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Islamic Banking Operations of Banks

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Islamic Banking Operations of Banks

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Forewords

The findings of the review workshop titled “Regulatory Reporting Requirements for Banks in Bangladesh” are presented as part of the ongoing dissemination of BIBM research outputs. The research was presented in an online session held on the Zoom platform on 14 September, 2022. Regulatory reports help regulators early identification of the risks and concerns that might affect safety and soundness of banks and undertake timely corrective actions. Regulatory and financial reports prepared and submitted or disseminated in response to the regulatory requirements are also useful to the shareholders, depositors, and other stakeholders of the banks and financial institutions.

To achieve the goals of the study, both primary and secondary data were gathered. Secondary information was collected from a variety of sources (journal articles, reports etc.) pertaining to regulatory reporting. Based on the survey and questionnaire data, the review study puts forward observations and recommendations for streamlining the regulatory reporting practices by banks in Bangladesh. It brings me great pleasure to offer this valuable resource of academic insights to bank and financial institution practitioners, regulatory agencies, policymakers, academics, and general readers on behalf of BIBM. I think that this review workshop will be a useful resource for policymakers in banking operations. We welcome feedback from our valued readers on this topic, as it will undoubtedly assist us in improving our research operations in the next years.

Md. Akhtaruzzaman, Ph.D.

Director General, BIBM

Acknowledgment

The review workshop titled “Regulatory Reporting Requirements for Banks in Bangladesh” comes to light with the immense support from many persons, especially from the executives of different banks to explore the concepts, status and practices of sales purchase contract of banks in Bangladesh. The study has identified issues or challenges of regulatory reporting and suggested measures. We would like to extend our gratitude to Dr. Md. Akhtaruzzaman, Honorable Director General of BIBM, for his valuable advice, observations and thoughts to progress our research work. We are also thankful to Dr. Md. Shahid Ullah, Associate Professor and Associate Editor for his Valuable Comments.

The research team is indebted to the chief guest, panelists and the participants of the workshop for their valuable comments that immensely helped us to improve the quality of the paper. We are also very grateful training wing of BIBM for its support to complete the publication process. Finally, we would like to thank all of those who extended their support in this research work.

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Executive Summary

The Islamic banking system has indeed been attracting the attention of researchers, customers, and policymakers in the recent decades, even more after the recent financial crisis following the subprime credit crisis. Islamic banks offer financial products and services that are compatible with Islamic doctrine, which allows Muslim individuals and firms with religious concerns to have access to finance or move from an informal to a formal financial system. In short, Islamic banks can mitigate financial exclusion and bring financial services to a broader population. This can also promote better strategies for poverty alleviation.

The term 'Islamic banking' or 'Islamic finance' suggests two significant meanings. The noun 'banking' or 'finance' suggests that these provide banking or financial services just like any other banking or financial institutions. However, the adjective 'Islamic' implies a fundamental difference from the conventional banking and finance. Islamic banking and finance is built upon the rules and principles of Islam which is referred to as the Shari'ah. The Islamic banks collect their deposits mainly through Mudarabah and to some extent through Qard (loan) or Wadiah (safekeeping) concepts. Saving and investment deposits are raised based on Mudarabah whereas, current deposits are generally obtained based on Qard or Wadiah principles. These funds are utilized in different investments using Islamic finance modes such as Murabahah, Ijarah, Mudarabah, Musharakah, HPSM, Salam and Istisna'a.

The broad objective of the study is to review the overall Islamic banking activities and operations by the banks in Bangladesh during 2020 – 2021. To achieve the objectives of the study, both primary and secondary data were used. In addition, interviews of several industry experts were conducted. The study covers full-fledged Islamic banks, and conventional banks having Islamic banking branches/windows. Findings of the study have mainly been presented in tabular form along with some graphic presentations. Apart from the complete set of statutes, rules and principles of Islamic Shari'ah, almost all the rules and regulations which are essential for running conventional banking and finance are necessary for conducting Islamic banking operations. To ensure Shari'ah compliance, international standards and regulations are also essential for Islamic banking operations in Bangladesh.

Over the years, the share of the industry is increasing in different parameters. Out of the total investment (credit) of the Bangladesh banking industry, share of Islamic banks (IBs) is about 26 percent, which is 24 percent in case of deposits. It has about 19 percent branch network and mobilises about 50 percent remittance. IB industry of Bangladesh is performing well considering ROA and ROE as compared to the overall banking sector. Similarly, IB industry is managing its asset quality in better.

The paper found that less than 5 percent of the total deposits have been collected by the industry under Wadiah Current Account i.e. more than 95 percent deposits of the IB industry have been collected under Mudarabah principle. Share of Murabahah and Muajjal is about 70 percent of total investments. It is evidenced that collective share of Mudarabah and Musharakah is less than one percent.

All Islamic banks perceived that executives of this industry must have specialized knowledge to deliver effective services. In 2021, about 43 percent of respondents stated that they are using a Investment Income Sharing Ratio (IISR or ISR) method for calculation and distribution of profit among the depositors. It is encouraging that banks are continuing their efforts to introduce new deposit products to meet up the emerging market needs. All of the Islamic banks have an internal Shariah rating system for measuring Shariah non-compliance risk. In addition to the in-house arrangement, 83 percent respondents expect an external Shariah rating system for ensuring Shariah compliance and governance.

The number of meetings conducted by Shariah Supervisory Committee (SSC) of IBs have been increased in 2021 compared to 2019 indicating more interactive environment to lead to more shariah compliant decision. It is shared by the respondents during a focus group discussion (FGD) that there is a dearth of manpower in the Shari'ah secretariat of the banks offering dual services. About 47 percent respondents think that remuneration for the members of SSC for attending each meeting is not rational. In more than 70 percent cases, member secretary of SSC are bank officials. A significant number of IBs allow the Shariah Secretariat Head/Member Secretary of SSC to attend the BoD meeting whereas, 52 percent banks are allowing them to attend management committee (MANCOM)/ Shariah management committee (SMT) meetings.

Relevant authorities and bank management may think about capacity development of the operational executives and Shari'ah scholars. Arranging an increased number of trainings/workshops/seminars may help in this regard. Besides, research and development should get priority.

List of Abbreviation

AIBL	Al-Arafah Islami Bank Limited
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ACR	Annual Confidential Report
AD	Authorized Dealer
BB	Bangladesh Bank
BRPD	Banking Regulation and Policy Department
BoD	Board of Directors
BRPD	Banking Regulation and Policy Department
CAGR	Compound Annual Growth Rate
CSBIBB	Central Shariah Board for Islamic Banks of Bangladesh
CEO	Chief Executive Officer
CRAR	Capital to Risk Weighted Asset Ratio
CRR	Cash Reserve Ration
CY	Calendar Year
LC	Letter of Credit
ECC	Export Cash Credit
FERA	Foreign Exchange Regulation Act
FGD	Focus Group Discussion
FI	Financial Institutions
FSIBL	First Security Islami Bank Limited
GCC	Gulf Cooperation Council
GFET	Guidelines for Foreign Exchange Transactions
IB	Islamic Banks
IBBL	Islami Bank Bangladesh limited
IBCF	Islamic Banks Consultative Forum
ICC	Internal Control and Compliance
IDB	Islamic Development Bank
IFCI	Islamic Finance Country Index
IFSB	Islamic Financial Services Board
IFSI	Islamic financial services industry
IIB	Investment Information Bureau
IIFM	Islamic Inter-bank Fund Market
IRTI	Islamic Research and Training Institute
ISBP	International Standard Banking Practice
ISF	Islamic social finance
ISR	Income Sharing Ratio
KYC	Know Your Customer
KYCC	Know Your Customer's Customer
KYE	Know Your Employee
MANCOM	Management Committee

MENA	Middle East and North Africa
MPI	Mudarabah Post Import
MPITR	Murabaha Post Import Trust Receipt
MTDR	Mudarabah Term Deposit Receipt
NGOs	Non-governmental organizations
OECD	Organisation for Economic Co-operation and Development
PCB	Private Commercial Banks
ROA	Return on Assets
ROE	Return on Equity
SIBL	Social Islami Bank Limited
SJIBL	Shahjalal Islami Bank Limited
SLR	Statutory Liquidity Ratio
SSBs	Shariah Supervisory Boards
SSC	Shariah Supervisory Committee
TA	Total Asset
UCPDC	Uniform Customs and Practice for Documentary Credits
UNDP	United Nations Development Programme
URC	Uniform Rules for Collections
URF	Uniform Rules for Forfaiting
URR	Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits

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Islamic Banking Operations of Banks

1. Introduction

1.1 Background of the study

Islamic banking and finance is expanding all over the world and in Bangladesh. When commercial banking emerged after the industrial revolution, Muslim scholars expressed reservations with the Western model of financial intermediation due to its reliance on interest (Iqbal & Molyneux, 2005; Molyneux & Iqbal, 2005). However, Islamic banking and finance is now considered as a competitive alternative to its conventional counterpart. The International Monetary Fund (IMF) and the World Bank also recognizes Islamic financial products as alternative means of financial intermediation (Sundararajan & Errico, 2002; World Bank, 2013). At this moment, both Muslims and non-muslims are owning, managing, operating Islamic banks. Similarly, these banks are collecting funds and deploying the same from/to both Muslims and non-muslims.

Therefore, Islamic banking system has gained a significant attention of researchers, policymakers, customers and careerists, even more after the recent financial crisis following the subprime credit crisis. In any economy, the banking and financial sector contributes toward better performance and helps in better resource utilization (Ahmed, 2010) and Islamic banking is playing similar role. Berger et al. (2006) believes that a well-functioning banking system plays a significant role in resource allocation, economic growth, and financial performance. In many jurisdictions, Islamic financial system is holding a systemic importance share and therefore it has become a part economic development of these countries.

Islamic financial system develops and offer products and services compliant with Shariah which are beneficial for individuals and corporates. Because of Shariah prohibition, a practicing Muslim does not want to be associated with Riba (interest), Gharar (ambiguity), and Maysir (gambling). However, Islamic financial products and services are not prohibited for non-muslims. In this way, Islamic financial system promote financial inclusion and bring financial services to a broader population of the jurisdiction. Therefore, Islamic banking system can promote better strategies for poverty alleviation (Rashwan, 2010) of the world.

