Islamic Banking Bulletin

September 2015

Islamic Banking Department
State Bank of Pakistan

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Closing Ceremony of One Week Training on "Liquidity Management in Islamic Banking" (Jointly Organized by IRTI & SBP)

Keynote Address by Mr. Saeed Ahmed,
Deputy Governor,
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October 09, 2015 (Karachi)

Bismillah-ir-Rehman-ir-Rahim

Brother Dr. Osman Babiker, Lead Economist & Training Specialist- Islamic Research and Training Institute (IRTI), Dr. Ousmane Seck, Senior Economist-IRTI, Dr. Shahin A. Shayan, CEO-Hoda International Financial Engineering Company, Dr. Hatim El Tahir, Director- Deloitte ME Islamic Finance Group, distinguished speakers, dear participants, Ladies & Gentlemen

Assalam-o-alaikum.
I would like to begin by congratulating the organizers, the joint team of Islamic Research and Training Institute (IRTI) and State Bank of Pakistan (SBP) on successful completion of this training program on Liquidity Management in Islamic Banking. Special thanks to foreign speakers and participants from brotherly countries of Iran, Turkey, Maldives, Bangladesh and Malaysia for their participation in the program. I am positive that this training would have been a good learning opportunity for all participants and I hope that you all had a very pleasant stay in Karachi.

I would also like to take this opportunity to extend my sincere thanks to IRTI and especially to Dr. Osman Babiker for the continuous support for these capacity building initiatives. I am confident that Insha Allah the cooperation and collaboration between IRTI and SBP would continue for building sound foundations of Islamic banking industry.

Ladies and Gentlemen
In a globalised world of today, financial problems may spread faster than before. Recent financial crises indicates that instability in banking sector can cause a number of systemic effects across various sectors of an economy and have a potential spill over into regional and global economies. During the global financial crisis of 2007-08, the weaknesses in the banking sector of many countries transmitted to the rest of the financial system and resulted in massive contraction of liquidity and credit availability. Drying up of liquidity in the financial markets during the crisis highlighted the dire need of effective liquidity management at institutional level. Moreover, need was also felt for effective mechanism with supervisory authorities for monitoring and providing facilities to financial institutions in stressed situation. Hence, post-crisis amendments that were introduced in global regulatory and supervisory framework generally referred to as Basel III aimed at developing more resilient and sustainable financial sector focused on liquidity risks management along with improving the quality and quantity of capital.

Ladies and Gentlemen
As you all are aware that relatively high resilience of Islamic financial institutions during the financial crisis owing to their inherent strengths has placed Islamic finance at the global centre stage. Given this

increasing interest, assets of global Islamic finance industry have reached to US$2 trillion (World Bank Report on Islamic Finance March 2015) and are expected to grow to US $ 5 trillion by end 2020. However, despite numerous efforts made over years Liquidity Management is still a long standing concern in the global Islamic financial industry at institutional, interbank and central bank levels.

Moreover, in the backdrop of meeting Basel-III liquidity risk requirements i.e. Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), liquidity management has become more challenging. As per, Liquidity Coverage Ratio banking institutions are required to hold sufficient high-quality liquid assets (HQLA) to withstand liquidity needs over a 30-day horizon. Likewise, Net stable funding ratio (NSFR) which will become minimum standard from January 1, 2018 require banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

Ladies & Gentlemen
Sukuk has been recognized as an effective liquidity management instrument and has played a pivotal role. Over the years Sukuk has been instrumental in the growth of global Islamic finance. In Pakistan the issuance of sovereign sukuk since 2008 provided relief to the domestic industry by providing an investment avenue but the gap between demand and supply could not be bridged due to infrequent supply of sovereign sukuk. Moreover, all issued sovereign sukuk are for tenure of three years which puts pressure on the industry particularly for short term liquidity management. Being cognizant with this challenge, we at SBP are working on developing multiple solutions for liquidity management of Islamic banking industry. In this regard, a significant milestone was achieved in recent past with the launch of Shariah compliant Open Market Operations OMOs on the basis of credit sale (bai-muajjal) of Sukuk. This transaction has not only extended support to the industry by providing an investment avenue but its successful implementation has also laid foundations for similar transactions with other stakeholders like government.

Ladies and Gentlemen
I would also like to share with you that the present Government of Pakistan has shown strong resolve towards developing this industry on sound foundations. To this end, the formation of the Steering Committee by the Government for Promotion of Islamic banking in Pakistan at start of last year (2014) helped a lot in creating harmony among all stakeholders. The Steering Committee which happens to be headed by me, has representation from all stakeholders including industry, Shariah community, Ministry of Finance, Security Exchange Commission of Pakistan (SECP) and State Bank of Pakistan.

Another significant step taken by the Government is the re-entry in international sukuk market after nine years. This five years dollar denominated sukuk has not only attracted overwhelming response from investors from different regions but was also given the deal of the year award by Islamic Finance News (IFN).

Ladies and Gentlemen
Given the inclination of the Government towards Shariah compliant financial system and support from regulators this is the most appropriate time for the domestic industry to develop more innovative solutions. Successful launch of few corporate Sukuk for public offering like Karachi-electric Sukuk are

positive developments in this regard. However, I would like to encourage the industry to diversify its product menu and think beyond the conventional products and system that has been the cause of past financial crisis. To sustain the growth momentum and achieve the core objective of Islamic finance innovative products that safeguard the interest of all investment holders are much desired.

We at SBP do acknowledge that our legal and taxation framework requires amendments for enabling the industry to take full advantage of inherent strengths of Shariah complaint banking system. To this end we in collaboration with the industry and other stakeholders are striving hard for bringing in changes that can make overall environment facilitative instead of accommodative for the development of Islamic finance industry in the country.

Ladies and Gentlemen

We are also cognizant of the fact that like any other industry the development of Islamic finance critically hinges upon quality of its human resource. Hence developing a high caliber and competent human resource is critical for addressing the challenges faced by the industry. In this regard, a number of initiatives have been taken by SBP to build the industry's HR capacity. We are offering certification courses along with general and customized training programs through our training arm National Institute of Banking and Finance (NIBAF). SBP is also collaborating with reputed national and international institutions for organizing targeted seminars, lectures, training programs and workshops.

