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Round Table Conference on Islamic Banking Potential of Pakistan

Key Note Address by Mr. Yaseen Anwar,
Governor, State Bank of Pakistan
15th January, 2014

I am privileged to be here today for addressing this prestigious gathering comprising all major stakeholders of the Islamic Banking Industry in Pakistan. The presence of foreign experts brings global experience to this roundtable conference and thus would further enrich the knowledge sharing experience. My appreciation to the organizers for holding this event to explore the real potential of Islamic banking in Pakistan, which I believe would give further boost to our efforts and optimism for growth and development of the industry.

Islamic finance during the last four decades has witnessed considerable progress at the global front. Besides the traditional Islamic finance markets of Middle East, financial centers across various Western countries are also accepting and recognizing the viability and utility of this alternate financial system. In particular the relative resilience of Islamic financial institutions during the recent financial crisis due to its asset backed nature and being devoid of speculation and uncertainty, has significantly improved its credibility as a more prudent and stable system. The scope and range of Islamic finance products has also widened considerably over the years and Islamic financial institutions are presently catering to most of the financial services needs of various sectors of the economy. There are dedicated regulatory, legal and academic institutions at the international level working and providing support for maintaining the high pace growth of the Islamic finance industry.

Pakistan, with more than 95 percent Muslim population, and a constitutional obligation of ensuring a riba free economic system, has had a favourable response to Islamic finance. Pakistan is amongst the pioneers of Islamic finance as we started planning for nurturing the Shariah compliant financial system way back in 1970s, and made a bold attempt in 1980s to bring the whole banking and financial system in conformity with Shariah principles. The pioneering work of 1980s particularly on the legal and regulatory front has been a source of guidance and inspiration for many countries that initiated Islamic finance in the 1980s and 90s. The attempt to transform the whole system however, met with limited success largely due to slippages at the implementation and execution stage. This lead us to re-launch Islamic banking in 2001 in parallel to conventional banking thus allowing both Islamic and conventional banks to co-exist and enabling the consumers to do banking with the system of their choice and preference.

This approach has proved to be a huge success in promoting Islamic banking in the country and ensuring its demand driven development. The industry has been growing at an impressive annual growth rate of over 30 percent over the last five years with sustained growth momentum despite significantly increased base. Islamic Banking is currently spread across 80 districts of the country with a network of 1200 branches offering Shariah compliant products and services. Islamic banking assets presently constitute almost 10 percent of the overall banking system in the country while in terms of deposits the share is above 10 percent. The future outlook of the industry is also very positive with bright prospects of doubling its market share by 2020.

The presence of his Excellency, the President of Pakistan, and the honorable finance minister in the conference speaks volumes about the strong commitment of the government for the promotion of Islamic banking and finance in the country. I would like to take this opportunity to highlight that State Bank of Pakistan has been playing a leading role in nurturing Islamic banking in the country on sound footings. Being the regulator of the banking sector, SBP over the years has introduced and implemented key regulatory reforms and prudential measures to ensure financial stability and to meet the evolving needs of the industry. We have also given a comprehensive and multi-tiered Shariah compliance framework to ensure Shariah conformity of Islamic banks' operations. To further strengthen the Shariah compliance environment in Islamic banks we have also developed a Shariah Governance Framework, which explicitly defines the Shariah related roles and responsibilities of all key organs of IBIs including Board of Directors, the executive management and Shariah Boards. It also institutionalizes the Shariah compliance function in IBIs.

Moreover, to develop effective prudential and risk management framework for Islamic finance, an incremental approach was adopted wherein new regulations for only such areas and risks of Islamic banks were developed which were not being covered by conventional prudential regulations and risk management framework.

Further, in order to align its regulatory framework with international regulatory standards and best practices, SBP regularly reviews and evaluates the standards issued by IFSB, AAOIFI, IIFM for their possible implementation keeping in view our local legal, regulatory and economic environment. Last year we issued landmark Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions (IBIs), which were well received both locally and internationally. The instructions are aimed at bringing standardization and improving transparency in profit & loss distribution practices of the industry and will be instrumental in improving the perception of Islamic banking amongst the masses.

Considering the demand of Islamic microfinance, SBP has offered various options to offer the services of Islamic microfinance. These options include the establishment of full-fledged Islamic microfinance banks, Islamic microfinance services by full-fledged Islamic banks and Islamic microfinance Divisions in conventional microfinance banks. This, coupled with its inherent checks on end use of the funds provided by microfinance institutions, the outlook for growth and development of Islamic microfinance in Pakistan is positive.

Similarly for an agro-based economy like ours, there is huge potential for development of Shariah Based Agriculture financing. SBP is working with the industry to develop Shariah compliant agriculture finance products particularly Dairy products which can generate more than $ 500 million in foreign exchange exports.

Islamic finance is an evolving industry and so is its understanding by the masses, the business community and the policy makers. Despite significant improvement during the last decade, still a large segment of our population does not have adequate understanding of Islamic finance and in unable to comprehend its distinction over conventional finance. The State Bank therefore, besides developing a supportive regulatory and supervisory framework, is also actively engaged in undertaking awareness creation and capacity building initiatives through its awareness campaign whereby targeted seminars and conferences are being organized for the business community, academia, bankers and policy makers throughout the country. In this context, the most significant milestone that has been achieved in the recent past is the launch of an industry wide media campaign under the support and guidance of SBP. This campaign is targeted to address mass awareness issues by using print, electronic and digital media.

Further, SBP has recently developed a five year Strategic Plan (2014-18) for the Islamic banking industry in Pakistan in consultation with all key stakeholders, which gives a consensus agenda and strategy to take the industry to its next level of growth and development. The plan has an extensive focus on improving public perception of Islamic banking as a distinct and viable system capable of catering to the varied financial services needs of various segments of the society. It envisages intensifying the awareness creation efforts, strengthening consultation mechanism with stakeholders, removing confusion and inconsistencies in legal, regulatory and taxation environment, deepening and broadening of product offerings by Islamic banks, doubling the outreach of Islamic banks during the next five years and increasing the market share to 15 percent of the banking system.

