# Islamic Banking Bulletin

## September 2019

**Islamic Banking Department**
**State Bank of Pakistan**

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# Islamic Banking Industry - Progress & Market Share

## Overview

Assets of Islamic banking industry increased by around Rs. 3 billion during the quarter July to September, 2019 and stood at Rs. 2,995 billion by September 30, 2019. Deposits of Islamic banking industry were recorded at Rs. 2,407 billion by end September, 2019. Market share of Islamic banking assets and deposits in the overall banking industry was recorded at 13.8 percent and 16.1 percent, respectively by end September, 2019 **(see Table 1)**. Profit before tax of Islamic banking industry was recorded at Rs. 46 billion by end September, 2019.

**Table 1: Industry Progress* and Market Share**

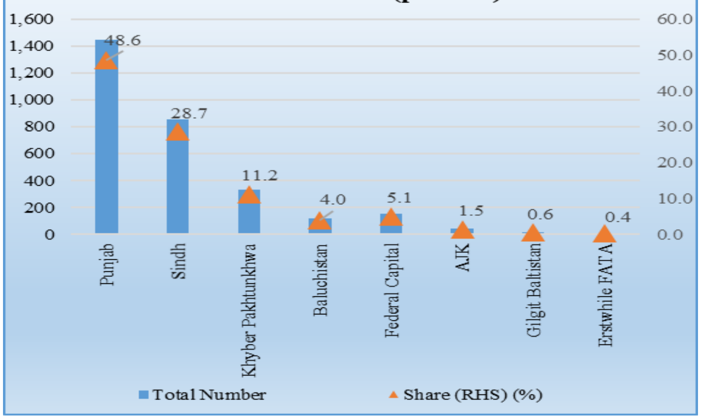
| Particulars | Industry Progress | | | YoY Growth (%) | Share in Overall Banking Industry (%) | | |
|---|---|---|---|---|---|---|---|
| | **Sep-18** | **Jun-19** | **Sep-19** | **Sep-19** | **Sep-18** | **Jun-19** | **Sep-19** |
| **Assets** (Rupees in billion) | 2,458 | 2,992 | 2,995 | 21.8 | 13.6 | 14.4 | 13.8 |
| **Deposits** (Rupees in billion) | 2,005 | 2,415 | 2,407 | 20.1 | 14.7 | 15.9 | 16.1 |
| **Number of Islamic banking institutions** | 21 | 22 | 22 | - | - | - | - |
| **Number of Islamic banking branches**** | 2,709 | 2,913 | 2,979 | 10.0 | - | - | - |

**Source**: Data submitted by banks under quarterly Reporting Chart of Accounts (RCOA)
*Figures in this bulletin are rounded off
**Including sub-branches

## Branch Network of Islamic Banking Industry

The network of Islamic banking industry consisted of 22 Islamic banking institutions; 5 full-fledged Islamic banks (IBs) and 17 conventional banks having standalone Islamic banking branches (IBBs) with 2,979 branches spread across 115 districts by end September, 2019. The number of Islamic banking windows operated by conventional banks having IBBs stood at 1,353 (see **Figure 1** and **Annexure I** for details).

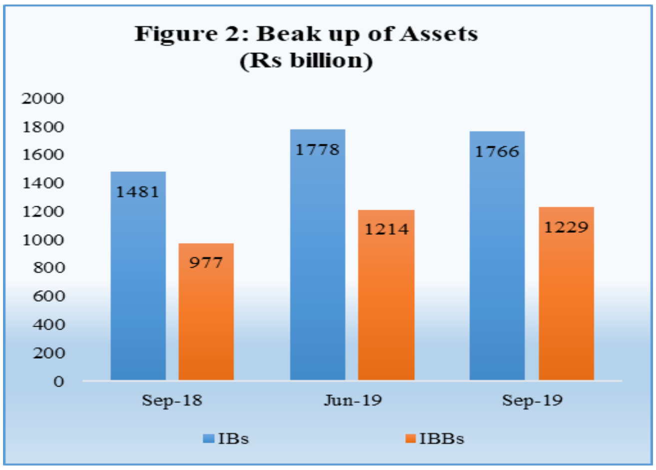
**Figure 1: Region Wise Branches (number) & Relative Shares (percent)**




## Asset and Liability Structure

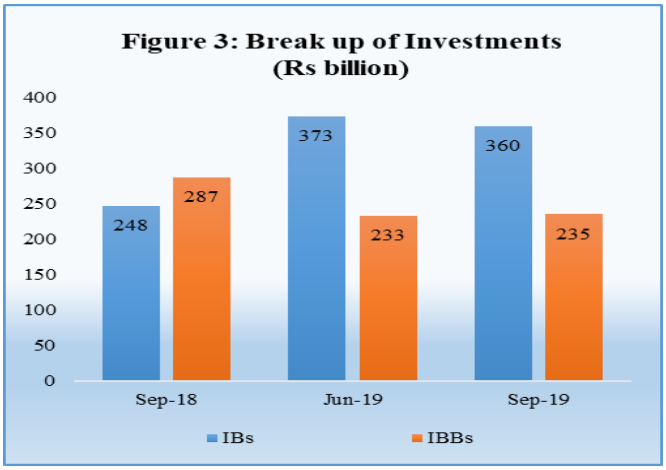
**Assets:** Assets of Islamic banking industry increased by Rs. 3 billion during the quarter July to September, 2019 and were recorded at Rs. 2,995 billion, compared to Rs. 2,992 billion in the previous quarter. Market share of Islamic banking industry's assets in overall banking industry's assets was recorded at 13.8 percent by end September, 2019. The share of financing and investments (net) in total assets of Islamic banking industry stood at 51.6 percent and 19.9 percent, respectively by end September, 2019 (see section below on **Investments, Financing and Related Assets** for details).

Bifurcation of assets among IBs and IBBs reveals (see **Figure 2**) that assets of full-fledged Islamic banks were recorded at Rs. 1,766 billion while assets of IBBs increased by around Rs. 15 billion and were recorded at Rs. 1,229 billion by end September, 2019. In terms of share, IBs accounted for 59 percent and IBBs 41 percent share in overall assets of Islamic banking industry during the period under review.




## Investments

Investments (net) of Islamic banking industry were recorded at Rs. 595 billion by end September, 2019 compared to Rs. 606 billion in the previous quarter. During the period under review, investments (net) of IBs declined by around Rs. 13 billion while that of IBBs increased by Rs. 2 billion (see **Figure 3**). Lack of Shariah compliant investment avenues can be one of the major reasons for decline in investments of the Islamic banking industry during the period under review.




## Financing and Related Assets

Financing and related assets (net) of Islamic banking industry increased by Rs. 2 billion to reach Rs. 1,546 billion by end September, 2019. Breakup of financing and related assets (net) among full-fledged Islamic banks and Islamic banking branches of conventional banks reveals that financing and related assets (net) of IBs declined by Rs. 15 billion during the period under review and stood at Rs 895 billion. Financing and related assets (net) of IBBs grew by Rs. 17 billion and were registered at Rs. 651 billion by end September, 2019 compared to Rs. 634 billion in the previous quarter. In terms of mode wise financing, Diminishing Musharaka continued improving its share in overall financing of Islamic banking industry with its share recorded at 35 percent, followed by Musharaka (20 percent) and Murabaha (13.0 percent) (see **Table 2**).

**Table 2: Financing Mix (% Share)**

| Mode | Sep-18 | Jun-19 | Sep-19 |
|---|---|---|---|
| Murabaha | 12.8 | 13.5 | 13.0 |
| Ijarah | 6.6 | 6.1 | 6.1 |
| Musharaka | 21.5 | 20.0 | 20.0 |
| Diminishing Musharaka | 33.4 | 33.6 | 35.0 |
| Salam | 2.3 | 2.6 | 2.3 |
| Istisna | 7.6 | 8.9 | 8.7 |
| Others | 15.8 | 15.3 | 14.9 |
| **Total** | **100.0** | **100.0** | **100.0** |

**Table 3: Sector Wise Financing Concentration (% Share)**

| | Sep-18 | Jun-19 | Sep-19 | Industry |
|---|---|---|---|---|
| Chemical and Pharmaceuticals | 3.9 | 3.7 | 3.4 | 3.3 |
| Agribusiness | 7.1 | 7.8 | 7.2 | 8.1 |
| Textile | 11.3 | 11.6 | 11.9 | 12.6 |
| Cement | 3.1 | 3.5 | 3.5 | 2.1 |
| Sugar | 3.2 | 3.9 | 2.5 | 2.6 |
| Shoes and leather garments | 0.5 | 0.5 | 0.5 | 0.4 |
| Automobile and transportation equipment | 1.0 | 1.3 | 1.4 | 2.0 |
| Financial | 0.9 | 0.5 | 0.4 | 2.8 |
| Electronics and electrical appliances | 1.3 | 1.2 | 1.1 | 1.4 |
| Production and transmission of energy | 18.0 | 17.9 | 18.3 | 17.0 |
| Individuals | 11.8 | 11.6 | 11.4 | 8.8 |
| Others | 37.9 | 36.5 | 38.4 | 38.9 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |

In terms of sector wise financing, production & transmission of energy remained the leading sector with a share of 18.3 percent in overall financing of Islamic banking industry, followed by textile (11.9 percent) and individuals (11.4 percent) by end September, 2019 (see **Table 3**).

