ASSIGNMENT No. 02

Fundamental of Money and banking (8593) BS ACCOUNTING AND FINANCE

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Q. 1 What is a commercial bank? Explain the different types of services provided by a commercial bank. (20)

If you're looking to open a business bank account, a personal account, or looking for a loan or investment opportunities, it's important to be aware of the different types of banks you can do business with.

The banking industry is full of opportunities, but it can be a complicated place. Many different types of banks and other financial institutions function differently, offer different services, and provide different benefits. That's why it's important to research before getting started.

In this article, we will discuss the different types of banks, and their key features, and give some insight into which type of bank is suitable for you.

1. Retail Banks

Retail banks, also referred to as consumer banking or personal banking, are the types of banks that offer services that cater to individuals. These banks can facilitate the majority of the services that individuals would require from a financial institution, including regular transactions, personal loans, and specific brokerage services.

Despite being widely used by the general public, retail banks also provide business bank accounts and are sometimes used by small businesses.

Small businesses may opt for retail banks instead of commercial banks due to eligibility issues such as a lack of required credit history or revenue. Additionally, they may prefer the convenience of retail banks which come with more locations and longer hours than commercial banks.

2. Commercial Banks

Commercial banks are designed for businesses and for commercial purposes, typically offering essential banking services to small and medium-sized businesses.

Compared to retail banks, commercial banks carry a few more fees and expenses to use, but they also offer more financial services and products.

These banks play an essential role in a local economy as they provide capital and liquidity in the market by taking deposited funds and lending them out in the form of credit which ultimately helps boost the economy.

3. Investment Banks

Investment banks are a bit different from the other two on the list. Their main function is to manage the trade of stocks, securities, and bonds between companies and their investors. Investment banks also specialize in complex services such as underwriting, corporate finance advice, and managing investment portfolios to raise capital for businesses and, in some cases, the federal government. Additionally, they play major roles in the mergers and acquisitions of companies, working to reorganize acquired firms. Typically, the type of customers with investment banking is high-profile companies and individuals.

4. Credit Unions

Credit unions are types of financial cooperatives that offer typical banking services but operate as non-profit institutions and are owned by their members. They have been a consistent alternative to traditional banking for many. As of 2023, the membership of credit unions has increased to 138 million, according to the Credit Union National Association.

In their functionality, they are very similar to retail and commercial banks, and their services are targeted at individual consumers, startups, and small businesses. The difference is credit unions mainly serve people affiliated with certain groups, such as people living in a certain region, those living in low-income communities, active members of the military or military veterans, and so on.

They charge much lower fees than other banks and aim to provide more affordable services to members.

5. Private Banks

Private banks are designed to be, from their name, private. Regular individuals may not be familiar with or come across many private banks because they cater specifically to high-net-worth individuals, like CEOs of larger corporations or someone with minimum liquid assets of USD 1 million. However, the minimum amount of cash required to open accounts varies from bank to bank. The financial products and services provided by private banks, such as account maintenance, carry fees. These fees can be avoided by meeting a certain account minimum balance, which shifts from bank to bank.

6. Savings and Loan Associations

Savings and Loan Associations (S&Ls), also known as Thrift Banks, are mutually owned financial institutions that offer mortgages, refinance loans, and alternative home loans using deposited savings.

Although S&Ls are not banks in the traditional sense as they focus on home financing, they also provide limited lending services to businesses, savings accounts and different types of deposit accounts. S&Ls are required to have at least 65% of their loans to consumers on housing-related terms, which is why their services to businesses are slightly less than those of individuals.

7. Challenger Banks

Challenger banks, also referred to as Online banks or Digital banks, are banks that challenge the traditional methods of banking. They offer most of the services that traditional banks do, but primarily through digital channels. Many challenger banks don't set up physical branches, while a few still maintain a limited number of physical locations. From 2016-2019, the search for Challenger banks online increased by 32%, while the search for traditional banks decreased by 22% during the same period. An increasing number of users have started considering this option mostly due to the challenges that they may face with traditional banks.

Because they challenge the traditional ways of banking, there have been doubts about their security and legitimacy. But many online banks have authorized banking licenses in the countries where they operate so they are regulated by respective local authorities. These banks have been a growing trend that focuses on improving their services through innovation, technology, and convenience.

Q. 2 What are the five Cs of credit? Discuss them in detail in the context of bank loans. (20)

Character is the first C of credit, and it refers to a person's moral fiber and their tendency to fulfill their financial obligations. It is essential to assess whether an individual is trustworthy and responsible in managing their finances. When evaluating an individual's character, lenders consider their past behavior, including their payment history, credit utilization, and any derogatory marks on the credit report. A person with a good character is likely to have a clean credit report, on-time payments, and a stable employment history. They are also more likely to communicate openly with creditors and seek help when experiencing financial difficulties. A person with good character is considered low-risk, and lenders are more likely to approve their credit applications. However, a person with poor character may be considered high-risk, and lenders may be hesitant to approve their credit applications.

