

Islamic Banking Bulletin

September 2017

**Islamic Banking Department
State Bank of Pakistan**

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Islamic Banking Industry - Progress & Market Share

Overview

Assets of Islamic banking industry (IBI) increased by Rs. 48 billion during the quarter July to September, 2017 and were recorded at Rs. 2,083 billion compared to Rs. 2,035 billion in the previous quarter. Deposits of Islamic banking industry were recorded at Rs. 1,729 billion by end September, 2017 compared to Rs. 1,720 billion in the previous quarter. Market share of Islamic banking assets and deposits in overall banking industry was recorded at 11.9 percent and 13.7 percent, respectively by end September, 2017 (see **Table 1**). Profit before tax of Islamic banking industry was registered at Rs. 17.6 billion by end September, 2017 compared to Rs. 12.1 billion in the same quarter last year. Other profitability indicators including return on assets (before tax) and return on equity (before tax) were recorded at 1.2 percent and 18.1 percent, respectively.

Particulars	Industry Progress			YoY Growth (%)	Share in Overall Banking Industry (%)		
	Sep-16	Jun-17	Sep-17	Sep-17	Sep-16	Jun-17	Sep-17
Total Assets (Rupees in billion)	1,788	2,035	2,083	16.5	11.8	11.6	11.9
Deposits (Rupees in billion)	1,476	1,720	1,729	17.1	13.3	13.7	13.7
Number of Islamic banking institutions	22	21	21	-	-	-	-
Number of Islamic banking branches*	2,226	2,320	2,368	6.4	-	-	-
Source: Data submitted by banks under quarterly Reporting Chart of Account (RCOA)							
*Including sub-branches							

Branch Network of Islamic Banking Industry

The network of Islamic banking industry consisted of 21 Islamic banking institutions; 5 full-fledged Islamic banks and 16 conventional banks having standalone Islamic banking branches by end September, 2017. Branch network of Islamic banking industry stood at 2,368 branches (spread across 110 districts) by end September, 2017. Province/Region wise breakup of branches shows that Punjab and Sindh accounted for 47.2 percent and 29.7 percent share, respectively, in overall Islamic banking industry's branch network. In terms of cities, 54.6 percent branch network of Islamic banking industry is based in five big cities (Karachi, Lahore, Rawalpindi, Islamabad and Faisalabad). The number of Islamic banking windows operated by conventional banks having standalone Islamic banking branches was recorded at 1,275 by end September, 2017 (see **Annexure I** for details).

Province/Region	Total Number	Share (%)
Punjab	1,117	47.2
Sindh	704	29.7
Khyber Pakhtunkhwa	272	11.5
Baluchistan	99	4.2
Gilgit Baltistan	10	0.4
FATA	9	0.4
Federal Capital	120	5.1
AJK	37	1.5
Total	2,368	100

Asset and Liability Structure

Assets: Assets of Islamic banking industry witnessed growth of Rs. 48 billion during the quarter July to September, 2017 to reach Rs. 2,083 billion compared to Rs. 2,035 billion in the previous quarter. This increase in assets was mainly on account of financing (net) that recorded quarterly growth of 5.9 percent. In contrast, investments (net) of Islamic banking industry declined by 2.3 percent during the review quarter. Market share of Islamic banking industry's assets in overall banking industry's assets increased to 11.9 percent by end September, 2017 compared to 11.6 percent in the previous quarter. The share of net financing and investments in total assets (net) of Islamic banking industry stood at 49.7 percent and 25.2 percent, respectively, by end September, 2017 (see section below on **Investments** and **Financing** for details).

Bifurcation of assets among full-fledged Islamic banks and Islamic banking branches of conventional banks reveals that assets of full-fledged Islamic banks witnessed quarterly growth of Rs. 23 billion during the review quarter to reach Rs. 1,233 billion compared to Rs. 1,210 billion in the previous quarter. Likewise, assets of Islamic banking branches of conventional banks witnessed quarterly growth of Rs. 25 billion and were recorded at Rs. 850 billion compared to Rs. 825 billion in the previous quarter. The share of full-fledged Islamic banks and Islamic banking branches of conventional banks in overall assets of Islamic banking industry was 59.2 percent and 40.8 percent, respectively, by end September, 2017.

Investments

Investments (net) of Islamic banking industry decreased by Rs. 12 billion (2.3 percent) during the period under review and were recorded at Rs. 525 billion by end September, 2017. Breakup of investments (net) among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that investments (net) of full-fledged Islamic banks declined to Rs. 220 billion by end September, 2017 from Rs. 226 billion in the previous quarter. Similarly, investments (net) of Islamic banking branches of conventional banks decreased to Rs. 305 billion by end September, 2017, compared to Rs. 311 billion in the previous quarter.

Financing and Related Assets

Financing and related assets (net) of Islamic banking industry increased by Rs. 58 billion (5.9 percent) during the review quarter and reached at Rs. 1,035 billion compared to Rs. 977 billion in the previous quarter. Bifurcation of financing and related assets (net) among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that financing and related assets (net) of full-fledged Islamic banks grew by 5.1 percent (Rs. 33 billion) during the review quarter and were recorded at Rs. 673 billion by end September, 2017. Financing and related assets (net) of Islamic banking branches of conventional banks showed quarterly growth of 7.3 percent (Rs. 25 billion) and stood at Rs. 362 billion by end September, 2017. Mode wise breakup of financing (gross) shows that share of Diminishing Musharaka remained higher in overall financing of Islamic

	Sep-16	Jun-17	Sep-17
Murabaha	16.9	17.0	14.1
Ijarah	7.8	6.8	8.3
Musharaka	12.0	17.9	21.0
Diminishing Musharaka	38.5	29.6	29.1
Salam	3.3	5.2	3.8
Istisna	7.0	7.2	6.2
Others	14.5	16.3	17.5
Total	100.0	100.0	100.0

banking industry followed by Musharaka and Murabaha (see **Table 3**). It is important to highlight here that share of Musharaka increased to 21 percent by end September, 2017 compared to 17.9 percent in the previous quarter.

In terms of sector wise financing, production & transmission of energy and textile sectors remained two main leading sectors and their share in overall financing of Islamic banking industry stood at 12.9 percent and 11.5 percent, respectively (see **Table 4**).

