

Kazi Abdul Muktedir: Islamic finance developments in Pakistan

Keynote address by Mr Kazi Abdul Muktedir, Deputy Governor of the State Bank of Pakistan, at the Islamic Finance news (IFN) Roadshow 2012, Karachi, 4 September 2012.

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Distinguished guests, ladies and gentlemen! Assalam-u-alikum and a very good morning. It is my great pleasure to welcome you all in this IFN road show. I would like to congratulate and thank Redmoney for organizing the show in Pakistan, which is one of the fastest growing Islamic finance markets across the globe. Such events not only enhance Islamic finance awareness and stimulate its demand but also provide a platform to Islamic finance stakeholders to share their experiences and insights about this fast emerging segment of the financial system. I hope that today's discussions and deliberations would help in addressing the key challenges being faced by the industry and contribute towards sustaining the growth momentum.

Ladies & Gentlemen! Since the inception of modern Islamic finance in 1960's, Islamic banking has evolved from its relatively modest size to a vibrant industry with an increasing global footprint. With a size of US\$1.35 trillion (according to Global Islamic Finance Report 2012) and annual growth rate of more than 20 percent, the Islamic financial industry now comprises 430 Islamic banks and financial institutions and around 191 conventional banks having Islamic banking windows operating in more than 75 countries. The relative resilience and stability of the industry during the financial crisis and its flexibility and responsiveness to changing business needs has helped the industry to establish itself as a viable financial system. The tremors and aftershocks of the financial crisis are still on either in the form of European debt crisis and/or weakening global economic outlook and the policy makers are still looking for answers to fix these issues. Islamic finance, with its roots in a moral economic model that supports productive economic activity and discourages excessive leveraging and imprudent risk taking, can play an important role in rebuilding the financial system. I believe that this is high time for Islamic economists and scholars to highlight the inherent strengths and potential of Islamic finance in addressing the existential challenges faced by the global financial and economic systems.

Ladies & Gentlemen! The evolution of Islamic finance industry in Pakistan has followed the same trajectory as global Islamic financial industry; with growth mainly intensifying over the last decade. Despite having introduced landmark changes during 1980s including amendment in the Banking Companies Ordinance, enactment of Mudaraba Companies and Mudarabas (Floatation and Control) Ordinance etc, efforts for transformation of financial system to Shariah Compliant met with limited success only. This was primarily due to unavailability of adequate infrastructure and lack of trained human resources.

Learning from past experience, Islamic banking was re-launched in 2002 with a more practical and gradual approach that allowed Islamic banks to operate in parallel with conventional banks. This time we also introduced a comprehensive Shariah compliance framework to ensure that the operations of Islamic banks are in conformity with the Shariah principles; this was necessary to give confidence to the consumers about Shariah permissibility of Islamic banks' business and operations. The approach has proved a mega success as the industry growing from scratch in 2002 now constitutes over 8 percent of the country's banking system with a network of 964 branches and over 500 windows across the country. The future outlook is also positive; the Islamic finance industry with its rapidly growing acceptability both amongst the providers and users of financial services, is likely to increase its share in the banking system to 15 percent during next five years. Encouragingly, the sustained growth of Islamic banking in the country during the last decade has also started catalyzing growth and development of Islamic capital markets, Mutual funds and Takaful companies etc; presently we have 5 Takaful operators, about 30 Islamic mutual

funds. We have an effective coordination mechanism with SECP – the capital markets and NBFIs' regulator – and I am sure that the non-banking Islamic financial services industry would also be growing in tandem with the Islamic banking industry.

Ladies & Gentlemen! The State Bank of Pakistan fully owns the Islamic banking industry and has been taking a number of initiatives to strengthen the legal, regulatory and Shariah compliance framework, create awareness amongst the masses and build the industry's HR capacity. I will share a few with this audience today. The development and issuance of sovereign Sukuk for the domestic market, which is an important liquidity management instrument was a long outstanding demand of the industry. The SBP in collaboration with the industry and the Federal Government developed sovereign Sukuk and you would be pleased to know that during last two years sovereign Sukuk of Rs.369 billion (USD 4 billion approx) have been issued that has largely addressed the liquidity management issue of the industry. The regular issuance of the Sukuk, almost on quarterly basis, has improved market confidence and tradability of the Sukuk.

To improve transparency and bring standardization in IBIs' profit distribution and pool management practices, we have developed a comprehensive profit distribution and pool management framework in consultation with the industry. The framework will be issued most probably within this month and will be instrumental in improving public confidence in Islamic banking generally and profit distribution policies and practices of IBIs particularly.

Similarly to further strengthen the Shariah governance in IBIs, we are in the process of developing a comprehensive Shariah Governance framework. The framework will explicitly define the roles and responsibilities of different organs of IBIs including the Board of Directors, Shariah Advisors/Committees and Executive Management for ensuring Shariah compliance. Presently Shariah compliance is perceived to be the responsibility of the Shariah Advisors only whereas Board of Directors and Executive Management assume no such responsibility. This we believe is contrary to the corporate governance principles as unless the BOD and management are not fully aware of the Shariah non-compliance risk, it would be difficult for the Shariah Advisor to develop an effective Shariah compliance mechanism in IBIs. The proposed framework will fix these and other similar issues.

Further, the SBP, in collaboration with the industry, will also be developing the strategic plan for the industry for the next five years ie 2013–2017. The plan will make a detailed assessment of the earlier plan (2007–2012) as well as the existing environment and will set the strategic direction for the industry. This is an important project which would define the strategies and action plans to move the industry to the next level of growth and SBP would expect active and meaningful involvement of the industry in development of the plan.

Ladies & Gentlemen! As you all know that SBP has been at the forefront of the initiatives and programs for creating awareness. Being the host of today's program is a part of its efforts to improve public understanding of Islamic banking and minimize their apprehensions and confusions. While seminars, conferences, workshops are being organized across the country on regular basis, we will soon be launching a mass media campaign to create awareness about Islamic banking. The campaign we believe will be instrumental in enhancing public awareness and allaying their apprehensions and confusions about Islamic finance and thus would give further boost to the growth momentum.

Lastly, I would reiterate my optimism about the growth prospects of the industry; I believe the growth momentum will not only be sustained but will gather further strength as we will see some more key players entering the market with aggressive expansion plans in very near future. The challenge will however be to develop suitably qualified and trained HR to man this growth; while SBP will be further intensifying its efforts to build the industry's HR capacity through its regular and specialized training programs, the IBIs would also have to significantly increase their investment in HR development. Another challenge would be diversification of assets mix and tapping non-traditional sectors like agriculture and SMEs to deploy the growing deposit base in productive avenues. Presently the IBIs' exposure in these

sectors is nominal that needs to be increased significantly, which would not only improve their reputation amongst the masses but would also provide them an attractive avenue to develop and expand their assets portfolios. SBP would be willing to provide necessary support to IBIs to build portfolios in these non-traditional but strategically important sectors.

My thanks and appreciation again to Redmoney for organizing this event and I hope such collaborations will continue in future. I wish all the foreign delegates to have pleasant stay in Karachi and a safe journey back home.

Thank you.