Islamic Banking Bulletin

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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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Governor's Speech

IFN Roadshow on Islamic Banking

Keynote Speech by Yaseen Anwar, Governor, SBP.

First and foremost, I wish to commend the Redmoney group's initiative for organizing this Road show in Pakistan, which is indicative of their continued interest and confidence in Pakistan's Islamic finance sector. I would also like to extend my gratitude to the sponsors of the event i.e. the CIMB Islamic Bank Malaysia, Meezan Bank Pakistan, Pak Qatar Family Takaful Pakistan and Dow Jones Indexes for their support in organizing this event. I also extend a warm welcome to the international speakers and delegates and hope that they will enjoy their stay in Pakistan.

Ladies and gentlemen! Islamic finance, initiated modestly about four decades ago to cater to the financial services needs of faith sensitive Muslim population, particularly the high net worth individuals and groups in UAE and Middle East, has now acquired the status as an integral component of the global financial system. The Islamic finance industry has been growing at an exceptionally fast pace and extending its outreach beyond the Muslim countries, which is indicative of its increasing acceptability as a viable and competitive alternative to the conventional system; since 2006 the industry has grown on average 28 percent annually with assets reaching US$822 billions. Presently more than 1100 Institutions offering Islamic Financial Services (IIFS) operate across the globe, which, coupled with a number of dedicated academic, legal, regulatory and supervisory institutions', provides a solid platform for future growth and development of the Islamic finance industry.

The recent crisis in the western financial markets has also given a big boost to the acceptability and promotion of Islamic banking as a more stable and prudent system than its conventional counterpart. The inherent checks and balances in Islamic finance, which prohibits Islamic financial institutions to deal in speculative and *Haram* activities (the businesses which are detrimental for welfare of the mankind) and requires them to ensure '**Equity, Justice and Transparency**' in their transactions, largely kept the Islamic financial Institutions insulated from the financial crisis. The frequently recurring crisis in the conventional system, several in the last four decades, on the other hand highlights its embedded weaknesses and vulnerability to speculative and self interest maximization behavior. As we witnessed during the financial crisis, even the most sophisticated and modern regulatory and supervisory systems were unable to ensure soundness and stability of a system with inherent weaknesses. Accordingly there is a need to revisit the conventional system and extricate from it the embedded weaknesses and avoid the often recurring crisis in the financial markets to achieve longer term economic stability. The inherent strengths and control mechanism of Islamic finance could provide the requisite stability, provided it achieves greater efficiency, consumer convenience and flexibility, that is the hall mark of the conventional system.

The current Islamic banking paradigm, both in Pakistan and elsewhere, is however, based on the replication of conventional banking products. While the replication and mimicking of conventional products to make them Shariah compliant does pass the Shariah permissibility test, it is insufficient to achieve the objectives of Islamic finance, particularly the broad based and equitable distribution of economic gains. The complete reliance of Islamic banks on debt based fixed income products and minimizing the risks close to those of the conventional system is not only blurring the distinction between Islamic and conventional finance but also making Islamic banks relatively less efficient than their conventional counterparts. Thus to sustain the growth momentum, the industry will need to diversify its product mix by focusing on areas where it has comparative advantage rather than blindly following the conventional system, that in itself possesses inherent weaknesses that give rise to cycles of booms and busts.

In Pakistan for instance 67% of Islamic banks' financing is concentrated in the corporate sector through Murabaha, Ijarah, and Diminishing Musharaka. As most corporates maintain banking relationships with conventional banks, the Islamic banks have to offer significant price discounts to attract such corporate clients. While this may improve the quality of its financing portfolio, it however reduces profit margins and inhibits its ability to offer better returns to the depositors. This also directs access to finance to the well established businesses and corporates and leaves the SMEs and startup businesses financially excluded. This naturally is contrary to the business model of Islamic finance, that promotes risk and reward sharing and encourages financing to promising startups that is critically important for promoting entrepreneurial culture. The financing to SMEs and startup ventures through participatory modes like Musharaka gives the SMEs/startups the necessary cushion to withstand the teething problems with no fixed interest cost. Although startups are relatively riskier, professional appraisal of the venture, and capacity of the entrepreneur to manage the venture could considerably lower the risk of failure and enable Islamic banks to earn attractive returns that will allow them to pay better returns to their depositors.

This takes us to another important issue regarding the scope of Islamic banks' business profile. The present scope is confined to that of conventional banks which generally caters to short term financing needs of the real economy through interest bearing instruments/facilities. While this scope is in line with the business model and deposit streams of conventional banks, it is not sufficient for Islamic banks that were originally conceived for catering to longer term financing needs of the real economy through risk and reward sharing instruments. As I said earlier, Islamic banks with this narrow scope will find it difficult to compete with conventional banks, that are giants when compared with Islamic banks and are highly efficient and flexible in catering to such financing needs of the real economy. The Islamic banks thus will need to expand their scope to offer both commercial and investment banking services to be financed by different streams of deposits i.e. current and PLS deposits for financing short term trade based activities and restricted investment accounts for financing longer term investment banking transactions. The scope so achieved will be instrumental in: a) increasing viability of Islamic banks, b) improving financial inclusion, c) promoting entrepreneurial culture, and d) significantly enhancing the returns to depositors. I am sure that the speakers and delegates in today's program will thoroughly discuss all these issues and will give recommendations to strengthen the Islamic financial system so that we may exploit its full potential.

Now I will briefly discuss Pakistan's Islamic finance industry, its evolution, growth potential and State Bank's plans to help and facilitate development of a robust Islamic banking system.

The Islamic banking initiative was re-launched in Pakistan in 2001 as an alternate and parallel system to provide an option to the public to enable them to choose the product that best serves their needs. Learning from the experience of 1980s, a comprehensive legal, regulatory and Shariah compliant framework was put in place before launching the initiative. The framework allowed three types of Islamic banking institutions viz. i) Full fledged Islamic banks, ii) Islamic banking subsidiaries of conventional banks and iii) Islamic banking branches (IBBs) of conventional banks. Additionally conventional banks having IBBs could also have Islamic banking windows in their conventional branches. Considering the increased interest of banks to convert their conventional branches into Islamic branches, we have recently announced the criteria for such conversions.

The initiative has been a big success; the Islamic banking Industry has grown manifold since 2001 and presently constitutes more than 6% of the banking system in Pakistan. Although there has been some deceleration in growth during the last couple of years, largely due to a slowdown in overall economic activity, the Islamic banking industry is likely to regain its growth momentum and increase its share to 10-12% over the next 2-3 years. There are numerous areas/sectors which could be explored to sustain and even accelerate the growth momentum, some of which I would like to highlight:

Large un-banked Population- Pakistan with a population of 170-180 million people, 97% Muslim, has a fairly large domestic market, second only to Indonesia. A large majority of the population is unbanked which is attributable to, among others, low penetration of the banking system[1] particularly in rural/semi rural areas and general dislike for interest (Riba). A World Bank study on access to finance published in 2008 estimated that only 14 % of the population in Pakistan is banked and has access to the formal financial system. Thus a huge un-tapped market, a significant proportion of which is also faith sensitive, is available for IBIs to offer shariah compliant financial services.

Large Un-served Agriculture Sector- Pakistan, being an agrarian economy, agriculture is strategically an important sector for the economy, having a 20% share of GDP and a major source of livelihood for 65% of the country's population living in rural areas. The sector is largely un-served/under-served by banks; less than 20% of about 7 million farm households in the country have access to bank credit[2]. The Islamic banks can capture a sizeable proportion of this market by reaching out to the growers either directly or through NGOs/MFIs. The IBIs are likely to have better acceptance in rural areas as the rural population is believed to be relatively more faith sensitive. Presently IBIs are largely concentrated in large urban centers. They will have to expand their outreach to smaller towns and rural/semi rural areas and optimally leverage the technology to serve the rural markets.