I would also like to share with you that in order to ensure adequate supply of trained human resource for the industry and to act as an incubator for research on contemporary issues SBP in collaboration with the government, Industry and other stakeholders is establishing Centers of Excellence for Islamic Banking and Finance (CEIFEs). In this regard, three universities have been selected for establishment of these centers.

Ladies and Gentlemen

I reiterate that limited liquidity management instruments in the backdrop of changing global regulatory environment are one of the key issues faced by Islamic banks in most jurisdictions including Pakistan. The need for stronger balance sheets with high quality capital and liquidity buffers is one great lesson of the global financial crisis. Hence, availability of Shariah compliant financial markets and instruments for liquidity management are much needed requisites of the Islamic banking industry today.

In the end I would like to thank our distinguished speakers for sharing their knowledge and experience with us. I hope that this training week has helped participants in acquiring skills to meet the challenge of liquidity management in Islamic banking industry.

I wish all our foreign guests a safe journey back home.

Thank you

Islamic Banking Industry- Progress & Market Share

Overview

Islamic banking industry (IBI) witnessed growth of 1.1 percent during the quarter July to September 2015 as its assets reached Rs 1,511 billion compared to Rs 1,495 in the previous quarter. Deposits of IBI stood at Rs 1,271 billion by end September 2015. Market share of Islamic banking assets and deposits in overall banking industry stood at 11.2 percent and 13.1 percent respectively by end September 2015 (see **Table 1**). Profitability of IBI was registered at Rs 6.5 billion during the review quarter. Among earning and profitability indicators, both Return on Equity (ROE) and Return on Assets (ROA) remained unchanged compared to the previous quarter.

Table 1: Industry Progress and market share **(Rupees in billions)**

	Industry Progress			Growth (YoY)			Share in Industry		
	Sep-14	**Jun-15**	**Sep-15**	**Sep-14**	**Jun-15**	**Sep-15**	**Sep-14**	**Jun-15**	**Sep-15**
Total Assets	1102	1495	1511	19.0%	37.3%	36.2%	9.9%	11.3%	11.2%
Deposits	*934*	1281	1271	20.4%	37.4%	36.1%	10.7%	12.8%	13.1%
Total Islamic Banking Institutions	22	22	22	–	–	–	–	–	–
Total No. of Branches*	1423	1702	1783	–	–	–	–	–	–

Source: Quarterly Unaudited Accounts

**number includes sub-branches*

IBI Network Expansion

IBI branch network continued to increase during the third quarter CY15. SBP allowed an Islamic banking institution to commence operations of its subsidiary during the review quarter. In all, 81 additional Islamic banking branches started operations during the review quarter, increasing the aggregate number of Islamic banking branches to 1,783. These additional branches were established in all provinces of the country (see **Table 2**). However, in terms of coverage, Islamic banking services expanded to one new district (Bajour Agency in FATA) during the review quarter. Windows operated by Islamic Banking Divisions (IBDs) of conventional banks also increased during the review quarter; 1,013 compared to 1,006 in the previous quarter (see **Annexure I** for details).

Table 2: Province Wise Additional Branches (Jul-Sep 2015)

Province	Additional	Total	Share
Punjab	34	831	46.6
Sindh	18	557	31.2
Khyber	16	196	11.0
Baluchistan	6	72	4.0
Gilgit Baltistan	1	8	0.4
FATA	1	6	0.3
Federal Capital	4	94	5.3
AJK	1	19	1.1
Total	**81**	**1,783**	**100**

Asset and Liability Structure

Assets: Asset base of IBI observed growth of 1.1 percent during the quarter July to September 2015 to reach Rs 1,511 billion from Rs 1,495 billion in the previous quarter. This pace of growth in Islamic banking assets was low compared to previous two quarters of 2015 and with growth rate of the overall banking industry (2.1 percent) during the quarter under review. Resultantly, the market share of assets of

IBIs' in overall banking industry's assets decreased from 11.3 percent in June 2015 to 11.2 percent in September 2015.

Analysis of asset composition of the banking industry reveals that investments accounted major share in total assets of the banking industry[1] as compared to advances at the end of the third quarter CY15. In contrast, the share of investments and financing in total assets of IBI stood at 26.0 percent and 35.3 percent respectively at the end of the quarter under review (see section on **Investments** and **Financing** for details). For IBI, financing to financial institutions witnessed a significant rise of Rs 181.4 billion (107.9 percent) over the same quarter last year and its share in overall assets of IBI reached at 23.1 percent while this share stood at 3.5 percent for overall banking industry by end third quarter CY15. This increase in financing to financial institutions can be mainly attributed to Bai-Muajjal of Sukuk transactions with SBP and deployment of excess liquidity in the interbank money market.

Analysis of assets by breakup among full-fledged Islamic Banks (IBs) and Islamic Banking Divisions (IBDs) of conventional banks indicate that the assets of IBs witnessed growth of 2.0 percent while the assets of IBDs declined by 0.3 percent compared to the previous quarter. Therefore, the share of IBs (62.7 percent) remained higher than that of IBDs (37.3 percent) in overall assets of IBI.

Table 3: Investments

Rupees in billion

				Growth	
	Sep-14	**Jun-15**	**Sep-15**	**YoY**	**QoQ**
Federal government securities	244.3	261.4	263.5	7.9	0.8
Fully paid up ordinary shares	5.8	11.1	11.3	93.1	2.0
Bonds/ PTCs/Sukuk certificates	42.4	43.0	55.1	30.1	28.4
Other investments	63.0	68.3	67.2	6.5	(1.7)
Provisions & deficit/ (surplus)	(1.5)	(4.6)	(4.7)	-	-
Net Investments	**354.0**	**379.2**	**392.4**	**10.8**	**3.5**

Investments:

Investments (net) of IBIs increased by 3.5 percent to reach Rs 392.4 billion by end September 2015 compared to Rs 379.2 billion by end June 2015 (see **Table 3**). In contrast to overall banking industry, which continued investments in government securities during the quarter under review[2], the increase in Investments (net) of IBIs can be linked to other avenues i.e. Bonds/PTCs/sukuk certificates while investments in federal government securities depicted only a small growth of 0.8 percent as compared to the previous quarter. Moreover, Investments to Deposits ratio (IDR) of IBI (30.9 percent) is lower than that of overall banking industry ratio which stood at 69.1 percent at the end of third quarter CY15. The main reason of lower IDR of IBI can be associated with the non issuance of any new GoP Iajra Sukuk since June 2014.

