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Compliance to the Basel Accord III Capital Standards and Financial Performance: Islamic vs. Conventional Banks of Pakistan

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Abstract:

The banking industry of a country plays a very significant role while fabricating the financial performance and economic growth of the country/region. The study assessing the financial performance of banking industry of Pakistan while seventeen conventional and five Islamic banks of Pakistan analyzed by the using of financial ratios i.e. profitability, liquidity, efficiency, solvency and Tier-I capital ratios. The quality capital of Islamic versus conventional banks examined for the period of six year i.e. 2008 to 2013 and the data of concerned banks was fetched form their published annual reports. The profitability, liquidity and solvency ratios of conventional banks are higher as compare to Islamic banks and efficiency ratios of Islamic banks are higher as compare to conventional banks. The difference between Islamic and conventional banks is significant at level 1% in term of NIM, TLD, TLA, CPD, CBD, AUR, OER, DER, DTA, EMR, TIR and CAR. The difference between Islamic and conventional banks is insignificant in term of ROA, ROE, ROD and CER. However, the results reveal that the Islamic banks are more efficient as compare to conventional banks.

Key words: Islamic Banks of Pakistan, Conventional Banks of Pakistan, Basel accord III Capital Standards, Financial Ratios and Financial Performance.

INTRODUCTION

The demand of Islamic finance has always been among the Muslim community and they preferred to Islamic financial products and services alternative to conventional finance which conform by the Shariah compliance in the light of the Holy Qur'an and Sunnah. The idea of interest-free banking was introduced by the Shariah (El-Galfy & Khiyar, 2012). At earlier stage, the both conventional and Islamic banking systems adopted parallel but later on the Pakistan become a first country to follow the full fledge Islamic banking system. Stream of Islamic Banking based on Islamic Shariah principles to avoid Interest (Riba/ Usury), Uncertainty (Gharrar), Gambling (Maysir) through establishment of a cooperative bank (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012).

Subprime crises of 2008 gave a wakeup call to the regulators to more develop the system with new and rigorous scrutinizing system. (Alam, 2012). The recent worldwide financial crisis spread better awareness about capital adequacy and Basel accord helps to identifying, analyzing, monitoring, treating and overcome the all kind of risks which are involved into the banking systems (Reyazat, 2013).

The financial performance of banking industry of Pakistan examined in this study wherein conventional and Islamic banks of Pakistan were analyzed by using financial ratios. The comparison between the both types of banks is main purpose of this study because the Islamic banking sector is growing and attracting worldwide.

In this study the twenty-two banks of Pakistan were analyzed for the period of six years wherein the seventeen

conventional banks and five Islamic banks. By the using of financial ratios i.e. profitability, liquidity, solvency and efficiency ratios were examined to identify that which type of banks performing better. It is also identify that which type of banks comply and working on the requirement of Basel accord III capital standards during the study period 2008 to 2013.

Some of following elements are distinguished in Islamic finance and Islamic banking as well, the prohibition of interest, free from uncertainty, money must be used, forward contract not dealt in consumable products, contracts should not be harmful for any party, both the parties have equal rights to breach and comply the contract, contract should not signed for any prohibited product and services e.g. alcohol, tobacco, gambling, sensual entertainment and pork products etc.

Actually Islamic finance is based on trading system under the Shariah principles. The main products or financing techniques of Islamic banking are Musharakah, Mudharabah, Murabaha and Ijarah. Islamic banking follows the Accounting and Auditing Organization in Islamic Financial Institutions (AAOIFI), according to its standard number five the profit distribution ratio and rules among the Islamic bank and investors must be disclosed and assets of Islamic financial institutions are different therefore, it's difficult to implement the Basel Accords on Islamic financial institutions as compare to conventional banks (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012) & (Kahf, 2005).

