Islamic Banking Bulletin

June 2017

Islamic Banking Department
State Bank of Pakistan

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Islamic Banking Industry - Progress & Market Share

Overview

Assets of Islamic banking industry witnessed growth of Rs. 150 billion during the quarter April to June, 2017 and were recorded at Rs. 2,035 billion compared to Rs. 1,885 billion in the previous quarter. On funding side, deposits of Islamic banking industry increased by Rs. 156 billion during the review quarter to reach Rs. 1,720 billion compared to Rs. 1,564 billion in the previous quarter. Market share of Islamic banking assets and deposits in overall banking industry was recorded at 11.6 percent and 13.7 percent, respectively by end June, 2017 **(see Table 1)**. Profit after tax of Islamic banking industry was registered at Rs. 8.8 billion by end June, 2017 compared to Rs. 6.1 billion in the same quarter last year. Other profitability indicators including return on assets (ROA) and return on equity (ROE) also witnessed some improvement during the quarter under review and were recorded at 0.9 percent and 13.8 percent, respectively.

Table 1: Industry Progress and Market Share

Particulars	Industry Progress			YoY Growth (%)	Share in Overall Banking Industry (%)		
	Jun-16	**Mar-17**	**Jun-17**	**Jun-17**	**Jun-16**	**Mar-17**	**Jun-17**
Total Assets (Rupees in billion)	1,745	1,885	2,035	16.6	11.4	11.7	11.6
Deposits (Rupees in billion)	1,461	1,564	1,720	17.8	13.2	13.2	13.7
Number of Islamic banking institutions	22	21	21	(4.5)	–	–	–
Number of Islamic banking branches*	2,146	2,317	2,320	8.1	–	–	–

Source: Data submitted by banks under quarterly Reporting Chart of Account (RCOA)

*Including sub-branches

Branch Network of Islamic Banking Industry

The network of Islamic banking industry consisted of 21 Islamic banking institutions; 5 full-fledged Islamic banks and 16 conventional banks having standalone Islamic banking branches by end June, 2017. Branch network of Islamic banking industry was recorded at 2,320 branches (spread across 110 districts) by end June, 2017. Province/Region wise breakup of branches reveals that Punjab and Sindh jointly account for 77.1 percent share in overall Islamic banking industry's branch network. In terms of cities, 55 percent branch network of Islamic banking industry is based in five cities (Karachi, Lahore, Rawalpindi, Islamabad and Faisalabad). The number of Islamic banking windows operated by conventional banks having standalone Islamic banking branches stood at 1,255 by end June, 2017 (see **Annexure I** for details).

Table 2: Region Wise Branches (June 30, 2017)

Province/Region	Total Number	Share (%)
Punjab	1,091	47.0
Sindh	699	30.1
Khyber Pakhtunkhwa	258	11.1
Baluchistan	99	4.3
Gilgit Baltistan	10	0.4
FATA	8	0.3
Federal Capital	119	5.1
AJK	36	1.6
Total	**2,320**	**100**

Asset and Liability Structure

Assets: The asset base of Islamic banking industry increased by 8.0 percent (Rs. 150 billion) during the quarter April to June, 2017 and stood at Rs. 2,035 billion compared to Rs. 1,885 billion in the previous quarter. Market share of Islamic banking industry's assets in overall banking industry's assets was recorded at 11.6 percent by end June, 2017. Analysis of assets composition reveals that major flow of funds of Islamic banking industry remained towards financing during the review quarter. The share of net financing and investments in total assets (net) of Islamic banking industry stood at 48 percent and 26 percent, respectively by end June, 2017 (see section below on **Investments** and **Financing** for details).

Analysis of assets by breakup among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that assets of full-fledged Islamic banks increased by 4.1 percent during the review quarter to reach Rs. 1,210 billion compared to Rs. 1,162 billion in the previous quarter. During the same period, assets of Islamic banking branches of conventional banks witnessed quarterly growth of 14.2 percent and were recorded at Rs. 825 billion compared to Rs. 723 billion in the previous quarter. The share of full-fledged Islamic banks and Islamic banking branches of conventional banks in overall assets of Islamic banking industry was 59 percent and 41 percent, respectively by end June, 2017.

Investments (net)

Investments (net) of Islamic banking industry increased by 9.9 percent (Rs. 48 billion) during the period under review and were recorded at Rs. 537 billion by end June, 2017. This increase in investments can be linked with issuance of Government of Pakistan Ijara Sukuk of Rs. 71 billion in June, 2017. Breakup of investments (net) among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that investments (net) of full-fledged Islamic banks declined to Rs. 226 billion by end June, 2017 from Rs. 232 billion in the previous quarter. In contrast, investments of Islamic banking branches of conventional banks increased by Rs. 54 billion during the review quarter and stood at Rs. 310 billion by end June, 2017, compared to Rs. 256 billion in the previous quarter.

Financing and Related Assets (net)

Financing and related assets (net) of Islamic banking industry witnessed growth of 5.9 percent (Rs. 54 billion) during the review quarter and were recorded at Rs. 977 billion by end June, 2017. Bifurcation of financing and related assets (net) among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that financing and related assets (net) of full-fledged Islamic banks grew by 4.6 percent (Rs. 28 billion) during the review quarter and stood at Rs. 640 billion by end June, 2017. Financing and related assets (net) of Islamic banking branches of conventional banks also witnessed quarterly growth of 8.4 percent (Rs. 26 billion) and reached at Rs. 337 billion by end June, 2017. In terms of mode wise financing, Diminishing Musharaka remained the leading mode of financing followed by Musharaka and Murabaha (see **Table 3**).

Table 3: Financing Mix (% Share)

	Jun-16	**Mar-17**	**Jun-17**
Murabaha	20.1	16.4	17.0
Ijarah	7.2	6.4	6.8
Musharaka	12.9	16.3	17.9
Diminishing Musharaka	35.8	32.3	29.6
Salam	3.3	5.2	5.2
Istisna	7.3	8.9	7.2
Others	13.4	14.5	16.3
Total	**100.0**	**100.0**	**100.0**

Review of sector wise financing shows that major portion of financing of Islamic banking industry was extended to production & transmission of energy and textile sectors. However, this is in line with overall banking industry's trend (see **Table 4**).