[1] The Share of investments and advances in overall assets of banking industry was 49.7 percent and 33.6 percent respectively at the end of third quarter of CY15.

[2] Investments in government securities increased by 8.5 percent compared to the last quarter.

Financing

Financing and related assets (net) of IBI observed growth of 4.1 percent during the quarter July to September 2015 and reached Rs 532.9 billion. Growth in Financing and slight decline in deposits resulted in improving Financing to Deposits ratio (FDR) (41.9 percent) of IBI by 2 percent compared to the previous quarter. However, the FDR of IBI is still below than that of industry average of 46.7 percent. Like previous quarters, mode wise financing remained concentrated in Diminishing Musharaka and Murabaha as these modes collectively account 59 percent of overall financing of IBI (see **Table 4**).

Table 4: Financing Mix

percent share

	Sep-14	Jun-15	Sep-15
Murabaha	30.3	24.8	24.8
Ijarah	8.6	7.7	7.5
Musharaka	10.1	10.2	13.6
Mudaraba	0.2	0.0	0.0
Diminishing Musharaka (DM)	35.1	34.7	34.2
Salam	2.6	5.6	4.4
Istisna	7.9	10.2	9.5
Qarz/Qarz-e-Hasna	0.0	0.0	0.0
Others	5.3	6.7	5.8
Total	**100.0**	**100.0**	**100.0**

Table 5: Financing Concentration - percent share

	Sep-14	Jun-15	Sep-15	Industry
Chemical and Pharmaceuticals	7.4%	8.7%	8.7%	4.3%
Agribusiness	1.4%	1.7%	7.0%	9.5%
Textile	16.8%	16.7%	15.9%	13.4%
Cement	0.7%	1.6%	2.6%	1.3%
Sugar	3.1%	4.2%	2.5%	2.7%
Shoes and leather garments	0.9%	1.1%	1.0%	0.5%
Automobile and transportation equipment	2.0%	1.4%	1.5%	1.1%
Financial	0.3%	0.5%	0.5%	2.7%
Insurance	0.0%	0.0%	0.0%	0.0%
Electronics and electrical appliances	2.6%	1.9%	1.7%	1.4%
Production and transmission of energy	12.5%	10.5%	9.3%	13.1%
Individuals	14.0%	12.7%	12.8%	8.5%
Others	38.3%	38.9%	36.6%	41.6%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Review of sector wise financing shows that financing extended by IBIs was mainly concentrated in textile sector which is in line with overall banking industry's trend. Among other sectors, financing by IBI was also concentrated in sectors like production & transmission of energy, chemical & pharmaceuticals and individuals (see **Table 5**).

Client wise financing of IBI remained concentrated in the corporate sector, having a share of 73.5 percent, followed by consumer financing (11.3 percent) (see **Table 6**). Like previous quarters, financing, extended by IBIs to SMEs and

Table 6: Client Wise Financing Portfolio (Share Percent)

	Sep-14	Jun-15	Sep-15	Industry
Corporate Sector	74.8%	78.2%	73.5%	65.6%
SMEs	3.8%	2.8%	2.8%	5.6%
Agriculture	0.3%	0.6%	0.8%	6.0%
Consumer Finance	13.0%	11.2%	11.3%	6.8%
Commodity Financing	6.2%	4.6%	7.9%	13.7%
Staff Financing	1.9%	1.4%	1.5%	2.2%
Others	0.1%	1.2%	2.2%	0.1%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

agriculture remained lower compared to overall banking industry's averages indicating limited outreach of IBI to these two sectors.

Asset Quality

During the quarter under review, Non-Performing Assets (NPA) of IBI slightly increased to Rs 34.6 billion, compared to Rs 34.1 billion in the previous quarter. Likewise, Non-Performing Financing (NPF) of IBI also witnessed growth of 1 percent during July to September quarter 2015 and reached Rs 31.4 billion from Rs 31.1 billion in the previous quarter. Provisions to NPFs ratio was 90.2 percent as of September 2015 compared to the industry average of 81.8 percent. However, overall asset quality indicators of IBI were better than those of overall banking industry (see **Table 7**).

Table 7: Assets Quality Ratios				
	Sep-14	**Jun-15**	**Sep-15**	**Industry**
NPFs to Financing	5.2%	5.8%	5.6%	12.5%
Net NPFs to Net Financing	1.1%	0.6%	0.6%	2.5%
Provisions to NPFs	79.9%	90.4%	90.2%	81.8%
Net NPAs to Total Capital	5.5%	0.9%	1.0%	9.0%
Non Performing Assets & Financing (Rupees in billions)				
Non Performing Assets	21.1	34.1	34.6	705.42
Non Performing Financing	18.4	31.1	31.4	629.86
Provision against Financing	14.7	28.1	28.3	514.92

Liabilities

Deposits base of IBI observed a dip of 0.8 percent during the quarter July to September 2015 and declined to Rs 1,271 billion from Rs 1,281 billion in the previous quarter. However, it is pertinent to mention here that deposits of overall banking industry witnessed more decline (2.6 percent) compared to IBI during the review quarter. As a result, market share of IBI's deposits in overall banking industry's deposits increased from 12.8 percent by end June 2015 to 13.1 percent by end September 2015. The period under review also witnessed an increase of Rs 10.02 billion in borrowing from financial institutions which indicates that growth in assets of IBI was also supported by borrowing due to decline in deposits.

