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Islamic Banking Department

State Bank of Pakistan



ISLAMIC BANKING DEPARTMENT

Vision

To make Islamic Banking the banking of first choice for the providers and users of financial services

Mission

To Promote and Regulate Islamic Banking Industry in line with Best International Practices, ensuring Shariah Compliance And Transparency

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Speech of Executive Director (BPRG)

SBP Contribution in Promoting Islamic Banking as Parallel Banking

I welcome you all to this awareness program on Islamic banking at the State Bank of Pakistan.

In the last few years, Islamic finance has taken exceptional strides. The growth of Islamic finance has been in double digits globally in the last decade. The estimated size of the industry is around US\$ 700 billion that is expected to reach US\$ 1.6 trillion by 2012.¹ In Pakistan, asset base of the Islamic Banking Institutions (IBIs) has grown by around 60 percent per annum since 2005; resulting in steady growth in the share of Islamic banking that reached at about 5.5 percent in deposits, and 5.3 percent in assets in September 2009. Currently, IBIs comprise 6 full-fledged Islamic banks and 13 conventional banks (having dedicated IBBs) with a network of more than 550 branches.² This is commendable achievement and is, in fact, better than some of the leading countries in Islamic finance—that started Islamic finance many years earlier than Pakistan.

So far, our efforts for the promotion of Islamic banking were largely focused on providing the requisite financial infrastructure in shape of Shariah compliance, legal, regulatory and supervisory frameworks. And we succeeded in establishing Islamic finance not only as a viable alternate means of finance but also as means to attract faith sensitive customers.

Looking back, the Islamic Banking Department was established at SBP in 2003 to lead Islamic banking efforts in Pakistan. Here, I like to describe some of the achievements of SBP:

1. A robust three-tiered Shariah compliance mechanism has been developed which encompasses international experiences and is working well for the last few years. The first tier is the SBP Shari'ah board that acts at the top level and provides guidance to all stakeholders. The second tier is the Shari'ah Advisers in all banks offering Islamic finance to help these institutions operate strictly within Shari'ah compliance mechanism. The third tier is the Shari'ah audit that ensures that IBs are working within specified boundaries.
2. Essentials and Model Agreements of Islamic Modes of Financing were issued. The Fit and Proper Criteria for Shariah Advisers of Islamic Banking institutions was prescribed that ensures objectivity in selection of Shariah Advisers and reduces conflict of interest.
3. SBP played an instrumental role in bringing changes in Sales Tax Act for Murabaha financing arrangement. And later on, major tax initiatives in Finance Bill 2007 were taken that ensured that taxation of Shariah compliant Islamic banking would be treated at par with conventional banking.
4. To bring standardization and uniformity, Risk Management Guidelines for Islamic Banking Institutions, Instructions & Guidelines for Shariah Compliance, and

¹ The Next Chapter in Islamic Finance - Higher Rewards but Higher Risks, Oliver Wyman, April 2009.

² Includes stand-alone Islamic banks, Islamic banking branches of conventional banks and Islamic window operations in conventional branches of conventional banks.

Essentials of Diminishing Musharaka were issued. Short term SLR eligible Shariah compliant government instrument (i.e., GoP Ijara Sukuk) was developed and issued. Guidelines for Islamic Microfinance Businesses and Islamic Agricultural Finance were issued.

5. SBP is coordinating and collaborating closely with International Islamic institutions like Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic International Rating Agency (IIRA), International Islamic Financial Market (IIFM), Liquidity Management Centre (LMC), and Islamic Development Bank (IDB) in different areas so that we are on the same wavelength in different aspects of regulations, standards, guidelines, and Shariah compliance. The proactive role played by SBP in promoting Islamic banking resulted in SBP being ranked second globally for its efforts in year 2008.³
6. Manual for conducting Shariah Compliance Inspection was developed and subsequently inspections are being done.

However, now the time has come to move forward and build on this financial infrastructure and strive to achieve the real potential of Islamic finance. Accordingly, State Bank of Pakistan has chalked out a detailed strategy for Islamic banking industry in 2008 that aims to increase the size of the Islamic banking industry to 12.0 percent of the total banking industry by 2012. The strategy has the following steps:

1. Expand and extend the outreach of Islamic banking products in existing Consumer and Corporate sectors as well as tap Microfinance, Agriculture, and SME sectors to fulfill financial needs of these sectors through Islamic banking.
2. Further strengthening Shariah Compliance framework and Regulatory framework in line with international best practices.
3. Help develop Human Resource for the industry.
4. Be part of the international Islamic banking community to appropriately position Pakistan to attract FDI.
5. Create awareness about Islamic banking not only in the Islamic banking community but also in the public at large.

This seminar is in line with our strategic goal of creating awareness amongst the external stakeholders about Islamic banking, its underpinnings, commercial viability and Shariah compliance. It is important to acknowledge the role of business and academic communities in the whole process. Awareness and confidence of these communities will further boost growth and credibility of Islamic finance. The task of keeping products and offerings Shariah compliant as well as commercially viable is not easy. It requires professional skills and utmost care at the banks' level and also at the customer level.

The banks have got Shariah Advisers who steer banks' operations carefully and keep an eye on adherence to the Shariah injunctions. The capacity of banks' staff is continuously being upgraded. However, customers, both current and potential, need to be educated. It is important, as unawareness on customers' front can result in great Shariah compliance

³ The fourth annual Islamic Finance News Poll 2008.

risk. For instant, the Murabaha—cost plus financing—needs utmost care in its sequencing, and mishandling on part of customer or bank executive will render the whole transaction as Shariah non-compliant. However, if the customer has the basic knowledge of the transaction, the Shariah compliance risk will be reduced substantially.

Among others, there are misconceptions that Islamic banking is all about charity or faith. This is not correct. Islamic banks are commercial entities and require earning competitive returns for their depositors and investors. Moreover, Shariah is not against earning profits. Actually, Shariah prohibits earning interest and it advocates trade—implying that all commercial transactions must be backed by some real economic activity. Mere document based transactions are not allowed.

There are other misconceptions as well. However, the range of products and financial solutions available in Shariah is vast and is expanding continuously. The range of products encompasses almost the entire range of Islamic modes of financing and business segments. The segments covered by the industry include Corporate/ Commercial, Agriculture, Consumer, Commodity Financing, SME, Treasury & Financial Institutions. These are served through various Shariah compliant modes such as Murabaha, Mudarbah, Musharaka, Ijarah, Diminishing Musharaka, Salam, Istisna, Wakala and Islamic Export Refinance.

