

## 5 Islamic Banking

The growth of Islamic Banking Industry has been substantial during the last few years. With the enhanced diversity of Islamic Banking products and services, Islamic Banking industry has been attracting a wide range of consumer base, and the steady increase in number of branches and Islamic windows has provided the necessary infrastructure support. The strong growth in the size of Islamic Banking industry continued in FY21. Further, SBP took a number of measures/steps to promote Islamic banking during FY21 including: issuing third five-year strategic plan for the Islamic Banking industry, updating guidelines for establishing Islamic Banking Institutions (IBIs), introducing guidelines for DFIs to undertake Shariah compliant businesses and operations, expanding the scope of operations of Islamic banking windows, strengthening Shariah standards, and improving Shariah governance framework for IBIs. SBP has been awarded as “Best Central Bank of the Year 2020” by Global Islamic Finance Awards.

### 5.1 Overview

The overall assets and deposits of the Islamic Banking Industry (IBI) witnessed a significant growth of Rs.1,164 billion and Rs.876 billion respectively, during FY21. By end June 2021, the industry’s asset base increased to Rs.4,797 billion, whereas deposits were recorded at Rs.3,822 billion. In terms of share, IBI achieved a significant mark of 17 percent and 18.7 percent in assets and deposits of overall banking industry, respectively in FY21 (Table 5.1).

|                 | Islamic Banking Industry |        |              |        | Share in Overall Banking Industry |        |
|-----------------|--------------------------|--------|--------------|--------|-----------------------------------|--------|
|                 | Progress                 |        | Growth (YoY) |        |                                   |        |
|                 | Jun-20                   | Jun-21 | Jun -20      | Jun-21 | Jun-20                            | Jun-21 |
| Total Assets    | 3,633                    | 4,797  | 21.4%        | 32.0%  | 15.3%                             | 17.0%  |
| Deposits        | 2,946                    | 3,822  | 22.0%        | 29.7%  | 16.9%                             | 18.7%  |
| Total IBIs      | 22                       | 22     | –            | –      | –                                 | -      |
| Total Branches* | 3,274                    | 3,583  | 12.4         | 9.4    | –                                 | -      |

Source: Data/information submitted by banks under quarterly Reporting Charts of Accounts (RCOA)  
\*Number includes sub-branches

During FY21, financing (net) of IBI showed a growth of 24.8 percent and increased to Rs.2,118 billion compared to Rs.1,698 billion in FY20. Financing to deposit ratio (FDR) of IBI was recorded at 55.4 percent compared to the conventional banking industry’s advances to deposits ratio of 43.1 percent. Investments (net) of IBI also witnessed a considerable increase of Rs.464 billion and were recorded at Rs.1,363 billion by end FY21.

FY21 ended with 22 Islamic Banking Institutions (IBIs), 5 full-fledged Islamic banks (IBs), and 17 conventional banks having standalone Islamic banking branches (IBBs), providing Shariah compliant products and services through their network of 3,583 branches spread across 124 districts of the country. To enhance outreach of Islamic Banking products and services, IBIs added 309 branches

during the fiscal year. The number of Islamic banking windows (dedicated counters at conventional branches) stood at 1,562 at end June 30, 2021.

## **5.2 Initiatives for Promotion of Islamic Banking**

Some of the key measures/steps taken for promotion of IBI during FY21 are given below:

### **5.2.1 SBP issued Third Five-year Strategic Plan for Islamic Banking Industry**

SBP issued its third five-year Strategic Plan (2021-2025) for the Islamic banking industry in April 2021 which aims to set a strategic direction for the industry to strengthen the existing progressive momentum and lead the industry to the next level of growth. The plan has been developed in close coordination and consultation with all key relevant stakeholders.

The headline targets set for Islamic banking industry to be achieved under the plan by 2025 include: (i) 30 percent share in both assets and deposits of overall banking industry, (ii) 35 percent share in terms of branch network of overall banking industry, and (iii) 10 percent and 8 percent share of SMEs and agriculture financing respectively, in private sector financing of IBI.

The strategic plan envisages achieving the specified targets by focusing on six strategic pillars, namely: (i) strengthening legal landscape, (ii) enhancing conduciveness of regulatory framework, (iii) reinforcing comprehensive Shariah governance framework, (iv) improving liquidity management framework, (v) expanding outreach & market development, and (vi) bolstering human capital & raising awareness.

Islamic banking has remained a top priority area for SBP, keeping in view its potential towards ensuring broad based economic growth and development. The plan provides a consensus-based agenda and strategy to make Islamic banking an efficient and practical solution for consumers. It also contains an extensive focus on improving the public perception of Islamic banking as a distinct and viable system capable of catering to the varied financial services needs of various segments of society. This would positively contribute to SBP's efforts to achieve and improve financial inclusion in Pakistan.

