Keynote address by Yaseen Anwar
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Your Excellencies, Distinguished Guests, Ladies and Gentlemen,

I am honoured to be here at this historic event at a time when Oman is opening its doors to Islamic finance. The prudent approach of Oman towards the financial sector has helped it in steering safely through the financial crisis, and I am sure that despite a relatively late entry in Islamic finance, given his Majesty Sultan Quboos support Oman will soon be amongst the leading Islamic finance markets in the region.

Your Excellency, Ladies & Gentlemen!

The last financial crisis is viewed as the worst of its kind and tremors from it are still being felt as we keep hearing about fears of economies continuing to remain in recession. Debates on reasons for the financial crisis have led to a wider belief of having greater accountability and a proactive role of regulators to ensure stability of the financial system. Post crisis the world has been trying to rearrange the infrastructure of the financial industry and I view Islamic finance fitting well in the new structure.

Islamic Banking can be traced back to four decades and has its values embedded in the ethics of Islamic society of 1400 years ago. The Islamic economic system is not just about prohibition of interest, it also promotes values such as accountability, transparency and social responsibility. After weathering the financial crisis rather well compared to their conventional counter parts, Islamic financial institutions are increasingly becoming popular. Perhaps the world has been able to see beyond the element of religion and view Islamic finance as an ethics central system that has linkages with real economic activities and an internal shock absorbing ability. From its humble origins Islamic finance today exists around the globe catering not only to the financial needs of Muslims but also to non Muslim clientele.

Volumes can be discussed with reference to Islamic finance and I am sure looking at the two day schedule, you will be hearing prominent speakers give you insights into issues of Islamic finance. Therefore I would restrict myself to sharing with you our experience of establishing and promoting Islamic finance as the preferred mode in Pakistan.

With more than 95 percent Muslim population, and a constitutional obligation of ensuring a riba free economic system, Pakistan has had a relatively favourable environment to launch Islamic finance in the country. However the approach adopted during the 80s for transforming the entire financial system to an interest free system did not meet much success. Despite having introduced landmark changes in the legal framework that included amendments in the Banking Companies Ordinance, enactment of Modarba companies and Mudarabas framework etc., the dream of transforming the entire financial system on Shariah principles could not translate into a reality. The major reasons that can be attributed to this unsuccessful attempt were a) abrupt conversion of the system without creating the necessary infrastructure and human resource, b) lack of ownership amongst the banks' management and staff as well as the business community to shift to the new system in one step, c) a weak judicial system and dispute resolution mechanism, and d) lack of general awareness among the masses about the utility of Islamic banking.

Learning from past experience, we adopted an evolutionary approach for establishing Islamic finance in the country in 2001 whereby both conventional and Islamic banks were allowed to operate in parallel. This enabled the masses to choose between the two systems that best serves their banking and financial services needs and is also in conformity with their faith. The approach has worked well since then and the industry starting from almost scratch in 2001, has gradually improved its share to more than 7.5 percent of the country's banking system. We have now 5 full-fledged Islamic Banks and 13 conventional banks having standalone Islamic banking branches. Given the strong growth momentum, which is over 30 percent annually for the last 6 years, we are hopeful of more full-fledged Islamic banks in the country in the near future.

State Bank of Pakistan, the country's central bank, has been at the forefront of all the major initiatives for development of the industry. We are one of the few regulators who have introduced a comprehensive legal, regulatory, and Shariah compliance framework for the Islamic Banking Industry. The framework allows three types of institutional models for offering Islamic banking services; (i) Full-fledged Islamic banks (2) Islamic banking subsidiaries of conventional banks and (3) Stand alone Islamic banking branches of conventional banks. Moreover, to encourage and facilitate conversion of conventional branches into Islamic banking branches, a detailed criterion has also been issued. The banks are required to have funds of their Islamic banking operations segregated from their conventional side and maintain a separate book of accounts. The permission to conventional banks to offer Islamic banking services through stand alone branches enabled us to leverage their vast network across the country to expand the outreach of Islamic finance. It has also been instrumental in gradually sensitizing the conventional banks about the utility of Islamic banking in business and economic development as well as its growth potential in countries like Pakistan. Presently the conventional banks' Islamic banking portfolio constitutes about 40 percent of the industry.