Pakistan has been an active member of leading global International Islamic finance institutions like the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and the International Islamic Financial Market (IIFM) that are all playing a key role in developing prudential and Shariah standards for the industry. Being part of the global efforts for the development of global standards for the industry has certainly helped us in improving our presence on the global Islamic finance map and adopting the prudential and Shariah standards in Pakistan.

I would also like to mention here that SBP is also a key member of the recently constituted steering committee for the promotion of Islamic banking by the government which is mandated to devise a comprehensive policy framework for the Islamic financial system, suggest practical steps needed to be taken for implementing Shariah-based financial system, and propose solutions for the Islamic secondary market / money market for liquidity management. These initiatives on part of the government sends a clear signal that the present government views Islamic banking and finance as an integral part of the overall financial system. We at SBP share the same view and believe that steps like these can go a long way in further increasing the scope of the industry in the country.

Innovation requires research, hence it is imperative that the industry players give utmost importance to research in their organizations. I am pleased to inform this esteemed audience that SBP has a dedicated team of researchers focusing on key areas relevant to the industry. We have recently conducted an extensive survey based study of 10,000 household across the country to assess the demand for Islamic banking and its attributes. The results of the survey will be shared with the industry soon and are highly encouraging as there is a huge unmet demand for Islamic banking in the country; and an even faster pace expansion of the industry would be needed to fill the demand and supply gap in the medium to long term.

Lastly! I would like to reiterate the full support and ownership of SBP in developing and nurturing a sound and stable financial system that meets the Shariah principles in letter and spirit. We will work with the industry and other stakeholders to ensure further strengthening of risk management practices, and an effective macro prudential framework and transparency in financial transactions and exposures. The State Bank of Pakistan remains committed to finding appropriate solutions to these challenges. I have no doubt that the support and cooperation of all stakeholders exhibited here today will lead to further strengthening the foundations of this important industry.

A pure Islamic financial system with its inherent focus on equity justice and social responsibility is ideal and this demands serious and coordinated efforts of all stakeholders on the continuous basis. I wish the best of luck to the industry and thanks once again to all the participants and organizers.

Thank you

Islamic Banking Industry- Progress & Market Share

Overview

The Islamic banking industry (IBI) finished CY13 with an asset base of Rs. 1014 billion by growing at 21.2 percent (YoY) (see **Table 1**) while the quarterly growth of assets was 9.5 percent in the last quarter of CY13 compared to 2.5 percent in the previous quarter (Jul-Sep 13). Similarly deposits of Islamic banking industry (IBI) by growing at quarterly growth of 12 percent in the quarter under review compared to less than 1 percent growth of the previous quarter reached to Rs. 868 billion (see **Table 1**). Consequently the market share of Islamic banking assets and deposits in overall banking industry increased from 9.5 percent and 10.1 percent by end Sep 13 to 9.6 percent and 10.4 percent respectively by end Dec 2013. In terms of profitability, there was an increase of Rs. 2.61 billion in profit in the quarter under review, however remained lower compared to the profit (Rs 9.9 billion) earned by the industry by the end Dec, CY 12. The industry also witnessed an increase in return on equity (ROE) during the quarter under review; however, return on assets (ROA) remained unchanged compared to the previous quarter. Both non-performing financing (NPF) and non-performing assets (NPA) of Islamic banking industry declined during October to December quarter CY 13 resulting in improving asset quality indicators like NPFs to financing ratio, Net NPAs to Capital and Net NPFs to Net Financing.

Table 1: Industry Progress and market share **(Rupees in billions)**

	Industry Progress			Growth (YoY)			Share in Industry		
	Dec-12	**Sep-13**	**Dec-13**	**Dec-12**	**Sep-13**	**Dec-13**	**Dec-12**	**Sep-13**	**Dec-13**
Total Assets	837	926	1014	30.5%	24.8%	21.2%	8.6%	9.5%	9.6%
Deposits	706	775	868	35.6%	23.5%	22.8%	9.7%	10.1%	10.4%
Net Financing & Investment	626	711	709	31.9%	24.6%	13.4%	8.1%	9.1%	8.5%
Total Islamic Banking Institutions	18	19	19	–	–	–	–	–	–
Total No. of Branches*	1097	1161	1304	–	–	–	–	–	–

Source: Quarterly Unaudited Accounts

**number includes sub-branches*

IBI Network Expansion

The last quarter of CY13 witnessed expansion in Islamic banking industry's branch network with addition of 143 branches. These additional branches were spread across all regions except FATA, however, even these new branches are concentrated in three big provinces and Federal capital ; Punjab leads with 64 branches followed by Sindh with 48, Khyber Pakhtoonkhawa (KPK) with 15 and , and the Federal Capital with 10 branches (see **Table 2**). Importantly, four new districts i.e. Jamshoro and Umer Kot in Sindh, Buner in Khyber Pakhtoonkhawa (KPK) and Baltistan in Giligit-Baltistan were added to the list of districts

Table 2: Province Wise Additional Branches (Sep-Dec 2013)

Province	Additional Number	Total Number	Share (percent)
Punjab	64	569	43.6
Sindh	48	438	33.6
Khyber Pakhtoonkhawa	15	147	11.3
Baluchistan	4	55	4.2
Gilgit Baltistan	1	5	0.4
FATA	0	4	0.3
Federal Capital	10	71	5.4
AJK	1	15	1.2
Total	**143**	**1304**	**100**

having Islamic banking branches (see **Annexure III** for details).

It is important mentioning that 207 additional branches were opened in CY13 and going forward it is expected that branch network of Islamic banking industry is likely to increase further as with increased focus of government conventional banks are showing more inclination towards establishing their Shariah compliant businesses and the most positive development in this regard is the issuance of the very first licence for Islamic banking Subsidiary in the country.