Table 4: Financing Concentration (% Share)				
	Jun-16	**Mar-17**	**Jun-17**	**Industry**
Chemical and Pharmaceuticals	6.5	6.1	5.4	4.1
Agribusiness	4.0	5.2	8.5	8.9
Textile	13.9	13.2	11.8	12.8
Cement	1.7	1.6	1.7	1.3
Sugar	2.8	4.7	4.1	3.9
Shoes and leather garments	0.6	0.5	0.4	0.4
Automobile and transportation equipment	1.4	1.2	0.9	1.5
Financial	0.6	0.6	1.1	3.1
Electronics and electrical appliances	1.1	1.2	1.2	1.2
Production and transmission of energy	14.9	15.4	14.2	14.6
Individuals	13.2	11.7	11.7	8.9
Others	39.2	38.6	39.0	39.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

Client wise financing remained concentrated in the corporate sector, having a share of 71.1 percent, followed by commodity financing with a share of 11.6 percent by end June, 2017 (see **Table 5**). The share of small and medium enterprises (SMEs) financing in overall financing of Islamic banking industry increased to 3.2 percent by end June, 2017 compared to 2.9 percent in the previous quarter. Share of agriculture financing in overall financing of Islamic banking industry stood at 0.4 percent at end June, 2017.

Table 5: Client Wise Financing Portfolio (% Share)				
	Jun-16	**Mar-17**	**Jun-17**	**Industry**
Corporate Sector	78.1	74.8	71.1	67.5
SMEs	2.8	2.9	3.2	5.9
Agriculture	0.8	0.6	0.4	4.5
Consumer Financing	10.9	10.3	10.5	6.2
Commodity Financing	5.6	9.4	11.6	11.6
Others	1.8	2.0	3.2	4.3
Total	**100.0**	**100.0**	**100.0**	**100.0**

Asset Quality

During the review quarter, key asset quality indicators of Islamic banking industry, including non-performing finances (NPFs) to financing (gross), net NPFs to net-financing and net non-performing assets (NPAs) to total capital remained better than those of overall banking industry's averages (see **Table 6**).

Table 6: Assets Quality Ratios (%)				
	Jun-16	**Mar-17**	**Jun-17**	**Industry**
NPFs to Financing (gross)	4.5	3.9	3.7	9.3
Net NPFs to Net Financing	0.4	0.8	0.8	1.6
Net NPAs to Total Capital	2.8	6.7	6.8	7.7
Provision to NPFs	91.5	80.5	79.6	83.7

Deposits

Deposits of Islamic banking industry witnessed a quarterly growth of 10 percent (Rs. 156 billion) during the quarter April to June, 2017 and were recorded at Rs. 1,720 billion compared to Rs. 1,564 billion in the previous quarter. This pace of growth in deposits of Islamic banking industry was higher than deposits' growth (6.5 percent) of overall banking industry. As a result, market share of Islamic banking industry's deposits in overall banking industry's deposits increased to 13.7 percent by end June, 2017 compared to 13.2 percent in the previous quarter. Category wise breakup of deposits shows that current (non-remunerative) and saving deposits increased by Rs. 74 billion and Rs. 67 billion, respectively; while, fixed deposits declined by Rs. 14 billion during the review quarter (see **Table 7**).

Table 7: Break up of Deposits

	Rupees in billion			% Growth	
	Jun-16	**Mar-17**	**Jun-17**	**YoY**	**QoQ**
Customers					
Fixed Deposits	314	344	330	5.1	(4.1)
Saving Deposits	567	616	683	20.4	10.9
Current accounts – Remunerative	9	7	9	-	28.6
Current accounts - Non-remunerative	460	507	581	26.3	14.6
Others	9	9	14	55.6	55.6
Sub-total	**1,359**	**1,483**	**1,617**	**18.9**	**9.0**
Financial Institutions					
Remunerative Deposits	100	79	102	2.0	29.1
Non-remunerative Deposits	2	2	1	(50.0)	(50.0)
Sub-total	**102**	**81**	**103**	**0.9**	**27.2**
Total	**1,461**	**1,564**	**1,720**	**17.7**	**10.0**

A further breakup of deposits among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that deposits of full-fledged Islamic banks increased by 7.4 percent (Rs. 70 billion) during the review quarter and reached at Rs. 1,027 billion compared to Rs. 957 billion in the previous quarter. In comparison, deposits of Islamic banking branches of conventional banks grew by 14.2 percent (Rs. 86 billion) and stood at Rs. 693 billion by end June, 2017 compared to Rs. 607 billion in the previous quarter. The share of full-fledged Islamic banks and Islamic banking branches of conventional banks in overall deposits of Islamic banking industry was recorded at 60 percent and 40 percent, respectively by end June, 2017.

Liquidity

During the review quarter, liquid assets to total assets and liquid assets to total deposits ratios were recorded at 30.2 percent and 35.7 percent, respectively. Financing to deposits ratio of Islamic banking industry was recorded at 56.8 percent by end June, 2017 compared to overall banking industry's advances to deposits ratio of 48.7 percent (see **Table 8**).

Table 8: Liquidity Ratios (%)

	Jun-16	**Mar-17**	**Jun-17**	**Industry**
Liquid Asset to Total Assets	38.6	29.3	30.2	53.8
Liquid Assets to Total Deposits	46.2	35.3	35.7	74.9
Financing to Deposits (net)	47.6	59.0	56.8	48.7

Capital

Table 9: Capital Ratios (%)				
	Jun-16	**Mar-17**	**Jun-17**	**Industry**
Capital to Total Assets	6.2	6.7	6.6	7.8
(Capital-Net NPAs) to Total Assets	6.1	6.3	6.1	7.2

Capital base of Islamic banking industry increased by 5.6 percent (Rs. 7 billion) during the quarter April to June, 2017 and reached at Rs. 134 billion compared to Rs. 127 billion in the previous quarter. Capital to total assets and capital minus net non-performing assets to total assets ratios of Islamic banking industry were recorded at 6.6 percent and 6.1 percent, respectively (see **Table 9**).

