

NBFI & Modaraba
Association of Pakistan
Member of Asian Financial Services Association (AFSA)



MODARABA SECTOR OF PAKISTAN

First Quarterly Report on the Modaraba Sector of Pakistan Issued by
NBFI & Modaraba Association of Pakistan

For the Quarter ended 31st December, 2013

SECTOR REPORT ON MODARABAS

Vision, Mission Statement of SECP

Vision

The development of modern and efficient corporate sector and capital market, based on sound regulatory principles that provide impetus for high economic growth and foster social harmony in the Country.

Mission

To develop a fair, efficient and transparent regulatory framework, based on international legal standards and best practices, for the protection of investors and mitigation of systemic risk aimed at fostering growth of a robust corporate sector and broad based capital market in Pakistan.

Vision, Mission of NBF & Modaraba Association:

Vision

To conceive and generate sustainable business opportunities for the uplift of the NBF and Modaraba Sectors through unified efforts and to come up with introduction of new products and various other profitable avenues for the stake and shareholders of the members of the Association.

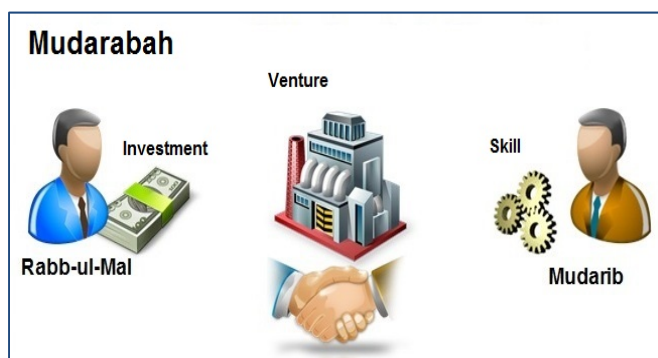
Mission

- To be the source of providing an intellectual platform to members so as to address and redress business issues and concerns through collective efforts.
- To assist and guide members through joint forums for achieving consistent growth for the NBFC Sector.
- To be able to create an atmosphere of trust and confidence amongst the regulators and members.

- To get facilitated and manage to resolve regulatory and compliance issues with the Regulators as and when faced by the members generally.
- To receive, assess and make implementation, recommendation of the research on remodeled business avenues and opportunities from members and consultants.
- To liaise with the regulators on seeking amendments to unnecessary restrictive business modules of the Leasing, Modarabas and Investment Finance Services.
- To hold special brain storming meetings to conceive new products for the uplift of the sector.

WHAT IS MODARABA?

Modaraba or Mudarabah is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called “rabb-ul-mal”, while the management and work is an exclusive responsibility of the other, who is called “mudarib.



TYPES OF MODARABA

1. **Modaraba Al Muqayyadah:** Mudarabah Al Muqayyadah means a restricted modaraba where the *Rabb-ul-maal* may specify a particular business or a particular place for the mudarib, in which case he shall invest the money in that particular business or place.
2. **Modaraba Al Mutlaqah:** Modaraba Al Mutlaqah means unrestricted modaraba where the rabb-ul-maal gives full freedom to the mudarib to undertake whatever business he deems fit.

ROLES OF MUDARIB

1. *Ameen*: The money and the assets belong to the Rabb-ul-Maal and the Mudarib held them as trustee.
2. *Wakeel*: The Mudarib steps in the role of agent while purchasing goods for trade in the business of Modaraba.
3. *Shareek*: in case the Modaraba earns profit, the Mudarib takes his share as partner and assume the role of *Shareek*.
4. *Zamin* (liable): The Mudarib is also a Zamin to the Modaraba and if the Modaraba business suffers a loss due to negligence of the Mudarib, he is liable to compensate the loss to the business.
5. *Ajeer*(employee): Where he acts against the charter of the Modaraba business and the Rabb-ul-Maal terminates the Modaraba, the role of Mudarib changes into employee and till the date he works for disposal of assets of the business he is entitled to salary for his work as Ajeer.

