

GUIDELINES FOR OPENING OF STAND ALONE BRANCHES FOR ISLAMIC BANKING BY EXISTING BANKS

With the objective of promoting Islamic banking in Pakistan, the following Guidelines for opening of Stand-alone branches for Islamic Banking by existing commercial banks have been prepared by State Bank of Pakistan. The banks desirous of offering Shariah compliant products and services are required to apply to the State Bank for issuance of a license under these Guidelines.

1. Definitions

The following terms, as used in these Guidelines, shall have the following meanings:-

- i) "banks" means commercial banks, including branches of foreign banks operating in Pakistan, which desire to offer Shariah compliant products and services;
- ii) "IBB" or "branch" means the Islamic Banking Branches of commercial banks, which offer the Shariah compliant products and services only;
- iii) "Shariah compliant products and services" means banking products and services offered by banks to their clients duly approved by their Shariah adviser/Shariah Supervisory Committee;
- iv) "IBF" means the Islamic Banking Fund set up by the banks to fund the operations of their Islamic Banking Branches;
- v) "IBD" means the Islamic Banking Division set up at the head office of the banks/ country offices in Pakistan to administer, supervise and regulate all matters pertaining to IBB.
- vi) "deposit" means deposits mobilized under section 26A of the Banking Companies Ordinance, 1962.

LICENSING REQUIREMENTS FOR ISLAMIC BANKING BRANCH(ES)

2. Eligibility Criteria

The eligibility of a bank to open Islamic banking branch(es) shall be considered by the State Bank keeping in view, among others, the financial strength of the bank as evident from its capital base(net capital free of actual and potential losses), adequacy of its capital structure, record of earning capabilities, future earning prospects of the bank, managerial capabilities, bank's liquidity position, track record of the bank's adherence to prudential regulations, credit discipline, quality of customer services and the convenience and the needs of the population of the area to be served by the proposed branch. In addition, the following considerations will also be taken in the grant of the license:-

- (i) Banks having CAMELS rating of 1, 2 and 3 in the last ON-SITE inspection shall be eligible for opening Islamic Banking Branches.
- (ii) There should not be major adverse inspection findings against the bank.
- (iii) The bank shall identify experienced and trained key staff to handle the IBB operations.

3. Working Paper/Proposal

The applying bank is required to submit a proposal to the Islamic Banking Division, Banking Policy Department of State Bank, outlining the following details:-

- i) Number of branches alongwith name of city where the IBB is to be offered within the next financial year.

- ii) Products and services to be offered by the IBB including deposits, financing, investment, etc.
- iii) Method of segregating the funds of IBB from the funds of commercial banking of the applying bank.
- iv) Infrastructure and logistic requirements, including manpower and training programs.
- v) The name, qualification and experience of Shariah Adviser(s).
- vi) Accounting aspects, such as accounting policies to be followed, profit and loss sharing mechanism, etc.

The banks will be required to submit such further information as required by State Bank while processing the case.

4. Issuance of License

- i) State Bank will evaluate the proposal of the bank keeping in view merits of the case and upon its satisfaction, will grant an approval in principle to the bank for opening of branch(es) upon such terms and conditions as it deems fit. However, license for individual branch opening shall be issued on receipt of formal application on prescribed format under the provisions of Section 28 of the Banking Companies Ordinance, 1962 (Application Form). This will be issued when requirements of para 5 hereof are complied with and evidence is provided that adequate security arrangements have been provided at the proposed place of business and the Town Planning Regulations are not violated.
- ii) In subsequent years, if the bank wishes to open more branches, the bank shall submit to State Bank of Pakistan for approval, an Annual Islamic Banking Branch Expansion Plan (the Plan) at least 30 days before the commencement of each calendar year (January-December) during which it plans to open branches. The plan would, inter alia, indicate the number of the new branches proposed to be opened in urban and rural areas, location of each of the proposed branch and the area which it would serve, branches proposed to be closed (if any), the number of existing branches incurring losses consecutively for the last three years, arrangements for managerial and other staff members and information technology access and linkage for the proposed branches and arrangements for housing each of the proposed branch. State Bank will consider the Plan for new branches keeping in view the need of the system and grant approval in principle for number of new branch(es) that bank will be allowed to open during the given calendar year within 30 days from the date of receipt of the Plan complete in all respect. The approval in principle granted under a particular Plan shall lapse in case bank fails to submit a formal application for issuance of license at least 30 days before the expiry of that particular year. Similarly license issued under the respective Plan shall expire where a bank fails to open the branch before 31st December of that year.
- iii) Request for a new branch in Azad Kashmir will have to be supported by the AJ&K Government.
- iv) The branch(es) shall be subject to the prevalent banking and other laws, rules and directives issued by SBP from time to time.
- v) Banks will be free to shift or reallocate their branches within the same city/town/village without prior approval of State Bank. Intimation of shifting of a branch will be sent by the bank concerned to the State Bank within 15 days from the date of its shifting on prescribed proforma (Annexure 'A').
- vi) The license may be revoked in case it subsequently transpires that the bank had made material misrepresentation of facts or concealment of material information and the responsible official(s) shall personally be liable for action under the relevant laws.

5. Commencement of Business

Before commencement of business, the bank will ensure that all the Documents and agreements pertaining to each type of products and services alongwith Risk management guidelines, Plans for Internal control and Information Technology systems are in place. All relevant documents/agreements and guidelines should be duly certified by their Shariah Adviser/Committee and a certificate in this regard will be submitted to the State Bank alongwith the Application Form. All these documents should be made readily available to the SBP Inspection Team during inspection of the bank.

