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BIBM RESEARCH COMPENDIUM 01

Islamic Banking and Finance in Bangladesh

Operations, Products, Capital Markets,
Risk Management & Shariah Governance

Editors

Dr. Md. Mahabbat Hossain
Mezbah Uddin Ahmed
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Bangladesh Institute of Bank Management

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Disclaimer: Modified and summarized versions of the original papers have been included in this research compendium. Readers interested in more comprehensive discussions are encouraged to consult the original papers referenced in the compendium.

Message from the Governor, Bangladesh Bank

Islamic banking is no longer a niche within Bangladesh's financial system. It holds roughly a quarter of the deposits of the banking sector and serves millions of customers who choose it on conviction. A segment of that size carries systemic weight, and with systemic weight comes a supervisory responsibility that Bangladesh Bank takes seriously.

The last few years have tested the sector. Liquidity pressures, governance failures at individual institutions and the strains of merger and resolution have shown that scale alone does not confer resilience. They have also shown where the architecture needs strengthening: in a dedicated regulatory framework rather than adapted conventional rules, in central Shariah oversight, in liquidity instruments that are genuinely Shariah-compliant, and in the competence and independence of Shariah supervisory committees.

Bangladesh Bank has moved on several of these fronts, including the establishment of a dedicated departmental focus on Islamic banking regulation and policy. Much remains to be done, and it will be done better with evidence. That is the value of this compendium. The studies collected here were conducted by researchers with access to the institutions themselves, and they record what practice actually looks like rather than what regulation assumes it to be. Several of their recommendations anticipate reforms now under consideration.

I congratulate the Bangladesh Institute of Bank Management (BIBM) on assembling this volume and commend it to regulators, bankers, scholars and students alike.

Md Mostaqur Rahman FCMA
Governor, Bangladesh Bank
Chairman, BIBM Governing Board

Message from the Secretary General, AAOIFI

In the name of Allah, the Most Gracious, the Most Merciful.

It is a great pleasure to note that the Bangladesh Institute of Bank Management (BIBM) has brought together this valuable Research Compendium on Islamic Banking and Finance in Bangladesh. I believe this important initiative will make a meaningful contribution to deepening knowledge and understanding of Islamic banking and finance, while supporting the growth of an industry that has become an integral component of Bangladesh's financial system.

The effectiveness and credibility of Islamic finance depend not only on Shari'ah compliant products, but also on sound governance, robust risk management, transparency, competent human resources and appropriate regulatory frameworks in line with Shari'ah principles and rules. I trust that the studies in this compendium address these interconnected dimensions and the areas requiring attention from all the stakeholders of the industry.

Over the years, the development of Islamic banking and finance in Bangladesh has generated valuable lessons for other jurisdictions seeking to establish or expand their Islamic finance sectors. Bangladesh's experience in product development, institutional growth, Shari'ah governance and human capital development offers a useful reference for understanding the opportunities and challenges involved in developing a prospering Islamic finance industry.

Standardisation also has an important role to play in this process. Consistent application of internationally recognised Shari'ah, accounting, auditing and governance standards can enhance transparency, comparability, confidence and cross-border integration. It is encouraging to see AAOIFI standards regularly cited in policy and regulatory discussions in Bangladesh, reflecting their relevance to the Bangladesh's continued progress of Islamic finance landscape.

Bangladesh is also home to one of the largest communities of AAOIFI certification holders in the world, demonstrating strong professional interest in internationally recognised standards. We look forward to further strengthening our collaboration with regulators, Shari'ah scholars, professionals, academia and institutions, such as BIBM in Bangladesh in support of effective implementation and further advancement of Islamic finance.

I commend BIBM, the editors and all contributing researchers for this important initiative. I am confident that this compendium will serve as a useful reference for policymakers, regulators, practitioners, Shari'ah scholars, academics and students, while encouraging further research and constructive dialogue on the future of Islamic banking and finance in Bangladesh.

I wish BIBM and all stakeholders in Bangladesh continued success in strengthening the Islamic finance ecosystem and contributing to its responsible and sustainable advancement.

Omar Mustafa Ansari
Secretary General
Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

Message from the Head, Islamic Finance Centre, Bahrain Institute of Banking and Finance (BIBF)

It is a pleasure to contribute this Islamic Banking and Finance in Bangladesh: Operations, Products, Capital Markets, Risk Management and Shariah Governance compendium, published by the Bangladesh Institute of Bank Management (BIBM). My sincere appreciation goes to the editors, authors, researchers, reviewers, and everyone whose commitment and hard work have brought this valuable publication to life.

What makes this compendium particularly valuable is the way it connects sound research with the realities of the industry. Its coverage of various industries and regulatory challenges offers useful perspectives for policymakers, regulators, practitioners, academics, and researchers.

Bangladesh holds a distinctive and increasingly important place in the global Islamic finance landscape. Over the past four decades, its Islamic banking sector has grown remarkably, serving millions of customers and making a meaningful contribution to financial inclusion, entrepreneurship, ethical finance, and socio-economic development. The chapters in this compendium reflect both how far the industry has come and where further work is needed.

At the Bahrain Institute of Banking and Finance (BIBF), we share this commitment. As a leading regional and international provider of education, training, research, consultancy and professional development, and as part of the Central Bank of Bahrain, BIBF remains dedicated to advancing Islamic banking and finance around the world. Bahrain has long played a pioneering role in the industry, and we continue to support that legacy by developing talent, strengthening institutions, promoting research, and encouraging the exchange of knowledge across markets.

Our work with Bangladesh has made this commitment especially meaningful. We look forward to building on this relationship with BIBM, Bangladesh Bank, the Ministry of Finance, academic institutions, and the wider financial services community.

I warmly congratulate BIBM and every contributor to this important publication. I hope it becomes a trusted reference for practitioners, regulators, scholars, and policymakers in support of Islamic banking and finance in Bangladesh and beyond.

Dr. Rizwan Malik
Head, Islamic Finance Centre
Bahrain Institute of Banking and Finance (BIBF)
Kingdom of Bahrain

Message from the Dean, IIUM Institute of Islamic Banking and Finance

In the name of Allah, the Most Gracious, the Most Merciful.

On behalf of the IIUM Institute of Islamic Banking and Finance (IIiBF), I congratulate the Bangladesh Institute of Bank Management (BIBM) on the publication of this compendium, which brings together more than a decade of BIBM's applied research on Islamic banking in Bangladesh.

Bangladesh and Malaysia both saw their first Islamic bank open in 1983, and the two industries have since come to hold comparable shares of their domestic banking systems. The routes they took, however, differ in important respects: in legal foundation, in Shariah governance architecture, in supporting infrastructure, in institutional and talent development, and in the depth of the Islamic insurance and Islamic capital market. Reading these chapters, one sees which of those differences matter, and why.

One constraint is common to every jurisdiction. Islamic financial institutions cannot be governed and run by those untrained in the discipline, and professionals competent in both Shariah and modern finance remain in short supply. It was to meet this need that the IIiBF was established in 2005. Scholars and graduates from Bangladesh have long been part of our postgraduate community and our research collaborations, a relationship we value and hope to see deepen.

I commend BIBM, the editors and the researchers on this volume of scholarly and practical worth, and pray that it serves the industry and the ummah.

Prof. Dr. Romzie Rosman
Dean
IIUM Institute of Islamic Banking and Finance
International Islamic University Malaysia

Foreword

The Bangladesh Institute of Bank Management (BIBM) was established to strengthen the professional capacity of the country's banking sector through training, education, research, and consultancy. Research has always been central to this mandate, and Islamic banking has been among its most sustained subjects of study.

This compendium brings together seventeen such studies. They span the industry's operating landscape, its financing modes and pricing practices, the development of Sukuk and the Islamic capital market, risk and liquidity management, Shariah governance, and the sector's experience through the COVID-19 pandemic and the disruptions that followed. Each was carried out by BIBM faculty working with colleagues from Bangladesh Bank, the industry, and partner institutions both at home and abroad, and each drew on direct evidence from the banks themselves.

BIBM research uncovers the practical realities of how Islamic banking is conducted in Bangladesh, where practice departs from precept, and where the gaps lie. Its findings and recommendations have long contributed to the deliberations that shape policy, and the studies collected here speak both to how the industry is performing and to what more needs to be done. A reader who works through them will come away with a coherent picture of an industry that has grown faster than the infrastructure that supports it.

I record my appreciation to the researchers whose work fills these pages; to the editorial team, who condensed more than seven hundred pages into a single usable volume without sacrificing the evidence behind it; and to the bankers, scholars, and regulators whose co-operation made the original studies possible.

It is my hope that this compendium will serve practitioners, policymakers, researchers, and learners alike, and that it will prompt further research and dialogue that this important sector deserves.

Md. Ezazul Islam, Ph.D.
Director General, BIBM
Editorial Advisor, BIBM Research Compendium

Preface

The Bangladesh Institute of Bank Management (BIBM) has studied Islamic banking and finance in Bangladesh from the very beginning of its inception. Over that period, its faculty and their co-researchers have produced a substantial body of applied work: reviews of industry operations, examinations of deposits and financing modes, assessments of Shariah governance, and studies of how the sector behaves under stress.

This compendium brings seventeen of those studies together in one volume. It is organized in five parts that follow the shape of the industry itself: the foundations and development of the industry, the financing modes and their pricing, the Islamic capital market and Sukuk, risk and liquidity management together with the sector's experience of crisis, and Shariah governance and institutional models. Read in sequence, the parts trace a single argument — that Bangladesh's Islamic banking industry has achieved scale well ahead of the institutional architecture required to sustain it.

Each chapter preserves the research as its authors reported it. Empirical findings, tables, figures and policy recommendations stand unchanged. What has been removed is duplication: repeated literature reviews, overlapping regulatory summaries and material that added length without adding evidence. The editorial work has been one of compression and correction, not reinterpretation.

Readers should note that the studies were written at different times. Statistics, institutional names, circulars and regulatory positions are evidence from the date of the underlying study, not statements of the position at the date of this volume. Where a chapter rests on an older dataset, its value lies in the baseline it records, the industry response it documents and the policy lesson that follows. The table that follows this preface shows which study each chapter is drawn from. At the end of the volume, an appendix sets out the findings and recommendations of every study side by side, and a glossary explains the Arabic and technical terms used.

Terminology, spelling, heading hierarchy, table presentation, abbreviations and the treatment of Arabic terms have been harmonized across the volume, and the figures have been redrawn to a single specification.

We record our gratitude to the researchers whose work forms these chapters, to the bankers, Shariah scholars and regulators who gave their time to the underlying surveys and interviews, and to BIBM for supporting both the original studies and this compendium. Responsibility for any error that remains in the editing is ours.

The Editors
Dhaka, October 2026

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2	**Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development** Md. Alamgir, Md. Mahabbat Hossain and Nur Al Faisal Alamgir, M., Hossain, M.M. and Faisal, N.A. (2017) "Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development", *Research Monograph 23*, pp. 1-75, BIBM, Dhaka, available at: https://ibfcbd.com/research	Chapters 1 and 2
3	**Product Diversification of Islamic Banks: Prospects and Challenges** Md. Alamgir, Md. Mahabbat Hossain, Md. Abdul Halim and Md. Mizanur Rahman Alamgir, M., Hossain, M.M., Halim, M.A., and Rahman, M.M. (2018). "Product Diversification of Islamic Banks: Prospects and Challenges", *Research Monograph 38*, pp. 1-38, BIBM, Dhaka, available at: https://ibfcbd.com/research	Chapter 4
4	**Application of Murabahah Mode of Financing by Islamic Banks of Bangladesh: Issues and Recommendations** Md. Mahabbat Hossain, Md. Atiqur Rahman Khan Khadem and Mezbah Uddin Ahmed Hossain, M.M. Khadem, M.A.R.K. and Ahmed, M.U. (2023). "Application of Murabahah Mode of Financing by Islamic Banks of Bangladesh: Issues and Recommendations", *Bank Parikrama: A Journal of Banking & Finance, XLVIII*(1 & 2), 40–71. (ABDC, C), available at: https://www.bibm.org.bd/publications-read.php?id=99	Chapter 5

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13	**COVID-19 Pandemic: Challenges and Opportunities for Islamic Banking Industry of Bangladesh** Md. Mahabbat Hossain, Md. Abdullah Sharif, Md. Golzare Nabi, Md. Siddiqur Rahman and Kamal Hossain Hossain, M.M., Sharif, M.A., Nabi, M.G., Rahman, M.S., and Hossain, K. (2022). "COVID-19 Pandemic: Challenges and Opportunities for Islamic Banking Industry of Bangladesh", *Bank Parikrama*, Vol. XLVII, Nos. 1&2, pp. 155-190, available at: https://www.bibm.org.bd/publications-read.php?id=82	Chapter 14
14	**COVID-19 and Risk Management for Islamic Banks: Proposal for the New Normal Scenario** Shah Md. Ahsan Habib and Md. Mahabbat Hossain Habib, S.M.A. and Hossain, M.M. (2020). "COVID-19 and Risk Management for Islamic Banks: Proposal for the New Normal Scenario", *Banking and Financial Sector Implications of CIVID-19*, Paper No. 03, pp. 55-68, BIBM, Dhaka, available at: https://ibfcbd.com/research	Chapter 14
15	**Shariah Governance in Islamic Banks of Bangladesh: An Evaluation** Md. Mahabbat Hossain, Mezbah Uddin Ahmed, Md. Alamgir and Muhammad Habibur Rahman Hossain, M.M., Ahmed, M.U, Alamgir. M., and Rahman, M.H. (2026). "Shariah Governance in Islamic Banks of Bangladesh: An Evaluation", *Research Monograph 77*, pp. 1-40, BIBM-INCEIF Joint Seminar held on March 30, 2026 at BIBM, Dhaka, available at: https://www.bibm.org.bd/publications-read.php?id=167	Chapters 3 and 15

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17	**Rationale and Process for Introducing Islamic Banking in Conventional Banks of Bangladesh** Mezbah Uddin Ahmed and Md. Mahabbat Hossain Ahmed, M.U., and Hossain, M.M. (2025). "Rationale and Process for Introducing Islamic Banking in Conventional Banks of Bangladesh", Conference Proceedings of Annual Banking Conference 2025, organized by Bangladesh Institute of Bank Management (BIBM) held during April 09-10, 2025, Dhaka, available at: https://www.bibm.org.bd/publications-read.php?id=152 A further developed version of the study is published as a journal article. Details: Ahmed, M.U., and Hossain, M.M. (2026). "Rationale for Islamic Banking Windows and Issues Impeding Their Effectiveness: Insights from Bangladesh", Journal of Islamic Finance, Vol. 15(1), pp. 35-52, available at: https://journals.iium.edu.my/iiibf-journal/index.php/jif/article/view/1091.	Chapter 17

List of Abbreviations

AAB	AAOIFI Accounting Board	**IF**	Islamic Finance
AACOBB	Anti-Money Laundering Compliance Officers of Banks in Bangladesh	**IFCI**	Islamic Finance Country Index
AAIB	Al-Arafah Islami Bank PLC	**IFDI**	Islamic Finance Development Indicator
AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions	**IFI**	Islamic Financial Institution
ACB	Audit Committee of the Board	**IFIs**	Islamic Financial Institutions
ACD	Agricultural Credit Department	**IFRS**	International Financial Reporting Standards
ADR	Advance-Deposit Ratio	**IFSB**	Islamic Financial Services Board
AGM	Annual General Meeting	**IiBFRBD**	IBFC Islamic Banking and Finance Report, Bangladesh
AIBL	Al-Arafah Islami Bank PLC	**IIFA**	International Islamic Fiqh Academy
ALCO	Asset-Liability Management Committee	**IIFM**	International Islamic Financial Market
ALM	Asset-Liability Management	**IIFS**	Institutions Offering Islamic Financial Services
AS	Alayhi-S-Salam (Peace be upon him)	**IILM**	International Islamic Liquidity Management Corporation
ASEAN	Association of Southeast Asian Nations	**IIRA**	Islamic International Rating Agency
ASF	Available Stable Funding	**Ijarah MBT**	Ijarah Muntahia Bittamleek
ASIFI	Auditing Standards for Islamic Financial Institutions	**ILO**	International Labour Organization
AT1	Additional Tier 1	**IMBT**	Ijarah Muntahia Bittamleek
ATDTL	Average Total Demand and Time Liabilities	**IMF**	International Monetary Fund
ATM	Automated Teller Machine	**INCEIF**	International Centre for Education in Islamic Finance
BBML	Banga Building Materials Ltd.	**IOM**	International Organization for Migration
BCA	Bank Company Act	**IRR**	Investment Risk Reserve
BCBS	Basel Committee on Banking Supervision	**ISA**	Internal Shariah Audit
BCP	Business Continuity Plan	**ISBS**	Islamic Shariah-Based Securities
BDBL	Bangladesh Development Bank Limited	**IsDB**	Islamic Development Bank
BDT	Bangladesh Taka	**ISO**	International Organization for Standardization
BG	Bank Guarantee	**ISR**	Income Sharing Ratio
BGIIB	Bangladesh Government Islamic Investment Bond	**ISRA**	International Shariah Research Academy for Islamic Finance
BGIS	Bangladesh Government Investment Sukuk	**IT**	Information Technology

AAB	AAOIFI Accounting Board	**IF**	Islamic Finance
BGITB	Bangladesh Government Islamic Treasury Bills	**JPY**	Japanese Yen
BGSS	Bangladesh Government Special Sukuk	**KII**	Key Informant Interview
BIA	Basic Indicator Approach	**KIIs**	Key Informant Interviews
BIBM	Bangladesh Institute of Bank Management	**KPI**	Key Performance Indicator
BIS	Bank for International Settlements	**KRIs**	Key Risk Indicators
BNM	Bank Negara Malaysia	**KSA**	Kingdom of Saudi Arabia
BO	Beneficiary Owner	**LC**	Letters of Credit
BoD	Board of Directors	**LCFP**	Liquidity Contingency Funding Plan
BRMC	Board Risk Management Committee	**LCR**	Liquidity Coverage Ratio
BRPD	Banking Regulation and Policy Department	**LGED**	Local Government Engineering Department
BSB	Bangladesh Shilpa Bank	**LIBOR**	London Inter-bank Offered Rate
BSEC	Bangladesh Securities and Exchange Commission	**LSEG**	London Stock Exchange Group
BSRS	Bangladesh Shilpa Rin Sangstha	**MANCOM**	Management Committee
CA	Current Account	**MCO**	Maximum Cumulative Outflow
CAD	Canadian Dollar	**MD**	Managing Director
CAGR	Compound Annual Growth Rate	**MENA**	Middle East and North Africa
CAMELS	Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk	**MFI**	Micro-Finance Institution
CAMELSS	Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity and Shariah Compliance	**MFS**	Mobile Financial Services
CAR	Capital Adequacy Ratio	**MIS**	Management Information System
CB	Conventional Bank	**MLS**	Mudarabah Liquidity Support
CBS	Core Banking Systems	**MoF**	Ministry of Finance
CCRO	Chief Credit Risk Officer	**MoU**	Memorandum of Understanding
CDWSP	Chattogram Division Upazila & Union Road Widening & Strengthening Project	**MPD**	Monetary Policy Department
CEO	Chief Executive Officer	**MPO**	Murabahah to the Purchase Orderer
CET1	Common Equity Tier 1	**MTDR**	Mudarabah Term Deposit Receipt
CFO	Chief Financial Officer	**NBA**	Network Behavior Analysis
CG	Corporate Governance	**NBR**	National Board of Revenue
CIBFP	Certified Islamic Banking and Finance Professional	**NCC**	National Credit and Commerce Bank PLC
CIBRR	Construction of Important Bridges on Rural Roads	**NOC**	Network Operation Center
CIPA	Certified Islamic Professional Accountant	**NPI**	Non-Performing Investments
CMSME	Cottage, Micro, Small, and Medium Enterprises	**NPL**	Non-Performing Loan
CNY	Chinese Yuan (Renminbi)	**NPLs**	Non-Performing Loans

AAB	AAOIFI Accounting Board	**IF**	Islamic Finance
COSO	Committee of Sponsoring Organizations of the Treadway Commission	**NRB**	Non-Resident Bangladeshi
COVID-19	Coronavirus disease 2019	**NRBC**	NRBC Bank PLC
CPD	Continuous Professional Development	**NSFR**	Net Stable Funding Ratio
CRAR	Capital to Risk-Weighted Assets Ratio	**OBU**	Offshore Banking Unit
CRO	Chief Risk Officer	**OECD**	Organisation for Economic Co-operation and Development
CRR	Cash Reserve Requirement	**OIC**	Organisation of Islamic Cooperation
CSAA	Certified Shariah Adviser and Auditor	**OIFI**	Other Islamic Financial Institutions
CSB	Central Shariah Board	**ORM**	Operational Risk Management
CSBIB	Central Shariah Board for Islamic Banks of Bangladesh	**ORMF**	Operational Risk Management Framework
CSE	Chittagong Stock Exchange	**OTPs**	One Time Password
CSI	Chittagong Stock Exchange Shariah Index	**PCB**	Private Commercial Bank
CSR	Corporate Social Responsibility	**PDI**	Perpetual Debt Instruments
DB	Dual Bank / Dual Banking	**PEP**	Politically Exposed Person
DDoS	Distributed Denial of Service	**PER**	Profit Equalization Reserve
DFIM	Department of Financial Institutions and Markets	**PLC**	Public Limited Company
DGHS	Directorate General of Health Services	**PLS**	Profit-and-Loss Sharing
DIB	Diploma in Islamic Banking	**PNCPS**	Perpetual Non-Cumulative Preference Shares
DMD	Debt Management Department (Bangladesh Bank); Deputy Managing Director (bank designation)	**PPE**	Personal Protective Equipment
DMZ	Demilitarized Zone (network security)	**PSD**	Payment Systems Department
DNS	Domain Name System	**PSIAs**	Profit-Sharing Investment Accounts
DOS	Department of Off-Site Supervision	**PSMOR**	Principles for the Sound Management of Operational Risk
DR	Disaster Recovery	**PSR**	Profit-Sharing Ratio
DSE	Dhaka Stock Exchange	**RegTech**	Regulatory Technology
DSES	DSE Shariah Index	**RMC**	Risk Management Committee
EDF	Export Development Fund	**RMD**	Risk Management Department
EMI	Equated Monthly Installment	**ROA**	Return on Assets
ERM	Enterprise Risk Management	**ROE**	Return on Equity
ERMC	Executive Risk Management Committee	**RR**	Rate of Return
ESG	Environmental, Social, and Governance	**RSBM**	Resident Shariah Board Member
EUR	Euro	**RSF**	Required Stable Funding
EXIM	Export Import Bank of Bangladesh PLC	**RWA**	Risk-Weighted Assets

AAB	AAOIFI Accounting Board	**IF**	Islamic Finance
FAQs	Frequently Asked Questions	**S&P**	Standard & Poor's
FAS	Financial Accounting Standard	**SAB**	Shariah Advisory Board
FC	Foreign Currencies	**SAC**	Shariah Advisory Committee
FCA	Fellow Chartered Accountant	**SAW**	Sallallahu Alaihi Wasallam (peace be upon him)
FCB	Foreign Commercial Bank	**SBAC**	SBAC Bank PLC
FCs	Finance Companies	**SBP**	State Bank of Pakistan
FDI	Foreign Direct Investment	**SCB**	Standard Chartered Bank
FDIC	Federal Deposit Insurance Corporation	**SCU**	Shariah Compliance Unit
FE	Foreign Exchange	**SDG**	Sustainable Development Goal
FF	Full-fledged Islamic Bank	**SDGs**	Sustainable Development Goals
FFIB	Full-Fledged Islamic Bank	**SFD**	Sustainable Finance Department
FGD	Focus Group Discussion	**SG**	Shariah Governance
FID	Financial Institutions Department	**SGF**	Shariah Governance Framework
FinTech	Financial Technology	**SGPD**	Shariah Governance Policy Document
FIs	Financial Institutions	**SIB**	Social Islami Bank PLC
FOREX	Foreign Exchange	**SIEM**	Security Information and Event Management
FSB	Financial Stability Board	**SJIB**	Shahjalal Islami Bank PLC
FSIB	First Security Islami Bank PLC	**SJIBL**	Shahjalal Islami Bank PLC
FY	Fiscal Year	**SLP**	Structural Liquidity Profile
GBP	British Pound Sterling	**SLR**	Statutory Liquidity Requirement
GCC	Gulf Cooperation Council	**SLS**	Special Liquidity Support
GDP	Gross Domestic Product	**SMART**	Six-month Moving Average Rate of Treasury Bill
GIB	Global Islami Bank PLC	**SME**	Small and Medium-sized Enterprises
GIFR	Global Islamic Finance Report	**SMESPD**	SME & Special Programs Department
GS	Governance Standards	**SMT**	Senior Management Team
HPMM	Hire Purchase Musharakah Mutanaqisah	**SNCR**	Shariah Non-Compliance Risk
HPSM	Hire Purchase under Shirkatul Melk	**SND**	Special Notice Deposit
HQLA	High-Quality Liquid Assets	**SOCB**	State-Owned Commercial Bank
IAH	Investment Account Holders	**SOFR**	Secured Overnight Financing Rate
IB	Islamic Bank	**SPV**	Special Purpose Vehicle
IBB	Islami Bank Bangladesh PLC	**SRO**	Statutory Regulatory Order
IBBL	Islami Bank Bangladesh Limited	**SS**	Shariah Standard
IBBW	Islamic Banking Branches and Windows	**SSB**	Shariah Supervisory Board
IBCA	Islamic Bank Companies Act	**SSC**	Shariah Supervisory Committee
IBD	Islamic Banking Division	**SupTech**	Supervisory Technology
IBF	Islamic Banking and Finance	**SWT**	Subhanahu Wa Ta'ala (Glorified and Exalted Be He)
IBFC	Islamic Banks and Finance Companies	**TA**	Total Assets
IBFS	Islamic Banking and Finance Statistics	**TBML**	Trade-Based Money Laundering

AAB	AAOIFI Accounting Board	**IF**	Islamic Finance
IBLF	Islamic Banks Liquidity Facility	**TIB**	Transparency International Bangladesh
IBRPD	Islamic Banking Regulations and Policy Department	**TSA**	The Standardized Approach
IBs	Islamic Banks	**TT**	Telegraphic Transfer
IBW	Islamic Banking Window	**UAE**	United Arab Emirates
ICAAP	Internal Capital Adequacy Assessment Process	**UIAH**	Unrestricted Investment Account Holders
ICB	ICB Islamic Bank Limited	**UK**	United Kingdom
ICC	Internal Control and Compliance (Chapters 11-12); International Chamber of Commerce (governance citation)	**UNCTAD**	United Nations Conference on Trade and Development
ICCD	Internal Control and Compliance Divisions	**UNDP**	United Nations Development Programme
ICD	Islamic Corporation for the Development of the Private Sector	**UPS**	Universal Pension Scheme
ICM	Islamic Capital Market	**USA**	United States of America
ICT	Information and Communications Technology	**USD**	United States Dollar
IDR	Investment-Deposit Ratio	**VAT**	Value Added Tax
IDRA	Insurance Development and Regulatory Authority	**WC**	Working Capital
IEDCR	Institute of Epidemiology, Disease Control and Research	**WHO**	World Health Organization

PART I: FOUNDATIONS AND DEVELOPMENT

Chapter 1: Fundamentals of Islamic Banking and Finance

This chapter draws on Section 2 of the review "Islamic Banking Operations in Bangladesh 2024" by Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Emon Arefin, and on the conceptual part of the study "Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development" by Md. Alamgir, Md. Mahabbat Hossain and Nur Al Faisal.

1.1 Conceptual Framework of Islamic Finance

Islamic finance, with banking as its core subset, represents a distinct and rapidly growing segment of the global financial system, governed by principles derived from Islamic law (Shariah). These principles prohibit interest (Riba), excessive uncertainty (Gharar), gambling (Maysir), and transactions involving harmful activities (Dharar), while emphasizing ethical conduct, social justice, and financial responsibility. Thus, Islamic finance is not just a system of prohibitions but a comprehensive framework that promotes equity, fairness, and risk-sharing. It anchors financial activities in real assets and socially beneficial investments, aligning finance with the broader goals of inclusive and sustainable development.

As a holistic financial ecosystem rooted in Islamic jurisprudence, Islamic finance encompasses banking, capital markets, and insurance. Islamic banking replaces interest-based lending with trade, partnership, and leasing contracts such as cost-plus sale (Murabahah), partnership (Musharakah), profit-sharing partnership (Mudarabah), and lease (Ijarah). In parallel, Islamic insurance (Takaful) represents mutual cooperation and risk-sharing among participants, while Islamic capital market instruments — such as Islamic investment certificates (Sukuk) and Islamic funds — offer investment avenues aligned with religious and ethical values. Collectively, these components integrate financial viability with moral obligations, seeking to advance both individual prosperity and societal welfare.

Islamic finance or Islamic Banking is, in many ways, very similar to conventional finance and banking (Ahmad, 2008). Islamic banking is based on Islamic *Shariah* law that provides fundamentals about financing and investing (El-Gamal, 2000). The Organisation of Islamic Conference (OIC) defined an Islamic bank as a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic *Shariah* and to the banning of the receipt and payment of interest on any of its operations (Hassan, 1999). Sometimes it is also called interest-free banking, and according to Khan and Bhatti (2008) interest-free Islamic banking is derived from two axioms, mutual fairness in transactions and reflection of actual reality.

1.2 Historical Evolution of Islamic Banking and Finance

The origins of Islamic finance trace back to the early Islamic era, where commercial practices were governed by ethical norms encouraging fairness and justice. Instruments such as trade and participatory investments, such as Mudarabah and Musharakah, were widely used during the lifetime of the Prophet Muhammad (SAW).

Modern Islamic finance re-emerged in the mid-20th century, beginning with small-scale experiments in Pakistan during the 1950s and the establishment of Mit Ghamr Savings Bank in Egypt in 1963. Although Mit Ghamr was short-lived, it laid the foundation for contemporary Shariah-compliant banking. The establishment of Tabung Haji in Malaysia in 1963 for Hajj pilgrims is another pioneering example. The founding of the Islamic Development Bank (IsDB) marked a turning point, institutionalizing Islamic finance on a multilateral scale: it was established pursuant to the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries in Jeddah in December 1973, its Articles of Agreement were signed by the founding members in 1974, and the Bank formally opened on 20 October 1975 following the inaugural meeting of its Board of Governors in July 1975.

The 1970s and 1980s witnessed the emergence of pioneering private institutions such as Dubai Islamic Bank, Faisal Islamic Bank of Sudan, and Bahrain Islamic Bank. In Bangladesh, the sector began with the establishment of Islami Bank Bangladesh Limited in 1983. Since then, Islamic finance has expanded worldwide, offering a wide range of products through both full-fledged Islamic institutions and Islamic windows of conventional banks.

The broad stages through which Islamic banking has developed across jurisdictions are summarized in Table 1.1.

Table 1.1: Development Stages of Islamic Banking in Global Economies

Cluster 1	Cluster 2	Cluster 3	Cluster 4
Exploration of Market Potential	**Sporadic Development**	**Market Development Activities**	**Expansion of Market Activities**
China, India, Hong Kong, Azerbaijan	Syria, Lebanon, Germany, USA, Singapore	Brunei, Indonesia, Morocco, Turkey, Qatar	Malaysia, Kuwait, Saudi Arabia, UAE, Bahrain, UK.

Source: Pricewaterhousecoopers, Malaysia.
Note: Bangladesh has not been considered in the study.

1.3 Core Principles and Ethical Foundations of IBF

Islamic banking and finance rest on principles derived from Shariah that guide transactions and reinforce justice, transparency and shared responsibility, distinguishing them from conventional finance and aligning them with religious obligations and social welfare.

1.3.1 Sources of Shariah

Shariah, the basis of Islamic banking, derives the rules of Fiqh Muamalat from primary and secondary sources. The primary sources are the Qur'an and the Sunnah — everything narrated from the Prophet (SAW): his acts, sayings and tacit approvals, and descriptions of his attributes and character (Kettell, 2011). The secondary sources are Ijma (the consensus of scholars' juristic opinions), Qiyas (analogy, taking one matter as the criterion for evaluating a closely similar one) and Ijtihad (the use of human reasoning to elaborate and explain Shariah).

1.3.2 Fundamental Principles

- **Application of permissible contracts:** transactions are structured on trade, lease and partnership contracts such as Mudarabah, Musharakah, Murabahah and Ijarah, earning income from real economic activity rather than interest, with mutual consent, clarity and fairness. As the Qur'an states:

  "…But Allah has permitted trading and forbidden interest…" (Surah Al-Baqarah, 2:*275*).

- **Fairness, transparency and ethical dealings:** parties must fully understand contractual terms, and ambiguity must be avoided to prevent injustice. The Qur'an commands:

  "Indeed, Allah commands you to render trusts to whom they are due and when you judge between people to judge with justice…" (Surah An-Nisa, 4:58).

- **Investment in permissible sectors:** funds may be invested only in permissible (Halal), productive activities; dealings in prohibited and harmful items such as alcohol, gambling or pork are forbidden. The Qur'an states:

  "O believers! Intoxicants, gambling, idols, and drawing lots for decisions are all evil of Satan's handiwork. So shun them so you may be successful." (Surah Al-Ma'idah, 5:90).

- **Risk sharing:** unlike interest-based lending, which shifts risk to the borrower, Islamic finance shares risk: Murabahah and Ijarah justify income through ownership risk, and Musharakah shares both profit and loss, while Mudarabah shares profit by an agreed ratio with financial loss borne by the capital provider unless it results from the Mudarib's negligence, misconduct or breach of contract — each reflecting the maxim:

  "Al-kharāj bi al-ḍamān – profit is justified by bearing liability."

- **Asset-backed transactions:** financing must be backed by real assets or services; in Murabahah or Ijarah, for example, the bank must own the asset before selling or leasing it. The Prophet Muhammad (SAW) said:

  "Do not sell what you do not possess." (Sunan Abu Dawud, Hadith 3503).

- **Pursuit of Maqasid al-Shariah:** the higher objectives of Islamic law — preserving religion, life, intellect, progeny and wealth — require products and services that promote justice, welfare and harmony. The Qur'an warns:

  "Do not consume one another's wealth unjustly…" (Surah Al-Baqarah, 2:188).

- **Social justice and accountability:** through obligatory alms (Zakat), voluntary charity (Sadaqah) and benevolent loans (Qard Hasan), financial inclusion and charity are core responsibilities, not optional acts. The Qur'an declares:

  "Indeed, Allah orders justice and excellence, and giving to relatives, and forbids immorality, bad conduct, and oppression…" (Surah An-Nahl, 16:90).

1.3.3 Key Prohibitions in Islamic Finance

- **Riba (interest):** paying or receiving interest — unjust enrichment from credit risk — is strictly prohibited. The Qur'an strongly condemns it:

  "O believers, fear Allah, and give up what remains due to you of interest, if you are true believers. If you do not, then be warned of war from Allah and His Messenger…" (Surah Al-Baqarah, 2:278–279).

- **Gharar (excessive uncertainty):** unclear terms, undefined conditions or speculative sales invalidate contracts, and the Prophet (SAW) forbade transactions involving uncertainty:

  "Abu Huraira (RA) reported that Allah's Messenger (SAW) forbade a transaction determined by throwing stones, and the type which involves some uncertainty." (Sahih Muslim, Hadith No. 1513)

- **Maysir (gambling):** gambling and games of chance, which yield gain without productive effort, are prohibited. The Qur'an cautions:

  "They ask you about wine and gambling. Say, 'In them is great sin and [some] benefit for people. But their sin is greater than their benefit.'" (Surah Al-Baqarah, 2:219).

- **Dharar (harm):** transactions causing unjust harm — exploitation, fraud, coercion or manipulation — are forbidden, following the maxim:

  "Lā ḍarar wa lā ḍirār – harm should neither be inflicted nor reciprocated."

- **Other prohibited practices:** Shariah also forbids dealing in impermissible goods, deception, coercion, hoarding and unjust enrichment (Zulm); dealings must be honest, consensual and fair. A Hadith Qudsi records:

  "Verily, I have made oppression unlawful for Myself and for My servants; so do not oppress one another." (Sahih Muslim, Vol. 6, Hadith 6247).

1.4 Shariah-based Contracts and Principles in Islamic Banking

Islamic banks use a variety of Shariah-based contracts and principles to offer alternatives to conventional products and services. These contracts and principles provide options for deposit mobilization, consumer and business finance, and investment, all while adhering to the Shariah. The following is an overview of the most widely applied ones by Islamic banks:

- **Qard (Interest-Free Loan):** Qard refers to loans extended on an interest-free basis.
- **Wadiah (Safekeeping):** safe custody (Wadiah) is a safekeeping contract under which customers deposit funds with the bank for custodial purposes. The bank acts as a trustee but may utilize the funds with the depositor's consent. While no return can be contractually agreed or promised, the bank may, at its discretion, provide a gift (Hibah).
- **Murabahah (Cost-Plus Sale):** Murabahah is among the most common contracts in Islamic banking. Here, the bank purchases an asset and sells it to the client at a disclosed cost-plus profit margin. Payment may be immediate or deferred.

- **Mudarabah (Profit-Sharing):** Mudarabah is a partnership in which one party (Rabb al-Mal) contributes capital, while the other (Mudarib) provides expertise and management. Profits are distributed according to a pre-agreed ratio, whereas financial loss — unless caused by negligence, misconduct, or breach of terms — is borne solely by the capital provider. This contract promotes entrepreneurship and risk-sharing.
- **Musharakah (Equity Participation):** Musharakah represents a joint venture in which partners contribute capital and, in some cases, managerial effort. Profits are distributed according to agreed ratios, while losses are shared in proportion to capital contributions. This mode encourages genuine partnership and equity financing.
- **Salam (Advance Purchase):** Salam contracts involve the advance payment of the purchase price for goods to be delivered at a future date. Frequently used in agriculture and manufacturing, Salam provides producers with upfront financing while ensuring delivery of goods in the future.
- **Istisna'a (Manufacturing/Construction Financing):** Istisna'a is applied in manufacturing and construction projects. The buyer commissions the seller to produce or construct an asset according to specified requirements, with payment terms agreed in advance (lump-sum, installment, or upon delivery). This contract is widely used for infrastructure, housing, and industrial projects.
- **Ijarah (Leasing):** Ijarah is a leasing arrangement whereby the bank purchases and leases an asset to a client in return for rental payments. The bank retains ownership, while the lessee acquires usage rights. A variant, Ijarah Muntahia Bittamleek, allows for eventual transfer of ownership to the client.
- **Bai' al-Sarf (Currency Exchange):** Bai' al-Sarf refers to the exchange of monetary units, such as foreign currencies or gold and silver, under strict Shariah conditions. Identical currencies must be exchanged in equal amounts and on the spot, while differing currencies must be exchanged with immediate delivery.
- **Bai' al-Dayn (Debt Trading):** Bai' al-Dayn refers to the sale and purchase of receivables arising from Shariah-permitted trade or service transactions. While it is generally permitted when conducted against assets such as commodities, it is not allowed when conducted against cash. Nevertheless, it has been practiced in Malaysia under specific regulatory frameworks, although its permissibility remains controversial.
- **Wakalah (Agency):** agency (Wakalah) is an agency contract whereby a principal appoints an agent (wakeel) to act on its behalf to conduct specified transactions. It is frequently applied in investment services, trade finance, Takaful, and Sukuk structuring. The agent may act with or without remuneration.
- **Supporting and Auxiliary Contracts and Principles:** Islamic banking also employs a number of supplementary contracts and principles. These include:
  - Suretyship (Kafalah) and pledge (Rahn) for credit security,
  - Hibah (gift) and endowment (Waqf) for charitable purposes,
  - Wa'd (promise), Hawala (debt transfer), and Ibra' (rebate) for operational flexibility.

1.5 Savings, Investment and Other Products of Islamic Banking

Islamic Financial Institutions serve as intermediaries between surplus and deficit units, however, the instruments of interest are replaced by a number of instruments (Ayub, 2007). In regard to the area specific tools (deposit, investment and other products), there are multiple uses of an Islamic mode to meet different banking needs (summarized mainly from Ayub, 2007; Kettell, 2011).

In regard to deposit products of Islamic banks, generally, no return is given on current accounts (based on *Wadiah* principle) on the grounds that such deposits take the form of investment given to Islamic banks and the investment cannot carry any return. They are kept as *trust (Amanah)*; but if the proceeds of such accounts are used by banks in their business, they are treated as investments that have to be paid back without any increase or decrease. All remunerative deposits in Islamic banks, including saving deposits against which banks provide checking facility, shall be accepted on a profit and loss sharing (PLS) basis. The ratio of profit distribution between the bank and the depositor shall be agreed at the time of account opening subject to the condition of the *Shariah*.

Bai-Murabahah, deferred-payment sale (Bai-Muajjal), Bai-Salam are particularly suitable for trade, while *Ijarah, Istisna'a* are especially suitable for industry. More specifically, in trade and industry, financing is needed for the purchase of raw materials, inventory (goods in trade) and fixed assets as well as some working capital, for the payment of salaries and other recurrent expenses. *Murabahah* can be used for financing of all purchases of raw materials and inventory. For procurement of fixed assets, including plant and machinery, buildings, etc., either installments sale or leasing can be used. Funds for recurrent expenses can be obtained by the advance sale of final products of the company using *Salam or Istisna'a*.

Personal finance for consumer durables can be provided through *Murabahah,* leasing and in special cases by way of return-free investments out of the current accounts or the banks' own funds. The alternatives for auto finance are *Ijarah Muntahia-bi-Tamleek* and *Murabahah*. Housing finance is possible through *Murabahah*, Diminishing *Musharakah* and rent-sharing. Project financing can be provided through various modes of financing. Currently, *Ijarah* is a popular mode of finance for undertaking project finance.

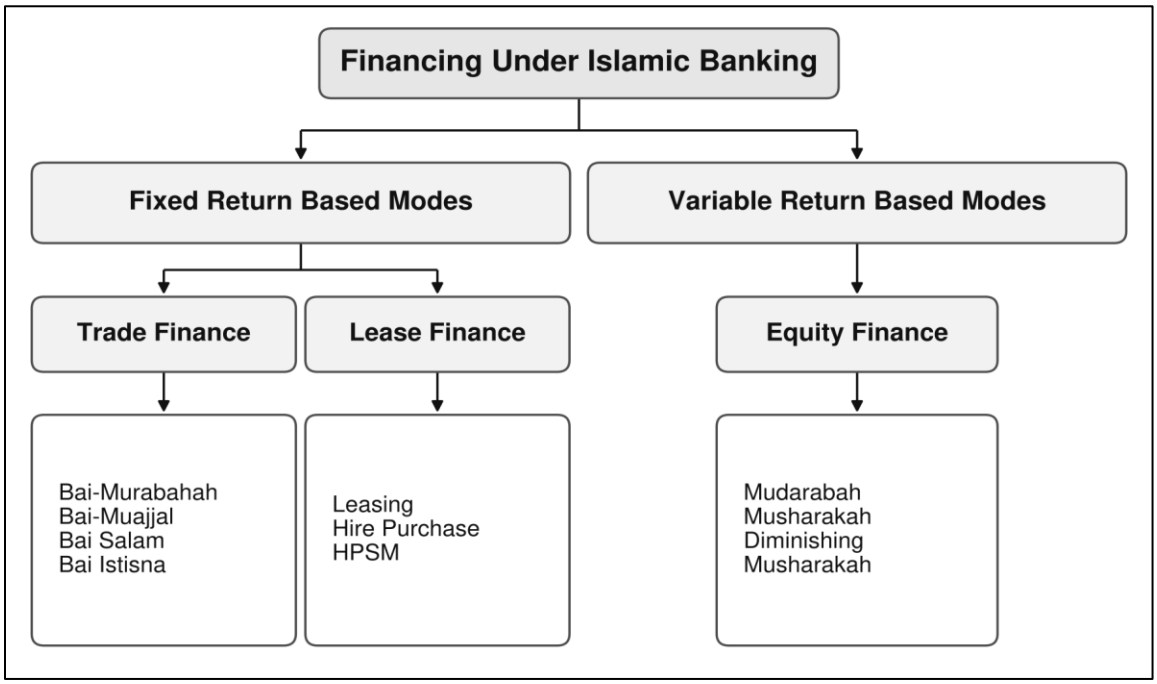
Five types of card representing plastic money, which are issued by banks and other institutions to withdraw cash from their accounts, to obtain credit or to pay for goods purchased or services received, are debit cards, charge cards, credit cards, Automated Teller Machine (ATM) cards and smart cards. These cards provide all or some of the benefits of liquidity, safety, mobility and flexibility to manage the budgets of the card holders. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has issued a *Shariah* standard on these cards, which provides a useful basis for developing electronic money by Islamic banks remaining within the *Shariah* framework.

Liquidity can be managed by the Islamic banks by dealing in the Islamic inter-bank fund market. The Mudarabah contract is the most useful instrument for transactions in the inter-bank market. Government and public sector enterprises can obtain finance by way of issuing *Mudarabah* or *Musharakah* certificates/Sukuk, which can be issued to purchase equipment or utility-generating assets. Ijarah, *Musharakah* and *Istisna'a* are best suited for infrastructure

projects in the public sector. Recently, *Ijarah Sukuk* has emerged as the most crucial instruments for financing of the public sector. Through syndication arrangement, Islamic banks can supply goods/assets of enormous value to government entities or corporations on a *Murabahah* basis by setting up joint *Murabahah* pool of funds. For the inflow of foreign resources, the instruments of portfolio investment through stock markets, flotation of various categories of Sukuk and direct investment by foreigners can be used.

There are alternative views in regard to the forward contract and participation the foreign exchange markets of Islamic banks. According to one school of thought, spot purchase and sale of one currency against another currency is allowed; forward purchase and sale is not allowed. However, Islamic Financial Institutions (IFIs) can enter into a promise to purchase and sell agreement, and on this principle, foreign currency forward cover is allowed with certain conditions, as per another school of thought. Figure 1.1 presents some common financing modes under Islamic banking.

Figure 1.1: Modes of Financing under Islamic Banking



Source: Wilson (2012), modified.

1.6 Comparing Conventional and Islamic Banking

There have been attempts in literature to compare Islamic and conventional banking. In this connection, Moumoud (2000) noted that 'Islamic finance' is in many ways similar to conventional finance. He added, 'Islamic banks' or 'Islamic financial institutions' are to ensure that all their contracts adhere to Islamic legal requirements as well as state requirements (Moumoud, 2000). According to Ahmad (2008), Islamic banking has same purposes and practice as conventional banking except that Islamic banks operate in accordance with Sha'riah laws. Islamic banks, in compliance with the welfare principle of Islam, offer facilities more or less the same as the conventional banks (Nienhaus, 1995).

According to El-Gamal (2001), the central concept in Islamic banking and finance is justice, which is achieved mainly through the sharing of risk; and stakeholders are supposed to share profits and losses. While justice stems usually from a religious or ethical basis, ethical finance is not a new concept.

Obviously, the operational procedures and approach of the Islamic banks are different. From a practical standpoint, Islamic banking varies in terms of the level of risk sharing. While conventional intermediation is largely debt-based, and allows for risk transfer, Islamic intermediation, in contrast, is asset-based, and centers on risk sharing (Moumoud, 2000). Ideally, in Islamic banking, investors (profit-sharing mode) share the risk and return with Islamic banks. The return on such investment is not guaranteed and depends on the bank's performance. Islamic banks share the risk in *Mudarabah* and *Musharakah* contracts and conduct sales contracts in most other contracts. In case of conventional banks, Depositors transfer the risk to the conventional banking, which guarantees a pre-specified return. Borrowers are required to pay interest independent of the return on their project. Conventional banks transfer the risk through securitization or credit default swaps. Financing is debt-based (Moumoud, 2000).

On the funding side, profit-sharing investment accounts are being replaced in a number of Islamic banks by time deposits based on reverse *Murabahah* transactions. These deposits do not have the risk-sharing features, since the return on them is guaranteed. In addition, demand deposits, which do not share profits or losses, represent a significant part of deposits in some banks. On the asset side, risk sharing (*Mudarabah, Musharakah*) is the exception rather than the rule: most financing is in the form of *Murabahah* contracts (cost plus financing) or installment sales (70–80%), making credit risk the main risk faced by IBs, similar to conventional banks. The Capital Adequacy and Risk Management standards issued by the Islamic Financial Services Board (IFSB) suggest that the type and size of financial risks in *Shariah*-compliant contracts are not significantly different from those in conventional contracts (IFSB, 2015).

1.7 Governance in Islamic Banks

Unlike conventional banks, Islamic banks combine corporate responsibility with Shariah accountability. Strong Shariah governance is therefore essential to ensure compliance, promote ethical conduct, protect stakeholder interests, and build public confidence. It also supports effective oversight, risk management, transparency, and alignment with Maqasid al-Shariah. Governance in Islamic banks has two interrelated dimensions: corporate governance, which focuses on accountability, efficiency, and strategic direction, and Shariah governance, which ensures compliance with Islamic principles. Together, they support operational integrity and long-term sustainability, while weaknesses in either area may create financial, reputational, and Shariah non-compliance risks. The components of both dimensions, and how they operate in the Islamic banks of Bangladesh, are examined in detail in Chapter 15.

Chapter 2: Islamic Finance in Bangladesh in the Perspective of Global Development: Issues and Challenges

Based on the study "Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development" by Md. Alamgir, Md. Mahabbat Hossain and Nur Al Faisal. The data in this chapter generally relate to 2014 and earlier years.

2.1 Introduction

2.1.1 Background of the Study

Finance is the provision of funds from surplus economic units to deficit economic units either directly or indirectly. But the same (finance) in the world financial markets may also be viewed from two different angles. One group of finances is based on the principles of interest and this group is known as conventional finance whereas the other group of finances is based on the rules and principles of Islamic *Shariah (an Arabic term meaning 'the path to be followed'; Kettell, 2011)* and this group is called Islamic finance.

Therefore, Islamic finance is the provision of funds from surplus economic units to deficit economic units either directly or indirectly in conformity with the principles of *Islamic law (Shariah)*. The sources of *Shariah* are the Holy Qur'an, the *Sunnah*, the *Ijma*, the *Qiyas* and the *Ijtihad*. So, Islamic financial institutions (IFIs) are those institutions which mediate between the surplus economic units and deficit economic units upholding the principles of Shariah. These IFIs are categorized as banking Islamic financial institutions and non-banking Islamic financial institutions.

The rapid growth of Islamic finance has drawn the attention of national policy makers and international institutions, both as a contributor to economic and social development and as a sector requiring adequate legal and regulatory frameworks for orderly growth and resilience — issues directly relevant to Bangladesh's large and growing Islamic finance industry.

The 1950s and 1960s were decades of experiment in Islamic banking and the 1970s the decade of establishment; since the mid-1970s it has spread to over 70 countries — about 57 developing and emerging economies and 13 developed countries (Otiti, 2014) — and research over three and a half decades has shown it to be a viable and efficient form of financial intermediation. Islamic banks have been established under diverse social, legal and economic systems, and major Western banks such as Chase Manhattan, Standard Chartered, ANZ Grindlays, HSBC and Citi NA have adopted Islamic banking techniques. As an evolving system facing many challenges, its performance, position and prospects need objective evaluation. This study examines the issues and challenges facing Islamic finance and banking in Bangladesh in the light of global developments, so that theorists and practitioners can devise strategies to meet them.

In Bangladesh, research on Islamic banking practices has been limited and recent; understanding the status, progress and trends of Islamic banking activities, and the issues and challenges they face, would help practitioners improve efficiency.

2.1.2 Objectives of the Study

The study aims to portray global developments in Islamic banking and to identify the challenges Islamic finance and banking in Bangladesh must meet to remain viable, compete and prosper. Its specific objectives are (i) to examine the development of the Islamic financial services industry in Bangladesh and globally; and (ii) to identify the challenges to Islamic finance and banking in Bangladesh and recommend how to overcome them.

2.1.3 Methodology and Data

The study uses primary and secondary data. Secondary data come from books, journals, the annual reports of commercial banks and Bangladesh Bank, and publications on Islamic banking at home and abroad. The purposive sample covered Islamic banks, conventional bank branches engaged in Islamic banking and the windows of a few conventional banks, surveyed with open- and close-ended questions. A questionnaire on the challenges facing the industry, based on IRTI's 2012 survey of global Islamic finance, was sent to 100 Islamic scholars; 79 responded, and the 68 complete responses were analyzed using simple financial and statistical tools and graphs.

The conceptual aspects of Islamic finance and banking examined in the original study — its principles, modes of investment, deposit and investment products, and its differences from conventional banking — are consolidated in Chapter 1.

2.2 Islamic Finance and Banking Development: Global Practice

2.2.1 Status of Islamic Finance and Banking

With the growth of Islamic finance, the global financial services industry has divided into conventional and Islamic segments. The global Islamic finance industry grew at a double-digit Compound Annual Growth Rate (CAGR) of 17% between 2009 and 2014, reaching an estimated USD 1.87 trillion in the first half of 2014, up from USD 1.79 trillion at end-2013 (IFSB, 2015). Islamic banking dominates, with an estimated 79.8% of Islamic financial assets in the first half of 2014, and the assets of Islamic banks and windows grew at a CAGR of 17.4% between 2008 and 2014. Islamic investment certificates (Sukuk) were the top-performing segment: annual primary issuance exceeded USD 100 billion in each of the two preceding years (USD 66.2 billion in the first half of 2014), and outstanding Sukuk reached USD 286.4 billion, up 16.8% from USD 245.3 billion a year earlier; Islamic insurance (Takaful) remained nascent, at about 1.0% of Islamic financial assets.

Table 2.1 shows that the Middle East and North Africa (MENA) region (excluding Gulf Cooperation Council (GCC)) ranks as first (42.93%) for the largest proportion of Islamic banking assets whereas the second one is the GCC (Saudi Arabia, the United Arab Emirates (UAE), Kuwait, Bahrain and Qatar) region (38.22). In case of Sukuk outstanding Asia stood first rank and GCC stood second. Overall, Islamic finance assets are heavily concentrated in the Middle East and Asia, although the number of new markets is expanding.

The GCC region accounts for the largest proportion of Islamic financial assets as the sector sets to gain mainstream relevance in most of its jurisdictions; the region represents 37.77% of

the total global Islamic financial assets (Table 2.1). The MENA region (excluding GCC) ranks a close second, with a 34.42% share, buoyed by Iran's fully *Shariah*-compliant banking sector. Asia ranks third, representing a 22.27% share in the global total, largely spearheaded by the Malaysian Islamic finance marketplace.

Table 2.1: Breakdown of Islamic Finance Segments by Region (2014)

Region	Banking Assets		Sukuk Outstanding		Islamic Funds Assets		*Takaful Contributions*		Total	
	USD billion	%	USD billion	%	USD billion	%	USD billion	%	USD billion	%
Asia	203.8	13.81	188.4	63.93	23.2	30.61	3.9	18.22	433.62	22.27
GCC	564.2	38.22	95.5	32.41	33.5	44.20	9	42.06	735.26	37.77
MENA (exc. GCC)	633.7	42.93	0.1	0.03	0.3	0.40	7.7	35.98	670.08	34.42
Sub-Saharan Africa	20.1	1.36	1.3	0.44	1.8	2.37	0.3	1.40	24.60	1.26
Others	54.4	3.69	9.4	3.19	17	22.43	0.3	1.40	82.20	4.22
Total	1476.2	100	294.7	100	75.8	100	21.4	100	1946.70	100

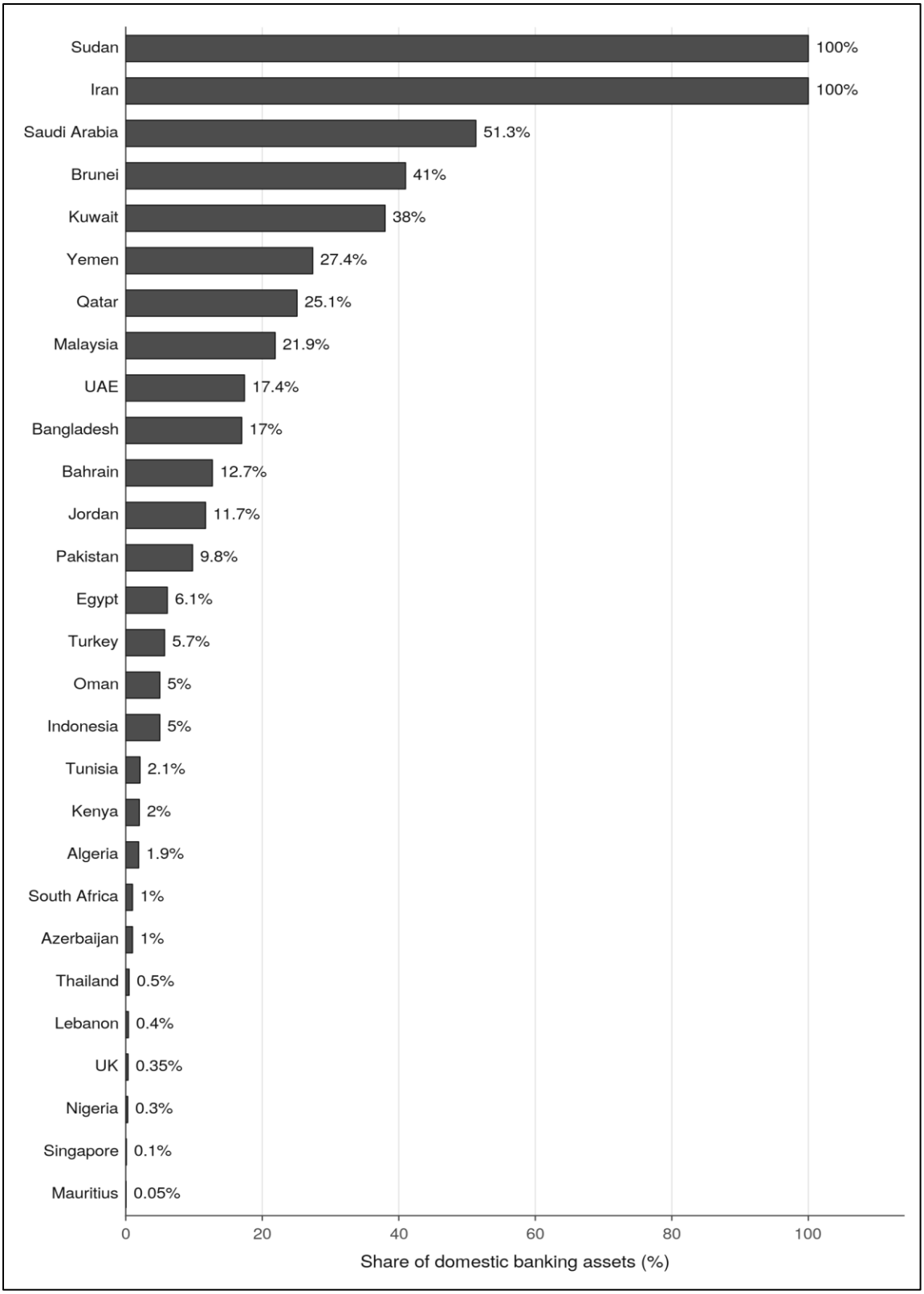
Source: The Banker, KFHR.

Note: The Total column and the regional totals are the source's own figures for all Islamic financial segments, not the sums of the four segments displayed. The four segments shown sum to USD 1,868.1 billion, USD 78.6 billion less than the reported total of USD 1,946.7 billion; the difference represents segments not presented separately here.

Islamic banking accounts for 100% of domestic banking assets in Iran and Sudan (Figure 2.1), but whereas Iran holds 40.21% of global Islamic banking assets, Sudan holds only 1% (Figure 2.2). Saudi Arabia's Islamic banks hold 51.3% of domestic banking assets and 18.6% of global Islamic banking assets; Malaysia's 21.9% and 9.56%; the UAE's 17.4% and 7.36%; and Bangladesh's 17% and 1.34%. Other systemically important markets include Brunei (41% of domestic banking assets), Kuwait (38%), Yemen (27.4%) and Qatar (25.1%), while Kuwait (5.79%), Qatar (4.47%) and Turkey (3.2%) hold notable shares of global Islamic banking assets.

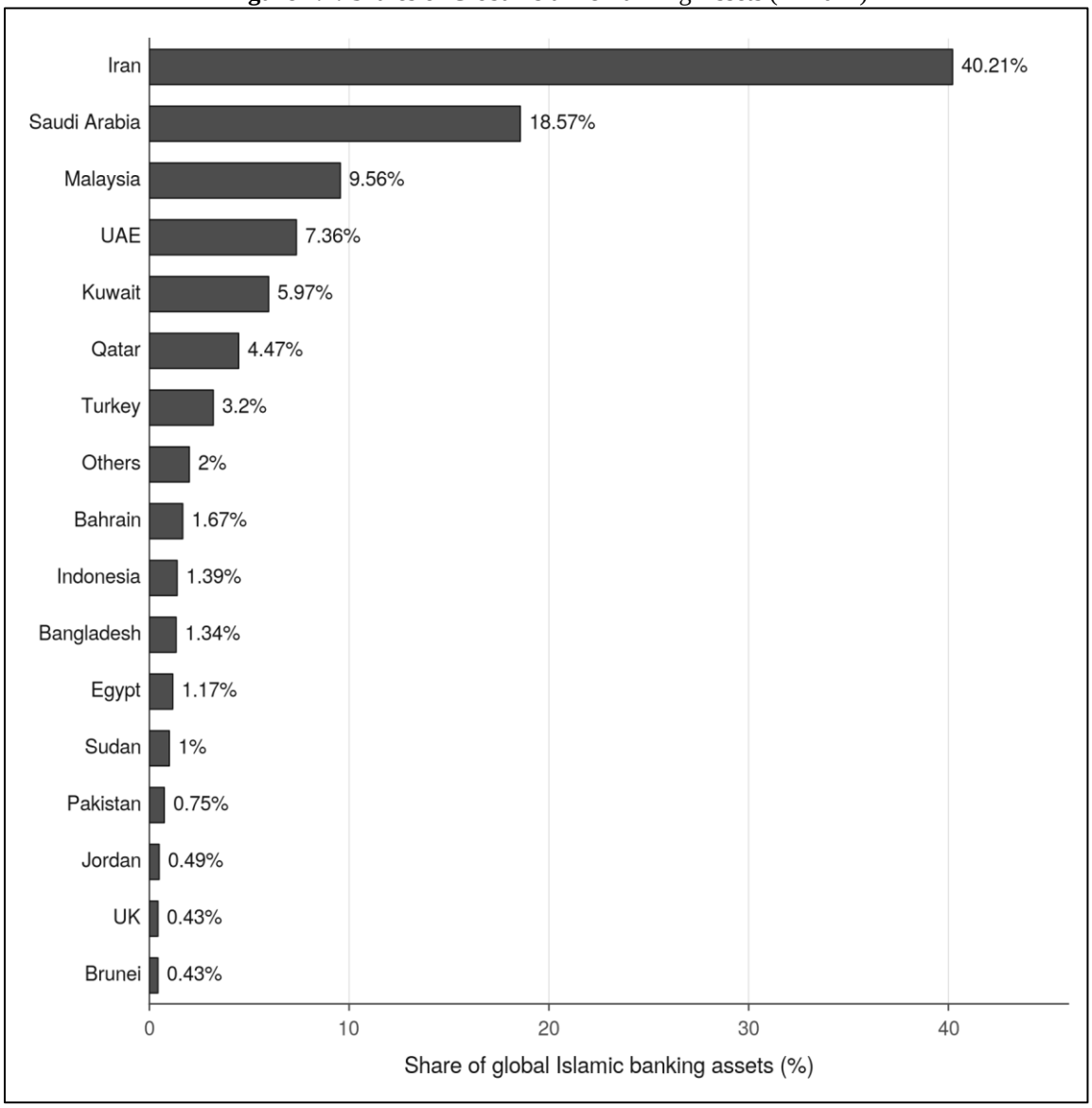
The Islamic Financial Services Board (IFSB, 2015) identifies Bahrain, Bangladesh, Jordan, Pakistan and Turkey as fast-growing markets where Islamic finance may gain systemic importance, supported by development efforts and regulatory road maps. The State Bank of Pakistan's strategic plan aims to raise Islamic banking's market share to 20% by 2018 (from 9.8% in the first half of 2014), backed by a revised Shariah Governance Framework and a high-level Steering Committee, formed in December 2013, on legal, regulatory and tax reform, liquidity management, the Islamic capital market and capacity building. Turkey aims for 15% by 2023 (from 5.7%), and in Jordan Islamic banking holds domestic market shares reported at 12.7% and 11.7%, with significant growth potential. In Bangladesh, Islamic banking holds 17% of banking assets, which grew at a CAGR of 22.85% in 2010–14 against 18.11% for the banking system, and the IFSB expected the sector to become systemically important by 2018.

Figure 2.1: Country-wise Islamic Banking Share of Total Domestic Banking Assets (1H2014)



Source: IFSB, 2015.

Figure 2.2: Shares of Global Islamic Banking Assets (1H2014)



Source: IFSB, 2015.

2.2.2 Legal, Regulatory and Enabling Framework of IFB

Countries committed to Islamic finance fall into three groups: those with fully Shariah-based legal systems (Iran and Sudan), those with partially Shariah-based systems (such as Bahrain, Malaysia, Indonesia and the UAE) and those with secular systems (such as Singapore, the United Kingdom (UK) and the United States of America (USA)). Two approaches to regulation are observed: a comprehensive, separate framework for Islamic finance parallel to the conventional one, or incremental adaptation of the existing conventional framework (NikThani & Othman, 2008). Most jurisdictions have taken the second route, retaining the conventional framework and adjusting it to integrate Shariah principles.

This gradualist approach poses challenges, since some existing provisions conflict with the Shariah that Islamic banks must follow, and the World Bank (2004) identified features of

Islamic finance that may hinder the development of a legal and regulatory framework. Legislators and judges need well-informed, timely support on Islamic specificities, since a single decision can affect the whole industry, and a legal harmonization committee could review the framework and propose solutions to conflicts between Islamic and secular law.

2.2.3 Competition and Transformation of Islamic Finance and Banking

The IFSB (2015) notes that Islamic banks face ever-increasing competition, as conventional banks — including international giants such as Chase Manhattan, Citibank, ANZ Grindlays, HSBC and Citi NA — have entered the market, a recognition of the viability of Islamic banking as an alternative model.

2.2.4 Global Status of Islamic Finance and Banking Education

The UK leads in Islamic finance education, with more than 60 institutions offering courses and 22 universities offering specialized degrees, followed by Malaysia (50 course providers and 18 universities) and the UAE (31 and nine). In research, Malaysia leads with more than 100 peer-reviewed papers in the preceding three years, followed by the UK with 56; no data were available for the UAE.

2.2.5 Supervisory Standards of Islamic Finance and Banking

In most countries Islamic banks are supervised by the central bank on the same basis as conventional banks, some with special laws for Islamic banking and others without (Chapra, 2000). A key concern for supervisors is how to apply internationally recognized standards, including those of the Basel Committee, while enabling Islamic banks to operate in conformity with Shariah.

Capital adequacy, now the core of systemic safety, is central to the credibility and growth of Islamic banking. Islamic banks' investments and investment deposits differ significantly from those of conventional banks; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)'s capital adequacy standards have helped crystallise these differences, although compliance has not yet fully materialized (Ernst & Young, 2013). Several bodies support the industry: an Organisation of Islamic Cooperation (OIC) committee of central bank governors has reported on the promotion, regulation and supervision of Islamic banks; the Islamic Development Bank (IDB) has helped spread Islamic banking in Muslim-majority countries; AAOIFI, based in Bahrain, issues accounting and other standards through its Accounting and Auditing Standards Board; the IFSB issues prudential standards and guiding principles for banking, capital markets and insurance and conducts research and industry initiatives; and the Islamic Research and Training Institute, Islamic universities and the OIC Fiqh Academy in Jeddah also contribute (IFSB, 2013).

2.2.6 Some Unresolved Issues and their Challenges for IFB

Some issues remain unresolved. One is wilful default on cost-plus sale (Murabahah) payments by buyers able to pay, discussed in Section 2.5.5. Another is hedging against exchange-rate fluctuations, which the classical verdict prohibits on three grounds: excessive uncertainty (Gharar), interest (Riba), and the forward sale of currencies. The Gharar objection is weak,

since hedging in fact reduces uncertainty by letting the importer buy foreign exchange at the current rate (Dusuki, 2011), and the bank can manage its own risk; but the prohibition of forward currency transactions in the Sunnah remains a serious objection. Designing Shariah-compatible financial instruments is thus one of the most important challenges facing Islamic financial institutions.

2.3 Status of Islamic Finance and Banking Operations in Bangladesh

Bangladesh has a long history of around 32 years in Islamic finance and banking. The first Islamic bank, Islami Bank Bangladesh Limited (IBBL), was established in the year of 1983. Since then, Islamic finance has shown continuous strong growth, not only in terms of deposits and assets/investments, but also in market share. Today, Islamic finance and banking industry of Bangladesh is composed of 8 full-fledged Islamic banks, 19 Islamic banking branches of 8 conventional commercial banks and 25 Islamic banking windows of 8 conventional commercial banks, 3 non-bank financial institutions, 5 insurance companies. These Islamic Financial Institutions (IFIs) are providing Islamic financial services in the form of deposit mobilization and investments in trade, industry and other sectors including agriculture of the economy. Some Islamic microfinance institutions have also started their activities in Bangladesh.

The number of Islamic banking branches (including Islamic branches of conventional banks and windows) was 934 at the end of 2014 which was 867 at the end of 2013. Information on branches of Islamic banks is shown in Table 2.2.

Table 2.2: Number of Branches of Islamic Banks as on December 2013 and 2014

S/N	Name of the Banks	No of Branches				Change
		As on Dec. 2014			Total in 2013	
		Urban	Rural	Total		
A)	**Full-fledged Islamic Banks**	559	331	890	823	67
1.	Islami Bank Bangladesh Limited	212	82	294	286	8
2.	ICB Islamic Bank Limited	28	5	33	33	0
3.	Social Islami Bank Limited	54	46	100	94	6
4.	Al-Arafah Islami Bank Limited	71	48	119	110	9
5.	EXIM Bank Limited	50	37	87	80	7
6.	Shahjalal Islami Bank Limited	59	34	93	92	1
7.	First Security Islami Bank Limited	71	66	137	117	20
8.	Union Bank Limited	14	13	27	11	16
B)	**IB Branches of CBs**	18	1	19	19	0
1.	The City bank Limited	1	0	1	1	0
2.	AB Bank Limited	1	0	1	1	0
3.	Dhaka Bank Limited	2	0	2	2	0
4.	Premier Bank Limited	2	0	2	2	0
5.	Prime Bank Limited	5	0	5	5	0
6.	Southeast Bank Limited	4	1	5	5	0
7.	Jamuna Bank Limited	2	0	2	2	0
8.	Bank Alfalah Limited	1	0	1	1	0
9.	HSBC Limited	0	0	0	0	0

S/N	Name of the Banks	No of Branches				Change
		As on Dec. 2014			Total in 2013	
		Urban	Rural	Total		
C)	**IB Windows of CBs**	25	0	25	25	0
1.	Sonali Bank Limited	5	0	5	5	0
2.	Janata Bank Limited*					
3.	Agrani Bank Limited	5	0	5	5	0
4.	Pubali Bank Limited	2	0	2	2	0
5.	Trust Bank Limited	5	0	5	5	0
6.	Standard Bank Limited	2	0	2	2	0
7.	Bank Asia Limited	5	0	5	5	0
8.	Standard Chartered Bank	1	0	1	1	0
D)	**Total=A+B+C**	602	332	934	867	67

Source: Bangladesh Bank.

*Note: *Has taken permission for starting Islamic Banking window from BB but not started yet.*

Table 2.3: Share of Different Groups of Islamic Banks (%)

Particulars	2014	2013
Based on Deposits		
a) Full-fledged Islamic Banks	94.84	94.37
b) Conventional banks having Islamic banking branches	3.59	3.87
c) Islamic banking windows	1.57	1.76
Based on Investments*		
a) Full-fledged Islamic Banks	95.32	94.63
b) Conventional banks having Islamic banking branches	3.34	3.86
c) Islamic banking windows	1.34	1.52
Based on Branches		
a) Full-fledged Islamic Banks	95.29	94.93
b) Conventional banks having Islamic banking branches	2.03	2.19
c) Islamic banking windows	2.68	2.88
Based on Manpower		
a) Full-fledged Islamic Banks	98.01	97.85
b) Conventional banks having Islamic banking branches	1.48	1.60
c) Islamic banking windows	0.51	0.55

Source: Bangladesh Bank.

*Note: *Excluding Inter-Bank Items.*

Table 2.3 shows that full-fledged Islamic banks held about 95% of the Islamic banking sector's deposits, investments and branches and 98% of its employees. Conventional banks' Islamic branches held more than their Islamic windows, which employed less than 1% of the sector's staff.

Islamic banks' financial position grew steadily (Table 2.4): total assets rose from BDT 733.6 billion in 2010 to BDT 1,632 billion in 2014, liabilities from BDT 678.9 billion to BDT 1,517.0 billion, and equity from BDT 54.7 billion to BDT 115.0 billion, while off-balance-sheet items changed little (Figure 2.3).

Table 2.4: Financial Position of Islamic Banks: 2010–2014 (Amount in Billion BDT)

Particulars	2010	2011	2012	2013	2014
Property & Assets:					
Cash in Hand (including FC)	7.3	9.3	12.2	15.6	14.1
Balance with Bangladesh Bank & SB (including FC)	64.1	77.3	104.0	102.3	124.2
Balance with other Banks & Fls	13.4	33.2	80.6	80.2	85.3
Money at Call & Short Notice	19.4	24.8	0.0	0.0	0.5
Total Investments	27.8	42.7	60.0	105.0	147.6
Total Investments and Advances	574.1	697.2	871.3	975.3	1,165.0
Fixed Assets	12.1	14.3	18.7	30.7	32.2
Other Assets	15.4	24.3	34.7	50.1	63.0
Non -banking Assets	0	0.0	0.0	0.0	0.1
Total Assets	**733.6**	**923.2**	**1,181.5**	**1,359.0**	**1,632.0**
Liabilities and Capital/Shareholders' Equity:					
Borrowings from other Banks/Fls/Agents	21.4	31.1	38.3	29.6	26.6
Total Deposits	617.1	776.1	995.6	1,133.6	1,370.5
Bills Payable	6.8	7.0	11.3	9.3	11.2
Other Liabilities	40.4	49.9	68.4	83.6	108.7
Total Liabilities	**678.9**	**857.1**	**1,102.2**	**1,256.2**	**1,517.0**
Capital/Shareholder's Equity	54.7	66.1	79.3	102.8	115.0
Total Liabilities & Equity	**733.6**	**923.2**	**1,181.5**	**1,359.0**	**1,632.0**
Off -balance Sheet Items	241.1	255.8	280.7	289.1	320.8

Source: Bangladesh Bank (2013 & 2014).

Figure 2.3: Financial Position of Islamic Banks

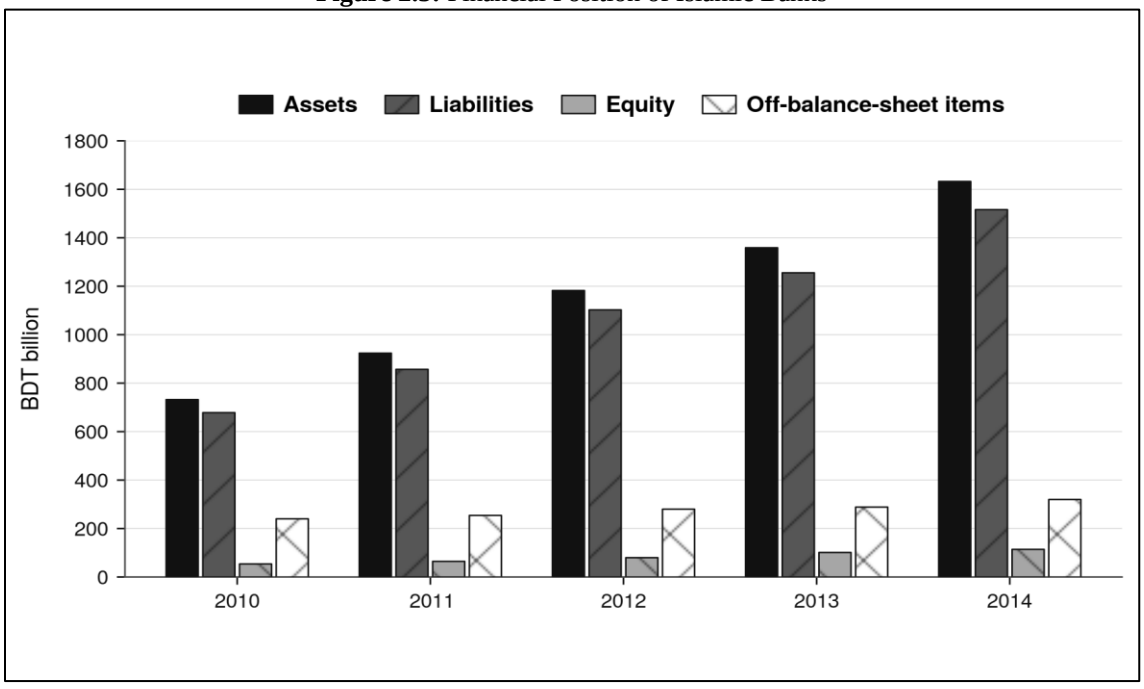


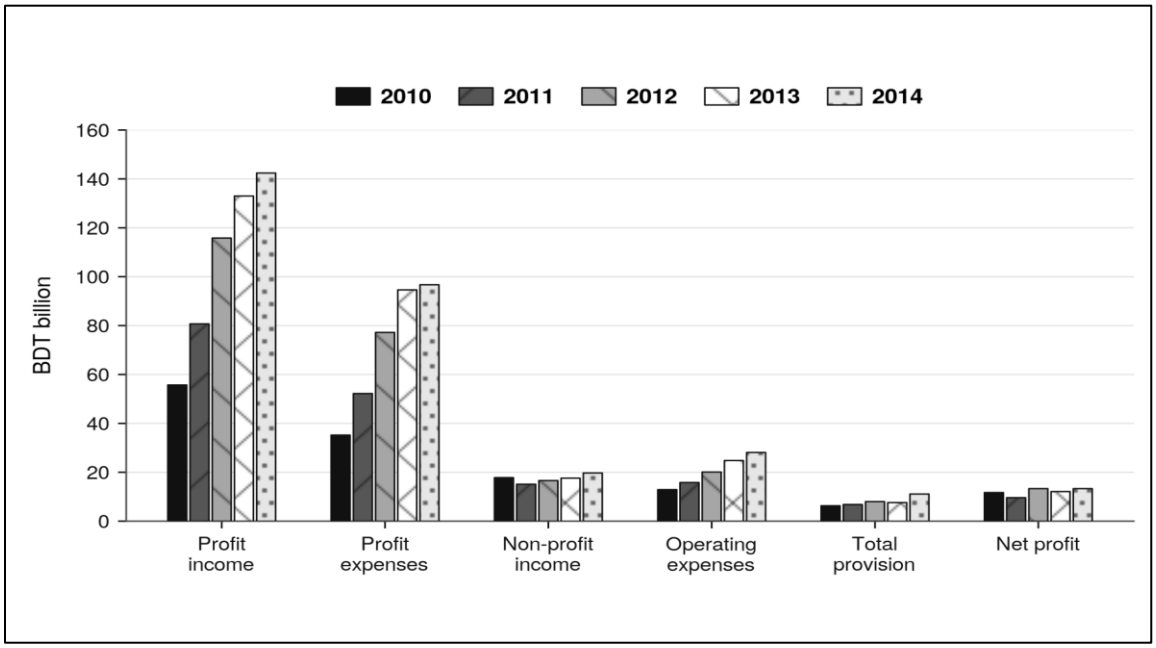
Table 2.5 and Figure 2.4 show that profit income rose from BDT 55.7 billion in 2010 to BDT 142.5 billion in 2014, with profit expense rising similarly, while non-profit income and net profit grew far more slowly.

Table 2.5: Financial Performance of Islamic Banks (Amount in Billion BDT)

	2010	**2011**	**2012**	**2013**	**2014**
Profit Income	55.7	80.7	115.9	133.0	142.5
Less: Profit Expenses	35.12	52.2	77.1	94.5	96.8
Net Profit Income	**19.95**	**28.5**	**38.7**	**38.5**	**45.7**
Non-Profit/Investment Income	17.94	15.1	16.6	17.7	19.8
Total Income	**37.89**	**43.6**	**55.4**	**56.2**	**65.5**
Operating Expenses	13.04	15.9	20.1	24.8	28.2
Profit before Provision	**24.85**	**27.7**	**35.2**	**31.4**	**36.6**
Total Provision	6.32	6.9	8.1	7.6	11.2
Profit before Taxes	**18.53**	**20.8**	**27.1**	**23.9**	**25.4**
Provision for Taxation	6.86	11.1	13.8	11.8	12.1
Profit after Taxation/Net Profit	**11.66**	**9.7**	**13.3**	**12.1**	**13.3**

Source: Bangladesh Bank (2013 & 2014).

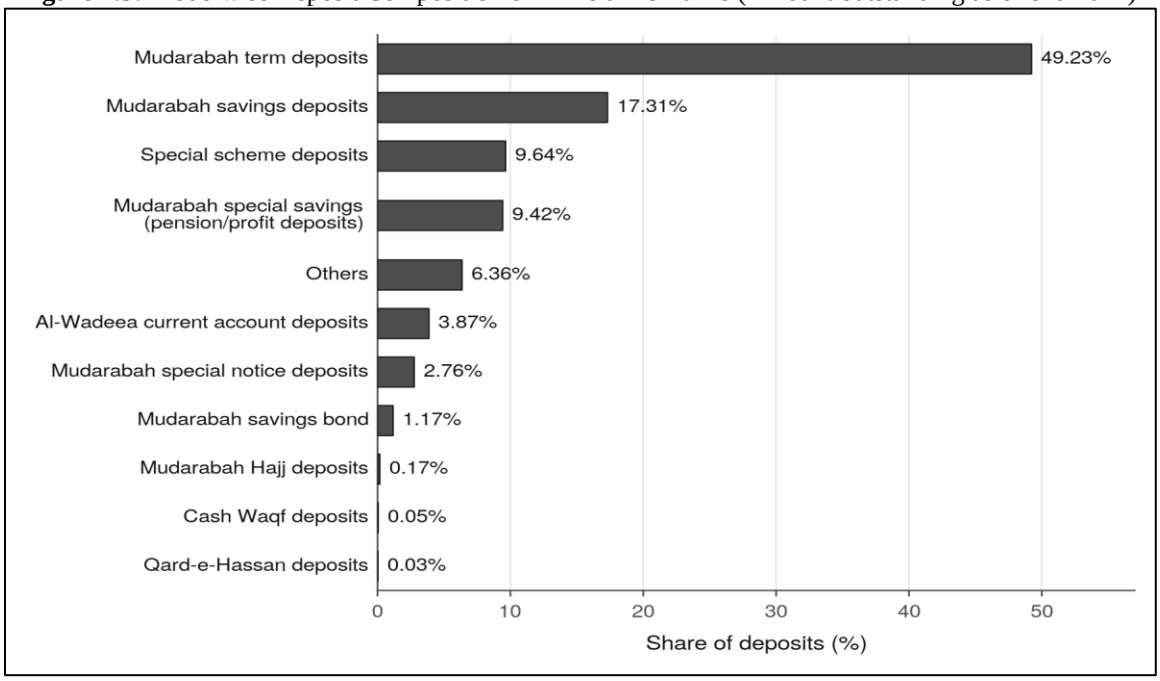
Figure 2.4: Financial Performance of Islamic Banks



2.3.1 Deposit Products and Amount of Islamic Banking in Bangladesh

profit-sharing partnership (Mudarabah) term deposits made up the largest share of deposits (49.23%), followed by Mudarabah savings deposits (17.31%), special scheme deposits (9.64%), Mudarabah special savings (pension/profit) deposits (9.42%) and current deposits (3.87%); benevolent loan (Qard Hasan) and cash endowment (Waqf) deposits were insignificant (Figure 2.5).

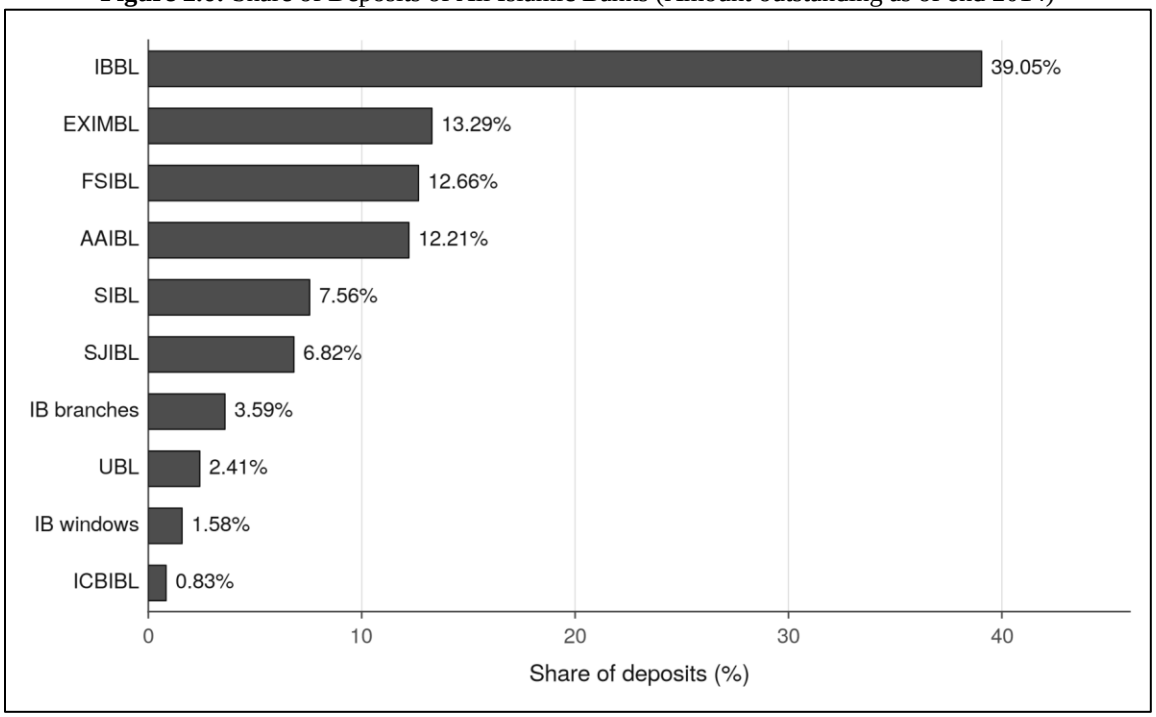
Figure 2.5: Mode-wise Deposit Composition of All Islamic Banks (Amount outstanding as of end 2014)



Source: Survey Data.

By bank, Islami Bank Bangladesh Limited held 39% of Islamic banking deposits, followed by Exim Bank and First Security Islami Bank (13% each), Al-Arafah Islami Bank (12%) and Shahjalal Islami Bank (7%), with Islamic banking branches, Union Bank, Islamic banking windows and ICB Islamic Bank holding 1–4% each (Figure 2.6).

Figure 2.6: Share of Deposits of All Islamic Banks (Amount outstanding as of end 2014)

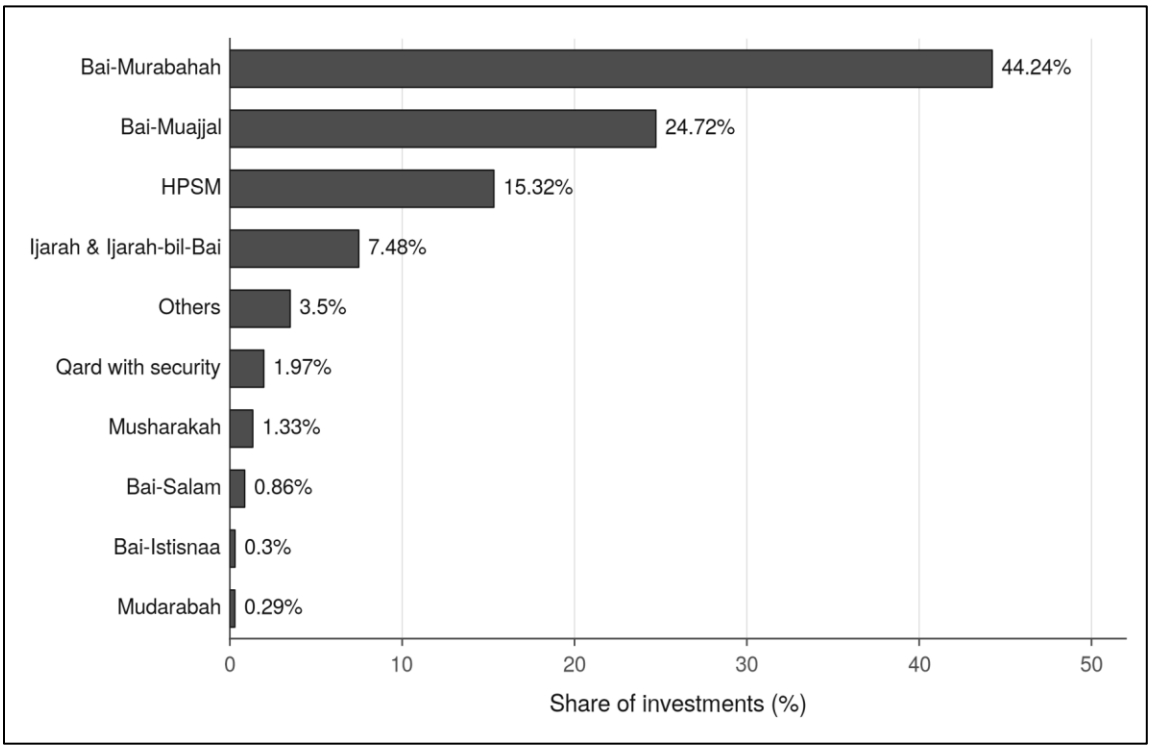


Source: Survey Data.

2.3.2 Investment Products and Amount of Islamic Banking in Bangladesh

At the end of 2014, Bai-Murabahah accounted for 44.24% of investments, deferred-payment sale (Bai-Muajjal) 24.72% and Hire Purchase under Shirkatul Melk (HPSM) 15.32% (Figure 2.7), while Mudarabah and partnership (Musharakah) investments were negligible — even though most deposits of Islamic banks were mobilized under Mudarabah.

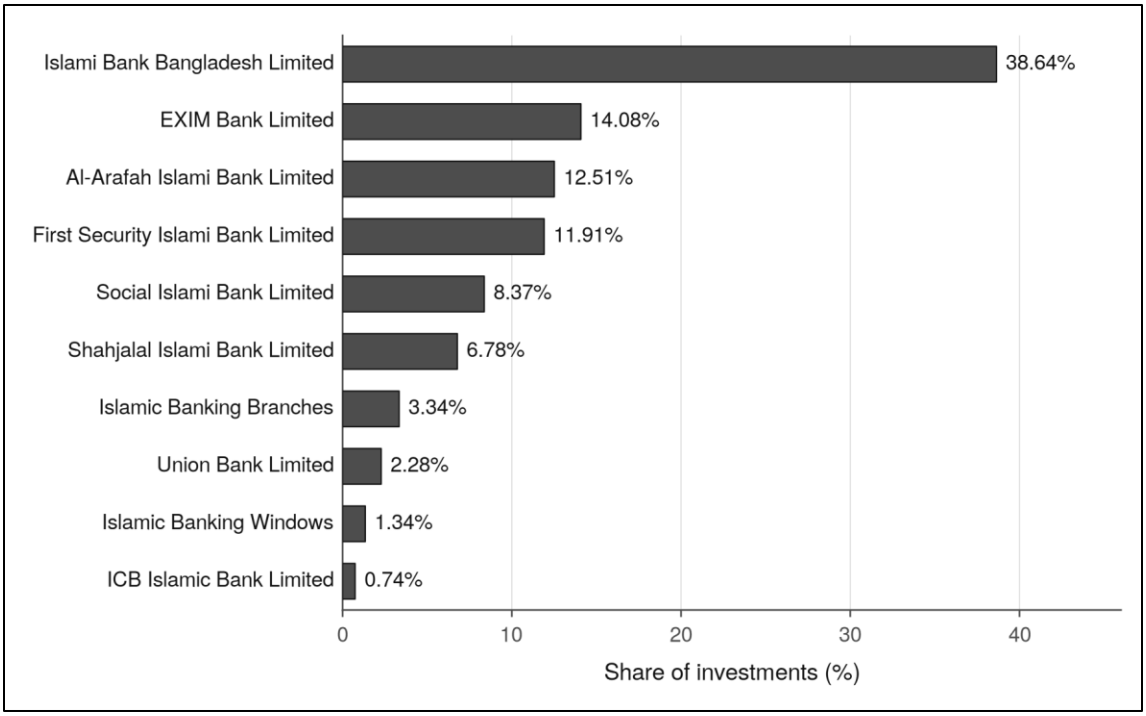
Figure 2.7: Mode-wise Investment of Islamic Banks (Amount outstanding as of end 2014)



Source: Survey Data.

Islami Bank Bangladesh Ltd. held 38.64% of Islamic banking investments in 2014, followed by Export Import Bank of Bangladesh PLC (EXIM) Bank (14.08%), Al Arafah Islami Bank (12.51%), First Security Islami Bank (11.91%), Social Islami Bank (8.37%), Shahjalal Islami Bank (6.78%), Union Bank (2.28%) and ICB Islami Bank (0.74%), with Islamic branches and windows holding about 5% (Figure 2.8).

Figure 2.8: Investment Composition of Islamic Banks (Amount outstanding as of end 2014)

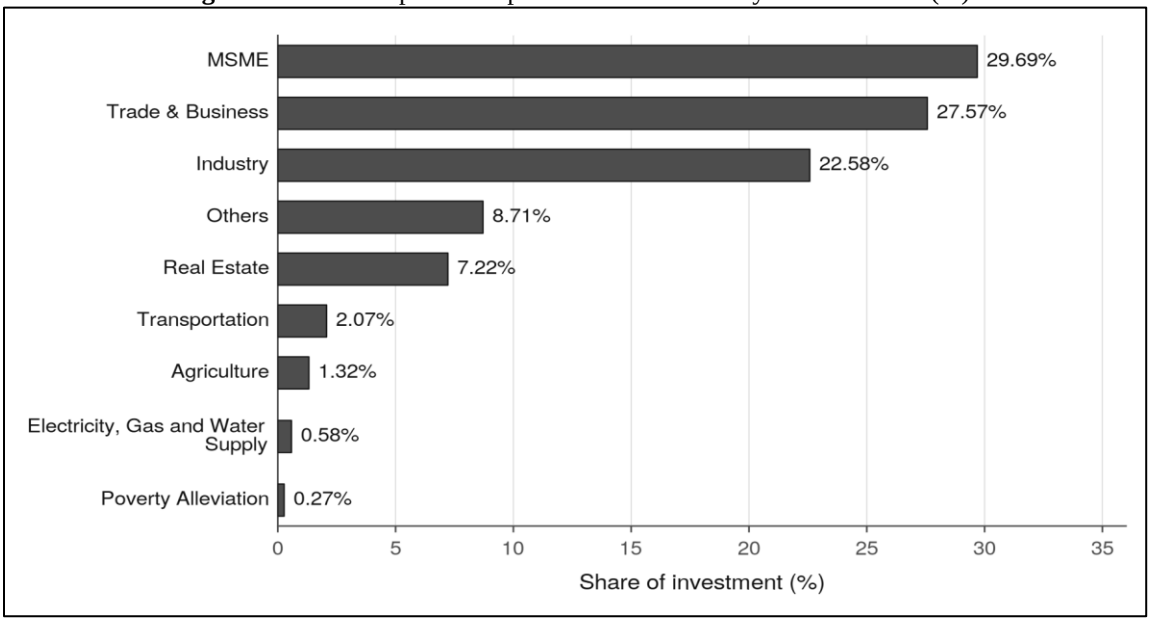


Source: Survey Data.

2.3.3 Sector Specific Exposure of Investment by Islamic Banks

By sector, MSMEs received the largest share of investment at the end of 2014 (29.69%), followed by trade and business (27.57%), industry (22.58%), others (8.71%) and real estate (7.22%), with transport (2.07%), agriculture (1.32%), electricity, gas and water (0.58%) and poverty reduction (0.27%) far smaller (Figure 2.9).

Figure 2.9: Sector Specific Exposure of Investment by Islamic Banks (%)

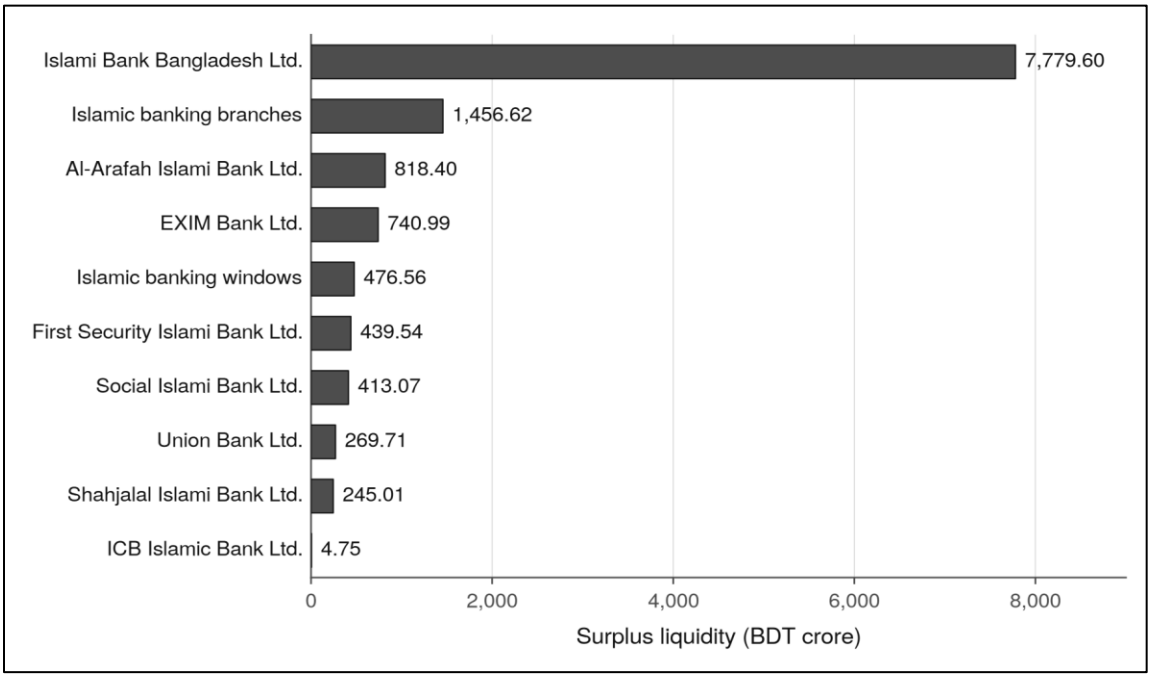


Source: Survey Data.

2.3.4 Excess Liquidity of Islamic Banks in Bangladesh

Surplus liquidity in the Islamic banking sector stood at BDT 12,644.25 crore at the end of 2014: BDT 10,711.07 crore in the eight Islamic banks, BDT 1,456.62 crore in Islamic banking branches and BDT 476.56 crore in Islamic windows of conventional banks (Figure 2.10).

Figure 2.10: Liquidity position of all Islamic Banks as of end 2014



Source: Survey Data.

2.3.5 Investment Situation in the Agricultural Sector

Total Islamic banking investment rose from BDT 102,718.3 crore in 2013 to BDT 123,950.14 crore in 2014, but agricultural investment fell from BDT 1,962.93 crore to BDT 1,634.07 crore, cutting its share from 1.91% to 1.32% (Table 2.6).

Table 2.6: Summary of Investments in Agricultural Sector

	2014	2013	Change (%)
Total Investment of Islamic Banks (BDT in Crore)	123950.14	102718.3	20.67
Investment in Agricultural Sector (BDT in Crore)	1634.07	1962.93	-16.75
Investment in Agriculture (%)	1.32	1.91	-0.59

Source: Bangladesh Bank.

Islamic banks' market share generally rose (Table 2.7): in 2014 they held 18% of banking assets (17% in 2013), 19% of deposits, 18% of liabilities, 16% of equity and 14% of off-balance-sheet items, the last also higher than in the previous year.

Table 2.7: Share of Islamic Banks in the Banking Sector

S/N	Particulars	2014		2013	
		Share of Islamic Bank (%)	Share of Conventional Banks (%)	Share of Islamic Bank (%)	Share of Conventional Banks (%)
1.	Due from Bangladesh Bank & other Banks/FIs	20	80	21	79
2.	Investment in Securities	8	92	7	93
3.	Investments (Loans and Advances)	22	78	21	79
4.	Other Assets including Fixed Assets	12	88	11	89
5.	Total Assets	18	82	17	83
6.	Total Deposits	19	81	18	82
7.	Total Liabilities	18	82	17	83
8.	Capital/Shareholders Equity	16	84	15	85
9.	Total Liabilities and Equity	18	82	17	83
10.	Off-balance Sheet Items	14	86	13	87

Source: Bangladesh Bank (2013 & 2014).

Islamic banks' ROA was slightly below the industry's in 2013 (0.89 against 0.90) but above it in 2014 (0.8 against 0.7) (Table 2.8). Their ROE, net profit margin and profit-to-assets ratios were also higher, and their capital adequacy and classified-investment ratios better, in both years, although some conventional banks performed equally well.

Table 2.8: Performance of Islamic Banks as Compared to Banking Industry (CY 13)

S/N	Particulars	2014		2013	
		Islamic Banking Sector*	Overall Banking Sector	Islamic Banking Sector*	Overall Banking Sector
1.	ROA	0.8	0.7	0.89	0.90
2.	ROE	11.5	8.1	11.71	10.70
3.	Net Profit Margin	3.4	1.8	3.32	2.10
4.	Profit (Interest) to Total Assets	8.7	6.9	9.79	7.74
5.	Net-profit (Interest) to Total Assets	2.8	1.5	2.83	1.65
6.	Non-profit (Interest) to Total Assets	1.2	2.8	1.30	2.75
7.	Investment (Credit)-Deposit Ratio	82.2	71.0	84.13	71.18
8.	Capital Adequacy Ratio	13.1	11.5	12.07	11.5
9.	Classified Investment (Credit) to Investment	4.9	9.7	4.20	8.90
10.	Classified Investment (Credit) to Capital	49.3	67.7	39.88	59.80

Source: Bangladesh Bank (2013 & 2014).

Note: Bills Payable is reported within the other liability lines for 2010–2012 and separately for 2013–2014. The listed components therefore sum to Total Liabilities only in 2013 and 2014; in every year Total Liabilities plus Capital/Shareholders' Equity equals Total Assets.

*Note: *Excluding ICB Islami Bank Ltd.*

2.3.6 Marketing of Islamic Finance and Banking Products

Religious belief and faith are the key factors for the popularity of the Islamic finance and banking in the country, as opined in the opinion survey. It is opined by the scholar that Islamic banking in Bangladesh is Muslim customer based which expedites the growth of this sector. However, customer service of this sector is increasing due to due competition. In Bangladesh, from the very beginning, a group of non-Muslims is also showing interests to the Islamic banking products as alternative channel of obtaining funds because of better services. This is obviously not true equally for all Islamic banks.

Survey result shows that mentionable numbers of both deposit-clients and investment-clients are non-Muslims. Survey also displays that even some non-Muslims have established *Waqf* fund in Islamic banks from which some *Mandirs* are getting contributions. It is said that the remarkable truth in the history of Islamic finance and banking in Bangladesh is that the first investment-client of IBBL was a non-Muslim. It has been found that most of the Islamic banks operating in Bangladesh have their own written policy for marketing of Islamic banking products. They have also established marketing department with separate employees and set-up in the banks.

2.3.7 Recruitment, Employee Development, Training and Research Activities

Survey shows that rarely non-Muslims are recruited in various IFIs though there is a policy framework. All Islamic banks (except one) have training or training & research centers to train their employees. Alongside organizing foundation training programs for their newly recruited employees, these training centers commonly offer employee development programs on the issues related to Islamic *Shariah*, banking procedures and regulatory requirements of the central banks. Islami Bank Training and Research Academy (IBTRA) publishes journal, conducts training programs for the other Islamic banks of the country and abroad, and arranges internship programs for the university students on the Islamic banking issues. It has also a certification program called 'Diploma in Islamic Banking (DIB)'.

2.3.8 Refinancing, Liquidity Management and Participation in the Bond Market

The only refinancing facility of the Bangladesh Bank i.e. 'Funding Assistance Program' (introduced in October 2013) remained inoperative till date. Though the Inter-bank Islami Fund Market has been formed to remove the temporary liquidity difficulty of the Islamic banks, yet it failed to attract substantial response from the market. In the first half of the year 2013, there were a few transactions under IIFM, but no single transaction was held in the second half of the same year. As of end June 2013, the total sale against the Bangladesh Government Islamic Investment Bond (Islamic Bond) amounted to BDT 107.13 billion while balance of total amount of financing stood at BDT 67.78 billion and the net outstanding against the bond stood at BDT 39.35 billion (Bangladesh Bank Information).

2.3.9 Corporate Social Responsibility Activities of Islamic Banks

All Islamic banks commonly pay *obligatory alms (Zakat)* on their respective equity and reserve position as per Islamic rules. Under the umbrella of Corporate Social Responsibility (CSR) activities, the Islamic banks in Bangladesh are engaged in contributing to different sectors

including natural disaster, environment, education, health and other social and humanitarian areas. Sources of funds of Islamic banks available for CSR activities include Zakat, compensation charges (penal charges from defaulting investment clients) and *Shariah*-permitted other sources of earnings.

Most of the Islamic banks have set up various types of foundations which are carrying out the social welfare, education, health and Medicare activities on behalf of banks. The aims and objectives of the foundations are to serve distressed humanity, promote people oriented mass education, extend health and Medicare facilities to the poverty-stricken people in urban and rural areas, create facilities for productive self-employment and develop human resources for improving economic condition and quality of life, assist healthy growth of art, culture and literature, science and technology, sports, research and propagation of Islamic teachings.

2.3.10 Legal and Regulatory Framework of Islamic Finance and Banking

Though there is no complete Islamic Banking Act in Bangladesh, some Islamic banking provisions have already been incorporated in the amended Bank Company Act, 1991 (Act No. 14 of 1991). At the time of this study, Bangladesh Bank had not set up a separate department at its head office to control, guide and supervise the operations of the Islamic banks; the Islamic Banking Regulation and Policy Department was established in March 2025 (see Chapter 3). Though there is a dedicated inspection department (DBI-4) for inspection of Islamic banks and foreign banks. The Inspection and supervision of the Islamic banking operations are conducted by the Bangladesh Bank as per the general guidelines framed for the conventional banks.

So, ensuring implementation of *Shariah* principles in the Islamic banks are being conducted by their own *Shariah* Committees. The role of Bangladesh Bank in controlling, guiding and supervising the Islamic banks in Bangladesh in accordance with Islamic *Shariah* is very minimal. In observing the *Shariah* implementation status of the Islamic banks, Bangladesh Bank examines only the report of the respective banks' *Shariah* Councils.

Considering lack of Islamic financial markets and instruments or products in the country, Bangladesh Bank had granted some preferential provisions for smooth development of Islamic banking in Bangladesh. For example, Islamic banks in Bangladesh have been allowed to maintain their Statutory Liquidity Requirement (SLR) at 5.5% of the total deposit liabilities while it is 13% for the conventional banks (Bangladesh Bank DOS Circular No. 1, 19 January 2014). Islamic banks have been enjoying relaxed rate of SLR mainly due to the non-availability of Islamic treasury bills/bonds in the market.

In the deregulated regime, Islamic banks are allowed to fix up their profit-sharing ratios and mark-ups independently commensurate with their own policy and banking environment. This freedom in fixing PLS ratios and Mark-up rates provided scope for the Islamic banks to follow the Shariah principles independently. However, according to the survey information, Islamic banks are to abide by the restriction of the interest rate spread of the Bangladesh Bank. At the time of this study there was no statutory central Shariah authority within Bangladesh Bank to monitor and examine the functions of Islamic banks in Bangladesh; the Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) is a private, industry-based advisory body without supervisory powers. Bangladesh Bank has to depend on the Shariah certificates provided by the Shariah Supervisory Committee of the respective Islamic banks.

In 2009 Bangladesh Bank issued guidelines for conducting banking business by Islamic banks and the Islamic branches of conventional banks (BRPD Circular No. 15, 9 November 2009). They were prepared on the recommendations of a focus group of representatives of the central bank, several Islamic banks and the Central Shariah Board for Islamic Banks of Bangladesh. The guidelines define the terms used in Islamic banking and set out the principles and modes of deposits and investments. They also cover liquidity, the maintenance of books of account, the preparation of financial statements and related issues.

The guidelines were issued under Section 45 of the Bank Company Act 1991 (amended in 2003) and supplement, rather than replace, existing banking laws, rules and regulations. On any point they do not cover, or in case of contradiction, the Bank Company Act 1991 and the Companies Act 1994 prevail. For the preparation and disclosure of financial statements, they refer to AAOIFI accounting and auditing standards.

In December 2011 Bangladesh Bank also initiated a call money market for Shariah-based banks, the Islamic Inter-bank Fund Market (IIFM) (Bangladesh Bank DOS Circular 23, 27 December 2011), which began operating on 3 June 2012. Although modeled on the conventional call money market to relieve Islamic banks' temporary, short-term liquidity shortages, it failed to attract a substantial response.

To engage Islamic banks in the agricultural and rural developments, Bangladesh Bank introduced 'Funding Assistance Program' for Islamic *Shariah*-based financing to 'Agro-based Product Processing Industries in Rural Areas' and 'Small Enterprises (including Women Entrepreneurs)' in Bangladesh in October 2013 (Bangladesh Bank SMESPD Circular, 29 October 2013). Islamic banks are also to abide by 'Guidelines for Islamic Banking', 'Prudential Regulations for Banks', 'Prudential Regulations for Financial Institutions' and other regulations put in force by Bangladesh Bank from time to time. Bangladesh Bank has also been undertaking different awareness and academic activities — for example, the IFSB–Bangladesh Bank international conference 'Islamic Finance News Roadshow' in February 2013, which discussed the challenges and opportunities of Bangladesh's Islamic finance sector, product diversification and Shariah-compliant investment flows in Bangladesh and South Asia — for promoting Islamic banking activities.

2.3.11 Governance of Islamic Finance and Banking in Bangladesh

Board, formed as per laws and regulations prevailing in the country and Bangladesh Bank Guidelines, is responsible for governing the banks whether it is Islamic or conventional. Board set and approve overall policy and strategy; monitor progress toward corporate objectives; and ensure accountability of the management protect stakeholders' right. As part of Shariah governance, a Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) was formed in 2001 by the Islamic banks and the conventional banks with Islamic banking operations themselves, as a private industry body offering Shariah-based directions and opinions to the Islamic banking industry of Bangladesh. It is not a statutory authority of Bangladesh Bank. However, till date its activities are mainly limited to organizing a few training and workshops; and publishing books and bulletin for Islamic bankers.

One of the important governance organs in an Islamic bank is the presence of *Shariah* Supervisory Committee (not applicable for conventional counterpart). The committee is

governed by the bye-laws approved by the Board. The committee gives opinion and guidelines to implement and comply with the *Shariah* principles in all activities of the bank and provide a clearance of *Shariah* compatibility of all products. It oversees the activities of the bank from *Shariah* perspective and ensures that the profit has been derived without violating the *Shariah* rulings. The committees of the Islamic banks also evaluate performance of the officials in terms of their *Shariah* compliance and conducts *Shariah* inspection to ensure that the *Shariah* principles are being implemented.

Like conventional banks, Islamic banks have Executive Committee, Management Committee, Asset-Liability Committee (ALCO), and Audit Committee to play similar roles. Audit committee is also responsible for *Shariah* compliance issues alongside the rules and standards of Bangladesh Bank. All the core risk management guidelines of the Bangladesh Bank are equally relevant for the Islamic and conventional banks of the country. Thus, it can be observed that the Islamic banks are to comply with some additional requirements than that of the conventional banks.

2.4 Institutional and Legal Challenges Faced by Islamic Banks

Islamic financial institutions in Bangladesh have achieved success over 32 years despite many challenges. This section examines their institutional and legal challenges; the following sections consider operational and risk management challenges.

2.4.1 Proper Institutional Framework

Islamic banks need supporting institutions tailored to their activities, but they rely on an institutional framework designed for conventional banking. Building a proper institutional set-up is perhaps the most serious challenge for Islamic finance in Bangladesh; a 'functional approach' is proposed, examining the functions performed by conventional institutions and modifying them, or establishing new ones, to support Islamic banks.

2.4.2 Appropriate Legal and Regulatory Framework and Supportive Policies

Bangladesh's bank company and company laws, framed for conventional banking, confine Islamic banking within conventional limits, and enforcing Islamic contracts in court may require extra effort and cost. Special laws are therefore needed so that Islamic banks can operate alongside conventional banks and Islamic transactions can find room in financial markets. Some countries enact Islamic banking acts governing specific banks and their relationship with the central bank, while others set general rules for Islamic banks operating alongside conventional ones.

2.4.3 Supervisory Framework

Supervision matters for transparency, the soundness of the financial system and the control of monetary policy, and for Islamic banks it has an additional Shariah dimension. The lack of an effective supervisory framework is a weakness of the present system, and a central Shariah board at Bangladesh Bank could supervise Shariah issues.

2.4.4 The Need for an Autonomous Shariah Supervisory Board

Most Islamic banks have their own Shariah boards, whose autonomy and powers have been questioned; different boards sometimes issue conflicting rulings on similar practices, which may confuse clients. An autonomous Shariah board to supervise the Shariah aspects of Islamic banks is therefore proposed; Bangladesh already has an industry-level Central Shariah Board for Islamic banks (CSBIB), but it has no statutory supervisory mandate and its de facto autonomy needs to be ensured.

2.4.5 Accounting Standards

Whereas conventional banks follow similar accounting standards, even across countries, Islamic banks' accounting practices differ so much that meaningful comparison of their financial statements is very difficult. AAOIFI, established by Islamic banks under the guidance of the Islamic Development Bank, issues standards on accounting, auditing, governance, ethics and Shariah, but as a voluntary body it cannot enforce them; the authorities concerned should ensure their implementation.

2.4.6 Lack of Equity Institutions

Long-term finance, provided in the conventional system through bonds, equities and specialized institutions such as investment banks, mutual funds, insurers and pension funds, matters even more to Islamic banks, which cannot deal in interest-bearing bonds. Yet securities markets are underdeveloped in most Muslim countries. Islamic banks should prepare to participate in growing equity markets through fund management, stock companies, mutual funds and equity-based instruments; the Dhaka Stock Exchange launched its Shariah index (DSES) in 2014 to encourage investment by Islamic institutions.

2.4.7 Establishment of Organized Secondary Islamic Financial Markets

Banking thrives on secondary markets in which short-term financial assets can be converted into cash quickly and cheaply. Islamic secondary markets would make Islamic banks' assets more liquid and attractive to savers and strengthen their ability to mobilize funds, but the Islamic instruments introduced so far — such as Bangladesh Government Islamic Investment Bond (BGIIB), Mudarabah perpetual bonds (MPB) and the equity instruments of various institutions — are insufficient.

2.4.8 Need of Market for Short-term Placements of Funds

Interbank transactions among Islamic banks are minimal, and they lack short-term instruments in which to invest profitably for short periods. Although a large share of their deposits is fixed-term, many depositors want the option to withdraw and savings deposits can be withdrawn within limits, so Islamic banks need instruments and institutional arrangements for short-term placements, even if overnight placement is less pressing. The IIFM has been introduced in Bangladesh, but its activity remains limited.

2.4.9 Shariah Governance Challenge for Islamic Finance and Banking

An effective Shariah framework is largely absent in Bangladesh. Malaysia, which also began Islamic banking in 1983 and has a similar market share of around 20%, offers a model, with the most complete Shariah framework in the Muslim world. Because Islamic finance is governed at the intersection of national and Shariah law, interpretations and practices vary within and across countries; AAOIFI and the IFSB work to harmonize and standardize Islamic financial practices and contracts.

2.5 Operational Challenges Faced by Islamic Banks

2.5.1 Financial Engineering

Financial engineering — used here broadly to mean developing new financial products in all areas of financial operations, including resource mobilization, placement of funds and risk management — designs products to meet users' needs for risk, maturity and yield, and it is imperative in increasingly sophisticated and competitive markets. Islamic financial tools have so far been largely limited to classical modes developed centuries ago; these offer useful guidance but need not restrict contemporary contracts.

2.5.2 Training of Shariah Scholars

No new product can be adopted until Shariah scholars clear it, and Shariah auditing is needed afterwards to ensure that practice complies — for business as well as religious reasons, since clients' confidence depends on it. Scholars' understanding of modern financial products is therefore crucial, yet it is believed that few members of the Shariah boards or advisers of Bangladesh's Islamic banks have formal training in modern banking and finance. Institutions in Islamic economics, banking and finance could organize such training.

2.5.3 Teaching, Training, Research and Development

Teaching, training and research are the cornerstones of any discipline, especially one still nascent in Bangladesh; many Islamic bank managers are not well trained in Islamic modes of finance, and efforts in this area need to be multiplied.

2.5.4 Lack of Profit-Sharing Finance

Islamic finance is either fixed-charge or profit-sharing, both involving the purchase and sale of real commodities. Economists hoped that Islamic banks would provide substantial profit-sharing finance, with development effects similar to direct investment, but in practice it has remained negligible. For firms, profit-sharing contracts have not been adapted to the needs of ongoing concerns that prefer unrestrictive finance encouraging reinvestment; for banks, they entail higher costs — feasibility studies, technical and financial evaluation, and follow-up and support to entrepreneurs — and require good accounting and scrupulous auditing of projects.

2.5.5 Defaulters and the Issue of Compensation and Penalties

Fixed-rate modes let Islamic banks sidestep moral hazard and adverse selection but create another problem: a Murabahah creates a fixed debt, and if the buyer defaults, the bank cannot

charge anything extra without taking Riba — a built-in incentive for unscrupulous buyers to default. It is generally agreed that penalties may be imposed on defaulters provided the bank does not benefit from them. Many contemporary scholars argue that the bank may be compensated for the damage caused, since Islam permits compensation for damages, but the issue remains unresolved.

2.5.6 Illiquidity of Assets

Debt-based modes are also hard to turn into negotiable instruments, since a debt can be transferred only at par, making Islamic financial markets highly illiquid and hindering the development of secondary markets. Instruments based on lease (Ijarah) and Salam have seen little use so far; the main hope lies in wider use of equity-based instruments and the securitization of existing modes.

2.5.7 Short-Term Asset Structure

Banks prefer short-term investments because they operate with small reserves, and Islamic banks' assets are even more short-term owing to the predominance of Murabahah. They need long-term resources, which in conventional systems come from securities markets that are underdeveloped in most Muslim countries.

2.5.8 Mobilization of Deposits

Islamic banks have mobilized deposits successfully, largely because of clients' religious commitment rather than higher returns; sustaining even modest growth will require attractive profit rates and deposits from new sources on a competitive basis.

2.5.9 Competition

Islamic banks' near-monopoly over religiously motivated clients is eroding as conventional banks, including international giants, enter the market (see Section 2.2.3); competition, however, generally benefits an industry by reducing costs, improving services and promoting innovation and product quality.

2.5.10 Globalization

Globalization brings both opportunities and challenges: wider portfolio diversification reduces the risk of profit-sharing modes, and Islamic banks may open more branches in non-Muslim countries, especially to serve Muslim communities there, but they will also face more intense foreign competition and must improve service quality and develop suitable products.

2.6 Risk Management Issues and Challenges Faced by Islamic Banks

Like all financial institutions, Islamic banks face credit, market, operational, solvency and liquidity risks — whose management has gained importance since the global recession and the failure of many renowned institutions — and, operating in the same environment as conventional banks, they also face risks unique to themselves. Bangladesh Bank has issued guidelines on core risks — credit, asset-liability, internal control and compliance, foreign

exchange, anti-money laundering and Information Technology (IT) risk — but none addressing the unique risks of Islamic institutions. Islamic banks use profit-and-loss sharing (PLS) contracts (Mudarabah and Musharakah) and non-PLS contracts (Murabahah, Ijarah, Salam, Istisna'a and Qard); even their debt contracts differ from conventional ones, since they must be backed by real assets and are free of Riba. Because investment account holders (IAHs) expect competitive returns as well as continuous Shariah compliance, all Islamic banks face two common risks: Shariah compliance risk and performance risk.

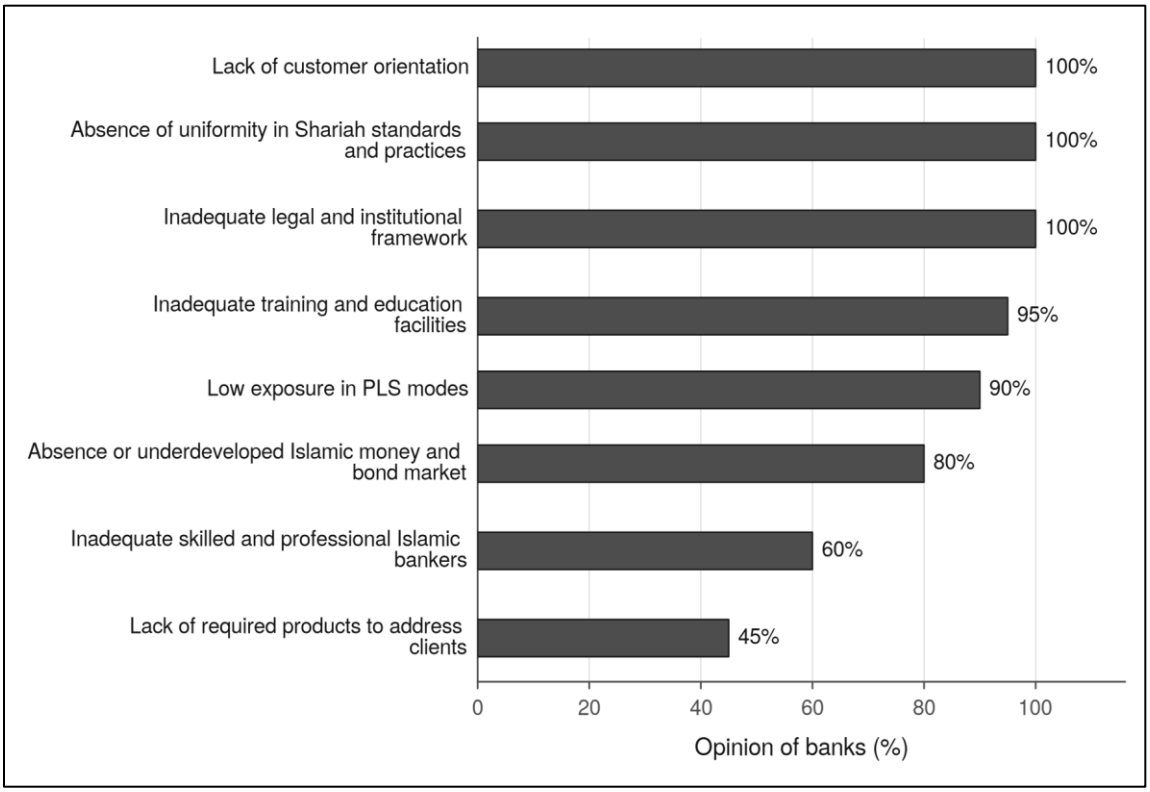
> Because the capital value and return of investment deposits are not guaranteed, competitive pressure may force banks to pay IAHs more than the funds actually earn, or else lose depositors. PLS contracts also create liquidity risk: depositors in restricted Mudarabah and current accounts may withdraw at any time, and in Musharakah the bank must be able to provide committed funds and meet partnership expenses or profit payments.
>
> Legal risk is substantial because laws suited to enforcing Islamic contracts are lacking in many countries: a Musharakah may require the bank to hold shares in a separate legal entity, which regulations may not permit, and existing law may invalidate PLS instruments — in Indonesia, for example, some Mudarabah bonds are treated as debt guaranteed by the Mudarib's assets, which conflicts with Shariah (Izhar, 2010).
>
> These risks have made PLS contracts unpopular, especially on the asset side, and Islamic banks in Bangladesh, like most elsewhere, rely mainly on non-PLS modes, which carry risks of their own. The complexity of Islamic contracts, fiduciary obligations, Shariah compliance risk and legal constraints make Islamic banks' risk exposure more complex than that of conventional banks, and without a clear strategy to address it, the use of Islamic contracts, and the industry's growth, may suffer.

2.7 Outcome of the Opinion Survey on Issues and Challenges of IBs

To identify the most important challenges faced by Islamic finance and banking, a detailed questionnaire was distributed among scholars working in the area. These valuable comments and suggestions have been presented in Figure 2.11 and Figure 2.12. All the respondents acknowledged that inadequate legal and institutional framework, absence of uniformity of *Shariah* standard and practices, lack of customer orientation are the major threats and challenges of the Islamic finance and banking industry of Bangladesh. 95% respondents opined that inadequate training and education facilities are challenges for Islamic finance industry whereas 90% respondents viewed that low exposure in PLS mode challenge for Islamic finance industry of Bangladesh.

It can be seen that lack of financial engineering, illiquidity of assets (due to lack of negotiable instruments), implication of globalization, lack of profit sharing on assets side and lack of mechanism to deal with defaulters of debt are perceived to be the five most important challenges facing Islamic banking in general both global and Bangladesh context.

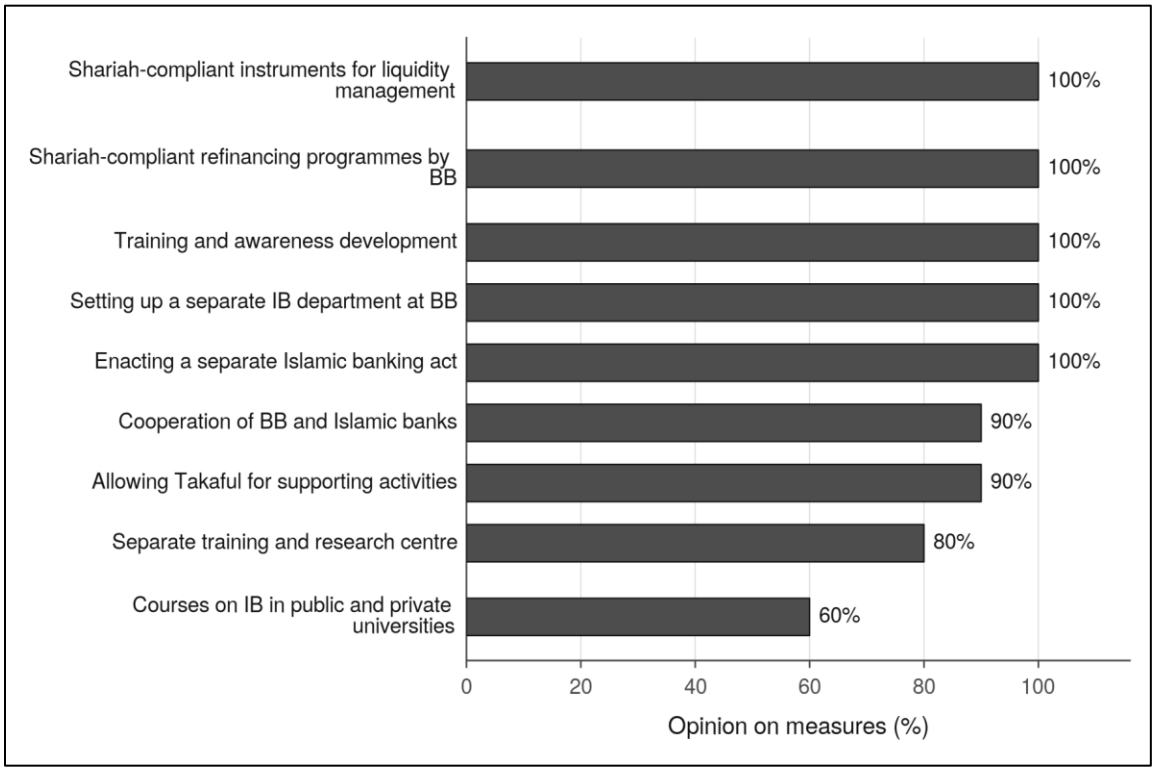
Figure 2.11: Opinions on the Problems of Islamic Banking in Bangladesh [as percentage of the total banks/branches/windows]



Source: Survey.

All of the respondents opined that enacting separate Islamic banking Act, setting up separate IB department at Bangladesh Bank, arranging training & awareness development programs, *Shariah-compliant* refinancing programs by Bangladesh Bank and *Shariah-compliant* instruments for liquidity management are essentials for ensuring smooth Islamic banking operations in Bangladesh (Figure 2.12). Allowing *Takaful* for supporting IB activities as well as cooperation between Bangladesh Bank and Islamic banks are important measures to improve Islamic banking operation in Bangladesh as perceived by 90% respondents. As per opinions of 80% respondent, a separate training and research center for IB is essential whereas 60% respondents believe that courses on IB should be included in universities' curriculum. Therefore, a coordinated approach is required to improve the quality of Islamic banking operations as well as to ensure expected growth of this sector in Bangladesh.

Figure 2.12: Opinions on the Measures to Improve Islamic Banking Operation in Bangladesh [as percentage of the total banks/branches/windows]



Source: Survey.

Table 2.9 shows the perception of the global Islamic scholars on the relevant and contemporary challenges faced by Global Islamic finance and banking. Islamic financial engineering specially the Islamic derivative instruments gets the topmost challenge of the global Islamic financial industry. On the other hand, Table 2.10 displays the perception of the Bangladeshi Islamic scholars on the relevant and contemporary challenges faced by Islamic finance and banking in Bangladesh.

It is observed from Table 2.9 that some important challenges faced by the global Islamic finance and banking are lack of financial engineering (61.67%), illiquidity of asset structure (60.34%), implications of globalization for Islamic banking (53.45%), lack of profit sharing on asset side (50.85%), lack of mechanism to deal with loan defaulters (46.67%), short-term asset structure (46.55%), lack of opportunities for short-term placement of funds (40.68%) and lack of lender of last resort (40.68%). In case of Bangladesh, moral hazard (66%), lack of financial engineering (59%), illiquidity of asset structure (57%), lack of supervision by central banks (45%), lack of risk management tools (37%), lack of opportunities for short-term placement of funds (36%) and lack of cooperation among Islamic banks (32%) are the relevant challenges for the Islamic finance and banking.

Table 2.9: Challenges Facing Global Islamic Finance and Banking: Perception of Global Islamic Scholars

Challenges	Not a Problem (%)	Mild problem for some Islamic banks (%)	Serious problem for some Islamic banks (%)	Mild problems for Islamic banking in general (%)	Serious problems for Islamic banking in general (%)
1. Lack of financial engineering	6.67	5.00	11.67	15.00	61.67
2. Illiquidity of asset structure	3.45	10.34	8.62	17.24	60.34
3. Implications of globalization for Islamic banking	8.62	8.62	3.45	25.86	53.45
4. Lack of profit sharing on asset side	11.86	1.69	15.25	20.34	50.85
5. Lack of mechanism to deal with loan defaulters	1.67	6.67	16.67	28.33	46.67
6. Short-term asset structure	5.17	8.62	8.62	31.03	46.55
7. Lack of opportunities for short-term placement of funds	5.08	11.86	11.86	30.51	40.68
8. Lack of lender of last resort	11.86	11.86	13.56	22.03	40.68
9. Lack of risk management tools	6.90	8.62	10.34	37.93	36.21
10. Lack of cooperation among Islamic banks	12.07	13.79	13.79	24.14	36.21
11. Lack of supporting institutions such as insurance etc.	3.45	13.79	13.79	34.48	34.48
12. Moral hazard	6.78	11.86	18.64	30.51	32.20
13. Lack of projects appraisal machinery & mechanism	6.78	8.47	30.51	22.03	32.20
14. Lack of ability of *Shariah* auditors in modern finance	7.02	17.54	7.02	36.84	31.58
15. Narrow ownership base	15.52	8.62	24.14	20.69	31.03
16. Unfair treatment in taxation	8.47	22.03	16.95	22.03	30.51
17. Adverse selection	15.52	15.52	15.52	24.14	29.31
18. Excess liquidity with Islamic Banks	10.17	6.78	20.34	35.59	27.12
19. Existence of competitors of different nature	27.59	10.34	12.07	24.14	25.86
20. Dominance of debt in asset structure	15.52	15.52	17.24	27.59	24.14
21. Lack of uniform accounting practices	18.97	6.90	8.62	41.38	24.14
22. Lack of transparency in p/s ratios among capital providers	12.07	17.24	18.97	27.59	24.14
23. Inability to meet financial needs of clients for different types of funds	13.79	12.07	25.86	24.14	24.14
24. Difficulties for Islamic banks to operate in non-Muslim countries	12.07	13.79	20.69	29.31	24.14
25. Lack of portfolio diversification	8.47	13.56	27.12	27.12	23.73
26. Lack of supervision by central banks	20.69	18.97	24.14	18.97	17.24
27. Lack of confidence of clients due to non-existence of deposit insurance	22.81	15.79	14.04	33.33	14.04
28. *Shariah* objections in issuing LGs/LCs	17.24	12.07	17.24	39.66	13.79
29. Lack of use of modern technology in banking and finance	11.86	11.86	27.12	35.59	13.56

Source: IRTI, 2012.

Table 2.10: Challenges Facing Global Islamic Finance and Banking: Perception of Local Islamic Scholars

Challenges	Not a Problem (%)	Mild problem for some Islamic banks (%)	Serious problem for some Islamic banks (%)	Mild problems for Islamic banking in general (%)	Serious problems for Islamic banking in general (%)
1. Lack of financial engineering	7	14	3	17	59
2. Illiquidity of asset structure	9	6	10	18	57
3. Implications of globalization for Islamic banking	19	22	6	49	4
4. Lack of profit sharing on asset side	19	34	3	25	19
5. Lack of mechanism to deal with loan defaulters	25	36	3	17	19
6. Short-term asset structure	19	42	3	17	19
7. Lack of opportunities for short-term placement of funds	9	11	9	35	36
8. Lack of lender of last resort	42	22	3	30	3
9. Lack of risk management tools	7	8	18	30	37
10. Lack of cooperation among Islamic banks	15	10	15	28	32
11. Lack of supporting institutions such as insurance etc.	21	38	6	18	17
12. Moral hazard	2	2	7	23	66
13. Lack of projects appraisal machinery & mechanism	10	15	35	17	23
14. Lack of ability of *Shariah* auditors in modern finance	11	50	6	28	5
15. Narrow ownership base	15	15	20	27	23
16. Unfair treatment in taxation	23	27	20	24	6
17. Adverse selection	28	56	8	6	2
18. Excess liquidity with Islamic Banks	28	44	6	6	16
19. Existence of competitors of different nature	20	25	5	30	20
20. Dominance of debt in asset structure	28	31	8	16	17
21. Lack of uniform accounting practices	8	34	6	29	23
22. Lack of transparency in p/s ratios among capital providers	20	25	10	20	25
23. Inability to meet financial needs of clients for different types of funds	25	44	0	28	3
24. Difficulties for Islamic banks to operate in non-Muslim countries	25	25	20	15	15
25. Lack of portfolio diversification	25	25	6	42	2
26. Lack of supervision by central banks	5	15	10	25	45
27. Lack of confidence of clients due to non-existence of deposit insurance	26	26	18	8	22
28. *Shariah* objections in issuing LGS/LCS	47	39	3	8	3
29. Lack of use of modern technology in banking and finance	22	47	0	28	3

Source: Survey.

2.8 Concluding Remarks

Islamic banks in Bangladesh face several challenges. Operating in a conventional environment, they need a legal and supervisory framework suited to their business, but the absence of a separate Act and comprehensive standards creates difficulties with Shariah compliance. Maintaining capable Shariah boards with enough scholars is costly, especially for small banks and Islamic branches and windows, and the Central Shariah Board needs to become a capable, active body advising on whether banks' operations, including investment procedures, comply with Shariah. Skilled professionals, customer awareness, and institutions for Islamic banking education and training are all in short supply, and liquidity management is hampered by an underdeveloped money market and shallow bond markets. The study therefore recommends the following:

(1) A separate Act on Islamic finance and banking is essential, with comprehensive provisions to enhance transparency and accountability; a parliamentary committee initiative for separate legal provisions has not yet materialized. Integrated rules may still work in areas such as prudential regulation, internal control, risk management and transparency.

(2) Smaller banks might share a common Shariah board, well versed in Shariah and modern finance and with adequate research facilities, and banks, with Bangladesh Bank's cooperation, should activate the Central Shariah Board — reducing overheads.

(3) Islamic finance professionals must be trained to meet the sector's needs. Islamic banking education should be offered alongside conventional banking education, producing enough bankers with full command of Shariah and Islamic products, and training — including at school and college level — should combine basics of banking, Islamic finance.

(4) Following many institutions worldwide, Islamic banks in Bangladesh could adopt a Shariah KYC template to deliver better services.

(5) Financial literacy is low, and lower among Islamic finance consumers than conventional ones, so consumer education should be a high priority, although raising literacy significantly may take a generation.

(6) The Islamic interbank money market should be activated through effective implementation of the IIFM, and Islamic institutions need more Shariah-compliant bonds for liquidity management; policy makers may consider Sukuk.

(7) The Central Shariah Board has little influence over Shariah audit, review, supervision and regulation, so a separate Shariah board under the central bank is essential. Bangladesh Bank could also propose provisions in the Money Loan Court Act for settling related disputes.

(8) Islamic banks should invest more in socially desirable sectors, especially agriculture and small enterprises, promote Mudarabah and Musharakah investment, and have access to more money and capital market instruments for their surplus liquidity.

Standard, harmonized guidelines and tools for expanding Islamic banking are lacking; some can be drawn from global standard setters, while the Qur'an allows sufficient flexibility for Shariah scholars to interpret, by consensus, how Islamic finance can serve the country's welfare.

Chapter 3: Islamic Banking Operations in Bangladesh: A Review of 2024

Based on the review "Islamic Banking Operations in Bangladesh 2024" by Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Emon Arefin. To keep the industry statistics together, this chapter also includes tables drawn from the studies underlying Chapter 12, Chapter 13 and Chapter 15.

3.1 Introduction

3.1.1 Background of the Study

Global Islamic finance reflects a dynamic interplay between tradition and innovation. Technology has extended its reach to underserved populations and small enterprises, while environmental and social considerations increasingly shape product design, making green finance, impact investment and blended finance central to aligning profitability with the higher objectives of Islamic law (Maqasid al-Shariah). Blended finance — integrating obligatory alms (Zakat), endowment (Waqf) and voluntary charity (Sadaqah) with commercial banking — promises scale and inclusion with financial sustainability, and experience in Malaysia and Indonesia shows the importance of regulatory support and tax incentives, pilot projects and cross-border collaboration.

The key challenge is to preserve credibility and a distinct identity while growing, rather than converging with conventional finance. Comparative experience offers lessons on regulation, product innovation and governance that balance ethical distinctiveness with market-driven innovation, and transparency, standardized reporting and robust Islamic law (Shariah) governance remain priorities.

In Bangladesh, Islamic banking has grown steadily since the first Islamic bank was established in 1983 and now holds a substantial share of the banking industry, reflecting strong demand for Shariah-compliant services. Despite its contribution to financial inclusion and development, concerns persist over Shariah non-compliance, the lack of product standardization, over-reliance on fixed-income instruments, the absence of dedicated legal and regulatory frameworks and operation within a dual banking system, alongside debates on mergers, asset recovery, liquidity support, digital banking, product diversification, Shariah governance and skilled human resources. Bangladesh Institute of Bank Management (BIBM)'s 2024 review of Islamic banking operations, drawing on institutional and regulatory engagement, assesses performance, identifies challenges and offers recommendations at this critical juncture.

3.1.2 Objectives of the Study

The study reviews Islamic banking operations in Bangladesh in 2024, compared with 2023. Its specific objectives are to:

a) examine the regulatory environment governing Islamic banking in Bangladesh;
b) analyze Islamic banking services, activities, and operations in Bangladesh within a global comparative perspective;
c) identify success factors and key challenges facing the Islamic banking sector; and
d) recommend strategies to enhance the effectiveness, resilience, and sustainability of Islamic banking operations.

3.1.3 Methodology of the Study

The study uses mixed methods. A semi-structured questionnaire was answered by thirty-two institutions — eight full-fledged Islamic banks and twenty-four conventional banks with Islamic branches or windows — and in-depth interviews and FGDs were held with board members, senior officials of Islamic banks, Shariah scholars and regulators. Secondary data came from the IFSB's Islamic Financial Services Industry Stability Report, London Stock Exchange Group (LSEG)'s Islamic Finance Development Report, the Cambridge IFA's Global Islamic Finance Report, Bangladesh Bank's Financial Stability Report, Scheduled Banks Statistics, Islamic Banking and Finance Statistics (IBFS) and Quarterly Report on Islamic Banking, and banks' annual reports and websites. The draft was presented at a stakeholder workshop of bankers, regulators and academics, whose feedback has been incorporated.

3.1.4 Limitations of the Study

The study has several limitations: not all banks provided complete data; self-reported survey and interview responses may be biased, particularly on Shariah governance and operational risk; the cross-sectional analysis of 2023–2024 cannot capture longer-term trends or cycles; cross-country comparisons are constrained by differing regulations, definitions and reporting standards; the scope excludes Islamic investment certificates (Sukuk), Islamic insurance (Takaful) and non-bank institutions; issues under active central bank review — mergers, high non-performing investments, asset recovery and liquidity management — are not addressed; and published data were not independently verified.

3.2 Review of the Literature

Contemporary Islamic finance literature reflects an interplay between innovation and tradition. Studies highlight fintech-driven financial inclusion, green and sustainable finance, and blended social–commercial models, while debating the risks of excessive financialization and the need for regulatory harmonization and robust Shariah governance. Within this discourse, Bangladesh stands out both as a success in market-share growth and as a cautionary case of persistent governance, regulatory and trust-related challenges.

3.2.1 Literature on Global Trend and Discourse

The global literature attributes the industry's growth over the past decade to demand for Shariah-compliant instruments, ethical investment and sustainable finance, while noting a tension between tradition and innovation — notably between Islamic social and commercial finance. It identifies three trends: technology enabling Islamic banks to serve small businesses and individuals in developing economies; environmental considerations shaping product design, with green and impact investing as key innovations; and unresolved questions about balancing profitability with the socio-economic objectives of Islamic finance.

3.2.1.1 Islamic Fintech and Digital Transformation

Islamic fintech has grown rapidly (Supriyono et al., 2024), with research on fintech in Islamic finance rising by 30% since 2020 (Beg et al., 2024). In Indonesia and Malaysia, Shariah-compliant digital platforms have improved Small and Medium-sized Enterprises (SME) access to financing (Supriyono et al., 2024; Othman et al., 2024), helped by regulatory sandboxes, although regulation remains fragmented across jurisdictions (International Monetary Fund (IMF), n.d.). Othman et al. (2024) link digital Islamic finance to the Sustainable Development Goals (SDGs) through Maqasid al-Shariah and Maslahah, and Alsmadi (2025) connects Islamic fintech with Corporate Social Responsibility (CSR) and financial inclusion, cautioning that technology must not undermine the foundational values of Islamic finance.

3.2.1.2 Green and Sustainable Islamic Finance

Sustainability has become central to Islamic finance, which can fund climate-resilience projects in developing markets (Maulina et al., 2023). Zhang et al. (2025) examine its role in inclusive, sustainable growth. Shahimi and Zahari (2025) call for instruments that meet both Shariah and Environmental, Social, and Governance (ESG) criteria. Sofiadin (2025) stresses innovation and education, and the World Bank (2022) highlights Islamic green finance — especially Sukuk and green funds — for renewable energy, led by Malaysia, Saudi Arabia and the United Arab Emirates. Green and sustainability-linked Sukuk are growing, led by Malaysia and increasingly the Gulf Cooperation Council (GCC) (Shahimi & Zahari, 2025; Abdullah & Ismail, 2022), though they remain below 5% of the global Sukuk market (Zhang et al., 2025) and ESG metrics are not yet standardized across Muslim-majority economies (Asutay & Yilmaz, 2024).

3.2.1.3 Integration of Social and Commercial Finance

Blending Islamic social finance (Zakat and Waqf) with commercial banking could close financial inclusion gaps, particularly for marginalized groups (Maulina et al., 2023; World Bank, 2022). Examples include hybrid Zakat–financing products in Indonesia and Malaysia (Supriyono et al., 2024) and Waqf-based investment funds in the GCC (Othman et al., 2024). Obstacles include mismatched timelines between social disbursement and long-term commercial investment (Beg et al., 2024), the regulatory separation of social and commercial finance (IMF, n.d.) and the risk of mission drift (Alsmadi, 2025). Success depends on standardized social-impact measurement, stronger governance and supportive regulation (Beg et al., 2024; Zhang et al., 2025).

