

ISLAMIC INTERBANK MONEY MARKET IN BANGLADESH : A LITERATURE REVIEW

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Different money market is imperative in efficient and effective operations of Islamic finance operations in Bangladesh and proper implementation of Islamic Shariah. But since inception, Islamic financial institutions operate here without having separate money market. Recently, Bangladesh Bank plan to establish Islamic Interbank Money market (IIMM) for Islamic financial institutions to facilitate Islamic finance at a great pace. On this purpose, they modify the existing “Islamic Investment Bond Rules-2004”. They want to create a new avenue for trading of the Islamic Bond in the near future through amending its rules. Islamic Bond will be transformed into an auctionable instrument among the Islamic banks to be of assistance in managing their liquidity in line with Islamic Shariah. This step is being treated as a pragmatic step because, Islamic finance and banking is growing at a large scale in the economy of Bangladesh and from the speech of specialists in this arena, this financial sector will dominate in the world economy in future. So in the era of globalization Bangladesh have to keep in line with this trend. Like establishing guidelines for operating Islamic financial activities, this step is being treated as the continuous support of central bank towards the establishment of Islamic finance in the soil of Bangladesh. This paper contains a literature review research of Islamic Bond, which is connoted as Sukuk and Islamic Interbank Money Market. The purpose of this literature review research is to set up a theoretical framework in regard to establish Islamic Interbank Money Market in Bangladesh.

Key words: Sukuk, Islamic Interbank Money market (IIMM), Bangladesh Bank.

1. INTRODUCTION:

In Bangladesh, Islami Banking is a fastest growing sector in the financial arena. As a first Islamic Financial Institution in Bangladesh, Islami Bank Bangladesh Ltd.(IBBL), which was incorporated on 14th March, 1983, went into operation on 30th March, 1983 and introduced a full package of banking services in August 1983, Islami Bank Bangladesh Limited is considered to be first interest – free bank in South East Asia. At the present era, it the most profit earning Bank of the country, and gains much popularity among peoples. According to Bangladesh Bank (BB), the central bank of Bangladesh reported that, the deposits of the Islamic banking systems are constituting 25 percent of all private banks deposits and its investments are 30 percent (AHMED. F, 2010)¹. According to M Azizul Huq², “The interest-free Shari`ah-based systems will be mainstream Banking and the conventional banks will be the minority systems in the OIC countries including Bangladesh within 2020 (AHMED. F, 2010)”³

¹ “Islami banking blooms in Bangladesh” by ferdous ahmed, Islami banking and finance journal, may 16, 2010

² M. Azizul Huq is the Pioneer of Islami Banking in Bangladesh. He was the first MD of IBBL and now a vice chairman of Sharia’h council and consultants of several Banks in Bangladesh.

³ Islami banking blooms in Bangladesh” by ferdous ahmed, Islami banking and finance journal, may 16, 2010

Islami Banking in Bangladesh has intensively regulated and supervised by four regulatory and supervisory bodies. These are: the Securities & Exchange Commission, Bangladesh Bank (central bank), the Islamic Banks' Consultative Forum, and the Central Shari'ah Board for Islamic Banks of Bangladesh (CSBIB).⁴ Albeit Islamic finance plays a major role in the Bangladeshi economy but regulatory development appears to have lagged behind the growth of the Islamic finance industry itself.⁵

Islamic financial institutions have to face difficulties in issuing and getting short term loans to facilitate their emergency needs on call money market or repo for the reason that, these instruments contain interests. And according to Islamic Shariah, interest is strictly prohibited. So the different money market is imperative in efficient and effective operations of Islamic finance operations in Bangladesh and proper implementation of Islamic Shariah. But since inception, Islamic financial institutions operate here without having separate money market.

Recently, Bangladesh Bank plan to establish Islamic Interbank Money market (IIMM) for Islamic financial institutions to facilitate Islamic finance at a great pace. On this purpose, they modify the existing "Islamic Investment Bond Rules-2004". They want to create a new avenue for trading of the Islamic Bond in the near future through amending its rules.⁶ Islamic Bond will be transformed into an auctionable instrument among the Islamic banks to be of assistance in managing their liquidity in line with Islamic Shariah.⁷ This step is being treated as a pragmatic step because, Islamic finance and banking is growing at a large scale in the economy of Bangladesh and from the speech of specialists in this arena, this financial sector will dominate in the world economy in future. So in the era of globalization Bangladesh have to keep in line with this trend. Like establishing guidelines for operating Islamic financial activities, this step is being treated as the continuous support of central bank towards the establishment of Islamic finance in the soil of Bangladesh.