As Islamic banking is founded on the ethos and values of Shariah, all the forms and contracts for deposit mobilization and financing are structured based on the

Overarching Islamic Principles. Predominantly, Mudarabah (partnership) and Qard (loan) contracts are used to collect deposit by Islamic banks. However, some of the jurisdictions apply Wadiah (safekeeping) and Tawarruq (monetization) concepts in this regard. Mudarabah and Tawarruq are income generating concepts whereas Qard and Wadiah are zero earning modes. These funds are utilized in different forms of financing modes such as Murabahah, Muajjal, Ijarah, Mudarabah, Musharakah and Wakalah. Operating in a dual banking environment and due to market demand, the Islamic banks prefer fixed income modes (e.g. Murabahah, Ijarah and HPSM) over profit-sharing modes (e.g. Mudarabah and Musharakah) in their investment activities. The market condition and regulatory requirements are also not conducive to profit-sharing modes. For example, these modes are subject to higher risk weightage than other modes. Through this study, Islamic banking operations of Bangladesh will be reviewed in line with international practices.

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 during 2020 – 2021. The specific objectives of the review paper are to:

- i. discuss the regulatory environment related to Islamic banking in global and local context;
- ii. discuss the Islamic banking services, activities, and operations in Bangladesh;
- iii. identify the success factors as well as challenges of Islamic banking operations; and
- iv. recommend future course of actions for improvement of Islamic banking operations in Bangladesh.

1.2 Methodology

To achieve the broad as well as specific objectives of the study, both primary and secondary data were used. To collect primary data, a semi-structured questionnaire was sent to the relevant banks. Out of these, thirty-three banks provided their feedback (Appendix-I). In addition, interviews of several industry experts were conducted. Secondary data were acquired from different journals and publications related to Islamic banking practices in global economies and in the country. For this purpose, data published by IFSB, BB and concerned banks were used. The study covers full-fledged Islamic banks, and conventional banks having Islamic banking branches/windows. Findings of the study have mainly been presented in tabular form along with some graphic presentations.

1.3 Structure of the Report

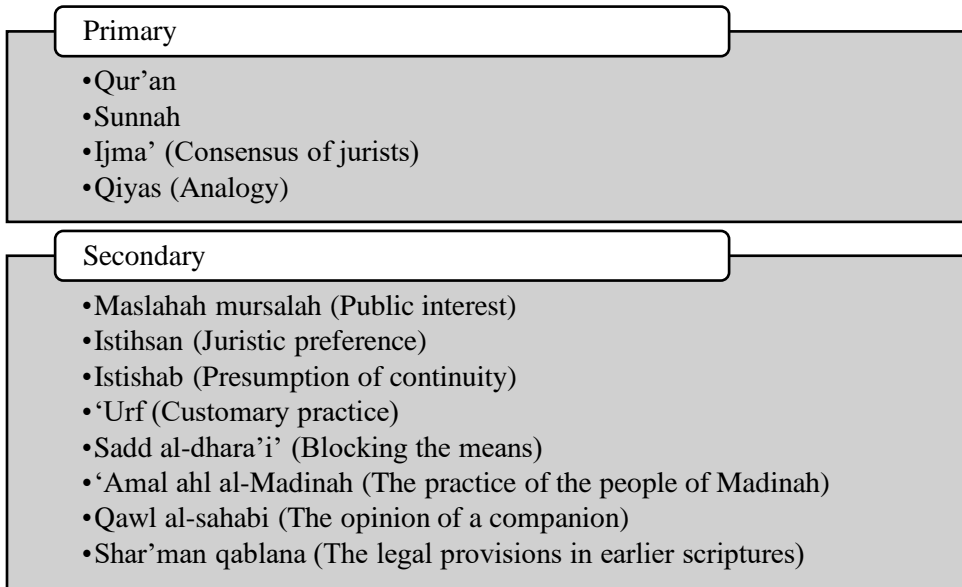
The report is organized under five sections. Under introduction, a background, objectives and methodology of the study are discussed in Section 1. Section 2 deals with conceptual aspects of Islamic finance and banking. Regulatory environment of the Islamic banking in Bangladesh is discussed in Section 3 of the paper. Section 4 represents the main part of study i.e. review and analysis of Islamic banking activities in global as well as Bangladesh context. Finally, Section 5 presents a set of issues identified in the study and recommendations thereof.

2. Conceptual Discussion on Islamic Finance and Banking

A discussion on fundamentals of Islamic banking and finance is a common component in any book on Islamic finance. Nonetheless, this section briefly discusses the important aspects to provide the readers an understanding on the essential matters.

The term 'Islamic banking' or 'Islamic finance' suggests two significant meanings. The noun 'banking' or 'finance' suggests that these provide the banking or financial services just like any other banking or financial institutions. However, the adjective 'Islamic' implies a fundamental difference from the conventional banking and finance (ISRA, 2016). Islamic banking and finance is built upon the rules and principles of Islam, which is referred to as the Shari'ah. The banking and finance institutions must adhere to these rules and principles to call them 'Islamic'. These rules and principles are derived from the primary and secondary sources of Islamic law, which are identified in Chart 2.1. While the Quran and authentic Sunnah are the undisputed primary sources, differences of opinion exist in terms of the status of the secondary sources, which is not the subject of this research.

Chart 2.1: Sources of Islamic Law



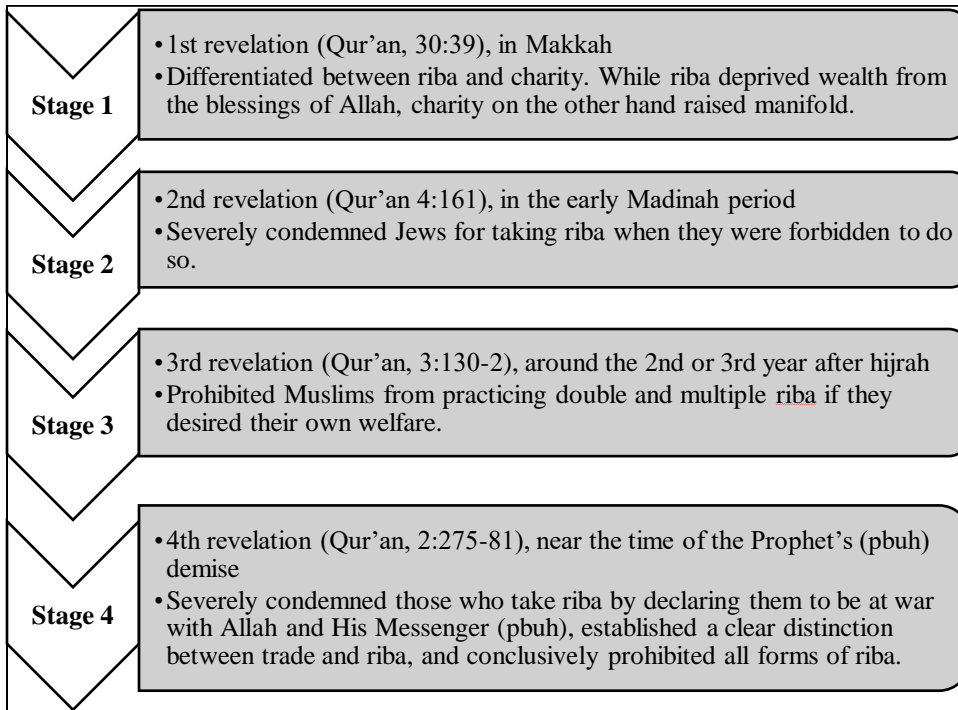
Source: ISRA (2016)

The fundamental elements of Islamic banking and finance can be divided into four parts:

- i. they must avoid the prohibited elements in transactions, such as riba (interest), gharar (ambiguity), and maysir (gambling);
- ii. they must avoid getting involved in prohibited businesses, such as those mentioned above as well as alcohol, tobacco, so on;
- iii. they must observe the requirements of Islamic finance contracts; and
- iv. they must uphold the principles and teachings of Islamic, such as fairness, justice, compassion, so on.

Riba is the primary prohibition that the Islamic banks and financial institutions observe. Riba is prohibited by the verses of the Quran and there are numerous evidences in the Hadith of Prophet (pbuh) prohibiting Riba. Chart 2.2 shows that the Quran has prohibited Riba in four stages, where the final stage prohibited all types of Riba.

Chart 2.2: Gradual Prohibition of Riba



Source: ISRA (2016)

In Islamic banking and finance, the general rule of permissibility is vital as it provides flexibility in developing new products and services. The rule states that the transactions are deemed permissible in the absence of a clear and authoritative text prohibiting it. In other words, the prohibition must be proven in transactions, not the permissibility.

In certain countries where the adjective 'Islamic' cannot be used due to the country's regulations, they use the terms like 'interest-free' or 'participatory' banking and finance instead.

3. Regulatory Environment of Islamic Banking

The principal regulatory framework of Islamic banking and finance is the complete set of rules and principles of Islamic Shariah. Apart from these, almost all the rules and regulations which are essential for running conventional banking and finance are also necessary for conducting Islamic banking operations. In order to facilitate Islamic banking activities in Bangladesh, Bangladesh Bank (central bank of Bangladesh) is the main regulator alongside Bangladesh Securities and Exchange Commission (BSEC) and Ministry of Finance. To ensure Shariah compliance, international standards, regulations are also essential for Islamic banking operations

in Bangladesh. It goes without saying that Shariah governance constitutes the binding and concreting framework for better regulation and effectiveness of regulatory environment of Islamic banks. That is why Shariah governance is also called the backbone of IFIs. In the global context, standards set by AAOIFI and IFSB have become among the main reference in setting the regulatory framework for IFIs.

Bangladesh Bank has issued a set of guidelines for conducting Islamic banking through a circular (BRPD Circular No. 15, Dated: November 09, 2009), based on Banking Companies Act 1991, Companies Act 1994 and Prudential Regulation of Bangladesh Bank. Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) played an important role in this regard. *Guidelines on Internal Control and Compliance (ICC) in Banks (2016)*, also cover *Shariah* audit. Bangladesh Bank has also prescribed a Shariah non-Compliance Risk Rating system. The main perseverance of *Mudaraba* based *Islamic Interbank Fund Market (IIFM, a full Shariah-compliant call money market)* is to manage liquidity by all Shariah-based banks, financial institutions and Islamic banking branches of the traditional financial institutions and banks operating in Bangladesh. Due to huge growth in Islamic banking in the country, an amendment of *Bangladesh Government Islamic Investment Bond (Amendment) Rules* was made in 2014. *Guidelines on Risk-Based Capital Adequacy*, a revised regulatory capital framework for banks in line with Basel III, have also covered risk factors relating to Islamic mode of investment. In the context of international trade, Islamic banks like conventional banks in the country are to comply with both domestic and international sets of regulations. FERA, 1947 has empowered Bangladesh Bank to regulate all kinds of foreign exchange dealings in Bangladesh. On the other hand, *Guidelines for Foreign Exchange Transactions (GFET) 2018* are the compilation of circular and circular letters issued by BB from time to time for exchange control purposes.