Asset & Liability Structure

Asset: Assets of the Islamic banking industry registered quarterly growth of 9.5 percent during October to December quarter 2013 to reach Rs. 1014 billion from Rs. 926 billion in the previous quarter. Consequently, the market share of Islamic banking assets in overall banking industry reached 9.6 percent by end December 2013. This increase in assets was mainly contributed by financing that witnessed quarterly growth of almost 18 percent. On the other hand, investments, the second major contributor in assets, witnessed decline during the review quarter.

Bifurcation of assets among full-fledged Islamic Banks (IBs) and Islamic Banking Divisions (IBDs) of conventional banks reveals that assets of both IBs and IBDs witnessed positive quarterly growth; IBDs recording relatively higher growth (13.3 percent) compared to IBs (7.4 percent). Consequently share of assets of IBs in overall assets of Islamic banking industry witnessed slight decline from 64 percent in September 2013 to 63 percent in December 2013.

Table 3: Investments

Rupees in million

				Growth	
	Dec-12	**Sep-13**	**Dec-13**	**YoY**	**QoQ**
Federal government securities	278,549.7	318,976.6	266,687.2	(4.3)	(16.4)
Fully paid up ordinary shares	3,479.1	3,922.8	4,334.8	24.6	10.5
TFCs, Debentures, Bonds, & PTCs	33,899.0	32,813.9	34,000.1	0.3	3.6
Other investments	79,641.2	91,205.3	90,869.6	14.1	(0.4)
Investments by type					
Held for Trading	75.82	147.96	2,183.66	2,780.1	1,375.9
Available for Sale	375,665.7	428,018.0	368,089.8	(2.0)	(14.0)
Held to Maturity	9,521.4	10,983.4	15,383.5	61.6	40.1
Surplus /(deficit) on revaluation	1,935.5	246.8	2,714.9	40.3	1,000.2
Net Investments	**394,376.9**	**445,478.6**	**394,372.0**	**(0.0)**	**(11.5)**

Investments:

Investments of Islamic banking industry declined to Rs 394 billion by end December 2013 from Rs 445 billion by end September 2013 reflecting quarterly negative growth of 11.5 percent (see **Table 3**). The fall in investments can be mainly attributed to non issuance of GoP Ijara Sukuk over the last nine months that has generally been the key investment option for Islamic banking industry. This is also reflected by the outflow of more than Rs. 52 billion in Federal government securities (negative quarterly growth of 16.4 percent) during the quarter under review though this still remain the highest contributor in investments.

Financing

Financing (gross) by Islamic banking industry witnessed growth of 17.9 percent during the quarter under review to reach above Rs 330 billion by end December 2013.This is in line with the seasonal pattern generally witnessed during the last quarter of a calendar year mainly due to the nature of business cycle of most industries; industries usually utilize their financing quota in second and fourth quarter while off load their financing in first and third quarter. This seasonal trend is also reflected while analyzing the financing

Table 4: Financing Concentration - percent share

	Dec-12	Sep-13	Dec-13	Industry
Chemical and Pharmaceuticals	7.4%	7.1%	6.3%	3.3%
Agribusiness	3.7%	3.8%	3.6%	7.5%
Textile	19.0%	16.2%	19.1%	17.3%
Cement	1.5%	1.1%	0.9%	1.2%
Sugar	3.8%	3.4%	3.9%	2.7%
Shoes and leather garments	0.9%	0.8%	0.9%	0.6%
Automobile and transportation equipment	1.4%	1.9%	1.7%	1.3%
Financial	1.4%	0.8%	0.7%	2.7%
Insurance	0.0%	0.0%	0.0%	0.0%
Electronics and electrical appliances	1.5%	1.8%	1.7%	1.3%
Production and transmission of energy	10.3%	9.2%	8.9%	11.0%
Individuals	14.2%	14.4%	13.3%	8.5%
Others	34.9%	39.4%	38.9%	42.6%
Total	100.0%	100.0%	100.0%	100.0%

concentration among various sectors; Textile, the major recipient of financing for overall banking industry including Islamic banks, registered positive growth in its financing during the quarter ending December 2013 compared to the previous quarter. Among other sectors, sugar and shoes & leather garments also witnessed an increase in their shares in overall financing portfolio during the quarter under review (see **Table 4**).

Table 5 : Financing Mix

	(a) Amount in billion Rupees			(b) Percent Share		
	Dec-12	Sep-13	Dec-13	Dec-12	Sep-13	Dec-13
Murabaha	97.5	112.5	134.2	39.7	40.2	40.6
Ijarah	22.5	24.2	25.4	9.2	8.6	7.7
Musharaka	1.9	11.6	22	0.8	4.2	6.7
Mudaraba	0.6	0.5	0.5	0.2	0.2	0.2
Diminishing Musharaka (DM)	87.7	92.6	101.8	35.7	33	30.8
Salam	7.3	9.5	13.3	3	3.4	4
Istisna	17.7	13.4	18.5	7.2	4.8	5.6
Qarz/Qarz-e-Hasna	0	0	0	0	0	0
Others	10.5	15.7	14.5	4.3	5.6	4.4
Total	**245.7**	**280.1**	**330.2**	100	100	100

In terms of financing mix, all modes of financing, except 'others', registered increase during the review quarter (see **Table 5 (a)**). However, like previous quarters, Murabaha and Diminishing Musharaka remained the most concentrated modes as these collectively contributed more than 70 percent in overall financing mix (see **Table 5 (b)**).

Similar to the previous quarter, client category wise financing of IBIs remained concentrated in corporate sector, having a share of above 70 percent followed by consumer financing (11.6 percent) and commodity financing (9.6 percent) (see **Table 6**). In line with the trend of overall banking industry financing extended by Islamic banking to SMEs and agriculture is low; 5.1 percent and 0.1 percent respectively. However, given that the share of overall banking industry's financing in SMEs and agriculture categories is still higher compared to Islamic banking industry depicting potential opportunity for Islamic banking to explore going forward to maintain its sustainable growth.