The Basel Committee on Banking Supervision (BCBS) has launched the Basel accord I in 1988 with the minimum 8% capital is the basic requirement of the credit risk by the Basel accord for all financial institutions. Basel accord I couldn't fulfill the requirements to monitor the risk of financial institution especially operational risk and no longer applicable and approximately after 10 years Basel accord faced lot of changes and weakness in various aspects, keeping in these

facts the Basel committee plan to change existing Basel accord and introduced Basel accord II in 2004 which is more risk sensitive (Hersh, 2011). The main feature of Basel accord II is that, it dealt operational risk indeed of market and credit risk which is not exists in Basel accord I. (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012).

The Basel accord II adopted by the both conventional and Islamic banking sector and the agreement of Basel accord II based on three types of pillars, first pillar dealt the minimum capital requirement by operational risk internal and external, credit risk which is not full and on time repaid by borrowers, market risk which is raised by depreciation due to market enforcement factors, second dealt the monitoring body for self monitoring and supervisory committee and third dealt the market discipline which is implemented by a formal policy for risky products and operations transparently to decrease the risk and maximize the benefit. To overcome the deficiencies of Basel accord I the pillars II and III support to pillar I, but the total capital ratio is same like in Basel accord I that is eight percent (8%) of risk weighted assets of the bank. It was predicted before implementation of Basel accord III that will be reducing the cyclicality of Basel accord II and increase the excellence and lucidity of the capital (Hersh, 2011), (Masood & Fry, 2011) and (Awang Mohammad, 2013). Basel accord III adopted by the world's largest economies i.e. G-20 countries in 2011 and three most important Muslim economies Saudia Arabia, Indonesia and Turkey. It is also predicted that it will be completely implemented in 2019 all over the world (Ahmed, Asutay, & Wilson, 2014).

LITERATURE REVIEW

In 1963, the Islamic banking was initiated by an Egyptian bank which is called Mit Ghamr. However, the idea of interest-free

banking was introduced by Anwar Qureshi, Naiem Siddiqi and Mahmud Ahmad in 1946, 1948 and 1952 respectively (El-Galfy & Khiyar, 2012). In 1974, the first Islamic bank was established by the name of Dubai Islamic Bank. In 1979, the Government of Islamic republic of Pakistan adopted the Islamic banking system. In the initial stage the both conventional and Islamic banking systems adopted parallel but later on the Pakistan become a first country to follow the full fledge Islamic banking system, whereas Indonesia, Malaysia, Egypt, and GCC (Bahrain, Qatar, Oman, Kuwait & UAE) adopted as parallel pattern for shifting the economy from interest-based to Islamic economic system.

By the Governors of central bank of 10 countries, the Basel committee was established in 1974 for banking regulations & supervisory practices. Its 1st meeting was held in February 1975 on regular bases 3 or 4 times in a year. The countries are represented by the committee members by their central banks and competent authorities. Banking system soundness is main issue for the competent authorities. In the earlier 1990s, the reliability of the banks was measured by leverage ratio. Ratio failed to measure and provision to accurate results especially could not differentiate assets & risk and banks become insolvent (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012).

The management strategy of liquidity and risk is very necessary requirement for both conventional and Islamic banks and its global issue which is not affected by religion, color and country. Financial service supervisory board, branches and various banks are the essential parameters for this fast growing new Islamic financial system (Mounira & Anas, 2008).
The recent worldwide financial crisis spread better awareness about capital adequacy and author argues that implementation of Basel accord should be same on both Islamic and conventional banks without any discrimination. Actually Basel

accord helps to identifying, analyzing, monitoring, treating and overcome the all kind of risks which are involved into the banking systems for example credit risk, market risk, equity investment risk, liquidity risk, rate of return risk, operational risk & Shariyah non-compliance risk. Basel accord I, Basel accord II & Basel accord III introduced in 1988, 2004 & 2010 respectively (Reyazat, 2013).

In 1988, first Basel accord was launched by the Basel committee with at-least minimum required capital set at eight percent (8%) of assets which will be adjusted as risk. Basel accord I was acknowledged by almost hundred countries all over the world, mean to say accepted globally to improve the flexibility of international banking sector by standard capital requirement. Actually Basel accord was originated in response of financial crisis of 1970s to reduce the systemic risk.

