Islamic Banking Bulletin

June 2015

Islamic Banking Department
State Bank of Pakistan

Table of Contents

Ceremony of Opening of Proposals for Establishment of Centre (s) of Excellence in Islamic Finance Education (CEIFE)

Keynote Address by Mr. Muhammad Ishaq Dar,
Federal Minister for Finance, Revenue, Statistics, Economic Affairs & Privatization
LRC, State Bank of Pakistan
March 25, 2015 (Karachi)

Distinguished Guests, Ladies and Gentlemen

Assalam-o-alaikum

I am honoured to be part of this important occasion on the opening of proposals for the Establishment of a Centre of Excellence for Promotion of Islamic Finance in the country.

I am pleased that efforts are being swiftly expedited to create the Centre of Excellence that was announced last year. In this regard, I would like to extend my special appreciation to the State Bank of Pakistan for supporting such initiatives. I am optimistic that this Centre will further strengthen the foundations of Islamic finance in the country through rigorous research and by addressing the challenge of the dearth of human resources.

Ladies & Gentlemen:

The rapidly increasing presence of Islamic finance around the globe is a long awaited development needed to address the issues created by the interest based financial system. Looking at the major jurisdictions in the world now promoting Islamic finance, whilst leading policy makers and regulators begin to take a serious look at a Shari'ah compliant system as a viable alternative to remedy the flawed financial architecture of today, gives me a great deal of pride as a Muslim.

As Islamic finance continues to reach new heights, its expansion is complemented by trends that suggest that the industry is evolving into a more mature and sustainable economic system. Whilst the relative resilience of Islamic finance has affirmed its viability, it has also conferred a significant responsibility on practitioners to develop a system based on the intrinsic values of Shariah. This task is challenging given the changing global financial landscape and the emergence of Islamic finance as a serious alternative system. Also, greater realism from within the industry is required as its impressive growth rates need to be assessed more carefully. Although based on comparatively sound foundations, the second round impact of the 2007-08 financial crisis cautioned of challenges and issues that require further attention.

Ladies & Gentlemen:

Against the backdrop of impressive growth globally, Islamic banking is increasing in its breadth and depth across the country in an impressive manner. Our Government wishes to further increase the industry’s pace of expansion as we not only consider the implementation of this system as our religious duty but also believe in its supremacy for inclusive development and broad-based growth. We are fully committed to facilitate the development of the Islamic finance industry by creating an enabling environment. Therefore, after coming to power we constituted a high level Steering Committee for the Promotion of Islamic Banking in the country. Through this Committee we have brought all stakeholders together on one platform to devise strategy and develop practical solutions for the challenges with which the industry is confronted. The Committee has, Masha Allah, successfully completed one year. I have high expectations from the Committee and I am looking forward to their recommendations to remove any impediments in maintaining the increasing growth trajectory of Islamic banking in the country.

Ladies & Gentlemen:

Government financing is an important area in the macroeconomic environment. Our determination to the cause of Islamic banking is reflected by Pakistan's re-entry to the global Islamic finance arena after nine years with the issuance of GoP international Ijara Sukuk that attracted an overwhelming response and was significantly oversubscribed. We are aware of the potential of Sukuk in attracting foreign funds and supporting domestic financing needs. The Steering Committee has been exploring various short and long term instruments and I am optimistic that in the near future we will have a range of Shari'ah compliant securities fulfilling the financing needs of government and corporates whilst also helping Islamic banks to efficiently manage their liquidity.

Ladies & Gentlemen

I would like to take this opportunity to applaud stakeholders of the Islamic finance industry for their strenuous efforts in achieving tremendous growth over all these years, however, the huge potential of this system is still not completely explored. Taking full advantage of this opportunity hinges upon encouraging research and development and ensuring availability of skilled human resources. The Islamic finance industry domestically is in dire need of investment in its human capital and product innovation is of critical importance to achieving sustainable expansion. The industry needs to establish knowledge sharing and research platforms to evolve strategies on how best to meet the surging demand for Shariah compliant products and services in Pakistan.

The silver lining in this situation is that there is recognition of this need at the Government and regulators level. This realisation has been repeatedly demonstrated and I was fortunate to be part of it two months back when the Financial Innovation Challenge Fund (FICF) round was launched for a much needed Centre of Excellence in Islamic finance at Islamabad. It is heartening to know that the challenge round has successfully attracted a good number of proposals from eminent higher education institutions and service providers. I foresee that the FICF Advisory Committee will have a difficult job in finalizing the challenge grants because of the intense competition due to the participation by high quality academic institutions. I would like to urge the prospective institutions and industry to join hands to help set-up the Centre for Excellence in Islamic Finance. I would also like to congratulate SBP and all stakeholders on managing the challenge round through an open and transparent process. It is my pleasure to witness the opening of proposals through this ceremony.

I am hopeful that this joint venture of the Government and State Bank of Pakistan will work as a catalyst for the growth of the Islamic finance industry and will make the presence of Pakistan prominent among countries promoting Islamic finance.

Ladies & Gentlemen:

Being a developing country, Pakistan has high financial exclusion levels, partly being contributed by religious based voluntary financial exclusion. Given the long history of conventional finance in the country, Islamic banking is a relatively nascent area that is not only faced with the challenges of a new entrant but also bears the responsibility of adhering to Shariah in its practice while staying compliant with the domestic regulatory regime. The Islamic banking industry needs to develop an innovative model by diverging from traditional business approaches that primarily remain concentrated in already banked locations. A country with a population of 200 million that is largely un-banked and with rural areas that remain significantly un-tapped, provides huge opportunities for Islamic banking. Financing SME, agriculture and infrastructure sectors is a win-win situation for both the clients and Islamic banks.

I am aware while suggesting this paradigm shift in the business approach that it requires human resources and facilitation from the regulators and policy makers. The challenge of a lack of adequate human resources is what we intend to address today. I am positive that the Centre of Excellence would go a long way in filling the HR gulf, and I extend the full support of my office to resolve any potential hurdles identified by the Steering Committee.

I have high hopes in achieving the broad based welfare of the masses through the development of Islamic finance in the country. With our sincere, collective efforts we will, Insha Allah, be able to meet the challenges facing us and provide our next generations with a system that is equitable and transparent and above all Shariah Compliant

Thank you.

