Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh

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Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh

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Forewords

The global financial ecosystem is undergoing significant transformation, with growing demand for ethical, transparent, and Shariah-compliant financial solutions. Against this backdrop, the Islamic Capital Market (ICM) has emerged as a critical pillar in promoting equitable growth, financial inclusion, and resilience within Islamic financial system.

Recognizing this evolution, the Bangladesh Institute of Bank Management (BIBM) has continued its mission to conduct forward-looking research that informs policy and strengthens institutional capacity. The present study titled "Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh" is a timely contribution that examines the dynamic interplay between ICM instruments and the operational, financial, and governance performance of Islamic banking industry of the country.

This research adopts a rigorous methodological approach—combining structured interviews, expert consultations, and sectoral analysis—to provide an in-depth understanding of how Islamic banks leverage capital market instruments such as Sukuk, Shariah-compliant equities, and investment funds to achieve both compliance and competitive advantage. It also identifies the existing constraints in market development and regulatory alignment, offering valuable insights for reform and strategic enhancement.

I extend my sincere appreciation to the research team for their analytical depth, strategic insight, and unwavering commitment to academic excellence. I am confident that this work will serve as an essential resource for policymakers, banking professionals, regulators, and scholars aiming to strengthen the foundations of Islamic finance in Bangladesh.

May this study pave the way for a more robust, transparent, and inclusive Islamic financial system that aligns with national development goals and global best practices.

Dr. Md. Akhtaruzzaman
Director General
Bangladesh Institute of Bank Management (BIBM)

Acknowledgment

The successful completion of this research study titled "Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh" has been made possible through the collective support, collaboration, and encouragement of numerous individuals and institutions. We extend our heartfelt gratitude to Dr. Md. Akhtaruzzaman, Director General of BIBM, for his support throughout the research process.

We are especially indebted to the Islamic banking community of Bangladesh for their active participation and valuable cooperation in conducting the study. Shariah scholars, Islamic banking professionals, capital market practitioners, and regulatory authorities, have shared critical insights, operational data, and professional reflections that have greatly enriched the depth and relevance of this study.

We also acknowledge the institutional support received from our colleagues at BIBM. The coordinated efforts from the Training, Administration, Accounts, and Publication Wings played a crucial role in ensuring the smooth execution and dissemination of the research.

Lastly, we express our sincere appreciation to all those who, directly or indirectly, contributed to this endeavor. The open engagement and continued dialogue with stakeholders have been instrumental in shaping a comprehensive understanding of the Islamic Capital Market's role in strengthening Islamic banking practices in Bangladesh.

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List of Abbreviations

ABS : Asset-Backed Securities
AT1 : Additional Tier 1
BB : Bangladesh Bank
BGIIB : Bangladesh Government Islamic Investment Bond
BGIS : Bangladesh Government Investment Sukuk
BIBM : Bangladesh Institute of Bank Management
BO : Beneficiary Owner
BRPD : Banking Regulation and Policy Department
BSEC : Bangladesh Securities and Exchange Commission
CAMELS : Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk
CDWSP : Chattogram Division Upazila & Union Road Widening & Strengthening Project
CIBRR : Construction of Important Bridges on Rural Roads
CIPA : Certified Islamic Professional Accountant
CSAA : Certified Shari'ah Advisor and Auditor
CSE : Chittagong Stock Exchange
DOS : Department of Off-Site Supervision
DPE : Directorate of Primary Education
DPHE : Department of Public Health Engineering
DSE : Dhaka Stock Exchange
DSES : DSE Shariah Index
FCCA : Fellow Chartered Certified Accountant
FGD : Focus Group Discussion
FIs : Financial Institutions
FY : Fiscal Year
GPSs : Government Primary Schools
IBBL : Islami Bank Bangladesh Limited
IBLF : Islamic Banks Liquidity Facility
ICM : Islamic Capital Market
IDRA : Insurance Development and Regulatory Authority
IiBFRBD : IBFC Islamic Banking and Finance Report, Bangladesh
ISBS : Islamic Shariah-Based Securities
LGED : Local Government Engineering Department
MIBF : Masters in Islamic Banking and Finance
MoF : Ministry of Finance
NBFIs : Non-Bank Financial Institutions
NBR : National Board of Revenue

PDI	: Perpetual Debt Instruments
PNCPS	: Perpetual Non-Cumulative Preference Shares
RCC	: Roller-Compacted Concrete
SDGs	: Sustainable Development Goals
SLR	: Statutory Liquidity Requirement
SPV	: Special Purpose Vehicle
SRO	: Statutory Regulatory Order
SSB	: Shariah Supervisory Board
T2	: Tier 2 Capital
VAT	: Value Added Tax

Executive Summary

The Islamic financial sector in Bangladesh is undergoing a pivotal transformation, driven by increasing demand for Shariah-compliant instruments and growing public confidence in Islamic banking. Within this context, the Islamic Capital Market (ICM) has emerged as a critical enabler for financial intermediation, ethical investment, and sustainable growth. This research study titled "Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh" investigates the evolving structure of the ICM and evaluates its influence on the performance, liquidity management, and capital adequacy of Islamic banks operating in the country.

Using a combination of qualitative and quantitative methodologies, the study draws on interviews, focus group discussions, regulatory reviews, and data analysis to assess how Islamic financial institutions in Bangladesh engage with capital market instruments such as Sukuk, Mudarabah bonds, Shariah-compliant equities, and investment funds. The findings highlight that while there has been some regulatory progress—particularly the introduction of the Bangladesh Government Investment Sukuk (BGIS), BSEC Sukuk Rules, and Green Sukuk directives—the ICM remains relatively underdeveloped. Despite the active participation of Islamic banks in instruments like Mudarabah bonds for regulatory capital, several key challenges persist. These include structural inconsistencies in profit distribution mechanisms, limited risk-sharing, lack of clarity in contractual arrangements, and deviations from Shariah compliance principles.

Regulatory fragmentation has further exacerbated these issues. While BSEC mandates the use of Special Purpose Vehicles (SPVs) for Sukuk issuance, Bangladesh Bank restricts the use of SPVs for Tier 1 and Tier 2 capital instruments. This contradiction has hindered the issuance of truly Shariah-compliant capital instruments by Islamic banks. The study also finds that the current Islamic capital market landscape is dominated by a small investor base, mainly consisting of Islamic banks, with limited participation from Takaful operators, mutual funds, corporations, or retail investors. This narrow investor engagement stems from a combination of low public awareness, insufficient financial literacy, and a lack of diversified investment options.

Notably, efforts to promote BGIS and corporate Sukuk are gaining momentum. Recent issuances have financed infrastructure, education, renewable energy, and water projects, aligning with national development goals and several Sustainable Development Goals (SDGs). However, despite positive market response, the lack of organized trading platforms for BGIS and insufficient impact reporting limit broader market participation and transparency. The governance structure also requires strengthening. Inadequate Shariah vetting by the Securities and Exchange Commission's Shariah Advisory Council and limited coordination among regulatory bodies contribute to investor skepticism.

To unlock the full potential of the ICM in Bangladesh, the study advocates for a coherent policy framework that ensures regulatory alignment, expands Shariah-compliant instruments, and fosters awareness through investor education and institutional training. Establishing robust secondary market infrastructure, mandating impact and sustainability reporting for Sukuk, and building strong governance and risk management systems are also essential. The integration of these measures will enhance the credibility, functionality, and growth trajectory of the ICM, thereby reinforcing the resilience and inclusivity of Islamic banking in Bangladesh. This research serves as a timely resource for regulators, bankers, policymakers, and scholars aiming to develop a well-governed, transparent, and efficient Islamic financial ecosystem.

Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh

1. Introduction

1.1 Research Background

The development of the Islamic financial ecosystem has gained significant momentum globally, with the Islamic capital market (ICM) emerging as a key pillar alongside Islamic banking, Islamic insurance (Takaful), and other Shariah-compliant financial services. The ICM is a segment of the financial market where capital is raised and invested in strict adherence to Shariah principles. Its primary components include Sukuk, Islamic funds, Shariah-compliant equities, and corporate debts. A distinguishing feature of the ICM is its prohibition of interest (Riba), excessive uncertainty (Gharar), gambling (Maysir), and investments in prohibited (haram) sectors, providing an ethical alternative to the conventional capital market.

In Bangladesh, the Islamic finance industry is experiencing rapid growth, with the Islamic banking sector leading the way. Currently, ten full-fledged Islamic banks operate alongside thirty conventional banks that offer Islamic banking services through dedicated branches and/or windows. This underscores the growing public demand for Shariah-compliant financial products and services. However, as the Islamic banking sector expands, it faces challenges in managing liquidity, diversifying investment portfolios, and sourcing long-term capital—areas where the ICM can play a significant role.

A notable trend in the market is the issuance of Mudarabah bonds by several Islamic banks to raise funds to meet their regulatory capital requirements in a Shariah-compliant manner. Furthermore, Islamic banks in Bangladesh frequently invest in the capital market as part of their portfolio management strategies while adhering to regulatory and Shariah requirements. This interaction highlights the interdependence between Islamic banking and the ICM.

In this context, it is essential to assess the impact of the ICM on the operations and performance of Islamic banks in Bangladesh. This study aims to explore how the ICM contributes to the financial health, investment behavior, and risk management practices of Islamic banks and whether it effectively complements the core objectives of Islamic banking. Through this research, we seek to bridge the knowledge gap regarding the practical influence of the ICM on Islamic financial institutions, providing insights that can inform policy, regulatory strategies, and institutional practices to strengthen Shariah-compliant finance in Bangladesh.

The study is structured into four principal sections. Chapter One provides the introduction and delineates the background, objectives, methodology, and overall structure of the study. Chapter Two depicts a summary on emergence of ICM. Chapter Three presents a review of pertinent regulations related with CM investment by banks. Chapter Four outlines the findings of the study, organized into thematic sub-sections based on data analysis. Chapter Five concludes the report by identifying key issues and offering a set of policy recommendations aimed at enhancing the development and impact of the ICM in Bangladesh.

1.2 Research Objectives

The objective of this research is to examine the contribution of ICM to the financial health, investment behavior, and risk management practices of Islamic banks in Bangladesh. To achieve this, the research reviews the current status of the capital market in Bangladesh, explains the key features and principles of the Islamic capital market, analyzes the development of ICM in a global context, and proposes actionable recommendations for enhancing ICM in Bangladesh.

1.3 Research Methodology

To facilitate a comprehensive understanding of the subject matter and achieve the research objectives, this study employs a descriptive methodology that integrates both qualitative and quantitative data. A content analysis is conducted on relevant laws, guidelines, and policy documents to evaluate the regulatory environment and structural framework of ICM. Secondary data are obtained from published materials, including academic journals, annual reports, industry publications, and the official websites of regulatory bodies and financial institutions. Additionally, primary data are collected through interviews and Focus Group Discussions (FGDs) with key stakeholders, including Shariah scholars, Islamic banking professionals, capital market practitioners, and regulatory authorities. These engagements provide valuable insights into the practical challenges and opportunities associated with the interactions between Islamic banking and capital market activities in Bangladesh. Quantitative data are presented in tables and graphs to enhance the visualization of trends and patterns, while qualitative findings are discussed narratively, reflecting the perspectives and interpretations of the involved stakeholders. The report has been finalized upon incorporation of the observations and feedback received during the workshop.

2. Emergence of ICM and the Need for It

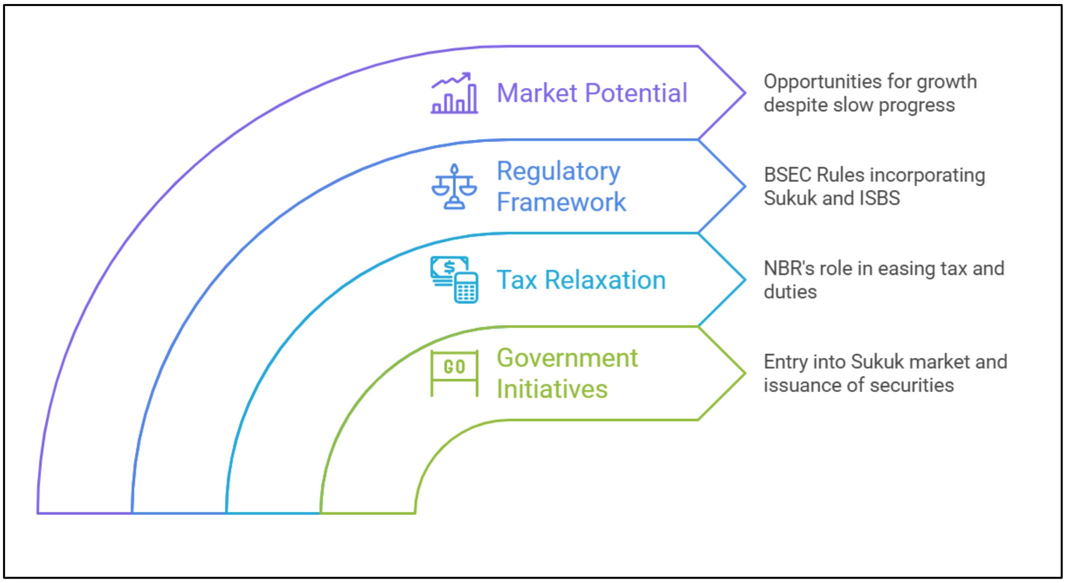
Islamic Capital Markets (ICM) function as platforms for financial transactions that comply with Islamic law (Shariah). Since the 1990s, ICMs have gained prominence due to globalization and financial liberalization. However, despite their growth, many markets face challenges in reaching the necessary development levels to significantly contribute to economic progress, as indicated by observations of their market dynamics. ICMs must adhere to principles of fairness, transparency, and equity, which are fundamental to Islamic finance. Key prohibitions in Islamic financial transactions include Riba (usury or interest), Gharar (excessive uncertainty), Maysir (gambling), Tadlis (deception), and Ikraha (coercion). These prohibitions ensure that transactions are based on tangible assets or activities, facilitating a just and equitable distribution of wealth. Additionally, innovations in ICM products are essential to meet evolving market demands, enhance liquidity in Islamic financial institutions, and foster further advancements in the sector.

