



Strategic Plan

Islamic Banking Industry of Pakistan

2014 – 2018

ISLAMIC BANKING DEPARTMENT

STATE BANK OF PAKISTAN

JANUARY 2014

TEAM

NAME	DESIGNATION	CONTACT
Saleem Ullah	Director	saleem.ullah@sbp.org.pk
Zulfiqar Ali Khokhar	Additional Director	zulfikar.khokhar@sbp.org.pk
Ghulam Shabbir	Joint Director	shabbir@sbp.org.pk
Ashfaq Ahmed	Joint Director	ashfaq.iba@sbp.org.pk
Bushra Shafique	Deputy Director	bushra.shafique@sbp.org.pk
Naveed Ahmad	Assistant Director	naveed.ahmed@sbp.org.pk

TABLE OF CONTENTS

Governor’s Message.....	i
Foreword.....	ii
Executive Summary	iii
Strategic Plan - Islamic Banking Industry Of Pakistan_2014-18	1
Introduction	1
Vision	1
Mission	1
Values.....	2
STRATEGIES.....	2
Strategies.....	3
A. Enabling Policy Environment:	3
B. Shariah Governance & Compliance	6
C. Awareness and Capacity building:	7
D. Market Development.....	9
Way Forward.....	13
Action Plan.....	14
1. Legal, regulatory and supervisory framework.....	14
2. Liquidity management framework.....	15
3. Taxation regime.....	15
4. Financial accounting & reporting framework.....	15
6. Coordination and collaboration amongst internal and external stakeholders	16
7. Awareness Enhancement	17
8. Capacity Building	18
9. Product Diversification.....	18
10. Financial Inclusion	19

GOVERNOR'S MESSAGE

The stability and resilience exhibited in the wake of financial crisis by Islamic financial industry has led to its wider recognition as a viable and competitive component of the financial system. The innate strengths of the Islamic financial system of being based on productive economic activity and devoid of excessive leverage and imprudent risk taking have been key drivers of its significantly improved acceptability and increasing share in the global financial system. However, this post financial crisis era is challenging at the same time, due to the low confidence of customers in the prevailing financial system along with the slowdown in global economic growth. The second round impact of financial crisis on Islamic financial institutions has also indicated that the inbuilt shields of the Islamic financial system need to be complemented with a robust regulatory framework, enhanced transparency and adequate buffers for ensuring its sustainable growth.

Domestically, much like internationally, Islamic banking industry is growing at a pretty fast pace and has acquired about 10 percent market share of the country's banking system. However, to sustain and further boost the growth momentum, significant changes in the architecture of the industry are needed. The SBP thus took the initiative to develop the strategic plan for the industry for next five years, which sets the future direction of the industry and gives a consensus strategy to take the industry to the next phase of growth and development. The plan has an extensive focus on improving public perception of Islamic banking industry as a distinct and viable system capable of catering to diversified financial needs of various segments of the society. It envisages intensifying the awareness creation efforts, strengthening consultation mechanism with stakeholders, removing confusions and inconsistencies in legal, regulatory and taxation environment, deepening and broadening of product offerings by Islamic banks, doubling the outreach of Islamic banking institutions during next five years and increasing the market share to 15 percent of the banking system.

The development of this consensus plan gives me optimism about sustenance of the strong growth momentum and the improvement in public perception about Islamic finance. The SBP will keep on demonstrating its ownership and resolve for developing the industry on sound footing through enabling legal and regulatory regime and partnering with the industry for addressing perception and taxation issues. I am confident that all stakeholders will collaborate and cooperate for successful implementation of this strategic plan and five years down the road we will have more vibrant and stronger Islamic banking industry with significantly improved perception about its utility and contribution towards development of a fair and equitable economic system.

YASEEN ANWAR
Governor
State Bank of Pakistan

FOREWORD

The re-launch of Islamic banking in Pakistan in 2001 has proved to be a big success as the industry starting from almost scratch now constitutes 10 percent of country's banking system with presence in more than 80 districts across the country. It has been growing at a very health CAGR of 53 percent since 2003 (27% since 2008) and maintaining the growth momentum despite the increasing base. The branch network is also growing 15-20 percent annually; the existence of about 1,200 branches is likely to grow to 2,000 branches during next five years. The industry has also made significant progress on developing Shariah permissible products for meeting the varying needs of the real economy. The sustained growth momentum over the last 10 years provides strong evidence of growing acceptability of Islamic banking as a viable and competitive alternate to the conventional banking.

While the achievements made by the industry during last decade are commendable and gives optimism about continuation of growth momentum, the industry is still in the evolutionary phase and need collaborative efforts by all stakeholders, particularly the regulator and practitioners, to take it to the next level of growth and development. Despite strong growth momentum the industry perception is still not very positive largely due to limited awareness and similarities between conventional and Islamic banking products. The legal and regulatory framework and taxation environment though improved over the years still need significant changes to enable Islamic banking to achieve its real potential and contribute in development of a sound, stable and inclusive financial system. Similarly the product offerings are overwhelmingly debt-based, which though meet the minimum Shariah requirements however don't meet the Shariah objectives of '**risk and reward sharing**' and equitable and broad based distribution of economic gains.

