

GUIDELINES FOR CONDUCTING ISLAMIC BANKING

Section I

Introduction to Islamic Banking

Islamic Banking has experienced a phenomenal growth and expansion in Bangladesh in the backdrop of strong public demand and support for the system along with its gradually increasing popularity across the world. As a result, a number of full-fledged Islamic Banks has been established, while a good number of conventional banks have come forward to offer services compliant with Islamic Shariah through opening of Islamic branches along with conventional ones. There is also a trend of conversion of conventional banks into Islamic bank.

It has, therefore, become necessary to ensure that activities of the fast growing Islamic Banks are carried out properly and uniformly according to the principles of Islamic Shariah. With this end in view, Bangladesh Bank constituted a Focus group comprising representatives of the central Bank, a number of Islamic Banks and the Central Shariah Board for Islamic Banks of Bangladesh to formulate an integrated guideline for conducting banking business of the Islamic Bank/Islamic bank branches of conventional banks. Based on the recommendations of the Focus group this guideline embodying different terminologies used in Islamic Banking operations, definitions of the terminologies, the principles and modes of deposits and investments has been prepared. It also dwelt upon the issues of liquidity, maintenance of books of accounts and preparation of financial statements and other related issues. This guideline has been prepared mainly on the basis of Banking Companies Act 1991, Companies Act 1994 and Prudential Regulations of Bangladesh Bank. However, this guideline should be treated as supplementary, not a substitute, to the existing banking laws, rules and regulations. In case of any point not covered under this Guideline as also in case of any contradiction, the instructions issued under the Banking Companies Act and Companies Act will prevail.

Definitions of Terms used in Islamic Banking Operations

The following terms as used in this guideline, if not repugnant to the subject or affairs, shall have the following meaning:

- a. "Shariah" means such rules and regulations as have their origin in the holy Qur'an and Sunnah to govern all aspects of human life.
- b. "Islamic bank" means such a banking company or an Islamic banking branch(es) of a banking company licensed by Bangladesh Bank, which follows the Islamic Shariah in all its principles and modes of operations and avoids receiving and paying of interest at all levels.
- c. "Islamic Banking Business" means such banking business, the goals, objectives and activities of which is to conduct banking business/activities according to the principles of Islamic Shariah and no part of the business either in form and substance has any elements not approved by Islamic Shariah.
- d. "Branch or Branch Office" means any branch or Branch Office of Islamic Bank Company or office or Branch of such interest based conventional Banks which run Islamic banking business.
- e. "Depositor" means some one who holds with any Islamic Banking Company any account namely Current account based on Al-Wadiah principles, Savings or long and short term deposit accounts under Mudaraba principles.
- f. "Investment" means any such modes of financing which Islamic Bank Company does in accordance with principles of Shariah or as per the Shariah approved modes like Mudaraba, Musharaka, Bai-Murabaha, Bai-Muajjal, Istisna, Lease, Hire-purchase under Shirkatul Melk, etc.
- g. "Client" means such a person or institution who/which has any business relationship with Islamic Banking Company.
- h. "Compensation" means such financial penalty as is imposed by a Islamic Banking Company over and above the amount of installment when a client fails to repay Bank's investment on due dates as per the agreement executed by him.

Section II

LICENSE

A. Criteria for setting up full-fledged Islamic Bank.

The following will be the broad criteria for consideration of setting up of the scheduled Islamic Commercial Bank:

1. The proposed bank company will be a public limited company and a minimum of 50% share shall be offered to the public.
2. All the financial transactions of the banking company shall be conducted based on the principles of Islamic Shariah.
3. The ways and means of resource mobilization, expansion and nature of business transactions have to be stated in the application form.
4. The applicant(s) shall indicate expertise and other facilities available with them for ensuring operation of their Islamic Banking business as per Islamic Shariah.
5. The banking company, to commence business, shall raise a minimum paid-up capital of Tk.2.00 billion and shall at all times maintain the required capital adequacy ratio, as prescribed by the Bangladesh Bank.
6. The minimum shareholding stake of each sponsor shall be Tk.2.5 million and the maximum shall be 10% of the proposed bank's total share capital. This ceiling of 10% applies to an individual, company or family member, either severally and jointly or both. Family includes spouse, father, mother, and son, daughter brother of the individual or anyone dependent on that individual.
7. The Sponsors' share shall not be transferred before expiry of 3(three) years from commencement of the business without permission from Bangladesh Bank.
8. The ceiling of 10% may be relaxed in case of a bank set up as a joint venture with a foreign financial institution or banking company.
9. Application shall stand disqualified if any of the sponsors and/or Directors, their spouses or firms:-
 - a. has been convicted by a court of Law for commission of any criminal offence inside or outside Bangladesh;
 - b. has been involved in any illegal activities, particularly illegal banking business, receipt of deposits, financial dealings and other business;
 - c. has failed to settle liability/meet obligation to banks and other financial institutions. They shall furnish names of the banks/ financial institutions along with the names of the branches with which they have had dealings. Bank reports are also required to be submitted;
 - d. has failed to pay tax/duties. They shall indicate their Tax identification numbers (TIN);
 - e. is in the opinion of the sanctioning authority enjoys adverse reputation regarding integrity and performance.