	Sep-16	Jun-17	Sep-17	Industry
Chemical and Pharmaceuticals	6.3	5.4	5.4	4.1
Agribusiness	3.4	8.5	10.3	9.2
Textile	14.9	11.8	11.5	12.9
Cement	1.9	1.7	1.6	1.3
Sugar	1.9	4.1	3.1	3.4
Shoes and leather garments	0.6	0.4	0.4	0.4
Automobile and transportation equipment	1.5	0.9	0.9	1.5
Financial	0.6	1.1	1.0	3.1
Electronics and electrical appliances	1.3	1.2	1.4	1.4
Production and transmission of energy	16.8	14.2	12.9	14.3
Individuals	13.4	11.7	12.0	9.2
Others	37.5	39.0	39.7	39.1
Total	100.0	100.0	100.0	100.0

Review of client wise financing shows that corporate sector accounted for 71.3 percent share in overall financing of Islamic banking industry followed by commodity financing having 12.3 percent share by end September, 2017 (see **Table 5**). Like previous quarters, the share of small and medium enterprises (SMEs) financing and agriculture financing in overall financing of Islamic banking industry remained low compared to overall banking industry's averages during the period under review.

Sector	Sep-16	Jun-17	Sep-17	Industry
Corporate Sector	79.8	71.1	71.3	69.3
SMEs	3.2	3.2	3.1	6.0
Agriculture	0.7	0.4	0.5	5.0
Consumer Financing	11.8	10.5	10.8	6.8
Commodity Financing	2.8	11.6	12.3	11.0
Others	1.7	3.2	1.9	1.9
Total	100.0	100.0	100.0	100.0

Asset Quality

Asset quality indicators of Islamic banking industry, including non performing finances (NPFs) to financing (gross) and net NPFs to net-financing were recorded at 3.5 percent and 0.7 percent, respectively by end September, 2017. However, provision to NPFs ratio was recorded at 80 percent compared to industry's average of 85.3 percent by end September, 2017 (see **Table 6**).

Ratio	Sep-16	Jun-17	Sep-17	Industry
NPFs to Financing (gross)	4.8	3.7	3.5	9.2
Net NPFs to Net Financing	0.6	0.8	0.7	1.5
Provision to NPFs	88.1	79.6	80.0	85.3

Deposits

Deposits of Islamic banking industry increased by Rs. 9 billion during the period under review and were recorded at Rs. 1,729 billion by end September, 2017. Market share of Islamic banking industry's deposits in overall banking industry's deposits stood at 13.7 percent. Category wise breakup of deposits shows that fixed and saving deposits witnessed growth of Rs. 22 billion and Rs. 2 billion respectively, while, current (non-remunerative) deposits declined by Rs. 26 billion during the period under review (see **Table 7**).

Table 7: Break up of Deposits					
	Rupees in billion			% Growth	
	Sep-16	Jun-17	Sep-17	YoY	QoQ
Customers					
Fixed Deposits	320	330	352	10.0	6.7
Saving Deposits	607	683	685	12.8	0.3
Current accounts – Remunerative	7	9	8	14.3	(11.1)
Current accounts - Non-remunerative	443	581	555	25.3	(4.48)
Others	8	14	11	37.5	(21.4)
Sub-total	1,385	1,617	1,611	16.3	(0.4)
Financial Institutions					
Remunerative Deposits	89	102	107	20.2	4.9
Non-remunerative Deposits	2	1	11	450.1	1,000
Sub-total	91	103	118	29.7	14.6
Total	1,476	1,720	1,729	17.1	0.5

Bifurcation of deposits among full-fledged Islamic banks and Islamic banking branches of conventional banks shows that deposits of full-fledged Islamic banks depicted growth of Rs. 11 billion during the review quarter and stood at Rs. 1,039 billion. On the other hand, deposits of Islamic banking branches of conventional banks declined by Rs. 2 billion and were recorded at Rs. 690 billion by end September, 2017. In terms of share, full-fledged Islamic banks accounted for 60.1 percent share in deposits of Islamic banking industry; while share of Islamic banking branches of conventional banks in overall deposits of Islamic banking stood at 39.9 percent by end September, 2017.

Liquidity

Liquid assets to total assets and liquid assets to total deposits ratios were registered at 28.8 percent and 34.7 percent, respectively, by end September, 2017. Both these ratios witnessed slight decline during the period under review. In contrast, financing to deposits ratio (net) of Islamic banking industry increased to 59.8 percent by end September, 2017 compared to 56.8 percent in the previous quarter (see **Table 8**).

Table 8: Liquidity Ratios (%)				
Ratio	Sep-16	Jun-17	Sep-17	Industry
Liquid Asset to Total Assets	41.8	30.2	28.8	54.5
Liquid Assets to Total Deposits	50.6	35.7	34.7	76.0
Financing to Deposits (net)	46.3	56.8	59.8	48.3

Capital

Capital base of Islamic banking industry was recorded at Rs. 135 billion by end September, 2017 compared to Rs. 134 billion in the previous quarter. Capital to total assets and capital minus net non-performing assets to total assets ratios of Islamic banking industry stood at 6.5 percent and 6.0 percent, respectively, by end September, 2017 (see **Table 9**).

Ratio	Sep-16	Jun-17	Sep-17	Industry
Capital to Total Assets	6.1	6.6	6.5	7.7
(Capital-Net NPAs) to Total Assets	5.8	6.1	6.0	7.1

Profitability

Profit before tax of Islamic banking industry recorded an increase of Rs. 5.4 billion during the period under review and was registered at Rs. 17.6 billion compared to Rs. 12.2 billion in the previous quarter. Profitability ratios like ROA and ROE before tax of Islamic banking industry were recorded at 1.2 percent and 18.1 percent, respectively, by end September, 2017 (see **Table 10**). Like previous quarters, Operating expense to gross income ratio of Islamic banking industry remained higher than that of overall banking industry's average.

Ratio	Sep-16	Jun-17	Sep-17	Industry
Profit Before Tax (Rupees in billion)	12.1	12.2	17.6	112
Return on Assets (before tax)	1.0	1.3	1.2	1.6
Return on Equity (before tax)	15.0	19.1	18.1	19.1
Operating Expense to Gross Income	76.6	68.2	71.0	61.2

Country Model: Maldives

Maldives, whose population of around 400,000 people is dispersed over around 200 islands, has an economy mostly based on tourism and fisheries. Since last few years, Maldives is also making a name for itself in the Islamic finance industry. With a strong commitment from government to position the country as a South Asian hub for Islamic finance and the Halal sector, the country has recently built its Islamic finance industry.

