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Reinventing Risk-Sharing: The Theory and Practice of Investment Pools and Weightage Mechanism in Pakistani Islamic Banking

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Abstract

This study explores the theoretical and operational framework of Profit and Loss Sharing (PLS) mechanisms in Islamic banking, focusing on pool management practices in Pakistan under State Bank of Pakistan (SBP) guidelines. It examines the complete process of investment pool formation on Musharakah and Mudarabah principles, associated risks (including Displaced Commercial Risk), Shariah-compliant investment allocation, profit calculation, expense deduction, reserve management (PER & IRR), and the widely used weightage system for profit distribution. The paper explains how weightages are assigned based on deposit tenure, amount, profit payment frequency, and customer category, along with their mathematical calculation and regulatory limits. It further discusses profit and loss distribution methods, transparency requirements, treatment of early withdrawals, and the gradual phasing out of special Hiba. The weightage system is justified from a Shariah perspective by analogy with Quranic inheritance shares. The study concludes that transparent and disciplined application of SBP's Pool Management Guidelines is essential for upholding authentic PLS principles, ensuring fairness, and maintaining depositors' trust in Islamic banking.

Keywords: Islamic banking, Profit and Loss Sharing, Pool management, Weightage system, Mudarabah, Musharakah, State Bank of Pakistan, Shariah compliance

1. Introduction

The foundational promise of Islamic banking is the replacement of interest-based lending with genuine profit and loss sharing (PLS) grounded in the classical contracts of Musharakah and Mudarabah. In theory, this risk-sharing paradigm distinguishes Islamic finance from its conventional counterpart and aligns it with the Quranic injunctions of justice, equity, and partnership. In practice, however, the implementation of pure PLS has proven challenging in modern retail banking environments characterized by millions of small, fluctuating deposits, intense competition, and depositor expectations of capital protection and competitive returns.

Pakistani Islamic banks have responded to this challenge by developing a sophisticated institutional mechanism: the regulated investment pool combined with a tiered weightage system for profit allocation. Far from being a mere administrative tool, this framework effectively reinvents the classical ideal of risk-sharing, transforming it into a workable, transparent, and Shariah-compliant model that balances commercial viability with ethical authenticity. Through State Bank of Pakistan-mandated pool management guidelines, mandatory reserves (Profit Equalization Reserve and Investment Risk Reserve)[1], gradual phasing-out of discretionary Hiba, and a mathematically structured weightage methodology, these institutions have created a unique bridge between theoretical principles and day-to-day banking operations.

This paper examines the complete architecture of this reinvention. It analyses the theoretical foundations of PLS, traces the regulatory evolution of pool management in Pakistan, explores the operational intricacies of investment pools, identifies associated risks (particularly Displaced Commercial Risk), and provides an in-depth explanation of the weightage mechanism—including its calculation methodology, regulatory ceilings, and Shariah justification through analogy with the Quranic rules of inheritance. By doing so, the study demonstrates how Pakistani Islamic banks have successfully operationalized authentic risk-sharing in a highly competitive market while remaining within the boundaries of both Islamic law and prudential regulation.

1.2 Research Objectives

The primary and secondary objectives of this study are as follows:

Primary Objective To critically examine how Pakistani Islamic banks have reinvented the classical Islamic principle of profit-and-loss sharing (PLS) into a practical, regulator-supervised, and mass-retail compatible model through the institutional mechanism of investment pools and the weightage-based profit distribution system.

Specific Objectives

1. To analyze the complete operational architecture of investment pool formation, management, and dissolution under the State Bank of Pakistan's regulatory framework.
2. To evaluate the theoretical foundations and Shariah legitimacy of the weightage system, particularly its widely accepted analogy with Quranic inheritance shares.
3. To explain the step-by-step methodology of weightage calculation, its determining factors, and regulatory safeguards.
4. To assess the role of profit-smoothing tools (PER, IRR, and phased-out Hiba) and their impact on authentic risk-sharing.
5. To identify persisting challenges (especially Displaced Commercial Risk) and propose policy measures for moving towards purer forms of PLS without compromising growth and stability.

1.3 Research Questions

How have Pakistani Islamic banks operationally reinvented authentic profit-and-loss sharing through the regulated investment pool framework and tiered weightage system while balancing Shariah authenticity, regulatory compliance, and market competitiveness?