The minimum 8% capital (owner's equity & retained earnings) is the basic requirement of the credit risk by the Basel accord for all financial institutions. Later on banks allocate various categories of risk weights i.e. 1.6% for 20%, 4% for 50% and 8% for 100% risk weight, that's why minimum 8% was announced as basic requirements as shows 100% capital which was measured by risk-based capital ratio. Basel accord I couldn't fulfill the requirements to monitor the risk of financial institution especially operational risk and no longer applicable and approximately after 10 years Basel accord faced lot of changes and weakness in various aspects, keeping in these facts the Basel committee plan to change existing Basel accord and introduced Basel accord II which is more risk sensitive (Hersh, 2011). The main feature of Basel accord II is that it dealt operational risk indeed of market and credit risk which is not exists in Basel accord I. (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012).

The Basel accord II adopted by the both conventional and Islamic banking sector and the agreement of Basel accord

II based on three types of pillars, first pillar dealt the minimum capital requirement by operational risk internal and external, credit risk which is not full and on time repaid by borrowers, market risk which is raised by depreciation due to market enforcement factors, second dealt the monitoring body for self monitoring and supervisory committee and third dealt the market discipline which is implemented by a formal policy for risky products and operations transparently to decrease the risk and maximize the benefit. To overcome the deficiencies of Basel accord I the pillars II and III support to pillar I, but the total capital ratio is same like in Basel accord I that is eight percent (8%) of risk weighted assets of the bank. It was predicted before implementation of Basel accord III that will be reducing the cyclicality of Basel accord II and increase the excellence and lucidity of the capital (Hersh, 2011), (Masood & Fry, 2011) and (Awang Mohammad, 2013).

The Basel accord II was already underway for improvement by the committee well before the globally crisis of world wide, the Basel accord III focuses on quality and quantity of capital, and capital target ratios revised as 7% minimum for core Tier I (4.5% for core Tier I capital and 2.5% for conservation buffer) and in broader sense 8.5% for Tier I where 1.5% included as non-core Tier I (Awang Mohammad, 2013).

Islamic banking follows the Accounting and Auditing Organization in Islamic Financial Institutions (AAOIFI), according to its standard number five the profit distribution ratio and rules among the Islamic bank and investors must be disclosed and assets of Islamic financial institutions are different therefore, it's difficult to implement the Basel Accords on Islamic financial institutions as compare to conventional banks. Musharakah and Mudarabah, those types of investment who have 100% weight so credit risk not involved. Islamic banks not involve in derivative contract therefore, its free from both credit and market risk even almost all transactions of

Islamic banks varying with conventional bank, therefore, and this is a massive reason to non-compliance of Basel Accords. Islamic banks not offer the fixed interest rather its share profit and loss as pre-defined agreement. Another challenge is that restricted and unrestricted transactions of Mudarabah are maintained in different methods of accounts. In Islamic banking system the assets are ignored by Basel Accord as assets support by the product or real estate (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012) and (Kahf, 2005).

Basel accord III adopted by the world's largest economies i.e. G-20 countries in 2011 and three most important Muslim economies Saudia Arabia, Indonesia and Turkey. It is also predicted that it will be completely implemented in 2019 all over the world (Ahmed, Asutay, & Wilson, 2014).

Subprime crises of 2008 gave a wakeup call to the regulators to more develop the system with new and rigorous scrutinizing system. In this study, regulatory and supervisory structures were examined in lieu of pillars of Basel accord III to tackle the risk on both banking system Islamic and Conventional for the period for four years i.e. 2006 to 2010 at Indonesia, Bahrain, Malaysia, Saudi Arabia, Egypt, Bangladesh, Qatar, UAE, Pakistan and Turkey and result suggested that regulatory and supervisory structures and rigorous scrutinizing system decreases convention banks and increase the technical efficiency for Islamic banks. Implementation of Basel accord III is better for Islamic banking as compare to conventional banks as Islamic banks have better equipped to fulfill the requirement of Basel accord III implementation (Alam, 2012).