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2.LITERATURE REVIEW:

2.1 Islamic Bond (Sukuk):

Islamic bond is termed as "Sukuk"⁸ in accordance with the Islamic Shariah which means securitized assets or business.⁹ It pays a return based on tangible assets in lieu of an interest rate.¹⁰ As Sukuk holders are not entitled to get interest, so, they are entitled to share in the proceeds of the realization of the Sukuk assets.¹¹ According to AAOIFI¹² (Accounting and

⁴ <http://www.cpifinancial.net/v2/print.aspx?pg=magazine&aid=2422> accessed October 2, 2011

⁵ Ibid

⁶ http://www.thefinancialexpress-bd.com/more.php?news_id=144891&date=2011-08-03 accessed October 2, 2011

⁷ Ibid

⁸ **Sukuk** (Arabic: صكوك, plural of صك Sakk, "legal instrument, deed, check") is the Arabic name for financial certificates, but commonly refers to the Islamic equivalent of bonds. In classical period Islam, Sakk (sukuk) – which is cognate with the European root "cheque" from Persian '(چک)' pronounced check' - meant any document representing a contract or conveyance of rights, obligations or monies done in conformity with the Shariah. Empirical evidence shows that sukuk were a product extensively used during medieval Islam for the transferring of financial obligations originating from trade and other commercial activities. (http://en.wikipedia.org/wiki/Sukuk#cite_note-0 accessed October 2, 2011)

⁹ <http://wiki.islamicfinance.de/index.php/Sukuk>

¹⁰ www.assaif.org/content/.../Analysis%20of%20Sukuk%20Market.pdf

¹¹ Ibid

¹²

Auditing Organization for Islamic Financial Institutions) there are 14 types of Sukuk is permissible¹³. These are:

- SUKUK AL-IJARAH
- SUKUK IJARAH MOWSUFA BITHIMA
- SUKUK MANFAA IJARAH
- SUKUK MANFAA IJARAH MOWSUFA BITHIMA
- SUKUK MILKIYAT AL-KHADAMAT
- SUKUK AL-SALAM
- SUKUK AL-ISTISNA'A
- SUKUK AL-MURABAHA
- SUKUK AL-MUSHARAKAH
- SUKUK AL-MUDARABA
- SUKUK AL-WAKALA
- SUKUK AL-MUZRA'A
- SUKUK AL-MUSAQA
- SUKUK AL-MUQARASA

Of them, Sukuk al Musharakah is now worldwide acceptable because it is based on profit and loss sharing technique.¹⁴

Sukuk can be repurchased after selling Sukuk certificate. The purchaser enters into a contract that he will get back the certificate with pre-agreed leasing fee. The issuer of Sukuk also entered in to a contract of buying back certificate at par value on agreed terms and conditions.¹⁵

The Islamic capital market is situating at its boom by issuance of Sukuk that can be utilized in different projects for a fixed period. Sukuk is now worldwide recognized as its value is increase at an average rate 40% per annum.¹⁶ Islamic market has occupied more than US\$ 700billion and the Islamic countries are successful in the form of Sukuk al Musharakah¹⁷ (for model¹⁸ see Appendix- A) as it is the successful form of Sukuk which provides more funds for operating mega projects.¹⁹

Global sales of Islamic bonds are forecast to rise nearly 60 percent this year than from previous years, i.e., \$22 billion.²⁰ The forecasts for expected global new Sukuk issuance in 2011 (in billion dollars)²¹:

- ABC Islamic Bank between \$17 billion-\$19 billion

¹³ Ibid

¹⁴ <http://www.islamonline.com/news/articles/73/The-success-story-of-Sukuk-in-Islamic-world.html> accessed October 3, 2011

¹⁵ Ibid

¹⁶ Ibid

¹⁷ Sukuk al Musharakah refers to the certificate which is representing projects or activities managed on the basis of the principle of "Musharakah" by employing either one of the partners or another person to administer the operation. (<http://www.scribd.com/doc/54920174/26/Sukuk-al-Musharakah> accessed October 2, 2011)