Capital markets play a pivotal role within an Islamic economic framework by attracting savings and facilitating investments in productive initiatives. This is evident in both primary and secondary market operations: the primary market directly influences the supply of funds, while secondary markets improve liquidity, pricing, and provide exit strategies for investors. The need for responsive and efficient capital markets is underscored by the growing demand for public finance through Islamic modalities. The development of ICM involves various factors, including regulatory frameworks, market microstructure, product diversification, and participant behavior. A thorough understanding of these elements will greatly enhance the potential for growth and expansion of ICM within the broader Islamic financial ecosystem. Effective governance, robust risk management practices, and the establishment of supportive institutions are crucial for the evolution and integration of Islamic capital markets.

Despite experiencing economic growth, many countries struggle with a lack of interest among companies in pursuing listings on domestic stock exchanges, reflecting a deficit of confidence in these markets. This challenge is compounded by the limited capital raised through these exchanges. Many companies listed in these markets are closely held, leading to restricted free float and limited market participation. Additionally, the investor base remains small and stagnant, even in nations with favorable market conditions. Market exchanges are often dominated by a small number of brokers, fostering a ‘closed club’ mentality that does not benefit the broader social interest. The proportion of traded stocks compared to total listed securities is low, heavily reliant on a few leading stocks for liquidity. Investors face risks of price manipulation, insider trading, and other forms of market abuse due to structural deficiencies. Although regulatory frameworks exist, their enforcement is generally inadequate, resulting in practices that contradict Islamic principles, such as interest-based borrowing and short-selling.

The Bangladesh government's entry into the Sukuk market, along with tax relaxations by the NBR and regulatory efforts by BSEC—such as the introduction of Shari'ah Advisory Council Rules—has created a foundation for developing the ICM. However, progress remains slow compared to other regional countries. To accelerate growth, the government should prioritize issuing more long- and short-term Shariah-compliant securities. Despite the slow momentum, there is strong potential for expansion in Bangladesh's Islamic capital market. Figure 2.1 depicts the opportunities for growth of the ICM.

Figure 2.1: Opportunities for Growth of the Islamic Capital Market

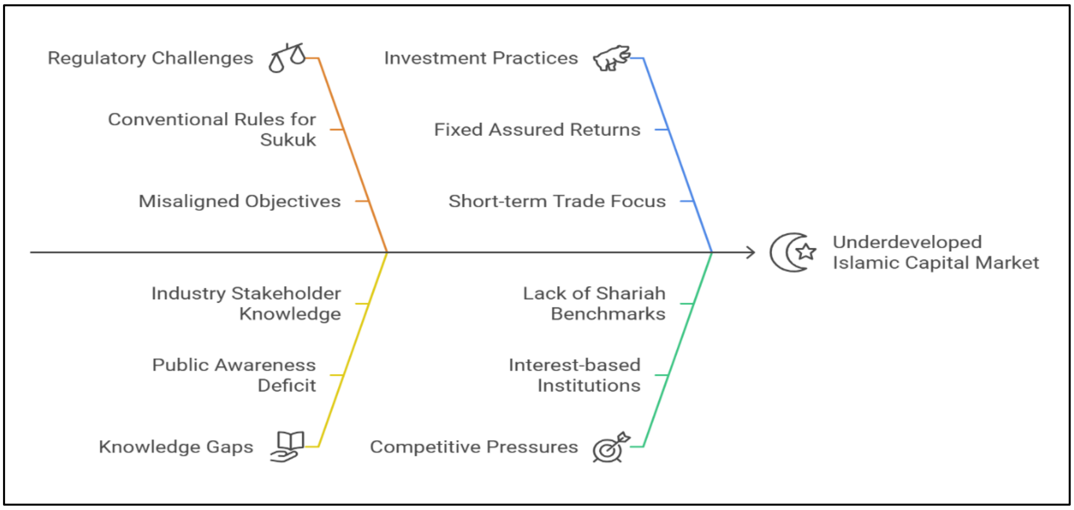


Source: *IiBFRBD 2024*

Despite being a Muslim-majority country, Bangladesh has entered the Islamic capital market relatively late, making it difficult to compete with more established jurisdictions. A lack of public and stakeholder awareness about Islamic financial principles and the application of conventional rules—such as the Debt Securities Rules—to sukuk issuance have further hindered its development. Most Islamic banks rely on fixed-return Mudarabah bonds and mark-up-based structures rather than profit-sharing models like Musharaka or Murabaha, limiting Shariah authenticity.

Investments remain concentrated in short-term trade, and economic challenges have weakened investor confidence. To advance, regulators and industry players must jointly develop targeted ICM policies and establish a robust Shariah index to guide profit rate determination. Figure 2.2 summarizes the challenges present in Bangladesh's ICM.

Figure 2.2: Challenges in the Islamic Capital Market



Source: *IiBFRBD 2024*

3. Regulatory Framework for ICM in Bangladesh

In a developing economy, the banking sector and capital market play complementary roles in fostering inclusive and sustained financial growth. Balanced development between these sectors facilitates long-term financing and enhances financial stability and investor confidence. In Bangladesh, the banking industry dominates financial intermediation. However, the capital market—particularly the ICM—is still in its early stages and needs a supportive regulatory environment to thrive alongside conventional markets.

According to the Bangladesh Securities and Exchange Commission (Debt Securities) Rules, 2021, Islamic capital market instruments, including Sukuk, may be classified as Islamic Shariah-Based Securities (ISBS). The BSEC issued the Investment Sukuk Rules, 2019, specifically to facilitate the issuance and governance of corporate Sukuk in Bangladesh. In addition, all Shariah-compliant debt instruments—including Sukuk, ISBS, and Asset-Backed Securities (ABS)—must adhere to the provisions outlined in both the BSEC (Debt Securities) Rules, 2021 and the BSEC (Asset-Backed Securities) Rules, 2004. The issuance and operational procedures of corporate Sukuk are primarily governed by the BSEC (Investment Sukuk) Rules, 2019, in conjunction with the BSEC (Debt Securities) Rules, 2021. Meanwhile, Shariah-based Mutual Funds and Alternative Investment Funds are regulated under a different set of guidelines, including the BSEC (Mutual Fund) Rules, 2001, to ensure their compliance with Shariah principles. Whereas, Bangladesh Government Investment Sukuk (BGIS) are operated under Public Debt Act 2022 and BGIS Guidelines 2020. This layered regulatory framework supports the structured development of the ICM in Bangladesh.

According to Section 26(2) of the Bank Companies Act, 1991, a bank cannot invest in the capital market beyond 30 percent of its paid-up capital and reserve capital or 30 percent of the paid-up capital of any individual company—whichever is lower. Additionally, total investments in shares must not exceed 10 percent of the bank's total liabilities. These provisions aim to minimize the risk of overexposure, especially since banks operate primarily with depositors' funds. While capital market investments may yield higher returns, they also expose banks to volatility and potential losses, which could undermine public trust and financial stability. Therefore, it is crucial to introduce structural safeguards to manage these risks, particularly for Islamic banks, which must adhere to Shariah principles.

To manage these exposures, Bangladesh Bank issued BRPD Circular No. 12 on October 14, 2009, mandating that all scheduled banks conduct capital market operations through separate subsidiaries. Under this regulation, banks can no longer hold Beneficiary Owner (BO) accounts or operate omnibus accounts in their own name. Instead, they must establish independent legal entities registered under the Companies Act to carry out capital market activities. These subsidiaries are considered parent companies for regulatory purposes and must maintain separate financial statements following Accounting Standards. This reform was crucial for segregating capital market activities from core banking operations, thereby reducing systemic risk and enhancing institutional accountability. For Islamic banks, this structure also allows for the greater development of Shariah-compliant capital market instruments while maintaining operational independence.

Building on this initiative, Bangladesh Bank issued DOS Circular No. 01 on February 10, 2020, titled "Special Fund for Investment in the Capital Market," allowing each scheduled bank to create a dedicated fund of up to BDT 200 crore. The fund can be sourced from the bank’s own capital or borrowed from Bangladesh Bank via repo arrangements. Importantly, investments from this fund will not count against the limit set in Section 26 of the Bank Companies Act 1991, thereby enhancing the limit of capital market exposure for banks. Furthermore, this policy provides Islamic banks with an opportunity to invest in Shariah-compliant instruments such as Sukuk and Islamic mutual funds, promoting the ICM ecosystem.

In support of sustainable and ethical finance, DOS Circular Letter No. 39, dated September 27, 2021, further expanded the scope of eligible investments by allowing banks to invest in Green Sukuk under the special fund scheme established by DOS Circular No. 01/2020. The circular mandates that Green Sukuk must be 100 percent asset-backed, and proceeds must be used for environmentally sustainable projects. Investments must be made through Special Purpose Vehicles (SPVs) and comply with Shariah and regulatory standards, requiring approval from BSEC. This regulation aligns with global sustainable development objectives and creates opportunities for Islamic banks to expand their ethical investment portfolios in accordance with Shariah principles and environmental goals.

Additional regulatory guidance was provided through Bangladesh Bank Circular No. 24/2020, which introduced controls for equity investment practices among banks. The circular mandated the listing of equity holdings within one year, capped investment in any single issue at 5% in the first year, and provided rules for convertible bonds and sinking funds. These regulations reinforce prudent investment behavior and discourage speculative activity. For Islamic banks, this framework aligns with international standards, enhancing Shariah compliance, governance, and accountability within the ICM.

To further mitigate risks, Bangladesh Bank Circular No. 01/2023 introduced strict provisioning requirements for listed and non-listed capital market instruments. For listed securities, banks must provision when the market value falls below cost. For non-listed instruments—including mutual funds, bonds, debentures, and preference shares—provisioning must be based on factors such as net worth erosion or dividend/coupon defaults. Monthly reporting requirements under this circular increase transparency and compliance, particularly for Islamic banks seeking to uphold ethical and responsible investment standards in line with Shariah principles.

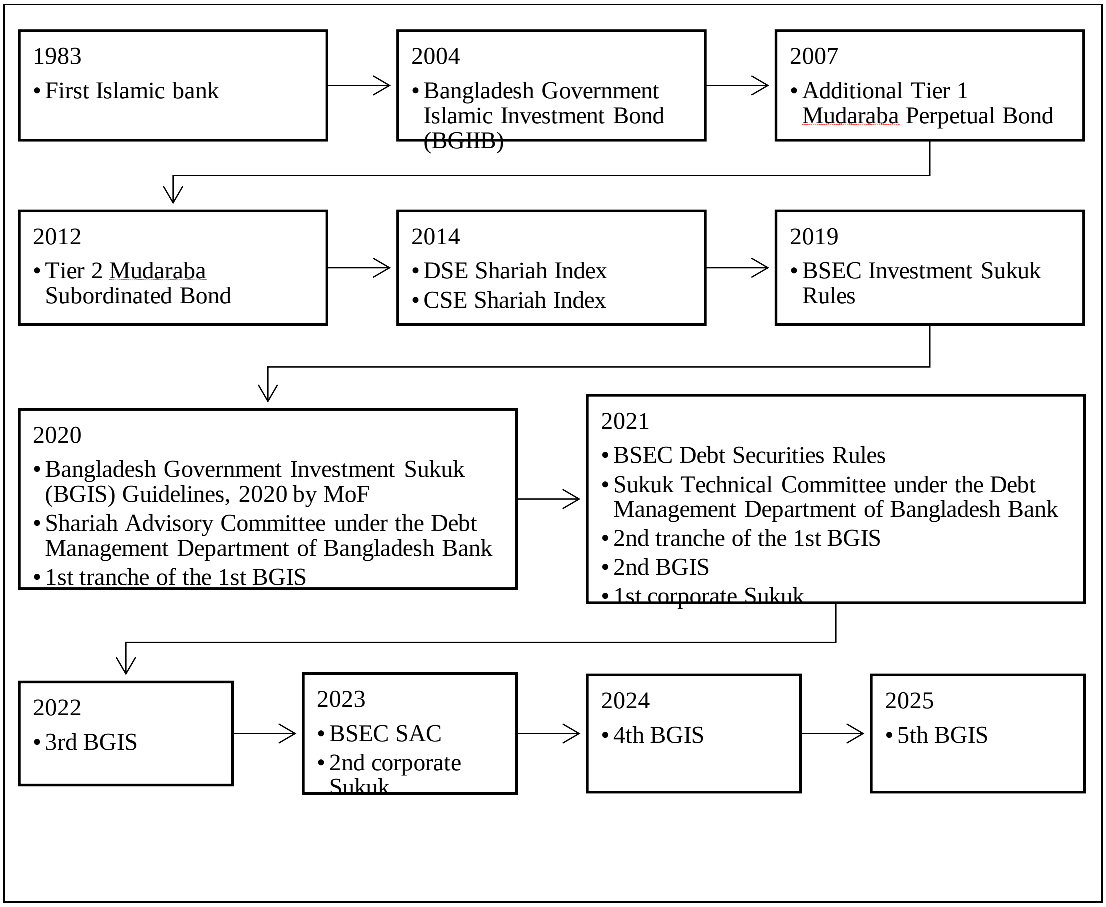
Additionally, under the Revised Regulatory Capital Framework (Basel III) issued in 2014, Bangladesh Bank allows scheduled banks to issue bonds to qualify as regulatory capital under Additional Tier 1 or Tier 2, subject to prior approval. These instruments must be fully paid-up and directly issued by the bank (not through SPVs). They may offer either fixed or floating returns, with floating rates linked to a market-determined benchmark.

In conclusion, the regulatory framework for ICM development in Bangladesh is evolving in a structured and risk-sensitive manner. Through strategic directives, Bangladesh Bank aims to balance capital market growth with financial stability, accountability, and Shariah compliance. These initiatives not only support the operational flexibility of Islamic banks but also enhance the credibility and resilience of the overall financial system. Strengthening the ICM through policy clarity, risk management, and ethical alignment is essential for the continued expansion and sustainability of Islamic banking in Bangladesh.

