

# **HPSM Mode of Investment by the Islamic Banks in Bangladesh: Issues and Challenges**

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Issue No. 01

**Md. Mahabbat Hossain *PhD, DIB, CSAA, CIPA***

**Mezbah Uddin Ahmed *CSAA, CIPA, FCCA, MIBF***

**Md. Atiqur Rahman Khan Khadem *CSAA***

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### **Research Team**

**Md. Mahabbat Hossain** *PhD, DIB, CSAA, CIPA*  
*Associate Professor, BIBM*

**Mezbah Uddin Ahmed** *CSAA, CIPA, FCCA, MIBF*  
*Research Fellow, ISRA Research Management Centre, INCEIF University, Malaysia*

**Md. Atiqur Rahman Khan Khadem** *CSAA*  
*Vice President, Islami Bank Bangladesh PLC*



**Bangladesh Institute of Bank Management (BIBM)**  
Mirpur, Dhaka-1216, Bangladesh

## HPSM Mode of Investment by the Islamic Banks in Bangladesh: Issues and Challenges

- Editor** : **Md. Akhtaruzzaman, Ph.D.**  
*Director General, BIBM*
- Executive Editor** : **Md. Alamgir**  
*Associate Professor and Director (Training & Certification Program), BIBM*
- Research Team** : **Md. Mahabbat Hossain PhD, DIB, CSAA, CIPA**  
*Associate Professor, BIBM*  
: **Mezbah Uddin Ahmed CSAA, CIPA, FCCA, MIBF**  
*Research Fellow, ISRA Research Management Centre  
INCEIF University, Malaysia*  
: **Md. Atiqur Rahman Khan Khadem CSAA**  
*Vice President, Islami Bank Bangladesh PLC*
- Support Team** : **Md. Al-Mamun Khan**  
*Publications-cum-Public Relations Officer, BIBM*  
**Dipa Roy, Training Officer &**  
*Program Officer (Certification Program), BIBM*  
**Sumona Moqutadar Happy, Office Assistant &**  
*Program Associate (Certification Program), BIBM*  
**Md. Morshadur Rahman, Proof Reader, BIBM**  
**Nippon Chakma, Computer Operator &**  
*Program Associate (Certification Program), BIBM*
- Graphics & Illustration** : **Azizur Rahman, Computer Operator, BIBM**
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## Forewords

Islamic financial institutions employ various modes or contracts to meet the diverse financing needs of their customers. These modes are subject to specific Shari'ah and regulatory requirements. This Research Workshop Paper focuses exclusively on Hire Purchase under Shirkatul Milk, widely referred to as HPSM, a prevalent investment mode adopted by Islamic Banks (IBs) in Bangladesh.

The researchers engaged with Shari'ah experts, industry leaders, and business executives for insights and identified several issues in the application of this mode of investment. The preliminary findings of the research were presented on September 20, 2023 at a Research Workshop titled 'HPSM Mode of Investment by Islamic Banks in Bangladesh: Issues and Challenges'. Subsequently, the researchers addressed valuable comments and suggestions from esteemed panelists, participants from various banks, and academics who contributed to the workshop.

I am pleased to share this research with policymakers, practitioners, academics, and general readers. We hope this research will serve as a valuable resource for understanding the existing limitations in current practices and inspire the necessary initiatives for further improvement in this domain.

**Dr. Md. Akhtaruzzaman**

Director General

## Acknowledgment

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The research is based on a combination of primary and secondary data. We owe a debt of gratitude to the banking community in our country for their active participation and valuable input, which significantly contributed to the preparation of this research paper. We also thank Mr. Md. Shihab Uddin Khan, an Associate Professor and the then Director (Training & Certification Program) at BIBM, for his valuable opinions and constructive suggestions that guided this research.

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We appreciate the open and sincere support received from all individuals who played a role in advancing our research efforts. With deep gratitude, we recognize the collective efforts that have made this research possible.

**Md. Mahabbat Hossain *PhD, DIB, CSAA, CIPA***

**Mezbah Uddin Ahmed *CSAA, CIPA, FCCA, MIBF***

**Md. Atiqur Rahman Khan Khadem *CSAA***

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## **Executive Summary**

Hire Purchase under Shirkatul Milk (HPSM) is a prominent investment mode among Islamic banks in Bangladesh. This mode intricately combines various Shari'ah contracts, including Sharikat (partnership), Ijarah (lease), Bai' (sale), and the Shari'ah principle of Wa'd (promise). HPSM embodies the core values of Islamic banking by involving tangible asset financing, transcending mere paper transactions. Despite the advantages of HPSM, concerns have arisen regarding its alignment with Shari'ah requirements, both in terms of its structural framework and its practical implementation by Islamic banks.

This research aims to comprehensively evaluate the implementation of HPSM by Islamic banks in Bangladesh, exploring diverse approaches and comparing them with Shari'ah requirements. It seeks to scrutinize operational practices and assess compliance with Shari'ah requirements. The research delves into modes similar to or synonymous with HPSM, including Musharakah Mutanaqisah and Ijarah Muntahia Bittamleek.

The research methodology incorporates the identification of essential requirements established by authoritative bodies, content analysis of contract forms, focus group discussions, interviews with experts, and the collection of secondary data. The research findings are presented in tabular form and graphs.

The research team conducted a comprehensive analysis of HPSM agreements within Islamic banks in Bangladesh, revealing crucial aspects of these agreements, highlighting both commonalities and discrepancies among the forms used by different banks. It identifies several areas of concern, such as the application process for HPSM financing, imposition of processing fees, requirements for collateral security, documentation costs, insurance practices, asset registration, ownership-related risks, and compliance with Shari'ah principles. Recommendations are proposed to enhance transparency, adherence to Shari'ah principles, and the overall effectiveness of HPSM operations within the Islamic banking framework.



To ensure Shari'ah compliance and transparency, recommendations include human resource development, the separation of contracts underlying the HPSM mode, proper accounting practices, adherence to Shari'ah principles in asset ownership transfers, a clear rationale for asset valuation, regular contract and document reviews, and the formulation of distinct regulatory guidelines tailored to Islamic banking operations. These recommendations aim to strengthen the framework for HPSM and promote a more robust and Shari'ah-compliant environment within Islamic banking in Bangladesh.

# **HPSM Mode of Investment by the Islamic Banks in Bangladesh: Issues and Challenges**

## **1.0 Introduction**

Hire Purchase under Shirkatul Milk (HPSM) is one of the most popular investment (financing) modes adopted by Islamic banks in Bangladesh. This mode combines several Shari'ah contracts in its underlying structure, namely Sharikat (partnership), Ijarah (lease), and Bai' (sale). The Shari'ah principle of Wa'd (promise) is the adhesive that combines all these in a single mode of investment.

The underlying principles of HPSM are closely aligned with some of the essential value propositions of Islamic banking. For example, it involves financing a real asset and a mutual share of risks. In this mode, a fictitious or mere paper-based transaction is impossible, as the bank must co-own a tangible asset over the financing tenure and bear the risk of the investment in proportion to the ownership.

However, despite the positive attributes of HPSM and its wide adoption by Islamic banks in Bangladesh, there are concerns about its compliance with Shari'ah requirements. Some of these concerns are regarding the structural form of HPSM, and most others are in the application by the Islamic banks. For example, is it primarily a Musharakah contract or an Ijarah contract? If it is a Musharakah, then what form is it? Shari'ah prohibits income and capital guarantees in a Musharakah contract, which could be looked at flexibly in an Ijarah contract. Therefore, there could be an intentional effort to justify that this is an Ijarah instead of a Musharakah. This effort should not compromise any of the Shari'ah principles but should be based on acceptable Shari'ah-based arguments. There is also the issue of ownership transfer. As it involves a series of contracts during the financing period, there is a concern about executing the sale contracts while complying with the Shari'ah. The application of promise is another concern as it is essential from the Shari'ah perspective to differentiate between a promise and a contract. The appropriateness of the contract documents is among the most significant concerns surrounding HPSM. Financial reporting of HPSM that reflects the Shari'ah-based structure is another critical concern.

Given the significant market share and robust growth of Islamic banking in Bangladesh, it is pertinent and timely to comprehensively and objectively review these concerns. Such a review is a testament to the industry's commitment to compliance and transparency. It provides an opportunity for valuable insights and enhancements to emerge, ensuring the continued evolution of Islamic banking practices in Bangladesh.

This examination of HPSM holds promise for the Islamic banking sector and the broader financial landscape in Bangladesh. As the industry continues to play an increasingly vital role in the country's economic development, it becomes imperative to address these concerns, fostering a more robust, resilient financial ecosystem. Additionally, it serves as a crucial platform for academic and practitioner collaboration, promoting a deep understanding of Islamic finance intricacies and facilitating the development of innovative solutions to enhance the sector's sustainability and alignment with Shari'ah principles.

### **1.1 Objective and Scope of the Research**

The primary objective of this research is to comprehensively assess the implementation of HPSM by Islamic banks in Bangladesh. This research endeavors to discern and analyze the diverse approaches to HPSM application among these financial institutions. Additionally, it seeks to juxtapose these operational practices with the Shari'ah requirements provided by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and other reputed Shari'ah authorities. The specific objectives are as follows:

- i) to elucidate the Shari'ah 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 Shari'ah requirements.

The scope of this research encompasses an exploration of HPSM as a multifaceted financing mode, integrating elements of Musharakah, Ijarah, and Bai with a focus on asset-based transactions. Therefore, the research will delve into aspects related to Musharakah Mutanaqisah (diminishing Musharakah) and Ijarah Muntahia Bittamleek (capital lease) within the context of HPSM. Additionally, it will consider the alternative terminology used by Bangladesh Bank, such as Hire Purchase Musharakah Mutanaqasah (HPMM), instead of HPSM.

## **1.2 Research Methodology and Structure of the Research**

The primary objective of this research is to examine the application of HPSM by IBs in Bangladesh, ensuring adherence to Shari'ah principles throughout their operations. To achieve this objective, the research methodology incorporates several vital components.

The research identifies crucial criteria and guidelines outlined by authoritative bodies, including AAOIFI and other reputed Shari'ah authorities. These standards serve as a foundational framework for evaluating HPSM practices within IBs.

The researchers conducted a comprehensive content analysis of relevant contract forms used in HPSM transactions. This analysis encompasses all full-fledged IBs in Bangladesh and provides insights into these contracts' structural elements and compliance with Shari'ah principles. The research team engaged in focus group discussions (FGDs) with business executives and Shari'ah experts to gain valuable insights and validate collected data. These discussions serve as a forum for addressing critical issues related to HPSM within the context of Islamic banking in Bangladesh. In-depth interviews are conducted with experts in the field of Islamic finance. These interviews offer different perspectives on the HPSM application, shedding light on industry-specific intricacies and challenges.

A comprehensive secondary data collection draws from national and international publications. Notable international sources include the Islamic Financial Services Industry Stability Report of the Islamic Financial Services Board (IFSB), the Islamic Finance Development Report of Refinitiv, and the Global Islamic Finance Report (GIFR) by Edbiz Consulting, among others. Locally, data is sourced from annual reports of concerned Islamic banks, the Financial Stability Report, the Quarterly Report on Islamic Banking published by Bangladesh Bank, and publications from the Bangladesh Institute of Bank Management (BIBM).