Today, we are fortunate that we are in the company of few of the most respected and knowledgeable people in the Islamic finance industry. They have diverse backgrounds with vast experience on Shariah, product development, legal and regulatory issues. I hope that you will get maximum benefit from this opportunity.

SBP envisages that through employing the outlined strategy, the Islamic financial services industry in general and Islamic Banking in particular would successfully run and flourish in parallel with the conventional banking.

In the end, I will thank all the speakers and participants for coming here and hope the seminar is an opportunity for participants to learn basics of Islamic finance and clear misconceptions, apprehensions, and concerns about Islamic banking in particular and Islamic finance in general besides providing opportunity to interact with each other.

(Welcome Address by Mr. Inayat Hussain, ED (BP&RG), State Bank of Pakistan at the opening ceremony of "Awareness Program on Islamic Banking" held on December 9, 2009)

Industry Progress and Market Share

The Islamic banking industry maintained the growth momentum during the quarter ended December, 2009 thus improving its market share to about 6 percent from 5.5 percent as at the beginning of the quarter. The total assets of Islamic banking in Pakistan grew by 33 percent following 34 percent growth last year, which is commendable, given the increasing base over the years. The growth is likely to continue at an even higher pace in the near future due largely to: (a) increasing acceptability of Islamic banking as a viable and prudent model particularly after the recent crises in global financial markets, and (b) the huge untapped market particularly the agriculture and SMEs sectors which are largely out of the banking system, both conventional and Islamic. The increased SBP focus on improving Islamic banking literacy will also translate into further growth and expansion of the sector.

	Rupees in billion & industry share in percent						
	Dec. 09* ^P	Dec.08	Dec.07	Dec.06	Dec.05	Dec.04	Dec.03
Total Assets	366	276	206	119	71	44	13
Share in industry	5.6	4.9	4	2.8	2	1.5	0.5
Deposits	283	202	147	84	50	30	8
Share in industry	5.9	4.8	3.8	2.6	1.8	1.3	0.4
Net Financing & Investment	226	186	138	73	48	30	10
Share in industry	4.5	4.4	3.5	2.3	1.7	1.3	0.5
Total Islamic Banking Institutions	19	18	18	16	11	11	4
Total No. of Branches**	649	515	289	150	70	48	17

*Source: Annual Accounts except for Dec 09, data for which is based on Unaudited Quarterly Accounts
 **number includes sub-branches
 P: Provisional Data

The continuation of the growth momentum will however be contingent on capacity building in the sector. The dearth of properly trained and qualified Islamic bankers has been one of the most serious challenges faced by the industry. In order to successfully convert this challenge into an opportunity, SBP is collaborating with national and international institutions to fill the skill gaps in the industry.

The continuation of growth momentum will also be contingent on Islamic banking institutions' (IBIs) capacity and willingness to tap new avenues like agriculture, SMEs etc. with innovative products. This would not only diversify the portfolio mix of IBIs, but would also contribute significantly in improving the financial inclusion.

Assets and Financing

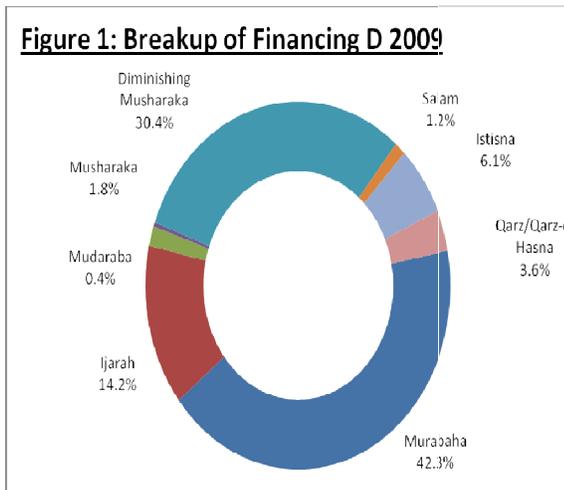
Total Assets of Islamic Banking in Pakistan grew by 10 percent to Rs 366 billion during the quarter ended December 2009. The net financing and investment portfolio also grew by 13 percent during the quarter to Rs 225 billion. In terms of market share, total assets, financing & investment, and deposits reached to 5.6 percent, 4.5 percent and 5.9 percent

respectively as at end December 2009. (see Table 1 & 2).⁴

	Rupees in billion		
	Sep - 09	Dec - 09 ^P	QoQ % Change
Cash and balances with treasury banks	26	30	15.1
Balances with other banks	30	29	-0.2
Due from financial institutions	37	46	22.8
Net Investments	65	72	11.6
Net Financing	134	153	14.8
Operating fixed assets	12	13	12.9
Other assets	20	22	9.8
Total Assets	323	366	9.8

P: Provisional Data

After a decline of 4.7 percent QoQ in preceding quarter, the financing activities revived with a QoQ increase of 14.8 percent during October-December 2009 (see Table 2). The net investment has also shown positive change. The simultaneous growth in net financing and net investment during the quarter is encouraging and reflects the improving business sentiments besides seasonal financing off-take.



The lack of diversification in financing portfolio, however, continued as reflected by more than 80 percent concentration in three financing modes, that is, Murabaha, Diminishing Musharakah and Ijarah (see Figure 1). The financing mix, however, witnessed some changes during the quarter. As opposed to a decline of 13 percent QoQ in the Murabaha portfolio in the preceding quarter, Murabaha financing increased by 33 percent during Oct-Dec 2009 while there was an almost matching decline (in percentage terms) in Ijarah financing (see Table 3). This

	Rupees in billion		
	Sep - 09	Dec - 09 ^P	% Change
Murabaha	50.6	67.1	32.7
Ijarah	29.8	22.6	-24.2
Musharakah	3.6	2.8	-22.8
Mudaraba	0.5	0.6	17.0
Diminishing Musharakah	38	48.2	26.9
Salam	1.7	1.9	9.3
Istisna'a	6.1	9.8	59.8
Others	7.9	5.7	-27.2
Total	138.7	158.6	14.4
Amount of Non performing Financing	8.9	10.0	12.4
Provision against Non Performing Financing	4.9	5.2	5.6
Net Non performing Fin.	4	4.8	20.8
Net Financing	133.7	153.5	22.5

P: Provisional Data

⁴ The sum figures, shares, and percentage in tables may not match because of separate rounding off.

is an opposite trend compared to the previous quarter, where there was a decline in Murabaha and a corresponding rise in Ijarah.