The strategic plan for the next five years (2014-18) is an effort to have an industry wide consensus on the future direction of the industry, the major strengths of industry and the strategy to build upon these strengths, the key issues and challenges faced and the strategy to address/resolve the issues and challenges. It thus identifies and preempts the key structural issues and challenges of the industry and provides a road map and action plan for resolving the challenges and taking the industry to the next level of growth and development. The plan focuses extensively on improving the perception through intensifying awareness efforts, improving product profiles of IBIs and making the legal and regulatory framework supportive and enabling for the industry. The plan also gives significant emphasis on Shariah standardization and harmonization across the industry, which among others is also critically important for improving the industry perception as a distinct, competitive and Shariah permissible financial system. I am grateful to all the stakeholders who provided their valuable feedback and suggestions for improving the draft plan and I hope that similar or even better cooperation and collaboration will be exhibited during the implementation phase.

SALEEM ULLAH
Director
Islamic Banking Department

EXECUTIVE SUMMARY

Islamic Banking Industry in Pakistan has been growing at a fast pace ever since its re-launch in 2001. Starting from almost scratch the Islamic banking industry now represents 10% of overall banking system with 19 banking institutions offering Islamic banking products and services.

State Bank of Pakistan (SBP) initiated three-prong strategy in 2001 and facilitated setting up of (i) Islamic Banks (ii) Islamic Banking subsidiaries of commercial banks and (iii) dedicated Islamic banking branches by the conventional commercial banks. During the period, SBP has issued detailed licensing criteria, instructions and guidelines for Shariah compliance, instructions for Profit & Loss Distribution and Pool Management and also adopted few IFSB prudential and AAOIFI Shariah standards.

Although industry has shown rapid growth, there are still areas which require concerted and proactive efforts by stakeholders to further develop and nurture the industry. To augment the existing growth momentum and to lead the industry to the higher level of professionalism, SBP has prepared “Strategic Plan for- Islamic Banking Industry of Pakistan 2014 – 2018”. The plan focuses on initiatives necessary for improving public perception of Islamic banking and promoting it as a distinct and viable system to address the financial services need of the public in general and business community in particular.

The strategic plan consists of (a) Vision, (b) Mission, (c) Values, (d) Functional Strategies and (e) Action Plans. The strategies and the action plans have been developed keeping in view the strengths, weaknesses, opportunities and threats to the industry.

SBP over the next five years in collaboration with stakeholders would keep its focus on the following key areas/objectives to facilitate and catalyze stable and distinct growth of Islamic banking in Pakistan:

- A. Enabling Policy Environment
- B. Shariah Governance & Compliance
- C. Awareness and Capacity Building
- D. Market Development

The functional strategies and action plan for achieving objectives in each area have been developed in consultation with the Islamic Banking Institutions and their Shariah advisors, SBP Shariah Board members, academicians, internal SBP departments, Securities and Exchange Commission of Pakistan

(SECP) and Institute of Chartered Accountants of Pakistan (ICAP). It is expected that with the implementation of this strategic plan, Islamic banking industry will grow prudently and distinctly with enhanced acceptance and confidence of the general masses contributing in the economic development of the country.

STRATEGIC PLAN - ISLAMIC BANKING INDUSTRY OF PAKISTAN 2014-18

INTRODUCTION

The Islamic banking industry starting from scratch in 2001-02 has grown manifold and in 2013 has achieved approx. 10% share of total banking industry despite tough economic conditions. The fast pace growth of Islamic banking in the country during the last decade is an indicator of a huge latent demand for Islamic Banking products and services. Although the growth is impressive, there are still areas which require concerted, proactive and prudent initiatives by stakeholders to further develop and nurture the industry.

Keeping in view the existing growth potential, SBP in collaboration with stakeholders has developed the “Strategic Plan - Islamic Banking Industry of Pakistan” for the period 2014-2018. The Strategic Plan focuses on critical issues and includes necessary initiatives for improving public acceptance and promoting Islamic banking as a distinct and viable system for meeting the financial services need of the public in general and business community in particular.

The Strategic Plan encompasses Vision, Mission, Values, Strategies and the Action Plans for the next five years.

The vision, mission and values are as under:

VISION

To evolve a stable and distinct Islamic Banking System based on Shariah principles that creates value for all stakeholders particularly the users and providers of Islamic financial services.

MISSION

To facilitate and catalyze development of Islamic banking industry in the country through a) enabling legal, regulatory and Shariah compliance framework, b) promotion of Islamic finance as a distinct and competitive system to serve the financial services needs of the masses, c) targeted research initiatives to better explore market dynamics and d) collaboration with the local and international stakeholders

for development of competitive and innovative solutions for the diverse financing need of the real economy.