3.2.1.4 Financialization and Ethical Concerns

A key debate concerns financialization. Qanas and Sawyer (2022) question whether integration with global markets compromises ethical standards, and Asutay and Yilmaz (2024) warn that market-driven practices increasingly resemble conventional finance, urging a focus on real economic activity; in product structuring, profit maximization often takes precedence over Shariah principles (Alsmadi, 2025). Some practices violate the prohibition of interest (Riba) in substance, and competitive pressure has encouraged complex financial engineering with only superficial compliance (Asutay & Yilmaz, 2024; Maulina et al., 2023). Proposed remedies include stronger Shariah audit, greater transparency in profit sharing (Othman et al., 2024) and a Maqasid-based approach to product development and risk management (IMF, n.d.). How the sector reconciles market competitiveness with its principles may determine its long-term viability (Supriyono et al., 2024; World Bank, 2022).

3.2.1.5 Regulatory and Standardization Efforts

Despite the work of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the IFSB on Shariah governance frameworks, including for fintech and sustainable finance (Othman et al., 2024), jurisdictional fragmentation and divergent interpretations persist (IMF, n.d.; Asutay & Yilmaz, 2024). The lack of unified ESG reporting for green Sukuk, for instance, complicates impact assessment (World Bank, 2022; Shahimi & Zahari, 2025). Regulatory sandboxes in Malaysia and Bahrain show how innovation can be balanced with adherence to Shariah (Supriyono et al., 2024; Alsmadi, 2025), and future standardization should integrate Maqasid al-Shariah while accommodating the sector's globalization (Maulina et al., 2023).

3.2.2 Literature on the Bangladesh Market

Islamic banking in Bangladesh, which began in 1983, now accounts for over one-fourth of total deposits and financing and nearly half of inward remittances (Mustafa et al., 2022). The literature nonetheless highlights persistent deficiencies in governance, product diversity, regulatory clarity and risk management (Ahmed, 2018; Alam et al., 2020b).

- **Shariah Governance:** The literature calls for more independent SSCs, greater transparency and external Shariah audits (Ahmed, 2017, 2020; Alam et al., 2023a), and for balancing the inclusivity of Islamic windows and subsidiaries with integrity through phased conversion and robust supervision (Ahmed et al., 2024). The independence, expertise and accountability of SSCs remain in question (Alam & Thakur, 2022); Shariah officers often report to management rather than to the Shariah Supervisory Committee (SSC), and Shariah audits cover only 10–20% of transactions (Alam et al., 2023b). Mandatory external Shariah audits and ratings, alongside continuous internal audit, are broadly supported (Ahmed et al., 2024; Hossain & Ahmed, 2024).
- **Debt-Mimicking Practices and the Risk of Convergence:** The sector relies heavily on debt-like contracts — cost-plus sale (Murabahah), deferred-payment sale (Bai-Muajjal) and Hire Purchase under Shirkatul Melk (HPSM) — while partnership (Musharakah) and profit-sharing partnership (Mudarabah) remain marginal (Ahmed et al., 2025), risking convergence with conventional banking (Ahmed, 2025c; Hossain &

Ahmed, 2024); accounting practices also mimic conventional banking (Ahmed et al., 2025). Pricing based on conventional benchmarks such as the Six-Month Moving Average Treasury Bill Rate (SMART) further erodes the authenticity of returns (Hossain et al., 2024). The literature advocates Shariah-based benchmarks, standardized contracts and wider use of risk-sharing structures (Hossain & Ahmed, 2024; Hossain et al., 2024).

- **Limited Diversification and Weak Capital Market Integration:** Growth has been quantitative rather than qualitative; unlike Malaysia or Bahrain, Bangladesh remains banking-centric, with little development of capital markets, Takaful or Islamic funds (Mustafa et al., 2022). Sukuk issuance faces high transaction costs, bureaucratic delays, shallow secondary markets and limited awareness (Mustafa et al., 2021, 2022; Alamgir et al., 2024), although sovereign Sukuk have shown their potential for infrastructure financing and liquidity management (Ahmed, 2025a; Ahmed & Hossain, 2023). Policy reviews call for more government Sukuk issuance, wider retail access and dedicated trading platforms.
- **Legal and Regulatory Framework:** Islamic banks operate under the Bank Company Act 1991 and ad hoc Bangladesh Bank circulars, producing fragmented governance and inconsistencies with Shariah (Ahmed, 2018). The Draft Islamic Bank Companies Act 2024 is a long-awaited step, but reviews call for stronger provisions on Shariah governance, depositor representation, audit and ownership concentration (Ahmed et al., 2024; Hossain & Ahmed, 2024). Ahmed et al. (2024) caution that rigid codification of contracts may stifle innovation and favor principle-based legislation, a dedicated Islamic banking department and Deputy Governor at Bangladesh Bank, and alignment with IFSB and AAOIFI standards.
- **Risk Management:** Underdeveloped Islamic money and capital markets create structural credit and liquidity vulnerabilities (Ahmed et al., 2022), prompting calls for liquidity support tools and a functional Islamic money market (Hossain & Ahmed, 2024). Operational risks — governance lapses, cyber threats and related-party exposures — remain pressing (Habib et al., 2025). Coronavirus disease 2019 (COVID-19) accelerated digitalization but exposed institutional fragilities (Habib et al., 2021), and establishing the bank's legal ownership of underlying assets is complicated (Ahmed et al., 2025). The merger of five troubled Islamic banks into a state-backed bridge bank shows proactive crisis management, but without deeper governance and Shariah reforms it risks becoming a temporary fix (Ahmed, 2025c).
- **Human Capital and Institutional Capacity:** Many Islamic bankers lack Shariah training and many Shariah scholars lack financial expertise (Malik et al., 2020). Recommendations include mandatory competency development for directors, a dedicated Islamic finance university and closer academia–industry collaboration, building an ecosystem for training, research and regulatory expertise comparable to Malaysia's International Centre for Education in Islamic Finance (INCEIF) model (Hossain & Ahmed, 2024).
- **Depositor Confidence:** Governance failures, Shariah lapses, high non-performing investments and withdrawal restrictions have eroded trust in several Islamic banks

(Ahmed, 2025c). Restoring it requires transparency, depositor representation, credible oversight, external Shariah audits, better disclosure, whistleblowing mechanisms and stronger compliance reporting (Hossain & Ahmed, 2024; Hossain et al., 2024).

In sum, the industry has achieved scale but retains foundational weaknesses. Legal reform, stronger Shariah governance, capital market development, more equity-based instruments and investment in human capital are critical to unlocking its potential (Hossain & Ahmed, 2024; Ahmed et al., 2024). Table 3.1 summarizes the challenges and recommendations identified in the literature.

Table 3.1: Challenges and Recommendations in the Literature on Islamic Banking in Bangladesh

Theme	Key Challenges Identified in the Literature	Recommendations / Proposed Reforms
Shariah Governance	• Weak independence and accountability of SSCs. • Shariah officers reporting to management instead of SSCs, limiting autonomy. • Shariah audits cover only 10–20% of transactions, exposing compliance risks.	• Strengthen the independence of SSCs. • Introduce mandatory external Shariah audits and ratings. • Enhance internal audit mechanisms. • Implement legal reforms that balance inclusivity with integrity.
Debt-Mimicking Practices & Benchmarking	• Heavy reliance on Murabahah, Bai-Muajjal, and HPSM. • Neglect of equity-based contracts such as Musharakah and Mudarabah. • Dependence on conventional benchmarks (e.g., SMART) for pricing.	• Promote risk-sharing instruments. • Develop Shariah-based benchmarks. • Standardize contracts to improve acceptability.
Diversification & Capital Market Integration	• Industry remains overly banking-centric with limited diversification. • Barriers to Sukuk issuance such as high costs, weak infrastructure, and bureaucratic delays. • Limited retail participation and investor awareness.	• Scale up sovereign Sukuk issuance and strengthen secondary markets. • Expand retail investor access. • Establish dedicated Islamic capital market platforms.
Legal & Regulatory Framework	• Continued reliance on outdated laws and ad hoc regulatory circulars. • Draft Islamic Bank Companies Act risks over-codification.	• Adopt principle-based legislation. • Strengthen Shariah governance and depositor representation. • Limit ownership concentration. • Establish a dedicated department and a Deputy Governor post. • Align with international standards such as IFSB and AAOIFI.
Risk Management	• Structural exposure to credit and liquidity risks due to underdeveloped Islamic money and capital markets. • Absence of Shariah-compliant liquidity support tools. • Operational risks from governance lapses, cyber threats, and related-party exposures.	• Develop Islamic money and liquidity markets. • Strengthen governance and accounting practices. • Institutionalize systemic risk frameworks beyond ad hoc fixes.

Theme	Key Challenges Identified in the Literature	Recommendations / Proposed Reforms
	• Crisis responses (e.g., bank mergers) risk being temporary fixes.	
Human Capital & Institutional Capacity	• Persistent dual skills gap: bankers lack Shariah expertise, while Shariah scholars lack financial expertise. • Weak training and research ecosystem.	• – Introduce mandatory training and competency development for directors and Shariah officers. — Establish a dedicated Islamic finance university. — Promote collaboration between academia and industry.
Depositor Confidence	• Declining trust due to governance failures, high NPIs, and withdrawal restrictions. • Absence of depositor representation in governance.	• Introduce external Shariah audits and ratings. • Enhance disclosure and compliance reporting. • Implement whistleblowing mechanisms. • Ensure depositor representation in governance structures.

Source: Authors' own.

3.3 Regulatory Framework of Islamic Banking

Islamic banking operates under a distinctive regulatory structure that combines the Qur'an, the Sunnah and scholarly interpretation with modern supervisory practice. International bodies promote standardization and cross-border harmonization, while national authorities implement these principles in their own contexts. Bangladesh's framework is evolving but fragmented: it relies on general banking legislation supplemented by circulars, leaving gaps in Shariah interpretation, product standardization and Shariah governance, and the absence of a dedicated Islamic Banking Act remains a pressing challenge. As a member of both AAOIFI and the IFSB, Bangladesh Bank is well placed to adopt international standards gradually.

3.3.1 International Standard Setters and Supporting Institutions

The global expansion of Islamic finance has created demand for internationally recognized standards on accounting, prudential supervision, governance and liquidity management, provided by several specialized institutions.

3.3.1.1 Accounting and Auditing Organization for Islamic Financial Institutions

Established in 1991 in Bahrain, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is the industry's foremost standard-setting body, with more than 115 standards on accounting, auditing, governance, ethics and Shariah rules, including detailed guidance on contracts such as Murabahah, Mudarabah, Musharakah, lease (Ijarah), agency (Wakalah), Salam and Istisna'a. Many jurisdictions have adopted its standards fully, partially or as references, and it also offers fellowships, certifications and training.

3.3.1.2 Islamic Financial Services Board (IFSB)

Headquartered in Malaysia, the IFSB plays a role comparable to that of the Basel Committee, developing prudential standards on capital adequacy, liquidity risk, stress testing and corporate governance for Islamic banks, Takaful operators and Islamic capital market participants; by 2024 it had issued more than 31 standards and guiding principles, which serve as benchmarks for regulators worldwide.

3.3.1.3 Supporting Global Institutions

Other institutions complete the international infrastructure: the General Council for Islamic banks and Financial Institutions (CIBAFI) supports policy dialogue, training and advocacy; the International Islamic Financial Market (IIFM) standardizes contracts and documentation, particularly for Sukuk and hedging; the International Islamic Liquidity Management Corporation (IILM) issues high-quality short-term Islamic instruments; the Islamic International Rating Agency (IIRA) provides Shariah-compliant ratings; and the International Islamic Fiqh Academy (IIFA) issues jurisprudential rulings on new financial products.

3.3.2 Domestic Regulatory Framework in Bangladesh

Domestically, Islamic banking operates under a hybrid framework: conventional banking laws provide the legal foundation, and Bangladesh Bank guidelines and circulars give operational direction for Shariah-compliant activities.

3.3.2.1 Bank Company Act, 1991

The Bank Company Act 1991 remains the primary legislation for all banks; amendments recognize Shariah-based practices such as Mudarabah and Musharakah, profit-sharing certificates and trade-based activities, but it has no comprehensive section on Islamic banking. Bangladesh Bank issued a draft Islamic Bank Companies Act for public comment in 2024.

3.3.2.2 Companies Act, 1994

The Companies Act 1994 governs Islamic banks' incorporation, corporate governance and shareholder relations; it does not address Shariah compliance, which is left to internal SSCs and Bangladesh Bank's oversight.

3.3.2.3 Guidelines for Conducting Islamic Banking (2009)

The Guidelines for Conducting Islamic Banking (BRPD Circular No. 15 of 2009) cover licensing, deposit and investment operations, Cash Reserve Requirement (CRR) and Statutory Liquidity Requirement (SLR), financial reporting and profit-sharing ratios, recognizing the SSC's role while making the board ultimately responsible for Shariah compliance. Bangladesh Bank is revising them (as of 2025) to address emerging challenges and align them with international standards.

3.3.2.4 Guidelines on Internal Control and Compliance (2016)

The Guidelines on Internal Control and Compliance (2016) incorporated Shariah audit into the risk management framework, requiring periodic Shariah reviews reported to SSCs and boards,

and corrective action; they have improved accountability, but practices remain unharmonized across banks.

3.3.2.5 Finance Company Act, 2023

The Finance Company Act 2023 extends Islamic finance services to finance companies, recognizing Islamic terminology, mandating profit-based nomenclature and permitting investment in Shariah-compliant instruments.

3.3.2.6 Other Circulars and Initiatives

Bangladesh Bank has also issued circulars on refinance schemes for farmers and small traders, liquidity support such as Mudarabah Liquidity Support (MLS) and the Islamic Banks Liquidity Facility (IBLF), and incentives for green investment.

3.3.2.7 Islamic Banking Regulation and Policy Department (IBRPD)

A major milestone came on 3 March 2025, when Bangladesh Bank created the Islamic Banking Regulation and Policy Department (IBRPD), meeting a long-standing demand renewed in reform calls after the July Revolution (Hossain & Ahmed, 2024). The IBRPD formulates policies on the establishment of full-fledged Islamic banks and of Islamic branches and windows, prepares and amends Islamic banking regulations, and provides regulatory guidance across Bangladesh Bank. It also reviews and implements IFSB standards and supports Bangladesh Bank's participation in the IFSB's council, committees, PSIFI data and surveys; liaises with the Islamic Development Bank (IsDB) and AAOIFI; and pursues the domestic adoption of AAOIFI standards.

3.4 Data Analysis and Findings

This section synthesises global and domestic evidence on Islamic banking and finance, drawing on Tables 3.2 to 3.11 — global assets, development indicators, country rankings, domestic market shares and financing contracts — to assess Bangladesh's strengths, vulnerabilities and prospects.

It also draws on a questionnaire sent to all Islamic banks, full-fledged and dual, covering human capital, general banking, financing, Shariah governance and other practices; since not all banks provided complete data, the findings rest on consolidated responses from the participating institutions.

3.4.1 Secondary Data: Global Context

3.4.1.1 Growth of Global Islamic Finance

The global Islamic finance industry more than doubled over the decade, from USD 2.02 trillion in 2014 to USD 4.93 trillion in 2023, and is projected to reach USD 7.53 trillion by 2028. Islamic banking accounts for over 70% of the total (USD 3.57 trillion in 2023, up from USD 1.44 trillion in 2014), the Sukuk market grew about two and a half times to USD 863 billion, and Islamic funds (USD 254 billion) and Takaful (USD 86 billion) remain smaller but steadily growing segments.

Table 3.2: Growth of Global Islamic Finance

Year	Global Islamic Banking Assets		Global Sukuk Outstanding		Islamic Funds Outstanding		Global Takaful Assets		Global OIFI Assets		Total Islamic Finance Assets	
	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)	USD Billion	Growth (%)
2014	1443	-7.38	346	133.78	66	8.2	36	0	131	9.17	2022	5.15
2015	1603	11.09	306	-11.56	71	7.58	47	30.56	143	9.16	2170	7.32
2016	1769	10.36	349	14.05	99	39.44	48	2.13	143	0	2408	10.97
2017	1831	3.5	420	20.34	123	24.24	46	-4.17	145	1.4	2565	6.52
2018	1882	2.79	470	11.9	116	-5.69	47	2.17	152	4.83	2667	3.98
2019	2133	13.34	539	14.68	150	29.31	54	14.89	154	1.32	3030	13.61
2020	2453	15	626	16.14	183	22	63	16.67	162	5.19	3487	15.08
2021	2875	17.2	713	13.9	244	33.33	77	22.22	158	-2.47	4067	16.63
2022	3244	12.83	788	10.52	220	-9.84	90	16.88	167	5.7	4509	10.87
2023	3569	10.02	863	9.52	254	15.45	86	-4.44	153	-8.38	4925	9.23
2028 (Projected)	5248	47.04	1521	76.25	396	55.91	138	60.47	225	47.06	7528	52.85
Share in 2023 (%)		72.50		17.50		5.16		1.75		3.11		100

Source: ICD-LSEG Islamic Finance Development Report 2024.

Note: Growth for 2014–2023 is year on year. The 2028 (Projected) row is cumulative growth over 2023–2028, not an annual rate; the equivalent compound annual growth rate for total Islamic finance assets is about 8.86%.

3.4.1.2 Global Islamic Finance Development Indicator (IFDI)

Malaysia topped the 2024 Islamic Finance Development Indicator (IFDI) with a score of 144, up from 103 in 2023 (Table 3.3), leading on every parameter except Knowledge — Financial Performance (157), Governance (101), Sustainability (128) and a maximum Awareness score (200), while Indonesia leads on Knowledge with 200 against Malaysia's 147. Saudi Arabia rose from 70 to 119, driven by Financial Performance (146) and Awareness (177), and the United Arab Emirates (UAE) moved from sixth to third (88), with perfect Awareness and strong Governance (85). Bangladesh rose from 34 to 41, placing tenth. Its Governance score (85) exceeds Turkey's (63) and Qatar's (65) — though arguably overstated given recent events — but it lags badly in Financial Performance (33), Knowledge (20) and Awareness (17, among the lowest in the top 15), whereas Pakistan (fifth, 75) scores well on Governance (78), Knowledge (119) and Awareness (200). Bangladesh's advancement is thus hindered by weak awareness, research capacity and financial depth.

Table 3.3: Global Islamic Finance Development Indicator (IFDI)

Country	Ranking		Parameter-Wise Score in 2024				
	2023 (Score)	2024 (Score)	Financial Performance	Governance	Sustainability	Knowledge	Awareness
Malaysia	1 (103)	1 (144)	157	101	128	147	200
Saudi Arabia	2 (70)	2 (119)	146	72	96	90	177
UAE	6 (53)	3 (88)	77	85	39	68	200
Indonesia	3 (58)	4 (85)	63	79	33	200	107
Pakistan	7 (51)	5 (75)	40	78	24	119	200
Kuwait	5 (54)	6 (70)	55	80	28	24	191
Bahrain	4 (54)	7 (68)	45	85	28	37	185
Iran		8 (65)	123	55	0	10	5
Qatar	10 (38)	9 (45)	30	65	27	15	101
Turkey	13 (33)	9 (45)	41	63	22	58	28
Bangladesh	11 (34)	10 (41)	33	85	23	20	17
Oman	8 (51)	11 (35)	14	75	24	23	46
Brunei		12 (29)	11	71	14	23	24
Jordan	9 (40)	13 (29	15	50	46	37	6
Nigeria	14 (27)	14 (28)	7	68	22	18	27
Global Average		(12)	8	21	8	9	13

Source: ICD-LSEG Islamic Finance Development Report 2023 & 2024.

3.4.1.3 Islamic Finance Country Index (IFCI) 2015–2024

In the Islamic Finance Country Index (IFCI) (Table 3.4), Malaysia held first place in 2016–2018 and 2020, Iran in 2015 and 2024, and Indonesia in 2019 and 2021; in 2024 the top five were Iran, Saudi Arabia, Sudan, Malaysia and, for the first time, Brunei. Bangladesh, absent from the top ten in 2015, entered in 2016, peaked at sixth in 2022 and stood tenth in 2024, behind Indonesia (sixth) and Pakistan (eighth) — visible, but fragile compared with the sustained dominance of Iran, Malaysia and Saudi Arabia.

Table 3.4: Islamic Finance Country Index (IFCI) 2015–2024

Rank	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
1	Iran	Malaysia	Malaysia	Malaysia	Indonesia	Malaysia	Indonesia	KSA	KSA	Iran
2	Malaysia	Iran	Iran	Iran	Malaysia	Indonesia	KSA	Malaysia	Malaysia	KSA
3	KSA	KSA	KSA	KSA	Iran	Iran	Malaysia	Indonesia	Pakistan	Sudan
4	UAE	UAE	UAE	UAE	KSA	KSA	Iran	Iran	Indonesia	Malaysia
5	Kuwait	Kuwait	Kuwait	Kuwait	Sudan	Sudan	Pakistan	Pakistan	Iran	Brunei
6	Bahrain	Indonesia	Pakistan	Indonesia	Brunei	Pakistan	Sudan	Sudan	**BD**	Indonesia
7	Indonesia	Qatar	Indonesia	Pakistan	UAE	Brunei	Brunei	**BD**	Sudan	Kuwait
8	Qatar	Bahrain	Bahrain	Bahrain	**BD**	UAE	**BD**	Brunei	Brunei	Pakistan
9	Sudan	Pakistan	Qatar	Qatar	Kuwait	**BD**	UAE	UAE	UAE	Bahrain
10	Pakistan	**BD**	**BD**	**BD**	Pakistan	Kuwait	Kuwait	Kuwait	Kuwait	**BD**

Source: Global Islamic Finance Report (GIFR) 2024.

3.4.1.4 Islamic Finance Country Index (IFCI) Projections to 2050

IFCI projections (Table 3.5) point to a major reordering by 2050: Pakistan is projected to rise from 8th to 1st place (score 40.44 to 143.31), Indonesia from 6th to 2nd (50.74 to 136.21), Malaysia to hold 3rd (61.59 to 129.91), and Bangladesh to leap from 10th to 4th (34.62 to 113.57), overtaking Saudi Arabia (2nd to 5th), Brunei (5th to 8th) and Iran (1st to 9th). South and Southeast Asia could thus become the global center of Islamic banking and finance by mid-century.

Table 3.5: Islamic Finance Country Index (IFCI) Projections to 2050

No.	Country	IFCI Future 2050	IFCI 2024	IFCI Future 2050 Rank	IFCI 2024 Rank
1	Pakistan	143.31	40.44	1	8
2	Indonesia	136.21	50.74	2	6
3	Malaysia	129.91	61.59	3	4
4	Bangladesh	113.57	34.62	4	10
5	Saudi Arabia	99.53	88.58	5	2
6	UAE	97.07	27.4	6	11
7	Turkey	84.88	8.62	7	16
8	Brunei	81.38	53.28	8	5
9	Iran	79.99	90.3	9	1
10	Bahrain	77.07	36.54	10	9
11	Kuwait	74.51	42.9	11	7
12	Qatar	69.97	19.75	12	12
13	Oman	61.95	12.59	13	13
14	Sudan	58.88	66.47	14	3
15	Jordan	56.62	11.5	15	14
16	Nigeria	49.49	0.56	16	29
17	Egypt	44.64	2.02	17	22
18	UK	37.65	0.21	18	34
19	Ethiopia	37.64	0.85	19	27
20	Kazakhstan	37.07	0.42	20	31
21	Somalia	36.08	4.07	21	18
22	Djibouti	34.74	9.8	22	15
23	Morocco	32.91	0.74	23	28
24	Tunisia	30.99	1.75	24	23
25	Kenya	26.53	0.3	25	32
26	South Africa	26.19	0.15	26	37
27	USA	24.99	0	27	47
28	Senegal	24.68	2.79	28	20
29	Lebanon	22.35	3.03	29	19
30	Afghanistan	19.02	2.15	30	21
31	Maldives	18.27	1.03	31	26
32	Sri Lanka	18.13	0.2	32	35

Source: Global Islamic Finance Report (GIFR) 2024.

3.4.1.5 Domestic Islamic Banking Share in Total Assets

Islamic banking's domestic share (Table 3.6) averaged 72.5% of financial assets in highly Islamised markets, 17.5% in emerging dual systems and under 10% in marginal markets in 2023. Bangladesh's share of about 25–30% of banking assets in 2024 is ahead of Turkey and Nigeria (below 10%) and comparable to Pakistan (over 30%, under its 2028 conversion roadmap) and Malaysia (30–35%, which balances banking with Sukuk and funds markets), but below Saudi Arabia (over 60%) and Sudan and Brunei, where Islamic banking dominates almost entirely.

Domestically, Islamic banking is a significant pillar of Bangladesh's financial system, but its reliance on bank-based finance, without comparable depth in Sukuk, funds or Takaful, limits its international competitiveness.

Table 3.6: Islamic Banking Share in Total Banking Assets (2024)

Countries Where Islamic Banking Achieved Systemic Importance Within the Domestic Market (>15%)			**Other Countries**		
No.	**Country**	**Islamic Banking Share (%)**	**No.**	**Country**	**Islamic Banking Share (%)**
1	Iran	100	1	Maldives	13.5
2	Somalia	100	2	Afghanistan	12.4
3	Sudan	100	3	Iraq	9.4
4	Saudi Arabia	75.3	4	Türkiye	8.2
5	Brunei	62.8	5	Libya	7.5
6	Kuwait	60.6	6	Indonesia	7.3
7	Mauritania	43.7	7	Tunisia	6.9
8	Malaysia	33.2	8	Egypt	5
9	Bahrain	31.6	9	Algeria	2.4
10	Qatar	28.4	10	Morocco	1.9
11	Djibouti	25	11	Kyrgyz Republic	1.4
12	UAE	22.9	12	Nigeria	1.3
13	**Bangladesh**	**22.5**	13	Kenya	1.3
14	Jordan	19	14	Sri Lanka	0.9
15	Pakistan	18.7	15	Tanzania	0.5
16	Oman	17.3	16	Thailand	0.4
17	Palestine	16	17	Kazakhstan	0.4
			18	South Africa	0.1
			19	Lebanon	0.1
			20	UK	0.1

Source: Islamic Financial Services Industry Stability Report 2025, IFSB.

3.4.1.6 Global Trends in Islamic Financing Contracts: 2021–2024

Globally, Murabahah and commodity-based cash financing (Tawarruq) together accounted for nearly 80% of Islamic financing contracts in 2021–2024, with Murabahah easing from 47.4% to 44.5% and Tawarruq rising from 25.7% to 34.5% — a growing preference for Tawarruq.

Ijarah and Ijarah Muntahia Bittamleek remained stable at around 10%, while Salam spiked to 12.6% in 2023 before settling at 10.6% in 2024.

Profit-and-loss sharing contracts such as Musharakah and Mudarabah rarely exceeded 3% in aggregate, and Diminishing Musharakah (1–2%), Istisna'a (below 1%) and Qard Hasan (0.1–0.2%) remained peripheral.

The dominance of these debt-like structures highlights the gap between Islamic finance's risk-sharing ideals and its risk-transfer, credit-based practice.

Table 3.7: Global Trends in Islamic Financing Contracts: 2021–2024

No.	Mode	2021	2022	2023	2024
1	Murabahah	47.4	44.0	42	44.5
2	Tawarruq	25.7	32.2	36	34.5
3	Ijarah/Ijarah Muntahia Bittamleek	10.2	10.2	9.4	10.4
4	Salam	4.1	3.8	12.6	10.6
5	Musharakah	2.8	2.4		
6	Diminishing Musharakah	1.3	1.9		
7	Mudarabah	0.2	0.2		
8	Istisna'a	0.7	0.6		
9	Wakalah	0.1	0.8		
10	Qard Hasan	0.1	0.2		
11	Others	7.4	3.6		
	Total	**100**	**100**	**100**	**100**

Source: https://data.ifsb.org/dashboards/islamic-banking, accessed on 17 August 2025.

3.4.1.7 Modes of Islamic Financing Contracts in Pakistan

Pakistan, by contrast, has embraced participatory modes. Between 2015 and 2024, Diminishing Musharakah rose from 31.7% to 44.8% of financing and Musharakah peaked at 25.3% in 2023 before falling to 12.8% in 2024, while Murabahah declined from 24.5% to about 13% and Ijarah from 6.6% to 5.2%. Mudarabah, Salam and Istisna'a together accounted for around 20–25% in some years.

Pakistan's financing structure is thus more oriented towards profit-and-loss sharing than global trends — a notable case of balancing Shariah ideals with market pragmatism.

Table 3.8: Modes of Islamic Financing Contracts in Pakistan

Year	Murabahah	Ijarah	Musharakah	Diminishing Musharakah	Mudarabah	Salam	Istisna'a	Others
2015	24.5	6.6	14.0	31.7	-	5.3	8.6	9.3
2016	15.8	6.8	15.6	34.7	-	4.4	8.4	14.3
2017	13.2	6.4	22.0	30.7	-	2.8	8.2	16.7
2018	13.6	6.2	19.9	33.3	-	2.4	9.1	15.5
2019	12.9	5.8	19.8	34.2	-	2.6	9.6	14.8
2020	13.7	4.8	22.7	33.6	-	1.9	8.3	15
2021	13.6	4.4	24.9	33.8	-	2.0	8.3	13

Year	Murabahah	Ijarah	Musharakah	Diminishing Musharakah	Mudarabah	Salam	Istisna'a	Others
2022	12.0	4.2	25.2	34.8	-	1.6	9.3	12.9
2023	13.1	4.1	25.3	32.1	-	2.1	10.6	13.0
2024	13.6	5.2	12.8	44.8	-	2.3	15.8	5.8

Source: Islamic Banking Bulletin, SBP. Retrieved from: www.sbp.org.pk on 18 August 2025.

3.4.2 Secondary Data: Bangladesh Context

The industry continued to expand in 2024, though unevenly (Table 3.9). Deposits grew 3.1% to BDT 4,355,575 million, driven by Islamic branches (40.15%) and windows (20.33%), with full-fledged banks up only 0.29%; investments, including Sukuk, rose 10.22% to BDT 5,262,709 million; and total assets grew 10.68% to BDT 8,432,907 million. Remittances handled fell 44.10% to USD 533 million, with full-fledged banks down 44.66%; investments by Islamic banking windows of conventional banks rose 6.21% to BDT 150,674 million. Exports rose 31.81% to USD 774 million and imports 29% to USD 1,208 million. Agent banking deposits grew 11.55% to BDT 216,316 million, and CSR spending fell 39.25%.

Table 3.9: Overall Islamic Banking Scenario in Bangladesh
(Remittance, Export, and Import are in USD mn; all other figures are in BDT mn)

Indicators	2024	2023	Growth (%)
1. Total Deposits (excluding Inter-bank & EDF)	**4355575**	**4224637**	**3.10**
a) Full-fledged Islamic Banks	3852507	3841360	0.29
b) Islamic Banking Branches of CBs	295972	211177	40.15
c) Islamic Banking Windows of CBs	207096	172100	20.33
2. Total Investments (including Sukuk/Islamic Bond)	**5262709**	**4774561**	**10.22**
a) Full-fledged Islamic Banks	4865000	4454304	9.22
b) Islamic Banking Branches of CBs	247035	178396	38.48
c) Islamic Banking Windows of CBs	150674	141861	6.21
3. Total Workers' Remittances (USD)	**533**	**954**	**-44.10**
a) Full-fledged Islamic Banks	526	951	-44.66
b) Islamic Banking Branches of CBs	3.14	0.32	896.82
c) Islamic Banking Windows of CBs	3.99	2.85	39.99
4. Total Export Receipts (excl. local export) (USD)	**774**	**587**	**31.81**
a) Full-fledged Islamic Banks	704	528	33.13
b) Islamic Banking Branches of CBs	49.07	31.97	53.51
c) Islamic Banking Windows of CBs	21.06	26.56	-20.69
5. Total Import Payment (excl. local import) (USD)	**1208**	**936**	**29.00**
a) Full-fledged Islamic Banks	991	808	22.62
b) Islamic Banking Branches of CBs	158.92	56.94	179.07
c) Islamic Banking Windows of CBs	58.13	71.36	-18.55
6. Total Agent Banking Deposits	**216316**	**193917**	**11.55**
a) Full-fledged Islamic Banks	215744	193488	11.50
b) Islamic Banking Branches of CBs	547.76	408.42	34.12
c) Islamic Banking Windows of CBs	24.62	20.50	20.11
7. Total Assets (excluding Contra. & OBU)	**8432907**	**7619498**	**10.68**

Indicators	2024	2023	Growth (%)
a) Full-fledged Islamic Banks	7784163	7144874	8.95
b) Islamic Banking Branches of CBs	386550	246153	57.04
c) Islamic Banking Windows of CBs	262194	228471	14.76
8. Total CSR Expenditure	**1941**	**3196**	**-39.25**
a) Full-fledged Islamic Banks	1920	3190	-39.81
b) Islamic Banking Branches of CBs	5.50	0.99	456.88
c) Islamic Banking Windows of CBs	*15.57*	*4.76*	*227.12*

Source: Islamic Banking and Finance Statistics (IBFS) of Bangladesh, December 2024.

The branches of the ten full-fledged Islamic banks listed in Table 3.10 total 1,697 in 2024 and 1,670 in 2023; the totals reported in the source, 3,721 and 3,693, are higher. Islami Bank Bangladesh PLC, the largest, has 400 branches and 21,864 employees, followed by Al-Arafah Islami Bank PLC (226 branches), First Security Islami Bank PLC (206) and Social Islami Bank PLC (180). The source reports 52,565 staff in 2024 against 48,242 in 2023, although five banks did not disclose 2024 employee numbers; the figures actually disclosed for 2024 total 31,650.

Table 3.10: Number of Branches and Employees of Full-Fledged IBs

No.	Name of Islamic Banks	Year of Establishment		Number of Branch*		Number of Employees	
		Bank	IB	2024	2023	2024	2023
1	Islami Bank Bangladesh PLC (IBB)	1983	1983	400	394	21864	20,809
2	ICB Islamic Bank Limited (ICB)	1987	1987	33	33	NA	374
3	Social Islami Bank PLC (SIB)	1995	1995	180	179	N/A	4,039
4	Al-Arafah Islami Bank PLC (AAIB)	1995	1995	226	215	N/A	5,184
5	Shahjalal Islami Bank PLC (SJIB)	1997	1997	141	140	N/A	2,835
6	Export Import Bank of Bangladesh PLC (EXIM)	1999	2004	155	151	3487	3,357
7	First Security Islami Bank PLC (FSIB)	1999	2009	206	205	N/A	5,406
8	Union Bank PLC (Union)	2013	2013	114	114	1670	1,776
9	Standard Bank PLC (Standard)	1999	2021	138	138	2143	2,239
10	Global Islami Bank PLC (GIB)	2013	2021	104	101	2486	2,223
	Total			**3721**	**3693**	**52565**	**48242**

Source: Annual Report of Concerned Banks.

*Note: *Quarterly Report on Islamic Banking of Bangladesh, December 2024. The branch and employee totals are those given in the source; they exceed the sum of the ten banks listed, and five banks did not disclose 2024 employee numbers.*

Thirty conventional banks offer Islamic banking through branches or windows (Table 3.11); about 865 of their 6,118 branches (14.14%) are engaged in Islamic banking, up from 654 in 2023 — growth of about 32%.

Table 3.11: Number of Branches of Dual Islamic Banks

No.	Name of Banks	Type of Islamic Bank	Year of Establishment		Number of Branch + Window 2024		Number of Branch + Window 2023	
			Bank	IB	Bank	IB*	Bank	IB*
1.	United Commercial Bank PLC (UCB)	Branch+Window	1983	2020	231	1+60	228	1+10
2.	ONE Bank PLC (ONE)	Branch+Window	1999	2020	112	2+14	111	2+14
3.	The Premier Bank PLC (Premier)	Branch+Window	1999	2003	147	2+25	136	2+25
4.	City Bank PLC (City)	Branch+Window	1983	2003	134	1+60	134	1+0
5.	NRB Bank (NRB)	Branch+Window	2013	2021	54	1+28	51	1+0
6.	Pubali Bank PLC (Pubali)	Branch+Window	1983	2010	508	3+25	504	0+19
7.	Prime Bank PLC (Prime)	Branch	1995	1995	146	5+0	146	5+0
8.	Dhaka Bank PLC (Dhaka)	Branch	1995	2003	119	2+0	118	2+0
9.	Southeast Bank PLC (SEBPLC)	Branch	1995	2003	135	5+0	135	5+0
10.	Jamuna Bank PLC (Jamuna)	Branch	2001	2003	169	2+0	167	2+0
11.	Bank Alfalah (Al Falah)	Branch	2005	2005	7	1+0	7	1+0
12.	AB Bank PLC (AB)	Branch	1982	2006	105	1+1	105	1+0
13.	National Credit and Commerce Bank PLC (NCC)	Branch	1993	2022	130	1+0	128	1+0
14.	Bangladesh Commerce Bank (BCB)	Branch	1998	2022	74	2+0	74	2+0
15.	Bengal Commercial Bank PLC (Bengal)	Branch	2021	2022	21	4+0	19	3+0
16.	IFIC Bank PLC (IFIC)	Branch	1983	2024	189	1+0	187	N/A
17.	Standard Chartered Bank (SCB)	Window	1948	2004	18	0+1	18	0+1
18.	Trust Bank (Trust)	Window	1999	2008	119	0+30	116	0+30
19.	Bank Asia PLC (BAPLC)	Window	1999	2008	139	0+5	135	0+5
20.	Sonali Bank PLC (Sonali)	Window	1972	2010	1233	0+58	1232	0+58
21.	Agrani Bank PLC (Agrani)	Window	1972	2010	978	0+61	974	0+60
22.	Meghna Bank PLC (Meghna)	Window	2013	2020	54	0+10	51	0+10
23.	Mutual Trust Bank PLC (MTB)	Window	1999	2020	175	0+15	120	0+15
24.	Mercantile Bank PLC (Mercantile)	Window	1999	2020	152	1+45	152	1+45
25.	Midland Bank Limited (Midland)	Window	2013	2020	39	0+1	39	0+1
26.	NRBC Bank PLC (NRBC)	Window	2013	2020	109	0+354	106	0+320
27.	SBAC Bank PLC (SBAC)	Window	2013	2021	90	0+10	89	0+10
28.	Padma Bank PLC	Window	2019	2023	60	0+5	60	N/A
29.	Rupali Bank	Window	1972	2023	586	0+2	586	0+1
30.	Eastern Bank PLC	Window	1992	2024	85	0+20	85	N/A
	Total				**6118**	**863**	**6013**	**654**

Source: Annual Reports of Concerned Banks.
*Note: *Quarterly Report on Islamic Banking of Bangladesh (December 2023 & 2024), BBB.*

Table 3.12 shows that Mudarabah Term Deposits dominated deposits throughout 2015–2024, at about 45–49% (48.9% in 2024), followed by Mudarabah Savings Deposits at about 18–19%. Other deposits under safe custody (Wadiah) or Qard (margin deposits, revenue and utility bill collections, uncashed pay orders and the like) rose from 15.8% to 18.4%, and Wadiah current deposits from 3.8% to over 4%.

Table 3.12: Islamic Banking Deposits by Contracts in Bangladesh (%)

	Wadiah CA Deposits	Mudarabah Savings Bond	Mudarabah Special Scheme	Mudarabah Hajj Deposits	Mudarabah Term Deposits	Mudarabah SND	Mudarabah Savings Deposits	Other Deposits
2015	3.83	1.02	7.80	1.74	48.46	2.94	18.32	15.79
2016	4.05	0.90	8.98	0.28	47.35	3.20	18.61	16.63
2017	4.41	0.75	8.71	0.22	47.45	3.76	18.38	16.32
2018	3.89	0.66	8.70	0.21	49.23	3.68	18.38	15.25
2019	3.58	0.58	8.62	0.22	48.21	3.94	17.60	17.23
2020	3.91	0.48	9.32	0.23	47.04	4.67	18.77	15.58
2021	4.71	0.37	9.63	0.19	45.55	4.80	19.39	15.36
2022	4.51	0.40	7.60	0.21	45.42	5.24	19.24	17.39
2023	4.57	0.23	7.39	0.21	45.86	4.75	19.21	17.77
2024	4.24	0.13	5.92	0.23	48.93	3.93	18.20	18.43

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

In financing (Table 3.13), Murabahah rose from 44.5% in 2015 to 48.1% in 2024, and Murabahah and Muajjal together accounted for about 70% in 2024. HPSM ranged between 16% and 24%, peaking at 23.6% in 2019 before settling at around 17–18%, and together with Ijarah accounted for about 22% in 2024; other modes were marginal.

Table 3.13: Islamic Banking Financing by Contracts in Bangladesh (%)

	Mura bahah	Muajjal	HPSM	Ijarah	Bai Salam	Bai Istisna'a	Muda rabah	Musha rakah	Qard with Security	Others
2015	44.47	24.93	16.54	6.08	0.76	0.30	0.38	1.54	1.45	3.59
2016	44.64	25.24	15.48	7.41	0.80	0.23	0.32	1.59	1.31	2.98
2017	43.81	25.17	16.94	7.35	0.96	0.22	0.26	1.53	1.32	2.44
2018	44.33	25.63	17.97	5.42	0.99	0.07	0.26	1.43	1.32	2.58
2019	44.60	23.95	23.62	0.02	0.03	1.16	0.32	1.38	0.05	4.87
2020	44.97	23.76	18.74	5.05	1.29	0.01	0.33	0.92	1.67	3.26
2021	46.39	23.24	18.98	4.32	1.23	0.02	0.25	0.49	1.11	3.98
2022	47.71	22.94	17.68	4.04	1.36	0.06	0.26	0.28	0.97	4.70
2023	47.57	22.5	17.88	4.07	1.70	0.06	0.25	0.32	0.88	4.75
2024	48.10	21.44	17.46	4.45	1.81	0.08	0.18	0.34	0.82	5.32

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

Islamic banks' market share (Table 3.14) rose in deposits from 20.1% in 2018 to 28.2% in 2024 and in financing from 23.1% to a peak of 26.3% in 2022 (24.8% in 2024), with assets and liabilities above 22% in recent years and equity at about 15–18%. Their share of

remittances peaked at 54.5% in 2022 (36.8% in 2024) and of agricultural credit rose from 7.0% in 2018 to nearly 20% in 2022 (17.5% in 2024); by 2024 they had about 15% of bank branches and nearly 25% of banking employees.

Table 3.14: Market Share of Islamic Banking in Bangladesh (%)

Particulars	Share of IBs in 2018	Share of IBs in 2019	Share of IBs in 2020	Share of IBs in 2021	Share of IBs in 2022	Share of IBs in 2023	Share of IBs in 2024
Financing/ Investment	23.1	23.14	24.0	25.8	26.28	25.93	24.75
Deposit (Mudarabah & Others)	20.1	20.96	21.6	23.5	23.03	22.18	28.15
Assets	19.1	19.58	20.1	22.1	22.63	22.47	22.1
Liabilities	19.4	19.85	20.4	22.3	22.93	22.75	22.5
Equity	15.6	15.57	15.4	17.8	17.73	17.85	16.1
Off-Balance Sheet Items	10.6	12.08	12.2	12.5	12.95	11.78	12.4
Profit Income (Interest Income)	34.31	24.32	26.3	28.6	27.58	27.45	26.38
Profit (Interest) Paid to Depositor	23.13	23.04	23.2	25.1	25.61	25.16	24.89
Non-Profit Income	9.25	10.1	7.7	8.8	11.68	10.02	10.38
Operating Expenses	17.12	18	18.1	19.7	20.07	20.37	20.61
Net Profit After Tax	38.32	24.01	36.7	40.4	18.14	18.33	5.54
Remittances*	35.38	35.34	40.51	49.18	54.53	54.30	36.76
Agricultural Credit*	7.01	2.57	13.41	16.94	19.85	19.04	17.46
Number of Bank Branches*	12.06	13.05	14.25	19.02	19.75	20.71	15.24
Number of Employees in IB	18.66 (33,027 of 177,000)	20.06 (35,906 of 179,000)	21.32 (38,784 of 181,937)	23.93 (45,260 of 189,161)	25.42 (49,851 of 196,102)	24.70 (50,306 of 203,696)	24.53 (52,565 of 214,245)

*Source: Financial Stability Report, Bangladesh Bank and *Quarterly Report on Development of IB in BD, Bangladesh Bank.*

Table 3.15 shows that Islamic banks outperformed the banking sector in profitability and asset quality in 2020–2023, with ROA and Return on Equity (ROE) almost double the sector average and higher net profit margins and profit-income ratios. The 2024 figures, not yet published in Bangladesh Bank's Financial Stability Report, may change markedly given the banking crisis.

Table 3.15: Selected Indicators of Banking Sector of Bangladesh (%)

Indicators	2019		2020		2021		2022		2023		2024	
	All	IBs	All	IBs	All	IBs	All	IBs	All	IBs	All	IBs
ROA	0.5	0.6	0.3	0.5	0.2	0.5	0.6	0.5	0.6	0.5	0.43	0.12
ROE	7.4	11.4	4.3	10.2	4.4	9.9	10.7	11.5	11.1	11.6	8.70	3.18
Net Profit Margin	2.1	2.9	1.4	2.4	1.3	2.3	1.4	2	1.6	2.3	1.30	1.89
Interest (Profit) Income to Total Assets (TA)	6.1	7.6	4.9	6.4	4.3	5.5	4.4	5.4	4.9	6.0	5.58	6.66
Net Interest (Profit) Income to TA	1.9	2.6	1.2	2.1	1.1	2.0	1.2	1.8	1.4	2.0	1.12	1.65
Non-Interest (Profit) Income to TA	1.8	0.9	2.0	0.8	2.0	0.8	2.1	1.1	2.0	0.9	2.43	1.14
Advance (Investment) to Deposit Ratio	77.3	94.3	81.4	83.3	73.2	84.7	79	91.4	80.4	95.3	81.55	97.06
CRAR	11.6	12.4	11.6	12.7	11.1	12.8	11.8	12.7	11.6	12.7	3.08	(4.95)
Classified Loans (Investment) to Advances	9.3	4.7	8.1	4.1	7.9	4.0	8.2	4.1	9.4	4.8	20.20	23.18
Classified Loans (Investment) to Capital	92.1	71.7	80.7	67.2	80.7	67.2	95	72.1	107.8	81.7	263.04	489.5

Source: Based on IBFC (2025) and Financial Stability Report, Bangladesh Bank.

The aggregated balance sheet (Table 3.16) shows the sector's total assets rising from BDT 4,508 billion in 2021 to BDT 5,820 billion in 2024, driven by general investments. Cash in hand rose until 2023 before declining, and balances with Bangladesh Bank fell sharply, while interbank placements rose notably in 2024 — signs of tighter liquidity. The investment portfolio shifted towards non-government securities, and a sharp rise in 'other assets' suggests higher receivables or pending adjustments. Deposits still dominate funding but grow slowly and have shifted towards costlier term deposits, reliance on interbank borrowing has increased markedly, and equity fell in 2024 despite asset growth, weakening the capital buffer; off-balance-sheet exposures rose moderately with trade activity.

Table 3.16: Aggregated Balance Sheet of IBs (Amount in Billion BDT)

Particulars	2021	2022	2023	2024
Cash in Hand (including FC)	41.7	52.3	60.9	53.5
Balance with Bangladesh Bank and SB (including FC)	385.2	257.2	257.6	234.8
Balance with other Banks and FIs	162.8	196.2	176.1	211.2
Placement with other Banks and FIs	18.3	8.0	8.3	7.0
Investments in Share and Securities				
Government	134.7	109.8	127.6	131.5
Others	171.6	170.3	177.3	291.4
Total Investments Share and Securities	**306.4**	**280.1**	**304.8**	**422.9**

Particulars	2021	2022	2023	2024
General Investments	3282.2	3739.8	4026.2	4334.1
Bills Purchased and Discounted	132.4	208.7	249.7	113.6
Total Investments and Advances	**3414.7**	**3948.5**	**4275.9**	**4447.7**
Fixed Assets	55.7	56.3	53.7	53.2
Other Assets	122.4	171.1	251.9	388.8
Non-banking Assets	0.9	0.9	0.9	0.9
Total Assets	4508.0	4970.7	5390.2	5820.1
Liabilities				
Placement from other Banks/FIs/Agents	285.4	579.0	678.1	956.9
Current Deposit	411.0	412.3	471.2	427.8
Savings Deposit	766.9	802.5	773.6	751.2
Fixed/Term Deposit	2015.6	2002.4	2223.7	2319.9
Interbank Deposit	114.3	152.6	151.9	204.4
Other Deposit	352.5	397.5	361.4	354.4
Total Deposits	3660.4	3767.3	3981.7	4057.7
Bills Payable	31.3	37.5	48.7	41.0
Other Liabilities	326.2	361.8	443.3	553.2
Total Liabilities	4303.3	4745.5	5151.9	5608.9
Total Equity	204.7	225.1	238.3	211.2
Total Liabilities & Shareholder's Equity	4508.0	4970.7	5390.2	5820.1
Off-balance Sheet Items	774.9	807.2	775.8	848.2

Source: Financial Stability Report 2024, Bangladesh Bank.

The aggregated income statement (Table 3.17) shows profit income rising from BDT 248.6 billion in 2021 to BDT 387.5 billion in 2024, but a sharp rise in profit expense, especially in 2024, cut net profit income. Non-profit and investment income fluctuated before strengthening in 2024, operating expenses rose each year, and profit before provisions weakened in 2024; provisions more than doubled that year, substantially eroding profitability.

Table 3.17: Aggregated Income Statement of IBs (Amount in Billion BDT)

Particulars	2021	2022	2023	2024
Profit Income	248.6	266.3	324.6	387.5
Less: Profit Expenses	160.0	177.0	214.3	291.6
Net Profit Income	**88.6**	**89.3**	**110.2**	**96.0**
Non-Profit/Investment Income	35.6	54.7	49.0	66.3
Total Income	**124.1**	**144.0**	**159.2**	**162.3**
Operating Expenses	69.4	84.0	90.3	101.3
Profit before Provision	**54.7**	**63.6**	**69.0**	**61.0**
Total Provision	13.7	13.3	14.9	38.2
Profit before Taxes	**41.0**	**50.3**	**54.1**	**22.8**
Provision for Taxation	20.7	24.5	26.5	16.1
Profit after Taxation	20.3	25.8	27.6	6.7

Source: Financial Stability Report 2024, Bangladesh Bank.

The sector comprises 10 full-fledged Islamic banks with 1,699 of the banking industry's 11,372 branches (excluding the ongoing merger), 45 Islamic branches of 17 conventional banks and 905 windows of 21 conventional banks. In 2025, the banking sector's excess liquidity stood at BDT 2,836 billion, of which the Islamic banking sector held BDT 119 billion, about 4% (Table 3.18).

Table 3.18: Current Status of Islamic Banking Sector in Bangladesh

(In BDT Billion)

Particulars	All Banks			Islamic Banks (Yearly Growth in %)			Share in Overall Banking Industry (%)		
	2023	2024	2025*	2023	2024	2025*	2023	2024	2025*
Assets	23984.0	26297.80	26947.56#	5848.18 (8.55)	6411.62 (9.63)	6606.68 (3.04)	24.38	24.38	24.52
Deposits	17491.30	18837.10	19965.80	4407.97 (7.72)	4577.41 (3.84)	4709.88 (2.89)	25.20	24.30	23.59
Investment	15383.40	16828.80	17341.70	4678.82 (9.87)	5015.49 (7.20)	5222.04 (4.12)	30.41	29.80	30.11
Gross NPLs/ NPIs	1456.33	3457.66	4203.35	248.45 (47.54)	2159.06 (769.00)	2629.09 (21.77)	17.06	62.44	62.55
Export** (Million USD)	55787.88	47245.41	23765.58	11347.30 (-12.86)	10305.49 (-9.18)	5087.63 (-50.63)	20.34	21.81	21.41
Imports** (Million USD)	65133.33	66924.73	35174.97	15967.30 (-14.92)	15878.83 (-0.55)	7821.49 (-50.74)	24.51	23.73	22.24
Remittances ** (Million USD)	21917.12	26888.42	16552.93	8314.49 (59.99)	8843.55 (6.36)	3660.81 (-58.60)	37.94	32.89	22.12
Branches	11283	11361	11372	1700 (1.07)	1731 (1.82)	1744 (0.75)	15.07	15.24	15.34
Liquidity excess (+) /Shortfall (-)	1631.78	2142.86	2836.40	111.07 (-13.71)	94.35 (-15.05)	119.90 (27.08)	6.81	4.40	4.23
Written-off bad debts	674.41	805.20	807.80#	36.63 (33.57)	30.66 (-16.29)	18.93 (-38.27)	5.43	3.81	2.34
Employment (In Person)	207692	-	-	50306 (0.91)	52565 (4.49)	51760 (-1.53)	24.22	-	-

*End June 2025, #End March 2025, ** During January-June 2025.

Source: Bangladesh Bank Annual Report, Monthly Economic Trends and Major Economic Indicators.

3.4.3 Islamic Banking Operations in Bangladesh: Questionnaire Survey

A questionnaire sent to all full-fledged Islamic banks and dual banks captured operational realities not evident in published reports; as some banks could not provide all the information requested, the findings are a consolidated overview of the participating banks. They show that while Islamic banks have grown in scale, qualitative challenges persist: Shariah governance frameworks exist in all banks but lack expertise, independence and resources, with underdeveloped secretariats and overlapping responsibilities; banks rely on conventional core banking systems poorly customized for Islamic products; product innovation is limited; customers, often unaware, resist Shariah documentation requirements; dual banks treat Islamic operations as secondary; and training in Islamic finance is uneven, especially in dual banks.

Deposits rely heavily on Mudarabah, exposing banks to displaced commercial risk, while profit smoothing reinforces depositors' belief in fixed returns; financing remains concentrated in Murabahah, Bai-Muajjal and HPSM, with Mudarabah and Musharakah marginal. Addressing these weaknesses in human resources, governance, product diversification and technology is critical to institutional resilience, depositor confidence and alignment with the Maqasid al-Shariah. The detailed findings follow.

3.4.3.1 Composition of Human Capital of Islamic Banks in Bangladesh

Table 3.19 shows that men made up about 90% of the employees of full-fledged Islamic banks in 2023–2024 and Muslims about 98%, while the share of temporary staff jumped from 1.9% in 2023 to 12% in 2024 as permanent employees fell from 98.1% to 88%.

Table 3.19: Manpower Composition of IBs (Based on Full-Fledged Banks only)

No.	Particulars	2024	2023
1	Male employees for IB (%)	90.15	89.80
2	Female employees for IB (%)	9.85	10.20
3	Muslim employees for IB (%)	97.66	98.50
4	Non-Muslim employees for IB (%)	2.34	1.50
5	Permanent employees for IB (%)	88.00	98.10
6	Temporary employees for IB (%)	12.00	1.90

Source: Survey Data.

Staff per branch in full-fledged Islamic banks rose slightly from 13 in 2023 to 14 in 2024 (Table 3.20), while conventional banks' fell from 19 to 17. Islamic branches and windows of conventional banks remained thinly staffed, though improving from 2 to 4 employees per branch.

Table 3.20: Manpower of IBs Considering Branches in Bangladesh

No.	Particulars	2024	2023
1	Number of employees per branch in full-fledged IBs	14	13
2	Number of employees per branch in CBs	17	19
3	Number of employees per Islamic branch/window in CBs	4	2

Source: Survey Data.

All banks agreed in both years that specialized knowledge is essential for Islamic banking (Table 3.21), and nearly all stressed the importance of certification or diploma programs.

Satisfaction with the availability of executives with adequate Islamic banking knowledge was low: in 2024, 69% of banks rated it below 50% and only 3% above 90%, compared with 16% above 90% in 2023 — possibly because in 2024 banks answered from an industry rather than an individual-bank perspective.

Table 3.21: Perception Regarding Capacity and Human Resource Development in Islamic Banks

No.	Aspect	2024 (%)	2023 (%)
1	Banks that perceive specialized knowledge is required to perform Islamic banking effectively	100	100
2	Banks that consider certification/diploma programs in Islamic banking preferable for all mid-level executives	98	96
3	Satisfaction with the sufficiency of executives possessing adequate Islamic banking knowledge (Industry Perspective)		
	• Above 90%	3	16
	• 80–90%	6	19
	• 60–80%	16	41
	• 50–60%	6	13
	• Below 50%	69	13

Source: Survey Data.

3.4.3.2 General Banking Operations in Islamic Banks of Bangladesh

In general banking and deposit operations (Table 3.22), most banks in 2024 saw a difference in opening Islamic deposit accounts. Fewer reported regulatory or policy difficulties in deposit collection (14%, down from 28%); 24% had issued Islamic bonds or Sukuk for long-term funding, and banks offered 22 deposit products on average. Half the banks' SSCs had reviewed all deposit products in the past year, but 30% had not done so within five years. Special products targeted women (58% of banks), garment workers (25%), farmers (21%) and underprivileged children (15%), yet 22% acknowledged gaps in meeting customer needs (17% in 2023). The weightage method of determining returns became dominant (86%, up from 58%) as use of the Income Sharing Ratio declined.

Table 3.22: General Banking Operations Including Deposit Mobilization in Islamic Banks

No.	Aspect	2024 (%)	2023 (%)
1	Banks reporting differences in procedures for opening deposit accounts in IB	85	N/A
2	Banks facing regulatory/policy difficulties in deposit collection	14	28
3	Banks issuing Islamic bonds/Sukuk for long-term funding	24	N/A
4	Average number of deposit products under Islamic mode (per bank)	22	N/A
5	Banks where all deposit products were reviewed by SSC		
	• In last year	50	N/A
	• Within last two years	10	N/A
	• Within last five years	10	N/A
	• Not reviewed	30	N/A
6	Banks offering special deposit products for women	58	N/A
7	Banks offering special deposit products for farmers	21	N/A
8	Banks offering special deposit products for garment workers	25	N/A
9	Banks offering special deposit products for underprivileged children	15	N/A
10	Banks perceiving deficiencies in deposit products	22	17
11	Framework for rate of return calculation on Mudarabah deposits		
	• Weightage-based method	86	58
	• Income Sharing Ratio (ISR) method	14	39
12	Banks introducing new deposit products		
	• In the previous year	67	68
	• Within previous two years	14	62

No.	Aspect	2024 (%)	2023 (%)
	• Within previous five years	5	58
	• Not introduced	14	0
13	Banks offering special religious-deposit products		
	• Hajj savings deposit	86	88
	• Muhor savings deposit	52	75
	• Cash Waqf deposit	52	83
	• Others (Marriage, Zakat, Sadaqah, etc.)	20	34

Source: Survey Data.

3.4.3.3 Investment (Financing) Operations in Islamic Banks

In financing operations (Table 3.23), all banks required additional documentation in 2024, 19% faced regulatory or policy challenges, and banks offered 23 financing products on average, though half considered these insufficient. SSCs had reviewed all financing products in the past year in 58% of banks but had conducted no review in 21%, and one-third of banks offered Islamic credit cards, as in 2023.

Table 3.23: Investment (Financing) Operations in Islamic Banking of Bangladesh

No.	Aspect	2024 (%)	2023 (%)
1	Banks requiring additional formalities for investment processing	100	N/A
2	Banks facing regulatory/policy difficulties in financing operations	19	N/A
3	Average number of Islamic investment/financing products (per bank)	23	N/A
4	Banks perceiving deficiencies in available financing products	50	N/A
5	Review of financing products by the SSC		
	• In the last year	58	N/A
	• Within last two years	21	N/A
	• Within last five years	0	N/A
	• Not reviewed	21	N/A
6	Banks offering Islamic credit cards	33	35
7	Introduction of new Islamic financing products		
	• In the previous year	45	44
	• Within previous two years	20	55
	• Within previous five years	10	41
	• Not introduced	25	0
8	Banks offering charity-oriented financing products		
	• Qard Hasan for employees	15	7
	• Qard Hasan for others	15	7
	• Others (e.g., Qard against MTDR)	0	22
9	Banks offering religious-purpose financing products		
	• Hajj finance	15	N/A
	• Muhor finance	5	N/A
	• Treatment finance	5	N/A
	• Others	5	N/A

Source: Survey Data.

3.4.3.4 Shariah Governance of Islamic Banks in Bangladesh

SSCs had between 3 and 10 members in 2024, averaging 6 against 10 in 2023 (Table 3.24); on average only 9% of members had banking experience, and full committees met 1 to 6 times a year, with sub-committees meeting up to 7 times.

Training remained limited: no bank trained its SSC members, though 52% reported SSC-led training for employees. SSC meeting fees ranged from BDT 8,000 to 10,000, which 68% of banks considered reasonable. Few supported including directors (5%) or employees (14%) as SSC members. Shariah secretariats ranged from 0 to 40 staff, with 1–24 Shariah auditors, about 80% of whom had branch experience (87% in 2023), and only 10% of banks published their SSCs' fatwas.

Table 3.24: Structure and Functioning of SSCs and Their Secretariats

No.	Aspect	2024	2023
1	Average number of SSC members (including chairman)		
	• Maximum	10	13
	• Minimum	3	7
	• Average	6	10
2	SSC members with banking experience (%)	9	N/A
3	Number of SSC meetings held annually (range)		
	• Full Committee	1–6	1–7
	• Sub-Committee	0–7	N/A
4	Banks that organized training/knowledge-sharing programs for SSC members (%)	0	N/A
5	Banks where SSC members organized training/knowledge-sharing programs for employees (%)	52	N/A
6	Remuneration for SSC members per meeting (BDT)		
	• Maximum	10,000	N/A
	• Minimum	8,000	N/A
7	Banks that considered SSC remuneration rational (%)	68	N/A
8	Banks that supported Board of Directors (BoD) members joining SSC (%)	5	N/A
9	Banks that supported management/employees joining SSC (%)	14	N/A
10	Number of staff in Shariah secretariats (range)	0–40	N/A
11	Number of Shariah auditors in banks (range)	1–24	N/A
12	Shariah auditors with branch banking experience (%)	80	87
13	Banks where SSC or secretariat disseminated Shariah knowledge among employees (%)	86	N/A
14	Banks where SSC or secretariat disseminated Shariah knowledge among customers (%)	71	N/A
15	Banks that published SSC fatwas/verdicts for public reference (%)	10	N/A
16	Banks with provision for job rotation of Shariah secretariat executives in mainstream banking (%)	62	54
17	Banks reporting discrimination/priority between Shariah secretariat and other units regarding promotion, salary, or benefits (%)	0	N/A

Source: Survey Data.

In 2024, 75% of banks had a separate Shariah secretariat (Table 3.25); 80% of these appointed a "Member Secretary" and 20% a "Secretary" to the SSC, although Bangladesh Bank requires a member secretary from among the bank's officials. The head of the Islamic Banking Division ranked one to six levels below the Managing Director (MD)/Chief Executive Officer (CEO), with 1 to 30 years of banking experience (up to 35 years in 2023).

Table 3.25: Head of Shariah Secretariat and Member Secretary of SSC

No.	Aspects	2024	2023
1	Banks having a separate Shariah Secretariat (%)	75	N/A
2	Banks having the member secretary/secretary of SSC (%)		
	• Member Secretary	80	N/A
	• Secretary	20	N/A
3	Position of the Head of IBD in the job ladder (steps below MD/CEO)		
	• Maximum	6	N/A
	• Minimum	1	N/A
4	Banking experience of the Shariah Secretariat head (years)		
	• Maximum	30	35
	• Minimum	1	1
5	Banks having specific written requirements for the post of Secretariat head (%)	32	36
6	Banks where the Secretariat head also performed operational duties (%)	25	37
7	Banks allowing Shariah Secretariat Head / Member Secretary to attend board-level meetings (%)		
	• Full BoD meeting	10	32
	• Executive Committee (EC) meeting	14	33
	• Risk Management Committee (RMC) meeting	19	30
	• Audit Committee of the Board (ACB) meeting	14	23
	• Management Committee/Senior Management Team (MANCOM/SMT)	57	46
	• Others	13	N/A

Source: Survey Data.

3.4.3.5 Other Issues of Islamic Banks

Among other issues (Table 3.26), 55% of banks apply a capital adequacy framework blending Basel and IFSB standards, 40% apply Basel directly and 5% the IFSB's prescriptions. Research capacity is limited: 43% of banks have research departments (up from 30% in 2023), 30% maintain databases of local Islamic products, 10% track foreign products, and only 16% had conducted market surveys in the past five years.

Product innovation has improved, with 45% of banks introducing pioneering Islamic products since 2019, and 84–85% acknowledged Islamic banking's distinctive contributions to the economy and society.

On Shariah governance, all banks have internal Shariah rating systems and 95% want an external rating system; 86% cite limited Islamic banking training and 95% a shortage of qualified scholars, while all agree on strong demand for expanding the industry. Only 19% of banks pay Zakat, and none transfer doubtful income to management costs or other purposes.

Table 3.26: Other Issues in Islamic Banking in Bangladesh (%)

No.	Aspect	2024	2023
1	**Capital Adequacy Framework of Islamic Banks**		
	Same as Basel Framework	40	N/A
	As prescribed by IFSB	5	N/A
	Customized mix of Basel and IFSB	55	N/A
2	Banks having a research department (%)	43	30
3	Banks maintaining a database of Islamic financial products/services in Bangladesh (%)	30	20
4	Banks maintaining a database of Islamic financial products/services in other countries (%)	10	11
5	Banks conducting market surveys within the last 5 years (%)	16	19
6	Banks designing new Islamic banking products within last 5 years (%)	45	29
7	Banks discontinuing/dropping old products within last 5 years (%)	29	14
8	Banks perceiving visible economic impact of Islamic banking beyond conventional banking (%)	84	80
9	Banks perceiving visible social impact of Islamic banking beyond conventional banking (%)	85	76
10	Banks with internal Shariah rating system to measure non-compliance risk (%)	100	100
11	Banks expecting an external Shariah rating system (%)	95	81
12	Banks citing limited training opportunities in Islamic banking (%)	86	71
13	Banks reporting shortage of qualified Islamic banking scholars (%)	95	82
14	Banks believing in strong demand for expansion of the Islamic banking industry (%)	100	93
15	Banks paying Zakat (%)	19	N/A
16	Banks transferring doubtful income to management cost or other purposes (%)	0	N/A

Source: Survey Data.

3.4.4 Summary Outcome of KII and FGD

3.4.4.1 KII Insights: Islamic Banking and Policy Department (IBRPD)

In a key informant interview (KII), officials of Bangladesh Bank's Islamic Banking and Policy Department (IBRPD) — ten officials led by a Director — reported that a separate Islamic Bank Companies Act has been drafted after stakeholder consultation and that the Guidelines for Conducting Islamic Banking (BRPD Circular No. 15/2009) are being revised to include detailed provisions on the SSC and the BoD and strategies to promote product diversification.

For capacity building, SSC and BoD members should attend at least two training programs, workshops or similar events a year. SSC members may receive a fixed monthly allowance, and a cap on memberships is being considered. To safeguard independence, SSC decisions should be final, members should be dismissed only with Bangladesh Bank's prior approval, and each SSC should have a Member Secretary, ideally not a bank official — although no additional allowances for SSC chairmen or member secretaries are planned.

The department stressed the importance of research in Islamic banking, not yet reflected in the draft guidelines. Recommended that the head of each bank's Islamic Banking Division sit within three tiers of the Managing Director, and considered SSC review of documents,

followed by Bangladesh Bank endorsement, desirable. Its vision is to strengthen Shariah compliance through empowered SSCs, and governance through managing directors and senior officials knowledgeable in Islamic banking. A Shariah Advisory Committee within Bangladesh Bank is under consideration, and Shariah-compliance supervision of Islamic banks has recently been intensified.

3.4.4.2 KII Insights: Full-Fledged Islamic Banks Facing Crisis and Recovery Efforts

Officials of a full-fledged Islamic bank recovering from crisis reported that it had overcome its liquidity problems — ensuring regular cash flow and meeting its CRR and SLR requirements — and had restructured its BoD and senior management team, which now function more effectively. Because most operational staff remain in place, however, additional controls, targeted training and proper screening are needed.

Externally, they called for a change of mindset in government and among regulators, a more robust regulatory framework, and stronger support from the central bank and the government for recovering non-performing financing. They welcomed Bangladesh Bank's decision to merge troubled banks into a large government-managed Islamic bank, expecting it to increase competition but also customer trust, and stressed that the sector's long-term growth will depend on the policies and commitment of the incoming government.

3.4.4.3 KII Insights: Full-Fledged Islamic Banks Outside the Crisis but Facing Governance Challenges

Full-fledged Islamic banks outside the crisis but facing governance challenges were concerned that merger regulations do not reflect the specific features of Islamic banking, and that, without sufficient controls, mergers could distort rather than support the sector's growth.

They emphasized good governance: Bangladesh Bank should require more independent directors on Islamic bank boards and managing directors with in-depth knowledge of Islamic banking, and chief risk officers should have Shariah expertise to manage operational risk. Shariah scholars should play a central role in product innovation — customer-oriented products are essential, but Shariah compliance is non-negotiable — and a risk-based capital adequacy framework suited to Islamic banking should be adopted.

They also proposed a registered association of Islamic bankers, similar to the Association of Anti-Money Laundering Compliance Officers of Banks in Bangladesh (AACOBB), to represent Islamic banks before regulators and government, and noted the paradox of high unemployment alongside a shortage of skilled, honest and ethical bankers.

Respondents also stressed the effective autonomy of the central bank and dynamic leadership as safeguards against future irregularities, citing the 2010 merger of Bangladesh Shilpa Bank (BSB) and Bangladesh Shilpa Rin Sangstha (BSRS) into Bangladesh Development Bank Limited (BDBL) as a lesson in the need for cautious, well-structured strategies, including bail-out processes. Mergers may have merit, but compulsory ones carry significant risks; with a crisis unprecedented in scale and nature, a sustainable turnaround — reinforcing governance, capacity and Shariah compliance across the banking sector — is imperative.

3.4.4.4 FGD Insights: Islamic Banking in Conventional Banks

A focus group discussion (FGD) with 26 chiefs or deputy chiefs of Islamic banking (or their nominees) from dual banks and three representatives of the Shariah secretariats of full-fledged Islamic banks identified priorities for strengthening dual Islamic banking: board oversight with Shariah-competent members; greater commitment and accountability from senior management; clearer integration of Islamic banking within dual institutions; KPIs that engage conventional staff in Islamic business; stronger positioning and competence of heads of Islamic banking; wider awareness and knowledge sharing; core banking systems that accommodate Islamic operations; and a Shariah-compliant Universal Pension Scheme (UPS). The details follow.

- **Governance and institutional support:** Boards of dual banks generally support their Islamic Banking Divisions (IBDs), but Shariah-competent board members would make this support more effective, and joint Shariah orientation programs by BIBM and Bangladesh Bank were recommended. Support from senior management is uneven: some business-oriented executives show little concern for Shariah, others delay Islamic banking decisions, and a few resist expansion for fear of losing their jobs if the bank converts; participants urged Bangladesh Bank to intervene more actively to strengthen IBDs.

  Participants perceived that profitability often outweighs compliance, that senior officers from conventional banking need more training and sometimes see Islamic operations as a "threat", and that a "delay culture" slows decisions: "The board is supportive, but management comes from conventional banking and Shariah compliance is not always a priority." Board commitment to Shariah was also questioned — "If the board had a genuine interest in Shariah compliance, it would convert the entire bank, not just launch an Islamic window" — since some banks open Islamic operations mainly to diversify, although boards driven by religious concern are more supportive; as another put it, "The board is interested in dual banking to leverage existing infrastructure. If a bank-within-a-bank model is imposed instead, dual banking will not be commercially viable."

- **Operational challenges:** Shared staff in many dual banks do little to promote Islamic products, owing to limited knowledge or competing conventional targets; participants proposed KPIs with explicit Islamic banking targets and incentives, backed by the commitment of the board and senior management. The position and competence of the head of Islamic banking are crucial: "The knowledge of the head of Islamic banking and senior management is essential; otherwise, they may impose incorrect practices even if junior staff are trained correctly."

- **Shariah compliance and portfolio management:** Compliance is costly for dual banks, which must also meet conventional requirements. Since most deposits are mobilized under Mudarabah, adequate profits are vital to pay Shariah-compliant returns and limit displaced commercial risk, and shared infrastructure, staff and resource costs must be properly allocated to assess Islamic banking performance. Product design is also more complex than in conventional banking and needs more innovation — "There needs to be more innovation in Islamic banking products" — while business pressure sometimes produces products with weak Shariah compliance.

- **Technology and systems:** Many dual banks still use conventional core banking systems with minimal customization, which fail to capture the distinct requirements of Islamic products — a significant operational constraint.
- **Customer awareness and market perceptions:** Most Mudarabah depositors expect fixed returns and some financing clients object to Shariah-required documentation; beyond banks' small-scale awareness initiatives, participants recommended broader joint knowledge-sharing programs.
- **Shariah governance:** Effective SSCs need members with both Shariah and banking knowledge rather than simply more members, supported by periodic internal knowledge sharing and external training.
- **Universal Pension Scheme (UPS):** Participants unanimously agreed that Islamic banks should not join conventional UPS structures and urged the early development of a Shariah-compliant UPS, which all Islamic banks should then support.

3.5 Conclusion and Recommendations

The 2024 review shows a sector of systemic significance with persistent structural vulnerabilities. Over four decades, Islamic banking has become a major part of the financial system, attracting depositors and advancing financial inclusion, but qualitative progress has lagged, with gaps in governance, human capital, product innovation and regulatory depth; without reform, the industry risks remaining a debt-based model that mimics conventional finance. Many recommendations of BIBM and other studies remain relevant — an Islamic Banking Act, phased conversion of Islamic windows, mandatory external Shariah audits, and SSCs with dual expertise in Fiqh and finance. The establishment of the IBRPD in 2025 is a milestone, but its effectiveness will depend on adopting AAOIFI and IFSB standards, strengthening crisis-resolution mechanisms and ensuring depositor- and stakeholder-focused governance.

Bangladesh stands at a crossroads: strong public demand, robust deposit mobilization and global visibility on one side; volatile performance, depositor trust deficits and reputational damage from non-performing investments on the other. The experience of Malaysia, Indonesia and Pakistan shows that progress requires coherent regulation, product diversification and the integration of Islamic social finance with commercial operations, not merely balance-sheet growth, and a new generation of Islamic bankers, regulators and Shariah scholars with dual expertise is urgently needed. Pursued with clarity and resolve, reform can make Islamic banking a credible pillar of ethical and sustainable finance and a significant contributor to global Islamic finance.

The following recommendations, drawn from the survey, interviews and expert consultations, address regulation, governance, innovation, capacity building and risk management.

3.5.1 Promulgation of Long-Term Vision for Islamic Banking and Finance for a Sustainable Economy

According to IFSB data, Islamic banking in Bangladesh passed a 15% market share several years ago, marking its systemic importance, yet the country lacks comparable standing in the

global industry, partly because growth has occurred without state-level planning: bottom-up growth is slower and less effective than a top-down policy framework, and without a long-term plan the industry has suffered setbacks and instability (locally termed "hochot kheyeche"). A comprehensive long-term vision is therefore essential for the sector and for a sustainable economy; following Malaysia's roadmap, which helped make it a global leader, the IBRPD is expected to lead its preparation.

3.5.2 Ensure Regular Review and Update of Contract Forms and Product Guidelines by Competent Shariah Scholars

Contract forms and product guidelines must be reviewed and updated periodically as products and market needs evolve, since outdated documents expose banks to Shariah non-compliance and reputational risks. SSCs should review them at regular intervals, and Bangladesh Bank may encourage a structured review mechanism supported by independent Shariah audits.

3.5.3 Ensure Effective Shariah Governance

Effective Shariah governance depends on an SSC combining Shariah knowledge with banking experience, a formal performance evaluation of members aligned with international practice such as the IFSB's, and continuous professional development for handling complex products. A national panel of certified Shariah advisors under Bangladesh Bank's guidance could serve as a reference for banks.

3.5.4 Establishment of a Strong Shariah Research Wing

Muamalat is dynamic, and Islamic banking needs ongoing, action-oriented research. Each Islamic bank should establish a Shariah research wing under the SSC's direct supervision to study new products, processes and market developments and identify Shariah-compliant alternatives, with its independence ensured by the board and resources provided by senior management — a strategic investment in sustainability and competitiveness.

3.5.5 Adoption of International Accounting Framework Consistent with Islamic Banking Products and Services

Transactions should be recorded and reported according to their substance, but the substance-over-form application of conventional standards such as International Financial Reporting Standards (IFRS) does not fully capture Islamic banking transactions. AAOIFI has developed Shariah, accounting and auditing standards for IFIs, and Bangladesh Bank, as an AAOIFI member, is well placed to adopt them gradually through a structured roadmap, improving the reliability, transparency and global acceptability of Islamic banks' financial reporting.

3.5.6 Strengthening Risk-Based Capital Adequacy Framework

Islamic banks' profit-and-loss sharing, asset-backed and other Shariah-compliant exposures carry risks not fully addressed by the Basel framework applied in Bangladesh. A risk-based capital adequacy framework tailored to Islamic finance — covering displaced commercial risk, equity investment risk and Shariah non-compliance risk, and building on IFSB standards —

should be developed, with Bangladesh Bank encouraging a gradual transition supported by capacity building and scenario-based stress testing.

3.5.7 Recognition of Shariah Non-Compliance Risk for IBs

Beyond credit, market and operational risk, Islamic banks face Shariah non-compliance risk, which arises from people, processes, systems or external events and is thus a significant aspect of operational risk. In line with IFSB standards, Bangladesh Bank may require Islamic banks to classify it formally as a core risk category and issue guidelines for identifying, measuring and managing it, supported by robust monitoring and accountability.

Appendices

Appendix A

Recommendations by Hossain and Ahmed (2024) on reforms towards advancing Islamic banking for a sustainable economy

No.	Recommendations	Priority	Implementation Entity
1	**Recommendations to Address the Current Crisis**		
1.1	Islamic Liquidity Support Tools Need to Be Urgently Developed	Immediate	Bangladesh Bank, IBs
1.2	Incompetent and Corrupt Individuals Must Be Identified and Removed from Key Positions in Islamic Banks	Immediate	IBs
1.3	Engagement with the Public Needs to Be Increased	Immediate	IBs, BAB, CSBIB, IBCF
1.4	Initiatives Needed to Accelerate the Recovery of Existing Investments	Immediate	GOV
2	**Recommendations Related to Reform Committees**		
2.1	Reform Taskforce/Committee/Commission Needs to Include Islamic Banking and Finance Experts	Immediate	GOV, Bangladesh Bank
2.2	An Islamic Banking and Finance Taskforce Needs to Be Formed Separately	Immediate	MOF, Bangladesh Bank, NBR, BSEC, IDRA
2.3	The Committees for the Revision of Islamic Banking Guidelines and the Drafting of the Islamic Banking Act Need to Be Reconstituted	Immediate	Bangladesh Bank
2.4	The Existing Bangladesh Bank Circulars Need to Be Reviewed and the Practice of Issuing Conventional Banking-based Circulars for Islamic Banking Needs to Be Discontinued	Intermediate	Bangladesh Bank
2.5	Committees for Financial Reporting and Auditing of Islamic Banking and Finance Need to Be Established	Intermediate	FRC, ICAB, Bangladesh Bank
3	**Recommendations for the Institutional Development of Bangladesh Bank**		
3.1	An Islamic Finance Department in Bangladesh Bank Needs to Be Established	Intermediate	Bangladesh Bank
3.2	A Deputy Governor Needs to Be Designated for Islamic Banking	Intermediate	Bangladesh Bank
3.3	A Shariah Advisory Committee in Bangladesh Bank Needs to Be Formed	Intermediate	Bangladesh Bank

No.	Recommendations	Priority	Implementation Entity
3.4	Adherence to the Standards Issued by the IFSB and AAOIFI Needs to Be Ensured	Intermediate	Bangladesh Bank
3.5	Consistency Needs to Be Ensured in Policies and Supervision	Intermediate	Bangladesh Bank
3.6	Whistleblowing Reporting Needs to Be Introduced	Intermediate	Bangladesh Bank
3.7	Capacity Development Initiatives Need to Be Enhanced for Bangladesh Bank Officers	Intermediate	Bangladesh Bank
4	**Recommendations Related to the Governance of Islamic Banks**		
4.1	Independent Directors Should Comprise the Majority, and Representation of Depositors Must Be Ensured	Intermediate	GOV, Bangladesh Bank
4.2	Relevant Competency, Continuous Professional Development, and Performance Evaluation of Directors Should Be Ensured	Intermediate	Bangladesh Bank
4.3	Existing SSCs Should Be Considered for Reconstitution	Immediate	Bangladesh Bank, IBs
4.4	Members of SSCs Should Possess Relevant Competency and Be Subject to CPD Requirements	Intermediate	Bangladesh Bank, IBs
4.5	A Shariah Governance Framework Needs to Be Issued and Shariah Compliance Culture Within Islamic Banks Must be Ensured	Intermediate	Bangladesh Bank, IBs
5	**Recommendations Related to Liquidity Management**		
5.1	An Islamic Money Market Needs to Be Established	Long-term	Bangladesh Bank
5.2	Government Sukuk Issuances Need to Be Increased	Intermediate	GOV, Bangladesh Bank
5.3	Initiatives Needed to Make Government Sukuk More Accessible for the Retail Sector and Develop an Efficient Trading Infrastructure	Intermediate	GOV, Bangladesh Bank, IBs, CBs
6	**Recommendations Related to Building Trust in Islamic Banking**		
6.1	Islamic Banking Products Need to Focus on Values (Beyond the Rate of Return and Other Commercial Features) in Advertisements	Intermediate	IBs
6.2	Disclosures and Transparency Regarding Shariah Compliance Must Be Significantly Enhanced	Intermediate	IBs
6.3	External Shariah Audit and Shariah Rating Need to Be Introduced	Intermediate	Bangladesh Bank, IBs
7	**Recommendations Related to Talent Development**		
7.1	Obtaining Islamic Finance Qualifications Should Be Encouraged	Immediate	Bangladesh Bank, IBs
7.2	Establishment of a Dedicated University for Higher Education and Research in Islamic Finance Needs to Be Considered	Intermediate	Bangladesh Bank, UGC, Universities
7.3	Collaboration Between Academia and Industry Should Be Increased and Industry Attachment Programs for Shariah Experts Need to Be Introduced	Immediate	IBs
7.4	Islamic Finance Education Needs to Be Incorporated into School and College Curriculum	Immediate	GOV

No.	Recommendations	Priority	Implementation Entity
7.5	Islamic Banking and Finance Forums Need to Be Empowered	Immediate	IBs

Source: Hossain and Ahmed (2024)

Appendix B

Recommendations by Ahmed et al. (2024) on the draft Islamic Bank Companies Act 2024

No.	Recommendations
1	Strategic direction for Islamic banking needs to be established
2	The role of the central bank in fostering Islamic banking in Bangladesh needs to be clearly established
3	The IBCA shall establish that there are no legal or regulatory barriers or tax burdens that may hinder the full application of Shariah rules and principles
4	Compliance with the standards issued by the IFSB and AAOIFI needs to be the basis for the regulatory and supervisory activities of Bangladesh Bank in regards to Islamic banking
5	The name of the Bangladesh Central Shariah Council needs to be changed and its authority needs to be clearly established
6	The roles and responsibilities of the board of directors and senior management team concerning Shariah compliance needs to be clearly defined and provisions for penalties needs to be included for anyone who engages in Shariah non-compliance due to misconduct or negligence
7	Liabilities and recourse in the event of losses due to breaches of terms, negligence, or misconduct need to be clearly established
8	The customers' representation on the board of directors needs to be ensured
9	More than one board member from the same family should not be allowed
10	The maximum shareholding needs to be reduced to 5%
11	Islamic banking and finance competencies of the board of directors needs to be ensured
12	The structure, scope, powers, and member appointments of the Shariah Supervisory Board need to be established, and their representation in board committee meetings needs to be ensured
13	The structure, scope, powers, and appointments of members of the Shariah Governance Committee need to be clearly established
14	Provisions for the Executive Committee need to be included
15	External Shariah audit and Shariah rating needs to be made mandatory for all Islamic banking institutions
16	Specific provisions need to be added for internal Shariah audit
17	The Islamic banking accounts needs to be divided into deposit accounts and investment accounts
18	The opportunity for charging compensation based on actual costs and the legal status of the 'undertaking to donate' in the case of overdue need to be clearly established
19	The IBCA need to refrain from identifying and defining Shariah-based contracts, as this may restrict the ability of Islamic banks to innovate
20	Zakat and charity fund management and reporting needs to be aligned with international standards and ensure transparency
21	Islamic branches and windows of conventional banks should continue to be allowed
22	The IBCA needs to add provisions allowing subsidiaries for Islamic digital banking, Islamic crowdfunding and others
23	Application of the provisions of BCA 1991 or FCA 2023 not mentioned in the draft IBCA
24	The IBCA needs to be properly vetted by competent Shariah authorities to ensure that there are no Shariah non-compliant elements and properly proofread
25	The IBCA needs to start with Bismillahir Rahmanir Raheem and the Islamic banking definition needs to be added
26	Reforming the committee for revising the draft IBCA
27	Initiatives needed to develop a comprehensive legal and regulatory framework for Islamic banking

Source: Ahmed et al. (2024)

Appendix C

Observation on the Recommendations Made in Previous Review Paper(s) by BIBM Team

No.	Recommendations*
A	**Regulatory and Legal Framework**
1.	Enact a separate "Islamic Banking Act" to provide a dedicated legal foundation for Islamic banking operations.
2.	Strengthen the regulatory framework to support growth, innovation, and compliance in the Islamic finance industry.
3.	Empower the Central Shariah Board with supervisory authority over Islamic banking institutions.
4.	Establish a separate Shariah Appellate Bench at the High Court to resolve legal disputes involving Islamic banking matters.
5.	Incorporate a new parameter—'Shariah Compliance'—into the CAMELS rating framework specific to Islamic banks.
6.	Issue enhanced regulatory circulars with clear elaboration tailored to the operational nuances of Islamic banks.
B	**Governance, Audit, and Standardization**
7.	Ensure the formation of Shariah Supervisory Committees (SSCs) as per global standards, emphasizing competency, independence, and engagement.
8.	Strengthen governance and transparency in Islamic banking institutions through effective oversight.
9.	Enhance Shariah auditing practices by developing clear guidelines and ensuring rigorous compliance.
10.	Standardize documents and operational templates to ensure uniformity in Shariah compliance.
11.	Improve accounting and reporting practices in line with Islamic financial principles and international standards.
C	**Product Development and Financial Innovation**
12.	Introduce Sukuk for efficient liquidity and asset-liability management.
13.	Promote more Profit and Loss Sharing (PLS) modes of financing
14.	Launch longer-term deposit products to attract stable funding bases.
15.	Introduce financial products for direct cash assistance in case of dire need.
16.	Develop structured instruments such as "Cash Waqf" for charitable and social development purposes.
17.	Establish a separate Waqf Bank to facilitate Islamic social business and charitable banking.
18.	Introduce Islamic Social Business as a viable frontier to align profit with purpose and ethics in line with Maqasid al-Shariah.
D	**Market Expansion and Reputation**
19.	Expand Islamic banking branches in rural and underserved regions to improve financial inclusion in line with Maqasid al-Shariah.
20.	Enhance the market reputation and public image of Islamic banking through awareness and branding initiatives.
21.	Prepare a comprehensive national report on Islamic Banking and Finance (IBF) to assess progress, identify challenges, and propose reforms.
E	**Capacity Building and Human Capital Development**
22.	Develop a skilled pool of Shariah auditors to strengthen internal controls and ensure compliance.
23.	Increase training and capacity-building initiatives for professionals engaged in Islamic finance.
24.	Introduce certification programs to professionalize and standardize the Islamic banking workforce.
25.	Promote specialization for business professionals in areas critical to the Islamic banking sector.
26.	Establish a dedicated Research Cell to design innovative, Shariah-compliant products and services.
F	**Financial Management and Risk Oversight**
27.	Determine nominal and effective profit rates based on the mode of contract and actual recovery, aligned with central bank ceiling rates.
28.	Strengthen risk management practices in Islamic banks by incorporating both Shariah and financial risk considerations.

*Note: *Most of the banks show their agreement with the recommendations.*

PART II: PRODUCTS, FINANCING MODES AND PRICING

Chapter 4: Product Diversification of Islamic Banks: Prospects and Challenges

Based on the study "Product Diversification of Islamic Banks: Prospects and Challenges" by Md. Alamgir, Md. Mahabbat Hossain, Md. Abdul Halim and Md. Mizanur Rahman. The data relate mainly to 2017.

4.1 Introduction

The Islamic finance industry has tripled in size since 2007, growing at a Compound Annual Growth Rate (CAGR) of 11.6%. It is systemically important, with a market share above 15%, in over 12 countries that together hold 92% of global Islamic banking assets, and global Islamic finance assets surpassed USD 2.5 trillion in 2017.

Islamic financial intermediaries, however, lack adequate market support in liquidity instruments, risk transfer and insurance. Without developed money markets and short-term securities such as treasury bills (Iqbal & Mirakhor, 2011), and barred from interest-based conventional instruments and borrowing, they struggle to manage both liquidity shortages and surpluses, which hampers portfolio management and diversification. Archer and Karim (2006) identify the incompleteness of Shariah-compliant financial instruments as the main obstacle to their development, and unlike conventional banks they cannot hold conventional interest-bearing treasury securities to maintain liquidity.

Combining assets with different price movements reduces portfolio risk, so diversification across products, activities and sectors should improve returns. Markowitz's (1952) Modern Portfolio Theory lets investors maximize return for a given level of risk or minimize risk for a given return.

Global financial firms, which once saw Islamic finance mainly as a source of liquidity management and cheap short-term funding, now see opportunities from project finance to securities issuance, and most international banks now have Islamic finance capabilities.

A World Bank–IDB study finds that Islamic finance has the greatest potential to finance infrastructure and services and identifies five growth drivers: funding for fast-growing Islamic sectors such as permissible (Halal) food, tourism, healthcare and cosmetics; growing demand that allows markets and customer segments to expand; microfinance and Small and Medium-sized Enterprises (SME) financing in emerging and developed markets; the relative safety and sustainability of Eastern emerging markets and real-sector investment; and electronic trading platforms for the Islamic economy. Whereas money in the conventional system may circulate without productive use, the Islamic economy holds that wealth should be proportional to effort.

Since most conventional liquidity instruments are not Shariah-compatible, the Islamic interbank money market remains limited, and Islamic investment certificates (Sukuk) have become a popular liquidity instrument — one of the most significant developments in Islamic capital markets, attracting added interest after the 2007–08 crisis. Bangladesh, Brunei, Hong Kong, Indonesia, Malaysia and Pakistan issue sovereign or quasi-sovereign Sukuk, and Indonesia, Malaysia and Singapore have extended Sukuk to corporates.

This chapter examines whether Islamic banks are sufficiently diversified in their products and services, considers Sukuk as a liquidity management instrument, and assesses the potential of new Islamic banking products and services.

4.1.1 Methodology

The study uses primary and secondary data. Primary data were collected from Islamic banks and Bangladesh Bank and through semi-structured questionnaires. The research team also exchanged views with central bank executives, board members and senior managers of Islamic banks, executives of the Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) and the Islamic Banks Consultative Forum (IBCF), and banking experts.

Secondary data came from journals and publications on Islamic banking at home and abroad. These include the IFSB's Islamic Financial Services Industry Stability Report and Bulletin. Bangladesh Bank's Scheduled Banks Statistics, Bangladesh Bank Quarterly, Financial Stability Report and Quarterly Report on Development of Islamic Banking in Bangladesh, and the annual reports and websites of Islamic banks.

The study covers all full-fledged Islamic banks and conventional banks with Islamic branches and windows. It also reviewed the product lines of eight conventional banks: Eastern Bank, The City Bank, Prime Bank, Jamuna Bank, IFIC Bank, Trust Bank, Pubali Bank and United Commercial Bank. For the international market, it examined the websites of one Islamic bank in each of five countries: Bank Mellat (Iran), Bahrain Islamic Bank (Bahrain), Bank Islam (Malaysia), Faisal Islamic Bank (Sudan) and Bank AlJazira (Saudi Arabia). The study is descriptive, uses simple statistical tools, and presents its findings mainly in tables and graphs.

4.2 Conceptualization of Islamic Banking Products and Their Development

4.2.1 Conceptualization of Islamic Banking Products

The products and services of Islamic banks are usually formed by using the principle of *Muamalat* such as *cost-plus sale (Murabahah)*, *Istisna'a*, *Bai Salam*, *lease (Ijarah)*, *profit-sharing partnership (Mudarabah)*, *partnership (Musharakah)*, *agency (Wakalah)*, *guarantee (Kafalah)*, etc. These products are developed in various phases in almost all countries.

Various modes of finance used by Islamic banks for fund mobilization and use of such funds can be categorized as participatory, non-participatory and accessory modes. In case of participatory mode, the bank takes a direct participation in the business or project and shares in the profits (or losses) of that enterprise. For this reason, it is referred to as profit-and-loss sharing. Strictly speaking this mode is not so much a financing method but more an equity investment by the bank into the enterprise. The main instruments or contracts used by this participatory mode are the various forms of *Mudarabah* and *Musharakah*.

Non-participatory mode — where the bank does not take a direct equity investment in the business but provides financing for the acquisition of an asset *(Murabahah)*, or for the use of that asset *(Ijarah)*, or for the production of that asset *(Salam* or *Istisna'a)* on behalf of its client. But in case of accessory mode, the bank plays some role acting on behalf of the client either as

agent or guarantor or acts in some other accessory role for the client. Islamic finance terminologies are summarized in Appendix 7.

4.2.2 Product Development Process

Most Islamic products are introduced as an alternative to conventional products. Looking at the ever changing and dynamic environment, Islamic banks need to innovate and create new products to remain competitive. The products must be attractive and appealing to individual and corporate clients. Not only that, but the advancement of technology and the evolution of financial markets demand that new products/services be introduced on a timely basis. To introduce a new product onto the market, the risk of failure has to be taken into account which is very high. Quite recently made researches show that on the consumer market in the U.S.A. 95% of all novelties are unsuccessful, while in Europe 90% of innovations fail (Kotler, 2006). There are number of stages/steps for a banking product development which is presented in Figure 4.1.

Idea Creation: The first step in developing a new financial product is to conceptualize it. The idea for a new product can arise from a variety of sources, such as client demand, internal sales force or a third party.

Idea Screening: At this stage, the product development team has to translate the idea into a tangible product that can be sold to the institution's clientele at a reasonable profit. The development team has to walk a fine line in devising a product that is neither unnecessarily complex (a real risk with financial products), nor is so plain-vanilla that it is easy for the competition to replicate.

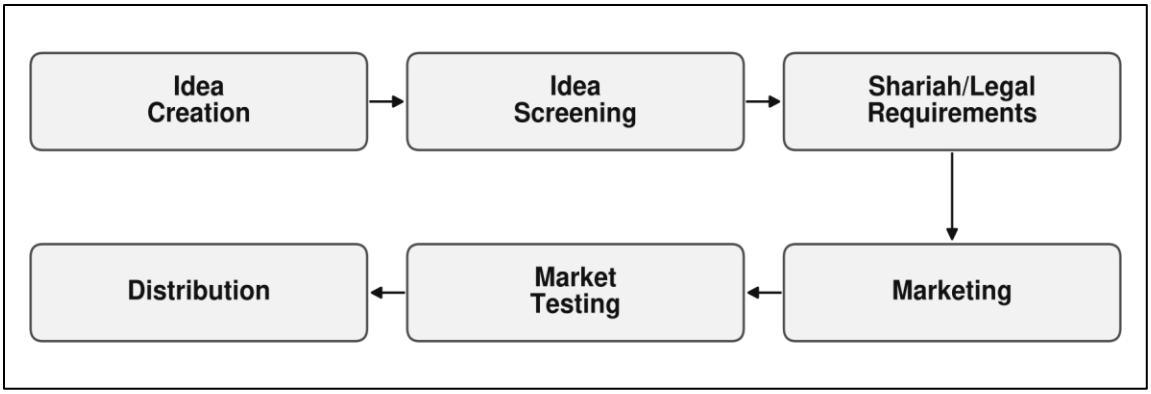
Regulatory or Legal Requirements: The new product must meet securities regulations mandated by the appropriate authority. As we are focusing on the Islamic banking products so the new products must be compliance with Islamic law (Shariah) principle.

Marketing: Marketing the new product is vital to ensure its success. This phase also involves educating the client if the product is quite complex. Developing marketing literature such as brochures and presentations that effectively communicate the product's features and benefits, and formulating a cohesive media strategy, are time-intensive activities that can take weeks to complete.

Market Testing: When product manufacturing is finished, the companies can make market testing be-fore its market promotion. Coming to this stage a product turns from an idea into a physical prototype. The product preparation for introduction onto the market must be launched, but before that the market testing is highly advisable.

Distribution: This is another key step, since if there is no effective sales force to sell or distribute the product, it will be doomed to failure. The firm or institution has to make a number of important decisions at this stage who will sell the product, how will they be compensated, what is the level of compensation and so on. The product's attributes are essential for determining the right target audience for it.

Figure 4.1: Banking Product Development Stages



Source: Based on Stols (2015).

4.3 Literature Review

Product diversification is a strategic decision with far-reaching implications for an organization's structure, systems and performance (Ansoff, 1957). Banking theory holds that it reduces bankruptcy risk by spreading resources across industries (Haugen, 2001) and lowers monitoring costs (Diamond, 1984), although corporate finance theory favors concentration (Laeven & Levine, 2007).

Banks may diversify their credit portfolios to improve performance and reduce risk, yet Acharya et al. (2002) found that industrial and sectoral diversification reduces returns while producing riskier loans.

Evidence on performance is mixed: Cubo-Ottone and Nurgia (2000) find a significant positive relation between diversification and abnormal returns, whereas Mercieca et al. (2007) find no direct benefit within or across business lines. New products often fail — more than 65% of newly launched products (Adams, 2010), frequently because they are unattractive (Euchner, 2008), and almost 90% miss their business objectives (Yahaya & Bakar, 2007) — although new product development, a complex, higher-order capability spanning multiple functions, is an important precursor of performance (Mishra & Shah, 2009; Bendoly, Bharadwaj & Bharadwaj, 2012).

Organizations increasingly recognize that new product development is vital to survival (Im & Rai, 2008), yet diversification has received less attention than performance and efficiency in Islamic banking (Chatti et al., 2008), and Goddard et al. (2008) conclude that diversification strategies should vary with institution size. Good customer relationships improve satisfaction and performance (Lo, 2012), and since customers routinely switch providers — nearly two-thirds have left a company for a competitor (Genesys, 2009) — Islamic banks in Bangladesh, part of the fast-growing services sector, seek to retain customers through new and innovative products and services such as internet banking (Ragoobur, Ayrga & Doomun, 2010).

Galbraith (2008) distinguishes related, linked and unrelated diversification: unrelated diversification shares little beyond finance and management, while related diversification adds synergies in technology, marketing, distribution or production; diversification may also extend backward or forward from existing products.

Studies across countries generally find benefits. Diversifying across sectors widens deposit opportunities and client niches (Rossi & Winkler, 2009), though combined with weak deposit-market power it may raise risk (Craig & Dinger, 2013). Income or product diversification increases risk-adjusted returns and performance in Italy (Chiorazzo et al., 2008; Cotugno & Stefanelli, 2012), in emerging economies (Sanya & Wolfe, 2011) and in the Philippines (Meslier et al., 2014), and increases lending capacity in the United States of America (USA) (Morgan & Stolyk, 2003), where small community banks benefit within but not between broad activity classes (Stiroh, 2004).

Securitization diversifies loan portfolios in Brazil (Cabiles, 2012). Insurers' diversification is not driven by risk pooling (Berry-Stölzle et al., 2011). Brokerage and investment activities improve financial firms' access to information in Canada (Rowley & Baum, 2009); and further work examines credit portfolios and the determinants of diversification in Turkey (Gönenç & Kılıçhan, 2004) and India (Bandyopadhyay, 2010; Arora & Kaur, 2009), cost-driven diversification in Japan (Kiyohiko & Rose, 2008), and public sector banks' limited non-interest activities in India (Pennathur et al., 2012). For Islamic banks, which have no interest income, diversification must be defined differently (Mercieca et al., 2007).

Sukuk also offer diversification gains, particularly during financial crises (Paltrinieri et al., 2015), including among local-currency Sukuk in Malaysia (Najeeb, Bacha & Masih, 2014), and firms that diversify into new products benefit (Hitt, Hoskisson & Kim, 2011).

Most of these studies concern conventional banks, and the few on Islamic banking focus on Malaysia and the Gulf Cooperation Council (GCC); such work is rare in Bangladesh, which this study seeks to address by examining the importance of diversifying Islamic banking products and services.

4.4 Status of Islamic Banking Products

The global and domestic landscape of Islamic banking — asset growth, market shares, financing modes and performance indicators — is presented with more recent data in Chapter 3. The discussion below concentrates on the product mix of Islamic banks in Bangladesh and on product-related practices as observed at the time of the study.

4.4.1 Islamic Banking in Bangladesh

Fixed deposits make up about 54% of Islamic banks' deposits, against 48% for private commercial banks and 46% for the industry (Table 4.1). Islamic banks have the lowest share of cost-free current accounts but a much higher share of recurring deposits, which bring regular inflows.

Table 4.1: Deposits distributed by types of accounts (%)

Types of Account	All Banks		PCBs including IBs		IBs	
	2017*	**2016***	**2017***	**2016***	**2017***	**2016***
Current and cash credit account	8.28	7.58	7.07	6.68	4.03	3.98
Savings deposits	20.67	20.04	17.98	17.53	18.96	19.21
Foreign currency account	0.43	0.54	0.12	0.15	0.1	0.14
Special notice deposits	10.27	8.76	9.23	8.21	3.54	2.72

Types of Account	All Banks		PCBs including IBs		IBs	
	2017*	2016*	2017*	2016*	2017*	2016*
Fixed deposits	45.63	48.84	48.45	51.12	54.20	54.05
Recurring deposits	7.86	7.85	9.52	9.49	12.64	12.83
Others	6.86	6.39	7.58	7.22	6.53	7.07
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Scheduled Banks Statistics, Bangladesh Bank.

*Note: *As on September 30.*

Most investment across the industry is secured by real estate, and at about 80% Islamic banks' share is even higher (Table 4.2); their investment against personal guarantees fell sharply, from 10.09% in 2016 to 2.70% in 2017. Islamic banks could serve society better by expanding unsecured investment such as microfinance.

Table 4.2: Investment (advances) categorized by securities (%)

Types of Securities	All Banks		PCBs including IBs		IBs	
	2017*	2016*	2017*	2016*	2017*	2016*
Machinery/Fixed assets	3.96	5.02	2.48	3.15	1.12	0.79
Commodities	4.95	6.21	4.48	4.94	3.60	2.98
Real estate	61.34	59.27	65.62	63.66	79.12	73.25
Financial obligations only	7.98	7.47	8.12	7.95	10.77	9.75
Guarantee of individuals	9.11	8.98	9.67	9.33	2.70	10.09
Others	11.7	12.04	9.15	10.45	2.65	2.8
Without security	0.96	1.01	0.48	0.52	0.04	0.34
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Scheduled Banks Statistics, Bangladesh Bank.

*Note: *As on September 30. The percentages are as reported in the source.*

By economic purpose (Table 4.3), trade and commerce takes the largest share of banking investment (34.38%) and about 41% of Islamic banks' investment, while agriculture, fishing and forestry, though a development priority, received only 1.88% of Islamic banks' investment in 2017, despite an increase from 2016.

Table 4.3: Investments (advances) categorized by economic purposes and sector (%)

Economic Purposes	All banks		PCBs including IB		IB	
	2017*	2016*	2017*	2016*	2017*	2016*
Agriculture, Fishing & Forestry	5.10	5.37	2.02	1.79	1.88	0.89
Industrial term loan	18.69	17.62	16.65	16.43	12.78	12.64
Industrial WC financing	21.59	20.22	23.96	22.43	26.78	23.48
Construction	9.02	8.98	9.67	9.63	9.33	8.80
Trade & Commerce	34.38	35.76	37.67	38.54	40.73	41.86
Consumer Finance	7.58	8.35	6.42	7.64	6.19	10.5
Others	3.64	3.7	3.61	3.54	2.31	1.83
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: Scheduled Banks Statistics, Bangladesh Bank.

*Note: *As on September 30.*

Islamic banks mobilize deposits mainly under Mudarabah (Table 4.4), with 4.41% in safe custody (Wadiah) current accounts and further funds through cash endowment (Waqf) and benevolent loan (Qard Hasan) deposits.

Table 4.4: Mode-wise deposit distribution of Islamic banks in Bangladesh (%)

Mode of Deposit	2017	2016	Change
Mudarabah Term Deposit	47.45	47.35	0.10
Mudarabah Savings Deposit	18.38	18.61	(0.23)
Special Scheme Deposit**	N/A	10.34	N/A
Mudarabah Special Savings Deposit	8.71	8.98	(0.27)
Wadiah Current Deposit	4.41	4.05	0.36
Mudarabah Special Notice Deposit	3.76	3.2	0.56
Mudarabah Savings Bond	.75	0.9	(0.15)
Mudarabah Hajj Deposit	.22	0.28	(0.06)
Cash Waqf Deposit**	N/A	0.06	N/A
Qard Hasan Deposit**	N/A	0.03	N/A
Other Deposits	16.32	6.2	10.12

Source: Quarterly Report on Development of Islamic Banking in Bangladesh, Bangladesh Bank.
*Note: *Rounding-off. **Might be included in Other Deposit group.*

By investment mode (Table 4.5), Islamic banks use Bai (trading), Ijarah (leasing), Shirkah (sharing) and Qard (interest-free loans); as elsewhere, trading modes dominate in Bangladesh, although wider use of sharing modes (Mudarabah and Musharakah) would better display the distinctive merits of Islamic banking.

Table 4.5: Mode-wise investment distribution of Islamic banks in Bangladesh (%)

Mode of Investment	2017	2016	Change
Bai-Murabahah	43.81	44.64	(0.83)
Bai-Muajjal	25.17	25.24	(0.07)
HPSM	16.94	15.48	1.46
Ijarah & Ijarah-Bil-Bai	7.35	7.41	(0.06)
Musharakah	1.53	1.59	(0.06)
Qard with Security	1.32	1.31	0.01
Bai-Salam	0.96	0.8	0.16
Mudarabah	0.26	0.32	(0.06)
Bai-Istisna'a	0.22	0.23	(0.01)
Others	2.44	2.98	(0.54)
Total	100	100	0.00

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

4.4.2 Banking Products in Bangladesh

4.4.2.1 Deposit Mobilization and General Banking Operations in Islamic Banks

On general banking and deposits (Table 4.6), about 30% of banks report extra formalities for opening accounts, although most are comfortable with the regulations; 25% perceive a deficiency in deposit products, despite recent launches. Most use the weightage-based method for returns. Religious products such as Hajj, Mohor, marriage and Waqf deposit accounts are offered, and respondents see a lack of long-term deposit products.

Table 4.6: General banking operations including deposit mobilization in Islamic banking

S/N	Aspect		Response
1.	Banks where there is any additional formality/document required for opening deposit a/c as an Islamic bank (%)		30.77
2.	Banks facing any regulatory/policy difficulty for collecting deposit as an Islamic bank (%)		7.7
3.	Banks believing that there is a deficiency in deposit products in Bangladesh for meeting customer needs (%)		25.00
4.	Framework for rate of return calculation for the Mudarabah depositors followed by your bank (%)	Weightage-based method	84.62
		ISR-based method	15.38
5.	Introduction of new deposit products (Islamic) in bank (%)	In last year (2017)	25
		Within last two years	36.36
		Within last five years	75.00
6.	Special religious-deposit products in Islamic bank (%)	Hajj savings deposit	85.71
		Muhor savings deposit	75.00
		Cash Waqf deposit	55.56
		Others (Marriage Deposit, etc.)	16.67

Source: Survey Data.

Most full-fledged Islamic banks (FFIBs) have issued bonds for long-term funds, unlike Islamic banking branches and windows (IBBWs), and FFIBs offer more deposit products (Table 4.7). Deposits generally have no upper limit, though some monthly schemes do. Most FFIBs and a few IBBWs offer products without a minimum balance. Some products target students, women, garment workers, farmers and the underprivileged, and some are linked to future investment, such as house-building deposit schemes.

Table 4.7: Issues on Long-Term Fund and Deposit Mobilization by Islamic Banks

S/N	Aspect	Positive Response (%)	
		FFIB*	IBBW*
1.	Banks having Islamic bond for collecting long-term fund	72	0
2.	Average number of deposit products under Islamic mode in bank	26	13
3.	Banks having any upper limit of amount for your Islamic deposit product	30	13
4.	Banks having any minimum limit of amount for your Islamic deposit product	75	75
5.	Maximum tenure of Islamic deposit product in your bank	25	20
6.	Banks having any Islamic deposit product which does not require minimum balance	72	13
7.	Banks having any special Islamic deposit product for students	100	43
8.	Banks having any special Islamic deposit product for women	60	57
9.	Banks having any special Islamic deposit product for farmers	100	43
10.	Banks having any special Islamic deposit product for garment-workers	72	25
11.	Banks having any special Islamic deposit product for underprivileged segment of population	60	29
12.	Banks having any customized deposit products for corporates	30	43
13.	Banks having Investment-linked Islamic deposit products	60	43

Source: Survey Data.
*Note: *FFIB = Full-Fledged Islamic Bank and IBBW = Islamic Banking Branch/Window.*

Some banks market specially labeled deposit products (Table 4.8) for customers such as corporations, retirees, the underprivileged, non-resident Bangladeshis and low-income earners, or for needs such as education, healthcare, shelter and social safety.

Table 4.8: Specially Labeled Deposit Products in Bangladesh

S/N	Specially Labeled Product	Target Group/Purpose
1.	Senior Citizen/Month Profit/Money Plant Deposit Scheme	Retired Person
2.	High Value Deposit A/c	Corporate
3.	Brighter Tomorrow/Nobagoto Deposit Scheme	New Borne Baby
4.	Special Savings Scheme for Low Income	Underprivileged Segment
5.	Hajj/Marriage/Mohor/Zakat Savings A/c	Religious
6.	Education/Healthcare Deposit Scheme	Basic Needs
7.	Probashi Deposit/NRB Trouble Deposit Scheme	Wage Earners
8.	Al-Wadiah Current Plus/Premium A/c	Current Account with Profit/insurance coverage
9.	Laksmapuran/Millionaire Deposit Scheme	Social Safety Net
10.	Shramajibi/ Mehnoty Savings Deposit	Workers
11.	Shuvecha/ Upohar Deposit Scheme	Households & Businesses
12.	Savings Bond	Middle & Higher Income Group
13.	Shukher Thikana/ Bashasthan/ House Building Deposit Scheme	Fund accommodation linked with home finance
14.	Shamriddhir Shopan Deposit Scheme	SME Entrepreneurs

Source: Survey Data.

4.4.2.2 Investment Operations in Islamic Banks

Most banks require no additional documents for investment accounts and face no difficulty investing funds (Table 4.9), but many see a deficiency in investment products and are developing new ones, and some offer interest-free Qard for social welfare. Respondents cite rising non-performing investment, a lack of legal support for Shirkah investment, and a lack of products for land purchase and for long-term home finance matched to clients' cash flows.

Table 4.9: Investment operations in Islamic banking

S/N	Aspect		Response (%)
1.	Banks where there is any additional formality/ document required for opening investment a/c in your Islamic bank (%)		33.33
2.	Banks facing any regulatory/policy difficulty for investing fund as an Islamic bank (%)		33.33
3.	Banks having Islamic credit card (%)		23.08
4.	Banks believing that there is a deficiency in investment products in Bangladesh for meeting customer needs (%)		66.67
5.	Introduction of new investment products (Islamic) in bank (%)	In last year (2017)	33.33
		Within last two years	33.33
		Within last five years	37.50
6.	Banks having special investment products for charity purpose (%)	Qard Hasan for own employees	36.36
		Qard Hasan for others	27.27
		Others (Qard against MTDR, etc.)	33.33

Source: Survey Data.

FFIBs offer more diversified investment products than IBBWs (Table 4.10), with maximum tenures of 25 years in both. Few IBBWs have investment products for students. About half of Islamic banks have products for women entrepreneurs but none for garment workers. Special schemes such as the Rural Development Scheme (RDS) and Urban Poor Development Scheme (UPDS) serve the underprivileged, and half offer deposit-linked products such as Qard against deposits and the Micro Enterprise Investment Scheme (MEIS).

Table 4.10: Issues Related with Islamic Banking Investment Products

S/N	Aspect	Positive Response (%)	
		FFIB*	IBBW*
1.	Average number of investment products under Islamic mode in bank	26	15
2.	Maximum tenure of Islamic investment product in bank	25	25
3.	Banks having any special Islamic investment product for students of schools and colleges	0	13
4.	Banks having any special Islamic investment product for household women	13	0
5.	Banks having any special Islamic investment product for woman entrepreneurs	50	50
6.	Banks having any special Islamic investment product for farmers	50	25
7.	Banks having any special Islamic investment product for garment-workers	0	0
8.	Banks having any special Islamic investment product for underprivileged segment of population	13	0
9.	Banks having any customized investment products for corporates	13	38
10.	Banks having deposit-linked Islamic investment products	50	50

Source: Survey Data.

*Note: *FFIB = Full-Fledged Islamic Bank and IBBW = Islamic Banking Branch/Window.*

Specially labeled investment products (Table 4.11) include Sahayak, the Marriage Investment Scheme, Saahib Finance, schemes for mosques and madrasas, Hajj Finance, Ladies Banking, Bahan, Uddyog, the Non-Resident Bangladeshi (NRB) Entrepreneurs Investment Scheme (NEIS) and the Women Entrepreneurs Investment Scheme (WEIS). Respondents suggest promoting domestic and international factoring and asset securitization.

Table 4.11: Specially Labeled Investment Products in Bangladesh

S/N	Specially Labeled Product	Target Group/Purpose
1.	Sahayak	Household Durables Investment
2.	Marriage Investment Scheme	Fund accumulation for meeting marriage expense
3.	Saahib Finance	Personal loan
4.	Investment Scheme for Mosque/Madrasa	Building and expansion
5.	Hajj Finance Investment Scheme	Intended to perform Hajj
6.	Ladies Banking	Banking branch operated by and for women
7.	Bahan/Rahabar	Automobile
8.	Uddyog/ Abalombon	SME
9.	NRB Entrepreneurs Investment Scheme (NEIS)	Non-Resident Bangladeshi Entrepreneurs
10.	Women Entrepreneurs Investment Scheme (WEIS)	To assist the potential unemployed women to involve them in production process

Source: Survey Data.

4.4.2.3 Foreign Exchange Operations in Islamic Banks

In foreign exchange (Table 4.12), conventional banks with Islamic branches or windows provide FOREX services through their conventional operations, and full-fledged Islamic banks mainly use cash in advance, documentary collection and documentary credit. 'open account' export financing is not allowed in Bangladesh but could be practiced under Wakalah if permitted. Islamic banks face few difficulties, except when non-funded facilities must be converted into funded ones without actual goods or when foreign counterparts demand interest, and respondents recommend an Islamic wage earners' bond.

Table 4.12: FOREX operations and Off-Balance Sheet activities in Islamic banking

S/N	Aspect	Response	
		FFIB	**IBBW**
1.	Banks practicing 'Cash in Advance' as a trade payment method in Islamic banking unit (%)	63 (Salam, Sarf, Wakalah, etc.)	**Generally, these services are provided through conventional banking units of these types of banks**
2.	Bank facing difficulty to practice 'Cash in Advance' as an Islamic bank (%)	0	
3.	Banks practicing 'Open Account' as a trade payment method in Islamic banking unit (%)	Not allowed in Bd (May be Salam, Wakalah)	
4.	Banks practicing 'Documentary Collection' as a trade payment method in Islamic banking unit (%)	75 (Wakalah, etc.)	
5.	Bank facing difficulty to practice 'Documentary Collection' as an Islamic bank (%)	0	
6.	Banks practicing 'Documentary Credit (LC)' as a trade payment method in Islamic banking unit (%)	100	
7.	Bank facing difficulty to practice 'Documentary Credit (LC)' as an Islamic bank	0	
8.	Banks providing 'Acceptance & Endorsements' service as an Off-Balance Sheet activity through Islamic banking unit (%)	88 (Kafalah)	
9.	Bank facing difficulty to provide 'Acceptance & Endorsements' service as an Islamic bank (%)	0	
10.	Banks providing 'Letter of Guarantee' service as an Off-Balance Sheet activity through Islamic banking unit (%)	75 (Kafalah)	
11.	Bank facing difficulty to provide 'Letter of Guarantee' service as an Islamic bank (%)	0	
12.	Banks providing 'Bill Collection' service as an Off-Balance Sheet activity through Islamic banking unit (%)	88 (Wakalah, etc.)	
13.	Bank facing difficulty to provide 'Bill Collection' service as an Islamic bank (%)	0	
14.	Banks providing any other service as an Off-Balance Sheet activity through Islamic banking unit (%)	88	
15.	Bank facing difficulty to provide such service as an Islamic bank (%)	0	
16.	Banks practicing 'Back-to-Back LC' as a pre-shipment credit to exporter in Islamic banking unit (%)	88 (Kafalah, Muajjal, etc.)	
17.	Banks facing difficulty to practice 'Back-to-Back LC' as an Islamic bank (%)	13 (Problem to create force investment in case of non-existence of goods)	

S/N	Aspect	Response	
		FFIB	IBBW
18.	Banks offering post-shipment credit facilities to exporter through Islamic banking unit (%)	75	
19.	Banks facing difficulty to offer such credit facility to exporter as an Islamic bank (%)	0	
20.	Banks offering product for financing to importer through Islamic banking unit (%)	100	
21.	Banks facing difficulty to offer such financing facility to importer as an Islamic bank (%)	0	
22.	Full-fledged Islamic banks having offshore banking unit (%)	63	
23.	Banks facing difficulty for Offshore banking operations as an Islamic bank (%)	13 (Might requires to pay interest to foreign banks)	

Source: Survey Data.

4.4.2.4 Treasury Operations in Islamic Banks

In treasury operations (Table 4.13), Islamic banks avoid the interest-bearing money market but may transact within the Islamic banking industry, and most SSCs have approved spot FOREX transactions. Liquidity management is a crucial problem: bankers propose Islamic treasury bills and bonds, Sukuk, a Shariah-compliant system for repo and reverse repo, a developed Islamic fund market and a benchmark for Islamic transactions, and cite accounting problems such as the lack of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)-compliant financial statement formats and of separate investment classification criteria.

Table 4.13: Treasury Operations in Islamic Banking

S/N	Aspect	Response (%)
1.	Islamic banks participating in call money market with other IB	38.46
2.	Islamic banks participating in call money market with other conventional banks	7.69
3.	Islamic banks participating in 'Repo and Reverse Repo' transactions	0.00
4.	Islamic banks participating in 'FOREX-Spot' transactions	38.46
5.	Banks facing difficulty to participate in 'FOREX-Spot' transactions	16.67
6.	Islamic banks participating in 'FOREX-Forward' transactions	7.69
7.	Banks facing difficulty to participate in 'FOREX-Forward' transactions	N/A
8.	Islamic banks participating in 'FOREX-Swap' transactions	7.69
9.	Banks facing difficulty to participate in 'FOREX-Swap' transactions	N/A

Source: Survey Data.

4.4.2.5 Other Issues Related with Islamic Banks

On product development and sustainability (Table 4.14), some banks lack well-functioning research departments, most do not keep databases of national and international products, and few have recently surveyed the market, although some have launched new products. Bankers point to the lack of a separate Islamic banking Act, an independent central Shariah board, and sufficient scholars and training institutions, and call for better publicity and coordinated support from the government, regulators, banks and customers.

Table 4.14: Issues Related with Product Development and Sustainability of Islamic Banking

S/N	Aspect	Positive Response (%)
1.	Banks having research department	38.46
2.	Banks maintaining data-base for Islamic financial product and services offered by local IBs	30.77
3.	Banks maintaining data-base for Islamic financial product and services offered in other countries	0.00
4.	Banks conduct market survey within last 5 years to know demand-side perception/need?	16.67
5.	Did you design any new Islamic banking product within last 5 years as a pioneer in Bangladesh?	23.08
6.	Do you have any Islamic banking product/services in your bank which was not asked by a single customer within last 5 years?	25.00
7.	Did you drop/discontinue any old Islamic banking product within last 5 years from your bank?	16.67

Source: Survey Data.
*Note: *FFIB = Full-Fledged Islamic Bank and IBBW = Islamic Banking Branch/Window.*

The original study also examined the prospects of Sukuk as an instrument for liquidity management and product diversification. As Sukuk and the Islamic capital market are treated comprehensively in Part III (Chapter 9 and Chapter 10), that material is not repeated here.

4.5 Concluding Remarks

Product diversification is essential for adapting to a changing environment and customer needs, expanding markets and ensuring sustainability. Islamic banks now offer diversified services alongside conventional banks, but there remains great scope to diversify their products and improve the industry's efficiency. The study concludes with the following observations.

(i) Islamic banks lack counterparties for Profit-and-Loss Sharing (PLS) (Mudarabah and Musharakah) investment; following Malaysia and Pakistan, they could promote Diminishing Musharakah, rethink its process and pricing, and seek regulatory support.

(ii) Islamic banking products should be simple and transparent, but translating their names into other languages risks losing their spirit; instead, the system and its products should be explained properly so that ordinary customers understand them.

(iii) To be profitable, an Islamic bank must build strong partnerships with customers, select investment clients for Shariah compliance and growth potential, and channel resources from the wealthy to the poor, including from obligatory alms (Zakat) payers to those seeking a better life.

(iv) Neither conventional nor Islamic banks collect long-term deposits, mainly because of interest rate volatility; Islamic banks could introduce long-term deposit products, whose market risk is limited under the Mudarabah principle.

(v) Shariah-compliant money market products are scarce in Bangladesh; the authorities and Islamic banks could structure short-term liquidity products, the central bank could design Shariah-compliant repo and reverse repo instruments, and the industry could develop Shariah-compliant derivatives for risk management.

(vi) To expand their markets, Islamic banks could design products for latent demand, such as deposit-linked investment and investment-linked deposit products, and pioneer a true deposit pension scheme, which no bank yet offers.

(vii) Islamic banks lack products for cash assistance to clients and could practice factoring and asset securitization to meet emerging business needs.

Islam promotes real economic activity, leaving ample room within Shariah to design products for existing and potential customers. Innovation and diversification benefit banks, the industry and the economy, and collective efforts by the government, regulators and market participants can foster the development of Shariah-based products and economic growth.

Chapter 5: Application of the Murabahah Mode of Financing: Issues and Recommendations

Based on the study "Application of Murabahah Mode of Financing by Islamic Banks of Bangladesh: Issues and Recommendations" by Md. Mahabbat Hossain, Md. Atiqur Rahman Khan Khadem and Mezbah Uddin Ahmed.

5.1 Introduction

Murabahah is a trust-based sale in which the seller discloses the cost of the goods and adds an agreed mark-up to set the price; disclosure of cost and mark-up distinguishes it from other sales. Deferred payment is not essential to Murabahah but is common in Islamic banking, creating a debt once the contract is executed, which is why Murabahah, though a sale, is often called debt financing (Miah & Suzuki, 2020).

The subject matter must exist at the time of contract, and the seller must own and possess it, physically or constructively, so bank and customer must follow a set sequence of steps for Islamic law (Shariah) compliance.

deferred-payment sale (Bai-Muajjal), an adaptation used by some Islamic banks in Bangladesh, is not a separate contract but the deferred-payment feature of a sale executed as Murabahah or negotiated-price sale (Musawamah); in Musawamah the seller need not disclose cost and mark-up separately, but the other Shariah rulings are the same. In this chapter 'Murabahah' includes Bai-Muajjal (also termed Bai Bithaman Ajil) unless the context requires otherwise.

Murabahah is the main financing mode of Islamic banks in Bangladesh and elsewhere. Examining 81 Islamic banks and financial institutions in 1994–95, Yousef (2004) described a 'Murabahah syndrome', with Murabahah accounting for 67% of financing in the Middle East and North Africa, 44.7% in East Asia, 67.5% in South Asia and 48.4% in Sub-Saharan Africa. It represented 54% of financing in Malaysia in June 2022, including Bai Bithaman Ajil (Bank Negara Malaysia, 2022), and 68.3% in Bangladesh in March 2022, including Bai-Muajjal (Bangladesh Bank, 2022).

Given its importance, Murabahah practice must comply with Shariah — in the product financed, the determination and disclosure of price and the sequence of steps — and stakeholders frequently question Islamic banks' Shariah compliance. This study examines how Islamic banks in Bangladesh apply Murabahah in their investment products and compares their practices with the Shariah requirements of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and other reputed Shariah authorities.

5.1.1 Objective and Scope of the Study

Although Islamic banks are often criticized for heavy reliance on Murabahah, which creates debt, Murabahah is Shariah-compliant and Shariah prefers no concept over another, so the study does not debate its merits; nor does it cover monetization (Tawarruq) or commodity Murabahah, which are not generally practiced in Bangladesh.

5.1.2 Research Methodology

The study analyzes the Murabahah contract documents of all full-fledged Islamic banks. Interviews 57 Islamic banking practitioners on the process flows and operations of Murabahah-based products, validated through FGDs. Conducts an opinion survey on a 10-point scale, and uses secondary data from Bangladesh Bank, the Islamic Financial Services Board (IFSB), Bank Negara Malaysia and the State Bank of Pakistan. It then proposes recommendations for improving Murabahah-based investment and Shariah compliance.

5.2 Literature on Murabahah

5.2.1 Legality of Murabahah

'Murabahah', derived from 'Ribh' (profit), is a Fiqh term for a sale in which buyer and seller agree on the markup (Usmani, 1998). As a commercial transaction (Muamalat), it is generally permissible (ISRA, 2020), its legitimacy resting on the consent of the majority of jurists (ISRA, 2016), provided its own conditions are met. Trade is endorsed in the Qur'an — "Allāh has permitted trade and has forbidden Riba" (2:275; see also 2:282 on credit transactions, 4:29 and 24:37) — and in the Hadith, which places the truthful, trustworthy merchant with the Prophets, the truthful and the martyrs (Sunan at-Tirmidhi, 1209) and promises blessing to transactions conducted with honesty and full disclosure (Sahih Muslim, 3715).

5.2.2 The Murabahah Concept

A sale is an exchange of things of value by mutual consent, and Shariah scholars have set out the rules governing Murabahah. The item must be lawful and of value in Shariah, specifically identified (by pointing or detailed specification), in existence at the time of the contract, and owned and possessed — physically or constructively — by the seller. Constructive possession means that control and all rights and risks, including impairment, have passed to the seller, who may buy directly or through an agent. The sale is concluded by offer and acceptance. The cost must be stated separately and the price must be certain and known to both parties; and the sale must be absolute, immediate and unconditional — a sale attributed to a future date or contingent on a future event is void, although a unilateral promise to sell in future is permissible. Box 5.1 summarizes these rules.

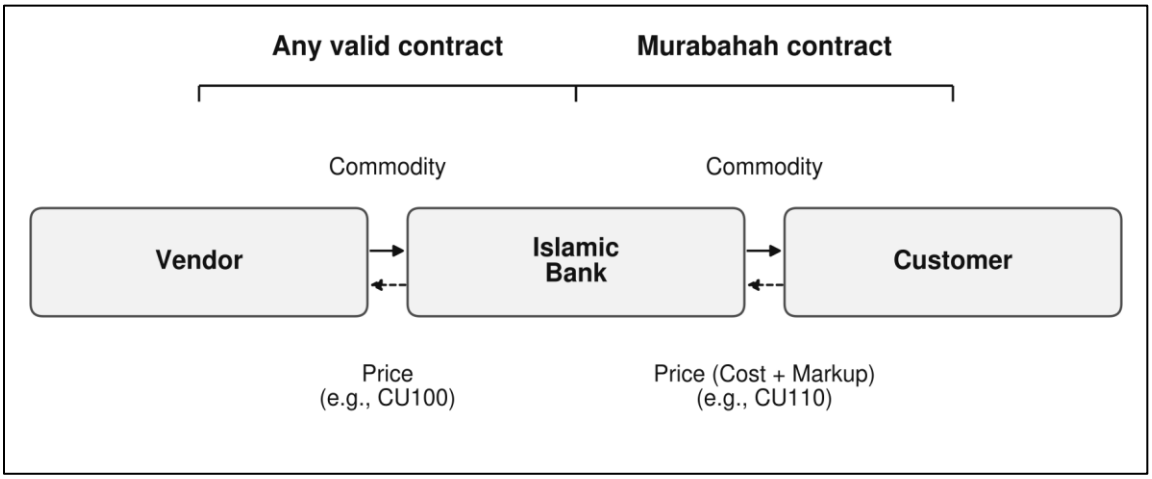
Box 5.1: A Summary of Basic Rules of Murabahah

Rule 1:	Permissible goods
Rule 2:	The subject matter of the sale contract must be specifically known and identified to the buyer.
Rule 3:	Existence, ownership, and possession of goods at the time of Murabahah contract. However, this is not a condition at the time of promise.
Rule 4:	The delivery to the buyer of the sold item must be certain (should not depend on a contingency or chance).
Rule 5:	The sale must be absolute, instant, and unconditional.
Rule 6:	The sale is executed through exchange of offer and acceptance.
Rule 7:	The cost of the seller must be determined and disclosed.
Rule 8:	The certainty of price is a necessary condition for the validity of the sale. It must be known to both parties and cannot be varied after the contract is executed.
Rule 9:	The transaction must be genuine, i.e., there should be genuine buy and sell of the subject matter, not just signing of some documents.

Source: Authors' Compilation.

Unlike an ordinary seller, who buys goods for known and unknown customers and bears the risks of damage, price falls and failing to find a buyer, an Islamic bank minimizes ownership risk by buying only against a customer's specific purchase order. This is known as banking Murabahah or Murabahah to the purchase orderer (MPO); Figure 5.1 shows its modus operandi.

Figure 5.1: Modus Operandi of a Murabahah to the Purchase Orderer



Source: Authors' Compilation.

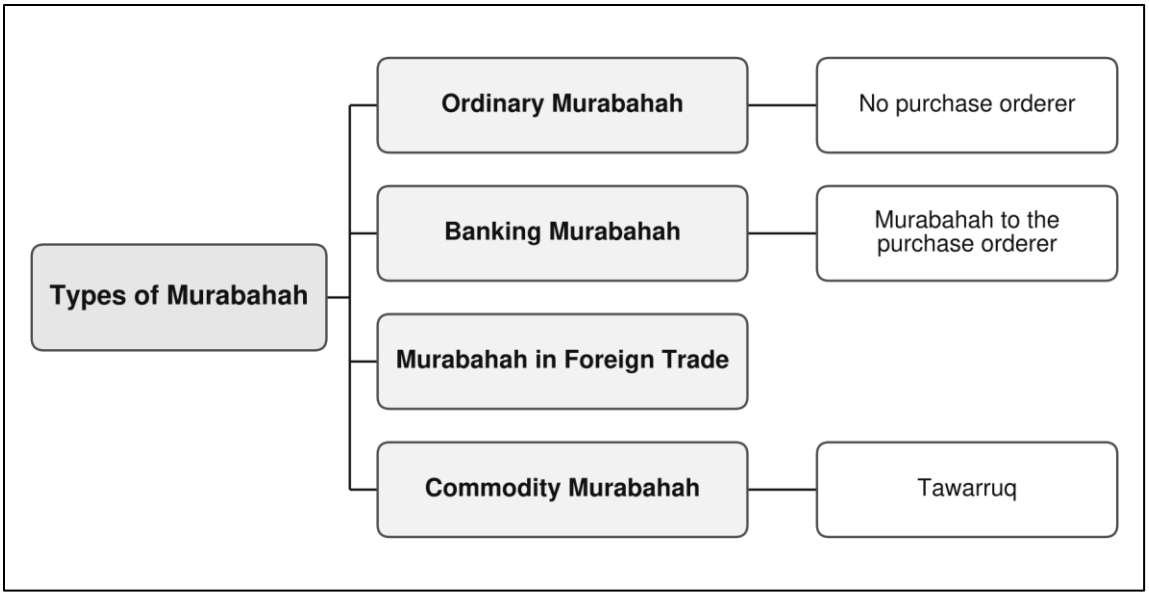
For example, at a customer's request the bank buys a commodity for CU100 from a vendor (who may be specified by the customer), discloses this cost, and sells the commodity to the customer with an agreed markup of CU10 for CU110. Because a seller cannot sell what he does not own, the bank must take ownership of the asset before selling it to the customer.

MPO is of two types, depending on whether the customer's promise to buy is binding. If it is not, the bank bears the full ownership risk: if the customer declines, the bank has no recourse, must refund any deposit, and must return the asset to the supplier or find another buyer, bearing any resulting loss — which is why this type is not practiced. If the promise is binding, the bank can recover its actual loss (not opportunity cost) from the customer, depending on whether a Hamish Jiddiyyah (security deposit) or Urbun (earnest money) was taken.

Credit is not an essential feature of Murabahah: payment may be immediate or deferred, as a lump sum or in installments. Islamic banks use it, however, mainly to finance customers who cannot pay the full price, and the financing may cover all or part of it.

Based on the practices of Islamic banks around the world, Murabahah can be divided into four types, which are identified in Figure 5.2.

Figure 5.2: Types of Murabahah



Source: Authors' Compilation.

5.2.3 Regulatory Framework for Banking Murabahah in Bangladesh

The Bank Company Act (BCA), 1991 is the primary law for establishing and operating banking business in Bangladesh, which is applicable for both Islamic and conventional banks. There is no separate law for conducting Islamic banking operations in Bangladesh. Some executive provisions have been incorporated in BCA 1991 to accommodate certain needs of Islamic banking activities, including involving in trading activities. For instance, although Section 9 of BCA 1991 prohibited the conventional banks in direct or indirect buying, selling or bartering of any articles or goods, it exempted the Islamic banks from this prohibition.

The *Guidelines for Islamic Banking* issued by Bangladesh Bank on 9 November 2009 vide Banking Regulation and Policy Department (BRPD) Circular No. 15 of the year is the only specific regulation concerning Islamic banking. The *Guidelines* provided definitions of Bai-Murabahah and Bai-Muajjal and elaborated their application in different Islamic banking scenarios.

5.2.4 AAOIFI Standards on Murabahah

As identified in Box 5.2, one of the Shariah standards of AAOIFI is specific to Murabahah. However, there are several other standards issued by AAOIFI that also have requirements applicable to Murabahah.

Box 5.2: A List of Murabahah Related AAOIFI Standards

AAOIFI SS 8	: Murabahah
AAOIFI SS 18	: Possession
AAOIFI SS 20	: Sale of Commodities in Organized Markets
AAOIFI SS 25	: Combination of Contracts
AAOIFI SS 30	: Monetization (Tawarruq)
AAOIFI SS 31	: Controls of Gharar in Financial Transactions

AAOIFI SS 39	: Mortgage and Its Contemporary Application
AAOIFI SS 49	: Unilateral and Bilateral Promise
AAOIFI SS 53	: Arboun (Earnest Money)
AAOIFI FAS 2	: Murabahah and Murabahah to the Purchase Orderer (Superseded by FAS 28)
AAOIFI FAS 20	: Deferred Payment Sales (Superseded by FAS 28)
AAOIFI FAS 28	: Murabahah and Other Deferred Payment Sales

Source: Authors' Compilation.

Under AAOIFI SS 8, an Islamic Financial Institution (IFI) may buy an item only at the customer's request; a bilateral promise binding on both parties and a commitment fee are not permitted. The customer may name a supplier, and the quotation should preferably be addressed to the IFI — if it is addressed to and accepted by the customer, the IFI may not conclude a Murabahah on that item. To avoid Bai al-Inah, the IFI may not buy the commodity from the customer, his agent or his parent company. Deferred Murabahah is not permitted for gold, silver or currencies, and a commodity that was the subject of a previous transaction between the bank and the customer may not be sold to him again by Murabahah.

Documentation costs may be shared as agreed, but no fee may be charged for the credit facility itself, although a lead arranger in a syndication may earn a fee and the IFI may charge for a feasibility study requested by the customer. Any Shariah-compliant security is allowed, but the two are not interchangeable: Hamish Jiddiyyah is taken at the promise stage and the IFI may retain from it only its actual loss, whereas Arboun applies only once the sale has been concluded. Ownership risk may not be transferred to the customer before the Murabahah is executed.

The IFI may not sell an item before acquiring it. The customer may act as its buying agent only in case of dire need, under an agency independent of the Murabahah, and the IFI should pay the supplier directly and take the first purchase in its own name wherever possible. The IFI must take physical or constructive possession and bear ownership risk and insurance before selling. Transit insurance may form part of the cost price but storage insurance may not, and only direct costs — not indirect expenses such as staff salaries — may be included.

Physical possession by the customer as agent does not execute the Murabahah; offer and acceptance must be exchanged. Discounts on the purchase price pass to the customer, and the IFI is liable for hidden defects that predate the contract unless the sale is on an 'as is' basis (Bai al-Bara). If the customer fails to take delivery in time, the IFI may revoke the contract or sell the asset to a third party on his behalf, recovering the price and having recourse for any shortfall.

Any security — guarantee, mortgage, cheque or promissory note — may be taken, and although transfer of ownership may not be delayed until full payment, registration may be. The customer may undertake to donate an amount, or a percentage of the debt, to charity if he pays late, but the IFI may not benefit from it. The IFI may forgo part of the price for early settlement, but not as a contractual term, and the customer may settle in another currency at the spot rate, provided this is not part of the Murabahah agreement.

5.3 Analysis and Findings

5.3.1 Application of Murabahah in Different Countries

Globally, Murabahah accounts for 36% of Islamic financing contracts (Table 5.1), commodity Murabahah/Tawarruq for about 24% and Bai Bithaman Ajil for 8.4% — a heavy concentration in Murabahah and its variants.

Table 5.1: Modes of Islamic Financing Contract in Globe (%)

SN	Mode	2018	2021
1	Murabahah	36.0	47.4
2	Bai Bithaman Ajil	8.4	-
3	Commodity Murabahah/Tawarruq	24.2	25.7
4	Ijārah/Ijārah Muntahia Bittamlīk	13.9	10.2
5	Salam	5.5	4.1
6	Musharakah	3.3	2.8
7	Diminishing Musharakah	1.5	1.3
8	Mudarabah	0.5	0.2
9	Istisna'a	0.4	0.7
10	Wakalah	0.2	0.1
11	Qard Hasan	0.1	0.1
12	Others	5.9	7.4
Total		**100**	**100**

In 1994–95, Share of Murabahah in total financing is 67% in Middle East and North Africa, 44.7% in East Asia, 67.5% South Asia, and 48.4% in Sub-Saharan Africa. (Yousef, 2004).

In Malaysia, as of June 2022, Murabahah (inclusive of Bai Bithaman Ajil) represents 54% of total financing. (Bank Negara Malaysia, 2022).

In Bangladesh, as of March 2022, Murabahah (inclusive of Bai-Muajjal) represents 68.3% of total financing. (Bangladesh Bank, 2022).

Source: https://ifsb.org/psifi_02.php, cited on 27 November 2020 and 25 August 2022.

Murabahah's share has been rising in Malaysia (Table 5.2), reaching more than 45% at end-2021 (including Tawarruq), with Bai Bithaman Ajil at about 9%.

Table 5.2: Application of Islamic Finance Mode in Investments: Malaysia (%)

Year	Bai Bithaman Ajil	Murabahah	Ijarah	Al-Ijarah Thumma al-Bai	Musharakah	Mudarabah	Istisna'a	Others
2014	23.79	25.33	2.42	20.64	6.78	0.02	0.53	20.48
2015	19.21	31.40	2.46	18.22	7.30	0.02	0.57	20.83
2016	15.87	37.18	2.25	16.04	9.26	0.02	0.47	18.91
2017	13.60	39.59	2.14	14.84	10.07	0.01	0.41	19.34
2018	11.56	39.90	1.70	13.02	9.32	0.01	0.23	24.24
2019	10.44	42.08	1.42	11.74	9.36	0.01	0.27	24.68
2020	9.39	44.11	1.25	11.52	9.16	0.02	0.18	24.37
2021	8.54	45.56	1.04	11.27	9.28	0.03	0.14	24.14

Source: BNM (2021).

Pakistan presents a different picture, reducing Murabahah and increasing Musharakah (Table 3.8 in Chapter 3): at end-2021, Murabahah accounted for 13.6% of financing and partnership (Musharakah), including Diminishing Musharakah, for about 60%. Of Bangladesh, Pakistan and Malaysia, Murabahah is used most in Bangladesh (Table 5.3).

Table 5.3: Application of Murabahah (%): Comparison

	Bangladesh			Pakistan	Malaysia		
Year	Bai al-Murabahah	Bai-Muajjal	Total	Murabahah	Murabahah	Bai Bithaman Ajil	Total
2014	44.24	24.72	68.96	30.1	25.33	23.79	49.12
2015	44.47	24.93	69.40	24.5	31.4	19.21	50.61
2016	44.64	25.24	69.88	15.8	37.18	15.87	53.05
2017	43.81	25.17	68.98	13.2	39.59	13.6	53.19
2018	44.33	25.63	69.96	13.6	39.9	11.56	51.46
2019	44.6	23.95	68.55	12.9	42.08	10.44	52.52
2020	44.97	23.76	68.73	13.7	44.11	9.39	53.5
2021	46.39	23.24	69.63	13.6	45.56	8.54	54.1

Source: Authors' Compilation.

5.3.2 Application of Murabahah in Bangladesh

The Islamic banking industry's share of the economy is rising (see Table 3.14 in Chapter 3). Thirty-three banks — 10 full-fledged, 9 with Islamic branches and 14 with windows — offer Shariah-based services (Bangladesh Bank, 2022), and at end-2021 Islamic banking investment stood at BDT 3,53,448 crore (Table 5.4), about 27.9% of the banking sector's total.

Table 5.4: Islamic Banking Investments (BDT Crore) and Its Growth (%)

Year	Full-fledged IB		IB Branches		IB Windows		Total Investments of IBs		All Bank Credits	
	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)
2014	1,21,321	-	4,138	-	1,665	-	1,27,124	-	5,07,627	-
2015	1,34,990	11.27	6,148	48.59	2,063	23.9	1,43,201	12.65	6,17,474	21.64
2016	1,60,831	19.14	5,186	-15.65	2,941	42.52	1,68,958	17.99	7,13,113	15.49
2017	1,91,279	18.93	5,583	7.66	4,237	44.1	2,01,100	19.02	8,44,436	18.42
2018	2,19,797	14.91	6,162	10.36	4,949	16.8	2,30,907	14.82	9,60,462	13.74
2019	2,49,885	13.69	7,494	21.62	5,373	8.58	2,62,752	13.79	10,58,707	10.23
2020	2,79,073	11.68	7,753	3.45	7,269	35.27	2,94,094	11.93	11,44,907	8.14
2021	3,37,668	21	8,242	6.31	7,538	3.71	3,53,448	20.18	12,67,561	10.71

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

In Bangladesh, no trade-based contract is used for deposits (Table 3.12 in Chapter 3), although some jurisdictions allow Tawarruq; in financing, more than 46% is under Bai-Murabahah and about 23% under Bai-Muajjal (Table 3.13 in Chapter 3) — in line with global practice, although Murabahah operations differ across jurisdictions.

5.3.3 Content Analysis of Murabahah Agreement

The research team reviewed the Murabahah agreements of all full-fledged Islamic banks; the similarities, differences and remarks are summarized in Table 5.5.

Table 5.5: Review of the Murabahah Agreements by Islamic Banks in Bangladesh

Issues of Review	Findings	Remarks
Language of contract	English	Whether all clients are proficient in English to understand the covenant laid down in the agreement?
Mode of agreement	Some banks use both Bai-Murabahah and Bai-Muajjal separately Some banks use either Bai-Murabahah or Bai-Muajjal	There is no issue about the terminology used however, AAOIFI SS 8 allows both cash and credit transactions under Murabahah.
Date of agreement	Found with all banks	
Reference of client's request to purchase the commodity	All banks (Some banks refer to MoU)	Whether mere request/proposal infers to wad or promise? Whether this request/proposal is binding for the client?
Descriptions of subject matter (Goods/Commodity)	Referred to separate schedule	It is one of the primary rule of Murabahah contract.
Shariah permissibility of goods	Found nowhere except with an Islamic bank. Few banks issued separate circular on permissible goods and services.	It is a basic rule for conducting Islamic finance contract.
Mentioning whether goods purchased/ will be purchased	Some banks have only mentioned as purchased goods. Some banks have options as goods purchased/will be purchased	Whether future procurable goods are permissible under Murabahah?
Sale price directly or cost and profit/markup separately	Some banks mention cost and profit/markup separately. Some banks mention sale price directly however, banking software calculate profit separately all the times.	It is important to disclose cost and profit/markup separately if it is a Murabahah agreement. However, it would not be a problem if it is concluded under Musawamah/Muajjal/Bai Bithaman Ajil mode.
Insurance coverage to be obtained	With the companies approved by banks.	It is important to ensure coverage would be an Islamic Insurance/ Takaful. Besides, Insurance cost should be borne by the owner of the goods.
Delivery of goods to client	With client's acknowledgment to delivery order/purchase schedule	
Compensation clause	Found with all banks except an Islamic bank.	Whether it would be a compensation clause or mandatory charity clause in case of willful defaulter?
Maturity of the agreement	Found with all banks (an Islamic bank has mentioned it in a separate clause).	
Dispute management	Respective bank's decision is final.	Is there any option to improve the clause to make it more logical in line with Shariah?

Source: Authors' Compilation.

5.3.4 Interview and Survey Findings

Interviews were held with Shariah Supervisory Committee (SSC) members, Islamic finance professionals and consultants, internal auditors and internal Shariah auditors (Muraqibs), heads of Islamic banking divisions of conventional banks, and branch executives of full-fledged Islamic banks and of Islamic branches and windows (the points discussed are listed in Box 5.3). Some findings were validated through FGDs with Islamic finance professionals (IFPs).

