

Shariah Supervisory Board Report - 2016

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 (ﷻ), the year under review was the fifteenth year of Islamic commercial banking for Meezan Bank Limited. During the year, the Shariah Supervisory Board (SSB) of Meezan Bank held four meetings to review various products, concepts, transactions, processes, issues highlighted by Shariah Audit and their Shariah-compliance, referred to them by the Resident Shariah Board Member (RSBM).

In Meezan Bank Limited, we have a team of professionals in the Product Development & Shariah Compliance department (PDSC) working under the guidance of RSBM. Main objective of this department is to facilitate and ensure Shariah compliance in all the new researches & product development activities, refinement of existing products & procedures, conduct Islamic banking trainings, Shariah-compliance reviews of branches, Head Office Units and for 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 Department is working under the Board of Director's Audit Committee to review the overall Shariah-compliance in the Bank's activities which submits the report to RSBM / Shariah Board for information, review and determination of appropriate corrective actions.

We would like to appreciate the efforts of the staff at PDSC and Shariah Audit for ensuring the Shariah compliance environment in the Bank.

It gives us comfort to note that there is no pending Shariah related issue in the Bank; which depicts the keen interest of the staff, the management and the Board members.

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

Research and New Product Development

In order to increase capital adequacy ratio of the Bank, the SSB was pleased to approve the structure for a privately placed Tier II Sukuk, based on Mudarabah.

The SSB is happy to recognize the commendable efforts of the PDSC team for conducting around 150 customer and industry visits to understand the business model and reviewing more than 3,000 different types of transactions as per the guidance of RSBM/SSB.

Structuring and documentation of around 13 syndicated transactions, involving hybrids of various structures such as Ijarah and Diminishing Musharakah, were structured by PDSC under the supervision of RSBM. All the syndicate transactions were catered towards various government and private entities such as WAPDA, Dasu Dam, Neelam Jehlum Hydro Power Company, Daewoo Pakistan, SSGC and SNGPL for various purposes such as infrastructure development, capital expansion and power project financing. It is worth mentioning that to strengthen the Shariah-compliance control, 100% physical inspection was

done for taking delivery in Istisna and Tijarah transactions.

The SSB appreciates persistent efforts of the management of Meezan Bank and RSBM to persuade the Government of Pakistan to allow Islamic Banks to be the sole custodian of Hajj deposit. This was a right leap in our quest to make the religious obligation of Hajj pure and free from Riba/Interest.

The SSB is also pleased by the Bank's initiative to launch Al-Diyana, an in-house pool management system, for profit calculation and distribution. Development of a pool management system would further enhance transparency in profit calculation and distribution and testifies to Meezan Bank's excellence in innovation.

Training & Development

SSB is pleased to note that the year 2016 was highly productive in terms of Islamic Banking Products Training. This is evident by the fact that during this year 150 training sessions were organized for the staff members across Pakistan catering to more than 2,500 employees of the Bank. This number includes, orientation sessions for new joiners, refresher programs and certification programs in Islamic Financial Products. Other than the training to internal staff the Bank also conducted 49 seminars which were attended by more than 4,000 participants representing customers, general public, professionals and students of various universities.

SSB appreciates the efforts of Meezan Bank as strategic partner with IBA-Centre for Excellence in Islamic Finance (CEIF) which is the premier institution in Pakistan for imparting the training sessions and awareness seminars on various topics of Islamic Finance.

SSB also lauds the efforts of the Bank in supporting the first World Islamic Finance Forum organised by IBA-CEIF. This conference was attended by scholars, academics, professionals, regulators (SBP and SECP).

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), Centre for Islamic Economics (CIE) and various other institutions in conducting Islamic banking training sessions. The Bank also supported various Islamic banking courses, sessions and degree programs in different institutes and organizations including Institute of Business Administration – Centre for Excellence in Islamic Finance, Center for Islamic Finance at LUMS, Sheikh Zayed Islamic Centre, CIBES, COMSATS Lahore, University of Engineering and Technology Lahore etc.

It is also worth mentioning that the Bank has entered into MOUs with world renowned Institutions in Islamic finance namely Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and International Shari'ah Research Academy (ISRA), for collaboration in various areas of Islamic Finance.

During the year, the Bank also facilitated Al Meezan Investment Management Limited (AMIM) and NBP

Fullerton Asset Management Limited (NAFA) in the launch of 4 funds, 2 sub-funds and 7 plans. Along with that, the Bank also facilitated Lakson Investment in converting one conventional fund into an Islamic fund. Besides that, Meezan Bank Limited also extended its Shariah advisory services in Bahrain to a reputed learning institute. Meezan Bank Limited also provided its Shariah advisory services to a local insurer for introducing Window Takaful Operations.

Review of Assets

The Bank primarily used Diminishing Musharakah, Running Musharakah, Istisna, Ijarah, Murabaha, Musawamah, Salam – Bills, Wakalah Tul Istithmar, Tijarah, Salam – Commodity, Musharakah and Bai Muajjal for its financing activities during the year.

