

5 Islamic Banking

5.1 Overview

Islamic banking industry (IBI) continued its double digit growth during FY16 with 16.8 percent and 14.1 percent year-on-year (YoY) growth in assets and deposits respectively. As of end June 2016, the industry's asset base reached Rs 1,745 billion, which is equivalent to 11.4 percent of the country's banking system's assets. Similarly, the IBI's deposits increased to Rs 1,461 billion constituting 13.2 percent of the overall banking industry's deposits

Table 5.1: Industry Progress and market share

	Islamic Banking Industry Progress		Growth (YoY)		Share in Overall Banking Industry	
	15-Jun	16-Jun	15-Jun	16-Jun	15-Jun	16-Jun
	Total Assets	1495	1745	37.3%	16.8%	11.3%
Deposits	1281	1461	37.4%	14.1%	12.8%	13.2%
Total IBIs	22	22	-	-	-	-
Total Branches*	1702	2146	-	-	-	-

Source: Data/information submitted by banks under quarterly Reporting Charts of Accounts (RCOA)

*Number includes sub-branches

(see **Table 5.1**). The outreach of Islamic banking industry has also expanded considerably and as of end June 2016, the network of IBI consists of 22 Islamic Banking Institutions (IBIs) (6 full-fledged Islamic banks and 16 conventional banks having standalone Islamic banking branches). The industry added 444 branches in its network during the year, which increased to 2146 branches in 98 districts across the country thus surpassing the target of 2000 branches as set in the second Strategic Plan 2014-18 of Islamic banking industry in the third year of the plan. The fast paced expansion of the industry's outreach could among others be attributed to the supportive and enabling role of SBP, which was voted as the best central bank in the world in 2015 for Promoting Islamic Finance in an international poll conducted by Islamic Finance News, an arm of Redmoney Group Malaysia.

The Current growth trajectory coupled with the strong commitment being demonstrated by the Central Bank and Government gives optimism that the Islamic Banking Industry Strategic Plan 2014-18 target of increasing the market share to 15 percent by 2018 will be conveniently achieved.

5.2 Steering Committee for Promotion of Islamic Banking

The Bank provided extensive support to the high level Steering Committee (SC) formed by the Government of Pakistan (GOP) for Promotion of Islamic banking in December 2013. The Steering Committee that was comprised of renowned Shariah scholars, senior government officials, industry experts (local and international) and business leaders has completed its tenure of two years in December 2015. The committee has compiled a comprehensive set of recommendations for laying sound foundations for sustainable growth of Islamic finance industry. Some of these recommendations have already been implemented such as establishment of Centers of Excellence in Islamic Finance Education, launch of All Share Islamic Index, establishment of Islamic Finance Department at Securities & Exchange Commission of Pakistan and issuance of Sukuk Regulations etc. Further, in order to execute recommendations of the Committee, an implementation committee has been constituted.

5.2.1 Establishment of Centers of Excellence in Islamic Finance Education (CEIFEs)

To ensure adequate supply of trained human resources to the industry as well as to act as an incubator for research on contemporary issues, the Bank in collaboration with GOP, Industry and other stakeholders has led and facilitated the establishment of three Centers of Excellence at leading

business schools i.e. Institute of Business Administration (IBA), Karachi; Lahore University of Management Science (LUMS), Lahore and Institute of Management Sciences (IMS), Peshawar.

5.3 Liquidity Management Solutions for Islamic Banking Industry

The Bank in its efforts towards providing multiple liquidity management solutions for the industry, started conducting Shariah compliant Open Market Operations (OMOs) by utilizing Ijara Sukuk (*Bai Muajjal* of *Sukuk*) issued by the GOP during FY15. Following this, GOP has offered similar mechanism/product to the industry for its liquidity deployment during FY16.

5.3.1 Bai-Muajjal of GIS by GOP

Under this transaction, GOP purchased GOP Ijara Sukuk (GIS) from market on deferred payment basis through competitive auction process. Since, Bai-Muajjal of GIS by GOP represents payment obligations of GOP thus it has also provided IBIs (as well as conventional banks) another eligible instrument for meeting statutory liquidity requirement. During FY16, GOP purchased GIS worth Rs 208.6 billion from IBIs on *Bai-Muajjal* basis for a period of one year.

