

Facilitation in conversion of conventional banking branches into Islamic banking branches

With a view to further facilitate banks in conversion of their branches, SBP has revised criteria for conversion of conventional banking branches into Islamic banking branches keeping in view the industry's needs and issues emerged from time to time. The revised criteria are as under:

A. Eligibility

All conventional banks having Islamic operations or those who intend to start Islamic banking operations shall be eligible to apply for conversion of its existing conventional branches into Islamic.

B. Applicable Fee

No licensing fee shall be applicable on conversion of conventional branches into Islamic.

C. Submission of Application

The bank shall submit its Annual Branch Conversion Plan (ABCP) aligned with its overall conversion plan along with a specific request for in-principle approval to convert its conventional branches into Islamic to Banking Policy & Regulations Department (BPRD) with a copy to Islamic Finance Policy Department (IFPD), SBP by 31st October of each preceding calendar year. Besides ABCP, bank may also approach SBP for approval of conversion of its conventional branches any time on a case to case basis.

Following information/documents shall be submitted to SBP for seeking in-principle approval for the conversion of branches:

- i. Identification of proposed branch(es) for conversion.
- ii. Plan for transfer of conventional assets or liabilities of those account holders who do not wish to convert to Islamic banking and other unconvertible portfolio to:
 - a) other conventional branches, or
 - b) a virtual conventional cost centre (IT based solution to segregate conventional portfolio of the branch) on temporary basis for 01-year period with effect from date of Islamic banking branch license issued by SBP (details of virtual conventional cost centre are in Para F (a) below).

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- iii. Details of systems and controls in place for segregation of conventional funds and the funds mobilized under Islamic modes at converted branches.
- iv. Plan for proper orientation and training of staff of the branches to be converted into Islamic.
- v. Timeline to start and complete the conversion process.
- vi. Any other requirements specified by the Shariah Board to ensure Shariah compliance during the conversion process.

D. Procedure for Conversion of Conventional Accounts into Shariah Compliant Accounts

The bank shall take following steps including provision of mandatory information and disclosures to the customers:

- i. The bank shall inform the general public and account holders about conversion of its respective conventional branches into Islamic at least three and a half months before the conversion, in the following ways:
 - a) Publication of notices in leading newspapers (both in Urdu and English)
 - b) Display of notices in all branches
 - c) Notice on bank's website or by any other banking channel used by account holders
- ii. The bank shall also approach account holders for seeking their consent for conversion of accounts through any appropriate channel such as letters, emails, SMS, telephone calls, any digital mode, etc. However, the bank shall provide at least thirty (30) days to the account holders for submission of consent or dissent on conversion of their accounts.
- iii. The bank shall ensure that the account holders are fully informed with new terms and conditions and any change in fee or paid services provided by the bank after conversion from conventional accounts to Islamic accounts.
- iv. The bank shall ensure that account holders are fully informed about alternative Islamic banking products including their features while providing an option for conversion.
- v. The bank shall share Frequently Asked Questions (FAQs) on Islamic banking with account holders, while approaching them for conversion of accounts.

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- vi. The bank shall provide clear information regarding expected profit rate(s) on each category of remunerative Islamic deposits.
- vii. In case of consent by the account holders, the accounts will be converted from conventional to Islamic whereas in case of dissent of the account holders on conversion of accounts, the bank may either allow transfer of their accounts to another conventional banking branch or close the accounts as per choice of the account holders.
- viii. If no response is received from the account holders, the bank may convert such current accounts based on the deemed consent as explained in Para 'E' below; however, the saving/fixed accounts where no response is received from the customer, shall either be parked in the virtual cost centre, details of which are given at Para F (a) or transferred to the nearest conventional branch under intimation to the customer.

E. Conversion of Current Accounts of Individuals based on Deemed Acceptance Basis¹

The bank may use deemed acceptance approach for conversion of current accounts of individuals with approval of its Shariah Board and clearance from the bank's legal counsel. However, the bank shall ensure following:

- i. The bank shall exhaust all possible avenues to approach the account holders for seeking their consent regarding the conversion of accounts. The bank will put in maximum efforts to approach all the account holders/customers through letters, emails, SMS, telephonic calls or any other appropriate means for seeking their consent regarding the conversion.
- ii. The bank shall provide necessary information and disclosures to the customers for conversion as mentioned above.
- iii. The bank shall send notice(s) to the account holders at least '2' times with a 30 days interval, before the effective date of conversion (both in English & Urdu languages). The last notice about changes in terms and conditions including cut-off date(s) for conversion of account on deemed acceptance basis, shall be given to the account holders at least 30 days before the effective date of conversion.

¹ Deemed acceptance means automatic conversion of current accounts from conventional to Islamic after exhausting all measures for seeking customer's consent as specified in this document

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- iv. The bank shall ensure mitigation of potential legal risk which may arise from conversion of conventional accounts into Islamic on deemed acceptance basis.
- v. The bank shall ensure that no account of a non-Muslim customer is converted from conventional to Islamic unless consented explicitly.
- vi. The bank shall not convert accounts under litigation, accounts of deceased persons, accounts involved in any dispute and accounts which are dormant/inactive.
- vii. Conversion methodology on deemed acceptance basis shall not be applicable on saving & fixed accounts, conversion of loan/financing portfolio and other than individuals' accounts.