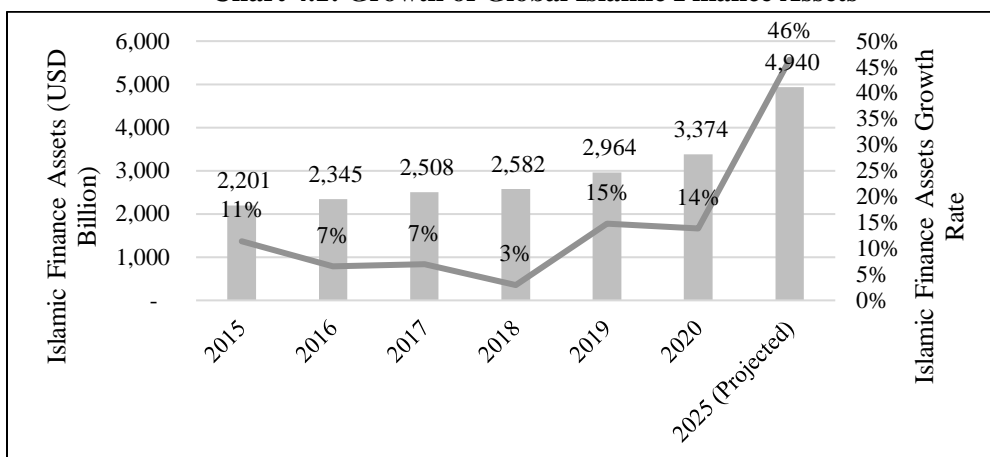
4. Review of the Islamic Banking Operations

4.1 Islamic Banking Activities in Global Context

4.1.1 Global Islamic Finance Landscape

Chart 4.1 shows that the growth of the global Islamic finance assets is back in a double-digit growth rate despite a slow growth between 2016-19. The total Islamic finance assets expected to reach USD 5 trillion in 2025. However, it shall be noted that the current share of Islamic finance assets represents a very small share of the total financial sector assets of the world (i.e. only 0.72% of the USD 468.7 trillion financial sector assets of the world).

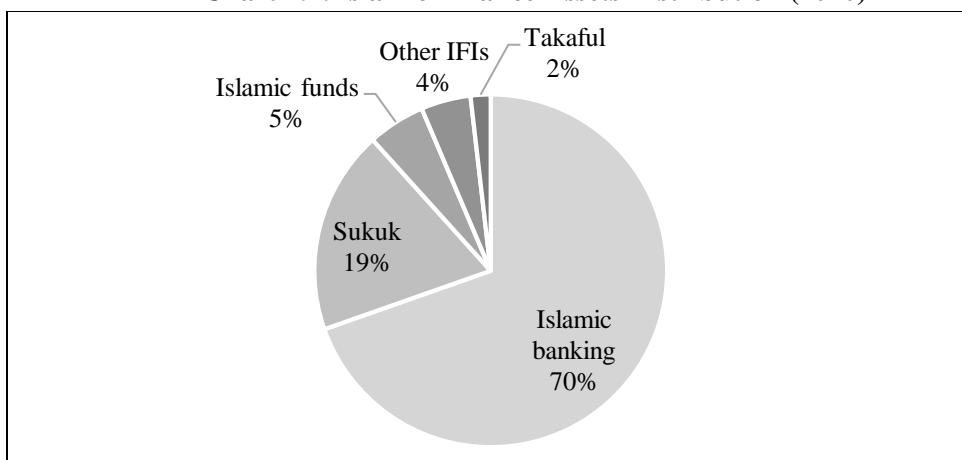
Chart 4.1: Growth of Global Islamic Finance Assets



Source: Refinitive (2021).

Chart 4.2 shows that the global Islamic finance assets are dominated by Islamic banks, followed by Sukuk, Islamic funds, other IFIs, and Takaful. It is not possible for Islamic banking to grow at a fast rate in absence of a facilitative ecosystem, i.e. the other components should grow as well.

Chart 4.2: Islamic Finance Assets Distribution (2020)



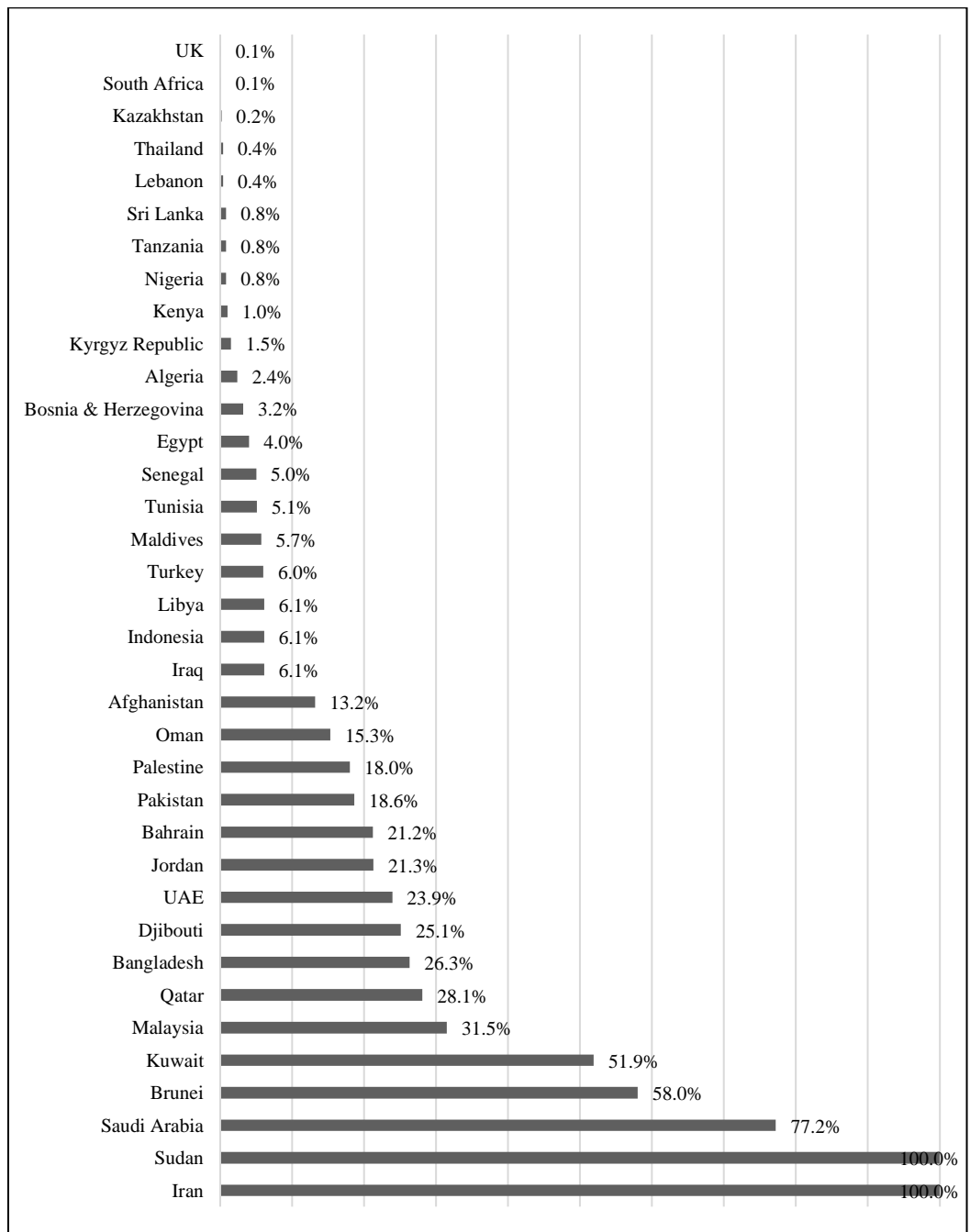
Source: Refinitive (2021).

4.1.2 Global Islamic Banking Assets

Chart 4.3 presents the Islamic banking share in total assets by jurisdictions as provided by IFSB (2022). It shows that the Islamic banking market share is 100% in two countries, achieved domestic systematic importance (i.e. more than 15% market share) in 15 countries, and established strong presence in several other countries including non-Muslim majority countries. It shall be noted that although Sudan made a decision to allow conventional banks in its country to attract international banks and exchange houses, there has not been any change in the 100% market share position of Islamic banks (Reuters, 2021).

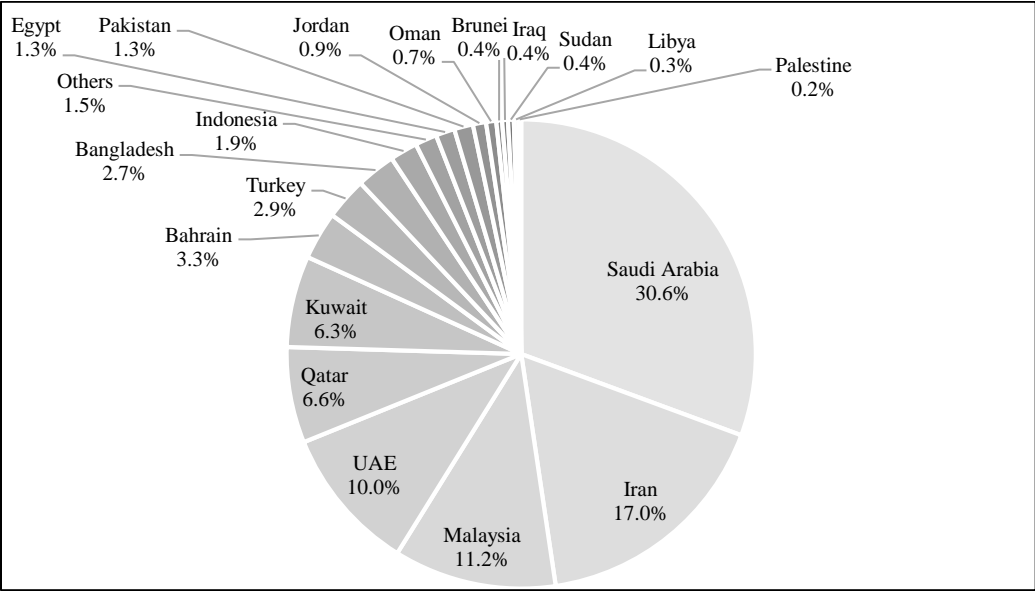
Chart 4.4 shows the concentration of Islamic banking assets by jurisdictions. It shows that the Islamic banking assets are concentrated in only a selected few, i.e. only six represents more than 80 percent of the global Islamic banking assets. These countries are Saudi Arabia, Iran, Malaysia, UAE, Qatar, and Kuwait (IFSB, 2022).

Chart 4.3: Islamic Banking Share in Total Banking Assets by Jurisdiction (%) (2021)



Source: IFSB (2022).

