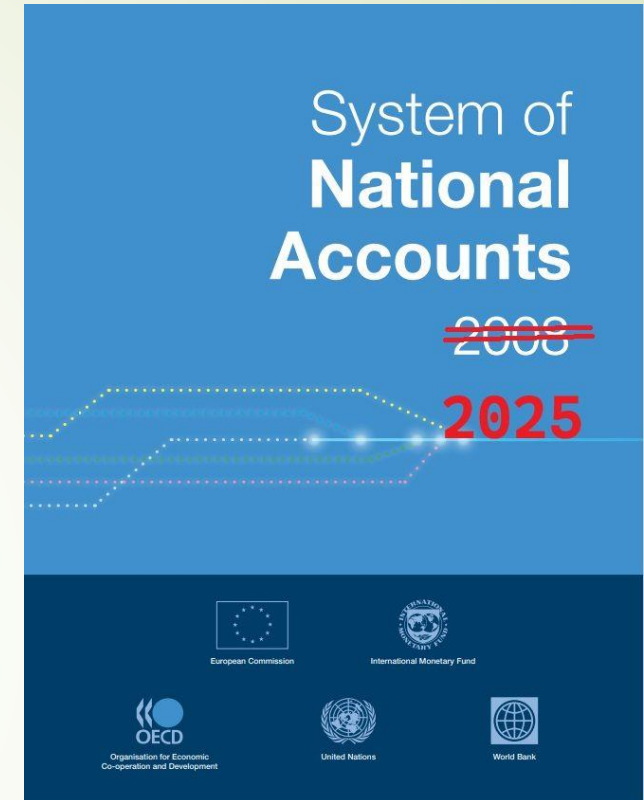




Islamic Finance

(Webinar on 2025 SNA Implementation)

July, 1 2025



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2025 SNA

- Chapter 26 and Chapter 17 of BPM7 is dedicated to **Islamic Finance in 2025 SNA**
- 2025 SNA presents guidance to properly account for Islamic Finance and insurance arrangements in **the framework of National Accounts**
- It addresses issues such as
 - **Nature of income** on certain Islamic Financial Instruments
 - The **sector classification** of Islamic Financial Instruments
 - Measurement of Output including the **measurement of implicit financial services on loans and deposits**
 - Treatment of **Islamic Insurance** etc.,



Characteristics of Islamic Finance

- Islamic finance differs from **conventional finance** as it follows the **Shari'ah Islamic** principles
- **Shari'ah Islamic** principle does not permit
 - Receipt and payment of **"Riba"** (interest)
 - **"Gharar"** (excessive uncertainty)
 - **"Maysir"** (gambling)
 - Short sales or financing activities that it considers harmful to society
- Instead, It emphasizes **mandatory charity due (or Zakah)** or **voluntary charity (Sadaqah)**. Both forms of giving can (but do not have to) be implemented through a type of endowment trust known as **Waqf**.
- The transaction should have a **real economic purpose** without undue speculation, and not involve any exploitation of either party
- It is based on **risk-sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts**



Islamic Banking in Pakistan



- **Islamization of financial system** started in 1977-78
- **Elimination of interest** from specialized financial institutions including HBFC, ICP and NIT in 1979 and that of commercial banks during 1981 to 1985
- The **Commission for Transformation of Financial System (CTFS)** was constituted in 2000 in the State Bank of Pakistan
- The State Bank of Pakistan (SBP) (Central Bank of Pakistan) established its **Shari'ah Board** in 2003 to provide
 - **Expert opinion and advice** to the SBP on Shari'ah related matters
- Later on Shariah Board was changed to **Shariah Advisory Committee (SAC)**
- SAC comprises of members with **diverse expertise** in the fields of Shari'ah as well as
 - **Accounting,**
 - **Law,**
 - **Economics/Banking & Finance**, with good knowledge of Islamic finance and practices

