

GUIDELINES & CRITERIA FOR SETTING UP OF AN ISLAMIC BANKING SUBSIDIARY BY THE EXISTING COMMERCIAL BANKS

1. Submission of Application

According to clause (aa) of sub-section (1) of section 23 of the Banking Companies Ordinance, 1962 the existing commercial banks are allowed to establish subsidiaries for Islamic banking operations. The banks interested in establishing an Islamic banking subsidiary may apply to the Director, Banking Policy & Regulations Department (BPRD), State Bank of Pakistan (SBP), I.I. Chundrigar Road, Karachi. Applications may be made giving details with supporting documents, forms etc. Applications, which are not complete in all respects, shall not be considered.

2. Issuance of No Objection Certificate (NOC) for Setting up an Islamic Banking Subsidiary

a. General Guidelines

The following shall be the broad criteria and guidelines for setting up of an Islamic banking subsidiary, by the existing commercial banks:

- i. The proposed subsidiary should be a Public Limited Company listed on the Pakistan Stock Exchange. In case it is not listed at the time of commencement of its business, the listing should be completed within a maximum period of two years from the date of commencement of business. A maximum of 49% of shares shall be offered to the general public.
- ii. For capital requirements the Islamic banking subsidiary shall follow the instructions mentioned in BPRD Circular No. 10 of 2014 or as amended from time to time.
- iii. At least 51% of the total paid up capital shall be subscribed by the applicant bank.
- iv. Banks meeting the Minimum Capital Requirement & Capital Adequacy Ratio as prescribed by State Bank from time to time and having at least 'Fair' on-site inspection rating in last three inspection reports, shall be eligible for establishing the subsidiary.
- v. Sponsor(s) shall not dispose off their shares in any manner whatsoever for a minimum period of 3 years and thereafter only with the specific written approval of the State Bank.
- vi. The applicant bank shall require prior written approval from SBP for entering into any share sale/purchase agreement/memorandum of understanding.
- vii. The board of directors and chief executive of the proposed subsidiary shall meet the Fit and Proper Test (FPT) prescribed by SBP and would require prior clearance from State Bank of Pakistan.
- viii. No director of a bank can be on the board of directors of any other bank including a Banking Subsidiary.
- ix. Not more than 25% of the directors shall be from the same family as defined in Section 5(ff) of the Banking Companies Ordinance, 1962.
- x. The overall operations and services of the subsidiary will be in accordance with the injunctions of Shariah under regulatory framework (instructions/directives/guidelines), issued by SBP for Islamic Banking Institutions (i.e. full-fledged Islamic banks, Islamic banking subsidiary & Islamic banking branches of conventional banks) from time to time.

- xi. The applicant shall indicate the Shariah compliant modes of finance proposed to be used for conduct of Islamic banking business and operations.
- xii. The applicant will also indicate expertise and other facilities available with them for ensuring compliance of their banking business with Shariah.
- xiii. Application shall stand disqualified if any of the sponsor(s):
 - has been convicted on account of any criminal offence or financial irregularity whatsoever;
 - has been associated with any illegal activity concerning banking business, deposit taking, financial dealings or any other business;
 - has failed to meet his or her obligations to banks or financial institutions.
 - has defaulted in payment of Government taxes and duties etc.
 - has been/is associated as Director and or Chief Executive with the Corporate Bodies whose corporate and tax record (at federal and provincial level) including customs duties, central excise and sales tax has been unsatisfactory.
 - in the opinion of the sanctioning authority, has adverse reputation regarding integrity and performance.
 - is associated with the business of brokerage, stock exchange, and money changing etc. as stipulated in BPRD Circular No.4 of 2007 or as amended from time to time.

b. Information/ Documents Required for Processing the Application

The applicant(s) will also submit the following documents/information along with the request:-

- i. Feasibility study on the proposed Islamic banking subsidiary covering inter alia organizational structure, business model, financial projections and sensitivity analysis. The study should also include analysis of Pakistan's macroeconomic environment and financial system. SBP will assess that applicant operates viably and would not adversely impact the financial stability of the existing banks /financial system.
- ii. Long and short term business strategy/ Plan including 3-5 years branch expansion plan.
- iii. List of companies/firms and their bankers in which the applicant bank, sponsor(s)/ director(s) and their family members as defined in Section 5(ff) of Banking Companies Ordinance, are interested as directors, chief executive, partner, proprietor, or major shareholders holding 5% or more shares.
- iv. A tentative list of Shariah Board members (identified in accordance with "Fit & Proper Criteria" as prescribed in SBP's Shariah Governance Framework) to be engaged shall be submitted. Subsequently if there is any change in the submitted list the same shall also be conveyed.
- v. After incorporating the proposed banking company with SECP it shall appoint the Shariah Board as per SBP's Shariah Governance Framework.
- vi. Names of sponsor(s), directors and chief executive along with attested copies of their Computerized National Identity Cards. In case of foreign sponsor(s), copies of their national identification cards and passports duly authenticated by the Embassy of Pakistan in that country.
- vii. The amount proposed to be subscribed by each sponsor is required to be indicated separately to consider his/her interest in the bank.

