

Yaseen Anwar: Islamic banking potential of Pakistan

Speech by Mr Yaseen Anwar, Governor of the State Bank of Pakistan, at the Round Table Conference on “Islamic banking potential of Pakistan”, Karachi, 15 January 2014.

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Mr. President, Honourable Governor Sindh, Honorable Finance Minister, Distinguished guests, ladies and gentlemen,

Assalamualaikum,

I am indeed privileged to be here today for addressing this prestigious gathering comprising all major stakeholders of the Islamic Banking Industry in Pakistan. The presence of foreign experts have today brings global experience to this roundtable conference and thus will further enrich the knowledge sharing experience. My appreciation to the organizers for holding this event to explore the real potential of Islamic banking in Pakistan, which I believe will give further boost to our efforts and optimism for growth and development of the industry.

Islamic finance during the last four decades has witnessed considerable progress at the global front. Besides the traditional Islamic finance markets of the Middle East, financial centers across various Western countries are also accepting and recognizing the viability and utility of this alternate financial system. In particular the relative resilience of Islamic financial institutions during the recent financial crisis due to its asset backed nature and being devoid of speculation and uncertainty, has significantly improved its credibility as a more prudent and stable system. The scope and range of Islamic finance products has also widened considerably over the years and Islamic financial institutions are presently catering to most of the financial services needs of various sectors of the economy. There are dedicated regulatory, legal and academic institutions at the international level working and providing support for maintaining the high pace growth of the Islamic finance industry.

Pakistan, with more than 95 percent Muslim population, and a constitutional obligation of ensuring a riba free economic system, has had a favorable response to Islamic finance. Pakistan is amongst the pioneers of Islamic finance as we started planning for nurturing the Shariah compliant financial system way back in 1970s, and made a bold attempt in 1980s to bring the whole banking and financial system in conformity with Shariah principles. The pioneering work of 1980s particularly on the legal and regulatory front has been a source of guidance and inspiration for many countries that initiated Islamic finance in the 1980s and 90s. The attempt to transform the whole system however, met with limited success largely due to slippages at the implementation and execution stage. This lead us to re-launch Islamic banking in 2001 in parallel to conventional banking thus allowing both Islamic and conventional banks to co-exist and enabling the consumers to do banking with the system of their choice and preference.

This approach has proved to be a huge success in promoting Islamic banking in the country and ensuring its demand driven development. The industry has been growing at an impressive annual growth rate of over 30 percent over the last five years with sustained growth momentum despite significantly increased base. Islamic Banking is currently spread across 80 districts of the country with a network of 1200 branches offering Shariah compliant products and services. Islamic banking assets presently constitute almost 10 percent of the overall banking system in the country while in terms of deposits the share is above 10 percent. The future outlook of the industry is also very positive with bright prospects of doubling its market share by 2020.

The presence of his Excellency, the President of Pakistan, and the honorable finance minister in the conference speaks volumes about the strong commitment of the government for the promotion of Islamic banking and finance in the country. I would like to take this opportunity to highlight that State Bank of Pakistan has been playing a leading role in

nurturing Islamic banking in the country on sound footings. Being the regulator of the banking sector, SBP over the years has introduced and implemented key regulatory reforms and prudential measures to ensure financial stability and to meet the evolving needs of the industry. We have also given a comprehensive and multi-tiered Shariah compliance framework to ensure Shariah conformity of Islamic banks' operations. To further strengthen the Shariah compliance environment in Islamic banks we have also developed a Shariah Governance Framework, which explicitly defines the Shariah related roles and responsibilities of all key organs of IBIs including Board of Directors, the executive management and Shariah Boards. It also institutionalizes the Shariah compliance function in IBIs.

Moreover, to develop an effective prudential and risk management framework for Islamic finance, an incremental approach was adopted wherein new regulations for only such areas and risks of Islamic banks were developed which were not being covered by conventional prudential regulations and risk management framework.

Further, in order to align its regulatory framework with international regulatory standards and best practices, SBP regularly reviews and evaluates the standards issued by IFSB, AAOIFI, and IIFM for their possible implementation keeping in view our local legal, regulatory and economic environment. Last year we issued landmark Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions (IBIs), which were well received both locally and internationally. The instructions are aimed at bringing standardization and improving transparency in profit & loss distribution practices of the industry and will be instrumental in improving the perception of Islamic banking amongst the masses.

