

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

The network of Islamic Banking Institutions (IBIs) consists of twenty-two (22) institutions, including six (6) full-fledged Islamic banks and windows of sixteen (16) conventional banks carrying out standalone Islamic banking operations. With further growth, IBIs now constitute around 23 percent share in total assets and 27.8 percent share in total deposits of the banking sector at end December 2025 (Figure 3.1.1). Within IBIs, the full-fledged Islamic banks continued to dominate the market with 58.3 percent share in total assets and 56.7 percent of total deposits of IBIs.

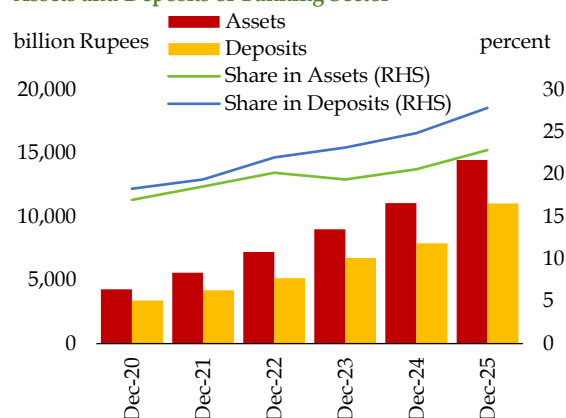
During CY25, the branch network of IBIs expanded by 1,545 to reach a total of 7,562 branches by end December 2025, which are dispersed over 146 districts of the country. Notably, the branch expansion was the highest-ever annual expansion in any calendar year. Moreover, Islamic banking branches (IBBs) of conventional banks increased by 678 to reach 2,931 by end December 2025. Mashreq Bank Pakistan Limited, a Digital Bank, has also started Islamic operations on full-scale in the last quarter of 2025. The significant expansion of the Islamic banking outreach reflects a continued focus on providing Shariah-compliant products and services, while catering to the growing demand of faith-sensitive customers.

The IBIs continued their growth momentum during CY25 and for the second consecutive year outpaced the growth of their conventional counterparts (Table 3.1.1). Assets of Islamic banks increased by Rs 3,397 billion (30.7 percent growth) in CY25 to reach Rs 14,467 billion by end December 2025. On the funding side, deposits of IBIs rose by Rs 3,132 billion (39.6 percent growth) during CY25, which was also higher than the growth of their conventional counterparts. Among other factors, the rebound in deposits mainly reflects recovery from the slowdown amid the ADR-linked tax policy during CY24 and the positive effect of recent SBP initiative on changes in profit sharing on saving deposits of IBIs.²¹

Both investments and advances (net) contributed to the expansion in asset base of IBIs. Investments rose by Rs 1,617 billion, mainly driven by growth in Government of Pakistan Ijarah Sukuk (GIS) during CY25. IBIs' financing also rose by Rs 1,617 billion and offset the decline in advances of their conventional counterparts. However, the major increase was in advances of the corporate sector, as a few energy-related public sector entities and commodity procurement agencies increased their borrowing from IBIs during CY25. Apart from public sector, advances of textile, sugar and chemical & pharmaceutical sector also rose during the year under review.

Islamic Banking Institutions maintained their soundness

The financial soundness of IBIs improved along key risk dimensions such as assets quality, liquidity and solvency (Table 3.1.2). By maintaining a sound financial position, IBIs contributed to the overall stability of banking sector.

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

Source: State Bank of Pakistan

Performance of Islamic Banking Institutions Table 3.1.1

	CY24	CY25	CY24	CY25
	IBIs		Conventional Banks	
	billion Rupees			
Total assets	11,070	14,467	42,623	48,765
Investments-net	4,988	6,605	24,803	32,461
Advances-net	4,037	5,654	11,768	9,203
Deposits	7,905	11,037	23,887	28,622
Borrowings	1,405	1,350	13,601	14,498
	YoY Change (percent)			
Total assets	23.1	30.7	14.1	14.4
Investments - net	17.8	32.4	13.9	30.9
Advances - net	21.1	40.0	33.1	-21.8
Deposits	17.1	39.6	6.7	19.8
Borrowings	61.1	-3.9	25.9	6.6
	Share within Total Assets (percent)			
Investments - net	45.1	45.7	58.2	66.6
Advances - net	36.5	39.1	27.6	18.9
Deposits	71.4	76.3	56.0	58.7
Borrowings	12.7	9.3	31.9	29.7
FDR/ADR*	51.1	51.2	49.3	32.2

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

Source: State Bank of Pakistan

²¹ For details see IFPD Circular No. 09 of 2024

The non-performing financing (NPF) to total gross financing ratio improved to 2.4 percent by end December 2025. The overall asset quality indicators remained at a comfortable level. The loans loss allowances and provisioning coverage of more than 100 percent and negative net NPF ratios suggested a muted credit risk to solvency from the delinquent portfolio of IBIs.