Major Models of Islamic Financing



Strategic Plan on Islamic Banking by SBP: 2021-2025

- **Islamic banking** industry has shown **remarkable growth** over the last two decades
- The industry accounts for **17% share in assets and 18.3% share in deposits** of overall banking industry (Dec 2020)
- **Headline Targets**
 - **30 % share** in assets and deposits of overall banking industry
 - **35 % share** in branch network of overall banking industry
 - **10 % share** of SMEs' Financing in Private Sector Financing of Islamic banking industry
 - **8 % share** of Agriculture Financing in Private Sector Financing of Islamic banking industry

Islamic Banking – Progress and Market Share

Particulars	Period & Amount (PKR Billion)			Yearly Growth (YoY)			Share in overall banking industry (%)		
	Mar-23	Dec-23	Mar-24	Mar-23	Dec-23	Mar-24	Mar-23	Dec-23	Mar-24
Assets	7,532	8,994	9,235	26.7	24.4	22.6	19.4	19.4	19.9
Deposits	5,352	6,749	6,875	26.0	30.8	28.5	21.5	23.2	23.2
Investments (net)	3,118	4,235	4,405	41.6	38.8	41.3	15.8	16.3	16.3
Financing (net)	3,226	3,335	3,259	19.8	7.1	1.0	27.5	27.4	28.0
Number of Islamic Banking Institutions	22	22	22	-	-	-	-	-	-
Number of Branches	4,427	4,955	5,101	10.9	12.7	15.2	-	-	-
Number of Islamic Banking Windows	1,832	1,922	1,916	25.4	26.8	4.6	-	-	-
<i>* Number includes sub-branches</i>									

Islamic Banking – Mode wise Financing (Share in %)

Mode	Period & Share (%)		
	Mar-23	Dec-23	Mar-24
Murabaha	11.8	13.1	12.6
Ijarah	4.1	3.8	4.2
Musharaka	24.3	25.3	24.4
Diminishing Musharaka	33.6	32.1	32.6
Salam	2.4	2.1	2.6
Istisna	9.5	10.6	10.9
Others	14.3	13.0	12.7
Total	100	100	100

Measurement of FISIM

Conventional Banking

Output of FISIM =
 $(r_L - rr) y_L + (rr - r_D) y_D$

- $\text{FISIM} = \text{FISIM on Loans} + \text{FISIM on Deposits}$
- $\text{FISIM on Loans} = \text{Stock of Loans} * [\text{Lending Rate} - \text{Reference Rate}]$
- $\text{FISIM on Deposits} = \text{Stock of Deposits} * [\text{Reference Rate} - \text{Deposits Rate}]$

Islamic Banking

Output of FISIM =
 $(r_L - rr) y_L + (rr - r_D) y_D$

- $\text{FISIM} = \text{FISIM on Financing} + \text{FISIM on Deposits}$
- $\text{FISIM on Financing} = \text{Stock of Financing} * [\text{Financing Rate} - \text{Reference Rate}]$
- $\text{FISIM on Deposits} = \text{Stock of Deposits} * [\text{Reference Rate} - \text{Profit Rate}]$

Islamic Insurance (Takaful)

Characteristics of Takaful

- **Takaful**, is based on the concept of **social solidarity, cooperation** and mutual indemnification of losses of members
- It is a pact among a **group of persons** who agree to jointly indemnify the **loss or damage** that may inflict upon any of them, out of the fund they donate collectively
- The **Takaful contract** so agreed usually involves the concepts of **Mudarabah, Tabarru'** (to donate for benefit of others) and **mutual sharing** of losses with the overall objective of eliminating the element of uncertainty
- Takaful companies normally divide the **contributions into two parts**, i.e., donations for meeting **mortality liability** or losses of the fellow policyholders and the other part for investment
- **Contribution** for mortality liability and for investment account is based on a **sound technical basis** of mortality tables and other actuarial requirements
- Both **accounts are invested** and returns thereof distributed on **Mudarabah principle** between the participants and the Takaful operators

