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Islamic Banking Operations in Bangladesh

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Islamic Banking Operations in Bangladesh

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Forewords

Islamic Banking in Bangladesh has made significant strides since its inception, providing Shari'ah-compliant financial services and contributing to the overall financial stability and inclusion in our country. This growth underscores the increasing demand for ethical and socially responsible banking practices. The Bangladesh Institute of Bank Management (BIBM) has been at the forefront of supporting and developing the Islamic banking sector through research, training, and capacity-building initiatives.

This Review Workshop Paper, titled "Islamic Banking Operations in Bangladesh," presents an in-depth analysis of the activities and operations of Islamic banking during 2021-2023. The research team, comprising dedicated professionals from BIBM and bank, has engaged extensively with Shari'ah experts, industry leaders, and practitioners to identify the success factors and challenges faced by the sector. The preliminary findings were discussed in a workshop held on July 16, 2024, where valuable feedback from esteemed panelists, banking professionals, and academics was incorporated to refine this study.

I am pleased to present this comprehensive research to policymakers, practitioners, academics, and the general public. It is our hope that this report will serve as a critical resource for understanding the current landscape of Islamic banking in Bangladesh and inspire necessary initiatives for further development and improvement in this vital sector.

Md. Akhtaruzzaman, Ph.D.

Director General, BIBM

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Executive Summary

Islamic banking in Bangladesh has experienced significant growth, driven by adherence to Shari'ah principles, which prohibit interest (Riba), excessive uncertainty (Gharar), and gambling (Maysir), while promoting ethical and socially responsible financial practices. This sector not only provides a viable alternative to conventional banking but also contributes to financial stability and inclusion, particularly post-global financial crisis. In a predominantly Muslim country like Bangladesh, there is substantial demand for Shari'ah-compliant financial services, offering an ethical alternative to conventional banking and aiding in poverty alleviation and entrepreneurship development, especially among SMEs.

The study aimed to review the activities and operations of Islamic banking in Bangladesh for the during 2023 and compare that with 2021. The specific objectives were to discuss the regulatory environment, analyze services and operations, identify success factors and challenges, and recommend future actions. Both primary and secondary data were used, with primary data collected through questionnaires and interviews, and secondary data sourced from reputable journals, reports, and publications. The report is structured into five sections: introduction, conceptual aspects, regulatory environment, review and analysis, and issues and recommendations.

Islamic banking in Bangladesh has grown significantly since its inception in 1983, now capturing more than 25 percent of the financial services industry. This sector includes full-fledged Islamic banks, Islamic windows, and branches of conventional banks, along with non-bank financial institutions offering Islamic services. The regulatory framework for Islamic banking and finance in Bangladesh is guided by the Banking Companies Act 1991, the Companies Act 1994, and various guidelines issued by Bangladesh Bank. However, this framework lacks specific legislation for Islamic finance, highlighting the need for more comprehensive and tailored regulations.

Islamic banks in Bangladesh have demonstrated superior financial performance, with higher returns on assets and equity compared to the overall banking sector. Their contribution to financial inclusion is notable, providing access to financial services for unbanked and underbanked populations. However, the sector faces several challenges, including the recent negative media reports that have affected its reputation. To restore the positive image of the Islamic banking sector, initiatives such as publishing positive and transparent reports, organizing more seminars, and

engaging in public lectures are necessary. Providing intellectual and satisfactory responses to issues raised will help rebuild trust and confidence in the industry.

Governance and transparency need significant improvement. Key components of good governance, such as external Shari'ah audits, are currently lacking. Ensuring the active involvement of the Shari'ah Supervisory Committee (SSC), including systematic evaluations and continuous professional development for its members, is essential. The publication of Fatwas issued by the SSC and regular interactions between the Board of Directors and SSC members will facilitate better understanding and cooperation, promoting transparency and trust among stakeholders.

The banking sector in Bangladesh adheres to International Financial Reporting Standards (IFRS). However, certain Islamic banking products and services, along with their underlying principles, do not align seamlessly with conventional accounting practices. Recognizing the unique aspects of Islamic banking and finance (IBF), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has developed a set of standards tailored specifically for this sector. Establishing a committee to evaluate the potential benefits and challenges of adopting AAOIFI standards alongside IFRS will bridge the gap between conventional and Islamic accounting practices, enhancing transparency, consistency, and reliability of financial reporting in the Islamic banking sector.

Internal and external audits are crucial for ensuring transparency and compliance within any financial institution. For Islamic Financial Institutions (IFIs), Shari'ah audits verify that operations comply with Islamic law. Most IBs in Bangladesh have established internal Shari'ah audit mechanisms, but there is a need to focus on their operational independence and efficiency. Strengthening the independence and functional integrity of internal Shari'ah audits will enhance their role in maintaining the ethical and religious standards of Islamic banking and finance. Despite progress in internal auditing, external Shari'ah audits are yet to be comprehensively implemented in Bangladesh. Establishing external Shari'ah audits will provide an additional layer of assurance to stakeholders, enhancing the credibility and integrity of Islamic financial institutions.

The substance and form of financial operations in Islamic Banking and Finance (IBF) must adhere to Shari'ah principles. Regular reviews and updates of documents, contract forms, and advertising materials by competent Shari'ah scholars ensure that every aspect of the operation aligns with Islamic principles.

Periodic reviews by an independent third party will maintain the integrity of Islamic banking operations and foster trust among customers and stakeholders. Ensuring both traditional banking practices and adherence to Shari'ah principles is crucial in IBF. Professionals in Islamic Financial Institutions (IFIs) must possess comprehensive knowledge of operational practices and Shari'ah compliance to excel in their roles. Recognizing the value of specialized knowledge and professional credentials during hiring and promotion processes will ensure that employees are well-equipped and motivated to pursue relevant qualifications, contributing to the overall growth and credibility of the industry.

Updating the “Guidelines for Islamic Banking 2009” and the “Guidelines on Internal Control & Compliance in Banks 2016” to reflect the evolving financial landscape, new financial products, technological advancements, and changing regulatory standards is crucial. Establishing a dedicated Islamic banking department within the central bank and forming a Central Shari'ah Board (CSB) will provide unified guidance, resolve disputes, and support individual institution-level boards. Implementing a standardized Shari'ah governance framework across all Islamic financial institutions (IFIs), in line with the latest IFSB-AAOIFI Revised Shari'ah Governance Framework (RSGF), will ensure consistency and uphold Shari'ah principles effectively.

Risk management systems should be tailored to align with the nature of the entity, its operations, products, services, and activities. Developing comprehensive risk management frameworks tailored to the unique risks faced by Islamic banks and conducting regular stress tests are essential for enhancing the stability of Islamic banking and finance. Adopting a preventive approach to risk management will help the industry address emerging challenges proactively.

Currently, most components of Islamic finance are present in Bangladesh, including Islamic banking, Sukuk, AuM, Takaful, crowdfunding, and other social finance. Establishing a platform to consolidate all data related to Islamic banking and finance in Bangladesh, providing regular updates for stakeholders, is essential. Recent international reports have highlighted Bangladesh's progress in Islamic finance. Proper reporting and representation of Bangladesh in the international domain will showcase the country's contributions and advancements in Islamic finance.

List of Abbreviation

AAIB	: Al-Arafah Islami Bank PLC
AAOIFI	: Accounting and Auditing Organization for Islamic Financial Institutions
ACB	: Audit Committee of the Board
AT1	: Additional Tier 1
AT2	: Additional Tier 2
AuM	: Assets under Management
BB	: Bangladesh Bank
BCBS	: Basel Committee on Banking Supervision
BDT	: Bangladesh Taka
BGIIB	: Bangladesh Government Islamic Investment Bond
BGIS	: Bangladesh Government Investment Sukuk
BIBM	: Bangladesh Institute of Bank Management
BoD	: Board of Directors
BRPD	: Banking Regulation and Policy Department
BSEC	: Bangladesh Securities and Exchange Commission
CA	: Current Account
CEO	: Chief Executive Office
CIBFI	: General Council for Islamic Banks and Financial Institutions
CIBFP	: Certified Islamic Banking and Finance Professional
CIPA	: Certified Islamic Professional Accountant
CPD	: Continuous Professional Development
CRAR	: Capital to Risk-Weighted Assets Ratio
CRR	: Cash Reserve Requirement
SLR	: Statutory Liquidity Reserve
CSAA	: Certified Shari'ah Adviser and Auditor
CSB	: Central Shari'ah Board
CSB	: Central Shari'ah Board
CSBIB	: Central Shariah Board for Islamic Banks of Bangladesh
CSCIIB	: Central Shari'ah Committee for Islamic Insurance of Bangladesh
CSE	: Chittagong Stock Exchange
DFIM	: Department of Financial Institutions and Markets
DIB	: Diploma in Islamic Banking
DMD	: Debt Management Department
DSE	: Dhaka Stock Exchange
EC	: Executive Committee
EXIM	: Export Import Bank of Bangladesh PLC
FGD	: Focus group Discussions
FID	: Financial Inclusion Department
FSIB	: First Security Islami Bank PLC
GCC	: Gulf Cooperation Council
GIB	: Global Islami Bank PLC

GIFR	: Global Islamic Finance Report
HPSM	: Hire Purchase under Shirkatul Melk
IB	: Islamic Bank
IBB PLC	: Islami Bank Bangladesh PLC
IBB	: Islami Bank Bangladesh PLC
IBBL	: Islami Bank Bangladesh Limited
IBF	: Islamic Banking and Finance
IBLF	: Islami Bank Liquidity Fund
ICB	: ICB Islamic Bank Limited
IFCI	: Islamic Finance Country Index
IFDI	: Islamic Finance Development Indicator
IFI	: Islamic Financial Institutions
IFRS	: International Financial Reporting Standards
IFSB	: Islamic Financial Services Board
IIFA	: International Islamic Fiqh Academy
IIFM	: International Islamic Financial Market
IILM	: International Islamic Liquidity Management Corporation
IIRA	: Islamic International Rating Agency
ISBS	: Islamic Shari'ah-based Securities
KSA	: Kingdom of Saudi Arabia
MANCOM	: Management Committee
MD	: Managing Director
MENA	: Middle East and North Africa
MFI	: Micro-Finance Institutions
MLS	: Mudaraba Liquidity Support
NBFI	: Non-Bank Financial Institutions
NPF	: Non-Performing Financing
OIC	: Organization of Islamic cooperation
IsDB	: Islamic Development Bank
OIFI	: Other Islamic financial institutions
PLC	: Public Limited Company
PPG	: Product-Program Guidelines
RMC	: Risk Management Committee
ROA	: Return on Assets
ROE	: Return on Equity
RSGF	: Revised Shari'ah Governance Framework
SFD	: Financial Stability Department
SIB	: Social Islami Bank PLC
SJIB	: Shahjalal Islami Bank PLC
SM	: Sallallahu Alaihi wa Sallam
SME	: Small and Medium-sized Enterprises
SMT	: Senior Management Team
SNCR	: Shari'ah Non-Compliance Risk

SND	: Special Notice Deosit
SSB	: Shari'ah Supervisory Board
SSC	: Shari'ah Supervisory Committee
SWT	: Subhanahu wa Ta'ala
TA	: Total Assets
UAE	: United Arab Emirates
UK	: United Kingdom
USA	: United States of America
USD	: United States Dollar
VAT	: Value Added Tax

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Islamic Banking Operations in Bangladesh

1. Background of the Study

Islamic banking and finance is experiencing robust growth globally, including in Bangladesh. The foundation of Islamic banking lies in its adherence to Shari'ah principles, which prohibit interest (Riba), excessive uncertainty (Gharar), and gambling (Maysir), and promote ethical and socially responsible financial practices (Iqbal & Molyneux, 2005; Molyneux & Iqbal, 2005). Recent studies have shown that Islamic banking is not only a viable alternative to conventional banking but also contributes to financial stability and inclusion (Asutay & Yilmaz, 2021).

Islamic banking has gained significant attention from researchers, policymakers, and consumers, especially in the aftermath of the global financial crisis. It offers a stable and ethical framework for financial intermediation, contributing to better resource utilization and economic growth (Ahmed, 2010; Berger et al., 2006). The banking sector in Bangladesh is no exception, where Islamic banking is becoming increasingly important due to the country's Muslim-majority population and growing demand for Shari'ah-compliant financial services (Hossain & Khan, 2021). Islamic banking promotes financial inclusion by offering alternatives to conventional interest-based products, thus catering to the needs of those who avoid conventional banking for religious reasons (Rashwan, 2010; Khan et al., 2017). This inclusivity is particularly significant in Bangladesh, where a large portion of the population remains unbanked or underbanked. Islamic banks provide access to financial services for these segments, helping to integrate them into the formal financial system (Obaidullah & Khan, 2008).

Additionally, Islamic banks play a crucial role in poverty alleviation and entrepreneurship development, particularly among small and medium-sized enterprises (SMEs) (Farooq & Ahmed, 2013). By offering financing products such as Mudarabah (profit-sharing) and Musharakah (joint venture), Islamic banks support entrepreneurial ventures and foster economic development. These financing modes encourage risk-sharing and partnership, aligning the interests of both the bank and the borrower, and thus promoting sustainable business practices (Siddiqui, 2001).

Furthermore, Islamic banking contributes to the stability of the financial system. By avoiding speculative activities and ensuring that all financial transactions are backed by tangible assets, Islamic banks minimize the risks associated with financial bubbles and economic downturns (Chapra, 2008). This asset-backed

nature of Islamic finance enhances the resilience of the banking sector and supports long-term economic stability (El-Gamal, 2006).

In the context of Bangladesh, the importance of Islamic finance cannot be overstated. As a Muslim-majority country, there is a substantial demand for financial services that comply with Islamic principles. The banking sector in Bangladesh has seen a significant shift towards Islamic banking, with several major banks offering Shari'ah-compliant products and services. This trend is not only meeting the religious and ethical needs of the population but also contributing to financial inclusion and economic development. Islamic banking in Bangladesh is fostering entrepreneurship, particularly among small and medium-sized enterprises (SMEs), by providing Shari'ah-compliant financial products and avoiding the pitfalls of conventional interest-based lending.

Islamic finance and banking is gradually but definitely demonstrating its potential to capture a major share of the global finance and banking industry. More than 25 percent of the financial services industry is under the purview of Islamic finance and services in Bangladesh. Starting its journey in 1983 with the establishment of Islami Bank Bangladesh PLC, this participatory banking has crossed almost forty-two years in line with conventional banking.

The number of products that are available in the Islamic finance industry may be standardized and extended for effective progressing. Islamic finance scholars are striving to develop better Shari'ah-compliant products with reasonably attractive features to enhance the share of Islamic banking activities. Apart from this, Islamic banking is facing all the main risks faced by conventional banking, in addition to Shari'ah non-compliance risk. In order to mitigate Shari'ah non-compliance risk, a strong and independent Shari'ah audit is absolutely essential for all types of Islamic banks, irrespective of full-fledged or dual banking operations in Bangladesh. Though Bangladesh Bank is working on this issue, the Islamic banking industry spares no time to have it for better operations and excellent performance.

In order to supply well-equipped human resources for the operations of Islamic banks in Bangladesh, BIBM is conducting a certification course titled 'Certified Islamic Banking and Finance Professional' (CIBFP) along with regular training, workshop and seminar. The Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) is also running some professional courses on Islamic banking to provide trained human resources for the Islamic banking industry. Besides, more than 600 Bangladeshis have completed Certified Shari'ah Adviser and Auditor (CSAA) and Certified Islamic Professional Accountant (CIPA) fellowships offered by

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). All these concerted efforts are showing promise for expanding Islamic banking activities in Bangladesh.

For tapping into the huge potential of Islamic banking, proper awareness programs are absolutely essential to be undertaken with new zeal. For the betterment of Islamic banking operations in Bangladesh, it is imperative to have a comprehensive view of the participatory banking activities of Islamic banking in Bangladesh.

The growth of Islamic banking in Bangladesh reflects a broader global trend towards ethical and inclusive finance. As the sector continues to expand, it plays a vital role in promoting financial stability, inclusion, and economic development, aligning with both religious principles and modern financial needs.

1.1 Specific Objectives of the Study

The overall objective of the study is to review the activities and operations of Islamic banking in Bangladesh 2023 as compared to that of 2021. The specific objectives are to:

- i. discuss the regulatory environment related to Islamic banking in both global and local contexts;
- ii. analyze the Islamic banking services, activities, and operations in the globe and Bangladesh;
- iii. identify the success factors and challenges of Islamic banking operations in Bangladesh; and
- iv. recommend future actions for the improvement of Islamic banking and finance operations in Bangladesh.

1.2 Methodology of the Study

To achieve the objectives of this study, both primary and secondary data were utilized. Primary data were collected through a semi-structured questionnaire distributed to relevant banks, with thirty-five banks providing their feedback. Additionally, interviews and focus group discussions (FGDs) with industry experts were conducted to gain deeper insights.

Secondary data were sourced from a variety of reputable sources, including journals, publications, and reports. These include Islamic Financial Services Industry Stability Report of Islamic Financial Services Board (IFSB), Islamic Finance Development Report by LSEG, Global Islamic Finance Report by Cambridge IFA, and Islamic Finance News by REDmoney Group, Global Islamic Bankers' Survey by the General Council for Islamic Banks and Financial

Institutions (CIBAFI), IIFM Sukuk Report by the International Islamic Financial Market (IIFM). Additional information was obtained from the websites of concerned entities. More on that data were collected from the Central Shari'ah Board for Islamic Banks of Bangladesh (CSBIB) and the Central Shari'ah Committee for Islamic Insurance of Bangladesh (CSCIIB).

The study encompasses both full-fledged Islamic banks and conventional banks that offer Islamic banking services. This comprehensive approach ensured that the data collected was robust and provided a thorough understanding of the Islamic banking operations in Bangladesh. The paper has been finalized after accommodating observations and suggestions of the workshop.

1.3 Structure of the Report

The report is meticulously organized into five sections, ensuring a logical flow and comprehensive coverage of the study. Section 1 serves as the introduction, detailing the background, objectives, and methodology employed in the research. This section sets the stage for the subsequent discussions by outlining the scope and purpose of the study. Section 2 delves into the fundamentals of Islamic banking and finance, exploring the conceptual aspects, basic principles and theoretical frameworks that underpin Islamic financial practices. This section provides a thorough understanding of the distinct characteristics that differentiate Islamic banking from conventional banking.

Section 3 examines the regulatory environment of Islamic banking in Bangladesh, highlighting the key policies, regulatory frameworks, and institutions that govern the industry. This analysis is crucial for understanding the compliance and operational dynamics within the sector. Section 4 presents a comprehensive review and analysis of Islamic banking activities, both globally and within Bangladesh. This comparative analysis offers insights into the performance, challenges, and opportunities faced by Islamic banks, providing a broader perspective on their operations. Finally, Section 5 identifies the prevailing issues within the Islamic banking sector and provides strategic recommendations for future improvements. This section aims to address the challenges and suggest actionable steps to enhance the effectiveness and growth of Islamic banking in Bangladesh.

2. Fundamentals of Islamic Banking and Finance

2.1 Conceptual Discussion on Islamic Banking and Finance

Islamic finance and banking represent a rapidly growing segment of the global financial system, based on the principles of Shari'ah. These principles emphasize ethical and socially responsible financial practices, prohibiting activities such as interest (Riba), excessive uncertainty (Gharar), gambling (Maysir) and harm (Dharar). Instead, Islamic finance promotes risk-sharing, asset-backed financing, and investments in permissible (halal) activities. The concept of Islamic finance is not merely a set of prohibitions but offers a comprehensive alternative to conventional finance, focusing on equity, justice, and fairness in financial activities.