VALUES

- Commitment (to promote Islamic banking in the country on sound and distinct footing)
- Consultative approach (all policy, regulatory and promotional initiatives to be taken in consultation with stakeholders; Shariah community, bankers, customers, etc.)
- Collaboration with local and international stakeholders (Government, other regulators, tax authorities, International Islamic Infrastructure Institutions)
- Transparency (clear and open policies for all industry players)
- Proactive approach (consistent proactive approach in policy formulation)

STRATEGIES

The main strategies will focus in the following key reform areas:

A. ENABLING POLICY ENVIRONMENT

- Enabling legal, regulatory, supervisory, liquidity management framework, taxation regime and financial accounting & reporting framework

B. SHARIAH GOVERNANCE & COMPLIANCE

- The focus in this area will remain on standardization and harmonization of Shariah practices, as well as on creating distinct Islamic banking products and services.

C. AWARENESS & CAPACITY BUILDING

- Efforts will be made for coordination and collaboration amongst internal and external stakeholders, enhancing awareness about Islamic finance, and building capacity of the stakeholders

D. MARKET DEVELOPMENT

- Initiatives will be undertaken for product diversification and financial inclusion with the collaboration of stakeholders

The detailed strategies in each area are given in the following pages.

STRATEGIES

A. ENABLING POLICY ENVIRONMENT:

An enabling policy environment is a pre-requisite for development and growth of any industry and Islamic banking industry is no exception to this rule. In Pakistan, there is a rich history of efforts for the development of Islamic Finance. The initial efforts made in 1960s to 1970s translated into country-wide transformation of financial sector into non-interest based financial system during 1980s. However, since early 2000s, Islamic Banking was re-launched in parallel to conventional banking to make the transformation of the system gradual and market driven. A number of reforms have been carried out in legal and regulatory framework, taxation etc since initiation of transformation efforts in 1980s. However considering the evolving nature of Islamic banking and finance not only in Pakistan but globally there is need for an ongoing review of the legal, regulatory and supervisory framework to ensure their responsiveness to the evolving dynamics of Islamic finance. The Strategic Plan accordingly identifies the key issues and weaknesses in the policy environment and gives strategies and action plans to address the issues etc. The plan includes initiatives for the following key areas of policy environment:

a. **Legal Framework**

The most important building block for sustainable growth and development of Islamic banking is the enabling legal framework. The current legal framework does not distinguish between conventional banking and Islamic banking and Banking Companies Ordinance (BCO) 1962 is equally applicable to both conventional and Islamic banks. In order to explicitly recognize the Islamic banking in the legal framework, it is envisaged that a separate chapter/Part in BCO 1962, necessary changes in SBP Act 1956, Recovery of Finance Ordinance 2001, Microfinance Institutions Ordinance 2001 and any other related law will be carried out and efforts would be made with government for the enactment of the proposed changes.

Moreover, there is severe concern that Islamic banking is largely providing alternates to conventional products and services and is not providing differentiated solutions. In order to mitigate the issue, the need and desirability of Islamic banking institutions to engage in (a) real trade, real estate, commodities (b) investment banking business and (c) act as Modarba Management Company will be assessed. The initiation of necessary changes in legal and regulatory framework if consensus is reached are also planned to be carried out during the next five years.

b. Alternate Dispute Resolution mechanism

Arbitration and legal proceedings are usually costly and time consuming, thus alternate dispute resolution mechanisms are now being encouraged across the globe. Pakistan being no exception to it has started developing Alternate Dispute Resolution Mechanism. SBP in coordination with stakeholders will work with existing and/or new alternate dispute resolution bodies for resolving Islamic banking dispute by devising customized dispute resolution mechanisms.

c. Regulations and Guidelines

Keeping in view the distinct and dynamic nature of Islamic banking modes and products a thorough revision of the existing regulations and guidelines will be undertaken to remove confusions and inconsistencies, improve transparency and disclosures and crystallizing the scope and mandate of IBIs. This provision will ensure a level playing field for Islamic banking industry viz a viz conventional banks. The focus of this exercise will be to identify any anomalies/conflicting instructions in the existing regulations and propose rectifying measures to address the same.

d. Prudential Standards

One of the important areas with respect to regulatory & supervisory framework is the adoption of international best practices and be at par with latest global regulatory standards. It will be done through adoption /adaption of prudential standards and guidelines issued by the international standard setting bodies like Islamic Financial Services Board (IFSB). SBP as IFSB's founding member is already playing an active role in the development of IFSB's standards. The standards issued by IFSB for Islamic banking industry shall be reviewed in the light of local legal and regulatory framework and shall be adopted with appropriate amendments, wherever required.

e. Guidelines for Development Finance Institutions (DFIs)

DFIs are important players of the financial sector that are providing valuable financial services in the country. At the moment, SBP instructions are available for conventional banks to start Islamic banking business through subsidiary or branch/window mode but these instructions are not available for DFIs. Accordingly, in order to facilitate DFIs to offer Islamic banking services, necessary instructions and guidelines will be issued.

f. Rationalization of Minimum Capital Requirement (MCR)