The rising trend in non-performing financing (NPF) seems to have moderated during the quarter. The NPF increased by 12.4 percent during the quarter as compared to increase of 23.3 percent in preceding quarter (see Table 3). The NPF stood at Rs. 10 billion as of end December 2009. The moderation in NPF trend might also have contributed to pickup in the financing activities. Nevertheless, the slowdown in rising trend of NPF was expected with the recovery in economic activity.

Sector-wise financing mix (for quarter ended December 2009) shows that the major portion of financing is extended to the corporate sector followed by consumer sector (Table 4). While, the number of borrowers is the highest in consumer sector followed by SMEs.

	Amount (Rupees in billions)				Number of borrowers			
	Sep - 09	Dec - 09 ^P	% Share	% Change	Sep - 09	Dec - 09 ^P	% Share	% Change
Corporate Sector	84.0	103.5	65.2	23.2	2,014	2,321	7.1	15.2
SMEs	11.8	12.3	7.7	3.8	2,497	2,529	7.8	1.3
Agriculture	0.1	0.1	0.03	(22.4)	128	129	0.4	0.8
Consumer Finance	31.6	31.7	20.0	0.3	26,723	25,244	77.4	(5.5)
Commodity Financing	6.9	7.6	4.8	8.7	14	13	0.04	(7.1)
Staff Loans	2.8	3.0	1.9	5.8	2,223	2,349	7.2	5.6
Others	1.4	0.6	0.4	(58.2)	19	17	0.05	(10.5)
Total	138.6	158.6	100.0	14.4	33,618.0	32,602.0	100.0	(3.0)

Sources of Funds

Total liabilities of Islamic banking institutions increased by 14.5 percent during the quarter while the net assets/equity increased by around 4.5 percent (see Table 5). Encouraging growth in deposits continued as deposits increased by 15.5 percent QoQ, which is substantially higher than preceding quarter growth of 2.8 percent. The deposit base of IBIs stood at Rs 282.6 billion as at end-December 2009 compared to Rs 244.8 billion in the previous quarter-end.

	Rupees in billion		
	Sep - 09	Dec - 09 ^P	% Change
Bills payable	4.3	3.1	-27.0
Deposits and other accounts	244.8	282.6	15.5
Other liabilities	20	19.5	-2.6
Total liabilities	283.2	324.4	14.5
Net assets	40.1	41.9	4.5
Equity (selected items)			
Paid-up capital/Head office capital account	36.9	37.7	2.1
Unappropriated/Unremitted profit	1.3	1.4	7.6
Equity	40.1	41.9	4.5

P: Provisional Data

The Fixed and saving deposits constitute the bulk of deposits with 36.7 percent and 32.2 percent share, respectively (see Table 6). On the conventional side, the comparable shares (of fixed and saving) in deposits stood at 32.9, and 34.5 percent, respectively. This suggests that although the Islamic banking depositors have relatively greater preference for fixed deposits, however the overall preferences of the depositors are more or less the same in Islamic and conventional banking. In terms of growth rates, the saving deposits have maintained relatively higher growth compared to fixed deposits: 12.2 percent QoQ rise in the former while the later grew by 10.6 percent QoQ. On the other hand, the growth in current accounts remained healthy, at 22.6 percent.

Growth in foreign currency accounts was at a much slower pace at 3.5 percent QoQ (previous quarter growth was 28 percent QoQ), while the growth in local currency deposits was strong at 16.4 percent QoQ compared to a mere 1.4 percent QoQ last quarter. Nonetheless, the Islamic banking deposits growth has consistently been higher than conventional banks' deposit growth for the last few quarters (see Figure 2).

Earning and Profitability

Both income and expense accounts have shown substantial growth during Oct-Dec 2009 with income increasing at a marginally higher rate. The net mark up income has increased by 37.6 percent during the quarter (see Table 7).

Table 6: Deposits and Other Accounts (selected items)

	Rupees in billion		
	Sep - 09	Dec - 09 ^P	% Change
A) Customers	231.2	263.5	14.0
Fixed deposits	93.8	103.7	10.6
Savings deposits	81.1	90.9	12.2
Current accounts	54.3	66.6	22.6
Others	2.0	2.0	0.4
B) Financial institutions	13.6	19.2	40.9
FI-Remunerative deposits	13.5	18.4	36.4
Particulars of deposits	244.7	282.6	15.5
In Local Currency	228.5	266.1	16.4
In Foreign currency	16.3	16.6	3.5

P: Provisional Data

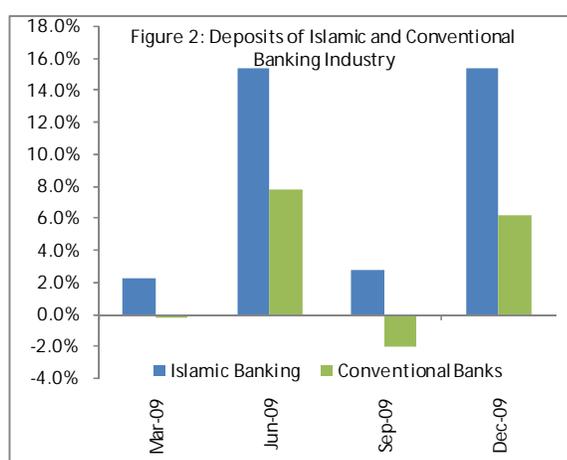


Table 7: Income and expenses (selected items)

	Rupees in billion		
	Sep - 09	Dec - 09 ^P	% Change*
Mark-up/Return Earned	23.0	31.6	37.2
Mark-up/Return Expenses	12.6	17.2	36.9
Net mark up income	10.4	14.3	37.6
Fees Commission & Brokerage	1.1	1.4	28.2
Other Income	0.3	0.6	100.3
Total Income	10.6	15.0	41.2
Administrative	8.8	12.6	43.3
Total Non-Mark up /Return	8.8	12.7	44.1
Profit/(loss) after	1.5	1.8	18.2

P: Provisional

In absolute terms, the ROA, ROE and NMM have declined marginally compared to the previous quarter. The slight increase in the intermediation cost might have suppressed profitability and returns (see Table 8). Nonetheless, the indicators of returns and profitability remained stable.