Box 5.3: A List of Points related with Murabahah Operations Discussed with IFPs

1. Ensuring transaction only for Shariah-compliant products/services.
2. Preventing fictitious transactions based on cooked voucher without exchanging product.
3. Taking ownership on goods by IFI before onward sale to the customer.
4. Ensuring possession by IFI before onward sale to the customer.
5. Ensuring execution of proper offer and acceptance between IFI and customer.
6. Appointing customer as an agent without searching other options.
7. Disbursing fund to the customer's account without searching other options.
8. Transferring ownership related risk and cost to the customer.
9. Settlement of old deal by new one without buying and selling anything.
10. Rescheduling Murabahah receivable by creating an artificial deal with new markup.
11. Canceling old Murabahah contract and concluding a fresh contract with revised markup on same items.
12. Taking over loan of an Islamic bank applying Murabahah mode with or without having tangible products.
13. Taking over loan of a conventional bank applying Murabahah mode with or without having products.
14. Creating Murabahah without existence of product in case of force loan.
15. Concluding the "Undertaking to Purchase" and "Murabahah Agreement" at a time.
16. Accepting voucher/price quotation addressed to the customer.
17. Preventing mismatch between investment (financing) amount and purchase voucher.
18. Conversion of Murabahah financing (working capital) in to long-term finance e.g., HPSM.
19. Paying off client's existing liability caused for credit purchase by creating a Murabahah deal.
20. Ensuring proper and transparent calculation process of cost and markup for Murabahah.
21. Granting rebate to the customer in all the cases of early settlement.
22. Asking LC commission from the client in case of import financing under Murabahah mode.
23. Ensuring transparency for applied mode on the margin kept by the client with the bank as security deposit.
24. Asking for processing fee from the client for granting the credit.
25. Incorporating compensation (mandatory charity) clause ignoring force majeure.
26. Transferring a part of compensation (mandatory charity) to the bank's income.
27. Failing to ensure the sequence of Murabahah execution process.
28. Ensuring compliance with prudential regulations of Bangladesh Bank in regard to pricing, reporting, rescheduling, etc.
29. Developing IFPs for Shariah compliance operations and conducting research for innovation.
30. Ensuring uniformity in the perception and application of Murabahah, Muajjal and Bai Bithaman Ajil.

Source: Authors' Compilation.

Banks generally ensure that the subject matter is not prohibited, through the Murabahah form or separate circulars, and Muraqibs have rarely found non-compliant items sold. Although banks seek genuine transactions, violations occur in operational procedure: fictitious transactions on fabricated vouchers without any exchange of goods; settling old deals with new ones without buying and selling anything; rescheduling receivables through artificial deals with

new mark-ups; canceling contracts and re-concluding them on the same items at revised mark-ups; and creating Murabahah receivables without any goods in the case of forced loans.

The bank must take ownership and possession before selling and execute offer and acceptance properly. These rules are breached when agreements are concluded on goods yet to be purchased, when purchased goods cannot be separated from the supplier's unsold stock before the contract, or when the sequence of contracts and documents is not observed.

Appointing the customer as buying agent is permissible if transactions are genuine, but without strong monitoring it invites fictitious transactions, so banks should look for other options first and should not routinely disburse funds to customers' accounts. As owner, the bank must bear the risks and costs of the goods and may not transfer them to the customer before the Murabahah contract is concluded.

In taking over loans from other institutions, Islamic banks must ensure Shariah compliance: they generally pay no interest when taking over a conventional loan, must ensure that goods exist before applying Murabahah — a takeover under Murabahah without goods is unacceptable — must document the process properly, and must avoid Bai al-Inah. Alternative approaches suggested by IFPs are summarized in Box 5.4.

Box 5.4: A Summary of Loan Take-over Process

Suppose Bank A has provided a working capital facility of CU 100,000 to Customer X creating hypothecation charge on the floating inventory of the customer. After certain time, Bank B is wishing to take over the loan. The loan take-over process may be concluded in the following ways:

Approach I:

1. Customer X will appoint the Bank A as selling agent to sell the existing available inventory to the Bank B.
2. Bank B will conduct valuation of the available inventory to ensure the reasonable value of the inventory.
3. A tri-party sale agreement will be concluded between Customer X and Bank B in the presence of agent Bank A.
4. Ownership of the inventory will be passed to the Bank B where payment will be made to Bank A for the settlement of existing debt. If the Bank A is a conventional bank, Bank B will not pay the amount charged as interest by the bank. It will be arranged by the Customer X.
5. Bank B will sell the inventory to the Customer X creating a Murabahah receivable.
6. Customer X will pay the dues to the Bank B as per the Murabahah agreement.

Approach II:

1. Bank A will enforce the hypothecation charge created over the inventory of Customer X and, with Customer X's authority, acquire title to it by an express sale; hypothecation creates only a security interest, not ownership, so a separate transfer of title is required.
2. Bank B will conduct valuation of the available inventory to ensure the reasonable value of the inventory.
3. Bank A will sell the inventory to Bank B for settling the dues of Customer X.
4. Ownership of the inventory will be passed to the Bank B where payment will be made to Bank A. If the Bank A is a conventional bank, Bank B will not pay the amount charged as interest by the bank. It will be arranged by the Customer X.
5. Bank B will sell the inventory to the Customer X creating a Murabahah receivable.
6. Customer X will pay the dues to the Bank B as per the Murabahah agreement.

Approach III:

1. Bank B will ask the Customer X to settle the dues with Bank A from his own arrangement.
2. Bank B will create a fresh Murabahah deal with the Customer X for fulfilling upcoming working capital requirements of the client.
3. Customer X will pay the dues to the Bank B as per the Murabahah agreement.

Source: Authors' Compilation based on Interview.

AAOIFI's Shariah Standard allows a voucher or price quotation addressed to the customer, but it is preferable that it be in the bank's name, as the bank is the purchaser. Vouchers under MPO should not always be in the customer's name, and mismatches between financing amounts and voucher figures are occasionally found.

Murabahah working-capital receivables should not be converted into long-term Hire Purchase under Shirkatul Melk (HPSM) or lease (Ijarah) financing without a tangible physical asset, and paying off a client's existing credit-purchase liability through a new Murabahah deal is prohibited. Cost and mark-up should be calculated transparently, and since Murabahah is a credit sale, banks should not charge a processing fee on the application but may reflect it in the negotiated mark-up.

A bank may grant a rebate at its discretion to expedite recovery, but it should not be the customer's right or a customary practice for all early settlements. A compensation (mandatory charity) clause in the agreement, excepting force majeure, is preferable, and no part of such compensation should be taken into the bank's income.

Because banks cannot use their own Import Registration Certificates (IRC) for business purposes, they import goods under Murabahah LCs using the customer's IRC, which raises questions about charging the customer a Letters of Credit (LC) commission for goods the bank will own, even if the agency (Wakalah) and Murabahah are treated as separate agreements. The mode applied to the client's margin (Hamish Jiddiyyah) — safe custody (Wadiah) or profit-sharing partnership (Mudarabah), both permissible — should be transparent to both parties, and bankers' understanding of Murabahah, Muajjal and Bai Bithaman Ajil varies.

Most respondents acknowledged a shortage of Islamic finance professionals with both Shariah and operational expertise. Since Bangladesh Bank makes the board responsible for Shariah-compliant operations, boards need directors with knowledge of Islamic jurisprudence. Senior management needs such expertise too — Bangladesh Bank expects the Chief Executive Officer (CEO) to have at least three years of Islamic banking experience — a skilled manpower pool is a condition of an Islamic banking license, and SSC members need knowledge of Islamic banking, economics and commercial jurisprudence. Continuous professional development — degrees, diplomas and certifications, and short courses, workshops and conferences for boards, senior managers, SSC members and operational staff — is therefore indispensable. IFPs' opinions are summarized in Table 5.6.

Table 5.6: Application of Murabahah for Financing: IFPs opinion
[Opinion of IFPs on Murabahah Operations in Bangladesh in a Ten-point Scale (10= Highest and 1=Lowest), n=369]

S/n	Aspects on Murabahah	Shariah Importance	Probability of Occurrence
1.	Ensuring that the transaction is only for Shariah-compliant products or services (Probability of non-compliant goods).	10	4.39
2.	Ensuring that the transaction is for genuine buy and sell (Probability of fake documents).	9.83	4.61
3.	Obtaining ownership of goods by the Islamic bank before sale to the customer (Probability of sale before getting ownership).	8.42	3.68

S/n	Aspects on Murabahah	Shariah Importance	Probability of Occurrence
4.	Obtaining possession (actual or constructive) by the Islamic bank before sale to the customer (Probability of sale before obtaining possession).	9.00	8.78
5.	Bearing risk of the purchased goods by the Islamic bank before sale to the customer (Probability of transferring risk to the customer).	7.43	8.45
6.	Execution of the sale contract only after execution of the purchase contract for the same good (Probability of sale before purchase)	7.80	7.51
7.	Passing of a significant time between purchase of goods by the bank and sale to the customer (Probability of sale and purchase at a time).	3.36	9.85
8.	Ensuring proper execution of offer and acceptance between Islamic bank and customer (Probability of non-exchanging)	9.24	9.24
9.	Disclosure on costs to customer on a break down basis i.e. providing details of each cost components (Probability of lump sum costing)	3.26	4.26
10.	Appointing customer as buying agent for goods to be sold by the Islamic bank to the same customer (Probability of happening so).	4.36	8.72
11.	Disbursing money to the customer's account by IFI without resorting other options (Probability of happening so).	5.20	8.54
12.	Obtaining evidences by IFI directly from the supplier where the customer is appointed as agent (Probability of happening so).	2.38	8.54
13.	Conducting a post-sale inspection at the customer's premises to ensure that the sale was genuine (Probability of non-happening so).	5.00	9.83
14.	Settlement of old deal by new one without buying and selling anything (Probability of happening so).	9.46	4.23
15.	Settlement of old deal by new one by buying and selling the already sold goods (Probability of happening so).	9.46	5.24
16.	Rescheduling Murabahah receivable by creating an artificial deal with new markup (Probability of happening so).	9.46	4.23
17.	Rescheduling or restructuring by canceling old Murabahah contract and executing a new contract with revised markup using the same items (Probability of happening so).	9.46	4.23
18.	Execution of an artificial Murabahah without existence or valid buy and sale of a product in case of force loan (Probability of happening so).	10	3.29
19.	Conversion of Murabahah financing (working capital) in to long-term finance e.g., HPSM (Probability of happening so).	9.12	2.15
20.	Concluding the "Undertaking to Purchase" and "Murabahah Agreement" at a time i.e. in the same sitting (Probability of happening so).	2.52	2.52
21.	Refinancing (takeover) of debt due to another Islamic bank applying Murabahah using the assets of the original transaction (Probability of happening so).	4.52	2.52
22.	Refinancing of debt due to another Islamic bank applying Murabahah without using any assets (Probability of happening so).	9.83	1.27
23.	Refinancing (takeover) of loan due to a conventional bank applying Murabahah using existing assets of the customer (Probability of happening so).	9.83	1.27
24.	Refinancing (takeover) of loan due to a conventional bank applying Murabahah using new assets that yet to be purchased by the customer (Probability of happening so).	10	1.27
25.	Paying off client's existing liability caused for credit purchase by creating a Murabahah deal (Probability of happening so).	9.83	1.27

S/n	Aspects on Murabahah	Shariah Importance	Probability of Occurrence
26.	Accepting voucher/price quotation addressed to the customer (Probability of happening so).	1.27	5.64
27.	Mismatch between investment (financing) amount and purchase voucher (Probability of happening so).	6.47	5.46
28.	Granting rebate to the customer in the case of early settlement (Probability of happening so).	3.21	9.83
29.	Imposing LC commission in case of import financing under Murabahah mode (Probability of happening so).	3.31	7.52
30.	Ensuring transparency for applied mode on the margin kept by the client with the bank as security deposit (Probability of non-transparency).	4.03	7.52
31.	Imposing processing fee for granting credit, i.e. sale on a Murabahah basis to the customer (Probability of happening so).	6.41	6.41
32.	Imposing compensation charges in case of delays in payment by the customer (Probability of happening so).	2.35	9.83
33.	Recognizing a part of compensation as the bank's income (Probability of happening so).	9.83	6.42
34.	Failing to ensure the sequence of Murabahah execution process (Probability of happening so).	8.85	6.42
35.	Ensuring compliance with prudential regulations of Bangladesh Bank in regard to pricing (9% Cap), reporting (Murabahah as continues loan), rescheduling (with additional profit), etc. (Probability of non-compliance).	9.74	4.23
36.	Ensuring that the markup added in Murabahah reflect the market rate for similar financings (Probability of non-happening so).	6.41	1.32
37.	To include the rebate clause in the Murabahah contract so that there is no uncertainty regarding this (Probability of happening so).	4.53	4.53
38.	Differences in the perception and application of Murabahah, Muajjal and Bai Bithaman Ajil.	1.27	9.85
39.	Developing IFPs for Shariah compliance operations and conducting research for innovation (Probability of non-happening so).	6.63	7.52

Source: Survey Data.

5.4 Conclusion and Recommendations

Murabahah is Shariah-compliant — Shariah does not prefer one concept over another — and, as it accounts for most of Islamic banks' financing in Bangladesh and elsewhere, adherence to all its Shariah rulings is essential to demonstrate the industry's compliance. Rigorous research is needed on better Shariah-compliant approaches and alternatives suited to the current banking environment and customers' needs, and the industry and standard setters should seek uniformity in the understanding and application of Murabahah, Muajjal and Bai Bithaman Ajil. The specific recommendations are:

- **Avoid signing all documents in a single sitting:** banking Murabahah requires a set sequence — the client's promise to purchase (wa'd), purchase and possession (qabd) by the bank, and then the Murabahah contract and delivery — with documents executed at different stages. If clients sign all the documents at once (the promise, purchase schedule, description of goods, delivery letter and Murabahah agreement), which is tempting to save time and cost, and the bank executes them later, the transaction becomes tantamount to conventional financing.

- **Do not appoint the client as agent in all cases:** purchases should preferably be made under the bank's direct supervision; since this is not always feasible, banks or the industry could establish a third-party agent to acquire goods on their behalf, and should not routinely appoint the client as agent or credit funds to the client's account without exploring other options.
- **Do not make rebates contractual or customary:** scholars differ on rebates for early settlement, and many disallow them to avoid interest (Riba); if granted routinely to compete with conventional banks, rebates link the credit amount to the credit period, while no extra charge may be imposed for early settlement.
- **Calculate cost and profit transparently:** the cost includes only amounts directly associated with the goods, not indirect costs, and the mark-up, whether absolute or a percentage of cost, must be fixed and known to the buyer.
- **Take ownership and possession before onward sale:** the bank must own and possess the goods before concluding the Murabahah; impossibility, lack of manpower or cost are no excuse.
- **Prevent fictitious transactions:** banks should adopt zero tolerance of fictitious Murabahah transactions — rollover, settling existing liabilities with new deals, disbursing funds to clients without any sale, or rescheduling with a new mark-up — without which there is no difference between a conventional and an Islamic bank.
- **The owner must bear risk and cost before sale:** when a customer acts as buying agent, ownership risks and costs may not be shifted to him; any risk management mechanism must conform to Shariah.
- **Take over loans in a Shariah-compliant way:** loan takeovers risk artificial transactions, and since AAOIFI does not approve Inah, the industry should not allow it.
- **Address regulatory issues on pricing, rescheduling and reporting:** Bangladesh Bank's prudential regulations treat Murabahah as a continuous loan, but Shariah forbids rollover and requires each sale to be independent; banks price in the credit period and the probability of delay, so the rate in the agreement may exceed the effective rate recovered within the regulatory cap; and rescheduling Murabahah is not feasible. Regulators should treat these issues differently for Islamic banks.
- **Adopt AAOIFI financial reporting standards:** since the contracts and business of Islamic banks differ from those of conventional banks, and many jurisdictions have adopted AAOIFI's Financial Accounting Standards (FASs), the regulator may consider adopting them in Bangladesh.
- **Develop Islamic finance professionals:** although Islamic banking began in 1983, Bangladesh has not built a pool of professionals comparable to those of Malaysia, Indonesia, Pakistan, Bahrain or Jordan; academic degrees, professional diplomas and certifications, training, workshops and conferences for boards, SSC members, senior managers and operational staff should be offered regularly, with Bangladesh Institute of Bank Management (BIBM), the Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) and the Bangladesh Bank Training Academy (BBTA) playing national roles alongside private providers.

Chapter 6: The HPSM Mode of Investment: Issues and Challenges

Based on the study "HPSM Mode of Investment by the Islamic Banks in Bangladesh: Issues and Challenges" by Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Atiqur Rahman Khan Khadem.

6.1 Introduction

Hire Purchase under Shirkatul Melk (HPSM), one of the most popular investment modes of Islamic banks in Bangladesh, combines partnership (Sharikat), lease (Ijarah) and Bai' (sale), bound together by Wa'd (promise).

It embodies essential values of Islamic banking: it finances a real asset, the bank must co-own a tangible asset throughout the tenure and bear risk in proportion to its ownership, and fictitious or paper-only transactions are impossible.

Yet there are concerns about its Islamic law (Shariah) compliance, some structural and most in application. Is it essentially a partnership (Musharakah) or an Ijarah — and if a Musharakah, of what form? Since Shariah prohibits income and capital guarantees in a Musharakah but is more flexible in an Ijarah, there may be a temptation to characterize it as Ijarah, which must rest on sound Shariah arguments. Other concerns include executing the series of sale contracts in a Shariah-compliant way during the financing period, distinguishing a promise from a contract, the appropriateness of contract documents, and financial reporting that reflects the Shariah structure.

Given Islamic banking's large market share and robust growth, a comprehensive, objective review of these concerns is timely: it demonstrates the industry's commitment to compliance and transparency, can strengthen the sector and the wider financial system, and fosters collaboration between academics and practitioners in developing solutions aligned with Shariah.

6.1.1 Objective and Scope of the Research

The research assesses how Islamic banks in Bangladesh implement HPSM, analyzing their different approaches and comparing them with the Shariah requirements of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and other reputed Shariah authorities. Its specific objectives are:

i) to elucidate the Shariah requisites associated with HPSM;

ii) to conduct a comprehensive examination of the practices concerning HPSM application within Islamic banks (IBs) operating in Bangladesh; and

iii) to assess the alignment or discordance between these practices and the Shariah requirements.

It covers HPSM as a multifaceted, asset-based mode combining Musharakah, Ijarah and Bai, including Musharakah Mutanaqisah (diminishing Musharakah) and Ijarah Muntahia

Bittamleek (capital lease), and the alternative term Hire Purchase Musharakah Mutanaqasah (HPMM) used by Bangladesh Bank.

6.1.2 Research Methodology and Structure of the Research

The methodology identifies the criteria set by AAOIFI and other reputed Shariah authorities as the framework for evaluation. Analyzes the HPSM contract forms of all full-fledged Islamic banks, and draws on FGDs with business executives and Shariah experts and in-depth interviews with Islamic finance experts. Secondary data come from international sources — the IFSB's Islamic Financial Services Industry Stability Report, Refinitiv's Islamic Finance Development Report and Edbiz Consulting's Global Islamic Finance Report (GIFR) — and from banks' annual reports, Bangladesh Bank's Financial Stability Report and Quarterly Report on Islamic Banking, and Bangladesh Institute of Bank Management (BIBM) publications. Quantitative data are presented in tables and graphs using simple tools, and the chapter incorporates insights from the research workshop.

6.2 Review of Literature on HPSM

6.2.1 Concept of HPSM

HPSM is a structured financing method in which the Islamic bank acquires joint ownership of a movable or immovable asset with the client, leases its portion to the client and sells its shares to the client gradually over the financing period, so that the partnership ends with the client's full ownership. It is used for long-term installment financing of apartments, vehicles, heavy industrial equipment, plant and machinery, lifts, generators and other Shariah-permissible assets for personal and commercial purposes. HPSM combines three independent contracts — Shirkat, Ijarah and Bai' — outlined below.

Shirkat (Partnership)

Shirkat (partnership) is a contract between parties who share capital and profits, and is valid so long as the purpose of the business and the parties' obligations meet Shariah requirements. Its legality is established in the Qur'an (38:24; 4:12), the Sunnah and the consensus of scholars; in a Hadith Qudsi, Allah says, "I am the third of the two partners as long as neither one deceives the other."

Shirkatul Melk (Partnership of Ownership)

partnership in ownership (Shirkatul Melk) is partnership in the ownership of assets, arising compulsorily or by choice. Under AAOIFI Shariah Standard (SS) No. 12, it combines the assets of two or more persons so that they share the realized income or any increase in the value of the assets. One partner may sell his share to the other and may charge rent for his part of the asset to the partner who benefits from it. AAOIFI SS No. 58 (para 5/4/3) allows one partner to promise to purchase the other's share, and SS No. 12 (para 5/7) permits a binding promise to acquire that share gradually at market value or at a price agreed at the time of acquisition — but not at original or face value, which would guarantee the value of the share (see Section 6.2.4).

AAOIFI SS No. 9 (para 8/7) adds that ownership of a leased asset cannot be transferred together with the Ijarah, because the transfer terminates the lease. It may be executed only at a future date, such as the end of the Ijarah.

Ijarah (Lease)

Ijarah is a contract on usufruct for compensation: renting an asset to benefit from its use, or hiring a person for a definite wage. Its permissibility rests on the Qur'an (28:26–27), the Sunnah — for example, "Pay the hired worker his wages before his sweat dries off" (Musnad Abu Yala) — and scholarly consensus. AAOIFI SS No. 9 defines Ijarah as a contract under which a specified permissible benefit, in the form of usufruct, is obtained for a specified period against a fixed, acceptable consideration.

Bai' (Buying and Selling)

Bai' is the exchange of one thing for another, that is, buying and selling (Al-Zuhayli, W., 2007); today it refers to trading in goods and commodities, executed on a spot or deferred basis in conformity with Shariah norms. Its validity is supported by the Qur'an ("And Allah has permitted trade", 2:275; see also 2:282 and 4:29), by the Sunnah — which requires sales to be by mutual consent (Bayhaqi, Ibn Majah) and forbids selling "that which you do not possess" (Tirmidhi, an-Nasaa'i, Abu Dawood, Ibn Maajah, Ahmad) — and by scholarly consensus.

Wa'd (Promise)

Wa'd (promise) carries a religious obligation to be fulfilled (Al Qur'an, 16:91; 17:34), and breaking a promise is described in the Hadith as a sign of hypocrisy (Bukhari, Muslim). A unilateral promise is therefore permissible and binding on the promisor, whereas a bilateral promise that resembles a contract is unacceptable if binding on both parties. AAOIFI SS No. 49 (para 3/4) provides that a promise is legally binding only where there is a real need; if the client's promise causes the bank actual financial damage, the bank can enforce it to recover that loss.

Combination of Contracts

Combining several contracts — such as sale, lease, loan or partnership — in a single set is controversial among jurists, because the Prophet (SAW) "prohibited two transactions in one transaction" (Musnad Ahmad; Rahman and Osmani, 2021). AAOIFI SS No. 25 permits such combinations subject to controls, the key one being that the underlying contracts remain independent.

Box 6.1: Some Contracts of Financing Similar to HPSM

Though HPSM is mostly a dominant financing structure against assets in Bangladesh, several similar structures are also available in international practices to facilitate the financing needs of the clients. These are as follows:

Ijarah

It is simply leasing an asset or property to the client on a rental basis for a specified period. A bank may procure the asset or construct its own before renting it to clients. The client pays rent for using the asset/property as per the agreement. The bank retains absolute ownership of the assets/properties in such cases. However, the asset may be sold to the client at an agreed price at the end of the leased period.

Ijarah Muntahia Bittamleek (IMBT)

IMBT is a form of leasing contract applied by Islamic banks for financing vehicles, capital machinery, instruments, buildings, apartments, etc., based on Ijarah with the ultimate objective of transferring ownership of the asset to the client at the end of the rental period through a promise by the lessor to the lessee to transfer the ownership of the leased asset/property. IMBT covers all the basic features of Ijarah. However, the promise of asset transfer upon maturity must be independent of the Ijarah contract and accomplished through a separate document. The commitment to transfer an asset to the client may occur by selling for a token of money, paying market value, accelerating the payment of the remaining rental amount, or promising to give it as a gift.

Hire Purchase Musharakah Mutanaqasa (HPMM)

The structure of HPMM is very similar to that of HPSM, where the bank acquires the ownership of assets with the client. Under this mode, the bank and the client jointly purchase vehicles, machinery, buildings, apartments, etc. The client uses the portion of the assets owned by the bank on a rental basis and acquires the ownership of the same assets by paying the bank's portion of the equity on the assets in installments and its rents as agreed upon.

Diminishing Musharakah

Diminishing Musharakah is a form of partnership financing in which one of the partners (client) promises to purchase the share against an asset or property of the other partner (bank) gradually until the title to the equity is completely transferred to the client. The promise to buy and sell shares between the partners should be independent of the partnership contract.

Sale and Leaseback

This is a unique nature of financing, where the seller (client) sells his assets to the bank and takes back the same assets as a lease from the bank under Ijarah Muntahia Bittamleek (IMBT). Usually, the bank applies such financing to facilitate liquidity to the client. According to AAOIFI SS No. 9, clause 3/2, the lease transaction should not be stipulated as a condition of the purchase contract by which the institution acquires the asset.

AAOIFI SS No. 58 (clause 5/2) permits the seller to lease the sold assets based on IMBT in compliance with AAOIFI SS No. 9 provisions under clauses 3/2, 8/5 and 8/6. However, clause 8/5 of SS No. 9 stipulates the following procedures to be followed:

> "If the leased asset was purchased from the lessee before it was leased back to the lessee on the basis of Ijarah Muntahia Bittamlik, a (reasonable) period of time, between the lease contract and the time of the sale of the asset to the lessee, must have expired, to avoid the contract of 'Inah. This period must be long enough so that the leased property or its value could have changed. This shall also apply to the case of early ownership of the asset where a sale contract is concluded during the Ijarah."

Source: Compiled by the Research Team.

6.2.2 Regulatory Framework for HPSM in Bangladesh

Domestic Regulations

HPSM transactions fall under term loans as per prudential regulation. The general legal and regulatory framework for Islamic banking in Bangladesh — the Bank Company Act 1991 and the Guidelines for Islamic Banking issued by Bangladesh Bank in 2009 — is outlined in Section 5.2.3 of Chapter 5.

The Guidelines for Islamic Banking (2009) provided definitions of different investment principles and investment products, including Musharakah, Ijarah, Ijarah Muntahia Bittamleek (Hire-Purchase), Hire-purchase Musharakah Mutanaqasa (HPMM) along with the import under diminishing proprietorship method (Hire Purchase under Shirkatul Melk-HPSM).

Maqasid al-Shariah (Objectives of Shariah) of HPSM Financing

Al-Ghazali identifies five objectives of Shariah: the protection of faith (din), life (nafs), intellect (aql), progeny (nasl) and wealth (mal) (Lahsasna, 2013). Since owning, trading and leasing are the primary forms of wealth creation, HPSM serves these objectives: it lets clients who cannot pay for an asset at once acquire it gradually, gives corporate clients longer repayment periods that lower their cost of production and serve the public interest (Maslahah Mursal), and provides banks with a long-term revenue stream.

Zakat (Compulsory Charity)

obligatory alms (Zakat) applies to trading assets that reach the Nisab. Under AAOIFI SS No. 35 (para 3/1/4), it is not payable on income-generating fixed assets not held for trade, such as leased assets, but is payable on the income they generate. Scholars agree that Zakat applies either to trading assets or to income from leased assets, not to both. Box 6.2 lists some Islamic legal maxims relevant to commercial activity.

Box 6.2: List of Islamic Legal Maxims

MAXIM 01: Judgment is to be based on knowledge and understanding
MAXIM 02: The presumption of validity and permissibility applies to all contracts
MAXIM 03: The fundamental requirement in every contract is justice
MAXIM 04: The general principle conferring validity to contracts is the consent of both parties, and the practical terms and conditions are what they agreed.
MAXIM 05: Deferment constitutes a part of the price
MAXIM 06: Matters are determined by intension
MAXIM 07: In contracts, greater weight is given to intention and meaning than words and forms
MAXIM 08: Giving effect to words is preferable to giving then no effect
MAXIM 09: Certainty is not overcome by doubt
MAXIM 10: No legal consideration is given to conjecture tainted by error.
MAXIM 11: Freedom from liability is the pre-existing and, therefore, the prevailing state
MAXIM 12: The basic rule is that a thing remains in its original state
MAXIM 13: The presumptive rule is that the transitory attribute does not exist
MAXIM 14: The presumption is that a development of legal significance is only of recent occurrence
MAXIM 15: Hardship begets facility
MAXIM 16: That which is easy cannot be waived due to that which is difficult
MAXIM 17: Necessities render the prohibited permissible
MAXIM 18: Necessity is to be assessed and treated proportionally
MAXIM 19: Need, general or specific, is treated like a necessity
MAXIM 20: Harm is to be eliminated
MAXIM 21: Averting harm takes precedence over achieving benefit
MAXIM 22: When the impediment is removed, the original Shariah rule is restored to full effect
MAXIM 23: [violations] may be tolerated in the means of performance but not taken in the objectives
MAXIM 24: Custom is an arbiter
MAXIM 25: A matter recognized by custom is like a [contractual] stipulation
MAXIM 26: Consideration is given to the predominant and widespread, not the rare.
MAXIM 27: Evaluation of shariah rulings [based on custom and ijtihad] due to changing times is not to be denied
MAXIM 28: Benefit goes with liability
MAXIM 29: Liability accompanies gain
MAXIM 30: Legal Permission negates liability
MAXIM 31: Ijtihad is not [to be] overturned by another Ijtihad
MAXIM 32: Act of those with authority over people must take their interests into account
MAXIM 33: Is it impermissible to dispose of another's property without authorization
MAXIM 34: Subsequent ratification is similar to prior approval
MAXIM 35: If permissibility and prohibition coincide, prohibition prevails.
MAXIM 36: What is prohibited to take is also forbidden to give
MAXIM 37: What is auxiliary [to something in fact] is additional [to it in ruling]
MAXIM 38: When a thing becomes null and void, what is included in it becomes null and void too
MAXIM 39: What has already been engaged cannot be employed by another.
MAXIM 40: Conditional promises are binding

Source: ISRA (2020).

6.2.3 Process Flow of HPSM Operations in Bangladesh

HPSM financing passes through several stages. The client submits all documents; the bank obtains a Credit Information Bureau (CIB) report from Bangladesh Bank's online platform and, for immovable property, verifies the land and construction documents through enlisted surveyors (for physical verification and valuation) and panel lawyers. The client bears these costs whether or not the financing is sanctioned or availed, and some banks also charge an upfront processing fee as a percentage of the approved amount.

For movable assets such as cars, generators, lifts and machinery, the bank verifies market price, brand and longevity. If policy requirements are met, it sanctions all or part of the amount requested, depending on the business unit's discretionary powers and the purpose of the financing, and the client accepts the sanction terms.

The bank then signs the HPSM agreement and disburses its share of the equity to the client's account, after mortgaging any collateral property in its favor. For assets under construction, disbursement is usually made in three installments as construction progresses; payment is sometimes made directly to the vendor.

The moratorium period starts from disbursement, after which the bank begins recovering installments; the moratorium is usually extended for a reasonable period if construction or setup is delayed. Because no usufruct is available until the asset becomes usable, no rent is charged during the moratorium; instead the bank recognizes a return at its usual rate through revaluation of the asset and recovers it with the regular installments, which comprise the bank's share (principal), rent and the moratorium component. Rent as such runs only from the date the asset becomes usable.

Rent is calculated by the annuity method, the average method or a mix (for example, average for staff and annuity for other clients). Under the annuity method, which favors the bank, rent is recovered first, so the principal portion varies between installments; the average method favors the client. One leading bank that uses the annuity method does not compound rent for defaulters. Some banks charge an early-settlement fee on foreclosure and penalties on rent for defaulters.

Imported assets require additional steps. Because regulations prevent the bank from opening an LC in its own name, it opens the LC under a letter of authorization stating that it will purchase the assets using the client's documents, which mitigates Shariah compliance risk. The bank charges a quarterly LC commission, and transport documents are issued in its favor, giving it constructive possession. The LC margin is kept as a cost-free deposit and usually adjusted as the client's equity, with no evidence of any return being paid on it (clients may recover it if discrepant documents are refused). Import and insurance costs are borne by the client. Figure 6.1 presents the typical process flow for car financing under HPSM, and Figure 6.2 some additional aspects of HPSM for other assets.

Figure 6.1: Typical Process Flow for Car Financing under HPSM



Source: Compiled by the research team based on market practice.

Figure 6.2: Some Additional Aspects of HPSM Applications for Other Assets

1. Car financing for individual, commercial and bank-employees

a. For individuals, banks may only finance up to 50%; the remaining would be equity financing.
b. For commercial financing, equity participation depends on the banker-customer relationship; banks generally ask for collateral securities.
c. For bank employees:
   i. Most of the banks charge a concessional rate
   ii. The average method for rent calculation is applied, whereas the annuity method is used for others.
   iii. Most banks adjust the principal in the initial years and then collect the rental
   iv. Some of the banks bear the initial registration cost of the asset
   v. Most of the banks bear more than 60% of the insurance cost
d. In a few cases, a gestation period may be granted by the bank

2. Ready-flat or commercial space financing

a. Registration will be done in the name of the client
b. Registered mortgage should be there
c. Additional security may be asked
d. The bank may grant a gestation period

3. Home financing under construction period

✓ along with above 2(a), (b), (c) and (d);
e. During the construction period, assets will not be rentable
f. Immediately after financing, the bank wants to earn against the financing
g. Most of the banks use valuation technique for adjusting the earning of the pre-rental period

4. Equipment financing

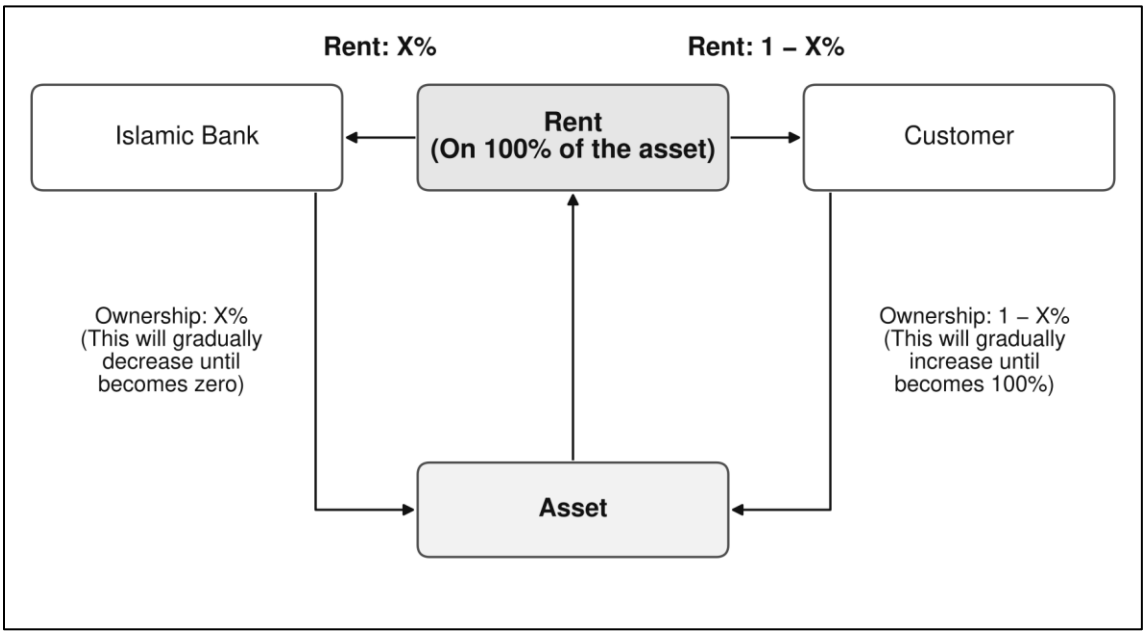
a. Registration is not required, generally
b. May be acquired from the domestic market – instant payment is required in local currency
c. May be imported – payment to be made in foreign currency
   i. Under Sight LC and Usance LC
   ii. The bank wants to charge an LC fee to the client
d. May or may not be rentable

Source: Compiled by the research team based on market practice.

6.2.4 Relevant Shariah Standards

AAOIFI Shariah Standards do not mention HPSM. The closest is Musharakah Mutanaqisah (diminishing partnership) in SS No. 12, Sharikah (Musharakah) and Modern Corporations, which defines it (para 5/1) as a partnership in which one partner promises to buy the other's equity share gradually until full title passes to him (Figure 6.3).

Figure 6.3: Diminishing Partnership



Source: Compiled by the research team based on AAOIFI Standards.

Paras 5/1–5/8 of SS No. 12 set the requirements for diminishing partnership. Either partner may lease the other's share for a specified amount and period, and one partner may give a binding promise to acquire the other's share gradually through sale contracts at market value or at a price agreed at the time of acquisition, but not at original or face value, which would guarantee the bank's share and is prohibited. The promise to buy or sell must be independent of the partnership contract, neither contract may be a condition of the other, one partner may not be required to bear all insurance or maintenance costs merely because he will eventually own the asset, and losses are shared in proportion to ownership.

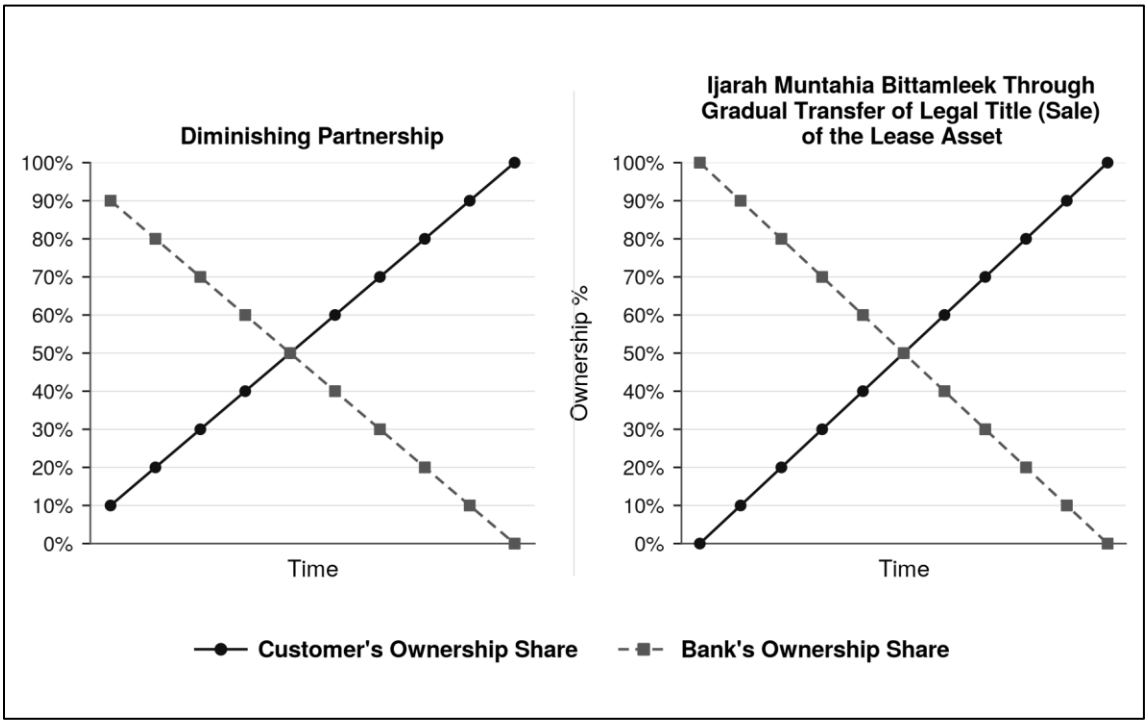
Para 5/2 applies the general rules of partnership — especially those of Sharikat al-'Inan — to diminishing partnership. This raises the question of whether the standard's diminishing partnership is the same as HPSM: in 'Inan both partners may deal in the partnership assets and share profit (para 3/1), whereas in HPSM the bank merely leases its portion, has no right to deal with the customer's portion and alone receives rent under the Ijarah agreement. The standard's Shariah basis explains that the partnership rules are applied precisely to prevent diminishing partnership from becoming mere interest-based financing.

AAOIFI SS No. 9, Ijarah and Ijarah Muntahia Bittamleek, defines Ijarah Muntahia Bittamleek as a lease that ends with the transfer of ownership to the lessee by sale or gift. The promise of transfer must be documented separately from the Ijarah contract (para 8/1).

SS No. 9 does not recognize gradual transfer of ownership, but AAOIFI Financial Accounting Standard (FAS) No. 8 does, as "Ijarah Muntahia Bittamleek through gradual transfer of legal title (sale) of the lease asset" (Appendix B, para 2/3/5): the lessor promises to transfer title gradually, the price is divided over the lease period, a separate sale contract is concluded for each share, and rent falls as the lessee's share grows. If the Ijarah is revoked before full transfer, title is shared in proportion to the shares already transferred — a safeguard for the lessee, who has paid rent above the fair rental amount.

This structure resembles diminishing partnership, except that in diminishing partnership both parties contribute capital at inception, whereas here one party contributes all the capital and the other acquires ownership gradually (Figure 6.4).

Figure 6.4: Difference Between Diminishing Musharakah and Ijarah Muntahia Bittamleek Through Gradual Transfer of Legal Title (Sale) of the Lease Asset



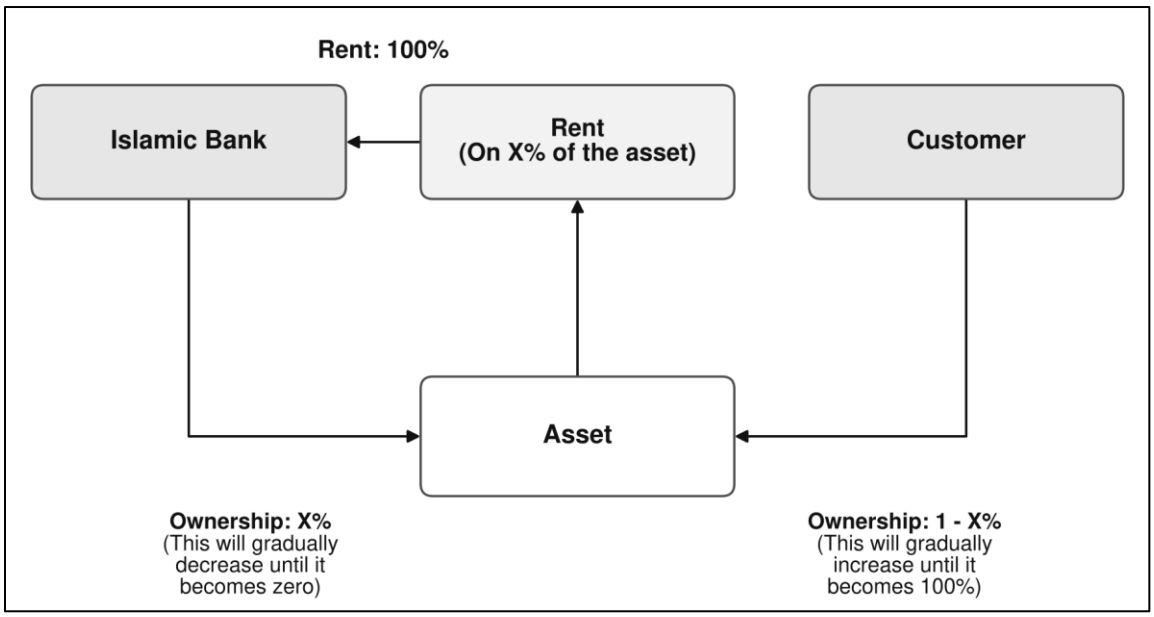
Source: Compiled by the research team based on AAOIFI Standards.

AAOIFI's newly issued FAS No. 32, Ijarah, which supersedes FAS No. 8, includes "Diminishing Musharaka Ijarah" (para 4(f)): a hybrid product combining co-ownership of a tangible asset without any common business, a promise by one co-owner to buy the other's share in periodic installments (each a separate sale), and a separate Ijarah under which one co-owner leases its share to the other. This form closely resembles HPSM. As an accounting standard, FAS 32 sets no Shariah requirements, but it provides a clear basis to argue that AAOIFI recognizes HPSM as a mode of financing.

It follows that the Shariah rulings on Ijarah, promise and sale all apply to HPSM. Unresolved is whether, and to what extent, the rulings on partnership also apply. If they do, a promise to buy or sell at a predetermined price would be impermissible. If the partnership is only joint ownership of the asset rather than a managed venture, the partnership rules would be limited

to that ownership: each partner bears proportionate ownership risk, only the bank's portion is leased and rented, and the customer, earning no income from its own portion, has no claim on the bank's rent (Figure 6.5).

Figure 6.5: Diminishing Musharakah Ijarah



Source: Compiled by the research team based on AAOIFI Standards.

6.2.5 Accounting of HPSM

The 2009 Guidelines for Islamic Banking define HPSM but set no accounting requirements for it. The accounting policies disclosed by Islamic banks in Bangladesh are summarized in Box 6.3.

Box 6.3: Accounting Policies for HPSM as Disclosed in the Notes Accompanying the Financial Statements of Islamic banks in Bangladesh

1. Islami Bank Bangladesh	The bank made the following disclosures specific to HPSM: • 'Unearned Income — the amount of unrealized portion of profit/ value addition of fixed assets [property, plant & equipment] under Hire Purchase Under Shirkatul Melk (HPSM) investment for gestation period.' • 'The Bank does not charge any rent during the gestation period of investment against Hire Purchase under Shirkatul Melk (HPSM) mode of investment but it fixes the sale price of the assets at a higher level in such a way to cover its expected rate of return. Such income is recognized on realization basis.'
2. ICB Islamic Bank	No specific disclosure on the accounting policy adopted for HPSM or 'Hire Purchase'.
3. Social Islami Bank	No specific disclosure on the accounting policy adopted for HPSM.
4. Al-Arafah Islami Bank	No specific disclosure on the accounting policy adopted for HPSM or 'Hire Purchase Investment'.
5. EXIM Bank	No specific disclosure on the accounting policy adopted for HPSM or 'Izara Bil Baia'.

6. Shahjalal Islami Bank	The bank made the following disclosures specific to HPSM: • 'As per IFRS 15, revenue should be recognized on accrual basis, but due to the unique nature of Islamic Banks, income from investment under … HPSM … is accounted for on realization basis as per AAOIFI and Bangladesh Bank guidelines.' • 'The Bank does not charge any rent during the gestation period of investment against Hire Purchase under Shirkatul Melk (HPSM) mode of investment but it fixes the sale price of the asset at a higher level in such a way to cover it expected rate of return. Such income is recognized on realization basis.'
7. First Security Islami Bank	No specific disclosure on the accounting policy adopted for HPSM other than stating the following: 'Unearned Income — the amount of unrealized portion of profit/value addition of fixed assets [property, plant & equipment] under Hire Purchase Under Sharikatul Melk (HPSM) investment for gestation period. Investments are stated in the Balance Sheet at the net amount excluding unearned income.'
8. Union Bank	The bank made the following disclosures specific to HPSM: 'The bank does not charge any rent during the gestation/interim period of investment under hire purchase, but it fixes the rent of the assets at a higher price in such a way to cover its expected rate of return. Such income is recognized on realization basis.'
9. Standard Bank	No specific disclosure on the accounting policy adopted for HPSM other than stating the following: 'Unearned Income — the amount of unrealized portion of profit/value addition of fixed assets [property, plant & equipment] under Hire Purchase Under Sharikatul Melk (HPSM) investment for gestation period.'
10. Global Islami Bank	No specific disclosure on the accounting policy adopted for HPSM other than stating the following: • 'Unearned Income — the amount of unrealized portion of profit/value addition of fixed assets [property, plant & equipment] under Hire Purchase Under Sharikatul Melk (HPSM) investment for gestation period.' • 'The Bank does not charge any rent during the gestation period of investment against Hire Purchase under Shirkatul Melk (HPSM) mode of investment but it fixes the sale price of the asset at a higher level in such a way to cover it expected rate of return. Such income is recognized on realization basis.'

Source: Financial Statements for the Year Ending 31 December 2022 of the Banks.

Although Islamic banks partly own HPSM assets and bear the related ownership risks and rewards, they recognize them as financial assets rather than fixed assets. This neither complies with AAOIFI FAS No. 32 nor reflects the Shariah form of HPSM.

FAS 32 requires Ijarah assets to be recognized initially at cost, including all costs of bringing them to their present location and condition, and subsequently at cost less accumulated depreciation and impairment. Ijarah revenue is recognized on an accrual basis using a straight-line (preferred), effective-rate-of-return or due-date method; rentals received during construction are not recognized until the lessor establishes its right to them.

The gradual transfer of ownership is recognized when it occurs. Figures 6.6 and 6.7 illustrate the journal entries and the presentation in the financial statements.

Figure 6.6: Journal Entries for Ijarah Through Gradual Transfer

Purchase of asset Dr Ijarah asset Cr Cash/Payable	**Ijarah revenue** Dr Cash Cr Ijarah revenue
Subsequent measurement: depreciation Dr Depreciation Cr Accumulated depreciation	**Unearned Ijarah rental** Dr Cash Cr Advance rental
Subsequent measurement: impairment Dr Impairment Cr Accumulated impairment	**Transfer of ownership** Dr Cash Cr Ijarah asset

Source: Compiled by the research team based on AAOIFI Standards.

Figure 6.7: Illustration of Financial Statements

Statement of Financial Position

Assets:	
Ijarah asset	
Cost	X
Minus: Accumulated depreciation	(X)
Minus: Accumulated impairment	(X)
	X
Initial direct costs	
Cost	X
Minus: Accumulated amortisation	(X)
	X
Advance payment to vendor	X
Liabilities:	
Advance rental	X

Statement of Profit or Loss

Ijarah revenue	X
Minus: Ijarah costs	(X)
Minus: Depreciation	(X)
Minus: Impairment	(X)
Minus: Amortisation of initial direct costs	(X)
Minus: Expenses related to Ijarah asset (e.g., Takaful, registration, legal, repair and maintenance)	(X)
Net Ijarah revenue	**X**

Source: Compiled by the research team based on AAOIFI Standards.

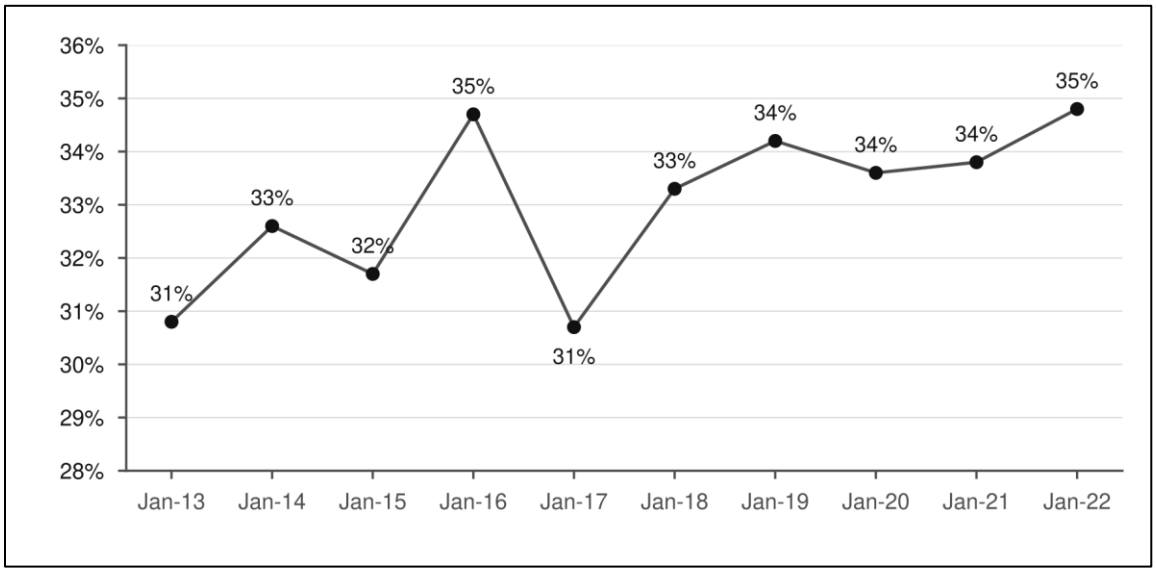
6.3 Analysis and Findings

6.3.1 Application of HPSM (including Ijarah/Diminishing Musharakah) in Different Countries

The growth of global Islamic finance and Bangladesh's position in international rankings are discussed in Chapter 3.

For conducting Islamic financing services in the globe, a number of Shariah-compliant modes are used by the banks and Table 5.1 in Chapter 5 presents a summary of this. About 12% of the financing has been made under Ijarah and Musharakah in 2021, which was 15% in 2018. If we consider HPSM as a proxy of these modes, it holds a significant share in comparison with other modes. In Malaysia, Ijarah and Musharakah (Malaysia reports Musharakah Mutanaqisah under Musharakah without distinguishing it from other forms of partnership) jointly hold about 22% of their total financing in 2022 as depicted in Table 8.1 in Chapter 8. It is worthy to mention that the joint share of Ijarah, Musharakah, and Diminishing Musharakah is about 64% in Pakistan in that year (Table 3.8 in Chapter 3). Figure 6.8 identifies the application of Musharakah Mutanaqisah by the Islamic banks in Pakistan.

Figure 6.8: Application of Musharakah Mutanaqisah by Islamic Banks in Pakistan



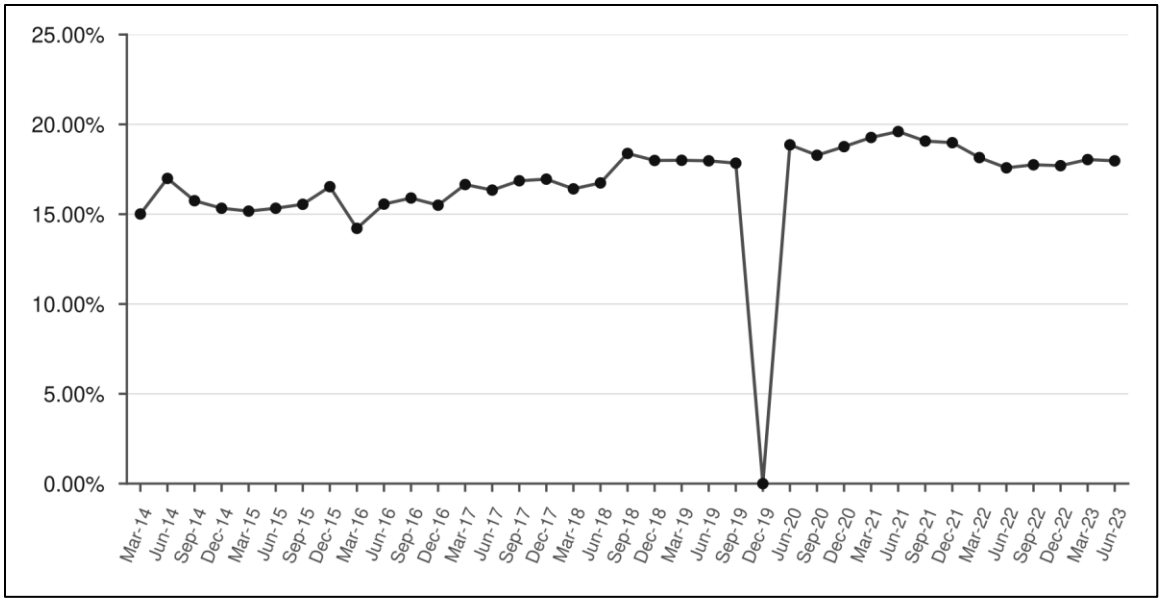
Source: SBP (n.d.).

6.3.2 Status of IB and Application of HPSM in Bangladesh

The market share and key performance indicators of Islamic banks in Bangladesh, which form the background of this study, are presented with updated data in Table 3.14 and Table 3.15 (Chapter 3).

Islamic banks in Bangladesh use several Shariah-compliant financing modes, shown in Table 3.13 in Chapter 3. In 2022, about 18% of financing was under HPSM and about 4% under Ijarah; since the two were previously reported jointly, HPSM and Ijarah together averaged about 23% over 2015–2022, while HPSM alone averaged about 18%.

Figure 6.9: Application of HPSM by Islamic Banks in Bangladesh



Source: Bangladesh Bank (n.d.).

Figure 6.9 shows Islamic banks' total HPSM investments, including those of Islamic branches and windows; the sudden drop in November 2019 reflects a one-off reclassification of the mode under Ijarah and Ijarah bi al-bay in Bangladesh Bank's reporting.

The banks' financial statements show that the use of HPSM varies widely across Islamic banks (Table 6.1), and a few use other names for the mode.

Table 6.1: HPSM to Total General Investments Ratio of Islamic Banks in Bangladesh

Bank	Different Term Used	HPSM or Equivalent to General Investments	
		2022	2021
1. Islami Bank Bangladesh	-	19.68	20.82
2. ICB Islamic Bank	Hire Purchase	39.63	39.71
3. Social Islami Bank	HPSM investment loan	18.83	20.34
4. Al-Arafah Islami Bank	Hire Purchase Investment	31.90	32.39
5. EXIM Bank	Izara Bil Baia	36.96	36.25
6. Shahjalal Islami Bank	-	26.08	23.64
7. First Security Islami Bank	-	7.65	8.88
8. Union Bank	-	4.76	5.22
9. Standard Bank	-	46.13	47.56
10. Global Islami Bank	-	6.81	7.60
Average (simple)	**-**	**23.84**	**24.24**

Source: Annual Report of the Banks.

6.3.3 Content Analysis of HPSM Agreement

A content analysis of the banks' HPSM agreements found that most use forms bearing their own logos, nomenclature varies, agreements are in English, and Shirkat, Ijarah, promise and Bai are not separated. In most cases the client bears all associated costs — insurance, registration, documentation, repair, maintenance and overhauling — and in case of damage the bank recovers its cost from an insurance claim or from the client. The findings are summarized in Appendix 4.

6.3.4 Summary of Interview and Survey Findings

i. **Prescribed form with bank logo:** HPSM agreements are usually documented on the bank's own form bearing its logo, although a neutral document without party-specific designations would be preferable.

ii. **Application process:** procedures vary — some banks require a prescribed form, others accept other formats, and some accept handwritten applications — and clients have been found using a Qard application form instead of the HPSM form, underlining the need for clear and accurate documentation.

iii. **Processing fee:** some banks charge a processing fee and others do not; any fee must relate to identifiable services and be justified to meet Shariah requirements. Bangladesh Bank allows both conventional and Islamic banks to charge processing fees in some cases, alongside its Six-month Moving Average Rate of Treasury Bill (SMART) policy capping interest and profit rates.

iv. **Collateral security:** banks take a charge over the financed asset as primary security and may require more. In car financing, where regulations require more than 50% equity from the client, the charge covers the full asset — a margin above 100% — and some banks demand security worth four to five times the financed amount, raising concerns of Zulm (injustice). Documentation costs for securities that benefit the bank are also passed to the client. Most Shariah experts permit these practices, but they warrant further consideration.

v. **Insurance in car financing:** clients must insure the vehicle for at least 110% of the bank's financing and bear the cost, even though they do not own the bank's share, while the bank's claim is settled first — contrary to the principle that the owner bears ownership risks and their mitigation costs, and a concern for Shariah experts. One bank's agreement, for example, requires the client to insure the asset comprehensively, at his own cost, for its cost price plus ten percent, with the bank's mortgage clause; to assist in lodging and realizing claims, which are applied first to the client's dues and related costs; and to pay any shortfall from his own sources.

vi. **Asset registration:** cars are registered jointly with a mortgage clause in the bank's favor, and flats in the client's name alone, with the client bearing registration costs in both cases. Where a jointly owned flat is registered solely to the client, some experts consider the correspondence, sanction advice and HPSM agreement sufficient evidence of the bank's ownership under Shariah, while others see inconsistencies.

vii. **Equity determination:** some banks calculate their contribution on the invoice or stated price, leaving all other costs to the client; since ownership risks follow each party's equity,

the actual contributions should be transparent, and some Shariah experts see potential excessive uncertainty (Gharar) here.

viii. **Several contracts at a time:** HPSM combines Musharakah, Ijarah and Bai, each requiring its own offer and acceptance. Combining contracts is permissible in principle; what is prohibited is contradictory or contingent linkage between them, Bai al-Inah, or any combination used as a device to produce Riba (AAOIFI SS 25). Most Shariah experts hold that these principles must be observed.

ix. **Undertakings by both parties:** a lessee may undertake to purchase the leased asset, but one partner may not guarantee another's capital in a Musharakah. Some HPSM agreements require the client to undertake to buy the bank's share at a set price and the bank to sell at a predetermined value — acceptable to some scholars but not to others.

x. **Early settlement:** most banks do not charge for early settlement, but a few do; Shariah experts oppose any extra charge.

xi. **Prepayment of installments:** some banks accept advance installments and adjust them against the cost price; others discourage or refuse them.

xii. **Documentation fees:** documentation mainly protects the bank, yet banks pass the full cost to clients; some Shariah experts suggest sharing it.

xiii. **Gradual ownership transfer:** ownership is assumed to pass proportionately with each installment, but some Shariah experts question whether offer and acceptance occur for each transfer, and transfer at original cost or face value may amount to a guarantee in the bank's favor.

xiv. **Waiver in case of damage:** since the asset is jointly owned, a client who is not negligent should not have to pay the remaining price if it is damaged; but regulations prevent banks from waiving principal, which, applied to HPSM, raises a question of Zulm, since the sale is incomplete without delivery of the asset.

xv. **Assets under construction:** no rent can be charged for an unusable asset, so banks recognize a capital gain by revaluing it at an effective rate of return; some Shariah experts accept this, while others question its justification and method.

xvi. **LC commission:** for imported assets, banks charge clients an LC commission as a agency (Wakalah) fee for an independent service, which some experts consider raises Shariah issues.

6.4 Issues and Recommendations

6.4.1 Development of Human Resources

Islamic banks should invest in specialized training on Shariah principles and their practical application to HPSM, work with qualified Shariah scholars who are accessible to staff for guidance, and foster continuous learning on evolving Shariah interpretations and regulation, encouraging professional certifications such as the Certified Islamic Banking and Finance Professional (CIBFP), Certified Islamic Professional Accountant (CIPA) and Certified Shariah Advisor and Auditor (CSAA). This would strengthen the Shariah-compliant execution of HPSM and customer trust.

6.4.2 Separation of Contracts in HPSM Agreement

HPSM integrates Musharakah, Ijarah and Bai agreements, so its contracts must be separated to observe proper offer and acceptance, the prohibition of combining contracts, the mitigation of ambiguity and risk, and transparency and customer understanding. Doing so would give customers and regulators confidence in HPSM agreements.

6.4.3 Reflection of Shariah in Accounting Record and Report

Accounting records and financial reports should reflect Shariah compliance. HPSM assets should be distinctly identified in the accounts — recording them as 'HPSM Financing' at initial recognition complicates later revaluation or sale of the underlying asset — and clear guidelines are needed for recognizing HPSM income so that no semblance of interest (Riba) arises, strengthening stakeholder trust and the integrity of HPSM transactions.

6.4.4 Compliance with the Shariah Requirement in Case of Ownership Transfer

Any full or partial transfer of ownership must meet all the Shariah requirements of a valid contract, including offer and acceptance and a Shariah-compliant transfer price, and must be precisely documented and recorded in the accounts, identifying each party's ownership risks and rewards.

6.4.5 Application of Valuation Technique

Banks apply valuation to recognize revenue when funds have been disbursed but the asset is not yet usable and no rent applies, as during construction. Its use needs a clear rationale: revaluing an asset under construction, or one not being handed over to a third party, is generally neither practical nor reasonable, and any revaluation should follow the fair value principle.

6.4.6 Revision of Contract Form

Content analysis shows scope to improve banks' HPSM forms: a restructured format should identify each contract separately, align the parties' roles with Shariah and allocate costs and risks in a balanced way — not all can be transferred, even by mutual agreement — and all forms and related documents should be reviewed periodically as understanding of HPSM evolves.

6.4.7 Regulatory Support

Bangladesh has no separate law for Islamic banking, and the single regulator sometimes issues directives framed for conventional banking without separate guidelines for Islamic banks, which may not suit them from Shariah or business perspectives. Separate regulatory guidance is needed on matters such as fixing and adjusting rates of return, restructuring or rescheduling claims, penalties and waivers, registration and insurance requirements and costs, and post-financing supervision fees.

Appendices

Appendix 4

A Summary of Content Analysis of the HPSM Agreement of IBs of Bangladesh

Issues of Review	Finding	Remark
Language of contract	English	Are all clients proficient in English to understand the covenant laid down in the agreement?
Mode of agreement	Exim Bank	Ijarah Bil Bia
	Shahjalal	Hire Purchase
	IBBL, AIBL, SBL, FSIBL, SIBL, UBL	Hire Purchase under Shirkatul Melk
The banks logo in the agreement	Except for SJIBL, most of the banks use their logo in the agreement form	As it is an agreement between the bank and the client, is it essential to have the logo of a specific party?
Commingling of 2/3 Contracts	Shirakat, Bai and Ijarah. are within the same agreement, and it is difficult to segregate the independence of each subject matter/contract.	There should be a severe Shariah concern to ensure the independence of Shirakat, Bai and Ijarah. However, banks may sign the agreement in a single format, segregating the 2/3 parts and representing each separately.
Equity	Shahjalal concludes the Hire Purchase Agreement; thus, the question of equity is irrelevant. Other banks mentioned the equity contribution of both the bank and the client.	Shahjalal Bank will purchase in its name. In the case of SJIBL, the provision for a down payment or signing money can be considered.
Equity/ Principal Realization	Fixed Amount of Bank's Share. Here, the sale price is fixed.	There is no offer or acceptance for purchasing the bank share while paying each installment. Depreciation is ignored. No clause is found on the Promise to purchase from the client.
Installment	Equated monthly installment (EMI)	Mixed practices are found among the banks. Some banks apply annuity, and some use the average method. An annuity is in favor of the bank, while the average is in favor of the client. Installment size varies due to the EMI calculation method for the same amount and rental rate.
Compensation	The provision of compensation is stipulated in the agreement.	The distribution of compensation amount is not mentioned in the contract.
Insurance	Insurance of assets is on account of the client	Both the bank and the client should have covered it. Are shares of underlying assets insurable? Due to EMI, shares are gradually transferred to the clients, so what is the justification for insurance to be covered in favor of the bank?
Maintenance/overhauling/ repairing/running	On account of the client.	Significant overhauling charges should be on a pro-rata basis.
Damage to the asset	If not fully covered by insurance/ sale of mortgages, the rest of the amount will have to be covered by the client.	The essence of Shirkat is affected seriously.
Descriptions of subject matter	Machinery, Equipment, Vehicle Project	
Dispute management	The respective bank's decision is final.	Is there any scope for unilateral dispute settlement in a joint venture project?

Source: Compiled by the research team based on agreement form of full-fledged IBs.

Chapter 7: Making Mudarabah and Musharakah More Effective

Based on the study "How Can Mudaraba and Musharaka Be More Effective in Bangladesh?" by Md. Alamgir, Md. Mahabbat Hossain and Maksuda Khatun.

7.1 Introduction

7.1.1 Background of the Study

Islamic banking conducts banking according to Islamic law (Shariah), with no element, in form or substance, that Shariah does not approve. It runs parallel to conventional banking and must avoid all Islamic prohibitions, so describing it simply as 'interest-free' is incomplete: the prohibition of interest is central, but it is supported by teachings on individual rights and duties, risk-sharing, the avoidance of excessive uncertainty and the sanctity of contracts.

Islami Bank Bangladesh Limited (IBBL), which began Islamic banking in Bangladesh in 1983, used both partnership and non-partnership financing to promote socio-economic welfare, but underreporting in the partnership modes — profit-sharing partnership (Mudarabah) and partnership (Musharakah) — hampered them, and it shifted increasingly to non-partnership modes, becoming highly successful at home and abroad. New full-fledged Islamic banks followed, conventional banks opened Islamic branches and windows, and some converted fully; by 2020 around thirty banks offered Islamic banking, using participatory, non-participatory and ancillary contracts to compete with conventional banks. With a larger market share, the industry is now mature enough to take on riskier Mudarabah and Musharakah financing and reveal the real merits of Shariah-based banking.

Islamic banks worldwide use Musharakah, Mudarabah, cost-plus sale (Murabahah), Salam, Istisna'a, lease (Ijarah), agency (Wakalah), guarantee (Kafalah), Jualah, safe custody (Wadiah) and Qard for deposits and financing, but most scholars and practitioners hold that profit-loss sharing (PLS) — mainly Mudarabah and Musharakah — is essential to a true transition from conventional to Islamic banking. Ahmed (2006) sees no alternative to implementing and popularizing these modes, and Chapra (2017) argues that the socio-economic benefits of prohibiting interest (Riba) cannot be fully realized until the share of PLS financing rises substantially.

Expanding Mudarabah and Musharakah financing, by overcoming the obstacles to it, is therefore essential to the development of Islamic banking in Bangladesh and calls for concerted efforts by bankers, Shariah scholars, practitioners, researchers and think-tanks, which would also create employment and contribute to Gross Domestic Product (GDP). This study seeks to help improve the effectiveness and efficiency of such financing.

7.1.2 Objectives of the Study

The objectives of the study are to:

(i) depict conceptual framework of Mudarabah and Musharakah financing;

(ii) discuss legal framework of Mudarabah and Musharakah financing;

(iii) highlight the current status of Mudarabah and Musharakah financing, both in Bangladesh and global context; and

(iv) identify impeding factors and problem areas of Mudarabah and Musharakah financing in Bangladesh; and finally, put forward a number of recommendations

7.1.3 Methodology and Data

The study uses primary and secondary data: a semi-structured questionnaire answered by 22 of 26 banks, a Focus Group Discussion (FGD) held via Zoom and informal discussions with experts and practitioners on sensitive matters, together with journals, publications and data from the Islamic Financial Services Board (IFSB), Bangladesh Bank and the banks concerned. It covers full-fledged Islamic banks and conventional banks with Islamic branches and windows, presents findings mainly in tables and graphs, and incorporates comments from a roundtable discussion.

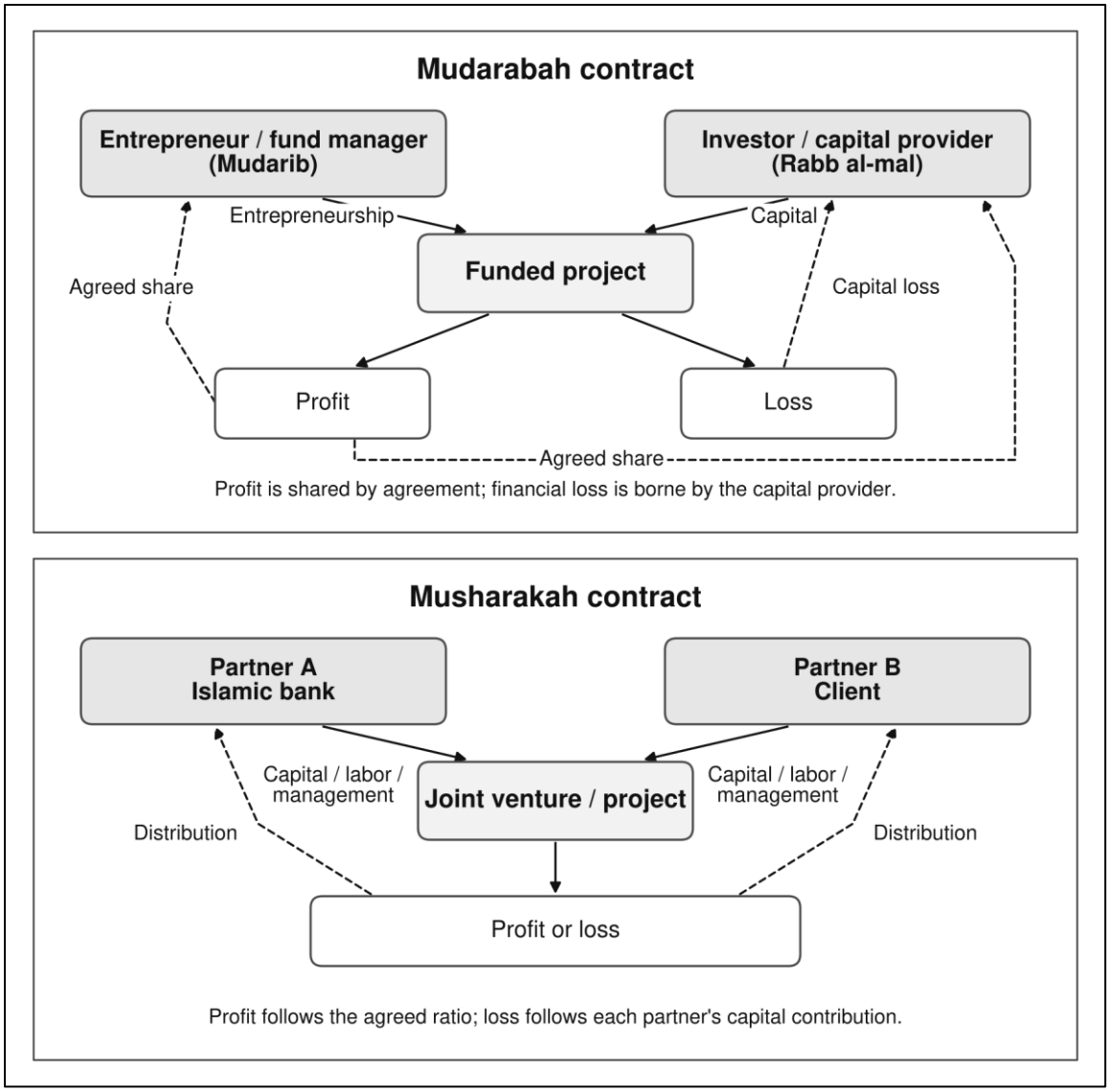
7.2 Conceptual Discussion on Mudarabah and Musharakah

7.2.1 Fundamentals of Mudarabah and Musharakah Contracts

The term Mudarabah is derived from *al-darb al-ard* which means traveling through the land as mentioned in the verse of the al-Quranul Majid: "…others traveling the land seeking of Allah's bounty" (Al-Muzzammil: 20). The three main characteristics of Islamic finance and banking are risk sharing, connected with real economy, Shariah compliance, all of which are truly reflected in Mudarabah and Musharakah financing. The allocation of risk and reward and the distribution of responsibilities among the parties in Mudarabah and Musharakah contract clearly demonstrates the social and ethical standards of shariah.

Both Mudarabah and Musharakah are partnership business. In case of Mudarabah contract, one party provides capital, known as *Rabbul-mal* and the other party provides entrepreneurship, known as *managing partner (Mudarib)*. The profit earned from the Mudarabah business is shared by both the parties at a pre-agreed ratio; however, in case of failure, the loss is borne completely by the capital provider. On the other hand, Musharakah is a partnership contract where more than one investor come together and jointly contribute the capital of a business venture (ElGindi *et al*., 2009). All the partners have right to take part in the management. The profit earned from a Musharakah is distributed at a pre–agreed ratio, while the loss is shared by all the partners according the proportion of their capital contribution (Febianto, 2009). Figure 7.1 presents Mudarabah and Musharakah structure.

Figure 7.1: Mudarabah and Musharakah Structure



Source: Based on definition.

7.2.2 Classification of Mudarabah and Musharakah Contracts

A Mudarabah contract may be restricted or unrestricted. In case of restricted Mudarabah, the investor mentions the particular business, asset class, region, time period, place, etc. for the entrepreneur to invest in. But, in case of unrestricted Mudarabah, the entrepreneur has the full independence to do the business to maximize the profits. Musharakah contract may be a constant Musharakah or diminishing Musharakah. In the case of latter, ownership of one party is gradually taken over by other party.

7.2.3 Basic Principles of Mudarabah and Musharakah Business

Generally, partners should provide capital in monetary form. However, if the capital is provided in any kind other than money, it should be valued in terms of money and should be

recognized as capital. Generally, liability should not be recognized as capital. One partner should not provide guarantee for profit or capital losses to the other party. However, guarantee may be provided against the negligence of the party. Independent third party e.g., Islamic Insurance Company, may provide such guarantee. Profit sharing ratio must be fixed in advance; however, the ratio may be changed in the subsequent period with the consent of the parties.

7.2.4 Rationale of PLS Financing

Other than sharing mode, there is a greater chance of wealth concentration. Therefore, Mudarabah and Musharakah financing techniques are more conducive to sharing risk and attainment of social equity, justice and stability in the system. Real sector determines the rate of return of the financial sector, because the profit-sharing techniques make the capital to share profit according to its actual realized productivity.

7.3 Legal Framework of Mudarabah and Musharakah Financing

Shariah regulation is one of the main components of Islamic banking and finance, and hence, this is also very much mandatory for Mudarabah and Musharakah financing. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standard No. 13 and AAOIFI Accounting Standard No. 3 are directly related with Mudarabah. Similarly, AAOIFI Shariah Standard No. 12 and AAOIFI Accounting Standard No. 4 are especially focused on Musharakah Financing. Besides, resolutions issued by the International Islamic Fiqh Academy of Organisation of Islamic Cooperation (OIC) are also important for Mudarabah and Musharakah operations. Further, IFSB standards are also mentionable for Islamic banking operations. Local regulations e.g., Bangladesh Bank guidelines and opinions of the concerned Shariah Supervisory Board (SSB) are to be followed by an Islamic bank.

For increasing popularity across the world and creating strong domestic mandate from a number of full-fledged Islamic banks as well as the desire of mass-population in Bangladesh, Bangladesh Bank (Bangladesh Bank) issued a set of guidelines for conducting Islamic banking through a circular (BRPD Circular No. 15, Dated: 9 November 2009) based on Bank Company Act 1991.

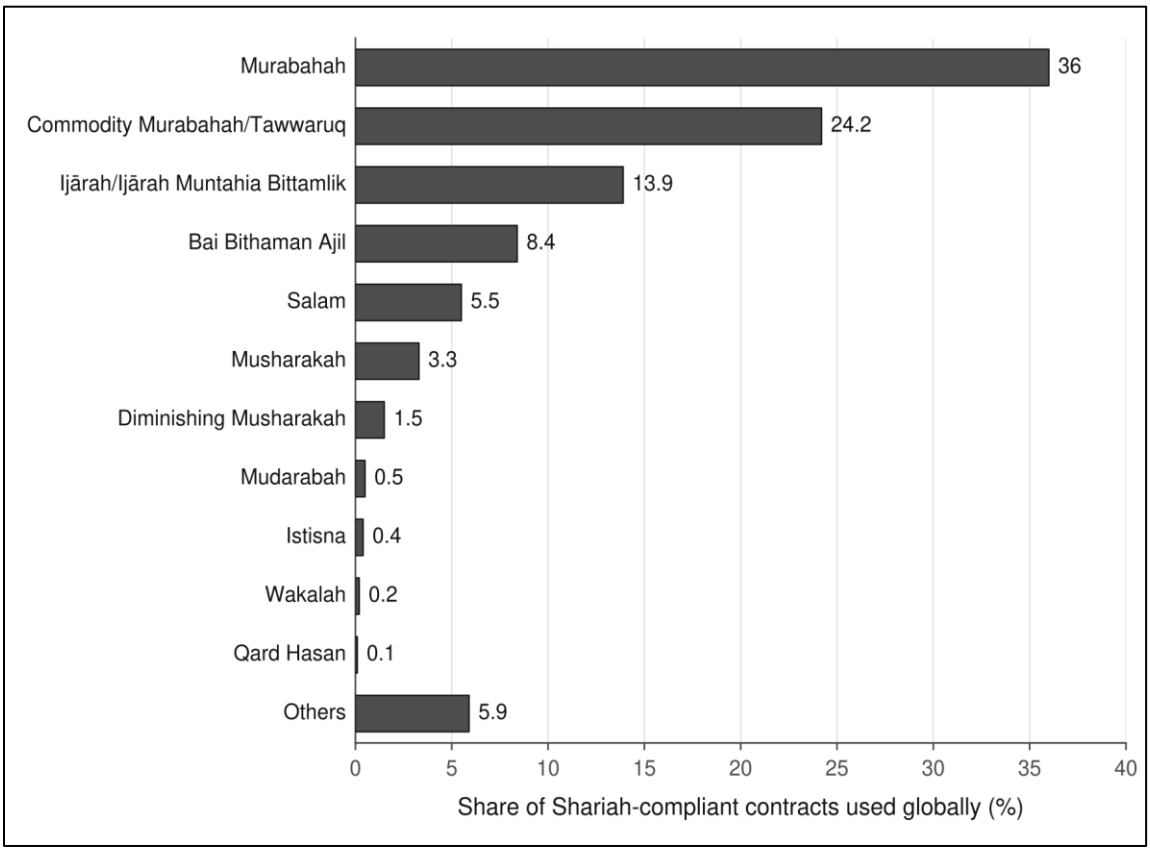
The Bangladesh Bank guidelines cover definitions of terminologies, criteria for setting up an Islamic bank or conversion from a conventional bank, principles and modes of deposit mobilization and investment, liquidity management, and provision for obligatory alms (Zakat). Also, the format of financial statement, the framework of rate of return, fit and proper criteria for selection of members of Shariah Supervisory Committee (SSC) are given in the Bangladesh Bank guidelines. All full-fledged Islamic banks and the conventional banks having Islamic branches and/or windows have to ensure that all of their transactions, services and behavior are vetted by its Shariah Supervisory committee/Council (SSC).

7.4 Status of Mudarabah and Musharakah Operations

7.4.1 Mudarabah and Musharakah Operations in Global Context

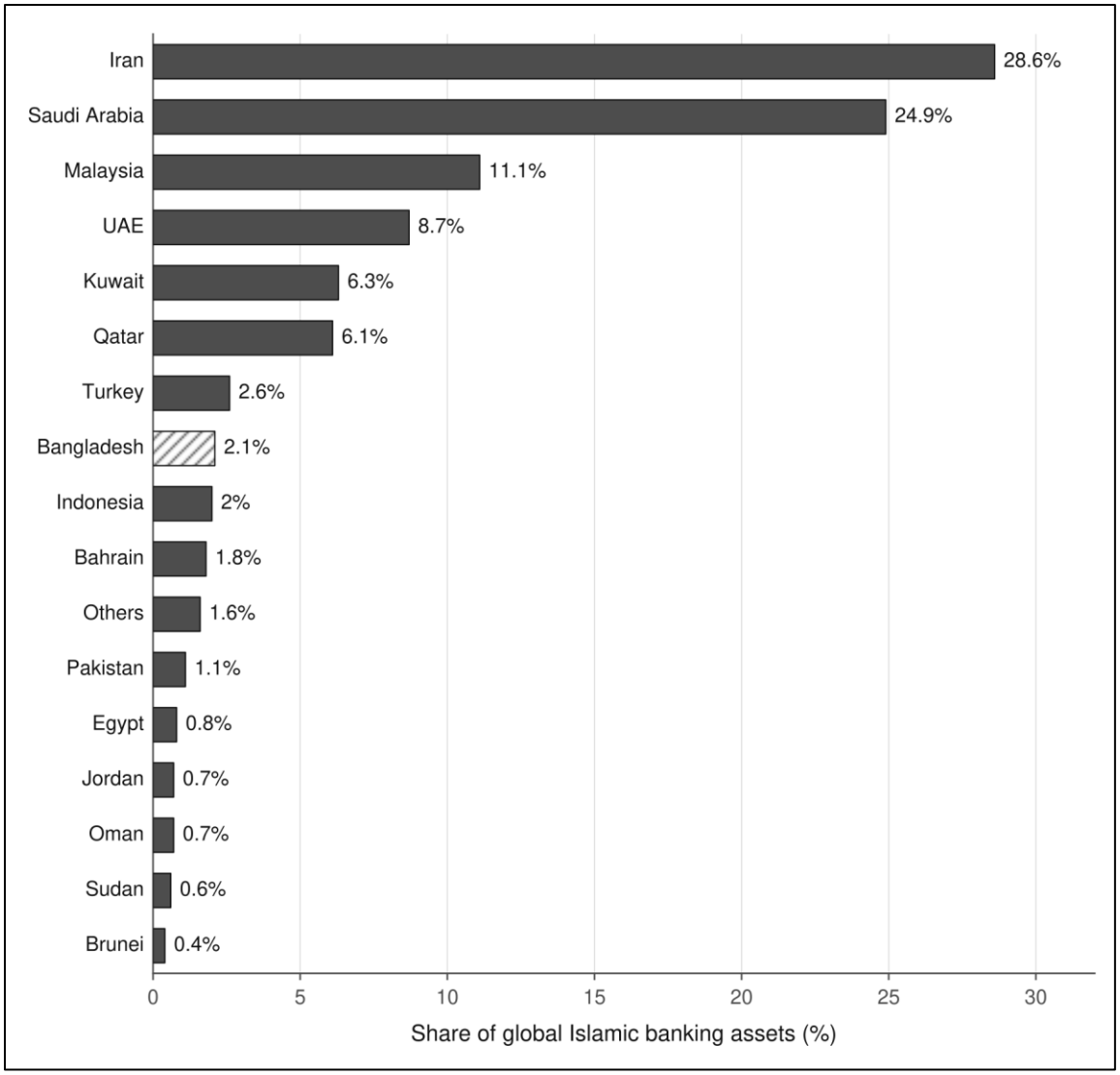
Islamic banking contracts may be accomplished under Bai-mechanism (buying-selling), *partnership (Sharikat)* mechanism (partnership), *Ijarah* (lease) and others. About 65% (*Murabahah* 36; *Tawwaruq* 24; and *Salam/Istisna'a* 6) contracts are done under trading mechanism, while only about 5% financing under sharing mode (*Mudarabah/Musharakah*) (Figure 7.2), Figure 7.3 presents country-wise Islamic banking share in global assets.

Figure 7.2: Mode-wise Shariah-compliant Contracts Used Globally



Source: Islamic Financial Services Industry Stability Report 2020, IFSB.

Figure 7.3: Country-wise Islamic banking share in global assets (%)



Source: Islamic Financial Services Industry Stability Report 2020, IFSB.

As shown in Figure 7.3, the highest share in global IB assets is contributed by Iran (28.6%), followed by Saudi Arabia (24.9%). In global context, Bangladesh is contributing only 2.1%, which is, however, greater than that in Indonesia, Bahrain and Pakistan.
The market share of Islamic banking in Bangladesh is presented in Table 3.14 in Chapter 3.

7.4.2 Deposit Mobilization by Islamic Banks of Bangladesh

Islamic banks have the authority to collect their deposits under Mudarabah, Wadiah or Qard principle. The structure and percentage of modes of deposit collection during the 2014–2020 period is shown in Table 7.1. The data show that about 80% of deposits are mobilized by the Islamic banks in Bangladesh under Mudarabah, which is a mode of sharing — 79.77% on average over 2014–2020, counting Mudarabah savings bonds, special savings, Hajj, term, SND and savings deposits. The remainder is held in Wadiah current accounts (3.95%) and other deposits, mainly under Wadiah or Qard (16.26%).

Table 7.1: Islamic Banking Deposits by Contracts (%)

	Wadiah **Current Account Deposits**	***Mudarabah*** **Savings Bond**	***Mudarabah*** **Special Savings (Pension /Profit Deposits)**	**Mudarabah Hajj Deposits**	**Mudarabah TD**	**Mudarabah SND**	**Mudarabah Savings Deposits**	**Other Deposits**
2014	4.00	1.00	9.00	0.00	49.00	3.00	17.00	17.00
2015	3.83	1.02	7.80	1.74	48.46	2.94	18.32	15.79
2016	4.05	0.90	8.98	0.28	47.35	3.20	18.61	16.63
2017	4.41	0.75	8.71	0.22	47.45	3.76	18.38	16.32
2018	3.89	0.66	8.70	0.21	49.23	3.68	18.38	15.25
2019	3.58	0.58	8.62	0.22	48.21	3.94	17.60	17.23
2020	3.91	0.48	9.32	0.23	47.04	4.67	18.77	15.58
Average	3.95	0.77	8.73	0.41	48.11	3.60	18.15	16.26

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

7.4.3 Investment Activities by Islamic Banks of Bangladesh

Islamic banking contracts which are used for investment purposes are shown in Table 7.2. Around 70% investments are in the mode of Murabahah and Muajjal which are trade mode of financing, whereas only about 2% investments are made in the form of Mudarabah and Musharakah financing. On the other hand, 5% financing has been performed under sharing mode across the globe. Therefore, Islamic banks of Bangladesh are lagging behind the globe by around 3% investments in the mode of Mudarabah and Musharakah. Effective initiatives can be undertaken to improve this position to remain at par with the desired global level.

Table 7.2: Islamic Banking Investment Activities by Contracts (%)

	Qard (Secured)	**Bai al-Murabahah**	**Bai-Muajjal**	**Bai al-Salam**	**Bai al-Istisna'a**	**Mudarabah**	**Musharakah**	**Ijarah/ HPSM**	**Others**
2014	1.33	44.24	24.72	0.86	0.30	0.29	1.32	22.66	4.10
2015	1.45	44.47	24.93	0.76	0.30	0.38	1.54	22.62	3.59
2016	1.31	44.64	25.24	0.80	0.23	0.32	1.59	22.89	2.98
2017	1.32	43.81	25.17	0.96	0.22	0.26	1.53	24.29	2.44
2018	1.32	44.33	25.63	0.99	0.07	0.26	1.43	23.39	2.58
2019	0.05	44.60	23.95	0.03	1.16	0.32	1.38	23.64	4.87
2020	1.67	44.97	23.76	1.29	0.01	0.33	0.92	23.79	3.26
Average	1.21	44.44	24.77	0.81	0.33	0.31	1.39	23.33	3.40

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

7.4.4 Urban-Rural Business Activities by Islamic Banks of Bangladesh

While Islamic banks are mobilizing deposits from the rural areas of around 18%, they are deploying investments of only about 5.85% which is far below its potential (Table 7.3). Therefore, the management of Islamic banks can take concrete initiatives to extend their investments to rural areas in the mode of Mudarabah and Musharakah by avoiding their risk aversion attitude. Though this PLs mode will invite risk, still it will be more Shariah compatible to attain *Maqasid al-Shariah* (objective of Shariah).

Table 7.3: Deposits and Investment (Credit) Distribution by Rural and Urban Areas (%)

Areas		All Banks		Islamic Banks	
		2020*	**2019****	**2020***	**2019****
Deposit	**Urban**	79.28	79.06	81.88	82.07
	Rural	20.72	20.94	18.12	17.93
Investment (Advances)	**Urban**	89.66	89.69	94.35	94.15
	Rural	10.34	10.31	5.65	5.85

Source: Scheduled Banks Statistics, Bangladesh Bank.
*Note: *As on June 30 **As on December 31.*

7.4.5 Economic Purposes-Wise Investments (Credit) in Bangladesh

There are thirteen economic purposes for which investments (credit) are to be directed. Though Islamic banks are nearly at par in the housing (commercial), export financing, import financing, transport, industrial working capital financing, they are far below in the agriculture, fishing, forestry and housing (residential) (Table 7.4). So, Islamic banks have huge potential to increase their share of investments in agriculture, fishing, forestry and housing (residential) sector by employing the Mudarabah and Musharakah contracts.

Our Honorable Prime Minister expressed her concern about famine across the globe due to coronavirus disease 2019 (COVID-19). To effectively address her concern, all the banks can extend more financing to the agricultural sector to produce more food grains. It is now high time for the Islamic banks to invest their idle funds to this investment-worthy agricultural sector through PLS mode, and thereby take, the pragmatic and effective role to help the country achieve targeted food production and alleviate the potential famine.

Table 7.4: Investments (Credit) Categorized by Economic Purposes and Sector (%)

	Economic Purposes	All banks		IB	
		2020*	**2019****	**2020***	**2019****
1.	**Agriculture, Fishing & Forestry**	4.61	4.44	1.68	1.76
2.	**Industrial term loan**	20.58	20.08	16.19	16.14
3.	**Industrial WC financing**	21.30	21.72	23.33	26.11
4.	**Housing (Commercial)**	2.26	2.30	2.69	2.83
5.	**Housing (Residential)**	3.02	3.05	2.41	2.51
6.	**Others Construction**	3.65	3.69	3.95	3.80
7.	**Transport**	1.34	1.41	1.39	1.17
8.	**Wholesale and Retail Trade**	17.70	17.56	28.85	28.26
9.	**Export Financing**	5.43	4.91	4.44	3.20
10.	**Import Financing**	10.08	10.01	10.58	9.06
11.	**Others Trade and Finance**	0.51	0.48	0.04	0.06
12.	**Consumer Finance**	6.34	7.07	2.89	3.55
13.	**Miscellaneous**	3.18	3.28	1.56	1.55
	Total	**100**	**100**	**100**	**100**

Source: Scheduled Banks Statistics, Bangladesh Bank.
*Note: *As on June 30; ** As on December 31.*

7.5 Impeding Factors in Making Mudarabah and Musharakah Financing More Effective

Generally, it is perceived that Mudarabah and Musharakah are more risky contracts. There is no certainty of return, and even the capital provider needs to bear the loss. Besides, agency problem and unfair tax treatment by the government may also cause uncertainty in the return on investment. Unfair tax treatment and legal discrimination against profit-loss sharing contracts force Islamic banks and other financial institutions to opt for non-partnership contracts (Zafar & Nor, 2019). From the market survey and discussion with the key practitioners, we have identified the following impeding factor behind Mudarabah and Musharakah financing in Bangladesh (Box 7.1).

Box 7.1: Impeding Factors of Mudarabah and Musharakah Operations

- Risk of fraud and forgery on the part of Mudarib (entrepreneur).
- Cumbersome taxation system i.e., when the PLS projects make more profit, then it is required to pay substantial amount of taxes to the exchequer.
- Highly complex nature of equity financing- PLS financing should be simple equity-based financing which is currently present in Iran, not pure equity financing.
- Additional costs to be spent for employing specialists for Mudarabah and Musharakah financing.
- Principal –agent problem on account of information asymmetry. This asymmetric information causes adverse selection and moral hazard problem.
- Lock up of investments in Mudarabah and Musharakah projects for a long time with relatively higher risk.
- These types of projects are of long-term nature and they generally offer low returns.
- In most cases, earnings are not immediate for long-term projects.
- Moral hazard of the entrepreneurs because of low ethical position in the existing society.
- Lack of correct and timely information from the entrepreneurs.
- Inadequate management skills of the entrepreneurs.
- Lack of intention of the Mudarib to declare the true profits and share it with the Shaheb-al-Maal (fund provider).
- Extra costs for the Islamic banks for monitoring the Mudarabah and Musharakah financing projects.
- Banks in their initial phase of operations do not want to get exposed to high risk by investing under Mudarabah and Musharakah.
- Skilled and efficient entrepreneurs are reluctant to take investments in these forms, because they are to share higher profits in this case whereas they are to share lower profits in case of Murabahah based financing.
- For normal financing, extensive evasion of tax by business houses in most of the cases, but in case of Mudarabah and Musharakah financed projects, actual returns are to be divulged, so no scope of tax evasion.
- Absence of incentive-compatible covenants/terms in the PLS based contracts.

Source: Survey Data.

For the growth of Islamic investment by complying with the principles of Shariah in Bangladesh, Islamic banks are facing severe challenges from investment clients. To remove operational and regulatory challenges, banks have raised some key regulatory requirements for the Islamic banking industry (Box 7.2).

Box 7.2: Expectation of Islamic Banks from Regulators to increase PLS investments

- Establishing separate Information Bureau (IB) for Islamic Investment.
- Establishing separate Aurtho Rin Adalat for Islamic Banks.
- Setting up Full-fledged Shariah Audit & Inspection of Bangladesh Bank.
- Conducting Shariah Rating for IFIs in Bangladesh.
- Ensuring transparency in accounting audit system.
- Revising tax provisions.
- Developing Commodity Exchange house.

Source: Survey data and FGD.

Sometimes, Islamic banks face problem to comply with common circulars issued for all banks. Among the circulars issued during COVID-19, extension of investment outstanding, stimulus packages from the Government of Bangladesh, and availing refinancing scheme are notable. In case of Murabahah financing, roll-over is not permitted in Shariah. In case of sharing mode, bank may not change the share of profit adversely. Islamic banks are facing *Shariah* compliance risk with stimulus package declared by the o Government of Bangladesh. Besides, operational procedures of recently issued refinance scheme from Bangladesh Bank is another concern on the part of Islamic banks for PLS financing.

7.6 Recommendations

Islamic banks mobilize deposits mostly under Mudarabah but invest largely through fixed-return modes, with Mudarabah and Musharakah financing very low. Banks could offer terms attractive to honest, skilled entrepreneurs; scholars and bankers should promote wider use of PLS tools in line with AAOIFI and IFSB standards; and management needs organized PLS financing and trained staff. The following issues call for action by the regulator, bank management and other authorities.

7.6.1 Potential for Long-term Investment

Basel III's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) make it harder for conventional banks to fund long-term projects with short-term deposits, whereas Islamic banks can finance long-term investment through Mudarabah.

7.6.2 Rate of Returen Risk in Banking

Since around 95% of Islamic banks' deposits are Mudarabah-based, deploying them through Mudarabah and Musharakah would eliminate rate of return risk — the Islamic counterpart of interest rate risk, a major risk for conventional banks.

7.6.3 Inclusion of Partnership Financing in the CAMELS Rating

Bangladesh Bank rates banks on the five-point CAMELS scale (Capital Adequacy, Asset Quality, Management Efficiency, Earning Quality, Liquidity and Sensitivity to Market Risk). A 'Shariah Compliance' dimension could be added and, just as the management rating reflects

regulatory targets for agricultural and Small and Medium-sized Enterprises (SME) financing, a weighting for PLS financing could be included for Islamic banks.

7.6.4 Funding for Establishing the Best Quality Specialized Hospital

The pandemic exposed weaknesses in the health sector; building on their Corporate Social Responsibility (CSR) healthcare work, Islamic banks could create dedicated funds to establish modern hospitals for COVID-19 and related diseases through PLS financing.

7.6.5 Reporting to Bangladesh Bank to Ensure Regulatory Compliance

Bangladesh Bank could issue guidelines requiring Islamic banks to report on Shariah compliance and on directed Mudarabah and Musharakah financing, and could direct that certain types of financing be done under these modes, whatever the type of bank.

7.6.6 Promoting Islamic Social Business through Partnership Modes

An endowment (Waqf) bank is needed to collect Waqf, Zakat and voluntary charity (Sadaqah) funds, which the Qur'an encourages, and Islamic banks could contribute more to charity funds that promote Islamic social business through PLS contracts.

7.6.7 Formation of Special Cell in Investment Departments for PLS Financing

Each Islamic bank could establish a special cell in its investment department for Mudarabah and Musharakah financing, with its own investment guidelines.

7.6.8 Overcoming the Moral Hazard Problem in PLS Financing

Low ethical standards make PLS contracts hazardous; built-in motivational measures and long-term targets could reduce this problem.

7.6.9 Using Sukuk for Meeting Long-term Funding Requirement

Islamic investment certificates (Sukuk), vital in global Islamic finance, could help the government, central bank, corporates and Islamic banks raise funds for long-term projects. Islamic banks could use Sukuk proceeds for large Mudarabah and Musharakah projects, and Sukuk could themselves be structured on these modes.

7.6.10 Extra Expenses for Monitoring Mudarabah/ Musharakah Projects

PLS projects need close monitoring, which costs more; bank management should accept these costs to expand Mudarabah and Musharakah financing, which can also earn more when successful.

7.6.11 Inclusion of Incentive-Compatible Covenants in the PLS-based Contracts

Agency theory holds that entrepreneurs will not always act in the financier's interest, so contracts should link the entrepreneur's self-interest to maximizing the project's earnings.

7.6.12 Introduction of Third-party Guarantee for Mudarabah/Musharakah

Some scholars and practitioners support third-party guarantees (Kafalah) of Mudarabah and Musharakah capital, preferably from the government or otherwise from private entities, with Islamic insurance (Takaful) also playing a role. Above all, banks need close screening, monitoring and supervision of entrepreneurs to make PLS financing more effective.

Chapter 8: Pricing of Islamic Banking Products in a Dual Banking Environment

Based on the study "Pricing of Islamic Banking Products in a Dual Banking Environment of Bangladesh" by Md. Mahabbat Hossain, Md. Alamgir, Muhammad Amir Hossain and Mezbah Uddin Ahmed.

8.1 Introduction

8.1.1 Background

Bangladesh's banking sector is dual, with conventional banks (CBs) historically dominant but Islamic banks (IBs) — full-fledged banks, Islamic branches and windows of CBs, and Islamic finance companies — growing rapidly, driven by demand for Shariah-compliant products. Whereas CBs earn the spread between deposit and lending rates, IBs avoid interest (Riba) through Shariah-based contracts — trading (Murabahah, Salam, Istisna'a), equity participation (Mudarabah and partnership (Musharakah)), leasing (Ijarah) and agency (Wakalah) — and must uphold fairness, transparency and ethical conduct under an additional layer of Islamic law (Shariah) governance.

Both share regulation, risk exposures, market volatility and operational challenges — credit risk, market fluctuations, financing purposes, rescheduling and early settlement — but IBs must address them within Shariah, so pricing their products requires careful attention to both regulatory and Shariah factors. Whether IBs should charge the same rates as CBs is complicated by their wider range of products and by customer risk, region, product type, rescheduling needs, market volatility and internal costs, and IBs must also determine permissible fees for processing, supervision and early settlement while remaining competitive. This chapter explores these challenges and how IBs in Bangladesh can navigate them.

8.1.2 Research Objectives

Each Shariah-compliant financing method — Murabahah, Ijarah, Mudarabah, Musharakah, Salam and Istisna'a — requires its own pricing approach, consistent with Shariah, competitive in the market and compliant with national laws, making transparent and ethical pricing strategies crucial. The study examines how IBs price their products in accordance with Shariah and the challenges to Shariah compliance; its specific objectives are:

a) to identify the regulatory and Shariah requirements that influence the pricing of Islamic Bank (IB) products;
b) to analyze the similarities and differences in the pricing strategies used by IBs based on current industry practices; and
c) to provide recommendations for ensuring Shariah compliance while maintaining market competitiveness.

In doing so, it seeks to show how IBs can balance regulatory obligations, Shariah compliance and competitiveness, drawing on the standards of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and other reputable Shariah authorities.

8.1.3 Research Methodology

Primary data were collected through structured questionnaires to key IB personnel, interviews with stakeholders and FGDs with business executives, Shariah experts and Bangladesh Bank officials. Secondary data came from the Islamic Finance Development Report, the Global Islamic Finance Report (GIFR), International Islamic Financial Market (IIFM) Sukuk Reports and the Islamic Financial Services Industry Stability Report, and from IBs' annual reports, Bangladesh Bank's Financial Stability Report and Quarterly Report on Islamic Banking, and Bangladesh Institute of Bank Management (BIBM) publications. Simple statistical tools were used, findings are presented in tables, and feedback from a BIBM research workshop has been incorporated.

8.2 Conceptual Framework

Whereas CBs use interest rates to manage deposits and financing, IBs avoid Riba and excessive uncertainty (Gharar) and collect and deploy funds through Shariah-compliant modes — safe custody (Wadiah), Mudarabah, Murabahah, Ijarah, Salam, Bai-al-Sarf, Istisna'a, Musharakah, Wakalah and Kafalah (Alamgir et al., 2024) — each with implications for pricing:

- **Wadiah:** an alternative to Qard for current-account deposits, with no pricing attached.
- **Mudarabah:** a partnership of capital provider (Rabb al-Mal) and manager (Mudarib) in which profit guarantees by the Mudarib are prohibited and the profit-sharing ratio must be agreed in advance (AAOIFI, 2015); IBs may smooth depositors' profits through gift (Hibah) (Ahmed, 2010) and, under AAOIFI, a Profit Equalization Reserve (PER) and Investment Risk Reserve (IRR), although Bank Negara Malaysia (BNM) allows none of these techniques for Mudarabah investment accounts (Ismail, 2013).
- **Murabahah:** cost and profit must be disclosed, only direct purchase expenses may be included in cost, and prices may not be altered after execution (AAOIFI, 2015); Ibra' (rebate) may be granted for early settlement.
- **Salam and Istisna'a:** Salam requires full payment at execution, while Istisna'a allows price adjustments by mutual agreement (Ayub, 2007).
- **Ijarah:** rent may be charged only while the asset is usable and in the lessee's possession, at fixed, variable or mixed rates (AAOIFI, 2015), with no additional charge for overdue rent.
- **Bai-al-Sarf:** currency exchange must be on a spot basis (AAOIFI, 2015).
- **Wakalah:** the agent may charge fixed, variable or mixed fees (El-Gamal, 2006).
- **guarantee (Kafalah):** no fee may be charged for a guarantee (AAOIFI, 2015).

These differing models shape pricing. Profit-sharing and non-interest financing require IBs to align pricing with both Shariah and market demands (Khan & Bhatti, 2008). CBs' interest-based pricing is more predictable, while IBs adjust their strategies for Shariah compliance (Iqbal & Molyneux, 2016); and cost-based asset pricing is common in Bangladesh (Hossain et al., 2012), built on the cost of funds, administrative expenses, cost of capital and a risk premium (Rahman & Hossain, 2013). CBs face pricing volatility from interest rate fluctuations (El-Gamal, 2006), whereas IBs must reconcile compliance with profitability (Ayub, 2007) and face

additional pricing risks from market volatility, regulatory change and complex products (Chong & Liu, 2009), making their pricing mechanisms more complex (Ahmed, 2010).

IBs must therefore keep refining their pricing of deposits, financing, non-funded commissions and charges to meet regulatory and Shariah standards while remaining competitive, basing all pricing on permissible profit rather than interest (Ayub, 2007), with Hibah and Ibra' providing flexibility and PER and IRR helping to manage performance and pricing variations (Khan & Bhatti, 2008). Pricing must serve the Maqasid al-Shariah (El-Gamal, 2006), since violations carry reputational and financial risks, even as competition pushes IBs to benchmark against CBs and central bank guidelines (Iqbal & Molyneux, 2016) and regulators impose caps or floors on fees and rates (Chong & Liu, 2009).

8.3 Regulatory Framework for Pricing Islamic Banking Products

Bangladesh Bank circulars on pricing, profit rates and penalties apply to both conventional banks (CBs) and Islamic banks (IBs); the key provisions are as follows.

Banking Regulation and Policy Department (BRPD) Circular No. 03 (24 February 2020) capped profit rates on unclassified loans and investments at 9%, with up to 2% penalty interest on classified loans (no longer applicable). BRPD Circular No. 09 (19 June 2023) allowed a maximum of Six-month Moving Average Rate of Treasury Bill (SMART) plus 3%, with an additional 1% supervision charge for Cottage, Micro, Small, and Medium Enterprises (CMSME) and consumer financing, which Shariah-compliant banks may also impose within the guidelines; and BRPD Circular No. 10 (8 May 2024) allows sector-specific rates within 1% above or below the declared rate, depending on the client's risk.

For finance companies, Department of Financial Institutions and Markets (DFIM) Circular No. 05 (6 October 2024) allows risk-based adjustment of up to 1%, DFIM Circular Letter No. 21 (8 October 2024) caps deposit rates at SMART plus 2.5%, and lending rates are capped at SMART plus 5.5%. Although the SMART-based system has since been withdrawn, it shows how such requirements shape the pricing of conventional and Islamic products alike.

Under the refinancing schemes of Sustainable Finance Department (SFD) Circular No. 02 (5 April 2018), IBs may finance green products under Mudarabah. Bangladesh Bank charges the lower of the participating institution's provisional Mudarabah savings rate or the bank rate, debiting banks' accounts according to the repayment schedule, but the participating institutions bear all recovery risk — at odds with the Shariah principle that the capital provider bears the business risk.

BRPD Circular No. 11 (10 June 2021), clarified by BRPD Circular Letter No. 09 (19 March 2023), regulates fees for account maintenance, loan processing and early settlement for IBs and CBs alike, although such fees often conflict with Shariah's discouragement of unconditional charges.

FE Circular No. 15 (1 September 2024) sets the Export Development Fund borrowing rate at Secured Overnight Financing Rate (SOFR) plus 0.5% without provisions for IBs. Monetary Policy Department (MPD) Circular No. 04 (24 September 2024) raised the policy rate to 9.5%. FE Circular No. 09 (8 May 2024) introduced a crawling peg exchange rate for all banks, and

FE Circular No. 04 (1 February 2024) set an all-in-cost ceiling of SOFR plus 4% for foreign trade finance. The framework poses several challenges for IBs:

- **Mudarabah and profit ceilings:** Mudarabah depositors should receive returns based on actual fund performance, but regulatory profit ceilings restrict returns that could better reflect it.
- **Risk and return in Mudarabah and Musharakah:** these higher-risk modes should earn higher returns, but financing-rate ceilings prevent IBs from realizing them and managing risk effectively.
- **Risk-based pricing by mode:** the permitted 1% adjustment reflects client creditworthiness but not the different risks of Shariah financing modes.
- **Penalties for defaulters:** CBs may charge penalty interest, but IBs cannot earn extra on defaulted Murabahah and, without a ceiling, may set higher initial rates to protect their returns.
- **Processing and supervision fees:** many Shariah scholars object to unconditional fees, but the framework makes no distinction between conventional and Islamic banking.
- **Refinancing and risk allocation:** refinance and pre-finance schemes under restricted Mudarabah leave business risk with the Mudarib rather than the capital provider, which also takes no part in financing decisions.
- **Account maintenance fees:** Bangladesh Bank allows maintenance fees on savings, current and Special Notice Deposit (SND) accounts, but AAOIFI prohibits recurring charges without defined services, and without specific guidance IBs follow conventional practice.

Despite efforts at alignment, conflicts therefore remain over profit ceilings, risk-based pricing and fees, pushing IBs into a hybrid approach that balances regulatory and Shariah requirements and sometimes exploits regulatory permissibility without adequate Shariah consideration.

8.4 Data Analysis and Findings

8.4.1 Shariah-Compliant Contractual Modes in the Global Market

This section examines the contractual modes used by IBs and their pricing compared with CBs. The global distribution of Islamic financing contracts is presented in Table 5.1 in Chapter 5 and Table 3.7 in Chapter 3: in 2022, Murabahah's share fell to 44% from 47.4%, Commodity Murabahah/Tawarruq rose to 32.2% from 25.7% and Ijarah held at 10.2%, while Salam (3.8%), Musharakah (2.4%), Diminishing Musharakah (1.9%), Wakalah (0.8%), and Mudarabah and Qard Hasan (0.2% each) were far smaller.

In Malaysia (Table 8.1), commodity-based cash financing (Tawarruq) dominated Islamic financing in 2022–2023, reaching 58.61% (RM 814,246.8 million) in 2023, followed by Ijarah (13.79%), Murabahah (12.69%), Musharakah (8.98%) and Bai' Inah (2.27%). Qard, Istisna'a and Mudarabah together accounted for less than 1%.

Table 8.1: Modes of Islamic Financing Contracts: Malaysia (%)

	Bai' Inah	Ijarah	Instisna	Mudarabah	Musharakah	Qard	Murabahah	Tawarruq	Others
2022Q1	2.42	13.81	0.09	0.02	9.19	0.39	14.08	55.74	4.25
2022Q2	2.24	13.87	0.09	0.02	9.17	0.39	13.71	56.37	4.14
2022Q3	2.09	13.81	0.08	0.02	9.08	0.39	13.16	57.47	3.89
2022Q4	2.29	13.71	0.08	0.02	8.93	0.42	12.83	58.58	3.15
2023M1	2.27	13.79	0.08	0.02	8.98	0.42	12.69	58.61	3.14

Source: BNM (2023).

Table 3.8 in Chapter 3 presents the distribution of Islamic financing contracts in Pakistan up to 2024. Diminishing Musharakah is the preferred mode, peaking at 34.8% in 2022 (32.1% in 2023), and Musharakah rose from 11% in 2014 to 25.3% in 2023, while Murabahah fell from 30.1% to 13.1% and Ijarah to 4.1%. Istisna'a reached 10.6% and 'Others' 13% in 2023 — a shift towards a more diverse, equity-based structure.

8.4.2 Shariah-Compliant Contractual Modes in the Bangladeshi Market

Table 3.12 in Chapter 3 presents the composition of Islamic banking deposits in Bangladesh, with Mudarabah Term Deposits consistently holding the largest share, around 45–49%. This indicates the significant reliance of IBs on long-term, profit-sharing contracts, which are vital to their deposit mobilization strategies. The pricing of these deposits is crucial for maintaining competitiveness while adhering to Shariah principles.

Mudarabah Savings Deposits, the second-largest category, have steadily grown to 19% by 2023, indicating increased depositor confidence in flexible savings products. In contrast, Wadiah Current Account (CA) Deposits remain stable but low at around 4%, serving more for liquidity than for profit-sharing. Excluding deposits under the Wadiah mode (Wadiah CA and Others), the remaining 78% of deposits are held under various Mudarabah modes.

Table 3.13 in Chapter 3 presents the distribution of Islamic financing in Bangladesh by mode. Deferred-payment and cost-plus contracts dominate — Bai Murabahah at 44–48% and deferred-payment sale (Bai-Muajjal) at 22–25% — followed by Hire Purchase under Shirkatul Melk (HPSM), which peaked at 23.62% in 2019 and has since stabilized at around 17–18%, and Ijarah at about 4–7%. Mudarabah, Musharakah and Bai Salam together account for less than 2%, and Qard with security and other modes are typically under 5%.

8.4.3 Rates Applied by Banks in Bangladesh According to Bank Type

Table 8.2 shows weighted average deposit rates by bank type in 2014–2023. IBs' rates were relatively stable, from 7.29% in 2014 to a low of 4.52% in 2021 (average 5.74%), reflecting the nature of profit-sharing Mudarabah deposits. PCBs paid the highest rates (8.06% in 2014), SOCBs intermediate rates (8% at their highest, in 2014) and FCBs much lower rates (1.67% in 2021).

In recent years, a notable convergence of deposit rates has been observed across all bank types, with rates stabilizing around 5% by 2023. This trend suggests an overall alignment in deposit offerings among the various banking groups, including IBs.

Table 8.2: Weighted Average Rate for Deposits by Banks in Bangladesh (%)

Year	All Banks (N=61)	SOCBs (N=06)	PCBs (N=43)	FCBs (N=09)	IBs (N=10)
2014	7.72	8.00	8.06	5.83	7.29
2015	6.49	6.86	6.90	3.99	6.47
2016	5.36	5.42	5.76	3.11	5.49
2017	5.10	4.58	5.60	2.82	5.44
2018	5.62	4.75	6.14	3.67	6.24
2019	5.96	4.85	6.65	3.45	6.80
2020	4.60	4.87	4.94	2.34	5.10
2021	4.10	4.48	4.44	1.67	4.52
2022	4.36	4.66	4.74	1.99	4.68
2023	4.90	5.29	5.35	2.20	5.35
Max	7.72	8	8.06	5.83	7.29
Min	4.10	4.48	4.44	1.67	4.52
Average	**5.42**	**5.38**	**5.86**	**3.11**	**5.74**

Source: Bangladesh Bank (2023b).

Weighted average financing rates (Table 8.3) show IBs' rates falling from 12.73% in 2014 to 6.96% in 2022 (average 9.77%), PCBs charging the highest (13.39% in 2014) and SOCBs and FCBs generally lower; by 2023 all bank types had converged at around 9–10% as financing costs rose.

Table 8.3: Weighted Average Financing Rates by Banks in Bangladesh

Year	All Banks (N=61)	SOCBs (N=06)	PCBs (N=43)	FCBs (N=09)	IBs (N=10)
2014	12.65	11.44	13.39	10.80	12.73
2015	11.33	9.84	12.17	9.08	11.82
2016	9.74	8.65	10.55	7.04	10.62
2017	9.24	7.70	9.98	7.06	10.12
2018	9.68	6.42	10.69	7.85	10.54
2019	9.86	6.43	10.77	8.52	10.31
2020	7.53	6.18	7.88	6.64	7.59
2021	7.02	6.08	7.49	5.25	7.07
2022	7.15	5.89	7.54	6.04	6.96
2023	9.77	9.73	9.88	9.50	9.95
Max	12.65	11.44	13.39	10.8	12.73
Min	7.02	5.89	7.49	5.25	6.96
Average	9.40	7.84	10.03	7.78	9.77

Source: Bangladesh Bank (2023b).

For general deposits excluding current accounts (Table 8.4), IBs offer a slightly higher average profit rate than CBs (5.27% against 4.97%), although CBs' maximum and minimum rates (6.83 and 1.67%) exceed IBs' (6.33 and 1.33%).

For savings deposits, the rates are similar, with IBs averaging 2.41% and CBs 2.37%. In Short Notice Deposits, CBs have a slight edge, offering an average rate of 2.54% compared to IBs' 2.36%, with maximum and minimum rates following a similar trend.

Regarding deposit schemes, CBs maintain a slight advantage with an average rate of 7.59%, while IBs average 7.34%. For placements from other banks and financial institutions, CBs significantly outperform IBs, offering an average rate of 6.38% compared to IBs' 3.87%.

For term deposits, profit rates for both banking types are closely aligned. IBs offer an average rate of 6.31% for 3-month deposits and 7.54% for 1-year deposits, while CBs provide slightly better rates, particularly for longer-term deposits, achieving 7.87% for 1-year deposits.

Table 8.4: Profit Rates for IB Depositors Compared to CB Depositors for 2023

	IBs %			**CBs %**		
	Average	**Max**	**Min**	**Average**	**Max**	**Min**
Deposits other than current accounts	5.27	6.33	1.33	4.97	6.83	1.67
Savings deposits	2.41	2.94	1.81	2.37	3.19	1.81
Short notice deposits	2.36	3.00	1.44	2.54	3.25	1.69
Schemes offered	7.34	9.06	6.31	7.59	9.31	6.56
Placements from other banks and financial institutions	3.87	4.38	3.90	6.38	6.70	5.71

Average rate of profit paid to the term depositors							
IB %				**CB %**			
3 months	**6 months**	**1 year**	**1year +**	**3 months**	**6 months**	**1 year**	**1year +**
6.31	7.37	7.54	7.47	6.34	7.66	7.87	7.80

Source: Survey Data.

Note: The figures are as reported by the responding banks; some averages fall outside the minimum and maximum reported for the same item.

Average financing rates are almost identical (Table 8.5): 10.03% for IBs and 10.02% for CBs, with minimal differences in working capital, commercial term, home and car financing and an equal 7.14% for other financing — IBs price competitively with CBs while adhering to Shariah principles.

Table 8.5: Rate of Profit Charged by IBs for Financing in Comparison with CBs for 2023

	IBs %			**CBs %**		
	Average	**Max**	**Min**	**Average**	**Max**	**Min**
Average rate of financing/investment	10.03	11.14	8.87	10.02	11.14	7.20
Average rate of financing/investment: Working Capital	10.16	11.47	8.70	10.19	11.47	9.16

	IBs %			CBs %		
	Average	**Max**	**Min**	**Average**	**Max**	**Min**
Average rate of financing/investment: Commercial Term Financing	10.34	11.25	9.34	10.34	11.25	9.15
Average rate of financing/investment: Home Financing	9.66	10.49	8.40	9.67	10.49	8.40
Average rate of financing/investment: Personal Car/ Transport Financing	10.09	10.79	9.49	10.09	10.65	9.21
Any other type of financing/investment	7.14	7.19	5.87	7.14	7.19	5.87

Source: Survey Data.

Fees and commissions are broadly similar (Table 8.6): non-funded services such as LCs and bank guarantees average 3.15% at IBs and 2.35% at CBs, annual debit card fees are identical (BDT 279.17), and CBs charge BDT 2,416 for credit cards (no IB data). IBs' investment processing fees (BDT 0.40) are comparable to CBs', IBs charge no supervision fee (CBs BDT 0.75), and IBs' late payment charges are slightly higher (BDT 625.00 against BDT 550.00).

Both banking sectors maintain consistent account maintenance fees for current accounts, with an annual average of BDT 391.67. Lastly, the account maintenance fees for savings accounts are also the same between IBs and CBs, averaging BDT 250.00.

Table 8.6: Fees/Commissions Charged by IBs in Comparison with CBs (%)

	IBs %			CBs %		
	Average	**Max.**	**Min.**	**Average**	**Max.**	**Min.**
Non-funded credit: Letter of Credit (LC) (%)	3.15	2.47	1.49	3.15	2.47	1.49
Non-funded credit: Bank Guarantee (BG) (%)	2.35	2.99	1.80	2.35	2.49	1.45
Annual fee for debit card (BDT)	279.17	493.75	66.67	279.17	493.75	66.67
Annual fee for credit card (BDT)	0.00	2125.00	850.00	2416.67	5800.00	1750.00
Credit/ Investment/ Loan processing fee (BDT)	0.40	5000.38	2.85	0.40	4000.40	3000.24
Credit/ Investment/ Loan supervision fee (BDT)	0.00	0.33	0.00	0.75	0.83	0.00
Credit/ Investment/ Loan late payment charge (Compensation/Penalty Interest) (BDT)	625.00	500.67	500.00	550.00	400.70	325.38
Account maintenance fee (Annual): Current A/c (BDT)	391.67	525.00	500.00	391.67	525.00	500.00
Account maintenance fee (Annual): Savings A/c (BDT)	250.00	500.00	233.33	250.00	500.00	133.33

Source: Survey Data.

Note: The figures are as reported by the responding banks; some averages fall outside the minimum and maximum reported for the same item, and fee items expressed in Taka and in percentages appear in the same column.

8.4.4 Summary of Findings from FGDs and Interviews

FGDs with over 70 Islamic finance professionals from 29 banks, together with interviews with senior industry officials, explored the challenges of aligning pricing with Shariah principles. The main findings are as follows.

Although Shariah scholars generally permit conventional benchmarks for pricing, the industry strongly expects separate pricing practices that reflect the principles of Islamic finance and distinguish IBs from CBs. Provisional profit rates may be declared to Mudarabah depositors on the basis of past performance and business prospects, but must be adjusted to the fund's actual performance. Some marketing practices, such as double-benefit schemes, overlook Shariah principles — a sign of the tension between competitiveness and the requirements of Islamic finance contracts.

Profit-smoothing tools such as Hibah and the PER are acceptable in Shariah but require transparency and strict compliance to prevent misuse that could amount to Riba. Many regulations apply to both CBs and IBs without addressing the latter's distinct needs, and regulators may mandate or permit pricing practices that sit uneasily with Shariah, even as IBs strive to align with the wider banking system.

In trade-based financing, problems include amending prices after Murabahah contracts are executed and recognizing profit on Salam and Istisna'a before the goods are received and sold in the second leg, contrary to the rule against selling what one does not own. Ibra' (rebates) for early settlement must also be granted in a Shariah-compliant manner. Under HPSM, rents follow general bank policy regardless of the asset's location; some bankers consider market-based rents impractical, pointing to the need for pricing policies suited to Islamic finance.

Participatory modes such as Mudarabah and Musharakah carry higher risk and should earn higher, performance-based returns than low-risk Murabahah, Salam and Istisna'a; regulators should allow separate pricing policies that reflect this distinction.

IBs, like CBs, charge fees and commissions on non-funded products such as LCs and bank guarantees; respondents called for Shariah compliance and uniform fees across IBs. Interbank Mudarabah placements, the IB alternative to call money, reportedly carry profit rates fixed in advance rather than adjusted to actual performance; an effective framework is needed to oversee their Shariah compliance.

Bangladesh Bank's refinance and pre-finance schemes often apply common terms to CBs and IBs, which is problematic, particularly regarding risk transfer.

Transactions that are technically Shariah-compliant may still fall short of the higher objectives of Islamic law (Maqasid al-Shariah) — justice and the avoidance of harm — so IBs should emphasize the Maqasid in all their operations.

Although IBs' operating model differs fundamentally from that of CBs, their pricing often does not, and customers perceive little difference. IBs need to communicate and implement pricing that reflects their value proposition, which rests on Shariah compliance — and the resulting Barakah (blessings) from Allah (SWT) — as well as on financial returns.

Finally, SSCs are vital for Shariah compliance across IBs, but need autonomy and full authority to guide their operations effectively.

8.5 Conclusion and Recommendations

IBs must balance Shariah compliance with regulatory requirements, which complicates their pricing and operations, and profit maximization at the expense of Shariah compliance is unacceptable. Despite progress, the findings point to the need for greater differentiation in pricing, stricter adherence to Shariah guidelines and a stronger focus on the ethical objectives of Islamic finance. The study recommends the following:

8.5.1 Regulatory Framework

Regulation and supervision, driven by conventional banking, do not address IBs' needs. Regulations and supervisory practices tailored to IBs are essential for a level playing field — a task for Bangladesh Bank's new Islamic Banking Regulation and Policy Department — and Bangladesh Bank staff need a deeper understanding of Islamic banking.

8.5.2 Shariah-Based Benchmark

With IBs now systemically important and demand growing, a Shariah-based pricing benchmark is urgently needed: conventional benchmarks, though permissible, risk compromising Shariah principles, whereas a dedicated benchmark would improve alignment, acceptability and the management of Shariah non-compliance risk.

8.5.3 Deposit Pricing

Profit-smoothing tools such as Hibah and PER require strict control under Shariah Supervisory Committee (SSC) guidance, so that provisional rates are adjusted to actual performance; using them merely to match distributions to provisional rates, regardless of asset performance, should be avoided.

8.5.4 Marketing Approach

IBs should promote the principles and ethical values of Islamic banking rather than rely solely on profit rates, an excessive focus on which may create negative perceptions and encourage improper practices.

8.5.5 Proper Disclosures

IBs must disclose clearly how depositors' profits are calculated, including any use of profit smoothing, and likewise for financing — for example, the revaluation methodology for HPSM assets under construction and the application of Ibra' in settling sale debts.

8.5.6 Fees and Commissions

IBs must identify the services for which fees and commissions are charged, since unidentified charges, common in conventional banking, are not Shariah-compliant, and guidelines should ensure transparency and compliance.

8.5.7 Autonomy of the SSCs

SSCs need sufficient autonomy to supervise and guide their banks, distinguishing Bangladesh Bank's mandatory requirements from mere permissions — what the regulator permits need not be adopted from conventional practice — and should include members with expertise in both Shariah and banking operations.

PART III: ISLAMIC CAPITAL MARKET

Chapter 9: Introducing Sukuk in Bangladesh: Key Issues

Based on the study "Introducing Sukuk in Bangladesh: Key Issues" by Mohammed Sohail Mustafa, Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Abdullah Sharif.

9.1 Introduction

Contemporary Islamic finance emerged in the last third of the twentieth century as an alternative to conventional finance. Though intended primarily for Muslims, it is widely accepted regardless of faith for its ethical values and real-economy basis, since fictitious, speculative and harmful activities are prohibited. Its resilience in the 2007–2008 global financial crisis, its role in supporting recovery during coronavirus disease 2019 (COVID-19) and its contribution to the Sustainable Development Goals (SDGs) have raised its profile.

Islamic finance comprises Islamic banking, Islamic insurance (Takaful), the Islamic capital market and Islamic social finance. Its commercial components totaled an estimated USD 2.70 trillion in 2020 — 68.20% Islamic banking, 30.90% the Islamic capital market and 0.90% Takaful (IFSB, 2021) — while Islamic social finance (Zakat, voluntary charity (Sadaqah) and endowment (Waqf)), for which reliable data are lacking, would comfortably exceed a trillion dollars.

Bangladesh was an early initiator and ranks among the top ten markets in Islamic banking and insurance: Islamic banking, begun in 1983, holds more than 27% of the banking sector's deposits and financing (Bangladesh Bank, 2021), and Takaful, begun in 1999, more than 14% of insurance contributions (IFSB, 2021). The Islamic capital market, by contrast, is in its infancy and far behind other countries.

The Islamic capital market comprises Islamic investment certificates (Sukuk), Islamic funds and Islamic equities, with Sukuk accounting for about 83% globally (IFSB, 2021). In many countries Sukuk are an integral part of the capital market, providing an alternative funding source for governments, government-linked entities and corporates and attracting investors of all faiths, including conventional institutions. The only restriction is that proceeds must be used for Shariah-compliant activities.

Sukuk proceeds can finance asset acquisition, business expansion, infrastructure and real estate, and recent studies find that Sukuk market development stimulates long-run economic growth (Yıldırım, Yıldırım & Diboglu, 2020; Ledhem, 2020; Smaoui, Mimouni & Salah, 2021) — an expectation shared by industry leaders, regulators and academics in Bangladesh.

The government can issue Sukuk to meet its funding needs, Bangladesh Bank to absorb excess liquidity, and corporates to diversify funding and reach more investors. Islamic financial institutions need sufficient Sukuk to manage liquidity, and other investors need them to diversify — Sukuk in conventional bond portfolios offer diversification benefits, particularly in downturns (Pirgaip, Ayaydin & Karan, 2020) — while in a Muslim-majority country more Sukuk are likely to draw more investors into the capital market.

Heavy reliance on bank financing without a diversified capital market, as in Bangladesh today, does not suit sustainable growth: Malaysia's experience in the 1997 Asian financial crisis,

when such reliance contributed to heavy corporate losses, illustrates the danger (Bix Malaysia, 2018). Sukuk can contribute greatly to a vibrant capital market in Bangladesh.

Given the importance of Sukuk for economic development and their very early stage in Bangladesh, the research aims:

a) to identify the key issues in operationalizing government and corporate Sukuk in Bangladesh; and
b) to provide recommendations that the relevant parties may adopt in resolving the issues and building a vibrant Sukuk market in Bangladesh.

To achieve these objectives, the research reviewed the literature on the fundamentals, history, global market and international experience of Sukuk. Identified regulatory initiatives in other countries and in Bangladesh to analyze gaps, and conducted 39 interviews with issuers, regulators, Shariah Supervisory Board members, Sukuk experts, lawyers and others to identify issues and validate recommendations suited to Bangladesh.

9.2 Fundamentals of Sukuk

9.2.1 Definition

Sukuk (plural of Sakk) are certificates of investment. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines them as 'certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or the assets of particular projects or special investment activities' (AAOIFI, 2003), and the Islamic Financial Services Board (IFSB, 2009) and the Securities Commission Malaysia (SCM, 2020) define them similarly.

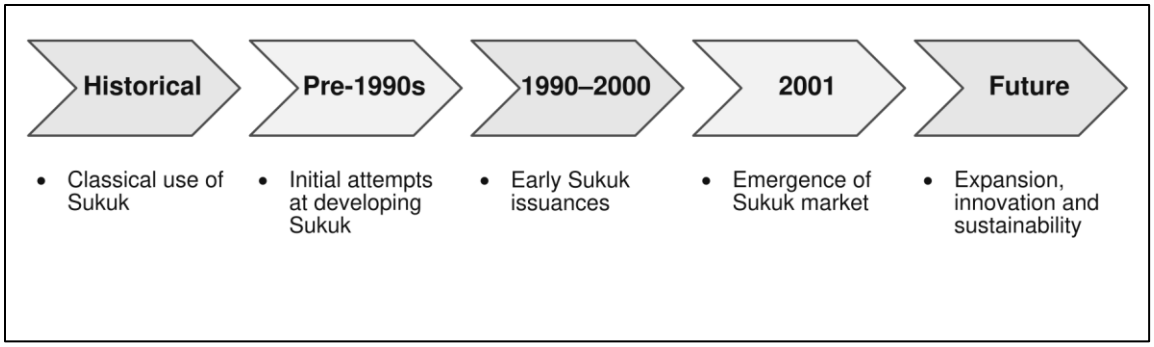
The definitions agree that Sukuk are structured on Shariah-based contracts and represent undivided ownership of the underlying assets or investment activities — features that distinguish them from conventional bonds, which are interest-bearing debt instruments prohibited in Islamic law (Shariah) whatever their name (OIC-IIFA, 1990; AAOIFI, 2004).

Sukuk are often called 'Islamic bonds', but the label is misleading: a bond is merely an interest-bearing debt contract, whereas a Sukuk may rest on a sale, lease, partnership or investment agency contract, or a combination, and even a fixed-income Sukuk differs in its Shariah foundation and asset backing. AAOIFI Shariah Standard No. 17 (Item No. 2) accordingly distinguishes Sukuk from bonds (AAOIFI, 2003), and AAOIFI Governance Standard No. 12 [Appendix C (BC5)] states that 'Sukuk should not be considered as bonds' (AAOIFI, 2019) — although calling a Sukuk a bond does not make it Shariah non-compliant.

9.2.2 Development of Global Sukuk Market

As identified in Figure 9.1, the development of the global Sukuk markets can be divided into several phases. This reflects the gradual development strategy that different countries adopted in developing their Islamic finance markets.

Figure 9.1: Phases of Global Sukuk Market Development



Source: Adapted from COMCEC (2018).

9.2.2.1 Historical: Classical Use of Sukuk

Classical examples differ substantially from modern Sukuk but lend them a form of legitimacy:

1st Century AH (Late 7th Century CE): Commodity or Grain Coupons

Under the Umayyad Caliph Marwan ibn al-Hakam, commodity or grain coupons (Sukuk) were issued to soldiers and public servants, entitling holders to receive commodities at maturity, as a narration in Imam Malik's al-Muwatta' records (ISRA, 2017).

1775: Securitization of Customs Collection by Issuing Shares

After its defeat by Russia, the Ottoman Empire issued Esham (shares) to fund its budget deficit, with no fixed maturity; buy-back was at the government's discretion (Musari, 2021).

9.2.2.2 Pre-1990s: Initial Attempts at Developing Sukuk

Initial ad hoc attempts included Muqaradah Sukuk in Jordan (1977), Participation Term Certificates in Pakistan (1980), the Government Investment Issue (GII) in Malaysia (1983) and Revenue Sharing Certificates in Turkey (1984) (ISRA, 2017), and the Organisation of Islamic Cooperation (OIC)'s International Islamic Fiqh Academy legitimised Muqaradah Sukuk in 1988 (OIC-IIFA, 1988).

9.2.2.3 1990–2000: Early Sukuk Issuances

The first corporate Sukuk, a RM 125 million issue by Shell MDS in Malaysia in 1990, was structured on Bai' Bithaman Ajil (deferred payment sale) (IIFM, 2010). Issuance remained sporadic, mainly small local issues in Malaysia, and the decade is regarded as a period of theory and model building (ISRA, 2017).

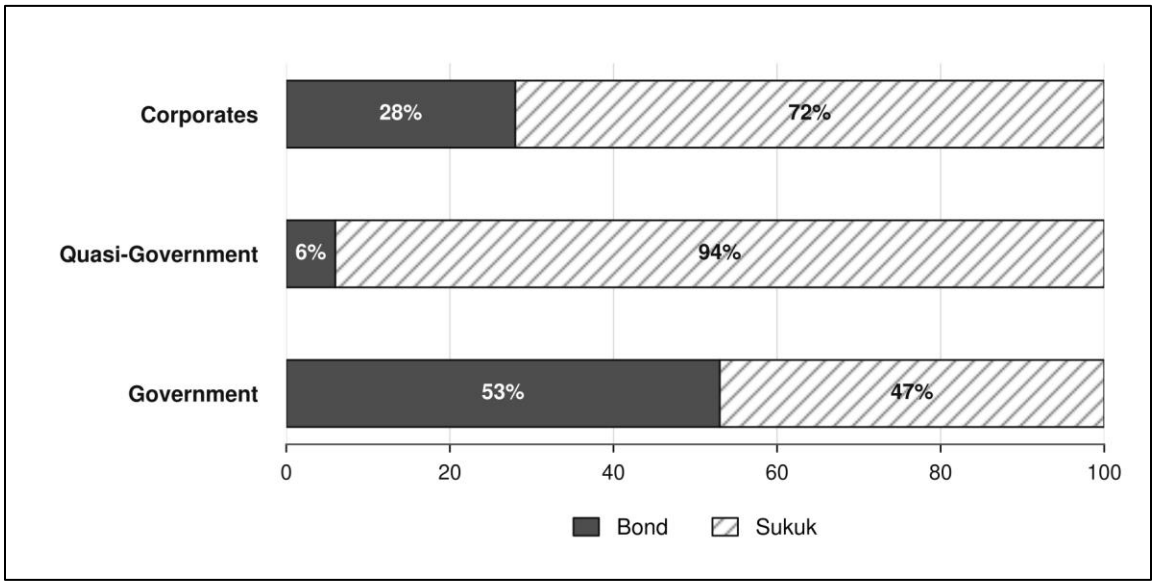
9.2.2.4 2001: Emergence of the Sukuk Market

Regular issuance began in 2001, marking the emergence of a Sukuk market. Notable firsts include Bahrain's first domestic sovereign Sukuk and Singapore's first (quasi-sovereign) Sukuk in 2001 (ISRA, 2017; IIFM, 2010). The first global corporate and quasi-sovereign Sukuk, by Kumpulan Guthrie Berhad of Malaysia, also in 2001 (IIFM, 2010). Indonesia's entry in 2002, with its first sovereign issue in 2008 (IIFM, 2010). The United Kingdom's first sovereign Sukuk in 2014 and a second, more than double the size, in 2021 (HM Treasury,

2021), and Hong Kong's USD-denominated Sukuk of 2014, 2015 and 2017 (Hong Kong Monetary Authority, 2019).

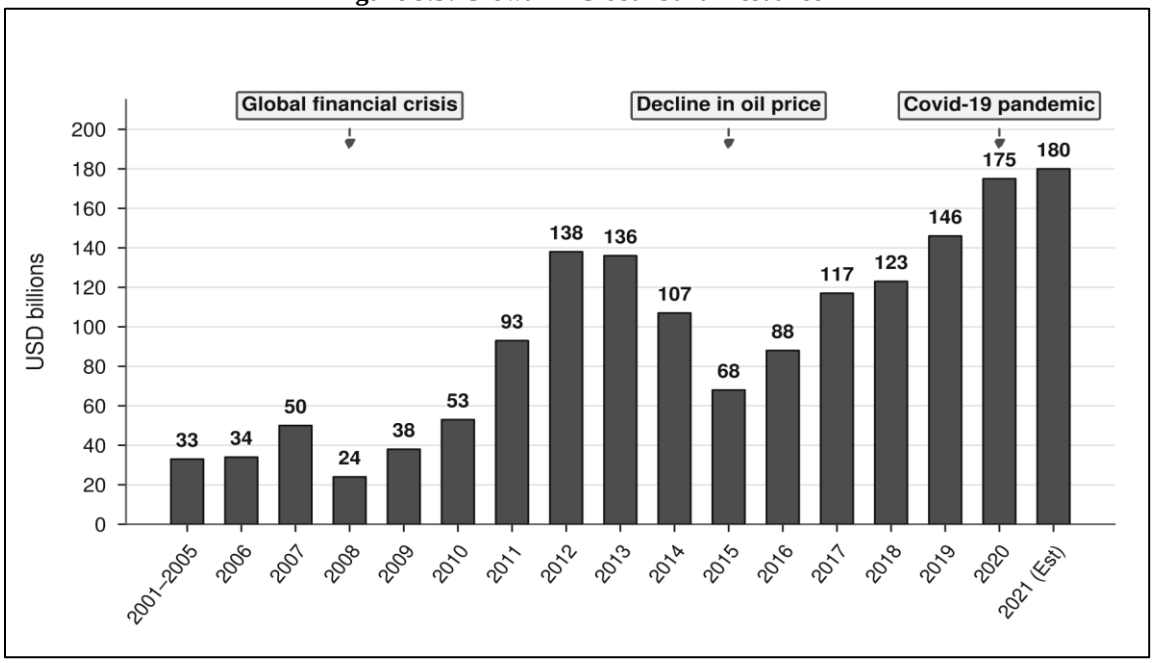
Since 2001, issuance has grown significantly, and in some markets Sukuk have become the instrument of preference: in Malaysia they account for 72%, 94% and 47% of corporate, quasi-sovereign and sovereign bond and Sukuk issuance respectively (Figure 9.2; Bix Malaysia, 2021). Figure 9.3 shows the growth of global Sukuk issuance since 2001, and Table 9.1 the Sukuk issuing markets.

Figure 9.2: Bond and Sukuk in Malaysia by Principal Outstanding as of 2021Q1



Source: Bix Malaysia (2021).

Figure 9.3: Growth in Global Sukuk Issuance



Source: Adapted from IIFM Sukuk Reports and Refinitiv.

Table 9.1: Sukuk Issuing Markets — Representation in Total Sukuk Issuance (2001 - 2020)

	Country	% of total		Country	% of total
1	Malaysia	56.22%	19	South Africa	0.04%
2	Saudi Arabia	12.27%	20	Jordan	0.03%
3	Indonesia	8.78%	21	Ivory Coast	0.03%
4	UAE	6.92%	22	Senegal	0.03%
5	Turkey	4.70%	23	Gambia	0.03%
6	Bahrain	2.77%	24	Egypt	0.02%
7	Qatar	2.53%	25	Mali	0.02%
8	Pakistan	1.60%	26	Luxembourg	0.02%
9	Sudan	1.44%	27	Yemen	0.02%
10	Brunei Darussalam	0.83%	28	Togo	0.02%
11	Oman	0.51%	29	Germany	0.01%
12	Kuwait	0.42%	30	Japan	0.01%
13	Hong Kong	0.22%	31	Morocco	0.01%
14	UK	0.12%	32	China	0.01%
15	Singapore	0.11%	33	Kazakhstan	0.01%
16	USA	0.10%	34	Maldives	0.002%
17	Nigeria	0.09%	35	Sri Lanka	0.0004%
18	Bangladesh	0.06%	36	France	0.0001%

Source: Adapted from IIFM Sukuk Reports.

9.2.2.5 Future: Expansion, Innovation and Sustainability

With Sukuk well established, attention is turning to innovative structures, financial inclusion, integration with the permissible (Halal) economy and sustainability; the World Bank's sustainable Sukuk themes, and the first issue under each, are shown in Table 9.2.

Table 9.2: Sustainable Sukuk Themes

Sukuk Type	Objective	The First
Green Sukuk	Positive environmental outcome	The first green Sukuk was issued by Tadau Energy in Malaysia in 2017 to finance a 50MW solar power plant.
Social Sukuk	Positive social outcome	IFFIm Sukuk Company Limited issued the USD 500 million 'Vaccine Sukuk' in 2014 on behalf of the International Finance Facility for Immunisation (IFFIm), the obligor, with the World Bank acting as IFFIm's Treasury Manager, to support immunization efforts for children in developing countries. It was the first time Sukuk investors were offered an asset with both economic and social returns.
Sustainability Sukuk	Positive environmental and social outcomes	In 2019, Edra Solar Sdn Bhd issued the first sustainability Sukuk to refinance the construction costs of its 50MW solar power plant in Malaysia. This Sukuk also included a social component, namely land set aside for agricultural use by local farmers.

Sukuk Type	Objective	The First
Sustainable Development Goal (SDG) Sukuk	Aligned with some or all the SDGs	In 2018, HSBC Amanah Malaysia Berhad issued the first SDG Sukuk that targeted specific SDGs.
Sustainable and Responsible Investment (SRI) Sukuk	Green, social, sustainable, SDG	Khazanah Nasional Berhad issued the first Ringgit-denominated SRI Sukuk in 2015 to support a non-profit organization to transform 20 public schools under a Trust Schools Program.
Blue Sukuk	Marine & ocean-based projects with positive environmental outcomes	No blue Sukuk has been issued so far. However, the first blue bond was issued in 2018. It is designed to support sustainable marine and fisheries projects.

Source: Adapted from World Bank Group (2020).

9.2.3 Types of Sukuk Issuers

Any entity may issue Sukuk for Shariah-permissible purposes. Issuers are sovereign (governments, whose large average issue size gives them a large share of volume despite fewer issues), quasi-sovereign (government-linked or state-owned entities, or those with government backing), corporate (with issue sizes from a hundred million to billions in any currency) and financial institutions, Islamic or conventional — a conventional institution may issue Sukuk provided the whole process and the use of proceeds comply with Shariah. Table 9.3 provides the distribution of global Sukuk issuance by issuer type.