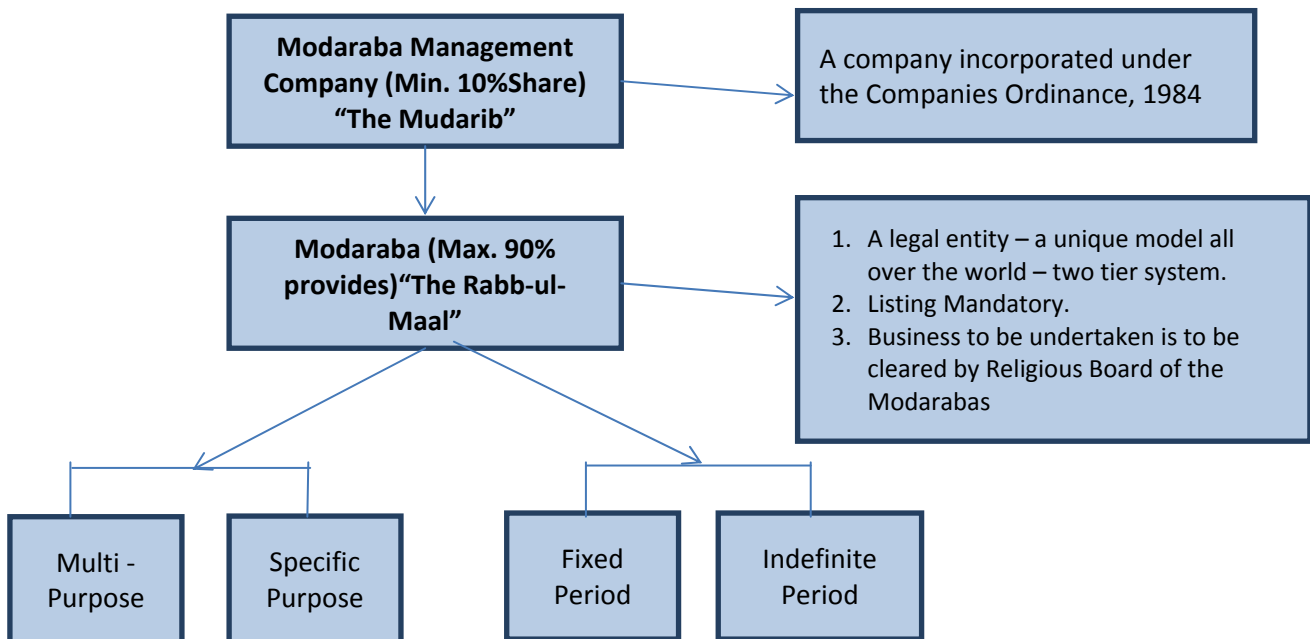
MODARABAS IN PAKISTAN

Modaraba is one of the prime modes of Islamic Financial System. In Pakistan the process of Islamization of the economy was initiated in 1977 and in light of the recommendations made by the Islamic Ideology Council, Government of Pakistan introduced certain changes in the Banking Companies Ordinance and promulgated the Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 to provide a legal framework for Islamic financial system. This was a major step through which the concept of “modaraba financing” was transformed into an Islamic financial institution in order to allow Modarabas to operate as legal corporate entities. Amongst the other activities, the Modarabas were allowed to undertake Ijarah, Murabahah, Musharakah, Diminishing Musharakah, Salam and Istisna financing activities; trading of Halal Commodities, project financing activities, investment in the stock market and can act as a special purpose vehicle.

Now the Modaraba Companies and Modarabas are operating in Pakistan for the last over 30 years as a unique model and is no example of similar legal entities is found in rest of the world.

BASIC STRUCTURE OF MODARABAS IN PAKISTAN

The basic structure of a Modaraba operating in Pakistan is given in the following diagram.



REGULATORY FRAMEWORK OF MODARABAS

The Modaraba Companies and Modarabas are working under the regulatory framework provided in following laws, rules and regulations.

- 1- Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980
- 2- Modaraba Companies and Modaraba Rules, 1981
- 3- Prudential Regulations for Modarabas
- 4- *Shariah* Compliance and *Shariah* Audit Mechanism
- 5- Code of Conduct of NBFIs & Modaraba Association of Pakistan

The Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980:

The Modaraba Companies & Modaraba (Floatation & Control) Ordinance, 1980 provides for matters to registration of modaraba companies and floatation and management and regulations of Modarabas.

The Modaraba Companies & Modaraba Rules, 1981:

In 1981 Modaraba Companies and Modaraba Rules were framed to provide Rules to do the business.

Prudential Regulations For Modarabas 2004:

In 2004 Prudential Regulations for Modarabas were issued. The regulations provide a wide range of risk management tools for conducting the day to day affairs and business of the Modarabas.