Earning indicators such as ROA and ROE moderated slightly, as after-tax profit fell to Rs 229 billion in CY25 from Rs 273 billion in CY24. The drag on earnings emanated from lower net profit income, which fell on year-on-year basis due to falling yields on earnings assets. Accordingly, IBIs contribution in after tax profit of the banking sector fell to 31.9 percent in CY25 from 42.3 percent of the after-tax earnings of the banking sector in CY24, but still higher than their market share in the overall banking sector.

Liquidity related FSIs also improved on the back of increased investments in Sukuk. Particularly, the liquid assets more than fully covered short term liabilities at end December 2025.

Solvency indicators such as CAR slightly moderated to 17.5 percent by end CY25, as higher growth in risk weighted assets, on the back of significant increase in advances, outpaced the growth in capital. Nonetheless, the CAR was well above the minimum regulatory requirement of 11.5 percent (Table 3.1.2).

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. SBP also established a high-level Committee for Transformation (CT) of conventional banking into Islamic. Under the CT, seven working groups and their 36 work streams/sub-work streams are actively engaged and meeting frequently to perform assigned tasks. The Committee, working groups and workstreams have held more than 500 meetings and are working proactively to provide policy and operational recommendations.

The working groups have made considerable progress in alignment with the set of action plans/key performance indicators set forth. Some key developments/work include: introduction of a dedicated chapter on Islamic Banking in BCO 1962 to provide explicit legal coverage for Islamic banking operations; complete assessment of legal and regulatory framework to ensure its alignment with the Shariah principles; development and launch of a comprehensive awareness creation campaign with variety of activities; roll-out of capacity building strategy constituting 16 different actionable items catering to the needs of different stakeholder and issuance of broad guiding parameters to facilitate banks in their conversion from conventional to Islamic. Further, SBP is working on the development of various solutions including hybrid/ Asset light Sukuk (ALS) structures in a bid to facilitate and provide liquidity management solutions for Islamic banking industry. Furthermore, SBP and MoF are working on developing an Assets Register of Government owned entities, which will enable quicker and simpler Sukuk issuances.

C. Policy Initiatives:

i. Facilitation in Commencement of Islamic Operations

Financial Soundness Indicators of Islamic Banking Institutions			
Table 3.1.2			
	percent		
	Dec-23	Dec-24	Dec-25
Asset Quality			
NPFs to Total Financing	3.8	3.5	2.4
Provision to NPFs	91.5	117.7	119.7
Net NPFs to Net Financing	0.3	-0.6	-0.5
Net NPFs to Capital	1.7	-3.0	-2.7
Earnings			
ROA before Tax	4.9	5.1	3.4
ROA after Tax	2.8	2.8	1.8
ROE before Tax	75.5	65.6	45.3
ROE after Tax	43.2	36.0	24.7
Liquidity			
Liquid Assets to Total Assets	49.1	47.1	52.2
Liquid Assets to Total Deposits	65.4	66.0	68.4
Liquid Assets/Short term Liabilities	112.1	101.4	117.2
Financing to Deposits	49.4	51.1	51.2
Customer Deposits to Total Financing	177.1	171.5	167.9
Capital			
Total Capital to Total RWA	20.7	19.8	17.5
Tier 1 Capital to Total RWA	17.3	16.3	15.4
Capital to Total Assets	7.3	7.9	7.2

Source: State Bank of Pakistan

During CY25, financial institutions exhibited growing interest in initiating Islamic operations, driven by strong demand for Shariah-compliant financial products. The trend was particularly evident among banks, microfinance banks, and development finance institutions, indicating a gradual expansion of Islamic finance activities and an enhanced responsiveness to evolving market needs.