The SME sector is another potential area for Islamic banks to explore. Presently only 0.2 million SMEs have access to bank financing out of 3.1 million SMEs across the country[3]; the IBIs have just around 2300 SME clients. The low presence of Islamic banks in SMEs is attributable to the high risk perception about SMEs, over conservatism of Islamic banks in underwriting the risks and their capacity constraints in serving the non-traditional sectors like SMEs and agriculture. The conventional banks place their surplus funds in risk free government securities, while the Islamic banks presently do not have this luxury. They should develop their capacity to deploy their surplus liquidity in avenues that have the potential to be the main drivers of growth for banks, including Islamic banks in the foreseeable future.

Similarly ***Housing finance*** is another attractive avenue for Islamic banks; they already have 12% share in the country's housing finance market, which is twice as large as their share in the banking system. Despite a deficit of more than six million housing units in the country that is increasing due to supply shortage, the housing finance market is largely under developed; mortgage loans are approximately 1 percent of GDP, which suggests that a huge un-tapped market awaits banks/IBIs to exploit. The Islamic banks can also develop partnerships with Federal and Provincial governments in developing/building low cost housing projects, that are on the active agenda of federal and provincial governments.

[1] One bank branch for more than 17,000 people with branches highly concentrated in 10 big cities
[2] SBP Data
[3] Federal Bureau of Statistics

SBP fully recognizes and appreciates the potential of Islamic banking in increasing the depth and breadth of the banking system and making it more diverse and stable. The system, we believe has the potential to provide stiff competition to the conventional system, provided it capitalizes on its own inherent strengths and avoids blind faith of the conventional system. It is an important component of our strategic goals and we are actively engaged with the industry as the regulator cum partner to catalyze and facilitate development of the industry on a sound footing. We have plans to further improve our legal and regulatory framework to provide the necessary support and flexibility to the industry and enhance its commercial viability. There are also plans to strengthen the shariah compliant framework to improve the shariah compliance levels in the industry and give comfort to the masses about the shariah permissibility of Islamic banks' operations.

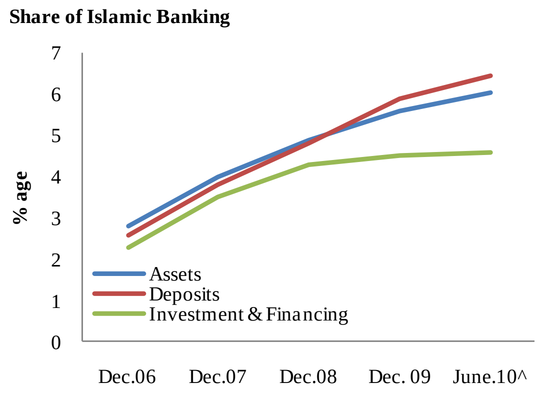
We have also launched an awareness campaign to improve Islamic banking literacy, which is critically important for future growth and development of the industry. We are also working with the industry and academia to build HR capacity of the industry, which presently is one of the key challenges faced by the industry. Further, considering the critical importance of risk and reward sharing participatory modes in success of Islamic banking initiatives, SBP is developing an incentive framework to promote the participatory modes. With both the industry and regulator on the same wavelength for the future direction of the industry, I am confident the Islamic banking industry will flourish and strengthen in the months and years to come.

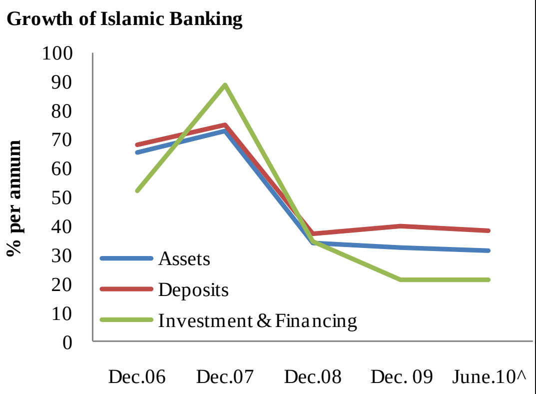
Finally and would once again thank Redmoney for taking this initiative and providing us the opportunity to deliberate on the possible strategies to take this industry forward to the next level of growth. Let me also assure the full cooperation and ownership of SBP for all such events in the future. Thanks.

Industry Progress and Market Share

Overview

Islamic banking maintained its high growth trajectory during quarter Apr-Jun 2010. The total assets of Islamic banking institutions (IBIs) increased to Rs 411 billion in June 2010 from Rs 313 billion in June 2009, showing an impressive growth of 31%. The deposits spearheaded the growth with 39% increase during the year. The investment and financing however did not show the same pace of momentum and have shown comparatively tenuous growth at 21% which is indicative of the difficulties being faced by IBI's in assets acquisition.





The assets, deposits and net investment & financing have posted growth rates of 31, 39 and 21 percent, respectively. The high growth in various components of Islamic banks balance sheet has enabled the Islamic Banks to make further inroads in the overall banking industry in Pakistan; the shares of assets, deposits and investment & financing increased to 6.1, 6.4 and 4.6 percent respectively during the quarter ended June 2010. The branch network increased to 667 branches from 651 in December 2009 (see **Table 1**).

Table 1: Industry Progress and market share

Rupees in billion & shares and growth in percent

	June.10	Dec. 09	Dec.08	Dec.07	Dec.06	Dec.05	Dec.04	Dec.03
Total Assets	411	366	276	206	119	71	44	13
Share in industry	6.1	5.6	4.9	4	2.8	2	1.5	0.5
Growth (YoY)	31.3	32.7	34	73.1	65.3	63.6	238.5	
Deposits	330	283	202	147	84	50	30	8
Share in industry	6.4	5.9	4.8	3.8	2.6	1.8	1.3	0.4
Growth (YoY)	38.6	39.9	37.4	75	68	66.7	275	
Net Financing & Investment	235	226	186	138	73	48	30	10
Share in industry	4.6	4.5	4.3	3.5	2.3	1.7	1.3	0.5
Growth (YoY)	21.2	21.3	34.8	89	52.1	60	200	
Total Islamic Banking Institutions	19	19	18	18	16	11	11	4
Total No. of Branches*	667	651	515	289	150	70	48	17

Source: Annual Accounts except for June 2010, data for which is based on Unaudited Quarterly Accounts
**number includes sub-branches*

The consistently high growth trends being exhibited by the industry over the last 4-5 years is indicative of growing acceptability of Islamic Finance as a commercial option for the different stake holders, along with the high growth ratios could also be partly attributed to the relatively low base compared to the conventional system. With the size of the industry increasingly at an appreciably high rate, the future growth ratio may slow down marginally largely due to continuously rising base.

The IBIs are flush with liquidity since last couple of years due to continued growth in deposits coupled with the dearth of liquidity management instruments. The excessive liquidity in IBIs could also be partly attributed to the cautious approach of IBIs in assets acquisition. The prime target market of IBI's has usually been the big conglomerates and MNC's. This in turn enables them to maintain a sound quality of their financial and investment portfolio. However this squeezes the profit margins of IBI's as due to the peculiar nature of their clientele, clients are able to solicit credit on their own terms. Moreover this also leaves the SMEs and startup business ventures devoid of Islamic financial services.

