



# Islamic Banking

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**Islamic Banking Department**

**State Bank of Pakistan**

# 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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Islamic Banking Department

# State Bank of Pakistan

# Governor's Speech

## Key Note address by Yaseen Anwar, Governor, State Bank of Pakistan

Islamic Economic Forum, Oman, 18-19 Dec, 2011 Speech

I am honoured to be here at this historic event at a time when Oman is opening its doors to Islamic finance. The prudent approach of Oman towards the financial sector has helped it in steering safely through the financial crisis, and I am sure that despite a relatively late entry in Islamic finance, given his Majesty Sultan Quboos support Oman will soon be amongst the leading Islamic finance markets in the region.

### Excellencies, Ladies & Gentlemen:

The last financial crisis is viewed as the worst of its kind and tremors from it are still being felt as we keep hearing about fears of economies continuing to remain in recession. Debates on reasons for the financial crisis have led to a wider belief of having greater accountability and a proactive role of regulators to ensure stability of the financial system. Post crisis the world has been trying to rearrange the infrastructure of financial industry and I view Islamic finance fitting well in the new structure.

Islamic Banking that can be traced back to four decades has its values embedded in the ethics of Islamic society of 1400 years ago. Islamic economic system is not just about prohibition of interest, it also promotes values such as accountability, transparency and social responsibility. After weathering the financial crisis rather well compared to their conventional counter parts, Islamic financial institutions are increasingly becoming popular. Perhaps the world has been able to see beyond the element of religion and view Islamic finance as an ethics central system that has linkages with real economic activities and an internal shock absorbing ability. From its humble origins Islamic finance today exists around the globe catering not only to the financial needs of Muslims but also to non Muslim clientele.

### Excellencies, Ladies & Gentlemen:

A lot can be discussed with reference to Islamic finance and I am sure looking at the two day

schedule that you will be hearing some prominent speakers giving you insights into issues of Islamic finance. Therefore I would restrict myself to sharing with you our experience of establishing and promoting Islamic finance as the preferred mode in Pakistan.

Having more than 95 percent Muslim population, and a constitutional obligation of ensuring a riba free economic system, Pakistan has had relatively favourable environment to launch Islamic finance in the country. However the approach adopted during 80s for transforming the entire financial system to an interest free system did not meet much success. Despite having introduced landmark changes in the legal framework that included amendment in the Banking Companies Ordinance, enactment of Mudarba companies and Mudarabas framework etc, the dream of transforming the entire financial system on Shariah principles could not translate into a reality. Major reasons that can be attributed to this unsuccessful attempt were a) abrupt conversion of the system without creating the necessary infrastructure and human resource, b) lack of ownership amongst the banks, management and staff as well as the business community to shift to the new system in one go, c) the weak judicial system and dispute resolution mechanism, and d) lack of general awareness among the masses about the utility of Islamic banking.

Learning from past experience, we adopted an evolutionary approach for establishing Islamic finance in the country in 2001 whereby both conventional and Islamic banks were allowed to operate in parallel. This enabled the masses to choose between the two systems that best serves their banking and financial services needs and is also in conformity with their faith. The approach has worked well since then and the industry starting from almost scratch in 2001, has gradually improved its share to more than 7.5 percent of the country's banking system. We have now 5

full fledged Islamic Banks and 13 conventional banks having standalone Islamic banking branches. Given the strong growth momentum, which is over 30 percent annual for the last 6 years, we are hopeful of having quite a few more full-fledged Islamic banks in the country in the near future.

State Bank of Pakistan- the country's central bank has been at the forefront of all the major initiatives for development of the industry. We are one of the few regulators who have introduced a comprehensive legal, regulatory, and Shariah compliance framework for the Islamic Banking Industry. The framework allows three types of institutional models for offering Islamic banking services; (i) Full-fledged Islamic banks (2) Islamic banking subsidiaries of conventional banks and (3) Stand alone Islamic banking branches of conventional banks. Moreover, to encourage and facilitate conversion of conventional branches into Islamic banking branches, a detailed criterion has also been issued. The banks are required to have funds of their Islamic banking operations segregated from their conventional side and maintain a separate book of accounts. The permission to conventional banks to offer Islamic banking services through stand alone branches enabled us to leverage their vast network across the country to expand the outreach of Islamic finance. It has also been instrumental in gradually sensitizing the conventional banks about the utility of Islamic banking in business and economic development as well as its growth potential in the countries like Pakistan. Presently the conventional banks. Islamic banking portfolio constitutes about 40 percent of the industry.

Further, in order to enhance the breadth and depth of the industry, the framework also allowed establishment of full-fledged Islamic Microfinance banks, Islamic microfinance services by full-fledged Islamic banks and Islamic microfinance Divisions in conventional microfinance banks. Considering the growing awareness and acceptability of Islamic microfinance coupled with its inherent controls to ensure end use of the funds provided by MFIs, the outlook for growth and development of Islamic microfinance in Pakistan is highly positive and we may see establishment and operations of a few

Islamic microfinance banks in very near future. Similarly Pakistan being an agro-based economy, there is huge potential for development of Shariah Based Agriculture financing. The central bank is working with the industry to develop Shariah compliant agriculture finance products to be offered by IBIs after necessary customization. We have recently circulated a model Shariah compliant agriculture finance product based on „Salam. to facilitate IBIs. entry in the country.s agrifinance markets, which so far have remained grossly unserved or under served.

### Excellencies, Ladies & Gentlemen:

A comprehensive and mutli-tiered Shariah compliance framework is another very important feature of our Islamic banking framework. It comprises

(a) Centralised Shariah Board at the Central bank, which is the apex Shariah Body in the country for Islamic banking institutions. The distinctive composition of this board of having Shariah scholars, an accounting professional, a legal expert and a professional banker benefits the industry by providing comprehensive solutions; that are not only Shariah complaint but also economically viable.

b)The Shariah Advisor at bank.s level to be appointed in accordance with the State Bank of Pakistan.s Fit and Proper criteria with the responsibility to ensure that the bank.s operations are in conformity with Shariah Principles.

c) Mandatory internal Shariah audit and

d) Periodic Shariah inspections by the Central Bank along with routine annual inspection of IBIs. The SBP is one of the very few central banks that have initiated Shariah Inspections. Before the formal launch of the Shariah inspection a comprehensive Shariah inspection manual was developed by engaging reputed Shariah consulting and auditing firm and adequate training was imparted to the Shariah inspectors. The Central bank has also notified the essentials of major Islamic finance products and instruments along with their model agreements; the IBIs while

ensuring adherence to the essentials, may develop their own products with the approval of their Shariah Advisor. This arrangement not only allows necessary flexibility to IBIs to develop their own products but also helps in achieving much needed standardization and Shariah harmonization. To further strengthen the Shariah harmonization drive, we are in the process of adopting the AAOFI Shariah standards.

In order to develop sound risk management system and ensure good governance, an incremental approach was adopted whereby the conventional framework was reviewed extensively to identify the gaps and limitations of the conventional system in covering risks and issues specific to IBIs. The new guidelines were thus formulated by tailoring IFSB and AAOIFI standards; they not only cover all major risk categories but also provide best practices for establishing and implementing risk management and corporate governance in IBIs.

While risk always finds an important place in discussions related to Islamic finance, I believe there is interplay between risk and innovative ideas. IBIs have an opportunity to deploy part of their liquidity into participatory modes such as mudaraba and musharaka. This will not only help them move away from current paradigm that is criticized for mirroring conventional instruments but will also help them capture the untapped markets like Small and Medium Enterprises. While IBIs have an advantage of attracting faith sensitive population they can further expand their outreach by reaching out to segments that have been earlier ignored by conventional banks. IBIs have a business model that enables them to cater to such clients however further sophistication is required in their product range to capitalize on this opportunity. Access to finance is a key challenge facing regulators and IBIs can play an important role in minimizing the incidence of financial exclusion. Realizing this recently the State bank of Pakistan revised its definition of rural areas encouraging IBIs to expand their branch network in these jurisdictions.