Islamic Banking Industry- Progress & Market Share

Overview

Islamic banking industry (IBI) continued its growth momentum as both assets and deposits witnessed increase during the second quarter of CY15. Assets of IBI reached Rs 1,495 billion during the quarter ending June 2015 compared to Rs 1,302 billion in the previous quarter depicting growth rate of 14.8 percent. Similarly deposits of IBI witnessed growth during the review quarter and were recorded at Rs 1,281 billion compared to Rs 1,122 billion in the first quarter of CY15 (see **Table 1**). The market share of both Islamic banking assets and deposits in overall banking industry also increased during the review quarter reaching 11.3 percent and 12.8 percent respectively.

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

	Industry Progress			Growth (YoY)			Share in Industry		
	Jun-14	**Mar-15**	**Jun-15**	**Jun-14**	**Mar-15**	**Jun-15**	**Jun-14**	**Mar-15**	**Jun-15**
Total Assets	1089	1302	1495	20.5%	28.2%	37.3%	9.8%	10.4%	11.3%
Deposits	*932*	1122	1281	20.9%	28.7%	37.4%	10.6%	12.2%	12.8%
Total Islamic Banking Institutions	*22*	*22*	*22*	–	–	–	–	–	–
Total No. of Branches*	*1335*	*1597*	*1702*	–	–	–	–	–	–

Source: Quarterly Unaudited Accounts

**number includes sub-branches*

IBI Network Expansion

Branch network of IBI witnessed increase during the second quarter of CY15. With addition of 105 branches during the quarter, the aggregate number of Islamic banking branches reached 1,702. Encouragingly, these additional branches were established in all provinces of the country (see **Table 2**). In terms of coverage, Islamic banking services expanded to six new districts during the review quarter. These new districts include Bhakkhar, Chiniot, Narowal and Rajanpur in Punjab province, and Bhimber and Kotli districts in Azad Jammu and Kashmir (AJK) (see **Annexure III** for details).

Table 2: Province Wise Additional Branches (Apr-June 2015)

Province	**Additional Number**	**Total Number**	**Share (percent)**
Punjab	56	797	46.8
Sindh	26	539	31.7
Khyber Pakhtoonkhawa	10	180	10.6
Baluchistan	3	66	3.9
Gilgit Baltistan	2	7	0.4
FATA	1	5	0.3
Federal Capital	5	90	5.3
AJK	2	18	1.1
Total	**105**	**1,702**	**100.0**

Asset and Liability Structure

Assets: Asset base of the IBI registered growth of 14.8 percent during April to June quarter 2015 to reach Rs 1,495 billion from Rs 1,302 billion in the previous quarter. This growth in Islamic banking assets was higher compared to growth in overall banking industry assets resulting in an increase in market share of assets of Islamic banking in overall banking industry assets from 10.4 percent in March 2015 to 11.3 percent in June 2015[1]. Like previous

[1] Assets of Islamic banking industry grew by 14.8 percent compared to 5.7 percent growth of overall banking industry assets during 2nd quarter CY 15

quarters, "investments" and "financing"[2] remained the two major contributors towards Islamic banking assets during the second quarter of CY15 (see sections on **Investments** and **Financing** for details).

Bifurcation of assets among full-fledged Islamic Banks (IBs) and Islamic Banking Divisions (IBDs) of conventional banks shows that assets of both IBs and IBDs witnessed positive growth compared to previous quarter with IBs recording relatively better quarterly growth (17.8 percent) compared to IBDs (10.2 percent). Consequently, the share of IBs assets in overall assets of IBI witnessed an increase as it improved from 60.6 percent in March 2015 to 62.1 percent in June 2015.

Investments:

Net Investments of IBI increased by 3.0 percent to reach Rs 379.2 billion by end June 2015 compared to Rs 368.2 billion by end March 2015 (see **Table 3**). Various components of investments including "federal government securities", "fully paid up ordinary shares" and "other investments" contributed in this overall increase in investments. In terms of contribution to overall investments, like previous quarters, federal government securities remained the highest contributor (68.1 percent) in overall investments.

Table 3: Investments

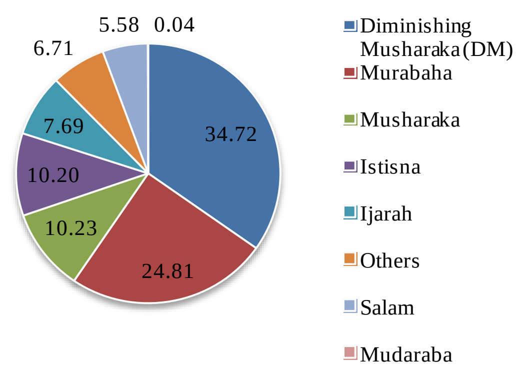
Rupees in billions

				Growth	
	Jun-14	**Mar-15**	**Jun-15**	**YoY**	**QoQ**
Federal government securities	247.2	248.7	261.4	5.8	5.1
Fully paid up ordinary shares	6.1	5.8	11.1	82.8	90.0
Bonds, & PTCs	40.9	50.2	43.0	5.1	(14.4)
Other investments	65.1	64.9	68.3	4.9	5.2
Net Investments	**357.8**	**368.2**	**379.2**	**6.0**	**3.0**

Financing

Net financing and related assets of Islamic banking industry reached Rs 511.9 billion by end June 2015. Amongst various modes of financing, Diminishing Musharaka remained the most preferred mode for financing by IBI as its share in overall financing was registered 34.72 percent in June 2015. Amongst other modes of financing, Murabaha and Musharaka remained the second and third preferred modes of finance having 24.81 percent and 10.23 percent share in overall financing (see **Figure 1**).

Figure 1: Share of Islamic Modes of Financing in Overall Financing -June 2015



In terms of sector wise financing, textile remained the

[2] Financing includes inventories and other related items pertaining to Islamic modes of financing

most concentrated sector having 16.7 percent share in overall financing. This is however, in line with the trend in overall banking industry though share of textile financing in overall banking industry is less (14.0 percent) compared to Islamic banking industry. Among other sectors, financing by IBI was also concentrated in sectors like production & transmission of energy, chemical & pharmaceuticals and individuals (see **Table 4**).

Client wise financing of IBI remained concentrated in corporate sector, having a share of above 78 percent followed by consumer financing (11.2 percent) (see **Table 5**). Like previous quarters, financing extended by Islamic banking in SMEs and agriculture remained lower compared to overall banking industry indicating limited outreach of IBI in these two sectors.