At present, full fledged Islamic banks are subject to same MCR regime as conventional banks... Moreover besides full fledged Islamic banks, conventional banks are also allowed to offer Islamic banking services through stand alone branches/window operations with nominal capital allocation from their existing capital. Further, for opening an Islamic banking subsidiary,

commercial banks have to come up with capital as high as a full fledged bank. Thus in order to provide level playing field, going forward, MCR regime for Islamic banks, Islamic banking subsidiaries and Islamic branch/window operations of conventional bank will be rationalized.

g. On-site Inspection Manual

SBP is one of few central banks which carry out 'On-Site' Shariah inspection of operations of Islamic banking institutions. The on-site inspection manual was developed few years ago. As the industry has grown in both size and complexity, it is essential that the supervisory tools are also upgraded. Accordingly, updation of 'On - Site' inspection manual will be carried out on priority basis.

h. Liquidity Management Framework

One of the major issues being faced by Islamic banking industry since its inception is the absence of an effective liquidity management framework. In this regard, it is envisaged that SBP in collaboration with internal and external stakeholders would develop a comprehensive liquidity management framework that would, inter alia, include development of Islamic inter-bank money market, short term liquidity management instruments/solution and availability of Shariah compliant discount window for IBIs.

i. Tax Neutrality

In order to provide level playing field certain amendments have been made in tax laws to facilitate Islamic banking. There are, however, areas that require resolution like tax neutrality for the users of Islamic Banking, registration and stamp duties and amendments in Sales Tax Act. Going forward, SBP in collaboration with industry will work with relevant Federal and Provincial Governments for resolution of tax issues to provide tax neutrality to enable Islamic banks to develop and after Shariah based products and services without incurring additional cost.

j. Financial Accounting & Reporting

The existing applicable financial accounting and reporting architecture is based on conventional banking & finance transactions, whereas Islamic banking is substantially different from conventional banking. In order to cater to the peculiarities of Islamic banking & Finance, SBP will continue to collaborate and work closely with ICAP in issuing financial accounting and reporting standards for the industry.

Shariah compliance is one of the most significant features and *raison d'être* for Islamic banks. Establishing a robust Shariah governance mechanism therefore remains critical to ensure that Islamic banks operate within Shariah boundaries. It is also important to have confidence and trust of masses to reflect that the bank they are dealing with is Shariah compliant at all times. Thus every Islamic financial institution requires comprehensive Shariah governance and compliance system at all levels of the institution and at each stage of business. Any transaction which does not pass the Shariah compliance test is classified as Shariah illegitimate and any return on the same does not become part of the bank's income resulting into financial loss to the bank. The Shariah non-compliance risk of the bank also leads to reputational risk and dents the very confidence of masses on this faith-driven financial system. Accordingly, the Strategic Plan will focus on following key areas for enhanced Shariah governance and compliance framework for Islamic banking industry of Pakistan.

a. Adoption of AAOIFI Shariah Standards

For the standardization and harmonization of Shariah practices in Islamic banking industry of Pakistan, SBP had earlier issued essentials of permissible modes of Islamic banking and finance in Pakistan. Moreover, SBP has also allowed use of AAOIFI Shariah Standards wherever SBP essentials are not available. AAOIFI is the global standard setting body which issues accounting, governance and Shariah standards which are followed by majority of jurisdictions offering Islamic banking and finance. SBP over the years has started adopting/adapting AAOIFI Shariah standards for their application in Pakistan. This is an ongoing and detailed process, where each standard is reviewed by Shariah Advisors of the industry to give their feedback. The industry feedback on each standard is reviewed by SBP Shariah Board's committee for standards adoption and the final standard is adopted/adapted based on local needs and circumstances after the approval of SBP Shariah Board. The Strategic Plan envisages adoption/adaption of AAOIFI Shariah standards over the course of next five years in consultation with industry and approval of SBP Shariah Board.

b. Issuance of Comprehensive Shariah Governance Framework

Strengthening the Shariah compliance is the regular feature of augmenting the overall regulatory and Shariah compliance framework for Islamic banking industry. Towards this end, a number of regulations concerning Shariah compliance have been issued from time to time. As the industry has now gained a significant market share, the size and diversity of financial transaction is growing and becoming more complex, it is necessary that the Shariah related risks are clearly identified and responsibilities of each organ of governance is fixed to address the same. In this perspective, the Strategic plan envisages to have in place a comprehensive Shariah Governance Framework which shall clearly specify role and responsibilities of each organ of governance i.e.

the board of director, executive management, Shariah supervisory Board, Shariah compliance mechanism and internal and external Shariah audit.

c. Product Standardization and Harmonization

In order to enhance the reach of Islamic banking and promote trust of masses on Islamic banking, standardization and harmonization of Islamic banking products and services is critical. SBP has already specified broader parameters for permissible Islamic modes of finance and banks have been allowed to develop products and services after getting approval of their Shariah Advisor(s) for each product and service they offer. In order to harmonize and standardize the Shariah practices of the industry, the Strategic Plan envisages reviewing in detail the available major products and services and issuing related instructions and/or guidelines on essential Shariah requirements of major product and services being offered in the market. This step is expected to improve the confidence and acceptance of Islamic banking by the masses.