2.1.1 Overview of Islamic Finance

Islamic finance refers to a system of financial practices that comply with the principles of Shari'ah, or Islamic law. Islamic finance comprises several key components, including Islamic banking, takaful (Islamic insurance), and Islamic mutual funds. Islamic banking operates on Shari'ah-permissible contracts rather than charging interest. Takaful is a cooperative system of insurance based on mutual assistance, where participants contribute to a pool to cover losses collectively. Islamic mutual funds invest in a diversified portfolio of Shari'ah-compliant assets, providing opportunities for ethical investment while ensuring adherence to Islamic principles.

2.1.2 Historical Background and Development

Islamic finance has its roots in early Islamic civilization, where trade and commerce were conducted based on principles that prohibited exploitation and promoted equitable distribution of wealth. The origin of Islamic banking is linked to the practice of Mudarabah during the era of Prophet Muhammad (SM). For example, "Abbas Ibn Abdul Muttalib used to pay money for Mudarabah and stipulate to the Mudarib that he should not travel by sea, pass by valleys or trade in livestock, and that the Mudarib would be liable for any losses if he did so. These conditions were brought before the Prophet (SM), and he approved them."¹

The modern resurgence of Islamic finance began in the mid-20th century, driven by the desire of Muslims to adhere to their religious principles in financial matters. The first attempt to establish an Islamic financial institution took place in Pakistan in late 1950s with the establishment of a local Islamic bank in a rural area.

¹. Sunan Al-Bayhaqi

Borrowers of the bank did not pay interest on the credit advanced, but a small charge was levied to cover the bank's operational expenses (Banglapedia, 2021). In 1963, the second experiment with Islamic banking was conducted in Egypt with the establishment of the Mit Ghamr Savings Bank by Ahmad El Naggar in a rural area of the Nile Delta. On the basis of success in the experiment more branches were soon opened in different parts of Egypt. The project suffered a setback due to political unrests in the country but was revived in 1971 under the name of Nasser Social Bank, which became the first Islamic bank in the urban areas in Cairo (Banglapedia, 2021).

The first bank explicitly based on Shari'ah principles was established by the Organization of Islamic cooperation (OIC) in 1974, called Islamic Development Bank (IsDB). This bank was primarily engaged in intergovernmental activities for providing funds for development projects running into member countries. Its business model involved fees for financial services and profit-sharing financial assistance for projects.

With time, during the 1970s several Islamic banks came into existence, including the Dubai Islamic Bank (first Islamic private commercial bank, 1975), the Faisal Islamic Bank of Sudan (1977) and the Bahrain Islamic Bank (1979).

In Bangladesh, the relevance and growth of Islamic finance are particularly pronounced. As a predominantly Muslim country, there is a strong cultural and religious inclination towards Shari'ah-compliant financial services. The Islamic banking industry in Bangladesh began with the establishment of Islami Bank Bangladesh Limited (IBBL)² in 1983. Since then, the sector has expanded significantly, with numerous conventional banks also offering Islamic banking windows or branches.

2.2 Principles of Islamic Banking

Islamic banking operates under a distinct framework guided by core principles and prohibitions rooted in Shari'ah law. Below is a brief description of these core principles and prohibitions:

². Now Islami Bank Bangladesh PLC (IBB)

2.2.1 Core Principles

2.2.1.1 Use of Permissible Contracts

The fundamental principle of Islamic finance is the use of permissible contracts based on trade, business, partnerships, and leases. This approach utilizes the earning potential of money through productive activities, unlike conventional finance, which relies on earning money through interest. While conventional finance primarily aims to allocate resources to investments to maximize shareholder value, Islamic finance follows Shari'ah rules. It structures transactions to adhere to Shari'ah principles aiming to balance the interests of individuals and society.

2.2.1.2 Justice, Transparency and Fair Dealing in Financial Transactions

Islamic financial institutions are required to maintain high standards of transparency and fair dealing. This includes clear communication of terms and conditions of contracts, ensuring that the contracting parties fully understand the nature of the financial products they are engaging with. Allah SWT emphasizes the importance of justice and fairness in all dealings in the several places of the Holy Quran. He stated, "Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice. Excellent is that which Allah instructs you. Indeed, Allah is ever Hearing and Seeing."³

2.2.1.3 Investment in Halal (permissible) Activities

Investments in Islamic banking must be made in Halal (permissible) activities. This means avoiding industries and businesses that engage in Haram (forbidden) activities, such as those involving alcohol, pork, gambling, and unethical practices. Islamic banks and financial institutions ensure that their funds are used in ways that are consistent with Islamic ethical standards. It means Islamic financial institutions strive to maximize wealth for all stakeholders through Halal means only.

2.2.1.4 Risk Sharing

Islamic finance, alongside other Shari'ah-permissible modes of finance, emphasizes risk sharing between the lender and the borrower. Instead of traditional loans with fixed interest payments, Islamic banks engage in profit-and-loss sharing contracts. For example, in a Mudarabah agreement, the bank provides capital while the entrepreneur offers expertise, and both share the profits according to a pre-agreed ratio. However, losses are borne by the provider of the capital.

³. Surah An-Nisa (4:58)

2.2.1.5 Asset-Backed Financing

Transactions in Islamic banking must be backed by tangible assets or services. This asset-backing principle ensures that financial activities are based on in real economic activity, which promotes stability and reduces speculative bubbles. For instance, in a Murabaha contract, the bank buys an asset and sells it to the customer at a profit, ensuring the transaction is tied to a real asset. Similarly, in Ijarah (leasing), the bank owns a tangible asset and leases it out, deriving income from real economic activity rather than speculative financial engineering. This approach not only aligns with Shari'ah principles but also contributes to a more resilient financial system by ensuring that money is linked to real-world economic activities.

2.2.1.6 Maqasid Al Shari'ah (Objectives of Shari'ah)

Maqasid Al Shari'ah refers to the overarching goals and objectives of Shari'ah, which aim to promote welfare and prevent harm. In the context of Islamic finance, this principle emphasizes the preservation of faith, life, intellect, progeny, and wealth. By adhering to these objectives, Islamic financial institutions ensure that their practices not only comply with the legalistic aspects of Shari'ah but also align with its broader ethical and social goals. This holistic approach fosters a balanced and just financial system that serves the needs of society as a whole.

2.2.1.7 Social Responsibility Initiatives

The prophet (SM) said, 'O people of trade! Indeed the Shaitan and sin are present in the sale, so mix your sales with charity.'⁴

This teaching underscores the importance of social responsibility in trade and financial dealings. Islamic financial institutions embody this principle by ensuring their activities benefit the community and adhere to the ethical guidelines prescribed by the Holy Quran and Sunnah. They are committed to promoting social welfare, contributing positively to society through various initiatives such as Zakat and Sadaqah, supporting environmental sustainability, and aiding microfinance and small and medium-sized enterprises (SMEs). To ensure that all community members can benefit from Islamic financial services, many institutions also run financial literacy programs that educate people about Islamic finance principles and foster informed, responsible financial behavior.

⁴. Jami` at-Tirmidhi, The Book on Business

2.2.2 Major Prohibitions

Islamic financial institutions adhere to several key prohibitions aimed at ensuring fairness and equity in financial transactions. These prohibitions include:

2.2.2.1 Prohibition of Riba (interest)

One of the fundamental tenets of Islamic finance is the prohibition of Riba, or interest. Charging or paying interest is deemed exploitative and unjust because it guarantees a return without any associated risk or effort, creating an imbalance in financial transactions.

Allah SWT said, “Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, 'Trade is [just] like interest.' But Allah has permitted trade and has forbidden interest...”⁵

"O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger”⁶

Jabir (R.) reported: "The Messenger of Allah (SM) cursed the one who accepts Riba (usury) and the one who pays it, and the one who records it, and the witnesses; and he said: They are all equal.”⁷

2.2.2.2 Prohibition of Gharar (uncertainty)

Shari’ah law forbids excessive uncertainty or ambiguity in contractual terms and conditions, a principle known as Gharar. Hazrat Abu Huraira (R.) said that the Prophet (SM) prohibited the Gharar sale.⁸

This prohibition ensures that all parties involved have clear, precise information about the transaction, fostering fairness and transparency. Contracts must be explicit, with well-defined terms to prevent disputes and avoid any party gaining an unfair advantage. By eliminating Gharar, Islamic finance promotes trust and integrity in financial dealings, reducing the risk of misunderstandings and fraud. Ensuring clarity and transparency in contracts is fundamental to achieving justice and equitable treatment in all financial transactions.

⁵. Surah Al-Baqarah (2:275)

⁶. Surah Al-Baqarah (2: 278)

⁷. Sahih Muslim, Business Transaction

⁸. Jami at Tirmiji, Business Transaction

2.2.2.3 Prohibition of Maysir (gambling)

Maysir, or gambling, is strictly prohibited in Islamic finance due to its reliance on chance and the inherent risk of unjust gain at the expense of others.

The Quran explicitly prohibits gambling. They ask you about wine and gambling. Say, "In them is great sin and [yet, some] benefit for people. But their sin is greater than their benefit..."⁹

This prohibition extends to any form of speculation or investment where the outcome is highly uncertain and dependent on luck.

2.2.2.4 Prohibition of Dharar (harm)

In Islamic finance, the prohibition of Dharar (harm) is a fundamental principle that ensures financial transactions do not cause undue harm or injustice to any party. Allah the Almighty has said,

"O you who have believed, do not consume one another's wealth unjustly or send it [in bribery] to the rulers in order that [they might aid] you [to] consume a portion of the wealth of the people in sin, while you know [it is unlawful]."¹⁰

Islamic financial institutions are required to avoid practices that could lead to exploitation, fraud, or inequitable outcomes. By adhering to these principles, Islamic finance aims to promote transactions that are mutually beneficial and socially responsible. The prohibition of Dharar ensures that the financial system contributes positively to economic stability and social welfare, aligning economic activities with ethical and moral values.

2.2.2.5 Others Prohibitions

In addition to the major prohibitions outlined above, Islamic finance also forbids other unethical practices to ensure fairness and equity in all transactions. These include Jahalah (ignorance), deception, coercion, unfairness, Zulm (injustice), illegal hoarding, and concealment of information. These practices are prohibited because they can lead to exploitation, misunderstanding, and inequitable outcomes. This comprehensive approach aligns economic activities with the ethical and moral values prescribed by Shari'ah law, fostering a more just and equitable financial system.

⁹. Sahih Muslim, Business Transaction

¹⁰. Surah Al Baqarah (2:219)

2.3 Major Islamic Banking Instruments

Islamic banking employs various financial instruments for deposit mobilization and investment operations that comply with Shari'ah principles. These instruments ensure transactions are based on ethical and equitable principles and free of above basic prohibitions. The key Islamic banking and finance instruments are summarized in the following box and figures:

Box 2.1: Key Islamic Banking and Finance Instruments

- **Al Wadiah (Safekeeping):** The bank acts as a custodian, safeguarding the depositor's funds without guaranteeing any returns.
- **Mudarabah (Profit-sharing):** One party provides capital, the other expertise. Profits are shared as agreed, with losses borne by the capital provider unless due to negligence or breach by the entrepreneur.
- **Bai Murabaha (Cost-plus Financing):** This involves the sale of goods at a profit margin agreed upon by both parties.
- **Bai Muajjal (Sale on Credit):** The seller delivers goods to the buyer at an agreed price, which is payable at a later date.
- **Bai Salam (Advance Sale):** This involves advance payment for goods to be delivered later.
- **Bai As Sarf:** This entails the exchange of currencies or monetary instruments.
- **Musharakah (Joint Venture):** This involves equity participation and profit/loss sharing.
- **Ijara (Leasing):** The lessor (owner) leases out an asset to a lessee (user) for an agreed period in exchange for rental payments.

Figure 2.1: Summary of Equity-Based Partnership Contracts

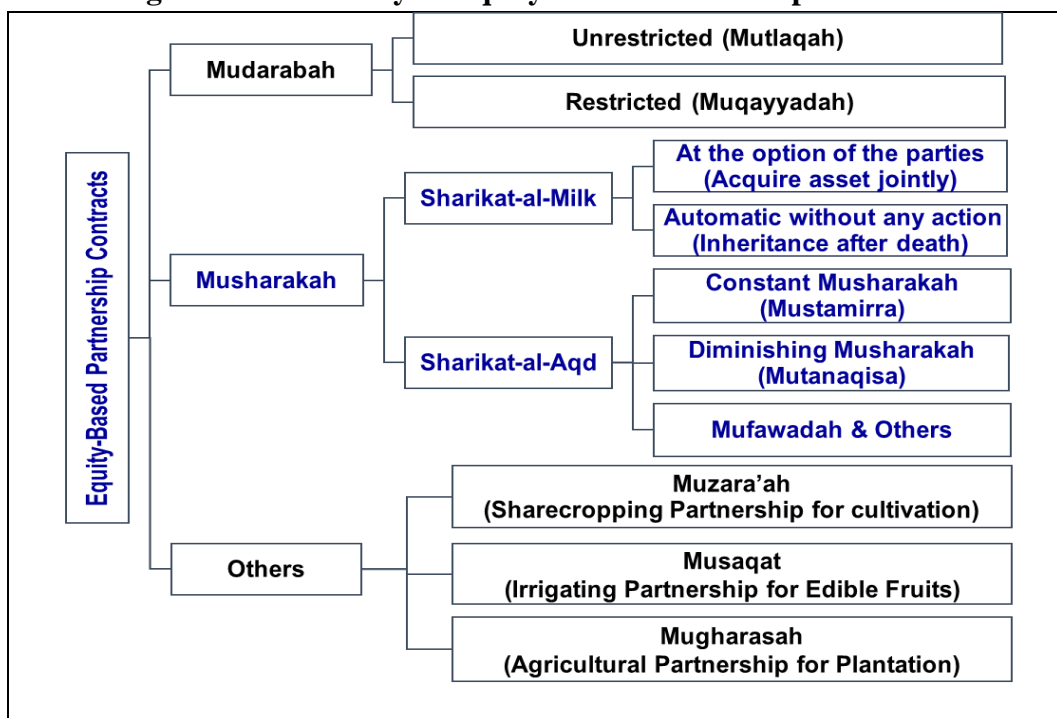


Figure 2.2: Summary of Trading-Based Contracts

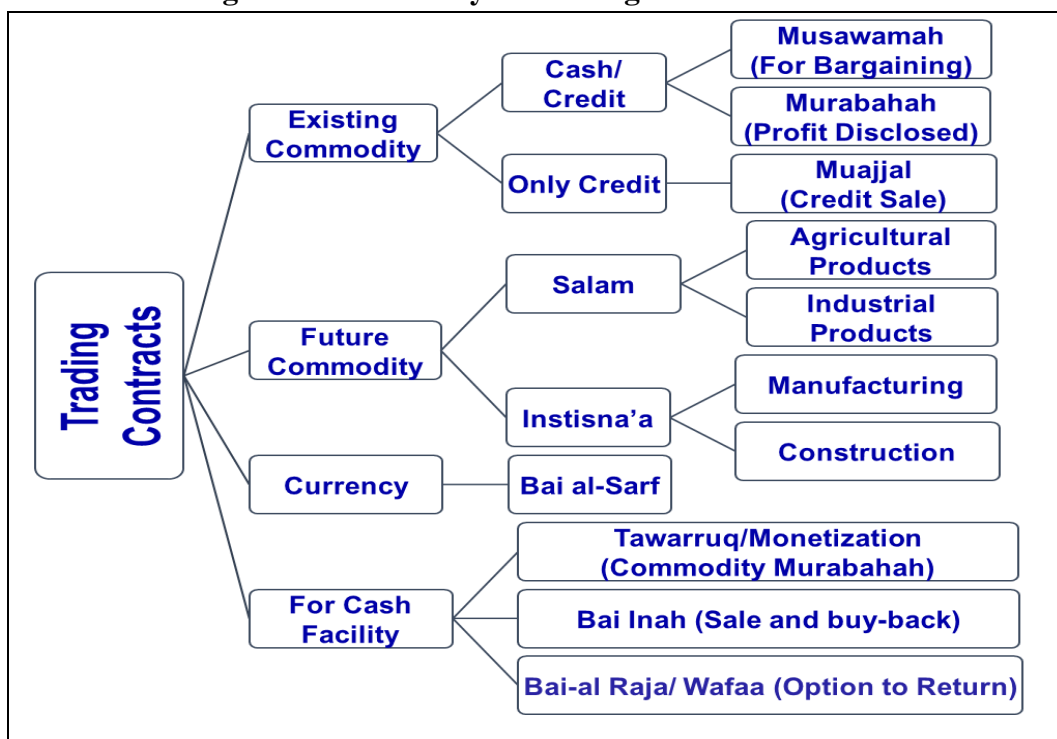
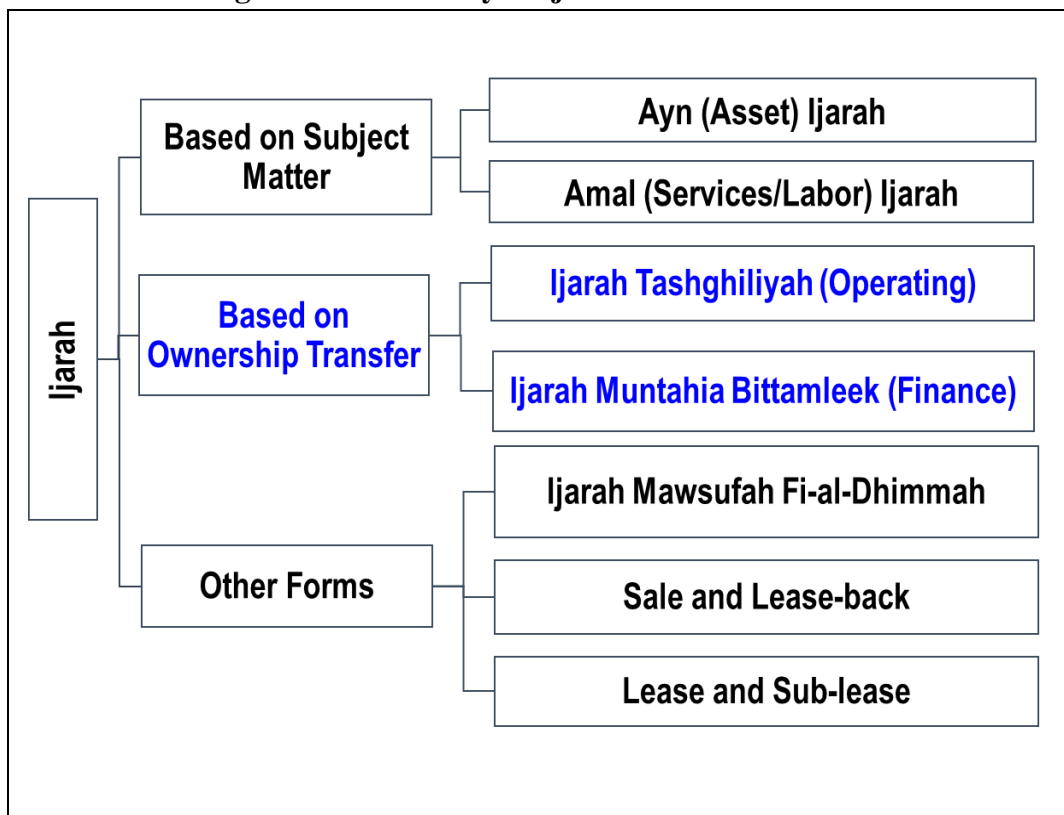


Figure 2.3: Summary of Ijarah-Based Contracts



2.4 Governance in Islamic Banking and Finance

Governance in Islamic finance ensures fair, efficient, and transparent management of financial institutions according to Shari'ah principles. It involves structuring, directing, and controlling organizations to meet strategic goals that satisfy a wide range of stakeholders, including shareholders, creditors, employees, customers, and the community. In Islamic financial institutions (IFIs), stakeholders also include Rab al-Maal (capital providers) and other capital contributors. Effective governance ensures practices and policies do not favor owners or equity-holders unfairly. By promoting equitable distribution of benefits and risks, it protects all parties' interests, upholds ethical standards, and fosters trust, accountability, and sustainability, benefiting the broader economy and society.