Review of client wise financing reveals that corporate sector accounted for 73.6 percent share in overall financing of Islamic banking industry, followed by commodity financing with a share of 11 percent and consumer financing 10.4 percent. The share of small and medium enterprises (SMEs) financing and agriculture financing in overall financing of Islamic banking industry were recorded at 3.3 percent and 0.4 percent, respectively (see **Table 4**).

**Table 4: Client Wise Financing Portfolio (% Share)**

| Sector | Sep-18 | Jun-19 | Sep-19 | Industry |
|---|---|---|---|---|
| Corporate | 72.7 | 73.5 | 73.6 | 71.2 |
| SMEs | 3.0 | 3.7 | 3.3 | 4.9 |
| Agriculture | 0.3 | 0.5 | 0.4 | 3.9 |
| Consumer Financing | 10.5 | 10.4 | 10.4 | 6.5 |
| Commodity Financing | 11.6 | 10.6 | 11.0 | 9.8 |
| Staff Financing | 1.1 | 1.0 | 1.1 | 1.8 |
| Others | 0.8 | 0.3 | 0.2 | 1.9 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** |

## Asset Quality

Asset quality indicators of Islamic banking industry including non-performing finances (NPFs) to financing (gross) and net NPFs to net financing increased slightly and were recorded at 3.1 percent and 0.9 percent, respectively by end September, 2019 (see **Table 5**). However, these ratios were still lower than those of the overall banking industry averages.

**Table 5: Asset Quality Ratios (%)**

| Ratio | Sep-18 | Jun-19 | Sep-19 | Industry |
|---|---|---|---|---|
| NPFs to Financing (gross) | 2.7 | 2.4 | 3.1 | 8.8 |
| Net NPFs to Net Financing | 0.5 | 0.3 | 0.9 | 1.8 |
| Provisions to NPFs | 82.8 | 87.2 | 72.4 | 80.5 |

## Liabilities

Deposits of Islamic banking industry were recorded at Rs. 2,407 billion by end September, 2019. Market share of Islamic banking industry's deposits in overall banking industry's deposits increased to 16.1 percent by end September, 2019 compared to 15.9 percent in the previous quarter.

The category wise breakup of deposits reveals that fixed deposits increased by 11.3 percent (Rs. 55 billion) while current (non-remunerative), saving and current (remunerative) deposits declined by 5.7 percent, 2.9 percent and 22.2 percent, respectively by end September, 2019 (see **Table 6**).

**Table 6: Break up of Deposits**

| | Rupees in billion | | | Growth (%) | |
|---|---|---|---|---|---|
| | **Sep-18** | **Jun-19** | **Sep-19** | **YoY** | **QoQ** |
| **Customers** | | | | | |
| Fixed Deposits | 425 | 489 | 544 | 27.9 | 11.3 |
| Saving Deposits | 803 | 906 | 880 | 9.6 | -2.9 |
| Current accounts – Remunerative | 9 | 13 | 10 | 23.8 | -22.2 |
| Current accounts - Non-remunerative | 656 | 804 | 759 | 15.6 | -5.7 |
| Others | 14 | 20 | 19 | 37.7 | -0.6 |
| **Sub-total** | **1,907** | **2,232** | **2,212** | **16.0** | **-0.9** |
| | | | | | |
| **Financial Institutions** | | | | | |
| Remunerative Deposits | 95 | 177 | 190 | 100.9 | 7.4 |
| Non-remunerative Deposits | 3 | 6 | 5 | 26.9 | -21.0 |
| **Sub-total** | **98** | **183** | **195** | **98.3** | **6.6** |
| **Total** | **2,005** | **2,415** | **2,407** | **20.1** | **-0.3** |

Breakup of deposits among IBs and IBBs reveals that deposits of full-fledged Islamic banks declined by Rs. 4 billion during the period under review and were recorded at Rs. 1,451 billion by end September, 2019. Similarly, deposits of IBBs declined by Rs. 3 billion and were recorded at Rs. 956 billion by end September, 2019. The share of IBs and IBBs in overall deposits of Islamic banking industry stood at 60.3 percent and 39.7 percent, respectively during the period under review.

## Liquidity

Liquid assets to total assets and liquid assets to total deposits of Islamic banking industry decreased as compared to previous quarter and stood at 19.5 percent and 24.3 percent, respectively by end September, 2019. Financing to deposits ratio (net) of Islamic banking industry was recorded at 64.2 percent by end September, 2019 compared to 53.6 percent of overall banking industry (see **Table 7**).

**Table 7: Liquidity Ratios (%)**

| Ratio | Sep-18 | Jun-19 | Sep-19 | Industry |
|---|---|---|---|---|
| Liquid Asset to Total Assets | 22.8 | 23.2 | 19.5 | 50.8 |
| Liquid Assets to Total Deposits | 27.9 | 28.7 | 24.3 | 73.5 |
| Financing to Deposits (net) | 68.1 | 63.9 | 64.2 | 53.6 |

## Capital

The ratios of Capital to total assets and capital minus net non-performing assets to total assets of Islamic banking industry were recorded at 6.6 percent and 6.1 percent, respectively by end September, 2019 (see **Table 8**). Both the ratios remained lower than those of overall banking industry averages.

**Table 8: Capital Ratios (%)**

| Ratio | Sep-18 | Jun-19 | Sep-19 | Industry |
|---|---|---|---|---|
| Capital to Total Assets | 6.4 | 6.3 | 6.6 | 7.0 |
| (Capital-Net NPAs) to Total Assets | 6.1 | 6.0 | 6.1 | 6.3 |

## Profitability

| Table 9: Profitability & Earning Ratios (%) | | | | |
|---|---|---|---|---|
| | **Sep-18** | **Jun-19** | **Sep-19** | **Industry** |
| Profit Before Tax (Rupees in billion) | 23 | 32 | 46 | 218 |
| Return on Assets (before tax) | 1.3 | 2.3 | 2.1 | 1.4 |
| Return on Equity (before tax) | 20.2 | 35.3 | 33.2 | 19.7 |
| Operating Expense to Gross Income | 65.1 | 52.6 | 52.5 | 57.4 |

Profit before tax of Islamic banking industry was recorded at Rs. 46 billion by end September, 2019. Profitability ratios like return on assets (ROA) and return on equity (ROE) before tax were recorded at 2.1 percent and 33.2 percent, respectively by end September, 2019. During the period under review, operating expense to gross income ratio was recorded at 52.5 percent, compared to 52.6 percent in the previous quarter (see **Table 9**). It is also important noting that this ratio was lower than that of overall banking industry ratio.

# Country Model: Indonesia

**Introduction**

Indonesia, the world fourth most populous country and $16^{th}$ largest area wise, is located in Southeast Asia and composed of some 17,500 islands, of which more than 7,000 are uninhabited. Indonesia is reported to have an impressive economic growth, which is projected to grow at 5.2 percent in 2019. The country's GDP per capita stood at US $3,932 in 2018. Regardless of being home to largest Muslim population in the world, the establishment of Islamic banking in Indonesia is considered late compared to other Muslim majority countries. Islamic banking began in Indonesia with the establishment of Bank Muamalat Indonesia (BMI) in 1992. Islamic banking constitutes 6 percent share of domestic banking assets and 1.9 percent share at global level in 2018. Indonesia is a prominent figure in global sukuk market.

**Islamic Banking and Finance**

The idea of Islamic banking in Indonesia was discussed theoretically until 1960 when Indonesian banks were operating on the basis of interest under banking Law No 14 of 1967. In 1968, a non-governmental Islamic organization named (Muhammadiyah) tried to establish banking institutions in accordance with Islamic rules. However, lack of commitment from Muslim community and governments delayed the establishment of Islamic banking in Indonesia. Later in 1980's, the Indonesian Muslim intellectuals and Ulama re-visited the idea of setting up of Islamic banking in the country. In October 1988, the Indonesian government issued a policy package (PAKTO) which stated that, banking can be established at zero percent interest rate. This policy paved the way for the establishment of Islamic banking in the country. Enforcement of Banking Act No. 7 by Bank Indonesia-the central bank, in 1992, allowed the setting up of Islamic banks in the country. In the same year on May 1, 1992 Bank Muamalat Indonesia (BMI), the first Indonesian Islamic bank, was inaugurated. According to the Otoritas Jasa Keuangan (OJK)-Financial Services Authority, there are now 14 full-fledged Islamic banks, 34 Islamic banking business units/windows and 196 Shariah rural banks with an asset base of IDR 481.174 billion (end July, 2019). Moreover, Islamic microfinance banks in the form of micro Wqaf banks under Act No.21 of 2011 of OJK, are operative in the country. The aim of this innovation is to increase financial inclusion among micro and small enterprises (MSEs) through Islamic boarding schools. Currently there are 33 Micro Waqf banks operating in the country.

**Regulatory Environment**

Bank Indonesia, in 1992, allowed the establishment of Islamic banking through enforcement of Banking Act No. 7 while in 1993, Indonesian Council of Ulama set up an arbitration forum (Badan Arbitrase Muamalat Indonesia) to resolve Islamic finance disputes. Subsequently, a number of legislative changes were made to lay sound legal foundations for Islamic finance industry in the country. In 1999 Bank Indonesia permitted to utilize Shariah compliant instruments as part of the monetary policy. After 1999, the Islamic finance structure in Indonesia started to take shape; the Indonesian Council of Ulama set up the National Shariah Board, an independent body authorized to issue rulings on Shariah products. In 2001, Bank Indonesia created the Islamic Banking Bureau to regulate, supervise and issue license for Islamic banks.