Companies Ordinance, 1984:

The affairs of Modarabas are managed through the Modaraba Management Company, which is required to be registered under the Companies Ordinance, 1984. As such, the modaraba company must comply with all the provisions of the Companies Ordinance without any exception. However, where there is consistency in the Modaraba Ordinance and the Companies Ordinance, the provisions of Modaraba Ordinance shall prevail for the Modarabas.

Shariah Compliance

In order to ensure compliance with the *Shariah* principles, *Shariah* Compliance and *Shariah* Audit Mechanism was issued by the Registrar Modaraba vide Circular No. 8 of 2012 dated 3rd February, 2012 after extensive consultation with the Association and market operators which provide a detailed framework for compliance of *Shariah* principles, investment of competent *Shariah* scholars for verification of business operations and publication of a certificate of *Shariah* compliance in the financial accounts of Modarabas.

These guidelines will improve the quality of existing compliance and eliminate the risk of any inadvertent violation of *Shariah* principles by the Modarabas. It is an important step towards the enhancement of the image of modarabas as a responsible component of Islamic Financial Industry and will help build their business links with Islamic Banks, mutual Funds and Takaful companies.

REGISTRAR MODARABA:

The Registrar Modaraba monitors the affairs of the Modaraba he is responsible for the registration, authorization, regulation and enforcement of regulatory

provisions pertaining to Modaraba Management Companies and Modarabas. A full-fledged wing within the Specialized Companies Division of Securities and Exchange Commission of Pakistan is looking after the affairs of Modarabas operating in Pakistan. The role of Registrar begins with the requirement that the Modaraba Company must be registered with him. Registration Certificate is issued after the Registrar has formed an opinion of the means, integrity and business acumen of the sponsors of the Modaraba Company. The Registrar approves the appointment of the directors of the management company.

The Certificate holders have no rights in the management under the concept of Modaraba. The Registrar looks after the interest of the certificate holders. Under Sector 21 of the Modaraba Ordinance, the Registrar may, on his own or on an application of certificate holder owning 10% of paid up capital of the Modaraba, cause an enquiry to be made into the affairs of a Modaraba company or the Modaraba or any business transaction entered into by it.

RELIGIOUS BOARD

The Federal Government of Pakistan constitutes Religious Board for Modarabas under section 9 of the Modaraba Companies and Modarabas (Floatation and Control) Ordinance, 1980, which comprises of a Chairman and two *Shariah* Scholars. No Modaraba can operate in Pakistan unless its business and prospectus is cleared from the Religious Board for the Modarabas. All the products and business activities of the Modaraba are approved by the Religious Board for Modarabas with the facilitation of the Modaraba Wing. The following is the composition of the Religious Board constituted by the Federal Government vide notification dated **August 30, 2012**:

- Former Justice Syed Zahid Husain Bokhari (Chairman) ;
- Mufti Muhammad Saeed Khan (*Shariah* Scholar); and
- Dr. Muhammad Tahir Mansoori (*Shariah* Scholar).

The Religious Board approved the 'Twelve Model Islamic Financing Agreements in the year 2008, details given below:

- Diminishing Musharaka DM-Immovable property financing agreement
 - DM-Joint Sharing Agreement

- DM-Musharakah Agreement
- DM-Rental Agreement
- Undertaking to purchase MU upon termination
- Undertaking to purchase MU during the term of DM
- Ijarah | Short Form Lease Agreement
- Istisna
- Mudarabah
- Musawamah
- Musharaka
- Murabahah
- Salam
- Syndicate Mudarabah
- Syndicate Musharakah
 - Syndicate Musharaka
 - Investment Agency Agreement
- Islamic CFS Murabahah
- Sukuk

