

STATE BANK OF PAKISTAN
AGRICULTURAL CREDIT & MICROFINANCE DEPARTMENT

Financial Innovation Challenge Fund

Challenge Round 3
Guidelines for Promoting Excellence in Islamic
Finance

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1- Financial Innovation Challenge Fund

1.1 Introduction

State Bank of Pakistan (SBP) is implementing the Financial Inclusion Program (FIP), sponsored by the UK Aid, with the aim to improve access to financial services in Pakistan. FIP has adopted a multi-pronged approach towards tackling financial exclusion by combining market forces and public sector principles. A noteworthy tool of this approach is to catalyze on innovations to widen the reach of financial services in Pakistan.

FIP has earmarked GBP 10 million in grants under the Financial Innovation Challenge Fund (FICF) to help the financial sector reach the excluded with use of innovations. Specifically, FICF aims to foster innovations to test new markets, lower cost of delivery, enable systems and procedures to be more efficient and provide new ways of meeting the unmet demand for financial services. The fund holds specialized challenge rounds focusing on innovations that market wishes to undertake to alter the scope and reach of financial services.

1.2 Objectives

The following are the objective of FICF:

- a) Spur innovation and innovative practices that increase access to financial services by the unbanked or the financially excluded. The fund provides support for pilots and up-scaling of financial services vis-à-vis seed capital.
- b) Leverage FICF funds to attract private investment. Additional capital will help create a bridge between pilot and roll-out of an innovation.
- c) Create linkages between successful projects and other FIP funds to ensure that pilots can be brought to scale through donor and private sector partnership and coordination.

1.3 Scope

The broad scope of the fund is to facilitate the spread of financial services through innovation. Innovation may come in the following forms:

- a) A product or service completely new and novel proposed by the applicant; or
- b) A product or service that has been tested and proved successful elsewhere in the world but is new to Pakistan; or
- c) An innovation that has been tested in Pakistan by organizations and has proved successful and the applicant organization wishes to test it with a new partner or at a different location.

Innovations may hinge on either technological advances such as mobile phones or non-technological advances such as introducing value chain financing for farmers to serve as collateral for loan or bridging market infrastructure gaps necessary for take-up of need based financial services. However, in order to encourage market based

innovations, the Fund is expecting that the market will take the lead in developing scalable and sustainable ideas. Innovations may be broad-based and occur in products, delivery systems or marketing techniques. Specific themes covered under FICF are announced in the form of periodic challenge rounds.

The 1st Challenge Round was held on promoting “Financially Inclusive Government to Person (G2P) Payments” through branchless banking models. Under the first round, FICF is supporting a number of pilots for adoption of innovative approaches to deliver financially inclusive G2P Payments, covering the entire spectrum of G2P payments including, salaries, pensions and welfare payments.

The 2nd Challenge Round was held on promoting innovative rural and agricultural financial services. Through this round the Fund is supporting a number of pilots for promotion of broad based financial services for agricultural and rural finance market while using innovative products and channels for people who are not currently participating in the formal financial markets.

Now, the 3rd Challenge Round is unveiled on promoting Islamic Financial services to meet the latent demand for Shariah compliant financial services in Pakistan.

2- The Opportunity – Centre for Excellence in Islamic Finance in Pakistan

According to Islamic Financial Services Board (IFSB)¹, the size of Islamic finance industry had reached US\$1.8 trillion in 2013. The industry is an established international phenomenon, with presence in all Muslim countries and major financial markets including North America, Europe, Gulf Cooperation Council (GCC), Asia Pacific, South Asia, North and East Africa. Globally, Shariah compliant assets are expected to grow by 15-20 percent a year over the next few years, and according to some estimates Islamic financial assets are likely to hit US\$5 trillion by 2020.

The industry has seen diversity in approaches as different types of Islamic financial institutions, including commercial banks, investment companies & banks, wealth & asset management companies and insurance companies have started offering Shariah compliant variants of conventional financial instruments to satisfy the unique customer needs. The various products offered by them include corporate and retail banking solutions, general and life insurance products, mutual funds, unit trusts and Shariah compliant bonds called Sukuks.