1.4 Research Methodology

This study employs a **qualitative, descriptive, and doctrinal research design**. It is based entirely on **secondary data** collected from:

- State Bank of Pakistan's official circulars and guidelines on Profit & Loss Distribution and Pool Management (2008–2025)
- AAOIFI Shariah Standards (Nos. 13, 27, 40)
- Published profit-distribution policies, pool circulars, and monthly weightage grids of major Pakistani Islamic banks (2023–2025)

- Leading scholarly works and peer-reviewed journal articles on Islamic banking in Pakistan

Data were analyzed through **regulatory content analysis**, **Shariah-doctrinal interpretation** (especially the inheritance-share analogy), and **critical evaluation** of operational practices. Informal discussions with Shariah advisors and pool-management staff were used only for validation purposes. No primary survey or quantitative modelling was conducted.

Scope: Pakistan's Islamic banking sector as of November 2025. Limitation: Descriptive rather than empirical; future studies may include statistical analysis of actual returns.

2. Formation of Investment Pools and Introduction of the Weightage System

Islamic banking institutions operate on the principle of risk-sharing rather than guaranteed returns. To operationalize this principle at a retail level, Islamic banks pool depositors' funds into common investment pools managed primarily under the contracts of Mudarabah (profit-sharing) and Musharakah (joint venture/partnership).[2] The creation of such pools is a highly structured, transparent, and regulator-supervised process governed by the State Bank of Pakistan's (SBP) Instructions for Profit & Loss Distribution and Pool Management.[3],[4]

The pool formation process begins with a thorough assessment of two components: (i) the bank's own equity contribution (shareholders' funds) and (ii) the expected inflow of investment deposits. Banks rely either on historical deposit behavior or on fresh projections supported by detailed market surveys, feasibility studies, and consultations with peer institutions already active in target sectors. All projections must fully comply with Shariah standards and SBP prudential regulations.

Once the anticipated size of the pool is determined, management estimates gross income potential from Shariah-compliant avenues and deducts permissible expenses and statutory reserves. On the basis of this net projected income, the bank provisionally fixes:

- The profit-sharing ratio between the bank (as Mudarib or working partner) and the depositors (as Rabb-ul-Maal or capital providers);
- The weightages to be assigned to different categories and tenors of deposits.

The weightage system is the cornerstone of profit distribution in Pakistani Islamic banks. It assigns a relative "weight" or multiplier to each deposit category, reflecting factors such as tenor, profit payment frequency, deposit size, customer segment, and currency. For example:

- A deposit of PKR 100,000 placed for three years and profit payable at maturity may be assigned a weightage of 1.80.
- A similar amount in a savings account with monthly profit payment and withdrawable on demand may receive a weightage of only 0.95.

Depositors receive profit proportionate to their weighted units rather than their actual invested amount. The bank announces applicable weightages and indicative profit rates in advance (typically within the first three working days of each month) through branch notices, websites, and account opening documentation, thereby fulfilling the Shariah requirement of transparency and mutual consent before conclusion of the Mudarabah contract.

Final profits are calculated daily on the basis of actual deployment of funds and are distributed monthly or at maturity according to the pre-declared weightages and the number of days each deposit remained in the pool.

Funds mobilised through these pools are subsequently channeled into a diversified portfolio of Shariah-compliant modes, primarily Murabahah, Ijarah, Diminishing Musharakah, running Musharakah, and Salam/Istisna, in predetermined percentages approved by the bank's Shariah

Board and disclosed in the pool circular. While the broad methodology remains uniform across full-fledged Islamic banks and Islamic banking branches/windows, individual institutions retain flexibility in setting pool parameters, asset allocation ratios, and specific weightage criteria within the boundaries prescribed by the SBP and AAOIFI Shariah Standards.[5]

3. Contractual Basis of Deposits and Formal Pool Creation Process

Investment deposits in Pakistani Islamic banks are mobilised principally under two Shariah contracts, or a combination thereof:

- **Mudarabah**: The depositor acts as Rabb-ul-Maal (capital provider) and the bank as Mudarib (investment manager). The bank enjoys full investment discretion, while profit is shared according to a pre-agreed ratio and loss is borne by the depositor unless caused by the bank's negligence or misconduct.
- **Musharakah**: A joint-venture arrangement in which both the bank (through its equity) and depositors contribute capital to a common pool and share profit and loss in proportion to their respective capital contributions.

In practice, most retail and corporate investment accounts in Pakistan operate on a restricted Mudarabah basis within a common pool that also includes a portion of the bank's own shareholders' equity, thereby creating a hybrid Musharakah–Mudarabah structure.

3.1 Pool Management Committee

The State Bank of Pakistan (SBP) mandates the establishment of a dedicated **Pool Management Committee** for every Islamic Banking Institution (IBI). The committee is typically chaired by the Head of Islamic Banking and includes:

- Head of Operations
- Head of Shariah Compliance
- Head of Risk Management
- Resident Shariah Board Member (RSBM) or his/her nominee
- Representatives from Treasury, Finance, and Islamic Banking Support Division

This committee bears ultimate responsibility for pool creation, asset allocation, inter-pool transfers, sub-pool management, weightage finalisation, reserve appropriation, and profit distribution.