Table 6: Client Wise Financing Portfolio (Share Percent)

	Dec-12	Sep-13	Dec-13	Industry
Corporate Sector	73.5%	69.4%	71.8%	67.7%
SMEs	4.1%	4.1%	5.1%	6.6%
Agriculture	0.1%	0.1%	0.1%	5.5%
Consumer Finance	13.1%	13.2%	11.6%	6.2%
Commodity Financing	7.3%	11.3%	9.6%	11.6%
Staff Financing	1.7%	1.7%	1.6%	2.1%
Others	0.2%	0.2%	0.2%	0.3%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Asset Quality

As a positive development, non-performing financing (NPF) of Islamic banking industry decreased during October to December 2013 quarter and reached Rs.18.9 billion showing quarterly (QoQ) decline of 4.0 percent. This reduction in NPFs was primarily due to 'doubtful' and 'loss' categories that registered negative growth of 12.5 percent and 4.2 percent respectively during the review quarter (see **Table 7**). Similarly non-performing assets (NPA) of Islamic banking industry also decreased during the October to December 2013 quarter.

Table 7: Non-Performing Financing & Assets

Rupees in billions

				Growth in %	
	Dec-12	**Sep-13**	**Dec-13**	**YoY**	**QoQ**
NPF	18.5	19.7	18.9	1.9	-4.0
Substandard	2.1	1.2	1.3	-37.3	13.1
Doubtful	2.5	2.0	1.8	-28.3	-12.5
Loss	14.0	16.5	15.8	13.0	-4.2
Provisions	12.3	13.7	14.1	14.1	3.0
Net NPF	6.2	6.0	4.8	-22.3	-19.8
Recovery (year to date)	0.9	0.4	1.2	36.1	226.4
NPA	21.7	23.4	22.3	2.7	-4.9
Net NPAs	7.0	7.3	5.6	-20.7	-23.6

Despite declining non-performing financing, provisions against financing witnessed increased during the review quarter, provisions to NPFs reached 77.4 percent compared to 69.4 percent in the previous quarter (see **Table 8**) showing the cautious approach of Islamic banks and to improve cushion against NPFs. However, other asset quality indicators including NPFs to financing ratio, Net NPAs to Capital and Net NPFs to Net Financing all declined compared to the last quarter reflecting relatively better asset quality of Islamic banking industry during the review quarter; furthermore all these above mentioned performance indicators of Islamic banking industry are also lower than those of overall industry.

Table 8: Performance Indicators

	Dec-12	Sep-13	Dec-13	Industry
Assets Quality Ratio				
NPFs to Financing	7.6%	7.0%	5.7%	13.0%
Net NPFs to Net Financing	2.7%	2.3%	1.5%	3.1%
Provisions to NPFs	66.5%	69.4%	74.4%	78.4%
Net NPAs to Total Capital	11.1%	11.1%	7.9%	13.9%
Real estate Financing to Total Financing	5.8%	5.7%	5.1%	1.3%
FCY Denominated Financing to Capital	7.7%	11.2%	23.8%	21.2%

Liabilities

Deposits of Islamic banking industry reached Rs. 868 billion by end December 2013 depicting a quarterly growth of 11.9 percent. Similarly, share of Islamic banking industry deposits in overall banking industry increased from 10.1 percent in September 2013 to 10.4 percent by the end December 2013. Both customers' deposits as well as financial institutions' deposits with IBIs registered positive growth during the review quarter. The significant increase in deposits of financial institutions in the quarter under review along with almost similar increase in the category of "due from financial institutions" on assets' side depicts the cosmetic arrangements of the industry for increasing their balance sheet at the end of the calendar year

Table 9: Break up of Deposits

Rupees in million and growth in percent

				Growth	
	Dec-12	Sep-13	Dec-13	YoY	QoQ
Deposits	**706,469.9**	**775,413.0**	**867,698.8**	**22.8**	**11.9**
Customers	**660,950.3**	**736,110.2**	**798,622.2**	**20.8**	**8.5**
Fixed Deposits	233,108.8	244,803.7	261,240.2	12.1	6.7
Saving Deposits	259,239.2	297,566.9	314,361.7	21.3	5.6
Current accounts - Remunerative	1,878.0	1,717.6	2,337.6	24.5	36.1
Current accounts - Non-remunerative	163,539.3	188,549.5	217,147.9	32.8	15.2
Others	3,185.0	3,472.5	3,534.8	11.0	1.8
Financial Institutions	**45,519.6**	**39,302.8**	**69,076.6**	**51.8**	**75.8**
Remunerative Deposits	35,514.6	38,496.4	68,490.4	92.9	77.9
Non-remunerative Deposits	10,005.0	806.4	586.2	(94.1)	(27.3)
Currency Wise					
Local Currency Deposits	672,841.5	731,333.8	820,442.8	21.9	12.2
Foreign Currency Deposits	33,628.4	44,079.2	47,256.0	40.5	7.2

Within customers' deposits, fixed deposits as well as saving deposits registered positive growth during the period under review though fixed deposits grew at a faster pace compared to saving deposits (see **Table 9**). It is worth mentioning that this is the first time since June 2012 that growth in fixed deposits has remained higher than growth in savings deposits. This was mainly due to Islamic banking divisions (IBDs) whose fixed deposits witnessed growth of nearly 18 percent compared to 9.3 percent growth in saving deposits. On the other hand, fixed deposits of Islamic banks (IBs) witnessed slightly lower growth (3.1 percent) compared to saving deposits (3.6 percent). In terms of currency wise deposits, local currency deposits continued to dominate overall deposits with 95 percent share in overall deposits.

Earning & Profitability

Profitability of the Islamic banking industry registered at Rs 9.4 billion by end December 2013 remained lower compared to Rs 9.9 billion profit in December 2012. This can be attributed to relatively lower share of investments[1] in overall assets of Islamic banks during December 2013 (38.9 percent) compared to December 2012 (47.1 percent). Among indicators of earnings and profitability return on equity (ROE) witnessed an increase during the quarter under review while return on assets (ROA) remained unchanged compared to the previous quarter (see **Table 10**). Non-Markup Income to Total Income of Islamic banking Industry also registered increase during the last quarter of CY13. ROA, ROE and Non-Markup Income to Total Income of Islamic banking industry are however lower than those of overall banking industry. On the other hand Net Mark up Income to Total Income (78.5 percent) declined during the quarter ending December 2013 but continued to stay above overall banking industry averages. In line with general trend Operating Expense to Gross Income of Islamic banking industry remained higher than that of overall banking industry.