#### Excellencies, Ladies & Gentlemen:

Besides Islamic banking, the Islamic capital markets

are also very important component of Islamic economic system, which can help both public and private sector to mobilize large amounts of capital for financing economic growth and development. The popularity of Sukuk particularly during last decade has not only been instrumental in fast pace expansion of Islamic finance but has also provided a good and stable source of funds to governments. It also defines the limits on public debt and restricts it to the extent of assets available with the government or the new assets to be created through deficit financing. The government of Pakistan is issuing Sukuk with considerably increased frequency since last couple of years and has raised more than USD 3 billion from domestic markets that helped Islamic banks to expand their asset base. Further, Islamic funds have found their way to supporting infrastructure projects around the world especially in the gulf. Being a Muslim country and given its strategic location Oman can benefit from this increasingly popular trend. Issuance of Shariah compliant papers by central bank, commercial banks, government treasury and private entities are likely to contribute significantly to growth and development of real economy.

#### Excellencies, Ladies & Gentlemen:

The limited liquidity management instruments and lack of lender of last resort facility have been amongst the key issues faced by Islamic banks in most jurisdictions including Pakistan. So far we have had limited success in developing an effective and ongoing liquidity management mechanism for IBIs due to infrequent issuance of sovereign Sukuk. As a result of extensive efforts made both at industry and the central bank level we are at an advanced level of development of a comprehensive liquidity management solution that would include i) development of Islamic interbank money market, ii) development of Islamic Interbank Offered Rate (IIBOR) for use as a benchmark for pricing of Islamic finance products, iii) transformation of a sizeable portion of conventional sovereign debt in the books of central bank into Shariah compliant debt, iv) allowing IBIs to place surplus liquidity with the central bank to be remunerated based the central bank's earnings on Shariah compliant assets and



investment portfolio, and v) lender of last resort facility for IBIs. The most challenging and time consuming aspect of this mechanism is the transformation of sovereign debt into Shariah compliant debt as it involves identification of the assets to be used for transformation, their valuation and documentation etc. However, I am confident that with the help and grace of Almighty, we should be able to finalize this mechanism in the near future. This would be a major milestone achieved and would give a big boost to the already buoyant Islamic finance industry in Pakistan.

#### Excellencies, Ladies & Gentlemen:

Islamic finance is an evolving industry and so is its understanding in the masses, the business community and the policy makers. Despite significant improvement during last 10 years, still a very large segment of our population does not have adequate understanding of Islamic finance and its distinction over the conventional finance. The Central Bank thus has assumed a dual role for Islamic banking ie the regulator and the promoter and facilitator. Under the facilitation hat we have been partnering with the industry to improve the Islamic banking awareness and understanding of the masses and to build the industry's HR capacity. To create awareness we have launched an awareness campaign, whereby targeted workshops, public seminars and conferences are being organized. Further, a media campaign is being launched for mass awareness using electronic and print media. To help the industry to build its HR capacity, our training subsidiary NIBAF (National Institute of Banking & Finance) is offering regular and customised Islamic Banking courses to national and international participants. Alhumdullilah! Over the years we have developed a good team of Islamic banking trainers cum practitioners, which coupled with the excellent training facilities at NIBAF, is enabling us to offer quality training programs for local as well as regional and global Islamic banking industry.

Innovation remains the corner stone of Islamic banking. IBIs need to increase their product mix in order to meet the needs of their ever increasing client base. Research and development which has

been long ignored in our part of the world should be the hall mark of IBI. We need to change our perceptions and invest in research as a core ingredient of our strategic objectives. While Islamic banking has made significant strides globally and domestically, I believe it is still in an evolutionary phase and relentless efforts are required to confront challenges in keeping the growth momentum of the industry. A pure Islamic financial system based on ethos of equity justice and social responsibility is ideal, but this cannot be achieved over night. Serious efforts on continuous basis will have to be made to achieve a financial system that is in line with maqasid shariah, and forums such as this help us in our journey towards achieving such a system.

Lastly I would congratulate Bank of Oman again for initiating Islamic banking and wish them every success in their efforts to develop a vibrant Islamic banking industry. Though a late starter they have the advantage of learning from the good and bad experiences of other countries including Pakistan and adopt an approach that is based on international best practices with necessary customization. Let me assure our full support to our colleagues in Bank of Oman and other related institutions and departments in setting up a strong and vibrant Islamic finance sector in this very important Muslim country.

I would also like to congratulate Amjaad Development for arranging this event and thank them for having me here. I hope that the deliberations here at this auspicious gathering of leading scholars and practitioners will not only help us in laying out the road map for Islamic finance in Oman but also help us in addressing key issues faced by the industry.

# Islamic Banking Industry - Progress & Market Shares

## Overview

By end of the last quarter CY 2011, the network of Islamic banking Industry consists of 886 branches, assets and liabilities both constitute 7.8 percent of the overall banking industry. Asset base of the industry reached to Rs. 641 billion indicating 13 percent quarterly growth by close of Dec 2011; YOY growth in assets was 34 percent which is slightly higher than that of the last quarter as well as of Dec 2010 (see Table 1). Growth in assets is mainly contributed by financing and investment that together grew by 15 percent during the quarter under study; the YOY growth was 40 percent. Deposits

Description	Dec-08	Dec-09	Dec-10	Dec-11
<b>Total Assets</b>	<b>276</b>	<b>366</b>	<b>477</b>	<b>641</b>
%age of Banking Industry	4.9%	5.6%	6.7%	7.8%
YoY Growth	34%	33%	30%	34%
<b>Deposits</b>	<b>202</b>	<b>283</b>	<b>390</b>	<b>521</b>
%age of Banking Industry	4.8%	5.9%	7.2%	8.4%
YoY Growth	37%	40%	38%	34%
<b>Financing. &amp; Invest.</b>	<b>186</b>	<b>226</b>	<b>338</b>	<b>475</b>
%age of Banking Industry	4.4%	4.5%	6.2%	7.4%
YoY Growth	35%	21%	50%	40%
<b>Full Fledge Islamic Banks</b>	<b>6</b>	<b>6</b>	<b>5</b>	<b>5</b>
Conventional Banks with Islamic Banking Branches*	<b>12</b>	<b>13</b>	<b>13</b>	<b>12</b>
No. of Branches (Including Sub Brs.)	515	651	751	886

\* Faysal Bank acquired RBS on 31 Dec.2010 while Emirates Global Islamic Bank Limited and Albaraka Islamic bank merged on Oct 29,2010  
Source: Annual accounts except for Dec 2011, data for which is based on Unaudited Quarterly accounts

reached to Rs. 521 billion depicting a quarterly growth of 12.5 percent and YOY growth of 34 percent by end of Dec 2011. Expansion of the industry is complemented with rising trend of profitability that has reached Rs. 10.6 billion by end Dec 2011. Operating performance indicators also showed encouraging picture for the last quarter of CY 2011; Non-Performing Financing (NPFs) declined while Return on Assets (ROA) and Return on Equity (ROE) both remained higher than that of overall banking industry average.

Province	Additions	Total	Share (percent)
Punjab	19	398	45
Sindh	12	290	33
Khyber Pakhtoonkwa	9	95	11
Balochistan	2	43	5
Gilgit Baltistan	0	1	0
FATA	1	2	0
Federal Capital	2	46	5
AJK	0	11	1
G. Total	45	886	100

## IBI Network Expansion

During CY 2011 Islamic banking Industry completed 94 percent of its approved expansion plan by having a network of 886 branches; showing an increase of 45 branches during the last quarter of the

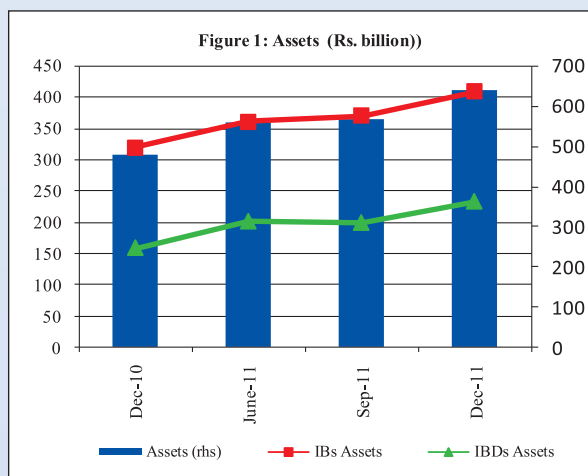
<sup>1</sup> Concentration of branches in Punjab and Sindh are 45 percent and 33 percent separately

year; Full Fledged Islamic banks (IBs) constitute 66 percent while Conventional banks having Islamic windows (IBDs) occupy 34 percent share (see Annexure III) of overall network of the industry. However, no change in terms of regional allocation of branches was observed; 78 percent concentration of branches remains in Punjab and Sindh<sup>1</sup> (see Table 2) while among cities 65 percent of the network is concentrated in 7 big cities (Karachi, Lahore, Faisalabad, Peshawar, Islamabad, Quetta and Rawalpindi). To increase the outreach the Industry needs to expand their network to second and third tier cities.