Profitability

Table 10: Profitability & Earning Ratios (%)				
	Jun-16	**Mar-17**	**Jun-17**	**Industry**
Profit after tax (Rupees in billion)	6.1	3.8	8.8	90.0
Return on Assets	0.7	0.8	0.9	1.1
Return on Equity	11.3	12.2	13.8	13.1
Operating Expense to Gross Income	75.6	71.1	68.2	55.8

Profit after tax of Islamic banking industry increased by Rs. 5 billion during the quarter April to June, 2017 and was recorded at Rs. 8.8 billion. Profitability ratios like ROA and ROE of Islamic banking industry showed some improvement and were recorded at 0.9 percent and 13.8 percent, respectively during the review quarter (see **Table 10**). Operating expense to gross income ratio witnessed decline of 2.9 percent during the review quarter. However, this ratio is still higher than that of overall banking industry’s average.

Country Model: Morocco

Morocco can be considered the most advanced of North African neighbours in developing Islamic finance. One of Africa's largest and most sophisticated economies, Morocco is taking assertive measures to boost its infrastructure and make itself more appealing to foreign investors, and this includes being a Muslim-friendly investment destination. The Kingdom is making efforts in positioning itself as an attractive Islamic finance market as it endeavors to make its regional financial hub (Casablanca Finance City) ambition come true.

Regulatory Environment

Since passing an Islamic finance bill in November 2014, Morocco has continued working toward strengthening its regulatory framework to facilitate Shariah compliant banking and financial services. In February 2015, the Higher Council of Ulemas established a new commission dedicated to Islamic banking and in July the same year, the Ministry of Finance and Economy approved an earlier circular outlining the banking licensing process including for Shariah compliant units.

Banking and Finance

Morocco's financial system is considered the most efficient in the MENA region because of its competitive and sophisticated capital market; its insurance industry that is positioned as the second largest in Africa and its mature and developed banking sector.

While official regulations were not passed until 2014, several Islamic banking products such as Ijarah, Musharaka and Murabaha were made available via conventional banks since 2007, although the take-up was limited. There were efforts to launch an Islamic window via Bank Wafa; however, that failed following political oppositions. It was in January, 2017 that the Bank Al-Maghrib, Morocco's central bank, announced the approval of five banks to provide Sharia-compliant products and services. The new legislation uses the phrase 'participatory' banking, rather than 'Islamic' banking, in a bid to encourage private firms to operate independently from the question of religion. The central bank has also established a central Shariah board to oversee the industry. Three of the five authorized institutions are leading national banks, while the central bank has also given approval for the subsidiaries of three leading French banks to offer Islamic products.

Takaful

In May 2015, the Moroccan government approved an insurance bill which introduced the concept of Shariah compliant insurance and details guidelines for running takaful and re-takaful operations including the segregation of funds and Shariah governance. The central bank is considering establishing an Islamic interbank market and working on sovereign treasury Sukuk issuances in order to support the Islamic finance industry.

Future Outlook

The demand for Shariah finance services in the North African country is significant as demonstrated by the number of foreign players keen to expand their geographical footprint into the market. These players are attracted by Morocco's Muslim demographics, strategic location as a gateway between Europe and

Africa and also its position as one of the region's top economies. Islamic financial products have been projected to be worth US$7 billion by 2018, less than 5% of the expected total market share, according to the Moroccan Association of Participative Financiers.

Islamic finance opportunities may be lucrative in Morocco, with many eager to jump at them; however, in order for the potential to be realized, the regulatory infrastructure needs to be further bolstered such as in the areas of Islamic insurance and tax. The country will also need to look at developing Shariah liquidity instruments, as at present, Morocco's financial market lacks liquidity and foreign investment. The introduction of Islamic banking will therefore help increase financial inclusion, investment stability and accelerate economic development for the nation. It has also been predicted that there will be a rise in the use of contactless payments and Sharia-compliant credit cards.

Sources of Information

- Central Bank of Morocco website https://www.bkam.ma
- www.islamicfinancenews.com
- https://www.islamicfinance.com/
- https://www.worldfinance.com/
- http://www.reuters.com/

A Brief on IFSB 12: Guiding Principles on Liquidity Risk Management for Institutions offering Islamic Financial Services (excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes)

Background, Purpose and Objectives

Institutions offering Islamic financial services (IIFS) have often found management of liquidity risk a very challenging part of their operations. These challenges can be observed at all tiers of the liquidity risk management framework of an IIFS – institutional, interbank and central bank levels.

The global financial crisis, which later transformed into a broad ranging economic crisis, impacted a large number of financial institutions in both developed and developing economies. Whereas IIFS were largely spared from the initial impacts of the financial crisis due to, among other things, a ban on investments in excessively leveraged financial products and Riba-based equity investments in the form of shares, subsequent tightening of liquidity and credit in the global financial markets adversely impacted a large number of financial institutions, including IIFS. Owing to the growing market share of IIFS in many jurisdictions and their potential significance for systemic soundness and stability of the overall financial system, the need for a robust liquidity risk management framework for IIFS cannot be overemphasized.

Keeping in view the significance of this subject, the Council of the Islamic Financial Services Board (IFSB), in its 15th meeting in Kuala Lumpur, Malaysia, approved the establishment of a working group to develop a set of Guiding Principles on Liquidity Risk Management for IIFS (hereinafter collectively referred to as the "Guiding Principles"). This set of Guiding Principles is intended to provide guidance to IIFS in a number of key areas in their management of liquidity risk, and to facilitate the supervisory authorities' assessment of the adequacy of IIFS' liquidity risk management framework and levels of liquidity within their constituency.

