

Article Section

From Islamic Banking Windows to Dedicated Islamic Banks: A Strategic Roadmap for Pakistan

Introduction

Islamic finance has evolved significantly over the past five decades, expanding across banking, Sukuk, Takaful, investment funds, asset management, and digital finance. Islamic banking remains a major component of this ecosystem.

Conventional banks initially introduced Islamic financial services through Islamic Banking Windows (IBWs), using existing branches, technology, treasury operations, and staff. This approach reduced entry costs and enabled banks to develop Shariah-compliant products gradually.

As the industry matures, dedicated Islamic banks and subsidiaries offer an alternative structure with greater operational focus, independent governance, and specialised management. For Pakistan, the transition presents both strategic opportunities and implementation challenges.

This article examines the benefits and limitations of Islamic Banking Windows, the rationale for establishing dedicated Islamic banks, international experiences, and a practical framework for conversion.

Islamic Banking Windows: Achievements and Limitations

The Role of Islamic Banking Windows

Islamic Banking Windows (IBWs) provided a practical starting point when specialised human resources, Shariah governance frameworks, and Islamic banking infrastructure were still developing.

Their principal advantages include:

- Lower establishment costs: Existing infrastructure reduces initial investment.
- Established customer networks: Conventional banks can leverage their branches and customer relationships.
- Gradual capacity building: Banks can develop Islamic banking expertise and test market demand.
- Operational efficiencies: Shared services can reduce duplication of administrative and technology costs.

This model has supported the expansion of Islamic banking in countries including Pakistan, Malaysia, Indonesia, the United Kingdom, and Oman.

Why Dedicated Structures Are Gaining Attention

As Islamic banking expands, greater attention is being given to governance, transparency, operational independence, and customer confidence.

Although effective segregation and Shariah governance can be maintained within a window structure, a dedicated Islamic bank can provide a clearer institutional identity and greater autonomy over strategic decisions, management, treasury, and risk functions.



Haroon Siddique, FCMA
Business Head – Commercial
MCB Bank

The choice of structure should therefore consider regulatory requirements, market conditions, operational capacity, and long-term business objectives.

Strategic Benefits of Dedicated Islamic Banks

Stronger Shariah Governance

A dedicated Islamic bank can establish its own Shariah Supervisory Board, compliance and audit functions, and governance arrangements. This enables closer integration of Shariah requirements into product development, risk management, and daily operations.

Greater Financial Transparency

A separate legal entity can maintain its own balance sheet, capital structure, treasury operations, and financial reporting. Clear segregation of funds and transactions can strengthen transparency and customer confidence.

Independent Management and Decision-Making

Dedicated management teams can focus on Islamic banking strategy, product development, customer service, and risk management. Greater autonomy may also support faster decisions and clearer accountability.

Product Innovation and Digital Banking

Independent product teams can collaborate with Shariah scholars, technology specialists, and financial professionals to develop new products.

Opportunities include digital Islamic banking, trade finance, fintech partnerships, and Shariah-compliant investment solutions.

Specialised Treasury and Liquidity Management

Dedicated treasury functions can develop expertise in Sukuk, Islamic interbank placements, Wakalah investments, approved commodity Murabaha arrangements, foreign exchange, and asset-liability management.

The effectiveness of these operations will depend on the availability of suitable Shariah-compliant liquidity instruments and the development of Islamic money markets.

Long-Term Institutional Sustainability

A dedicated structure may support stronger branding, focused marketing, specialised relationship management, and improved operational controls. However, these benefits depend on effective execution, adequate capital, sound governance, and sustainable business planning.

Key Challenges in Conversion

Converting an Islamic Banking Window into a dedicated Islamic bank is a complex institutional transformation involving legal, financial, technological, and operational changes.

Capital and Financial Requirements

The new institution must meet applicable minimum capital requirements and maintain regulatory ratios, including the Capital Adequacy Ratio (CAR) and relevant liquidity requirements.

Financial planning should account for technology investments, staffing, branding, treasury infrastructure, contingency reserves, and transition costs.

Legal and Regulatory Restructuring

Conversion may require the establishment of a new legal entity, transfer of assets and liabilities, contractual novation, collateral transfers, registration of security interests, and arrangements for employee contracts.