Regulatory Environment

The basic regulatory infrastructure for Islamic finance has been provided by the Government of Maldives. The sector is being regulated by the Maldives Monetary Authority (MMA) and the Capital Market Development Authority (CMDA). Shariah banking falls under Islamic Banking Regulations 2011, overseen by the MMA, while the CMDA has enacted several regulations for the Islamic capital markets including for Sukuk issuance and Islamic securities screening. In 2015, a Zakat bill and regulation for Waqf were also drafted with the assistance of the IDB and the Islamic Research and Training Institute. Due to few legal gaps, the regulators are currently working on developing a more comprehensive and effective regulatory framework.

Banking and Finance

Islamic Finance was first introduced in Maldives in 2005 through a Sri Lankan company, which began offering general insurance products based on Shariah principles. The Maldives Banking Act was passed in 2010, authorizing the MMA to issue regulations relating to the conduct of Islamic banking activities. Pursuant to this mandate, Maldives Islamic Banking Regulations were issued in 2011, which govern the “licensing, financial, prudential, supervisory matters relating to Islamic banking business in the Maldives.” In the same year, the Maldives Islamic Bank was established, the first full-fledged Islamic bank to operate in the country. In 2012, the first-ever Islamic window of a non-banking financial institution, HDFC Amna, a unit of the Maldivian Housing Finance Corp HDFC was introduced to offer musharakah-based home financing instruments. Currently, there are about 13 financial institutions offering Islamic financial services and products in the country.

To drive up the market share of Islamic finance, the government in January 2016 set up a dedicated firm, Khazana Maldives, tasked with developing Shariah finance, as well as established the Maldives Center for Islamic Finance (MCIF) with the objective of making the nation as a hub for Islamic finance and Halal industry for South Asia. The center is a 100% government owned entity, which performs a wide range of functions relating to Islamic finance, including: conducting research, providing product structuring and consultancy services, floating Islamic capital market instruments on the Maldives Stock Exchange, among many others.

Takaful

The history of Maldives’s Islamic finance began in 2005 in the form of Amana Takaful Maldives which offered general insurance products. In 2011, the operator became the first Shariah compliant equity stock to be listed on the Maldives Stock Exchange. The Takaful sector is showing promising signs of growth as in 2014, Allied Insurance Maldives the largest local insurer launched an Islamic window, Ayady Takaful

which partnered with the National Disaster Management Center in 2017 to roll out a new Takaful scheme for natural disasters.

Sukuk

Although Maldives is relatively a new entrant in the area of Islamic finance, it has successfully issued Sukuk. The Government has established a Shariah advisory board and laid the regulatory groundwork for Sukuk investment. In 2013, the first corporate Sukuk in Maldives was issued by Housing Development Finance Corporation Plc which was a 10-year corporate real estate Sukuk raising USD 3.9 million in proceeds for the issuer. This followed a private sovereign Sukuk, Wakalah/ Mudarabah facility using oil trading as an underlying asset.

Future Outlook

Recent years have seen important initial steps towards the development of Islamic finance in Maldives. The country is focusing on developing its Islamic finance talent pool; especially, it has been making collaborative efforts to attract more women into the Islamic finance industry by means of training and research among others. According to Bloomberg, the tourism-dependent island nation is looking to diversify its economy by luring Islamic debt sales and deposits from India, where there is a large Muslim population but no Sukuk or Shariah lenders.

With the promotion of Islamic economy in Maldives, not only Islamic banking and finance will grow but Halal Industry, Halal Tourism and individual power are also expected to expand. Government can get financial resources in the form of Sukuk for its various developmental plans and through Halal Tourism millions of tourists can be attracted towards Maldives. The country, however, would need to make more efforts for creating awareness about Islamic finance in masses.

Sources of Information

- Central Bank of Maldives website <http://www.mma.gov.mv>
- www.islamicfinancenews.com
- <https://www.adb.org/sectors/finance/islamic-finance/country-profiles>
- <https://islamicbanker.com/publications/islamic-finance-in-maldives>
- <https://www.globalbankingandfinance.com/list-of-islamic-banks-in-maldives>

A Brief on IFSB 12: Guiding Principles on Liquidity Risk Management for Institutions offering Islamic Financial Services (excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes)

Background, Purpose and Objectives

Owing to the growing market share of institutions offering Islamic financial services (IIFS) in many jurisdictions and their potential significance for systemic soundness and stability of the overall financial system, the need for a robust liquidity risk management framework for IIFS cannot be overemphasized.

Keeping in view the significance of this subject, the Council of the Islamic Financial Services Board (IFSB), in its 15th meeting in Kuala Lumpur, Malaysia, approved the establishment of a working group to develop a set of Guiding Principles on Liquidity Risk Management for IIFS (hereinafter collectively referred to as the “Guiding Principles”). These guiding principles endeavour to provide a set of principles for the robust management of liquidity risk by IIFS and its vigorous supervision and monitoring by supervisory authorities, taking into consideration the specificities of the IIFS and complementing relevant existing and emerging international best practices. There are 23 guiding principles in the area of liquidity risk management for IIFS (excluding (a) Islamic insurance (Takaful) institutions, and (b) Islamic collective investment schemes).

In previous edition of Islamic Banking Bulletin (June, 2017), the background, purpose and objectives, scope and application of the standard, liquidity risk and its management, necessary elements of effective liquidity risk management in the Islamic financial services industry (IFSI) were discussed. In the present edition, out of the total 23 guiding principles, we will discuss the first 15 principles which relate to general and guiding principles for the IIFS while remaining 10 principles will be covered in next edition of Islamic Banking Bulletin.

Principle 1: General Principle

An IIFS should have in place a sound and comprehensive liquidity risk management framework, integrated into its enterprise risk process, in order to maintain sufficient liquidity to meet its daily funding needs and to cover both expected and unexpected deviations from normal operations for a reasonable time. The IIFS should have an appropriate governance process, including board and senior management oversight, in order to identify, measure, monitor, report and control the liquidity risk in compliance with Shariah rules and principles and within the context of available Shariah-compliant instruments and markets. Supervisory authorities should have a rigorous process for evaluating the liquidity risk management position and framework of IIFS and requiring prompt corrective action in case of any deficiency.