¹⁸ Hasan, Aznan, Partnership Contract in Islamic Banking and Finance, Ahmad Ibrahim Kulliyah of Laws, International Islamic University Malaysia, < <http://www.scribd.com/doc/54920174/26/Sukuk-al-Musharakah> >

¹⁹ Ibid

²⁰ <http://www.kippreport.com/2011/01/sukuk-market-seen-reviving-in-2011-issuance-to-rise-60-pct/?bnr=> accessed October 3, 2011

²¹ Ibid

- Algebra Capital less than \$14 billion Bank
- Muamalat Malaysia between \$20 billion-\$22 billion
- Bank of London and Middle East between \$20 billion-\$22 billion
- CIMB Islamic above \$22 billion
- Credit Agricole CIB between \$20-\$22 billion
- HSBC Amanah between \$14 billion-\$16 billion
- John Sandwick (Islamic asset manager) above \$22 billion
- Malaysian Rating Corp above \$22 billion
- Maybank Investment Bank above \$22 billion
- MIDF Amanah Investment Bank between \$20 billion-\$22 billion
- OCBC Al-Amin Bank between \$20 billion-\$22 billion
- Rasameel Structured Finance above \$22 billion
- Royal Bank of Scotland above \$22 billion
- Unicorn Investment Bank between \$17 billion-\$19 billion.

2.2 Islamic Interbank Money Market (IIMM):

Theoretically, the idiom 'money market' encompasses the market in short term interest-based instruments and the foreign exchange market.²² As money is the life blood of Banks so they largely depends upon the money market in order to manage their liquidity. For liquidity management banks borrow and lend money at interbank rates²³, which are often known as the "Inter-bank Money Market".²⁴

The term "Islamic Interbank Money Market (IIMM)" coined by Obiyathulla Ismath Bacha in his article "The Islamic Inter bank Money Market and Banking System: The Malaysian Experience" (2008). When there is a consideration of Islamic concepts, the concept of interest is not allowed according to Islamic Shariah. Islamic financial institutions enjoy the facility for funding and adjusting portfolios over the short-term, and secondly, serving as a channel for the transmission of monetary policy.²⁵ Financial instruments and interbank investment would allow surplus banks to channel funds to deficit banks, thereby maintaining the funding and liquidity mechanism necessary to promote stability in the system.²⁶ Islamic Interbank Money Market (IIMM) refers to such interbank money market where Islamic Shariah is applicable. The first IIMM (<http://iimm.bnm.gov.my/>) was established at January 3, 2011 in Malaysia with the initiative of Bank Negara Malaysia (BNM), the central bank of Malaysia according to the Guidelines on the IIMM published by BNM on December 18, 1993.

²² http://www.islamic-finance.com/c_moneymarket.htm accessed October 2, 2011

²³ Interbank rates refers to the rate of interest charged on short-term loans made between banks. (<http://www.investopedia.com/terms/i/interbankrate.asp#ixzz1ZhaTZkgm> accessed October 3, 2011)

²⁴ http://www.investopedia.com/terms/i/interbank_call_money_market.asp#axzz1ZhCaXKKv accessed October 2, 2011

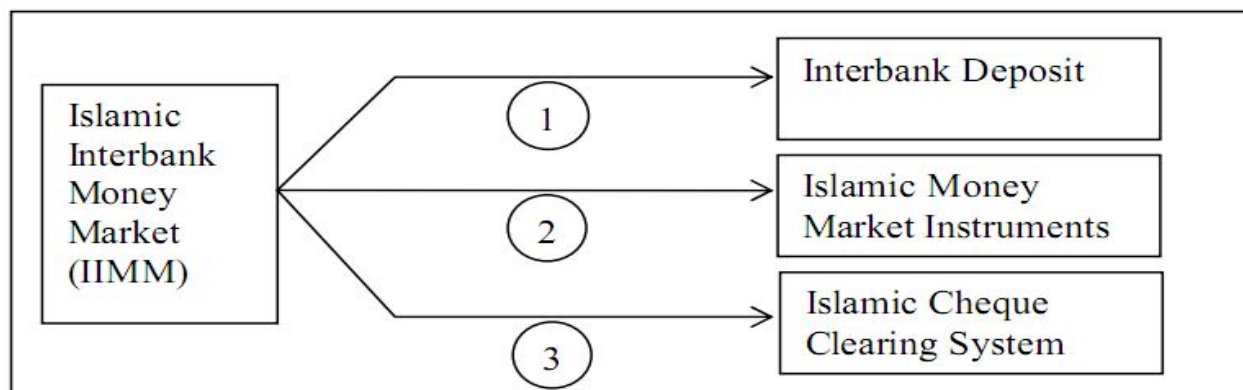
²⁵ <http://answers.yahoo.com/question/index?qid=1006021813630> accessed October 2, 2011

