3.2 Performance and Risk Analysis of the Islamic Banking

Compared to steady global growth, Islamic Banking continues to establish its foot print in the in Pakistan with a YoY growth of 22.60 percent in assets. With a broad based rise, Islamic finance has increased its share in total financing of all banks to 18.53 percent in CY17. While Diminishing Musharaka still holds the largest share, participatory modes of financing have gained some impetus. Majority of Islamic finance is extended to corporates, though consumer finance has also grown considerably. With deposits as the main source of funding, liquidity management remains a challenge for IBIs given the limited availability of Shariah compliant securities. NPFs have remained stagnant and profitability of IBIs has significantly improved which has strengthened their solvency. Given the continuous SBP efforts and favorable economic environment, IBIs should look to create diversified products across different sectors of the economy.

Growth in Islamic banking across the globe has remained consistent till Jun-17. As per the statistics[147] published by the Islamic Financial Services Board (IFSB), assets of Islamic banking have increased by 6.14 percent during the first six months of CY17[148] (**Table 3.2.1**).

Table 3.2.1

Global Islamic Banking Statistics

	CY14	CY15	CY16	Jun-17
	USD billion			
Total Assets	1,280.6	1,331.1	1,441.0	1,529.5
Sharīah-compliant Financing	809.5	854.1	936.2	992.8
Total Liabilities	1,180.1	1,238.6	1,320.4	1,406.7
	Number			
Islamic banks	165	169	169	172
Islamic banking windows	85	85	83	84
Islamic banks branches	28,787	29,855	29,788	29,681

Source: IFSB: http://www.ifsb.org/psifi_05.php?selfolder=

This seems encouraging when compared to 8.26 percent YoY growth in CY16 but is lower than average YoY growth of 7.4 percent during first six months of CY14 and CY15. Moreover, if the industry continues to follow the pattern observed in the last three years, the second half of CY17 could witness slowdown in growth.

Out of the total assets of the global Islamic banking, Shariah compliant financing has constituted around 65 percent by Jun-17.With regard to the Islamic banking structure, the contractionary phase of branch network growth, started in CY16, continues, which can be attributed to technological advancements and growing branchless banking.

In line with the growth trends published by IFSB, the Global Islamic Finance Report (GIFR), 2017 also iterates that the growth in global Islamic financial services industry seems to have stagnated in recent past[149]. This calls for all stakeholders to re-think the future strategy for growth and expansion. Using two different projections, the GIFR expects the assets of the Islamic finance industry[150] to be somewhere between US$ 3 trillion and US$ 4.3 trillion by the end of CY20.

147 The aggregated data for total assets (16 countries), total Shariah-compliant financing (16 countries), and total funding/liabilities (15 countries) are calculated from available countrywide structural data from Islamic banks and Islamic banking windows of conventional banks, converting into U.S dollar terms, at the end period exchange rates. http://www.ifsb.org/psifi_05.php?selfolder=

148 As defined in Islamic Financial Services Industry Stability Report 2017, Islamic banking window is that part of a conventional financial institution (which may be a branch or a dedicated unit of that institution) that provides both fund management (investment accounts) and financing and investment that are Shariah-compliant, with separate funds. It could also provide takāful or retakāful services.

149 http://www.gifr.net/publications/gifr2017/intro.pdf

150 Includes both banking and non-banking assets.

Table 3.2.2

Performance of Islamic Banking in Pakistan

	IBIs			Conv. Banks	
	CY15	CY16	CY17	CY16	CY17
	PKR billion				
Total Assets	1,610.0	1,852.9	2,271.8	13,978.1	16,069.8
Investments (net)	431.9	490.0	534.2	7,019.2	8,194.8
Financing (net)	645.3	820.9	1,206.7	4,677.9	5,305.7
Deposits	1,374.8	1,573.3	1,885.0	10,224.5	11,126.8
	Growth in percent (YoY)				
Total Assets	27.90	15.09	22.60	11.53	14.96
Investments (net)	21.07	13.45	9.03	8.84	16.75
Financing (net)	57.86	27.21	47.01	12.17	13.42
Deposits	28.52	14.44	19.81	13.42	8.82

Source: SBP

…while it flourishes in Pakistan due to enabling macroeconomic conditions

Islamic banking institutions[151] (IBIs) assets have continued to outpace their conventional counterparts registering a growth of 22.60 percent during CY17 (14.96 percent for conventional banks) (**Table 3.2.2**).

Unlike conventional banks, most of the growth in IBIs' assets has been contributed by 47.01 percent rise in financing against 13.42 percent for conventional banks. Encouragingly, IBIs contributed 38.07 percent of increase in the overall advances growth of the banking sector of PKR 1,013.7 billion. On the funding side, healthy growth in deposits (19.81 percent) has facilitated the IBIs to finance the healthy growth in assets.