Principle 2: Role of the Board of Directors

The Board of Directors has the ultimate responsibility for setting the level of liquidity risk to be incurred (the liquidity risk tolerance) and the liquidity risk management framework of IIFS. Therefore, it should establish a level of liquidity risk tolerance for the IIFS commensurate with its ability to have sufficient recourse to Shariah-compliant funds in order to mitigate this risk. In line with the stated risk tolerance, the board should establish, approve and review from time to time the liquidity risk management strategy and

significant policies, taking into consideration the IIFS's business model, legal structure, complexity, key lines of business, and macroeconomic and regulatory environment.

Principle 3: Governance Structure and the Role of Senior Management

The governance structure of IIFS should specify the roles and responsibilities of senior management, the Shariah supervisory board, as well as various functional and business units, including that of the risk management department, with appropriate segregation between operational and monitoring functions. The senior management of the IIFS has responsibility for executing the liquidity risk management strategy and policies approved by the board in an integrated manner, while ensuring that liquidity is effectively managed on a regular and timely basis and that appropriate policies and procedures are established to limit and control material sources of liquidity risk.

Principle 4: Identification of Liquidity Risk

An IIFS should be able to identify all sources of primary and secondary risks whether idiosyncratic, market-wide or cross-border that can lead to and interact with its liquidity risk. In particular, the IIFS should be able to model the contractual as well as the behavioural profiles of its investment account holders (IAH), current account holders and other fund providers, in normal and stressed market conditions. In doing so, the IIFS should take account of the effects of any smoothing practices it has adopted in making profit payouts to its IAH, and its possible access to Shariah-compliant deposit insurance.

Principle 5: Interactions of Liquidity Risk and Implications of Islamic Financing Contracts

The IIFS should ensure that liquidity risk management practices are incorporated within a firm-wide, integrated enterprise risk management framework that fully takes into account the interactions between liquidity risk and other risks, including market, credit and operational risk, displaced commercial risk, reputational and Shariah non-compliance risk. This framework should also address liquidity risk arising from various Shariah-compliant financial contracts, either directly due to the nature of the contract or indirectly as a consequence of other risks at any stage during the period of the contract.

Principle 6: Measurement of Liquidity Risk

An IIFS should be able to measure and forecast its prospective cash flows arising from on-and off-balance sheet positions over a variety of appropriate time horizons in different currencies and market conditions, using suitable metrics and methodologies including deterministic, behavioural and statistical modeling, where appropriate. The results of these calculations, along with suitable stress testing and scenarios analysis, should provide a basis for setting thresholds and limits, as well as for making any adjustments in the liquidity risk management strategy, policies and procedures.

Control and Mitigation of Liquidity Risk

Principle 7: Diversified Funding Base

An IIFS should ensure that it has a well-diversified funding base that is commensurate with the nature and size of its business, products offered and market environment. Such diversification should address potential concentrations by providers of liquidity (retail or wholesale), funding types (secured or

unsecured), maturity profile, currencies and geographical locations. The IIFS should test, on a regular basis, its ability to raise funds from each funding source, and make appropriate adjustments in its diversification strategies in anticipation of changes in its internal and external environment. The potential funding base may include, where appropriate, Shariah-compliant securitisation.

Principle 8: Consolidated Management of Liquidity Risk

If an IIFS is part of a financial group (e.g. a fully fledged Islamic bank or Islamic investment bank) or part of a conventional bank (e.g. an Islamic window operation) which has a centralized structure for managing liquidity risk, the board and senior management at the group/parent level should prepare a strategy, policies and procedures for the Islamic operations. This should be done taking into account the position of such operations within the overall group/parent, with due consideration to mutual independencies and constraints in transfers of liquidity on a Shariah-compliant basis between the group entities.

Principle 9: Maintaining a High Quality Liquidity Buffer

An IIFS should maintain a liquidity buffer, composed of cash and other highly liquid Shariah-compliant assets, in order to withstand a prolonged period of potential stress conditions. There should be minimal legal, regulatory or operational obstacles to the sale or pledge of such assets in order to generate funding in a variety of market stress situations. The magnitude and composition of these assets should be in line with the IIFS's risk tolerance and its liquidity requirements as estimated by its stress testing exercises.

Principle 10: Preparing a Contingency Funding Plan

All IIFS, regardless of their nature and complexity, should have a contingency funding plan that delineates the action plan and procedures for dealing with liquidity stress events. Such a plan should be prepared with input from all relevant functions of the IIFS, while carefully incorporating the results from stress tests, including scenario analyses. The plan should establish a clear designation of roles and responsibilities and backup of key functions, with a suitable internal and external communication plan addressing various stages of stress events. The plan should include regular monitoring of related triggers, with appropriate escalation procedures. It should be reviewed as the business and market environment changes.

Principle 11: Managing Shariah-Compliant Collateral

An IIFS should be able to identify its needs for Shariah-compliant collateral over different time horizons, and should address the Shariah, legal and operational constraints on the use of such collateral. The IIFS should actively manage its collateral positions while differentiating between encumbered and unencumbered assets and its information system should be able to identify available unencumbered collateral by type, currency and location, in both normal and stressed times.

Principle 12: Collaboration between IIFS

With due attention to the lack of well-developed Islamic interbank markets for effective liquidity risk management in a number of jurisdictions, IIFS should closely cooperate among themselves in order to develop Shariah-compliant arrangements, solutions and trading mechanisms for liquidity management purposes. Such collaboration may involve Islamic banking industry associations in the jurisdiction. These and other arrangements may be supported by the supervisory authorities in order to provide a robust

platform and harmonised agreements for active trading between the IIFS, with availability of market makers in various trading instruments and mechanisms.

Principle 13: Meeting Payment and Settlement System Obligations

Irrespective of whether an IIFS uses a net or a gross payment and settlement system, it should be able to manage short-term (overnight and intraday) liquidity in order to meet on a timely basis its payment and settlement obligations in all circumstances. In view of the interdependencies and interconnectedness between payment and settlement systems, an IIFS should ensure that its critical payments are always made on a timely basis in order to avoid any potential systemic disruptions which could prevent the smooth functioning of other payment systems and money markets.