Table 4: Sector Wise Financing - percent share

	June-15	Industry
Chemical and Pharmaceuticals	8.7%	3.9%
Agribusiness	1.7%	8.4%
Textile	16.7%	14.0%
Cement	1.6%	1.1%
Sugar	4.2%	3.5%
Shoes and leather garments	1.1%	0.5%
Automobile and transportation equipment	1.4%	1.2%
Financial	0.5%	2.3%
Insurance	0.0%	0.0%
Electronics and electrical appliances	1.9%	1.4%
Production and transmission of energy	10.5%	12.8%
Individuals	12.7%	8.7%
Others	38.9%	42.3%

Table 5: Client Wise Financing Portfolio (Share Percent)

	June-15	Industry
Corporate Sector	78.2%	67.2%
SMEs	2.8%	5.6%
Agriculture	0.6%	5.9%
Consumer Finance	11.2%	6.6%
Commodity Financing	4.6%	12.6%
Staff Financing	1.4%	2.1%
Others	1.2%	0.1%
Total	**100.0%**	**100.0%**

Asset Quality

Non-performing assets (NPA) of IBI were Rs 34.1 billion by end June 2015 compared to Rs 22.8 billion in the previous quarter. This increase can be mainly attributed to addition of classified assets of a conventional bank (KASB Bank Limited) into portfolio of an IBI (BankIslami Pakistan Limited). Similarly, Non-performing financing (NPF) of IBI also witnessed an increase of Rs 10.9 billion during the quarter ending June 2015. Amongst various categories of non-performing financing, "loss" remained the major contributor followed by "doubtful" and "sub-standard". Provisions to NPFs reached 90.4 percent as of June 2015 (see **Table 6**) which is higher than the industry average of 80.8 percent.

Table 6: Non-Performing Financing & Assets

	Mar-15	Jun-15
Non-Performing Financing & Assets	**Rupees in billion**	
NPF	20.1	31.1
Substandard	1.6	1.3
Doubtful	0.8	1.6
Loss	17.6	28.0
Provisions	17.5	28.1
NPA	22.8	34.1
Assets Quality Ratio		**in percent**
Net NPAs to Total Capital	3.7%	0.9%
NPFs to Financing	4.8%	5.8%
Provisions to NPFs	87.2%	90.4%

Liabilities

Growth in IBI's deposits continued during the quarter April to June 2015 and reached Rs 1,281 billion compared to Rs 1,122 billion in the previous quarter; an increase of 14.1 percent during the quarter. Similarly, market share of IBI deposits in overall banking industry deposits also increased from 12.2 percent by end March 2015 to 12.8 percent by end June 2015. Both customers' deposits as well as financial institutions' deposits contributed in the rise in overall deposits, though financial institutions' deposits grew more (33.8 percent) compared to customers' deposits (13.1 percent). Within customers' deposits, fixed deposits as well as saving deposits registered positive growth during the period under review (see **Table 7**). Other categories of customers' deposits including remunerative as well as non-remunerative current accounts also grew during the review quarter. Breakup of deposits among IBs and IBDs shows that deposits of both IBs and IBDs witnessed increase during the quarter ending June 2015 with deposits of IBs growing at a higher pace (15.8 percent) compared to growth in deposits of IBDs (11.5 percent).

Table 7: Break up of Deposits

Rupees in billions and growth in percent

	Jun-14	Mar-15	Jun-15	Growth YoY	Growth QoQ
Deposits	**931.9**	**1,122.3**	**1,280.6**	**37.4**	**14.1**
Customers	**869.6**	**1,067.1**	**1,206.6**	**38.8**	**13.1**
Fixed Deposits	238.2	331.9	352.8	48.1	6.3
Saving Deposits	333.8	429.5	468.3	40.3	9.0
Current accounts - Remunerative	3.3	3.9	5.9	79.1	49.3
Current accounts - Non-remunerative	286.8	297.6	373.5	30.2	25.5
Others	7.4	4.1	6.1	(17.9)	49.8
Financial Institutions	**62.4**	**55.2**	**73.9**	**18.5**	**33.8**
Remunerative Deposits	58.5	44.5	56.5	(3.4)	27.1
Non-remunerative Deposits	3.9	10.8	17.4	348.4	61.9

Maturity Gap

The short term assets in bucket of up to 3 months witnessed an increase during second quarter CY15 that resulted in increasing positive gap of IBI for this bucket. This trend is in line with the overall banking industry, however, for overall banking industry the gap in the mentioned category is negative (see **Figure 2(b)**). For the category of 3ms to 1 yr, both IBI and overall banking industry depicted positive gap, however, the positive gap for both (IBI as well as overall banking industry) showed downward trend due to decline in assets of 3ms to 1 yr. However, for longer term categories; (i) from 1 yr to 5yrs and (ii)

Figure 2(a): Maturity Gap(Asset-Liabilities) as percent of assets

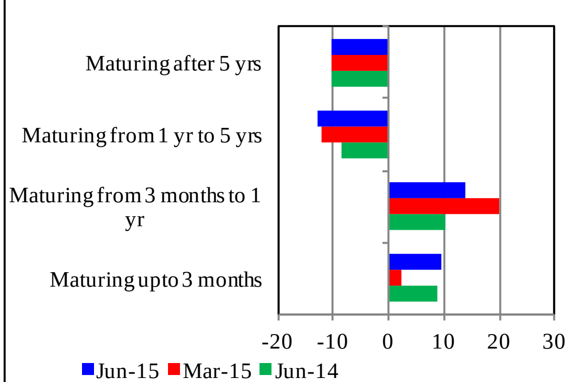
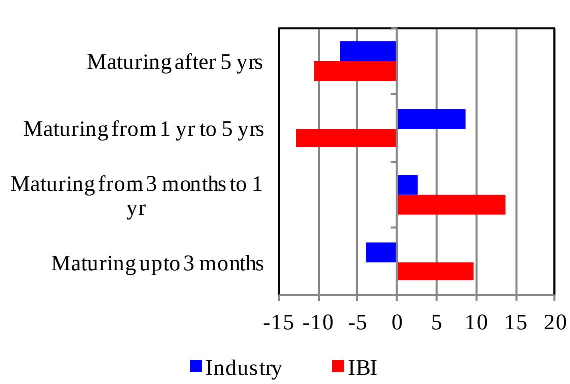


Figure 2(b): Maturity Gap (as percent of assets) (IBI vs. Overall Banking Industry)

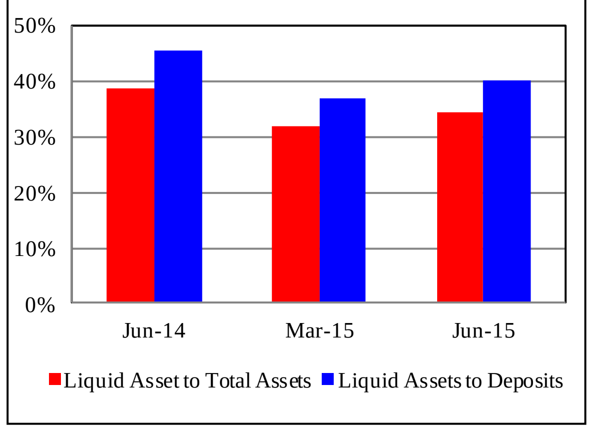


above 5 yrs, IBI following usual trend depicted negative gap though the overall banking industry showed positive gap for the first category and negative for the second category.