Basel accord III framework is replace the previous accord of Islamic banks, Basel accord II to raise the resilience of financial institutions/ banking sector for the regulatory of capital framework. Basel accord III is designed to absorb the shocks regarding market situation by the lesson learnt in crisis

to improve the risk management system. Basel accord criteria for capital adequacy also introduced a leverage, liquidity coverage and net stable funding ratios in Basel accord III to ensure criteria for maintenance of minimum capital requirement (Shamsuddin 2013).

Role of Islamic banks is also play a very vital position into the whole world like that conventional banks, Basel accord III setup a better risk coverage criteria butt unfortunately Basel committee not considered the Islamic banks (Harzi, 2012).

Approximately seventy-five banks, fifty-five conventional & twenty Islamic banks of GCC region were examined in lieu of ratios analysis and Basel accord III requisites and parameters were monitored for better quality capital. Both Islamic and conventional banks affected due to globally recent financial crises but in lieu of return on average equity, leverage & capital ratio Islamic banks more suffered as compare to conventional banks, whereas liquidity and return on average assets ratios show that conventional banks more affected as compare to Islamic banks. Some time is requirement to take all requirements of Basel accord III implementations until 2019 but early adaptation of Basel accord III will be best for maintain the reputation of the banks (Al-Hares, AbuGhazaleh, & El-Galfy, 2012).

The performance of twelve banks wherein six Islamic and six conventional banks of GCC were compared during and before the global financial crisis by the using of six financial ratio analysis, namely return on average equity, return on average assets, capital adequacy, equity to total assets, cost to income and liquid assets to total assets ratios for the period of 2006 to 2009. The result of the study shows that the conventional bank have more suffered in term of liquidity and return on average assets as compare to Islamic banks while the Islamic banks have more suffered in term of leverage, capital

and return on average equity ratios as compare to conventional banks during the global financial crisis (Parashar & Venkatesh, 2010).

The authors compared the financial performance of conventional and Islamic banking sector of Pakistan for the period of five years with effect from 2007 to 2001 by using the financial ratios including profitability and capital adequacy ratios. The results indicate that the conventional banks of Pakistan are more risky in term of dealing in less capable in expense management and loans and Islamic banks of Pakistan are less risky (Sehrish, 2012).

METHODOLOGY

In this study the data of twenty-two bank of Pakistan wherein seventeen conventional and five Islamic banks were analyzed for the period of six years i.e. 2008 to 2013. The financial data fetched from annual reports and analyzed under the same ratios for both conventional and Islamic banks irrespective of their sizes.

To assess the performance of the bank the financial ratios were used on the annual data in term of profitability ratios, efficiency ratios, liquidity ratios and solvency ratios as used in previous studies (Al-Hares, AbuGhazaleh and El-Galfy, 2013; Olson and Zoubi, 2008; Yudistira, 2004; Essayyad and Madani, 2003; Rosly and Abu Baker, 2003; Samad and Hassan, 2000; Demirgue-Kunt and Hizinga, 1999). After evaluating of mean/average of each ratio then apply T-test to conclude the performances of the banks (Al-Hares, AbuGhazaleh, & El-Galfy, 2012).

The ability of the banks in comparison to generate the earning with its expenses is measured by profitability ratios and it is basic financial ratio to measure the performance of a bank wherein return on equity (ROE), return on assets (ROA),

return on deposits (ROD) and net interest margin (NIM) (Ross, Westerfield, & Jaffe, 2005). The profitability ratio of Islamic banks of GCC is higher as compare to conventional banks (Olson & Zoubi, 2008).

The capability of the banks to avoid financial distress and meet the financial obligations in short-term and well in time is measured by liquidity ratios wherein total loans to total assets (TLA), total loans to deposits (TLD), cash & bank balances to deposits (CBD) and cash & portfolio investment to deposits (CPD) (Ross, Westerfield, & Jaffe, 2005). The liquidity ratio of conventional banks is better as compare to Islamic banks (Kader & Asarpota, 2007).