The IBIs have fared relatively well during and post 2008 global financial markets crises; however the recent floods—worst in the history of Pakistan—are likely to adversely affect asset quality of banks including IBIs. Consequently, the performance of the banking system including IBIs during the coming few quarters may remain under stress.

Operating Performance

The operating performance of IBIs remained weaker than the banking system. The ROA and ROE of IBIs at 0.8% & 6.9% was relatively lower than the industry average of 1.1% and 10.6%, the ROE though improved to 6.9 % in June 2010 compared to 6.0 % in June 2009. The major source of IBI income, at around 80 %, is mark-up income compared to around 70 percent for the conventional banks, which is indicative of low diversification of IBIs sources of Income compared to the conventional banks.

Table 2: Performance Indicators

	Jun-10	Mar-10	Jun-10	Industry
Capital				
Capital to Total Assets	7.0%	11.4%	10.4%	9.9%
(Capital - Net NPAs) to Total Assets	12.4%	9.6%	9.2%	8.2%
Assets Quality Ratio				
NPFs to Financing	5.0%	7.3%	6.5%	12.9%
Net NPFs to Net Financing	2.4%	3.8%	2.8%	3.8%
Provisions to NPFs	54.4%	50.0%	58.8%	73.2%
Net NPAs to Total Capital	11.6%	15.8%	11.5%	17.2%
Real estate Financing to Total Financing	10.8%	11.3%	10.8%	2.3%
FCY Denominated Financing to Capital	11.1%	5.8%	9.6%	16.1%
Earnings and Profitability				
Net Income to Total Assets(ROA)	0.8%	0.8%	0.8%	1.1%
Return on Equity (ROE)	6.0%	7.0%	6.9%	10.8%
Net Interest Income to Gross Income	82.0%	81.1%	80.7%	74.7%
Non-interest Income to Gross Income	18.0%	18.9%	19.3%	25.3%
Trading & Fx Gains/(Losses) to Gross Income	6.1%	7.0%	8.0%	7.8%
Operating Expense to Gross Income	65.1%	70.2%	71.8%	52.6%
Personnel Expense to Operating Expense	29.7%	32.2%	32.1%	36.7%
Spread Between Financing & Deposit Rate	7.1%	7.7%	7.7%	6.9%
Liquidity				
Liquid Asset to Total Assets	24.8%	26.8%	25.8%	34.2%
Liquid Assets to Deposits	32.6%	34.5%	32.2%	45.3%
Avg. Maturity of Liabilities (Days)	308.25	387.61	383.55	417
Avg. Maturity of Assets (Days)	708.43	638.72	595.73	594

The operating *expense to gross income ratio* of IBIs is also much higher than the industry. Specifically, *expense to gross income ratio* of IBIs is 71.8 % compared to 52.8 % of the industry. The high level of operating expenses are however advisable to their expansion drive rather than inefficiency. The IBIs branch network more than doubled during last two years; the branches opened particularly during last one years would be achieving break evens during next 2-3 quarters, thus enabling the IBIs to improve their expense to income ratios. Interestingly personnel expenses of IBIs are lower than the industry median (though it has gradually increased in last few quarters), which may be indicative of relatively weaker quality of human resource of IBI.

The spread (based on actual yield on the financing less deposits) is relatively higher for IBIs at 7.7 percent compared to the industry average of 6.9 percent as at end-June 2010. The higher spread of IBIs is largely coming from a lower level of NPFs compared with their conventional counterparts. The relative better assets quality enabled them to earn better yield on their financing portfolio than the industry as a whole. Nonetheless, higher spread remains an area of concern as it reflects sub-optimal returns to the deposits, both for IBIs and conventional banks.

Outreach Expansion

The branch network of IBIs has increased to 667 branches by end-June 2010. With addition of 210 and 143 branches in 2008 and 2009, an increase of 29 branches in during Jan-Jun 2010 does not seem very impressive. The slowdown in branch expansion is reflected in both the full-fledged Islamic banks (IBs) and Islamic banking branches of conventional banks (IBBs). The slowdown is attributable to fast pace expansion of branch network during last two years with current focus on making the branches fully operational. Further, the growth in branch network during next 1-2 years would largely be emanating from conventional banks having IBBs both through conversion of existing conventional branches into Islamic Banking Branches (IBBs) and new IBBs.

The IBs accounts for 416 branches and IBBs accounts for 183 branches while the rest 68 are sub branches of both IBs and IBBs. The geographical coverage of Islamic banking extends across the four provinces, Azad Kashmir, Northern areas and Federal capital covering 84 cities. The province-wise data reveals that Sindh, Punjab, Balochistan, Khyber-Pakhtunkhwa and Azad Kashmir accounts for 223, 297, 73, 34, and 7 branches respectively, while the rest 32 branches are in the Federal Capital. 653 branches are in the banked areas while only 14 branches which represent a minuscule 2.3 percent are in the unbanked areas.

The IBIs’ branch network is however largely concentrated in big cities and banked areas. The need is for IBIs to focus more on the unbanked and rural areas so that a larger populace can access Islamic banking at their doorsteps. The conventional banks having Islamic banking branches are in an advantageous position to convert their existing conventional branches in these areas into Islamic banking branches.

Asset Quality

As shown in **Table 3**, during the quarter Apr-Jun 2010 the non-performing financing has increased substantially YoY basis, however there is a decrease of around 10 percent on QoQ basis. The net non-performing financing shows similar YoY and QoQ trends.

Table 3: Non-Performing Financing & Assets

Rupees in million

	Jun-09	Mar-10	Jun-10	Growth YoY	Growth QoQ*
NPF	1,803.2	11,871.3	10,649.9	490.6	-10.3
Provisions	788.7	5,935.7	6,261.8	693.9	5.5
Net NPF	1,014.4	5,935.6	4,388.1	332.6	-26.1
NPA	1,953.2	13,628.6	12,454.4	537.7	-8.6
Net NPAs	1,030.9	6,659.8	4,921.1	377.4	-26.1

The NPAs and net NPAs also have similar inclining trends. However, on a positive note the recovery has improved substantially both on YoY and QoQ basis. The slowdown in NPF and NPA coupled with better recovery derive reflects positively on asset management of the IBIs.

The infection ratio, net infection ratio, and NPA to capital ratio, of IBI are better than the industry at end-June 2010. The assets infection as depicted by *NPFs to financing ratio* at 6.5% is almost the half of the industry average which stood at 12.9%. The *net NPFs to net financing ratio* at 2.8% is also much better than the industry average of 3.8%. Similarly the net *NPAs to Capital* ratio of IBIs at 11.5% is also better than the industry average of 17.2%. (see **Table 2**). The improved asset quality of IBIs can be evidenced from rapid fall in infection ratio both on gross and net basis while there is an increase in provisions against NPFs. The only concern seems to be an increase of 4.7 percentages in foreign currency exposures as percent of capital.

The foreign currency exposure in financing for IBIs at 9.6% is also much lower than the industry median of 16.1% at the quarter end and has shown a declining trend for the IBIs. The exposure of IBIs on the real estate sector is much higher at 10.8% than the industry average of 2.3% at end-June 2010.

Nevertheless, the recent economic slowdown due to massive flooding in the country can potentially reverse these encouraging trends.

Financing Products

The financing mix remained concentrated in Murabaha financing. In fact, the Murabaha financing has rebounded during the quarter under review from 37.1% to 44.1% of the financing. There is a slight decline in DM financing, Salam and Istisna modes. Nonetheless, Murabaha, Ijarah and DM constitute around 87 % of the financing (see **Table 4**).