Table 10: Earning & Profitability	Dec-12	Sep-13	Dec-13	Industry
Net Income to Total Assets (ROA)	1.2%	0.9%	0.9%	1.1%
Return on Equity (ROE)	14.1%	11.6%	12.0%	12.4%
Net mark up Income to Gross Income	80.1%	79.0%	78.5%	70.3%
Non-mark up Income to Gross Income	19.9%	21.0%	21.5%	29.7%
Trading & Fx Gains/(Losses) to Gross Income	6.6%	6.8%	7.3%	9.3%
Operating Expense to Gross Income	67.3%	70.0%	69.7%	57.4%
Personnel Expense to Operating Expense	35.3%	37.3%	37.6%	42.5%

[1] Return on government securities is generally higher than the return on financing

Country Model

Turkey

The 17th largest economy the Republic of Turkey is the eighth most populous Muslim country and therefore is a natural market for Sharia-compliant business. However, due to the secular stance of the government, Islamic finance was not focused in past, Islamic banks are still not even known as Islamic banks but participation banks in the country. Since recent financial crisis the government of Turkey started focusing on capitalizing this emerging industry admitting its unavoidable significance and overwhelming demand from domestic and international market. Furthermore growing ties of Turkish Government with Middle East is also stimulating the growth of Islamic finance in the country because of stronger demand of investors from that region. Given huge demand along with the increased focus of the government, Islamic finance industry is expected to substantially grow in Turkey.

The history of Islamic finance in Turkey can be traced back to the establishment of Al Baraka Financial House in 1985 when to differentiate it from conventional finance this was given a special status of special finance house. In 2005, banking law legislated Islamic banks to be known as “participation banks” and since then the industry has started progressing. By growing at an annual growth rate of 33.5 percent in contrast to 20.5 percent of overall banking industry, the Islamic banking industry consisting of four banks now constitute above 5 percent share[2] of overall banking industry. Among the four banks; Asya bank leads the share with 30.8 percent followed by Kuveyt Türk, Türkiye Finans and AlBaraka Türk with 26.5%, 24.1%, and 18.6% respectively. However, these participation banks are still not considered as banks and therefore are not part of the Turkish Association of Banks though a trade body set up; Participation Banks Association of Turkey (TKBB); was formed to promote Islamic banking. Furthermore Participation banks are lobbying to address the regulatory obstacles that hinder growth of Islamic finance in the country. The government of Turkey is also reviewing certain laws for making it favourable for Islamic finance industry to grow in the country. Some of the significant steps in this regard are the Istanbul Stock Exchange (ISE) participation index that tracks 30 Shariah compliant companies and regulatory changes conducive to develop capital market.

In 2012 the Turkish government entered the Sukuk mark with a five year Sukuk of $ 1.5 billion followed by another sovereign Sukuk of $ 1.25 billion after almost a year (Oct, 2013). These issuances have provided an attractive investment opportunity to participation banks resulting in over subscription of these issuances. Owing to the stronger demand of Sukuk in the market, government of Turkey has decided to issue Sukuk twice a year.

With the increasing popularity and growing significance of Islamic finance across the globe, the dominant Muslim population in the country with enhanced focus of the government and growing ties with MENA

[2] This data is for Dec 2012

region, the future of the Islamic finance industry seems quite buoyant in Turkey. According to Earnest & Young Report the market of Turkey is expected to triple its assets by 2023.

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http://www.hurriyetdailynews.com/turkey-has-long-way-to-go-for-islamic-finance-system.aspx?pageID=238&nID=58463&NewsCatID=346 {accessed on Feb3, 2014)

Adoption of AAOIFI Shariah Standards: Case of Pakistan

Diminishing Musharkaha

AAOIFI Shariah Standard No. 12 " Sharika (Musharaka) and Modern Corporation" covers rulings for (i) joint partnership, (ii) reputation partnership, (iii) vocation partnership , (iv) modern corporations and (v) diminishing partnership on the basis of Sharikat-al-aqd. However, this standard cannot be applicable on diminishing musharakah in case of Pakistan because of the underlying contract which is Sharikat-ul-milk instead of sharikat-al-aqd. The central Shariah board of the State Bank of Pakistan has therefore issued its own standard of Sharikat ul-milk and Diminishing Musharkaha[3] .

According to the scope of the standard this will be applicable on Diminishing Musharakah and all forms of joint ownerships, structured on the basis of Sharikat ul Milk of asset or property (excluding receivables and cash and cash equivalent. The standard consists of four main clauses including the scope of the standard in the first clause. Brief details of remaining clauses are as follows;

Second clause of the standard defines Sharikat ul milk and the relationship of joint owners in this case. Third clause explains general rulings for Sharikat ul Milk; this clause has been sub divided into two main parts (i) Execution of a Sharikah contract and (ii) Withdrawal from or Termination of Sharikat-ul-Milk.

i. ***Execution of a Sharikah contract:*** This part consists of thirteen sub-clauses. The first sub clause explains the basis for existence of Sharikat-ul-Milk through inheritance or joint purchase while the determination of proportionate share of joint owners of the partnership is discussed in subsequent clause. The standard clearly stipulates that the proportionate share in the joint partnership will be determined by evaluator (s) on the basis of market prices or the mutually agreed fixed value or on the basis of cash contribution by joint owners. In terms of banking, the standard explains that institution offering Islamic financial services may enter into Sharikat ul Milk with conventional banks and other financial institutions for syndicate financing though subjective to ensuring Shariah compliance of operations.

This clause stipulates the right of each joint owner to sell/gift/ rent out (Ijarah) his share in the joint asset or property to the other joint owner(s) or to anyone else, however, this should not affect the right of other joint owner(s). The standard also allows to undertake the purchase of share of other joint owner(s) at face value, book value, agreed value, or market value, however, this undertaking should be independent of the Sharikat ul Milk contract.

