Shariah Based Banking

THE INSTITUTE OF BANKERS, BANGLADESH (IBB)
DR Tower (12th Floor), 65/2/2 Bir Protik Gazi Golam Dostogir Road, (Box Culvert Road) Purana Paltan, Dhaka-1000
Phone: 02-55112857-60, Fax : (8802) 55112856, E-mail : ibb.diploma@gmail.com
Web : www.ibb.org.bd & www.online.ibb.org.bd

Banking Professional Examination

Shariah-based Banking

AIBB

(Associate of the Institute of Bankers, Bangladesh)

By

Dr Mohammed Haider Ali Miah

Banking Professional Examination

Shariah-based Banking

AIBB

(Associate of the Institute of Bankers, Bangladesh)

By

Dr Mohammed Haider Ali Miah

PREFACE

All my gratitude to almighty Allah that I have had the good luck to get such an opportunity to contribute to the country's Islamic banking movement through providing such a text for the students of Banking Diploma. I was always passionate in my life to do such types of jobs whenever and whenever it seems to be necessary. I have the enthusiasm to acquire knowledge regarding Islamic banking and also to transmit it country's aspiring pupils from all disciplines.

Preparing this text was a mammoth job of course. But supports and suggestions from all my well-wishers helped me a lot to finish this job with great satisfaction. My high gratitude goes to Bangladesh Bank and the Institute of Bankers, Bangladesh due for providing me with such a great opportunity which will help the learners of this arena to become rich in the coming days.

I never believe that the first edition of this text will be a complete one but it will be our all-time endeavour to make it perfect over the time period. Finally, I just want to say that if this text is proved a little bit useful for the students and bankers who possess a sound desire to serve as an ansar of the Islamic banking movement I will be happier than ever.

Praise goes to Allah the almighty.

SYLLABUS

MODULE A: Principles of Islamic Economics and Banking—

- Islamic Economics—Meaning, Source and Scope, Nature of Economic Law, Islam and other Economic Systems, Consumption and Production in Islam, Distribution of Wealth in Islam, Trade and Commerce in Islam, Islamic Approach to Money, Banking and Monetary Policy.
- Interest in Islam, Meaning and Types of *Riba*, Conceptual Issues Related to *Riba*, Comparative Analysis between Interest and Profit, Classical and Keynesian Views of Interest
- Objectives and Functions of Islamic Banking, Operational Mechanism of Islamic Banking System, Guarantee in Islamic Banking, Non-Banking Services of Islamic Banks, Islamic Bank and Central Bank, Conventional vis-à-vis Islamic Banking.

MODULE B: Deposit Mobilization Process—

- *Al-Wadia* and *Al-Mudaraba* Accounts—their Characteristics and Mode of Operations; *Hajj* Deposit Account, *Cash Waqf* Account

MODULE C: Finance and Investment in Islamic Banks—

- Musharaka, Mudaraba, Bai Murabaha, Bai Muazzal, Bai Salam, Bai Al-Istisna, Hire Purchases, Hire Purchase Under Shirkatul Milk, Quard-e- Hasana, Lease Finance, Auction Investment, Syndicated Investment, Izara bil Baia, Muzara'a, Mugarasa, Musaqat
- Specialized Financing—Rural, Agro-, Micro and SME Finance—their modes and operational procedures;
- Corporate Social Responsibilities—Zakat, Sadaqa, Cash Waqf, Quard-e-Hasana

MODULE D: Foreign Exchange Operation of Islamic Bank—

- Import and Export Financing—MIB, MTR, MPI; Methods of Trade Payments; Exchange Rates; Applicable Rates for FEX Operations; Offshore Banking—discounting, UPAS, Deposit Collection, etc. under Islamic Modes; Export Development Fund, Refinancing Facilities from Bangladesh Bank

MODULE E: Fund and Capital Management in Islamic Bank—

- Asset-Liability Management (ALM), Liquidity Management, Liquidity versus Profitability, Liquidity Theories and Islamic Banking, Risk Management in Islamic Banks, Islamic Money Market, BGIBB Operation; Islamic bonds—*Mudaraba* Perpetual Bond, *Mudaraba* Subordinate Bond, *Sukuk* Bond

MODULE F: Accounting Standards and Supervisory Framework—

- Central Banking in Islamic Framework-Monetary policy in Islamic Banking Supervision
- Need for Shariah Supervisory Board-Relationship with Board of Directors and Central Bank-Role and Function of shariah Supervising Board in Shariah Compliance
- General Accounting Concepts-Accounting and Shariah Standards for Murabaha, Musharaka, Ijara, Bai-Salam-AAOIFI Standards-Profit Distribution and Weight Calculation
- Global and Bangladesh Practice of Islamic Banking

INDEX

CHAPTER I

Principles of Islamic Economics and Banking

Syllabus—

- Islamic Economics—Meaning, Source and Scope, Nature of Economic Law, Islam and other Economic Systems, Consumption and Production in Islam, Distribution of Wealth in Islam, Trade and Commerce in Islam, Islamic Approach to Money, Banking and Monetary Policy.
- Interest in Islam, Meaning and Types of *Riba*, Conceptual Issues Related to *Riba*, Comparative Analysis between Interest and Profit, Classical and Keynesian Views of Interest
- Objectives and Functions of Islamic Banking, Operational Mechanism of Islamic Banking System, Guarantee in Islamic Banking, Non-Banking Services of Islamic Banks, Islamic Bank and Central Bank, Conventional vis-à-vis Islamic Banking.

Islamic Economics—Meaning, Source, Scope and Nature—

An economic system is self-interest-driven interaction among people within a framework comprising of rules directed by the government and norms practised by the society with the goal of producing goods and services to be distributed judiciously among the people. While achieving this goal, the system should conserve the resources for use by the future generations and take care of the nature for the sake of regeneration of the resources. To achieve these objectives, all economic frameworks have some guidelines, strategies, interfering methods, compensations, workarounds and assumptions.

Islamic Economic framework is directed to justice and equity in the society and purification in the individuals' life as its main goal. So Islamic economics is primarily normative, *i.e* it takes human behavior as a key factor in controlling its economic system. It is concerned about how much of the resources an individual can utilize, how much he has to leave for others' use and furthermore how much he should voluntarily leave to others for utilization, and off course how they should use the resources. This is how *Zakat* and *fitra* have come to be obligatory charities for eligible Muslims and optional charities like *Sadaka*, *Quard,* etc. have supplemented to the charities.

The primary sources of Islamic economic system are the Quran and the Sunnah. Their archetype implementation can be found in Prophet's life in the city of Medina after the Hijra.

Like in all other economic systems, the market with all its factors interacting rationally is the venue where Islamic economic activities take place with the proviso that rationality must be constrained by human behavour so as not to bring about injustice and inequity. The key assumptions of Islamic economics are that if resources are utilized honestly and rationally in participation of all people, justice and equity shall be in place. Thus Islamic economics is normative by nature and pivots round these basic assumptions.

Islamic and other Economic Systems—

The basic difference between one economic system and the other lies in prioritization of markets or commands. The system that relies solely on markets is purely capitalist system whereas the system that is fully directed by the government, is a command economic system. All other economic systems lie somewhere between these two extreme poles. These systems can be called mixed market economy, where markets are relied on but not left alone, mixed socialist economics, where social concerns like employment, education, healthcare, amenities, security, poverty alleviation are prioritized over freedom of market, and traditional economics, which is governed primarily by social norms, customs, religious values and is far away from governmental control.

The Islamic Economic system is a market-based economic system. However, for the sake of welfare, equity, justice, the market is constrained by religious norms, rules and ethics. The regulations are aimed at protecting workers, producers, investors and consumers and at the same time ensuring market efficiency, *i.e.* maximum production with the least resource utilization. It readily intervenes when wealth of a nation tends to polarize to a small section of the total population giving them all tools for exploiting others. Thus Islamic Economics works for enduring justice for the people and sustainable growth of the economy.

Consumption and Production in Islam—

Consumption in Islamic Economics is in proportion to one's needs and not to one's pleasure pursuits. Every consumption should make room for others' wants to be fulfilled. In Islamic Economics, consumption is not only confined in the consumer who has acquired the goods but also is preserved for all prospective consumers who are yet to acquire the goods by means of transaction or charity. Consumption is viewed as one of the means for balanced wealth distribution among individuals. Islamic Economics forbids indulgence in luxury and wastage as well. So Islamic Economics is meant for well-being of the human race as a whole.

Islamic Economics maintains that humans are the caretakers of the resources, or production factors on earth. They have to take care of the resources in a manner that the factors produce benefits for human beings and not any opportunities for them to indulge in luxury. Islamic Economics suggests producing goods upto human needs not upto maximization of profit. However, profit maximization is not prohibited in Islamic Economics. Production of harmful goods is strictly prohibited. While using resources, humans must follow the conservation principles so that the future generations have equal opportunities to use and reuse them for further production. To Islamic Economics, humans as a factor of production is not considered a substitute for mechanical tool rather functional human beings having rights, responsibilities, pains, happiness and above all dignity. In Islamic Economic system capital as a means of production is not transacted for interest, rather shared or purchased. So production in Islamic Economics is humane in ideology and judicious in practice.

Distribution of Wealth in Islam—

The ultimate objective of Islamic Economics is to ensure judicious distribution of wealth among individuals and nations. All the tools and devises ranging from obligatory donations like *Zakat* and *Fitra* to voluntary ones like *Quard* and *Sadaka* work together towards this end. As a wealth distribution tool, *Zakat* has been made a routine religious ritual like all other physical and mental rituals. A Muslim is obliged to give away 2.5% of his/her gold, silver or cash, if he has an amount of them equivalent to the *Nisab*—for gold the *Nisab* is 7.5 *tolas*, for Silver it is 52.5 *tolas* and for cash it is equal to the monetary value of the *Nisab* of silver. Likewise, *Nisabs* have been fixed for camels, cows, bulls, sheep, goats, land and mines differently and varied percentages have been fixed for them to be given away as *Zakat*. The beneficiaries can make use of the *Zakat* received in income-generating enterprises and contribute to the economy. *Fitra* is another obligatory donation on part of the eligible people who perform this obligation yearly at the end of the Ramadan. *Sadaka* or optional charity is another major way of making wealth available among the poor and needy people, who in turn can make it capital for business enterprises and can be a worthy person for the economy. If reusable asset is given away as *Sadaka*, it is called *Waqf*. Land or cash given away as *Waqf* keeps on doing charity to the beneficiaries eternally while generating income and employment for the people. Likewise, yearly sacrifice of cattle during the Holy Hajj and distribution of meat among the relatives, neighbours and poor people contribute to the health and nourishment of the people in the society. *Akika*, which is performed while naming a new-born baby, is another ritual in which meat of sacrificed animals is distributed among the poor. *Quard* or interest-free loan is a dignified way of rehabilitating educated entrepreneurs. These are all lateral distribution of wealth. At the same time there is a well-structured system for vertical distribution of wealth—definite inheritance law where the rights of sons, daughters, widows, siblings have been judiciously addressed. Furthermore, a Muslim can give away his asset, or a portion of it through *Hiba* for the charity of the people in general.

Trade and Commerce in Islam—

Trade and commerce have always been an important part of Islam and Islamic Economics. Islam encourages work in general, and trade and commerce in particular. The Quran says [Al-Baqarah-275], "Allah has permitted trading and forbidden *Riba*." Prophet Muhammad (PBUH) himself was engaged in business and was a successful businessman. The early Muslims went to distant lands to carry on business enterprises. The Quran and the *Hadith* lay out behaviuoral standards for producers, traders, salesmen and even consumers to ensure a disciplined market with information disclosure, just transactions, and level playing fields. The Prophet has said: "Sell the good and bad separately. He who deceives is not of us." The ethical standards that Islamic Economics promote are mutual trust, respect, justice and honesty in the market. So transactions in Islamic Markets are not confined in exchange of goods and money, rather extended to interchange of good-wishes and honesty. Islam ordains each transaction be definite and real so that there is no room for misunderstandings and subsequent litigation between parties. However, Islamic Markets prohibit sale and purchase of *haram* goods like alcohol, drugs. Furthermore, Islam condemns hoarding and fraud forgery. Islamic markets protect not only buyers from sellers but also sellers from sellers by establishing order and discipline in the market.

Islamic Approach to Money—

In general, money represents asset and asset confers prosperity. However, In Islamic point of view money brings in prosperity and responsibility equally to the owner. The more is the money, the more is the responsibility. If we consider *Zakat*, we can see a richer Muslim has to give away a larger amount to the poor to be legitimate owner of the rest. So Islamic Economics does not bestow absolute ownership to money when it has been acquired, rather this is his provisional ownership and is subject to be legitimized. In Islamic viewpoint money is not a means for pursuing pleasure only, rather it is a means to perform good deeds and gain happiness with. For money a Muslim can only purchase exactly what he needs not whatever he wishes. While rolling in the market, money tends to accumulate in the hands of a few. Islamic Economics discourages such accumulation because it becomes a means of exploitation. Islamic Economics has equipped its markets to fetter free roll of money to the hands of prospective exploiters.

Banking and Monetary Policy—

Monetary policy is directed at the supply of money in the market which in turn influences employment, inflation, Gross Domestic Product (GDP), etc. The higher is the money supply, the more is employment and inflation. Considering the context of the economy, the Central Bank undertakes either expansionary policy, *i.e.* increasing money supply, or contractionary policy, *i.e.* decreasing money supply. The Central Bank controls the supply of money through several instruments like Reserve Requirement, Open Market Operations, Interest Rate on Excess Reserves, Discount Rate, etc. The reserve requirement refers to the money banks must keep on hand overnight. Reserves include money kept in the vaults or with the central bank. If commercial banks are allowed by the Central Bank to reserve less liquidity, they can lend more and thus can make more money available in the market. Open Market Operations mean buying and selling securities by the central bank to the commercial banks. If the central bank buys securities from the commercial banks, it injects cash to the vaults of the commercial banks and thereby increases their lending capacity. On the other hand when the Central Bank wants to withdraw money from the market with this instrument, it only sells securities to the Commercial Banks. By lowering and raising the interest rates for excess reserves, the Central Bank can change the direction of flow of money from the Central Bank to the people and vice versa. If the Central Bank wants Commercial Banks to lend more, it lowers the interest rate paid on excess reserves. If it wants commercial banks to lend less, it raises the interest rate.

Interest in Islam—

The *Quranic* term that describes interest is *Riba* meaning increase. In lending and borrowing *Riba* is the additional amount of money which the lender charges for the use of his money. *Riba* is calculated as a fixed percentage of the amount lent in terms of the length of time used. Such increase of money at a predetermined rate is prohibited in Islam. The Quran [Al-Baqarah-275] says, "Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity..." However, trade also causes increase of money. This increase occurs in the form of profit. Profit is the additional amount of money asked by the seller over the cost price of his commodity and accepted by the buyer while buying it. Profit may be calculated as a fixed percentage of cost price. However, the amount of profit does not increase in terms of time. The profit of trade might be confounded with *Riba* in lending as an identical increase. The Quran [Al-Baqarah-275] has eliminated such confusion by saying, "...But Allāh has permitted trade and has forbidden interest…" The Quran [An-Nisa-29] further says, "O believers! Do not devour one another's wealth illegally, but rather trade by mutual consent…" Thus there is clear demarcation between profit and *Riba* in Islamic Economics though they both refer to increase of an amount of money over another amount.

Meaning and Types of *Riba*—

In Islamic Economics, *Riba* is generally defined as the additional amount of money or commodity that is charged on the amount or commodity lent in terms of the time period the amount or commodity is lent for. There are two types of *Riba*—*Riba an-Nasia* and *Riba al-Fadl*. The additional amount of money or commodity a lender charges upon the amount or commodity lent for the period of usage of the money or the commodity for a period of time is *Riba an-Nasia*. Suppose, a lender lends Tk. 1,00,000/- to a borrower for one year on the condition of returning the amount with additional amount of Tk. 15,000/- after that that period. This Tk. 15,000/- is *Riba an-Nasia*. In essence, the lending terms can be expressed as 15% interest per anum. If the borrower fails to repay the amount in one year and takes further time, the interest on the amount will be calculated at this rate for that additional time. Thus additional amount increases in terms of time and becomes interest from the viewpoint of Islamic Economics. *Riba an-Nasia* is not confined in monetary transactions alone. If goods are transacted in the same way, *Riba an-Nasia* will take place. Suppose, a lender has lent 100 kg salt to a borrower at the condition of returning the same along with an additional amount of 5 kg in 4 months. The additional 5 kg salt is *Riba an-Nasia*. By contrast, *Riba al-Fadl* occurs in exchange of larger amount of inferior goods for smaller amount of superior ones. According to Abu Sayeed al-Khudri, the Prophet (PBUH) says, "Bilal brought to the Prophet (PBUH) some good quality dates. The Prophet (PBUH) inquired as to where he got those dates. Bilal replied that he had some low quality dates which he had exchanged in 2:1 ratio for high quality ones in order to present the latter to the Prophet (PBUH). Upon hearing this, the Prophet (PBUH) said: "Oh no! Oh no! That is *Riba*. That is exactly *Riba*. Do not do it again. If you want to do such an exchange, first sell your dates (for money or another commodity) and then buy other ones."

Comparative Analysis between Interest and Profit—

The Quran [Al-Baqarah-275] has made it clear that profit should not be confused with interest by saying, "Those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (The offence) are companions of the Fire: They will abide therein (for ever)." Profit is essentially different from interest although they both appear to have some attributes in common. A comparative analysis between them will delineate their exclusive areas clearly—

1. Interest is a predetermined amount, either expressed as a percentage or as a lump sum, which a borrower pays above the actual amount he borrowed. On the other hand, profit is a sum received by the owner of an asset, enterprise or investment by way of carrying out businesses.

2. Interest can be calculated on daily, weekly, monthly or yearly (annual) basis. However, profit can only be calculated when a round of business is finished.

3. Interest rates are the products of interplay between demand and supply of money in an economy while profit is largely a product of demand and supply of goods and services.

4. The concept of interest relates to lending and borrowing while the concept of profit relates to sales and businesses.

5. Since interest is predetermined, there is no risk for the lender. But in the case of capital investment, the investor has risks of loss.

Classical and Keynesian Views of Interest—

The difference between Keynesian and Classical views of interest starts mainly from the difference in perception about money. Keynes considers money as a store of value whereas the Classical views consider money only as a medium of exchange. The classical theory of interest presumes full employment of resources. On the other hand, Keynes theory of interest assumes that income and employment fluctuate constantly. Classical views consider interest rates an equilibrating factor between saving and investment. Keynes proposes changes in income acts as an equilibrating mechanism between them. According to classical views, a higher rate of interest boosts savings. However, Keynes claims savings will fall because the level of income will fall, for the investment will be less due to the higher cost of interest. The situation will end up in a decline of income and hence savings.

Classical views concentrates on interest of bank loans, whereas Keynes was concerned with the complete structure of loan and interest in the market including the complex rates of interest. In his theory, long-term rate of interest on loans, bonds and securities occupy greater significance as they influence long-term investment. Classical views hold that savings automatically flow into investment. On the contrary, Keynes holds that it is investment that automatically leads to saving out of current income. Further, classical views hold that investment could be increased by saving more but Keynes holds that investment could increase income and the increased income will encourage savings flow. Classical views are keen to consider savings to investment as determining factors whereas Keynes omitted them completely from his theory of interest.

Objectives and Functions of Islamic Banking—

The final objective of Islamic banking is to establish a banking system without interest with an ultimate goal of bringing in optimum allocation of resources among people, income and employment generation, poverty alleviation, sustained well-being of human beings. With these objectives and goals in view, Islamic banking promotes business ethics and norms in banking operations that includes resisting finance to *haram* products and services. The functions of an Islamic bank are directed in achieving these objectives in the long run. In order to avoid interest in all its manifestation, Islamic banking resorts as far as to buy-sale mechanisms while financing traders and making funds available to end-level consumers. However, at the core of Islamic banking there is business, of which the bank is a partner and the client that needs capital for that business is the other partner and the profit or loss that comes off that business is legitimately and obligatorily shared by these two partners subject to their agreement. This is the core function of Islamic banking. Islamic banks participate in businesses, renting out land, buildings, factories, machinery, equipment, etc. to industrialists as per Islamic business principles. It also rents out and sells consumer items to households and pays tuition fees to students as an Islamic business firm. It implements foreign trade, transacts foreign currencies, offers guarantees, manages funds and liquidity, provides ancillary banking services avoiding interest and speculative income.