A clear legal framework and early regulatory engagement are essential to minimise delays and uncertainty.

Core Banking and Technology Migration

Technology migration is among the most demanding stages. The new institution must ensure that its systems support Islamic financial contracts, appropriate accounting treatments, profit calculations, regulatory reporting, and Shariah-compliant transaction processing.

Data migration, cybersecurity, payment interfaces, system testing, and disaster recovery arrangements must be completed without disrupting customer services.

Human Capital and Organisational Culture

Islamic banking requires specialised expertise in treasury, product structuring, Shariah audit, Islamic accounting, documentation, and risk management.

Banks should invest in recruitment, professional training, certification, and succession planning. Shariah compliance must also be embedded across the organisation rather than treated solely as the responsibility of the Shariah Supervisory Board or compliance department.

Liquidity Management

Islamic money markets may offer fewer short-term instruments than conventional markets. A dedicated Islamic bank must develop capabilities in liquidity forecasting, Sukuk investment, Islamic interbank placements, foreign exchange, and profit-rate risk management.

Customer and Portfolio Migration

Transferring customer accounts, deposits, financing facilities, collateral, guarantees, and payment instructions requires careful legal and operational planning.

Depending on applicable law and regulatory approvals, migration may require explicit customer consent or another legally permissible notification process.

Clear communication, dedicated customer support, accurate documentation, and contingency planning are essential to minimise complaints and customer attrition.

Business Continuity

Branches, ATMs, mobile banking, and payment systems must remain operational throughout the transition. A phased implementation plan, supported by rigorous testing and contingency arrangements, can help protect customer confidence.

International Experiences

Different jurisdictions demonstrate that Islamic banking structures can evolve through different regulatory and commercial approaches.

Pakistan

Pakistan has examples of both full conversion and dedicated subsidiary models. Faysal Bank converted from a conventional bank into a full-fledged Islamic bank, while MCB Islamic Bank operates as a dedicated Islamic banking institution within the wider MCB group.

The State Bank of Pakistan (SBP) has also outlined a transition roadmap targeting the conversion of the banking system to an interest-free framework by 31 December 2027. This makes regulatory clarity, institutional readiness, and coordinated implementation particularly important.

Malaysia

Malaysia has developed a comprehensive Islamic financial services framework supported by dedicated legislation and Shariah governance requirements. Institutions such as Maybank Islamic, CIMB Islamic, and RHB Islamic demonstrate how dedicated subsidiaries can combine specialised operations with selected group-level services.

United Arab Emirates

The UAE has emphasised Shariah governance through central-level oversight and recognised standards. Its Islamic banking institutions illustrate the importance of specialised risk management, treasury operations, and investment in digital capabilities.

Indonesia

Indonesia has pursued consolidation to strengthen the scale and competitiveness of Islamic banking. Bank Syariah Indonesia, formed through the merger of several Islamic banking subsidiaries, illustrates the potential benefits of combining resources and operations.

Saudi Arabia

Saudi Arabia demonstrates the scale achievable in a mature Islamic banking market. Institutions such as Al Rajhi Bank and Bank AlJazira operate within a financial system supported by substantial Islamic banking activity and an established Sukuk market.

These experiences highlight the importance of regulatory support, appropriate legal frameworks, shareholder commitment, technological readiness, effective Shariah governance, and transparent customer communication.

A Strategic Regulatory Conversion Framework

A successful transition requires a structured implementation plan. The proposed Strategic Regulatory Conversion Framework (SRCF) comprises eight stages.

Stage 1: Assess Business Viability

Prepare realistic financial projections covering profitability, capital requirements, funding, liquidity, market share, and shareholder returns. Stress testing should assess the institution's resilience under adverse conditions.

Stage 2: Establish Regulatory Readiness

Identify licensing, legal, tax, prudential, and Shariah governance requirements at the outset. Engage the regulator early to clarify approval procedures, timelines, and applicable transitional arrangements.

Stage 3: Separate Governance Structures

Establish the Board of Directors, Shariah Supervisory



Board, executive management, risk and audit committees, compliance functions, treasury leadership, and finance teams before operational migration.

Stage 4: Plan Technology and Operational Migration

Establish a dedicated project management office responsible for data cleansing, system integration, product configuration, cybersecurity, testing, disaster recovery, and implementation oversight.