The financing through participatory modes remained at extremely low levels both due to low demand and IBIs reluctance to increase their risk appetite. Similarly, use of financing modes like Salam and Istisna, which can be used to finance nontraditional sectors like agriculture and SME, remained lack luster.

Table 4: Financing Mix
Rupees in billion

	Jun.09	Mar.10	Jun,10
Murabaha	58.0	60.8	72.4
Ijarah	26.2	22.7	23.8
Musharaka	3.7	2.8	6.0
Mudaraba	0.9	0.4	0.4
Diminishing Musharaka (DM)	45.3	51.3	46.4
Salam	2.9	6.5	3.2
Istisna	4.8	10.6	6.4
Others	2.3	7.0	5.4
Total	**144.3**	**162.1**	**164.0**
Murabaha	40.2	37.5	44.1
Ijarah	18.2	14.0	14.5
Musharaka	2.6	1.7	3.7
Mudaraba	0.7	0.2	0.2
Diminishing Musharaka (DM)	31.4	31.7	28.3
Salam	2.0	4.0	2.0
Istisna	3.3	6.6	3.9
Others	1.6	4.3	3.3
Total	**100.0**	**100.0**	**100.0**

Sectoral Concentration of Financing

The IBIs financing concentration does not show much sign of improvement and is concentrated in a few sectors. Though the trend is in line with the overall banking industry's financing the same cannot be deemed desirable.

The IBI financing is confined to sectors like Textile, Chemical & pharmaceutical and Individuals, where IBIs have around 18.3, 9.1 &

Table 5: Financing Concentration - percent share

	Jun-09	Mar-10	Jun-10	Industry
Chemical and Pharmaceuticals	7.1%	10.5%	9.1%	4.1%
Agribusiness	1.0%	0.6%	1.1%	5.8%
Textile	20.5%	20.6%	18.3%	16.9%
Cement	2.2%	2.8%	3.5%	2.5%
Sugar	2.8%	6.0%	3.6%	2.3%
Shoes and leather garments	1.6%	1.2%	1.1%	0.6%
Automobile and transportation equipment	2.6%	2.0%	1.9%	1.6%
Financial	1.1%	1.0%	1.3%	1.2%
Insurance	0.0%	0.0%	0.0%	0.0%
Electronics and electrical appliances	1.1%	1.0%	0.9%	1.6%
Production and transmission of energy	4.5%	4.5%	4.8%	9.4%
Individuals	22.8%	20.1%	19.1%	12.8%
Others	36.4%	31.6%	36.4%	41.1%
Total	100.0%	100.0%	100.0%	100.0%

19 % concentration compared to 16.9 & 4.1 and 12.8 % respectively for the rest of the banking industry (see **Table 5**).

The concentration in a few sectors implies concentration of risk as well. For instance, the likely distress to Textile sector due to expected higher cotton prices (resulting from losses in floods) may adversely affect the textile sector and its financiers. Moreover, the financing to the individuals is very sensitive to the overall economic activity and in times of distress there are higher chances of defaults.

Investments

The investments of IBIs have shown substantial growth of YoY 46% and QoQ 7.0% in June 2010. The YoY growth primarily represent the Rs 14.4 billion GoP Ijarah Sukuk and Rs 6.8 billion PIA Sukuk issued in September and October 2009, respectively. There is a substantial decline of 12 percent in investment in shares during the quarter, though investments in shares remained marginally positive on YoY basis (see **Table 6**).

Table 6: Investments
Rupees in million

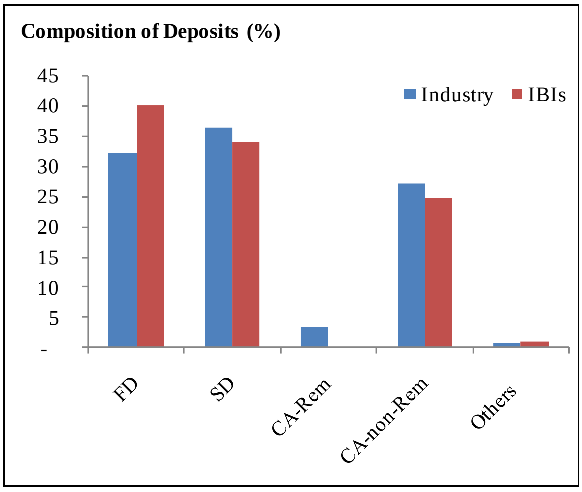
	Jun-09	Mar-10	Jun-10	Growth YoY	Growth QoQ*
Federal government securities	17,073.6	27,081.1	27,032.7	58.3	(0.2)
Fully paid up ordinary shares	1,678.5	1,997.9	1,757.6	4.7	(12.0)
TFCs, Debentures, Bonds, & PTCs	19,408.3	24,866.2	26,173.8	34.9	5.3
Other investments	15,891.9	19,564.4	23,841.6	50.0	21.9
Investments by type					
Held for Trading	127.6	-	-		
Available for Sale	39,904.9	59,147.0	64,717.5	62.2	9.4
Held to Maturity	11,211.4	11,465.8	11,697.2	4.3	2.0
Surplus /(deficit) on revaluation	(31.8)	254.3	110.7	(447.9)	(56.4)
Net Investments	**53,539.8**	**72,892.7**	**77,999.7**	**45.7**	**7.0**

In terms of investment types, investments are largely concentrated in *Held for sale* and *Held to maturity* categories, while there are negligible securities in *Held for trading* category—largely a result of lack of Shariah compliant tradable securities. The constraint on availability of proper investment avenues is a major constrain on profitability of IBIs. The constraint is more disturbing in wake of rapid growth in deposits.

The SBP and the domestic and international Islamic banking community are striving to evolve effective and efficient Shariah compliant liquidity management tools.

Deposits mobilization

The deposit mobilization remained strong during Apr-Jun 2010. The YoY and QoQ growth in deposits remained robust at 38.5% and 14.1 % respectively. The YoY growth in deposits is largely coming from the customer deposits at 40.6 percent. All the customer deposit types—fixed, saving and current—have shown close to 40 percent YoY growth. Similar trends have continued during the quarter ended June 2010.



The comparative analysis of composition of deposits of IBIs and industry reveals that the behavior of IBI depositors and conventional banks depositors is almost similar (see **Figure 2**).

Table 7: Break up of Deposits
Rupees in million and growth in percent

	Jun-10	Mar-10	Jun-10	Growth YoY	Growth QoQ*
Deposits	**238,168.5**	**289,090.3**	**329,778.3**	**38.5**	**14.1**
Customers	**219,079.4**	**274,106.4**	**308,067.0**	**40.6**	**12.4**
Fixed Deposits	88,871.8	113,179.6	123,484.7	38.9	9.1
Saving Deposits	75,176.1	94,321.1	105,162.7	39.9	11.5
Current accounts - Remunerative	-	-	-		
Current accounts - Non-remunerative	53,165.4	64,086.7	76,676.9	44.2	19.6
Others	1,866.1	2,518.9	2,742.7	47.0	8.9
Financial Institutions	**19,089.2**	**14,983.8**	**21,711.3**	**13.7**	**44.9**
Remunerative Deposits	19,039.8	14,813.4	21,340.1	12.1	44.1
Non-remunerative Deposits	49.4	170.5	371.2	651.3	117.7
Currency Wise					
Local Currency Deposits	225,474.1	272,091.3	312,488.5	38.6	14.8
Foreign Currency Deposits	12,694.5	16,999.0	17,289.8	36.2	1.7

The similar depositors' preferences in IBIs and overall banking industry may reflect that IBIs need to do better with reference to the vast potential of the market. A stronger evidence of this assertion came from high level of non-remunerative current accounts in IBIs. This implies that the IBIs have to focus more aggressively on their awareness campaign together with effective marketing of Islamic banking as offering Shariah compliant returns to the depositors. Possibly, a combined marketing campaign by IBIs under a single banner.

