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Legal And Regulatory Framework of Islamic Financial Services in Bangladesh with Special Reference to the Islamic Capital Market: A Way Forward

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Abstract

Sustainable economic growth is the prime concern of today's globalized world. Money markets around the world are functioning as key players to realize that goal and often looking for new avenues to increase the capital that may embolden overall growth of economy of a country. This paper in adopting doctrinal method has tried to explore the legal barriers responsible for non-practicing the Islamic capital market in Bangladesh. The study has mainly focused on certain laws of Bangladeshi legal system which function as key legislative directives in governing Islamic financial services with special reference to the capital market through legal infrastructure in Bangladesh. It has examined the relevant laws and regulations of the existing legal system prevalent in the capital market of Bangladesh influencing the promotion and proliferation of capital through strict compliances by the companies and protection of the investors in terms of realizing profit without any hindrance. The study has further investigated the modus operandi of Islamic banks as found in the Capital Market of Bangladesh and scrutinized the major

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challenges and potentials thereto. Having looked into the legal and regulatory practices prevalent in the Islamic capital market of Bangladesh, the present work has maintained that capital market of Bangladesh suffers from the lack of integrated shariah compliant legislations which would govern and regulate the Islamic capital market in a more proper fashion. Given that the paper has tried to propose a set of recommendations which would help the Islamic capital market grow accordingly and hence, trigger the speedy amelioration of national economy globally.

Keywords: Regulatory Framework, Islamic Finance, Financial Services, Islamic Capital Market, Bangladesh

Introduction

Capital market refers to a market, primary and/or secondary, where securities of companies and entities like shares, stocks and bonds are issued and traded in order to increase long-term financing. A capital market assists investors to select an appropriate and profitable institution for investing their capital to the businesses of the company, and by way of this market, listed companies and governments raise their funds for boosting their businesses and national economy. Islamic capital market, on the other hand, maintains Shariah compliance policies in transactions that make the said market adhere to the commandments, principles, and limitations drawn by Shariah such as *riba* or usury, *maisir* or gambling and *gharar* or ambiguity. Islamic capital market embodies an assertion of upholding Shariah guidelines in commercial dealings which is absolutely free from the elements of *riba*, *maisir* and *gharar* (Mohammad Aman Uddin Muzahid and Irfana Sadat, 2016). Therefore, products of Islamic capital market should be in line with the permissibility [doctrine] as a general rule under Islamic Shariah and comprises ethical values which entail plurality of benefits for here and hereafter (Al-Bashir, M., & Al-Amine, M. 2008). Furthermore as the fairness and justice are the major components and sustenance of financial transactions, hence, both are to be ensured in the Islamic capital market (ISRA, 2011). The worth of Islamic capital markets rising rapidly with 12 to 15 percent growth annually and the current Islamic assets worth an estimated \$1 trillion which is 25 percent of the total world capital markets (www.dummies.com). According to the European financial review, Islamic capital market achieved a significant progress in the last decade for building instruments and investment vehicles which lead to an opportunity to the investors for accessing wide range of wealth with risk-return profiles along with Shariah-compliance. The most outstanding contribution behind this progress is the acceleration of the *sukuk* market or Shariah-compliant certificates which still remain promising in international

capital market with more than \$237 by 2013 (Sohail Jaffer, 2014; Thomson Reuters Zawya). Another report shows that the Shariah-complaint certificates' worth is now closely approaching US\$ 1 trillion in worldwide capital market (Herzi, 2008; Islamic Finance News Forum Roadshow, 2008). It is also evident that the growth of global trade is lower than the capital market in recent years (Ainagul Amangeldinovna Adambekova and Regina Ernstovna Andekina, 2013). With regard to Bangladeshi capital market, two capital markets are functioning, Dhaka and Chittagong stock exchange, with more than 872 listed securities where total market capital of Dhaka and Chittagong is more than Tk. 4043536.418 million (Dhaka Stock Exchange, 2018) and Tk. 3123839 million (Chittagong Stock Exchange, 2016-2017) respectively. However, in Dhaka stock exchange the Shariah index rose to the highest points of 1,394.26 in 2017 and in comparison with the lowest points of 941.28 in 2014 (Dhaka Stock Exchange, 2018). Therefore, it clearly shows that the capital market of Bangladesh expanding gradually with market potentials and the DSE is planning to introduce Shariah-complaint products including *sukuk* in the Market. In this research, the study will briefly focus on relevant literatures and background of Islamic financial market in Bangladesh in first part and regulatory frameworks and legal issues in the second. Finally, it will discuss the problems and offer recommendations in the last part of the study.

