

Vision

To Make Islamic Banking the banking of first choice for the providers and users of financial services

Mission

To Promote and Regulate Islamic Banking Industry in line with Best International Practices, ensuring Shariah Compliance And Transparency

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Editorial

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Deputy Governor's Speech

Islamic Banking in Pakistan at crossroads

First of all I would like to congratulate the organizers of this 3rd International Conference & Exhibition on Islamic Banking and Takaful on organizing this auspicious event. Such international events are needed for projecting the efforts of Pakistan in the promotion of Islamic banking and Takaful as well as for the sake of knowledge sharing and dissemination.

Islamic banking has grown at a rapid pace in the last few years. Both the local and global Islamic Financial Services Industry (IFSI) shared this trend. The main drivers of this tremendous growth are (a) faith based nature of Islamic Finance, (b) surplus liquidity in the GCC market, and (c) the interest of world's influential financial centers. In Pakistan, this growth has resulted from the highly positive response of private sector to policies for promotion of Islamic banking and finance introduced after 2001 by the State Bank of Pakistan. Collectively these factors have contributed to evolution of new and innovative products by Islamic Financial Industry in tandem with a strong and Shariah Compliant regulatory framework. According to an estimate, total Shariah compliant assets worldwide have grown to about US\$ 700 billion – with annual growth exceeding 10.0 percent during the past decade - and are projected to grow to US\$ 1.6 trillion by 2012.

These facts primarily have two important implications: (a) Islamic Finance is there to stay with a continual increase in its share in world financial industry; and (b) Islamic Finance is not confined to traditional boundaries and is attracting clients from major world economies like UK, Japan, China, France, Singapore, Hong Kong and US. The focus is not merely confined to Muslim countries as there is a growing need to redefine and reposition the Islamic Financial Services Industry in global economy in order to fully appreciate its potential. The diverse locations like Africa, Syria, and Sri Lanka are also on the roadmap.

The global market perceives Islamic Finance as an advantageous opportunity to diversify that will not affect their existing business adversely. Interestingly, Islam at times is related to conservatism but Islamic finance has proven a radical and choice enhancing avenue. The ethically oriented financial solutions are closely tied with overall social benefit. Islamic financial institutions (IFIs), while not directly impacted by the repercussions of the recent global financial crisis, did experience the knock-on risks transmitted through indirect channels like downturns in real estate and equity markets coupled with a rise in Non-performing financing emanating from slow-down in economy. The emergence of these risks as a consequence of the financial crisis has brought forth the realization that IFIs, while resilient to adverse developments, are not risk immune. The defining features of Islamic Finance are its close links with the real economy and inbuilt prohibitions against interest, excessive uncertainty and speculation. Looking at the Islamic financial intermediation model, we will see that it is based on: Involvement of real economic activity for generation of income and wealth, Ethical and social responsibility, Avoidance of over leveraging and excessive speculative activities, and Inclusive financial services growth such that all segments of the

population get access.

The asset base of the Islamic Banking Institutions (IBIs) in Pakistan on average has grown at around 59 percent per annum since 2005. The growth in the deposit base and the ongoing expansion in outreach, based on the number of branches, is also impressive. As a proportion of the overall banking industry, the combined share of Islamic banking industry is 5.2 percent in deposits, and 5.1 percent in assets, as of end-June 2009. In 2008 as well assets of Islamic banking industry grew by 34 percent as compared to growth of overall banking industry by 8.8 percent. State Bank of Pakistan's strategic plan for Islamic banking industry launched in 2008, aims to increase the size of the industry to 12.0 percent (of total banking assets) by 2012. In essence, the focus of the strategic plan is: (a) to extend the outreach of Islamic banking services by covering a broad-based geographical area and encouraging product development; (b) strengthen the Shariah-compliance mechanism and regulatory support; while (c) building the capacity of Islamic banking institutions. Islamic banking industry is duly supported by the non -banking Islamic financial sectors like Takaful, Islamic Mutual and Pension Funds, Modarabas, etc., which are playing a complementary role for development of a comprehensive Islamic financial system.

The Islamic Financial Services Industry needs to further strengthen itself to continue its growth and acceptability. The main target areas include: (a) financial inclusion of SME, Agriculture and Microfinance, (b) Regulatory and Shariah Compliance Framework, (c) awareness and capacity building, and (d) greater coordination with stakeholders both locally and globally.

Financial Inclusion

The three most notable financially excluded areas are Microfinance, Agriculture finance, and SME. In my view Islamic finance is better placed to cater to the needs of these sectors, as people that are reluctant to deal with the conventional finance on religious grounds would have access to financial services. Moreover, this will help in achieving the most important objectives of the Islamic economic system, that is, fair distribution and non -exploitative economic dealings. State Bank has announced policies for Islamic microfinance and would encourage the sponsors and promoters to establish Islamic microfinance institutions, which can provide financial services to the public in accordance with their faith. Reducing transaction costs is particularly important for enabling access for micro and small enterprises, which can be achieved through technology based solutions or using the vast network of mosques and religious places at a very low cost.

Another potential area is Agriculture and agro based industry. Agriculture finance could prove to be a very powerful tool for poverty alleviation especially in agrarian economies like Pakistan. This is even more pertinent nowadays as the Agriculture finance could lead to food self-sufficiency thus helping the domestic economy to reduce and stabilize commodity prices. While, most banks do not have rural branch network or/and agricultural lending expertise. As a result, significant number of Agriculture population still relies heavily on informal financial arrangements and there is a need for development of products for Islamic agriculture finance by Islamic banking industry. Realizing the importance of this sector, State

Bank has issued Guidelines for Islamic Agriculture Finance, which can be used by Islamic banks in this regard.