Liquidity Ratios

Liquid Assets (LA) to Total Assets and LA to Deposits depicted a rising trend compared to the last quarter but both ratios are lower than those of the same period last year (CY14) (see **Figure 3**). The significant increase in these ratios compared to last quarter is mainly due to amalgamation of a conventional bank into an Islamic bank and increase in 'due from financial institutions' of the Islamic banking industry.

Figure 3: Liquidity Indicators (percent)



Capital

Overall capital of Islamic banking industry increased by Rs 6.7 billion during the second quarter CY15 which can be associated with rise in paid up capital of full fledged Islamic banks[3]. This growth in share capital can be mainly attributed to increase in capital of an Islamic bank resulting from issuance of right shares (see **Figure 4**). However mostly Islamic banking institutions are in process of building up their

Figure 4a: Capital (Rs. in billion)

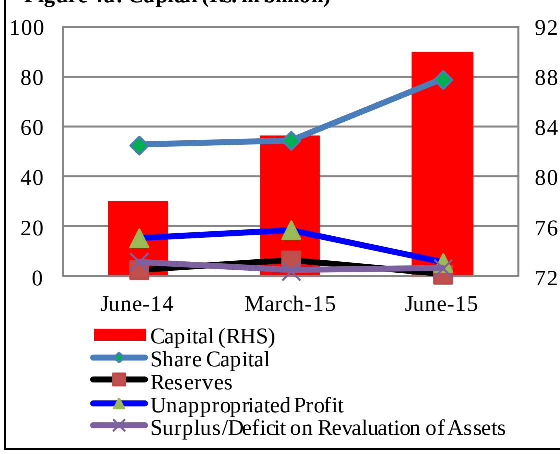
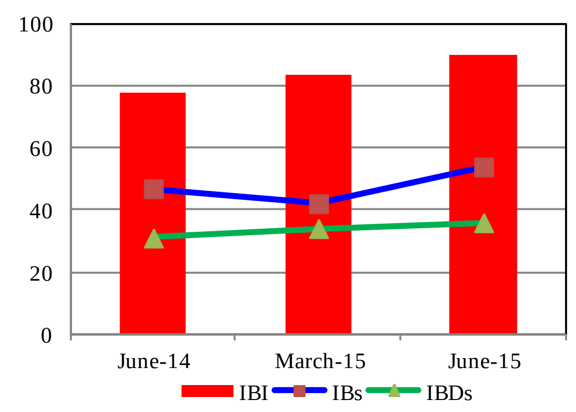


Figure 4b: Capital IBI, IBs & IBDs) (Rs. in billion)



capital to meet regulatory requirement minimum capital and therefore ratios like Capital to Assets (6.0 percent) and Capital – Net NPAs to Total Assets of IBI (6.0 percent) are lower than those of industry averages which are at 10 percent and 9 percent respectively (see **Table 8**).

Table 8 : Performance Indicators

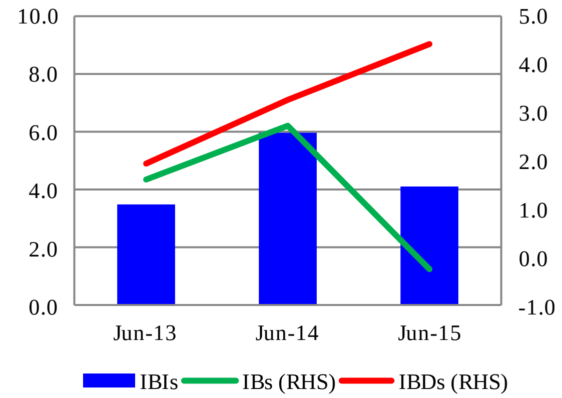
	Jun-14	Mar-15	Jun-15	Industry
Capital to Total Assets	7.2%	6.4%	6.0%	10%
(Capital - Net NPAs) to Total Assets	6.8%	6.2%	6.0%	9%

[3] Growth in revaluation of assets appears significant at above 47 percent; however, this high growth is the result of base effect.

Profitability & Earnings

Profitability after tax (PAT) of IBI was Rs. 4.2 billion by the end second quarter CY15 compared to Rs 6.0 billion in the same quarter last year. This decline was mainly contributed by IBs which earned losses of Rs 0.25 billion by the end of second quarter CY15. It is worth mentioning here that amalgamation of a conventional bank into an Islamic bank resulted in this loss of IBs[4]. As a result, both ROA and ROE of IBI showed a significant decline in the second quarter CY15 as compared to same quarter of last year (see **Table 9**).

Figure 5: Profitability of IBI (Rs. billion)



Due to its expansionary phase, IBI has yet not been able to bring expenses at level comparable to conventional banking industry as indicated by Operating Expense to Gross Income. However Personnel Expense to Operating Expense for IBI is lower than that of the overall industry average.

Table 9: Profitability & Earnings of IBI

	Jun-14	Mar-14	Jun-15	Industry
Net Income to Total Assets (ROA)	1.2%	1.2%	0.6%	1.6%
Return on Equity (ROE)	16.1%	18.7%	9.8%	16.0%
Operating Expense to Gross Income	66.6%	63.9%	66.0%	46.1%
Personnel Expense to Operating Expense	40.3%	40.1%	36.3%	39.5%

[4] The loss of conventional bank amounted to Rs.3.3 billion by end quarter June, 2015

Country Model

Jordan

Islamic Banking started in Jordan in 1979 with the establishment of Jordan Islamic Bank for Finance and Investment (later renamed as Jordan Islamic Bank). Islamic banking industry in Jordan consists of twenty six banks including four full-fledged Islamic banks. Apart from banking institutions, two Takaful companies are also offering Shariah compliant insurance solutions in the country. The Jordanian government has also been focusing on Islamic finance and the government agreed various Shariah compliant financing arrangements with different financial institutions during the year 2015.