10. The Chief Executive (CE) would be a professional combined with at least 3 years Islamic banking experience, and having complied with all the terms & conditions of the "Fit & proper Test" issued by Bangladesh Bank and have no adverse information regarding his integrity and performance. The appointment of the CE shall require prior approval of the Central Bank.
11. The applicant shall submit the following documents along with the application:
 - a) Feasibility report with organizational structure for formation of the bank company and proposed name of the Chief Executive Officer.
 - b) Short term & long term business plan.
 - c) Plans for Internal control management, Risks management guidelines and details of the approval authority.
 - d) Working system and procedure for business activities/ operations.
 - e) List of other Companies/Firms and their bankers in which sponsor director(s) and their family as defined in The Bank Company Act, 1991 are interested as director(s), Chief Executive, Partner, proprietor or major share holders holding 5% or more shares.
12. The bank which may be permitted to be established shall be subject to the prevalent banking and other laws, rules, regulations and directives issued by the Bangladesh Bank from time to time.
13. The sponsors shall give an undertaking to the effect that the bank, if permitted, shall comply with all instructions to be issued by Bangladesh Bank and the Govt. of the People's Republic of Bangladesh from time to time.
14. All other terms and conditions as set by Bangladesh Bank for establishing a bank company shall be applicable.

B. Terms & conditions for the conventional Banks to obtain License for opening Islamic Banking Branch(es).

Conventional banks intending to open Islamic banking branch(es) shall fulfill the following conditions:

1. Eligibility criteria:

The eligibility of a bank to open Islamic banking branch(es) shall be considered by the Bangladesh Bank keeping in view, among others, the financial strength of the bank as evident from its capital base(net capital free of actual and potential losses), adequacy of its capital structure, record of earning capabilities, liquidity position, track record of bank's adherence to prudential regulations, credit discipline, quality of customer services and the convenience and the needs of the population of the area to be served by the proposed branch. In addition, (1) banks must have CAMEL rating of 1/2 in the last On-Site inspection of Bangladesh Bank and (2) there should not be major adverse inspection findings against the bank.

2. Required working papers:

The applying bank is required to submit a proposal for opening Islamic branch(es) to the concerned department of Bangladesh Bank with the following details:-

- a) Specify the number of branches to operate in line with Islamic Shariah and the names of the proposed towns / districts.

- b) A statement of services and products to be offered (regarding deposits, investments, financing etc.) by the Islamic banking branch(es).
- c) Commitment to keep funds and accounts of Islamic banking branches completely separate from those of the conventional ones.
- d) Methods of segregating the funds of the Islamic branches from the funds of commercial branches of the bank.
- e) A Statement showing infrastructural and logistic facilities including manpower and training.
- f) Accounting aspects, such as accounting policies to be followed, the principles and mechanism of profit / loss sharing / distribution.
- g) Undertaking for preparing separate financial statement for the Islamic branches.

3. Formation of an Islamic Banking Division:

- a) An Islamic Banking Division has to be set-up in the Head Office of the local Bank(s) and in the Country Office (in Bangladesh) in case of foreign Bank(s).
- b) An organizational structure of the division indicating qualifications and Islamic Banking experiences of the top Executives is to be submitted to the concerned division of Bangladesh Bank.
- c) The responsibilities & duties of the Islamic Banking Division of the concerned Banks would be as under:
 - i. Framing of Islamic Banking rules and regulations and ensuring their implementations.
 - ii. Maintaining co-ordination with the Shariah Supervisory Committee, if any, and the other divisions/offices of the Bank.
 - iii. Ensuring investment of Funds received for Islamic Banking business under modes approved by Islamic Shariah.
 - iv. Arrangement is to be made to train up the manpower deployed in the Islamic banking branch.
 - v. Submission of required statements to the Central Bank is to be ensured.
 - vi. Ensuring of implementation of the guide-lines/rules and regulations concerning Islamic banking framed/issued/instructed by the Central Bank.
 - vii. Maintaining of SLR/CRR according to the instructions of the Central Bank.
 - viii. Complying of any other responsibility(ies), the Central Bank may assign from time to time.

- d) A senior Executive would be the chief of Islamic Banking Division who shall remain accountable to the CEO. This Division is to be provided with sufficient manpower.

4. Control and segregation of Islamic Banking Fund:

Separation of Funds of Islamic banking branches and control and pursuance of appropriate procedures are to be ensured for safeguarding the interest of the depositors. The following steps are to be taken to address the above issues:

- a) An operational Manual for running Islamic banking business is to be prepared and got duly approved by the Board of Directors of respective banks. In case of foreign bank(s), it is to be approved by their Head Office.
- b) A full set of documents pertaining to deposits, investments & financing products of Islamic banking is to be prepared and followed.
- c) Required documents, Forms, Books, and Deposit Receipts, cheque Books etc. of Islamic branch (es) are to be designed in such a way as to make them distinct from those used in conventional banking branches.

5. Maintenance of Accounts and Financial Statements:

- a) The Banks have to maintain separate accounting system for their Islamic banking branches. For this purpose, separate ledger books, software etc. are to be maintained for keeping records of deposits, investments, profit & loss A/Cs, etc.
 - b) Separate trial Balance for daily transactions of Islamic banking branch (es) is to be prepared and maintained.
 - c) The bank has to prepare and submit quarterly, half yearly and yearly Financial Statements to Bangladesh Bank relating to the Islamic bank branch (es).
6. All other terms and conditions as set by Bangladesh Bank for opening of a bank branch shall be applicable.