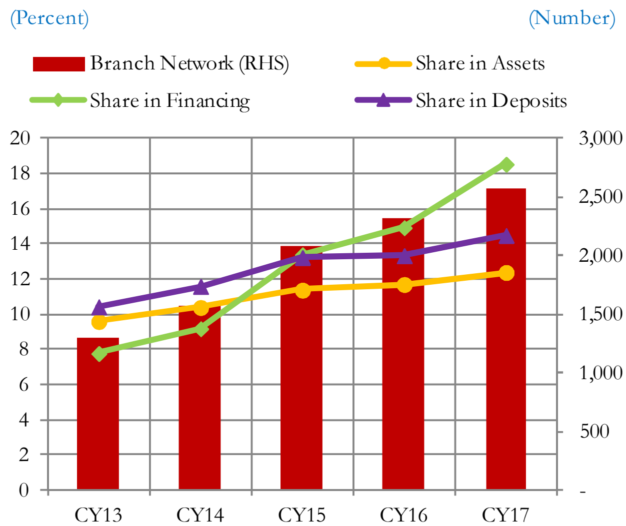
Share of Islamic banking continues to rise…

Healthy growth in assets has enhanced the share of Islamic banking in the overall banking assets by 69 bps to 12.39 percent during CY17. Though this share in assets falls short of the target of 15 percent set in Strategic Plan for Islamic Banking industry[152], the share of Islamic financing in overall financing has jumped to 18.53 percent in CY17 from 14.93 percent last year. Similarly, deposits of IBIs now represent 14.49 percent of total banking sector deposits and are expected to cross 15 percent by the end of 2018. (**Figure 3.2.1**).

Figure 3.2.1

Expansion of Islamic Banking continues

Share and Number of branches of Islamic Banking



Source: SBP

The target of 2000 branches set under the strategic plan has already been achieved in CY15 and IBIs network has reached 2,581 branches by end of CY17.

…as financing to both public and private sector rise

Significantly higher growth of Islamic financing has resulted from active participation of IBIs in public sector commodity finance (especially for wheat). With more than 150 percent growth, the share of

151 Islamic banking institutions include Islamic banks and Islamic banking branches of conventional banks.

152 The SBP's 5 year Strategic Plan for Islamic Banking industry (2014-2018) , inter alia, envisages Islamic banking industry to achieve a target of 2000 branches, increase the market share to 15 percent of the banking system, and improve "advance to deposit ratio' to be at least at par with that of conventional banking system by the end of 2018 http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy%20Paper-Final.pdf

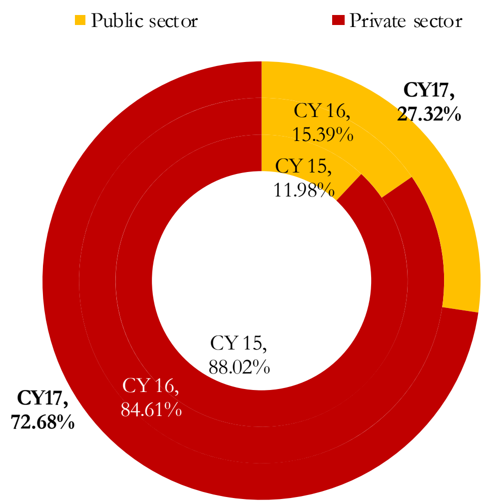
public sector financing has jumped to 27.32 percent in total Islamic financing in CY17 from 15.39 percent a year earlier. This extraordinary surge does not pose a significant credit risk due to the secured nature of commodity finance. Private sector financing has also surged by 24.93 percent in CY17 compared to 20.77 percent increase in CY16 (**Figure 3.2.2**).

Figure 3.2.2

Financing to public sector has significantly grown in CY17

Public and private sector Islamic Financing

(Percent)



Source: SBP

Diminishing Musharaka still holds the largest share…

Islamic banking across the world is characterized by a number of products that can be differentiated based on the underlying contract. In Pakistan, Diminishing Musharaka continues to hold the highest share in Islamic financing followed by trade-based[153] modes of financing. While financing in these modes is growing, both these modes of financing are shedding their share due to substantial growth in Musharaka Financing (**Table 3.2.3**).

Table 3.2.3

Islamic modes of financing

	CY15*		CY16*		CY17	
	Amount	Share	Amount	Share	Amount	Share
	amount in PKR billion, share in percent					
Murabaha	161.6	23.87	136.7	16.07	162.8	13.16
Salam	35.1	5.19	37.1	4.36	34.6	2.80
Istisna	56.8	8.39	75.0	8.82	101.0	8.16
Musharaka	92.1	13.60	133.4	15.68	272.1	21.99
Ijara	43.3	6.40	58.2	6.84	78.8	6.37
Car Ijara	27.5	4.06	37.5	4.41	46.6	3.76
Plant and machinery Ijara	9.2	1.36	11.1	1.31	13.8	1.12
Equipment Ijara	0.6	0.08	1.1	0.13	3.1	0.25
Others Ijara	6.1	0.90	8.6	1.01	15.4	1.25
Diminishing Musharaka	208.7	30.83	293.7	34.53	380.2	30.73
Other Islamic modes of finance	79.1	11.69	116.2	13.67	206.8	16.72
Mudarabah	0.2	0.03	0.1	0.01	-	-
Qard/Qard-e-Hasan	0.04	0.01	0.20	0.02	0.68	0.06
Total	677.0	100.00	850.6	100.00	1,237.0	100.00

* Revised

Source: SBP

…while Musharaka financing has gained some impetus

With a growth of 103.81 percent, share of Musharaka financing has significantly risen to 21.99 percent in CY17. Introduction of new products by the IBIs (like Running Musharaka[154]) has played a key role in the high growth in Musharaka financing.