Stakeholders expect strict adherence to Shari'ah principles and demand a corporate structure that ensures Shari'ah compliance in all operations. Effective governance in IFIs goes beyond standard practices, requiring a deep understanding of Islamic principles and ethics, along with mechanisms for transparency, accountability, and

fairness. Upholding these principles helps IFIs maintain stakeholder trust and confidence, reinforcing their reputation as ethical and reliable institutions.

2.4.1 Major Components of Governance in Islamic Financial Institutions

Governance in Islamic financial institutions (IFIs) is structured to ensure compliance with Shari'ah principles, maintain ethical standards, and promote transparency and accountability. The primary components include the Shari'ah Supervisory Board (SSB), composed of scholars in Islamic jurisprudence to ensure all financial products and services adhere to Shari'ah principles (Grais & Pellegrini, 2006). The Board of Directors oversees strategic direction and management, ensuring adherence to Shari'ah and financial growth (Chapra & Ahmed, 2002). Senior management implements strategies and policies while ensuring operational efficiency and ethical compliance (IFSB, 2006). Internal Shari'ah audits regularly review activities for compliance, and risk management frameworks identify and manage risks per Shari'ah principles (AAOIFI, 2010; Khan & Bhatti, 2008).

Furthermore, IFIs maintain high levels of transparency and disclosure, essential for fostering trust and accountability among stakeholders (Hassan & Lewis, 2007). They engage with stakeholders, including customers, regulators, shareholders, and the community, to align practices with stakeholder expectations, promoting a positive image and long-term relationships (Grais & Pellegrini, 2006). These governance components collectively ensure that Islamic financial institutions operate with integrity, uphold ethical standards, and comply with Shari'ah principles, contributing to their sustainability and growth.

The governance of Islamic banks encompasses several key components to ensure adherence to Shari'ah principles, transparency, accountability, and ethical conduct. A summary of the Shari'ah governance is depicted in the following box and figure.

Box 2.2: Summary of the Shari'ah Governance Framework

Shari'ah Supervisory Board/Committee (SSB/SSC): The SSB/SSC, comprised of Islamic scholars specializing in fiqhul muamalat (Islamic jurisprudence related to transactions), is responsible for ensuring that all banking activities comply with Shari'ah principles. They review products, services, and transactions of Islamic banks to ensure they are Halal (permissible) and free from Riba (interest) and other prohibited elements.

Board of Directors: The Board of Directors oversees the strategic direction and overall performance of the bank. They are responsible for setting policies, approving major decisions, and appointing senior management, ensuring alignment with Shari'ah principles and ethical standards.

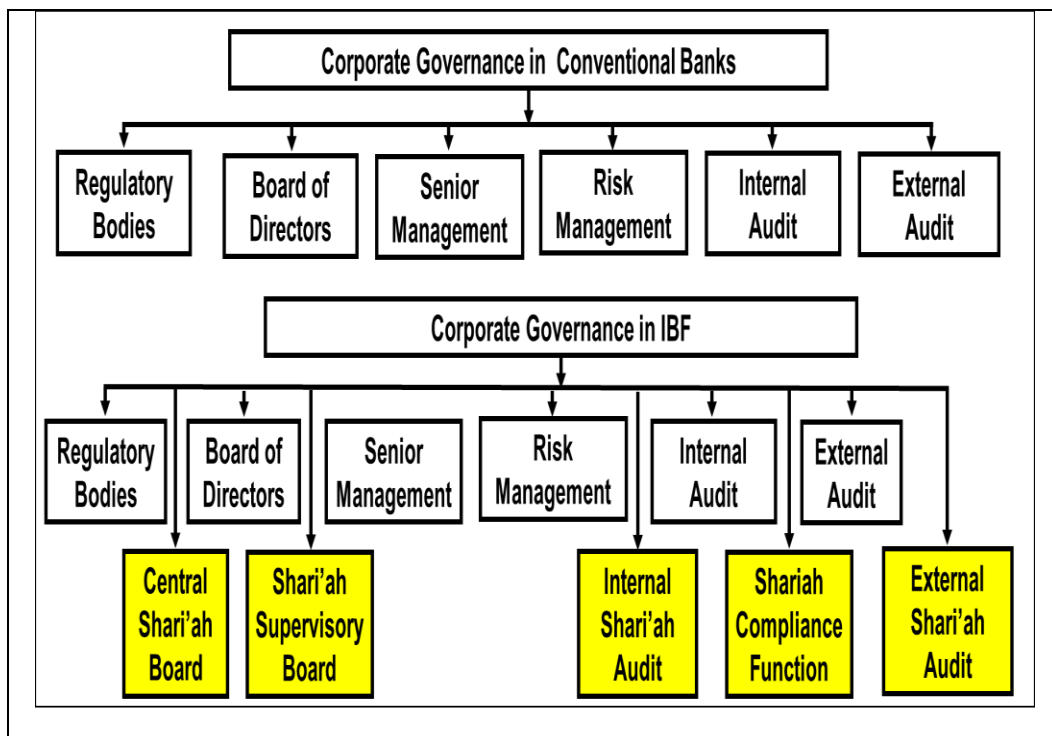
Senior Management: Responsible for the day-to-day operations of the bank, senior management must implement the policies and directives set by the Board of Directors while ensuring compliance with Shari'ah principles. They play a crucial role in upholding transparency, integrity, and ethical conduct within the organization.

Internal Controls and Risk Management: Robust internal control mechanisms are essential to mitigate risks and safeguard the interests of stakeholders. Islamic banks must have effective risk management frameworks in place to identify, assess, and manage risks in accordance with Shari'ah principles and regulatory requirements.

Auditing and Compliance: Internal and external audits are conducted to ensure compliance with Shari'ah principles, regulatory standards, and internal policies. Compliance departments monitor adherence to laws and regulations, as well as internal codes of conduct, to prevent violations and ensure ethical conduct.

Stakeholder Engagement: Islamic banks must actively engage with stakeholders, including shareholders, customers, employees, regulators, and the wider community. Transparent communication and stakeholder dialogue are essential for building trust, fostering accountability, and maintaining the institution's reputation.

Figure 2.4: Governance Framework of Islamic Financial Institutions



3. Regulatory Environment of Islamic Banking

3.1 Divine Regulations

Islamic banking is deeply rooted in the principles of Islamic Shari'ah. The regulatory environment of Islamic banking is thus distinct and requires specific frameworks to ensure compliance with Shari'ah principles. Allah (SWT) says:

“Then We put you, [O Muhammad], on an ordained way (Shari'ah) concerning the matter [of religion]; so follow it and do not follow the inclinations of those who do not know.”¹¹

Allah (SWT) has provided Prophet Muhammad (SM) with a clear and ordained path, a Shari'ah, which encompasses all aspects of life, including faith, worship, ethics, and transactions.

The above-mentioned verse underscores the importance of adhering to divine guidance (Shari'ah), avoiding conventional practices, and to avoid the inclinations of those who do not know (i.e., those who do not follow or understand Shari'ah).

Prophet Muhammad (SM) said: "I have left two matters with you. As long as you hold to them, you will not go the wrong way. They are the Book of Allah and the Sunnah of His Prophet."¹²

Islamic banking, conducted according to Shari'ah principles, adheres to a set of guidelines derived from the Holy Qur'an (Book of Allah SWT) and Sunnah to ensure that financial transactions comply with Islamic rules. A critical aspect of this process is *ijtihad*, the independent reasoning used by Islamic scholars to interpret and apply these primary sources (Quran and Sunnah) to contemporary financial issues. Different legal maxims (*Qawaid Fiqhiyyah*), derived from the Quran, Sunnah, and Islamic jurisprudence (*Fiqh*), play a crucial role in structuring and guiding operations in Islamic banking. For instance, there are five major legal maxims considered pillars of Shari'ah that have significant applications in Islamic banking operations, which are presented in the following box:

¹¹. Surah Al-Jathiyah (45:18)

¹². Muwatta Malik

Box 3.1: Summary of Five Major Legal Maxims Applied in Islamic Banking and Finance

- i. **Matters are judged by their objectives (Al-umuru bi maqasidiha):** In Islamic banking, this maxim ensures that financial products are structured with Shari'ah-compliant objectives. For instance, a Murabaha contract (cost-plus financing) should genuinely aim to facilitate trade and not serve as a disguised loan with interest.
- ii. **Certainty is not overruled by doubt (Al-yaqin la yazulu bis-shakk):** This maxim helps Islamic banks in maintaining clear and unambiguous contracts. It emphasizes the importance of clear documentation and terms in financial agreements, reducing uncertainties and potential disputes in transactions under different modes.
- iii. **Harm should not be inflicted nor reciprocated (laa dharara walaah dhiraar):** In Islamic banking, this principle mandates that financial transactions avoid causing harm or injustice to any party. It guides the development and execution of Shari'ah-compliant products, ensuring fairness, ethical conduct, and mutual benefit for all stakeholders. For example, if a customer faces genuine financial hardship, the bank may offer restructuring of their financing agreement without imposing additional punitive charges, thereby preventing further harm.
- iv. **Hardship begets facility (Al-mashaqqatu tajlibu al-taysir):** This maxim allows for flexibility in exceptional circumstances. Islamic banks might provide concessions or alternative solutions to clients facing financial difficulties, ensuring that the principles of justice and fairness are upheld. For example, in times of economic hardship, banks may offer payment deferrals or restructuring options in a Shari'ah-compliant manner.
- v. **Custom is an arbitrator (Al-adah muhakkamah):** This maxim acknowledges the role of local customs and practices in shaping financial transactions. Islamic banks consider customary practices when developing and offering products to ensure they meet the needs of their clientele while remaining Shari'ah-compliant. For example, profit and loss sharing ratios in Mudarabah contracts may be influenced by prevalent business practices.

3.2 International Regulatory Bodies

The international regulatory environment for Islamic banking is shaped by several key organizations that set global standards and best practices, ensuring Shari'ah compliance in Islamic financial institutions (IFIs).

3.2.1 Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is a leading international non-profit organization that develops standards on accounting, Shari'ah, governance, auditing, and ethics for Islamic Financial

Institutions (IFIs). Its standards are widely adopted by IFIs around the world, providing a consistent basis for financial transactions, reporting, and disclosure.

AAOIFI has issued a total of 117 standards and technical pronouncements for the international Islamic finance industry. These standards are available in various languages (AAOIFI, 2024). The Shari'ah Standards issued by AAOIFI provide detailed guidance on various Islamic financial transactions, ensuring they comply with rules of Islamic Shari'ah. These standards cover a wide range of issues, including various products and services rendered by IFIs in different jurisdictions across the globe.

In addition to standard-setting, AAOIFI is actively involved in training, research, and capacity-building programs. These initiatives are designed to enhance the skills and knowledge of professionals in the Islamic finance industry. AAOIFI conducts various training programs, workshops, and seminars to ensure that practitioners are well-versed in the application of its standards. Furthermore, AAOIFI engages in research activities to continuously improve and update its standards in response to evolving market needs and regulatory requirements.

3.2.2 Islamic Financial Services Board (IFSB)

The IFSB is an international organization dedicated to establishing standards and enhancing the stability and soundness of the Islamic financial services industry. It accomplishes this by issuing global prudential standards and guiding principles encompassing banking, capital markets, and insurance. Additionally, the IFSB engages in research, coordinates initiatives on industry-related matters, and organizes roundtables, seminars, and conferences for regulators and industry participants.

The IFSB works in a similar capacity to the Basel Committee on Banking Supervision (BCBS) for conventional banking, adapting global best practices to the unique requirements of Islamic finance. By providing a consistent framework, the IFSB harmonizes regulatory approaches across different jurisdictions, facilitating cross-border operations and enhancing the global integration of Islamic finance.

3.2.3 Other Significant International Regulatory Bodies

The international regulatory environment for Islamic banking is supported by some other significant organizations, which collectively ensure that IFIs operate within a stable, transparent, and Shari'ah-compliant framework. Each body plays a crucial role in different aspects of regulation, standard-setting, and market development,

contributing to the overall robustness and growth of the Islamic finance industry. A summary is presented in the following box:

Box 3.2: Summary Other Significant International Regulatory Bodies

- i. **The General Council for Islamic Banks and Financial Institutions (CIBAFI)** acts as an umbrella organization for Islamic banks and financial institutions worldwide. It advocates for the Islamic finance industry by promoting cooperation, dialogue, and Islamic finance principles. CIBAFI conducts research, training, and capacity-building programs to support industry development, and represents members' interests in international forums and policy-making processes.
- ii. **The International Islamic Financial Market (IIFM)** develops standardized Shari'ah-compliant financial contracts and documentation, aiming to create a more liquid, transparent, and efficient Islamic financial market. It introduces frameworks and agreements for Sukuk, Islamic swaps, and other financial instruments, enhancing cross-border transactions and increasing market confidence through standardization efforts.
- iii. **The Islamic International Rating Agency (IIRA)** provides Shari'ah-compliant credit ratings and assessments for Islamic financial institutions and instruments, ensuring that ratings reflect the unique risks of Islamic finance. The IIRA helps investors make informed decisions with reliable ratings and contributes to market stability and investor confidence through independent creditworthiness assessments.
- iv. **The International Islamic Liquidity Management Corporation (IILM)** issues short-term Shari'ah-compliant financial instruments to facilitate effective liquidity management for IFIs. It aims to enhance cross-border liquidity flows among Islamic financial markets, supporting overall stability and efficiency by addressing liquidity management challenges with high-quality, highly liquid instruments.
- v. **International Islami Fiqh Academy (IIFA)** is an esteemed scholarly body under the auspices of the Organization of Islamic Cooperation (OIC). It serves as a global authority on Islamic jurisprudence (Fiqh), focusing specifically on contemporary issues and challenges faced by the Islamic finance industry. The rulings given by IIFA provide clarity on Shari'ah-compliant practices, helping to harmonize interpretations across different jurisdictions and ensuring ethical compliance within IFIs. The academy plays a crucial role in promoting uniformity and standardization in the application of Islamic law across the global Islamic finance landscape.

3.3 Local Regulatory Environment of Islamic Banking and Finance

In Bangladesh, although there is no specific legislation for governing Islamic finance, the Bangladesh Bank (BB) provides guidelines for Islamic banking. In formulating the guidelines, the existing Banking Companies Act of 1991, the Companies Act of 1994, and the prudential regulations of Bangladesh Bank were considered. It is essential to note that BB is the central authority responsible for governing the financial system in Bangladesh. It regulates the entire financial industry through eleven different laws, rules, and regulations, along with approximately sixty-three guidelines and prudential regulations covering all aspects of the banking sector in Bangladesh (Zakaria, 2022. P-33). The pivotal laws are discussed below in chronological order.

3.3.1 The Banking Companies Act 1991

The Banking Companies Act 1991 is a principal legislative instrument regulating the banking industry of the country. This Act came into force in 14 February, 1991. This Act encompasses the entire banking sector, including the Islamic financial industry. Although the Act predominantly addresses conventional banking, it includes various issues related to Islamic banking across five sections in total. However, other sections of the Act applicable to all types of banking, including Islamic banking, remain notably inactive regarding Sharia compliance.

The 1995 amendment to the Act introduced additional provisions concerning Islamic Shari'ah for Islamic banking companies. It provided a detailed definition of Mudarabah and Musharakah in Section 5 of the Act. Section 7 of the Act allowed two forms of Islamic business: Musharakah certificates and Mudarabah certificates. Section 9 of the 1991 Act prohibited certain types of businesses for all banks but did not separately address Islamic banking. This was rectified by the Amendment Act of 1995, which permitted Islamic banking to engage in buying, selling, or bartering goods or articles in a manner consistent with Islamic Shari'ah.

Section 26 of the Act addresses the formation of subsidiary companies by banks, generally restricting it except for specific purposes. However, the law permits Islamic banks to establish subsidiary companies provided they operate in accordance with Islamic Shari'ah guidelines.

Section 30 of the 1991 Act excluded the jurisdiction of the courts from adjudicating suits based solely on the excessiveness of interest realized by banking companies, a provision applicable to all banks. The 1995 amendments expanded this scope of exclusion to cover 'interest' in conventional banks and 'profits and return rates of rent' in Islamic banks.

3.3.2 The Companies Act 1994

The Companies Act 1994 is another significant piece of legislation in Bangladesh that regulates all types of companies, including Islamic banking and financial institutions. The Act covers essential requirements for establishing a company, ranging from incorporation to winding up, including the memorandum and articles of association, shareholdings, and directors of the company, among other aspects. However, the Act does not include specific provisions that necessitate Shari'ah guidelines and directives for dealing with Islamic banking and Shari'ah issues for these types of companies. As a result, the Act applies to Islamic banking companies in the same manner as it does to conventional banking companies. Although Islamic banking companies comply with the requirements of the Act, Shari'ah compliance issues remain outside the legal and regulatory framework.

3.3.3 Bangladesh Bank Guideline for Islamic Banking

The Bangladesh Bank issued “Guidelines for Conducting Islamic Banking” in 2009 (BRPD Circular No. 15) to establish a legal framework for Islamic banking in Bangladesh. The guidelines cover major areas of Islamic banking operations, some of which are discussed below:

The guideline consists of eight sections covering licensing, Shari'ah compliance, deposit and investment principles, CRR/SLR maintenance, preparation of financial statement and framework of rate of return. However, it lacks specific provisions for dispute resolution in Islamic transactions, referring such disputes to civil courts, which may not uphold Shari'ah principles. For Islamic banking licenses, 50% of shares must be market-offered and comply with Shari'ah principles. It provides instructions for establishing Islamic banking branches in conventional banks, including account management and conversion processes for conventional banks to Islamic banks.

In the Guidelines, Shari'ah compliance responsibility is delegated to the banks themselves, with no oversight from BB. The board of directors of banks must ensure their activities and products are Shari'ah compliant. Directors should have expertise in Islamic Jurisprudence, and the board may form an independent Shari'ah Supervisory Committee with knowledgeable individuals. However, the board remains accountable for any lapses or irregularities by the committee. The guideline outlines 13 investment modes for Islamic banks, such as mudaraba, musharaka, and bai-Murabaha, while the Banking Companies Act approves musharaka and mudaraba certificates. Additionally, it covers Shari'ah-compliant

export/import investment mechanisms, CRR/SLR maintenance, financial statement preparation, and rate of return structure.

3.3.4 Guideline on Internal Control & Compliance

In 2016, Bangladesh Bank issued the “Guidelines on Internal Control & Compliance in Banks,” which included a separate chapter on “Shari’ah Audit.” These guidelines mandate that full-fledged Islamic banks, Islamic banking branches, and Islamic windows of conventional banks ensure their operations comply with Shari’ah principles alongside general banking guidelines. Shari’ah audits are essential for verifying that all banking activities, from product development to transaction processing, adhere to Islamic Shari’ah.

A crucial aspect of these guidelines is the focus on Shari’ah non-compliance risk (SNCR), which refers to the risk of failing to adhere to Shari’ah principles in banking operations. SNCR is significant for Islamic banks because non-compliance can lead to reputational damage, financial losses, operational inefficiencies, legal penalties, and ultimately the loss of Barakah (blessing) from Allah (SWT). To manage SNCR effectively, banks must conduct thorough risk assessments, develop risk-based audit plans, conduct regular and surprise audits, and implement corrective actions promptly. This risk-based approach ensures that high-risk areas receive more attention, helping to prevent significant non-compliance issues.

Additionally, the guidelines suggest that deficiencies identified during the Shari’ah audit should be notified to the appropriate level and reported to the member-secretary of the SSC and the ACB, with a copy sent to the MD/CEO. At the end of each quarter, a summary report on the Shari’ah audit findings and corrective actions taken should be forwarded to the SSC, ACB, Board of Directors, and MD/CEO.