A person's character can also be assessed through their credit score, which is a numerical representation of their creditworthiness. A higher credit score indicates good credit, while a lower credit score indicates poor credit. The credit scoring system takes into account various factors, including payment history, credit utilization, length of credit history, and credit mix. Creditors use these scores to determine the likelihood of lending to an individual and the interest rate to charge. A person with a good credit score is considered more creditworthy and may be eligible for lower interest rates. On the other hand, a person with a poor credit score may be considered less creditworthy and may be charged higher interest rates.

Lenders also consider a person's personal characteristics, such as their age, income, employment history, and education. A person with a stable employment history, a steady income, and good education is considered a lower-risk borrower. In contrast, a person with a history of job hopping, unstable income, or poor education may be considered a higher-risk borrower. A person's credit history also plays a crucial role in assessing their character. A person with a short credit history or a history of late payments is considered a higher-risk borrower than one with a long credit history and a history of on-time payments.

A person's social and family ties can also impact their character. For instance, a person with a stable family life, a good social network, and a strong community presence is considered a lower-risk borrower. In contrast, a person with a history of family problems, social isolation, or community conflicts may be considered a higher-risk borrower. A person's character can also be influenced by their cultural and social norms. For example, a person from a culture that values community and family ties may be considered a lower-risk borrower than one from a culture that emphasizes individualism.

Capital

Capital is the second C of credit, and it refers to a borrower's net worth or the amount of money they have available to repay a loan. Capital plays a crucial role in determining creditworthiness, as it indicates a borrower's ability to repay their debts. The amount of capital available to a borrower can be assessed through their income, assets, and liabilities. A borrower with a stable income, few debts, and significant assets is considered a lower-risk borrower than one with a variable income, high debts, and few assets. In essence, capital represents the borrower's financial cushion, which is their ability to absorb financial shocks without defaulting on their loans.

The importance of capital in credit analysis cannot be overstated. A borrower with a good capital base is considered more creditworthy because they have a lower likelihood of defaulting on their loans. Conversely, a borrower with a poor capital base is considered higher-risk because they may struggle to repay their debts. Capital also influences a borrower's interest rate and loan term. A borrower with good capital, for instance, may be eligible for lower interest rates and longer loan terms. In contrast, a borrower with poor capital may be charged higher interest rates and shorter loan terms.

Capital can take various forms, including income, assets, and cash reserves. Income serves as the primary source of repayment, as borrowers use their income to service their debts. Assets, such as property, stocks, and bonds, can be used as collateral to secure loans. Cash reserves provide an emergency fund for borrowers, allowing them to absorb financial shocks without defaulting on their loans. A borrower with a diverse portfolio of income, assets, and cash reserves is considered more creditworthy than one with limited or uncertain sources of capital.

A borrower's capital can also be assessed through their debt-to-income (DTI) ratio, which compares their monthly debt payments to their monthly income. A DTI ratio below 36% is generally considered good, while a ratio above 43% is considered high-risk. A borrower with a low DTI ratio is considered more creditworthy because they have sufficient income to service their debts.

Lenders also consider a borrower's credit utilization ratio, which compares their outstanding debt balances to their available credit limits. A low credit utilization ratio indicates responsible credit behavior and a good capital base. In contrast, a high credit utilization ratio suggests poor credit behavior and a weak capital base.

Credit History

Credit History is the third C of credit, and it refers to a borrower's past payment behavior, including their on-time payments, late payments, and defaults. A borrower's credit history serves as a predictor of their future credit performance, allowing lenders to assess their creditworthiness. The length of a borrower's credit history is also crucial, as longer credit histories are generally considered more creditworthy than shorter ones. This is because longer credit histories provide lenders with more information about a borrower's credit behavior over time.

A borrower's credit history can take various forms, including credit reports, credit inquiries, and public records. Credit reports provide information about a borrower's payment history, credit utilization, and credit mix. Credit inquiries indicate the frequency and types of credit applications made by a borrower. Public records, such as bankruptcies, foreclosures, and tax liens, can have a significant impact on a borrower's creditworthiness.

Credit scoring systems, such as the popular FICO scoring model, use credit history data to calculate a borrower's credit score. A higher credit score indicates good credit, while a lower credit score indicates poor credit. The FICO scoring model takes into account various factors, including payment history, credit utilization, length of credit history, and credit mix. Payment history accounts for 35% of the credit score, while credit utilization accounts for 30%. Length of credit history accounts for 15%, and credit mix accounts for 10%.