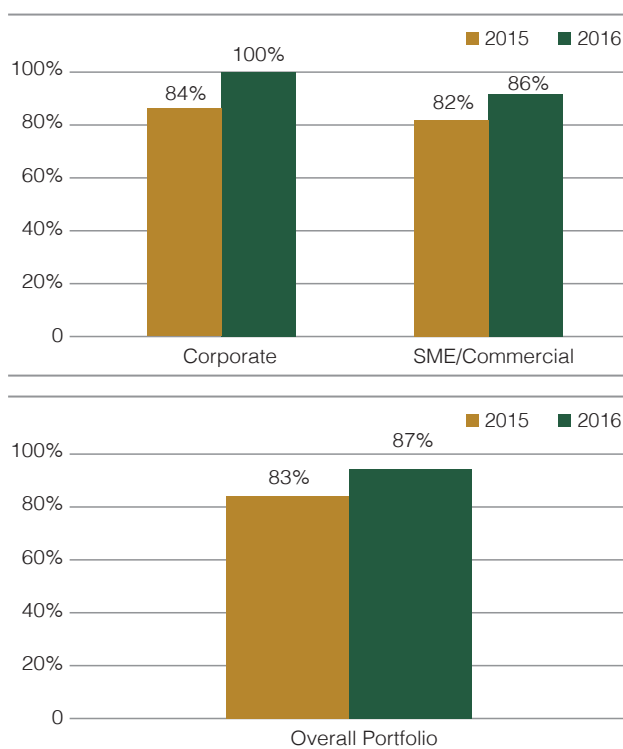
It is worth mentioning that the Bank has moved towards diversification in the usage of various financing products and has reduced the reliance on Murabaha, as is evident from the Bank's financing portfolio. There is a growth of 10.4% in Musharakah based financing (including Running Musharakah) from previous year. There is also a growth of 6.68% in Ijarah and 5.6% in Diminishing Musharakah. The Bank's total financing portfolio reached Rs. 312 billion (gross) as of December 31, 2016.

Financing Modes	2016 %	2015 %	Growth / (Decline)%
Diminishing Musharakah	31.86	30.17	5.61
Musharakah & Running Musharakah	24.73	22.41	10.39
Istisna	12.94	13.44	(3.73)
Ijarah	7.96	7.60	6.86
Murabaha	5.51	9.56	(42.44)
Musawamah	4.75	5.74	(16.77)
Salam - Bills	4.12	3.40	21.20
Wakalah Tul Istithmar	3.99	-	-
Tijarah	1.87	2.47	(24.13)
Salam - Commodity	0.63	2.32	(73.00)
Other	1.63	2.89	(34.58)

During the year 2016, direct payment for Murabaha financings to Corporate and SME/Commercial customers was maintained at 87%. It is highly recommended that efforts be continued to increase this percentage of direct payment of Murabaha transactions.

Summary of Direct Payment in Murabaha Financing for Meezan Bank

	2015	2016	Growth/(Decline)
Overall Portfolio	83%	87%	4%
Segment wise			
Corporate	84%	100%	16%
SME/Commercial	82%	86%	4%



Review of Liabilities

The Bank offered liability side products based on Shariah-compliant modes such as 'Mudarabah' & 'Qard'. It is heartening to see deposits grow by 19.5% to reach a sum of Rs 564 billion as on December 31, 2016. During 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 were monitored and reviewed in accordance with the respective pool management guidelines of SBP and Meezan Bank.

Shariah Audit Department

The Shariah Audit function plays a vital role in achieving the objective of ensuring Shariah-compliance by evaluating adherence to Shariah guidelines in each and every activity undertaken by the Bank.

As part of the Shariah Governance Framework, issued by the State Bank of Pakistan (SBP), a separate Shariah Audit Department under the reporting of Board of Directors' Audit Committee is effectively in place. This department is playing 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 Islamic Banking Division of SBP. The Shariah Audit function also 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 572 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. These audits not only cover the transactions that the branches/departments undertake but also include an evaluation of the knowledge of staff pertaining to Islamic Finance.

Charity

During the year an amount of Rs 28.2 million was transferred to the Charity Payable Account. This includes Rs 0.71 million to eliminate the non-compliant income portion identified during Shariah audit, Rs 2.59 million to purify the dividend income earned from the investment made in the Shariah-compliant stocks by the Bank and Rs 24.9 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 37.82 million was disbursed from the Charity Account after approval of the Resident Shariah Board Member. Details of charity account are available in the note # 20.4.

Recommendation

Based on the review of various transactions, reports of Internal Shariah Audit and Shariah Compliance 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. This will not only enhance the Bank's brand image as a leading global Islamic bank but would also enhance the country's image as a potential global/regional hub of Islamic banking and finance.
- Keeping in view the criticality and technicality of the job; the Bank should also focus on capacity building and training of the work force associated with Product Development and Shariah Compliance and Shariah Audit functions of the Bank.
- The Bank should focus on targeting government and semi government institutions, for Shariah-compliant deposits and Shariah-compliant financing as this will have a greater impact on our society.
- 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 pursue with State Bank of Pakistan for launch of Islamic Long Term Financing Facility (LTFF), Islamic Benchmark Rate and Islamic Discount window.
- It is highly recommended that the 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.
- The Bank should take up the issue of Government's interest based borrowings with the Government officials asking them to minimize such borrowings and focus more on issuing Sukuks.
- China Pakistan Economic Corridor is a very essential project for Pakistan's economy so GOP should maximize the financing for this project through Islamic modes and ask the Government officials for increasing the financing share of Islamic Banks in CPEC projects.
- The Bank should conduct awareness sessions regarding Islamic Finance for industry practitioners, lawyers, Judiciary, members of the legislature, public representatives, educationists, media professionals, business community, and members of the Armed Forces.

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 reports 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 (ﷻ) bless us with the best Tawfeeq to accomplish His cherished tasks, make us successful in this world and in the life hereafter and forgive our mistakes.

Wassalam Alaikum WaRahmat Allah Wa Barakatuh.



Dr. Muhammad Imran Ashraf Usmani
Resident Shariah Board Member



Sheikh Esam Mohamed Ishaq
Member Shariah Supervisory Board



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

Dated: 4th Jamada al-Awwal 1438 H / February 02, 2017