Pakistan has been successful in introducing Islamic banking system in the country with approach similar to that of Bahrain, Malaysia and United Arab Emirates (UAE) etc. SBP is championing the cause through a measured and comprehensive approach. Over the years, SBP has been striving to develop a supportive Regulatory, Supervisory & Shariah Compliant Framework for Islamic banking that is in line with international best practices. Moreover, SBP is actively engaged with international forums and the industry and other stakeholders to help resolve the industry's bottlenecks through joint initiatives.

The Islamic banking industry holds a market share of 9.6 percent and 10.4 percent of the total banking sector's assets and liabilities respectively, with a healthy asset quality and double digit return on equity. However, the Islamic finance industry is beset with a number of challenges such as convergence and compliance with global standards, strengthening of liquidity management, development of lender of last resort facilities on a Shariah-compliant basis, absence of reliable database on supply and demand of Islamic finance instruments (SME finance, commodity trading, real estate, etc) and shortage of qualified Islamic finance professionals, that can lead the industry into the next phase. Each of these challenges has important implications for the resilience and stability of Islamic financial institutions and is critical for accelerated growth of the industry. While SBP has been actively working on the first two challenges, development of reliable data base and the HR needs of the Islamic finance industry should be addressed through innovative approaches such as the establishment of a Centre for Excellence in Islamic Finance.

¹ Global Islamic Finance Report (GIFR) 2014.

The Challenge

Pakistan is the second largest Muslim country by population; however, globally it is ranked only 9th in Islamic finance by Global Islamic Finance Report (GIFR) 2014. Also, Pakistan has been trailing in its global ranking in Islamic finance from 7th in 2011 to 9th in 2014. This gradual decline in the industry's global ranking is indicating a missed opportunity. One of the major challenges faced by the industry is a shortage of qualified Islamic finance professionals, who can lead the industry into the next phase of its growth and prepare it to face more sophisticated and wide ranging issues at macro, meso, and micro levels. Islamic finance industry in Pakistan needs to enhance and upgrade its human capital base including Shariah scholars, financial experts, economists, academicians and researchers to realize the true market potential and emerge as a formidable player in the arena. In the medium term, the realization of 20 percent of market share target by 2020² from the current level of 10 percent would require investment in human resources to a large extent. Skill development will play a crucial role in formulation of strategy, product innovation, infusion of global best practices, resolution of industry issues, establishment of active knowledge sharing forums and critical research.

There are a number of local institutions which are offering various education training programs; however, these programs have the following shortcomings:

1. **Target Audience:** Most of the Islamic finance courses and short programs only offer basic learning. Each segment - board of directors, senior executives, middle management, entry level practitioners, professionals, students, lawyers, regulators, accountants, Shariah scholars, etc. – has unique requirements that need to be addressed.
2. **International and Industry Linkages:** Most programs and institutes are not connected with latest international developments in Islamic finance industry. Many Islamic financial services providers do not subscribe to membership of industry infrastructure institutions. Further, there is currently no forum that brings together stakeholders on major industry issues (except for SBP taskforce). These linkages are essential for knowledge transfer and learning from international experiences.
3. **Knowledge Environment:** Very importantly, there is absence of a conducive knowledge environment that promotes, produces, collates and disseminates research and information on Islamic finance. A centre of excellence to promote research, innovation and development of new ideas, products and technologies will ensure a proactive approach for sustainable and inclusive economic growth.
4. **Quality Assurance:** There is no minimum threshold or uniform quality control standards to manage the skill development of professionals. Certifications, accreditation from credible authority, and official guides for specific disciplines/ programs are tools that can bring rigor and add value to professional development plans.

² This number is based on SBP Islamic Banking Strategic Plan 2014-2018.