In 2002, Bank Indonesia issued a strategic plan; 'The Blueprint for Islamic Banking Development', detailing clear priorities to create a sound Shariah banking system in the country. The year 2008 is considered to be a groundbreaking year, when Law 21 of 2008, the authoritative law on Islamic finance, was passed in Indonesia. The law covers; company formation, permissible and prohibited form of Islamic transactions, corporate governance and dispute resolution. In 2018, the Financial Services Authority, OJK, also announced various new regulations, including asset management, fintech, sukuk and takaful. Moreover, the government of Indonesia recently launched Shariah Economy Master Plan (MEKSI) 2019-24 and a roadmap aims at strengthening Halal products, Shariah Finance, Micro, Small and Medium Enterprises (MSMEs) and optimizing the digital economy. The Indonesian National Islamic Finance Committee is also drafting a development roadmap for Islamic microfinance institutions, expected to be launched this year.

**Sukuk**

Indonesia is the key player in the global sukuk market. The sukuk issuance in Indonesia began with the first series of Surat Berharga Syariah Negara (SBSN) with the total issuance of IDR 7.51 billion in 2008. Since this initiation, varieties of sukuk have been available in the market making Indonesia as one of the key players in the global sukuk market. Currently, sukuk market of Indonesia consists of Retail Sukuk (SR), Indonesian Global Sukuk (SNI), Pilgrimage Sukuk, Treasury Sukuk (SPN-S), Project Based Sukuk and Saving Sukuk. Indonesia is also the pioneer of first ever-sovereign green sukuk worth US$ 1.25 billion, issued in 2018.

In August 2019, the ministry amended its regulation on the issuance and sale of state sukuk in foreign exchanges in the international primary market to boost the participation of local banks in its sovereign sukuk market. Under this new regulation, domestic financial institutions have been allowed to be joint lead managers of state sukuk even if they only have domestic operations. It is expected that this will assist in enhancing the contribution of Indonesia towards sukuk market.

**Future Outlook**

With growing significance and focus on Islamic banking and finance industry, and having Muslim population of more than 87 percent in Indonesia, there are ample opportunities for the industry to grow in the country. The concerned authorities are also working for creating a conducive environment for Islamic banking and finance through introducing legal amendments. The Islamic banking network is also expected to undergo changes over the next few years, as conventional banks will be required to convert their Islamic windows into separate stand-alone units by 2023. According to Islamic Finance News (October 2019) Islamic finance assets are projected to reach US$ 3.81 billion in 2023 in Indonesia.

**Sources of Information**


- Islamic finance news { www.islamicfinancenews.com}
- Bank of Indonesia website {https://www.bi.go.id/en}
- Otoritas Jasa Keuangan {https://ojk.go.id/id/}
- The World Bank {https://www.worldbank.org/}
- Global Islamic Finance Report{ http://www.gifr.net/gifr}
- Central Intelligence Agency The Fact Book {https://www.cia.gov/the-world-factook/}
- International Islamic Financial Market { http://www.iifm.net}

# Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standard No. 14: Documentary Credit

State Bank of Pakistan, vide IBD Circular No. 01 of 2019, has adopted six AAOIFI Shariah Standards; (i) No. 2 (Debit Card, Charge Card and Credit Card), (ii) No. 5 (Guarantees), (iii) No. 14 (Documentary Credit), (iv) No. 18 (Possession (Qabd)), (v) No. 24 (Syndicated Financing) and (vi) No. 38 (Online Financial Dealings). These standards are being discussed in detail one by one in six issues of quarterly bulletin since January 2019.

In the last issue, standard No. 05 (Guarantees) was discussed while in the current issue, standard No. 14 (Documentary Credit) is discussed below with amendments advised by Shariah Advisory Committee of State Bank of Pakistan. It is important mentioning that amendments that are made in standards are in the form of footnotes.

**Standard**

The Standard was adopted by the AAOIFI Shariah Board in its meeting No. 10 held during 3-8 May 2003 A.D.

**Preface**

The purpose of this standard is to define documentary credits, their characteristics, Shariah rules and regulations so as to facilitate transactions in them by the Islamic financial institution/ institutions[1]).

## 1. Scope of the Standard

This standard covers documentary credit extended by an institution, either on the basis of client orders or for the use of the institution itself, including all types and forms of documentary credit, the various stages of their execution and the relationships created between the parties to the transaction.

## 2. Definition, Types and Characteristics of Documentary Credit

### 2/1 Definition of documentary credit

A documentary credit is a written undertaking by a bank (known as the issuer) given to the seller (the beneficiary) as per the buyer's (applicant's or orderer's) instruction or is issued by the bank for its own use, undertaking to pay up to a specified amount (in cash or through acceptance or discounting of a bill of exchange), within a certain period of time, on condition that the seller presents documents for the goods conforming to the instructions. In brief, a documentary credit is an undertaking by a bank to pay subject to conformity of the documents to the contractual instructions.

### 2/2 Procedural stages of documentary credit

2/2/1- The stage of concluding a credit contract: This stage precedes credit, and the contract concluded is usually a sale contract in which the seller stipulates that the price be paid through documentary credit, however, the contract may be a lease contract, agency with commission or any other contract.

[1] The word (Institution/ lnstitutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

2/2/2- The stage of requesting the opening of credit: At this stage, the buyer requests the bank to open the credit so that the seller can be notified.

2/2/3- The stage of issuing credit and notifying the seller: At this stage, the bank issues and sends the letter of documentary credit to the buyer, either directly or through an intermediary bank.

2/2/4- The stage of executing the credit: At this stage, the beneficiary presents the documents stipulated in the letter of credit to the bank. The bank examines them in accordance with the credit conditions. If the documents conform to instructions, the bank accepts them, executes the credit and delivers the documents to the buyer, in case it is not the institution itself, after the receipt of partial or full payment of the value or receives a deed of commitment to pay on the date of maturity so that the buyer is able to receive the goods represented by the documents. If the documents do not conform to instructions, the bank reserves the right to accept, reject or seek amendment of the documents.

2/2/5- Coverage by correspondents: If more than one bank participate in the execution of credit, the accounts are settled in accordance with the terms of coverage agreed upon between the banks.

**2/3-Types of documentary credit**

**2/3/1- Basic classification**

Documentary credit is classified, according to the strength of the undertaking into two types; namely (I) revocable credit, which can be amended or cancelled without consulting the beneficiary, and (II) irrevocable credit, which cannot be amended or cancelled without the consent of the parties.

**2/3/3- Other classifications**

There are other classifications of documentary credit. These include the following:

- Transferable documentary credit: This credit entitles the beneficiary to request the executing bank to make the credit available, partially or totally, to another beneficiary or beneficiaries.
- Back-to-back credit, which means the credit issued is guaranteed by another credit.
- Revolving or renewable credit, which means the beneficiary, can repeatedly submit new documents for new operations within the limits of the credit amount and during its permissibility.
- Red clause or advance payment credit whereby the bank is allowed to pay a certain percentage of the credit before submission of the documents, against an undertaking by the beneficiary to repay that amount if the goods are not shipped or the beneficiary fails to use the credit during the period of its permissibility. Such payment may be made against a letter of guarantee from the beneficiary.
- Import and export credit (depending on the issuing bank).
- Local and foreign credit.
- Confirmed and non-confirmed credits.
- Partial shipment and a non-partial shipment credit.
- On sight or immediate payment credit, deferred payment credit, acceptance credit and negotiable credit.
- Syndicated credit (partnership credit), which describes the state of participation by more than one bank due to the huge amount of credit granted with each bank providing a letter of guarantee, to the extent of its participation, to the leading bank.
- Standby credit (guarantee credit). This credit resembles letters of guarantee with a clause that payment is conditional upon beneficiary's (in this case the contractor's) failure to perform.

**2/4- Characteristics of documentary credit**

2/4/1- Dealing in documentary credit takes place on the basis of the documents alone and is executed without reference to the goods. Documentary credit, in essence, makes it binding for the bank to execute the credit whenever the beneficiary presents, within the duration of the validity of the contract, the documents required by the credit and conforming to the instructions.

2/4/2- Opening of credit by the buyer (orderer), though it may be acted upon with certainty, is not considered a final payment of the price of the goods. The buyer remains liable for the payment until the bank pays the value of the documents, however, the seller (beneficiary) does not have a right to request payment from the buyer as long as the credit subsists and is valid. If the credit expires before the submission of the documents, the seller has the right to claim payment directly from the buyer, because expiry of the credit in itself does not amount to revocation of the sale contract.

2/4/3- The bank is obliged to pay the value of the credit to the beneficiary when the latter presents the documents that conform to instructions, except upon proof of fraud or forgery of the documents, or in the case of a court decision declaring the sale contract null and void.

2/4/4- Interpretation of the duties and obligations of the parties to documentary credit are subject to International Commercial Terms (INCOTERMS 2000) and the Uniform Customs and Practices for Documentary Credit (UCP 500) when reference is made to INCOTERMS in the sale contract and to UCP in documentary credit.

