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An Analysis of Mode-wise Investment of Islamic Banks in Bangladesh



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Executive Summary

Islamic banking in Bangladesh has emerged as a significant component of the financial system, demonstrating robust growth and an increasingly prominent role in financial intermediation. Between June 2019 and June 2025, total Islamic banking investments expanded from BDT 2,152 billion to BDT 5,147 billion, representing a 139.2 percent increase and an annualized compound growth rate (CAGR²) of 15.0 percent. The sector contributes to approximately 25 percent of total deposits and 30 percent of investment activities within the banking system, and that reflects a growing customer preference for *Shariah*-compliant financial services in a predominantly Muslim economy.

However, the structure of this investment portfolio reveals a significant trend that calls for thoughtful policy intervention. This policy note identifies a pronounced concentration in various fixed-return modes, such as *Bai* (sale) and *Ijara* (lease), rather than in profit-and-loss sharing (PLS) modes. It should be noted that fixed-return modes sometimes resembles conventional credit instruments, whereas PLS modes are thought to be the cornerstone of Islamic finance's distinctive identity.

As of June 2025, PLS modes (*Musharaka* and *Mudaraba* combined) represent just 0.5 percent of total Islamic banking investments, down from 1.6 percent in June 2019. *Musharaka* alone contracted by 53.7 percent in absolute terms (from BDT 30.9 billion to BDT 14.4 billion). This contraction in the PLS modes and shifting towards various fixed-return modes, raises fundamental concerns for the Islamic banking sector regarding alignment with core *Shariah*-banking principles and the potential for systemic risk concentration.

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²CAGR is a standard financial mathematics formula based on compound interest theory. Standard notation for calculating CAGR = $(\text{Ending Value} / \text{Beginning Value})^{(1 / \text{Number of Years})} - 1$

This note collects primary data from Islamic banks and reviews a comprehensive trend analysis of the investment patterns and identifies critical policy issues. In this regard, three structural trends define this period: (i) the continued dominance and deepening concentration of *Bai-Murabaha* (rising from 45.4 percent to 52.2 percent of total portfolio); (ii) the rapid fourfold expansion of *Ijara* and HPSM modes, which collectively grew from 5.8 percent to 21.7 percent of total investments, driven by real estate demand and liquidity management needs; and (iii) the near-elimination of genuine risk-sharing modes despite being theoretically optimal for promoting entrepreneurship and inclusive development.

In light of the analysis and findings, this research proposes a six-pillar policy framework for Bangladesh Bank (BB): (i) incentivizing PLS modes through minimum allocation targets and preferential capital adequacy treatment; (ii) deepening the *Sukuk* market for Islamic liquidity management; (iii) building human capital capacity for PLS financing; (iv) modernizing the regulatory framework to reduce structural penalties on risk-sharing modes; (v) directing Islamic banking toward development-priority sectors; and (vi) establishing market infrastructure for information sharing and coordination. Sustained implementation of this framework would position Bangladesh's Islamic banking sector for growth that is simultaneously commercially sustainable and principle-aligned, a balance that is both achievable and necessary.

1. Introduction

Islamic banking in Bangladesh commenced operations in 1983 with the establishment of Islami Bank Bangladesh Limited (now, Islami Bank Bangladesh PLC), marking a significant institutional development in the country's financial sector. Over four decades, the sector has evolved from a nascent experiment into a major component of the banking landscape, serving approximately 25 percent of the banking system's deposits and channeling roughly 30 percent of total banking sector investments. This notable expansion reflects both the religious preferences of a 91 percent Muslim population and the demonstrated efficiency of *Shariah*-compliant financial services in meeting diverse economic needs.

Bangladesh Bank (BB), as the regulatory authority, consistently monitors the development of Islamic banking through onsite supervision and regular reporting, via prescribed formats, from Islamic banks. Various analytical reports generated from the received data (quarterly by the Research Department, BB) serve as primary policy instruments through which BB tracks compliance with *Shariah* principles, assesses financial stability, and guides the sector's evolution.

The present trend analysis (from June 2019 to June 2025) examines the composition and dynamics of Islamic banking investments³ across different modes—contractual frameworks through which Islamic banks channel credit to the economy. Understanding mode-wise investment patterns is essential because each mode carries distinct risk characteristics, profit-and-loss implications, and compliance requirements under Islamic jurisprudence. Shifting in the mode preferences over time, signal changes in market conditions, regulatory pressures, technology adoption, and the strategic orientation of Islamic banks.