These Guiding Principles endeavour to provide a set of principles for the robust management of liquidity risk by IIFS and its vigorous supervision and monitoring by the supervisory authorities, taking into consideration the specificities of the IIFS and complementing relevant existing and emerging international best practices. There are 23 guiding principles in the area of liquidity risk management for IIFS (excluding (a) Islamic insurance (Takaful) institutions, and (b) Islamic collective investment schemes).

Scope and Application of the Standard

This set of Guiding Principles is primarily intended to serve banking institutions offering Islamic financial services. These IIFS include, but are not limited to: full-fledged Islamic commercial banks; Islamic investment banks/companies; Islamic banking subsidiaries of conventional banks; Islamic banking branches/divisions/units of conventional banks (hereinafter collectively referred to as "Islamic windows"); and other Shariah-compliant fund-mobilizing institutions, as determined by the respective supervisory authorities. Supervisory authorities shall implement these Guiding Principles with due consideration to proportionality taking account of the size, sophistication and complexity of the IIFS in their market.

The Guiding Principles are prepared in line with the objectives of the IFSB to (i) promote the development of a prudent and transparent IFSI through introducing new, or adapting existing, international standards consistent with Shariah principles, and recommending these for adoption; and (ii) provide guidance on the effective supervision and regulation of institutions offering Islamic financial products and to develop for the IFSI the criteria for identifying, measuring, managing and disclosing risks.

IIFS need to recognize that, like other areas of risk management, liquidity risk and asset– liability management (ALM) should be integrated with their enterprise risk management (ERM) systems and overall stress testing frameworks. For this purpose, IIFS will be expected to implement enhanced data management processes which can provide accurate risk intelligence to senior management and various business units across the IIFS.

Liquidity Risk and Liquidity Risk Management

Liquidity risk is the potential loss to IIFS arising from their inability either to meet their obligations or to fund increases in assets as they fall due without incurring unacceptable costs or losses. Liquidity risk can be categorized into two major types: funding and market liquidity risk. Funding liquidity risk is the risk that an IIFS will not be able to meet efficiently both its expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the IIFS. Market liquidity risk is the risk that an IIFS cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption.

Liquidity risk can arise due to funding or market risk, or various factors arising due to a combination of these risks, which might be linked to changes in institutional or systemic behavior. An IIFS may face funding liquidity risk due to unexpected withdrawals or transfers of funds by its investment account holders (IAH) and depositors for several reasons, including reduced creditworthiness, displaced commercial risk, Shariah non-compliance risk or reputational risk. On the assets side, an IIFS may face funding strain due to problems in its financing and investment portfolio – for example, a fall in value of marketable assets held for trading or in the banking book, lack of liquid markets for holdings of Sukuk and other Shariah-compliant instruments, the impairment of Islamic financing assets due to the financial distress of customers, and large drawdowns under committed line-of-credit agreements. An IIFS may also face increased liquidity risk due to operational and information system failures of counterparties, or because of problems in a payment and settlement system resulting in late payment or non-payment of funds due.

Bearing in mind the strong interactions between funding and market liquidity risk, the Guiding Principles provide various insights into both funding and market liquidity risk in IIFS and their correlations. The Guiding Principles also elaborate the role of supervisory authorities in providing a necessary framework and complementing it with regulatory guidelines for enhancing market liquidity for IIFS. In order to meet the shortfall in funding liquidity, an IIFS can opt to sell its assets in the Islamic money market. In this way, funding liquidity risk is mitigated through raising cash by the selling of assets. Insufficient market depth – due to the lack of an adequate number of players, as well as the insufficient quantity and volume of instruments in the market – can make it difficult for an IIFS to generate cash by selling assets, thus contributing to an increased funding liquidity risk. In stressed conditions, deterioration in market liquidity may either impact the liquidity of a particular type of instrument or affect a wide range of assets in the market.

Necessary Elements of Effective Liquidity Risk Management in the IFSI

The term "liquidity infrastructure" refers to a set of key institutional and operational arrangements which in any jurisdiction can provide a facilitating environment to financial institutions in that jurisdiction for managing their liquidity in normal and stressed times, as well as supporting market liquidity in the system. The components of a balanced liquidity infrastructure are largely institutional in nature. These infrastructure elements may or may not be within the scope of the authority of the supervisory authority. Nevertheless, supervisory authorities should communicate to the relevant state authorities and institutions the actual and potential negative repercussions of not providing a facilitating atmosphere to IIFS for managing their liquidity in an effective and competitive manner and thus ensuring the soundness and stability of IFSI as well as of the financial sector as a whole. Supervisory authorities may also liaise with relevant state authorities and institutions by providing the necessary technical support and assisting in finding appropriate solutions for IFSI.

IIFS, like their conventional counterparts, are involved in maturity transformation by accepting short-term deposits and investment accounts and providing financing mainly on a medium- to long-term basis. This maturity transformation process entails a number of risks for an IIFS, including liquidity risk. Commonly, major risks faced by conventional financial institutions are managed through instruments that offer opportunities to hedge and transfer the risk, financial markets that make available other counterparties for funding positions for desired maturities, and an enabling payment and settlement system that provides a platform for clearance and processing of payments across the financial institutions. There are a number of shortcomings faced by the IFSI in terms of various components of a liquidity infrastructure for IIFS, as described earlier. In many jurisdictions, there is a shortage or unavailability of a supporting liquidity infrastructure in terms of market players, Shariah-compliant instruments and associated interbank, money and secondary markets. Likewise, conditions may not exist for ensuring the effectiveness of a Shariah-compliant LOLR facility and Shariah-compliant deposit insurance. In addition, there is typically a lack of a well-functioning insolvency regime for IIFS.