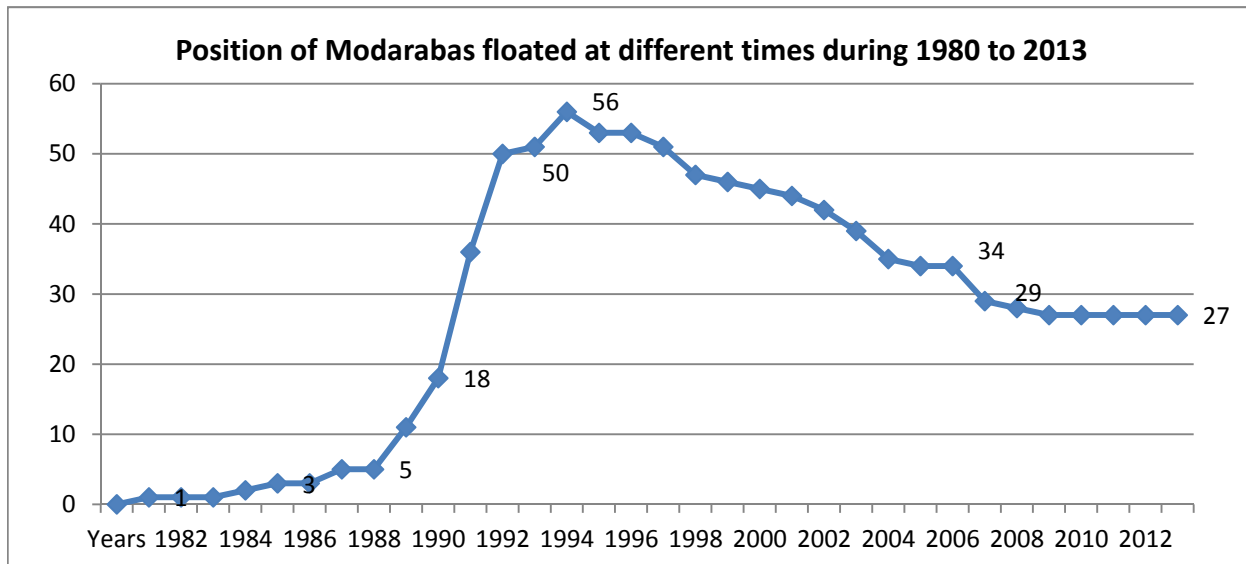
BRIEF HISTORY OF ISLAMIC FINANCE AND MODARABAS IN PAKISTAN:

Islamic finance during the last four decades has witnessed considerable progress at the global front. Besides the traditional Islamic finance markets of Middle East, financial centers across various western countries are also accepting and recognizing the viability and utility of this alternate financial system. In particular the relative resilience of Islamic financial institutions during the recent financial crisis due to its asset backed nature and being devoid of speculation and uncertainty, has significantly improved its credibility as a more prudent and stable system. The scope and range of Islamic finance products has also widened considerably over the years and Islamic financial Institutions are presently catering to most of the financial services needs of various sectors of the economy. These are dedicated regulatory, legal and academic institutions at the international level working and providing support for maintaining the high pace growth of the Islamic finance Industry.

In Pakistan, the Islamic financial industry is represented by Islamic Banks, Islamic

Banking Windows of Conventional Banks, Modarabas, Islamic Mutual Funds and Takaful Companies.

The Modaraba sector being the pioneer in providing Islamic financial services in Pakistan is an important segment of the financial sector. The first modaraba was floated in July, 1980 and then came a boom and total number of modarabas at one time went up to as high as 56. These modarabas were not only trend setters of Islamic modes of financing in a pre-dominant conventional financial system in Pakistan but also built confidence among the general public regarding practice of Islamic modes of financing.



Initially the business of the modaraba sector was restricted to only three basic products i.e. Ijarah, Musharakah and Murabahah. There was a need to design new innovative Islamic business products to capture the market for consistent growth of the Modaraba Sector. In the year 2008 with the joint efforts of the Regulator and Modaraba Association of Pakistan, 12 new products were got approved by the Religious Board. In addition model financing agreements of all these products were approved.

Another milestone in the history of Modaraba Sector was introduction and implementation of *Shariah* Compliance and *Shariah* Audit Mechanism in February, 2012. The Mechanism was issued by the Regulator after extensive consultation with the Association and market players which provided a detailed framework for compliance of *Shariah* principles, involvement of competent *Shariah* scholars for verification of business operations and publication of certificate of *Shariah*

compliance in the financial accounts of modarabas. In accordance with these Mechanism, every modaraba has appointed its *Shariah* Advisor who looks after their *Shariah* issues and provide them guidance on an on-going basis.

The Association also facilitated its members and *Shariah* Advisors by issuing a detailed *Shariah* Compliance Guide and also compiled all the model financing agreements in a booklet form for their ready reference. The Association is also arranging workshops on different topics of Islamic finance to educate and guide the staff of modarabas.