Operational Mechanism of Islamic Banking System—

In the core, banking is taking from people their surplus money and giving it to people for use on condition that the latter would return it to the bank, along with the charges for its use. In banking terms, the money taken by the bank is deposit, the money given by the bank is loans and advance and the charge levied on the use of the money is interest. Interest is determined as a percentage of the amount given with relation to the period of time it has been used for. In a nutshell, banking is the service of making funds flow from the surplus units to the deficit ones in exchange for interest.

Islamic banking is also driving funds in the same route without levying any interest, because interest is prohibited in Islam. However, Islam has allowed, to be precise, has promoted business and trade. In Islamic banking, trade and business are leveraged for the fund flow so that interest can be avoided altogether. While collecting deposit, a *Shariah*-based bank typically receives funds from clients, as their business agents, to conduct business on behalf of them on the condition of sharing returns with them. The funds so derived cannot be lent outright to loan aspirants for a fixed return only to complete the round of mediation of funds between surplus and deficit units. Rather, it must implement another round of business, or trade, to discharge the funds to the people needing it. Typically, a *Shariah*-based bank trades goods with customers, as a trader or their agent, or gets involved in partnership businesses, as their partner, or co-owns a productive property with them, in order to complete the latter half of fund-intermediation, *i.e.* supply of funds to the people who need them. The businesses so done are the ones that the *Shariah*-based bank has already promised to the deposit clients and the portions of the returns of the bank are ones that the bank has promised to share with the deposit clients. This is how two rounds of businesses or trades implement the core banking operation in Islamic banking system averting interest in any of its manifestations.

Guarantee in Islamic Banking—

Guarantee is a three party affair where the first party needs undertaking by the third party to fulfill a commitment of the second party in case of failure by the second party. Suppose, the first party is going to sell some goods to the second party on condition of payment one month later from the delivery of the goods. To secure the payment, the seller (the first party) may ask the buyer (the second party) to arrange a reliable third party which will undertake to perform the latter's commitment in case of the latter's failure. Now, the third party (such as a bank) at the request of the second party and for some fees/commission gives that undertaking on behalf of the second party in favour of the first party. In this three-party contract, the first party eliminates his risk of non-payment by getting a trustworthy party involved in the affair, the second party gets goods at convenient payment terms and the third pay gets fees/commission for the risk he has undertaken, and thus can offer this service professionally. The bank is such an institution, which offers guarantee services professionally in addition to its pure banking service, *i.e.* lending and borrowing services because of its bona fides in financial dealings. The party that provides the service is a guarantor. As a professional guarantor, a typical commercial bank offers guarantee services by issuing Standby Letters of Guarantee, Bid Bonds, Performance Bonds, Shipping Guarantees, Counter Guarantees, Advising Guarantees, etc.

As a commercial bank, Islamic banks offer guarantee services in Islamic modes. While issuing guarantee an Islamic bank acts as a *Kaafil* or guarantor. The guarantee service is called *Kafalah* (كَفالة) in Arabic. *Kafalah* means surety or responsibility. It refers to attaching oneself to another person to perform his responsibility to a third person. According to AAOIFI *Shariah* Standard No. 5, *Kafalah* are guarantees that are intended to secure obligations and protect amount of debts, either from being uncollectible or from being in default. In *Kafalah* there are four key conditions the parties must fulfill—(1) a guarantor who is of sound mind, has legal capacity and willingly gives his consent and agreement to the contract, (2) a debtor, who does not need to have legal capacity and can even be a minor, insane person or a bankrupt, (3) a creditor, who must be known to all parties and (4) a guaranteed object or asset that must be an actual asset, is possible to collect from the guarantor, and is an asset that can be legally owned and sold should the debtor fail to fulfill his obligations. The bank can charge commission for the risk it is taking while providing with guarantee.

Non-Banking Services of Islamic Banks—

Islamic Banking sits at the core of Islamic Economics which vows to implement justice in financial transactions, transparency in market information, equitability in wealth distribution, improvement of living conditions, and all that brings about welfare to human beings. Therefore, Islamic banks play the key role in fulfilling the commitments of Islamic Economics. However, all that relates to money is not banking. However, banks as financial institutions can facilitate them like mobilization of *Zakat* fund, collection and distribution of *Sadaka*, intermediating *Cash Waqf* and its benefits between the *Waakif* and the beneficiaries, etc. Islamic banks, in addition to their banking and financial services, facilitates these financial affairs. Besides, there are some benevolent works that are not directly related to banking transactions, like healthcare, education, training, publication, disaster management, relief distribution, etc.

Islamic banks run specialized universities, like agricultural universities, which are not so profitable commercially. They also offer medical services to the poor free or at a cheap rate. They found charity hospitals of their own. Besides, they sponsor research works and publications and campaign to promote social and cultural values.

Islamic Bank and Central-Bank—

In the present context of banking, Islamic banks in most countries have to co-exist with conventional banks in the same market. The Central Bank regulates and guides the Islamic banks so as to retain a level playing ground for the Islamic banks vis-à-vis their conventional counterparts. In doing so the Central Bank has to ensure all Islamic central banking services to the Islamic commercial banks. The Central Bank manages Islamic equivalents to call money market to facilitate overnight liquidity management of Islamic banks. At the same time the Central Bank manages Islamic bonds to facilitate long-term investment of the surplus liquidity of Islamic banks and enforce Statutory Liquidity Ratio by Islamic banks. The Central Bank also fixes accounting standards for the Islamic Commercial Banks. The Central Bank controls the Islamic banking system of the country and formulates policies and guidelines for it through an Islamic banking window.

However, the Central Banking under Islamic framework encompasses a vast area of macro-economics. It has to maneuver macro-economic tools with a view to implementing the objectives of Islamic economics. With this in view, the Central Bank under Islamic framework formulates and applies policies to ensure stability of monetary value, regulation in the supply of money, judicious distribution of wealth, growth of employment, boost of income, savings, foreign reserves, domestic products, and so forth.

Conventional vis-à-vis Islamic Banking—

Islamic banking differs from conventional banking at the issue of interest. All other differences either in principle on in modus operandi emanate from this core issue. All products and services, core banking and ancillary, have been framed avoiding interest in all its manifestations whereas their counterparts in the conventional banking evolve round interest at different rates. In Islamic Banking system, taking deposit is not borrowing money from customers unlike in conventional system. Islamic banks take deposit for Current Account in the form of *Amanat*, for Savings Account and Short Notice Account in the form of capital for a joint venture with the customer on the condition of sharing profit and loss as per agreed ratio. While giving money to traders for buying merchandise with, to businessmen to invest in enterprises, to industrialists to set up factories, or to consumers to buy daily commodities, conventional banks give the money in the form of loan on a predetermined rate of interest. On the contrary, Islamic banks take part in the business of the businessmen by supplying equity to their concerns, or sell at a profit merchandise to the traders for final sale to the actual customers or daily commodities to consumers for their use, or rent out equipment, machinery, factories, land to industrialists, and thereby make the goods or necessities available for the customers at present and make their repayment deferrable to a future time.

With the use of interest, conventional banks establish a debtor-creditor relationship with customer while collecting deposit or giving loan. However, in Islamic banking there are several relationships, from business partners to buyer-seller depending on the types of transactions.

In Islamic banking, there are restrictions to investment in *haram* enterprises and buy-sale of *haram* commodities. However, in conventional banking system only the economic value, not the ethical or welfare concern, of the enterprises or commodities is considered.

Islamic Banking is an integral and inseparable part of Islamic economics that is committed to distributive justice. The funds from the surplus units are to be flowed to the deficit units so as to prevent accumulation of wealth in the hands of a few and retain distributive justice.

Short Questions—

1) Define Islamic Economics.
2) What is production?
3) Define wealth from the viewpoint of Islamic Economics.
4) What is distribution of wealth in Islamic Economics?
5) What is monetary policy?
6) What are the sources of Islamic Economics?
7) What is the Islamic approach to money?
8) What are Islamic Economic tools that are applied to maintain a balance distribution of wealth?
9) Define *Riba*.
10) What are the types of *Riba*?
11) Enumerate some key non-banking services that a typical Islamic bank does.

Broad Questions—

1) What are objectives of Islamic Economics?
2) Discuss the meaning and scope of Islamic Economics.
3) What are the basic principles of Islamic Economics?
4) Compare between Islamic Economics and Capitalist Economics.
5) Describe the importance of Islamic Economics.
6) Enumerate the main features of Islamic Economics.
7) Describe the factors of production from the viewpoint of Islamic Economics.
8) Describe the factors of production from the view point the Quran and the *Hadith*.
9) Discuss the principles of acquisition and distribution of wealth from the viewpoint of the Islamic Economics.
10) Discuss the principles of wealth distribution in Islamic Economics.
11) What are the objectives of wealth distribution in Islamic Economics?
12) Discuss relation between needs, consumption and production from the viewpoint of Islamic Economics.
13) Why does Islamic Economics forbid luxury?
14) What are the responsibilities of human with regard to the factors of production under Islamic Economics?
15) Discuss *Zakat* as the means of distribution of wealth.
16) How are trade and commerce viewed in Islamic Economics?
17) Discuss with examples *Riba al-Fadl*.
18) Discuss with examples *Riba an-Nasia*.
19) How is profit of trade different from *Riba* of loan?
20) Discuss different types of *Riba*.
21) Give and comparison between Profit and *Riba*.
22) What are the key features of *Riba*?
23) What are the salient features of Interest?
24) Give a comparison between Classical and Keynesian views of Interest.
25) What are the objectives of Islamic Banking?
26) Discuss the role of Islamic banking in achieving the objectives of Islamic Economics.
27) Give a brief outline of Islamic Banking operation.
28) ‘The core function of banking is to ensure fund flow from the surplus unit to the deficit unit’—discuss how Islamic Bank ensures it.
29) Discuss guarantee in Islamic banking.
30) Discuss the non-banking services of Islamic banks.
31) What are the functions of the Central Bank?
32) Discuss central banking under Islamic banking framework.
33) Give a comparison between Islamic Banking and Conventional Banking.

Short Notes—

1) *Riba*
2) *Riba al-Fadl*
3) *Riba an-Nasia*
4) Command Economic System
5) Factors of Production
6) *Zakat*
7) *Fitra*
8) *Quard*
9) *Nisab*
10) *Hiba*
11) Profit
12) Interest
13) *Kafalah*
14) *Kaafil*
15) Guarantee
16) *Cash Waqf*

CHAPTER II

Deposit Mobilization Process

Syllabus—

- *Al-Wadia* and *Al-Mudaraba* Accounts—their Characteristics and Mode of Operations; *Hajj* Deposit Account, *Cash Waqf* Account

Deposit Mobilization Process in Islamic Banking—

Deposit in Islamic Banking comes from two main ways—funds laid by customers in the hands of Islamic banker for safekeeping and funds invested by customers with Islamic banker to run business with on profit-sharing contracts. As per Islamic Banking principles funds for safe-keeping are taken on *al-Wadia* contracts and do not earn any profit for the customers whereas funds taken as investment by customers are on *al-Mudaraba* contracts and earns profit for the customers.

Al-Wadia—

Wadia, as an Arabic term, means depositing. In *al-Wadia* contracts, customers lay funds in Islamic banks for safekeeping without intention of receiving any additional amount for the funds. The Islamic bank takes the funds on condition of subsequent investment for profit. In exchange, it guarantees the customers safekeeping of the fund and giving it back whenever the customer asks for it. The funds so taken are kept in the customers' respective *al-Wadia* Accounts. These accounts are popularly called *al-Wadia* Current Accounts as well. The features of *al-Wadia* Account—

1) There are two parties in an *al-Wadia* contract—depositor *(al-Mudi)* and safe-keeper (*al-Mustauda*). In the context of the bank, the depositor is the client and the safe-keeper is the bank and the money that is kept for safekeeping is deposit *(al-Wadia)*.

2) The main intention of the client to lay money with the bank under this contract is safe-keeping and returning immediately on demand.
3) The depositor allows the bank to invest the money elsewhere, of course subject to the *Shariah* principles, for the benefits of the bank only, not for any direct benefit of the client.

4) The bank is not bound to share the profit earned from the investment of the deposit with its depositor.

5) For safekeeping of the money, on-demand withdrawal facilities and other banking services related to it, the bank can charge fees.

6) Since accounts conducted on the *al-Wadia* contract serve all the purpose of the current accounts of a conventional bank, al-Wadiah accounts are a *Shariah*-based equivalent of conventional current accounts.

Al-Mudarabah—

This is a business contract between two parties, where one party provides funds and the other party provides managerial skill and experience for an enterprise. The party providing fund is *Saahib al-Maal* and the party employing managerial skill is *Mudarib*. In these business arrangements, the *Mudarib* is contracted by *Saahib al-Maal* to conduct business on behalf of him and share profit, if any, as per the agreed ratio whereas the loss, if any, shall be borne solely by the *Saahib al-Maal* in consideration the time and efforts of the *Mudarib* as his loss. *Shariah*-based banks collect funds from customers by serving as the *Mudarib* for the funds of the customers (*Saahib al-Maal*).

Mudarabah contracts can primarily be divided into two types—Restricted *Mudarabah* and Unrestricted *Mudarabah*. When the *Saahib al-Maal* imposes restrictions on the *Mudarib*, say in line of business, or its period, location, or suppliers, etc., the *Mudrabah* contract becomes a Restricted *Mudarabah*. In Unrestricted *Mudarabah*, the *Mudarib* is at liberty to choose his ways of business within the *Shariah* premises and statutory laws. In deposit collection, banks prefer to practise Unrestricted *Mudarabah*.

The features of the *Mudarabah* Account—

1) Both the parties to *Mudarabah* contract should be capable of appointing agents and accepting agency.
2) Any of the parties can terminate the contract unilaterally unless the *Mudarib* has already started the business. In that case the termination of the *Mudaraba* contract can only be done on mutual consent.

3) There should be a definite agreement between the parties as to the ratio on which the profit is to be distributed between the parties. However, the profit cannot be a lump sum or a percentage of the capital.

4) The ratio of profit distribution should be fixed at the time of agreement. However, the ratio can be altered on mutual consent of the both parties at any subsequent time.

5) The losses of the *Mudarabah* are borne by the *Saahib al-Maal* alone. The *Mudarib* does not bear any loss unless it arises out of his breach of terms and conditions. The managerial resources such as time, skills, etc. of the *Mudarib* are considered his loss.

6) The *Mudarib* plays three roles together while the *Mudarabah* is going on in the usual course. He acts as the trustee of the investment. So he has to act with prudence. He acts as an agent to purchase, sell and manage the business on behalf of the *Saahib al-Maal*. At the same time, he is also the partner *(Sharik)* of the business. The *Mudarib* has to play two more roles in an unusual event. When the *Mudarabah* incurs losses due to breach of contract on his part, the *Mudarib* has to make good of this loss. In such case he is the *Zamin* (liable). When the Mudarabah gets *Fasid* (void) due to any reason, he becomes a mere employee *(Ajeer)* for salary.

Hajj **Deposit Scheme Account—**

As per the *Mudarabah* contract, capital can be given in instalments over a long period of time. Accordingly, a *Shariah*-based bank, as a *Mudarib*, can take the funds in fixed monthly instalments for different periods of time ranging from 3 to 20 years. While taking the instalments, the bank invests them and keeps the portion of the profit of the *Saahib al-Maal* earned over a specific period of time, usually one year, in his account, and hands over to him all the accumulated profit at end of the tenure. Such type of deposit scheme is called *Mudarabah* Monthly Savings Scheme. To promote savings tendency among people and ensure long-term retention of the funds, a *Shariah*-based bank may offer the *Saahib al-Maal* for higher profit by investing the funds in more beneficial enterprises. Sometimes, a higher ratio of profit is offered to some special groups of *Saahib al-Maal* to promote savings among them like women, students, senior citizens, third gender citizens, etc. Sometimes, these higher ratio savings are meant for especial purposes like repayment of *Denmohor*, performance of the holly *Hajj*, medical treatment, etc. *Hajj* Deposit scheme is such a *Mudarabah* Monthly Saving scheme of higher profit ratio. In this *Mudarabah* contract the *Saahib al-Maal* is allowed to provide capital in fixed monthly instalments for a longer period of time in exchange of higher ratio of profit. The *Mudarabah* enterprise expires with payment of the last instalments and the *Saahib al-Maal* is entitled to the profit at the ratio already agreed upon along with the capital he has deposited so far.

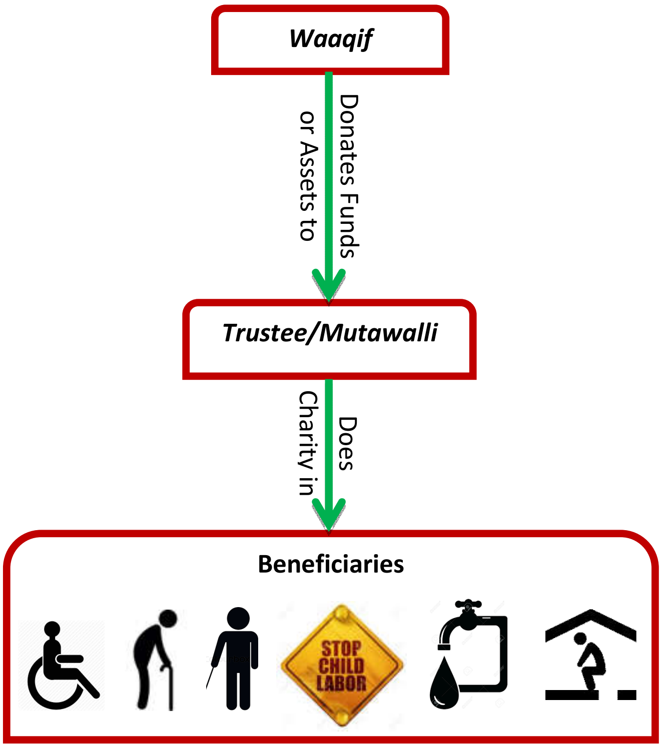
Cash *Waqf* Account—

The Arabic term *Waqf* actually means stopping a thing from moving further. As an Islamic legal term it means stopping the inheritance or sale of a property by handing it over to a trust for doing charity. Here the trust usually deploys the property for public welfare or uses it for any business to earn profit and do charity with that profit. *Waqf* is considered *Sadaqah Jariyah* (ongoing charity).

