

Shariah Supervisory Board Report - 2015

الحمد لله رب العالمين، و الصلاة و السلام
على خاتم الأنبياء والمرسلين، محمد المصطفى
الأمين، وعلى آله وأصحابه أجمعين، وبعد:

By the Grace of Allah, the year under review was the fourteenth year of Islamic commercial banking for Meezan Bank Limited. During the year, the Shariah Supervisory Board (SSB) of Meezan Bank held three meetings to review various products, concepts, transactions, processes and their Shariah-compliance, referred to them by the Resident Shariah Board Member.

As part of the Shariah Governance Framework, a full-fledged Product Development & Shariah Compliance department (PDSC) is working under the guidance of Resident Shariah Board Member. The role of this function is to facilitate new research & product development activities, refine existing products & procedures, conduct Islamic banking trainings, conduct Shariah-compliance reviews of each class of transactions, the relevant documentation and process flows on test check basis and to provide secretarial services to the Bank's Shariah Supervisory Board. In addition, a separate Shariah Audit & Advisory Department is working under the Board Audit Committee in order to review the overall level of Shariah-compliance in the Bank's activities which submits the report to Shariah Board for information, review and determining appropriate corrective actions.

Following were the major developments that took place during the year:

Research and New Product Development

Alhamdulillah, the SSB is very pleased by the Bank's initiative to launch Meezan Upaisa - the first Islamic Branchless Banking to enhance the outreach of Islamic banking to all segments of the society.

During this year, the SSB approved the conversion plan of Pakistan banking operations of HSBC Bank Oman S.A.O.G (HBON Branch Business), pursuant to which the Bank acquired Pakistan operations of HSBC Bank Oman S.A.O.G (HBON Branch Business). In order to resolve the issue of determining the exact cost of goods in Foreign Import Murabaha transactions, the SSB advised the Bank to convert the Foreign Import Murabaha based products to Musawamah which was later implemented by the Bank under the supervision of RSBM.

The SSB appreciates the efforts of PDSC team for conducting around 180 customer and industry visits to understand the business model and reviewing more than 2000 different types of transactions as per the guidance of RSBM/SSB. In addition to above, structuring and documentation of around 18 syndicated transactions were reviewed by PDSC under the supervision of RSBM. It is also worth mentioning that 100% physical inspection was done for taking delivery in Istisna and Tijarah transactions.

It is encouraging to mention that several Government Institutions like Pakistan Agricultural Storage & Services

Corporation Ltd.(PASSCO), Trading Corporation of Pakistan (Pvt.) Ltd (TCP), Punjab Food Department, etc, have used Shariah-compliant financing products and services of Meezan Bank limited to meet their financing needs which also include the biggest Running Musharakah disbursement of Rs 9.5bn to Punjab Food Department. To facilitate the coal mining operations of Sindh Engro Coal Mining Company the bank provided a hybrid of Istisna-Ijarah-Salam based solution. The Bank also actively supported the establishment of different wind and coal power generating units like Engro Powergen Limited, FFBL Power Limited, Master Wind Energy Limited etc by providing structured finance solutions on the concepts of Diminishing Musharakah and Ijarah. The Bank also keenly supported the infrastructure development activities of the Government by working on a structured syndicated solution for financing development of M9 Motorway. We would like to appreciate that Meezan Bank has entered into Musharakah/Wakalah based relationship with Karandaaz (a member of the World Bank Group) to support Small and Medium sized organizations in Pakistan through different Shariah-compliant vendor financing agreements. It is encouraging to note that as members of the Steering Committee for the Promotion of Islamic Banking and Finance created by the Finance Minister, the CEO and RSBM of the Bank are actively contributing in the Committee with the Vision of establishing Islamic banking as banking of first choice

Training & Development

We are pleased to inform that the Bank is actively pursuing the cause of training its human resources about various aspects of Islamic Banking and Finance which is evident from the fact that during the year around 120 Islamic banking training sessions were conducted where knowledge pertaining to Islamic banking was extended to more than 2200 employees of the Bank. Other than the training to internal staff the Bank also conducted approx 40 seminars which were attended by more than 5500 participants representing customers, general public and professionals.