Borrowers with a good credit history are considered more creditworthy than those with a poor credit history. A borrower with a long credit history and many on-time payments is likely to be eligible for lower interest rates and longer loan terms. In contrast, a borrower with a short credit history and late payments may be considered a higher-risk borrower and charged higher interest rates.

Lenders also consider the age of a borrower's credit accounts, which can impact their credit score. Newer credit accounts may have a negative impact on a borrower's credit score, as they may indicate a greater risk of default. Conversely, older credit accounts can have a positive impact on a borrower's credit score, as they demonstrate a longer credit history and a lower risk of default.

Collateral

Collateral is the fourth C of credit, and it refers to the assets pledged by a borrower to secure a loan. Collateral can take various forms, including property, vehicles, stocks, and bonds. A borrower with significant collateral is considered a lower-risk borrower, as they have a financial cushion to absorb financial shocks and repay their debts.

The type and value of collateral are critical factors in evaluating a borrower's creditworthiness. For example, a borrower with a high-value property as collateral is considered a lower-risk borrower than one with a low-value property. Lenders also consider the liquidity of collateral, as it affects their ability to recover their loan amount in case of default.

Collateral can also be used to determine the loan-to-value (LTV) ratio, which compares the loan amount to the collateral's value. A lower LTV ratio indicates a lower-risk loan, while a higher LTV ratio indicates a higher-risk loan. Lenders may offer more favorable terms to borrowers with a lower LTV ratio, such as lower interest rates and longer loan terms.

Collateral can have a significant impact on a borrower's creditworthiness, and lenders use various techniques to assess its value. For example, they may use property appraisals, vehicle assessments, or stock valuations to determine the collateral's value. A borrower with a high-quality collateral is considered more creditworthy than one with low-quality collateral.

A borrower's willingness to pledge collateral can also impact their creditworthiness. A borrower who is willing to pledge collateral is considered a lower-risk borrower, as they demonstrate a greater commitment to repaying their debts. Conversely, a borrower who is hesitant to pledge collateral may be considered a higher-risk borrower.

Capacity

Capacity is the fifth C of credit, and it refers to a borrower's ability to repay their debts. This includes their income, assets, and credit history, which serve as indicators of their financial stability. A borrower with a stable income, significant assets, and a good credit history is considered a lower-risk borrower, as they have a greater ability to repay their debts.

A borrower's capacity can be assessed through various metrics, including their debt-to-income (DTI) ratio, credit utilization ratio, and net worth. A borrower with a low DTI ratio and credit utilization ratio is considered more creditworthy, as they have a better ability to repay their debts. Conversely, a borrower with high DTI and credit utilization ratios may be considered a higher-risk borrower.

Lenders also consider a borrower's income stability and growth prospects when evaluating their capacity. A borrower with a stable income and a history of job stability is considered a lower-risk borrower, as they have a greater ability to repay their debts. Conversely, a borrower with an unstable income or a history of job changes may be considered a higher-risk borrower.

A borrower's credit history can also impact their capacity to repay debts. A borrower with a long credit history and many on-time payments is considered a lower-risk borrower, as they have demonstrated their ability to repay their debts. Conversely, a borrower with a short credit history or a history of late payments may be considered a higher-risk borrower.

The amount borrowed relative to a borrower's capacity is also a critical factor in credit analysis. A borrower with a high debt burden relative to their income and assets may be considered a higher-risk borrower, as they may struggle to repay their debts. Conversely, a borrower with a manageable debt burden relative to their income and assets is considered a lower-risk borrower.

A borrower's capacity to repay debts can also be influenced by their lifestyle and expenses. A borrower with a relatively simple lifestyle and few expenses may be considered a lower-risk borrower, as they have a greater ability to save and repay their debts. Conversely, a borrower with a complex lifestyle and many expenses may be considered a higher-risk borrower.

Credit Mix

Credit Mix is an essential factor in evaluating a borrower's creditworthiness, and it refers to the variety of credit types used by a borrower. A borrower with a diverse mix of credit, including credit cards, loans, and mortgages, is considered a lower-risk borrower, as they have demonstrated their ability to manage different credit types. Conversely, a borrower with only one or two credit types may be considered a higher-risk borrower.

The type and quality of a borrower's credit mix can significantly impact their creditworthiness. For example, a borrower with a mix of high-quality credit, such as mortgage and student loans, is considered a lower-risk borrower than one with high-risk credit, such as payday loans and credit cards.

A borrower's credit mix can also be influenced by their credit score, which can impact their eligibility for different credit types. A borrower with a high credit score is considered more creditworthy and may be eligible for lower-interest credit cards, loans, and mortgages. In contrast, a borrower with a low credit score may be considered less creditworthy and may be charged higher interest rates on their credit applications.

