

Appendix-B

ISLAMIC BANKING IN SOME SELECTED COUNTRIES

Islamic Banking in Malaysia¹

Emergence: - The Islamic financial system in Malaysia was first introduced in 1963. It started from a modest beginning with the establishment of the Malaysian Pilgrims Fund Board (Tabung Haji), to the setting up of the country's first Islamic bank, Bank Islam Malaysia Berhad (BIMB), which commenced business on 1 July 1983.

BNM adopted a step-by-step approach to introduce Islamic banking. The first step to spread the virtues of Islamic banking was to disseminate Islamic banking on a nation-wide basis, with as many players as possible and to be able to reach all Malaysians. After a careful consideration of various factors, BNM decided to allow the existing banking institutions to offer Islamic banking services using their existing infrastructure and branches. The option was seen as the most effective and efficient mode of increasing the number of institutions offering Islamic banking services at the lowest cost and within the shortest time frame.

Legal & Regulatory Framework:- Dual Banking System: In Malaysia, separate Islamic legislation and banking regulations exist side-by-side with those for the conventional banking system. The legal basis for the establishment of Islamic banks was the Islamic Banking Act (IBA) which came into effect on 7 April 1983. The IBA provides BNM with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks. Both Conventional and Islamic Banking Systems are regulated by the Central Bank of Malaysia (Bank Negara Malaysia – BNM).

Statistics: - Islamic banking assets: RM147 billion with market share of about 12.3% in the overall banking industry. It has the largest Islamic private debt securities (IPDS) market. Out of the total outstanding bonds the percentage of outstanding sukuk as at 31st March 2008 was 56.1%. The size of outstanding sukuk (exclusive of government sukuk) stood at RM 149 Bn. As at 31st March 2008. The size of the Takaful assets is around RM6.9 billion. Active Islamic money market is channeling about RM30 billion - RM40 billion monthly. The spread of Islamic finance is also notable in the listed companies on the Stock Exchange as 86 percent of 853 companies are Shariah compliant.

Currently there are 18 Islamic banking players and 9 Takaful operators in Malaysia. The Islamic banking players include:

- 2 domestic Islamic banks
- 9 Islamic subsidiaries

¹ <http://www.bnm.gov.my>

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- 3 full-fledged foreign owned Islamic banks
- 4 Islamic windows

The Malaysia's official target for the Islamic Banking is 20% market share by 2010.

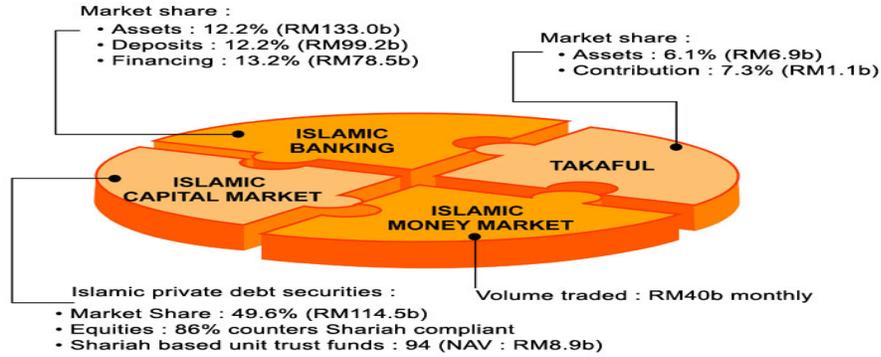
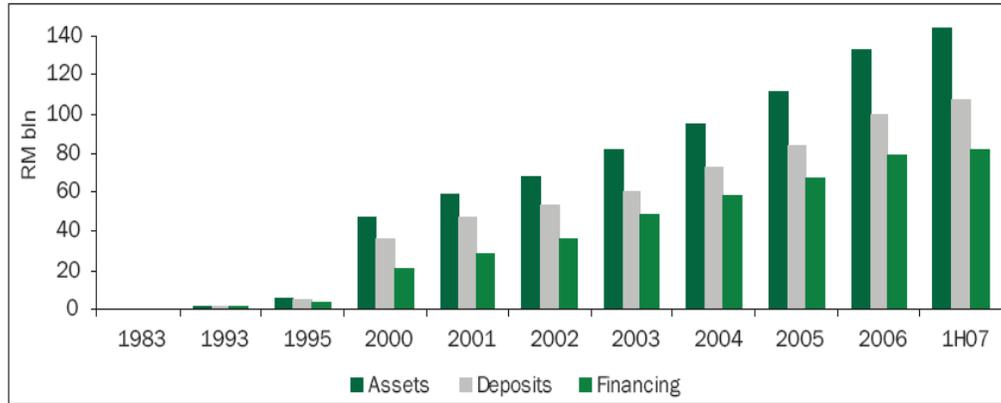