During CY25, SBP granted approval to one digital bank, Mashreq Bank, and two microfinance banks, Mobilink Microfinance Bank and LOLC Microfinance Bank, to commence Shariah-compliant operations. Further, SBP accorded in-principal approvals to five institutions: Samba Bank Limited, HBL Microfinance Bank, ASA Microfinance Bank, Sindh Microfinance Bank, and Pak Libya Holding Company to initiate Islamic banking operations. SBP remained actively engaged with these institutions, providing guidance and necessary support to facilitate the initiation of Islamic business operations.

ii. Profit Sharing on Saving Deposits of Islamic Banking Institutions (IBIs)

SBP has been taking measures to enhance depositors' protection, promote fairness and transparency in profit distribution by Islamic banking institutions (IBIs). Accordingly, IBIs are advised to pay a minimum profit rate of 75 percent of the weighted average gross yield of all investment pools, effective from January 1, 2025.²² These measures aimed to ensure that the returns offered to depositors are closely aligned with the performance of underlying Islamic banking investment pools.

iii. Adoption of International Standards for the Islamic Banking Industry

To further enhance the Shariah compliance framework and promote uniformity in practices and products across the Islamic banking sector, SBP continued to align its regulatory framework with international best practices by adopting standards issued by global standard-setting bodies, including the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB).

During the period under review, SBP adopted three (03) additional AAOIFI Shariah standards, covering controls on Gharar, rules for profit calculation, and sale of commodities in organized markets, bringing the total number of adopted AAOIFI Shariah standards to forty-five (45) by end December 31, 2025. Moreover, six (06) IFSB standards were adopted during the period under review, increasing the number of adopted IFSB standards to ten (10). The adoption of international standards is expected to enhance regulatory consistency, market discipline, and systemic resilience, while strengthening stakeholder confidence in the Islamic banking sector and supporting its sustainable growth.

iv. Awareness Creation and Capacity Building Initiatives

SBP facilitated the Islamic banking industry in developing a comprehensive awareness campaign that pivots on the penetrating power of social media for creating awareness of Islamic banking among all strata of population. The campaign focuses on 9 distinct activities designed to build a robust narrative and systemically dispel misconceptions.

Further, in alignment with SBP's strategic goal of transforming the banking system into a Shariah-compliant framework, a comprehensive Capacity Building Strategy (CBS) for Islamic banking and finance has been developed encompassing sixteen (16) specific action items. These actions are designed to address the capacity-building needs of various stakeholder groups, including regulated entities, academic institutions (both universities and Madaris), and relevant government departments.

In addition to the awareness creation campaign and capacity building strategy, SBP regularly engages with the industry stakeholders through various awareness and capacity building activities. During CY25, SBP, through its subsidiaries, SBP BSC and NIBAF, intensified its engagement with government officials, academia, and Madaris to promote awareness and understanding of Islamic banking and finance. Under these initiatives, 60 awareness and

²² IFPD Circular No. 09 of 2024

sensitization sessions were conducted nationwide for university students and faculty, along with 22 sessions specifically organized for Madaris students.

Similarly, a range of specialized and customized capacity-building programs were conducted for key stakeholder groups, including government departments, Shariah scholars, academia, journalists, and the judiciary. These programs were designed to enhance participants' understanding of Islamic finance and to enable them to play a more informed and effective role in the development of the Islamic banking industry.

v. Other Initiatives

a) Assessment of Knowledge, Attitudes, and Practices in Islamic Banking

SBP conducted a Knowledge, Attitude, and Practices (KAP) study to assess the perceptions and preferences of both users and non-users of Islamic banking during CY25. The study examined the factors influencing adoption or non-adoption of Islamic banking, identified challenges faced by customers, and collected both positive and negative feedback to guide future regulatory improvements.

The survey, carried out digitally, engaged over 21,700 respondents representing both the supply and demand sides of the industry. This large-scale exercise provided valuable insights into customer behavior and institutional practices, representing a key milestone in efforts to further strengthen the Islamic banking framework.

b) Shariah Advisors Forum

SBP reactivated and convened Shariah Advisors Forum (SAF), which met twice in 2025 to discuss and address key structural and operational challenges in Islamic banking and finance. The forums were deliberately outcome-oriented, with a clear focus on moving beyond discussion to actionable and implementable solutions. The forums provided an opportunity to Shariah scholars and SBP to discuss the challenges being faced by the industry and way forward.