

# Shariah Supervisory Board Report - 2017

الحمد لله رب العالمين، والصلاة والسلام  
على خاتم الأنبياء والمرسلين، محمد المصطفى  
الأمين، وعلى آله وأصحابه أجمعين، وبعد:

All praises to Allah (ﷻ). This was the sixteenth year of Islamic commercial banking for Meezan Bank Limited which is under review. During the year, the Shariah Supervisory Board (SSB) of Meezan Bank held six meetings to review various issues, referred to them by the Bank.

Meezan Bank Limited has a team of professionals in the Product Development & Shariah Compliance department (PDSC) working under the guidance of RSBM. The 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, conducting Islamic banking trainings, Shariah-compliance review of branches, Head Office Units and for each class of transactions, 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 Audit Committee of Board of Directors 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, SSB appreciate the efforts of the staff of PDSC and Shariah Audit Department for their efforts in promoting and strengthening the environment of Shariah compliance in the Bank.

It gives us comfort to note that other than few operational matters there are no other pending Shariah related issues in the Bank and this shows the high level of commitment of the staff, management and the board members.

It is also encouraging to know that there are more than 9500 staff members in the Bank who are the source of Halal income for their families.

During the year ended December 31, 2017 major developments are as under:

## Research and New Product Development

The SSB recognizes the efforts of the Bank for conducting around 170 customer and industry visits to understand the business model and reviewing more than 2500 different types of transactions as per the guidance of RSBM/SSB.

Structuring and documentation of 5 syndicated transactions, involving hybrids of various structures such as Ijarah and Diminishing Musharakah, were prepared by PDSC under the supervision of RSBM. All the syndicate transactions were catered towards various government and private entities such as WAPDA, Power Holding Pvt. Ltd, Cherat Cement Ltd, Sukh Chain Valley, Shifa International for various purposes such as infrastructure development, capital expansion and power project financing. It is worth mentioning that to strengthen the Shariah-compliance control, physical inspection of delivery was carried in almost all the Istisna and Tijarah transactions.

The SSB appreciates the efforts of RSBM and PDSC team in playing an active role in the implementation committee made by the Federal Minister and in supporting Government for introducing tax reforms for Islamic modes of financing.

During the year, the SSB provided guidelines for different issues, most noteworthy of them were:

- Structure of Murabaha transactions through the Pakistan Mercantile Exchange (PMEX) platform for liquidity management of Islamic Banking Industry.
- Wakalah and Murabaha based structure for oil field acquisition.
- Standardized process flows for Murabaha, Istisna, and Tijarah products.
- Murabaha based financing structure for the purchase of Shariah-compliant shares.
- Shirkat ul aqd based structure for development of a residential product.
- Murabaha based solution for reducing cost of financing for SME customers.
- Personal financing product for converting interest based debts.
- GOP Ijarah sukuk structure.
- Risk Management solutions for strengthening Running Musharakah product of the Bank.

## Training & Development

SSB is pleased to note that the year 2017 was highly productive in terms of Islamic Banking Products Training. A special training session was arranged at Darul Uloom Karachi for the members of Board of Directors of the Bank which was conducted by the Chairman of the SSB and its honourable member Sheikh Esam Ishaq. During the year around 70 members of the senior management and executives of the Bank were also given training on Islamic Banking.

During the year 93 training sessions comprising of 985 man-hours were organized for the staff members across Pakistan catering to more than 3,000 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 of internal staff the Bank also conducted 55 seminars in 38 cities which were attended by more than 5,600 participants representing customers, general public, professionals and students of various universities.

SSB also appreciates the efforts of the Bank in supporting IBA CEIF in conducting various specialized sessions for ulema, traders, academicians, judges and bankers which are crucial for dispensing message of Islamic Banking in Pakistan.

## Shariah Advisory and Industry support

The SSB is also pleased to share that the Bank is actively supporting the Islamic finance industry across the globe by providing tailor-made Shariah advisory solutions for their business needs. Some of the notable services provided by the Bank during the year are:

- Shariah advisory and training services to an Islamic cooperative institution in Australia related to housing finance and also advising the client to introduce Takaful services in Australia as well.

- Assisting the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in developing draft exposure of Internal Shariah Audit Standard.
- Shariah advisory services in Bahrain to a reputed learning institute.
- Facilitation of the Bank's capital market clients for launching various funds and plans bringing the total number of funds and plans under its advisory to more than 45 covering more than half of the Islamic mutual fund industry.

#### 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.

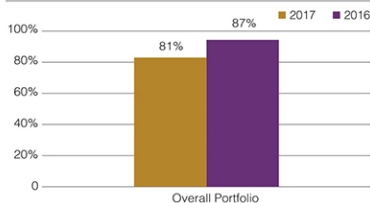
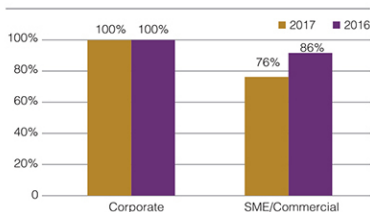
The SSB is pleased to note that the Bank has moved towards diversification in the usage of various financing products and has reduced the reliance on Murabaha, as is evident from the Bank's financing portfolio. There is a proportionate growth of 38.29% in Musharakah based financing (including Running Musharakah) from previous year. There is also a proportionate growth of 15.94% in Ijarah. The Bank's total financing portfolio reached Rs. 429 billion (gross) as of December 31, 2017.