### Asset & Liability Structure:

#### Assets

Following the usual trend, assets of the Islamic banking industry picked up in the last quarter of CY 2011 after registering a drop in the third quarter. The asset base of the industry reached to Rs. 641 billion depicting a quarterly growth rate of 13 percent and annual growth of 34 percent compared to 30 percent YOY growth achieved last year past two years<sup>2</sup>. Bifurcation of assets among IBs and IBDs (see Figure 1) shows that IBs dominate with 68 percent share, however, a relative rise in the share of IBDs can be observed since 2009. It is worth noticing that the quarterly growth of assets of IBDs during the quarter under study is higher than that of IBs, however, this may be linked to the base effect.



Growth in assets of the industry is reflected by positive growth of all components other than “Due from Financial Institutions”. Focusing on Financing and Investment<sup>3</sup>, both showed significant quarterly growth of 13 percent and 16 percent respectively. The growth in investment can be linked to the recent issuance of Sukuk in December while financing growth can be associated with the business cycle of all major industries that require financing in the last quarter of the calendar year.

Table 3: Financing Concentration - percent share

	Dec-10	Sep-11	Dec-11	Industry
Chemical and Pharmaceuticals	7%	7%	7%	4%
Agribusiness	3%	3%	4%	8%
Textile	22%	17%	20%	18%
Cement	4%	4%	3%	2%
Sugar	2%	3%	3%	2%
Shoes and leather garments	1%	1%	2%	1%
Automobile and transportation equipment	2%	2%	1%	1%
Financial	1%	1%	1%	2%
Insurance	0%	0%	0%	0%
Electronics and electrical appliances	2%	1%	2%	2%
Production and transmission of energy	7%	10%	10%	10%
Individuals	17%	16%	15%	9%
Others	33%	34%	31%	41%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

<sup>2</sup> Growth rate of assets was 32.7 percent and 30.2 percent in 2009 and 2010 respectively

<sup>3</sup> Both together constitute almost 75 percent of assets



**Financing:** Financing of Islamic Banking Institutions (IBIs) has jumped to Rs. 212 billion by the quarter ending under study depicting a quarterly growth rate of 13 percent compared to retrenchment of almost 6 percent in the last quarter. This trend is usual for the overall banking industry as a whole and is linked with the nature of business cycle of most industries.

**Industry wise** financing concentration of Islamic banking Institution also signifies growth in financing of all industries. Textile (see Table 3) that constitutes the major share of financing depicted 33 percent growth in financing during the quarter. It also resulted in raising its share from almost 17 percent in Sep 2011 to above 20 percent in Dec 2011.

**Financing type wise** mix of IBIs. (see Table 4) portfolio indicates no change during CY 2011; Murabaha dominates financing mix followed by DM and Ijara with all other modes constitute relatively small shares. However, the quarter under study witnessed a rise in share of more than 2 percentage points in the share of Murabaha compared to the last quarter, while other two major components

	Rupees in billion			% Share		
	Dec-10	Sep-11	Dec-11	Dec-10	Sep-11	Dec-11
Murabaha	85.4	78.4	92.8	44.9	41.5	43.8
Ijarah	24.1	22.5	22.1	12.7	11.9	10.4
Musharaka	5.5	5.2	5.1	2.9	2.8	2.4
Mudaraba	0.3	0.3	0.3	0.2	0.1	0.1
Diminishing Musharaka (DM)	56.1	62.8	67.9	29.5	33.2	32.0
Salam	2.7	2.8	5.1	1.4	1.5	2.4
Istisna	11.0	7.2	9.3	5.8	3.8	4.4
Qarz/Qarz-e-Hasna	0.0	0.0	0.0	0.0	0.0	0.0
Others	4.9	9.8	9.2	2.6	5.2	4.4
<b>Total</b>	<b>190.2</b>	<b>189.0</b>	<b>211.8</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Diminishing Musharkaha and Ijara both depicted a decline in their share by 1.2 and 1.5 percentage points respectively over the said period.

**Client type wise financing** of IBIs ( see Table 5) shows heavy concentration of financing portfolio in Corporate sector with a share of 73 percent followed by Consumer Financing (14 percent), SME (5.2 percent) and Commodity Financing (5.9 percent); all other categories constitute negligible share. Financing in Agriculture sector though started showing slight improvement<sup>4</sup>; however, its share is still negligible at 0.1 percent. The gradually increasing penetration of IBIs in smaller towns and semi urban areas is likely to improve share of agri-financing in IBIs. financing portfolio. SBP has been encouraging IBIs to improve its penetration in agri-finance and has issued a standard Salam based product<sup>5</sup> to facilitate their entry in Agriculture sector.

	Dec-08	Dec-09	Dec-10	Dec-11
Corporate Sector	64.4%	65.2%	69.0%	73.1%
SMEs	9.8%	7.7%	5.8%	5.2%
Agriculture	0.0%	0.0%	0.0%	0.1%
Consumer Finance	22.3%	20.0%	15.9%	13.9%
Commodity Financing	1.1%	4.8%	6.5%	5.9%
Staff Financing	1.7%	1.9%	1.7%	1.6%
Others	0.7%	0.4%	1.0%	0.1%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>4</sup> Agriculture Financing amount has increased from Rs. 48 billion to Rs. 187 billion during the calendar year (CY 2011)

<sup>5</sup> AC&MFD Circular No. 03 of 2011, Oct 18, 2011

**Investment:** The recent issuance of Sukuk in December 2011 enabled the Islamic banking Industry to increase its investment portfolio from Rs. 236 billion in the last quarter (Sep 2011) to Rs. 274 billion in Dec 2011 depicting a quarterly growth of 16 percent compared to 2.2 percent growth of the last quarter (see Table 6). This also resulted in raising the share of investment in total assets from 41.6 percent in the last quarter to 43 percent by end of the quarter under review. Annual comparison

	Dec-09		Dec-10		Sep-11		Dec-11	
	Share		Share		Share		Share	
Federal government securities	25.6	35%	78.6	50%	153.1	64.4%	179.0	65.0%
Provincial govt. securities	0.0	0%	0.0	0%	-	0.0%	-	0.0%
Fully paid up ordinary shares	1.9	3%	2.2	1%	2.4	1.0%	2.3	0.8%
TFCs, Debentures, Bonds, & PTCs	26.5	36%	36.0	23%	27.9	11.7%	27.5	10.0%
Other investments	18.7	26%	42.0	26%	54.5	22.9%	66.6	24.2%
<b>Total Investments</b>	<b>72.8</b>	<b>100%</b>	<b>158.7</b>	<b>100%</b>	<b>237.9</b>	<b>100.0%</b>	<b>275.5</b>	<b>100.0%</b>
Less: Provisions & deficit/ (surplus) against HFT Securities	-0.6	<b>Share in Assets</b>	-0.9	<b>Share in Assets</b>	-1.5	<b>Share in Assets</b>	-1.2	<b>Share in Assets</b>
<b>Investments (Net of Provisions)</b>	<b>72.2</b>	<b>20%</b>	<b>157.8</b>	<b>33%</b>	<b>236.4</b>	<b>42%</b>	<b>274.3</b>	<b>43%</b>

of investment depicts a persistent and considerable rise in investment share since 2010 mainly due to frequent issuances of Sukuk. This is evident by looking at components of investment that indicate a considerable rise in share of Federal government securities from 35 percent (Rs. 25.6 billion) in CY 2009 to 65 percent share (Rs. 179 billion) by end of CY 2011

	Dec-10	Sep-11	Dec-11	Industry
NPFs to Financing	7.3%	8.4%	7.6%	16%
Net NPFs to Net Financing	3.2%	3.3%	2.9%	6%
Provisions to NPFs	58.6%	62.4%	63.0%	67%
Net NPAs to Total Capital	13.3%	11.8%	10.2%	26%
Real estate Financing to Total Financing	8.0%	7.6%	6.7%	2%
FCY Denominated Financing to Capital	15.1%	12.9%	13.0%	18%

**Asset Quality:** The non-performing financing (NPF) to total financing decelerated by almost 1 percentage point to 7.6 percent during the quarter (see Table 7), which though encouraging, however, is largely attributable to the significant rise in the financing portfolio rather than decline in the NPF. Further the rise in the share of “loss” categorized NPF during the quarter to 11 percent from 10.4 percent in the last quarter (see Table 8) is indicative of limited success of IBIs in regularizing NPF. The overall asset quality of IBIs is however, significantly better than the banking industry as a whole with NPF ratio of IBIs being less than half of that of the banking system.