d. Guidelines for Treasury Operations/Products of IBIs

The provision of full spectrum of products and services in all areas of banking has been a major challenge facing the industry specially in offering treasury products in both local and foreign currencies including trade finance and inter-bank products. At the moment, the industry is at different stages of product development and the practices are also divergent. The Strategic Plan thus envisages development and issuance of guidelines and /or regulations for this important function of Islamic banking institutions to guide the industry and bring standardization.

e. Restricted use of “Agency”, “Hiba” & “Waad” in Islamic Banking Transactions

Some of the industry practices like ‘Agency Agreement with Client’, ‘Hiba (Gift)’ and ‘Waad (promise)’ though Shariah compliant, nevertheless, are amongst the key source of criticism for Islamic banking. In order to strengthen the trust of the masses in Islamic banking and finance, there is a need to move away from these structures. It is expected that with the collaboration of the industry, the use of agency, Hiba and Waad will be minimized over the next five years.

C. AWARENESS AND CAPACITY BUILDING:

Although Islamic banking industry has shown respectable growth over the decade, the lack of public awareness and buy-in from the masses stands out as one of the key concerns surrounding the industry. As the industry runs in parallel to its conventional banking, the current paradigm offers products whose business and economic outcomes are more or less conventional this creates confusions and misperception amongst the masses about Islamic banking and its distinction over conventional banking. Therefore to improve the coordination & collaboration, awareness and capacity

building of stakeholders, to make Islamic banking industry distinct and acceptable by masses, following initiatives are identified as major components of Strategic Plan.

a. Coordination and Collaboration amongst Stakeholders

Given the evolving nature of Islamic finance and multi-faced issues faced by the industry, effective collaboration and co-operation mechanism amongst all the key stakeholders is critically important for sustaining the growth momentum. The plan thus envisages constitution of an Islamic Banking and Finance Consultative Group (IBFCG) under the lead of SBP with representation of IBIs, Securities & Exchange Commission of Pakistan (SECP), Institute of Chartered Accountants of Pakistan (ICAP), etc. This group will be responsible for developing and implementing strategies for development of Islamic Banking & Finance in the country.

Moreover, for the sustainable growth of Islamic Banking and Financial Industry, an active and efficient Islamic capital market and Takaful industry are essential components. The joint forum of SBP and SECP on Islamic banking and finance will be actively utilized for collaboration between the two financial sector regulators to synergize their efforts for facilitating development of the industry on sound footings.

Similarly the cooperation and collaboration with International Islamic Infrastructure Institutions like IFSB, IIFM, AAOIFI, and IRTI will be strengthened for improving the policy and business environment and capacity building of the industry.

Further, being an important and active player of global Islamic finance having ample technical expertise and resources in this field, technical and intellectual assistance will be extended to the countries who are new entrants into Islamic banking & finance. SBP in collaboration with NIBAF will also design and offer customized training programs for international participants from central and Islamic banks of other countries, especially GCC and Central Asian countries. Efforts will also be made to market NIBAF's Islamic Banking Certification Course (IBCC) as an internationally recognized certification for Islamic banking professionals.

b. Creating Awareness

Lack of awareness and understanding of Islamic finance and its business and operating model has been one of the key causes of confusion and misperception about Islamic finance. The plan thus gives extensive focus on intensifying the awareness efforts both at industry and individual intuitions level. The media campaign launched last year will be further strengthened to leverage print, electronic and digital media for promotion of Islamic finance and clearing confusions and misperceptions. Further, special and targeted awareness sessions will be designed and conducted with senior management of conventional banks and SBP, local chambers of

commerce, Judiciary/lawyers and academia, etc. to enhance their understanding about Islamic finance and its inherent business and economic sense. Bi-annual international conference, lectures and sessions by leading local and international Shariah scholars and professionals and International road shows on Islamic Banking will also be arranged at major hubs of Islamic finance to showcase Pakistan as one of the leading countries promoting Islamic banking and finance.

c. Capacity Building

The capacity building of the industry is another major component of the strategic plan. It envisages developing specialized trainings and strengthening cooperation and collaboration with national and international stakeholders for significantly enhancing training and capacity building initiatives. The linkages with institutions especially the business schools and professional accounting bodies like ICAP, ICMAP will be strengthened to encourage and facilitate Islamic economics, finance and banking courses, specialization etc in their institutions.

Further, the IBIs will be significant by strengthening their existing training facilities and programmes either individually or in collaboration and partnership with IBIs educational/professional training institutes. The plan also envisages Shariah scholars to improve their understanding of finance, treasury operations, accounting and auditing etc. This will enable them to effectively assess the financial products and transactions designed and give well informed opinions/fatwas. It is also planned to collaborate with the Shariah educational institutions to offer courses pertaining to banking and finance as part of their specialization programs.