Further, in order to enhance the breadth and depth of the industry, the framework also allowed establishment of full-fledged Islamic Microfinance banks, Islamic microfinance services by full-fledged Islamic banks and Islamic microfinance Divisions in conventional microfinance banks. Considering the growing awareness and acceptability of Islamic microfinance coupled with its inherent controls to ensure end use of the funds provided by MFIs, the outlook for growth and development of Islamic microfinance in Pakistan is highly positive and we may see establishment and operations of new Islamic microfinance banks in very near future. Similarly Pakistan being an agro-based economy, there is huge potential for development of Shariah Based Agriculture financing. The central bank is working with the industry to develop Shariah compliant agriculture finance products to be offered by IBIs after necessary customization. We have recently circulated a model Shariah compliant agriculture finance product based on 'Salam' to facilitate IBIs' entry in the country's agrifinance markets, which so far have remained grossly un-served or under served. This untapped market includes Dairy products as Pakistan is the fourth largest producer of milk in the world. Cows in Pakistan produce 1000 liters/annum, Australian cows 4000 liters and US cows 9000 liters. This represents an excellent sector for Islamic Finance and once developed, can generate more than $ 500 million in foreign exchange exports. Nestle and Engro have already invested heavily to tap this market segment.

A comprehensive and mutli-tiered Shariah compliance framework is another very important feature of our Islamic banking framework. It comprises

(a) Centralised Shariah Board at the Central bank, which is the apex Shariah Body in the country for Islamic banking institutions. The distinctive composition of this board of having Shariah scholars, an accounting professional, a legal expert and a professional banker benefits the industry by providing comprehensive solutions; that are not only Shariah complaint but also economically viable.

(b) The Shariah Advisor at bank's level to be appointed in accordance with the State Bank of Pakistan's Fit and Proper criteria with the responsibility to ensure that the bank's operations are in conformity with Shariah Principles.

(c) Mandatory internal Shariah audit and

(d) Periodic Shariah inspections by the Central Bank along with routine annual inspection of IBIs. The SBP is one of the very few central banks that have initiated Shariah Inspections. Before the formal launch of the Shariah inspection a comprehensive Shariah inspection manual was developed by engaging a reputed Shariah consulting and auditing firm and comprehensive training was imparted to the Shariah inspectors. The Central bank has also notified the essentials of major Islamic finance products and instruments along with their model agreements; the IBIs while ensuring adherence to the essentials, may develop their own products with the approval of their Shariah Advisor. This arrangement not only allows necessary flexibility to IBIs to develop their own products but also helps in achieving much needed standardization and Shariah harmonization. To further strengthen the Shariah harmonization drive, we are in the process of adopting the AAOFI Shariah standards.

In order to develop sound risk management system and ensure good governance, an incremental approach was adopted whereby the conventional framework was reviewed extensively to identify the gaps and limitations of the conventional system in covering risks and issues specific to IBIs. The new guidelines were thus formulated by tailoring IFSB and AAOIFI standards; they not only cover all major risk categories but also provide best practices for establishing and implementing risk management and corporate governance in IBIs.

While risk always finds an important place in discussions related to Islamic finance, I believe there is interplay between risk and innovative ideas. IBIs have an opportunity to deploy part of their liquidity into participatory modes such as Mudarabas and musharaka. This will not only help them move away from current paradigm that is criticized for mirroring conventional instruments but will also help them capture the untapped markets like Small and Medium Enterprises. While IBIs have an advantage of attracting faith sensitive population they can further expand their outreach by reaching out to segments that have been earlier ignored by conventional banks. IBIs have a business model that enables them to cater to such clients however further sophistication is required in their product range to capitalize on this opportunity. Access to finance is a key challenge facing regulators and IBIs can play an important role in minimizing the incidence of financial exclusion. Realizing this recently, the State Bank of Pakistan revised its definition of rural areas encouraging IBIs to expand their branch network in these jurisdictions.

