

# Development of Islamic Banking in Bangladesh: Issues and Challenges

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## *Abstract*

*Islamic shariah principles are the foundations of Islamic banking. Islamic banking is responsible not only to avoid riba, but also to avoid unethical practices and participate actively in achieving the welfare goals in an Islamic economy. In the process of offering Islamic banking services, the practitioners have been facing several challenges. Addressing some of these challenges is critical for improving the efficiency of Islamic banking activities in the country. As opined in the survey, while operating in conventional environment, Islamic finance requires a different legal and supervisory framework appropriate to its nature of business. Absence of separate act and comprehensive standards covering all areas for the Islamic Banking activities in Bangladesh are creating difficulties in a number of ways on Shariah compliance issues. Apart from this, the human capital involved in Islamic banking must be trained in the relevant field in accordance with the demand of the sector. The study identifies the dearth of standard and harmonized guidelines and tools for expansion of Islamic banking in the country. Many of these may be required to address country and society specific need. There is no doubt that in certain areas global common standards may be drawn from the globally recognized standard setters of Islamic banking. It is also important to activate interbank money market of the country. Islamic banks in Bangladesh need more Shariah compliant bonds to manage their liquidity effectively. The policy makers of the country may think of having bonds like Sukuk and potential of introducing Commodity Murabaha may also be explored.*

Keywords: Islamic banking; Islamic Shariah; Riba.

JEL Classification: G21, G32

## **1. Introduction**

### **1.1: Background of the Study**

Islamic banking is a collection of banking activities that complies with the shariah principles . Islamic banking is obligated not only to remain free from riba, but also to maintain ethical practices and to participate actively in achieving the welfare goals in an Islamic economy. In Islamic law, riba is totally prohibited because it has a lot of bad effects on society (Usmani, 1996). The Islamic Shariah and its various sources like the Holy Quran, Sunnah, Ijma and Qiyas are the basis for forming and running the Islamic banking system. It has been argued in the Islamic banking literature that the investment in Islamic financial system could really be helpful to economy that might enhance the businesses and

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welfare of the society (Ahmad, 2008). In regard to the history of Islamic banking, 1950s and 1960s are seen as the decades of experiments, and 1970s is considered as the decade of establishment. Since the mid 70s Islamic banking and finance has expanded to over 70 countries encompassing most of the Muslim world; about 57 developing and emerging market countries and 13 other developed countries of the world (Otit, 2014). While Islamic banking may not be a totally new concept, the widespread expansion of this form of banking is certainly not a fairly old phenomenon that started mainly from mid 1980s. Islamic banking commenced operations in Bangladesh in 1983, and now alongside full-fledged Islamic banks, a good number of conventional banks have been offering Islamic banking services using their branch networks. Since inception, Islamic banks have grown consistently in the country during a period of over 30 years. The efficiency level of the banking operations depends upon a number of factors of which adequate and reliable information are also crucial. In the context of Bangladesh, the information on the Islamic banking practices is being made available through limited research activities only in recent years. For the improvement of the Islamic banking practices, it is important to understand the status of operations, progress and trends in different Islamic banking activities by the bankers, academicians and researchers of the relevant fields. Capturing the detailed information on the trends, changes, dimensions, issues and challenges would also facilitate practitioners and academicians to handle challenges and to undertake future course of action for greater efficiency.

### **1.2: Objectives of the Study**

The objectives of the study are: (1) to discuss conceptual aspects of Islamic banking and to review relevant literature; (2) to examine regulatory environment of Islamic banking in Bangladesh; (3) to discuss Islamic banking services and operation in Bangladesh; and (4) to identify challenges for improving Islamic banking operation in the country and place some recommendations.

### **1.3: Methodology and Data**

Both primary and secondary data have been collected to fulfill the objectives of the study. Secondary data are collected from different books, journal, and publications related to Islamic banking practices in global economies and in the country. Both open-ended and close-ended questions have been incorporated in the questionnaire for the survey. Moreover, a schedule (open ended questionnaire) was used to obtain opinion on several critical issues of Islamic banking. The survey samples (Islamic banks and selected branches of the conventional banks) are determined purposively based on three considerations: one, Islamic banking practices of banks of the country should be brought under the survey; two, branches of the conventional banks that are involved in Islamic banking transactions should be covered by the study; and three, practices of the windows of a few conventional banks should be covered by the study.

#### **1.4: Organization of the Report**

The report has been organized under six sections: after an introductory section with the objectives and methodological issues, section 2 deals with the conceptual issues. Section 3 discusses Islamic banking practices in global economies. Legal environment of the Islamic banking in the country are discussed in section 4. Section 5 deals with the activities and operations of Islamic banking in Bangladesh. And section 6 identified challenges and put forward a few recommendations.

### **2. Islamic Banking: Conceptual Aspects**

#### **2.1: Evolution and Expansion of Islamic Banking**

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

It is difficult to say with accuracy which was the first such company or bank that pioneered this concept in practice. As found in some literature (Chapra 1996; Oitti, 2004) early experiments with Islamic Banking took place in Malaysia in the mid 1940s, in Pakistan in the late 1950s and in Egypt in 1960s. Some analysts and experts in the field are of the opinion (Mohamed 2007) that, Islamic banking and finance, in the modern context, first emerged in 1963, when Mit-Ghamr Saving Bank began an experimental project offering interest free banking in Egypt. According to Mastura (1988), Mit Ghamr Bank helped set general guidelines and came up with new terminologies that helped future Islamic banks and gave them the hope that Islamic banking could be competitive and profitable. In the seventies, a number of Islamic banks came into existence in the Middle East, e.g., the Dubai Islamic Bank (1975), the Faisal Islamic Bank of Sudan (1977), the Faisal Islamic Bank of Egypt (1977), and the Bahrain Islamic Bank (1979), to mention a few (Siddiqi 1988). Islamic banking made its debut in South and Southeast Asia in 1983 with the establishment of Islami Bank Bangladesh Ltd. and Bank Islam Malaysia Berhad (BIMB) which represent full-fledged Islamic commercial banks in Bangladesh and Malaysia (Man, 1988). Currently, Malaysia, Saudi Arabia, UAE and Bahrain with the largest concentration of Islamic financial institutions are hosting a good number of Islamic financial institutions dealing in diversified activities including commercial banking, investment banking and funds management (Ernst and Young, 2013). Of the other countries, notably, Sudan and Iran also switched over to Islamic banking system at national level in 1984. The Islamic

Banking System (now called Islamic Finance House), established in Luxembourg in 1978, represents the first attempt at Islamic banking in the Western world. In recent time, notable initiatives have been undertaken in UK, Germany, and USA.