The availability of the infrastructure elements at the jurisdiction level not only provides a level playing field for IIFS– making them more sound, competitive and in tune with the international legal and regulatory environment – but also fosters avenues for international cooperation and the expansion of IIFS. It will also help IIFS to reduce their cost of intermediation, enhance the level of liquidity in the system, and improve their profitability by removing obstacles to the effective management of liquidity risk and the deployment of liquid funds in the market. From a macro-prudential stability viewpoint, these necessary building blocks will enhance the ability of an IIFS to meet expected and unexpected cash-flow obligations, thus reducing the possibility of liquidity shortfalls and systemic contagion across the financial markets. (Detailed analysis on the Guiding Principles will be presented in the forthcoming edition of Islamic Banking Bulletin).

Source: IFSB website http://www.ifsb.org/

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

A. Events

Training Program on "Islamic Banking & Finance" for Shariah Scholars held at Lahore

Keeping in view the training needs identified at various forums, SBP, in collaboration with SBP-BSC, Lahore office, arranged a 3-day training program on Islamic Banking & Finance during April 1–3, 2017 at Jamia Naeemia, Lahore. The program was attended by 31 Shariah scholars and was delivered by Mufti Syed Sabir Hussain, Resident Shariah Board Member, MCB Islamic Bank Limited. The closing ceremony was graced by the presence of Regional Head Central/Chief Manager SBP-BSC, Lahore Office.

Training Programs on "Fundamentals of Islamic Banking Operations" (FIBO) held at Sialkot, Islamabad and Quetta

IBD, in collaboration with NIBAF, arranged three training programs titled 'Fundamentals of Islamic Banking Operations' (FIBO). The training programs were aimed to enhance skills and knowledge base of field staff of Islamic banking institutions particularly branch managers (BMs), operation managers (OMs) and relationship managers (RMs). These programs were organized during the period April 10-14, 2017, April 24-28, 2017 and April 15-19, 2017 at Sialkot, Islamabad and Quetta, respectively. The training programs were also attended by academia and Shariah scholars of the respective regions.

SBP-CIIT Capacity Building Workshop for Shariah Scholars and Bankers held at Abbottabad

IBD, in collaboration with Centre of Islamic Finance (CIF), COMSATS Institute of Information Technology (CIIT) agreed to arrange six capacity building workshops on Islamic banking & finance in various cities. In this regard, first workshop was arranged during May 17-18, 2017 at Abbottabad. The program was attended by 84 participants, including local Shariah scholars and staff of Islamic banking institutions and received an overwhelming response.

B. Developments

IBD, SBP has actively pursued the Federal Board of Revenue (FBR) for resolution of taxation issues faced by the Islamic banking institutions and their customers. A summary of some significant issues which have been resolved is as under:

- According to FBR circular dated June 19, 2017:
  a) Net income, as opposed to gross receipts, from Islamic modes of financing namely Murabaha, Bai Muajjal, Bail Salam, Istisna, Tijarah, Istijrar financing and Tawarruq/Commodity Murabaha will be considered as turnover for the purpose of levying minimum tax under Section 113.
  b) Profit implicit in Ijara financing income of Islamic banking institutions shall be recognized for tax purposes as is the case of finance lease by other banking companies.

- The Ministry of Finance issued SRO 588(I) 2017 dated 1st July, 2017 stating that Musawamah, Bai Muajjal, Bai Salam, Istisna, Tijarah, Istijrar financing products shall not be subject to double taxation under Sales Tax Act 1990.
- According to Federal budget speech 2017-18, investment in Sukuk up to Rs. 2 million shall be exempted from tax.
- According to the Finance Act 2017:

  a) Customers availing financing under Musharaka and Diminishing Musharaka modes will receive equal tax treatment vis a vis their conventional counterparts.
  b) Taxation rates previously applicable only on return on investment in Sukuk, received from a Special Purpose Vehicle (SPV), shall also be applicable on Sukuk which is issued by a company without establishing SPV.

Islamic Banking News and Views

A. Local Industry News

SECP approves prospectuses of two new Modarabas

The Securities and Exchange Commission of Pakistan (SECP) has approved the prospectuses of two new Modarabas in Pakistan: Habib Metro Modaraba and Orient Rental Modaraba. According to a statement, the SECP's board certified that the business specified in the prospectuses of both Modarabas complies with the precepts of Islam. Habib Metro Modaraba will primarily provide car financing solutions, while Orient Rental Modaraba will focus on the rental business of generators and heavy machinery.
www.islamicfinancenews.com

Meezan and 1Link launch debit cards

Meezan Bank has partnered with 1Link, an interbank payment network service provider, to issue PayPak branded debit cards. According to a press release, the domestic payment scheme will enhance accessibility to ATMs and point-of-sale terminals and will boost the usage of plastic money in the country. The Islamic debit card is targeted to provide cost-effective payment solutions to the underserved and unbanked population of Pakistan.
www.islamicfinancenews.com

SBP and SECP to initiate council of regulators

The State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP) has signed a letter of understanding to establish a Council of Regulators, according to a statement by the central bank. The council will provide a platform to discuss systemic risk issues, especially those with cross-market and stability implications, among other features. The council will consist of the two regulators: the SBP will be represented by the governor, a deputy governor and an executive director while the SECP will be represented by the chairman, a commissioner and an executive director.
www.islamicfinancenews.com

Future of Islamic banking bright: Governor Sindh

Sindh Governor, Muhammad Zubair has observed that Islamic finance is fast growing globally and the future of Islamic banking remains bright not only in Muslim countries but also in non-Muslim countries. Addressing the participants at the inauguration of sixth Islamic Finance Expo and Conference, organised by The Professionals Network (TPN) on May 04, 2017, the governor stressed the need for looking for more logical reasons to attract people towards Shariah compliant banking as more than 95 percent of people strongly believe that the conventional banking is against Shariah.
http://nation.com.pk/karachi/05-May-2017/future-of-islamic-banking-bright-governor

SECP relaxes Sukuk regulations

The SECP has announced that it is making amendments to the 2015 Issue of Sukuk regulations with an aim to reduce the cost of issue and easing the regulatory burden, according to a press release. The proposed amendments include: waiving mandatory underwriting where the purpose of the issue is to repay existing debts; reducing the minimum number of underwriters from two to one; and aligning the definition of Sukuk with the definition given by AAOIFI, among others.