2. Investment Modes: Conceptual Framework

Modes of Islamic banking investments can be categorized into four primary functional types, each with distinct contractual structures and risk-return profiles:

2.1 Buy-Sale Modes (*Bai* Mechanisms)

These modes are based on the fundamental principle of buying and selling goods and services. *Bai-Murabaha* (cost-plus markup sale) and *Bai-Muajjal* (sale on deferred payment or credit sale) dominate this category. In *Bai-Murabaha* transactions, the bank purchases specific goods at the customer's request and sells them at a markup. *Bai-Muajjal* follows similar principles but allows for extended payment periods.

These modes are characterized by relatively low credit risk (provided the receivables arising from the sale are backed by sufficient collateral), predictable returns to the bank, and straightforward operational procedures. However, critics point out their similarity to conventional loans, as they lack meaningful asset-related risk borne by the bank (since the customer is generally appointed as the bank's agent) and yield fixed returns akin to interest.

2.2 Partnership-Based Modes (PLS Mechanisms)

Musharaka (partnership business) and *Mudaraba* (capital–labor partnership) represent the foundation of Islamic banking principles, embodying risk-sharing between financial and entrepreneurial inputs.

In *Musharaka* investments, both the bank and the client contribute capital, while the client also provides entrepreneurial skills in the form of labor and management. Profits are shared according to agreed ratios, while losses are borne in proportion to capital contributions. *Mudaraba* investments involve the bank providing the full capital, while the client contributes entrepreneurial skills. Profits are distributed according to agreed ratios, while losses are borne solely by the capital provider.

³The unit convention for Islamic banking investment used throughout this policy note, is standardized to BDT billion.

These modes theoretically offer superior developmental outcomes by fostering genuine partnerships with real economic agents. As participatory modes, they possess inherent loss-absorption features, enabling more flexible capital and payout management during downturns. However, they also entail higher credit risk, require intensive monitoring, and are particularly vulnerable to adverse selection and moral hazard.

2.3 Ijara Modes (Ownership and Lease Mechanisms)

Ijara and Hire Purchase under *Shirkatul Melk* (HPSM) involve the bank acquiring specific assets, leasing them to clients, and enabling ownership transfer through a combination of lease and sale agreements. These modes balance *Shariah* compliance with risk mitigation through asset backing, offering moderate credit risk and defined return structures while maintaining a connection to real economic activity.

2.4 Other Modes (*Qard* Mechanism)

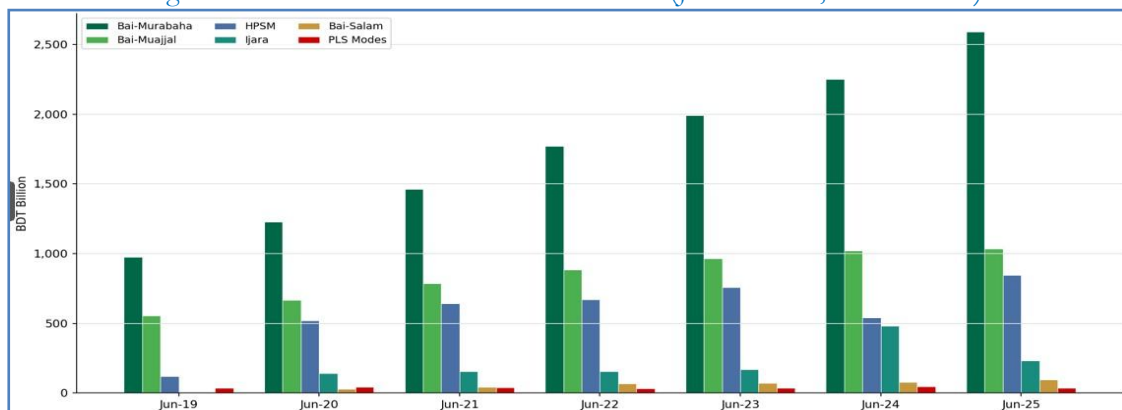
Islamic banks employ two variations of *Qard* (loan), recognizing that any pre-agreed, anticipated, or customary increment over a loan is prohibited under *Shariah*. However, charges for actual costs and services rendered may be permissible.

A *Qard* is a loan in which the borrower is obligated to repay only the principal amount at maturity, without any increase. *Qard-e-Hasan*, in contrast, is a benevolent loan in which the borrower repays the principal while retaining full discretion to offer a voluntary payment above the principal, provided that no explicit or implicit prior arrangement exists.

These modes, particularly *Qard*-based arrangements, occupy an intermediate space between pure charitable lending and commercial financing, combining social welfare objectives with limited institutional sustainability.

3. Trends in Mode-wise Investment (2019-2025)

Figure 1: Investment Modes' Absolute Values (June Annual, BDT Billion)



Source: Data as of December-2025 from Islamic Banks.