3.2 Mandatory Disclosure Requirements through Pool Circular

Every new pool (general pool, high-yield pool, FCY pool, specific pool, or sub-pool) must be formally instituted through an official **Pool Circular** issued by the bank. As per SBP's IBD Circular No. 02 of 2012 (Annexure-III) and subsequent instructions, the circular must explicitly disclose the following parameters:

1. Quantum and percentage of bank's own equity in the pool
2. Minimum prescribed equity-to-asset ratio
3. Minimum account opening balance and deposit slabs
4. Deposit categories and their respective initial weightages[6]
5. Customer segmentation (retail, corporate, government, financial institutions, etc.)
6. Nature and characteristics of assets to be financed from the pool
7. Approved investment strategy and sectoral exposure limits

8. Specific objectives of the pool (if any)
9. Percentage allocation to Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR)[7]
10. Liquidity/maintenance period of the pool
11. Notice period required for premature withdrawal
12. Methodology for direct and indirect expense allocation
13. Dispute resolution mechanism
14. Any other material terms and conditions[8,9]

Once a depositor accepts these terms (either explicitly through the account opening form or implicitly through continued deposit maintenance), the contract becomes binding. No unilateral change in weightages, profit-sharing ratios, or other key parameters is permissible during the declared liquidity period of the pool (Bank of Khyber, 2024; SBP, 2012).

4. Risk Profile of Investment Pools

The pooling mechanism, while essential for operationalising profit-and-loss sharing at scale, exposes both the Islamic Banking Institution (IBI) and its depositors to a distinct set of risks. Some of these risks are inherent to all banking activity, whereas others arise specifically from the prohibition of riba and the obligation to share actual losses with investment account holders (IAHs).

The State Bank of Pakistan and AAOIFI Shariah Standard No. 13 (Mudarabah)[10] explicitly require IBIs to identify, measure, and disclose the following key risks associated with PLS pools:

Risk Category	**Definition and Relevance to PLS Pools**	**Primary Mitigation Tools (as practised in Pakistan)**
Displaced Commercial Risk (DCR)	The risk that an IBI voluntarily forgoes part or all of its Mudarib share (or dips into PER/IRR) to pay competitive returns to IAHs when actual pool earnings are lower than market expectations. This is the single largest risk threatening authentic PLS implementation.	Profit Equalization Reserve (PER), limited Hiba (being phased out), minimum equity cushion, transparent indicative rates
Credit Risk	Counterparty failure to repay financing extended from the pool (Murabahah, Ijarah, Diminishing Musharakah).	Strict credit appraisal, collateral/Takaful cover, provisioning policy, exposure limits
Shariah Non-Compliance Risk	Risk of income contamination or contract invalidation due to violation of Shariah rules, rendering returns impermissible.	Resident Shariah Board Member approval, pre- and post-transaction Shariah audit, purification of impure income
Market (Rate of Return) Risk	Adverse movement in benchmark rates (KIBOR) or commodity prices that reduces actual pool returns relative to conventional deposits	Asset-liability matching, hedging through Salam parallel contracts, diversification

Risk Category	Definition and Relevance to PLS Pools	Primary Mitigation Tools (as practised in Pakistan)
Equity Investment Risk	Price volatility of Sukuk, shares, or Musharakah ventures held in the pool	Approved positive/negative lists, Meezan Islamic Index screening, maximum 30–40 % equity exposure
Liquidity Risk	Inability to honour premature encashment demands without distress sale of assets	Statutory liquidity reserves, commodity Murabahah placements with CBR, notice periods for term deposits
Operational Risk	Losses arising from failed processes, systems, fraud, or human error in pool accounting and profit calculation	Segregation of pool-wise accounting, daily product system, independent audit
Withdrawal/Displacement Risk[11]	Sudden large-scale withdrawal by IAHs when returns lag behind conventional banks (closely linked to DCR)	PER/IRR buffers, smoothing through weightage adjustments, marketing of long-tenor products

Among these, Displaced Commercial Risk remains the most critical challenge to genuine risk-sharing in Pakistan. When pool returns fall below conventional savings rates, market pressure often forces banks to smooth returns through PER utilisation or Mudarib fee waiver (Hiba) – a practice that the SBP has been systematically restricting since 2012 and aims to eliminate for special customers entirely.