MODARABA INDUSTRY REVIEW

I. Business of Modaraba

In Pakistan the Modaraba Sector is involved in various types of business which are approved by Religious Board. In March, 2008, the Religious Board approved the following Model Financing Agreements for Modarabas:

- i. Diminishing Musharakah
- ii. Ijarah
- iii. Salam
- iv. Istisna
- v. Mudarabah
- vi. Musharakah
- vii. Murabahah
- viii. Musawamah
- ix. Syndicate Murabahah
- x. Syndicate Musharakah
- xi. Islamic CFS Murabahah

Besides these Islamic modes of financing, the Modarabas also involved in the activities like:

- i. Trading of Halal commodities
- ii. Manufacturing
- iii. Investment in Equities
- iv. Portfolio Management
- v. Private Equity/Venture Capital
- vi. Investment Finance Services
- vii. Housing Finance

2. Growth & Branch Network

Almost all Modarabas are located at Karachi and Lahore. A few Modarabas are having their branches network at various cities such as Islamabad, Faisalabad, Multan, Sialkot and others. Presently there are 51 branches of Modaraba operating in Pakistan.

3. Present Market Players

Presently there are 27 active modarabas working in Pakistan, list is given below:

Sr.No.	Name of Modaraba	(Rupees in million)			Dividend for 2012-13
		Total Assets	Paid up	Equity	
1	Allied Rental Modaraba	4,439.58	975	2,352.73	30% (Cash) 5% (Bonus)
2	B.F. Modaraba	128.51	75.15	122.97	--
3	B.R.R. Guardian Modaraba	3,011.65	780.46	802.06	3.10%
4	Crescent Standard Modaraba	160.58	200.00	124.77	1.50%
5	Elite Capital Modaraba	193.47	113.40	133.69	5.50%
6	First Equity Modaraba	665.51	524.40	627.51	-
7	First Al-Noor Modaraba	359.48	210.00	323.55	5.00%
8	First Fidelity Leasing Modaraba	374.23	264.14	343.84	--
9	First Habib Bank Modaraba	883.13	397.07	716.41	14.75%
10	First IBL Modaraba	219.98	201.88	173.68	3.35%
11	First Imrooz Modaraba	308.61	30.00	132.75	100.00%
12	First Paramount Modaraba	266.95	76.22	175.67	11%(Cash) 10%(Bonus)
13	First Punjab Modaraba	1569.35	340.20	32.50	-
14	First Treet Manufacturing Modaraba	1644.47	1,304.00	1519.49	9.50%
15	First Habib Modaraba	4718.93	1,008.00	3,053.00	20.00%
16	KASB Modaraba	1516.09	282.743	265.72	--
17	Modaraba Al-Mali	239.31	184.24	179.29	1.25%
18	First National Bank Modaraba	2,003.70	250.00	297.90	--
19	First Pak Modaraba	78.67	125.40	73.30	1.20%
20	First Prudential Modaraba	584.89	872.18	515.68	2.30%
21	Standard Chartered Modaraba	6,840.03	453.84	1,002.57	20.00%
22	Trust Modaraba	428.52	298.00	304.51	6.00%
23	First UDL Modaraba	794.23	263.87	551.46	20.00%
24	Unicap Modaraba	3.65	136.40	-0.96	-
	Total	31,433	9,266	13,367	

FINANCIAL DATA:

