

Shariah Supervisory Board Report - 2018

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 seventeenth year of Islamic commercial banking for Meezan Bank which is under review. During the year, the Shariah Supervisory Board (SSB) of Meezan Bank held five meetings to review various issues, referred to them by the Bank.

Meezan Bank has a team of professionals in the Shariah Compliance Department (SCD) working under the guidance of SB. The main objective of this department is to perform research and analysis on Shariah issues, facilitate and ensure Shariah compliance in all the new processes, procedures and product development, refinement of existing products and procedures, conduct Islamic banking trainings, Shariah compliance reviews of branches, Head Office Units and for each class of transactions, maintain relevant documentation and process flows on test check basis and to provide secretarial services to the Bank's Shariah Board.

In addition, a separate Shariah Audit Department is working under the Board Audit Committee to review the overall Shariah compliance in the Bank's activities which submits the report to Resident Shariah Board Member (RSBM) / Shariah Supervisory Board for information, review and determination of appropriate corrective actions.

To comply with the requirements of the Shariah Governance Framework – 2018, function of Product Development has been transferred to Customer Support Group, which is an independent group reporting directly to the Deputy CEO. We appreciate the efforts of the staff of SCD and Shariah Audit Department for their efforts in promoting and strengthening the environment of Shariah compliance in the bank.

It gives us comfort to observe high level of commitment of the staff, management and the Board members of the Bank. It is also encouraging to know that there are more than 10,035 staff members in the Bank who are the source of halal income for their families.

During the year ending December 31, 2018 major developments are as under:

Research and New Product Development

The SB recognizes the efforts of the Bank for conducting around 150 customer and industry visits to understand the business model and reviewing more than 4,500 different types of transactions as per the guidance of RSBM / SSB.

Review of more than 8 syndicated transactions, involving various hybrid structures such as Ijarah, Diminishing Musharakah and Running Musharakah was done by the Bank under the supervision of RSBM / SSB. All the syndicate transactions were catered towards

various government and private entities such as Lucky Energy Limited, China Power Company, Siddiqsons Energy Limited, K-Electric, Javedan Corporation Private Limited, Hyundai Nishat Motors Private Limited, Agha Steel Industries Limited, Martin Dow Marker Limited 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 of goods was carried in almost all the Istisna and Tijarah transactions.

During the year, the Bank has played a vital role in promoting the Islamic banking industry of Pakistan. Awareness programs were conducted for religious scholars, Parliamentarians, Bureaucrats and Government officials, independently and in collaboration with Institute of Business Administration - Center of Excellence in Islamic Finance (IBA - CEIF). The direct result of this program was a unanimously passed Senate Resolution resolving that at least 30% of the Government debt should be replaced with Shariah-compliant modes.

We are pleased to inform that the Bank is leading a consortium of Islamic Banks for the structuring of Pakistan Energy Sukuk for Ministry of Energy / Power Holding Private Limited for settling part of the energy sector circular debt.

The Bank was also involved in devising a Shariah-compliant solution for the Deposit Protection Corporation Scheme (DPC) launched by the State Bank of Pakistan.

The Bank has been actively supporting the State Bank of Pakistan for various matters relating to the Islamic banking industry, such as suggestions for Shariah Governance Framework, solutions for Energy Finance Scheme, issuance of new Sukuk etc.

The SSB appreciated the efforts of RSBM and SCD 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 SB provided guidelines for different issues, most noteworthy of them were:

- Issuance of the first ever Shariah-compliant Tier-1 Sukuk in Pakistan
- GOP Financing - Bai Muajjal with Ministry of Finance (MoF)
- Meezan Bank as Payroll Partner
- Shares custodial facility
- Guidelines for durable goods financing through e-commerce / digital platform
- Personal financing product for different purposes

Training & Development

SSB is pleased to note that the year 2018 was highly productive in terms of Islamic banking products training. A special training session was arranged for the members of Board of Directors of the Bank which was

delivered by Dr. Imran Ashraf Usmani and Sheikh Esam Mohamed Ishaq.

During the year, 105 training sessions comprising 840 man-hours were organized for staff members across Pakistan catering to more than 5,000 employees of the Bank. This number includes orientation sessions for new joiners, refresher programs like Asset Refresher, Deposit Refresher, Trade Finance & Treasury operations and certification programs in Islamic Financial Products. For the newly opened branches, the Bank organized 11 sessions (5 days each) of basic Islamic banking, to equip staff with the required level of knowledge. In order to create awareness, other than the training of internal staff, the Bank also conducted 65 seminars in 38 cities (Karachi, Islamabad, Lahore, Peshawar, Rawalpindi, Faisalabad, Multan, Hyderabad, Azad Jammu & Kashmir, Hazara, Abbottabad and DG Khan etc.) which were attended by more than 6,500 participants representing customers, general public, professionals, ulema, muftian-e-karam and students of various universities.