The frequency and types of credit inquiries can also impact a borrower's creditworthiness. A borrower with a large number of credit inquiries, especially in a short period, may be considered a higher-risk borrower, as they may be experiencing financial difficulties. Conversely, a borrower with few or no credit inquiries is considered a lower-risk borrower.

The credit mix of a borrower can also impact their credit utilization ratio, which compares their outstanding debt balances to their available credit limits. A borrower with a good credit mix and a low credit utilization ratio is considered a lower-risk borrower, as they have demonstrated their ability to manage their credit responsibly. Conversely, a borrower with a poor credit mix and a high credit utilization ratio may be considered a higher-risk borrower.

Q. 3 What are the major types of bank advances and loans? Discuss in detail. (20)

In Pakistan, various types of bank accounts cater to different needs, ranging from basic savings and checking accounts to more specialized accounts like foreign currency and Islamic banking accounts. These accounts offer a range of services to individuals, businesses, and institutions, ensuring that financial needs are met effectively.

Current Accounts

Current accounts are primarily designed for individuals and businesses that require frequent transactions. These accounts typically do not offer interest, but they provide easy access to funds, unlimited withdrawals, and the ability to make payments and transfers. Current accounts are ideal for businesses and professionals who need to manage cash flow efficiently.

Savings Accounts

Savings accounts are designed for individuals who want to save money while earning interest. These accounts offer a modest interest rate, encouraging savings while providing liquidity. Savings accounts are suitable for individuals who wish to grow their funds over time while retaining the ability to access their money when needed.

Fixed Deposit Accounts

Fixed deposit accounts, also known as term deposit accounts, allow individuals to deposit a lump sum of money for a fixed period, ranging from a few months to several years. In return, the bank offers a higher interest rate compared to savings accounts. These accounts are ideal for individuals looking to earn a higher return on their savings without requiring immediate access to their funds.

Profit and Loss Sharing (PLS) Accounts

PLS accounts are a type of savings account offered by Islamic banks in Pakistan. Instead of earning interest, account holders receive a share of the bank's profits based on pre-agreed ratios. These accounts are Shariah-compliant and are suitable for individuals who want to save money in accordance with Islamic principles.

Islamic Current Accounts

Islamic current accounts operate similarly to conventional current accounts but are Shariah-compliant. These accounts do not pay interest, and all transactions are conducted according to Islamic banking principles. Islamic current accounts are designed for individuals and businesses who prefer to manage their finances within an Islamic framework.

Foreign Currency Accounts

Foreign currency accounts allow individuals and businesses to hold and transact in foreign currencies such as US dollars, euros, or British pounds. These accounts are useful for those who receive payments in foreign currencies or want to hedge against currency fluctuations. They are available in both current and savings account formats.

Business Accounts

Business accounts are tailored to meet the needs of small, medium, and large enterprises. These accounts offer services such as payroll management, cash handling, and transaction monitoring. Business accounts often come with additional features like overdraft facilities, trade finance, and business loans, making them essential for managing corporate finances.

Joint Accounts

Joint accounts are shared by two or more individuals, such as spouses, family members, or business partners. These accounts allow all account holders to deposit, withdraw, and manage the account together. Joint accounts are commonly used by families for household expenses or by partners in a business venture.

Basic Banking Accounts

Basic banking accounts, also known as no-frills accounts, are designed for low-income individuals or those with minimal banking needs. These accounts typically have low or no minimum balance requirements and offer basic banking services such as deposits, withdrawals, and fund transfers. Basic banking accounts promote financial inclusion by making banking accessible to everyone.

Pension Accounts

Pension accounts are special accounts designed for retirees to receive their pension payments. These accounts provide easy access to funds and often come with additional benefits like discounts on banking services. Pension accounts ensure that retirees have a secure and convenient way to manage their retirement funds.

Student Accounts

Student accounts are tailored for students and young adults, offering low fees, no minimum balance requirements, and other incentives such as free debit cards or discounts on educational products. These accounts are designed to help students manage their finances while encouraging them to develop good financial habits.

Senior Citizen Accounts

Senior citizen accounts are specifically designed for individuals aged 60 and above. These accounts often offer higher interest rates on savings, lower fees, and additional benefits such as free checkbooks or priority banking services. Senior citizen accounts cater to the financial needs of older adults, ensuring they receive special attention and benefits.

Asaan Accounts

Asaan accounts are simplified accounts with minimal documentation requirements, designed to promote financial inclusion. These accounts are suitable for individuals who may not have the necessary documentation for opening a regular account. Asaan accounts offer basic banking services with lower fees and easy access to funds.

Roshan Digital Accounts

Roshan Digital Accounts (RDA) are specifically designed for non-resident Pakistanis (NRPs). These accounts allow NRPs to manage their finances in Pakistan remotely, offering services such as investment in stock markets, real estate, and government securities. RDAs are available in both conventional and Islamic formats, providing NRPs with a convenient way to invest in Pakistan's economy.