To further leverage the NIBAF's capacity building initiatives, it is planned to offer self-learning Islamic Banking Certification Course (IBCC). It is envisioned that NIBAF, industry experts and educationists will be brought together to publish course material in the form of interactive study books, audio/video lectures, visuals, exercises etc. to make self-learning easy and effective. The distant learning programs by NIBAF and other institutions will also be facilitated and encouraged. NIBAF will also develop intermediate to advance level Islamic Banking courses for middle and senior level management of IBIs besides offering Training of Trainers program to groom industry experts and Shariah scholars as international trainers in the field of Islamic Banking and Finance.

D. MARKET DEVELOPMENT

The Islamic Banking industry has come a long way in developing solutions to varying needs of the economy; the product offering and extent of outreach however is limited yet. In order to take the

industry to next level, the Strategic Plan proposes various initiatives for product diversification and financial inclusion. The key strategic initiatives in this regard are as under:

a. Product Diversification

In order to sustain the growth momentum and provide differentiated products the need for focused research for innovative products catering to varying needs of different segments of the society is essential.

Going forward, efforts will be made to develop housing finance product(s) based on market prices and rentals vis-à-vis current practice of fixed property prices and KIBOR linked rentals. This will not only improve Islamic banking perception but would also have tremendous appeal for the prospective home owners and depository investors facilitate customers in reduced installments and there will be incentive for them to increase their equity share at the earliest as they have to purchase equity share at market prices. The bank will have benefit of earning capital gains as property price usually moves in upwards direction. The depositor consequently will also earn enhanced returns. The deposits for financing these products shall be mobilized separately so that payment system and investment deposits shall remain segregated.

The main criticism on the current Islamic banking paradigm is the overwhelming use of debt creating products while the equity products based on Musharaka and Mudaraba have been very limited on asset side. To attend to this critical area, the Strategic Plan envisages working closely with industry to develop and offer Musharaka/Modaraba based products.

Project/infrastructure financing has great significance in economic development of the country and Islamic finance offers viable alternates to both debt and equity project/infrastructure Sukuk for private and public sector. In this regard, policy guidelines will be developed for the issuance of project/infrastructure specific Sukuk.

b. Financial Inclusion

Since its re-launch in 2002 the Islamic banking industry has expanded considerably, however; it is still concentrated in urban, semi-urban areas where financial services have greater availability. A large untapped market (more than 80% of population is excluded from the financial sector)¹ ; while a significant percentage of faith sensitive voluntary exclusion signifies huge potential demand for Islamic banking in the country. The SBP and the industry will therefore collaborate to expand its network to areas/regions/sectors where there is no or limited availability of financial services particularly the rural agricultural areas, SMEs, low cost housing and microfinance.

¹ Source: Access to Finance ; World bank Study

c. Agriculture Financing

Similar to SME sector, agriculture sector development is critical for the overall growth of our economy but is among the sectors that are being ignored by the banking industry in general and Islamic banking Institutions in particular. Considering the potential of the sector and the support from SBP, the industry is expected to allocate at least 5% of the deposits or 10% of financing whichever is higher to the Agriculture financing.

d. Small and Medium Enterprises (SMEs) Financing

Recent economic crisis once again has signified the importance of SMEs in reducing unemployment and sustaining growth. SBP will provide support to Islamic banking institutions in terms of enabling regulations, facilitating research to develop products for this sector and encourage the industry to make use of its market expertise to explore the huge potential of this sector. There also exists an anecdotal argument that entrepreneurs in SME sector are more inclined towards Islamic banking products due to their religious sensitivity. Having enabling regulatory environment and the limited availability of banking services for this sector, the Strategic Plan envisages that the Islamic Banking Industry will allocate and finance at least 5% of the deposits or 10% of financing whichever is higher for SMEs.

e. Low Income Housing

Low Income housing is another sector which has remained excluded from the banking industry though has huge potential; there is a backlog of 7.5 million housing units in Pakistan which is accumulating by 0.35 million per year. The formal financial sector caters to only one to two percent of all housing transactions in the country, whereas informal financing caters to 10-12 percent of such transactions. Going forward SBP will support in terms of capacity building, coordination and collaboration among various stakeholders, focused research and pilot projects to encourage Islamic banking institutions to develop this sector.

f. Islamic Microfinance (MF)

Islamic Microfinance has great potential to provide support to the poor by providing financial services at their doorstep. The asset based nature of Islamic modes of financing safeguard customers against mis-utilization of financing and thus over indebtedness. The regulatory environment for developing Islamic MF in Pakistan is quite conducive as detailed guidelines for Islamic Microfinance industry including detailed licensing criteria are already available. Going forward, support will be provided to the Islamic MF industry for capacity building, coordination & collaboration among various stakeholders, focused research and pilot projects to develop this sector.