3.1 Growth and Composition

As illustrated in Figures 1 and Table 1, Islamic banking investment pattern reflects sustained expansion from BDT 2,152 billion to BDT 5,147 billion between June 2019 to June 2025, with an increase of 139.2 percent and an annualized compound growth rate (CAGR) of 15.0 percent. However, composition of the investment portfolio shows a growing concentration in sale-based modes (*Bai-Murabaha* and *Bai-Muajjal* combine share 70.4 percent), whereas partnership-based PLS modes experienced declining trend (*Musharaka* and *Mudaraba* together sharing only 0.5 percent) over the period.

Table 1: Investment Modes' Characteristics

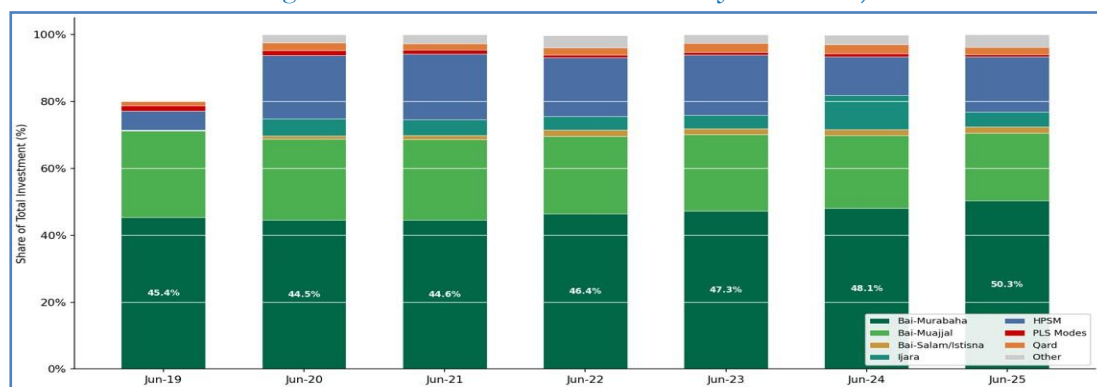
Investment Mode	Category	Nature	Risk Profile	3 Year Gr. rate (Jun-22 to Jun-25)	Jun-25 Share	6-Year Trend
<i>Bai-Murabaha</i>	Sale-Based	Cost-plus markup	Low (Fixed returns)	13.5%	50.3%	Growing
<i>Bai-Muajjal</i>	Sale-Based	Deferred payment sale	Low (Fixed returns)	5.4%	20.1%	Declining/ Stable
HPSM	Ownership Sharing	Lease purchase	Medium (Asset-backed)	8.1%	16.5%	Growing
<i>Ijara</i>	Lease	Lease financing	Medium (Asset-backed)	14.4%	4.5%	Growing
<i>Musharaka</i>	Partnership-Based	Profit-sharing partnership	High (Loss-bearing)	1.3%	0.3%	Declining
<i>Mudaraba</i>	Partnership-Based	Capital + labor partnership	High (Loss-bearing)	-2.5%	0.2%	Declining/ Stable
<i>Qard-e-Hasan</i>	Loan	Interest-free lending	Very Low (Charitable)	10.7%	2.2%	Growing

Source: Authors' own assessment, Data as of December-2025 from Islamic Banks.

3.2 Dominance of *Bai-Murabaha*

Bai-Murabaha is the primary investment mode in Islamic banking, accounting for 50.3 percent of total investments in June 2025, up from 45.4 percent in June 2019 (with 165.4 percent growth and CAGR of 16.9 percent). This growth trajectory outpaces overall portfolio expansion (15.0 percent CAGR), indicating a systematic preference toward *Bai* mechanisms (Figure 2).

Figure 2: Mode-wise Share Stacked Bar (June Annual)



Source: Data as of December-2025 from Islamic Banks.

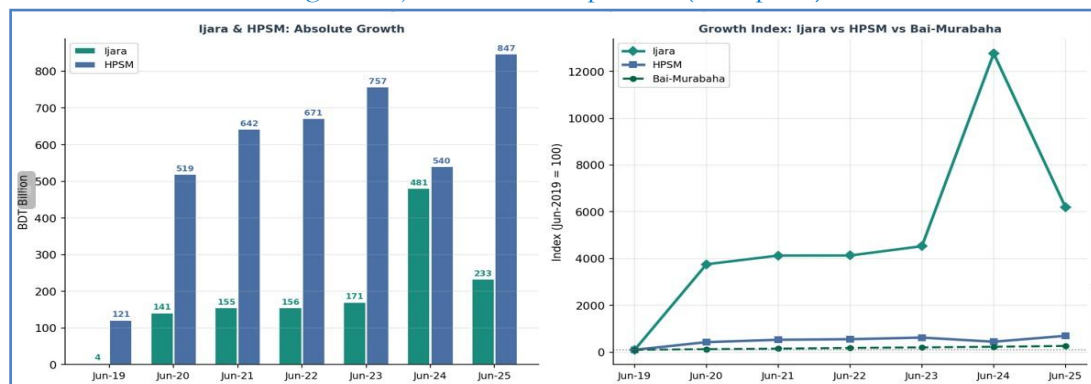
The consistency of *Bai-Murabaha* returns, combined with relatively straightforward operational procedures and lower monitoring costs, explain its ongoing dominance. From financial management perspective, *Bai-Murabaha*, with its fixed-return structure, simplifies risk assessment, capital adequacy calculations, and profit provisioning, offering operational advantages in complex modern banking environments.