C. Conversion of a Conventional Bank to an Islamic Bank:

(A) The necessary measures for conversion

- 1. The bank will set up all necessary procedures, create the required tools, explore alternatives to non-permissible financial practices, and train and promote the personnel required for proper implementation of the procedures of conversion.
- 2. The appropriate administrative arrangements must be in place, including changing the bank's operating license by Bangladesh Bank, and amending the bank's memorandum and articles of association through the required procedures so that they include objectives and operational measures that are appropriate to Islamic banking. The memorandum and articles of association must be cleansed from anything that contradicts the nature of Islamic banking.
- 3. Restructuring the organizational structure of the bank and its employment procedures, conditions and employee statutes to fit the situation of conversion.

4. Written consent/no objection through an acceptable legal process should be obtained from the existing depositors and clients for transforming their accounts into Islamic mode.
5. The transactions that are concluded before the decision to convert must be ceased or disposed of immediately.
6. Reformatting or designing standard contracts or specimens or exemplars of documents, forms, books, register etc. that comply with Shariah rules and principles.
7. Preparing a special program for preparing personnel and impart them training to deal with the application of Islamic banking practices.
8. Exerting all possible efforts to adapt the ways of dealing with Central banks regarding deposits, liquidity needs or otherwise in a way that does not conflict with the rules of Shariah, especially rules that govern riba transactions.
9. Any dealings with conventional banks must be limited to the magnitude of the need to do so.
10. Revamping the transactions with conventional banks on the basis of riba-free transactions and the application of instruments acceptable by Shariah.
11. Before commencement of business of the converted Islamic bank, the books of accounts and statement of affairs of the conventional bank must be reconstructed as per Shariah principles.

(B) The effect of conversion on the interest based receivables, impermissible earnings, obligation and their Shariah alternatives

1. All traces of conventional transactions whereby the bank originated any monetary assets and is liable to pay interest for them must be liquidated prior to date of conversion. This is the rule whether such transaction involve individuals, banks or Central bank.
2. The bank must confine itself to permissible operations for acquiring the necessary funds to operate or to meet its liabilities.
3. If the capital of the bank has increased due to non-permissible transactions or the accumulation of reserves based on non-permissible transactions, then its treatment must be in accordance with the treatment of non-permissible receivables or other non-permissible assets in the possession of the bank.
4. All interest-based investment instruments must cease to be used and must be replaced by permissible investment instruments prior to date of conversion.
5. All interest-based loans that the bank has made prior to date of conversion must be terminated or converted to Shariah based transaction.
6. All liabilities in the form of obligation to provide non-permissible service must be terminated by refunding the consideration, even if it has to pay compensation for non-fulfillment of such obligations.

(C) Starting from the financial period in which the bank decides to convert, the following must be done

1. If a conventional bank is acquired with the intention to convert it to an Islamic bank, the new owners are not obliged to dispose of interest and impermissible

earnings that have been earned before such acquisition.

2. If a conventional bank is converted by its existing shareholders into a bank, then the process of disposing of interest and impermissible earnings should be considered as commencing at the beginning of the financial period in which the conversion starts to take effect. However, for any impermissible earnings that have been distributed prior to conversion, it is necessary, on ethical grounds, for the shareholders and depositors to whom these earnings have been distributed to dispose of them personally. The bank is not bound to do so.
3. Revenues not yet received that are of doubtful permissibility are not subject to compulsory disposal, whether they were earned before or during the financial period in which the bank decides to convert. The same rule applies to revenues of doubtful permissibility that have been already received because of a belief that they are permissible on the basis of (a) an interpretation of a person who is qualified to perform ijihad on issues that are subject to personal Juristic interpretation, (b) Juristic position of an authoritative school of Shariah or (c) the opinion of some eminent and knowledgeable scholars.
4. If the bank has rights to prohibited non-monetary assets, it may receive them with the intent to destroy them. If the bank is entitled to receive consideration for supplying non-permissible assets or services, the bank may receive the consideration with the intent to donate it to charity. The same rule applies to any income that has been acquired from non-permissible assets during the period in which the bank decides to convert. All impermissible and doubtful earnings must be spent for charity.
5. If the bank is converted and it has, among its tangible assets, impermissible commodities, the bank is obliged to destroy them. If the bank has sold some of these commodities and is yet to receive the price thereof, the price must be received and be spent for charity.
6. If the liabilities are in the form of payment of interest, the bank should employ all lawful means to avoid paying such interest. This rule does not apply to the principal amounts of debts or loans. The bank should not pay interest except on the basis of dire need.
7. If the liabilities are in the form of obligations to provide non-permissible services, then the bank is obliged to make every effort to terminate such liabilities, by refunding the consideration, even if it has to pay compensation for non-fulfillment of such obligations.

(D) External conversion through acquisition of the bank by parties interested in converting it

If the purchaser is capable of negotiating a deal that could exclude all non-permissible receivables (e.g. interest and non-permissible assets) from the acquisition deal in a way that will make the seller solely liable for non-permissible liabilities, then the Shariah requires the purchaser to do so. However, if the acquisition cannot be concluded unless all assets of the bank including the non-permissible assets and receivables are acquired, then there is no objection to the acquisition on this basis on condition that the purchaser acts as quickly as possible to dispose of non-permissible liabilities even if the purchaser has to suggest to the creditors of the bank an earlier repayment for a discount.