The presence of bank equity in the pool and the mandatory creation of PER and IRR provide the first line of defence, ensuring that ordinary depositors are not immediately exposed to day-to-day fluctuations. However, these reserves do not eliminate risk; they merely redistribute and delay its impact, thereby preserving public confidence while the industry transitions towards fuller risk-sharing.[12]

5. Objectives of Pool Creation

The primary objective of establishing an investment pool is to **maximise risk-adjusted, Shariah-compliant returns** for all participants (depositors and the bank's shareholders) while preserving the authenticity of profit-and-loss sharing. Secondary objectives include:

- Mobilising stable, long-tenor investment deposits
- Facilitating treasury and liquidity management through commodity Murabahah and interbank placements
- Creating specialised sub-pools or specific pools for asset acquisition, foreign currency operations, or high-yield products
- Building and maintaining Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR) to smooth returns and absorb potential losses
- Achieving a target Return on Equity (ROE) for the bank's own capital committed to the pool

These objectives are explicitly declared in each pool circular and approved by the Resident Shariah Board Member.[13]

6. Investment Strategy and Asset Allocation Framework

Pakistani Islamic banks adopt a prudent, diversified, and strictly Shariah-screened investment strategy for pool funds. The strategy is formulated by the Pool Management Committee, vetted by the Shariah Board, and disclosed in advance to depositors.

6.1 Permissible and Prohibited Investments

- Investments are restricted to ventures and instruments free from riba, excessive gharar, maysir, and other prohibited elements.[14]
- Each bank maintains and periodically updates two screening lists:
  - **Negative List**: Companies or instruments involved in alcohol, tobacco, pork, conventional finance, entertainment, weapons, etc.
  - **Positive List**: Shariah-compliant entities that have passed quantitative and qualitative screening (e.g., companies listed on the KMI-30 Index, Dow Jones Islamic Market Pakistan, or certified by the bank's Shariah advisor).[15]

6.2 Asset Allocation Policy

Banks pre-commit to indicative percentage allocations across financing modes. A typical general pool allocation observed in leading Pakistani IBIs (2023–2025) is presented below:

Financing Mode	Approximate Allocation (%)	Risk–Return Profile
Murabahah & Commodity Murabahah	30–50	Low risk, stable returns
Ijarah & Diminishing Musharakah	20–35	Medium risk, predictable cash flows
Running Musharakah & Mudarabah	10–25	Higher risk, higher potential return
Salam & Istisna	0–10	Commodity price risk
Islamic Sukuk & Equity Participation	5–15	Market & equity risk

These percentages are indicative and may vary monthly depending on market opportunities and liquidity needs, but material deviations require Shariah Board approval.

6.3 Priority of Fund Deployment

The deployment hierarchy observed in practice (illustrated by Bank of Khyber and other major players) is as follows:

1. Statutory Liquidity Requirement (SLR) and cash reserves
2. Interbank commodity Murabahah placements for liquidity management
3. Financing of pre-approved trade transactions (Murabahah)
4. Leasing and house-finance portfolios (Ijarah & Diminishing Musharakah)
5. Profit-sharing partnerships with SMEs and corporates (Musharakah/Mudarabah)
6. Direct equity or Sukuk investments (within approved limits)[16]

6.4 Treatment of Current Account Funds

Although current accounts are accepted on Qard (interest-free loan) basis, surplus funds (after maintaining operational liquidity) are often deployed in short-term Shariah-compliant instruments. Any income generated is credited to the charity account or used for customer-benefit initiatives, as current account holders bear no investment risk.

The investment strategy, while broadly uniform across Pakistani Islamic banks, retains institution-specific nuances in sectoral exposure, equity limits, and the relative emphasis on fixed-income versus profit-sharing modes.[17]

7. Profit Distribution Mechanism in Pakistani Islamic Banking

Unlike conventional banks that guarantee a predetermined interest rate irrespective of actual earnings, Islamic banks distribute only the **actual net profit** generated by the pool after deduction of direct expenses and provisions. The entire process is governed by SBP's "Instructions for Profit & Loss Distribution and Pool Management" and AAOIFI Shariah Standard No. 13.

Four theoretical methods of profit distribution exist in Islamic finance literature. In Pakistan, however, the overwhelming majority of Islamic banks and Islamic banking branches employ the **weightage system** for retail and SME depositors, while the other methods are used only in limited corporate or treasury pools.

Method	Basis of Distribution	Applicability in Pakistan	Practical Limitation
1. Percentage of Distributable Profit	Fixed percentage agreed upfront (e.g., 45:25:30)	Used when bank's own equity participates in the same pool	Not suitable for fluctuating retail deposits
2. Ratio of Distributable Profit	Profit shared in proportion to capital contribution (e.g., 14/30, 10/30)	Applied in permanent Musharakah or diminishing Musharakah with stable partners	Requires constant capital – impractical for daily deposits/withdrawals
3. Investment Ratio	Profit shared strictly according to capital ratio; working partner may receive extra remuneration	Common in project-finance Musharakah or SME running finance	Rarely used for pooled retail deposits
4. Weightage System	Relative weight (multiplier) assigned to each deposit category based on tenor, profit frequency, size, etc.	Dominant method (99 % of retail & corporate investment accounts in Pakistan)	Most practical and widely accepted

7.1 The Weightage System: Concept and Rationale

The weightage system assigns a numerical multiplier (weight) to every deposit category, reflecting its relative contribution and risk profile. A long-tenor, profit-at-maturity deposit is awarded a higher weight than a short-tenor, monthly-profit, on-demand savings account.