The plan also emphasizes that IBIs must develop innovative products based on distinctive Shariah characteristics to cater to underserved sectors, particularly SMEs and agriculture, which are critical for growth of the country's economy.

### **5.2.2 Guidelines and Criteria for Establishing (IBIs) and Commencement of Shariah Compliant Business and Operations by Development Finance Institutions (DFIs)**

Keeping in view the various developments over time, SBP updated the guidelines, for establishing IBIs vide IBD Circular No. 4 of 2020. The updated guidelines deal with the establishment of a full-fledged Islamic bank, Islamic banking subsidiary and Islamic banking branches of conventional banks. In addition, these guidelines cover different areas including minimum capital adequacy, requirements related to sponsor directors, Shariah governance and preconditions for commencement of business. Further, to enhance the scope of Shariah compliant financial services in the country, SBP also issued guidelines for DFIs to undertake Shariah compliant businesses and operations.

### **5.2.3 Revised instructions on Islamic Banking Windows Operations**

Recognizing the significant potential of Islamic banking windows in enhancing the share and outreach of Shariah compliant financial services, SBP issued revised instructions for IBIs vide IBD Circular No. 02 of 2020 to expand the scope of operations of Islamic banking windows. Islamic banking windows can now offer all types of financing products to their customers including corporates, small and medium enterprises, agriculture, housing, and retail consumers subject to fulfilment of certain regulatory requirements.

### **5.2.4 Instructions to Improve Shariah Non-Compliance Risk Management**

To ensure stability and soundness of the Islamic banking sector, SBP issued instructions on Shariah Non-Compliance Risk (SNCR) management vide IBD Circular No. 01 of 2021 dated June 14, 2021. These instructions would complement the existing comprehensive Shariah Governance Framework, being already in place for IBIs and will push them to broaden their focus on management of SNCR and align the same with their overall risk management framework.

### **5.2.5 Adoption/Adaption of AAOIFI Shariah Standards**

To align and standardized the practices of the domestic Islamic banking industry with internationally recognized standards, SBP notified adoption of Shariah Standard of AAOIFI<sup>17</sup> Shariah Standard No. 49 (Unilateral and Bilateral promise) in FY21. With adoption of this AAOIFI Standard (No. 49), SBP has adopted total sixteen AAOIFI Shariah Standards, while six AAOIFI Shariah Standards i.e., (1) Mortgage and Its Contemporary Applications, (2) Combination of Contracts, (3) Salam and Parallel Salam, (4) Istisna and Parallel Istisna, (5) Al-Wakalah Bi Al-Itithmar (Investment Agency), and (6) Irrigation Partnership (Musaqat) are also under process for adoption.

### **5.2.6 Instructions on Shariah Governance Framework (SGF) for Islamic Banking Institutions (IBIs)**

SBP amended Para 3A (v) of IBD Circular No.1 of 2018 (Shariah Governance Framework for IBIs) vide IBD Circular No.1 of 2021. As per the amendment, the Shariah Board members, except Resident Shariah Board Member (RSBM), may serve on the Shariah Boards of up to three IBIs in Pakistan. However, the IBI must ensure that its Shariah Board has at least 2 members (other than RSBM), who are not on the Shariah Board of any other IBI. Hence, each IBI will have at least three unique members in Shariah Board including RSBM. The revision - effective from July 1, 2021- is aimed at enhancing pool of Shariah Scholars in the Islamic banking industry and provides flexibility to IBIs to have Shariah Boards with diversified experience and exposure.

### **5.2.7 Liquidity Management Solutions for Islamic Banking Industry**

Taking in view the importance of liquidity management for Islamic banking industry, SBP is working to provide multiple liquidity management solutions for the industry. SBP has also been conducting Shariah compliant Open market Operations (OMOs) by utilizing Ijara Sukuk issued by the Government of Pakistan (GoP). During FY21, total twelve (12) Sukuk (Government of Pakistan Ijara

<sup>17</sup> Accounting and Auditing Organization for Islamic Financial Institutions

Sukuk– Fixed Rental Rate & Variable Rental Rate) were issued amounting to Rs.467 billion, providing a Shariah compliant investment avenue to the Islamic Banking industry and its clientele.

### **5.2.8 Awareness and Capacity Building Programs for Islamic Banking Industry**

Awareness creation and capacity building has always remained one of the key focus areas of SBP for promotion and development of the Islamic banking sector in the country.