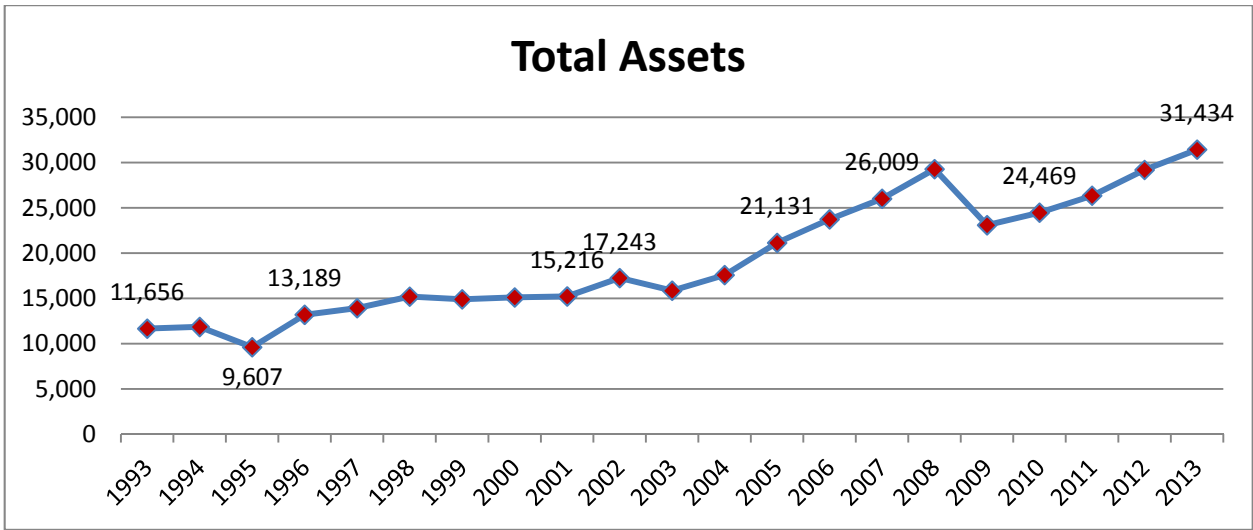
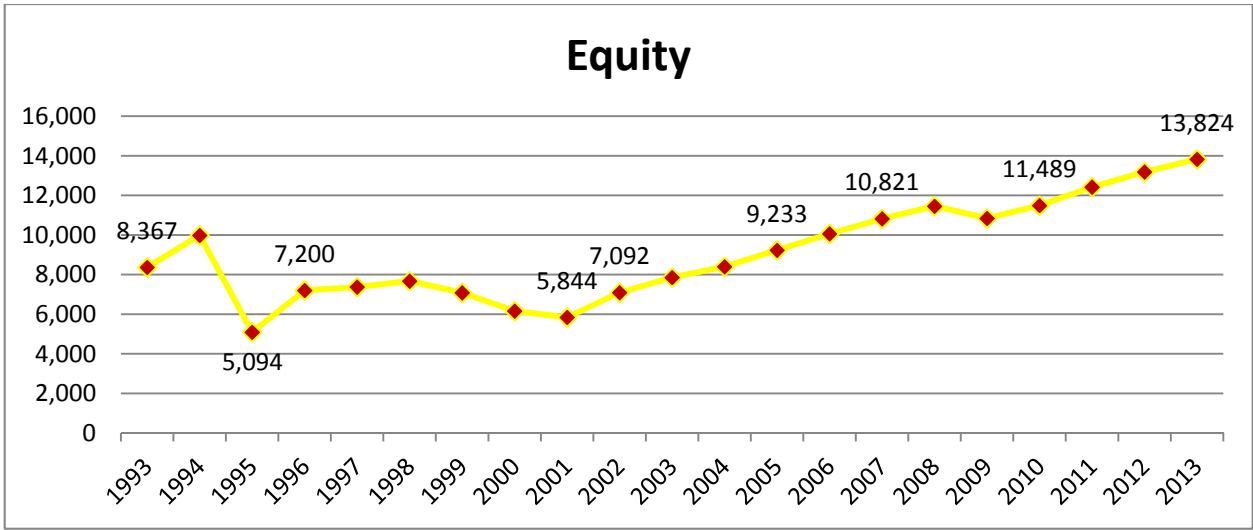
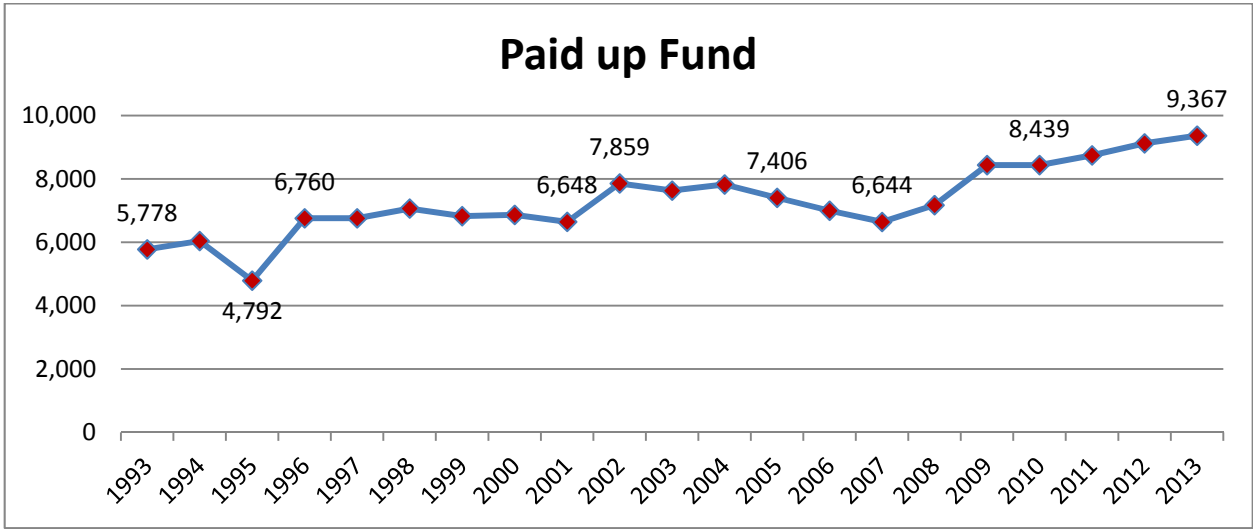
The modaraba sector has positioned itself as a stable form of Islamic financial institution over the period of last 30 years. With the exception of few years, there has been a gradual growth in paid-up fund, equity, assets and profits of the Modarabas.