To analyze numerical data, the research employed some simple tools. The findings are presented in tabular forms and graphs, facilitating a clear and concise representation of quantitative information. This multi-faceted methodology ensures a robust and comprehensive assessment of HPSM application by Islamic banks in Bangladesh, with a keen focus on compliance with Shari'ah principles and industry standards.

The research paper is organized into four sections for clarity and coherence. Section 1 delves into the research's background, objectives, scope, and methodology. Section 2 offers an extensive literature review, encompassing the conceptual dimensions of HPSM, pertinent legal maxims, and the regulatory framework surrounding this topic. Section 3 is dedicated to analyzing data and operational aspects of HPSM. Finally, Section 4 presents the conclusions and recommendations. It is important to note that the paper's content has been refined and enriched with insights and suggestions gathered from the research workshop.

## **2. Review of Literature on HPSM**

### **2.1 Concept of HPSM**

HPSM is a structured method of financing practiced by Islamic banks through availing joint ownership on any moveable or immovable assets, subsequently leasing the bank's portion to the client and selling shares to the client gradually within the tenure of the financing period. In other words, HPSM is a partnership on an asset, leasing the same to a client, which ends with full ownership of the asset through a gradual transfer of ownership. HPSM is applied for financing different assets where the client must pay in instalments, usually for a long term. The term depends on the nature of the assets and the respective client's profile. The financing assets include apartments, vehicles, heavy industrial equipment, plants, machinery, lifts, generators, and other suitable assets for personal and commercial financing permissible in terms of Shari'ah. HPSM consists of three independent contracts, i.e., Shirkat, Ijarah, and Bai. These concepts are elaborated below.

#### ***Shirkat (Partnership)***

Shirkat means partnership and is a valid contract as long as the purpose of the business and contractual obligations of the parties meet Shari'ah requirements. Though different schools of thought defined partnership from different perspectives, the most exclusive definition of partnership is a contract between individuals who share the capital and profits. The legality of partnership contracts is established in the Quran, Sunnah, and consensus of the scholars.

“...And, truly, many partners oppress one another, except those who believe and do righteous good deeds, and they are few...” (Al Quran, 38: 24)

“If more than two, then they share in third” (Al Quran, 4:12)

Legality of partnerships is also found in the Hadith Qudsi, where Allah says, “I am the third of the two partners as long as neither one deceives the other. However, if one cheats the other, I leave their partnership”.

### ***Shirkatul Milk (Partnership of ownership)***

Shirkatul Milk is a form of partnership in the ownership of assets. The fundamental element of Shirkatul Milk is mingling the ownership of assets or properties, either compulsorily or by choice.

According to AAOIFI Shari’ah Standard (SS) No. 12, partnership of ownership (Sharikatul Milk) is the combination of assets of two or more persons in a manner that creates a state of sharing the realized profit or income or benefiting from an increase of the value of the partnership of assets. One partner can sell his share to the other, and the owner may demand rental for his part of the property/asset from the benefitting partner. AAOIFI SS No. 58 (para 5/4/3) states that one partner of Shirkatul Milk may promise to purchase the share of another partner. AAOIFI SS No. 12 (para 5/7) stipulates the following provisions for transferring shares:

“It is permissible for one of the partners to give a binding promise that entitles the other partner to acquire, on the basis of a sale contract, his equity share gradually, according to the market value or a price agreed upon at the time of acquisition. However, it is not permitted to stipulate that the equity share be acquired at their original or face value, as this would constitute a guarantee of value of the equity share of one partner (the institution) by the other partner, which is prohibited by Shari’ah.”

However, AAOIFI SS No. 9 (para 8/7) further states that the ownership transfer in the leased property cannot be executed along with Ijarah. The contract for ownership transfer terminates Ijarah, hence, it may only be executed on a future date, e.g., at the end of Ijarah.

### ***Ijarah (Lease)***

Ijarah is a contract relating to usufruct with compensation. Ijarah may be hiring or renting an asset to benefit from its usufruct. It also incorporates employing someone to accomplish a work for a definite wage. Scholars have consensus on the validity of Ijarah as its general permissibility is based on the holy Quran and Sunnah.

“Said one of them: O father, hire him on wages, for truly the best to employ is a strong, trustworthy man’. He said: I intend to wed one of my daughters to you,

on condition that you work for me for eight years, and if you complete ten full years, that will be a grace from you’.” (Al Quran, 28:26-27)

The validity of Ijarah has proof from Sunnah and is derived from the Hadith: “Pay the hired worker his wages before his sweat dries off.” (Narrated by Abu Hurayrah r.a., Musnad Abu Yala).

“Whoever hires a worker should inform him of his wages.” (Musannaf Abdul Razzaq).

Another Hadith narrated by Sa’d r.a.: “We used to rent lands in exchange for water and seeds, but the Prophet s.a. forbade us and ordered us to rent it with gold or silver (money) (Ahmad, Abu Daud, Nasai).

According to AAOIFI SS No. 9, Ijarah means a contract under which a specified permissible benefit in the form of a usufruct is obtained for a specified period in return for a fixed acceptable consideration.

### ***Bai’ (Buying and selling)***

Bai’ means exchange of one thing with another. The Arabic term *Bai’* refers to buying and selling activities (Al-Zuhayli, W., 2007). Bai’ implies that if one party is a seller, his counterpart is a buyer. In the modern context, bai’ refers to the trading of goods or commodities, and its validity has strong supporting evidence from the Quran, Sunnah, and the consensus of scholars.

“And Allah has permitted trade.” (Al Quran, 2:275)

“And take witnesses whenever you make a commercial contract.” (Al Quran, 2:282)

“And let there be among you traffic and trade by mutual goodwill.” (Al Quran, 4:29)

The Prophet (SAW) was asked: “Which are the best forms of income generation?” He replied: “A man’s labour, and every legitimate sale” (Jami al Sagir).

“A sale must be by mutual consent” (Bayhaqi, Ibn Majah).

It was narrated by Hakeem ibn Hizaam (RA): “I came to the Prophet s.a. and said: A man may come to me wanting to buy something that I do not possess; should I buy it for him from the marketplace then sell it to him? He said: “Do not sell that which you do not possess” (Tirmidhi, an-Nasaa’i, Abu Dawood, Ibn Maajah, Ahmad).

Bai' can be executed on a spot or deferred basis. Bai' must be taken place in conformity with the permissible norms of Shari'ah.

### ***Wa'd (Promise)***

Wa'd mean promise. Promise has religious obligations to be fulfilled. "Honor Allah's covenant when you make a pledge and do not break your oaths after confirming them, having made Allah your guarantor." (Al Quran, 16:91).

"...Honor your pledges, for you will surely be accountable for them." (Al Quran, 17:34)

Among the signs of a hypocrite are three, even if he fasts and prays and claims to be a Muslim: when he speaks, he lies; when he gives a promise, he breaks it; and when he is trusted with an Amanah, he betrays" (Bukhari, Muslim).

Hence, a unilateral promise is permissible and binding upon the promisor. A bilateral promise is two back-to-back promises that resemble a contract and are unacceptable if binding upon the parties. However, AAOIFI SS No. 49, para 3/4, stipulates that a promise is not legally binding except when there is a real need to be enforced. If the subject promise causes financial harm and creates a liability to the promisee due to the promise of the client, then the bank can legally enforce the promisor to realize actual financial damages incurred.

### ***Combination of Contracts***

Combination of contracts means executing more than one contract in a single set, such as concluding the sale, loan, lease, partnership or similar agreement in one format. However, combining the contracts in a single deal has been controversial among the jurists as it contradicts the explicit notion of the Prophetic narrations prohibiting two contracts in one agreement (Rahman and Osmani, 2021).

The Hadith was narrated by Abdullah bin Mas'ud (RA): "The Prophet (SAW) prohibited two transactions in one transaction" (Musnad Ahmad).

According to AAOIFI SS No. 25, Shari'ah permits the combination of multiple contracts in one set subject to the fulfilment of some controls. The individual agreements must be satisfied that the underlying contracts are independent.



### **Box 2.1: 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 Bit Tamlik (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 instalments 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 Bit Tamlik (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*

## **2.2 Regulatory Framework for HPSM in Bangladesh**

### **Domestic Regulations**

HPSM transactions fall under term loans as per prudential regulation. The Bank Companies Act (BCA), 1991 and its subsequent amendments are the primary law for establishing and operating banking business in Bangladesh, which applies to Islamic and conventional banks. There is no independent law for conducting Islamic banking operations in Bangladesh. Some important provisions have been included in the BCA, 1991, to accommodate specific operational needs of Islamic banking, including involvement in trading activities. For instance, though Section 9 of the BCA 1991 prohibited conventional banks from directly or indirectly buying, selling or bartering any articles or goods, it exempted Islamic banks from this prohibition.

The Guidelines for Islamic Banking issued by Bangladesh Bank on November 09, 2009, vide BRPD Circular No. 15 of the year, is the only specific regulation on Islamic banking. The Guidelines provided definitions of different investment principles and investment products, including Musharakah, Ijarah, Ijarah Muntahia Bit Tamlik (Hire-Purchase), Hire-purchase Musharakah Mutanaqasa (HPMM) along with the import under diminishing proprietorship method (Hire Purchase under Shirkatul Milk-HPSM).

### **Maqasid al-Shari'ah (objectives of Shari'ah) of HPSM Financing**

Al-Ghazali broadly explains the objectives of Shari'ah and contains five ultimate purposes for the preservation and protection of faith (din), life (nafs), intellect(aql), progeny (nasl) and wealth (mal). These are considered the most valuable matters of life (Lahsasna, 2013).

Shari'ah gives the right to own, earn, and create wealth to achieve the mentioned objectives because owning, trading, and leasing are the primary forms of wealth creation needed to survive and prosper. HPSM extends financing solutions to clients who cannot afford to buy assets at a time. It helps the client to accumulate assets gradually to maintain dignity in life. Corporate clients also benefit from HPSM financing as they get longer tenure to pay back to banks, which reduces their cost of production and ultimately serves the public interest (Maslahah Mursal). Banks also benefit from earning a revenue stream for a more extended period.

## **Zakah (compulsory charity)**

Zakah applies to all trading assets if they reach the Nisab (minimum threshold). AAOIFI SS No. 35 (para 3/1/4) stipulates that Zakah is not obligatory on fixed assets which generate income and are not acquired for trade, such as leased assets. Still, Zakah is mandatory for the remaining portion of the revenue generated by these assets. However, scholars have a consensus that Zakah can be applied for trading assets or income from leased assets rather than the assets qualifying for both features.

There are some Islamic legal maxims for governing the commercial activities of human beings. A list of some relevant legal maxims is presented in Box 22.