www.islamicfinancenews.com

Pakistan's Companies Act 2017 takes effect

Pakistan's president, Mamnoon Hussain has signed the Companies Act 2017 into law, according to a statement by the Securities and Exchange Commission of Pakistan. The law, which has 515 sections and eight schedules, is expected to provide smaller companies with a simpler regime, encourage e-governance and increase transparency, among others.
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SECP approves draft Insurance Bill

The draft Insurance Bill, 2017, which includes provisions for the regulation of takaful and re-takaful, has been approved by the SECP and submitted to the Ministry of Finance for its onward submission to the Ministry of Commerce to begin the necessary legislative process, the regulator confirmed in a statement.
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Islamic bankers greet tax neutrality on financial instruments

Islamic banking industry commended the government's move to consider Shariah-compliant financial institutions at par with conventional banking in terms of tax liability on inter-bank transactions and when it comes to taxation on their investment products. The government, in the budget speech for the fiscal year 2017-18, said tax neutrality for Islamic banking instruments, such as Musharaka, Ijarah, Murabaha as compared with conventional banking, "is proposed to be provided," on the recommendation of the State Bank of Pakistan (SBP) and to promote Islamic mode of financing.
https://www.thenews.com.pk/print/206818-Islamic-bankers-greet-tax-neutrality-on-financial-instruments

B. International Industry News

IFSB to expand PSIFIs coverage

The IFSB will extend the coverage of its Prudential and Structural Islamic Financial Indicators (PSIFIs) project to include the takaful and Islamic capital market sectors, Acting Secretary General, Zahid Ur Rehman Khokher said in a statement. "The IFSB will work closely with its member regulatory supervisory authorities from these two sectors and multilateral organizations on the selection of the relevant soundness indicators and the preparation of a compilation guide for the reference of contributing organizations and users," Zahid said.
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Alliance launches Alliance Cash2Home

Alliance Bank and Alliance Islamic Bank have unveiled 'Alliance Cash2Home', a mobile foreign remittance application which provides paperless account opening and remittance services via mobile phone. According to a press release, the app primarily offers foreign remittance service to nine countries, namely Indonesia, Nepal, Bangladesh, Myanmar, India, the Philippines, Sri Lanka, Pakistan and Vietnam. The app, which is the first of its kind in Malaysia, authorizes mobile transactions via facial recognition biometrics and by securing the smartphone owned by the account holder.
www.islamicfinancenews.com

AAOIFI approves accounting standard

AAOIFI's accounting board has approved in principle the exposure draft of the accounting standard on impairment and credit losses during the board's meeting, according to a press release. The standard aims to list rules and principles for impairment and credit losses, focusing on current and expected losses; and to aid the classification of assets and exposures according to the credit risk and other risks involved. The standard, once published, will be replacing AAOIFI's earlier standard, FAS 11 Provisions and Reserves.
www.islamicfinancenews.com

Bank of England plans liquidity tool for Islamic banks

The Bank of England said it will develop a Shariah compliant liquidity tool for use by Islamic banks, underscoring efforts to attract business from the industry's core centers in the Middle East and South East Asia. The central bank has issued a consultation paper on a fund-based deposit model for the facility, which would help Islamic lenders meet regulatory requirements for liquid asset buffers.
http://www.businesstimes.com.sg/banking-finance/bank-of-england-plans-liquidity-tool-for-islamic-banks

IMF warns Kenya of loopholes in Islamic banking regulation

The International Monetary Fund (IMF) has warned that the rapid growth of Islamic finance in Kenya is happening without adequate protection of depositors as is the case with conventional banking. The IMF says in a newly released report that Kenya is yet to refine its prudential regulations to cater for Islamic banking despite the fact that the Shariah banks are offering loan products that are collateralized differently from conventional bank loans. "The legal framework exhibits some gaps, prudential frameworks have not been adapted to the specificities of Islamic banking and there are also remaining gaps in the Shariah governance framework, consumer protection framework, liquidity management, resolution and safety nets," says the IMF report.
http://www.businessdailyafrica.com/news/IMF-warns-Kenya-risk-Islamic-banks/539546-3981960-jbhr1pz/index.html

IFSB adopts IFSB-19

The IFSB, in the 30th meeting of the IFSB Council, witnessed the resolution to approve the Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukuk and Islamic Collective Investment Schemes) or the IFSB-19.
www.islamicfinancenews.com

Ummah Finance to become first UK-based mobile Islamic bank

Ummah Finance aims to be "the first UK born Islamic bank solely set up and operating from London", with a fully digital proposition. Whilst there are 40 banking services currently offering Islamic banking solutions in the UK, "none of these offer a fully mobile and 100% Shariah compliant banking service", Ummah Finance claims. It will incorporate all features of a standard bank but will be fully compliant with the Islamic principles, the company says.
http://www.bankingtech.com/800762/ummah-finance-to-become-first-uk-based-mobile-islamic-bank/

Bangladesh Bank issues BGIIB

The central bank of Bangladesh, Bangladesh Bank has announced in a statement that it has issued the six-month Bangladesh Government Islami Investment Bond (BGIIB). The paper received a total of six bids amounting to BDT1.85 billion (US$22.58 million). The profit-sharing ratio of the accepted bids was 90:10.

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IFSB launches TN-2 user guide

The IFSB has released a user guide to facilitate the use and implementation of the stress testing templates in its Technical Note on stress testing for institutions offering Islamic financial services (TN-2). TN-2 has five stress-testing templates, one each on conducting credit, market and liquidity risk assessments as well as for the rate of return risk and a scenario analysis template that combines credit and market risk stress tests. The user guide is to complement the main technical note while providing additional guidance on the use of the templates set out in TN-2.