Principle 14: Foreign Exchange Liquidity Risk

An IIFS should have a measurement, monitoring and control mechanism for liquidity positions in each currency with a significant exposure. An IIFS should assess, monitor and, where appropriate, limit the size of its cash-flow mismatches over particular time horizons for foreign currencies in aggregate and for each significant individual currency in which it operates, especially with respect to its domestic currency (or, where different, its functional currency). The IIFS should employ appropriate stress tests and make use of Shariah-compliant hedging strategies for limit setting and controlling currency risk. The IIFS should especially limit its exposures in currencies that are not highly liquid or have low convertibility.

Principle 15: Reporting and Disclosure of Liquidity Risk

An IIFS should have a fully integrated information system, commensurate with its nature, size and complexity of operations, that provides clear, timely and accurate liquidity risk reports to its relevant functional units and senior management. The information system should, at suitable intervals, present to senior management and the board a clear understanding of the IIFS's liquidity risk exposures, its compliance with established policies and limits, as well as the appropriateness of management strategies with respect to approved risk tolerance. The IIFS should make appropriate and regular disclosures of qualitative and quantitative information about its liquidity position and liquidity risk management practices through suitable channels.

Source:

IIFS website <http://www.ifs.org/>

Events and Developments at Islamic Banking Department (IBD)-SBP

A. Events

- **Capacity Building Workshops under collaborative arrangement between SBP and COMSATS**

Islamic Banking Department (IBD), in collaboration with Centre of Islamic Finance (CIF), COMSATS Institute of Information Technology (CIIT) has planned to hold six capacity building workshops on Islamic banking & finance in various cities. In this regard, second and third workshops were arranged during May 17-18 and August 16-17, 2017 at Attock and Wah Cantt, respectively. The said programs were attended by around 160 participants comprising of local Shariah scholars, staff of Islamic banking institutions and academia from CIIT.

- **Young Leaders' Summer Camp on Islamic Finance by IBA CEIF-Visit to SBP Museum and Art Gallery**

As part of Young Leaders' Summer Camp on Islamic Finance, Centre of Excellence in Islamic Finance (CEIF)- Institute of Business Administration (IBA) organized a visit of respective participants to Museum and Art Gallery Department, SBP on July 26, 2017. In this regard, Mufti Irshad Ahmad Aijaz, Chairman Shariah Board-BankIslami Pakistan Limited graced the visit as guest speaker and responded to queries by visiting participants. IBD facilitated CEIF- IBA in the said visit.

- **Islamic Banking and Finance Awareness - Event at FPCCI**

Dunya Media Group initiated an awareness drive earlier this year wherein they held 13 sessions with universities and chambers of commerce & industries at various cities like Peshawar, Islamabad, Lahore, Multan, Quetta and Karachi. IBD facilitated and supported Dunya Media Group throughout the awareness drive besides participation of SBP officials as speakers/ chief guests. The program titled "Dunya Islamic Banking & Finance Awareness Drive- 2017" was held at FPCCI, Karachi on July 28, 2017 and was attended by senior SBP officials, bankers and business community, while Mr. Jamil Ahmad, Deputy Governor graced the occasion as chief guest.

- **Islamic Banking & Finance Awareness- Mega Event at Karachi**

The concluding event of the awareness drive launched by Dunya Media Group was held on August 03, 2017 at Movenpick Hotel, Karachi. The opening session of the event was graced by Mr. Tariq Bajwa, Governor- SBP as Chief Guest, while Mr. Jameel Ahmad, Deputy Governor- SBP chaired the concluding session. The program was attended by eminent personalities of Islamic finance industry of Pakistan like Presidents/ CEOs of IBIs, experts on Islamic banking, practitioners, Shariah scholars and students of Islamic finance.

B. Developments

- **IBD Circular No. 01 of 2017 ‘Guidelines for Conversion of a Conventional Bank into an Islamic Bank’**

In order to promote Islamic banking and facilitate the process of conversion of an existing conventional bank into an Islamic bank, SBP issued detailed guidelines vide IBD Circular No. 01 dated July 06, 2017. The guidelines include eligibility criteria, necessary measures and the process of conversion comprising of three stages: i) In-principle approval to start conversion process, ii) Conversion of existing conventional banking branches into Islamic banking branches and iii) Issuance of full-fledged Islamic Bank license.

These guidelines are a step forward in the existing policy framework for Islamic banking institutions including detailed criteria for establishment of full-fledged Islamic banks, Islamic banking subsidiaries, Islamic banking branches/ division and Islamic banking windows by conventional commercial banks.

Islamic Banking News and Views

A. Local Industry News

Islamic agri. financing becomes key focus

The State Bank of Pakistan Governor Tariq Bajwa has called on Islamic banks to increase their focus on Islamic agricultural financing, noting the huge scope and demand for the product. Addressing financial institutions in an Agricultural Credit Advisory Committee meeting recently, Tariq stressed the need for financial institutions to disburse a total of Rs 1 trillion (US\$9.48 billion) loans to agriculture sector in FY 2017-18 (during FY 2016-17, Rs 700 billion (US\$6.63 billion) were disbursed), increase financial inclusion of smallholder farmers, rationalize mark-up rates on agricultural financing to pass on the benefit of a historically low discount rate and increase the banking sector's footprint in underserved regions.

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FBR updates tax rates on Sukuk

The Federal Board of Revenue (FBR), in its updated withholding tax rate card for 2017-18, said that an SPV and a company are required to deduct withholding tax from Sukuk holders on the payment of the gross amount of return on investment at the time of actual payment under Section 150A of Income Tax Ordinance, 2001. The rate of withholding tax on the payment of return on investment in Sukuk is 15% if the Sukuk holder is a company; 12.5% if the Sukuk holder is an individual or an association of person, if the return on investment is more than one million; 10% if the Sukuk holder is an individual and association of person, if the return on investment is less than one million; and 17.5% if the Sukuk holder is a non-filer.

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SECP sets up new fund

The Securities and Exchange Commission of Pakistan (SECP) has formed the Investor Education and Awareness Fund dedicated to raising awareness and educating investors on the Pakistani capital market, according to a media release. The new fund is being created under the requirement of the Companies Act 2017 (the Act). Under Section 244 of the Act, any shares and Modaraba certificates as well as dividends that are unclaimed over three years will be vested with the federal government; the SECP will sell these unclaimed investments, proceeds of which will go to the federal government and credited to the new fund.