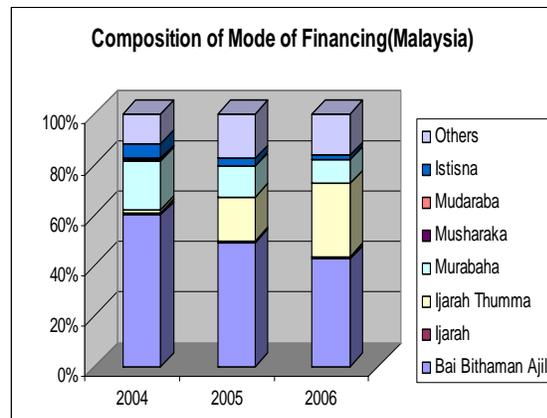
Chart 1: Malaysia's Islamic Banking Growth Trend (Assets, Deposits and Financing)



Source: Islamic Finance News Guide 2008

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Products and Services:- There are more than 100 Islamic financial products (covering both Asset and Liability side) and services which are currently offered by the banks using various Islamic concepts such as Mudharabah, Musharakah, Murabahah, Bai' Bithaman Ajil (deferred payment sale), Ijarah, Qard, Istisna' and Ijarah Thumma Bai'(leasing & subsequent purchase).



Islamic Interbank Money Market (IIMM):- The Islamic inter-bank money market (IIMM) was introduced in Malaysia on January 3, 1994 as a short-term intermediary to provide a ready source of short-term investment outlets based on Shariah principles. Through the IIMM, the Islamic banks and banks participating in the Islamic Banking Scheme (IBS) match their funding requirements effectively and efficiently. The IIMM covers the Mudaraba Interbank Investment and Interbank trading of Islamic financial instruments. Total of 12 instruments are used in the IIMM.

MIFC Initiative: August 2006 marked the launch of a nationwide initiative to promote Malaysia as an International Islamic Financial Centre - MIFC. The MIFC initiative is aimed at fortifying Malaysia's position as a vibrant, innovative and competitive Islamic financial hub. The Committee comprises a high-level group of 28 top officials from key Federal Ministries, Government Departments and Agencies, financial and market regulators and key representatives from the banking and takaful sectors. The Committee provides high-level policy direction while overseeing the review of existing policies towards ensuring the comprehensive and coordinated promotion of the MIFC. Wide range of incentives (including tax incentives) focusing on local & foreign investors, issuers, Islamic financial products and services have been offered by the government. Information regarding these and a whole list of guidelines relating to Islamic banks, takaful operators, Islamic REITs, Islamic Securities etc. are made available at the website of Malaysian International Islamic Finance Centre.