6. Islamic Banking Division

- (i) The bank will be required to set up an Islamic Banking Division (“IBD”) at the Head Office/Country Office in Pakistan.
- (ii) The bank will submit the organizational structure of the IBD alongwith details of key persons of the division (qualification and years and type of experience) to Banking Policy Department of State Bank alongwith the Application Form.
- (iii) The responsibilities of the IBD shall be as follows:-
 - (a) To manage and be responsible for the operations of IBB(s), including policy and procedural matters;
 - (b) To liaise with other departments in the bank and Shariah Adviser/Committee to ensure smooth operations of IBB(s);
 - (c) To ensure that all funds pooled into the IBF are channeled into Shariah compliant financing and investment activities;
 - (d) To arrange training of staff on Islamic banking;
 - (e) To arrange for compilation and submission of such returns, as may be required to be submitted to State Bank from time to time;
 - (f) To ensure that all directives and guidelines, particularly those applicable to Islamic banking, issued by State Bank are strictly complied with;
 - (g) To maintain the Statutory Cash Reserve and Liquidity Requirement with State Bank as prescribed by State Bank from time to time.
 - (h) Other roles and responsibilities as determined by the bank or State Bank from time to time.
- (iv) The IBD shall be headed by a senior and experienced officer directly reporting to the Chief Executive (in case of foreign banks, the Country Manager) and manned by qualified staff.

7. Islamic Banking Fund

- (i) The bank shall be required to maintain a minimum fund of Rs 50 million or 8% of the risk weighted assets of IBB(s), whichever is higher.
- (ii) The IBF shall be funded by way of an allocation by the head office of the bank or in case of foreign bank, its country office.
- (iii) The IBF shall be placed under the control of IBD to fund the operations of the IBB(s).

8. Physical set-up

Every licensed branch of a bank shall carry a name, and shall invariably be required to prominently display the name of the branch as stipulated in the license.

9. Shariah Compliance

The bank shall be required to appoint a Shariah Adviser/Shariah Supervisory Committee consisting of Shariah scholar(s) of repute to advise the IBD on matters pertaining to Shariah. Shariah Adviser/Committee will be responsible to vet all agreements and products and services offered by IBD and/or IBB(s) in order to ensure Shariah compliance.

10. Systems and Control

The bank shall ensure that proper systems and controls are in place in order to ensure segregation of funds and protect the interest of depositors, including but not limited to the followings:-

- i) The bank shall be required to prepare procedure manuals for the IBD and IBB operations duly approved by their Shariah Adviser/Shariah Supervisory Committee as well as the Board of Directors or in case of branches of foreign banks operating in Pakistan, by their Head Office.
- ii) The bank shall prepare a full set of documents pertaining to the deposit, investment and financing products pertaining to IBB operations.
- iii) The full set of the documents duly vetted by their Shariah Adviser/Shariah Supervisory Committee shall be maintained by the IBD. Similarly, all documents in respect of new schemes offered by IBB(s) shall also be prepared and maintained by IBD before launching of the scheme.
- iv) All documents (including ledgers, registers, pay-in-slips, cheques, receipts, passbooks, etc.) used in the IBD and IBB(s) shall be appropriately marked, so as to easily distinguish them from the documents pertaining to commercial banking.
- v) In order to efficiently utilize the existing branch network, the bank may authorize some of its branches to sell the Islamic banking deposit schemes. However, in such cases proper systems and control should be in place to ensure that the fund transfer takes place on the same day to/from the IBB. The authorized branches shall not, in any manner whatsoever, receive/pay interest on such services. The authorized branches may charge a reasonable fee/commission on sale of such deposit schemes under a policy to be approved by the Board of Directors or in case of branches of foreign banks, their Head Office. Proper training in Islamic banking should also be provided to the staff of authorized branches dealing with such deposit schemes.
- vi) The bank shall be required to undertake comprehensive internal audit including internal Shariah Review on the operations of the IBB(s) and IBF at least once in a year.

11. Accounting Records and Disclosure

- (i) The banks shall keep separate book of accounts in respect of Islamic banking operations and ensure proper maintenance of records for all transactions for segregation of funds.
- (ii) The banks shall prepare a separate daily trial balance of the operations arising from the IBB(s).
- (iii) Based on the balances of all the items (assets, liabilities, expenses and income) relating to the operations of the IBD/IBB(s), the bank shall prepare and submit separate annual as well as quarterly financial statements for its IBB operations alongwith its periodical financial statements on the format prescribed by State Bank from time to time.

12. Statutory Liquidity and Cash Reserve Requirements

In order to maintain the Statutory Cash Reserve and Liquidity requirement in respect of IBB operations, the IBD will open a separate current account with State Bank. In this account, IBD will maintain the Cash Reserve with State Bank in the manner prescribed for commercial banks (at present @ 5% of time and demand liabilities). For Statutory Liquidity Requirement (SLR), till the development of Shariah compliant approved securities, they will for the present, maintain an additional cash amount equivalent to 6% of their TDL in the same current account with State Bank in lieu of SLR (i.e., 40% of 15% SLR at present). Therefore, in all, IBD will maintain 11% of time and demand liabilities (TDL) of the Islamic banking branches in this current account with State Bank on weekly average basis and 10% of TDL on daily basis in lieu of CRR and SLR for IBB operations of the bank.

13. Reporting to State Bank

- i) In the Weekly Statement of Position submitted to the State Bank, the banks shall submit separately the position of IBB operations.
- ii) The banks shall also be required to submit such other statements regarding their Islamic banking operations as prescribed from time to time.

14. Processing Fee

A processing fee @ Rs. 25,000/- per branch applied in the Proposal/Plan has been fixed. The banks while submitting the Proposal/Plan shall invariably enclose a cheque in the name of State Bank of Pakistan as processing fee. The Proposal/Plan without the amount of processing fee shall not be entertained. The processing fee will be non-refundable.