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Summit Bank approves merger

Summit Bank's board of directors has approved the amalgamation of the bank with and into Sindh Bank, which offers Shariah compliant solutions, under Section 48 of the Banking Companies Ordinance, 1962, according to a bourse filing. The merger is subject to all applicable regulatory approvals. As a consequence of this proposed amalgamation, one ordinary share of Sindh Bank is proposed to be issued for every 3.85 ordinary shares of Summit Bank.

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SECP and PSX release survey on Sukuk

A survey of listed companies included in the KSE 100 Index by the Securities and Exchange Commission of Pakistan (SECP) and the Pakistan Stock Exchange (PSX) indicates that only a minority of companies had considered floating Sukuk in the last five years. A majority of the respondents (90%) indicated interest to attend a seminar focused on the CFOs of listed companies to learn how best they can raise capital by issuing Sukuk. The SECP and the Federal Board of Revenue have rolled out a series of reforms removing the tax and compliance disadvantages which were previously faced by the issuers in issuing Sukuk. The SECP will also be organizing seminars focused on companies to help develop the Sukuk market.

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Bank Alfalah to expand to UAE

Bank Alfalah, which provides Islamic banking solutions, has been granted a license to establish a wholesale banking branch and to conduct business in Dubai by the Central Bank of the UAE. According to a statement, the branch will be opened in due course pending the completion of formalities.

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NBP to offer Islamic product under PMYBL

National Bank of Pakistan (NBP) is likely to launch the Prime Minister Youth Business Loan (PMYBL) scheme under its Islamic banking division within a month to attract faith-based customers, The News reported quoting Saeed Ahmad, the bank's CEO and president. "The upcoming product will make the National Bank of Pakistan the first bank to offer a Shariah compliant product under the Prime Minister Youth Business Loan scheme," he said. NBP will also open at least two branches to launch its banking operations in China in a bid to expand its footprint in China's market and to finance projects related to the China-Pakistan Economic Corridor. However, he did not mention if the branches will offer Shariah compliant solutions.

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Silk Bank to amp up Islamic Banking

Silk Bank plans to expand its Islamic banking business amid growing demand for Shariah compliant financial products in Pakistan, The News International reported quoting Shaukat Tarin, the advisor to the bank's chairman. At least 50% of all new branches are expected to be Islamic in the next three to five years. The bank could also clearly separate its operations into Islamic and conventional banking in the near future.

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B. International Industry News

IIFM publishes Sukuk report

Approximately US\$66 billion worth of global Sukuk, with an issuance size of at least US\$100 million and with a tenor of more than a year, will mature over 2017-18, according to the International Islamic Financial Market (IIFM) which expects a significant portion of these to be refinanced through Sukuk. In its latest annual Sukuk report, the standard-setting body noted that US\$88 billion was raised through Sukuk in 2016, up 44% from US\$61 billion in 2015. Malaysia, Saudi Arabia, the UAE and

Indonesia accounted for 86% of the US\$367 billion outstanding Sukuk while Turkey, Pakistan and Africa are expected to gradually increase their market share in the coming years.

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LIBOR to cease

Andrew Bailey, CEO of the Financial Conduct Authority, revealed in a speech that the LIBOR benchmark will be phased out by the end of 2021. The global benchmark, underpinning trillions in financial products including Sukuk, will be replaced with measures more aligned with the lending markets.

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SRB introduces express Shariah review

Shariyah Review Bureau (SRB) has announced via a press release that it has launched the Express Shariah Review service, an initiative to ensure that the reviewing of financial institutions' product and fund documentation is done efficiently in terms of time and cost. SRB's 31 scholars in 16 countries will be involved in the initiative.

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Kerala set to see its first Islamic bank

The Communist Party of India-Marxist (CPM) is set to launch the first Islamic bank in Kerala, according to Asianet News Network. The cooperative bank is named 'Halal Fayida Coop Society' and will be located in Kannur. The CPM's move to set up an Islamic bank is to lure the Muslim minority to the party. The CPM wants the bank to function under cooperative banking laws as the state government will have the power to take decisions.

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Cambodia welcomes Islamic finance

Malaysia's Amanah Ikhtiar Malaysia (AIM) and Yapeim, both Shariah compliant, are expected to open branches in Cambodia soon, according to Khmer Times. AIM plans to launch by the end of the year whereas Yapeim is expected to open its branch in 2018. At present, Cambodian Muslims are having trouble accessing the Kingdom's financial services as paying interest is not allowed under Islamic law. Cambodian Prime Minister Hun Sen has approved the replacement of interest with a 'fee charge' for Muslims accessing financial services. The matter, which will be under the supervision of the Ministry of Economy and Finance, will see the term 'interest rate' changed to 'loan service fee' ranging from 1-1.3% per month.

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IDB calls OIC members to collaborate

The president of the IDB, Dr Bandar Hajar, has stressed the need for joint collaborations among OIC member countries to address poverty, youth unemployment and fragility. According to a press release, he stated that the problem can be tackled by developing special programs for the advancement of youth population, boosting quality of education, establishing business incubators to encourage youth involvement in entrepreneurship and facilitating financing for SMEs, among others. The IDB is currently reviewing its projects in member countries to ensure that they promote entrepreneurship and capacity-building.

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Indonesia takes big step towards boosting Islamic finance industry

The world's most populous Muslim nation, so far a laggard in developing a comprehensive Islamic finance industry, took a big leap towards the creation of a supportive framework for Shariah-compliant banking on July 27. It was the day when the country's President Joko Widodo inaugurated the National Committee for Shariah Finance, or KNKS for its abbreviated Indonesian name, as part of the government's push to make Indonesia a global hub for the Islamic financial industry. The KNKS has been tasked to accelerate, expand and develop Shariah-compliant financial services to support the country's development.

<http://www.gulf-times.com/story/558660/Indonesia-takes-big-step-towards-boosting-Islamic->

CBN authorizes two Islamic microfinance banks

The Central Bank of Nigeria (CBN) has granted operational licenses to two non-interest microfinance banks, namely Tijarah Microfinance Bank in Bauchi State and I-Care Microfinance Bank in Kano State, Leadership reported. A third company in Ibadan is awaiting the CBN's final approval.

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Nigeria to offer liquidity support to boost Islamic banking

Nigeria's central bank said it is setting up two financial instruments to provide liquidity support to its non-interest paying lenders. It is a push by Nigeria, home to the largest Muslim population in sub-Saharan Africa, to establish itself as the African hub for Islamic finance, which follows religious principles such as bans on interest and gambling. The central bank has been working to set regulatory ground rules for such things as Islamic bonds (sukuk) and insurance (takaful) to try to emulate the success of the industry in Malaysia. Nigeria's banking industry is dominated by lenders offering conventional products.