However, *Bai-Muajjal* the second-largest mode by market share (20.1 percent), showing modest growth of 86.1 percent and 10.5 percent CAGR, has gradually declining market share from 25.9 percent to 20.1 percent.

3.3 Growth of *Ijara* Modes

The most striking trend is observed in asset ownership and lease-based modes, *Ijara* and HPSM collectively expanded from 5.8 percent to 21.0 percent of total investments, nearly a fourfold increase in the market share. *Ijara* recorded exponential growth, a 6090.2 percent increase with a CAGR of 93.5 percent. HPSM investments also expanded significantly, reflecting a 597.9 percent growth with a CAGR of 36.5 percent (Figure 3).

Figure 3: *Ijara* & HPSM Expansion (Dual panel)



Source: Data as of December-2025 from Islamic Banks.

This exceptional expansion in *Ijara*-based modes explains several underlying market dynamics. First, real estate and infrastructure sectors have shown strong demand for long-term financing, for which *Ijara* structures are well-suited. Second, these modes provide Islamic banks with a middle ground between the operational simplicity of *Bai* modes and the intensive monitoring of PLS modes.

Third, the asset backing inherent in *Ijara* and HPSM helps mitigate investment risk while providing tangible collateral, thereby addressing regulatory capital adequacy considerations. Fourth, customers increasingly perceive these modes as more authentically aligned with *Shariah* principles while offering competitive cost-structures relative to conventional financing.

The rapid growth of *Ijara* is particularly noteworthy, as it signals increasing market acceptance of lease-based structures in financing infrastructure and capital-intensive sectors. However, such accelerated expansion also warrants careful monitoring for potential concentration risks and asset–liability mismatches.

3.4 Structural Decline in Partnership-Based PLS Modes

Considering Islamic finance's distinctive identity, the most concerning trend involves the systematic contraction of PLS modes. *Musharaka* investments declined between June 2019 to June 2025, (in market share from 1.4 percent to 0.3 percent, and in absolute values a 53.7 percent decline). *Mudaraba*, while remaining stable in absolute terms around BDT 4-9 billion, represents only 0.2 percent of total investments. Combined, partnership-based PLS modes hold only 0.5 percent of the Islamic banking portfolio.

This decline reflects structural impediments to PLS financing. First, Islamic banks face adverse selection in PLS arrangements; only inherently risky projects opt for profit-sharing financing given the availability of lower-cost fixed-return alternatives. Second, moral hazard considerations lead banks toward extensive monitoring, reducing cost-efficiency for smaller borrowers.

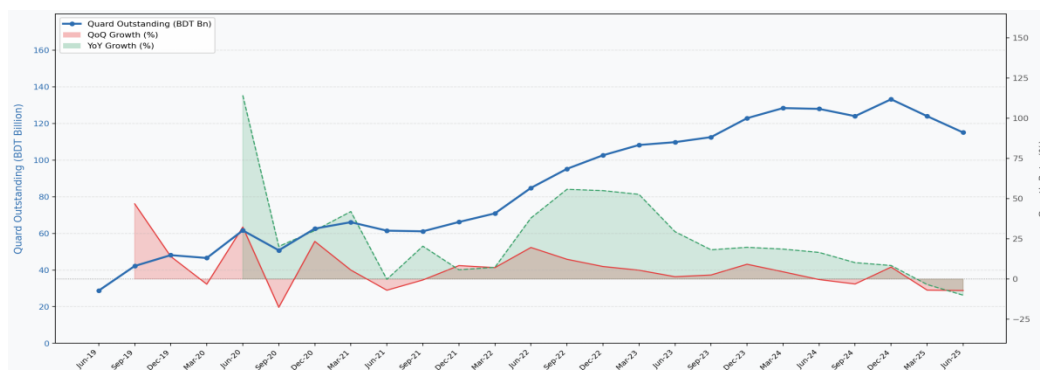
Third, the information asymmetry between banks and entrepreneurs makes PLS particularly vulnerable to dispute over financial reporting and profit calculation. Fourth, regulatory capital adequacy requirements, while theoretically favorable to PLS modes, effectively penalize through complex calculations and higher provisioning standards. Fifth, customer preference gravitates toward predictable returns in uncertain economy, particularly during the post-pandemic recovery periods.