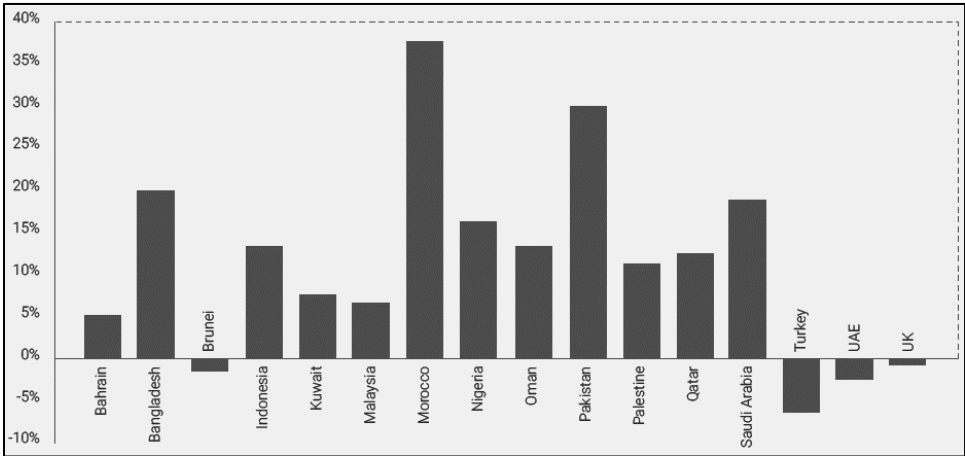
Chart 4.4: Jurisdiction Share of Global Islamic Banking Assets (%) (2021)



Source: IFSB (2022).

Chart 4.5 shows that Islamic banking assets in general are growing across the jurisdictions, except a few mainly due to their internal economic conditions. For instance, the high depreciation of the Turkish Lira is reflected in the negative growth rate of Islamic banking assets. In the UAE, the negative growth rate of the Islamic banking assets is due to a decreased in financing although the Islamic banking deposits has increased during the same period (IFSB, 2022).

Chart 4.5: Islamic Banking Assets Annual Growth Rates for Various Countries (%) (4Q'21)



Source: IFSB (2022).

4.1.3 Islamic Finance Development Status

Table 4.1.1 presents the ranking and scores of selected jurisdictions in terms of their development in selected areas of Islamic finance ecosystem, namely: quantitative development, knowledge, governance, corporate social responsibility, and awareness. The Islamic Finance Development Indicators (IFDI) shows that in terms of Islamic finance knowledge, Malaysia and Indonesia are the global leaders, and their scores are significantly higher than other countries. Most of the countries seriously lack in knowledge and awareness scores, which shows that a great effort is needed by these jurisdictions in overall development of Islamic finance in their respective jurisdictions.

Table 4.1.1: Top IFDI Markets and Global Average IFDI Values of 2021

	Ranking	IFDI 2021	Quantitative Development	Knowledge	Governance	Awareness	CSR
Malaysia	1	114	98	200	89	152	32
Indonesia	2	76	27	200	65	56	33
Saudi Arabia	3	74	74	66	54	54	119
Bahrain	4	64	36	79	89	67	48
UAE	5	53	34	71	76	44	39
Jordan	6	50	14	76	58	16	88
Pakistan	7	46	22	85	66	43	16
Kuwait	8	44	47	18	77	29	51
Oman	9	40	16	46	74	34	28
Maldives	10	35	22	25	68	20	42
Qatar	11	35	27	25	58	34	30
Brunei Darussalam	12	34	13	59	60	28	11
Nigeria	13	33	5	24	57	11	68
Bangladesh	14	31	13	25	72	10	32
Turkey	15	27	15	27	50	14	29
Global Average		11	6	12	15	16	7

Source: Refinitive (2021).

4.1.4 Application of Islamic Finance Concepts

Table 4.1.2 and 4.1.3 presents the application of Islamic finance concepts in Malaysia and Pakistan respectively. They show that the Islamic banks are preferring fixed income generating contracts over equity-based contracts. This is due to the fact that Islamic banks try to achieve a stable return in the investment side so that they can distribute a stable profit in the deposit side that are based on Mudarabah contract. A higher application of equity-based contracts in the investment side will expose the depositors to a higher equity risk, which could be detrimental to the confidence over Islamic banking as it runs in competition to conventional banking in a dual banking system. Nonetheless, it shall be noted that the share of Musharakah is increasing both in Malaysia and Pakistan.

Table 4.1.2: Application of Islamic Finance in Investments: Malaysia (%)

	Bay' bi thaman ajil	Ijarah	Al- ijarah thumma al-bay'	Murabahah	Musharakah	Mudarabah	Istisna'	Others
2006	40.68	1.04	29.26	7.23	0.21	0.20	0.69	20.68
2007	37.04	1.35	30.22	11.35	0.44	0.13	0.94	18.53
2008	32.99	2.65	30.44	15.15	1.08	0.30	1.32	16.06
2009	32.13	3.02	29.16	17.30	1.76	0.28	1.11	15.24
2010	33.70	2.48	27.30	14.71	2.48	0.17	1.02	18.15
2011	32.05	2.17	25.85	15.45	3.75	0.13	0.74	19.87
2012	31.86	2.11	23.23	17.17	5.13	0.06	0.68	19.76
2013	29.54	2.36	22.20	20.34	5.82	0.05	0.52	19.15
2014	23.79	2.42	20.64	25.33	6.78	0.02	0.53	20.48
2015	19.21	2.46	18.22	31.40	7.30	0.02	0.57	20.83
2016	15.87	2.25	16.04	37.18	9.26	0.02	0.47	18.91
2017	13.60	2.14	14.84	39.59	10.07	0.01	0.41	19.34
2018	11.56	1.70	13.02	39.90	9.32	0.01	0.23	24.24
2019	10.44	1.42	11.74	42.08	9.36	0.01	0.27	24.68
2020	9.39	1.25	11.52	44.11	9.16	0.02	0.18	24.37
2021	8.54	1.04	11.27	45.56	9.28	0.03	0.14	24.14

Source: BNM (2021).

Table 4.1.3: Application of Islamic Finance in Investments: Pakistan (%)

	Dec- 13	Dec- 14	Dec- 15	Dec- 16	Dec- 17	Dec- 18	Dec- 19	Dec- 20	Dec- 21
Murabahah	40.60	30.10	24.50	15.80	13.20	13.60	12.90	13.70	13.60
Ijarah	7.70	7.70	6.60	6.80	6.40	6.20	5.80	4.80	4.40
Musharakah	6.70	11.00	14	15.60	22	19.90	19.80	22.70	24.90
Mudarabah	0.20	0.10							
Diminishing Musharakah	30.80	32.60	31.70	34.70	30.70	33.30	34.20	33.60	33.80
Salam	4	4.50	5.30	4.40	2.80	2.40	2.60	1.90	2.00
Istisna	5.60	8.30	8.60	8.40	8.20	9.10	9.60	8.30	8.30
Others	4.40	5.60	9.30	14.30	16.70	15.50	14.80	15	13.00

Source: SBP (2021)

4.1.5 Standardization Efforts

To ensure Shariah compliance, application of the best practices, harmonization and building public confidence, various initiatives has been undertaken globally to develop standards for Islamic banking and finance. These initiatives include but not limited to the following:

- Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI): Shariah, accounting, auditing, governance, and ethics standards
- Islamic Financial Services Board (IFSB): standards for prudential requirements
- International Islamic Financial Market (IIFM): standards for Islamic capital and money markets
- Bank Negara Malaysia (Central Bank of Malaysia): Shariah standards, Shariah governance framework and other rules and regulations

Among the above, the AAOIFI standards have the significant global acceptability as it has been adopted by several countries as identified in Table 4.1.4.

Table 4.1.4: Adoption Status of AAOIFI Standards

Level of AAOIFI standards adoption	No. of regulatory jurisdictions			No. of countries		
	Shariah	Accounting	Governance	Shariah	Accounting	Governance
Full adoption	19	24	18	16	18	15
Partial adoption	4	5	6	3	5	6
Guidance/reference material	9	7	8	9	7	8
Local standards based on AAOIFI standards	2	4	4	2	4	3
Guidance & local standards based on AAOIFI standards	1	2	3	1	1	2
Supplementary reporting	-	1	1	-	1	1

Source: AAOIFI (2020)

4.2 Islamic Banking Activities in Bangladesh Context

Table 4.2.1 presents a summary of market share of Islamic banking industry in Bangladesh. Over the years, share of the industry is increasing in different parameters. Out of total investment (credit) of the Bangladesh banking industry at the end of 2021, share of Islamic banks (IBs) is about 26 percent which was 24 percent in the previous year. In case of deposit, IBs' share is about 24 percent at the end of 2021. Holding about 19 percent branch network, IBs is mobilizing about 50 percent remittance in 2021.

Table 4.2.1: 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
Total Investment (Loans & Advances)	22.96	23.1	23.14	24.0	25.8
Total Deposits	20.39	20.1	20.96	21.6	23.5
Total Assets	19.29	19.1	19.58	20.1	22.1
Total Liabilities	19.6	19.4	19.85	20.4	22.3
Total Equity	15.22	15.6	15.57	15.4	17.8
Total Liabilities and Equity	19.29	19.1	19.58	20.1	22.1
Off-Balance Sheet Items	11.2	10.6	12.08	12.2	12.5
Profit Income (Interest Income)	22.63	34.31	24.32	26.3	28.6
Profit (Interest) Paid to Depositor	20.44	23.13	23.04	23.2	25.1
Non-Profit Income	8.32	9.25	10.1	7.7	8.8
Operating Expenses	16.21	17.12	18	18.1	19.7
Net Profit After Tax	19.15	38.32	24.01	36.7	40.4
Remittances	36.14*	35.38*	35.34*	40.51*	49.18*
Total Number of Bank Branches	11.52	12.06	13.05	14.25	19.02*
Total Agricultural Credit	8.87	7.01	2.57*	13.41*	18.99*
Total Number of Employees (No.)	30606*	33027*	35906*	38784*	45260*

Source: *Financial Stability Report, BB; *Quarterly Report on Development of Islamic Banking in Bangladesh, BB*

Not only holding a systemically important market share, but IB industry of Bangladesh is also performing better as compared to the overall banking sector (Table 4.2.2). In 2021, ROE of all banks and IBs were 4.4 percent and 9.9 percent respectively and similar finding is observed in case of ROA. IB industry is managing its asset quality in better way as compared to overall industry.

