

Shariah Supervisory Board Report - 2020

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 nineteenth 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 four meetings to review various issues, referred to them by the Bank.

We are thankful to the Almighty and pay our heartiest congratulations to the Bank's Management on receiving the "Best Bank of Pakistan" award by Pakistan Banking Awards. We are very humbled to receive some of the most prestigious awards in the domain of Shariah compliance during 2020 which are Shariah Authenticity Award and the Shariah Auditor of the Year Award from Global Islamic Finance Awards (GIFA 2020) and the Most Innovative Islamic Bank- Global Award from Islamic Finance News, Malaysia. All these accolades reflect the Bank's commitment to provide customers with excellent banking services that completely adhere to Shariah principles.

Meezan Bank has a team of professionals in the Shariah Compliance Department (SCD) working under the guidance of SSB. The main objective of this department is to facilitate and ensure Shariah-compliance in all processes, procedures and products, refinement of existing products and procedures, Islamic banking trainings & awareness sessions and Shariah-compliance reviews of transactions. The SCD also serves as secretariat to the Bank's Shariah Supervisory Board.

We appreciate the efforts of entire staff of the Bank towards promoting and strengthening the environment of Shariah compliance in the Bank. It gives us comfort to observe a 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 10,600 staff members in the Bank who are a source of Halal income for their families.

We are pleased to share the major achievements of Meezan Bank towards the growth of Islamic Banking during the year ended December 31, 2020:

Research and New Product Development

This year was a challenging year for the businesses in Pakistan due to the COVID-19 pandemic and its adverse effects on continuity and profitability of businesses.

We are pleased to share that the Bank extended financing on Qard e Hasna basis to some medical institutions to support medical infrastructure in the country. We had reviewed and provided our guidelines and approvals for the following:

- Islamic Refinance Facility for combating COVID-19 (IRFCC) for supporting Health institutions.
- Islamic Refinance Scheme for payment of wages and salaries to workers and employees
- Islamic Temporary Economic Refinance Facility (ITERF) for import of medical equipment to support country health infrastructure in combating COVID-19.
- Guidelines for principal deferment and restructuring for existing customers to give immediate financial relief to the customers.
- Guidelines for repricing of existing financing to give benefit of lower benchmark rate to the customers.

Meezan Bank continued to play a leading role towards the Sukuk market development and Sukuk worth Rs 736 billion were issued in 2020 which included Pakistan Energy Sukuk II and series of GOP Ijarah Sukuk. This year the Shariah Board also approved the reopening mechanism for GOP Ijarah Sukuks which would further streamline the process of Sukuk issuance in future.

We would also like to appreciate the Bank's effort in supporting the low-income segment by working on various initiatives such as:

- Low-cost housing scheme in collaboration with Akhuwat;
- Collaboration with PMRC for supporting low-cost housing sector in Pakistan;
- Support towards development of small businesses through the Kamyab Jawan scheme of the Government;
- Financing support to retailers, distributors and vendors of different corporate entities.

We are also pleased to share that the Bank has continued to provide financing towards those areas that are environmentally friendly and contributed towards green financing such as Solar Panels financing.

The SSB recognizes the efforts of the SCD for conducting around 150 customer and industry visits to understand their business model and reviewing more than 2,000 different types of cases as per the guidance of RSBM/SSB.

During the year, seventeen Shariah-compliant syndicated transactions for various private and public sector entities involving various structures such as Ijarah, Diminishing Musharakah and Running Musharakah were executed for infrastructure development, capital expansion and project financing related needs.

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

- Structure of Islamic charge card (an alternative to non-revolving credit card).
- Digital platform for Shariah-compliant retailer financing.
- Asaan Mobile Account, which provides a digital platform to individuals for opening bank accounts.

- Shirkat ul aqd based structure for financing the construction of mega residential project.
- Launch of Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) for effective pool management.
- Treatment of subsidy given by the Government for commodity financing operations of different provincial governments.

Training & Development

During the year, 171 training sessions comprising more than 900 man-hours were organized for staff members across the country, catering to more than 6,900 employees of the Bank. This number includes Orientation and Batch trainings for new joiners, refresher programs such as Asset Refresher, Deposit Refresher, specialized training for CAD and SME department and certification programs in Islamic financial products. The Bank conducted three training sessions for awareness of Islamic Naya Pakistan Certificates to the masses to explain the features of these certificates. Three Islamic banking e-Learnings were also launched, through which 5,130 staff got trained.

In order to create awareness of Islamic banking among general public, the Bank conducted 65 seminars in major cities which were attended by more than 5,000 participants from different spheres of the society. Owing to the pandemic, most of these sessions were conducted through digital media. During the year, one Shariah training session was also arranged for the BOD and senior management of the Bank.

It is heartening to observe that in order to disseminate the teachings of Holy Quran, 38 lectures on Understanding Quran were held for all staff.

Shariah Advisory and Industry support

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. Following are the notable advisory services provided by the Bank during the year:

- Advisory services related to Takaful to an Islamic Financial Institute in Australia.
- Technical Advisory services to a Shariah-compliant stock trading platform for Shariah screening of various foreign companies listed in different stock markets globally.

- Technical Shariah Advisory to “Akhuwat Islamic Microfinance Company” for launching various schemes.
- Advisory services to more than 60 funds and plans, which covers a major share of the Islamic Mutual Fund industry.
- Facilitation to NCCPL for launch of a platform for Shariah-compliant share financing.
- Facilitation to Pakistan Mortgage Refinance Company (PMRC) in structuring of Pakistan Mortgage Sukuk and Credit Guarantee Scheme to support low cost housing finance schemes.