(E) The Zakah Obligation

When the conversion is initiated by outsiders who acquired the conventional bank for the purpose of converting it, then they are not obliged to make zakah payment for the past financial periods because the zakah for previous periods is the liability of the previous owners. The zakah liability will start to exist for the new owners from the date of the decision to convert. However, if the decision to convert was made by the shareholders and the zakah was not paid for the previous financial periods, the shareholders are obliged to pay zakah for these periods. They must take into account that they are obliged to pay zakah even if the revenues and the money earned are impermissible because the shareholders are obliged in the first place to dispose of all accrued interest and impermissible earnings, so, the payment of zakah is part of the obligation to dispose of impermissible earnings and interest.

Section III

Responsibility for Shariah Compliance:

It will be the responsibility of the board of directors of the respective banks to ensure that the activities of the banks and their products are Shariah compliant. The Board of the Islamic banks/ Subsidiary company/Conventional commercial banks having Islamic branches, therefore, be constituted with directors having requisite knowledge and expertise in Islamic Jurisprudence. The Board may form an independent Shariah Supervisory Committee with experienced and knowledgeable persons in Islamic Jurisprudence. However, the Board shall be responsible for any lapses/irregularities on the part of the Shariah Supervisory Committee. A fit and proper criteria for selection of members of the Shariah Supervisory Committee is enclosed in Appendix-1.

Section IV

Principles of Deposit

Shariah principles for receiving deposits

Islamic banks receive deposits under two principles:

- i) Al-Wadeeah principle.
- ii) Mudaraba principle.

Al-Wadeeah:

Fund which is deposited with Banks by the depositors with clear permission to utilize / invest the same is called Al-Wadeeah. Islamic banks receive deposits in Current Accounts on the basis of this Al-Wadeeah Principle. Islamic banks obtain permission from the Al-Wadeeah depositors to utilise the Funds at its own responsibility and the depositors would not share any profit or loss earned/incurred out of using of this funds by the bank. The banks have to pay back the deposits received on the principle of Al-Wadeeah on demand of the holders. The depositors have to pay government taxes and other charges, if any.

Mudaraba:

Mudaraba is a partnership of labour and capital, where one partner provides full capital and the other one manages the business. The capital provider is called Sahib-Al-Maal and the user of the capital is called Mudarib. As per Shariah principles, the Mudarib will conduct the business independently following Shariah principles. The Sahib-Al-Maal may provide advices, if he deems fit but he can not impose any decision over the Mudarib. Profit, if any, is divisible between the Sahib-Al-Maal and the Mudarib at a predetermined ratio, while loss, if any, is borne by the Sahib-Al-Maal. Mudarib can not avail of any salary or remuneration against his labour as a manager or conductor of the enterprise/business. The deposits, received by Islamic banks under this principle are called Mudaraba Deposits. Here, the depositors are called Sahib-Al-Maal and the bank is called Mudarib. The Mudaraba deposits include:

- i) Mudaraba Savings Deposits (MSD)
- ii) Mudaraba Short Notice Deposits (MSND)
- iii) Mudaraba Term Deposits (MTD).

Different Islamic banks have developed various deposit schemes on the basis of this Mudaraba principle such as monthly deposit-based Hajj Scheme, Monthly/One time deposit-based Term Deposit Scheme, Monthly Mudaraba Profit Deposit Scheme, Monthly Mudaraba Marriage Savings Scheme, Mudaraba Savings Bond etc.

Section V

Investment Principles & Investment Products

Islamic banks do not directly deal in money. They run business with money. The funds of Islamic banks are mainly invested in the following modes:

- 1) Mudaraba;
- 2) Musharaka;
- 3) Bai-Murabaha (Murabaha to the purchase orders);
- 4) Bai-Muajjal;
- 5) Salam and parallel Salam;
- 6) Istisna and parallel Istisna;
- 7) Ijara;
- 8) Ijarah Muntahia Bittamleek (Hire Purchase);
- 9) Hire Purchase Musharaka Mutanaqisa (HPMM);
- 10) Direct Investment;
- 11) Investment Auctioning etc.
- 12) Quard
- 13) Quard Hassan etc.

1. **Mudaraba:** Mudaraba is a shared venture between labour and capital. Here Bank provides with entire capital and the investment client conducts the business. The Bank, provider of capital, is called Sahib-Al-Maal and the client is called Mudarib. The profit is to be distributed between the Bank and the investment client at a predetermined ratio while the bank has to bear the entire loss, if any.
2. **Musharaka:** Musharaka means partnership business. Every partner has to provide more or less equity funds in this partnership business. Both the Bank and the investment client reserve the right to share in the management of the business. But the Bank may opt to permit the investment client to operate the whole business. In practice, the investment client normally conducts the business. The profit is divided between the bank and the investment client at a predetermined ratio. Loss, if any, is to be borne by the bank and the investment client according to capital ratio.
3. **Bai-Murabaha:** Contractual buying and selling at a mark-up profit is called Murabaha. In this case, the client requests the Bank to purchase certain goods for him. The Bank purchases the goods as per specification and requirement of the client. The client receives the goods on payment of the price which includes mark-up profit as per contract. Under this mode of investment the purchase/ cost price and profit are to be disclosed separately.
4. **Bai-Muajjal:**
Meaning: "Bai-Muajjal" means sale for which payment is made at a future fixed date or within a fixed period. In short, it is a sale on Credit.

It is a contract between a buyer and a seller under which the seller sells certain specific goods (permissible under Shariah and Law of the Country), to the buyer at an agreed fixed price payable at a certain fixed future date in lump sum or within a fixed period by fixed installments. The seller may also sell the goods purchased by him as per order and specification of the buyer.