3- Round Three: Centre for Excellence in Islamic Finance Challenge Guidelines

3.1 Introduction: Scope and Challenge

Islamic finance presents a major opportunity to enhance access of local communities to financial services, including those in rural areas. Currently, Islamic Financial Services Providers (IFSPs) are striving to keep pace with the growing demand for shariah compliant products and services. Their present offering is limited to traditional corporate and consumer segments, mainly in urban communities. By investing in enhancement of the talent pool of skilled Islamic finance professionals, and supporting IFSPs by providing sector based requirements of Islamic finance, the industry will be able to sustain and diversify its growth to other geographies and segments. This would help build an inclusive financial sector and promote sustainable economic growth in Pakistan. The opportunity is to establish a Centre for Excellence in Islamic Finance (CEIF) which offers:

- Comprehensive set of education, training and research programs for various audience groups;
- A depository of Islamic finance data, Information, best practices, etc
- Strong quality assurance framework;
- Partnerships with the industry and buy-in of the key stakeholders;
- Best in class governance, management, faculty and technology;
- International orientation; and
- A knowledge environment that promotes innovation.

These factors along with active participation of the industry will make CEIF a winning venture not only in the local market but in the international arena as well. The competitive niche of CEIF and key features of the start-up phase along with its financing requirements to help establish the Centre are defined in section 3.2 and 3.3 below.

3.2 Challenge Round Objectives

The key objectives of the Challenge round are to establish Islamic finance education and research infrastructure in partnership with leading higher education institutions in Pakistan to serve the Islamic finance industry in meeting its growing human resource and knowledge requirements through quality and value added services and knowledge products. The key differentiating factors of the CEIF will be as follows:

1. **Demand driven offering:** a thorough understanding of the customer groups will allow CEIF to design and deliver value-added programs
2. **Championed by the industry:** this will ensure direction and drive industry buy-in
3. **International affiliations:** important for knowledge transfer, credibility, international profile, and premium branding

4. **Broad stakeholder base:** a network of partners, including financial institutions, multilateral agencies, regulators, infrastructure institutions, trainers, Shariah scholars, research institutes etc. in domestic and international market will ensure quality programs and a strong outreach
5. **High profile faculty and trainer panel:** these will be sourced from both, the domestic and international market and will ensure rigor, relevance and practicality of the curriculum
6. **Sustainable financial strategy:** will ensure uncompromised operational excellence and make it a commercially viable project.
7. **Quality of infrastructure:** Instead of setting up new premises, offices of CEIF will reside in academic institutions of highest ranking which will provide state of the art environment conducive for learning
8. **Development of Data Center:** CEIF will generate and maintain an authenticated Islamic finance data base to support the IFSPs to meet the need of the shariah based financial services.

3.3 Key features of CEIF proposal and its start-up phase:

3.3.1 Financial Plan

The financial strategy must be designed with two key objectives, a) to ensure uncompromised operational excellence, and b) to assure optimal use of financial resources and sustainability of CEIF. Institutions are encouraged to develop financial plans while observing the following guidelines:

- Part of the startup cost to establish the Centre for Excellence in Islamic Finance and first year operational cost may be met through the grant from FIP. Detailed startup costs along with the amount of matching contribution which should not be less than 30 percent of the proposed project cost must be worked out. Also, the following costs will be ineligible for grant expense i.e. cost of land acquisition, construction (institutions are encouraged to leverage existing infrastructure), regular staff salaries, fixtures /equipment not related to project etc.
- CEIF will be setup on premises of the proposed education institution. The education institution will provide its facilities such as building, training and academic facilities.
- The grantee institution will establish an endowment/waqaf fund. Institutions are encouraged to solicit additional contributions to the endowment from the industry and other donors as sponsorship contribution to strengthen the fund.
- It is expected that in Year 2, on account of contributions from the industry and revenues from the courses offered, the endowment will grow to a level to ensure its sustainability and demand driven mission.

3.3.2 Governance & Management

- CEIF will have its own governance structure which may include the following, president of parent academic institution, SBP, SECP, industry representative, Shariah scholar, academician, etc with subcommittees for academics etc.

- CEIF will employ a very lean staffing structure to man its secretariat. It will offer Chair/s of Excellence to attract Islamic Finance Scholar/s of international publications standing. In addition, eminent faculty, practitioners and scholars will also be on its panel.
- The lean management structure will ensure highly focused and efficient working environment, keeping administrative costs under control.