### **Box 2.2: List of Islamic Legal Maxims**

- MAXIM 01: Judgement 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 recognised 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 ijihad] 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

<p>MAXIM 33: Is it impermissible to dispose of another's property without authorisation</p> <p>MAXIM 34: Subsequent ratification is similar to prior approval</p> <p>MAXIM 35: If permissibility and prohibition coincide, prohibition prevails.</p> <p>MAXIM 36: What is prohibited to take is also forbidden to give</p> <p>MAXIM 37: What is auxiliary [to something in fact] is additional [to it in ruling]</p> <p>MAXIM 38: When a thing becomes null and void, what is included in it becomes null and void too</p> <p>MAXIM 39: What has already been engaged cannot be employed by another.</p> <p>MAXIM 40: Conditional promises are binding</p>
--

*Source: ISRA (2020)*

## **2.3 Process Flow of HPSM Operations in Bangladesh**

HPSM financing generally involves different operational stages. The client simultaneously places all the documents related to HPSM transactions at the bank's counter. Bank collects Credit Information Bureau (CIB) reports from Bangladesh Bank's online platform to conform to regulatory requirements. If there are any issues with immovable property, bank verifies all the land and construction documents and engage enlisted surveyors for 'on the ground' verification of property(ies) and valuation of market price, etc. Bank also engages enlisted panel lawyer to validate land-related documents. The costs related to the surveyor or lawyer are on account of the client whether the financing is sanctioned, availed or not. There are cases where banks realize processing fees to be paid upfront by the client as a percentage of the approved amount.

In the case of movable assets (e.g., car, generator, lift, machinery, etc.), bank verifies the market price, brand, longevity, etc. If the investment policy and other requirements are fulfilled, bank sanctions the amount in favor of the client, either the amount sought for or lesser than the amount applied for. The sanctions of financing amount depend on the discretionary power of business units and the purpose of financing. Bank requires the client to accept the sanction terms.

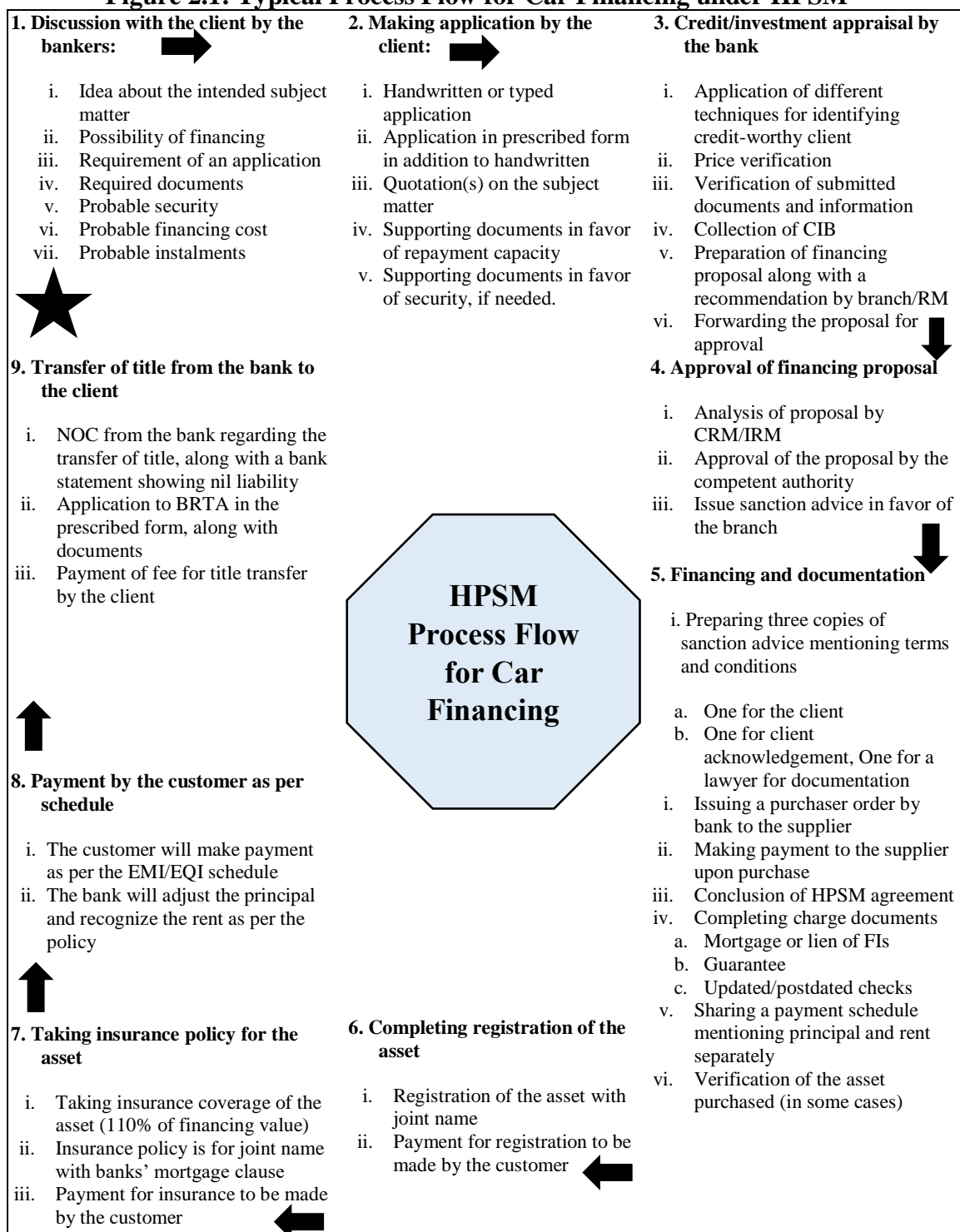
The bank signs an HPSM agreement and disburses the amount to the client account as the bank's share of the equity. Before disbursement, bank ensures mortgage of the property in favor of the bank as collateral, if any. Usually, bank makes disbursement (if not ready, apartment/car/lift/ machinery) to the client in three instalments upon the progression of the construction of the building/apartment. Bank sometimes make payment directly to the vendor, comingling the client's share or independently if the client advances to the vendor.

From the date of disbursement of funds by the bank, the rent or moratorium period starts. Upon completion of the moratorium period, banks begin to recover instalments. If the construction of the building/apartment/machinery setup cannot

be completed within the sanctioned moratorium period, banks usually extend the time for a reasonable period. For the moratorium period, bank charges fair value for the said period at the usual rate of return and realize the amount with regular instalments throughout the financing period as capital gain through valuation. Bank realizes instalments comprising principal (bank share), rent, and profit (for a moratorium period).

The method of calculation of rent depends on the respective bank's policy. Some apply the annuity method, and others use the average method. In some cases, mixed methods are also in practice, i.e., for the staff, they apply the average method and the annuity method for the clients. In the case of the annuity method, bank first realize the rental amount from the instalment, and hence, the principal amount may vary from instalment to instalment. The annuity method is in favor of the bank, and the average method is in favor of the client. A leading bank confirms that though they apply the annuity method, it does not compound the rent for the defaulter clients. In case of foreclosure, some banks charge an early settlement fee on the outstanding amount. Some banks charge penalties on rent for the defaulter clients. Where the asset is to be procured through import, some additional steps must be completed. The bank cannot open an LC of its name for regulatory constraints. Hence, banks open LC to mitigate Shari'ah compliance risk through a letter of authorization stating that the bank will purchase the assets using the client's documents. The bank takes a commission for LC services on a quarterly basis. And such a commission amount varies from quarter to quarter. Transport documents are issued in favor of the bank, which forms the constructive possession of assets. LC margin is kept as a cost-free deposit for the bank. Usually, banks adjust the money saved as security as the client's equity. The cost of importation, including insurance coverage, is on the client's account. There is no recorded evidence that banks pay the clients any return against the security sum. However, clients may get back the security money in case of LC while documents are discrepant; accordingly, clients refuse to receive documents. Figure 2.1 presents the typical process flow for car financing under HPSM, whereas Figure 2.2 summarizes some additional aspects of HPSM applications for other assets.

**Figure 2.1: Typical Process Flow for Car Financing under HPSM**



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

**Figure 2.2: Some Additional Aspects of HPSM Applications for Other Assets**

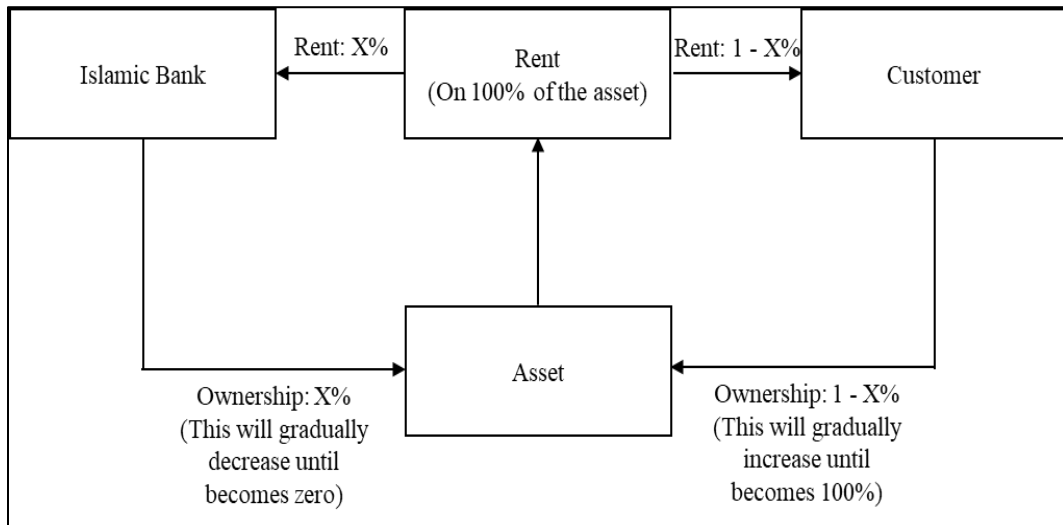
1. Car financing for individual, commercial and bank-employees
  - a. For individuals, banks may only finance up to 50%; the remaining would be equity financing.
  - b. For commercial financing, equity participation depends on the banker-customer relationship; banks generally ask for collateral securities.
  - 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. Immediate 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*

## **2.4 Relevant Shariah Standards**

There is no mention of HPSM in AAOIFI Shariah Standards. The closest is the Musharakah Mutanqisah (diminishing partnership) identified in AAOIFI Shariah Standard No. 12 *Sharikah (Musharakah) and Modern Corporations*. In Para 5/1 of the standard, the diminishing partnership is defined as a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. An illustration of diminishing partnership is provided in Figure 2.3.

**Figure 2.3: Diminishing Partnership**



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

The Shariah Standard No. 12 in Para 5/1 – 5/8 stipulated several requirements in the application of diminishing partnership. It is permissible for either of the partners to rent or to lease the share of the other partner for a specified amount and for whatever duration. It is also permissible for one of the partners to give a binding promise that entitles the other partner to acquire, on the basis of a sale contract, his equity shares gradually, according to the market value or a price agreed at the time of acquisition. However, it is not permitted to stipulate that the equity share of another partner be acquired at their original or face value, as this would constitute a guarantee of the value of the equity shares of one partner (the bank) by the other partner, which is prohibited by Shari’ah. Besides, the buy and sale should not be part of the partnership contract. Therefore, the promise to buy or to sell should be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other. It is not permitted to stipulate that one partner should bear all the cost of insurance or maintenance on the ground that he will eventually own the subject matter of the partnership. The loss, if any, shall be borne in accordance with the participation ratio of each partner.