The decline in partnership-based PLS modes represents a fundamental departure from Islamic banking genuine risk-sharing mechanism. This structural trend demands policy review for holding the distinctive nature of PLS Islamic banking relative to conventional banking.

3.5 Emergence of Qard Mechanism

Qard-based investment increased with 300.3 percent growth rate during the period under review (in market share from 1.3 percent to 2.2 percent). This rise implies both regulatory encouragement (BB explicitly promoting charitable lending by service-charge exemptions on certain *Qard* products) and market recognition as intermediate risk instruments. Growth in *Qard-e-Hasan* without service charges shows increasing institutionalization of charitable funding even as commercial variants with service charges provide profitability.

Figure 4: Qard Investments and its Growth over time



Source: Data as of December-2025 from Islamic Banks.

3.6 International Benchmarking

Bangladesh's 0.5 percent PLS share stands among the lowest of any major Islamic banking jurisdiction. Cross-country evidence from the Islamic Financial Services Industry Stability Report (IFSB, 2025) reveals that while PLS underutilization remains is a systemic challenge, peer economies have maintained higher proportions through targeted regulatory action.

Table 2: Cross-country comparison

Country	PLS Share (%)	Total IB Share#	Key PLS-Enabling Policy	Source
Malaysia	6–8%	~33.2% banking	<i>Musharaka Mutanaqisab (Dim. Musharaka)</i> for property finance; BNM PLS incentives	BNM Annual Report 2024
Pakistan	8–12%	~18.7% banking	SBP minimum PLS targets for IBs; agricultural <i>Musharaka</i> scheme	SBP Islamic Banking Bulletin Q2 2025
Bahrain	18–22%	~31.6% banking	AAOIFI standard adoption; mandatory <i>Shariah</i> audit; developed <i>Sukuk</i> market	CBB Financial Stability Report March 2025
Indonesia	35–40%	~7.3% banking	OJK mandates <i>Musharaka</i> ratio reporting; target 15% IB market share	OJK Sharia Banking Statistics 2024
Bangladesh	0.5%	~22.5% banking	No explicit PLS targets in place	Research Dept, BB (this note)

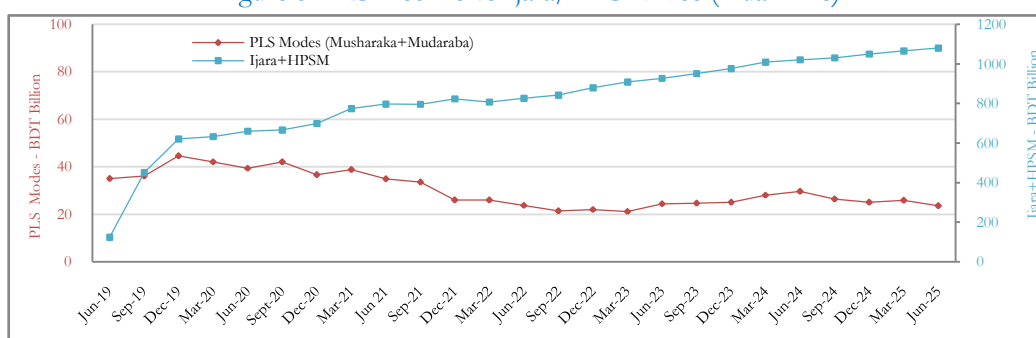
Note: PLS share means partnership-based financing (*Musharaka*, *Mudaraba*, and Diminishing *Musharaka*) as a proportion of total Islamic banking investments.

IB share stands for Islamic banking assets as a share of total banking sector assets, and source from IFSB IFSI Stability Report 2025 (PSIFIs Q3 2024)

Table 2 shows that PLS share in Bangladesh is 6.3 percent lower than that of Pakistan's despite having a comparable Islamic banking market size. Countries with higher PLS ratios share common features: explicit regulatory targets, developed *Sukuk* markets for liquidity, and AAOIFI-aligned *Shariah* governance standards. This international evidence reinforces the imperative for targeted policy intervention outlined in Section 6.

4. Structural Drivers and Institutional Constraints

Figure 5: PLS Decline vs Ijara/HPSM Rise (Dual Axis)



Source: Data as of December-2025 from Islamic Banks.

4.1 Macroeconomic Context

The post-COVID-19 macroeconomic landscape in Bangladesh (2021-2025) experienced elevated inflation, exchange rate pressures, and subdued private sector credit demand. In this context, fixed-return modes provide Islamic banks with clearer income visibility and reduced exposure to counterparty credit deterioration. Besides, Basel III capital adequacy standards set by BB, may inadvertently penalize credit-intensive PLS financing through higher risk-weighting.