	Dec-10	Jun-11	Sep-11	Dec-11
Break up of NPFs:	13.8	14.9	15.8	15.9
OAEM	0.0	0.0	0.0	0.0
Substandard	2.7	2.2	2.9	1.9
Doubtful	2.1	2.3	2.5	3.0
Loss	9.0	10.4	10.4	11.0

**Liabilities:** Deposits of Islamic banking industry reached to Rs. 521 billion (see Table 9) by end of CY 2011 registering a quarterly growth of 12.5 percent compared to 2.2 percent of the last quarter. Break up of deposits indicate growth in all types of deposits, except Fixed Deposits that shows a drop in its quarterly growth rate from 7.5 percent by end Sep 2011 to 5.8 percent by end of the quarter under study.

	Dec-10	Sep-11	Dec-11	YoY	QoQ
<b>Deposits</b>	<b>390.1</b>	<b>463.1</b>	<b>521.0</b>	<b>33.6</b>	<b>12.5</b>
<b>Customers</b>	<b>363.2</b>	<b>433.7</b>	<b>483.2</b>	<b>33.0</b>	<b>11.4</b>
Fixed Deposits	142.7	174.9	185.1	29.7	5.8
Saving Deposits	126.3	153.2	172.4	36.5	12.5
Current accounts - Remunerative	0.0	0.5	1.0	3,253.5	100.4
Current accounts - Non-remunerative	91.5	102.9	122.2	33.6	18.8
Others	2.7	2.2	2.5	(7.5)	12.2
<b>Financial Institutions</b>	<b>26.9</b>	<b>29.4</b>	<b>37.8</b>	<b>40.7</b>	<b>28.7</b>
Remunerative Deposits	26.8	29.2	37.5	40.0	28.3
Non-remunerative Deposits	0.1	0.2	0.3	228.6	93.7
<b>Currency Wise</b>					
Local Currency Deposits	371.7	444.0	499.6	34.4	12.5
Foreign Currency Deposits	18.4	19.0	21.4	16.5	12.2

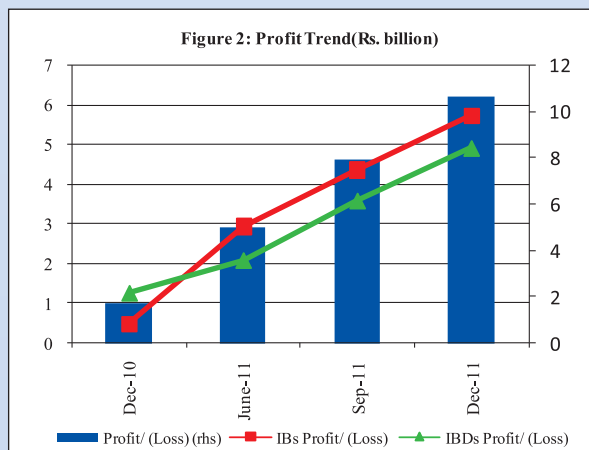
### Asset-Liability Mismatch:

No major change was observed in asset liability mismatch of IBIs; IBIs are more liquid in short tenor while in longer term assets are more than liabilities (see Table 10). Negative asset liability mismatch in short term signifies a relatively greater need for developing and exploring short term investment avenues for the industry.

	Dec-10	Sep-11	Dec-11	Industry
Maturing upto 3 months	-18.0	-17.4	-18.8	-7.8
Maturing from 3 months to 1 yr	-4.1	-5.2	-7.4	11.2
Maturing from 1 yr to 5 yrs	18.2	23.9	25.3	-2.7
Maturing after 5 yrs	4.0	-1.3	0.9	-0.6

**Earnings & Profitability:** Profit of the industry continued its rising trend and crossed Rs. 10 billion mark for the first time. IBs with profit of Rs.5.7 billion had 59 percent share of industry's profitability whereas IBDs with earnings of Rs. 4.7 billion had 41 percent share (see Figure 2).

However, the pace of growth of profit of IBDs (37 percent) during this quarter is significantly higher than that of IBs (31 percent). Rising trend of profitability also translated into continuous improvement in return on assets (ROA) and return on equity (ROE) (see Table 11). During CY 2011, IBIs achieved ROA of 2 percent which is twice as large as of the overall banking industry average. ROE at 17 percent in the quarter ending Dec 2011 is also 2 percentage points higher than the industry average of 15 percent.



In terms of expenses also, the industry is showing positive signals; Operating expense to Gross Income continued the declining trend; however, this ratio is still higher than that of overall banking industry average. One of the major reasons for

.....Continued on Page 15

# Events & Developments at IBD

**Training program on “Islamic Banking & Finance – Philosophy, Practices and Issues”**  
Held on 21 -25 November 2011 at NIBAF, Islamabad.

IBD, State Bank of Pakistan (SBP) arranged a five day international training course titled “Islamic Banking & Finance - Philosophy, Practices and Issues., from 21 – 25 November 2011 at the National Institute of Banking and Finance (NIBAF), Islamabad. This training was held in collaboration with Islamic Research and Training Institute (IRTI) – a Member of the Islamic Development Bank Group (IDB). The course was targeted for middle management level employees of Islamic Financial Institutions and Central Banks of IDB Member Countries. The purpose of this international training course was to understand the Islamic banking philosophy and the developments taking place in the industry at local and global level. On the last day Deputy Governor of SBP delivered the closing speech at the certificate distribution ceremony. During his speech the Deputy Governor emphasised that training programs like these will play a positive role in addressing the challenges faced by the industry.

## **Invoice in Murabaha Transactions:**

IBD Circular No. 01 of 2012 dated February 06, 2012

IBD issued a new circular on the above subject to facilitate IBIs in Murabaha transactions considering the practical difficulties in obtaining invoices, particularly, in transactions like purchase of phutti, raw hides, milk, sugarcane etc. the instructions on obtaining invoices was reviewed and amended as under:

1. The invoice issued by the supplier shall be in the name of Bank- Account Client e.g. “1st Islamic Bank – ABC Company”. In case where obtaining invoice in the name of IBI is not possible, the invoice in the name of client may also be acceptable, subject to specific approval of the Shariah Advisor, for all such transactions.
2. In transaction where obtaining formal invoice either in the name of bank or the client is not possible, then the document or combination of documents like Truck Receipts, Delivery Note, Goods Received Notes, Physical Inspection Report, Kachi Parchi, Inward Gate Pass etc having particulars (i.e. names of buyer & seller, date of purchase/delivery, description of goods, quantity and purchase amount etc.) may be accepted in lieu of invoice with the approval of Shariah Advisor.
3. The Shariah Advisor while approving any transactions as mentioned in Para (i), (ii) above, shall document the reasons/industry norms etc. due to which obtaining invoice and/or making payment directly to the supplier is not possible. He shall also review and approve the process flows etc to be adopted by the client/IBI to execute such transactions. The Shariah Advisors shall also, either themselves or through suitably trained staff of the IBIs, make onsite verifications of such transactions on sample basis.
4. The payment for Murabaha transactions shall either be made directly to supplier or credited in an escrow account by the IBIs. However, in cases where direct payment to supplier is not possible due to genuine reasons, the payment to the supplier may be made through the agent subject to explicitly recording the reasons and approval of process flow etc of all such transactions by the Shariah Advisor.

# Islamic Banking News & Views

## News

Indonesia's Islamic banking assets grow near 47 pct in September

The assets of Indonesia's Islamic banking in September expanded by 46.55 percent to 126 trillion rupiah (some 14.002 billion US dollars) year on year, Deputy Governor of central bank Halim Alamsyah said here on Friday. The deputy said that the growth was much better than those Islamic banking in other countries which grew by 10 to 15 percent only.

Source:[http://www.shanghaidaily.com/article/article\\_xinhua.asp?id=30003](http://www.shanghaidaily.com/article/article_xinhua.asp?id=30003)

Islamic banking is not growing fast enough, says Noor CEO

If Islamic banking is to develop into a global alternative to conventional banking, the global financial industry must take responsibility for driving the sector forward and not rely on the regulators to lead the way, according to Hussain Al Qemzi.