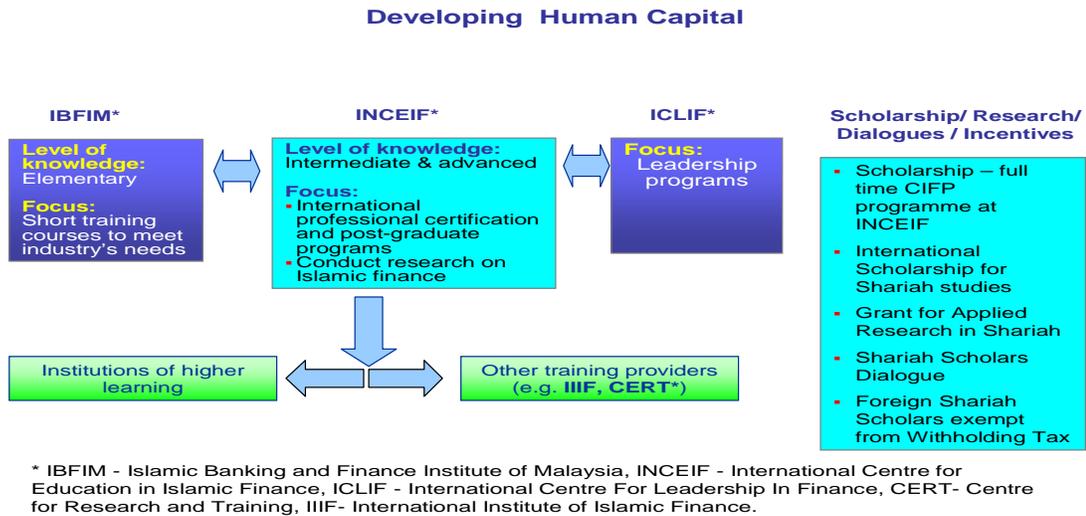
Special Measures: - The government recently outlined five measures to put more vigor into the development of Islamic finance in the country.

- Islamic finance institutions to have full time Shariah experts
- Advisers to be accorded proper standing in an institution
- Islamic finance institutions to promote research and development on a full-time basis

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- The make-up of Shariah panels should be of both Malaysian and international advisers
- Institutions to have more discussion programmes

Human Resource Development



Dispute Resolution – a) Dedicated commercial court to adjudicate Islamic banking cases. b) Regional arbitration centre for international disputes and financial mediation bureau for domestic disputes.

The Malaysian Accounting Standards Board adapts the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI's) Accounting Standards.

Islamic Banking in Bahrain²

In Bahrain, the Islamic finance industry first emerged exactly three decades ago, with the establishment of a commercial bank in 1978. Following a fairly quiet decade, Islamic banking activity began gathering momentum in the 1990s and since then there has been no turning back.

In recent years, Bahrain has rapidly become a global leader in Islamic finance, playing host to the largest concentration of Islamic financial institutions in the Middle East. In addition, Bahrain is at the forefront in the market for Islamic securities (Sukuk), including short-term government sukuk. The Central Bank of Bahrain ('CBB') is responsible for regulating and supervising the whole of Bahrain's financial sector.

² <http://www.cbb.gov.bh/cmsrule/index.jsp?action=article&ID=19>

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Statistics The Central Bank of Bahrain has played a leading role in developing the dynamic regulatory framework in Bahrain. The assets of wholesale Islamic banks stood at US\$20.1 bn in September 2007, while assets of retail Islamic banks touched US\$ 6.99 bn. Presently, there are 29 Islamic banks, 50 Islamic Mutual Funds and 18 Islamic insurance companies (takaful) operating in the Kingdom.

The Islamic funds industry is estimated to be growing at a rate of 20% a year with Islamic funds currently representing US\$ 1 billion of assets under management, in CBB registered funds.

Products: Islamic banks provide a variety of products, including murabaha, Ijara, mudaraba, musharakah, al Salam and Istisna, restricted and unrestricted investment accounts, syndications and other structures used in conventional finance, which have been appropriately modified to comply with Shariah principles.

Supervision/Regulation: Bahrain pursues a dual banking system (Islamic and conventional). In terms of regulation, the Islamic financial sector is subject to the same supervisory regulations as conventional banks, including any requirements of the Basel agreements. The Prudential Information and Regulatory Framework (PIRI) - regulations which cover capital adequacy, asset quality, management of investment accounts, corporate governance and liquidity management - was the first comprehensive framework created specifically to deal with Islamic banks.