Financing Modes	2017 %	2016 %	Growth / (Decline) %
Diminishing Musharakah	19.72	31.86	(38.04)
Musharakah & Running Musharakah	34.16	24.73	38.29
Istisna	13.31	12.94	2.96
Ijarah	9.22	7.96	15.94
Murabaha	4.61	5.51	(16.31)
Musawamah	4.54	4.75	(4.31)
Salam - Bills	2.76	4.12	(32.94)
Wakalah Tul Istithmar	7.29	3.99	82.83
Tijarah	1.91	1.87	2.17
Salam - Commodity	0.96	0.63	36.11
Other	1.52	1.63	(6.23)

During 2017, the percentage of direct payment for Murabaha financings to Corporate and SME/Commercial customers was 81%. It is highly recommended that efforts be continued to increase this percentage of direct payment of Murabaha transactions. We appreciate that the Bank is also focusing on financing alternative energy projects to reduce carbon footprints.

#### Summary of Direct Payment in Murabaha Financing for Meezan Bank

	2017	2016	Growth/(Decline)
Overall Portfolio	81%	87%	(6)%
<b>Segment wise</b>			
Corporate	100%	100%	-
SME/Commercial	76%	86%	(10)%



#### Review of Deposits

The Bank continued to offer different type of deposit products based on Shariah-compliant modes such as 'Mudarabah' & 'Qard'. It is heartening to see deposits grow by 19.4% to reach a sum of Rs. 673 billion as on December 31, 2017. 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.

It is heartening to know that Meezan Asaan Account has been contributing towards the goal of Financial Inclusion in Pakistan, with over 230,000 Meezan Asaan accounts (all New to Bank relationships). As the idea of 'Asaan Account' was given by Meezan Bank to SBP, it is encouraging to see such growth and formalization of the economy through Islamic Banking.

#### 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 reporting to the Audit Committee of Board of Directors 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 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 614 branches, area offices, consumer & corporate hubs, Head Office departments and

special assignments 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 31.4 million was transferred to the Charity Payable Account. This includes Rs 1.9 million to purify the dividend income earned from the investment made in the Shariah-compliant stocks by the Bank and Rs 29.5 million transferred to Charity Payable Account in the normal course of business on account of non-timely payments by customers in various financial transactions. An amount of Rs 31.05 million was disbursed from the Charity Account after approval of the Resident Shariah Board Member. Details of charity account are available in the note # 19.4

#### Review of Financing Assets

We have noted that as per our guidelines, the Bank reversed the financing of PKR 296 million provided to its customers under Murabaha & Istisna without any profit as those transactions could not be converted into real trade due to genuine business reasons. Similarly, in Ijarah financing the Bank being the owner of asset bore the loss of Rs. 0.22 million due to shortfall in takaful claims.

#### Recommendations

Based on the review of various transactions, reports of Internal and External Shariah Audit and Shariah Compliance operations of the Bank, it is recommended that:

- The Bank should propose Shariah-compliant avenues to the Government of Pakistan to meet its short term and long term financing requirements in a Shariah Compliant yet convenient manner.
- The Bank should explore Shariah compliant products and solutions for FinTech, internet banking and branchless banking.
- 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 beneficial impact on our society.
- Due care regarding the mind-set and commitment towards the cause of Islamic banking should be taken during the hiring process of new staff.
- The Bank should pursue with State Bank of Pakistan for launch of different Islamic schemes, Islamic Benchmark Rate and Islamic Discount window.
- For liquidity management purposes, the Bank should use Bai Muajjal when other avenues like Musharakah placement, Commodity Murabaha through PMEX and Sukuk are not available.
- China Pakistan Economic Corridor is a very essential project for Pakistan's economy. Bank should pursue the GoP to maximize the Islamization of financing this project in order to increase the financing share of Islamic Banks in CPEC projects.
- The Bank should conduct awareness sessions regarding Islamic Finance for Shariah Scholars, industry practitioners, lawyers, the Judiciary, members of the legislature, public representatives, academics, media professionals, business community, and members of the Armed Forces.
- The Bank should more proactively employ the social media for increasing the public awareness for the socio-economics benefits of Islamic financial system.

- The Bank in collaboration with academia, Higher Education Commission and educational text boards should take initiatives to design the courses or chapters related to the benefit of Islamic financial system on society.
- The Bank should initiate and support SME & Agriculture financing to alleviate poverty currently prevailing in the rural areas of the country. The Bank shall encourage energy projects which are environmental friendly such as solar panels and windmills.
- The Bank should work on launch of deposit products for senior citizens and widows.

#### 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 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 documentations, processes, profit distribution mechanism for the depositors by PDSC Department, review of Internal Shariah Audit and External Shariah Audit reports and Management's representation made in this regard, the Bank, in our opinion, has complied 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: 15<sup>th</sup> Jamada al-Awwal 1439 H / February 02, 2018