

## **Islamic banking industry in Pakistan set to double its market share in next five years: Yaseen Anwar**

Mr. Yaseen Anwar, Governor, State Bank of Pakistan (SBP) has expressed the hope that Pakistan's Islamic banking industry is all set to double its market share in the next five years.

Inaugurating the second two-day International Conference on Islamic Business (ICIB) on 'Managing Shariah Conforming Businesses: Prospects, Practices and Personnel' organized by Riphah International University at the National Institute of Banking & Finance (NIBAF), Islamabad today, he said that Islamic banking industry in Pakistan is growing at a fast pace and maintaining an average growth rate of 30 percent over the past six years.

He said the Islamic banking industry's asset base has reached Rs. 641 billion which constitutes almost 8 percent of the overall banking industry while deposits represent 8.5 percent of the banking system's deposits. Islamic banking network is also spread across the country at a significant pace with the total number of branches reaching 886, he said, adding that the industry is still facing challenges and constraints that need to be addressed to sustain the growth momentum.

'Given its relatively short history, the industry has over one trillion dollar assets with presence in over 75 countries across the globe. The widespread growth has not only been a result of activities of pure Islamic financial institutions but also has contributions of conventional institutions that eyed Islamic finance as a profitable economic opportunity. Moreover, resilience of Islamic financial institutions during the financial crisis has lent them more credence than their interest-based conventional counterparts,' SBP Governor added.

Mr. Anwar said that a closer look at the second round impacts of recent financial crisis shows that Islamic financial institutions did take some hit as a result of downturn in property markets (real sector). He said that the inherent risk sharing mechanism though has helped the industry steer through this turbulent period but economic anxiety of these times has pointed towards the need of better risk management practices and due diligence on part of Islamic financial institutions.

SBP Governor pointed out that Islamic banks, both at global and domestic level, are working in the shadow of conventional finance i.e. adoption of conventional products that have been tailored to comply with Shariah principles. He said that problems of moral hazard, adverse selection are of serious nature and remain a major hurdle in using participatory modes of financing. 'However, their absence deprives the industry from attaining one of its desired socio economic goals of ensuring equitable distribution of wealth. State Bank of Pakistan is aware of the issue and is working on a framework in consultation with the industry to encourage participatory mode based financing,' he added.

Mr. Anwar said that agriculture and SME are sectors of paramount importance in terms of their contribution to Pakistan's GDP, employment generation and overall development of the country. However, these remain largely ignored despite their huge potential and financing appetite, he added. 'For example, agriculture comprises 21% of GDP and 45% of the workforce, that Pakistan is also the fifth largest milk producer in the world but does not export any dairy products as New Zealand. This represents huge Sharia compliant opportunities for Islamic banks,' he said and added that reaching out to such sectors will not only be beneficial for Islamic financial industry but will also guarantee economic welfare of the society. 'Realizing the significance of Shariah-compliant agriculture financing, the State

Bank is working rigorously with the industry to develop standardized products and has issued a model Salam based product recently to facilitate financing in this sector,' SBP Governor added.

He said that SBP is incentivizing and facilitating Islamic banks to expand in 2<sup>nd</sup> and 3<sup>rd</sup> tier cities. SBP has revised the definition of rural and underserved areas, according to which any district having less than 10 Islamic Banking Branches (IBBs) will be termed as underserved with respect to Islamic banking facilities,' he said, adding that Islamic banks need to be more aggressive in increasing their outreach to these areas as more than 70 percent of their presence is still concentrated in 12 cities.

'In order to encourage existing Islamic banking players and incentivizing new entrants, SBP has not only allowed the establishment of full-fledged Islamic microfinance banks and permitted full-fledged Islamic banks and Islamic windows to offer Islamic microfinance services but has also issued guidelines for Islamic microfinance business,' Mr. Anwar added.

Referring to issues confronting the industry which revolve around asset liability mismatch due to lack of investment avenues and its adverse impact on portfolio of Islamic banks, he said that limited Shariah compliant instruments and avenues make it difficult for Islamic banks to efficiently place their excess liquidity that negatively affects their deposit mobilization ability. To this end the development of Sukuk has been instrumental, he said, adding that frequent Sukuk issuance in Pakistan since October 2010 has resulted in improving profits of the industry. Mr. Anwar said that absence of secondary market and Lender of Last Resort facility in many countries including Pakistan further creates barriers for Islamic financial institutions in managing their operations effectively.

'Acknowledging the dire need of an Islamic Money Market, SBP is focused on developing a comprehensive solution that would provide Islamic interbank money market, Islamic Interbank Offered Rate (IIBOR) as benchmark for pricing of various Islamic banking products, development of Shariah Compliant portfolio of SBP to offer placement facility to Islamic banks and the provision of lender of last resort facility. This mechanism can also help the government in bridging its financing needs,' he added.

SBP Governor emphasized that the growth of any industry is subject to overall global environment and so the architecture of Islamic banking industry needs to be agile enough to adjust to ever changing requirements. 'Investment in human resource, technology and research and development can be key building blocks of such architecture, he said and added: 'We are encouraging Islamic banks to use sophisticated technologies to be more efficient and have provided them leverage for product development.'

He said that SBP is helping the industry in developing desired human resource. 'We offer regular Islamic Banking courses to domestic and international participants through our training subsidiary, NIBAF. We also offer customized training for professionals and experts as well as cross country official visits,' Mr. Anwar added.

'We are also collaborating with many international and domestic well-reputed research and training institutes and universities for developing and conducting Islamic banking courses, trainings and degree programmes. We have recently launched customized capacity building programme for front line managers with special focus on handling client queries,' he said, adding that for raising awareness, we have also launched mass awareness campaign and have conducted targeted workshops, public seminars and conferences.

'On the legislation front, regulations should be dynamic enough to facilitate the growth of the industry while protecting interest of all stakeholders and I can assure you that the State Bank of Pakistan remains committed to these objectives,' SBP Governor added.

\*\*\*\*