4. ICM in Bangladesh

The Islamic Capital Market (ICM) in Bangladesh has evolved significantly since the establishment of the first Islamic bank in 1983, marked by key milestones such as the introduction of the Bangladesh Government Islamic Investment Bond (BGIIB) in 2004 and the launch of Shariah-compliant indices (DSE and CSE Shariah Indices) in 2014. Regulatory advancements, including the BSEC Investment Sukuk Rules (2019) and Bangladesh Government Investment Sukuk (BGIS) Guidelines (2020), formalized Sukuk frameworks, enabling the issuance of sovereign and corporate Sukuk. The Debt Management Department of Bangladesh Bank established the Shariah Advisory Committee and Sukuk Technical Committee to oversee compliance. By 2023, Bangladesh saw its second corporate Sukuk issuance, and the ICM continues to expand with regular sovereign Sukuk tranches (e.g., 5th BGIS by March 2025). BSEC (Securities Market Shari'ah Advisory Council) Rules, 2022 is another importance milestone for establishing independent Shariah Advisory Council (SAC) in the regulatory body. Figure 4.1 depicts a summary of ICM progress in Bangladesh.

Figure 4.1: Development of ICM in Bangladesh



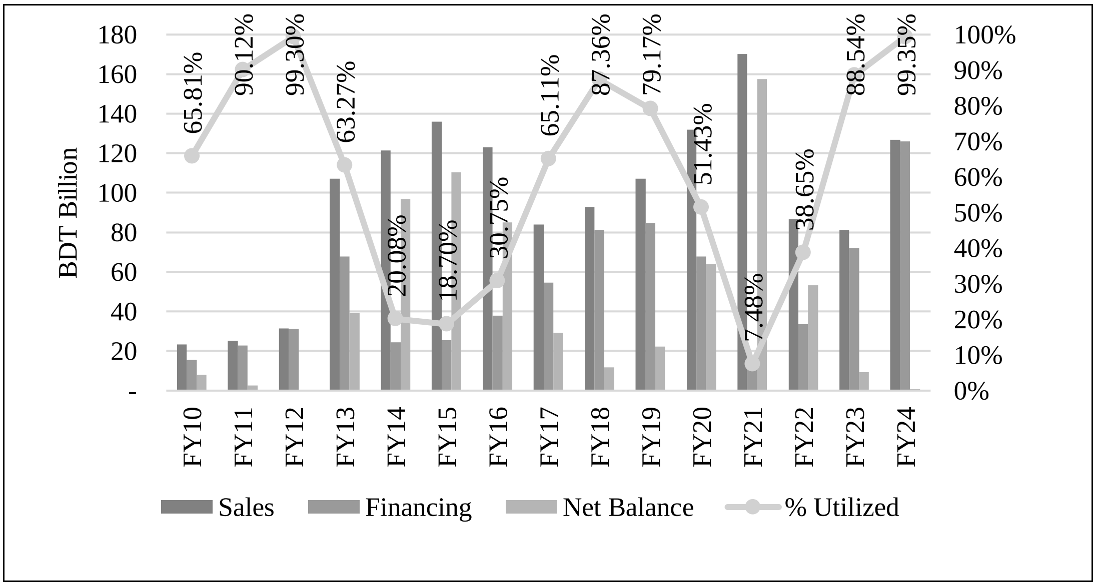
Source: *Authors' creation*

4.1 Bangladesh Government Islamic Investment Bond (BGIIB)

The Bangladesh Government Investment Bond (BGIIB) was introduced in 2004 and is available for purchase by individuals, private and public limited companies, Islamic banks, and financial institutions, with a minimum investment of BDT 100,000. The BGIIB is structured in accordance with Mudarabah principles, with the Bangladesh Bank acting as Mudarib on behalf of the government. The BGIIB is regulated by the Bangladesh Government Islamic Investment Bond (Islamic Bond) Rules 2004 (amended 2014), and the Bangladesh Bank, through Circular No. 5 dated September 1, 2014, authorized Islamic banks to invest in the BGIIB to fulfill their Statutory Liquidity Requirement (SLR). Before the introduction of the Bangladesh Government Investment Sukuk (BGIS), the BGIIB was the only approved Shari'ah-compliant security for Islamic banks to use in maintaining their SLR. Additionally, the BGIIB can serve as collateral for loans or investments from various financial institutions due to its classification as a qualified liquid asset.

Despite the necessity for Islamic banks to invest in the BGIIB to meet their SLR, market responsiveness has been somewhat limited due to prevailing supply and demand dynamics. The profit rate offered by the BGIIB is generally lower than that of government treasury bonds, other interest-bearing bonds, and deposit rates. Furthermore, although it is a government instrument, the BGIIB cannot be leveraged by the government to address its budget deficit, making it less attractive to investors seeking higher yields. Since the government does not use the proceeds from the issuance of the BGIIB, these funds merely circulate among Islamic banks, resulting in low and unattractive yields. Consequently, the demand for the BGIIB often falls significantly short of supply. Moreover, the minimum tenor of three months for the BGIIB presents liquidity challenges, preventing banks from using it for short-term or overnight financing needs. Figure 4.2 provides the sales, financing, and net balance (i.e., unutilized amount) of BGIIB over the periods of FY10–FY24.

Figure 4.2: Sales, Financing, and Net Balance of BGIIB



Source: Based on Bangladesh Bank Quarterly Reports on Development of Islamic Banking in Bangladesh

4.2 Bangladesh Government Investment Sukuk (BGIS)

BGIS, introduced in 2020, marks the beginning of the Sukuk era in Bangladesh. BGIS allows banks and other financial institutions to manage surplus liquidity by investing in secure, asset-based Islamic securities. BGIS is held by banks and financial institutions and qualifies as approved assets for meeting the SLR requirement, enhancing its appeal. Additionally, BGIS can serve as collateral for Islamic banks seeking access to the Islamic Banks Liquidity Facility (IBLF) through a Mudarabah contract with the Bangladesh Bank. All BGIS issued so far are intended to fund socio-economic development projects.

The first BGIS was issued in two tranches, each for BDT 40 billion. The first tranche was issued on December 28, 2020, followed by the second on June 9, 2021. Proceeds from this Sukuk financed the government project 'Safe Water Supply for the Whole Country,' executed by the Department of Public Health Engineering (DPHE). This five-year project began on January 1, 2020, and is expected to be completed by June 30, 2025. The total estimated cost of the project is BDT 88.51 billion, with Sukuk funds covering 90.39%. The project includes facilities for rainwater harvesting and deep tube wells to provide safe water, ensuring an arsenic-free supply and delivering fresh (salt-free) water to coastal areas. This project addresses serious health concerns related to waterborne diseases, significantly reducing morbidity and mortality rates. The introduction of tubewell drinking water, combined with improved sanitation and enhanced primary healthcare, is crucial for lowering mortality rates due to diarrheal diseases.

The second BGIS, amounting to BDT 50 billion, was issued on December 30, 2021, to fund the 'Need-Based Infrastructure Development of Government Primary Schools Project (Phase 1),' managed by the Directorate of Primary Education (DPE). This project commenced on July 1, 2016, and it is projected to be completed by December 31, 2022. The total estimated cost is BDT 91.23 billion, with Sukuk funding covering 54.81%. This project aims to construct 40,000 additional classrooms in existing government primary schools (GPSs) and provide water and sanitation facilities for 8,000 GPSs to address health and hygiene issues. It also includes furnishing 36,500 classrooms with benches, teachers' tables, and chairs, as well as equipping 3,500 teachers' rooms with necessary furniture. The project emphasizes free primary education for all children and seeks to reduce social disparities in educational access. By increasing classroom availability, hiring new teachers, and improving student-teacher ratios—particularly by employing women as quality teachers—the project aims to enhance the effectiveness of primary education and improve student learning and completion rates. These efforts are expected to create a child-friendly atmosphere in GPSs, positively impacting social productivity. Additionally, the project considers the temporary employment opportunities generated during implementation and their potential to reduce poverty.

The third BGIS, also amounting to BDT 50 billion, was issued on April 20, 2022, to finance the 'Important Rural Infrastructure Development Project on Priority Basis-3,' executed by the Local Government Engineering Department (LGED). This project began on July 1, 2020, and is expected to be completed by June 30, 2026. The total estimated cost is BDT 64.77 billion, with Sukuk funding covering 77.20%. The project aims to establish a continuous rural road network by constructing 305.21 kilometers of upazila roads, 660.37 kilometers of union roads, and 5,075.76 kilometers of village roads. It also includes maintaining 1,090.77 kilometers of existing rural roads and improving 7.99 kilometers of road structures, such as bridges and culverts. This project seeks to enhance the socioeconomic conditions of rural communities by connecting them with urban facilities, healthcare, and family welfare centers, educational institutions, and other social organizations through improved paved roads. As road connectivity and market systems improve, the quality of rural livelihoods is expected to rise due to better access to health and education. Furthermore, this project is poised to generate both short- and long-term employment opportunities, contributing to a decrease in the unemployment rate in the project area. Enhanced transportation is anticipated to improve educational attainment, while maternal and infant mortality rates are projected to decline as healthcare access improves. Additionally, the improved transportation system will facilitate the marketing of agricultural products, allowing local NGOs and microfinance institutions to expand their activities and contribute to national financial growth.

The fourth BGIS, amounting to BDT 10 billion, was issued on June 6, 2024, to finance the ‘Chattogram Division Upazila & Union Road Widening & Strengthening Project,’ managed by the LGED. The project commenced in July 2023, with an expected completion date of June 2028. The total estimated cost is BDT 31.10 billion, with Sukuk funding covering 32.15%. This project involves widening roller-compacted concrete (RCC) roads, constructing RCC drains, reconstructing bridges and culverts, building bus bays and intersections, and developing related structures along various upazila and union roads. A total of 1,160.92 kilometers of roads are planned for widening and strengthening, along with 7.32 kilometers of culverts and bridges to be constructed on rural roads. Developing a continuous road network is essential for enhancing transportation and trade in rural areas, providing significant socioeconomic benefits to residents and travelers across 11 districts in the Chattogram Division, a key region for trade and commerce in Bangladesh. The project aims to support the growing development of the rural economy and accelerate economic growth through the construction of rural infrastructure. It seeks to establish climate-resilient and sustainable rural infrastructure by upgrading and strengthening designated three-lane rural roads, expanding agricultural and non-agricultural production and marketing facilities, and generating both direct and indirect employment through investments in road infrastructure. The project’s implementation aligns with Bangladesh’s national policies, prioritizing infrastructure development to alleviate poverty, particularly among disadvantaged populations.

The fifth BGIS was issued on March 13, 2025, raising BDT 30 billion for a socioeconomic development project titled ‘Construction of Important Bridges on Rural Roads (Phase II).’ This project entails constructing 82 bridges, totaling 17.70 kilometers in length, along with 38.80 kilometers of approach roads and 8.23 kilometers of necessary river management works. The improved rural road communication system resulting from the project is expected to enhance agricultural production, reduce transportation costs for both agricultural and non-agricultural goods, and create employment opportunities in the short and long term. The project's outcomes align with several Sustainable Development Goals (SDGs), specifically SDG 3 (Good Health and Well-being), SDG 4 (Quality Education), SDG 5 (Gender Equality), SDG 10 (Reduced Inequalities), and SDG 11 (Sustainable Cities and Communities). Table 4.1 provides a summary of BGIS issued from inception to March 2025.

Table 4.1: Summary of BGIS Issued

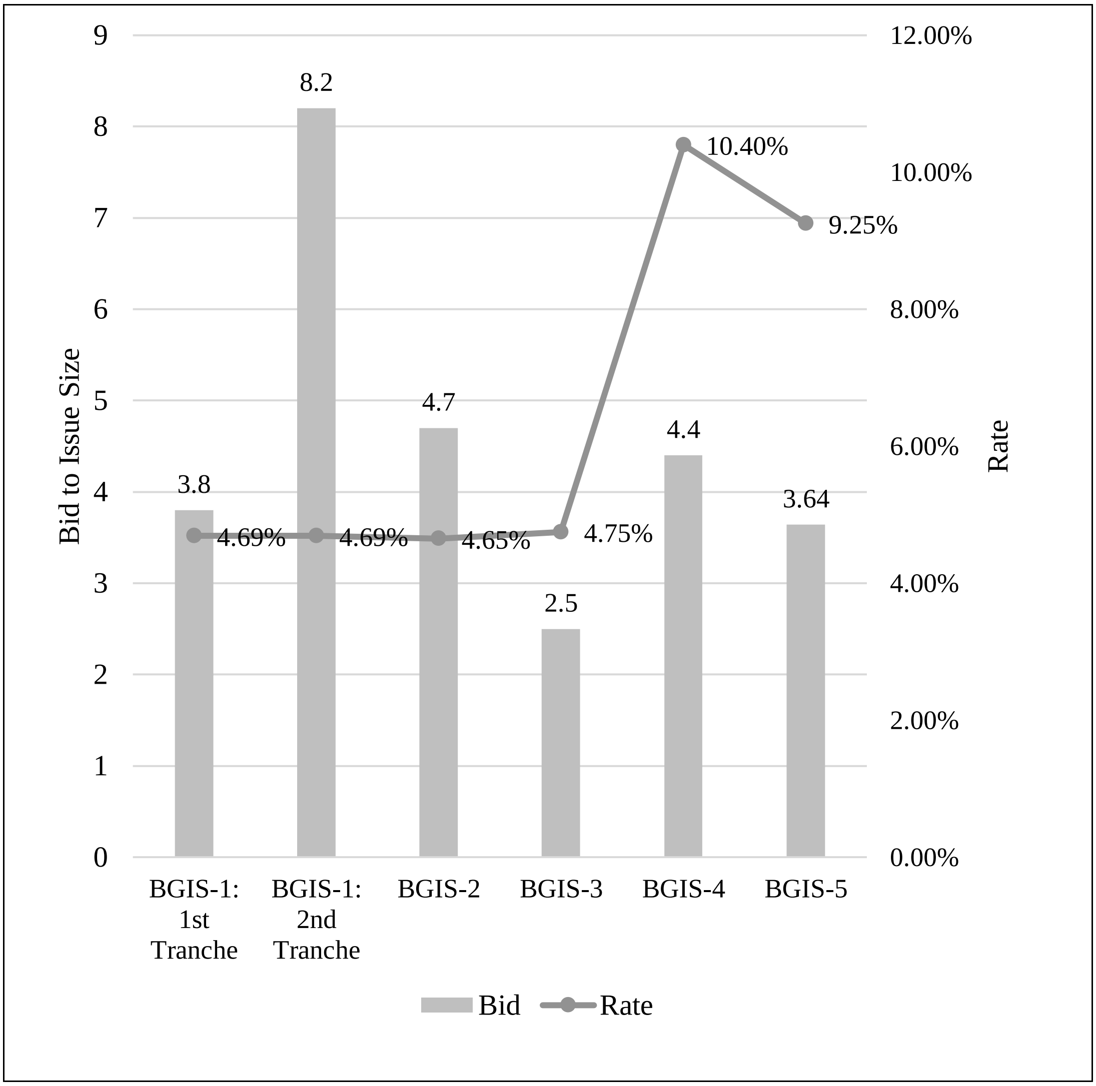
	BGIS-1	BGIS-2	BGIS-3	BGIS-4	BGIS-5
Name	Ijarah Sukuk	Ijarah Sukuk	IRIDP-3 Social Impact Sukuk	CDWSP Social Impact Sukuk	CIBRR-2 Socio-Economic Sukuk
Project	Safe Water Supply to the Whole Country	Need-Based Infrastructure Development of Government Primary School Project (1st Phase)	Important Rural Infrastructure Development Project on Priority Basis-3	Chattogram Division Upazila & Union Road Widening & Strengthening Project (CDWSP)	Construction of Important Bridges on Rural Roads (Phase-II) (CIBRR-2)
Issue Date	First tranche on 28 December 2020 and second tranche on 9 June 2021	30 December 2021	20 April 2022	06 June 2024	13 March 2025
Tenure	Five years	Five years	Five years	Five years	Seven years
Issue Amount	Each tranche for BDT 40,000 million	BDT 50,000 million	BDT 50,000 million	BDT 10,000 million	BDT 30,000 million
Principal Underlying Contract	Ijarah	Ijarah	Istisna'a and Ijarah	Istisna'a and Ijarah	Istisna'a and Ijarah