Waqf is implemented with the interaction of three parties, namely *Waaqif, Mutawalli* and Beneficiaries with the *Mutawalli* carrying out the most responsibilities for its effective implementation. The three parties of *Waqf* that interplay to implement a *Waqf* scheme are as follows—

1) *Waaqif* (Founder)—the person who donates the property or cash
2) *Mutawalli* (Manager)—the person to whom the property/cash is given for management
3) Beneficiaries—the people for whose welfare the property is donated

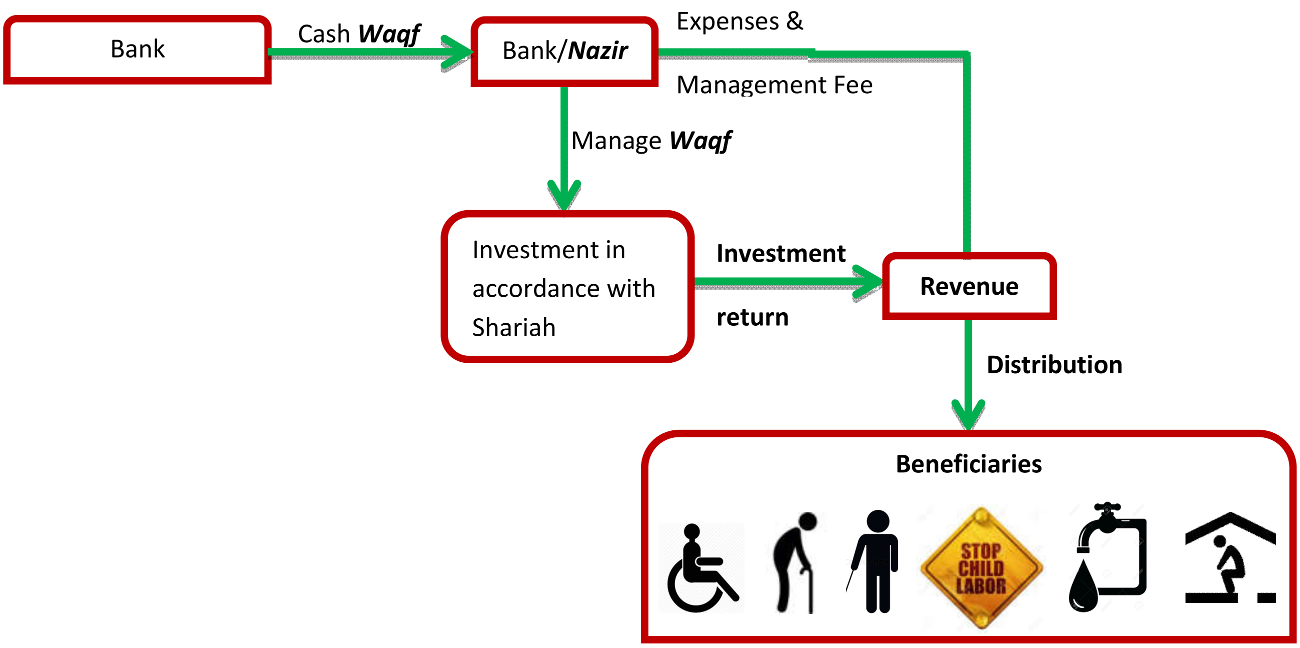
WAQF PROCESS



The *Mutawalli* (*Nadjir*) is the trustee. He protects the *Waqf* property, invests it for profit generation and does charity with the profit. However, the *Mutawalli* cannot give or lease the *Waqf* property without legal permission. Therefore, the *Mutawalli* should be honest. The *Mutawalli* must ensure that the basic principles of *Waqf* are complied with properly. One of the basic principles of Cash *Waqf* is that the property donated as *Waqf* cannot be sold, inherited or transferred in any way to others. Another basic principle is that the donated property remains as a *Waqf* for ever.

When the donation is in the form of cash and the bank is made *Mutawalli* or *Nadjir* (or *Mudarib* in case the fund is accepted on *Mudarabah* contract for profit generation) of the fund, it becomes Cash *Waqf* with the bank.

CASH WAQF PROCESS



The purpose of the Cash *Waqf* is the same as the general *Waqf*, that is to say doing charity. The bank, as the *Mutawalli*, or *Nadjir* does the charity as per the instructions of the *Waaqif*. The *Waaqif* gives the instructions when he opens a Cash *Waqf* account with a bank. He gives the instructions on the account opening form.

To the bank, Cash *Waqf* is a deposit product. The bank usually takes the deposit under *Shariah* principles. Thus it does business with the *Waqf* subject to the consent of the *Waaqif*. The bank does the charity with the profit from the business. The bank ensures maximum productivity of the fund with its management experience. The bank can guarantee maximum charity with Cash *Waqf* by dint of its honesty and integrity. Although the bank takes the fund from the *Waaqif* forever, it runs business on yearly basis. In a *Waqf* account, the *Waaqif* can either deposit the full amount at a time or deposit the amount in regular or irregular instalments. The bank calculates the profit in an appropriate way. However, once deposited, the amount cannot be taken back by the *Waaqif*.

Key features of Cash *Waqf* Account—

1) Although *Waqf* can be both perpetual and temporary, the bank usually accepts perpetual type of *Waqf*. It means that *Waqf* fund cannot be withdrawn. So no cheques or debit cards are issued against such bank accounts.

2) The eligible depositor(s) deposit their *Waqf* fund in cash at a time or in instalments.

3) The banks also accept foreign currency complying relevant rules and formalities.

4) Profit is credited to *Waqf* account monthly on a provisional profit rate. Although the bank applies profit to the bank on monthly basis on a provisional rate, it fixes the actual profit rate at the end of the year. Then the bank settles the excess or shortfall of profit applied to the *Waqf* accounts. If it has paid more than is due, the bank can either take it back or leave it. As per Islamic culture, the bank usually shows superior values. It does *Ehsan* or leaves it dues generously.

5) Profit earned in the account can be withdrawn and spent by the *Mutawalli* (Bank or *Waaqif* as appropriate as per the terms and conditions signed by the both parties at the time of account opening). If the banks is the *Mutawalli* it withdraws and spends the money for doing charity in the area(s) specified by the *Waaqif*. If the *Waaqif* opts

for doing charity himself, he withdraws the profit and serves as the *Mutawalli* at his discretion.

6) Although, the principal amount of the account will not be allowed to withdraw, the *Waaqif* in his/her life time may transfer the account elsewhere at his/her own discretion.

7) This is a perpetual account, which will be continued for ever until/unless it is transferred to other bank as per decision of *Waaqif*.

8) If the *Waaqif* opts for being the *Mutawalli,* he has to nominate, a the time of account opening, the successive *Mutawalli(s)* who will play his role on his death.

At the time of account opening, the *Waaqif* selects the area or areas for charity. Usually, the areas include, education, healthcare, sanitation, social utility services, food, shelter, physically handicapped, street beggars, destitute women, orphans, informal education, art, culture, heritage, *Dawah* activities, supply of pure drinking water, legal aid to deserving women, marriage to poor girls without dowry, tree plantation, social awareness against gambling and other social crimes, maintenance of graveyards, etc.

The purchasing capacity of the Cash *Wafq* fund may decrease over time due to inflation, and accordingly the scope of charity is likely to shrink. In order to prevent narrowing of charity scope in the future, there should be provision for inflation adjustment so that the fund can ensure equal volume of charity over time. The adjustment may be done from the profit earned from business with it. The fund has been forsaken by the *Waaqif* eternally and thus if it is exposed to damage and depletion from interplay of economic factors, the effect will be eternal, and the fund may be reduced to an insignificant amount someday. As a *Nadjir* or *Mutawalli*, it is the duty of the bank to safeguard it from all damages including devaluation, otherwise the bank will do injustice to the *Waaqif* by allowing factual depletion of the asset. However, if a portion of the profit is applied for inflation adjustment, it may retain its future value intact but reduce charity for the present beneficiaries. Still the bank should provide for the likely devaluation of the asset because the eternal donation or *Waqf* can ensure charity eternally only if it is prevented from damage and loss every time.

Case Study-1—

Abdul Malek runs a grocery at a remote village in Bangladesh. His shop is at the intersection of the two semi-pukka village roads, one of which runs to their union parishad bazaar. Ablud Malek sells daily necessaries like rice, flour, oil, dairy products, bakery items, cosmetics, stationery, toys, etc. His customers are village folks—farmers, van-pullers, day labourers, wage earners, children, etc. Being the sole grocery in the village, it is frequently visited by customers. A good number of his customers are women since they find it in their close vicinity. Kids also like to visit his grocery for chocolate bars, chewing gum, kites and tops besides stationery for their education. Sometimes, people from towns and other villages come to the village to visit their relatives and buy biscuits, dry sweets, etc. for them. Sometimes, even some retailers from the union parishad bazaar come to him for purchasing rice and wheat in large quantities for wholesale prices because of his honest dealings. Thus he has monthly revenue of around Tk. 1,50,000/- (Taka one lakh and fifty thousand) against his monthly investment (working capital) of around Tk. 1,10,000/- (Taka one lakh and twenty thousand) giving him a net profit of Tk. 30,000 per month which he spends for his family comprising 5 members—his wife, two children, his widow mother and him himself. But not all the amount is extinguished after he meets all his regular family expenses. He keeps the remaining money with his wife. One night his wife expressed her concerns as to whether it was safe to keep the money in home. Abdul Malek brushed aside his wife's apprehensions saying thieves would not waste their time looking for their meagre amount. His wife said the amount might be meagre but it was all they had for the future of their children, treatment of their old-aged mother and prosperity of their family. Abdul Malek took notice of the final words his wife mentioned, *i.e.* prosperity of their family. He asked his wife how further prosperity was possible. His wife suggested opening another shop in the upazilla parishad bazaar. Abdul Malek tat-tatted at it saying it was a big deal and he could not take care of another business concern so diligently with the same honesty. He was not interested in losing his reputation in the village for a bad concern in the town. That would neither add to his good names nor could bring prosperity. Still his wife was insistent upon trying their luck, possibly in the town. Abdul Malek reconsidered his opinion because all his perception is based on mere speculations. He asked his wife about the amount of their savings. His wife said it was Tk. 3,50,000/- (Taka five lakh fifty thousand) and is hopefully going to be more than Tk. 5,00,000/- (Taka seven lakh) by the end of the current IRRI-season. Abdul Malek was pleased to know the amount that they had saved for long 10 years of business. However, he was not confident of running a business concern with that amount in the town. He said that it was a sizeable amount but was far short of running a shop in the town. He shared his diffidence outright with his wife. His wife dissipated his concerns. She advised him to select an experienced and honest person to the run business with rather. Abdul Malek was not convinced with her arguments but was concerned about the safekeeping of their savings. He considered keeping the money with a bank for its safekeeping first and his wife was upto their prosperity, and of course in *Shariah*-based ways.

Abdul Malek conceded to his wife's plan and they together went to Ameen Bazaar Branch of Ideal Shairah-based Bank Ltd. The officer at customer care described two options—opening an *al-Wadia* Current account in the name of their grocery 'M/S Alif Monohory Store' or a *Mudarabah* Savings Account in the name of either of them. They asked the bank officer about their respective advantages and disadvantages. The officer at the customer care said since *bhabee* was upto doing business with an experienced and honest person, she could do it with the bank opening a *Mudarabah* Savings Account. The bank officer continued that as per the *Mudarabah* contract of the *Mudarabah* Savings account, *bhabee,* as the account holder or *Saahib al-Maal* (owner of the capital) will provide the bank with funds and the bank as her *Mudarib* (manager) will provide its managerial experience to run the business on contract of returning her profit of the business, if any, on an agreed ratio, or financial loss, if any, solely to her, on consideration of time and labour the losses of the *Mudarib*. By far they were convinced that the bank was both experienced and honest in dealing with business, since the officer at the customer care was so knowledgeable about *Shariah*-based banking and so candid about the dealings of his bank, Ideal Sharia-based Bank Ltd. However, Abdul Malek was upto exploring business opportunities with the bank by his own since he had got an idea that bank could be engaged in business entrepreneurship. The officer ensured that the bank could invest money with them the way they could do with the bank. However, before that the bank was to be sure that Mr Malek and his wife were skilled, worthy and honest in business dealings. Asked how it could be proved, the officer explained that their business transactions should be recorded in some bank and the amount and frequency of the transactions should reflect the real worth of their business concern. Then the bank could consider running partnership businesses with the clients. Abdul Malek and his wife could readily understand that for the daily earnings and expenses to the recorded accurately and analysed minutely, they should have an *al-Wadiah* Current Account with a bank.

Abdul Malek and his wife came out of the office of Amin Bazaar Branch of Ideal Islamic Bank Ltd. with the knowledge that *Shariah*-based bank does business with clients on different terms and shares profits with customers in addition to keeping money safe, recording of transactions properly, transferring money fast, and assessing one's financial worth for creditworthiness. Returning home they planned to leave all their financial concerns with Amin Bazaar Branch of Ideal Islamic Bank Ltd. For it they brought their home several account opening forms, one for *al-Wadia* Account, on for *Mudaraba* Savings account and a few for *Mudarabah* Monthly Deposit Scheme Accounts for their minor children and old-aged mother.

Short Questions—

1) What are the main ways of deposit collection in Islamic Banking?
2) Mention the main functions of the Islamic bank with respect to *al-Wadia* Current Account.
3) Who act as the *Nadjir*, the *Waaqif* and the *Mutawalli* in the context of cash *Waqf* with the bank?

Broad Questions—

1) What are the main features of *al-Wadia* accounts?
2) What are the main features of *Mudarbah* Savings Account?
3) Mention the key differences between *al-Wadia* Current Account and *Mudaraba* Savings Accounts.
4) Mention main areas to which customers usually want the profit of Cash *Waqf* to be distributed.
5) Propose your plan to adjust inflation in Cash *Waqf* accounts vis-à-vis prospective devaluation of the funds.
6) Describe how *Hajj* deposit account is maintained by the bank as a *Mudarabah* business contract.
7) Describe profit distribution process of Cash *Waqf* accounts.
8) How are *Hajj* Deposit accounts operated in Islamic banks?

Short Notes—

1) *Mudarib*
2) *Saahib al-Maal*
3) *Al-Wadia*
4) *Mutawalli*
5) *Hajj* Deposit Account
6) Inflation adjustment to Cash Wafq account

CHAPTER III

Finance and Investment in Islamic Banks

Syllabus—
• Musharaka, Mudaraba, Bai Murabaha, Bai Muazzal, Bai Salam, Bai Al-Istisna, Hire Purchases, Hire Purchase Under Shirkatul Milk, Quard-e- Hasana, Lease Finance, Auction Investment, Syndicated Investment, Izara bil Baia, Muzara'a, Mugarasa, Musaqat
• Specialized Financing—Rural, Agro-, Micro and SME Finance—their modes and operational procedures;
• Corporate Social Responsibilities—*Zakat*, *Sadaqa*, Cash *Waqf*, *Quard-e-Hasana*

Islamic Modes of Investment—

The key principle in Islamic financing modes is to avoid interest that is an inseparable element to loans and credits and constitutes earnings of a conventional bank. Islamic financing is implemented in three ways—by way of partnership with the customers' business, by way of renting out asset and through outright sale of goods to him. Thus the modes of investment in Islamic banking can be broadly categorized in three groups—(i) partnership-based modes *(Musharaka)*, (iii) *Ijarah*-based modes and (iii) buy-sale-based modes.

In the partnership-based modes, an Islamic bank executes a joint-venture contract with the client to the effect that the profits and losses of the venture shall be distributed among the bank and the client as per agreed upon rate. The commonly explored partnership-based investment modes are *Musharaka*, *Mudarabah*, *Muzara'a*, *Mugarasa* and *Musaqat*.

In *Ijaraha*-based modes, non-fungible goods, like land, factories, machinery, are rented out to the client for a specific period usually for more than one year for rentals payable monthly, quarterly, or as per any other agreed schedule. The widely practised *Ijarah*-based modes are *Ijarah bil-Baiya* and Hire Purchase under *Shirkatul Milk*. However, there are other modes as well like *Ijarah wa Iqtina* and *Ijaraha Muntihiya bil-Tamlik*. Although all these modes are pivoted on *Ijarah*, they are implemented in association with non-*Ijara* modes. Long term financing, like project financing, factory construction, machinery purchase, is provided in *Ijarah* modes.

Buy-sale based modes involve buying goods and services by the bank, usually on spot payment, at a lower price, directly or indirectly, through agent or by itself and then selling the goods, typically on deferred payment, to the customer on profit for his further sale or consumption. The price for which the bank bought the goods is the investment on the banks part and the profit that the bank adds while selling the goods to the customer is the profit on the investment. The common buy-sale-based modes are *Bai Muajjal*, *Bai Murabaha*, *Bai Salam*, *Bai Istisna*, etc. Islamic banks usually finance traders, manufacturers, famers, cottage-enterpreneurs, and consumers in buy-sale based modes to provide funds to purchase raw materials, tools and machinery, seeds, fertilizers, irrigation, merchandise, household utensils, etc.

Musharaka—

The Arabic term *Musharakah* means taking part or joining. It is the verbal noun of *Sharaka* (to take part, or to join), which in turn derives from *Sharika* (to share, to participate). In business, it refers to a partnership where two or more persons provide capital to conduct a business jointly on the contract of sharing profits and loss together. In *Shariah*-based banking, the bank joins a business with the customer and provides a share of the capital or working capital on the contract of profit and loss. The fund so provided to the customers is the investment of the bank which can be construed as the equivalent of the loans and advances for conventional banks.

Features of *Musharakah*—

1) The contribution of the capital by the partners may be equal or unequal.

2) *Musharakah* is based on the principle of entitlement to return proportionate to the risk exposure.

3) In *Musharakah*, labour, skill, management, goodwill, creditworthiness, connections whichever are contributory to the profitability of the business can be considered capital in addition to money and the partner or partners that provide such capital are entitled to the profit of business equally with the partners providing financial capital.

4) Every partner has the right to take part in the management of the business.

5) Each partner works in the *Musharakah* on behalf of himself and as an agent of the partner or partners.

6) The partners may appoint workers to perform their tasks on payment.

7) Without agreement of other partners, a partner can borrow or lend money for the partnership.

8) In general, the profit/loss would be distributed as per the proportion of the capital each partner has provided. In *Musharakah,* it is not valid to give profit or loss to any partner in lump sum or in a percentage of the capital. As such, if a partner is promised that his profit would be 12% of his capital, it would be an invalid *Musharakah*.

9) One or more partners may be sleeping partners. The profit and loss proportions of the sleeping partners can be determined judiciously at a percentage less than the proportions to the capital. Suppose, a partnership of Tk. 10 lakh has earned a profit of Tk. 1 lakh, and thus the ratio of the profit to the capital comes to 10% to the capital. Therefore, the profit of each partnership, would be an amount which is 10% to his capital. However, in *Musharaka*, it is permissible to a lower ratio of profit to sleeping partners, if any.

10) Even if all the partners are active, the profit sharing ratio of a partner can be more than his capital ratio.

11) Most of the Islamic jurists are in the opinion of sharing the loss in proportionate to the capital.

12) The *Musharakah* will be void on the fulfillment of the purpose for which a *Musharakah* has been made. However, any partner has the right to withdraw from the partnership at any time giving prior notice to other partners.

13) On liquidation of the *Musharaka*, the assets, if any, are distributed on pro rata basis among the partners.

14) If one or more partners withdraw from the *Musharakah*, the other partners can purchase the shares of the outgoing partners.

Mudarabah—

Mudarabah means to travel or move with business undertakings. Here in Islamic commerce, one party provides capital to the other party who travels to do business with the capital for profit and shares the profit, if earned, on the principle of one's capital contribution and the other's management contribution. The party that undertakes the business is *Mudarib* (manager) and the party that provides the fund is *Saahib al-Maal* (owner of the capital) and the business so run is *Mudarabah*. In Islamic banking, the bank may provide capital for its clients to run *Mudarabah* businesses on a profit-sharing contract. The funds so provided are investment (finance) by the bank and the client so contracted is a *Mudarib*. However, the profit prospects for the bank are heavily depended on the parties' honesty, sincerity, accountability and skill, and therefore such investment is highly vulnerable for the bank whereas it deals largely with money taken from people, not owned by it.

Bai Murabaha—

Murabaha is a contract between a buyer and a seller where the seller buys a certain product to a buyer at a cost plus a negotiated price payable on the spot or on some date in the future in lump sum or by instalments. The profit may either be fixed as a lump sum based on the cost or as a percentage of the cost. So unlike other buy-sale arrangements, *Mudarabah* requires the seller to declare the cost and profit separately. In Islamic banking, the bank sells a product to a customer on an agreed upon profit whereas they both know the cost of the product. The customer, if he is a trader, sells the goods to consumers and pays the price of the goods to the bank on the spot or at a deferred time, and if he is a consumer, starts consuming the goods purchased from the bank, and pays the price at a future date when money is available with him. However, it should be noted that the bank has already had to pay for the commodity to its supplier in cash. The funds so spent are investment on an Islamic Bank's part. The sale proceeds so earned by the bank are repayment of the investment.