Research Methodology

In conducting the research and working out the research objectives, doctrinal method will be employed. Relevant laws of the Bangladeshi legal system and some other government guidelines and regulations will be used as primary source. In determining the status of Islamic financial service activities, some online based databases will be treated as the secondary source.

Literature Review

As regards the literature on Islamic capital market (later referred to as ICM) in a global setting, there have been conducted innumerable research. However, in the milieu of Bangladesh an insignificant number of research works are found that dealt with ICM. Apart from works on ICM, some other studies are found addressing the issues of conventional capital market (CCM) of Bangladesh. In the current study, researcher has reviewed the works available together with few reports focusing on the legal-framework for ICM or Islamic financial Market (later referred to as IFM) and challenges for snowballing the ICM in Bangladesh. For instance, Azad, Kabir, Bhuiyan, and Masum (Md. Abul Kalam Azad, Mohammad Rokibul Kabir, Faruk Bhuiyan, & Abdul Kadar Muhammad Masum, 2013), in their study on "Prospects Analysis of an Islamic Capital Market in Bangladesh", focused mainly on viability of the

market confidence for Islamic capital in Bangladesh by assessing variety of product to be fit in the existing market. They also tried to address national and international snags towards the ICM and investigate the plausible threshold for further enhancement under existing regulatory mechanisms in Bangladesh. However, the study has not examined legal provisions whether or not enough or inadequate for ICM.

In their study, Muzahid and Sadat (Mohammad Aman Uddin Muzahid and Irfana Sadat, 2016), have revealed the key problems of the ICM in Bangladesh. They have investigated the competitiveness of small and new ICM with established interest based conventional capital market in terms of legal and regulatory protection of the investors. However, the article remained silent on the discrepancies and shortages of law. In contrast, Perves (Mohammad Masud Perves, 2015), has exposed the regulatory vacuums in Bangladesh for promoting Islamic Banking industry in particular and ICM in a wider context. However, the work also did not talk much regarding the looseness of existing statutory mechanism for regulating ICM in particular and Islamic banking in general, and went silent on passive tendencies of financial institutions of Bangladesh toward them. However, Wilson (Rodney Wilson, 2017), on the other hand, emphasized on the regulatory infrastructures for ICM products and services under Islamic Shariah. Study shows that, this regulatory governance is essential for liabilities and assets management of Islamic banks, liquidity and capital adequacy, product information disclosure, and transparency. His study further highlighted the scope of regulators in making sound rules of procedures for ensuring Shariah compliance for ICM in any jurisdiction including Bangladesh. Although the study did not address ICM in Bangladesh but contains general guidelines for ICM in any market that advocated that a level playing field is needed for ICM to develop its market confidence around the world.

Bangladesh Bank report (Bangladesh Bank, Capital Market Developments Report, 2017), on “Capital Market Developments in Bangladesh”, basically focused on the increasing ratio of market size as compared to the previous years. It has also observed that the Banks are dominant in financing activities in Bangladesh which are not sustainable for long-term investment schemes for variety of reasons. It has further explored that the expansion of capital market (including ICM) may be the appropriate direction for market economy of Bangladesh under adequate legal facilitation. In this regard BSEC should play a vital role through administering good corporate governance under strong regulatory measures in cooperation of good companies of the country. Furthermore, Sarkar (Abdul Awwal Sarker, 2012), revealed that the existing

legal status of Islamic Financial Industry (IFI) and authorities under Bangladesh Bank (BB) and other bodies are dealing with Shariah-based ICM in Bangladesh, whereas, Hossain (Md. Mahabbat Hossain, 2012), addressed the legal requirements for preparing financial statements (FSs) of Islamic banks with Shariah compliance in Bangladesh. In addition, Alamgir (Md. Alamgir, 2013), addressed the urgent need of the distinct legal and supervisory framework for developing ICM in Bangladesh.