Source:<http://www.cpfinancial.net/v2/News.aspx?v=1&aid=10080&sec=Islamic%20Finance>

Islamic banking assets could reach \$1.8 trillion by end of 2016

Islamic banks may be bolstered by a nearly doubling of assets within five years, as borrowers seek alternative methods of financing due to a cutback in lending at European and US banks, according to a report by Deutsche Bank. The bank expects that mortgage financing, particularly in Saudi Arabia, could provide \$100 billion in assets to the overall industry.

Source:<http://arabnews.com/economy/article534633.ece>

IDB to help build sustainable Islamic finance

The Islamic Development Bank (IDB) Group will continue assisting in building a sustainable Islamic financial system and sound regulatory framework both in Bahrain and Malaysia. "A system of proper corporate governance processes in line with Islamic principles must be in place in our financial institutions," said Khalid Mohammad, chief executive officer of Islamic Corporation for Development of the Private Sector (ICD), IDB.

Source:<http://biz.thestar.com.my/news/story.asp?file=/2011/11/23/business/20111123144514&sec=business>

Working group to be set up to introduce Islamic banking in CIS

Financial and Banking Council (FBC) of the CIS has proposed to set up a working group to apply and develop Islamic banking in the CIS states following IV Baku International Banking Conference of CIS member states "CIS Financial Markets: ways of sustainable development in the context of global instability". The proposal came from Chairman of the Coordinating Council of the CIS Financial and Banking Council Anatoly Kazakov after the conference.

Source:<http://www.news.az/articles/economy/50044>

Islamic Australia Index opens doors to 'sharia-compliant' portfolios

AN INDEX for investors who want to build "sharia-compliant" Australian equity portfolios has been launched in Australia. It comes ahead of potential changes to federal tax guidelines that could clear the way for Islamic investment products to enter the local market. The Thomson Reuters Crescent Wealth Islamic Australia Index, launched yesterday, covers more than 140 stocks with a combined market capitalisation of \$160 billion. It joins a list of major global Islamic sharemarket indices, including the family of Dow Jones Islamic Market indices, and the FTSE Global Islamic Index series.

Source:<http://www.smh.com.au/business/islamic-australia-index-opens-doors-to-shariacompliant-portfolios-20120201-1qtax.html>



## Nigeria/Islam-Finance: Islamic Banking Finally Starts in Nigeria

Outliving a strong Christian opposition, the Islamic banking has finally started operations in Nigeria to fulfill Muslim needs for Sharia-compliant financial products. "This is coming after over five years of raising fund for capitalization, stiff opposition from some Christian groups and media bigots amidst a myriad of other challenges," Disu Kamor, spokesman of the Muslim Public Affairs Centre (MPAC), told OnIslam.net.

[http://iina.me/wp\\_en/?p=1006584](http://iina.me/wp_en/?p=1006584)

## 'Islamic banking market share set to double in five years'

Yaseen Anwar, governor State Bank of Pakistan (SBP) has expressed the hope that the country's Islamic banking industry is all set to double its market share in the next five years.

Inaugurating the second two-day International Conference on Islamic Business (ICIB) on „Managing Shariah Conforming Businesses: Prospects, Practices and Personnel. organised by Riphah International University at the National Institute of Banking & Finance (NIBAF), Islamabad on Tuesday, he said that Islamic banking industry in Pakistan is growing at a fast pace and maintaining an average growth rate of 30 percent over the past six years.

<http://www.thenews.com.pk/TodaysPrintDetail.aspx?ID=95093&Cat=3>

## State Bank to develop liquidity framework for IBIs

The central bank is currently at an advanced level of development of a comprehensive liquidity management solution for Islamic Banking Institutions (IBIs) following extensive efforts made both by the industry and the State Bank of Pakistan.

Source: [http://www.dailytimes.com.pk/default.asp?page=2011%5C12%5C20%5Cstory\\_20-12-2011\\_pg5\\_7](http://www.dailytimes.com.pk/default.asp?page=2011%5C12%5C20%5Cstory_20-12-2011_pg5_7)

## SECP issues Shariah audit mechanism for modarabas

KARACHI: A system has been finalized under the guidance of the SECP Religious Board that will ensure and verify that the business transactions undertaken by modarabas are in accordance with the pattern of Islamic banks in compliance with injunctions of Islam.

Source: <http://www.brecorder.com/pakistan/banking-a-finance/45047-secp-issues-shariah-audit-mechanism-for-modarabas.html>

## Articles/Views

### Road to Islamic banking

<http://www.pakistantoday.com.pk/2011/11/road-to-islamic-banking/>

### Debt, corruption and Islamic banking

<http://www.pakistantoday.com.pk/2011/11/debt-corruption-and-islamic-banking/>

### Western debt crisis spurs growth of Islamic Finance

<http://www.reuters.com/article/2011/11/30/us-finance-islamic-idUSTRE7AT1DS20111130>

### 'Basel III doesn't work for Islamic banking'

[http://www.gulfimes.com/site/topics/article.asp?cu\\_no=2&item\\_no=473485&version=1&template\\_id=48&parent\\_id=28](http://www.gulfimes.com/site/topics/article.asp?cu_no=2&item_no=473485&version=1&template_id=48&parent_id=28)

### Islamic Agri Finance can uplift rural areas

<http://nation.com.pk/pakistan-news-newspaper-daily-english-online/Business/06-Nov-2011/Islamic-Agri-Finance-can-uplift-rural-areas>

# Book Review

## Strategies for the Development of Islamic Capital Markets Infrastructures and Legal Aspects of Islamic Asset Securitization Islamic Financial Services Board (IFSB)

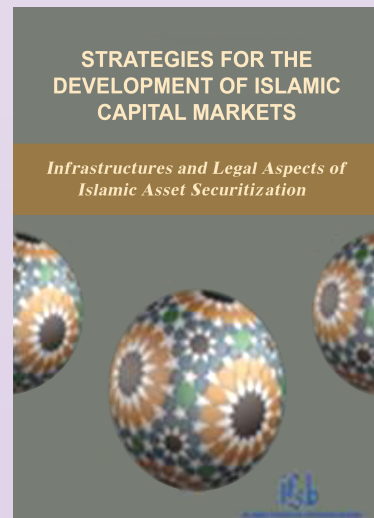
This book was published in 2011 by Islamic Financial Services Board (IFSB), Malaysia<sup>7</sup>. The book has published results of research done by IFSB to identify strategies for the development of Islamic capital markets, including the legal aspects of Islamic asset securitization. Contributions in this book have been made by distinguished scholars from both academia as well as financial markets.

Authors of the book have examined the responses to the survey questionnaires that the IFSB sent to its member countries in April 2010, followed by discussion in different countries i.e. Bahrain, Indonesia, Malaysia and Sudan. In terms of topics covered, the book can be broadly divided into three areas; (i) the development of Islamic capital market strategies; (ii) building a liquidity management infrastructure for Islamic finance; and (iii) legal aspects of Islamic asset securitization.

In the section on Islamic capital markets, authors have identified key issues faced by the Islamic capital markets based on the results of Survey questionnaire on Islamic capital market operations. The questionnaire covered aspects related to legal and regulatory infrastructure; Islamic financial services and products; monitoring of Shariah Compliance; issues of disclosure, benchmark prices, costs and taxation; organization of secondary markets and market intermediaries; and professional training and investor training. Authors conclude that market liquidity was the most important concern faced by the Islamic capital market. The book thus provides recommendations based on four broad areas; (i) encouraging issuance of Islamic capital market instruments; (ii) development of institutional investors; (iii) encouraging participation of retail investors; and (iv) motivating market makers in such instruments with well designed privileges and strong enforcements.

The section on „building of a liquidity management infrastructure for Islamic finance. tries to capture the current state of Islamic money markets in selected countries, like Malaysia and Indonesia. The authors also draw comparison between Islamic and conventional markets. Based on these analyses, major issues faced by the Islamic money markets are highlighted and possible solutions are suggested. These suggestions include (i) increasing the number of sovereign Sukuk issuances; (ii) ensure that tax systems do not impose extra burden on Islamic financial transactions; (iii) standardization of documents; (iv) facilitating harmonization of Shariah interpretation (v) ensuring that ancillary services and infrastructure is in place to support and enhance liquidity.