²⁶ Ibid

The significance of Islamic money market has been talked about by Zeti Akhtar Aziz in the 2nd International Islamic finance conference, 22 September 2003, that;

“Today, the Islamic money market has become an integral part of the Islamic financial system, with transactions of more than RM2 billion a day and a broad spectrum of instruments, among which included the Government Investment Issues, Bank Negara Negotiable Notes, Islamic accepted bills and the Islamic private debt securities.”²⁷

Since inception IIMM of BNM is treated as the model of operating and establishing IIMM for any country. The graphical representation of IIMM of BNM is underneath below,

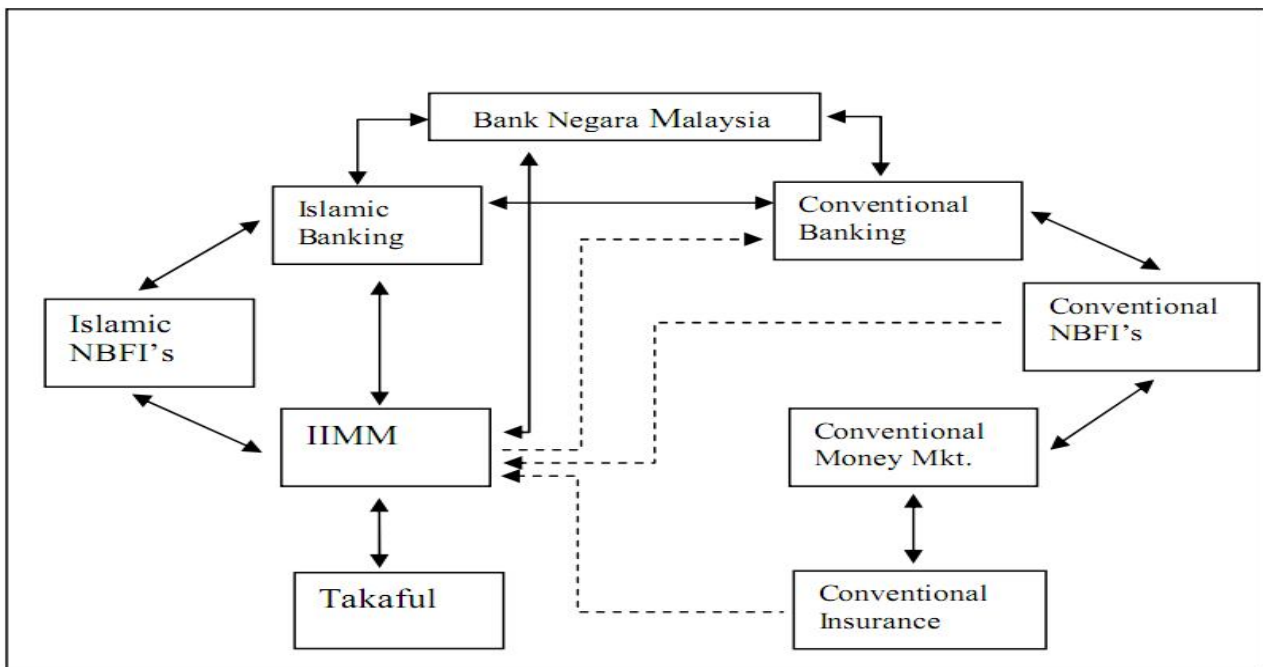


Source : The Islamic Inter bank Money Market and Banking System: The Malaysian Experience by Bacha, O.I (2008)