To promote understanding of Islamic banking among university students, visits were arranged for student of Institute of Business Administration (IBA), Institute of Business Management (IoBM) and Bahria University. Presentations on Islamic banking was delivered and discussions were held to address the major questions related to Islamic banking concepts.

SSB is pleased to note that our RSBM and one of the team members of SCD were involved in the translation of AAOIFI Shariah Standard in Urdu, which is a commendable achievement on their part.

During the year, around 118 members of the senior management and executives of the Bank were also given training on Islamic banking. 44 staff members were sent to Institute of Business Administration - Center of Excellence in Islamic Finance (IBA - CEIF) to attend the Advanced Certificate in AAOIFI Shariah Standards (ACSS). Till date 14 staff members have cleared Certified Shariah Auditor and Advisor (CSAA) certification.

Shariah Advisory and Industry Support

SSB is also pleased to share that the Bank is actively supporting the Islamic Finance industry across the world by providing tailor-made Shariah Advisory solutions to their business needs. Following are the notable advisory services provided by the Bank during the year:

- Technical services to support the Pakistan Mercantile Exchange (PMEX) platform for liquidity management of Islamic Banking Industry.
- Advisory services to Islamic Co-operative Finance, Australia related to the introduction of Takaful services in Australia.
- Assisted AAOIFI in developing draft exposure of Internal Shariah Audit Standard.
- Advisory services to Bahrain Institute of Banking and Finance – Bahrain.
- Conducted capacity building sessions including workshops in Turkey at Borsa Istanbul, Central bank of Turkey.
- Facilitation of 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 50, 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.

We appreciate that the Bank is also focusing on financing alternative energy projects to reduce Carbon footprints. 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 39.65% in Ijarah from previous year. The Bank has mainly focused on financing through Musharakah modes, including Diminishing Musharakah and Running Musharakah and these modes of financing constitute 49.25% of the Bank's total financing. The Bank's total financing portfolio reached Rs 522 Billion (gross) as of December 31, 2018.

Financing Modes	2018 %	2017 %	Growth / (Decline) %
Diminishing Musharakah	18.75	19.72	(0.97)
Musharakah & Running Musharakah	30.50	34.16	(3.66)
Istisna	14.06	13.31	0.76
Ijarah	10.57	9.22	1.35
Murabaha	3.82	4.61	(0.78)
Musawamah	7.63	4.54	3.09
Salam - Bills	1.10	2.76	(1.66)
Wakalah Tul Istithmar	7.82	7.29	0.53
Tijarah	2.57	1.91	0.66
Salam - Commodity	1.82	0.96	0.86
Other	1.36	1.53	(0.17)

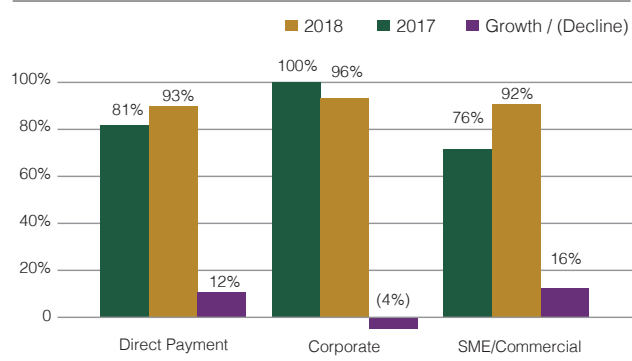
We have noted that as per our guidelines, the Bank reversed the financing of Rs 8.9 Million provided to its customers under Murabaha & Istisna without any profit as those transactions could not be converted into real trade due to genuine business reasons. As a result the Bank had to forego the profit of Rs 1.09 Million. Similarly, in Ijarah financing, the Bank being the owner of asset bore the loss of Rs 1.57 Million due to shortfall in Takaful claims.

Summary of Direct Payment in Murabaha Financing

During 2018, direct payment for Murabaha financings to Corporate and SME / Commercial customers was 93%. It is highly recommended that efforts be continued to increase this percentage of direct payment of Murabaha transactions.