Source: *Bangladesh Bank*

Although BGIS offers a significantly lower return compared to conventional treasury instruments—though higher than BGIIB—especially during its first three issuances, it has attracted substantial response from the market, particularly from Islamic banks. Despite experiencing liquidity shortfalls, these banks remain the primary investors in BGIS, mainly due to the absence of alternative Shariah-compliant government instruments. Figure 4.3 shows the BGIS rate of return, payable semi-annually, along with the bid amounts compared to their issue sizes. Additionally, Figures 4.4-8.8 illustrate the investment amounts from various types of investors. Notably, in BGIS-

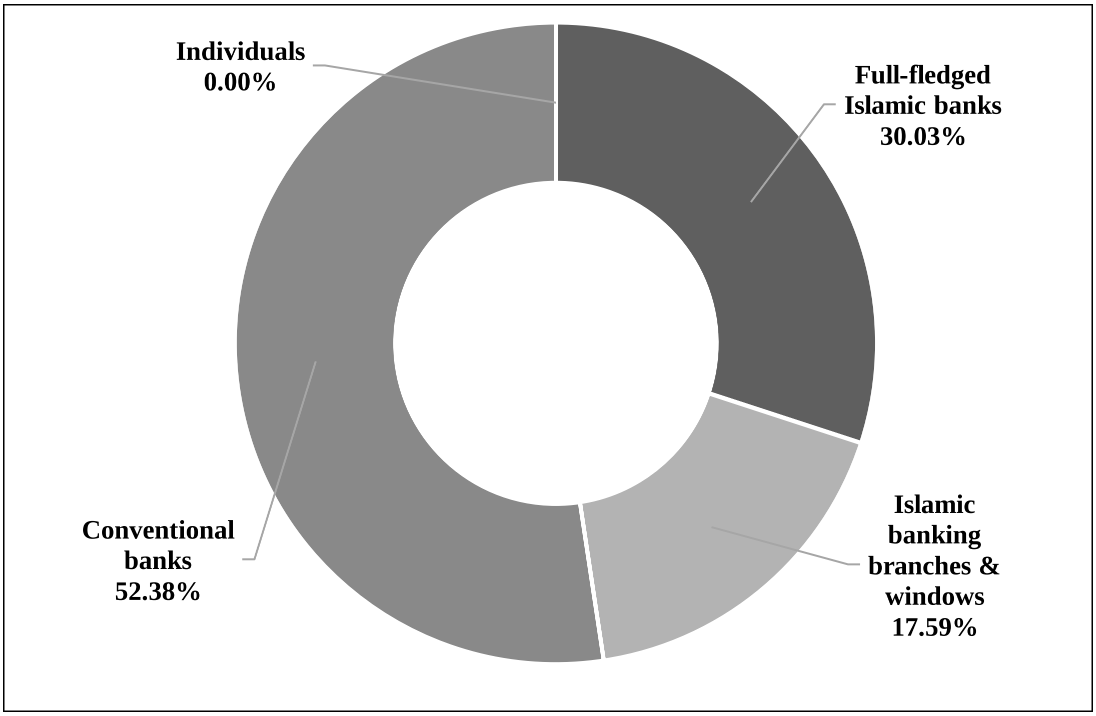
5, bids were submitted by Islamic insurance companies for the first time in the context of BGIS.

Figure 4.3: Bid and Rate of BGIS Issued



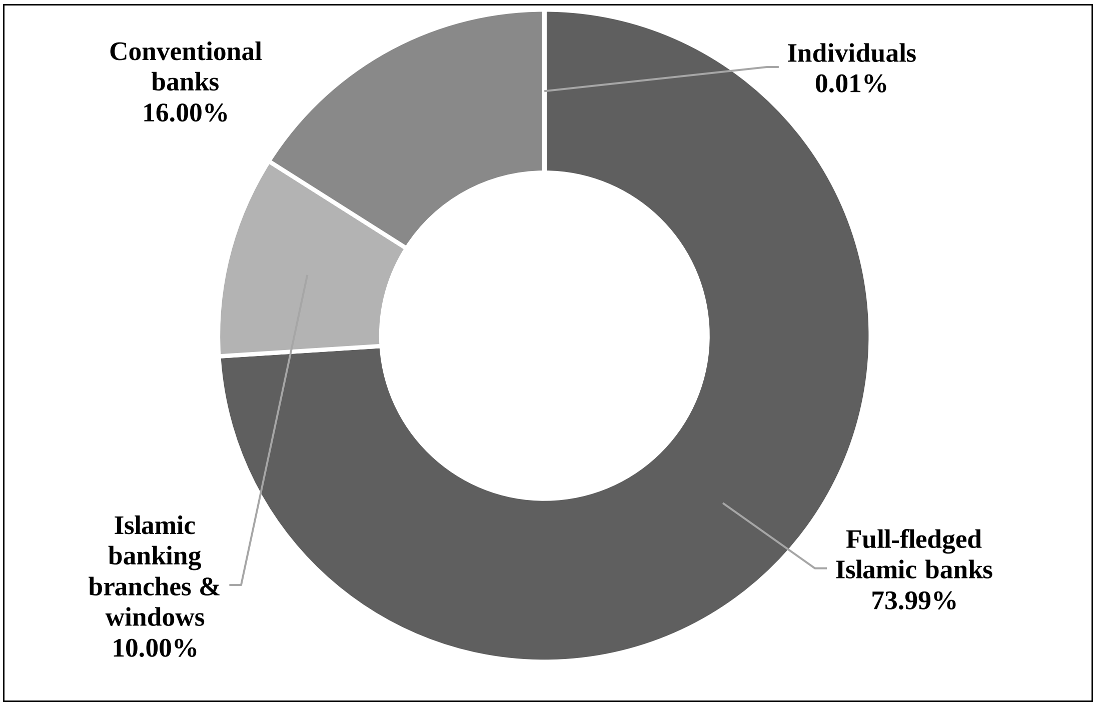
Source: *Bangladesh Bank*

Figure 4.4: Investors in BGIS-1 (1st Tranche)



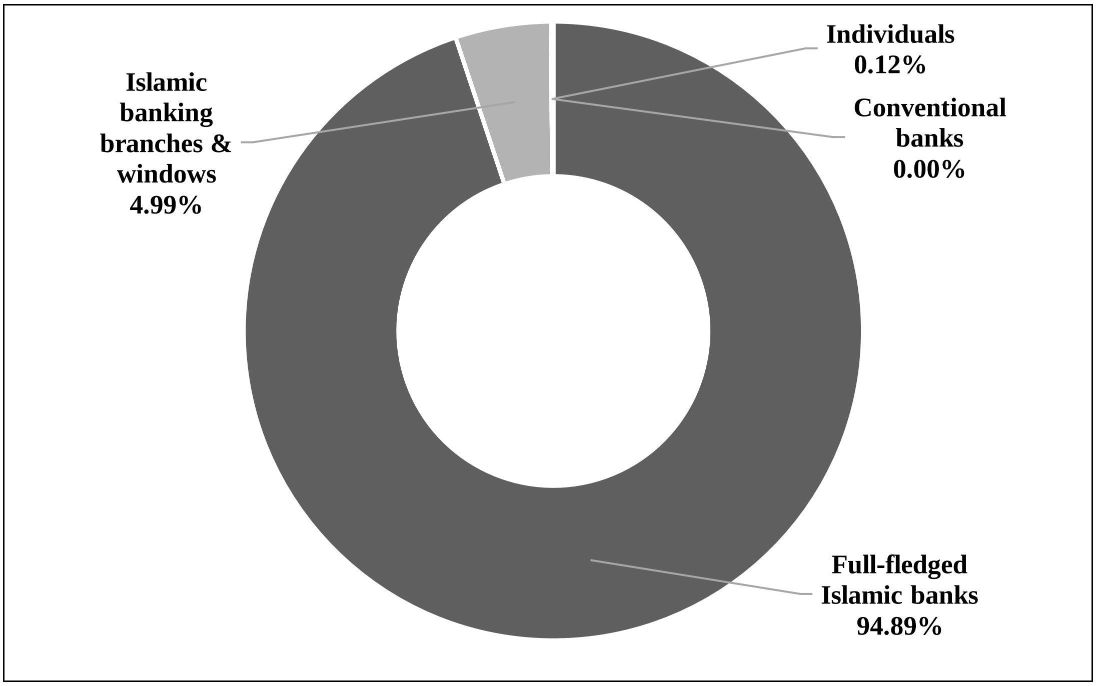
Source: *Bangladesh Bank*

Figure 4.5: Investors in BGIS-2



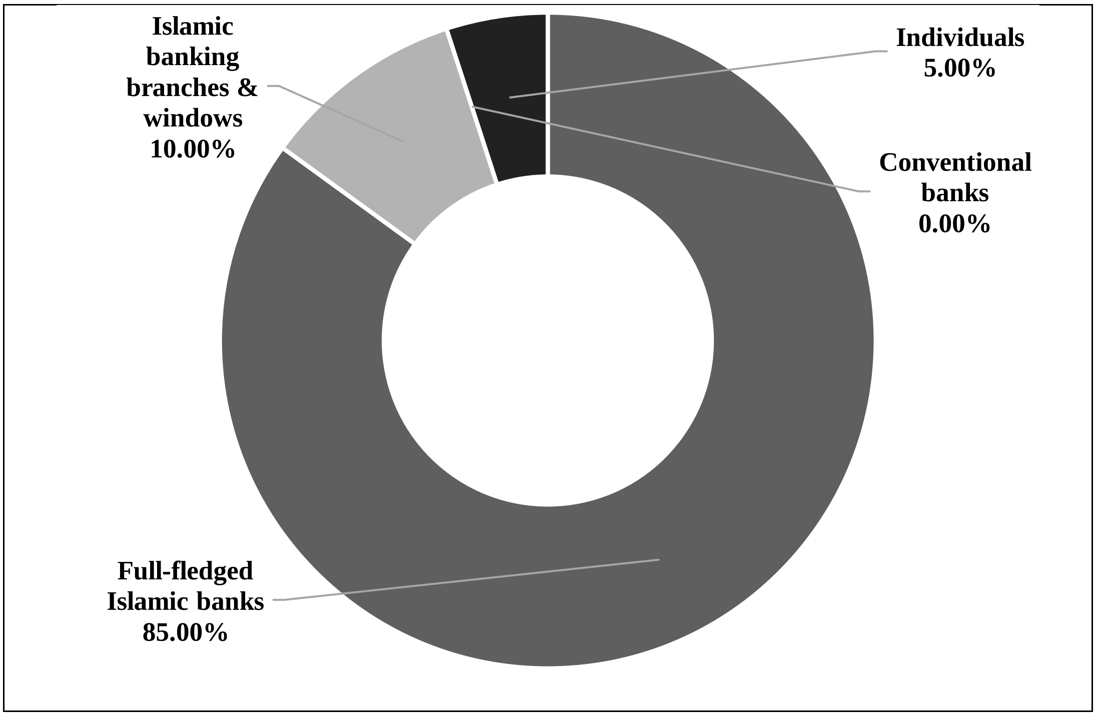
Source: *Bangladesh Bank*

Figure 4.6: Investors in BGIS-3



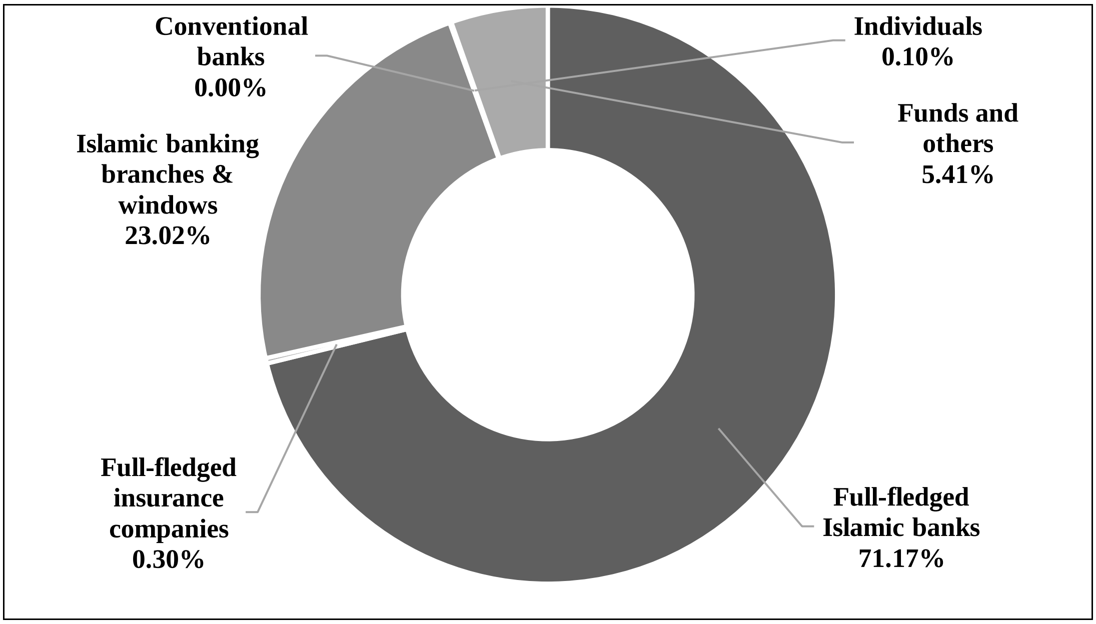
Source: *Bangladesh Bank*

Figure 4.7: Investors in BGIS-4



Source: *Bangladesh Bank*

Figure 4.8: Investors in BGIS-5



Source: *Bangladesh Bank*

Ahmed and Hossain (2023 & 2024) presented several recommendations for developing the BGIS market, several of which are currently being addressed. A summary of this is presented in Table 4.2.