Evaluation of Islamic Capital Market (ICM) in Bangladesh

In Bangladesh, ICM encompasses two key sectors-Islamic banking and Islamic Insurance (*takaful*) with their limited products, alongside the mainstream financial activities. Ongoing popularity of Islamic banking among the people and steady increase of ICM is tracing back to the year of 1983 when first Islamic bank began to operate and made significantly positive changes in the market throughout the years. As Khan observed, that “Bangladesh’s financial sector comprises money market, credit market, capital market, Islamic and non-Islamic insurance companies, several financial institutions, and microfinance” (Khan et al., 2016). According to Bangladesh Bank’s Islamic banking developments report, till the end of June 2021, there have been operating 10 full-fledged Islamic banks with 1569 branches out of total 10788 branches of the whole banking sector (Bangladesh Bank, Islamic Banking Developments Report, 2021). The report has further explored that another 21 conventional commercial banks with their 8 Islamic banking branches and 194 Islamic banking windows are also offering Islamic financial services in Bangladesh (Bangladesh Bank, Islamic Banking Developments Report, 2021). Apart from scheduled banks, non-banking financial institutions (NBFIs) such as financing and leasing companies, are also exerting significant impact on the resource mobilization in the same market. There are 29 NBFIs are functioning in the market since 2001 and out of which two are serving in accordance with Islamic Shariah (IFIL, 2001).

Furthermore, Islamic insurance institutions have a substantial influence on the ICM in Bangladesh. Islamic insurance, *takaful*, has also played a vital role in enhancing IFI and ICM in Bangladesh. *Takaful* is also a fast-growing industry in Bangladesh which has been rendering its performance in the market since 1999. Islami Insurance Bangladesh Limited is the first fully Shariah based insurance company in Bangladesh established in 1999 (Kalil ME, 2011). From its inception in this sub-continent during the British administration (Razaul Karim, 2016), the insurance business has been continuously growing. At present 78 companies are operating their business in the market and offering different policy products such as life insurance, general insurance, reinsurance, micro-insurance, and *takaful* or Islamic insurance. Immediately after the independence of Bangladesh, there were two state-owned insurance companies which provided insurance coverage for individuals and business properties. In 1985, first private insurance company was established in

Bangladesh and took a new shape of advancement which was absent before 1985 in terms of infrastructural building, policy formulation and business expansion (Dr. Mohammed Shamim Uddin Khan, and Mohammad Nazim Uddin, 2013). There are 8 full-fledged Islamic insurance companies operating since the inception in 1999 (Issa Khan, Noor Naemah Binti Abdul Rahman, Mohd Yakub Zulkifli Bin Mohd Yusoff and Mohd Roslan Bin Mohd Nor, 2016) and about 13 Islamic insurance windows under conventional insurance companies opening takaful in Bangladesh (TJCSCIIB, 2012). However, *takaful* industry of Bangladesh is facing several difficulties, absence of regulatory framework for takaful business is one of the key problems in this regard.

In terms of performance analysis of IFI, positive trend has been observed over the decades in different perspectives as compared to its conventional counterpart. Islamic financial market especially the banks have recorded a robust performance over the last 34 years in Bangladesh. According to BB report, at the end of 2014, Islamic banking possessed 21 percent of the entire deposits which was BDT 1335.61 billion and Islamic branches and windows of conventional banks collected BDT 48.18 billion and 20.80 billion respectively (Bangladesh Bank Financial Stability Report, 2013; Bangladesh Bank Islamic Banking Developments Report, 2014). Another report presented that Islamic banking contained 25 percent of total market shares of banking sector in Bangladesh (M Hamid, 2013). This IFI is [growingly] increasing with more than 20 percent annual growth rate and contributing to the 6 percent of national growth throughout the decades (Md. Golzare Nabi.). As regards the performance of overall Insurance companies including takaful, Bangladesh Insurance Association (BIA) provides a clear picture of gradual increase of total premium income in private sector. Life insurance companies rose from Tk. 62,429 million in 2013 to Tk. 66,879 million in 2014 and the income of non-life private sector insurance companies increased from Tk. 21,038 million in 2013 to Tk. 22,670 million in 2014 with a growth rate of 7.76% (Bangladesh Insurance Market Report, 2017).