Features of Bai Murabaha—

1) The bank as the seller of the commodity must possess it whether physical or constructive.

2) *Murabaha* is a real buy-sale of commodities, not financing the customer for his payment of utility bills, tuition fees, wages, or the like.

3) The sale contract must be a valid one.

4) *Murabaha* is not financing a customer to purchase goods, rather it is selling of goods by the bank to the customer on the facility of deferred payment.

5) The payment for the commodity may be deferred or on spot.

Bai Muajjal—

Bai Muajjal is almost like *Bai Murabaha* excepting the requirement of disclosing the cost price and profit separately on the seller's part. In fact, the name implies deferred payment. *Ajal* means a fixed time of period. *Bai Muajjal* is primarily meant for credit sale.

In Islamic banking, the bank purchases goods specified by the customer and sells it to the customer for profit, however without declaring its cost price, and hands over the goods to the customer then and there with the provision in favour of the customer that he may pay the price later, usually in one year. Thus *Bai Muajjal* is a credit sale of goods by which the ownership of the goods is transferred by the bank to the client and the latter is allowed to pay the price in a future date. The cost price of the goods is investment on part of an Islamic bank and the profit for which the goods are sold to its client is the profit on investment.

Through *Bai Muajjal* mode, bank can provide credit facilities, i.e. selling goods in credit to customers of a wide range—household utensils, electronics, etc. to consumers; merchandise, supplies, etc. to traders; raw materials, machine equipment, etc. to manufacturers, seeds, fertilizer, etc. to farmers, and even *Umrah* packages, education expenses, etc. as long as the services are provided in packages.

As an investment mode of a bank, a round of buy-sale-payment under *Bai Muajjal* takes place with a client, typically a trader, expresses his intention to the bank to buy specific goods from it in credit. If the bank agrees, the bank and the client sign a *Bai Muajjal* agreement where the client mainly specifies the amount and type of the goods and the bank specifies the price for which it will sell them and the deadline for payment, usually one year. The agreement also contains delivery date, time and place of the goods. The bank then can implement the purchase of the specified goods in two ways—either by itself and by employing an agent. Whatever the bank does, it must ensure that money has been transferred to goods and the goods have been sold to the customer for a *Bai Muajjal* sale-buy to be religiously valid or it will be financing arrangement for interest in disguise. So the bank first owns the goods in all senses and then sells them as their owner to the client for profit the price of which is payable in a future date typically one year. The fund spent by the bank to purchase the goods is its investment and thus is entitled to get back the principal with its profit.

Bai Salam—

Bai Salam is an advance sale-purchase where the buyer pays for the commodity in advance and the seller delivers it in a future time which is specified in the agreement between them. A typical use case of such sale-purchase is regarding agricultural produce which the petty farmer is going to grow and therefore presently needs working capital for seeds, irrigation, labour, etc. Such advance buy-sales provide a petty farmer with capital and secure sale.

In the *Bai Salam* mode of investment, an Islamic bank comes to a contract with its client, typically a farmer or a manufacture by profession, to the effect that the former shall pay for a certain amount of commodity of him presently and the later would deliver it in the specified quantity and quality in a specified future date after the client has grown or manufactured it. The price of the produce that the bank pays is investment on the bank's part. However, for profit on the investment, there should be another round of sale-purchase and of course in a higher price. Since the bank is the owner of the produce buy way of purchasing, it can sell it to another person, and in a higher price. The bank can implement a spot sale to avoid storage of the commodity whenever it comes to its possession. For a secure sale, the bank can arrange for another *Bai Salam* contract parallel to the original *Salam* one whereby the bank is committed to delivering a certain amount of produce in a certain quality on a certain date. This resale is usually at a higher price, and the profit the bank earns from this sale is the profit of the investment that took place when it made the advance payment to the first client.

Important Features of Bai Salam—

1) If the commodity or product is ready for sale, *Bai Salam* shall not be valid in the *Shariah*.

2) It is permissible to obtain security as mortgage, guarantee or hypothecation from the seller to cover the risks of non-supply or partial supply of the commodity or supply of defective products.

3) The manufacturer or cultivator client may be made agent of the bank to sell the commodities delivered to the bank. However, a separate agency agreement shall be executed between the bank and the client.

4) The exact time and place for the delivery of the commodity, cost of its transportation, godown rents for its storage and insurance premiums must be specified properly.

5) Price shall be paid to the seller client in full at the contract execution time.

6) Delivery of the commodity can be at one time or in instalments within the specified period of time.

7) If the seller client delivers commodity less than what was contracted, the buyer bank is entitled to getting back the portion of the advance equivalent to the price of undelivered quantity.

8) In case of default in delivery, the guarantor is liable to deliver the commodity.

9) The seller client of the product is not liable to disclose the cost and profit of the commodity separately.

10) The bank may either receive the commodity and resell it or authorize the seller client to find another buyer for it.

11) The bank may direct the seller client to deliver the commodity directly to a third party whom the bank has parallelly contracted for selling it.

12) The bank can sell the commodity at a higher price.

Bai Istisna—

Bai Istisna is derived from Arabic term *sana* that means manufacturing. Thus *Bai Istisna* implies buy-sale of manufactured or produced goods and thereby implies deferred delivery.

Bai Istisna is almost like *Bai Salam* excepting deference of payment of the goods at option. *Bai Istisna* is an agreement where the price, quantity, quality and delivery time of a commodity are negotiated at the time of agreement between the buyer and seller and the seller manufactures it and delivers it within the fixed period. The payment may be done at the time of contract, or at the delivery time or at any future time mutually agreed upon and the payment may be either in intalments or in full.

Bai Istisna allows an Islamic bank, in the capacity of buyer to contract with a manufacturer client for a specific commodity and pay in advance so that the manufacturer client can buy materials, pay for wages and other expenses and have enough time to manufacture the commodity to be delivered at a future to the bank whereas the bank sells the commodity at a higher price to another client on spot or deferred payment. The advance payment the bank made to the manufacturer is the investment of the bank's part and the profit it has earned on the sale of it is the profit on the investment. However, each buy-sale event is a separate one and does not depend on one another. To complete a round of investment in *Bai Istisna* mode, an Islamic Bank can execute two parallel *Istisna* contracts, in the first of which the bank, in the capacity of the seller, commits itself to supply a producible commodity to a trader or consumer client and executes, in the capacity of a buyer, a second *Istisna* contract, therefore a parallel Istisnia, with a manufacturer client to produce it. In the original *Istisna* contract the bank, as a seller, charges a higher price to the buyer client.

Main features of Bai Istisna'a—

1) The kind, type, material, quality, and quantity of the commodity must be specified.

2) The commodity must be of the kind that is manufactured like garments, furniture, tools, cars, not grown like corn, wheat, fruit or any natural products.

3) The payment of the price may be in instalments or in full and may be payable at the time of contract, delivery, or any future time agreed upon between the buyers and sellers.

4) It is the responsibility of the manufacturer to supply the materials. If the buyer supplies the materials, it would be *Ijarah* and not *Istisna'a*.

5) The buyer has the right to obtain collaterals from the manufacturer buyer to secure the payment, if done in advance.

6) The manufacturer has the right to secure collaterals from the buyers as guarantee of the payment in case of deferred payment.

7) It is permitted for the buyer to stipulate penalty clauses in the contract against breach of the contract by the manufacturer.

8) If it is not stipulated in the contract that the manufacturer with whom the contract has been executed shall manufacture the commodity by himself, he can contract with another manufacturer for the goods specified in the first contract.

Ijara Mechanism—

Ijara means wages, rents or remuneration. Thus *Ijara* as a mode of transaction implies giving an asset on rent, employing somebody on remuneration or wages and hiring some animal on rent. In fact *Ijara* is a kind of sale where services of the assets, human beings or animals are bought and sold whereas a usual buy-sale contract requires the exchange of the commodity itself for money.

In Islamic banking, *Ijara* allows an Islamic bank to let out equipment, machinery, industrial projects, vehicles, real estates, infrastructure projects to its industrialist customer or consumer customer for rents payable periodically to the bank over a longer period and thereby enables the bank to make short, medium or long term investment. In *Ijara* mode, an Islamic bank can provide industrialist clients with working capital by hiring labour first and then sub-leasing it to the client.

Ijarah requires that the lessor (bank) retain ownership of the asset to be able to rent it out to the lessee. However, a bank's purpose is not to accumulate assets and go around renting them out to people for money. It should dispose of the leased asset as soon a round of investment/financing is over. Therefore, in order to complete a round of *Ijarha* investment, an *Ijarah* should end in sale after the term of finance. So, *Ijarah* is implemented as *Ijarah wa Iqtinau'* (Ijarah and Ownership) or *Ijarah Muntahia bil Tamiliik* (Ijarah ending in Ownership Transfer) as an Islamic mode of investment because Hire Purchase, a conventional way of lease financing, entails first financing the purchase of an asset, like vehicles, etc. by the bank and then selling it to the client for a higher price to the client which is repayable in instalments within a fixed period of time. Since there is ambiguity, in the case of Higher Purchase, over whether it is bailment or outright sale of the asset/property to the customer from the beginning of the repayment, *Ijarah* wa Iqtinau' (Ijarah and Ownership) or *Ijarah Muntahia bil Tamiliik* (Ijarah ending in Ownership Transfer) comes to ensure the retention of ownership of the leased asset/property till the last installment of the rent and then a sale and thereby enabling a true *Ijarah* in the *Shariah* sense. In *Ijarah wa Iqtinau'* and *Ijarah Muntahia bil Tamiliik*, an Islamic bank first purchases an asset specified by the customer, then leases out it to the customer (letting the customer use only its utility or services) and lastly hands over the ownership either by sale or gift.

However, in *Ijarah wa Iqtinau'* and *Ijarah Muntahia bil Tamiliik*, the lessee (bank's client) is likely to incur a huge expenditure while purchasing the asset at the end of the term if the instalments include the rents and exclude the price of asset/property. If *Ijarah wa Iqtinau'* and *Ijarah Muntahia bil Tamiliik* take place under *Shirkatul Milk* (Equity Sharing), an instalment can comprise of a portion of the price of the asset and a portion of the rent thereby exempting the lessee from paying whole price at a time. This combined mode of investment is called Higher Purchase under Shirkatul Milk.

Muzara'a—

Muzara'a is a contract between a landowner and a farmer where the farmer cultivates the land of its owner for an agreed upon share of its produce. The practice of *Muzara'a* varies depending on who will provide seeds and machinery, and the share of the crop is determined in accordingly.

Mugarasa—

Mugarasa means plantation. In Islamic mode of investment, *Mugarasa* is a contract between a land owner and a farmer where the land owner allows the farmer to plant trees on it on contract of sharing the produce.

Musaqat—

Musaqat is a contract between the owner of an orchard and a cultivator where the cultivator waters and nurtures the trees of the orchard for an agreed upon share of its produce.

Quard al-Hasana—

Quard al-Hasana is a loan given to beneficiaries without interest. Since bank deals with public money, it has to consider earning money to pay dividends to the shareholders, profits to depositors, remunerations to the staff, etc. as a commercial organization. This is why an Islamic bank practises *Quard al-Hasana* in a selective way like for students, distressed people, under-privileged sections of people, ultra-weak enterpreneurs, etc. Some Islamic banks have provision to provide interest-free loans to their valued depositors.

Syndicated Investment—

Syndicated finance refers to group financing typically to a large industrial project where two or more banks or financial institutions contribute equal or varying sums to a common pool of loans, advances and guarantees, etc. under the invitation, coordination and management of a lead bank or financial institution and disburse from the pool loans, advances and guarantees to the enterpreneur to purchase land, build factories and offices, import and install machinery, have working capital for the project to be completed. In Islamic banking context, there are two tiers of transactions—one between the lead bank and the participating banks and the other between the lead bank and the entrepreneur of the project. At the first tier the lead bank takes the contributions from other banks as a *Mudarib* on *Mudarabah* contract or as a *Wakeel* on *Wakalah* (agency) contract. The *Mudarabah* contract stipulates that *Mudarib* shall share the profit earned from his business or investment with the entrepreneur with each of the participating banks on an agreed upon ratio and in case of loss solely the participating banks have to share it between them proportionately to their contributions. In case of *Wakalah* contract, the lead bank takes the fund from other banks on fixed agency fees regardless of the profit or loss from the investment done with the funds from the participating bank. Being an agency contract, *Wakalah* is largely governed by the state laws apart from the *Shairah*. At the second tier the lead bank provides finances, out of the syndicated pool, for different project implementation phases, like land acquisition, factory construction, machinery import, working capital supply in different Islamic investment modes appropriate for a particular phase. All Islamic modes of investment are possible at this tier of syndicated finance.

Specialized Financing—Rural, Agro-, Micro and SME Finance—their modes and operational procedures—

Agriculture, cattle raising, poultry, fish-farming, orchard, and medium, small and cottage industry are the major economic activities of rural areas that underpin the economy of Bangladesh by creating employment, alleviating poverty, promoting women empowerment, uplifting standard of the life there and thereby contributing to the national gross product. So financing in rural areas means increased economic activities and accelerated national growth. However, rural financing is a challenging one and is thus designated as specialized. This is mainly because of widespread poverty, lack of adequate collateral, less accessibility to banks, less technology access, excessive reliance on traditional money-lenders and poor financial education of the rural people. Furthermore, their economic activities are more short-term and season specific by nature and there produce and products are largely easily perishable. However, rapid infrastructural development by the government, gradual expansion of mobile network by the mobile phone operators, increasing remittance inflow by the Bangladeshi expatriates, inclusive banking move and branch-sub-branch expansion policy by the central bank, continuous micro-credit operations by specialized and private commercial banks and NGO's in the rural areas over the recent decades years or so, have changed the scenario to a great extent. Now, it has almost become only a matter of policy for a bank or financial institution to extend finance to rural farmers, fishermen, carpenters, entrepreneurs and small traders and developing appropriate modes of investment.

Farmers have small land properties to cultivate and thus they need a small amount of loan and for a short time, typically for three months, while their crops of a particular season are growing to be harvested. But they need it direly. If the farming for that season is not adequately financed, a huge portion of the cultivable land of the country will be uncultivated. This is a typical scenario in agro-investment, unless it is for a large farm or agro-project. This is the case with fishermen, carpenters and cottage enterprises, as well.

Some buy-based and *Ijarah*-based Islamic modes are especially appropriate for agricultural finance. A farmer need to possess a piece of land; to purchase ploughs, seeds and pesticides to cultivate a crop on it, to pay for irrigation services or to purchase pumps for irritation, to hire labourers for farming activities and to sell his produce justly and securely. Several modes of investment can come up to finance all these needs. An Islamic bank can finance the purchase of farm land and machinery like tillers, irrigation pumps, etc. on *Ijarah* under *Shirkatul Milk* (joint purchase with the farmer and transferring ownership gradually to him over a longer period), can sell seeds, pesticides, etc. on *Bai Muajjal* (sport delivery to the farmer but deferred payment by the farmer usually in one year), can purchase the produce in advance on *Bai Salam* (advance spot payment by bank to the farmer and delayed delivery of produce by the farmer) with which the farmer can pay for the irrigation services, labourers' wages, and all incidental expenses.

Corporate Social Responsibilities (CRS)—Zakat, Sadaqa, Cash Waqf, Quard al-Hasana—

Islamic banking performs corporate social responsibilities in two ways—by way of donation as *Zakat*, *Sadaqa*, etc. and by way of banking in the modes of Cash *Waqf*, *Quard al-Hasana*, etc. Some of the donation is obligatory by the diction of the *Shariah* and then incumbent upon by the regulators as an Islamic bank while some donations are solely voluntary out of religious motivation.

Zakat—

The Shariah obliges a Muslim individual to donate, to designated beneficiaries, a portion of his/her savings equal to or exceeding the minimum eligible amount of asset (*nisab*) that he/she has held for a lunar year. It is usually incumbent upon individuals. In case of an Islamic bank, the regulatory reserves that the bank holds in the forms of Statutory Reserves, Dividend Equalization, Retained Earnings, Exchange Equalization, General Reserves, etc. for one financial year are counted for organizational *Zakat* payable by the bank whereas the paid-up capital is left out to its individual owners as their asset to pay *Zakat* on.

Sadaqa—

Sadaqa is a voluntary charity that a Muslim does out of benevolence to add to his good deeds in addition to obligatory religious duties. An Islamic bank does charity out of its income to share the blessings of the good deeds with its stakeholders. Furthermore, as a religious organization, such charity adds to its brand image among its clientele as well.

Cash *Waqf*--

Cash *waqf* is a unique feature in Islamic banking in which a pious Muslim deposits, as *Sadaqa Jariya*, an amount with an Islamic bank usually on *Mudaraba* contract with the intention of doing charity with the profit the bank, as the *Mudarib*, earns from the *Mudarabah* business. The *Saahib al-Maal* or *Waaqif* (trustee) may choose to do the charity by himself or may designate areas of charity or beneficiaries and engage the bank as the *Nadjir* (caretaker) to do the charity to.

***Quard al-Hasana*—**

Quard al-Hasana is another unique feature in Islamic banking. *Quard al-Hasanah* is a benevolent loan given without interest and thus is given only to needy people like, poor students, under-privileged people, impoverished enterpreneurs.

Case Study—

Abdul Khaleq is a poor farmer in a remote village far away from Netrokona District. He has only 1 *bigha* of farm land merely sufficient for him to afford his family of 5 members including him. Still his wife, Julekha and he try their best to cultivate the land three times a year to grow rice, jute and pulses one after another. Julekha grows vegetables all the year round on the land around their small hearth. The vegetables are mostly used to meet their daily needs. However, when some vegetable grows in large quantities, she gives them to his husband to sell in their village hut. Abdul Khaleq sells them in the hut and returns sale proceeds to his wife. But Abdul Khaleq's one *bigha* land hardly produces more food staff to be sold in the hut. His family needs all of them. Even he cannot sell jute because with all the jute he has to repay his debts that he has had to take from village *mahajans* as working capital for farming. However, his children were growing up and no wonder the family expenses were on the increase. His wife and he were looking for ways to follow the pace of their daily expenses and to secure the future of their children. However, the only plot of farm land they had could not grow at the pace of their ever increasing daily expenses. Julekha suggested lease some farm land on contract sharing contracts or working on others' land as an agricultural labourer for wages. Abdul Khaleq said both were good plans and would definitely bring in some more money for their family but the earnings could be hardly enough for their family in the long run because crop-sharing and wage-earning had many limitations because they allow a little liberty to a farmer. After their long and detailed discussion they both could realize only money could give them sufficient liberty to produce enough for their present solvency and future prosperity. With money they could take on lease as much farm land as they could manage properly. They could purchase sufficient amount of quality seeds, cultivate them with modern technology, irrigate them in time, sufficient number of labourers to assist him. When Julekha counted her money that she had been saving for years by selling her excess vegetables, they came to know that money was one thing that they did not have enough.

One day Abdul Khaleq and Julekha went to the manger of Shimultali Sub-branch of Ideal Shariah-based Bank Ltd. at their union parishad bazaar. The manager was pleased to know that that rural family had planned to expand their agricultural enterprise and wished them success. However, the manager made it clear that his bank did not lend money and what, instead, his bank could do was to purchase all his produce in cash. Abdul Khaleq said once the staff was produced, it could be sold anywhere, but his main challenge was to produce the staff itself because he did not have sufficient money for which they had approached the bank. The manager replied that as a *Shariah*-based bank, his bank could purchase Abdul Khaleq's produce in advance and pay for it in advance as well under a *Bai-Salam* contract whereas Abdul Khaleq would have to hand over the contracted produce when it is ready to deliver. Abdul Khaleq and his wife Julekha readily knew where the money would come from for lease farm land and produce crop on it. However, they knew nothing about the terms and conditions of the prospective *Bai Salam* contract. The manager reassured them by giving them all the documents relating to the *Bai Salam* contract.