Table 4.2: Earlier Recommendations to Develop the BGIS Market

No.	Recommendations	Developments
1	The government needs to target a diverse range of investors, including Takaful companies, which are required to allocate a portion of their investments to government instruments.	• The Insurance Development and Regulatory Authority (IDRA) issued a letter to Takaful companies on 19 February 2025, directing life insurers to allocate at least 30% of their funds to BGIS and other government securities and general insurers to invest at least 7.5%. • Although very small, the BGIS-5 has, for the first time, seen bids from Takaful companies.
2	The government needs to target the large Muslim population, along with other investor groups such as mutual funds, provident funds, corporations,	• The allotment quota for individual investors, provident funds, deposit insurance funds, and similar investors was

	and conventional institutions seeking Shariah-compliant investment opportunities.	increased to 20% for BGIS-5, up from 5% in earlier issuances. • Since BGIS-5, Bangladesh Bank has noticeably increased its issuance of press releases to inform the media and public about Sukuk, resulting in greater media coverage. • Although still not significant, the number of individual and fund investors has increased.
3	Competitive rates of return compared to conventional instruments need to be offered for BGIS.	Although not yet at par, the rate of return offered for BGIS-4 and BGIS-5 are closer to conventional treasury instruments.
4	Projects financed by BGIS need to be labeled as 'Sukuk-funded projects' to enhance public confidence in the proceeds generated from these investments.	Although the application is yet to be visible, the requirement has been added to the prospectus and structure documents of BGIS-4 and BGIS-5.

Source: *Authors' creation.*

However, several recommendations proposed by Ahmed and Hossain (2023 & 2024) have yet to be implemented. They advocate for selecting significant development projects for BGIS to generate substantial public interest and media attention. Additionally, they emphasize the need for income-generating projects to address public concerns about the current income-generating capacity of BGIS-funded projects. They also recommend producing periodic reports detailing the utilization of Sukuk funds and the progress of the underlying projects. Given the focus on achieving Sustainable Development Goals (SDGs), they stress the importance of the government and the Bangladesh Bank incorporating issued BGIS into their sustainability reports. To enhance the marketing of Sukuk issuances, they suggest engaging professional issue managers to handle technical aspects such as project evaluation, Sukuk structuring, documentation, and the drafting of contracts and prospectuses. Furthermore, they advocate for issuing short-term Sukuk to meet the specific funding needs of short-term projects undertaken by the government and state-owned enterprises. Lastly, they highlight the introduction of incentives to encourage investment in BGIS during the early stages of the Sukuk market's development as an effective strategy.

Ahmed (2025) proposed further recommendations for BGIS, emphasizing that the underlying projects are closely tied to socio-economic objectives. He notes that, despite BGIS's crucial role in advancing Bangladesh's socio-economic development, these Sukuk have not been included in the country's sustainability reports or those from international impact issuance trackers. He highlights a significant gap in this area, pointing out the lack of impact reporting for BGIS issuance.

To address these issues, he calls for improved coordination among departments within Bangladesh Bank and relevant government agencies to ensure that sustainability reports incorporate BGIS. Additionally, he suggests that commercial banks investing in BGIS should present these investments as key components of their sustainability strategies. He stresses the need for Bangladesh Bank to effectively oversee BGIS-funded projects, ensuring timely implementation and evaluation of socio-economic impacts against projections. Regular reports should be published to share oversight findings, enhancing market awareness and confidence while promoting accountability for government projects.

However, Ahmed (2025) highlights the challenges in implementing these recommendations. He indicates that significant limitations will persist unless Bangladesh Bank allocates dedicated resources for BGIS, as the tasks involved are considerable. Currently, only a small number of personnel in Bangladesh Bank's Debt Management Department handle BGIS-related responsibilities on an ad hoc basis. Furthermore, impact reporting would be a major challenge in Bangladesh, as it requires data from various ministries and government agencies, which often do not maintain the necessary data or produce data that is viewed with skepticism regarding its accuracy. Additionally, bureaucratic processes can hinder data collection efforts unless a coordinated approach is undertaken.

4.3 Mudarabah Bonds

The corporate Islamic bond market in Bangladesh was established in 2007 when Islami Bank Bangladesh PLC issued the BDT 300 crore 'Mudaraba Perpetual Bond' to meet its Additional Tier-I (AT1) capital requirements. The first Tier-II (T2) bond issued by an Islamic bank in the country was in 2012 by First Security Islami Bank PLC. In 2014, Bangladesh Bank outlined the criteria for instruments to qualify as AT1 and T2 in its *Guidelines on Risk Based Capital Adequacy: Revised Regulatory Capital*

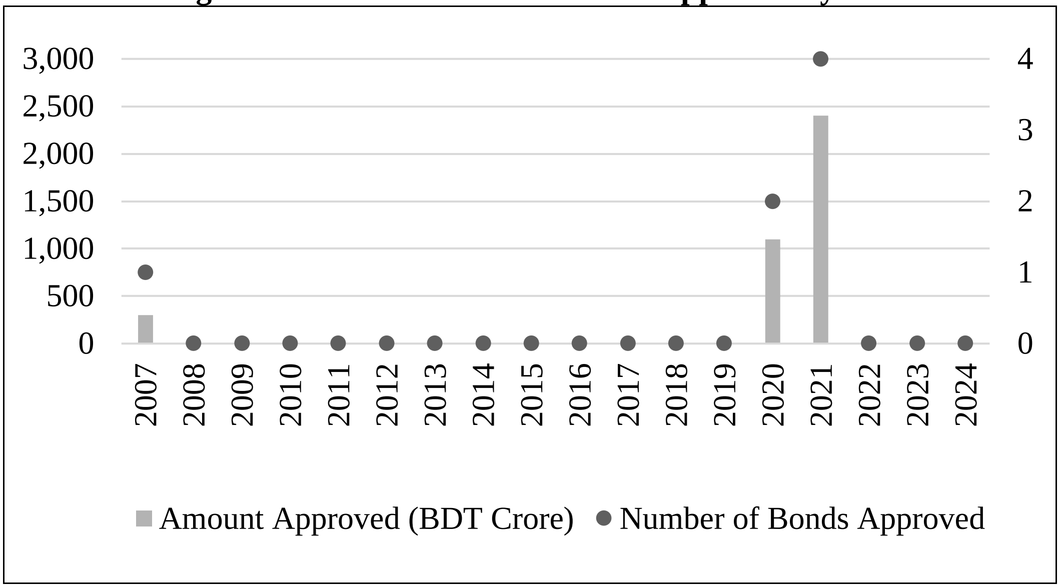
Framework for Banks in Line with Basel III. While the detailed criteria are provided in Appendix 1, the following is a summary of the requirements:

- **General eligibility criteria to qualify as regulatory capital:** The AT1 and T2 instruments must be issued directly by the bank and fully paid up, rather than by any Special Purpose Vehicle (SPV). Dividends payable to investors may be fixed or floating, linked to a market Taka interest benchmark rate. The instruments cannot include a 'put option'; however, a 'call option' is permissible under strict conditions. This option can only be exercised after ten years, requires prior approval from the Banking Regulation and Policy Department (BRPD) of Bangladesh Bank, and must not create any expectation of being exercised. The call option should only be executed if it meets specified conditions, such as replacing it with capital of equal or superior quality under sustainable income conditions or maintaining a capital position above minimum requirements after the call is executed. Calls due to tax or regulatory events may also be allowed, subject to the same conditions. The coupon or dividend payment policy must be clearly outlined in the indenture to prevent conflicts between ordinary shareholders and instrument holders. Additionally, no credit-sensitive coupon feature is permitted—dividends must not vary based on the bank's credit rating, and any reference to a credit-sensitive index will not qualify. Prior BRPD approval may be required for floating reference rates. In the event of liquidation, investor claims will be ranked as follows: subordinate to depositors and general creditors, and senior to equity shareholders. These instruments cannot be secured or enhanced through guarantees, nor can they contribute to liabilities exceeding assets in insolvency assessments. Furthermore, banks or their related parties cannot repurchase these instruments or use the issuing bank’s resources for such purchases, including retirement benefit funds for bank employees. The instruments must not include features that restrict recapitalization, and regulations must align with any stipulations from the Bangladesh Securities and Exchange Commission (BSEC) or other authorities regarding instrument issuance.

- **Specific eligibility criteria to qualify as AT1 capital:** The instrument must be perpetual with no maturity date, and no incentives for redemption should exist. Any repayment of principal requires prior approval from Bangladesh Bank, and repurchase conditions must include replacing it with higher-quality capital under sustainable conditions while maintaining a capital position above minimum requirements after any repurchase. Banks should have complete discretion to cancel dividend payments, with such cancellations not triggering default events or limiting operational flexibility, except concerning common stakeholders. Dividends must be non-cumulative, meaning missed payments will not be repaid in future years, and incentives for dividends based on the bank’s credit standing are prohibited. While banks may restrict common share dividends if AT1 dividends are unpaid, this must not impede recapitalization or operational agility. The Loss Absorption Features of this category should involve either conversion into shares or a write-down at a pre-specified trigger, affecting the claim in liquidation and the amount repaid when a call is executed. Banks must maintain a minimum of 6% Tier 1 capital relative to risk-weighted assets, with additional instruments contributing to Total Tier 1 Capital beyond this threshold, subject to specific limits on Perpetual Non-Cumulative Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI).

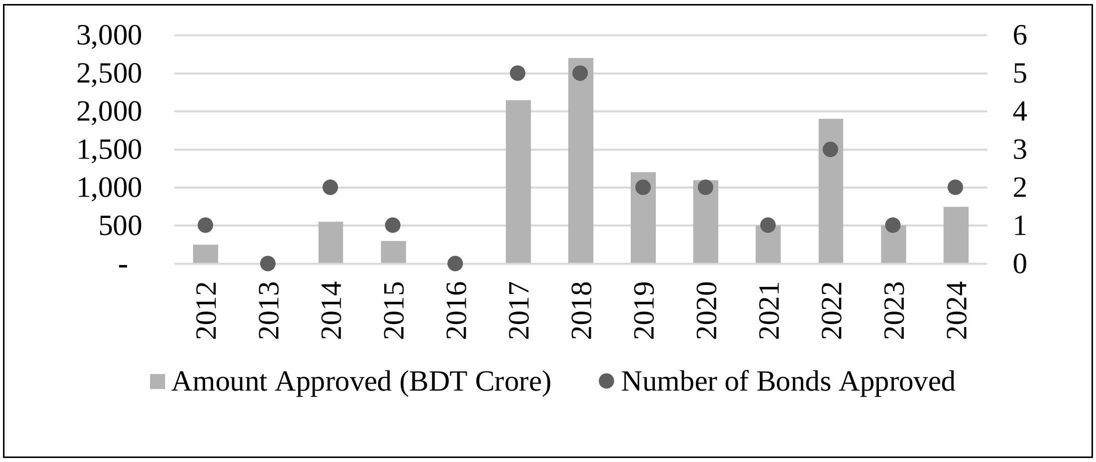
- **Specific eligibility criteria to qualify as T1 capital:** It is defined as raising debts through public or private placements, typically featuring a fixed interest component. Subordinated debt ranks below deposits and other claims, affecting the repayment order in liquidation. Convertible subordinated debts allow for an exchange into ordinary shares under specified conditions. To qualify, the debt must be unsecured and fully paid, with CAMELS ratings of at least '2' and debt ratings of at least '3'. These debts cannot be used as loan collateral or insured by deposit insurance schemes. Subordinated debt must have a minimum maturity of five years, along with specific rules regarding amortization during the last five years and repayment schedules. The payment policy must prioritize preventing conflicts between ordinary shareholders and subordinated debt holders in liquidation. The amount of subordinated debt included as T2 capital is limited to a maximum of 30% of Tier 1 capital, with total T2 capital capped at a maximum of 100% of Tier 1 capital. Until March 2025, BSEC approved seven AT1 and thirteen T2 issuance applications from Islamic banks. Figures 4.9 and 4.10 provide a snapshot of these approvals.