Maturity Profile

As shown in **Table 9**, the maturity profile of assets and liabilities of IBIs closely resembles that of the banking industry at end-June 2010. The average asset maturity of IBI as of June 2010 is concentrated in 3-month maturity. On the liability side, the average maturity is also concentrated in shorter tenor.

The maturity gaps as of June 2010 depict higher gaps in shorter tenors as compared to longer tenors. This trend is also consistent with the industry behavior.

Table 8: Maturity of Assets and Liabilities
percent share

	Jun-09	Mar-10	Jun-10	Industry
		Assets		
Maturing upto 3 months	37.7	40.1	42.9	43.4
Maturing from 3 months to 1 yr	22.5	22.8	22.6	27.0
Maturing from 1 yr to 5 yrs	26.4	26.7	25.1	17.8
Maturing after 5 yrs	13.3	10.4	9.4	11.9
		Liabilities		
Maturing upto 3 months	58.6	51.7	54.3	55.8
Maturing from 3 months to 1 yr	25.2	28.2	25.5	21.3
Maturing from 1 yr to 5 yrs	11.0	14.9	15.0	16.9
Maturing after 5 yrs	5.2	5.2	5.2	6.0
		Gap--asset share minus liability share		
Maturing upto 3 months	(20.9)	(11. 7)	(11.4)	(12.4)
Maturing from 3 months to 1 yr	(2.7)	(5.3)	(3.0)	5.7
Maturing from 1 yr to 5 yrs	15.4	11.8	10.1	0.8
Maturing after 5 yrs	8.0	5.2	4.3	6.0

Events & Developments at IBD

IFN Roadshow at State Bank of Pakistan Karachi August 5, 2010:
IFN is working for the promotion and development of Islamic Banking and Finance with the collaboration of other Intuitions locally and internationally. In this regard a roadshow was supported by the State Bank of Pakistan and arranged at State Bank of Pakistan Karachi on 5th August 2010. The one-day seminar was attended, among others, by participants from financial institutions, Islamic scholars, academia, etc. besides senior officials of the SBP. In this roadshow different issues related to Islamic banking and Finance were discussed such as Islamic Finance in the current Paradigm, Issuing and Investing in the Islamic Financial markets, Possibilities and Opportunities for Diversification of Islamic Products, Examining Market Trends, Challenges and Further Opportunities for Islamic Financial Markets in Pakistan, Establishing and Accelerating Pakistan's' Growth as an Islamic Financial Hub etc. The roadshow was a success and attracted a lot of interest from all stakeholders.

IFSB Survey on Islamic Capital Market and Islamic Money Market
To assess at the regulatory framework available at various jurisdictions for Islamic capital market and money market, and to look at the initiatives undertaken for the development and promotion of this financial sector, IBD facilitated IFSB to seek feedback on their survey from Pakistan. The survey comprising of two sets focused on the following aspects:

i. Supervisory and regulatory framework for Islamic Capital Market and Islamic Money Market
ii. Main features of Islamic Capital Market
iii. Development, main features and volume of Islamic money market

IBD coordinated with the entire Islamic financial industry and sought their feedback on the survey questionnaire. Subsequently, the feedback was compiled and forwarded to IFSB to help them realize the objectives of survey conducted at international level.

Establishment of Musharaka/Mudaraba Task Force
Islamic banking industry is progressing at a rapid pace since its re-launch in Pakistan during 2002. Despite its continuous impressive growth, the industry is facing many challenges - the foremost of which is to maintain its distinction over conventional banking. It is therefore viewed that current trend of total reliance on the debt-based fixed return products may not be sustainable in the long run.

Further, a consensus is emerging on the need for diversifying the product mix offered by Islamic Banking Institutions (IBIs) to gradually move towards participatory modes of Musharaka and Mudaraba in which IBIs may have comparative advantage over their conventional counterparts. However, there are quite a few major impediments in the IBIs' movement towards these participatory modes including trust deficit between IBIs and entrepreneurs, information asymmetries, taxation issues, willingness of depositors to allow IBIs to invest their funds under participatory modes.

In order to take the Islamic banking industry towards Musharka financing, a Task Force has been established by SBP to review in detail the constraints faced in Musharaka/Mudaraba financing, to suggest recommendations for removing the constraints and to develop incentive framework for promotion of Muhsarka/Mudaraba financing. The Task Force will be represented by SBP, Islamic banks, Shariah-community, SECP, Chambers of Commerce, chartered accountants, and academia.

Islamic Banking News

Mehmood Ghazi passes away, laid to rest in capital

Former judge of the Federal Shariah Court and ex-religious minister Dr. Mehmood Ahmed Ghazi, who died early on Sunday of cardiac arrest, was laid to rest here. He was 60. According to details Dr. Ghazi suffered from cardiac arrest at his residence in Sector H-11. He was shifted to PIMS but he could not survive. He has left behind a wife and five daughters. Besides holding several important portfolios, he served as president of International Islamic University, Islamabad (IIUI), and as professor at the Faculty of Shari'ah and Law, IIUI. Dr. Ghazi also authored a number of books.

Meanwhile, President Asif Ali Zardari on Sunday expressed his deep sorrow and grief over the deaths of Dr. Mahmood Ahmed Ghazi, former president of the International Islamic University, Islamabad, and PPP leader Afaq Shahid. The president lauded the services of Dr Ghazi in research and his contribution towards higher education and analytical study of the religion.

The president also spoke high of the services of Afaq Shahid for strengthening the party and democracy in the country. Meanwhile, Federal Minister for Religious Affairs Syed Hamid Saeed Kazmi on Sunday expressed deep grief and sorrow over the demise of Mehmood Ahmad Ghazi, former federal minister for religious affairs and ex-judge of Federal Shariat Court.

In a condolence message to the family of the deceased, he prayed to Allah Almighty to rest the departed soul in eternal peace and grant courage to them to bear this irreparable loss with fortitude. The minister paid glorious tributes to the deceased, adding that he would be remembered for his services rendered for the nation during his life in different capacities.

http://www.thenews.com.pk/27-09-2010/islamabad/6834.htm

IMF report: Islamic banking can spur growth in Muslim world

A recent International Monetary Fund (IMF) report has argued that the rapidly growing Islamic banking sector may accelerate economic development of the Muslim world.

In their working paper "Islamic Banking: How Has it Diffused?" IMF researchers Patrick Imam and Kangni Kpodar note that Islamic banking with its finance potential can solve the problem of slow growth in the world's Muslim nations. "We showed that Islamic banking has, in a few decades, moved from a niche market into the mainstream. Because Muslim populations are underbanked, and given the tremendous need for infrastructure projects like roads and housing across the Muslim world, [the] development of Islamic banking can spur growth in these regions and can be part of the solution to the slow development process," they wrote in the report.

Islamic banking came as a market response to the financial needs of devout Muslims who have been looking to invest their savings in a way that does not conflict with Islam, which proscribes engaging in interest-bearing transactions, a mainstay of conventional banks. "It is an increasingly visible alternative to conventional banks in Islamic countries and in countries with large Muslim populations, such as the UK. Globally, the assets of these institutions have grown at double-digit rates for a decade, and some conventional banks have opened Islamic windows, with Shariah-compliant financial assets reaching an estimated $509 billion at end-2007," the IMF report said, reiterating the International Organization of Securities Commissions (IOSCO) prediction that "as much as half of the savings of the world's estimated 1.2-1.6 billion Muslims will be in Islamic financial institutions by 2015."

