

5 Islamic Banking

5.1 Overview

Islamic banking industry has registered substantial growth during the last few years. Parallel to increase in number of branches, windows and diversity of Islamic banking products and services, the size of Islamic banking industry's balance sheet has significantly improved. The industry continued its growth trend during FY20, as the assets & deposits of the Islamic

banking industry grew by 21.4 percent and 22 percent, respectively. Due to substantial growth, Islamic banking industry has become systemically important¹³ as it presently constitutes share of 15.3 percent and 16.9 percent of the overall banking industry's assets and deposits, respectively (at end June 30, 2020) (**Table 5.1**)¹⁴. Financing to Deposit Ratio (FDR) of Islamic banking industry was recorded at 57.6 percent comparatively higher than the overall banking industry's advances to deposits ratio of 46.3 percent (at end June 2020). Moreover, the Return on Equity (ROE) and Return on Assets (ROA) after tax of Islamic banking industry, recorded at 29.6 percent and 2 percent, respectively, were better than overall banking industry's averages (at end June 2020).

In terms of market infrastructure, Islamic banking industry has sustained a positive growth over the years. Presently, there are 22 Islamic Banking Institutions (IBIs) including 5 full-fledged Islamic banks, one specialized bank and 16 conventional banks having Islamic banking branches. The IBIs are providing Shariah-compliant products and services through their network of 3,274 branches in 122 districts. To enhance outreach of Islamic banking products and services, IBIs added 361 branches to their branch network during FY20. To cater the needs of lower income strata of the populace, Islamic Microfinance services are also being provided by two IBIs: NRSP Bank and MCB-Islamic.

5.2 Initiatives for Promotion of Islamic Banking during FY20

SBP continued its efforts for sustainable growth of Islamic banking industry in the country. In this regard, following measures were taken by SBP:

Table 5.1: Industry Progress and Market Share*

	Islamic Banking Industry Progress		Growth (YoY)		Rs. in billion Share in Overall Banking Industry	
	Jun-19	June-20	Jun -19	June-20	Jun-19	June-20
Total Assets	2,992	3,633	20.6%	21.4%	14.4%	15.3%
Deposits	2,415	2,946	18.8%	22%	15.9%	16.9%
Total IBIs	22	22	—	—	—	—
Total Branches**	2,913	3,274	8.5%	12.4%	—	—

Source: Data/information submitted by banks under quarterly Reporting Charts of Accounts (RCOA)

**Number includes sub-branches

¹³ The Islamic Financial Services Board (IFSB) considers the Islamic financial industry to be systemically important when the total Islamic banking assets in a country encompass more than 15 percent of its total domestic banking sector assets. (IFSB – Islamic Financial Services Industry Stability Report 2019).

¹⁴ The latest figures available are for June 30, 2020.

5.2.1 Measures related to COVID-19

As a result of the global pandemic, central banks across the globe have swiftly acted with measures including easing monetary policy, regulatory relaxations and providing liquidity support to the banking sector. In line with global measures, SBP also played its key role to support the banking sector, to revive economic & business activities and to tackle the adverse effects of the COVID-19. These activities can be broadly divided into Regulatory Measures and Market Development. Brief detail with respect to both categories for Islamic banking is as follows:

- **Regulatory Measures:** The policy measures mainly include reduction in policy rate, reduction in Capital Conservation Buffer (CCB) from its existing level of 2.50 percent to 1.50 percent to increase loanable funds with banks, deferment of principal or rescheduling & restructuring of financing facilities, increase in the existing regulatory retail loan limit from Rs.125 million to Rs.180 million for capital adequacy calculations, relaxation in Debt Burden ratio (DBR) for consumer loans from 50 percent to 60 percent, reduction in margin call requirement of 30 percent vis-a-vis banks' financing against listed shares to 10 percent, promoting digital payments and relaxing credit requirement for exporters and importers. These measures are equally applicable on IBIs. However, especially for IBIs, SBP issued Shariah guidelines (i.e. Guidelines for Implementation of Regulatory Relief to Dampen the Effects of COVID-19) in April 2020 with a view to facilitate the customers of IBIs for smooth implementation of relaxation provided by SBP regarding deferment of principal or rescheduling & restructuring of financing facilities. It is expected that it will provide necessary relief to customers of Islamic banking industry which has been adversely impacted by the COVID-19 pandemic and are unable to meet their due obligations.
- **Market Development:** SBP has introduced some refinance schemes along with their Shariah compliant alternates to address economic challenges. These schemes mainly include 'Islamic Temporary Economic Refinance Facility (ITERF), Islamic Refinance Facility for Combating COVID-19 (IRFCC) and Islamic Refinance Scheme for Payment of Wages & Salaries to the Workers and Employees of Business Concerns.
 - ITERF provides concessionary refinance for setting up of new industrial units.
 - IRFCC provides refinance support to hospitals & medical centers to develop & enhance their capacities to deal with prevalent health emergency owing to COVID-19. It is also available for entities planning to engage in manufacturing of masks/protective gears, dresses/testing kits, hospital beds, ventilators and other items to combat COVID-19.
 - 'Islamic Refinance Scheme for Payment of Wages & Salaries to the Workers and Employees of Business Concerns' commonly known as 'SBP Rozgar Scheme' is expected to ease cash flow constraints of the employers and to avoid layoff. The Scheme provides refinance for payment of wages and salaries of permanent, contractual, daily wagers and outsourced employees of existing and new customers of banks and Development Finance Institutions.