Figure 4.9: AT1 Mudarabah Bonds Approved by BSEC



Source: *BSEC*

Figure 4.10: A2 Mudarabah Bonds Approved by BSEC

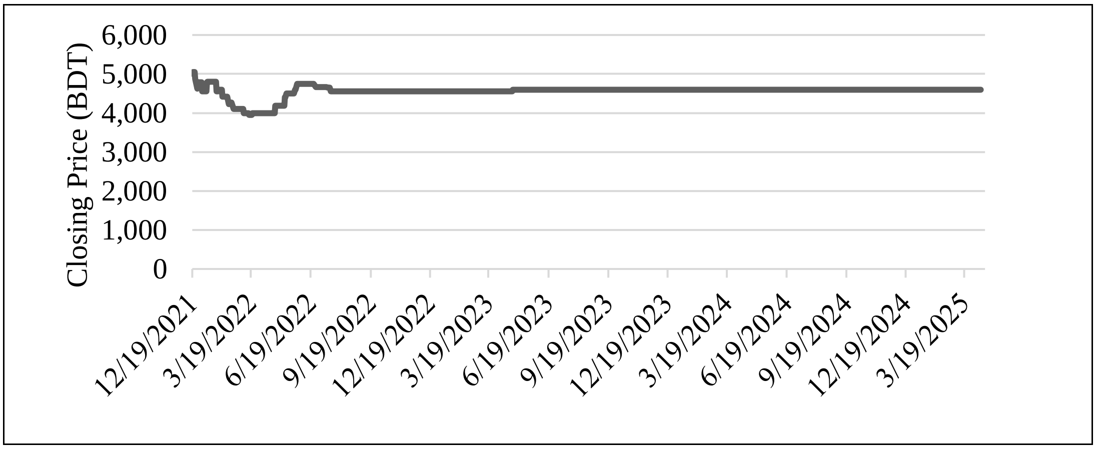


***Source**: BSEC*

4.3.1 Commercial issues

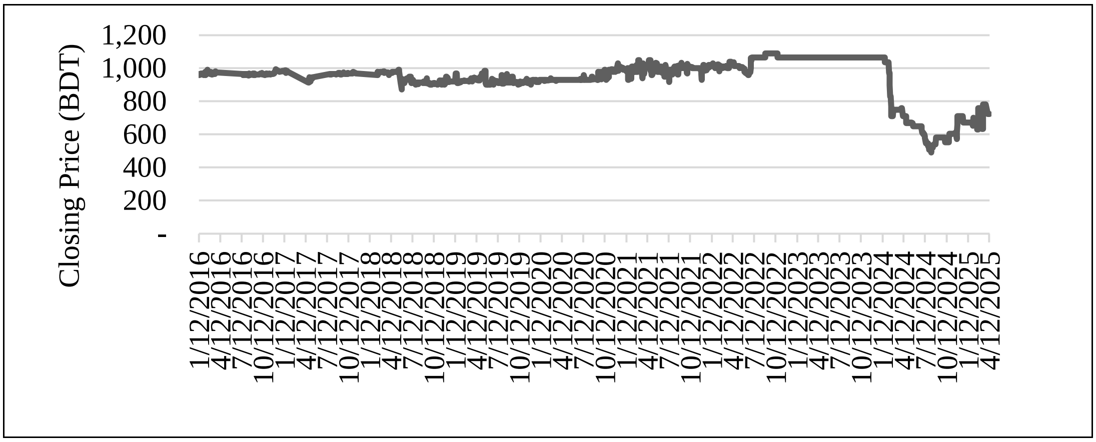
- **Trading at lower than face value:** Four AT1 Mudarabah Perpetual Bonds are listed on the DSE and CSE: AIBL Mudaraba Perpetual Bond, IBBL Mudaraba Perpetual Bond, IBBL 2nd Perpetual Mudaraba Bond, and SJIBL Mudaraba Perpetual Bond. Figures 4.11-4.14 show the changes in their closing prices since trading began on the CSE, indicating that all these bonds are currently trading below their face values, although one traded above face value for a time. Since these instruments are not redeemable and do not offer high profit potential like shares, their trading below face value and the risk of a downward price trend raise concerns about their attractiveness to investors.

Figure 4.11: AIBL Mudarabah Perpetual Bond Closing Price



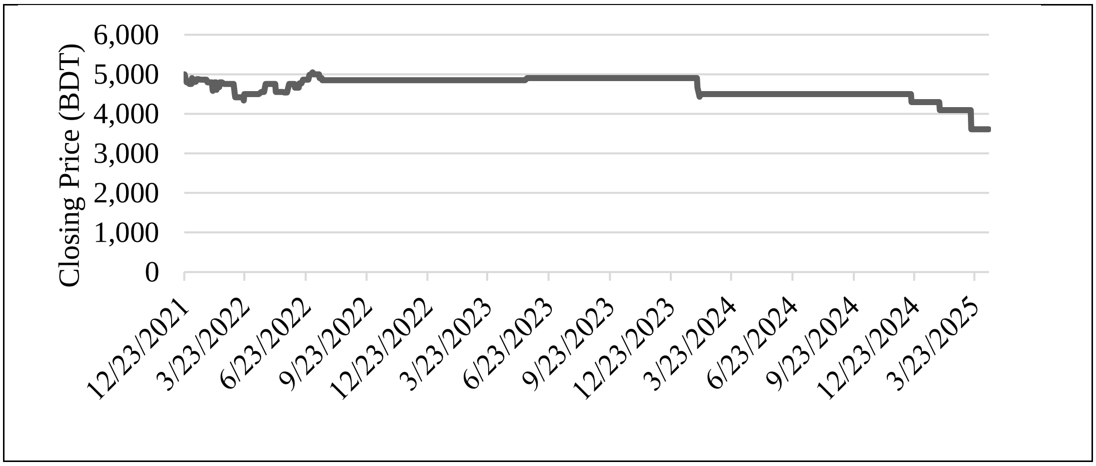
***Source:** CSE*

Figure 4.12: IBBL Mudarabah Perpetual Bond Closing Price



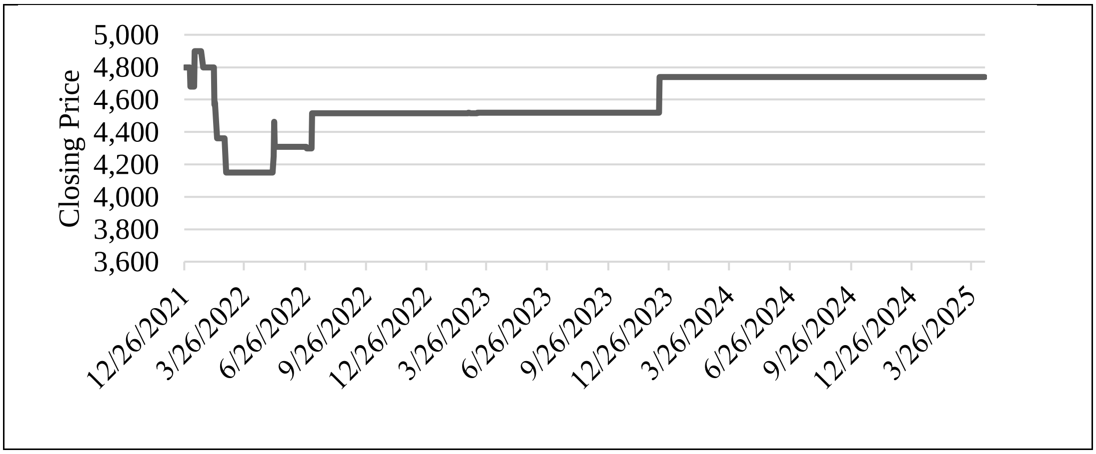
Source: *CSE*

Figure 4.13: IBBL 2nd Perpetual Mudarabah Bond Closing Price



Source: CSE

Figure 4.14: SJIBL Mudarabah Perpetual Bond Closing Price



Source: *CSE*

4.3.2 Shariah-compliance issues

- **Benchmark-based profit instead of performance-based profit:** The profit rate for the Mudarabah bonds is determined based on benchmarks, such as the issuer's deposit rate or certain market rates. However, since these bonds are structured under the Mudarabah contract, the profit rate is supposed to depend on the actual performance of the investments financed by the proceeds from the bond issuance.

The following examples depict the profit calculation policies stated by issuer banks for Mudarabah Perpetual Bonds (AT1):

> **Example 1:** 'Profit paid against Mudarabah Perpetual Bond is the final profit rate of 8 (eight) years Mudarabah Savings Bond and an additional amount equivalent to 10.00% of the rate of dividend declared for the respective year.'
>
> **Example 2:** 'Profit paid against Mudaraba Perpetual Bond is the published deposit rate to be taken from "Announced Profit rate chart of the scheduled banks (Deposit rate) (1 year but < 2 Year)'' published by Bangladesh Bank in its website and an additional profit margin @ 2.50%.'

The following examples depict the profit calculation policies stated by issuer banks for Mudarabah Redeemable Subordinated Bonds (T2):

> **Example 1:** 'The rate of profit will be calculated at prevailing Mudaraba Term Deposit Profit Rate (Provisional) in 6 Months tenor plus additional 1.25% (indicative/ provisional) per annum on the outstanding balance of the bond from pre-tax profit/ operating income of the Bank.'
>
> **Example 2:** 'The total profit/ return on the bond will be calculated as the average Rates of 6 months of Full-fledged Shariah based banks collected from latest available "Announced Profit Rate Chart of those Banks (Deposit Rate)" published by Bangladesh Bank in its website at the beginning of any Profit Payment Period with an additional profit rate of 2.00% per annum. After each financial year-end, the Issuer will give adjustment to the Bondholders if there is any additional profit reported in the respective financial year for Mudaraba Term Deposit Profit Rate for 6 months tenor.'

- **Minimum profit guarantee:** From the Shariah perspective, guaranteeing a minimum profit for Mudarabah-based investments is not allowed. However, a review of Mudarabah bond features reveals practices that guarantee a minimum profit for bondholders. For example, one Islamic bank states the following in its profit calculation policy for the Mudarabah Perpetual Bond (AT1): 'The range of return/profit is fixed from 6% to 10% and the payment of profit is made annually after the end of calendar year.' The same range appears in four out of seven approved AT1 instances by BSEC in its approval announcements, indicating the minimum profit rate for bondholders.

- **Guarantee of capital:** From the Shariah perspective, guaranteeing capital for Mudarabah-based investments is prohibited. However, a review of Mudarabah Redeemable Subordinated Bonds (T2) reveals practices that guarantee capital to bondholders. For example, the Information Memorandum and financial reporting disclosures of such a bond state: '20% of the total bond value will be redeemed at the end of each year starting from year 2 at face value.'

- **Junior to depositors and senior to shareholders:** One key requirement of a general partnership (Sharikat al-Inan) is that all capital providers must share the risk of loss in proportion to their contributions. However, in the case of Mudarabah bonds, bondholders rank junior to the depositors and senior to shareholders, despite all their funds being combined in investments, raising a significant Shariah compliance concern.

The following is an example from the disclosure made regarding Mudarabah Perpetual Bonds (AT1):

> 'The instrument subordinated to the claims of other creditors and depositors. In the case of liquidation, the subordinated debt holders would be paid just before paying to the shareholders assuming there are assets to distribute after all other liabilities and debts have been paid.'

The following is an example from the disclosure made regarding Mudarabah Redeemable Subordinated Bonds (T2):

> 'The claims of the subordinated bondholders are junior to the claims of the depositors and the other creditors.'

- **No mention of profit-sharing ratio:** The agreement on a profit-sharing ratio is essential for a valid Mudarabah contract. However, a review of the information memorandums of Mudarabah bonds reveals that this crucial component is missing, raising significant concerns from the Shariah perspective.

- **Late payment penalty:** A review of the information memorandums for Mudarabah bonds reveals that the issuing banks face a late payment penalty of 2% above the coupon rate. This penalty applies to any unpaid amount from the due date until the actual payment date. While intended to protect investors and meet regulatory requirements, this penalty raises concerns from a Shariah perspective, as imposing a penalty on a debt (i.e., the unpaid amount) is considered Riba (interest). Although the penalty may be justified for the payer to encourage timely payments of its obligations, the information memorandums and other disclosures lack clarity on whether Islamic investors are required to donate any received penalty amounts to charity.

- **Undue delay possibility in distributing profit:** A review of the disclosures reveals that the issuing bank may make the profit payment within 60 days of the profit calculation period's expiry. This presents an opportunity for an undue delay in fulfilling the bank's profit payment obligation.

4.3.3 Governance issues

- **No Shariah vetting by the SAC of BSEC:** BSEC, despite being the primary regulator for Mudarabah bonds and having established its SAC in 2023, did not place any Mudarabah bonds approved by it for the vetting of its SAC, leaving an essential aspect of Shariah governance unutilized.

4.3.4 Other issues

- **Renaming Mudarabah bonds to Sukuk or ISBS:** The introduction of Mudarabah bonds in Bangladesh occurred before the BSEC issued the Sukuk Rules and Debt Securities Rules. Although the Sukuk Rules were issued in 2019 and the Debt Securities Rules in 2021, which include the term Islamic Shariah-Based Securities (ISBS), the AT1 and T2 instruments are still labeled as 'bonds' instead of 'Sukuk' or 'ISBS'. The distinction between them is important because a 'bond' is seen as a debt instrument, whereas Mudarabah-based instruments cannot be regarded as debt instruments from a Shariah perspective; instead, they are equity instruments based on risk-sharing. Therefore, referring to the AT1 and T2 instruments structured based on Mudarabah as Sukuk or ISBS would better reflect their Shariah-compliant nature, which is essential for establishing them as legitimate Shariah-compliant instruments.

4.4 Corporate Sukuk

The Bangladesh Securities and Exchange Commission (BSEC) introduced the Investment Sukuk Rules on 22 May 2019, followed by the Debt Securities Rules on 31 May 2021. The inclusion of Sukuk alongside Islamic Shari'ah-based securities (ISBS) in the 2021 Debt Securities Rules marks a significant advancement for Islamic finance in Bangladesh. As Sukuk signifies undivided ownership of the underlying assets by the holders, it is also subject to the Asset-Backed Securities Rules of 2004. These regulations aim to create a structured framework for the issuance and management of Sukuk in accordance with Islamic finance principles.

The Investment Sukuk Rules require the establishment of a Special Purpose Vehicle (SPV) under the Trust Act of 1889, which must be registered in accordance with the Registration Act of 1908. The SPV operates independently from the Sukuk originator, ensuring a clear separation of duties and responsibilities. It is tasked with issuing Sukuk and is managed by an independent trustee who is not affiliated with the originator. This structure provides a layer of protection for investors, safeguarding their interests.