Expansion and Outreach

The branch network of Islamic Banking Industry reached to 649 at end-December 2009, from 551 at the end of preceding quarter; the cumulative increase in the branch network during the 2009 was 98. The geographical presence of IBIs improved slightly to 81 cities across the country from 78 as at the beginning of the quarter. Encouragingly, the pace of branch network expansion is very close to that envisaged for 2009 in the strategic plan for Islamic banking industry in Pakistan at 655 and this gives optimism about achieving the overall target set out in the strategic plan for 2012.

While the growth in IBIs branch network is encouraging, however, 45 percent of Islamic Banking branches are in two biggest cities, Lahore and Karachi and needs to be diversified to enable the banking consumers in smaller towns and cities to access Islamic banking facilities.

The province wise details, reveals that Punjab has major share of 45 percent (290 branches) followed by Sindh 28 percent (218 branches). While the bank wise position of branches reflects that Meezan bank with 201 and Bank Alfalah with 60 branches are at the top in full fledged Islamic banks and Islamic banking branches of conventional banks, respectively.

	Sep - 09	Dec - 09 ^p
Earnings		
ROA After Tax	0.70%	0.57%
ROE After Tax	5.40%	4.59%
Net Markup Margin (NMM)	5.70%	5.57%
Intermediation Cost	4.90%	5.04%
Assets Quality		
NPFs to Financing	6.50%	6.31%
Net NPFs to Net Financing	3.00%	3.15%
Earnings and Profitability		
Net Markup Income to Gross Income	79.00%	79.38%
Non-markup Income to Gross Income	21.00%	20.62%
Operating expense to Gross Income	67.20%	70.33%
Personnel Expense to Operating Expense	29.10%	29.48%

Events & Developments at IBD

Promotional Initiatives

Awareness program on Islamic banking

The IBD as a part of its efforts to improve Islamic banking literacy (understanding) organized an awareness program at Learning Resource Center (LRC) SBP on December 9, 2009. The program was attended by a large number of bankers, business community, women entrepreneurs, academia, industrial associations, traders etc. The Executive Director (BPRG) SBP Mr. Inayat Hussain inaugurated the program with his key note speech/address. He highlighted the efforts being made by SBP for facilitating development of a sound and stable Islamic banking industry. He also underlined the key issues faced by the sector and possible strategies to address the same. The other key speakers included Mufti Muneeb Ur Rehman, Mufti Irshad Ahmad Ijaz, Omar Mustafa Ansari and Muhammad Faisal Shaikh.

The program also emphasized the need for greater public awareness in making Islamic banking a success. The speakers discussed the Islamic Banking products being offered by IBIs, the Shariah compliance levels in the industry and also made critical assessment that whether the current IB paradigm is purely Islamic. The program concluded on a positive note that despite the need for improvement in Shariah compliance levels in the industry; the current paradigm is a good solid source for development of a sound IB Industry.

Policy Initiatives

Adoption of Shariah Standards Issued by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)⁵

Standardization and harmonization of Shariah practices within the Islamic Banking Institutions (IBIs) in Pakistan is a key objective of Islamic Banking Department. In this regard 'Essential of Islamic modes of financing' and related Model agreements⁶ in 2005 as minimum requirements for Shariah compliant products. These general guidelines were later on made compulsory in 2008⁷ with the advice that "For the Islamic modes for which essentials have not been prescribed; AAOIFI Shariah standards may be used as guidelines by IBIs in consultation with their SA". During the quarter four AAOIFI Shariah Standards were adopted. These include AAOIFI's Shariah Standards No.3 (Default in Payment by a Debtor), No.8 (Murabaha to the Purchase Orderer), No.9 (Ijarah & Ijarah Muntahia Bittamleek) and No.13 (Mudaraba). These standards will be effective from July 01, 2010.

⁵ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an international autonomous body that prepares accounting, auditing, governance, ethics, and Shariah standards for Islamic financial institutions. AAOIFI was established on February 26, 1990 in Algiers and registered on March 27, 1991 in Bahrain. As an independent international organization, AAOIFI is supported by institutional members (approx 200 members from 45 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide. (AAOIFI website)

⁶ <http://www.sbp.org.pk/press/Essentials/Essentials-Mod-Agreement.htm>

⁷ <http://www.sbp.org.pk/ibd/2008/C2.htm>

<http://www.sbp.org.pk/ibd/2008/Annex-c2-1.pdf>

These AAOIFIs' Shariah Standards are adopted after a thorough review process which included consultation with IBIs, Shariah Adviser Forum (SAF), SBP Shariah Board, and different SBP departments. In the next phase, Shariah Standards on Guarantees, Conversion of a Conventional Bank to an Islamic Bank, Salam and Parallel Salam, Istisna'a and Parallel Istisna'a, Sharika (Musharaka) and Modern Companies, and Investment Sukuk will be adopted.

Commodity Operations Financing (COF) of the Government and their Agencies Departments

The Government through its affiliated agencies carries out financing to facilitate commodity operations. The SBP plays an important role in the whole process. The banks are advised to provide finance for commodity operations. Islamic banking institutions are now being encouraged to take part in COF, as well.

Accordingly, IBD & SMEFD are initiating joint efforts to harmonize the Shariah compliance structures and procedures for COF. The concerned Public Sector Procurement Agencies/Departments like PASSCO, TCP, Food Department of Punjab and Sind are also collaborating. It is hoped that these efforts will result in enhancing the share of Islamic banking in COF.

Other developments

New Director of Islamic Banking Department

Mr. Saleem Ullah has recently joined the Islamic Banking Department as its Director. He has more than 15 years of central banking experience, primarily in the areas of banking supervision and development finance. Starting his career in SBP as Bank examiner in 1995 he served at different positions in banking examination and supervision departments. He served as Head Microfinance Division (MFD) SBP from 2001 to 2005. As Head MFD, he pioneered the development of regulatory and supervisory framework for Microfinance Banks in Pakistan, which is considered as one of the most progressive in the world. He also served as Head Strategic Management, SBP for about six months before assuming the charge of Director Agriculture Credit Department in 2006. Basically an MBA from Bahaudin Zakariya University Multan, he has the rare distinction of studying at Harvard University. He completed his Masters in Public Policy from Kennedy School of Government, Harvard University in June 2007 as a mid career student. Before his appointment as Director IBD, he was serving as Director Development Finance Support Department, SBP-BSC Karachi, where he mobilized SBP-BSC field network to propagate SBP initiatives for development of an "Inclusive Financial System" in the country. He has plans to make "Islamic Banking" a better choice for the users of banking services in the country.