Legal Framework for Capital Market

Islamic financial industry (IFI) has observed a phenomenal growth and rapid expansion along with its dominating conventional market environment in Bangladesh. Influence of fast emerging Global IFI and popularity among the public and investors are reinforcing and accelerating the market which seriously requires an active and robust legal framework that may both ensure uniformity in Islamic banking operation and protect benefits of the investors in line with the shariah compliance principles. Unfortunately, there is no

specific legislation yet to have been enacted for governing IFI or ICM in Bangladesh. However, BB has provided a guideline for Islamic Banking in accordance with the recommendations of Bangladesh Bank Focus Group, comprising of the representative of BB, of members from the Islamic Banks and of representation from the central *Shariah* Board for Islamic banks. In preparing outlines for Islamic Banking, the group had considered the existing Banking Companies Act 1991, Companies Act 1994 and Prudential Regulations of Bangladesh Bank. It is pertinent to mention here that, BB is the central authority responsible for governing financial system in Bangladesh. It regulates total financial industry by eleven different laws, rules and regulations along with approximately sixty-three different guidelines and prudential regulations covering all the aspects of banking sectors in Bangladesh. However, the prudential regulations are the summery of the principles and directions from law and guidelines provided by the BB (Bangladesh Bank, 2011). The pivotal laws are discussed below in a chronological manner.

Banking Companies Act 1991

Banking Companies Act 1991 is one of the main Acts in regulating financial system of Bangladesh. The Act deals with total banking sector including Islamic financial industry. There are only two special sections in the Act which talk about Islamic products. However, other sections of the Act applicable to all type of banking including Islamic banking are seen to stand utterly passive regarding the Shariah compliance. Section 7 of the Act approved two modes of Islamic business such as *musharika* certificates, *mudareba* certificates and section 26 of the Act mentioned about the subsidiary companies of a bank which the law restricted except for certain purposes it may be permitted. The law has permitted for Islamic banks to form a subsidiary company willing to run its business in accordance with the guideline of Islamic Shariah (The Banking Companies (Amendments) Act, 1995, Section 26). While in 1995, the Act was amended, few more provisions on Islamic *Shariah* for Islamic Banking companies had been incorporated. The Act has incorporated detail definition of *Mudareba* and *Musharika* certificates in section 5 of the Act. Section 9 of the 1991 Act addressed the prohibition of certain types of businesses for all banks and did not mention separately about Islamic banking which was subsequently incorporated by the Amendment Act 1995. In the amendment, Islamic banking has been approved direct or indirect buying, selling or bartering goods or articles in line with Islamic *Shariah* prescribed manners (The Banking Companies (Amendments) Act, 1995, Section 26). Section 30 of the Act of 1991, excluded the jurisdiction of the court from trying the suits on mare grounds of excessiveness of the interest realized by

banking companies which generally covered all banks. However, the provisions of the Amended Act of 1995 have broadened the scope of exclusion from ‘interest’ in conventional banks and ‘profits and return rates of rent’ in Islamic banks.

Companies Act 1994

This is another major Act in Bangladesh regulating all types of companies in general including Islamic banking and financial companies. The Act contains all essential requirements for establishing a company ranging from incorporation to winding up including memorandum and article of association, shareholdings, and directors of the company etc. However, the Act does not provide any specific provisions that may necessitate shariah guidelines and directives in dealing with Islamic banking and Shariah issues for this particular type of companies. Therefore, it applies to Islamic banking companies, identical to those of conventional banking which creates ambiguity and confusion among the investor over the distinctiveness of the *riba* based and *riba* free banking. Although Islamic banking companies are complying with requirements of the Act, *Shariah* compliance issues still remain outside of the legal and regulatory boundaries.