The section on „legal aspects of Islamic asset securitization. covers a major part of the book. In this section the author analyses legal issues that arise in the development of Islamic financial markets in general and the legal aspects of Islamic asset securitization in particular. The role of law in development of financial markets and relevant legal issues in the Islamic law related to the creation of Shariah compliant financial instruments are part of discussion in the section. The section focuses on four areas (i) ownership; (ii)



<sup>7</sup> IFSB is an international organization that issues guiding principles and standards for the banking, insurance and capital market sectors in order to promote standardization and stability in the Islamic financial services industry.

effective and efficient transfer of ownership (iii) insolvency and (iv) taxation. The role and significance of the prudential regulations are also examined in the chapter. The section concludes by providing policy recommendations for resolving the regulatory and legal issues facing Islamic capital markets and suggests the need for detailed analysis on the sufficiency, sustainability and efficacy of various legal rules and procedures for development of viable markets and products.

The recommended actions in the areas of Islamic capital markets, the liquidity management infrastructure and the legal and regulatory framework of Islamic financial markets are summarized in the fourth and last chapter of the book. In general the book can be termed as a valuable addition to the existing Islamic banking literature and can serve as a useful guide for both practitioners and students of Islamic banking and finance.

**SAHI BUKHARI**

Volume 5, Book 57, Number 1:

Narrated Abu Said Al-Khudri:

"Allah's Apostle said, "A time will come upon the people, when a group of people will wage a holy war and it will be said, 'Is there amongst you anyone who has accompanied Allah's Apostle?' They will say, 'Yes.' And so victory will be bestowed on them. Then a time will come upon the people when a group of people will wage a holy war, and it will be said, "Is there amongst you a none who has accompanied the companions of Allah's Apostle?' They will say, 'Yes.' And so victory will be bestowed on them. Then a time will come upon the people when a group of people will wage a holy war, and it will be said, "Is there amongst you anyone who has been in the company of the companions of the companions of Allah's Apostle ?' They will say, 'Yes.' And victory will be bestowed on them."

.....Continued from Page 10

these relatively higher values of Operating Expense to Gross Income is the on-going expansionary phase<sup>6</sup> of Islamic banking industry as the ratio of Personnel Expense to Operating Expense of Islamic Banking Industry is lower than that of overall industry average.

	Dec-10	Sep-11	Dec-11	Industry
Net Income to Total Assets(ROA)	1%	2%	2%	1%
Return on Equity (ROE)	5%	18%	17%	15%
Net mark-up Income to Gross Income	78%	82%	82%	76%
Non-markup Income to Gross Income	22%	18%	18%	24%
Trading & Fx Gains/(Losses) to Gross Income	9%	5%	5%	8%
Operating Expense to Gross Income	73%	59%	60%	51%
Personnel Expense to Operating Expense	31%	35%	35%	38%

<sup>6</sup> New branches take some time to achieve full scale operations and break even

# Country Model: Indonesia

Despite having the largest Muslim population in the world, history of Islamic banking and finance in Indonesia is relatively new compared to countries like Malaysia and Bahrain. Islamic financial services began in Indonesia with the establishment of Bank Muamalat Indonesia in 1992, the first Indonesian Islamic Bank. However, it was as late as 1999 when the real infrastructure for Islamic Banking and Finance started developing in the country with the establishment of National Shariah board (Historical developments are summarized in Table 1 below).

Islamic banking services in the country are currently being provided by three different types of institutions i.e. Islamic Commercial Banks (BUS), Islamic Banking Windows/Unit (UUS) and Islamic Rural Banks (BPRS). It is pertinent to note that despite showing strong growth the market share of Islamic banking in overall banking assets still remains low.<sup>8</sup> A wide range of products based on Islamic financing modes such as Murabaha, Ijara, Mudaraba, Musharaka, Salam and Istitsna'a are being offered by Islamic banks in Indonesia.

<b>Year</b>	<b>Development</b>
1990	Conference of Indonesian Ulama Board (MUI)
1992	Act No. 7 of 1992 on Banking, allowing establishment of Islamic banks in the country
1992	Bank Muamalat Indonesia, first Indonesian Islamic bank was inaugurated
1998	Amendment of Act No. 7 of 1992 on Banking allowing Islamic banks to operate fully as Islamic Banks (BUS) or by opening Islamic Banking Windows/Unit (UUS).
1999	Establishment of National Shariah Board
1999	Central Bank Act No. 23/1999 was established
2000	Establishment of Jakarta Islamic Index
2001	Establishment of Islamic Banking Bureau
2002	Bank Indonesia released "The Blueprint of Islamic Banking Development in Indonesia"
2008	Bank Indonesia released "Grand Strategy of Islamic Banking Development"
2008	Law 19/2008 on selling of sovereign Sukuk was constituted
2008	Law 21/2008 an authoritative law on Islamic finance in Indonesia was constituted
2008	Introduction of Islamic Banking Act

## Historical Development:

The efforts for Islamic Banking in Indonesia can be traced back to 1990 when the conference of Indonesian Ulama Board (MUI) proposed the establishment of Islamic bank in the country to serve the needs of Indonesian Muslims who wanted interest free banking services. It took another two years when in 1992 Banking Act No.7 was enforced by Bank Indonesia allowing the establishment of Islamic banks in the country. In the same year Bank Muamalat Indonesia (BMI), the first Indonesian Islamic bank was inaugurated, thus beginning Islamic banking services in the country (see Table 1).

Despite the inauguration of BMI, Islamic banking services remained limited in the country during the decade of 1990s as the mentioned BMI remained the only institution providing Shariah compliant financial services. However, in 1998 Banking Act No.7 of 1992 was amended, that allowed Islamic banks to operate fully as

<sup>8</sup> According to Bank Indonesia, the market share of Islamic banking assets in overall industry has reached 4 percent as of end year 2011 compared to 3.28 percent a year earlier. However, annual average growth of Islamic banking assets is more than 65 percent in the last five years.

Islamic Banks (BUS) or by opening Islamic Banking Windows/Unit (UUS). This paved the way for establishment of new Islamic banks. An important development during this period was the establishment of National Shariah board by the Indonesian Ulema council in 1999. The National Shariah board was set up as an independent body authorized to issue rulings on Shariah products and the infrastructure for Islamic banking and finance started developing in the country. In the same year Central Bank Act No. 23/1999 was enacted in which the central bank was mandated to regulate, supervise and develop Islamic banks. The Act also gave authority to Bank Indonesia to conduct its monetary policy based on Sharia principles.

The following three years witnessed important developments in the Indonesian Islamic banking and finance industry. These developments included the establishment of Jakarta Islamic Index in 2000, the establishment of Islamic Banking Bureau in 2001 for regulating, supervising and licensing Islamic banks and the release of “The blueprint of Islamic banking development in Indonesia” in 2002 (for details see section on “The blueprint of Islamic banking development in Indonesia”).

2008 was also an important year in the history of Indonesia.s Islamic banking industry; Bank Indonesia.s “Grand strategy of Islamic Banking Development” also known as market development strategic program, was released. The comprehensive strategy covered strategic aspects, such as: determining the vision of 2010 as the leading Islamic banking industry in ASEAN, creating the new image of inclusive and universal Islamic banking, mapping a more accurate market segment, developing new products, improving services as well as adopting new communication strategy of Islamic banking. Law 19/2008 supporting legal framework enabling government to issue Sukuk<sup>9</sup> as well as Law 21/2008 covering various aspects of Islamic finance in the country<sup>10</sup> were constituted in 2008. Islamic banking Act, aimed at promoting the expansion of Islamic financial services in the country was also introduced in the same year.

#### Blue print of Islamic Banking in Indonesia:

In 2002, Bank Indonesia released “The Blueprint of Islamic Banking Development in Indonesia” for the period 2002-2015, in order to provide guidance to stakeholders of Islamic banking. The revised blueprint of 2005 defined the vision and mission of Islamic banking providing clear priorities for the next ten years (2005-2015). In particular the six programs to be implemented till 2015 included:

- a) Increasing the Shariah compliance;
- b) Increasing the quality of prudential banking operations;
- c) Increasing the operational efficiency and competitiveness;
- d) Increasing the stability of banking system;
- e) Increasing the expertise and quality of human resources;
- f) Optimizing the social roles of Islamic banks in developing the small and medium enterprises (SME).

#### Conclusion:

From the above discussion it can be concluded that Islamic financial services in Indonesia have shown growth over the years. However despite having the world.s largest Muslim population the market share of Islamic banking assets in the country still remains relatively small. Efforts are thus required from all stakeholders to provide an enabling legal, regulatory and Shariah compliance environment for increasing the scope and outreach of Islamic financial services to hitherto a potentially untapped market.