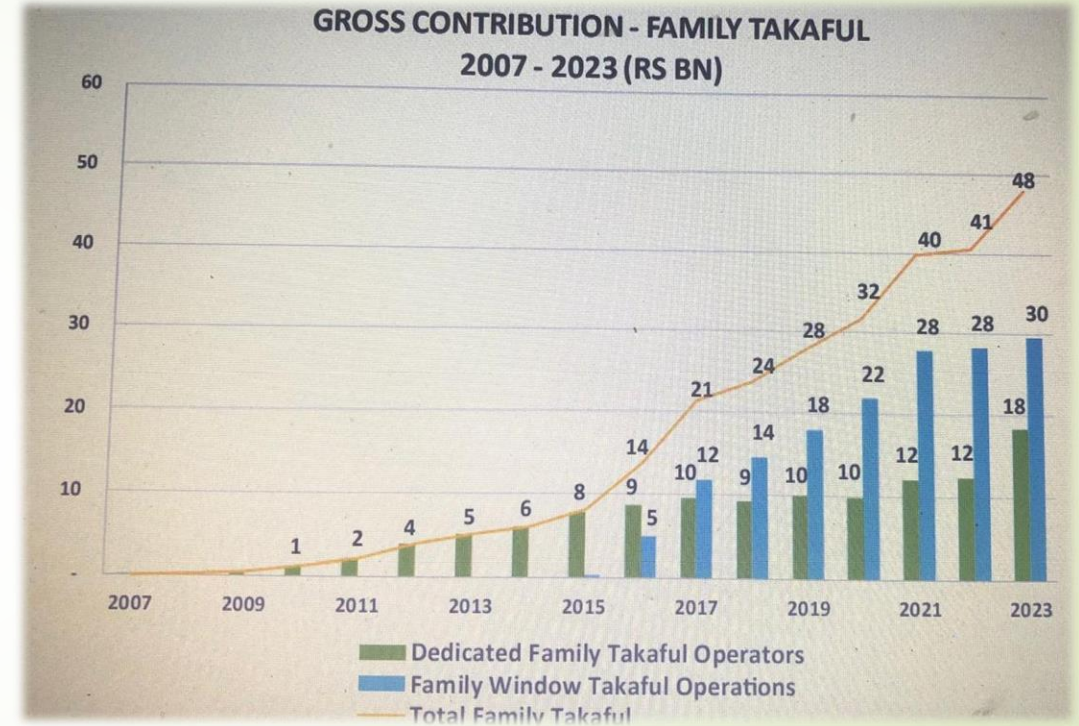
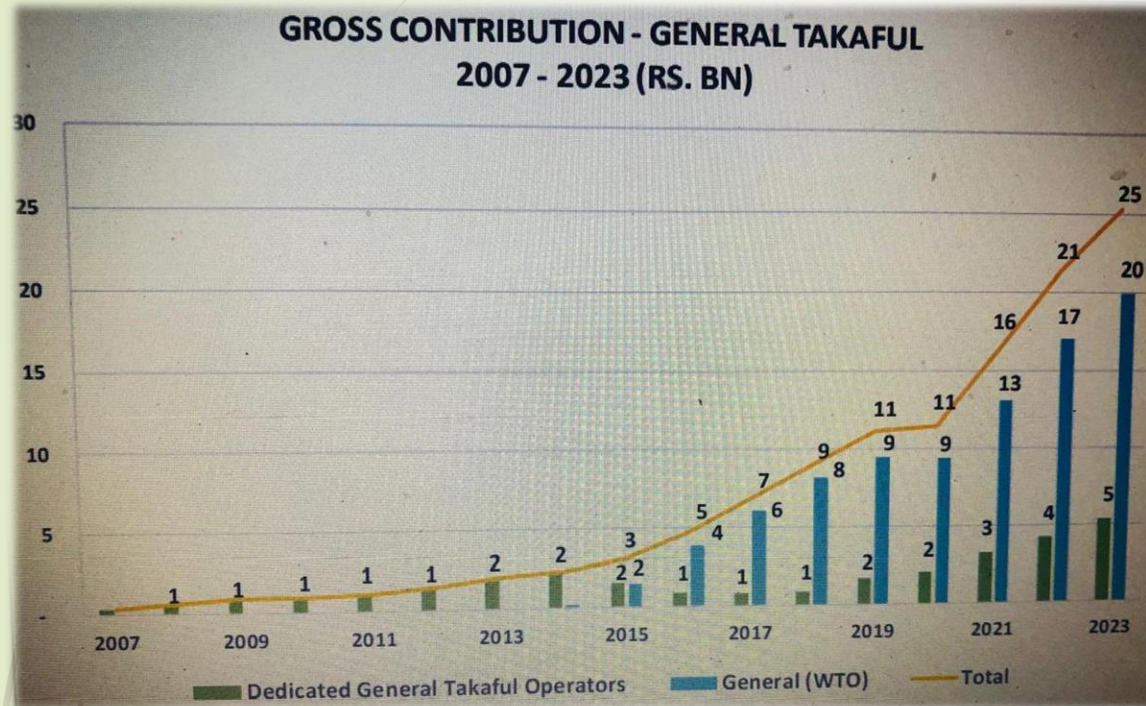
Takaful in Pakistan