Table 9.3: Distribution of Global Sukuk Issuance by Issuer Type

Year	USD Billions					% of Year Total			
	Sovereign	**Quasi-Sovereign**	**Corporate**	**FIs**	**Total**	**Sovereign**	**Quasi-Sovereign**	**Corporate**	**FIs**
2001 – 2005	11.32	1.98	19.19	0.74	33.22	34	6	58	2
2006	6.87	1.45	23.42	1.86	33.61	20	4	70	6
2007	7.59	1.50	39.70	1.40	50.18	15	3	79	3
2008	10.64	0.86	12.55	0.30	24.34	44	4	52	1
2009	24.88	4.00	8.86	0.19	37.93	66	11	23	1
2010	34.07	3.03	14.78	1.25	53.13	64	6	28	2
2011	67.77	5.65	16.05	3.71	93.17	73	6	17	4
2012	87.09	21.65	23.24	5.62	137.60	63	16	17	4
2013	83.21	12.79	34.59	4.97	135.56	61	9	26	4
2014	68.79	21.64	12.68	4.20	107.30	64	20	12	4
2015	33.34	11.50	14.73	8.25	67.82	49	17	22	12
2016	41.26	21.32	19.82	5.40	87.78	47	24	23	6
2017	62.17	28.55	16.84	9.16	116.72	53	24	14	8
2018	67.38	23.61	22.04	10.12	123.15	55	19	18	8
2019	74.38	30.82	21.70	18.80	145.70	51	21	15	13
2020	88.87	29.66	22.35	33.77	174.64	51	17	13	19
Total	**769.61**	**220.00**	**322.51**	**109.73**	1,421.85	**54**	**15**	**23**	**8**

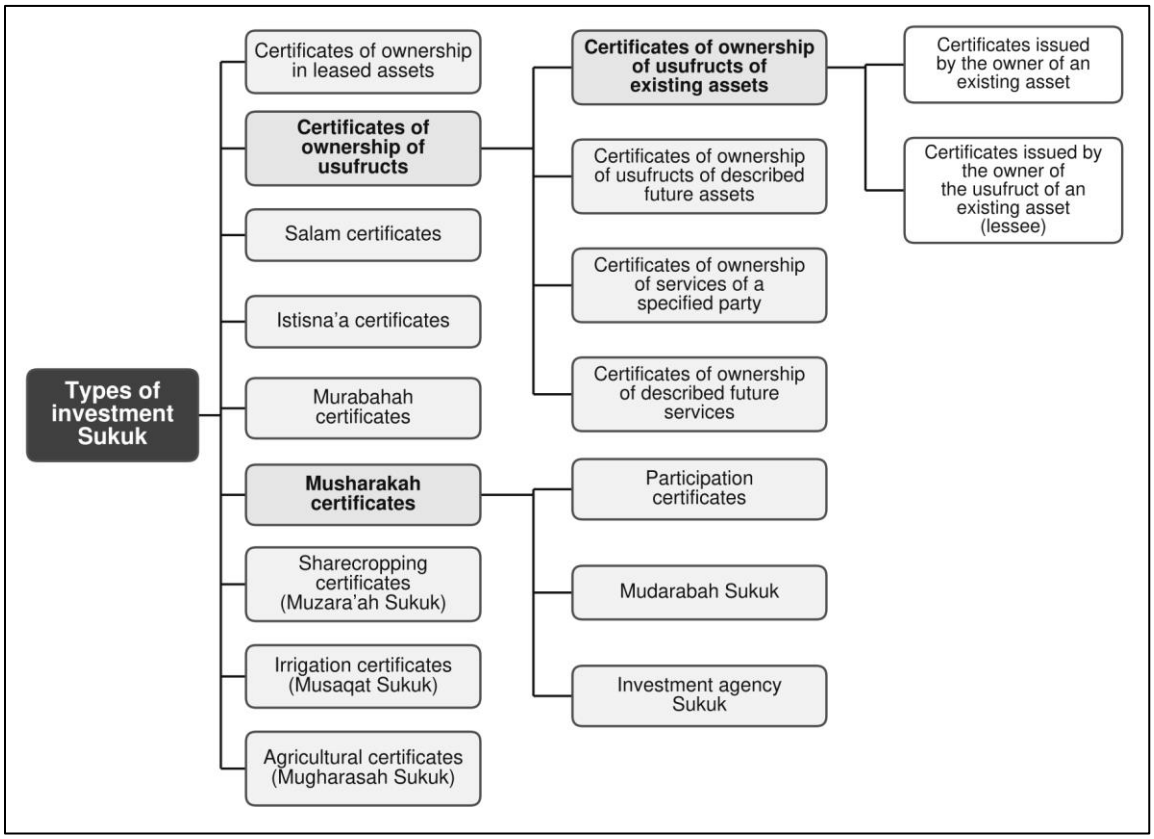
Source: Adapted from IIFM Sukuk Reports.

9.2.4 Types of Sukuk Based on Underlying Shariah Contracts

Sukuk can be structured with many Shariah contracts, the choice depending on expected cash flow, rate of return, tenure, the available assets, risk appetite, credit remoteness, target rating, tax implications and the preferred Shariah opinion (Ahmad, Ahmed, & Abojeib, 2021). Shariah does not prefer one contract over another.

Both the Bangladesh Government Investment Sukuk Guideline 2020 and the Bangladesh Securities and Exchange Commission (Investment Sukuk) Rules 2019 allow all Shariah concepts in structuring investment Sukuk, especially those named in AAOIFI Shariah Standard No. 17, which are shown in Figure 9.4.

Figure 9.4: Types of Sukuk Named in AAOIFI Shariah Standard No. 17



Source: AAOIFI (2003).

Various innovations are observed in the global market in terms of underlying assets and Shariah contracts (COMCEC, 2018). With experience and gaining of expertise, Sukuk structures have evolved from plain vanilla structures to complex structures involving several Shariah contracts. This is to maneuver different regulatory barriers and also to cater for different needs and circumstances of the parties involved. Sukuk can be structured in a way that in financial substance and in risk-reward features it become almost similar to equity or bonds or a hybrid instrument. Nonetheless, Tables 9.4–9.8 identifies the application of Shariah contracts based on different types of issuance.

Table 9.4: Popular Shariah Contracts in Structuring Sovereign Sukuk (%)

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001 – 2018	2019	2020	Total	2001 – 2018	2019	2020	Total	2001 – 2018	2019	2020	
Bai' Bithaman Ajil	0.00	0.00	0.00	**0.00**	4.15	0.00	0.00	**3.28**	3.65	0.00	0.00	**2.87**
Murabahah	0.13	0.00	0.00	**0.10**	61.27	32.25	30.02	**54.90**	53.89	27.34	26.74	**48.19**
Salam	2.68	0.00	0.00	**2.08**	1.77	1.70	2.68	**1.87**	1.88	1.44	2.39	**1.89**
Istisna'a	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Ijarah	52.43	36.03	53.71	**50.59**	20.62	30.78	48.40	**24.82**	24.46	31.58	48.98	**27.98**
Mudarabah	0.00	0.00	0.00	**0.00**	1.23	0.00	0.02	**0.97**	1.08	0.00	0.02	**0.85**
Musharakah	0.00	0.00	0.00	**0.00**	4.30	0.00	1.14	**3.53**	3.78	0.00	1.01	**3.10**
Wakalah	23.78	17.65	25.71	**23.24**	0.91	5.72	0.77	**1.34**	3.67	7.54	3.50	**4.03**
Hybrid — Unidentified	2.73	0.00	0.00	**2.12**	0.33	0.00	0.00	**0.26**	0.62	0.00	0.00	**0.49**
Hybrid — Ijarah/ Musharakah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Wakalah/ Murabahah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Ijarah/ Murabahah	1.16	24.26	20.57	**5.94**	0.00	0.00	0.00	**0.00**	0.14	3.70	2.25	**0.73**
Hybrid — Musharakah/ Murabahah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Wakalah/ Mudarabah	2.05	0.00	0.00	**1.59**	0.00	0.00	0.00	**0.00**	0.25	0.00	0.00	**0.19**
Hybrid — Murabahah/ Mudarabah	15.03	22.06	0.00	**14.33**	5.42	29.54	16.98	**9.03**	6.58	28.40	15.12	**9.68**
Islamic Exchangeable Sukuk	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**

Source: Adapted from IIFM Sukuk Reports.

Table 9.5: Popular Shariah Contracts in Structuring Quasi-Sovereign Sukuk (%)

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Bai' Bithaman Ajil	0.00	0.00	0.00	**0.00**	0.03	0.00	0.00	**0.02**	0.01	0.00	0.00	**0.01**
Murabahah	1.09	0.00	0.00	**0.77**	53.98	37.07	68.37	**52.96**	25.89	17.91	23.94	**24.51**
Salam	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Istisna'a	0.00	0.00	0.00	**0.00**	0.02	0.00	0.00	**0.01**	0.01	0.00	0.00	**0.01**
Ijarah	12.01	0.00	0.00	**8.49**	7.40	0.00	13.71	**6.95**	9.85	0.00	4.80	**7.79**
Mudarabah	2.65	7.85	7.78	**4.16**	0.80	47.61	0.00	**7.67**	1.78	27.05	5.06	**5.76**
Musharakah	0.51	0.00	0.00	**0.36**	27.09	2.16	2.84	**20.88**	12.98	1.04	0.99	**9.69**
Wakalah	77.69	92.15	85.73	**80.90**	4.07	0.93	2.66	**3.46**	43.17	48.08	56.65	**45.67**
Hybrid — Unidentified	0.71	0.00	2.59	**0.92**	1.30	0.00	6.47	**1.64**	0.98	0.00	3.95	**1.25**

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Hybrid — Ijarah/ Musharakah	0.00	0.00	0.00	**0.00**	0.00	8.03	5.94	**1.81**	0.00	3.88	2.08	**0.82**
Hybrid — Wakalah/ Murabahah	0.00	0.00	0.00	**0.00**	0.00	4.20	0.00	**0.62**	0.00	2.03	0.00	**0.28**
Hybrid — Ijarah/ Murabahah	1.18	0.00	3.89	**1.46**	0.00	0.00	0.00	**0.00**	0.63	0.00	2.53	**0.79**
Hybrid — Musharakah /Murabahah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Wakalah/ Mudarabah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Murabahah/ Mudarabah	0.00	0.00	0.00	**0.00**	5.31	0.00	0.00	**3.97**	2.49	0.00	0.00	**1.81**
Islamic Exchangeable Sukuk	4.16	0.00	0.00	**2.94**	0.00	0.00	0.00	**0.00**	2.21	0.00	0.00	**1.60**

Source: Adapted from IIFM Sukuk Reports.

Table 9.6: Popular Shariah Contracts in Structuring Corporate Sukuk (%)

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Bai' Bithaman Ajil	0.00	0.00	0.00	**0.00**	5.57	0.00	0.00	**4.78**	4.29	0.00	0.00	**3.70**
Murabahah	8.82	22.29	0.00	**9.27**	27.44	23.41	24.73	**26.96**	23.14	23.16	20.47	**22.95**
Salam	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Istisna'a	0.00	0.00	0.00	**0.00**	1.70	0.00	0.00	**1.46**	1.31	0.00	0.00	**1.13**
Ijarah	34.07	2.74	46.75	**32.61**	16.95	10.92	4.27	**15.59**	20.91	9.06	11.58	**19.45**
Mudarabah	9.16	0.00	1.30	**8.12**	8.67	29.99	23.04	**11.19**	8.78	23.17	19.29	**10.49**
Musharakah	10.34	0.00	0.00	**9.09**	23.08	5.21	6.17	**20.61**	20.14	4.03	5.11	**18.00**
Wakalah	22.55	42.55	28.57	**24.24**	5.92	12.50	9.61	**6.64**	9.76	19.33	12.87	**10.63**
Hybrid — Unidentified	2.77	0.00	0.00	**2.43**	10.27	10.11	27.53	**11.55**	8.54	7.81	22.79	**9.48**
Hybrid — Ijarah/ Musharakah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Wakalah/ Murabahah	2.17	0.00	12.99	**2.60**	0.21	6.35	0.00	**0.61**	0.66	4.91	2.24	**1.06**
Hybrid — Ijarah/ Murabahah	3.77	22.29	10.39	**5.39**	0.00	0.00	0.00	**0.00**	0.87	5.07	1.79	**1.22**
Hybrid — Musharakah /Murabahah	0.00	0.00	0.00	**0.00**	0.00	1.03	0.00	**0.07**	0.00	0.80	0.00	**0.05**
Hybrid — Wakalah/ Mudarabah	0.00	0.00	0.00	**0.00**	0.00	0.00	3.19	**0.24**	0.00	0.00	2.64	**0.18**

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Hybrid — Murabahah/ Mudarabah	0.00	10.13	0.00	**0.69**	0.00	0.48	1.46	**0.14**	0.00	2.67	1.21	**0.27**
Islamic Exchangeable Sukuk	6.35	0.00	0.00	**5.58**	0.19	0.00	0.00	**0.17**	1.61	0.00	0.00	**1.39**

Source: Adapted from IIFM Sukuk Reports.

Table 9.7: Popular Shariah Contracts in Structuring Sukuk Issued by Financial Institutions (%)

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Bai' Bithaman Ajil	0.00	0.00	0.00	**0.00**	2.65	0.00	0.00	**1.21**	1.35	0.00	0.00	**0.73**
Murabahah	4.23	0.00	23.54	**7.70**	33.89	19.38	11.00	**23.04**	19.40	12.91	14.55	**16.88**
Salam	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Istisna'a	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Ijarah	10.41	0.00	5.23	**7.89**	1.94	0.00	53.73	**20.06**	6.08	0.00	40.00	**15.17**
Mudarabah	21.20	35.86	12.12	**21.31**	5.49	0.02	10.29	**6.19**	13.17	11.99	10.81	**12.27**
Musharakah	16.12	0.00	0.00	**10.52**	5.94	1.04	1.07	**3.29**	10.91	0.69	0.76	**6.20**
Wakalah	28.83	47.41	13.60	**28.20**	33.78	53.66	8.84	**28.55**	31.36	51.57	10.19	**28.41**
Hybrid — Unidentified	14.96	0.00	0.00	**9.76**	5.77	0.00	0.00	**2.65**	10.26	0.00	0.00	**5.51**
Hybrid — Ijarah/ Musharakah	1.18	0.00	0.00	**0.77**	0.00	0.00	0.00	**0.00**	0.58	0.00	0.00	**0.31**
Hybrid — Wakalah/ Murabahah	2.42	0.00	7.85	**3.23**	0.23	25.90	0.00	**4.89**	1.30	17.25	2.22	**4.22**
Hybrid — Ijarah/ Murabahah	0.00	11.95	13.60	**4.50**	0.00	0.00	0.00	**0.00**	0.00	3.99	3.85	**1.81**
Hybrid — Musharakah/ Murabahah	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**
Hybrid — Wakalah/ Mudarabah	0.64	4.78	24.06	**6.12**	0.00	0.00	15.07	**5.38**	0.31	1.60	17.62	**5.68**
Hybrid — Murabahah/ Mudarabah	0.00	0.00	0.00	**0.00**	10.31	0.00	0.00	**4.73**	5.27	0.00	0.00	**2.83**
Islamic Exchangeable Sukuk	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**	0.00	0.00	0.00	**0.00**

Source: Adapted from IIFM Sukuk Reports.

Table 9.8: Popular Shariah Contracts in Structuring Sukuk — Total (%)

Shariah Contracts	International Sukuk Issuances				Domestic Sukuk Issuances				Total			Total
	2001–2018	2019	2020	Total	2001–2018	2019	2020	Total	2001–2018	2019	2020	
Bai' Bithaman Ajil	0.00	0.00	0.00	**0.00**	4.09	0.00	0.00	**3.19**	3.15	0.00	0.00	**2.44**
Murabahah	3.14	2.86	5.31	**3.38**	51.21	30.03	28.81	**46.41**	40.24	22.86	23.10	**36.36**
Salam	0.78	0.00	0.00	**0.59**	1.11	1.00	1.60	**1.16**	1.03	0.74	1.22	**1.02**
Istisna'a	0.00	0.00	0.00	**0.00**	0.43	0.00	0.00	**0.33**	0.33	0.00	0.00	**0.26**
Ijarah	29.17	10.97	17.74	**25.60**	17.86	19.80	40.48	**20.79**	20.44	17.47	34.96	**21.92**
Mudarabah	5.72	9.10	6.39	**6.20**	3.20	11.30	5.12	**4.23**	3.77	10.72	5.43	**4.69**
Musharakah	4.70	0.00	0.00	**3.55**	11.04	1.24	1.96	**8.98**	9.60	0.91	1.48	**7.71**
Wakalah	42.27	56.55	50.53	**44.98**	3.64	11.72	3.63	**4.43**	12.45	23.55	15.02	**13.90**
Hybrid — Unidentified	3.50	0.00	1.18	**2.80**	3.09	1.58	4.36	**3.09**	3.18	1.16	3.59	**3.02**
Hybrid — Ijarah/ Musharakah	0.14	0.00	0.00	**0.11**	0.00	1.12	0.47	**0.17**	0.03	0.82	0.35	**0.15**
Hybrid — Wakalah/ Murabahah	0.84	0.00	2.95	**1.01**	0.06	4.60	0.00	**0.50**	0.24	3.39	0.72	**0.62**
Hybrid — Ijarah/ Murabahah	1.69	11.96	10.49	**4.00**	0.00	0.00	0.00	**0.00**	0.39	3.16	2.55	**0.93**
Hybrid — Musharakah /Murabahah	0.00	0.00	0.00	**0.00**	0.00	0.16	0.00	**0.02**	0.00	0.12	0.00	**0.01**
Hybrid — Wakalah/ Mudarabah	0.67	0.78	5.42	**1.29**	0.00	0.00	3.21	**0.39**	0.15	0.21	3.74	**0.60**
Hybrid — Murabahah/ Mudarabah	4.37	7.80	0.00	**4.21**	4.24	17.45	10.37	**6.28**	4.27	14.90	7.85	**5.80**
Islamic Exchangeable Sukuk	3.01	0.00	0.00	**2.28**	0.05	0.00	0.00	**0.04**	0.72	0.00	0.00	**0.56**

Source: Adapted from IIFM Sukuk Reports.

9.2.4.1 Naming of Sukuk

Naming a Sukuk after its underlying Shariah contract conveys its legal and structural features (Rainey & Salah, 2011) but is a regulatory, not a Shariah, requirement. In Bangladesh, Section 5 of the Investment Sukuk Rules 2019 requires a Sukuk based on a single Shariah concept to be named after it, and one based on several concepts to be named after the prime concept, with the concepts used disclosed in its principal terms and conditions.

If a Sukuk is structured based on only one Shariah contract, then its naming is straightforward. However, in reality, more often Sukuk are structured based on multiple Shariah contracts. In such cases, Bangladesh Securities and Exchange Commission (BSEC, 2019) requires naming the Sukuk after the 'prime concept'. But, in a hybrid structure, where the Sukuk is structured based on multiple Shariah contracts, which is the 'prime concept' could be debated. For instance, in Tables 9.4–9.8 above, Sukuk structured based on agency (Wakalah) may also include lease (Ijarah) and cost-plus sale (Murabahah). The Ijarah structures may also include Istisna'a.

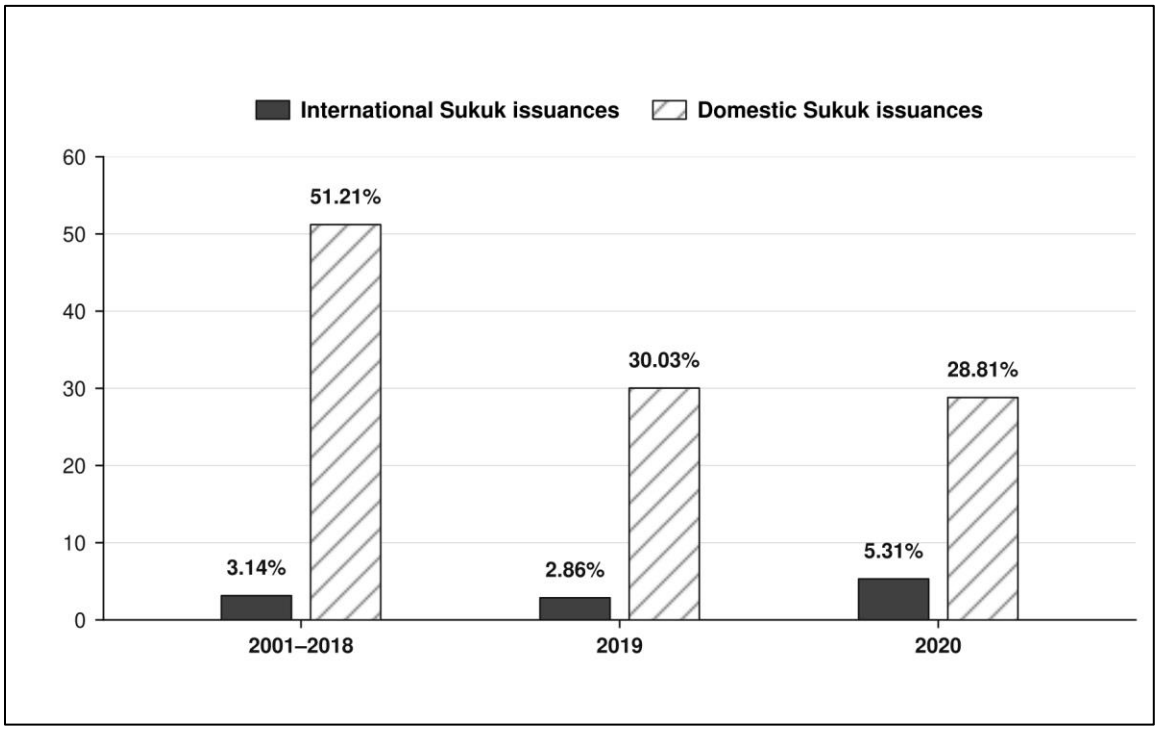
In this context, the SC Malaysia (2019) states that where the Sukuk are structured using multiple Shariah principles, the Sukuk may be named according to the name of the issuer or obligor (where applicable). In any case, the application of the multiple Shariah principles must be disclosed in the principal terms and conditions of the Sukuk.

9.2.4.2 Differences of Opinion in Application of Shariah Principles

Tables 9.4–9.8 provided above shows that the Shariah contracts' application varies depending on the type of issuer and whether the issuance is an international or domestic one. One of the reasons behind this is that differences of opinion exist among the Shariah scholars, supervisory boards and standard setters.

Although all Sukuk are approved by their Shariah boards, their acceptability varies with Shariah opinion. The sale of debt at a negotiated price, for example, is accepted in Malaysia but not by most others (ISRA, 2017), so Murabahah Sukuk, which create debt, are popular in Malaysia's domestic market, where they can trade at negotiated prices, but not internationally (Figure 9.5).

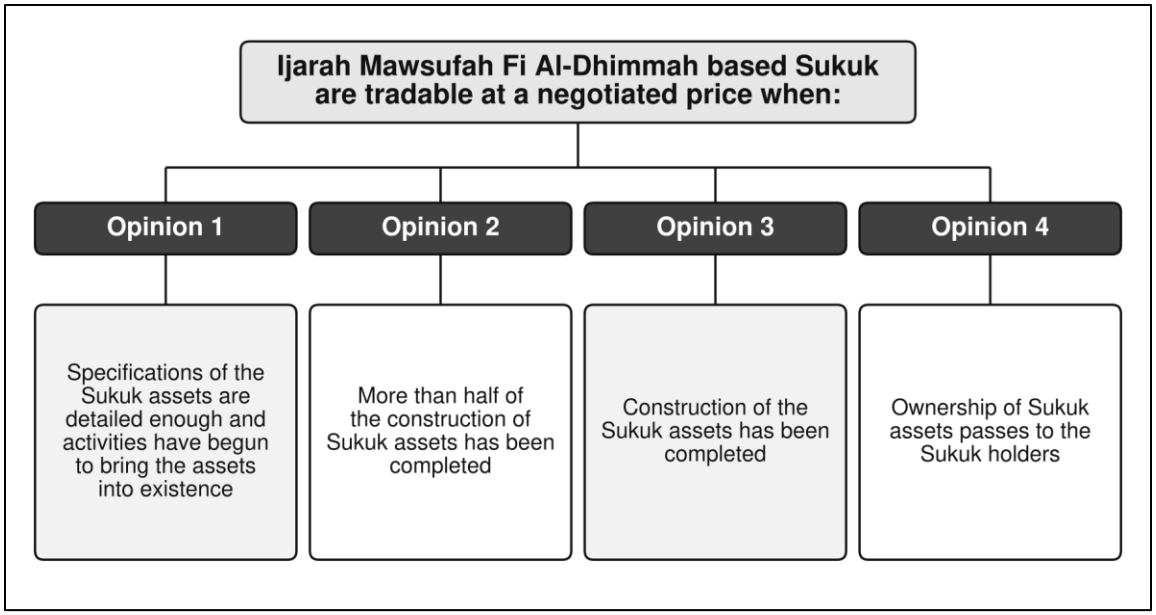
Figure 9.5: Share of Murabahah Sukuk in International and Domestic Issuances



Source: Adapted from IIFM Sukuk Reports.

Figure 9.6 provides another example of differences of opinion. It shows that four different opinions are available regarding tradability of Ijarah Mawsufah Fi Al-Dhimmah based Sukuk.

Figure 9.6: Tradability of Ijarah Mawsufah Fi Al-Dhimmah based Sukuk



Source: Bouheraoua, Sairally, & Hasan (2012).

Because such differences persist, Sukuk prospectuses usually remind investors that Shariah views may differ and advise them to obtain independent Shariah advice on whether the structure meets their standards and on its future tradability (IIFM, 2020).

9.2.4.3 Evolution of Practice with Greater Clarity in Shariah Standards

Practice also evolves as Shariah standards are clarified. After Sheikh Muhammad Taqi Usmani criticized certain participatory structures at an AAOIFI conference (Usmani, 2007), AAOIFI's 2008 resolution clarified the use of participatory contracts (AAOIFI, 2008), leading to amendments in Sukuk documentation (ISRA, 2017) and a sharp, if temporary, decline in participatory structures (International Islamic Financial Market (IIFM) Sukuk Reports, n.d.). Similarly, AAOIFI Shariah Standard No. 59 clarified trading rules not covered by Standard No. 17 (Jivraj, 2021), with implications for Sukuk structured to comply with AAOIFI standards (Fitch Ratings, 2021) and short-term challenges for the United Arab Emirates (UAE) market, which must comply with them (Arab News, 2021). In the long run, such changes bring the market closer to fundamental Shariah principles and push it to innovate.

9.2.5 Structures of Sukuk Based on Shariah Contracts

This section provides definition and illustration of some of the Sukuk based on their Shariah contracts.

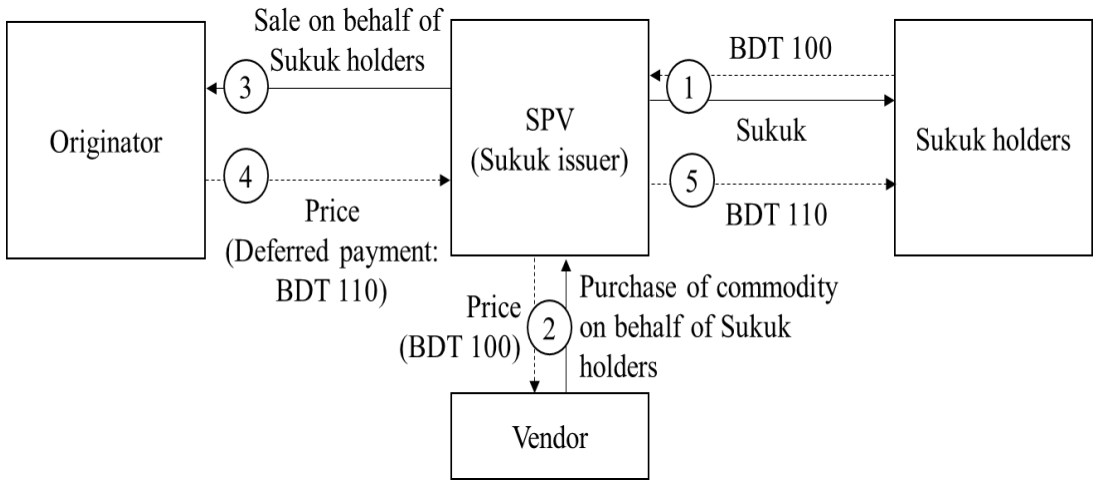
9.2.5.1 Murabahah Sukuk

The definition of Murabahah Sukuk as provided by different Islamic finance authorities are provided in Table 9.9 and a simple illustration is provided in Figure 9.7.

Table 9.9: Definition of Murabahah Sukuk

AAOIFI (2003)	These are certificates of equal value issued for the purpose of financing the purchase of goods through Murabahah so that the certificate holders become the owners of the Murabahah commodity. The certificate holders own the Murabahah commodity and are entitled to its sale price.
IFSB (2009)	In this case, the originator (and also, in some cases, the issuer) of the Sukuk is the buyer (on credit) of the Murabahah asset, the Sukuk investors are the sellers (on credit) of that asset, and the credit provided by the Sukuk investors and received by the issuer consists of the Murabahah selling price of the asset, which the originator sells to obtain the funds it seeks. The Sukuk holders own the Murabahah and are entitled to receive payment of that receivable (the selling price of the asset) either in installments or in a lump sum at the end of the Murabahah contract. Such Sukuk, being securitized receivables, are not generally considered tradable in most jurisdictions.
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract.

Figure 9.7: Illustration of a Basic Murabahah Sukuk



Step	Event	Underlying Assets of Sukuk
1	The Special Purpose Vehicle (SPV) has issued Sukuk and received BDT 100 crore from the Sukuk holders to purchase specified commodities.	Cash
2	The SPV has purchased the commodities from a vendor.	Commodities
3	The SPV on behalf of the Sukuk holders has sold the commodities to the originator on a deferred payment basis (BDT 110 crore).	Receivables
4	The originator makes payment to the SPV.	Cash
5	The Sukuk holders receive payment from the SPV.	This marks the maturity of the Sukuk

Source: Authors' own.

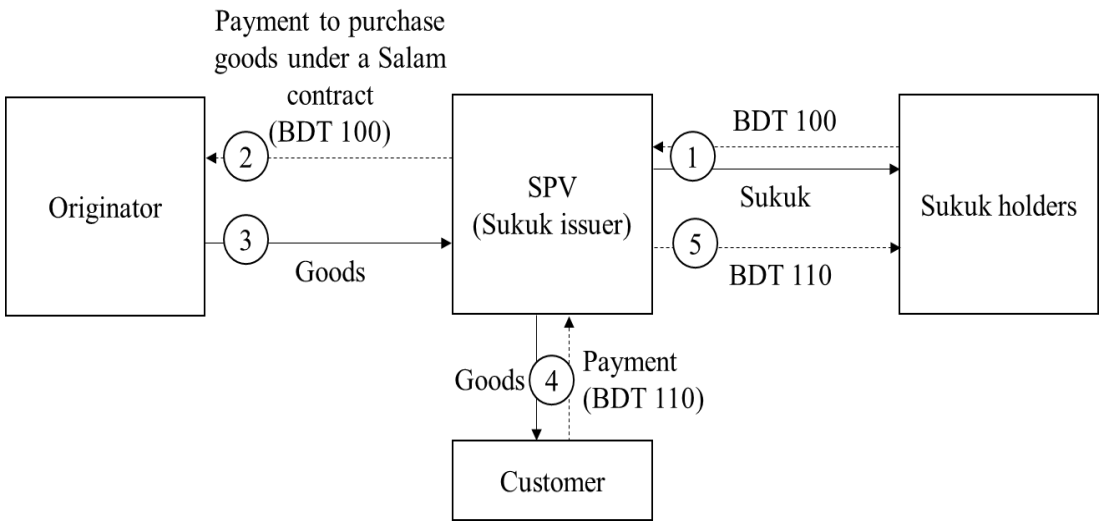
9.2.5.2 Salam Sukuk

The definition of Salam Sukuk as provided by different Islamic finance authorities are provided in Table 9.10 and a simple illustration of a Salam Sukuk is provided in Figure 9.8.

Table 9.10: Definition of Salam Sukuk

AAOIFI (2003)	These are certificates of equal value issued for the purpose of mobilizing Salam capital so that the goods to be delivered on the basis of Salam come to be owned by the certificate holders. The holders of Salam certificates are the owners of the Salam goods and are entitled to the sale price of the certificates or the sale price of the Salam goods sold through a parallel Salam, if any.
IFSB (2009)	Salam Sukuk represents proportionate ownership of the capital of a Salam transaction, where the Salam capital is constituted by an advance payment to a counterparty as supplier of a commodity (the subject matter) to be delivered at a future date. This type of Sukuk is generally considered to be non-tradable since the subject matter is considered to be a financial asset (a receivable).

Figure 9.8: Illustration of a Basic Salam Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore from the Sukuk holders to purchase described assets under a Salam contract.	Cash
2	The SPV on behalf of the Sukuk holders has entered into a Salam contract with the originator and paid BDT 100 crore for goods that the originator will deliver on a specified future date.	Receivables (Good to be received in the future)
3	On the specified delivery date, the originator has delivered the goods to the SPV.	Goods
4	The SPV has sold the goods to a customer and received BDT 110 crore as sale price.	Cash
5	The Sukuk holders receive payment from the SPV.	This marks the maturity of the Sukuk

Source: Authors' own.

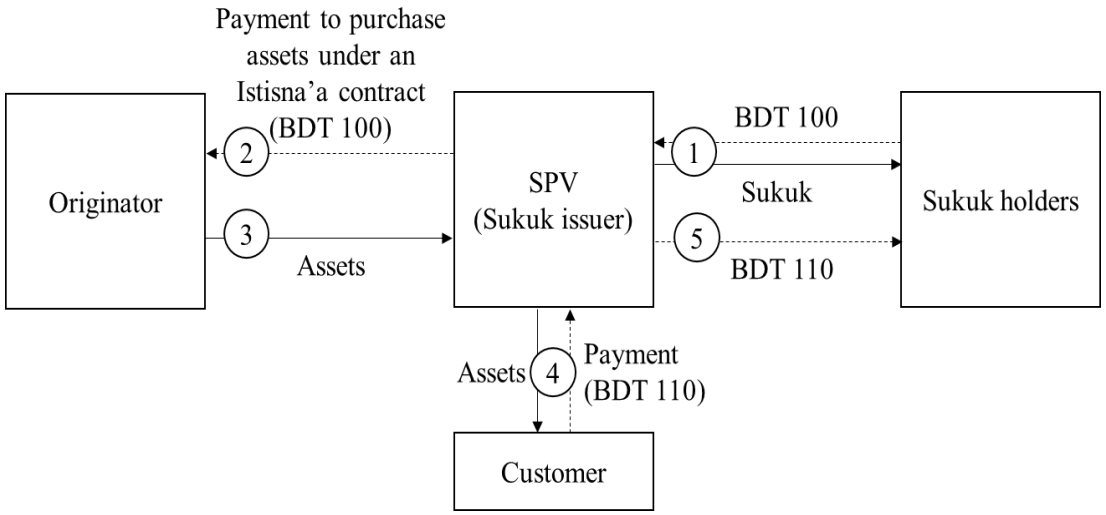
9.2.5.3 Istisna'a Sukuk

The definition of Istisna'a Sukuk as provided by different Islamic finance authorities are provided in Table 9.11 and a simple illustration of an Istisna'a Sukuk is provided in Figure 9.9.

Table 9.11: Definition of Istisna'a Sukuk

AAOIFI (2003)	These are certificates of equal value issued with the aim of mobilizing funds to be employed for the production of goods so that the goods produced come to be owned by the certificate holders. The certificate holders own the product and are entitled to the sale price of the certificates or the sale price of the product sold on the basis of a parallel Istisna'a, if any.
IFSB (2009)	Istisna'a Sukuk represent proportionate shares in the financing of a project to construct an asset at a price to be paid in future installments, the total of which equals the total face value of the Sukuk, in addition to mark-up.
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership of the asset, including the rights to the receivables arising from the underlying contract.

Figure 9.9: Illustration of a Basic Istisna'a Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore from the Sukuk holders to purchase described assets under an Istisna'a contract.	Cash
2	The SPV on behalf of the Sukuk holders has entered into an Istisna'a contract with the originator and paid BDT 100 crore for assets that the originator will deliver on a specified future date.	Receivables (Assets to be received in the future)
3	On the specified delivery date, the originator has delivered the assets to the SPV.	Manufactured Assets
4	The SPV has sold the assets to a customer and received BDT 110 crore as sale price.	Cash
5	The Sukuk holders receive payment from the SPV.	This marks the maturity of the Sukuk

Source: Authors' own.

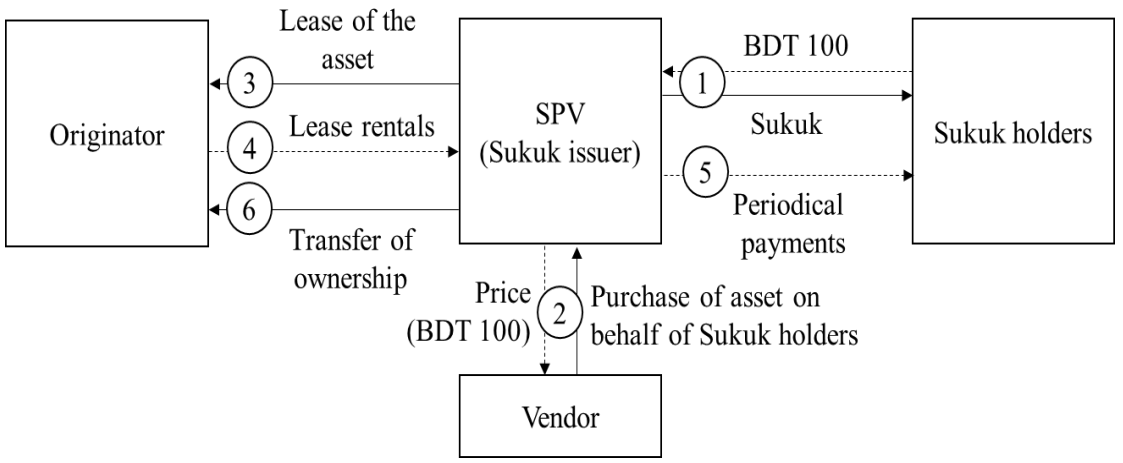
9.2.5.4 Ijarah Sukuk

The definition of Ijarah Sukuk as provided by different Islamic finance authorities are provided in Table 9.12 and a simple illustration of an Ijarah Sukuk is provided in Figure 9.10.

Table 9.12: Definition of Ijarah Sukuk

IFSB (2009)	Ijarah and Ijarah Muntahiyah Bi al-Tamlik (IMB) Sukuk represent the holder's proportionate ownership in leased assets where the Sukuk holders will collectively assume the rights and obligations of the lessor. The Sukuk holders are entitled to a share of the lease rentals in proportion to their ownership shares in the leased assets. Ijarah and IMB Sukuk are tradable from the issuance date, as the subject matter is a non-financial asset owned by the Sukuk holders.
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership of the leased asset and/or usufruct and/or services and rights to the rental receivables from the said leased asset and/or usufruct and/or services.

Figure 9.10: Illustration of a Basic Ijarah Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore from the Sukuk holders to purchase specified assets.	Cash
2	The SPV has purchased the assets from a vendor.	Assets to be leased
3	The SPV on behalf of the Sukuk holders has leased the assets to the originator based on an IMB arrangement.	Leased assets (Lessor)
4	The originator makes periodical rental payments to SPV.	
5	The Sukuk holders receive periodical payments from the SPV.	
6	The ownership of the asset is transferred to the originator at the end of the lease term.	This marks the maturity of the Sukuk

Source: Authors' own.

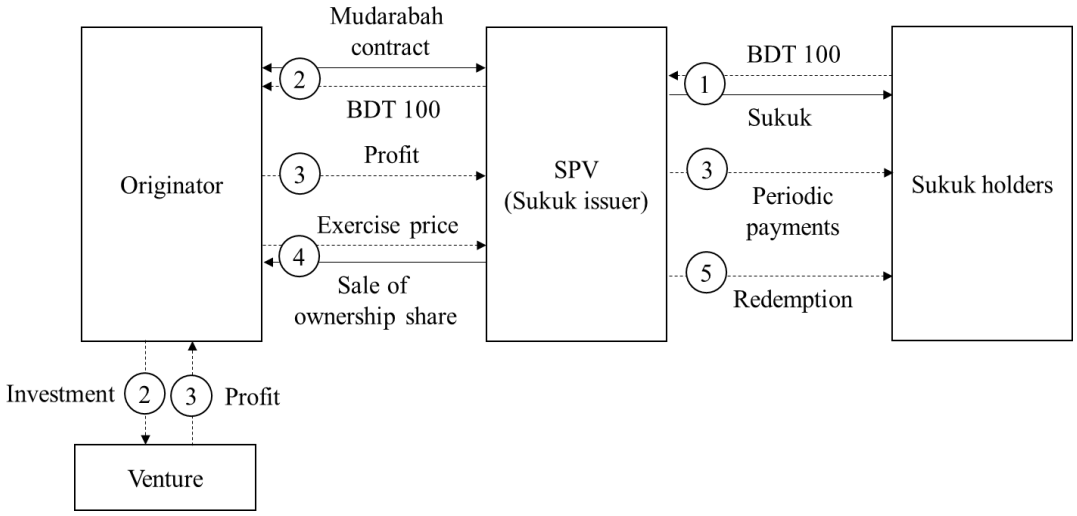
9.2.5.5 Mudarabah Sukuk

The definition of Mudarabah Sukuk as provided by different Islamic finance authorities are provided in Table 9.13 along with a simple illustration in Figure 9.11.

Table 9.13: Definition of Mudarabah Sukuk

AAOIFI (2003)	These are certificates that represent projects or activities managed on the basis of Mudarabah by appointing one of the partners or another person as the Mudarib for the management of the operation. The certificate holders own the assets of Mudarabah and the agreed upon share of the profits belongs to the owners of capital and they bear the loss, if any.
IFSB (2009)	Sukuk holders subscribe to the certificates issued by a Mudarib and share the profits and bear any losses arising from the Mudarabah operations. Underlying investments in Mudarabah can be categorized as follows: a) Private commercial enterprise to undertake trading activities in, for example, commodities b) Private commercial enterprise to undertake business venture or project [other than (a)]
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership in the Mudarabah venture.

Figure 9.11: Illustration of a Basic Mudarabah Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore from the Sukuk holders.	Cash
2	The originator has invested the capital in the venture as Mudarib of the Sukuk holders' capital.	Assets of the venture
3	The profit generated from the venture is shared between the originator and Sukuk holders as per pre-agreed ratio. The Sukuk holders received their share of profit in the form of periodic payments.	Assets of the venture
4	The originator has purchased the Sukuk holders' ownership share in the venture.	Cash
5	The SPV has transferred the redemption amount to the Sukuk holders.	This marks the maturity of the Sukuk

Source: Authors' own.

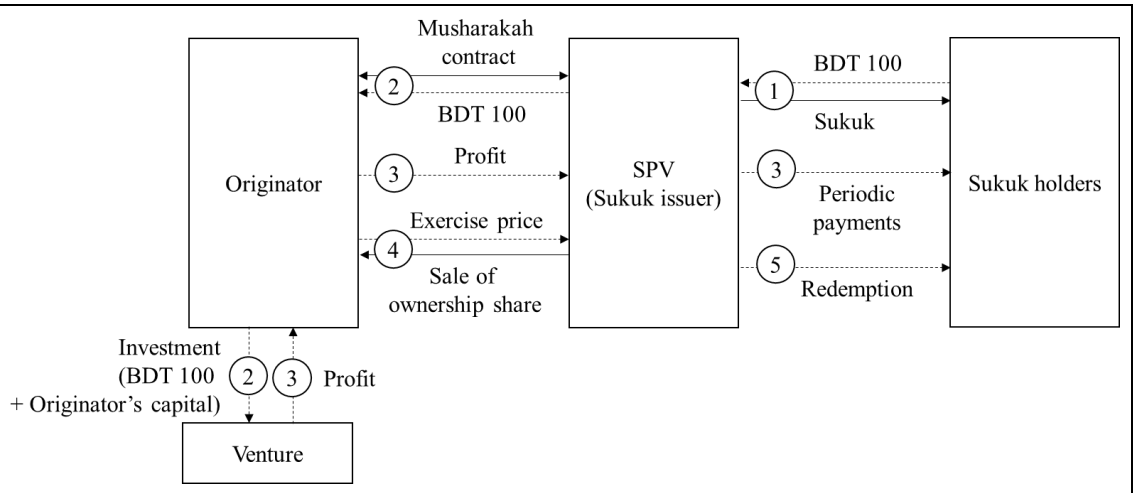
9.2.5.6 Musharakah Sukuk

The definition of Musharakah Sukuk as provided by different Islamic finance authorities are provided in Table 9.14 and a simple illustration is provided in Figure 9.12.

Table 9.14: Definition of Musharakah Sukuk

AAOIFI (2003)	These are certificates of equal value issued with the aim of using the mobilized funds for establishing a new project, developing an existing project or financing a business activity on the basis of any of partnership contracts so that the certificate holders become the owners of the project or the assets of the activity as per their respective shares. The certificate holders own the assets of partnership with the accompanying profits and losses and are entitled to their share in the profits of the partnership, if any.
IFSB (2009)	Musharakah Sukuk represent the direct proportionate ownership shares of the holders in the assets of a private commercial enterprise or project, where the subscription money is normally employed in purchasing non-liquid assets or assets such as real estate or movable assets. A Musharakah Sakk is a profit- and loss-sharing instrument where the exposure is of the nature of an equity position in the banking book, except in the case of investments (normally short-term) in assets for trading purposes. Underlying investments in Musharakah that can be categorized as follows: a) Private commercial enterprise to undertake trading activities in, for example, commodities b) Private commercial enterprise to undertake business venture or project [other than (a)] c) Joint ownership of real estate or movable assets (such as cars)
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership in the Musharakah venture.

Figure 9.12: Illustration of a Basic Musharakah Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore.	Cash
2	The originator has invested the Sukuk holders' capital together its own in the venture.	Proportionate share of assets in the venture
3	The profit generated from the venture is shared between the originator and Sukuk holders as per pre-agreed ratio. The Sukuk holders received their share of profit in the form of periodic payments.	Proportionate share of assets in the venture
4	The originator has purchased the Sukuk holders' ownership share.	Cash
5	The SPV has transferred the redemption amount to the Sukuk holders.	This marks the maturity of the Sukuk

Source: Authors' own.

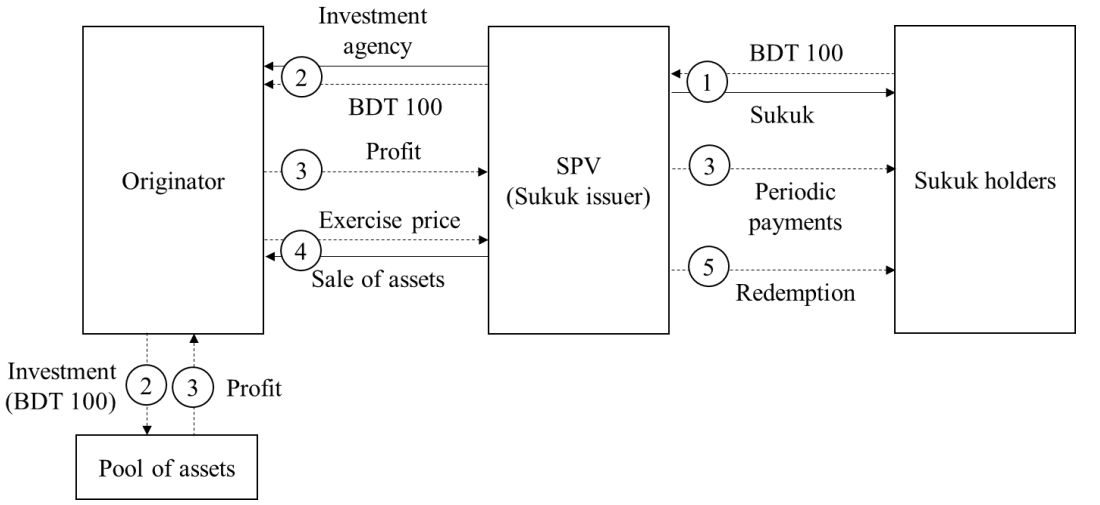
9.2.5.7 Wakalah Sukuk

The definition of Wakalah Sukuk as provided by different Islamic finance authorities are provided in Table 9.15 and a simple illustration of a Wakalah Sukuk is provided in Figure 9.13.

Table 9.15: Definition of Wakalah Sukuk

AAOIFI (2003)	These are certificates that represent projects or activities managed on the basis of an investment agency by appointing an agent to manage the operation on behalf of the certificate holders. The certificate holders own the assets represented by the certificates with its benefits and risks, and they are entitled to the profits, if any.
IFSB (2009)	The Wakalah Sukuk holders provide the capital for Shariah-compliant investment activity, and the investment agent (Wakil) undertakes investment of the funds. In this type of Sukuk structure, the portfolio of assets may comprise a broad range of Shariah-compliant assets that will be selected by the Wakil for a period of time corresponding to the duration of the Sukuk. The range of assets may include: Shariah-compliant equities; Shariah-compliant assets such as real estate and cars; Murabahah, Istisna'a or even other Sukuk, etc. The underlying investments in Wakalah can be categorized as follows: a) To undertake trading activities in foreign exchange, shares or commodities b) To invest in assets that can be leased or sold on a Murabahah basis c) To invest in a combination of assets comprising shares, leasable assets, receivables from Murabahah or Salam, etc
SC Malaysia (2020)	These refer to certificates of equal value evidencing the certificate holder's undivided ownership in the investment assets pursuant to their investment through the investment agent.

Figure 9.13: Illustration of a Basic Wakalah Sukuk



Step	Event	Underlying Assets of Sukuk
1	The SPV has issued Sukuk and received BDT 100 crore.	Cash
2	The originator has invested the Sukuk holders' capital in a pool of assets.	Pool of assets
3	The profit generated from the pool of assets is distributed to the Sukuk holders as periodic payments.	Pool of assets
4	The originator has purchased the assets from the Sukuk holders.	Cash
5	The SPV has transferred the redemption amount to the Sukuk holders.	This marks the maturity of the Sukuk

Source: Authors' own.

9.3 Sukuk in Bangladesh

The Bangladesh Government Investment Sukuk (Ijarah Sukuk) is the first Sukuk issued under the *Bangladesh Government Investment Sukuk Guideline, 2020* and the Beximco Green-Sukuk Al Istisna'a is the first Sukuk issued under the *Bangladesh Securities and Exchange Commission (Investment Sukuk) Rules, 2019*. They are respectively considered as the first government Sukuk and first corporate Sukuk in Bangladesh. However, earlier examples of issuing Islamic alternative to conventional bond include Bangladesh Government Islamic Investment Bond (BGIIB) and Mudarabah Bond issued by a few Islamic banks.

The Bangladesh Government Islamic Investment Bond (BGIIB), introduced in 2004, and the profit-sharing partnership (Mudarabah) bonds issued by Islamic banks to raise regulatory capital are discussed, with updated data, in Section 10.4.1 and Section 10.4.3 of Chapter 10.

9.3.1 Bangladesh Government Investment Sukuk (Ijarah Sukuk)

The BDT 8,000 crore 5-year Sukuk was issued to fund an infrastructure project named Safe Water Supply to the Whole Country. The Sukuk was issued in two tranches. The first was on 28 December 2020 and the second was on 9 June 2021, each for BDT 4,000 crore. It has received an overwhelming response from the market. The bid for the first tranche was around four times and the bid for the second tranche was around eight times than the target amount. The key particulars of the Sukuk are provided in Table 9.16.

Table 9.16: Key Particulars of Bangladesh Government Investment Sukuk

<table>
<tr><td>Parties involved in Sukuk</td><td>Originator, Obligor and Lessee:
Finance Division, Ministry of Finance on behalf of the Government of the People's Republic of Bangladesh

SPV, Issuer and Lessor:
A separate section named "Islamic Securities Section" has been formed in the Debt Management Department (DMD) of Bangladesh Bank. The Deputy General manager of the DMD has been appointed as the head of the section. This section will work as SPV for the issuance and management of this Sukuk. SPV will work separately and independently as a front office and back office to issue Ijarah Sukuk certificate to raise funds from the investors and manage the fund.

Trustee/ Trust Committee:
A trust committee comprising six members (headed by a Deputy Governor of Bangladesh Bank) is formed to ensure the rights and benefits of Sukuk certificate holders and mitigate any kinds of dispute arising during the Sukuk period.</td></tr>
<tr><td>Shariah Governance</td><td>A Shariah Advisory Committee has been formed by Bangladesh Bank comprising:<table><tr><td>• Ex-officio members from Bangladesh Bank</td><td>4</td></tr><tr><td>• Ex-officio members from Ministry of Finance</td><td>1</td></tr><tr><td>• Members of Shariah Supervisory Committees of Islamic banks</td><td>5</td></tr><tr><td>• Secretary General of Central Shariah Board for Islamic Banks of Bangladesh (CSBIB)</td><td>1</td></tr><tr><td>Total</td><td>11</td></tr></table></td></tr>
<tr><td>Uses of Proceeds</td><td>Infrastructure development (such as building construction, machinery, equipment and part purchase, arsenic iron removal plant, rain water harvesting unit, hydrological characterization, the establishment of submersible pump, deep tube</td></tr>
</table>

<table>
<tr><td></td><td>well, hand pump, multiple hand pump, solar panel, etc.) for implementing the project “Safe Water Supply to the Whole Country.”</td></tr>
<tr><td>Sukuk Assets</td><td>Ownership of existing and future assets including usufruct under the project</td></tr>
<tr><td>Rate of Return</td><td>BGIIB rate as declared for the calendar year 2019 dated 12/05/2020 by the Bangladesh Bank + 1% which is 3.69%+1% = 4.69% (Fixed) per annum, payable semi-annually</td></tr>
<tr><td>Security</td><td>Backed by the full faith and credit of the government</td></tr>
<tr><td>Auction Result</td><td>• 1st tranche: 39 bids of BDT 15,153 crore
• 2nd tranche: 67 bids of BDT 32,726 crore</td></tr>
<tr><td>Allotment</td><td>• 1st tranche: Pro-rata basis
• 2nd tranche: The allotment was subject to the following quota
<table>
<tr><th>Investor Category Type</th><th>Allotted</th></tr>
<tr><td>Shariah Based Islamic Bank, Financial Institute and Insurance Companies</td><td>70%</td></tr>
<tr><td>Islamic Branch and Windows of Conventional Banks</td><td>10%</td></tr>
<tr><td>Conventional banks and other Financial Institutes</td><td>15%</td></tr>
<tr><td>Individual investors</td><td>5%</td></tr>
</table></td></tr>
</table>

Source: Bangladesh Bank (2020 and 2021).

Subsequent issues of Bangladesh Government Investment Sukuk (BGIS), and the first corporate Sukuk in Bangladesh — the Beximco Green-Sukuk Al Istisna’a issued in 2021 — are discussed with updated data in Section 10.4.2 and Section 10.4.4 of Chapter 10.

9.3.2 Regulations Facilitating Sukuk Issuance

The regulators and relevant authorities took active initiatives in introducing Sukuk in Bangladesh. Some of these initiatives are:

Bangladesh Government Investment Sukuk Guideline, 2020

The Ministry of Finance issued the Guideline via a Notification dated 8 October 2020 and circulated by Bangladesh Bank via a Circular on 21 October 2020 to all scheduled banks and financial institutions. The Guideline applies to matters related to issuance of Bangladesh Government Investment Sukuk.

Initiatives Under Progress

Few other initiatives are currently under progress, which include — (a) at the time of the study, provisions on Sukuk were proposed for inclusion in the then-draft Public Debt Act (subsequently enacted as the Public Debt Act 2022; see Chapter 10); and (b) Similar to other government securities, income tax exemption for investment in government Sukuk is under consideration.

The Bangladesh Securities and Exchange Commission (BSEC) (Investment Sukuk) Rules 2019, the BSEC (Debt Securities) Rules 2021, Bangladesh Bank’s special fund for investment in green Sukuk, the requirements for Sukuk trustees, the Shariah Advisory Council of BSEC, and the Value Added Tax (VAT), tax and stamp-duty waivers for Sukuk are reviewed in Section 10.3 and Section 10.4.4 of Chapter 10.

9.4 Summary of Interview Findings

Interviews covered both government and corporate Sukuk. The interviewees included regulators and policy makers, parties directly involved in Sukuk issuance, members of the technical committees for Sukuk structuring, the legal adviser for Sukuk documentation, members of Sukuk SSBs, and experts from industry and academia; their views are summarized below.

9.4.1 Government Sukuk

9.4.1.1 Positive Experience During the 1st Sukuk Issuance

The positive experience in issuance of the 1st government Sukuk as identified from the interviews are provided below:

Trust-based cooperation among the government agencies

The government agencies coordinated well, adopting a 'soft' rather than a 'hard' form of coordination to minimize issuance costs, on the argument that there is no question of mistrust of the government and that a separate Special Purpose Vehicle (SPV) and trustee would add costs ultimately borne by Sukuk holders.

Sukuk issued before the target date

The first Sukuk was offered before the target date, thanks to the dedication of the Finance Division of the Ministry of Finance and Bangladesh Bank and the government's support.

Support from the stakeholders

The Sukuk issuance process received support from all stakeholders. The National Board of Revenue (NBR) extended crucial support in reducing the tax burden in Sukuk issuance.

Overwhelming market response

The first tranche was subscribed four times and the second eight times. The authorities, pleased with the response, have begun preparing a second Sukuk and are considering larger issues rather than small ones.

9.4.1.2 Challenges Faced During the 1st Sukuk Issuance

As the first-ever Sukuk issued by the government, the parties involved in Sukuk issuance has faced some challenges. The challenges include:

Absence of prior knowledge in Sukuk issuance

Officials at Bangladesh Bank and the Ministry of Finance had no prior experience of Sukuk structuring or operations, nor knowledge of whom to consult, and learned from publications and web-based resources.

Challenges in forming the Shariah Advisory Committee (SAC)

Forming the Shariah Advisory Committee (SAC) was difficult because competent Shariah and Sukuk experts were not readily identifiable and Sukuk expertise is scarce among Shariah scholars; yet the SAC must understand a Sukuk's modus operandi before endorsing it.

Difficulty in dealing with the operational process

Without separate laws and regulations, the operational process was difficult; initially, for example, no one had a clear idea of how to form the SPV and trustee for a government Sukuk.

COVID-19 pandemic

Those involved in Sukuk issuance also faced challenges due to the COVID-19 pandemic.

9.4.1.3 Recommendations for Future Sukuk Issuance

The interviewees suggested several recommendations for future Sukuk issuance which are summarized in the following box:

- **Regarding competent resources**
  - Formation of a technical committee for structuring Sukuk.
  - Developing competent resources at Ministry of Finance and Bangladesh Bank and not transferring them without ensuring replacement with necessary skill set.
  - Formation of a dedicated Sukuk unit under the Finance Division of MoF
  - BIBM and other educational and training institutions may invite Ministry of Finance, Bangladesh Bank and BSEC to all Sukuk related programs
  - More research should be done for developing Sukuk market in Bangladesh.
- **Regarding Sukuk operations**
  - Considering individual investors, government may offer higher rate of return aligning with inflation and bank-deposit rate for the upcoming issues.
  - To develop efficient mechanism and platform for transferring and trading Sukuk.
  - Formation of pricing guidelines for trading and redemption of Sukuk
  - Coordination with Dhaka Stock Exchange (DSE) for developing a platform for trading of Sukuk.
  - Formulation of plan (short, medium and long-term) for Government Sukuk with proper coordination
  - Identification of suitable project/assets for structuring Sukuk
  - SPV and trustee could be independent entities like Bangladesh Financial Intelligence Unit (BFIU)
  - Disclosure of Shariah basis by the SAC for general investors
  - Academia and researcher may propose some suitable structure for Government Sukuk.
- **Regarding regulations**
  - To introduce a dedicated Act on Sukuk.
- **Regarding future direction**
  - To establish Sukuk as an alternative to conventional savings certificates (Sanchayapatra) with a competitive rate.
  - To establish Sukuk as a tool for Social Safety Net program with a long-term vision
  - To establish Sukuk as an alternative to BGIIB
  - To create awareness among mass people for expanding the Sukuk market
  - The government may offer incentives for individual investors for expanding the Sukuk market

Source: Survey data.

9.4.1.4 Contrary Recommendations

Few interviewees provided recommendations contrary to the commonly identified ones. They are provided below:

Not to rush in issuing the 2nd Sukuk

One interviewee advised against rushing the second issue, preferring to observe the progress of the first, since Bangladesh had developed without Sukuk so far and would not suffer if none were issued urgently.

Not to provide immediate tax waivers

Another saw no need for tax and duty waivers until Sukuk had first proved their credibility.

9.4.2 Corporate Sukuk

9.4.2.1 Originator's Perspective

High issuance cost

Issuance costs are much higher than for conventional bonds — including trustee costs, government duties and fees on asset transfers, Shariah governance costs and listing fees — a major concern for originators.

9.4.2.2 Issue Manager's Perspective

Positive market response

Overall, there is positive attitude among the stakeholders of Bangladesh to the Shariah-compliant instruments especially to be interest-free.

Underdeveloped market

The bond market is undeveloped and Sukuk are new; investors so far prefer equities to bonds or Sukuk despite the regular income Sukuk offer, and there are misconceptions about Sukuk.

Wait and see approach of potential issuers

Potential issuers are waiting and watching: several are interested but are weighing issuance costs, documentation requirements and investor perceptions, and more institutional investors capable of informed decisions are needed.

Need an innovative approach

Innovations needed considering requirements of the originators, nature of underlying assets, risks of the obligor and investors, and tax implications.

More initiatives needed to reduce the tax burden

Despite some amendments, further measures are needed to achieve tax neutrality, including tax incentives to attract participants while the market is young.

9.4.2.3 Underwriter and Trustee's Perspective

Greater risks involve in Sukuk

Underwriters feel they bear greater risk because of the market's composition, investors' limited awareness and risk perceptions, and the economy's overall readiness.

Fees not commensurate with the risks

The current underwriting fee is not commensurate with the additional risk taken by the underwriter.

Shariah compliance concern

AAOIFI Shariah Standards do not permit fees for underwriting; although other opinions allow them where necessary and no free underwriting is available, a mechanism is needed that resolves the Shariah concern without disadvantaging any party.

9.4.2.4 Trustee's Perspective

Too many responsibilities

Because of the salient features of Sukuk, a trustee has a tremendous role and responsibilities in the Sukuk process. For that reason, some of the entities are not much comfortable to act as a Trustee in a Sukuk.

9.4.2.5 Legal Advisor's Perspective

The requirements for SPV and trust formations needs to be further clarified

BSEC rules appear to require the SPV to be a trust, which has caused confusion, including over separating the trust from the trustee. Regulators could also permit SPVs as incorporated entities, as in securitization in Singapore, the EU, Australia and the United Kingdom (UK) — an 'orphan' structure with professional managers on the board and total separation from other assets — but this needs a legal framework, since existing company law cannot provide an entity that enjoys tax exemption and can be wound up easily after final payment. Such entities could be registered with the RJSC only with BSEC's consent, with objects limited to the Sukuk, and wound up only with BSEC's permission. Alternatively, the regulations could clarify the role, position and relationship of the SPV and the trustee.

A copy-paste approach in drafting Sukuk documents is not appropriate

Every Sukuk is unique, so its documents must be drafted with care rather than copied — particularly in Bangladesh, where drafters are still learning.

9.4.2.6 Technical Committee and SSB Members' Perspective

The originator, technical committee and SSB demonstrated their best efforts

Technical committee members found originators willing to modify documents to achieve Shariah compliance, and the technical committee and Shariah Supervisory Board (SSB) members did their best to make the structure, documents and contracts Shariah-compliant.

Sukuk advisors must be equipped with up-to-date knowledge

Knowledge of Sukuk technicalities and Shariah compliance is generally lacking; advisers must keep up to date, and a pool of experts combining Shariah and Sukuk knowledge should be developed.

Sukuk advisors and SSB members must be mindful of the volume of work involved in Sukuk

SSB members must be mindful of their fiduciary responsibility: they cannot decide instantly on many documents, and originators may rush issuance, leaving little time for drafting and finalizing documents. Documents should reach the SSB in good time, and a systematic, time-budgeted approach to drafting, review and Shariah vetting would reduce time and effort.

Meeting times should be properly utilized

During the meetings, important matters should be prioritized for the best utilization of the limited time.

A formal communication channel to be established between BSEC and SSB

BSEC may consider establishing a formal communication mechanism to seek clarification regarding any Shariah and regulatory compliance issues and promptly resolve any matters arising.

9.4.2.7 Industry Experts' and Academics Perspective

Several recommendations are presented by the interviewees, which include:

- At the initial stage, small sized issues should be preferred over big sized issues.
- To build market confidence, the issuers should be credible and trustworthy corporate entities.
- There should be transparency and assurance regarding the quality of the underlying Sukuk assets along with relevant financials.
- Instead of a part, a total project may be considered for issuing a Sukuk and the whole project should be transferred to the SPV.
- To enhance confidence on issue and originator's rating, the rating may be done by an external credit assessment institution (ECAI) having affiliation with a reputed international firm.
- Sukuk may be a suitable investment opportunity for the pension fund and insurance fund. Industry experts believe that this potentiality should be realized through timely and prudent decision.
- A coordinated approach between government agencies, regulators, corporate bodies and other associated entities is essential to develop a strong Sukuk market in Bangladesh.

9.4.2.8 Regulators' Perspective

Sukuk is needed for the development of the country's economy

The growing economy needs more capital than bank-based financing can provide, and Sukuk can attract all investors — Muslim and non-Muslim, individual and institutional, local and foreign. Regulators expect dependence on bank financing to fall as fixed-income securities make the capital market more vibrant; BSEC is holding international roadshows that include Sukuk, and initiatives for the local market are under way.

More awareness efforts needed

Awareness and learning programs are offered by the Bangladesh Institute of Capital Market (BICM) and the Bangladesh Academy for Securities Markets (BASM); Bangladesh Institute of Bank Management (BIBM) and others could contribute by inviting BSEC and corporate representatives to Sukuk programs.

Supportive response from government agencies

Government as a whole, NBR and BSEC are supportive to the Sukuk issuance. Setting a visionary and strategic approach and joint/coordinated efforts are crucial for developing the Sukuk market.

Green and small-sized Sukuk are preferred

Sukuk especially green Sukuk are getting the highest attention in the approval process. BSEC is thinking positively for bringing a number of small-sized Sukuk by trustworthy corporates.

Greater participation needed from the Islamic banks

Islamic banks have shown little interest in leading corporate Sukuk issuance; recognizing Sukuk directly in regulation as an eligible component of banks' regulatory capital would remove this obstacle.

Greater participation needed from the Islamic Insurance / Takaful Operators

Insurance Development and Regulatory Authority (IDRA) may take initiatives to include some provisions in their regulations for motivating/directing insurance companies for investing Sukuk.

Branding of Sukuk as a separate instrument

It is expected that regulators will take initiatives for branding of Sukuk separately, not as a type of bond in Bangladesh.

9.5 Observations and Recommendations

9.5.1 Human Capital Development

Most of the stakeholders agreed that there is a knowledge gap from technical and Shariah aspects. For developing the market and proper structuring and efficient operation of Sukuk, a talent pool of well conversant with Shariah and operational regulations is a crucial need. Especially, a group of selected officials of Finance Division under Ministry of Finance, Debt Management Department of Bangladesh Bank, concerned units of BSEC and NBR should be trained. However, many other organs are associated with Sukuk process. Therefore, a mass-level initiative may be undertaken for developing the requisite human capital.

9.5.2 Shariah Governance and Shariah Advisory Services

Shariah is the fundamental issue in the Sukuk structuring and operations. Most of the investors are very sensitive about Shariah compliance. However, they may not have proper knowledge and capacity to properly evaluate the Shariah compliance aspects. Therefore, those who are charged with governance have to acquire the trust of mass people. In this context, forming a competent and credible SSB and its proper composition and structure is important. A technical committee may be formed to assist the SSB in the structuring phase of the Sukuk and drafting the relevant documents.

9.5.3 Regulatory Impediment

As Sukuk is different from the conventional bond and other instruments, enacting separate laws and regulations are needed. It is applicable for both government issuance and corporate issuances. The existing laws and regulations need to be reviewed regularly to make them accommodative to the developments in the Sukuk market. A mechanism may be there to provide prompt clarification on different regulatory aspects in structuring and issuance of Sukuk.

9.5.4 Financial Institution Issuance

In the Bangladesh context, banks and financial institutions have acceptability to the general investors. To developing the Sukuk market, financial institutions needs to step forward in issuance and investment in Sukuk.

There appears to be a contradicting clause in the BSEC (Investment Sukuk) Rule 2019 and Guidelines on Risk Based Capital Adequacy 2014 that became a barrier for the Islamic banks in issuing Sukuk. According to BSEC (Investment Sukuk) Rule 2019, Sukuk should be issued by an SPV. On the contrary, Guidelines on Risk Based Capital Adequacy 2014 of Bangladesh Bank stated that the instruments should be issued by the bank not by any 'SPV' set up by the bank as to fulfill general eligibility criteria to qualify as regulatory capital. Therefore, banks, even an Islamic bank, are collecting fund through bond instead of Sukuk. Considering international experiences, regulators may think to make required changes in the regulations to support development of the Sukuk market.

9.5.5 Cost of Issuance and Investors' Incentives

As compared to conventional bond, cost of issuance is higher in case of Sukuk. These are related with processing, offering and legal expenses connected with transactions. To make it competitive, concerned authorities may consider to reduce and waive much of these costs. It is noted that some of the costs have already been reduced by government. Even after that, some other costs remain significant. Furthermore, some tax incentives for the investors may also be considered in the market developing phase.

9.5.6 Judiciary System for Resolving Sukuk Matters

In case of default in performance by the obligor, the trustee and SPV need to play vital roles in protecting the interest of the investors. At the same time, there should be a supportive judiciary system for resolving disputes in Sukuk maters and protecting the interest of the investors.

Chapter 10: Islamic Capital Market and Its Impact on Islamic Banks

Based on the study "Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh" by Md. Alamgir, Mezbah Uddin Ahmed, Md. Mahabbat Hossain and Mohammad Monirul Islam Sarker.

10.1 Introduction

10.1.1 Research Background

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

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

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

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

10.1.2 Research Objectives

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

10.1.3 Research Methodology

To facilitate a comprehensive understanding of the subject matter and achieve the research objectives, this study employs a descriptive methodology that integrates both qualitative and quantitative data. A content analysis is conducted on relevant laws, guidelines, and policy documents to evaluate the regulatory environment and structural framework of ICM. Secondary data are obtained from published materials, including academic journals, annual reports, industry publications, and the official websites of regulatory bodies and financial institutions.

Additionally, primary data are collected through interviews and Focus Group Discussions (FGDs) with key stakeholders, including Shariah scholars, Islamic banking professionals, capital market practitioners, and regulatory authorities. These engagements provide valuable insights into the practical challenges and opportunities associated with the interactions between Islamic banking and capital market activities in Bangladesh. Quantitative data are presented in tables and graphs to enhance the visualization of trends and patterns, while qualitative findings are discussed narratively, reflecting the perspectives and interpretations of the involved stakeholders. The report has been finalized upon incorporation of the observations and feedback received during the workshop.

10.2 Emergence of ICM and the Need for It

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

Capital markets play a pivotal role within an Islamic economic framework by attracting savings and facilitating investments in productive initiatives. This is evident in both primary and secondary market operations: the primary market directly influences the supply of funds, while secondary markets improve liquidity, pricing, and provide exit strategies for investors. The

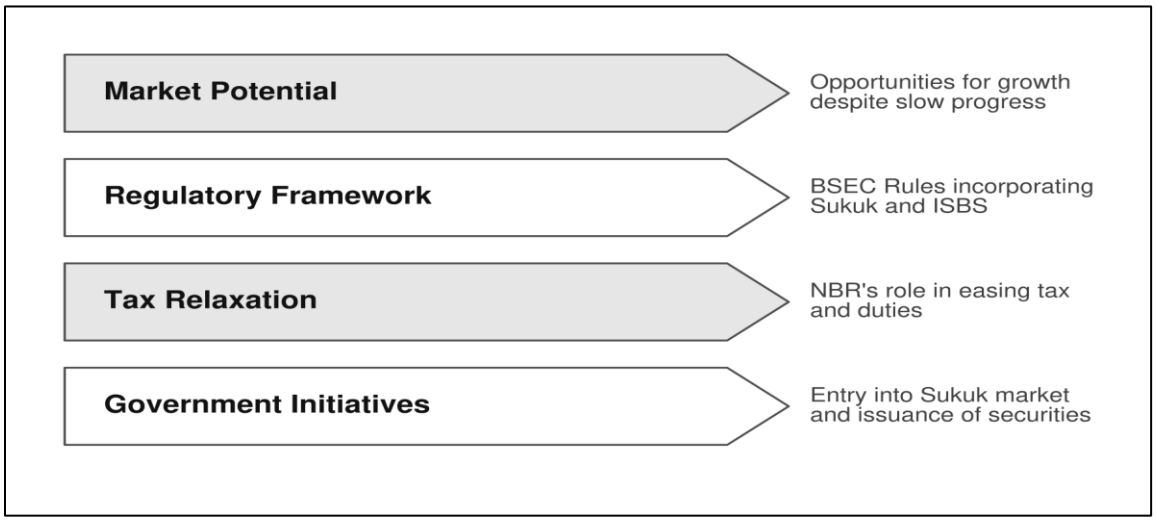
need for responsive and efficient capital markets is underscored by the growing demand for public finance through Islamic modalities. The development of ICM involves various factors, including regulatory frameworks, market microstructure, product diversification, and participant behavior. A thorough understanding of these elements will greatly enhance the potential for growth and expansion of ICM within the broader Islamic financial ecosystem. Effective governance, robust risk management practices, and the establishment of supportive institutions are crucial for the evolution and integration of Islamic capital markets.

Despite experiencing economic growth, many countries struggle with a lack of interest among companies in pursuing listings on domestic stock exchanges, reflecting a deficit of confidence in these markets. This challenge is compounded by the limited capital raised through these exchanges. Many companies listed in these markets are closely held, leading to restricted free float and limited market participation. Additionally, the investor base remains small and stagnant, even in nations with favorable market conditions.

Market exchanges are often dominated by a small number of brokers, fostering a 'closed club' mentality that does not benefit the broader social interest. The proportion of traded stocks compared to total listed securities is low, heavily reliant on a few leading stocks for liquidity. Investors face risks of price manipulation, insider trading, and other forms of market abuse due to structural deficiencies. Although regulatory frameworks exist, their enforcement is generally inadequate, resulting in practices that contradict Islamic principles, such as interest-based borrowing and short-selling.

The Bangladesh government's entry into the Sukuk market, along with tax relaxations by the National Board of Revenue (NBR) and regulatory efforts by Bangladesh Securities and Exchange Commission (BSEC)—such as the introduction of Shariah Advisory Council Rules — has created a foundation for developing the ICM. However, progress remains slow compared to other regional countries. To accelerate growth, the government should prioritize issuing more long- and short-term Shariah-compliant securities. Despite the slow momentum, there is strong potential for expansion in Bangladesh's Islamic capital market. Figure 10.1 depicts the opportunities for growth of the ICM.

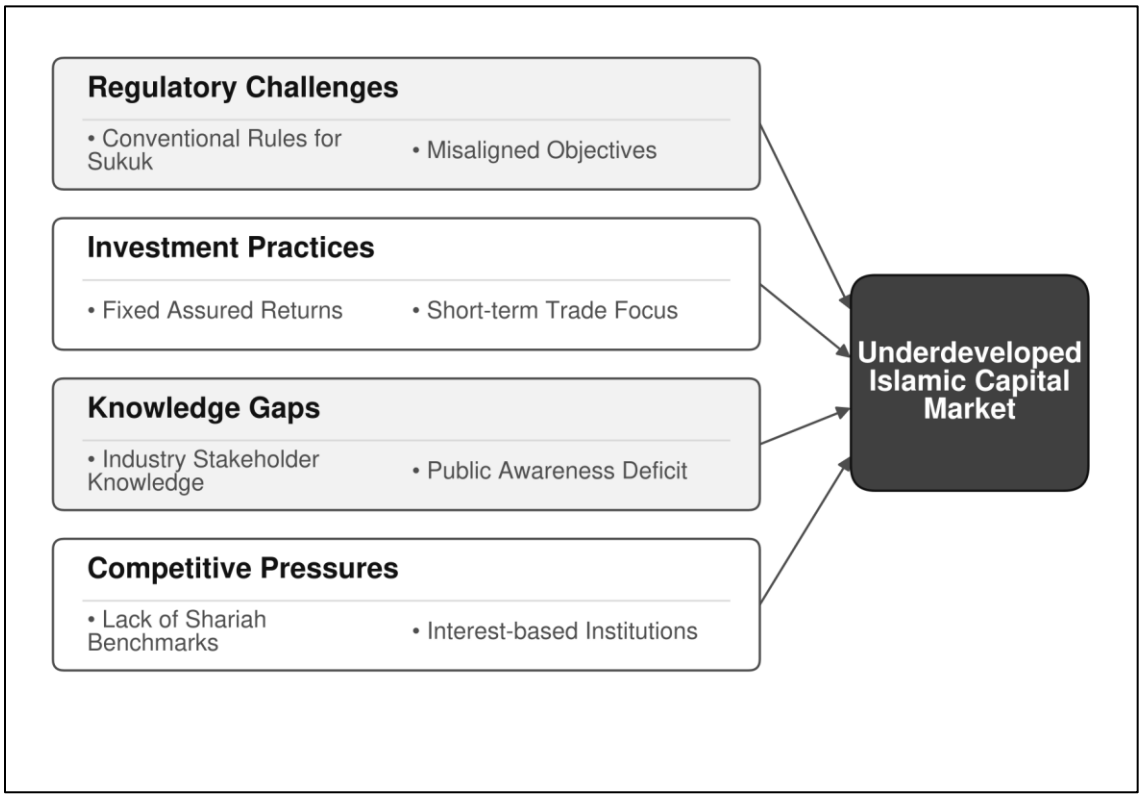
Figure 10.1: Opportunities for Growth of the Islamic Capital Market



Source: IiBFRBD 2024.

Despite being a Muslim-majority country, Bangladesh has entered the Islamic capital market relatively late, making it difficult to compete with more established jurisdictions. A lack of public and stakeholder awareness about Islamic financial principles and the application of conventional rules — such as the Debt Securities Rules — to Sukuk issuance have further hindered its development. Most Islamic banks rely on fixed-return Mudarabah bonds and mark-up-based structures such as cost-plus sale (Murabahah) rather than genuine profit-sharing models such as partnership (Musharakah) or profit-sharing partnership (Mudarabah), limiting Shariah authenticity. Investments remain concentrated in short-term trade, and economic challenges have weakened investor confidence. To advance, regulators and industry players must jointly develop targeted ICM policies and establish a robust Shariah index to guide profit rate determination. Figure 10.2 summarizes the challenges present in Bangladesh's ICM.

Figure 10.2: Challenges in the Islamic Capital Market



Source: IiBFRBD 2024.

10.3 Regulatory Framework for ICM in Bangladesh

Balanced development of the banking sector and the capital market supports long-term financing, stability and investor confidence, but in Bangladesh banks dominate intermediation, and the Islamic capital market (ICM) is still nascent and needs a supportive regulatory environment.

Under the BSEC (Debt Securities) Rules 2021, ICM instruments including Sukuk may be classified as Islamic Shariah-Based Securities (ISBS). Corporate Sukuk are governed mainly by the BSEC (Investment Sukuk) Rules 2019 together with the Debt Securities Rules 2021,

and all Shariah-compliant debt instruments — Sukuk, ISBS and asset-backed securities — must also comply with the Asset-Backed Securities Rules 2004. Shariah-based mutual funds and alternative investment funds fall under separate rules, including the BSEC (Mutual Fund) Rules 2001, while Bangladesh Government Investment Sukuk (BGIS) operate under the Public Debt Act 2022 and the BGIS Guidelines 2020.

Section 26(2) of the Bank Company Act 1991 limits a bank's capital market investment to 30% of its paid-up capital and reserves, or 30% of any company's paid-up capital, whichever is lower, and its total share investment to 10% of total liabilities — safeguards against volatility that could threaten depositors' funds and public trust, and particularly relevant for Islamic banks bound by Shariah.

Banking Regulation and Policy Department (BRPD) Circular No. 12 (14 October 2009) requires banks to conduct capital market operations through separate subsidiaries registered under the Companies Act, which keep separate financial statements; banks may no longer hold Beneficiary Owner (BO) or omnibus accounts in their own names. This separates capital market activities from core banking, reducing systemic risk and giving Islamic banks room to develop Shariah-compliant instruments.

Department of Off-Site Supervision (DOS) Circular No. 01 (10 February 2020) allows each bank a special capital market fund of up to BDT 200 crore, from its own capital or repo borrowing from Bangladesh Bank, outside the Section 26 limit — an opportunity for Islamic banks to invest in Sukuk and Islamic mutual funds.

DOS Circular Letter No. 39 (27 September 2021) extended the special fund to Green Sukuk, which must be 100% asset-backed, finance environmentally sustainable projects, be issued through SPVs and be approved by BSEC in compliance with Shariah and regulatory standards.

Bangladesh Bank Circular No. 24/2020 requires equity holdings to be listed within one year, caps investment in any single issue at 5% in the first year, and sets rules for convertible bonds and sinking funds, discouraging speculation.

Circular No. 01/2023 requires provisions when listed securities fall below cost and, for non-listed instruments such as mutual funds, bonds, debentures and preference shares, on the basis of factors such as net-worth erosion or dividend or coupon default, with monthly reporting.

Under the Basel III capital framework (2014), banks may, with prior approval, issue fully paid bonds directly (not through SPVs) that qualify as Additional Tier 1 or Tier 2 capital, with fixed returns or floating returns linked to a market benchmark.

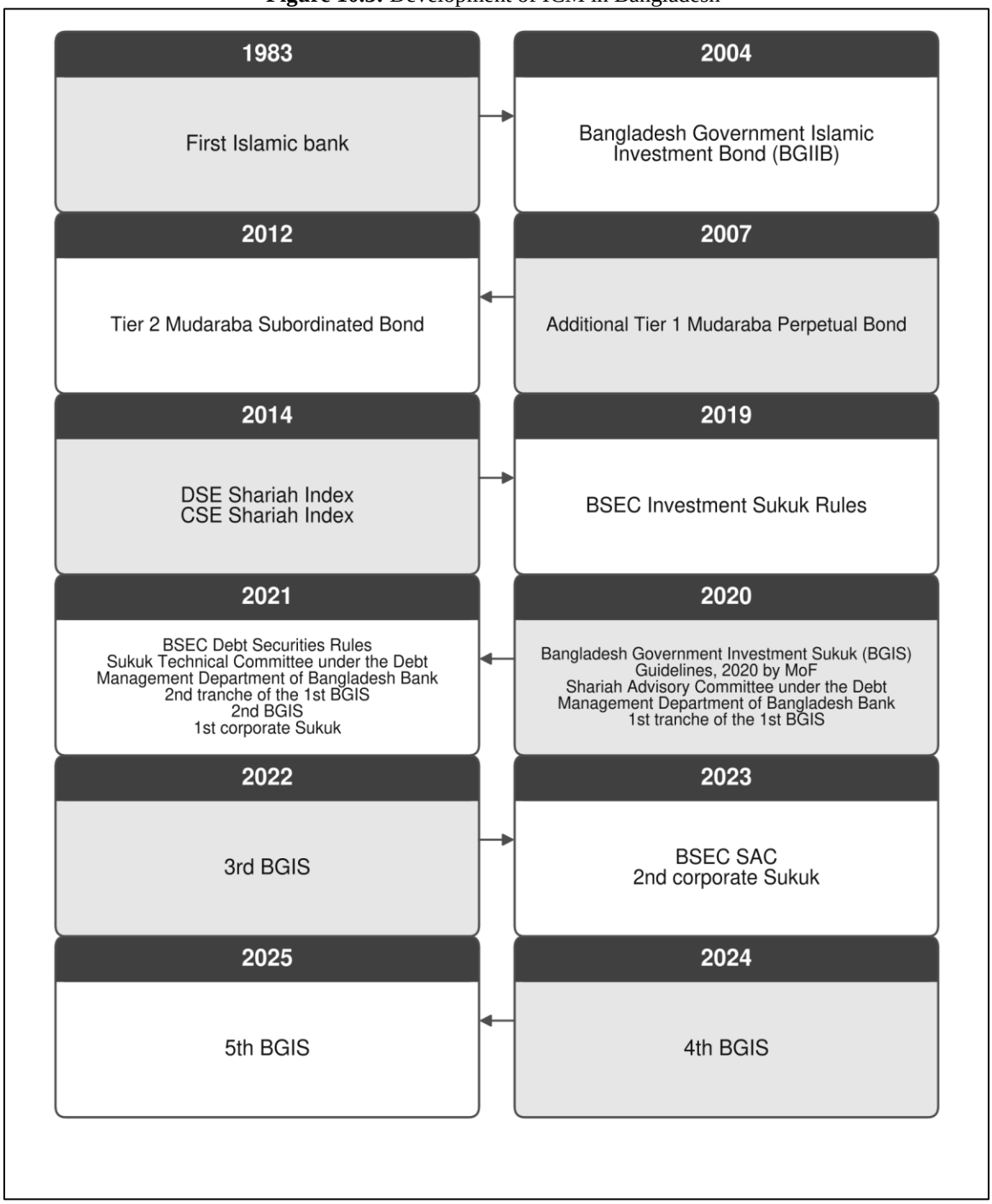
The ICM regulatory framework is thus evolving in a structured, risk-sensitive way, balancing capital market growth with stability, accountability and Shariah compliance; greater policy clarity, risk management and ethical alignment will be essential for its continued development.

10.4 ICM in Bangladesh

Islamic capital market (ICM) milestones in Bangladesh include the first Islamic bank (1983), the Bangladesh Government Islamic Investment Bond (BGIIB, 2004), the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) Shariah indices (2014), and the BSEC Investment Sukuk Rules (2019) and Bangladesh Government Investment Sukuk (BGIS)

Guidelines (2020), which enabled sovereign and corporate Sukuk, overseen by the Shariah Advisory Committee and Sukuk Technical Committee of Bangladesh Bank's Debt Management Department. The BSEC (Securities Market Shariah Advisory Council) Rules 2022 established an independent Shariah Advisory Council (SAC) within the regulator; the second corporate Sukuk followed in 2023, and sovereign issuance continued with the fifth BGIS in March 2025 (Figure 10.3).

Figure 10.3: Development of ICM in Bangladesh



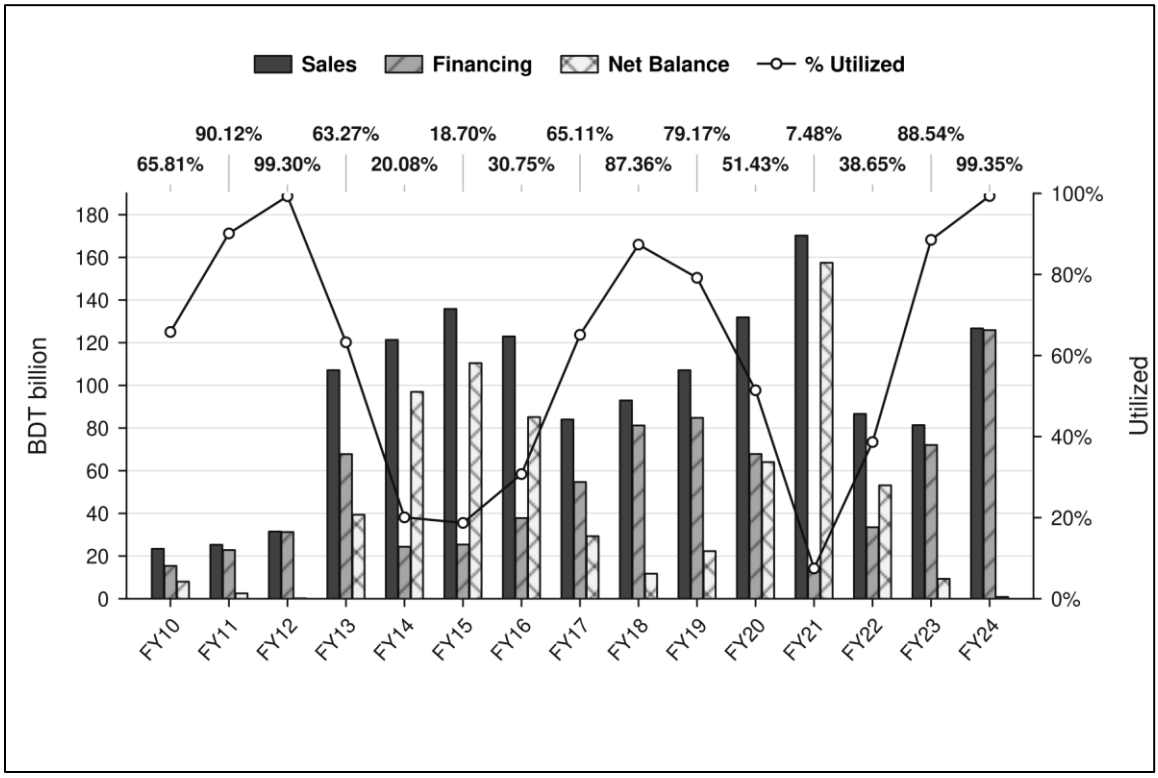
Source: Authors' creation.

10.4.1 Bangladesh Government Islamic Investment Bond (BGIIB)

The BGIIB, introduced in 2004 under the Bangladesh Government Islamic Investment Bond (Islamic Bond) Rules 2004 (amended 2014), is a Mudarabah instrument, with Bangladesh Bank acting as managing partner (Mudarib) for the government, open to individuals, companies, Islamic banks and financial institutions with a minimum investment of BDT 100,000. Bangladesh Bank Circular No. 5 of 1 September 2014 allowed Islamic banks to hold it towards their Statutory Liquidity Requirement (SLR); until BGIS it was the only approved Shariah-compliant SLR security, and as a qualifying liquid asset it can also serve as collateral.

Demand has nonetheless been limited. BGIIB yields less than treasury bonds, other bonds and deposits because the government does not use the proceeds, which merely circulate among Islamic banks, so demand often falls well short of supply. Its three-month minimum tenor also rules out short-term or overnight use. Figure 10.4 shows BGIIB sales, financing and unutilized balances in FY10–FY24.

Figure 10.4: Sales, Financing, and Net Balance of BGIIB



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

10.4.2 Bangladesh Government Investment Sukuk (BGIS)

BGIS, introduced in 2020, began the Sukuk era in Bangladesh. It lets banks and financial institutions invest surplus liquidity in secure, asset-based securities that count towards the SLR and can serve as collateral for the Islamic Banks Liquidity Facility (IBLF); all issues so far have funded socio-economic development projects.

The first BGIS, issued in two tranches of BDT 40 billion each on 28 December 2020 and 9 June 2021, financed the Department of Public Health Engineering's 'Safe Water Supply for

the Whole Country' project (January 2020–June 2025; cost BDT 88.51 billion, 90.39% Sukuk-funded), providing rainwater harvesting and deep tube wells for arsenic-free drinking water and salt-free water in coastal areas to reduce waterborne disease.

The second BGIS (BDT 50 billion, 30 December 2021) funded the Directorate of Primary Education's 'Need-Based Infrastructure Development of Government Primary Schools Project (Phase 1)' (July 2016–December 2022; cost BDT 91.23 billion, 54.81% Sukuk-funded): 40,000 additional classrooms, water and sanitation facilities for 8,000 schools, and furniture for 36,500 classrooms and 3,500 teachers' rooms, to widen access to free primary education and improve learning outcomes.

The third BGIS (BDT 50 billion, 20 April 2022) financed the Local Government Engineering Department's (LGED) 'Important Rural Infrastructure Development Project on Priority Basis-3' (July 2020–June 2026; cost BDT 64.77 billion, 77.20% Sukuk-funded): 305.21 km of upazila, 660.37 km of union and 5,075.76 km of village roads, maintenance of 1,090.77 km of rural roads and 7.99 km of bridges and culverts, connecting rural communities with markets, health care and education and creating employment.

The fourth BGIS (BDT 10 billion, 6 June 2024) financed LGED's 'Chattogram Division Upazila & Union Road Widening & Strengthening Project' (July 2023–June 2028; cost BDT 31.10 billion, 32.15% Sukuk-funded), widening and strengthening 1,160.92 km of roads and building 7.32 km of bridges and culverts across 11 districts to create climate-resilient rural infrastructure, support trade and generate employment.

The fifth BGIS (BDT 30 billion, 13 March 2025) funds 'Construction of Important Bridges on Rural Roads (Phase II)': 82 bridges totaling 17.70 km, with 38.80 km of approach roads and 8.23 km of river management works, supporting Sustainable Development Goals (SDGs) 3, 4, 5, 10 and 11. Table 10.1 summarizes the BGIS issued up to March 2025.

Table 10.1: Summary of BGIS Issued

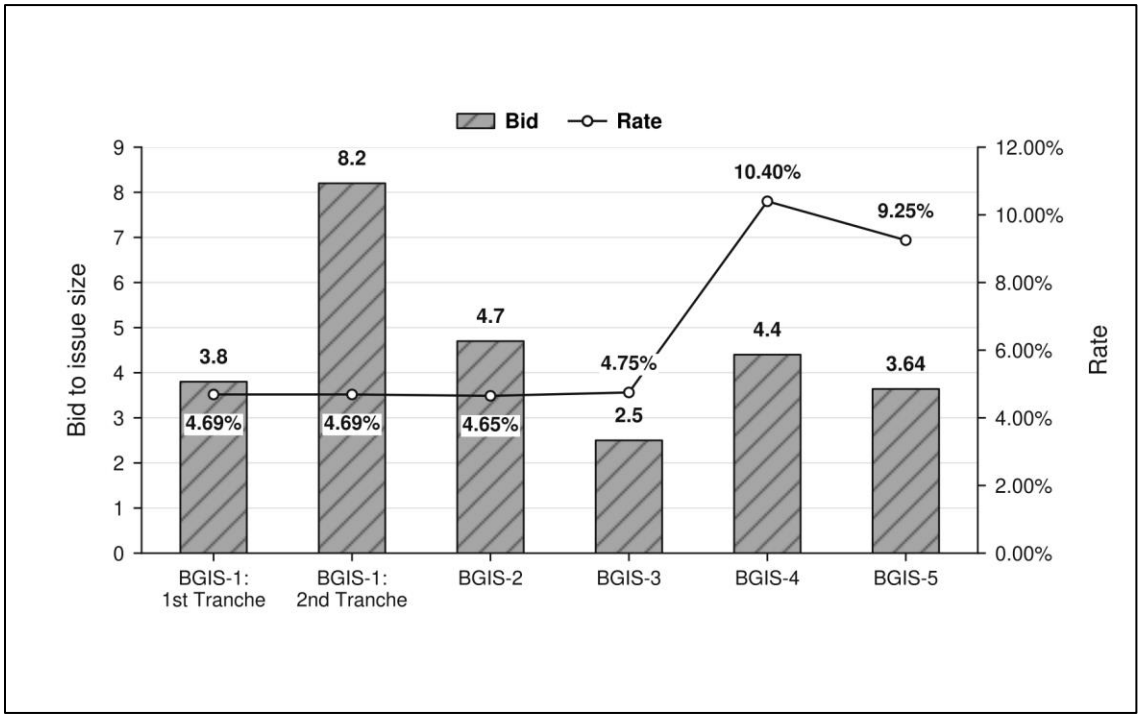
	BGIS-1	**BGIS-2**	**BGIS-3**	**BGIS-4**	**BGIS-5**
Name	Ijarah Sukuk	Ijarah Sukuk	IRIDP-3 Social Impact Sukuk	CDWSP Social Impact Sukuk	CIBRR-2 Socio-Economic Sukuk
Project	Safe Water Supply to the Whole Country	Need-Based Infrastructure Development of Government Primary School Project (1st Phase)	Important Rural Infrastructure Development Project on Priority Basis-3	Chattogram Division Upazila & Union Road Widening & Strengthening Project (CDWSP)	Construction of Important Bridges on Rural Roads (Phase-II) (CIBRR-2)
Issue Date	First tranche on 28 December 2020 and second tranche on 9 June 2021	30 December 2021	20 April 2022	6 June 2024	13 March 2025
Tenure	Five years	Five years	Five years	Five years	Seven years

	BGIS-1	BGIS-2	BGIS-3	BGIS-4	BGIS-5
Name	Ijarah Sukuk	Ijarah Sukuk	IRIDP-3 Social Impact Sukuk	CDWSP Social Impact Sukuk	CIBRR-2 Socio-Economic Sukuk
Issue Amount	Each tranche for BDT 40,000 million	BDT 50,000 million	BDT 50,000 million	BDT 10,000 million	BDT 30,000 million
Principal Underlying Contract	Ijarah	Ijarah	Istisna'a and Ijarah	Istisna'a and Ijarah	Istisna'a and Ijarah

Source: Bangladesh Bank.

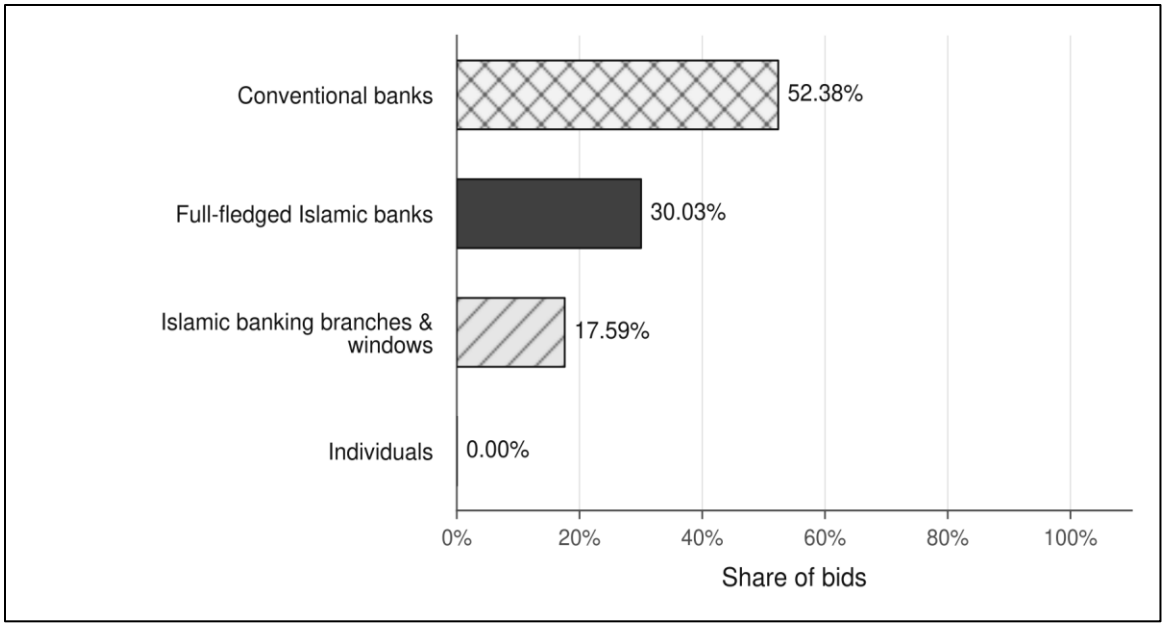
Although BGIS offers a significantly lower return compared to conventional treasury instruments — though higher than BGIIB—especially during its first three issuances, it has attracted substantial response from the market, particularly from Islamic banks. Despite experiencing liquidity shortfalls, these banks remain the primary investors in BGIS, mainly due to the absence of alternative Shariah-compliant government instruments. Figure 10.5 shows the BGIS rate of return, payable semi-annually, along with the bid amounts compared to their issue sizes. Additionally, Figures 10.6–10.10 illustrate the investment amounts from various types of investors. Notably, in BGIS-5, bids were submitted by Islamic insurance companies for the first time in BGIS.

Figure 10.5: Bid and Rate of BGIS Issued



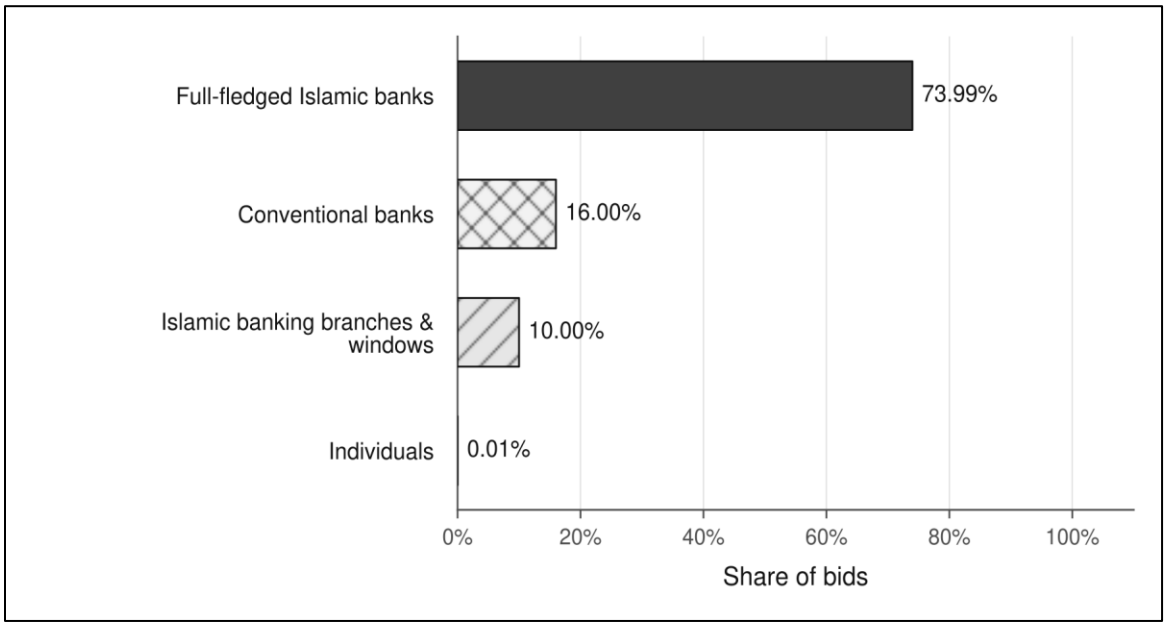
Source: Bangladesh Bank.

Figure 10.6: Investors in BGIS-1 (1st Tranche)



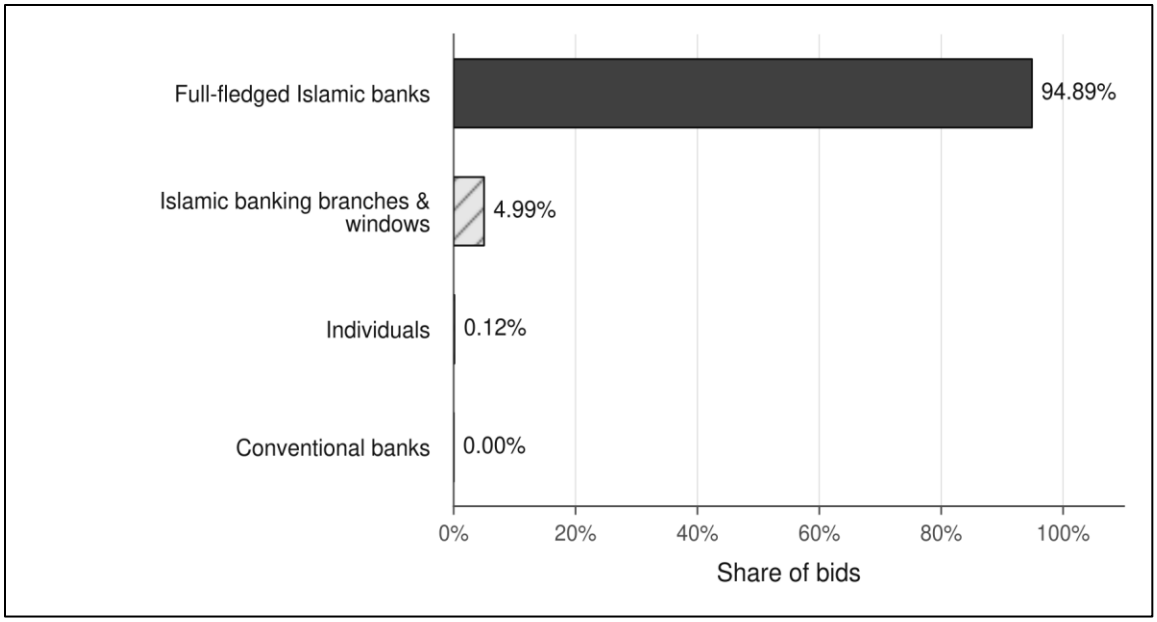
Source: Bangladesh Bank.

Figure 10.7: Investors in BGIS-2



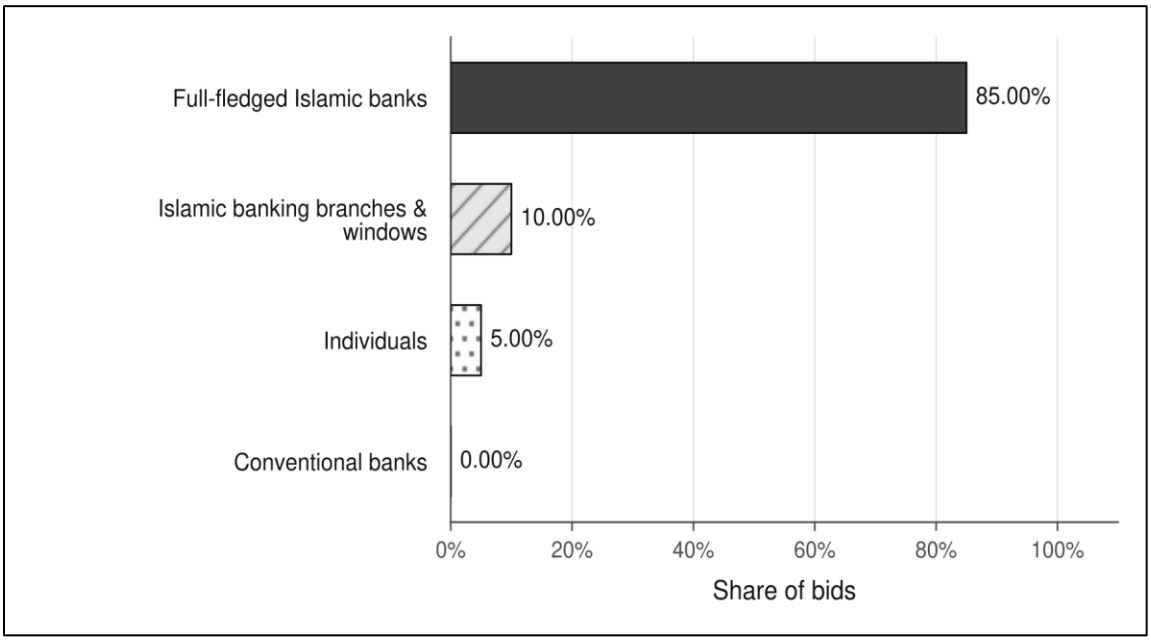
Source: Bangladesh Bank.

Figure 10.8: Investors in BGIS-3



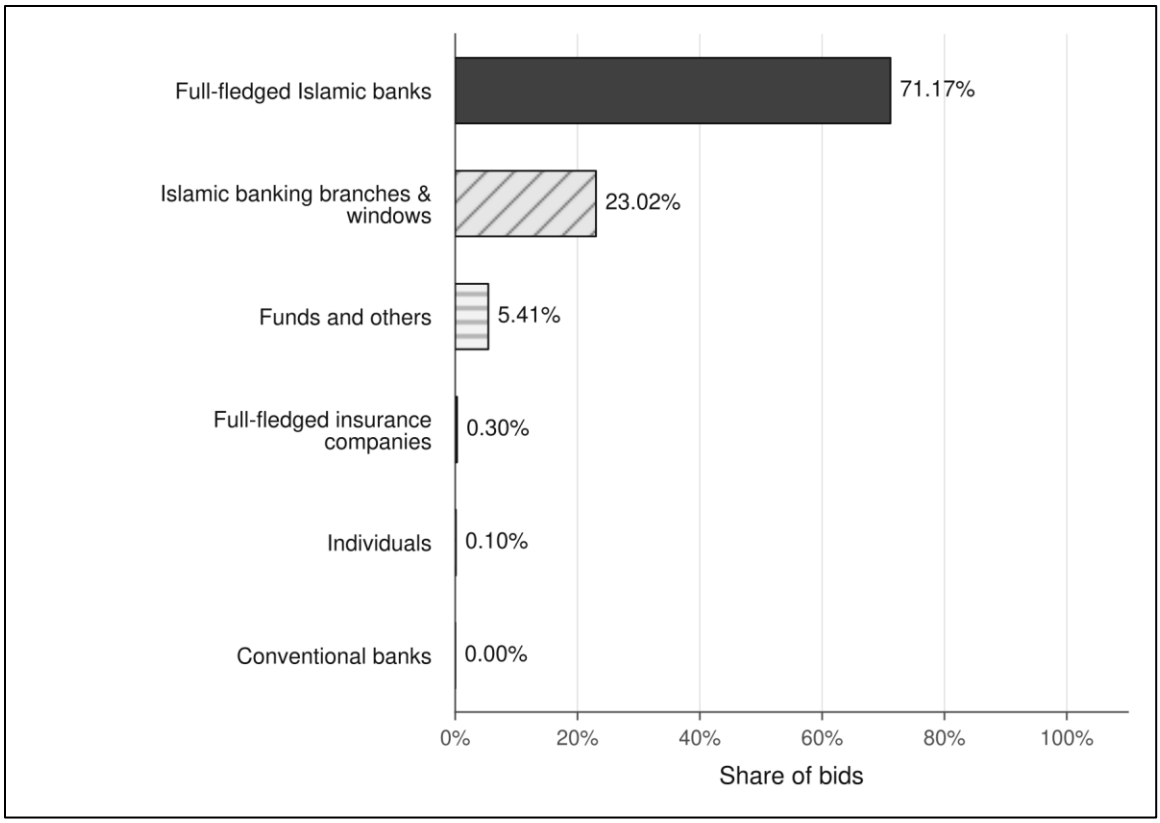
Source: Bangladesh Bank.

Figure 10.9: Investors in BGIS-4



Source: Bangladesh Bank.

Figure 10.10: Investors in BGIS-5



Source: Bangladesh Bank.

Ahmed and Hossain (2023 & 2024) presented several recommendations for developing the BGIS market, several of which are currently being addressed. A summary of this is presented in Table 10.2.

Table 10.2: Earlier Recommendations to Develop the BGIS Market

No.	Recommendations	Developments
1	The government needs to target a diverse range of investors, including Takaful companies, which are required to allocate a portion of their investments to government instruments.	• The Insurance Development and Regulatory Authority (IDRA) issued a letter to Takaful companies on 19 February 2025, directing life insurers to allocate at least 30% of their funds to BGIS and other government securities and general insurers to invest at least 7.5%. • Although very small, the BGIS-5 has, for the first time, seen bids from Takaful companies.
2	The government needs to target the large Muslim population, along with other investor groups such as mutual funds, provident funds, corporations, and conventional institutions seeking Shariah-compliant investment opportunities.	• The allotment quota for individual investors, provident funds, deposit insurance funds, and similar investors was increased to 20% for BGIS-5, up from 5% in earlier issuances. • Since BGIS-5, Bangladesh Bank has noticeably increased its issuance of press releases to inform the media and public about Sukuk, resulting in greater media coverage. • Although still not significant, the number of individual and fund investors has increased.

No.	Recommendations	Developments
3	Competitive rates of return compared to conventional instruments need to be offered for BGIS.	Although not yet at par, the rate of return offered for BGIS-4 and BGIS-5 are closer to conventional treasury instruments.
4	Projects financed by BGIS need to be labeled as 'Sukuk-funded projects' to enhance public confidence in the proceeds generated from these investments.	Although the application is yet to be visible, the requirement has been added to the prospectus and structure documents of BGIS-4 and BGIS-5.

Source: Authors' creation.

Recommendations by Ahmed and Hossain (2023 & 2024) not yet implemented include selecting high-profile and income-generating projects to build public interest. Periodic reporting on the use of Sukuk funds and project progress; including BGIS in the sustainability reports of the government and Bangladesh Bank. Engaging professional issue managers for project evaluation, structuring, documentation and prospectuses. Issuing short-term Sukuk for short-term public projects, and offering incentives for BGIS investment while the market is young.

Ahmed (2025) notes that, despite their socio-economic role, BGIS are absent from Bangladesh's sustainability reports and from international impact-issuance trackers, and there is no impact reporting. He calls for coordination between Bangladesh Bank departments and government agencies to include BGIS in sustainability reports, for banks to present BGIS holdings as part of their sustainability strategies, and for Bangladesh Bank to oversee BGIS-funded projects and publish regular reports on their implementation and impact. He cautions, however, that this will require dedicated resources — BGIS is currently handled ad hoc by a few staff in the Debt Management Department — and that impact reporting will be hampered by weak or doubtful ministry data and bureaucratic processes unless a coordinated approach is adopted.

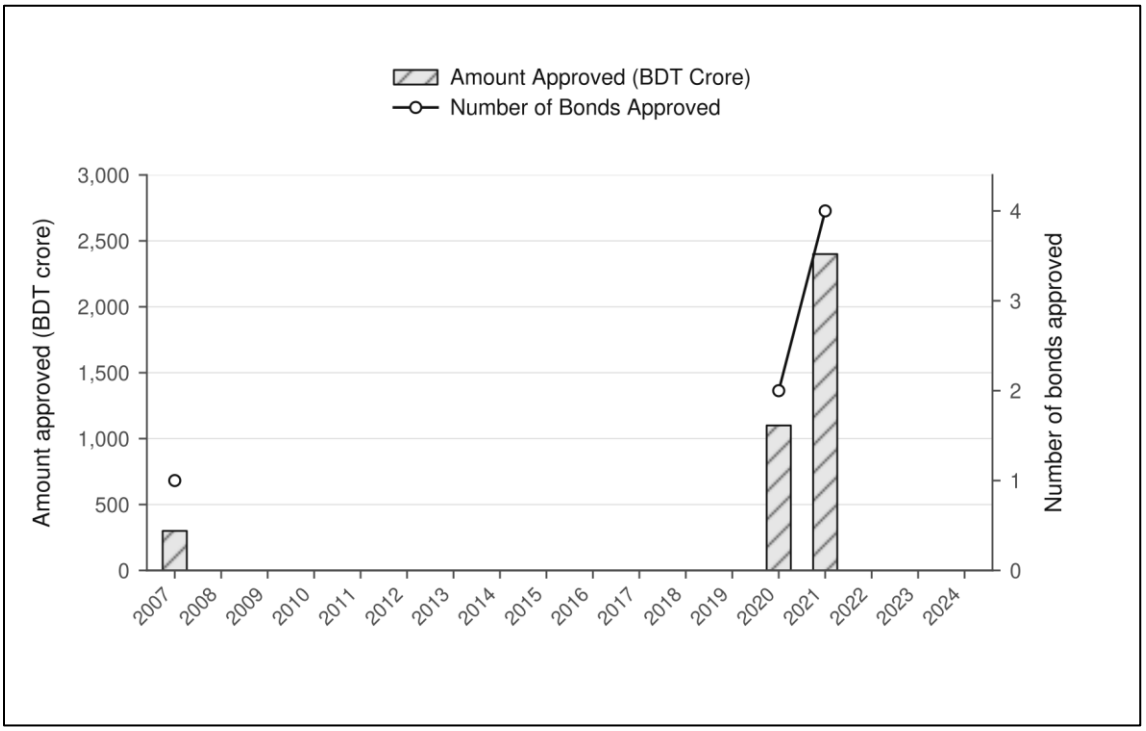
10.4.3 Mudarabah Bonds

The corporate Islamic bond market began in 2007, when Islami Bank Bangladesh PLC issued its BDT 300 crore Mudaraba Perpetual Bond as Additional Tier 1 (AT1) capital. First Security Islami Bank PLC issued the first Islamic Tier 2 (T2) bond in 2012. Bangladesh Bank's 2014 Basel III capital guidelines set the criteria for AT1 and T2 instruments, detailed in Appendix 1 and summarized below:

- **General eligibility criteria:** AT1 and T2 instruments must be issued directly by the bank (not through a Special Purpose Vehicle (SPV)) and fully paid; dividends may be fixed or floating against a Taka benchmark but not credit-sensitive; there may be no put option, and a call option may be exercised only after ten years with prior approval from Bangladesh Bank's Banking Regulation and Policy Department (BRPD), without creating an expectation of exercise, and only if the instrument is replaced with capital of equal or better quality or the capital position remains above the minimum. Holders rank below depositors and general creditors and above shareholders; the instruments may not be secured, guaranteed, repurchased by the bank or its related parties (including staff retirement funds), or impede recapitalization, and must meet any BSEC requirements.

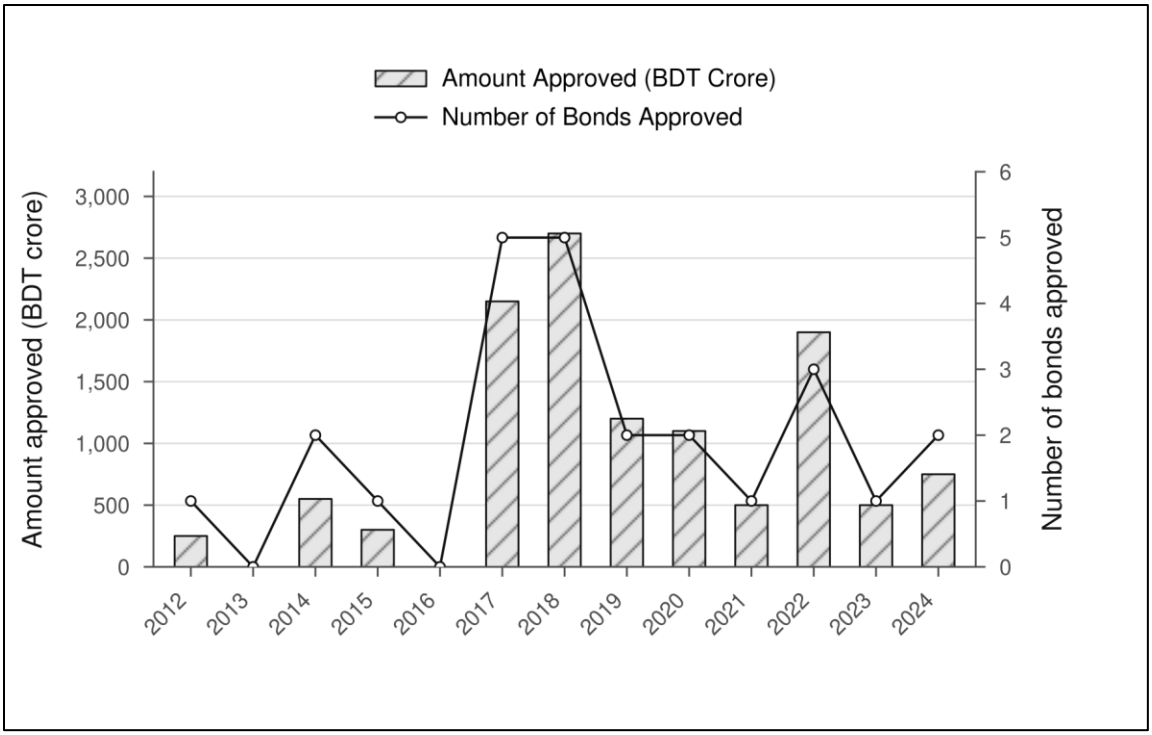
- **AT1-specific criteria:** the instrument must be perpetual, with no incentive to redeem; principal may be repaid only with Bangladesh Bank's approval and, on repurchase, replaced with higher-quality capital; the bank must have full discretion to cancel non-cumulative dividends without triggering default; there must be a loss-absorption feature (conversion into shares or write-down at a pre-specified trigger); and banks must hold at least 6% Tier 1 capital to risk-weighted assets, with limits on Perpetual Non-Cumulative Preference Shares (PNCPS) and Perpetual Debt Instruments (PDI).
- **T2-specific criteria:** subordinated debt raised through public or private placement, typically at a fixed rate, ranks below deposits and other claims and may be convertible into ordinary shares; it must be unsecured and fully paid, the issuer must have a Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS) rating of at least '2' and a debt rating of at least '3', and it may not be used as loan collateral or covered by deposit insurance. Its minimum maturity is five years, with amortization rules for the final five years; subordinated debt counted as T2 is capped at 30% of Tier 1 capital and total T2 capital at 100% of Tier 1. By March 2025, BSEC had approved seven AT1 and thirteen T2 issues by Islamic banks (Figures 10.11 and 10.12).

Figure 10.11: AT1 Mudarabah Bonds Approved by BSEC



Source: BSEC.

Figure 10.12: A2 Mudarabah Bonds Approved by BSEC



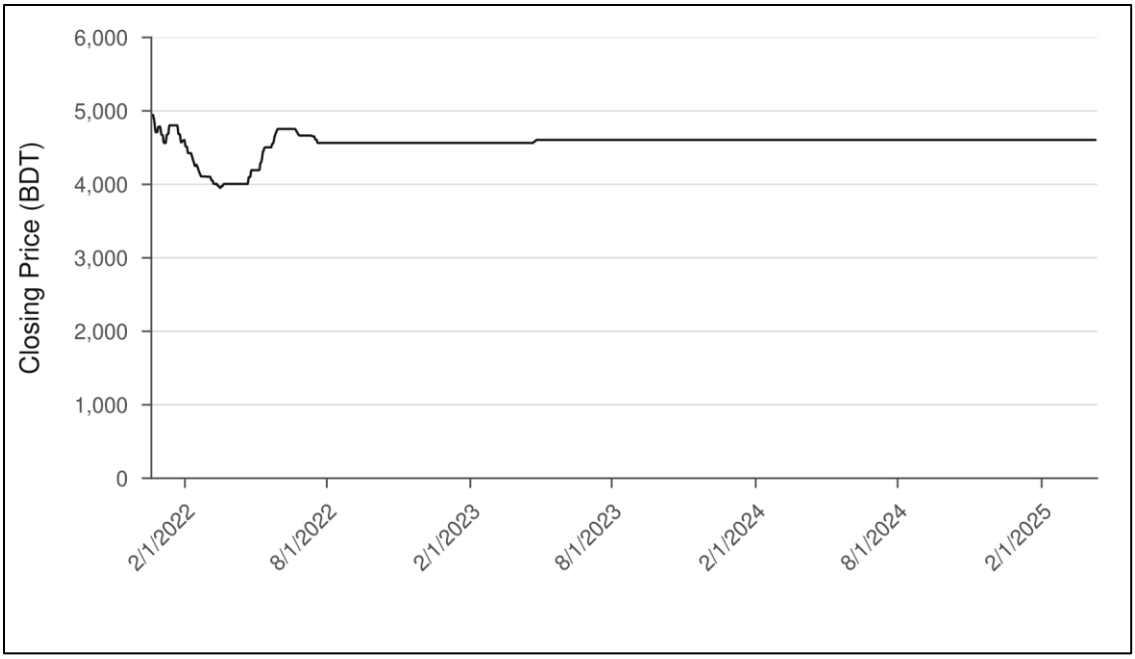
Source: BSEC.

Several issues are present in the case of Mudarabah bonds, including commercial, Shariah compliance, and governance concerns.

10.4.3.1 Commercial Issues

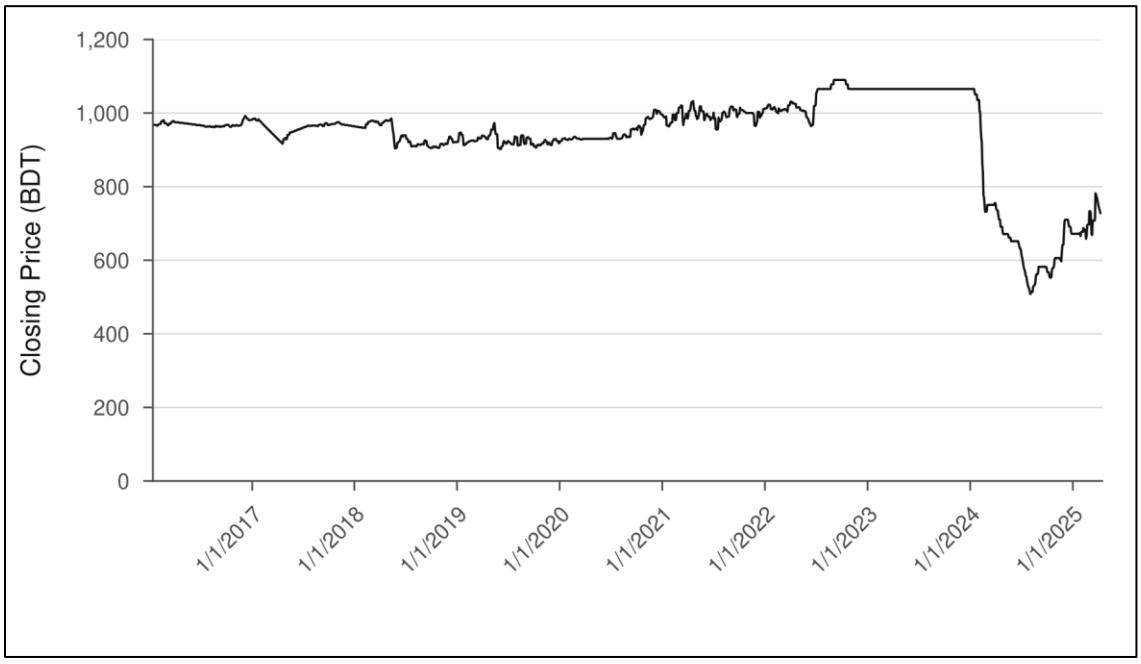
- **Trading below face value:** all four AT1 Mudarabah perpetual bonds listed on the DSE and CSE — AIBL Mudaraba Perpetual Bond, Islami Bank Bangladesh Limited (IBBL) Mudaraba Perpetual Bond, IBBL 2nd Perpetual Mudaraba Bond and Shahjalal Islami Bank PLC (SJIBL) Mudaraba Perpetual Bond — now trade below face value, although one traded above it for a time (Figures 10.13–10.16); being non-redeemable and offering none of the upside of shares, they risk losing their appeal to investors.

Figure 10.13: AIBL Mudarabah Perpetual Bond Closing Price



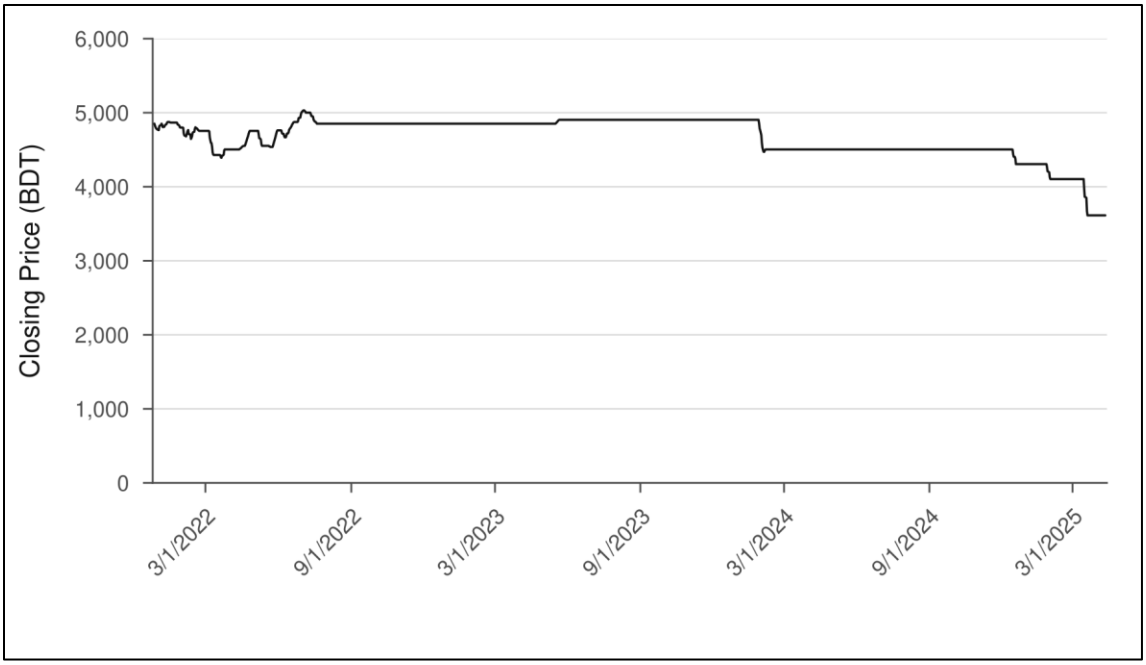
Source: CSE.

Figure 10.14: IBBL Mudarabah Perpetual Bond Closing Price



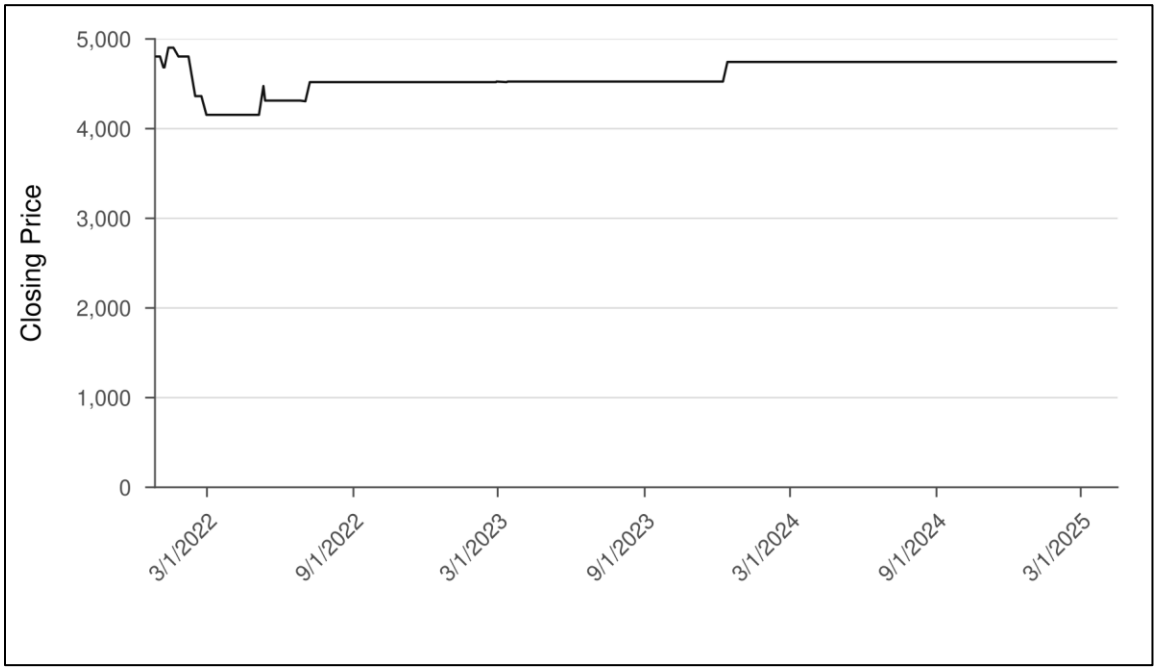
Source: CSE.

Figure 10.15: IBBL 2nd Perpetual Mudarabah Bond Closing Price



Source: CSE.

Figure 10.16: SJIBL Mudarabah Perpetual Bond Closing Price



Source: CSE.

10.4.3.2 Shariah-Compliance Issues

- **Benchmark-based rather than performance-based profit:** although structured as Mudarabah, whose returns should depend on the actual performance of the investments financed, the bonds' profit rates are set by benchmarks. For AT1 perpetual bonds, issuers pay, for example, the final rate on an eight-year Mudarabah savings bond plus 10% of the declared dividend rate, or Bangladesh Bank's published one-to-two-year deposit rate plus 2.50%; for T2 subordinated bonds, the six-month Mudarabah term deposit rate plus 1.25%, or the average six-month deposit rate of full-fledged Islamic banks plus 2.00%, adjusted after year-end.
- **Minimum profit guarantee:** a minimum profit on Mudarabah investment is not permitted, yet one bank fixes its AT1 bond's return 'from 6% to 10%', and the same range appears in four of the seven AT1 approvals announced by BSEC.
- **Capital guarantee:** guaranteeing Mudarabah capital is prohibited, yet one T2 bond's disclosures state that '20% of the total bond value will be redeemed at the end of each year starting from year 2 at face value.'
- **Junior to depositors, senior to shareholders:** partnership (Sharikat al-Inan) requires all capital providers to share losses in proportion to their capital, yet bondholders — whose funds are pooled with others' — rank below depositors and other creditors and above shareholders, as the disclosures for both AT1 and T2 bonds state.
- **No mention of profit-sharing ratio:** The agreement on a profit-sharing ratio is essential for a valid Mudarabah contract. However, a review of the information memorandums of Mudarabah bonds reveals that this crucial component is missing, raising significant concerns from the Shariah perspective.
- **Late payment penalty:** issuers pay a penalty of 2% above the coupon on overdue amounts; imposing a penalty on a debt is Riba, and the disclosures do not say whether Islamic investors must give such receipts to charity.
- **Undue delay possibility in distributing profit:** A review of the disclosures reveals that the issuing bank may make the profit payment within 60 days of the profit calculation period's expiry. This presents an opportunity for an undue delay in fulfilling the bank's profit payment obligation.

10.4.3.3 Governance Issues

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

10.4.3.4 Other Issues

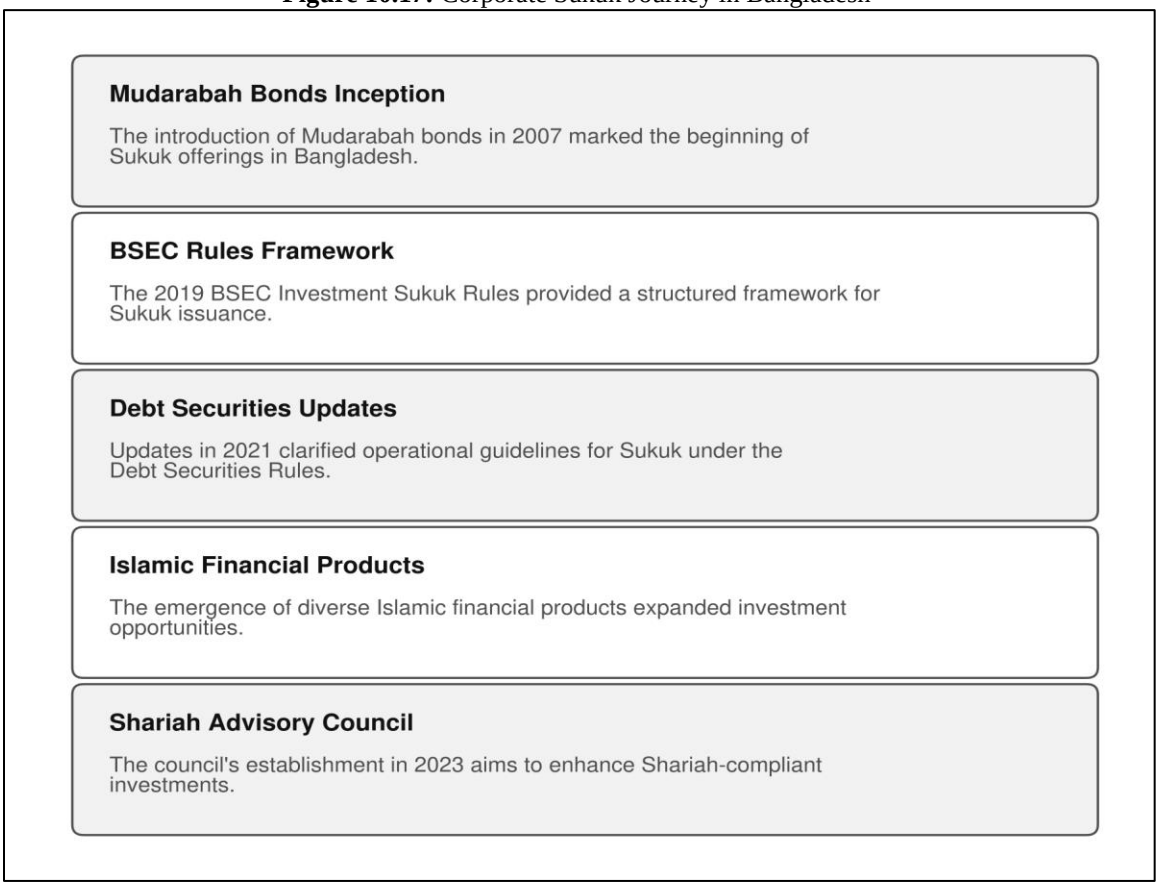
- **Renaming Mudarabah bonds as Sukuk or ISBS:** the AT1 and T2 instruments predate the BSEC Sukuk Rules (2019) and Debt Securities Rules (2021), which introduced the term Islamic Shariah-Based Securities (ISBS), yet are still called 'bonds'. Since Mudarabah instruments are risk-sharing equity rather than debt, calling them Sukuk or ISBS would better reflect their Shariah nature.

10.4.4 Corporate Sukuk

BSEC introduced the Investment Sukuk Rules on 22 May 2019 and the Debt Securities Rules, which cover Sukuk and ISBS, on 31 May 2021; because Sukuk represent undivided ownership of assets, the Asset-Backed Securities Rules 2004 also apply. The Investment Sukuk Rules require a Special Purpose Vehicle (SPV) set up as a trust under the Trusts Act 1882 and registered under the Registration Act 1908, independent of the originator and managed by an unaffiliated trustee. The assets must be legally and beneficially transferred to the SPV, and BSEC's final approval requires a definitive pronouncement from an independent Shariah supervisory board of at least five qualified members, which also monitors the use of proceeds and the SPV's operations.

The trustee manages the Sukuk assets and ensures timely, Shariah-compliant payments. A directive of 13 September 2021 limits a trustee to 40 debt securities at a time and its total trusteeship to 100 times its paid-up capital or net worth (75 times where net worth exceeds capital). On 23 August 2022, BSEC established the Securities Market Shariah Advisory Council to validate Shariah pronouncements on Sukuk and other ISBS and to develop further Islamic securities. To encourage participation, banks and non-bank financial institutions are exempted from certain investment exposure limits, and banks may invest up to BDT 200 crore in unlisted BSEC-approved SPVs with board approval. Figure 10.17 summarizes the corporate Sukuk journey in Bangladesh.

Figure 10.17: Corporate Sukuk Journey in Bangladesh



Source: IiBFRBD 2024.

Early issuance was hampered by Value Added Tax (VAT) and tax on asset transfers, so fiscal measures in FY21 exempted Sukuk transactions between originator and SPV from VAT and tax, and 2023 amendments to the Income Tax Act removed the tax on deed registration for property transfers to Sukuk SPVs (Table 10.3).

Table 10.3: Tax, VAT, and Stamp Duty Waivers for Sukuk

Particulars	Tax or VAT, any other Duty implications	
Tax		
Any Sukuk-related transaction between the Originator and the SPV	As per SRO No. 317-Ain /Income Tax/2021	TDS exempted
Issuer/ SPV Income from Sukuk (SPV for only for the purpose of Sukuk approved from Bangladesh Bank or BSEC)	As per SRO No. 317-Ain /Income Tax/2021	Tax exempted
Capital Gain Tax on the transfer of any assets (except immovable assets) between the Originator and the SPV	As per Income Tax Ordinance 1984, 31A & 32A	15%
Tax on transfer of house property, including land	As per Income Tax Ordinance 1984, 53H	Tax exempted
Rental payment on the lease Agreement between the Originator and the SPV	As per Income Tax Ordinance 1984, 53A	5% TDS
VAT		
Asset transfer between the Originator and the SPV	As per SRO No. 294-AIN /2021/165-Mushak	VAT exempted
Rental payment on the lease Agreement between the Originator and the SPV	As per SRO No. 294-AIN /2021/165-Mushak	VAT exempted
Stamp Duty		
On Trust Property after the declaration of Trust	Stamp Act 1899, Schedule I, Section 63	0.10% on the value of the trust property, max. BDT 10 lac
Sale of receivables to the SPV for securitization	Stamp Act 1899, Schedule I, Section 61	exempted

Source: IiBFRBD 2024.

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

Corporate Sukuk debuted in 2021 with the Beximco Green Sukuk Al Istisna'a, the first approved by BSEC: an asset-backed issue of BDT 3,000 crore — the largest private-sector debt security in Bangladesh to date — whose assets were transferred to the SPV without legal impediment. Its proceeds finance a 200 MW solar power project (the country's largest), a further 30 MW solar project, and the refinancing of obligations and purchase of new machinery for Beximco Ltd.'s textile division.

The rental is calculated as 9% + {10% × (cash dividend declared by Beximco in the preceding year − base rate)}, multiplied by the number of Sukuk held on the record date, linking returns to the company's performance. Investors may convert their holdings into listed Beximco shares annually or receive the final redemption payment, and are protected both by ownership of the Sukuk assets and by a sinking fund of up to 10% of the issue size held in a trust account.

Of the issue, 75% was placed privately and 25% offered to the public (face value BDT 100; minimum subscription BDT 5,000). As the first instrument of its kind, the public offer was at one stage undersubscribed — owing to limited awareness of debt securities and of Sukuk, and to an underdeveloped regulatory framework — and BSEC allowed the unsubscribed portion to be placed privately, but sustained engagement and education eventually secured full subscription.

Figure 10.18 shows images of the projects funded by the proceeds from Beximco Green Sukuk Al Istisna'a.

Figure 10.18: Pictures from Beximco Green Sukuk Al Istisna'a Projects



Source: IiBFRBD 2024.

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

The second corporate Sukuk, the BBML Sukuk Al lease (Ijarah) of Banga Building Materials Ltd. (PRAN-RFL Group), was issued in 2023: BDT 300 crore for six years, including a one-year grace period, fully subscribed through private placement, to refinance loans on existing machinery and acquire new machinery, with proceeds held in a 'BBML Sukuk Project Account' at a Shariah-compliant bank. Its floating rental — the average rate on three-year-and-above fixed deposits of Islamic private commercial banks plus 300 basis points, bounded between 8% and 11% — is paid semi-annually after the grace period (months 18, 24, 30 and so on) with redemption installments, the consideration price falling due in month 72, after which the assets revert to the originator. Figure 10.19 shows the projects funded.

Figure 10.19: Pictures from BBML Sukuk Al Ijarah Projects



Source: IiBFRBD 2024.

Table 10.4: Synopsis of Two Corporate Sukuk in Bangladesh

Particulars	Beximco Green Sukuk Al Istisna'a	BBML Sukuk Al Ijarah
Issue Size	BDT 3,000 Crore	BDT 300 Crore
Purpose	✓ BDT 1,886 crore for Teesta Solar Ltd.; ✓ BDT 308 crore for Korotoa Solar Ltd. ✓ BDT 806 crore for the Textile Division of Beximco Ltd.	✓ BDT 161 crore for Refinancing of Existing Machineries ✓ BDT 139 crore for Procurement of New Machineries
Tenor	05 years	06 years
Grace Period	No Grace period	01 year
Rate of Return to the Investors	Base Rate- 9% Rate of return = [Base Rate+ {10% x (Cash Dividend of Beximco declared in the preceding year − Base Rate)}] x Number of Beximco Green-Sukuk held by a Sukukholder on the Record Date for Period Distribution (x) Face Value of Beximco Green- Sukuk (BDT 100 each)	Base Rate – 8% & ceiling rate 11% Rate of return = Simple Average of 3 Years and above Fixed Deposit Rate of Islamic PCB+ 300 Basis Points
Conversion option	Conversion option with a multiple of 5%, 10%, 15% & 20% annually. The unexercised option may be exercised with the next year's option. Conversion Rate- 25% less than the weighted average market price of ordinary shares of Beximco in the Dhaka Stock Exchange of twenty (20) trading days prior to the Record Date for Conversion.	Non-Convertible

Particulars	Beximco Green Sukuk Al Istisna'a	BBML Sukuk Al Ijarah
Default Mechanism	▪ Insurance or Takaful for respective machineries of respective projects in case of a Total Loss Event ▪ 10% Sinking Fund of the Issue Size ▪ Machinery of Solar Projects and machinery of textile division assets transferred to the Trustee ▪ Assignment Agreement with the SPV of future receivables of Solar Projects ▪ Corporate Guarantee from the Originator	▪ Insurance or Takaful for Sukuk Assets in case of Total Loss Event ▪ Sukuk Assets of BDT 300 crore transferred to the SPV ▪ Corporate Guarantee of Durable Plastics Ltd., a sister Concern of PRAN-RFL Group ▪ Personal Guarantee from the Directors of Originator
Security	▪ Teesta Solar Project New Machineries- BDT 1,886 crore ▪ Korotoa Solar Project New Machineries- BDT 308 crore ▪ Textile Machinery of Beximco Ltd.- 806 cr.	▪ Existing Machinery- BDT 161 crore ▪ New Machinery- BDT 139 crore
Mode of offer	Private Placement- 50% of Sukuk Issue with BDT 1,500 crore; Existing Shareholders- 25% of Sukuk Issuance with BDT 750 crore Public Offer- 25% of Sukuk Issuance with BDT 750 crore	Private Offer- 300 crore
Listing Platform	Main Platform of DSE & CSE	Shall be listed in the Alternative Trading Board
Subscription Status	Fully Subscribed. ▪ Private Offer- 24.40 billion ▪ General Public- 4.23 billion ▪ Underwriter- 1.35 billion ▪ Existing Shareholders- 0.02 billion	Fully subscribed by 11 Banks with one corporate in two tranches
Issuance Date	22 December 2021	✓ 1st Tranche Issuance Date: 31 July 2023 ✓ 2nd Tranche Issuance Date: Aug. 29, 2023
Fund utilization status	Fully Utilized	Fully Utilized
Project Completion Status	▪ Solar Panel & Other equipment Purchase completed both for Teesta Solar Ltd. & Korotoa Solar Ltd. ▪ Teesta Solar Ltd. COD- 8 January 2023 ▪ Korotoa Solar Ltd. COD- November 2024 ▪ Refinancing of Textile Division Machineries- Completed	▪ Procurement of new machinery completed ▪ Refinancing of existing machinery completed
Sukuk Outstanding status	BDT 2800 crore as BDT 200 crore have been converted into ordinary shares of Beximco Ltd.	BDT 300 crore, as payment will start in February 2025 of 1st tranche and in march 2025 of 2nd tranche after the end of grace period of Sukuk.