In Bank's perspective, Bai-Muajjal is treated as a contract between the Bank and the Client under which the bank sells to the Client certain specified goods, purchased as per order and specification of the Client at an agreed price payable within a fixed future date in lump sum or by fixed installments.

5. **Salam and Parallel Salam:** Salam means advance purchase. It is a mode of business under which the buyer pays the price of the goods in advance on the condition that the goods would be supplied / delivered at a particular future time. The seller supplies the goods within the fixed time.

Parallel Salam:

Parallel Salam is a Salam contract whereby the seller depends, for executing his obligation, on receiving what is due to him - in his capacity as purchaser from a sale in a previous Salam contract, without making the execution of the second Salam contract dependent on the execution of the first one.

The following conditions are essential in the contracts of Murabaha, Bai-Muajjal and Salam. The respective contracts must include the following aspects regarding the goods:

- * Number/Quantity
- * Quality
- * Sample
- * Price and amount of profit
- * Date of supply/time limit
- * Place of supply
- * Who will bear the cost of supply?
- * Timeframe for payment in case of Bai-Murabaha and Bai-Muajjal.

6. **Istisna and parallel Istisna:** A contract executed between a buyer and a seller under which the seller pledges to manufacture and supply certain goods according to specification of the buyer is called Istisna. An Istisna agreement is executed when a manufacturer or a factory owner accepts a proposal placed to him by a person or an Institution to produce/manufacture certain goods for the latter at a certain negotiated price.

Here, the person giving the order is called Mustasni, the receiver of the order is called Sani and the goods manufactured as per order is called Masnu.

An order placed for manufacturing or producing those goods which under prevailing customs and practice are produced or manufactured will be treated as Istisna contract.

Conditions & characteristics of Istisna are enumerated below:

- a) The concerned Agreement must contain the details, such as, the type, class, quantity and features of the goods to be produced, so that no misunderstanding is created later on.
- b) The price has to be settled; payment time/schedule and modes thereof is to be predetermined.

- c) When, where and on whose cost the goods to be supplied has to be clearly mentioned.
- d) If agreed by both parties, payment may be made in advance to the seller in part or in full or may be deferred to be paid in due course/ agreed time.
- e) Generally timeframe is not mandatory for supplying the goods under Istisna agreement. It may be executed without determining timeframe. But in case of bank, timeframe for supplying goods must be determined to avoid any dispute in future.
- f) Condition for imposing stipulated compensation/penalty may be included in the Istisna agreement against the party who breaches the terms of the agreement causing the other party to suffer. But no compensation/penalty would be imposed on any party if it happens for any valid reason or unavoidable circumstances.
- g) As per opinion of the contemporary jurists, the compensation in case of Istisna may be treated as legal income.

Parallel Istisna:

If it is not stipulated in the contract that the seller himself would produce/provide the goods or services, then the seller can enter into another contract with third party for getting the goods or services produced/ provided by the third party. Such a contract is called Parallel Istisna. This may be treated as a sub-contract. The main features of this contract are:-

- i) The original Istisna contract remains valid even if the Parallel Istisna contract fails and the seller will be legally liable to produce/ provide the goods or services mentioned in the Istisna contract.
 - ii) Istisna and Parallel Istisna contracts are treated as two separate contracts.
 - iii) The seller under the Istisna contract will remain liable for failure of the sub-contract.
- 7. Ijara :** The mode under which any asset owned by the bank, by creation, acquirement / or building-up is rented out is called Ijara or leasing. In this mode, the leasee pays the Bank rents at a determined rate for using the assets/properties and returns the same to the Bank at the expiry of the agreement. The Bank retains absolute ownership of the assets/properties in such a case. However, at the end of the leased period, the asset may be sold to the client at an agreed price.
- 8. Ijarah Muntahia Bittamleak (Hire-Purchase):** Under this mode, the bank purchases vehicles, machineries and instruments, building, apartment etc. and allowed clients to use those on payment of fixed rents in installments with the ultimate objective to sell the asset to the client at the end of the rental period . The client acquires the ownership/ title of the assets/ properties subject to full payment/ adjustment of all the installments.
- 9. Hire-purchase Musharaka Mutanaqasa (HPMM):** Hire-purchase Musharaka Mutanaqasa means purchasing and acquiring ownership by one party by sharing in equity and paying rents for the rest of the equity held by the Bank/or other party. Under this mode, the Bank and the client on contract basis jointly purchase vehicles, machineries, building, apartment etc. The client uses the portion of the assets owned

by the bank on rental basis and acquires the ownership of the same assets by way of paying banks portion of the equity on the assets in installments together with its rents as agreed upon.