The standard (Para 5/2) also states that the general rules for partnerships must be applied to a diminishing partnership, especially the rules for Sharikat al-’Inan. This raises a concern whether the diminishing partnership stated in the AAOIFI Shariah standard is the same as the HPSM. This is because Sharikat al-’Inan is defined as a partnership where both partners have ‘a right to deal in the assets of the partnership,



on condition that the profit is distributed according to the partnership agreement' (Para 3/1). Whereas, in HPSM, the Islamic bank is merely a lessor of its ownership portion and does not have any right to deal with the customer's portion of the asset. Also, in HPSM, there is no profit distribution among the partners, rather only the Islamic bank receives rental of the asset based on the Ijarah agreement between it and the customer. There is no rental income for the customer. Nonetheless, the Shariah basis of the standard states that the reason for stipulating 'all the general rules for partnerships, especially the rules for 'Inan partnership, are applicable to diminishing partnerships is to safeguard this new form of partnership from becoming a mere interest-based financing transaction in which a client undertakes to pay another party for his finance in addition to a share in the partnership income'. The AAOIFI Shariah Standard No. 9 *Ijarah and Ijarah Muntahia Bittamleek* identified Ijarah Muntahia Bittamleek as a form of Ijarah where the lease ends with the transfer of ownership of the underlying asset from the lessor to the lessee. The transfer of ownership can be in the form of sale or gift. The standard's Para 8/1 stipulates that the transfer of ownership must be evidenced in a document separate from the Ijarah contract. The promise to sale or gift must be in a separate document and cannot be an integral part of the Ijarah contract.

Although the Shariah Standard No. 9 has not identified gradual transfer of ownership as a form of Ijarah Muntahia Bittamleek, the AAOIFI Financial Accounting Standard (FAS) No. 8 *Ijarah and Ijarah Muntahia Bittamleek* identified "Ijarah Muntahia Bittamleek through gradual transfer of legal title (sale) of the lease asset" as a form of Ijarah. Appendix B, Para 2/3/5, defines this form of Ijarah as:

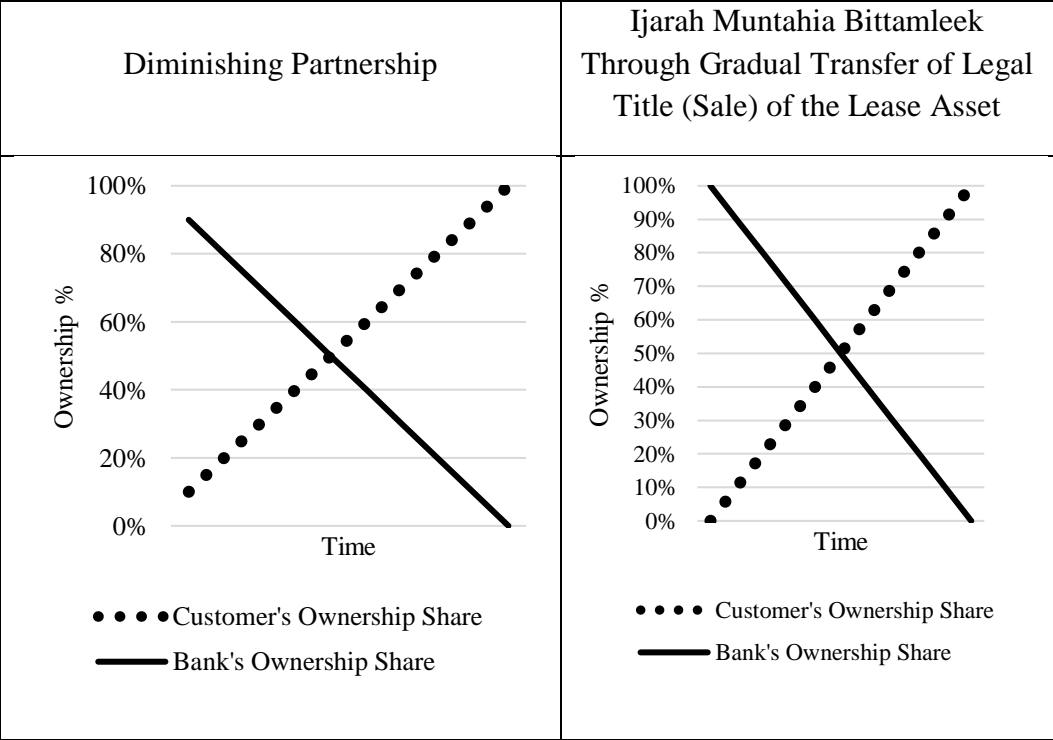
... an Ijarah contract with a promise made by the lessor that he will gradually transfer the legal title of the leased asset to the lessee until the lessee has full legal title of the leased asset. This would involve determining the price of the leased asset which is to be divided over the period of the Ijarah contract so that the lessee is able to acquire a share of the leased asset for proportionate consideration of the total price until the full title of the leased asset is transferred to the lessee at the end of the Ijarah contract. It should be noted that there should be a sale contract for each share sold to the lessee. In addition, the amount of rent should decrease as the lessee acquires a greater share of the leased asset.

If, for any reason, the Ijarah contract is revoked prior to the transfer of title to the lessee, then the title of the leased asset will be shared by both the lessor and the lessee to whom partial title of the leased asset has been transferred. This gives justice to the lessee whose aim is to acquire title of the leased asset through payment of a rent in excess of the fair rental amount.

Some juristic rules can be extrapolated from the above definition. The lessor makes the promise to gradually sell his share of ownership to the lessee. Besides, there should be a sale contract for each share sold to the lessee. The total sale price could be predetermined and spread over the period of the Ijarah contract. If the Ijarah is discontinued, each party will be entitled to their respective shares of ownership as of that point.

The illustrative presentation of this form of Ijarah would be the same as the one presented for diminishing partnership, except that the partners in diminishing partnership jointly contribute capital at the inception of the partnership, whereas in the Ijarah, only one party contributes the full capital at the inception and, subsequently, the other gradually obtain ownership. Figure 2.4 provides an illustration.

**Figure 2.4: 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* supersedes the FAS No. 8. This standard includes “Diminishing Musharaka based on Shirkat-ul-Milk with Ijarah” (or, simply, “Diminishing Musharaka Ijarah”), which is defined in Para 4(f) as:

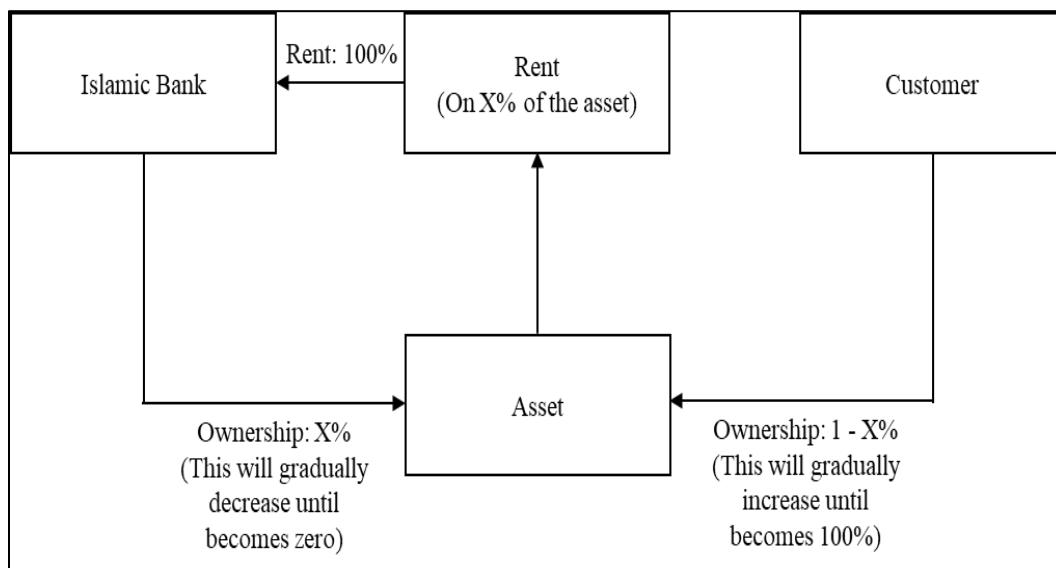
... a hybrid Ijarah product similar to ‘Ijarah Muntahia Bittamleek through gradual transfer’ comprising of:

- i. a co-ownership in which two parties share the ownership of a tangible asset in an agreed proportion (without intention to engage in common business with respect to such asset); and
- ii. a promise under which one of the co-owners undertakes to buy in periodic installments the proportionate share of the other co-owner until the ownership/title to such tangible asset is completely transferred to the purchasing co-owner (whereby each transaction takes place as a sale); and
- iii. a separate Ijarah contract, whereby one co-owner (lessor) rents out its proportionate share in the asset to the other co-owner (lessee);

This form of Ijarah perfectly resembles HPSM. However, this standard being an accounting standard, does not provide any Shariah requirements for such an Ijarah. Nonetheless, this provides a clear basis to argue that AAOIFI recognize HPSM as a mode of financing.

Based on the above discussion, it appears that all the relevant Shariah rulings of Ijarah shall be applicable to HPSM. The rulings relevant to promise and sale are also applicable to this. However, a concern remains unresolved as to whether HPSM shall bear the Shari'ah rulings of a partnership. If yes, what would be the extent of it? If HPSM bears the ruling of a partnership, the promise to sell or purchase by one partner to another at a predetermined price would be deemed impermissible. Whereas, if it can be established that the partnership is only in the form of joint ownership of the asset, not managing the asset as in the form of a partnership venture, it is possible to argue that the rules of the partnership will be only limited to the joint ownership. This means that the partners will bear proportionate ownership risks, but the rewards will depend on the management of the respective share of the asset, i.e., there would not be any income generated from the ownership portion of the customer in reference to the partnership. Here, only the bank's ownership portion is leased to the customer, not the whole asset. Accordingly, the rent determined is only for that portion, not for the whole asset. The bank earns its share of income only because it has leased its ownership portion to the customer and the customer has no basis to share in that income. Figure 2.5 provides an illustration of diminishing Musharaka Ijarah.

**Figure 2.5: Diminishing Musharaka Ijarah**



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

## 2.5 Accounting of HPSM

Although the *Guidelines for Conducting Islamic Banking* (issued in November 2009) defined HPSM but has not provided any specific requirements for its accounting. The accounting policies adopted by the Islamic banks in Bangladesh, as disclosed in the notes accompanying the financial statements, are provided in Box 2.3.