Growth in financing remains quite diversified…

Concentration risk, in terms of sectors, remains low as sector-wise distribution of Islamic financing reveals adequate diversification (**Figure 3.2.3**). With over 50 percent growth and 16.36 percent share, energy sector is the largest user of Islamic finance in CY17, followed by textile and individuals[155]. Moreover, highest growth has been observed in case

153 Murabaha, Salam & Istisna

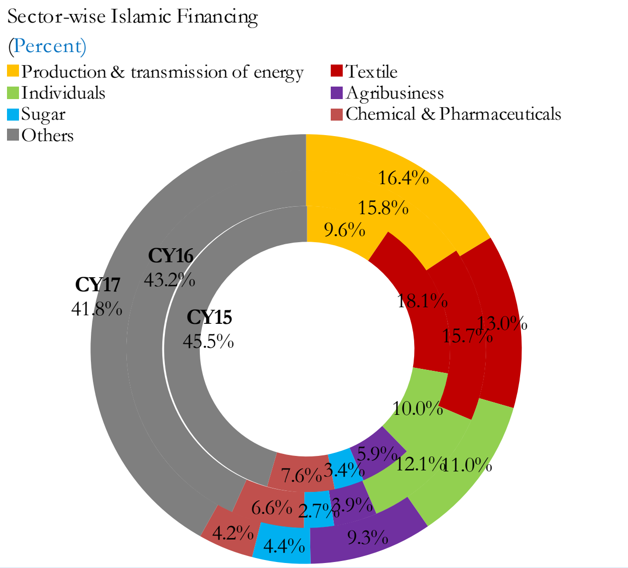
154 Based on Shirkat-ul-Aqd, Running Musharakah is used to finance customer's operating activities.

155 Individuals sector includes financing to consumers, sole proprietorships, and any business owned by a single individual, irrespective of the size of its operations.

of agribusiness due to rise in public sector commodity finance as discussed earlier.

Figure 3.2.3

Islamic financing is diversified across sectors



Source: SBP

…with major part of financing availed by corporates

In terms of segments, most of the financing by IBIs has been availed by corporates (**Table 3.2.4**). However, it is encouraging to note that despite 32.64 percent growth, share of financing to corporates has come down to 70.64 percent in CY17 from 77.45 percent in CY16 mainly because of rise in financing to the public sector. In contrast, conventional banks' concentration in corporates has risen to 68.29 percent in CY17 from 65.82 percent in CY16.

IBIs have provided both long term (Fixed Investment) and short-term (Working Capital and Trade Finance) financing to the corporate sector. In terms of tenor, the financing seems well diversified (48.70 percent long term versus 51.30 percent short term). It is encouraging to note that the fixed investment remains the prime avenue for both IBIs and conventional banks, which is a good omen for future productive capacity of the economy.

Table 3.2.4

Segment-wise Islamic financing

	IBIs			Conv. Banks	
	CY15	CY16	CY17	CY16	CY17
	PKR billion				
Corporate Sector:	503.3	658.8	873.8	3,397.9	3,955.8
Fixed Investment	215.1	339.5	425.5	1,571.7	1,803.8
Working Capital	228.7	260.4	360.5	1,111.3	1,326.7
Trade Finance	59.5	58.8	87.7	715.0	825.3
SMEs:	20.8	29.0	40.6	375.6	411.8
Fixed Investment	6.0	7.4	12.3	80.9	86.1
Working Capital	13.2	20.3	26.5	250.6	284.2
Trade Finance	1.6	1.4	1.9	44.2	41.5
Agriculture	4.3	6.8	5.6	287.5	310.6
Consumer Finance	67.7	89.7	122.1	282.1	326.4
Commodity Financing	58.2	47.4	172.0	571.9	563.4
Staff Loans	8.8	10.0	11.8	94.1	103.7
Others	13.9	8.8	11.1	153.4	120.9
Total	677.0	850.6	1,237.0	5,162.5	5,792.4

Source: SBP

SME finance has registered decent growth while agri-finance remains neglected

With its share hovering around 3 percent, SME finance has grown to PKR 40.6 billion in CY17 from PKR 29.0 billion in CY16. Unlike the past trends where only working capital finance grew, growth in fixed investment has also been observed.

IBIs continue to elude agriculture finance as it has declined by 18 percent to PKR 5.6 billion in CY17. Share of agriculture finance in total financing provided by IBIs is well below 1 percent while it holds 1.77 percent share in total agri-finance provided by all banks. IBIs need to focus on developing products tailored to the needs of agriculture segment since this untapped segment presents huge potential for Islamic finance.