The breakup of deposits reveals that fixed and current deposits registered negative growth while saving deposits grew during the period under review (see **Table 8**). A further break up of deposits among IBs and IBDs shows that deposits of IBs increased by Rs 2.7 billion, however, deposits of IBDs witnessed a

Table 8: Break up of Deposits					
				Rupees in billion and growth in percent	
				Growth	
	Sep-14	**Jun-15**	**Sep-15**	**YoY**	**QoQ**
Deposits	933.7	1,280.6	1,270.8	36.1	(0.8)
Customers	883.4	1,206.6	1,188.0	34.5	(1.5)
Fixed Deposits	265.4	352.8	340.8	28.4	(3.4)
Saving Deposits	364.7	468.3	494.9	35.7	5.7
Current accounts - Remunerative	2.7	5.9	4.4	62.8	(25.5)
Current accounts - Non-remunerative	246.2	373.5	342.1	38.9	(8.4)
Others	4.4	6.1	5.9	34.4	(3.4)
Financial Institutions	50.3	73.9	82.8	64.6	12.1
Remunerative Deposits	49.6	56.5	80.9	63.2	43.1
Non-remunerative Deposits	0.8	17.4	2.0	161.7	(88.7)

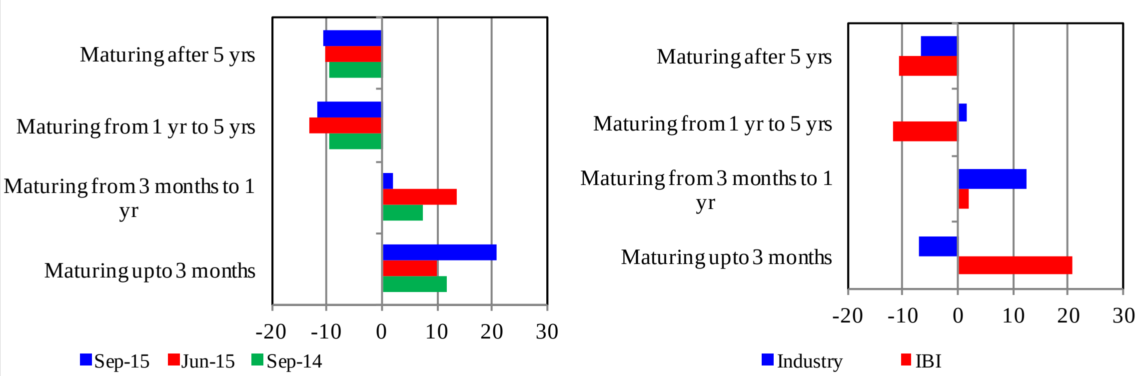
decline of Rs 12.4 billion during the quarter ending September 2015. The share of IBs and IBDs in overall deposits of Islamic banking industry was 62.5 percent and 37.5 percent respectively.

Maturity Gap

Increase in short term assets during the third quarter CY15 resulted in increasing the positive gap of IBI for the short term category of up to 3 months (ms). This trend is in line with the overall banking industry, however, for overall banking industry gap in the above mentioned category is negative (see **Figure 1(b)**). For the category of 3ms to 1 yr, both IBI and overall banking industry depicted positive gap, however, the positive gap for IBI showed downward trend due to decline in assets of 3ms to 1 yr. For long term categories from 1yr to 5yrs and above 5yrs, IBI exhibited a negative trend. For 1yr to 5yrs, the negative gap decreased from 13.1 percent to 11.9 percent as a decline in assets of this tenure was greater than the decline in liabilities of this duration during the mentioned period. For the category of above 5 yrs, the gap for both IBI and the banking industry remained negative during the review quarter.

Figure 1(a): Maturity Gap(Asset-Liabilities) as percent of assets

Figure 1(b): Maturity Gap (as percent of assets) (IBI vs. Overall Banking Industry)



Liquidity Ratios

Liquid assets (LA) of the Islamic banking industry witnessed a slight decline during the quarter ending September 2015. The decline in liquid assets was mainly contributed by "balances with other banks" and "call money financing" of the IBI. Decline in liquid assets resulted in a decline in (LA) to Total Assets though LA to Deposits witnessed a slight increase during the third quarter of FY15.

Table 9:Liquidity Ratios

	Sep-14	Jun-15	Sep-15	Industry
Liquid Asset to Total Assets	34.7%	34.4%	33.8%	53.8%
Liquid Assets to Deposits	40.9%	40.1%	40.2%	74.8%

Capital

The capital base of IBI witnessed an increase of 11.2 percent during the third quarter CY15 compared to the previous quarter. As most IBs are in the process of building up their capital to meet regulatory requirement, therefore, ratios like Capital to Assets (6.6 percent) and Capital – Net NPAs to

Table 10 : Capital Ratios

	Sep-14	Jun-15	Sep-15	Industry
Capital to Total Assets	7.1%	6.0%	6.6%	9.8%
(Capital - Net NPAs) to Total Assets	6.7%	6.0%	6.6%	8.9%

Total Assets of IBI (6.6 percent) were lower than those of industry averages which were at 9.8 percent and 8.9 percent respectively (see **Table 10**).

Profitability & Earnings

Profitability after tax (PAT) of IBI was Rs 6.5 billion by the end third quarter CY15 compared to Rs 9.4 billion in the same quarter last year. This decline can be associated with IBs, which earned PAT of only Rs 0.5 billion by end third quarter CY15 compared to Rs 4.1 billion in the same quarter last year. In contrast, IBDs earned PAT of Rs 6 billion by end third quarter CY15 compared to Rs 5.3 billion in the same quarter last year. As a result of overall decline in profitability of IBIs, both ROA and ROE showed a decline in the third quarter CY15 compared to the same quarter last year. Like previous quarters, both these ratios of IBI were below than those of industry averages. Due to its expansionary phase, IBI has not been able to bring expenses at level comparable to conventional banking industry as indicated in **Table 11** there is a further increase in operating expenses to gross income ratio during the quarter under review.

Table 11: Profitability & Earnings of IBI

	Sep-14	Jun-14	Sep-15	Industry
Return on Assets (ROA)	1.2%	0.6%	0.6%	1.5%
Return on Equity (ROE)	16.7%	9.8%	9.8%	15.7%
Operating Expense to Gross Income	65.6%	66.0%	68.2%	46.9%
Personnel Expense to Operating Expense	40.3%	36.3%	37.5%	40.7%

Country Model

Iraq

Islamic Banking started in Iraq in 1993 with the establishment of Iraqi Islamic Bank for Investment and Development. At present, Islamic banking industry in Iraq consists of twelve banks including eight full-fledged local Islamic banks and four foreign Islamic banks. The Central Bank of Iraq (CBI) also allowed the opening of two Islamic banking windows in 2011. These Islamic banking windows work as a separate department within a conventional bank and operate under guidance by an independent Shariah Advisory Board of the bank. Islamic banking window is allowed to offer its products and services through conventional branches or dedicated Islamic branches of the conventional bank.