Liquidity management in Islamic banks is challenging due to limited availability of *Sukuk* and the 5.5% SLR requirement, forcing banks to prefer mechanisms with more assured monetization prospects. *Ijara* modes, being asset-backed, provide alternate options for liquidity management when market conditions need rapid portfolio adjustment.

4.2 Operational Efficiency and Cost Dynamics

Operational cost of different modes explains partial variation in modesshifting. *Bai-Murabaha* trades involve standardized commodity purchase-sales, enabling economies of scale and lower per-transaction processing costs. *Ijara* modes similarly benefit from established asset valuation procedures in real estate and equipment markets. Conversely, PLS modes require customized contracts, extensive monitoring, detailed financial analysis, and complex profit-loss calculations, resulting in significantly higher operational costs per trade. For smaller loans prevalent in retail banking and SME finance—these higher unit costs render PLS modes unviable.

4.3 Customer Preference and Market Segmentation

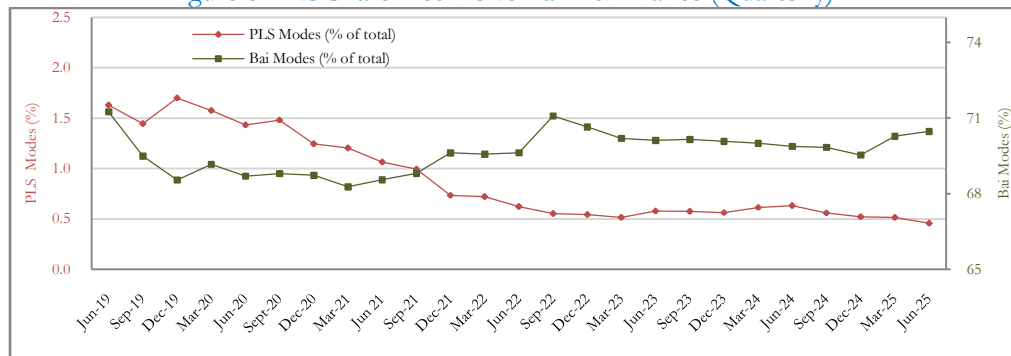
Atiquz Zafaret *al* (2021) empirically shows Islamic banks' customers exhibiting heterogeneous preferences for various transaction structures. Retail Islamic banking customers prefer simple, transparent pricing through *Murabaha* mode over the complex PLS mechanism (Hussain, J. G. 2016). Similarly, corporate clients prioritize defined payment schedules facilitating budgeting and cash flow planning. Conversely, genuine entrepreneurs seeking capital investment are the ideal clientele for *Musharaka* and *Mudaraba*, often patronize conventional banks where interest-based finance offers lower costs and simpler methods. Although economically rational, this segmentation generates a gap between Islamic banking ideals and what clients actually prefer.

4.4 Credit Risk and Information Asymmetry

Islamic banks in Bangladesh operate amid limited financial transparency, informal accounting practices, and weak corporate governance in several sectors. These conditions render credit assessment in PLS modes challenging. In response, Islamic banks focus on modes with tangible asset backing (HPSM, *Ijara*) or simple sale contracts (*Bai-Murabaha*, *Bai-Muajjal*), where credit risk assessment relies on collateral value rather than anticipated earnings.

5. Policy Implications & Systemic Considerations

Figure 6: PLS Share Decline vs Bai Dominance (Quarterly)



Source: Data as of December-2025 from Islamic Banks.

5.1 Alignment with *Shariah* Principles

The fundamental purpose of Islamic banking involves genuine risk-sharing, equitable resource allocation, and the avoidance of speculative or unproductive activities. The current mode preference raises concerns regarding adherence to these principles. With 70.5 percent of investments concentrated in *Bai* contracts, the system can replicate key features of conventional banking. Although sale-based modes are *Shariah*-compliant, their overwhelming dominance may indicate a lack of emphasis on PLS modes, which are widely regarded as the most development-friendly and justice-oriented financing.

5.2 Systemic Risk Concentration

Bai-Murabaha and *Bai-Muajjal* are primarily based on trade and commerce, HPSM largely focuses on real estate and capital asset acquisition, while *Ijara* investments are directed toward infrastructure and equipment leasing. Notwithstanding their underlying structures, these modes are often arranged in ways that give rise to debt or debt-like exposures. This results in debt concentration risk, which may amplify economic shocks and heighten systemic vulnerability.

5.3 Liquidity Management Challenge

The asset-backed *Ijara* mode expansion also creates asset-liability management challenges. HPSM and *Ijara* typically involve longer maturity profiles than *Bai-Murabaha* (which frequently extends for 1-3 years) or *Bai-Muajjal* structures. These longer-tenure asset-backed arrangements must be funded through customer deposits with shorter average tenures, creating maturity mismatches. Without a functioning secondary market, these assets exhibit near-complete illiquidity, posing significant constraints on liquidity management.