F. Other Regulatory Instructions

a) Establishment of Virtual Cost Centre(s)

In order to further facilitate and accelerate the conversion of branches, banks may establish a virtual conventional cost centre(s) on a temporary basis to park unconvertible deposits and asset portfolio of converted branches with the approval of bank's Shariah Board. However, the bank shall ensure compliance with the following:

- i. A virtual conventional cost centre can be established on need basis for each branch proposed to be converted (IT based solution to segregate conventional portfolio of the branch) on temporary basis for 01-year period with effect from date of Islamic banking branch license issued by SBP. The bank shall ensure conversion or transfer of outstanding unconvertible portfolio to mapped conventional branches by end of this period.
- ii. The virtual conventional cost centre(s) shall only be used for managing existing conventional business. No new business or enhancement in the existing business or roll over of conventional assets would be allowed through virtual cost centre(s).
- iii. The bank shall ensure that proper systems and controls are in place at converted Islamic banking branches to ensure segregation of funds and to deal with conventional unconvertible portfolio.
- iv. The bank shall prepare and put in place Standard Operating Procedures (SOPs) duly vetted by its Shariah Board in order to guide branches/staff(s) in handling of unconverted portfolio parked in virtual cost centre(s).

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- v. The bank shall ensure that dissented customers/accounts are shifted to the adjacent conventional branches rather than the virtual conventional cost centre(s).

b) Collaterals/Securities Management

In case of collateral/security held against conventional loans at converted Islamic banking branches, the bank may keep collaterals/securities against booked assets of the converted Islamic branch or any adjacent branch for 01-year period with effect from date of Islamic banking branch license issued by SBP. The bank shall ensure existence and provision of Shariah Board approved Service Level Agreement (SLA) between Islamic and conventional side, which should include inter alia clear roles and responsibilities of the authorized official/staff to perform activities related to custodian function.

c) Reporting Line

With a view to facilitate expansion of Islamic banking and allow flexibility in prioritizing this segment, Islamic banking branches and related business functions may report to the conventional side under any suitable reporting structure keeping in view the size and operations of the bank. However, the bank shall ensure compliance with following requirements:

- i. The bank shall seek approval of the reporting structure from their Shariah Board and Board of Directors (BoD) before implementation.
- ii. The bank shall have Shariah Board and BoD approved SLA that clearly defines roles and responsibilities of both conventional and Islamic sides.
- iii. The bank shall provide appropriate training in the area of Islamic banking and finance on a continuous basis to staff of conventional side.
- iv. The Head-Islamic banking will continue to report directly to the President/CEO.

d) Compliance & Audit

- i. For smooth conversion of conventional branch(es) into Islamic, the bank shall designate a relevant senior official to oversee and supervise the conversion process of branch(es). The bank shall also form a team consisting of staff from essential departments/divisions (Islamic Banking, IT, Finance, Compliance, etc.) to execute conversion plan smoothly and to ensure regulatory compliance during the conversion process.

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- ii. The bank shall develop SOPs for conversion of branches, which shall inter alia include pre & post conversion processes, roles/responsibilities of field staff and head office level staff involved in conversion of branches. The bank shall disseminate such SOPs among all relevant staff of branch(es)/head office for guidance purpose.
- iii. Shariah Compliance Department (SCD) of the bank shall conduct periodic internal Shariah review(s) to ensure Shariah compliance during conversion process for virtual cost centre(s), management of collaterals/securities & reporting line. SCD shall submit its report to the Shariah Board.
- iv. Internal Audit of the bank shall conduct thematic audit of converted branch(es) particularly to review conversion process and highlight irregularities noticed (if any).
- v. The bank shall develop a proper customer complaint handling mechanism, ensuring that no customer is aggrieved in the process of conversion.
- vi. The bank shall solicit account holders' experience and feedback regarding conversion on an ongoing basis and take necessary actions to improve processes, if required.

e) Others

- i. The bank shall ensure that all instruments and instructions for payments and receipts originating to or from previous account numbers shall be duly accepted and honored without any extra requirement or inconvenience for the account holders.
- ii. The bank shall maintain proper MIS/record of all consents and dissents received from its account holders and the efforts exhausted including all kinds of communication made with customers. The same shall be made available for audit or inspection purpose.

G. In-Principle Approval of SBP and Issuance of License

- i. SBP may grant in-principle approval after evaluating bank's request for conversion of conventional branches. The bank shall initiate conversion process as per the conversion plan and in-principle approval.
- ii. Upon completion of all requirements in light of conversion plan and in-principle approval, the bank shall apply to BPRD for license(s) of Islamic banking branch(es) and submit

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Shariah Board certificate confirming that the whole conversion process has been undertaken in conformity with Shariah. Accordingly, the bank shall surrender the existing license(s) of conventional branch(es).

- iii. The branch under conversion shall not establish new conventional relationship after initiation of conversion process as per in-principle approval.

H. Microfinance Banks (MFBs)

All above instructions shall also be applicable to MFBs for the purpose of conversion of their branches from conventional to Islamic. The terms 'Shariah Board' and 'Shariah Advisor' shall be used interchangeably as deemed appropriate for MFBs operating with Shariah Board or Shariah Advisor.