Consumer finance continues to grow…

Islamic consumer finance has grown by more than 30 percent each year during the last three years with highest growth of 36.08 percent in CY17 (**Table 3.2.5**). Auto finance and mortgage finance are the major contributors, which have grown by 38.87 percent and 31.73 percent, respectively. Growth in these two sub-segments has been so impressive that Islamic auto and mortgage finance constitute 44.81 percent and 55.13 percent of the total auto and mortgage finance provided by all banks. On the other hand, 'personal loans' is the biggest product of consumer finance for conventional banks, which is negligible in case of IBIs.

Table 3.2.5
Consumer Financing

	IBIs			Conv. Banks	
	CY15	CY16	CY17	CY16	CY17
	PKR Billion				
Total Consumer Finance	67.7	89.7	122.1	282.1	326.4
Credit Card	0.3	0.4	0.4	27.9	33.8
Auto Finance	40.3	54.7	75.9	71.2	93.5
Consumer Durable	0.2	0.2	0.5	0.1	0.2
Mortgage Finance	25.0	32.3	42.5	29.3	37.5
Other Personal Finance	1.8	2.2	2.8	153.5	161.3
	Growth in percent (YoY)				
Total Consumer Finance	33.87	32.63	36.08	9.99	15.70
Credit Card	27.81	28.76	8.15	15.30	21.16
Auto Finance	35.20	35.54	38.87	30.17	31.34
Consumer Durable	(4.58)	(2.42)	100.42	(2.43)	119.81
Mortgage Finance	31.53	28.98	31.73	60.58	27.71
Other Personal Finance	47.36	23.39	27.95	(3.55)	5.10

Source: SBP

…with manageable risks and asset quality

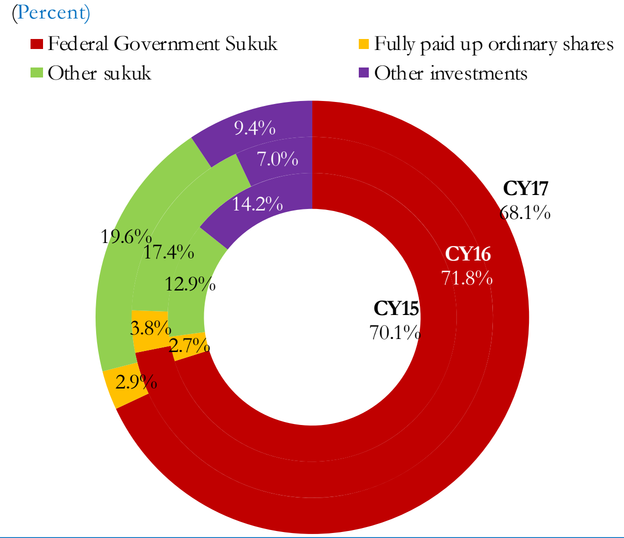
The inherent structure of the Islamic finance products is the main factor contributing to the success of consumer finance. At the same time, this also minimizes the incidence of NPFs to some extent as indicated by NPFs to financing ratio of 2.94 percent in CY17 (3.31 percent in CY16). For instance, mortgage finance is normally structured as a Diminishing Musharaka product. The terms and conditions of such a product are such that at any point in time, both the bank and customer are clear about their share in the property, which improves the confidence of the customer.

GoP Sukuk dominate the investment portfolio of IBIs

The deceleration in growth of investments observed in the last year has continued in to CY17 as the portfolio grew by only 9.02 percent. Limited availability of Shariah compliant instruments (Sukuk) is the main factor behind slower accumulation of investments. Hence, the decline in share of investments in total assets is not surprising. On the other hand, this binding constraint is incentivizing the IBIs to venture more into financing avenues.

Figure 3.2.4
GoP Sukuk dominate the investment portfolio of IBIs

Breakdown of Investments of IBIs
(Percent)



Source: SBP

Composition of the investments has not changed much with GoP Sukuk holding majority share (68.05 percent) in CY17 (**Figure 3.2.4**). Encouragingly, consistent growth has been observed in corporate/ privately placed Sukuk over the last few years, which now constitute 19.58 percent of the total investments of IBIs.

Deposits remain the key funding source

IBIs are mainly reliant on deposits for meeting their funding requirements with share remaining above

80 percent of the overall liabilities for the last few years (**Table 3.2.6**). Deposits of IBIs have seen accelerated growth of 19.81 percent, which among other things, is facilitated by fast expanding branch network of the IBI (**Table 3.2.2**). In stark contrast, growth in deposits of conventional banks has decelerated, amid slower growth in their branch network (2.71 percent) during CY17.