5.4 Economic Development and Inclusive Growth Implications

The near absence of genuine PLS financing has significant implications for economic development objectives. *Musharaka* and *Mudaraba* arrangements are particularly well-suited for supporting entrepreneurship, promoting small and medium enterprise development, and modernizing the agricultural sector—thereby fostering inclusive

growth. By focusing primarily on trade finance and real estate investment, Islamic banks are limited in their ability to effectively expand productive capacity and generate inclusive employment.

5.5 Regulatory and Prudential Considerations

Capital adequacy calculations that impose higher riskweights on PLS assets, even when theoretically justified, may inadvertently discourage beneficial financing methods. Similarly, PLS provisioning standards may inadequately reflect the risk-mitigation value of genuine partnership arrangements in which both parties share losses. BB's regulatory framework should support, not discourage, authentic Islamic financing methods.

From the above discussion on structural drivers and their policy implications, a summary analysis highlighting strategic insights—including key issues, policy concerns and suggestions—is presented in the following Table 3.

Table 3: Strategic Insights: Issues, Policy Concerns and Recommendations

Issue	Current State	Policy Concern	Recommendation
Dominance of Fixed-Return <i>Bai</i> Modes	<i>Bai</i> modes 70.5% of portfolio	Risk of resembling conventional banking	Incentivize Partnership-based PLS instruments
Decline of PLS Modes	Only 0.5% of the portfolio	Weakening Islamic principle adherence	Capacity building for PLS financing
<i>Ijara</i> Mode Expansion	21.0% and growing rapidly	Market response but potential systemic risks	Monitor collateral dependencies
Liquidity Management Challenge	5.5% SLR requirements	Shortage of <i>Sukuk</i> and Islamic instruments	Expand <i>Sukuk</i> market and instruments
Risk Concentration	Heavy concentration in real estate/trade	Sectoral exposure and credit risk	Sector diversification requirements
Economic Development Impact	Limited SME financing through partnerships	Limited pro-poor and developmental financing	Enhance SME and agricultural financing

Source: Authors' own assessment, Data as of December-2025 from Islamic Banks.

6. Recommendations

Based on the analysis, Bangladesh Bank (BB) may pursue the following targeted interventions to ensure sustainable, balanced, and principle-aligned growth of Islamic banking in Bangladesh.

6.1 Incentivizing Profit-and-Loss Sharing Modes

- BB may set clear, time-bound targets for PLS mode expansion, measured against new investment disbursements rather than portfolio stock. By June 2028, some considerable percentage of new Islamic banking investments per half-year must be channeled into *Musharaka*, *Mudaraba*, or Diminishing *Musharaka* arrangements. This threshold may gradually rise to higher percentage by June 2032. Each bank

and Islamic window may submit quarterly monitoring reports to BB's Islamic Banking Regulation and Policy Department (IBRPD), with results published on their website for public accountability.

- To support this transition, BB may establish a PLS Financing Technical Assistance Fund to help smaller banks cover monitoring and due diligence costs; publish standardized *Musharaka* and *Mudaraba* agreement templates, create a dedicated PLS Dispute Resolution Panel within IBRPD with a specified resolution timeline to give banks greater certainty; and offer a considerable reduction in risk-weight calculations for well-documented PLS investments, meaningfully lowering the capital cost of these modes.

6.2 Sukuk Market Developments

- The shortage of *Shariah*-compliant liquid instruments is one of the most structural barriers facing Islamic banks today, pushing them toward short-tenor *Bai-Murabaha* arrangements by default. A well-functioning *Sukuk* market would allow banks to hold longer-tenor assets confidently, creating the foundation for broader *Ijara* and PLS growth. BB may scale up Bangladesh Government Investment *Sukuk* (BGIS) issuance to higher amounts annually by FY27, with a focus on 3 and 5-year maturities to deepen medium-term investment avenues. Alongside this, launching a short term *sukuk* would provide a short-term liquidity tool, reducing the structural disadvantage Islamic banks currently face relative to their conventional peers.
- BB may also establish an Islamic Interbank Money Market (IIMM) featuring standardized repo mechanisms, a primary dealership system, and real-time settlement infrastructure. A *Sukuk* Market Development Fund over medium term would support market-making activities during the critical early growth phase. Finally, joint guidelines with the Bangladesh Securities and Exchange Commission may enable large corporate and infrastructure entities to issue *Musharaka Sukuk*, broadening the investable universe for Islamic banks.