## 2.2: Shariah Laws and Key Principles of Islamic Banking

It is well-known that Shariah' is the basis for Islamic banking. The rules and practices of fiqh muamalat are derived from the Holy Quran and the Sunnah, and other secondary sources of Islamic law such as opinions collectively agreed among Shariah scholars (ijma'), analogy (qiyas) and personal reasoning (ijtihad). More specifically, two sources have been identified for Shariah: primary and secondary sources. The Quran is the first primary source of Shariah. Sunnah is the second primary source. Sunnah generally refers to all that is narrated from the Prophet, his acts, his sayings, whatever he tacitly approved, plus all the reports that describes his physical attributes and characters (Kettell, 2011). Thus Sunnah is the second source of the Sharia'a after Qur'an; scholars of Islamic laws are to observe the order of priority. The secondary sources are Ijma, Qiyas and Istihad. Ijma means consensus of juristic opinions of the Scholars. Qiyas .i.e. analogical reasoning, suggests an equality or close similarity between two things, one of which is taken as the criterion for evaluating the other. The Arabic word Ijtihad literally means an effort or exercise to arrive at one's own judgment. In its widest sense, it means the use of human reason in the elaboration and explanation of Shariah a law. Qiyas or analogical reasoning, then, is a particular form of Ijtihad, the method by which the principles established by the Quran, Sunnah and Ijma are to be extended and applied to the solution of new problems not expressly regulated before (Kettell, 2011).

In Islamic finance, Riba is totally prohibited which is the return derived from the loan/debt. The word 'riba' as appearing in the Holy Quran is translated in English as 'usury' or 'interest'. Riba literally means an 'increment' or 'excess' but in essence it means unfair advantage or profiteering, which is prohibited in Islam<sup>2</sup>. Thus in some literature, attempts have been made to make distinction between Interest and Riba. However, according to most available literature and schools of thoughts, Interest is not different from Riba and is prohibited in Islam. Transactions must also avoid uncertainty (Gharar)<sup>3</sup>, or anything that could lead to the unjust enrichment or unfair exploitation of one of the parties to a contract (Dusuki, 2011). Another kind of activity which banks have to avoid is gambling/games of chance (Ayub, 2007). Moreover, transaction cannot be made that involve prohibited products or activities, such as alcohol, illicit drugs and tobacco because Islam wants to develop an ethical and friendly environment in the society (Imeson, 2007). Thus, based on

2 Khan, Shahnewas (undated) The Differences between Riba, Usury and Interest.  
<http://www.paklink.biz/articles/interest-riba.html>

3 Gharar refers to entering into a contract in absolute risk or uncertainty about the ultimate result of the contract and the nature and/or quality and specifications of the subject matter or the rights and obligations of the parties. Gharar is also involved if there is a lack of adequate value-relevant information or there is inadequacy and inaccuracy of any vital information which leads to uncertainty and exploitation of any of the parties. (Ayub, 2007).

the Islamic laws and prohibitions, some key principles can be derived for the Islamic banking activities (based on Ayub, 2007; IERB, 2008; Kettell, 2011): predetermined loan repayments as interest is prohibited; profit and loss sharing is at the heart of the Islamic system; making money out of money is unacceptable- all financial transactions must be asset-backed; only Shariah-approved contracts are acceptable. However, it is to be mentioned that all prefixed returns are not Riba.<sup>4</sup> Available literature (Ayub, 2007; Kettell, 2011) also identified several business ethics to be followed while offering Islamic banking services: Justice in fair dealing; dealing in goods and not in money; adequate transparency and disclosure; and entitlement to profit with risk and responsibility. A Shariah compliant banking must meet all the requirements of Islamic law. To facilitate this, Shariah Supervisory Committee is commonly appointed. According to Fuad and Iqbal (2011), because of the religious dimension of Islamic banking and finance, no new product can be adopted until it is cleared by Shariah scholars. Even after a new product is put into use, Shariah auditing of the operations of financial institutions is very important to ensure that the actual practice complies with the requirements of Shariah.

### 2.3: Modes of Investment in Islamic Banking

The nature of Islamic banking is based on risk-sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts using various Islamic modes of finance. Different modes have been prescribed in the available literature (Peter, 1992; Ayub, 2007; Ahmad, 2008) that comply with the Islamic Shariah: Partnerships or Mudaraba/Musharaka; Cost plus sale or Murabaha; Credit sales or Bai-muajjal; Leasing or Ijara; Islamic forwards or salam and Istisna. According to Usmani (1998) the partnership products like Musharakah and Mudarabh are ideal instruments of financing according to the Shariah. Murabaha is the most widely used instruments in Islamic finance. Nowadays the Home Finance and Islamic mortgage are based on the concept of Ijara and it is very successful tool in Islamic banking. Islamic forwards or Salam is not very commonly used.

Mudaraba or Trust Financing is a mode of Islamic banking that commonly grouped under the banner 'profit and loss sharing'. It has been assumed by some that the profit and loss sharing methods were somehow more ideal from an Islamic point of view. It is a contract between investors/bank/financial institutions (FI) and entrepreneur/client, acting as silent partners, and a FI, acting as a fiduciary/manager, to invest in an activity or a pre-determined asset class that earns each partner an agreed upon profit portion of the investment.

Musharaka or Partnership is an equity participation arrangement where a bank and an enterprise in which the bank supplies and its partner share the profits which may be different from capital contributed. Alternatively, 'Diminishing Musharaka' agrees to buy out the Bank's share over a period of time.

<sup>4</sup> Any return on investment/transaction may not be variable. In a number of structures it could be fixed and still Shariah compliant. It depends upon the nature of transactions (Ayub, 2007).

Cost plus sale or Murabaha contracts in which a financial institution purchase goods upon the request of a client, who makes deferred payments that cover the cost and an agreed-upon profit margin for the financial institution. In such a contract, the Islamic bank or financial institution must own the item at the time the customer buys it from them with the specified profit margin.

Bai-Mua'jjal or Credit Sale is a deferred payment sale contract between the bank and client. As per the contract, the bank earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments.

Ijarah or Leasing is not a sale of the object, but rather a sale of the usufruct (the right to use the object) for a specified period of time. The most important financial difference between the Shariah permitted leasing and conventional financial leasing is that the leasing agency must own the leased object for the duration of the lease.

Salam and Istisna or Islamic forwards are not very commonly used. These are contracts in which advance payment is made for goods to be delivered later on. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract.

#### **2.4: Savings, Investment and Other Products of Islamic Banking**

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

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

Bai-Murabaha, Bai-Muajjal, Bai-Salam are particularly suitable for trade, while Ijarah, Istisna'a are especially suitable for industry. More specifically, in trade and industry, financing is needed for the purchase of raw materials, inventory (goods in trade) and fixed assets as well as some working capital, for the payment of salaries and other recurrent expenses. Murabaha can be used for financing of all purchases of raw materials and

inventory. For procurement of fixed assets including plant and machinery, buildings, etc., either installments sale or leasing can be used. Funds for recurrent expenses can be obtained by the advance sale of final products of the company using Salam or Istisna. Personal finance for consumer durables can be provided through Murabaha, leasing and in special cases by way of return-free investments out of the current accounts or the banks' own funds. The alternatives for auto finance are Ijarah Muntahia-bi-Tamleek and Murabaha. Housing finance is possible through Murabaha, Diminishing Musharakah and rent-sharing. Project financing can be provided through various modes of financing. Currently, Ijarah is a popular mode of finance for undertaking project finance.