Regulatory and Shariah Compliance Framework

Devising a regulatory framework for Islamic finance is challenging as some regulations are imposed from a Shariah standpoint while most of the conventional banking regulations based on prudential standards are also applicable. Collaborative efforts across jurisdictions have improved credibility of Islamic Finance in the global financial industry. Many international institutions like Islamic Financial Services Board, Accounting and Auditing Organization for Islamic Financial Institutions, Islamic Development Bank, International Islamic Financial Market, International Islamic Rating Agency are playing a key role in this regard. Pakistan has played an active role in these initiatives and would continue to support them.

The legal and regulatory framework for Shariah compliance in Pakistan is regarded as among the best ones in the world duly supported by the Constitution of Islamic Republic of Pakistan, judicial system and supporting legislation, regulations and supervision. We have further strengthened it in the Draft Banking Act, which includes specific provisions relating to Islamic banking and addresses the concerns like banker -customer relationship, deposit taking, legal cover to Shariah Board of State Bank and Shariah Advisors of Islamic banks, issues in liquidation, etc. We are further augmenting the regulatory framework by adopting or adapting the international standards issued by above mentioned international organizations in a gradual manner after a careful study in collaboration with the stakeholders. Shariah compliance inspection of Islamic banking institutions recently started by State Bank and the requirements for publishing the report of Shariah Advisor in annual accounts would boost the public confidence. Recently, one of the conventional banks has been granted permission by the State Bank to convert their Islamic banking branches into an Islamic banking subsidiary. We would encourage the other players having Islamic banking branches to convert themselves into Islamic banking subsidiary, whether individually or jointly.

Capacity building and awareness

The envisaged phenomenal growth in Islamic finance will further amplify the human resource needs. Developing human resource would be a greater challenge as Islamic banks need professionals that not only understand Islamic finance but also have appropriate skill set for banking operations. The Human resource need would particularly be more pressing in areas like product development, risk management, Shari'ah compliance and audit. The growing demand for Islamic banking professionals necessitates a corresponding growth in Islamic finance training. As a part of our Strategy for Islamic Banking, we plan to establish an Islamic finance training institute in collaboration with the Islamic banking industry in near future. Islamic banking industry also needs to follow the good example set by Takaful operators in developing a generic campaign for Islamic banking and finance for greater awareness among public.

Coordination with Stakeholders

Coordination is also required among various government authorities to ensure a level playing field for Islamic Financial Institutions. Some countries, like Malaysia, UK, Singapore and most recently France; have used tax neutrality and exemptions to help kick start IBs besides providing a level playing field for competing with the well established conventional banking. In Pakistan, amendments in tax laws have been introduced to facilitate Islamic banking transactions and we are coordinating with Securities and Exchange Commission of Pakistan for development of Non bank Islamic financial institutions.

SBP plans to further streamline the cross border coordination with international institution by taking initiatives like; (1) seek technical assistance from IRTI/IDB, IFSB and INCEIF for education, training and conferences, (2) supporting IIFM in workshops for development of Islamic financial market, (3) encouraging Islamic financial institutions of Pakistan to seek membership in IFSB and opening of overseas branches.

Conclusion

Globally Islamic Financial Services Industry has made commendable progress in the last few years. The pace of growth remained much higher compared to the conventional finance industry. All major stakeholders and industry experts expect the trend to continue in medium to long term. I agree with positive outlook of the global Islamic Financial Services Industry, but there is no room for complacency. There is still a lot to be done. We have to move forward and work for achieving the core and fundamental objective of an Islamic economic system. Last but not the least, the State Bank will continue its efforts to strengthen regulatory infrastructure in order to ensure that Islamic banking in Pakistan continues to grow fast and on sound footings.

In the end, I would once again applaud the efforts of Al Huda for arranging the conference, exhibition and workshops and hope that these would be success in meeting the objectives and contribute in further promotion of Islamic banking in Pakistan and abroad

Industry Progress and Market Share

Islamic banking in Pakistan continued to expand during the quarter ended-September 2009. The share of Islamic banking in assets, deposits and financing & investment of banking industry has further strengthened. The highlight of quarter July-September 2009 was that most of the indicators of the Islamic banking Pakistan remained robust. However, there were some slippages in asset quality and slight decline in financing activities.

Assets and Financing

Table 1: Industry Progress and market share

	Rupees in billion & industry share in percent							
	Sep 09*	Jun 09*	Dec.08	Dec.07	Dec.06	Dec.05	Dec.04	Dec.03
Total Assets	323	313	276	206	119	72	44	13
Share in industry	5.3	5.1	4.9	4.0	2.8	2.0	1.5	0.5
Deposits	245	238	202	147	84	50	30	8
Share in industry	5.5	5.2	4.8	3.8	2.6	1.8	1.3	0.4
Net Financing & Investment	198	194	186	138	73	48	30	10
Share in industry	4.2	4.2	4.3	3.5	2.3	1.7	1.3	0.5
Total Islamic Banking Institutions	19	18	18	18	16	11	11	4
Total No. of Branches**	551	528	515	289	150	70	48	17

*Source: Annual Accounts except for June and Sept 09, data for which is based on Unaudited Quarterly Accounts

**number includes sub-branches

Total Assets of Islamic Banking in Pakistan reached Rs 323 billion in September 2009 compared with Rs 313 billion in June 2009. The financing and investment portfolio of Islamic banks reached Rs 198.4 billion in September 2009 compared with Rs 194 billion in June 2009. In terms of market share, total assets, financing & investment and deposits reached to 5.3 percent, 4.2 percent and 5.5 percent at end September 2009. Branch network of six full-fledged Islamic banks and 13 conventional banks (with dedicated Islamic banking branches—IBBs) increased to 551 branches in September 2009 (see **Table 1**).¹