Table 3.2.6

Funding profile of IBIs vs Conventional Banks

	IBIs			Conv. Banks	
	CY15	CY16	CY17	CY16	CY17
	Share in Percent				
Bills Payable	0.93	1.14	1.22	1.16	1.19
Due to financial institutions	3.72	3.75	5.30	13.40	18.70
Deposits	85.39	84.91	82.97	73.15	69.24
Sub-ordinated Sukuk	0.44	0.45	0.60	0.36	0.32
Deferred Tax Liabilities	0.03	0.16	0.06	0.42	0.27
Other Liabilities	2.89	2.87	3.65	2.73	2.57
Net Assets	6.60	6.72	6.19	8.79	7.72
Total liabilities & equity	100.00	100.00	100.00	100.00	100.00

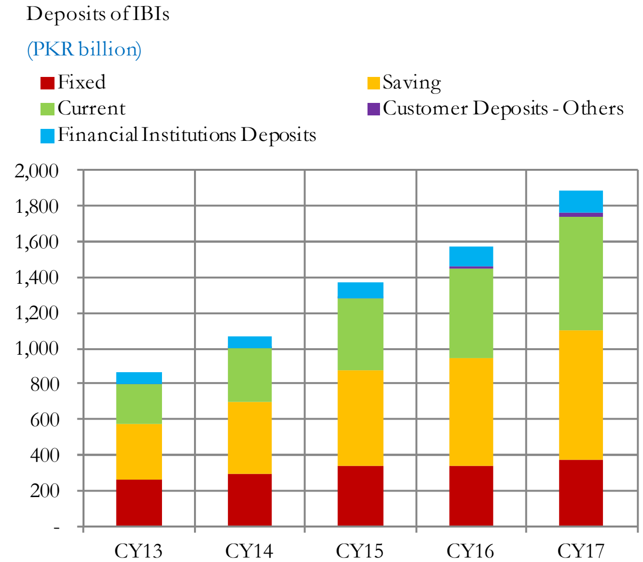
Source: SBP

Profit sharing accounts have a larger share in deposits of IBIs

In the last few years, growth in Qard based current accounts has outpaced the growth in saving and fixed deposits. In order to manage their profit expenses and stay competitive, IBIs have focused on raising current deposits much like their conventional counterparts. However, profit sharing accounts (saving and fixed) primarily based on the Mudaraba contract still have more than 58 percent share in deposits of IBIs (**Figure 3.2.5**). In order to improve transparency and disclosures and bring standardization in IBIs' profit and loss distribution policies and practices; SBP has in place detailed instructions for Profit & Loss Distribution and Pool Management for IBIs that were issued back in CY12[156].

Figure 3.2.5

Profit sharing accounts have a larger share in deposits of IBIs



Source: SBP

While dearth of instruments continue to challenge liquidity management…

Owing to limited availability of approved Shariah compliant instruments, IBIs have kept higher amount of assets in the form of cash and with treasury banks (25.09 percent) compared to their conventional counterparts (12.38 percent) (**Figure 3.2.6**). Major share of the IBIs liquid assets represent the GoP Sukuk (60.03 percent), though is much lower than the share of Government Securities in Liquid Assets of conventional banks (82.70 percent).

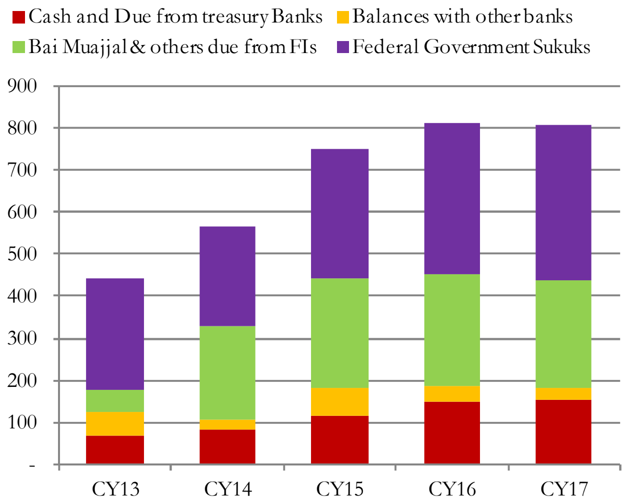
Dearth of approved Shariah compliant instruments also reflects in relatively lower liquidity ratios maintained by IBIs as compared to conerntional banks. Due to modest rise in liquid assets of IBIs both liquid assets to total assets and liquid assets to deposits ratios have dipped by 5.88 pps and 6.18

156 IBD Circular No. 03 of 2012:
http://www.sbp.org.pk/ibd/2012/C3.htm

pps to 27.03 percent and 32.57 percent respectively as of end CY17(**Figure 3.2.7**). While Statutory Liquidity Requirement (SLR) set by SBP has remained above the required level[157] throughout the year, the ratio at 28.21 percent as of end CY17 is much lower than the 60.44 percent maintained by the conventional banks.