<https://af.reuters.com/article/commoditiesNews/idAFL8N1LA5EX>

C. Articles & Views

Standardization in the Islamic finance industry

In order to further deepen the outreach by bringing greater transparency that leads to better understanding, Islamic finance undoubtedly requires some form of standardized Islamic financial contracts and product templates. Standards are essential to lay down some ground rules that ultimately allow the market to have confidence in adopting these standards and at the same time to provide a level playing field to all the market participants particularly to financial institutions.

www.islamicfinancenews.com

Islamic banking: an ethical alternative to the conventional financial system

Islamic finance is an unconventional financial system which has witnessed impressive growth over the last decade. Global Islamic investments have increased by 150 percent since 2006, and according to estimates, the sector is growing 50 percent faster than the overall banking sector. However, despite this major milestone, this year's Global Islamic Economy report revealed that Islamic finance is still very little known by the general public, Muslims and non-Muslims.

<https://www.standard.co.uk/news/islamic-banking-an-ethical-alternative-to-the-conventional-financial-system-a3583031.html>

Why growth in Islamic banking will slow in the coming years?

Analysts at BMI Research expect growth in Islamic banking to be slow over the coming years, as lower-for-longer oil prices continue to weigh on the economic outlook of the Gulf Cooperation Council (GCC) countries, which account for more than two thirds of total Islamic banking assets.

<http://asianbankingandfinance.net/islamic-banking/news/heres-why-growth-in-islamic-banking-will-slow-in-coming-years>

To grow Islamic finance, we need to minimize contractual uncertainty

Reliable and efficient contract enforcement is essential for a successful economy. When you compare countries, those which have courts with independent, well trained and non-corrupt judiciaries are on average much more successful economically than those countries which do not. That is why the World Bank in its annual ‘Doing Business: Measuring Regulatory Quality and Efficiency’ publication has a section on enforcing contracts, and gives a score for every country covered in the survey.

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Using the SDGs to catalyze more impactful action in OIC member countries

During a recent meeting, UN Deputy Secretary-General Amina Mohammed and IDB President Dr Bandar Hajjar discussed collaboration between those two organizations around the UN Sustainable Development Goals (SDGs). When speaking to the media, Amina commented that: “We need US\$3-4 trillion a year to invest globally, but now we are talking in millions”. She went on to explain a few areas where the IDB in particular was focusing its efforts relating to the goals: infrastructure, smart agriculture, renewable energy and clean energy while also emphasizing the importance of youth participation, especially by women, to meet the goals.

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Challenges for the Pakistani takaful industry

For the past 10 years, the takaful industry in Pakistan has been growing consistently at the average rate of 15% annually. The life insurance industry grew at 16% while non-life insurance grew at 6% in 2014. Like any developing country, the conventional insurance industry is predominant at all levels across Pakistan. As such, the takaful industry has to face severe challenges in order to gain ground and expand market coverage.

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Corporate Sukuk: issues and challenges

Corporate Sukuk has been going through an interesting phase during this period. While global Sukuk issuance stood at around US\$74 billion in 2016, corporate Sukuk issuance was around 63% or US\$47 billion of total issuance. Experts opine that this is considered higher than the typical overall Sukuk issuance where sovereign Sukuk tend to have a larger market share as governments want to finance their budget deficits during this period of global economic slowdown.

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Islamic finance- surviving innovation

In some jurisdictions, Islamic finance has been emulating the conventional financial services sector including banking, wealth management and insurance but its most prominent demand, and perhaps most authentic service offering, is investment activities, with funds and portfolios around the globe being structured to attract investors looking for Shariah/ethical investments. Innovation has great opportunity in this segment as investment activities, where profits and losses are shared, are the most in line with Shariah compliance.

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Shariah compliant structures in asset finance

The IFSB's Islamic Financial Services Industry Stability Report, published earlier this year, put the value of the global Islamic financial services industry at some US\$1.88 trillion and growing, with the GCC contributing over US\$744 billion to this global figure. There is an increasing pool of liquidity in this market and it is becoming more common to see a greater variety of entities providing this finance, in addition to the regulated banks (for example, financiers that are not authorized lenders/to act as a 'lender of record', such as private equity houses, Shariah compliant funds and such).

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Aviation and marine financing: big potential, small market share

Due to the emergence of middle classes in developing countries, globalization and containerization, the aviation and marine industries have become very healthy over the past few years. Despite players of both markets mainly financing their development through conventional products, the rise of new players in the Middle East, Asia and Africa offers real opportunities for Shariah compliant financial institutions.

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Annexure: I

Islamic Banking Branch Network

(As of September 30, 2017)

Type	Name of Bank	No of Branches	Windows
Islamic Banks	AlBaraka Bank (Pakistan) Limited	177	-
	BankIslami Pakistan Limited	204	-
	Dubai Islamic Bank Pakistan Limited	200	-
	Meezan Bank Limited	571	-
	MCB Islamic Bank Limited	68	-
	Sub-Total	1,220	
Standalone Islamic Banking Branches of Conventional Banks	Allied Bank Limited	84	-
	Askari Bank Limited	91	-
	Bank AL Habib Limited	49	110
	Bank Alfalah Limited	151	121
	Faysal Bank Limited	168	-
	Habib Bank Limited	45	495
	Habib Metropolitan Bank Limited	28	214
	National Bank of Pakistan	150	-
	Silk Bank Limited	10	-
	Sindh Bank Limited	14	13
	Soneri Bank Limited	18	-
	Standard Chartered Bank (Pakistan) Limited	9	88
	Summit Bank Limited	14	35
	The Bank of Khyber	83	39
	The Bank of Punjab	53	-
	United Bank Limited	47	160
	Sub-Total	1014	1,275
	Total Branches	2,234	-
Sub Branches	AlBaraka Bank (Pakistan) Limited	8	-
	Askari Bank Limited	3	-
	BankIslami Pakistan Limited	118	-
	The Bank of Punjab	2	-
	Habib Bank Limited	2	-
	United Bank Limited	1	-
	Total Sub-Branches	134	-
	Grand Total Branches/Sub-Branches	2,368	1,275

Source: Information/Data obtained from different banks

Province/Region wise Break-up of Islamic Banking Branch Network

(As of September 30, 2017)