The capacity of the banks to proper utilization and controls over its assets and turn these resources into revenue is measured by efficiency ratios wherein operating efficiency/revenue ratio (OER) and assets utilization/turnover ratio (AUR). The efficiency ratio of conventional banks is more efficient as compare to Islamic banks (Olson & Zoubi, 2008).

The ability of the banks to increase probable gain or losses to invest the own funds and may also be refereed that which a bank depend upon debt financing rather than equity and which is measured by solvency/financial leverage ratios wherein equity multiplier ration (EMR), debt to equity ratio (DER) and debt to total assets ratio (DTA), the long-term obligations of debt is also measured by the solvency/financial leverage ratios. The high leverage leads to higher financial distress and bankruptcy (Ross, Westerfield, & Jaffe, 2005). According to previous research Islamic banks are less risky as compare to conventional banks (Kader & Asarpota, 2007).

Banking system soundness and reliability is the main issue, therefore, Basel accord capital standard adopted for better capital structure & buffers, higher risk-weighted assets (RWAs) (Hussain, Ramzan, Ghauri, Akhtar, Naeem, & Ahmad, 2012). Actually Basel accord helps to identifying, analyzing,

monitoring, treating and overcome the all kind of risks which are involved into the banking systems (Reyazat, 2013). It is also predicted that it will be completely implemented in 2019 all over the world (Ahmed, Asutay, & Wilson, 2014).

The Basel accord III focuses on quality and quantity of capital, and capital target ratios revised as 7% minimum for core Tier I (4.5% for core Tier I capital and 2.5% for conservation buffer) and in broader sense 8.5% for Tier I where 1.5% included as non-core Tier I (Awang Mohammad, 2013).

RESULTS AND DISCUSSION

The descriptive statistics of Islamic and conventional banks are given in table 1 and 2 for comparative performance of both. The performance of Pakistani conventional and Islamic banks was analyzed by the using of financial ratios for the period of six year. In this study, banks were also evaluated as a whole in group (Islamic and conventional) by using t-test as detailed in table 5.

The average profitability ratios of six years of conventional banks are higher as compare to Islamic banks. On average, conventional banks recorded higher ROA (0.027% > 0.002%), ROE (0.182% > 0.016%), NIM (0.026% > 0.012%) and ROD (0.037% > 0.004%) during the period of 2008-2013. The better quality assets indicated by higher profitability ratios of conventional banks. The result in table 5 shows that there are insignificant difference between conventional and Islamic banks in term of ROA, ROE and ROD and significant at level 1% in term of NIM. The higher profitability of conventional banks is due to high net income margin, inter-bank activities and money market in Islamic banks.

The average liquidity ratios of conventional banks are higher as compare to Islamic banks. On average, conventional banks recorded higher TLD (0.643% > 0.547%), TLA (0.468% >

0.422%) and CPD (0.454% > 0.360%) but lower CBD (0.221% < 0.244%) during the period of 2008-2013. The result of p-value shows that there is a significant difference between conventional and Islamic banks in term of TLD, TLA, CPD and CBD at level 1%. The better liquidity of conventional banks might be due to shortage of available long-term investment in commercial money market and as well as Islamic banks provided limited financing.

The average efficiency ratios of Islamic banks are higher as compare to conventional banks. On average, Islamic banks recorded higher AUT (0.101% > 0.098%) and OER (0.428% > 0.377%) during the period of 2008-2013. The result in table 5 shows that there is a significant difference between conventional and Islamic banks in term of AUR and OER at level 1% and Islamic banks of Pakistan are better as compare to conventional banks to generating revenue by diversified sources.

The average solvency ratios of conventional banks are higher as compare to Islamic banks. On average, conventional banks recorded higher DER (20.119% > 8.063%) and EMR (23.810% > 9.000%) but lower DTA (0.762 < 0.860) during the period of 2008-2013. The result of t-test shows that there is a significant difference between conventional and Islamic banks in term of DER, DTA and EMR at level 1% and conventional banks more leveraged as compare to Islamic banks.