The standard allows the assignment of management of the joint asset or property to joint owner(s) or a third party and also permits the remuneration for managing the joint asset. However, it is not permissible for joint owner(s) to use share of other owner without consent.

[3] IBD Circular No. 02 of 2013

This clause explicitly mentions that expenses including taxes, levies, fees related to the joint ownership will be borne by all joint owners in proportion of their ownership. With reference to profit and loss the standard explains that any gain and loss in the jointly owned asset/property due to any reason will be shared by joint owners in proportion of their ownership while it also allows a joint owner in a Sharikat ul Milk to indemnify loss of the other joint owner(s), in case of misconduct, negligence and breach of contract. It is also allowed to stipulate for another joint owner to provide personal guarantee or pledge to cover cases of misconduct, negligence or breach of contract.

ii. ***Withdrawal from or Termination of Sharikat-ul-Milk:*** The standard allows a joint partner to withdraw his share from the joint asset or property after serving a due notice to other joint owner (s) subject to agreement or by mutual consent of joint owners. However, a withdrawal of one or more joint owner(s) shall not lead to the termination of the joint ownership among remaining joint owner(s). The standard explains that the withdrawal can be affected by sale or gift to existing joint owner (s) or to any other person while the parties may agree on face value, book value, agreed value or market value in case of sale. Furthermore it is also allowed under standard that joint owners can agree on the termination of the joint ownership before the agreed period.

The fourth clause of the standard covers rulings related to Diminishing Musharkaha (DM) on the basis of Sharikat ul Milk. The standard defines DM as the joint ownership in asset or property in which any of the joint owners undertakes/promises to buy the ownership share of the other joint owner(s) gradually until the ownership of the joint asset or property is completely transferred to the purchasing joint owner. However, it has been discussed explicitly that all contracts and undertakings in DM arrangement must be independent of each other and must follow the sequence as specified under this standard; Shrikat ul Milk Agreement of joint ownership will be followed by the agreement of Ijarah between the lessor and lessee (both being joint owners) and then an undertaking from any joint owner for Sale or Purchase of share of other joint owner may be given to the other joint owner of selling/purchasing all the shares at a mutually agreed price until the entire ownership of the asset or property is transferred to him. It has also been explained that all other relevant terms and conditions of relevant modes of financing, contracts or agreements are applicable on such DM arrangement. Furthermore, the standard stipulates that the documentation regarding sale of shares by a joint owner to the other joint owner shall be in mutually agreed manner.

With particular respect to case where the ‘joint owner as purchaser’ fails to honor his undertaking with regard to the periodic payment and purchase, the asset may be sold in the open market and the joint owner as seller shall be entitled to recover:

- Actual loss, which is the difference between the market price and price mentioned in the undertaking, if any, not being the opportunity cost.
- In addition to the above, the joint owner shall be entitled to recover outstanding periodic rental payments in respect of the period for which the other joint owner has actually used or possessed the joint asset or property.

This standard on Sharikat ul-milk and Diminishing Musharkaha has been made effective on Islamic banking Industry since July 1, 2013.

Sources:

- Shariah Standards for Islamic Financial Institutions, AAOIFI (2010)
- Website of State Bank of Pakistan (www.sbp.org.pk)
- Usmani, T.M. (2000); An Introduction to Islamic Finance; Idaratul Ma'arif, Karachi

Events and Developments at IBD

Focus Group Meeting & Awareness Session
Held on December 13, 2013 at UET Lahore
Director – Islamic Banking Department (IBD) participated as a guest speaker in an Awareness Session on Islamic Banking & Finance, at University of Engineering and Technology (UET), Lahore on December 13, 2013. The same is in line with IBD's objective of improving awareness of Islamic banking among different segments of society including academia and students. It was arranged as one of the supplementary program along with Islamic Banking Focus Group meeting at SBP-BSC Lahore office, on the same date.

Conference/Seminar on Fundamentals of Islamic Banking
Held on December 02, 2013 at SBP-BSC Quetta
In line with the objective of Islamic Banking Department (IBD) of improving awareness of Islamic finance among various segments of the society, a one day seminar on Fundamentals of Islamic Finance was conducted at SBP-BSC Quetta office on December 2, 2013. Director –IBD participated as a chief guest and the programme was attended by more than 100 participants, representing academia, chamber of commerce & banking industry including both conventional and Islamic banks.

Islamic Banking News and Views

Global Islamic banking assets set to top $2 trillion
Global Islamic banking assets which stood at $1.3 trillion in 2011 are expected to reach $2 trillion in 2014 and have registered an average annual growth of 19 per cent over the last four years, according to the regional head of Thomson Reuters.
http://main.omanobserver.om/?p=17701

Islamic Development Bank to support Africa sovereigns to diversify funding
Islamic Development Bank (IDB) is actively involved in supporting African governments' efforts to diversify funding through Islamic capital markets, said Kodeidja Malle Diallo, director, group risk management department of IDB. Speaking to Gulf News on the sidelines of the second Annual Standard & Poor's Islamic Finance Conference in Dubai, Diallo said, IDB welcomes many African sovereigns' efforts develop regulatory structures and capital market infrastructure in their respective countries.
http://gulfnews.com/business/banking/islamic-development-bank-to-support-africa-sovereigns-to-diversify-funding-1.1238467

IDB to launch Dh37 billion sukuk on Nasdaq Dubai
The Islamic Development Bank (IDB) has announced that it intends to list Dh37 billion sukuk programme on Nasdaq Dubai, the region's international exchange. The announcement was made at the World Islamic Economic Forum being held in London. The IDB, which provides project financing for its 56-member countries, has expanded its sukuk programme to Dh37 billion from Dh24 billion previously, as it increases its financial support for economic and social development.
http://www.khaleejtimes.com/kt-article-display-1.asp?xfile=data/uaebusiness/2013/November/uaebusiness_November33.xml&section=uaebusiness