3.3.5 The Finance Company Act 2023

The Finance Company Act 2023 introduces significant provisions aimed at facilitating Islamic finance activities within non-bank financial institutions (NBFIs). Under this act, definitions include specific Islamic finance (IF) terminology and allow for Shari’ah-compliant activities that are not permissible under conventional financial frameworks. It includes exclusive provisions enabling NBFIs to offer Shari’ah-based financial services and permits investments in Islamic Shari’ah-based Securities (ISBS). The act mandates the use of 'profit' instead of 'interest' in financial transactions and requires the preparation of financial statements in accordance with guidelines set forth by Bangladesh Bank, as directed in DFIM Circular 11/2009.

3.3.6 Major Circulars Recently Issued by BB for IFIs

Besides the above, Bangladesh Bank has issued several important circulars to regulate and facilitate the functioning of Islamic financial institutions (IFIs) in the country. These circulars provide detailed guidelines and instructions on various aspects of Islamic banking operations, ensuring compliance with Shari'ah principles and enhancing the overall regulatory framework. A summary of some of the significant circulars is depicted in Box 3.3.

Box 3.3: Summary of Recent Circulars Issued by Bangladesh Bank

- i. **FID Circular no. 1/2021, dated 05.09.2021** on the “Refinance Scheme for Marginal/Landless Farmers, Fixed Income Professionals, School Banking Account Holders, and Small Traders” allows Shari'ah-based banks to provide investments to customers under the specified schemes.
- ii. **FID Circular No. 2/2021, dated 28.10.2021**, on the “Refinance Scheme for Low-Income Professionals, Farmers, and Small/Marginal Businessmen Affected Due to COVID-19,” allows Islamic Shari'ah-based banks to receive funds from Bangladesh Bank under this scheme after sanctioning investments in favor of small entrepreneurs following Shari'ah principles.
- iii. **BRPD Circular no. 42/2022, dated 26.10.2022**, on “Pre-finance for Providing Working Capital Investment Facilities to Large Industrial and Service Sectors Affected by the Outbreak of Novel Corona virus (COVID-19),” announces the decision to provide funds to Shari'ah-based banks, branches, windows, and financial institutions through Shari'ah-compliant pre-finance instead of refinancing allotted under the said refinancing scheme.
- iv. **DMD Circular No. 03/2022, dated 05.12.2022**, on “Islami Bank Liquidity Fund (IBLF),” introduces a 14-day liquidity facility to ensure sound liquidity management for Shari'ah-based banks.
- v. **DMD Circular No. 02/2023, dated 05.02.2023**, on “Mudaraba Liquidity Support (MLS),” is another initiative by the central bank to ensure sound liquidity management for Shari'ah-based banks in the country.
- vi. **SFD Circular No. 02/2023, dated 30.08.2023**, on “Refinance Scheme for Environment-Friendly Products/Projects/Initiatives,” allows Shari'ah-based banks and financial institutions to utilize this scheme to support their customers using Shari'ah-compliant investment modes.

4. Data Analysis and Findings

This section presents a comprehensive analysis of the market status and prospects of Islamic banking and finance, utilizing both primary and secondary data. The initial part focuses on international data from various dimensions, providing a global perspective on Islamic finance. Subsequently, the analysis narrows down to the Bangladesh market, offering detailed insights into its specific dynamics. Finally, a summary of opinions collected through questionnaires, focus group discussions (FGDs), and interviews will be illustrated, highlighting key findings and expert perspectives on the state and future of Islamic banking and finance.

4.1 Islamic Banking and Finance in Global Market

Currently, many countries offer Islamic banking and finance services, encompassing both comprehensive and specific segments. Islamic finance is increasingly gaining popularity among stakeholders, transcending religious boundaries and appealing to diverse populations globally. This sub-section will analyze the trends, current status, and prospects of Islamic banking and finance from multiple perspectives, highlighting its growing acceptance and integration into the global financial system.

4.1.1 Global Islamic Banking and Finance: Size and Growth

Table 4.1.1 presents a summary of Global Islamic Finance (IF) along with its growth during 2013 to 2022. Over the decade, the global Islamic finance sector has experienced significant growth across various segments. In 2022, total IF assets increased by 11 percent to USD 4,509 billion. During this period, Islamic banking assets grew by 13 percent to USD 3,244 billion. The Takaful sector witnessed a robust growth of 17 percent, while assets of other Islamic financial institutions (OIFI) assets increased by 6 percent. However, the growth of Islamic funds was negative in the same year. Among the five components of IF, the share of IB is the largest at 72 percent, whereas the share of Sukuk is 17 percent in 2022. This consistent growth reflects the rising demand for Shari'ah-compliant financial products and the sector's increasing integration into the global financial system.

Table 4.1.1: Global Islamic Finance (IF): Size and Growth in the Last Decade

Year	Global Islamic Banking Assets		Global Sukuk Outstanding		Global Takaful Assets		Islamic Funds Outstanding		Global OIFI Assets		Toal Islamic Finance Assets	
	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)
2013	1558	19.57	148	-30.52	36	16.13	61	5.17	120	10.09	1923	12.19
2014	1443	-7.38	346	133.78	36	0.00	66	8.20	131	9.17	2022	5.15
2015	1603	11.09	306	-11.56	47	30.56	71	7.58	143	9.16	2170	7.32
2016	1769	10.36	349	14.05	48	2.13	99	39.44	143	0.00	2408	10.97
2017	1831	3.50	420	20.34	46	-4.17	123	24.24	145	1.40	2565	6.52
2018	1882	2.79	470	11.90	47	2.17	116	-5.69	152	4.83	2667	3.98
2019	2133	13.34	539	14.68	54	14.89	150	29.31	154	1.32	3030	13.61
2020	2453	15.00	626	16.14	63	16.67	183	22.00	162	5.19	3487	15.08
2021	2875	17.20	713	13.90	77	22.22	244	33.33	158	-2.47	4067	16.63
2022	3244	12.83	788	10.52	90	16.88	220	-9.84	167	5.70	4509	10.87
Share in 2022 (%)	72%		17%		2%		5%		4%		100%	

Source: ICD - LSEG Islamic Finance Development Report 2023

4.1.2 Global Islamic Finance (IF) Assets: Major Countries

Table 4.1.2 presents the share of Islamic finance assets across the top 10 countries by segment. Considering the total Islamic finance (IF) assets, Bangladesh holds the tenth position, mirroring its status in the Islamic banking segment. In the Takaful segment, Bangladesh ranks ninth. Iran leads in total Islamic finance assets and dominates most segments except for Sukuk, where Malaysia holds the top position. This distribution highlights the significant presence of Islamic finance in these leading countries and underscores Bangladesh's notable position in the global Islamic finance landscape.

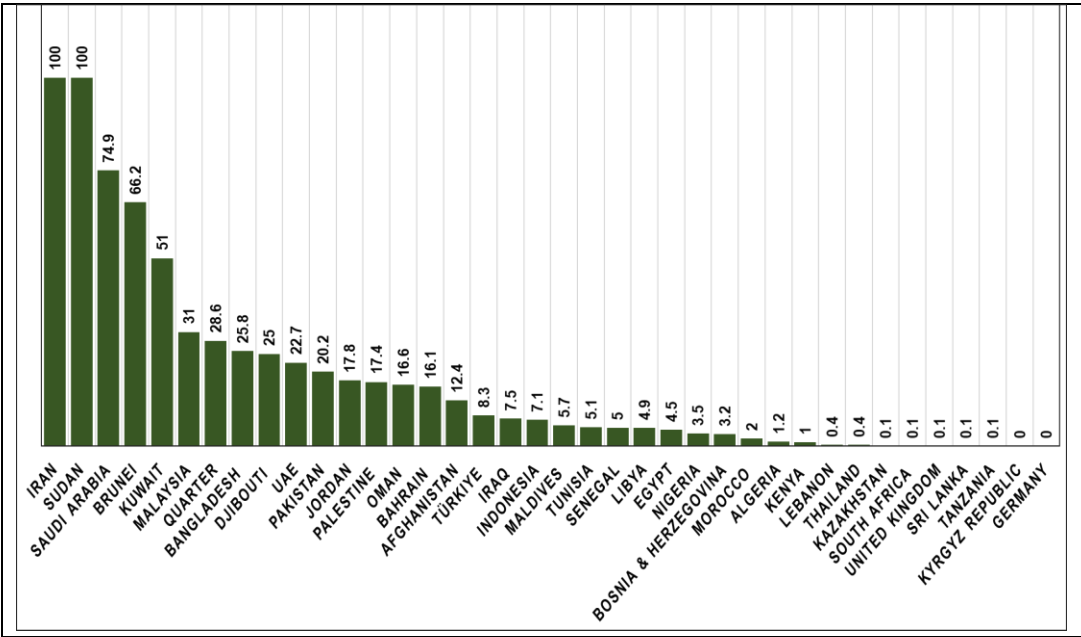
Table 4.1.2: Global Islamic Finance (IF): Share of Top 10 Countries in the Last Decade

Top 10 Countries by IF Assets	Total IF %	IB %	Sukuk %	AUM %	Takaful %	OIFI %
Iran	33.76 (1)	40.44 (1)	2.16 (7)	46.82 (1)	43.33 (1)	31.14 (1)
KSA	22.56 (2)	22.29 (2)	28.17 (2)	14.55 (2)	24.44 (2)	17.96 (3)
Malaysia	14.77 (3)	8.57 (3)	38.07 (1)	14.55 (3)	14.44 (3)	25.75 (2)
UAE	6.14 (4)	6.57 (4)	6.73 (4)		3.33 (5)	3.59 (6)
Kuwait	4.61 (5)	5.80 (5)	1.27 (10)			5.39 (5)
Qatar	3.97 (6)	4.38 (6)	2.92 (5)		1.11 (8)	7.78 (4)
Indonesia	3.28 (7)	1.42 (7)	12.06 (3)	1.36 (7)	3.33 (6)	
Bahrain	2.48 (8)	2.96 (8)	1.90 (9)			0.60 (9)
Turkey	1.57 (9)	1.94 (9)	2.54 (6)	3.18 (5)	2.22 (7)	
Bangladesh	1.29 (10)	1.60 (10)			0.56 (9)	
Pakistan			2.03 (8)	1.36 (8)	4.44 (4)	
UK				9.55 (4)		
USA				2.73 (6)		
Luxembourg				1.36 (9)		
South Africa				1.36 (10)		
Oman					0.56 (10)	
Switzerland						3.59 (7)
Brunei Darussalam						1.20 (8)
Senegal						0.60 (10)
Share by Top 10 (%)	94.45	95.96	97.84	96.82	97.78	97.60

Source: ICD - LSEG Islamic Finance Development Report 2023

According to the IFSB report, two countries—Iran and Sudan—have economies that are fully Islamic, as depicted in Figure 4.1.1. Approximately 75 percent of the banking activities in Saudi Arabia are Islamic, highlighting the significant role of Shari'ah-compliant finance in the kingdom. In Malaysia, 31 percent of banking activities adhere to Islamic principles, reflecting the country's robust Islamic finance infrastructure. Bahrain, the host country of AAOIFI, has a domestic share of 16 percent in Islamic banking compared to its total banking activities. Indonesia, with the largest Muslim population globally, has 7 percent of its banking activities aligned with Islamic finance. In this context, Bangladesh holds the eighth position, indicating its growing yet significant presence in the global Islamic banking landscape.

**Figure 4.1.1: Domestic Share of Islamic Banking and Takaful:
by Jurisdiction in 2022 (%)**

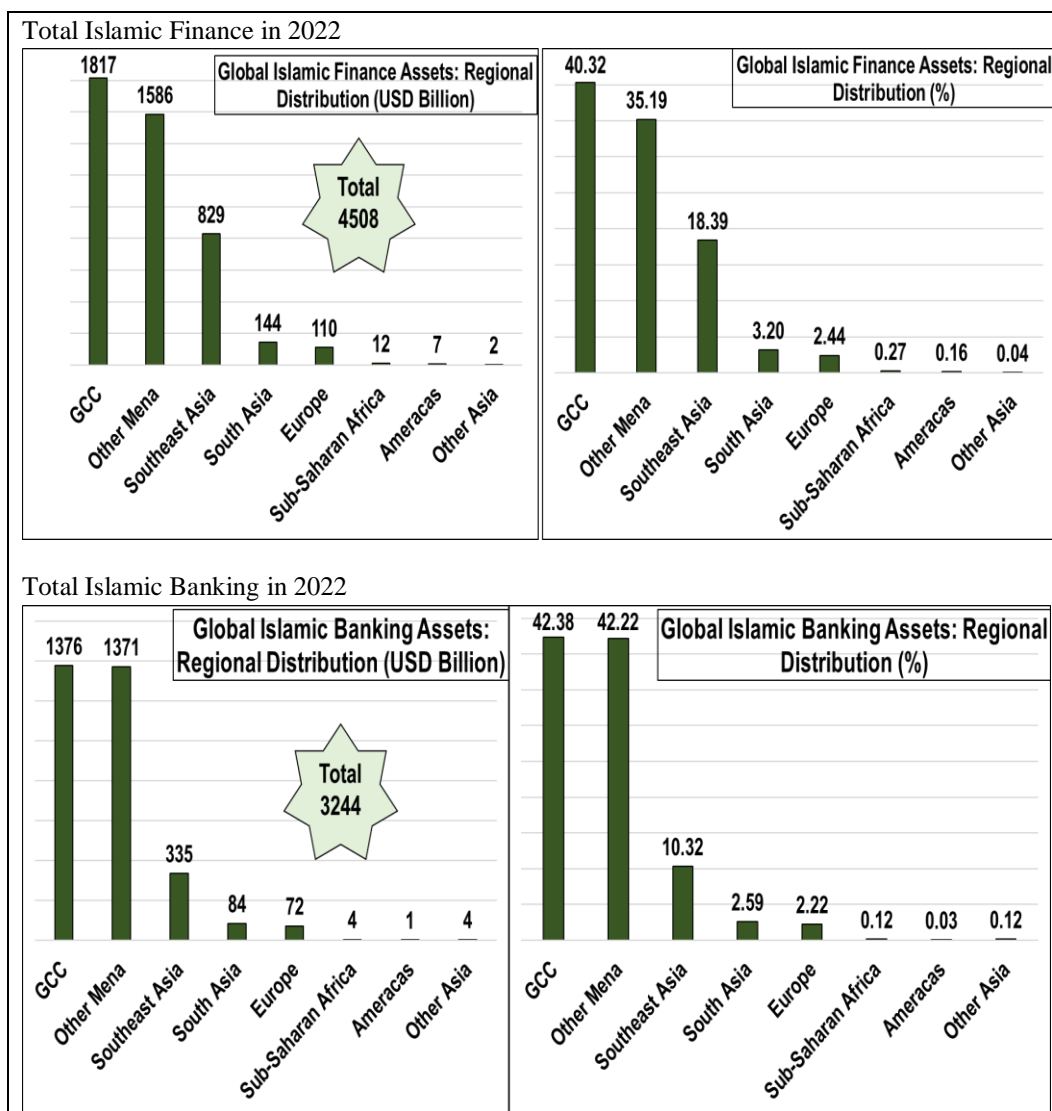


Source: IFSB Industry Stability Report 2023

4.1.3 Global Islamic Banking and Finance Assets in 2022: Regional Share

Figure 4.1.2 demonstrates the regional distribution of global Islamic finance and banking assets. The Gulf Cooperation Council (GCC) region holds USD 1,817 billion in Islamic finance assets, representing more than 40 percent of the global total. Other MENA (Middle East and North Africa) countries contribute over 35 percent to the global Islamic finance assets. In 2022, South Asian countries contributed about 3 percent to the global Islamic finance assets. A similar distribution pattern is observed in global Islamic banking assets, reflecting the significant concentration of Islamic finance within the GCC and other MENA regions, while South Asia's contribution remains relatively modest.

Figure 4.1.2: Global Islamic Finance Assets in 2022: Regional Share (%)



Source: ICD - LSEG Islamic Finance Development Report 2023

4.1.4 Ranking of Countries Based on Islamic Finance Development Indicators

Based on five crucial indicators — financial performance, governance, sustainability, knowledge, and awareness — the Islamic Finance Development Report ranks countries annually. Table 4.1.3 summarizes the rankings of the top 15 countries in 2022 and 2023. Malaysia maintained its top position in both years. In 2023, Bangladesh's IFDI rank was 11th, down from 10th in the previous year. To improve its standing, Bangladesh may need to focus on enhancing the sustainability aspect of its Islamic banking sector.

Table 4.1.3: Global Islamic Finance Development Indicator (Top IFDI Countries 2022 & 2023)

Country	Ranking 2022 (Score)	Ranking 2023 (Score)	Parameter-Wise Score in 2023				
			Financial Performance	Governance	Sustainability	Knowledge	Awareness
Malaysia	1 (113)	1 (103)	84	95	124	112	152
Saudi Arabia	2 (74)	2 (70)	56	57	122	54	116
Indonesia	3 (61)	3 (58)	30	57	30	200	43
Bahrain	4 (59)	4 (54)	26	80	53	32	120
Kuwait	5 (59)	5 (54)	36	74	21	18	142
UAE	6 (52)	6 (53)	28	74	43	36	120
Pakistan	8 (43)	7 (51)	27	75	32	46	105
Oman	7 (48)	8 (51)	12	94	59	30	108
Jordan	13 (29)	9 (40)	19	48	109	40	25
Qatar	9 (38)	10 (38)	20	51	27	13	108
Bangladesh	10 (36)	11 (34)	18	63	16	14	69
Maldives	11 (32)	12 (33)	18	80	55	10	9
Türkiye	12 (Brunei Darussalam 31)	13 (33)	34	47	17	30	21
Nigeria	14 (Sudan 27)	14 (27)	4	56	17	13	71
Sri Lanka	15 (Singapore 27)	15 (27)	10	50	60	10	19
Global Average			5	17	9	7	12

Source: ICD - LSEG Islamic Finance Development Report 2023

4.1.5 Islamic Finance Country Index

Table 4.1.4 presents the ranking of the top 10 countries according to the Islamic Finance Country Index (IFCI) from 2013 to 2023. Throughout this period, Indonesia has shown notable performances. During the periods, first position held by Malaysia 4 times, Iran 3 times, Indonesia 2 times and KSA 2 times. Bangladesh made significant progress over the decade. Initially ranked 10th in 2013, it maintained this position during 2016-2018. From 2019 onwards, Bangladesh's rank improved and remained consistently in the top 10, reaching R6 in 2023 and maintaining this position through 2023. This steady climb reflects the growing importance and development of the Islamic finance sector in Bangladesh. In summary, the table highlights the dynamic nature of the Islamic finance industry, with Indonesia showing a notable rise to the top positions in recent years, while Bangladesh has made substantial progress, reflecting its expanding role in the global Islamic finance landscape.