## 3. Shariah Ruling on Documentary Credit

**3/1- Permissibility of documentary credit**

3/1/1- Dealing in documentary credit includes agency for providing procedural services, the most important of which is the examination of documents, and the provision of institutional guarantee to the importer. As both agency and guarantee, contracts are permissible, documentary credit becomes permissible subject to the conditions stipulated in this standard.

3/1/2- Opening of all types of documentary credit, its issuance and confirmation, on the basis of the client's order or for the institution itself, are permitted to an Institution. It is also permissible to an institution to participate, or play an intermediary role, in such dealings and to notify, amend or execute in any way such credit, either for its own use or on behalf of another institution or bank, according to the available forms of executing documentary credit, subject to item (3/1/3) below.

3/1/3- It is not permissible for the institution to undertake transactions in documentary credit, in accordance with what is stated in item (3/1/2), either for itself or on behalf of another as a client or institution or by way of collaboration, when such credit pertains to goods that are prohibited by the Shariah, or is based on a contract that is void or irregular (according to the Shariah) due to vitiating conditions or includes interest, either charged or paid, whether explicitly as in the case of loan upon payment by the beneficiary of amounts not fully or partially covered in similar credit, or impliedly, as in the case of discounts or trading (payment) on bills of exchange with deferred and delayed payments.

It is stipulated for the permissibility of the subject of documentary credit that the contract upon which reliance is placed be a contract that is valid in the Shariah insofar as its elements, conditions and type of transaction, whether currency exchange, ordinary sale or another, are concerned, and also with respect to its specific additional conditions.

3/1/4- The bank is obliged to execute the credit when it conforms to instructions, except upon proof of fraud or forgery of the documents, in which case it is under no obligation to execute it. Provided that if the contract concluded prior to opening of documentary credit is nullified by a court decision, the execution of the credit is subject to a new agreement.

**3/2- The contract preceding the opening of credit**

3/2/1- It is permissible for the seller to stipulate in the sale contract that payment be made through documentary credit. Such a condition is-valid and its performance is binding upon-the buyer.

3/2/2- It is permissible to secure international transactions using documentary credit provided that the secured transactions do not violate the rules of the Shariah.

3/2/3- When the contract stipulates that its interpretation is subject to INCOTERMS (issue 2000) or the United Nation's Convention in respect of the International sale of goods or any other reference, then-such potential interpretation is circumscribed with a condition that it must not violate the rules of the Shariah. [See item 3/2/2]

**3/3- Commissions and expenses in documentary credit**

3/3/1- It is permissible for the institution to charge actual expenses incurred in issuing documentary credit. It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount, provided that the duration of the credit is not considered in determining the commission. This rule applies to services rendered for both import and export credit, except where the amendment involves a rescheduling of the duration of the credit facility. It is, therefore, permissible for the institution to charge only the actual expenses incurred, in which case it will be a definite sum and not a percentage.

The Institution must abide by the following conditions:

a) The aspect of guarantee per se must not be taken into account when estimating fees for documentary credit. Accordingly, it is not permissible for an institution to charge an amount in addition to the actual expenses incurred if it endorses a credit facility issued by another bank, because endorsing a credit facility is an addition over guarantee. The rule for endorsement applies to participation in the issuance and endorsement of credit as well as issuance of standby credit (guarantee credit), as long as services or obligations are not required.

b) The issuance of a credit facility should not involve Riba bearing profits or become a means for such profits.

c) It is not permissible to use a combination of contracts in documentary credit as an excuse for involvement in the prohibited transactions, such as taking a commission for providing a guarantee or extending a loan.

3/3/2- The rule of item 3/3/1 above equally applies to receiving or payment of commissions and expenses and in a situation where the institution acts as an intermediary in these respects, irrespective of whether the transaction is between the institution and its client (the orderer or beneficiary) or between the institution and other institutions and banks.

3/3/3- The ruling of commission for providing letters of guarantee that was stated in the Shariah Standard No. (5) on Guarantees must be applied when determining commissions for the letters of guarantee that accompany documentary credits, such as letters of guarantee provided in the case of advance payment of a portion of the amount or the shipping guarantee that is issued for releasing the goods before the arrival of documents.

**3/4- Guarantees in documentary credits**

3/4/1- It is permissible for the institution to secure the obligations arising out of documentary credit, or to provide documentary credit as security for payment in favour of institutions and banks dealing with it. The institution may act as an intermediary for facilitating documentary credit using other permissible and acceptable forms of guarantee. It is, therefore, permissible to use a number of means as a cover for documentary credit including cash, freezing of permissible accounts and negotiable instruments valid according to the Shariah, certificates of shares in real estate and withholding the documents of the credit that stand for the goods.

The cover of a documentary credit may be also one of the following: a transferable letter of credit; a back-to-back letter of credit; a letter of guarantee issued by the bank of the beneficiary against the advance payment in case of advanced payment credits; a letter of guarantee issued by a bank participating in the issuance or confirmation of the credit; relinquishment receivables and commercial-papers, such as bill of exchange and promissory notes. This item must be read together with item 3/4/2 below.

3/4/2- It is not permissible for the institution to accept the following types of guarantees: interest-based bonds, shares of companies that deal in prohibited activities, and interest-based receivables. It is also not permissible for the institution to provide any of these guarantees as security for its obligation to other institutions or banks or to act as an intermediary to facilitate such guarantees.

3/4/3- It is permissible for the institution and the applicant for documentary credit to agree on investing the cash cover of the credit in accordance with Mudarabah partnership.

**3/5 Murabahah transactions in documentary credit**

When a client intends to purchase imported goods from the institution through Murabahah financing of the documentary credit, the following must be observed:

3/5/1- Opening of documentary credit should not precede the conclusion of the sale contract between the orderer and the beneficiary (the seller) irrespective of the orderer having taken possession of the goods that are the subject matter of the contract.

3/5/2- Institution should be the party who purchases from the supplier, and then sells to the client through Murabahah as per the rulings stated in Shariah Standard No. (8) on Murabahah, while taking into account item 2/2/2 in respect to cancellation of contract and item 3/1/3 in respect to agency in Murabahah.

**3/6- Musharakah contract with the client to finance documentary credit for imported goods**

3/6/1- In case the institution signs a partnership contract with the client to purchase goods prior to the opening of credit and before the client concludes a sale contract with the supplier, it is permissible to open the credit in the name of either partner. It is permissible for the institution, after receipt of the goods, to sell its share to a third party or to its partner through a spot or deferred payment. Murabahah on the condition that the sale to the partner is not based on an earlier exchange of binding promises or stipulated in the Musharakah contract.

3/6/2- It is permissible for the institution to sign a partnership contract with the client in respect of goods purchased by the client on the condition that the institution does not sell its share to the client on a deferred payment basis.

**3/7- General rules**

3/7/1- If the credit transaction includes a provision that it is subject to the prevalent principles and practices that unify documentary credit, it is necessary to qualify such a statement with the stipulation that it will not violate Shariah rules and principles. It is preferable that the institution presents alternatives that could be agreed upon between the institution and the correspondent banks.

It is a requirement to explicitly state that a provision stipulating interest will not be acted upon, and also for trading activities that contravene the provisions of the Shariah. For valid substitutes. [See Shariah Standard No. (17) On Commercial Papers,-items-5/2-and- 5/3]

3/7/2- It is not permissible for the institution to discount accepted bills of exchange, i.e. to purchase these bills before maturity at less than their nominal value.

3/7/3- It is not permissible for the institution to trade in deferred payment documents or accepted bills of exchange, i.e. to purchase these instruments at less than their nominal value. It is also not permissible for the institution to act as an intermediary, whether by payment or notification, between the beneficiary and the issuing or confirming bank to facilitate such dealings.

3/7/4- It is not permissible for the institution to negotiate, for less than their nominal value, documents payable on sight or payable bills of exchange.

3/7/5- It is not permissible for the institution, as far as possible, to present bills of exchange that it undertakes to pay to clients whose debts to the institution are represented by these bills, to get them discounted by other banks that may accept them.

3/7/6- The institution should arrange its relationships with other institutions and correspondent banks on the basis of non-payment of interest and avoidance of prohibited transactions with respect to covering operations between the correspondent banks when such relationships involve settlement of interbank obligations resulting from documentary credit and other banking operations.