According to the IMF paper, the diffusion of Islamic banking has happened in relation to increasing oil prices but also has links to economic integration with the Middle Eastern countries and proximity to Islamic financial centers Malaysia and Bahrain. "Rising interest rates hinder the diffusion of Islamic banking because they raise the opportunity cost for less devout individuals or non-Muslims to put their money with an Islamic bank," the researchers also stated. With these findings, the report, however, refuted the wide belief that Islamic banks owe their expansion to the deadly terrorist attacks on the World Trade Center in New York on Sept. 11, 2001. "Contrary to what many observers say, our results suggest that the attacks of 9/11 were not crucial to the diffusion of Islamic banking.

Instead, the attacks coincided with rising oil prices, which appear to overshadow the significance of 9/11," the IMF researchers noted.

In addition to that, the international organization's report also opposed the marginal view that Islam negatively affects growth. "Much of the evidence does not support this argument. First, the Golden Age of Islam between the 9th and 15th centuries, when advances were made in science, literature, navigation, law, and philosophy, illustrates that Islamic societies are capable of progress and innovation when the right environment is in place. In fact, not only does Islam not negatively impact growth, but Islamic banking could complement conventional banks and thereby help diversify systemic risk," the report concluded.

http://www.todayszaman.com/tz-web/news-220625-105-imf-report-islamic-banking-can-spur-growth-in-muslim-world.html

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The Malaysian central bank's sharia advisers have outlawed the payment of a fee to support a pledge made in Islamic forward foreign currency transactions, saying such charges contravene the religion.

Islamic banks tend to levy a payment when a promise or "waad" is made to enter into a forward foreign currency hedging contract to reflect the parties' commitment to the transaction.

But Bank Negara's sharia advisory council, whose rulings are binding on Islamic banks in Malaysia, said such charges would render the promise a bilateral waad, which is not allowed by the sharia."Islamic financial institutions are allowed to enter into forward foreign currency transaction for hedging purposes based on unilateral waad (promise) that carries binding effect on the promisor," Bank Negara's sharia advisers said in a statement.

"Nevertheless, no consideration (or fee) is allowed to be charged on the promisee in view that upfront cash payment for forward currency transaction would lead to a bilateral waad which is not allowed by sharia."A bilateral waad is deemed a contract and some experts said in this context it could lead to an agreement without the present delivery of the price and subject matter of the transaction, giving rise to uncertainty which is prohibited by Islamic law.

"Realising the realities of the situation that they need to have sharia-compliant structures for forwards, banks would probably work out a way in which the fee is built into the structure itself," said Megat Hizaini Hassan, an Islamic banking lawyer at Zaid Ibrahim & Co."If you deal with two institutions, probably they can work it out in such a way that the fee is built into the pricing and therefore payment of the fee is deferred as part of the pricing for the underlying transaction."Bank Negara's 10-member sharia advisory council includes Mohd Daud Abu Bakar, Sheikh Ghazali Abdul Rahman, Mohamad Akram Laldin and Muhammad Syafii Antonio.

http://www.reuters.com/article/idUSSGE67O0GD20100826 August 26,2010.

Islamic Development Bank to Sell $1 Billion of Sukuk

The Islamic Development Bank, a Saudi Arabia-based multilateral lender, plans to sell $1 billion of Islamic bonds to fund development projects in its member countries, Vice President Abdul Aziz Al Hinai said today.The five-, seven- and 10-year sukuk, part of the IDB's $3.5 billion Medium-Term Note program, will be issued in the fourth quarter and listed in London and Kuala Lumpur, Al Hinai told reporters in the Malaysian capital after registering a separate ringgit issuance on the local exchange. CIMB Group Holdings Bhd. and four international banks will manage the sale, he said.

Global sales of sukuk will pick up in the second half of the year and rise above the total in 2009, as more companies and governments tap the market, said Badlisyah Abdul Ghani, head of CIMB's Islamic banking unit. Issuance will climb to as much as $25 billion from about $20 billion last year, he said.

"The market is buzzing with new liquidity," said Badlisyah. "We have seen announcements in the Saudi market where corporate is coming in, announcing that they will be doing riyal sukuk. There are companies in Malaysia coming in very aggressively in the second half and three are coming in within this month. So the pipeline is healthy." Saudi Electricity Co., the Arab world's largest utility company, may issue sukuk in 2011 after a sale in April of 7 billion riyal ($1.9 billion), Executive Director of Treasury Fahad Alsudairy said on May 18.

Khazanah Nasional Bhd., Malaysia's state investment agency, sold S$1.5 billion ($1.1 billion) of five- and 10-year Islamic notes on Aug. 11, and the nation's biggest mortgage company Cagamas Bhd. sold 1 billion ringgit ($318 million) on Aug. 19.

'Highly Needed'

The IDB, which has 56 member countries including Egypt, Saudi Arabia and Turkey, is financing up to $8 billion of projects in 2010, said Vice President Al Hinai. The proceeds from the sukuk will be used to mostly finance infrastructure development of $3 billion to $3.5 billion, projects that "are highly needed for the growth of our member countries," he said. The sukuk are rated AAA by Standard & Poor's, according to a statement issued by the bank today. IDB's ringgit sukuk listing in Malaysia, the world's largest market for Islamic bonds, adds to those completed by Nomura Holdings Inc. and General Electric Capital Corp. The lender has sold 400 million ringgit under the 10-year, 1 billion ringgit sukuk program so far, and $1.1 billion under the dollar plan, Al Hinai said.

'New Asset Class'

Islamic finance transactions are based on the exchange of asset flows rather than interest to comply with the religion's Shariah principles. Shariah-compliant notes returned 3.8 percent this quarter, up from 0.8 percent in the previous three months, according to the

HSBC/NASDAQ Dubai US Dollar Sukuk Index."Islamic finance is a new asset class that has the potential to bring new economic growth to our member countries," Al Hinai said. "The potential for the growth of Islamic finance is clear. It is essential for all of us to look beyond the current global financial turbulence and treat the development of Islamic finance as an investment for the future."

http://www.businessweek.com/news/2010-08-24/islamic-development-bank-to-sell-1-billion-of-sukuk.html

Islamic banking in the heart of Geylang Serai Maybank opens branch dedicated to Syariah-compliant products

Maybank Singapore has launched the first dedicated Islamic banking branch here and plans to roll out home loans and motor insurance products that are based on Syariah principles.

The bank did not disclose the details of the new Islamic financial products at Friday's launch but confirmed they were in the pipeline and formed part of its strategy to grow its Islamic banking business beyond its domestic market in Malaysia. The new Islamic banking branch in Singapore is located in the heart of Geylang Serai, home to a large base of Muslims. It is part of Maybank's bigger plans for its Islamic banking unit as it aims to be the leading Islamic bank in Asean.

Malaysia's biggest lender also said it hoped that earnings from outside its home country would contribute a higher percentage to its overall profits over the next five years. Maybank chief executive Abdul Wahid Omar said: "The idea here will be to grow our profit to make up about 40 per cent from our international operations by 2015." Apart from the Asean region, the bank also expects demand coming from the Middle East, China and India.