6.3 Human Capital Development

- BB may establish an Islamic Finance Institute (IFI) ideally under Bangladesh Institute of Bank Management (BIBM), within FY26. The IFI may deliver mandatory accredited training for licensed Islamic banking professionals, covering PLS structuring, *Shariah*-compliant asset valuation, liquidity management, and regulatory compliance.
- A Professional Certification in Islamic Banking (PCIB), developed in collaboration with AAOIFI and the Islamic Financial Services Board, would establish a structured and credible career pathway for industry practitioners. The IFI may also publish a quarterly Islamic Banking Research Bulletin tracking

domestic trends against international benchmarks, offer product consultation services to banks introducing new PLS instruments, and engage with the University Grants Commission to integrate Islamic finance into university curriculum, building the long-term talent pipeline the sector urgently needs.

6.4 Regulatory Framework Modernization

- BB may undertake a focused review of the Islamic banking regulatory framework, targeting four key areas. First, on capital adequacy, PLS risk-weight calculations may be revised to reflect genuine risk-sharing characteristics, and a separate capital tier for Restricted Profit-Sharing Investment Accounts (PSIA) may be introduced consistent with IFSB Standard-15.
- Second, a PLS-specific provisioning framework may recognize asset-sharing arrangements as partial risk mitigants, reducing the provisioning burden that currently discourages banks from expanding PLS portfolios.
- Third, each Islamic bank and window may be required to maintain an independent *Shariah* Supervisory Committee, with at least one AAOIFI or IFSB-credentialed member, publishing its decisions quarterly.
- Fourth, Islamic windows of conventional banks may maintain full fund segregation, with operations self-funded from Islamic earnings to prevent cross-subsidization.

6.5 Sectoral Targeting and Inclusive Growth

- BB may direct Islamic banks to allocate new PLS investments toward key development sectors. Some considerable amount of new *Musharaka* and *Mudaraba* disbursements should target agricultural modernization by June 2028, supporting food security goals.
- For SMEs, an Islamic Banking SME Credit Guarantee Scheme may offer some sort of guarantees on PLS investments to businesses, with subsidized premiums for first-time borrowers through 2028.
- On green finance, a considerable amount of basis point reduction in profit rate requirements for BB refinancing on qualifying green *Ijara* projects would align Islamic banking growth with Bangladesh's climate commitments.
- To manage concentration risk, HPSM and real estate *Ijara* exposure should be capped at some considerable percentage of total investments, tightening gradually to even lower percentage by 2030.

6.6 Market Infrastructure and Information Systems

- BB may coordinate the creation of three critical shared infrastructure pieces. An Islamic Finance Information Bureau (IFIB), operational within BB's Statistics Department by December 2026, may publish quarterly mode-wise investment data, NPL rates, and profit-sharing ratios in machine-readable format.
- A formal Islamic Banking Association of Bangladesh (IBAB), with mandatory membership, may serve as the industry's voice for regulatory dialogue and collective capacity building.
- Together, IBAB and IFIB may develop an Islamic Banking Benchmark Return (IBBR), a quarterly weighted average profit rate across PLS investments, providing a credible, market-observable reference rate for contract negotiation, with the first publication targeted by December 2026.
- Supplementary AML/KYC guidelines tailored to PLS documentation patterns may also be issued to strengthen compliance across the sector.

7. Conclusion

Data from June 2019 to June 2025 illustrates how Bangladesh's Islamic banking sector is rationally adjusting to market conditions and functional limitations. But beneath this operational efficiency lies a growing tension: the sector's increasing reliance on fixed-return and asset-backed financing raises genuine questions about how faithfully it honors *Shariah's* deeper spirit, particularly its emphasis on risk-sharing and inclusive economic participation.

Given the availability of lower-cost fixed-return alternative and strong demand for long-term infrastructure financing, banks are less inclined to adopt authentic profit-and-loss sharing (PLS) modes due to its higher monitoring costs and complex calculations. The rising moral hazard problem has also undermined the spread of PLS financing in banking. The steady withdrawals of PLS investments is not merely a trend but a structural concern that demands serious policy attention. The enactment of necessary law supporting PLS may pave the way for enhancement of investments under partnership modes.

Standardized financing modes do deliver real operational gains, yet sustainable growth for Islamic banking cannot be built on convenience alone. Reorienting the sector toward its foundational risk-sharing principles is both a strategic necessity and a moral imperative. Bangladesh Bank is well positioned to lead this shift, and doing so would reinforce the sector's distinct identity, build long-term financial resilience, and meaningfully advance inclusive development goals.

The findings of the research suggest that by 2027, three indicators would tell the clearest story: i) whether PLS disbursements are genuinely growing, ii) whether the Islamic liquidity market is deepening through *Sukuk* issuance and accessible money market instruments, and iii) whether financial stability metrics such as non-performing investments and liquidity stress are moving in the right direction. Tracked together, these signals will offer a reliable and honest scorecard for reform.

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