Illustrative Example Actual deposit: PKR 1,000,000,000

Deposit Type	Assigned Weightage	Effective Weighted Units	Reason for Weightage Difference
5-Year Term Certificate (profit at maturity)	2.10	2,100,000	Long lock-in period, stable funding for bank

Deposit Type	Assigned Weightage	Effective Weighted Units	Reason for Weightage Difference
Regular Saving Account (monthly profit)	0.90	900,000	High withdrawal flexibility, lower funding stability

When the pool earns a total distributable profit, each depositor receives a share proportional to his/her **weighted units**, not actual deposit amount**. This mechanism enables Islamic banks to reward depositors who provide stable, long-term funds while remaining fully Shariah-compliant.

The weightage system is announced in advance, remains fixed for the declared period, and is disclosed through branch displays, websites, and account-opening documents, thereby satisfying the Shariah requirement of transparency and consent before contract conclusion.[18]

7.2 Legal and Regulatory Status of Weightage System in Pakistan

- SBP permits weightages but caps the highest weight at **three times** the lowest saving-account weight.
- Any change that reduces a depositor's expected return entitles him/her to penalty-free premature encashment.
- In case of loss, weightages are ignored, and loss is borne strictly according to actual capital contribution.[19]

8. Step-by-Step Profit and Loss Distribution Process in Pakistani Islamic Banks

The profit calculation and distribution process follows a strict, regulator-mandated sequence that ensures transparency, Shariah compliance, and gradual movement towards authentic risk-sharing. The entire methodology is applied on a **daily-product basis** using average daily balances.

8.1 Computation Stages (Flowchart Summary)

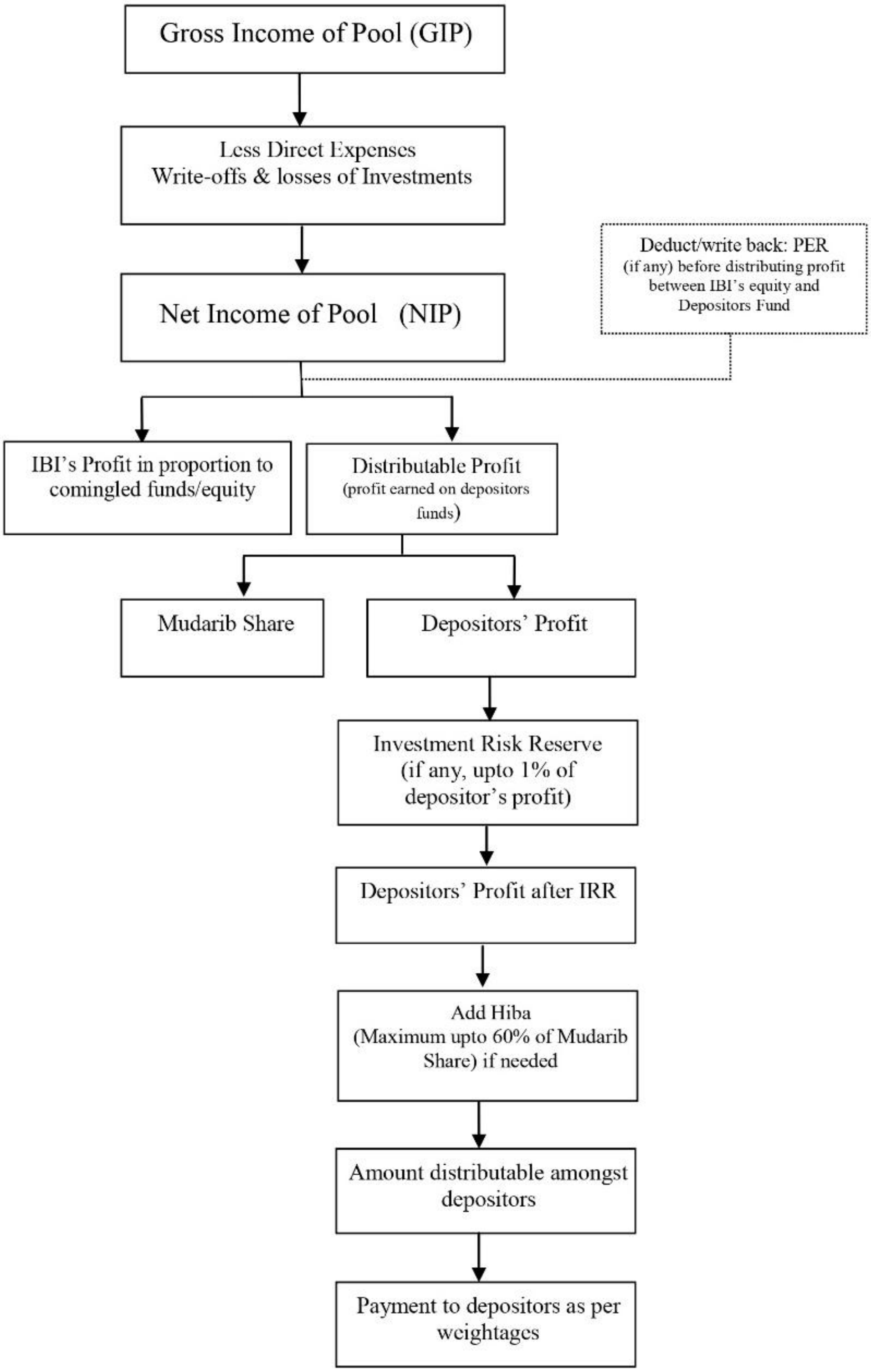
Stage	Description	Regulatory Reference
1. Gross Income	All income from financing, investments, fee-based services, capital gains, and revaluation surplus	SBP IBD Circular 02/2012
2. Direct Expenses	Deducted from the respective pool (depreciation of Ijarah assets, cost of goods sold in Murabahah, Takaful premium, stamp duty, brokerage, impairment losses on pool-specific assets)	Direct expenses borne by pool
3. Indirect Expenses & Provisions	Borne entirely by the bank as Mudarib (salaries, rent, general provisions, specific provisions against NPFs)	Indirect expenses NOT charged to pool
4. Net Pool Income	Gross Income − Direct Expenses	
5. Profit Equalisation	Portion of income may be transferred to or released from PER to smooth returns	Maximum PER accumulation is at the discretion of the bank