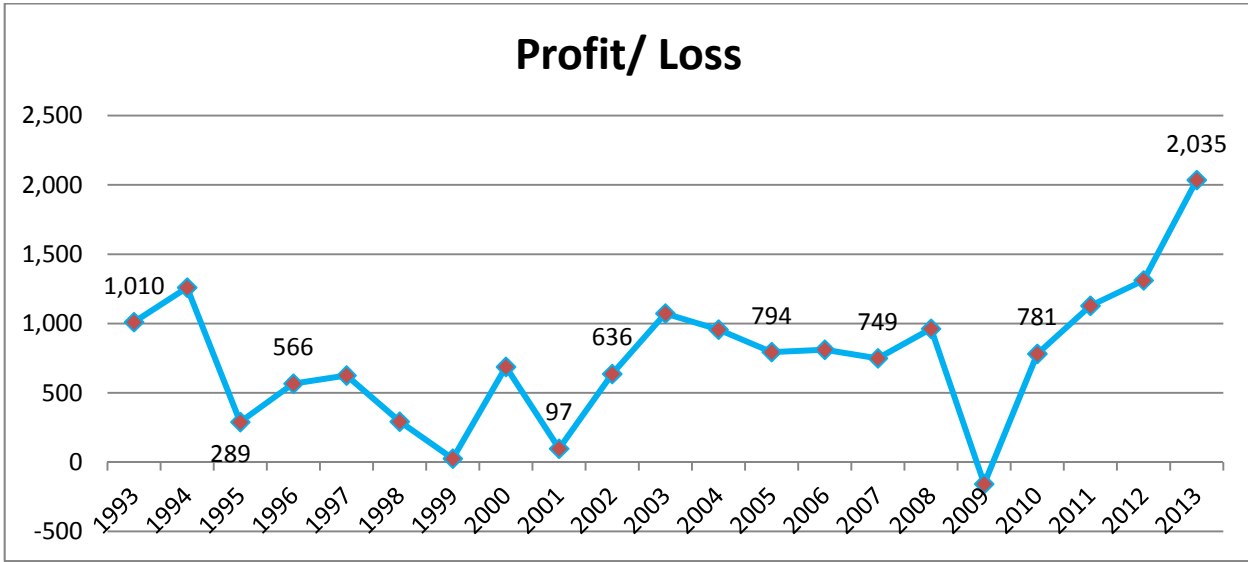
Key statistics of modaraba sector from 1993 to 2013 are given in the Table below:

Rupees in million

Years	Paid up Capital	Equity	Total Assets	Profit / Loss
1993	5,778	8,367	11,656	1,010
1994	6,042	9,981	11,845	1,259
1995	4,792	5,0945	9,607	289
1996	6,760	7,200	13,189	566
1997	6,760	7,374	13,921	625
1998	7,067	7,673	15,195	292
1999	6,828	7,082	14,899	25
2000	6,867	6,161	15,103	687
2001	6,648	5,844	15,216	97
2002	7,859	7,092	17,243	636
2003	7,633	7,854	15,852	1,072
2004	7,827	8,401	17,574	956
2005	7,406	9,233	21,131	794
2006	6,999	10,062	23,736	811
2007	6,644	10,821	26,009	749
2008	7,175	11,456	29,281	962
2009	8,439	10,839	23,087	(158)
2010	8,439	11,489	24,469	781
2011	8,746	12,422	26,343	1,128
2012	9,124	13,186	29,195	1,311
2013	9,367	13,824	31,434	2,035