5.2.2 Islamic Financing Facilities

SBP issued Shariah-compliant alternatives of its major conventional refinance facilities during the FY20 which mainly include ‘Islamic Refinance Scheme for Working Capital Financing of Small Enterprises and Low-End Medium Enterprises’, ‘Islamic Financing Facility for Renewable Energy (IFRE)’ and ‘Islamic Long Term Financing Facility (ILTFF) for Plant & Machinery’.

5.2.3 Adoption/Adaption of AAOIFI Shariah Standards

With the purpose of standardization and to align the practices of the domestic Islamic banking industry with internationally recognized standards, SBP notified adoption of three Shariah Standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) i.e. Shariah Standards No. 19 (Loan (Qard)), No. 23 (Agency and the Act of an Un-commissioned Agent (Fodooli)) and No. 28 (Banking Services in Islamic Banks) in FY20. With adoption of the aforementioned Standards, SBP adopted fifteen AAOIFI Shariah Standards while further Shariah Standards are in pipeline for adoption.

5.2.4 Awareness and Capacity Building Programs for Islamic Banking Industry

One of the key focus of SBP pertains to capacity building of the industry and raising awareness among masses regarding Islamic banking and finance. SBP has been playing its key role as a regulator and facilitator.

As a regulator: SBP issued instructions in January 2020 requiring banks to arrange training sessions for branch level staff of IBIs.

As a facilitator: Following a multipronged strategy, SBP is not only supporting stakeholders for their capacity building & awareness initiatives, but also remained actively involved in conducting programs on its own and through its training subsidiary, NIBAF. COVID-19 pandemic has affected the frequency of awareness and capacity building programs for the Islamic banking industry during FY20. Nonetheless, the following initiatives were taken during the FY20:

Box 5.1: Initiatives for Awareness and Capacity Building Programs for Islamic Banking Industry

- SBP, in collaboration with the NIBAF, offered nine iterations of a training program titled ‘Fundamentals of Islamic Banking Operations (FIBO)’. The customized training program is designed to target branch managers, operation managers and relationship managers of banks, academia and Shariah scholars. The program was offered at various geographical locations of the country including Bahawalpur, Quetta, Peshawar, Faisalabad, Lahore, Sukkur, Sialkot, Hyderabad, and Multan.
- To promote better awareness about Islamic finance amongst the Shariah community, short certification programs of one/two day(s) each were also conducted in collaboration with IBA-CEIF, COMSATS, and religious educational institutions during FY20.
- In pursuit of up-scaling capacity levels of Shariah scholars serving the Islamic banking industry, SBP, in collaboration with NIBAF, launched a comprehensive training program exclusively for Shariah scholars. The second iteration of the certification program was successfully concluded during the FY20.
- SBP, in collaboration with NIBAF, organized a dedicated two-day program for officials of Federal Board of Revenue (FBR) in FY20. The objective of the program was to provide them an overview of Islamic banking products and services and to clarify their queries and misconceptions about Islamic banking.

- On the recommendation of SBP, Focus Group on Islamic Finance at Ministry of Finance is serving as a center point to deal with the matters related to Islamic banking and finance. During FY20, two day capacity building program was organized for the focal persons at MoF and other government departments/ministries. The program was attended by the officials of the Federal Board of Revenue, Securities and Exchange Commission of Pakistan, Ministry of Religious Affairs, and Ministry of Finance.
- During FY20, SBP continued to provide patronage to Islamic banking industry for Islamic Finance Media Campaign. In FY20, the media campaign was rolled out through television, newspapers, radio and digital media.
- Islamic Finance News (IFN), in collaboration with SBP, organized the 'IFN Pakistan Forum' during FY20. The Forum served as a platform to identify critical issues surrounding the Islamic financial industry and objectively explored potential solutions to overcome the challenges. Participants from the local Islamic financial industry, regulatory bodies, academia and Shariah scholars attended this forum.
- SBP organized AAOIFI's Public Hearing Session on two Exposure Drafts, i.e. i) Code of Ethics for Islamic Finance Professionals and ii) Waqf Governance during FY20. The session was attended by leading Shariah scholars and senior Islamic bankers from Pakistan. Secretary General AAOIFI also attended the session.