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

Liquidity can be managed by the Islamic banks by dealing in the Islamic inter-bank fund market. The Mudarabah contract is the most useful instrument for transactions in the inter-bank market. Government and public sector enterprises can obtain finance by way of issuing Mudarabah or Musharakah certificates/Sukuk, which can be issued to purchase equipment or utility-generating assets. Ijarah, Musharakah and Istisna are best suited for infrastructure projects in the public sector. Recently, Ijarah Sukuk has emerged as the most crucial instruments for financing of the public sector. Through syndication arrangement, Islamic banks can supply goods/assets of enormous value to government entities or corporations on a Murabaha basis by setting up joint Murabaha pool of funds. For the inflow of foreign resources, the instruments of portfolio investment through stock markets, flotation of various categories of Sukuk and direct investment by foreigners can be used.

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

## **2.5: Comparison between Conventional Banking and Islamic Banking**

There have been attempts in literature to compare Islamic banking and conventional banking. In this connection, Moumoud (2000) noted that 'Islamic finance' is in many ways similar to conventional finance. He added, 'Islamic banks' or 'Islamic financial

institutions' are to ensure that all their contracts would adhere to Islamic legal requirements (Moumoud, 2000). According to Ahmad (2008), Islamic banking has same purposes and practices as conventional banking except that Islamic banks operate in accordance with Sha'riah laws. Islamic banks, in compliance with the welfare principle of Islam, offer facilities more or less the same segment of the economy as the conventional banks do (Nienhaus, 1995).

According to El-Gamal (2001), the central concept in Islamic banking and finance is justice, which is achieved mainly through the sharing of risk; and stakeholders are supposed to share profits and losses. While justice stems usually from a religious or ethical basis, ethical finance is not a new concept. As Subbarao (2009) noted, people often forget that the godfather of modern capitalism, and often called the first economist, Adam Smith was not an economist, but rather a professor of moral philosophy. Smith had a profound understanding of the ethical foundations of markets and was deeply suspicious of the "merchant class" and their tendency to arrange affairs to suit their private interests at public expense.... in short, Smith emphasized the ethical content of economics, something that got eroded over the centuries as economics tried to move from being a value-based social science to a value-free exact science (Subbarao (2009).

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

On the funding side, profit sharing investment accounts are being replaced in a number of Islamic banks by time deposits based on reverse Murabahah transactions. These deposits do not have the risk-sharing features, since the return on them is guaranteed. In addition, demand deposits, which do not share profits or losses, represent a significant part of deposits in some banks. On the asset side, risk sharing (Mudharabah, Musharakah) is the exception rather than the rule: most financing is in the form of Murabahah contracts (cost plus financing) or installment sales (70-80 percent), making credit risk the main risk faced by Islamic Banks, similar to conventional banks. The Capital Adequacy and Risk Management standards issued by the Islamic Financial Services Board (IFSB) suggest that the type and size of financial risks in Shariah-compliant contracts are not significantly different from those in conventional contracts (IFSB, 2013).

### **3. Islamic Banking Practices in Global Economies**

#### **3.1: Status of Islamic Banking in the Global Economy**

Islamic banking markets have been expanding rapidly over the years and Islamic banks account for the lion's share of total assets in the global Islamic finance market that is estimated to around 75 percent of the total (Standard & Poor, 2012). Global Islamic banking assets with commercial banks reached to USD1.8 trillion in 2013 from USD 1.3 trillion in 2011, representing average annual growth of 17 percent; it is forecasted to grow beyond the milestone of USD2 trillion by 2014 (Ernst & Young, 2013). Several factors have contributed to the strong growth of Islamic banking and finance, including: one, strong demand in many Islamic countries for Shariah-compliant products; two, progress in strengthening the legal and regulatory framework for Islamic finance; three, growing demand from conventional investors, including for diversification purposes; and four, the capacity of the industry to develop a number of financial instruments that meet most of the needs of corporate and individual investors (IFSB, 2013). According to a recent publication, potential for Islamic financial services is estimated at USD4 trillion by 2020 (Failaka International)<sup>5</sup>.

In regard to the use of Islamic banking instruments, the PLS transactions are not often conducted by Islamic banks (Sobol, 2012). The reason for such a situation lies in the fact that there are many problems associated with those modes of finance, and most of the problems result from the information asymmetry which may lead to moral hazard behavior of the borrowers. As a consequence of problems associated with PLS transactions, other methods of finance such as murabaha, salam, istisna and ijara are much more often used by Islamic banks (Schoon, 2010).

#### **3.2: Competition and Transformation of Islamic Banking**

IFSB (2013) in its Islamic Financial Services Stability Report 2013 observed that Islamic banks were facing ever-increasing competition, and an important development in Islamic banking in the last few years had been the entry of some conventional banks in that market. Even some Giants of international banking business such as Chase Manhattan, Citibank, ANZ Grindlays, HSBC, Citi NA etc. have initiated Islamic banking activities in different locations; and these are kind of recognitions of the viability of Islamic banking as an alternative model (IFSB, 2013).

#### **3.3: Regulatory and Supervisory Standards of Islamic Banking**

The supervision of Islamic banks is as important as that of the conventional banks. In most countries, Islamic banks are put under the supervision of the central bank of the country and are given the same treatment as given to normal commercial banks. In some countries special laws have been introduced to facilitate Islamic banking, while in others no such

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5 <http://failaka.com/#sthash.nrssKGYy.dpbs>

laws have been introduced (Chapra, 2000). One of the most important concerns of regulators and supervisors of Islamic banks is how to apply internationally recognized standards to these institutions while, simultaneously, enabling them to operate in conformity with the Shariah. Islamic banks are generally supervised within the framework of the prevailing international commercial banking supervisory systems, and thus regulatory standards of the Basel Committee are also necessary for Islamic banks, because, there are systemic considerations.

Since capital adequacy is now internationally considered to be the core of systemic safety and hence supervisory concerns, the fulfillment of this crucial requirement help enhance the credibility and growth of Islamic banking worldwide. While the nature of demand deposits of these banks is not different from that of conventional banks, the nature of investments and deposits are significantly different. The establishment of capital adequacy standards by the AAOIFI has helped crystallize the differences between the capital of Islamic and conventional banks. However, the compliance with the standards of AAOIFI has not yet fully materialized (Ernst & Young, 2013). Some organizations and committees have been contributing in the development of Islamic banking in global economy as standard setters and for handling the unresolved issues related to Islamic banking. OIC and Islamic Development Bank (IDB) and AAOIFI have been playing crucial role in this connection. A committee of experts set up by the Governors of Central Banks and Monetary Authorities of the OIC countries have been working on the whole range of relationships between the Central Banks and the Islamic Banks and submitted several reports on Promotion, Regulation and Supervision of Islamic Banks. In regard to the spreading of Islamic banking practices in the Muslim majority countries, the active role of IDB has been a positive factor in the development of Islamic banking. AAOIFI, a technical and juridical organization of IDB, now functional and based in Bahrain, is composed of a supervisory committee and a Financial Accounting Standards Board responsible for preparing, issuing and amending the accounting standards. IFSB is another international standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB also conducts research and coordinates initiatives on industry related issues, as well as organizes roundtables, seminars and conferences for regulators and industry stakeholders. Some Institutions such as the Islamic Research and Training Institute and Islamic universities are also playing an active role, and of these OIC Fiqha Academy in Jeddah is notable (IFSB, 2013).

