

5 Islamic Banking

5.1 Islamic Banking

Growth momentum of Islamic banking industry in Pakistan continued during FY15. Both assets and deposits of Islamic Banking Institutions (IBIs) witnessed increase of more than 37 percent during the review year. As of end June 2015, the industry's asset base reached Rs 1,495 billion and constituted market share of 11.3 percent in overall banking industry. Similarly, deposits of Islamic banking industry increased to Rs 1,281 billion having a share of 12.8 percent in overall banking industry deposits (see Table 5.1). The outreach of IBIs also expanded and, as of June 2015, the branch network of IBIs consisted of 1,702 branches spread across 95 districts of the country.

Table 5.1: Industry Progress and market share of Islamic Banking Institutions
Rs in billions

| | Growth (YoY) | | | | Share in Industry | |
|----------------------|--------------|--------|--------|--------|-------------------|--------|
| | Jun-14 | Jun-15 | Jun-14 | Jun-15 | Jun-14 | Jun-15 |
| Total Assets | 1089 | 1495 | 20.5% | 37.3% | 9.8% | 11.3% |
| Deposits | 932 | 1281 | 20.9% | 37.4% | 10.6% | 12.8% |
| No. of Islamic Banks | 22 | 22 | — | — | — | — |
| No. of Branches* | 1335 | 1702 | — | — | — | — |

Source: Quarterly Unaudited Accounts

*number includes sub-branches

SBP remained actively engaged in facilitating development of Islamic banking in the country through various promotional and regulatory initiatives. Some of the key measures and steps taken during FY15 are listed below:

5.1.1 Steering Committee for Promotion of Islamic Banking

The Government of Pakistan (GoP) has demonstrated strong commitment for supporting development of Islamic finance in the country. To this end, a high level Steering Committee for promotion of Islamic banking has been set up chaired by Deputy Governor SBP. The steering committee comprises renowned Shariah scholars, senior government officials, industry experts (local and international) and business leaders.

The Committee was to carry out an objective review of the current paradigm of Islamic banking and to formulate a comprehensive policy framework for an Islamic financial system in conformity with Shariah principles. To accomplish its mandate, the Committee has shown significant progress on various top priority areas including; review of legal, regulatory and taxation frameworks; developing liquidity management tools ; developing solutions for conversion of government debt into Shariah compliant financing; development of an Islamic capital market; reforms in Mudaraba sector; and several initiatives for capacity building and creating awareness among masses to have a better understanding about Islamic finance.

5.1.2 Shariah Compliant Open Market Operations OMOs - Bai Muajjal of Sukuk

SBP is working on providing multiple liquidity management solutions for the industry. In this regard the Shariah compliant OMOs (Bai Muajjal of Sukuk) utilizing Sukuk issued by the GoP was introduced during FY15. This transaction is helping SBP in mopping up excess liquidity from the market and improving implementation of monetary policy stance of SBP.

5.1.3 Implementation of Shariah Governance Framework

To strengthen the overall Shariah compliance environment in IBIs, a comprehensive Shariah Governance Framework was issued during FY14. In view of the feedback received from various quarters and deliberations of SBP Shariah Board, the Framework has been further refined and issued for compliance to IBIs. The Framework has come into force with effect from July 1, 2015. It aims at institutionalizing Shariah compliance function in IBIs.

5.1.4 Rationalization of Minimum Capital Requirements (MCR) for Islamic Banking Subsidiaries

In order to provide a level playing field to IBIs, SBP developed a proposal for rationalization of MCR for Islamic banking branches (IBBs) and Islamic banking subsidiaries of conventional banks. Accordingly, SBP has revised the MCR for Islamic banking subsidiary from Rs 10 billion to Rs 6 billion. However, the intending Islamic banking subsidiary shall be required to raise its paid-up capital (net of losses) up to Rs 10 billion within a period of 5 years from the date of commencement of its operations.

5.1.5 Awareness Creation and Capacity Building Programmes for Islamic Banking Industry

Islamic banking industry in collaboration with SBP has been running a mass media campaign for promotion of Islamic banking. After successful launch of the first phase in 2013, second phase was launched in December 2014 which focused more on education, awareness, and improving understanding of Islamic banking and finance. Second phase involved advertisements in newspapers, radio and distribution of brochures and placement of roll-up standees in IBIs' branches.

SBP has also been collaborating with reputed national and international institutions for organizing targeted seminars, lectures, training programmes and workshops for the Islamic banking industry.

5.1.6 Global Participation

SBP is playing active role in addressing the challenges and issues faced by the global Islamic financial industry. SBP continued to contribute in the Working Group of Islamic Financial Services Board (IFSB) on core principles for Islamic finance regulation (banking segment). SBP also became part of IFSB Task Force on Technical Note on stress testing for institutions offering Islamic financial services.

SBP participated actively at various international forums on Islamic finance, such as IFSB meetings and events, Global Islamic Finance Forum (GIFF), meeting of Central Banks and Monetary Authorities of the OIC member countries, Board of Trustees meeting of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). Moreover, SBP facilitated AAOIFI in arranging a meeting of its Shariah Board's Shariah Standards Review and Translation Committee in Pakistan. SBP was awarded 'IFN Deal of the Year' by Islamic Finance News (IFN) for a deal of US\$ 1 billion GoP Ijara Sukuk.

5.1.7 Pakistan International Sukuk

Pakistan entered the international Sukuk Market after nine years during FY15, through Dollar denominated Sukuk. The issue size of this Sukuk was US\$ 1.0 billion having maturity of 5 years. The Sukuk was listed at the Luxembourg Stock Exchange and was received well in the international market.

5.1.8 Launch of KAP Study

SBP launched its survey based study; “Knowledge, Attitude and Practices of Islamic Finance in Pakistan (KAP)”, during FY15. The survey findings are highly encouraging and positive for Islamic banking in the country. Given the supply-demand gaps, there is huge potential for further development of Islamic banking in Pakistan. As a large segment of demand for Islamic banking is yet to be met and a significant proportion of demand lies amongst those who are still financially excluded, greenfield growth in Islamic banking has a huge scope.

5.1.9 Establishment of Centre of Excellence in Islamic Finance Education (CEIFE)

The sustenance of growth momentum of Islamic banking industry critically hinges upon skilled and well trained human resources. To fill the gap in demand and supply of suitably qualified and trained human resource there is a need to develop dedicated institutions that can lead, steer, and synergize all efforts for bridging these capacity gaps. The Steering Committee for promotion of Islamic banking in Pakistan recommended establishing Centre of Excellence in Islamic Finance (CEIEF).

The center will have:

- Comprehensive set of educational and training programs for various audience groups
- Strong quality assurance framework
- State of the art research facilities
- Partnerships with the industry and buy-in of the key stakeholders
- Good governance, management, faculty and technology
- International orientation; and
- Knowledge environment that promotes innovation

Three universities have been selected for establishment of CEIFEs based on the quality of their proposals and capacity to effectively manage the Center. Under this initiative, the grantee institutions will perform a wide range of activities including setting-up exclusive Islamic Finance education and research infrastructure, curriculum development, international collaborations, industry linkages, and most importantly they will attract private investments for ensuring sustainability of the initiative.

It is envisioned that the initiative will have positive impact the Islamic finance industry as a whole through sharing of Islamic finance curriculum/research material, initiation of distance learning programs, establishment of Islamic finance teaching resource pool, short courses/trainings for Islamic finance industry and holding of international conferences/events, etc.