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Islamic finance sustains market share in 2016

According to the IFSB's Islamic Financial Services Industry Stability Report 2017, amidst a challenging external environment and shifting global economic landscape, institutions offering Islamic financial services have continued to grow and gain market share, particularly in their home jurisdictions. The market share of Islamic banks increased in 18 jurisdictions while the number of jurisdictions where Islamic finance has achieved domestic systemic importance also increased to 12 in the past year.

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The race to become Islamic banking's fintech hub

For all the sophistication of some of its financial centres, and despite the ubiquity of smartphones, the Middle East has been a late adopter of financial technology, or fintech. Of more than $50bn in fintech investment globally since 2010, according to Accenture, a consultancy, only 1% has gone to the Middle East and North Africa.

https://www.economist.com/news/finance-and-economics/21722895-financial-centres-middle-east-scramble-join-fintech-wave-race

Takaful and re-takaful: the steady growth

The global takaful industry recorded a 12% year-on-year growth in contributions while conventional insurance premiums only grew by 4% in 2016, according to the IFSB's Islamic Financial Services Industry Stability Report 2017.

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Islamic finance may slow down in 2018

The international Islamic finance industry is set to expand this year, but 2018 would see a slowdown, says S&P Global Ratings. S&P reported that most of the industry's growth is centered within the GCC, Malaysia and Iran, all of which collectively account for more than 80% of the industry's assets. Though Malaysia's Islamic finance sector continues to perform adequately, the average growth rate in

the GCC dropped significantly between 2012 and 2017. Worsening currency exchange rates have also impacted the performance of the industry in Iran, Malaysia, Turkey and Egypt.
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C. Articles & Views

Testing territory: the evolution of Islamic trade finance
Trade finance has had a troubled time of it lately, with the last few years experiencing a slump in activity amid a slowing economic climate, struggles with sanctions and soaring compliance requirements. This has increased the burden on many banks, but in the case of Islamic finance, things are only getting better.
www.islamicfinancenews.com

Human capital: an ever-growing need
Islamic finance is in need of trained and experienced talent as the pool of people with the right skill set capable of taking on the increasing amount of positions in the industry has not grown as much as the sector itself. Fortunately, the industry is aware of the situation and is addressing this issue through the development of courses, degrees and e-learning platforms.
www.islamicfinancenews.com

What's the importance of risk modeling in Islamic finance?
Risk models in finance are, in many respects, not that different from finance models in general. Risk models are simply finance models which embed uncertainty into the model set up. For example, a Sukuk valuation model becomes a Sukuk risk model when we use it to understand how we expect Sukuk values to change if other things linked to a Sukuk value change, such as credit default rates on receivables which underlie the Sukuk.
www.islamicfinancenews.com

Infrastructure Sukuk – a viable financing alternative for infrastructure projects
The critical role of infrastructure in growth, productivity, job creation and poverty alleviation is undeniable. The extent (mainly access to basic services such as clean water, electricity, adequate sanitation and transportation) and quality of infrastructure in emerging markets and developing economies (EMDEs) are still considerably lower than in advanced economies. This lack of infrastructure not only comes at enormous social costs but also hampers future economic growth in these regions, causing these countries to lag behind their peers in sustainable development.
www.islamicfinancenews.com

Financialization of commodities: new growth opportunities in Islamic finance
The global economy continues to stay volatile and uncertain. This volatility would touch 2020 or even beyond. Some wiseacres can deny it or live in illusion by stating that the global economy is recovering or heading into the phenomenal growth mode. On the other hand, market intelligence reports are getting to be quite amazing and crisis specific. We are heading into a financial earthquake where a lot of investors would lose their wealth if they had taken a position in overvalued asset classes.
www.islamicfinancenews.com

Increased utilization of Islamic financing a boost to secondary markets

With more infrastructure projects utilizing Islamic financing coming to the fore in recent times, there is growth opportunity for the Islamic capital markets, given that there will be a better liquidity prospect which would help provide the much-needed boost to the secondary markets.

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Private equity: participation in risk and return

Private equity (PE) is a source of investment capital raised from institutional investors and wealthy people by professional investment managers to be invested into private companies or public companies with a view to delist and manage them privately. PE is a vehicle for investors to gain access to potential high returns that businesses around the world can generate. At the end of the day, business profits are the original source of returns on which any other securities' returns, such as bonds, stocks and such are all dependent.

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Annexure: I

Islamic Banking Branch Network

(As of June 30, 2017)

Type	Name of Bank	No of Branches	Windows
Islamic Banks	AlBaraka Bank (Pakistan) Limited	178	-
	BankIslami Pakistan Limited	204	-
	Dubai Islamic Bank Pakistan Limited	200	-
	Meezan Bank Limited	571	-
	MCB Islamic Bank Limited	66	-
	Sub-Total	**1,219**	
Standalone Islamic Banking Branches of Conventional Banks	Allied Bank Limited	83	-
	Askari Bank Limited	91	-
	Bank AL Habib Limited	42	109
	Bank Alfalah Limited	151	121
	Faysal Bank Limited	157	-
	Habib Bank Limited	45	494
	Habib Metropolitan Bank Limited	25	213
	National Bank of Pakistan	134	-
	Silk Bank Limited	10	-
	Sindh Bank Limited	14	13
	Soneri Bank Limited	18	-
	Standard Chartered Bank (Pakistan) Limited	9	88
	Summit Bank Limited	14	35
	The Bank of Khyber	79	39
	The Bank of Punjab	48	-
	United Bank Limited	47	143
	Sub-Total	**967**	**1,255**
	Total Branches	**2,186**	
Sub Branches	AlBaraka Bank (Pakistan) Limited	8	-
	Askari Bank Limited	3	-
	BankIslami Pakistan Limited	118	-
	The Bank of Punjab	2	-
	Habib Bank Limited	2	-
	United Bank Limited	1	-
	Total Sub-Branches	**134**	**-**
	Grand Total Branches/Sub-Branches	**2,320**	**1,255**

Source: Information/Data obtained from different banks

Annexure: II

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

(As of June 30, 2017)

