

IN FOCUS: ISLAMIC BANKING

a case study of *Meezan Bank*

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The Shariah compliance function is the core differentiating factor between an Islamic Bank and a conventional Bank. Over the years, the global Islamic Banking industry has witnessed rapid growth with particular focus on improvement of the Shariah compliance mechanisms currently in place. With focus on the awareness of the Islamic Finance consumers, the Islamic Finance industry is rigorously working to provide more authentic and reliable mechanisms of Shariah compliance so that the system is preferred by its customers to fulfill their banking needs.

Islamic banks are playing an active role in this aspect by putting comprehensive Shariah controls and mechanisms in place. The Pakistani Islamic Banking industry, particularly, Meezan Bank has made notable efforts and progress in this area. In the year 2013, Meezan Bank was recognized as the 'Best Research & Development' institution by the Global Islamic Finance Awards. This achievement goes onto show the support of the central bank which has led Meezan Bank as being referred to, a benchmark of Shariah Compliance in both local & global Islamic Finance industry.

ISLAMIC BANKING IN PAKISTAN

Pakistan, in recent years has showed strong inclination towards Islamic Banking. The first Commercial Islamic Bank in the country was established in 2002 and within 12 years, the Islamic Banking share became more than 12% of the entire banking industry. Over the last decade, Islamic Banks have been successful in providing end to end Shariah compliant alternatives to all conventional banking products. The robust regulatory framework of Islamic Banks in the country is one of the major success factors which have supported this rapid growth. With more than 1300+ Islamic Banking branches and more than 30% annual growth in deposits, assets, financing and investments, the Pakistani Islamic Banking industry is set to become the hub of Islamic Banking of the region.





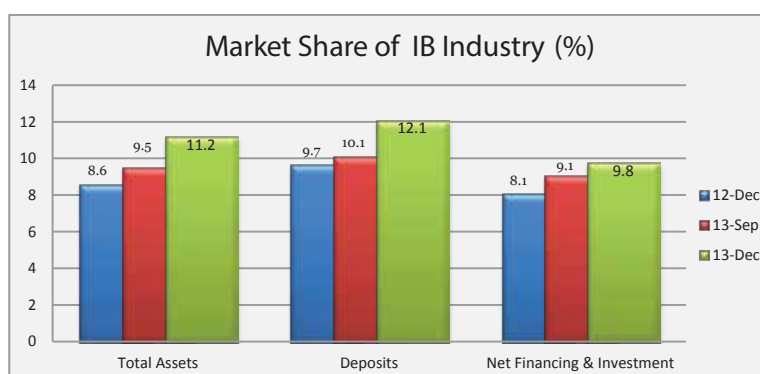
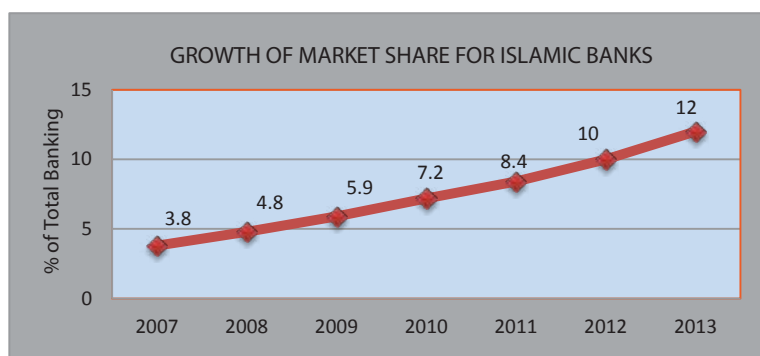
Meezan House