### **3.4: Some Unresolved Issues**

Despite repeated efforts and discussion, some issues and areas remain challenging for the Islamic bankers and their well wishers. One of the most important of these issues is the failure of the purchaser of goods and services under the Murabaha mode of financing to

make payment on time even when he is capable of doing so. If this failure is due to strained circumstances, then Islam recommends not just rescheduling but even remission, if necessary. However, if it is due to unscrupulousness, then the question is whether a penalty can be imposed on the defaulter and whether the financier or the bank can be compensated for the damage as well as the loss of income caused by such default? If the late payment does not lead to any penalty, there is a danger that the default may tend to become a widespread phenomenon through the long-run operation of self-reinforcing mechanisms. Designing Shariah compatible financial instruments is one of the most important challenges confronted by the Islamic financial institutions at present. One of the most effective applications of financial engineering has been in the area of hedging. The question that, therefore, arises is whether the mechanism of hedging to protect the importer from exchange rate fluctuations is permissible. The classical verdict so far is that hedging is not permissible. This opinion is based on three objections. These are that: hedging involves Gharar (excessive uncertainty), interest (riba) payment and receipt, and forward sale of currencies. All three of these are prohibited by the Shariah. As far as Gharar is concerned, the objection is not valid because hedging in fact helps eliminate Gharar by enabling the importer to buy the needed foreign exchange at the current exchange rate (Dususki, 2011). The bank can also handle its own risk. The third objection is, of course, very serious. Forward transactions in currencies have been prohibited in Sunnah.

#### **4. Legal Environment of Islamic Banking in Bangladesh**

Bangladesh Bank issued license in 1983 (as per the Banking Companies Act 1991) for establishment of the first Islamic bank in Bangladesh. The Bangladesh Government had participated in establishing the Bank, by subscribing five percent share in the paid up capital. Though there is no complete Islamic Banking Act for controlling, guiding and supervising the Islamic banks in Bangladesh, some Islamic banking provisions have already been incorporated in the amended Banking Companies Act, 1991 (Act No. 14 of 1991). Bangladesh Bank has not set up any separate Department at its Head Office to control, guide and supervise the operation of the Islamic banks. Though there is a dedicated Inspection Department (DBI-4) for inspection of Islamic banks and foreign banks, the Inspection and supervision of the Islamic banking operations are conducted by the Bangladesh Bank as per the general guidelines framed for the conventional banks. So, ensuring implementation of Shariah principles in the Islamic banks are being conducted by their own Shariah Committees. The role of Bangladesh Bank in controlling, guiding and supervising the Islamic Banks in Bangladesh in accordance with Islamic Shariah is very minimal. In observing the Shariah implementation status of the Islamic banks, Bangladesh Bank examines mainly the report of the respective banks' Shariah Councils.

Considering lack of Islamic financial markets and instruments or products in the country, Bangladesh Bank had granted some preferential provisions for smooth development of Islamic banking in Bangladesh. For example, Islamic banks in Bangladesh have been allowed to maintain their Statutory Liquidity Requirement (SLR) at 11.5 percent of the

total deposit liabilities while it is 19 percent for the conventional banks<sup>6</sup>. Islamic banks have been enjoying relaxed rate of SLR mainly due to the non-availability of Islamic treasury bills/bonds in the market. In the deregulated regime, Islamic banks are allowed to fix up their profit-sharing ratios and mark-ups independently commensurate with their own policy and banking environment. This freedom in fixing PLS ratios and Mark-up rates has provided scope for the Islamic banks to follow the Shariah principles independently. However, according to the survey information, Islamic banks are to abide by the restriction of the interest rate spread of the Bangladesh Bank. At present, there is no Central Shariah Supervisory Board to monitor and examine the functions of Islamic banks in Bangladesh. Bangladesh Bank has to depend on the Shariah certificates provided by the Shariah Supervisory Committee of the respective Islamic banks.

Bangladesh Bank formulated a guideline<sup>7</sup> in 2009 for conducting banking business of the Islamic Bank/Islamic bank branches of conventional banks. This guideline embodying the principles and modes of deposits and investments also dwelt upon the issues of liquidity, maintenance of books of accounts and preparation of financial statements and other related issues. The guideline was issued in pursuance of Section 45 of Banking Company Act, 1991 (Amended in 2003). As noted in the guideline, this should be treated as supplementary, not substitute, to the existing banking laws, rules and regulations. It refers to AAOIFI standards for accounting and auditing in case of preparation and disclosure of financial statements.

The BB guideline pointed out specific criteria for setting up full-fledged Islamic Bank in the country. The financial transactions of the bank shall be conducted based on the principles of Islamic Shariah. The banking company is to maintain the required capital adequacy ratio, as prescribed by the Bangladesh Bank. The Chief Executive (CE) would be a professional combined with at least 3 years Islamic banking experience, and having complied with all the terms & conditions of the 'Fit & proper Test' issued by Bangladesh Bank and have no adverse information regarding his integrity and performance. Practically, the provisions related to the establishment of Islamic banks and appointments of CE are almost same.

The guidelines identifies terms & conditions for the conventional Banks to obtain License for opening Islamic Banking Branch. The applying bank is required to submit a proposal for opening Islamic branch to the concerned department of Bangladesh Bank with a working paper that states services and products to be offered (regarding deposits, investments, financing etc.) by the Islamic banking branch; commitment to keep funds and accounts of Islamic banking branches completely separate from those of the conventional ones; methods of segregating the funds of the Islamic branches from the funds of

6 BB DOS Circular No-1, 19 January 2014.

7 Based on the recommendations of a Focus Group comprising representatives of the central Bank, a number of Islamic Banks and the Central Shariah Board for Islamic Banks of Bangladesh (BRPD Circular No 15, Nov 09, 2009).

commercial branches of the bank; accounting aspects to be followed, the principles and mechanism of profit / loss sharing / distribution; undertaking for preparing separate financial statement for the Islamic branches. According to BB guideline, the conventional banks which have Islamic banking branches or windows must have Islamic banking division in their respective head offices and in case of foreign Bank in the Country Office (in Bangladesh). These Islamic banking divisions are required to coordinate their Islamic banking activities with the central bank to ensure proper compliance of various rules and regulations.

