

Shamshad Akhtar: Global transaction banking

Keynote address by Dr Shamshad Akhtar, Governor of the State Bank of Pakistan, at the Annual Global Transaction Banking Seminar, organised by Deutsche Bank, Karachi, 3 May 2006.

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Let me first welcome the Deutsche Bank global team to Pakistan. Deutsche Bank has been an age-old partner in the development of Pakistan's banking industry and we look forward to the advice of their global team, and their contribution to supporting the enhancement of global transactions in Pakistan's banking industry.

Today, Pakistan offers a promising ground for financial experimentation and innovation. Pakistan's banking industry has seen brisk growth in banking assets which today stand at over \$60 billion. Bank's profitability is at an all time high and unprecedented, reaching close to Rs 95 billion by end 2005. Aside from higher efficiency gains in the industry attributable to benefits arising from significant banking sector restructuring and reforms, high profitability of banks has been achieved because of high interest margins. In the period ahead, the financial industry however has to be positioned for a more competitive environment and has to cater for more diverse and complex requirements of Pakistan's consumers and infrastructure. Pakistan, like the rest of Asia, is growing fast and the rise in per capita income, emergence of the middle income group and relative wealth increases altogether bring with them new demands for the retail banking industry. Among others, both investors and industry are seeking better investments and financing alternatives and solutions, with demand for private debt, asset based and mortgage based securities, credit derivatives and hedge products etc. now emerging from different segments of the economy and population.

Beside these real sector developments and requirements, financial industry of Pakistan has to catch up fast with the global developments and achieve better financial diversification and strengthen its risk management systems. In Pakistan's context, it has to be recognized that while large banks will continue to thrive on volumes of business which they have traditionally captured given their reach across the country, it is the foreign banks with their competitive edge in global transaction banking that can offer unique and new financial solutions and lead the way for the rest of the banking industry to provide to customers an integrated solution that caters for emerging consumer and industry requirements.

Global changes in the financial industry

Compulsions to go this route are mounting. World-wide, the financial landscape has changed driven by:

- Changing macroeconomic factors such as economic growth and demography and institutional development as capital markets have matured and population demands for retirement funding and insurance has grown
- The phenomenal growth in financial markets and cross border flows
- The ability of the financial industry to take advantage of the opportunities provided by the lending and mortgage markets, and development of credit risk transfer instruments which involve structuring and trading of credit derivatives and asset backed securities that allows risk inherent in a loan to be repackaged into two or three tradable components to offer optimal allocation of risks– this is particularly relevant in the context of developing financial markets where the risk profiles of banks are still dominated by credit risk predominantly of the issuance of loans even though there are moves towards corporate bonds or transactions in over-the-counter markets, which involve the risk of a counterparty defaulting.
- Adoption and adaptation of technological advancements in communication and information technology that has seen the explosion of financial innovation with service providers now offering multiple and diverse solutions that enhance efficiency and reach of products across boundaries and across national jurisdictions.
- Need to globally integrate financial systems and encourage end-to-end straight through processing capabilities and development of payment, clearing and settlement systems to overcome time zone and currency constraints.

- With globalization of markets & businesses, there is greater need for global transaction solutions for effective cash management, trade finance, trust & securities services, and continuous linked settlement.
- Finally, there are now mounting regulatory pressures to seeking greater IT solutions to tracking money laundering as well as adopting the new risk management framework including Basle II.

Role of the central bank

Recognizing that Pakistan's banking industry subsequent to its restructuring is now positioned to move to the next level of development, SBP has been focusing on promoting gradual migration from a predominantly cash and paper-based system to electronic payments. This has involved on one hand development of the Real Time Gross Settlement (RTGS) system, awareness creation and information dissemination about the role, importance and issues of payment systems and protection of consumer interests. On the other hand, it has involved encouraging banks to invest in technology and improve their payment and settlement system infrastructure, internal controls and move to e-banking.

Clearing and settlement systems in Pakistan

As a custodian of the Payment System of the country, SBP has nurtured and supervised the operation of the clearing house for the member banks operating within its jurisdiction. Automated Clearing services are now provided by National Institutional Facilitation Technologies (NIFT) under the supervision of SBP in nine major cities of Pakistan. A complete range of conventional clearing services including overnight clearing, same day high value clearing, intercity clearing etc are provided by NIFT. In rest of the business centres the process is manual but would eventually need to be automated. The Local US dollar clearing system provides a low cost and efficient clearing system for US dollar denominated local instruments. The new system has reduced the clearing time of US dollar cheques from three weeks to only four days and has reduced the cost to the account holders. Banks and their branches in eleven cities are fully utilizing this facility.