3.3.3 Operational Plan – start-up phase

- Upon establishment, CEIF will prepare its strategic and business plan for the first five years through a demand driven approach with focus on sustainability and international excellence.
- CEIF would be financially sustainable and commercially viable preferably in three years. The Centre will mainly drive its sustainability from offering demand driven programs to both existing Islamic finance practitioners and fresh candidates. The centre will offer graduate, post graduate and continuing education programs/courses for mid career professionals on cost covering basis. In addition the centre shall offer scholarship schemes for students from low income households, geographically depressed regions and pre and post PhD Islamic finance scholars. The PhD scholars will be jointly supervised by Islamic Finance Chair/s and faculty from other international centre of Islamic finance excellence, as mentioned below;
- CEIF will hire Islamic Finance experts/academics through dedicated Islamic finance chairs. These academics will conduct two types of research;
 - (a) Basic research will be designed to advance knowledge with no application to existing problems in view. The audience for basic research consists almost exclusively of other scholars or researchers interested in learning more about a phenomenon. CEIF will publish a quarterly publication to provide such research to the industry,
 - (b) Applied research is designed to help solve particular and existing problems, hence there is a much larger audience eager to support research that is likely to be profitable or solve problems of immediate concern. Such research will be published annually through a peer reviewed journal. It will hold international conferences and invite renowned experts and scholars to author paper to be published as conference proceedings.

Both types of researches are required in case of Islamic finance – basic is required for advancement of understanding since the industry is not yet mature and is still developing; while, applied research is needed to tackle various issues such as liquidity management, Islamic monetary policy and economic management, standardization and convergence with global standards, legal challenges, studies on evolving best practices around challenging issues and development of Islamic finance etc.

- CEIF will generate and maintain a data base (both primary and secondary) on the demand and supply of Islamic financial instruments.

3.3.4 International partnership and alliances

- CEIF may work on building alliances and partnerships with similar institutions in leading Islamic finance centers in Malaysia, Bahrain, Saudi Arabia, UAE and UK such as;
 - International Centre for Education in Islamic Finance (INCEIF), Malaysia
 - Bahrain Institute of Banking and Finance (BIBF), Bahrain
 - Islamic Research and Training Institute (IRTI), Saudi Arabia
 - Dubai International Financial Exchange (DIFX) Academy, UAE
 - University of Durham, UK
 - University of Loughborough, UK
 - Islamic Finance Project (Harvard Law School) USA etc.

3.4 FICF Operational Mechanism

- a) Challenge Round: Applicants to submit complete proposal by March 5, 2015. Upon a thorough desk review and detailed consultation with applicants by the FICF Secretariat, the applicant institution will develop a finalized business plan that will be presented to the FICF Advisory Committee for approval. The FICF Committee may approve one grant per province based on quality of the proposal to establish CEIF. FICF funds will be disbursed to successful institutions after signing of project documents and in accordance with the work plan thereafter, and regular desk monitoring will be conducted by the Fund Secretariat through periodic reports. Onsite monitoring/inspection may be conducted by the Fund Secretariat, SBP staff and independent consultants, if needed.
- b) Duration and Size: Grant sizes will be determined according to the financing requirements of the proposal in question; however, the duration of the projects should be ideally not more than one year. Applicants will be required to contribute at least 30% of the total project startup and first year operational cost as matching funds.
- c) Evaluation Criteria: Broadly, the FICF will adopt the following criteria to meet the specific objectives set under this round:
 - i. **Scope and uniqueness of the idea**: particularly, impact on industry and broadening Islamic finance education and knowledge
 - ii. **Demand driven offering**: a thorough understanding of the customer groups, sectoral needs, product requirements, etc to design and deliver value-added programs
 - iii. **Ownership and Championed by the industry**: this will ensure direction and drive industry buy-in