Legal Framework for Islamic Banks in Jordan:

The Central Bank of Jordan (CBJ) issued a law for the purpose of establishing Islamic banks in the country in 1978. As a result, the first Islamic bank i.e. Jordan Islamic Bank for Finance and Investment was established. Later on, the Jordanian government passed a Banking Law in 2000 and incorporated a separate section relating to laws/regulation for Islamic banks in the banking law of the country. Accordingly, at present CBJ regulates both conventional and Islamic banks through a single regulatory framework and Islamic banking activities fall under the domain of the Banking Law 2000.

Islamic Jurisprudence Supervision Board:

In accordance to Banking Law of 2000, each Islamic bank is required to establish Islamic Jurisprudence Supervision Board in order to discharge its obligations and to comply with the rules of Islamic jurisprudence. Further, it is mandatory to appoint at least three members on the board. The banking law defines following main responsibilities of the board:

- Monitoring the compliance of the operations and activities of the Islamic bank with Islamic jurisprudence rules.
- Giving opinion on the text of contracts required for the operations and activities of the bank.
- Considering any matters referred thereto pursuant to specific orders of the Central Bank.

Islamic Capital Market in Jordan:

The government of Jordan passed a Sukuk Law in 2012. However, to date Jordan has issued only one corporate Sukuk worth JOD85 million (US$119.53 million) in 2011 by Al Rajhi Cement. As per industry sources, a number of Sukuk are expected to appear in the coming years in the country. The government of Jordan is also making developments to tap the potential of Islamic debt capital markets. In April 2015, the Ministry of Finance Jordan mandated the Islamic Corporation for the Development of the Private Sector (ICD) to provide technical support for its planned domestic Sukuk issuance that it hopes to market before the end of 2015.

Way Forward

With growing significance of Islamic banking and finance across the world, a large Muslim population in the country and an enhanced focus of the government, further growth in Islamic banking and finance is expected in Jordan.

Sources

- Global Islamic Finance Report (various editions), Edbiz Consulting Limited, UK
- Central Bank of Jordan website http://www.cbj.gov.jo/
- www.islamicfinancenews.com

Brief on IFSB-15

Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services [excluding Islamic Insurance (takāful) Institutions and Islamic Collective Investment Schemes]

Keeping with its objective of promoting soundness and stability of Islamic financial services industry, Islamic Financial Services Board (IFSB) issued Basel-II based Capital Adequacy Standard IFSB-2 for institutions offering Islamic financial services (IIFS) in December 2005. The standard provided detailed guidance on calculating capital adequacy requirements (CAR) for IIFS and was complemented with many other publications including Guidance Note 1 (2008) on Recognition of Ratings by External Credit Assessment Institutions (ECAIs) on Shari'ah-Compliant Financial Instruments, Guidance Note 2 (2009) in Connection with the Risk Management and Capital Adequacy Standards: Commodity Murābahah Transactions, Guidance Note 3 (2010) on the Practice of Smoothing the Profits Payout to Investment Account Holders and Guidance Note 4 (2011) in Connection with the IFSB Capital Adequacy Standard: The Determination of Alpha in the CAR for IIFS. However, following are some of limitations of these standards and guidelines;

- these did not cover advanced approaches for the calculation of various risks like foundation and advanced internal rating-based approaches for calculation of credit risk, the duration method for sukuk held in the trading book (market risk), and the advanced measurement approach for operational risk.

- various components of regulatory capital were left to the discretion of supervisory authorities to decide the criteria for various instruments to be included in different tiers of capital.

The change in global regulatory landscape, issuance of Basel III aimed at strengthening the global capital and liquidity rules to promote a more resilient banking sector, coupled with limitations of earlier issued standards and guidance notes, the Revised Capital Adequacy Standard Working Group (RCASWG) was formed in 17th meeting of the Council of the IFSB in 2010. The RCASWG was mandated to prepare a revised standard on capital adequacy for IIFS to provide comprehensive guidance to supervisory authorities and IIFS in this area.

The revised Standard was issued in 2013 that provides a more comprehensive guidance to supervisory authorities on the application of capital adequacy regulations for IIFS by combining and enhancing the contents of IFSB-2 and IFSB-7.

Objective: Main objectives of the Standard are as follows:

a) to assist the IIFS and their supervisory authorities in the implementation of a capital adequacy framework that will ensure effective coverage of risk exposures of the IIFS and allocation of appropriate capital to cover these risks, thus enhancing the resilience of the IFSI;
b) to provide guidance on the maintenance of high-quality regulatory capital components by IIFS, which comply with Shari'ah rules and principles;
c) to address the capital adequacy requirements of various risk exposures related to Shari'ah compliant products and services offered by IIFS;

d) to provide guidance on the capital adequacy treatment of involvement of an IIFS in sukuk issuance and securitisation processes in various capacities, including as originator, servicer and credit enhancer; and
e) to adapt international best practices, as well as current and emerging standards, relating to capital adequacy for IIFS.

Structure: Standard is divided into following six sections;

1) section I provides the background and objectives, scope and coverage, along with the proposed date of starting implementation of the Standard. It also includes a brief overview on the specificities of Islamic financial instruments and the structure of the Standard.
2) basic features and criteria for various components of capital to be applicable to IIFS in addition to regulatory adjustments and deductions attached to these components are part of section II. This section also explains the application of the capital conservation buffer, countercyclical buffer and leverage ratio for IIFS, keeping in view their balance sheet structure and specificities in the application of these requirements.
3) section III expands the guidance provided in earlier IFSB documents related to calculation of credit risk, market risk and operational risk, in order to incorporate recent enhancements in the global capital standards. This part also includes a sub-section on profit-sharing investment accounts (PSIAs) that extends updated and comprehensive guideline on the treatment of PSIAs and adjustments in the CAR.
4) section IV outlines the minimum capital adequacy requirements for both credit and market risks for each of the Shari'ah-compliant financing and investment instruments.
5) section V is focused on sukuk and provides guidance on capital adequacy treatment of sukuk and securitization by combining IFSB-2 and IFSB-7, and incorporates global regulatory developments related to originating, issuing and holding sukuk in various stages of the securitisation process.
6) capital requirements for exposures of IIFS related to real estate financing and investment activities, when an IIFS utilises its own (shareholders') funds or those generated from PSIA and other fund providers forms section VI of the standard.

Limitation: Though this revised version provides updated information/guidance related to of capital requirements in respect of various risks, however, does not cover advanced approaches such as the foundation and advanced internal rating-based (IRB) approaches for calculation of credit risk capital requirements and the advanced measurement approach (AMA) for the calculation of operational risk capital requirements. Supervisory authorities, at their discretion, may allow IIFS in their jurisdiction to adopt to the advanced approaches[5.]

