

Box 3.1: Islamic Banking Institutions: Financial Performance and Recent Initiatives to Promote Islamic Finance

The network of IBIs consists of twenty-two (22) Islamic Banking Institutions (IBIs) including six (6) full-fledged Islamic banks and sixteen (16) conventional banks having standalone Islamic banking branches. During CY24, IBIs branch network grew by net 1,062, reaching a total of 6,017 branches by end of December 2024. This expansion was driven by the addition of 750 new Islamic branches and the conversion of 322 conventional branches into Islamic ones. It is important to highlight this was the highest ever increase in branch network of IBIs in any year. Furthermore, Islamic banking windows (dedicated counters at conventional branches) also increased by 331 to reach 2,253 by end December 2024. The expansion of the Islamic banking branch network highlights the continued focus on offering Shariah-compliant products and services and addressing the needs of faith-sensitive customers.

Islamic banking sector has seen significant growth, with full-fledged Islamic banks dominating the market. By end of December 2024, full-fledged Islamic banks accounted for 65.6 percent share of the total assets of IBIs, while Islamic banking branches held 34.4 percent share. In terms of deposits, full-fledged Islamic banks held around 63 percent of the total, while Islamic banking branches held around 37 percent of IBI's deposits. With further growth, IBIs now constitute one-fifth share in total assets and one-fourth share in total deposits of the banking sector in CY24 (**Figure 3.1.1**).²⁴

Islamic Banking Institutions (IBIs) experienced significant growth over the last few years and the growth momentum continued during the period under review (**Table 3.1.1**). During CY24, assets of Islamic banks increased by Rs 2,076 billion (or 23.1 percent growth) to reach Rs 11,070 billion by end December 2024. On the funding side, deposits of IBIs rose by Rs 1,156 billion (or 17.1 percent growth) during the period under review and reached Rs 7,905 billion by end December 2024.

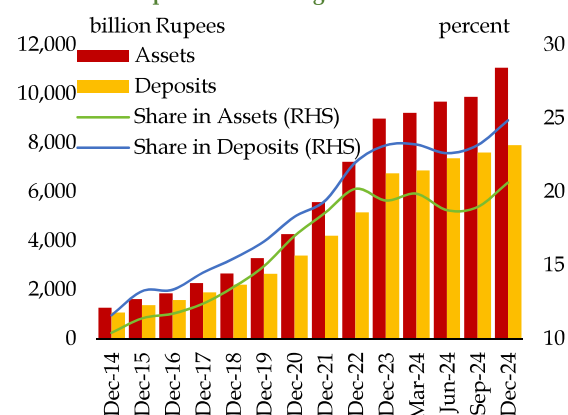
The growth in IBI's assets was primarily driven by a rise in investments (mainly Government of Pakistan Ijarah Sukuk), which increased by Rs 753 billion (or 17.8 percent) during CY24, reaching Rs 4,988 billion by end December 2024. On the other hand, IBI's financing also witnessed a significant increase of Rs 702 billion (or 21.1 percent

Table 3.1.1: Performance of Islamic Banking Institutions

	CY22	CY23	CY24	CY22	CY23	CY24
	IBIs			Conventional Banks		
	billion Rupees					
Total assets	7,229	8,994	11,070	28,567	37,369	42,623
Investments-net	3,051	4,235	4,988	15,349	21,784	24,803
Advances-net	3,113	3,335	4,037	8,705	8,843	11,768
Deposits	5,161	6,749	7,905	18,301	22,379	23,887
Borrowings	1,115	872	1,405	6,730	10,801	13,600
	YoY Change (percent)					
Total assets	29.6	24.4	23.1	16.7	30.8	14.1
Investments-net	64.8	38.8	17.8	20.8	41.9	13.9
Advances-net	19.9	7.1	21.1	15.7	1.6	33.1
Deposits	22.6	30.8	17.1	4.5	22.3	6.7
Borrowings	66.1	-21.8	61.1	65.5	60.5	25.9
	Share within Total Assets (percent)					
Investments-net	42.2	47.1	45.1	53.7	58.3	58.2
Advances-net	43.1	37.1	36.5	30.5	23.7	27.6
Deposits	71.4	75.0	71.4	64.1	59.9	56.0
Borrowings	15.4	9.7	12.7	23.6	28.9	31.9
FDR/ ADR*	60.3	49.4	51.1	47.6	39.5	49.3

*FDR=Financing to Deposits ratio and ADR=Advances to Deposits ratio

Source: State Bank of Pakistan

Figure 3.1.1: Share of Islamic Banking Institutions in Assets and Deposits of Banking Sector

Source: State Bank of Pakistan

²⁴ The market shares of assets and deposits of IBIs in overall banking sector improved to 20.6 percent (19.4 percent in CY23) and 24.9 percent (23.2 percent in CY23), respectively.

growth), totaling Rs 4,037 billion by end December 2024. However, the major increase was in advances of the corporate sector.

Islamic Banking Institutions maintained their soundness

IBIs maintained a sound financial position and contributed to the overall financial stability of banking sector. The non-performing financing (NPF) to total gross financing ratio improved to 3.5 percent in December 2024 and the overall asset quality indicators remained at a comfortable level with provisioning coverage of more than 100 percent and negative net NPF ratios, suggesting muted credit risk to solvency from the delinquent portfolio of IBIs.

Earning indicators such as ROA and ROE showed a mixed trend. After tax profit rose to Rs 273 billion in CY24 from Rs 225 billion in the same period last year. The pace of earnings growth, however, decelerated on year-on-year basis due to falling yields on earnings assets. However, IBIs contributed 42.3 percent of the after-tax earnings of the banking sector in CY24 (around 35 percent share during CY23), much higher than their market share in the overall banking sector.