Malaysia have a dual banking system, i.e., both conventional and Islamic Banking systems. But, they manage effectively a separate Inter bank Money Market for their Islamic financial institutions. The model provided by Obiyathulla Ismath Bacha²⁸ on his article “The Islamic Inter bank Money Market and Banking System: The Malaysian Experience” (2008) which is representing dual Banking and Insurance services of Malaysia. The pictorial representation is underneath below,

²⁷ http://www.applied-islamicfinance.com/sp_money_market_1.htm accessed October 3, 2011

²⁸ Dept. of Business Administration , College of Economics and Management Sciences , International Islamic University, Malaysia



2.2.1 Islamic Money Market Products

In his article “Concept of Islamic Money Market” Prof. Dr. Mohd. Ma’sum Billah mentioned some products that may contain a particular IIMM which are extensively followed in the IIMM of Malaysia^{29, 30}. These are underneath below,

Al-Mudaraba Interbank Investment (MII)

The Al-Mudaraba Interbank Investment (MII) refers to the system whereby an Islami Bank to obtain funds from another Islami bank on a Mudaraba (profit-sharing) basis. The period of investment is from overnight to 12 months. The minimum amount of investment for the MII in Malaysian Ringgit is RM50, 000. The rate of return is based on the rate of gross profit before distribution for investments of one year of the receiving bank, while the profit-sharing ratio is negotiable. When an Islami Bank obtains investment from another Islami Bank for any period, the principal invested is repaid at the end of the period, together with a share of the profit arising from the use of the fund by the receiving bank.

Islamic Inter bank Cheque Clearing System (IICCS)

Islami Banks or IBD (Islami Banking Division) of commercial banks actively involved in the Islamic Interbank Cheque Clearing System (IICCS) at the **Kuala Lumpur Automated Clearing House (KLACH)**.³¹ Banks have to maintain a clearing account at the Bank Negara Malaysia³² on an Al-Wadiah Yad Dhamanah (*guaranteed safe-custody*) basis. Bank Negara Malaysia

²⁹ http://www.applied-islamicfinance.com/sp_money_market_1.htm accessed October 3, 2011

³⁰ http://www.islamic-world.net/islamic-state/malay_islamoneymarket.htm accessed october 4, 2011

³¹ ibid

³² Central Bank of Malaysia

allocates and squares the positions of the surplus and the deficit banks at the midnight clearing. Any surplus funds of the IBD of commercial banks at the midnight clearing are automatically invested with the deficit banks.

Government Investment Certificate (GIC)

Government Investment Certificates were introduced in 1983, with the establishment of the Islamic bank in Malaysia. The government issued for the first time non-interest bearing Government Investment Certificate to meet the special needs of the bank and other corporations who are interested in these securities. Government of Malaysia provides certificates with maturities of one year or more to be issued and for dividend instead of interest, to be paid on the certificates.

Cagamas³³ Mudarabah Bonds (CMB)

Cagamas Mudarabah Bonds were commenced in 1 March 1994. These Bonds are issued based on Al-Mudarabah concept by Cagamas . The purchase of housing debt on Islamic principles by Cagamas is managed based on the Bai' Al-Dayn concept whereas the issue of Cagamas Mudharabah bonds is based on the All-Mudarabah concept. Under this concept the bondholder and Cagamas will share profits according to ratios agreed earlier together. The agreements pertaining to the purchase of housing debt based on Islamic principles will be sealed between Cagamas Berhad and Bank Islam Malaysia Berhad.

Islamic Accepted Bills (IAB)

Islamic Accepted Bills as an order to a bank by a bank customer to pay a sum of money at a future date. When the bank endorses the order for payment as accepted, it assumes responsibility for ultimate payment to the holder of the acceptances. These bills can be used for import or purchase and export for sales, with one condition, the trade of "halal" goods.

"Green" Bankers Acceptance

Banks may purchase BA issued by other banks (inclusive of conventional banks) provided that it is a "halal" BA. To be considered as "halal", the BA must be:

- An export or sales BA
- Drawn to finance "halal" goods or commodity.