ADB sees prospects for Islamic finance
Asia needs to invest about $8 trillion in overall national infrastructure, the use of cross-border financing and investment through Islamic finance will help to widen the investor base and lower the cost of

financing for well-structured investments, the Asian Development Bank said. "The outlook for Islamic banking in Asia is bright, given the region's strong economic and financial fundamentals, coupled with growing middle-class affluence and increased awareness of Islamic finance as a mechanism for promoting financial inclusion".
http://www.dawn.com/news/1053696/adb-sees-prospects-for-islamic-finance

Cameron unveils Islamic bond plan
Prime Minister David Cameron has announced that the UK will become the first non-Muslim country to issue an Islamic bond. At the World Islamic Economic Forum (WIEF) in London, he also announced plans for a new Islamic index on the London Stock Exchange. It is intended to attract more Islamic investors by making it clearer which companies match their criteria.
http://www.bbc.co.uk/news/business-24722440

World Bank to open first Islamic finance center in Borsa Istanbul
The World Bank will open its first center on Islamic Finance at Borsa Istanbul premises, the exchange market. Turkey issued its first sukuk, Islamic equivalent of bonds, in September 2012, and this year in the same month Istanbul hosted an international forum on financial systems where the topic of Islamic finance featured prominently.
http://www.aa.com.tr/en/world/245024--world-bank-to-open-first-islamic-finance-center-in-borsa-istanbul#

Global sukuk supply/demand gap to peak in 2014
A gap between global supply and demand for Islamic bonds is likely to peak in 2014 and then shrink gradually for several years as issuance grows, a study by Thomson Reuters predicted. Potential demand for sukuk among cash-rich Islamic investors in the Gulf and Southeast Asia has exceeded supply for at least several years, analysts estimate.
http://www.reuters.com/article/2013/11/20/islamic-finance-sukuk-idUSL5N0J32E620131120

Islamic finance to sustain double-digit growth in next 2 years: S&P
The growth of the Islamic finance market globally has continued unabated this year, undeterred by the uncertain recovery elsewhere in the world's financial markets, according to rating agency Standard & Poor's (S&P). According to (S&P) „Islamic finance 2014: We expect double digit growth and a push for regulation and standards", the agency said that worldwide, Sharia-complaint assets estimated at more than $1.4 trillion were expected to sustain double digit growth in the next two to three years."
http://www.omantribune.com/index.php?page=news&id=156680&heading=Business

Takaful gains popularity in Islamic countries
The Global Islamic Insurance (Takaful) industry made major inroads into the insurance business as it recorded a five-year com-pounded annual growth rate (CAGR) of 33.2 per cent compared to 19.9 per cent achieved by the conventional insurance industry, a recent study by Moody's Investor Services showed. Takaful premiums which exceeded $4 billion in 2007 are expected to reach $20 billion by 2017.
http://gulfnews.com/business/banking/takaful-gains-popularity-in-islamic-countries-1.1259065

PM has decided on Riba-free loans for youth
Maryam Nawaz, Chairperson of the newly-launched Rs100 billion Youth Business Loan scheme, has revealed that the prime minis-ter has decided that these loans will be offered through the Islamic banking system to avoid the un-Islamic practice of Riba/interest. She hoped that it would be the beginning of complete elimination of interest/Riba-based financial system in the country.

http://www.thenews.com.pk/Todays-News-13-27232-PM-has-decided-on-Riba-free-loans-for-youth-Maryam

Govt notifies ten-member committee to promote Islamic Banking

Minister for Finance, Revenue, Economic Affairs, Statistics and Privatization Senator Mohammad Ishaq Dar has announced the constitution of a Ten-member Steering Committee for the promotion of Islamic Banking with Saeed Ahmad, Actuary/Banker as its Chairman. According to a statement of the Finance Ministry Maulana Mufti Muneeb-ur-Rehman, Religious Scholar, Muhammad Imran Usmani, Religious Scholar, Dr Waqar Masood Khan, Secretary Finance, Munir Kamal, Banker, Afaq Khan, Banker, Irfan Siddiqui, Banker, Atif Bajwa, Banker, Mian Muhammad Idrees, Industrialist and Director, Islamic Banking Department, State Bank of Pakistan as its members.

http://www.brecorder.com/top-news/1-front-top-news/148098-govt-notifies-ten-member-committee-to-promote-islamic-banking.html

Articles/Views:

Global sukuk 'set for long-term growth'

While the annual global issuance of sukuk has grown at a compound annual growth rate of 38 per cent to $81 billion in 2012, up from $3.3 billion in 2002, the market is likely to maintain its positive long-term growth trends, a report said. Of the $371 billion of sukuk issued since 2001, $274 billion remains outstanding, added the Islamic Finance report from Moody's Investors Service.

http://www.tradearabia.com/news/BANK_247213.html

Acceptability of Islamic financial instruments

It seems that Islamic financial instruments are not only becoming popular in the Muslim world but are also attracting more attention and gaining wider acceptability in the rest of the world. Addressing the 9th World Islamic Economic Forum (WIEF) in London on 29th October, 2013, British Prime Minister David Cameron announced the introduction of "world first" Islamic Index for the London Stock Exchange as well as plans for Britain to become the first non-Muslim country in the world to issue Islamic bonds.

http://www.brecorder.com/editorials/0:/1248759:acceptability-of-islamic-financial-instruments/

Will the Islamic Finance Industry witness a scandal in 2014?