**Adoption of the Standard in Pakistan**

Following amendments in the form of footnotes have been made in the standard for its adoption in the country.

| Clause No. | Original clause | Clarifications/amendments |
|---|---|---|
| 2/2/3 | The stage of issuing credit and notifying the seller: At this stage, the bank issues and sends the letter of documentary credit to the buyer, either directly or through an intermediary bank. | The term ‘buyer’ should be read as ‘seller’. |
| 3/1/1 | Dealing in documentary credit includes agency for providing procedural services, the most important of which is the examination of documents, and the provision of institutional guarantee to the importer. As both agency and guarantee, contracts are permissible, documentary credit becomes permissible subject to the conditions stipulated in this standard. | In this clause the text ‘and the provision of institutional guarantee to the importer’ should be read as ‘and the provision of institutional guarantee for the importer.’ |

| | | |
|---|---|---|
| 3/3/1 | It is permissible for the institution to charge actual expenses incurred in issuing documentary credit It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount, provided that the duration of the credit is not considered in determining the commission. This rule applies to services rendered for both import and export credit, except where the amendment involves a rescheduling of the duration of the credit facility. It is, therefore, permissible for the institution to charge only the actual expenses incurred, in which case it will be a definite sum and not a percentage. | The first para of the clause should be read as: 'It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount. This rule applies to services rendered for both import and export credit and amendments therein, except where the amendment is only rescheduling of the duration of the letter of credit/documentary credit and in this case, it is permissible for the institution to charge only the actual expenses incurred. It will be a definite sum and not a percentage.' |
| 3/3/1<br>(a&b**)** | a) The aspect of guarantee per se must not be taken into account when estimating fees for documentary credit. Accordingly, it is not permissible for an institution to charge an amount in addition to the actual expenses incurred if it endorses a credit facility issued by another bank, because endorsing a credit facility is an addition over guarantee. The rule for endorsement applies to participation in the issuance and endorsement of credit as well as issuance of standby credit (guarantee credit), as long as services or obligations are not required.<br>b) The issuance of a credit facility should not involve Riba bearing profits or become a means for such profits. | The term 'credit facility' should be read as 'letter of credit/documentary credit'. |
| 3/4/2 | It is not permissible for the institution to accept the following types of guarantees: interest-based bonds, shares of companies that deal in prohibited activities, and interest-based receivables. It is also not permissible for the institution to provide any of these guarantees as security for its obligation to other institutions or banks or to act as an intermediary to facilitate such guarantees. | The clause should be read as: 'The interest bearing debt instruments (Shariah non-compliant) may be accepted up to the issued price (Ras-Ul- Maal) or face value, whichever is less, of the instrument'. |
| 3/5 | When a client intends to purchase imported goods from the institution through Murabahah financing of the documentary credit. | The clause 3/5 is also applicable in documentary credit issued on the basis of Musawamah. |

| | | |
|---|---|---|
| 3/5/1 | Opening of documentary credit should not precede the conclusion of the sale contract between the orderer and the beneficiary (the seller) irrespective of the orderer having taken possession of the goods that are the subject-matter of the contract. | The word 'not' is expunged before the word 'precede'. |
| 3/7/1 | If the credit transaction includes a provision that it is subject to the prevalent principles and practices that unify documentary credit, it is necessary to qualify such a statement with the stipulation that it will not violate Shari'ah rules and principles. It is preferable that the institution presents alternatives that could be agreed upon between the institution and the correspondent banks.<br>It is a requirement to explicitly state that a provision stipulating interest will not be acted upon, and also for trading activities that contravene the provisions of the Shariah For valid substitutes. | The qualifying statement prescribed in this clause should preferably be included in the documentary credit or at least in letter of credit form. |

**Source:**
AAOIFI website: http://aaoifi.com/
IBD Circular No. 01 2019, March 01, 2019 {http://www.sbp.org.pk/ibd/2019/C1.htm}

# Events and Developments at Islamic Banking Department (IBD)-SBP

## Events

- **AAOIFI's Public Hearing Session**

IBD organized AAOIFI's public hearing session on two exposure drafts, i.e. i) Code of Ethics for Islamic Finance Professionals and ii) Waqf Governance. The session was organized at State Bank of Pakistan Karachi on September 24, 2019. Leading Shariah scholars and senior Islamic bankers attended the session from Pakistan. Mr. Omar Mustafa Ansari, Secretary General AAOIFI also graced the occasion. The session yielded fruitful discussions on both the exposure drafts of AAOIFI.

- **Islamic Banking Certificate Course for Shariah Scholars**

In pursuit of up-scaling capacity levels of Shariah scholars serving Islamic banking industry, IBD, in collaboration with National Institute of Banking and Finance (NIBAF), launched a comprehensive certification course exclusively for Shariah scholars. The certification program comprises of ten modules of two-days each, covering various important topics. The second iteration of the certification program was successfully conducted on August 26, 2019. The program was divided in three stages, each stage comprising of three/four modules. Certificates were awarded to only those participants who qualified the examination with necessary passing percentage.

# Islamic Banking News and Views

## A. Local Industry News

### SBP continues limits of Islamic facilities

State Bank of Pakistan (SBP) has announced in a statement that it has decided to continue the limits of the Islamic export refinance scheme (IERS) and the Islamic long-term financing facility (ILTFF), among others. The limits sanctioned by banks to individual exporters under Part II of the IERS for the year 2018–19 shall continue up to 31 August 2019 whereas for the ILTFF, the SBP has decided to continue the existing limits until fresh limits for the 2019-20 financial year are notified.
https://www.islamicfinancenews.com

### Ajman Bank arranges Islamic financing for Pakistan

UAE-based Ajman Bank has solely arranged an Islamic syndicated financing worth US$275 million for the government of Pakistan, Reuters reported. A number of banks participated in the one-year facility, which follows the Murabahah structure.
https://www.islamicfinancenews.com

### A new initiative of Bank of Khyber (BOK)

The Bank of Khyber (BOK) has taken the initiative to provide banking, particularly Islamic banking services to unserved areas of tribal districts. Recently, the BOK chalked out a comprehensive plan to set up new Islamic and conventional branches to provide state-of the-art banking services to tribesmen through the latest technology and trained human resources at their doorstep. The BOK is confident that this initiative will not only encourage the faith-based voluntarily financially excluded segment to become part of the formal sector but also significantly contribute to the improvement of employment opportunities, income-generating activities and poverty alleviation.
https://www.islamicfinancenews.com

### Pakistan plans sukuk and Eurobond program

The government of Pakistan is gearing up to roll out a medium-term note program covering sukuk and Eurobonds for an initial period of one year. According to Business Recorder, citing sources from the Finance Division, the division has sought the federal cabinet’s approval to set up and execute the program.
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### State Bank of Pakistan introduces new Islamic refinancing scheme for eight SME industries

As part of Prime Minister Imran Khan’s efforts to address the nation’s economy and his promise to facilitate the rapid growth of SMEs, boost green growth and unleash Pakistan’s potential in various sectors, SBP has included eight sectors under its new Islamic refinancing scheme for SMEs, in a bid to solidify the bridge between Shariah compliant financing and SME sectors. The sectors included are information technology; furniture; surgical goods; dates processing; gems and jewelry; leather; fruits, vegetables and food processing and packaging; as well as printing and packaging. Named the Islamic Refinance Scheme for Working Capital Financing of Small Enterprises and Low-End Medium Enterprises (IWCF), the initiative uses the Mudarabah structure. The scheme has a tenor of one year.

Medium enterprises with an annual sales turnover of up to PKR300 million (US$1.87 million) are eligible under the scheme, with the maximum financing limit at PKR50 million (US$312,256).
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**SECP approves Murabahah share financing regulations**

The Securities and Exchange Commission of Pakistan (SECP) has approved the regulations for Murabahah share financing. The SECP has directed the National Clearing Company of Pakistan to provide a platform to extend credit for Shariah compliant share financing and to make the necessary arrangements for system development and integration with the Central Depository Company and the Pakistan Stock Exchange by the 2nd September 2019.
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**PSX approves listing of Islamic hybrid fund**

The Pakistan Stock Exchange (PSX) announced in a statement that it has approved the formal listing and quotation of the units of the JS Islamic Hybrid Fund of Funds - 3, an open-ended mutual fund, effective from 25 September 2019.
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## B. International Industry News

**Kyrgyzstan's central bank approves instructions for working with Islamic bank accounts and deposits**

The board of directors of Kyrgyzstan's central bank, the National Bank of the Kyrgyz Republic, has approved the instructions for working with bank accounts and accounts for bank deposits opened in accordance with Islamic principles of banking and financing. The instructions define the minimum requirements for working with bank accounts and bank deposit accounts opened in accordance with the Islamic principles of banking and financing and the procedure for conducting transactions on them. They apply to banks and deposit-taking microfinance companies and credit unions that operate in accordance with the Islamic principles of banking and finance, including within the framework of the Islamic window.
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**Equitativa to launch Belt and Road Islamic REIT**

Capturing the imagination of many, China's Belt and Road Initiative has sparked a flurry of projects and birthed new opportunities for Islamic finance, including in the REIT segment as the world's largest Islamic REIT manager considers establishing a Shariah compliant vehicle leveraging on the multitrillion-dollar initiative as part of its aggressive emerging markets focused expansion strategy. Equitativa Group, which manages over US$2 billion in assets, is working on diversifying its REIT pool and exposure to cover a wider geographic footprint and asset profile. The group, which boasts Emirates REIT (the largest Islamic REIT globally) and The Residential REIT (the first Shariah compliant residential REIT) as part of its portfolio, has its eyes set on new markets beyond the UAE and the GCC region.
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**Two years post-sukuk test, Russia is ready to debut sukuk**

Following a test sukuk facility in 2017, the Russian wheels are being greased again with a potential Islamic corporate issuance to fund its agriculture industry. The sukuk, currently in the planning stage, the push the country needs to establish a sound Shariah compliant debt capital market, the sukuk issuance is expected to be US$5–15 billion in size. It will be potentially floated by Agrofin Sever Yug, an SPV of the Higher School of Economics (HSE), and the team behind the sukuk project. The sukuk facility, which may come with a three year repayment period, is expected to onboard investors from Oman, Qatar, Kuwait, Saudi Arabia and Lebanon, among others. The sukuk paper is planned to be structured under the Salam structure, while Musharakah, Mudarabah or hybrid structures are also being considered.
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**Growth of Islamic capital market on right track in first semester of 2019**