Table 4.1.4: Islamic Finance Country Index (Top 10 IFCI 2013-2023)

Rank	Y 2013	Y 2014	Y 2015	Y 2016	Y 2017	Y 2018	Y 2019	Y 2020	Y 2021	Y 2022	Y 2023
R 1	Iran	Iran	Iran	Malaysia	Malaysia	Malaysia	Indonesia	Malaysia	Indonesia	KSA	KSA
R 2	Malaysia	Malaysia	Malaysia	Iran	Iran	Iran	Malaysia	Indonesia	KSA	Malaysia	Malaysia
R 3	KSA	KSA	KSA	KSA	KSA	KSA	Iran	Iran	Malaysia	Indonesia	Pakistan
R 4	UAE	Bahrain	UAE	UAE	UAE	UAE	KSA	KSA	Iran	Iran	Indonesia
R 5	Indonesia	Kuwait	Kuwait	Kuwait	Kuwait	Kuwait	Sudan	Sudan	Pakistan	Pakistan	Iran
R 6	Bahrain	UAE	Bahrain	Indonesia	Pakistan	Indonesia	Brunei	Pakistan	Sudan	Sudan	Bangladesh
R 7	Kuwait	Indonesia	Indonesia	Qatar	Indonesia	Pakistan	UAE	Brunei	Brunei	Bangladesh	Sudan
R 8	Pakistan	Sudan	Qatar	Bahrain	Bahrain	Bahrain	Bangladesh	UAE	Bangladesh	Brunei	Brunei
R 9	Sudan	Pakistan	Sudan	Pakistan	Qatar	Qatar	Kuwait	Bangladesh	UAE	UAE	UAE
R 10	Bangladesh	Qatar	Pakistan	Bangladesh	Bangladesh	Bangladesh	Pakistan	Kuwait	Kuwait	Kuwait	Kuwait

IFCI is based on a multivariate analysis. For construction of the index, original dataset included information on several variables, including macroeconomic indicators of the countries. Variables are: (i) Number of Islamic Banks, (ii) Number of IsBFIs, (iii) Shari'ah Supervisory Regime, (iv) Islamic Financial Assets, (v) Muslim Population, (vi) Sukuk, (vii) Education & Culture, and (viii) Islamic Regulation & Law.

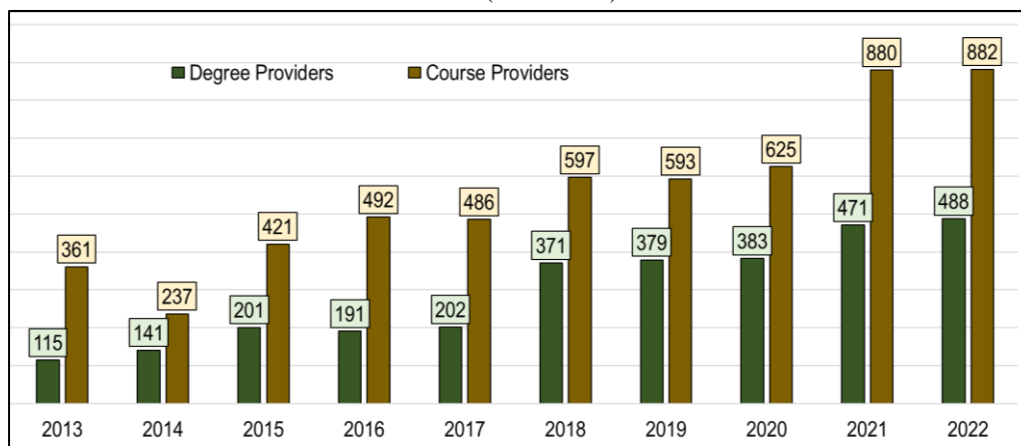
Source: Global Islamic Finance Report (GIFR) 2023

4.1.6 Global Islamic Finance Industry and Supporting Ecosystem

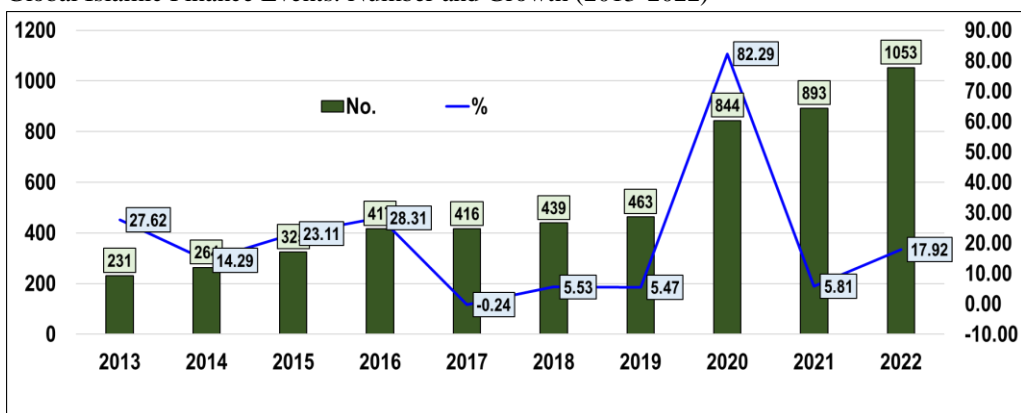
Effective functioning and smooth expansion of a system depend on the entire ecosystem. Figure 4.1.3 summarizes key components such as Islamic finance education providers, relevant events, and other supporting factors. According to the Islamic Finance Development Report, in 2022, a total of 488 degree-providers offered 882 courses, which is slightly higher than the previous year. More than 1000 events related to Islamic finance occurred in 2022, marking an 18 percent increase compared to 2021. Additionally, approximately 14,650 reports on Islamic finance were published in 2022. Globally, over 14,240 Islamic banking branches are in operation. These components collectively contribute to the robust growth and sustainability of the Islamic finance ecosystem.

Figure 4.1.3: Global Islamic Finance Industry and Supporting Ecosystem

Global Islamic Finance Education Providers (2013-2022)



Global Islamic Finance Events: Number and Growth (2013-2022)



Global Islamic Finance Industry and Supporting Ecosystem (2022)

Countries providing Islamic Financial Services considered for IFDI 2022		Countries providing Islamic Financial Services considered for IFCI 2022*		No. of Islamic Financial Institutions		No. of Islamic Banks	
136		65		1871		610	
No. of Full-Fledged IBs	No. of IB Branches	No. of Employees in IBs**	No. Shari'ah Scholars	No. of Sukuk Outstanding	No. of Islamic Funds	No. of Takaful	
175**	14241	351,917	1325	4806	2233	344	
No. of Islamic Finance Education Providers		No. of Islamic Finance Degree Providers		No. of Islamic Finance Events	No. of IF Virtual Events	No. of Islamic Finance Seminars	
882		488		1053	698	107	
No. of Islamic Finance Conferences		No. of Islamic Finance News		No. of Islamic Finance Journals			
88		14652		129			

*IFCI 2022; **IFSB FSR 2023

Source: Islamic Finance Development (IFDI) Report 2023

4.1.7 Nature of Banks in Global Islamic Banking Operations

Table 4.1.5 presents the distribution of Islamic banking and finance services across different types of institutions from 2015 to 2023. Over this period, full-fledged Islamic banks have consistently dominated the market, accounting for more than 78 percent of operations in 2023. Islamic windows of conventional banks also play a significant role, contributing about 11 percent to the total Islamic banking operations. Additionally, some conventional institutions have established Islamic banking subsidiaries instead of windows to offer Shari’ah-compliant services. This structure enables a broader reach and specialization in Islamic finance, catering to diverse customer needs while adhering to Islamic principles.

Table 4.1.5: Nature of Banks in Global Islamic Banking Operations (%)

	Full Fledged IB	IB Subsidiary	IB Windows	Others	Total
2015	77.8	8.6	13.6		100
2016	81.7	6.1	12.2		100
2017	76.6	7.1	16.3		100
2018	82.1	6.6	11.3		100
2019	83.8	6.6	9.6		100
2020	79.2	9.4	11.4		100
2021	78.7	10.6	8.5	2.2	100
2022	78.7	10.6	8.5	2.1	100
2023	78.6	8.7	10.7	1.9	100

Source: Global Islamic Bankers' Survey 2021, 2022 and 2023 by CIBAFI

4.1.8 Performance of Global Islamic Banking Operations

Table 4.1.6 presents the global weighted average for key performance indicators of Islamic banking from 2013 to 2022. The Return on Assets (ROA) shows a steady performance, reaching 1.7 percent in 2022 from 1.4 percent in 2013, reflecting improved asset utilization. Return on Equity (ROE) also improved significantly from 13.7 percent in 2013 to 17.5 percent in 2022, indicating better profitability and value creation for shareholders. The Capital to Risk-Weighted Assets Ratio (CRAR) has shown a consistent increase, reaching 19.0 percent in 2022, signifying enhanced capital adequacy and financial stability. Notably, the Gross Non-Performing Financing (NPF) ratio has been reduced significantly over the years, dropping from 5.91 percent in 2013 to 2.5 percent in 2022, highlighting improved asset quality and risk management in Islamic banking.

Table 4.1.6: Global Islamic Banking Weighted Average ROA & ROE, CRAR and NPL

	ROA (%)	ROE (%)	CRAR (%)	Gross Non-performing Financing (%)
2013	1.4	13.7		5.91
2014	1.4	12.7		5.75
2015	1.5	14.1		5.15
2016	1.6	13.6		5.06
2017	1.9	16.9		4.99
2018	1.8	15.2		5.00
2019	1.6	14.0	18.4	2.5
2020	1.3	11.8	18.6	2.6
2021	1.6	15.9	18.5	2.5
2022	1.7	17.5	19.0	2.5

Source: IFSB Financial Stability Report 2023

4.1.9 Islamic Financing Contracts: Major Modes Used Globally

Instead of relying on a single mode like Qard, the Islamic banking system employs various contracts such as trading, sharing, leasing, and agency. Table 4.1.7 illustrates the distribution of these financing contracts from 2018 to 2022. Over these years, Murabahah (along with Bai Bithaman Ajil and Tawarruq) has consistently dominated, accounting for about 69 percent in 2018, and increased to 76 percent in 2022. Ijarah (leasing) remained stable (10%) during this period. Share of partnership modes (constant Musharakah, diminishing Musharakah and Mudarabah) are less than 5 percent in 2022. This data highlights the varying preferences and usage trends of different Islamic financing contracts in the global market.

Table 4.1.7: Modes of Islamic Financing Contracts in Globe

SN	Mode	2018 (%)	2021 (%)	2022(%)
1	Murabahah	36.0	47.4	44.0
2	Bai Bithaman Ajil	8.4		
3	Commodity Murabahah/Tawarruq	24.2	25.7	32.2
4	Ijārah/Ijārah Muntahia Bittamlik		10.2	10.2
5	Salam	5.5	4.1	3.8
6	Musharakah	3.3	2.8	2.4
7	Diminishing Musharakah	1.5	1.3	1.9
8	Mudarabah	0.5	0.2	0.2
9	Istisna'a	0.4	0.7	0.6
10	Wakalah	0.2	0.1	0.8
11	Qard Hasan	0.1	0.1	0.2
12	Others	5.9	7.4	3.6
Total		100	100	100

Source: https://ifsb.org/psifi_02.php, cited on September 14, 2023

4.2 Islamic Banking and Finance Industry of Bangladesh

Bangladesh, officially the People's Republic of Bangladesh, is located in South Asia and has a population predominantly following Islam (more than 90 percent). The country's financial sector comprises 62 scheduled banks, including one digital bank, with 10 being full-fledged Islamic banks (IBs). The Islamic banking sector began in 1983 with the establishment of Islami Bank Bangladesh PLC (IBB PLC). Over the last four decades, Islamic banking has grown to become a critical component of the country's overall economy.

In addition to the 10 full-fledged IBs, around 30 conventional banks offer Islamic banking services through their branches and/or windows. Moreover, several other conventional banks are in the process of obtaining Islamic banking licenses from the central bank. The non-bank financial institutions (NBFIs) sector consists of 35 institutions, with about eight providing Islamic financial services either fully or through branches/windows.

As time progressed, various elements of Islamic finance, including Sukuk, Islamic funds, and Takaful, have been introduced and integrated into the market. The insurance industry in Bangladesh includes 81 companies, split between life (35) and non-life (46) sectors. Out of these, about 34 companies offer Islamic insurance policies, with 18 operating full-fledged Islamic insurance and 16 through windows. The country's two stock exchanges have Shari'ah indexes: the Dhaka Stock Exchange (DSE) with 129 companies and the Chittagong Stock Exchange (CSE) with 132 companies, though the numbers can vary. Additionally, approximately 18

Shari’ah-based mutual funds operate within Bangladesh. Some micro-finance institutions (MFIs) and cooperatives are also in the process of converting to Islamic financial services. Sovereign Sukuk (4 issuances totaling BDT 19,000 crore) and corporate Sukuk (2 issuances totaling BDT 3,300 crore) are present in the country, contributing to the growth of Islamic finance.

This sub-section will focus on the operations of Islamic banking in Bangladesh, exploring its development, current status, and future prospects within the broader context of the country's financial system.

4.2.1 Full-Fledged Islamic Banks in Bangladesh: Basic Information

Table 4.2.1 titled ‘Islamic Banks in Bangladesh (2023): Full-Fledged Islamic Banks’ provides key details about the full-fledged Islamic banks operating in Bangladesh. Islami Bank Bangladesh PLC (IBB), established in 1983, is the oldest and largest with 394 branches and 20809 employees, making it a major player in the sector. Al-Arafah Islami Bank PLC and Social Islami Bank PLC, both established in 1995, have significant branch networks of 215 and 179 respectively, employing over 5100 and 4000 individuals. Four conventional banks – EXIM, FSIB, Standard and GIB, have been converted into full-fledged Islamic banks in Bangladesh. A total number of 48242 employees are working in 1670 branches of these 10 full-fledged Islamic banks in Bangladesh.

**Table 4.2.1: Full-Fledged Islamic Banks in Bangladesh (2023):
Basic Information**

S/n	Name of Islamic Banks	Year of Establishment	IB Starting	No. of Branch*	No. of Employee
1	Islami Bank Bangladesh PLC (IBB)	1983	1983	394	20,809
2	ICB Islamic Bank Limited (ICB)	1987	1987	33	374
3	Social Islami Bank PLC (SIB)	1995	1995	179	4,039
4	Al-Arafah Islami Bank PLC (AAIB)	1995	1995	215	5,184
5	Shahjalal Islami Bank PLC (SJIB)	1997	1997	140	2,835
6	Export Import Bank of Bangladesh PLC (EXIM)	1999	2004	151	3,357
7	First Security Islami Bank PLC (FSIB)	1999	2009	205	5,406
8	Union Bank PLC (Union)	2013	2013	114	1,776
9	Standard Bank PLC (Standard)	1999	2021	138	2,239
10	Global Islami Bank PLC (GIB)	2013	2021	101	2,223
	Total			1670	48242

Source: Website and annual report of concerned entity

4.2.2 Branch/Window -Based Islamic Banks in Bangladesh: Basic Information

In addition to the 10 full-fledged Islamic banks (IBs), many conventional banks in Bangladesh offer Islamic banking services through dedicated branches or windows. Two additional banks have received primary consent from the central bank to commence Islamic banking operations and are preparing to launch their services (Table 4.2.2). Notably, HSBC-Bangladesh previously operated Islamic banking services but discontinued them. Janata Bank PLC has also been licensed by Bangladesh Bank to provide Islamic banking services but has not yet initiated operations. Five conventional banks provide Islamic banking services through both dedicated branches and windows, while others offer these services through either branches or windows. This diverse approach highlights the expanding landscape of Islamic banking in Bangladesh, accommodating both specialized Islamic banks and conventional banks integrating Islamic services.

Table 4.2.2: Branch/Window -Based Islamic Banks in Bangladesh (2023): Basic Information

S/n	Name of Banks	Type of Islamic Bank	Year of Establishment		No. of Branch + Window		No. of Employee	
			Bank	IB	Bank	IB*	Bank	IB (2022)
1	United Commercial Bank PLC (UCB)	Branch + Window	1983	2020	228	1+10	5749	28
2	ONE Bank PLC (ONE)	Branch + Window	1999	2020	111	2+14	4276	68
3	The Premier Bank PLC (Premier)	Branch + Window	1999	2003	136	2+25	2720	101
4	Prime Bank PLC (Prime)	Branch	1995	1995	146	5+0	2958	66
5	Dhaka Bank PLC (Dhaka)	Branch	1995	2003	118	2+0	1989	33
6	Southeast Bank PLC (SEBPLC)	Branch	1995	2003	135	5+0	3125	98
7	Jamuna Bank PLC (Jamuna)	Branch	2001	2003	167	2+0	4174	54
8	City Bank PLC (City)	Branch	1983	2003	134	1+0	4963	23
9	Bank Alfalah (Al Falah)	Branch	2005	2005	7	1+0	193	15
10	AB Bank PLC (AB)	Branch	1982	2006	105	1+0	2325	18
11	NRB Bank (NRB)	Branch	2013	2021	51	1+0	817	15
12	National Credit and Commerce Bank PLC (NCC)	Branch	1993	2022	128	1+0	2374	17
13	Standard Chartered Bank (SCB)	Window	1948	2004	18	0+1	2054	8
14	Trust Bank (Trust)	Window	1999	2008	116	0+30	2199	79

S/n	Name of Banks	Type of Islamic Bank	Year of Establishment		No. of Branch + Window		No. of Employee	
			Bank	IB	Bank	IB*	Bank	IB (2022)
15	Bank Asia PLC (BAPLC)	Window	1999	2008	135	0+5	2751	72
16	Pubali Bank PLC (Pubali)	Branch + Window	1983	2010	504	0+19	9608	120
17	Sonali Bank PLC (Sonali)	Window	1972	2010	1232	0+58	17542	131
18	Agrani Bank PLC (Agrani)	Window	1972	2010	974	0+60	10140	145
19	Meghna Bank PLC (Meghna)	Window	2013	2020	51	0+10	924	15
20	Mutual Trust Bank PLC (MTB)	Window	1999	2020	120	0+15	2703	6
21	Mercantile Bank PLC (Mercantile)	Window	1999	2020	152	1+45	2695	203
22	Midland Bank Limited (Midland)	Window	2013	2020	39	0+1	807	2
23	NRBC Bank PLC (NRBC)	Window	2013	2020	131	0+320	3804	27
24	SBAC Bank PLC (SBAC)	Window	2013	2021	89	0+10	1165	38
25	Bangladesh Commerce Bank (BCB)	Branch + Window	1998	2022	76	2+0	N/A	N/A
26	Padma Bank PLC (July 09, 2023)	Window	2019	2023	N/A	N/A	N/A	N/A
27	Rupali Bank (October 11, 2023)	Window	1972	2023	586	0+1	7221	N/A
28	Bengal Commercial Bank PLC (Bengal)	Branch	2020	N/A	N/A	3+0	N/A	N/A
29	Eastern Bank PLC (EBPLC)	Window	1992	Yet to Start Operation				
30	IFIC Bank PLC (IFIC)	Branch	1983					

Source: Website and annual report of concerned entity; *BB Report on IB, Oct.-Dec. 2023

4.2.3 Islamic NBFIs in Bangladesh (2023): Basic Information

A total number of 35 Non-Bank Financial Institutions (NBFIs) are operating in Bangladesh. There are currently seven NBFIs in Bangladesh offering Islamic financial services, with three operating as full-fledged Islamic NBFIs and four through Islamic windows (Table 4.2.3). Additionally, Bangladesh House Building Finance Corporation, a state-owned specialized financial institution, offers Islamic financial products. The Islamic Finance and Investment Limited (IFIL), established in 2001, is the first Islamic NBFI in the country. Bangladesh Finance initiated its Islamic finance operations in 2021, being the first to adopt a window-based

approach. Most recently, in 2024, IDLC Finance PLC launched its Islamic window, expanding the landscape of Islamic finance services in Bangladesh.

Table 4.2.3: Non-Bank Financial Institution in Bangladesh (2023): Islamic Financial Services

Company Name	Type of Entity	Year of Establishment	Year of IF Commencement
Islamic Finance and Investment Limited (IFIL)	Full-Fledged	2001	2001
Hajj Finance Company Limited (HFC)	Full-Fledged	2006	2006
Aviva Finance Limited (AFL)	Full-Fledged	1996	2020
DBH Finance PLC (DBH)	Window	1996	2023
Bangladesh Finance Limited (BDF)	Window	1999	2021
SFIL Finance PLC (SFIL)	Window	2020	2022
IDLC Finance PLC (IDLC)	Window	1985	2024
Bangladesh House Building Finance Corporation (HBFC) (Specialized Financial Institution)	Products	1952 (1973)	2021

Source: Website and annual report of concerned entity

4.2.4 Market Share of Islamic Banking in Bangladesh

Table 4.2.4 illustrates the growing prominence of Islamic banks over seven years. Total financing by IBs increased from 23 percent in 2017 to 29 percent in 2023, while total deposits rose from 20 percent to 25 percent in the same period. Islamic banks' total assets also expanded from 19 percent in 2017 to 23 percent in 2022, indicating a broader market presence.