Figure 3.2.6
Liquid assets of IBIs are well diversified

Composition of Liquid Assets of IBIs
(PKR billion)



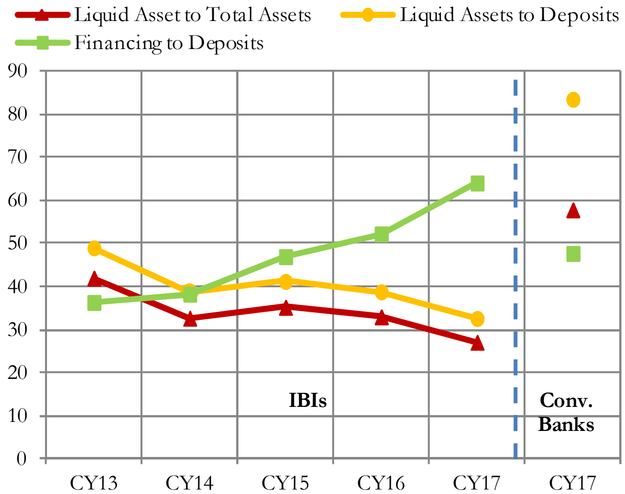
Source: SBP

…it allowed IBIs to improve the intermediation

Robust growth in Islamic financing has improved the financing to deposits ratio by 11.84 pps to 64.02 percent in CY17, which is well above the ratio of 47.68 percent maintained by the conventional banks. (**Figure 3.2.7**). Actually, availability of additional liquidity allowed IBIs to use this extra space for enhancing the financing activity. As such, IBIs have been fostering financial intermediation by extending Islamic finance to various sectors of the economy.

Figure 3.2.7
Liquidity indicators continue to decline

Liquidity ratios of IBIs
(Percent)



Source: SBP

Asset quality of IBIs has further improved…

Asset quality of IBIs is much better than conventional banks due to lower growth in fresh Non-performing Financing (NPF) and high financing growth. NPF to total financing ratio (NPFR) of 2.97 percent in IBIs is far less as compared to NPLR of 9.60 percent of conventional banks in CY17. With a decline of 2.16 pps, Provisions to NPF ratio stands at a comfortable level of 82.51 percent, which has resulted in Net NPFR of 0.53 percent in CY17 down from 0.66 percent a year earlier. . While conventional banks have higher provisions coverage (87.56 percent), their Net NPLR is also higher (1.30 percent) than Net NPFR of IBIs as of end CY17 (**Figure 3.2.8**).

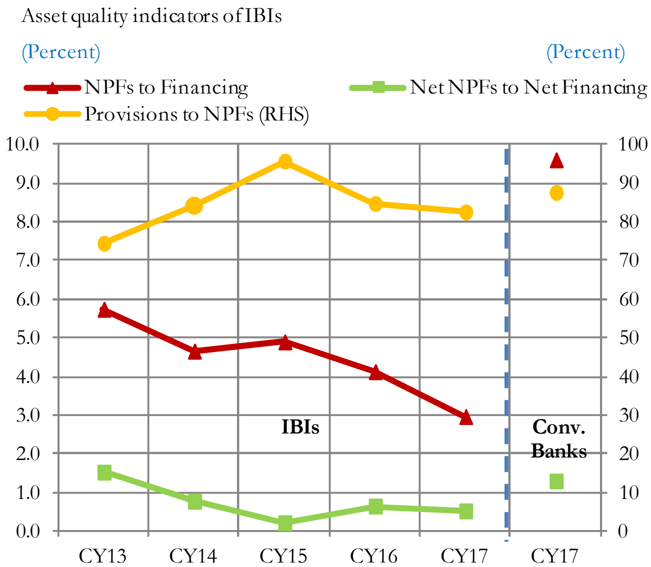
…though prolific growth in financing may increase NPFs in future

157 Islamic Banks/Islamic Banking Branches are required to maintain the liquid assets (excluding Statutory Cash Reserve maintained under section 36(1) of the SBP Act, 1956) at 14 percent of their total demand liabilities and time deposits with tenor of less than one year in Pakistan (DMMD Circular No. 5 of 2018: http://www.sbp.org.pk/dmmd/2018/C5.htm

Credit risk management becomes all the more important whenever financing in any banking sector is growing and there is potential for subsequent infection. Hence, it is imperative that IBIs keep a watch on the sectoral and economic developments, in order to timely manage any potential risks in the future. Moreover, SBP has put in place various micro and macro prudential measures for checking buildup of credit risk.

Figure 3.2.8

Asset quality of IBIs has further improved



Source: SBP

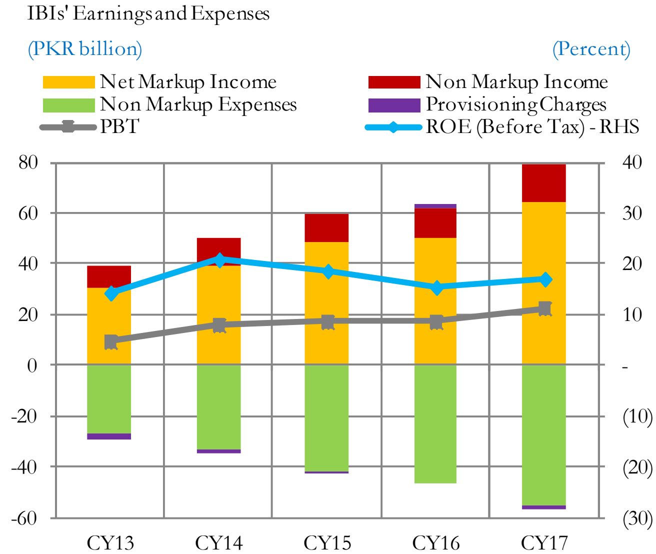
Profitability of IBIs has picked up…

Profitability of IBIs has significantly improved as profit before tax (PBT) has increased to PKR 22.6 billion in CY17 from PKR 17.2 billion in CY16 (**Figure 3.2.9**). Both profit and non-profit incomes have increased with profit income contributing the major portion of earnings.