Islamic Banking News

SBP Chief lauds Islamic banks performance

<http://www.dawn.com/wps/wcm/connect/dawn-content-library/dawn/news/business/09www.dawn.com/wps/wcm/connect/dawn-content-library/dawn/news/business/09sbp-chief-lauds-islamic-banks-performance--szh-04>

State Bank of Pakistan Governor Salim Raza has said that the performance of Islamic banks has been impressive compared to their conventional counterparts during the last two years.

Speaking at a opening ceremony of 10 more branches of Dubai Islamic Bank here on Wednesday, the SBP governor said due to active support of the central bank the total assets of Islamic banking industry had grown to Rs323 billion up to September 2009 while their deposits reached to Rs245 billion. Mr. Raza said that in terms of market share the total assets and deposits of Islamic banks account for 5.3 per cent and 5.5 per cent of the conventional banking industry, respectively. He said cumulative growth rate of Islamic banking industry had remained above 55 per cent since inception despite a healthy growth in conventional banks. The growth rate had slowed down during 2008 and 2009 due to global economic down turn, however, when compared with their conventional counterparts it was impressive by all counts, he remarked.

The SBP governor said that last year the central bank had unveiled its Strategic Plan for Islamic banking that broadly outlined the future direction of Islamic banking until 2012. 'Our target is to increase the share of Islamic banking to 12 per cent of total assets of the banking sector,' he added.

He pointed out that branch network of six full-fledged Islamic banks and 13 conventional banks with dedicated Islamic banking branches increased to 560 branches. Raza said that the central bank was determined to ensure a level-playing field for the Islamic banking industry and it had put in place a robust regulatory framework with a strong focus on Shariah compliance and competitiveness.

He said State Bank played a key role in issuance of Ijara Sukuk, which has paved the way for effective liquidity management of Islamic banks. 'We have also ensured a tax neutral regime for Islamic banking transactions through amendments in tax laws,' he said. He said that the SBP had introduced a comprehensive Shariah compliance framework which includes inspection of Islamic banks coupled with joint audit of profit distribution to depositors by the external auditors and Shariah Adviser of the bank. Each bank is also required to publish report of their Shariah Adviser on Islamic banking operations in annual accounts, he added.

Best Islamic Bank in the UK

<http://www.eyeofdubai.com/v1/news/newsdetail-38313.htm>

Bank of London and The Middle East plc (BLME), the London based wholesale, Shari'ah compliant bank, announced that it has been voted Best Islamic Bank in the UK, Best Leasing Provider in the UK, as well as for UK Deal of the year, by the Islamic Finance News (IFN) Annual Poll 2009.

Participants in the poll, which is considered the most comprehensive and definitive industry survey, nominated BLME to win the award of Best Islamic Bank in the UK in recognition of the bank's expertise in providing bespoke financing to a significant cross section of institutions, businesses and individuals. The award for Best Leasing Provider was won by BLME following a year in which the bank completed a large number of innovative leasing transactions competing directly with conventional banks. Throughout 2009 BLME provided £102 million of lease finance including \$68 million in the US lease market.

The IFN Annual Awards Polls are seen as the most transparent and competitive awards in Islamic finance, based on a unique poll which is a highly qualitative reflector of the global Islamic financial markets. The award recognizes the best providers of Islamic financial services across a series of markets and sectors as voted by readers of IFN, who include Islamic finance issuers, investors, non-banking financial intermediaries and government bodies from around the world. The results were announced after 2,657 votes were cast over a month-long period across 45 categories. The

winners will receive the prestigious awards at two special awards ceremonies: the first will take place on the evening of the 25th February 2010 at the Mandarin Oriental Hotel in Kuala Lumpur, followed by another at the Grand Hyatt Dubai on the 8th March 2010

Thomson Reuters unveils risk management solution for Islamic banking

<http://www.istockanalyst.com/article/viewStockNews/articleid/3791379>

Thomson Reuters announced the launch of a risk management system specifically tailored for Islamic banking. Kondor+ Suite for Islamic Banking is a real time trade and risk management solution, which will provide full front-to-back and cross-asset coverage for Islamic banks as well as Islamic windows in conventional banks.

Thomson Reuters is the largest provider of Trade and Risk Management solutions globally serving over 750 financial institutions. Thomson Reuters Risk solutions offer sophisticated, tailored functionality at every step of the trade - from STP enabled front-to-back trading systems to enterprise wide risk management - allowing customers to efficiently manage their market, credit, operational and liquidity risks. The company has the global strength that is required of a long term strategic partner with more than 900+ risk professionals in 83 countries. Thomson Reuters was recently recognized as the "# 1 Overall Risk Vendor" in the ASIA RISK Annual Technology Survey, voted the "Best Risk Management Vendor" by WATERS magazine and received the "Best Trading System Vendor" in RISK magazines RISK20 awards.

Morocco seek Islamic financial system

http://www.yacout.info/Morocco-seek-Islamic-financial-system_a1107.html

Moroccan banks may introduce the concepts and practices of sharia (Islamic law) finance and banking to the public, thanks to recent tax rate changes, Merieme Addou reports for African News.

The new tax rates mean that sharia-approved alternative banking products will be charged the same taxes as traditional banking products and loans.

As of January 2010, the VAT on alternative banking products like Mourabaha and Ijara will be 10%, as opposed to the 20% that was previously charged.

Lenders will offer leasing (Ijara) products, whereby they rent an asset to a customer who may later be able to buy it at a fixed date, while Mourabaha will allow a lender to buy an asset and re-sell it to a client at a margin decided in advance.

Many Moroccan welcome this alternative banking practices especially the ones who reject the concept of bank interest. Thought Moroccans who had reservations about accepting traditional bank loans will be able to finance a loan.

Lending companies will market these products via their subsidiaries. These services are regulated by "the Accounting and Auditing Organization for Islamic Financial Institutions", a Bahrain-based organization that includes 130 members from 29 countries.

Islamic or Sharia banks differ from regular banks in two major ways. As commanded in the Quran, the charging of interest is prohibited in all monetary transactions. The other defining feature of Islamic banks is that they are supervised by a board of Islamic scholars and clerics whose job it is to ensure that the banks' activities comply with Islamic law.