The financing portfolio has declined by 4.7 percent QoQ (see **Table 2**). This is in contrast to an increase in financing in the previous quarter. However, during quarter Jan-Mar 2009 there was a decline as well. Interestingly, the decline in financing in current quarter and quarter Jan-Mar 2009 is almost the same—in both these quarters financing seems to have shifted towards investment. More specifically, the current quarter decline in financing is

Table 2: Assets classifications

	Rupees in billion		
	Jun 09	Sep 09	QoQ % Change
Cash and balances with treasury banks	25.1	25.7	2.7
Balances with other banks	33.9	29.5	-12.8
Due from financial institutions	30.7	37.2	21.4
Net Investments	53.5	64.7	20.8
Net Financing	140.3	133.7	-4.7
Operating fixed assets	11.7	11.5	-1.6
Deferred tax assets	1	1.2	20.6
Other assets	16.8	19.7	16.7
Total Assets	313	323.3	3.3

Rs 6.6 billion while investment has increased by Rs 11.2 billion—implying that gain in investment has more than compensated for the fall in financing. Nonetheless, investment has shown a consistent rise in the previous few quarters, while the trend in financing has been

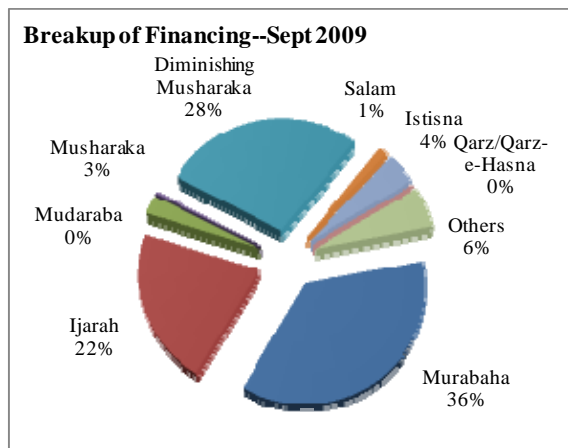
¹ The sum figures, shares, and percentage in tables may not match because of separate rounding off.

volatile—increasing in one quarter and declining in the other. This behavior might be depicting seasonal fluctuations in financing and/or a greater reliance of banks on investments in wake of relatively uncertain economic and business environment.

The financing mix has shown a decline of around 13 percent QoQ in the Murabaha portfolio (see **Table 3**) while there is an almost matching increase (in percentage terms) in Ijarah financing. This is an opposite trend compared to the previous quarter, where there was a rise in Murabaha and a corresponding decline in Ijarah. The increase in Ijarah financing may reflect resurgence in consumer market while the decline in Murabaha is probably a seasonal decline. Nevertheless, a decline in Murabaha is a welcome sign as this may reflect a move towards more diversification. However, the conception of diversification does not hold as there is a decline in financing through almost all other modes except for Istisna. Still, there is no financing through Qarz/Qarz-e-Hasna.

	Rupees in billion		
	Jun 09	Sep 09	% Change
Murabaha	58.0	50.6	-12.8
Ijarah	26.2	29.8	13.5
Musharaka	3.7	3.6	-2.8
Mudaraba	0.9	0.5	-48.1
Diminishing Musharaka	45.3	38.0	-15.0
Salam	2.9	1.7	-41.7
Istisna	4.8	6.1	26.2
Others	2.3	7.9	242.4
Total	144.3	138.7	-3.9
Amount of Non performing Financing	7.3	8.9	23.3
Provision against Non Performing Financing	4	4.9	24.6
Net Non performing Fin.	3.3	4	21.7
Net Financing	140.3	133.7	-4.7

Alarmingly, the non-performing financing (NPF) has further increased by 23.3 percent on top of an increase of 15.4 percent during the preceding quarter. Though, banks have increased provisioning by almost 25 percent, the net non-performing financing has still increased by an upsetting 22 percent (see **Table 3**). This high increase in non-performing financing might have tempted Islamic banks to contract financing and increase investments.



Sector-wise financing mix for the quarter shows a decline in share of financing to the corporate sector from around 63.7 percent to around 60.6 percent (see **Table 4**). While, the consumer sector's share in financing has increased to 22.8 percent (from 20.7 percent in previous quarter). The number of borrowers is the highest in consumer sector followed by SME. The corporate share in number of borrowers is just six percent. Greater financing to very few corporate clients reflects high level of financing concentration. The sectoral financing mix still shows concentration towards corporate sector while the share in financing to the priority sectors has further declined.

Table 4: Sector-wise breakup of financing

	Amount (Rupees in billions)				Number of borrowers			
	Jun 09	Sep 09	% Change	% Share	Jun 09	Sep 09	% Change	% Share
Corporate Sector	91.9	84.0	-8.7	60.6	2,162	2,014	-6.8	6.0
SMEs	12.5	11.8	-5.1	8.5	2,525	2,497	-1.1	7.4
Agriculture	0.1	0.1	22.1	0.1	132	128	-3	0.4
Consumer Finance	29.9	31.6	5.7	22.8	26,392	26,723	1.3	79.5
Commodity Financing	6.2	6.9	12.4	5.0	35	14	-60	0.0
Staff Loans	2.7	2.8	3.5	2.0	2,095	2,223	6.1	6.6
Others	1	1.4	44.3	1.0	17	19	11.8	0.1
Total	144.3	138.7	-3.90%	100.0	33,358	33,618	0.80%	100.0

Deposits and Liabilities

Despite a decline in financing activities the growth in deposits continued—deposits have increased by 2.8 percent QoQ, though the growth has moderated from 15.5 percent QoQ of previous quarter. The deposit base of Islamic banks stood at Rs 244.8 billion at end-September 2009 compared to Rs 238.2 billion on the previous quarter-end (see **Table 5**).

