged by a notable 51.9 percent, on the back of higher gross income in recent years, which forms the basis of operational risk under Basic Indicator Approach (BIA) for calculation of capital requirement for operational risk.

Keeping in view the relatively constrained future prospects of earnings owing to shrinking yields on government securities, DFIs have started to adopt alternative strategies which focus on exploring the potentials of various areas. DFIs diversified their operations by investing in digital banks, venture capital and launching dedicated Islamic Finance division to

provide a diverse array of Sharia-compliant financial products.

The DFIs were established to promote development finance and support the capital formation in the economy. However, various challenges have hindered their growth, leading them to adopt a conservative business approach. DFIs have faced several constraints, including the structural challenges like limited access to capital market, which also lacks depth, a low national savings rate, and subdued demand for long-term financing due to multiple factors. They have quite constrained access to deposits vis-à-vis commercial banks, and unlike their counterparts in other jurisdictions, DFIs lack access to concessional lending schemes for development objectives. Amid these challenges, the DFIs need to find innovative ways to promote development finance and support the capital formation process in the country. For instance, exploring potential strategies such as alternative financing models and public private partnerships would help DFIs play their due role in development.

<sup>3</sup> Trading book portfolio entails more stringent capital charge for interest rate risk as compared to banking book.