Bangladesh Bank Guideline for Islamic Banking

This section will analyze the contents of the BB guideline for ascertaining legal status and suitability of the guideline for IFI or ICM in Bangladesh. On the ground of certain differences between interests based conventional banking and *Shariah* based Islamic banking, it was deemed to have a proper guideline in the absence of specific law on Islamic banking in Bangladesh. It was also considered necessary for bringing transparency and accountability in Islamic banking. Therefore, in 2009, BB provided a guideline for banking based on *Shariah* principles, and made it compulsory for all Islamic banks to submit their *Shariah* compliance report in 2010 (BRPD Circular No. 15, 2009). Moreover, the guideline covers major areas of Islamic banking operations. Among them few have been discussed under this section.

In the preamble, it is clearly stated that the guideline will not serve as a substitute to the existing laws, rules and regulations. It will instead serve as a complementary to those instruments. It has further stated that, in case of any situation where any point or issue which is not covered by the guideline or any inconsistencies between guideline and law, the Banking Companies Act and Companies Act shall prevail (Guidelines for Conducting Islamic Banking, Introduction to Islamic Banking, Bangladesh Bank, Section 1). Furthermore, sub-section 12-14 of Section II of the Guideline made Islamic banking subject

to the prevalent laws, rules, regulations, and directives issued by BB from time to time. Furthermore, all other terms and conditions established by Bangladesh Bank for establishing a bank company shall also be applicable. The Banking Companies Act, 1991 empowered the BB to give direction on certain grounds such as determining public interest, improving financial policy, preventing activities prejudicial to the depositors and running and operating banking company, or ensuring better management of the banking company. In addition, the Act made such directions mandatory for the companies by saying that “it may issue such direction as it deems fit; and the banking company concerned shall be bound to comply with such direction” (Banking Companies Act 1991, Section 54). However, in the absence of specific legislation for the IFI, Islamic banks are obliged to comply with the Guideline as its governing law for continuing their business.

The Guideline has eight sections dealing with license, responsibility for *Shariah* compliance, principles of deposit, investment principles and investment products, maintenance of cash reserve ratio (CRR)/statutory liquidity ratio (SLR), preparation of financial statements, and framework of rate of return. However, there is no specific outline for dispute settlement pertaining to Islamic transaction which is principally different from conventional contract, and hence, needs special tribunal or authority for dispute resolution. The Guideline seems silent on this point. The Guideline refers any dispute pertaining to Islamic transactions to the civil court for resolution which is (the existing court) incompetent to deal with problems arising under Islamic transactions and in many cases, court settles the dispute in accordance with existing laws which do not uphold the spirit of *Shariah*. with regard to obtain license for Islamic Banking, 50% share shall be offered in the market, and shall comply with principles of Islamic *Shariah*. It is also required to submit available facilities for ensuring business and management as per Islamic *Shariah*. However, the guideline has not provided details about *Shariah* principles and facilities for Islamic banking. It has however provided outline for establishing Islamic banking branches and divisions in conventional banks along with constitution, control and segregation and maintenance of accounts and statements. Furthermore, it has given prescriptions for conversion of conventional bank into Islamic bank.