This Standard is primarily intended to serve banking institutions offering Islamic financial services including full fledged Islamic banks, Islamic banking subsidiaries of conventional banks; Islamic banking branches/divisions/units of conventional banks and such other financial institutions as may be determined

[5] IFSB intends to prepare a separate comprehensive guidance to address advance approaches for the benefit of supervisory authorities and IIFS

by the respective supervisory authority. The application of this Standard by supervisory authorities should be commensurate with the nature, size, complexity and type of products of the IIFS in the jurisdiction. The Standard is not applicable at the consolidated level to a group or sub-group that consists of entities other than IIFS as defined in the Standard.

Implementation: Supervisory authorities were expected to start implementation of this Standard in their jurisdictions by January 1st, 2015 with option of early implementation, however, implementation needs to be in compliance with Shari'ah and within the legal and regulatory framework applicable in the jurisdiction.

Source: Website IFSB
{http://www.ifsb.org/1CACD32A-3914-48C8-8626-48DDD8402C3D/FinalDownload/DownloadId-D5BF91DC11964BAAF2B77C85E59F3A6F/1CACD32A-3914-48C8-8626-48DDD8402C3D/standard/2014-01-28_eng_IFSB15%20Revised%20Capital%20Adequacy_(Jan%202014).pdf} {accessed on Aug 28, 2015}

Events and Developments at IBD

Developments

Taxation Issues of Islamic Banking

A Joint Forum has also been formed, to identify and develop comprehensive recommendations for taxation issues currently being faced by Islamic Banking Institutions and their clients. The forum consists of nominees from relevant departments of SBP, PBA, SECP, ICAP, FPCCI and renowned tax consultants.

Relaxed Transaction Limit on Salam of Foreign Currency Transactions

In order to facilitate the Islamic Banking institution (IBIs) conducting Salam of foreign currency transactions, the prescribed minimum limit of normal ready transactions referred in IBD Circular Letter No. 2 of 2014 has been lowered from USD 50,000 to USD 25,000 or equivalent in other foreign currencies vide IBD Circular Letter No. 1 of 2015 dated June 30, 2015.

Licensing & Coordination

NRSP Bank has been granted approval to start Islamic microfinance operations through a pilot project vide SBP's letter BPRD (LD-05)850-NRSP/IMF-P/2015-14112 dated June 19, 2015.

Events

Training Program on "Fundamentals of Islamic Banking Operations" (FIBO)
Held during May 11 – 15, 2015 at Bahawalpur

The seventh program of series of training program titled "Fundamentals of Islamic Banking Operations" (FIBO) focused on enhancing skills and knowledge base of field staff of Islamic Banking Institutions (IBIs) particularly Branch Managers (BMs), Operation Managers (OMs) and Relationship Managers (RMs), was organized from the platform of NIBAF at Bahawalpur . The duration of the program was five days and was attended by academia and students of the region along with human resource of Islamic banking industry.

Seminar on Islamic Finance for Students
Held on June 18, 2015 at LRC, SBP

SBP organized a seminar on Islamic finance on June 18, 2015 at LRC – SBP, wherein Mufti Muhammad Hassaan Kaleem, Resident Shariah Board Member – Dubai Islamic Bank Pakistan Limited, was the guest speaker. The session was attended by students of various universities and degree awarding institutions. Organizing such events is in line with the objective of Islamic Banking Department of improving and enhancing awareness of Islamic finance among different segments of society.

Awareness Programs during April to June 2015

In line with the SBP's objective of improving awareness of Islamic finance among various segments of the society, various awareness programs were held in Sialkot, Quetta and Muzaffarabad. The same were attended by SBP representatives and Shariah scholar as guest speakers, while a good number of people including academia, students, representatives of Islamic banking institutions (IBIs), members of Chamber of Commerce & Industries, etc. attended these programs as participants.

Islamic Banking News and Views

News

IMF endorses Islamic finance

The International Monetary Fund has endorsed the principles of Islamic finance, saying it could prove safer than conventional finance, but the multilateral lender warned Islamic bankers that they must tighten rules and follow them more consistently. A report released by the IMF showed the lender's growing interest in Islamic banking, which is expanding in much of the world. Last October, the IMF launched discussions with an external advisory group of Islamic finance experts and industry bodies. The IMF's report noted that because Islamic banking forbids pure monetary speculation and stresses that deals should be based on real economic activity, it could pose less risk than conventional banking to the stability of financial systems.

http://www.spyghana.com/imf-endorses-islamic-finance/

S&P Dow Jones debuts multi-asset Islamic indices

S&P Dow Jones Indices (S&P DJI) rolled out its first-ever multi-asset Shariah compliant indices at a time when the largest stock market of the Middle East opened up its doors to foreign investors. Known as the S&P Pan Arab Shariah Balanced Index Family, the family consists of three indices combining the S&P, Pan Arab Composite Shariah and Dow Jones Sukuk Index at various fixed weights depending on the desired allocation of the user. "The methodology for the index family is straightforward, in that it combines the core equity and Sukuk benchmarks: the S&P, Pan Arab Composite Shariah and Dow Jones Sukuk Indices, into one index. Offering three indices with differing equity and Sukuk weights allows investors to utilize an index that best reflects their investment style," explained Michael Orzano, the director of global equity indices at S&P DJI.

www.islamicfinancenews.com

Long-term Sukuk the new flavor

Short and medium-term Sukuk may have long been favored by market players; however, recent trends are showing a gradual shift towards longer-term papers, in line with the rise of infrastructure projects and indicative of the growing tolerance from investors for longer time frames. Traditionally issued within the three and seven-year time frame, newer issuers are, however, leaning towards longer maturities, more notably in the 10-year and 30-year range. Recently, two entities in Malaysia revealed their respective 30-year Sukuk plans: oil and gas service provider Sapura Kencana Petroleum and communication services provider Maxis – decisions likely to be motivated by the government's successful dual-tranche (10-year and 30-year) US dollar Sukuk earlier in April.

www.islamicfinancenews.com

IFSB seeks to boost financial inclusion through Microtakaful

The IFSB is evaluating current Islamic microinsurance frameworks across different markets as it seeks to bolster the sector through an enhanced revision to such regulatory infrastructure. Despite being touted as a high-potential Islamic instrument for social inclusion, especially when 25% of the global Muslim population are living on less than US$1.25 per day, microtakaful has struggled to gain traction in many nations due to the limiting factors of the present operating landscape. "Regulators and supervisors in jurisdictions where Takaful providers offer their services have relatively little experience or empirical data to support their role in creating a conducive environment for the microtakaful market that could work effectively for the lower income segments," explained the IFSB in a statement.
www.islamicfinancenews.com