5.3.2 Fixed Rental Rate GIS

In February 2016, a Fixed Rental Rate (FRR) GIS was introduced. As compared to the Variable Rental Rate GIS, where rental rate is determined on the basis of latest 6-month MTB weighted average rate, the rate on FRR GIS remains fixed for the entire tenor of the Sukuk. SBP conducted auctions of FRR-GIS on February 8, 2016 and March 24, 2016 to raise Rs 116.3 billion and Rs 80.4 billion respectively for the Government.

5.4 Implementation of Shariah Governance Framework

A comprehensive Shariah Governance Framework was notified for IBIs which has come to effect from July 01, 2015. The Framework aims at strengthening *Shariah* compliance environment at IBIs and explicitly defines the roles and responsibilities of various organs of IBIs including the Board of Directors, Executive management, Shariah Board, Shariah Compliance Department and internal and external auditors. As per the requirement of the Framework, the Shariah Boards of all 22 IBIs have been established after due diligence carried-out by the Bank.

5.5 Initiation of Islamic Microfinance Operations by Microfinance Bank

In a major development, a Microfinance bank started offering Islamic microfinance products during the year by establishing a dedicated Islamic microfinance division during FY16. Given the numerous similarities between the objectives of Islamic finance and Microfinance, this could be a first big step towards expanding the outreach of Islamic finance to the low income segments of our society. This would also enable the MF clientele to have access to just and transparent Shariah compliant financial services.

5.6 Awareness Creation and Capacity Building Programs for Islamic Banking Industry

The mass media campaign for promotion of Islamic banking initiated last year by the Islamic banking industry with full support of the Bank continued during the year and a number of promotional advertisements in print and electronic media were given. In order to reinforce the message of the media campaign, numerous seminars, lectures, training programs and workshops were organized in collaboration with reputed national and international institutions. An international course on 'Liquidity Management in Islamic Banks' was also organized at Karachi in collaboration with Islamic Research and Training Institute (IRTI). The course was attended by foreign and local participants from Islamic finance industry. Similarly, a seminar on "Islamic Hedging and Liquidity Management" was organized at Karachi in partnership with Bahrain based International Islamic Financial Market

(IIFM). Further, National Institute of Banking and Finance (NIBAF), the training arm of the Bank, arranged training programs in 6 districts for the IBIs' field staff including branch managers, operation managers and relationship managers as well as academia and local Shariah scholars. Further, as a part of its strategy to build the capacity of *Madaris* (Religious Schools) in Islamic finance, the Bank organized comprehensive training programs for *Madaris* in Sheikhpura and Lahore, which were well received by the faculty and students of the *Madaris*.

5.7 Tax Neutrality

The tax neutrality for Shariah compliant banking is an essential component of the overall policy environment for development of Islamic banking and finance. To address the taxation issues being faced by Islamic banking industry, detailed tax proposals have been developed after extensive deliberations with key stakeholders such as Institute of Chartered Accountants of Pakistan, Securities and Exchange Commission of Pakistan, Pakistan Banks' Association, renowned tax consultants and Federation of Pakistan Chambers of Commerce & Industry and sent to the relevant authorities. Hopefully, the proposals would soon be incorporated in the tax laws giving much needed tax neutrality to Islamic finance products *vis-à-vis* conventional products. The removal of tax related anomalies/bottlenecks will give big boost to Islamic banking industry from both demand and supply sides.

5.8 Strengthening of Shariah Compliance Inspection

The *Shariah* Compliance Inspection Manual developed in 2006 was revised during the year to make the inspection process more objective and effective in assessing the *Shariah* non-compliance levels in IBIs and risk associated with the non compliance. This revision was identified as one of the action goals in the Industry's Strategic Plan for 2014-18 to enhance *Shariah* compliance levels in the industry. The findings of *Shariah* inspections among others are an important source of information about *Shariah* related issues prevalent in the industry for SBP and its *Shariah* Board.

5.9 Global Participation

The SBP actively participated at various international forums on Islamic finance, such as meetings and events of Islamic Financial Service Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Research & Training Institute (IRTI)/Islamic Development Bank (IDB) etc. Besides, collaboration and cooperation with International Monetary Fund (IMF) and World Bank, regulatory bodies of various jurisdictions and other international entities have been enhanced in areas of Islamic banking and finance. AAOIFI & Islamic banking industry of Pakistan initiated a landmark project of "Urdu Translation of AAOIFI's *Shariah* Standards" which will enable an Urdu literate large population to get the benefit from these standards. Further, in its efforts to promote development of global Islamic finance industry, the Bank provided Technical Assistance to the Central Bank of Mozambique (CBM) by conducting a 5-days training program for their officials in collaboration with IRTI-IDB.