Total liabilities of Islamic have increased by 3.3 percent during the quarter while the net assets and equity increased by around 3 percent each. There is an increase of 6 percent QoQ in the reserves and the un-appropriated profits have increased by 40 percent QoQ (see **Table 5**).

The distribution of deposits shows that fixed and saving deposits make the bulk of deposits (see **Table 6**). However, saving deposits have maintained relatively higher growth trend compared to fixed deposits. In specific terms, the saving deposits have increased by 7.8 percent QoQ while fixed deposits have increased by 5.6 percent QoQ. The current accounts remained at around 22 percent of the deposits—almost unchanged to the previous quarter. The foreign currency dominated accounts have increased at a rapid pace of 28 percent QoQ, while growth in local currency deposits is a mere 1.4 percent.

Table 5: Deposits and other liabilities (selected items)

	Rupees in billion		
	Jun 09	Sep 09	% Change
Bills payable	3.3	4.3	29.4
Deposits and other accounts	238.2	244.8	2.8
Other liabilities	19.4	20	2.9
Total liabilities	274	283.2	3.3
Net assets	39	40.1	2.9
<i>Represented by</i>			
Paid-up capital/Head office capital account	36.3	36.9	1.7
Unappropriated/Unremitted profit	0.9	1.3	39.2
Equity	39	40.1	2.9

Table 6: Deposits and Other Accounts

	Rupees in billion		
	Jun 09	Sep 09	% Change
A) Customers	219.1	231.2	5.5
Fixed deposits	88.9	93.8	5.6
Savings deposits	75.2	81.0	7.8
Current accounts	53.2	54.3	2.1
Others	1.9	2.0	7.5
B) Financial institutions	19.1	13.6	-28.7
FI-Remunerative deposits	19	13.5	-28.8
FI-Non Remunerative deposits	0.05	0.05	--
Particulars of deposits	238.2	244.7	2.8
In Local Currency	225.5	228.5	1.4
In Foreign currency	12.7	16	28.0

Both income and expense accounts have shown substantial growth during the quarter ended September 2009. The net mark up income has increased by 46.1 percent during the quarter. The net mark up income has increased from Rs 7.2 billion to Rs 10.4 billion (see **Table 7**). However, in percentage terms the increase in markup income is less than markup expense. Similar to the previous quarter, the non-mark up income is showing a greater increase.

The ROA, ROE and NIM remained almost at the same level as compared to previous quarter (see **Table 8**). The

measures of returns and profitability remained good. However, the measures of asset quality are showing some slippages especially owing to the rising trend in NPFs—almost all indicators of infection have further deteriorated during the quarter. The earning and profitability ratios shows that share of markup income have declined at the expense of non-markup income. While, there is a rise in operating expenses to gross income from 65.1 percent to 67.2 percent that reflects relatively higher operating expenses. However, there is a slight decline in personal expenses to operating expense ratio thus reflecting better control over personal expenses. To sum up, we can say that the profitability has remained largely intact, though the quality of assets continued to decline.

Rupees in billion			
	Jun 09	Sep 09	% Change*
Mark-up/Return Earned	15.4	23.0	49.3
Mark-up/Return Expenses	8.3	12.6	52.2
Net mark up income	7.2	10.4	46.1
Fees Commission & Brokerage Income	0.8	1.1	46.8
Other Income	0.1	0.3	97.0
Total Income	7.0	10.6	76.7
Administrative expenses	5.6	8.8	57.1
Other expenses	0.004	0.009	125.0
Total Non-Mark up /Return Expenses	5.7	8.8	56.6
Profit/(loss) after taxation	1.1	1.5	38.4

	Jun 09	Sep 09	Change (percentage points)
Earnings			
ROA After Tax	0.8%	0.7%	-0.1
ROE After Tax	6.0%	5.4%	-0.6
Net Markup Margin (NMM)	6.0%	5.7%	-0.3
Intermediation Cost	4.9%	4.9%	--
Assets Quality			
NPFs to Financing	5.0%	6.5%	1.5
Net NPFs to Net Financing	2.4%	3.0%	0.6
Earnings and Profitability			
Net Markup Income to Gross Income	82.0%	79.0%	-3.0
Non-markup Income to Gross Income	18.0%	21.0%	3.0
Operating expense to Gross Income	65.1	67.2	2.1
Personnel Expense to Operating Expense	29.7%	29.1%	-0.6

Bank in Focus

Dawood Islamic Bank²

Overview of company

Dawood Islamic Bank Limited (DIBL) was incorporated in Pakistan as a public limited company on August 29, 2005. The bank obtained “Scheduled Islamic Commercial Bank” license in 2007. The bank is principally engaged in commercial, consumer and investment activities.

Branch network

DIBL has 31 branches (as on September 30, 2009) in 12 cities of Pakistan. DIBL branch network growth is expected to rise to a figure of 50 by the end of 2009 in line with objective of State Bank of Pakistan. To enhance economic activities in rural areas, DIBL has launched Rural Business Centers (RBCs) program.

Table: Bank’s Performance at a Glance

	(Rs in Million)	% of Islamic Banking Industry
Deposits	7,370	3.0
Financing	4,664	3.5
Total Assets	13,776	4.3
Branch Network	31	5.6

Position as of September 30, 2009

Products/services range

DIBL is offering wide range of Shariah compliant products & services on Asset & Liability sides. DIBL products range includes, working capital finance through Murabaha for importers and exporters, Shariah compliant substitute for conventional foreign and local bills discounting. Running Finance Musharakah (based on Shirkat-ul-Aqd) is offered as substitute for conventional banking running finance facility. Services Ijarah is used to finance services based trade & industries.