Stage	Description	Regulatory Reference
Reserve (PER) Adjustment		but subject to Shariah Board approval
6. Mudarib Share & Hiba	Bank takes its pre-declared Mudarib share (e.g., 50:50 or 60:40). Bank may voluntarily forgo up to 60% of its share as Hiba (gift) to IAHs. Special/individual Hiba has been completely phased out since 2015.	SBP phased-out timeline 2011–2015
7. Investment Risk Reserve (IRR) Adjustment	After Mudarib share, a portion may be allocated to IRR. In low-profit scenarios, IRR can released to top-up depositor returns.	Only after profit allocation to bank
8. Net Distributable Income	Final amount available for distribution to IAHs	
9. Final Distribution to Depositors	Based on pre-announced weightages and daily product (weighted units × declared rate per 1,000 weighted units)	Weightage system

8.2 Treatment of Losses[20]

1. First line of defence: Utilise accumulated PER (if any)
2. Second line: Utilise accumulated IRR
3. Any remaining loss borne by:
   - Investment Account Holders in proportion to their capital contribution (weightages ignored)
   - Bank's equity in proportion to its share in the pool
4. Losses caused by bank's misconduct, negligence, or violation of SBP regulations borne 100 % by the bank (not charged to the pool)
5. Mandatory disclosure of loss reasons to depositors via website/branch notice within 7 days
6. Depositors wishing to exit post-loss must give the declared notice period

Figure 1: Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions (IBIs)[21]



8.3 Practical Illustration (Simplified)

Item	Amount (PKR million)
Gross Income	10,000
Direct Expenses	(1,200)
Net Pool Income	8,800
PER appropriation (5 %)	(440)
Income after PER	8,360
Mudarib share 50 %	4,180
Bank voluntarily waives 40 % as Hiba	(1,672)
Amount available for IAHs	5,852
IRR appropriation (3 %)	(176)
Final distributable to IAHs	5,676

Depositors then receive returns according to their weighted units.

This tightly regulated, multi-layered process represents the practical reinvention of risk-sharing in Pakistan: while pure loss absorption by depositors remains the Shariah ideal, the combination of PER, IRR, capped Hiba, and weightage-based smoothing has made large-scale retail PLS operationally viable and publicly acceptable.

9. The Weightage System: Concept, Shariah Justification, and Operational Framework

The weightage system constitutes the operational backbone of profit distribution in Pakistani Islamic banking. It assigns a relative multiplier (weight) to each deposit category so that depositors who provide longer-tenor, more stable funding receive a proportionally higher share of the pool's profit without violating the Mudarabah principle that profit must be shared according to an agreed ratio.