Achievements

- The CBB has granted the license to Dubai's Masrafy Bank, the world's first Islamic investment bank aimed particularly at women.
- The CBB has also approved in principle the first Shariah-compliant bank, "First Energy Bank" which will focus on the investment, financing and service needs of the energy sector.
- The Central Bank of Bahrain was also the first central bank to implement the standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), for the local market, which were then adopted by Sudan, Jordan and Qatar.
- Bahrain was the first country to develop and implement in 2001 a comprehensive regulatory framework for Islamic banks. This was followed in 2005 by a regulatory framework specific to Islamic insurance (takaful) and reinsurance (retakaful) companies. And, from the start of 2008, the CBB has notched up another first by implementing Basel II requirements for both conventional and Islamic banks.

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Supporting activities for Islamic finance³

- Besides the numerous Islamic financial institutions active in its financial sector, Bahrain also plays host to a number of organizations involved in the development of Islamic finance on global front, including:
 - (i) The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI);
 - (ii) Liquidity Management Centre (LMC);
 - (iii) The International Islamic Financial Market (IIFM),
 - (iv) The Islamic International Rating Agency (IIRA).
- A Waqf Fund was established in 2006 with an initial capital \$4.6 million by the Bahrain Central (CBB) in partnership with several Islamic financial institutions (IFIs) aimed at furthering Islamic finance training and education. This programme also includes public awareness programmes, roundtable discussions and Shariah programmes, in addition to financing professional and academic studies of individuals working in the Islamic finance industry. The Fund will also seek out prestigious international organizations, which could partner with the Bahrain Institute of Banking and Finance (BIBF) in delivering training programmes. BIBF is ready to launch Diploma in Islamic accounting & Compliance with the collaboration of Association of International Accountants.
- Islamic retail banks in Bahrain have been granted a key exemption, which will considerably facilitate the Islamic mortgage business. The new move eliminates the payment of stamp duty twice in mortgages extended in accordance with Islamic principles. Earlier the stamp duty was being paid twice on Islamic mortgages, once by the bank and once by the buyer as Shariah-compliant mortgages usually involve the bank buying the property and customer 'renting' it over a length of time at the end of which the customer 'buys' the property from the bank but now Islamic banks are no longer required to pay the stamp duty when buying properties on behalf of customers.³

Islamic Banking in Indonesia⁴

The development of the Shariah banking in Indonesia started well before a formal legal base for Shariah banking operation came into force. Former presidents, Sukarno and Suharto were wary of promoting Islamic law in a multi-religious and multi-ethnic country, even though Muslims make up the majority of Indonesia's 209.4 million citizens. However, Suharto's successor, B.J. Habibie is credited with giving

³ Central Bank of Bahrain's "Islamic Finance Review" October, 2006

⁴ The Report – "Emerging Indonesia-2007" by Oxford Business Group

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Islamic banking a big boost. Abdurrahman Wahid, who used to head a major Muslim organization, also further encouraged Islamic banking.

The development of modern Islamic banking in Indonesia was formally initiated in 1992⁵, in line with the enactment of Banking Act No. 7 of 1992 which includes provisions to develop interest-free banking. Indonesia's first Islamic bank was Bank Muamalat, which was established in 1991. It operates according to the tenets of Shariah law, which prohibits charging interest on loans and paying interest on deposits. Based on the Banking Act No. 7 of 1992, Indonesia recognized the existence of a dual banking system, that is, a system where conventional banking grows side-by-side with Islamic banking to serve the economy.

During the period 1992 to 1998, there was only one Shariah commercial bank and 78 Shariah rural banks. Subsequently in 1998, an amendment was made in the laws which gave a stronger legal foundation to the existence of Shariah banking system. During the period between 1998 to 2001, Shariah banking system grew by about 74 percent annually (in terms of asset size). The numbers of Shariah branch offices and Shariah unit banks also increased from 26 to 51 branches.