Source: IiBFRBD 2024.

10.5 Issues and Recommendations

10.5.1 Sukuk Issuance by Islamic Banks

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

10.5.2 Mobilization of Long-Term Funds by IBs through the Capital Market

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

10.5.3 Regular Publication of Shariah-Compliant Securities Lists

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

10.5.4 Trading of BGIS on the Organized Securities Market

While efforts are underway to facilitate the trading of conventional government securities on the Organized Securities Market Platform, similar initiatives for Bangladesh Government Investment Sukuk (BGIS) have not yet materialized. The inclusion of BGIS on organized trading platforms would enhance market liquidity, price discovery, and investor participation. The relevant authorities should prioritize this process to strengthen the secondary market for Islamic government securities.

10.5.5 Limited Availability of Shariah-Compliant Instruments

The Islamic Capital Market (ICM) in Bangladesh currently suffers from a scarcity of diversified Shariah-compliant instruments. To deepen the market, regulators and market participants should work together to develop Shariah-compliant alternatives to popular

instruments such as zero-coupon bonds and preferred shares. Additionally, efforts should be made to promote more corporate Sukuk, short-term BGIS, and Islamic asset-backed securities to cater to a wide range of investment and financing needs.

10.5.6 Low Awareness Among General Investors

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

10.5.7 Governance and Regulatory Oversight

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

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

Appendices

Appendix 1

Eligibility Criteria of AT-I and T-II Instruments

General Eligibility Criteria to Qualify as Regulatory Capital:

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

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

5. The coupon or dividend payment policy must be clearly articulated in the debt indenture to avoid any conflict of interest between ordinary shareholders and the holders of the instrument.
6. The instrument cannot have a credit-sensitive coupon feature, i.e., a dividend that is reset periodically based in whole or in part on the bank's credit standing. For this purpose, any reference rate, including a broad index sensitive to changes in the bank's creditworthiness and/or the creditworthiness of the wider banking sector, will be treated as a credit-sensitive reference rate. Banks wishing to offer a floating reference rate may seek prior approval from the BRPD regarding the permissibility of such rates.
7. In the event of the liquidation or winding up of the issuer's business, the claims of investors in this instrument shall be (i) superior to the claims of investors in equity shares, (ii) subordinated to the claims of depositors, and general creditors of the bank; and (iii) neither secured nor covered by a guarantee of the issuer, a related entity, or any arrangement that legally or economically enhances the seniority of the claim relative to bank creditors.
8. The instrument cannot contribute to liabilities exceeding assets if such a balance sheet assessment is required to prove insolvency under any law or otherwise.
9. Neither the bank nor a related party over which the bank exercises control or significant influence (as defined under relevant accounting standards) should purchase the instrument, nor can the bank directly or indirectly fund the purchase. The same restriction applies to the employees' retirement benefit funds of the issuing bank. Banks should also not grant advances against the security of the instrument issued by them.
10. The instrument cannot have any features that hinder recapitalization, such as provisions requiring the issuer to compensate investors if a new instrument is issued at a lower price during a specified time frame.
11. Banks should comply with the terms and conditions, if any, stipulated by BSEC or other regulatory authorities regarding the issuance of the instruments.

Specific Eligibility Criteria to Qualify as Additional Tier 1 Capital

a. Maturity Period

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

b. Repurchase / Buyback / Redemption

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

ii. Banks may repurchase/buy-back/redeem the instruments only if:

a) They replace such instruments with capital of the same or better quality, and the replacement of this capital is done under conditions that are sustainable for the income capacity of the bank or

b) The bank demonstrates that its capital position is well above the minimum capital requirements after the repurchase/buy-back/redemption.

c. Dividend Discretion

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

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

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

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

v. Dividends must be paid out of distributable items;

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

in future years, even if adequate profit is available and the level of CRAR conforms to the regulatory minimum.

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

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

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

d. Loss Absorption Features

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

a) Reduce the claim of the instrument in liquidation;

b) Reduce the amount repaid when a call is exercised and

c) Partially or fully reduce dividend payments on the instrument.

e. Limits

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

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

1. Introduction

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

2. Definition

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

period. When first issued, they act just like regular subordinated debt with the promise to pay their obligations to their holders.

3. Qualifying criteria as regulatory capital

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

a. Basic criteria:

i. The debt will be unsecured and fully paid up;
ii. The CAMELS rating of the banks should be at least '2'; the Issue/Debt/Instrument rating and Issuer's entity rating will be at least '3';
iii. The debt may be convertible into ordinary shares in part or full according to the conversion ratio, subject to the prior approval of Bangladesh Bank;
iv. It will be ineligible as collateral for a loan made by the issuing bank;
v. This instrument will not be insured by the deposit insurance scheme.

b. Permanence:

i. The debt must have a maturity of at least 5 (five) years;
ii. The amount of subordinated debt in the regulatory capital will have to be reduced (amortized) in the last five (5) years of the bond's life by 20% (twenty percent) from the amount of the instrument at the beginning of each of the last five (5) years of the instrument's life;
iii. In the last year of the instrument's life, the amount of subordinated debt will not be included in the bank's regulatory capital (Tier 2 or Tier 3);
iv. Once any scheduled payments of principal begin, all payments shall be made at least annually, and the amount repaid each year shall be no less than in the prior year;
v. The approved redemption plan cannot be altered without the prior approval of Bangladesh Bank.

c. Ranking among the claimants:

i. The interest and dividend payment policy must be well articulated in the debt indenture in such a manner that there will be no scope to arise any conflict of interest between or among the ordinary shareholders and the subordinated debt holders;
ii. In the event of the liquidation or winding up of the issuer's business and distribution of return on investment, the bondholders will be ranked after claims of the depositors and other creditors, i.e., it will be ranked immediately ahead of ordinary shareholders;

d. Quantitative limits:

i. Eligibility limit: The total amount of subordinated debt that a bank may consider as Tier 2 capital will be limited to a maximum of 30% of the amount of Tier 1 capital. The total amount of Tier 2 capital (supplementary capital) elements will be limited to a maximum of 100% of the total amount of Tier 1 capital (core capital);
ii. Coupon/Interest Rate: Coupon/Interest rate and yield of the debt will be well matched/compatible with the prevailing market conditions;
iii. Bangladesh Bank may set any other quantitative limits deemed necessary applicable to the convertible bonds.

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

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

Source: Bangladesh Bank.

PART IV: RISK, LIQUIDITY AND CRISIS MANAGEMENT

Chapter 11: Risk Management in Shariah-Based Banking

Based on the study "Risk Management in Shari'ah-Based Banking in Bangladesh" by Md. Nehal Ahmed, Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Tofayel Ahmed.

11.1 Introduction

Globalization, competition, complex cross-border products and rapid technological change have made banking risks greater and more dynamic, and effective risk management — identifying, measuring and minimizing the risks of banking activities — is a precondition for sound bank management.

Risk management in Bangladesh's banks has developed in phases, largely driven by regulation. A landmark came in 2003–2005, when Bangladesh Bank introduced core risk management guidelines to manage key risks uniformly. It has since kept reviewing banks' risk management capacity and extending regulation as needed, so that the sector now has a reasonably rich set of policies and guidelines consistent with international best practice, culminating in a dedicated organizational structure with the Risk Management Division (RMD) at the center of the risk management process.

Conventional banks hold the lion's share of Bangladesh's banking sector, but Islamic banking is expanding and may reach 30% to 35% within the next decade. Whether pursued out of faith, market potential or resilience under stress, Islamic banking must comply with Shariah: it must avoid interest (Riba), excessive uncertainty (Gharar), harm (Dharar) and gambling (Maysir) and finance only permitted activities that uphold the higher objectives of Islamic law (Maqasid al-Shariah), and full compliance requires all stakeholders to exercise due diligence and fiduciary responsibility, since lapses in Shariah governance may lead to deviations, knowingly or otherwise.

Each Shariah-based financing contract has a distinct risk profile, and non-compliance also creates reputational risk, so risk management frameworks must reflect the special features of Islamic financial products and services.

Information on Islamic banking practices in Bangladesh, built up over four decades through limited research, should be readily available to bankers, academics and researchers to help practitioners address risk management challenges. This study therefore aims (i) to understand the risks in Shariah-based banking; (ii) to present tools and techniques for mitigating them; and (iii) to identify the issues and challenges of risk management in Shariah-based banking in Bangladesh.

Primary data were collected through a structured questionnaire sent to all full-fledged and branch- or window-based Islamic banks, of which 31 responses are summarized, and through interviews with key stakeholders. Secondary data came from global literature and publications of Bangladesh Bank and BIBM. Descriptive analysis was used, and the draft was finalized after comments from expert practitioners and Islamic finance professionals at a research workshop.

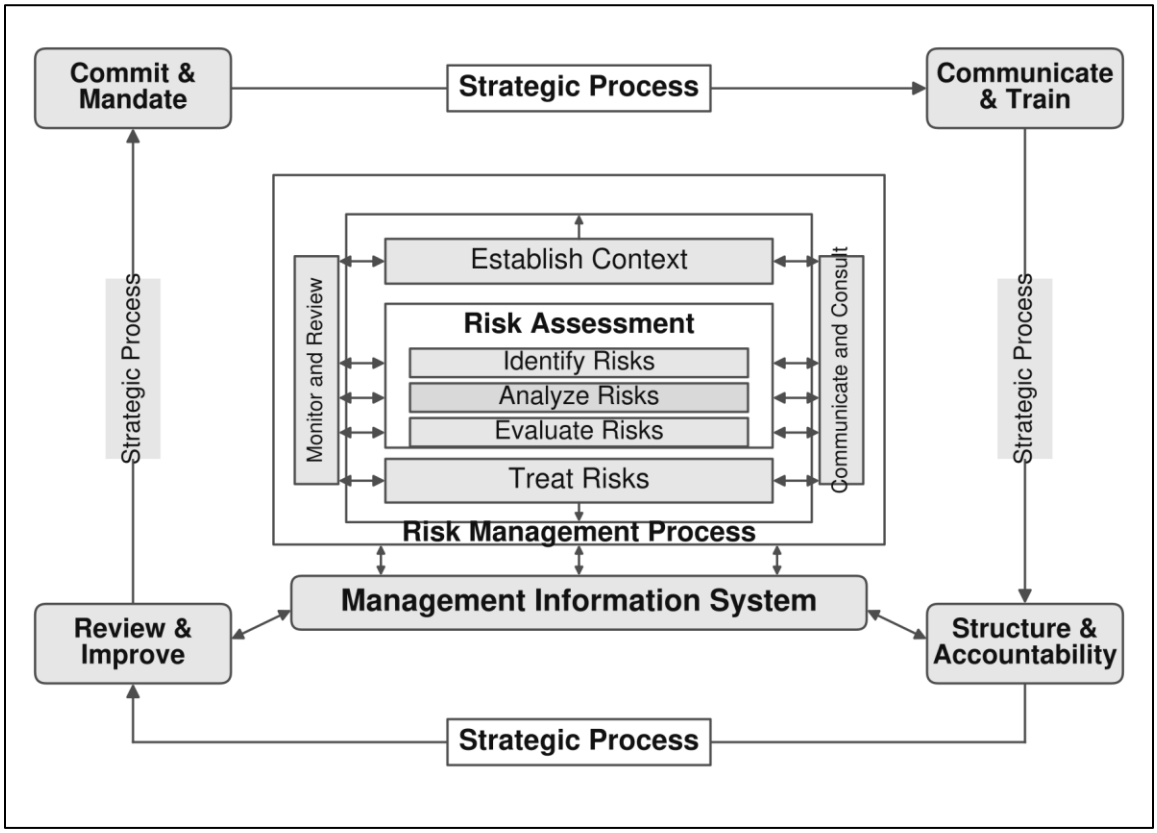
11.2 Conceptual Framework of Risk Management Process in Banks

Interest in risk management has grown worldwide, not least since the global financial crisis; this section sets out the conceptual framework of risk management.

11.2.1 ISO Framework and Process for Risk Management

Of the many approaches, the principle-based International Organization for Standardization (ISO) 31000 framework provides a general structure within which organizations design their own detailed frameworks. Figure 11.1 shows an ISO-compatible framework and risk management process for a financial organization, with the processes and functions needed for implementation and continuous improvement.

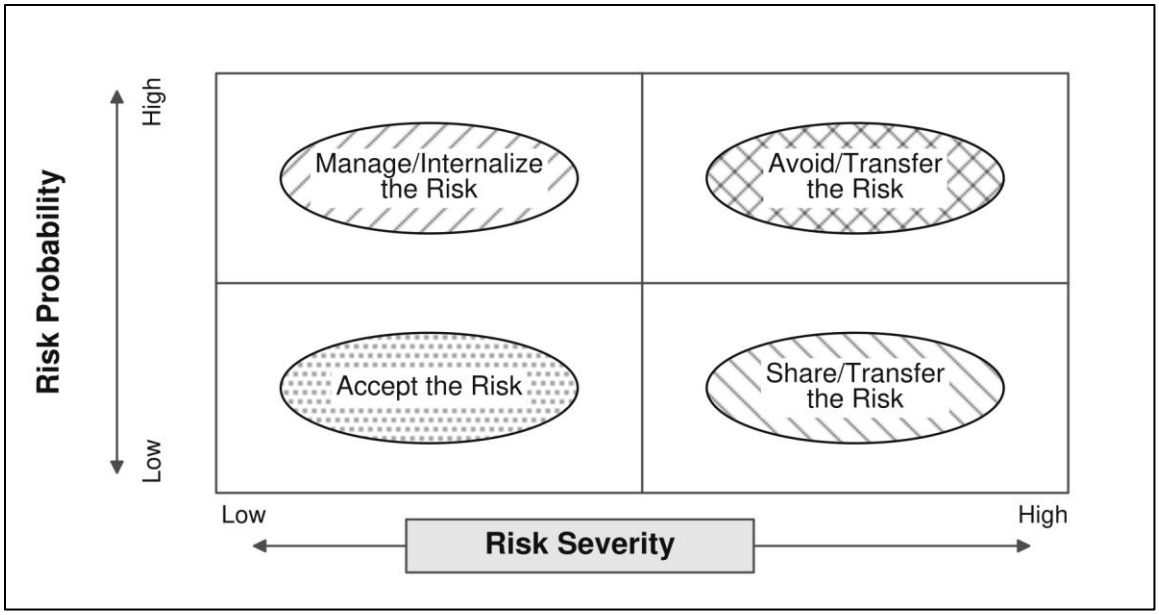
Figure 11.1: ISO 31000 Compatible Risk Management Framework and Process



Source: John Shortreed (2010).

A management information system that reports exposures and losses accurately and on time underpins the core process and its strategic feedback loop, since no learning or improvement is possible without it. Risk treatment — identifying and evaluating options and preparing and implementing treatment plans — is another key element; Figure 11.2 maps strategies by severity and probability:

Figure 11.2: Risk Severity/Risk Probability Map and Risk Management Strategies



Source: Based on e-learning Manual, CERM Program, Frankfurt.

- **High severity, low probability:** share or transfer the risk, classically through insurance, which works best for rare but catastrophic risks where moral hazard is low — although Shariah authorities do not permit conventional insurance.
- **Low severity, high probability:** manage the probability and absorb the losses, since transfer would not be cost-effective.
- **Low severity, low probability:** simply accept the risk, as mitigation could cost more than the potential loss — just as many firms no longer police office supplies, preferring to print their logo on them and let staff spread the marketing message.
- **High severity, high probability:** avoid the activity or, if it is unavoidable, transfer it to a specialist entity with the technology and skills to reduce both probability and severity.

People instinctively favor mitigation or hedging, but risk management is about dealing effectively with uncertainty and complexity, not simply eliminating risk.

11.2.2 Three Lines of Defense (3LD) Framework for Risk Management

Effective risk management rests on sound internal governance: the board builds a strong risk culture, senior management implements the board-approved framework, and internal and external audit, as the third line of defense, independently challenge the assurance provided by business operations and oversight functions. The formality of the three lines varies with a bank's nature, size, complexity and risk profile (Figure 11.3).

Figure 11.3: Three Lines of Defense (3LD) Framework for Risk Management

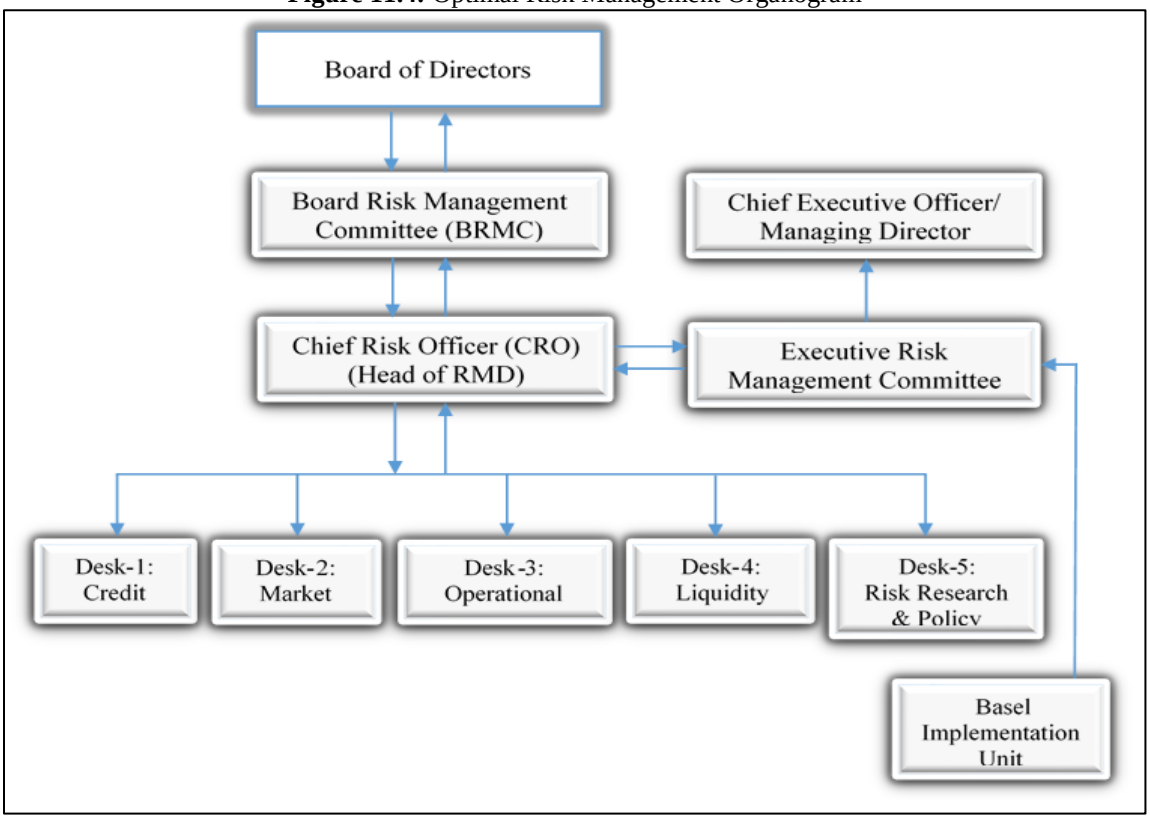


Source: KPMG, 2009.

11.2.3 Risk Management Framework: Bangladesh Perspective

Bangladesh Bank issued risk management guidelines for banks in 2012, revised in 2018 in line with the revised Basel Core Principles for Effective Banking Supervision (BCBS, September 2012), requiring a comprehensive risk management process and prescribing an optimal risk management organogram (Figure 11.4).

Figure 11.4: Optimal Risk Management Organogram



Source: Risk Management Guidelines for Banks 2018, Bangladesh Bank.

11.3 Regulatory Framework for Risk Management in the Banking Sector

One of the main functions of central bank is to regulate and supervise banks and financial institutions with a view to bringing stability in the industry and protecting customer's interest. Besides, Bank Company Act 1991 authorizes Bangladesh Bank to formulate relevant regulations for the banking sector. Accordingly, Bangladesh Bank issues circulars/guidelines in line with international best practices. Considering the banking industry as unique and different from other businesses, Bangladesh Bank took the following initiatives to ensure sound risk management practices in the banking sector.

- Issuance of Six Core Risk Management Guidelines
- Formation of Separate Risk Management Division
- Issuance of Separate Risk Management Guidelines
- Strengthening and Updating the Risk Management System in Banks
- Implementation of Revised Regulatory Capital Framework in Line with Basel-III
- Guidelines for Recognition of Eligible External Credit Assessment Institutions (ECAIs)
- Guidelines on Supervisory Review Evaluation Process (SREP)
- Implementation of Basel III Liquidity Ratios
- Issuance of Stress Testing Guideline
- Formation of Risk Committee at the Board Level
- Determination of Risk Rating and its Uses
- Issuance of Guidelines on Environmental & Social Risk Management (ESRM)

11.4 Salient Risk Management Framework for Islamic Banks based on Domestic and International Regulations

Bangladesh Bank's Risk Management Guidelines for Banks (DOS Circular No. 04 of 8 October 2018) also apply to Shariah-based banks, setting out how they should strengthen their own financial soundness and the stability of the financial sector. The main risk management aspects are summarized below.

Table 11.1: Risk Management Process of Islamic Banks

Dimension	Key Points for Risk Management and Financial Stability
Objective of Risk Management	Developing Risk culture, risk strategy, Risk Strategy and Risk Appetite, establishing a three-lines of defense model and Identifying risk and eliminating unacceptable risk
Risk Management System	Active involvement of board and senior management, Adequate organization, policies and procedures, adopting Appropriate management information systems; and creating Comprehensive internal controls and limits.
Risk Management Process	identify the responsible persons involved in risk assessment, understanding the context in which risk exists, Identifying and analyzing the risks, evaluating the risks and monitoring the risks
Operational Risk Management	Adopting and utilizing standard categorizations of operational risk events, according to event type and business line
Capital Management	Maintaining adequate capital, assessing internal capital adequacy of the bank and calculating its capital adequacy ratio
Risk Management Reporting	Preparing the Monthly Risk Management Report (MRMR) and the Comprehensive Risk Management Report (CRMR) according to the formats and timelines prescribed by Bangladesh Bank

Source: Risk Management Guidelines for Banks 2018, Bangladesh Bank.

Under the revised regulatory capital framework, all banks, including Islamic banks, must measure and hold capital against credit, market and operational risk, and Islamic banks may nominate the external credit assessment institutions (ECAIs) recognized by Bangladesh Bank. Minimum capital requirements for credit and market risk are set for each Shariah-compliant financing and investment instrument (Table 11.2), and operational risk capital is to be measured using the Basic Indicator Approach.

Table 11.2: Risk Weighted Assets of Shari'ah-Based Products

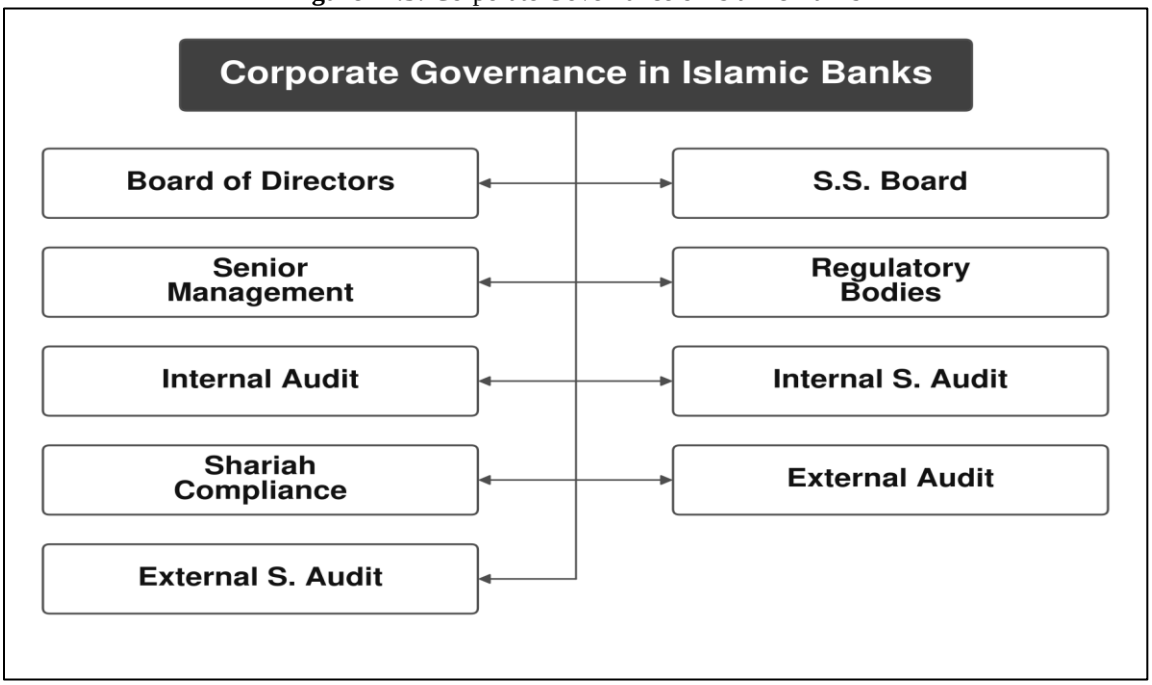
Mode	RW for the Credit Risk	Capital charge for the market risk
Murabahah Contracts	On the Accounts Receivable	15% of the amount of the position
Salam contract	On the Accounts Receivable	15% of the net position and 3% on gross positions
Istisna'a contract	On the Accounts Receivable	
Ijarah and Hire Purchase under Shirkatul Melk (HPSM) contracts	Future Ijarah receivable amount over the duration of the lease contract	15% of the amount of the asset's market value

Source: Researchers' Compilation.

The Guidelines for Islamic Banking (BRPD Circular No. 15 of 9 November 2009) cover licensing, responsibility for Shariah compliance, deposit and investment principles and products, Cash Reserve Requirement (CRR)/Statutory Liquidity Requirement (SLR) maintenance, financial statements, the rate-of-return framework and fit and proper criteria for Shariah Supervisory Committee members. They are discussed in Section 12.3.2.

The Guidelines on Internal Control and Compliance in Banks (BRPD Circular No. 03 of 8 March 2016) add, in Section 8, requirements on Shariah audit and inspection, Shariah non-compliance risk rating, measures against Shariah violations, and monitoring and follow-up (see also Section 12.3.2). Figure 11.5 depicts the corporate governance framework of Islamic banks.

Figure 11.5: Corporate Governance of Islamic Banks

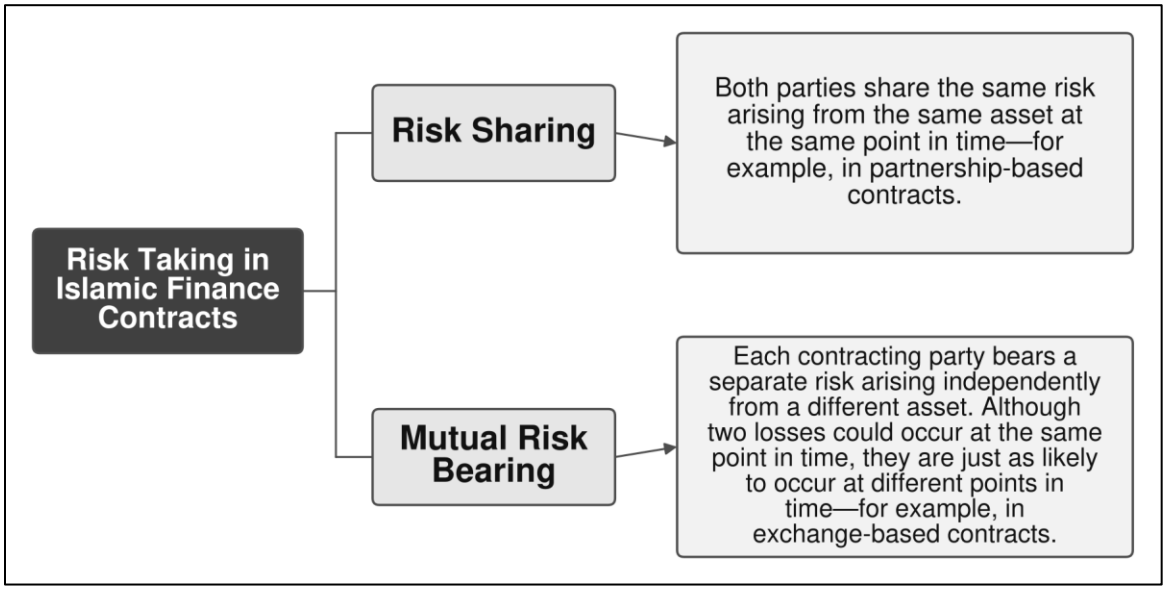


Source: Researchers' Compilation.

11.4.1 Risk Justifies Gain in Islamic Finance

While undertaking gambling like activities or activities that entail major uncertainties are prohibited in Islamic finance transactions, bearing risk is an inherent feature in each and every contract approved by the Shariah (Abdul Khir, et al., 2015). As identified in Figure 11.6, the risk taking in Islamic finance can be divided into two types: risk sharing that is applicable to partnership contracts and mutual risk bearing that is applicable to exchange-based contracts.

Figure 11.6: Risk Taking from Islamic Perspective

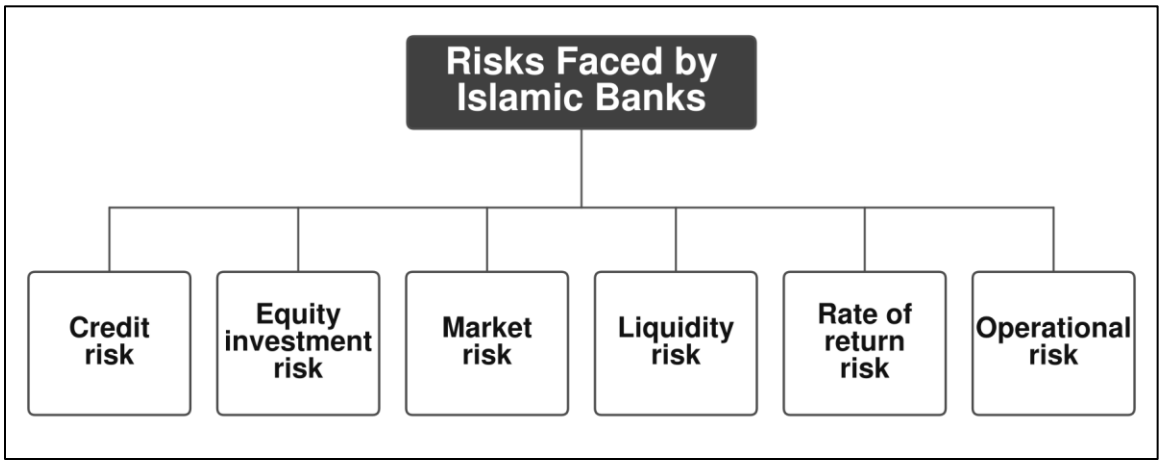


Source: Abdul Khir, et al. (2015).

11.4.2 Risks Faced by Islamic Banks

Different international authors and authorities have identified different risks of Islamic banks. For instance, the risks faced by the Islamic banks are grouped into six categories by the Islamic Financial Services Board (IFSB, 2005). These risks are identified in Figure 11.7.

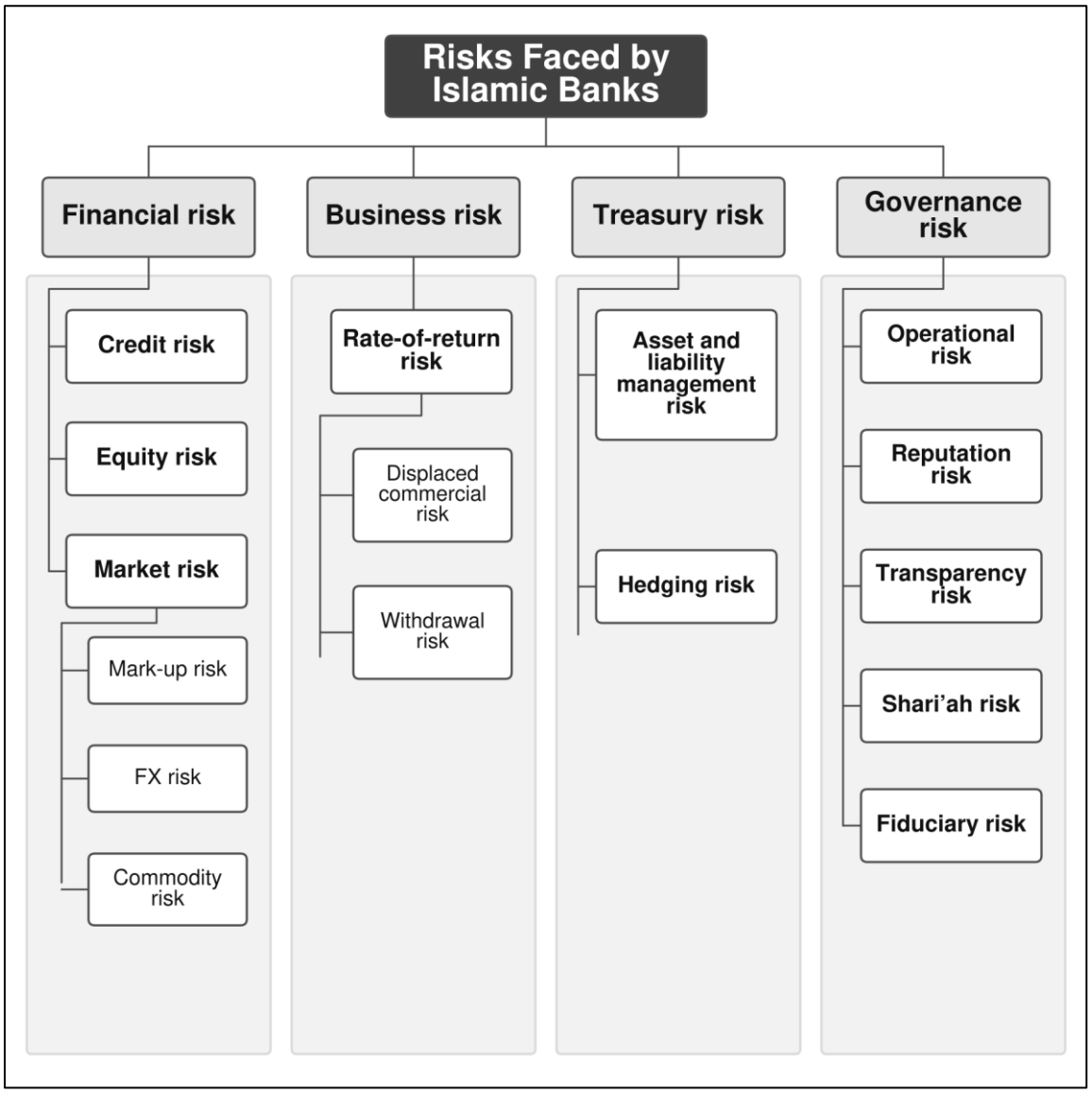
Figure 11.7: Risks Faced by Islamic Banks — IFSB (2005)



Source: IFSB (2005).

Iqbal and Mirakhor (2011) have identified a more detailed list of risks that the Islamic banks face. These are provided in Figure 11.8.

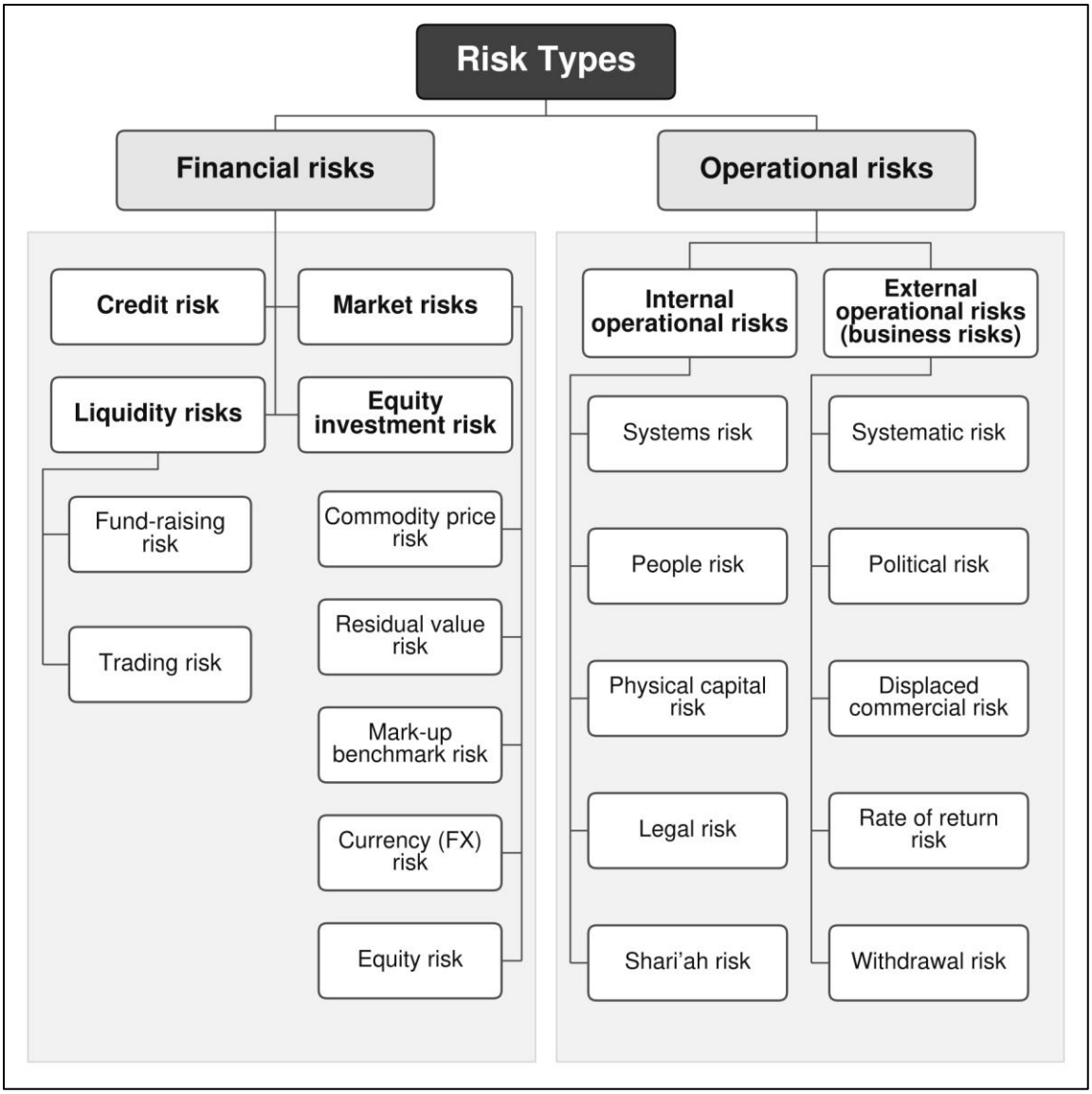
Figure 11.8: Risks Faced by Islamic Banks — Iqbal and Mirakhor (2011)



Source: Iqbal and Mirakhor (2011).

Salem (2013) has identified a similar risk profile of the Islamic banks, which is provided in Figure 11.9.

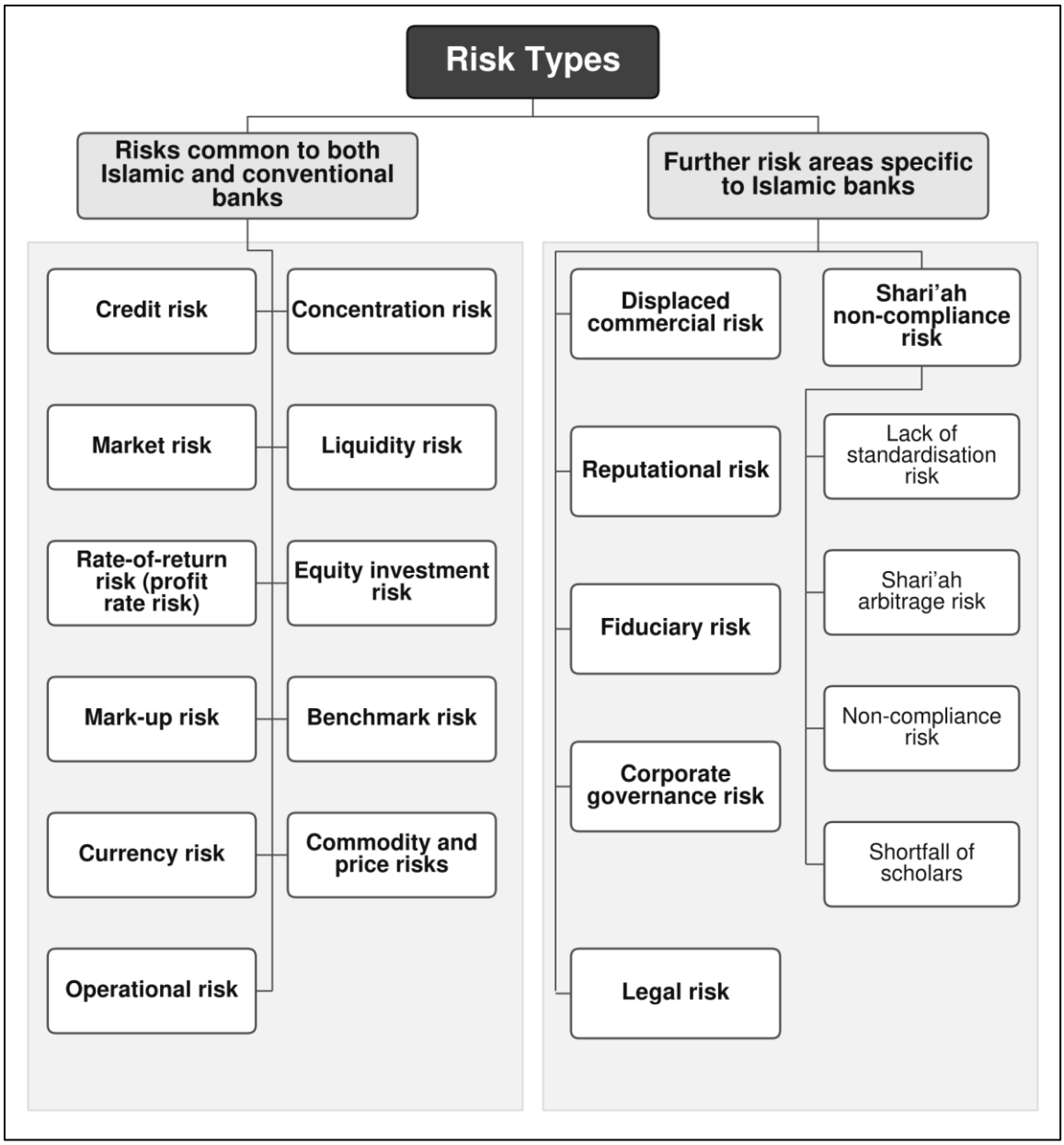
Figure 11.9: Risks Faced by Islamic Banks — Salem (2013)



Source: Salem (2013).

Whereas, Eid and Asutay (2019) divided risks faced by Islamic banks into two types: (i) risks that are common with conventional banks, and (ii) risks that are unique to Islamic banks. These risks are identified in Figure 11.10.

Figure 11.10: Risks Faced by Islamic Banks — Eid and Asutay (2019)



Source: Eid and Asutay (2019).

The risks faced by the Islamic banks along with the risk management principles as provided by the IFSB (2005) are briefly discussed below.

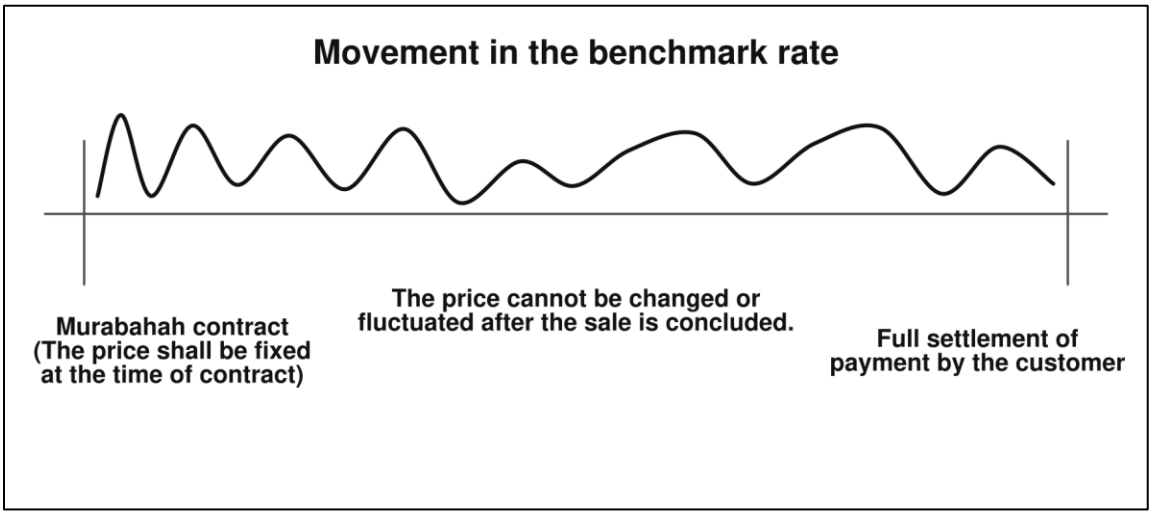
- **Credit risk:** the risk that a counterparty fails to make its contractual payments — for example, non-payment by a customer in a deferred-payment cost-plus sale (Murabahah); in profit-sharing partnership (Mudarabah) and partnership (Musharakah) financing it includes capital impairment and non-payment of profit by the managing partner (Mudarib) or partner (Oz, Khokher, Ali, & Rosman, 2016). IFSB (2005) requires a Shariah-compliant financing strategy that recognizes exposures at each stage of each contract, due diligence on counterparties before an instrument is chosen,

methodologies for measuring and reporting exposures under each instrument, and Shariah-compliant mitigation techniques.

- **Equity investment risk:** unique to Islamic banks, the risk that Mudarabah and Musharakah investments do not generate a steady or expected income, which complicates cash-flow management. IFSB (2005) requires appropriate strategies, risk management and reporting for equity investments. Consistent valuation methods, agreed with the Mudarib or partners, whose effects on profit calculation and allocation are assessed, and exit strategies, including extension and redemption conditions, approved by the Shariah board.
- **Market risk:** the risk of loss on on- and off-balance-sheet positions from movements in market prices (IFSB, 2005), for which Islamic banks must have an appropriate market risk management and reporting framework covering all assets held, including those without a ready market or with high price volatility. Examples include:

➢ **Mark-up risk:** in Murabahah and other trade-based contracts the mark-up is fixed for the tenure, so if the benchmark rate rises the bank cannot benefit, since increasing the receivable would be Riba (Figure 11.11).

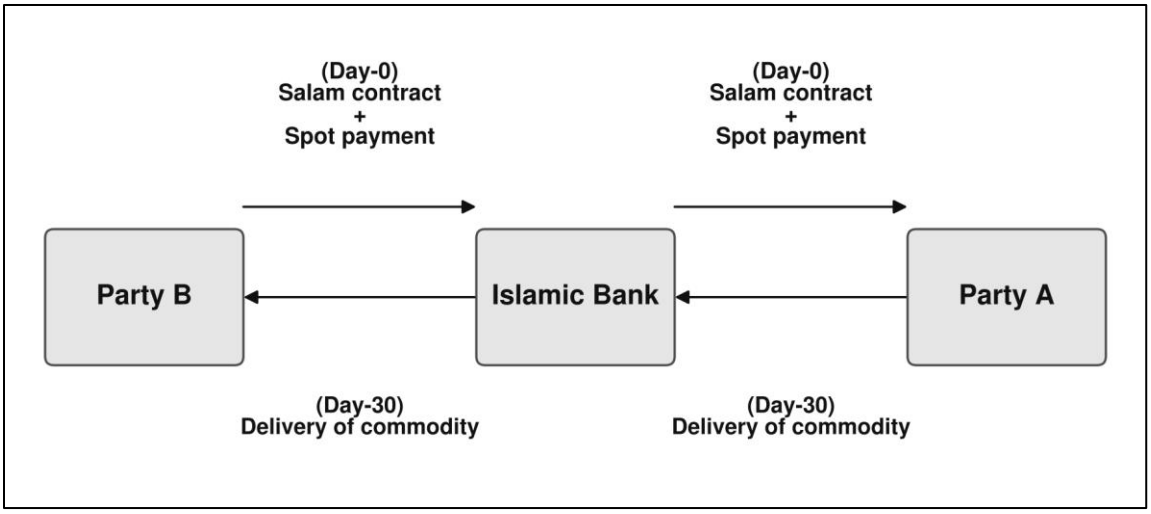
Figure 11.11: Mark-up Risk in Murabahah Financing



Source: Authors' own.

➢ **Price risk:** in a Salam contract the bank, as buyer, bears the risk of changes in the commodity's price before delivery; a parallel Salam in which it sells the same commodity mitigates this, but if the first seller fails to deliver, the bank must buy in the market to meet its obligation under the second contract (Figure 11.12).

Figure 11.12: Salam and Parallel Salam



Source: Authors' own.

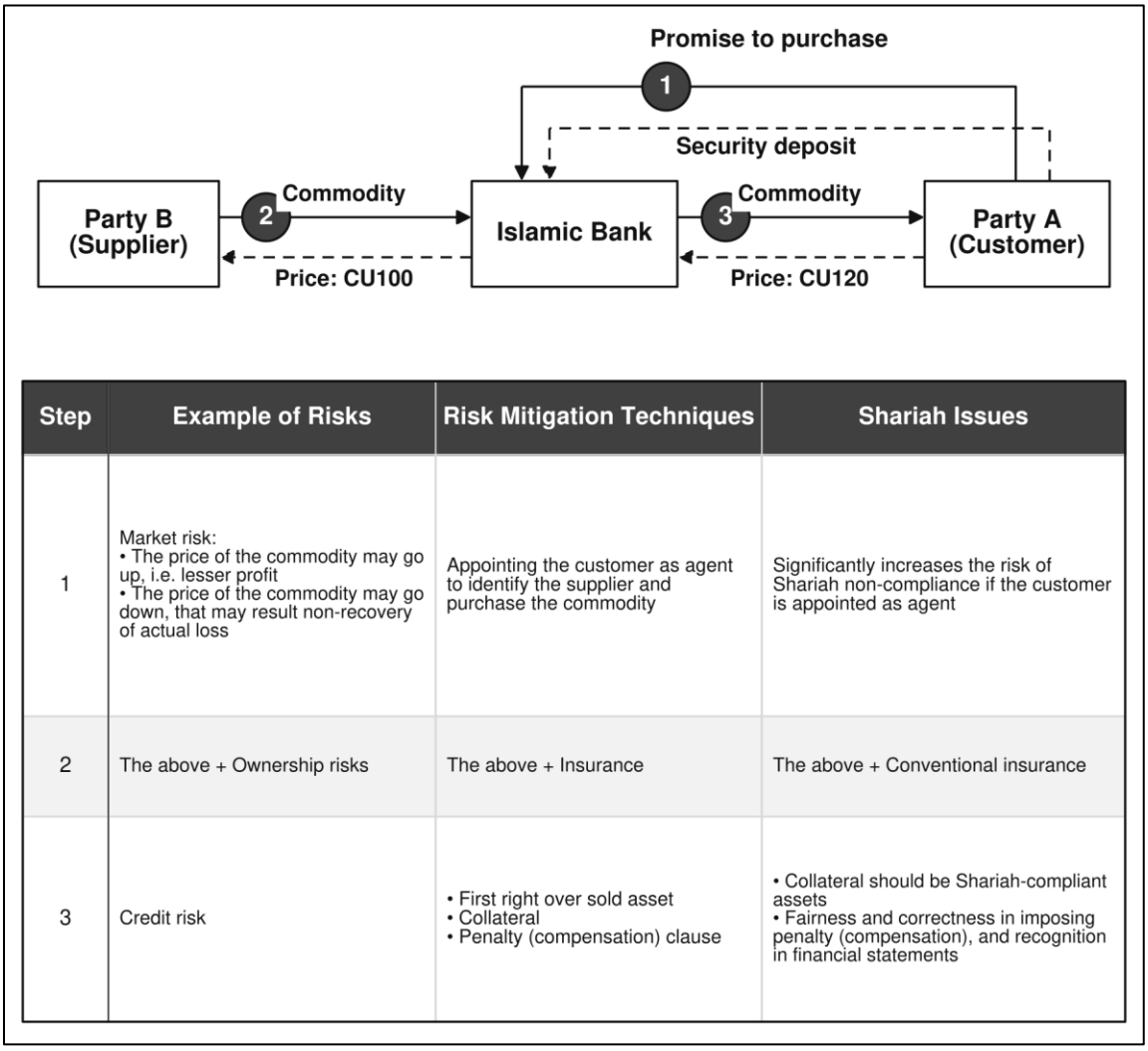
- **Liquidity risk:** the risk of holding illiquid assets that make obligations hard to meet, or of lacking access to funding at reasonable cost. It is greater for Islamic banks, which cannot borrow on interest, raise funds without a real transaction or sell receivables at a discount, and which have limited Shariah-compliant money and interbank markets. It arises mainly from maturity mismatches, securities that suddenly become illiquid and placements in structured assets that are hard to exit. IFSB (2005) requires a liquidity management framework that treats current, unrestricted and restricted investment accounts separately and together, and liquidity risk commensurate with the bank's recourse to Shariah-compliant funds.
- **Rate of return risk:** unlike conventional interest rate risk, this affects both financing, since Islamic banks cannot charge interest even on late payment, and deposits, since profit distributed to depositors must reflect the performance of the financing they fund. IFSB (2005) requires a process for assessing how market factors affect asset returns relative to the returns expected by investment account holders (Mudarabah depositors), and a framework for managing displaced commercial risk.
- **Operational risk:** the risk of loss from inadequate or failed internal processes, people and systems or from external events, including, for Islamic banks, losses from Shariah non-compliance and failure of fiduciary responsibilities (Oz, Khokher, Ali, & Rosman, 2016). Sources of Shariah non-compliance risk include lack of staff knowledge, skills and training. Weak monitoring, supervision and internal control; weak Information Technology (IT) infrastructure, particularly when riding on conventional systems. Human error; moral hazard; dual banking operations; miscommunication, and poor logistics (Lahsasna, 2014). Lahsasna (2014) grades the risk as high (contracts invalidated without remedy or profit not recognized, such as a sale executed without identifying the underlying asset), medium (breaches of contract conditions that can be rectified but may cause loss of profit, such as late-payment charges above the actual loss channelled to charity) or low (other minimal risks, such as advertising with indecent images that may harm reputation).

11.4.3 Risks Faced in Islamic Finance Contracts

As the execution of an Islamic finance transaction often involve entering into several contracts, a common Shariah non-compliance risk present is not following the appropriate sequence in execution of the contracts. A mitigation technique for this risk is to providing proper training to the staffs on the importance of following the right sequence in executing different stages of the contract.

Nonetheless, Figure 11.13 to 11.16 of this section identifies the risks faced in Islamic finance contracts at different stages of their execution, the common risk management techniques undertaken by the Islamic banks and the potential Shariah issues regarding the risk management techniques. It shall be noted that a risk itself may be Shariah-compliant, but the risk of Shariah non-compliance may arise in the mechanism of managing the risk.

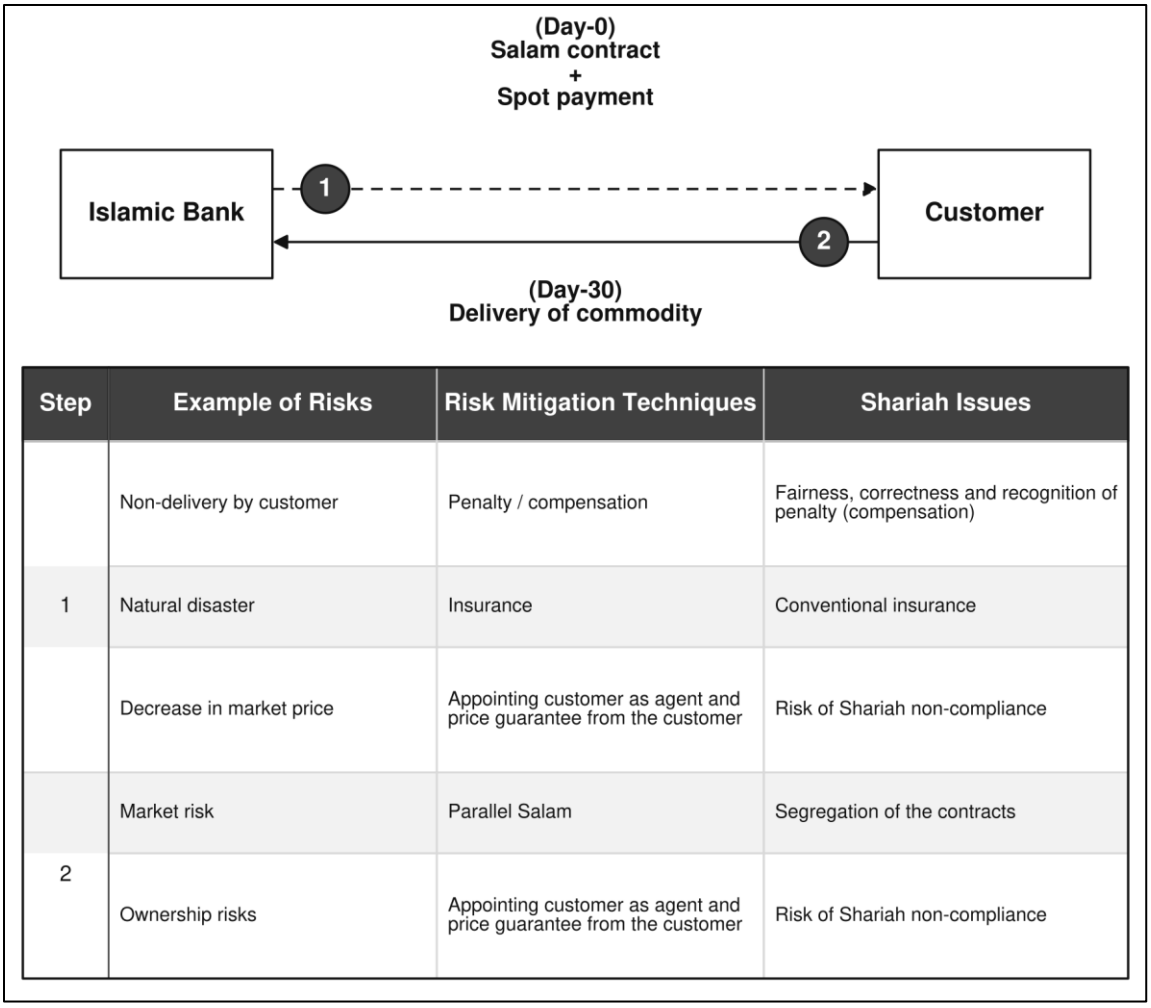
Figure 11.13: Murabahah Financing



Step	Example of Risks	Risk Mitigation Techniques	Shariah Issues
1	Market risk: • The price of the commodity may go up, i.e. lesser profit • The price of the commodity may go down, that may result non-recovery of actual loss	Appointing the customer as agent to identify the supplier and purchase the commodity	Significantly increases the risk of Shariah non-compliance if the customer is appointed as agent
2	The above + Ownership risks	The above + Insurance	The above + Conventional insurance
3	Credit risk	• First right over sold asset • Collateral • Penalty (compensation) clause	• Collateral should be Shariah-compliant assets • Fairness and correctness in imposing penalty (compensation), and recognition in financial statements

Source: Authors' own.

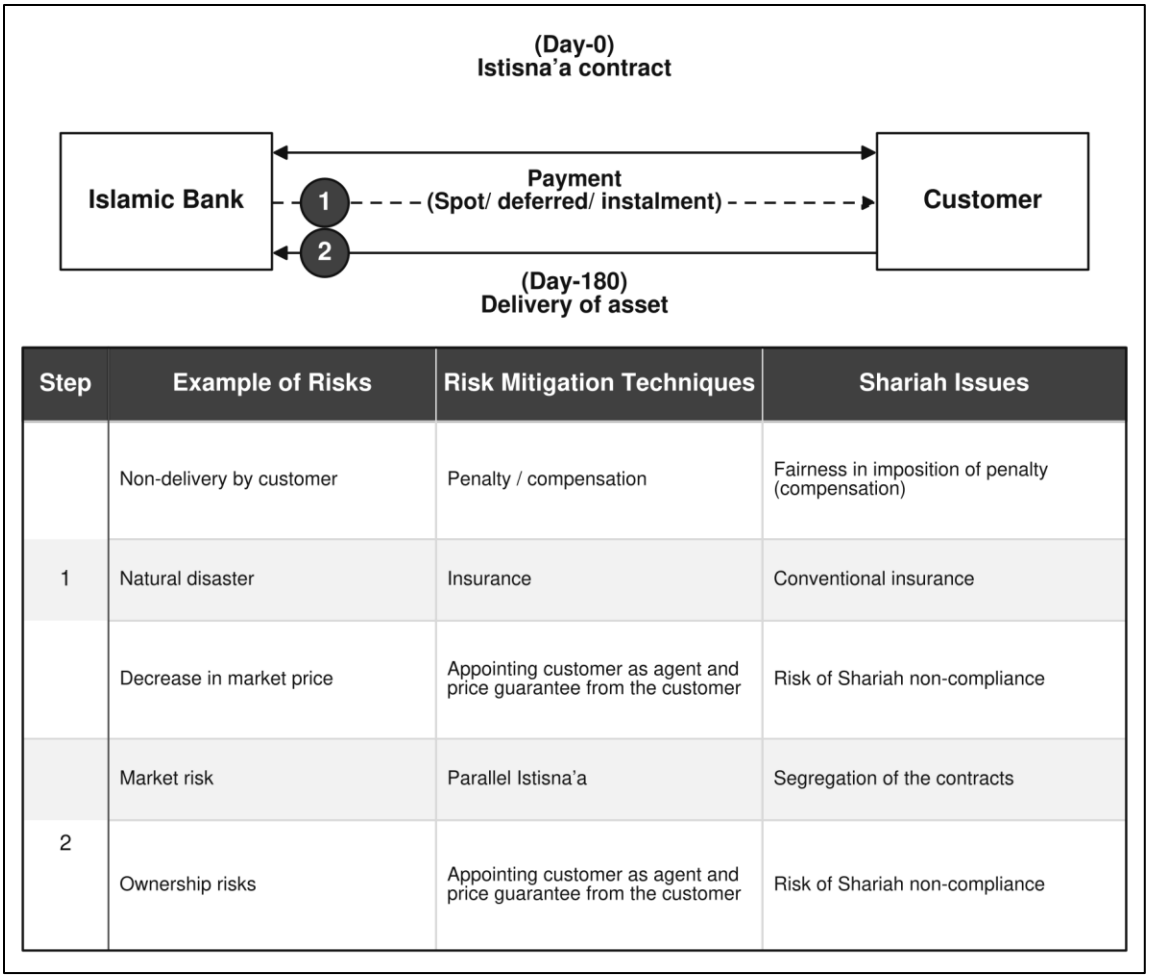
Figure 11.14: Salam Financing



Step	Example of Risks	Risk Mitigation Techniques	Shariah Issues
	Non-delivery by customer	Penalty / compensation	Fairness, correctness and recognition of penalty (compensation)
1	Natural disaster	Insurance	Conventional insurance
	Decrease in market price	Appointing customer as agent and price guarantee from the customer	Risk of Shariah non-compliance
	Market risk	Parallel Salam	Segregation of the contracts
2	Ownership risks	Appointing customer as agent and price guarantee from the customer	Risk of Shariah non-compliance

Source: Authors' own.

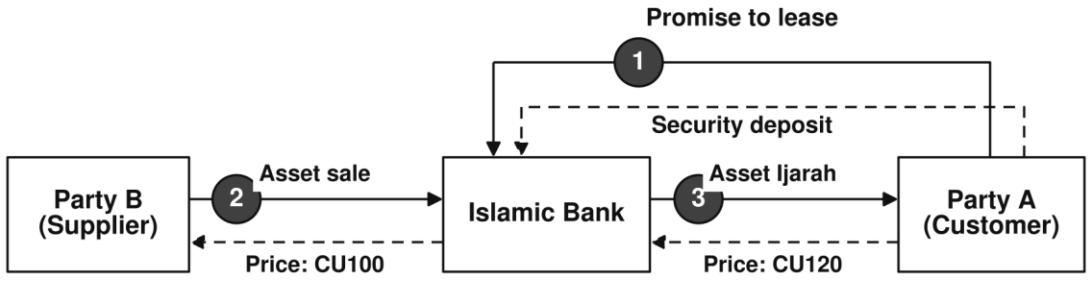
Figure 11.15: Istisna'a Financing



Step	Example of Risks	Risk Mitigation Techniques	Shariah Issues
	Non-delivery by customer	Penalty / compensation	Fairness in imposition of penalty (compensation)
1	Natural disaster	Insurance	Conventional insurance
	Decrease in market price	Appointing customer as agent and price guarantee from the customer	Risk of Shariah non-compliance
	Market risk	Parallel Istisna'a	Segregation of the contracts
2	Ownership risks	Appointing customer as agent and price guarantee from the customer	Risk of Shariah non-compliance

Source: Authors' own.

Figure 11.16: Ijarah Financing



Step	Example of Risks	Risk Mitigation Techniques	Shariah Issues
1	Market risk: • The market rate may go up, i.e. lesser rental charged to customer	• Floating rate based on a reference rate • Changes in lease rental	Rental mechanism to be agreed at the time of contract
	• The price of the asset may go down, that may result non-recovery of actual loss	Appointing the customer as agent to identify the supplier and purchase the asset	Increases the risk of Shariah non-compliance if the customer is appointed as agent
2	The above + Ownership risks	The above + Insurance	The above + Conventional insurance
3	Credit risk	• Collateral • Penalty (compensation) clause	• Collateral should be Shariah-compliant assets • Fairness and correctness in imposing penalty (compensation), and recognition in financial statements
	Ownership risks	Insurance	Conventional insurance
		Delegating the tasks associated with ownership risks to the customer	Significantly increases the risk of Shariah non-compliance
	Market risk: The market rate may go up, i.e. lesser rental charged to customer	Change in lease rental	• Rate to be fixed prior to the beginning of the period • Rental rate cannot be changed retrospectively

Source: Authors' own.

In addition to the above, the risks involve in Mudarabah and Musharakah-based financing include adverse selection and moral hazard. Furthermore, Islamic banks will be liable for any negligence and misconduct in managing the funds provided by the depositors. Transferring the risks involve in Mudarabah and Musharakah to the counterparty (for example, by guaranteeing profit or capital) will result in Shariah non-compliance.

11.5 Data Analysis

The status and performance of the Islamic banking industry in Bangladesh are reviewed with more recent data in Chapter 3. This section concentrates on the risk management practices of Shariah-based banks as revealed by the survey.

11.5.1 Risk Management Practices of Shariah Based Banking in Bangladesh

11.5.1.1 General Perception Regarding Risk of Shariah-based Banks

All full-fledged Islamic banks agree that Islamic banks face different risks from conventional banks (Table 11.3); 52% of respondents consider deposit collection less risky for Islamic banks, but about 60% consider investment riskier, with similar views on market, liquidity and operational risks.

Table 11.3: General perception regarding risk of Shariah-based banks and conventional banks (%)

S/n	Aspects	Response of Full-fledged IB			Response of IB Industry		
		A	B	C	A	B	C
1.	Do you think that the risk faced by the Islamic banks in general is different from the conventional banks? a) Yes; b) No	100	0		90	10	
2.	Do you think that the risk faced by the Islamic banks in collection of deposits is different from the conventional banks? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	40	50	10	42	52	6
3.	Do you think that the risk faced by the Islamic banks in investing funds is different from the conventional banks? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	60	30	10	58	32	10
4.	Do you think that the operational risk faced by the Islamic banks is different from the conventional banks? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	80	10	10	71	13	16
5.	Do you think that the market risk faced by the Islamic banks is different from the conventional banks? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	60	40	0	59	28	13

S/n	Aspects	Response of Full-fledged IB			Response of IB Industry		
		A	B	C	A	B	C
6.	Do you think that the liquidity risk faced by the Islamic banks is different from the conventional banks? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	70	20	10	67	27	6
7.	Do you think that there are differences of risk in Islamic banks (IBs) as compared to conventional banks (CBs) in regard to capital adequacy? a) Risk of IB is higher than CB b) Risk of IB is lower than CB c) There is no difference	50	20	30	33	20	47
8.	Do you think that differences in verdicts of Shariah scholars' impact on the risk management of IBs? a) Yes; b) No	60	40		71	29	0

Source: Questionnaire Survey.

11.5.1.2 Perceptions Regarding Operational Risk of Shariah-based Banks

About 81% of respondents find it hard to recruit staff with relevant Islamic banking expertise, and 57% report a lack of training (Table 11.4). Most full-fledged Islamic banks face no extra challenge in acquiring Shariah-compliant software, though the wider industry does, and many face difficulties in Shariah-compliant operations owing to limited knowledge, market pressure, owners' business motives, a shortage of competent Shariah scholars and the cost of Shariah governance and monitoring.

Table 11.4: Perceptions regarding operational risk of Shariah-based banks (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
1.	**Related with Human Resources:** Do you face any challenge to recruit manpower having relevant expertise/education? (Because, combination of traditional and Shariah knowledge is essential).	70	30	81	19
2.	Do you face any challenge to develop your manpower by catering proper training? (Because, combination of traditional and Shariah knowledge is essential).	67	33	57	43
3.	**Related with System**: Do you face any challenge related with Shariah-compliant software (e.g., availability and maintenance)?	33	67	60	40
4.	**Related with Process:** Do you face any challenge related with Shariah-compliant process of operations due to lack of knowledge and market pressure?	67	33	70	30

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	**No**	**Yes**	**No**
5.	Do you face any challenge related with Shariah-compliant process of operations due to Business motives of the banks' owners ignoring Shariah?	11	89	23	77
6.	Do you face any challenge related with Shariah-compliant process of operations due to unavailability of competent Shariah scholars and their role in Shariah Supervisory Committee?	11	89	40	60
7.	Do you think that cost of operation is higher in IB as compared to CB due to additional cost for ensuring Shariah governance and monitoring?	100	0	83	17
8.	**Related with External Event:** Do you face any challenge related with external event in case of Mudarahah and Musharakah investment due to legal framework, accounting system and ethical values of the counterparty?	56	44	59	41
9.	Do you face the underlying asset's ownership risks in Murabahah contract?	56	44	63	37
10.	Do you face the underlying asset's ownership risks in Salam contract?	44	56	64	36
11.	Do you face the underlying asset's ownership risks in Istisna'a contract?	44	56	62	38
12.	Do you face the underlying asset's ownership risks in Ijarah contract?	44	56	41	59

Source: Questionnaire Survey.

11.5.1.3 Perceptions Regarding Deposit Mobilization Risk of Shariah-based Banks

Less than half of respondents see Mudarabah deposit mobilization as hampered by conventional banks' fixed returns (Table 11.5), but banks face displaced commercial risk and Shariah non-compliance risk in marketing, and all full-fledged banks see high Shariah non-compliance risk in operations, such as guarantees of Mudarabah capital or profit. Mudarabah deposits nonetheless give them a cost-of-funds advantage.

Table 11.5: Perceptions regarding risk management of Shariah-based banks: Deposit (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	**No**	**Yes**	**No**
1.	Do you face any challenge to collect deposits under the Mudarabah principle? (The conventional banks offer fixed and positive return in deposit collection, whereas the Mudarabah principle is a profit sharing and loss bearing contract.)	40	60	45	55
2.	Do you face any challenge related with displaced commercial risk as there is a variable rate of return on deposit unlike conventional banks?	50	50	55	45

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
3.	Do you face any challenge related with Shariah non-compliance risk in the area of marketing (e.g., double benefit scheme)? (Because, the mode is profit sharing but loss bearing).	70	30	67	33
4.	Do you face any challenge related with Shariah non-compliance risk in regard to operation (e.g., capital/profit guarantee)? (Because, capital/profit may not be guaranteed).	100	0	63	37
5.	Do you face any challenge related with Shariah non-compliance risk in regard to profit calculation/distribution (e.g., lack of transparency)	50	50	35	65
6.	Do you think that IB enjoy competitive advantages related with cost of fund as deposit collected under Mudarabah principle?	80	20	70	30

Source: Questionnaire Survey.

11.5.1.4 Perceptions Regarding Investment (Credit) Risk of Shariah-based Banks

Counterparty risk is higher for Islamic banks because they cannot charge extra on default (Table 11.6). Some banks consider compensation charges alone ineffective against a culture of default and see a role for Islamic credit insurance, though fully Shariah-compliant, asset-backed investment linked to the real economy should be less prone to default.

Table 11.6: Perceptions regarding risk management of Shariah-based banks: Credit (Investment) (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
1.	Do you think that the counterparty risk of Islamic banks increases in comparison to conventional banks due to not charging any additional amount in the cases of default?	56	44	53	47
2.	Do you think the compensation (i.e., penalty) charge is an effective risk management technique for the Islamic banks?	33	67	63	37
3.	Do you think that the Shariah requirement of not imposing the compensation (i.e., penalty) charge on an insolvent or incapable customer places Islamic banks in a disadvantageous position in comparison to conventional banks in credit risk management?	67	33	43	57
4.	Do you face any challenge in managing the counterparty risk because there is no Islamic credit insurance service provider in Bangladesh?	78	22	66	34
5.	Do you think that there is a less possibility of default in Islamic banking because all investments are linked with real economy and asset-backed?	89	11	83	17
6.	Do you think that there is a difference in concentration risk of Islamic banks as compared to conventional banks?	78	22	53	47

Source: Questionnaire Survey.

11.5.1.5 Perceptions Regarding Market Risk of Shariah-based Banks

Most respondents consider displaced commercial risk relevant (Table 11.7), although banks' varied profit-calculation methods pose no difficulty and commodity price volatility has little impact. Currency risk is a challenge for lack of Islamic derivatives, and equity price risk for lack of sufficient Shariah-compliant equity instruments.

Table 11.7: Perceptions regarding risk management of Shariah-based banks: Market (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
1.	Do think that the displaced commercial risk is a relevant risk for Islamic banks in Bangladesh? (Displaced commercial risk refers to the risk of losing deposit customers by Islamic banks due to providing lower than the expected profit or Market rate.)	56	44	57	43
2.	Do you face any challenge related with rate of return on deposit due to different mechanism of profit calculation (e.g., ISR or Weightage method)?	22	78	40	60
3.	Do you face any challenge related with commodity price in case of Murabahah (possibility of change in price before delivery to customer)?	56	44	37	63
4.	Do you face any challenge related with commodity price in case of Salam & Istisna'a (possibility of change in price after getting delivery from customer but before selling to others)?	22	78	36	64
5.	Do you face any challenge related with commodity price in case of Ijarah (possibility of change in price of the Ijarah asset at the end of the period)?	22	78	14	86
6.	Do you face any challenge related with currency price due to lack of Islamic derivatives?	89	11	62	38
7.	Do you think that there is a difference in equity risk of IB as compared to CB because there is lack of Shariah-compliant sufficient equity instruments?	78	22	79	21
8.	Do you face the additional risks in comparison to conventional banks due to the lack of Islamic hedging instruments?	78	22	70	30

Source: Questionnaire Survey.

11.5.1.6 Perceptions Regarding Liquidity Risk of Shariah-based Banks

Islamic banks face liquidity challenges for lack of attractive, tradable instruments (Table 11.8), which some professionals expect Islamic investment certificates (Sukuk) to ease.

Table 11.8: Perceptions regarding risk management of Shariah-based banks: Liquidity (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
1.	Do you face any challenge related with liquidity due to lack of sufficient attractive instruments unlike CB?	78	22	83	17
2.	Do you face any challenge related with liquidity due to lack of tradability of all instruments unlike CB?	78	22	86	14
3.	Do you face any challenge related with liquidity due to lack of sufficient secondary market instruments unlike CB?	89	11	90	10
4.	Do you face any challenge related with liquidity due to low return of the instruments unlike CB?	67	33	76	24

Source: Questionnaire Survey.

11.5.1.7 Perceptions Regarding Capital Adequacy Requirements of IBs

Almost all banks believe that capital adequacy requirements for Islamic banks should differ from those for conventional banks, reflecting their distinctive products and contracts and including Shariah non-compliance risk (Table 11.9). Credit risk accounts for more than 90% of full-fledged Islamic banks' risk-weighted assets (Table 11.10).

Table 11.9: Capital adequacy requirements (%)

S/n	Aspects	Response of Full-fledged IB		Response of IB Industry	
		Yes	No	Yes	No
1.	Do you think that the capital adequacy requirements for Islamic banks should be different from the conventional bank?	100	0	94	6
2.	Do you think that the Shariah non-compliance risk must be considered in determining the capital adequacy requirements for Islamic banks?	100	0	87	13

Source: Questionnaire Survey.

Table 11.10: Risk weighted assets of full-fledged Islamic banks (%)

Year	Credit Risk	Market Risk	Operational Risk	Total
2016	91.43	1.96	6.61	100
2017	92.02	1.49	6.48	100
2018	91.86	1.46	6.73	100
2019	91.76	1.38	6.85	100
2020	91.38	1.37	7.25	100
2021	91.44	1.69	6.87	100
Average	**91.65**	**1.55**	**6.80**	**100**

Source: Questionnaire Survey.

Further details of the respondents' perceptions, and additional risk management issues raised by them, are given in Appendices A and B.

11.6 Observations and Recommendations

11.6.1 Human Capital Development

Islamic banking's special features — internal control failures, unskilled use of technology, the difficulty of implementing Islamic contracts in the existing legal environment, and flawed drafting and execution of asset-backed contracts such as Salam, Murabahah and Istisna'a — give rise to operational risk, which can be kept to a tolerable level only by competent, committed, technologically skilled staff free from greed and fraud.

11.6.2 Development of a Pool of Shariah Scholars

Shariah risk arises from the functioning and structure of SSBs/SSCs, the unstructured practice of Shariah contracts and non-compliance, and divergent application of Shariah can produce inconsistent accounting, reporting and auditing. Only a few scholars serve the SSBs of Bangladesh's banks, and academic curricula do not balance Fiqh Ibadah and Fiqh Muamalat, so a pool of Shariah scholars should be developed to reduce the risk of Shariah non-compliance.

11.6.3 Changing the Mindset of the Management and BoD

Islamic banks differ from conventional banks in principles, motives and mechanisms, so Shariah principles and ethics must take priority: boards and senior management should guide staff to do business in a Shariah-compliant way rather than follow conventional practice, support business units, and ensure accountability for Shariah violations, making the industry more sustainable.

11.6.4 Formulation of Strategic Plan by the Branch/Window-Based IBs

Branch- and window-based Islamic banks differ from full-fledged banks in reaching customers and in their network, operational, governance and risk management infrastructure, and their employees' perceptions matter. A strategic plan aligning the board's perspective, senior management's thinking and the business units' motivation, with a long-term vision rather than short-term gain, would help them achieve economies of scale.

11.6.5 Adoption of Shariah-based Framework for Reporting and Risk Management

Reporting and risk management tools have not kept pace with the growth of Islamic banking: Islamic banks have few risk management instruments compared with conventional banks, need a stringent reporting and governance framework suited to their products, and publish financial statements that do not properly reflect Shariah-based activities; more should be invested in research and development of better risk management and reporting tools.

11.6.6 Popularization of Sukuk and Shariah-Based Instruments

Islamic banks lack Shariah-based instruments for raising funds quickly when short of liquidity; Sukuk and Sukuk-linked instruments should be popularized among investors, building on initiatives by Bangladesh Bank, the Ministry of Finance and Bangladesh Securities and Exchange Commission (BSEC).

11.6.7 Demonstrating Universalism and Innovation and Diversification Products

Islamic banking should demonstrate its universalism — it is not only for Muslim owners, employees or customers — and design products for market demand and a changing business environment, gaining market share and aiding risk management.

11.6.8 Strengthening Shariah-Based Supervision and Monitoring

Shariah-based supervision and monitoring, an additional requirement for Islamic banks, are essential to ensure that performance meets the standards set by both the regulator and the Shariah Supervisory Board (SSB) and that business is conducted through real asset-based transactions, realizing Islamic banking's full potential.

11.6.9 Reforming Judiciary System for Dispute Settlement in IBs

The judicial system for dispute settlement is designed for conventional finance, whereas Shariah-based contracts, and their violations, differ in nature; with Islamic banking growing, the system should be reformed to settle Islamic banking disputes.

Appendices

Appendix A

Perceptions of the Respondents

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
1.	Do you think that the risk faced by the Islamic banks in general is different from the conventional banks?	• Islamic Banks faces some unique and specific risks in performing their operations for using permissible Islamic modes in financing and collecting deposits. Conventional Banks have no risk of Shariah violation but IS Banks have. • IB faces difficulties in investing fund where both general and shariah compliance rules have to mitigate.
2.	Do you think that the risk faced by the Islamic banks in collection of deposits is different from the conventional banks?	• In addition to regular banking risk, IB faces shariah compliance risk which involved shariah compliant optimum return. • Islamic Bank collects deposits in PLS and non-PLS systems. And the risk of loss in PLS method has to be borne by the depositors (Shahibul Maal). Interest or predetermined payment (Riba) beyond the actual amount is prohibited by the Islamic bank. The depositors will be disappointed if they receive, returns on their deposits that are lower than the market rate. This will make the depositors to seek withdrawal of their deposit amount from the bank. On the other hand, the conventional bank collects deposits on the basis of pre-determined rate. Here the depositors do not carry any risk. For this reason, risk faced by the Islamic bank in collection of deposit is different from conventional bank.

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
3.	Do you think that the risk faced by the Islamic banks in investing funds is different from the conventional banks?	• Modes of investment of IBs are different than those of CBs. Islamic Banks uses risk sharing method in investing funds. IB's investment always linked with real asset which also has associated risk but in CB there is no such associated risk of asset. Avoidance of financial transaction in this case is the main risk for IB. Investment products in IB faces some more steps which require more documentations and time. • Islamic banking is less risky than conventional bank for investing under Bai Murabahah, Bai-Muajjal and HPSM method. Because, the investment is disbursed directly against the actual products and services. Conventional banking system does deal with actual product. Moreover, investing in PLS system (Mudarabah & Musharakah) is riskier in Islamic banking than conventional banks.
4.	Do you think that the market risk faced by the Islamic banks is different from the conventional banks?	• IBs deal with asset/commodity which price may be fluctuated. IB has to bear loss incurred from price fall in Shirkat. Restriction of Investment Sector i.e. Gambling, Garar. Islamic Banks invest in shariah based instruments that are less risky. • According to Islamic Shariah- any interest or predetermined payment (Riba) beyond the actual amount is prohibited by the Islamic bank. For example, in a Murabahah contract the mark-up is determined by adding the risk premium to the benchmark rate (usually the LIBOR). Consequently, if the benchmark rate changes, the mark-up rates on these fixed income contracts cannot be adjusted. As a result, Islamic banks face risks arising from movements in market interest rate. Commodity price risk arises as a result of the bank holding commodities or durable assets as in Salam, Ijarah and Mudarabah/Musharakah. All these increase the market risk in IB than CB.
5.	Do you think that the liquidity risk faced by the Islamic banks is different from the conventional banks?	• Islamic Banks have less instruments available to invest that can be converted easily into cash as well as the market for these instruments is limited. Islamic banks have limited scope to invest surplus fund and have a very limited scope to manage stress fund during liquidity scarce. • Islamic banks are prone to facing serious liquidity risks such as First, there are high restrictions on the securitization of the existing assets of Islamic banks, which are predominantly debt in nature. Second, slow development of financial instruments, Islamic banks are also unable to raise funds quickly from the markets. Third, the existing lender of last resort (LLR) facilities are based on interest, therefore Islamic banks cannot/avail benefit from LLR.

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
6.	Do you think that the operational risk faced by the Islamic banks is different from the conventional banks?	• IBs may face Shariah non-compliance risk which is not taken under consideration in CBs. Islamic Banks operate within the ways available to them as per Islamic Shariah. Islamic banks may not have enough qualified professionals (capacity and capability) to conduct the Islamic financial operations. • Because of their unique contractual features and legal environment. Specific aspects and diversity of contract could raise the operational risks of Islamic banks. • Risk of loss arising from a negative perception of the Islamic bank's reputation due to its business practices or conduct, which may unfavorably influence its operations, profitability or shareholder value.
7.	Do you think that there are differences of risk in Islamic banks (IBs) as compared to conventional banks (CBs) in regard to capital adequacy?	• Risk of IB is lower than CB because different type of risk function is not permitted in IB. The specific risk in IB increases the operational risk of the bank but the capital maintained under Pillar-I/Pillar-II (ICAAP) for operational risk is sufficient which decreases overall the capital adequacy requirements. • To maintain adequate capital, when we take initiative to raise capital through sub-ordinated bond or perpetual bond we can sell to any banks or FIs.
8.	Do think that differences in verdicts of Shariah scholar's impact on the risk management of IBs?	• Differences in the interpretations of Shariah rules may result in differences in financial reporting, auditing and accounting treatments. • Compliance with Shariah reduces bank's risks and improves asset quality. Shariah members of the bank may reach in one opinion regarding problems. We can solve this problem by following the verdicts/opinion of Central Shariah Board for Islamic Bank of Bangladesh.
Perceptions regarding risk of Shariah-based banks: Operational risk		
9.	**Related with Human Resources:** Do you face any challenge to recruit manpower having relevant expertise/education? (Because, combination of traditional and Shariah knowledge is essential)	• Shariah Based Banking has both traditional banking along with compliance with shariah rules/guidance. As new joiners who have only exposure in traditional banking find it difficult in working with Islamic Bank. • Manpower risk in Islamic banks is significantly higher than in conventional banks because the staff needs to have knowledge of both Islamic and conventional banks.
10.	Do you face any challenge to develop your manpower by catering proper training? (Because, combination of traditional and Shariah knowledge is essential)	• The sincerity and good intention of the policy makers and management is required with special attention. Shortage of talent is one of the most significant issues facing the Islamic banks. • There is not much program available on this topic. But it is not so big challenge to develop your manpower because of above 90% people are Muslim and they have knowledge in Shariah and we have enough Islamic bankers and Islamic organization

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
		through which proper training can be arranged.
11.	**Related with System**: Do you face any challenge related with Shariah-compliant software (e.g., availability and maintenance)?	• Man behind the machine with policy support as well as Shariah knowledgeable IT Man are required to mitigate software challenge. Beside this, Shariah-compliant software is cry need for further development. In Bangladesh few software companies offer wide range of software solutions to Islamic banks and Islamic financial institutions in order to tackle all their operational requirements.
12.	**Related with Process:** Do you face any challenge related with Shariah-compliant process of operations due to lack of knowledge and market pressure?	• Recruiting manpower having relevant expertise/education and proper Shariah orientation/training may reduce the challenge. Existing software may include Shariah-compliant mode. • Software needs re-engineering with the help of skilled manpower with adequate Shariah knowledge on banking and IT.
13.	Do you face any challenge related with Shariah-compliant process of operations due to Business motives of the banks' owners ignoring Shariah?	• No persuasion from owners. They are interested in complying Shariah. Bank Management are always emphasis to maintain shariah compliant process of operations by strong Shariah board and Shariah audit. • Shariah governance may be strengthened and regulators /licensing authority may increase surveillance to keep the bank in right track.
14.	Do you face any challenge related with Shariah-compliant process of operations due to unavailability of competent Shariah scholars and their role in Shariah Supervisory Committee?	• Some of SSC members are not capable to catch the point. Appointing competent Shariah scholars and their role in Shariah Supervisory Committee. Inclusion of Islamic Banking and finance subject in academic level, Strengthening R&D by the IBs, arrangement of high voltage training for the members of SSC, giving proper honorarium and other supports to the scholars for giving sufficient times in studying the issues before giving opinion.
15.	Do you think that cost of operation is higher in IB as compared to CB due to additional cost for ensuring Shariah governance and monitoring?	• If IBs comply Shariah principles in their all activities, non-performing asset will be reduced and recovery related cost will be saved resulted increase of profitability. • For ensuring Shariah governance and monitoring cost of operation is little bit higher in IB. However, the impact of this cost is very negligible in Banks' total operating cost. On the contrary, it helps to create good image of the Bank as a Shariah-compliant IB to the stake holders. Eventually IBs are benefitted by this cost.
16.	**Related with External Event:** Do you face any challenge related with external event in case of Mudarahah and Musharakah investment due to legal framework, accounting system and ethical values of the counterparty?	• Clients are acquainted with Mudarabah and Musharakah. Moreover, non-shariah based system of the country, absence of IB Act & clients are not habituate. • Mass awareness, commitment and Taqwa feelings of the clients, regulatory initiatives may minimize this challenge. Legal framework, accounting system and

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
		ethical values of the counterparty, etc. need to be restructured. • Highly ethical value is necessary for investment under Mudarabah and Musharakah investment. So legal framework, like a separate 'Bank Company Act' for IB's, which defines rights & obligations for each party (Bank & Client) may act as a remedy for ethical deficiency.
17.	Do you face the underlying asset's ownership risks in Murabahah contract?	• Usually, Bank do not stock its goods for the purpose of sell to the client. Bank establishes ownership on underlying assets by purchasing goods as per quotation of the client. Ultimate aim to sell those goods by adding profit to the client. It reveals that some companies do not want to make voucher in the name of Bank. Because they sell their goods to their dealers or distributors only. So, in this case, if any dealer wants to avail Murabahah facility from IB then establishment of ownership becomes difficult. Govt. may enact a law in this regard through its concerned Ministry. • Underlying asset's ownership should be always with asset owner. Shariah motivated manpower and client's commitment for complying Shariah may solve the problem.
18.	Do you face the underlying asset's ownership risks in Salam contract?	• Theoretically, its answer is 'Yes'. But in reality, IBs arrange Parallel Salam against a Salam to minimize the ownership risk. • In the context of our country Bai-Salam mode of financing used in agricultural sector. Usually, farmers do not have enough facility to maintain separate go-down for Bank. So, it is difficult to identify the goods purchased by the Bank under specific Salam contract.
19.	Do you face the underlying asset's ownership risks in Istisna'a contract?	• In the context of our country Istisna'a contract is mainly done for pre-shipment finance in RMG sector. They stock their own products with Bank's product under Istisna'a contract in the same go-down. In this case, it is difficult to identify the goods under specific Istisna'a contract.
20.	Do you face the underlying asset's ownership risks in Ijarah contract?	• In true sense, an Ijarah asset may be damaged without any misconduct or negligence of lessee. Further, an Ijarah asset may be damaged by force majeure. In these cases, IBs supposed to face ownership risk and Proper Insurance coverage (which is supposed to bear by IBs) may be arranged to compensate the loss. • Risk that is default occurs, the bank has to re-rent or dispose the asset /property in open market at lower price than agreed. Also, if clients decide not to take ownership of the asset/property at the end of the period, risk is that market price is lower than the book value. Market risk is partly mitigated by the value of

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
		asset/property and advance payment.
Perceptions regarding risk management of Shariah-based banks: Deposit		
21.	Do you face any challenge to collect deposits under the Mudarabah principle? (The conventional banks offer fixed and positive return in deposit collection, whereas the Mudarabah principle is a profit sharing and loss bearing contract.)	• Religiously motivated people want to avoid interest. Mentionable, interest/usury is prohibited/discouraged in major religions of the world. In our country majority people are muslim and they believe that keeping money in Islamic banks is safe and interest free. • Due to the prevalence of income sharing Mudarabah instead of net profit Mudarabah and the practice of provisional profit method, the practice of Mudarabah system do not arise any problem. As in most of the cases Islamic Banks (IB) pay profit as per initial provisional profit rate. • In addition to regular banking risk, IB faces shariah compliance risk which involved shariah compliant optimum return.
22.	Do you face any challenge related with displaced commercial risk as there is a variable rate of return on deposit unlike conventional banks?	• In our country most of the people are Islamic minded. Normally religiously motivated depositors of IBs do not switch over to the CBs for more gain with few exceptions. • All Islamic Bank (IB) initiate their relationship with customer through a contract and always try to educate customer of the impact of this contract. Although some IBs have experienced outrageous reaction when bank have paid lower amount of profit than initial provisional rate. • Vary on rate of return on deposit in Islamic Bank. In Bai & Ijarah mode the rate of returns is fixed.
23.	Do you face any challenge related with Shariah non-compliance risk in the area of marketing (e.g., double benefit scheme)? (Because, the mode is profit sharing but loss bearing)	• We do calculate final rate at the end of each year. After that we adjust additional profit or extra profit in the form of Ehsan. • Strengthening Shariah governance especially strong supervision of SSC may solve the problem. From true shariah perspective, it has been difficult to offer a fixed rate of return over the years. There are no guaranteed returns for depositors. But if we follow the shariah rules then there will be no loss in the bank.
24.	Do you face any challenge related with Shariah non-compliance risk in regard to operation (e.g., capital/profit guarantee)? (Because, capital/profit may not be guaranteed)	• In IB's, capital/profit is not guaranteed. Islamic Banks manages Shariah non-compliance risk in regard to operation at their own discretion. • Capital providers are well informed about Shariah Banking risk. But clients usually want a guarantee of profit and for this sometimes IBs faces negative reaction from customer as IBs operate in conventional environment as well as it is difficult to educate customer on Mudarabah principal. Publicity should be increased to enrich their ideas about Islamic banking.

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
25.	Do you face any challenge related with Shariah non-compliance risk in regard to profit calculation/distribution (e.g., lack of transparency)	• The profit distribution ratio is mentioned in the account opening form. Actual profits are distributed annually and customers willingly accept ISR. • Most of the IBs don't adhere to stringent Shariah principle and transparency. Profit calculation in IBs is some extent complicated compared to CBs. Deep Study/research may be conducted to device easily understandable method.
26.	Do you think that IB enjoy competitive advantages related with cost of fund as deposit collected under Mudarabah principle?	• Very few IBs enjoy competitive advantage as most of the IBs operational procedure and other scenario are as like as conventional commercial banks. But it is one of the beauty and unique characteristics of the IBs and key reason of sustainability of the Islamic banking system. • Generally, Mudarabah depositors are not price sensitive. Because the profit is given to the fund provider according to the rational profit distribution ratio. IB's declare a provisional rate not fixed rate.
Perceptions regarding risk management of Shariah-based banks: Credit (Investment)		
27.	Do you think that the counterparty risk of Islamic banks increases in comparison to conventional banks due to not charging any additional amount in the cases of default?	• We can charge an additional amount in case of willful defaulters or can convert their mortgage/collateral into liquid money. Because according to various Islamic scholars we get to know that-we can obviously charge an additional amount to defaulters who willfully did not pay back the investment amount after proper surveillance of that defaulter. • Compliance of Shariah principles and asset backed finance reduce the counterparty risk. Besides, charging this compensation along with a strong and effective monitoring system minimize the risk.
28.	Do you think the compensation (i.e., penalty) charge is an effective risk management technique for the Islamic banks?	• This is only for willful defaulters. Because this charge helps to decrease the risk of the bank and also help to stop the practice of being defaulter willfully in Islamic Banking sector. • Compensation is not the effective solution. Because it is to spent charity. But overdue culture will be reduced if compensation charged. Besides, the law should be enacted to stop willful defaulters and increase investments in PLS system.
29.	Do you think that the Shariah requirement of not imposing the compensation (i.e., penalty) charge on an insolvent or incapable customer places Islamic bank in a disadvantageous position in comparison to conventional banks in credit risk management?	• Waiver of penalty in case of insolvent clients is a beauty of IBs. Shariah compliance or extending hand of 'Ihsan' upon the insolvent clients may cause of 'Barakah' for IBs. • Regarding this issue, Islamic banks can reduce their corporate tax rates. Giving an amount from their CSR fund, providing them with various entrepreneurial knowledge, training, of course giving priority to shariah requirement.
30.	Do you face any challenge in managing the counterparty risk because there is no	• Islamic Insurance is available in Bangladesh to secure the Investment.

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
	Islamic credit insurance service provider in Bangladesh?	• As Islamic Banking is getting popular in our country, Islamic investment insurance company may be introduced by the concerned body.
31.	Do you think that there is a less possibility of default in Islamic banking because all investments are linked with real economy and asset-backed?	• Asset backed investment may be a safeguard of the IBs' money and if Shariah compliance is ensured along with good governance, there would be less scope of diverting the Banks' fund in the unproductive sectors. • All investments are linked with real economy and asset backed and bankers strongly monitoring the loan from the beginning and that's why loans are rarely defaulted. Islamic Banking will remain strong as long as this scenario sustains.
32.	Do you think that there is a difference in concentration risk of Islamic banks as compared to conventional banks?	• Islamic banking system encourages to diversify the assets and to achieve Maqasid al-Shariah by distributing asset among the underprivileged people of the society. • In IB concentration risk is little bit lower than CB. Because as per Maqasid al-Shariah, IBs should distribute their investment fund across the segments of the society. Moreover, underline asset movement remove the concentration risk of Islamic Banks.
Perceptions regarding risk management of Shariah-based banks: Market		
33.	Do you think that the displaced commercial risk is a relevant risk for Islamic banks in Bangladesh? (Displaced commercial risk refers to the risk of losing deposit customers by Islamic banks due to providing lower than the expected profit or Market rate.)	• As very few IBs paid profit as per Mudarabh with weightage mechanism. Rather most of the banks like to give profit as per their initial offering. Some cases, if necessary, even they provide excess profit amount than the true Mudarabh weightage calculation under the principle of Ehsan. • Islamic funds are available in the market with a little effort with higher profit rate and deposit are increasing day by day. If Islamic Banking volume increased then displaced commercial risk will be reduced.
34.	Do you face any challenge related with rate of return on deposit due to different mechanism of profit calculation (e.g., ISR or Weightage method)?	• Most of the depositors are in the dark regarding profit calculation method of IBs. Different mechanism of profit calculation imposed in some of deposit mode for extra attraction like Hajj deposit, pension deposit, etc. For this, Bank has maintained feature CBS for solve it. • These two methods have different calculation mechanism. Though ISR is more shariah compliant mode but most of the Islamic Banks have been practicing weightage method.
35.	Do you face any challenge related with commodity price in case of Murabahah (possibility of change in price before delivery to customer)?	• As practice of our country, it is said that the IBs delivered the goods to the clients at supplier's premises. So, the goods are transferred from supplier control to the client's control without delay. Therefore, fluctuation of the price cannot affect the IBs. • The commodity is owned by the bank for a very short

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
		time. As all the transactions happened within very short span of time in Murabahah mode, there is negligible impact on price fluctuation of commodity. • The Shariah contract applied for Murabahah via Commodity Murabahah arrangement. It is a method of sale with a mark-up price whereby the Customer makes payment over an agreed period of time. The underlying asset for the sale transaction between the Customer and the Bank will be a specific tradable Shariah-compliant commodity.
36.	Do you face any challenge related with commodity price in case of Salam & Istisna'a (possibility of change in price after getting delivery from customer but before selling to others)?	• General Bai Salam is not in practice in our country except in case of export sectors where this challenge is rarely found. Most of the Islamic banks go through under a parallel Salam or Istisn'a at same time. • Though the commodity is owned by the bank for a very short time, market price of commodity should be observed carefully before disbursement as well as keeping proper cushion and educating the stakeholders.
37.	Do you face any challenge related with commodity price in case of Ijarah (possibility of change in price of the Ijarah asset at the end of the period)?	• In Ijarah/ HPSM assets is sold to the client at the purchase price and most of the Islamic banks are practicing hire purchase under Shirkatul Melk (HPSM) rather than pure Ijarah, where ownership is transferred gradually to the customer. Therefore, salvage value of the asset at the end of Ijarah period does not create any challenge on IBs. The Hirer may acquire the full title of the Hire's portion of the asset on payment of the total price at the end of the Ijarah period.
38.	Do you face any challenge related with currency price due to lack of Islamic derivatives?	• The risk can be minimized by a clause in the contract showing an agreement between the two parties that a certain level of price fluctuation will be acceptable, but beyond that point the gaining party shall compensate the party which is adversely affected by the price movements. Moreover, innovation and use of Shariah-compliant derivatives should be formulated and increased along with alternate Islamic Financial Instrument may be introduced. • Islamic banks, similar to conventional banks, face credit risk, liquidity risk, profit-rate risk and currency risks, among others. Conventional banks use derivatives to hedge their exposures against interest-rate risk and currency risk, in addition to offering their customers derivative products. However Islamic banks do not use derivatives, and most of that use it in a limited capacity, constraining it to instruments like profit-rate swaps and Islamic-currency forward contracts.

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
39.	Do you think that there is a difference in equity risk of IB as compared to CB because there is lack of Shariah-compliant sufficient equity instruments?	• It is an inherent strategic disadvantage compared to conventional counterparts. Islamic banks have to sacrifice business opportunity as they can only deal foreign currency against real need. • IBs earn very little from BGIIB compared to T-Bond & T.Bill. Islamic money market area should be enhanced and Shariah-compliant instruments should be increased.
40.	Do you face the additional risks in comparison to conventional banks due to the lack of Islamic hedging instruments?	• It is also an inherent strategic disadvantage compared to conventional counterparts. Shariah-compliant instruments should be introduced widely and more equity instruments are needed for Islamic Market.
Perceptions regarding risk management of Shariah-based banks: Liquidity		
41.	Do you face any challenge related with liquidity due to lack of sufficient attractive instruments unlike CB?	• Collecting liquidity (deposit) is not problem at all for IBs. Because IBs' deposit products are sufficient compared to CBs. Besides Halal features added an extra attraction to the deposit products of IBs. • Sometimes IB's face challenge to manage their liquidity with so little alternatives unlike their counterparts. Some IBs manage it through Mudarabah Special Notice Deposit (MSND) account with other Islamic banks/ windows or branches and sometime manage to borrow from Bangladesh Government Islamic Investment Bond (BGIIB). But IB's earn nominal profit from BGIIB and our funds stay idle. Issuance of tradable Shariah Compliant instruments by the Govt. and repo/reverse repo options against Sukuk/bond.
42.	Do you face any challenge related with liquidity due to lack of tradability of all instruments unlike CB?	• As there is no or scanty market structure of Islamic banks like their conventional counterparts, IBs have to maintain excess liquidity by sacrificing cost and opportunity. • Islamic money market needs to expand. May be issued different tenor Sukuk with attractive profit rate and developed unique & electronic trading platform. Opening repo/reverse repo/ withdrawal facility against Sukuk. Allowing ALS/ELS facility against Sukuk/bond investment by Islamic Banks.
43.	Do you face any challenge related with liquidity due to lack of sufficient secondary market instruments unlike CB?	• The avenues to invest IBs' idle fund is limited compare to CBs which creates risk of liquidity management for IBs. As there is no or scanty market structure of Islamic banks like their conventional counterparts, IBs have to maintain excess liquidity by sacrificing cost and opportunity, in absence of secondary market instruments. Shariah-based instrument in secondary market is very few. For this BGIIB and Sukuk are not vibrant. • Sufficient secondary market instruments should be increased. May be listed in the Capital Market. Issue of long-term high yield bond/Sukuk from

General perceptions regarding risk of Shariah-based banks and conventional banks		
S/n	**Aspects**	**Response**
		government and tradable featured bond/Sukuk issuance.
44.	Do you face any challenge related with liquidity due to low return of the instruments unlike CB?	• As there is no or scanty market structure of Islamic banks like their conventional counterparts, IBs have to maintain excess liquidity by sacrificing cost and opportunity. Lately Bangladesh Government has introduced is Ijarah SUKUK which has given Islamic banks to explore some investable options though these instruments' price is significantly lower than same tenured conventional bonds which ultimately create hinder to make level playing field. • Research as well as regulatory initiatives to develop appropriate liquidity management instrument and nourish secondary market for IBs. May be issued different tenor & rated Shariah-based Instruments. Unless and until the Islamic money market increased this problem will not be solved.
Capital adequacy requirements		
45.	Do you think that the capital adequacy requirements for Islamic banks should be different from the conventional bank?	• Shariah principles are different from the conventional banking policy. Most Islamic Banking investment are asset backed. In case of calculation of RWA against operational risk of IBs should be different because there is Shariah non-compliance risk in IBs. So, the capital adequacy requirements should be different. • Islamic bank has an equity-based capital structure, dominated by shareholders' equity and investment deposits based on profit and loss sharing [PLS]. There is no need for capital adequacy regulations if the Islamic banks are structured as pure PLS-based organizations.
46.	Do you think that the Shariah non-compliance risk must be considered in determining the capital adequacy requirements for Islamic banks?	• An option of charging capital based on average doubtful income of last three years or any relevant factor should be included under Pillar-2 (ICAAP). • For better shariah practice, Shariah non-compliance risk should be considered in determining the capital adequacy requirements. Regulatory initiatives are required to be taken in this regard.

Appendix B

Additional Issues of Risk Management of Islamic Banks in Bangladesh

S/n	Problems	Suggestions
1.	Lack of Islamic banking knowledge of depositors, borrowers and employees.	To create awareness and proper train up about the Islamic Banking by advertising, distribution of leaflet among the customer.
2.	There is no uniform Shariah Auditing system in the IBs of Bangladesh.	Regulatory role is necessary to ensure uniform Shariah Auditing system in the IBs of Bangladesh.
3.	There is no Shariah Non-compliance Risk Management Guidelines in IBs.	Every IB should Shariah Non-compliance Risk Management Guidelines in light of BRPD 3/2016.
4.	Underdeveloped money market and govt securities based on profit loss sharing.	There is a need to establish a systematic Islamic money market for Islamic financial institutions.
5.	Weightage of the assets.	A system can be introduced for risk weighting of all the assets of the Islamic Bank separately with internationally accepted practices.
6.	Treasury management challenge	Strengthening Shariah-compliant Islami Bond market.
7.	Reluctance to comply Shariah	Buildup of Shariah awareness among all stakeholders.
8.	Islamic Banking Windows within a conventional banking branch create competition between them to some extent.	Co-operation of mother branch can mitigate the problem.
9.	Commitment Limitation	Various limitations for banking operation set by the Bangladesh Bank should be relaxed in case of Islamic Bank. So that it can reduce the potentiality of moral hazard in the PLS modes, by helping the banks to have adequate amount of their own capital at risk.
10.	Investment Risk	An improvement in the institutional infrastructures and a refinement of the Islamic banking products can be instrumental in enhancing the collateral quality and reducing credit risks.

Chapter 12: Operational Risk Management in Islamic Banks: Best Practices and Evaluation

Based on the study "Operational Risk Management in Islamic Banks: Best Practices and Evaluation" by Md. Mahabbat Hossain, Md. Alamgir, Md. Rabiul Karim, Md. Atiqur Rahman Khan Khadem and Md. Emon Arefin.

12.1 Introduction

12.1.1 Background of the Study

Operational risk management (ORM) has become a crucial pillar of risk governance. The Basel Committee on Banking Supervision (BCBS) defines operational risk as the risk of loss from inadequate or failed internal processes, people and systems or from external events (Jayahama, 2005; Habib et al., 2025), including legal risk but excluding strategic and reputational risk (FDIC, 2023; IFSB 2021). Rapid technological change, regulatory pressure and complexity make resilient frameworks essential (KPMG, 2022).

Islamic banks face these risks — process failures, cyber events, fraud, system outages and human error — and more, since they must integrate Islamic law (Shariah) compliance into all operations, and violations bring reputational damage and regulatory sanctions as well as financial loss. Contracts such as cost-plus sale (Murabahah), profit-sharing partnership (Mudarabah), partnership (Musharakah) and lease (Ijarah) add documentation, interpretational and Shariah non-compliance risks (Reyazat, 2012), so controls must align with Shariah governance as well as with sound risk principles.

The Islamic Financial Services Board (IFSB)'s Guiding Principles of Risk Management (IFSB-1, 2005) address operational, Shariah and compliance risks, requiring a risk management architecture consistent with each institution's business model and Shariah obligations, and complement the Basel framework so that Islamic banks can adapt global rules to their faith-based requirements (IFSB-23, 2021).

In Bangladesh, Islamic banks must meet both Bangladesh Bank's risk and capital regulations and Islamic jurisprudential norms, and prior studies note measurement challenges, a lack of standardized disclosure and weak integration between Shariah governance bodies and risk units (Shakhatreh, Biancone & Radwan, 2016). This study therefore explores ORM in Islamic banks — identifying best practices, evaluating existing frameworks in Bangladesh and proposing context-sensitive recommendations — to help them strengthen their operational resilience within Shariah boundaries.

The BCBS formulated ORM in response to wide operational ambiguities (Ahmed, 2010), and banks now hold capital against operational as well as credit and market risk. Islamic banks, with their Shariah principles, unique contracts and governance structure, are more exposed. The IFSB's capital and risk framework treats Shariah non-compliance as operational risk (Archer & Karim, 2007), and regulators in Malaysia, Pakistan and Indonesia have adopted Basel/IFSB standards. Distinctive sources include errors in contract design, more complex

mechanisms and additional approval steps (Hasan, 2019). ORM uses qualitative methods (risk assessment, key risk indicators and staff training) and quantitative methods (as prescribed by the IFSB and Basel), backed by strong internal control and compliance to detect regulatory and Shariah violations. Larger banks disclose operational risk more fully than small Islamic banks, and cyber-attacks, system failures and natural calamities have added new forms of risk (Ali, 2021).

Yet operational risk in Islamic banks has received far less scholarly attention than credit and market risk (Noman et al., 2020), perhaps because of the complexity of its origins — a gap this study addresses for Bangladesh.

In conventional banks, robust ORM enhances stability and market confidence. Operational risk, once regarded as residual, is now central to enterprise risk frameworks that integrate loss databases, risk and control self-assessments and key risk indicators (Pakhchanyan, 2016; Ferreira, Nunes & Pereira, 2019). Studies in Europe, the Middle East and Asia confirm a shift towards data-driven, technology-enabled assessment under the revised Basel III standards (Cornwell et al., 2023; Jadwani, 2024).

Hassan (2016) links Shariah non-compliance arising from errors in documentation or execution intrinsically with operational risk, whereas Archer and Karim (2009) and Al-Musheifri (2021) argue that it should be a distinct risk, since its ethical and legal implications affect investor confidence and systemic reputation. The IFSB treats it as operational risk, but some national regulations address it separately (Ahmed, 2009).

Internationally, Malaysian Islamic banks integrate Shariah governance with operational risk through dual reporting lines between the risk unit and the Shariah board (Hassan, 2011); in the Gulf Cooperation Council (GCC), board oversight and Shariah audits mitigate operational and compliance risks (Neifar & Jarboui, 2018); and in Pakistan and Indonesia, non-standardized documentation and Information Technology (IT) infrastructure contribute to process losses (Masood & Javaria, 2018). Effective ORM thus requires integrating internal controls with Shariah governance.

In Bangladesh, ORM in Islamic banks is still evolving. Bangladesh Bank's Risk Management Guidelines (2018) prescribe comprehensive internal controls, but there is no standalone directive on operational risk for Islamic banks, and most banks follow conventional ORM templates with little Shariah perspective (Habib et al., 2025). Documentation errors, product mis-structuring and manual contract execution are the most frequent lapses (Makiyan, 2009).

12.1.2 Objectives of the Study

As Islamic banks expand within Bangladesh's dual banking system, understanding how they identify, assess and mitigate operational risks is essential to their stability and Shariah compliance. The study evaluates their ORM governance, frameworks and practices and the issues affecting their effectiveness; its specific objectives are:

a. to evaluate the operational risk management frameworks adopted by Islamic banks in Bangladesh;
b. to identify and analyze the key challenges Islamic banks encounter in managing operational risks in comparison with conventional banks;

c. to examine the roles and responsibilities of various stakeholders in mitigating operational risks within Islamic banks; and
d. to develop practical recommendations for strengthening ORM in Islamic banks to ensure both Shariah compliance and institutional sustainability.

12.1.3 Methodology of the Study

The study extends BIBM's earlier research on 'Governance and Practices of Operational Risk Management in Banks', drawing on its findings (Habib et al., 2025) for continuity and comparability between the conventional and Islamic contexts. It uses mixed methods, including content analysis of Bangladesh Bank regulations and of IFSB and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) standards.

Primary data came from FGDs and Key Informant Interviews (KIIs) with officials of Bangladesh Bank's Islamic Banking Regulations and Policy Department (IBRPD), representatives of banks' Internal Control and Compliance Divisions (ICCD), internal Shariah auditors, senior managers of Islamic banks and Shariah Supervisory Committee (SSC) members. Secondary data came from the annual reports and websites of Islamic banks and Bangladesh Bank, and from the websites and reports of foreign central and commercial banks for international comparison.

12.2 Conceptual and Theoretical Framework

12.2.1 Concept of Risk (Mukhatarah) and Risk Management

In Islamic finance, the concept of risk derives from the Qur'an and the Sunnah. Mukhatarah (مخاطرة) means exposure to danger or uncertainty, but whereas conventional finance seeks to minimize risk to maximize profit, Islamic finance treats risk as a natural and necessary part of trade and wealth creation: under the maxim "Profit comes with liability" (Al-Kharaj bi al-Daman, Ibn Majah), no one should gain without bearing responsibility for possible loss. Islam nevertheless distinguishes excessive uncertainty (Gharar) from Mukhatarah. Gharar is excessive uncertainty in the basic terms of a contract, such as the subject matter, price or delivery, and is prohibited because it invites deception and dispute. Mukhatarah is the normal business risk that a project may fail or an asset lose value, and it is permitted when both parties understand and accept it (Ayub, 2007).

The higher objectives of Islamic law (Maqasid al-Shariah) — the protection of faith (Din), life (Nafs), intellect (Aql), family (Nasl) and wealth (Mal) — guide all Islamic economic activity. The protection of wealth from injustice, loss and misuse is the objective most closely related to risk management (Chapra, 2008).

From these principles, Islamic finance applies the following ways to manage risk:

Risk Management Strategies	Objectives
Avoid Prohibited Risk (Gharar and Maysir)	Islam prohibits transactions involving excessive uncertainty and gambling. These are unfair and lead to unearned profit.
Transfer of Risk through Permitted Contracts	Certain Islamic contracts allow sharing or transfer of risk. For example, in a Salam contract, the seller faces production risk, and

Risk Management Strategies	Objectives
	the buyer faces delivery risk. In Ijarah (leasing), the owner carries the ownership risk, and the user carries the usage risk.
Reduce Risk with collateral (Rahn)	Using collateral or a pledge helps reduce credit risk and ensures repayment.
Share Risk through Partnership Contracts	In Musharakah, both parties share profits and bear losses in proportion to their capital. In Mudarabah, the investor provides the money and the entrepreneur provides effort and management, so profit is shared in an agreed ratio while a financial loss falls on the investor, the entrepreneur losing his effort, unless the loss arises from his negligence, misconduct or breach of contract.

Source: Iqbal & Mirakhor (2011).

Thus, Islamic risk management is not only a technical task. It is a moral and religious duty that ensures fairness, trust, and stability in financial activities.

12.2.2 Shariah Viewpoints on Risk (Mukhāṭarah) and Risk Management

Contemporary scholars hold that risk management is permissible and necessary in Shariah, since it protects wealth (Hifẓ al-mal) and contractual fairness. Qur'an 2:282 requires debts to be documented, recorded by a just scribe and witnessed. The Prophet (ﷺ) advised a man to "tie your camel and then rely on Allah" (Jami al-Tirmidhi, no. 2517), showing that reliance on Allah (Tawakkul) must be accompanied by precaution. The legal maxims Al-ghunm bil-ghurm and Al-kharaj bi al-ḍaman tie profit to the bearing of liability, so that profit is legitimate only where real business risk is borne.

The Qur'an treats uncertainty as intrinsic to life, since only Allah knows the future (31:34), and it gives examples of prudence. Prophet Yaqub (AS) advised his sons to enter Egypt by different gates (12:67), an early form of diversification combined with Tawakkul. Prophet Yusuf (AS) advised storing grain in years of plenty against future famine (12:46–49), a model of forward-looking contingency planning. The prohibition of the unjust consumption of wealth (4:29) underlies the rejection of exploitative, deceptive or speculative risk structures.

The Sunnah reinforces disciplined risk-taking. The instruction to invest orphans' wealth so that obligatory alms (Zakat) does not erode it requires prudent action against certain loss. The Mudarabah conditions set by Abbas ibn Abd al-Muṭṭalib (RA), who forbade his agent to cross the sea or use hazardous routes and was later approved by the Prophet (SAW), illustrate early risk allocation and operational limits. Classical jurists such as Ibn Taymiyyah and Ibn al-Qayyim distinguished productive commercial risk from prohibited risk associated with gambling (Maysir) and excessive uncertainty (Gharar faḥish), a distinction that underpins modern Islamic finance.

From the perspective of Maqaṣid al-Shariah, risk management protects stakeholders from unjust loss and promotes stability. Risk in Islamic finance can thus be grouped as (i) permissible risk, inherent in legitimate commercial activity. (ii) prohibited risk, arising from unjust, speculative or exploitative practices, and (iii) tolerable but avoidable risk, to be minimized through documentation, Shariah-based controls, Islamic insurance (Takaful) and sound governance. These principles form the conceptual basis for integrating Shariah governance with operational risk management in Islamic banks.

12.2.3 Theoretical Foundations of Operational Risk in Islamic Finance

The Basel Committee on Banking Supervision (BCBS, 2011) defines operational risk as the risk of loss from inadequate or failed internal processes, people and systems or from external events. The Islamic Financial Services Board (IFSB, 2021) adds legal, cyber and Shariah non-compliance risks, while excluding strategic and reputational risk.

Islamic banks face operational risks beyond those of conventional banks, the most significant being Shariah non-compliance risk — loss from failure to adhere to Shariah rules and principles (IFSB, 2005), which can bring penalties, reputational damage and income purification. Multi-step contracts such as Murabahah, Mudarabah and Ijarah increase exposure to human and procedural error, as do divergent Shariah interpretations and a shortage of staff with both banking and Shariah expertise. Banks mitigate these risks through internal controls, Shariah audit, automated compliance checks in core banking systems, staff training, process audits and risk registers.

Operational risk in Islamic banking can be understood through agency theory, stakeholder theory and the nature of Islamic contracts.

Agency Theory and Information Asymmetry

Under agency theory, the two-tier Mudarabah structure complicates the principal–agent relationship: depositors are principals and the bank their agent (Mudarib), while the bank in turn provides funds to entrepreneurs. This layering can create moral hazard and adverse selection — the bank may favor shareholders over depositors or fail to appraise projects properly (Sundararajan & Errico, 2002).

Stakeholder Theory and Responsibility

Stakeholder theory emphasizes that Islamic banks are responsible to depositors as well as shareholders, so internal failures that lead to Shariah violations damage both reputation and trust. Reputational damage is therefore a principal consequence of operational risk events in Islamic banks, although reputational risk itself is treated as a separate category under the Basel and IFSB definitions adopted in this chapter (Grais & Pellegrini, 2006).

Nature of Islamic Contracts

Each contract also carries its own operational risks. Mudarabah and Musharakah are exposed to incorrect profit calculation and weak monitoring. Murabahah is exposed to failure to take real ownership and to documentation errors, a common source of Shariah non-compliance. Hire Purchase under Shirkatul Melk (HPSM) and Ijarah are exposed to poor maintenance and lease-calculation errors, and Salam and Istisna'a to late or non-conforming delivery. Operational risk in Islamic banks is therefore wider and more complex than in conventional banks.

12.2.4 Key Operational Risk Categories in Islamic Banks

Islamic banks face the Basel and IFSB (2005) operational risk categories, shaped by Shariah requirements. Internal fraud covers bypassing contract procedures, embezzlement and manipulating profit-sharing calculations, while external fraud covers cyberattacks, forgery, theft and manipulation of records by a partner. Employment and workplace risks form a third

category. Client, product and business-practice risks include Shariah non-compliance, such as failing to take ownership in a Murabahah; fiduciary breaches, such as commingling clients' and shareholders' funds; and mis-selling and documentation errors in Islamic investment certificates (Sukuk). The remaining categories are system failures and process failures, such as not insuring leased assets or registering ownership. Managing them requires conventional controls, such as internal audit and IT safeguards, together with Shariah controls embedded in the Shariah Governance Framework.

12.2.5 Relationship between Operational Risk and Shariah Risk

Operational risk in Islamic banks — makhāṭir al-tashghīl fī al-maṣārif al-Islāmiyyah, the risks arising from the functioning of the bank (Wehr, 1994) — falls into the same broad categories as in conventional banks, with additional exposures arising from Shariah governance, contract structures and the role of depositors. It is closely linked to Shariah risk, which the IFSB (2005) defines as the possibility of failing to comply with Shariah rules and principles: most Shariah breaches stem from process, human or system failures, making Shariah risk largely a subset of operational risk.

A single lapse, such as failing to take ownership in a Murabahah, can invalidate a transaction, causing financial loss, contract cancellation and loss of public trust (Hasan, 2011). Because Shariah risk permeates every function, from product structuring to reporting, a robust Shariah Governance Framework is required (BNM, 2019), and differing scholarly interpretations (Ikhtilaf) add complexity for international banks. Operational and Shariah risks are thus mutually reinforcing, and risk management must integrate operational safeguards with strong Shariah oversight.

12.2.6 Interdependencies of Operational Risk with Major Risks in Banking

Operational risk is intertwined with other banking risks. Weak controls can lead to poor credit assessment and defaults, while large defaults can strain operations through disputes, documentation backlogs and system overloads (Kelliher et al., 2020). Failures in monitoring or valuation systems can cause market losses, as at Barings Bank, and extreme volatility can expose operational weaknesses (FDIC, 2006). Fraud, cyberattacks or outages can erode depositor confidence and create liquidity stress (BCBS, 2008), and data breaches or ethical lapses damage reputation and amplify credit, market and liquidity risks (Management Solutions, 2021). Many compliance breaches — regulatory penalties, anti-money laundering violations and reporting errors — arise from control failures, making compliance risk effectively a subset of operational risk (IMF, 2023). Operational risk management (ORM) is thus a vital part of enterprise risk management (ERM), supplying key risk indicators, scenario analysis, self-assessments and loss data that strengthen resilience and risk-based decision-making.

12.2.7 Basic Features of Operational Risk in Banks

Operational risk has four defining features (Lu Jin, 2024). It is complex and hard to separate from credit and market risk, since a breakdown in credit processes or valuation systems produces losses across categories. It is broad and multidimensional, arising from human error,

control failures, IT disruption and external shocks such as natural disasters or cyber incidents, with a scope that varies with an institution's size, complexity and technology. It is unpredictable and dynamic, originating in any business unit and shaped by management quality, culture and governance, so that static models become inadequate as digital platforms and outsourcing grow. And it stems largely from human factors — lapses of judgment, misconduct or negligence — which can be mitigated through training, a culture of accountability, robust controls, automation and process redesign.

12.2.8 Calculation of Capital Requirement for Operational Risk under Basel

Adequate capital is key to absorbing losses, and the Basel framework provides the following methods for estimating the capital requirement for operational risk.

Basic Indicator Approach

Capital Requirement = 15% × Average Annual Gross Income (over the last 3 years)

Standardized Approach

Capital = sum of capital charges for each business line [Gross income of each business line; Assigned factor (12–18)% per business line]

Advanced Measurement Approach

Internal models based on: (i) Internal loss data; (ii) External data; (iii) Scenario analysis; (iv) Business environment and internal control factors, subject to supervisory approval.

Bangladesh Bank Guidelines

Under Bangladesh Bank's Guidelines on Risk Based Capital Adequacy (Revised Regulatory Capital Framework for Banks in line with Basel III, 2014), the operational risk capital charge follows Basel methodologies, with two permissible approaches: the Basic Indicator Approach (BIA) and the Standardized Approach (TSA). These are domestic requirements: the Basel Committee itself replaced the Basic Indicator, Standardized and Advanced Measurement Approaches with a single standardized approach, built on the Business Indicator, the Business Indicator Component and the Internal Loss Multiplier, with effect from 1 January 2023. Banks are encouraged to migrate to more sophisticated approaches as their systems and data mature, and may not revert to a simpler approach without supervisory approval. Conversely, Bangladesh Bank may require a bank that no longer meets the eligibility conditions — for example, because of weak loss data, governance or methodology — to return temporarily to a simpler approach until it demonstrates full compliance.

12.3 Regulatory and Institutional Framework

Operational risk cannot be addressed by a single, uniform solution. As a core pillar of enterprise risk management, it often triggers other risks and arises in every part of a bank, so poor management can undermine credibility and public confidence. International standard-setters and regulators have accordingly issued comprehensive standards to strengthen operational risk governance and resilience.

12.3.1 Guiding Framework for ORM in Banks: International

Basel Principles for ORM in Banks

In 2021, the BCBS revised its Principles for the Sound Management of Operational Risk (PSMOR) to close implementation gaps and address emerging risks. The 12 principles, to be applied in proportion to a bank's size, complexity and risk profile, cover governance, the operational risk management framework (ORMF), Information and Communications Technology (ICT) risk, business continuity and disclosure. The Board promotes a strong risk culture, approves key policies and oversees the ORMF, while senior management implements them in line with the bank's risk appetite. Risks are identified and assessed across all products and activities using event data, self-assessments, control monitoring and scenario analysis. The principles also require structured change management, robust monitoring and reporting, a strong internal control environment with segregation of duties, resilient and secure ICT systems, forward-looking business continuity planning and transparent disclosure. Supervisors are expected to assess banks' ORMFs and require timely corrective action.

Basel Framework for Capital Adequacy of Banks

Basel III treats operational risk as a core component of risk-weighted assets alongside credit and market risk, requiring sufficient high-quality capital to absorb losses from failures of people, processes, systems or external events. It replaced the earlier Basic Indicator and Standardized Approaches with a more risk-sensitive methodology based on loss data, scenario analysis and control assessments, and links operational resilience to capital through the capital conservation and countercyclical buffers, the leverage ratio and disclosure requirements. Because operational lapses in Islamic banks often trigger Shariah non-compliance, the regime's emphasis on governance, internal control, documented processes and integrated risk data aligns well with Shariah governance requirements.

IFSB Standards

The IFSB's prudential standards complement Basel III while addressing the contractual and Shariah-specific features of Islamic finance.

IFSB-1, Guiding Principles of Risk Management (2005), sets out fifteen principles across six risk categories. It recognizes that Islamic banks face Shariah-specific risks as well as credit, market, liquidity and operational risks, and embeds Shariah compliance in operational and fiduciary risk management through strong governance, proper allocation of assets to investment account holders (IAH), effective controls and transparent reporting. It treats operational risk as including losses from Shariah non-compliance and breaches of fiduciary duty. Shariah non-compliance risk (SNCR) is the failure to adhere to the rulings of the institution's Shariah Supervisory Board (SSB) or of the national Shariah authority. It can invalidate contracts, render income illegitimate and require purification. Because customers choose Islamic banks for their Shariah adherence, even a perceived lapse can trigger withdrawals and lasting reputational damage, placing SNCR at the top of operational risk priorities.

Fiduciary risk arises when an Islamic bank fails to honour the trust placed in it by current account and investment account holders: lack of due care in managing investment funds,

misallocation of earnings or operational weaknesses can cause forgone profits or losses to IAH and, in extreme cases, insolvency.

IFSB-12, Guiding Principles on Liquidity Risk Management (2012), is discussed with the other liquidity standards in Chapter 13.

IFSB-23, Revised Capital Adequacy Standard (2021), replaces IFSB-15 with the most comprehensive Basel III–aligned capital framework for Islamic banks to date. It sets instrument-specific capital requirements for Murabahah, Ijarah, Musharakah, Mudarabah, Salam, Istisna'a and agency (Wakalah). Defines Shariah-compliant Common Equity Tier 1 (CET1), AT1 and Tier 2 instruments. Provides a methodology for Profit-Sharing Investment Accounts (PSIAs), including the alpha factor and displaced commercial risk. Strengthens Risk-Weighted Assets (RWA) calculation for credit, market and operational risks, recognizing SNCR as an important component of operational risk, and incorporates the capital conservation and countercyclical buffers and the leverage ratio.

IFSB-30, Revised Corporate Governance Principles (2023), strengthens the board's role in shaping culture, values and risk appetite. Integrates Shariah governance into overall corporate governance. Tightens oversight of senior management, risk, compliance, internal audit and Islamic window operations. Enhances the protection of IAHs, transparency and accountability. Addresses climate, Environmental, Social, and Governance (ESG) and sustainability risks, and recognizes the three lines of defense. While aligned with AAOIFI, BCBS and Organisation for Economic Co-operation and Development (OECD) governance standards, it targets governance gaps specific to Islamic finance.

IFSB-31, Effective Supervision of Shariah Governance (2025), sets supervisory expectations for the whole Shariah governance ecosystem: supervisory powers and enforcement, the obligations of boards and senior management, and the structure, independence and competence of SSBs. It promotes risk-based supervision of Shariah non-compliance, including escalation, corrective action and reporting, and oversight of Islamic windows, group structures and outsourced Shariah functions.

Together, the IFSB standards form a coherent prudential architecture integrating Shariah governance, risk management, liquidity, capital adequacy, corporate governance and supervision.

AAOIFI Standards

AAOIFI's governance standards complement this architecture. GS 1, Shariah Governance Framework (revised 2024), sets out the responsibilities of the board, senior management, SSBs and internal control units and requires structured processes for issuing, implementing and monitoring Shariah pronouncements to prevent SNCR. GS 9, Shariah Compliance Function, requires dedicated compliance units, internal review, real-time monitoring and documentation to prevent, detect and rectify non-compliance. GS 10, Shariah Compliance and Fiduciary Ratings for Islamic Financial Institutions, provides a framework for independently rating an institution's management of SNCR and of its fiduciary duties, relevant to jurisdictions seeking to institutionalize external Shariah review.

GS 11, Internal Shariah Audit, sets the scope, auditor competencies, planning, reporting and follow-up requirements for an independent internal Shariah audit function. GS 20, SSB Functions and Operations, governs the SSB's mandate, independence, membership, reporting lines, meetings, confidentiality and conflict-of-interest safeguards, and its interaction with Shariah control, audit and management. GS 21, SSB Review and Report, specifies the SSB's Shariah reviews and the structure and content of its annual Shariah report, including its opinion, identified breaches and rectification. Auditing Standards for Islamic Financial Institutions (ASIFI) 6, External Shariah Audit, establishes the framework — objectives, scope, ethics, evidence, materiality and reporting — for independent external Shariah assurance.

12.3.2 Guiding Framework for ORM in Banks: Domestic

Bangladesh's domestic ORM framework for Islamic banking has evolved since the early 1980s. Islamic banking began formally with Islami Bank Bangladesh Limited in 1983, following the country's accession to the Islamic Development Bank in 1974 and international endorsements in 1978 and 1980, and Bangladesh Bank has since developed guidelines, preferential regulatory treatment, liquidity-support mechanisms and oversight arrangements for the sector.

Bank Company Act 1991

The Bank Company Act 1991 is the legal foundation for regulating all banking in Bangladesh, including Islamic banking. Although framed for conventional banks, its prudential provisions — licensing, capital adequacy, liquidity, risk management, corporate governance, inspection and enforcement — apply equally to Islamic banks unless Bangladesh Bank exempts or supplements them, and it is the statutory basis on which Bangladesh Bank issues circulars and guidelines for Shariah-based operations.

Guidelines for Conducting Islamic Banking 2009

Bangladesh Bank issued the Guidelines for Conducting Islamic Banking on 9 November 2009 (Banking Regulation and Policy Department (BRPD) Circular No. 15) under Section 45 of the Bank Company Act 1991 — the first comprehensive regulatory framework for the sector — to enhance transparency, accountability, governance and Shariah compliance under a uniform regime. Section I defines an Islamic bank as a licensed banking company, or designated Islamic branch of a conventional bank, that conducts all its operations in accordance with Shariah, avoiding interest at every stage. It defines Islamic banking business as activity whose objectives, processes and substance contain no element contrary to Shariah.

Section II requires a detailed operational manual — the primary instrument for managing operational risk in a dual bank — covering the segregation of Islamic and conventional funds, internal processes and controls, and the protection of depositors and contractual integrity. Islamic funds must be kept separate through dedicated accounting, records and Management Information System (MIS) to prevent commingling and ensure accurate profit allocation. Risks must be identified through rigorous pre-sanction due diligence and post-sanction monitoring, and banks must maintain strong internal controls, standardized documentation and system-based oversight.

The Guidelines also set a roadmap for converting a conventional bank into a full-fledged Islamic bank or opening Islamic windows, restructuring interest-bearing assets and liabilities and aligning processes with Shariah. They call for mitigation measures such as avoiding non-permissible activities, strengthening Shariah-compliant collateral, enhancing controls and maintaining contingency arrangements for critical functions. The Board bears primary responsibility for Shariah compliance and ultimate accountability for any irregularity, even where an independent SSC is formed. The Guidelines further prescribe reporting on Shariah compliance, operations and financial statements, and set principles for Islamic deposits, investment modes, Cash Reserve Requirement (CRR)/Statutory Liquidity Requirement (SLR) maintenance and the determination and distribution of returns, reducing displaced commercial risk.

Internal Shariah Audit Guidelines

Bangladesh Bank's Guidelines on Internal Control and Compliance (ICC) in Banks, issued through BRPD Circular No. 03 of 8 March 2016, added a dedicated section on internal Shariah audit for Islamic banks and windows. It formalizes Shariah audit as a function distinct from conventional internal audit, assessing adherence to Shariah, validating contracts and documentation, and ensuring that financing complies in form and substance. Shariah violations can cause operational lapses, invalid contracts, reputational damage, regulatory consequences and non-halal income. The Guidelines introduced a Shariah non-compliance risk rating that classifies branches by major and minor violations into a Shariah Index, which sets inspection frequency and priority. The violations include disbursing cash in Bai-based modes, adjusting investments without asset transfer, bypassing documentation and obtaining backdated cash memos. The Guidelines also require annual risk-based audit planning, surprise inspections of high-risk branches, reporting of deficiencies to the SSC Secretariat, Chief Executive Officer (CEO) and Board, and quarterly summary reports.

Guidelines on Risk Based Capital Adequacy 2014

Bangladesh Bank's Risk Based Capital Adequacy Guidelines 2014, issued under Basel III, raised the quality of capital, extended risk coverage and introduced leverage constraints and buffers. Banks must maintain a minimum Capital to Risk-Weighted Assets Ratio (CRAR), mainly in Common Equity Tier 1, with an explicit Pillar 1 capital charge for operational risk under the BIA or TSA, making internal control, ICT governance, process integrity, Shariah compliance and human resources determinants of capital adequacy. Under Pillar 2, banks must assess risks not captured in Pillar 1 — system failures, model, cyber and fraud risks, documentation weaknesses and governance failures — and Bangladesh Bank may impose additional capital through the supervisory review dialogue. The framework also requires stress testing, an internal capital adequacy assessment process (ICAAP) and Pillar 3 disclosure.

Risk Management Guidelines 2018

The Risk Management Guidelines 2018 consolidate earlier circulars into an enterprise-wide framework. They require a board-approved risk appetite, stronger roles for the Board Risk Management Committee (BRMC) and Executive Risk Management Committee (ERMC), a mandatory Chief Risk Officer (CRO), and comprehensive identification, assessment,

mitigation, monitoring and reporting of operational risk. These are supported by clear segregation of duties, enhanced MIS, scenario-based stress testing, annual reviews and periodic reporting to Bangladesh Bank. For Islamic banks, these requirements reinforce system-based operational risk management and discipline over non-compliance risk.

Other Circulars and Directives of Bangladesh Bank

Bangladesh Bank has also issued circulars on liquidity and digital operations. The Bangladesh Government Islamic Investment Bond (BGIIB) was introduced in 2004 and amended by Debt Management Department (DMD) Circular No. 05 of 1 September 2014. BRPD Circular Letter No. 42 (26 October 2022) replaced conventional refinance with a Shariah-compliant prefinance structure, and BRPD Circular Letter No. 30 (8 July 2024) covers online banking by conventional banks' Islamic branches and windows. The Islamic Interbank Fund Market (DOS Circular Letter No. 23 of 2011) uses Mudarabah, Wakalah, Murabahah and safe custody (Wadiah) contracts in place of the call money market. The liquidity facilities are the Islamic Banks Liquidity Facility (IBLF; DMD Circular 03 of 5 December 2022, amended by DMD Circular Letter No. 05 of 25 March 2024), Mudarabah Liquidity Support (MLS; DMD Circular 02 of 5 February 2023) and Special Liquidity Support (letter Ref. No. DMD/239/2024-149 of 18 January 2024). Operational guidelines for the Bangladesh Government Investment Sukuk (BGIS) were issued by DMD Circular No. 05 of 21 October 2020.

In Shariah governance, IBRPD Circular No. 01 (28 September 2025) provides a comprehensive framework for the formation, appointment, removal, roles and responsibilities of SSC members, strengthening Shariah oversight and uniform governance across all banks offering Islamic banking services.

12.4 ORM Practices in Banks of Bangladesh

12.4.1 ORM Practices in Banks in Bangladesh: Questionnaire Survey

A semi-structured questionnaire survey, supplemented by FGDs and KIIs with heads and deputy heads of risk management departments, examined the status of and challenges in operational risk management in Islamic banks.

Benchmark results from a recent industry survey on operational risk management in banks (Habib et al., 2025) are reproduced in Appendix I.

ORM Governance and Institutional Framework

ORM governance is inconsistent and weak: only about one-third of banks have a standalone ORM unit, many fold ORM into enterprise risk management or spread it across departments without coordination, and nearly one-fourth lack any formal ORM governance framework — fragmenting accountability and weakening oversight.

Board and Senior Management Oversight

Leadership oversight is inadequate: only about 30% of banks review ORM at Board Risk Committee level, others rely on irregular or departmental reporting, and about one-fifth show no concern for ORM oversight at all.

Implementation of the Three Lines of Defense

The Three Lines of Defense model is largely informal: only about 17% of banks have implemented it fully across business units, leaving most without clearly defined responsibilities for risk ownership, control and assurance.

Risk Identification and Control Tools

Risk identification is reactive: about 60% of banks rely on audit findings, while key risk indicators (KRIs), loss event databases and scenario analysis remain underused, preventing early detection of emerging risks.

Regulatory Compliance and Alignment

Regulatory alignment is uneven: about half of banks align ORM with Bangladesh Bank regulations and 40% with Basel standards, but nearly one-third show limited or inconsistent compliance, calling for stronger supervisory enforcement.

Data Management and Scenario Analysis

Loss data management is among the weakest areas: only 20% of banks keep a centralized loss database and about 25% record no loss data at all; only about one-fourth conduct scenario analysis regularly across all business lines, hindered by the lack of a standard methodology, historical data and expertise.

Monitoring and Reporting Mechanisms

Monitoring depends largely on internal audit and compliance (57% of banks), with only 28% using standardized dashboards or KRIs; ORM reporting is regular, mostly monthly or quarterly, but lacks analytical depth and integration into decision-making.

Outsourcing and Vendor Risk Management

Outsourcing risk is poorly addressed: only about 35% of banks conduct vendor risk assessments or have a vendor management policy, and nearly 30% have no framework — a significant threat given growing dependence on third-party IT and payment providers.

Cybersecurity and IT Risk

Cybersecurity is left mainly to IT: about 70% of banks rely solely on IT and information security teams, and only 3% coordinate across ORM, audit and IT, isolating cyber risk from the wider ORM framework.

Risk Culture and Human Capital Development

Risk culture is still developing: around 60% of banks run regular ORM training and communication, but only 20% formally assess risk culture and 15% link incentives to risk performance, and although half assess training, there are no benchmarks of its effectiveness.

Overall Insights and Implications

Overall, ORM in Bangladesh's banks remains compliance-driven and fragmented, lacking integration, standardization and forward-looking methods. As banking becomes more digital and interconnected, banks need a holistic ORM approach aligned with Basel III and IFSB-1

(Guiding Principles of Risk Management for IIFS), with stronger governance, data-driven monitoring, cross-functional coordination and a culture of proactive risk ownership.

12.4.2 Operational Risk in Banks of Bangladesh: Case Studies

Bangladesh's banks face operational risks from human error, weak processes, cyber threats, misconduct and operational complexity, some of exceptional scale and seriousness. Drawing on the cases outlined in Appendix II, the key issues are as follows.

Governance-Related Risks

- **Weak board oversight and political influence:** boards and sponsor-directors misuse authority, approve unethical financing and divert funds; strong corporate governance, fit-and-proper criteria and board independence are essential.
- **Breakdown of Shariah governance:** replacing competent board and Shariah committee members with politically influenced individuals has led to governance collapse in Islamic banks; Shariah governance must be integrated with ORM to ensure Shariah-compliant decisions and independent oversight.
- **CRO versus CCRO conflict:** chief risk officers, often drawn from credit backgrounds, confine themselves to credit risk; banks need a dedicated, independent CRO responsible for all risks — credit, market, operational, IT and Shariah non-compliance.
- **Fraudulent approvals and collusive governance:** large-scale scams involved collusion among executives, directors and customers; segregation of duties, controls over approvals and governance audits are essential safeguards.
- **Lack of ethical culture and accountability:** persistent irregularities and self-serving behavior call for a strong risk culture, a code of conduct and zero tolerance of misconduct.

People-Related Risks

- **Incompetence and lack of professionalism:** unqualified appointments and discontinued training reduce risk awareness; talent management, capacity building and professional certification (such as Certified Islamic Banking and Finance Professional (CIBFP), Certified Shariah Adviser and Auditor (CSAA) and Certified Islamic Professional Accountant (CIPA)) are essential for key risk functions.
- **Internal collusion and fraud:** document forgery, unauthorized withdrawals and fake investment accounts reveal serious ethical lapses; behavioral risk assessment, whistleblowing mechanisms and staff rotation help detect and prevent them.
- **Lack of segregation of duties:** staff exploit overlapping responsibilities, especially during branch transfers and digital transitions; job rotation, dual control and hierarchical approval are needed in all sensitive areas.
- **Mismanagement in agent banking:** agent fraud, misuse of funds and customer deception require strict background checks, digital monitoring and structured training for agents.
- **Change management failures:** poor handling of staff during technological or organizational change leads to errors and fraud; change management and HR strategies must be aligned with operational risk controls.

Process-Related Risks

- **Process failures and high NPIs:** weak appraisal, monitoring and recovery let defaults escalate; stronger approval workflows, post-disbursement monitoring and early warning systems are needed.
- **Bypassing core banking procedures:** ignoring approval hierarchies and controls enables corruption and misreporting; strict adherence to SOPs, process documentation and audit trails is mandatory.
- **Inadequate internal control and compliance:** fake trade documents, shell companies and fictitious LCs expose banks to fraud; stronger internal audit, verification of trade finance and automated compliance are crucial.
- **Deficient change and transition procedures:** inadequate testing and segregation during system upgrades or reorganization enable fraud and data manipulation; change control protocols, approval gates and post-change reviews are vital.

System-Related Risks

- **Cybersecurity vulnerabilities:** the Bangladesh Bank cyber heist and Automated Teller Machine (ATM) scams exposed weak system architecture and defenses; multi-layered protection, real-time fraud detection and dedicated incident response teams are crucial.
- **Data integrity and manipulation:** manipulation at head-office level distorted financial reporting; robust data governance, access controls and periodic data integrity audits are needed.
- **Technological risks in MFS and e-money:** fraudulent e-money creation and misuse of customer data call for secure digital verification, system audits and strong authentication across fintech services.
- **Business continuity and disaster recovery:** many banks lacked frameworks to sustain critical operations during cyber disruptions; comprehensive BCP and DR plans, real-time data replication and alternative data centers are fundamental.

External Environment-Related Risks

- **Trade-based money laundering (TBML):** large-scale trade mis-invoicing undermines financial integrity; AI-driven trade surveillance, cross-border data integration and enhanced due diligence are needed.
- **Regulatory gaps and inconsistent enforcement:** these have enabled systemic irregularities and recurring scams; stronger enforcement, better coordination among regulators and risk-based inspection are essential.
- **Political and external interference:** interference in credit approvals, board appointments and management decisions compromises independence; bank autonomy and risk functions must be insulated from political influence.
- **Emerging digital and market threats:** data breaches, third-party risks and rapid technological change call for continuous adoption of Regulatory Technology (RegTech) and Supervisory Technology (SupTech).

Operational risk is the dominant source of distress in Bangladesh's banking sector, often appearing as credit problems but rooted in governance lapses and process deficiencies. Islamic banks face both conventional operational risks and Shariah-specific risks from non-compliance and ethical violations. Governance reform, modern internal controls, digital security and an ethical banking culture are vital, within holistic ORM frameworks aligned with international standards and with the Shariah principles of Mukhatarah, Al-Ghunm-bil-Ghurm and Maqasid al-Shariah.

12.5 Findings and Data Analysis

12.5.1 Islamic Banking in Bangladesh

The aggregated balance sheet and income statement of Islamic banks for 2021–2024, and their performance relative to the banking industry, are presented with the other industry statistics in Table 3.16, Table 3.17 and Table 3.15 (Chapter 3). This section focuses on the capital that Islamic banks hold against credit, market and operational risks.

Both Islamic and conventional banks allocate the largest share of regulatory capital to credit risk (Table 12.1). Market-risk capital is the smallest component for Islamic banks, averaging 2.20%, and operational-risk capital averages 8.07%, against 9.01% for conventional banks, although some Islamic banks — such as Shahjalal Islami Bank PLC — hold markedly more because of Shariah-sensitive processes and compliance complexity. Since credit and market risks also depend largely on people, internal procedures, IT infrastructure and external parties, prudent operational risk management underpins the management of all risks.