At the end of 2018, observers mostly estimated that the growth of the Indonesian economy would be disturbed by the presidential election with no exception for the Islamic capital market in 2019. According to the data for the first semester, it turns out that their predictions were not right. The growth of the Indonesian Islamic capital market is on the right track with all indicators showing quite a good performance. Although the market experienced several shocks caused by the trade war between the US and China, as well as the domestic issue regarding the presidential election, the fluctuation of Islamic-based stock prices at the Indonesia Stock Exchange (IDX) was relatively stable.
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**The Central Advisory Board of Turkey prepares to issue new standards**

In recent years, countries such as Malaysia, Indonesia, Bahrain and Pakistan have established a National Shariah Board under the related regulatory authority of their countries and in May 2018, Turkey joined the list with the establishment of the Central Advisory Board (the Board), which was a long-awaited development for the industry. Before the Board was established, for more than 30 years Islamic financial institutions in Turkey operated with the approval of their own advisory board, which caused conflicting opinions among banks. The Board, set up with a decision of the Banking Regulation and Supervision Agency (BRSA) under the Participation Banks Association of Turkey, is an independent board whose decisions are binding on Islamic financial institutions. The Board not only serves participation banks but also other financial institutions that operate on an interest-free structure.
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**Jersey tax authority delivers landmark ruling on Tawarruq transactions**

The Profits from commodity Murabahah contracts will be tax-free in Jersey as the off shore center makes a landmark move to level the playing field for Islamic finance. The ruling issued by Revenue Jersey was secured by VG, a Jersey-based fiduciary service provider in cooperation with other local parties. The Statement of Practice declares that the provisions of Article 123 D(4)(e) will not be in the context of Shariah compliant funding structures utilizing Tawarruq/ Murabahah contracts and confirms the equality of treatment between Islamic funding structures and the treatment of loans between Jersey SPVs established to facilitate financing in the conventional markets.
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**Japan takes a step forward in expanding Islamic finance**

Since 2011, Japan has changed its financial regulations to create an environment in which Islamic bonds can be issued in the country. For example, sukuk issued under an Ijarah structure are defined as a bond-like beneficial interest under the Asset Securitization Act. In addition, institutional changes were made to make it easier for foreign investors, particularly those from the Islamic world, to purchase sukuk issued in Japan. Because of this institutional response, several Islamic bonds have been issued in Japan.

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**IILM reissues three tranches of dollar sukuk**

The International Islamic Liquidity Management Corporation (IILM) has reissued three tranches of its short-term sukuk amounting to US$1.05 billion. The issuance consists of a US$250 million tranche with a one-month tenor at a profit rate of 2.25%; a US$400 million tranche with a three-month tenor at a profit rate of 2.3%; and a US$400 million tranche with a six-month tenor at a profit rate of 2.25%. Purchases of the sukuk by Islamic primary dealers amounted to 54%, 92% and 25% for the one-month, three-month and six-month papers, respectively. The allocation of GCC-based primary dealers stood at 46%, 79% and 50% for the one-month, three-month and six-month instruments respectively.

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**AAOIFI rolls out standard on risk reserves**

The accounting board of AAOIFI has issued its financial accounting standard (FAS) No 35 'Risk Reserves'. The standard was finalized by the board after conducting extensive discussions and industry consultations, which included inviting and evaluating industry participants and regulators through public hearings, according to a statement.

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**IFSB publishes DFS of member countries**

The IFSB has announced in a statement that it has released the first dissemination of country-level data on detailed financial statements (DFS) of the Islamic banking systems for the third quarter of 2017 and the four quarters of 2018. The publication includes data from seven of the 24 Prudential and Structural Islamic Financial Indicators (PSIFIs) member countries, namely Afghanistan, Bangladesh, Malaysia, Pakistan, Palestine, Turkey and the UAE. Data on each country covers three types of statements: (i) income and expense statements, (ii) consolidated statement of financial position, and (iii) memorandum items. The IFSB expects the number of PSIFIs member countries for reporting DFS data will increase gradually.

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**Islamic banking to grow in CIS**

Islamic banking will grow substantially in Commonwealth of Independent States (CIS) in the next five years from a very low base, driven by government initiatives to nurture the sector, Moody's Investors Service noted in a report. "Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan are set to lead this expansion of Islamic banking," said Svetlana Pavlova, an assistant vice-president and analyst at Moody's. "These countries have large Muslim populations, and are notable for their governments' commitment and progress in establishing better legal and regulatory infrastructure for Islamic finance.

Kazakhstan and Kyrgyzstan target to increase the share of Islamic banking from 0.2% and 1.4% to 3% and 5% by 2025 and 2021, respectively.
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**Indonesia to soft launch national Shariah digital payment system**

Indonesia's National Islamic Finance Committee (KNKS) expects to soft launch a Shariah compliant digital payment system soon as part of its multipronged five-year Islamic economy master plan to become a preferred global hub of the Halal industry. The Shariah version of LinkAja has been in development over the last four months. Instead of having conventional banks as part of the payment settlement process, the platform will instead utilize local Islamic banks as settlement banks while merchants will be carefully curated to ensure end-to-end Shariah compliance. It is learned that the upcoming Shariah digital payment platform will be integrated with e-commerce platforms, which KNKS is in discussions with, to have these platforms, carve out a specific segment for Halal products, including Islamic financial investment instruments.
https://www.islamicfinancenews.com

**Kenya gets it's first-ever Shariah compliant credit card**

GAB Kenya has launched a Shariah compliant credit card. Billed as one of its kind in the East African region, the launch solidifies Kenya's position as the regional Islamic finance leader. The Visa-branded card comes with an expandable limit of up to KES2 million (US$19,073.7). The card will be in line with the tenets of Shariah, avoiding charging interest but instead attract a flat service fee regardless of the outstanding balance. Besides that, clients are not allowed to use the card to purchase any non-Shariah compliant goods or services
https://www.islamicfinancenews.com

**UK Investment Company set to auction debut Wakalah notes**

Brexit looms large and the process has turned into a "nightmare", but the UK's Islamic finance ship appears to be in full sail with a new deal on the horizon as Godwin Capital plans to issue Wakalah notes, a transaction said to be the first-of-its-kind in the European market. Godwin Capital aims to raise GBP20 million (US$24.9 million) through Wakalah notes, which will be used to fund property developments across the UK.
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## C. Articles & Views

**Does surplus liquidity make Islamic banks more competitive?**

Liquidity and cash flow management are essential for Islamic banks as well, where liquidity management enables the bank to channel surpluses to settle obligations. A liquidity-resilient Islamic bank earns the confidence of investors and customers and receives access to funding at adequate prices even during challenging times. In times of financial crises, the religious foundation of Islamic banks puts them in a better position to maintain the supply of credit, according to the IMF. However, being less developed, the Islamic banking industry is more susceptible to liquidity shock as in some countries there are no lenders of last resort to come to their rescue.
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**Unlocking Islamic Fintech- can Islamic venture capital offer a better solution?**

According to an Islamic Finance Development Report (IFDI), the Islamic finance industry grew by a compound annual growth rate (CAGR) of 6% in 2017 from 2012, including Islamic banking, takaful and sukuk. Despite the fact that the growth prospects for Islamic finance are exciting, Islamic banks will still largely dominate the assets. The Islamic banking industry accounted for more than 70% of the total Islamic finance industry in 2017 globally, according to a Thomson Reuters report. However, banks are known to be, technically and from a regulatory point of view, short-term financiers, risk-averse and do not entertain start-ups, leaving a huge funding gap for Islamic fintech. With the fintech industry growing globally, attracting more funding than any other tech subindustry, Islamic fintech has, however, not featured much on the scene.
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**Zakat as a global fiscal tool**

The response to the 2008 economic crisis has relied on monetary stimulus, in the form of quantitative easing and 'near-zero' interest rates. Nonetheless, it did lack structural reforms. As a result, the excess liquidity injected into economies by central banks was not allocated efficiently, and global asset prices rose to levels even higher than those prevailing before 2008. High levels of inequality can play a significant role in stoking conflict. According to research by Thomas Piketty, a French economist, a spike in income inequality is often followed by a great crisis. This correlation (although yet to be proven given the limited data) should not be taken lightly especially with wealth and income inequality at historically high levels. The Zakat may function successfully in today's odd financial system where wealth is poorly distributed. The pillar of Zakat, in Islam, is an instrument that can be used to reduce poverty and increase social welfare. .
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**Opportunities in Islamic wealth management**

One might think that the current economic difficulties in the Middle East would have a negative impact on the wealth management industry in the region. Quite to the contrary, private high-net-worth wealth in the Middle East and North Africa has increased and a variety of reports have come to the same positive prognosis: private wealth in the Middle East will continue growing at a strong and stable rate and it is expected to outperform the development of this market in most developed countries. The main growth in the Middle East is coming from GCC countries; this will mean that the Islamic wealth management industry will grow at a similar pace, as the Islamic wealth management industry plays an important role in these countries.
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**Islamic finance graduates: do we have an unemployment issue?**