Besides Islamic banking, the Islamic capital markets are also very important component of Islamic economic system, which can help both public and private sector to mobilize large amounts of capital for financing economic growth and development. The popularity of Sukuk particularly during last decade has not only been instrumental in fast pace expansion of Islamic finance but has also provided a good and stable source of funds to governments. It also defines the limits on public debt and restricts it to the extent of assets available with the government or the new assets to be created through deficit financing. The government of Pakistan is issuing Sukuk with considerably increased frequency since last couple of years and has raised more than USD 3 billion from domestic market that helped Islamic banks to expand their asset base. Further, Islamic funds have found their way to supporting infrastructure projects around the world especially in the Gulf. Being a Muslim country and given its strategic location Oman can benefit from this increasingly popular trend. Issuance of Shariah compliant papers by central bank, commercial banks, government treasury and private entities are likely to contribute significantly to growth and development of real economy.

The limited liquidity management instruments and lack of lender of last resort facility have been amongst the key issues faced by Islamic banks in most jurisdictions, including Pakistan. So far we have had limited success in developing an effective and ongoing liquidity management mechanism for IBIs due to the infrequent issuance of sovereign Sukuk. As a result of extensive efforts made both at the industry and the central bank level, we are currently at an advanced level of development of a comprehensive liquidity management solution that would include i) development of Islamic interbank money market, ii) development of Islamic Interbank Offered Rate (IIBOR) for use as a benchmark for pricing of Islamic finance products, iii) transformation of a sizeable portion of conventional sovereign debt in the books of central bank into Shariah compliant debt, iv) allowing IBIs to place surplus liquidity with the central bank to be remunerated based on the central bank's earnings on Shariah complaint assets and investment portfolio, and v) lender of last resort facility for IBIs. The most challenging and time consuming aspect of this mechanism is the transformation of sovereign debt into Shariah complaint debt as it involves identification of the assets to be used for transformation, their valuation and documentation etc. However, I am confident that with the help and grace of Almighty Allah, we should be able to finalize this mechanism in the near future. This would be a major milestone achieved and would give a big boost to the already buoyant Islamic finance industry in Pakistan.

Islamic finance is an evolving industry and so is its understanding by the masses, the business community and the policy makers. Despite significant improvement during last 10 years, still a very large segment of our population does not have adequate understanding of Islamic finance and its distinction over conventional finance. The Central Bank has thus assumed a dual role for Islamic banking i.e., the regulator, the promoter, and facilitator. Under the facilitation hat we have been partnering with the industry to improve the Islamic banking awareness and understanding of the masses and to build the industry's HR capacity. To create awareness we have launched an awareness campaign, whereby targeted workshops, public seminars and conferences are being organized. Further, a media campaign is being launched for mass awareness using electronic and print media. To help the industry to build its HR capacity, our training subsidiary NIBAF (National Institute of Banking & Finance) is offering regular and customised Islamic Banking courses to national and international participants. Alhumdullilah! Over the years we have developed a good team of Islamic banking trainers cum practitioners, which coupled with the excellent training facilities at NIBAF, is enabling us to offer quality training programs for local as well as regional and global Islamic banking industry.

Innovation remains the corner stone of Islamic banking. IBIs need to increase their product mix in order to meet the needs of their ever increasing client base. Research and development which has been long ignored in our part of the world should be the hall mark of IBIs. We need to change our perceptions and invest in research as a core ingredient of our strategic objectives. While Islamic banking has made significant strides globally and domestically, I believe it is still in an evolutionary phase and relentless efforts are required to confront challenges in keeping the growth momentum of the industry. A pure Islamic financial system based on ethos of equity justice and social responsibility is ideal, but this cannot be achieved over night. Serious efforts on continuous basis will have to be made to achieve a financial system that is in line with maqasid Shariah, and forums such as this help us in our journey towards achieving such a system.

Lastly I would like to congratulate Central Bank of Oman again for initiating Islamic banking and wish them every success in their efforts to develop a vibrant Islamic banking industry. Though a late starter they have the advantage of learning from the good and bad experiences of other countries, including Pakistan, and adopt an approach that is based on international best practices with necessary customization. Let me assure our full support to our colleagues at the Central Bank of Oman and other related institutions and departments in setting up a strong and vibrant Islamic finance sector in this very important Muslim country.

I would also like to congratulate Amjaad Development for arranging this event and thank them for having me here. I hope that the deliberations here at this auspicious gathering of leading scholars and practitioners will not only help us in laying out the road map for Islamic finance in Oman but also help us in addressing key issues faced by the industry.

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