DIBL is using Consumer Car Ijarah as Shariah compliant substitute for conventional auto finance and Diminishing Musharakah Housing Finance as Shariah compliant substitute for conventional mortgaged financing. The bank also presents a variety of deposit schemes such as (a) Current accounts ,(b) Saving accounts based on Mudarbah, (c) Term Deposit Receipts for different maturities based on Islamic mode and (d) Investment Banking services for structuring and transaction documentation for syndicated financing and Investment Sukuk, etc.

² Information provided by: Dawood Islamic Bank Limited. For further information visit <http://www.dawoodislamic.com>

Frequently Asked Questions

(Part IV)

Q. No.20: What is Mudarbah?

Answer: A form of partnership where one party provides the funds while the other party provides expertise. The people who bring in money are called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the "Mudarib". The profit sharing ratio is determined at the time of entering into the Mudarbah agreement whereas in case of loss it is borne by the Rab-ul-Mal only. In case of Islamic banks, the depositors are called Rabb-ul-Maal and the bank is called Mudarib. There are two types of Mudarbah:

1. Al-Mudarbah Al-Muqayyada: Rab-ul-Maal who, in case of Islamic bank, is depositor specifies a particular business or a particular place for the mudarib (bank), in which case he shall invest the money. This is called Al -Mudarbah AlMuqayyadah (restricted Mudarabah).
2. Al-Mudarbah Al-Mutlaqah: In case where Rab-ul-maal (depositor) gives full freedom to the Mudarib (bank) to undertake whatever business he deems fit, this is called Al-Mudarbah Al-Mutlaqah (unrestricted Mudarbah).

It is necessary for the validity of Mudarbah that the parties agree on a certain formula of sharing the actual profit right at the beginning of the contract. The Shariah has prescribed no particular proportion of profit sharing rather it has been left to the mutual consent of the parties.

For the deposit management, Islamic banks create different pools of investment keeping in view the risk and maturity profile of the depositors. The deposits of the customers are placed in these pools and profit there from is distributed between the bank and the depositors as per weightages assigned at the time of agreement. Mudarbah agreement cannot allow a lump sum amount of profit for any party nor can it determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs.100,000/-, parties cannot agree on a condition that Rs.10,000 out of the profit shall be the share of the Mudarib nor can they say that profit equivalent to 20% of the capital shall be given to Rab -ul- Maal. However they can agree that 40% of the actual profit shall go to the Mudarib and 60% to the Rab -ul-Maal or vice versa.

Q No. 21: What is Musharakah?

Answer: Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. Under Islamic banking, it is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management but not necessarily required to do so. The profit is distributed among the partners in pre agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions. The following are the rules with regard to profit and loss sharing in Musharakah:

1. The profit sharing ratio for each partner must be determined in proportion to the actual profit accrued to the business and not in proportion to the capital invested by him. For example, if it is agreed between them that 'A' will get 10% of his investment, the contract is not valid.
2. It is not allowed to fix a lump sum amount for anyone of the partners or any rate of profit tied up with his investment. Therefore if 'A' & 'B' enter into a partnership and it is agreed

between them that 'A' shall be given Rs.10,000/- per month as his share in the profit and the rest will go to 'B', the partnership is invalid.

3. If both partners agree that each will get percentage of profit based on his capital percentage, whether both work or not, it is allowed.

4. It is also allowed that if an investor is working, his profit share could be higher than his capital contribution irrespective of whether the other partner is working or not. For instance, if 'A' & 'B' have invested Rs.1000/- each in a business and it is agreed that only 'A' will work and will get two third of the profit while 'B' will get one third. Similarly if the condition of work is also imposed on 'B' in the agreement, then also the proportion of profit for 'A' can be more than his investment.

5. If a partner has put an express condition in the agreement that he will not work for the Musharakah and will remain a sleeping partner throughout the term of Musharakah, then his share of profit cannot be more than the ratio of his investment.

6. It is allowed that if a partner is not working, his share of profit can be established at a rate lower than his capital share.

7. If both are working partners, the share of profit can differ from the ratio of investment. For example, Mr. A and Mr. B both have invested Rs.1000/- each. However, Mr. A gets one third of the total profit and B will get two third, this is allowed.

8. If only a few partners are active and others are only sleeping partners, then the share in the profit of the active partner could be fixed at higher than his ratio of investment e.g. 'A' & 'B' put in Rs.100 each and it is agreed that only 'A' will work, then 'A' can take more than 50% of the profit as his share. The excess he receives over his investment will be compensation for his services.

The following are the Basic rules of distribution of Loss in case of Musharakah: All scholars are unanimous on the principle of loss sharing in Shariah based on the saying of Syedna Ali ibn Talib (RA) that is as follows:

"Loss is distributed exactly according to the ratio of investment and the profit is divided according to the agreement of the partners." Therefore the loss is always subject to the ratio of investment. For example, if Mr. A has invested 40% of the capital and Mr. B has invested 60%, they must suffer the loss in the same ratio, not more, not less. Any condition contrary to this principle shall render the contract invalid.

Q No. 22: What is Murabaha?

Answer: Murabaha is one of the most common modes used by Islamic Banks. It refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest rather it is a sale of a commodity at profit.

The mechanism of Murabaha is that the bank purchases the commodity as per requisition of the client and sells him on cost-plus-profit basis. Under this arrangement, the bank is bound to disclose cost and profit margin to the client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sells those goods to the customer on profit.

A question may be raised that selling goods on profit (under Murabaha) and charging interest on the loan (as per the practice of conventional banks) appears to be one of the same things and also produces the same results. The answer to this query is that there is a clear difference

between the mechanism/structure of the product. The basic difference lies in the contract being used. Murabaha is a sale contract whereas the conventional finance overdraft facility is an interest based lending agreement and transaction. In case of Murabaha, the bank sells an asset and charges profit which is a trade activity declared halal (valid) in the Islamic Shariah. Whereas giving loan and charging interest thereupon is pure interest -based transaction declared haram (prohibited) by Islamic Shariah.