### Box 2.3: Accounting Policies for HPSM as Disclosed in the Notes Accompanying the Financial Statements of Islamic banks in Bangladesh

Islami Bank Bangladesh	<p>The bank made the following disclosures specific to HPSM:</p> <ul style="list-style-type: none"> <li>‘Unearned Income - the amount of unrealized portion of profit/ value addition of fixed assets [property, plant &amp; equipment] under Hire Purchase Under Shirkatul Melk (HPSM) investment for gestation period.’</li> <li>‘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.’</li> </ul>
ICB Islamic Bank	No specific disclosure on the accounting policy adopted for HPSM or ‘Hire Purchase’.
Social Islami Bank	No specific disclosure on the accounting policy adopted for HPSM.
Al-Arafah Islami Bank	No specific disclosure on the accounting policy adopted for HPSM or ‘Hire Purchase Investment’.

EXIM Bank	No specific disclosure on the accounting policy adopted for HPSM or ‘Izara Bil Baia’.
Shahjalal Islami Bank	<p>The bank made the following disclosures specific to HPSM:</p> <ul style="list-style-type: none"> <li>• ‘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.’</li> <li>• ‘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 its expected rate of return. Such income is recognized on realization basis.’</li> </ul>
First Security Islami Bank	<p>No specific disclosure on the accounting policy adopted for HPSM other than stating the following:</p> <p>‘Unearned Income - the amount of unrealized portion of profit/value addition of fixed assets [property, plant &amp; 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.’</p>
Union Bank	<p>The bank made the following disclosures specific to HPSM:</p> <p>‘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.’</p>
Standard Bank	<p>No specific disclosure on the accounting policy adopted for HPSM other than stating the following:</p> <p>‘Unearned Income - the amount of unrealized portion of profit/value addition of fixed assets [property, plant &amp; equipment] under Hire Purchase Under Sharikatul Melk (HPSM) investment for gestation period.’</p>
Global Islami Bank	<p>No specific disclosure on the accounting policy adopted for HPSM other than stating the following:</p> <ul style="list-style-type: none"> <li>• ‘Unearned Income - the amount of unrealized portion of profit/value addition of fixed assets [property, plant &amp; equipment] under Hire Purchase Under Sharikatul Melk (HPSM) investment for gestation period.’</li> <li>• ‘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 its expected rate of return. Such income is recognized on realization basis.’</li> </ul>

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

Although the Islamic banks partly own the HPSM assets and accordingly bear the respective ownership risks and rewards, they do not recognize these assets similar

to fixed assets in their statement of financial position. Instead, they are recognized similar to financial assets. This form of accounting does not comply with the AAOIFI Financial Accounting Standard (FAS) No. 32 *Ijarah* and also does not reflect the Shari’ah form of the HPSM mode.

AAOIFI FAS No. 32 requires that the Ijarah assets shall be initially recognized at cost where all costs of purchase and other costs incurred in bringing the underlying asset to its present location and condition shall be included. In subsequent measurement, the Ijarah assets shall be measured at cost less accumulated depreciation less accumulated impairment, if any. The Ijarah revenue shall be recognized in the statement of profit or loss of the lessor on an accrual basis, applying a systematic basis which could be (i) a straight-line method, (ii) an effective rate of return method, or (iii) when Ijarah revenue become due. FAS 32 identified the straight-line method as the preferred method of revenue recognition. Any Ijarah rental received during the construction period of the asset shall not be recognized as revenue of the lessor as it has yet to establish right over such rental. Such revenue shall be recognized in the statement of profit or loss of the lessor following one of the recognition methods identified above, as determined by the accounting policy of the lessor.

The gradual transfer of ownership shall be recognized coinciding with the timing of such transfer. A simple illustration of the journal entries is provided in Figure 2.6 and an illustration of presentation in financial statements is provided in Figure 2.7.

Figure 2.6: Journal Entries for Ijarah Through Gradual Transfer	
<b>Purchase of Asset</b> Dr Ijarah asset Cr Cash/Payable	<b>Ijarah revenue</b> Dr Cash Cr Ijarah revenue
<b>Subsequent Measurement: Depreciation</b> Dr Depreciation Cr Accumulated depreciation	<b>Unearned Ijarah rental</b> Dr Cash Cr Advance rental
<b>Subsequent Measurement: Impairment</b> Dr Impairment Cr Accumulated impairment	<b>Transfer of ownership</b> Dr Cash Cr Ijarah asset

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

**Figure 2.7: Illustration of Financial Statements**

<b>Statement of Financial Position</b>				
<b>Assets:</b>				
Ijarah asset				
Cost				X
Minus: Accumulated depreciation				(X)
Minus: Accumulated impairment				(X)
				<u>X</u>
Initial direct costs				
Cost				X
Minus: Accumulated amortization				(X)
				<u>X</u>
Advance payment to vendor				X
<b>Liabilities:</b>				
Advance rental				X
<b>Statement of Profit or Loss</b>				
Ijarah revenue				X
Minus: Ijarah costs				(X)
Minus: Depreciation				(X)
Minus: Impairment				(X)
Minus: Amortization of initial direct costs				(X)
Minus: Expenses related to Ijarah asset (e.g., Takaful, registration, legal, repair and maintenance)				(X)
				<u>X</u>
<b>Net Ijarah revenue</b>				<u>X</u>

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

### 3. Analysis and Findings

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

**Table 3.1: Global Islamic Finance (IF) Assets and Islamic Banking (IB) Assets**

	IF Assets		IB Assets		Summary
	(USD Billion)	Growth (%)	(USD Billion)	Growth (%)	In 2021 IF Breakdown:
2015	2170	9.87	1603	11.09	IB = 70%
2016	2347	8.16	1707	6.49	Sukuk = 18%
2017	2501	6.56	1768	3.57	Islamic Funds = 6%
2018	2601	4.00	1819	2.88	Takaful = 2%
2019	2961	13.84	2069	13.74	Other IFIs = 4%
2020	3390	14.49	2364	14.26	Total = 100%
2021	3958	16.76	2765	16.96	Total IF Institutions = 1679 Total Islamic Banks = 566
2025 (Projected)	4940	24.81	3306	19.57	
2026 (Projected)	5900	19.43	4,025	21.75	

*Source: ICD-REFINITIV Islamic Finance Development Report 2022*



Table 3.1 presents a summary of Islamic finance (IF) assets. At the end of 2021, it was 3958 USD billion, expected to be 5900 USD billion in 2026. Similarly, Islamic banking (IB) assets was 2765 were 2765 USD billion as of December 31, 2021, representing of total IF assets.

It is demonstrated in Table 3.2 that the return on assets (ROA) and return on equity (ROE) of global Islamic banking in 2022 are 1.70 percent and 17.50 percent, respectively, and improving financial performance is observed. The industry's capital-to-risk weighted assets ratio (CRAR) is 19.0 percent in 2022, which was 18.5 percent of the previous year. Besides, non-performing financing of the sector is appreciable. All of these are some excellent indications and better prospects for the Islamic banking industry around the globe.

Considering IF assets, Bangladesh is the 10<sup>th</sup> top country in the world, whereas it is 7<sup>th</sup> considering total IB assets (Appendix 1). As per Global Islamic Finance Report 2022, Bangladesh scored 7<sup>th</sup> position based on Islamic finance country index (IFCI) and it achieved 10<sup>th</sup> rank based on global Islamic finance development indicator (IFDI) (Appendix 2). These indicate that Bangladesh scored a significant position in the would considering Islamic banking and finance activities.

**Table 3.2: Global IB Weighted Average ROA & ROE, CRAR and NPL**

Year	ROA (%)	ROE (%)	CRAR (%)	Gross Non-performing Financing (%)
2015	1.5	14.1	N/A	5.15
2016	1.6	13.6		5.06
2017	1.9	16.9		4.99
2018	1.8	15.2		5.00
2019	1.6	14.0	18.4	2.5
2020	1.3	11.8	18.6	2.6
2021	1.6	15.9	18.5	2.5
2022	1.7	17.5	19.0	2.5

*Source: IFSB Financial Stability Report 2023*

For conducting Islamic financing services in the globe, a number of Shari’ah compliant modes are used by the banks and the Table 3.3 presents a summary of this. About 12 percent of the financing has been made under Ijarah and Musharakah in 2021, which was 15 percent 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<sup>1</sup> jointly hold about 22 percent of their total financing in 2022 as depicted in Table 3.4. It is worthy to mention that the joint share of Ijarah, Musharakah, and Diminishing Musharakah is about 63 percent in Pakistan in that year (Table 3.5). Figure 3.1 identifies the application of Musharakah Mutanaqisah by the Islamic banks in Pakistan.

**Table 3.3: Modes of Islamic Financing Contracts 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	Ijarah/Ijarah Muntahia Bittamlik	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
<b>Total</b>		<b>100</b>	<b>100</b>

*Source: IFSB Website ([https://ifsb.org/psifi\\_02.php](https://ifsb.org/psifi_02.php)), cited on September 14, 2023)*

**Table 3.4: Modes of Islamic Financing Contracts: Malaysia**

Table 5.11: Modes of Islamic Financing Contracts, Malaysia									
	Bai Bithaman Ajil	Ijarah	Ijarah Thumma Al-Bai	Murabahah	Musharakah	Mudarabah	Istisna'	Others	
2015	19.21	2.46	18.22	31.40	7.30	0.02	0.57	20.83	
2016	15.87	2.25	16.04	37.18	9.26	0.02	0.47	18.91	
2017	13.60	2.14	14.84	39.59	10.07	0.01	0.41	19.34	
2018	11.56	1.70	13.02	39.90	9.32	0.01	0.23	24.24	
2019	10.44	1.42	11.86	42.08	9.36	0.01	0.26	24.58	
2020	9.39	1.25	11.52	44.11	9.16	0.02	0.18	24.37	
Changed in Reporting Format									
	Qard	Ijarah	Tawarruq	Bai` `Inah	Mura bahah	Musha rakah	Muda rabah	Istisna'	Others
2021	0.40	13.79	55.10	2.54	14.44	9.19	0.03	0.09	4.42
2022	0.42	13.71	58.58	2.29	12.83	8.93	0.02	0.08	3.15

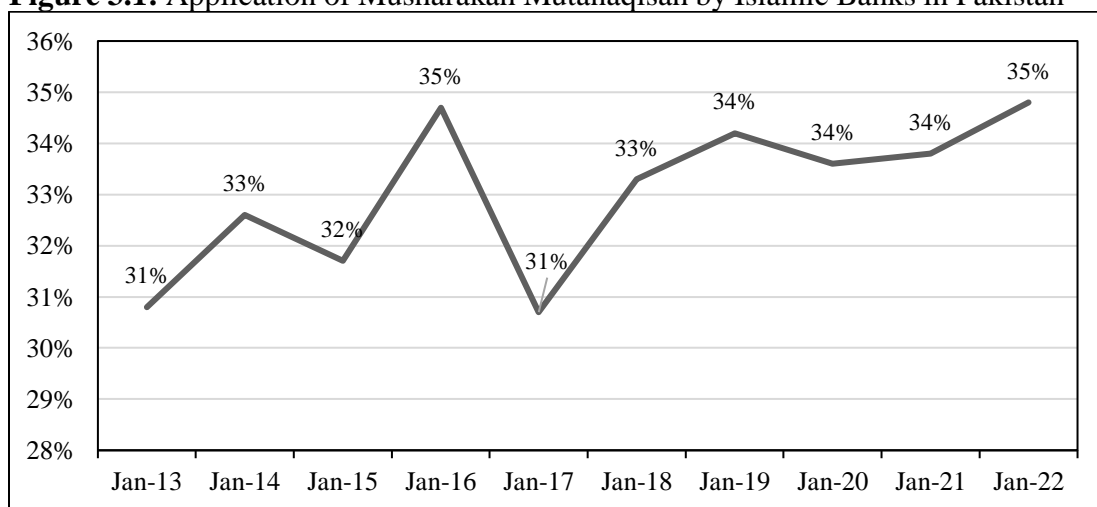
*Source: Monthly Highlights and Statistics published by BNM (<https://www.bnm.gov.my>)*

<sup>1</sup> In Malaysia, Musharakah Mutanaqisah is reported under the broad head of Musharakah without differentiating it from other forms of partnership.