As noted in the BB guideline, separation of Funds of Islamic banking branches and control and pursuance of appropriate procedures are to be ensured for safeguarding the interest of the depositors. In this connection, an operational Manual for running Islamic banking business is to be prepared and get approved by the Board of Directors of respective banks and in case of foreign bank, it is to be approved by their Head Office. The Banks have to maintain separate accounting system for their Islamic banking branches. For this purpose, separate ledger books, software etc. are to be maintained. The BB guideline prescribes the necessary measures for the conversion of a Conventional Bank to an Islamic Bank in the country. It will be the responsibility of the board of directors of the respective banks to ensure that the activities of the banks and their products are Shariah compliant. The Board of the Islamic banks/ Subsidiary company/Conventional commercial banks having Islamic branches, therefore, be constituted with directors having requisite knowledge and expertise in Islamic Jurisprudence. The Board may form an independent Shariah Supervisory Committee, however, the Board shall be responsible for any lapses/irregularities on the part of the Shariah Supervisory Committee. A fit and proper criteria for selection of members of the Shariah Supervisory Committee is also noted.

The guideline noted Shariah principles for receiving deposits<sup>8</sup> and making investments<sup>9</sup> by the Islamic banks under different modes including export and import businesses, remittance and other banking services. Besides, the Islamic banks are to fully abide by the national and international norms and guidelines relating to export/import business. Other than these Islamic banks can transfer money through D.D, T.T, T.C etc. and collect the bills (cheque, Draft, Payment order etc.) and realise commission or service charges within the norms of Shariah. Islamic banks can render miscellaneous banking services like locker services, receipt and payment of clients' bills, issuance of Guarantee and working as agents

8 i) Al-Wadeeah principle; and ii) Mudaraba principle.

9 As the investment principles the funds of Islamic banks are to be mainly invested in the following modes: Mudaraba; Musharaka; Bai-Murabaha (Murabaha to the purchase orders); Bai-Muajjal; Salam and parallel Salam; Istisna and parallel Istisna; Ijara; Ijarah Muntahia Bittamleek (Hire Purchase); Hire Purchase Musharaka Mutanaqisa (HPMM); Direct Investment; Investment Auctioning; Quard; Quard Hassan etc. i) Import of Commercial goods. ii) Import of raw materials for production purpose. iii) Import of capital / machineries. The importers avail of investment facilities against all kinds of imports. But in case of imports under category (i) and (ii), investments are made under the Shariah approved Bai-Murabaha and Bai-Muajjal modes and in case of import under category (iii), investment is made under the Shariah compliant mode of Hire Purchase under Shirkatul Melk (HPSM). Investment facilities are also provided for import business through Bai-Salam, Musharaka and Mudaraba modes.

of clients against commission or service charges. Collection of service charges or commissions for rendering those services are permissible under Shariah.

According to the BB guideline, in case of liquidity surplus and crisis the Islamic banks or branches of the conventional banks may invest in the 'Bangladesh Government Islamic Investment Bond' (Islamic Bond introduced by the Government). In the same way, Islamic banks/branches facing liquidity crisis can tide over the crisis by availing of investment from Islamic Bond fund as per the prescribed rules. The operations of 6-month, 1-year and 2-year Bangladesh Government Islamic Investment Bond (Islamic Bond) is introduced in FY05.

Bangladesh Bank initiated to introduce a call money market in December 2011<sup>10</sup> titled Islamic Inter-bank Fund Market (IIFM) for Shariah-based banks that came into existence in June 3, 2012. In such a market, transactions are based on profit instead of interest. On the first day, Islami Bank Bangladesh Ltd offered funds worth Tk 100 crore, while four banks applied for taking Tk 60 crore from the funds. According to rules, if any bank has excess fund, it will invest the amount in the IIFM for one day. Another Islamic bank requiring fund will borrow the money from the IIFM for one day. Though the IIFM has been formed in the model of the traditional call money market to remove the temporary and short-term liquidity crisis of the Islamic banks, yet it failed to attract substantial response from the market. In the first half of the year 2013, there were a few transactions under IIFM, but no single transaction was held in the second half of the same year.

## 5. Islamic Banking Activities and Operations in Bangladesh

The financial sector of Bangladesh is dominated by the banking sector. At present, out of 56 commercial banks in Bangladesh, eight are full-fledged Islamic banks. In addition, fifteen other regular commercial banks and one foreign bank are offering Islamic products through their Islamic banking branches/windows (a total number of 8 banks licensed for branches and 8 banks for windows). Thus as a whole, eight banks<sup>11</sup> are operating as full fledged Islamic banks with more than 750 branches, and eight conventional banks are offering Islamic banking through setting up of 20 Islamic banking branches and eight more conventional banks are doing so with 30 Islamic banking windows<sup>12</sup>. As per the survey observation, all conventional banks which have Islamic banking branches or windows have Islamic banking divisions. According to the BB information, the market share of the Islamic Banks was around 15 percent of the total assets of all banks as of end 2013 in terms of total assets. The figure would definitely be higher if the assets of the branches and windows are considered. In a recent article in a newspaper (Financial Express)<sup>13</sup> it has been

10 BB DOS Circular 23, December 27, 2011.

11 Excluding the newly established Union Bank Limited.

12 Md Touhidul Alam Khan (2014), Huge demand for Islamic banking in Bangladesh, 2014, A country report on Islamic Banking in Bangladesh, Islamic Finance News (IFN) Annual Guide-2014, Malaysia.

13 M Hamid (2013), Streamlining Islamic finance in Bangladesh, Financial Express, 06 April 2013.

claimed that Islamic banking is having 25 per cent market share in the banking sector of Bangladesh. According to the BB information, during 2013, Islamic banks achieved around 15 percent asset growth which is higher the growth archived by the conventional bank (14%). Other than one, all other Islamic banks met required capital adequacy requirement of 10 percent as of end 2013. The non-performing investments of Islamic banks (excluding ICB Islamic and Bank Al-falah) was less than 4 percent of their total investments which is significantly lower than the overall figure of the banking sector<sup>14</sup>.

### **5.1: Governance of Islamic Banking in Bangladesh**

Board, formed as per laws and regulations prevailing in the country and Bangladesh Bank Guidelines, is responsible for governing the banks whether it is Islamic or conventional. Board set and approve overall policy and strategy; monitor progress toward corporate objectives; and ensure accountability of the management to protect stakeholders' right. As part of Shariah governance, a Central Shariah Board for Islamic Banks of Bangladesh (CSBIB) has been formed in 2001 as per the direction of the Bangladesh Bank with the objective to offer the Shariah-based directions and opinions for the Islamic banking industry of Bangladesh. However, till date its activities are mainly limited to organizing a few training and workshops; and publishing books and bulletin for Islamic bankers. One of the important governance organs in an Islamic bank is the presence of Shariah Supervisory Committee (not applicable for conventional counterpart). The committee is governed by the bye-laws approved by the Board. The committee gives opinion and guidelines to implement and comply with the Shariah principles in all activities of the bank and provide a clearance of Shariah compatibility of all products. It oversees the activities of the bank from Shariah perspective and ensures that the profit has been derived without violating the Shariah rulings. The committees of the Islamic banks also evaluate performance of the officials in terms of their Shariah compliance and conducts Shariah inspection to ensure that the Shariah principles are being implemented. Like conventional banks, Islamic banks have Executive Committee, Management Committee, Asset-Liability Committee (ALCO), and Audit Committee to play similar roles. Audit committee is also responsible for Shariah compliance issues alongside the rules and standards of Bangladesh Bank. All the core risk management guidelines of the BB are equally relevant for the Islamic and conventional banks of the country. Thus it can be observed that the Islamic banks are to comply with some additional requirements than that of the conventional banks.