Salary Accounts

Salary accounts are current or savings accounts opened by employers for their employees to receive their monthly salaries. These accounts often come with additional benefits such as no minimum balance requirements, free debit cards, and discounts on loans. Salary accounts make it easy for employees to manage their finances and access their salaries conveniently.

Escrow Accounts

Escrow accounts are specialized accounts used to hold funds securely during a transaction between two parties, such as in real estate deals or business acquisitions. The funds are released to the seller or service provider only when specific conditions are met, ensuring a secure and transparent transaction process.

Non-Resident Pakistani (NRP) Accounts

NRP accounts are designed for Pakistanis living abroad. These accounts allow NRPs to maintain savings, make investments, and transfer funds to Pakistan. NRP accounts are available in both local and foreign currencies, offering flexibility and convenience for overseas Pakistanis.

Agricultural Accounts

Agricultural accounts are tailored for farmers and agribusinesses, providing specialized banking services such as agricultural loans, crop insurance, and subsidies. These accounts are designed to support the agricultural sector, which is a significant part of Pakistan's economy, by offering financial products that meet the unique needs of farmers.

Trust Accounts

Trust accounts are opened by individuals or entities who act as trustees, holding funds on behalf of beneficiaries. These accounts are used for managing estates, charities, and other fiduciary responsibilities. Trust accounts ensure that funds are managed according to the terms of the trust agreement, providing security and accountability.

High-Net-Worth Individual (HNI) Accounts

HNI accounts cater to wealthy individuals who require personalized banking services. These accounts offer exclusive benefits such as priority banking, wealth management, investment advisory services, and access to premium products. HNI accounts are designed to meet the complex financial needs of affluent clients.

Q. 4 Briefly discuss the role and functions of the State Bank of Pakistan. (20)

State Bank of Pakistan is the Central Bank of the country. While its constitution, as originally laid down in the State Bank of Pakistan Order 1948, remained basically unchanged until 1st January 1974 when the Bank was nationalised, the scope of its functions was considerably enlarged. The State Bank of Pakistan Act 1956, with subsequent amendments, forms the basis of its operations today.

Under the State Bank of Pakistan Order 1948, the Bank was charged with the duty to "regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in Pakistan and generally to operate the currency and credit system of the country to its advantage". The scope of the Bank's operations was considerably widened in the State Bank of Pakistan Act 1956, which required the Bank to "regulate the monetary and credit system of Pakistan and to foster its growth in the best national interest with a view to securing monetary stability and fuller utilisation of the country's productive resources". Under financial sector reforms, the State Bank of Pakistan was granted autonomy in February 1994. On 21st January, 1997, this autonomy was further strengthened by issuing three Amendment Ordinances (which were approved by the Parliament in May, 1997) namely, State Bank of Pakistan Act, 1956, Banking Companies Ordinance, 1962 and Banks Nationalisation Act, 1974. The changes in the State Bank Act gave full and exclusive authority to the State Bank to regulate the banking sector, to conduct an independent monetary policy and to set limit on government borrowings from the State Bank of Pakistan. The amendments in Banks Nationalisation Act abolished the Pakistan Banking Council (an institution established to look after the affairs of NCBs) and institutionalised the process of appointment of the Chief Executives and Boards of the nationalised commercial banks (NCBs) and development finance institutions (DFIs), with the Sate Bank having a role in their appointment and removal. The amendments also increased the autonomy and accountability of the Chief Executives and the Boards of Directors of banks and DFIs.

Like a Central Bank in any developing country, State Bank of Pakistan performs both the traditional and developmental functions to achieve macro-economic goals. The traditional functions, which are generally performed by central banks almost all over the world, may be classified into two groups: (a) the primary functions including issue of notes, regulation and supervision of the financial system, bankers' bank, lender of the last resort, banker to Government, and conduct of monetary policy, and (b) the secondary functions including the agency functions like management of public debt, management of foreign exchange, etc., and other functions like advising the government on policy matters and maintaining close relationships with international financial institutions. The non-traditional or promotional functions, performed by the State Bank include development of financial framework, institutionalisation of savings and investment, provision of training facilities to bankers, and provision of credit to priority sectors. The State Bank also has been playing an active part in the process of islamization of the banking system. The main functions and responsibilities of the State Bank can be broadly categorised as under.

Regulation Of Liquidity

Being the Central Bank of the country, State Bank of Pakistan has been entrusted with the responsibility to formulate and conduct monetary and credit policy in a manner consistent with the Government's targets for growth and inflation and the recommendations of the Monetary and Fiscal Policies Co-ordination Board with respect to macro-economic policy objectives. The basic objective underlying its functions is two-fold i.e. the maintenance of monetary stability, thereby leading towards the stability in the domestic prices, as well as the promotion of economic growth.