Net profit income has grown by 28.41 percent in CY17 compared to a meager rise of 2.84 percent in CY16. Comparatively higher increase in gross profit income (20.06 percent) compared to profit expenses (10.81 percent) has improved the net profit income. While IBIs have earned much higher profit income primarily from financing activities (33.04 percent growth), they have been able to limit expenses on deposits (7.07 percent rise) to some extent, by attracting higher amount of Qard based current deposits in CY17.

Figure 3.2.9

Profitability of IBIs has improved



Source: SBP

Similarly, non-profit income of IBIs has increased by 25.53 percent in CY17 compared to 6.14 percent in CY16, mainly on the back of improvement in fee and commission income (40.91 percent rise). Growth in both profit and non-profit income have been more than sufficient to account for the 18.72 percent rise in non-profit expenses.

…which has boosted the profitability indicators of IBIs

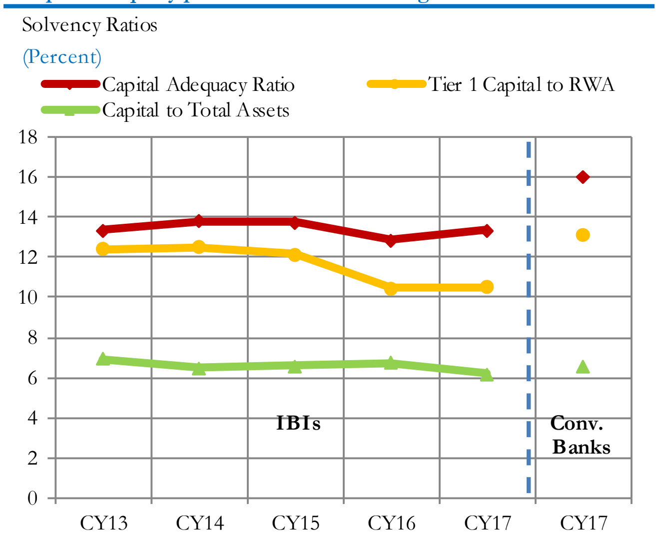
In terms of profitability indicators of IBIs, both ROA before tax and ROE before tax have risen to 1.12 percent and 17.09 percent in CY17 from 1.00 percent and 15.45 percent in CY16 respectively, compared to decrease in both indicators for conventional banks. Despite considerable rise, profitability indicators of IBIs are at somewhat lower levels compared to conventional banks. This is due to the higher operating cost of IBIs and limited availability of risk-free Shariah compliant securities.

Better earnings and fresh capital injection have strengthened the solvency of IBs[158]…

As discussed in FSR 2016, Islamic banks (IBs) considerably expanded their operations during CY16 that affected their overall solvency as RWAs increased. However, during CY17, continued growth in financing has begun to yield profits, which in turn has increased the capital of IBs. The plowing back of profits coupled with fresh capital injection has resulted in a growth of 15.47 percent in Tier 1 capital of IBs in CY17 compared to a small increase of 1.23 percent in CY16.

Figure 3.2.10

Capital adequacy position of IBIs has strengthened



Note: Capital Adequacy Ratio and Tier 1 Capital to RWA ratio are for Islamic Banks only, while Capital to Total Assets include both Islamic Banks and Islamic Banking Branches.
Source: SBP

Given the comparatively larger volume of public sector financing, RWAs did not increase by the same proportion (14.76 percent) as the total assets of IBs in CY17 (17.82 percent). As a result, CAR of IBs has risen to 13.36 percent in CY17 from 12.85 percent in CY16 (**Figure 3.2.10**). However, it is still lower than CAR of conventional primarily due to huge portfolio of risk free Government securities on their books that attract zero risk weight.

…while leverage has slightly gone up

Compared to CAR, Capital to total assets ratio (CTAR) is a broader measure of leverage as it includes all on-balance sheet assets. Considering the level of growth across the entire banking sector, it is not surprising that CATR of IBIs has declined to 6.19 percent in CY17 from 6.72 percent in CY16 and CTAR of conventional banks has also dipped by 69 bps to 6.61 percent in CY17.

In order to avoid building-up excessive on- and off-balance sheet leverage in the banking system, SBP introduced a simple, transparent and non-risk based Leverage Ratio as part of its instructions for Basel III implementation in Pakistan[159]. As of end CY17, leverage ratio of IBs stands at 4.79 percent against the minimum requirement of 3 percent, which indicates sufficient cushion for further portfolio expansion.