Abdul Khaleq was concerned only about his working capital for farming whereas his wife was interested about the features of such an agro-friendly arrangement of the Shariah-based bank. From the contract documents, she came to know among many details that one person could contract another person to produce or manufacture staff for the former and could take sale proceeds in advance which the latter is at liberty to use as working capital for production or manufacturing of the contracted staff, She could not make out what a bank would do with this stuff.

One other day the family went to the manager and signed the contract papers for sale proceeds of Tk. 10,00,000/- (Taka ten lakh). At one point Julekha politely asked the manager if he would mind telling them what his bank would do with so much rice. The manager replied with a cordial smile that they would then and there sell it to a customer for profit once it is at their possession. Julekha asked the manger how he could sell it then and there. With another cordial smile, the manager reassured Julekha that they could do it because they were going to look for a customer whom they would make a sale contract with for the stuff. Abdul Khaleq had so far been concerned more about immediate availability of the working capital than of the hazards the bank was going to undertake with his rice. At this point Abdul Khaleq hit upon another plan to make further financial gains. He asked the manager whether he (Abdul Khaleq) could be that customer the bank was going to look for to sell the stuff. The manager reassured him with a smile and said that in that case Abdul Khaleq would have to sign another contract for purchasing the rice.

The manager reminded that after delivery of the rice to the bank, its owner would be the bank and would be entitled to sell it to customer with profit. Accordingly, the manager told him the sale-price of the product that included profit. Abdul Khaleq even agreed to purchase the prospective rice at that higher price the manager asked for because Abdul Khaleq knew rice usually sold at a higher price in off-season and he could sell them for an even higher price if only he could store them till the off-season. However, the off-season would be far away from that time he would purchase the rice from the bank. Abdul Khaleq told the manager that he would not have enough money at that time to purchase so much rice, however money would probably be available with him at the end of the off-season for rice. The manager reassured him that he could purchase the produce in credit. Abdul Khaleq readily signed the contract papers for purchasing the prospective rice that he is going to cultivate in the forthcoming *boro* season and sell to the bank in the harvesting season.

Short Questions—

1) What are the investment modes in Islamic Banking?
2) Define *Bai Murabaha*
3) What are the *Bai* modes in Islamic banking?
4) Define *Bai Muajjal*
5) Define *Bai Salam*
6) Define *Bai Istisna*
7) Define *Musharaka* investment mode
8) What is Hire Purchase?
9) What do you mean by Hire Purchase Under *Shirkatul Milk*?
10) What is *Ijarah*?

Broad Questions—

1) Discuss any five of the investment modes in Islamic Banking.
2) Discuss different types of *Bai Murabaha*
3) What are the main features of the *Bai Murabaha* investment mode?
4) Discuss the steps to disburse *Bai Murabaha*
5) Discuss the legal framework of *Bai Murabaha*
6) Discuss the breaches of the principles that a banker might do while disbursing investment in *Bai Murabaha* mode.
7) Discuss the common irregularities while practising *Bai Murabaha.*
8) Discuss the conditions to be fulfilled for a valid *Bai Muajjal* investment.
9) Describe the main features of *Bai Muajjal*.
10) Give a comparison between *Bai Murabaha* and *Bai Muajjal* investment modes.
11) Discuss the conditions to be fulfilled for a valid *Bai Salam*.
12) Compare between *Bai Salam* and *Bai Muajjal*.
13) Discuss the main features of *Bai Istisna*.
14) Discuss the conditions for a valid *Bai Istisna* investment.
15) Give a comparison between *Bai Istisna* and *Bai Salam*.
16) Describe main features of *Musharakah* investment mode.
17) Discuss the main conditions for a valid *Musharaka* investment.
18) What are the differences between *Musharaka* and *Mudaraba* investment modes?
19) Describe the main features of Hire Purchase.
20) Describe the main features of Hire Purchase Under *Shirkatul Milk*.
21) Compare between Hire Purchase and Higher Purchase Under *Shirkatul Milk*.
22) What are the key features of *Ijarah*?
23) Discuss the conditions for a valid *Ijarah* agreement.
24) Describe the differences between *Ijarah* and Rent.

25) Why are *Musharakah* and *Mudaraba* modes called the best of all Islamic Investment modes?
26) What steps can an Islamic bank take to mitigate risks of loss in *Musharakah* and *Mudaraba* investment?

Short Notes—

1) *Bai Murabaha*
2) *Bai Muajjal*
3) *Ijarah*
4) Rent
5) *Bai Istisna*
6) Parallel *Bai Salam*

CHAPTER IV

Foreign Exchange Operation of Islamic Bank

Syllabus—

- Import and Export Financing—MIB, MTR, MPI; Methods of Trade Payments; Exchange Rates; Applicable Rates for FEX Operations; Offshore Banking—discounting, UPAS, Deposit Collection, etc. under Islamic Modes; Export Development Fund, Refinancing Facilities from Bangladesh Bank

Foreign Trade—

A country may produce a certain commodity at a cheaper rate because of cheaper labour, raw materials, technology, etc. In that case it produces the commodity more than it needs with the expectation to export the surplus amount to a country that has difficulties in producing it and therefore finds it more cost effective to import it from other countries. In fact no country can produce all the commodities it needs to meet its domestic demands, and relies on imports from other countries trough foreign trade.

Methods of Payment—

The main challenge in foreign trade is the credibility of the seller and the creditworthiness of the buyer because they live in two different countries. The level of credibility and creditworthiness of buyer and seller have given rise to the issue of securing the payment and thus different methods of payment have evolved over time to make sure the payment. In general, the less the buyer is creditworthy, the more advantageous is the payment method for the seller. The payment method that is the most advantageous for the seller is Cash with Order (Cash in Advance) in which the payment is done along with the order. The seller insists upon such payment when the buyer is the least creditworthy. However, in such payment arrangement, the importer is at risk of getting delivery of the goods. The delivery of the goods is confirmed in Open Account method in which the seller ships the consignments without getting any payment and then submits the bill to the buyer as per the terms and conditions already negotiated between the two parties. This payment system ensures the shipment of the goods but put the exporter at extreme risk of not getting the payment. In Documentary Collection, the seller, as per the agreement with the buyer, submits his bill along with documents to his bank for collection from the buyer's bank on shipment of the goods. The buyer and seller can make such payment arrangement, which is advantageous to the buyer, when the seller is confident of the payment. The payment method that is the most advantageous to the buyer is Consignment Sale in which the seller sends the goods to his representative in a foreign country and the consignee of goods makes the payment to the consignor after selling them to the real customer. In all four methods of payment mentioned hereto, there is risk either of non-payment by the buyer or of non-delivery or discrepant delivery by the seller because of the absence of guarantee by a bona fide party. Here comes the Letter of Credit in which the bank undertakes to make the payment on behalf of its customer to the seller through his bank.

Letter of Credit—

In the simplest sense, a Letter of Credit is an undertaking by a bank to make payment to a seller for his specific consignment of specific goods on behalf of the buyer. On being ensured of payment by a bank, a seller agrees to supply goods to the buyer, even to a foreign country, whom the seller has little option to realize the payment from, in the event of the buyer's failure. Prior to approaching a bank for the guarantee, the buyer has contacted with the seller, specified the goods and their quantity, quality and price.

Flow chart—

1) Issuing a letter of credit by the buyer's bank guaranteeing payment
2) Shipment of the goods by the seller and submission of the bill by the seller
3) Payment of the seller's bill the issuing bank
4) Taking delivery of the goods either by the bank or by the buyer-customer
5) Delivery of the goods to the buyer-customer (usually with post finance facilities)

In Islamic banking system, there is not provision for credit since it entails interest. So to Islamic banking viewpoint, the undertaking of payment is an assurance of payment not a credit. Since there is no involvement of funds at the time of issuing the assurance, there is no transaction between the buyer and undertaking bank and no question of any Islamic modes of investment. The issue of modes of investment arises at the time of payment to the seller, when his goods have been delivered.

In order to avoid *Riba* and *Gharar,* the Islamic bank can issue a letter of credit in three ways depending on three different payment arrangements between the bank and the buyer-customer. If the buyer-customer pays the full price in advance and deposits the amount for that purpose, the issuing bank only executes the purchase of goods as the *Waakil* (buying agent) of his buyer-customer. In case of partial payment by the buyer customer at the time of issuing the letter of credit, the banker has either of the two options—*Musharkah* (purchasing the goods jointly with buyer-customer with equal or unequal capital contributions) and *Murabaha* (first purchasing the goods on spot payment by the bank from the seller and selling them to its buyer-customer on spot delivery, in full or in instalments, and on deferred payment.

While acting as a *Waakil* (agent) for the buyer the banker's responsibility is to execute the payment of the goods to the seller. The bank requires the buyer-client to place the full amount of the price in his account, which the bank accepts on *al-Wadiah* principle. The bank issues a Letter of Credit favouring the seller/importer and makes payment with the deposit of the client on dispatch of the consignment by the seller/exporter. Then the bank delivers the necessary documents to the client to receive the goods bought/imported. The bank can charge agency fees to the client for these services.

In case of partial payment by the buyer-customer, the bank has to arrange the remaining fund from its own source to pay to the buyer in full. If the bank intends to purchase the goods jointly with the buyer-customer principle, it provides the fund, at the L/C payment stage, as a *Musharik* in that *Musharakah* purchase through Letter of Credit. The bank and the customer have joint ownership of the goods and thus the bank has options, at the post finance stage, to sell its equity to the customer in an *Ijara* mode or sell them in any of the *Bai*-based investment modes like *Bai Murabaha* or *Bai Muajjal* usually on deferred payment. However, this way of executing a letter of credit is not so common among Islamic banks. Alternatively, if the bank intends to pay for the goods from its own sources, the bank may purchase the goods from a foreign seller on spot payment and then sell them at a cost-plus-profit price in *Murabaha* or *Muajjal* modes to its buyer-customer usually on deferred payment. At the time of issuing an L/C a *Murabaha/Muajjal* agreement is executed between the buyer and the issuing bank to the effect that the buyer will buy, from the bank, a specific amount of specific goods, which the buyer has already specified to the seller prior to coming to the bank. So in *Murabaha*- or *Musharakah*-centered letter of credit, an Islamic bank has to execute a two-tier buy-sale—one between the bank and the seller, at the time of L/C payment and another between the buyer and the bank at the time of post finance.

The bank pays to the seller outright as per national and international commercial norms, at payment stage. However, if it is not a *Wakalah*-based letter of credit, the bank has to discharge the goods or merchandise to the buyer-customer by way of renting or selling at the post-finance stage. At this stage there is a question of investment on the bank's part since the buyer-customer typically needs credit facilities. The bank has several Islamic investment modes available to support the credit facilities considering the convenience and ability of the buyer-customer and types of the goods. For machinery, equipment, etc. the bank, as the co-partner or buyer of the merchandise, finances the customer for a longer term in any of the *Ijarah* modes—like *Ijara bil Baia* or Higher Purchase Under *Shirkatul Milk*. For finished goods or raw materials, the bank, as the buyer of the goods, sells them to the customer-buyer usually in a *Murabaha* or *Muajjal* mode for a cost plus profit price. The cost is the investment on the bank's part, since the bank has already spent the amount in cash while making payment for the goods to the seller, and the profit or mark-up charged to the buyer-customer is the profit against the investment. However, since the bank has not got the full amount of the price from the buyer-customer, it retains the control of the goods either by taking delivery of the goods and storing them in its own godown or allowing, after securitization with collateral, the buyer-customer to take the delivery of the goods and to store at his warehouse/godown. The customer then takes the amount for goods out of the godown on payment of the required price to the bank for subsequent sale to the real customer. At the time a *Murahaba/Muajjal* agreement takes place between the bank and the customer where the way of control over the goods are specified. If the control of the goods are at the hands of the bank, the post import finance is commonly called *Murabaha* Post Import in Islamic banking parlance and if the goods are placed are the parties' godown on proper securitization with collaterals and trust receipts, the post import finance is called *Murabaha* Trust Receipt (MTR).

Exchange Rates and Applicable Rates for FEX Operation—

Exchange rate is the value of a currency in relation with another currency. The currency that is compared with is the base currency and the currency whose value is determined on the base currency is the related currency. While importing goods from another country, the importing and exporting countries negotiate the price of the goods in terms of an internationally accepted currencies, like Dollar, Euro, Pound Sterling, Renminbi, etc. or alternatively in currency of the exporting country. Thus the demand for the currencies of those countries arises. The supply of the currencies has already taken place when those countries have imported goods and paid for them in those currencies. The supply of a currency also takes place when one country makes investments or gives loans to another country in one of those currencies. Wage earners' remittance also contributes to foreign currency boost to their home countries. Thus the demand and supply of currencies keep going simultaneously with each transaction and make one's currency available in the hands of another for the latter's future use.

There are several factors that influence the exchange rate of a currency against another currency. The currency of the country that has higher exports than imports has greater demand in the international trade market and has a greater value per unit.

Exchange rates can be classified from different approaches depending on transaction types, calculation formulae, interval periods between booking and settlement dates, risk sharing, settlement procedures, interest/profit, etc. In this way a variety of terminology relating foreign currency transaction has evolved.

In foreign exchange parlance, declaring the values for a currency by a bank is price quotation. A bank quotes the price of each currency in pair—one is Buying Price, for which it will buy the currency and the other is Selling Price, for which it will sell the currency. The Buying Price is usually quoted lower than the Selling Price. The price of a currency is quoted in terms of one unit of another currency. The unitary currency is the Base Currency and the variable currency is Quoted Currency. A bank quotes its price in home currency in terms of a fixed unit of foreign currency or vice versa.

Currency rates vary depending on the gap between the agreement date and the settlement date. The rates quoted for immediate delivery of the currency is Spot Rate. In international foreign exchange market a gap of a maximum of two working days is considered immediate settlement. Foreign exchange rates are liable to fluctuate everyday and at the same time the availability of the currencies. A bank can minimize risk and ensure availability of a particular currency in its hand by booking it with another bank in advance, usually from 1 month to 1 year ahead. This is called Forward Booking and the rate quoted by the buyer bank is Forward Rate. The longer is the gap between the agreement and settlement dates, the more unpredictable are the prices of the currencies and thereby expose both the buyer and the seller to greater risk of losses and higher prospects for gains. So Forward Rate is quoted at premium over the spot rate of the deal date considering the market trend.

In international money exchange services, the rates are grouped under different categories depending on transaction types. Some transactions like Telegraphic Transfers (TTs) are settled immediately. So there is no question of interest. Therefore, while effecting an inward Telegraphic Transfer, the bank buys the incoming foreign currency for lower rates while paying to the recipient customer. There are two types of telegraphic transfers—one is simple delivery of/payment in local currency to the recipient in exchange of the incoming foreign currency and the other is delivery of/payment in local currency after handling documents. When the bank does not handle any document like invoices, bills of lading, bills of exchanges, etc., it applies TT (Clean) Rate which is the base for calculating all other buying rates. When the bank has to handle documents before making a TT payment to the recipient, it applies TT (Document) Rate, which is calculated by deducting document handling charge to the TT (Clean) Rate. These two rates are grouped under TT Buying Rates. Whatever the names suggest, for Payment of Drafts, Air Mail Transfers, Foreign Electronic Transfers, etc. banks apply these two rates while making payment to the customers in exchange for their remitted foreign currencies since these transactions are settled in two days from the date of transmission/instruction. While purchasing or negotiating sight export bills, banks apply OD Sight (Export) Rate because there is a longer gap between (usually in 21 days) purchase of the bills from the customer and actual crediting of the proceeds in the NOSTRO Account of the bank. While collecting personal cheques, drafts and Travellers' Cheques drawn in a foreign currency, banks apply OD Transfer Buying Rate which is usually further lower than OD Sight Export Buying Rate since such collections requires longer time, more risks, etc.

On the flip side of the foreign exchange transaction, there is a set of selling rates, each roughly corresponding to a buying rate mentioned above. While sending outward remittance through Telegraphic Transfers or Mail Transfers, the bank applies TT Selling Rate, which is the base rate for calculating other selling rates. While issuing Foreign Currency Demand Drafts (FDDs) or Travellers' Cheques (TCs), the bank applies OD Selling Rate. Since both the rates are equal in amount in the current commercial practice, there is a combined name for them, TT&OD Selling Rate, in the foreign exchange market. BC (Bills for Collection) Selling Rate is applied for the payment of importers' bills abroad. All these rates are grouped under Spot Rates because all these rates are settled in not more than two days from the buy-sale agreement date.

While purchasing export Usance Bills, banks offer buying rates to the local exporter clients for different tenures considering time value of money and risks arising from rate fluctuation. Therefore the longer is the tenure, the lower is the rate. This rate is called Usance Export Bill Buying Rate.

Offshore Banking—

When there are special prospects for collecting deposit profusely in a foreign land, a bank opens a banking unit in that foreign land away from its land of incorporation. The offshore unit has to collect deposit and lends in the currency of that foreign land which is typically different from the currency of the mother bank's land. In the beginning, while opening offshore banking units, a bank considered several other factors like exemption from tax, greater privacy, protective regulatory policies, etc. So, Bahamas, Bahrain, The Cayman Islands, Hong Kong, Panama, Singapore were popular choices for offshore banking operations. However, a bank can open such offshore banking units in its land of incorporation where it takes deposits in foreign currencies from non-resident nationals of the country and resident foreigners and foreign companies in that country, and utilizes the currencies in payment of import and export bills and interbank foreign currency transactions with a greater convenience.

An Islamic Offshore Banking Unit (OBU) collects deposit in *al-Wadia* or *Mudarabah* principles and finances it in *Murabaha* and i principles. However, it can invest funds in any Islamic modes of investment convenient for commercial purpose. It can issue L/C's in the *Wakala* or *Murabaha* principles as the case may be and offer trade finance in any Islamic Investment Modes a mainstream Islamic bank does.

Discounting of Bills and UPAS—

Discounting of Usance Bills is a regular practice in trade payment. When the seller agrees to receive his payment on a future date specified in the contract with the buyer and delivers goods presently, the bill the seller draws is a Usance Bill. The bill is a receivable on his part. Now he can sell the bill for cash to a bank when his buyer has given acceptance to it. Buying such a Usance Bill or receivables from the seller by a bank is called discounting of Usance Bills or Usance Bill Paid At Sight (UPAS). In exchange of the bill, the bank pays in cash to the seller and holds the buyer responsible to repay to the bank on that specified future date. In discounting, the seller gets immediate cash and the buyer gets credit facilities. However, the bank buys the bill from the seller at lower price than the face value of the bill because it has to deploy fund presently which will be adjusted in the future by the buyer. The price for the bill depends on the length of the period. The greater is the period, the lower is the price at the time of discounting.

Deposit Collection—

Deposit collection in foreign currencies is like that in local currencies, *i.e* in *Mudarabah* and *al-Wadiah* bases. For profit bearing foreign currency deposit accounts, the Islamic bank acts as the *Mudarib* or manager of the *Mudaraba* enterprise and the depositor deposits the amount with the bank as the *Saahib al-Maal* of the business. They both share the profit, if any, after the *Mudarabah* business or an accounting period of it elapses, on an agreed upon ratio, whereas the financial loss is solely borne by the *Saahib al-Maal* and the time and effort of the *Mudarib* is considered his loss. In the case of *al-Wadiah*-based Foreign Currency Deposit Account, the Islamic bank acts as the safe-keeper of the fund in exchange of fees.