Moreover, the Investment Sukuk Rules stipulate that the assets must be legally and beneficially transferred to the SPV for the benefit of the Sukuk holders. A definitive Shari'ah pronouncement from a qualified, independent Shari'ah supervisory board

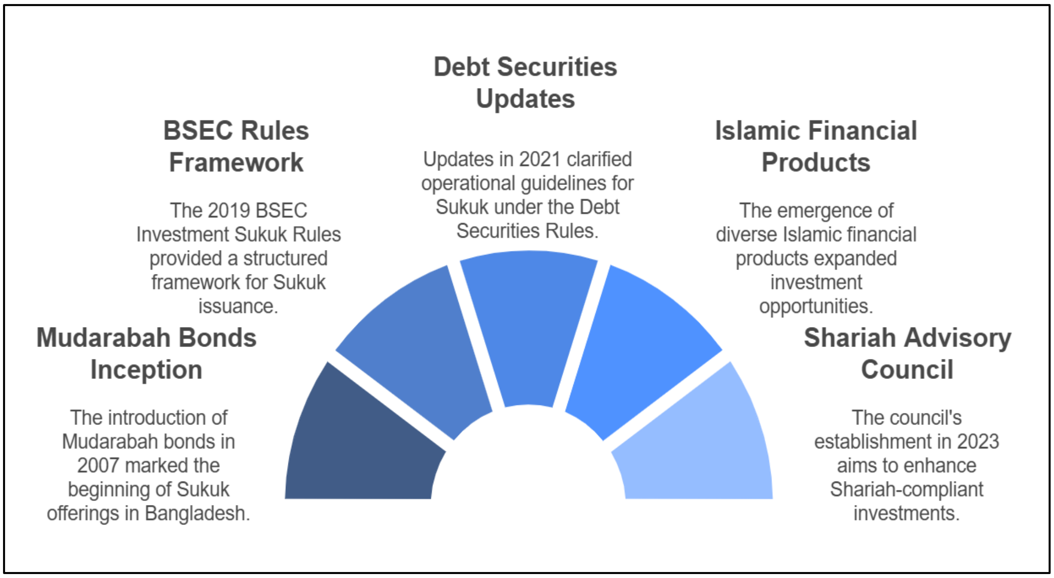
(SSB) is also required before the BSEC grants final approval, underscoring the importance of Shari'ah compliance within this investment structure. The SSB must consist of at least five qualified Shari'ah scholars or members who are responsible for monitoring the use of Sukuk proceeds and overseeing the SPV's operations at specified intervals to ensure adherence to Islamic principles.

The appointed trustee plays a vital role in managing the Sukuk assets, ensuring timely payments to Sukuk holders while maintaining compliance with Shari'ah principles throughout the duration of the Investment Sukuk. Following a directive issued on 13 September 2021, specific regulations established governance protocols, including limits on debt exposure to prevent the trustee from managing more than 40 debt securities simultaneously. Additionally, total trusteeship is restricted to 100 times the trustee's paid-up capital or net worth, with stricter limits of 75 times applicable for trustees whose net worth exceeds their capital.

An important advancement in the governance of Islamic finance was initiated by the BSEC on 23 August 2022 with the establishment of the Securities Market Shari'ah Advisory Council. This council is tasked with validating Shari'ah pronouncements related to Sukuk and other ISBS and formulating regulations to develop additional Islamic securities, thereby expanding the options available for Shari'ah-compliant investments.

To enhance participation in Shari'ah-compliant securities, banks and Non-Bank Financial Institutions (NBFIs) have been granted exemptions from certain investment exposure limits. Banks are also permitted to invest up to BDT 200 crore in unlisted SPVs approved by BSEC, provided they have secured the necessary board approvals. This regulatory flexibility aims to stimulate investment in the growing Islamic finance sector. Figure 4.15 summarizes the corporate Sukuk journey in Bangladesh.

Figure 4.15: Corporate Sukuk Journey in Bangladesh



Source: *IiBFRBD 2024*

The initial issuance of Sukuk faced significant challenges, particularly regarding VAT and tax obligations related to asset transfers. To address these issues, fiscal measures were implemented in FY21, which included exemptions from VAT and tax for Sukuk-related transactions between the originator and the SPV. Additionally, amendments to the Income Tax Act in 2023 removed the tax on deed registration specifically for property transfers to SPVs established for Sukuk, thereby facilitating Sukuk issuances in Bangladesh. Table 4.3 identifies the tax, VAT, and stamp duty waivers for Sukuk.

Table 4.3: Tax, VAT, and Stamp Duty Waivers for Sukuk

Particulars	**Tax or VAT, any other Duty implications**	
Tax		
Any Sukuk-related transaction between the Originator and the SPV	As per SRO No. 317-Ain /Income Tax/2021	TDS exempted
Issuer/ SPV Income from Sukuk (SPV for only for the purpose of Sukuk approved from Bangladesh Bank or BSEC)	As per SRO No. 317-Ain /Income Tax/2021	Tax exempted
Capital Gain Tax on the transfer of any assets (except immovable assets) between the Originator and the SPV	As per Income Tax Ordinance 1984, 31A & 32A	15%
Tax on transfer of house property, including land	As per Income Tax Ordinance 1984, 53H	Tax exempted
Rental payment on the lease Agreement between the Originator and the SPV	As per Income Tax Ordinance 1984, 53A	5% TDS
VAT		
Asset transfer between the Originator and the SPV	As per SRO No. 294-AIN /2021/165-Mushak	VAT exempted
Rental payment on the lease Agreement between the Originator and the SPV	As per SRO No. 294-AIN /2021/165-Mushak	VAT exempted
Stamp Duty		
On Trust Property after the declaration of Trust	Stamp Act 1989, Schedule I, Section 63	0.10% on the value of the trust

Particulars	Tax or VAT, any other Duty implications	
Tax		
		property, max. BDT 10 lac
Sale of receivables to the SPV for securitization	Stamp Act 1989, Schedule I, Section 61	exempted

Source: *IiBFRBD 2024*

4.4.1 Beximco Green Sukuk Al Istisna'a (1st Corporate Sukuk in Bangladesh)

Corporate Sukuk made its debut in Bangladesh in 2021 with the issuance of Beximco Green Sukuk Al Istisna'a, launched by Beximco (Bangladesh Export Import Company) Ltd. This marked a significant development in the country's financial landscape, as it was the first corporate Sukuk approved by BSEC. This landmark issuance not only broadens investment opportunities but also supports sustainable financing through green projects. The Sukuk is structured as an asset-backed instrument, with ownership of the Sukuk assets effectively transferred to the SPV without legal impediments. It represents an ambitious total issue size of BDT 3,000 crore in a market that lacks a fully developed Sukuk or bond framework.

The proceeds from the Beximco Green Sukuk are allocated to:

- Financing the largest solar power project in Bangladesh, which has an electricity production capacity of 200 MW, aimed at diversifying the energy mix and reducing reliance on fossil fuels.
- Developing an additional solar power project with a capacity of 30 MW, reinforcing the commitment to sustainable energy.
- Refinancing existing obligations and procuring new machinery to enhance operational efficiencies and capabilities within Beximco Ltd.'s textile division, demonstrating a commitment to modernization and sustainable practices.

This Sukuk issuance stands out as the largest private-sector debt security in Bangladesh to date. The rental rate of the Sukuk is calculated as: 9% + {10% x (cash dividend of Beximco declared in the preceding year - base rate)} multiplied by the number of Sukuk held on the record date, thereby directly linking investor returns to the company's performance and profitability. Investors also have the option to convert their Sukuk holdings into publicly listed shares of Beximco Ltd. on an annual basis or receive a final redemption payout at the conclusion of the Sukuk tenor.

In this asset-backed Sukuk, investors are safeguarded not only through ownership of the Sukuk assets but also by the originator's commitment to maintaining a sinking fund of up to 10% of the total issue size. This fund is accumulated in a Trust Account specifically designated for periodic payments and final repayments throughout the Sukuk tenor.

In a strategic move regarding its issuance, 75% of the Sukuk was allocated through a private placement, while only 25% was offered to the public. Each Sukuk unit has a face value of BDT 100 and a minimum subscription requirement of BDT 5,000, making it accessible to a wider range of investors. However, as the first financial instrument of its kind, the Sukuk faced challenges in attracting investor confidence, resulting in an undersubscribed public offering at one stage. Consequently, the BSEC permitted the allocation of these unsubscribed portions through private offers. Several factors contributed to these underwriting challenges, including a widespread lack of awareness about trading in debt securities and a limited understanding of Sukuk specifically. Moreover, the absence of a robust regulatory framework to support Islamic financial instruments in Bangladesh exacerbated these issues. It is important to note, however, that the Sukuk ultimately achieved full subscription from investors through consistent engagement and educational initiatives.

Figure 4.16 shows images of the projects funded by the proceeds from Beximco Green Sukuk Al Istisna'a.

Figure 4.16: Pictures from Beximco Green Sukuk Al Istisna'a Projects

Source: *IiBFRBD 2024*

4.4.2 BBML Sukuk Al Ijarah (2nd Corporate Sukuk in Bangladesh)

The BBML Sukuk Al Ijarah is the second corporate Sukuk issued in Bangladesh, originated by Banga Building Materials Ltd., a member of the PRAN-RFL Group. With an issue size of BDT 300 crore, this Sukuk has a tenor of six years, including a one-year grace period. Its primary aim is to refinance existing bank loans related to current machinery and acquire new machinery for the company's expansion projects. Offered through private placement, it was fully subscribed. Subscription proceeds are managed in the 'BBML Sukuk Project Account' at a Shari'ah-compliant bank in Bangladesh.

The Sukuk was issued in 2023 and features a floating rental rate with a minimum of 8% and a maximum of 11%. This rate is calculated based on the average rates of three-year and above fixed deposits from Islamic Private Commercial Banks, plus 300 basis points. Payments for the Sukuk consist of periodic semi-annual payments made after the grace period, which include rental payments and redemption. The rentals are scheduled for specified months, including months 18, 24, 30, and so on, culminating in the consideration price payable in month 72. Upon fulfilling its obligations to the Sukuk holders, the Sukuk holders will transfer all Sukuk assets back to the originator for dissolution. Figure 4.17 shows images of the projects funded by the proceeds from BBML Sukuk Al Ijarah.

Figure 4.17: Pictures from BBML Sukuk Al Ijarah Projects

Source: *IiBFRBD 2024*

Table 4.4: Synopsis of Two Corporate Sukuk in Bangladesh

Particulars	Beximco Green Sukuk Al Istisna'a	BBML Sukuk Al Ijarah
Issue Size	BDT 3,000 Crore	BDT 300 Crore
Purpose	✓ BDT 1,886 crore for Teesta Solar Ltd.; ✓ BDT 308 crore for Korotoa Solar Ltd. ✓ BDT 806 crore for the Textile Division of Beximco Ltd.	✓ BDT 161 crore for Refinancing of Existing Machineries ✓ BDT 139 crore for Procurement of New Machineries

Particulars	Beximco Green Sukuk Al Istisna'a	BBML Sukuk Al Ijarah
Tenor	05 years	06 years
Grace Period	No Grace period	01 year
Rate of Return to the Investors	Base Rate- 9% Rate of return = [Base Rate+ {10% x (Cash Dividend of Beximco declared in the preceding year – Base Rate)}] x Number of Beximco Green-Sukuk held by a Sukukholder on the Record Date for Period Distribution (x) Face Value of Beximco Green- Sukuk (Tk. 100 each)	Base Rate - 8% & ceiling rate 11% Rate of return = Simple Average of 3 Years and above Fixed Deposit Rate of Islamic PCB+ 300 Basis Points
Conversion option	Conversion option with a multiple of 5%, 10%, 15 & 20% annually. The unexercised option may be exercised with the next year's option. Conversion Rate- 25% less than the weighted average market price of ordinary shares of Beximco in the Dhaka Stock Exchange of twenty (20) trading days prior to the Record Date for Conversion.	Non-Convertible
Default Mechanism	▪ Insurance or Takaful for respective machineries of respective projects in case of a Total Loss Event ▪ 10% Sinking Fund of the Issue Size ▪ Machinery of Solar Projects and machinery of textile division assets transferred to the Trustee ▪ Assignment Agreement with the SPV of future receivables of Solar Projects ▪ Corporate Guarantee from the Originator	▪ Insurance or Takaful for Sukuk Assets in case of Total Loss Event ▪ Sukuk Assets of BDT 300 crore transferred to the SPV ▪ Corporate Guarantee of Durable Plastics Ltd., a sister Concern of PRAN-RFL Group ▪ Personal Guarantee from the Directors of Originator
Security	▪ Teesta Solar Project New Machineries- BDT 1,886 crore ▪ Korotoa Solar Project New Machineries- BDT 308 crore ▪ Textile Machinery of Beximco Ltd.- 806 cr.	▪ Existing Machinery- BDT 161 crore ▪ New Machinery- BDT 139 crore
Mode of offer	Private Placement- 50% of Sukuk Issue with BDT 1,500 crore;	Private Offer- 300 crore

Particulars	Beximco Green Sukuk Al Istisna'a	BBML Sukuk Al Ijarah
	Existing Shareholders- 25% of Sukuk Issuance with BDT 750 crore Public Offer- 25% of Sukuk Issuance with BDT 750 crore	
Listing Platform	Main Platform of DSE & CSE	Shall be listed in the Alternative Trading Board
Subscription Status	Fully Subscribed. ▪ Private Offer- 24.40 billion ▪ General Public- 4.23 billion ▪ Underwriter- 1.35 billion ▪ Existing Shareholders- 0.02 billion	Fully subscribed by 11 Banks with one corporate in two tranches
Issuance Date	December 22, 2021	✓ 1st Tranche Issuance Date: July 31, 2023 ✓ 2nd Tranche Issuance Date: Aug. 29, 2023
Fund utilization status	Fully Utilized	Fully Utilized
Project Completion Status	▪ Solar Panel & Other equipment Purchase completed both for Teesta Solar Ltd. & Korotoa Solar Ltd. ▪ Teesta Solar Ltd. COD- January 8, 2023 ▪ Korotoa Solar Ltd. COD- November 2024 ▪ Refinancing of Textile Division Machineries- Completed	▪ Procurement of new machinery completed ▪ Refinancing of existing machinery completed
Sukuk Outstanding status	BDT 2800 crore as BDT 200 crore have been converted into ordinary shares of Beximco Ltd.	BDT 300 crore, as payment will start in February 2025 of 1st tranche and in march 2025 of 2nd tranche after the end of grace period of Sukuk.

Source: *IiBFRBD 2024*

5. Issues and Recommendations

5.1 Sukuk Issuance by Islamic Banks

A major regulatory inconsistency exists regarding the issuance of Additional Tier 1 (AT1) and Tier 2 (T2) Sukuk instruments. While the Bangladesh Securities and Exchange Commission (BSEC) mandates the use of Special Purpose Vehicles (SPVs) for Sukuk issuance, the Bangladesh Bank does not permit AT1 and T2 capital instruments to be issued through SPVs. This contradiction creates a significant barrier for Islamic banks intending to issue regulatory capital-compliant Sukuk. A coordinated approach among regulatory bodies is essential to harmonize these frameworks and facilitate Sukuk issuance within a Shariah-compliant and prudentially sound structure.