Table 12.1: Comparative Capital Requirements of IBs and CBs in 2023

S/n	Name of Bank	Capital Requirement for Credit Risk		Capital Requirement for Market Risk		Capital Requirement for Operational Risk		Total Capital Requirement of the Bank	
		(BDT Million)	%	(BDT Million)	%	(BDT Million)	%	(BDT Million)	%
A	**Purposively Selected 7 Full-Fledged Islamic Banks**								
1	Islami Bank Bangladesh PLC (IBB)	77,742.21	90.56	1,073.31	1.25	7,028.12	8.19	85,843.64	100
2	First Security Islami Bank PLC (FSIB)	30,543.30	89.45	802.80	2.35	2,799.40	8.20	34,145.50	100
3	Al-Arafah Bank PLC (AAIB)	28,352.59	90.60	523.53	1.67	2,418.70	7.73	31,294.83	100
4	Social Islami Bank (SIB)	27,814.92	90.92	605.13	1.98	2,172.25	7.10	30,592.30	100
5	Shahjalal Islami Bank PLC (SJIB)	19,274.77	85.05	641.65	2.83	2,746.26	12.12	22,662.68	100

S/n	Name of Bank	Capital Requirement for Credit Risk		Capital Requirement for Market Risk		Capital Requirement for Operational Risk		Total Capital Requirement of the Bank	
		(BDT Million)	%	(BDT Million)	%	(BDT Million)	%	(BDT Million)	%
6	Export Import Bank of Bangladesh PLC (EXIM)	3,391.65	89.23	194.02	5.10	215.53	5.67	3,801.20	100
7	Union Bank PLC (Union)	1,796.23	92.26	4.64	0.24	145.98	7.50	1,946.85	100
	Average	**26,987.95**	**89.72**	**549.30**	**2.20**	**2,503.75**	**8.07**	**30,041.00**	**100**
B	**Purposively Selected 7 Conventional Banks**								
1	IFIC Bank PLC (IFIC)	40,502.41	90.87	1,918.00	4.30	2,152.50	4.83	44,572.91	100
2	Eastern Bank PLC (EBL)	26,635.00	85.41	1,423.00	4.56	3,127.00	10.03	31,185.00	100
3	Mercantile Bank PLC (MBL)	25,698.40	87.86	696.10	2.38	2,854.60	9.76	29,249.10	100
4	Trust Bank PLC (Trust)	25,288.65	89.70	263.72	0.94	2,640.82	9.37	28,193.19	100
5	Bank Asia PLC (BA)	21,269.00	86.04	741.00	3.00	2,709.00	10.96	24,719.00	100
6	Dhaka Bank PLC (Dhaka)	20,761.50	89.20	455.90	1.96	2,057.60	8.84	23,275.00	100
7	NCC Bank PLC (NCC)	17,803.47	85.69	1,037.34	4.99	1,935.40	9.32	20,776.21	100
	Average	**25,422.63**	**87.82**	**933.58**	**3.16**	**2,496.70**	**9.01**	**28,852.92**	**100**

Source: Annual Report of the Concerned Banks.

12.5.2 Summary of FGD and KII Outcomes

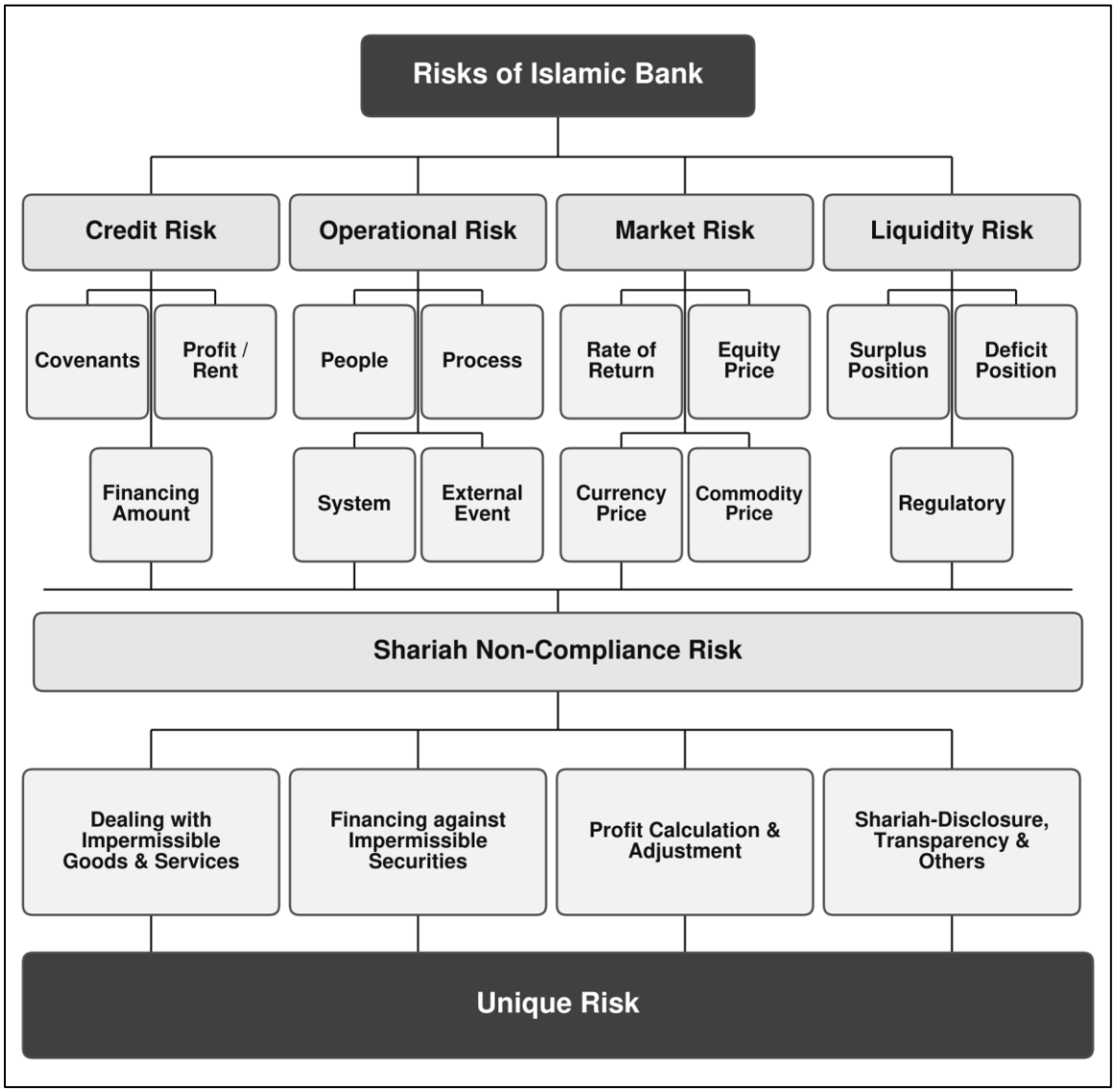
12.5.2.1 Perception About Salient Operational Risks of Islamic Banks

Islamic banks face the Basel risk categories — credit, operational, market and liquidity — with added complexity from their Shariah obligations (see the figure below). Operational risk arises from people, processes, systems and external events. Credit-risk elements such as covenants, financing amounts and profit or rent arrangements can trigger operational failures and Shariah non-compliance through lapses in documentation, contract execution or collateral management. Market-risk factors — rates of return, exchange rates, commodity prices and equity volatility — must be managed without conventional hedging tools; and liquidity risk, whether regulatory or arising from surplus or deficit positions, can lead to non-compliance where suitable instruments and mechanisms are lacking.

Shariah non-compliance risk sits at the center: many operational failures stem from deviations in product structuring, transaction execution, profit calculation or dealings in impermissible goods, services or securities, with financial, reputational and fiduciary consequences, and Islamic banks also carry ‘unique’ risks absent in conventional banks. Because Shariah narrows

the permissible universe beyond regulatory limits, all underlying assets and collateral must be Shariah-compliant. Profit, rent, charges and Mudarabah returns must satisfy both Shariah and statutory rules, and banks must communicate continuously with counterparties when executing or modifying contracts. Operational risk in Islamic banks is thus multidimensional and closely tied to Shariah governance, internal controls, accurate documentation and disciplined practice.

Figure 12.1: Salient Operational Risk of Islamic Banks



Source: Compilation by the Authors based on the FGD and KII.

Box 12.1 shows how credit, market, liquidity and unique exposures often materialize through operational weaknesses and become Shariah issues: terms not aligned with Shariah or poorly structured documentation in credit; mishandled contracts, misapplied rates or impermissible instruments in market operations; non-compliant fund-raising or investment under liquidity stress; and impermissible assets, improper profit recognition or inadequate disclosure. The quality of people, processes, systems and governance determines whether these risks are contained.

Box 12.1: Relationship of Others Risks with Operational Risk of Islamic Banks

A. Credit Risk

a. Breach of Covenants: Lack of proper documentations and inclusion of impermissible covenants in credit document and contract may lead to Shariah non-compliance. For example, in case of HPSM, bank imposes customer to have an insurance at his own cost however, if the insurance does not cover the financing amount, client will be liable to settle the payment to the bank. In case of Murabahah, generally banks include compensation clause (in lieu of undertaking to donate) as a part of the agreement without segregating procrastinating debtor and forced measures.

b. Default in Payment of Financing or Investment Amount: As a part of credit risk mitigation, there is practice taking security through creation of charges. However, if the security is not Shariah permissible, it would be a Shariah non-compliance risk.

c. Default in Payment of Profit/Rent: As a part of credit risk mitigation, there is practice of rescheduling of debt. However, rescheduling of debt in case of Murabahah financing with additional charge is an explicit violation of Shariah. Furthermore, to mitigate risk, banks sometimes charge a mark-up in Murabahah considering the longer period and make a commitment to allow rebate for early settlement.

Check Point

i) Proper Shariah review of all contracts and associated documents by the SSC before execution of operations;

ii) Arrangement of proper training and knowledge development programs of the operational people and ensuring internal check by the business unit during execution of the contracts;

iii) Independent review and monitoring by the compliance and risk-management unit during the execution of the contract.

iv) Through Shariah audit by the competent internal and external Shariah auditors after the execution of the contracts.

v) Shariah review by the SSC after execution of the contracts mainly based on documents and audit reports.

B. Market Risk

a. Rate of Return: In case of interbank placement, generally provisional rate is declared under Mudarabah principle however, if this rate is not adjusted based on actual performance then it will be a Shariah non-compliance risk. In case of Mudarabah/Musharakah mode, if both the parities make an undertaking to give-up there claim above the provisional amount distributed, this may also be a Shariah concern. Furthermore, excessive use of PER and gift may lead to Shariah non-compliance risk.

Generally, banks set a provision to change the rent in the subsequent period at its exclusive discretion without getting consent of the client or allowing him to liquidation of the contract.

b. Equity Price: As a part of portfolio, banks hold equity instruments as held for trading or held to maturity approach. However, holding of an equity instrument after becoming the instrument non-qualified subsequently because of dull market situation.

c. Currency Price: Banks need trade foreign currency. To prevent the currency price risk, conventional banks use some financial derivatives like forward, future, option however, these are not Shariah permissible. If any Islamic bank engages with these instruments, it would be considered Shariah non-compliance.

d. Commodity Price: To mitigate the commodity price risk, if there is a linkage between Istisna'a with parallel Istisna'a and Salam with parallel Salam contract. Furthermore, conduct the Murabahah contract before purchasing the commodity is also prohibited.

Check Point

i) Proper Shariah review of all contracts and associated documents by the SSC before execution of operations;
ii) Arrangement of proper training and knowledge development programs of the operational people and ensuring internal check by the business unit during execution of the contracts;
iii) Independent review and monitoring by the compliance and risk-management unit during the execution of the contract.
iv) Through Shariah audit by the competent internal and external Shariah auditors after the execution of the contracts.
v) Shariah review by the SSC after execution of the contracts mainly based on documents and audit reports.

C. Operational Risk

a. People: Hiding major information from the counter party during the contract may lead to Shariah non-compliance risk. Communicating with customers with unprofessional manner may be another source of operational risk.
b. Internal Process: As per the Shariah preview, ensuring the sequence is mandatory in some contract like Murabahah. For example, conclusion of Murabahah agreement before acquiring the underlying asset is a Shariah non-compliance.
c. System: Due to lack of compatible IT infrastructure, there is a high possibility of Shariah violation. For example, charging rent automatically before ensuring usability of the leased asset or booking mark-up after disbursement of fund without ensuring Murabahah contact.
d. External Event: Shariah non-compliance may be due to external parties like false purchase of goods by the agent, creating pressure as displaced commercial risk by the investment account-holders, non-cooperation to in ensuring Shariah-compliance process, accounting engineering by the Mudarabah/Musharakah client to hide the actual performance of the business.

Check point

i) Proper recruitment, staffing, training and development under the supervision of the SSC, SMT and BoD
ii) Vetting of all internal process-flow by the SSC and continuous internal review by the auditors.
iii) Acquiring Shariah compatible Core Banking Solution by the IFI and duly vetted by the SSC.
iv) Proper screening and selection of the customers, and arranging customer awareness programs.

D. Liquidity Risk

a. Regulatory: Like conventional banks, IBs need to maintain liquidity to comply with regulatory requirements. However, it is essential to ensure Shariah compliance in meeting the regulatory requirements. For example, due to shortage of BGIS or BGIIB, no IB can invest funds for meeting SLR requirement to the conventional T-bill or T-bond. Besides, any short-fall in the CRR, the bank will be charged Penal Interest (Bank Rate plus 5%) by the central bank.
b. Surplus Position: When an IB is in surplus liquidity position, it needs to invest the fund in the Shariah-compliant instruments like, capital market exposure, interbank placement etc. However, there is a possibility of Shariah non-compliance risk due to impermissible instrument for process fault.
c. Deficit Position: To meet up the regulatory liquidity or business requirement, an IB need to collect funds from peer banks or from the central bank, as a lender of last resort. However, this fund collection should not violate the Shariah principles.

Check Point

i) Shariah review of all intended instruments and associated documents by the SSC;
ii) Independent review and monitoring by the compliance and risk-management unit during the execution.
iii) Through Shariah audit by the competent internal and external Shariah auditors after the execution.

E. Unique Risk Factors

a. Dealing with Impermissible Goods and Services: There are some goods and services, which are permissible in trading from conventional banking point of view however, Shariah may not allow all of these like tobacco, alcohol, pork, etc.
b. Financing Against Impermissible Securities: Accepting securities of impermissible assets as collateral are not permitted for Islamic financial institutions.
c. Profit Calculation, Recognition and Distribution: In case of Murabahah, profit should not be calculated based on indirect cost. At this time of execution of Instisna'a and Salam contract, profit should not be recognized. In case of HPSM, profit calculation and recognition during the construction period should be compliant with Shariah. Furthermore, profit calculation for the Mudarabah depositors should follow some Shariah principles.
d. Disclosure and Transparency and Others: Besides avoiding Riba, there are some requirements to make a contract Shariah-compliant like free from Gharar, Mysir, Combination of Contract, etc.

Check point

i) Ensuring at effective and proper governance structure in place with accountability.
ii) Ensuring proper and sufficient training and development programs for the Islamic finance professionals.
iii) Ensuring an independent Shariah review and audit mechanism.
iv) Adoption of international best practices and proper implementation customized regulatory framework.

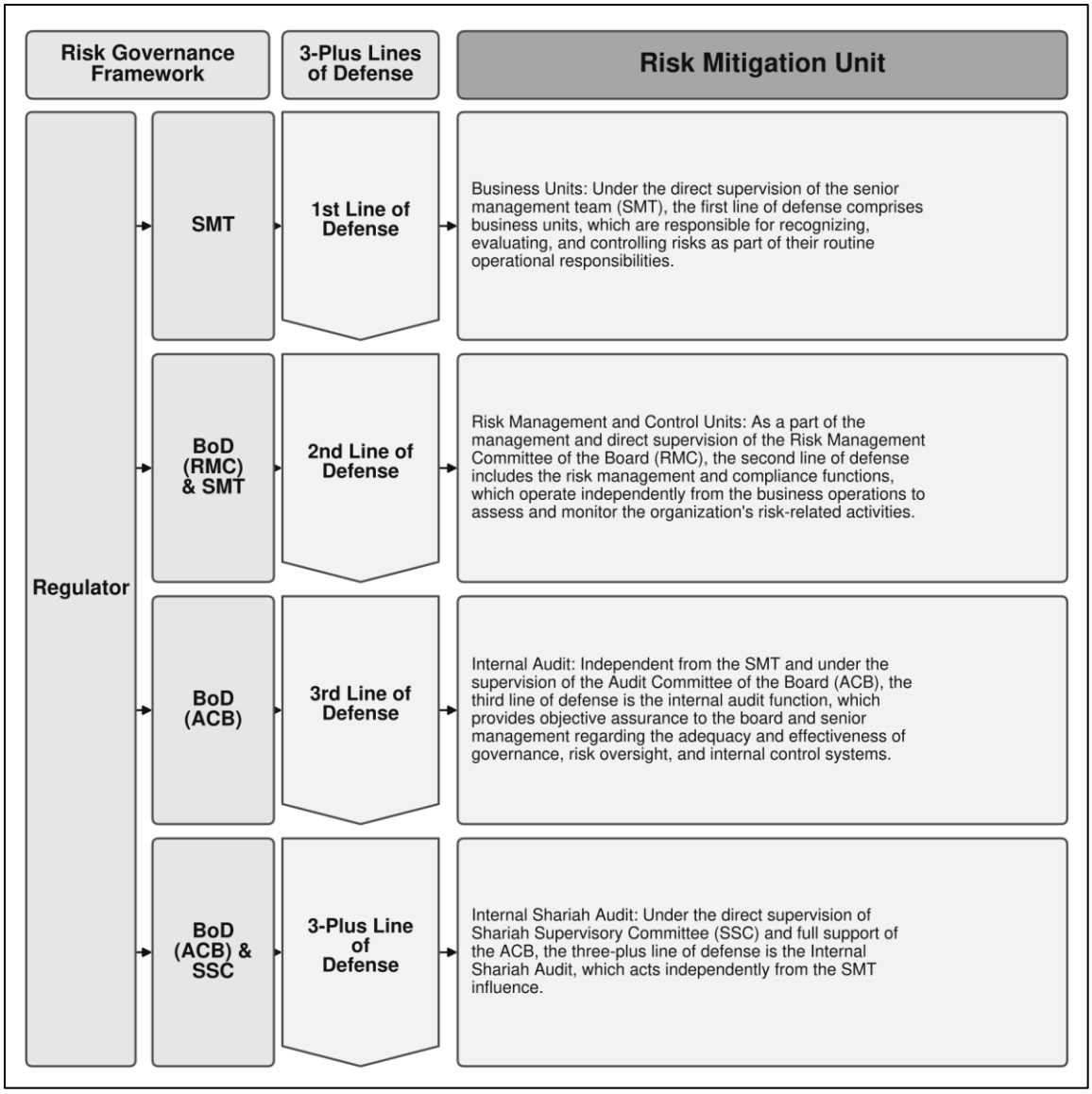
Therefore, Shariah non-compliance risk is the salient operational risk of Islamic banking operations all over the globe.

Source: Compilation by the Authors based on the FGD and KII.

12.5.2.2 Operational Risk Governance Framework of Islamic Banks

Operational risk is governed through a '3-plus lines of defense' model (Figure 12.2). Business units under senior management form the first line, considering Shariah issues alongside business norms. Risk management and compliance, independent of business and reporting to the Board Risk Management Committee, form the second, overseeing the risk profile including Shariah non-compliance risk; and internal audit, reporting to the Audit Committee of the Board, forms the third, including Shariah issues in its reviews. Islamic banks add a 'plus' line — Internal Shariah Audit, independent under the SSC with the Audit Committee's support — so that Shariah compliance is embedded in every layer. Regulatory oversight of each stage is essential; its absence contributed to the disarray of recent years.

Figure 12.2: Operational Risk Governance Framework of Islamic Banks



Source: Compilation by the Authors based on the FGD and KII.

12.5.2.3 Control Points for Operational Risk Management of Islamic Banks

Effective management of operational risk in Islamic banks requires a coordinated focus on four core control areas: processes, people, systems, and external stakeholders.

Internal Processes

All product structures, process flows and operational manuals must be vetted by the SSC before implementation and reviewed periodically. A robust Internal Shariah Audit (ISA) provides independent assurance, and post-execution SSC review of audit reports and documentation ensures timely correction of deviations.

People

Qualified Islamic banking and finance (IBF) professionals are scarce relative to the industry's size. The central bank may encourage universities to offer IBF programs, the Institute of Bankers, Bangladesh (IBB) may introduce specialized diplomas, and BIBM may expand training, certification and advanced diplomas. Recruitment should favor candidates with strong academic records and IBF knowledge, screened for integrity (including psychological assessment where appropriate), followed by structured induction, continuous professional development and competency assessment.

Systems

Core banking systems must be purpose-built or customized for Islamic products, with Shariah experts involved in their design and automated Shariah controls — such as blocking non-permissible transactions or contract-sequence violations. The SSC should vet the system before implementation, and during operation ISA should audit it continuously while the SSC periodically reviews end-to-end processes.

External Events and Stakeholder Behavior

Customers' limited understanding of Shariah requirements causes operational lapses; financial literacy initiatives, including in academic curricula, industry-wide awareness programs coordinated through Islamic banking forums, and regular customer engagement by individual banks can reduce behavior-driven Shariah risk.

Box 12.2: Summary of Control Points for Operational Risk Management of Islamic Banks

A. People

- **Availability:** It is opined that there is dearth of competent IBF professionals considering existing IBF market size and its potential growth.
  - Bangladesh Bank may take initiatives to motivate the concerned authorities to introduce Islamic banking and finance related degree and courses.
  - Institute of Bankers, Bangladesh (IBB) may take initiatives to introduce specialized Islamic banking diploma.
  - BIBM may introduce different programs on Islamic banking and finance in different levels. For example, regular training programs, certification programs for specialized areas and advanced level diploma/post graduate diploma.
- **Recruitment:** A candidate having academic excellency along with Islamic banking and finance knowledge should get priority in selecting the bankers. The selection criteria should be designed accordingly.
- **Honesty:** Banking is a very sensitive profession where an official may be deviated easily during dealing with finance. Therefore, banks may consider to introduce psychological test for assessing the moralities ethical standard. Reward and punishment system through proper key performance indicators.
- **Development Program:** After joining of new officials, a comprehensive training may be imparted before assigning the desk in the banking operations. Besides, continuous development program targeting different levels of executes and department, competency test may be introduced.

B. Internal Process

- **Shariah Vetting**: All of the product program guidelines and banking process flow should be properly vetted by the Shariah Supervisory Committee (SSC) before implementation. More on the that, all of these documents must be reviewed at a certain interval to accommodate changing business environment, updated knowledge, international standards and best practices.

- **Shariah Audit:** As a third eye of different stakeholders, internal Shariah audit (ISA) plays an important role by providing assurance service about Shariah compliance. Therefore, an effective and efficient ISA mechanism need to have in place.
- **Shariah Review:** After execution of the operations, the SSC will review through two ways — evaluating the report of ISA and separate review directly based on documents and interaction the bank-officials.

C. System

- **Compatible System:** It is expected that an Islamic banking software should be specially designed considering the salient features and activities. If it is not properly developed, there is risk of Shariah non-compliance. The system developer should engage competent Shariah scholars during the development process of the core banking solution.
- **Shariah Control Check Points:** To minimize the Shariah non-compliance risk, core banking system should incorporate some check points, which may automatically prevent the non-compliant transactions.
- **Shariah Vetting:** Before introducing a core banking solution, it should be thoroughly reviewed and vetted by the SSC. Without ensuring this, regulator may not allow to launch banking operations.
- **Shariah Audit:** As an independent organ, internal Shariah audit (ISA) should review end-to-end the core banking system from the Shariah lens during operations. Any deviation or deem to be non-compliant should bring to the notice of the SSC and other governance organ. It should be a continuous process in an Islamic financial institution.
- **Shariah Review:** At a certain interval, the SSC may be engaged to review the end-to-end process executed through core banking system.

D. External Event

- **State-Level Awareness Program:** It is generally opined that Shariah compliance is not possible without proper cooperation from the customers. Because of poor understanding and business priority, Islamic banking customers do not act accordingly in some cases. Therefore, it is important to improve financial literacy and especially Islamic modalities. It would be holistic, if state-level initiatives are taken like inclusion of Islamic banking and finance related courses in the relevant academic curricular.
- **Collective Program by Islamic Banking Industry:** In the second layer, Islamic banking sector may conduct national-wide awareness program through their collective forum. It will be affordable to increase coverage with a minimum cost.
- **Initiatives of Individual Banks:** Individual banks should also take some initiatives to share views with their customers. These may be materialized in two approaches — interaction during banking operations; and through separate customized program. This type of initiatives may also act as a market tools to reach the potential customers.

Source: Compilation by the Authors based on the FGD and KII.

12.5.2.4 Internal Shariah Audit (ISA) and Shariah Supervisory Committee (SSC)

Effectiveness of Internal Shariah Audit (ISA)

ISA's effectiveness depends on the breadth, depth and independence of its oversight: coverage should move from selective sampling to population-based review; a system-based approach should enable real-time detection, rectification and prevention of Shariah breaches; and the ISA unit should mirror the Internal Control and Compliance Department (ICCD), with:

- **On-site audits** conducted by competent *Muraqibs* with full operational independence;
- **Off-site surveillance**, supported by documentation reviews and ICT-enabled monitoring; and
- **Continuous follow-up and reporting** to ensure timely correction and escalation of issues.

Muraqibs need sound Shariah knowledge, banking expertise and audit skills. Despite its formal independence, however, ISA sometimes faces pressure — including reassignment or termination — that discourages objective reporting and, over time, fosters self-censorship and undetected non-compliance.

Activeness of the Shariah Supervisory Committee (SSC)

An active SSC is a key determinant of Shariah governance quality and should be proactive in creating a Shariah-compliant environment, not merely reactive. This requires a composition combining Shariah expertise with Islamic banking and finance knowledge. Clear terms of reference setting out responsibilities, authority and reporting lines. Continuing professional development, and SSC representation in board and committee meetings, to keep members informed and prevent Shariah issues at the policy level. Strong support from the board and its Audit Committee is indispensable for both ISA and the SSC to work independently and effectively.

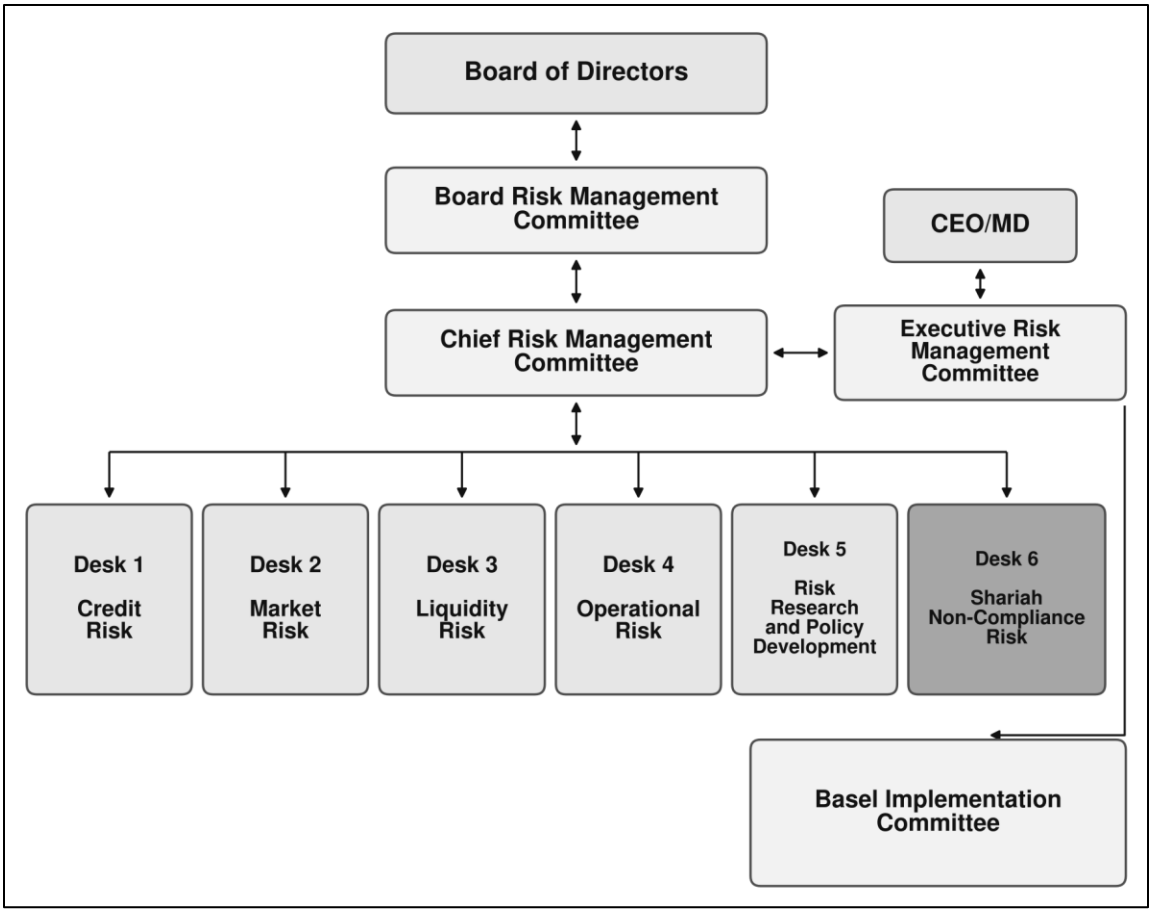
12.5.2.5 Regulatory Framework Addressing Operational Risk of Islamic Banks

Under the IFSB framework, Islamic banks must recognize Shariah non-compliance risk (SNCR) in their capital adequacy, reflecting its severe financial, legal and reputational consequences, whereas the Basel framework omits it — a structural gap for Islamic banks under Basel-based standards. Bangladesh Bank should therefore progressively align practice with IFSB as well as Basel requirements.

Bangladesh Bank could also extend Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS) to Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity and Shariah Compliance (CAMELSS), adding an 'S' for Shariah compliance. The Internal Control and Compliance Guideline (2016) includes a chapter on internal Shariah audit, but its 'Shariah Non-Compliance Risk Rating' template is outdated and needs revision to capture risks from new business models, digital channels and technology-enabled operations, alongside robust Shariah-aligned policies across all functions.

The Risk Management Guidelines for Banks (DOS Circular No. 04 of 8 October 2018) require a risk management organogram with five desks — credit, market, liquidity and operational risk, and risk research and policy development. Islamic banks and finance companies need an additional Shariah Non-Compliance Risk Desk (Figure 12.3). All guidelines, circulars and directives applicable to both conventional and Islamic banking should also undergo Shariah review before issue.

Figure 12.3: Optimal Risk Management Organogram



Source: Compilation by the Authors based on the FGD and KII.

12.5.2.6 Other Issues of Operational Risk of Islamic Banks

Operational risk in IBs extends beyond standard process failures and includes several institution-specific vulnerabilities arising from Shariah governance, these dimensions require careful attention to prevent SNCR and ensure operational integrity across all business lines.

Product Design and Shariah Validation

All products of an IB, whether deposit, financing, international trade, treasury, or offshore banking, must undergo comprehensive Shariah review prior to approval and rollout. This review should validate the contractual structure, underlying covenants, sequence of transactions, documentation design, customer obligations, and exit mechanisms. Any oversight at the design stage may embed structural flaws that later cause violations during execution.

Product Implementation Risks

Even well-designed products can breach Shariah if implemented poorly: inadequate training, weak supervision and inconsistent checks cause deviations, so staff need product-specific Shariah knowledge and documentation protocols, backed by supervision and periodic on-site review.

System Implementation and Automation Gaps

Products can also become non-compliant if the core banking system misrepresents their Shariah features — through configuration errors, automated charges or workflow sequencing — as with automatic fixed rebates on early settlement of Murabahah receivables or automatic compensation charges on defaulting clients. System audits, user acceptance testing and Shariah-compliant parameter settings should be mandatory before deployment.

Board Composition and Accountability for SNCR

The board must include members with banking and Islamic finance exposure. It bears ultimate accountability for Shariah non-compliance, must keep policies, risk frameworks and product strategies aligned with Shariah, and must support Shariah governance organs such as ISA and the SSC. Failure at board level amplifies systemic risk and undermines stakeholder confidence.

Strengthening Oversight Committees

The Audit Committee of the Board should engage regularly with ISA, as it does with internal audit, and include members with Shariah banking backgrounds, and the Board Risk Management Committee should include at least one member with Islamic banking expertise, so that SNCR receives proportionate attention.

Shariah Competence of MD/CEO

Managing directors and CEOs should have proven orientation in Islamic banking and finance before appointment and continue their professional development, since the tone from the top shapes the compliance culture, including the management of SNCR.

Dedicated Shariah Inspection by Bangladesh Bank

Bangladesh Bank should institutionalize a dedicated Shariah inspection function in a specialized department, reviewing Shariah governance, product structures, system configurations and branch-level implementation, with at least one Shariah expert in each inspection team.

Inclusion of Shariah Expert in Internal Audit Team

Just as many banks include IT specialists in their internal audit teams, every bank's internal audit team should include a qualified Shariah expert to capture Shariah risks, validate product execution and identify deviations from approved structures.

Rationalizing Business Targets and Incentives

Unrealistic business targets can push employees to deviate from Shariah requirements; targets should be rationalized and incentives linked to compliance as well as growth, so that Shariah violations offset target achievement and minimizing SNCR is rewarded.

Shariah-Compliant Investment Administration

The investment administration function must strictly adhere to Shariah requirements in documentation, asset verification, payment flows, collateral management, and post-disbursement monitoring. Weaknesses in execution may convert a Shariah-compliant financing structure into a non-compliant transaction, thereby exposing the bank to financial loss and reputational risk.

Enforcement of Job Rotation and Mandatory Leave

Proper implementation of job rotation and mandatory leave policies helps detect irregularities, prevent collusion, and strengthen internal controls. These measures are particularly important in Shariah-sensitive functions such as investment administration, trade operations, and treasury.

12.6 Issues and Recommendations

Operational risk in Islamic banks combines conventional vulnerabilities with Shariah-specific exposures. The survey, FGDs, KIIs, case studies and regulatory analysis trace most lapses to three root causes — weak understanding of and attention to ORM. Inadequate Shariah governance and monitoring, and systemic deficiencies in people, processes, systems and oversight — requiring institution-wide strengthening of governance, capability, regulatory alignment and accountability.

12.6.1 Understanding Level of and Attention to ORM

Most Islamic banks have limited understanding of ORM, which remains compliance-driven rather than strategic. ORM units are often under-resourced, too low in the hierarchy or fragmented within risk or audit functions, and weak board and senior management oversight leaves risk management reactive.

Recommendations

- Institutionalize ORM as a **strategic function**, requiring Board-level review of ORM reports and ensuring ORM independence under the CRO.
- Mandate an **institution-wide ORM framework** aligned with Basel III and IFSB-23.
- Enhance staff competency through **structured, mandatory ORM certification programs** for all officers involved in operations, trade finance, investment, treasury, and IT.
- Introduce **ORM dashboards**, Key Risk Indicators (KRIs), and loss-event databases to promote real-time awareness.

12.6.2 Shariah Non-Compliance Risk as Integral Part of Risk Management

Shariah non-compliance is the most salient operational risk in Islamic banks, arising from documentation errors, incorrect contract sequencing, weak supervision, system misconfiguration and inadequate product knowledge. Yet in most banks SNCR remains confined to Shariah functions rather than integrated into ORM.

Recommendations

- Recognize SNCR as a **distinct but integral component of ORM**, with a dedicated desk under the CRO.
- Embed Shariah compliance checkpoints in **all stages of operations** — design, execution, system configuration, audit, and reporting.

- Mandate **SSC vetting of every product program guideline, SOP, process flow, and core banking system module** prior to implementation.

12.6.3 Proper Selection in Entry Level Officials and Development Subsequently

The shortage of qualified IBF professionals contributes significantly to operational failures: recruitment rarely prioritizes Islamic finance knowledge, ethics or risk awareness, and training is irregular, unspecialized or insufficient for increasingly complex products.

Recommendations

- Revise recruitment frameworks so that **candidates with strong academic profiles, IBF knowledge, and ethical screening** receive priority.
- Introduce **psychometric and integrity assessments** for entry-level recruits and sensitive operational roles.
- Institutionalize comprehensive **induction programs**, Continuous Professional Development (CPD), competency tests, and structured learning pathways (CIBFP, CSAA, CIPA, etc.).
- Require banks to adopt **succession planning and rotation policies** for sensitive roles to reduce collusion and behavioral risks.

12.6.4 Regulatory Initiatives and Updating Regulations

Regulatory frameworks remain partially aligned with IFSB and AAOIFI requirements and do not adequately reflect Shariah governance needs in a digitized environment. There is no standalone Shariah inspection wing within Bangladesh Bank, and existing risk templates and guidelines are outdated.

Recommendations

- Establish a **Shariah Inspection Wing** at Bangladesh Bank staffed with qualified Shariah scholars and banking experts.
- Revise and modernize Shariah-related regulatory guidelines, particularly the SNCR rating system, internal Shariah audit chapter, and product governance requirements.
- Bangladesh Bank may issue separate guidelines on internal Shariah audit in line with AAOIFI GS 11 and update its 'Shariah Non-Compliance Risk Rating' template to reflect digital operations, new products and emerging delivery channels.
- Require all circulars and guidelines applicable to Islamic banks to undergo **mandatory Shariah review** before issuance.

12.6.5 Shariah-Based KPI of Banks and Employees

Performance evaluation frameworks largely prioritize volume-driven growth, leading to excessive pressure, cutting procedural corners, and triggering SNCR. There is no standardized Shariah-based KPI mechanism across banks.

Recommendations

- Integrate Shariah-based KPIs into the **CAMELSS rating framework** (CAMELS + Shariah) for institutions.
- Establish regulatory penalties for banks that repeatedly violate Shariah rules or fail Shariah audits.
- For employees, develop **dual KPIs**: (i) business performance; (ii) Shariah compliance score, including adherence to processes, audit findings, and SNCR incidents.
- Introduce a **balanced scorecard** enforcing penalties for Shariah violations, process breaches, data manipulation, and unethical behavior. Apply negative scoring for **any Shariah breach**, irrespective of business achievements.
- Link promotions, incentives, and branch ratings to Shariah-compliance performance. Reward branches and officials demonstrating **zero SNCR, high audit scores, and exemplary compliance culture**.
- Implement a **whistleblower protection mechanism** to strengthen integrity.

12.6.6 Massive Shariah Awareness Programs

Customer behavior, lack of literacy in Islamic contracts, and weak understanding of Shariah guidelines contribute directly to operational lapses. Industry-wide awareness remains minimal.

Recommendations

- Introduce Islamic finance concepts into **national curricula** in universities and technical institutions.
- Conduct industry-wide awareness campaigns through **collective Islamic banking forums**, reducing cost and expanding coverage.
- Banks should run **ongoing customer sessions** during onboarding and product execution to mitigate behavioral risks.
- Develop digital content (videos, mobile alerts, Frequently Asked Questions (FAQs)) to communicate Shariah conditions in simple language.

12.6.7 Independence of ISA and Pro-activeness of SSC

Internal Shariah Audit (ISA) often lacks operational independence and institutional authority. SSC engagement remains uneven, sometimes reactive instead of proactive. In some banks, SSC and ISA face internal resistance and management influence.

Recommendations

- Ensure ISA's **functional independence**, reporting jointly to the SSC and the Audit Committee of the Board.
- Expand ISA coverage towards **population-based audits** and automated Shariah auditing using system logs.
- Ensure SSC involvement in **policy formulation, system vetting, product approval, and post-execution reviews**.

- Provide SSC members with **capacity-building and CPD programs** to keep them updated with evolving global standards.
- Require SSC participation in Board Risk Management Committee (BRMC) meetings to influence policy-level decisions.

Islamic banks in Bangladesh must move from a compliance-driven, fragmented approach to an institution-wide, data-driven, Shariah-embedded operational risk framework, with stronger governance, human capacity, modern systems, updated regulations and an ethical, Shariah-conscious culture — improving resilience, protecting depositors and upholding the Shariah integrity that defines their mandate.

The study also recommended introducing external Shariah review and fiduciary rating of Islamic banks. That recommendation is discussed, together with the other Shariah governance recommendations, in Section 15.6.6 of Chapter 15.

Appendices

Appendix I

Industry Survey on Operational Risk Management in Banks

Governance Structure of Operational Risk Management in Banks	
Particulars	**Industry Survey (Opinion)**
Standalone ORM Unit function under RMD	30% [10%-40%]
Integrated with enterprise risk management	24% [5%-75%]
Decentralized across business units	35.5% [5%-50%]
No formal ORM governance framework	25.5% [5%-70%]
Board and Senior Management Oversight on ORM Practices in Banks	
Particulars	**Industry Survey (Opinion)**
Regular review at Board Risk Committee	30% [5%-70%]
Quarterly reporting to senior management only	33% [10%-50%]
Periodic updates	38.5% [10%-75%]
Not Applicable	20.5% [0%-70%]
Implementation of Three Lines of Defense Model in Banks	
Particulars	**Industry Survey (Opinion)**
Fully implemented and effective across all units	17% [5%-30%]
Partially implemented	31% [5%-80%]
Informally implemented without clear definition	34.5% [10%-65%]
Not implemented	17.5% [0%-80%]
Primary Tools and Methods Used to Identify Operational Risks in Banks	
Particulars	**Industry Survey (Opinion)**
Risk Control by the Business Unit	27% [10%-70%]
Internal audit findings	60% [15%-100%]
Incident/loss event reviews	16% [5%-50%]
Key risk indicators (KRIs)	22% [5%-50%]
Banks ORM Aligned with Regulatory Frameworks	
Particulars	**Industry Survey (Opinion)**
Fully aligned with Basel	40% [10%-70%]

Governance Structure of Operational Risk Management in Banks	
Aligned with Domestic Regulation	50% [15%-100%]
Limited Alignment	30.5% [5%-50%]
Not Aligned	2.5% [5%-50%]
Internal Loss Event/Incident Data Collected and Managed in Banks	
Particulars	**Industry Survey (Opinion)**
Centralized database/system with regular updates	20% [10%-40%]
Departmental logs consolidated periodically	30% [5%-60%]
Manual tracking and adhoc updates	25% [10%-50%]
Loss data is not formally maintained	25% [10%-75%]
Conducting Scenario Analysis in Banks	
Particulars	**Industry Survey (Opinion)**
Yes, in all business lines	23% [5%-90%]
Yes, only in selected high-risk areas	22% [5%-50%]
Occasionally, as part of internal control	37% [10%-70%]
Not conducted	18% [0%-60%]
Challenges of Conducting Scenario Analysis in Banks	
Particulars	**Industry Survey (Opinion)**
Lack of expert input or engagement	28.5% [10%-70%]
Limited historical data	37% [20%-60%]
Lack of standardized methodology	39% [20%-70%]
Not prioritized due to resource constraints	22.5% [5%-80%]
Monitoring Operational Risk Across Department/Branches in Banks	
Particulars	**Industry Survey (Opinion)**
Standardized dashboards and KRIs	28% [10%-60%]
Internal audit and compliance oversight	57% [40%-80%]
Business units manage independently	17.5% [20%-50%]
No structured monitoring	15.5% [10%-50%]
Key KRIs used in Banks	
Particulars	**Industry Survey (Opinion)**
Number of fraud incidents	40% [5%-90%]
System downtime/IT failures	27% [10%-70%]
Staff turnover rate	30% [10%-60%]
Customer complaints	25% [10%-60%]
Unauthorized transactions	23% [10%-70%]
Loss event frequency	15% [5%-40%]
Negative media reports	2%
More criteria are considered	2%
Frequency of ORM Reporting to Senior Management/Board in Banks	
Particulars	**Industry Survey (Opinion)**
Monthly	35% [10%-90%]
Quarterly	42% [10%-80%]
Semi-annually	15.5% [10%-40%]
As & when required	7.5% [5%-20%]
Managing Operational Risk of Outsourcing	
Particulars	**Industry Survey (Opinion)**

Governance Structure of Operational Risk Management in Banks	
Vendor risk assessment and monitoring in place	35% [10%-90%]
Included in ORM assessments occasionally	22% [5%-40%]
Not consistently addressed	23.5% [5%-70%]
No framework exists	29.5% [0%-50%]
Management of Cybersecurity Risk	
Particulars	**Industry Survey (Opinion)**
IT and Information Security Team	70% [20%-100%]
Operational Risk Management Unit	15% [5%-30%]
Internal Audit	12% [5%-25%]
All of the above	3% [0%-10%]
Building ORM Culture and Awareness in Banks	
Particulars	**Industry Survey (Opinion)**
Regular training and communication campaigns	60% [20%-100%]
Risk culture assessments	20% [10%-40%]
Staff incentives linked to risk performance	15% [5%-20%]
None of the above	5% [10%-40%]
Assessment of Training Effectiveness	
Particulars	**Industry Survey (Opinion)**
Post-training assessments and surveys	50% [10%-80%]
Monitoring performance/KRIs post-training	20% [0%-50%]
No formal assessment conducted	17.5% [0%-80%]
Feedback from supervisors only	12.5% [10%-50%]

Source: Habib et al. (2025).

Appendix II

Case Study Collected from BIBM Study

General Case of Operational Risk of Banks-1: Crisis of High NPL in Bangladesh

The banking sector is severely affected by an unparalleled crisis of NPLs, where wilful defaulters play a central role in the sectoral deterioration. Back in 2009, NPLs stood at BDT 224.82 billion. By September 2024, this figure rises steeply to BDT 2.84 trillion, excluding BDT 640 billion in written-off loans. The NPL ratio surged from 9.93% in September 2023 to 16.93% by September 2024. By December 2024, classified loans exceeded BDT 3.45 trillion (20.2% of total loans). As per the Bangladesh Bank forecasts, NPLs may exceed 30% by June 2025 due to systemic weaknesses, regulatory gaps, and exploitative practices. As per the white paper released in December 2024, distressed assets (including NPLs, rescheduled, restructured, written-off, and litigated loans) crossed BDT 6.75 lakh crore by FY 2023–24. The consequences are severe due to a majority of large defaulters are politically connected business conglomerates. Top defaulters of the country are some business houses that have executed the crime in connivance with a section of bank executives and external powerful quarters. Additionally, sponsor-directors of banks often take loans anonymously through mutual agreements and don't repay them, then approve dividends benefiting themselves despite poor bank health. Basically, these are innovative irregularities to siphon off the money in the name of loan which matches with the definition of operational risk. These circumstances impede the stability of the entire financial system and demand urgent attention to governance reforms, stricter regulations, and cultural shifts in borrower accountability. These non-performing loans are credit-risk exposures, but their scale in the banking industry of Bangladesh reflects extremely high operational risk as the underlying cause — process failure and internal and external financial crime (The Financial Express, 3 March and 7 April 2025; The Business Standard, 17 March 2025).

General Case of Operational Risk of Banks-2: Gross Manipulation in Some Shariah Based Banks

ABC Shariah Bank PLC, once one of the most reliable customers and profitable Islamic banks in Bangladesh, encountered a sharp decline in performance due to a complete breakdown of operational risk management

(ORM). Between 2017 and 2024, the bank's non-performing investment (NPI) ratio soared from 4% to over 40%. Once compliant with regulatory capital and liquidity requirements, the bank is now facing a capital deficit and severe liquidity crisis. This rapid deterioration is rooted in a fundamental failure of governance — where committed and competent board members were abruptly replaced by politically influenced and unethical appointees. Senior management was similarly overhauled, removing experienced leaders and installing individuals lacking expertise and accountability

In parallel, the bank's historically disciplined human resource practices collapsed. A bulk number of new recruits were appointed without proper screening, and staff development initiatives were discontinued. Critical operational processes, especially in credit and treasury, were bypassed or ignored, giving rise to unchecked exceptions and widespread corruption. Meanwhile, core banking systems were manipulated from the head office level-branch operations were restricted, data integrity was compromised, and frequent misreporting affected both internal communication and external disclosures. The situation worsened due to undue external interference in daily operations, which eroded institutional autonomy and encouraged unethical practices. Overall, this case highlights a gross failure across all key dimensions of ORM-governance, people, process, system, and external environment-serving as a cautionary example of how institutional breakdown can occur when operational risks are neither identified nor mitigated systematically.

General Case of Operational Risk of Banks-3: Big Scams and Operational Risks in Banking

The Hallmark Group committed one of the biggest financial scams in Bangladesh. The organization skimmed money of around 3600 crore taka over a number of years while presenting fraudulent company transactions using faked documents and letters of credit. Investigations disclosed that the bank's approval processes were highly corrupt, and several officials were engaged in the plan. (Source: The Daily Star)

The Bismillah Group scammed around 1200 crore taka using fake export documents. The group created shell companies to show fictitious international trade deals and to secure large loans. Bank officials were involved in approving these transactions without proper verification. A major vulnerability in Bangladesh's trade financing sector was unveiled through this scam. (Source: Prothom Alo)

Destiny Group operated one of Bangladesh's largest fictitious schemes. The company used a multi-level marketing policy to recruit new investors whose money was used to pay earlier participants. Later, it was found that none of the promised projects were operational, with funds being diverted to personal accounts. Around 4000 crore taka was siphoned off through this scam. (Source: Dhaka Tribune)

Mr. X was involved the systematic looting of ABC Leasing and several other financial institutions. He created a complex network of fake companies to get loans that were never repaid and approximately 3,634 crore taka was transferred from various banks, financial institutions and the capital market to Canada and India. (Source: The Business Standard)

The chairman and other directors of the ABC Bank approved loans to shell companies without proper collateral. Audits revealed serious irregularities in loan documentation and approval processes. The scandal forced Bangladesh Bank to intervene with a bailout package of around 4000 crore taka to save the bank from complete failure. (The Financial Express)

The XYZ Bank approved thousands of questionable loans without proper documentation. Investigators found that most borrower companies either didn't exist or were not operational. Despite clear evidence of a major scam, the politically exposed people involved were able to withdraw around BDT 4,500 crore. (Source: New Age)

The Crescent Group took large loans to develop state-owned jute mills, but instead diverted the funds for other purposes. Investigations revealed the mills never became operational despite receiving large financing. The group used complex financial maneuvers to hide the misappropriation of funds over several years and in this process, BDT 2,000 crore was siphoned off from the market. (Source: The Independent)

Evaly took advance payments for products it never delivered, using new customer deposits to pay earlier buyers. The scandal affected thousands of customers and merchants and around 1000 crore taka was scammed by Evaly. Later, It prompted new regulations for e-commerce businesses in the country. Source: Bangla Tribune)

General Case of Operational Risk of Banks-4: Illicit Outflows using Trade is a Huge Risk

Trade-Based Money Laundering (TBML) poses a significant risk to the financial integrity of Bangladesh, serving as a critical channel for illicit fund outflows through the manipulation of trade transactions. The true volume of illegal transfers is hard to measure, since much activity is hidden. Besides trade fraud, money is moved via underground banking, shell firms, and informal remittances. Bangladesh loses billions of dollars each year to illicit financial outflows (IFFs), undermining growth and governance. Transparency International

Bangladesh (TIB) cites GFI data finding an average of USD 8.275 bn/year (2009–18) via export under-invoicing and import over-invoicing-about 17% of trade value. A recent government white paper estimates USD 234 billion siphoned out over 2009–23 i.e. 16 billion per year (reported in The Financial Express). UN agencies and NGOs highlight that Bangladesh produced official estimates of illicit flows (drugs, human trafficking, etc.) only in 2023 (UNCTAD). Available figures point to large and growing flows: the Bangladesh Bank Governor reported a single Chattogram-based scheme that sent USD 20 bn abroad illegally (The Daily Star). These estimates underscore a persistent upward trend in illicit outflows and Bangladesh's trade mis invoicing over the years.

General Case of Operational Risk of Banks-5: Cyber security Concern in Banks

Bangladesh Bank Cyber Heist

In 2016, hackers attempted to steal nearly USD 1 billion from Bangladesh Bank's account at the Federal Reserve Bank of New York. While most transfers were blocked, approximately USD 81 million was successfully siphoned off. (Source: www.thedailystar.net)

Mobile Financial Services (MFS) Scam

MFS scammers imitate an MFS officials to extract sensitive information such as PINs and OTPs for unauthorized transactions. They collect customer information from MFS agent points and transfer the amount scammed to multiple accounts, which makes it difficult to identify. In another case, Bangladesh Bank detected fraud against MFS provider for creating BDT 645 crore in e-money without the necessary cash backing and filed a case in this regard. It is also blamed for unauthorized withdrawals of approximately BDT 1,711 crore from accounts maintained for government allowances. (Source: www.thedailystar.net)

ATM frauds

From 2016 to 2019, several ATM frauds were detected. Scammers frequently copied customer card information of various banks to withdraw approximately 10 million taka. Thieves stole 1.2 million taka from ATMs of a bank in two incidents and some of these scams were done by foreign groups. Additionally, customs officials found ATM cards illegally imported from Singapore, with 100,000 illegal cards linked to 4.1 million taka in unpaid taxes. Scammers also used POS machines at shops, hotels, and other businesses to steal over 50–60 million taka. Another scam involved a Turkish hacking group targeting a number of Bangladeshi banks. Foreign nationals withdraw 3 lakh taka from a bank's ATM booth (Source: www.thedailystar.net)

General Case of Operational Risk of Banks-6: Agent Banking Deserve Greater Attention

Starting its operations in 2013 as a safe alternative delivery channel of banking services to the underserved population, agent banking expanded rapidly, particularly in rural areas. Till December 2024, the number of accounts grows to around 16 million, deposits BDT 41,955 (crore), and remittances BDT 173,390 (crore). The business is mainly performed by 16,021 agents of 31 banks through 21,248 outlets. Despite the rapid growth, some agents misappropriated deposits, misused funds, and engaged in unauthorized lending, leading to losses estimated in the hundreds of crores of BDT (For example, a major financial scandal has been alleged at the Akkelpur agent banking branch of a shariah based bank situated in Joypurhat in this year. The cashier was involved in withdrawing nearly BDT 3 crore from customer and institutional accounts, systematically using deceptive tactics. Another scandal had been alleged one year ago at Nimai kashari agent banking branch of the same bank in Narayangonj where the agent escaped with BDT 2 crore of customers' money. This kind of incidents lead to operational and reputational risks, which compel banks to follow conservative lending practices to mitigate risks and avoid systemic impact (The Financial Express, 18 February 2025; The Business Standard; The Daily Star, 3 January 2024 and 3 March 2025).

General Case of Operational Risk of Banks-7: Cyber Disruption

In 18 September 2023 at 7:50 am, Dumni Network Operation Center (NOC) officials informed the Network Team that Internet DMZ Perimeter Firewall-01 had gone down in the network monitoring system (Nagios). Around 8:15 am, Mr. X from the network team arrived at SMDR and observed that the mentioned firewall was experiencing significant packet loss, causing a slowdown in the entire internet traffic. Mr. X then activated the standby secondary DMZ Perimeter Firewall-02. However, it also encountered high processing load (packet loss). The network team decided to shut down all public-facing services and gradually bring them back online around 9:00 pm. During this period, both DMZ Perimeter Firewalls generated substantial traffic and sent it to the Security Systems (SIEM, NBA).

In 22 September 2023 at around 2:25 pm, all internet-based services became inaccessible, and the Network Team identified that the CPU usage of the Internet DMZ Perimeter Firewall had exceeded 90%. During this period, the Authoritative Domain Name System (DNS) server received 75 million connections between 2:25 pm and 3:45 pm. Concurrent connections/sessions at the Internet DMZ Perimeter Palo Alto Firewall (new) reached 1 million (10,00,000) at that time, whereas the Internet DMZ Perimeter Firewall (Cisco ASA 5525) could handle a maximum of 500,000 (0.5 million) sessions. As a result, the firewall's CPU utilization exceeded 90%, leading to the outage of all services.

Considering both situations, ITSD of ABC Bank reviewed the entire traffic on Security Information and Event Management (SIEM) and Network Behavior Analysis (NBA). After analyzing the NBA and SIEM traffic, ITSD observed that the regular NBA network traffic ranged from 70 million to 80 million. However, on 22 September 2023, during the incident, it reached almost 285 million. Furthermore, the regular SIEM flow was around 1 million, but during that time, the traffic exceeded 3 million. NBA collects network flow data for network connections, whereas SIEM only collects log data. Additionally, they observed DNS traffic initiated from different IPs and countries. Based on the traffic pattern and behavior, ITSD assumed that this was a Distributed Denial of Service (DDoS) attack. Source: Basd on FGD Discussion

General Case of Operational Risk of Banks-8: CRO vs CCRO

Bangladesh Bank's 2018 Risk Management Guidelines mandate that all commercial banks establish a dedicated risk management division and appoint a Chief Risk Officer (CRO) at the rank of Deputy Managing Director to lead it. The CRO is expected to oversee the bank's entire risk landscape, ensuring robust risk practices and compliance with applicable regulations. This role involves identifying threats that may hinder the institution's strategic goals and fostering a risk-aware culture.

According to the Basel Committee on Banking Supervision (BCBS), the CRO should serve as an independent senior executive, entrusted with the design and implementation of the institution's comprehensive risk management framework across all levels of the organization.

However, in the context of Bangladesh the scenario is somewhat different. As risk management is yet to get due importance in our banking system, the Head of RMD and the CRO is not the same person in most of the cases. It is also true that the CRO performs the role of Chief Credit Risk Officer (CCRO) as the CRO is appointed from the credit background. As such the CRO is primarily focused on managing credit risk instead of overall risk management. This is a serious cause of concern from the true risk management point of view.

General Case of Operational Risk of Banks-9: Change Management and Operational Risk in Banking

When a bank undergoes a major transformation (e.g., digitalization), change management plays a critical role because poor handling of organizational or system changes can directly lead to operational risks, such as service disruptions, fraud, regulatory breaches, and data loss. In line with change management, talent management ensures the right people with the right skills are in place to support the change. Mismanagement of talents leads to errors, non-compliance, undetected fraud, reduced service quality, causing reputational damage and customer attrition. For example, in the year 2020, a bank employee serving as Chief Regional Officer at the Radhanagar branch in Magura of XYZ Bank, exploited systemic weaknesses by accessing official email accounts that shared a common default password. He sent a fraudulent Telegraphic Transfer (TT) order of BDT 5 lakh using these accounts.

In 2022, ABC Bank faced a massive loan scam where approximately BDT 20 billion was embezzled through loans to non-existent organizations. The fraudulent activities were facilitated by internal collusion and inadequate due diligence, leading to significant financial and reputational damage.

In 2023, seven bank officers, including a branch manager of PQR Bank, were implicated in the embezzlement of over BDT 3 crore. Their fraudulent activities included forging customer signatures, creating unauthorized loan accounts, and misappropriating funds through various channels.

The incidents indicate inadequate oversight during the transfer of personnel to critical positions, a lack of segregation of duties, allowing collusion among staff, and inadequate selection during internal transfers and promotions.

Source: Based on Interview; Based on FGD Discussion; https://www.tbsnews.net/, https://www.dailymessenger.net/ and, Kabir, Musnun & Hosen, Md. Mosharaf. (2024); Habib et al. (2025).

Chapter 13: Liquidity Management of Islamic Banks

Based on the study "Liquidity Management of Islamic Banks: Bangladesh Context" by Md. Mahabbat Hossain, Md. Abdul Karim, Md. Farid Uddin, Md. Emon Arefin, Md. Omor Faruq and A.K.M. Mizanur Rahman.

13.1 Introduction

Liquidity management is among a bank's most critical functions: its sustainability and public confidence depend on meeting obligations as they fall due without unacceptable losses. Because banks fund medium- and long-term financing with deposits that are short-term and withdrawable on demand, they inherently face maturity transformation and liquidity risk, and liquidity is often regarded as the lifeblood of banking operations (Abdullah, 2010). Given the risks of too little liquidity and the opportunity costs of too much, liquidity management seeks a balance between safety and profitability (Sobol, 2013).

The global financial crisis of 2007–2009 showed that even sound institutions can suffer severe distress if liquidity risk is mismanaged, with consequences extending to bank failures and systemic instability (Majid, 2003), and regulators responded with the Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). In Bangladesh, changing macroeconomic conditions, inflation, volatile deposit growth, rising non-performing loans, evolving regulation and recent banking-sector problems have made sound liquidity management increasingly important for depositor confidence and financial stability.

Conventional banks manage liquidity through regulatory reserves, money market transactions, central bank facilities and government securities — treasury bills and bonds, call money, repo and reverse repo, standing lending facilities and interbank borrowing — supported by well-developed money and capital markets.

Islamic financial institutions (IFIs) face additional complexity: they cannot use interest-based instruments, their largely short-term liabilities fund medium- to long-term assets, and all liquidity activities must avoid interest (Riba), excessive uncertainty (Gharar) and gambling (Maysir). They must therefore balance adequate liquidity, profitability and Islamic law (Shariah) compliance, and the scarcity of Shariah-compliant money market instruments and active secondary markets has long made liquidity risk one of their most significant risks.

Bangladesh Bank has introduced several Shariah-compliant instruments: the Bangladesh Government Islamic Investment Bond (BGIIB), the Bangladesh Government Investment Sukuk (BGIS), the Bangladesh Government Special Sukuk (BGSS), the Islamic Interbank Fund Market and interbank profit-sharing partnership (Mudarabah) placements. It has also introduced support facilities, including the Islamic Banks Liquidity Facility (IBLF), Mudarabah Liquidity Support (MLS) and Special Liquidity Support (SLS). These have improved the framework, but concerns remain about the availability, competitiveness, tradability and operational effectiveness of the instruments.

The literature also stresses the need for such instruments: Sumon and Ahmed (2022) argue that Islamic investment certificates (Sukuk) can help Islamic banks meet statutory liquidity

requirements while financing government development projects, and Sarker et al. (2019), drawing on the experience of Bahrain and Malaysia, propose Bangladesh Government Islamic Treasury Bills (BGITB) and unrestricted Wakalah-based instruments.

Internationally, the Basel Committee on Banking Supervision (BCBS) introduced the LCR and NSFR under Basel III. The Islamic Financial Services Board (IFSB) issued IFSB-12 on liquidity risk management and addresses liquidity within capital adequacy and risk management in IFSB-23, and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standard No. 44 sets out permissible means of obtaining and deploying liquidity. Domestically, Bangladesh Bank has issued the Guidelines for Conducting Islamic Banking (2009), the Risk Management Guidelines (2018), the Asset Liability Management Guidelines (2016) and circulars on the Cash Reserve Requirement (CRR), Statutory Liquidity Requirement (SLR), LCR, NSFR, BGIIB, BGIS, IBLF, MLS and SLS.

Challenges nonetheless persist. Some Islamic instruments yield less than comparable conventional ones, the IIFM does not function effectively, and secondary markets and Shariah-compliant capital market instruments are limited. Foreign-currency liquidity, correspondent banking, Nostro management and the lack of Offshore Banking Units for Islamic windows pose further difficulties, and ensuring Shariah compliance throughout liquidity operations remains critical. These call for a comprehensive assessment of the framework and practical recommendations for strengthening it.

13.1.1 Objectives of the Study

The study evaluates the liquidity management framework of Islamic banks in Bangladesh from regulatory, operational and market perspectives, examining the management of surplus and deficit positions and the effectiveness of existing instruments and facilities. Its specific objectives are:

a. to evaluate the liquidity management of Islamic banks from regulatory perspective;
b. to identify operational issues of liquidity management in surplus position of funds of an Islamic bank;
c. to examine the operational issues of liquidity management in deficit position of funds of an Islamic bank; and
d. to develop practical recommendations for strengthening liquidity management of Islamic banks in Bangladesh.

13.1.2 Methodology of the Study

The study is qualitative and descriptive. It reviews the international standards of the BCBS, IFSB and AAOIFI and Bangladesh Bank's regulations on liquidity management, treasury operations and risk management of Islamic banks.

Primary data were collected through structured questionnaires, FGDs and Key Informant Interviews (KIIs). The participants were treasury executives of full-fledged Islamic banks and of the Islamic operations of conventional banks, heads of Islamic Banking Divisions of dual banks, Shariah Secretariat officials, and representatives of Bangladesh Bank's Debt Management Department (DMD), the Special Purpose Vehicle (SPV) for government Sukuk

and other departments. Secondary data came from Bangladesh Bank publications and circulars, regulatory guidelines, international standards, research articles and reports. The information was analyzed qualitatively and thematically. The respondents and participants are summarized in Table 13.1.

Table 13.1: Respondent of the Questionnaire and Participants of the FGD/KII

S/n	Particulars	Respondents
1.	Number of Islamic Financial Institutions Provided Quantitative Data	▪ Full-Fledged IB: 04 ▪ Dual IB: 10 ▪ Finance Companies (FCs): 02
2.	Number of Islamic Financial Institutions provided Qualitative Data	▪ Full-Fledged IB: 04 ▪ Dual IB: 14 ▪ FCs: 02
3.	Number of Officials Participated in the FGD/KII	▪ Officials of Bangladesh Bank: 07 ▪ Officials of Full-Fledged IB: 09 ▪ Officials of Dual IB: 17 ▪ Officials of FCs: 03 ▪ Officials of BIBM: 02 ▪ IB Expert: 02

13.2 Shariah Perspectives and Literature Review

13.2.1 Shariah Viewpoints on Liquidity Management

Although liquidity management is a modern banking concept, its principles are rooted in Shariah, which emphasizes prudent financial management, fulfillment of obligations, preservation of wealth, avoidance of harm and preparedness for contingencies. Its aim is not merely to hold cash but to manage resources in a Shariah-compliant way that safeguards depositors, investors, shareholders and other stakeholders.

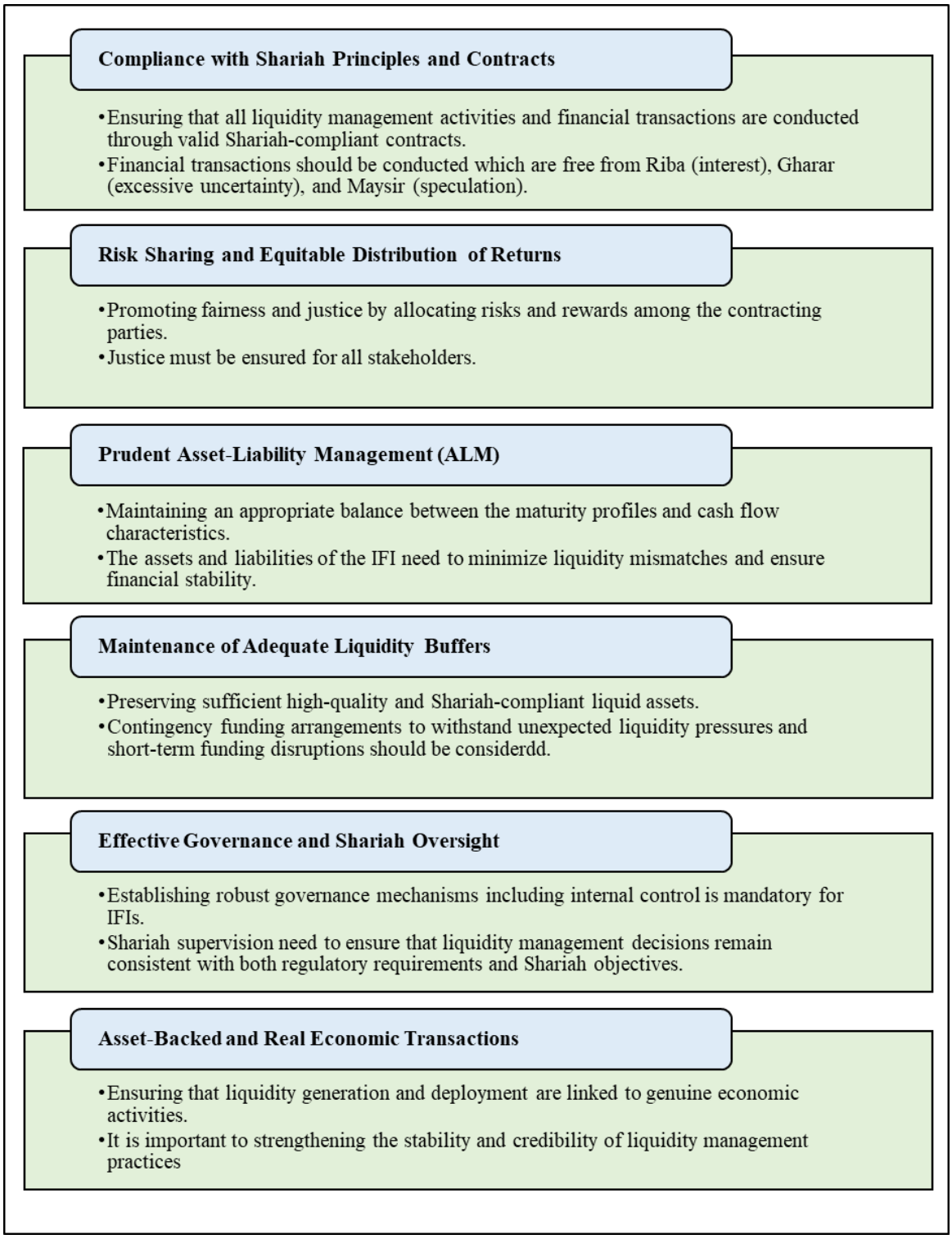
The Qur'an commands believers to fulfill all contracts (5:1) — for a bank, adequate liquidity is what allows it to meet withdrawals and settle its obligations — and to record debts (2:282), stressing transparency and sound financial management. Prophet Yusuf's (AS) advice to store surplus produce in years of abundance against years of scarcity (12:47–49) anticipates modern liquidity buffers and contingency funding. The injunction "do not throw yourselves with your own hands into destruction" (2:195) and the maxim Al-Darar Yuzal (harm must be eliminated) support holding adequate reserves against distress, reputational damage and insolvency. The Hadith "Delay in payment by a wealthy person is injustice" (Sahih al-Bukhari, Hadith No. 2400; Sahih Muslim, Hadith No. 1564) requires the capacity to discharge obligations on time.

Preservation of wealth (Hifz al-Mal), one of the higher objectives of Islamic law (Maqasid al-Shariah), is thus a foundation of liquidity management: adequate liquidity protects depositors' funds, ensures the continuity of operations and supports financial stability, making it a Shariah imperative as well as a regulatory requirement, in the public interest (Maslahah).

Under AAOIFI Shariah Standard No. 44, liquidity is cash and assets readily convertible into cash, and liquidity management means balancing the quick, cost-effective securing of liquidity against the efficient deployment of funds (AAOIFI SS 44, Clause 2). Islamic banks must do this without Riba, Gharar, Maysir or other prohibited elements, relying on genuine trade, real

economic transactions, profit-and-loss sharing and asset-backed instruments. Figure 13.1 presents the key preconditions for liquidity management in Islamic banks.

Figure 13.1: Preconditions for Effective Liquidity Management in Islamic banks



Source: Authors' Own Compilation.

Liquidity must be managed in surplus and deficit situations as well as for regulatory compliance. In surplus, idle funds erode profitability, so a bank must turn them into earning assets for its Investment Account Holders (IAH) and shareholders, in keeping with Hifz al-Mal. Deficits require proactive management, since sudden withdrawals, asset–liability mismatches, funding disruptions and loss of confidence can quickly escalate into solvency crises and systemic instability. Prudence therefore requires Islamic banks to hold enough liquidity to meet obligations as they fall due while using funds productively, in line with trust (Amanah), Maslahah and Hifz al-Mal.

From a Shariah perspective, compliance with the law of the land and regulatory requirements issued by the competent authority is an important obligation, provided that such requirements do not contradict any explicit injunction of Shariah. The Holy Qur'an commands believers to obey Allah, His Messenger, and those entrusted with authority among them (Surah Al-Nisa, 4:59).

For Islamic banks, receiving funds is generally limited to transactions with other Islamic banks or Islamic banking operators. However, Shariah scholars in Bangladesh have expressed support for allowing Islamic banks to receive funds from conventional banks, provided these are maintained through current accounts or Mudarabah accounts, which do not involve Riba (interest).

The Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) addressed this issue at the 41st meeting of its Fiqh Committee on 6 August 2019. Its resolution (translated from Bangla) states that Islamic banks should make every effort to meet liquidity shortfalls from Shariah-approved sources, so that conventional funds are not needed. Where this is not possible, funds or deposits may, in case of urgent need, be taken from conventional banks or financial institutions through Shariah-approved methods, with the advice of the Shariah Supervisory Committee where necessary.

Islamic banks — full-fledged or dual — are expected to have a fund management policy. One dual bank's policy provides that its Islamic banking division may invest excess liquidity in BGIIB and BGIS. In a liquidity crisis, the division may draw on BGIIB, Mudarabah Liquidity Support or the Islamic Banks Liquidity Facility, or receive deposits from other Islamic banking divisions in Mudarabah Special Notice Deposit (SND)/TD accounts at pre-agreed profit-sharing ratios (PSR) and weightages.

Another bank's policy notes that the conventional treasury earns mostly interest income, of which only foreign exchange gains are permissible in Shariah. It therefore requires a restricted Mudarabah agreement between the Islamic banking division and the head-office treasury to deploy the division's idle funds. In effect, the bank places its Islamic surplus with the conventional treasury under a restricted Mudarabah and shares the profit.

AAOIFI Shariah Standard No. 44 prohibits obtaining or deploying liquidity through interest-bearing loans, overdrafts or interest-bearing commission-based facilities, and requires any liquidity support from central banks or other regulators to be provided only through Shariah-compliant modes such as Mudarabah and investment agency (Clause 4/1). It recommends Salam, Istisna'a, sale and leaseback, commodity-based cash financing (Tawarruq) and interest-free loans as permissible alternatives (Clause 4/2).

13.2.2 Literature Review

Liquidity Management in International Banks

International banks, with their cross-border exposure, face more complex liquidity management than domestic banks, and the global financial crisis of 2007–2009 led to Basel III. Diamond and Dybvig (1983) framed liquidity risk as the maturity mismatch between short-term deposits and long-term lending, and later work linked liquidity risk to solvency. Basel III introduced the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) to ensure sufficient high-quality liquid assets in the short term and stable funding in the long term. Giordana and Schumacher (2013) find that these standards have made European banks stricter in managing liquidity, affecting their lending and monetary transmission, with banks that have larger maturity mismatches more sensitive to liquidity shocks.

Dutch banks hold liquidity above the regulatory minimum as a precaution (Bonner & Eijffinger, 2016). Liquidity requirements reduce maturity mismatch but may lower profitability by restricting lending (Mordel, 2018). The LCR raises holdings of high-quality liquid assets and reduces reliance on unstable short-term funding (Doerr & Drehmann, 2026), and international Islamic banks are more exposed to liquidity risk because they cannot use interest-based instruments (Mohammad et al., 2020).

Liquidity Management in Bangladeshi Banks

In Bangladesh, liquidity management has become one of the most critical challenges for bank management, both for financial stability and for regulatory compliance, and studies have examined the causes of liquidity shortages and ways of maintaining balanced liquidity (Bhowmik, Hossain, & Sarker, 2025). Rahman and Banna (2016) find that Shariah restrictions require Islamic banks to hold more liquidity than conventional banks, and that liquidity risk contributes to losses and insolvency in both.

Tasnova (2022), studying 29 listed banks, finds that both bank-specific and macroeconomic determinants, including monetary policy and business conditions, shape liquidity. Bari and Uddin (2022) find that the loan-to-deposit ratio, Gross Domestic Product (GDP) growth, inflation, bank size and capital adequacy significantly affect liquidity, with private banks managing it better than state-owned banks, while Naoaj (2023) finds that size and regulatory requirements reduce liquidity and leverage increases it. Asset–liability mismatch is a key indicator of liquidity risk (Lee, 2013) — the liquidity gap arises largely from funding long-term financing with short-term liabilities (Ara & Haque, 2014) — and net interest margin, capital adequacy and credit quality improve liquidity performance (Hoque et al., 2024).

Liquidity Management of International Islamic Banks

Islamic banks must balance Shariah compliance, profitability and liquidity, a task complicated by the scarcity of Islamic liquid instruments and an unstructured interbank market (Dhiraj, Puneri, & Benraheem, 2019). In Pakistan, the LCR and NSFR significantly affect the profitability and stability of Islamic banks, and Basel III supports their resilience at some cost to profitability (Ayub, Alhabshi, & Othman, 2023). In Association of Southeast Asian Nations (ASEAN), the stability of Islamic banks adhering to Basel III depends on the regulatory environment and institutional culture (Wahyudi, Zuliansyah, & Musthofa, 2024). Limited

Shariah-compliant instruments, weak secondary markets and regulatory divergence remain major challenges, making governance, risk measurement and technology vital (Mikou, Lahrichi, & Achchab, 2024), and sound asset–liability management is key to reducing liquidity risk (Malhou & Maimoun, 2021).

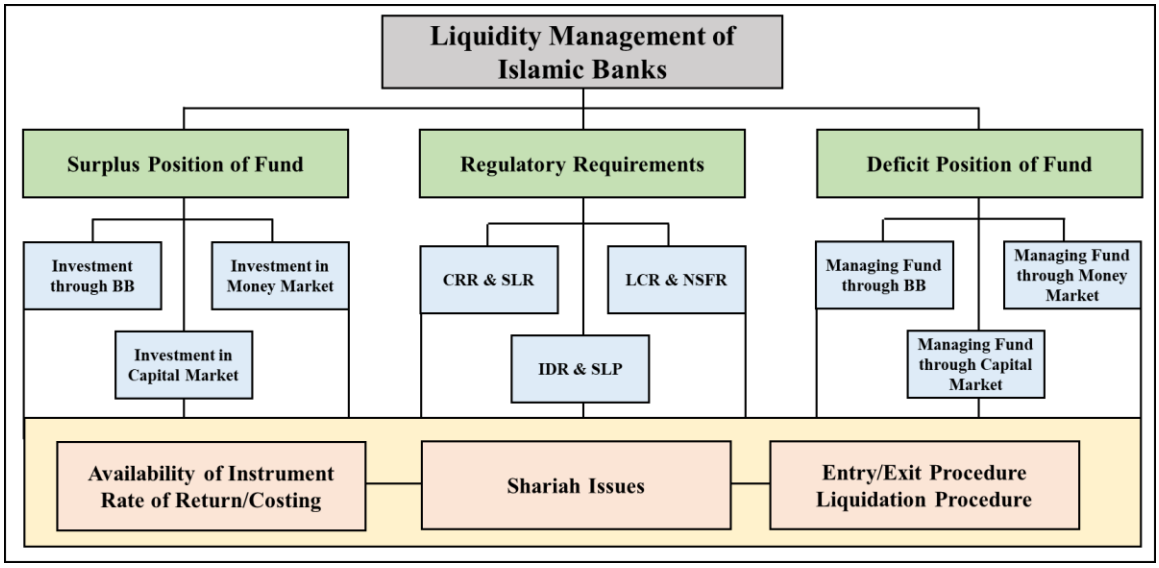
Liquidity Management of Bangladeshi Islamic Banks

In Bangladesh, where high non-performing loans already strain banks, the inability to use interest-based instruments makes liquidity management especially difficult for Islamic banks, which lack suitable instruments and cannot borrow from interest-bearing sources (Rahman & Banna, 2016). Comparing five Islamic and five conventional banks, Jalil and Biswas (2018) find higher liquidity ratios but negative liquidity gaps in the Islamic banks, owing to maturity mismatch between investments and deposits, alongside compliance with Basel III standards. Chowdhury, Zaman and Alam (2019) find that non-performing assets worsen liquidity risk while ROA, Return on Equity (ROE), capital adequacy and the investment-to-deposit ratio improve liquidity management, and Rahman (2019) attributes Islamic banks' fewer liquidity tools to an underdeveloped money market, calling for Sukuk, an Islamic interbank market and central bank-supported Shariah-compliant instruments.

13.3 Theoretical Foundations of Liquidity Management of Islamic Banks

Several theories explain how banks manage liquidity, allocate funds and address asset–liability mismatches; developed for conventional banking, they remain relevant to Islamic banks, subject to Shariah-compliant interpretation. Figure 13.2 presents the main aspects of liquidity management in Islamic banks in Bangladesh.

Figure 13.2: Overall Liquidity Management of Islamic Banks



Source: Authors' Compilation.

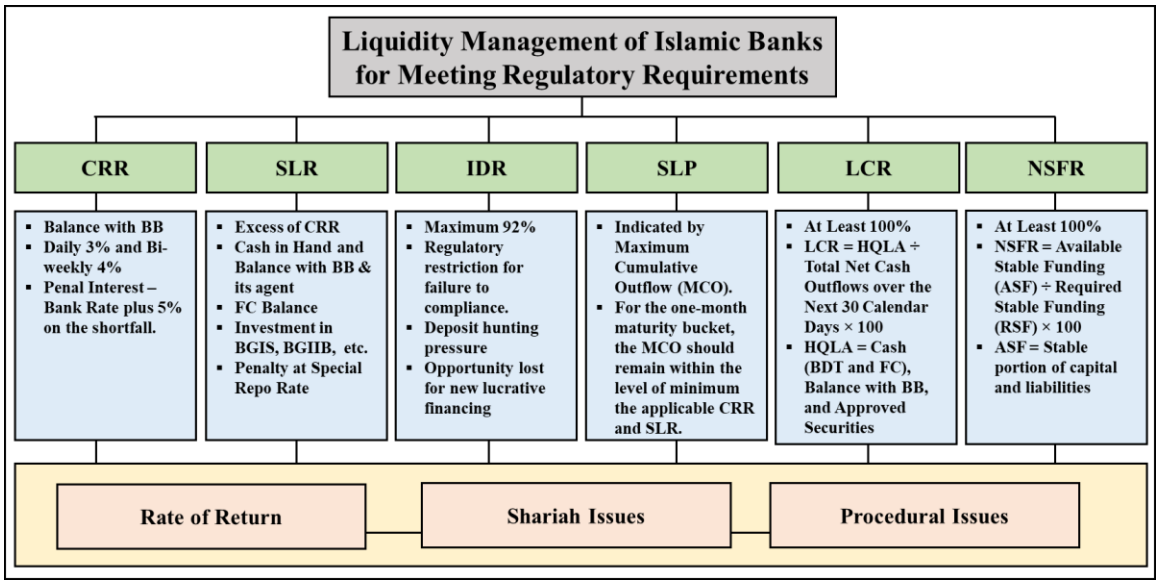
Figure 13.2 centers liquidity management on three connected areas: meeting regulatory liquidity requirements; deploying surplus funds — through Bangladesh Bank instruments,

money market placements and capital market instruments — to earn returns for depositors and shareholders; and covering shortages through Shariah-compliant funding from Bangladesh Bank facilities, the interbank market or the capital market. Three cross-cutting considerations shape all three: the availability and return or cost of instruments, their Shariah compliance, and operational factors such as entry, exit and liquidation procedures. Effective liquidity management therefore requires a comprehensive approach that balances regulatory compliance, profitability, cost, operational efficiency and Shariah compliance.

13.3.1 Regulatory Liquidity Management Requirements for Islamic Banks in Bangladesh

Islamic banks in Bangladesh must meet the statutory and prudential liquidity requirements prescribed by Bangladesh Bank. The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) are imposed under the Bangladesh Bank Order 1972 and the Bank Company Act 1991. The Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) strengthen short- and long-term resilience, and the Investment–Deposit Ratio (IDR) is prescribed by Department of Off-Site Supervision (DOS) Circular No. 02 of 12 April 2020. Their approach to meeting these requirements is summarized in Figure 13.3; the legal provisions are set out in Section 13.4.2.

Figure 13.3: Liquidity Management of Islamic Banks for Meeting Regulatory Requirement



Source: Authors' Compilation.

Cash Reserve Ratio (CRR)

Under Article 36(1) of the Bangladesh Bank Order 1972 and Section 33(1) of the Bank Company Act 1991, banks must hold a prescribed percentage of their Average Total Demand and Time Liabilities (ATDTL) as cash reserves with Bangladesh Bank. The CRR is both a primary liquidity buffer and a monetary policy instrument. Banks must currently maintain a daily minimum CRR of 3.00% and a bi-weekly average of 4.00% of ATDTL for Domestic Banking Operations (MPD Circular No. 01 of 4 March 2025; FE Circular No. 07 of 29

February 2024), held in unencumbered BDT current accounts with Bangladesh Bank. Balances under lien, including liens against discounting facilities or capital liens of foreign banks, are excluded.

Statutory Liquidity Ratio (SLR)

The Statutory Liquidity Ratio (SLR) requires banks to hold a prescribed percentage of ATDTL in approved liquid assets, providing a further buffer against unexpected needs. Islamic banks must currently maintain a daily SLR of at least 5.50% of ATDTL for both Domestic and Offshore Banking Operations (MPD Circular No. 02 of 10 December 2013; DOS Circular No. 01 of 19 January 2014). Unlike the CRR, it may be met with cash in hand (local and foreign currency), balances with Sonali Bank as Bangladesh Bank's agent, excess CRR, investments in BGIIB, unencumbered BGIS and other approved assets, and, for offshore operations, Nostro balances in major currencies (USD, GBP, EUR, JPY, CAD and CNY). Shortfalls attract a penalty at the prevailing Special Repo Rate on the daily shortfall (DOS Circular No. 01 of 19 January 2014).

Liquidity Coverage Ratio (LCR)

The Basel III Liquidity Coverage Ratio (LCR) requires banks to hold enough High-Quality Liquid Assets (HQLA) to cover their projected net cash outflows over a 30-calendar-day stress period, with a minimum of 100%:

> **LCR = High-Quality Liquid Assets (HQLA) ÷ Total Net Cash Outflows over the Next 30 Calendar Days × 100**
>
> **Total Net Cash Outflows = Total Expected Cash Outflows — Total Expected Cash Inflows**

Inflows are capped at 75% of outflows so that banks do not rely excessively on expected inflows. For Islamic banks in Bangladesh, HQLA typically comprise cash in hand, unencumbered balances with Bangladesh Bank in local and foreign currencies, and unencumbered approved securities. The LCR is a key supervisory measure of short-term resilience, but it is harder for Islamic banks to meet because Shariah-compliant HQLA are scarce and few Islamic instruments are actively traded — underlining the need for a broader range of such instruments.

Net Stable Funding Ratio (NSFR)

The Net Stable Funding Ratio (NSFR) addresses structural liquidity risk over a one-year horizon. It requires the ratio of Available Stable Funding (ASF) — capital and liabilities likely to remain stable for a year, even under stress — to Required Stable Funding (RSF), determined by the liquidity and maturity profile of assets and off-balance-sheet exposures, to be at least 100%:

> **NSFR = Available Stable Funding (ASF) ÷ Required Stable Funding (RSF) × 100**

By limiting reliance on short-term funding and maturity mismatches, the NSFR is especially relevant to Islamic banks, whose financing is often medium- to long-term while their deposits are relatively short-term.

Investment Deposit Ratio (IDR)

The Investment–Deposit Ratio (IDR) is the Islamic counterpart of the conventional Advance–Deposit Ratio (ADR). It measures investments against deposits and other eligible funding and is capped to prevent excessive deployment of funds. Under DOS Circular No. 02 of 12 April 2020, the maximum IDR for Islamic banks is 92%, against an ADR of 87% for conventional banks (the method for setting the ceiling is described in Section 13.4.2).

Structural Liquidity Profile (SLP) and Maximum Cumulative Outflow (MCO)

Under the Asset-Liability Management (ALM) Guidelines 2016, banks must prepare a Structural Liquidity Profile (SLP) of expected inflows and outflows across maturity buckets in local and foreign currencies (see also DOS Circular No. 02 of 29 March 2011). A negative gap in any bucket is an early warning to realign maturities.

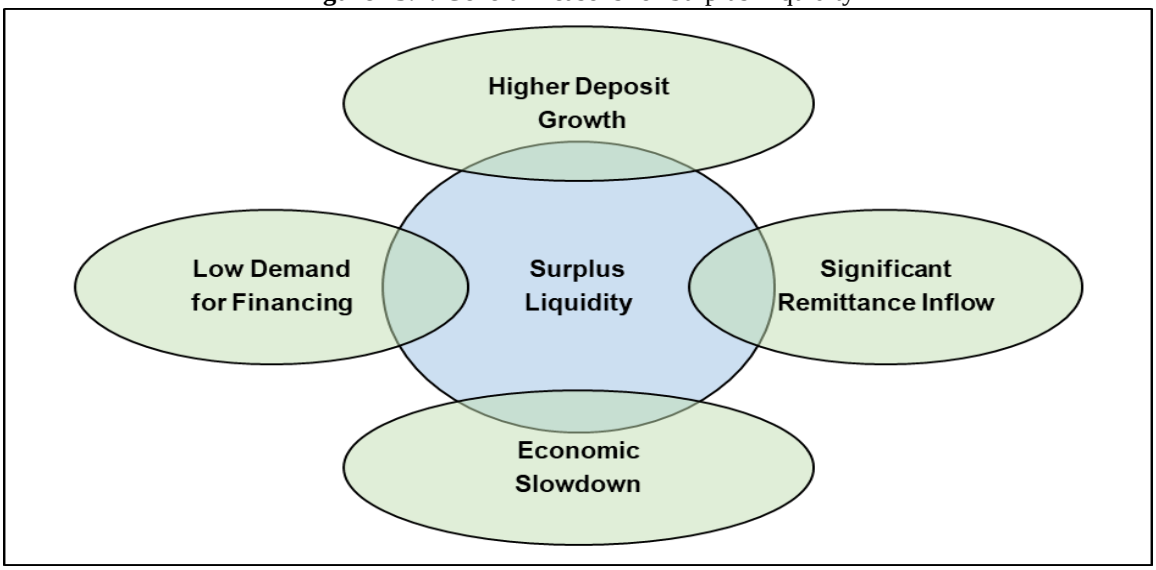
The Maximum Cumulative Outflow (MCO) ratio derived from it compares the cumulative net outflow in a bucket with available liquidity. For the one-month bucket it should generally stay within the combined CRR and SLR — 17% for conventional banks (a 4% CRR plus a 13% SLR) and 9.5% for Shariah-based banks (4% plus 5.5%). Limits for longer buckets are set, and periodically reviewed, by the board (or by Asset-Liability Management Committee (ALCO) for foreign banks) in the light of the business model, funding structure and risk appetite, and conventional banks with Islamic operations prepare a combined SLP and MCO. For the one-month bucket, the MCO may be calculated as follows:

MCO	=	***Total outflow up to one month + Total OBS up to one month***
		Total inflows + Net Nostro A/c balance + Available FC balance with BB

13.3.2 Liquidity Management of Islamic Banks in Surplus Position

Surplus liquidity arises from strong deposit growth, large remittance inflows, weak investment demand, limited financing opportunities and economic slowdown (Figure 13.4), and must be deployed productively to protect profitability and stability.

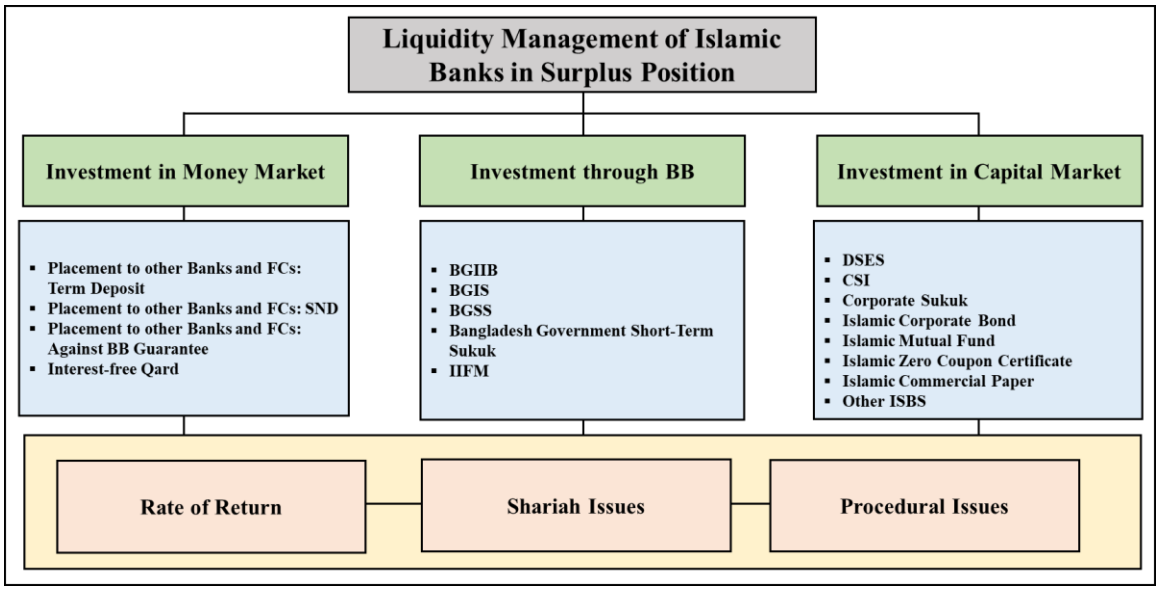
Figure 13.4: General Reasons for Surplus Liquidity



Source: Authors' Compilation.

Surplus liquidity arises when available funds exceed financing, investment and regulatory needs. Idle funds depress returns to depositors and shareholders, so Islamic banks must deploy them in Shariah-compliant avenues that earn reasonable returns while preserving liquidity. In Bangladesh these include Bangladesh Bank instruments — BGIIB, BGIS, the Bangladesh Government Special Sukuk (BGSS) and the Islamic Interbank Fund Market. Capital market instruments — Shariah-compliant equities, corporate Sukuk, Islamic corporate bonds and Islamic mutual funds, and money market placements such as Mudarabah term deposits and Special Notice Deposits (SND). Their usefulness depends on availability, expected return, Shariah compliance and the procedures for investment, redemption and liquidation.

Figure 13.5: Liquidity Management of Islamic Banks in Surplus Position



Source: Authors' Compilation.

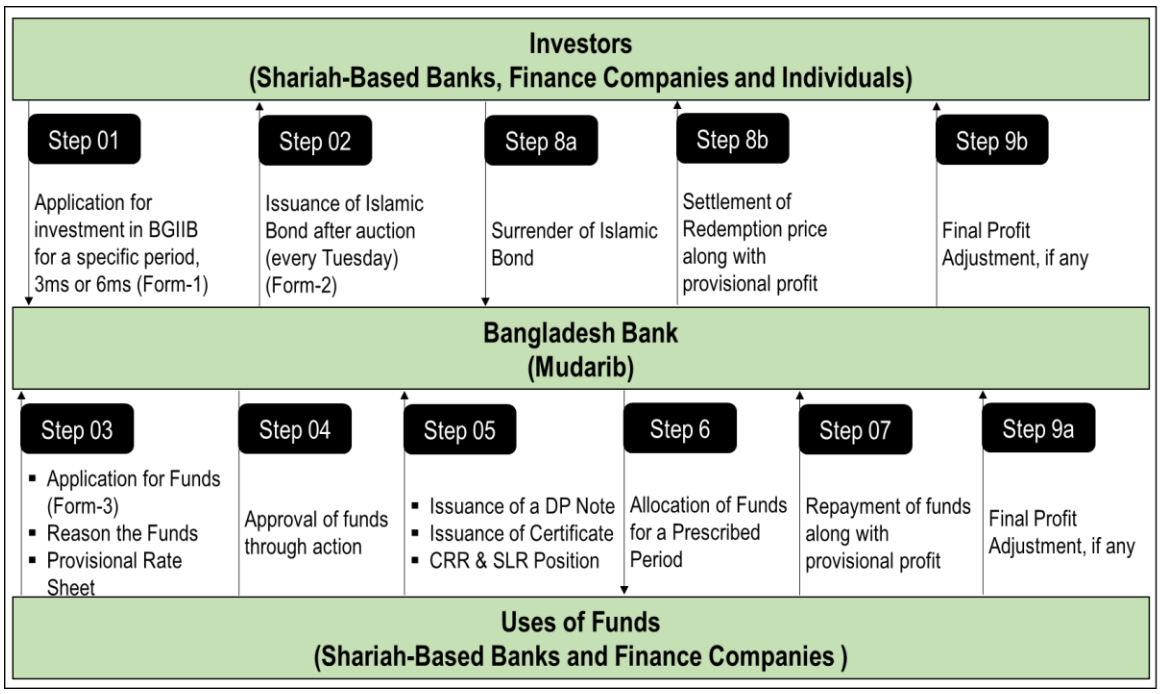
Two government instruments dominate the deployment of surplus liquidity by Islamic banks: BGIIB and BGIS. Their issuance history and investor base are reviewed in Section 10.4.1 and Section 10.4.2 of Chapter 10; the discussion here focuses on their role in liquidity management.

Bangladesh Government Islamic Investment Bond (BGIIB)

The Bangladesh Government Islamic Investment Bond (BGIIB), introduced on 5 September 2004 under the Bangladesh Government Islami Investment Bond (Islami Bond) Rules 2004 (amended by DMD Circular No. 05 of 1 September 2014), is a pooled Mudarabah through which Islamic banks, Islamic branches, financial institutions and individuals invest surplus funds, with Bangladesh Bank as managing partner (Mudarib) and a 90:10 profit-sharing ratio in favor of investors. It offers three-month (since January 2015) and six-month (since 2004) maturities, allocated through weekly auctions held on Tuesdays; one- and two-year bonds have been suspended since January 2015. Returns depend on the actual profit on the pooled funds and are benchmarked to the three- and six-month Mudarabah Term Deposit Receipt (MTDR) rates of the institutions using the funds. A provisional rate is paid at maturity and adjusted to the actual outcome, usually by 31 March of the following year.

BGIIB is an eligible SLR asset for Islamic banks, and funds obtained through it are not netted against SLR holdings, so it serves both liquidity management and regulatory compliance. It remains one of the most important Shariah-compliant liquidity instruments, but its short maturities, lack of a secondary market, limited tradability and uncompetitive returns are concerns, and some scholars and practitioners question the Shariah governance and transparency implications of large, persistent gaps between provisional and actual profit.

Figure 13.6: Operational Procedures of BGIIB



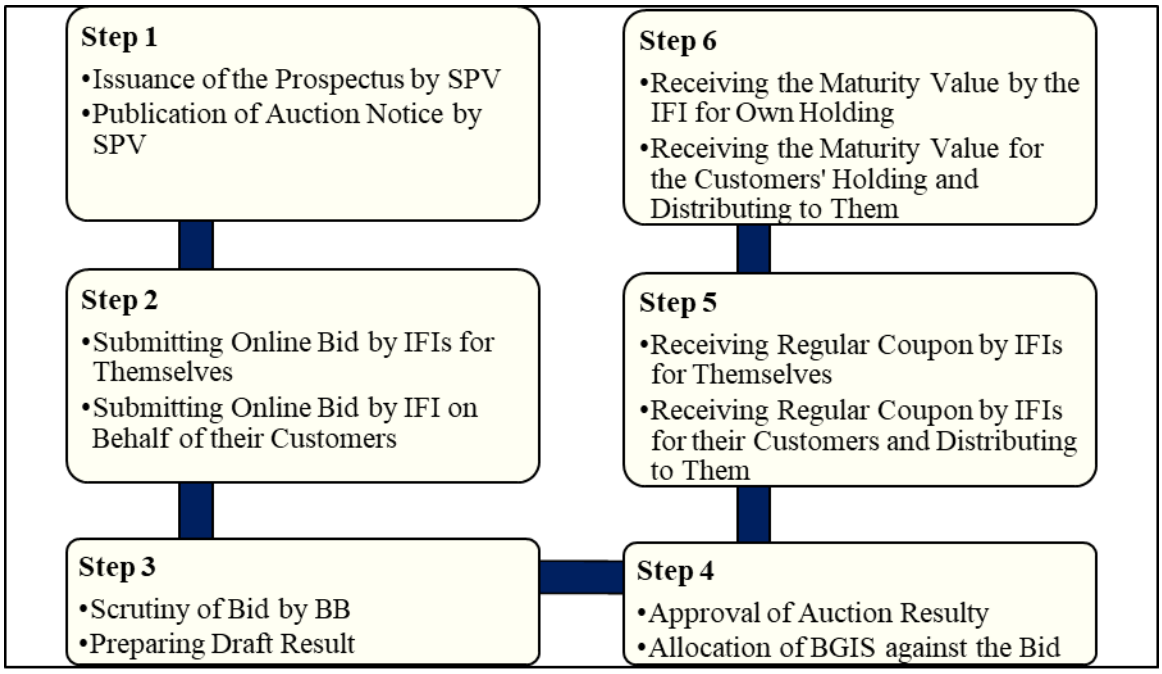
Source: Authors' Compilation.

Bangladesh Government Investment Sukuk (BGIS) Including Special Sukuk (BGSS)

The Bangladesh Government Investment Sukuk (BGIS), first issued on 28 December 2020, finances development projects while giving Islamic institutions a long-term (five- to ten-year) investment that qualifies as an approved security for the SLR; no short-term BGIS exists yet. Investors receive periodic income from the underlying assets — 4.69% a year, paid semi-annually, on the first issue and 9.75% on BGIS-9 — and, as sovereign instruments, BGIS are low-risk, with returns competitive with conventional government securities. Under DMD Circular Letter No. 13 of 4 August 2025, 80% of publicly offered Sukuk certificates are allocated to Shariah-based banks, Islamic finance and insurance companies and the Islamic operations of conventional banks and financial institutions, making BGIS increasingly important for their liquidity management and SLR compliance.

Figure 13.7 illustrates an indicative process for investing in BGIS; the process for BGSS and short-term Sukuk may differ with their structure.

Figure 13.7: Indicative Operational Procedures of Investment in BGIS



Source: Authors' Compilation.

Islami Interbank Fund Market (IIFM)

The Islami Interbank Fund Market (IIFM), introduced by DOS Circular Letter No. 23 of 27 December 2011, was intended as a Shariah-compliant alternative to the call money market. Islamic banks and Islamic branches or windows of conventional banks place surplus funds, after meeting their own needs, in the Islamic Bond Fund (Islamic Banking and Finance (IBF)), which allocates them to participating institutions under Mudarabah, generally according to prescribed profit-sharing ratios. Provisional profit is paid daily and adjusted to the recipients' final annual profit rates; unutilized funds earn nothing; and placements are usually overnight, extended over holidays. The market has not become active: practitioners cite low returns relative to alternatives, operational constraints and other available avenues, so most Islamic banks do not use it.

Utilization of Surplus Liquidity through the Islamic Money Market

Islamic banks also place surplus funds with other Islamic banks and Islamic banking operations through Mudarabah term deposits and Special Notice Deposits (SNDs), which earn returns on idle funds while preserving liquidity and channel funds from surplus to deficit institutions. The main concern is Shariah compliance in execution, particularly the calculation and distribution of profits, which requires transparency and adherence to Mudarabah principles.

Investment in Capital Market

Islamic banks may invest part of their surplus in the capital market for diversification and higher returns, at the cost of market, price and liquidity risk and within regulatory and internal limits (see Section 13.4.2). They invest mainly in Shariah-compliant equities in the DSE Shariah Index (DSES) and the Chittagong Stock Exchange Shariah Index (CSI), and in

corporate Sukuk and Islamic corporate bonds. They may also invest in Shariah-based mutual funds, Islamic zero-coupon certificates, Islamic commercial papers and other Islamic securities approved by the Bangladesh Securities and Exchange Commission (BSEC) and Bangladesh Bank. Such investment remains limited by the shortage of instruments, an underdeveloped secondary market, liquidity constraints, and concerns about valuation and volatility.

13.3.3 Liquidity Management of Islamic Banks in Deficit Position

A liquidity deficit, where the demand for funds exceeds supply, threatens a bank's ability to meet withdrawals, interbank settlements, payments and regulatory requirements, and can disrupt operations and damage confidence. It is harder for Islamic banks, which cannot use interest-based funding and must rely on a narrow set of Shariah-compliant instruments and facilities.

In Bangladesh, shortages stem from rising non-performing investments, slow recovery, weak deposit growth, heavy government borrowing from banks, monetary tightening, economic and market shocks, governance scandals and adverse media reports, asset–liability mismatches, and seasonal cash demand around festivals, harvests and government payment cycles. Box 13.1 summarizes the main causes.

Box 13.1: Major Causes of Liquidity Deficits in Islamic Banks

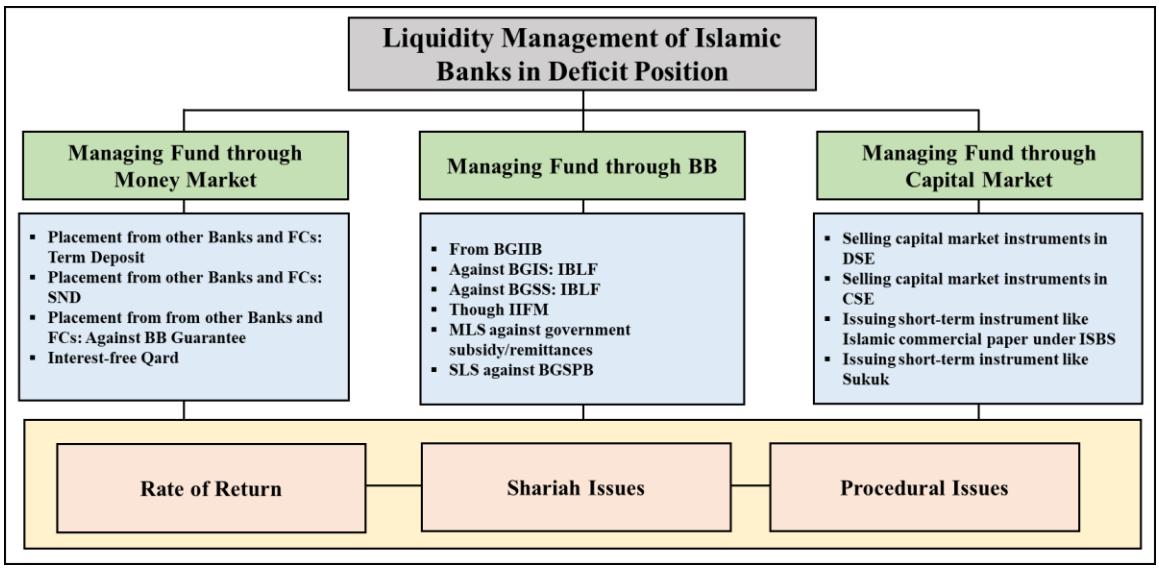
- **High Growth of Non-Performing Investments (NPIs)**, reducing cash inflows and limiting the recycling of funds.
- **Delay in Recovery of Investments and Receivables**, causing liquidity to remain locked in financing portfolios.
- **Weak Deposit Growth or Deposit Withdrawal Pressure**, resulting in a mismatch between funding requirements and available resources.
- **Decline in Inward Remittance Inflows**, which may adversely affect deposit growth and liquidity availability, particularly for Islamic banks that rely heavily on remittance-linked deposits as a significant source of funding.
- **Asset-Liability Mismatches**, arising from differences in the maturity profiles of deposits and investments.
- **Excessive Investment Expansion**, where financing growth outpaces deposit mobilization and stable funding sources.
- **Limited Availability of Shariah-Compliant Liquidity Management Instruments**, restricting access to alternative funding sources during liquidity stress.
- **Underdeveloped Islamic Interbank Money Market**, limiting opportunities for short-term liquidity placement and borrowing.
- **Monetary Tightening Measures by Bangladesh Bank**, which may absorb liquidity from the banking system and increase funding constraints.
- **Large-Scale Government Borrowing from the Banking Sector**, reducing the volume of funds available to banks.
- **Economic Slowdown and Business Recession**, adversely affecting investment recovery and deposit mobilization.
- **Financial Market Volatility and External Shocks**, including geopolitical conflicts, exchange rate instability, and global financial crises.
- **Loss of Depositor Confidence**, resulting from financial irregularities, governance weaknesses, adverse media reports, or reputational concerns.
- **Seasonal and Event-Based Cash Demand**, particularly during religious festivals, agricultural harvesting periods, and major government payment cycles.

- **Foreign Currency Liquidity Shortages**, arising from trade imbalances, exchange rate pressures, and limited access to Shariah-compliant foreign currency funding sources.
- **Concentration of Deposits or Financing Portfolios**, which may expose banks to sudden liquidity shocks if major depositors withdraw funds or large investments become impaired.

Source: Authors' Compilation.

Figure 13.8 presents the framework for managing a deficit. Islamic banks may raise funds in the Islamic money market through Mudarabah term deposits, SNDs and placements backed by Bangladesh Bank guarantees. In the capital market they may sell Shariah-compliant securities or issue short-term Sukuk, Islamic commercial papers or other Islamic securities. From Bangladesh Bank they may draw on BGIIB, the IIFM, the Islamic Banks Liquidity Facility (IBLF), Mudarabah Liquidity Support (MLS) and Special Liquidity Support (SLS).

Figure 13.8: Liquidity Management of Islamic Banks in Deficit Position



Source: Authors' Compilation.

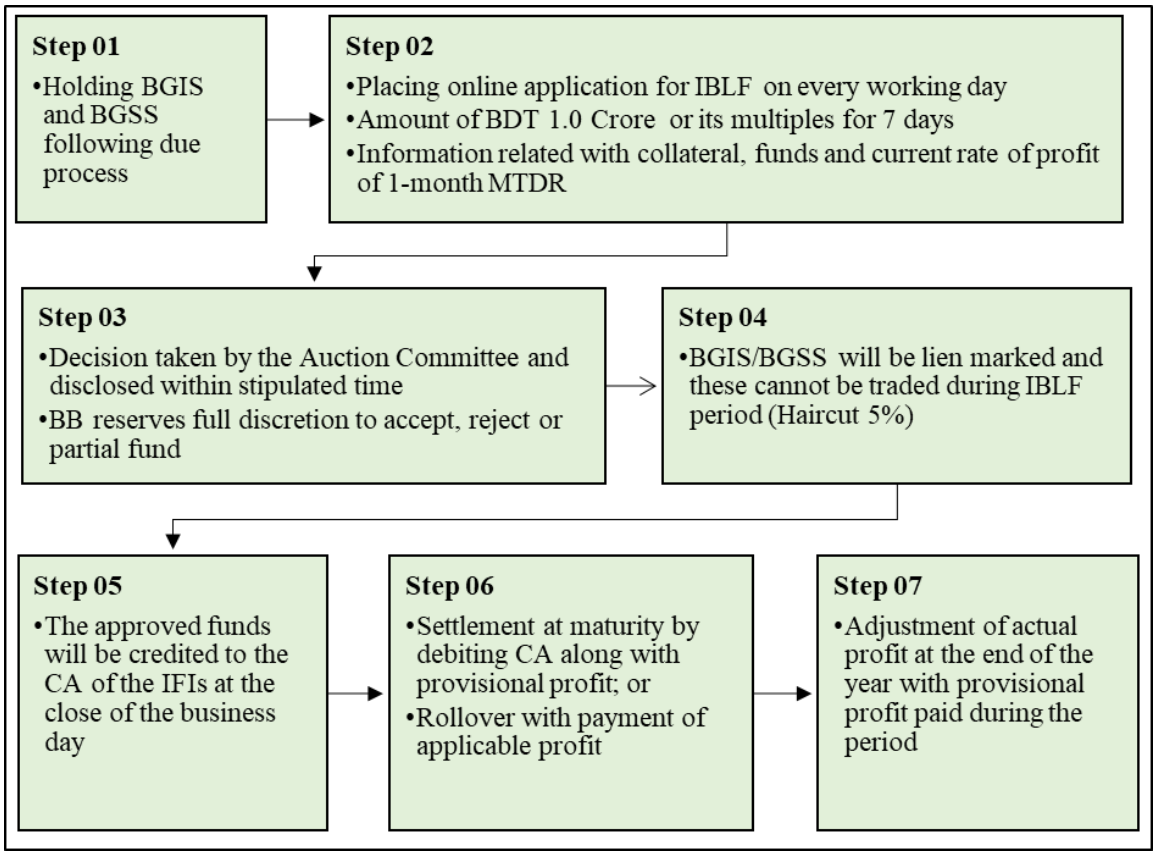
Islamic Banks Liquidity Facility (IBLF)

Bangladesh Bank introduced the Islamic Banks Liquidity Facility (IBLF) through DMD Circular No. 03 of 5 December 2022 to provide short-term Shariah-compliant liquidity to scheduled Islamic banks. Structured as a Mudarabah, with Bangladesh Bank as capital provider (Rabb al-Mal) and the bank as Mudarib, it is secured by unencumbered BGIS or BGSS with a 5% haircut; the collateral remains under lien while the bank keeps its interim income. Originally provided for 14 days at the bank's three-month MTDR rate, it is now generally provided for seven days at the one-month MTDR rate, with rollovers subject to payment of profit and compliance.

Banks may apply online on any working day for BDT 1.0 crore or multiples thereof; approved amounts are credited the same day at the Auction Committee's discretion. At maturity, Bangladesh Bank debits principal and profit and releases the collateral (extended to the next working day over holidays), and the provisional profit is adjusted at year-end to actual performance.

The IBLF is a significant milestone in the development of Shariah-compliant liquidity tools in Bangladesh; Figure 13.9 shows its indicative operational procedure.

Figure 13.9: Operational Procedures of IBLF for IFIs

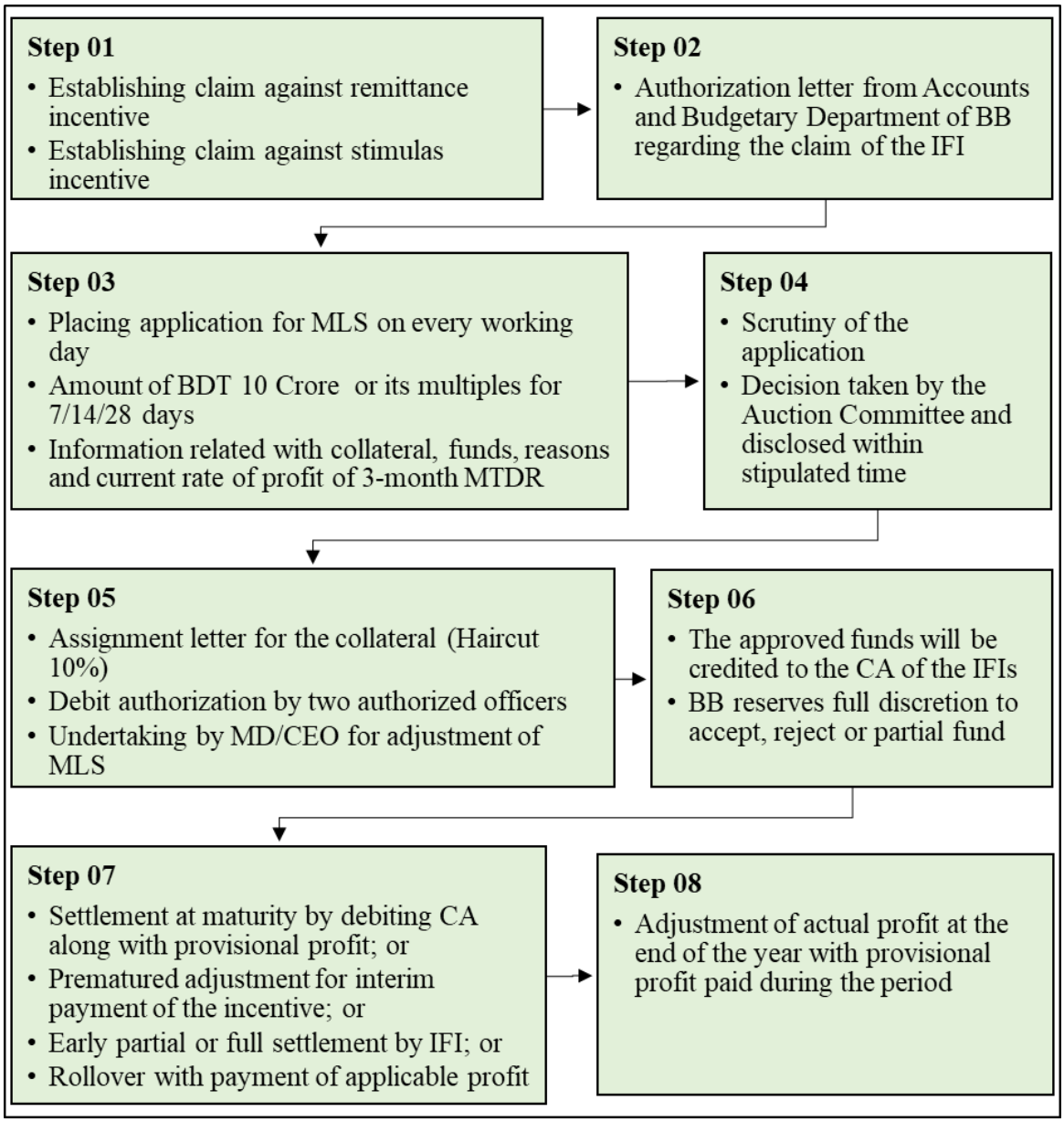


Source: Authors' Compilation.

Mudarabah Liquidity Support (MLS)

Mudarabah Liquidity Support (MLS), introduced by DMD Circular No. 02 of 5 February 2023, is a contingency facility for Islamic banks facing temporary shortages in exceptional circumstances. Like the IBLF it is a Mudarabah, with Bangladesh Bank as Rabb al-Mal, but it is secured not by Sukuk but by approved claims on the Government. These are remittance-incentive claims and subsidy claims under industrial, service-sector and Cottage, Micro, Small, and Medium Enterprises (CMSME) stimulus schemes, lodged with and approved by Bangladesh Bank and subject to a 10% haircut. The claims are assigned to Bangladesh Bank, which may use them to recover losses arising from negligence, misconduct or breach of contract. The expected profit rate is the bank's three-month MTDR rate. Tenors are 7, 14 or 28 days (Actual/Actual day count), and the minimum amount is BDT 10 crore or multiples thereof, approved at the discretion of the departments concerned and the Auction Committee.

Figure 13.10: Operational Procedures of MLS to IFIs



Source: Authors' Compilation.

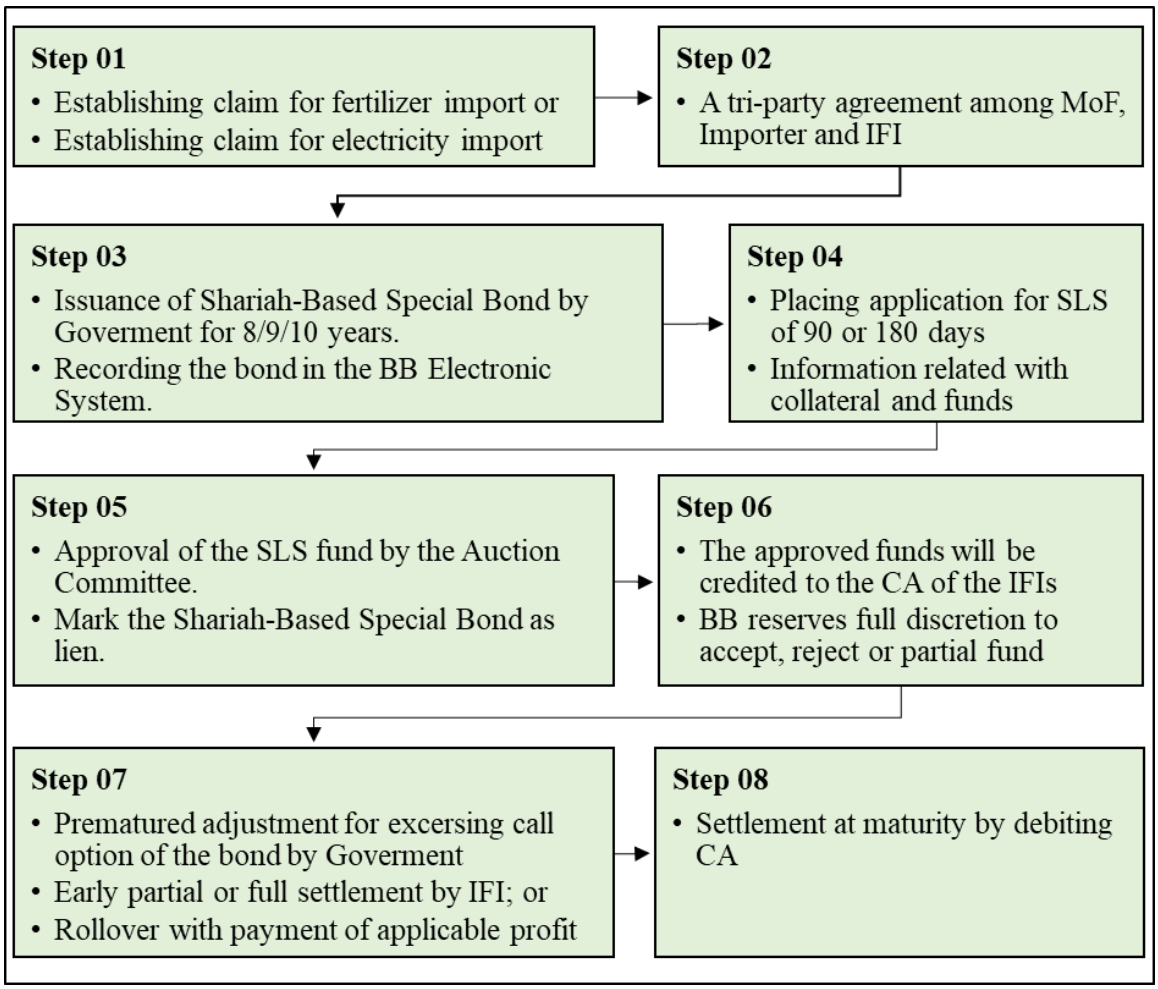
At maturity, Bangladesh Bank debits principal and profit and releases the collateral; partial or full early settlement is allowed, with profit charged only for the actual holding period, and any payments received on the assigned claims are adjusted. As with other Mudarabah facilities, the provisional profit is adjusted at year-end to actual performance (Figure 13.10).

Special Liquidity Support (SLS)

Special Liquidity Support (SLS) was introduced in 2024 (Ref. DMD/239/2024-148 of 18 January 2024). It is an emergency facility under which Islamic banks pledge unencumbered, interest-free Shariah-based Special Bonds issued by the Government as collateral (Rahn) for a profit-free Qard equal to the bonds' face value, for 90 or 180 days. The bonds represent claims

for subsidies payable to importers of essential commodities such as fertiliser and electricity. The bank marks an electronic lien on the bonds in Bangladesh Bank's securities registry. At maturity the amount is debited from its current account and the lien is released. If the Government calls the bonds early, the SLS balance is adjusted, and the bank remains eligible for SLS against the redeemed amount, subject to Bangladesh Bank's conditions. Figure 13.11 shows the standard procedure.

Figure 13.11: Operational Procedures of SLS to IFIs



Source: Authors' Compilation.

13.4 Regulatory Framework for Liquidity Management of Islamic Banks

13.4.1 Liquidity Management of Islamic Banks: International Standard

Effective liquidity risk management ensures that a bank can meet its payment, settlement and funding obligations in normal and stressed conditions; a shortfall at one institution, especially a large one, can undermine confidence across the system. International standard-setters have therefore issued principles and standards for identifying, measuring, monitoring and mitigating liquidity risk.

The Basel Committee on Banking Supervision (BCBS)

The BCBS Principles for Sound Liquidity Risk Management and Supervision (September 2008) comprise seventeen principles, confirmed as fit for purpose in January 2019 and applied in proportion to a bank's size, complexity and systemic importance. They call for a board-approved liquidity risk tolerance and strategy, sound governance and controls, cash-flow forecasting, comprehensive stress testing, adequate liquidity buffers, contingency funding plans, intraday liquidity management, disclosure and effective supervision.

After the 2007–2009 crisis, Basel III added quantitative standards: the liquidity framework of 2010, the revised LCR (2013) and the final NSFR (2014). These are supplemented by monitoring tools covering contractual maturity mismatch, funding concentration, available unencumbered assets, the LCR by significant currency and market-related indicators (BCBS, 2013a), and by intraday liquidity monitoring tools developed with the Committee on Payment and Settlement Systems (BCBS, 2013b).

Islamic Financial Services Board (IFSB)

Given the growing systemic relevance of Institutions Offering Islamic Financial Services (IIFS), the IFSB has issued standards tailored to Islamic finance. IFSB-1 (December 2005) identifies liquidity risk as one of six major risks, sets two principles for managing it through appropriate policies, systems and controls, and calls on supervisors to provide Shariah-compliant lender-of-last-resort and other liquidity support (IFSB, 2005).

IFSB-12 (March 2012) sets out 23 guiding principles for the management, supervision and monitoring of liquidity risk in IIFS, complementing BCBS practice while reflecting the contractual, operational and Shariah features of Islamic finance (IFSB, 2012). Its main areas relating to liquidity management are summarized in Box 13.2.

Box 13.2: Major Areas Covered by IFSB-12 Related with Liquidity Management

- **Board and Senior Management Oversight:** The board of directors should approve the liquidity risk tolerance, strategy, and key policies of the IIFS. Senior management should ensure the effective implementation of these policies and maintain appropriate systems, controls, and reporting arrangements.
- **Liquidity Risk Management Framework:** An IIFS should establish a sound and comprehensive liquidity risk management framework integrated with its overall enterprise risk management process. The framework should enable the institution to maintain sufficient liquidity to meet its obligations as they fall due under both normal and stressed conditions.
- **Liquidity Risk Strategy, Policies, and Procedures:** IIFS should formulate and implement a clearly defined liquidity risk management strategy supported by appropriate policies, procedures, limits, and operating guidelines. The strategy should take account of the institution's business model, funding structure, risk appetite, market access, and availability of Shariah-compliant liquidity instruments.
- **Governance Structure and Segregation of Functions:** IFSB-12 emphasizes a clear governance structure that specifies the respective roles and responsibilities of the board of directors, senior management, Assets and Liabilities Committee (ALCO), treasury function, risk management function, Shariah Supervisory Board, and other relevant business units. Appropriate segregation should be maintained between liquidity risk-taking, monitoring, control, and review functions.
- **Liquidity Risk Identification, Measurement, Monitoring, and Reporting:** IIFS should establish effective processes for identifying and measuring liquidity risk arising from on- and off-balance-sheet exposures, funding concentration, maturity mismatches, contingent liabilities, and the specific liquidity

implications of Islamic financing and investment contracts. Regular monitoring and timely reporting should be ensured for effective decision-making.

- **Liquidity Buffers and Shariah-Compliant High-Quality Liquid Assets:** IIFS should maintain an adequate stock of unencumbered, high-quality, and Shariah-compliant liquid assets that can be readily converted into cash or used to generate liquidity during periods of stress.
- **Stress Testing:** IIFS should conduct regular liquidity stress tests to assess the potential effects of institution-specific, market-wide, and combined stress scenarios on their liquidity position. Stress-testing results should be incorporated into liquidity risk limits, liquidity buffers, funding strategies, and contingency planning.
- **Liquidity Contingency Funding Plan:** An IIFS should develop and maintain a robust Liquidity Contingency Funding Plan (LCFP) to address unexpected liquidity pressures. The plan should identify potential stress events, alternative sources of Shariah-compliant funding, roles and responsibilities, communication arrangements, and procedures for timely escalation and decision-making.
- **Disclosure and Market Discipline:** IIFS should disclose relevant qualitative and quantitative information on their liquidity position and liquidity risk management practices. Appropriate disclosure enables stakeholders and market participants to assess the institution's capacity to manage liquidity risk effectively.
- **Supervisory Oversight:** Supervisory authorities should establish an appropriate legal, regulatory, and supervisory framework for monitoring liquidity risk in IIFS. They should assess the adequacy of liquidity risk management practices through both on-site inspections and off-site surveillance, require corrective action where deficiencies are identified, and support the development of Shariah-compliant liquidity infrastructure and liquidity support mechanisms.

Source: Authors' Compilation.

IFSB-23, although a capital standard, links liquidity to profit-rate risk and the behavior of unrestricted investment account holders (UIAH): if returns on long-term cost-plus sale (Murabahah), lease (Ijarah) or similar assets fall below market expectations, UIAH may withdraw their funds. To remain competitive, an institution may smooth the returns paid to IAHs — displaced commercial risk — by forgoing shareholders' income or using a Profit Equalization Reserve (PER) or Investment Risk Reserve (IRR), which shifts part of the risk to shareholders. Supervisors may therefore require capital against that risk through the alpha (α) parameter. Liquidity management in Islamic banks thus cannot be separated from profit-rate risk, displaced commercial risk, IAH behavior and capital resilience.

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) provides the Shariah foundation. Its Shariah Standard No. 44, Obtaining and Deploying Liquidity, sets no quantitative ratios but requires liquidity arrangements to use valid Shariah contracts free of Riba, Gharar and Maysir (AAOIFI, 2010), linked to genuine economic activity and identifiable assets, usufructs, services, projects or investments. Liquidity support from central banks, supervisors or other institutions must therefore use permissible modes such as Mudarabah, agency (Wakalah) bi al-Istithmar or Qard; Box 13.3 summarizes these modes.

Box 13.3: Permissible Modes for Obtaining Liquidity by IFI

- **Salam:** An Islamic financial institution may obtain immediate liquidity by entering into a Salam contract as the seller, whereby it receives the full purchase price in advance and undertakes to deliver the specified commodities at a future date. The transaction must comply with the requirements of AAOIFI SS 10 on *Salam and Parallel Salam*.
- **Istisna'a:** Liquidity may be obtained through an Istisna'a contract in which the institution acts as the manufacturer or seller and receives the agreed consideration in advance or according to the agreed payment schedule. Such transactions must comply with AAOIFI 11 on *Istisna'a and Parallel Istisna'a*.
- **Sale and Leaseback Arrangement:** An institution may sell an asset that it owns for immediate cash and subsequently lease the asset from the purchaser. However, the sale and lease transactions must be independently valid, properly documented, and must not result in a prohibited buy-back arrangement. The relevant requirements of AAOIFI SS 9 on *Ijarah and Ijarah Muntahia Bittamleek* should be observed.
- **Mudarabah and Musharakah Arrangements:** An institution may mobilize funds through Mudarabah or Musharakah-based investment arrangements, provided that the funds are deployed in Shariah-compliant activities and the parties share profit according to an agreed ratio. Losses must be borne in accordance with the applicable Shariah principles. These arrangements are governed by AAOIFI SS 12 on *Sharikah (Musharakah) and Modern Corporations* and Shariah Standard No. 13 on *Mudarabah*.
- **Issuance of Investment Sukuk:** Islamic financial institutions may raise liquidity by issuing Shariah-compliant investment Sukuk. The Sukuk should represent ownership interests in identifiable underlying assets, usufructs, services, projects, or investment activities and should comply with AAOIFI SS17 on *Investment Sukuk*.
- **Monetization (Tawarruq):** An institution may obtain liquidity through Tawarruq by purchasing a commodity on deferred-payment-terms under a Murabahah or Musawamah arrangement and subsequently selling that commodity to an independent third party for immediate cash. The institution must acquire ownership and possession, whether actual or constructive, of the commodity before its resale. The arrangement must comply with AAOIFI SS 30 on *Monetization (Tawarruq)* and should not involve prohibited organized or circular arrangements.
- **Qard:** Liquidity may also be obtained through a Qard, which is an interest-free loan repayable at its principal amount. No additional amount may be stipulated in favor of the lender as a condition of the loan. This arrangement is governed by AAOIFI SS 19 on *Loan (Qard)*.

Source: Authors' Compilation.

13.4.2 Liquidity Management of Islamic Banks: Domestic Regulations

Bangladesh Bank Order, 1972

Article 36(1) of the Bangladesh Bank Order 1972 requires every scheduled bank to maintain with Bangladesh Bank a balance of at least the prescribed portion of its demand and time liabilities, set in line with monetary policy and notified in the Official Gazette. Article 36(3) requires periodic returns signed by two responsible officers. Shortfalls attract penal interest above the Bank Rate, rising if the shortfall persists (Article 36(4)). Continued default may lead to fines on directors and officers who knowingly contribute to it and a prohibition on accepting fresh deposits, with further daily fines for non-compliance (Article 36(5)). Failure to submit returns incurs a penalty of Taka 25,000 a day (Article 36(6)) and materially false returns a fine of up to Taka 10 lakh each (Article 36(7)). Penalties are payable on demand and recoverable through the civil courts with the Government's prior sanction (Article 36(8)).

Bank Company Act, 1991

Section 33 of the Bank Company Act 1991 requires every banking company to maintain prescribed liquid assets in Bangladesh, cash including balances and current-account deposits with Bangladesh Bank or its agents (and certain deposits of foreign banks under Section 13(3)). Bangladesh Bank prescribes the method of ascertaining assets and liabilities and the liquid-asset ratio (Section 33(3)). Banks submit monthly returns of liquid assets and of time and demand liabilities as at each Thursday (Section 33(4)), and shortfalls attract penalties (Section 33(5)).

Guidelines for Islamic Banking, 2009

Section VI of the Guidelines for Islamic Banking 2009 requires Islamic banks — and conventional banks' Islamic branches, through a separate current account with Bangladesh Bank — to maintain CRR and SLR at the prescribed rates. It allows surplus funds to be invested in BGIIB. Banks facing shortages may draw on the Islamic Bond Fund or, where they hold no BGIIB, on Bangladesh Bank funds at a provisional profit rate linked to their Mudarabah Short Notice Deposit rate, unless bond sale proceeds remain available for investment. Islamic banks and branches may also maintain Mudarabah SND accounts with one another, so that an institution under liquidity pressure can take deposits from one with surplus funds at the applicable SND rate or an agreed profit-sharing ratio (Clause 4, Section VI).

Bangladesh Bank Circulars on CRR and SLR Requirements

Bangladesh Bank prescribes CRR and SLR rates by circular under these laws and the Guidelines. The CRR — at least 3% of ATDTL daily and 4% on a bi-weekly average (MPD Circular No. 01/2020 of 9 April 2020; MPD Circular No. 01/2025 of 4 March 2025) — must be held in unencumbered Taka current accounts, aggregated across Bangladesh Bank offices. The SLR for Islamic banks is 5.50% of ATDTL daily for domestic and offshore operations (MPD Circular No. 02 of 10 December 2013; DOS Circular No. 01 of 19 January 2014). It may include cash in tills, gold, excess cash reserves, balances with Bangladesh Bank's agent bank, unencumbered approved securities under Section 5(Ka) of the Bank Company Act and Foreign Currency Clearing Account balances. Table 13.2 summarizes the prevailing requirements, whose operation is described in Section 13.3.1.

Table 13.2: Prevailing CRR and SLR Requirements to Scheduled Banks in Bangladesh.

Reserve Ratios		Conventional Banking	Islamic Banking	Offshore Banking
CRR (%)	Daily	3.0	3.0	Nil
	Biweekly	4.0	4.0	Nil
SLR (%)	Monthly	13.0	5.5	13

Source: Based on DOS Circular No. 01/2014, dated 19/01/2014; MPD Circular No. 01/2020, dated 09/04/2020; and MPD Circular No. 01/2025, dated 04/03/2025.

Bangladesh Bank Circulars on Investment–Deposit Ratio (IDR)

Although called the Investment–Deposit Ratio, the IDR's denominator includes all prescribed liabilities and funding sources except capital. Bangladesh Bank requires the ADR or IDR to be kept at a prudent level, benchmarked as:

Maximum ADR/IDR = 100% - (CRR + SLR)%

Taking account of capital, liquidity, asset quality, non-performing investments and LCR and NSFR compliance, the board may add up to 4.5 percentage points (conventional banks) or 2 percentage points (Shariah-based banks) to this benchmark. The resulting maximums are 87% for the ADR and 92% for the IDR (DOS Circular No. 05 of 17 September 2019; DOS Circular No. 02 of 12 April 2020).

Asset-Liability Management (ALM) Guidelines, 2016

The revised Asset-Liability Management (ALM) Guidelines (BRPD Circular No. 02 of 7 March 2016), which replaced those of 2003, incorporate the Basel III LCR (Section 1.1.1) and NSFR (Section 1.1.2), supplemented by separate guidance notes and by the Risk Based Capital Adequacy Guidelines of 2014. Section 1.3 covers the ADR/IDR, wholesale borrowing, the structural liquidity profile and maximum cumulative outflow (described in Section 13.3.1), contingency funding plans, liquidity risk limits and compliance, and the Guidelines assign monitoring roles to the Asset-Liability Management Committee (ALCO), the Treasury Department and senior management.

Guidelines on Risk Based Capital Adequacy, 2014

The Risk Based Capital Adequacy Guidelines (December 2014) treat liquidity risk as material and require banks to monitor the CRR, SLR, ADR/IDR, LCR and NSFR. Under market discipline, banks must disclose qualitative information, namely the board's approach, measurement methods, management systems and mitigation policies. They must also disclose quantitative data: the LCR, NSFR, stock of HQLA, net cash outflows over the next 30 days, and available and required stable funding.

Risk Management Guidelines for Banks, 2018

The Risk Management Guidelines for Banks (DOS Circular No. 04 of 8 October 2018), which replaced those of 2012 and apply to all scheduled banks including Islamic banks and windows, require a board-approved risk management framework proportionate to each bank's size and complexity and reviewed at least annually. For liquidity risk, banks need policies, limits, Management Information System (MIS), internal controls and a risk appetite framework. The Treasury Department manages liquidity day to day, while the Risk Management Department's Liquidity Risk Desk provides independent oversight in coordination with the Basel Implementation Unit. The desk reviews the SLP, projected sources and uses of funds and ATDTL statements, and monitors the CRR, SLR, ADR/IDR, LCR, NSFR, MCO, wholesale borrowing and undrawn commitments.

Regulations Related with Capital Market Exposure by Banks

Capital market investments are subject to regulatory limits prescribed by Bangladesh Bank under Section 26(Ka) of the Bank Company Act, 1991. As per DOS Circular No. 02 dated 16 September 2013, banks' capital market exposure on a solo basis is capped at 25% of Paid-up Capital, Share Premium, Statutory Reserve and Retained Earnings. DOS Circular No. 07 dated 25 February 2014 permits a consolidated exposure limit of up to 50% of the same capital components.

13.5 Findings and Data Analysis

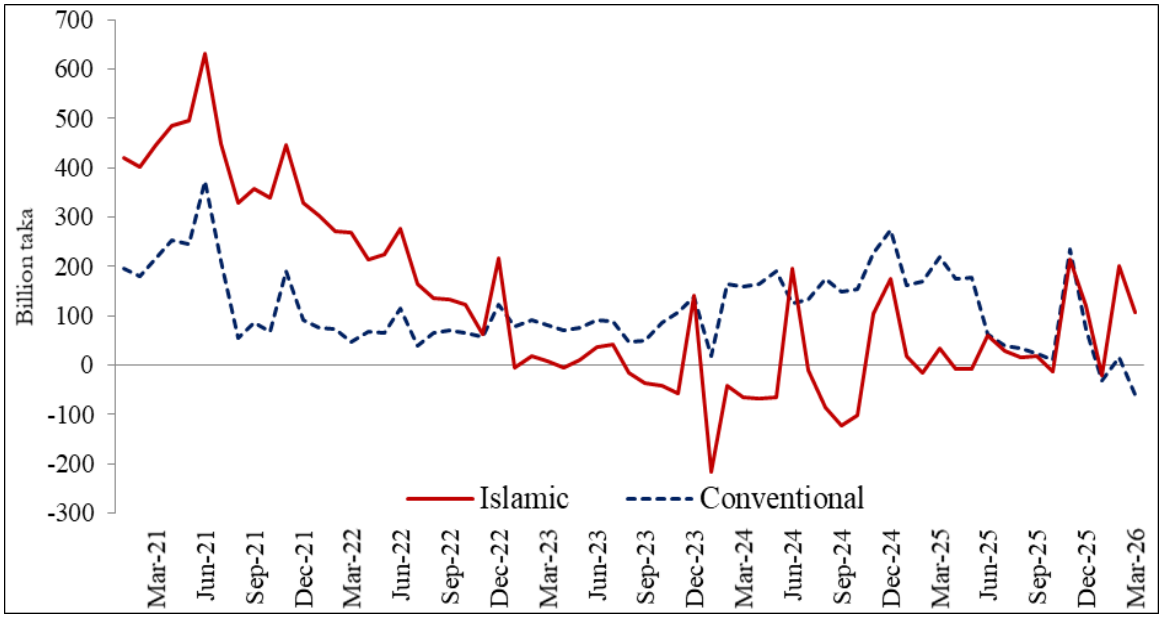
The current status of the Islamic banking sector in Bangladesh, including provisional data for 2025, is presented with the other industry statistics in Table 3.18 (Chapter 3).

13.5.1 Liquidity Trend of Islamic Banks

Liquidity conditions from March 2021 to March 2026 (see the figure below) show distinct patterns for Islamic and conventional banks. In early 2021, Islamic banks held a substantial surplus, well above that of conventional banks, whose buffer fluctuated within BDT 150–350 billion — probably reflecting weak investment demand during the post-pandemic recovery. From late 2021 through 2022, Islamic banks' liquidity declined steeply, owing to high non-performing investments (NPIs) from credit fraud and irregularities, slow recovery, withdrawal pressure and the lack of deep, diversified Shariah-compliant money market instruments. In early 2023 their liquidity approached zero and then turned negative, reaching a deficit of nearly BDT 200 billion by late 2023, with sharp spikes and falls that point to fragile liquidity management.

The graph shows that Islamic banks began with higher liquidity but suffered far greater volatility and long-term deterioration, reflecting limited instruments and weaker interbank integration, while conventional banks' liquidity was more stable, supported by diversified tools and mature markets. Declining liquidity and rising volatility towards the end of the period point to tightening conditions, possibly from contractionary monetary policy, inflation or external imbalances. Shariah-compliant money market instruments, better interbank coordination and stronger oversight are therefore urgently needed, while emerging pressure on conventional banks suggests a system-wide tightening that calls for carefully calibrated monetary policy. Figure 13.12 summarizes the banking sector's liquidity position.

Figure 13.12: Liquidity Position in the Banking Sector: Conventional and Islamic



Source: Liquidity Forecasting Wing, Monetary Policy Department, Bangladesh Bank.

13.5.2 Islamic Financial Institution-wise Liquidity Position

Beyond meeting regulatory requirements, IFIs must deploy surplus funds efficiently in Shariah-compliant avenues and raise funds when in deficit. Since financing is the purpose of deposit mobilization, prolonged excess liquidity erodes profitability, but alternative instruments should not take priority over financing the real economy. Table 13.3 presents liquidity indicators for the surveyed full-fledged Islamic banks (FF), Islamic operations of conventional banks (Dual Bank / Dual Banking (DB)) and finance companies (FCs).

Table 13.3: IFI-wise Liquidity Indicators as on 31 December 2025

IFI	Investment to Deposit (IDR)	Cash Reserve with Bangladesh Bank to Deposit	CRR Maintained to Requirement	Investment in Govt. Instrument to Deposit	Investment in Govt. Instrument to Financing	SLR Maintained to Requirements	Interbank Placement to Deposit	Interbank Placement to Financing
	(%)	(%)	(%)	(%)	(%)	(%)	(%)	(%)
FF-01	102.35	4.48	116.43	6.55	6.40	123.85	4.84	4.73
FF-02	92.19	3.95	112.28	10.84	11.76	224.13	1.21	1.32
FF-03	96.65	4.52	110.68	14.28	14.77	250.00	5.17	5.35
FF-04	98.47	4.26	112.21	9.61	9.76	183.97	3.54	3.60
DB-01	47.47	3.94	101.62	5.99	12.62	112.38	2.13	4.48
DB-02	62.69	25.21	630.33	6.92	11.04	125.78	3.97	6.33
DB-03	61.18	11.41	277.85	38.07	62.23	674.50	1.14	1.86
DB-04	67.33	4.51	164.86	34.16	50.73	682.76	2.21	3.28
DB-05	50.85	4.94	128.47	10.36	20.37	195.74	1.61	3.17
DB-06	32.35	8.76	376.00	47.65	147.26	1123.08	5.59	17.29
DB-07	31.84	5.81	137.50	38.38	120.56	907.04	32.57	102.32
DB-08	26.15	4.56	113.70	24.91	95.24	451.86	29.53	112.90
DB-09	27.02	7.35	204.52	9.20	34.05	186.26	0.00	0.00
DB-10	71.88	1.56	100.00	113.28	157.61	4833.33	0.00	0.00
FC-01	73.59	1.01	101.87	27.37	37.19	791.48	3.37	4.58
FC-02	100.23*	1.37	101.30	5.29	5.27	112.35	4.25	4.24

Source: Questionnaire Survey.
*Note: *Interbank placement was used for financing in addition to deposit.*

Liquidity positions vary widely. All four full-fledged Islamic banks reported IDRs at or above the 92% maximum — from 92% (FF-02) to 102% (FF-01) — indicating tight liquidity and possible funding pressure, whereas the Islamic operations of dual banks had IDRs of only 26 to 72%, leaving much of their deposits undeployed in financing.

Cash reserves with Bangladesh Bank range from 1.56 to 25.21% of deposits, and all institutions report meeting the 4% CRR. DB-02, DB-03 and DB-06 hold 630, 278 and 376% of the requirement respectively, reflecting surplus liquidity, limited investment opportunities or cautious liquidity management.

