Islamic Banking Industry – Pakistan

Mr. Saeed Ahmad
Deputy Governor
State Bank of Pakistan
Outline

- Financial Landscape of Pakistan
- Current Islamic Finance Scenario
- Strategic Framework for Islamic Banking 2014-18
- Enabling Policy Environment and Other Initiatives under Strategic Framework
- Risk Based Supervisory Framework
- SBP Vision 2020 and Financial Inclusion Targets
- Regulatory and Supervisory Challenges
- Way Forward
Financial Landscape of Pakistan

- Banks
  - Nationalized Banks
  - Islamic Banks
  - Private Banks
  - Foreign Banks
  - Islamic Banking Subsidiaries
- Development Finance Institutions
- Microfinance Banks

- Non Bank Financial Institutions
  - Investment finance companies
  - Leasing companies
  - Fund Management
  - Modaraba companies
- Insurance & Takaful Companies

State Bank of Pakistan

Securities and Exchange Commission of Pakistan

Others: Un-regulated Microfinance Institutions both Islamic & Conventional

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Islamic Banking Industry Trend – Last 5 years

As of Dec 2015
Number of IBIs: 23
Number of Branches: 2075

Islamic Banking Industry Progress

Market Share

Source: Quarterly Unaudited Data

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### Historical Growth of Islamic Banking Industry (IBI)

<table>
<thead>
<tr>
<th>Description</th>
<th>Dec-15</th>
<th>Dec-14</th>
<th>Dec-13</th>
<th>Dec-12</th>
<th>Dec-11</th>
<th>Dec-10</th>
<th>Dec-09</th>
<th>Dec-08</th>
<th>Dec-07</th>
<th>Dec-06</th>
<th>Dec-05</th>
<th>Dec-04</th>
<th>Dec-03</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td>1,610</td>
<td>1,259</td>
<td>1,014</td>
<td>837</td>
<td>641</td>
<td>477</td>
<td>366</td>
<td>276</td>
<td>206</td>
<td>119</td>
<td>71</td>
<td>44</td>
<td>13</td>
</tr>
<tr>
<td>% age of Banking Industry</td>
<td>11.3%</td>
<td>10.4%</td>
<td>9.6%</td>
<td>8.6%</td>
<td>7.8%</td>
<td>6.7%</td>
<td>5.6%</td>
<td>4.9%</td>
<td>4.0%</td>
<td>2.8%</td>
<td>2.0%</td>
<td>1.5%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Deposits</td>
<td>1,375</td>
<td>1,070</td>
<td>868</td>
<td>706</td>
<td>521</td>
<td>390</td>
<td>283</td>
<td>202</td>
<td>147</td>
<td>84</td>
<td>50</td>
<td>30</td>
<td>8</td>
</tr>
<tr>
<td>% age of Banking Industry</td>
<td>13.2%</td>
<td>11.6%</td>
<td>10.4%</td>
<td>9.7%</td>
<td>8.4%</td>
<td>7.2%</td>
<td>5.9%</td>
<td>4.8%</td>
<td>3.8%</td>
<td>2.6%</td>
<td>1.8%</td>
<td>1.3%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Financing &amp; Invest.</td>
<td>1,077</td>
<td>765</td>
<td>709</td>
<td>626</td>
<td>475</td>
<td>338</td>
<td>226</td>
<td>186</td>
<td>138</td>
<td>73</td>
<td>48</td>
<td>30</td>
<td>10</td>
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<tr>
<td>Full fledged Islamic Banks</td>
<td>6</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Conventional Banks with IBBs</td>
<td>17</td>
<td>17</td>
<td>14</td>
<td>13</td>
<td>12</td>
<td>12</td>
<td>13</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>9</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>No. of Branches</td>
<td>2,075</td>
<td>1,574</td>
<td>1,304</td>
<td>1,097</td>
<td>886</td>
<td>751</td>
<td>649</td>
<td>515</td>
<td>289</td>
<td>150</td>
<td>70</td>
<td>48</td>
<td>17</td>
</tr>
</tbody>
</table>