To regulate the volume and the direction of flow of credit to different uses and sectors, the Bank makes use of both direct and indirect instruments of monetary management. Until recently, the monetary and credit scenario was characterised by acute segmentation of credit markets with all the attendant distortions. Pakistan embarked upon a program of financial sector reforms in the late 1980s. A number of fundamental changes have since been made in the conduct of monetary management which essentially marked a departure from administrative controls and quantitative restrictions to market-based monetary management. A reserve money management programme has been developed. In terms of the programme, the intermediate target of M2 would be achieved by observing the desired path of reserve money - the operating target. While use in now being made of such indirect instruments of control as cash reserve ratio and liquidity ratio, the program's reliance is mainly on open market operations.

Regulation And Supervision

One of the fundamental responsibilities of the State Bank is regulation and supervision of the financial system to ensure its soundness and stability as well as to protect the interests of depositors. The rapid advancement in information technology, together with growing complexities of modern banking operations, has made the supervisory role more difficult and challenging. The institutional complexity is increasing, technical sophistication is improving and technical base of banking activities is expanding. All this requires the State Bank for endeavoring hard to keep pace with the fast-changing financial landscape of the country. Accordingly, the out dated inspection techniques have been replaced with the new ones to have better inspection and supervision of the financial institutions. The banking activities are now being monitored through a system of 'off-site' surveillance and 'on-site' inspection and supervision. Off-site surveillance is conducted by the State Bank through regular checking of various returns regularly received from the different banks. On other hand, on-site inspection is undertaken by the State Bank in the premises of the concerned banks when required.

To deepen and broaden financial markets as also to diversify the sources of credit, a number of non-bank financial institutions (NBFIs) were allowed to increase substantially. The State Bank has also been charged with the responsibilities of regulating and supervising of such institutions. To regulate and supervise the activities of these institutions, a new Department namely, NBFIs Regulation and Supervision Department was set up. Moreover, in order to safeguard the interest of ultimate users of the financial services, and to ensure the viability of institutions providing these services, the State Bank has issued a comprehensive set of Prudential Regulations (for commercial banks) and Rules of

Business (for NBFIs).

The "Prudential Regulations" for banks, besides providing for credit and risk exposure limits, prescribe guide lines relating to classification of short-term and long-term loan facilities, set criteria for management, prohibit criminal use of banking channels for the purpose of money laundering and other unlawful activities, lay down rules for the payment of dividends, direct banks to refrain from window dressing and prohibit them to extend fresh laon to defaulters of old loans. The existing format of balance sheet and profit-and-loss account has been changed to conform to international standards, ensuring adequate transparency of operations. Revised capital requirements, envisaging minimum paid up capital of Rs.500 million have been enforced. Effective December,1997, every bank was required to maintain capital and unencumbered general reserves equivalent to 8 per cent of its risk weighted assets.

The "Rules of Business" for NBFIs became effective since the day NBFIs came under State Bank's jurisdiction. As from January, 1997, modarbas and leasing companies, which are also specialized type of NBFIs, are being regulated/supervised by the Securities and Exchange Commission (SECP), rather than the State Bank of Pakistan.

Exchange Rate Management And Balance Of Payments

One of the major responsibilities of the State Bank is the maintenance of external value of the currency. In this regard, the Bank is required, among other measures taken by it, to regulate foreign exchange reserves of the country in line with the stipulations of the Foreign Exchange Act 1947. As an agent to the Government, the Bank has been authorised to purchase and sale gold, silver or approved foreign exchange and transactions of Special Drawing Rights with the International Monetary Fund under sub-sections 13(a) and 13(f) of Section 17 of the State Bank of Pakistan Act, 1956.

The Bank is responsible to keep the exchange rate of the rupee at an appropriate level and prevent it from wide fluctuations in order to maintain competitiveness of our exports and maintain stability in the foreign exchange market. To achieve the objective, various exchange policies have been adopted from time to time keeping in view the prevailing circumstances. Pak-rupee remained linked to Pound Sterling till September, 1971 and subsequently to U.S. Dollar. However, it was decided to adopt the managed floating exchange rate system w.e.f. January 8, 1982 under which the value of the rupee was determined on daily basis, with reference to a basket of currencies of Pakistan's major trading partners and competitors. Adjustments were made in its value as and when the circumstances so warranted. During the course of time, an important development took place when Pakistan accepted obligations of Article-VIII, Section 2, 3 and 4 of the IMF Articles of Agreement, thereby making the Pak-rupee convertible for current international transactions with effect from July 1, 1994.

