

5 Islamic Banking

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Islamic Banking industry of Pakistan expanded briskly during the last decade and the trend continued in FY14. From June 2013 to June 2014, total assets of the industry recorded a phenomenal growth of 20.5 percent. As of June 2014, the industry's asset base reached above Rs 1 trillion and constituted nearly 10 percent of the overall banking industry. Deposits of Islamic banking industry increased to reach Rs. 932 billion having a share of 10.6 percent in overall banking industry deposits (see **Table 5.1**). Similarly, the outreach of Islamic banking institutions (IBIs) witnessed considerable expansion and presently a network of 1335 branches across Pakistan (see **Table 5.2**). Three conventional banks started Islamic banking operations through opening Islamic banking branches (IBBs) during FY14. State Bank of Pakistan as its strategic objective played a key role in the expansion and promotion of Islamic banking industry in the country.

To support the performance of the industry, following key initiatives were taken during the year under review.

Strategic Plan for Islamic Banking 2014-2018

SBP prepared a strategic plan in consultation with internal and external stakeholders to improve public perception of Islamic banking and to make the industry a distinct and viable alternative financial system capable to address the demand for financial services of the public in general and business community in particular. The strategic plan comprises vision, mission, values, strategies and the action plans for the next five years. The main strategies are following:

- Strengthening legal, regulatory, supervisory, liquidity management, financial accounting & reporting structure and coordination with FBR to resolve taxation issues.
- Improving *Shariah* governance and compliance through standardization and harmonization of *Shariah* practices, as well as facilitating the creation of distinct Islamic banking products and services.
- Enhancing coordination and collaboration amongst internal and external stakeholders to increase awareness about Islamic finance and capacity building of the stakeholders.
- Market development by means of increasing product diversification and financial inclusion.

Table 5.1: Industry Progress and market share (Rupees in billions)

	Industry Progress		% Growth (YoY)		% Share in Industry	
	June-13	June-14	June-13	June-14	June-13	June-14
Total Assets	903	1089	27	20.5	9	9.8
Deposits	771	932	28	20.9	9.9	10.6
Net Financing & Investment	700	682	28.9	-2.5	8.8	7.8
Total Islamic Banking Institutions	19	22	-	-	-	-
Total No. of Branches*	1115	1335	-	-	-	-

Source: Quarterly Unaudited Accounts

*number includes sub-branches

Table 5.2: Region Wise Branch Network (June 2014)

Region	Total Number	Share (%)
Punjab	590	44.2
Sindh	446	33.4
Khyber Pakhtoonkhawa	148	11.1
Baluchistan	55	4.1
Gilgit Baltistan	5	0.4
FATA	4	0.3
Federal Capital	72	5.4
AJK	15	1.1
Total	1,335	100

Regulatory Initiatives and Shariah Governance

To reinforce the regulatory framework and to address issues of the Shariah Governance in Islamic banking industry, SBP reviews existing regulations as well as issues new directives to perform its supervisory role. Major initiatives during the year included:

- **Shariah Governance Framework:** A comprehensive *Shariah* Governance Framework was issued by SBP to strengthen the overall *Shariah* compliance environment in Islamic banking institutions. The framework aims at institutionalizing the *Shariah* compliance function in IBIs. It explicitly defines the roles and responsibilities of all organs of IBIs including Board of Directors, executive management, *Shariah* board, *Shariah* compliance department and internal and external auditors towards *Shariah* compliance. The framework requires IBIs to constitute *Shariah* Boards comprising at least three *Shariah* scholars meeting SBP fit and proper criteria.
- To address the issues of capacity building, level playing field, and reputational risk and to promote more disciplined and well thought out expansion of Islamic Banking Windows (IBWs) of the banks, the regulatory framework for IBWs was strengthened. To achieve standardization in *Shariah* practices, SBP adopted *Shariah* Standard No. 17 on 'Investment *Sukuk* issued by Accounting and Auditing Organization for Islamic Financial Institutions' with certain clarifications/amendments.
- SBP also issued instructions regarding provision of free-of-cost priority banking services to harmonize the Islamic banking industry practices. It was prescribed that priority banking services can be provided to both current and saving account holders. However provision of the same to current account holders only is not permissible. Further, instructions require Islamic Banking Institutions (IBIs) to explicitly mention in their promotional activities that such free-of-cost priority banking services are offered on bank's sole discretion to both current and saving account holders. The instructions further mention that IBIs may prescribe a certain level of minimum balance for current and saving account holders to avail priority banking services.
- To streamline *Shariah* practices of Islamic banking institutions regarding foreign bill discounting, SBP advised the IBIs interested in undertaking *Salam* of foreign currency to execute the same at the market rate of the day as defined in IBD Circular Letter No.2 of 2014. Further, in case of '*Qard-e-Hasanah cum Wakalah*' model, the IBIs shall ensure that the agency fee charged for collecting the proceeds of the bill is based on '*Ujratul Mithl* (market fee)' and is not linked to the bill amount and the tenor, etc. Moreover, IBIs may also use *Murabaha*, *Musawama*, *Salam*, *Istisna-cum-Wakalah*, etc. to meet financing needs of their customers independent of foreign bill.