Real Time Gross Settlement

Pakistan's Real time Inter bank Settlement Mechanism (PRISM) is at an advanced stage of installation and is expected to be live by the 3rd quarter of 2006. It will automate the current inter-bank settlement systems for large value payments at SBP and will minimize risks like credit, liquidity and settlement risks inherent in the end of the day settlement system. Its implementation will make the payments system much more efficient and resilient, offering transactional features which are hard to achieve under the current settlement systems. The RTGS system is based on the Society for Worldwide Inter-bank Financial Telecommunication topology and includes the functionalities of Queue management, Grid Lock Resolution and interfacing with Globus.

PRISM will not only automate the Inter Bank funds transfer but will also facilitate the settlement of government securities transactions in Primary and Secondary Markets. After the implementation of PRISM, settlement of securities between the participants will be on Delivery vs. Payment basis thus reducing the risk in securities trading by minimizing the settlement lag. SBP will also be able to settle the open market operation transaction through PRISM. PRISM will also bring more efficiency in inter-city and intra-city clearing between the banks as NIFT will handle clearing on multilateral basis and these clearing results will be settled on a real time basis in PRISM. PRISM will also facilitate the commercial banks in making time critical third party funds transfers on behalf of its customers.

Payments System and Electronic Funds Transfers Act 2005

To facilitate nation-wide RTGS and electronic funds transfer, Pakistan has now drafted the "Payments System and Electronic Funds Transfers Act 2005" that ensures conformance with industry demands and the Bank for International Settlements Core Principles for Systemically Important Payment Systems. The proposed Act addresses issues like operation of payment systems, including the clearing and settlement obligations of the parties involved, supervisory role of SBP, documentation requirements by the participants, liabilities of parties in payment systems and legal proceedings in case of any conflict, finality and irrevocability of settled transactions etc. The Act also gives necessary

legal coverage to PRISM. SBP is also framing the requisite rules and regulations for the smooth operations and participation in PRISM.

Progress in electronic payment systems

There has been substantial improvement in the payment system infrastructure and consumers' payment patterns over the last few years, particularly in urban areas, which is evident from the exponential growth in Automated Teller Machines (ATM) Cards, Debit & Credit Cards, ATM outlets, Points of Sales (POS) accepting payments through cards and number of online branches of commercial banks providing SWIFT intra bank account to account funds transfer facilities and the interconnectivity of the two ATM switches viz. the MNet and 1-Link. With the strategic focus of SBP to develop a well functioning and efficient payment system in the country coupled with rapid technological changes, the pace of growth in payment system infrastructure will further accelerate in the medium term and its outreach will extend to even smaller towns. This will enable a larger number of consumers to use the enhanced and extended payment system infrastructure, and will bring greater efficiency and cost effectiveness in the system.

Online branches network

The online branch network is also expanding at a fast pace and reached to 3,265 at the end of Dec 2005 from 2,475 at the end of the preceding year, indicating an impressive increase of 32 percent or 790 branches. The addition of 315 branches into the online network in the fourth quarter is signalling further acceleration in the pace of growth of the online branches. The coverage of online branches as a percentage of total branches (7,245 branches) has now reached 45 percent. At this pace, the whole branches network of the banking system will be online in the very near future, which will substantially improve efficiency of the payment system.

Point of sale transactions

Usage of cards at POS is expanding with the passage of time. This channel recorded remarkable growth of 62 percent in number of transactions, to 13 million transactions in FY05 from 8 million in the previous year. Value of transactions grew by 56 percent to Rs 42.8 billion in FY05 from Rs27.4 billion in FY04.

Conclusion

The GTB concept though newer to Pakistani banks, will help service the ever growing need for Pakistan's trade & finance and facilitate investors' awareness to the growing Pakistani economy & markets. We see inter-exchanges like this to further strengthen the transaction banking business in Pakistan. SBP is conscious of the need to further strengthen the payments & settlement systems in Pakistan to reduce inherent settlement risks and bringing efficiency to the financial system. We look forward to global entities, like Deutsche Bank, in performing their due role to facilitate providing awareness & expertise to further strengthen the financial system.

GTB will help in providing fully integrated risk mitigation, settlement, financing and information solutions, which help unlock working capital trapped in inefficient order-to-cash and purchase-to-pay cycles. It will also assist businesses to achieve greater integration of the supply chain, which facilitates greater efficiencies and streamlined workflows, whilst reducing operating costs and accelerating payment cycles. More efficient trade processes also mitigate risk exposure and help the businesses optimise returns from trade assets.