The descriptive statistics are given in table 3 and 4 for the comparative Basel accord III capital requirement. The results point out that Pakistani bank, as a whole, not sufficiently capitalized for Basel accord III capital standards. According to the CAR not satisfy the capital requirement of Basel accord III. The results also indicate that on average CAR of Islamic banks are higher (0.447% > 0.328%) as compare to conventional banks. The Tier-I capital ratios of both conventional and Islamic banks are 0.328% and 0.222%

respectively are lower as required by Basel accord III Tier I capital standards (i.e. 8.5%). The result t-test shows that there are significant difference between conventional and Islamic banks in term of TIR and CAR at level 1% and insignificant in term of CER.

Table 1: Descriptive Statistics of "Conventional Banks" – Financial Ratios (2008 – 2013)

Ratios	Mean	Std. Dev.	Minimum	Maximum
Profitability Ratios				
ROA %	0.027	0.061	0	0.15
ROE %	0.182	0.274	0.02	0.72
NIM %	0.026	0.005	0.03	0.02
ROD %	0.037	0.086	0	0.21
Liquidity Ratios				
TLD %	0.643	0.074	0.57	0.76
TLA %	0.468	0.062	0.4	0.57
CBD %	0.221	0.009	0.21	0.23
CPD %	0.454	0.082	0.32	0.57
Efficiency Ratios				
AUT %	0.098	0.005	0.09	0.1
OER %	0.377	0.022	0.35	0.41
Solvency Ratios				
DER %	20.119	2.820	17	23.69
DTA %	0.762	0.012	0.74	0.77
EMR %	23.810	2.823	20.28	27.47

This table explains descriptive statistics for financial performance of conventional banks of Pakistan. The value of every ratio represents the average for the period of six year i.e. 2008-2013. The study observes the financial performance by using financial ratios in terms of profitability, liquidity, efficiency, solvency and compliance with Basel accord III's new quality capital standards. Descriptive statistics for the conventional banks of Pakistan's the compliance with the Basel accord III's new quality capital standards are indicated separately in Table 3.

Table 2: Descriptive Statistics of "Islamic Banks" – Financial Ratios (2008 – 2013)

Ratios	Mean	Std. Dev.	Minimum	Maximum
Profitability Ratios				
ROA %	0.002	0.006	0.01	0
ROE %	0.016	0.039	0.03	0.07
NIM %	0.012	0.007	0.02	0
ROD %	0.004	0.008	0.02	0.01

Liquidity Ratios				
TLD %	0.547	0.047	0.48	0.61
TLA %	0.422	0.021	0.4	0.45
CBD %	0.244	0.081	0.18	0.4
CPD %	0.360	0.094	0.24	0.49
Efficiency Ratios				
AUT %	0.101	0.009	0.09	0.12
OER %	0.428	0.088	0.33	0.53
Solvency Ratios				
DER %	8.063	2.883	4.75	12.25
DTA %	0.860	0.060	0.77	0.92
EMR %	9.000	2.907	5.68	13.23

This table explains descriptive statistics for financial performance of Islamic banks of Pakistan. The value of every ratio represents the average for the period of six year i.e. 2008-2013. The study observes the financial performance by using financial ratios in terms of profitability, liquidity, efficiency, solvency and compliance with Basel accord III's new quality capital standards. Descriptive statistics for the Islamic banks of Pakistan's the compliance with the Basel accord III's new quality capital standards are indicated separately in Table 4.

Table 3: Descriptive Statistics of "Conventional Banks" – Basel III Capital Standards

Ratios	Mean	Std. Dev.	Minimum	Maximum
Basel III Capital Standards				
CER %	0.021	0.070	0.04	0.11
TIR %	0.160	0.016	0.15	0.19
CAR %	0.328	0.030	0.31	0.38

Descriptive statistics for the conventional banks of Pakistan's the compliance with the Basel accord III's new quality capital standards are indicated separately in Table 4. The value of every ratio represents the average for the period of six year i.e. 2008-2013.