**Table 3.5: Modes of Islamic Financing Contracts: Pakistan (%)**

	Murabahah	Ijarah	Musharakah	Diminishing Musharakah	Mudarabah	Salam	Istisna	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
2022	15.7	4.6	22.9	35.2		1.4	8.4	11.8

*Source: Islamic Banking Bulletin of State Bank of Pakistan (<https://www.sbp.org.pk/ibd>)*

**Figure 3.1: Application of Musharakah Mutanaqisah by Islamic Banks in Pakistan**

*Source: SBP (n.d.)*

### 3.2 Status of IB and Application of HPSM in Bangladesh

**Table 3.6: Market Share of Islamic Banking in Bangladesh (%)**

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

**Source:** Financial Stability Report, BB and \*Quarterly Report on Development of IB in BD, BB; \*\*Annual Report of Bangladesh Bank

Table 3.6 depicts market share of IBs in overall banking industry of Bangladesh. At the end of 2022, share of IBs in total financing (credit) was more than 26 percent whereas share of deposit was about 23 percent. In case of remittance, the share of IBs is about 55 percent in 2022. It is evidenced that share of IBs is increasing over the years.

**Table 3.7: Some Selected Indicators of Banking Sector of Bangladesh (%)**

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

**Source:** Financial Stability Report, BB

Considering different measures, IB sector is performing better as compared to overall banking industry of Bangladesh (Table 3.7). However, ROA and ROE of IBs are slightly lower in 2022. Some recent banking scams may be one of the reasons behind this. Even then, quality of assets of IBs measured by non-performing assets is much appreciable. Appendix 3 presents a summary of Islamic banking investments (financing) in Bangladesh.

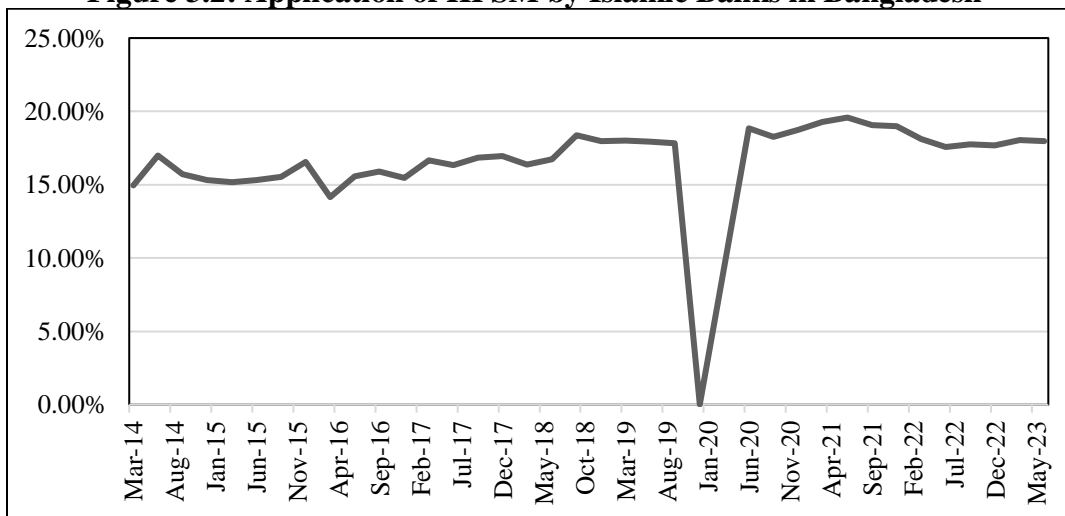
**Table 3.8: Modes of Islamic Financing Contracts: Bangladesh (%)**

	Qard with Security	Mura bahah	Bai Muajjal	Bai Salam	Bai Istisnaa	Muda rabah	Musha rakak	Ijarah/HPSM	Others
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
2021	1.11	46.39	23.24	1.23	0.02	0.25	0.49	23.30	3.98
2022	0.97	47.71	22.94	1.36	0.06	0.26	0.28	21.72	4.70

**Source:** Quarterly Report on Development of IB published by BB(<https://www.bb.org.bd>)

Islamic banking industry of Bangladesh uses Shari’ah compliant different modes for financing. Table 3.8 demonstrate a picture of these financing modes. In 2022, about 18 percent of total financing was concluded as per HPSM principles whereas share of Ijarah is about 4 percent. Previously, HPSM and Ijarah were reported jointly. Therefore, average share of HPSM during 2015-2022 is about 22 percent.

**Figure 3.2: Application of HPSM by Islamic Banks in Bangladesh**



*Source: Bangladesh Bank (n.d.)*

Figure 3.2 shows the total investments of Islamic banks (including Islamic banking branches and windows of conventional banks) based on HPSM. The sudden drop in November 2019 was due to the reclassification of this mode under Ijarah & Ijarah bi al-bay in the Bangladesh Bank’s reporting only for that period.

However, as presented in Table 3.9, the financial statements of the Islamic banks in Bangladesh show that the application of HPSM as an investment mode is not uniform among the Islamic banks in Bangladesh. Moreover, instead of using the term ‘HPSM’ in abbreviation or in full form, other terms are also used by a few banks.

**Table 3.9: HPSM to Total General Investments Ratio of Islamic Banks in Bangladesh**

Bank	Different Term Used	HPSM or Equivalent to General Investments	
		2022	2021
Islami Bank Bangladesh	-	19.68	20.82
ICB Islamic Bank	Hire Purchase	39.63	39.71
Social Islami Bank	HPSM investment loan	18.83	20.34
Al-Arafah Islami Bank	Hire Purchase Investment	31.90	32.39
EXIM Bank	Izara Bil Baia	36.96	36.25
Shahjalal Islami Bank	-	26.08	23.64
First Security Islami Bank	-	7.65	8.88
Union Bank	-	4.76	5.22
Standard Bank	-	46.13	47.56
Global Islami Bank	-	6.81	7.60
<b>Average</b>	-	<b>21.60</b>	<b>22.42</b>

*Source: Annual Report of the Banks*

### 3.3 Contents Analysis of HPSM Agreement

The research team conducted content analysis of HPSM (and align) agreements of IBs of Bangladesh. Most of the banks use their own logos in the agreement form. There is a variation in the nomenclature. Agreement is concluded in English language. There is no segregation of Shirkat, Ijarah, promise and Bai in the agreement. In most of the cases, all associated cost including insurance, registration, documentation, are borne by the client. Along with repair and maintenance, overhauling cost is incurred by the client solely. In case of damage, banks recover their cost of the asset form lodging insurance claim or from client. A summary of contents analysis of HPSM agreements is depicted in Appendix 4.

### 3.4 Summary of Interview and Survey Findings

- i. **Prescribe Form with Bank Logo:** HPSM, an acronym for Hire Purchase under Shirkatul Milk, represents an agreement between an Islamic Financial Institution (IFI) and a financing client. This significant arrangement is typically documented using a recognized format adorned with the bank's logo. There is a general expectation that such agreements should be formalized in a neutral document, devoid of specific party designations.
- ii. **Application Process in HPSM:** To initiate the HPSM financing process, a client must apply to the bank. However, the application procedure varies among banks. Some banks require the use of a prescribed application form, while others offer flexibility and accept applications in different formats. Interestingly, there are cases where banks accept both prescribed and handwritten application forms. An important observation has been made regarding clients inadvertently using a Qard facility application instead of the appropriate HPSM application. This highlights the importance of ensuring clear and accurate documentation during the application process.
- iii. **Processing Fee in HPSM Financing:** Within the context of HPSM financing, certain financial institutions levy a processing fee, while others abstain from this practice. An IFI may impose a fee for the services rendered in support of the client's financial transactions. Nevertheless, it is essential to delineate the nature of these services and provide justifiable reasoning for the imposition of such processing fees to adhere to Shari'ah compliance. It is noteworthy to mention that BB authorizes both conventional and Islamic banks to levy a processing fee in some cases. Furthermore, the BB has instituted the Six months Moving Average Rate of Treasury Bill (SMART) rate policy, setting forth guidelines that restrict the charging of interest/profit.
- iv. **Collateral Security in HPSM:** Universally, financial institutions create a charge over the assets financed by the bank as primary security. Moreover, banks may request additional security. In the case of car financing, regulatory requirements dictate that more than 50% should be financed through equity. However, it's important to note that a security charge is created on the full asset, resulting in a margin exceeding 100%. This raises a concern regarding potential Zulm (injustice) when banks ask for 4-5 times the value of the financed asset as security. Furthermore, security charge is created for the benefit of the bank



however, cost of the documentation is transferred to the client. While most Shari'ah experts permit these practices, this warrants further consideration within the Islamic banking framework.

- v. **Insurance Expense and Claims in Car Financing:** When obtaining car financing from an Islamic financial institution (IFI), it is a requirement to secure insurance coverage equivalent to at least 110% of the bank's financed amount. According to the terms outlined in the HPSM agreement, the customer is responsible for covering the insurance costs, despite not being the owner of this particular asset portion. Interestingly, the bank prioritizes its claim settlement in the event of an insurance claim. This contradicts the conventional practice where the owner, rather than the lessee, bears the risks associated with ownership and the corresponding mitigation expenses. Notably, Shari'ah experts express apprehensions regarding these prevailing practices. A bank's policy in this aspect is mentioned below:

“That, the Client shall keep the Asset/Property comprehensively insured with Bank's mortgage clause against loss or damage by Fire/RSD/Flood/Theft/Accident etc. and all other usual risks including 1st Party Risk coverage with an Islamic Insurance Company or in the absence, with any Insurance Company on Bank's approved list minimum to the extent of its cost/purchase price Plus ten percent at his/her/their cost.

In case, insurance claims are to be lodged, the Client shall actively assist the Bank in lodging related claims and realizing claims thereof. The insurance claim realized as such will be appropriated towards adjustment of Client's dues to the Bank and for paying such costs as may be required for realizing the claim. Any balance left after such appropriation shall, however, be paid by the Client. In case the insurance claim does not cover the dues of Bank and other cost, the Client shall pay the shortfall from Client's own sources.”