Government instruments are an important avenue, especially for dual banks: they equal 6.55 to 14.28% of deposits at the full-fledged banks but far more at DB-03, DB-04, DB-06, DB-07, DB-08 and DB-10, several of which invest more in government securities than in private financing. DB-10 is exceptional, with government instruments equal to 113% of deposits and

SLR holdings at 4,833% of the requirement. All institutions exceed the 5.5% SLR (at 112 to 4,833% of the requirement); such holdings provide a cushion and access to Shariah-compliant liquidity facilities, but excessive amounts may signal limited Shariah-compliant private financing opportunities.

Interbank placements are generally modest, but at DB-07 and DB-08 they equal about 33 and 30% of deposits and 102 and 113% of financing — a major use of funds in place of financing that exposes these banks to concentration, counterparty, rollover and return risks. Overall, full-fledged Islamic banks show high investment deployment and potential liquidity pressure, while several dual banks' Islamic operations hold large surpluses in excess CRR balances, government instruments and, in some cases, interbank placements.

The Islamic operations of dual banks and finance companies have no separately managed capital, as they are not subsidiaries, and deploy Islamic deposits after meeting the CRR and SLR. One dual bank reported access to a Qard facility from its parent. Finance companies face different requirements — a CRR of 1.5% and an SLR of 5% including the CRR, with placements at other banks eligible for the SLR — so their indicators should be read separately.

13.5.3 Perception Regarding Availability and Operations of the Instruments

The survey's findings on liquidity management practices and instruments are presented in Tables 13.4 to 13.10.

Table 13.4: Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Is there any Shariah issues. faced for maintaining CRR by your Islamic banking operations?	15.00	85.00	➢ Scope for return from CRR ➢ No secondary market and return insufficient from eligible SLR instruments ➢ Low profitability and lengthy process ➢ Shariah non-compliance ➢ Limited issuance, low trading volume and weak secondary market of BGIS ➢ Short term BGIS ➢ Islamic repo and reverse repo
2.	Do you face any operational problems in investing funds in Bangladesh Government Islamic Investment Bond (BGIIB) as a part of SLR?	25.00	75.00	
3.	Do you face any Shariah non-compliance problem in investing funds in BGIIB as a part of SLR?	15.00	85.00	
4.	Do you face any operational problem in investing funds in Bangladesh Government Investment Sukuk (BGIS) as a part of SLR?	15.00	85.00	
5.	Do you face any Shariah non-compliance problem in investing funds in BGIS as a part of SLR?	10.00	90.00	
6.	Do you expect any Shariah-compliant new instruments for SLR purpose?	100.00	0.00	

Source: Questionnaire Survey.

Most Islamic banks (75–90%) report no substantial problems with the CRR and SLR regulations, though 10–15 have Shariah non-compliance concerns. About 25% face operational

problems investing in BGIIB for the SLR, mainly because of its rate of return, and all expect new Shariah-compliant SLR instruments such as short-term BGIS (Table 13.4).

Table 13.5: Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in maintaining Liquidity Coverage Ratio (LCR) as Islamic Banking operations?	15.00	85.00	➢ Lack of high-quality liquid asset. ➢ There is no requirement for Islamic NBFI and or windows separately
2.	Do you face any Shariah non-compliance problem in maintaining LCR as Islamic Banking operations?	10.00	90.00	
3.	Do you face any operational problem in maintaining Net Stable Funding Ratio (NSFR) as Islamic Banking operations?	20.00	80.00	
4.	Do you face any Shariah non-compliance problem in maintaining NSFR as Islamic Banking operations?	0.00	100.00	

Source: Questionnaire Survey.

Most IFIs are also satisfied with the LCR and NSFR requirements (Table 13.5): only 15% report difficulties in complying with the LCR and 20% with the NSFR, and Shariah concerns are minimal (10% for the LCR and none for the NSFR). Focus Group Discussion (FGD) participants nonetheless suggested that applying these ratios to IFIs needs further regulatory consideration, given the scarcity of Shariah-compliant HQLA and the underdeveloped Islamic money market.

Table 13.6: Investment Deposit Ratio (IDR)

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in maintaining Investment Deposit Ratio (IDR) as Islamic Banking operations?	30.00	70.00	➢ Maximum allowable IDR should gradually be decreased
2.	Do you face any Shariah non-compliance problem in maintaining IDR as Islamic Banking operations?	5.00	95.00	

Source: Questionnaire Survey.

Islamic banks face no major difficulty with the IDR (Table 13.6), though 30% report daily operational problems, and 95% report no Shariah issues. Respondents and FGD participants suggested that Bangladesh Bank consider reducing the maximum IDR, subject to adequate Shariah-compliant liquidity instruments, so that banks can keep adequate buffers without creating idle funds or constraining financing.

Table 13.7: Instrument for Investing Surplus Liquidity Through Bangladesh Bank

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in investing funds in BGIIB as additional to the SLR requirement?	35.00	65.00	➢ Low profit rate and delay in profit distribution ➢ Shariah non-compliance in final settlement of BGIIB. ➢ More short term BGIS ➢ Lack of confidence ➢ Ensure good governance ➢ More BGIS issuance for Full-fledged IBs ➢ Regular issuance of BGIS
2.	Do you face any Shariah non-compliance problem in investing funds in BGIIB as additional to the SLR requirement?	15.00	85.00	
3.	Do you face any operational problem in investing funds in BGIS as additional to the SLR requirement?	25.00	75.00	
4.	Do you face any Shariah non-compliance problem in investing funds in BGIS as additional to the SLR requirement?	5.00	95.00	
5.	As per your opinion, do you think that the Islamic Inter-bank Fund Market is efficient and effective?	15.00	85.00	
6.	Do you expect any Shariah-compliant new instruments for investing surplus fund in government instrument?	95.00	5.00	

Source: Questionnaire Survey.

Investing surplus liquidity is harder (Table 13.7): 35% of banks face operational problems investing in BGIIB beyond the SLR and 25% in BGIS; FGD and KII participants question the Shariah basis of finalizing BGIIB's provisional rate against actual performance; and 85% find the Islamic Interbank Fund Market ineffective. Around 95% want Bangladesh Bank to introduce alternative government instruments for surplus funds.

Table 13.8: Instrument for Surplus Liquidity through Money Market

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in investing funds in other banks as placement?	65.00	35.00	➢ Problem in recovery of the placed fund ➢ Shariah-compliance in settlement. ➢ Ensure transparency disclosure ➢ Mixing Islamic funds with conventional funds
2.	Do you face any Shariah non-compliance problem in investing funds in other banks as placement?	55.00	45.00	
3.	Do you expect any Shariah-compliant new instruments for investing surplus fund through interbank placement?	100.00	0.00	

Source: Questionnaire Survey.

In the money market (Table 13.8), 65% of banks face operational problems and 55% Shariah concerns in placing funds with other banks, and all want new Shariah-compliant instruments for interbank investment. Respondents recommended Shariah-compliant alternatives to repo and reverse repo.

Table 13.9: Instrument for Surplus Liquidity through Capital Market

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in investing funds in capital market?	65.00	35.00	➢ Low yield of Shariah-compliant instruments. ➢ Need market stability ➢ Mostly debt-based instruments. ➢ Shariah-compliant more equity-based instruments ➢ More Sukuk with good image
2.	Do you face any Shariah non-compliance problem in investing funds in capital market?	45.00	55.00	
3.	Do you expect any Shariah-compliant new instruments for investing surplus fund in capital market?	90.00	10.00	

Source: Questionnaire Survey.

The capital market poses similar difficulties: 65% of banks face regular operational problems owing to the limited number of Shariah-compliant instruments, whose yields are also lower than those of conventional ones, and 90% want new Shariah-compliant capital market instruments.

Table 13.10: Instrument for Fund Collection in Deficit: Through Bangladesh Bank

S/n	Questions	Yes (%)	No (%)	Suggestions
1.	Do you face any operational problem in managing/collecting funds from Bangladesh Bank under Islamic Banks Liquidity Facility (IBLF)?	20.00	80.00	➢ Adequate collateral and Shariah-based securities needed. ➢ Shariah issues in final settlement. ➢ Insufficient collateral
2.	Do you face any Shariah non-compliance problem in managing/collecting funds from Bangladesh Bank under IBLF?	5.00	95.00	
3.	Do you face any operational problem in managing/collecting funds from Bangladesh Bank under Mudarabah Liquidity Support (MLS)?	20.00	80.00	
4.	Do you face any Shariah non-compliance problem in managing/collecting funds from Bangladesh Bank under MLS?	10.00	90.00	
5.	Do you face any operational problem in managing/collecting funds from Bangladesh Bank under Special Liquidity Support (SLS)?	20.00	80.00	
6.	Do you face any Shariah non-compliance problem in managing/collecting funds from Bangladesh Bank under SLS?	5.00	95.00	
7.	Do you expect any Shariah-compliant new instruments for getting liquidity support from Bangladesh Bank?	85.00	15.00	

Source: Questionnaire Survey.

No dual bank has yet used the IBLF, MLS or SLS, which only full-fledged banks have availed; since all three require eligible instruments, which are scarce, 85% of institutions expect further Shariah-compliant liquidity support options from Bangladesh Bank (Table 13.10).

13.5.4 Summary Outcome of FGD and KII

FGD and KII participants called for an efficient overnight Islamic fund placement market and, similar to the IBLF, an interbank arrangement against BGIS holdings to provide short-term liquidity among Islamic banks. Some cautioned that investment in government instruments should not take priority over private-sector financing.

Most acknowledged that interbank Mudarabah placements often operate like the conventional money market, with profit agreed in advance rather than reflecting the actual use of funds, weakening risk-sharing and raising Shariah concerns. They urged a stronger operational framework, profit-calculation methodology, disclosure and Shariah oversight.

They also noted a regulatory advantage in BGIIB: an institution may invest surplus funds in the BGIIB pool and draw liquidity from the same pool. Because funds drawn are not netted against SLR holdings, it can continue to count its BGIIB investment towards the SLR while using the liquidity obtained.

Participants urged a more active role for SSCs and Internal Shariah Audit in the final settlement of interbank placements, BGIIB, IBLF and MLS. Dedicated avenues for Shariah-compliant foreign-currency funds, and a mechanism allowing Islamic banks to earn on their foreign-currency accounts with Bangladesh Bank, from which they currently earn nothing.

A few suggested that IFIs establish separate, independent Qard-based liquidity-support arrangements for temporary shortages, each at the lender's discretion, not conditional on a reciprocal facility and free of any interest, return or stipulated benefit, subject to proper documentation, internal approval and Shariah governance.

The authorities reported that a BGIS issuance calendar is under consideration. That initiatives are under way to develop an Islamic money market and Shariah-compliant open market operations. That BGIS and BGSS issuance is expected to become regular, with short-term government Sukuk to follow. That they are seeking to align BGIS returns with comparable conventional instruments and to develop innovative structures and Sukuk-based projects, and that they expect participants to disclose their rates transparently when using the IBLF. Box 13.4 summarizes the issues and suggestions.

Box 13.4: Key Issues and Suggestions Emerging from the FGD and KII

- Development of an effective and efficient overnight Islamic fund placement market for short-term liquidity management.
- Introduction of an interbank liquidity-support arrangement against BGIS holdings, similar to the IBLF mechanism, to facilitate liquidity support among Islamic banks.
- Need to ensure that excessive investment in government instruments does not crowd out private-sector financing, as the core function of banks is to channel deposits into productive economic activities.
- Review of the regulatory treatment of BGIIB transactions, particularly where an institution invests in the BGIIB pool and simultaneously avails liquidity support from the same pool without netting off the liquidity facility against SLR-eligible holdings.

- Strengthening the role of the Shariah Supervisory Committee (SSC) and Internal Shariah Audit (ISA) in reviewing the final settlement, profit calculation, documentation, and Shariah compliance of interbank placements, BGIIB, IBLF, and MLS transactions.
- Development of dedicated Shariah-compliant foreign currency liquidity-management arrangements for Islamic banks.
- Consideration of an appropriate Shariah-compliant earning mechanism for foreign currency accounts maintained by Islamic banks with Bangladesh Bank.
- Introduction of separate and independent Qard-based liquidity-support arrangements among IFIs, subject to proper documentation, internal approval, regulatory oversight, and Shariah governance.
- Preparation and publication of a regular BGIS issuance calendar to support liquidity planning and investment decisions by Islamic banks.
- Development of an active Islamic money market and Shariah-compliant open market operation framework.
- Regular issuance of BGIS and BGSS to expand the stock of Shariah-compliant liquidity-management instruments.
- Regular issuance of short-term government Sukuk to address the short-term liquidity-management needs of Islamic banks.
- Alignment of the expected rate of return on BGIS, BGSS, and short-term Sukuk with comparable conventional instruments, while maintaining Shariah compliance.
- Exploration of innovative Sukuk structures and Sukuk-based projects to diversify the range of Shariah-compliant instruments available in the market.
- Ensuring rational, transparent, and consistent disclosure of rates by market participants while availing IBLF and other liquidity-support facilities.
- Strengthening the operational framework, profit-calculation methodology, disclosure practices, and Shariah governance of interbank placements to ensure that Mudarabah-based transactions reflect actual fund utilization and risk-sharing principles.

Source: Based on FGD and KII.

Case Study 1: Managing Withdrawal Pressure Through Controlled Liquidity Measures

Background

ABC Bank PLC, a full-fledged Islamic bank in Bangladesh, had historically maintained adequate liquidity and had not experienced any significant liquidity crisis. However, this case concerns the severe liquidity stress the bank faced toward the end of 2022 following media reports alleging investment-related irregularities. The reports reportedly affected depositor confidence and intensified withdrawal pressure, despite the bank's earlier record of maintaining a sufficient liquidity position. Over the following three to four months, the bank's deposit base reportedly declined at its lowest point. The situation created significant challenges for day-to-day liquidity management and, according to the case information, affected the bank's ability to maintain the prescribed CRR and SLR requirements.

Despite availing available liquidity-support mechanisms from Bangladesh Bank, including the IBLF, MLS, and SLS, the bank continued to face substantial withdrawal pressure. The case demonstrates that, during periods of financial stress, liquidity management depends not only on the availability of funds and regulatory support but also on depositor confidence, communication, and the pace of cash outflows.

Measures Adopted by the Bank

The bank reportedly adopted a gradual and controlled disbursement strategy rather than imposing a complete restriction on withdrawals. The objective was to moderate the speed of fund outflows, preserve available liquidity, and minimize the risk of wider depositor panic.

Cheque-based Withdrawal Management

Initially, the bank introduced a system-based ceiling of BDT 5 crore for cheque-based withdrawals. However, some customers reportedly attempted to circumvent the limit by issuing several cheques below the prescribed threshold. In response, the bank progressively reduced the withdrawal ceiling to BDT 2 crore and subsequently to BDT 50 lakh.

According to the case information, cheques exceeding BDT 50 lakh were subject to additional processing and were not immediately honored during the first or second presentation. This arrangement reportedly slowed the pace of large withdrawals while avoiding an outright and visible restriction on customers' access to funds. Such measures, however, should be considered only within the applicable legal, regulatory, contractual, and customer-protection requirements.

ATM Withdrawal Management

The bank also introduced temporary controls on cash withdrawals through ATMs, including transactions initiated by cardholders of other banks, in order to manage immediate cash outflows more prudently.

Financing and Trade-business Management

The bank undertook several measures to conserve liquidity and prioritize essential economic activities. These included rationalizing new financing approvals, aligning financing disbursements with the level of investment recovery where practicable, encouraging the opening of letters of credit against 100% cash margin, prioritizing letters of credit for essential commodities and industrial raw materials, and discouraging the opening of letters of credit for non-essential or luxury items.

Stakeholder Communication and Confidence Building

The bank also emphasized internal communication and customer assurance. Employees were encouraged to communicate consistently with customers and assure them that their deposits remained protected. The bank reportedly received moral and institutional support from investment clients, regulators, and other stakeholders, which contributed to efforts to restore confidence.

Support Provided by the Central Bank

Financial Regulatory Support

Although internal liquidity redistribution and coordinated cash-flow management served as essential first-line measures, support from the central bank became indispensable during the period of severe and prolonged liquidity stress. Bangladesh Bank extended liquidity assistance through the Shariah-compliant facilities and instruments designed to provide timely cash support. When withdrawal pressure exceeds an institution's internal liquidity capacity, such assistance, together with appropriate regulatory flexibility, becomes critical to maintaining uninterrupted payment services, meeting legitimate withdrawal demands, preserving depositor confidence, and preventing wider disruption to the banking system.

Non-Financial Regulatory Support

The regulatory support is not limited to the provision of funds only. Clear, credible, and reassuring communication from the central bank can play an equally important role in restoring public confidence. Structured, targeted, and frequent messages from senior regulatory officials may help counter rumors, reduce panic-driven withdrawals, and reassure customers about the safety and continuity of banking services. Accordingly, Bangladesh Bank provided support in a timely and prudent manner, considering the bank's systemic importance and the potential contagion effects that prolonged liquidity stress could create for the wider banking sector. Such communication, when timely, fact-based, and consistent with the actual support measures undertaken, can complement financial assistance and contribute meaningfully to stabilizing depositor confidence.

Practical Insights

The case suggests that liquidity management during a period of exceptional withdrawal pressure is not merely a matter of maintaining regulatory ratios or obtaining emergency funding. It is also closely linked to depositor sentiment, market perception, communication quality, and the ability of management to control the pace of outflows without triggering further panic.

The reported approach sought to reduce the speed of withdrawals, avoid a crowd reaction, preserve a degree of normal customer access, and maintain confidence in the institution. According to the case information, withdrawal pressure gradually moderated, sudden liquidity depletion was avoided, and depositor confidence was substantially preserved.

Lessons for Islamic Banks

The case highlights the importance of maintaining a robust contingency funding plan, reliable early-warning indicators, effective depositor-communication strategies, and coordinated decision-making among the Treasury Department, Risk Management Department, Asset-Liability Management Committee (ALCO), senior management, Shariah governance functions, and regulator. These arrangements should be

supported by clearly defined roles, escalation procedures, and regular stress testing to ensure timely action when liquidity pressure emerges.

The case also indicates that, during periods of liquidity stress, carefully designed and legally compliant soft-control measures may help manage withdrawal pressure more effectively than abrupt or blanket restrictions. However, any such measure must remain consistent with Bangladesh Bank directives, contractual obligations, customer rights, and Shariah principles.

Most importantly, the case demonstrates that internal liquidity-management measures alone may not be sufficient during severe and prolonged stress. Timely support from the regulator may become indispensable when withdrawal pressure exceeds the bank's internal liquidity capacity. Such support should extend beyond liquidity assistance and may include appropriate operational flexibility, supervisory guidance, and coordinated regulatory intervention.

Clear, credible, and reassuring communication from the central bank is essential for restoring and sustaining public confidence. Structured and timely messages from senior regulatory officials may help counter rumors, reduce panic-driven withdrawals, and reassure customers about the safety and continuity of banking services. In this way, financial assistance and regulatory communication can jointly contribute to stabilizing the affected institution and reducing the risk of contagion across the wider banking sector.

Source: Authors' Compilation Based on KII.

Case Study 2: Coordinated Branch Cash-Flow Management under Liquidity Stress

Background

During the period of liquidity stress, XYZ Islamic Bank faced an uneven distribution of cash across its branch network. While certain branches maintained surplus cash balances, others experienced difficulty in meeting increased withdrawal demands. According to the case information, the bank was expected to ensure that customers with legitimate withdrawal requests were not turned away without payment. This heightened the operational sensitivity of branch-level liquidity management and required continuous monitoring of cash positions across the network.

Measures Adopted by the Bank

The bank primarily relied on internal coordination, structured monitoring, and the redistribution of available cash within its branch network before seeking external funding support.

Zonal-level Liquidity Monitoring

Zonal Heads were assigned responsibility for monitoring the daily liquidity positions of branches under their respective jurisdictions. This enabled the timely identification of branches with surplus cash and those facing immediate shortages. Surplus funds were then reallocated, where operationally feasible, to branches experiencing withdrawal pressure.

Role of Feeder Branches

Feeder branches acted as intermediate liquidity-management points within their networks. They coordinated the transfer of cash between branches, balanced local surplus and deficit positions, and reduced the need for frequent intervention by Head Office. This decentralized support mechanism improved the speed of liquidity redistribution and helped maintain uninterrupted branch operations.

Head Office Oversight and Prioritization

The Head Office maintained central oversight of the overall liquidity position and intervened when branch- or zone-level adjustments were insufficient. In such cases, cash allocations were made based on the urgency of the requirement, the scale of withdrawal pressure, and the operational importance of the concerned branch, rather than solely on a first-come-first-served basis.

Exceptional External Support

In extreme circumstances, the bank reportedly arranged temporary liquidity support from other banks, which was encashed through Bangladesh Bank and deployed to meet urgent withdrawal requirements. Such support was not used as a routine funding source; rather, it was treated as an exceptional measure for maintaining operational continuity during periods of heightened stress. Any such arrangement should remain subject to applicable regulatory requirements, proper documentation, and Shariah review where relevant.

Use of Regulatory Facilities

Where internal cash redistribution could not adequately meet branch-level requirements, the bank obtained funds through cheque encashment with Bangladesh Bank and subsequently distributed the funds among branches according to priority and need.

Practical Insights

The case demonstrates that effective liquidity management during stress periods is neither fully centralized nor fully decentralized. Rather, it requires a coordinated structure in which branches respond promptly to local cash needs, zonal offices balance liquidity within their networks, and Head Office intervenes strategically when internal adjustments are insufficient. The approach also highlights the importance of real-time cash-flow information, clear escalation procedures, prioritization criteria, and close coordination among branches, zonal offices, Head Office, and Bangladesh Bank.

Outcome and Lessons

According to the case information, the coordinated approach enabled branches to continue cash payments, reduced operational disruption, and supported compliance with regulatory expectations during a period of significant withdrawal pressure. The principal lesson is that internal liquidity redistribution should constitute the first line of defense during branch-level liquidity stress. External funding support, including central-bank facilities or other exceptional arrangements, should generally be considered after available internal liquidity-management options have been assessed and utilized. Effective branch-level coordination, therefore, remains essential for preserving depositor confidence and ensuring operational continuity during periods of liquidity pressure.

Source: Authors' Compilation Based on KII.

Case Study 3: From a Sustainable Shariah-Based Bank to a Vulnerable Institution

Background

Shariah Bank PLC began operations in 19XX as a full-fledged commercial bank operating on Shariah principles. During its first three decades, the bank grew rapidly and became one of the leading financial institutions in the country, supported by increasing public acceptance of Islamic banking and a conservative approach to liquidity management. For nearly a decade, it was reportedly the only Bangladeshi bank included among the world's top 1,000 banks, reflecting its institutional strength and market position during that period.

A defining feature of the bank's early operations was its cautious liquidity strategy. Instead of maintaining only the minimum regulatory liquidity requirement, the bank consistently held substantial liquidity buffers. This reflected a prudent approach to liquidity risk management and helped strengthen depositor confidence. The following discussion is based on indicative data and reported developments; therefore, the figures and events should be interpreted as case-based evidence rather than independently verified findings.

Phase I: Conservative Liquidity Management, 19XX–2011

The bank's liquidity position during this phase indicates a consistent pattern of conservative liquidity management. In 2004, against a CRR requirement of 6.00%, the bank reportedly maintained 14.76%. Similarly, against an SLR requirement of 5.50%, it maintained 20.84%, far above the regulatory minimum. By 2011, the CRR cushion had narrowed to 7.24% against the 6.00% requirement; however, the SLR remained significantly higher at 23.51% against the required 5.50%.

This pattern suggests that the bank's liquidity surplus was not merely a temporary position. Rather, it reflected an institutional culture of prudence and self-control in liquidity management. Such buffers involved an opportunity cost, as excess liquidity could reduce short-term profitability. However, they also provided resilience against unexpected withdrawal pressure and reputational shocks.

Phase II: Reputational Pressure and Initial Liquidity Stress, 2012–2013

During 2012–2013, the bank faced reputational pressure following public allegations linking it with terrorism financing and other adverse narratives. Although such allegations did not necessarily reflect the bank's financial fundamentals, they had the potential to influence depositor perception. In banking, reputational risk can quickly transform into liquidity risk when depositors respond to uncertainty through withdrawals.

In the second half of 2013, the bank experienced its first major liquidity pressure since commencement of operations. However, the long-standing liquidity buffers enabled the bank to absorb withdrawal pressure without breaching major regulatory requirements. This episode demonstrates that maintaining liquidity above the regulatory minimum can function as an important form of institutional insurance during periods of confidence shock. It is noted that the regulatory support helped a lot regain the depositors' confidence.

Phase III: Governance Change and Progressive Liquidity Weakening, 2017–2023

The year 2017 marked an important turning point in the bank's governance history. The bank reportedly experienced significant changes in ownership, board composition, and senior management. Contemporary media reports described a major shift in control and rapid changes in senior positions. This case study does not independently verify those reports or assess the motives behind the governance transition. However, it notes that the period following 2017 coincided with a gradual weakening of institutional performance, market confidence, and liquidity resilience.

The situation deteriorated sharply toward the end of 2022, when extensive negative media coverage regarding the bank's financial condition triggered a serious loss of depositor confidence and large-scale withdrawals. Unlike the 2013 episode, the bank's accumulated liquidity buffers were no longer sufficient to absorb the pressure. For the first time in its history, the bank reportedly faced difficulty in consistently maintaining the required cash reserve with the central bank.

Bangladesh Bank responded by extending liquidity support and introducing additional Shariah-compliant liquidity-support instruments for the sector. The stress was not confined to this bank alone; several other Islamic banks also experienced withdrawal pressure during the same period. This suggests that the episode had sector-wide confidence implications, rather than being limited to a single institution.

The 2023 liquidity indicators highlight the nature of the stress:

Indicator	Regulatory Requirement	Maintained
CRR	4.00%	5.10%
SLR	5.50%	6.04%
LCR	100%	48.74%
NSFR	100%	100.09%

Although the bank technically maintained CRR and SLR, the position was reportedly supported by central bank assistance. The LCR shortfall was particularly significant, as the maintained ratio stood at 48.74% against the 100% requirement. This indicates acute short-term liquidity pressure. In contrast, the NSFR remained marginally compliant at 100.09%, suggesting that the core problem was not necessarily the long-term funding structure but the immediate availability of liquid assets during a period of depositor panic.

Phase IV: Regulatory Intervention and Partial Recovery, 2024–2025

Following the political transition in 2024, the interim government reconstituted the bank's board through a special appointment process. The new board initiated corrective measures aimed at restoring depositor confidence, strengthening governance, and improving liquidity management. These measures appeared to produce some positive results. By the end of 2025, the bank reportedly maintained a CRR of 4.66% against the requirement of 4.00% and an SLR of 6.81% against the requirement of 5.50%. These buffers were modest compared with the bank's earlier conservative liquidity position, but they indicated partial recovery from the 2023 stress period.

Phase IV: Regulatory Intervention and Partial Recovery, 2024–2025

Following the political transition in 2024, the interim government reconstituted the bank's board through a special appointment process. The new board initiated corrective measures aimed at restoring depositor confidence, strengthening governance, and improving liquidity management. These measures appeared to produce some positive results. By the end of 2025, the bank reportedly maintained a CRR of 4.66 against the requirement of 4.00 and an SLR of 6.81 against the requirement of 5.50. These buffers were modest compared with the bank's earlier conservative liquidity position, but they indicated partial recovery from the 2023 stress period.

Phase V: Renewed Liquidity Stress, 2026

In June 2026, the bank again experienced liquidity pressure. This time, the immediate trigger was reportedly linked to uncertainty regarding the central bank's approach to the bank's board composition. Although the trigger was governance-related rather than directly financial, it again affected depositor confidence. Withdrawal pressure reportedly intensified, with deposits declining by around BDT 20,000

crore within a short period. Bangladesh Bank provided emergency liquidity support exceeding BDT 12,000 crore to stabilize operations and maintain payment continuity.

This episode reinforces an important lesson: compliance with regulatory ratios alone cannot fully protect a bank from liquidity stress if depositor confidence deteriorates sharply. Confidence can weaken faster than regulatory indicators are able to capture.

Case Analysis

First, maintaining liquidity above the regulatory floor may involve an opportunity cost, but it can provide critical resilience during periods of stress. The bank's ability to withstand the 2013 reputational shock was largely supported by the liquidity buffers accumulated during its earlier years. This suggests that excess liquidity, when maintained prudently, may serve as an institutional safeguard against sudden confidence shocks.

Second, reputational and governance risks can rapidly transform into liquidity risks. Allegations, adverse narratives, governance changes, and uncertainty regarding institutional control may influence depositor behavior, even where the bank had a long record of strong performance. As long as banks are able to mobilize deposits and retain depositor confidence, internal liquidity outflows may remain manageable. However, continuous public discussion of reported irregularities involving Islamic banks can create panic among depositors, stakeholders, and the wider public, thereby accelerating liquidity outflows and sharply reducing fresh cash inflows.

Third, regulatory support becomes essential during severe liquidity stress, particularly where the affected institution has systemic importance. In this case, the regulator responded promptly by extending liquidity support to the affected Islamic bank and other vulnerable institutions. However, the case also suggests that financial assistance alone may not be sufficient to restore depositor confidence on a sustainable basis. One Islamic bank was initially able to regain the confidence of certain groups of depositors and temporarily stabilize its position, but it later faced renewed liquidity pressure due to continuing uncertainty regarding institutional stability. Depositor trust must therefore be rebuilt through transparent governance, credible management, effective communication, asset-quality improvement, and consistent regulatory oversight.

Fourth, large-scale withdrawals may distort the fund mix of Islamic banks. A decline in low-cost and no-cost deposits may increase reliance on higher-cost funds, thereby putting pressure on profitability and limiting the capacity for profit distribution. In addition, Islamic banks may face income-recognition constraints where income is derived from doubtful or irregular transactions. Such constraints may further weaken profitability and reduce the institution's ability to respond effectively to withdrawal pressure.

Fifth, Islamic banks face additional constraints because their liquidity management must remain within Shariah-compliant instruments and arrangements. This makes it particularly important to develop diversified liquidity-support facilities, active Islamic money-market instruments, credible contingency funding plans, and effective depositor-communication strategies.

Overall, the case reinforces the need for stronger preventive measures within the broader regulatory framework. Islamic banks should strengthen self-regulatory practices, including governance standards, early-warning indicators, contingency funding plans, internal controls, asset-liability management, and Shariah governance oversight. At the sectoral level, the implementation of a national integrity strategy and stronger ethical standards in banking may help improve governance practices and restore confidence. Unhealthy and aggressive competition among banks should also be contained, as such practices may weaken risk discipline and increase systemic vulnerability.

Conclusion

The broader lesson of this case is that liquidity management in Islamic banks cannot be reduced to mechanical compliance with CRR, SLR, LCR, and NSFR requirements. These ratios are necessary, but they are not sufficient. Liquidity resilience ultimately depends on governance quality, institutional reputation, depositor confidence, asset quality, effective communication, and the availability of Shariah-compliant liquidity instruments. A bank may remain formally compliant with selected regulatory ratios and still become vulnerable if public confidence, governance credibility, and short-term liquidity access deteriorate simultaneously. Therefore, sustainable liquidity management requires not only regulatory compliance but also strong governance, proactive regulatory support, and continuous efforts to preserve depositor trust.

Source: Authors' Compilation Based on KII.

13.6 Issues and Recommendations

The study identifies regulatory, market, operational and Shariah governance issues in IFIs' liquidity management. Despite BGIIB, BGIS, BGSS, IBLF, MLS and SLS, the framework is constrained by scarce short-term and tradable instruments, an underdeveloped Islamic interbank market, settlement concerns and weak Shariah governance. The following recommendations aim to strengthen liquidity resilience, improve the productive deployment of surplus funds and help IFIs manage temporary deficits without compromising Shariah compliance.

13.6.1 Ensuring Shariah Compliance in Liquidity Management

Shariah compliance should govern the whole liquidity-management cycle — placement, collection, collateral, profit calculation, provisional-profit adjustment, settlement, rollover and early redemption. Although most respondents reported no major Shariah concerns with the CRR, SLR, LCR and NSFR, some raised concerns about the final settlement of BGIIB, interbank placements, IBLF and MLS, especially where provisional profit is later adjusted: opaque or persistently large gaps between provisional and final profit create governance concerns. Each instrument's contract structure, profit-sharing mechanism, calculation method, collateral and settlement process should be clearly documented and consistently applied, with standardized agreements, manuals, settlement checklists and disclosure formats for BGIIB, interbank Mudarabah placements, IBLF, MLS, SLS and future facilities, and a transparent basis and process for adjusting Mudarabah profit.

13.6.2 Expanding Shariah Review and Internal Shariah Audit

Treasury activities — interbank placements, liquidity facilities, Sukuk, foreign-currency transactions, capital market operations and profit settlement — should be brought explicitly within Shariah Supervisory Committee (SSC) review and Internal Shariah Audit, which in many banks focus mainly on financing and branch operations. The SSC should approve the Shariah structure of treasury products, and ISA should verify its implementation, including fund segregation, profit calculation and distribution, provisional-profit adjustment, documentation of Qard arrangements and settlement of Mudarabah placements. ISA should report regularly to senior management, the SSC, the Board Risk Management Committee and the Audit Committee, so that compliance is maintained through execution and settlement, not only at product design.

13.6.3 Ensuring Adequate Shariah-Compliant Instruments Before Any Increase in SLR Requirements

Many IFIs hold substantial excess SLR in government instruments; this provides a cushion but, if prolonged, reduces their capacity to finance the private sector, which should remain the principal purpose of deposit mobilization. Any increase in the SLR for Islamic banks should therefore follow, not precede, an adequate and regular supply of diversified Shariah-compliant SLR-eligible instruments. A published issuance calendar for BGIS, BGSS and future short-term Sukuk, including one-, three-, six- and nine-month and one-year tenors, would improve liquidity management. A secure electronic trading, transfer and settlement platform for an

active secondary market would improve price discovery and the usefulness of Sukuk as HQLA, while reducing dependence on BGIIB.

13.6.4 Considering LCR and NSFR Requirements in Light of IFI-Specific Constraints

Most IFIs manage the LCR and NSFR without major difficulty, but FGD participants noted that the scarcity of Shariah-compliant HQLA puts them at a disadvantage to conventional banks, which have ample eligible assets. Bangladesh Bank may review the application of these ratios to Islamic banks and Islamic banking operations, with equivalent prudential objectives, taking account of the availability, maturity, market liquidity and tradability of Shariah-compliant HQLA.

13.6.5 Ensuring Competitive and Transparent Rates of Return on Shariah-Compliant Instruments

Some participants consider the returns on BGIIB, BGIS and other Islamic instruments less attractive than those on comparable conventional instruments; persistently lower returns without compensating liquidity or tradability impose opportunity costs that affect profitability, depositors' returns and competitiveness. Expected returns on Shariah-compliant government instruments should be set transparently and on economically reasonable terms — reflecting the Shariah structure, actual asset performance, market conditions, maturity, risk and comparable conventional yields — without replicating interest-based transactions.

13.6.6 Introducing Shariah-Compliant Earnings on Foreign Currency Accounts Maintained with Bangladesh Bank

Islamic banks earn nothing on their foreign-currency balances with Bangladesh Bank because of Shariah concerns, an opportunity cost that reduces the efficiency of foreign-currency liquidity management. Bangladesh Bank may consider a Shariah-compliant mechanism — for example, a separate pool for Islamic banks structured through Wakalah, Mudarabah or another permissible arrangement, subject to legal, regulatory, accounting, operational and Shariah assessment — through which such balances earn permissible returns.

13.6.7 Developing Shariah-Compliant Foreign Currency Liquidity and Funding Arrangements

Islamic banks also need Shariah-compliant foreign-currency liquidity support during temporary funding stress, to manage trade payments, correspondent banking obligations, Nostro requirements and currency mismatches. Bangladesh Bank, with Islamic banks, Shariah scholars and market participants, may explore such arrangements with international institutions such as the Islamic Development Bank (IsDB).

13.6.8 Introducing Islamic Interbank Liquidity Support Against BGIS and Developing an Overnight Facility

The existing IIFM does not effectively address daily or overnight mismatches, and participants called for an efficient overnight placement and collection mechanism. Bangladesh Bank may

introduce an interbank Shariah-compliant liquidity-support arrangement against unencumbered BGIS or BGSS holdings. Like the IBLF, it would let one Islamic bank obtain short-term liquidity from another by placing eligible Sukuk under lien or Rahn. It would provide an alternative to conventional repo and reverse repo and help to build an active Islamic money market.

13.6.9 Recalibrating the Maximum IDR in Line with Instrument Availability

The maximum IDR for Islamic banks exceeds the ADR for conventional banks, and stakeholders suggest reviewing it where high financing deployment creates liquidity as well as credit pressure. Any reduction should, however, accompany adequate Shariah-compliant investment and liquidity instruments, or it may create idle funds and reduce financing to the real economy.

13.6.10 Strengthening Coordination and Institutional Capacity

Coordinated action is needed by Bangladesh Bank, the Ministry of Finance, the Sukuk SPV, Islamic banks, finance companies, Shariah scholars and market infrastructure providers. Bangladesh Bank may establish a regular consultation mechanism to identify market constraints, evaluate existing facilities and design new instruments. Islamic banks, for their part, should strengthen treasury management, liquidity forecasting, stress testing, contingency funding planning and Shariah governance, with their Treasury, Risk Management Department, ALCO, Basel Implementation Unit, Shariah Secretariat and Internal Shariah Audit working together, and should improve disclosure and reporting to strengthen market discipline.

13.6.11 Rate of Return for Depositors and Profit-Smoothing Practices

About 80% of Islamic banks' deposits are Mudarabah-based: depositors, as Rabb al-Mal, share actual profits and bear losses except where caused by the Mudarib's misconduct, negligence or breach of contract. To manage displaced commercial risk, banks may use permissible profit-smoothing mechanisms, subject to Shariah and regulatory requirements, but should not hold excessive surplus liquidity while attracting further Mudarabah deposits with high expected rates, which raises the cost of funds and burdens shareholders and depositors. Declared profit rates should rest on actual performance, prudent liquidity planning and transparent distribution methods. Banks should strengthen asset-liability management, forecasting and deposit pricing, and any profit-equalization mechanisms should follow policies approved by the SSC, the board and regulators and be subject to regular Shariah review and internal Shariah audit.

13.6.12 Modification of Associated Regulations

Article 36(4) of the Bangladesh Bank Order 1972, reflected in DOS Circular No. 01 of 19 January 2014, allows Bangladesh Bank to impose penal interest above the Bank Rate on CRR shortfalls. The Guidelines for Islamic Banking 2009 require Islamic banks to avoid receiving and paying interest in all their operations. The study therefore recommends reviewing the Order and associated regulations so that, for Islamic banks, the sanction is framed as a 'penalty' or other regulatory sanction rather than 'penal interest', preserving enforcement while ensuring consistency with Shariah.

13.6.13 Mutual Liquidity Support Through Qard Arrangements Among IFIs

As a form of mutual cooperation, two IFIs may establish separate, independent Qard arrangements: for example, Bank A may, at its discretion, lend Bank B up to BDT 100 crore interest-free during a temporary shortfall, and Bank B may separately lend Bank A up to BDT 120 crore. Each arrangement must be independently documented, approved and operated; neither may be conditional on the other. No interest, return, compensatory balance, preferential treatment or other stipulated benefit may be required, and each drawdown remains subject to the lender's liquidity position, internal approval and Shariah governance. The structure must be approved by a competent Shariah authority before implementation.

An effective liquidity-management framework for IFIs thus requires diversified Shariah-compliant instruments, an active Islamic money market, sound regulatory support and strong Shariah governance, achieved through coordinated effort by Bangladesh Bank, the Government, IFIs, Shariah scholars and market participants.

13.6.14 Structuring New Shariah-Compliant Liquidity-Support Instruments

Bangladesh Bank and market participants may also develop further liquidity-support instruments in line with AAOIFI Shariah Standards. Short-term facilities could use Salam or Istisna'a linked to genuine assets, commodities or future delivery obligations. Medium-term support could use sale and leaseback under a separate Ijarah, with any repurchase independent of the sale and lease contracts. Such instruments need standardized documentation, clear procedures, appropriate collateral and risk management, and prior approval from competent Shariah authorities and Bangladesh Bank; they would diversify liquidity support and reduce dependence on the few existing facilities.

Appendices

Appendix I

Summary of Recommendation Proposed by Respondents

- The introduction of Islamic repo and reverse repo.
- Availability of High-Quality Liquid Assets (HQLA).
- Initiative for enhancing profit rate on BGIIB.
- Alignment of the rate of return from BGIS and other treasury instruments.
- Effective functioning of the Islamic Interbank Fund Market.
- Greater clarity from Bangladesh Bank regarding modes applied liquidity support provided.
- Strengthen corporate governance and proper disclosure.
- Improve Shariah governance for liquidity operations.
- Recovery concerns regarding interbank placements.
- Introduction of Tawarruq-based instruments with proper governance for restricted use.
- Segregation of conventional and Islamic funds.
- Increase of equity-based Islamic instruments.
- Ensuring trading platform of BGIS in secondary market.

In a nutshell, Islamic banks need access to a well-developed Shariah-compliant money market for effective liquidity management. Key measures include introducing short-term tradable Sukuk and Islamic treasury instruments, increasing BGIS and BGIIB issuance, developing digital trading platforms and secondary markets, and automating interbank treasury transactions. Strong collaboration between Bangladesh Bank and Islamic banks, supported by standardized Shariah-compliant instruments and centralized Shariah oversight, would further strengthen liquidity management in Bangladesh's Islamic banking sector.

Source: Questionnaire Survey.

Appendix II

Example of CRR, SLR, IDR, LCR and NSFR Calculation

A. Cash Reserve Ratio (CRR) Calculation

Formula

- CRR = Average Total Demand and Time Liabilities (ATDTL) × Prescribed CRR Rate

Hypothetical Data

- Total Countable Liabilities known as ATDTL for April 2026= Tk. 50,000 crore
  (ATDTL figure of 2 months back, i.e., average figure of April 2026, which has been communicated by the bank to BB within May 10, 2026)
- CRR Rate = 3% (On daily basis)
- CRR Requirement (Daily) = Tk. 50,000 crore × 3% or Tk. 1500 crore (Any day of June 2026)
- Therefore, the bank must maintain cash reserve balance of Tk. 1500 crore with Bangladesh Bank in June 2026.
- Balance with BB on June 18, 2026= Tk. 2200 crore. Therefore, CRR maintained on the day is 4.4%
- CRR maintained during last two weeks (From June 07-18, 2026): 3.5%, 4.1%, 3.6%, 3.9%, 4.7%, 3.0%, 4.8%, 3.4%, 4.8%, and 4.4%.
- CRR Requirement on Bi-weekly basis will be calculated at the end of each week. Therefore, CRR maintained at the end of the week (June 18, 2026)= 4.02%.
- **The CRR information will be preserved in the Bank but communicated to BB on monthly basis (within 10th day of the subsequent month).**

B. Statutory Liquidity Ratio (SLR) Calculation

Formula

- SLR = Average Total Demand and Time Liabilities (ATDTL) × Prescribed SLR Rate

Hypothetical Data

- Total Countable Liabilities known as ATDTL for April 2026 = Tk. 50,000 crore
  (ATDTL figure of 2 months back, i.e., average monthly figure of April 2026, which has been communicated by the bank to BB within May 10, 2026)
- Required SLR Rate (for June 2026) = 5.5%
- SLR Requirement = Tk. 50,000 crore × 5.5%, or Tk. 2750 crore
- Therefore, the bank must maintain liquid assets of at least Tk. 2750 crore in approved forms.
- CRR Requirement (Bi-weekly) = Tk. 50,000 crore × 4% or Tk. 2000 crore
- Daily excess of Cash Reserve = (Day-end balance of unencumbered cash maintained in Taka current accounts with BB – Required cash reserve on Bi-weekly average basis).
- Actual Cash Reserve with BB (June 18, 2026)= Tk. 2200 Cr. Therefore, excess of CRR on the day= Tk. 2200 Cr-2000 Cr. = Tk. 200 Cr.
- The Bank maintained approved liquid assets (June 18, 2026):
  Cash in Hand including FC Tk. 523 crore; Investment in BGIIB Tk. 2,035 crore; Investment BGIS (Unencumbered) Tk. 8 crore; FC Clearing Account Tk. 73 crore; Nostro A/c Balance Tk. 1 crore; Balance with Sonali Bank PLC as an agent of BB Tk. 27 crore; HFT Securities Tk. 6 crore; Excess Cash Eligible for SLR Tk. 200 crore.
- Total Eligible SLR Assets = Tk. 2870 crore; therefore, Excess/(Shortfall) of SLR = Tk. 120 crore (June 18, 2026)
- CRR shortfall, if any, will be ignored for SLR calculation
- Funding form BGIIB net of with investment in BGIIB
- **The SLR information will be preserved in the Bank but communicated to BB on monthly basis (within 10th day of the subsequent month).**

C. Investment to Deposit Ratio (IDR) Calculation

Formula

- IDR = (Total Investments – EDF & Refinance Investments) ÷ (Total Demand and Time Deposits + Bond Surplus + Interbank Deposit Surplus)

Hypothetical Data (All are Day-end Balance)

- Total Demand and Time Deposits excluding Interbank Deposit = Tk. 50,000 crore
- Interbank Deposit Surplus = Tk. 2000 crore
- Bond Surplus = Tk. 500 crore (Difference between Bond issuance and purchase by the Bank)
- Total Investments = Tk. 40,000 crore
- EDF & Refinance Investments = Tk. 2000 crore
- Bond Deficit, if any, will be ignored in adjusted deposit calculation.

Step 1: Calculation of Adjusted Deposits

- Adjusted Deposits = 50,000 + 2000 + 500 = Tk. 52,500 crore

Step 2: Calculation of Adjusted Investments

- Adjusted Investments = 40,000 – 2000 = Tk. 38,000 crore

Step 3: Calculation of IDR

- IDR = 38,000 Cr. ÷ 52,500 Cr. = 72%
- **The IDR information will be preserved in the Bank but communicated to BB on monthly basis (within 10th day of the subsequent month).**

D. Liquidity Coverage Ratio (LCR) Calculation

Formula

- LCR = High Quality Liquid Asset (HQLA) ÷ Total Net Cash outflows over next 30 calendar days

Hypothetical Data

S/n	Components	Weight	Amount	Weighted Amount
1	**Customer Deposit (excluding Financial Institutions):**			
a.	Current (including 10% of savings)----10%	0.10	157,968,772.24	15,796,877.22
b.	Savings (90%)----------5%	0.05	483,471,646.06	24,173,582.30
c.	Fixed (less than 1 month)-------5%	0.05	24,604,110.49	1,230,205.52
d.	Fixed (more than 1 month)-----0%	0.00	817,216,397.46	-
2	**Deposit from financial institutions:**			
a.	Current -----100%	1.00	54,419.31	54,419.31
b.	Fixed (less than 1 month)------100%	1.00	110,738.01	110,738.01
c.	Fixed (more than 1 month)-----75%	0.75	1845090.52	1383817.89
3	Other borrowings & placement received--100%	1.00	24,370,702.84	24,370,702.84
4	All other monetary liabilities issued by the bank that do not fit into one of the above categories--75%	0.75	75,536,265.34	56,652,199.01
5	Amounts outstanding of commercial letters of credit (settlement date within the next 30 days). ---100%	1.00	71,566,037.63	71,566,037.63
6	Amounts outstanding of guarantees, standby letters of credit, performance bonds, bid bonds, and similar instruments-20%	0.20	18,842,871.28	3,768,574.26
7	Principal and interest receivables, on performing Term loans, from all non-financial customers within the next 30 days	-0.50	9,449,138.74	(4,724,569.37)
A	**Total Net Cash outflows over next 30 calendar days**		**1,685,036,189.93**	**194,382,584.63**
8	Cash on hand (Lcy+Fcy)	1.00	59,463,971	59,463,971

9	Balance with Bangladesh Bank:			
	a) Local Currency Total (Total TK. Current account balance with BB)	1.00	75,375,743	75,375,743
	b) Foreign Currency Total (Total FC clearing account balance with BB)	1.00	3,852,603.94	3,852,603.94
10	Book value of other unencumbered eligible GOVT. Securities in HTM portfolio	1.00	85,854,390.11	85,854,390.11
B	**HQLA**		**224,546,708.00**	**224,546,708.00**

- **Liquidity Coverage Ratio (LCR): 115.52%**

E. Net Stable Funding Ratio (NSFR) Calculation

S/n	Component	Weight	Amount	Weighted Amount
1	Regulatory Capital (consolidated)	100%	114,037,564	114,037,564
2	**Customer Deposit (excluding Financial Institutions):**			
a	Current (including 10% of savings)	80%	180,114,000	144,091,200
b	Savings (90%)	90%	599,026,955	539,124,260
d	Fixed (more than 1 month to less than 1 year)	100%	1,571,751,733	1,571,751,733
4	Liabilities with a remaining maturity of one year or more (excluding those mentioned in 2, 3, 5 and 6)	100%	170,158,242	170,158,242
5	All other monetary liabilities (excluding those mentioned in 2,3,4 above and amounts owed to financial institutions)	50%	126,378,229	63,189,114
A	**Available Stable Funding (ASF)**		**2,761,466,723**	**2,602,352,113**
7	Residential Mortgages, regardless of maturity, those qualify for the 50% RW under Basel lll Standardized Approach	65%	30,632,686	19,911,246
8	Loans to non-financial client other than natural persons or small businesses with a residual maturity of less than a year	50%	84,766,340	42,383,170
9	Other Loans to non-financial clients with remaining maturity of one year or more, those qualify for the 50% RW under Basel lll Standardized Approach	65%	954,174,738	620,213,580
11	All loans (excluding those mentioned from 7 to 10 and 21 to 22) with a residual maturity of one year or more	100%	1,412,536,579	1,412,536,579
12	Cost price of debt securities (excluding those issued by other FIs) with a residual maturity of one year or more	100%	126,032,093	126,032,093
14	Undrawn portion of lines of credit (continuous loans)	10%	192,298,531	19,229,853
15	Undrawn portion of lines of credit (Tern loans)	5%	22,683,768	1,134,188
16	Amounts outstanding of commercial LC	20%	83,329,431	16,665,886
17	Amounts outstanding of guarantees, standby letters of credit, performance bonds, bid bonds, acceptance and similar instruments.	10%	499,893,693	49,989,369
19	Fixed assets (Cost Price)	100%	10,214,300	10,214,300
20	All other assets not mentioned above	100%	46,141,663	46,141,663
B	**Required Stable Funding (RSF)**		**3,462,703,822**	**2,364,451,927**

- **Net Stable Funding Ratio (NSFR): 110.06%**

Chapter 14: COVID-19 and Islamic Banking: Challenges, Responses and Risk Management

This chapter combines two studies. Its main body is based on "COVID-19 Pandemic: Challenges and Opportunities for Islamic Banking Industry of Bangladesh" by Md. Mahabbat Hossain, Md. Abdullah Sharif, Md. Golzare Nabi, Md. Siddiqur Rahman and Kamal Hossain (14 September 2022). The section on reshaping risk management for the new normal is based on "COVID-19 and Risk Management for Islamic Banks: Proposal for the New Normal Scenario" by Shah Md. Ahsan Habib and Md. Mahabbat Hossain (17 October 2020). The Bangladesh Bank circulars cited are listed separately in the Bibliography.

14.1 Introduction

Coronavirus disease 2019 (COVID-19) emerged in Wuhan, China, in late December 2019, spread to more than 200 countries and territories (IOM, 2020) and was declared a pandemic by the World Health Organization (WHO) on 11 March 2020; by 26 June 2020 there were more than 9,454 thousand confirmed cases and 483 thousand deaths worldwide (WHO), and 130 thousand cases and 1,661 deaths in Bangladesh (Institute of Epidemiology, Disease Control and Research (IEDCR)). Lockdowns, border closures, travel restrictions and quarantines plunged the global economy into what leading economists called its greatest challenge since the Second World War, affecting health, education, transport and every other sphere. Bangladesh, the world's eighth most populous country, suffered severe effects across its economy, and its banking sector — conventional and Islamic — faced serious challenges in maintaining operations and its intermediary role in promoting saving, investment, inclusive growth and employment. This chapter focuses on the challenges facing Islamic banks and policy directions for mitigating the pandemic's impact.

Islamic banking in Bangladesh had expanded rapidly in assets, deposits, investments and customers, reaching close to 25% of the banking sector (Bangladesh Bank, 2019) and playing a significant role in mobilizing deposits and financing inclusive growth. The pandemic affected its intermediary role as it did that of conventional banks, but its inclusive financial tools give it the potential to mitigate the impact. The chapter analyzes the pandemic's effects on the global and Bangladesh economies and on Islamic banking, and offers policy options for meeting its challenges and exploring its opportunities.

14.1.1 Objective

The main objective is to discuss the pandemic's challenges and opportunities for Islamic banking in Bangladesh; the specific objectives are:

i) to review policy initiatives for Islamic banking industry of Bangladesh;

ii) to identify challenges faced by the industry; and

iii) to identify probable opportunities combating COVID-19 epidemic.

14.1.2 Methodology

Primary data were collected through an unstructured questionnaire to Islamic banks and the central bank, with data from three full-fledged Islamic banks and five conventional banks with Islamic branches or windows compiled, supplemented by telephone interviews with professionals and experts and a Focus Group Discussion (FGD) with bankers. Secondary sources included publications of Bangladesh Bank, Islamic banks, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB), the International Monetary Fund (IMF), the WHO and Bangladesh's Institute of Epidemiology, Disease Control and Research (IEDCR), together with Bangladesh Bank circulars and guidelines and banks' policy initiatives. The study is descriptive, presents data in tables, and was finalized after a webinar presentation.

14.2 COVID-19 and Overall Economy

This section would focus on adverse impacts on global economy and its ramifications on Bangladesh Economy.

14.2.1 World Economy

Following outbreak of the pandemic, the global economy is projected to contract sharply by 4.9% in 2020, much worse than during the 2008–09 financial crisis (Table 14.1). Due to worldwide massive stimulus package, the global economy is projected to grow by 5.4% in 2021 if economic activity normalizes. World trade is projected to decline by 11.9% in 2020 and increase by 8.0% in 2021. Trade of advance economies, and emerging market and developing economies may go down by 13.4% and 9.4% in 2020 respectively. Trade of advance economies and emerging market and developing economies are forecasted to rise by 7.2% and 9.4% in 2021 respectively.

Table 14.1: Overview of the World Economic Outlook Projections

Particulars	2019	2020[P]	2021[P]
Economic Growth			
World Output	2.9	-4.9	5.4
Advanced Economies	1.7	-8.0	4.8
United States	2.3	-8.0	4.5
Euro Area	1.2	-10.5	6.0
Emerging Market and Developing Economies	**3.7**	**-3.0**	**5.9**
Middle East and Central Asia	1.2	-4.7	3.3
World Trade Volume (goods and services)	0.9	-11.9	8.0
Advanced Economies	1.5	-13.4	7.2
Emerging Market and Developing Economies	**-0.8**	**-9.4**	**9.4**

Source: World Economic Outlook, IMF, June 2020 (P=Projection).

According to International Labour Organization (ILO), there will be a reduction of global jobs equivalent to about 195 million full-time workers. The United Nations Conference on Trade and Development (UNCTAD) is forecasting that the global flow in Foreign Direct Investment (FDI) will shrink by 5% to 15% in 2020. In addition, it is forecasted that due to the global

lockdowns and the historic slump in oil prices, global remittance is likely to reduce by 20% (National Budget Speech 2020–21, Government of Bangladesh).

14.2.2 Bangladesh Economy

The economy of Bangladesh has performed well attaining near 7% annual economic growth during the past decade before the coronavirus outbreak. According to data of IMF, Bangladesh attained 8.2% growth during FY19 (IMF Country Report No. 20/187, June 2020). Following coronavirus outbreak, the government has adopted many precautionary measures to contain the spread of the virus. The government declared a national holiday prompting the closure of government and private offices, factories as well as restrictions on public transport and individual movement. Localized outbreaks have led to the imposition of stricter lockdowns in major parts of the country. As results, public and private business units have experienced unprecedented loss in economic output.

Domestic economic activity is projected to decline as policies to limit the spread of COVID-19 are implemented and the national shutdown mandated by the government aims to keep people indoors. The large share of workers in the informal sector and in daily paid work indicates that a substantial part of the labor force is highly vulnerable to the COVID-19 shock. Growth is projected to decline to 3.8% in 2020 which is 4.4 percentage points lower than that of FY19, the largest one-year decline in the last three decades. Exports and Imports are predicted to go down by 17.9% and 8.8% in 2020 respectively. Remittances are forecasted to grow only 1.4% in 2020 relative to 9.6% in 2019.

Since the beginning of the COVID-19 pandemic, the government has undertaken various steps to combat its fallout under a comprehensive plan (National Budget Speech 2020–21). The comprehensive plan includes four main strategies. Firstly, it will discourage luxury expenditures and prioritize government spending that creates job. Due to sound macro-fiscal operation, Debt-to-Gross Domestic Product (GDP) ratio is still as low as 34%. This provides a cushion against any negative macroeconomic implication on the eve of increasing public spending to overcome the crisis.

Secondly, the strategy is to create loan facilities through commercial banks at subsidized interest rate for the affected industries and businesses so that they can revive their economic activities and maintain competitiveness home and abroad. The third strategy is to expand the coverage of the government's social safety net programs to protect the extreme poor and low paid workers of informal sector from the sudden loss of their source of earning due to pandemic. Finally, the fourth strategy lies in increasing money supply to the economy while making a delicate balance between increased money supply and possible inflationary pressure.

Table 14.2: Impacts of COVID-19 on Key Economic Indicators

Particulars	FY17	FY18	FY19	FY20^{P}	FY21^{P}
Real GDP	7.3	7.9	8.2	3.8	5.7
CPI inflation, annual average	5.4	5.8	5.5	5.7	5.6
Current Account balance (Percent of GDP)	-0.5	-3.5	-1.7	-2.2	-3.5
Exports of Goods	1.7	6.7	10.1	-17.9	-0.8
Imports of Goods	9	25.2	1.8	-8.8	4.8

Particulars	FY17	FY18	FY19	FY20[P]	FY21[P]
Remittances	-14.5	17.3	9.6	1.4	-7.1
Gross official reserves (in millions of USD)	33,471	32,838	32,762	30,652	26,778
In months of Goods and services	6.4	6	5.9	5.6	4.8
Budget Deficit (Percent of GDP)	-3.3	-4.6	-5.3	-6.3	-6.1
Public sector total debt (Percent of GDP)	33.4	34.6	35.9	39.1	40.7
Of which External sector Debt	13.7	14.9	14.9	16	15.8

Source: Country Report on Bangladesh, IMF, June 2020 (P=Projected).

In light of the comprehensive plan and strategies described above, the government has declared a number of stimulus packages to support the emergency healthcare services, protect jobs and achieve smooth economic recovery. The economic recovery packages declared so far has totaled BDT 1031.17 billion equivalent to 3.7% of GDP, which is the largest in the South Asia region.

14.3 Islamic Banking Industry and COVID-19 Pandemic

14.3.1 Islamic Banking Industry of Bangladesh

Bangladesh established its first Islamic bank 'Islami Bank Bangladesh Limited' in 1983 which is the first Islamic bank in South Asia. At present, Bangladesh's Islamic banking sector with assets of USD 30 billion dominates among different components of Islamic finance and it recorded robust growth during the last three decades (Bangladesh Bank, Financial Stability Report 2018). Bangladesh accounts for 1.9% share of global Islamic banking assets securing 8th position (IFSB, Islamic Financial Services Industry Stability Report 2019).

Bangladesh Islamic banking sector conducts its operations following Bank Company Act 1991 (amended in 2013) and other relevant acts/regulations as the conventional banking sector. Though there is no separate Act for Islamic banks, some clauses have been incorporated in Bank Company Act for smooth functioning of Islamic banks. In addition, Islamic banks follow Bangladesh Bank's Guidelines, 2009 (BRPD Circular No. 15/2009, 9 November 2009) in conducting its operations.

As central bank, Bangladesh Bank issues licenses for Islamic banks under certain terms and conditions, monitors operations of Islamic banks and conducts on-site and off-site inspection in Islamic banks regularly. According to Bangladesh Bank's Guidelines, 2009, each Islamic bank has established Shariah Advisory Board/Committee to look after Islamic law (Shariah) compliance issues. Furthermore, Bangladesh Bank Guidelines on Internal Control & Compliance in Banks 2016 (BRPD Circular No. 03/2016, 8 March 2016) incorporated a separate section on Shariah audit. There is a Shariah non-Compliance Risk Rating approach in the guidelines. Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) has been established by Islamic banks and other conventional banks having Islamic banking operations to offer advisory services on Shariah compliance and impart training on Islamic finance.

At the end of December 2019, Bangladesh's eight full-fledged Islamic banks operated 1,380 of the banking industry's 10,578 branches, and 9 conventional banks offered Islamic services

through 19 Islamic branches and 8 through 88 windows. Three more conventional banks had permission to convert into full-fledged Islamic banks, and others to open Islamic branches or windows. Islamic banks held nearly 25% of the industry's deposits and investments (Appendix I summarizes the industry for the first quarter of 2020; market shares are shown in Table 14.3).

Table 14.3: Share of Islamic Banking Industry at the End of December 2019

Aspects	Entire Banking Industry	Islamic Banking Industry	Share of Islamic Banking Industry (%)
Total Deposits (BDT in Millions)	11369796	2802278	24.65
Total Investments (BDT in Millions)	10587073	2627520	24.82
Remittances (BDT in Millions)	414091	146325	35.34
Number of Bank	59	8	13.56
Total Number of Bank Branches	10578	1380	13.05
Number of Account Holders	106,595,211	19,406,416	18.21

Source: Quarterly Report on Developments of Islamic Banks and SBS, Bangladesh Bank, December 2019.

The Islamic banking sector is also showing better financial performance compared to conventional banks in terms of financial performance indicators such as return on assets (ROA), return on equity (ROE), investment-deposit ratio (IDR), capital adequacy ratio (CAR) and classified investment ratio (Table 14.4).

Table 14.4: Comparative Financial Performance of Islamic Banks in 2019 (%)

Ratios	Islamic Banking Industry	Entire Banking Industry
Return on Asset (ROA)	0.6	0.5
Return on Equity (ROE)	11.4	7.4
Net Profit Margin	2.9	2.1
Investment (Advance)-Deposit Ratio	94.3	77.3
Classified Investment (Credit) to Investment	4.7	9.3
Classified Investment (Credit) to Capital	71.7	92.7
Capital to Risk Weighted Assets Ratio (CRAR)	12.4	11.6

Source: Financial Stability Report, Bangladesh Bank (2019).

14.3.2 COVID-19 and Regulatory Initiatives for Banking Industry of Bangladesh

Bangladesh Bank eased monetary policy to contain the fallout: it cut the repo rate by 75 basis points in two steps to 5.25% and the Cash Reserve Requirement (CRR) by 150 basis points to 3.5% daily and 4% on a bi-weekly average; raised the ADR/IDR ceilings by 2 percentage points, to 87% for conventional and 92% for Shariah-based banks; required banks to provide minimum services during the national shutdown; and relaxed foreign exchange rules for trade and certain non-trade transactions.

Recovery was projected to begin in the second quarter of FY21. Despite disruption to food supply chains, inflation was expected to remain broadly unchanged thanks to a bumper harvest, and with ample food reserves and foreign exchange reserves above USD 32 billion (about six months of imports), Bangladesh hoped to withstand the uncertainties of the pandemic.

14.3.2.1 COVID-19 and a Summary of Bangladesh Bank Directives

To revive economic activity, protect jobs and keep entrepreneurs competitive, Bangladesh Bank issued a series of instructions to banks, summarized below:

14.3.2.1.1 Financial Stimulus Package

Payment of Salary/Wages of the Export Oriented Industries

A BDT 5,000 crore government fund paid three months' (April–June 2020) wages of workers in active export-oriented industries. Bangladesh Bank charged banks no profit on it, and banks charged clients a one-time service charge of 2% (BRPD Circular 7, 2 April 2020; BRPD Circular Letters 15 and 21, 11 and 27 April 2020; FE Circular Letter 19, 3 May 2020).

Working Capital for the COVID-19 affected Industrial & Service Sector Clients

A BDT 30,000 crore fund subsidized working capital for COVID-affected industrial and service enterprises (other than CMSMEs): banks sanctioned a special working capital limit of 30% of the existing (or estimated) limit at 9%, half paid by the client and half by a government subsidy (BRPD Circular 8, 12 April 2020; BRPD Circular Letters 22, 25, 30 and 33, 3 May to 25 June 2020).

Working Capital Refinancing Scheme for Industrial & Service Sector Business Enterprises (other than Cottage, Micro, Small, and Medium Enterprises (CMSME))

A revolving BDT 15,000 crore refinance scheme covers 50% of banks' disbursements under this special limit, at 4% charged quarterly by Bangladesh Bank, for three years (BRPD Circular 10, 23 April 2020).

Special Loan/Investment Facility- SME

A BDT 20,000 crore fund subsidized working capital for COVID-affected cottage, micro, small and medium enterprises (CMSMEs) at 9% (4% paid by the client, 5% by government subsidy), valid for three years for banks and for one non-renewable year per client (SMESPD Circular 1, 13 April 2020; SMESPD Circular Letters 1, 3 and 5, 30 April, 12 May and 22 June 2020).

Working Capital Refinancing Scheme for Cottage, Micro, Small and Medium Enterprise (CMSME) Clients

A revolving BDT 10,000 crore refinance scheme covers 50% of banks' disbursements under the CMSME package, at 4% charged quarterly, for three years (SMESPD Circular 2, 26 April 2020; SMESPD Circular Letter 2, 7 May 2020).

Agricultural Loan/Investment on Additional Items at Concessional Rate in the Crop Sector

Under the Agricultural and Rural Credit Policy and Program 2019–20, banks may finance import-substitute crops (lentils, oilseeds, spices and maize) at a concessional 4% from 1 April 2020 to 30 June 2021, claiming the 5% shortfall in return from Bangladesh Bank (ACD Circular 2, 27 April 2020).

14.3.2.1.2 Refinance Scheme

Pre-shipment Credit Refinance Scheme for the Export Oriented Industries

A revolving BDT 5,000 crore pre-shipment credit refinance scheme runs for three years; banks borrow at 3% and lend at 6% (previously 7%) (BRPD Circular 9, 13 April 2020; SFD Circular 1, 22 April 2020).

Refinance Scheme for Agricultural Sector

A BDT 5,000 crore working capital refinance scheme serves the agricultural and agro-based sector other than crops (including horticulture, fisheries, poultry, dairy and livestock) and traders who buy directly from farmers: Bangladesh Bank lends at 1% and banks at 4%, for 18 months (ACD Circular 1, 13 April 2020).

Refinance Scheme for Low Income Professionals, Farmers and Marginal/Small Business Enterprises

A revolving BDT 3,000 crore scheme supports low-income professionals, farmers and marginal and small businesses for three years, with 24-month financing including up to a year's grace: Bangladesh Bank lends to banks at 1%, banks to MFIs at 3.5% and MFIs to clients at 9% (FID Circular 1, 20 April 2020).

Reduction of Rate of Return (RR) of existing 3 Refinancing Schemes (Term & Working Capital (WC) Investment) under SME & Special Programs Department (SMESPD)

The Small Enterprise Refinance Scheme, the Refinance Scheme for Setting up Agro-Based Product Processing Industries in Rural Areas and the Refinance Scheme for New Entrepreneurs in the Cottage, Micro and Small Enterprise Sector (SMESPD Circular 2 of 5 September 2019) were enlarged to BDT 1,500 crore, BDT 1,400 crore and BDT 100 crore respectively (SMESPD Circular Letter 2, 7 May 2020).

14.3.2.1.3 Foreign Exchange Policy Guidelines

Relaxation in Different FOREX Trade Transactions — Time Extension Facility

Authorized dealers may give exporters 60 days' additional time to realize export proceeds and allow up to 180 days for submitting bills of entry for back-to-back LCs and Export Development Fund (EDF) loans (FE Circulars 13 and 19, 19 March and 12 April 2020).

Broadening Area of Bullet Repayment for Imports under Supplier's/ Buyer's Credit

Bullet repayment was extended to all usance imports under supplier's or buyer's credit (FE Circular Letter 11, 12 April 2020).

Extension of Usance Period

Usance periods may be extended up to 360 days for industrial raw materials, agricultural implements and chemical fertilisers and up to 180 days for life-saving drugs (FE Circulars 16 and 17, 23 and 24 March 2020; FE Circular Letter 18, 26 April 2020).

Reduction of Rate of Return of Bangladesh Bank EDF

Bangladesh Bank cut the rate on EDF funds to authorized dealers to 1.00% (from six-month USD London Inter-bank Offered Rate (LIBOR) + 0.50%), with dealers charging manufacturer-exporters 2.00% (FE Circular 18, 7 April 2020).

Reducing LC Margin Requirement

LC margins on baby food imports were capped at 5% to stabilize prices and prevent shortages (BRPD Circular Letter 12, 4 April 2020).

Increasing limit of foreign remittance

Expatriates can receive the 2% remittance incentive without documents on remittances up to BDT 5 lakh/USD 5,000 (previously USD 1,500), and larger remittances require documents within two months (previously 15 days) (FE Circular Letter 20, 12 May 2020).

14.3.2.1.4 Policy Relaxation

A borrower's classification status could not be shown as worse on 30 September 2020 than it was on 1 January 2020, although improvements could be recorded, and no penal interest or additional fee of any kind could be charged during this period (BRPD Circulars 04 and 13, 19 March and 15 June 2020). Credit card bills due on or after 15 March 2020 could be paid up to 31 May 2020 without any additional charge, fee, penal interest or late payment fee (BRPD Circular Letter 11, 4 April 2020).

Bangladesh Bank's Monetary Policy Department reduced the Cash Reserve Requirement (CRR) to 4.0% on a bi-weekly average basis (from 5.50%), with a daily minimum of 3.5% (from 5%), from 15 April 2020 (MPD Circular 03, 9 April 2020). To support the government's stimulus packages, the repo rate was cut from 5.75 to 5.25% (MPD Circular 04, 9 April 2020). The investment-deposit ratio (IDR) of Islamic banks was raised from 90 to 92% from 15 April 2020, and conventional banks' advance-deposit ratio from 85 to 87% (DOS Circular 2, 12 April 2020).

Banks were allowed to submit all regulatory statements to Banking Regulation and Policy Department (BRPD), Department of Off-Site Supervision (DOS) and other Bangladesh Bank departments up to the tenth day after normal business reopened (BRPD Circular Letter 16, 11 April 2020; DOS Circular Letter 12, 12 April 2020), and their audited financial statements up to 30 June 2020 (DOS Circular Letter 15, 27 April 2020).

Interest or profit earned, or to be earned, from 1 April to 31 May 2020 on a client's loans or investments outstanding on 31 March 2020 had to be transferred to a blocked account bearing no interest or profit, not to the income account (BRPD Circular 11, 3 May 2020; BRPD Circular Letter 23, 4 May 2020; BRPD Circular 12, 10 June 2020).

14.3.2.1.5 Other Policy Initiatives of Bangladesh Bank

Bangladesh Bank issued circulars from time to time on limited banking operations in different locations and during the government's general holidays (DOS Circular Letters 13, 14, 18 and 20, 16 April to 15 June 2020). Each bank had to form a 'Central Quick Response Team' of senior executives at head office and zone level to take prompt decisions in the changed situation (BRPD Circular 05, 22 March 2020). All meetings of the board, executive committee, audit committee and risk management committee were to be held virtually (BRPD Circular Letters 9 and 26, 23 March and 17 May 2020). As lockdowns were lifted and full operations resumed, each bank had to follow 13 instructions issued by the Directorate General of Health Services (DGHS) of the Ministry of Health (BRPD Circular Letter 28, 17 May 2020).

Dividends were limited according to banks' capital adequacy ratio (CAR) relative to risk-weighted assets. Banks with a CAR of 12.50% or more could declare dividends of up to 30%, of which up to 15% in cash. Banks with a CAR of 11.25–12.50% could declare up to 15% (up to 7.5% in cash), and those below 11.25% up to 10% (up to 5% in cash). Cash dividends to individual local and foreign investors could be paid before 30 September 2020 (DOS Circular 3, 11 May 2020; DOS Circular Letter 19, 7 June 2020).

The government announced a financial incentive, paid by the banks, for officials and staff working at bank premises during the COVID-19 general holidays up to 28 May 2020, together with conveyance allowances for working on those holidays. A special health insurance facility was also announced for bank employees affected by COVID-19 and for the families of deceased employees (BRPD Circular Letters 17, 18 and 27, 12 April, 15 April and 17 May 2020).

Bangladesh Bank launched a special collateralized 360-day repo. Participating banks could borrow 85% of the face value of treasury bills and 95% of that of treasury bonds, at a rate set by auction with the existing repo rate (5.25%) as the base, and the funds could be used only to implement the stimulus packages (DMD Circular 02, 13 May 2020). No late payment fee or additional charge could be imposed on depositors who missed their April and May 2020 installments in any deposit scheme, provided they paid the overdue installments by 20 June 2020 (BRPD Circular Letter 29, 1 June 2020).

The government decided to provide one-time cash assistance of BDT 2,500 directly to the mobile accounts of 50 lakh distressed families across Bangladesh through mobile financial services (MFS) (PSD Circular 04, 13 May 2020). Banks were advised to spend their allocated Corporate Social Responsibility (CSR) funds in the health sector, providing essential medical equipment for COVID-19 patients and safety equipment for health workers (SFD Circular Letter 3, 16 June 2020).

14.3.3 COVID-19 Pandemic and Initiatives Taken by International Organizations for Banks

AAOIFI's Accounting Board (AAB) issued a statement on the 'Accounting Implications of the Impact of COVID-19 Pandemic', and its Governance and Ethics Board (AGEB) issued a separate statement on the 'Application of AAOIFI governance, ethics and auditing standards in view of the impact of COVID-19 pandemic'. The Islamic Financial Services Board (IFSB) issued a statement on the COVID-19 situation on 10 March 2020, followed on 8 July 2020 by another on its implications for Islamic banking and Islamic capital markets.

The pandemic raises the prospect of a deep recession. Borrowers and businesses face job losses, falling sales and declining profits as the virus spreads, and banking customers are likely to seek financial relief, which Bangladesh Bank is encouraging banks to provide. To cushion the blow, the authorities have deployed prudential regulation, supervision and other financial policies as well as monetary and fiscal measures.

Regulators in many jurisdictions announced payment moratoriums, deferrals and suspensions: some extended contract periods without increasing profit, some suspended payments without extending the period, and some extended the period with additional profit where Shariah

permits. Suspending the amortization of deferred profit, or recognizing an upfront loss, during a moratorium may not be fair to participatory stakeholders, including unrestricted investment account holders.

For cost-plus sale (Murabahah) and other deferred sales, the original transaction is not derecognized. A moratorium without additional profit on established receivables (Dains) is permissible, but extending a debt's due date in exchange for additional payment is not, whether or not the debtor is solvent.

For Ijarah Muntahia Bittamleek (MBT), Islamic Financial Institutions (IFIs) may offer a moratorium without increasing rentals, either extending the lease (Ijarah) term — amortizing unrecognized Ijarah revenue and charging depreciation over the extended term — or without extending it, or, for capable clients, with increased rentals and a changed term.

In all other transactions, whereby the payment moratorium is allowed (subject to mutual consent of parties and fulfillment of *Shariah* principles and rules, as confirmed by Shariah Supervisory Committee (SSC) of the institution), with or without additional returns/profits, the accounting treatment shall be in line with the requirement of relevant Standard.

A transaction may also be settled early and replaced by a new one, either of the same kind (a Murabahah or commodity-based cash financing (Tawarruq) replaced by another on different terms) or of a different kind (a Murabahah replaced by an Ijarah MBT), provided Shariah requirements and the derecognition criteria of the relevant standard are met.

Governments or regulators may provide IFIs with interest-free loans (Qard Hasan) and zero-return repos. Since many IFI products are exposed, wholly or at some stage, to operational, market and equity investment risks rather than credit risk, Financial Accounting Standard (FAS) 30 requires the carrying value of non-monetary assets, including inventory, not to exceed their recoverable amount. Given the uncertainty, almost all asset classes needed extensive impairment testing.

The Bank for International Settlements (BIS) recommended that regulators support credit supply by easing capital and other requirements and supervisory stances. Allowing flexibility in loan classification with adequate disclosure. Pairing the use of capital and liquidity buffers with restrictions on dividends and bonuses and a clear process for rebuilding them, and applying expected-loss provisioning with sensible transitional arrangements.

As community transmission spread, the World Health Organization advised contactless payment and minimal handling of banknotes, on which the virus may survive for days, and banks, consumers and governments increasingly turned to digital channels.

14.4 COVID-19 and Islamic Banks: Observations and Findings

14.4.1 COVID-19 and Steps Taken by Islamic Banks of Bangladesh

Following the regulatory initiatives, Islamic banks, like conventional banks, provided limited services during the general holidays, rotated staff duties, directed customers in locked-down areas to nearby branches, offered 24/7 hotline support and expanded alternative delivery channels, with some reducing or waiving fees for online services. They ensured timely receipt

of remittances, raised withdrawal limits, kept ATMs and cash recycler machines stocked and running, sometimes collected EMIs and small deposits off-premises, and moved board and committee meetings and training online. For staff safety and welfare they provided Personal Protective Equipment (PPE). Sanitised premises and incoming customers; installed disinfection machines and thermal scanners. Arranged hand-washing facilities, disinfected transport, telemedicine, testing, ambulances and oxygen. Offered health insurance and incentives for staff attending in person, and gave cash and in-kind support to affected families. Some also supported agent banking outlets, raised employees' card limits and distributed health and sanitation supplies to the poor.

14.4.2 Shariah Issues for Islamic Banks Regarding Regulatory Initiatives

14.4.2.1 Extension of Repayment Period for Installment (Credit)

Regulators required banks to extend repayment periods for large numbers of customers. Conventional banks can charge additional interest for the extension, but Islamic banks cannot charge further profit or re-fix the sale price of Murabahah goods — a significant problem, since more than 70% of their investments are trade-based (Bai), and a source of income mismatch between banks operating in the same environment.

14.4.2.2 No Separate Guidelines for Islamic Banks in Availing Stimulus Package

The stimulus packages and Bangladesh Bank's guidelines did not consider Shariah compliance. The 4.50% interest subsidy, for example, conflicts with Murabahah, in which the mark-up is added to the cost of goods at execution and shown as the client's liability, whereas BRPD Circular 8 of 12 April 2020, clause 6(kha), requires the subsidy not to be shown as the client's liability unless the client fails to pay on time, and requires banks to claim it quarterly (March, June, September and December) after collecting the client's portion.

This suits conventional working-capital lending — cash credit or overdraft facilities on which only interest is collected quarterly — but not Islamic banks, which finance deal by deal against actual purchases and recover the sale price within the due date. Islamic banks could instead charge the full mark-up (say 9%) as the client's liability and allow a rebate equal to the subsidy, if received, when the deal is adjusted.

14.4.2.3 Availing Refinance Scheme

Bangladesh Bank's refinancing facilities (50% for large and CMSME investments and 100% for other sectors) operate on a fully conventional, interest-based basis: there is no Shariah-permissible alternative such as profit-sharing partnership (Mudarabah) or agency (Wakalah), banks must repay with an additional charge at maturity whether or not they recover from customers, and in some cases 2% interest is charged. Separate Shariah-compliant guidelines are needed; some Islamic banks have raised the issue with Bangladesh Bank, and some SSCs have temporarily consented to refinance given the urgency.

14.4.2.4 Blocking Interest and Waiver Thereof

BRPD Circular No. 11 of 3 May 2020 required banks to block all interest charged or accrued for April–May 2020, and Circular No. 12 of 10 June 2020 set out how profit was to be waived, the unwaived amount recovered and income recognized. This procedure did not fit Islamic banks' practice, and it made it difficult for banks using the monthly Income Sharing Ratio (ISR) method to distribute profit to Mudarabah depositors for those months.

14.4.2.5 Implementing Single Digit Profit of Investment and Penalty Interest Rate

BRPD Circular No. 03 of 24 February 2020 fixed a 9% rate on all unclassified investments from 1 April 2020, but Islamic banks cannot change the rate in a Murabahah before maturity or adjustment, although they may grant rebates at their discretion on recovery. The circular's 'penalty interest rate' also conflicts with Shariah, and Islamic Muamalat encourages pricing that differs by product, client and contract.

14.4.3 Challenges and Opportunities for the IB Industry in Bangladesh

14.4.3.1 Health Hazard of Bank Employees

Bankers kept working through the lockdown and general holidays to prevent an economic meltdown, often without sufficient PPE, and most private banks declared no specific allowances for affected or deceased staff, many of whom were infected and some of whom died. The pandemic has also underlined the Islamic principle of cleanliness in daily life.

14.4.3.2 Salary Reduction of the Bank Employee and Lay-Off

While Islamic banks financed businesses' working capital, including wages, some bank owners and managers sought to cut costs by reducing staff salaries and benefits, arguing that every member of the 'bank family' must share the sacrifice. Employees countered that, as agents, they should not bear ownership risks under Shariah, and that cuts were inconsistent with the extra allowances given to government employees and with Bangladesh Bank's instruction to motivate staff. No Islamic bank employee should lose his or her job because of the pandemic.

14.4.3.3 Obstacle in Regular Banking Operations

Regular operations — client and business appraisal, information flow, file processing, documentation and meetings — have been severely disrupted, giving dishonest employees and customers opportunities to exploit the situation. Islamic banks can expect higher integrity from their employees and customers only if it was already established before the pandemic.

14.4.3.4 Operating Expenses for Safety and Employee Allowances

Revenues fell while operating expenses rose, since most costs are fixed and about 6% of operating expenses went on health safety and COVID allowances (Appendix II), although some costs, such as those of physical meetings, fell sharply. Banks with ample retained earnings are better placed to pay dividends, and the pandemic shows the value of building internal capital beyond the regulatory minimum.

14.4.3.5 Status of Deposit

Falling incomes may reduce new deposits and increase withdrawals, while stimulus disbursements and weak recovery increase funding needs. Yet some Islamic banks are in deposit surplus and others expect more deposits, so the overall deposit position is satisfactory, and deposits may grow further as public awareness of the prohibition of interest (Riba) rises.

14.4.3.6 Share of Profit for Livelihood of Depositors

Most deposits of Islamic banks are Mudarabah deposits, whose returns depend on investment performance. Regulatory relief has focused on borrowers, with little attention to depositors, many of whom live on their deposit income. Deferred or waived earnings will cut banks' income and depositors' profits, exposing banks to displaced commercial risk — acutely so in April–May 2020 for banks using the ISR method. Profit equalization reserves (PER) and investment risk reserves (IRR) can cushion this, and the Mudarabah principle gives Islamic banks more flexibility than conventional banks in managing their cost of funds. Banks should also make Mudarabah depositors aware that a pandemic may leave little or no profit to share.

14.4.3.7 Recovery of Dues, Extending New Investment and Maintaining Asset Quality

Many businesses cannot repay existing debts or qualify for new finance, and some solvent clients exploit the regulatory relaxation. Since most Islamic bank investments are trade-based (Table 3.13, Chapter 3), banks cannot charge for extended time, although regulatory easing will keep reported asset quality from deteriorating. An ideal Islamic bank — whose every disbursement became a real asset, with no diversion of funds, full transparency, no adjustment of old deals by new ones, no hidden classified assets, ethical customer selection, partnership relationships and strong monitoring — has less to fear, but it must still address threats to its customers' going-concern status.

14.4.3.8 Selecting Priority Sectors for Investment

Islamic banking derives from divine regulation, and the higher objectives of Islamic law (Maqasid al-Shariah) must be achieved through its Muamalat. An Islamic bank is therefore expected to prioritize investment projects and clients according to the hierarchy of needs: basic necessities (Daruriyyat) such as food, clothing and shelter; complementary needs (Hajiyyat) such as higher education and a comfortable home; and embellishments (Tahsiniyyat) such as luxury cars and jewellery. Banks that fail to do so will suffer in this pandemic, and agriculture, health and CMSMEs should receive priority.

Preventing environmental degradation and ensuring ecological balance are also teachings of Islam. If the banking industry follows this principle in its investment decisions, it is hoped that Almighty Allah will protect mankind from pandemics. It is sometimes said that COVID-19 has affected some people adversely and others favorably.

14.4.3.9 Remittance Mobilization

Islamic banks handle about 35% of remittances, and their share has risen during the pandemic thanks to their services; although flows may fall if the pandemic persists, the channel's recognition among remitters, and a possible strengthening of faith, may give Islamic banks a competitive advantage in the new normal.

14.4.3.10 Implementation of Stimulus Packages

Islamic banks operate in a dual system dominated by conventional banks, so most stimulus packages were designed around interest-bearing concepts, and the Islamic banking sector should collectively ask the regulator to amend the relevant directives. Stimulus support is itself a feature of Islamic economics: funds for Qard Hasan, obligatory alms (Zakat) and cash endowment (Waqf) could help Islamic banks support deserving customers, and corporate social responsibility (CSR) for the poor is built into Islamic finance. Urging that charity be linked with business, the Prophet (peace be upon him) said, "mix some charity with trade" (Jami at-Tirmidhi, Book on Business, Hadith No. 1208).

14.4.3.11 Governance, Supervision and Monitoring

Governance has changed: board and committee meetings are held online, senior officials no longer visit the regions, and off-site surveillance has gained importance. Most Islamic banks have suspended on-site internal and Shariah audits; banks with audit software and strong Management Information System (MIS) are benefiting from efficient, low-cost virtual audit, supervision and monitoring — an opportunity for the whole industry.

14.4.3.12 Training and Development

Training has moved online: Bangladesh Institute of Bank Management (BIBM) and Islamic banks offer webinar programs, cutting cost, travel and time and letting trainees learn alongside their work, and all parties have grown comfortable with Information and Communications Technology (ICT)-based training. With the IMF projecting recovery in 2021, executives need to be well versed in Financial Technology (FinTech) and new products, and banks that postponed training to save costs should treat it as an investment for the new normal.

14.4.3.13 Use of ICT and Its Threat

With operations, supervision, surveillance and audit depending on ICT and remote access, ICT risk has become a major threat for which banks are unequally prepared; addressing it must be a top priority (Habib, 2020).

14.4.3.14 Conversion of Bank Who Got Approval Recently

Some conventional banks approved for full conversion to Islamic banking have been unable to complete it because of the pandemic and have sought extensions. They, and banks newly permitted to open Islamic branches or windows, should press ahead to seize new-normal opportunities, with the support of existing Islamic banks, strengthening the industry's market share and bargaining power.

14.5 Reshaping Risk Management for the New Normal

The Islamic banking industry is fighting COVID-19-related risks and working out how to sustain itself in the new normal. The complex multi-crisis situation — which an article in the Harvard Business Review described as a combination of real recession, policy recession and financial crisis (Carlsson-Szlezak et al., 2020) — has created huge challenges for banking and finance, and Islamic banking and finance is no exception (AAOIFI, 2020a).

The industry is struggling to turn around from a very risky environment of acute business and financial disruption, fear and lack of confidence among entrepreneurs and clients, and scepticism about legal liabilities. Shaping the right approach and adopting the right risk management framework are critical to its transformation and survival. The root cause of the crisis must also be part of Islamic banks' risk management approach, protecting the natural order by upholding their ethical commitment and Shariah compliance. Environmental protection is an important aspect of Islam, and the Holy Qur'an presents the environment in terms of unity, balance, order and harmony (Shah, 2020).

Risk management is a dynamic field that receives special attention after every major challenge and banking crisis. Its approach changed markedly after the global financial crisis of 2007–09, and it is receiving renewed attention in the COVID-19 crisis. Conventional and Islamic banks alike follow this classical banking rule, and their risk management frameworks are broadly similar because they face many of the same banking risks. As Salma and Khalid (2019) put it, Islamic banks confront both common risks, similar to those of conventional banks, and risks specific to themselves.

There are, however, notable differences in the risks, and their management, arising from transactions and Shariah. Islamic banks' distinctive operations and value-based approach require compliance with Shariah rules, so their risk management framework must be wider in scope and cover more categories of risk. There is no logical basis for simply replicating the conventional framework: although its components are the same and largely applicable under Shariah, the framework for Islamic banks must be inherently different and broader, because the foundation of Islamic banking is different (Alfatakh, 2018).

Both conventional and Islamic banks are transforming and streamlining their risk management frameworks to survive and flourish in the new normal — the state in which an economy or society settles after a crisis, when it differs from the pre-crisis situation (Wikipedia.org). Islamic banks logically need greater efforts to do so.

This section, based on the October 2020 study "COVID-19 and Risk Management for Islamic Banks: Proposal for the New Normal Scenario", discusses risk management approaches in the COVID-19 context and, drawing on published information and opinions, proposes elements of a risk management framework for Islamic banks in the new normal.

14.5.1 COVID-19 Devastations, Risks, and Reshaping Need Associated with Islamic Banking

COVID-19 created an environment of unprecedented risk for global banking. Uncertain business conditions intensified almost every type of risk faced by conventional and Islamic banks. Islamic banks are exposed to even higher risks because of their distinctive business

models: they share many characteristics with their conventional peers but face additional risks arising from the specific nature of their business (Chattha, 2020).

Four risks are common to both. Credit risk is the risk that a counterparty will not meet its obligations as agreed (Helmy, 2012). Liquidity risk is the potential loss from a bank's inability to fund an obligation on time without unacceptable losses, and market risk arises from an unfavourable change in the price of a generally traded asset (De Coussergues and Bourdeaux, 2010). Operational risk stems from inadequate control of internal processes and practices and may cause real losses of income and reputation (Islamic Banker, 2018).

Other risks arise from the specific transactions of Islamic banking products. They include transaction risk; valuation or equity risk, since some contracts, especially equity-based structures, are difficult to value; and displaced commercial risk — the mismatch between contracted obligations to depositors and uncertain financing income, which may prove insufficient to meet them (Reyazat, 2012).

Islamic banks also face Shariah risks, arising from non-compliance with Shariah decisions and instructions. These include Shariah compliance risk, where failure to comply puts operations at risk of being regarded as non-Shariah-compliant business. Fiduciary risk, the risk of loss from the bank's negligence, fault or violation of its investment mandate, and regulatory and reputational risks. Shariah risks are also considered a subset of operational risk.

Islamic banks' risk structure depends heavily on their assets. In debt-based financing, risks are transferred to customers, while in equity-based financing, fund providers also bear investment risk. Equity-based financing (Musharakah and Mudarabah) makes up only around 5% of global Islamic banking assets: Musharakah, Diminishing Musharakah and Mudarabah together accounted for 5.5% in the fourth quarter of 2018 (IFSB Bulletin, 2019). Since most Islamic banking products are debt-based, the risk environment is in practice similar for conventional and Islamic banks, except for Shariah risks (Alfatakh, 2018). The risks that COVID-19 created for global banking therefore have notable implications for Islamic banks as well.

The pandemic changed growth, pricing and products across the financial sector (FSB, 2020). Liquidity deteriorated sharply, even in traditionally deep markets (IMF, 2020a); non-performing loans rose, especially to SMEs, airlines, hotels, tour operators, restaurants, retail, construction and real estate (Ozili and Thankom, 2020); and demands on capital and liquidity increased (FSB, 2020). Banks entered the crisis with more capital and liquidity than in the past, and the Basel Committee on Banking Supervision (BCBS) allowed some flexibility in capital treatment, but existing capital and risk management approaches remained crucial.

Financial crime risk became particularly visible during COVID-19. Cybercrime has long been a danger, but more people online for longer, amid the anxiety and fear of lockdown, gave cybercriminals greater opportunities and led to a proliferation of e-crimes (UNICRI, 2020). Money laundering through international trade and electronic payment systems is also critical: illicit financial flows threatened the integrity and stability of the global financial system even in normal times, and there is growing evidence that the problem expanded during the pandemic (FATF, 2020a).

Wilful default arising from moral hazard is a further risk. In a crisis, some unethical borrowers take advantage of the situation and deliberately fail to repay banks. If not handled properly,

moral hazard during COVID-19 could become a critical source of financial crime and credit risk.

Islamic institutions were hit much as conventional banks were: lower financing demand, reduced fee income and additional subsidized financing squeezed revenues, and non-performing facilities were expected to rise (Global Finance, 2020). The USD 2.4 trillion industry, with some 1,400 institutions in 80 countries (Domat, 2020), faced unprecedented challenges from the pandemic, oil-price volatility and macroeconomic uncertainty (Brown, 2020). Risks varied by country (Al-Natoor, 2020): Indonesian Islamic banks with tourism exposure were more affected; Malaysian banks' credit profiles were expected to remain broadly stable, with adequate loss-absorption buffers, unless the outbreak was prolonged; and Turkish Islamic banks faced significant asset-quality pressure from rapid financing growth, risky exposures and foreign-currency financing.

In the Gulf Cooperation Council (GCC) countries, where Islamic banks depend heavily on government spending, the collapse in energy prices had serious implications (Domat, 2020). In many Asian and African countries, Islamic finance has a large share of microfinance, SME and retail lending (Domat, 2020), so the pandemic — which hit SMEs and low-income earners particularly hard — affected Islamic finance more severely than conventional banking (Brown, 2020).

In Bangladesh, the Islamic banking industry, a very important segment of the banking sector, has also faced turbulence in most areas of business and operations. The implications of COVID-19 are similar for Islamic and conventional banks because debt-based investment modes dominate in the country's Islamic banks.

Performance has improved on the deposit and credit fronts, although banks in general have remained cautious, which is logical. Deposit growth returned to normal, but small depositors are struggling (Habib et al., 2020). Credit to large enterprises improved remarkably, but CMSMEs still face many challenges: disbursement to the sector has been slow, and by 15 September banks had distributed only BDT 3,330 crore of the BDT 20,000 crore package, or 16.65% (The Business Standard). For certain banks, the concern amid business uncertainty is a liquidity surplus rather than a liquidity crunch.

Despite the improvement, banks are underperforming in customer service, and there are fears that customers' confidence will erode. With cash flows reduced, businesses are reportedly struggling to pay their suppliers, their employees and ultimately their bankers. Payment risks in international trade have also become a concern. Bangladesh's banks, Islamic and conventional, are heavily involved in trade transactions and may face greater liabilities from trade disruptions, and back-to-back LCs could become a problem if not handled properly.

Overall, the situation points to a notable contraction of banks' financing and fee income. If unfavourable business conditions and a prolonged pandemic push non-performing loans up substantially, banks may face capital and solvency risks — critical indicators of financial stability.

Existing risk management frameworks, conventional and Islamic, have paid inadequate attention to environmental risk. COVID-19 shows the need to manage environmental risks in all economic and business activities, including banking. The pandemic is a reminder of the

intimate and delicate relationship between people and the planet (WHO, 2020), and preventing the next one requires transforming humanity's relationship with nature (WWF, 2020b).

Shariah gives strong guidance on handling environmental risks and protecting the natural order. As stewards of the Earth, Muslims are responsible for caring for the environment proactively. The Qur'an encourages them to reflect on the relationship between living organisms and their environment and to maintain the ecological balance created by Allah (Al-Banna, 2020): "Allah surely loves not those who transgress the bounds of what is right. Do not cause any disruption on earth after it has been so well ordered" (Qur'an 7:55–56).

Unfortunately, the pandemic has worsened environmental disruption on some fronts. Poaching and deforestation increased after COVID-19 restrictions took effect, bushmeat and ivory poaching became more frequent in Africa, and Amazonian deforestation in Brazil reached a nine-year high (Price, 2020b). The crisis is also interrupting the green and sustainable development agenda, including efforts to implement the UN Sustainable Development Goals (SDGs). There is evidence that SDG 2 (zero hunger), SDG 3 (good health and well-being), SDG 6 (clean water and sanitation), SDG 7 (affordable and clean energy), SDG 13 (climate action) and SDG 17 (partnerships for the goals) are being affected (UNIDESA, 2020).

The Islamic attitude towards the environment and natural resources rests not only on the prohibition of over-exploitation but also on sustainable development (Al-Banna, 2020). Environmental awareness and the protection of natural resources are integral to Islamic belief: people are keepers of all creation, including soil, air, water, animals and trees, and a major objective of Islamic teaching is to build and maintain a healthy, clean environment (Al-Banna, 2020).

COVID-19 is shifting the dynamics of banking and has created new opportunities for Islamic finance by accelerating trends such as socially responsible investing, sustainability and digitalization (Brown, 2020). Its aftermath may create further opportunities for Islamic banking, particularly with the rise of socially responsible investing and the growing popularity of ESG — the environmental, social and governance factors used to measure the sustainability and societal impact of an investment. Surveys in various countries and regions have also strongly favored green and sustainable recovery measures. According to Usher and Daouda (2020), Islam's promotion of social trust, cooperation and solidarity makes Islamic banking products well suited to SDG impact (Box 14.1).

Box 14.1: Aligning Islamic Banking and Finance with SDGs

Policymakers and Islamic banks should come together to ensure SDG impact metrics and reporting are agreed upon that are both shariah compliant and in line with international standards
To better support the SDGs, leaders must develop a range of Shariah-compliant impact investing tools and instruments that are attractive to large investors. IsDB's Youth Employment Support (YES) program, for example, pioneered venture capital financing (restricted Mudarabah) for micro and small businesses run by young people.
Make SDG-compliant Zakat investments the norm to channel funds to the local SDG projects. These include renewable energy projects in underserved communities. In Palestine, for example, Zakat funds support SMEs through Islamic microfinance structures.
Create pro-poor and environmentally sustainable initiatives to attract investment from the public and private sector stakeholders with success indicators that can be and measured

Islamic finance institutions could not only provide a range of products to vulnerable communities but might also ensure these communities are adequately empowered by strengthening technical and managerial capacities, addressing climate risks, accessing markets, and building partnerships.

Source: Authors' Compilation based on Usher and Daouda, 2020.

The pandemic has shown that survival depends heavily on investment in science, technology and innovation (Bicer, 2020). Beyond its immediate economic effects, COVID-19 is forcing the Islamic finance industry to adapt to rapidly changing market conditions and is accelerating trends such as digitalization (Brown, 2020). The global Islamic banking software market is expected to grow by USD 460 million in 2020–2024, with the pandemic creating new opportunities overall (Technavio, 2020). The Middle East and Africa (MEA) region led the market in 2019 across retail, corporate and other segments, followed by Asia-Pacific, Europe, North America and South America.

14.5.2 Crisis Responses and the Challenges of the Islamic Banks in the Context of COVID-19

In response to the pandemic's health, economic, monetary and financial effects, policy makers are giving unprecedented support to households, firms and financial markets worldwide, through public health, human control, fiscal and monetary measures (Ozili and Arun, 2020). As the United Nations Development Programme (UNDP, 2020) notes, Islamic finance can contribute to the response through instruments suited to each stage: emergency and short term, medium term and long term.

Zakat can be an important part of national emergency support programs. Effectively a Muslim 'wealth tax', it is a sacrifice of wealth — not mere charity but a core duty that 'purifies' the rest of one's wealth (Iqbal, 2020). The UNDP's partnership since 2017 with BAZNAS, Indonesia's national Zakat collection agency, shows how Zakat stakeholders can systematically link their projects with the SDGs, including in crises. Its recently announced partnership with the Dubai Islamic Economy Development Centre shows how it can support private companies' social impact.

In the medium term, Islamic banks and financial institutions can support recovery by financing equipment, vehicles and other sources of livelihood, and through trade finance. Aligning their financing with the SDGs is a significant opportunity: in 2018, Al Baraka Banking Group began working with the UNDP to align over USD 600 million of its financing portfolio with the SDGs in the Middle East, Asia, Africa and Europe, and the pandemic makes such initiatives all the more urgent.

In the long term, SDG-linked Islamic investment certificates (Sukuk), such as the Government of Indonesia's 2018 Green Sukuk, can be an important source of capital for governments and companies engaged in response and recovery. Waqf endowments can also contribute to long-term resilience and social infrastructure (Rehman, 2020).

FSB (2020) classifies the policy responses at three levels: at the system level, central banks use policy tools, with fiscal support, to maintain financial stability; at the supervisory level, authorities review banks' pandemic plans, defer certain activities and scrutinize services; and

at the firm level, banks strengthen operational readiness, contingency planning and service continuity (FSB, 2020). The BCBS, AAOIFI and IFSB also introduced supportive measures.

The government of Bangladesh began preventive measures in early February 2020, even before the first confirmed case, and responded quickly with economic stimulus packages. By mid-September, according to a study published by Springer, 19 packages worth 3.7% of GDP had been announced. Bangladesh Bank complemented them with market interventions and refinancing schemes, and from the outset encouraged payments, especially online, by raising monthly and daily transaction limits and waiving charges on certain online payments (KPMG).

As the monetary authority, Bangladesh Bank also injected liquidity by buying back government securities, cutting repo rates and, very importantly, reducing the Cash Reserve Requirement (CRR) and raising banks' investment-deposit ratio (IDR). The CRR was cut from 5.5 to 5% on a bi-weekly average basis and from 5 to 4% daily on 1 April, and further to 4% bi-weekly and 3.5% daily from 15 April. Islamic banks' IDR was raised from 90 to 92% on 12 April (Bangladesh Bank BRPD circulars).

The government's stimulus packages are channelled mainly through the banking industry to support the core sectors affected by COVID-19, and Bangladesh Bank facilitates the process through complementary guidelines, directives and incentives. As an initial response, on 19 March it announced a moratorium on loan repayments until 30 June 2020, later extended to December 2020. The moratorium also relieved banks, at least temporarily, of loan classification and provisioning requirements.

In another circular, the central bank relaxed provisions on international trade and introduced policy support for exporters and importers amid the slowdown in external trade. It extended the time allowed for realizing export proceeds, submitting import bills of entry, settling back-to-back LCs and export development fund loans, and repatriating export bills. Further circulars helped banks and their clients to access the stimulus packages for the MSME and agricultural sectors. These measures were introduced through BRPD, Department of Financial Institutions and Markets (DFIM), Monetary Policy Department (MPD), Foreign Exchange (FE), SMESPD, ACD, Debt Management Department (DMD), Financial Institutions Department (FID) and DOS circulars issued in March–May 2020.

> The stimulus packages provide working capital to affected industries, traders, enterprises and individuals through Islamic and conventional banks, which bear the credit or investment risk; besides supporting economic recovery, they are expected to help restore customers' financial strength.
>
> At the response stage, Islamic banks faced several risks and challenges. When Bangladesh Bank told banks to block all interest charged or accrued for April–May 2020 and not to collect it from clients, Islamic banks struggled to distribute profit to Mudarabah depositors for those months. Under AAOIFI Shariah Standard No. 40, they could have used a profit equalization reserve (PER) to smooth profits and an investment risk reserve (IRR) to offset losses, but Islamic banks in Bangladesh generally do not maintain such reserves.
>
> As in other jurisdictions, Bangladesh Bank also told Islamic banks to extend customers' installment periods. Roll-over is strictly prohibited in Bai transactions, the

most common mode in Bangladesh, so Islamic banks could not charge any profit or re-fix the sale price of Murabahah or Muajjal goods for the extended time. They also faced Shariah issues in using refinance funds, and the challenge of adopting digital technology quickly.

This raises the question of how Islamic banks should respond: how existing and emerging risks should be handled, and what risk management approach they should adopt for recovery and for the future.

14.5.3 Reshaping Proposals for the Risk Management Approach of Islamic Banks in the New Normal

14.5.3.1 Risk Management Approach as Recovery Measures by the Islamic Banks

During the disruption, Islamic banks need patience and sacrifice, and crisis management must follow an integrated enterprise risk management approach within Shariah principles, involving top management, departments, branches and regions. Boards should revisit their strategies and risk frameworks for the pandemic and after, interact more often with risk committees, focus on consequences rather than causes, monitor risk-appetite metrics, install contingency arrangements, and update their treatment of new forms of credit, cyber, crime and other operational risks, satisfying themselves that risk information is reliable and prioritized. Honesty and strong moral principles among boards, management and stakeholders — values rooted in the Qur'an and the Hadith — are central to surviving the crisis and reviving Islamic banking with a reshaped risk management framework.

To manage macro risks, Islamic banks should invest in support of policymakers' efforts to inject liquidity; national goals cannot be met unless banks lend proactively. Each bank needs an internal, Shariah-compliant strategy for stimulus packages so that its clients and the bank benefit optimally, and unaffected, financially strong clients should not receive scarce stimulus funds.

Irrational profit targets would undermine risk management at this time. Islamic banks must instead guard their reputation by showing that they care for depositors, investors, the public and the environmental and natural factors behind the disruption — an opportunity to support clients and communities. To meet funding needs in recession, banks may create a profit equalization reserve (PER) and investment risk reserve (IRR). Honouring commitments, especially international payment obligations, avoiding unethical trade practices for short-term gain, managing reputational and country risk, and closely monitoring Information Technology (IT) and fintech platforms for cyber risk and financial crime are essential for sustainable operation after COVID-19.

Moral hazard — borrowers lacking incentives to repay and bankers lacking incentives to pursue recovery — can become a major source of credit risk in a crisis, especially for thinly capitalized banks. Strategic communication, and support combined with follow-up, can address it, protecting investment quality while retaining clients; continued digital marketing can also build trust and confidence, without which business recovery would be difficult.

14.5.3.2 Risk Management Approach of the IBs for Industry Consolidation

COVID-19 shows that environmental risk must be a core part of Islamic banking operations and of Shariah compliance risk. Recovery and new investment should integrate environmental concerns and the natural order into all banking activities rather than treating green banking as a separate line, since investment that disregards the environment and nature is not approved in Shariah. Guided by their boards and Shariah principles, Islamic banks should lead the country's green banking and green growth movement, supporting financial inclusion, small and micro-enterprise and agricultural financing — which offer high long-term economic, social and environmental returns — and innovative Islamic modes for projects aligned with the SDGs.

Technology and fintech are efficient banking and risk management tools for the new normal: digitization may be the immediate strategy, but digitalization should be the goal. Although technology brings its own financial crime risks, such as cyber fraud and money laundering through new payment systems, embracing it can also provide the best defense against them.

Portfolio reallocation is also needed: a balanced mix of debt-based and equity-based products, aligned on both sides of the balance sheet, is itself a fundamental risk management tool. Equity-based products (Mudarabah and Musharakah) address moral hazard, and hence credit risk, when executed diligently. They can finance business-process innovation, distinguish Islamic from conventional banks in transaction as well as Shariah risks, and act as built-in risk absorbers in a crisis. Adding Sukuk would further strengthen the risk management of Islamic banks in the country.

Effective risk management needs a supportive regulatory and governance framework, including more engaged and independent oversight by Shariah supervisory committees of Shariah-compliance risks, including environmental risk. Stakeholders commonly call for a separate Islamic banking act, but with debt-based products similar to those of conventional banks the case is weak. A distinctive product basket combining debt- and equity-based modes would make a much stronger case for separate legislation.

14.6 Conclusion

COVID-19 has spread worldwide and severely affected advanced, developing and least developed economies alike. Some see it as nature's reaction to the ecological imbalance created by mankind, while Muslims believe that everything is planned by Allah (SWT), who may test believers to reward them, warn mankind, forgive sins through lesser hardship, or punish wrongdoing in this life. The Holy Qur'an says:

> "And We will surely test you with something of fear and hunger, and a loss of wealth and lives, and fruits, but give good tidings to the patient" (Surah Al-Baqarah: 2/155).
>
> "And We will surely let them taste the nearer punishment short of the greater punishment that perhaps they will repent." (Surah As-Sajdah: 32/21).
>
> "Corruption has appeared throughout the land and sea by [reason of] what the hands of people have earned so He may let them taste part of [the consequence of] what they have done that perhaps they will return [to righteousness]" (Surah Ar-Rum: 30/41).

> "Then why, when Our punishment came to them, did they not humble themselves? But their hearts become hardened, and Satan made attractive to them that which they were doing" (Surah Al-An'am: 6/43).
>
> "…And We sent to no city a prophet except that We seized its people with poverty and hardship that they might humble themselves (to Allah)…And if only the people of the cities had believed and feared Allah, We would have opened upon them blessings from the heaven and the earth" (Surah Al-A'raf: 7/94&96).
>
> "…And never give up hope of Allah's mercy. Certainly no one despairs of Allah's mercy, except the people who disbelieve" (Sura Yousuf: 12/87).

In the light of these verses, Muslims may regard COVID-19 as a test in which true believers will be rewarded for their response: trusting in Allah, we must strive to overcome the economic crisis without panic or despair, hoping for His mercy and maintaining ethical standards in every sphere of life, including banking.

The pre-COVID normal will not return, and banks must prepare for a new normal accelerated by the shift to digital banking, offering real-time guidance to ease customers' concerns about digital transactions so that they no longer need to visit branches. The post-COVID economy is expected to be vibrant and competitive, favoring those who decide prudently and promptly: redesigning products and processes, expanding and securing ICT infrastructure, retaining and equipping staff, maintaining close customer relationships, exercising patience, and researching new products in response to the pandemic will all be crucial.

As Islamic banking rests on divine guidance, Muslims must demonstrate its superiority and resilience: any failure in combating COVID-19 would be a failure of the people behind the system, not of the system itself. Banks that are truly Shariah-compliant in their operations should lead after the pandemic, In Sha Allah, and a change in people's beliefs and practices may create a great opportunity for Islamic banking in Bangladesh and worldwide. Islamic banks cannot be silent spectators at this critical time for the nation; it is the time to stand by those affected by COVID-19.

Appendices

Appendix I

Islamic Banking Activities in Bangladesh, January -March 2020

(BDT in Million)

	March 2020#	December 2019#	March 2019#	Changes		% Changes	
	Quarter	Quarter	Quarter	Quarterly	Annual	Quarterly	Annual
Total Deposits* (Outstanding)	2846113.83	2802278.03	2421188.01	43835.81	424925.83	1.56	17.55
a) Full-fledged Islamic Banks	2673407.48	2637564.36	2273818.49	35843.11	399588.99	1.36	17.57
b) Conventional banks having Islamic banking branches	88488.19	87375.92	82209.38	1112.27	6278.81	1.27	7.64
c) Islamic banking windows	84218.16	77337.74	65160.14	6880.42	19058.03	8.90	18.69

	March 2020#	December 2019#	March 2019#	Changes		% Changes	
	Quarter	Quarter	Quarter	Quarterly	Annual	Quarterly	Annual
Total Investments* (Outstanding)	2673089.42	2627519.94	2372792.00	45569.48	300297.42	1.73	10.74
a) Full-fledged Islamic Banks	2544223.51	2498847.08	2247931.66	45376.43	296291.85	1.82	11.16
b) Conventional banks having Islamic banking branches	73642.96	74938.57	70914.28	-1295.61	2728.68	-1.73	5.67
c) Islamic banking windows	55222.95	53734.29	53946.06	1488.66	1276.89	2.77	0.00
Investment/Deposit Ratio	0.94	0.94	0.98	0.00	-0.04	0.17	-4.16
a) Full-fledged Islamic Banks	0.95	0.95	0.99	0.00	-0.04	0.18	-3.74
b) Conventional banks having Islamic banking branches	0.83	0.86	0.86	-0.03	-0.03	-3.23	-3.52
c) Islamic banking windows	0.66	0.69	0.83	-0.03	-0.17	-5.04	-20.86
Total Remittances	100593.19	146324.97	83377.46	-45731.77	17215.74	-31.25	20.65
a) Full-fledged Islamic Banks	100083.91	145649.97	82907.30	-45566.07	17176.61	-31.28	20.72
b) Conventional banks having Islamic banking branches	321.00	476.12	377.06	-155.12	-56.06	-32.58	-14.87
c) Islamic banking windows	188.28	198.87	93.10	-10.59	95.18	-5.32	102.24
Total Branches	1428	1380	1252	48	176	3.48	14.06
a) Full-fledged Islamic Banks	1274	1273	1198				
b) Conventional banks having Islamic banking branches	19	19	19				
c) Islamic banking windows	135	88	35				
Total Manpower	36372	35906	34128	466	2244	1.30	6.58
a) Full-fledged Islamic Banks	35530	35145	33540	385	1990	1.10	5.93
b) Conventional banks having Islamic banking branches	361	351	387	10	-26	2.85	-6.72
c) Islamic banking windows	481	410	201	71	280	17.32	139.30

Source: Bangladesh Bank.

*Note: * Excluding Inter-Bank Items # Provisional.*

Appendix II

Status of Islamic Banking Industry in COVID-19 Pandemic

(Based on provisional data & perception)

Particulars	Status as on 31 March 2020 as % that of 2019	Status as on 25 June 2020 as % that of 2019	Status as on 25 June 2020 as % of Target of 2020	Comment
Total Amount of Deposits	114%	107%	91%	Some new deposits have been collected but not as per target.
Total Profit Paid to Depositors	112%	85%	73%	Because of *Mudarabah* principle, lesser amount of profit has been considering income.
Total No. of Deposit A/c	112%	110%	95%	Some new a/c have been opened but not as per target.
Total Amount of Investments	111%	103%	96%	Due to stimulus package, some new investment have been disbursed.
Total Amount of Investment Income	108%	85%	68%	Due to Bangladesh Bank guidelines, business depression, *Murabahah* principle, income has been decreased.
Total No. of Investment A/c	103%	95%	95%	Existing customer availed some additional facilities but not new.
Total Amount of Remittance	117%	82%	74%	A large no. of wage-earners have returned back in Bangladesh some other lost jobs.
Total Operating Income including commission, charges etc.	97%	71%	64%	Both funded and non-funded income have been decreased.
Total Operating Expenses	110%	93%	85%	As most of the expenses are fixed in nature and additional allowances for COVID-19.
Total Amount of Operating Profit	97%	60%	52%	More decrease in income as compare to expenses.

(Based on provisional data & perception)

Particulars	Status as on 31 December 2019	Status as on 31 March 2020	Status as on 25 June 2020	Comment
Investment-Deposit Ratio	88.44%	89.35%	90.06%	Because of Bangladesh Bank relaxation.
Classified Investments	Unchanged			Because of Bangladesh Bank instructions.
Total COVID-19 Allowance Paid to Employees and Expenses Incurred for Safety Measures as % of operating expenses	N/A	N/A	6%	Due of Bangladesh Bank instructions for COVID-19 allowances and other safety measures
No. of new branches Opened as % of approved No. of Branches	N/A	N/A	0%	Generally, new branches opening start from the 2nd quarter

Source: Survey Data.

PART V: SHARIAH GOVERNANCE AND INSTITUTIONAL MODELS

Chapter 15: Shariah Governance in Islamic Banks: An Evaluation

Based on BIBM Research Monograph 77, "Shariah Governance in Islamic Banks of Bangladesh: An Evaluation", by Md. Mahabbat Hossain, Mezbah Uddin Ahmed, Md. Alamgir and Muhammad Habibur Rahman, prepared jointly by BIBM and INCEIF University.

15.1 Background of the Study

Governance is a critical determinant of institutional integrity, especially for banks, which manage others' funds: effective governance enhances transparency, stakeholder confidence and prudent risk management, while weak governance invites mismanagement, fraud, failure and systemic instability. It matters even more for Islamic banks, which operate under a dual structure in which an Islamic law (Shariah) governance (SG) framework forms an additional, distinct layer alongside regulatory compliance — a layer whose value depends on the sound structuring and functioning of its components, not merely on its existence.

Islamic banking in Bangladesh began in 1983 with Islami Bank Bangladesh Limited (now Islami Bank Bangladesh PLC); by end-2024, 10 full-fledged Islamic banks and around 30 conventional banks with Islamic branches or windows accounted for about one-fourth of the banking sector, making Islamic banking a key part of the financial system and of financial inclusion. The industry has often outperformed conventional banking, but its governance, particularly SG, has not kept pace with its growth, exposing it to considerable risk, with political influence a significant contributor to governance failures.

Recent governance failures in several Islamic banks — violations of banking norms by boards and senior management, weak Shariah Supervisory Committee (SSC) oversight, inadequate supervision and political interference — have disrupted operations, exposed structural weaknesses and intensified instability. Standard & Poor's (S&P) Global Ratings assigned Bangladesh one of the highest risk levels in its Banking Industry Country Risk Assessment, a score of 9 out of 10, where 10 is weakest, as reported by The Daily Star on 15 August 2024 (S&P Global Ratings, 2024), and most full-fledged Islamic banks, with few exceptions, now face acute liquidity pressure, rising non-performing assets and eroding depositor confidence.

The distress reflects recurring patterns: governance breakdowns at Farmers Bank, National Bank and BASIC Bank show that weak governance, mismanagement and regulatory shortcomings are persistent institutional deficiencies rather than isolated incidents, even though external shocks can also hinder objectives regardless of internal controls (COSO, 2013). In Islamic banks, where governance also covers ethical and religious compliance, failures undermine both financial performance and the credibility of Islamic banking. This study therefore assesses existing governance structures, identifies key gaps and offers policy recommendations for strengthening SG in Islamic banks in Bangladesh.

15.2 Objectives of the Study

The primary objective of this study is to identify and critically assess governance-related issues in Islamic banks in Bangladesh. The specific objectives of the study are:

a. to evaluate the existing SG framework of Islamic banks in Bangladesh in light of international standards and local regulatory guidelines, with the aim of identifying key governance components and clarifying their respective roles;
b. to examine the institutional arrangements and operational mechanisms of SG, including Shariah compliance functions, internal Shariah audits, and the integration of Shariah non-compliance risk (SNCR) into the overall risk management framework; and
c. to develop actionable policy recommendations and reform measures aimed at strengthening SG practices within the Islamic banking sector in Bangladesh.

15.3 Methodology of the Study

This study adopts a mixed-method research approach, combining qualitative inquiry with descriptive analysis of structured questionnaire responses, to evaluate the SG framework of Islamic banks in Bangladesh, drawing on both primary and secondary sources.

Primary data are collected through Key Informant Interviews (KIIs) and Focus Group Discussions (FGDs) conducted with key stakeholders, including officials of the central bank, members of boards of directors, Shariah scholars serving on SSCs, senior management, internal auditors, and experts in bank governance.

An FGD organized at BIBM was attended by representatives from 25 banks, primarily Heads of Shariah Secretariat or Heads of Islamic Banking. In addition, two further FGDs were conducted at the Islamic Banking Regulation and Policy Department (IBRPD) of Bangladesh Bank and at the Shariah Secretariat of Islami Bank Bangladesh PLC. These engagements generated in-depth insights into governance practices, structural weaknesses, regulatory challenges, and potential reform directions within the sector.

Furthermore, opinions were collected through a structured questionnaire. A total of 20 banks responded, representing more than 50% of Islamic banking institutions in Bangladesh, thereby ensuring adequate sectoral coverage and strengthening the reliability of the findings.

Secondary data are obtained through content analysis of relevant international standards, including those issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB), as well as regulatory guidelines, published reports, academic literature, and official websites of concerned institutions. This facilitates a structured benchmarking of local practices against global standards and established frameworks. The collected data are analyzed thematically to identify key patterns, gaps, and areas of concern in existing SG practices.

The findings of this study are expected to provide practical, policy-relevant insights for regulators, policymakers, banking executives, and SSCs, thereby strengthening governance frameworks and enhancing the long-term sustainability of Islamic banking in Bangladesh.

15.4 Literature Review

15.4.1 Global Trends and Domestic Dynamics of Islamic Banking in Bangladesh

The growth of the global Islamic finance industry, Bangladesh's position in the Islamic Finance Country Index, and the market share and key performance indicators of Islamic banks in Bangladesh during 2018–2024 are presented in Chapter 3 (Table 3.2, Table 3.4, Table 3.14 and Table 3.15). This section highlights the supporting ecosystem of the industry, Bangladesh's standing in the Islamic Finance Development Indicator, and recent governance developments.

Table 15.1 shows the institutional infrastructure supporting the global Islamic finance industry in 2024. Islamic finance operates in 57 countries, but only 23 have central Shariah committees; Environmental, Social, and Governance (ESG) Islamic investment certificates (Sukuk) reached USD 61.5 billion; and awareness events, education providers, research output and academic journals continue to grow, supporting human capital development and innovation.

Table 15.1: Islamic Finance Industry Supporting Ecosystem in 2024

A	Governance	
1	Countries	57
2	Countries with Central Shariah Committee	23
3	Scholars in Shariah Boards	1,617
B	**Sustainability**	
4	Total Value of ESG *Sukuk* Outstanding (USD Billion)	61.5
5	Total CSR Funds Disbursed (USD Billion)	1.7
C	**Awareness**	
6	Number of Islamic Finance In-person Events	1,031
7	Islamic Finance Virtual Events	379
8	Number of Islamic Finance News	9,480
D	**Knowledge**	
9	Islamic Finance Education Providers	1,186
10	Islamic Finance Research Papers Produced	5,291
11	Islamic Finance Journals	379

Source: Based on IBFC (2025) and ICD–LSEG Islamic Finance Development Report 2025.

Bangladesh ranks 11th in the Islamic Finance Development Indicator (IFDI) 2025 with a score of 38 (Table 15.2). Its governance score is strong (80), but weak sustainability, knowledge and awareness scores hold back its overall position, pointing to the need to strengthen the wider Islamic finance ecosystem.

Table 15.2: Top IFDI Countries and Global Average Score (2025)

Rank	Country	IFDI Score	Financial Performance	Governance	Sustainability	Knowledge	Awareness
1	Malaysia	135	144	98	155	101	200
2	Saudi Arabia	114	136	73	111	48	200
3	United Arab Emirates	92	88	85	56	50	200
4	Indonesia	75	59	76	32	200	49
5	Pakistan	72	40	78	24	88	200
6	Kuwait	67	47	79	29	17	195
7	Bahrain	66	47	84	30	22	173
8	Iran	64	119	55	–	21	6
9	Qatar	40	31	64	27	8	69
10	Türkiye	39	33	65	26	41	15
11	**Bangladesh**	**38**	**31**	**80**	**17**	**13**	**19**
12	Oman	34	17	75	23	15	37
13	Brunei Darussalam	31	9	72	14	22	44
14	Iraq	30	31	59	1	4	20
15	Jordan	29	16	51	41	28	14
	Global Average	**11**	**8**	**20**	**8**	**6**	**11**

Source: Based on IBFC (2025) and ICD–LSEG Islamic Finance Development Report 2025.

Table 15.3 lists the boards of seven Islamic banks dissolved or restructured in August–September 2024. Several of these banks were linked to the S Alam Group, others faced separate governance and ownership concerns, and all were in severe financial distress with high non-performing loan ratios. Given their market share, the crisis had systemic implications; board restructuring and merger initiatives followed to restore stability and oversight.

Table 15.3: Board Dissolution and Restructuring of Islamic Banks in Bangladesh (2024)

S/n	Bank Name	Date of Board Dissolution	Key Reason
1.	Islami Bank Bangladesh PLC	22 August 2024	S Alam Group control, governance concerns
2.	Social Islami Bank PLC	25 August 2024	High NPL, planned for merger*
3.	Union Bank PLC	27 August 2024	High NPL, planned for merger*
4.	Global Islami Bank PLC	27 August 2024	High NPL, planned for merger*
5.	Export Import Bank of Bangladesh PLC	29 August 2024	High NPL, planned for merger*
6.	First Security Islami Bank PLC	1 September 2024	High NPL, planned for merger*
7.	Al-Arafah Islami Bank PLC	3 September 2024	S Alam Group connection

Source: Based on IBFC (2025).

*Note: *The merger of five banks is currently in progress.*

The 2024 annual reports of full-fledged Islamic banks show inconsistent Shariah governance disclosure (Table 15.4): six banks reported SSC meetings (6.3 a year on average, ranging from 5 to 11), four did not, and only two reported Shariah awareness programs — underlining the need for a standardized reporting framework.

Table 15.4: Meetings of SSC in Full-fledged Islamic Banks in 2024

S/n	Name of the Bank (Alphabetical order)	No. of Meetings of SSC	No. of Shariah Awareness Programs
1	Al-Arafah Islami Bank PLC	5	Not disclosed
2	Export Import Bank of Bangladesh PLC	5	Not disclosed
3	First Security Islami Bank PLC	Not disclosed	Not disclosed
4	Global Islami Bank PLC	Not disclosed	Not disclosed
5	ICB Islamic Bank Limited	Not disclosed	Not disclosed
6	Islami Bank Bangladesh PLC	11	5
7	Shahjalal Islami Bank PLC	6	Not disclosed
8	Social Islami Bank PLC	6	Not disclosed
9	Standard Bank PLC	5	1
10	Union Bank PLC	Not disclosed	Not disclosed

Source: Based on IBFC (2025).

In 2024, SSC fees and expenses of most full-fledged Islamic banks in Bangladesh declined markedly compared to 2023 (Table 15.5), although the reasons for this decline cannot be determined from the available data.

Table 15.5: SSC Fee and Expense of Full-fledged Islamic Banks in 2024

S/n	Name of the Bank (Alphabetical order)	2024 (BDT)	2023 (BDT)	Growth (%)
1	Al-Arafah Islami Bank PLC	526,355	491,793	7
2	Export Import Bank of Bangladesh PLC	503,100	624,600	(19)
3	First Security Islami Bank PLC	60,000	307,000	(80)
4	Global Islami Bank PLC	294,476	338,653	(13)
5	ICB Islamic Bank Limited	88,000	152,000	(42)
6	Islami Bank Bangladesh PLC	1,399,774	1,556,000	(10)
7	Shahjalal Islami Bank PLC	808,100	1,073,245	(25)
8	Social Islami Bank PLC	320,132	867,376	(63)
9	Standard Bank PLC	378,229	562,824	(33)
10	Union Bank PLC	358,400	334,800	7

Source: Based on IBFC (2025).

Table 15.6 shows that, despite wide networks of branches, sub-branches and agent outlets, Shariah audit coverage in 2024 was limited or undisclosed in many banks. Audit coverage and reporting need to be extended consistently across all channels.

Table 15.6: Shariah Audit Activities of Full-fledged Islamic Banks in 2024

S/n	Name of the Bank (Alphabetical order)	No. of working units as on 31 December 2024			No. of working units covered under Shariah audit in 2024		
		Branch	Sub Branch	Agent Outlets	Branch	Sub Branch	Agent Outlets
1	Al-Arafah Islami Bank PLC	226	18	100	226	Not disclosed	
2	Export Import Bank of Bangladesh PLC	155	73	9	Not disclosed		
3	First Security Islami Bank PLC	206	177	108	Not disclosed		

S/n	Name of the Bank (Alphabetical order)	No. of working units as on 31 December 2024			No. of working units covered under Shariah audit in 2024		
		Branch	Sub Branch	Agent Outlets	Branch	Sub Branch	Agent Outlets
4	Global Islami Bank PLC	105	154	20	Not disclosed		
5	ICB Islamic Bank Limited	33	0	0	Not disclosed		
6	Islami Bank Bangladesh PLC	400	265	2783	394	33	147
7	Shahjalal Islami Bank PLC	141	5	120	140	Not disclosed	
8	Social Islami Bank PLC	181	240	370	Not disclosed		
9	Standard Bank PLC	138	0	11	Not disclosed		
10	Union Bank PLC	114	60	0	Not disclosed		

Source: Based on IBFC (2025).

15.4.2 Literature on Shariah Governance

The IFSB defines a Shariah governance (SG) system as the arrangements that ensure effective and independent oversight of Shariah compliance, including the issuance and dissemination of Shariah pronouncements, internal compliance review and periodic verification by the Shariah board (IFSB, 2009). Regulators have institutionalized these principles — Bank Negara Malaysia's Shariah Governance Framework (2011, revised 2019), for example, defines the roles of the board, the Shariah committee, senior management and control functions — with the Shariah board central to compliance, transparency and accountability (Alam et al., 2021).

The effectiveness of SG depends on the credibility, independence and competence of Shariah board members (Aziz & Ghadas, 2022). Grais and Pellegrini (2006) note that SG arrangements are largely internal to Islamic Financial Institutions (IFIs), relying on Shariah Supervisory Boards (SSBs) and internal review; this proximity aids responsiveness but raises concerns about independence, conflicts of interest and disclosure. The core components of SG — the board, internal and external audit, and Shariah review — together form an integrated governance system that supports efficiency, transparency and long-term sustainability (Shah, 2019).

Strong SG improves the performance of Islamic banks: adherence to SG principles aligned with the higher objectives of Islamic law (Maqasid al-Shariah) enhances service quality, financial performance and reputation (Kiranawati et al., 2023); Islamic corporate governance and Shariah compliance are linked to financial performance (Hasan et al., 2022; Tarihoran et al., 2021); SSBs encourage Corporate Social Responsibility (CSR) disclosure (Kachkar & Yilmaz, 2023); and a robust framework mitigates legal and Shariah risks (Karimah, 2022).

Approaches vary across jurisdictions: Gulf Cooperation Council (GCC) countries follow a minimalist model and many Asian jurisdictions a more interventionist one (Ulfi, 2022), while other studies stress centralized Shariah advisory mechanisms, harmonized standards and stronger coordination (Hailu & Tekdoğan, 2023).

In Bangladesh, the SG framework remains underdeveloped, fragmented and largely voluntary. SSBs often act only in an advisory capacity with limited enforcement authority, while ultimate responsibility for compliance rests with the board of directors. In the period covered by this

literature — that is, before the establishment of Bangladesh Bank's Shariah Advisory Board in 2025 (Section 15.4.3.2) — there was no centralized Shariah authority or binding standards, so banks relied on self-developed frameworks under limited oversight, producing heterogeneous practices, weak monitoring, potential conflicts of interest and inconsistent interpretation (Alam et al., 2019).

Existing scholarship is largely normative and drawn from mature environments such as Malaysia and the GCC, which limits its applicability to Bangladesh. It emphasizes formal structures rather than how they work in practice under regulatory constraints, political-economy pressures and institutional weakness — a gap made evident by recent governance failures, liquidity stress and loss of depositor confidence in several Islamic banks. This study addresses that gap with a contextually grounded, evidence-based assessment of SG in Bangladesh, identifying structural deficiencies, implementation gaps and reform priorities.

15.4.3 Governance Structures in Islamic Banks of Bangladesh

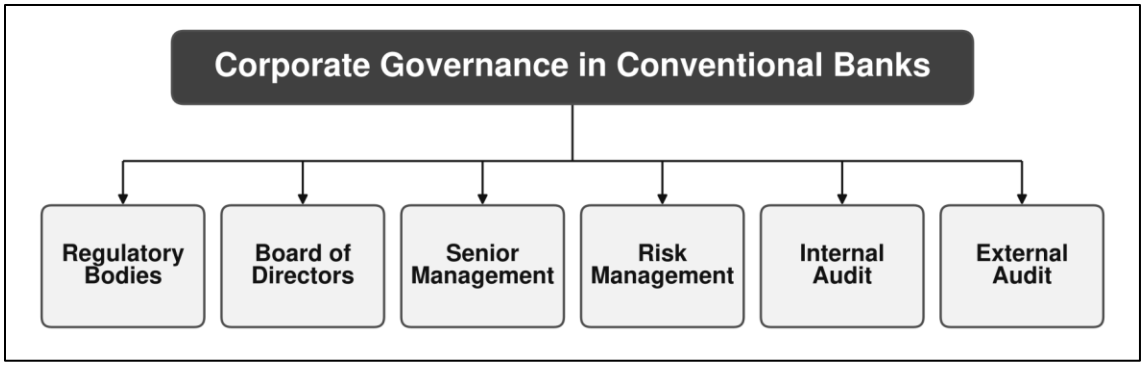
Corporate governance (CG) protects the interests of all those connected with a company while prioritizing the long-term well-being of the public. It is consistent with Islamic teachings on ethics, honesty and integrity: in IFIs, Islamic moral and ethical values should guide every decision and become part of the organization's culture (IFSB, 2023). The governance framework of Islamic banks in Bangladesh therefore combines conventional CG with the SG mechanisms that distinguish them from conventional banks.

15.4.3.1 Traditional Corporate Governance in Banks

CG is the framework for directing and controlling an entity so as to meet the expectations of shareholders, creditors, employees, customers and other stakeholders. Definitions converge: the World Bank (1999) and the Organisation for Economic Co-operation and Development (OECD, 2015) describe it as the structures and relationships among management, the board, shareholders and other stakeholders through which objectives are set, pursued and monitored; the International Chamber of Commerce (ICC, 2005) stresses the board's accountability and the corporation's conformity with law and regulation; the Basel Committee on Banking Supervision (BCBS, 2015) focuses on how boards and senior management govern a bank's business; and the IFSB (2023) adopts the OECD formulation while incorporating SG within CG.

Because most of their funds come from depositors and the public, banks function in many respects as public institutions, and a bank failure falls heavily on depositors who bear no responsibility for its governance. Figure 15.1 presents a CG framework for conventional banks.

Figure 15.1: Corporate Governance Framework in Conventional Banks



Source: Based on Hossain and Ahmed (2025).

Banks operate under the supervision of the central bank. Bangladesh Bank, established under the Bangladesh Bank Order, 1972 (P.O. No. 127 of 1972) with effect from 16 December 1971, regulates all scheduled banks and finance companies and sets the legal and regulatory framework within which they operate, ensuring compliance, preventing fraud and maintaining financial stability.

The Board of Directors (BoD), the highest governing body and the representative of shareholders, has overall responsibility for the bank, including approving and overseeing management's implementation of strategy, the governance framework and corporate culture (BCBS, 2015). Bangladesh Bank prescribes its roles and responsibilities.

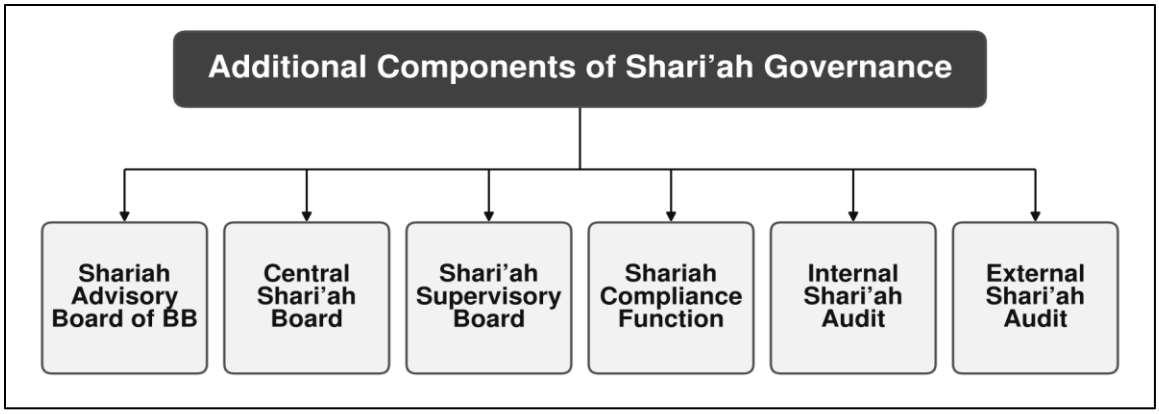
Senior management — the Chief Executive Officer (CEO), Chief Financial Officer (CFO) and other top executives — implements the board's directives and manages day-to-day operations consistently with the strategy, risk appetite, remuneration and other policies approved by the board (BCBS, 2015).

Internal audit, which must be independent of management, and risk management, which operates under senior management to keep risks within tolerable limits, together ensure compliance with governance policies, regulation and financial controls. External audit verifies the financial statements, assesses internal controls and identifies risks of fraud or mismanagement, strengthening credibility and stakeholder confidence.

15.4.3.2 Additional Components of Governance of IFIs

IFIs apply the general CG framework but add components to ensure Shariah compliance and the proper discharge of their fiduciary responsibilities, reflecting an accountability that extends beyond stakeholders to Allah (SWT). Figure 15.2 illustrates these additional components.

Figure 15.2: Additional Components of Shariah Governance



Source: Based on Hossain and Ahmed (2025).

The Shariah Advisory Board (SAB) of Bangladesh Bank, established in 2025, is the central authority for Shariah compliance in Islamic banking: it advises on Islamic jurisprudence, reviews products and regulatory policies for Shariah compliance, and promotes harmonization across banks, in line with practice in countries such as Malaysia and Bahrain.

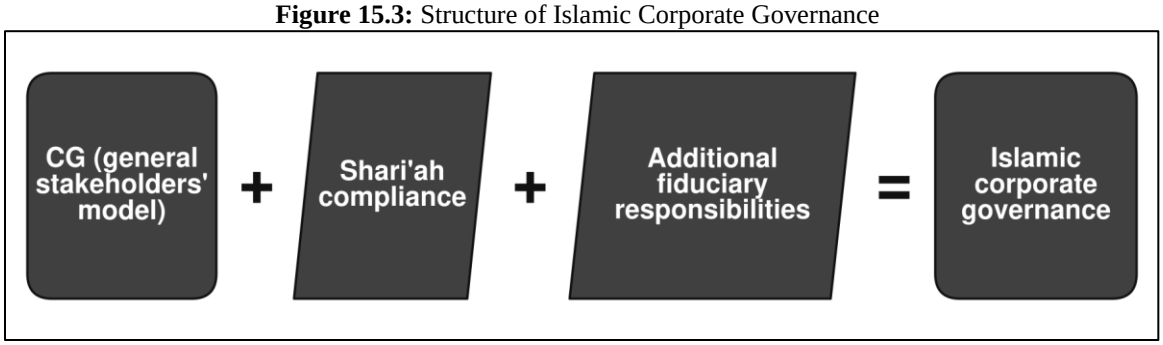
The Central Shariah Board for Islamic Banks of Bangladesh (CSBIB), a forum of the chairmen and secretaries of member banks' SSCs, issues guidance, rulings and fatwas to promote uniform practice, focusing on advisory work, regulation and limited supervision across institutions.

Within each bank, the SSC advises management on Shariah matters, reviews products, issues fatwas and contributes to product development, risk assessment and decision-making; its activities are classified as ex ante and ex post (IFSB 10).

The internal Shariah audit, which should be independent of management, assesses processes and transactions, identifies gaps and recommends corrective action, while the Shariah compliance unit — part of management — gives departments real-time guidance to prevent violations. An external Shariah audit would independently verify compliance for shareholders, investors and regulators, but no such system yet exists in Bangladesh.

Together, these components form a comprehensive framework for Shariah compliance that builds stakeholder trust and supports the sustainable growth of Islamic banking. Figure 15.3 presents the structure of Islamic CG.

Figure 15.3: Structure of Islamic Corporate Governance

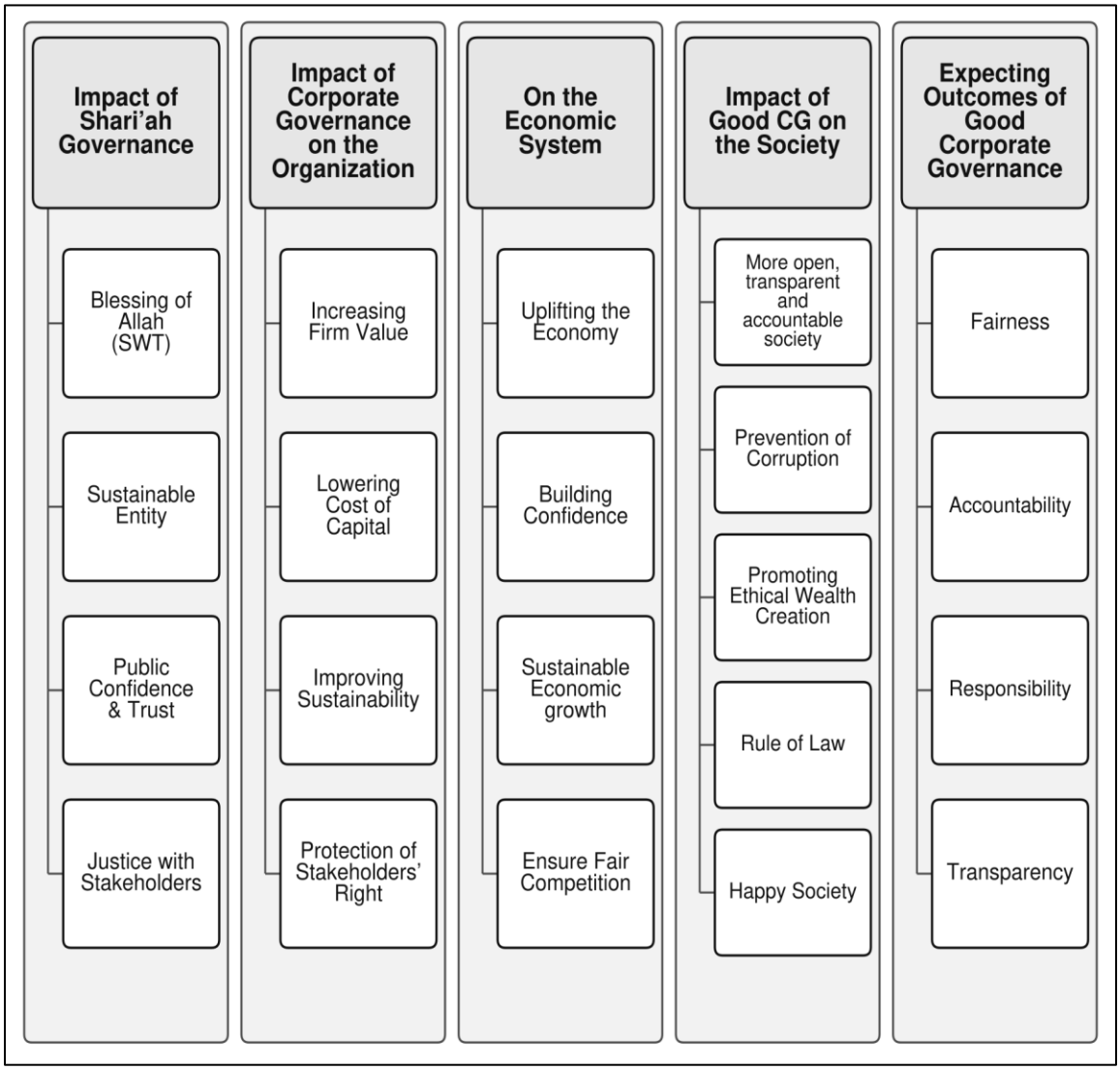


Source: Authors' creation.

15.4.3.3 Impact of Good Corporate Governance in IFIs

A central objective of CG is to resolve principal–agent conflicts so as to protect all stakeholders and the soundness of the financial system (Chapra & Ahmed, 2002). Good corporate and Shariah governance benefits institutions, the economy and society. SG embeds divine accountability and fairness in dealings with stakeholders. Within the organization, good governance raises firm value, lowers the cost of capital and protects stakeholders; in the economy, it builds confidence, sustainable growth and fair competition; and in society, it promotes transparency, the rule of law, ethical wealth creation and social justice (Figure 15.4).

Figure 15.4: Impact of Good Corporate and Shariah Governance of IFIs



Source: Hossain and Ahmed (2025).

15.4.3.4 Regulatory Framework for Governance Structure of Islamic Banks

Local Regulatory Framework

The governance of Islamic banks in Bangladesh rests on the Bank Company Act 1991 and the Companies Act 1994, supplemented by Bangladesh Bank's Guidelines for Conducting Islamic Banking (2009), the corporate governance codes of Bangladesh Bank and the Bangladesh Securities and Exchange Commission (BSEC), and the Prudential Regulations for Banks.

Besides the above, Bangladesh Bank has issued BRPD Circular No. 02 (11 February 2024) and BRPD Circular Letter No. 56 (30 December 2024) outlining specific guidelines regarding the formation of the BoD and clarifying their roles and responsibilities in ensuring effective governance in banks.

The Islamic Banking Regulation and Policy Department of Bangladesh Bank issued Circular No. 01 on 28 September 2025 on the governance of SSCs in banks conducting Islamic banking. It places responsibility for the Shariah compliance of all deposit, investment and other activities on the BoD, whose members must have adequate knowledge of Shariah and Islamic banking, and requires full-fledged Islamic banks and conventional banks with Islamic branches and windows to constitute an SSC of knowledgeable, skilled and impartial experts in Islamic jurisprudence. Recognizing that detailed guidance is still needed — on SSC composition, appointment and removal, tenure, remuneration, duties, the chairman and secretary, the Shariah secretariat, decision-making, compliance and annual reports, performance evaluation and confidentiality — it expects banks to follow best practice in the meantime.

International Standards and Best Practices

Islamic banks in Bangladesh are also guided by international standards. AAOIFI's Governance Standards (GS) together provide a comprehensive framework covering the SG framework. Internal and external Shariah review and audit. The independence, appointment, composition and functioning of SSBs. Shariah compliance functions; audit and governance committees. Fiduciary responsibilities and ratings; disclosure; CSR and ethics, and centralized Shariah oversight through a central Shariah board.

The IFSB complements these with a broader prudential framework. IFSB-10 stresses sound governance structures, clear responsibilities and internal controls, with boards embedding Shariah compliance, ethics and risk management in decision-making. IFSB-30 updates it with a focus on board accountability, risk governance, transparency and fiduciary duties to investment account holders, within an independent SG framework integrated into overall governance.

Banks also draw on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control–Integrated Framework (2013), the G20/OECD Principles of Corporate Governance (2023), BCBS standards, and guidance from the Institute of Internal Auditors and the International Federation of Accountants.

Implementation Challenges

Despite these frameworks, implementation remains weak: many SSCs cannot function effectively because governance mechanisms are incompletely implemented, Shariah audit systems are inadequate and oversight of SSC activities is limited. Bangladesh also lacks an

independent external Shariah audit framework and dedicated Islamic banking legislation, leaving regulatory ambiguities that allow governance deficiencies to persist.

15.5 Findings and Discussion

15.5.1 Survey Findings

The questionnaire survey assessed the effectiveness of Shariah governance (SG) in Islamic banks across several dimensions: the role and performance of SSCs, governance structures, regulatory oversight, Shariah disclosure, and the interaction between governance and institutional stability. It reveals significant gaps between regulatory expectations and operational reality — structural weaknesses, capacity constraints and enforcement challenges — suggesting that SG in Bangladesh is at an inflection point and must move from a certification-based to a governance-driven model, in which SSCs act not merely as contract validators but as participants in risk governance, accountability and value creation. The survey results are summarized in Tables 15.7–15.12.

