

## **Kamran Shehzad urges Islamic banks to diversify their investment portfolios**

Mr. Muhammad Kamran Shehzad, Deputy Governor, State Bank of Pakistan has stressed upon the Islamic banks to diversify their investment portfolios by enhancing financing to Small and Medium Enterprises (SMEs), agriculture, housing finance and microfinance sectors of the country.

Delivering his keynote address at a two-day World Islamic Finance Summit 2011 at a local hotel in Karachi today, he said that Islamic banks can not only increase their depth and breadth but also contribute to higher financial inclusion levels in the country by targeting these underserved sectors of the economy as the share of these sectors in overall Islamic financing is very low despite their significant contribution in Gross Domestic Product (GDP).

SBP Deputy Governor observed that the business model of current paradigm of Islamic banking industry both at domestic and international level has a relatively lower mix of participatory modes such as Musharka and Mudarba. 'Moving closer to these modes will help Islamic banking industry to bring in their fold clientele such as SME that has been ignored by conventional finance industry because of its relatively high risk perception', he added.

He noted with concern that the overall financing by Islamic banking industry in agriculture remains below 3 percent. 'A country like Pakistan where agriculture has the highest contribution in domestic production, Islamic banks can increase their market share by reaching out this sector', he added.

Mr. Kamran Shehzad said that housing finance, particularly the low cost housing, is another largely untapped area which the Islamic banks can venture by developing suitable products. Islamic microfinance is also an important area where Islamic banks can serve people, who remain unbanked due to their inability of meeting criteria of commercial banks, he observed.

He said that to encourage the industry to venture into participatory modes of financing, State Bank has constituted a Task Force having representation of Islamic banks, business community, academia and accounting professionals to develop an incentive framework for promotion of such products. 'This framework will be aimed at encouraging Islamic banks to offer participatory modes while minimizing issues of moral hazard, adverse selection, information asymmetries and trust deficit between Islamic banking institutions (IBIs) and entrepreneurs,' he added.

He said that SBP has played a key role in facilitating Islamic banking industry to reach a point of recognition both at the local and international level. State Bank while being a regulator, has also remained committed to being a facilitator for the industry; it is one of the few regulators that have introduced comprehensive legal, regulatory and Shariah compliance framework for Islamic banking industry, he said. 'Moreover, SBP has issued model agreements for encouraging standardization

within the industry and in order to ensure that this does not undermine element of innovation, banks are allowed flexibility in developing products’, he added.

‘In order to bring harmony and to make local industry at par with international industry, the central bank is reviewing and customizing AAOIFI Shariah Standards in a gradual manner,’ he said and added that development of Shariah Inspection regime and an enforcement framework for Shariah compliance in Islamic Banking Institutions also exhibit regulator’s commitment towards promoting Islamic finance in the country.

Mr. Kamran Shehzad said that innovation is a corner stone in providing solutions for financing needs of Islamic bank clients. ‘SBP has taken a number of initiatives to build IBIs’ HR capacity that include introduction of Islamic Banking Certificate Course at NIBAF, introducing field training programs for field staff and collaborating with renowned national educational institutions for introduction of Islamic banking courses in their regular programs,’ he said. Moreover, marketing is another area that requires attention and Islamic banks need to be proactive in this area, he stressed.

SBP Deputy Governor said that Pakistan having a large Muslim population of about 180 million remains at the fore front in promoting Islamic finance. ‘The sector has witnessed strong growth during the last decade and now constitutes about 7.5 percent of the country’s banking system with an asset base of about Rs 560 billion and a network of about 800 branches of both full-fledged Islamic banks and conventional banks having Islamic banking branches,’ he said, adding that this growth trend is likely to gather further momentum with increasing awareness level and expansion of Islamic banking branches in second and third tier cities.

He said that Islamic finance which started off with some local initiatives catering only to the needs of faith sensitive individuals has now evolved into a vibrant global financial industry over the last four decades attracting both Muslims and non-Muslims clientele. The significant growth of Islamic finance is reflective of its increasing acceptability as a competitive system, he said.

He said that the Middle East and Asia at present are the largest Islamic financial markets with countries including USA, U.K, Europe, Korea, Luxembourg, and Singapore being among the list of non-Muslim countries having Islamic financial services. ‘Islamic financial institutions have gone through major transformation while proactively responding to market demands. With a network of more than 600 institutions operative in more than 75 countries and an asset base of over US\$ 1.13 trillion, the industry is steering towards improving its share in global financial markets during next few years. However given 22 percent of the world population being Muslim, 1 percent contribution by Islamic financial institutions towards global financial assets and deposits depicts a significant untapped market’, he added.

He said that if adopted in total and in true spirit, the Islamic financial system could save us from the often recurring crisis in financial markets and their negative fallouts on real economy. ‘I strongly believe that Islamic banking will experience significant growth in times to come,’ he concluded.

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