The features of this mode are elaborated below:

- a) The client applies to the Bank expressing his/her wishes to purchase the assets/properties and the bank accords its approval after proper evaluation/ scrutiny.
- b) The client deposits his/her share of equity with the bank after obtaining approval and the bank pays total price of the assets/properties together with its equity.
- c) Before purchase of the assets/properties an agreement is executed stipulating the actual prices, monthly rents, price of the bank's portion of the assets/properties, payment schedule and installment amount and the nature of the security etc.
- d) The bank shall rent out its own portion of the assets/properties to the client as per terms & conditions of the agreement.
- e) The client (Hirer) pays off in installments bank's portion of equity on the assets together with its fixed rent as per the terms and conditions of the agreement.
- f) With the payment of installments by the client, the ownership of the bank in the assets/properties gradually diminishes, while that of the client increases.
- g) The amount of the rent receivable by the bank, reduces gradually proportionate to the increase in the ownership of the client on the assets/properties.
- h) The client acquires full ownership of the goods/assets after payment of the entire dues of the bank.
- i) The client may acquire the full ownership of the assets/properties before expiry of the deal by paying off the entire dues to the bank.
- j) The rent remains payable in proportion to Bank's ownership, if the client fails to pay the due installment(s).
- k) The bank can take of the assets / properties under its control, if the client fails to pay the installment(s) as per the terms and conditions of the agreement.
- L) The ownership of the assets/properties remains with the bank until the entire equity provided by the bank together with the fixed rent is fully paid off. On full payment/ adjustment of Bank's dues, it transfers the ownership to the client.
- m) The amount which the bank receives as rent is its income. The rent should not treat as a part of the equity in any way.

10. Direct Investment: Under this mode, the bank can under its full proprietorship conduct business by directly investing in the industries, trading, transports etc. In these cases, the profit/loss fully goes to the bank.

11. Investment Auctioning: Selling by auction of those assets/goods acquired by the bank through direct investment is called Investment auctioning. Generally, the bank establishes industrial units by direct investment, makes the same operationally profitable and then sells out on auction. This mode of investment is very helpful for industrialization of the country.

12. Quard:

It is a mode to provide financial assistance/ loan with the stipulation to return the principal amount in the future without any increase thereon.

13. Quard Hassan:

This is a benevolent loan that obliges a borrower to repay the lender the principal amount borrowed on maturity. The borrower, however, has the discretion to reward the lender for his loan by paying any amount over and above the amount of the principal provided there will be no reference (explicit or implicit) in this regard.

If a bank provides its client any loan, it can receive actual expenditure relating to the loan as service charge only once. It can not charge annually at a percentage rate.

If a loan is provided against the money deposited by a client in the bank, it has the right not to pay any profit against the amount of money given as loan. But profit should be paid on the rest of the amount deposited as per previous agreement.

Investment System for import/export business
as per Islamic Shariah

Import Business :

The import business is broadly divided into the following three categories:-

- i) Import of Commercial goods.
- ii) Import of raw materials for production purpose.
- iii) Import of capital / machineries.

The importers avail of investment facilities against all kinds of imports. But in case of imports under category (i) and (ii), investments are made under the Shariah approved Bai-Murabaha and Bai-Muajjal modes and in case of import under category (iii), investment is made under the Shariah compliant mode of Hire Purchase under Shirkatul Melk (HPSM). Investment facilities are also provided for import business through Bai-Salam, Musharaka and Mudaraba modes. Besides, the Islamic banks will fully abide by the national and international norms and guidelines relating to export/import business.

1 Import under the Bai-Murabaha system

1.1 Definition of the Bai-Murabaha: Bai-Murabaha is a contract between a buyer and a seller under which the seller sells certain specific goods permissible under Islamic Shariah and law of the land to the buyer at a price determined by charging agreed profit, margin or mark-up over the cost price. In this case, the buyer either makes cash payment to receive the goods or is allowed to make payment by instalments or on a fixed future date. The profit mark-up may be fixed in lump sum or in percentage over the cost price of the goods.

1.2 Some important features of the Bai-Murabaha mode of investment

- a) The client (buyer) requests the bank to purchase particular goods and promises to purchase the same from the bank at a price fixed by charging profit over the cost price.
- b) Under the Bai-Murabaha mode of investment there is no scope to increase the price once it is fixed.
- c) After buying the goods, the Bank has to bear all the risk until goods are actually delivered to the client.

Import of goods under Bai-Murabaha mode of investment

In the import business, the importer provides an irrevocable letter of authority to the Bank to import specific goods on behalf of him (the client) from the foreign seller and promises to buy the same from the Bank. In this case, the Bank is designated as a consignee in the Bill of lading and later on the Bank hands over the same to the importer through endorsement i.e. the ownership of the goods is transferred to the importer. As per uniform customs and practices, the seller lodges his claim or places claim for dues to the buyer's Bank through the bill of exchange and the buyer's bank discharges the claim on behalf of the buyer. The above import system is fully approved/ supported by the Islamic Shariah.

1.3 **Investment in imports by Islamic Banks**

In the import business, Bai-Murabaha investment is accomplished through a single deal at the time of opening L/C, Bills and Shipment. For example:

- a) Murabaha Import L/C
- b) Murabaha Import Bills
- c) Murabaha Post Import.

1.4 **Murabaha Post Import (MPI)**

The importers apply for investment facility against imported goods after shipment for payment of the invoice values of the goods to the seller/supplier including custom duty, VAT and other expenses. In such a case, Islamic banks allow a Bai-Murabaha investment facility under single deal concept. It is so called as the Letter of Credit. Bills and the handling of Post-shipment are settled under one agreement while opening the letter of credit for importing the goods.

1.5 **Accounting procedure for purchase price, profit and sale price**

- a) **Price payable to the supplier**
- b) **Other expenses related with purchase**
 - i) Conveyance - TA/DA
 - ii) Commission payable to the agents.
 - iii) The expenditures in connection with supplier's payment.
 - iv) Transportation cost up to the Bank's godown.
 - v) Transit Insurance and other expenses.
 - vi) Godown rent and salary of officials etc. incurred before sale of goods.

