

Yaseen Anwar: Developments of Islamic banking in Pakistan

Keynote address by Mr Yaseen Anwar, Governor of the State Bank of Pakistan, at the Islamic Finance News Pakistan Roadshow, Karachi, 27 August 2013.

* * *

Thank You for inviting me to speak at today's event. I am honored to have this opportunity of addressing such a distinguished audience. My appreciation to the organizers for once again having assembled a strong list of speakers at this year's Islamic Finance News Road show and a warm welcome to the international delegates. With all of us gathered here at the central bank sends a strong signal about commitment and determination of the State Bank of Pakistan and the Government towards ensuring sustainable growth of the Islamic finance industry in the country. As I look around I am optimistic that the collective experience of speakers will lead to rich debates that will not only help us in understanding the key issues but will also enable us to map out the future of the industry.

The Islamic finance industry has come a long way to be recognized as a viable alternate to conventional finance. Islamic financial institutions are currently offering a wide range of services catering to both Muslim and non-Muslim communities. The unprecedented growth of the Islamic finance industry can be associated to efforts of dedicated regulatory, Shariah and academic institutions along with the presence of diversified players in the field i.e. Islamic banks, investment banks, takaful companies, Islamic fund management companies, Islamic brokerage companies etc. The Introduction of Sukuk and Islamic stock market indices have also added the necessary depth and breadth to the Islamic financial markets. In particular Sukuk; has proved to be a powerful tool in attracting investors and building their confidence in Islamic finance while fulfilling financing needs of the public and private sector in a Shariah compliant manner.

Pakistan is no exception to this; rather the country has remained at the fore front in promoting Islamic finance by being a key member of International Islamic finance institutions established to develop necessary legal, regulatory, supervisory and Shariah compliance infrastructure for Islamic finance institutions. Pakistan's active engagement with the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the International Islamic Financial Market (IIFM) and collaboration with other central banks has helped the growth of the Islamic banking industry both locally and at the global level.

Islamic banking in Pakistan has witnessed significant growth during the last decade and now constitutes over 10 percent of the country's banking system with an asset base of over Rs.900 billion and a network of more than 1,100 branches. Given the interest of all stakeholders and a relatively high level of financial exclusion in the country, we believe this expansionary trend is likely to continue and the industry is well set to double its market share by 2020. This success could not have been possible without the leading role of the central bank in setting the direction of the industry and providing unusual support for its promotion and development. Promoting Islamic finance as a viable and competitive component of the financial system through an enabling legal, regulatory and supervisory environment has remained an important component of SBP's strategic goals. Considering the evolutionary stage of the industry, we are continuously engaged in refining and improving the legal and regulatory framework to ensure: a) its responsiveness to the evolving industry dynamics and b) its effectiveness in identifying, measuring and mitigating the risks associated with Islamic finance. In the recently concluded fiscal year we issued detailed instructions for Profit & Loss Distribution and Pool Management to bring standardization, improve transparency and safeguard interests of Investment Account Holders (the savings depositors). The instructions developed through rigorous consultations with the industry have been well received both domestically and globally.

Similarly to further improve the Shariah compliance environment in IBIs, our Islamic Banking Department has completed industry consultations on the draft Shariah Governance framework and will soon be issuing the same. The framework will be another key milestone achieved, which will institutionalize the Shariah compliance function and crystallize the Shariah compliance related roles and responsibilities of all key organs of IBIs including BODs, executive management and Shariah Boards. Moreover, to encourage standardization and Shariah harmonization, SBP over time has issued permissible Islamic modes of finance model Islamic financing agreements besides adapting AACIFI Shariah Standards for the Pakistani market in a gradual manner.

The continuation of growth momentum achieved during last the 4–5 years is contingent on making an objective assessment of the successes, failures and future challenges and developing consensus strategies and action plans to build on the successes and address the challenges. We have accordingly developed the five year Strategic Plan for Islamic Banking industry again through a rigorous and meaningful consultation with all key stakeholders. The plan to be issued soon lays down the future road map of the industry, highlight areas of improvement in legal, regulatory and taxation environments, emphasize diversification of products and markets covering non-traditional but strategically important sectors of agriculture and SMEs and increasing the Islamic banking market share to over 15% of the country's banking system during the next five years.

SBP has also played a vital role in raising awareness and building capacity of the industry. To address the awareness and misconception issues, SBP launched an awareness campaign that consists of seminars, conferences, targeted programs and focused discussions for the business community, academia, bankers and policy makers. A recent significant milestone is the launch of a Mass Media Campaign where the whole Islamic banking Industry joined hands under the ambit of SBP to target the challenge of misconceptions related to the Islamic banking business model and practices. Similarly a number of initiatives have been taken to build the industry's human resource capacity and enhance its skills mix. In this regard support from international organizations like the Islamic Research and Training Institute (IRTI) and Islamic Financial Services Board (IFSB) is also being leveraged.

One key benefit of the promotion of Islamic finance is its potential to contribute significantly to financial inclusion by extending the outreach of the financial system to the masses who are out of the system due to faith reasons. Islamic Microfinance, a confluence of two industries; Islamic Finance and Microfinance, can not only be an efficient tool for financial inclusion by catering to both voluntary and involuntary financially excluded but also towards poverty reduction due to its inherent characteristic of being prudent and asset based. The Islamic finance industry has so far not done much to tap the potential of Islamic microfinance due to its perceived high risk and its preoccupation in serving the financing needs of the government and large corporates.

I would thus urge the industry to make individual as well as collaborative efforts to develop this sector, which would improve their market perception besides enabling them to diversify their clientele. The IBIs may also develop partnerships with Islamic microfinance institutions to serve the low income population.

Similarly, Agriculture and SMEs are areas that have so far been missed out by both conventional and Islamic banks due to the perception of high risk despite their paramount importance for the country's economy. Financial inclusion is one of the key strategic objectives of SBP and as most are aware, very near to my heart; I would thus strongly emphasize the industry to come out of these perception myths and develop capacity to tap these strategically important sectors and create value for your shareholders, depositors and the country's economy as a whole. SBP will provide every support and facilitation to the industry in its efforts to build and expand its portfolio in these sectors.

Islamic capital markets, mutual funds and Takaful industry are also very important components of the Islamic financial system and need to be nurtured and developed along with Islamic banking. We are working closely with the Securities and Exchange Commission of Pakistan (SECP), regulator of capital markets to help develop these non-bank financial institutions. We appreciate and acknowledge the important steps taken by SECP, including review of Mudaraba guidelines, issuance of Sukuk guidelines, establishment of central Shariah advisory board etc, and believe that these are likely to help in development of the overall Islamic finance industry.

Lastly, I would like to emphasize the critical importance of investment in research and development particularly for the evolving sectors of Islamic finance. Unfortunately we are not making adequate investment in this area, which is limiting our capacity to develop Shariah based solutions for various business and economic needs of the real economy. The research and development is also needed to develop solutions for bringing monetary and fiscal policies and practices in conformity with Shariah principles. The strategic plan for the next five years envisages a number of such initiatives and I hope that the collaborative efforts by the regulator and practitioners would be instrumental in improving investment in R&D and developing better solutions for serving the financing needs of the real economy.

In conclusion, I thank all the speakers and participants for coming here and hope that the deliberations and discussions during the Road show will help the industry in moving towards more inclusive growth and equitable distribution of gains in the economy.