#### Sources:

Global Islamic Finance Report 2011

Bank Indonesia website.

Rifiki Ismal “The Indonesian Islamic Banking: Theory and Practices”, Gramata Publishing 2011.

<sup>9</sup> Following the law two sovereign Sukuk structured as Sukuk Al-Ijarah were issued in 2008.

<sup>10</sup> The law covers areas including company formation, permissible and prohibited forms of Islamic transactions, corporate governance and dispute resolution.



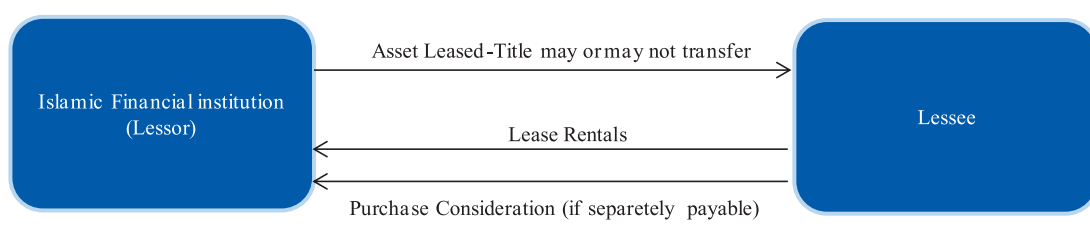
# Islamic Financing Mode in Focus

## An Introduction to Ijarah

An Ijarah is lease of an object involving the transfer of usufruct for a rent consideration. It can either take effect as an operating lease with the asset returning to the lessee at the end of the contract (simple Ijarah) or the more usual lease in financial transactions with the lessor gaining possession of the asset at maturity of contract (Ijarah wa iqtina).

Ijarah is a widely used by Islamic banks for consumer finance. In Pakistan, Ijarah based financing constitutes more than 10 percent of the overall Islamic banking financing (for details see section on Market Analysis).

**Figure 1: Model Ijarah Structure**



## Model Ijarah Structure:

The model Ijarah structure can be explained with the help of an example. The Islamic financial institution (lessor) purchases the asset and then transfers possession to the borrower (lessee). However the bank doesn't sell the asset to the borrower but leases it to the lessee. The lessee pays lease rentals to the lessor during the period of contract. At the end of the tenure, the bank, under a separate agreement, may sell the asset to the customer either by way of gift or a token value (see Figure 1).

Due to long term nature of housing finance Ijarah structure is highly suitable as it can be structured as a variable rate financing product. It is worth mentioning that in practice the above mentioned Ijarah structure is also used as a hybrid mode of financing along with other modes such as Istisna, Wakala and Diminishing Musharaka.

## Basic rules of Ijarah:

1. The subject of lease must have a valuable use.
2. It is necessary for a valid contract of lease that the corpus of the leased property remains in the ownership of the seller, and only its usufruct is transferred to the lessee.
3. The rental consideration must be for a fixed value whether payable in a lump sum or installments.
4. The term of Ijarah must be precisely determined.
5. The rent must be specified as a fixed sum for the rental term. However, the rent may escalate or diminish during the rental term so long as the amounts of such escalation and/or decrease are specified and known to both parties.
6. The lessor is responsible for structural maintenance of the assets and the obligations may not be passed to the lessee pursuant to Ijarah. Moreover, if the asset to be insured the insurance expense must be borne by the owner /lessor. However, this cost may be factored into the calculation of the lease rental.

7. The lessee cannot use the leased asset for any purpose other than the purpose specified in the lease agreement. If no such purpose is specified in the agreement, the lessee can use it for Shariah permissible purposes.
8. If the lessee defaults in making the lease rental payment, the lessor cannot charge any additional rent. However, the lease agreement contract may require the lessee to make an additional payment towards a charitable cause.
9. If the leased asset has totally lost the function for which it was leased, and no repair is possible, the lease shall terminate on the day in which such loss has been caused. However, if the loss is caused by the misuse or by the negligence of the lessee, he will be liable to compensate the lessor for the depreciated value of the asset as it was immediately before the loss.
10. If the lessee contravenes any term of the agreement, the lessor has a right to terminate the lease contract unilaterally. However, if there is no contravention on the part of the lessee, the lease agreement cannot be terminated without mutual consent.

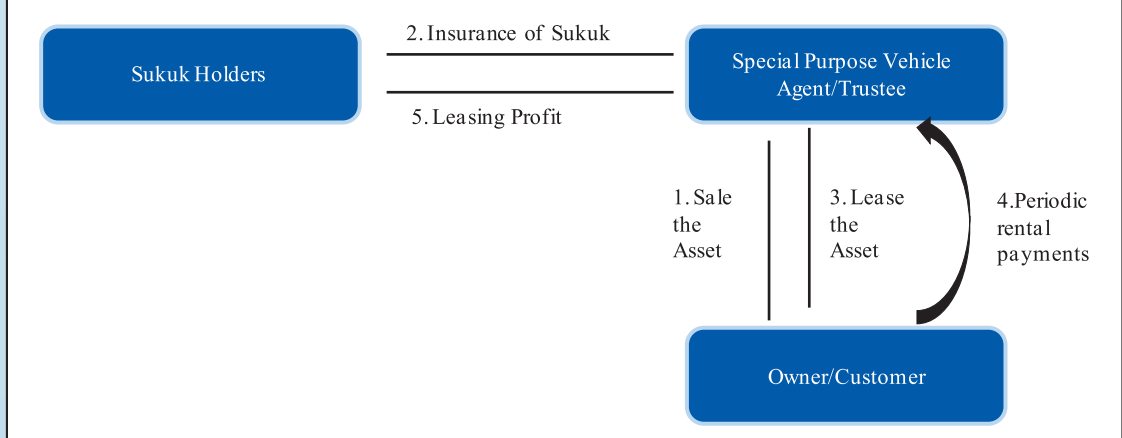
<b>Islamic Ijara Contract</b>	<b>Conventional Lease Contract</b>
Payments commence after delivery of asset.	Payments commence at the time of funding.
Risk of destruction or loss of asset remains with lessor, unless caused by negligence or misconduct.	Risk of destruction or loss of asset is transferred to lessee.
Major repairs & maintenance are the responsibility of lessor or as agreed between contracting parties.	Repairs & maintenance are passed on to lessee.
The lessor has a right to terminate the lease contract unilaterally only if the lessee contravenes any term of the agreement.	Lessor has the unilateral right to cancel the lease contract at his sole discretion.
Ijara payments should be stopped if asset is out of order if not due to misuse or negligence of lessee.	Lease payments will not stop if the asset is out of order.
Late payment penalty should be fixed in the contract in advance that goes to charitable causes.	Penalty is an interest charge which is earning for conventional lessor.
Ijara payments cannot be assigned to third party.	Conventional lease payments can be assigned to third party.

### **Ijarah Sukuk:**

Ijarah Sukuk has emerged as one of the most popular Sukuk structures. In particular, sovereign Sukuk are generally based on this structure. This is mainly due to the characteristics of this instrument which is generally simple in nature, provides a secure revenue stream, ownership in the underlying asset and is tradable in secondary market. In Pakistan, more than 75 percent of the Sukuk are based on Ijarah including all sovereign Sukuk (amounting to Rs. 294 billion) issued by government of Pakistan.

A typical Ijarah Sukuk structure generally involves three parties; i.e. owner/customer, a special purpose vehicle (SPV) and Sukuk holders. Typically under an Ijarah Sukuk agreement customer enters into an asset sale agreement with another company, typically a SPV for raising finance. SPV raises cash needed to purchase the asset by issuing Sukuk to investors. Thus the SPV acts as an agent for the customer. On behalf of investors, SPV acts as a trustee and leases the same asset to the customer in return of lease payments. The leasing profit is then distributed among the investors and the principal amount is paid at the maturity, when at the end of the Sukuk period, the owner will purchase the asset back from the SPV and this provides SPV with cash to repay Sukuk investors (see Figure 2).

**Figure 2: Ijarah Sukuk Structure**



**Conclusion:**

Ijarah is widely used by Islamic banks for consumer financing. Moreover for issuance of Sukuk, particularly sovereign Sukuk, Ijarah is considered a preferred mode. However, basic Shariah rules for Ijarah, as mentioned above, must be followed.