In addition to the trainings provided to the staff by PDSC, the SSB also had a meeting with the BOD where a brief talk over commitment to cause and values of Islamic banking was made by SSB members to the BOD. Furthermore SSB is satisfied with the level of awareness, capacity and sensitization of the staff and management and the BOD in appreciating the importance of Shariah-compliance in the products and processes of the Bank

Shariah Advisory and Industry support

The SSB is also pleased to share that the Bank is actively supporting capacity building activities of the industry by extending its support to institutions including National Institute of Banking and Finance (NIBAF) and Centre for Islamic Economics (CIE) in conducting Islamic banking training sessions. The Bank also supported various Islamic banking courses, sessions and degree programs in different institutes and organizations including IBA – Karachi, Sheikh Zayed Islamic Centre, Commecs, COMSATS (Lahore), Peshawar University, AJK University Muzafarabad, Wah University etc.

During the year the Bank worked actively to structure



the Bai Muajjal transaction with Ministry of Finance and to structure the issuance of GOP Ijarah Sukuk over Jinnah International Airport to address the liquidity concerns of the industry.

It is also worth mentioning that Bank has entered into MOUs with IBA, LUMS and IM Sciences (Peshawar) for the support and launch of Centre of Excellence in Islamic Banking and Finance.

During the year, the Bank also facilitated AMIM and NAFA in the launch of 3 funds and 4 plans.

In the area of Capital Markets, the Bank has contributed towards the launch of the KMI - All Share Index in collaboration with Karachi Stock Exchange (KSE), State Bank of Pakistan (SBP), Securities & Exchange Commission of Pakistan (SECP) and mutual fund industry of Pakistan in November 2015.

Review of Assets

The Bank primarily used Murabaha, Ijarah, Diminishing Musharakah, Musawamah, Istisna, Tijarah, Musharakah and Salam for its financing activities during the year.

It is worth mentioning that the Bank has moved towards diversification in the usage of various financing products and has reduced the reliance on Murabaha, as is evident from Bank's financing portfolio. In this context it is extremely encouraging to witness a growth of 6% in Musharakah based financing in total financing portfolio. Share of Diminishing Musharakah and Musawamah increased by 5%, while the share of Istisna, Murabaha and Ijarah stood at 13%, 10% and 7% of the total financing portfolio. The Bank's total financing portfolio reached Rs. 215.775 billion (gross) as of December 31, 2015.

Financing Modes	2014 %	2015 %	Growth/(Decline) %
Diminishing Musharakah	25	30	5
Murabaha	15	10	(5)
Musawamah	1	6	5
Istisna	22	13	(9)
Musharakah & Running Musharakah	16	22	6
Ijarah	6	7	1
Salam – Bill	3.6	3.4	(0.2)
Tijarah	1	2.5	1.5
Salam – Commodity	6	2	(4)
Others	4.4	4.1	(0.3)
Total	100	100	-

Review of Liabilities

On the liability side, the Bank offered different Shariah-compliant deposit products based on the mode of 'Mudarabah' & 'Qard' and it is encouraging that Total deposits of the Bank increased by 24% and reached a sum of Rs.471.820 billion as at December 31, 2015.

Throughout the year, the process of allocation of assets and funds to various deposit pools; announcement of overall profit sharing ratios for Mudarabah-based deposits; monthly allocation of weightages and distribution of income to deposit accounts was monitored and reviewed in accordance with Meezan Bank's Pool Management guidelines, and SBP Pool Management guidelines.

Shariah Audit Department

As part of the Shariah Governance Framework, a separate Shariah Audit Department under reporting of Board of Directors' Audit Committee is formed and effectively in place which will play a significant role towards accomplishment of the objective of ensuring Shariah compliance by evaluating the adherence to Shariah guidelines prescribed by Shariah Supervisory Board, Resident Shariah Board Member and Shariah guidelines of IBD-SBP in activities undertaken by the Bank. The Shariah Audit function keeps a continuous check on all activities starting right from the time of opening of a branch and goes hand in hand at each step of product offering till the stage of final profit distribution to the customers.

Shariah Audit of 412 branches, Area offices, Consumer & Corporate hubs and head office departments was conducted as a part of the Bank's efforts to strengthen the internal Shariah controls mechanism. Shariah evaluation of Area offices was introduced this year for evaluating the level of Shariah-compliance and reviewing the effectiveness of Shariah control mechanism at the Area Offices.