Islamic banking system requires improvements

http://www.thenews.com.pk/daily_detail.asp?id=220208

The present Islamic banking system requires improvements to bring it with full conformity with the Shariah, said Muhammad Ayub, a globally recognized scholar in Islamic economics.

He stated this while presenting a paper on 'What is Islamic Banking and Where does it Stand?' at a seminar on 'Understanding of Islamic Banking and Finance' organised by the Riphah Centre of

Islamic Business, a constituent institute of Riphah International University, Islamabad, here on Friday.

Professor Dr. Anis Ahmed, vice Chancellor of the university, was the chief guest on the occasion.

Muhammad Ayub said the State Bank of Pakistan has a Shariah Board to look after the affairs of Islamic banking in the country but it has to be made more proactive to achieve the purpose of promoting Islamic banking system.

He said that the system is not fully prepared to play a significant role in ensuring the health and stability of the national and international banking system. The Islamic banking ensures that there is no 'Riba' which is interest, 'Gharar' which is the uncertain conditions and 'Maysir and Qimar', which is gambling. In Islamic banking, there is a fixed stature which is based on Holy Quran and Sunnah and everything is based on them.

Professor Dr. Anis Ahmed, in his remarks, said that the seminar would help explain the fact that Islamic principles of business and finance provide checks for all factors that have corrupted the national and global economy and finance. These principles need to be adopted for relief to the mankind. Islamic banking has become a hallmark of today's financial world.

Islamic banking to bring lot of changes in world economic system: KU VC

http://www.brecorder.com/epaper/br_155424_580.html?title=Islamic%20banking%20to%20bring%20lot%20of%20changes%20in%20world%20economic%20system:%20KU%20VC

Professor Dr Pirzada Qasim, Vice Chancellor of Karachi University said that the purpose of universities and research centres were not only to give education but to develop and make easy access to enhance modern knowledge of the students.

He was delivering presidential address in the seminar on "Islamic Banking" here on Saturday at a local hotel He said due to those scholars ,teachers, students and Ulema who struggled for the recent system of the Islamic banking, which we are enjoying now, this system depicts the better solution of our today's economical problems, but there is a need to develop the system to meet the modern age challenges and to frame laws in this respect.

The Chief Executive United Chartered Bank of America Asif Aslam told the audience that the banking sector of that kind got 15 percent to 20 percent growth in the past one decade among 500 Islamic financial and monitoring institutions in 51 countries of the world affecting 1.39 billion Muslims. He also described in detail the target and goals for the betterment of the system.

Professor Masroor Qureshi from the Shariah Department of the United Chartered Bank America said that Islamic banking system will bring vital changes in the present banking system but there is a need for much more research in that respect.

In the end Professor Saleem Memon said Karachi University will continue that type of programmes in the future as well in collaboration with Standard Chartered Bank. Dr Shahbaz Gaza and Dr Aimer compared the programme as well. Senior bankers, executives of various financial institutions, research scholars, Ulema, teachers, professors of Karachi University and Urdu University participated in the seminar.-

Disclaimer: The news section of Islamic Banking Bulletin is based on information obtained from local and international print and electronic media and it may not reflect SBP views and policy.

Bank in Focus

MCB Islamic Banking Division⁸

Overview of company

MCB bank started Islamic banking in 2003. MCB has the distinction to enter Islamic banking market in the very first year of Islamic banking in Pakistan.

Branch network

Currently branch network of MCB IBD consists of 11 branches spread in 9 cities, ensuring presence in all provinces of the country. MCB IBD plans to expand its branch network by 45 percent in the year 2010 extending total branch network to 16.

Products/services range

MCB IBD is offering wide range of Shariah compliant products and services on both assets and liability side.

Deposits

MCB IBD offers both non-remunerative and remunerative deposit products namely Iqanat (current) account, Al Makhraj Saving Account and tenure based deposits with maturity period ranging from 1 month to 5 years with various profit rates.

Assets

MCB IBD provides Corporate, SME, and Consumer banking products. Working capital facilities are provided under Murabaha mode of financing to cater to the requirements of its customers including importers and exporters. Currently following products on asset side are offered:

- Murabaha to finance various types of business sectors for their diversified needs like imports, local purchase, and term finance
- Islamic Export Refinance Scheme
- Consumer & Corporate financing products are offered under Ijarah for medium to long term which includes:
 - Car Ijarah Facilitates to provide non-commercial or semi commercial vehicle on rent for Individuals, corporate and SMEs.
 - Equipment Ijarah facility for providing industrial machinery and all type of equipments required by industrial and commercial organizations against rentals to be paid on monthly, quarterly or at an agreed interval basis. The facility is offered for a period of 1 to 5 years. Equipment financing is also being offered under the Diminishing Musharakah for purchase of equipment/machinery by SMEs and Corporate.

Shariah Adviser Profile

MCB-IB is benefiting from services of Dr. Muhammad Zubair Usmani as Shariah Adviser since its establishment. Dr. Zubair holds a Ph.D. in Islamic Finance from Karachi University. He has a vast experience in the field of Shariah Advisory and is also well known for conducting training/awareness on Islamic banking both locally and internationally.

Table: Bank's Performance at a Glance

(Rs in billions)
% of Islamic Banking Industry

Deposits	1.9	0.7
Financing	3.5	2.3
Total Assets	8.2	2.2
Branch Network	11	1.8

Position as of December 31, 2009

⁸ The section is included to create awareness about Islamic banking institutions and their products. The write-up is based on information provided by MCB Bank

Frequently Asked Questions⁹ (Part V)

Q. No.24: What is Murabaha used for in Islamic banks?

Answer: Murabaha is typically used to facilitate the short-term financing requirements of the customer. The following are the uses of Murabaha:

1. Purchase of raw material, goods and merchandise of all kinds and description
2. Purchase of equipments
3. Import of goods and merchandise
4. Export financing (pre-shipment)
5. Other financing of working capital nature

Presently, the majority of financing extended by Islamic banks is based upon Murabaha.

Question No. 25). What is Bai Muajjal?