Q No. 23: What are the basic rules of a valid Murabaha transaction?

Answer: The following are the rules governing a Murabaha transaction:

1. The subject matter of sale must exist at the time of the sale. Thus anything that may not exist at the time of sale cannot be sold and its non-existence makes the contract void.
2. The subject matter should be in the ownership, either actual or constructive, of the seller at the time of sale. If he sells something that he has not acquired himself then the sale becomes void.
3. The subject matter of sale must be in physical or constructive possession of the seller when he sells it to another person. Constructive possession means a situation where the possessor has not taken physical delivery of the commodity yet it has come into his control and all rights and liabilities of the commodity are passed on to him including the risk of its destruction.
4. The sale must be instant and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. For example, 'A' tells 'B' on 1st January 2008 that he will sell his car on 1st February 2008 to 'B', the sale is void because it is attributed to a future date.
5. The subject matter should be a property having value. Thus goods having no value cannot be sold or purchased.
6. The subject matter of sale should not be a thing used for an un-Islamic purpose.
7. The subject matter of sale must be specifically known and identified to the buyer. For Example, "A" owner of an apartment says to "B" that he will sell an apartment to 'B'. Now the sale is void because the apartment to be sold is not specifically mentioned or identified to the buyer.
8. The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.
9. The certainty of price is a necessary condition for the validity of the sale. If the price is uncertain, the sale is void.
10. The sale must be unconditional. A conditional sale is invalid unless the condition is recognized as a part of the transaction according to the usage of trade.

Excerpt from FAQs published by IBD, SBP and available at
<http://www.sbp.org.pk/departments/ibd/FAQs.pdf>

Developments at Islamic Banking Department, State Bank of Pakistan

Handbook of Islamic Banking Products and Services (IBP&S)

Strategic Plan for Islamic banking, issued by State Bank of Pakistan (SBP) in 2008, aims to achieve 12 percent market share by 2012. Islamic banks are encouraged to enter into new challenging segments of Microfinance and SME finance in addition to Agriculture finance

The Islamic Banking industry offers a wide range of products encompassing almost the entire range of Islamic modes of financing. In this regard a *Handbook of Islamic Banking Product & Services* has been developed by Islamic Banking Department (IBD). It is an attempt to compile all the Asset side 'Financing products' and liability side 'Deposit products' of all 18 existing IBIs³ at one place as per available data of Dec 31, 2008. The handbook renders general information including description of the product, underlying mode, sector targeted, limit, tenor, and collateral required. This document would help to understand current spectrum of product offering of the Islamic Banking Institutions (IBIs).

Handbook of Islamic Banking Products & Services (IB P&S) is available at <http://www.sbp.org.pk/ibd/Handbook-IBD.pdf>.

Handbook on Islamic SME Financing (iSME)

SME is a potential segment for the growth of Islamic finance and a few Islamic banks have already focusing on this sector. A need was felt to develop a *Handbook on Islamic SME Financing*, focusing particularly on various modes which can be used as alternative to conventional SME finance. In this regard, IBD took the initiative and studied the conventional framework of SME finance. Likewise intensive deliberations and discussion were conducted with IBIs offering SME products and other stakeholders. These efforts led to the development of a *Handbook on SME Financing*.

This handbook carries comprehensive information regarding financing SME sector in the light of Shariah principles. The handbook touches upon the regulatory requirements, modes of financing, proposed products, their accounting treatment and risk management mechanism. This document can be used as a basic tool for developing new products thus enabling IBIs to expand their existing business by exploring some new sectors like SME and providing Shariah compliant alternate financial solutions. .

Handbook of Islamic SME Financing (iSME) is available at [http://www.sbp.org.pk/ibd/pdf/Handbook-\(iSME\).pdf](http://www.sbp.org.pk/ibd/pdf/Handbook-(iSME).pdf)

Lecture Series on Islamic Topics

The Islamic Banking Department, State Bank of Pakistan (during the holy month of Ramadan) organized a series of lectures on different topics of Islam. The objective of holding

³ There are 19 IBIs in total as of September 2009 by addition of one more player "Faysal Bank Limited" starting Islamic Banking Operations.

these lectures was to invite renowned Shariah Scholars to share their knowledge on various aspects thereby enhancing the understanding of SBP officers.

The first lecture of the series on 'Saum & Zakat and related Issues' was held on August 24, 2009. Renowned Islamic scholar, Mufti Muneeb-ur-Rehman delivered a comprehensive lecture on the importance of Saum (Roza) and Zakat. The second lecture of the series was held on September 12, 2009. Renowned Islamic scholar, Mufti Irshad Ahmad Aijaz spoke on 'Shabb-e-Qadar aur aakhari ashray kay fazail'. The third lecture of the series was held on 15th September 2009. The topic of the lecture was 'Quran hum sai kaya chata hay'. That was delivered by renowned Islamic scholar, Prof. Dr. Ihsanul Haq, Chairman, Department of Arabic, Karachi University. The Ramadan lecture series was concluded with a lecture on 'Hurmat-e-Sood-Quran Ke Roshni Mein', delivered by renowned scholar, Mufti Irshad Ahmad Ijaz on September 17, 2009.

All these lectures were attended by a large number of officials from SBP and SBP BSC with religious spirit and enthusiasm.