Despite the volatility in the country, Islamic banks in Iraq are continuing their growth plans, including expansion in product and size. Iraqi Islamic Bank for Investment and Development acquired an insurance company with the intention of offering Takaful services.

Legal Framework for Islamic Banks in Iraq:

CBI regulates both conventional and Islamic banks through a single regulatory framework and Islamic banking activities fall under the domain of the Banking Law 2004. In the year 2011, the Central Bank of Iraq issued Islamic banking regulations. These regulations specified the activities that can be performed by the Islamic banks and activities which the Islamic Banks (and Islamic windows within conventional banks) are prohibited to carry out. Further, these regulations also stipulated funding and dealing mechanisms regarding the purchase of foreign currencies, foreign currency exchange companies, commercial papers and stock market, etc. The regulations also permit conventional and investment bank to open an Islamic banking window or to establish an Islamic branch.

In addition, work on further improvement in the Islamic banking law is under process and revised draft of Islamic banking is expected to be approved in the current year. The revised Islamic banking law will regulate the operations of the Islamic banks in a more detailed manner. One of the important articles in the draft law is to exclude Islamic banks and their branches from the taxes and fees arising from dealing in contracts relating to estate, land, cars, Murabaha and Ijara deals.

Shariah Board:

In terms of regulations issued by CBI in 2011, each Islamic bank and the Islamic banking window is required to establish Shariah Board which is responsible of providing a Shariah view on the operations of the bank in order to ensure its compliance with the Sharia Law. The main responsibilities of the Shariah Board are to recommend to the General Assembly of the bank or its Board of Directors all the necessary steps that need to be taken or carried out to achieve compliance with Sharia Laws. The decisions of the Shariah Board are binding on the executive management of the bank.

Way Forward

With growing significance of Islamic banking and finance across the world and a large Muslim population in the country, further growth in Islamic banking and finance is expected in Iraq.

Sources

- Central Bank of Iraq website http://www.cbi.iq/
- www.islamicfinancenews.com
- http://iraqdailyjournal.com

Brief on FAS 27

Brief on Financial Accounting Standard No.27 (FAS 27) Investment Accounts issued by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)

At the end of 2014, AAOIFI issued a new accounting standard on investment accounts – Financial Accounting Standard No. 27 (FAS 27) Investment Accounts. The new FAS 27 updates and replaces two of AAOIFI's previous accounting standards relating to investment accounts – FAS 5 Disclosure of Bases for Profit Allocation between Owners' Equity and Investment Account Holders as well as FAS 6 Equity of Investment Account Holders and their Equivalent.

This standard sets out the principles for accounting recognition, measurement, presentation and disclosure of investment accounts which form an integral part of the financial statements of Islamic Financial Institutions, particularly Islamic Banks. This standard applies to investment accounts based on Mudaraba contracts which represent "equity of investment accountholders and on Mudaraba contracts that are placed on "short term basis" (overnight, seven days, one month basis) by other financial institutions as "interbank-bank deposits" for the purpose of liquidity management. However, it is not applicable to own equity instruments, wakala contracts, reverse murabaha, musharaka or sukuk.

The new standard introduces the concept of authority to take decisions in relation to use of and deployment of funds received from investment account holders in determining the treatment of such funds as on-balance sheet or off-balance sheet items. In contrast to the previous standard, the new standard stipulates that accounting treatment for such fund is not dependent merely on whether the mudaraba contract is designated as restricted or unrestricted investment accounts. Under, the new standard, on-balance sheet accounting treatment is required for investment accounts that provide Islamic financial institutions with the authority for decision making and strategic policy, as well as day-to-day administrations and operations in relation to where, when and how the investment funds will be deployed.

In cases, where Islamic financial instructions have little authority or limited or no discretion in respect to the use of and deployment of the funds, they qualify for an off-balance sheet treatment. Notwithstanding, such off-balance treatment needs to be accompanied with sufficient disclosures.

This standard shall be effective for financial periods beginning 1st January 2016.

Sources

- www.aaoifi.com
- Global Islamic Finance Report 2015

Events and Developments at IBD

Meeting of AAOIFI Shariah Board's Shariah Standards Review and Translation Committee Held on 21 – 23 July 2015 at Serena Hotel, Islamabad

AAOIFI conducted the meeting of its Shariah Board's Shariah Standards Review and Translation Committee during July 21 – 23, 2015 at Serena Hotel, Islamabad. The meeting was attended by renowned international scholars including Dr. Hamed Hassan Merah (Secretary General – AAOIFI), Sheikh Nizam Yaqoobi, Sheikh Esam Eshaq and Sheikh Muhammad Taqi Usmani. Facilitating such events is in line of IBD's objective of leveraging support to international infrastructure institutions dealing Islamic finance.

Awareness Programs on Islamic Banking

In order to create awareness of Islamic banking among business community, SBP in collaboration with the Standing Committee on Islamic Banking & Takaful of The Federation of Pakistan Chambers of Commerce & Industry (FPCCI) arranged two orientation sessions during August 17 – 18, 2015 at Peshawar and Islamabad respectively. The programs were attended by SBP representatives and IBI officials as guest speakers, while members of Chambers of Commerce & Industries and a large number of business community also attended as participants.

IRTI – SBP Joint Training Course on "Liquidity Management in Islamic Banking" Held on 5 – 9 October 2015 at PC Hotel, Karachi

A 5-day joint training program under the theme "Liquidity Management in Islamic Banking" was conducted by Islamic Research and Training Institute (IRTI) – a member of the Islamic Development Bank Group (IDB), and SBP during October 5 – 9, 2015 at PC Hotel, Karachi. The course was attended by both international and local speakers and participants from field of treasury and product development, etc. Arranging such capacity building programs in collaboration with international institutions is in line of IBD's objective of improving and enhancing awareness of Islamic finance among different segments of society.