Answer: Bai' Muajjal is the Arabic equivalent of "sale on deferred payment basis". The deferred payment becomes a debt payable by the buyer in lump sum or in installments as may be agreed between the two parties. In Bai' Muajjal, all those items can be sold on deferred payment basis which come under the definition of tangible goods where quality does not make a difference but the intrinsic value does. Those assets do not come under definition of capital where quality can be compensated for by the price and Shariah scholars have an 'ijmah' (consensus) that demanding a high price on deferred payment in such a case is permissible. The following are the conditions of a valid Bai' Muajjal:

1. The price to be paid must be agreed and fixed at the time of the deal. It may include any amount of profit agreed between the parties.
2. Complete/total possession of the object in question must be given to the buyer, while the deferred price is to be treated as a debt due from him.
3. Once the price is fixed, it cannot be decreased in case of earlier payment nor can it be increased in case of default.
4. In order to secure the payment of price, the seller may ask the buyer to furnish a security either in the form of mortgage or in the form of any other item.
5. If the commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

Question No. 26). What is Musawamah?

Answer: Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus, it is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. Both the parties negotiate on the price. All other conditions relevant to Murabaha are valid for Musawamah as well. Musawamah can be used where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell.

Question No. 27: What is Ijarah?

Answer: Ijarah refers to transferring the usufruct of an asset but not its ownership. Under Islamic banking, the bank transfers the usufruct to another person for an agreed period at an agreed consideration. The asset under Ijarah should be valuable, non-perishable, non-consumable identified and quantified. All those things which do not maintain their corpus during their use cannot become the subject matter of Ijarah, for instance money, wheat etc.

Question No. 28): What are the salient features of Ijarah transaction?

⁹ FAQs are included in order to create awareness about Islamic banking. These FAQs are already published and are available on SBP website (<http://www.sbp.org.pk/departments/lbd/FAQs.pdf>)

Answer: The customer approaches the bank and expresses his desire for a particular asset/property. The bank acquires that asset as per undertaking of the customer to acquire the said asset on Ijarah basis. The bank leases (transfers the use of the asset) it to the customer for an agreed period of time and against an agreed amount of rentals. An Ijarah agreement, signed between the bank and the customer, stipulates all the relevant conditions with regard to the transaction. According to this agreement the bank is Lessor and the customer is Lessee. During the Ijarah period, the corpus of the leased property remains in the ownership of the bank and only its usufruct is transferred to the lessee. The following main points are considered in the Ijarah transaction:

1. As the corpus of the leased asset remains in the ownership of the Islamic bank, all the liabilities emerging from the ownership shall be borne by the bank. It is necessary for a valid lease that the leased asset is fully identified by the parties.
2. The lessee (customer) cannot use the leased asset for any purpose other than the purpose specified in the lease agreement. However, if no such purpose is specified in the agreement, the lessee can use it for whatever legitimate purpose it is used in the normal course.
3. The lessee is liable to compensate the lessor (bank) for any harm to the leased asset caused by any misuse or willful negligence. The leased asset shall remain in the risk of the bank throughout the lease period in the sense that any harm or loss caused by the factors beyond the control of the lessee shall be borne by the lessor.
4. A property jointly owned by two or more persons can be leased out and the rental shall be distributed between all joint owners according to the proportion of their respective shares in the property. A joint owner of a property can lease his proportionate share only to his co-sharer and not to any other person.
5. The rental must be determined at the time of contract for the whole period of lease. It is permissible that different amounts of rent are fixed for different phases during the lease period, provided that the amount of rent for each phase is specifically agreed upon at the time of executing a lease. If the rent for a subsequent phase of the lease period has not been determined or has been left at the option of the lessor, the lease is not valid.
6. The determination of rental with regard to the aggregate cost incurred in the purchase of the asset by the lessor, as normally done in financial leases, is not against the rules of Shariah, if both parties agree to it, provided that all other conditions of a valid lease prescribed by the Shariah are fully adhered to.
7. The lessor cannot increase the rent unilaterally, and any agreement to this effect is void.
8. The lease period shall commence from the date on which the leased asset has been delivered to the lessee.
9. If the leased asset has totally lost the function for which it was leased, the contract will stand terminated.
10. The rentals can be used on or benchmarked with some Index as well. In this case the ceiling and floor rentals would specifically be mentioned in the agreement for validity of lease.
11. At the end of the lease period, the ownership of the property may be transferred to the lessee against a nominal price through a separate sale deed to be executed after the expiry of the lease.

Question No. 29 What is the difference between conventional mortgage financing and Islamic Mortgage financing?

Answer: There are several key differences between conventional mortgage finance and Islamic mortgage finance. Under conventional mortgage, in order to purchase a property the customer borrows money and repays it with an additional amount over a period of time. The additional amount is the amount of interest which is against the Shariah rulings of Islam. Under Islamic mortgage finance facility, Islamic bank shares with the customer in purchasing his desired property. Accordingly, the customer and the bank become the joint owners of the property in proportion to their share in purchasing the property. In order to own and use the entire property, the customer purchases the share of bank's property over a period of time and also pays the rent for using the bank's share of the property. Over a period of time, the customer manages to purchase the entire share of bank in the property. Ultimately, the customer becomes the sole owner.

Further, in case of Islamic mortgage finance, the rent will be charged after the lessee has taken delivery of the property and it is in workable/usable condition. Rent cannot be charged from the day the price was paid to acquire the property/asset. If the supplier has delayed the delivery after receiving the full price, the lessee should not be liable for the rent of the period of delay. In case of conventional mortgage finance, normally the lease rentals starts from the date the bank make payment for purchasing the property/asset.

Question No. 30): The rental amount under Ijarah transaction is normally linked to interest based benchmark like LIBOR or KIBOR. Is not it an interest based financing?

Answer: The difference between an interest based financing and a valid lease does not lie in the amount to be paid to the lessor. The basic difference is that in the case of Islamic Ijarah, the ownership and title in the asset/property rest with the lessor who assumes the full risk of the corpus of the leased asset. If the asset is destroyed during the lease period, the lessor will suffer the loss. Similarly, if the leased asset loses its usufruct without any misuse or negligence on the part of the lessee, the lessor cannot claim the rent, while in the case of an interest-based financing, the financier is entitled to receive interest, even if the debtor did not at all benefit from the money borrowed. So far as this basic difference is maintained, (i.e. the lessor assumes the risk of the leased asset) the transaction cannot be categorized as an interest-bearing transaction, even though the amount of rent claimed from the lessee may be equal to the rate of interest.

Therefore, the use of the rate of interest merely as a benchmark does not render the Ijara contract invalid as an interest-based transaction. It is, however, advisable at all times to avoid using interest even as a benchmark so that an Islamic transaction is totally distinguished from an un-Islamic one, having no resemblance of interest whatsoever.