- The concept of **Takaful** introduced through the **Insurance Ordinance, 2000**
- Takaful has **contributed** a mere **11% to 13%** to overall insurance market **till 2023**
- Securities and Exchange Commission of Pakistan in its **5-year strategic plan**, has targeted the **share of takaful** contribution **greater than 30%** of the total industry premium **by 2028**
- Prevalent model practiced in Pakistan is the **Wakalah-Waqf Mode**
 - Establishment of a **Waqf fund** (referred to as “**Participant Takaful Fund**” or “PTF”),
 - A separate fund that **serves as an endowment**, with the contributions from participants, also referred to as **Tabarru (voluntary donations)**, being pooled therein
- Whilst **payment of Tabarru** into Waqf and corresponding payment of benefits (claims) by PTF are independent elements of an arrangement, the contributions are generally explicitly designated for **risk-sharing purposes**, such as covering claims and related expenses.

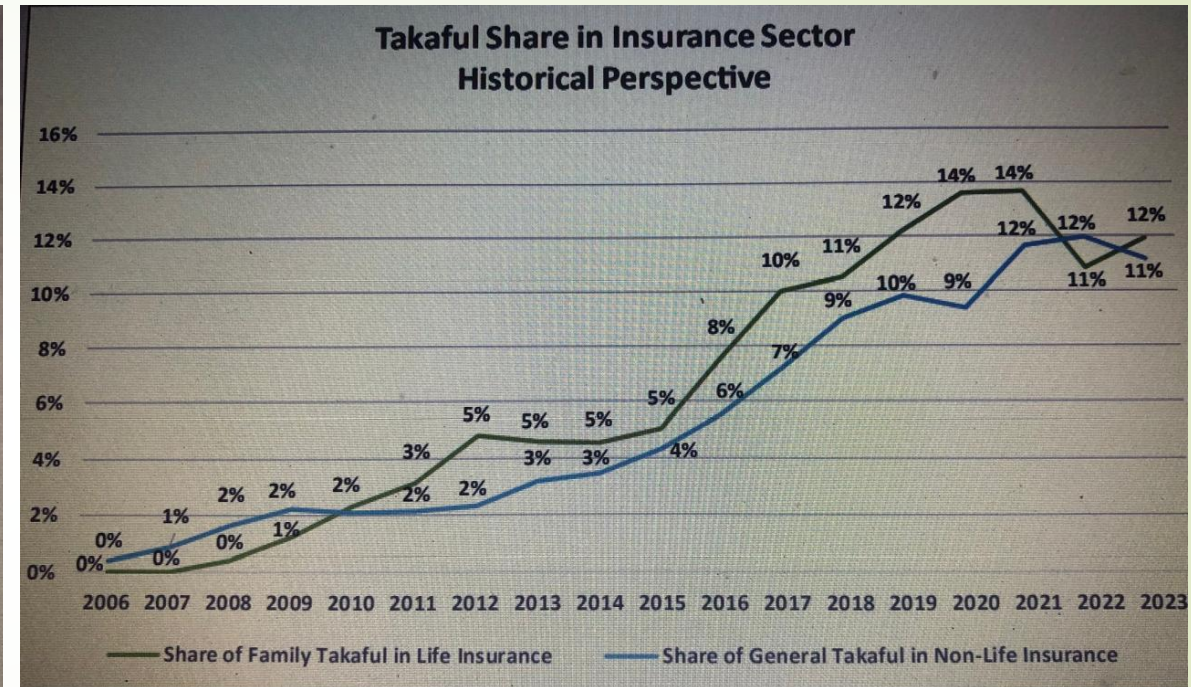
Takaful in Pakistan

- **Relationship** between participants and Takaful operator is **mediated through PTF**, where Takaful operator acts as a **Wakeel on behalf of fund**
- In this capacity, **operator manages all aspects of the PTF**, including underwriting, risk-sharing arrangements, claims processing, and compliance with Shariah guidelines etc
- Operator also **oversees investment of surplus funds of PTF**, generally governed through a Mudarabah arrangement, wherein Takaful operator, acts as Mudarib (investment manager) with PTF being Rab-ul-Maal (owner of funds)
- PTF and Operator **share profits on investments net of expenses** according to pre-determined ratio
- **Surplus of PTF** is totally attributable to **takaful participants** and Operator distributes same to participants in accordance with predetermined criteria.

Takaful – Progress and Market Share



Takaful – Progress and Market Share



Output of Takaful

Production Approach is used to estimate the GVA of Life and Non-Life Insurance companies.

Output = Premium+ Premium Supplement- Claims

IC is calculated from the their financial statement.

Gross output for insurance/ takaful services:

Insurance/ Takaful = Premium/ Contribution income + Investment income (premiums supplement)-

Claims paid

THANK YOU

Major Modes of Islamic Banking

- **MURABAHA** - Mutually agreed profit. Technically, it is a contract of sale in which seller declares his cost and profit. Islamic banks have adopted this as a mode of financing