9.1 Definition and Scholarly Recognition

Weightage is officially defined as "the relative value or importance assigned to different categories of investment accounts for the purpose of distributing profit" (SBP Pool Management Guidelines, 2012).[22] Leading scholars endorse its use:

- Muhammad Ayub: "Different weightages can be assigned to different depositors depending upon their tenure and size."[23]
- Muhammad Akram Khan: "Each category of joint investment accounts has a different weightage system."[24]
- AAOIFI Shariah Standard No. 13 explicitly permits weightage-based allocation provided it is disclosed in advance and does not guarantee capital or return.[25]

9.2 Shariah Justification through Analogy with Fara'id (Inheritance Shares)

The strongest and most widely accepted Shariah rationale in Pakistan draws a direct analogy with the Quranic rules of inheritance[26]:

"For male heirs, a share equivalent to that of two females."

Just as Allah Himself has assigned differential fixed shares (a son = 2 × daughter) within the same estate, Islamic banks may assign differential weights within the same profit pool. Key parallels:

Islamic Inheritance (Fara'id)	Weightage System in Banking
Shares fixed in advance by Shariah	Weightages fixed and announced in advance
Ratio remains constant regardless of estate size	Weightage multiplier remains constant
Actual amount per heir varies with total estate and number of heirs	Actual profit per depositor varies with pool performance and total weighted units
Flexibility for changing number of heirs	Flexibility for daily deposits/withdrawals

This analogy, accepted by the Shariah boards of Meezan Bank, Bank Islami, Dubai Islamic Bank Pakistan, Al-Baraka, and others, removes any residual doubt about the legitimacy of differential profit rates among depositors of the same pool.

9.3 Factors Determining Weightage Assignment (SBP Framework)[27]

The State Bank of Pakistan explicitly lists permissible differentiation criteria:

Factor	Rationale	Typical Impact on Weightage
Tenure of deposit	Longer lock-in provides funding stability	Strongly positive
Profit payment frequency	Monthly payout reduces bank's reinvestment capacity	Negative
Deposit size	Larger amounts reduce administrative cost per rupee	Mildly positive
Customer category	Social-welfare consideration (widows, orphans, disabled, students, etc.)	Positive (capped)
Purpose of deposit	Hajj, marriage, education savings schemes	Usually positive
Currency	FCY pools often carry higher risk/yield	Varies
Premature withdrawal clause	Higher notice period = higher weight	Positive

9.4 Regulatory Safeguards on Weightage Practice[28]

Rule	SBP Reference
Maximum weightage ≤ 3.00 times the lowest saving-account weight	IBD Circular 02/2012
Weightages must be announced within first 3 working days of the month	Pool Management Guidelines
No mid-month downward revision that harms existing depositors	Customer protection clause
In case of loss, weightages are disregarded; loss borne on actual capital	Mandatory

These safeguards ensure the system remains equitable, transparent, and fully aligned with both Shariah and modern regulatory standards.

10. Methodology of Weightage Calculation: Step-by-Step Illustration

Pakistani Islamic banks employ a systematic, additive scoring-based methodology to compute weightages. The process is transparent, auditable, and fully compliant with State Bank of Pakistan guidelines. The following illustration is based on actual practices observed across leading IBIs (2023–2025) and aligns with the framework prescribed in SBP's Pool Management Guidelines.

10.1 Step-by-Step Weightage Computation

Step	Action	Example Values (Typical Range)
1	Fix the **Basic Weight** for the lowest-risk, most liquid product (usually PLS Saving Account)	1.00
2	Define additive factors for **tenure**	• 0.010 per month or • 0.030 per completed year
3	Add premium for **profit at maturity** (encourages long-term stable funding)	+0.100 to +0.150
4	Apply penalty for **monthly/quarterly profit payout** (reduces reinvestment capacity)	–0.040 to –0.060
5	Add special social-welfare premium (widows, orphans, disabled, students, Hajj savers, etc.)	+0.20 to +0.50 (capped)
6	Add incremental weight for **very large deposits** (> PKR 100 million) or **FCY deposits**	+0.05 to +0.20
7	Sum all factors → **Final Weightage**	—

10.2 Practical Weightage Grid (Illustrative – 2025)

Product	Tenure	Profit Payment	Tenure Factor	Maturity Bonus	Monthly Profit Penalty	Disability/Social Premium	Final Weightage
PLS Saving Account (Basic)	Open	Monthly	0.000	0.000	–0.040	0.000	**1.000**
2-Year Term Certificate	24 months	Monthly	0.240 (24×0.010)	0.000	–0.040	0.000	**1.260**
2-Year Term Certificate	24 months	At Maturity	0.240	+0.100	0.000	0.000	**1.400**
5-Year Term Certificate	60 months	Monthly	0.600 (60×0.010)	0.000	–0.040	0.000	**1.710**
5-Year Certificate for	60 months	Monthly	0.600	0.000	–0.040	+0.500	**2.210**