Table 4.2.2: Some selected indicators of banking sector of Bangladesh (%)

Indicators	2019					
	All Banks	IBs	All Banks	IBs	All Banks	IBs
ROA	0.5	0.6	0.3	0.5	0.2	0.5
ROE	7.4	11.4	4.3	10.2	4.4	9.9
Net Profit Margin	2.1	2.9	1.4	2.4	1.3	2.3
Interest (Profit) Income to Total Assets (TA)	6.1	7.6	4.9	6.4	4.3	5.5
Net Interest (Profit) Income to TA	1.9	2.6	1.2	2.1	1.1	2.0
Non-Interest (Profit) Income to TA	1.8	0.9	2.0	0.8	2.0	0.8
Advance (Investment) to Deposit Ratio	77.3	94.3	81.4	83.3	73.2	84.7
CRAR	11.6	12.4	11.6	12.7	11.1	12.8
Classified Loans (Investment) to Advances	9.3	4.7	8.1	4.1	7.9	4.0
Classified Loans (Investment) to Capital	92.1	71.7	80.7	67.2	89.8	67.0

Source: *Financial Stability Report, BB*

Islamic banking activities are conducted under different modes. Table 4.2.3 depicts Islamic banking deposits by contracts. According to the table, less than 5 percent of the total deposits have been collected by the industry under Wadiah Current Account i.e. more than 95 percent deposits of the IB industry have been collected under Mudarabah principle ('other deposits' are basically different schemes under Mudarabah). Out of total deposits of the IBs, share of term deposits (TD) and savings deposits are about 46 percent and 20 percent respectively.

Table 4.2.3: Islamic Banking Deposits by Contracts (%)

	<i>Wadiah Current Account Deposits</i>	<i>Mudaraba Savings Bond</i>	<i>Mudaraba Special Savings</i>	<i>Mudaraba Hajj Deposits</i>	<i>Mudaraba TD</i>	<i>Mudaraba SND</i>	<i>Mudaraba Savings Deposits</i>	<i>Other Deposits</i>	<i>Total</i>
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

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

Like fund mobilization, financing (investment) by IBs is concluded under various Shari'ah principles e.g., trading, sharing, lease, etc. Under the trading principle, the banks in Bangladesh use Murabahah, Muajjal, Salam and Istisna'a. The share of Murabahah and Muajjal is about 70 percent of total investments (Table 4.2.4), whereas the share of Ijarah/HPSM is around 23 percent. It is evidenced that the cumulative share of Mudarabah and Musharakah is less than one percent. It shall be noted that HPSM is a hybrid instrument that combines Musharakah, Ijarah and Sale.

Table 4.2.4: Islamic Banking Investments by Contracts (%)

	<i>Qard with Security</i>	<i>Bai al-Murabahah</i>	<i>Bai al-Muajjal</i>	<i>Bai al-Salam</i>	<i>Bai al-Istisna</i>	<i>Mudarabah</i>	<i>Musharaka</i>	<i>Ijarah/HPSM</i>	<i>Others</i>	<i>Total</i>
Dec-17	1.32	43.81	25.17	0.96	0.22	0.26	1.53	24.29	2.44	100
Dec-18	1.32	44.33	25.63	0.99	0.07	0.26	1.43	23.39	2.58	100
Dec-19	0.05	44.60	23.95	0.03	1.16	0.32	1.38	23.64	4.87	100
Dec-20	1.67	44.97	23.76	1.29	0.01	0.33	0.92	23.79	3.26	100
Dec-21	1.11	46.39	23.24	1.23	0.02	0.25	0.49	23.30	3.98	100

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

Table 4.2.5 demonstrates the deposits of different groups of banks and their growth. Deposit growth of the full-fledged IBs in 2021 is the highest among all other groups of banks and the overall industry as well. Conversion of two conventional banks into Islamic banks is one of the reasons. Similar picture is established in case of investment activities as summarized in Table 4.2.6. Total deposits of IB industry is about BDT 4 hundred crore, whereas total financing (investment) is 3.5 hundred cores at the end of 2021.

Table 4.2.5: Islamic Banking Deposit and its Growth (BDT Crore)

	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-17	203,698	13.89	5,866	11.01	4,695	32.32	2,14,259	14.15	9,26,179	10.22	23.13
Dec-18	223,657	9.8	7,479	27.49	6,231	32.71	2,37,367	10.78	10,09,981	9.05	23.50
Dec-19	263,756	17.93	8,738	16.83	7,734	24.12	2,80,228	18.06	11,36,980	12.57	24.65
Dec-20	306,000	16.02	10,181	16.52	10,741	38.88	3,26,922	16.66	12,90,472	13.5	25.33
Dec-21	370,384	21.04	11,025	8.29	11,702	8.95	3,93,111	20.25	14,09,343	9.21	27.89

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

Table 4.2.6: Islamic Banking Investment and its Growth (BDT Crore)

	Full-fledged IB		IB Branches		IB Windows		Total Investments		All Bank Credits		Share of IBs (%)
	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	
Dec-17	1,91,279	18.93	5,583	7.66	4,237	44.1	2,01,100	19.02	8,44,436	18.42	23.81
Dec-18	2,19,797	14.91	6,162	10.36	4,949	16.8	2,30,907	14.82	9,60,462	13.74	24.04
Dec-19	2,49,885	13.69	7,494	21.62	5,373	8.58	2,62,752	13.79	10,58,707	10.23	24.82
Dec-20	2,79,073	11.68	7,753	3.45	7,269	35.27	2,94,094	11.93	11,44,907	8.14	25.69
Dec-21	3,37,668	21	8,242	6.31	7,538	3.71	3,53,448	20.18	12,67,561	10.71	27.88

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

A total number of 10 full-fledged IBs along with other 23 conventional banks are providing Islamic banking services in Bangladesh (Table 4.2.7). Among all IBs, Islami Bank Bangladesh Limited (IBBL) is holding about 35 percent of deposits (Table 4.2.8) and 33 percent of financing (Table 4.2.10) of the sector. First Security Islami Bank Limited (FSIBL), EXIM Bank Limited (EXIM) and Al-Arafah Islami Bank Limited (AAIBL) are holding 2nd, 3rd, and 4th position respectively. In the deposit mix, fixed term deposit is more than 53 percent whereas, saving deposits is about 20 percent (Table 4.2.9). As per Table 4.2.11, financing rate has been decreased in Islamic banking segment in 2021 as compared to that of 2020 however, spread has been increased in 2021.

Table 4.2.7: Name of Banks Providing IB Services in Bangladesh (2022Q1)

	Full-fledged Islamic Banks	Islamic Banking Branches in Conventional Banks	Islamic Banking Windows in Conventional Banks
1.	IBBL (384)	The City Bank Limited (1)	Sonali Bank Limited (58)
2.	ICB Islamic Bank Limited (33)	AB Bank Limited (1)	Janata Bank (Not Started)
3.	Social Islami Bank Limited (172)	Dhaka Bank Limited (2)	Agrani Bank Limited (31)
4.	Al-Arafah Islami Bank Limited (201)	Premier Bank Limited (22)	Pubali Bank Limited (17)
5.	EXIM Bank Limited (140)	Prime Bank Limited (5)	Trust Bank Limited (15)
6.	Shahjalal Islami Bank Limited (132)	Southeast Bank Limited (6)	Bank Asia Limited (5)
7.	FSIBL (201)	Jamuna Bank Limited (2)	Standard Chartered Bank (1)
8.	Union Bank Limited (104)	Bank Alfalah Limited (1)	Mercantile Bank Limited (45)

	Full-fledged Islamic Banks	Islamic Banking Branches in Conventional Banks	Islamic Banking Windows in Conventional Banks
9.	Standard Bank Limited (138)	NRB Bank Limited (1)	Midland Bank Limited (2)
10.	Global Islami Bank Limited (174)		NRBC Bank Limited (231)
11.			One Bank Limited (2)
12.			United Commercial Bank (11)
13.			Meghna Bank Limited (1)
14.			Mutual Trust Bank Limited (15)
	Total No. of Branch =1679 Total No. of Manpower =46777	Total No. of Branch =41 Total No. of Manpower=418	Total No. of Branch =434 Total No. of Manpower =732

Source: Quarterly Report on Development of Islamic Banking in Bangladesh

Table 4.2.8: Islamic Banking Deposits by Banks (%)

	IBBL	FSIBL	EXIM	AAIBL	SIBL	SJIBL	Union	ICB	SBL	GIB	IB Br.	IB. Win.	Total
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	0.33	4.24	3.00	2.80	2.97	100

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

Table 4.2.9: Deposits Distributed by Types of Accounts:

Types of Account	All Banks		PCBs including IBs		IBs	
	2021	2020	2021	2020	2021	2020
Current and Cash Credit Account	9.08	8.67	8.87	7.92	5.18	4.09
Savings Deposit	22.41	21.19	20.12	18.47	20.99	19.89
Foreign Currency Account	0.39	0.35	0.26	0.20	0.01	0.01
Special Notice Deposits	9.69	10.37	8.44	8.25	4.42	4.19
Fixed Deposits	44.62	44.95	46.43	48.48	53.51	53.33
Recurring Deposits	7.48	7.72	9.36	9.64	10.73	11.86
Others	6.33	6.75	6.53	7.04	5.16	6.63
Total	100	100	100	100	100	100

Source: Scheduled Bank Statistics, Bangladesh Bank

Table 4.2.10: Islamic Banking Investments by Banks (%)

	IBBL	FSIBL	EXIM	AAIBL	SIBL	SJIBL	Union	ICB	SBL	GIB	IB Br.	IB Win	Total
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	12.60	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	0.24	4.64	3.03	2.33	2.13	100

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB

Table 4.2.11: Weightage Average Rate of Interest/Profit:

	All Banks		PCBs including IBs		IBs	
	2021	2020	2021	2020	2021	2020
Investment (Advance)	7.42	7.69	7.73	8.10	8.10	8.49
Deposit	4.06	4.56	4.18	4.78	4.38	5.14
Spread	3.36	3.13	3.55	3.32	3.72	3.35

Source: Scheduled Bank Statistics, Bangladesh Bank

4.3 Islamic Banking Operations in Bangladesh: Questionnaire Survey

This section is based on primary data collected through a questionnaire. Analysis was conducted on the available responses only since all banks were not able to provide complete information.

4.3.1 Human Capital of Islamic Banks

Except for the average number of female employees per bank, both the average number of employees per branch/window and the number of non-Muslim employees per bank increased in 2021 over 2019, though not at a significant level (Table 4.3.1).

Table 4.3.1: Manpower of Islamic banks

S/N	Aspect	2019	2021
1.	Average No. of employees per branch/window	21.3	23.2
2.	Average No. of female employees per bank	141	117
3.	Average No. of non-Muslim employees per bank	17	19

Source: Survey Data

As per Table 4.3.2, all Islamic banks perceived that executives of this industry must have specialized knowledge to deliver effective services. Besides, 97 percent of respondents preferred Islamic banking related different certification/diploma programs for all mid-level executives to make them more confident in providing

knowledge-based services. It drew high attention when only 14 percent of respondents were over 90 percent satisfied in this regard.