15.5.1.1 Role, Effectiveness, and Structural Limitations of SSC

The survey (Table 15.7) shows SSCs to be formally important but of limited practical effectiveness. Most respondents agree that SSCs play an effective role in ensuring Shariah compliance (60%, SSC4) and operate independently of management (65%, SSC1), yet 60% disagree that they effectively scrutinize high-risk and related-party investments (SSC3) and 70% consider them ineffective in preventing questionable investments before approval (SSC5) — a reactive rather than proactive role. Only 25% believe SSC members have sufficient financial and banking expertise (SSC2), while 45% disagree. Half are neutral on whether SSCs evaluate economic substance (SSC6), and 35% agree, against 50% who disagree, that SSCs mainly serve a marketing function (SSC9), echoing concerns that SG risks becoming symbolic.

Respondents strongly emphasize accountability: 75% regard failure to detect major non-compliance as governance negligence (SSC12), and 85% support holding SSC members accountable for governance failures (SSC13). Overall, SSCs operate within a compliance-oriented, certification-driven paradigm with limited influence over core risk-taking decisions.

Table 15.7: SSC Role and Oversight (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
SSC1	The SSC operates independently from management influence.	5.00	25.00	5.00	50.00	15.00
SSC2	SSC members possess sufficient financial and banking expertise.	15.00	30.00	30.00	20.00	5.00
SSC3	SSC scrutinizes high-risk and related-party investments.	15.00	45.00	15.00	25.00	0.00
SSC4	The SSC plays an effective role in ensuring Shariah compliance.	0.00	25.00	15.00	50.00	10.00
SSC5	The SSC is effective in preventing questionable investments before approval.	15.00	55.00	20.00	5.00	5.00

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
SSC6	The SSC evaluates economic substance in addition to contractual form.	5.00	20.00	50.00	25.00	0.00
SSC7	The SSC considers risk concentration and portfolio quality.	5.00	30.00	20.00	40.00	5.00
SSC8	The SSC adds substantive value to Islamic banking operations beyond formal certification.	10.00	25.00	35.00	30.00	0.00
SSC9	The SSC primarily serves a marketing function rather than strengthening governance.	10.00	40.00	15.00	35.00	0.00
SSC10	Positive Shariah certification does not necessarily reflect high-quality investments.	15.00	20.00	30.00	25.00	10.00
SSC11	Good Shariah performance does not automatically imply sound asset quality.	15.00	15.00	20.00	35.00	15.00
SSC12	Failure of SSC to detect major non-compliance constitutes governance negligence.	0.00	15.00	10.00	45.00	30.00
SSC13	SSC members should be accountable for the governance failures in Islamic banks.	5.00	10.00	0.00	55.00	30.00

Source: Questionnaire Survey.

15.5.1.2 Shariah Governance Structure and Institutional Framework

Formal governance structures exist but lack clarity, transparency and standardization (Table 15.8): only 40% of respondents agree that banks have clearly defined internal SG frameworks (SGSF1), while 35% disagree; 60% report that such frameworks are not publicly available (SGSF2); and 40% are neutral on alignment with AAOIFI and IFSB standards (SGSF3), suggesting partial or poorly understood adoption. Although 55% support scholar-only SSCs (SGSF6), 95% favor combining Shariah scholars with industry experts (SGSF7), and 95% support stronger fit and proper criteria for SSC members (SGSF8).

Table 15.8: Shariah Governance Structure and Framework (SGSF) (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
SGSF1	Islamic banks in Bangladesh have clearly defined internal Shariah governance frameworks.	0.00	35.00	25.00	35.00	5.00
SGSF2	Shariah governance structures are publicly available.	15.00	45.00	15.00	25.00	0.00
SGSF3	Shariah governance frameworks align with international standards (e.g., AAOIFI, IFSB).	5.00	15.00	40.00	35.00	5.00

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
SGSF4	Internal policies clearly define SSC roles and responsibilities.	0.00	30.00	10.00	55.00	5.00
SGSF5	SSC members play their roles independently in practice.	5.00	35.00	20.00	40.00	0.00
SGSF6	The composition of SSCs consisting solely of Shariah scholars enhances the effectiveness of SSC deliberations.	5.00	15.00	25.00	45.00	10.00
SGSF7	A balanced composition of SSCs comprising both Shariah scholars and industry experts enhances the effectiveness of SSC deliberations.	0.00	0.00	5.00	60.00	35.00
SGSF8	The fit-and-proper criteria for SSC members should be strengthened.	5.00	0.00	0.00	65.00	30.00

Source: Questionnaire Survey.

15.5.1.3 Regulatory Framework and Supervisory Effectiveness

The regulatory framework is seen as incomplete and weakly enforced (Table 15.9): half the respondents consider it comprehensive (RFOE1), but 85% disagree or are neutral on the effectiveness of supervision (RFOE2) and 80% on whether enforcement deters governance failures (RFOE3). And while 90% agree that coordination between regulators and SSCs would improve governance (RFOE5), 70% say it does not exist in practice (RFOE6).

Table 15.9: Regulatory Framework and Oversight Effectiveness (RFOE) (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
RFOE1	The regulatory framework for Shariah governance is comprehensive.	0.00	25.00	25.00	45.00	5.00
RFOE2	Regulators effectively supervise compliance with Shariah governance standards.	5.00	40.00	40.00	10.00	5.00
RFOE3	Enforcement mechanisms are strong enough to deter governance failures.	0.00	40.00	40.00	20.00	0.00
RFOE4	Clear guidelines exist for addressing governance failures.	5.00	35.00	30.00	30.00	0.00
RFOE5	Coordination between regulators and SSCs enhances governance effectiveness.	0.00	0.00	10.00	65.00	25.00
RFOE6	Coordination between regulators and SSCs is currently present in practice.	20.00	50.00	5.00	25.00	0.00

Source: Questionnaire Survey.

15.5.1.4 Shariah Disclosure Quality and Reporting Practices

Disclosure is moderate but lacks depth (Table 15.10). While 40% of respondents agree that SSC reports provide meaningful disclosures and 55% that they explain the basis of Shariah decisions (SDQR1–2), and 55% believe disclosure quality reflects governance performance (SDQR4), 65% find the reports lacking in analytical depth (SDQR5) and only 40% agree that significant non-compliance events are disclosed (SDQR3). Encouragingly, 85% believe better disclosure would improve depositor trust (SDQR6), making disclosure reform a high-impact, low-cost intervention.

Table 15.10: Shariah Disclosure Quality and Reporting (SDQR) (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
SDQR1	Shariah compliance reports provide meaningful disclosure rather than customary statements.	5.00	30.00	25.00	40.00	0.00
SDQR2	SSC reports clearly explain the basis of Shariah decisions.	5.00	25.00	15.00	55.00	0.00
SDQR3	SSC reports disclose significant non-compliance events.	10.00	30.00	20.00	40.00	0.00
SDQR4	SSC disclosure quality reflects true governance performance.	5.00	30.00	10.00	50.00	5.00
SDQR5	Current SSC reports lack sufficient analytical depth.	0.00	15.00	20.00	55.00	10.00
SDQR6	Enhanced disclosures by the SSCs would improve depositor trust.	0.00	5.00	10.00	60.00	25.00

Source: Questionnaire Survey.

15.5.1.5 Governance Dynamics and Crisis Interaction

SG effectiveness is embedded in wider institutional governance (Table 15.11): board commitment (75%), senior management support (85%) and effective internal Shariah audit (90%) are seen as shaping SSC performance (GSI1–3), and all respondents agree that weak internal governance reduces SSC effectiveness (GSI4). Most also agree that governance deficiencies contributed to recent defaults (90%) and that liquidity crises expose governance weaknesses (65%) (GSI5–6): SG is a core determinant of financial stability, not merely a compliance function.

Table 15.11: Governance Dynamics and Crisis Interaction (GSI) (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
GSI1	Board-level commitment influences Shariah governance effectiveness.	0.00	10.00	15.00	50.00	25.00
GSI2	Senior management support influences SSC performance.	0.00	10.00	5.00	65.00	20.00

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
GSI3	Internal Shariah audit effectiveness influences governance outcomes.	0.00	5.00	5.00	75.00	15.00
GSI4	Weak internal governance structures reduce SSC effectiveness.	0.00	0.00	0.00	80.00	20.00
GSI5	Liquidity crises expose weaknesses in governance systems.	5.00	20.00	10.00	35.00	30.00
GSI6	Governance deficiencies contributed to recent defaults.	0.00	0.00	10.00	50.00	40.00

Source: Questionnaire Survey.

15.5.1.6 External Shariah Assurance and Market Confidence

There is strong support for external Shariah assurance (Table 15.12): 90% of respondents favor external Shariah audits and 80% Shariah ratings (ESAMC1, ESAMC3), and 95% and 90% respectively believe these would improve stakeholder trust (ESAMC2, ESAMC4) — a clear demand for independent assurance that reflects limited confidence in existing internal arrangements.

Table 15.12: External Shariah Assurance and Market Confidence (ESAMC) (Response %)

Code	Measurement Item	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
ESAMC1	External Shariah audit would enhance Shariah compliance and governance of Islamic banks.	0.00	0.00	10.00	65.00	25.00
ESAMC2	External Shariah audit would enhance stakeholder trust in Islamic banks.	0.00	0.00	5.00	60.00	35.00
ESAMC3	External Shariah rating would enhance Shariah compliance and governance of Islamic banks.	0.00	0.00	20.00	45.00	35.00
ESAMC4	External Shariah rating would enhance stakeholder trust in Islamic banks.	0.00	0.00	10.00	45.00	45.00

Source: Questionnaire Survey.

Taken together, the survey presents a coherent diagnosis: formal structures exist but lack substantive effectiveness, especially in risk oversight and influence over decisions; competency gaps limit SSCs' engagement with complex financial realities; weak enforcement undermines the regulatory framework; and disclosure is insufficiently transparent and analytical. These weaknesses reflect wider institutional deficiencies — compounded in Bangladesh by regulatory gaps and recent crises — and the risk of "form over substance", and point to reform through stronger accountability, fit and proper criteria, and external assurance.

15.5.2 Findings from FGDs and KIIs

15.5.2.1 Dual Governance Structure and Implementation Gaps

The FGDs and KIIs indicate that SG is evolving within a dual governance framework increasingly aligned with corporate governance. There is no inherent legal conflict between corporate and SG regulations; the challenge lies in coordinating and implementing them. Governance outcomes are strongly influenced by political economy factors — external pressures, politically exposed persons (PEPs), weak enforcement and limited institutional capacity — and a persistent gap separates formal provisions from practice, with mechanisms implemented procedurally rather than to secure substantive Shariah compliance.

15.5.2.2 Formal Compliance versus Substantive Shariah Implementation

SG is largely documentation-driven rather than substance-oriented. Fatwas, audit reports and compliance documents are generally produced, but operational implementation is inconsistent, and SSCs engage minimally, relying heavily on management-provided information rather than independent verification. Compliance is often judged by the existence of documentation rather than the authenticity of transactions — documentation is sometimes used to regularise transactions — and audits emphasize form over substance, so reported compliance may not reflect actual practice.

15.5.2.3 Weaknesses in Board Governance and Oversight

Board governance is a critical concern: dominant chairmen and weak collective decision-making limit board effectiveness, and independent directors often lack genuine independence, acting as affiliates of controlling interests. SSCs and internal Shariah audit likewise struggle to remain independent owing to self-censorship, managerial influence and structural limitations. Boundaries between the board, management and Shariah functions are blurred — boards involve themselves in operational matters such as credit approvals — and Shariah knowledge among directors and senior management is generally inadequate, producing discretionary, influence-driven rather than institutionalized governance.

15.5.2.4 Independence and Effectiveness of SSCs

Although SSCs are formally established, standardized appointment criteria integrating Shariah and banking expertise are lacking; SSCs have limited involvement in operational verification, rely heavily on management information, and see their decisions weakly implemented. They therefore often function as procedural or advisory bodies — issuing opinions and approving documents — rather than as active governance institutions monitoring substantive compliance.

15.5.2.5 Fragmented Governance Architecture

SG functions are fragmented, with unclear roles among SSCs, Shariah secretariats, internal Shariah audit, management and compliance, and overlapping responsibilities in dual banks. There is no clearly defined second line of defense against Shariah non-compliance risk (SNCR): internal Shariah audit exists as a third line, but dedicated Shariah risk management or compliance within management is rare. Shariah audit is sometimes placed under the Internal Control and Compliance Division (ICCD) or business units, compromising its independence;

Shariah secretariats lack authority and standing; and multi-layered assurance — external and SSC-led reviews — is largely absent.

15.5.2.6 Weaknesses in Internal Shariah Audit and Compliance

Internal Shariah audit is critical but structurally weak. It is mainly sample-based, leaving non-compliance undetected; auditors face management influence and pressure that encourage self-censorship; reporting and evaluation lack independence; and audits emphasize after-the-fact rectification over prevention and early detection. Some participants reported that findings may be softened or suppressed and that non-compliant income is occasionally regularised through documentation, raising serious concerns about the integrity of the audit.

15.5.2.7 Weak Integration of Shariah Compliance into Operations

Shariah compliance is poorly integrated into operations, treated as an ex post, documentation-based function rather than part of transaction execution. Deficiencies include inadequate verification of underlying assets in trade-based contracts, compromised documentation in corporate financing, implicit guarantees on profit-sharing partnership (Mudarabah) deposits, and weak or inconsistent checks at initiation, approval and disbursement — a fundamental disconnect between formal frameworks and daily operations.

15.5.2.8 Human Capital and Competency Gaps

Shariah knowledge is inadequate among directors, senior management, SSC members and operational staff, and qualified human capital — particularly trained Muraqibs and experienced Shariah professionals — is scarce, with few structured training programs or academic and professional pathways. Participants also observed that early Islamic banking combined weaker technical capacity with stronger ethical commitment, whereas today technical expertise has improved but ethical orientation has declined, leaving compliance driven by procedure rather than intrinsic Shariah values.

15.5.2.9 Technology and System Constraints

Heavy reliance on foreign core banking systems not designed for Islamic banking delays Shariah-compliant modifications, and the lack of a standardized system architecture across banks produces inconsistent processes and compliance practices, reducing efficiency and hindering compliance.

15.5.2.10 Political Economy and External Influence

Many governance challenges are rooted in political economy: the influence of PEPs, concentrated and family-controlled ownership, and external pressures on regulators and institutions constrain independent oversight, weaken enforcement and let influence and vested interests, rather than regulatory and SG principles, shape decisions.

15.5.2.11 Institutional Culture and Behavioral Constraints

The institutional culture is marked by weak professionalism, “yesmanship” and fear: employees are reluctant to challenge authority or raise irregularities, and internal auditors and Shariah staff often censor themselves for fear of repercussions, marginalization or lost career

opportunities. Effective whistleblowing mechanisms are lacking, and participants cited malpractices such as manipulated documentation, non-transparent procurement and informal financial arrangements — weaknesses embedded in routine operations as well as at the strategic level.

15.5.2.12 Policy–Implementation Disconnect

Although Bangladesh Bank and other regulators have issued numerous circulars, guidelines and frameworks, enforcement remains weak and procedural: inspections and audits focus on documentation rather than the substance of transactions, and fragmented oversight, poor coordination among supervisory departments and regulators, and capacity constraints further reduce effectiveness, so governance frameworks often become procedural exercises rather than systems of real compliance and accountability.

15.5.2.13 Lack of Standardization and Market Discipline

Product structures, contract implementation and operational practices vary widely across institutions, reflecting the absence of industry standards for Islamic products: contracts are applied inconsistently, verification of underlying assets is insufficient, and compliance rests on documentation rather than economic substance. In dual banks, manpower shortages, conventional core banking systems and tensions between business targets and Shariah requirements worsen these problems, and inconsistent application of regulations undermines market discipline — compromising compliance especially in corporate working capital and trade-based financing.

15.5.2.14 Weak Accountability and Stakeholder Representation

Accountability is weak and fragmented: responsibility for Shariah non-compliance is often not clearly assigned, allowing blame-shifting; enforcement measures are applied inconsistently; and there is no structured system of sanctions. Depositors, central to Islamic banking under Mudarabah, are barely represented in governance structures, raising concerns about fiduciary responsibility and stakeholder protection.

15.6 Recommendations

Shariah governance challenges in Bangladesh are systemic, requiring a coordinated approach that combines regulatory reform, institutional strengthening, cultural change and effective enforcement; otherwise governance weaknesses will continue to erode public trust and the sustainability of Islamic banking. The FGDs and KIIs favor principle-based regulation backed by strong, consistent enforcement over prescriptive rules. Stronger institutional capacity in regulators and banks. Structural reforms, including separation of the policy, compliance, risk management and audit functions, dedicated Shariah risk management units and greater independence for SSCs and Shariah secretariats; and structured, ongoing training and knowledge sharing for boards, senior management, SSCs and operational staff.

15.6.1 Restoring Governance Integrity through Independent and Competent Board Structures

Weak board oversight, the politically driven replacement of competent and independent directors, and the appointment of less qualified Shariah committee members undermine governance, facilitate unethical financing, weaken accountability and increase exposure to SNCR. Stronger fit-and-proper criteria, genuine independence of the board and Shariah bodies, and integration of Shariah governance into the risk management framework are essential to restore oversight and institutional integrity.

15.6.2 Aligning Corporate Governance with Shariah Governance for Effective Institutional Oversight

Shariah governance cannot be effective without sound corporate governance, since an Islamic bank's governance encompasses both; the board, senior management and SSC must fulfill their roles together.

15.6.3 Formalizing the Shariah Compliance Function within the Three Lines of Defense Model

Each Islamic bank should establish a dedicated Shariah Compliance Unit (SCU) within management to implement and monitor SSC decisions, rulings and guidelines. Compliance functions now sit in the Shariah Secretariat of full-fledged banks or the Islamic Banking Division of conventional banks. The SCU should instead form a second line of defense, like risk management and compliance, with no business targets, implementing SSC decisions at all levels, monitoring products and processes, coordinating with business units, identifying and mitigating SNCRs, and reporting to management and the SSC.

15.6.4 Strengthening Scope, Rigor, and Independence of Internal Shariah Audit

Internal Shariah audit should move from selective sampling to population-based review and a system-driven approach enabling real-time detection, rectification and prevention of non-compliance. Aligned with the ICCD, it should combine independent on-site audits by qualified Muraqibs, who need Shariah, banking and audit skills, with Information and Communications Technology (ICT)-supported off-site surveillance and continuous follow-up. In practice its independence is often constrained: pressures such as reassignment or job insecurity discourage objective reporting and, over time, foster self-censorship and undetected non-compliance.

15.6.5 More Active Engagement of the SSC

The SSC should be proactive in fostering a Shariah-compliant environment, not merely reactive. This requires a balanced mix of Shariah expertise and practical banking knowledge. Clear terms of reference on responsibilities, authority and reporting. Institutionalized continuing professional development; regular participation in board and committee meetings to address Shariah issues at the policy level, and strong support from the board and its Audit Committee.

15.6.6 Introduction of External Shariah Review and Fiduciary Rating

Shariah assurance now relies mainly on internal controls and the SSC, with little independent external validation, limiting transparency and comparability, and fiduciary risks to Mudarabah depositors and unrestricted investment account holders are inadequately assessed and disclosed. A formal External Shariah Review framework, run by an authorized independent body with mandatory, externally verified annual Shariah assurance reporting, and a Fiduciary Rating framework assessing how well banks protect investment account holders should be introduced, aligned with AAOIFI Auditing Standards for Islamic Financial Institutions (ASIFI) 6 and GS 10 and with IFSB-1 and IFSB-30 (Hossain et al., 2025).

15.6.7 Shariah-Based Performance Metrics for Institutions Including SMT

Performance systems that emphasize business volume encourage neglect of procedural discipline and Shariah requirements, and there is no unified Shariah-focused KPI framework. Shariah-oriented indicators should be built into institutional and individual evaluations and, at the institutional level, into an expanded supervisory framework such as a Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity and Shariah Compliance (CAMELSS)-type model (Hossain et al., 2025).

15.6.8 Strengthening SSC Composition through Fit and Proper Criteria

AAOIFI governance standards and IFSB principles call for SSC members to be appointed on clear fit-and-proper criteria of expertise, integrity and independence. Because sound Shariah decisions require an understanding of banking operations as well as jurisprudence, an SSC should combine qualified Shariah experts with members of financial and operational expertise (Hossain et al., 2025), who under international practice may serve as non-voting members.

15.6.9 Enhancing Stakeholder Awareness of Shariah Governance

Banks should raise stakeholder awareness of Shariah governance: Bangladesh Bank's Guidelines on Internal Control and Compliance (BRPD Circular No. 3/2016) identify the lack of awareness programs for employees and customers as an SNCR. Structured, ongoing training for employees on Shariah principles, product structures and compliance, and customer awareness through simplified disclosures and educational campaigns, would strengthen both internal compliance and public trust.

15.6.10 Principle-Based Regulation and Functional Separation in Supervision

A principle-based regulatory approach, in line with international standards, suits Shariah governance better than rigid rules: regulations should set overarching principles and let banks design implementation according to their size, nature and complexity. Policy formulation and supervision should be clearly separated, and regulation should build a strong compliance culture — emphasizing ethics, discipline and sustainable governance — rather than reacting to isolated incidents with ever more rules.

15.6.11 Capacity Development and Structured Knowledge Enhancement

A comprehensive capacity-development framework is needed across all governance layers: targeted training for operational staff; structured knowledge sharing for the board, senior management and SSC; grounding in economics and banking for SSC members and in governance standards and domestic regulations for directors; a basic level of Shariah knowledge for all; and institutionalized Continuous Professional Development (CPD) for the board, senior management and SSC.

15.7 Conclusion

The study reveals a disconnect between formal governance structures and their effectiveness in Bangladesh's Islamic banks: governance, particularly SG, has not kept pace with the sector's growth since 1983, exposing banks to reputational risk, financial instability and eroding public trust. Governance shows a form-over-substance dynamic: SSCs, internal controls and regulatory frameworks exist but have limited influence on core decisions, risk management and accountability, with SSCs largely certifying rather than assessing economic substance, monitoring high-risk transactions or preventing failures — limitations linked to capacity constraints, weak independence and unclear accountability.

SG weaknesses are intertwined with failures of corporate governance: concentrated ownership, eroded SSC independence and politicisation have weakened oversight, and informal power structures often override institutional processes, undermining fiduciary responsibility and professional standards. The liquidity pressures, rising non-performing assets and declining depositor confidence of recent crises are manifestations of these governance failures.

Reform requires stronger corporate and Shariah governance: structured training for boards, senior management and SSCs in risk management, ethics and compliance; independent, technically expert SSCs free from management influence; and adequately resourced, professionally structured internal Shariah audit protected from interference. Regulatory reform should improve enforcement, supervisory effectiveness and coordination between regulators and governance bodies, drawing on the practices of Malaysia and Bahrain, and better disclosure and transparency are essential to rebuild confidence. Equally, Islamic banks need a strong ethical foundation — Shariah-compliant investment, transparent reporting and firm accountability — with SG positioned not merely as a compliance function but as a central pillar of ethical and sustainable banking.

The sector's revitalization depends on implementing these reforms with strong regulatory oversight, professionalism and integrity, political will, and coordinated effort by regulators, policy makers and institutions; without a shift to substantive, accountable and ethically grounded governance, it risks continued instability despite its strong growth and social relevance.

Chapter 16: Shariah Supervisory Committees: Practices, Issues and Policy Recommendations

Based on the study "Shariah Supervisory Committees in Bangladesh: Practices, Issues, and Policy Recommendations" by Md. Mahabbat Hossain and Mezbah Uddin Ahmed.

16.1 Introduction

Islamic banks and Finance Companies (IBFCs) must avoid interest (Riba), excessive uncertainty (Gharar), gambling (Maysir) and dealings in unethical or harmful products, and must follow Islamic law (Shariah) in executing contracts. To ensure this, they establish Shariah Supervisory Committees or Councils (SSCs) — also called Shariah Supervisory Boards (SSBs), Shariah Advisory Committees or Councils (SACs), or Shariah committees — which act at both pre- and post-operational stages as a mandatory part of the Shariah Governance Framework (SGF) and a key pillar of corporate governance. As the highest institutional authority on Shariah, the SSC guides compliance, reviews Product Program Guidelines (PPGs) and other documents, and oversees the implementation of Shariah in transactions, significantly influencing the institution's strategic direction.

An effective SGF sustains IBFCs' growth, credibility and public trust, but SSC effectiveness depends on appropriate composition, adequate authority from the board, strong management support and a well-defined operating framework, as well as on independence, expertise, decision-making power and the ability to address contemporary challenges; without these, inefficiency, non-compliance and reputational damage may follow. With demand for Shariah-compliant products rising in Bangladesh, this study evaluates the role of SSCs in IBFCs — their governance role, structures, decision-making, impact on compliance and challenges — and explores how to enhance their performance and strengthen Shariah governance.

16.1.1 Research Methodology

The study uses a qualitative, multi-source design. A content analysis of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) governance standards, Islamic Financial Services Board (IFSB) 10, IFSB 30 and Bangladesh Bank guidelines provides the assessment benchmark. Semi-structured interviews, following a guide aligned with the benchmark — covering composition, independence, meetings, Shariah audit, disclosure, remuneration and Continuous Professional Development (CPD) — were held with purposively selected SSC and board members, Shariah secretariat officers, senior Islamic bankers, academics and central bank officials, each with at least three years' experience in Shariah governance and drawn from full-fledged Islamic banks, Islamic windows and branches, and finance companies. Findings were triangulated through feedback at a national seminar and an academic conference, and secondary data came from the IBFC Islamic Banking and Finance Report Bangladesh (IiBFRBD), central bank publications and institutional websites. The analysis reflects the context up to 10 March 2025.

Findings are reported in aggregate to preserve confidentiality. The study is descriptive and interpretive, not causal, and is limited by incomplete public disclosure in some institutions,

potential response bias and the absence of inferential statistics — mitigated by cross-verification, document triangulation and convergent validity across stakeholder groups. Future research could apply quantitative and survey-based methods and extend to Islamic insurance (Takaful), Islamic funds, Islamic investment certificates (Sukuk) and Islamic social finance.

16.2 Conceptual Framework and Literature Review

16.2.1 Theoretical Framing and Recent Evidence

Agency theory predicts that weak or conflicted SSC monitoring leads managers to underinvest in Shariah compliance, so stronger board oversight and an independent SSC should improve outcomes (Safiullah et al., 2024). Institutional theory attributes cross-bank variation in SSC practice to regulatory, normative and mimetic pressures from administrations, regulators and government (Alam & Miah, 2024). Empirically, SSC size, expertise and multiple appointments are linked to risk-taking, though SSCs appear less effective in curbing IBFCs' risk-taking in Bangladesh (Islam et al., 2021). Members' backgrounds in economics, finance or Islamic law and their experience are associated with lower risk, while higher education may encourage more risk-taking (Mukhibad & Setiawan, 2022).

SSCs promote social reporting, accountability and transparency (Wijayanti & Setiawan, 2022) and, like the board, are integral to good governance in Islamic banks (Simanjuntak et al., 2025). Shariah compliance depends on governance structure, although Rahman et al. (2024) find no significant difference in compliance between full-fledged and other Islamic banks. In Bangladesh, the Shariah governance system remains largely voluntary rather than regulatory (Alam et al., 2019).

Under AAOIFI GS 1 (para 2), an SSC is an independent body of jurists specialized in Fiqh al-muamalat, responsible for directing, reviewing and supervising the activities of IFIs to ensure Shariah compliance (AAOIFI, 1998). IFSB-10 describes the Shariah governance system as the arrangements through which an institution ensures Shariah compliance, with SSCs acting as panels of Shariah advisers (IFSB, 2009). There is no direct Western equivalent, though SSCs are sometimes compared to non-executive directors or external auditors. Within a bank they oversee ex ante and ex post Shariah governance; at the macro level, they help develop Shariah standards and promote uniform practice.

Because SSC members are paid by the institution, their objectivity may be compromised; where their decisions limit profitability, management may try to influence them, leading to 'fatwa shopping' (Grais & Pellegrini, 2006).

SSCs became standard practice only gradually. The Islamic Development Bank and Dubai Islamic Bank, both founded in 1975, initially consulted individual scholars and formed SSCs only in 2003 and 1999 respectively, whereas Faisal Islamic Bank of Egypt established the first formal SSC in 1976, followed by Jordan Islamic Bank and Kuwait Finance House. SSCs also operate in secular jurisdictions such as the United Kingdom (UK) and the US, where banks establish their own committees or consult bodies such as the Assembly of Muslim Jurists of America or Shariah advisory firms (INCEIF University, 2023).

16.2.2 Functions and Responsibilities of SSC

SSCs advise Islamic banks on Shariah matters and supervise the application of Shariah principles; where regulatory support is weak, the advisory role may dominate. IFSB 30 classifies their activities as ex ante and ex post.

Ex ante, the SSC approves all product and service documentation — contracts, agreements and promotional material — and internal policies and procedures. Ex post, it oversees profit and loss calculation and distribution to Investment Account Holders (IAHs), approves the accounting treatment of products, verifies the annual obligatory alms (Zakat) calculation on behalf of shareholders, reviews reports of the Shariah compliance function and of internal and external audits, and directs the disposal of income from prohibited sources to charity while working to reduce such income in future.

16.2.3 Appointment of SSC Members

Appointment practices vary. SSC members are usually appointed by the BoD or approved by shareholders at the Annual General Meeting (AGM) on the board's recommendation, often with prior regulatory approval. AAOIFI GS 1 (para 3) requires ratification by shareholders at the AGM, subject to local custom and regulation.

In Malaysia, the BNM Shariah Governance Policy Document (BNM-SGPD) lets the BoD appoint members, subject to a written application to BNM at least three months before a candidate's duties begin (or before an incumbent's term expires) and BNM's written approval. In Pakistan, the State Bank of Pakistan's SGF (SBP-SGF) requires the BoD to appoint the SSC and approve its terms of reference and remuneration; for foreign banks' Islamic branches, the country manager or Chief Executive Officer (CEO) appoints it with prior SBP approval. In Saudi Arabia, the Saudi Central Bank's Shariah Governance Framework (SAMA-SGF) requires the BoD to form the SSC on the recommendation of the nomination and remuneration committee, with the central bank's written non-objection; internal policy may also require the general assembly's approval.

16.2.4 Composition of SSC

Under AAOIFI GS 1 and IFSB 10, an SSC must have at least three specialized jurists in Islamic commercial jurisprudence, who must form the majority and include the chairman. Experts in finance, banking, accounting, economics or law may also be included. Directors, significant shareholders and employees are ineligible, and diversity of schools of thought and seniority is encouraged.

Jurisdictions add their own requirements. Malaysia requires at least five members, mostly Shariah-qualified (three for Islamic windows). A member may serve only one institution in the same industry segment, for up to nine years, and may not be a substantial shareholder, executive director, senior officer or active politician, while having an SSC member on the BoD is advisable. Pakistan requires at least three Shariah members, with legal and accounting experts as non-voting advisers. One serves full-time as the Resident Shariah Board Member (RSBM). Members may sit on up to three SSCs (except the RSBM and at least two others), may not engage in operational management, and serve three-year terms approved by the SBP.

Saudi Arabia requires three to five members, an independent chairman, at least two-thirds independent members and service on only one bank's SSC, with sufficient Shariah knowledge and the ability to understand financial statements.

16.2.5 Resident Shariah Board Member (RSBM) in Pakistan

The RSBM clarifies operational Shariah issues and products for management and staff on the basis of previous SSC rulings, guides the compliance department's reviews and its responses to client queries, supports Shariah training and development, and reports quarterly to the SSC on operational Shariah matters for ratification.

16.2.6 SSC Meeting

SSC meetings deal with Shariah issues in new and existing products, investment portfolios, documentation and compliance, and frameworks prescribe minimum frequencies: at least every two months for Islamic banks under the BNM-SGPD (twice a year for windows and foreign branches) and at least quarterly under the SBP-SGF and the SAMA-SGF. Beyond these minimums, the SSC should meet whenever decisions or emerging issues require.

Members should receive meeting papers — financial reports, compliance updates and product proposals — at least a week in advance. Decisions are ideally unanimous; otherwise they are taken by majority, the BNM-SGPD (para 11.8) allows all members to vote, while some other frameworks count only members with recognized Shariah backgrounds.

Deliberations, rationales and dissenting opinions are minuted and submitted to the BoD for action; BNM-SGPD (para 10.8) requires SSC decisions, including dissents, to be submitted to BNM, and the SBP-SGF requires minutes to reach the SBP within 15 days.

Physical attendance is the norm, but virtual participation is permitted in some circumstances (BNM-SGPD); the coronavirus disease 2019 (COVID-19) pandemic made virtual meetings routine, underscoring the need for flexibility while maintaining confidentiality.

16.2.7 Independence of the SSC

Because Islamic banks remunerate SSC members, conflicts of interest may undermine the legitimacy of their rulings, although many argue that members' accountability to Allah (SWT) and Islamic ethics safeguard their integrity; regulation is still needed to strengthen professionalism. To ensure independence, members should hold no managerial role and have no close relationships with the bank's employees, and AAOIFI GS 5 requires ongoing assessment of their independence.

16.2.8 Time Commitment of SSC Members

Many SSC members hold other permanent positions, raising concerns about time commitment and conflicting legal obligations: in Malaysia, members who are also directors must comply with the IFSA 2013 and the Companies Act 2016, and a breach under one law may affect their SSC role. Scholars have traditionally sat on several SSCs with few limits. Kuwait and the United Arab Emirates (UAE) still impose none, whereas Saudi Arabia, Malaysia and Oman

restrict multiple memberships (Malaysia bars service on competing banks), since spreading members too thin may compromise due diligence and the quality of rulings.

16.2.9 Performance Assessment of SSC

The BNM-SGPD calls for annual assessment of the committee and of individual members covering accountability, communication with governance bodies and the handling of Shariah compliance risks, with attendance, contribution and integrity as key indicators. IFSB 10 likewise requires separate assessment of the committee and its members.

16.2.10 Competency Requirements for SSC

Members need knowledge of both Shariah and Islamic banking operations; the BNM-SGPD mandates ongoing professional development for directors on Islamic finance, and IFSB 10 emphasizes continuous professional development (CPD) and training.

16.2.11 Legal Status of Shariah Pronouncements

The binding force of SSC rulings varies: in Malaysia, the BNM-SGPD requires board members to ensure compliance with Shariah rulings, and Kuwait provides a legal framework for centralized Shariah decisions. Arbitration is often recommended as an alternative to the courts, and legislation should strengthen the binding nature of Shariah rulings.

16.3 SSC within Corporate and Shariah Governance

The components of corporate and Shariah governance in Islamic banks, and the importance of good Shariah governance, are discussed in Section 15.4.3 of Chapter 15. The discussion below focuses on the international standards and domestic regulations that govern Shariah Supervisory Committees (SSCs).

16.3.1 International Governance Framework: AAOIFI Standards

Under AAOIFI standards, the SSC — with at least three members — oversees the institution's adherence to Shariah, and its report, signed by all members, is included in the annual report with an annual fatwa and presented at the AGM. Management holds primary responsibility for compliance; the SSC reviews and verifies it, with unrestricted access to contracts, agreements, policies, financial statements and other records.

An internal Shariah review, conducted by an independent department or internal audit under the SSC's supervision and in accordance with the AAOIFI Code, assesses adherence to Shariah and the SSC's rules and reports to the board, SSC and management. Its reviewers, proficient in Shariah and Islamic commercial jurisprudence, are appointed with the SSC's consent and kept separate from operational roles.

The Audit and Governance Committee (AGC), which should understand Shariah, safeguards the integrity of financial reporting and shareholders' interests, reviews internal controls, including Shariah audit, and reports to the board and management.

SSC members must be independent: they may not be employees or involved in managerial decisions, former officers or employees need a three-year cooling-off period, relationships

must be assessed continuously, and unresolved independence issues lead to resignation and notification to the general assembly.

Robust governance — effective compliance frameworks, clear leadership criteria, strong oversight, sound risk management, avoidance of conflicts of interest, fair remuneration, transparent disclosure and ethical conduct — sustains customer trust, Shariah compliance and stakeholder protection.

AAOIFI also recommends a Central Shariah Board (CSB) of scholars of Islamic commercial jurisprudence and banking experts, serving three- to five-year terms, to promote uniform products and practices through advice, fatwas and regulatory support. CSBs may be national or regulatory, with membership varying by industry segment.

16.3.2 International Governance Framework: IFSB Guidelines

The IFSB framework calls for a Shariah governance structure proportionate to the institution's size and complexity, with clear terms of reference and procedures for the SSC. Fit-and-proper, competent members supported by CPD; formal assessment of SSC effectiveness. Independence to judge objectively; timely and comprehensive information. Confidentiality, and adherence to the legal and regulatory framework for Shariah pronouncements in the jurisdiction.

IFSB performance measures assess the SSC's organizational accountability, its communication with the board, management and auditors, its identification of Shariah non-compliance and reputational risks, its promotion of ethics and values, and the continuous improvement of Shariah controls. Individual members are assessed on active contribution, integrity, diligence, cultural sensitivity, awareness of context, rational reasoning, openness to learning and an inquisitive mindset.

16.3.3 SGF: Bangladesh Perspective

The Bangladesh Securities and Exchange Commission (BSEC) Corporate Governance Code (2018) requires boards of 5 to 20 members, at least one-fifth independent. Separate Chair and Managing Director (MD)/CEO roles; clearly defined appointments of the MD, Chief Financial Officer (CFO) and Company Secretary, and an Audit Committee of at least three members with an independent chair, reporting to the board, BSEC and shareholders. It does not address Shariah compliance.

Bangladesh Bank's governance rules include Banking Regulation and Policy Department (BRPD) Circular No. 02/2024 (11 February 2024) on the formation, composition and responsibilities of boards. The Prudential Regulation for Banks: Selected Issues (2024); the Code of Conduct for Banks and Non-Bank Financial Institutions (2017); the Guidelines on Internal Control and Compliance (2016), which require internal Shariah audit in Islamic banks; and corporate governance guidelines (BRPD Circular No. 11, 27 October 2013). Boards oversee the internal control system, and the Audit Committee of the Board — at least five members, including two independent directors, with suitable qualifications — covers internal control, financial reporting, internal and external audit and legal compliance; but these rules contain no specific Shariah governance provisions.

Bangladesh Bank's Guidelines for Islamic Banking (BRPD Circular No. 15, 9 November 2009) require an SSC and set fit-and-proper criteria for its members, while vesting overall responsibility for Shariah compliance in the board.

More recent regulatory developments, including Circular No. 01 of 28 September 2025 issued by the Islamic Banking Regulation and Policy Department of Bangladesh Bank, are discussed in Section 15.4.3 of Chapter 15.

16.4 Findings of the Study

This section presents the study's findings based on secondary data from publicly available sources, primary data collected through interviews, and insights from the seminar. The findings reveal that, despite the existence of SSCs within IBFCs in Bangladesh and adherence to regulatory requirements, there remain areas for improvement to enhance their effectiveness.

16.4.1 SSC in Full-Fledged Islamic Banks

Table 16.1 presents the SSCs of the 10 full-fledged Islamic banks. All have one, some called Shariah Boards; some include expert members, and in some the Chairman of the BoD, the Managing Director or CEO, or a Deputy Managing Director is a member. Membership ranges from 4 to 10.

Table 16.1: SSC in Full-Fledged Islamic Banks of Bangladesh

Islamic Banks	Year of Establishment	IB Starting	No. of SSC Members	Business Expert
Islami Bank Bangladesh PLC	1983	1983	10	N/A
ICB Islamic Bank Ltd.	1987	1987	4	2
Social Islami Bank PLC	1995	1995	8	2
Al-Arafah Islami Bank PLC	1995	1995	7	1 (Chairman of BoD)
Shahjalal Islami Bank PLC	1997	1997	5	N/A
Export Import Bank of Bangladesh PLC	1999	2004	8	3 (Including CEO)
First Security Islami Bank PLC	1999	2009	8	1
Union Bank PLC	2013	2013	5	N/A
Standard Bank PLC	1999	2021	7	3 (Including CEO and DMD)
Global Islami Bank PLC	2013	2021	6	N/A

Source: Based on the websites of the respective banks, accessed on 10 March 2025.

16.4.2 SSC in Islamic Banking Branches and Windows of Conventional Banks

Among conventional banks with Islamic branches or windows (Table 16.2), some SSCs include both Shariah scholars and business experts and others do not. Some have non-Faqih chairpersons or fewer Faqih than non-Faqih members. Membership ranges from 2 to 8, and some banks do not disclose their members' names, so the dataset is incomplete.

Table 16.2: SSC in Dual Banks of Bangladesh

No.	Banks with Islamic Branches &/ Windows	Type of IB	Year of Estab.	IB Starting	No. of SSC Members	Business Expert
1	United Commercial Bank PLC	Branch+ Window	1983	2020	5	N/A
2	ONE Bank PLC	Branch+ Window	1999	2020	7 (A Non-Faqih Chairman)	5 (Including Chairman of BoD and MD)
3	The Premier Bank PLC	Branch+ Window	1999	2003	5	2
4	Prime Bank PLC	Branch	1995	1995	7	4 (Including Chairman of BoD, MD, and Head of IB)
5	Dhaka Bank PLC	Branch	1995	2003	7 (A Non-Faqih Chairman)	4 (Including MD and Head of IB)
6	Southeast Bank PLC	Branch	1995	2003	8	5 (Including Chairman and Members of BoD, and MD)
7	Jamuna Bank PLC	Branch	2001	2003	7	2 (Including MD and Head of IB)
8	City Bank PLC	Branch+ Window	1983	2003	8	N/A
9	Bank Alfalah	Branch	2005	2005	5	N/A
10	AB Bank PLC	Branch+ Window	1982	2006	6 (A Non-Faqih Chairman)	2 (Including MD)
11	NRB Bank PLC	Branch+ Window	2013	2021	5	N/A
12	National Credit and Commerce Bank PLC	Branch	1993	2022	5	N/A
13	Standard Chartered Bank	Window	1948	2004	4	N/A
14	Trust Bank PLC	Window	1999	2008	5	2 (Including MD and Head of IB)
15	Bank Asia PLC	Window	1999	2008	5	N/A
16	Pubali Bank PLC	Branch+ Window	1983	2010	7	2
17	Sonali Bank PLC	Window	1972	2010	7	4 (Including Member of BoD and MD)
18	Agrani Bank PLC	Window	1972	2010	6	3 (Including Head of IB)
19	Meghna Bank PLC	Window	2013	2020	5	2
20	Mutual Trust Bank PLC	Window	1999	2020	8	3 (Including MD and Head of IB)

No.	Banks with Islamic Branches &/ Windows	Type of IB	Year of Estab.	IB Starting	No. of SSC Members	Business Expert
21	Mercantile Bank PLC	Branch+ Window	1999	2020	6	N/A
22	Midland Bank PLC	Window	2013	2020	5	3 (Including Member of BoD and MD)
23	NRBC Bank PLC	Window	2013	2020	8	6 (Including Chairman and Members of BoD)
24	SBAC Bank PLC	Window	2013	2021	8	N/A
25	Bangladesh Commerce Bank	Branch	1998	2022	N/A	N/A
26	Padma Bank PLC	Window	2019	2023	2	N/A
27	Rupali Bank PLC	Window	1972	2023	8	2 (Including MD and DMD)
28	Bengal Commercial Bank PLC	Branch	2020	2021	7	4 (Including Chairman, Members of BoD, and MD)
29	IFIC Bank PLC	Branch	1983	2024	7	N/A
30	Eastern Bank PLC	Window	1992	2024	3	N/A

Source: Based on the websites of the respective banks, accessed on 10 March 2025.

Note: The branch/window classification above reflects the banks' own website disclosures as at 10 March 2025 and yields 8 banks with both branches and windows, 9 with branches only and 13 with windows only. Chapter 17 reports Bangladesh Bank's approval categories as at December 2024 (5, 11 and 14 respectively). The two counts rest on different sources and reference dates and are not directly comparable.

16.4.3 SSC in Finance Companies of Bangladesh

All Islamic finance companies have SSCs, with 4 to 8 members (Table 16.3); in one, a non-Faqih member chairs the committee.

Table 16.3: SSC in Finance Companies of Bangladesh

No.	Institution Name	Type	Year of Establishment	IB Starting	No. of SSC Members	Business Expert
1	Islamic Finance and Investment PLC	Full-Fledged	2001	2001	8	2 (Including MD and Head of Shariah)
2	Hajj Finance Co. Ltd.	Full-Fledged	2006	2006	7 (A Non-Faqih Chairman)	3 (Including Chairman of BoD and MD)
3	Aviva Finance Co. Ltd.	Full-Fledged	1996	2020	5	1
4	DBH Finance PLC	Window	1996	2023	7	5 (Including MD and Head of IF)
5	Bangladesh Finance Ltd.	Window	1996	2021	6	3 (Including MD and Head of IF)

No.	Institution Name	Type	Year of Establishment	IB Starting	No. of SSC Members	Business Expert
6	SFIL Finance PLC	Window	1999	2022	5	2 (Including Chairman and Member of the BoD)
7	IDLC Finance PLC	Window	1985	2024	5	2
8	Bangladesh House Building Finance Corporation, a Specialized Financial Institution	Products	1952 (1973)	2021	4	1 (Head of the Unit)

Source: Based on the websites of the respective institutions, accessed on 10 March 2025.

Data on SSC meetings and Shariah awareness programs, SSC fees and expenses, and Shariah audit coverage in full-fledged Islamic banks, updated to 2024, are presented in Table 15.4, Table 15.5 and Table 15.6 in Chapter 15.

16.4.4 Summary Outcome of Interviews and Seminar

Semi-structured interviews were held with SSC and BoD members, Shariah secretariat officials, academics, senior Islamic bankers and central bank officials, and the draft paper was discussed at a national seminar. Their views are summarized below.

Presence of Governance Components

The governance components required by AAOIFI GS 6 and IFSB 30 are mostly present in IBFCs in Bangladesh, but external Shariah audit has yet to be established; most respondents strongly support introducing it to enhance transparency, accountability and compliance.

Appointment and Dismissal of SSC Members

AAOIFI GS 1 provides for SSC members to be appointed at the AGM on the BoD's recommendation, but in Bangladesh they are appointed by management or the board. Most respondents favor aligning practice with international standards and raising the SSC's status within the organization, although a few see no problem with current practice.

Naming of the SSC

International standards (AAOIFI GS 1, IFSB 30) call the apex Shariah body the SSB, while Bangladesh uses SSC; some Shariah scholars recommend renaming it SSB to reflect its authority and align with global practice, although others consider the distinction insignificant.

Shariah Review of Documents and Contracts

SSCs' responsibilities cover ex ante and ex post activities (AAOIFI GS 2, IFSB 30), including vetting all documents, contracts and advertising. Some contract forms, PPGs and advertisements are nonetheless published without SSC vetting, leading to Shariah non-compliance, and respondents strongly recommend that management submit all such materials for SSC review and approval before release.

Independence of SSC

SSC independence is crucial (AAOIFI GS 5, IFSB 10), yet some IBFCs include directors, senior managers or heads of Islamic banking on their SSCs — a practice the central bank and Islamic finance professionals strongly oppose, although a few respondents argue that including the chairman or MD speeds the implementation of SSC decisions. Independence must be real, not merely on paper, with all members free to decide solely on Shariah grounds, without external influence.

Composition of SSC Confirming Fit and Proper Criteria

Domestic regulations and international standards (AAOIFI GS 1 and GS 6, IFSB 10 and IFSB 30) set fit and proper criteria emphasizing expertise, integrity and independence. Sound Shariah decisions require an understanding of business processes, so an SSC should combine a majority of Shariah experts with business professionals; many IBFCs lack this mix, which Islamic finance professionals regard as a serious concern.

Composition of BoD with Proper Knowledge of Islamic Finance

The SSC's effectiveness depends heavily on the BoD's support. The Basel Committee on Banking Supervision (BCBS) Corporate Governance Principles (2015) and IFSB 30 stress a well-composed board, and Bangladesh Bank requires IBFC boards to include members with Shariah knowledge. Since the board is responsible for Shariah compliance, a knowledgeable board — with a supportive tone at the top from the BoD and senior management, and an Audit and Governance Committee that supports Shariah compliance (AAOIFI GS 4) — greatly strengthens the SSC.

Adequate and Proper Disclosure and Transparency

International standards — AAOIFI GS 1, GS 2 and GS 6, IFSB 30, the BCBS Corporate Governance Principles (2015), the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance (2015) and the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control–Integrated Framework (2013) — treat a proper and timely flow of accurate information as fundamental to effective governance. For IBFCs this means regularly publishing SSC fatwas and decisions (AAOIFI GS 1, GS 2) to build accountability and trust, but this remains uncommon, and most respondents strongly urge that it be addressed.

Objective Assessment of the Performance of SSC and Its Members

Every governance component must be accountable. IFSB 10 sets objective criteria for assessing both SSCs as a whole and their individual members, an approach strongly supported by the central bank and respondents.

CPD and Training of SSC Members

IFSB 10 requires continuing professional development (CPD) and training for SSC members, without which they cannot contribute effectively. Bangladesh Bank plans to introduce CPD requirements in its forthcoming Shariah governance framework, following well-established practice in Malaysia.

Internal Shariah Review (Audit) and Its Reporting Line

An independent internal Shariah audit — the SSC's 'third eye' — reviews activities ex post and should report clearly to the SSC, BoD and senior management (AAOIFI GS 3, IFSB 30). In Bangladesh, however, boards show little interest in using it, so senior management faces little pressure to act on its findings and there is no direct channel to the board; some stakeholders advocate a direct reporting line to the BoD.

Regular Interaction among BoD, SMT and SSC

Regular interaction among the BoD, senior management and the SSC, recommended by IFSB 30, lets the board and management judge whether the SSC works in a conducive environment and lets the SSC convey its concerns directly for prompt action. Respondents note that no such structured interaction exists in Bangladesh.

SSC Roles, Engagement, and Remuneration

SSC remuneration should match members' ex ante and ex post responsibilities (AAOIFI GS 1, GS 6). In some jurisdictions members receive a monthly honorarium as well as meeting fees, but in Bangladesh they receive only meeting fees of about BDT 8,000, considered inadequate. Market participants and the central bank are exploring a monthly package similar to that of independent directors, though higher pay will achieve little without stronger capacity and expertise.

Limiting the Maximum Number of Engagements for SSC Members

Unlike some jurisdictions, Bangladesh does not limit the number of SSCs an individual may join, and overlapping memberships are common, diluting members' time and contribution. Bangladesh Bank is considering a cap in line with international practice, although some Shariah experts argue that the small number of meetings each year makes multiple memberships manageable.

Frequency and Duration of SSC Meetings in Relation to Agenda

Some IBFCs hold only one or two SSC meetings a year, crowd too many agenda items into a meeting, and lose much of the time to prayer and lunch breaks or social interaction. Some members arrive late, engage little or come unprepared. Respondents recommend adopting international practice on the frequency and structure of meetings, with active participation and sufficient time for each agenda item.

Meeting Minutes and Reporting to Bangladesh Bank

Minutes do not attribute individual members' opinions, making contributions hard to assess, and there is no formal mechanism to evaluate them. Several respondents and central bank officials support submitting SSC minutes to the central bank to strengthen oversight, alongside an environment that encourages active participation.

16.5 Conclusion and Way Forward

Although key governance components give SSCs in Bangladesh's IBFCs a structured approach to Shariah compliance, critical gaps remain in their independence, competency and alignment with international standards. SSCs need de facto independence, appointment processes aligned with best practice, and stronger knowledge among both SSC and board members. Transparency and accountability through published fatwas and decisions, structured performance evaluation and better disclosure. CPD and training; adequate meeting time, and stronger internal Shariah audit with direct reporting lines to the board. The main recommendations are:

- Establish a Central Shariah Supervisory Board (CSSB) under Bangladesh Bank to issue binding guidance, harmonize practices, and review institutional SSC minutes and fatwas.
- Prohibit CEOs/BoD members from serving on SSCs, require conflict-of-interest declarations, and limit multiple concurrent SSC appointments.
- Mandate internal Shariah audit reporting to the BoD or audit committee and introduce external Shariah audit for independent assurance.
- Ensure at least quarterly SSC meetings, pre-circulation of papers (≥7 days), recording of dissenting opinions, and regular publication of fatwas and decisions.
- Strengthen fit-and-proper criteria with periodic assessments, mandate CPD hours, and introduce performance evaluations of SSCs and their members.
- Adopt a mixed remuneration structure (meeting fees plus monthly retainers) tied to role scope and performance, benchmarked to independent directors.
- Include standardized SSC disclosures in annual reports (charter, composition, attendance, key rulings, audit coverage, and handling of non-compliance).
- Encourage practitioner-academic collaborations and develop datasets to evaluate links between SSC attributes and outcomes.

Regulatory enhancements, governance reforms and capacity building aligned with global best practice and independent oversight will thus be crucial to strengthening SSCs and Shariah governance in Bangladesh's Islamic banking and finance sector.

Chapter 17: Rationale and Process for Introducing Islamic Banking in Conventional Banks

Based on the paper "Rationale and Process for Introducing Islamic Banking in Conventional Banks of Bangladesh" by Mezbah Uddin Ahmed and Md. Mahabbat Hossain.

17.1 Introduction

Islamic banking windows (IBWs) within conventional banks emerged as Western banks began accepting interbank deposits from Islamic banks and offering tailored solutions for high-net-worth (HNW) clients from the Middle East. These banking activities must comply with Islamic law (Shariah) rules and principles, which strictly prohibit interest. As banks developed a deeper understanding of Islamic finance, they began to establish IBWs as distinct departments (Khan & Bhatti, 2008). Today, IBWs are found not only in Western banks but also in many conventional banks in Muslim-majority countries. According to London Stock Exchange Group (LSEG, 2023), there are 274 conventional banks with IBWs across 55 countries, including both Muslim-majority and minority nations.

However, the structures of IBWs vary. Some are established as dedicated Islamic banking branches of conventional banks, while others operate as designated desks within branches that also offer conventional banking services. There are also virtual IBWs that provide Islamic banking services solely through digital platforms, without physical branches. Additionally, the type of regulatory approval for IBWs varies across countries. In most cases, IBWs are subject to separate regulatory approval, as well as operational, Shariah governance, and reporting requirements. However, in some instances, there may not be distinct regulatory requirements for IBWs, although stakeholders still expect them to maintain a Shariah governance system and ensure Shariah compliance in their activities on their own initiative.

In Bangladesh, the approval for Islamic banking granted by Bangladesh Bank — the country's central bank — to conventional banks comes in two forms: 'branch' and 'window'. As of December 2024, there are 30 conventional banks offering Islamic banking services in Bangladesh. Among these, five banks have received approval from Bangladesh Bank for both branch and window-based Islamic banking. Another 11 banks are approved for branch-based Islamic banking, while 14 banks are approved for window-based Islamic banking (Hossain et al., 2024). In this research, they are collectively referred to as IBWs. Together, they represent 11.66% of total Islamic banking deposits and 7.57% of total Islamic banking investments (Bangladesh Bank, 2024).

Despite a significant number of conventional banks offering Islamic banking services and capturing a notable market share within the total Islamic banking sector, IBWs in Bangladesh face scepticism due to their reliance on a leveraged model, where the Islamic banking segment operates alongside the facilities and infrastructure of the conventional parent bank. While this model provides cost-saving benefits and other advantages, there are significant concerns in the market regarding Shariah governance and the potential mixing of Shariah-compliant and non-

compliant funds. Such concerns led Bangladesh Bank to attempt to discontinue IBWs several times (ISRA, 2023), the latest being in the Draft Islamic Bank Companies Act 2024.

As Bangladesh stands at a crossroads, with IBWs maintaining a strong presence in the Islamic banking sector while simultaneously facing scepticism, this research investigates the rationale for IBWs. It examines the regulatory requirements for IBWs, as well as the operational models of IBW approvals granted by Bangladesh Bank, along with their advantages and disadvantages. It also provides a generic process flow for launching IBWs in Bangladesh, accompanied by recommendations to enhance Shariah governance and compliance.

This research represents a significant contribution to the literature on Islamic finance, as there is currently no existing research addressing these aspects within the context of Bangladesh. Furthermore, it possesses considerable practical implications, offering essential guidance to conventional banks interested in introducing IBWs, not only in Bangladesh but also in other jurisdictions, particularly in regions where Islamic banking is emerging. The findings of this research would also be pertinent to regulators in the formulation of effective regulations for IBWs.

17.2 Literature Review

17.2.1 Arguments in Support and Against IBWs

Islamic banking windows (IBWs) are well established in several countries, particularly where Islamic banking is developing. Where demand is low, IBWs may be the only viable way of providing Islamic banking and promoting financial inclusion. They draw on the expertise and systems of the parent bank to offer good products at lower cost, have ready access to liquidity from the conventional side — important where Islamic liquidity tools are limited — stimulate competition and better pricing, and have proved more stable than full-fledged Islamic banks (Hasan & Risfandy, 2021).

Some countries prohibit IBWs or restrict them: Qatar does not permit them, and in Malaysia most were converted into Islamic subsidiaries after Bank Negara Malaysia's call in 2002 (Ariff, 2017). Supervisors' reluctance stems from their risks: rumours of commingling with conventional funds could trigger withdrawals and raise consumer protection concerns.

IBWs may also weaken governance and risk management, as the parent's board and management may not understand the specific risks of Islamic banking or meet fit and proper criteria for it, and Shariah boards may find full segregation hard to verify. They can invite regulatory arbitrage — for example, riskier financing through IBWs because profit-sharing account holders bear the losses, or shifting securities between conventionally funded and IBW-funded portfolios to smooth returns — and complicate oversight: Islamic prudential ratios and window financial statements are hard to monitor, the orderly resolution of a distressed conventional bank with IBWs is difficult to reconcile with Shariah, and because conventional banks can fund Islamic assets with conventional deposits, IBW pricing may not reflect Shariah-compliant liquidity, complicating monetary policy.

IBWs can nonetheless be a step towards full conversion or an Islamic subsidiary by building Islamic banking capital, and authorities that permit them impose firewalls such as fund

segregation, separate branches and separate accounting systems. Whether IBWs can operate in a Shariah-compliant and profitable way within the economic context of Bangladesh remains an open question.

17.2.2 AAOIFI Requirements for IBWs

Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) issued FAS 40, Financial Reporting for Islamic Finance Windows, in December 2021, superseding FAS 18 (2002), and in November 2023 an exposure draft governance standard, Application of Shariah Governance Principles to Islamic Finance Windows. AAOIFI recognizes that IBWs have widened the reach and visibility of Islamic finance, but notes stakeholder concerns about their governance, compliance and reporting risks, which could affect the whole industry given their systemic importance in some markets, and has therefore set essential governance and reporting requirements.

IBWs should operate as an 'institution within an institution', with maximum independence from the conventional parent's management, through dedicated Islamic-only branches whose customer-facing staff serve only IBW customers. All business units and functions (products, sales, service and marketing) must be managed by the IBW, while control and support functions may be shared under defined cost allocation and service level agreements.

Although the parent's board and management are responsible for the adequacy of the IBW's Shariah governance, the IBW must have the same components as any Islamic financial institution: a Shariah Supervisory Board (SSB), a Shariah compliance function, internal Shariah audit and external Shariah audit. A senior, experienced head of the IBW, dedicated exclusively to it and reporting to the parent's Chief Executive Officer (CEO), must have adequate knowledge and experience of Islamic banking and Shariah and meet fit and proper criteria. An independent Shariah compliance department (SCD) must also be established, its head appointed by the head of the IBW with the SSB's approval and reporting to the SSB (and administratively to the head of the IBW).

IBW funds should, as far as practicable, be fully segregated from the parent's on a day-end clearing basis, with separate accounts at the central bank and clearing houses where applicable. An IBW may receive funds from its parent under a Shariah-compliant contract but may not place funds with the parent or any other conventional institution, directly or indirectly.

The IBW's core banking system must recognize the nature of Islamic contracts, terminology and processes, support Shariah-compliant profit calculation and accounting, and provide pool and treasury management for fund segregation and profit calculation.

Separate books must be kept, and supplementary IBW financial statements published as an appendix or note to the parent's financial statements, showing the funds mobilized under Shariah principles, the assets they finance, and the related income and expenses. They must disclose the extent of any commingling with conventional funds. The sources and uses of funds; how any deficit is covered. Any Shariah-prohibited income and its disposal; any reserves deducted from Shariah-compliant funds, their purpose and to whom they revert. The share of funds provided by the parent or other conventional entities, and any other details required by the regulator.

17.2.3 IFSB Requirements for IBWs

According to IFSB-17 Core Principles for Islamic Finance Regulation (Banking Segment), the supervisory authorities should satisfy themselves that the institutions offering window-based Islamic services have the internal systems, procedures and controls to provide reasonable assurance that (a) the transactions and dealings of the windows are in compliance with Shariah rules and principles, (b) appropriate risk management policies and practices are followed, (c) Islamic and non-Islamic business are properly segregated, and (d) the institution provides adequate disclosures for its window operations.

17.2.4 Regulatory Requirements Regarding IBWs in Different Jurisdictions

17.2.4.1 Malaysia

In Malaysia, conventional banks establishing an IBW must comply with the Shariah Principles and Implementation (SPI) Guidelines for an Islamic Banking Division, including a core capital ratio (CCR) of 4% and a risk-weighted capital ratio (RWCR) of 8%, statutory reserve and liquidity requirements, single-customer limits and disclosure requirements. They must maintain an Islamic Banking Fund of at least RM20 million (RM6 million for investment banks), allocated by the head office to fund IBW operations. IBW income may be paid as dividends to the parent's shareholders only if these minimum and RWCR requirements are met, and must otherwise be retained in Islamic banking.

17.2.4.2 Nigeria

In Nigeria, IBWs require a notional capital fund based on risk-weighted assets, a dedicated Islamic banking department, a separate account with the Central Bank of Nigeria, compliance with the framework for institutions offering non-interest financial services, the conventional minimum capital adequacy ratio, and investment in eligible Shariah-compliant instruments to meet the minimum liquidity ratio.

17.2.4.3 Pakistan

Pakistan permits both Islamic banking branches of conventional banks and windows within conventional branches, but actively favors dedicated Islamic Banking Divisions. Conventional banks must establish such a division and an Islamic Banking Fund, allocated by the head office (or country office for foreign banks), with minimum capital of Rs 50 million or 8% of the risk-weighted assets of Islamic operations, whichever is greater. Islamic operations must maintain a separate current account with the State Bank of Pakistan (SBP) for the cash reserve (currently 5% of time and demand liabilities) and, until Shariah-compliant approved securities are available, an additional 6% in cash for the Statutory Liquidity Requirement (SLR) — a weekly average of 11% and 10% daily.

17.2.4.4 UAE

The United Arab Emirates (UAE) requires a conventional bank with an IBW to maintain a separate Liquidity Coverage Ratio (LCR) for its Islamic operations, supported by a dedicated asset-liability management framework that ring-fences Shariah-compliant assets and liabilities, and to report separate LCR, Net Stable Funding Ratio (NSFR) and Eligible Liquid Assets Ratio

(ELAR) figures; where liquidity is managed separately, sufficient Shariah-compliant high-quality liquid assets must cover 30 days of net outflows.

17.3 Research Methodology

To assess the feasibility of conventional banks introducing IBWs, this study conducted a series of interviews and discussions with key stakeholders. These stakeholders included heads of Islamic banking at various conventional banks, project managers responsible for transforming conventional banks into Islamic banking entities, individuals involved in dual banking initiatives, operational executives, officials from regulatory bodies, Islamic banking consultants, and a select group of professionals in Islamic finance.

17.4 Findings and Discussion

17.4.1 Rationale for Introducing IBWs in Bangladesh

A bank's success depends on its products and the quality of its services, and Islamic banking offers conventional banks a way to retain existing customers and attract new ones, enrich their product mix and tap growing demand for Shariah-compliant services, which practitioners report is rising. Some banks adopt it to stop valued customers switching to Islamic providers, and it strengthens their competitive position.

Islamic banks can collect funds from conventional as well as Islamic sources, but cannot place funds with conventional banks or invest in conventional instruments. They can therefore attract deposits more cheaply and invest at lower cost, and because Islamic banking is closely linked to the rest of Islamic finance, it also gives conventional banks easy access to wider Islamic finance opportunities.

The entry of reputable conventional banks matters particularly in Bangladesh, where many full-fledged Islamic banks face liquidity shortages and reputational damage: such banks offer customers reliable alternatives, can deploy their excess liquidity in a Shariah-compliant way — supporting Islamic banks short of liquidity and investing in Islamic investment certificates (Sukuk) — and, by collaborating with Islamic banks, strengthen the wider Islamic banking ecosystem.

Islamic banks also generally outperform the wider banking industry. Growth through conventional banks may, however, provoke scepticism if the public doubts their intentions, which may explain why Bangladesh Bank's draft Islamic Bank Companies Act 2024 (IBCA) would prohibit branch- and window-based Islamic banking: such banks would have to choose between conventional and Islamic banking within six months of enactment and, if converting, complete the transition within three years (extendable by up to one year), or else establish Islamic banking subsidiaries with Bangladesh Bank's prior approval.

Replacing branches and windows with subsidiaries appears promising in theory and in Malaysia's experience, but would likely hinder Islamic banking in Bangladesh: Malaysia has a clear strategic vision for Islamic finance and a world-leading ecosystem, whereas Bangladesh lacks such a vision and has an underdeveloped, fragile ecosystem that must be built before drastic measures are taken.

Thirty banks now provide branch- or window-based Islamic banking, accounting for nearly ten percent of the sector's deposits and investments. Some are perceived as stronger than full-fledged Islamic banks in Shariah compliance, governance and service quality. They have become an attractive alternative while some Islamic banks face a crisis of confidence, and the awareness they create benefits full-fledged Islamic banks too.

Forced closure would waste the investment made in systems, technology and people and endanger the jobs of more than 1,500 employees, many of whom are unwilling to work in interest-based banking. Bangladesh Bank's reported rationale — parity between the two banking systems — has not been tested empirically for its effect on Islamic banking, and Bangladesh's large Muslim population is likely to prefer the expansion of Islamic banking to mere parity.

A provision for Islamic banking subsidiaries was added to the Bank Company Act in 2013, yet Bangladesh Bank continued to approve branches and windows without directing interested banks to form subsidiaries, and the provision was removed in 2023 for unclear reasons. Stakeholders ask why banks should bear the cost of these policy inconsistencies, and whether subsidiaries are realistic at all, given reports that Bangladesh Bank has discouraged some conventional banks' plans to convert, calls to reduce the number of banks, and little evident interest in forming subsidiaries.

Nearly all conventional banks' Islamic operations are too small to sustain the cost of a subsidiary, and the draft IBCA does not specify what a subsidiary must satisfy, leaving approval to the discretion of Bangladesh Bank officials. The aim should be to enhance and expand, not discontinue, branch- and window-based Islamic banking, with sufficient time, resources and infrastructure allowed for any complete transition.

At least 274 conventional banks in 55 countries offer window-based Islamic banking, and more operate virtual windows. The dual approach should therefore continue until the financial system as a whole becomes Islamic: both full-fledged and dual Islamic banking need improvement, but discontinuing the dual system would be illogical, would deny customers a free choice, and could not be replaced by subsidiaries in the Bangladeshi context.

17.4.2 Regulatory Requirements for IBWs

A conventional bank can offer Islamic banking in several ways. It may convert into a full-fledged Islamic bank, as Export Import Bank of Bangladesh, First Security Islami Bank, Standard Bank and Global Islami Bank did, or form an Islamic subsidiary under Section 26 of the Bank Company Act 1991 — a route no bank has taken and which a later amendment repealed, although the draft Islamic Bank Companies Act includes it.

It may also operate as a dual bank, opening a new branch dedicated to Islamic banking (as AB Bank did), converting an existing branch (as Bangladesh Commerce Bank did) or offering Islamic services through windows in designated conventional branches (as Standard Chartered Bank does). Each requires separate approval from Bangladesh Bank; given its reluctance to allow foreign banks additional branches, windows or branch conversions are the more viable options.

Bangladesh Bank's permissions differ between the two main approaches. Dedicated Islamic branches are provided for in the 2009 Islamic banking guidelines, whereas windows appear in neither the Bank Company Act 1991 nor the 2009 Guidelines, and permitting them is an internal matter for Bangladesh Bank. The two systems compare as follows:

a. **Regulatory preference:** Bangladesh Bank has expressed no formal preference; its stance varies with the officials involved, and it currently allows both approaches.
b. **Capital requirement:** unlike a subsidiary, neither approach requires separate capital; banks meet risk-based capital requirements for their whole portfolio, and none has kept separate capital for its Islamic operations.
c. **Infrastructure requirement:** branch specifications are similar for conventional and Islamic banking, while windows, operating within a branch, need less. Bangladesh Bank typically expects separate entry and exit points and dedicated staff for Islamic customers, and requires separate fund management, but not separate vaults.
d. **Source of funds:** Islamic operations usually begin by mobilizing deposits, but stakeholders recommend that banks allocate a dedicated fund to the Islamic banking division as its equity, consistent with its operating as "a bank within a bank".
e. **Manpower requirement:** both systems should have dedicated staff with Islamic banking knowledge or experience — practice varies among banks — and a dedicated branch needs more staff than a window.
f. **Head office setup:** there is no significant difference. Under the 2009 Guidelines, local banks must establish an Islamic Banking Division at the head office (foreign banks at their country office), submit its organizational structure, with the qualifications and Islamic banking experience of senior executives, to Bangladesh Bank, and staff it adequately under a senior head accountable to the CEO.

Both approaches require a Shariah Supervisory Committee (SSC), staff training, Cash Reserve Requirement (CRR) and SLR compliance, internal Shariah audit and a Shariah-compatible Information Technology (IT) solution, and both offer the same range of services. Customers, however, tend to feel more comfortable with a separate branch, which clearly distinguishes Islamic from conventional services, although a standardized window setup, as at Bank Asia, can narrow the gap.

Bangladesh Bank typically approves a specific number of designated branches or windows, but some banks, such as The City Bank, serve Islamic banking customers across all their branches through an Information and Communications Technology (ICT) platform, recording and reporting transactions through the designated outlets. Bangladesh Bank is thought unlikely to endorse all services — particularly financing — through non-designated outlets, and some banks have opened Islamic banking service desks in them.

Section II(B) of the 2009 Guidelines (BRPD Circular No. 15 of 9 November 2009) sets the prerequisites for a conventional bank's Islamic branches: financial strength — capital base, capital adequacy, earnings record, liquidity, prudential compliance, credit discipline and service quality — and the needs of the proposed service area, together with a CAMEL rating of 1 or 2 at the latest on-site inspection without significant adverse findings. Applicants must submit documents on establishing an Islamic Banking Division at the head office, segregating

Islamic funds and keeping separate accounts, and must be ready to comply with these requirements when operations begin.

17.4.3 Process Flow of Launching IBWs

Based on the interviews conducted, Table 17.1 provides a process flow for launching IBWs. The process is the same for branch-based and window-based permissions granted by Bangladesh Bank to conventional banks.

Table 17.1: Process Flow of Launching IBWs

Step	Details
1	Generate proposals for initiating Islamic banking operations at the institution and assign foundational responsibilities to an executive. An Islamic banking consultant may also be engaged to conduct preliminary groundwork.
2	Conduct preliminary groundwork, including a feasibility study for the proposed Islamic banking branches or windows, considering customer demand, existing Islamic banking branches of other institutions, and the potential for Islamic banking deposits and financing. Present the findings to the Management Committee (MC) for deliberation.
3	Engage in discussions within the MC and formulate recommendations for the Board of Directors (BoD) regarding the initiation of Islamic banking.
4	Present the decision on initiating Islamic banking to the BoD and secure a formal resolution.
5	Apply to the Banking Regulation and Policy Department (BRPD) of the Bangladesh Bank for establishing Islamic banking branches or windows. The application should include supporting documentation, including the BoD resolution endorsing the initiation of Islamic banking operations.
6	Forward the application to the Licensing Unit under the BRPD for evaluation, supervised by an Additional Director.
7	Assess the application by a team from the BRPD (Licensing Unit and/or Islamic Banking Cell) according to the provisions outlined in the Bangladesh Bank Guidelines (BRPD Circular No. 15/2009), identifying specific conditions that must be met to obtain an Islamic banking license.
8	Issue a letter, considered primary consent, from the Bangladesh Bank to the institution, instructing compliance with a set of requirements and the submission of a new application along with supporting documentation after fulfilling those requirements.
9	Initiate an Islamic banking project at the institution and assign responsibilities to an executive or an Islamic banking consultant, depending on the bank's in-house capabilities.
10	Prepare an appropriate organogram for establishing the Islamic Banking Division at the head office and implement it accordingly.
11	Compile a comprehensive list of Islamic banking products and services to be provided.
12	Draft the necessary documents by the assigned executive and/or Islamic banking consultant. The documents should include but are not limited to, the Islamic banking operational manual, the Product Program Guidelines (PPG), contract documents and forms for all proposed deposit products, financing products, and other activities and services, and documents related to fund management.
13	Constitute a competent Shariah Supervisory Committee (SSC) along with the by-laws governing the committee.
14	Undertake Shariah vetting of all drafted documents by the SSC or a sub-committee of the SSC.

Step	Details
15	Apply to the BRPD for final approval of a specified number of Islamic banking branches or windows. This application should include supporting documents such as a list of products and services to be offered, the operational manual for Islamic banking, draft PPGs and fund management policy, the organogram of the Islamic banking and its staffing status, the status of human resource development, the status of the SSC, the profit distribution mechanism for depositors, a commitment to prepare separate financial statements for Islamic banking operations, and the feasibility report for the branches or windows, among others.
16	Evaluate the application and all supporting documents by the designated Bangladesh Bank team.
17	Gather information from various units of the Bangladesh Bank and evaluate it (CAMELS, adverse comments/non-compliance, etc.) to formulate recommendations for the higher authority regarding approval.
18	Initiate a note by the BRPD Team to secure approval from the higher authority of the Bangladesh Bank (through the regular channels up to the Governor).
19	Issue final consent by the Bangladesh Bank based on the Governor's approval, detailing specific conditions and indicating deadlines for the launch.
20	Develop existing manpower and, if necessary, recruit external experts from the market by the concerned bank.
21	Prepare a list of requirements for the project (Request for Proposal) for acquiring Islamic banking software.
22	Solicit tenders based on the Request for Proposal.
23	Select an appropriate vendor.
24	Prepare branches or windows in accordance with Bangladesh Bank approval, including structural and interior arrangements, deployment of personnel, and preparation of the vault room (separate or in conjunction with conventional banking).
25	Formulate a strategic plan for ensuring the sustainability of the Islamic banking operation in parallel with or surpassing the conventional operations of the bank, focusing on target customers, target products and services, an appropriate portfolio for Islamic banking, its achievement process in relation to the conventional segment, expected market share, and anticipated profit.
26	Install Islamic banking software (i-CBS) and integrate it with the conventional core banking system (CBS).
27	Establish an Al-Wadiah (or Qard) current account with the Bangladesh Bank for the Cash Reserve Ratio (CRR) and other settlements between the bank and the Bangladesh Bank.
28	Launch Islamic banking operations in selected branches or windows immediately for deposit products and within seven days for financing products.
29	Report to the Bangladesh Bank within 15 days of the launch of Islamic banking.
30	The Bangladesh Bank will conduct a special on-site inspection to ensure compliance with the stipulations provided by the Bangladesh Bank, re-evaluating information from the relevant bank and reviewing real-time data for compliance verification.
31	Provide ongoing training to ensure that the Islamic banking operation remains profitable and sustainable.

Source: Interviews.

Some of these steps are further elaborated below.

17.4.3.1 Identification of the Customer Segments

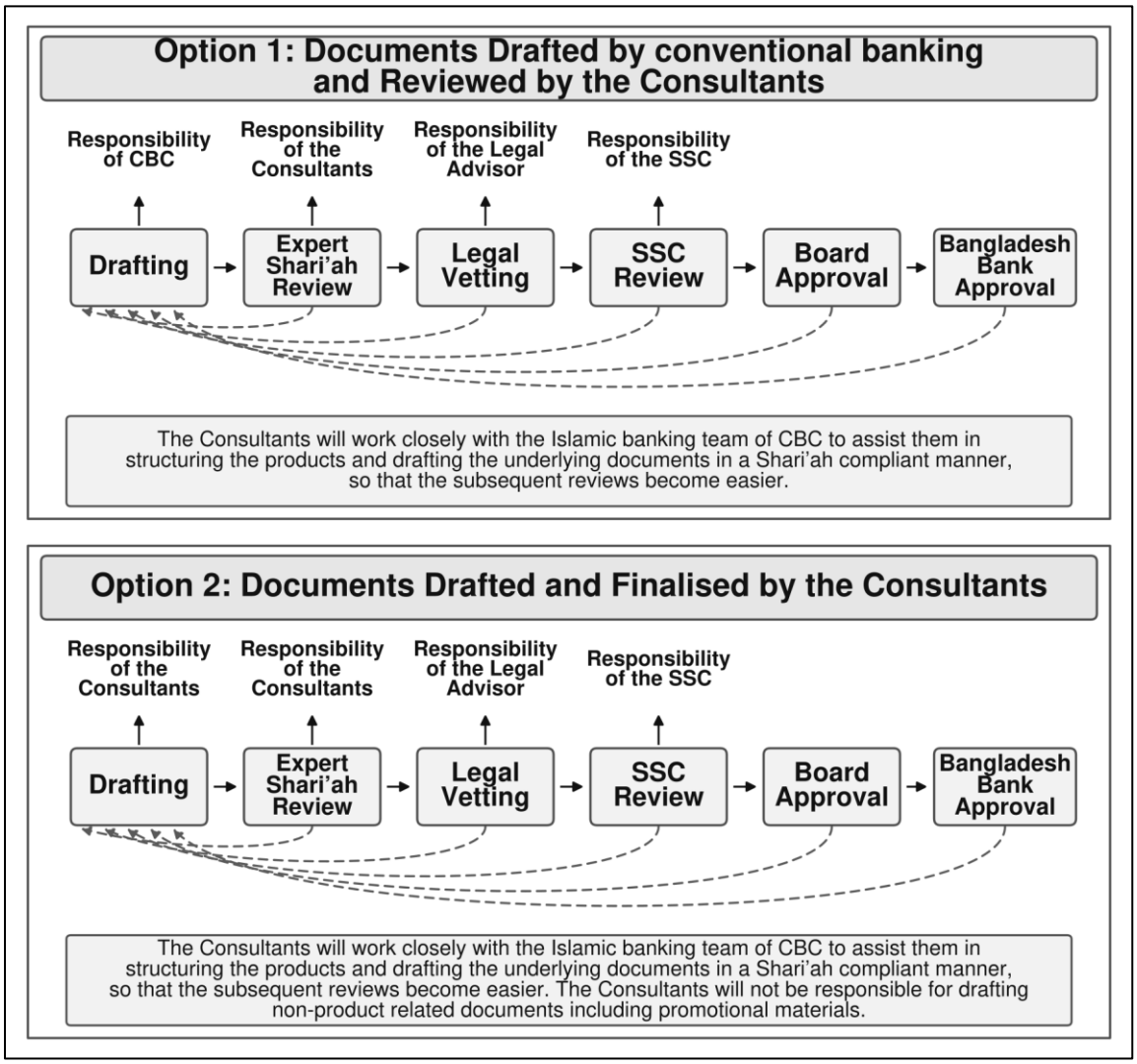
A bank must first identify its target customer segments and the Islamic products they need, and draft a Product Program Guideline (PPG) for each, covering the Shariah structure, terms and conditions, product features and accounting treatment. Deposits are typically based on Qard and profit-sharing partnership (Mudarabah) and financing on lease (Ijarah) and Hire Purchase

under Shirkatul Melk (HPSM), but there is scope for innovation, depending on customers' needs and management's appetite for it.

17.4.3.2 Drafting of PPGs

Two recommended approaches to drafting PPGs are shown in Figure 17.1. The Shariah structure and documents must meet Bangladesh's Shariah and regulatory requirements, which may differ from the standards and interpretations of other countries. Banks often expect the SSC to rewrite substandard PPGs, which has proved ineffective and leaves documents weak; the SSC works far better when it receives high-quality drafts. Banks also need an Islamic banking manual and related operational procedures, which should be prepared using one of these approaches.

Figure 17.1: Recommended Approaches to Drafting the PPGs



Source: Interviews.

17.4.3.3 Establishment of the Shariah Supervisory Committee (SSC)

The bank must establish an SSC of prominent Shariah scholars, mostly or wholly from Bangladesh; including Islamic banking experts improves its deliberations, while management should attend only as observers or to answer queries, not as members. Ideally the SSC should have at least five members, with a majority — including the chairman — from a Shariah background, and meet at least every two months (more often before launch), for up to two hours per meeting, under a by-law. Its supervisory role includes vetting all Islamic banking documents, promotional materials and accounting and financial reporting, and reviewing the Islamic banking IT solution before and after implementation.

17.4.3.4 Core Banking Solution Used for Islamic Banking

There are several core banking solutions available in Bangladesh. While management has the discretion to choose the solution provider, it is crucial to recognize that not all providers have the necessary controls to ensure Shariah compliance for Islamic banking activities. Notably, only Millennium Information Solution Limited has established a Shariah Advisory Committee for its Islamic core banking solution.

17.4.3.5 Capacity Building

Staff must understand Islamic products thoroughly, or they may present them in a conventional manner and compromise Shariah compliance. Before launch, the bank should provide at least two days of training for top management, 50 hours for staff directly engaged in Islamic banking and 20 hours for other staff, nominate some officials for specialized national and international programs, and possibly report its readiness to Bangladesh Bank.

17.4.3.6 Strategic Planning in Deposit Collection

The rate of return on Islamic banking deposits depends on the actual performance of investment and financing activities. Therefore, it is crucial to avoid excess idle deposit funds. Management should proactively identify investment and financing opportunities to ensure depositors receive attractive returns. There is also a significant opportunity for conventional banking to innovate in mobilizing its funds, for example, by introducing new products or participating in syndicated financing.

17.4.3.7 Assurance Regarding Shariah Compliance

Ensuring Shariah compliance is not enough; stakeholders must also be assured of it, through promotional materials, disclosures, awareness initiatives and informed handling of customers' queries.

17.4.3.8 Size of the Islamic Banking Portfolio

Cost-effectiveness requires integrating Islamic products within the conventional framework. Islamic windows face intense competition from full-fledged Islamic banks with strong Shariah foundations and must adopt competitive strategies to remain viable (Ali et al., 2021). Market discussions suggest that a dual bank benefits from a substantial Islamic portfolio — around 10 to 25% of its overall operations — which lets it tap the Islamic finance market without compromising the stability of its conventional business, harnessing the synergies between the two while promoting inclusion and profitability.

17.5 Conclusion

Islamic banking windows (IBWs) offer Islamic products within conventional banks rather than as separate legal entities, which complicates compliance and reporting and, together with the central bank's limited capacity to supervise Islamic banking, raises questions about integrity, stability and confidence. Some experts argue that banks should first be licensed as Islamic banks.

Bangladesh Bank temporarily halted new Islamic banking licenses for conventional banks and, on resuming them, imposed stringent Shariah compliance conditions to ensure commitment to Islamic principles and reinforce the sector's credibility, while recognizing growing demand. A substantial Islamic portfolio lets a dual bank diversify, serve a broader customer base and capitalize on the ethical and inclusive principles of Islamic finance.

Conventional banks should therefore be encouraged to offer Islamic banking, meeting the needs of customers who prefer ethical, faith-based finance, under a licensing approach that ensures transparency and adherence to Islamic principles from the outset. IBWs could also become fully or partly owned subsidiaries once they reach a threshold of assets and regulatory capital, streamlining operations and supervision.

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Appendix: Findings and Recommendations

Study	Key Findings	Recommendations
Part I: Foundations and Development		
Study 1 **(Published in 2025)** *Islamic Banking Operations in Bangladesh 2024* Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Emon Arefin	• Bangladesh's Islamic banking sector is systemically important and ranked tenth in two global indices, but the wider system remains bank-centered and weak in research, knowledge, awareness, international visibility, funds, Takaful and Sukuk depth. • Growth in 2024 was uneven: branches and windows expanded faster than deposits, while full-fledged-bank deposit and remittance growth, sectoral CSR, financing share and earlier profitability and asset-quality advantages weakened amid crisis conditions. • Financing remains concentrated in Murabahah, Bai-Muajjal and HPSM, while participatory modes, agriculture, rural deployment, housing and customer-specific products remain underdeveloped; Mudarabah funding also creates displaced-commercial risk and fixed-return expectations. • Staffing, product governance and research are weak: specialist executives, scholars, training, product reviews, research departments, databases and market surveys are insufficient. • SSC banking expertise, training, meeting frequency, fatwa publication and secretariat support are limited; Shariah-audit coverage is uneven, external assurance is absent and depositor representation is missing. • Accounting and capital treatment are fragmented, with mixed Basel/IFSB practice and inadequate recognition of displaced-commercial, equity-investment and Shariah non-compliance risks.	• Adopt a national roadmap and a principle-based Islamic banking law, led by a strengthened Bangladesh Bank Islamic-finance department, advisory body and expert reform committees with consistent supervision and specialized dispute resolution. • Require periodic SSC review of contracts and products; strengthen SSC dual competence, authority, evaluation and CPD; create certified adviser panels and bank-level Shariah research wings. • Mandate independent external Shariah audit and rating, strengthen internal audit, disclosure and whistle-blowing, and build a bank-wide compliance culture. • Phase in AAOIFI accounting and an IFSB-aligned capital framework covering displaced-commercial, equity-investment and Shariah non-compliance risks, with stress testing and risk-management requirements. • Reform boards through competence, independence, depositor representation, controlled ownership concentration and accountability; use cautious, Shariah-sensitive merger, recovery and resolution processes. • Provide Shariah-compliant crisis liquidity, accelerate recovery of existing investments, deepen the Islamic money market and government Sukuk, and enable retail access, secondary trading and longer-term funding. • Expand participatory, long-term deposit, cash-assistance, Waqf, social-business, rural and pension products and strengthen product, technology and market-research capacity.

Study	Key Findings	Recommendations
	• Dual-bank operations face weak senior commitment, shared staff and competing targets, unclear cost allocation, conventional core systems and a tendency to prioritize profit over compliance. • Liquidity stress, irregular and non-performing investments, withdrawal restrictions and governance failures have damaged trust; compulsory mergers and unclear resolution rules may add risk if Islamic-bank characteristics are ignored.	• For dual banks, clarify executive accountability, Islamic-head status, KPIs, cost allocation, staffing and core systems; resolve the source's competing window-continuation and phased-conversion proposals through explicit evidence-based policy. • Expand professional qualifications, school and university curricula, scholar industry attachments, academia–industry collaboration and recognized Islamic-bankers' forums.
Study 2 **(Published in 2017)** *Issues and Challenges for Islamic Finance and Banking in Bangladesh in the Perspective of Global Development* Md. Alamgir, Md. Mahabbat Hossain and Nur Al Faisal	• The study's mainly 2013–2014 evidence showed growth and comparatively favorable profitability, capital and asset quality, supported by broad faith-based and non-Muslim demand, but customer orientation remained uneven. • Bangladesh lacked a dedicated Islamic finance Act, central-bank department and Islamic-specific supervisory and risk framework; unsuitable conventional laws increased cost and constrained contracts. • Institutional Shariah supervision is fragmented, bank-level rulings can conflict and central oversight lacks authority and autonomy; accounting is not comparable and AAOIFI standards remain voluntary. • Refinancing and the Islamic interbank fund market were largely inactive, while short-term placements, government instruments, equity institutions, secondary markets and risk-management tools remained inadequate. • Limited financial engineering, banker and scholar expertise, management training and research compound moral hazard, costly monitoring, default-compensation and legal, liquidity, fiduciary and displaced-commercial risks.	• Create a functional institutional framework, enact a dedicated Islamic finance and banking Act and comprehensive guidance, and amend dispute-resolution law for Islamic contracts. • Establish a dedicated Bangladesh Bank department and autonomous central Shariah board with binding, research-capable shared services for smaller banks and windows. • Harmonize and enforce country-adapted AAOIFI accounting, audit, governance and Shariah standards while retaining common prudential rules only where genuinely suitable. • Expand specialized banker and scholar education, training centers, research and curricula, and prioritize consumer financial literacy and service quality. • Apply equal treatment to Muslim and non-Muslim staff and customers and develop Shariah-sensitive customer-due-diligence requirements. • Activate Islamic interbank and refinancing arrangements; develop Sukuk, Takaful support, liquidity, equity, secondary-market and risk-management instruments. • Increase agriculture and small-enterprise finance and promote Mudarabah, Musharakah,

Study	Key Findings	Recommendations
	• Surveyed stakeholders reported weak law, institutions, supervision, customer service, education, interbank cooperation and uniform Shariah practice, with negligible profit-and-loss sharing finance. • Agricultural finance was low and declining, whereas MSME finance was already the largest sectoral exposure; recommendations therefore concern further small-enterprise expansion, not an absence of SME finance.	financial engineering and commercially viable risk-sharing. • Strengthen Bangladesh Bank–industry cooperation, institutional supervision, customer orientation and transparent, competitive depositor returns.
Part II: Products, Financing Modes and Pricing		
Study 3 **(Published in 2018)** *Product Diversification of Islamic Banks: Prospects and Challenges* Md. Alamgir, Md. Mahabbat Hossain, Md. Abdul Halim and Md. Mizanur Rahman	• Islamic banks have achieved scale and conventional-service comparability, but sale modes still dominate and an incomplete Islamic ecosystem restricts liquidity, risk-transfer, insurance and genuine risk-sharing products. • Investments were highly concentrated in real-estate security and trade and commerce, while agriculture, unsecured welfare finance and products for underserved groups remained limited. • Strong deposit, investment and remittance shares coexisted with large excess cash reserves, weak fee income and inadequate productive deployment — especially for agriculture. • Surveyed banks reported deposit- and investment-product deficiencies; full-fledged banks offered markedly more products than windows, with gaps in long-tenor, partnership, land, home, student, worker and low-income finance. • Foreign-exchange operations face forced-financing, foreign-interest and open-account export constraints, and Islamic windows often depend on conventional units.	• Develop short-term treasury and liquidity instruments, Shariah-compliant repo alternatives, an effective interbank fund market, risk-management products and an Islamic transaction benchmark. • Expand government, corporate and bank Sukuk for long-term funding and liquidity management. • Promote Diminishing Musharakah and other partnership modes through simpler processes, risk-sensitive pricing, legal support, commercial and Shariah screening and suitable social-finance linkages. • Introduce long-tenor Mudarabah, deposit-linked investment, investment-linked deposit, genuine pension and Islamic wage-earner products. • Expand agriculture, unsecured microfinance, land-purchase, longer-tenor home finance and products for students, garment workers and other underserved groups. • Develop cash-assistance, domestic and international factoring, securitization and compliant open-account export solutions, while resolving forced-financing and foreign-interest problems. • Establish research units, product databases and regular demand surveys; strengthen the legal

Study	Key Findings	Recommendations
	• Treasury participation was extremely limited: few banks used Islamic call money, virtually none used repo or reverse repo, and forward or swap activity was negligible. • Product-development capacity is weak — few research units, databases, demand surveys or pioneering products — alongside legal, central Shariah governance, scholar, training and AAOIFI-reporting gaps.	framework, central Shariah governance, specialist capacity, AAOIFI reporting and public communication.
Study 4 **(Published in 2023)** *Application of Murabahah Mode of Financing by Islamic Banks of Bangladesh: Issues and Recommendations* Md. Mahabbat Hossain, Md. Atiqur Rahman Khan Khadem and Mezbah Uddin Ahmed	• Murabahah and Bai-Muajjal represent about 70% of financing, but banks use inconsistent terminology, English-only contracts and unclear provisions on promises, permissible goods, cost, profit, insurance and disputes. • Cooked vouchers, fictitious sales, reuse of goods, settlement of old liabilities, artificial rollover or rescheduling and financing without actual products were reported. • Bank purchase, ownership, actual or constructive possession, separation of goods, offer and acceptance and document sequence are not consistently established. • Routine customer agency, direct credit to customer accounts and shifting pre-sale ownership costs and risks to customers increase fictitious-transaction and compliance risk. • Loan takeovers can pay conventional interest or create transactions without goods or prohibited Bai al-Inah; working-capital liabilities are sometimes refinanced through artificial HPSM or Ijarah structures. • Quotation and voucher mismatches, processing and LC fees, security deposits, direct costs and markup calculations lack consistent transparency.	• Do not execute all documents in one sitting; preserve the sequence of promise, bank purchase and possession and a later, separately evidenced sale. • Develop third-party purchasing agents and avoid routinely appointing or directly funding the customer as agent. • Apply zero tolerance to fictitious sales, repeated goods, rollover, artificial rescheduling and cash disbursement without goods; retain ownership risks and costs with the bank before sale. • Design compliant loan takeovers, prohibit Bai al-Inah and require genuine goods and post-sale inspection in refinancing and working-capital transactions. • Standardize Murabahah, muajjal and Bai Bithaman Ajil definitions and disclose goods, direct costs, fixed markup, fees, deposits, rebates, charity and compensation transparently. • Do not make early-settlement rebates contractual or customary, recognize force majeure and prevent impermissible compensation from becoming bank income. • Tailor pricing caps, classification, rescheduling, reporting and supervision to Islamic sale finance and implement AAOIFI-aligned financial reporting. • Provide continuing role-specific development for boards, SSCs, management and operational staff

Study	Key Findings	Recommendations
	• Early-settlement rebates risk becoming customary, charity and compensation may ignore force majeure or enter bank income, and directors, SSCs, management and staff lack combined Shariah and banking competence.	and periodically review all documents and processes.
Study 5 **(Published in 2023)** *HPSM Mode of Investment by the Islamic Banks in Bangladesh: Issues and Challenges* Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Atiqur Rahman Khan Khadem	• HPSM accounted for roughly one-fifth of financing, but nomenclature and the extent to which partnership rules apply remain unsettled, creating concerns over undertakings, risk allocation and predetermined transfer values. • Banks generally record HPSM as financing rather than owned Ijarah assets, contrary to its Shariah form and AAOIFI FAS 32. • English-only, inconsistently named contracts and even inappropriate application forms accompany commingled partnership, lease, promise and sale components without separately evidenced offer and acceptance. • Processing and documentation fees, collateral up to four or five times financing, insurance, repairs and other ownership costs and risks are often shifted excessively to customers. • Assets may be registered only in the customer's name despite co-ownership; equity contributions, title and gradual transfers are weakly evidenced and fixed face-value transfers can resemble capital guarantees. • Bilateral undertakings, early-settlement fees, advance installments, compensation, installment methods and unilateral dispute settlement vary and raise compliance concerns. • Customers may remain liable after asset destruction without negligence, while construction-period valuation gains, LC commissions and income	• Provide continuing practical training, recognized professional certification and reliable access to qualified Shariah scholars. • Separate and present the partnership, lease, promise and sale components transparently with valid, distinct offer and acceptance. • Recognize HPSM assets distinctly and establish clear, Shariah-consistent income-recognition rules aligned with AAOIFI FAS 32. • Document and account for every gradual ownership transfer and allocate risks, rewards, insurance, maintenance and damage according to actual ownership. • Justify valuations clearly and use stated fair value rather than mechanical construction-period accretion or guaranteed face-value transfer. • Revise and periodically review applications and contracts, identify every constituent agreement and rebalance security, fees, costs, undertakings and dispute terms. • Issue Islamic-specific regulation for returns, restructuring, penalties, waivers, registration, insurance, valuation, accounting and post-financing supervision fees.

Study	Key Findings	Recommendations
	recognition can conflict with ownership and fair-value principles.	
Study 6 **(Published in 2022)** *How Can Mudaraba and Musharaka Be More Effective in Bangladesh?* Md. Alamgir, Md. Mahabbat Hossain and Maksuda Khatun	• More than 95% of deposits use Mudarabah, yet only about 2% of financing uses Mudarabah or Musharakah and roughly 70% remains in fixed-earning Murabahah and muajjal modes. • Rural areas provide about 18% of deposits but receive under 6% of investment; agriculture, fishing, forestry and residential housing are materially underserved. • Fraud, information asymmetry, adverse selection, concealed profits, tax-evasion incentives, moral hazard, long lock-in and delayed returns deter participatory financing. • Banks are risk-averse and lack specialist teams, timely entrepreneur information, technical support and incentive-compatible covenants, and are reluctant to bear higher screening and monitoring costs. • Common circulars on extensions, stimulus and refinancing can conflict with participatory and sale-contract rules, while tax and legal disadvantages add cost. • Institutional gaps include an Islamic-investment information bureau, specialized court, central-bank Shariah audit and inspection, Shariah ratings, transparent accounting, tax reform and a commodity exchange.	• Create dedicated profit-and-loss sharing cells, trained teams and institution-specific guidelines aligned with AAOIFI and IFSB, and accept the monitoring resources these projects require. • Use long-term Mudarabah funds for participatory assets to reduce rate-of-return mismatch and mobilize additional long-term capital through participatory Sukuk. • Add Shariah compliance to CAMELS, reward sound participatory finance in the management rating and issue specialized reporting and, where appropriate, directed-finance guidance. • Strengthen entrepreneur screening, monitoring and technical support; use longer-term incentives and covenants that align entrepreneur returns with project performance. • Permit independent government or private guarantees and Takaful support without making the entrepreneur a prohibited capital guarantor. • Create dedicated health-sector funds and hospitals and channel Waqf, Zakat and Sadaqah through a Waqf bank and Islamic social businesses. • Establish the proposed investment-information bureau, specialized court, central-bank Shariah audit and inspection, Shariah rating, transparent accounting, tax reform and commodity exchange. • Design attractive agreements for skilled, honest entrepreneurs and expand participatory finance to rural, agricultural, housing and other underserved activities.

Study	Key Findings	Recommendations
Study 7 **(Published in 2025)** *Pricing of Islamic Banking Products in a Dual Banking Environment of Bangladesh* Md. Mahabbat Hossain, Md. Alamgir, Muhammad Amir Hossain & Mezbah Uddin Ahmed	• Islamic pricing is contract-specific — actual-performance Mudarabah returns, fixed post-contract Murabahah prices, possession before Ijarah rent, spot exchange and service-linked fees — yet common banking rules often ignore these constraints. • Sale modes dominate financing and Mudarabah dominates deposits; despite different contracts, 2023 financing rates had converged to 10.03% for Islamic banks and 10.02% for conventional banks, while Islamic interbank placements earned less. • Provisional depositor returns are permissible only when reconciled to actual fund performance; opaque Hibah, profit-equalization reserves and rate-matching promotions can recreate fixed-return expectations. • Reported trade-finance issues include changing a Murabahah price after execution, recognizing Salam or Istisna'a profit too early, uncertain rebates and HPSM rentals set without sufficient asset-specific valuation. • Participatory modes require risk-sensitive pricing, but regulation does not adequately distinguish them from low-risk sale modes; interbank Mudarabah and refinancing can also misallocate or obscure actual risk and return. • Fees and commissions lack consistent service-based guidance, while weak maqasid orientation, customer perceptions of limited distinctiveness and insufficient SSC autonomy reduce confidence in Islamic pricing.	• Issue Islamic-bank-specific pricing rules and supervision and strengthen the regulator's Islamic-finance competence. • Develop a Shariah-rooted benchmark and permit mode-sensitive pricing that reflects the different risks of sale, lease and participatory contracts, including sound refinancing risk allocation. • Reconcile depositor and interbank Mudarabah returns to actual performance and place Hibah, reserves and all profit-smoothing under active SSC control. • Prohibit post-contract Murabahah price changes and premature Salam or Istisna'a profit recognition; apply compliant rebates and asset-based HPSM rental and revaluation methods. • Disclose profit-calculation, smoothing, revaluation and rebate methods, and link every fee or commission transparently to an identified service. • Market Islamic banking through its contractual, ethical and maqasid value — not rates or questionable benefit promises alone — and strengthen SSC competence and autonomy.

Study	Key Findings	Recommendations
Part III: Islamic Capital Market		
Study 8 **(Published in 2021)** *Introducing Sukuk in Bangladesh: Key Issues* Mohammed Sohail Mustafa, Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Md. Abdullah Sharif	• The Islamic capital market remains embryonic: the older BGIIB largely recycled bank funds at low yields, although the BDT 8,000 crore sovereign Sukuk drew overwhelming demand and the BDT 3,000 crore Beximco issue opened the corporate market. • The first sovereign issuance benefited from government support and inter-agency cooperation, but officials initially lacked technical and operational expertise and no dedicated law clarified SPV, trust, trustee or transaction processes. • Corporate issuance faces higher trustee, transfer, governance and listing costs, weak investor understanding, issuer hesitation and an underdeveloped market. • Underwriters considered compensation inadequate — and underwriting fees raise Shariah questions — while heavy trustee duties and confusion between trustees and bankruptcy-remote SPVs discourage participation. • Each Sukuk requires transaction-specific documentation, yet combined technical and Shariah expertise is scarce, review time is compressed and SSBs lack a formal communication channel with BSEC. • Confidence depends on credible issuers, transparent high-quality assets and credible ratings; participation by Islamic banks, Takaful and other institutions remains below potential and Sukuk lacks distinct market branding. • BSEC's SPV rule conflicts with Bangladesh Bank's direct-issuance rule for bank capital instruments, while default responsibilities and specialized	• Build and retain multidisciplinary expertise through dedicated Sukuk units and technical committees across the Ministry of Finance, Bangladesh Bank, BSEC, NBR and market institutions, supported by education and research. • Adopt coordinated short-, medium- and long-term sovereign plans covering suitable projects, competitive pricing, retail access, transfer and trading platforms and redemption arrangements. • Use competent SSBs and technical support; disclose the Shariah basis, provide documents early, schedule systematic drafting and review and establish formal BSEC–SSB communication. • Enact dedicated sovereign and corporate Sukuk rules; clarify tax-neutral SPV and trustee roles, default responsibilities, investor protection and specialized judicial resolution. • Harmonize BSEC and Bangladesh Bank rules so financial institutions can issue genuine SPV-based Additional Tier 1 and Tier 2 Sukuk. • Reduce avoidable taxes, duties and fees; begin with appropriately sized issues from credible issuers using transparent assets, tailored structures and credible external ratings. • Broaden pension, insurance, Takaful, bank and retail participation; give Sukuk distinct branding and sustain coordinated investor education and market development.

Study	Key Findings	Recommendations
	dispute resolution remain unclear.	
Study 9 **(Published in 2025)** *Islamic Capital Market and Its Impact on Islamic Banks in Bangladesh* Md. Alamgir, Mezbah Uddin Ahmed, Md. Mahabbat Hossain and Mohammad Monirul Islam Sarker	• Regulatory progress has not overcome limited instruments, investors, risk-sharing, contractual clarity and market integration; BGIIB remains low-yielding, bank-funded and unsuitable for overnight liquidity. • Five government Sukuk financed public projects and attracted strong demand despite below-treasury returns, but Islamic banks remained the main investors and short-term and secondary-market options stayed limited. • Project selection, fund-use, progress, sustainability and socio-economic-impact reporting are weak; Bangladesh Bank administers issues with limited dedicated staff and fragmented government data. • Approved Additional Tier 1 and Tier 2 Mudarabah bonds showed weak secondary performance and material Shariah issues: benchmarked returns, guarantees, unclear loss-sharing, missing profit ratios, penalties and payment delays. • BSEC's Shariah Advisory Council had not vetted those bonds, and describing risk-sharing instruments merely as 'bonds' obscures their Sukuk or Islamic-securities character. • Tax and registration reforms enabled corporate Sukuk, but public subscription initially proved difficult and the corporate market remains shallow. • BSEC requires SPVs for Sukuk while Bangladesh Bank requires direct bank issuance for regulatory capital; bank-to-bank purchases recycle funds and leave short-term deposits funding long-term assets.	• Harmonize Bangladesh Bank and BSEC requirements for genuine SPV-based Additional Tier 1 and Tier 2 Sukuk. • Mobilize long-term retail and non-bank institutional capital — including Takaful, mutual, provident and pension funds — using competitive returns and suitable market-building incentives. • Select prominent income-generating government projects and publish periodic fund-use, progress, sustainability and socio-economic-impact reports with dedicated regulatory personnel and resources. • Use professional issue managers, issue short-tenor government Sukuk and place government instruments on organized platforms for liquidity, participation and price discovery. • Diversify corporate Sukuk, Islamic asset-backed securities and Shariah-compliant alternatives to zero-coupon bonds and preference shares. • Create an expert Shariah and financial screening team, perform periodic reviews and publish updated Shariah-index constituents regularly. • Correct mudarabah-bond returns, profit ratios, guarantees, penalties and payment terms; require BSEC Shariah vetting and designate the instruments accurately. • Strengthen public education, institutional training, governance, transparency, monitoring, enforcement and coordination among the Ministry of Finance, Bangladesh Bank and BSEC.

Study	Key Findings	Recommendations
	• Shariah-index screening, organized government-Sukuk trading, instrument variety, investor awareness, transparency, governance and enforcement remain inconsistent.	
Part IV: Risk, Liquidity and Crisis Management		
Study 10 **(Published in 2022)** *Risk Management in Shari'ah-Based Banking in Bangladesh* Md. Nehal Ahmed, Md. Alamgir, Md. Mahabbat Hossain, Mezbah Uddin Ahmed and Tofayel Ahmed	• By end-2021, Islamic banks held about BDT 4 trillion in deposits and BDT 3.5 trillion in investments and showed comparatively strong growth and performance, but financing remained concentrated in fixed-return sale modes. • Respondents viewed deposit-mobilization risk as lower but investment, operational, market and liquidity risks as higher; differences among scholars' rulings were themselves considered risk-relevant. • Recruitment, training, software and process constraints are substantial, alongside limited scholars, ownership risk and legal, accounting and ethical obstacles to participatory modes. • Mudarabah deposits can lower funding cost but create displaced-commercial and Shariah risk through marketing, capital or profit guarantees and profit-distribution practices. • Counterparty risk rises because rescheduling cannot generate extra return and compensation is disputed; Islamic credit insurance is scarce, although genuine asset-backing can reduce default risk. • Currency, equity-price and liquidity risk are hard to manage because permissible hedges, tradable instruments, secondary markets and attractive liquidity products are insufficient. • Most respondents favored Islamic-specific capital rules that recognize Shariah non-compliance; reporting, risk	• Recruit and develop competent, ethical personnel with Islamic-finance, technology and process skills, while broadening the scholar pool and strengthening relevant curricula. • Make boards and senior management accountable for Shariah and ethical conduct and require branches and windows to follow long-term strategies aligned across management and business units. • Invest in Islamic-specific risk, governance and financial-reporting R&D and introduce differentiated capital, asset-risk-weight and Shariah non-compliance guidance and uniform Shariah audit. • Deepen Sukuk, money and secondary markets and diversify Shariah-compliant treasury, hedging and liquidity instruments. • Innovate and refine products, expand universal market access and build stakeholder understanding of Islamic banking's accessibility and value. • Strengthen Shariah monitoring and supervision at both institutional and regulatory levels, supported by awareness, sound infrastructure and quality collateral. • Reform dispute-resolution and judicial arrangements for Islamic contracts and ensure conventional parent institutions properly support Islamic windows while preserving segregation and governance.

Study	Key Findings	Recommendations
	tools, board–management alignment and window infrastructure also remain weak.	
Study 11 **(Published in 2025)** *Operational Risk Management in Islamic Banks: Best Practices and Evaluation* Md. Mahabbat Hossain, Md. Alamgir, Md. Rabiul Karim, Md. Atiqur Rahman Khan Khadem and Md. Emon Arefin	• Severe 2024 deterioration — including negative capital adequacy, sharply higher classified investments and lower profit — was attributed primarily to operational-risk-management failure, not to the Islamic business model. • ORM governance is fragmented: few banks have standalone units, board review is limited and full implementation of the three lines of defense is uncommon. • Practice remains reactive and audit-driven; central loss-event data, KRIs, dashboards and regular scenario analysis are underused. • Vendor and cyber risks are weakly integrated, cross-functional coordination is rare, and formal risk-culture assessment and risk-linked incentives are limited. • Case evidence links distress to weak boards, political influence, collusive approvals, unethical culture, poor recruitment, process bypasses, cyber and data weaknesses, inadequate continuity planning, trade-based laundering and inconsistent enforcement. • Shariah non-compliance can arise across documentation, sequencing, collateral, pricing, systems, funding and disclosure; the intended '3-plus lines' model adds independent Shariah audit but is not consistently realized. • Product guidelines, process flows and systems are not always vetted or periodically reviewed; manual overrides, limited customer understanding, selective audits, skill shortages and pressure on auditors persist.	• Institutionalize ORM as an independent strategic function under the CRO with board review, Basel/IFSB-aligned frameworks, dashboards, KRIs, loss-event data and scenario analysis. • Treat Shariah non-compliance as a distinct integrated risk, create a dedicated CRO desk and automate checkpoints across products, execution, systems, audit and reporting; require SSC vetting of every guideline, SOP and system module. • Strengthen cyber resilience, data governance, vendor controls, incident response, business continuity and coordination among risk, audit and IT. • Reform recruitment and development through Islamic-finance and ethical screening, integrity testing, induction, CPD, qualifications, succession planning, rotation and mandatory leave. • Introduce independent external Shariah review, annual assurance and fiduciary ratings for Mudarabah depositors and investment-account holders. • Create a Bangladesh Bank Shariah Inspection Wing, modernize SNCR and audit rules, and use CAMELSS, Shariah KPIs, penalties, compliance-linked incentives and whistle-blower protection. • Give internal Shariah audit functional access to both the SSC and Board Audit Committee, move toward population-based automated coverage and expand SSC and Shariah-expert participation in governance and inspection. • Build Islamic-finance competence among boards, CEOs and committees; rationalize business targets, strengthen investment

Study	Key Findings	Recommendations
	• Regulatory templates, specialist inspection and Islamic-finance competence on boards, management, audit and supervisory teams remain insufficient; independent external Shariah assurance is absent.	controls and deliver national, institutional and customer awareness programs.
Study 12 **(Published in 2026)** *Liquidity Management of Islamic Banks: Bangladesh Context* Md. Mahabbat Hossain, Md. Abdul Karim, Md. Farid Uddin, Md. Emon Arefin, Md. Omor Faruq and A.K.M. Mizanur Rahman	• Post-pandemic surplus liquidity turned volatile and negative in 2023, driven by irregular and non-performing investments, slow recovery, withdrawals, confidence loss and too few Islamic liquidity instruments. • Surveyed full-fledged banks operated at or above the investment–deposit ceiling, while several windows held excess CRR, government securities and interbank placements, revealing sharply different liquidity positions. • Most respondents could meet CRR, SLR, LCR and NSFR, but limited Shariah-compliant high-quality liquid assets prevent equivalent efficiency and all wanted more SLR-eligible instruments. • Surplus deployment is constrained by low returns, limited issuance, tradability and settlement; BGIIB and government Sukuk have operational limits and the Islamic interbank fund market is widely viewed as ineffective. • Interbank placements raise recovery, transparency, fund-mixing and Shariah concerns because returns may be effectively pre-agreed rather than based on actual Mudarabah performance. • Capital-market deployment and central-bank deficit support are constrained by scarce instruments, yields and eligible collateral; only full-fledged banks had used the available deficit facilities. • Stakeholders identified gaps in overnight liquidity, Sukuk-	• Apply Shariah governance across placement, collection, collateral, profit, settlement, rollover and redemption; standardize agreements, manuals, checklists and disclosures and extend SSC and internal-audit review throughout treasury operations. • Publish a regular calendar of government and short-tenor Sukuk with varied maturities and secure electronic issuance, transfer, settlement and active secondary trading. • Calibrate SLR, LCR, NSFR and investment–deposit requirements to the availability and tradability of compliant instruments; set transparent competitive returns and align deposit pricing and smoothing with actual asset performance. • Create permissible earning arrangements for foreign-currency balances and develop foreign-currency funding support, including possible Islamic Development Bank (IsDB) cooperation. • Establish an effective overnight market and government-Sukuk-backed liquidity facility, and permit separately documented, discretionary and non-reciprocal Qard support without stipulated benefit. • Explore properly approved Salam or Istisna'a facilities for short-term support and separately contracted sale-and-leaseback structures for medium-term liquidity. • Strengthen coordination, treasury capability, forecasting, early-warning indicators, stress testing, contingency funding, governance,

Study	Key Findings	Recommendations
	backed support, foreign-currency facilities, independent Qard, short-tenor issuance, treasury oversight and transparent returns. • Case studies show that governance and reputational shocks can quickly become liquidity crises; ratios alone cannot replace confidence, credible communication, buffers, early warning, stress testing and contingency funding.	communication and depositor-confidence management. • Replace 'penal interest' for Islamic-bank reserve shortfalls with an appropriate regulatory sanction and avoid tightening prudential ratios before sufficient compliant instruments exist.
Study 13 **(Published in 2022)** *COVID-19 Pandemic: Challenges and Opportunities for Islamic Banking Industry of Bangladesh* Md. Mahabbat Hossain, Md. Abdullah Sharif, Md. Golzare Nabi, Md. Siddiqur Rahman and Kamal Hossain	• Pandemic directives created contract-specific Shariah conflicts: sale-finance extensions cannot add profit, while interest-based stimulus, refinance, subsidies, waivers, fixed rates and penalties do not map cleanly to Islamic contracts. • Because more than 70% of financing used sale modes, moratoria created income-timing mismatches, and absent profit-equalization and investment-risk reserves complicated Mudarabah depositor returns. • Banks faced staff illness, safety expenditure and pressure over allowances, salary cuts and jobs, alongside disrupted appraisal, documentation and monitoring that increased misconduct risk. • Deposit withdrawals, weaker new deposits and depositor livelihood shocks heightened displaced-commercial risk, while recovery pressure, asset-quality deterioration and opportunistic use of relief threatened solvency and capital. • The crisis reinforced the importance of health, agriculture, CMSMEs, environment, remittances, Qard Hasan, Zakat, Waqf and CSR as priority, inclusive and social-finance opportunities.	• Issue Islamic-specific rules for moratoria, stimulus, refinance, subsidies, waivers, pricing and penalties that preserve each contract's ownership, liability and profit rules. • Protect staff health and jobs through PPE, safe operations, appropriate allowances and skill retention, and build resilience through retained earnings and internal capital. • Develop profit-equalization and investment-risk reserves under SSC oversight and explain displaced-commercial risk and actual profit outcomes clearly to depositors. • Apply rigorous client selection, asset-based transaction integrity, monitoring and going-concern assessment; prevent fund diversion, artificial rollover and opportunistic use of relief. • Prioritize affected clients and health, agriculture, CMSMEs, environment and remittance services, and mobilize Qard Hasan, Zakat, Waqf and CSR for inclusive recovery. • Strengthen remote board and SSC oversight, audit software, MIS, secure digital infrastructure, cybersecurity, data controls and incident preparedness. • Maintain online and role-specific training, FinTech capability, product research, process redesign

Study	Key Findings	Recommendations
	• Virtual governance, supervision, audit, MIS, training and customer service became essential, but accelerated technology use intensified cyber, data and operational risks. • Conversions and new Islamic windows were delayed even as distressed clients required real-time guidance, product redesign and stronger values-based relationships. • The broader opportunity is a digitally enabled, socially responsive Islamic banking model that retains capable staff, protects customers and aligns recovery with real-economy and ethical objectives.	and real-time customer guidance and communication. • Continue sound conversion and window-development initiatives with regulatory clarity and practical support from established Islamic institutions.
Study 14 **(Published in 2020)** *COVID-19 and Risk Management for Islamic Banks: Proposal for the New Normal Scenario* Shah Md. Ahsan Habib and Md. Mahabbat Hossain	• Islamic-bank risk frameworks must be broader than conventional templates because transaction, equity-valuation, displaced-commercial, fiduciary, Shariah, ethical and environmental risks arise from their contracts and mandate. • COVID-19 intensified credit, liquidity, market, operational, cyber, financial-crime, moral-hazard and reputational risks, while reduced demand and income, trade disruption and potential non-performance threatened capital and solvency. • Bangladesh's debt-heavy Islamic portfolios made many pandemic effects resemble those of conventional banks and exposed sale-contract problems in moratoria, interest blocking, profit distribution and refinance. • Existing frameworks gave inadequate attention to environmental risk even though Shariah requires protection of natural order and the crisis strengthened demand for ESG, SDG and socially responsible finance. • Strategic communication and support are essential because	• Use integrated enterprise risk management within Shariah, with board-led strategy revision, frequent board and risk-committee review, reliable risk information, updated appetite metrics and contingency plans. • Develop an internal strategy for stimulus packages, direct scarce support to genuinely affected clients and update credit, cyber, crime and operational controls without pursuing irrational profit targets. • Consider profit-equalization and investment-risk reserves, meet domestic and international obligations, avoid unethical trade practices and protect reputational and country risk. • Use strategic communication, customer support and digital marketing to limit moral hazard, improve recovery incentives and preserve client confidence. • Mainstream environmental risk into every financing decision and Shariah review and support green recovery, inclusion, micro and small enterprise, agriculture and measurable SDG-aligned investment.

Study	Key Findings	Recommendations
	irrational profit targets, opportunistic borrowers, weak recovery incentives and unmet payment obligations can quickly erode customer trust and country reputation. • Digitization and FinTech create service and control opportunities but also cyber-fraud, money-laundering and new-payment-system risks. • Balanced debt- and equity-based products across assets and liabilities can absorb risk and distinguish Islamic banks; separate legislation is more defensible when the product basket is genuinely differentiated.	• Pursue secure digitalization — not digitization alone — with intensive cyber, AML, FinTech and financial-crime monitoring. • Rebalance assets and liabilities toward well-governed Mudarabah, Musharakah and Sukuk, strengthen independent SSC oversight including environmental risk and align any separate Act with genuine product differentiation.
Part V: Shariah Governance and Institutional Models		
Study 15 **(Published in 2026)** *Shariah Governance in Islamic Banks of Bangladesh: An Evaluation* Md. Mahabbat Hossain, Mezbah Uddin Ahmed, Md. Alamgir and Muhammad Habibur Rahman	• Formal Shariah governance structures exist, but practice often remains certification- and procedure-driven rather than a substantive system for preventing and correcting non-compliance. • SSC independence and authority are recognized formally, yet proactive review of high-risk and related-party investments, economic substance, follow-through and banking and financial competence remain weak and committees rely heavily on management information. • Internal frameworks, role boundaries and AAOIFI/IFSB alignment are unclear or inconsistently disclosed; regulatory supervision, enforcement and coordination with SSCs do not reliably close the policy–practice gap. • Shariah failures are intertwined with weak corporate governance — chair dominance, nominally independent directors, concentrated ownership, political or family influence and	• Restore genuinely independent, competent and accountable boards and SSCs through stronger fit-and-proper rules, balanced scholar–industry expertise, clear terms of reference and continuing development. • Align corporate and Shariah governance and define the simultaneous roles and reporting lines of the board, senior management, SSC, audit, risk and compliance functions. • Create a dedicated Shariah Compliance Unit as a target-free second line that implements SSC decisions, monitors products and processes, identifies non-compliance and reports to management and the SSC. • Make internal audit independent, population- and system-oriented and preventive, supported by on-site Muraqibs, off-site ICT surveillance, tracked remediation and staff with combined audit and Shariah skills. • Require independent external Shariah review and annual assurance and introduce fiduciary ratings and fuller non-compliance disclosure for investment-account holders.

Study	Key Findings	Recommendations
	blurred board–management–SSC accountability. • Governance architecture is fragmented: secretariats, audit and compliance lack status and independence, and many banks have no effective second-line Shariah compliance and risk function. • Internal audit is largely sample-based and post-facto, can face management pressure, self-censorship or suppressed findings, and is not complemented by independent external or SSC-led assurance. • Compliance breaks occur at approval, documentation, asset verification and disbursement; corporate-finance products, implicit deposit guarantees, nonstandard contracts and conventional-oriented core systems add risk. • Shortages of Muraqibs and dual-skilled staff, declining ethical orientation, weak whistle-blowing, 'yesmanship', documentation manipulation, inconsistent penalties and limited depositor protection undermine accountability and trust.	• Use institutional and employee Shariah KPIs, CAMELSS-type supervision, structured penalties, board accountability and protected whistle-blowing to reinforce compliance culture. • Apply principle-based regulation with consistent enforcement, clear policy–supervision responsibilities and stronger regulator–SSC coordination rather than reactive rulemaking. • Standardize products, contracts, accounting and disclosures; modernize Shariah-compatible systems and strengthen asset verification, documentation and depositor safeguards. • Deliver structured capacity building and awareness for boards, management, SSCs, auditors, operational staff and customers through simplified disclosures and continuing knowledge sharing.
Study 16 **(Published in 2025)** *Shariah Supervisory Committees in Bangladesh: Practices, Issues, and Policy Recommendations* Md. Mahabbat Hossain and Mezbah Uddin Ahmed	• All surveyed institutions had SSCs, but size and composition varied widely; some included board chairs, CEOs or business heads, had non-faqih chairs or majorities and disclosed membership incompletely. • Board or management appointment, executive participation and overlapping memberships weaken de facto independence, while competency mixes and even the committee's institutional status remain unsettled. • Some contracts, product program guidelines and advertisements are issued without prior SSC vetting, creating ex-ante compliance gaps.	• Establish a Central Shariah Supervisory Board under Bangladesh Bank with authority to issue binding guidance, harmonize practice and review institutional minutes and fatwas. • Prohibit executives and board members from SSC service, require conflict declarations and cap concurrent appointments. • Strengthen fit-and-proper criteria, maintain an appropriate majority of Shariah experts with complementary business expertise, assess members periodically and improve board competence. • Require SSC review of every product document, contract,

Study	Key Findings	Recommendations
	• Independent external Shariah audit is absent; internal coverage of branches, sub-branches and agent outlets varies and audit lacks a direct communication channel to the board. • SSC effectiveness depends on Islamic-finance competence and support from boards, management and committees, but structured interaction among these bodies is generally weak. • Fatwas and decisions are rarely published, disclosures are incomplete and formal assessment of committees and individual members is generally absent. • Some institutions meet too infrequently; agendas can be overloaded and poorly prepared, minutes do not attribute contributions, and remuneration is inconsistent and often inadequate for the expected work.	program guideline and advertisement before issuance. • Make internal Shariah audit report to the board or audit committee and introduce independent external Shariah audit. • Require at least quarterly meetings, papers seven days in advance, adequate deliberation, recorded dissent and contributions and suitable regulatory access to minutes. • Publish fatwas and decisions regularly and standardize annual disclosure of charters, composition, attendance, rulings, audit coverage and treatment of non-compliance. • Mandate CPD and formal evaluation, adopt role-appropriate retainer and meeting remuneration and encourage practitioner–academic research on SSC effectiveness.
Study 17 **(Published in 2025)** *Rationale and Process for Introducing Islamic Banking in Conventional Banks of Bangladesh* Mezbah Uddin Ahmed and Md. Mahabbat Hossain	• Islamic windows and branches meet growing customer demand, retain clients, broaden product mix and access the Islamic ecosystem; reputable conventional parents may also diversify funding and support liquidity and Sukuk investment. At December 2024, thirty conventional banks' Islamic operations held 11.66% of Islamic deposits and 7.57% of investments, demonstrating a material — though smaller — market role. • Public skepticism about intent, fund mixing, arbitrage and credibility requires a genuine bank-within-a-bank model and visible assurance of segregation and compliance. • Bangladesh's Islamic-finance ecosystem remains too fragile for abrupt abolition or a subsidiary-only model; closure could reduce access, strand	• Retain and encourage viable branches and windows under explicit legislation, transparent licensing, a strategic national ecosystem and close Shariah and prudential supervision; require evidence before any blanket abolition. • Enforce a bank-within-a-bank structure with segregated funds and accounts, defined capital and shared-cost allocation, dedicated staff and Islamic-banking functions and controlled branch, window and service access. • Require formal readiness assessment, CAMELS 1 or 2 eligibility, Bangladesh Bank inspection before or soon after launch and a clearly documented licensing and implementation process. • Identify target customers and products and prepare expert-vetted product guidelines, contracts, operating manuals and

Study	Key Findings	Recommendations
	systems and human-capital investment and jeopardize more than 1,500 jobs. • Bangladesh Bank policy has fluctuated, the legal framework does not explicitly define windows and small operations may not support subsidiary costs, despite wide international use of the model. • Readiness varies in capital allocation, fund and account segregation, shared-cost allocation, dedicated staff and Islamic-banking departments, SSCs, audit, reserve management and Shariah-compatible core systems. • Product and operational readiness requires clear customer segments, high-quality product guidelines, manuals and accounting — not reliance on SSCs to rewrite weak documents after the fact. • Sustainable operations also depend on staff and management training, credible IT and Shariah review, productive deposit deployment, innovative syndication, transparent public communication and a viable portfolio scale.	accounting treatments before launch. • Create an independent, balanced SSC—recommended at five or more members, led mainly by scholars with Islamic-banking expertise and no management members — to meet at least every two months and vet documents, marketing, accounting and IT. • Use a Shariah-compatible core system subject to pre- and post-implementation review, with separate reporting, reserve controls, internal Shariah audit and reliable compliance assurance. • Before launch, provide at least two training days for top management, 50 hours for direct staff and 20 hours for other staff, followed by continuing role-specific development. • Deploy deposits productively through innovation and syndication, communicate safeguards publicly, target a viable 10–25% Islamic portfolio and convert to a subsidiary once defined asset and capital thresholds make it sustainable.

Glossary of Key Terms

- **AAOIFI**: Accounting and Auditing Organization for Islamic Financial Institutions; the Bahrain-based standard-setter for Shariah, accounting, auditing, governance and ethics standards in Islamic finance.
- **Amanah**: Trust; property held in trust, giving rise to a fiduciary duty of safe custody.
- **Bai' (bay')**: Sale; the family of sale-based contracts underlying much of Islamic bank financing.
- **Bai-Muajjal**: A sale on deferred payment terms, widely used by Islamic banks in Bangladesh; the price may be paid in a lump sum or installments without disclosure of a cost-plus mark-up structure.
- **Bai-Salam**: A forward sale in which the price is paid in full at contract while the goods are delivered later; used mainly to finance agriculture and small producers.
- **Bangladesh Bank**: The central bank of Bangladesh and the primary regulator of the country's banking system, including its Islamic banking industry.
- **BGIIB**: Bangladesh Government Islami Investment Bond; a government instrument through which Islamic banks have historically placed surplus liquidity.
- **BIBM**: Bangladesh Institute of Bank Management; the national institute for training, research and education in banking, established by Bangladesh Bank and the country's banks.
- **CSBIB**: Central Shariah Board for Islamic Banks of Bangladesh; a voluntary apex body of Shariah supervisory bodies of banks offering Islamic banking services.
- **Diminishing Musharakah**: A partnership in which the bank's share in an asset is bought out by the customer in installments, so ownership passes gradually to the customer; the basis of the HPSM and Musharakah Mutanaqisah structures.
- **Displaced commercial risk**: The risk that an Islamic bank forgoes part of its own profit share to pay depositors a competitive return, transferring risk from investment account holders to shareholders.
- **Fatwa**: A considered religious ruling issued by a qualified Shariah scholar or board on a point of Islamic law.
- **Fiqh al-Muamalat**: Islamic commercial jurisprudence; the body of rulings governing transactions.
- **Gharar**: Excessive uncertainty or ambiguity in the subject matter or terms of a contract; prohibited in Islamic commercial law.
- **Halal**: Permissible under Shariah.
- **Haram**: Prohibited under Shariah.
- **Hibah**: Gift; a voluntary transfer made without consideration, sometimes given by banks on Wadiah or qard-based deposits at their discretion.
- **HPSM**: Hire Purchase under Shirkatul Melk; a composite mode combining partnership in ownership (Shirkatul Melk), lease (Ijarah) and sale (Bai'), by which the client gradually acquires the bank's share of an asset.
- **Ibra'**: A rebate voluntarily granted by the financier, typically on early settlement of a sale-based debt; it may not be a contractual right of the customer.
- **IFSB**: Islamic Financial Services Board; the Kuala Lumpur-based standard-setter issuing prudential and supervisory standards for Islamic financial services.
- **Ijarah**: Lease; the transfer of the usufruct of an asset for rent. In Ijarah muntahiyah bi al-tamlik (or Ijarah wa Iqtina), the lease ends in transfer of ownership to the lessee.
- **Investment account**: A deposit accepted by an Islamic bank, typically on Mudarabah principles, whose return depends on the outcome of the bank's investments rather than a promised rate.

- **Islamic window**: A Shariah-compliant banking operation — a dedicated branch or a window within conventional branches — run by a conventional bank alongside its conventional business.
- **Istisna'a**: A contract of manufacture or construction in which price and specifications are agreed in advance and the asset is delivered on completion; used for project and housing finance.
- **Kafalah**: Guarantee; an undertaking to answer for the obligation of another.
- **Maqasid al-Shariah**: The higher objectives of Islamic law — commonly the protection of faith, life, intellect, progeny and wealth — against which the substance of financial transactions is assessed.
- **Maysir**: Gambling or speculative games of chance; prohibited in Islamic commercial law.
- **Mudarabah**: A partnership in which one party (Rabb al-Mal) supplies capital and the other (Mudarib) supplies effort and management; profits are shared by agreed ratio while financial losses fall on the capital provider absent misconduct or negligence.
- **Mudarib**: The managing partner in a Mudarabah.
- **Murabahah**: A cost-plus sale in which the seller discloses cost and mark-up; in banking practice, the bank acquires a commodity at the client's request and sells it to the client at a disclosed profit, usually on deferred payment.
- **Muraqib**: A Shariah auditor or reviewer who examines an institution's transactions and documents for compliance with the rulings of its Shariah Supervisory Committee.
- **Musawamah**: A sale in which the price is negotiated without the seller disclosing cost and mark-up, unlike Murabahah.
- **Musharakah**: A partnership in which all partners contribute capital, profits are shared by agreed ratio, and losses are borne in proportion to capital.
- **Musharakah mutanaqisah**: Diminishing Musharakah; a partnership in which the client progressively purchases the financier's share until sole ownership is achieved.
- **Profit-sharing ratio**: The pre-agreed ratio by which profit is divided between the parties to a Mudarabah or Musharakah, or between an Islamic bank and its investment depositors.
- **Provisional profit rate**: The indicative rate at which an Islamic bank credits profit to investment depositors during a period, subject to adjustment when final results are determined.
- **Qard / Qard Hasan**: An interest-free loan; only the principal is repayable. Qard Hasan denotes such a loan extended as benevolence.
- **Rabb al-Mal**: The capital-providing partner in a Mudarabah.
- **Rahn**: A pledge of an asset as security for an obligation; used, for example, where Sukuk are placed under lien for liquidity support.
- **Rate of return risk**: The risk to an Islamic bank's earnings arising from movements in market rates of return interacting with the repricing characteristics of its assets and funding.
- **Riba**: Any stipulated excess over principal in a loan or debt, and unequal or deferred exchanges of specified ribawi commodities; the interest prohibition at the heart of Islamic finance.
- **Sadaqah**: Voluntary charity.
- **Shariah**: Islamic law as derived from the Qur'an and the Sunnah together with the recognized sources of jurisprudence.
- **Shariah audit**: An independent assessment — internal or external — of an institution's compliance with Shariah rulings and resolutions applicable to its activities.
- **Shariah governance**: The set of institutional arrangements — supervisory committees, secretariats, review, audit and disclosure — through which an Islamic financial institution ensures Shariah compliance.
- **Shariah non-compliance risk**: The risk of loss — including the loss of tainted income and of stakeholder confidence — arising from failure to comply with Shariah rules and principles.

- **Shariah Supervisory Committee (SSC)**: The body of Shariah scholars and experts charged with directing, reviewing and supervising an institution's activities for Shariah compliance; also styled a Shariah Supervisory Board or Shariah Committee.
- **Shirkatul Melk**: Partnership in ownership; joint ownership of an asset, the basis of the HPSM mode.
- **Sukuk**: Certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs, services or ventures; the Islamic capital-market alternative to conventional bonds. Common structures include Ijarah, Mudarabah, Musharakah, Wakalah, Salam and Istisna'a Sukuk.
- **Takaful**: Islamic insurance based on mutual assistance, in which participants contribute to a common fund used to indemnify losses.
- **Tawarruq**: A commodity-based arrangement in which an asset is bought on deferred payment and sold to a third party for cash; used, with debate, for liquidity management and personal financing.
- **Wa'd**: A unilateral promise; binding in many contemporary rulings, and the adhesive that binds composite structures such as HPSM.
- **Wadiah**: Safe custody; deposits accepted for safekeeping, repayable on demand.
- **Wakalah**: Agency; one party acts on behalf of another for a fee, used in investments, remittances and Takaful models.
- **Waqf**: An endowment of property dedicated in perpetuity, the income of which is applied to charitable or social purposes.
- **Zakat**: The obligatory alms levied on qualifying wealth of Muslims, one of the pillars of Islam.

About Authors

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Mr. Ahmed also serves the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Bahrain, in various capacities, including as a curriculum and examination reviewer, a working committee member, and a consultant. He has also been recognized as a Master Trainer by AAOIFI. Many trainers of AAOIFI Shari'ah standards use the illustrated learning materials prepared by him, which are among the most accessed resources on I-Fikr, ISRA's knowledge repository. He regularly provides training on various aspects of Islamic finance, particularly in Shari'ah, accounting, auditing, governance, sukuk, and industry practices. He has conducted training programs and presented research papers at conferences in Bangladesh, Bahrain, Brunei Darussalam, Indonesia, Iran, Malaysia, Oman, Türkiye, the UAE, and Uzbekistan. His earlier professional experience includes working in audit and assurance at a PwC network firm in Bangladesh. He is the first Bangladeshi to obtain AAOIFI's CIPA qualification and the first to hold both CIPA and CSAA qualifications. He is also a Member and Fellow of the Association of Chartered Certified Accountants (ACCA), UK. Mr. Ahmed completed his MSc in Islamic Banking and Finance (MIBF) at the Institute of Islamic Banking and Finance (IIiBF), International Islamic University Malaysia (IIUM), and holds a BSc in Applied Accounting from Oxford Brookes University, UK.

Kamal Hossain is a Senior Executive Vice President at Al-Arafah Islami Bank PLC with over 16 years of banking experience. He has a professional background as an FCA from ICAB, and holds certifications as a Certified Islamic Professional Accountant (CIPA) and Certified Shariah Advisor and Auditor (CSAA) from AAOIFI, Bahrain. Before joining Al-Arafah Islami Bank PLC, he was an Audit & Assurance Manager at K. M. Alam & Co.

He has extensive expertise in auditing, internal control, compliance, financial accounting, and branch banking operations. Mr. Hossain has held leadership roles such as Head of the Audit & Inspection Division, Head of Internal Control & Compliance, and CFO. Since 2011, he has conducted training on topics like internal audit, risk management, Basel-III, Shariah governance, and Islamic banking at prominent institutions in Bangladesh. He is actively involved in developing Islamic financial standards, serving on various working groups of AAOIFI, and has contributed to research on internal audit and Shariah banking, with publications in BIBM. Additionally, he has participated in committees within ICAB and has experience as a course facilitator for AAOIFI certification programs.

A.K.M. Mizanur Rahman is an accomplished professional in Islamic banking with three decades of experience in various financial institutions in Bangladesh. He has a diverse educational background in arts, science, and finance. Mr. Rahman obtained Dakhil and Alim certifications in 1984 and 1986, respectively. In 1990, he earned a Bachelor of Science (Pass) degree from Jagannath University College, affiliated with Dhaka University. In 1992, he obtained a Master of Arts in Mass Communication and Journalism from Dhaka University. In 2005, he obtained an MBA with a specialization in Finance from Darul Ihsan University.

Mr. Rahman began his banking career in 1996 as a Management Trainee Officer (MTO) at Social Islami Bank Limited. He has held various positions at Eastern Bank PLC, Islamic Finance & Investment Limited, AB Bank Limited, and Bank Asia Limited. Currently, he is a Senior Executive Vice President and Head of Islamic Banking at Eastern Bank PLC. He holds certifications from the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Bahrain, earning titles of Certified Islamic Professional Accountant (CIPA) and Certified Shariah Adviser and Auditor (CSAA) in December 2020.

Mr. Rahman is a resource person for the Central Shariah Board for Islamic Banks of Bangladesh (CSBIB), Bangladesh Institute of Bank Management (BIBM) and served as a guest lecturer in Islamic Banking and Finance at Jahangirnagar University. He is sought after by various banks and financial institutions for training programs. Mr. Rahman is involved in key industry working groups, including the Sukuk Technical Committee at Bangladesh Bank and the Commodity Murabahah Working Group at AAOIFI, demonstrating his dedication to advancing the field of Islamic finance in Bangladesh.

Md. Abdullah Sharif is a researcher and Islamic finance expert with over 27 years of professional experience in Islamic banking, Takaful, and Shariah governance. He serves as Senior Vice President and Head of Shariah Secretariat at City Bank PLC and is a member of the AAOIFI Education Board, Bahrain. His research interests include Shariah governance, Islamic banking regulation, Sukuk, Takaful, AAOIFI standards, and Fiqh al-Muamalat. He has contributed to policy development as a former member of the Islamic Banking Act Legislation Committee and the Shariah Advisory Board of Bangladesh Bank. He also played a pioneering

role in introducing Sukuk financing and AAOIFI's CIPA and CSAA professional qualifications in Bangladesh.

Mr. Sharif completed his M.Phil. in Islamic Microfinance from the University of Dhaka. He holds AAOIFI's CIPA and CSAA qualifications, in addition to an MBA, an MA (Islamic Studies), and Kamil (Hadith). He has authored research papers, delivered academic and professional training, and presented at national and international seminars on Islamic finance. His work bridges academic research with practical policy and industry applications, contributing significantly to the advancement of Islamic banking and finance in Bangladesh.

Md. Atiqur Rahman Khan Khadem is a senior Islamic banking professional with over 26 years of leadership experience in Shari'ah-compliant finance, product innovation, Branch banking and international banking operations. He currently serves as Senior Vice President and Head of the Financial Institutions Division at Islami Bank Bangladesh PLC, where he oversees global correspondent banking relationships, strategic alliances, and international treasury arrangements. Mr. Khadem has been accredited the Certified Shari`ah Advisor and Auditor (CSAA) fellowship from Bahrain-based AAOIFI. Apart from this, he holds Certified Expert in Risk Management (CERM) from Frankfurt School of Management and BIBM. He completed his M. Com in Finance from University of Dhaka. Later he obtained Commonwealth Executive Master of Business Administration (CEMBA). To further strengthen his professional skill, he has completed Post Graduate Diploma in Islamic Banking and Insurance from IIBI (UK), DAIBB from Institute of Bankers Bangladesh and Diploma in Islamic Banking (DIB) from IBTRA.

He also serves as a widely recognized trainer, researcher in Islamic finance. He has contributed extensively to professional capacity building through training programs, workshops, and academic engagements, and is a published author in reputed journals on Islamic banking and financial products. He regularly extends consultancies to Islamic banking practitioners in Bangladesh on Islamic banking matters, including product development and structuring, document review and training. He is an active voice in discussions on Islamic banking and finance policy and regulation in Bangladesh. He is a recipient of the "BAFF Award 2024," awarded by the Bangladeshi AAOIFI Fellows Forum (BAFF), for his contribution in Islamic banking and finance.

Muhammad Habibur Rahman is a seasoned Islamic banking professional with over two and half decades of experience in Islamic banking operations, Shari'ah governance, and audit. He currently serves as Senior Vice President and Head of Internal Shari'ah Audit Division at Islami Bank Bangladesh PLC (IBBPLC), the country's first and largest Shari'ah-based commercial bank. He joined the bank as a Probationary Officer in 2000 and has extensive experience in general banking, investment operations, and Shari'ah audit.

He holds Kamil (Hadith), B.A. (Hons.), M.A. in Islamic Studies, MBA, DAIBB, Diploma in Islamic Banking (DIB), Certified Islamic Professional Accountant (CIPA), and Certified Shari'ah Adviser and Auditor (CSAA) from AAOIFI, Bahrain. Mr. Rahman specializes in Shari'ah audit, Shari'ah governance, product development, policy formulation, and Shari'ah risk management. He has contributed to the development of Shari'ah-compliant banking products, manuals, and operational guidelines, and regularly writes on Islamic banking and

finance. He is the author of "Debit Card, Credit Card: Islami Dristikon (Islamic Perspective)." His international exposure includes visits to India, Nepal, Bhutan, Malaysia, Thailand, Bahrain, and Saudi Arabia.

Md. Farid Uddin, FCA, is an Executive Vice President & CFO of NCC PLC. Prior to this, he was Senior Vice President of Islami Bank Bangladesh PLC. He is a seasoned banking and finance professional with more than 13 years of experience in banking, audit, finance, taxation, treasury, risk management, and internal control. He has served in various leadership roles within the bank, including Chief Financial Officer, Head of Finance, and Head of Internal Audit. He obtained both his Bachelor of Business Studies (Honours) and Master of Business Studies in Accounting from Jagannath University with First Class distinctions.

A Fellow Chartered Accountant (FCA) by profession, he also holds internationally recognized certifications from the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), including Certified Islamic Professional Accountant (CIPA) and Certified Shariah Adviser and Auditor (CSAA). He possesses extensive expertise in Islamic banking, corporate governance, regulatory compliance, financial reporting, treasury management, and internal control systems. To further strengthen his professional skill, he has completed DAIBB and Diploma in Islamic Banking (DIB) from Institute of Bankers Bangladesh.



Certified
Islamic Banking and Finance Professional (CIBFP)
[Led by Global & Local Islamic Finance Professionals]

Admission going on for the Next Intake

Two Intakes in a year (January & July)

Background of the Program

Islamic banking and finance industry is growing faster than the conventional counterpart both in global and local context. In line with this, there is huge demand for a set of skilled people with technical and Shariah knowledge for expediting the growth and making the Bangladeshi banking and finance industry sustainable. Besides, all types of key stakeholders should have operational knowledge in Islamic banking and finance for working together for the development of our economy. Moreover, there is no sufficient scope for acquiring relevant knowledge in this area through the existing education system. To meet-up this indispensable need of the economy, BIBM as a national-level apex training institute, is offering a unique certification program designed to develop a competent resource pool.

Summary of the Program

A. Online Module (Duration 8 weeks)

Regulations, websites and reports of different national and international entities are main sources of the study. Expected study duration for this module are 50 hours. Objectives of the module are:

- To familiarize the candidates with the associated entities in local and global context;
- To acquaint the candidates with regulations and market status; and
- To gather primary knowledge for effective participation in the subsequent modules.

B. Classroom-based On-Campus Module (Duration 14 Weeks)

Face-to-face interaction, learning guide and lecture synopses are main sources of the study for this module. Subject matter experts will lead the sessions for 42 hours. Excluding class-room discussion, desirable study duration for this module is 85 hours. Objectives of the module are:

- To accustom the candidates about the operational aspects of Islamic banking and finance;
- To make aware the candidates about the Shariah aspects in process and mechanism of Islamic banking and finance contracts; and
- To inspire the candidates for continuous thinking about a sustainable and compliant banking and finance industry.

C. Virtual Interactive Session Led by Global Islamic Finance Professionals (Duration 6 weeks)

Virtual interactive sessions with global Islamic finance professionals for about 39 hours will upgrade understanding of the candidates. The candidates will achieve following objectives by spending 40 hours, in addition to the interactive sessions:

- To share international regulations and practices related with Islamic banking and finance;
- To equip the candidate for making contribution for the development of Islamic banking and finance industry of the country; and
- To enhance the confidence level of the candidates for working in international market place.

Target Group of the Program

Certified Islamic Banking and Finance Professional (CIBFP) [Led by Global & Local Islamic Finance Professionals] program is structured considering the need of the diversified stakeholders including:

- Professionals working in Islamic banking and finance institutions either full-fledged or dual;
- Professionals working in conventional financial institutions having interactions with Islamic finance entities;
- Executives of the regulatory bodies, academic staffs and researchers of different organizations;
- Job-seekers for widening the expected market.

Maximum 30 Participants per Intake

Evaluation Process:

Assignments, Quizzes, Presentation and Pen-Paper Based Final Examination

Methods:

Self-Study of E-Learning Materials, Lecture, Scenario Based Learning, Group Discussion, Open Discussion

For More Information

Certification Program Office
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Course Fee BDT 60,000 per participant

For Enrollment

For Objectivs Contents and Rules & Regulations

Bangladesh Institute of Bank Management

Plot No. 4, Main Road No. 1 (South), Section No. 2 Mirpur, Dhaka-1216

Bangladesh's Islamic banking industry has achieved scale well ahead of the institutional architecture required to sustain it.

This compendium brings together seventeen studies by the Bangladesh Institute of Bank Management (BIBM), conducted with colleagues from Bangladesh Bank, the industry and partner institutions at home and abroad. Drawing on surveys and interviews with the banks themselves, they record how Islamic banking is practiced in Bangladesh, where practice departs from precept, and where the gaps lie.

The editors have condensed more than seven hundred pages of original research into one volume, keeping each chapter's findings, tables and policy recommendations as its authors reported them. An appendix sets the findings of all seventeen studies side by side, and a glossary explains the Arabic and technical terms. It is written for regulators, bankers, Shariah scholars, researchers and students alike.

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