Type	Bank Name	Azad Kashmir	Balochistan	FATA	Federal Capital	Gilgit-Baltistan	Khyber Pakhtunkhwa	Punjab	Sindh	Grand Total
Islamic Banks	AlBaraka Bank (Pakistan) Limited	3	6	-	6	1	16	98	48	178
	BankIslami Pakistan Limited	3	12	-	9	2	17	90	71	204
	Dubai Islamic Bank Pakistan Limited	7	5	-	11	-	8	85	84	200
	Meezan Bank Limited	6	19	-	30	2	36	288	190	571
	MCB Islamic Bank Limited	-	9	1	3	-	7	26	20	66
	Islamic Banks	**19**	**51**	**1**	**59**	**5**	**84**	**587**	**413**	**1,219**
Standalone Islamic Banking Branches of Conventional Banks	Allied Bank Limited	1	3	-	4	-	8	48	19	83
	Askari Bank Limited	-	3	-	8	1	13	46	20	91
	Bank AL Habib Limited	-	2	-	1	-	3	13	23	42
	Bank Alfalah Limited	1	5	-	10	-	8	89	38	151
	Faysal Bank Limited	2	10	-	7	1	23	80	34	157
	Habib Bank Limited	2	1	1	4	-	4	23	10	45
	Habib Metropolitan Bank Limited	-	-	-	1	-	4	8	12	25
	National Bank of Pakistan	7	5	2	3	-	23	69	25	134
	Silk Bank Limited	-	1	-	1	-	2	4	2	10
	Sindh Bank Limited	1	1	-		-	2	7	3	14
	Soneri Bank Limited	-	1	-	2	1	2	8	4	18
	Standard Chartered Bank (Pakistan) Limited	-	-	-	1	-	1	1	6	9
	Summit Bank Limited	-	1	-	2	2	1	2	6	14
	The Bank of Khyber	-	4	4	2	-	56	10	3	79
	The Bank of Punjab	1	-	-	4	-	6	37	-	48
	United Bank Limited	1	4	-	1	-	11	14	16	47
	Islamic Banking Branches Total	**16**	**41**	**7**	**51**	**5**	**167**	**459**	**221**	**967**
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	57	118
	Faysal Bank Limited	-	-	-	-	-	-	-	-	-
	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**	**45**	**65**	**134**
Grand Total		**36**	**99**	**8**	**119**	**10**	**258**	**1,091**	**699**	**2,320**

Annexure: III

District wise Break-up of Islamic Banking Branch Network

(As of June 30, 2017)

S. No	Province	District	No of Branches*
1	Sindh	Badin	2
2		Dadu	5
3		Ghotki	3
4		Hyderabad	48
5		Jacobabad	4
6		Jamshoro	2
7		Karachi City	571
8		Khairpur	2
9		Larkana	5
10		Matiari	1
11		Mirpurkhas	10
12		Naushahro Feroze	1
13		Shaheed Benazir Abad	11
14		Sanghar	9
15		Shikarpur	1
16		Sukkur	14
17		Shahdadkot	1
18		Tando Allahyar	4
19		Tando Mohammad Khan	1
20		Thatta	1
21		Umer Kot	3
Sindh Total			**699**
22	Punjab	Attock	15
23		Bahawalnagar	11
24		Bahawalpur	20
25		Bhakkar	1
26		Chakwal	12
27		Chiniot	3
28		Dera Ghazi Khan	9
29		Faisalabad	93
30		Gujranwala	51
31		Gujrat	44
32		Hafizabad	4
33		Jhang	10
34		Jhelum	14
35		Kasur	14
36		Khanewal	15
37		Khushab	4
38		Lahore City	368
39		Layyah	6
40		Lodhran	4
41		Mandi Bahauddin	10
42		Mianwali	7
43		Multan	59
44		Muzaffargarh	7
45		Nankana Sahib	4
46		Narowal	5
47		Okara	12
48		Pakpattan	7
49		Rahim Yar Khan	29
50		Rajanpur	3
51		Rawalpindi	121
52		Sahiwal	23
53		Sargodha	25
54		Sheikhupura	15
55		Sialkot	36
56		Toba Tek Singh	14
57		Vehari	16
Punjab Total			**1,091**

S. No	Province	District	No of Branches*
58	Khyber Pakhtunkhwa	Abbottabad	19
59		Bannu	5
60		Batagram	3
61		Buner	3
62		Charsadda	9
63		Chitral	4
64		Dera Ismail Khan	10
65		Hangu	4
66		Haripur	6
67		Karak	1
68		Kohat	7
69		Lakki Marwat	1
70		Lower Dir	10
71		Malakand	10
72		Mansehra	11
73		Mardan	17
74		Nowshera	14
75		Peshawar	84
76		Shangla	4
77		Swabi	6
78		Swat	25
79		Tank	1
80		Torghar	1
81		Upper Dir	3
Khyber Pakhtunkhwa Total			**258**
82	Gilgit-Baltistan	Skardu	1
83		Diamir	5
84		Gilgit	4
Gilgit-Baltistan Total			**10**
85	FATA	Bajaur Agency	1
86		Khyber Agency	4
87		Mohmand Agnecy	1
88		Orakzai Agency	2
FATA Total			**8**
89	Federal Capital	Islamabad	119
Capital Total			**119**
90	Balochistan	Chaghi	1
91		Gawadar	3
92		Harnai	1
93		Turbat	1
94		Khuzdar	1
95		Lasbela	5
96		Loralai	5
97		Pishin	6
98		Quetta	59
99		Qilla Abdullah	6
100		Qilla Saifullah	4
101		Zhob	6
102		Ziarat	1
Balochistan Total			**99**
103	Azad Kashmir	Bagh	1
104		Bhimber	1
105		Dadyal	4
106		Hattian Bala	1
107		Kotli	3
108		Mirpur	15
109		Muzaffarabad	9
110		Poonch	2
Azad Kashmir Total			**36**
Grand Total			**2,320**

*including sub-branches