Equity improved from 15 percent to 18 percent, and profit income surged from 23 percent to 28 percent, reflecting enhanced profitability. Remittances through IBs grew remarkably from 36.14 percent to 54 percent, highlighting increased trust in their services. The number of branches and employees in Islamic banks also saw significant growth, reinforcing their expanding role in the financial sector of Bangladesh.

Table 4.2.4: Market Share of Islamic Banking in Bangladesh (%)

Particulars	Share of IBs in Dec. 2017	Share of IBs in Dec. 2018	Share of IBs in Dec. 2019	Share of IBs in Dec. 2020	Share of IBs in Dec. 2021	Share of IBs in Dec. 2022	Share of IBs in Dec. 2023
Total Financing	22.96	23.1	23.14	24.0	25.8	26.3	28.92*
Total Deposits	20.39	20.1	20.96	21.6	23.5	22.6	25.35*
Total Assets	19.29	19.1	19.58	20.1	22.1	22.6	
Total Liabilities	19.6	19.4	19.85	20.4	22.3	22.9	
Total Equity	15.22	15.6	15.57	15.4	17.8	17.7	
Total Liabilities and Equity	19.29	19.1	19.58	20.1	22.1	22.6	
Off-Balance Sheet Items	11.2	10.6	12.08	12.2	12.5	12.9	
Profit Income (Interest Income)	22.63	34.31	24.32	26.3	28.6	27.58	
Profit (Interest) Paid to Depositor	20.44	23.13	23.04	23.2	25.1	25.61	
Non-Profit Income	8.32	9.25	10.1	7.7	8.8	11.68	
Operating Expenses	16.21	17.12	18	18.1	19.7	20.08	
Net Profit After Tax	19.15	38.32	24.01	36.7	40.4	18.13	
Remittances	36.14*	35.38*	35.34*	40.51*	49.18*	54.53*	54.30*
Total Number of Bank Branches (No.) and Total Industry	11.52	12.06	13.05	1528 (14.25) 10752	2080 (19.02%)* 10937	19.88* (2217) 11153	(50,306)*
Total Agricultural Credit	8.87	7.01	2.57*	13.41*	16.94*	23.44*	
Total Number of Employees in IB (Total)	30606* (175,027)	33027* (177,00)	35906* (179,00)	38784* (181,937)	45260* (189,161)	49851* (196,102)	

Note: Data for 2023 will be included upon publication of the Financial Stability Report of BB.

Source: Financial Stability Report, BB and *Quarterly Report on IB in BD, BB

4.2.5 Performance of Islamic Banking Sector of Bangladesh

Table 4.2.5 presents selected indicators of the banking sector of Bangladesh, comparing Islamic banks (IBs) and all banks from 2019 to 2023. Islamic banks generally performed better in terms of Return on Assets (ROA) and Return on Equity (ROE) compared to the overall banking sector. For instance, IBs' ROA was slightly higher at 0.5 percent in 2021 as compared to 0.2 percent of overall banking sector. However, ROA of IBs in 2022 was slightly lower than the overall industry. The ROE for IBs was significantly higher, with 11.5 percent in 2022 against 10.7 of overall industry. Similar status is observed in case of Capital to Risk-weighted Assets Ratio (CRAR). Additionally, IBs had a lower ratio of non-performing assets with 4.1 percent in 2022, highlighting better asset quality. Other indicators such as liquidity ratios and profit income percentages also showed that IBs maintained robust performance, underscoring their increasing stability in Bangladesh's financial sector. It is shared by the interviews and participants of the FGD that the reputation of the Islamic banking industry has damaged in the recent time and it may have impact on the performance of the sector. Good governance should be ensured in the industry to regain the image.

Table 4.2.5: Performance of Banking Sector of Bangladesh (%)

Indicators	2019		2020		2021		2022		2023	
	All Banks	IBs	All Banks	IBs	All Banks	IBs	All Banks	IBs	All Banks	IBs
ROA	0.5	0.6	0.3	0.5	0.2	0.5	0.6	0.5		
ROE	7.4	11.4	4.3	10.2	4.4	9.9	10.7	11.5		
Net Profit Margin	2.1	2.9	1.4	2.4	1.3	2.3	1.4	2		
Interest (Profit) Income to Total Assets (TA)	6.1	7.6	4.9	6.4	4.3	5.5	4.4	5.4		
Net Interest (Profit) Income to TA	1.9	2.6	1.2	2.1	1.1	2.0	1.2	1.8		
Non-Interest (Profit) Income to TA	1.8	0.9	2.0	0.8	2.0	0.8	2.1	1.1		
Advance (Investment) to Deposit Ratio	77.3	94.3	81.4	83.3	73.2	84.7	79	91.4		
CRAR	11.6	12.4	11.6	12.7	11.1	12.8	11.8	12.7		
Classified Loans (Investment) to Advances	9.3	4.7	8.1	4.1	7.9	4.0	8.2	4.1		
Classified Loans (Investment) to Capital	92.1	71.7	80.7	67.2	80.7	67.2	95	72.1		

Note: Data for 2023 will be included upon publication of the Financial Stability Report of BB.

Source: Financial Stability Report, BB and *Quarterly Report on IB in BD, BB

4.2.6 Islamic Banking Deposits in Bangladesh

Table 4.2.6 provides an overview of Islamic banking deposits in Bangladesh from 2014 to 2023. The data shows that full-fledged Islamic banks have consistently dominated in terms of deposit amounts, with significant growth each year. By December 2023, these banks held deposits totaling BDT 403,850 crore, growing by 6.29 percent from the previous year. Islamic banking branches and windows have also contributed to the growth, with deposits reaching BDT 41,554 crore in 2023. The total Islamic banking deposits amounted to BDT 443,403 crore in December 2023, reflecting an 8.16 percent growth.

In the Islamic banking sector, Islami Bank Bangladesh PLC (IBB) hold about 35 percent deposit followed by First Security Islami Bank PLC (FSIB) 10.27 percent (Table 4.2.7). Though, ICB Islamic Bank is a old bank compared to other Islamic banks in Bangladesh, market share of the bank is low (0.28%).

Table 4.2.8 illustrates the distribution of various deposit contracts within Islamic banking from December 2014 to December 2023. In Bangladesh, only Wadiah and Mudarabah modes are used to collect deposits by IBs. Along with current account (CA), others deposits are maintained under Wadiah principle i.e. no cost deposit. Therefore, about 78 percent funds are collected Mudarabah modes for savings a/c, SND, special scheme, etc. This data highlights the adaptability and growth of

Islamic banking deposits across various contract types, catering to the diverse needs of the banking population.

Table 4.2.6: Islamic Banking Deposits (BDT Crore) and Its Growth (%)

	Full-fledged IB		IB Branches		IB Windows		Total IB Deposits		All Bank Deposits		Share of IBs (%)
	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	
Dec-14	136,710		5,172		2,267		144,149		693,113		20.80
Dec-15	155,023	13.40	5,189	0.33	2,883	27.16	163,095	13.14	745,023	7.49	21.89
Dec-16	178,862	15.38	5,285	1.84	3,548	23.09	187,695	15.08	840,268	12.78	22.34
Dec-17	203,698	13.89	5,866	11.01	4,695	32.32	214,259	14.15	926,179	10.22	23.13
Dec-18	223,657	9.80	7,479	27.49	6,231	32.71	237,367	10.78	1,009,981	9.05	23.50
Dec-19	263,756	17.93	8,738	16.83	7,734	24.12	280,228	18.06	1,136,980	12.57	24.65
Dec-20	306,000	16.02	10,181	16.52	10,741	38.88	326,922	16.66	1,290,472	13.50	25.33
Dec-21	370,384	21.04	11,025	8.29	11,702	8.95	393,111	20.25	1,409,343	9.21	27.89
Dec-22	379,951	2.58	13,883	25.92	16,116	37.72	409,950	4.28	1,588,254	12.69	25.81
Dec-23	4,03,850	6.29	19,121	37.74	20,433	26.79	4,43,403	8.16	17,49,191	10.13	25.35

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

Table 4.2.7: Islamic Banking Deposits by Banks (%)

	IBB	FSIB	EXIM	AAIB	SIB	SJIB	Union	Standard	GIB	ICB	IB Br.	IB. Win.	Total
Dec-14	39.05	12.66	13.29	12.21	7.56	6.82	2.41			0.83	3.59	1.57	100
Dec-15	37.72	14.18	13.67	10.44	8.45	6.50	3.41			0.68	3.18	1.77	100
Dec-16	36.22	14.61	12.36	11.69	9.24	6.63	3.96			0.58	2.82	1.89	100
Dec-17	35.08	13.96	11.90	12.12	9.38	6.79	5.32			0.53	2.74	2.19	100
Dec-18	34.67	13.48	11.45	12.05	9.43	7.39	5.26			0.48	3.15	2.62	100
Dec-19	33.83	13.44	12.71	11.56	9.53	7.26	5.36			0.43	3.12	2.76	100
Dec-20	36.13	13.11	12.25	10.61	9.15	6.69	5.28			0.38	3.11	3.29	100
Dec-21	35.18	11.93	10.75	9.66	8.52	5.53	5.09	4.24	3.00	0.33	2.80	2.97	100
Dec-22	34.45	11.54	10.42	10.25	7.80	5.56	5.20	4.17	3.00	0.30	3.39	3.93	100
Dec-23	34.72	10.27	10.10	9.89	7.80	5.63	5.09	4.34	2.98	0.28	4.31	4.61	100
Ranking	1	2	3	4	5	6	7	8	9	10			

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

Table 4.2.8: Islamic Banking Deposits by Contracts (%)

	Wadiah CA Deposits	Mudarabah Savings Bond	Mudarabah Special Savings (Pension)	Mudarabah Hajj Deposits	Mudarabah Term Deposits	Mudarabah Special Notice Deposits	Mudarabah Savings Deposits	Other Deposits	Total
Dec-14	4.00	1.00	9.00	0.00	49.00	3.00	17.00	17.00	100
Dec-15	3.83	1.02	7.80	1.74	48.46	2.94	18.32	15.79	100
Dec-16	4.05	0.90	8.98	0.28	47.35	3.20	18.61	16.63	100
Dec-17	4.41	0.75	8.71	0.22	47.45	3.76	18.38	16.32	100
Dec-18	3.89	0.66	8.70	0.21	49.23	3.68	18.38	15.25	100
Dec-19	3.58	0.58	8.62	0.22	48.21	3.94	17.60	17.23	100
Dec-20	3.91	0.48	9.32	0.23	47.04	4.67	18.77	15.58	100
Dec-21	4.71	0.37	9.63	0.19	45.55	4.80	19.39	15.36	100
Dec-22	4.51	0.40	7.60	0.21	45.42	5.24	19.24	17.39	100
Dec-23	4.57	0.23	7.39	0.21	45.86	4.75	19.21	17.77	100

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

4.2.7 Financing by Islamic Banks in Bangladesh

Table 4.2.9 titled "Financing of Islamic Banking (BDT Crore) and Its Growth (%)" provides a detailed breakdown of Islamic banking financing in Bangladesh from December 2014 to December 2023. Full-fledged Islamic banks have shown a significant increase in financing, growing from BDT 121,321 crore in 2014 to BDT 414,680 crore in 2023. The growth rates have varied, with notable increases in 2016 (19.14 percent) and 2021 (21 percent). IB branches and IB windows have also contributed to the growth, with IB branches seeing a substantial increase from BDT 4,138 crore in 2014 to BDT 14,692 crore in 2023, and IB windows growing from BDT 1,665 crore in 2014 to BDT 15,602 crore in 2023. The total investments of IBs have risen steadily, reaching BDT 444,974 crore in 2023. The share of IBs in total bank credits has also increased, from 25.04 percent in 2014 to 28.92 percent in 2023, highlighting the expanding role of Islamic banking in the financial sector of Bangladesh.

Like deposits, Islami Bank Bangladesh PLC (IBB) holds about 34 percent of the total financing by Islamic banks (IBs) in Bangladesh (Table 4.2.10). Over the years, First Security Islami Bank PLC (FSIB) has shown steady progress, increasing its market share from 12 percent in 2014 to 13 percent in 2023. In 2023, the market share of Union Bank, IB branches, and IB windows increased compared to the previous year, while the share of other banks decreased.

Bai Murabahah and Bai Muajjal are the dominant modes of financing by IBs in Bangladesh, accounting for about 70 percent of total financing. Hire Purchase under Shirkatul Melk (HPSM) and Ijarah collectively hold approximately 22 percent of total Islamic banking financing. However, there is no positive growth of sharing modes, like Musharakah and Mudarabah, over the period (Table 4.2.11).

Table 4.2.9: Financing of Islamic Banking (BDT Crore) and Its Growth (%)

	Full-fledged IB		IB Branches		IB Windows		Total Investments of IBs		All Bank Credits		Share of IBs (%)
	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	
Dec-14	121,321		4,138		1,665		127,124		507,627		25.04
Dec-15	134,990	11.27	6,148	48.59	2,063	23.90	143,201	12.65	617,474	21.64	23.19
Dec-16	160,831	19.14	5,186	-15.65	2,941	42.52	168,957	17.99	713,113	15.49	23.69
Dec-17	191,279	18.93	5,583	7.66	4,237	44.10	201,100	19.02	844,436	18.42	23.81
Dec-18	219,797	14.91	6,162	10.36	4,949	16.80	230,907	14.82	960,462	13.74	24.04
Dec-19	249,885	13.69	7,494	21.62	5,373	8.58	262,752	13.79	1,058,707	10.23	24.82
Dec-20	279,073	11.68	7,753	3.45	7,269	35.27	294,094	11.93	1,144,907	8.14	25.69
Dec-21	337,668	21.00	8,242	6.31	7,538	3.71	353,448	20.18	1,267,561	10.71	27.88
Dec-22	383,584	13.60	10,518	27.61	11,100	47.25	405,202	14.64	1,387,565	9.47	29.20
Dec-23	4,14,680	8.11	14,692	39.69	15,602	40.55	4,44,974	9.82	15,38,453		28.92

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

Table 4.2.10: Islamic Banking Financing by Banks (%)

	IBB	FSIB	EXIM	AAIB	SIB	SJIB	Union	Standard	GIB	ICB	IB Br.	IB Win	Total
Dec-14	38.64	11.91	14.08	12.51	8.37	6.78	2.28			0.74	3.34	1.34	100
Dec-15	37.15	12.53	13.38	11.57	9.05	6.76	3.18			0.64	4.3	1.44	100
Dec-16	36.48	13.07	12.76	11.16	9.9	7.28	3.97			0.55	3.07	1.74	100
Dec-17	34.86	13.24	12.08	11.48	10.12	7.89	5.01			0.44	2.78	2.11	100
Dec-18	34.51	13.06	12.61	11.13	10.25	8.06	5.19			0.37	2.67	2.14	100
Dec-19	34.32	13.84	12.6	10.96	9.97	7.51	5.57			0.32	2.85	2.05	100
Dec-20	34.49	14.09	13.07	10.53	10.08	6.68	5.66			0.29	2.64	2.47	100
Dec-21	33.31	12.84	11.75	9.41	8.71	6.13	5.48	4.64	3.03	0.24	2.33	2.13	100
Dec-22	33.88	13.27	10.96	9.75	8.11	5.85	5.49	4.24	2.93	0.2	2.6	2.74	100
Dec-23	33.82	13.19	10.46	9.6	7.66	5.43	5.75	4.15	2.95	0.18	3.3	3.51	100
Ranking	1	5	7	2	4	6	8	10	9	3			

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

Table 4.2.11: Modes of Islamic Financing Contracts in Bangladesh (%)

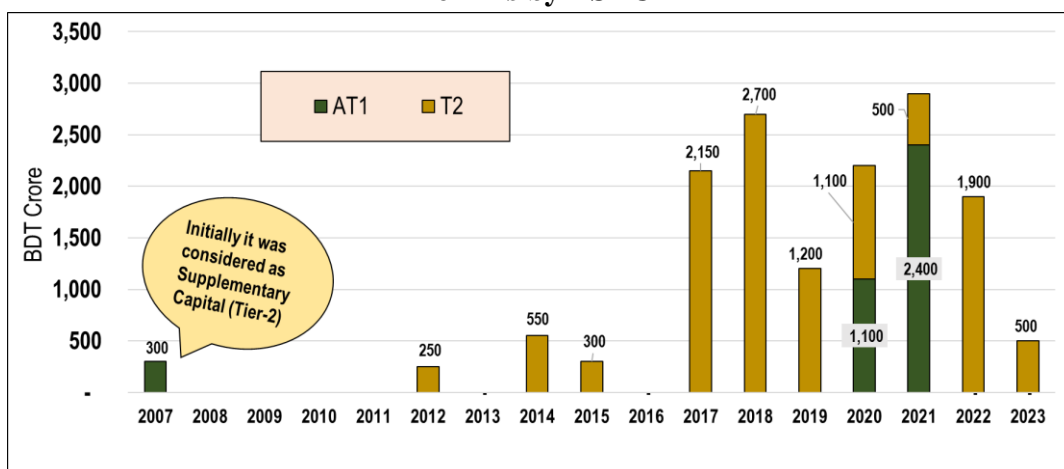
	Bai Murabahah	Bai Muajjal	HPSM	Ijarah	Bai Salam	Bai Istisnaa	Mudarah	Musharakah	Qard with Security	Others	Total
Dec-14	44.24	24.72	15.32	7.34	0.86	0.30	0.29	1.32	1.33	4.10	100
Dec-15	44.47	24.93	16.54	6.08	0.76	0.30	0.38	1.54	1.45	3.59	100
Dec-16	44.64	25.24	15.48	7.41	0.80	0.23	0.32	1.59	1.31	2.98	100
Dec-17	43.81	25.17	16.94	7.35	0.96	0.22	0.26	1.53	1.32	2.44	100
Dec-18	44.33	25.63	17.97	5.42	0.99	0.07	0.26	1.43	1.32	2.58	100
Dec-19	44.60	23.95	23.62	0.02	0.03	1.16	0.32	1.38	0.05	4.87	100
Dec-20	44.97	23.76	18.74	5.05	1.29	0.01	0.33	0.92	1.67	3.26	100
Dec-21	46.39	23.24	18.98	4.32	1.23	0.02	0.25	0.49	1.11	3.98	100
Dec-22	47.71	22.94	17.68	4.04	1.36	0.06	0.26	0.28	0.97	4.70	100
Dec-23	47.57	22.5	17.88	4.07	1.70	0.06	0.25	0.32	0.88	4.75	100

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

4.2.8 Islamic Bond Issued by Islamic Banks in Bangladesh

To meet capital requirements, Islamic banks in Bangladesh issue bonds structured according to Shari'ah principles, starting with Islami Bank Bangladesh PLC (IBB) in 2007. Over the years, other Islamic banks have followed suit, issuing bonds as Additional Tier 1 (AT1) and Tier 2 (T2) capital, in accordance with the capital adequacy guidelines set by Bangladesh Bank. The Bangladesh Securities and Exchange Commission (BSEC) oversees the approval of these bonds. In 2021, a record issuance of BDT 2,900 crore in Mudarabah bonds was observed, marking the highest issuance in a single year. This trend underscores the growing importance and utilization of Islamic bonds in maintaining the financial stability and capital adequacy of Islamic banks in Bangladesh. However, it is expected that IBs will issue Islamic Shari'ah-based securities (ISBS), as defined by BSEC, instead of bond.