Currently there are 3 Full Commercial Sharia Bank with 365 offices (including of sub branches, and cash offices) 25 Conventional Commercial Banks having Sharia Banking Full-Branches with 164 offices (including of sub branches and cash offices) and 109 Islamic Rural Banks in Indonesia. HSBC is the only foreign bank currently licensed to conduct Islamic banking in Indonesia According to Bank Indonesia, Islamic banking assets reached in March, 2007 to 1.67 percent of total assets as compared with 0.7 percent in 2003. The deposits stood at 1.69% and financing at 2.60% of the total banking sector.

Bank Muamalat Indonesia (BMI) was the first Islamic bank established in 1991. Endorsed by the Indonesian Council of Ulemas (MUI) and the Government of Indonesia, it commenced operations in May 1992. On October 27, 1994, BMI received its license to operate as a Foreign Exchange Bank. This recognition strengthened the Bank's position as the first and leading Shariah (Islamic) bank in Indonesia with a growing array of products and services. On June 21, 1999, Islamic Development Bank (IDB) based in Jeddah, Saudi Arabia, officially became one of the shareholders of BMI.

Bank Syariah Mandiri is the largest bank in Indonesia in term of assets, loans and deposits. On December 2006, the bank had 924 branches spread across three different time zones in Indonesian archipelago and six branches abroad.

⁵ "Case Study of bank Indonesia" by Maulana Ibrahim

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In 2002, Bank Indonesia published ‘The Blueprint of Islamic Banking Development in Indonesia’ (Bank Indonesia, 2002). This blueprint outlines the central bank’s goal, and implementation strategy, for the development of an Indonesian Shariah Banking System, which complies with international standards in terms of financial products and services.

The Blueprint defines the position, vision and strategic initiatives in developing Shariah banking for the next ten years. The Blueprint serves as a critical reference for Shariah banking stakeholders. The vision of Shariah banking is defined as follows:

“The establishment of a competitive and efficient Shariah banking that complies with prudential banking principles, and significantly supports real sector activities through share-base financing with real underlying transactions in the spirit of justice, brotherhood and good deeds, to promote the well-being of the nation. “

The Blueprint initiatives can be categorized into four major activities:

- Ensuring better Shariah compliance
- Improvement on prudential regulations
- Supporting operational efficiency and competitiveness
- Supporting a higher level of systemic stability

These initiatives are being implemented in three stages:

- The first stage puts forth strong foundation for sustainable development of the industry.
- The second stage focuses in strengthening the structure of the industry.
- The last stage focuses on the adoption of international standards for Shariah banking services.

The strategies formulated by Bank Indonesia for the development of an Islamic banking system can be summed up via four major steps:

- Further strengthen and improve the legal framework for the co-existence of an Islamic banking system. It should be paralleled with the development of regulatory instruments, to create a sound Islamic banking system.
- Develop a network of Islamic banks in order to provide greater access to the public in utilizing Islamic banking products and services.
- Create and develop monetary instruments that could support both monetary objectives on a macro economic level, as well as the operational objectives of Islamic banks.
- Publicize the Islamic banking concept, as well as conduct training for the development of human resources.
- Reach 5 percent of total banking assets by 2011. To attain this target, Shariah financing has to expand 60 percent to 70 percent annually.

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Communication Center for Islamic economics (PKES)

Islamic banking and finance industry together with stake holders agreed to form Center of Communication for Islamic Economics (PKES) on 17 December 2003. PKES is an independent institution established by practitioners of Islamic Economics comprises of Bank Indonesia, Islamic banks, Non-bank financial institutions and other supporting institutions. The objective of PKES is to create synergy among practitioners of Islamic banks to socialize and communicate the system(s), products and institutions of Islamic finance (whether bank or non bank) in effective and efficient ways.