The Enron scandal, exposed in October 2001, eventually led to the bankruptcy of one of the largest American energy companies and the dissolution of accounting giant Arthur Andersen. Could a similar scenario take place in the heavenly haven of Sharia-compliant finance? According to Laurent Marliere, a professor and expert in Islamic finance, poor risk-management could dramatically hit the new-born Islamic economy.

http://gulfbusiness.com/2013/12/will-the-islamic-finance-industry-witness-a-scandal-in-2014/

Annexure: I

Islamic Banking Branch Network

(As of December 31, 2013)

Type	Name of Bank	No of Branches*
Islamic Banks	AlBaraka Bank (Pakistan) Limited	108
	BankIslami Pakistan Limited	112
	Burj Bank Limited	74
	Dubai Islamic Bank Pakistan Limited	124
	Meezan Bank Limited	349
		767
Islamic Branches of Conventional Banks	Askari Bank Limited	39
	Bank AL Habib Limited	17
	Bank Alfalah Limited	139
	Faysal Bank Limited	53
	Habib Bank Limited	38
	Habib Metropolitan Bank Limited	6
	MCB Bank Limited	27
	National Bank of Pakistan	20
	Silkbank Limited	10
	Soneri Bank Limited	9
	Standard Chartered Bank (Pakistan) Limited	10
	The Bank of Khyber	44
	The Bank of Punjab	7
	United Bank Limited	22
		441
Sub Branches	AlBaraka Bank (Pakistan) Limited	2
	Askari Bank Limited	2
	BankIslami Pakistan Limited	89
	Habib Bank Limited	2
	United Bank Limited	1
		96
		1304

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

Annexure: II

Province wise Break-up of Islamic Banking Branch Network

(As of December 31, 2013)

Type	Bank Name	Azad Kashmir	Balochistan	FATA	Federal Capital	Gilgit-Baltistan	Khyber Pakhtun khwa	Punjab	Sindh	Grand Total
Islamic Banks.	AlBaraka Bank (Pakistan) Limited	1	3		4	1	11	58	30	108
	BankIslami Pakistan Limited	1	10	1	5	2	13	42	38	112
	Burj Bank Limited	1	2		4		3	32	32	74
	Dubai Islamic Bank Pakistan Limited	1	5		6		7	53	52	124
	Meezan Bank Limited	5	11		16		30	165	122	349
	IB. Total	**9**	**31**	**1**	**35**	**3**	**64**	**350**	**274**	**767**
Islamic Branches of Conventional Banks	Askari Bank Limited		2		2	1	6	19	9	39
	Bank AL Habib Limited		1				1	3	12	17
	Bank Alfalah Limited	1	5		8		8	78	39	139
	Faysal Bank Limited		2		3		14	22	12	53
	Habib Bank Limited	2	1	1	3		4	16	11	38
	Habib Metropolitan Bank Limited				1			1	4	6
	MCB Bank Limited		1		2		2	13	9	27
	National Bank of Pakistan	1			1		2	10	6	20
	Silkbank Limited		1		1		2	4	2	10
	Soneri Bank Limited		1		2	1	1	1	3	9
	Standard Chartered Bank (Pakistan) Limited				1		1	2	6	10
	The Bank of Khyber		2	2	1		29	7	3	44
	The Bank of Punjab						4	3		7
	United Bank Limited	1	2		1		4	8	6	22
	SAIBBs Total	**5**	**18**	**3**	**26**	**2**	**78**	**187**	**122**	**441**
Sub Branches	AlBaraka Bank (Pakistan) Limited				1				1	2
	Askari Bank Limited				1				1	2
	BankIslami Pakistan Limited	1	6		8		4	32	38	89
	Habib Bank Limited								2	2
	United Bank Limited						1			1
	Sub Branches Total	**1**	**6**	**-**	**10**	**-**	**5**	**32**	**42**	**96**
Grand Total		**15**	**55**	**4**	**71**	**5**	**147**	**569**	**438**	**1,304**

Annexure: III

District wise Break-up of Islamic Banking Branch Network

(As of December 31, 2013)

S. No	Province	District	No of Branches		S. No	Province	District	No of Branches
1	Sindh	Badin	3		49	Khyber Pakhtunkhwa	Abottabad	12
2		Dadu	3		50		Banu	4
3		Ghotki	1		51		Batagram	3
4		Hyderabad	27		52		Buner	1
5		Jacobabad	1		53		Charsadda	5
6		Jamshoro	1		54		Chitral	3
7		Karachi City	364		55		Dera Ismail Khan	6
8		Larkana	3		56		Hangu	2
9		Matiari	1		57		Haripur	6
10		Mirpurkhas	5		58		Kohat	5
11		Naushero Feroze	1		59		Lower Dir	1
12		Nawabshah	6		60		Malakand	1
13		Sanghar	6		61		Mansehra	12
14		Sukkur	10		62		Mardan	10
15		Tando Allahyar	4		63		Nowshera	5
16		Tando Mohammad Khan	1		64		Peshawar	49
17		Umer Kot	1		65		Shangla	1
Sindh Total			**438**		66		Swabi	5
18	Punjab	Attock	12		67		Swat	9
19		Bahawalnagar	7		68		Tank	1
20		Bahawalpur	4		69		Upper Dir	5
21		Chakwal	6		**KP Total**			**146**
22		Dera Ghazi Khan	6		70	Gilgit-Baltistan	Baltistan	1
23		Faisalabad	52		71		Diamir	3
24		Gujranwala	23		72		Gilgit	1
25		Gujrat	19			**GB Total**		**5**
26		Hafizabad	2		73	**FATA**	Khyber Agency	1
27		Jhang	5		74		Orakzai Agency	3
28		Jhelum	8		**FATA Total**			**4**
29		Kasur	4		75	**Capital**	Islamabad	72
30		Khanewal	9			**Capital**		**72**
31		Khushab	5		76	Balochistan	Chagi	1
32		Lahore City	210		77		Gawadar	1
33		Layyah	1		78		Kila Abdullah	4
34		Lodhran	1		79		Killa Saifullah	3
35		Mandi Bahauddin	1		80		Lasbela	2
36		Mianwali	2		81		Loralai	5
37		Multan	38		82		Pishin	1
38		Muzaffargarh	5		83		Quetta	37
39		Okara	8		84		Zhob	1
40		Pakpattan	3		**Balochistan Total**			**55**
41		Rahim Yar Khan	13		85	**Azad Kashmir**	Mirpur	11
42		Rawalpindi	67		86		Muzaffarabad	3
43		Sahiwal	6		87		Poonch	1
44		Sargodha	13		**AJK Total**			**15**
45		Sheikhupura	9		**Grand Total**			**1304**
46		Sialkot	19					
47		Toba Tek Singh	4					
48		Vehari	7					
Punjab Total			**569**					