As the number of graduates from Islamic finance programs increases, the demand for employability skills that students learn during their time in universities and colleges also increases. Thus, there has been growing interest in the development of 'employability skills'. The issues surrounding human capital across the global Islamic finance industry today typically highlight the shortage of talent. One severe problem is the mismatch between the industry itself on one side and academic institutions and students on the other side. Upon graduation, students find themselves in a predicament when they apply for Islamic finance jobs on the basis that they do not meet the requirements for these positions for various reasons that include lack of employability skills. Therefore, universities should embed job

market requirements into the syllabus or have adjunct lecturers from the industries to ensure students are well prepared for the working environment.
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**Islamic fintech outlooks**

S&P Global Ratings recently released its annual Islamic finance report providing insights into the state of the industry and predictions for the future. Its most notable statement suggested that globally the industry would continue to expand, but slowly. It is thought that the implementation of fintech, along with inclusive standardization and a greater focus on the social role of Islamic finance, could be the key to accelerate the rate of growth. Focusing on fintech, it is suggested that the wider implementation of technology in the Islamic finance sector has the ability to improve the operational efficiency of lots of services.
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**Islamic and conventional mixed syndications- a tricky affair**

Syndication financing is a form of financing where rather than one bank financing a transaction, several banks join hands to provide financing to one customer under the same terms and conditions. With the growth in Islamic banking, various projects have been financed through syndications. Ideally, an Islamic syndication finance should not include any conventional bank because of various Shariah issues. However, due to the small size of Islamic banks in many jurisdictions as compared to conventional banks, it is not possible in many cases for Islamic banks to make a syndication of a group of Islamic banks to carry out the funding on their own. Deciding not to finance such a project would mean losing an opportunity to fund an attractive project and hampering the overall growth of Islamic banking. The option is to involve conventional banks in such syndications while ensuring that the underlying transaction involves an Islamic structure for all participants of the syndicate including conventional banks.
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**Risk management: deep transformation as new risks emerge**

Risk management consists of the identification, analysis, assessment, control, avoidance, minimization or elimination of unacceptable risks. There are six main risks faced by banks, namely credit risk, equity investment risk, market risk, liquidity risk, rate of return risk and operational risk. Some other risks are specific to the Islamic industry. This is the case with the Shariah non-compliance risk arising from the Islamic financing products such as Murabahah, Ijarah, Tawarruq, Mudarabah and Musharakah are structured. Risk management in banking has been transformed over the past few years, especially since the 2008 financial crisis. The structure of risk management departments is dramatically changing as it is extremely difficult to predict what risks or disruptions banks will face in 10 years, whether in terms of technology or the macro economy, for instance. As a result, a McKinsey research suggests that by 2025, about 25% of bank staff will be dedicated to risk-related operational processes such as credit administration, while 40% will work in analytics.
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**Standardization of Islamic financial institutions: a Shariah supervisory board-free model**

Currently, the standardization of Islamic finance practices is greatly recommended by the industry. The demand is due to the high costs and to address this issue, several strategies are being studied. A

model free from the Shariah supervisory board (SSB) at any level is one that could emerge in the future once the industry has reached a satisfactory level of standardization and Shariah governance. This SSB-free model visualizes the Shariah supervision of Islamic financial institutions in a broader context and assumes the presence of unified Shariah references. These references, which would be needed for the development of any Islamic financial institution activity, would be standardized to facilitate their adoption across geographical boundaries. Such comprehensive references do not currently exist. AAOIFI and IFSB standards are a step in this direction.
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**Does Islamic finance have a role in New India's aspirational US$5 trillion economy?**

What comes to our mind when we hear the word 'India' changes every decade and fortunately, for Indians it has been changing for good. India is well known for its commercial ability. A policy matter in any country ahead of its promulgation needs to pass the test of times and necessarily be politically acceptable, socially desirable, technologically feasible, financially viable, administratively doable and judicially tenable. The question before us today, is whether Islamic finance in the context of India delivered on either or all OR neither or none of these parameters. Islamic finance ideally should have been seen as a compelling offering that offers financial risk management at par or even better than what conventional finance instruments actually achieve. Its features, and not the audience, should have attracted more attention.
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**Scaling for growth- the challenge for Islamic banks**

In recent years, both conventional and Islamic banks in the GCC countries have faced increased competition amid a challenging economic environment; this has been against a backdrop of liquidity pressures (especially in the relatively smaller banks), increasing operating costs and asset quality that is not improving. The outlook for the Shariah compliant banks is perhaps more of a challenge. While, on the one hand, the global Islamic economy is increasing its share of the total, the opportunities for consolidation do not always keep pace. It is also time for Islamic banks to commit to digitalization. Islamic banks cannot practically expect to grow if they are behind their conventional peers in digital services.
https://www.islamicfinancenews.com

**Islamic finance in the aviation market**

The past two decades have seen the rise of new airlines in the Gulf region as global aviation players. The aviation sector is one that is particularly in need of finance. The placement of bulk purchase orders for aircraft regularly runs into the billions. Islamic finance and the aviation market have always been closely entwined. Many aspects of Islamic finance have their roots in structures adopted in structured aviation finance transactions. In a typical sale and lease structure for an airline, aviation assets are particularly well suited to Islamic finance. The assets are easily identifiable, capable of valuation and income producing.
https://www.islamicfinancenews.com

**Islamic banking in India: a way to financial inclusion**

Islamic banking may be a relatively new term for the Indian economy owing to the fact that little dialogue has taken place relating to Islamic banking. India has a population of 1.3 billion, and it is the second-highest populated country after China. In addition, there are around 201 million Muslims in

India, and it is the third-most Muslim-populated country in the world after Indonesia and Pakistan. This development will be a significant step toward achieving financial inclusion in India. The country is striving to achieve financial inclusion. This is the right time for the Indian government to think about Islamic banking. India's current financial situation is not working well, and it is the right time for the Reserve Bank of India (RBI) to think seriously about introducing Islamic banking. The RBI plays a significant role in permitting Islamic banking, and there is a possibility of getting it approved if the bankers and corporate sector collectively request or apply for it.
https://www.islamicfinancenews.com

Annexure: I

## *Islamic Banking Branch Network*

(As of September 30, 2019)

| Type | Name of Bank | No. of Branches | Windows |
|---|---|---|---|
| Islamic Banks | AlBaraka Bank (Pakistan) Limited | 184 | - |
| | BankIslami Pakistan Limited | 218 | - |
| | Dubai Islamic Bank Pakistan Limited | 200 | - |
| | Meezan Bank Limited | 689 | - |
| | MCB Islamic Bank Limited | 178 | - |
| | **Sub-Total** | **1,469** | |
| Standalone Islamic Banking Branches of Conventional Banks | Allied Bank Limited | 117 | 60 |
| | Askari Bank Limited | 91 | - |
| | Bank Al Habib Limited | 78 | 141 |
| | Bank Alfalah Limited | 157 | 121 |
| | Faysal Bank Limited | 311 | 5 |
| | Habib Bank Limited | 48 | 493 |
| | Habib Metropolitan Bank Limited | 31 | 221 |
| | National Bank of Pakistan | 189 | - |
| | Silk Bank Limited | 30 | - |
| | Sindh Bank Limited | 14 | 13 |
| | Soneri Bank Limited | 21 | - |
| | Standard Chartered Bank (Pakistan) Limited | 6 | 62 |
| | Summit Bank Limited | 14 | 35 |
| | The Bank of Khyber | 84 | 39 |
| | The Bank of Punjab | 88 | - |
| | United Bank Limited | 97 | 163 |
| | Zarai Taraqiati Bank Limited | 5 | |
| | **Sub-Total** | **1,381** | **1,353** |
| | **Total Full-Fledged Branches** | **2,850** | **-** |
| Sub Branches | AlBaraka Bank (Pakistan) Limited | 8 | - |
| | Askari Bank Limited | 3 | - |
| | BankIslami Pakistan Limited | 112 | - |
| | The Bank of Punjab | 2 | - |
| | Faysal Bank Limited | 1 | |
| | Habib Bank Limited | 2 | - |
| | United Bank Limited | 1 | - |
| | **Total Sub-Branches** | **129** | **-** |
| | **Grand Total Branches/Sub-Branches** | **2,979** | **1,353** |