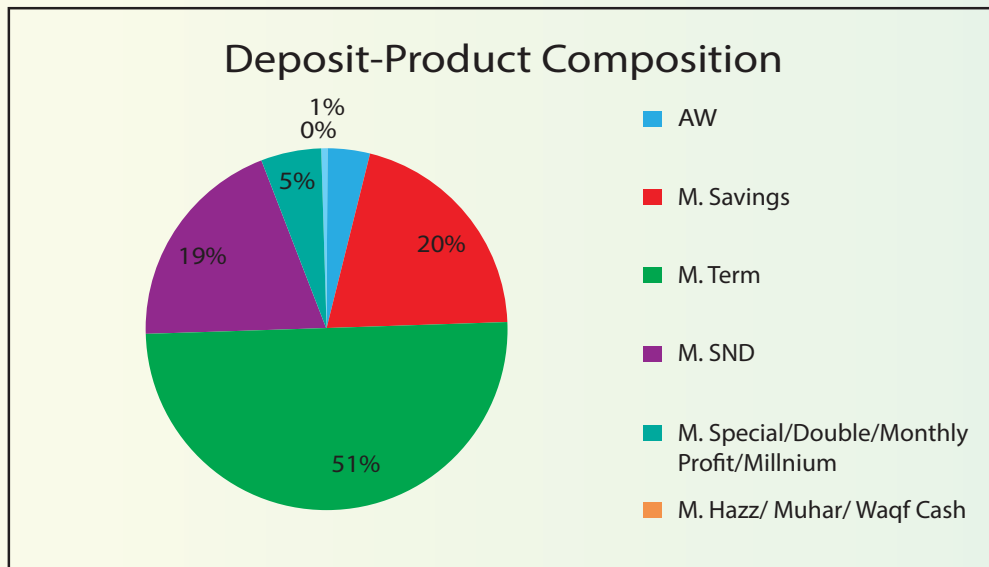
### **5.2: Deposit Products in Islamic Banking in Bangladesh**

According to the available information of BB, as of end 2013, in Bangladesh, the total Shariah-based deposit was around 19 percent of the total deposits of the banking sector. As

<sup>14</sup> Bangladesh Bank (BB) Governor Dr Atiur Rahman told in a seminar that Islamic banks in Bangladesh are performing better than conventional ones, "Barring one exception of a small sick Islamic bank in process of restructuring, the Islamic banks in Bangladesh generally have higher capital adequacy ratios and lower non performing loan ratios than their conventional banking counterparts," (News today, September 24, 2013).

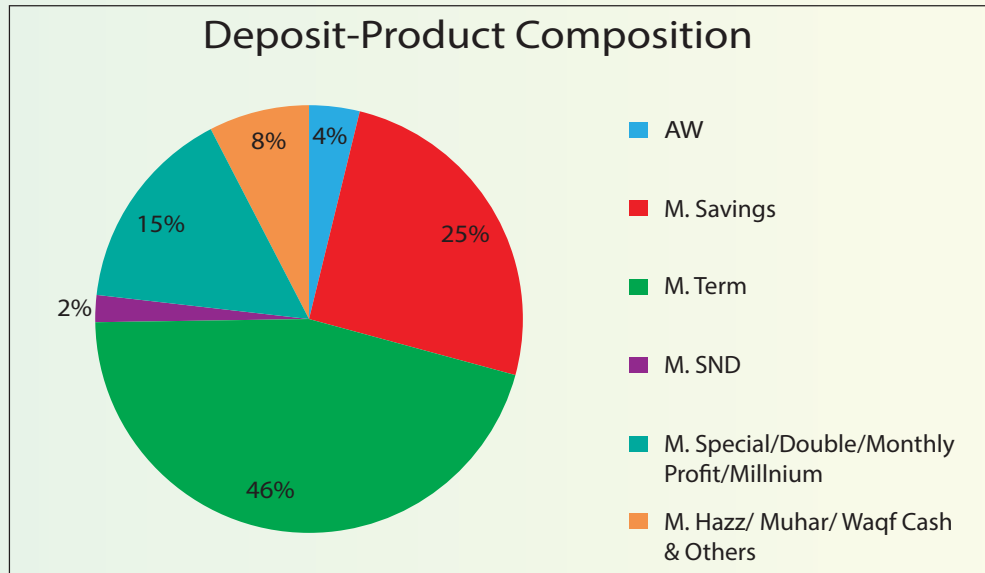
observed in the survey observation, the major deposit products of Islamic banks and Islamic banking branches/windows are based on the basic principles of Islamic Shariah: Al-wadeeah and Mudaraba. The first one is basically in the nature of current account of conventional banking where the customers are not entitled to receive any benefits/profits from the banks. Whereas, in case of Mudaraba products/schemes profits are distributed as per pre-agreed ratio that generally take different forms and titles: Mudaraba savings; Mudaraba term deposit; Mudaraba Short notice deposit; and a few special deposit schemes targeted to certain category of clients and to meet certain purposes. According to the survey data, 'Mudaraba term deposits' is the major component that comprises 51 percent of the total deposits of Islamic banks (Figure-1). Other major forms of deposits include Mudaraba savings (20%) and Mudaraba SND (19%). The volume of Al-wadeeah form of deposits is relatively low with only around 4 percent. Similar composition of deposits is observed in case of Islamic banking branches/windows of the conventional banks (figure-2).

**Figure 1: Deposit Composition of Islamic Banks (Amount outstanding as of end of 2013)**



Source: Survey Data

**Figure 2: Deposit Composition of Islamic Banking Branch/Window of the Conventional Banks (Amount outstanding as of end of 2013)**



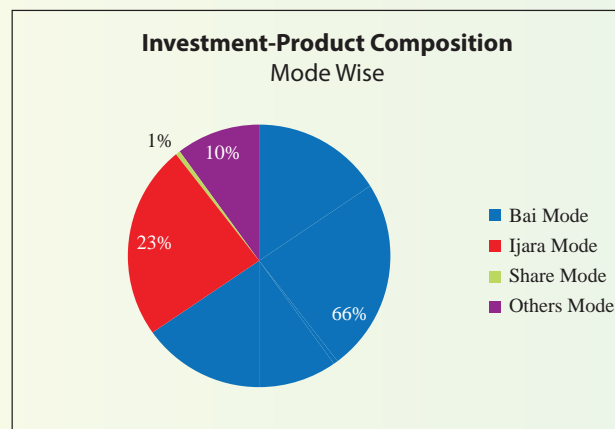
Source: Survey Data

### 5.3: Investment Products in Islamic Banking in Bangladesh

According to BB information, Shariah-based investment accounted for around 21 percent of the total investment and advances as of end of 2013. As observed in the survey observation, the major investment products of Islamic banks and Islamic banking branches/windows (of the conventional banks) are based on the Bai- mechanism or buying and selling as per Islamic Shariah principles. Other mechanism includes Ijara and Share. In most cases, all the other basic modes of Islamic banking have been tagged with these mechanisms. Of the Bai modes, the common investment products that are in use in the country include Bai Murabaha; Bai Muajjal; Bai Salam; Bai-as-sarf; and Bai Istisna. Hire purchase and Hire Purchase under Shirkatul Meelk are related to Ijara mechanism, whereas share mechanism includes Mudaraba and Musharaka. According to the survey data, Bai mode (66%) is the most commonly used investment mechanism of which Bai Muajjal and Bai Murabaha are particularly popular (figure-3). It is to be mentioned here that in some literature, no distinction is made in between Bai Maujjal and Bai Murabaha because of the similarity of the processes. Of the total investment Ijara (HPSM) accounts for 23 percent of the total. It can be observed that the use of the most ideal form of Islamic banking tool based on PLS (Mudaraba and Musharaka) is hardly in use. Similar situation can also be