After nuclear detonation by Pakistan in 1998, a two-tier exchange rate system was introduced w.e.f. 22nd July 1998, with a view to reduce the pressure on official reserves and prevent the economy to some extent from adverse implications of sanctions imposed on Pakistan. However, effective 19th May 1999, the exchange rate has been unified, with the introduction of market-based floating exchange rate system, under which the exchange rate is determined by the demand and supply positions in the foreign exchange market. The surrender requirement of foreign exchange receipts on account of exports and services, previously required to be made to State Bank through authorized dealers, has now been done away with and the commercial banks and other authorised dealers have been made free to hold and undertake transaction in foreign currencies.

As the custodian of country's external reserves, the State Bank is also responsible for the management of the foreign exchange reserves. The task is being performed by an Investment Committee which, after taking into consideration the overall level of reserves, maturities and payment obligations, takes decision to make investment of surplus funds in such a manner that ensures liquidity of funds as well as maximises the earnings. These reserves are also being used for intervention in the foreign exchange market. For this purpose, a Foreign Exchange Dealing Room has been set up at the Central Directorate of State Bank of Pakistan and services of a 'Forex Expert' have been acquired.

Developmental Role Of State Bank

The responsibility of a Central Bank in a developing country goes well beyond the regulatory duties of managing the monetary policy in order to achieve the macro-economic goals. This role covers not only the development of important components of monetary and capital markets but also to assist the process of economic growth and promote the fuller utilisation of a country's resources.

Ever since its establishment, the State Bank of Pakistan, besides discharging its traditional functions of regulating money and credit, has played an active developmental role to promote the realisation of macro-economic goals. The explicit recognition of the promotional role of the Central Bank evidently stems from a desire to re-orientate all policies towards the goal of rapid economic growth. Accordingly, the orthodox central banking functions have been combined by the State Bank with a well-recognised developmental role.

The scope of Bank's operations has been widened considerably by including the economic growth objective in its statute under the State Bank of Pakistan Act 1956. The Bank's participation in the development process has been in the form of rehabilitation of banking system in Pakistan, development of new financial institutions and debt instruments in order to promote financial intermediation, establishment of Development Financial Institutions (DFIs), directing the use of credit according to selected development priorities, providing subsidised credit, and development of the capital market.

Q. 5 Write notes on the following: (20)

i. Islamic Banking

Islamic banking operates based on the principles of Sharia law, which prohibits the payment or receipt of interest (Riba) and emphasizes ethical investments. Unlike conventional banking, which generates profit through interest, Islamic banks earn their revenue from profit-sharing arrangements, leasing activities, and trading. The fundamental concept of Islamic banking is to promote risk-sharing and financial transactions that are morally sound and beneficial to society. Consequently, financial products and services in Islamic banking are structured to align with Sharia principles, ensuring that all activities are compliant with Islamic ethical standards.

Islamic banking utilizes various financial instruments, such as Murabaha (cost-plus financing), Mudarabah (profit-sharing), and Ijarah (leasing), to facilitate economic activities. Murabaha, for example, involves the purchase of an asset by the bank, which is then sold to the customer at a profit margin agreed upon upfront. This approach allows customers to acquire goods without incurring interest. Mudarabah facilitates partnership models where one party provides capital while the other manages the investment, sharing profits according to a predetermined ratio. By relying on these principles, Islamic banks aim to contribute to socio-economic development while maintaining financial stability.

ii E-Banking

E-banking, or electronic banking, refers to the use of electronic platforms to conduct financial transactions and manage banking services. This innovation has transformed the way individuals and businesses interact with their banks by offering convenience and accessibility. Customers can perform a range of banking activities, including money transfers, bill payments, account statements, and loan applications, through online banking websites or mobile applications. E-banking improves customer experience by allowing 24/7 access to financial services without the need for physical branch visits.

In addition to enhancing customer convenience, e-banking allows financial institutions to reduce operational costs associated with maintaining physical branches. By leveraging technology, banks can streamline processes, automate transactions, and improve efficiency. Customers benefit from quicker service delivery, and banks can allocate resources more effectively. However, the rise of e-banking also introduces challenges such as cybersecurity risks, fraud, and the need for compliance with regulations governing electronic transactions. As such, banks continuously invest in security measures to safeguard their customers' sensitive information.

iii Mobile Banking

Mobile banking is a subset of e-banking that specifically focuses on services delivered through mobile devices, such as smartphones and tablets. This platform has gained popularity in recent years, primarily due to the widespread use of mobile technology and connectivity. Mobile banking provides customers with the flexibility to manage their accounts, execute transactions, and access financial information on-the-go. Users can make payments, check balances, and even receive alerts regarding account activity, all through mobile applications tailored for their specific bank.