*Source: Information/Data obtained from different banks*

Annexure: II

## *Province/Region wise Break-up of Islamic Banking Branch Network*

(As of September 30, 2019)

| Type | Bank Name | Azad Kashmir | Balochistan | Erstwhile FATA* | Federal Capital | Gilgit-Baltistan | Khyber Pakhtunkhwa | Punjab | Sindh | Grand Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Islamic Banks | AlBaraka Bank (Pakistan) Limited | 3 | 7 | - | 6 | 2 | 16 | 102 | 48 | 184 |
| | BankIslami Pakistan Limited | 3 | 12 | - | 9 | 2 | 19 | 95 | 78 | 218 |
| | Dubai Islamic Bank Pakistan Limited | 7 | 5 | - | 11 | - | 8 | 85 | 84 | 200 |
| | Meezan Bank Limited | 6 | 24 | 1 | 34 | 3 | 43 | 361 | 217 | 689 |
| | MCB Islamic Bank Limited | 2 | 11 | 1 | 9 | 1 | 11 | 75 | 68 | 178 |
| | | | | | | | | | | |
| | **Islamic Banks** | **21** | **59** | **2** | **69** | **8** | **97** | **718** | **495** | **1,469** |
| Standalone Islamic Banking Branches of Conventional Banks | Allied Bank Limited | 2 | 4 | - | 6 | 1 | 12 | 69 | 23 | 117 |
| | Askari Bank Limited | - | 3 | - | 8 | 1 | 13 | 46 | 20 | 91 |
| | Bank Al Habib Limited | - | 4 | - | 2 | - | 10 | 27 | 35 | 78 |
| | Bank Alfalah Limited | 1 | 5 | - | 11 | - | 11 | 90 | 39 | 157 |
| | Faysal Bank Limited | 4 | 15 | 1 | 15 | 4 | 32 | 176 | 64 | 311 |
| | Habib Bank Limited | 2 | 1 | 1 | 4 | - | 4 | 24 | 12 | 48 |
| | Habib Metropolitan Bank Limited | - | - | - | 1 | - | 7 | 9 | 14 | 31 |
| | National Bank of Pakistan | 9 | 6 | 3 | 5 | 1 | 35 | 96 | 34 | 189 |
| | Silk Bank Limited | 1 | 1 | - | 3 | - | 5 | 11 | 9 | 30 |
| | Sindh Bank Limited | 1 | 1 | - | | - | 2 | 7 | 3 | 14 |
| | Soneri Bank Limited | - | 1 | - | 2 | 1 | 4 | 8 | 5 | 21 |
| | Standard Chartered Bank (Pakistan) Limited | - | - | - | 1 | - | 1 | 1 | 3 | 6 |
| | Summit Bank Limited | - | 1 | - | 2 | 2 | 1 | 2 | 6 | 14 |
| | The Bank of Khyber | - | 4 | 4 | 2 | - | 61 | 10 | 3 | 84 |
| | The Bank of Punjab | 1 | 3 | - | 6 | - | 12 | 66 | - | 88 |
| | United Bank Limited | 1 | 4 | | 4 | - | 19 | 39 | 30 | 97 |
| | Zarai Taraqiati Bank Limited | | - | - | 1 | - | 1 | 2 | 1 | 5 |
| | **Islamic Banking Branches Total** | **22** | **53** | **9** | **73** | **10** | **230** | **683** | **301** | **1,381** |
| Sub Branches | AlBaraka Bank (Pakistan) Limited | - | - | - | 1 | - | - | 1 | 6 | 8 |
| | Askari Bank Limited | - | 1 | - | | - | 1 | 1 | - | 3 |
| | BankIslami Pakistan Limited | 1 | 6 | - | 8 | - | 5 | 41 | 51 | 112 |
| | Faysal Bank Limited | - | - | - | - | - | - | 1 | - | 1 |
| | Habib Bank Limited | - | - | - | - | - | - | - | 2 | 2 |
| | The Bank of Punjab | - | - | - | - | - | - | 2 | - | 2 |
| | United Bank Limited | - | - | - | - | - | 1 | - | - | 1 |
| | **Sub Branches Total** | **1** | **7** | **0** | **9** | **0** | **7** | **46** | **59** | **129** |
| | **Grand Total** | **44** | **119** | **11** | **151** | **18** | **334** | **1,447** | **855** | **2,979** |

* Merged with KP through 25th Amendment to Constitution

Annexure: III

## *District wise Break-up of Islamic Banking Branch Network*

(As of September 30, 2019)

| S. No. | Province | District | No. of Branches* |
|---|---|---|---|
| 1 | Sindh | Badin | 4 |
| 2 | | Dadu | 6 |
| 3 | | Ghotki | 3 |
| 4 | | Hyderabad | 60 |
| 5 | | Jacobabad | 5 |
| 6 | | Jamshoro | 3 |
| 7 | | Karachi City | 684 |
| 8 | | Khairpur | 3 |
| 9 | | Larkana | 6 |
| 10 | | Matiari | 3 |
| 11 | | Mirpurkhas | 12 |
| 12 | | Naushahro Feroze | 3 |
| 13 | | Shaheed Benazir Abad | 17 |
| 14 | | Sanghar | 14 |
| 15 | | Shikarpur | 1 |
| 16 | | Sukkur | 18 |
| 17 | | Shahdadkot | 2 |
| 18 | | Tando Allahyar | 4 |
| 19 | | Tando Mohammad Khan | 1 |
| 20 | | Thatta | 2 |
| 21 | | Umer Kot | 4 |
| **Sindh Total** | | | **855** |
| 22 | Punjab | Attock | 18 |
| 23 | | Bahawalnagar | 16 |
| 24 | | Bahawalpur | 24 |
| 25 | | Bhakkar | 3 |
| 26 | | Chakwal | 18 |
| 27 | | Chiniot | 6 |
| 28 | | Dera Ghazi Khan | 17 |
| 29 | | Faisalabad | 109 |
| 30 | | Gujranwala | 72 |
| 31 | | Gujrat | 55 |
| 32 | | Hafizabad | 5 |
| 33 | | Jhang | 15 |
| 34 | | Jhelum | 17 |
| 35 | | Kasur | 17 |
| 36 | | Khanewal | 23 |
| 37 | | Khushab | 6 |
| 38 | | Lahore City | 482 |
| 39 | | Layyah | 6 |
| 40 | | Lodhran | 5 |
| 41 | | Mandi Bahauddin | 14 |
| 42 | | Mianwali | 8 |
| 43 | | Multan | 86 |
| 44 | | Muzaffargarh | 10 |
| 45 | | Nankana Sahib | 8 |
| 46 | | Narowal | 7 |
| 47 | | Okara | 25 |
| 48 | | Pakpattan | 9 |
| 49 | | Rahim Yar Khan | 38 |
| 50 | | Rajanpur | 4 |
| 51 | | Rawalpindi | 148 |
| 52 | | Sahiwal | 31 |
| 53 | | Sargodha | 34 |
| 54 | | Sheikhupura | 25 |
| 55 | | Sialkot | 49 |
| 56 | | Toba Tek Singh | 19 |
| 57 | | Vehari | 18 |
| **Punjab Total** | | | **1,447** |

| S. No. | Province | District | No. of Branches* |
|---|---|---|---|
| 58 | Khyber Pakhtunkhwa | Abbottabad | 23 |
| 59 | | Bannu | 8 |
| 60 | | Batagram | 3 |
| 61 | | Buner | 5 |
| 62 | | Charsadda | 10 |
| 63 | | Chitral | 7 |
| 64 | | Dera Ismail Khan | 13 |
| 65 | | Hangu | 5 |
| 66 | | Haripur | 11 |
| 67 | | Karak | 1 |
| 68 | | Kohat | 11 |
| 69 | | Lakki Marwat | 1 |
| 70 | | Lower Dir | 14 |
| 71 | | Malakand | 14 |
| 72 | | Mansehra | 13 |
| 73 | | Mardan | 21 |
| 74 | | Nowshera | 22 |
| 75 | | Peshawar | 101 |
| 76 | | Shangla | 4 |
| 77 | | Swabi | 7 |
| 78 | | Swat | 29 |
| 79 | | Tank | 1 |
| 80 | | Torghar | 1 |
| 81 | | Upper Dir | 7 |
| 82 | | Kohistan | 2 |
| **Khyber Pakhtunkhwa Total** | | | **334** |
| 83 | Gilgit-Baltistan | Skardu | 2 |
| 84 | | Diamir | 7 |
| 85 | | Gilgit | 9 |
| **Gilgit-Baltistan Total** | | | **18** |
| 86 | Erstwhile FATA** | Bajaur District | 2 |
| 87 | | Khyber District | 5 |
| 88 | | Mohmand District | 1 |
| 89 | | Orakzai District | 2 |
| 90 | | Kurram District | 1 |
| **Erstwhile FATA Total** | | | **11** |
| 91 | Federal Capital | Islamabad | 151 |
| **Federal Capital Total** | | | **151** |
| 92 | Balochistan | Chaghi | 1 |
| 93 | | Gawadar | 6 |
| 94 | | Harnai | 1 |
| 95 | | Kech | 2 |
| 96 | | Khuzdar | 3 |
| 97 | | Lasbela | 6 |
| 98 | | Loralai | 6 |
| 99 | | Nasirabad | 1 |
| 100 | | Panjgur | 2 |
| 101 | | Pishin | 8 |
| 102 | | Qilla Abdullah | 6 |
| 103 | | Qilla Saifullah | 5 |
| 104 | | Quetta | 63 |
| 105 | | Turbat | 2 |
| 106 | | Zhob | 6 |
| 107 | | Ziarat | 1 |
| **Balochistan Total** | | | **119** |
| 108 | Azad Kashmir | Bagh | 1 |
| 109 | | Bhimber | 1 |
| 110 | | Dadyal | 4 |
| 111 | | Hattian Bala | 1 |
| 112 | | Kotli | 6 |
| 113 | | Mirpur | 17 |
| 114 | | Muzaffarabad | 11 |
| 115 | | Poonch | 3 |
| **Azad Kashmir Total** | | | **44** |
| **Grand Total** | | | **2,979** |

*including sub-branches

** Merged with KP through 25th Amendment to Constitution