(Rs in Billion)
Commitment of Government of Pakistan Towards Development of Islamic Finance

Formation of High Level Steering Committee – Dec 2013

Comprising of:
- Renowned Shariah Scholars
- High Level Government Officials
- Banking Experts
- Business Leaders

Road-map for Progression of Islamic Banking and Finance

Legal Framework

Policy Framework

Tax Neutrality

Coordination Among Stakeholders

Strengthening Shariah Supervisory Regime

Capacity Building and Awareness

Research and Development

Development of Islamic Financial Markets

Liquidity Management

Development of Islamic Capital Markets
Islamic Banking (IB) is an important, integral and evolving part of banking & finance

Requires ownership and coordination of all stakeholders

Specifies responsibilities and obligations of stakeholders

Maps how to achieve the set targets

Helps sustain the growth momentum

Four Key Reform Areas:
- Enabling Policy Environment
- Shariah Governance & Compliance
- Awareness & Capacity Building
- Market Development
Functional Strategies and Action Plan

- Amendments in Taxation and Legal Framework
- Shariah Compliance Framework
- Rationalization of MCR
- Liquidity Management Framework
- Financial Accounting & Reporting Framework
- Awareness & Capacity Building
- Adoption of International Standards
- Financial Inclusion
- Coordination Among Stakeholders
Enabling Policy Environment

Amendments in Taxation and Legal Framework
- Efforts to create level playing field for IBIs
- Review of BCO 1962 and SBP Act 1956
- Taxation / Legal Proposals
- Recovery Ordinance

Shariah Compliance Framework
- Shariah Governance Framework
- Thematic Inspections
- Revise ‘On-site’ inspection Manual for Shariah Compliance

Rationalization of MCR
- Facilitating expansion and consolidation in Islamic banking industry
- MCR for Islamic banking subsidiary to begin with Rs. 6 billion and gradually reach Rs. 10 billion

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Development of Liquidity Management Framework

Open Market Operations Based on Bai Muajjal of GOP Sukuk

• State Bank has developed mechanism to absorb surplus liquidity from IBIs

Shariah Compliant Provider of Last Resort

• Development of Shariah compliant LOLR mechanism for Islamic banking industry is currently underway

Issuance of Long-term and Short-term Sukuk by the Government

• The State Bank of Pakistan is working closely with the Federal Government of Pakistan for issuance of long-term and short-term sukuk in order to facilitate the liquidity management of IFIs, meet the financing needs of the Government and for conversion of Government financing.
To address issues of transparency, disclosure and true risk profiling, SBP works in coordination with Institute of Chartered Accountants of Pakistan (ICAP) and other stakeholders.

Islamic Financial Accounting Standards (IFAS) on Murabaha (IFAS 1), Ijarah (IFAS 2) and PLS deposits (IFAS 3) have been developed and notified by SECP.

Work has been initiated on other Islamic Financial Accounting Standards.
Capacity Building & Talent Development

Three Centers of Excellence in Islamic Finance (CEIF)
Research Infrastructure in Partnership with LUMS, IBA and IM Sciences

- Incubator for research on contemporary issues
- Comprehensive source of education, training and degree programs
- International orientation and collaboration
- Mobilizing local and international expertise
- Strong quality assurance network
- Innovation & capacity building

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SBP has successfully adopted / adapted 6 AAOIFI Shariah Standards and 4 IFSB Prudential standards. Further work is in progress for adoption of more international standards.

<table>
<thead>
<tr>
<th>AAOIFI-3</th>
<th>• Default in Payment by a Debtor</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAOIFI-8</td>
<td>• Murabaha to the Purchase Orderer</td>
</tr>
<tr>
<td>AAOIFI-9</td>
<td>• Ijarah &amp; Ijarah Muntahia Bittamleek</td>
</tr>
<tr>
<td>AAOIFI-12</td>
<td>• Mudaraba</td>
</tr>
<tr>
<td>AAOIFI-13</td>
<td>• Sharika (Musharaka) and Modern Corporations</td>
</tr>
<tr>
<td>AAOIFI-17</td>
<td>• Investment Sukuk</td>
</tr>
<tr>
<td>IFSB-1</td>
<td>• Risk Management for IIFS</td>
</tr>
<tr>
<td>IFSB-3</td>
<td>• Corporate Governance for IIFS</td>
</tr>
<tr>
<td>IFSB-4</td>
<td>• Disclosures to Promote Transparency and Market Discipline for IIFS</td>
</tr>
<tr>
<td>IFSB-10</td>
<td>• Sharī‘ah Governance System</td>
</tr>
</tbody>
</table>