Considering the demand of Islamic microfinance, SBP has offered various options to offer the services of Islamic microfinance. These options include the establishment of full-fledged Islamic microfinance banks, Islamic microfinance services by full-fledged Islamic banks and Islamic microfinance Divisions in conventional microfinance banks. This, coupled with its inherent checks on end use of the funds provided by microfinance institutions, the outlook for growth and development of Islamic microfinance in Pakistan is positive.

Similarly for an agro-based economy like ours, there is huge potential for development of Shariah Based Agriculture financing. SBP is working with the industry to develop Shariah compliant agriculture finance products particularly Dairy products which can generate more than \$ 500 million in foreign exchange exports.

Islamic finance is an evolving industry and so is its understanding by the masses, the business community and the policy makers. Despite significant improvement during the last decade, still a large segment of our population does not have adequate understanding of Islamic finance and is unable to comprehend its distinction over conventional finance. The State Bank therefore, besides developing a supportive regulatory and supervisory framework, is also actively engaged in undertaking awareness creation and capacity building initiatives through its awareness campaign whereby targeted seminars and conferences are being organized for the business community, academia, bankers and policy makers throughout the country. In this context, the most significant milestone that has been achieved in the recent past is the launch of an industry wide media campaign under the support and guidance of SBP. This campaign is targeted to address mass awareness issues by using print, electronic and digital media.

Further, SBP has recently developed a five year Strategic Plan (2014–18) for the Islamic banking industry in Pakistan in consultation with all key stakeholders, which gives a consensus agenda and strategy to take the industry to its next level of growth and development. The plan has an extensive focus on improving public perception of Islamic banking as a distinct and viable system capable of catering to the varied financial services needs of various segments of the society. It envisages intensifying the awareness creation efforts, strengthening consultation mechanism with stakeholders, removing confusion and

inconsistencies in legal, regulatory and taxation environment, deepening and broadening of product offerings by Islamic banks, doubling the outreach of Islamic banks during the next five years and increasing the market share to 15 percent of the banking system.

Pakistan has been an active member of leading global International Islamic finance institutions like the Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and the International Islamic Financial Market (IIFM) that are all playing a key role in developing prudential and Shariah standards for the industry. Being part of the global efforts for the development of global standards for the industry has certainly helped us in improving our presence on the global Islamic finance map and adopting the prudential and Shariah standards in Pakistan.

I would also like to mention here that SBP is also a key member of the recently constituted steering committee for the promotion of Islamic banking by the government which is mandated to devise a comprehensive policy framework for the Islamic financial system, suggest practical steps needed to be taken for implementing Shariah-based financial system, and propose solutions for the Islamic secondary market / money market for liquidity management. These initiatives on part of the government sends a clear signal that the present government views Islamic banking and finance as an integral part of the overall financial system. We at SBP share the same view and believe that steps like these can go a long way in further increasing the scope of the industry in the country.

Innovation requires research, hence it is imperative that the industry players give utmost importance to research in their organizations. I am pleased to inform this esteemed audience that SBP has a dedicated team of researchers focusing on key areas relevant to the industry. We have recently conducted an extensive survey based study of 10,000 household across the country to assess the demand for Islamic banking and its attributes. The results of the survey will be shared with the industry soon and are highly encouraging as there is a huge untapped demand for Islamic banking in the country; and an even faster pace expansion of the industry would be needed to fill the demand and supply gap in the medium to long term.

Lastly! I would like to reiterate the full support and ownership of SBP in developing and nurturing a sound and stable financial system that meets the Shariah principles in letter and spirit. We will work with the industry and other stakeholders to ensure further strengthening of risk management practices, and an effective macro prudential framework and transparency in financial transactions and exposures. The State Bank of Pakistan remains committed to finding appropriate solutions to these challenges. I have no doubt that the support and cooperation of all stakeholders exhibited here today will lead to further strengthening the foundations of this important industry.

A pure Islamic financial system with its inherent focus on equity justice and social responsibility is ideal and this demands serious and coordinated efforts of all stakeholders on the continuous basis. I wish the best of luck to the industry and thanks once again to all the participants and organizers.

Thank you.