Table 4: Descriptive Statistics of "Islamic Banks" – Basel III Capital Standards

Ratios	Mean	Std. Dev.	Minimum	Maximum
Basel III Capital Standards				
CER %	0.043	0.079	0.01	0.15
TIR %	0.222	0.057	0.15	0.3
CAR %	0.447	0.112	0.3	0.6

Descriptive statistics for the Islamic banks of Pakistan's the compliance with the Basel accord III's new quality capital standards are indicated separately in Table 4. The value of every ratio represents the average for the period of six year i.e. 2008-2013.

Table 5: Difference between the Means of Conventional and Islamic Banks Financial Ratios (2008 – 2013) – "t-test"

Ratios	Conventional Banks (Mean)	Islamic Banks (Mean)	*t*-test	*p*-value
Profitability Ratios				
ROA %	0.027	0.002	1.041	0.345**
ROE %	0.182	0.016	1.660	0.158**
NIM %	0.026	0.012	14.408	0.000*
ROD %	0.037	0.004	1.025	0.352**
Liquidity Ratios				
TLD %	0.643	0.547	22.572	0.000*
TLA %	0.468	0.422	23.676	0.000*
CBD %	0.221	0.244	24.764	0.000*
CPD %	0.454	0.360	12.892	0.000*
Efficiency Ratios				
AUT %	0.098	0.101	50.206	0.000*
OER %	0.377	0.428	64.040	0.000*
Solvency Ratios				
DER %	20.119	8.063	15.130	0.000*
DTA %	0.762	0.860	87.600	0.000*
EMR %	23.810	9.000	17.813	0.000*
Basel III Capital Standards				
CER %	0.021	0.043	0.892	0.413**
TIR %	0.160	0.222	17.389	0.000*
CAR %	0.328	0.447	18.784	0.000*

This table represents the results of both Islamic banks vs. conventional banks of a t-test for equality of means between for each of the financial ratios. The value of every ratio represents the average for the period of six year i.e. 2008-2013

conventional banks in 1st column and Islamic banks in 2nd column accordingly. The value in the 3rd column is the coefficient of determination and * indicates significance at the 1 percent levels. The significance values are given in 4th column.

CONCLUSION

The main purpose of study to evaluates the financial performance of conventional and Islamic banks of Pakistan by using financial ratio analysis for the period of 2008 to 2013 under the umbrella of capital standard Basel accord III. It is also indicates that which banking system is better comply with the requirements of Basel accord III capital standards. Total twenty-two banks, while seventeen conventional and five Islamic banks were analyzed for the period of six years and every bank supposed to treat as equal irrespective of their sizes. To disseminate the financial performance of the both types of banks Islamic and conventional banks of Pakistan the financial ratios (profitability, liquidity, efficiency, solvency and Basel accord III capital standard) were applied on the data of concerned bank which was fetched form their annual reports. The profitability, liquidity and solvency ratios of conventional banks are higher as compare to Islamic banks and efficiency ratios of Islamic banks are higher as compare to conventional banks. The difference between Islamic and conventional banks is significant at level 1% in term of NIM, TLD, TLA, CPD, CBD, AUR, OER, DER, DTA, EMR, TIR and CAR. The difference between Islamic and conventional banks is insignificant in term of ROA, ROE, ROD and CER. However, the results reveal that the Islamic banks are more efficient as compare to conventional banks.

It is also observed that the both types of banks of Pakistan conventional and Islamic are performing better but not fulfill and comply the requirements of Tier I capital ratio

under the umbrella of Basel accord III capital standards. Therefore, it is suggested that in future perspective the Basel accord is standard where in banks growth become more and improve their efficiency and profitability as well.

The study is limited in several manners; some of annual reports which are available publically do not contain adequate detail for better and accurate analysis. Both the types of banks treated equally as whole, irrespective of their sizes.

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