Product	Tenure	Profit Payment	Tenure Factor	Maturity Bonus	Monthly Profit Penalty	Disability/Social Premium	Final Weightage
Disabled Persons							

10.3 Regulatory Ceilings and Safeguards (SBP)

Rule	Detail
Maximum permissible weightage	≤ 3.00 × basic saving weight (currently 3.00 maximum)
Announcement timeline	Within first 3 working days of the month
Stability	Once announced, cannot be reduced during the month
Premature encashment	If weightage is reduced mid-tenure, depositor can withdraw without penalty
Loss scenario	Weightages completely ignored; loss absorbed strictly pro-rata to actual capital

This additive scoring model allows banks to remain competitive while rewarding genuine long-term partnership (the true spirit of Musharakah/Mudarabah) and simultaneously fulfilling social-responsibility objectives.

11. Summary, Policy Recommendations and Conclusion

11.1 Summary of Key Findings

This study has demonstrated that Pakistani Islamic banks have successfully reinvented the classical ideal of profit-and-loss sharing for the modern retail banking environment through a unique combination of three institutional innovations:

1. **Regulated Investment Pools** built on hybrid Musharakah–Mudarabah contracts and mandatory equity participation by the bank, and full disclosure of pool parameters via SBP-mandated circulars.
2. **A sophisticated tiered Weightage System** that assigns differential but pre-announced multipliers to deposits based on tenure, profit-payment frequency, size, customer category, and social-welfare considerations. The system is justified by direct analogy with Quranic inheritance shares (Surah an-Nisa 4:11) and enjoys unanimous approval from Shariah boards and AAOIFI.
3. **A multi-layered return-smoothing and loss-absorption architecture** comprising Profit Equalization Reserve (PER), Investment Risk Reserve (IRR), capped and eventually phased-out Hiba (2011–2015), and strict segregation of direct/indirect expenses. This has enabled Islamic banks to offer competitive, relatively stable returns while gradually moving towards fuller risk-sharing.

The net result is a practical model that preserves Shariah authenticity (no guaranteed capital or return, actual profits only, losses are borne by depositors when reserves are exhausted) while remaining commercially viable in a market dominated by conventional fixed-return products.

11.2 Policy Recommendations

1. **Accelerate Full Phase-Out of Remaining Smoothing Practices** SBP should set a firm deadline (e.g., 2028) for complete elimination of PER utilisation and Mudarib-share waiver except in genuine loss scenarios, thereby restoring pure PLS.
2. **Introduce Mandatory "Pure PLS" Product Lines** Every IBI should be required to offer at least one un-smoothed, pure Mudarabah/Musharakah investment account with no PER/IRR topping-up so that ethically conscious customers have a genuine risk-sharing option.
3. **Enhance Transparency through Digital Dashboards** Real-time pool performance, weightage history, reserve levels, and asset allocation should be published on bank websites and the SBP portal.
4. **Cap Maximum Weightage at 2.5×** (instead of current 3.0×) to prevent excessive return disparity and potential perception of injustice.
5. **Encourage Equity-Heavy Pools** Minimum bank equity participation in general pools should be raised from current practice (5–15 %) to at least 25 % so that the bank has stronger "skin in the game" and Displaced Commercial Risk is genuinely reduced.

11.3 Conclusion

More than four decades after the global Islamic finance revival began, Pakistan stands out as one of the few jurisdictions that has transformed the theoretical principle of risk-sharing into a mass-retail reality. Through the innovative yet tightly regulated mechanism of investment pools and the weightage system, Pakistani Islamic banks have reconciled the apparently conflicting demands of Shariah authenticity, depositor expectations, competitive pressure, and prudential stability.

The weightage-based framework, far from being a deviation from Islamic partnership principles, represents their intelligent adaptation to the complexities of modern banking. By drawing legitimacy from the Quranic inheritance paradigm itself the weightage system enjoys robust Shariah legitimacy. When implemented transparently and within the evolving SBP guidelines, it constitutes a legitimate and sustainable reinvention of profit-and-loss sharing—one that other Muslim-majority countries can study and emulate.

The journey towards completely un-smoothed, pure risk-sharing remains ongoing, but the Pakistani practice has already proven that authentic Islamic finance can thrive at scale without resorting to riba or fictitious contracts. This model therefore not only serves Pakistan's growing Islamic banking sector but also offers valuable lessons for the global Islamic finance industry in its quest to move from form to substance.

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