- vi. **Asset Registration:** The registration of assets, particularly in the cases of vehicles and real estate, entails a mandatory regulatory process incurring significant costs. Specifically, in car financing, the vehicle is registered in a joint name along with a mortgage clause favoring the bank. Conversely, for immovable assets like flats, the registration is completed in the client's name. It's important to note that the associated registration costs are not borne by the bank in either scenario. An additional complexity arises when a flat is co-owned by both the IFI and the client, yet it is registered solely in the client's name. This situation raises questions about how the bank's ownership of the asset can be

substantiated. Some experts argue that correspondence with the client, sanction advice, and the HPSM agreement serve as supporting documents to establish the bank's claim, even without a registered document in favor of the bank, as per Shari'ah principles. However, there are differing opinions on this matter, with some experts identifying inconsistencies in this approach.

- vii. Equity Determination:** In certain instances, an IFI calculate its own contribution for an asset based on the invoice or stated price, leaving all other associated costs to be covered by the client. Given that the asset is jointly owned by both the bank and the client, it is crucial to maintain transparency regarding the actual financial contributions made by each party. This transparency is vital, as ownership-related risks are allocated according to the equity in the asset. Consequently, some Shari'ah experts express concerns about the potential presence of Gharar (uncertainty) in such arrangements.
- viii. Several Contracts at a Time:** It is well known that HPSM includes Musharakah (partnership), Ijarah (lease) and bai (buying and selling) agreements. To be a valid contract there must be an offer and acceptance. Besides, combination of two contracts is generally prohibited. Most of the Shari'ah experts opine that these principles should be observed in case of HPSM.
- ix. Undertaken by Both Parties:** Within the framework of Hire Purchase under Shirkatul Melk (HPSM), denoting a partnership arrangement for asset acquisition, the customary recognition allows lessee to issue an undertaking for the eventual purchase of the leased item. However, it is traditionally understood that one partner may not extend a capital guarantee to another in case of Musharakah. Some formulations of HPSM agreements stipulate that the client shall furnish an undertaking to acquire the bank's share of asset ownership upon payment of the prescribed price. Simultaneously, the bank commits to disposing of the property to the client at the predetermined valuation. While a segment of revered scholars deems this configuration admissible within the contours of Islamic finance, others espouse a divergent stance concerning its acceptability.
- x. Early Settlement:** Sometimes, client wants to settle or purchase the assets before completion of the the lease tenure. Most of the banks do not charge early settlement fee however, few banks charge fee. Shari'ah experts do not in favor of charging any extra in this situation.
- xi. Prepayment of Some Instalments:** If customers want, they may pay some of the installments in advance. Some of the banks accept these and adjust the paid

amount with the cost price however, some others discourage or do not accept advance installment.

- xii. Documentation Fee:** Considering the nature of asset, different types of documentation fees are involved. Most of the cases, these documents are for protecting the interest of the bank. However, banks transfer the full cost to the customer. Some of the Shari'ah experts opine to share the cost with client.
- xiii. Gradual Ownership Transfer Process:** As per the promise made by the client and payment schedule, clients make the payment. It is assumed that the proportionate ownership of the asset will be transferred from bank to client upon payment of the installment. Some Shari'ah experts raise the question about the offer and acceptance of the transfer. Besides, transfer of ownership at original cost price or face value of the assets may be a concern of guarantee against in favor of bank by the client.
- xiv. Waiver Customer in Case of Damage:** As the asset is jointly owned by the bank and client, it should not be the responsibility to pay the remaining price of asset in case of damage, if there is no negligence of the client. However, there is a common regulation that bank could not waive the principal amount due to the client. If IBs apply this principle in case of HPSM, there is a question of Zulm because without handing over the asset sales would not be completed.
- xv. Asset under Construction:** If the assets not usable, rent would not be charged. However, as the banks' fund has been used, banks want to earn during this period. For this, they want to recognize capital gain through valuation of the assets applying the effective rate of return. Some of the Shari'ah experts do not consider it as Shari'ah violation however, some others raise question about the justifications and method applied.
- xvi. Letter of Credit Commission:** If the asset under consideration needs to be imported, there is an issue of cost related with letter of credit (LC) and payment mechanism. Generally, banks charge commission to the client as a Wakalah fee considering it as an independent service. Some the experts Shari'ah issues in this connection.

## **4. Issues and Recommendations**

### **4.1 Development of Human Resources**

In the context of Islamic banking and specifically the implementation of HPSM mode of investment, the development of human resources is crucial. Islamic banks should invest in specialized training programs for their staff to ensure a deep understanding of Shari'ah principles and how they apply to financial transactions, particularly HPSM. This training should cover not only the theoretical aspects of Islamic finance but also practical applications within the bank's operations. Collaborate with qualified and experienced Shari'ah scholars who can provide guidance and oversight in the development and execution of Shari'a-compliant HPSM contracts. Ensure that these scholars are accessible to bank employees for consultation and clarification of Shari'ah principles.

Establish a culture of continuous learning and professional development among bank employees involved in HPSM processes. Encourage them to stay updated with evolving Shari'ah interpretations and financial regulations relevant to Islamic banking in Bangladesh. IFI may encourage employees to pursue recognized certifications in Islamic banking and finance such as Certified Islamic Banking and Finance Professional (CIBFP), Certified Islamic Professional Accountant (CIPA), Certified Shari'ah Advisor and Auditor (CSAA), etc. By prioritizing the development of human resources with a focus on Shari'ah compliance, Islamic banks can strengthen their ability to execute HPSM process in a manner that aligns with Islamic principles and regulatory requirements, ultimately enhancing customer trust and market credibility.

### **4.2 Separation of Contracts in HPSM Agreement**

The separation of contracts in HPSM agreement is an essential aspect of adhering to Islamic finance principles. HPSM typically involves the integration of various financial contracts, including Musharakah (partnership), Ijarah (lease), and Bai (buying and selling) agreements. To ensure the validity and compliance of these contracts, several key principles must be observed e.g., proper offer and acceptance, prohibition of combining contracts, mitigation of ambiguity and risk, transparency and customer understanding. Banking institutions engaged in HPSM activities should ensure that their contracts adhere to Sharia'ah principles.

The separation of contracts in HPSM agreement is a practice rooted in Islamic finance principles, including the requirement of offer and acceptance, the

prohibition of combining contracts, and adherence to Shari'ah guidance. By upholding these principles and promoting transparency, Islamic banks in Bangladesh can establish robust and compliant HPSM agreements that inspire confidence among customers and regulatory bodies alike.

#### **4.3 Reflection of Shari'ah in Accounting Record and Report**

In the realm of HPSM transactions, it becomes imperative to ensure that accounting records and financial reports meticulously mirror adherence to Shari'ah principles. This imperative recommendation is rooted in the pursuit of transparency, accountability, and unwavering commitment to Islamic finance tenets throughout the accounting and reporting procedures. Accounting principles must align seamlessly with the specific prerequisites of Islamic finance contracts, including HPSM. For instance, if 'HPSM Financing' is recorded during initial recognition, complications may arise when an Islamic Financial Institution (IFI) seeks to revalue the underlying asset or negotiate its sale. It is of paramount importance to distinctly delineate HPSM assets in accounting records to facilitate tracking and reporting. Furthermore, it is equally vital to establish well-defined guidelines for recognizing income generated from HPSM transactions, thereby preventing any semblance of Riba. This meticulous approach not only ensures compliance with Shari'ah principles but also elevates the credibility of Islamic banks' HPSM dealings. By placing a premium on the accurate reflection of Shari'ah compliance in accounting records and reports, Islamic banks can reinforce stakeholder trust, bolster the integrity of their HPSM transactions, and unequivocally underscore their dedication to ethical and transparent financial practices in strict accordance with Islamic principles.

#### **4.4 Compliance with the Shari'ah Requirement in Case of Ownership Transfer**

The transfer of ownership, whether in entirety or in part, within the context of HPSM, must strictly adhere to all Shari'ah requirements for a valid contract. This entails the essential elements of a valid contract, including proper offer and acceptance, which must be present. Furthermore, the transfer price should fully align with Shari'ah principles. Comprehensive and precise documentation plays a pivotal role in identifying the risks and rewards associated with ownership held by each party involved in the HPSM agreement. Proper documentation not only serves as a critical tool for risk assessment but also ensures that the financial records accurately reflect the nuances of ownership transfers in accordance with Shari'ah

principles. It is essential that these ownership transfers are meticulously documented and appropriately recorded in the books of accounts.

#### **4.5 Application of Valuation Technique**

In the context of HPSM, banks employ a valuation approach when the underlying asset is not yet ready for immediate use however fund has been disbursed. This technique is utilized to recognize revenue during the period when rent is not applicable, such as when the asset is under construction. However, it is imperative to establish a clear rationale for determining when and how this valuation process is applied. Typically, it is not deemed practical or reasonable to revalue the asset while construction is in progress or when the asset is not in the process of being handed over to a third party. The revaluation, when executed, should adhere to the principle of fair value, ensuring that the asset's worth is assessed in a manner consistent with sound financial practices.

#### **4.6 Revision of Contract Form**

Upon conducting a comprehensive content analysis, it has become evident that there is room for improvement in the HPSM forms currently utilized by banks. Within these forms, inconsistencies have been identified, and there is an opportunity for enhancement. One crucial aspect of form restructuring involves creating a format that clearly distinguishes and identifies all contracts and agreements separately. This restructured format should also ensure that the roles and responsibilities of the involved parties are fully aligned with Shari'ah principles. Moreover, it is essential to recognize that not all costs and risks can be entirely transferred, even when mutually agreed upon by both parties. The contractual arrangements should reflect a balanced distribution of costs and risks that is consistent with Islamic finance principles. In addition, the understanding and knowledge related to HPSM evolve over time. Therefore, it is advisable to subject all contract forms and associated documents to meticulous and periodic reviews at specified intervals. This practice helps ensure that the forms remain aligned with evolving best practices and regulatory requirements while upscaling the understanding and knowledge base.

#### **4.7 Regulatory Support**

In the context of Bangladesh's dual banking environment, where both conventional and Islamic banking coexist, it is noteworthy that there is no distinct legislation governing Islamic banking operations. Instead, both types of banks are subject to oversight by a single regulatory authority. It has been observed that, at times, the

regulator issues directives without the formulation of separate guidelines for Islamic banking operations. These directives are often conceived with a primary focus on conventional banking practices, which may not always be suitable for Islamic banks (IBs) from both Shari'ah and business perspectives. Notably, the operational methods of conventional and Islamic banks significantly differ, and thus, adhering to uniform guidelines can pose challenges.

To address these disparities effectively, it is imperative to establish separate regulatory guidelines tailored to Islamic banking operations. For instance, matters related to fixing and adjusting rates of return, restructuring or rescheduling of claims, imposing penalties or granting waivers, requirements and costs associated with registration and insurance, and post-financing supervision fees, all necessitate distinct and specialized regulatory guidance. Such customized guidelines would enhance the regulatory framework's compatibility with the unique nature of Islamic banking.