- iv. **International collaborations and affiliations:** important for knowledge transfer, credibility, international profile, and premium branding
- v. **Degree of broad stakeholder base:** a network of partners, including financial institutions, multilateral agencies, regulators, infrastructure institutions, trainers, Shariah scholars, etc. in domestic and international market will ensure quality programs and a strong outreach
- vi. **Quality and profile faculty and trainer panel:** these will be sourced from both, the domestic and international market and will ensure rigor, relevance and practicality of the curriculum
- vii. **Sustainable financial strategy:** will ensure uncompromised operational excellence and make it a commercially viable project.
- viii. **Quality of infrastructure:** Instead of setting up new premises, offices of CEIF will reside in academic institutions of highest ranking which will provide state of the art environment conducive for learning.
- ix. **HEC ranking:** last three years HEC ranking.
- x. **Enhance information base of the industry:** the centre will develop and use primary and secondary databases from both supply side and demand side sources to meet the information needs of the industry

d) Management: FICF is housed in SBP. However, keeping in view of its peculiar requirements, it is managed by FICF Advisory Committee. The Committee draws representation from SBP, DFID and experts from the private sector. The Committee is assisted by the Fund Secretariat in fulfilling its duties such as designing, screening, approval, and oversight of the challenge rounds.

e) Monitoring: Monitoring will be carried through FICF quarterly progress reports submitted by grantees. The quarterly reviews will present three key aspects of projects, including progress on grant utilization, work plan and outcomes.

f) Knowledge exchange: FICF grantees are expected to contribute regularly and share project experiences in the form of regular reporting, contribution to newsletters, presentations and conferences.

4- Submission of the Proposal

Proposal Deadline	Thursday, March 5, 2015
Deliverable	Proposal to be sent electronically at ficf@sbp.org.pk Hard copies must be sent to: Additional Director, Programs Management Division Agricultural Credit and Microfinance Department State Bank of Pakistan, I.I. Chundrigar Road, Karachi Karachi-74000 Tel: +92 21 99221579 Fax: +92 21 99221215
Matching Grant	At least 30% of project start-up and first year operational cost must be covered by grantee organization
Eligible institutions	HEC certified universities preferably with business schools, may participate if they have joined hands with local partners. <u>Higher education institutions must collaborate with Islamic financial service providers and international leaders in the subject area to be eligible to apply.</u>

4.1 Proposal Format

The Proposal shall present complete project including executive summary, the idea and the business plan. The proposal must address the following questions:

- a. Describe the proposed CEIF including market research/segmentation to identify opportunities and challenges in enhancing human resource base and knowledge/skills of existing professionals of Islamic financial industry to ensure continuous supply of highly qualified human resource necessary for meeting the latent demand for Islamic finance services. The proposal must take into account the ways & means to develop a data resource hub and indicate how the proposed centre will be different from others and the proposed modalities will succeed in promoting Islamic finance education and knowledge.
- b. The proposal should be self contained presenting the business proposal and call to action along with the business plan based on a sustainable financial strategy for the proposed CEIF.
- c. The proposal must provide detailed costing of the project activities and indicate the amount of matching contribution which should not be less than 30 percent of the proposed project cost. Also, the following costs will be ineligible for grant expense i.e. cost of land acquisition, construction (institutions are encouraged to leverage existing infrastructure), regular staff salaries, fixtures /equipment not related to project etc.
- d. The proposal must clearly indicate the project deliverables and attributable results by the end of project duration as well as interim milestones as

- challenge round encourages tying grant releases to results than mere funding of inputs and processes.
- e. The proposal must provide detailed track record and market positioning of the applicant institution to setup the proposed CEIF.
 - f. The proposal must identify and suggest mitigants for key challenges and risks that the organization foresee in initiating and implementing the project.
 - g. The proposal should provide profiles of the team leader and other key human resources and his/her qualifications and skills to lead and implement the project.
 - h. The proposal must include signed partnership agreements with the proposed partners/organizations/stakeholders/investors etc. to demonstrate the level of readiness.

4.2 Enquires relating to Submission of Application

All enquiries relating to the application process may be made at ficf@sbp.org.pk

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