Coordination with International Standard Setting Bodies and Other Institutions

SBP is among the pioneers in Islamic banking and has developed different procedures and manuals for Islamic banking operations. During the last year, SBP provided technical assistance to Bosna Bank International (BBI) – Bosnia Herzegovina by conducting a 7-day Islamic Banking Training Course in collaboration with NIBAF.

SBP also conducted a session on Islamic Finance during D-8 Countries' Central Banks Experts Meeting at NIBAF, in Islamabad on April 21, 2014. A separate session on Islamic finance was scheduled wherein the experts from the member countries shared their experiences regarding growth of Islamic finance. The session was concluded by emphasizing the need for more concerted and coordinated efforts towards the enhanced cooperation among D-8 countries at government and regulatory bodies.'

Capacity Building and Awareness Campaign

Awareness creation and capacity building has remained a vital component of SBP strategy for future development of the industry. During FY 14, SBP conducted awareness seminars in various cities including Bahawalpur, Quetta, Rawalpindi, and Sukkur. Further, a workshop on Islamic banking and finance, exclusively for journalists, was conducted at Learning Resource Centre, Karachi. Similarly, Phase-I of a specialized training course on “Fundamentals of Financial Accounting” for Shariah Advisors of Islamic Banking Institutions was organized.

Redmoney, a Malaysian based group, organized an Islamic Finance News (IFN) Roadshow in Pakistan, with support of SBP. The central bank also launched the Mass Media Campaign in Ramadan 1434AH (July FY13) with focus on improving the visibility of Islamic banking and improving the financial literacy of the masses. Banking Industry consulted with other stakeholders to plan the next phase of the campaign with more focus on the education, awareness and improving the understanding of Islamic banking and finance. Similarly, presentations on financial intermediation and monetary transmission were made in international financial and educational institutions namely, IMF, Central Bank of Turkey, and New York University.

Market Research Findings

To assess demand for the Islamic banking in Pakistan, SBP has completed a survey-based study on “Knowledge, Attitude and Practices of Islamic Finance in Pakistan”. The study is based on first hand information collected through a survey from both banked (Islamic and conventional) and un-banked sectors of the country with a sample of 10,000 household (retail) and corporate respondents. According to the study there is an overwhelming demand for Islamic banking in Pakistan in both retail and corporate sectors.

Developments Regarding Promotion of Islamic Banking Industry

- **Taxation Issues of Islamic Banking**
Ensuring a level playing field is one of the key challenges in development of Islamic banking industry as an alternative banking system in Pakistan. In this connection, proposals prepared by SBP in consultation with Pakistan Banks’ Association Sub-Committee for Islamic Banking to address the long outstanding taxation issues of Islamic Banking industry were forwarded to Federal Board of Revenue (FBR) through Ministry of Finance for their consideration and resolution.
- **Permission for Three New Islamic Banking Institutions**
Summit Bank, Allied Bank, and Sindh Bank were permitted to start Islamic banking operations through Islamic banking branches in 2014. It is pertinent to mention that Summit Bank has also announced to convert the bank into full fledged Islamic Bank in next 3-5 years.
- **Establishment of First Islamic Banking Subsidiary- MCB Islamic Bank**
MCB Bank has been granted license by SBP for establishing of first Islamic Banking subsidiary (IBS) in the country with the name of “MCB Islamic Bank Ltd.”. It is expected that other larger conventional banks having IBSs will also follow this path and more IBS will be formed.
- **Approval for NRSP to start Islamic Microfinance operations**
SBP granted an approval to NRSP to establish an Islamic Microfinance branch in Bahawalpur. NRSP is going to be the first Microfinance Bank to start Islamic Microfinance operations in Pakistan.