	2018 %	2017 %	Growth/ (Decline) %
Overall Portfolio	93%	81%	12%
Segment wise			
Corporate	96%	100%	(4)%
SME/Commercial	92%	76%	16%

Summary of Direct Payment in Murabaha Financing



Liquidity Management

For the purpose of liquidity management the Bank invested Rs 46 Billion in GoP Ijarah Sukuks. Due to lack of availability of venues for the Shariah-complaint investments, Rs 227 Billion in Bai Muajjal was executed after the approvals (which is approximately 24% of the total assets of the Bank).

Review of Deposits

The Bank continued to offer deposit products based on Shariah-compliant modes such as 'Mudarabah' & 'Qard'. It is heartening to see deposits grow by 18% to reach a sum of Rs 785 Billion as on December 31, 2018. 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.

The Bank also continued to play its vital role in developing and revamping of deposit products. Some of the important initiatives undertaken during the year are as under:

- MAC Senior: In order to cater to the needs of Senior citizens/widows/disabled, and to motivate them towards Shariah-compliant products, new MAC-Senior tiers of 5.5 years and 7 years were introduced.
- Meezan Express Account: The account has been designed to facilitate the beneficiaries of home remittance and encourage them to use formal banking channels.

Shariah Audit

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 Board 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 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 537 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 assessment of financial transactions and operational activities that the branches and departments undertake but also include an evaluation of the knowledge of staff pertaining to Islamic Finance.

Charity

During the year an amount of Rs 36.92 Million was transferred to the Charity Payable Account. This includes Rs 1.15 Million to eliminate the non-compliant income portion identified during Shariah audit, Rs 3.39 Million to purify the dividend income earned from the investment made in the Shariah-compliant stocks by the Bank and Rs 32.38 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 38.4 Million was disbursed from the Charity Account after approval of the RSBM / SB. Details of charity account are available in the note # 20.4

Suggestions

For the purpose of further improving the business of the Bank, SSB suggests the following:

- To support government initiative of converting up to 30% debts into the Islamic mode (as per the Senate Resolution no. 393), Meezan Bank should suggest Shariah-compliant alternates for the short and long-term financing requirements of the Government of Pakistan.
- Government has taken the initiative of providing low cost housing schemes for the low income group of society. The Bank should coordinate and collaborate with SBP and Government of Pakistan to maximize the financing of this project through Islamic mode of finance.
- The Bank should explore Shariah-compliant products and solutions for FinTechs, internet banking and branchless banking.
- The Bank should pursue the SBP for the launch of different Islamic special purpose financing schemes and Islamic discount window.
- The Bank should work for an alternate Islamic product for National Saving Scheme.
- The Bank should pursue the Government for developing cost-effective Islamic financing solution for construction of dams.
- To alleviate the poverty currently prevailing in the rural areas of the country and for financial inclusion, the Bank should initiate and support SME & Agriculture financing.

- The Bank should encourage environment friendly energy projects such as solar panels and windmills in line with the objectives of UNDP's Sustainable Development Goals.
- The Bank should encourage Government of Pakistan to utilize Islamic banking facilities for new Foreign Direct Investment (FDI) in different sectors especially for China Pakistan Economic Corridor (CPEC), power and petroleum sectors.

Recommendations

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

- Proper measures should be adopted with regards to commitment and mind-set of the resources in the hiring process.
- For liquidity management purposes, the Bank should use Bai Muajjal when other avenues like Musharakah placement and Sukuk are not available.
- The Bank should focus on creating awareness to eliminate the misconceptions regarding Islamic banking by conducting seminars / programs / awareness sessions for the masses. The Bank should more proactively utilize 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.
- Training should be conducted for relevant departments to update them regarding current practices, manuals and guidelines prescribed by Shariah Board and SCD.
- Conventional insurance is not permissible from Shariah perspective. Therefore, it is recommended to convert all clients to Islamic Insurance i.e. Takaful as soon as possible.

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 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 transactions, related documentations, processes, profit distribution mechanism for the depositors by SCD, 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 SB.

Based on the strength and capacity of the full-fledged SCD 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.



Mufti Muhammad Naveed Alam

Resident Shariah Board Member



Sheikh Esam Mohamed Ishaq

Member Shariah Supervisory Board



Dr. Muhammad Imran Ashraf Usmani

Member Shariah Supervisory Board



Justice (Retd.) Muhammad Taqi Usmani

Chairman Shariah Supervisory Board

Dated: 30th Jamada al-Awwal 1440 H / February 06, 2019