Additional expenses

1. Duty
 2. VAT
 3. License fee
 4. Commission for C&F agent etc.
- c) Cost price or total value = a + b
- d) Estimated profit/Mark-up profit (profit percentage on purchase/cost price)
- e) Sale price = c + d
- f) The net Investment amount is determined after deduction of the down payment (if any) from figure at "e" above.

Import under the Bai-Muajjal mode of investment

2.1. The term Bai-Muajjal means "deferred payment sale" or "Sale on Credit"

Under this mode of investment a contract is made between the buyer and seller for buying and selling of goods approved by Islamic Shariah and law of the land on the stipulation to pay the agreed price at a specific future date or by fixed installments.

2.2 Some important features of the Bai-Muajjal mode of investment

Most of the features of Bai-Murabaha and Bai-Muajjal are alike excepting the following:

1. Bai-Muajjal sale is executed completely on deferred payment system
2. The sale price is determined adding the profit with cost price. It is not necessary to disclose the cost price and the profit mark-up separately to the client. But in Bai-Murabaha, the cost price and the profit mark-up ratios are to be disclosed separately to the client.
3. The accounting procedure for imported goods under both the Bai-Muajjal and Bai-Murabaha mode are alike. But so far as contract is concerned they are different. Bai-Murabaha contract and Bai-Muajjal contract are executed for imports under Bai-Murabaha and Bai-Muajjal modes respectively.

3. Import under diminishing proprietorship method (Hire Purchase under Shirkatul Melk-HPSM)

Capital machineries and other re-usable goods are imported under this mode. It combines three modes: rent (Ijara), partnership (Shirkat) and buying and selling.

- a) The Bank and the client invest their capital jointly through a contract called partnership (Shirkat).

- b) The bank leases its portion at a certain rent.
- c) The Bank sells its portion to the client on receipt of the price under this system.

Import under Musharaka mode of investment:

4.1. Definition of Musharaka: Musharaka is a Shariah compliant mode of investment wherein the bank and the client jointly provide the capital. Here no pre-fixed profit is earmarked like in Bai-Murabaha or Bai-Muajjal. Profit, if any, is distributed as per agreement between the client and the bank while the loss, if any, is shared according to capital ratio.

4.2. Some general features of Musharaka mode of investment :

- a) The Musharaka agreement shall clearly laid down the amount of capital investment to be provided by the bank and the client and the profit/ loss sharing ratio as agreed between them.
- b) The actual profit of the business is to be distributed between the bank and the client as per the agreed ratio. But loss, if any, is to be borne by them as per ratio of the capital.
- c) The client shall properly maintain ledger, register, books of accounts etc. and have to show those to any authorized person of the bank on demand.
- d) For the success of client's business the bank shall have the right to give any decision and supervise the business activities.

4.3. Before establishing Letter of Credit, the bank shall receive an application from the client in prescribed form which shall include the following aspects:

- a) The price of goods to be imported, C&F price as per quotation/indent.
- b) Wholesale/retail price of every unit/ton/bag/carton.
- c) Import cost including estimated import expenditures.
- d) Expected sale price of imported goods.
- e) Per unit/ton/bag/cartoon expected sale price of the imported goods.
- f) Particulars of any other expenditure in addition to the import cost.
- g) Estimated net profit.
- h) Capital and profit /loss sharing ratios.

4.4. The Bank shall, thereafter, receive the equity portion of the client and after completion of documentation shall make payment against the import liability and all expenses related to it as per the Musharaka agreement. If there is profit, bank shall receive its share of profit as per agreement and in case of loss, shall bear the same according to capital ratio.

4.5. Fixation of liability in case of loss:

If loss is incurred after performing all duties and responsibilities as per agreement, then the loss would be borne by the bank and the client according to capital ratio. But if the loss is incurred due to carelessness, negligence or breach of any condition by the client, then the client would be liable to bear the loss.

5. Import under Mudaraba mode of investment:

5.1. Definition of Mudaraba: Under the Mudaraba mode of investment, the client or businessman or capital user does not invest any capital. In this case, the bank alone invests all the required capital and the entrepreneur (the client) directly manages and looks after the business.

5.2. Under this mode, the bank bears all the expenditures related to imports. In this case, the Bank supervises the use of capital, system of business operation and income of the business etc. The client maintains all the registers, documents and accounts concerning buying & selling of the goods.

5.3. In this case, profit, if any, is distributed between the bank and the client as per the agreed ratio and loss is fully borne by the Bank.

Investment in exports:

To accomplish export process/ order as per the terms and conditions of the letter of credit (L/C) and the agreement executed between the seller and buyer, an exporter needs financial and other banking facilities on urgent basis. So, it is one of the important functions of a bank to provide investment and banking facilities to the exporter at different stages of export business.

An exporter needs financial facilities at two stages of export process. such as:

- a) At pre-shipment stage, and
- b) At post-shipment stage.

Hence, financial facilities to export sector may be classified as:

- a) Pre-shipment Finance.
- b) Post-shipment Finance.

Financial assistance/ facilities complying Shariah principles are provided at both the stages of export process.

Investment at Pre-Shipment stage as per Islamic Shariah:

An exporter needs various financial facilities till shipment of goods. Finance is needed for procurement of raw materials and to meet transportation and other related cost upto shipment.