Growth of Islamic finance to facilitate Financial Inclusion

The growth of the Islamic finance industry offers important potential benefits, the IMF stated in its IMF Research bulletin. The IMF stated the sector could facilitate financial inclusion by increasing access to banking services to underserved Muslim populations. Furthermore the risk-sharing characteristics of Islamic financial products can facilitate access to finance by small- and medium-sized enterprises (SMEs) whilst the asset backed nature of Sukuk makes them suitable for infrastructure financing that can help spur economic development, including creating an enabling environment for private sector investment.
http://www.islamicfinance.com/2015/06/growth-facilitate-financial-inclusion-sme-sukuk-imf/

First Islamic property fund of subcontinent: over Rs 22.23 billion Dolmen City REIT launched

The first Rs 22.237 billion Islamic rental property fund of the subcontinent was launched at Karachi Stock Exchange (KSE). The two-day book building process for the country's first Rental Real Estate Investment Trust (REIT), Dolmen City REIT (DCR), was initiated by Sindh Finance Minister Murad Ali Shah here at KSE trading hall. The initial public offering (IPO) envisages a total of 555.92 million units, 75 percent or 416.94 million shares would be offered to institutions and high net worth individuals (HNWIs). The balance 138.98 million or 25 percent units would go to retail subscribers.
http://www.brecorder.com/money-a-banking/198:pakistan/1194294:first-islamic-property-fund-of-subcontinent:-over-rs-2223-billion-dolmen-city-reit-launched

Pakistan's K-electric sells country's largest corporate sukuk

Karachi-based utility K-Electric has sold 22 billion rupee ($215.9 million) worth of seven-year Islamic bonds, the largest listed corporate sukuk in the country, the firm said in a bourse filing. Issuance of corporate sukuk is gathering pace, helping broaden Pakistan's Islamic capital market, which in recent years has relied on the government for the bulk of such deals. Proceeds would help refinance debt including around 18 billion rupees of long term loans from the International Finance Corporation and the Asian Development Bank, K-Electric said.
http://www.reuters.com/article/2015/06/01/k-electric-sukuk-idUSL5N0YN02H20150601

SECP approves Shariah advisory board for Islamic finance

Pakistan's securities commission has approved a four-member Shariah advisory board to oversee Islamic financial products in the country, as the regulator looks to address credibility concerns which still haunt

the industry. The board, which comprises three religious scholars and a technical member, would advise the Securities and Exchange Commission of Pakistan (SECP) on a range of issues including the operation, auditing and reporting of Islamic mutual funds, pensions and insurance operators. "It is expected that the new board will be instrumental in harmonizing the sharia-related business, operations and structure of the instruments of the Islamic capital market," the regulator said in a statement.
http://english.alarabiya.net/en/business/banking-and-finance/2015/06/10/Pakistan-approves-sharia-advisory-board-for-Islamic-finance.html

Sindh Province to raise US$200 million in Sukuk as part of state budget
Syed Murad Ali Shah, the minister of finance for Sindh in a recent budget speech, has tabled the government's plans to tap the Islamic debt capital market. Located in the southern region of the country, Sindh is one of the four provinces of Pakistan. The state government by virtue of Article 167 of the Constitution plans to launch the Sindh Infrastructure Development Bond under which it will raise up to US$200 million in Sukuk for development and infrastructure projects in Sindh. Denominated in US-dollars, the Sukuk will address the challenge of arranging the necessary funding to finance such projects due to budgetary constraints.
www.islamicfinancenews.com

Islamic banks leading housing finance
The recently released quarterly housing finance review by the central bank reveals that housing finance portfolio during the quarter ended March 2015 saw meager growth of Rs0.8 billion, taking the total size of outstanding loans to Rs54.5 billion, from Rs53.7 billion in December 2014. Clearly, in the face of falling interest rates that's a sorry state of affairs. The central bank report shows that the gross outstanding of housing finance of Islamic banking industry (5 Islamic banks and 14 Islamic banking divisions of conventional banks) stood at Rs19.40 billion as on March 2015 compared to Rs 18.41 billion in December 2014. Islamic banks now make up over 30 percent of total gross outstanding as of March 2015, from 24 percent in March 2014, and 18 percent January 2013.
http://www.brecorder.com/br-research/44:miscellaneous/5628:islamic-banks-leading-housing-finance/

Articles/Views:

The Nature of Money: Islamic Banking and Conscious Capitalism
At the January 2010 World Economic Forum Annual Meeting in Davos, the erudite and prolific Sharia scholar, Muhammad Taqi Usmani, was invited to present a paper with a somewhat radical theme: reforming the world's post-crisis financial landscape through the lens of religion. The paper generated little interest from the world's media, which preferred instead to focus on the forum's lack of reform plans and the predictably defensive stance taken by bankers. Had they read the 37-page document, though, they might have concluded that "caring capitalism" had the potential to be more than a mere romantic notion. Usmani's paper proved inspirational for introspective Islamic bankers searching for direction.
https://www.foreignaffairs.com/articles/2015-05-15/nature-money

Innovation is key to the future of Islamic banking
The word "innovation" is extremely malleable: it means different things to different people and within the banking fraternity it's no different. Generally speaking, though, it is a loosely used, or dare I say, a much

"abused", word, at least in terms of marketing, with claims to be innovative and unique in their offerings of products and services. Despite Islamic banking being a fast growing sector, the pace of innovation has been slow. Unless we differentiate ourselves in terms of value — a competitive price; innovative products; and high quality customer service — we will struggle to compete with conventional banks.
http://gulfnews.com/business/sectors/banking/innovation-is-key-to-the-future-of-islamic-banking-1.1512208

Are bigger banks and more hubs better for Islamic finance?
Islamic finance has emerged as an attractive alternative operating almost at par with the conventional segment, with more countries jumping on the bandwagon. But are more hubs and bigger banks any better? Experts beg to differ, saying that bigger and more hubs are not necessarily good for the industry. Chief Economist for Bahrain Economic Development Board Dr Jarmo Kotilaine said globalisation of Islamic finance is a work in progress. "Building a global Islamic finance industry is not a beauty contest. You cannot have too many Islamic finance centres." Kotilaine stressed that what the market needs more is a significant number of active jurisdictions to ensure Islamic finance lives up to its principles of risk sharing and asset-based financing.
http://www.themalaymailonline.com/money/article/are-bigger-banks-and-more-hubs-better-for-islamic-finance