Islamic Banking News

Guideline out for Islamic banking - Bangladesh

<http://www.thedailystar.net/newDesign/news-details.php?nid=113545>

The Bangladesh Bank (BB) on November 10, 2009 set guidelines for Islamic banking. Under the guidelines, the board of directors of Islamic banks have now been empowered more, instead of the Shariah Council. The central bank had been trying to issue the guidelines for years to establish proper control on the Islamic banking system, but it did not take place because of political interests. The Central Shariah Council is working as the parallel regulator of the central bank for the Islamic banks. In line with the guidelines, an Islamic bank can form an optional Shariah supervisory committee, but there will be no central council. Islamic banking was first introduced in Bangladesh in 1983. Now, a total of seven banks operate as full-fledged Islamic banks. Another dozen commercial banks have Islamic banking wings to cater to the growing market.

Luxembourg is emerging as important domicile for funds, sukuk

<http://www.arabnews.com/?page=6§ion=0&article=128761&d=23&m=11&y=2009>

The Governor of the Banque centrale du Luxembourg, the central bank, Yves Mersch, has called on European banking authorities to familiarize themselves with Islamic banking and stressed that the current needs of Europe's 38 million plus Muslims and those interested in faith-based ethical finance have "not yet appropriately been addressed by the conventional banking offering". Gov. Mersch, one of the more proactive European central bankers as far as Islamic financial inclusion is concerned, while addressing the 5th Economic Forum of the Belgium-Luxembourg-Arab Countries held in Brussels last week, said that although banking authorities in Europe are not competent in Shariah matters relating to financial transactions, it is important that they "become more familiar with the principles and practices specific to Islamic finance in order to make appropriate supervisory and regulatory judgments".

Luxembourg is emerging as one of the more important domiciles for Islamic financial products such as funds and sukuk, and is poised to become the first European Union country to be an associate member of the Islamic Financial Services Board (IFSB), the Kuala Lumpur-based prudential and supervisory standard setting body for global Islamic finance industry. Mersch confirmed that the central bank has applied to join the IFSB and the decision to accept the Banque centrale du Luxembourg as a member is a formality and will be announced in Kuala Lumpur in due course after a meeting of the IFSB council. The Banque centrale du Luxembourg will also second staff to the IFSB so that they can become familiar with Islamic finance concepts and study the various issues, notably liquidity and risk management. Luxembourg has been steadily increasing its political support to facilitate Islamic finance in its jurisdiction.

TUNISIA: ZITOUNA Bank Created, active in Islamic Finance

<http://www.ansamed.info/en/top/ME12.WAM50200.html>

TUNIS - Banque Zitouna, the new Islamic Tunisian bank created by businessman Mohamed Sakher El Materi, son-in-law of President Ben Ali, will be opened in the first quarter of 2010. The bank's general assembly in Tunis has approved the articles of association and the appointment of directors. Banque Zitouna has a capital of 30 million dinar (around 15.5 million euros). So far, only a Saudi bank was active in the sector of Islamic finance in Tunisia.

El Materi, the website Infotunisie reports, underlined that Banque Zitouna "was created at the right time, to make the orientation of President Ben Ali on the consolidation of the banking system more concrete, in support of business, as well as Tunisian and international investments".(ANSAméd).

Watchdog touts Germany as Islamic finance base

<http://www.forbes.com/feeds/afx/2009/10/29/afx7062773.html>

Germany wants to establish itself as a market for financial products that conform with Islamic law, the head of German financial regulator said on Thursday. 'We are seeing great interest from investors in Islamic countries, who want to invest their money in Germany according to shariah principles,' Bafin president Jochen Sanio said at a conference on Islamic finance in Frankfurt. Shariah, or Islamic law, requires investments to be based on a specific asset and bans excessive speculation, interest-based lending and gambling, alcohol and pornography-related activities. Germany makes it easy to obtain a licence to sell the products, which are also compatible with the country's financial rules.

'We hope to soon welcome the first interested party that wants to start offering these products,' Sanio said. Though no financial institution has made the move so far, Germany's 4.3 million Muslims, mainly from Turkey, represent a market with bigger potential than in any other European country.

Ireland outlines tax laws for Shariah-compliant products

<http://www.zawya.com/Story.cfm/sidZAWYA20091026033022/Ireland%20outlines%20tax%20laws%20for%20Shariah-compliant%20products>

Ireland, like other European countries, is warming to Islamic finance and Dublin has emerged as an Islamic investment fund rival to the Channel Islands and Luxembourg. Indeed several Shariah-compliant funds are registered there, including the Oasis Crescent Global Equity Fund which is based in Dublin and so is the planned CIMB Global Islamic Equity Fund which is due to be launched over the next month or so. Last week the Irish Revenue Service, the tax authorities, outlined in detail the tax treatment of Shariah-compliant products and structures for the funds, leasing and Takaful (Islamic insurance) industries.

Part 27 of the Taxes Consolidation Act (TCA) 1997 governs the taxation of funds. Chapter 1A of that Part applies the gross-roll-up taxation regime to all funds set up after March 31, 2000. According to the Revenue Service, the regime does not impose an annual tax on the profits of the fund but requires the fund/fund manager to deduct and account for tax out of payments made to unit holders - except for certain classes of unit holder who can, by use of a declaration procedure, be paid gross. Provided the fund is constituted in accordance with Chapter 1A, these arrangements apply irrespective of whether the fund is a Shariah-compliant fund or a conventional fund.

Any income received by a service provider, which is linked to the profits or performance of a fund should be treated as fee income where it relates to duties performed by the service provider. There is no specific VAT exemption for funds but would depend on the activities of the fund. There is no stamp duty on the issuance or redemption of units/shares in a fund. In addition, the transfer of units/shares in a fund is not chargeable to stamp duty to the extent that the fund is an investment undertaking within the meaning of section 739B of the TCA 1997 or a common contractual fund within the meaning of section 739I of the TCA 1997.

Disclaimer: The news section of Islamic Banking Bulletin is based on information obtained from local and international print and electronic media.