Analysts say that oil-enriched Middle Eastern investors are attracted to Asia as the outlook for the United States and Europe remain sombre. Mr Raj Mohamad, managing director of consultancy firm Five Pillars, said: "Asia is very well-positioned now to offer what is commonly known as Syariah-compliant products, to attract these monies from the Middle East." With about two-thirds of the world's Muslim population in Asia, there is a huge potential for retail Islamic banking products to grow, analysts said.

http://www.todayonline.com/Business/EDC100904-0000094/Islamic-banking-in-the-heart-of-Geylang-Serai

BoK launches Islamic banking counters in AJK

Finance Minister of Khyber Pakhtunhawa Engr. Muhammad Humayoon Khan here Wednesday said that the government of KP including its financial institutions will leave no stone unturned to restore the flood and terrorism affected economy of the country. Addressing the inaugural ceremony of the newly-established Mirpur branch of The Bank of Khyber here Wednesday, he said the KP government has planned the expansion of the provincial banking across Pakistan and AJK with mission to ensure maximum role of the institution in strengthening the national economy. He said that besides the traditional banking, the BoK has also introduced the Islamic banking to attract its customers across the region.

He expressed the hope that emergence of the BoK branch in Mirpur district will promote business activities in the areas of AJK. Referring to the terrorism and floods related losses, he said that economy and infrastructure were badly hit by menace of terrorism and natural calamity. He said that National Motorway Peshawar section was also damaged due to floods triggered by heavy monsoon rains.

The minister said that despite the tough circumstances, KP with the liberal financial assistance of the federal government, would leave no stone unturned to bring the life back to normal. Addressing the ceremony, Dr. Z.U.Khan Advisor to the AJK President said that since banking was known as the parameter of economics, the AJK government will extend maximum support to the banking sector.

He pointed out that 34 world reputed banks have so far established their branches only in Mirpur besides the capital city of Muzaffarabad. The Advisor said that success of the banking sector all depends upon the services of the concerned bank.

http://pakobserver.net/detailnews.asp?id=46513

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

National Bank of Pakistan Islamic Banking Division[4]

Table: Bank's Performance at a Glance	
	(Rs in Millions)
Deposits	692.63
Financing	849.15
Total Assets	991.55
Number of branches	8

NBP started Islamic Banking operations by opening first branch in Karachi in December 2006. Since then, branch network has expanded to eight (8) branches. Presently NBP-IBD has presence in Karachi, Lahore, Peshawar, Rawalpindi, Faisalabad, Hyderabad, Muzafarabad and Mirpur. On asset side NBP-IBD is offering Ijarah and Murabaha and is planning to offer Diminishing Musaharakah and Istisna.

Mr. Abdul Sattar Laghari Bank's Shariah advisor of NBP-IBD. He is one of the prominent student of Mulana Muhammad Taqi Usmani. He possesses Master's degree in Islamic studies besides Shahada tu Al Almiah from wifaqual Madaris Al Arabiah . He is specialized in Tafseer Al Quran Al Majeed, AlFiaqh Al Islami and Usool-e-fiqh. He has on his Credit number of experiences of giving Fatwa/Shariah Rulings for prominent institutions. He has also attended several national and international seminars and courses on Islamic banking and conducted Islamic banking courses.

Deposit Schemes being offered by NBP-IBD include Current Deposit Scheme, Profit & Loss Sharing (PLS) Deposit Scheme, and Current Deposit Scheme.

PLS Saving Deposits Scheme will accept deposits on Mudaraba basis, where the depositor will be Rabb-ul-Mal and Bank will be Mudarib. The Bank will give profit to the Depositors on the basis of agreed ratio of actual profits to be announced by the Bank from time to time. In the event of financial loss, the PLS depositors will bear the loss in proportion of their investment.

Commercial and Corporate customers requiring financing have the following financing facilities available: Murabaha, Ijarah (Leasing) is available for Vehicles (both Commercial and Private), Office Equipment and Plant and Machinery.

In addition to Shariah acceptable standard general banking services, such as Letter of Credit Facility, Handling of Remittances, Issuance of Bank Drafts and Pay Orders, Collection of Export Bills, Collection of Local Bills, Government Collections, Utility Bills Collection.

Having one of the biggest branch network spread all across the country, NBP has the opportunity to explore this sector which is one of the emerging sector not only in Pakistan but across the globe. NBP can expand its business through opening of Islamic banking windows in its existing branches in order to attract more depositors and gain more market shares and through conversion of conventional branches into Islamic.

For more information please visit http://www.nbp.com.pk/Islamic/index.aspx

[4] Contributed by NBP-IBD.

Book Review:

Report of Council of Islamic Ideology (CII) on elimination of interest from Economy - Revisited

The report of CII on elimination of interest is a landmark and seminal work on the elimination of riba from the economy. Work of CII has became the basis of launching of Islamic banking not only in Pakistan but almost all countries that started Islamic banking. The Report was used as a basic source, still now. The purpose of this review is twofold; one is revisit the pioneering work of the commission and record to highlight and appreciate the efforts of the commission that produced such a comprehensive report.

The council appointed a panel of economists and bankers to take up the important task of elimination of Riba from the economy. The report is a combined effort of this panel and the members of CII. The council upfront pointed out elimination of interest is only a part of the Islamic economic system and fruit of this cannot be reaped until and unless the whole economic system is Islamized. The council stressed on inculcating basic virtue (such as fear of God Almighty, honesty, trust worthiness, sense of duty and patriotism) of Islamic in the society as a whole. Need for a mass media campaign was highlighted to bring about such a social change through persuasion and public participation in the whole process.

The council also outlined the need for changes in the tax system (especially simplification of system of income tax) in order to incentivize the corporate to shun the practice of council actual profitability. The council emphasized that the profit and loss sharing or Qard-Hasan are the true alternatives to the interest based banking system. However, recognizing the difficulties in practical application of Profit & Loss and Qard-Hasan, the council recommended alternatives like leasing, hire-purchase and Bai Muajjal as second best alternatives.

The council was especially concerned with the prevalent morality standards that constraint application of truly Islamic financing modes. The council clearly pointed out the danger of misuse and eventual opening of a back-door for interest by using debt/trade based instruments. The alternative financial tools as identified by the CII are service charges, indexation of bank deposits and advances, leasing, investment auctioning, Bai Muajjal, Hire-purchase, financing on the basis of nominal rate of return, time multiple counter loans, and special loans facility.

The report is comprehensive yet precise as it deals with elimination of Riba from commercial banks, NBFIs, financing of fiscal deficit and conduct of monetary policy. The alternatives for elimination of inertest from commercial banking have been given keeping in view both the consumer and corporate financing needs. The report has suggested for cheaper ways to finance the lower income segments of the economy. The conduct of monetary policy is suggested through use of CRR and SLR—to be maintained by investment in Shariah compliant instruments—selective credit controls and moral suasion. The fiscal deficit is suggested to be financed primarily by the SBP through interest free loans.

All in all, the book is an excellent resource for not only the Islamic banking professionals but for academia, researchers and public at large.

Frequently Asked Questions[5] (Part VII)

Question No. 37) Is it permissible for an Islamic bank to impose penalty in case receivables are delayed?

Answer: In Islamic law it is permissible to penalize a debtor who is financially sound but willfully delays payment of debt without any genuine reason. Such act of the debtor is unjust as the Prophet (PBUH) has said,

"A rich debtor who delays payment of debt commits Zulm".