Workshop on "Islamic Hedging and Liquidity Management" Held on October 6, 2015 at PC Hotel, Karachi

A workshop on "Islamic Hedging and Liquidity Management" was arranged by SBP on October 6, 2015 at PC Hotel, Karachi wherein (1) Mr. Ijlal Ahmed Alvi, CEO – International Islamic Financial Market (IIFM), (2) Mr. Ismail Ebrahim Dadabhoy, Advisor to CEO – IIFM and (3) Mr. Khurram Hilal, Head of Global Islamic Products – Standard Chartered Bank were the guest speakers. The workshop was chaired by Mr. Muhammad Ali Malik, Executive Director – FMRM and was attended by SBP officials, Shariah Advisors, bankers, etc.

Workshop on "Sukuk Structuring" Held on October 8, 2015 at PC Hotel, Karachi

A full day workshop on "Sukuk Structuring" was arranged by SBP on October 8, 2015 at PC Hotel, Karachi. The workshop was conducted by (1) Dr. Shahin Shayan, CEO – Hoda International Financial Engineering Company and (2) Mufti Irshad Ahmad Aijaz, Chairman Shariah Supervisory Board – BankIslami Pakistan Limited. The workshop was attended by SBP officials, Shariah Advisors, bankers, investment heads, Islamic banking practitioners, etc.

Islamic Banking News and Views

News

IIFM to provide guidance on Islamic derivative instruments; to issue new standards this year

International Islamic Financial Market (IIFM) is targeting to issue two new standard agreements this year as work on certain Islamic derivative instrument templates progresses with several other frameworks in the pipeline. “We are currently working on two currency standards namely cross-currency and foreign exchange (FX) forward; and will soon commence work on standardization of specific Sukuk structures,” according to Ijlal Alvi, CEO of IIFM. “Our tar-get for this year is to issue two new standard agreements, by the will of Allah. The Islamic cross-currency swap and (FX) forward product templates fall under IIFM’s Tahawwut Master Agreement – the world’s first international standardized documentation for over-the-counter Islamic hedging products, jointly published with the International Swaps and Derivatives Association.

www.islamicfinancenews.com

Sukuk market forecasted to perform well across GCC this year, resilient to global macro moves

In spite of oil prices remaining at depressed levels, the GCC remains on strong ground as Sukuk prices continued performing well on a relative basis, with demand technically outstripping supply so far this year. In a recent asset management report by the Bank of Lon-don and The Middle East (BLME), portfolio manager Jamil Mufti conveyed that this premise is primarily attributed to the current ac-count surpluses accumulated over the years while oil traded at a high price as well as due to an effort to diversify away from oil revenues.

www.islamicfinancenews.com

Islamic finance to grow to $3 trillion by 2018: Report

Islamic finance has been growing rapidly over the past decades, reaching $1.8 trillion in 2014 and is expected to exceed $3 trillion by 2018, according to Consultancy.uk - a leading online platform for the management consulting industry in the UK. In a recent article by BearingPoint Institute, the consulting firm considers the differences between the partnership practice of Islamic banking and the practice of interest. The firm also explores the wider challenges faced by both Islamic and western banking institutions as the practice of Islamic banking further expands to meet the needs of up to 1.6 billion potential participants in Islamic financial products and services. Today Islamic banking is a $1.8 trillion dollar financial structure, with a large number of different segments being served by Islamic banking institutions. The baking practice is growing rapidly, with double digits, and is expected to be worth up to $3 trillion by 2018. One of the main financial instruments in Islamic banking is sukuk, which is roughly equivalent to bonds. Through entering into partnerships with small players, Islamic banks provide a different funding source than government finances, which accounts for 62 percent of some markets.

http://www.ummid.com/news/2015/August/13.08.2015/islamic-finance-to-grow-to-3-triliion-dollar.html

Oil price slump hits Islamic financial services

The decline in global oil prices and the weak oil price outlook for 2015 and 2016 are already seen a taking toll on both Islamic banking and the Islamic financial services sector, according to analysts. Rating

agency Fitch has warned that the global Islamic financial services industry could face further pressure in terms of low demand for sukuk issuance due to a combination of factors such as fall in oil prices, potential rise in global interest rates and contraction across global emerging markets. Fitch Ratings said in a recent report that total new bonds and sukuk (with a maturity of more than 18 months) from the GCC, Malaysia, Indonesia, Turkey, Singapore, Pakistan, Sri Lanka, and Taiwan (GCC+7) declined 27 per cent in the first half of 2015 from a year ago. Data for the first six months of the year shows bonds were down 30 per cent and sukuk by 16 per cent.
http://www.albawaba.com/business/oil-price-slump-hits-islamic-financial-services-737192

Indonesia lists world's biggest sovereign sukuk in Dubai
Indonesia listed four Islamic bonds (sukuk) on Nasdaq Dubai, the world's biggest sovereign Islamic sukuk in the Gulf emirate. Indone-sia's Finance Minister Bambang Bodjonegoro rang the market-opening bell to celebrate the listing of the bonds worth six billion U.S. dollars. The listing of "our sukuk on Nasdaq Dubai is an important step forward in further strengthening Indonesia’s ties with the UAE and the wider Middle East”, the minister said."Since our international debut in 2009, we have issued global sukuk valued at 7.65 bil-lion dollars," Bodjonegoro said. Mohammed Abdulla Al-Gergawi, United Arab Emirates (UAE) cabinet affairs minister and chairman of the Dubai Islamic Economy Development Centre, said the listing of the Indonesian sukuk in Dubai was "a milestone in the drive that Dubai started several years ago to become the capital of the Islamic Economy globally."
http://en.arabstoday.net/business/internationaleconomy/indonesia-lists-worlds-biggest-sovereign-sukuk-in-dubai.html

Meezan Bank gets SBP nod to merge HSBC Oman operations
The State Bank of Pakistan (SBP) cleared the amalgamation of the HSBC Bank Oman S.A.O.G operations in Pakistan with Meezan Bank Limited (MBL), the country's first Shariah-compliant bank. The in-principle approval from the banking regulator means that Meezan Bank now would be allowed to carry out the required formalities that include getting its shareholders' nod, for the proposed merger. The central bank was "pleased to grant you in-principle approval to proceed with completing the required formalities". The proposed amalgamation is subject to compliance with applicable laws, rules and Shariah standards, said the SBP.
http://www.brecorder.com/top-stories/0/1213852/