The Indonesian Institute of Accountants (IAI)

On 25 June 2003, an agreement was signed between Bank Indonesia and IAI to structure the accounting standard for Islamic banks (including the implementation of research and training cooperation for the field that relates to the competency of IAI). Since 2001, Audit Guideline for Islamic banks, Review on Guideline of Financial Accounting Standard (PSAK) 59 and Financial Accounting Standard for Islamic Bank in Indonesia (PAPSI) have been issued by IAI. In drafting the Shariah financial accounting standards, IAI works with Bank Indonesia, National Shariah Board and Shariah banking practitioners. Standards released by the International Shariah financial accounting body such as AAOIFI are used as a benchmark.

National Agency for Islamic Arbitrage (BASYARNAS)

The National Shariah arbitrage was established in 1992 as Indonesian Muamalat Arbitration Board. Its name was changed to National Agency for Islamic Arbitrage Basyarnas in 2003. Basyarnas supports the infrastructure of developing national Shariah banking industry. Since its establishment, only a few cases have been submitted for arbitrage due to insufficient information on the benefits offered by Basyarnas for the settlement of the disputes.

Islamic Banking Cares for Community Program (PSPU)

Islamic Banking Cares for Community Program (PSPU) is a platform to maximize benefits of social funds that are controlled by Islamic banks. This forum was formed at the end of 2005 with members comprising of all Islamic banks, Bank Indonesia, Zakat Amil Institution (LAZ) networks and Zakat Management Unit (UPZ). The activities of PSPU are focused on the improvement of management of the social funds in order to reduce poverty and empower small and medium enterprises.

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Country Wise Regulatory and Shariah Compliance Framework for Islamic Banking

Country	Regulatory Authority	Islamic Banking Law	Shariah Committee		Shariah Standards	Accounting Standard
			At Central Bank	at bank Level		
Malaysia	Bank Negara Malaysia	Islamic Banking Act 1983	National Shariah Advisory Council (NSAC)	Shariah Committee	All Products approved by NSAC of BNM	Accounting Standards developed by MASB
Bahrain	Central Bank of Bahrain	NIL	Shariah Supervisory Committee	Shariah Supervisory Board	AAOIFI	AAOIFI
Indonesia	Bank Indonesia	Introduced in 1992 & Amended in 1999	National Shariah Board (NSB)	Shariah Supervisory Board	Fatwa on products issued by NSB	AAOIFI
Iran	Central Bank of Islamic Republic of Iran	Usury free Banking Act 1983	Council of Guardian	N.A	Guidelines provided by Council of Guardians	IAS being adopted
Brunei	Ministry of Finance	Islamic Banking Act Cap.168	Shariah Financial Supervisory Board (SFSB)	Shariah Advisory Board	SFSB Approves Islamic products of Financial Institutions	IAS
Pakistan	State Bank of Pakistan	BCO,62 amended to support Islamic banking	Shariah Board	Shariah Advisor	Essentials for Islamic modes	AAOIFI standards are being adapted by committee of ICAP
Gambia	Central Bank of Gambia	Islamic banking law exists	NA	Shariah Board	NA	IAS

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Jordan	Central Bank of Jordan	Provisions for IB included in Banking Law of 2000	NA	Shariah Board	AAOIFI	IAS
Kuwait	Central Bank of Kuwait	Provisions for IB included in Banking Law	NA	Shariah Board	NA	IAS
Sudan	The Bank of Sudan	Islamic banking law exists	Higher Shariah Supervisory Board	Shariah Board	AAOIFI	AAOIFI
Turkey	Central Bank of Turkey (TCMB)	Law about Special Finance Houses covers IBs	NA	NA	NA	IAS
UAE	Central Bank of UAE	Islamic banking law exists	NA	Shariah Board	AAOIFI	IAS
Saudi Arabia	SAMA	NIL	NA	NA	AAOIFI	AAOIFI
Syria	Central Bank of Syria	IB law exists (Legislative Decree No.35)	NA	Shariah Board	AAOIFI Standards	AAOIFI Standards
Yemen	Central Bank of Yem (CBY)	Islamic banking law exists	NA	Shariah Board	NA	IAS