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

S/N	Aspect		2019	2021
1.	Proportion of banks perceive that specialized knowledge is required to perform Islamic banking (IB) effectively (%)		96	100
2.	Proportion of banks perceive that certification/diploma related with IB should be preferable for all mid-level executives (%)		96	97
3.	Satisfaction level about sufficient number of executives having Islamic banking knowledge (%)	Above 90%	28	14
		(80-90)%	17	32
		(60-80)%	38	35
		(50-60)%	14	5
		Below 50%	3	14

Source: Survey Data

4.3.2 General Banking Operations in Islamic Banks

General banking operations related information are given in Table 4.3.3, including deposit mobilization in Islamic banking system. Only 17 percent opined that additional formalities/documents are required for opening deposit accounts with Islamic banks. Compared to 2019, a reduced percent (17%) of Islamic banks perceived in 2021 that Islamic deposit products are deficient in fulfilling the customers' need, which requires intense market survey and up-gradation of existing product propositions. In 2021, about 43 percent of respondents stated that they are using the ISR-based method. It is encouraging that banks are continuing their efforts to introduce new deposit products over the last five years to meet up the emerging market needs. Among some special religious-deposit products, Islamic banks gave more concentration in Hajj savings deposits and cash Waqf deposit in 2021.

Table 4.3.3: General banking operations including deposit mobilization in IB

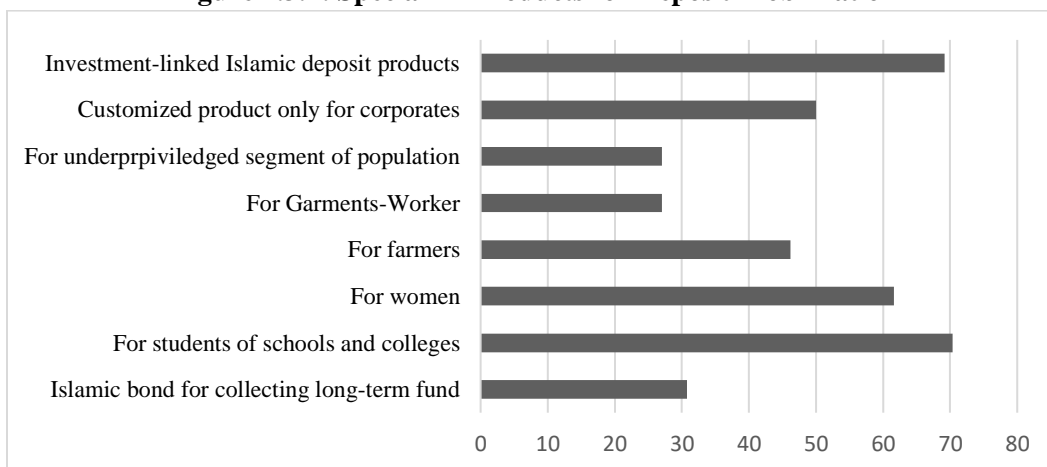
S/N	Aspect	2019	2021
	Banks where there is any additional formality/document required for opening deposit a/c as an Islamic bank (%)	48	17
	Banks facing any regulatory/policy difficulty for collecting deposit as an Islamic bank (%)	5	17
	Banks believing that there is a deficiency in deposit products in Bangladesh for meeting customer needs (%)	29	17

	Framework for rate of return calculation for the Mudaraba depositors followed by your bank (%)	Weightage-based method	87	57
		ISR-based method	13	43
5.	Introduction of new deposit products (Islamic) in bank (%)	In previous Year	52	52
		Within previous two years	52	50
		Within previous five years	41	62
6.	Special religious-deposit products in Islamic bank (%)	Hajj savings deposit	93	96
		Muhor savings deposit	67	61
		Cash Waqf deposit	68	80
		Others (Marriage Deposit, etc.)	7	4

Source: Survey data

Like before, Islamic banks offered some special IB products in 2021 also to mobilize deposit covering more segments of the society. Of them, 70 percent of banks have special Islamic deposit product for students of schools and colleges, followed by investment-linked Islamic deposit products and deposit products 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 Other Issues in Islamic Banking

Some other issues are there which have well-connection with Islamic banking operations. As shown in Table 4.3.4, all of the Islamic banks have an internal Shariah rating system for measuring Shariah non-compliance risk. In addition to the in-house arrangement, 83 percent IBs are expecting to have an external *Shariah* rating system for ensuring *Shariah* compliance and governance which was 10 percent lower in 2019 reflecting their intention to be more transparent and

compliant. Although 93 percent of respondents pronounced that there is a demand for the expansion of IB industry in Bangladesh, a significant number of them (76%) observed a dearth of IB scholars for expansion of this industry. So, it is high time to minimize this gap to flourish IB industry in Bangladesh.

Table 4.3.4: Other Issues in Islamic Banking (%)

S/N	Aspect	2019	2021
1.	Islamic banks having internal Shariah rating system for measuring Shariah Non-Compliance risk	55	100
2.	Islamic banks expecting external Shariah rating system for the banking industry of Bangladesh	73	83
3.	Islamic banks believing that there is a limited opportunity for training on IB in Bangladesh	77	67
4.	Islamic banks thinking that there is a dearth of IB scholars for expansion of the industry in Bangladesh	77	76
5.	Islamic banks thinking that there is a demand for expansion of IB industry in Bangladesh	96	93
6.	Applied previously but did not get license for additional branch/windows	53	25

Source: Survey Data

4.3.4 Shariah Supervisory Committee (SSC) of Islamic Banks

Shariah Supervisory Committee and its secretariat related some aspects are given in Table 4.3.5. In 2021, most of the aspects were almost identical to 2019 except a few. For example, number of meetings conducted by Shariah Supervisory Committee (SSC) of IBs have been increased in 2021 compared to 2019 indicating more interactive environment to lead to more Shariah compliant decision. Besides, it is always expected to have blending of Shariah knowledge and branch banking experience among the auditors of IBs which has been observed in 2021 with a good jump (from 57% to 78%). On the contrary, banks enfolded job rotation provisions for the executives of Shariah secretariat in the main-stream banking operation notably (65%) in 2021.

Table 4.3.5: Shariah Supervisory Committee (SSC) and its secretariat

S/N	Aspect		2019	2021
1.	Average number of members in Shariah Supervisory Committee (SSC) including chairman (No.)	Maximum	13	13
		Minimum	6	5
		Average	8	8
2.	Members in Shariah Supervisory Committee (SSC) having banking experience (%)		36	36
3.	No. of SSC meeting held in a year (Range)		1-17	1-24

4.	Banks where any member of BoD is a member of SSC	73	56
5.	Banks where MD/CEO is a member of SSC	71	70
6.	Banks having provision of job rotation for the executives of Shariah secretariat in the main-stream banking operation	92	65
7.	Shariah auditors having branch banking experience (% of executives)	57	78

Source: Survey Data

4.3.5 Investment Operations in Islamic Banks

More than 50 percent of banks opined that additional formalities/documents are required to open investment account with Islamic banks (Table 4.3.6). In 2021, introduction of new investment products by IBs were double in straightway against 2019 which helped to increase the market depth by addressing multi-dimensional customers' need. Whereas all IBs were more or less conservative in practicing different special investment products for charity purpose, remarkably *Qard-e-Hasan*.

Table 4.3.6: Investment operations in Islamic banking

S/N	Aspect		2019	2021
1.	Additional formality/ document required for opening investment A/c in Islamic bank (%)		43	60
2.	Banks having Islamic credit card (%)		35	41
3.	Introduction of new investment products (Islamic) in bank (%)	In previous year	30	60
		Within previous two years	20	53
		Within previous five years	35	44
4.	Banks having special investment products for charity purpose (%)	Qard-e-Hasan for own employees	30	19
		Qard-e-Hasan for others	25	14
		Others (Qard against MTDR, etc.)	35	33

Source: Survey data

IBs experienced several barriers in conducting their investment operations in 2021. Of them, lack of opportunity for using idle fund by IBs, lack of investment mode on Bai to fulfill the cash requirement as working capital and lack of fearing the Almighty attitude and as well as Islamic knowledge both in IB officials and clients are mentionable. Box-4.3.1 tried to frame those barriers along with some probable suggestions in line with the identified barriers.

Box 4.3.1: Barriers and Possible Suggestions in Islamic Investment Operations

Barriers	Suggestions
No Specific law for operating IB	Special law for Islamic Bank is required.
Lack of opportunity for using idle fund.	Increase available scope for investment.
Lack of Investment mode on Bai to fulfill the cash requirement of the client as working capital.	New products for Bai-mode of Investment need to be launched to fulfill the cash requirement of the client as working capital.
Absence of Buy and Sell of Murabaha Goods.	Buying and Selling of Murabaha Goods should be procured by the bank officials.
Lack of ALLAH fearing attitude and Islamic knowledge among the IB officials and clients.	Frequent training, seminar, and other programs to impart theoretical and practical knowledge to the officials of the IBs and motivational program on Shariah need to be arranged for the investment client at branch and head office level.
Lack of publicity for investment products.	Necessary steps need to be taken for publicity of different Islamic investment products using advanced promotional tools and outlets.

Source: Survey data and FGD Outcome

IBs face several challenges from their investment clients in doing their investment activities, especially in case of complying with *Shariah*. Some of those barriers identified in the survey have been attempted to be farmed here (Box-4.3.2). To face and solve these challenges in a practical and effective manner, banks have also identified some probable drives from the regulator side (Box-4.3.3).

Box-4.3.2: Challenges Faced by IBs from Investment Clients

<p>Misconception of client regarding Islamic banking.</p> <p>Greediness and unwillingness to comply with Shariah law.</p> <p>Mix up with conventional banking policies.</p> <p>Distortion of Islamic banking due to lack of proper execution of buying and selling.</p> <p>Sometimes making profit gets priority over becoming Shariah compliant.</p>

Source: Survey data and FGD Outcome

Box-4.3.3: Expectation of Islamic Banks from Regulators

<p>Shariah Supervisory Committee should be given more importance and independence.</p> <p>Availability of scholars with dual specialization in <i>Shariah</i> and finance need to be boosted for sustainable market development.</p> <p>Strong supervision is highly required in all segments of IB activities.</p> <p>Give more focus on punishment/exemplary treatment for violations of <i>Shariah</i> to ensure market correction.</p> <p>Accelerate the existing supports in customized manner by Bangladesh Bank to overcome the probable risk of market distortion.</p>
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Source: Survey data and FGD Outcome

Table 4.3.7 depicts the structure of the SSC and its secretariat. On an average, 5 officials are working in Shari'ah Secretariat of the full fledged IBs. However, it is shared by the respondents during FGD that there is a dearth of manpower in the secretariat of the banks offering dual services. About 47 percent banks think that remuneration for the members of SSC for attending each meeting is not rational (Table 4.3.7). In more than 70 percent cases, member secretary of SSC are bank officials (Table 4.3.8). In 42 percent IBs allow Shariah Secretariat Head/Member Secretary of SSC to attend the BoD meeting (Table 4.3.8) whereas 52 percent banks are allowing them to attend MANCOM/SMT meetings.