Type	Bank Name	Azad Kashmir	Balochistan	FATA	Federal Capital	Gilgit-Baltistan	Khyber Pakhtunkhwa	Punjab	Sindh	Grand Total
Islamic Banks	AlBaraka Bank (Pakistan) Limited	3	6	-	6	1	16	98	47	177
	BankIslami Pakistan Limited	3	12	-	9	2	17	90	71	204
	Dubai Islamic Bank Pakistan Limited	7	5	-	11	-	8	85	84	200
	Meezan Bank Limited	6	19	-	30	2	36	288	190	571
	MCB Islamic Bank Limited	-	9	1	3	-	8	27	20	68
	Islamic Banks	19	51	1	59	5	85	588	412	1,220
Standalone Islamic Banking Branches of Conventional Banks	Allied Bank Limited	1	3	-	4	-	8	49	19	84
	Askari Bank Limited	-	3	-	8	1	13	46	20	91
	Bank AL Habib Limited	-	2	-	2	-	3	17	25	49
	Bank Alfalah Limited	1	5	-	10	-	8	89	38	151
	Faysal Bank Limited	2	10	1	7	1	23	88	36	168
	Habib Bank Limited	2	1	1	4	-	4	23	10	45
	Habib Metropolitan Bank Limited	-	-	-	1	-	6	8	13	28
	National Bank of Pakistan	8	5	2	3	-	28	78	26	150
	Silk Bank Limited	-	1	-	1	-	2	4	2	10
	Sindh Bank Limited	1	1	-	-	-	2	7	3	14
	Soneri Bank Limited	-	1	-	2	1	2	8	4	18
	Standard Chartered Bank (Pakistan) Limited	-	-	-	1	-	1	1	6	9
	Summit Bank Limited	-	1	-	2	2	1	2	6	14
	The Bank of Khyber	-	4	4	2	-	60	10	3	83
The Bank of Punjab	1	-	-	4	-	8	40	-	53	
United Bank Limited	1	4	-	1	-	11	14	16	47	
	Islamic Banking Branches Total	17	41	8	52	5	180	484	227	1,014
Sub Branches	AlBaraka Bank (Pakistan) Limited	-	-	-	1	-	-	1	6	8
	Askari Bank Limited	-	1	-	-	-	1	1	-	3
	BankIslami Pakistan Limited	1	6	-	8	-	5	41	57	118
	Faysal Bank Limited	-	-	-	-	-	-	-	-	-
	Habib Bank Limited	-	-	-	-	-	-	-	2	2
	The Bank of Punjab	-	-	-	-	-	-	2	-	2
	United Bank Limited	-	-	-	-	-	1	-	-	1
	Sub Branches Total	1	7	0	9	0	7	45	65	134
	Grand Total	37	99	9	120	10	272	1,117	704	2,368

District wise Break-up of Islamic Banking Branch Network

(As of September 30, 2017)

S. No	Province	District	No of Branches*		S. No	Province	District	No of Branches*
1	Sindh	Badin	2		58	Khyber Pakhtunkhwa	Abbottabad	20
2		Dadu	6		59		Bannu	5
3		Ghotki	3		60		Batagram	3
4		Hyderabad	49		61		Buner	3
5		Jacobabad	4		62		Charsadda	9
6		Jamshoro	2		63		Chitral	5
7		Karachi City	573		64		Dera Ismail Khan	11
8		Khairpur	2		65		Hangu	4
9		Larkana	5		66		Haripur	6
10		Matiari	1		67		Karak	1
11		Mirpurkhas	10		68		Kohat	7
12		Naushahro Feroze	1		69		Lakki Marwat	1
13		Shaheed Benazir Abad	11		70		Lower Dir	11
14		Sanghar	10		71		Malakand	12
15		Shikarpur	1		72		Mansehra	11
16		Sukkur	14		73		Mardan	18
17		Shahdadkot	1		74		Nowshera	16
18		Tando Allahyar	4		75		Peshawar	87
19		Tando Mohammad Khan	1		76		Shangla	4
20		Thatta	1		77		Swabi	6
21		Umer Kot	3		78		Swat	26
				79	Tank	1		
				80	Torghar	1		
				81	Upper Dir	4		
	Sindh Total		704					
22	Punjab	Attock	15		81			
23		Bahawalnagar	11					
24		Bahawalpur	20			Khyber Pakhtunkhwa Total		272
25		Bhakkar	1		82	Gilgit-Baltistan	Skardu	1
26		Chakwal	12		83		Diamir	5
27		Chiniot	4		84		Gilgit	4
28		Dera Ghazi Khan	9			Gilgit-Baltistan Total		10
29		Faisalabad	94		85	FATA	Bajaur Agency	1
30		Gujranwala	51		86		Khyber Agency	5
31		Gujrat	44		87		Mohmand Agency	1
32		Hafizabad	4		88		Orakzai Agency	2
33		Jhang	10			FATA Total		9
34		Jhelum	15		89	Federal Capital	Islamabad	120
35		Kasur	14				Capital Total	
36		Khanewal	15			Balochistan	Chaghi	1
37		Khushab	4		90		Gawadar	3
38		Lahore City	381		91		Harnai	1
39		Layyah	6		92		Turbat	1
40		Lodhran	5		93		Khuzdar	1
41		Mandi Bahauddin	10		94		Lasbela	5
42		Mianwali	7		95		Loralai	5
43		Multan	60		96		Pishin	6
44		Muzaffargarh	7		97		Quetta	59
45		Nankana Sahib	4		98		Qilla Abdullah	6
46		Narowal	6		99		Qilla Saifullah	4
47		Okara	13		100		Zhob	6
48		Pakpattan	7		101		Ziarat	1
49		Rahim Yar Khan	29		102			
50		Rajanpur	3					
51		Rawalpindi	124					
52		Sahiwal	23			Balochistan Total		99
53		Sargodha	25		103	Azad Kashmir	Bagh	1
54		Shekhupura	17		104		Bhimber	1
55	Sialkot	36		105	Dadyal		4	
56	Toba Tek Singh	14		106	Hattian Bala		1	
57	Vehari	17		107	Kotli		3	
				108	Mirpur		16	
				109	Muzaffarabad		9	
				110	Poonch	2		
					Azad Kashmir Total		37	
	Punjab Total		1,117		Grand Total		2,368	

*including sub-branches