Excerpt from FAQs published by IBD, SBP and available at <http://www.sbp.org.pk/departments/ibd/FAQs.pdf>

Islamic Banking Branch Network (As of December, 31, 2009)

Type	Name of Bank	No of Branches ¹⁰
Full Fledge Islamic Banks	Al Baraka Islamic Bank	29
	BankIslami Pakistan Limited	70
	Dawood Islamic Bank Limited	42
	Dubai Islamic Bank Pakistan Ltd	35
	Emirates Global Islamic Bank Ltd	58
	Meezan Bank Ltd	166
	Sub Total	400
Islamic Branches of Conventional Banks	Askari Bank Limited	29
	Bank Alfalah Ltd	60
	Bank Al Habib	6
	Faysal Bank Limited	6
	Habib Bank Ltd	1
	Habib Metropolitan Bank	4
	MCB Bank Ltd	11
	National Bank of Pakistan	8
	Soneri Bank Ltd	6
	Standard Chartered Bank	11
	The Bank of Khyber	18
	The Royal Bank of Scotland	3
United Bank Ltd	5	
	Sub Total	168
Sub Branches	Askari Bank Limited	2
	BankIslami Pakistan Limited	32
	Dawood Islamic Bank Limited	8
	Dubai Islamic Bank Pakistan Ltd	1
	Emirates Global Islamic Bank Ltd	2
	Meezan Bank Ltd	35
	The Bank of Khyber	1
	Sub Total	81
	Grand Total	649

¹⁰ Source: Banking Policy & Regulations Department, State Bank of Pakistan.

Annexure: II

Province wise Break-up of Islamic Banking Branch Network (As of December, 31, 2009)

Type	Bank Name	Azad Kashmir	Balochistan	Federal Capital	Northern Areas	NWFP	Punjab	Sindh	Grand Total
IB.	Albaraka Islamic Bank B.S.C. (E.C.)	1		2		3	15	8	29
	BankIslami Pakistan Limited	1	8	2	1	5	30	23	70
	Dawood Islamic Bank Limited		1	2		1	18	20	42
	Dubai Islamic Bank Pakistan Limited		3	2		3	16	11	35
	Emirates Global Islamic Bank Limited		3	2		6	27	20	58
	Meezan Bank Limited	2	4	8		15	78	59	166
IB. Total		4	19	18	1	33	184	141	400
SAIBBs	Askari Bank Limited		2	1		5	14	7	29
	Bank AL Habib Limited		1			1	2	2	6
	Bank Alfalah Limited		1	3		3	39	14	60
	Habib Bank Limited							1	1
	Habib Metropolitan Bank Limited						1	3	4
	MCB Bank Limited		1	1		1	5	3	11
	National Bank of Pakistan	2				1	3	2	8
	Soneri Bank Limited		1	1		1	1	2	6
	Standard Chartered Bank(Pakistan)		1	1		3	3	3	11
	The Bank of Khyber		1			12	3	2	18
	The Royal Bank of Scotland						1	2	3
United Bank Limited					1	3	1	5	
Faysal Bank Limited		1			1	3	1	6	
SAIBBs Total		2	9	7		29	78	43	168
Sub Branches	Askari Bank Limited			1				1	2
	BankIslami Pakistan Limited	1	3	3		2	9	14	32
	Dawood Islamic Bank Limited						3	5	8
	Dubai Islamic Bank Pakistan Limited					1			1
	Emirates Global Islamic Bank Limited			1				1	2
	Meezan Bank Limited		1	1		4	16	13	35
The Bank of Khyber					1			1	
Sub Branches Total		1	4	6		8	28	34	81
Grand Total		7	32	31	1	70	290	218	649

City wise Break-up of Islamic Banking Branch Network (As of December, 31, 2009)

Annexure: III

S. No	Province	Cities	No of Branches
1		Badin	1
2		Hyderabad	17
3		Karachi	180
4		Larkana	1
5		Matiari	1
6	Sindh	Mirpur Khas	3
7		Nawabshah	4
8		Sakrand	1
9		Sanghar	2
10		Sukkur	5
11		Tando Adam	1
12		Tando Allahyar	2
Sindh Total			218
13		Arifwala	1
14		Attock	4
15		Bahawalpur	3
16		Chakwal	2
17		Daska	1
18		Dera Ghazi Khan	2
19		Faisalabad	26
20		Gojra	1
21		Gujar Khan	1
22		Gujranwala	10
23		Gujrat	9
24		Hafizabad	2
25		Jaranwala	2
26		Jhang	3
27		Jhelum	4
28		Kamoki	1
29		Kasur	2
30		Khanewal	1
31		Khushab	4
32	Punjab	Lahore	109
33		Mandi	1
34		Bahauddin	1
35		Mian Channu	2
36		Mianwali	1
37		Multan	23
38		Okara	2
39		Pakpattan	1
40		Pindi Ghaib	1
41		Rahim Yar Khan	6
42		Rawalpindi	31
43		Sadiqabad	2
44		Sahiwal	3
45		Sargodha	6
46		Sheikhupura	3
47		Sialkot	12
48		Texila	1
49		Toba Tek Singh	1
50	Vehari	4	
	Wah Cantt	2	
Punjab Total			290

S. No	Province	Cities	No of Branches
51		Abottabad	11
52		Banu	1
53		Batkheela	1
54		Charsadda	1
55		Chitral	1
56		Dera Ismail Khan	3
57		Hangu	1
58		Haripur	3
59	NWFP	Kohat	2
60		Mansehra	6
61		Mardan	4
62		Mingora	1
63		Nowshera	3
64		Peshawar	28
65		Swabi	2
66		Tank	1
67		Timergara	1
NWFP Total			70
68	Northern Areas	Gilgit	1
Northern Areas Total			1
69	Federal Capital	Islamabad	31
Federal Capital Total			31
70	Balochistan	Chaman	1
71		Gawadar	1
72		Hub Chowki	1
73		Kuchlack	1
74		Loralai	3
75		Muslim Bagh	1
76		Pishin	1
77		Qilla Saifullah	1
78		Quetta	21
79		Zhob	1
Balochistan Total			32
80	Azad Kashmir	Mirpur AJK	4
81		Muzaffarabad	3
Azad Kashmir Total			7
Grand Total			649

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