Table 4.3.7: Shariah Supervisory Committee (SSC) and Its Secretariat

S/N	Aspects		2021
1.	Average manpower in Shariah secretariat (No.)	No. of executives (officer and above)	5
		No. of support staffs	1
		No. of executives having branch banking experience	4
		Joint/Parallel involvement with other department(s)	1
2.	Banks thinking the amount of remuneration for the members of SSC for attending each meeting is rational (%)		53
3.	Banks having discrimination between executives of Shariah secretariat and other banking units regarding promotion, salary and allied employee benefits (%)		0
4.	Banks having priority of executives of Shariah secretariat and other banking units regarding promotion, salary and allied employee benefits (%)		0

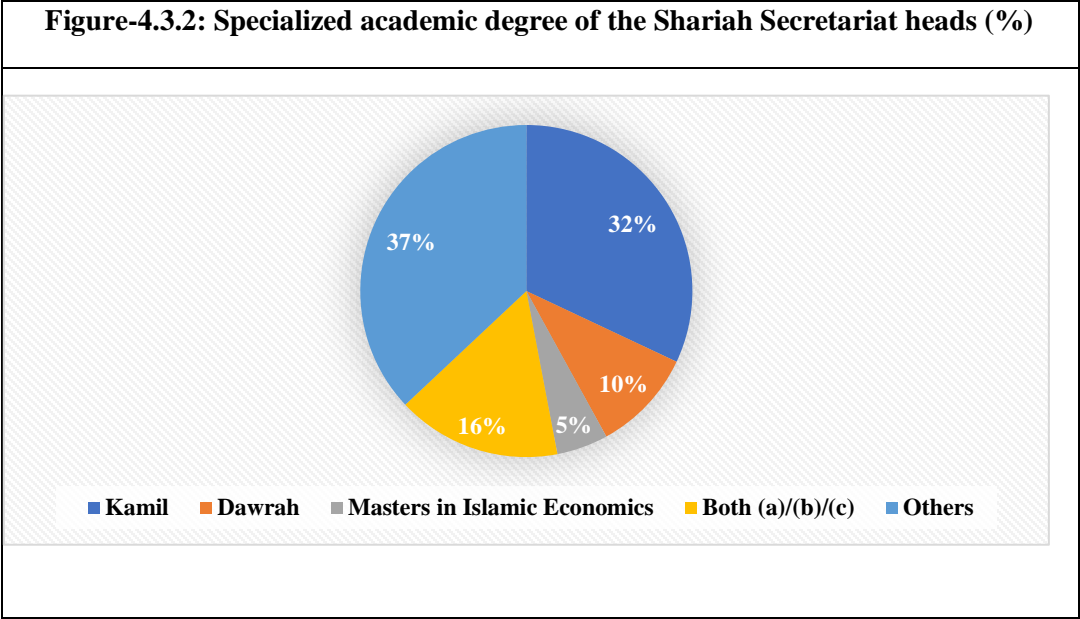
Source: Survey data

Table 4.3.8: The Head of Shariah Secretariat and Member Secretary of SSC

S/N	Aspects		2021
1.	Banks having the member secretary of SSC an official of the bank (%)		71
2.	Position of Shariah Secretariat head in the job ladder (-----step immediate below the MD/CEO)	Max.	9
		Min.	2
3.	Banking experience of the Shariah Secretariat head (Years)	Max.	35
		Min.	5
4.	Banks having specific requirement in written for the post of Shariah Secretariat head (%)		48
5.	Banks having the head of Shariah Secretariat perform operational duties for the banks or its affiliates (%)		46
6.	Banks allowing Shariah Secretariat Head/ Member Secretary of SSC to attend board level meetings (%)	Full BoD meeting	42
		EC meeting	22
		RMC meeting	24
		ACB meeting	30
7.	Banks allowing Shariah Secretariat Head/ Member Secretary of SSC to attend MANCOM/SMT meetings (%)		52

Source: Survey data

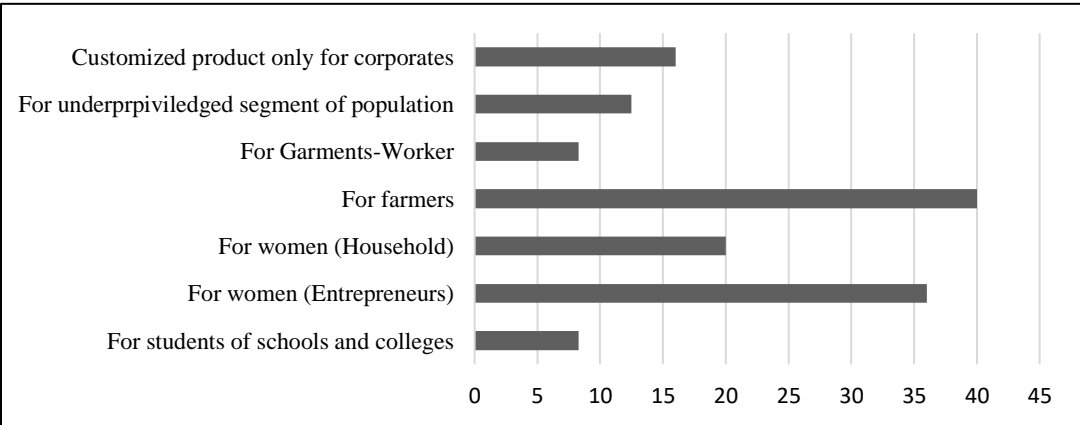
Heads of Shariah secretariat should have specialized degrees. But the survey shows the is mixed results i.e. some banks have it but some of the banks don't have it (Figure-4.3.2)



Source: Survey data

Islamic banks also offered some special IB products in 2021 to deploy their funds covering more segments of the society. Of them, 40 percent banks have special Islamic investment product for farmers, followed by investment products for women which is 36 percent. It is displayed in Figure- 4.3.3.

Figure-4.3.3: Special IB Investment Products



Source: Survey data

Only 24 percent Islamic banks have research department and 17 percent banks are maintaining data-base for Islamic financial products which is much lower than the expected required level (Table-4.3.9). As per the opinion of the FGD respondents, some banks are trying to transfer a portion of doubtful income to the banks' income.

Table 4.3.9: Other Issues in Islamic Banking

S/N	Aspects		2021
1.	Banks having research department (%)		24
2.	Banks maintaining data-base for Islamic financial product and services offered by banking industry in Bangladesh (%)		17
3.	Banks maintaining data-base for Islamic financial product and services offered in other country's (%)		10
4.	Banks conducting market survey within last 5 years to know demand-side perception/need (%)		37 (100% internally)
5.	Banks designing new Islamic banking product within last 5 years as a pioneer, which was offered previously in Bangladesh (%)		17
6.	Banks dropping/discontinuing Islamic banking old product within last 5 years from their bank (%)		18
7.	Average amount of doubtful income (Tk. in Crore)	2021	4.72
		2020	4.50
8.	Average accumulated balance of doubtful income (Tk. in Crore)	2021	14.05
		2020	14.64
9.	Banks believing the visible impact on overall economy of Bangladesh, which was not possible through conventional banking (%)		79
10.	Banks believing the visible impact on society, which was not possible through conventional banking (%)		76
11.	Banks having Islamic banking product/services which was not asked by a single customer within last 5 years (%)		0

Source: Survey data

4.4 A Summary of Interview and FGD Outcome

To get some insights of operational mechanisms and regulatory initiatives, the research team has conducted interviews of Shari'ah scholars working in the Shari'ah Supervisory Committee (SSC) of different banks, Islamic finance professionals, and consultants. Different aspects of Murabahah operations, Islamic banking launching process through branches/windows in a conventional bank, conversion process of a conventional bank into an Islamic bank have been discussed. Some findings of the interviews have been validated through focus group discussions (FGD) participated by a good number of Islamic finance professionals (IFPs).

Islamic banking and financing activities are conducted based on different modes complying with Shari'ah. In case of financing, about 70 percent are concluded under trading (Bai) principle and Murabahah is the dominant mode. Banking sector is highly regulated and supervised; however, some irregularities (from conventional regulations and Shari'ah perspective) are witnessed in this sector. Therefore, the bank management, internal and external Shari'ah auditor, SSC and their secretariat, and the regulators should be cautious about the following aspects of Murabahah operations.

Box-4.4: A List of Concerns related with Murabahah Operations

- Transaction of prohibited products/services.
- Fictitious transaction based on cooked vouchers.
- Selling goods without ensuring ownership and/or possession of the bank.
- Absence of proper offer and acceptance between the bank and the customer.
- Disbursing fund to the customer's account without genuine reason.
- Transferring ownership-related risk and cost to the customer.
- Rescheduling Murabahah receivable by creating an artificial deal with new markup.
- Paying off client's existing liability caused for credit purchase by creating a Murabahah deal.
- Ensuring proper and transparent calculation process of cost and markup for Murabahah.
- Asking for processing fee from the client for granting the credit.
- Failing to ensure the sequence of Murabahah execution process.
- Variation in the perception and application of Murabahah, Muajjal and Bai-Bithaman Ajil.

Source: Authors' Compilation

About 23 conventional banks are providing Islamic banking services in Bangladesh through their branches/windows and some others will launch such services. Either business perspective or Shari'ah may be the motivation in this regard. The banks face several challenges in the launching process. Sometimes, it is difficult to convince all influential stakeholders where an individual takes such initiative. Another important aspect is to align the intention/perception/commitment between senior management and the board. Due to a lack of a sufficient number of experts in the market, banks face difficulties in all aspects. The big challenge the banks face in this regard is acquiring a Shari'ah compliant software compatible with the existing core banking solution (CBS). It is expected that the launching decision should be supported by proper groundwork and a high-level strategic plan should be there to ensure an attractive portfolio for making the operation profitable and sustainable. The development of human resources should get the top-most priority

for successful operations in Shari'ah compliant and profitable manner. Without targeting short-term profit, a long-term vision should be there, and Shari'ah compliance should be the driver for success.