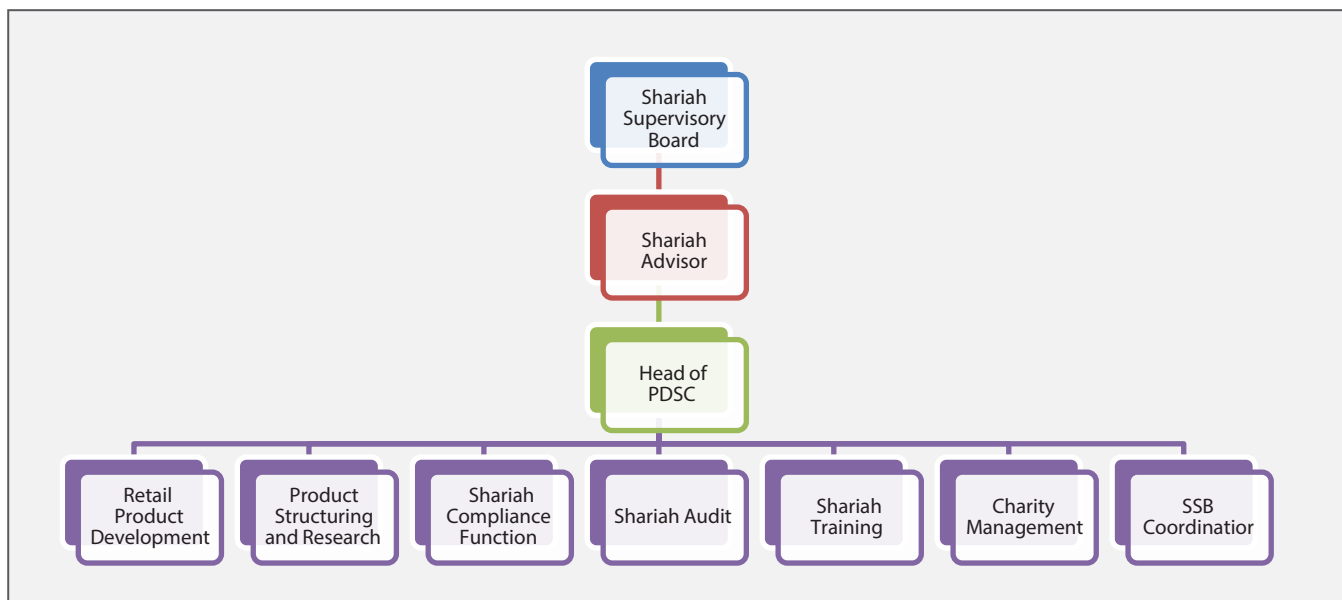
SHARIAH SCHOLARS

The presence and guidance of Shariah scholars is the backbone for any Islamic Bank. Pakistan is one of the most resourceful countries in this regard. The presence of eminent scholars, like Sheikh Muhammad Taqi Usmani, world's leading and most respected scholar on Islamic finance gives a major boost to the cause of Islamic banking and its global acceptability. There are many other Pakistani Shariah scholars who are part of Shariah boards across the globe. Fortunately, the Pakistani Islamic Banking industry has been working under the supervision of world's renowned scholars which have made Islamic Banking very sound and reliable.

Training

Quality human resource is a key component of a successful venture. When it comes to Islamic banking it bears the same importance, in fact the nature of the industry demands highly skilled and





technically sound employees to carry the prestigious label of Islamic banking. The Pakistani Islamic Banking industry, over the years has developed technical expertise with the ability to conduct training sessions at various forums. In order to help establish Islamic banking in other countries, training and development of human resources is a necessity. Pakistan can play a vital role in fulfilling the need of quality human resource. There are many distinguished speakers who regularly participate in national and international conferences, seminars, workshops and other platforms. Eminent scholars conduct Islamic Banking courses at various academic institutes and provide services for course structuring, curriculum development and testing services.

Development Of Regulatory Framework And Initiatives From The Central Bank

The regulatory framework of banking industry must be technically sound and Pakistan is one of those few countries, where central bank has devised a robust regulatory framework with the support of Islamic banks. The State Bank of Pakistan has also established a separate department to support and monitor Islamic Banking in the country. Although, the Islamic banking industry is just a decade old, its regulatory framework is quite comprehensive which covers almost all aspects of Islamic Banking. Specific regulations for Shariah compliance are one of the major highlights of SBP along with a separate

comprehensive Shariah governance framework for Islamic Banks.