Export Development Fund—

It is a refinancing fund of Bangladesh Bank to facilitate export that requires import of industrial raw materials. Manufacture of readymade garments, fabric, yarn, etc. needs raw materials that are to be imported from foreign countries. In order to maximize value addition to the national economy, the bills for imported raw materials are settled on sight to provide the local exporter with interest and price benefits thereby widening the margin between export proceeds and import proceeds. When a local exporter receives an Sight or Usance L/C to export garments, fabrics, yarn, etc., he approaches a bank with the L/C and requests the bank to issue another L/C in favour of him whereby he can import raw materials, such as fabrics for readymade garments, yarns for fabrics or cotton for yarns, as the case may be, to manufacture the merchandise with them. The bank issues a Sight L/C for his local exporter-customer and pays the bills for the imported raw materials on sight basis creating a loan in favour of the local exporter-customer at 2% interest rate, which is much lower than the commercial interest rate. On paying the import bills, the commercial bank claims funds to Bangladesh Bank from the EDF. Bangladesh Bank gives loan to commercial bank for the equal amount of foreign currency at 1% interest rate. As a result, the local exporter-customer gets raw materials at a reasonable price, manufactures the merchandise, exports the merchandise as per the original L/C and gets the proceeds accordingly. Now, he repays his loans with his bank at 2% interest rate and his local bank repays its corresponding loan under EDF facilities with Bangladesh Bank with the interest at 1% interest rate. An Islamic bank avails itself of the EDF facilities under a *Shariah*-compliant mode. They avail themselves of the fund on deal-to-deal Restricted *Mudaraba* Agreement.

Refinancing Facilities from Bangladesh Bank—

In order to facilitate priority-based investment in agriculture, cottage, small and medium enterprises, landless farmers, professionals with marginal income, students under lower interest rate, Bangladesh Bank maintains a fund to refinance from. A commercial bank first sanctions loan to a client of any of the designated areas at an interest rate ranging from 3% to 9% (3% for no-frill account holders, marginal and landless farmers, microfinance institutes (MFI), low income professionals and students; 4% for agricultural sectors contributing to country food safety, Covid-affected CMSME; 7% for SME Startups and 9% for Credit Guarantee Scheme). Then the commercial bank requests to Bangladesh Bank for an equal amount of loan from corresponding fund. Bangladesh Bank gives that loan at an interest rate of 0.5% or 1.0%. The party repays the amount as per the schedule to the commercial bank and the commercial bank repays its corresponding loan with Bangladesh Bank. The loans from Bangladesh Bank are sanctioned in applicable conventional modes like Term Loan for equipment or machinery, Continuous Loan for working capital, etc. Islamic banks sanction investment in corresponding Islamic modes such as *Iajarah* for equipment or machinery, *Bai Muajjal* or *Bai Murabaha* for working capital, etc. to the client.

Case Study—

Mr Mokbul is a wholesale trader at Khatungonj in Chattogram. He trades in sugar. He usually collected it from different importers and local traders in bulk and stored it in different rented warehouses for wholesale to retailers round the year. He had around 100 regular buyers who would finish his stock of 100 tonnes in one month or so. Over time, with the spread of his reputation, his customers started taking only a half of a month to finish his stock and still turning up for more, and at one time he was in a real crisis to cater to their demands, since there were limitations of supplies of sugar from the importers and local traders.

Mr Mokbul went to the Manager of Khatungonj Branch of Ideal Islamic Bank Ltd. and told him that he had a customer base which he could sell 500 metric tonnes of sugar per month to. The Manager congratulated him with a smile and said, ‘Carry on!’ Mr Mokbul responded, ‘I can’t because I have to sell some of it in credit and do not have enough money to order for more. The importers and local traders are not willing to supply so much sugar in credit to me either. Will you give me loan?’ The manager replied in the negative, ‘We do not provide any loan.’ Mr Mokbul asked how his bank could help him. The manager assured him that his bank could help him by selling to him sugar enough for him to meet all the orders by his buyers and off course at a lower price so that he could sell it to his customers at a sizeable profit. Mr Mokbul was surprised that a bank could sell commodities and could do it so cheaply. He never heard of it. So he could not believe it in full. His suspicion grew more when the manager seriously enquired about the specifications and the amount of the commodity. Mr Mokbul planned to order for 500 metric tonnes in the first consignment, and he was more ambitious to import sugar of better quality. He chuckled in mind that if he could buy from the bank so much of sugar at a cheaper rate, he could serve many orders from his customers and make more profit. However, his worries did not go altogether because he could not pay for the entire price immediately. The manager reassured him that his bank would sell the sugar in credit and Mr Mokbul was required to pay the price whenever he could sell the sugar to his retailer customers and get the proceeds. All worries went from his face. The manager reiterated that Mr Mokbul would have to provide the bank with particulars and amount of the commodity he would like to buy from the bank and only then the bank would buy it for him.

Mr Mokbul left the manager's chamber with a plan in his head. He met the importers from whom he used to buy sugar and enquired them about good quality sugar and its foreign suppliers. He gathered a lot of information from them and could specify what type of sugar he would buy, how much and from whom. Later he contacted the exporter in Brazil from whom he would by 500 metric tonnes of sugar. The Brazilian exporter sent him an invoice detailing price, quantity and quality of sugar.

With all the specifications of his desired commodity printed on the invoice, Mr Mokbul went to the manager again. The manager gave him a number of forms and papers where he has to put in all the specifications of the product including the names and address of the Brazilian exporter, quantity and quality of the sugar, its unit price and total price asked by the exporter and authorize the bank to buy the product for him. Mr Mokbul could readily understand that the documents are nothing but a *Murabaha* buy-sale agreement between the bank and him whereby the bank would buy the specified goods from the specified foreign supplier and sell them to him for the agreed upon price whereas both he and the bank knew the cost of the goods and profit charged thereupon separately.

In fine morning, 500 metric tonnes of sugar arrived at Chattogram port from Brazil and Mr Mokbul was notified about it in due course. He went to the manager to buy the sugar from the bank. Thus fur he had only paid a meagre portion of the total price of the goods and was unable to pay the remaining amount in cash. The manager assured him that he should bother about it. He could buy the sugar in instalments over 3 months from the bank and the goods would be at our godown.

Whenever Mr Mokbul got an order for an amount of sugar from his customer, he bought that amount from the bank for cash. This way he finished buying all 500 metric tonnes of sugar in 3 instalments over 3 months while he ordered the bank on *Murabaha* agreements for 3 such consignments of sugar from Australia, India, and Morocco, and over time became an reputed sugar importer of the country with a regular customer base that orders around 5000 metric tonnes of sugar per year.

Short Questions—

1) What is foreign trade?
2) What do you mean by foreign currency?
3) What is L/C?
4) What is foreign investment?
5) What is foreign exchange?
6) What do you mean by foreign exchange rate?
7) What is discounting.
8) What are the purposes of EDF?

Broad Questions—

1) Discuss the importance of foreign trade.
2) What is the importance of foreign currencies for a country?
3) Discuss export financing.
4) Discuss the method of bill discounting under *Shariah*-based banking.
5) Discuss different types of L/Cs.
6) Describe the Islamic investment modes in export financing.
7) What are the objectives of foreign trade?
8) Discuss different deposit collection modes of Islamic banking in foreign currencies.
9) Discuss the applicable exchange rates for trade payments.
10) What is Offshore Banking?
11) How does an Islamic bank take refinancing facilities from Bangladesh Bank.
12) Describe Refinancing Facilities of Bangladesh Bank.

Short Notes—

1) MIB

2) MPI
3) MTR
4) UPAS
5) Export Development Fund (EDF)

CHAPTER V

Fund and Capital Management in Islamic Bank

Syllabus—

- Asset-Liability Management (ALM), Liquidity Management, Liquidity versus Profitability, Liquidity Theories and Islamic Banking, Risk Management in Islamic Banks, Islamic Money Market, BGIBB Operation; Islamic bonds—*Mudaraba* Perpetual Bond, *Mudaraba* Subordinate Bond, *Sukuk* Bond

Asset-Liability Management (ALM)—

Assets are property and goods a business enterprise, bank, etc. uses to repay its liabilities. Assets can be fixed, like land, buildings, factories, machinery, etc. or current, like cash, deposit lying in other financial institutions, bonds and securities bought, raw materials, finished goods, etc. All assets are weighed up in terms of their monetary values and are categorized in terms of the ease with which they can be converted to cash. The quality of convertibility of asset to cash is called its liquidity.

Liability is a legal obligation expressed in terms of money that a company has to repay to their respective creditors like shareholders, owners, directors (for dividends, etc.), depositors, investors, creditors, employees (for salary, bonus, gratuity, etc.), government (for Tax, VAT, etc.), regulators (for provision for bad loans, etc.) and so on. Like assets liabilities are of two types – current liability and term liability.

In course of business operation, the assets of a company tend to be fixed from current for the sake of profitability and by way of investment whereas its liabilities may tend to be current or demand in nature. A financial institution is required to ensure sufficient assets in different categories to be able to repay the corresponding categories of liabilities. This is called asset liability management.

Liquidity Management—

Liquidity refers to the ease with which an asset, or security, can be converted into ready cash without losing its value. Cash is the most liquid of assets, while tangible items are less liquid. In the course of business, cash, the most liquid form of the assets, is invested in purchasing bonds and securities for fixed return, raw materials for manufacturing merchandise, building factories for manufacturing the merchandise in, leasing land for building factories on, and thereby cash assumes less liquid forms or more fixed forms of assets. All these business operations are done for the sake of earning profits. The less of the cash is invested, the less will it be profitable, and the more will it remain capable of repaying its liabilities. Liquidity management is trading off or striking balance between profitability and capability of repaying liabilities.

Liquidity versus Profitability—

For the sake of earning profits, which is the ultimate goal of company, it invests from its liquid assets, and thereby keeps on transforming its liquid assets to fixed assets. By course of operation, most of its liquid assets turn to be fixed one. The more a company converts it liquid assets to fixed assets, the more is it likely to be profitable. At the same time, it loses its solvency to meet creditors' obligations. So liquidity and profitability are in a conflicting relationship.

However, a company has to maintain liquidity, due to regulatory requirements, risk mitigation, day-to-day operations, credibility and business reputation. Companies maintaining higher liquidity are at lower risk. Their current asset pool lets them stay solvent. With solvency the company can meet creditors' obligations with ease and can maintain creditworthiness. Nevertheless, if a company maintains more liquidity than necessary, it damages its profitability because its funds are tied up in operations and cannot be used for the production and expansion of the company.

Since profitability is the ultimate aim of a company and creditworthiness is one of the major contributory means of it, the company has to manage its working capital the best way possible.

Liquidity Theories and Islamic Banking—

Liquidity is current sufficiency of liquid assets to repay present liabilities and prospective sufficiency of them to repay prospective liabilities. The sufficiency is expressed in terms of risks because there is every possibility of insufficiency arising mainly from a business strive for profit maximization and subsequent conversion of liquid assets to fixed assets at different levels. A bank may face two types of liquidity risk—funding liquidity risk and market liquidity risk. Maturity transformation exposes a bank to the funding liquidity risk. Market liquidity risk is the likelihood of loss incurred when a market participant wants to execute a trade or to liquidate a position immediately while not hitting the best price.

Liquidity is a must for every financial institution in order to continue its day-to-day transactions as well as to settle the regular claims placed on its counter. So Islamic banks also are in need of maintaining liquidity like other financial institutions. Islamic bank uses some instruments such as tradeable government Sukuk, Islamic inter-bank placements, and Islamic liquidity facilities with the central bank in addition to cash or notes.

Risk Management in Islamic Banks—

Every transaction in any financial institution entails risk. In an Islamic bank, the concept of risk management is based on the *Shariah* principle of "Protection of wealth" which is also a fundamental right of any citizen.

Risks are also involved in the transaction of conventional banking. But it is more in any Islamic banking transaction due to its nature. We all know in any conventional banking a bank is working as a medium or we can say a bank performs its job as an intermediary. But in any Islamic banking, a bank performs its role as a participant. So, it is obvious that risk is higher when a bank performs as an investor, partner, buyer, seller, executor, or even sometimes as a proprietor, etc.

In any bank, the risks are of so many kinds. In the cases of taking equity and deposits in various forms risks lie in the matter of payment or pay it back. In the case of investing the fund or utilizing or engaging it in any form of business or transaction or services risks lie first of all when the case of return comes.

In the cases of taking deposits or investing them in different fields common risks such as market risk, credit risk, or operational risk are also involved. Besides, there are so many risks that are also involved in the transactions of any Islamic bank such as *Shariah* compliance risk and displacement (force migration) risks.

Every Islamic bank also faces some inherent risks in every country. They are lacking *Shariah* complaint money market instruments and inter-bank market. It also includes the immature nature or tendency of secondary financial instruments. With all the risks involved there, we can also add a regular risk of Islamic banking transactions which is due to a shortage of sufficient money market financial instruments for Islamic banks. This risk is called liquidity risk.

Now, the question comes naturally how do Islamic banks manage and minimize these risks. Like traditional banks Islamic bank also uses traditional methods, formulas, techniques, measurements, methods, etc. In addition to these, Islamic banks at the very beginning try to sort out the risks involved in every transaction and take necessary caution before making transactions. Islamic banks strictly avoid unfair or volatile sectors as well as they also refrain from any sector which is not permitted by *Shariah* even if the sector seems to be very profitable.

Islamic Money Market—

The money market is the core component of the financial market. The money market provides short-term funds generally a period of a year or less. Participants of the money market, banks, non-bank financial institutions, leasing companies, etc. borrow or lend short-term funds by issuing, selling and purchasing money market instruments like bonds, treasury bills, asset-backed securities, etc. The money market is a tool for liquidity management for the financial institutions. When they have excess liquidity which is expected to lie idle for a short time, usually not more than one year, they buy treasury bills, bonds, etc. at a discounted rate and/or for a return at a fixed rate on maturity. On the flip side, financial institutions having run into short-term shortage of liquidity, sell these assets for cash and meet their liquidity crisis. The money market instruments guarantee high liquidity at low risk. Moreover, the money market instruments serve the financial institutions' regulatory instructions of statutory liquidity requirements. At the macro scenario, the government, sitting at the top of the market, maneuvres money market instruments to control money circulation as part of its monetary policy.

The conventional money-market instruments are all interest bearing. *i.e* based on predetermined return on maturity. This is why Islamic financial institutions cannot engage in buying, purchasing or issuing such instruments. Islamic scholars have developed their *Shariah* equivalents based on buying-selling, partnership and renting principles.

Different countries of the world have introduced money market instruments complying *Shariah* principles under different names and styles, like Islamic Interbank Money Market, Islamic Accepted Bills, Liquidity Management Centre, *Mudaraba* Bonds, Commodity *Murabaha*, *Musharakah* Certificates, Islamic Negotiable Notes, etc. However, the basic modes of operations are any of the three Islamic financing mechanisms—*Izara*, *Bai* and *Shirkah*—or their combinations. The Interbank Money Market is an Islamic equivalent of the conventional call money market. The mode is usually *Mudarabah*-based. Under this mechanism, a bank having fund deficit can obtain investment, as a *Mudarib*, from a bank having surplus funds. The ratio of the profit is determined through negotiation by the *Mudarib* and the *Sahib-al Maal*. The central bank usually intermediates the fund-flow mechanism. Such mechanism may be operated on *Al-Wadiah* principles as well where funds provider is not guaranteed any additional amount over the funds. However, the fund user may give, as gifts, to the provider additional amount over the funds used.

Another Islamic Money Market mechanism is Commodity *Murabaha*. This way the central bank can offer the service of flowing funds from surplus units to deficit units and thereby can help banks manage their liquidity in a *Shariah*-permitted way. The mechanism can be described from two points of view—liquidity absorption and liquidity injection. While absorbing liquidity the central bank intermediates the following events to take place one after another for a round of *Murabaha*-based fund injection to complete—

1) Islamic Bank X having a surplus fund and willing to invest it for some months buys some commodity from broker A on stop delivery. Now, Islamic Bank X is able to offload its surplus fund to Broker A and is in possession of a commodity thereagainst.

2) Now, Islamic Bank X sells that commodity for profit to the central bank on spot delivery and deferred payment. Thus the central bank owns the commodity and can sell it on spot delivery and spot payment to Broker B. The cash obtained from Broker B can be invested times and again by the central bank for profit to repay to Islamic Bank X on deferred payment date.

3) On the deferred payment date, suppose after 6 months, the central bank pays for the commodity to Islamic Bank X with profit. Thus Islamic Bank X earns profit by investing its surplus fund and thereby manages liquidity.

While injecting liquidity the central bank intermediates the following events to take place one after another for a round of *Murabaha*-based fund injection to complete—

1) Islamic Bank X having a deficit of fund wants to obtain it for some months. Now, the central bank buys a commodity on spot delivery and spot payment from Broker A. Thus the central bank owns the commodity and sells it on spot delivery to Islamic bank X on deferred payment for profit.

2) Now, Islamic Bank X sells the commodity to Broker B on spot payment and spot delivery and thereby obtains required cash which it will invest times and again.

3) On the contracted deferred payment date, suppose after six months, Islamic Bank X pays for the commodity with profit to the central bank.

This *Murabaha*-based money market mechanism can be practised between two commercial banks as well.

Like in the Islamic countries in the world, in Bangladesh there are also different implementations of money market instruments. Islamic Interbank Fund Market (IIFM), an Islamic equivalent of conventional call money market, is one such money market mechanism. Formal transaction started under this mechanism on 3 June 2013. Bangladesh Bank serves as the custodian of the funds placed by Islamic banks having surplus funds and gives it to the banks having deficit of liquidity for overnight use. The mechanism is run on *Mudarabah* principle.

Bangladesh Government Islamic Investment Bond (BGIIB) Operation—

This is another liquidity management system under Islamic money market framework to manage liquidity for 3 months and 6 months. It was launched in 2004 as a *Shariah*-based equivalent of interest bearing Treasury Bonds and Treasury Bills. BGIIB mechanism is run on *Mudarabah* principle. When an Islamic bank buys Islamic bonds, it actually engages in a *Mudarabah* business contract with the issuer for 3 months or 6 months. Islamic banks having surplus fund invest it for such periods by buying the Islamic Investment bonds. The profit is shared on agreed upon ratio on the maturity of the bond between the investing bank (*Sahib-al Maal)* and the issuer of bond (*Mudarib* of the enterprise). Bangladesh Bank can invest the fund with Islamic banks having fund deficits on the same *Mudarabah* principles and help Islamic banks manage their shortage of liquidity.

Islamic bonds—

Bonds are debt instruments that offer interest at a fixed rate. This is why Islamic banks cannot issue bonds for collecting capital. However, there are *Shariah*-based equivalents of conventional bonds that serve all the purposes both of the issuers and of the purchasers. In order to collect capital Islamic banks issue bonds on the *Mudarabah* principles where the issuer, or the bank, serves as the *Mudarib* of the enterprise and the purchaser as the *Sahib-al Maal*. They enter into a *Mudarabah* business enterprise for the period coincident with the tenure of the bond on a profit sharing ratio. However, the profit is paid on a provisional rate from time to time which is adjusted on the final calculation of the actual profit of the bank.

***Mudarabah* Perpetual Bond—**

One of the most popular Islamic bonds that *Shariah*-based banks issue to collect capital is styled *Mudarabah* Perpetual Bond. As the name suggests, it is operated as a *Mudarabah* enterprise on a profit-sharing ratio between the *Mudarib* (the issuing bank of the bond) and the *Sahib al-Maal*, (the investor customer). The key feature of *Mudarabah* Perpetual Bond is that it is perpetual by nature, *i.e.* is not redeemable. It is fully paid-up capital. Technically this bond is a subordinated one, *i.e.* if the borrower of a perpetual subordinated loan defaults, the creditor won't get repaid until the borrower's unsubordinated loans are repaid.

***Mudaraba* Subordinated Bond—**

Mudaraba Subordinated Bond is another popular bond that *Shariah*-based banks issue to collect capital for a fixed period of time usually for 5 or 7 years. As the name suggests, it is a subordinated bond *i.e.* if the borrower of a perpetual subordinated loan defaults, the creditor won't get repaid until the borrower's unsubordinated loans are repaid. Main difference from the bond styled *Mudarabah* Perpetual bond is that it is redeemable after maturity.

***Sukuk* Bond—**

The *Sukuk* Bond is an Islamic equivalent of bonds. In literal sense, as the Arabic term *Sukuk* (صكوك) connotes it is a certificate which entails the purchaser partial ownership to an asset. Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines the *Sukuk* bonds as securities of equal denomination representing individual ownership interests in a portfolio of eligible existing or future assets. The *Sukuk* can be operated in different Islamic modes like *Izara*, *Mudarabah*, *Musharakah*, *Istisnah*, etc. and is classified accordingly.