Islamic Banking Branch Network (As of September, 30, 2009)

Type	Name of Bank	No of Branches ⁴
Full Fledge Islamic Banks	Al Baraka Islamic Bank	30
	BankIslami Pakistan Limited	70
	Dawood Islamic Bank Limited	25
	Dubai Islamic Bank Pakistan Ltd	24
	Emirates Global Islamic Bank Ltd	42
	Meezan Bank Ltd	140
	Sub Total	331
Islamic Branches of Conventional Banks	Askari Bank Limited	22
	Bank Alfalah Ltd	6
	Bank Al Habib	48
	Faysal Bank Limited	1
	Habib Bank Ltd	1
	Habib Metropolitan Bank	4
	MCB Bank Ltd	11
	National Bank of Pakistan	8
	Soneri Bank Ltd	6
	Standard Chartered Bank	11
	The Bank of Khyber	16
	The Royal Bank of Scotland	3
United Bank Ltd	5	
	Sub Total	142
Sub Branches	Askari Bank Limited	2
	BankIslami Pakistan Limited	32
	Dawood Islamic Bank Limited	6
	Dubai Islamic Bank Pakistan Ltd	2
	Emirates Global Islamic Bank Ltd	1
	Meezan Bank Ltd	35
	Sub Total	78
	Grand Total	551

⁴ Source: Banking Policy & Regulations Department, State Bank of Pakistan.

Province wise Break-up of Islamic Banking Branch Network (As of September, 30, 2009)

Bank Name	Azad Kashmir	Baluchistan	Federal Capital	Northern Areas	NWFP	Punjab	Sind	Grand Total
Al Baraka Islamic Bank B.S.C.	1		3		3	15	8	30
BankIslami Pakistan Limited	1	8	2	1	5	30	23	70
Dawood Islamic Bank Ltd			1		1	8	15	25
Dubai Islamic Bank Pakistan Ltd		1	2		1	12	8	24
Emirates Global Islamic Bank Ltd		1	2		6	20	13	42
Meezan Bank Limited	1	4	7		13	66	49	140
Sub-Total	3	14	17	1	29	151	116	331
Islamic Banking Divisions								
Askari Bank Limited		1	1		4	11	5	22
Bank AL Habib Limited		1			1	2	2	6
Bank Alfalah Limited		1	3		3	29	12	48
Faysal Bank Limited							1	1
Habib Bank Limited							1	1
Habib Metropolitan Bank Ltd						1	3	4
MCB Bank Limited		1	1		1	5	3	11
National Bank of Pakistan	2				1	3	2	8
Soneri Bank Limited		1	1		1	1	2	6
Standard Chartered Bank		1	1		3	3	3	11
The Bank of Khyber		1			10	3	2	16
The Royal Bank of Scotland						1	2	3
United Bank Limited					1	3	1	5
Sub-Total	2	7	7		25	62	39	142
Sub-Branches								
Askari Bank Limited			1				1	2
BankIslami Pakistan Limited	1	3	3		2	9	14	32
Dawood Islamic Bank Ltd						3	3	6
Dubai Islamic Bank Pakistan Ltd					1		1	2
Emirates Global Islamic Bank Ltd			1					1
Meezan Bank Limited		1	1		4	16	13	35
Sub-Total	1	4	6		7	28	32	78
Grand Total	6	25	30	1	61	241	187	551

City wise Break-up of Islamic Banking Branch Network (As of September, 30, 2009)

S. No	Province	Cities	No of Branches
1	Sindh	Hyderabad	14
2		Karachi City	156
3		Larkana	1
4		Mirpur Khas	2
5		Nawabshah	3
6		Sakrand	1
7		Sanghar	2
8		Sukkur	5
9		Tando Adam	1
10		Tando Allahyar	2
	Sindh Total		187
11	Punjab	Arifwala	1
12		Attock	1
13		Bahawalpur	2
14		Chakwal	2
15		Daska	1
16		Dera Ghazi Khan	2
17		Faisalabad	24
18		Gojra	1
19		Gujar Khan	1
20		Gujranwala	9
21		Gujrat	6
22		Hafizabad	2
23		Jaranwala	2
24		Jhang	2
25		Jhelum	2
26		Kamoki	1
27		Kasur	1
28		Khanewal	1
29		Khushab	2
30		Lahore City	95
31		Mandi Bahauddin	1
32		Mian Channu	2
33		Mianwali	1
34		Multan	19
35		Okara	2
36		Pakpattan	1
37		Pindi Ghaib	1
38		Rahim Yar Khan	5
39		Rawalpindi	23
40		Sadiqabad	2
41		Sahiwal	3
42		Sargodha	5
43		Sheikhu pura	2

S. No	Province	Cities	No of Branches
44	Punjab	Sialkot	11
45		Texila	1
46		Vehari	2
47		Wah Cantt	2
		Punjab Total	
48	NWFP	Abottabad	8
49		Banu	1
50		Batkhela	1
51		Charsadda	1
52		Chitral	1
53		Dera Ismail Khan	3
54		Hangu	1
55		Haripur	3
56		Kohat	1
57		Mansehra	6
58		Mardan	3
59		Mingora	1
60		Nowshera	3
61		Peshawar	25
62		Swabi	1
63		Tank	1
64	Timergara	1	
	NWFP Total		61
65	Northern Areas	Gilgit	1
	Northern Areas Total		1
66	Federal Capital	Islamabad	30
	Federal Capital Total		30
67	Balochistan	Chaman	1
68		Gawadar	1
69		Hub Chowki	1
70		Kuchlack	1
71		Loralai	2
72		Muslim Bagh	1
73		Pishin	1
74		Qilla Saifullah	1
75		Quetta	15
76		Zhob	1
	Balochistan Total		25
77	Azad Kashmir	Mirpur AJK	4
78		Muzaffarabad	2
	Azad Kashmir Total		6
	Grand Total		551

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