Besides working on the Shariah compliance framework, the State Bank has also taken a major initiative by bringing all stake-holders on a single platform for launching a joint media campaign to promote the Islamic Banking Industry in the country.

The Shariah Compliance Framework at Meezan Bank

Meezan Bank has a separate department for Shariah compliance known as the Product Development and Shariah Compliance (PDSC) department, with the mandate to ensure Shariah compliance, conduct Shariah Audit of the Bank, Research for new product development through innovative ideas, Charity Management and Shariah Training. PDSC Department has more than 35 professionals which is a large team for Shariah compliance across the globe.

Product Structuring & Research (PSR)

The Product Structuring and Research is the origination point of innovation of new products and services as per Shariah guidelines. Various financial products and services have been developed to fulfill previously addressed financial needs of the customers. Besides developing new products, the PSR function also conducts research in order to refine, modify and redefine existing financial products. Providing customized Shariah compliant financial solutions to Corporate,

Commercial, SME Clients and development of Liquidity management and treasury related products are highlights of the PSR function.

Customized Shariah compliant financial needs for all segments of business are done by analyzing the following:


- Customer's business cycle
- Tenure (short term or long term)
- Existing alternatives present in the market
- Rate of financing (fixed or variable)
- Payment flexibility (possibility of early repayment)
- Tax concerns
- Accounting treatment
- Regulatory aspect
- Risk mitigation measures
- Mode and nature of the Assets
- Basic Shariah Principles

Once the idea and the structure of a new product are finalized, they are presented before the Shariah Advisor who may either approve, decline or suggest modification in the product.

In cases where the Shariah advisor may not approve or decline the product but rather give instructions for the presentation of the same in the next Shariah Supervisory Board (SSB) meeting, the SSB will then take the final decision on the product.

Shariah Compliance Function (SCF)

The Shariah compliance function has a broad scope in terms of its involvement with all departmental functions in the bank. The basic purpose of SCF is to

A photograph of a modern interior space, likely a hallway or lobby. On the left, there is a large window with horizontal metal bars or louvers. The wall to the right of the window is made of light-colored, textured stone or concrete blocks. The ceiling is dark with recessed lighting. The floor is dark and reflective. The overall atmosphere is contemporary and professional.

Meezan Bank's Shariah Advisor report is considered as the most informative and comprehensive report in the global Islamic banking industry and also referred as a benchmark.

ensure and monitor Shariah compliance related to:

- Corporate, Commercial and SME financing (assets of MBL)
For each customer a separate process flow is devised. Hence, Murabaha Process Flow for a textile concern will be different from that designed for a sugar mill, leather tannery, fiber producer, power station etc.
- Investment banking transactions related to Sukuk and syndicated financings.
- Funding, financing, investment, foreign exchange related as well as other activities conducted by the department of the bank.
- Pool Management and profit distribution of deposit products.
- Development of bank wide policies, procedures and guidelines for ensuring Shariah compliance and vetting policies of other departmental functions such as HR, marketing, admin etc.

The importance of SCF can be judged from the fact that the bank's management has designated the authority to approve or disapprove any financing proposal so that nothing is compromised on Shariah principles. For example, upon review if SCF holds the opinion that facilities proposed in the financing proposal are not practical as per Shariah then SCF will not approve the limit and will propose a different solution/product to the business unit. In 2012 alone, the SCF function reviewed more than 1300 financing proposals.

Besides reviewing all financing transactions and bank policies, the SCF also serves as the coordination unit with

the Shariah Supervisory Board which includes planning the meetings of the Shariah board, preparing agenda items to be presented in the meeting, rolling out the decisions taken in the Shariah board meeting across the bank as well as ensuring proper implementation of the rulings.

Shariah training also falls in the ambit of SCF which conducts all Shariah related trainings within the bank and among the customers, covering concepts of Islamic finance, product training in light of Shariah rulings and refresher courses to reinforce the concepts of Islamic Finance along with any further updates regarding the development in the Islamic finance industry. Different modules of trainings are designed in order to cater to different kinds of audiences. The period of training may vary from one day to as long as 4 months based on the complexity of the course. Trainings may be focused on a single product or may cover the entire ambit of Islamic Finance.