Stage 5: Segregate Financial and Balance-Sheet Operations

Ensure the appropriate segregation of Shariah-compliant assets, liabilities, reserves, treasury portfolios, and accounting records. Establish independent financial statements, capital structures, and regulatory reporting mechanisms.

Stage 6: Establish Independent Treasury Capabilities

Develop dedicated treasury and financial control functions for liquidity management, Sukuk investments, foreign exchange, asset-liability management, and participation in Islamic money markets.

Stage 7: Migrate Customer Portfolios

Implement a phased migration plan covering customer communication, legal documentation, contract transfers, collateral arrangements, customer education, and contingency measures.

Stage 8: Optimise Post-Conversion Performance

Following launch, focus on product innovation, digital banking, customer acquisition, strategic partnerships, treasury efficiency, Environmental, Social and Governance (ESG) integration, and continuous improvement in governance and compliance.

The framework should be treated as a long-term transformation programme rather than a one-time restructuring exercise.

Policy Recommendations

For Regulators

- Establish clear legal and regulatory pathways for conversion.
- Assess business plans using realistic financial projections and stress tests.
- Clarify procedures for transferring assets, liabilities, contracts, and customer relationships.
- Expand the availability of Shariah-compliant liquidity management instruments.
- Strengthen alignment with recognised international standards, including those of AAOIFI and IFSB, where appropriate.
- Consider time-bound transitional arrangements for regulatory compliance, subject to prudential safeguards.
- Invest in capacity building for regulators, Shariah scholars, and Islamic finance professionals.

For Islamic Banks

- Secure long-term shareholder commitment before initiating conversion.
- Develop realistic financial projections and identify capital and liquidity requirements.
- Engage regulators early and plan for all applicable approvals.
- Establish a dedicated programme management office with clear accountability.
- Invest in technology modernisation, cybersecurity, and operational resilience.
- Strengthen Shariah governance before migration.
- Prioritise staff training, professional development, and succession planning.
- Maintain transparent communication with customers throughout the transition.

The Way Forward: Digitalisation and Sustainable Finance

The future of Islamic banking will depend not only on institutional restructuring but also on the ability to respond to technological change and evolving customer expectations.

Digital banking, artificial intelligence, cloud computing, and data analytics can improve customer engagement, fraud detection, risk assessment, and regulatory compliance. Islamic fintech can also create opportunities in payments, wealth management, trade finance, and microfinance.

Sustainable finance offers further potential. Islamic finance principles can complement environmental, social, and governance (ESG) objectives in areas such as renewable energy, affordable housing, healthcare, education, and socially responsible infrastructure.



Dedicated Islamic banks with sound governance, modern technology, and strategic flexibility may be better positioned to pursue these opportunities. However, success will depend on effective execution, responsible innovation, and compliance with applicable Shariah and regulatory requirements.

Conclusion

Islamic Banking Windows have played an important role in expanding access to Shariah-compliant financial services by allowing conventional banks to use existing infrastructure and customer networks.

As the industry develops, dedicated Islamic banks can offer greater institutional focus, specialised governance, financial transparency, and operational autonomy. Realising these benefits, however, requires adequate capital, clear regulation, effective Shariah oversight, technological readiness, skilled professionals, and careful customer migration.

The proposed Strategic Regulatory Conversion Framework provides a structured approach for regulators and financial institutions to manage this transition. For Pakistan, the priority should be to ensure that the evolving Islamic banking system is supported by practical implementation arrangements, strong institutional capacity, and sustainable business models.

Ultimately, the objective is not merely to change organisational structures, but to build a resilient, transparent, innovative, and inclusive Islamic financial system capable of supporting long-term economic development.

About the Author: ***Haroon Siddique*** *is a senior Islamic Banking professional with over 26 years of experience and currently serves as Business Head – Commercial, SME & Agriculture Financing at MCB Islamic Bank Ltd. He holds FCMA, MS Islamic Banking & Finance (Patron's Medal), and CSAA (AAOIFI) qualifications, with expertise in Shariah governance, risk management, Islamic finance, and strategic decision-making. He is also a former Visiting Faculty member at Punjab University and an experienced trainer in Islamic finance.*