Sector overview: The exit of foreign banks
The recent confirmation of HSBC Bank Oman selling its Pakistan business to Meezan Bank should not come as a surprise to those who have been following financial media and developments of the banking sector in the country. Meezan Bank has already acquired HSBC Group's Pakistan operations in 2014. To clarify a possible confusion, HSBC Group owned a separate bank in Pakistan through its subsidiary, HSBC Bank Middle East, which was sold to Meezan Bank last year. Meezan Bank is not the only local bank that has acquired foreign banks operating in Pakistan. Previously, Royal Bank of Scotland (RBS) sold its Pakistani business to Faysal Bank, another bank with substantial Islamic banking operations in Pakistan. RBS had acquired ABN Amro Pakistan in 2007 as part of its rather disastrous purchase of global operations of ABN Amro.
http://tribune.com.pk/story/915410/sector-overview-the-exit-of-foreign-banks

Annexure: I

Islamic Banking Branch Network

(As of June 30, 2015)

Type	Name of Bank	No of Branches*
Islamic Banks	AlBaraka Bank (Pakistan) Limited	121
	BankIslami Pakistan Limited	123
	Burj Bank Limited	74
	Dubai Islamic Bank Pakistan Limited	174
	Meezan Bank Limited	474
		966
Islamic Branches of Conventional Banks	Allied Bank Limited	6
	Askari Bank Limited	63
	Bank AL Habib Limited	26
	Bank Alfalah Limited	156
	Faysal Bank Limited	63
	Habib Bank Limited	43
	Habib Metropolitan Bank Limited	12
	MCB Bank Limited	34
	National Bank of Pakistan	51
	Silkbank Limited	10
	Sindh Bank	5
	Soneri Bank Limited	15
	Standard Chartered Bank (Pakistan) Limited	10
	Summit Bank Limited	6
	The Bank of Khyber	59
	The Bank of Punjab	37
	United Bank Limited	25
		621
Sub Branches	AlBaraka Bank (Pakistan) Limited	14
	Askari Bank Limited	2
	BankIslami Pakistan Limited	95
	Faysal Bank Limited	1
	Habib Bank Limited	2
	United Bank Limited	1
		115
		1702

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

Annexure: II

Province wise Break-up of Islamic Banking Branch Network

(As of June 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	17		22		33	235	161	474
	IB. Total	**11**	**38**	**1**	**44**	**3**	**70**	**455**	**344**	**966**
Islamic Branches of Conventional Banks	Allied Bank Limited				1			5		6
	Askari Bank Limited		2		7	1	8	33	12	63
	Bank AL Habib Limited		1				2	7	16	26
	Bank Alfalah Limited	1	5		8		8	94	40	156
	Faysal Bank Limited		2		3		16	27	15	63
	Habib Bank Limited	2	2	1	4		4	19	11	43
	Habib Metropolitan Bank Limited				1			4	7	12
	MCB Bank Limited		1		2		2	17	12	34
	National Bank of Pakistan	2	1	1	1		8	28	10	51
	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			2	1	1	1	6
	The Bank of Khyber		3	2	2		40	9	3	59
	The Bank of Punjab				3		6	28		37
	United Bank Limited	1	2		1		4	9	8	25
	SAIBBs Total	**6**	**22**	**4**	**37**	**4**	**104**	**296**	**148**	**621**
Sub Branches	AlBaraka Bank (Pakistan) Limited				1			12	1	14
	Askari Bank Limited						1	1		2
	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**	**6**	**-**	**9**	**-**	**6**	**46**	**47**	**115**
Grand Total		**18**	**66**	**5**	**90**	**7**	**180**	**797**	**539**	**1,702**

Annexure: III

District wise Break-up of Islamic Banking Branch Network

(As of June 30, 2015)

S. No	Province	District	No of Branches
1	Sindh	Badin	3
2		Dadu	4
3		Ghotki	1
4		Hyderabad	30
5		Jacobabad	2
6		Jamshoro	1
7		Karachi City	452
8		Larkana	4
9		Matiari	1
10		Mirpurkhas	7
11		Naushero Feroze	1
12		Nawabshah	6
13		Sanghar	6
14		Shahdadkot	2
15		Sukkur	11
16		Tando Allahyar	5
17		Tando Mohammad Khan	1
18		Umer Kot	2
Sindh Total			**539**
19	Punjab	Attock	14
20		Bahawalnagar	12
21		Bahawalpur	10
22		Bhakkar	1
23		Chakwal	8
24		Chiniot	1
25		Dera Ghazi Khan	10
26		Faisalabad	69
27		Gujranwala	30
28		Gujrat	29
29		Hafizabad	3
30		Jhang	6
31		Jhelum	10
32		Kasur	9
33		Khanewal	15
34		Khushab	5
35		Lahore City	266
36		Layyah	2
37		Lodhran	3
38		Mandi Bahauddin	5
39		Mianwali	5
40		Multan	54
41		Muzaffargarh	6
42		Nankana Sahib	1
43		Narowal	1
44		Okara	11
45		Pakpattan	5
46		Rahim Yar Khan	20
47		Rajanpur	1
48		Rawalpindi	98
49		Sahiwal	15
50		Sargodha	21
51		Sheikhupura	14
52		Sialkot	24
53		Toba Tek Singh	5
54		Vehari	8
Punjab Total			**797**

S. No	Province	District	No of Branches
55	Khyber Pakhtunkhwa	Abottabad	14
56		Banu	4
57		Batagram	3
58		Buner	2
59		Charsadda	5
60		Chitral	5
61		Dera Ismail Khan	8
62		Hangu	2
63		Haripur	6
64		Kohat	6
65		Lower Dir	2
66		Malakand	2
67		Mansehra	12
68		Mardan	14
69		Nowshera	10
70		Peshawar	57
71		Shangla	1
72		Swabi	5
73		Swat	14
74		Tank	1
75		Upper Dir	7
KP Total			**180**
76	Gilgit-Baltistan	Baltistan	2
77		Diamir	4
78		Gilgit	1
	GB Total		**7**
79	**FATA**	Khyber Agency	2
80		Orakzai Agency	3
FATA Total			**5**
81	**Capital**	Islamabad	90
	Capital		**90**
82	Balochistan	Chagi	1
83		Gawadar	1
84		Kila Abdullah	5
85		Killa Saifullah	3
86		Lasbela	3
87		Loralai	6
88		Pishin	1
89		Quetta	43
90		Zhob	3
Balochistan Total			**66**
91	**Azad Kashmir**	Bhimber	1
92		Kotli	1
93		Mirpur	11
94		Muzaffarabad	4
95		Poonch	1
AJK Total			**18**
Grand Total			**1702**