Figure 4.2.1: Islamic Capital Market in BD: Mudarabah Bonds Approved for IBs by BSEC



Source: BIBM 2024

4.2.9 Bangladesh Government Islamic Investment Bond (BGIIB)

All banks in Bangladesh are required to maintain a Statutory Liquidity Reserve (SLR) as per guidelines set by Bangladesh Bank. Conventional banks primarily invest their funds in government securities, which usually bear interest. To facilitate Islamic banks, the Bangladesh Government Islamic Investment Bond (BGIIB) was introduced in 2004. Table 4.2.12 summarizes the status of BGIIB over the period of 2013-2023. Notably, in 2023, the net balance was significantly reduced to BDT 9.32 billion, indicating a severe liquidity crunch in the banking industry. This trend underscores the growing challenges faced by Islamic banks in maintaining liquidity while adhering to Shari'ah-compliant financial principles.

Table 4.2.12: Bangladesh Government Islamic Investment Bond (BDT Billion)

	Sale	Financing	Net Balance
FY13	107.13	67.78	39.35
FY14	121.34	24.37	96.96
FY15	135.84	25.40	110.44
FY16	122.94	37.80	85.95
FY17	84.01	54.70	29.31
FY18	92.95	81.20	11.75
FY19	107.11	84.80	22.31
FY20	131.88	67.82	64.06
FY21	170.21	12.74	157.47
FY22	86.64	33.49	53.14
FY23	81.36	72.04	9.32

Source: Quarterly Report on Islamic Banking in Bangladesh by Bangladesh Bank

4.2.10 Bangladesh Government Investment Sukuk (BGIS)

The Bangladesh Government launched Sukuk in 2020, issuing a total of four Bangladesh Government Investment Sukuk (BGIS) worth BDT 19,000 crore. Table 4.2.13 presents a comparative summary of these BGIS. Since BGIS meets the Statutory Liquidity Reserve (SLR) requirements, many Islamic banks are encouraged to invest in this Shari'ah-compliant instrument. To prioritize Islamic banks, Bangladesh Bank has implemented a quota system for allocating BGIS. Conventional banks have also shown interest in investing in BGIS, and all four BGIS were oversubscribed. Aside from BGIS-1, the majority of the BGIS allocations were given to Islamic banks. All four Sukuk have a five-year maturity and are classified as social impact Sukuk. Notably, BGIS-4 offers a 10.40 percent fixed return under the Ijarah principle.

Table 4.2.13: Comparative Summary of Bangladesh Government Investment Sukuk (BGIS)

	BGIS-1	BGIS-2	BGIS-3	BGIS-4
Name	Ijarah Sukuk	Ijarah Sukuk	IRIDP-3 Social Impact Sukuk	CDWSP Social Impact 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)
Issue Date	<ul style="list-style-type: none"> 1st tranche: 28.12.20 2nd tranche: 09.06.21 	30 December 2021	20 April 2022	06 June 2024
Tenure	5 years	5 years	5 years	5 years
Issue Amount	<ul style="list-style-type: none"> 1st: BDT 4,000 crore (≈ USD 473 million) 2nd: BDT 4,000 crore (≈ USD 473 million) 	BDT 5,000 crore (≈ USD 585 million)	BDT 5,000 crore (≈ USD 580 million)	BDT 1,000 crore (≈ USD 116 million)
Principal Contract	Ijarah	Ijarah	Istisna'a and Ijarah	Istisna'a and Ijarah
Rate	4.69% (payable on a half-yearly basis)	4.65% (payable on a half-yearly basis)	4.75% (payable on a half-yearly basis)	10.40% (payable on a half-yearly basis)
Bid Submitted against Auction	<ul style="list-style-type: none"> 1st tranche: 3.8 times the issue amount 	4.7 times the issue amount	2.5 times the issue amount	4.4 times the issue amount

	<ul style="list-style-type: none"> • 2nd tranche: 8.2 times the issue amount 			
Sukuk Allocation	1 st Tranche Allocation: <ul style="list-style-type: none"> • Full-fledged IB (30.03%) • Conventional Banks (52.38%) • Branch/win-dow-based IB (17.59%) • Individuals (0.001%) 	<ul style="list-style-type: none"> • Full-fledged IB (74%) • Conventional Banks (16%) • Branch/win-dow-based IB (10%) • Individuals (0.01%) 	<ul style="list-style-type: none"> • Full-fledged IB (95%) • Conventional Banks (0%) • Branch/win-dow-based IB (5.00%) • Individuals (0.12%) 	<ul style="list-style-type: none"> • Full-fledged IB (85%) • Branch/win-dow-based IB (10%) • Conventional Banks (0%) • Individuals (5%)

Source: Bangladesh Bank; and IIFM Sukuk Report 2023

During the interviews and focus group discussions (FGD), several key issues were highlighted. Participants emphasized that Shari’ah compliance and the actual activities of Islamic banking should be accurately reflected in the accounting processes. They noted that there is considerable room for improvement in the internal Shari’ah audit system, and there is a notable lack of external Shari’ah audits. Banks often use documents copied from other sources without sufficient modification, indicating a need for more rigorous review and updating of these documents. The industry is also expecting an updated version of the Islamic banking guidelines from Bangladesh Bank (BB). Additionally, the limitations of the existing risk management approaches followed by Islamic banks were underscored, suggesting a need for more robust and tailored risk management frameworks. For easy access to overall Islamic finance data base, a platform may be established.

4.3 Islamic Banking Operations in Bangladesh: Summary of Questionnaire Survey

Findings from primary data collected through questionnaire have been described in this section. Since all banks were not able to provide required information, the analysis was conducted based on the congregated responses only.

4.3.1 Human Capital of Islamic Banks

In 2023, out of total employees of IBs, almost 90% were male, 98.5% were Muslim and 98% were permanent (Table 4.3.1).

Table 4.3.1: Manpower of Islamic banks

Particulars	Status in 2023
Male employees for IB (%)	89.80
Female employees for IB (%)	10.20
Muslim employees for IB (%)	98.50
Non-Muslim employees for IB (%)	1.50
Permanent employees for IB (%)	98.10
Temporary employees for IB (%)	1.90

Source: Survey Data

According to Table 4.3.2, it has been perceived by all Islamic banks that executives of this industry must possess the specialized knowledge to deliver effective services as previous. Besides, almost all respondents preferred different certification/diploma programs related to Islamic banking for all mid-level executives to serve the customers with more knowledge-based services. Even though a little positive shift (2%) has been observed in case of being more than 90% satisfied about the number of executives having Islamic banking knowledge, it should gain more.

Table 4.3.2: Perception of bank employees for capacity development of IBs

S/N	Aspect		2021	2023
1.	Proportion of banks perceive that specialized knowledge is required to perform Islamic banking effectively (%)		100	100
2.	Proportion of banks perceive that certification/diploma program related with IB should be preferable for all mid-level executives (%)		97	96
3.	Satisfaction level about sufficient number of executives having Islamic banking knowledge (%)	Above 90%	14	16
		(80-90)%	32	19
		(60-80)%	35	41
		(50-60)%	5	13
		Below 50%	14	13

Source: Survey Data

4.3.2 General Banking Operations in Islamic Banks

Table 4.3.3 elucidates the general banking related information including deposit mobilization by Islamic banks of Bangladesh. Some additional formalities/documents are required for opening deposit accounts with Islamic banks has been observed in 2023. Some regulatory/policy related difficulties were observed by IFIs in case of collecting deposit, like- lack of Shariah-compatible regulatory and supervisory standard, inability of NBFIs to receive deposit from client, etc. Like before, 17 percent banks still believe that their deposit products are suffering from some deficiencies which lag them behind in fulfilling the customers' multi-facet needs, which requires extensive market survey and up-gradation of current product propositions. Despite of this, IBs introduced more deposit products in 2023 compared to 2021 as well as within last two years, which is very encouraging. Among some special religious-deposit products, IBs gave highest attention to Hajj savings deposits followed by cash Waqf deposit in 2023.

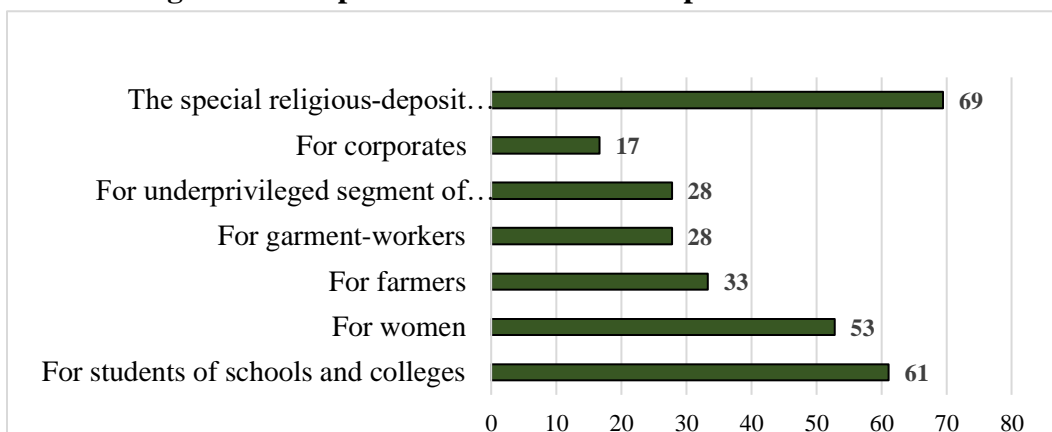
Table 4.3.3: General banking operations including deposit mobilization in IB

S/N	Aspect		2021	2023
1.	Banks where there is any additional formality/document required for opening deposit a/c as an Islamic bank (%)		17	15
2.	Banks facing any regulatory/policy difficulty for collecting deposit as an Islamic bank (%)		17	28
3.	Banks believing that there is a deficiency in deposit products in Bangladesh for meeting customer needs (%)		17	17
4.	Framework for rate of return calculation for the Mudaraba depositors (%)	Weightage-based method	57	58
		ISR-based method	43	39
5.	Introduction of new deposit products (%)	In previous Year	52	68
		Within previous two years	50	62
		Within previous five years	62	58
6.	Special religious-deposit products (%)	Hajj savings deposit	96	88
		Muhor savings deposit	61	75
		Cash Waqf deposit	80	83
		Others (Marriage Account, Zakat Savings Account, Sadaqah Account etc.)	4	34

Source: Survey data

As before, Islamic banks offered some special IB products in 2023 to mobilize deposit covering diverse parts of the society. Of them, almost 70 percent of banks have special religious-deposit products, followed by deposits for students of schools and colleges and then for women as depicted in Figure 4.3.1.

Figure 4.3.1: Special IB Products for Deposit Mobilization



Source: Survey Data

4.3.3 General Banking Operations in Islamic Banks

As per Table 4.3.4, number of issues/problems have been perceived related to general banking operations of Islamic banks. Of them shortage of skilled and knowledgeable manpower, lack of understanding and awareness of customers about Islamic Banking leading to unrealistic demands for fixed profit rates, limited product diversification, decreasing savings levels due to high inflation and lack of Shariah awareness among clients and staff are notable.

Table 4.3.4: Issues/Problems related to general banking operations faced by Islamic banks

SN	Problem
1.	Shortage of skilled and knowledgeable manpower.
2.	Lack of understanding and awareness of customers about Islamic Banking leading to unrealistic demands for fixed profit rates.
3.	Limited product diversification and inconsistency in applying banking methods.
4.	Competition for deposits and improper maintenance of financial records.
5.	Absence of a separate Islamic Bank Company Act.
6.	Decreasing savings levels due to high inflation and a general lack of Shariah awareness among clients and staff.

Source: Survey data

Some recommendations/observations by the respondents have been placed in Table 4.3.5 to solve the issues/problems addressed in Table 4.3.4. In 2023, banks focused more on establish a Central Shariah Supervisory Board and enhance monitoring through the SSC, prioritize short-term deposits and diversify product offerings, update policy guidelines to reflect the spot-on scenario of IB industry, specific employees should be assigned dedicated to deal with Islamic banking products and

upgrade them through extensive Shariah-based training on regular basis, arrange customer awareness programs for better understanding of their multifarious needs, procure separate Core Banking Software with consolidated report facilities for Islamic banking windows/branch, employees expecting to transfer from conventional branch to Islamic banking branch/window should receive at least 30 days of training on Islamic banking operations.

Table 4.3.5: Observations of Issues/Problems related to General Banking of IBs

SN	Recommendations
1.	Establish a Central Shariah Supervisory Board and enhance monitoring through the SSC.
2.	Prioritize short-term deposits and diversify product offerings.
3.	Update policy guidelines to reflect the spot-on scenario of Islamic Banking industry.
4.	Specific employees should be assigned dedicated to deal with Islamic banking products and upgrade them through extensive Shariah-based training.
5.	Ensure proper implementation of institutional steps to get benefits of regulatory initiatives.
6.	Arrange customer awareness programs for better understanding of their multifarious needs.
7.	Disseminate Shariah knowledge among stakeholders and ensure strict monitoring of it by the regulator.
8.	Procure separate Core Banking Software with consolidated report facilities for Islamic Banking Windows.
9.	A separate Islamic Bank Company Act can be introduced.
10.	Employees expecting to transfer from conventional branch to Islamic banking branch/window should receive at least 30 days of training on Islamic banking operations.
11.	Arrange more knowledge and views exchanged based programs on Islamic banking among the stakeholders, specially cover bank employees and customers on regular basis.

Source: Survey data

4.3.4 Shari’ah Supervisory Committee (SSC) of Islamic Banks

Shari’ah Supervisory Committee (SSC) and its secretariat related observations are discoursed in Table 4.3.6. In 2023, all aspects but banks having provision of job rotation for the executives of Shariah secretariat in the main-stream banking operation, experienced a positive change. The industry always welcomes the logical blending of branch banking experience and Shari’ah knowledge among the auditors of IBs which has been observed in 2023. Besides, 70 percent respondent opined that member of BoD should not be the member of SSC.

Table 4.3.6: Shariah Supervisory Committee (SSC) and its secretariat

S/N	Aspect	2021	2023
1.	Average number of members in Shariah Supervisory Committee (SSC) including chairman (No.)	Maximum	13
		Minimum	5
		Average	8
2.	No. of SSC meeting held in a year (Range)	1-6	1-7
3.	Banks having provision of job rotation for the executives of Shariah secretariat in the main-stream banking operation	65	54
4.	Shariah auditors having branch banking experience (% of executives)	78	87

Source: Survey Data

Table 4.3.7 exhibits the issues related to head of Shariah Secretariat and Member Secretary of SSC. Only 36 percent IBs have specific requirement in written for the post of Shari'ah Secretariat head, which is expected to be more. Banks were little bit rigid in allowing Shariah Secretariat Head/ Member Secretary of SSC to attend full BoD meeting and ACB meeting in 2023 compared to 2021, but reverse picture has been observed in case of EC meeting and RMC meeting. In all the cases, an interactive and fruitful participation is always welcome for sustainable development of IBs. 46 percent IBs allowed Shariah Secretariat Head/Member Secretary of SSC to attend MANCOM/SMT meetings which was 52 percent in earlier study, reflecting their less participation.

Table 4.3.7: The Head of Shari'ah Secretariat and Member Secretary of SSC

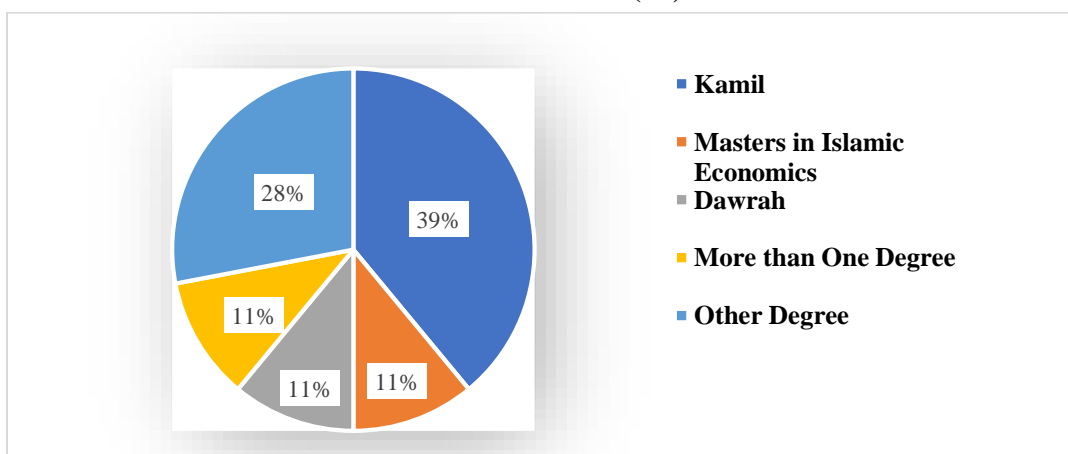
S/N	Aspects		2021	2023
1.	Banks having the member secretary of SSC as an official of the bank (%)		71	61
2.	Position of Shariah Secretariat head in the job ladder (- ----step immediate below the MD/CEO)	Max.	9	9
		Min.	2	0
3.	Banking experience of the Shariah Secretariat head (Years)	Max.	35	35
		Min.	5	1
4.	Banks having specific requirement in written for the post of Shariah Secretariat head (%)		48	36
5.	Banks having the head of Shariah Secretariat perform operational duties for the banks or its affiliates (%)		46	37
6.		Full BoD meeting	42	32

	Banks allowing Shariah Secretariat Head/ Member Secretary of SSC to attend board level meetings (%)	EC meeting	22	33
		RMC meeting	24	30
		ACB meeting	30	23
7.	Banks allowing Shariah Secretariat Head/ Member Secretary of SSC to attend MANCOM/SMT meetings (%)		52	46

Source: Survey Data

Heads of Shariah secretariat ought to have specialized academic degrees. In this case, the highest attention was drawn by ‘Kamil’ degree, whereas other got same level of concentration (Figure-4.3.2). Appropriate synchronization between banking requirement and Shariah-based knowledge is imperative to attain competitive advantage of the industry.

Figure 4.3.2: Specialized academic degree of the Shariah Secretariat heads (%)



Source: Survey data

4.3.5 Investment Operations in Islamic Banks

Different aspects related to investment operations of IBs are expounded in Table 4.3.8. In 2023, additional formalities/documents required for opening an investment account with Islamic banks, as observed from the table. To fulfill the customers’ up-to-the-minute needs, 55 percent IBs introduced new investment products within previous two years. All Islamic banks were very conservative in carrying out different special investment products for charity purpose, remarkably *Qard-e-Hasan*.

Table 4.3.8: Investment operations in Islamic banking

S/N	Aspect		2021	2023
1.	Additional formality/ document required for opening investment A/c in Islamic bank (%)		60	65
2.	Banks having Islamic credit card (%)		41	35
3.	Introduction of new investment products (Islamic) in bank (%)	In previous year	60	44
		Within previous two years	53	55
		Within previous five years	44	41
4.	Banks having special investment products for charity purpose (%)	Qard-e-Hasan for own employees	19	7
		Qard-e-Hasan for others	14	7
		Others (Qard against MTDR, etc.)	33	22

Source: Survey data

IBs faced a number of problems related to investment operations in 2023. It has been vividly mentioned by the respondent that still the industry is suffering from the failure to reach the desired level of awareness among the customers regarding investment products, shortage of skilled manpower as well as knowledgeable customers, dearth of sufficient and need based investment products, challenging to meet up customers' cash need directly are some of them (Box 4.1). Addressing these problem respondents paced some suggestions as well. Organize formal gathering with the existing and prospective clients on regular basis, select third parties very carefully to ensure the 'complete buying and selling process' in investment, deal wise agreement should be practiced more to ensure Shari'ah compliance, etc. are mentionable.