- **IJARAH** - Ijarah or leasing is transfer of usufruct for a consideration which is rent in case of hiring of assets or things and wage in case of hiring of persons.
- **IJARAH-WAL-IQTINA** - A contract under which an Islamic bank provides equipment, building or other assets to client against an agreed rental together with a unilateral undertaking by bank or client that at end of lease period, ownership in asset would be transferred to lessee
- **MUSAWAMAH** - Musawamah is a general and regular kind of sale in which price of commodity to be traded is bargained between seller and buyer without any reference to price paid or cost incurred by former. It is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. Both parties negotiate on price
- **ISTISNA A** - It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. Istisna'a can be used for providing facility of financing manufacture or construction of houses, plants, projects and building of bridges, roads and highways.

Major Modes of Islamic Banking

- **BAI MUAJJAL** - Means a credit sale. Technically it is a contract in which bank earns a profit margin on his purchase price and allows buyer to pay price of commodity at a future date in a lump sum or in installments. It has to expressly mention cost of commodity and margin of profit is mutually agreed. Price fixed for commodity in such a transaction can be same as spot price or higher or lower than spot price.
- **MUDARABAH** - A form of partnership where one party provides funds while other provides expertise and management. Latter is referred to as Mudarib. Any profits accrued are shared between two parties on a pre-agreed basis, while loss is borne only by provider of capital.
- **MUSHARAKAH** - Means a relationship established under a contract by mutual consent of parties for sharing of profits and losses in joint business. In-fact Islamic bank provides funds, which are mixed with funds of business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. Profit is distributed among partners in pre-agreed ratios, while loss is borne by each partner strictly in proportion to respective capital contributions.
- **BAI SALAM** - Means a contract in which advance payment is made for goods to be delivered later on. Seller undertakes to supply some specific goods to buyer at a future date in exchange of an advance price fully paid at time of contract. It is necessary that quality of commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. Objects of this sale are goods and cannot be gold, silver or currency