- viii. Personal net worth of each sponsor, duly supported with the certified copies of income tax and wealth tax statements, filed during the last three years.
- ix. In case a sponsor is a resident of a country where filing of wealth statement is not a requirement of law, two certificates of personal Net Worth and general reputation issued by international banks of repute shall be submitted. This requirement is also mandatory for Pakistanis who have recently returned to Pakistan after a stay of more than 10 years abroad.
- x. Balance sheets and accounts of the companies in which sponsor(s)/ directors and their family members have interest and hold 5% or more shares.
- xi. Last three years balance sheets and accounts of all those concerns in which sponsor(s) have controlling interest.
- xii. Certified copies of Memorandum and Articles of Association of the banking company.
- xiii. The applicant shall furnish the name of the banks and financial institutions, along with account numbers and name of branches, with which they have been dealing, along with the credit reports from those banks in a separate confidential envelope.
- xiv. Any additional information/ documents required by SBP shall also be provided by the applicant.

c. Application Fee

The applicant(s) shall deposit Rs. 4 million (Rupees four million only) as processing fee through RTGS along with the application. In case of non-availability of RTGS, the same can be deposited through demand draft or pay order. The fee so deposited shall be non-refundable. Incomplete application shall neither be entertained nor returned and processing fee in such case shall be nonrefundable. Re-submission would attract fresh fee. In case permission is to be refused, SBP shall give an opportunity to the applicant for a representation in writing.

In addition to these guidelines and criteria, wherever deemed necessary, the Guidelines and Criteria for setting up of a commercial bank may also be made applicable by SBP.

3. Issuance of License

- i. The subsidiary, will be granted a license under section 27 of the Banking Companies Ordinance, 1962 to conduct the banking business strictly in accordance with Shariah and would be considered as an Islamic Commercial Bank.
- ii. The license for establishment of an Islamic banking subsidiary, once issued by SBP under Section 27 of Banking Companies Ordinance, 1962 shall be valid for a period of six months from the date of its issuance. The license shall automatically stand cancelled /withdrawn without any notice, in case commencement of banking business as per terms and conditions of the license has not started within six months from the date of issue of license. SBP may, however, consider a request received in writing for an extension in commencement of business on merit.
- iii. The subsidiary, shall be subject to the prevalent banking and other laws, rules and directives issued by SBP from time to time.
- iv. In case of a conventional bank already having Islamic banking branches (IBBs), its Islamic Banking Division shall as per applicable laws and regulations be demerged from parent company and will be required to be merged with the proposed subsidiary.

- v. The subsidiary must commence operations within six months of the grant of license. The opening of up to 10 branches immediately after the commencement of business till 31st December of the Calendar year in which subsidiary has commenced business may be considered in addition to already merged IBBs of the applicant bank, if any, subject to provisions of BPRD's branch licensing policy. The opening of subsequent branches during a calendar year shall be subject to annual branch expansion plan in accordance with the branch licensing policy enforced.
- vi. The NOC / license may be revoked in case it subsequently transpires that the applicant/bank made material misrepresentation of facts or concealment of material information and those responsible shall personally be liable for action under the relevant laws.

4. Commencement of Banking Business

- i. For commencement of business the subsidiary shall follow instructions mentioned in BPRD Circular No. 01 of 2015 or as amended from time to time.
- ii. All the policies of the subsidiary duly vetted by the Shariah Board and approved by the Board of Directors shall be in line with complexity of operations and cover, as a minimum, the requirements set out in BSD Circular No. 03 of 2007 or as amended from time to time. In this regard the following should also be ensured:
 - a. The organogram submitted shall also cover all the functional areas necessary to execute the roles and responsibilities of various organs of subsidiary including those defined in related SBP instructions on Shariah Governance Framework as amended from time to time.
 - b. Accounting policies shall also inter alia include reference to SBP circulars on Islamic Financial Accounting Standards applicable on Islamic banking institutions.
 - c. Formulation of pool management and profit and loss distribution policy in light of SBP instructions issued from time to time. In this regard the bank shall have in place an adequate IT based system which inter alia suitably caters to the requirements of allocation of (a) deposits, (b) financing, investments and placements, (c) income and expenses and (d) movement of assets to/from different pools.
 - d. Charity policy in line with instructions issued by SBP on the subject from time to time.
 - e. Regarding continuous capacity building of all organs of corporate and Shariah governance, a comprehensive Shariah board vetted and BoD approved training policy along with annual training plan shall also be submitted as per applicable Islamic banking and other SBP departments instructions, issued from time to time.
 - f. Further, before commencement of banking business, the Islamic banking subsidiary, granted license by SBP, shall provide following information/documents:-
 - Name of chief executive and other key executives as indicated in BPRD Circular No. 4 of 2007 or as amended from time to time.
 - Risk management guidelines
 - Plans for internal control system and scale of authority.
 - Working system and procedure for business operations.
 - Information / documents related to products and services in compliance of IBD Circular Letter No. 2 of 2013 or as amended from time to time.
 - Implementation status in respect of requirements mentioned in SBP's Shariah Governance Framework.

Process Flow (Annexure-II)

1. Submission of Application

The sponsor(s) shall submit the application complete in all respect including the processing fee to the Director, Banking Policy & Regulations Department, State Bank of Pakistan, Karachi for grant of license to establish an Islamic banking subsidiary.

2. NOC for Incorporation with SECP

The SBP shall process the application and if satisfied with the quality of the proposal, shall issue NOC to the sponsor(s) for incorporation of the proposed subsidiary with Securities and Exchange Commission of Pakistan (SECP). After incorporating the proposed banking company with SECP it shall appoint a Shariah Board as per requirements of SBP's Shariah Governance Framework and fulfil other conditions specified in the NOC.

3. Grant of License

After incorporating the proposed subsidiary with SECP and fulfillment of other conditions specified in the NOC, the sponsor(s) by submitting the incorporation certificate shall approach BPRD, SBP for issuance of formal banking license.

4. Commencement of Banking Business

For commencement of business the subsidiary shall follow instructions mentioned in BPRD Circular No. 01 of 2015 or as amended from time to time.