**Sources:**

1. Global Islamic Finance Report 2010, BMB Islamic.
2. Global Islamic Finance Report 2011, BMB Islamic.
3. The Chancellor Guide to the Legal and Shariah Aspects of Islamic Finance, BMB Islamic (2009).
4. Strategies for the Development of Islamic Capital Markets: Infrastructures and Legal Aspects of Islamic Asset Securitization, Islamic Financial Services Board (2011).
5. Muhammad Taqi Usmani (2000), "An Introduction to Islamic Finance", Idaratuk Ma.arif Karachi.
6. M. Kabir Hassan and Mervynn K. Lewis (2007), "Handbook of Islamic Banking", Edward Elgar Publishing Limited.

**SAHI BUKHARI**

Volume 5, Book 57, Number 16:

Narrated Abu Huraira:

I heard Allah's Apostle saying, "While I was sleeping, I saw myself standing at a well, on it there was a bucket. I drew water from the well as much as Allah wished. Then Ibn Abi Quhafa (i.e. Abu Bakr) took the bucket from me and brought out one or two buckets (of water) and there was weakness in his drawing the water. May Allah forgive his weakness for him. Then the bucket turned into a very big one and Ibn Al- Khattab took it over and I had never seen such a mighty person amongst the people as him in performing such hard work, till the people drank to their satisfaction and watered their camels that knelt down there."

# Islamic Banking Branch Network

(As of December 31, 2011)

Annexure: I

Type	Name of Bank	No of Branches*
Islamic Banks	Al Baraka Islamic Bank	87
	BankIslami Pakistan Limited	70
	Burj Bank Limited	42
	Dubai Islamic Bank Pakistan Ltd	75
	Meezan Bank Ltd	275
		<b>549</b>
Islamic Branches of Conventional Banks	Askari Bank Limited	29
	Bank Al Habib Ltd	11
	Bank Alfalah Ltd	85
	Faysal Bank Limited	45
	Habib Bank Ltd	22
	Habib Metropolitan Bank	4
	MCB Bank Ltd	22
	National Bank of Pakistan	8
	Soneri Bank Ltd	7
	Standard Chartered Bank	15
	The Bank of Khyber	26
	United Bank Ltd	14
<b>Sub Total</b>		<b>288</b>
Sub Branches	Al Baraka Islamic Bank	2
	Askari Bank Limited	2
	BankIslami Pakistan Limited	32
	Burj Bank Limited	8
	MCB Bank Ltd	2
	The Bank of Khyber	3
<b>Sub Total</b>		<b>49</b>
<b>Grand Total</b>		<b>886</b>

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

# Province wise Break-up of Islamic Banking Branch Network (As of December 31, 2011)

Annexure: II

Type	Bank Name	Azad Kashmir	Balochistan	FATA	Federal Capital	Khyber Pakht-unkhwa	Gilgit-Baltistan	Punjab	Sindh	Grand Total
Islamic Banks	Albaraka Islamic Bank	1	3	-	4	9	-	42	28	87
	BankIslami Pakistan Limited	1	8	-	2	5	1	30	23	70
	Burj Bank Limited	-	1	-	2	2	-	17	20	42
	Dubai Islamic Bank Pakistan Limited	1	5	-	4	3	-	36	25	75
	Meezan Bank Limited	4	8	-	13	24	-	132	86	275
<b>IB. Total</b>		<b>7</b>	<b>25</b>		<b>25</b>	<b>43</b>	<b>1</b>	<b>257</b>	<b>191</b>	<b>549</b>
Islamic Branches of Conventional Banks	Askari Bank Limited	-	2	-	1	5	-	14	7	29
	Bank AL Habib Limited	-	1	-	-	1	-	3	6	11
	Bank Alfalah Limited	-	3	-	6	4	-	52	20	85
	Habib Bank Limited	-	2	-	1	12	-	20	10	45
	Habib Metropolitan Bank Limited	2	1	-	2	2	-	9	6	22
	MCB Bank Limited	-	-	-	-	-	-	1	3	4
	National Bank of Pakistan	-	1	-	2	1	-	11	7	22
	Soneri Bank Limited	1	-	-	-	1	-	4	2	8
	Standard Chartered Bank(Pakistan)	-	1	-	2	1	-	1	2	7
	The Bank of Khyber	-	1	-	1	3	-	4	6	15
	United Bank Limited	-	2	2	-	17	-	3	2	26
Faysal Bank Limited	-	1	-	1	2	-	5	5	14	
<b>SAIBBs Total</b>		<b>3</b>	<b>15</b>	<b>2</b>	<b>16</b>	<b>49</b>		<b>127</b>	<b>76</b>	<b>288</b>
Sub Branches	Albaraka Islamic Bank	-	-	-	1	-	-	-	1	2
	Askari Bank Limited	-	-	-	1	-	-	-	1	2
	BankIslami Pakistan Limited	1	3	-	3	2	-	9	14	32
	Burj Bank Limited	-	-	-	-	-	-	3	5	8
	MCB Bank Limited	-	-	-	-	-	-	1	1	2
	The Bank of Khyber	-	-	-	-	1	-	1	1	3
	<b>Sub Branches Total</b>	<b>1</b>	<b>3</b>	<b>-</b>	<b>5</b>	<b>3</b>	<b>-</b>	<b>14</b>	<b>23</b>	<b>49</b>
<b>Grand Total</b>		<b>11</b>	<b>43</b>		<b>46</b>	<b>95</b>	<b>1</b>	<b>398</b>	<b>290</b>	<b>886</b>



# City wise Break-up of Islamic Banking Branch Network

(As of December, 31, 2011)

Annexure: III

S.No.	Province	Cities	No. of Br.	S.No.	Province	Cities	No. of Br.		
1	Sindh	Badin	1	44	Khyber Pakhtunkhwa	Abottabad	11		
2		Dadu	2	45		Banu	2		
3		Hyderabad	22	46		Charsadda	3		
4		Jacobabad	1	47		Chitral	1		
5		Karachi	237	48		Dera Ismail Khan	5		
6		Larkana	1	49		Hangu	2		
7		Matiari	1	50		Haripur	4		
8		Mirpur Khas	3	51		Kohat	3		
9		Naushero Feroze	1	52		Malakand	1		
10		Nawabshah	5	53		Mansehra	6		
11		Sanghar	5	54		Mardan	6		
12		Sukkur	9	55		Nowshera	4		
13		Tando Allahyar	2	56		Peshawar	38		
<b>Sindh Total</b>			<b>290</b>	57	Swabi	3	KP Total	<b>95</b>	
14	Punjab	Attock	6	58	Swat	2			
15		Bahawalnagar	5	59	Tank	1			
16		Bahawalpur	4	60	Upper Dir	3			
17		Chakwal	3	61	Balochistan	Chagi			1
18		Dera Ghazi Khan	3	62		Gawadar			1
19		Faisalabad	37	63		Kila Abdullah			2
20		Gujranwala	14	64		Killa Saifullah	3		
21		Gujrat	16	65		Lasbela	1		
22		Hafizabad	2	66		Loralai	4		
23		Jhang	3	67		Pishin	1		
24		Jhelum	6	68		Quetta	29		
25		Kasur	3	69		Zhob	1		
26		Khanewal	7	<b>Balochistan Total</b>		<b>43</b>			
27		Khushab	5	70	Gilgit-Baltistan	Gilgit	1		
28		Lahore	147	<b>Gilgit-Baltistan Total</b>		<b>1</b>			
29		Lodhran	1	71	FATA	Khyber Agency	1		
30		Mandi Bahauddin	1	72	<b>FATA Total</b>		<b>2</b>		
31		Mianwali	2	73	Federal Capital	Islamabad	46		
32		Multan	28	<b>Federal Capital Total</b>		<b>46</b>			
33		Muzaffargarh	3	74	Azad Kashmir	Mirpur AJK	8		
34		Okara	3	75	<b>Azad Kashmir Total</b>		<b>11</b>		
35		Pakpattan	2	<b>Grand Total</b>				<b>886</b>	
36		Rahim Yar Khan	10						
37		Rawalpindi	44						
38		Sahiwal	4						
39		Sargodha	12						
40		Sheikhupura	4						
41		Sialkot	15						
42		Toba Tek Singh	3						
43		Vehari	5						
<b>Punjab Total</b>			<b>398</b>						

## Contact Details of Islamic Banking Department Officials

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