SBP allows MCB Islamic Bank to start operations
State Bank of Pakistan (SBP) has allowed MCB Bank to commence operations of its subsidiary MCB Islamic Bank countrywide in accordance with requirement of its license. According to official disclosure, SBP has issued the certificate of commencement of bank-ing business under the section 27 of the Banking Companies Ordinance 1962, which is subject to compliance with all applicable laws, rules and regulations. MCB Bank will convert all its 34 dedicated branches of Islamic Banking into separate subsidiary of MCB Islamic Bank in future. SBP is working aggressively for expanding Islamic banking industry throughout the country, setting up ambitious targets of growth and giving incentives to bank to work in line with its direction of promoting Shariah-based financing.
http://www.dailytimes.com.pk/national/16-Sep-2015/sbp-allows-mcb-islamic-bank-to-start-operations

Pak Islamic banks among top 5 institutions in region

As many as four leading financial institutions of Pakistan have been placed in the top five Islamic banks of the region, as per the South Asian Financial Disclosure Index rankings. The conveners of the 22nd annual World Islamic Banking Conference (WIBC) revealed on Wednesday the ranking of South Asia's top 5 Islamic banks rated according to their financial disclosure, subsequent to the announcement of the launch of the WIBC Leaderboard. Pakistan-based Meezan Bank and Bangladesh-based Social Islamic Bank are positioned at the top of Islamic financial institutions in South Asia. They are closely followed by Bank Islami, Faysal Bank and MCB Bank. More, importantly, Meezan Bank ranked 10th in the top 15 global Islamic banks.

http://www.thenews.com.pk/Todays-News-3-339193-Pak-Islamic-banks-among-top-5-institutions-in-region

Articles/Views:

Growing trend: Islamic finance goes offshore

The rise of Islamic finance and sukuk issuances have brought with it a growing phenomenon: Shariah banking is increasingly taking advantage of offshore banking jurisdictions, and this for a number of reasons. Many offshore centres around the world meanwhile offer a wide range of features allowing Shariah principles to be upheld when creating Islamic financial products. This goes in tandem with offshore companies and trusts that have proven to be a useful ingredient to Islamic finance products. Many offshore jurisdictions also offer multiple other benefits such as low income, capital gains, profit or withholding taxes or no taxes at all, no restrictions on foreign exchange or foreign ownership, experienced service providers and operational support. Offshore financial centres that have attracted Islamic finance are, among others, Cayman Islands, Jersey, Bermuda, British Virgin Islands and Labuan in Malaysia, the latter mainly for Asian transactions.

http://www.gulf-times.com/eco.-bus.%20news/256/details/450809/growing-trend:-islamic-finance-goes-offshore

The standardization of Islamic finance industry

Standardization efforts made by AAOIFI, the IFSB and the International Islamic Financial Market (IIFM) had guided the industry quite effectively in the last 25 years. AAOIFI's emergence since 1991 set forth the most basic Shariah rulings and accounting standard that were necessary at the early stage of the industry. The IFSB and IIFM have now spiced up the industry with the mandate of regulatory, supervision and product standardization of the Islamic capital and money market, corporate finance and trade finance. One then wonders why this young industry has three standard bodies while conventional banking has given much authority to the Basel Committee. The need to always differentiate Fatwa, contracts and products cannot be overemphasized. This then leads to the question of which of these needs standardization. Should Musharaka or Mudaraba contracts be different anywhere in the world?

www.islamicfinancenews.com

Islamic ETFs: A right fit for Shariah investing

Islamic or Shariah compliant exchange-traded funds (ETFs) have been around for almost a decade globally, yet the size and number of funds issued pale in comparison to the phenomenal growth of ETFs

as a whole. To date, there are only 16 Shariah equity ETFs issued worldwide with total assets under management of around US$355 million compared to the overall ETFs which have recently touched US$3 trillion, growing from only US$70 billion in 2000. Identifying the issues and pointing out the demand and supply of Islamic ETFs is an intertwined issue. For ETF issuers, the lack of interest from market participants may hold them back from issuing new funds, whereas for investors the limited product range and perceived liquidity are among the key deterrents to investing in Islamic ETFs. The article aims to provide insight into some of the contemporary issues among retail and institutional investors and illustrate the benefits of Islamic ETFs as an alternative investment tool.
www.islamicfinancenews.com

Displaced commercial risk: The case for restricted investment accounts

Displaced commercial risk (DCR) relates to the absorption of excess risk by Islamic bank shareholders in respect of assets funded by profit sharing investment accounts (PSIAs). Contractually, all of the risk of assets funded by PSIAs should vest with PSIA holders. However, either due to regulatory or commercial pressure or both, bank shareholders assume some of this risk and subsidize PSIA returns so as to match them to conventional deposit benchmarks. This practice begs a natural question. Rather than provide PSIA holders with participation opportunities in the same asset pool as bank shareholders, would it not be more efficient — given diver-gent risk appetites and capacity to absorb risk — to define a different sub-portfolio of total assets in which the PSIA holders would invest?
www.islamicfinancenews.com

Shariah compliant crowdfunding

Crowdfund investing has been termed as the act of funding a project or a venture by raising amounts of money from a group of peo-ple, typically facilitated via crowdfunding platforms on the internet. These platforms too have made its mark in the Islamic finance space witnessing a growing number of Shariah compliant crowdfunding platforms across the globe. The article provides an update of the latest developments in Islamic crowdfund investing.
www.islamicfinancenews.com

Annexure: I

Islamic Banking Branch Network

(As of September 30, 2015)

Type	Name of Bank	No of Branches*	Windows
Islamic Banks	AlBaraka Bank (Pakistan) Limited	121	
	BankIslami Pakistan Limited	123	
	Burj Bank Limited	74	
	Dubai Islamic Bank Pakistan Limited	174	
	Meezan Bank Limited	494	
		986	
Islamic Branches of Conventional Banks	Allied Bank Limited	15	0
	Askari Bank Limited	71	0
	Bank AL Habib Limited	28	14
	Bank Alfalah Limited	157	20
	Faysal Bank Limited	63	0
	Habib Bank Limited	44	488
	Habib Metropolitan Bank Limited	20	203
	MCB Bank Limited	34	3
	National Bank of Pakistan	53	0
	Silkbank Limited	10	10
	Sindh Bank	5	2
	Soneri Bank Limited	15	0
	Standard Chartered Bank (Pakistan) Limited	10	91
	Summit Bank Limited	10	2
	The Bank of Khyber	64	39
	The Bank of Punjab	44	0
	United Bank Limited	38	141
		681	**1013**
Sub Branches	AlBaraka Bank (Pakistan) Limited	14	
	Askari Bank Limited	3	
	BankIslami Pakistan Limited	95	
	Faysal Bank Limited	1	
	Habib Bank Limited	2	
	United Bank Limited	1	
		116	
		1783	