Pre-shipment facilities are generally provided for the following purposes:

- i) To procure raw-materials.
- ii) To process the exportable goods.
- iii) For transportation and packaging.
- iv) For payment of insurance premium.
- v) For payment of water, electricity and gas bills etc.
- vi) For payment of wages and salary/bonus to employees.
- vii) For payment of freight of the ship.

Shariah compliant modes for Pre-shipment Finance:

1. Back to Back Letter of Credit (Back to Back L/C)

Bank extends Back to Back letter of credit (L/C) facility to exporters to procure/import raw-materials for producing/manufacturing exportable goods at pre-shipment stage under the mode of Bai-Muajjal. Initially, no financial facility from the Bank is required when the back to back L/C is opened. But if the exporter fails to pay the L/C value at maturity or on due date, the bank provides financial facilities to the client under Bai-Muajjal mode.

2. Bai-Murabaha TR (Trust Receipt) :

To procure/purchase raw-materials for executing export order the bank provides investment facilities to the client under the mode of Murabaha TR. In this case, the bank obtains Trust Receipt signed by the client and handover the imported goods to the exporter.

3. Bai-Salam :

3.1 Under the Bai-Salam mode of investment, payment is made in advance to purchase the goods and the supplier makes promise to deliver the goods at a future date.

3.2 Investment under Bai-Salam mode is made to meet other expenses of the exporter excepting the manufacturing cost of exportable goods. The Bank purchases a portion of the exportable goods under the Bai-Salam mode and makes advance payment for the same on the condition that arrangements will be made by the exporter to export the goods purchased by the bank along with other goods of the exporter.

3.3 Fixing purchase price of the goods and recovery of bank's investment:

The purchase price is determined by deducting estimated profit of Bank's purchased portion of the exportable goods. The bank recovers its dues after realization of export proceeds.

4. Musharaka:

Pre-shipment investment may be made under Musharaka mode of investment if there is any pre-determined investment arrangement.

5. Post-Shipment Investment :

Bank provides post-shipment investment facilities through Negotiation (FBN) and purchase of export bills. It normally negotiates or purchases the export documents if the documents/bills prepared by the exporter are found in order/correct in all respect. The bank adjusts the liabilities against FBN/FBP after receiving the export proceeds and earns exchange income from this. This mode of investment is in compliance with the Islamic Shariah.

Other functions:

a) Remittance or Money Transfer:

Islamic banks can transfer money through D.D, T.T, T.C etc. and collect the bills (cheque, Draft, Payment order etc.) and realise commission or service charges within the norms of Shariah.

b) Miscellaneous Banking Services:

Islamic banks can render miscellaneous banking services like locker services, receipt and payment of clients' bills, issuance of Guarantee and working as agents of clients against commission or service charges. Collection of service charges or commissions for rendering those services are permissible under Shariah.

Section VI

Maintenance of CRR/SLR

All Islamic Banking Companies shall maintain Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) as per rates prescribed by Bangladesh Bank from time to time. Every commercial Bank having Islamic bank branches shall maintain SLR/CRR for its Islamic branches at the same rate as prescribed for the Islamic banks and shall, for the purpose, maintain a separate Current Account for the Islamic branches with Bangladesh Bank.

Addressing of liquidity crisis and utilization of surplus fund of the Islamic Banks:

In case of liquidity surplus and crisis the banks can take recourse to the following:

1. The excess liquidity of the Islamic banks/ Islamic branches of conventional Scheduled banks may be invested in the 'Bangladesh Government Islamic Investment Bond' (Islamic Bond introduced by the Government). In the same way, Islamic banks/branches facing liquidity crisis can tide over the crisis by availing of investment from Islamic Bond fund as per the prescribed rules.
2. In case Islamic banks/branches have surplus/ enough investment in the Islamic Investment Bond and subsequently faces liquidity crisis then the bank / branch may overcome the crisis by availing of investment facilities from Islamic Bond Fund against lien of their over purchased Islamic Bonds. To meet the crisis, REPO system may also be introduced for the Islamic Bonds.
3. The Islamic banks/branches having no surplus investment in 'Bangladesh Govt. Islamic Investment Bond' at the time of their liquidity crisis, if arises, may availed funds from Bangladesh Bank at a provisional rate on profit on its respective Mudaraba Short Notice Deposit Accounts which will be adjusted after finalization of Accounts and rate of profit of the concerned Islamic banks/branches. But till funds generated from sell of Islamic Investment Bonds remain available for investment such financial support may not be available from Bangladesh Bank.

4. The Islamic banks/branches may open/ maintain Mudaraba SND accounts with each other and can meet liquidity crisis by receiving deposits in the Mudaraba SND account at MSND rate from those having surplus liquidity.
5. To meet the liquidity crisis, if any, of the Islamic branches of the conventional commercial bank fund may be collected from sources which follow Islamic Shariah.

Section VII

Preparation of Financial Statements:

All the Islamic banks/Islamic branches of the conventional commercial banks shall prepare financial statements and provide information as per enclosed guideline (Appendix-II).

Section VIII

Framework of Rate of Return:

Under Mudaraba principles, profit accrued from investment and financing are shared between the depositors and the bank based on pre-agreed profit ratio. Losses, if any, will be borne by the depositor unless the loss is due to the negligence by the bank in managing the depositors' funds.

Given this unique relationship where the depositors would have a direct financial interest over the bank's income, it is essential to ensure calculation of rate of return in a fair and equitable manner. To this end, a standard framework for calculation of rate of return is enclosed in Appendix-III.