Box 4.1: Problems and Possible Suggestions in Islamic Investment Operations

	Problems	Suggestions
i.	Lack of awareness among the customers regarding investment products of Islamic Banking	Organize formal gathering with the existing and prospective clients on regular basis to make them understood and uplift their awareness regarding investment with IBs.
ii.	Shortage of skilled manpower	Introduce some third parties (approved by the concern authority) to ensure the 'Complete buying and selling process' in investment.
iii.	Customers do not have adequate knowledge	Deal wise agreement is required in investment to ensure Shari'ah compliance.
iv.	Dearth of sufficient and need based investment products	Arrange different issue specific views-exchange programs with customers.
v.	Challenging to meet up customers' cash need directly	More focus should be given on effective monitoring in recovery.
vi.	Increasing rate of willful defaulters	Buying Agent should be selected very carefully.

Source: Survey data

Islamic banks offered some special IB products in 2023 as well besides their regular investment products to deploy their funds covering more parts of the society. Of them, 45 percent banks have special Islamic investment product for woman entrepreneurs, followed by farmers (34%), corporates (28%) and others as displayed in Figure 4.3.3.

Figure 4.3.3: Special IB Investment Products



Source: Survey data

4.3.6 Different Issues Regarding Investment in Islamic Banking

Some issues, well-connection with Islamic banking operations are shown in Table 4.3.9. It is very appreciating that, IBs gave more attention on research in 2023 to explore the market potentiality as well as recover the existing limitations of IB products/services. In addition, 29 percent IBs designed new Islamic banking product within last 5 years as a pioneer, in earlier study which was only 17 percent. Banks position in believing the visible impact of Islamic banking system on the overall economy and society of Bangladesh, which was not possible through conventional banking system, was almost same both in 2021 and 2023. Banks were comparatively reluctant in doing market survey within last 5 years to know demand-side perception/need as it was reduced by 48.65 percent in 2023 over 2021. IBs should concentrate more on their promotional activities to make their product/services eminent and attractive to capture the untapped market, as 4 percent respondents opined that within last 5 years not a single customer asked regarding their IBs’ product/services.

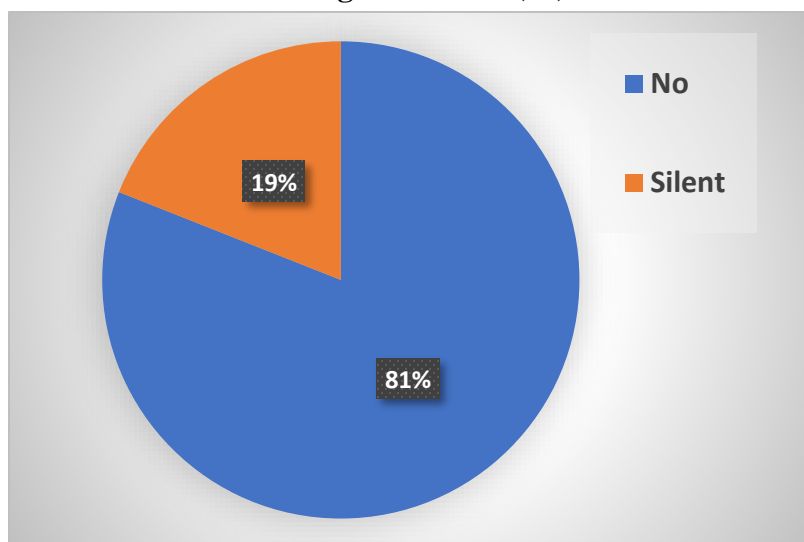
Table 4.3.9: Different Issues Regarding Investment in Islamic Banking (%)

S/N	Aspects	2021	2023
1.	Banks having research department (%)	24	30
2.	Banks maintaining data-base for Islamic financial product and services offered by banking industry in Bangladesh (%)	17	20
3.	Banks maintaining data-base for Islamic financial product and services offered by other country's (%)	10	11
4.	Banks conducting market survey within last 5 years to know demand-side perception/need (%)	37	19
5.	Banks designing new Islamic banking product within last 5 years as a pioneer, which was not offered previously in Bangladesh (%)	17	29
6.	Banks dropping/discontinuing their old products within last 5 years (%)	18	14
7.	Banks believing the visible impact of Islamic banking system on the overall economy of Bangladesh, which was not possible through conventional banking system (%)	79	80
8.	Banks believing the visible impact Islamic banking system on society, which was not possible through conventional banking system (%)	76	76
9.	Banks having Islamic banking product/services which was not asked by any customer within last 5 years (%)	0	4

Source: Survey data

On the issue of doubtful income, 81% respondent claimed that they didn't transfer it to the bank's income as management cost, whereas 19% were silent.

Figure 4.3.4: Doubtful Income Transferred to Bank's Income as Management Cost (%)



Source: Survey data

Some other issues related to overall Islamic banking are covered in Table 4.3.10. In case of measuring Shariah non-compliance risk using internal Shari'ah rating, all IBs has a system in place. Besides, more than 80 percent respondents expected external Shariah rating system in this regard. A significant number of IBs believed that there is a limited opportunity for training (71%) as well as dearth of IB scholars for expansion of the industry in Bangladesh (82%).

Table 4.3.10: Other issues in Islamic banking (%)

S/N	Aspect	2021	2023
1.	Islamic banks having internal Shariah rating system for measuring Shariah Non-Compliance risk	100	100
2.	Islamic banks expecting external Shariah rating system for the banking industry of Bangladesh	83	81
3.	Islamic banks believing that there is a limited opportunity for training on IB in Bangladesh	67	71
4.	Islamic banks thinking that there is a dearth of IB scholars for expansion of the industry in Bangladesh	76	82
5.	Islamic banks thinking that there is a demand for expansion of IB industry in Bangladesh	93	93
6.	Applied previously but did not get license for additional branch/windows	25	66

Source: Survey Data

5. Issues and Recommendations

Based on the secondary data analysis, opinions collected through the questionnaire, and input from stakeholders through interviews and discussions with professional experts during FGDs, the research team has identified several key issues for discussion. Leveraging the team's understanding, a set of recommendations has been developed and included in this section. These observations and recommendations have been finalized after considering the outputs of the workshop, which is attended by a pool of expert Islamic finance professionals. This collaborative approach is followed to ensure that the recommendations are well-informed and comprehensive, addressing the needs and challenges of the Islamic banking sector in Bangladesh.

5.1 Enhance Market Reputation and Image

In recent years, the reputation and image of the Islamic banking industry in Bangladesh have suffered due to negative media reports. Until 2022, the financial strength, profitability, and stability of the industry were superior to the overall banking sector. However, from 2022 onwards, the industry has shown signs of decline. To restore the positive image of the Islamic banking sector, several initiatives should be undertaken. These include publishing positive and transparent reports in public domains and on social media, organizing more seminars and workshops, and arranging public lectures. Additionally, providing intellectual and satisfactory responses to issues raised will help rebuild trust and confidence in the industry. These efforts will contribute to regaining the favorable perception of Islamic banking in Bangladesh.

5.2 Strengthening Governance and Transparency

Recent years have seen the Islamic banking (IB) industry in Bangladesh marred by publicized scams and raised concerns regarding Shari'ah compliance. These issues highlight the need for improved governance and enhanced transparency within the sector. Key components of good governance, such as external Shari'ah audits, are currently lacking. To address these challenges, it is essential to ensure the active involvement of the Shari'ah Supervisory Committee (SSC).

The composition of the SSC should include not only Shari'ah scholars but also subject-matter experts to provide a comprehensive oversight. There should be systematic evaluations of the SSC and its members to ensure their performance and contributions meet the required standards. Implementing continuous professional development (CPD) requirements for SSC members will help keep them updated with the latest knowledge and practices in Islamic finance.

Additionally, the publication of Fatwas issued by the SSC will promote transparency and trust among stakeholders. The SSC should be more involved in the operational aspects of Islamic banks by increasing the frequency of their meetings and ensuring the minutes are communicated effectively with the central bank. Regular interactions between the Board of Directors (BoD) and SSC members will facilitate better understanding and cooperation.

Organizing get-togethers for SSC members to exchange views and discuss issues can lead to more effective solutions to Shari'ah-related challenges. These measures will collectively contribute to restoring confidence in the Islamic banking industry by ensuring that it operates with the highest standards of governance and transparency.

5.3 Accounting and Reporting

The banking sector of Bangladesh adheres to International Financial Reporting Standards (IFRS) for accounting purposes. However, certain Islamic banking products and services, along with their underlying principles, do not align seamlessly with conventional accounting practices. Recognizing the unique aspects of Islamic banking and finance (IBF), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has developed a set of standards tailored specifically for this sector. Despite their relevance, these standards have not yet been adopted or implemented in Bangladesh.

Some Bangladeshi professionals have already obtained the Certified Islamic Professional Accountant (CIPA) qualification, offered by AAOIFI, indicating a readiness within the professional community to embrace these specialized standards. To evaluate the potential benefits and challenges of adopting AAOIFI standards alongside IFRS, it is recommended that the concerned regulatory authority will establish a committee. This committee should include representatives from the central bank, the banking sector, accounting professionals, and Shari'ah scholars.

The committee's mandate would be to conduct a comprehensive review of the AAOIFI standards, considering their applicability and potential to enhance the transparency, consistency, and reliability of financial reporting in the Islamic banking sector. This initiative could help bridge the gap between conventional and Islamic accounting practices, ensuring that Islamic financial institutions in Bangladesh are better equipped to meet global standards and stakeholder expectations.

By aligning the accounting and reporting practices with internationally recognized standards, the Islamic banking industry in Bangladesh can improve its credibility and attractiveness to both local and international investors. This step would also ensure that the financial statements of Islamic banks more accurately reflect their financial position and performance, thereby enhancing stakeholder confidence and supporting the industry's sustainable growth.

5.4 Strengthening Shari'ah Auditing Practices

Internal and external audits are crucial components of corporate governance, ensuring transparency and compliance within any financial institution. For Islamic Financial Institutions (IFIs), the significance of Shari'ah audits is even greater, as these audits verify that operations comply with Islamic law. AAOIFI and IFSB both recommend the implementation of internal and external Shari'ah audits to uphold Shari'ah compliance.

Most IBs in Bangladesh have established internal Shari'ah audit mechanisms. However, to ensure their effectiveness, it is essential to focus on their operational independence and efficiency. These internal audits must be empowered to identify and report Shari'ah non-compliance issues without any undue influence from other departments or management. Strengthening the independence and functional integrity of internal Shari'ah audits will enhance their role in maintaining the ethical and religious standards of Islamic banking and finance.

Despite the progress in internal auditing, Bangladesh has yet to implement external Shari'ah audits comprehensively. The Bangladesh Securities and Exchange Commission (BSEC) has shown a positive inclination toward approving licenses for external Shari'ah rating firms, which is a promising step forward. To date, Bangladesh boasts over 550 Certified Shari'ah Advisors and Auditors (CSAA) certified by AAOIFI. These professionals are well-equipped to undertake rigorous Shari'ah audits, ensuring that all aspects of Islamic banking operations adhere to Shari'ah principles.

Implementing external Shari'ah audits will provide an additional layer of assurance to stakeholders, enhancing the credibility and integrity of Islamic financial institutions. It will also align Bangladesh's Islamic banking practices with international standards, fostering greater trust among investors, customers, and the global financial community. Therefore, regulatory authorities and industry stakeholders should prioritize the establishment and rigorous enforcement of external Shari'ah audits to ensure comprehensive Shari'ah compliance across the sector.

5.5 Standardization of Documents for Shari'ah Compliance

In Islamic Banking and Finance (IBF), both the substance and form of financial operations must adhere to Shari'ah principles. However, discrepancies often arise where an operation might be Shari'ah-compliant in practice, but the associated contract forms and documentation processes fall short of compliance, or vice-versa. To address this issue, it is essential that all documents, contract forms, and advertising materials are thoroughly reviewed and vetted by competent Shari'ah scholars.

This rigorous review process ensures that every aspect of the operation aligns with Islamic principles. Additionally, derivative banking products and services, along with their relevant documents, should also undergo Shari'ah review to maintain overall compliance. It's not just about initial compliance; regular reviews are crucial to ensure that all documents and procedures stay current and effective in meeting Shari'ah standards.

Furthermore, banking manuals, product-program guidelines (PPGs), and applicable forms should be periodically reviewed by an independent third party. This 'third eye' review ensures that documents are not only updated but also enhanced to meet evolving Shari'ah compliance needs and market dynamics. Regular reviews and updates help in maintaining the integrity of Islamic banking operations and foster trust among customers and stakeholders.

Implementing these measures will reinforce the Shari'ah-compliant nature of Islamic banking products and services, enhancing their credibility and acceptance in the market. It will also ensure that the Islamic banking industry in Bangladesh operates with the highest standards of transparency and ethical conduct, contributing to its growth and sustainability.

5.6 Specialization for Business Professionals in the IB Sector

In Islamic Banking and Finance (IBF), ensuring both traditional banking practices and adherence to Shari'ah principles is crucial. Professionals in Islamic Financial Institutions (IFIs) must possess comprehensive knowledge of operational practices and Shari'ah compliance to excel in their roles. Having a professional degree or recognition in Islamic finance can provide significant advantages, making individuals more effective and efficient in their positions.

To enhance the quality of human resources in the IB sector, it is recommended that concerned authorities and employers allocate additional weight to candidates possessing such qualifications during hiring and promotion processes. Recognizing

the value of specialized knowledge and professional credentials will not only ensure that employees are well-equipped but also motivate current and prospective professionals to pursue relevant qualifications.

By prioritizing specialized training and certification, the IB sector can build a workforce that is adept at navigating both conventional financial operations and the unique requirements of Islamic finance. This approach will contribute to the overall growth and credibility of the industry, ensuring that it meets the highest standards of professional excellence and Shari'ah compliance.

5.7 Strengthening the Regulatory Framework

To ensure the sustainability and growth of Islamic banking and finance, several areas need further regulatory attention. First, it is crucial to update the “Guidelines for Islamic Banking 2009” and the “Guidelines on Internal Control & Compliance in Banks 2016” to reflect the evolving financial landscape, new financial products, technological advancements, and changing regulatory standards. Establishing a dedicated Islamic banking department within the central bank can provide focused oversight, ensuring the sector's growth, stability, and adherence to Shari'ah principles.

Moreover, forming a Central Shari'ah Board (CSB) at central bank will provide unified guidance, resolve disputes, and support individual institution-level boards. It is noted that BSEC has already formed a Shaiah Advisory Council for the security market. This can be complemented by forming a dedicated Shari'ah audit team at the central bank to rigorously oversee compliance activities. Implementing a standardized Shari'ah governance framework across all Islamic financial institutions (IFIs), in line with the latest IFSB-AAOIFI Revised Shari'ah Governance Framework (RSGF), will ensure consistency and uphold Shari'ah principles effectively.

Additionally, issuing industry-specific circulars tailored for Islamic banks will address unique needs, such as profit rates on deposits, return rates on investments, asset insurance, refinancing, provisions, write-offs, waivers, rescheduling, restructuring, deferral facilities, VAT, tax, and stamp charges. This will simplify compliance without compromising the interest-free nature of Islamic banking. It is noteworthy that Bangladesh Bank is forming a team of Islamic finance experts to strengthen regulatory and supervisory practices, thereby fostering a well-regulated and robust Islamic banking and finance sector.

5.8 Strengthening Risk Management Practices

Risk management systems should be tailor-made to align with the nature of the entity, its operations, salient products, services, and activities. At present, Bangladeshi banks, both conventional and Islamic, are following a single approach and framework for their risk management. To enhance the stability of Islamic banking and finance, it is crucial to develop and enforce comprehensive risk management frameworks tailored to the unique risks they face, including Shari'ah non-compliance risk. These frameworks should address all aspects of risk, ensuring a holistic approach to risk management. Additionally, conducting regular stress testing is essential to assess the resilience of IFIs to various economic and financial shocks. Given the current liquidity crisis faced by Islamic banks in the country, these tests will help identify potential vulnerabilities and prepare contingency plans to manage liquidity and other crises effectively in the future. It is well-known that adopting a preventive approach in advance is far better than addressing issues after they occur. Therefore, the industry should seriously consider new dimensions of risk management to proactively address emerging challenges.

5.9 Comprehensive Report on IBF of Bangladesh

Currently, most components of Islamic finance are present in Bangladesh, including Islamic banking, Sukuk, AuM, Takaful, crowdfunding, and other social finance. To support these sectors, concerned regulators are taking various initiatives. Additionally, several entities are playing supportive roles in education, training, seminars, and podcasts. However, there is no platform that consolidates all this information. Therefore, an initiative should be undertaken to compile all data related to Islamic banking and finance in Bangladesh, providing stakeholders with regular updates. Recently, Bangladesh has been featured in international reports such as the Islamic Financial Stability Report by IFSB, the Islamic Finance Development Report by LSEG, the Global Islamic Finance Report by Cambridge IFA, Global Islamic Bankers' Survey by the General Council for Islamic Banks and Financial Institutions (CIBAFI) and Islamic Finance News by REDmoney Group. There should also be initiatives to ensure proper reporting and representation of Bangladesh in the international domain, highlighting the country's progress and contributions in Islamic finance.

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Appendix I

Selected Recommendations Made in the Previous Review Paper(s)

SN	Recommendation
1.	Enactment of Separate Islamic Banking Act
2.	Initiative to Introduce Cash <i>Waqf</i>
3.	Introduction of Commodity Murabaha in Bangladesh
4.	Introduction of Longer-Term Deposit Product in Islamic Banks
5.	Launching Certification Program on Islamic Banking
6.	Central Shariah Board with Supervisory Authority
7.	Striving for More PLS Mode of Financing
8.	Introduction of Sukuk for Efficient Liquidity Management
9.	Separate Shariah Appellate Bench at High Court
10.	Creation of More Shariah Auditors
11.	Introduction of Products for Giving Cash Assistance
12.	Expansion of More Islamic Branches in Rural Areas
13.	Composition of SSC as per Global Standard Considering Competency, Independence and Engagement
14.	Development of Research Cell for Structuring Shariah-Compliant Innovative Products and Services
15.	More Training for Islamic Finance Professionals
16.	Introducing Islamic Social Business in Bangladesh
17.	Nominal and Effective Profit Rate on Investment Considering Mode of Contract and Actual Recovery in Compliance with the BB regulations
18.	More Elaboration of the Circulars by the Regulators for Islamic Banking Industry
19.	Inclusion of a New Dimension in CAMELS Rating Called ‘Shariah Compliance’
20.	Setting up of Waqf Bank for Promoting Islamic Social Business

Appendix II

List of Banks Responded to the Questionnaire

S/n	Name of Bank	S/n	Name of Bank
1.	Islami Bank Bangladesh PLC	2.	Sonali Bank PLC
3.	Social Islami Bank PLC	4.	Pubali Bank PLC
5.	Export Import Bank of Bangladesh PLC	6.	Rupali Bank PLC
7.	Al-Arafah Islami Bank PLC	8.	ONE Bank PLC
9.	Global Islami Bank PLC	10.	Jamuna Bank PLC
11.	First Security Islami Bank PLC	12.	Mutual Trust Bank PLC
13.	Shahjalal Islami Bank PLC	14.	South Bangla Agriculture and Commerce Bank PLC
15.	Standard Bank PLC	16.	National Credit and Commerce Bank PLC (NCC)
17.	Union Bank PLC	18.	Mercantile Bank PLC
19.	Southeast Bank PLC	20.	The Premier Bank PLC
21.	Dhaka Bank PLC	22.	NRB Bank Limited
23.	Prime Bank PLC	24.	Bank Asia PLC
25.	Trust Bank Limited	26.	Bangladesh Commerce Bank Limited
27.	City Bank PLC	28.	Midland Bank PLC
29.	Agrani Bank PLC	30.	Standard Chartered Bank
31.	NRB Bank PLC	32.	Bengal Commercial Bank PLC
33.	Meghna Bank PLC	34.	AB Bank PLC
35.	United Commercial Bank PLC		

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