The convenience of mobile banking has empowered users to engage with their finances in real-time. With a few taps, customers can perform transactions without being tied to a desktop setup, making banking activities much more spontaneous and user-friendly. Mobile banking applications often incorporate biometric security features such as fingerprint and facial recognition, enhancing security while simplifying user authentication. However, the dependence on electronic channels raises concerns about access for unbanked populations, as well as potential risks associated with inadequate security measures and unauthorized access.

iv. ZTBL.

The **Zarai Taraqiati Bank Limited** (**ZTBL**), formerly known as **Agricultural Development Bank of Pakistan**, is Pakistani government-owned agricultural development bank which is based in Islamabad, Pakistan. Founded in 1961 as the agricultural development bank, the bank was renamed in 2002 as Zarai Taraqiati Bank Limited (ZTBL) and was subsequently incorporated as a public limited company in 2002 under Companies Ordinance 1984.[3]

The bank provides agricultural credit and banking services to farmers across the country. It remains the largest public sector agriculture development financial institution in the country.

History

Agricultural Development Finance Corporation was created in 1952 under a Central Act for the purpose of expanding financial facilities and promoting the Development and Modernization of Agriculture in Pakistan. In 1957, the **Agricultural Bank of Pakistan** was established and advanced both short and long-term loans. Both these institutions were merged as the Agricultural Development Bank of Pakistan in February 1961. On December 14, 2002, the Federal Government converted the Agricultural Development Bank of Pakistan (ADBP) into **Zarai Taraqiati Bank Ltd (ZTBL)**. The new corporate structure redefined the banks as a single public limited company with an independent Board of Directors.

Zarai Taraqiati Bank (ZTBL) was registered under the Companies Ordinance 1984, and all assets, liabilities, and proceedings were transferred to and vested in Zari Taraqiati Bank with effect from December 14, 2002.

Products and services

- Supervised Agricultural Credit Scheme
- Deposits (Fixed, Saving, Current Accounts, Zarai Bachat Scheme, ZTBL Junior Account, Mustaqbil Mehfooz A/C & Rozana Bachat A/C, etc.)
- Loan Schemes(Production Loan Schemes, Development Loan Schemes, Crop Loan Insurance, Model Village Establishment
- Locker Facility (Small, Medium, Large)
- UPaisa (Branchless Banking facility)
- Treasury
- Home Remittance (Western Union, Xpress Money and some other nearly 40 companies)
- Hajj applications
- One Window Operation
- Revolving Finance Scheme (RFS)/Sada Bahar Scheme (SBS)
- Crop Maximisation Project[6]
- Motorcycle-based account officers who travel to farmers' doorstep

IDBP

Industrial Development Bank of Pakistan (IDBP) is one of Pakistan's oldest development financing institutions and was created with the primary objective of extending term finance for investment in the manufacturing sector of the economy. Over the years, however, the Bank has become an institution fostering the growth of Small and Medium Enterprises in the rural/less developed regions of the country.

Industrial Development Bank of Pakistan is wholly owned by Pakistani Government entities with 57% of its shares held by the Federal Government, 36% by the State Bank of Pakistan and 7% by Provincial Governments and other public sector corporations. Its board of directors consists of representatives of the private sector appointed by the Ministry of Finance.

The IDBP has suffered from significant losses due to loan defaults.[1] By the mid-2000s, the IDBP had accumulated a loss of about Rs27 billion and was insolvent. The Pakistani government merged IBDP with the Profitable Investment Corporation of Pakistan in 2006[2] in part to improve IBDP's financial performance.

The bank continued to struggle commercially and by end of 2009 the accumulated deficit had risen to Rs28 billion. The Pakistani government continues to explore ways to make IDBP economically viable.

Mission

The Bank provides Medium and Long Term Finance in local and Foreign Currencies for fixed asset investment in new industrial projects as well as for expansion, balancing, modernization or replacement of existing projects. It extends technical, financial and managerial advice to its clients in planning and execution of the industrial projects. It also facilitates transfer of technologies from developed countries to industrial enterprises in Pakistan.

A unique feature of Industrial Development Bank of Pakistan is that besides Development Financing Institution, it is also a Scheduled Bank and authorized dealer of Foreign Exchange. Thus, IDBP extends all kinds of Merchant, Investment and Commercial Banking services to its clients which include provision of short term advances, Trade Financing, Lease Financing, guarantees and under-writing. Thus, Industrial Development Bank of Pakistan operates a full-fledged Bank in addition to its role as a Development Financing Institution.

Industrial Development Bank of Pakistan has the unique distinction of financing the first ever projects for a diversified list of products. These include Ultra High Temperature (UHT) pack milk, three wheelers, radio/wireless receiving sets, Marble Processing, Coal Mining, Granite, Acetic Yarn, PVC Deep Sea Fishing etc. The projects implemented through IDBP's financing generated over 100,000 new jobs and have an export potential of about Rs.10.00 billion per annum. The value addition by the completed project is estimated at about Rs.15 billion per annum.