As regards the paid-up capital, the Guideline provided strict conditions for Islamic banking about Tk.2.00 billion which 20 times bigger than that of Tk.100 million or an amount of 6 percent of the total amount demand and time liabilities of the company whichever is higher for all banks (Bank Companies Act 1991, section 13 (2)). In case of new banks (The Bangladesh Banks

(Nationalization) Order, 1972; Bank Companies Act 1991 (sec.5(h)), or especial banks (Bank Companies Act 1991, Section 5(m)) which is entirely dependent on the Government, and whose revised capital and reserves has fallen below the lowest limit, the bank will be assisted by the Government for the benefit of the bank (Bank Companies Act 1991, Section 13 (3)). However, these facilities are not approved for any private banks including Islamic banks in Bangladesh. In terms of *Shariah* compliance, BB has not taken any responsibility to undertake or monitor *Shariah* compliance of the Islamic banks. Rather it made the concerned conventional banks responsible to ensure the fulfilment of *Shariah* requirements. In addition, Guideline directed the Islamic banks, its subsidiary companies and conventional banks having Islamic branches to include experts having Islamic jurisprudential knowledge in the board of directors. Furthermore, it has advised to form an independent *Shariah* supervisory committee for every institution. However, there is no provision in the Bank Companies Act 1991 regarding *Shariah* compliance of the Islamic banks in Bangladesh. As per modus operandi of Islamic Banks, the Guideline approved 13 investment modes along with some other related modes such as: *mudaraba*, *musharika*, *bai-Murabaha*, *bai-Muajjal salam* and parallel *salam*, *istisna* and parallel *istisna*, *ijara*, *ijarah Muntahia Bittamleek* (Hire Purchase), hire purchase *musharaka Mutanaqisa*, direct investment, investment Auctioning etc., *quard*, *quard hassan* etc. On the other hand, the Banking Companies Act also approved two business modes for Islamic banks such as *musharika* certificates, *modareba* certificates. Apart from the above aspects, some other issues have also been outlined in the guideline such as *Shariah* approved export and import investment mechanism, maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) in accordance with the direction of BB, making financial statements, and structure of rate of return.

Financial Institute Act, 1993

The Financial Institute Act, 1993 and Financial Institute Regulation, 1994 as amended in 2003 are also the basic laws responsible for governing the financial industry of Bangladesh. These laws deal with non-banking financial institutions and supplement other laws regulating financial system such as Banking Companies Act etc. In order to provide license for financial institutions and effectively control and monitor the day-to-day commercial transactions of these institutions, the government enacted Financial Institute Act, 1993 and its regulations in 1994. However, there is no specific provision dealing with Islamic financial institution in Bangladesh. Rather it maintains general principles applicable to all types of financial institutions except banks. Therefore, it is the need of the hour to incorporate relevant provisions for

Islamic financial institutions into the provisions of law for better regulation of the market.

Insurance Act, 2010

In order to regulate the Insurance companies including *takaful* properly and effectively, Bangladesh government enacted Insurance Act and Insurance Development and Regulatory Authority Act in 2010. Prior to this, the industry was governed by the Insurance Act, 1938, Insurance Rules of 1958, Bangladesh Insurance (Nationalization) Order 1972, the Insurance Corporations Act, 1973, and Insurance (Amendment) Ordinances of 1984. The Act has repealed Insurance Act 1938. Currently there are 20 other rules and regulations complementing to the main Act and some 14 draft rules and regulations are proposing to develop the industry. As we mentioned earlier that Islamic insurance is now governed by the Insurance Act 2010. Section 2(7) of the Act defines Islamic insurance to be governed by Islamic *Shariah*. The Act approves insurance business based on *Shariah* principles with certain conditions. It declares that, prior to the enactment of this Act, those companies were given licenses for operating Islamic insurance (*takaful*) business under the Insurance Act 1938 may continue their businesses in any kind such as *Shariah* based *takaful* and general insurance based on interest being a company or an individual subject to the permission of the current Act. The Act further, stipulates that no individual or company is allowed to run two businesses at the same time. Therefore, those persons or companies were operating both kind of insurance is now required to choose one of the two and inform in writing to the authority within six months of the formation of Authority. Furthermore, the companies as well as individuals are required to continue those policies until the expiry of the policy duration and all claims are settled between policy holder and Insurance Company (the Insurance Act 2010, Section 7). In addition, the Act authorizes the government to make rules for Islamic Insurance (*takaful*) companies.

