

Welcome address by Governor

On the occasion of a Talk with Dr. Umer Chapra on 'Current Islamic Paradigm and Way Forward'

It is indeed a great pleasure to welcome Dr. Umer Chapra to this important session on Islamic Banking. On behalf of myself and my colleagues at SBP, we are grateful he has been able to spare time for us, to share his expertise and insights in the sphere of Islamic banking and finance, here, in Pakistan.

Dr. Chapra is a well noted and distinguished figure with respect to the subject, and his scholarly contributions have been received with admiration and high regard by professionals and academics alike.

From a modest start in 2002, Islamic banking in Pakistan has made good progress, and has reached 6% market share now. Though we may fall short of our original target of 12% by 2012, the heightened global interest in the subject, particularly after the recent financial crisis, leads one to expect that Islamic banking will make more rapid strides now, globally and in Pakistan. The recent crisis was aggravated by extreme use of financial leverage as a source of profit in itself, which is the antithesis of the Islamic principle of equity and real economic activity based returns on investment.

Progress will require concerted and focused effort by all stakeholders to address issues and challenges faced by the industry, in order to broaden and deepen the industry's operational framework.

With respect to Pakistan, some of these challenges include:

1. An immediate objective is to improve and diversify avenues for short term liquidity management. IBs in Pakistan have to live with the big constraint of only being able to place their surplus funds with other IBs, in the absence of suitable investment opportunity. This market gap both limits earnings, and inhibits aggressive deposit mobilization drives.

The SBP is now actively working with the industry and the Federal Government to develop Shariah compliant short term Government paper, to be issued regularly, on an ongoing basis.

I would hope Dr. Chapra could make some observations on how overnight and short term investment markets have developed elsewhere, as leads for alternatives we could develop in Pakistan.

2. Clearly, we will continue to need more diversification in Islamic Banking products. What we may see happening often is simple replication of conventional products, without the use of innovation based on Islamic principles that can both provide structures and products that can give attractive alternatives and improvements on the conventional markets.

I would hope that today's discussions would provide some guidance on where Dr Chapra thinks we in Pakistan need to add to our inventory of Islamic products, based on evolutions in Islamic markets elsewhere.

3. There is perhaps also a need to improve understanding among investors more broadly, about those principles in Islamic finance that provide investors assurance about risk evaluation, risk management framework and practices that improve upon most conventional counterparts. I refer here to participatory financing modes, where risk is shared between the entrepreneur, the bank and the investor. These structures can provide all the advantages that venture capital and private equity structures do in conventional finance without the risk often created by high leverage, and the view of the investment as a largely financial exercise, rather than as one that seeks to achieve true economic value added.

Similarly our Islamic bankers could benefit from more training with respect to development to their capacity to apply Islamic banking tools and principles.

While SBP has taken a number of initiatives in the past to train the Islamic bankers, the pace of growth of the industry is faster than the supply of trained and well qualified Islamic bankers. A strategy is therefore, being developed to improve the skills of the Islamic banking industry which includes collaboration with reputed national and international institutions offering/sponsoring Islamic banking trainings. I have been informed that the Islamic Banking Department has had some discussion with Dr. Chapra on possible cooperation between Islamic Research Training Institute (IRTI) and SBP for training and capacity building in Islamic banking industry in Pakistan. I am confident that this cooperation would materialize and would contribute significantly in improving the skills mix in Islamic banking industry.