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Other Major Achievements

### Awareness Campaigns
- Nation-wide Islamic Banking Mass Awareness Campaigns
- Specialized Training Sessions For Legal Experts, Journalist Community, Shariah Scholars and Various Stakeholders
- Seminars and Focus Group Sessions round the year

### KAP Survey
- Quantifying Demand for Islamic Banking
- Analyzing Faith Based Financial Exclusion
- Identification of Critical Areas

### Technical Assistance
- Technical Assistance to countries in collaboration with IRTI & World Bank
- Technical input on research papers /studies of IFSB, AAOIFI, IIFM, IRTI, IILM and other international bodies
- Sharing of expertise through Technical Committee/Working Groups of IFSB.

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Other Major Achievements in Islamic Finance

Development of Islamic Capital Markets

- Issuance of Takaful Rules
- Joint Forum of SBP-SECP
- Issuance of Sukuk Guidelines
- Launch of Pakistan All Shares Islamic Index
- Islamic Finance Department
- Review of Modaraba Law and Regulation

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Supervisory Framework
(Risk Based Macroprudential Approach)

- Prudential Regulations
  - Per party exposure limit
  - Limit on contingent liabilities
  - Limit on exposure against common equity
  - Pool Management
  - SGF

- Framework of stress testing based on single factor sensitivity and regression-based analysis
  - Rate risk, credit risk, real estate price risk, equity price risk

- Off-Site Surveillance and On-Site Supervision
  - On Site inspection on CAMELS-S rating
  - Off-site supervision on CAELS rating
  - Shariah compliance inspection
  - Thematic inspection

- Financial Soundness Indicators (FSIs)
  - MCR
  - CAR
  - Advances to deposit ratio
  - Liquid assets to total deposits ratio
  - ROA/ROE
  - D-SIFIs

- Stress Testing
  - Stress Testing based on single factor sensitivity and regression-based analysis
  - Rate risk, credit risk, real estate price risk, equity price risk
SBP Strategic Plan 2020 - Vision

Islamic Finance highlighted as a priority area

- Formation of Development Finance Coordination Committee
- National Financial Inclusion Strategy
- Formation of Financial Inclusion Dept

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National Targets for Financial Inclusion

**Long term:**
**Universal** financial access

**2020 Vision:**
50% of adults with transaction account

**2015:**
23% formally served
16% of adults with bank accounts (over 30% increase from 2008).
Global Regulatory and Supervisory Challenges For IBIs

- **Different Shariah versions**
- **IFIs are working under non Shariah compliant legal and regulatory frameworks**
- **Lack of standardized disclosures, regulatory clarity and harmonization**
- **Lack of awareness among the providers and potential users of Islamic financial services**
- **Dearth of adequately trained human resources**
General Regulatory and Supervisory Challenges

- Development of early warning tools
- Consolidated supervision
- Strengthening IFI’s capital and Reducing procyclicality
- Development of financial safety nets (especially for IFIs)
Way Forward

- Strengthening Islamic financial regulatory infrastructure
- Role of multilateral institutions-IMF, World Bank, IFC, ADB and IDB
- Implementation/adoption of Islamic international prudential, accounting and Shariah standards
- Efforts to bring more standardization/harmonization in Shariah interpretation
Way Forward

IFIs should engage in more profit & loss sharing and real trade transactions for which an enabling legal & regulatory environment need to be developed

Need a paradigm shift in order to reap the real benefits of an Islamic economic and financial system

Promote Research and Development in the fields of Fiscal and Monetary policies in Islamic framework

More coordination and cooperation for public awareness, capacity building and talent development
THANKS