In the history of the banking sector in Bangladesh, a number of conventional banks have been converted into Islamic banks, e.g. Export Import Bank of Bangladesh Limited in 2004, First Security Islami Bank Limited in 2009, and Global Islami Bank Limited and Standard Bank Limited in 2021, and some others are expected to be converted. Along with others, proper mapping of all existing products into Shari'ah-compliant products is a major challenge in the conversion process. As there is a shortage of expertise, a bank has to face difficulties in preparing products related documents and operational manuals, software acquisition and data migration, and developing a large number of human resources within a short period. It is highly recommended that the conversion process should take place gradually without overnight conversion if the shareholders want to minimize financial shock. Besides, conversion decision should be supported by proper groundwork and a high-level strategic plan to ensure proper data migration and product mapping.

Some initiatives have been taken by the Bangladesh Bank, especially related to the Islamic banking industry. In recent times, BB has nominated several officials for acquiring Islamic banking certifications e.g., Certified Islamic Banking and Finance Professional (CIBFP) offered by BIBM, Certified Islamic Professional Accountant (CIPA) and Certified Shari'a Adviser and Auditor (CSAA) offered by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Certificate Course on Islamic Banking and Finance (CIBF) run by Central Shariah Board for Islamic Banks of Bangladesh (CSBIB), so on. Islamic Banking & Finance Database (IBFD) Unit in the Statistics Department of BB has been formed and working on compiling, preserving and disseminating statistics to different departments of Bangladesh Bank, ministries, government, non-government and international organizations as per their requirements focusing on Macroeconomic aspects. The central bank's Banking Regulation and Policy Department (BRPD) is working on a revised Islamic banking guideline. Besides, the department is thinking seriously about improving the Shari'ah governance of the Islamic banking industry. The regulator also allowed conventional NBFIs (e.g. Aviva Finance Limited and BD Finance Limited) to offer Islamic financial services through branches/windows. A Shariah Advisory Committee (SAC) has been formed under the Debt Management Department to facilitate the Sukuk issuance and operations. Several projects are running on Shariah-based Green Banking under the Sustainable Finance Department of BB and it is currently considering the

introduction of Islamic Refinancing Scheme. It is expected that BB will be a member of AAOIFI very soon. BB is closely working with Islamic Financial Services Board (IFSB) to issue some new and/or revised prudential regulations for the Islamic banking industry. It is noted that CSBIB is running a project of Bengali Translation of AAOIFI Shari'ah Standards and it will be finalized by this year. An initiative will be undertaken to draft and enact a separate Islamic Banking Act.

5.0 Observations, Challenges and Recommendations

The review exhibits mainly Islamic banking operations in Bangladesh during the period of 2020-2021. The review shows the operational performances and challenges of Islamic banking activities. To improve the industry's efficiency, there are huge scopes of using internationally recognized Islamic banking guidelines like AAOIFI and IFSB's standards. Some of the issues identified in our previous review studies are addressed recently (Appendix II). Besides, BB has drafted revised guidelines for IBs. Practically, some previous challenges also remained valid for the current review. The current review ends with the following observations, challenges and recommendations:

5.1 Forcing the Islamic banks to be more Shariah Compliant through Audit, Inspection and Supervision

The study shows that a few Islamic banks knowingly or unknowingly become deviant from complying with Shariah rules and principles at varying degrees. These deviations can be reduced by conducting proper Shariah audit, inspection and Shariah supervision of Bangladesh Bank.

5.2 Dearth of Islamic Banking Scholars in the Industry

As per the study, 93 percent of respondents stated that there is a demand for expansion of IB industry in Bangladesh though a significant number of them (76%) observed a dearth of IB scholars for expansion of the market. So, it is high time to minimize this gap to flourish IB industry in Bangladesh by arranging regular training, workshops, and seminars in collaboration with local and foreign scholars in Islamic banking.

5.3 More Training for Islamic Finance Professionals

The human capital involved in Islamic finance and banking must be adequately trained. In the current situation, facilitating *Shariah* based banking education, alongside modern banking education, is an immediate need. Effective training on Islamic banking must blend basic banking, *Shariah* rules, Islamic finance and banking.

5.4 Increased Application of *Qard-e-Hasan*

The study revealed that although IBs are generally conservative in practising different special investment products for charity purposes, remarkably in 2021, they practiced Qard-e-Hasan for their employees. The IBs can take further initiatives to broaden the base of beneficiaries of such initiatives.

5.5 Supporting the Standardizing Efforts

Various standard development initiatives have been undertaken globally to ensure Shariah compliance, application of the best practices, harmonization, and building public confidence. These initiatives include but are not limited to the AAOIFI, IFSB and IIFM standards. Around 13 Bangladeshis are CIPA holders and around 150 are CSAA holders. These numbers are inadequate compared to Bangladesh's Islamic finance industry requirements. So, IFIs of Bangladesh can motivate and finance their employees to secure CIPA and CSAA professional degrees.

5.6 CAMELS Rating for Islamic banks may be CAMELSS

Bangladesh Bank assess the banks using CAMELS in 5-point scale to appraise the performance and financial position for the next supervisory action. CAMELS stands for Capital adequacy, Asset quality, Management efficiency, Earnings quality, Liquidity performance and Sensitivity to market risk. This is required for all the banks irrespective of Islamic or conventional. But to compel the Islamic banks to be Shariah compliant, the additional facet 'Shariah Compliance' may be added in CAMELS rating to make it CAMELSS.

5.7 Integration of Waqf in Islamic Banking Business

Charity and donation are opportunities for Muslims to obtain rewards from Allah (SWT). Survey exhibits that believers are more desirous of donating their funds in the mode of cash waqf. So, establishing a waqf bank or incorporating the waqf concept in some banking products has become essential for mobilizing the waqf and Sadaqah funds.

5.9 Composing of SSC/SSB as per AAOIFI Standard

The study displays that most Islamic banks include BoD and/or MD/CEO members in their SSB/SSC. However, AAOIFI governance standards suggest that SSC/SSB should be independent of the bank's management and owners. Islamic banks may consider constituting independent SSC/SSB with competent members.

5.10 Establishment of Research Cell

As a service industry, banks should develop new products/services for their expansion and sustainable growth. The study shows that only 24% of Islamic banks have established their research cell. Therefore, to develop more and better *Shariah*-compliant products/services, every Islamic bank should establish an active research cell without delay.

Above all, enacting an Islamic Banking Act and ensuring Shariah Appellate Bench at High Court are essential for supporting quick expanding of the Islamic banking industry of our beloved country.

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Appendix I: List of Banks Responded to the Questionnaire Survey

SN	Respondent Banks	SN	Respondent Banks
01.	Islami Bank Bangladesh Limited	18.	Union Bank Limited
02.	Social Islami Bank Limited	19.	NRB Commercial Bank Limited
03.	EXIM Bank Limited	20.	Premier Bank Limited
04.	Global Islami Bank Limited	21.	Bank Asia Limited
05.	First Security Islami Bank Limited	22.	ONE Bank Limited
06.	Standard Bank Limited	23.	Jamuna Bank Limited
07.	Dhaka Bank Limited	24.	Mutual Trust Bank Limited
08.	United Commercial Bank Limited	25.	Pubali Bank Limited
09.	Prime Bank Limited	26.	South Bangla Agriculture and Commerce Bank Limited
10.	Trust Bank Limited	27.	National Credit and Commerce Bank Ltd.
11.	The City Bank Limited	28.	Al-Arafah Islami Bank Limited
12.	Eastern Bank Limited	29.	Mercantile Bank Limited
13.	Southeast Bank Limited	30.	Sonali Bank Limited
14.	AB Bank Limited	31.	Pubali Bank Limited
15.	Meghna Bank Limited	32.	ICB Islamic Bank Limited
16.	NRB Bank Limited	33.	Shahjalal Islami Bank Limited
17.	Agrani Bank Limited		

Appendix II: Status of Observations Made in Previous IB Review Papers

S/N	Recommendation	Agree (%)	Status in Banks (%)			
			N/A	Yet to be done	Partially done	Done
1.	Enactment of Separate IB Act	96	50	36	0	14
2.	Initiative to Introduce Cash Waqf	96	0	40	4	56
3.	Introduction of Commodity Murabaha in Bangladesh	77	25	55	5	15
4.	Introduction of Longer-Term Deposit Product in Islamic Banks	100	4	45	13	38
5.	Launching Certification Program on Islamic Banking	100	13	52	13	22
6.	Central Shariah Board with Supervisory Authority	96	30	35	9	26
7.	Striving for More PLS Mode of Financing	100	5	59	18	18
8.	Introduction of Sukuk for Efficient Liquidity Management	100	5	59	18	18
9.	Separate Shariah Appellate Bench at High Court	100	45	55	0	0
10.	Creation of More Shariah Auditors	100	13	35	35	17
11.	Introduction of Products for Giving Cash Assistance	92	4	78	9	9
12.	Expansion of More Islamic Branches in Rural Areas	100	4	54	29	13
13.	Composition of SSC as per Global Standard Considering Competency, Independence and Engagement	100	5	27	36	32
14.	Development of Research Cell for Structuring Shariah-Compliant Innovative Products and Services	100	0	61	26	13
15.	More Training for Islamic Finance Professionals	100	4	25	50	21
16.	Introducing Islamic Social Business in Bangladesh	100	10	76	14	0
17.	Nominal and Effective Profit Rate on Investment Considering Mode of Contract and Actual Recovery in Compliance with the Ceiling Rate (9%)	88	26	26	11	37
18.	More Elaboration in Circulars by the Regulators for Islamic Banking Industry	100	46	24	24	6
19.	Inclusion of a New Dimension in CAMELS Rating Called 'Shariah Compliance'	100	37	53	5	5
20.	Setting up of Waqf Bank for Promoting Islamic Social Business	96	45	55	0	0

Source: Survey data

As a values based bank, BRAC Bank chooses to invest in education and training that fuels strong, sustainable and balanced economic growth. Such is the nature of the partnership between the bank and Bangladesh Institute of Bank Management that will enable people to understand and engage in finance, as part of their mandate. BRAC Bank supports the expansion of financing opportunities for all, and going forward, we intend to scale up the development opportunities of knowledge and excellence in order to broaden the capabilities and economic prospects.

It gives us great pleasure for a fifth successive year to be a part of this publication that is passionate about driving the skills development agenda. It is a well thought out initiative undertaken by Bangladesh Institute of Bank Management (BIBM) to provide access to an extensive pool of knowledge on the key functional areas of the banking of Bangladesh: Credit Operation; Trade Services Operation; Internal Control and Compliance; Islamic Banking Operation; Information Technology Operation; Treasury Operations; Human Resource Management; Sustainable Banking Activities; and Regulatory Reporting Requirements in Banks.

I am confident this document will bring a dramatic improvement in the management and operational quality of the banking industry.



Selim R. F. Hussain
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