g. Refinance Schemes

SBP has been facilitating trade & commerce specially exports business through various schemes with concessional financing facilities. In this regard, Shariah compliant Export Refinance Scheme (EFS) is already in place. The Strategic plan envisages revamping of Shariah compliant EFS and making available Shariah compliant Long Term Financing Facility. In addition, other related conventional schemes will also be provided in Shariah compliant manner to provide level playing field to Islamic banking institutions and their customers.

h. Market Share

Considering the average annual growth rate of IB industry over the last decade and significant financial exclusion level, achieving a target of 15% share in overall banking industry along with doubling of number of branches in the next five years has been envisaged in the Plan as an attainable target for the industry. Moreover, the Strategic Plan envisages that the financing to deposit ratio of Islamic banking institutions would be at least at par with conventional banks.

i. Alternate Delivery Channels (ADC)

SBP remains committed to providing enabling environment for inclusive growth by creating conducive policy framework for banking institutions to enhance financial inclusion. ADC in recent past has become the focus of financial sector in international and local market. ADCs help in reducing costs and offering financial services to hitherto excluded market segments. Pakistan is among those countries that have got detailed guidelines for branchless and mobile banking and IBIs can take advantage of these guidelines to use innovative mechanisms to reach the unserved and underserved segments of the society. Therefore it has been highlighted in the Strategic Plan that the industry would be capitalizing on these avenues to enhance the breadth and depth of its outreach.

WAY FORWARD

All the strategies given in preceding pages are converted into time bound specific actions plans appended in the next section. The responsibility to execute the Strategic Plan will rest with the Director – Islamic Banking Department (IBD), State Bank of Pakistan. The Director will make necessary working teams and/or committees of SBP officials and the stakeholders to deliver on action plans. A quarterly review shall be carried out by the Director to review the progress and take necessary corrective actions.

ACTION PLAN

A. ENABLING POLICY ENVIRONMENT

1. LEGAL, REGULATORY AND SUPERVISORY FRAMEWORK

Action Plan	Timeline	Responsibility
1.1 Prepare a separate chapter on Islamic banking for inclusion in BCO 1962 1.1.1 Review and suggest amendments (if any) in Microfinance (MF) ordinance 2001 to offer Shariah compliant services	2018	IBD with BPRD & LSD
1.2 Prepare amendments in SBP Act 1956, Recovery of Finances Act 2001 and any other related laws for smooth Islamic banking operations	2018	IBD with BPRD & LSD
1.3 Assess the need and desirability of allowing IBIs to: a) engage in trade and hold proprietary position in commodities, real estate etc, b) act as Mudaraba Management Company, c) undertake investment banking business, Initiate necessary changes in legal and regulatory framework if consensus is reached	2018	IBD with BPRD & LSD
1.4 Review existing regulations and guidelines to remove anomalies/conflicting instructions	2015	IBD with BPRD
1.5 Adopt/adapt prudential standards issued by Islamic Financial Services Board (IFSB)	On-going	SBP/IBD
1.6 Issue Licensing Guidelines for Development Finance Institutions (DFIs) to offer Islamic financing products and services	2015	SBP/IBD
1.7 Rationalize Minimum Capital Requirements (MCR) regime for IBIs	2016	SBP/IBD in collaboration with BPRD

1.8	Develop revised/updated 'On-site' inspection manual for Shariah compliance	2016	BID with IBD
1.9	Develop alternate Dispute Resolution Mechanism for Islamic banking transactions	2016	IBD in collaboration with LSD

2 LIQUIDITY MANAGEMENT FRAMEWORK

	Action Plan	Timeline	Lead
2.1	Develop Islamic pricing benchmark	2015	IBD with DMMD
2.2	Develop liquidity management framework including development of Islamic interbank market and availability of Islamic discount window	2015	IBD with DMMD/ Industry

3 TAXATION REGIME

	Action Plan	Timeline	Lead
3.1	Coordinate with FBR for removal of tax anomalies, inconsistencies and achieving tax neutrality for both Islamic banking institutions and users/customers of Islamic banking services	2016	IBD with MoF and FBR
3.2	Coordinate with Federal and Provincial Governments / Boards of Revenue for exemption of property tax, stamp duties, etc related to Islamic modes of finance.	2016	IBD with MoF and provincial Boards of Revenue

4 FINANCIAL ACCOUNTING & REPORTING FRAMEWORK

	Action Plan	Timeline	Lead
4.1	Collaborate with ICAP/SECP to issue Islamic Financial Accounting Standards	On-going	ICAP/SECP in collaboration with SBP and industry
4.2	Prescribe separate presentation and disclosure framework for IBIs	2016	IBD with BPRD & ICAP

B. SHARIAH GOVERNANCE & COMPLIANCE

Action Plan	Timeline	Lead
5.1 Adopt Shariah standards issued by Accounting & Auditing Organization of Islamic Financial Institutions (AAOIFI)	On-going	SBP/IBD
5.2 Issue comprehensive Shariah Governance Framework	2014	SBP/IBD
5.3 Standardize and harmonize products across the IBI industry by conducting thorough review of existing products	2016	SBP/IBD
5.4 Issue guidelines for treasury operations/products of IBIs	2015	SBP/IBD and DMMD
5.5 Restrict use of “ Agency”, “Hiba” and “ Waad” in IB transactions	2016	SBP/IBD and Industry