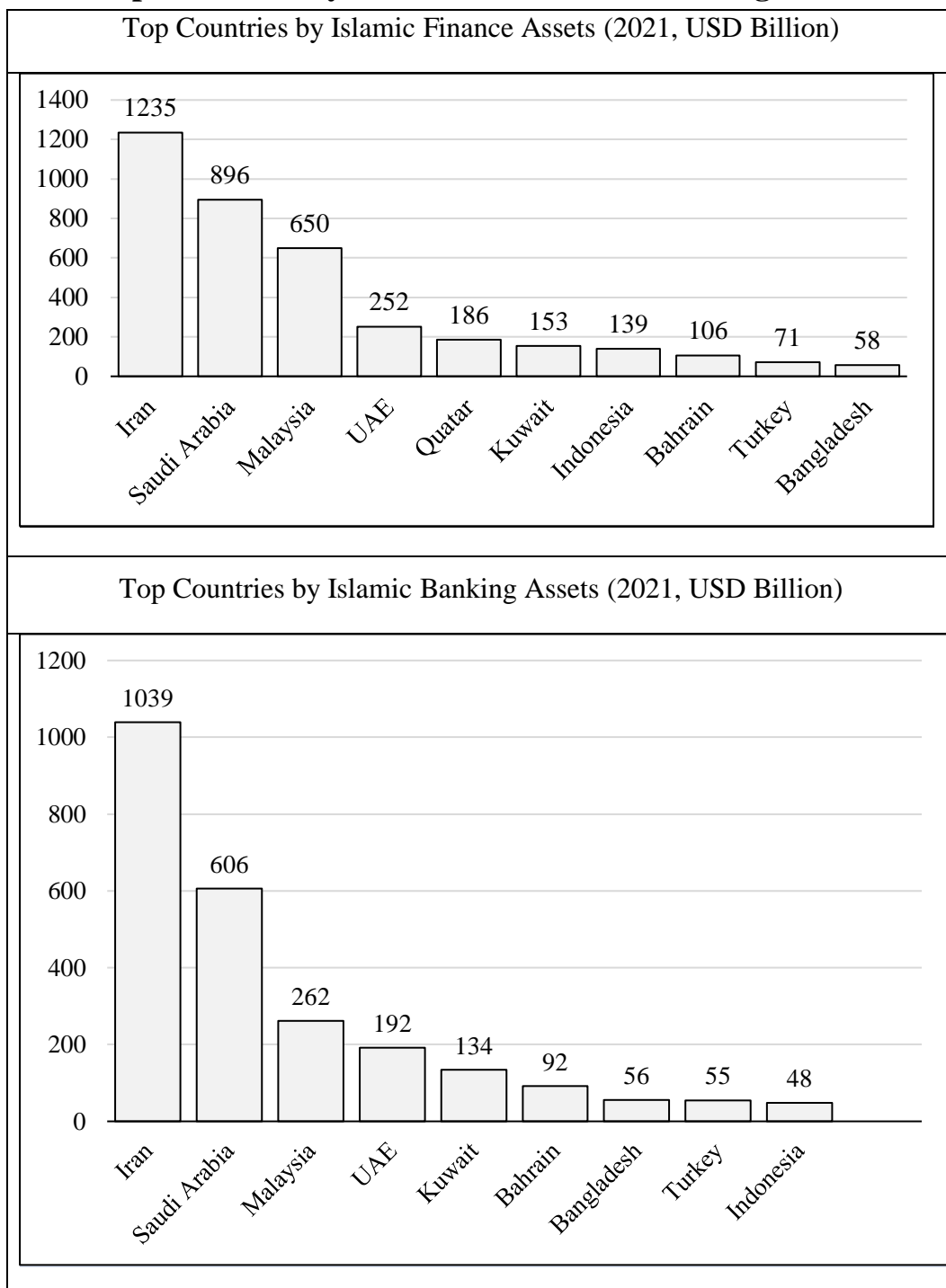
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## Appendix 1

### Top Countries by Islamic Finance and Banking Assets



Source: ICD-REFINITIV Islamic Finance Development Report 2022

## Appendix 2

### Top Countries by IFCI and IFDI

Top 10 Countries by Islamic Finance Country Index (IFCI)						
Rank	Y 2017	Y 2018	Y 2019	Y 2020	Y 2021	Y 2022
R 1	Malaysia	Malaysia	Indonesia	Malaysia	Indonesia	KSA
R 2	Iran	Iran	Malaysia	Indonesia	KSA	Malaysia
R 3	KSA	KSA	Iran	Iran	Malaysia	Indonesia
R 4	UAE	UAE	KSA	KSA	Iran	Iran
R 5	Kuwait	Kuwait	Sudan	Sudan	Pakistan	Pakistan
R 6	Pakistan	Indonesia	Brunei	Pakistan	Sudan	Sudan
R 7	Indonesia	Pakistan	UAE	Brunei	Brunei	Bangladesh
R 8	Bahrain	Bahrain	Bangladesh	UAE	Bangladesh	Brunei
R 9	Qatar	Qatar	Kuwait	Bangladesh	UAE	UAE
R 10	Bangladesh	Bangladesh	Pakistan	Kuwait	Kuwait	Kuwait
Bangladesh was in 10 <sup>th</sup> position in 2013 however, it was not within top 10 countries in 2014 and 2015. Subsequently, it was scored 10 <sup>th</sup> again in 2016.						
Source: GLOBAL ISLAMIC FINANCE REPORT 2022						

Global Islamic Finance Development Indicator (Top IFDI Market 2022)								
Country	Ranking	IFDI Score in 2022	Financial Performance	Gover nance	Sustain ability	Knowl edge	Aware ness	Ranking in 2021 (Score)
Malaysia	1	113	98	94	117	147	172	1 (114)
KSA	2	74	65	49	89	75	143	3 (74)
Indonesia	3	61	31	65	30	195	56	2 (76)
Bahrain	4	59	35	86	36	49	112	4 (64)
Kuwait	5	59	42	75	20	21	157	8 (44)
UAE	6	52	33	71	28	34	116	5 (53)
Oman	7	48	16	89	45	28	94	9 (40)
Pakistan	8	43	22	75	24	52	58	7 (46)
Qatar	9	38	25	47	21	16	102	11 (35)
Bangladesh	10	36	30	61	18	14	47	14 (31)
Maldives	11	32	16	72	35	12	19	10 (35)
Brunei Darussalam	12	31	14	58	10	32	48	12 (34)
Jordan	13	29	15	40	51	43	17	6 (50)
Sudan	14	27	32	51	3	9	5	
Singapore	15	27	4	66	61	4	8	
Global Average		9	5	16	7	7	12	
Note: In 2021, Nigeria was ranked 13 <sup>th</sup> (Score 33) whereas Turkey was ranked 15 <sup>th</sup> (Score 27)								
Source: ICD-REFINITIV Islamic Finance Development Report 2022								

## Appendix 3

### Summary of Islamic Banking Investments (Financing) in Bangladesh

Islamic Banking Investments (BDT Crore) and Its Growth (%)												
	Full-fledged IB		IB Branches		IB Windows		Total IB Invest.		All Bank Credits		Share of IB (%)	
	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)	Amount	Growth (%)		
2025	134,990	11.27	6,148	48.59	2,063	23.90	143,201	12.65	617,474	21.64	23.19	
2016	160,831	19.14	5,186	(15.65)	2,941	42.52	168,957	17.99	713,113	15.49	23.69	
2017	191,279	18.93	5,583	7.66	4,237	44.10	201,100	19.02	844,436	18.42	23.81	
2018	219,797	14.91	6,162	10.36	4,949	16.80	230,907	14.82	960,462	13.74	24.04	
2019	249,885	13.69	7,494	21.62	5,373	8.58	262,752	13.79	1,058,707	10.23	24.82	
2020	279,073	11.68	7,753	3.45	7,269	35.27	294,094	11.93	1,144,907	8.14	25.69	
2021	337,668	21.00	8,242	6.31	7,538	3.71	353,448	20.18	1,267,561	10.71	27.88	
2022	383,584	13.60	10,518	27.61	11,100	47.25	405,202	14.64	1,387,565	9.47	29.20	
Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB												
Bank-wise Investments by IBs (%)												
	IBBL	FSIBL	EXIM	AAIBL	SIBL	SJIBL	Union	ICB	SBL	GIB	IB Br.	IB Win
2015	37.15	12.53	13.38	11.57	9.05	6.76	3.18	0.64			4.30	1.44
2016	36.48	13.07	12.76	11.16	9.90	7.28	3.97	0.55			3.07	1.74
2017	34.86	13.24	12.08	11.48	10.12	7.89	5.01	0.44			2.78	2.11
2018	34.51	13.06	12.61	11.13	10.25	8.06	5.19	0.37			2.67	2.14
2019	34.32	13.84	12.60	10.96	9.97	7.51	5.57	0.32			2.85	2.05
2020	34.49	14.09	13.07	10.53	10.08	6.68	5.66	0.29			2.64	2.47
2021	33.31	12.84	11.75	9.41	8.71	6.13	5.48	0.24	4.64	3.03	2.33	2.13
2022	33.88	13.27	10.96	9.75	8.11	5.85	5.49	0.20	4.24	2.93	2.60	2.74
Ranking	1	2	3	4	5	6	7	10	8	9		
Source: Quarterly Report on Development of Islamic Banking in Bangladesh, BB												
Investments (advances) categorised by economic purposes and sector (%)												
S/n	Economic Purposes					All banks		IB				
						2022	2021	2022	2021			
1	Agriculture, Fishing & Forestry					4.83	4.70	2.44	2.24			
2	Industrial term loan					19.67	20.92	16.06	16.96			
3	Industrial WC financing					19.47	20.37	22.69	24.66			
4	Housing (Commercial)					1.85	2.15	1.88	2.47			
5	Housing (Residential)					2.66	2.44	2.05	1.99			
6	Transport					0.84	1.04	0.90	0.98			
7	Others Construction					3.50	3.87	3.02	3.54			
8	Wholesale and Retail Trade					18.24	18.07	30.20	29.46			
9	Export Financing					6.00	5.85	5.38	5.01			
10	Import Financing					10.11	9.27	8.27	7.52			
11	Other Trade and Finance					0.56	0.62	0.12	0.15			
12	Consumer Finance					9.29	7.88	5.93	3.77			
13	Miscellaneous					2.98	2.82	1.06	1.11			
	Total					100	100	100	100			
Source: Scheduled Banks Statistics, BB												

## Appendix 4

### A Summary of Contents 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	Ijara 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?
Comingling 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 Shari'ah 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 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.
Instalment	Equated monthly instalment (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. Instalment 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



## **Bangladesh Institute of Bank Management**

Plot No.-4 MainRoad No.-1(South), Section No. - 2, Mirpur, Dhaka - 1216  
Tel: 48032091-4; 48032097-8; 48032104; email: [office@bibm.org.bd](mailto:office@bibm.org.bd); Website: [www.bibm.org.bd](http://www.bibm.org.bd)

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