It is needless to assume that the Islamic insurance (*takaful*) industry will be growing up without having strong and effective legal backings. It is also inappropriate to bring *takaful* companies under the same footing with conventional insurance businesses and provide same regulation. Due to the distinct nature, *Shariah* based *takaful* business needs detailed rules derived from *Shariah* principles of transaction. In this concern, the current Act does not contain any rules for *takaful* industry in line with *Shariah* principles. In addition, the Act defines the Islamic insurance as the Insurance based on Islamic *Shariah*. However, the rules for the application of *Shariah* based *takaful* business is not provided by the Act (Kazi Md Mortuza Ali, 2013). The

Act further imposes obligation on the companies to deposit in BB and in approved securities. Therefore, it is difficult for *takaful* companies to invest in interest-based securities (the Insurance Act 2010, Section 23). There is no instructions in the Act for *takaful* companies about how to avoid such interest incurred complexities. Moreover, the Act is also silent about the payment to the insurer by a *takaful* company. However, it provides provisions for general insurance companies about the interest rate to be payable by the company to the policy holder which cannot be applicable in the operation of Islamic insurance company and its policy holders (the Insurance Act 2010, Section 72).

Islamic Capital Market Policy Instruments in Bangladesh

In the global context, Islamic capital markets are not well integrated in many jurisdictions except few such as Malaysia, Bahrain, and UEA. Current instruments are operating with special mechanism with conventional banks (Daud Vicary Abdullah, 2011). Bangladesh is not out of this context in terms of Islamic capital market policy instruments. Nevertheless, Government Islamic Investment Bond (GIIB) is the only policy instrument in Bangladesh introduced by the government in 2004. The design of the bond has been framed in accordance with the principles of *Mudaraba* where a bondholder receives profits on the maturity of the bond. The account is adjusted after finalization of the investment accounts of the bond to the Islamic banks or financial institution from whom profits is realized. In this regard, profit should be calculated by the borrower banks or institutions on the basis of pre-agreed ratio of the banks or institutions. However, on maturity BB receives the profit from the borrower's institutions and share with the bondholders on agreed profit-sharing ratio (Md. Abdul Awwal Sarker, 2016). However, a research has proposed another two monetary policy instruments for BB after examining the monetary policy instruments of several countries. Those are Central Bank *Mudaraba Sukuk* (CBMS) and Government *Murabaha Sukuk* (GMS). The objectives of this policy is to facilitate BB to regulate the liquidity of the Islamic banks for smooth money supply to the Islamic banking sector.

Central Bank *Mudaraba Sukuk* (CBMS) is a non-tradable *Mudaraba Sukuk* for the Banking and non-banking financial institutions on weekly auction based for open market operation. In this CBMS investor will be known as *Rabbul Maal* or owner of the money and Bank will be known as *Mudarib*, and due to its short term nature, it may extent from 3 months to 1 year. As regards the Profit-Sharing Ratio (PSR), it will depend on length of the policy and decision of BB in controlling monetary flow in the market. In order to handle this operation BB may establish a Special Purpose Vehicle (SPV) such as

“Bangladesh Islamic Microfinance Foundation” to ensure sukuk investment directly to the Islamic Microfinance institutions. BB thereafter, will share the return received from BIMF with the sukuk holders according to the PSR settled by mutual agreement. Thus, the sukuk instrument may make a relation between financial sector and real sector via microfinance project financing (Md. Abdul Awwal Sarker, 2016).

On the other hand, Government *Murabaha* Sukuk’ (GMS) is another instrument which may be issued by BB in favor of the Government on imported items specially oil from Middle Eastern countries on *Murabaha* basis through a competitive bidding auction. As like PSR in CBMS, the ratio may also vary considering the BB monetary policy, economic situation and real buying and selling of the importable commodities. It is also short-term nature, therefore, the length of the transaction may be 1 or 2 months and may extend to 1 year. After successful bidding, the bidders may appoint BB as an agent to buy the commodity and sell in favor of the bidder to the Government at a mark-up price to be paid on deferred payment date. GMS is a long-term Government treasury bill based on Islamic principles for funding import expenditure of government (Md. Abdul Awwal Sarker, 2016).