Shariah Audit

The objective of Shariah audit is to ensure proper execution of transactions as per the guidelines laid out by product development and Shariah compliance team. The Shariah audit team reports directly to the Shariah Supervisory Board and works under the supervision of the in-house Shariah Advisor. The Shariah audit of a branch/department is conducted by a particular team assigned, based on which the Shariah audit report is prepared and assigned a rating taking into consideration the audit observations raised. In 2012, more than 250 branches were audited and reports issued.

In case of financing branches, if an audit observation is raised on transac-

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tions of a particular customer and if it is of serious nature with respect to Shariah compliance then charity may be imposed. Based on the seriousness of the audit observations, Shariah audit may refer the case to Shariah compliance team for the revision of the process flow. Until the process flow is revised no future disbursement may be made. The Shariah Audit team also ensures proper fresh hiring throughout the bank by taking interviews of the candidates by testing their basic Shariah knowledge.

The Shariah Audit team works closely with the Shariah Advisor in preparing the Shariah Advisor report each year. Meezan Bank's Shariah Advisor report is considered as the most informative and comprehensive report in the global Islamic banking industry and also referred as a benchmark. The report entails all activities of the bank and provides information of the Shariah activities, new product development and areas of improvement as well in the banking activities, if required.

Advisory Services

Meezan Bank has developed alternatives of all types of assets and liability products which any conventional bank may offer. Having a well established

Year	Number of training sessions	No-of Employees Trained
2010	76	1750
2011	100	2786
2012	109	3314

Year	Number of Seminars	Attendance
2009	24	1955
2010	38	4370
2011	39	4540

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product catalogue, Meezan bank offers its counterparts assistance in developing products. Meezan bank has provided consultancy services to international banks such as Amanah Banks which is in the process of formation, ensuring Shariah compliance not only at startup but also making it certain that there are no loopholes which may pull the bank towards being non-Shariah compliant in future. Another important function to provide consultancy is Shariah audit and Shariah compliance as well strengthening and streamlining the internal operations of its client organizations from the Shariah Compliance perspective.

Retail Product Development

Retail product development is another vibrant function of the Product Development & Shariah compliance department. The unit functions in developing innovative deposit products, consumer financing products and is also involved in the profit distribution and pool management system of the bank. This unit plays a vital role in re-vamping existing products to retain existing customers and also to attract new customers to the bank. Recently, Meezan Kafalah, a saving plan with takaful benefits was developed by this unit which received an overwhelming response from the market.

Charity Management

At Meezan bank, charity management is done through Ihsan Trust which was founded in January 2010. Ihsan Trust Fund is a Waqf, made through a separate Waqf Deed. There are two sources through which Ihsan Trust raises funds which include charities from customers and donations from other Islamic Banks and Islamic Asset Management companies.

Ihsan trust has been focusing particularly in the areas of health and education

by providing medical equipment to hospitals and by providing interest-free loans (Qarz-e-Hasn) to students who lack financial resources to continue their higher educations. Till now, Ihsan Trust has helped more than 1000 students to pursue higher education in leading universities like IBA, LUMS, NUST, GIKI and others.

Shariah Supervisory Board Coordinator

The Product Development & Shariah compliance department plays another important role in the bank by acting as the coordinator with the Shariah Supervisory board. Coordination including arranging meetings, follow up and implementation of the directives of the SSB is also the responsibility of this department.

The Shariah compliance functions has become a critical driving factor for not only performing well but also as a survival mean in the Islamic Finance industry. Meezan Bank, in this regard has emerged as a role model for other banks both locally and globally, which can be proved by its unmatched success which has led Meezan Bank to win the award of the best Islamic Bank of the country on regular basis on different forums. Recently, Meezan Bank was named as the ‘Best Research & Development in Islamic Finance 2013’ by Global Islamic Finance Awards.

The entire banking industry of Pakistan is currently facing challenging times due to the declining discount rates which has squeezed the banks’ margin of profits and in this situation, Islamic Banks face further challenges of not only maintaining their performance in terms of profitability but also maintain it without any compromise on Shariah compliance.