5.2 Mobilization of Long-Term Funds by Islamic Banks through the Capital Market

Islamic banks generally issue bonds to meet capital adequacy requirements set by the central bank. However, in practice, these bonds are often purchased by other banks, creating a circular flow of funds without attracting genuine long-term investors. Furthermore, due to the underperformance of development finance institutions, banks are required to finance both short- and long-term needs of clients. This leads to maturity mismatches, as the majority of their deposits are short-term in nature. To mitigate this risk and diversify funding sources, Islamic banks should consider raising long-term funds from the capital market by attracting institutional and retail investors beyond the banking sector.

5.3 Regular Publication of Shariah-Compliant Securities Lists (DSES and CSES)

Both the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) have introduced separate Shariah indices. However, the screening and publication process for Shariah-compliant securities lacks consistency. It is recommended that a dedicated team of Shariah and financial experts be established to carry out rigorous and periodic Shariah screening of listed securities. Moreover, the updated list of Shariah-compliant stocks under the DSE Shariah Index (DSES) and CSE Shariah Index (CSES) should be published regularly to guide and encourage ethical investment by Shariah-conscious investors.

5.4 Trading of BGIS on the Organized Securities Market

While efforts are underway to facilitate the trading of conventional government securities on the Organized Securities Market Platform, similar initiatives for

Bangladesh Government Investment Sukuk (BGIS) have not yet materialized. The inclusion of BGIS on organized trading platforms would enhance market liquidity, price discovery, and investor participation. The relevant authorities should prioritize this process to strengthen the secondary market for Islamic government securities.

5.5 Limited Availability of Shariah-Compliant Instruments

The Islamic Capital Market (ICM) in Bangladesh currently suffers from a scarcity of diversified Shariah-compliant instruments. To deepen the market, regulators and market participants should work together to develop Shariah-compliant alternatives to popular instruments such as zero-coupon bonds and preferred shares. Additionally, efforts should be made to promote more corporate Sukuk, short-term BGIS, and Islamic asset-backed securities to cater to a wide range of investment and financing needs.

5.6 Low Awareness Among General Investors

Public understanding of Islamic capital market instruments remains low, due in part to limited financial literacy and general unawareness of Shariah-compliant investment options. To address this, awareness campaigns, educational programs, and investor training initiatives should be undertaken by the government, regulatory authorities, and financial institutions. Corporate entities also have a role to play in educating their clients and employees about ethical and Shariah-compliant investment practices.

5.7 Governance and Regulatory Oversight

Concerns over weak governance and regulatory enforcement have eroded investor confidence in the market. Cases of financial mismanagement, fraud, and unethical behavior have surfaced in both public and private institutions. To restore trust and foster a resilient Islamic capital market, it is imperative to ensure strong governance structures, enhanced transparency, and effective regulatory monitoring at both the institutional and national levels.

A robust Islamic finance ecosystem relies on the effective integration of its key components, especially Islamic banking and ICM. The ICM plays a vital role in offering Shariah-compliant financing and investment options that support the growth of Islamic banks. However, in Bangladesh, the ICM remains underdeveloped due to limited instruments, weak integration with Islamic banks, and low awareness. To unlock its full potential, coordinated efforts are needed from the Ministry of Finance, Bangladesh Bank, BSEC, and other stakeholders. Priority should be given to expanding Shariah-compliant products, strengthening regulatory support, and promoting awareness through training and capacity-building initiatives.

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Appendix 1: Eligibility Criteria of AT-I and T-II Instruments

General Eligibility Criteria to Qualify as Regulatory Capital:

1. The instruments should be issued by the bank (i.e., not by any 'SPV' set up by the bank for this purpose) and must be fully paid up.
2. The amount of the instrument to be raised may be determined by the Board of Directors of the bank.
3. The rate of dividend payable to investors may either be a fixed rate or a floating rate referenced to a market-determined Taka interest benchmark rate.
4. The instrument shall not be issued with a 'put option.' However, banks may issue the instruments with a call option on a specific date, subject to the following conditions:
    a. The call option on the instrument is permissible after it has been active for at least ten years;
    b. To exercise a call option, a bank must receive prior approval from the Banking Regulation and Policy Department (BRPD) of Bangladesh Bank;
    c. A bank must not create any expectation that the call will be exercised, and
    d. Banks must not exercise a call unless: (i) they replace the called instrument with capital of the same or better quality, and the replacement of this capital is done under conditions sustainable for the bank's income capacity; or (ii) the bank demonstrates that its capital position is well above the minimum capital requirements after exercising the call option.

    The use of tax event and regulatory event calls may be permitted. However, exercising these calls is subject to the requirements set out in points (b) to (d). Bangladesh Bank will permit the bank to exercise the call only if it is convinced that the bank could not have anticipated these events at the time of issuance of the instrument.

5. The coupon or dividend payment policy must be clearly articulated in the debt indenture to avoid any conflict of interest between ordinary shareholders and the holders of the instrument.
6. The instrument cannot have a credit-sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the bank's credit standing. For this purpose, any reference rate, including a broad index sensitive to changes in the bank's creditworthiness and/or the creditworthiness of the wider banking sector, will be treated as a credit-sensitive reference rate. Banks wishing to offer a floating reference rate may seek prior approval from the BRPD regarding the permissibility of such rates.
7. In the event of the liquidation or winding up of the issuer's business, the claims of investors in this instrument shall be (i) superior to the claims of investors in equity shares, (ii) subordinated to the claims of depositors, and general creditors

of the bank; and (iii) neither secured nor covered by a guarantee of the issuer, a related entity, or any arrangement that legally or economically enhances the seniority of the claim relative to bank creditors.

8. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet assessment is required to prove insolvency under any law or otherwise.
9. Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant accounting standards) should purchase the instrument, nor can the bank directly or indirectly fund the purchase. The same restriction applies to the employees' retirement benefit funds of the issuing bank. Banks should also not grant advances against the security of the instrument issued by them.
10. The instrument cannot have any features that hinder recapitalization, such as provisions requiring the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.
11. Banks should comply with the terms and conditions, if any, stipulated by BSEC or other regulatory authorities regarding the issuance of the instruments.

Specific Eligibility Criteria to Qualify as Additional Tier 1 Capital

a. Maturity Period

The instrument shall be perpetual, i.e., there is no maturity date, and there are no step-ups or other incentives to redeem.

b. Repurchase / Buyback / Redemption

i. The principal of the instruments may be repaid (e.g., through repurchase or redemption) only with prior approval of Bangladesh Bank, and banks should not assume or create market expectations that supervisory approval will be given. (This repurchase/buy-back/redemption of the principal is in a situation other than in the event of the exercise of a call option by the bank. One of the major differences is that, in the case of the former, the option to offer the instrument for repayment upon announcement of the decision to repurchase/buy-back/redeem the instrument would lie with the investors, whereas, in the case of the latter, it lies with the bank.)

ii. Banks may repurchase/buy-back/redeem the instruments only if:
   a) They replace such instruments with capital of the same or better quality, and the replacement of this capital is done under conditions that are sustainable for the income capacity of the bank or
   b) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase/buy-back/redemption.

c. Dividend Discretion

i. The bank must have full discretion at all times to cancel distributions/payments;

ii. Cancellation of discretionary payments must not be an event of default;

iii. Banks must have full access to canceled payments to meet obligations as they fall due;

iv. Cancellation of distributions/payments must not impose restrictions on the bank except in relation to distributions to common stakeholders;

v. Dividends must be paid out of distributable items;

vi. The dividend shall not be cumulative, i.e., dividends missed in a year will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum. When a dividend is paid at a rate lesser than the prescribed rate, the unpaid amount will not be paid in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

vii. The instrument cannot have a credit-sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the bank's credit standing. For this purpose, any reference rate, including a broad index that is sensitive to changes in the bank's own creditworthiness and/or to changes in the creditworthiness of the wider banking sector, will be treated as a credit-sensitive reference rate. Banks desirous of offering a floating reference rate may take prior approval from the Bangladesh Bank regarding the permissibility of such reference rates.

viii. In general, it may be in order for banks to have a dividend stopper arrangement that stops dividend payments on common shares in the event the holders of Additional Tier 1 instruments are not paid a dividend/coupon. However, dividend stoppers must not impede the full discretion that the bank must have at all times to cancel distributions/payments on the Additional Tier 1 instrument, nor must they act in a way that could hinder the recapitalization of the bank. For example, it would not be permitted for a stopper on an Additional Tier 1 instrument to:

- attempt to stop payment on another instrument where the payments on this other instrument were not also fully discretionary;
- prevent distributions to shareholders for a period that extends beyond the point in time that dividends/coupons on the Additional Tier 1 instrument are resumed;
- impede the normal operation of the bank or any restructuring activity (including acquisitions/disposals). A stopper may act to prohibit actions that are equivalent to the payment of a dividend, such as the bank undertaking discretionary share buybacks, if otherwise permitted.

d. Loss Absorption Features

The instrument should have principal loss absorption through either (i) conversion to common shares at an objective pre-specified trigger point or (ii) a write-down mechanism that allocates losses to the instrument at a pre-specified trigger point. The write-down will have the following effects:

a) Reduce the claim of the instrument in liquidation;
b) Reduce the amount repaid when a call is exercised and
c) Partially or fully reduce dividend payments on the instrument.

e. Limits

While complying with a minimum Tier 1 of 6% of risk-weighted assets, a bank cannot admit Perpetual Non-Cumulative Preference Shares (PNCPS) together with Perpetual Debt Instruments (PDI) in Additional Tier 1 Capital, more than 1.5% of risk-weighted assets. However, once this minimum total Tier 1 capital has been complied with, any additional PNCPS and PDI issued by the bank can be included in the Total Tier 1 capital reported. Excess PNCPS and PDI can be reckoned to comply with Tier 2 capital if the latter is less than 4% of RWAs.

Specific Eligibility Criteria for Subordinated Debt to Qualify as Tier 2 Capital

1. Introduction

The scheduled banks in Bangladesh may issue subordinated debt to qualify as regulatory capital (Tier 2 or Tier 3) subject to the prior approval of Bangladesh Bank.

2. Definition

- **Debt:** Debt will be defined as 'the selling or issuing of debt securities by a banking company through public issue or private placement, or a combination of both, to collect funds on a long-term basis. A debt will generally be a fixed interest-bearing debt instrument, implying that the issuer or borrower will pay the interest on predetermined time schedules, but the principal will be repaid at maturity. The amount that will be repaid at maturity is called the bond's face value or par value. The number of years until the face value is paid will be called the bond's time to maturity. The debt can also be a 'zero-coupon debt,' which will be issued at a discount and redeemed at par value or face value.
- **Subordinated debt:** Subordinated debt refers to the debt instruments that are subordinated to deposits and other liabilities of the bank. It implies that the claims of the subordinated debt holders will be junior to the claims of the depositors and other creditors.
- **Convertible subordinated debt:** Convertible bonds will be bonds that have a conversion provision. The conversion provision will give the holder the option to exchange part or full of the bond for a number of ordinary shares of the issuing company according to the conversion ratio after a certain period. When first issued, they act just like regular subordinated debt with the promise to pay their obligations to their holders.

3. Qualifying criteria as regulatory capital

The subordinated debts must meet the following eligibility criteria of hybrid capital instruments to qualify as the Tier 2 Capital component:

a. Basic criteria:

i. The debt will be unsecured and fully paid up;

ii. The CAMELS rating of the banks should be at least '2'; the Issue/Debt/Instrument rating and Issuer's entity rating will be at least '3';

iii. The debt may be convertible into ordinary shares in part or full according to the conversion ratio, subject to the prior approval of Bangladesh Bank;

iv. It will be ineligible as collateral for a loan made by the issuing bank;

v. This instrument will not be insured by the deposit insurance scheme.

b. Permanence:

i. The debt must have a maturity of at least 5 (five) years;

ii. The amount of subordinated debt in the regulatory capital will have to be reduced (amortized) in the last five (5) years of the bond's life by 20% (twenty percent) from the amount of the instrument at the beginning of each of the last five (5) years of the instrument's life;

iii. In the last year of the instrument's life, the amount of subordinated debt will not be included in the bank's regulatory capital (Tier 2 or Tier 3);

iv. Once any scheduled payments of principal begin, all payments shall be made at least annually, and the amount repaid each year shall be no less than in the prior year;

v. The approved redemption plan cannot be altered without the prior approval of Bangladesh Bank.

c. Ranking among the claimants:

i. The interest and dividend payment policy must be well articulated in the debt indenture in such a manner that there will be no scope to arise any conflict of interest between or among the ordinary shareholders and the subordinated debt holders;

ii. In the event of the liquidation or winding up of the issuer's business and distribution of return on investment, the bondholders will be ranked after claims of the depositors and other creditors, i.e., it will be ranked immediately ahead of ordinary shareholders;

d. Quantitative limits:

i. Eligibility limit: The total amount of subordinated debt that a bank may consider as Tier 2 capital will be limited to a maximum of 30% of the amount of Tier 1 capital. The total amount of Tier 2 capital (supplementary capital) elements will be limited to a maximum of 100% of the total amount of Tier 1 capital (core capital);

ii. Coupon/Interest Rate: Coupon/Interest rate and yield of the debt will be well matched/compatible with the prevailing market conditions;

iii. Bangladesh Bank may set any other quantitative limits deemed necessary applicable to the convertible bonds.

In addition to Tier 2 capital, certain subordinated debt may qualify as Tier 3 capital. Tier 3 capital will be limited to 250% of a bank's Tier 1 capital that is available after meeting credit risk capital requirements to support market risk. This means that a minimum of about 28.5% of market risk must be supported by Tier 1 capital. To be considered as Tier 3 capital, the subordinated debt must:

- be unsecured and fully paid up;
- have an original maturity of at least 2 (two) years;
- not be redeemable before maturity without prior Bangladesh Bank approval;
- include a lock-in clause that precludes payment of either interest or principal (even at maturity) if the payment would cause the issuing bank's risk-based capital ratio to fall or remain below the minimum as required under Risk-Based Capital Adequacy for banks (RBCA);
- neither contain nor be covered by any covenant, terms, or restrictions that are inconsistent with safe and sound banking practices.

Source: Bangladesh Bank

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