Apart from supporting the stakeholders in their capacity building & awareness creation initiatives, SBP through its subsidiary, i.e., National Institute of Banking and Finance (NIBAF) conducts customized programs for the banking industry, academia, Shariah scholars, and chambers of commerce, etc. Some of the major initiatives taken in this regard during FY21 include the following:

- SBP, in collaboration with NIBAF, organized ten iterations of five-days ‘Fundamentals of Islamic Banking Operations (FIBO)’ throughout the country. The programs were held at Peshawar (2 iterations), Quetta, Faisalabad, Sukkur, Hyderabad, Bahawalpur, Lahore, Multan and Rawalpindi/Islamabad region. The training programs were aimed at enhancing skills and knowledge base of field staff of Islamic banking institutions, particularly Branch Managers (BMs), Operation Managers (OMs), Relationship Managers (RMs), academia, students and Shariah scholars.
- In addition to FIBO programs, SBP launched a new three-days training program titled ‘Islamic Banking Branch Operations (IBBO)’ in FY21. The program is especially designed for upscaling capacity levels of Islamic banking branch operations staff, academia and Shariah scholars in the second tier cities and their adjoining areas. During FY21, nine iterations of the program were successfully held at Swat, Sahiwal, Azad Jammu and Kashmir, Shaheed Benazirabad, Dera Ismail Khan, Mansehra, Gujranwala, Sialkot and Rawalpindi.
- To upgrade the capacity level of Shariah scholars serving the industry, SBP in collaboration with NIBAF held two iterations of focused capacity building programs for Shariah Scholars of industry on i) Islamic Fintech & Islamic Digital Finance, and ii) Pool Management Practices. SBP, also in association with Federal Judicial Academy, organized a two-day program on ‘Islamic banking and finance’ for the Judges of the Banking Courts. The program was attended by twenty-six (26) judges of the banking courts from across the four provinces of the country.
- SBP hosted the UK Islamic Finance Council (UK IFC) Task Force meeting on ‘Global Islamic Finance & UN Sustainable Development Goals (SDGs)’ on November 16, 2020. The meeting was attended by the senior management of SBP as well as Presidents/CEOs of leading Islamic banks. During the meeting, the Governor SBP formally launched the Pakistan Chapter of the Taskforce and a working group was constituted. The first meeting of the Pakistan working group on UN SDGs comprising officials of seven local banks was held on December 15, 2020.
- SBP in collaboration with UK IFC organized an online ‘Executive Education Session’ facilitated by renowned international speakers on the topics of ‘Sustainable Banking’ and ‘Principles for Responsible Banking (PRB)’. The program was held on February 18, 2021 and was attended by officials of local banking industry and SBP.

- SBP hosted an awareness session for Sialkot Chamber of Commerce and Industry on January 21, 2021 wherein participants were enlightened on the basic concepts and practices of Islamic banking with a focus on Shariah compliant refinancing schemes notified by SBP.
- SBP collaborated with the Islamic Finance News (IFN) - a leading provider of international Islamic finance news- in arranging and hosting a virtual IFN On-Air Roadshow focusing on “New Opportunities for Islamic Finance in Pakistan” on June 17, 2021.
- SBP extended its technical support to various universities in their conferences, seminars and workshops on the theme of Islamic finance. Some of the universities include IBA– CEIF Karachi, Institute of Business Management Karachi, Riphah International University Islamabad, and Minhaj University Lahore.
- SBP has recently established a focal group comprising representatives from leading Chambers of Commerce across the country for creating awareness on the Shariah compliant refinance schemes notified by SBP.
- In order to enhance awareness about Islamic banking amongst academic circles, orientation sessions were held at the leading universities at Dera Ismail Khan, Multan, and Sialkot. The programs highlighted the significant features of Islamic banking model and the regulatory initiatives taken in this regard.

### **5.3 Global Participation**

SBP has always remained actively engaged at the global level with international Islamic banking and finance standards issuing bodies such as Islamic Financial Services Board (IFSB), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), International Islamic Financial Market (IIFM), etc. SBP has been actively represented at the Council, Executive Committee, Technical Committee and various Working Groups of IFSB. The IFSB Council (a senior executive and policy making body comprising heads of the regulatory and supervisory authorities on Islamic finance) in its 37th meeting held on December 10, 2020, appointed Governor-SBP, Dr. Reza Baqir, as the Deputy Chairman of the Council for the year 2021. Further in its meeting held on June 09, 2021, he has also been appointed as the Chairman of the General Assembly of IFSB for the year 2022.

Similarly, SBP also has active senior level representation on the Board of Trustees of AAOIFI -a body that develops accounting, auditing, governance, ethics and Shariah standards for Islamic financial institutions. During FY21 relevant SBP’s officials also participated virtually in various events organized by AAOIFI including AAOIFI 18th Shariah Boards Conference, 15th AAOIFI – Islamic Development Bank Group (ISDB) annual conference, Regulators Roundtable etc.

### **5.4 Global Recognition**

In recognition of its efforts, SBP has been awarded as “Best Central Bank of the Year 2020” by Global Islamic Finance Awards (GIFA). SBP has also been voted as the Best Central Bank for 2020 in promoting Islamic finance by a poll conducted by Islamic Finance News (IFN), an arm of REDmoney Group, Malaysia.