The basic mechanism of *Sukuk* operation can be exemplified in the context of an *Izara Sukuk* whereby huge funds for a mega project, supposedly for construction of a Tk. 100 billion power plant, can be collected from the people. The government, the issuer of the *Sukuk,* divides the equity of the power plant in 1,000 shares of equal value each worth Tk. 10 lakh. For each share, the government issues a certificate, i.e. a *Sukuk* bond, that entails the purchaser rents proportionate to his equity after the plant has run into operation. He will keep getting the rents periodically till the maturity of the *Sukuk* and, on the maturity, the face value, or alternatively, the face value may be partially redeemed periodically over the tenure.

The government or companies can raise funds for mega projects by means of *Sukuk*. So this is an effective mechanism for socio-economic development.

Short Questions—

1) Define asset in the context of a company.
2) Define liability in the context of a company.
3) What are the special risks that an Islamic bank faces?

Broad Questions—

1) Examine the relationship between profitability and liquidity.
2) Discuss Asset-Liability Management.
3) Discuss Islamic money market.
4) Discuss Commodity *Murabaha*.
5) Discuss Risk Management in Islamic banks.
6) Discuss Bangladesh Government Islamic Investment Bond (BGIIB) Operation.
7) Discuss, with examples, Islamic bonds.

Short Notes—

1) Asset
2) Liability
3) *Sukuk* Bond
4) *Mudarabah* Subordinated Bond
5) *Mudarabah* Perpetual Bond

CHAPTER VI

Accounting Standards and Supervisory Framework

Syllabus—

- Central Banking in Islamic Framework-Monetary policy in Islamic Banking Supervision
- Need for Shariah Supervisory Board-Relationship with Board of Directors and Central Bank-Role and Function of shariah Supervising Board in Shariah Compliance
- General Accounting Concepts-Accounting and Shariah Standards for Murabaha, Musharaka, Ijara, Bai-Salam-AAOIFI Standards-Profit Distribution and Weight Calculation
- Global and Bangladesh Practice of Islamic Banking

Central Banking in Islamic Framework—

Central banking in Islamic framework is a centralized organization which controls money supply for all the Islamic banks under its jurisdiction. In doing so, it remains consistent with the Islamic ideals like social justice, equity, fairness and balance.

Actually, it is the organization responsible for implementing monetary policy objectives of which are:

(i) Stability in the value of money

(ii) Economic well-being with full employment and option of economic growth, and

(iii) Distributive justice

It also does all the activities like the central bank for conventional banks which include—

(i) It works as the central or pivotal organization of Islamic banking system

(ii) It issues currency

(iii) It stabilizes the value of money

(iv) It implements monetary policy

(v) Promotion, Regulation and supervision of all Islamic financial institutions

(vi) It confirms and ensures health and Development of public interest

(vii) It plays the most important role as the lender of the last resort.

Besides, it also performs its duties by extending its facilities to all Islamic institutions by opening current account providing clearing house facility.

Monetary policy in Islam—

Monetary policy in Islamic bank is based on the principle of discarding interest in all types of its transactions. In doing this, it does not allow monetary instruments which contains variable of interest rates. It uses the method of Profit Sharing Rates widely known as PSR.

Monetary policy in Islam makes sure the stability in the value of money by controlling the supply of money most efficiently. It also ensures economic growth and employment by developing various projects or confirms justice by ensuring proper distribution of wealth and economic power as well as preventing being concentrated them in the hands of any specific social groups.

In order to implement monetary policy, central bank uses some instruments which includes (i) Target Growth in Money Supply, (ii) Statutory Reserve Requirements, (iii) Credit Creation, (iv) Allocation of Credit, (v) Selective Credit Control and (vi) Moral suasion and some other minor instruments such as setting up the profit rate, ratio for different Islamic banking modes, amount of charges etc.

Banking Supervision—

Banking supervision includes its inspection and auditing of all the activities of all Islamic banks. In Islamic banking, it is most important to ensure that whether there is a violation of *Shariah* or not. For every Islamic central bank, it sets standard rules to ensure *Shariah* compliance. Besides, it also observes that whether the fund is extended to any viable project or not. It is strongly prohibited to provide finance in any project or industry which is engaged in any kind of *Shariah* prohibited activities such as gambling or producing of liquor.

Banking supervision also includes whether the depositors are provided with proper profit rate or not and whether the invesrment clients are charged with appropriate profit rate or rent or not. Actually, central bank has the sole authority to check or inspect or audit any type of activities done by any Islamic financial institutions.

Need for Shariah Supervisory Board—

Islamic banking operation is based on Islamic *Shariah*. Every single transaction should be *Shariah* permissible. Besides, it is also very important to ensure the finance is judicious and profitable for the bank as well as for the society and ultimately for the country.

Sometimes, bankers can also be indulged into evil deeds, suppose, involving themselves in taking hush money or bribery. *Shariah* board not only inspects or audits day-to-day activities or finds out violation of *Shariah* but also provides necessary policies and rules for regulating financial institutions.

A judicious panel consisting of Islamic scholars creates a *Shariah* board. Sometimes, experts in banking, finance, economics having vast knowledge in Islamic Jurisprudence are also included in the *Shariah* board for the sake of more effectiveness.

There is a *Shariah* board for every financial institution but in some Islamic countries there is also a central *Shariah* board which also performs their responsibilities regarding *Shariah* compliances.

If we sum up the responsibilities of a *Shariah* board, we will see that it performs important jobs which include (a) approving the products (b) approving the documents, records, contracts and correspondence and (c) review of contract formula, documents and existing applications in the bank to ensure compliance of Islamic law.

To be a *Shariah* board member is not only a simple matter of performing regular duties but also a matter of taking all the responsibilities of taking the risk of non-compliance of *Shariah* principles. So, it is a job with great responsibilities as well as prudence and judiciousness.

Relationship with Board of Directors and Central Bank—

Board of Directors of a bank is liable to govern the bank in order to achieve its goal. Board of Directors also prepares policies under the guidelines of central bank. It also helps the bank to implement all the circulars and instructions issued by central bank to implement government policies regarding financial sectors. Board of Directors also provides financial statement to the central bank and also declares dividend for shareholders which are also a central bank's compliance. Board of Directors is liable for any kind of mismatches occurred in the bank.

Role and Function of *Shariah* Supervising Board in *Shariah* Compliance—

Shariah Supervising Board is a committee consisting of Islamic scholars. Member of this committee are not regular employees of the bank. But they meet from time to time through meeting. In their meeting they review actions taken by the bank officials as well as all other committees. They also review actions taken by the Board of Directors whether they are *Shariah* compliant or not.

Shariah Supervising Board also monitors day-to-day activities of the bank whether there are violation of *Shariah* principles. They also review all the policies, schemes for Deposit and modes of investment adopted by the bank from time to time.

General Accounting Concepts—

When we talk about accounting, two fundamental concepts hit our mind at the very outset. They are asset and liability. If we go forward we find that the concept of liability includes equity and deposits collected from various sources.

Sometimes, we see that many people try to express these two concepts through an equation Asset = Liability + Equity. But if we are more specific we will find that equity also is a part of liability which comes from the Directors and Sponsors at the primary stage and secondly from the public through selling shares in the market. So, equity is a component of liability.

This relationship, which we find in the equation 'Asset = Liability', is balanced by two of its outputs such as revenues and expenses. These two very important factors, components or actions accelerate the business and effects the equation.

Though the equation seems very simple but it is the title of the whole accounting book. Suppose, if we talk about other accounting concepts which we consider to execute our accounting jobs we must find some basic concepts like Business Entity, Money Measurement, Going Concern, Accounting Period, Cost Concept, Duality Aspect Concept, Realisation Concept, Accrual Concept, and Matching Concept etc.

Besides the above mentioned concepts, we will also find some basic assumptions which are very important in the whole accounting process. It includes assumption of Going Concern, assumption of Consistency and assumption of Accrual.

And finally, we can say that in the business world, Generally Accepted

Accounting Principles which is widely known as GAAP includes concepts of Business Entity, Money Management, Cost, Dual Resources, Time period, Realization, Consistency, Matching etc.

Accounting and *Shariah* Standards for *Murabaha*—

Concepts of Financial Accounting for Islamic Banks and Financial Institutions stipulate that historical cost will be the basis used in measuring and recording the assets at the time of acquisition. Therefore, the assets possessed by the Islamic Bank for the purpose of selling them on the basis of *Murabaha* purchase order will be measured at the time of their acquisition on an historical cost basis.

In the cases where the asset value declines below cost whether due to damage, destruction or from other unfavourable circumstances, such decline will be reflected in the valuation of the asset at the end of each financial period.

If the Islamic bank finds that there is an indication of possible non-recovery of the costs of goods available for sale on the basis of *Murabaha* to the purchase order which is not obliged to fulfill his promise, the asset will be measured at the cash equivalent i.e. net realizable value. This will be achieved by creating a provision for a decline in the asset value to reflect the difference between acquisition cost and the cash equivalent value.

In cases where the Islamic Bank is likely, at the time of concluding the contract with the client, to obtain a discount on the asset available for sale on the basis of *Murabaha* or *Murabaha* to the purchase order, and the discount is in fact received subsequently, such discount will not be considered as revenue for the Islamic Bank; instead, the cost of the relevant goods will be reduced by the amount of the discount. Consideration should be given to the impact this will have on both the profits of the current period and future deferred profits.

The discount may, however, be treated as revenue for the Islamic bank if this is decided by the *Shari'ah* Supervisory Board of the Islamic Bank. Such revenue will be recognized in the income statement.

Murabaha receivables will be recorded at the time of occurrence at their face value. *Murabaha* receivables are measured at the end of the financial period at their cash equivalent value. Thus, receivables are valued at the amount of debt due from the customers at the end of the financial period less any provision for doubtful debts.

Profits of *Murabaha* or *Murabaha* to the purchase order are recognized at the time of contracting if the sale is for cash or on credit not exceeding the current financial period. Profits of a credit sale which will be paid for either by means of one payment due after the current financial period or by installments over several, future financial periods will be recognized by using one of the following two methods:

(a) Proportionate allocation of profits over the period of the credit whereby each financial period will carry its portion of profits irrespective of whether or not cash is received. This is the preferred method.

(b) As and when the installments are received, this method will be used based on a decision by the *Shari'ah* Supervisory Board of the Islamic Bank or, if it is required, by the Supervisory authorities.

Deferred profits will be offset against *Murabaha* receivables in the statement of financial position.

If a client accelerates his payment of one or more installments prior to the date specified for such payment, the Islamic Bank may deduct part of the profit to be agreed upon between the Islamic Bank and the client at the time of settlement. The deducted amount will be credited to the *Murabaha* receivable account and excluded from the profit recognized in respect of the installments.

The same accounting treatment applies when the client accelerates his payments by one or more installments prior to the time specified for such payment and the Islamic Bank may not allow the client a deduction of part of the profit but may ask the client to pay the full amount and thereafter the Islamic Bank may reimburse the client with part of the profit.

If the client is delinquent in paying his debt installments, any additional amount received by the Islamic Bank from the client as a penalty (either by mutual agreement or by court ruling) will be treated according to what the *Shari'ah* Supervisory Board of the Islamic Bank deems appropriate either as:

a) revenue to the Islamic bank; or
b) an allocation to a charity fund.

If it becomes evident that the client's non-payment was due to insolvency, then the Islamic bank cannot ask the client to pay any additional amount by way of penalty.

Accounting and *Shariah* Standards for *Musharaka*—

The Islamic Bank's share in *Musharaka* capital (cash or kind) is to be recognized when it is paid to the partner or made available to him on account of the *Musharka*. This share will be presented in the Islamic Bank's book under a *Musharaka* financing account (in the name of the client) and it should be included in the financial statement under the heading "*Musharka* financing".

The Islamic Bank's share in the *Musharaka* capital provided in cash is to be measured by the amount paid or made available to the partner on account of *Musharaka*.

The Islamic Bank's share in *Musharakah* Capital provided in kind (trading assets or non-monetary assets for use in the venture) is measured at the fair value of the assets (value agreed between the partners), and if the valuation of the assets result in a difference between fair value and book value, such difference will be recognized as profit or loss to the Islamic Bank itself.

Expenses of the contracting procedures incurred by one or both parties (e.g., expenses of feasibility studies and other similar expenses) should not be considered part of the *Musharaka* capital unless otherwise agreed by both parties.

The Islamic Bank's share in the constant *Musharaka* capital is to be measured at the end of the financial period at historical cost (the amount which was paid or at which the asset was valued at the time of contracting).

The Islamic Bank's share in the diminishing *Musharaka* is to be measured at the end of a financial period at historical cost after deducting the historical cost of any share transferred to the partner (such transfer being by means of a sale at fair value). The difference between historical cost and fair value will be recognized as profit or loss in the Islamic Bank's income statement.

If the diminishing *Musharaka* is liquidated before complete transfer is made to the partner, the amount recovered in respect to the Islamic Bank's share will be credited to the Islamic Bank's *Musharaka* financing account and any resulting profit or loss, namely the difference between the book value and the recovered amount, is to be recognized in the Islamic Bank's income statement.

If the *Musharaka* is terminated or liquidated and the Islamic Bank's due share of the *Musharaka* capital (taking account of any profits or losses) remains unpaid when a settlement of account is finalized, the Islamic Bank's share will be recognized as a receivable due from the partner.

Profits or losses in respect of the Islamic bank's share in *Musharaka* financing transactions that commence and end during a financial period is to be recognized in the Islamic Bank's accounts at the time of liquidation.

In the case of a constant *Musharaka* that continues for more than one financial period, the Islamic Bank's share of profits for any period resulting from partial or final settlement between the Islamic Bank and the partner, is to be recognized in its accounts for the period in which the profits are distributed. On the other hand, the Islamic Bank's share of losses for any period is to be recognized in its accounts for that period to the extent that such losses are being deducted from its share of the *Musharaka* capital.

Items which also applies to a diminishing *Musharaka* which continues for more than one financial period, after taking into consideration the Accounting System and Management Information System in Islamic Banking decline in the Islamic Bank's share in *Musharaka* capital and its profits or losses.

For some accounts, if the partner does not pay the Islamic Bank its due share of profits after liquidation or settlement of account is made, the due share of profit is to be recognized as a receivable due from the partner.

If losses are incurred in a *Musharaka* due to the partner's misconduct or negligence, the partner will bear the Islamic Bank's share of such losses. Such losses are to be recognized as a receivable due from the partner.

The Islamic Bank's unpaid share of the proceeds is to be recorded in a *Musharaka* receivables account. A provision is to be made for these receivables if they are doubtful.

Accounting and *Shariah* Standards for *Ijara*—

There are two general principles in the Islamic Accounting System – Justice and Benevolence. Considering these things, under *Ijarah* rent is charged when the asset is made available to the lessee for use while under conventional leasing interest is charged once the contract is signed and cash made available to the customer, irrespective of whether asset is actually available for use or not.

In the financial statements of a lessee, accounting for *Ijarah* as a finance lease would confer the lessee rights over an asset similar to ownership of that asset, making the lessee comparable with other entities that own such an asset.

Accounting and *Shariah* Standards for *Bai-Salam*—

For a transaction to qualify as *Bai Salam*, the Lender must pay the purchase price in full. Asset subject to the transaction must be describable and described with specificity. Quantity of the asset must be describable and described with specificity.

AAOIFI Standards—

AAOIFI issues standards for auditing, governance, and ethics. The AAOIFI has issued 117 standards that address 59 *Shariah*, 33 accounting, 8 auditing, 14 governance standards, and 3 codes of ethics. Some of the standards are mentioned bellow:

1. AAOIFI Conceptual Framework for Financial Reporting (Revised 2020)
2. FAS 1 (Revised 2021) – General Presentation and Disclosures in the Financial Statements
3. FAS 28 – *Murabaha* and other deferred payment sales
4. FAS 30 – Impairment and Credit Losses and Onerous Commitments
5. FAS 31 – Investment Agency (*Al – Wakala Bi-Al – Istithmar*)
6. FAS 32 - *Ijarah*
7. FAS 33 – Investment in *Sukuk*, Shares and Similar Instruments
8. FAS 34 – Financial Reporting for *Sukuk*-holders
9. FAS 35 – Risk Reserves
10. FAS 36 – First Time Adoption of AAOIFI Financial Accounting Standards
11. FAS 37 – Financial Reporting by *Waqf* Institutions
12. FAS 38 – *Wa'ad*, *Khiyar* and *Tahawwut*
13. FAS 39 – Financial Reporting for *Zakah*
14. FAS 40 – Financial Reporting for Islamic Finance Windows
15. FAS 42- Presentation and Disclosures in the Financial Statements of *Takaful* Institutions
16. FAS 43- Accounting for Takaful: Recognition and Measurement;

and so on.

Objectives of AAOIFI—

AAOIFI, within the Islamic *Shari'ah* rules and principles, has the following objectives:

1. to develop accounting, auditing, governance and ethical thought relating to the activities of Islamic financial institutions taking into consideration the international standards and practices which comply with Islamic *Shari'ah* rules;

2. to disseminate the accounting, auditing, governance and ethical thought relating to the activities of Islamic financial institutions and its application through training seminars, publication of periodical newsletters, preparation of reports, research and through other means;

3. (A) to harmonize the accounting policies and procedures adopted by Islamic financial institutions through the preparation and issuance of accounting standards and the interpretations of the same to the said institutions,
(B) to improve the quality and uniformity of auditing and governance practices relating to Islamic financial institutions through the preparation and issuance of auditing and governance standards and the interpretation of the same to the said institutions,
(C) to promote good ethical practices relating to Islamic financial institutions through the preparation and issuance of codes of ethics to these institutions;

4. to achieve conformity or similarity to the extent possible in concepts and applications among the *Shari'ah* supervisory boards of Islamic financial institutions to avoid contradiction and inconsistency between the *fatwas* and the applications by these institutions, with a view to activating the role of the *Shari'ah* supervisory boards of Islamic financial institutions and central banks through the preparation, issuance and interpretations of *Shari'ah* standards and *Shari'ah* rules for investment, financing and insurance.

5. to approach the concerned regulatory bodies, Islamic financial institutions, other financial institutions that offer Islamic financial services, and accounting and auditing firms in order to implement the standards, as well as the statements and guidelines that are published by AAOIFI;

6. to offer educational and training programs, including professional development programs on accounting, auditing, ethics, governance, *Shari'ah*, and other related areas, so as to promote knowledge on, and to encourage greater professionalism in, Islamic banking and finance. Training, examination and certification shall be carried out by AAOIFI itself and/or in coordination with other institutions;

7. to carry out other activities, including certification of compliance of AAOIFI's standards, so as to gain wider awareness and acceptance of AAOIFI's standards on accounting, auditing, ethics, governance, and Shari'ah.

Profit Distribution and Weightage Calculation—

Isamic banks collect deposits in *Mudarabah* accounts that are invested into business ventures by the bank directly or through some other third party. Any profit earned from these investments is distributed among the *Mudarabah* depositors at a predetermined percentage and the bank retains the residual amount as its profit.

Profit is distributed according to the pre-determined profit-sharing ratio among the partners mentioned in the partnership deed. If there exists no partnership deed and there is no verbal agreement, profits should be distributed equally among the partners of a partnership firm.

By Weightages, we mean weightages for participation approved by the Bank for Savings Accounts and Time Deposit Accounts in the *Mudarabah* mode. The depositors' share in the profit is distributed according to the weightages of the product that they have invested their funds in. Weightages are assigned based on 3 criteria i.e. tenor, amount and profit payment frequency.

Method of Calculation of Rate of Return:

Islamic banks accept various deposits under the principle of Mudaraba in which the bank plays the role of entrepreneur (Mudarib) and the depositors as fund provider (Rabb Al-Maal). Under this principle, profit accrued from investment and financing are shared between the Mudaraba depositors and the bank as per pre-agreed profit-sharing ratio. Losses, if any, will be borne by the depositors unless the loss is due to the negligence by the banks in managing the depositors' funds.