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

Annexure: II

Province wise Break-up of Islamic Banking Branch Network

(As of September 30, 2015)

Type	Bank Name	Azad Kashmir	Balochistan	FATA	Federal Capital	Gilgit-Baltistan	Khyber Pakhtunkhwa	Punjab	Sindh	Grand Total
Islamic Banks	AlBaraka Bank (Pakistan) Limited	2	4		4	1	12	67	31	121
	BankIslami Pakistan Limited	1	10	1	6	2	13	48	42	123
	Burj Bank Limited	1	2		4		3	32	32	74
	Dubai Islamic Bank Pakistan Limited	1	5		8		9	73	78	174
	Meezan Bank Limited	6	18		23	1	35	245	166	494
	IB. Total	**11**	**39**	**1**	**45**	**4**	**72**	**465**	**349**	**986**
Islamic Branches of Conventional Banks	Allied Bank Limited		2		1		1	10	1	15
	Askari Bank Limited		2		7	1	8	38	15	71
	Bank AL Habib Limited		1				2	8	17	28
	Bank Alfalah Limited	1	5		9		8	94	40	157
	Faysal Bank Limited		2		3		16	27	15	63
	Habib Bank Limited	2	2	1	4		4	20	11	44
	Habib Metropolitan Bank Limited				1		3	8	8	20
	MCB Bank Limited		1		2		2	17	12	34
	National Bank of Pakistan	2	1	1	1		9	29	10	53
	Silkbank Limited		1		1		2	4	2	10
	Sindh Bank						1	3	1	5
	Soneri Bank Limited		1		2	1	1	6	4	15
	Standard Chartered Bank (Pakistan) Limited				1		1	2	6	10
	Summit Bank Limited		1		1	2	1	1	4	10
	The Bank of Khyber		3	3	2		44	9	3	64
	The Bank of Punjab	1			4		6	33		44
	United Bank Limited	1	4		1		9	11	12	38
	SAIBBs Total	**7**	**26**	**5**	**40**	**4**	**118**	**320**	**161**	**681**
Sub Branches	AlBaraka Bank (Pakistan) Limited				1			12	1	14
	Askari Bank Limited		1				1	1		3
	BankIslami Pakistan Limited	1	6		8		4	32	44	95
	Faysal Bank Limited							1		1
	Habib Bank Limited								2	2
	United Bank Limited						1			1
	Sub Branches Total	**1**	**7**	**-**	**9**	**-**	**6**	**46**	**47**	**116**
Grand Total		**19**	**72**	**6**	**94**	**8**	**196**	**831**	**557**	**1,783**

Annexure: III

District wise Break-up of Islamic Banking Branch Network

(As of September 30, 2015)

S. No	Province	District	No of Branches		S. No	Province	District	No of Branches
1	Sindh	Badin	3		55	Khyber Pakhtunkhwa	Abottabad	14
2		Dadu	4		56		Banu	4
3		Ghotki	2		57		Batagram	4
4		Hyderabad	32		58		Buner	2
5		Jacobabad	2		59		Charsadda	5
6		Jamshoro	1		60		Chitral	5
7		Karachi City	466		61		Dera Ismail Khan	8
8		Larkana	4		62		Hangu	3
9		Matiari	1		63		Haripur	6
10		Mirpurkhas	7		64		Kohat	6
11		Naushero Feroze	1		65		Lower Dir	3
12		Nawabshah	7		66		Malakand	2
13		Sanghar	6		67		Mansehra	13
14		Shahdadkot	2		68		Mardan	14
15		Sukkur	11		69		Nowshera	14
16		Tando Allahyar	5		70		Peshawar	64
17		Tando Mohammad Khan	1		71		Shangla	1
18		Umer Kot	2		72		Swabi	5
Sindh Total			**557**		73		Swat	15
19	Punjab	Attock	14		74		Tank	1
20		Bahawalnagar	12		75		Upper Dir	7
21		Bahawalpur	11		**KP Total**			**196**
22		Bhakkar	1		76	Gilgit-Baltistan	Baltistan	2
23		Chakwal	8		77		Diamir	4
24		Chiniot	1		78		Gilgit	2
25		Dera Ghazi Khan	11			**GB Total**		**8**
26		Faisalabad	72		79	FATA	Bajaur Agency	1
27		Gujranwala	35		80		Khyber Agency	2
28		Gujrat	31		81		Orakzai Agency	3
29		Hafizabad	3		**FATA Total**			**6**
30		Jhang	7		82	**Capital**	Islamabad	94
31		Jhelum	10			**Capital**		**94**
32		Kasur	9		83	Balochistan	Chagi	1
33		Khanewal	15		84		Gawadar	1
34		Khushab	5		85		Kila Abdullah	5
35		Lahore City	276		86		Killa Saifullah	4
36		Layyah	2		87		Lasbela	3
37		Lodhran	3		88		Loralai	8
38		Mandi Bahauddin	5		89		Pishin	1
39		Mianwali	5		90		Quetta	46
40		Multan	55		91		Zhob	3
41		Muzaffargarh	6		**Balochistan Total**			**72**
42		Nankana Sahib	1		92	**Azad Kashmir**	Bhimber	1
43		Narowal	1		93		Kotli	1
44		Okara	11		94		Mirpur	11
45		Pakpattan	5		95		Muzaffarabad	4
46		Rahim Yar Khan	20		96		Poonch	2
47		Rajanpur	1		**AJK Total**			**19**
48		Rawalpindi	105		**Grand Total**			**1783**
49		Sahiwal	15					
50		Sargodha	22					
51		Sheikhupura	14					
52		Sialkot	25					
53		Toba Tek Singh	5					
54		Vehari	9					
Punjab Total			**831**					