Review of Assets

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 5% growth in Diminishing Musharakah over the previous year. The Bank has mainly focused on financing through Musharakah modes and these constitute 53.6% of the Bank’s total financing. The Bank’s total financing portfolio reached Rs. 532 billion (gross) as of December 31, 2020. Breakup of different financing modes is as follows:

Financing Modes	2020 % in total portfolio	2019 % in total portfolio	(Decline)% in total portfolio
Diminishing Musharakah	27.6	22.6	5.0
Musharakah & Running Musharakah	26.0	30.5	(4.5)
Istisna	12.8	11.5	1.3
Ijarah	9.4	10.9	(1.5)
Murabaha	2.6	3.3	(0.7)
Musawamah	7.1	5.4	1.7
Salam - Bills	0.8	1.5	(0.7)
Wakalah Tul Istithmar	7.5	8.1	(0.6)
Tijarah	2.0	2.6	(0.6)
Salam - Commodity	1.8	2.1	(0.3)
Other	2.4	1.5	0.9

We have noted that as per our guidelines, the Bank reversed the financing of Rs. 855 million provided to its customers under Murabaha & Musawamah without any profit, as those transactions could not be converted into real trade due to genuine business reasons.

Summary of Direct Payment in Murabaha Financing

During the year 2020, 93% of payments for Murabaha financings to Corporate and SME/Commercial customers were direct payments. It is highly recommended that efforts be continued to increase this percentage of direct payments in Murabaha transactions.

It is worth mentioning that in order to strengthen the Shariah-compliance control, physical inspection of delivery of goods was carried out in almost all Istisna and Tijarah transactions.

Liquidity Management

For the purpose of liquidity management, the Bank invested Rs 112 Billion in Pakistan Energy Sukuks I and II and Rs 179 billion in GOP Sukuk. Due to lack of availability of venues for Shariah-compliant investments, Bai Muajjal transactions worth Rs 327 Billion were outstanding at year end.

by evaluating adherence to Shariah guidelines prescribed by Shariah Supervisory Board, Resident Shariah Board Member and Shariah guidelines of Islamic Banking Department of the SBP. This department submits its report to RSBM / Shariah Supervisory Board for information, review and determination of appropriate corrective actions.

During the year under review, Shariah Audit of 682 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/departments undertake but also include an evaluation of the knowledge of staff pertaining to Islamic finance.

Review of Deposits

We are pleased to observe that the Bank has launched Roshan Digital Account which supported the inward cash flow into Pakistan from Non-Resident Pakistanis and facilitated launch of Islamic Naya Pakistan Certificates.

It is heartening to see that deposits grew by 35% to reach a sum of Rs. 1,254 billion as on December 31, 2020. 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 was monitored and reviewed in accordance with the respective pool management guidelines of SBP and Meezan Bank.

Shariah Audit

In compliance of the Shariah Governance Framework issued by the State Bank of Pakistan (SBP), a dedicated Shariah Audit Department reporting to the Audit Committee of the Board is in place. This department is playing a significant role towards accomplishment of the objective of ensuring Shariah compliance

Charity

An amount of Rs 96.3 million was transferred to the Charity Payable Account during the year. This includes Rs 21.1 million to eliminate the non-compliant income portion, which was identified during Shariah audit, Rs 8.6 million to purify the dividend income earned from investment made in the Shariah compliant stocks by the Bank and Rs 66.6 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 95 million was disbursed from the Charity Account after approval of the RSBM/SSB.



Details of charity account are available in the note # 20.4

Suggestions and Recommendations

For the purpose of further improving the business of the Bank and the overall Islamic Banking Industry, SSB suggests the following:

- The Bank should work towards increasing its penetration in SME sector which would pave the way for a better documented SME sector.
- The Bank should collaborate with SBP for implementation of the IFSB standard on Capital Adequacy for Islamic Financial Institutions, for introduction of Shariah-compliant alternatives of Discount Window, and introduction of separate laws for Islamic banking.
- To create awareness and capacity building about Islamic finance, the Bank should focus on conducting awareness sessions and work with education bodies to introduce courses related to Islamic finance in the curriculum at different levels of education.
- The Bank should continue to focus on the youth, construction sector, low income segment, digitization and green financing and should focus on programs such as the Kamyab Jawan scheme.
- To promote the cause of Islamic banking, we would urge the Bank to spread awareness in thought leaders from all

spheres of the society including government officials and media personnel.

- It is suggested that public-private sector partnership be encouraged for issuance of Sukuk to support financing requirements of the Government.
- It is suggested that the Bank should incorporate Shariah compliance in the KPIs of business units as this would enhance the accountability culture within the Bank and also conduct functional level activity based Shariah trainings.
- The Bank should develop an ongoing training and testing mechanism to ensure that all people assuming key positions are well versed with Shariah concepts.
- For liquidity management purposes, the Bank should use Bai Muajjal when other avenues like Musharakah placement and Sukuk are not available.
- Conventional insurance is not permissible from a Shariah perspective; therefore, it is again recommended to convert more clients to Islamic Insurance i.e. Takaful as soon as possible.

Conclusion

As per the charter of the Bank, it is mandatory for 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 extensive reviews of sample cases for each class of transaction, related documentations, processes, profit distribution mechanism for the depositors by SCD 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 Advisory Committee of the 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 is being utilized properly in accordance with the instructions of the SSB.

Based on the strength and capacity of the full-fledged SCD department and policies/guidelines for 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: 8th Jamadi us Sani 1442 H / January 22, 2021