Liquidity profile of IBIs remained comfortable on the back of increased investments in Sukuk.

Solvency indicators such as CAR slightly moderated to 19.8 percent by end CY24, as higher growth in risk weighted assets on the back of significant increase in advances outpaced the growth in capital. Nonetheless, the CAR which mainly comprised Tier-I capital was well above the minimum regulatory requirement of 11.5 percent as well as higher than the overall CAR of the banking sector (Table 3.1.2).

Financial Soundness Indicators of Islamic Banking Institutions Table 3.1.2

	percent		
	Dec-22	Dec-23	Dec-24
Asset Quality			
NPFs to Total Financing	2.6	3.8	3.5
Provision to NPFs	96.1	91.5	117.7
Net NPFs to Net Financing	0.1	0.3	-0.6
Net NPFs to Capital	0.8	1.7	-3.0
Earnings			
ROA before Tax	2.9	4.9	5.1
ROA after Tax	1.7	2.8	2.8
ROE before Tax	51.4	75.5	65.6
ROE after Tax	30.5	43.2	36.0
Liquidity			
Liquid Assets to Total Assets	41.6	49.1	47.1
Liquid Assets to Total Deposits	58.2	65.4	66.0
Liquid Assets/Short term Liabilities	88.6	112.1	101.4
Financing to Deposits	60.3	49.4	51.1
Customer Deposits to Total Financing	149.5	177.1	171.5
Capital			
Total Capital to Total RWA	17.8	20.7	19.8
Tier 1 Capital to Total RWA	15.0	17.3	16.3
Capital to Total Assets	5.9	7.3	7.9

Source: State Bank of Pakistan

B. Update on implementation of FSC's judgement

It may be recalled that the Federal Shariat Court (FSC) announced its judgement with respect to 'Riba' case on April 28, 2022. In pursuance of FSC's judgement, the federal government constituted a high-level Steering Committee (SC) in December 2022, entrusted with the vital task of providing strategic guidance for the effective implementation of FSC's judgment on Riba. State Bank of Pakistan (SBP) also established a high-level Committee for Transformation (CT) of conventional banking into Islamic. Under the Committee, seven working groups and their 35 work streams/sub-work streams are actively engaged and meeting frequently to perform assigned tasks.

The path is beset with some challenges, including full conversion of public debt to Shariah-compliant instruments, need of Shariah-consistent framework for implementation of monetary policy, need to reform laws and judicial system, scarcity of skilled human resources, among others (For details see "Box 3.2 - SBP's Strategy to transform the banking sector to Islamic mode - key challenges and opportunities" in FSR 2022). Various working groups and work streams under CT have made major progress in their respective areas. Some key developments include: complete assessment of legal and regulatory framework to ensure its alignment with the Shariah principles; launch of a comprehensive campaign to create awareness about Islamic banking, roll out of capacity building strategy for key stakeholders for improving and developing the skilled workforce for the Islamic banking industry, developing

hybrid Sukuk structure, issuance of broad guiding parameters to facilitate banks in their conversion from conventional to Islamic.

C. Policy Initiatives:

i. Guidelines for conversion of conventional banks into Islamic - Broad parameters

In order to facilitate banks in their conversion from conventional to Islamic, SBP vide IFPD Circular No. 03 of 2024 prescribed broad guiding parameters, which will help banks to devise their own conversion plans.

ii. Facilitation in conversion of conventional banking branches into Islamic banking branches

In order to facilitate banks and streamline the process for conversion of their conventional branches, SBP has revamped the criteria in October 2024 vide SBP IFPD Circular No. 05 of 2024. The revised criteria mainly include disclosure requirements for conversion of accounts, permission for use of digital channels/ means for seeking consent from customer for conversion, permission for conversion of current accounts from conventional to Islamic after exhausting all measures for seeking customers' consent, flexibility in conversion process by allowing permission to establish virtual conventional cost center(s), flexibility in safekeeping of securities/collaterals during phase out of conventional portfolio and facilitation in reporting line.

iii. Shariah Governance Framework for Islamic Banking Institutions (IBIs)

To align with international best practices and recent developments in the Islamic banking industry, SBP has further strengthened Shariah Governance Framework (SGF) in November 2024 vide IFPD Circular No. 8 of 2024.

iv. Profit Sharing on Saving Deposit of Islamic Banking Institutions (IBIs)

SBP issued instructions on profit sharing on saving deposits of IBIs in November, 2024 vide SBP IFPD Circular No. 09 of 2024. As per aforesaid instructions, with effect from January, 2025, all IBIs have been advised to pay profit on their PKR saving deposits (excluding deposits of financial institutions, public sector enterprises and public limited companies) equivalent to at least 75 percent of the weighted average gross yield of all pools of an IBIs.

v. Adoption of AAOIFI Shariah Standards

In order to further strengthen standardization and to harmonize Shariah practices in the IBIs, SBP adopted 15 additional Shariah standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) during CY24. With adoption of these standards, total number of AAOIFI Shariah standards adopted by SBP stood at 38 by end December, 2024. All the adopted standards are also available in compendium of Shariah standards vide IFPD Circular No. 07 of 2024 to provide ease of access to the end users.

vi. Awareness Creation and Capacity Building Initiatives:

SBP through its subsidiaries (i.e. SBP BSC and NIBAF) intensified its efforts to engage with the business community, government officials and academia to promote Islamic banking. As part of these initiatives, over 20 sessions were held with leading chambers of commerce and industries across Pakistan, more than 30 sessions were conducted nationwide with university students and faculty, along with an equal number of sessions for Madaris students. Further, various specialized capacity-building programs were organized for government departments, Shariah scholars, academia, bankers and judiciary. These programs aimed to equip stakeholders with essential knowledge of Islamic finance, enabling them to contribute effectively to the industry's development.