IBIs are exposed to operational risks that are different from conventional banks

In addition to the general operational risks[160] faced by both conventional and Islamic banks, IBIs are subject to additional risks arising from documentation of the asset-based Islamic financing products. Moreover, IBIs also face Shariah non-compliance risk defined as "the risk of non-compliance resulting from the failure of an IBI's Shariah governance mechanism (systems and personnel) to ensure its compliance with Shariah

[158] Solvency of only Islamic Banks (IBs) has been discussed here.
[159] BPRD Circular No. 06 of 2013:
http://www.sbp.org.pk/bprd/2013/Basel_III_instructions.pdf

[160] Operational risk is the risk of losses from inadequate or failed internal processes, people and systems, or from external events.

rules and principles as determined by its Shariah board or other relevant body[161]".

SBP, cognizant of the risks associated with Shariah non-compliance, has put in place detailed Shariah Governance Framework for IBIs[162]. The comprehensive framework covers the areas of corporate governance, Shariah board, resident Shariah board member, Shariah Compliance Department, both internal and external Shariah audit and conflict resolutions. Through effective implementation of the Shariah Governance Framework, IBIs can greatly minimize the risks associated with the Shariah non-compliance.

Way forward

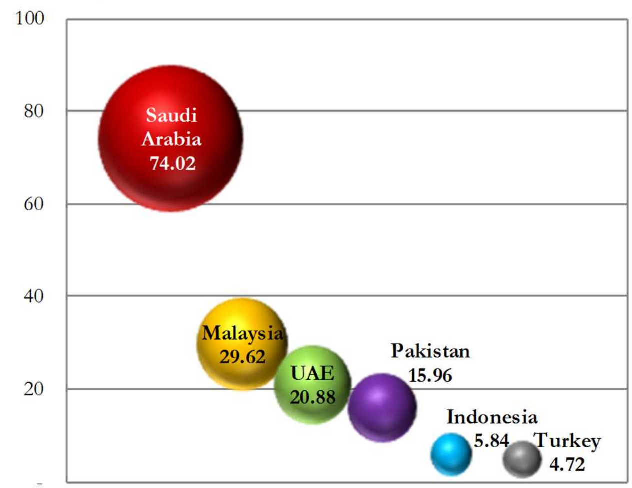
While Islamic banking has grown steadily across the globe in CY17, IBIs have grown rather aggressively in Pakistan. Share of Shariah compliant financing in total financing has significantly grown in Pakistan from 14.93 percent in CY16 to 18.57 percent in CY17 (15.96 percent in Q2CY17). Despite this growth, latest statistics reveal that Pakistan was ranked fourth in terms of share of Shariah compliant financing in total financing as of end Q2CY17 (**Figure 3.2.11**). Moreover, considering the fact that Islamic banking assets of Pakistan constituted less than 2 percent of the global Islamic banking assets in Q2CY17[163], the potential for further growth is huge.

As of end CY17, 40.50 percent of Islamic banking assets belong to the Islamic banking branches of conventional banks, which proves the growing popularity and adoption of Islamic finance in the country. Given the size of their Islamic banking windows, some of these conventional banks can convert these to Islamic banking subsidiaries in the near future[164]. Moreover, SBP has issued detailed guidelines for conversion of a conventional bank into an Islamic bank in CY17[165] in order to facilitate banks desirous of converting their entire banking operations from conventional to Islamic.

Figure 3.2.11
Share of Shariah compliant financing has been growing in Pakistan

Share of Shariah compliant financing in total financing - Q2CY17

(Percent)



Source: IFSB: http://www.ifsb.org/psifi_05.php?selfolder= & IMF: http://data.imf.org/regular.aspx?key=61404590

SBP has been playing its role in promotion of the Islamic banking through implementation of action plans as per SBP's Strategic Plan (2014-18) for the Islamic banking industry[166].Using the unique characteristics of Islamic finance, IBIs should look to innovate and create diversified products across

161 IFSB-15: Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services Excluding Islamic Insurance (Takāful) Institutions and Islamic Collective Investment Schemes - http://www.ifsb.org/standard/2014-01-28_eng_IFSB15%20Revised%20Capital%20Adequacy_(Jan%202014).pdf

162 IBD Circular No. 01 of 2018: http://www.sbp.org.pk/ibd/2018/C1.htm

163 IFSB: http://www.ifsb.org/psifi_05.php?selfolder= and http://www.ifsb.org/psifi_03.php?selfolder=

164 MCB Bank converted its Islamic banking window in to an islamic banking subsidiary in 2015 (MCB Islamic Bank Limited): http://www.sbp.org.pk/notifications/bprd/2015/ntf5.pdf

165 IBD Circular No. 01 of 2017: http://www.sbp.org.pk/ibd/2017/C1.htm

166 http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy%20Paper-Final.pdf

different sectors of the economy with specific focus on the untapped agriculture and SME segments.