Given this unique relationship where the depositors would have a direct financial interest over the bank's income, a standard framework for calculation of rate of return is essential that depositors will receive their portion of the investment profits in a fair and equitable manner. The framework of rate of return should also be transparent, perceivable and address all necessary information. Towards these, Bangladesh Bank has prepared a framework of rate of return to standardize the method on the calculation of rate of return for the full- fledged Islamic banks, Islamic bank subsidiaries and Islamic branches of the conventional banks.

This framework of rate of return on Mudaraba deposit is applicable to full-fledged Islamic banks and Islamic branches of the conventional banks licensed under Bank Companies Act 1991.

The following principles should be followed by the Islamic banks of all categories in distributing investment income to the Mudaraba depositors:

1) Mudaraba depositors of the bank will share income derived from investment activities by deploying the Mudaraba funds. Income under this category will mean and include Profit, Dividend, Capital gain, Rent, Exchange Gain and any other income derived from the deployment of fund.

2) Profit Sharing Ratio (PSR) between the Mudaraba deposits and the bank (Mudarib) should be declared before the starting of accounting year/at the time of Mudaraba contract and to be duly disclosed to the Mudaraba depositors.

3) The banks may reduce or raise the PSR before the starting of any accounting year/at the time of Mudaraba contract; but it by cannot be reduced after the declaration is done for any accounting year.

4) The Gross Income derived from investment during the accounting year will, at first, be allocated to Mudaraba deposits, as per ratio of participating fund in the outstanding investment. If the Mudaraba deposits is higher that the total outstanding investment, then participating ratio of Mudaraba deposits (as per Annexure -1) to be considered as 100%. Profit on investment income to be distributed amongst the Mudaraba depositors as per pre-agreed ratio taking 100% as the participating fund in the total outstanding investment.

5) Management fee and Investment Loss Off-Setting Reserve, if any, may be deducted from Mudaraba depositors' share of investment income subject to prior declaration of the same before starting of the accounting year/at the time of Mudaraba contract.

6) Mudaraba deposits shall get priority in the matters of investment over Bank's Equity and other Cost- Free Fund i.e. Bank's Equity & Cost Free Fund will be deployed only after full investment of Mudaraba deposits. Bank's Equity shall mean and include paid up capital, statutory reserve, investment loss off-setting reserve, general reserve and any other reserve or fund created by the bank, Cost Free Fund means any type of funds received by the bank free of cost and not for sharing any income of the bank.

7) Mudaraba fund accepted by the Islamic bank shall be utilized in all sorts of investment activities (i.e. general investment, investment in shares & securities, placement with other banks and financial institutions etc.) approved by the bank's Shari'ah Supervisory Board as well as Board of Directors of the Bank.

8) Income from Exchange Gain derived from buying & selling of foreign currency should be shown separately (in the Annexure - 1) and to be added in the distributable income for the purpose of distribution of profit to depositors.

9) Islamic Banks and Islamic Branches of the Conventional Banks will be required to assign weight-age to all types of Mudaraba deposits. The weight-age will represent the importance attached to the holding of each deposit in determination of profit. In this context, the assumption held is that longer the tenure of a Mudaraba deposits, the higher the risk.

10) The weightage and any subsequent change in weight-age of Mudaraba deposits should be disclosed to Mudaraba depositors before the starting of any accounting year/Mudaraba contract.

11) Profit may be calculated on different types of Mudaraba deposit accounts as per their respective rules for time & manner of deposit and withdrawal restrictions.

12) Mudaraba deposits shall mean average balance of all types of Mudaraba deposit accounts standing in the books of the bank as on last day of each month during the accounting year to which the distribution of income relates after deducting Statutory Liquidity Reserve to be maintained as per Bank Company Act. 1991.

The methodology in deriving the distributable profit to Mudaraba depositors using the three tables described in the formats could be better understood from the following example as under :-

Example:

Business information of an Islamic bank as on 31/12/2004 is given below:

	Tk. in Crore
1. Paid up Capital & Reserve	100
2. Total Al-Wadiah and Other Cost Free deposits	120
Sub Total	**220**
3. Mudaraba Deposits:	

a. M. Hajj Deposits above 10 years	5
b. M. Special Savings Scheme up to 10 years	30
c. M. Savings Bond for 5 years	5
d. M. Savings Bond for 8 years	10
e. M. Term Deposits for 3 months	80
f. M. Term Deposits for 6 months	100
g. M. Term Deposits for 12 months	90
h. M. Term Deposits for 24 months	70
i. M. Term Deposits for 36 months	100
j. M. Savings Deposit	250
k. M. Short Notice Deposit (SND)	40
Total Mudaraba Deposits	**Tk. 780 Crore**
Total Fund (220 + 780)	**=Tk.1000**
Total Outstanding Investment	**Crore**
(Excluding profit receivable, profit/rent/compensation suspense etc.)	**800**
Gross Investment Income	**96**

Assume that the above figures of all types of funds and investments have been continued in average from January to December 2004 and Profit Sharing Ratio (PSR) between the Mudaraba deposits and the bank (Mudarib) is 65:35 and SLR is 10%.

Other information:	Weightage
2 Mudaraba Deposits:	
a. M. Hajj Deposits above 10 years	1.35
b. M. Special Saving Scheme up to 10 years	1.30
c. M. Saving Bond for 5 years	1.10
d. M. Savings Bond for 8 years	1.25
e. M. Term Deposits for 3 months	0.88
f. M. Term Deposits for 6 months	0.92
g. M. Term Deposits for 12 months	0.96
h. M. Term Deposits for 24 months	0.98
i. M. Term Deposits for 36 months	1.00
j. M. Savings Deposit	0.75
k. M. Short Notice Deposit (SND)	0.55

Allocate the distributable income for *Mudaraba* depositors and calculate the rate of return for different *Mudaraba* deposits using the Format shown in Annexure 1, 2 and 3.

Solution: Let us fill-up the Table using the data above in the annexure shown in 1, 2 and 3.

Table 1: Ratio of participating fund in the outstanding investment for the year 2004 (In core Taka)

Month	Outstanding investment	Mudaraba Deposits									Less liquidity reserve	net M Deposits	Cost free fund deployed
		Mud Hajj	MSS	M. Muhar	MM Muhar	MS Bond	M Term	M. Savings	SND	Total			
1	2	3	4	5	6	7	8	9	10	11=(3-10)	12(11 x10%)	13(11-12)	14(2-13)
Jan	800	5	30			15	440	250	40	780.00	78.00	702.00	98.00
Feb	800	5	30			15	442	251	42	780.00	78.50	706.50	93.50
Mar	800	5	29			15	441	249	40	779.00	77.90	701.10	98.90
Apr	800	6	31			14.5	441	250	41	783.00	78.35	705.15	94.85
May	800	5	31			15.5	440	250	40	781.00	78.15	703.35	96.56
Jun	800	4	28			15	438	250	38	773.00	77.30	695.70	104.30
Jul	800	5	30			15	439	248	39	776.00	77.60	698.40	101.60
Aug	800	5	29			16	439	250	40	779.00	77.90	701.10	98.90
Sep	800	5	32			15	440	250	40	782.00	78.20	703.80	96.20
Oct	800	7	30			14.5	440	251	41	783.50	78.35	705.15	94.85
Nov	800	5	29			14.5	440	251	40	779.50	77.95	701.55	98.45
Dec	800	3	31			15	440	250	39	778.00	77.80	700.00	99.80
Total yearly profit	9600	60	360	0	0	180	5280	3000	480	9360.00	936.00	8424.00	1176.00
Total monthly profit	800	5	30	0	0	15	440	250	40	780	78	702	98
Ratio of Each participating fund												87.75%	12.25%

Note: Outstanding Investment = Total Outstanding Investment (Credit Balance of Profit Receivable A/C, Unearned Income A/c Profit Rent / Compensation Suspense A/C etc.)

Ratio of M. Deposits = $\frac{\text{Net M. Deposits (Col. 13)}}{\text{Outstanding Investment (Col. 2)}} \times 100$

Ratio of C. F.Fund = <u>Cost Free Fund (Col. 14</u> x l00
(Including Bank's Equity) Outstanding
Investment (Col. 2)

Table 2: Distributable Profit for the Year 2004.

SL No	Particulars	Amount (In core Taka)
1.	Ratio of Mudaraba Deposits and Cost Free Fund (Including Bank's Equity) to Total Investment as per Table-1	87.75% : 12.25%
2.	Gross Investment Income	96.00
3.	Share of Cost Free Fund and Bank's Equity of Gross Investment Income as Serial no 1	11.76
4. 5.	Share of Mudaraba Deposits of Gross Investment Income as per ratio at serial no. 1 **Less:**	84.24
	Management Fee (say 20% of serial no 4)	16.848
	Investment Loss Off-Setting Re-serve (say 15% of serial no. 4)	12.636
	Sub Total (5a+5b) = { (20% +15% 35% of serial no. 4}	29.484
6.	Total Distributable Profit to Mudaraba Depositors (carried over to Table -3) 4-5) (i.e. say 65% of serial no. 4.)	54.756

Table 3: Allocation of Distributable Profit to Mudaraba Depositors and the Rate of Return for Year 2004

Distributable Profit (Crore Taka) = 54.756

(From Table 2, serial no. 6) (Figure in Crore)

Sl No	Deposit Type	Total Yearly Product	Weightage	Weighted Product	Share of Distributable Profit	Rate of Return
1	**2**	**3**	**4**	**5**	**6**	**7**
1.	Mudaraba Hajj Savings					
	Above l0Years Term	5.00	1.35	6.75	0.535152393	10.70%

2.	Mudaraba Special Savings (Pension Scheme (MSS)					
	l0YearsTerm	30.00	1.3	39	3091991602	10.31%
3.	Mudaraba Savings Bond					
	8 Years Term	10.00	1.25	12.5	0.991022949	9.91%
	5 Years Term	5.00	1.1	5.5	0.436050098	8.72%
	Sub Total	**15.00**		**18**	**1.427073047**	**9.51%**
4.	Mudaraba Term Deposit					
	36 Months Term	100.00	1	100	7.928183595	7.93%
	24 Months Term	70.00	0.98	68.6	5.438733946	7.77%
	12 Months Term	90.00	0.96	8.64	6.849950626	7.61%
	6 Months Term	100.00	0.92	92	7.293928908	7.29%
	3 Months Term	80.00	0.88	70.4	5.581441 51	6.98%
	Sub Total	**440.00**		**417.4**	**33.09223833**	**7.52%**
5.	Mudaraba Savings Deposit	250.00	0.75	187.5	14.86534424	5.95%
6.	Mudaraba SND	40.00	0.55	22	1.744200391	4.36%
7.	Grand Total (1 a+2a+3c+4f+5+6+7)	780.00		690.65	54.756	

Note:
Weighted Product = Total Yearly Product (Col 3) x Weightage (Col 4)

Share of Distributable Profit

= Total Distributable Profit x Individual Weighted Product
Grand Total of Weighted Product (Col. 5 of Sl. No. 7)

Rate of Return

= Share of Distributable Profit of Individual Mudaraba Deposit (Col. 6) x 100
Total Yearly Product of Individual Mudaraba Deposits (Col 3)

Compliance Requirement—

Islamic bank and Islamic branches of the conventional banks will preserve the records of calculation of rate of return for distributing the profit to Mudaraba depositors to facilitate to examination by Bangladesh Bank, Statutory Auditors, Shari'ah Supervisory Committee, if any, etc. from time to time. The relevant authority of the Islamic bank of all categories shall endorse such records.
The Islamic banks should also publish a framework of rate of return approved by the Board of Directors from their own perspective in the light of the Bangladesh Bank, guideline. This framework of return should be available to all the officials of the relevant department and a copy of the same to be forwarded to Bangladesh

Bank for information and necessary action. Any subsequent change, modification of alternation of framework of rate of return duly approved by the Board of Directors of the respective bank should immediately be informed to the Bangladesh Bank.

Global and Bangladesh Practice of Islamic Banking—

The origin of Islamic banking can be found in the life of the Prophet Muhammad (Sm) himself when he worked as the *Mudarib* (agent) for his wife, who entrusted her capital or merchandise to him for trading as a *Sahib al Maal*. As a *Mudarib* he got an agreed share of the earned profit as the business was profitable one and her wife who was the *Sahib al Maal* got back the principal plus an agreed share of the earned profit.

As the starting of modern Islamic Banking dates back to 1963, the present-day practice started in 1975, when banks were established and mandated to operate in compliance with *Shariah* rules and principles. From then, Islamic Banking has become one of the fastest growing sectors in the global banking sector.

The Mit-Ghamr Savings Bank, established in 1963 in Egypt, is commonly referred to as the first example of Islamic banking in the modern world.

On 13th March 1983, Islami Bank Bangladesh Limited was registered as the first *Shariah*-based Bank in South-East Asia and began operation on 30th March of the year. Along the path of success of the country's first Islamic bank, several Islamic banks like EXIM Bank, Social Islami Bank Ltd., Al Arafah Islami Bank Ltd., etc were established in later years.

According to Bangladesh Bank data, the total Islamic banking deposits amounting to Tk4,21,375.00 crore at the end of September 2022. The share of Islamic banks in the country's total bank deposit stood at 26.80% in September 2022.

Islamic Banking sector has significant contributions towards the growth and economic development of Bangladesh. The sector seems progressively attractive and profitable to conventional banks for their lower Statutory Liquidity Ratio (SLR) and higher Investment-Deposit Ratio (IDR).

In Bangladesh, Islamic banking and finance has a great potential but still have some challenges like lack of Islamic banking and finance infrastructure, lack of concrete legal basis, low attention from the central bank, lack of Islamic capital market and unavailability of *Shariah* law experts and people's awareness.

Though Islamic banking industry in Bangladesh has achieved more than 20% annual growth, the industry has enormous potentials for further expansion as Bangladesh is a Muslim majority country with a vibrant economy of 6% real economic growth over the last decades.

Short Questions-

(1) Define Central Bank.
(2) Define Islamic economy.
(3) Define monetary policy.
(4) Who are the members of Shariah Supervisory Board?
(5) What are the duties of a Board of Directors?
(6) Is there any relation between a Board of Directors and the central bank?
(7) What do you mean by Shariah compliance?
(8) What are the general accounting concepts?
(9) What is accounting and Shariah Standards for Ijara?
(10) What is accounting and Shariah Standards for Bai-Salam?
(11) Name five AAOIFI standards
(12) What do you mean by weightage?
(13) Name Five Islamic banks in Bangladesh.
(14) Name Five Islamic banks in the world.

Broad Question-

(1) Describe central banking system in an Islamic economy
(2) What is monetary policy in an Islamic banking system?
(3) What do you mean by banking supervision?
(4) What are the necessities of *Shariah* Supervisory Board?
(5) Describe relationship with Board of Directors and Central Bank
(6) What are the functions of *Shariah* Supervisory Board?
(7) Describe accounting and *Shariah* Standards for *Murabaha.*
(8) Describe accounting and *Shariah* Standards for *Musarakah*
(9) Describe AAOIFI standards.
(10) How can we distribute profit in an Islamic banking industry?
(11) Write about Islamic banking in Bangladesh

Short Notes-

(1) Central bank

(2) Islamic Economy
(3) Monetary policy in Islam
(4) *Shariah* Supervisory Board
(5) Board of Directors
(6) General Accounting Concepts
(7) AAOIFI Standards
(8) Weightage Calculation
(9) Global Islamic banking

Reference Books—

01. Ahmed, Shaikh Mahmud—Towards Interest Free Banking, International Islamic Publisher, Delhi.
02. Choudhury. Masudul Alam, Money in Islam, Routledge, London
03. Hasan, Kabir M. —A Text Book on Islamic Banking
04. Hoque, Ataul—Readings in Islamic Banking, Islamic Foundation Bangladesh.
05. Mannan. M. A. Islamic Economics: Theory and Practice, New Delhi. India.
06. Rahman, M.M. and Rahman. B.M.H.—Islamic Finance System
07. Shaghil. M —Islamic Economics, New Delhi. India
08. Miah. Dr. Mohammed Haider Ali.—A Way to Islamic Banking Custom and Practice
09. Miah. Dr. Mohammed Haider Ali—তারল্য ব্যবস্থাপনার শরিয়া ভিত্তিক পদ্ধতিসমূহ (Shanah-based instruments for Liquidity Management), Islamic Banks Consultative Forum
10. Miah, Dr. Mohammed Haider Ali— দারিদ্র্য বিমোচনে ইসলামী অর্থনীতির ভূমিকা (Role of Islamic Economics in Poverty Alleviation). Islamic Banks Consultative Forum
11. Miah. Dr. Mohammed Haider Ali, — আর্থ-সামাজিক উন্নয়নে ইসলামী বিনিয়োগ শ্রেষ্ঠ বিকল্প (Islamic Investment for Socio-economic Development: Better Alternative), Islamic Banks Consultative Forum
12. Huq Mr. Azizul — Bangladesh Marches Towards Islamic Banking.
13. Taqi Usmani Mufti Muhammud – Introduction to Islamic finance.
14. Hussain prof. Muhammad Sharif – Islamic Banking a superior banking system.
15. Shahajan Md. – Prohibitions in Islam.
16. Ashraf Usmani Dr. Muhammad Imran – Islamic Banking.
17. Ahmed Dr. Mahmood-Islamic banking “A solution for global financial challenges”.
18. Al Qardowi Dr. Yousuf – poverty alleviation in Islam.
19. Mohan Iqbal Kabir – Islamic economics and banking.
20. Arif Mohammad – Islamic banking.
21. Ahmed Shaikh Maksud – Toward interest free banking.
22. Hoque Ataul – Reading in Islamic banking.

Dr Mohammed Haider Ali Miah

A banking veteran, Dr Mohammed Haider Ali Miah took his BSc (Hon.) and MSc degrees from Dhaka University in 1978 and 1979 respectively. He obtained his MBA degree with outstanding performance and distinction from Stamford University, Bangladesh in 1999. He also obtained Banking Diploma from Institute of Bankers, Bangladesh (IBB) and post-graduate diploma in Islamic Banking & Insurance from the Institute of Islamic Banking & Insurance (IIBI), London, UK. He is an Associate Fellow of IIBI. He has been awarded PhD from California, USA. He has attended prestigious executive development programmes in USA and UK. In 2015, he attended a value creation and strategic management programme at INSEAD Business School, France.

Dr Haider embarked upon a challenging career of a private sector banker in 1984 as Probationary Officer. In 2000, he joined Export Import Bank of Bangladesh Ltd. as Vice President. He was appointed as its Managing Director & CEO in 2012. He served the position for long 10 years with numerous accolades in home and abroad.

He was declared the 'Most Talented Islamic Banking Professional (CEO)' in a CMO Asia-sponsored conference held in Singapore in 2014. In home, he is equally revered for his farsightedness and assiduity as a Managing Director. He has been conferred upon Central Shariah Board Islamic Banking Award 2015 by Central Shariah Board for Islamic Banks of Bangladesh.

His 39-years-long banking career was mostly spent in foreign exchange operation, investment operation, branch management and policy formulation.

As an inquisitive and studious banking prodigy, Dr Miah has a number of books to his credit—'A Handbook of Islamic Banking and Foreign Exchange Operation' (1995), 'A Way to Islamic Banking: Customs and Practice' (2014), 'Role of Islamic Economics in Poverty Alleviation' (2016), 'Islamic Investment for Socio-economic Development: the Better Alternative' (2017) and 'Shariah-based Instruments for Liquidity Management' (2018). His articles on banking and economics are regularly published in various journals. Presently, he doing post-doctoral thesis entitled 'Corporate Governance and Bank Performance: Evidence from Bangladesh' in Shri Govind Guru University, Godhra, Gujarat, India.

On occasion of the Ekushe Book Fair 2016, he published a book titled ‘Memoirs of the Liberation War’ compiling the memoirs of his participation in the Liberation War 1971 as one of the youngest freedom fighters.

Presently, Mr. Miah is the President of Human Rights Watch Commission, Bangladesh.

***