The sector lifecycle in terms of paid-up fund, equity, assets and profit exhibited by the modaraba sector can be seen through the graphical representations given below (figures in PKR million)



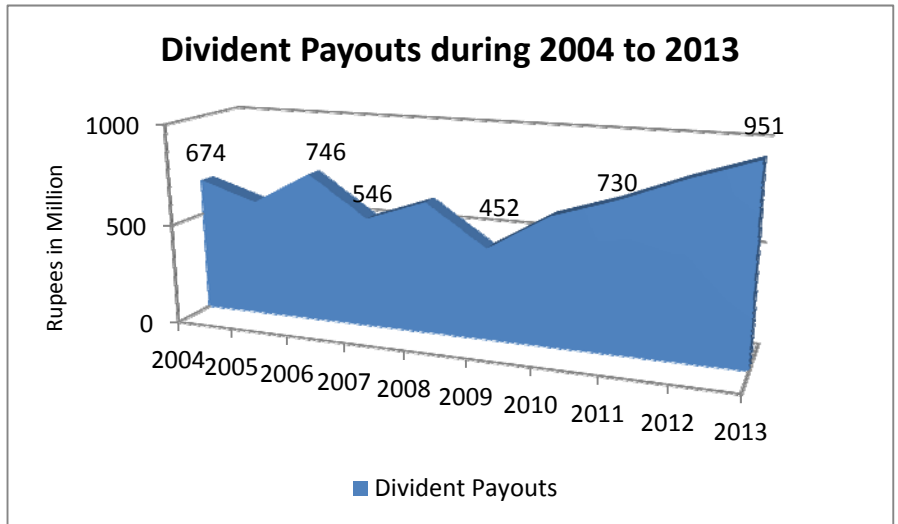


Dividend Payout

Modaraba Sector is consistently paying cash dividend to its Certificate holders. Some of them are regularly paying cash dividend to their certificate holders since inception.

Dividend payouts during the last ten years are as under:-

<u>Year</u>	<u>Amount</u>
2013	Rs. 950.89 million
2012	Rs. 848.82 million
2011	Rs. 730.24 million
2010	Rs. 631.57 million
2009	Rs. 452.52 million
2008	Rs. 652.21 million
2007	Rs. 546.26 million
2006	Rs. 745.81 million
2005	Rs. 583.18 million
2004	Rs. 673.87 million



Deposit Taking Modarabas

In accordance with the criteria laid down by the SECP, following modarabas are eligible to issue Certificate of Musharaka (COM):

- a. First Habib Modaraba
- b. Standard Chartered Modaraba
- c. KASB Modaraba
- d. First Punjab Modaraba

- e. First Paramount Modaraba
- f. First National Bank Modaraba

SOURCES OF FUNDS

The major problem of the modaraba sector is Resource Mobilization. Most of the Modarabas are totally depending on its equity. However, six modarabas are accepting deposits from the general public under the Scheme of Certificate of Musharakah (COM). In the past one modaraba had floated Terms Finance Certificate (TFCs) which has now completed its tenure and the capital has redeemed.

Another deposit taking scheme in the name of Certificate of Investment (Modaraba) (COIM) is in the process of finalization which will also resolve the issue of resource mobilization to some extent.

Though all the Modarabas are shariah compliant but with the introduction of Shariah Compliance and Shariah Audit Mechanism (SCSAM) the managements of Modarabas are following the Shariah principles with zealous and extra care. SCSAM has further strengthened the identity of Modarabas being Islamic financial institutions by increasing their numbers on the only Islamic index of the country. Islamic Banks are also moving forward to cater the financing needs of the modarabas which will resolve the issue of resource mobilization for the modarabas to the large extent.

FUTURE PROSPECTS

Keeping in view of growth of Islamic finance in the country, we are confident that Modaraba has good potential to expand the business within the Islamic financial market in various sector of the country for example Agriculture, housing finance, treasury operations etc. Moreover, modarabas are mostly located in the big cities like Karachi Lahore and Islamabad. There are a number of cities where the financial activities increased manifold but modarabas have not tapped the market of these areas. It is desired to expand the branch network of modarabas in the small and medium size cities where a good potential is available.

It is desired to explore the new markets and introduce new and innovative products and services for growth of the sector. It is need of the time to diversity the business operations, innovate new products, develop resource Mobilization, concentrate on *Shariah* compliance and *Shariah* Audit Mechanism for its future growth.