C. AWARENESS & CAPACITY BUILDING

6 COORDINATION AND COLLABORATION AMONGST INTERNAL AND EXTERNAL STAKEHOLDERS

Action Plan	Timeline	Lead
6.1 Establish Islamic Banking Consultative Group	2014	IBD-SBP
6.2 Coordinate with SECP for promotion of Islamic finance in the country	Ongoing	IBD-SBP & SECP Joint Forum
6.3 Actively participate and collaborate with International Institutions and forums like IDB, IRTI, World Bank, IMF, ADB, IFSB, AAOIFI, IIFM, D-8 and SAARC etc. especially for capacity and joint research initiatives	Ongoing	IBD
6.4 Provide technical assistance, knowledge sharing, deputation and secondment etc. to countries entering into Islamic banking and finance	Ongoing	IBD with industry

6.5	Conduct/arrange International / Regional training programs	Ongoing	IBD with NIBAF
6.6	Collaborate with NIBAF for Internationalization of IBCC	Ongoing	NIBAF and IBD with industry

7. AWARENESS ENHANCEMENT

	Action Plan	Timeline	Lead
7.1	Carry out nationwide mass media campaign for awareness / promotion	2013–2015	IBD with industry
7.2	Conduct International Islamic Banking & Finance Conference at SBP	Once every two years	IBD with stakeholders
7.3	Arrange lectures by leading local / international experts on Islamic Banking & Finance	On-going	IBD with active industry participation
7.4	Arrange sessions with leading Shariah scholars to promote awareness	On-going	IBIs/Shariah scholars with IBD
7.5	Arrange awareness sessions with: <ul style="list-style-type: none"> i. Senior management of conventional banks ii. Senior management of SBP iii. Chambers of Commerce iv. Judiciary/Lawyers v. Universities / Centers of Excellence 	On-going	IBD with SBP-BSC/ DFSD and industry
7.6	Arrange road shows in major cities of Pakistan	On-going	IBD with industry
7.7	Arrange road shows in major international hubs of Islamic finance	On-going	IBD with industry

8. CAPACITY BUILDING

Action Plan	Timeline	Lead
8.1 Arrange training session on banking and finance for Shariah Advisors	On-going	IBD in collaboration with industry
8.2 Collaborate to arrange banking and finance courses at Shariah Educational Institutions	2017	IBD with industry
8.3 Develop a customized Islamic Banking Certification Course (IBCC) for potential Shariah Advisors	2015	NIBAF/IBD
8.4 Introduce online IBCC certification	On-going	NIBAF and IBD with industry
8.5 Develop of intermediate and advance level courses for middle and senior level management of IBIs	2015	NIBAF and IBD with industry
8.6 Design and conduct "Training of Trainers" (TOT) program to develop local experts/trainers in Islamic Banking	2015	NIBAF and IBD with industry

D. MARKET DEVELOPMENT

9. PRODUCT DIVERSIFICATION

Action Plan	Timeline	Lead
9.1 Develop "Diminishing Musharaka" (DM) products based on market prices and rentals	2017	IBD in collaboration IH& SMEFD with the industry
9.2 Develop incentive mechanisms and enabling policy environment to stimulate "Musharaka" and "Mudaraba" based financing	2014-15	IBD

9.3 Develop policy guidelines for project/infrastructure specific "Sukuk"	2015	IBD
---	------	-----

10. FINANCIAL INCLUSION

Action Plan	Timeline	Lead
10.1 IBIs to make collaborative efforts to: <ol style="list-style-type: none"> Increase market share by 50% (to 15% from existing 10%) Increase branch network by 100% (to 2,000 branches from existing 1,000 branches) Improve "advance to deposit ratio" to be at least at par with that of conventional banking system 	2018	IBIs/PBA sub-committee on Islamic Banking and IBD
10.2 Continuously interact and collaborate with IBIs to enhance: <ol style="list-style-type: none"> Agriculture financing to; at least 5% of the deposits or 10% of financing whichever is higher Small enterprises financing to; at least 5% of the deposits or 10% of financing whichever is higher 	2015	IBIs with IBD, AC & MFD, IH and SMEFD
10.3 Facilitate Islamic Microfinance through initiatives like capacity building, product development, focused research and pilot projects	2018	IBD with AC & MFD and IBI
10.4 Encourage Islamic Low Income Housing finance through capacity building, product development, focused research and pilot projects etc.	2018	IBD with IH & SMEFD
10.5 Enhance use of Alternative Delivery Channels by IBIs.	2018	IBD with AC & MFD, PSD and industry
10.6 Develop/revamp refinance schemes for Islamic banking industry specially; <ol style="list-style-type: none"> Islamic Long Term Financing Facility (ILTFF) Islamic Export Refinance Scheme (IERS) 	2015	IBD with IH & SMEFD and industry