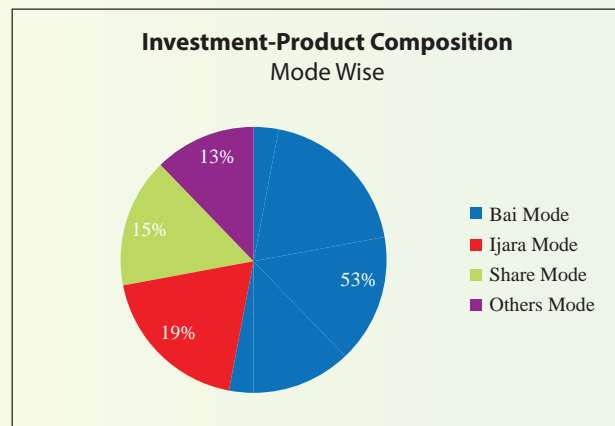
observed in case of Islamic banking branches/windows of the conventional banks where Bai is again the most commonly used mechanism in the country. The only exception is that 15 percent of the total investment portfolio of the branches/windows is in the category of share mode i.e.,Mudaraba/Musharaka (Figure-4). These investments are in the nature of Diminishing Musharaka used mainly by a single foreign bank. To meet the same purposes, local banks generally use Ijara mode (HPSM).

**Figure 3: Investment Product Composition of Islamic Banks (Amount outstanding as of end 2013)**



Source: Survey Data

**Figure 4: Investment Composition of Islamic Banking Branch/Window of Conventional Banks (Amount outstanding as of end of 2013)**



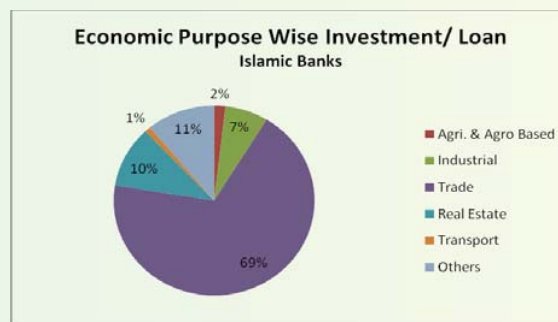
Source: Survey Data

Islamic banks offer trade related services to their clients that are related to letter of credit, back-to-back LC, foreign bank guarantees, bill purchases, and exports bill collections for which different Shariah permissible modes are followed. While opening LC, Islamic banks generally obtain a letter of authorization from the client to act as an agent on behalf of the client. In Islamic Shariah, banks are supposed to handle goods. In this connection, application of UCPDC (mandatory for all banks in the country) may contradict. Generally, goods are consigned to the name of the bank in case of import where banks take ownership of the goods and then sell it to the client under Murabaha agreement. Inland documentary bills are purchased by the Islamic banks under Musharaka mechanism. Purchase and negotiation of export bills are done by the Islamic banks under Bai-as-Sarf mode for which Islamic bank realizes commission or get exchange gain (or loss). Of the other investment products, all Islamic banks offer ATM card services. Two banks (one Islamic bank and other Islamic banking windows of a conventional foreign bank) have credit card services for their clients. Exim Bank Limited is the first local Islamic bank that has introduced credit card in the country for their clients. In regard to the foreign exchange transactions, Islamic banks only transact on the spot.

#### 5.4: Sector Specific Exposure of Investment by Islamic Banks/Branches/Windows

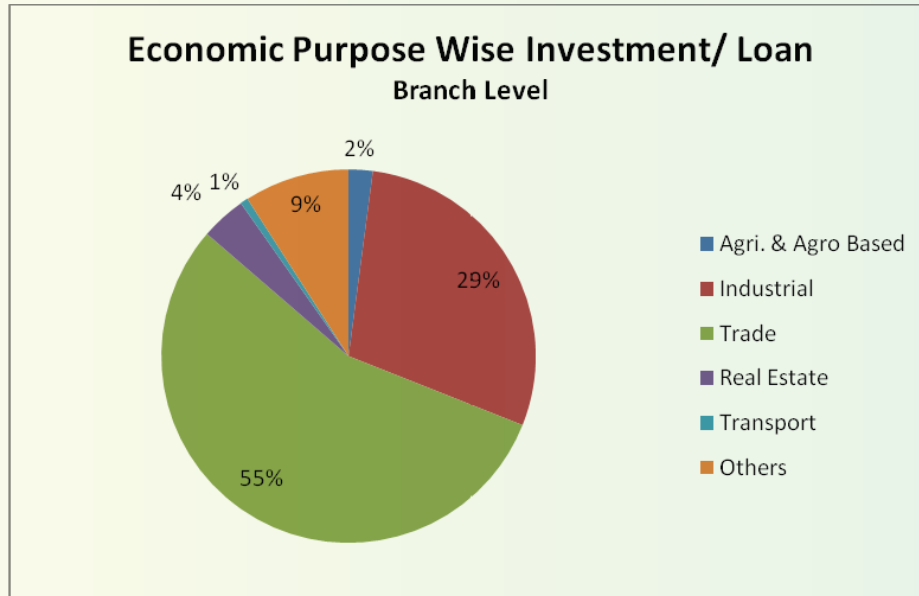
Most of investments of Islamic banks are allocated to the trading sector of the country. Other sectors include industry, real estate etc. Islamic banks are now also focusing on a wider horizon, by getting involved with SME financing, microfinance and financing in agricultural sectors. According to the survey observations, 69 percent of the total investments of the Islamic banks were in trading sector as of end of 2013 (figure-5). In this context, the Islamic banks are not very different from conventional banks. Notable portions of investments are also allocated to real estate (10%) and industrial sector (7%). The sectoral distributions of the Islamic banking branches/windows are not very different (figure-6).