A heavy non-performing portfolio and default on the part of clients is a serious problem confronting the financial institutions all over the world including Pakistan. This problem may be a threat to the success of Islamic banking system if not properly addressed. If clients do not honour their commitments in respect of timely payment of a debt created in installment sale, Murabaha, leasing or do not pay banks' share of profit in participatory modes or do not deliver goods at stipulated time in Salam and Istisna, it could cause irreparable loss to the system. The banks, financial institutions, depositors and ultimately the economy will have to suffer its consequences. The jurists allow punishment (T´azir) to such willful defaulters in the form of fine. In view of the severity of the problem, Islamic Fiqh Academy of the OIC and Shariat Appellate Bench of the Supreme Court of Pakistan have approved the provision of penalty clause in the contractual agreements. This would also help in maintaining a credit discipline in the banking and act as a deterrent against debts becoming bad or unrealizable. However, the penalty proceeds would be used for charity as penalty cannot become source of income for the bank in any manner.

Question No. 38) Can Islamic banks claim compensation or liquidated damages on account of late payment/default by the clients?

Answer: The contemporary Shariah scholars have evolved a consensus that banks are authorized to impose late fees on the delinquent. However, the proceeds of such penalty are to be used for charity purposes. It is the court or any recognized alternative independent dispute resolution body which can allocate any part of the penalty as liquidated damages/solatium for the banks.

Liquidated damages can be given to banks in case of default on the part of banks' clients provided it is based on actual financial loss. The court or a recognized adjudicating forum may reasonably adjust the amount of compensation. The actual financial loss cannot be the loss in terms of conventional opportunity cost. It has to be proved by the bankers themselves to the satisfaction of the court or any arbitrator.

Question No. 39) Islamic bank's financing is sometime costlier than that of the conventional banking. Why is it so?

[5] 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/ibd/FAQs.pdf)

Answer: Islamic banking is in its early stage and is in the process of strengthening its base in the economies having conventional banking rooted deeply in the current interest-dominated system. The volume of business captured by the conventional banking system gives it an edge over Islamic banking in terms of cost due to its ability of having achieved economies of scale. The conventional banks can avail the economies of scale due to their wide network and huge volume of business which the Islamic banking, in its nascent stage cannot avail given the present volume of their business. Further, Islamic banking has to maintain some additional documentation which adds to the cost of its operations. While Islamic banking may appear to be marginally costlier at this stage, the incremental cost is not prohibitive in relation to the benefits.

Question No. 40) Does discounting of bills is allowed under Islamic Shariah?

Answer: A promissory note or a bill of exchange represents a debt payable by the debtor to the holder. This debt cannot be transferred to anybody except at its face value. Discounting of bill or a Note or a Cheque, therefore, involves interest. In an Islamic financial market, the papers representing money or debt cannot be traded (except at face value). However, the papers representing holder's ownership in tangible assets, like shares, lease certificates, Musharkah certificates, etc. can be traded due to the underlying assets they represent. Islamic banks have various modes of finance through which the business needs of the customer can be satisfied without discounting the bill.

A majority of Islamic Shariah scholars do not allow Salam in gold, silver, currencies or monetary units, although a few jurists have allowed it. As such, a few Islamic banks have been using Salam in currencies as an alternative to bill discounting[6].

[6] Muhammad Ayub, Understanding Islamic Finance, 1807 WILEY 2007, p 245

Annexure: I

Islamic Banking Branch Network

(As of June, 30, 2010)

Type	Name of Bank	No of Branches[7]
Islamic Banks	Al Baraka Islamic Bank	29
	BankIslami Pakistan Limited	70
	Dawood Islamic Bank Limited	42
	Dubai Islamic Bank Pakistan Ltd	36
	Emirates Global Islamic Bank Ltd	58
	Meezan Bank Ltd	181
	Sub Total	**416**
Islamic Branches of Conventional Banks	Askari Bank Limited	29
	Bank Alfalah Ltd	6
	Bank Al Habib	60
	Faysal Bank Limited	10
	Habib Bank Ltd	11
	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	19
	The Royal Bank of Scotland	3
	United Bank Ltd	5
	Sub Total	**183**
Sub Branches	Askari Bank Limited	2
	BankIslami Pakistan Limited	32
	Dawood Islamic Bank Limited	8
	Emirates Global Islamic Bank Ltd	2
	Meezan Bank Ltd	21
	The Bank of Khyber	3
	Sub Total	**68**
	Grand Total	**667**

[7] *Source: Banking Policy & Regulations Department, State Bank of Pakistan.*

Annexure: II

Province wise Break-up of Islamic Banking Branch Network

(As of June, 30, 2010)

Type	Bank Name	Azad Kashmir	Balochistan	Federal Capital	Khyber Pakhtunkhwa	Northern Areas	Punjab	Sindh	Grand Total
Islamic Banks.	Albaraka Islamic Bank	1		2	3		15	8	29
	BankIslami Pakistan Limited	1	8	2	5	1	30	23	70
	Dawood Islamic Bank Limited		1	2	1		18	20	42
	Dubai Islamic Bank Pakistan Limited		3	2	4		16	11	36
	Emirates Global Islamic Bank Limited		3	2	6		27	20	58
	Meezan Bank Limited	2	4	9	17		84	65	181
IB. Total		**4**	**19**	**19**	**36**	**1**	**190**	**147**	**416**
Islamic Branches of Conventional Banks	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	2		4	3	11
	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		2		12		3	2	19
	The Royal Bank of Scotland						1	2	3
	United Bank Limited				1		3	1	5
	Faysal Bank Limited		1		2		4	3	10
SAIBBs Total		**2**	**11**	**8**	**32**		**83**	**47**	**183**
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
	Emirates Global Islamic Bank Limited			1				1	2
	Meezan Bank Limited		1		2		11	7	21
	The Bank of Khyber				1		1	1	3
Sub Branches Total		**1**	**4**	**5**	**5**		**24**	**29**	**68**
Grand Total		**7**	**34**	**32**	**73**	**1**	**297**	**223**	**667**

Annexure: III

City wise Break-up of Islamic Banking Branch Network

As of June, 30, 2010)

S. No	Province	Cities	No of Branches
1	Sindh	Badin	1
2		Hyderabad	17
3		Karachi	185
4		Larkana	1
5		Matiari	1
6		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			**223**
13	Punjab	Arifwala	1
14		Attock	4
15		Bahawalpur	3
16		Chakwal	2
17		Daska	1
18		Dera Ghazi Khan	2
19		Faisalabad	27
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		Lahore	113
33		Mandi Bahauddin	1
34		Mian Channu	2
35		Mianwali	1
36		Multan	24
37		Okara	2
38		Pakpattan	1
39		Pindi Ghaib	1
40		Rahim Yar Khan	6
41		Rawalpindi	31
42		Sadiqabad	2
43		Sahiwal	3
44		Sargodha	6
45		Sheikhupura	3
46		Sialkot	13
47		Texila	1
48		Toba Tek Singh	1
49		Vehari	4
50		Wah Cantt	2
	Punjab Total		**297**

S. No	Province	Cities	No of Branches
51	Khyber Pakhtunkhwa	Abottabad	11
52		Banu	1
53		Batkhela	1
54		Charsadda	1
55		Chitral	1
56		Dera Ismail Khan	3
57		Hangu	1
58		Haripur	3
59		Kohat	2
60		Mansehra	6
61		Mardan	5
62		Mingora	1
63		Nowshera	3
64		Peshawar	29
65		Swabi	2
66		Tank	1
67		Timergara	1
KP Total			**73**
68	**Northern Areas**	Gilgit	1
Northern Areas Total			**1**
69	**Federal Capital**	Islamabad	32
Federal Capital Total			**32**
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	22
79		Zhob	1
Balochistan Total			**34**
80	**Azad Kashmir**	Mirpur AJK	4
81		Muzaffarabad	3
Azad Kashmir Total			**7**
Grand Total			**667**

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