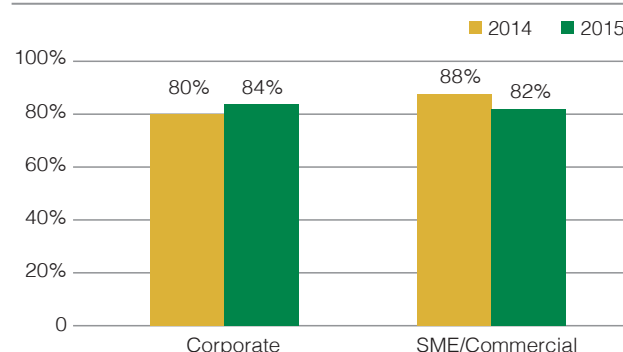
During the year 2015, direct payment for Murabaha financings to Corporate and SME/Commercial customers was maintained at 83%. It is highly recommended that efforts be continued to increase this percentage of direct payment of Murabaha transaction.

Summary of Direct Payment in Murabaha Financing for Meezan Bank

	2014	2015	Growth/(Decline)
Overall Portfolio	83%	83%	-

Segment wise

	2014	2015	Growth/(Decline)
Corporate	80%	84%	4%
SME/Commercial	88%	82%	(6)%



Charity

During the year an amount of Rs 47.76 million was transferred to the Charity Payable Account, this includes Rs. 1.53 million to eliminate the non-compliant income portion identified during Shariah audit, Rs 2.67 million to purify the dividend income earned from the investment made in the Shariah-compliant stocks by the Bank and Rs. 43.27 million transferred to charity payable account in the normal course of business on account of non-timely payments by customers in various financial transactions. Moreover, an amount of Rs. 49.58 million was disbursed from the Charity Account after approval of the Resident Shariah Board Member. Details of Charity are available in note # 19.4.

Recommendation

Based on the review of various transactions and operations of the Bank, it is recommended that:

- The Bank should evaluate the possibility of offering its products, services and network in the international market so as to make more people benefit from Islamic banking.
- Due care regarding the mindset and commitment towards the cause of Islamic banking should be taken during the process of hiring of new staff.
- The Bank should continue its policy of expansion to spread Islamic banking and in this regard continue its focus on employees' training related to Islamic banking products and services offered by the Bank with specific focus on front line staff so as to ensure customer satisfaction towards Shariah understanding.
- The Bank should increase the frequency of awareness sessions to public and customers.
- The Bank should pursue with State Bank of Pakistan for launch of Islamic LTFF, Islamic Benchmark Rate and Islamic Discount window.
- While being the largest and fastest growing Islamic bank, the Bank should focus more on the establishment, dependence and implementation of systems to ensure Shariah-compliance in every aspect of its operations and minimize its dependence on individuals to ensure smooth running of business in a Shariah-compliant manner.
- We recommend that Bank should focus more on supporting business and trade activities like warehouse receipt financing and vendor financing etc
- It is highly recommended that Bank should make more efforts in enhancing their coordination with the scholars through sharing the concepts of Islamic banking & finance and providing them with opportunities to see Meezan Bank's working so that the message of Islamic banking & finance can be passed to the masses through them in an efficient manner.

Conclusion

As per the charter of the Bank, it is mandatory on the management and employees to ensure application of Shariah principles and guidelines issued by the Shariah Supervisory Board and Resident Shariah Board Member and to ensure Shariah-compliance in all activities of the Bank. The prime responsibility for ensuring Shariah-compliance of the Bank's operations thus lies with the Board of Directors and Executive management.

Based on the extensive reviews of sample cases for each class of transaction, related documentation, processes, profit distribution mechanism for the depositors by PDSC Department, review of Internal Shariah Audit report and management's representation made in this regard, in our opinion, the Bank complies with the rules & principles of Islamic Shariah in light of the guidelines and directives given by the Shariah Supervisory Board, Resident Shariah Board Member of Meezan Bank and guidelines issued by Shariah Board of SBP related to Shariah-compliance. The non-compliant income identified during the review is being transferred to the Charity Account through a well-defined system and being utilized properly in accordance with the instructions of SSB.

Based on the strength and capacity of the full fledged PDSC department and policies / guidelines for the Shariah-compliance issued at the Bank, we are of the opinion that an effective mechanism is in place to ensure Shariah-compliance in overall operations of the Bank.

May Allah bless us with the best Tawfeeq to accomplish His cherished tasks, make us successful in this world and in the Hereafter, and forgive our mistakes.

Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh.



Dr. Muhammad Imran Ashraf Usmani
Resident Shariah Board Member



Sheikh Essam M. Ishaq
Member Shariah Supervisory Board



Justice (Retd.) Muhammad Taqi Usmani
Chairman Shariah Supervisory Board

Dated: 13th Jamadi-ul-Awwal 1437 H / February 22, 2016