

State and need of an

Islamic Inter-Bank Market in Pakistan

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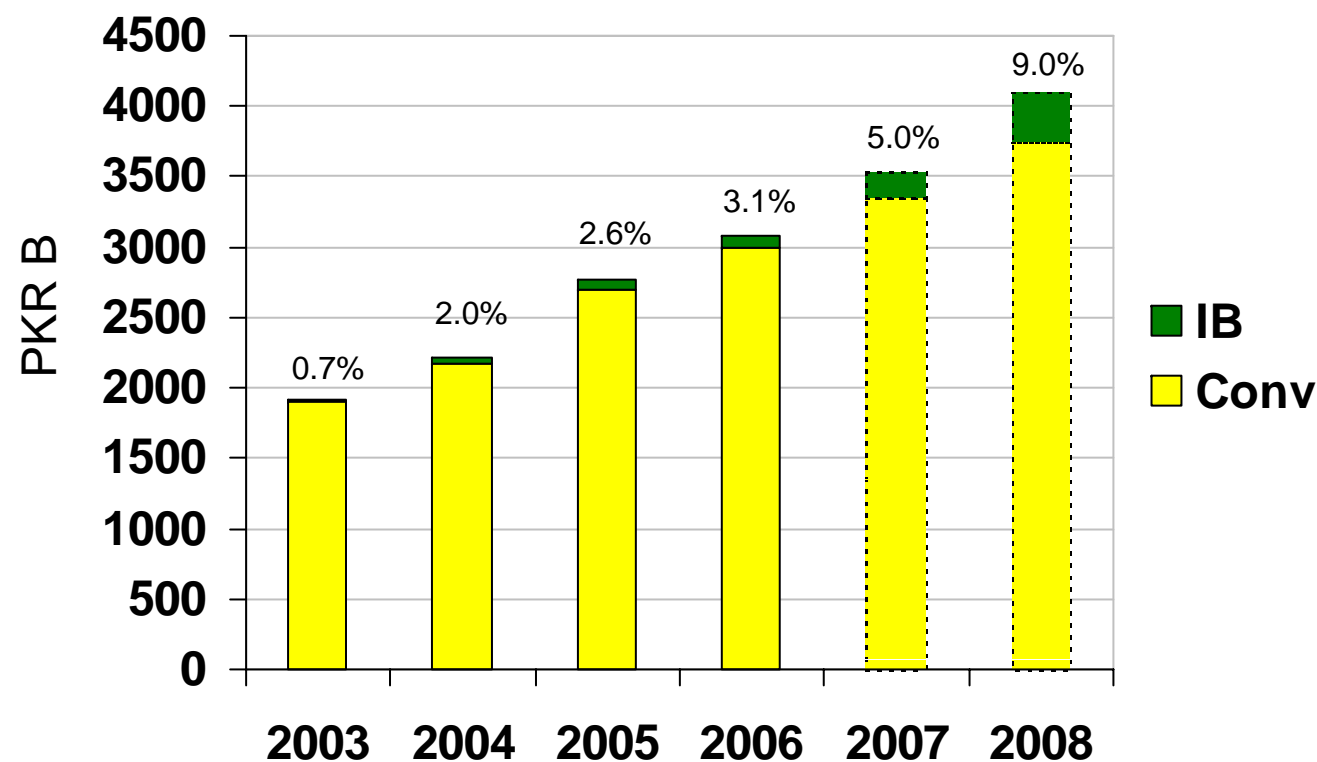


Outline

1. The backdrop – industry growth
2. Current scenario - Islamic IB Market in Pakistan
3. What constitutes a good Islamic IB market
4. Potential Products
5. Cross-border inter-bank market
6. Structure of an Islamic inter-bank market
7. Implementation



Islamic Banking market share - Assets



Islamic banking expected CAGR is 100%+



The backdrop – Islamic Banking in Pakistan

2006

Total Banking industry deposits \$ **48 B**
(Historical growth rate **16% p.a.**)
Islamic banking deposits \$ **1 B**
(Historical growth **122% p.a.**)
Total Islamic banking branches **110**



2010

Total Banking industry deposits \$ **78 B**
(Projected growth rate **13% p.a.**)
Islamic banking deposits \$ **12 B**
(Projected growth **81% p.a.**)
Total Islamic banking branches **440**

2006

Islamic Banking market share **2%**



2010 : Islamic Banking Deposit market share

	% share	\$ B
Pessimistic	10%	8
Average	15%	12
Optimistic	20%	16



Islamic Inter-bank market in Pakistan – Current scenario

- Islamic banks managing reserve requirements by high cash reserves and low liquidity reserve
- Absence of level playing field with conventional banks,
 - unavailability Shariah compliant securities
 - no lender of last resort
- Quantum requirement of Islamic inter-bank market estimated at US\$ 1- 1.5 billion
- Number of players on the increase (2 in 2001 to 16 in 2006)



Islamic Inter-bank market in Pakistan – Current scenario

- Listed issues of WAPDA Sukuk (Rs.8B) & Al Zamin Modaraba Trust Certificates
- Floatation of the 1st Pakistan Sovereign Sukuk in the International Market in 2005
- Privately placed Sukuks of Sitara Chemicals & Al Wateen Telecom during 2006
- Around US\$ 150 M – US\$ 200 M Sukuks in the pipeline



Constituents of a good Interbank Market

FEATURES	IMPLEMENTATION
Wide Range of securities	<ul style="list-style-type: none">• Government paper• Corporate paper
Large number of players	<ul style="list-style-type: none">• Islamic institutions• Conventional institutions• Foreign players
Efficient Principal Dealership	Promote Liquidity thru active trading and 2 way pricing
Efficient Settlement System (transparency)	An SGLA system (Security transfer against cash transfer)



Potential products

- Sukuks of various tenors, issued or guaranteed by Federal Government
- Musharaka certificates (work-in-progress at SBP)
- Commodity Murabaha – short term fixed income product (allows for interaction between Islamic and conventional banks)
- Equity (Shares) not ideal for use in an inter-bank market
- Islamic benchmark rate should be developed (although KIBOR can be used initially)
- Islamic rating needs to be developed



Cross-border Market

Where Pakistani Banks can invest in international Shariah compliant securities and vice versa

- To benefit from frequent sukuk issues in the GCC market (International Islamic Sukuk issues over US\$ 8B)
- Will result in 2 way capital flow (in USD and EUR)
- However Net inflows from (capital exporting) GCC countries will far exceed outflows into foreign issues
- Foreign currency exposures would be controlled through regulatory / risk limits



Structure of Islamic inter-bank market

- Islamic banks should be given prime dealer roles to avoid crowding out by stronger conventional banks
- Islamic banks should take the lead in market making to create an actively traded secondary market
- This market will not be limited to Islamic players, conventional banks will also actively participate if risk/return features are attractive



Implementation

- Islamic banks must securitize exposures to enhance the quantum and quality of the inter-bank market
- This will compel obligors to adopt good corporate governance and seek ratings, (this will improve the quality of the overall banking market)
- Islamic industry grouping needed to encourage issuance of Shariah compliant government securities
- Need for a robust Islamic regulatory framework