**Figure 5: Sector Specific Exposure of the Investments of Islamic Banks (Amount outstanding as of end of 2013)**



Source: Survey Data

**Figure 6: Sector Specific Exposure of the Investments of Islamic Banking Branch/Window of Conventional Banks (Amount outstanding as of end of 2013)**



### 5.5: Marketing of Islamic Banking Products

Religious belief and faith is the key factor for the popularity of the Islamic banking in the country, as opined in the opinion survey. Almost unanimously it is agreed (in the opinion survey) that it is the Muslim customer base because of which Islamic banking activities are increasingly adopted by a growing number of banks. However, services of the banks have been adding value to pull their customer bases with the increasing competition. Today, even a group of non-Muslims is also showing interests to the Islamic banking products as alternative channel of obtaining funds because of the services. This is obviously not true equally for all Islamic banks. With the growing competition, Islamic banks are also getting aggressive alongside conventional banks to improve their customer bases. Most of the Islamic banks operating in Bangladesh have their own written policy for marketing of Islamic banking products. They have also established marketing department with separate employee set-up in the banks.

### 5.6: Employee Development, Training and Research Activities

All Islamic banks (except one) have training or training & research centers to train their employees. Alongside organizing foundation training programs for their newly recruited employees, these training centers commonly offer employee development programs on the issues related to Islamic Shariah, banking procedures and regulatory requirements of the

central banks. Islami Bank Training and Research Academy (IBTRA) publishes journal, conducts training programs for the other Islamic banks of the country and abroad, and arranges Internship programs for the university students on the Islamic banking issues. It has also a certification program called ‘Diploma in Islamic Banking (DIB)’.

### 5.7: Refinancing, Liquidity Management and Participation in the Bond Market

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

### 5.8: Corporate Social Responsibility Activities of Islamic Banks

All Islamic banks commonly pay Zakah on their respective equity and reserve position as per Islamic rules. Under the umbrella of Corporate Social Responsibility (CSR) activities, the Islamic banks in Bangladesh are engaged in contributing to different sectors including natural disaster, environment, education, health and other social and humanitarian areas. Most of the Islamic banks have set up various types of Bank Foundations which are carrying out the social welfare, education, health and medicare activities on behalf of banks. The aims and objectives of the Foundation are to serve distressed humanity, promote people oriented mass education, extend health and medicare facilities to the poverty-stricken people in urban and rural areas, create facilities for productive self-employment and develop human resources for improving economic condition and quality of life, assist healthy growth of art, culture and literature, science and technology, sports, research and propagation of Islamic teachings.

### 5.9: Outcome of the Opinion Survey on Challenges of Islamic Banking and Suggestion

Inadequate legal and Institutional Framework	100%
Absence of Uniformity on Shariah Standards and Practices	100%
Lack of Customer Orientation	100%
Inadequate Training and Education Facilities	95%
Low exposure in PLS modes	90%
Absence or underdeveloped Islamic Money and Bond market	80%
Inadequate skilled and Professional Islamic Banker	60%
Lack of Required Products to address the Clients	45%

<b>Table-2: Opinions on the measures to Improve Islamic Banking Operation in Bangladesh [as percent of the total banks/branches/windows]</b>	
Enacting Separate Islamic Banking Act	100%
Setting up Separate Islamic Banking Department in the Central Bank	100%
Facilitating Training and Awareness Development Programs for the Stakeholders	100%
Introducing Shariah Compliant Refinancing Programs by BB	100%
Introducing Effective Shariah Compliant Instruments for Liquidity Management	100%
Allowing Takaful (Islamic Insurance) for Supporting Shariah Compliant Activities	90%
Cooperation of BB and Islamic Banks on Shariah Compliance	90%
Establishment of Separate Training and Research Centre for Islamic Banks	80%
Introducing Courses on Islamic Banking in Public and Private Universities	60%

## 6. Concluding Remarks

In the process of offering Islamic banking services, the practitioners have been facing several challenges. Addressing some of these challenges is critical for improving the efficiency of Islamic banking activities in the country. As opined in the survey, while operating in conventional environment, Islamic finance requires a different legal and supervisory framework appropriate to its nature of business. Absence of separate act and comprehensive standards covering all areas for the Islamic Banking activities in Bangladesh are creating difficulties in a number of ways on Shariah compliance issues. In some countries, such Acts were introduced before initiation of Islamic Banking activities. Apart from this, maintaining a capable and active Shariah Board with adequate number of scholars and experts is a challenge for banks. It is also a challenge to transform the Central Shariah Board to a highly capable and active organization to perform the role of advising and giving directives as to whether all functions of the Islamic banks including investment procedures are being carried out in accordance with Shariah or not. A good volume of overhead expenditure is also involved in this process. For small Islamic banks and Islamic banking branches/windows of conventional banks may find the process undesirable. Lack of skilled and trained professionals to fulfill the requirements of the fast growing Islamic banking industry of Bangladesh is a major barrier to the development of Islamic banking in Bangladesh. Islamic banking has also great challenges due to lack of awareness about Islamic banking by its customers. In comparison to the growth of Islamic banking in Bangladesh, there is a shortage of related human resources as well as institutions to teach and train Islamic banking. The Islamic banks of the country face difficulties in liquidity management due to the underdeveloped nature of money market, very shallow bond market and secondary market. Considering these, the study came up with the following recommendations for improving the operational efficiency of the Islamic banking activities of banks:

- (1) A separate act on Islamic banking may be enacted. Currently the central bank has a guideline for Islamic banks. As Islamic banking has become a part of mainstream banking in Bangladesh, it has become necessary to introduce more comprehensive guidelines to bring greater transparency and accountability to the industry. However, in some areas integrated rules would be workable like standards related to prudential regulation, internal controls, risk management and greater transparency. From the central bank's point of view, it is obviously not regulating the religion rather but merely regulating and supervising the commercial transactions just like any other financial transactions. Regulation should aim at achieving healthy growth of the sector and welfare of the society.
- (2) It might be desirable, at least for smaller banks to have a common Shariah board to determine the Shariah compatibility of their products. A common platform well-versed in both the Shariah and modern finance and having adequate research facilities may perhaps be the most suitable for providing the services of a Shariah board. For improving efficiency banks should undertake initiative to activate Central Shariah Board to the desired level with the cooperation of the Bangladesh Bank. The establishment of such institutions will help reduce the overhead costs of Islamic banks and raise their profitability.
- (3) The human capital involved in Islamic banking must be trained in the relevant field in accordance with the demand of the sector. In the current situation of the market, facilitating Islamic banking education alongside modern banking education is an immediate need. To establish Islamic banking and financial system on strong ground, it is essential to create sufficient number of Islamic bankers having full command of Shariah, Fiqha, and Islamic financial products. An effective training on Islamic banking must blend basic banking, Islamic banking, Shariah law and state law.
- (4) It is important to activate interbank money market of the country. Islamic banks need more Shariah compliant bonds to manage their liquidity effectively. The policy makers of the country may think of having bonds like Sukuk; and potential of introducing Commodity Murabaha may also be explored.

The study identifies the dearth of standard and harmonized guidelines and tools for expansion of Islamic banking in the country. Many of these may be required to address country and society specific need. There is no doubt that in certain areas global common standards may be drawn from the globally recognized standard setters of Islamic banking. However, at the same time we think, the Holy Quran has allowed us enough space and flexibility to interpret certain things based on consensus by our own experts and scholars for the well-being of the country through Islamic banking tools.

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