There are some other market instruments found in different countries for the liquidity management of the banking system such as Sale and Buyback Agreements, Central Bank *Wadi’ah* Certificates, *Sukuk* Bank Negara Malaysia *Murabaha*, Government Investment Issues (GII), Bank Negara Monetary Notes *Murabaha*, and *Sukuk* Bank Negara Malaysia *Ijarah* are the instruments in Malaysia. In Sudan, Central Bank *Musharaka* Certificates (CMCs), Government *Musharaka* Certificates (GMCs), and Government Investment Certificates (GICs) and Central Bank (or Government) *Ijarah* Certificates (Ali Salman Syed, 2005,). *Sukuk Al-Salam*, *Sukuk Al-Ijarah* are for Bahrain and Iran introduced Central Bank Participation Papers, Government Participation Papers as a monetary policy instrument (Central Bank of Bahrain, Annual Report 2011).

Challenges and Recommendations

At present Bangladesh has been facing various challenges for IFI or ICM which if removed, ICM would be the strong basis for long-term and sustainable national economy. Major challenges that encounter the acceleration of the ICM in Bangladesh are first of all, absence of law for Islamic Banking and Insurance companies. As we discuss the basic laws governing the banking and insurance industry are not dealing with *Shariah*, therefore, without legal support, IFI or ICM cannot move forward with its own

potential growth ratio. In addition, in the absence of *Shariah* based instruments and legal framework, Islamic banks are unable to participate in the public projects of the government as a project financier. Secondly, there remains a serious inadequacy of Islamic capital market instruments. Bangladesh Bank has only one instrument GIIB. Therefore, IFI is facing difficulties in liquidity management due to shortage of scope in investing excess fund of the banks. Thirdly, small portion of only about 10 percent of total investments are made by the entire Islamic banks in the original profit loss sharing business such as *mudaraba* and *musaraka* whereas 90 percent investment goes for marked up and rental based modes of financing such as *murabaha*, *bai-muajjal*, and *ijara*. Fourthly, social financing like microfinance and small and medium enterprises are the significant and potential sectors for intensifying the Islamic capital market in Bangladesh. However, at present IFI is selecting big industry or firm for finance. Therefore, IFI may consider this plausible sector for accommodating more businesses for building robust ICM in Bangladesh. Fifthly, there are only 8 Islamic insurance companies are now in the market which is not enough for IFI to protect investments against unforeseen hazards and catastrophes. Therefore, more Islamic *takaful* company should come in the market. Finally, shortage of adequate efficient and skilled manpower for IFI is a big problem in Bangladesh for enhancing ICM. Therefore, necessary steps should be taken by the IFI to produce skilled people through pursuing higher degree in the field. In addition, shortage of resources to understand the IFI and its modes, *Shariah* principles and guidelines are also a big challenge to explore the industry. Due to the lack of resources in terms of literatures, training, propagation and awareness, people are not familiar with Islamic financing and its merits. Therefore, Islamic banks and insurance companies should initiate project focusing on the needs of IFI and its huge appeal to the increasingly financial demand of the society (Md. Golzare Nabi and others, 2016).

Conclusion

It goes without saying that Bangladesh is a potential country for developing Islamic capital market with sizable investment and return which may be the basis of sustainable economy of the country. Islamic financial industry has proven its potentiality with regular growth ratio as opposed to the conventional monetary practices in terms of fairness, profit-making, and corporate social responsibilities. Lack of proper legal and regulatory mechanism for IFI is deemed to be the most significant obstacle to the IFI's successful advancement in Bangladesh. However, for the overall development of IFI it is required to have an effective national policy for IFI advancement including short- and long-term targets. Under short term policy, government may legislate a

comprehensive law for Islamic banking and takaful (Insurance) companies. In addition, establishing strong *Shariah* regulatory authority centrally, which would govern and monitor the Shariah board of all financial institutions, initiating more financial products in the market, may also come within the short-term policy. In contrast, joint collaboration of global IFI industries, international policy instruments, extensive research and innovative cooperation, may come under the long-term policy of the government.

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