³³ **Cagamas Berhad (Cagamas)**, the **National Mortgage Corporation**, was established in 1986 to promote the broader spread of house ownership and growth of the secondary mortgage market in Malaysia. It issues debt securities to finance the purchase of housing loans from financial institutions and non-financial institutions. Cagamas is the leading issuer of AAA debt securities in Malaysia as well as one of the top Sukuk issuers in the world. (<http://www.cagamas.com.my/index.html> accessed October 4, 2011)

Repurchase Agreements

Although the application of repo in Islamic banking is not exactly the same as the conventional repo, the conceptual framework is still the same. The Sell and Buy Back Agreement (Islamic Repo) are underneath below³⁴

1. Under the Sell and Buy Back Agreement (SBBA), the transacting parties shall enter into two separate agreements as follows:
 1. First agreement – the seller (owner) of INI sells and the buyer (investor) buys the instrument at a specified price agreed by both parties; and
 2. Second agreement – a forward purchase agreement whereby the buyer (investor) promises to sell back the INI to the original owner who shall buy it back at a specified price on a specified future date.
2. Ownership of the INI shall be transferred to the buyer (investor) upon conclusion of the first agreement of the SBBA.
3. An INI may be sold under SBBA, subject to the following conditions:
 - (i) An Issuer shall not buy its own INI under SBBA; and
 - (ii) The tenor of the SBBA must be within the tenor of the INI used for the transaction.
4. The INI used for the SBBA is not required to be delivered, unless otherwise agreed by the two transacting parties.
5. Where the SBBA transaction involves an INI that does not pay interim dividends or coupon profits (as in the case of NIDC), the amount of proceeds receivable by the seller under the first agreement of the SBBA shall not exceed the nominal value of the INI.
6. A licensed financial institution may provide on a regular basis a two-way quotation either by quoting rates or profit-sharing ratio to indicate its willingness to enter into SBBA.
7. Upon its release, the Guidelines on Sell and Buy Back Agreement shall govern SBBA transactions involving INI.

Islamic Private Debt Securities

Islamic Private Debt Securities (IPDS) has been introduced since 1990 at Malaysia and currently operating through Bai Bithaman Ajil, al-Musharakah, al-Mudharabah, Qardul Hassan, Murabahah etc.

The IDS note is the substantiation of debt for the sum, which is hitherto to be repaid. The loan will be repaid by liquidating the IDS after certain epoch of time. The IDS is issued together with the Transferable Subscription Right (TSR³⁵).

³⁴ http://www.islamic-world.net/islamic-state/malay_islamoneymarket.htm accessed October 4, 2011

Preparation of Bangladesh Bank for IIMM:

Albeit, Bangladesh Bank is not finally establish any rules regarding separate Islamic Interbank Money Market in Bangladesh, they just plan to modify the existing “Islamic Investment Bond Rules-2004”.³⁶ They take some plan regarding it which are underneath below,

- Islamic Bond will be converted into an auctionable instrument among the Islamic banks in order to help in liquidity management.³⁷
- Introduction of repurchase agreement (repo) and reverse repo among the Islamic banks through using the Islamic bond.³⁸
- Duration of existing bonds will be reduced. The new duration will be from one month to six months.³⁹
- Bangladesh Bank will arrange auction on the basis of PSR (Profit Sharing Ratio). In this regard Bangladesh Bank acted as a trustee.⁴⁰

Bangladesh Bank has asked seven Islamic banks and two non-banking financial institutions (NBFIs) to submit their proposals.⁴¹ The last date of submitting proposals by Islami Banks and NBFIs was 22nd September.⁴² BB will submit a plan to MoF, Government of Peoples, Republic of Bangladesh for approval.

CONCLUSION:

If truth be told it is a pragmatic step of Bangladesh Bank to establish Islamic Interbank Money Market. In this regard, I want to draw their attention towards the model proposed by Obiyathulla Ismath Bacha concerning Islamic Interbank Money Market in Malaysia where they efficiently and effectively manage their dual banking systems. By following this model, I hope Bangladesh Bank will efficiently and effectively manage dual money market. Every concerning parties should be cooperative with Bangladesh Bank in this perspective because, it is a huge task. It will be blessings for Islamic finance in Bangladesh in smooth operation and prohibition of interest from the economy.

³⁵ The TSR is the form of a “gift” (hibah) to the holder of the papers. (http://www.islamic-world.net/islamic-state/malay_islamoneymarket.htm accessed October 4, 2011)

³⁶ http://www.businessnews-bd.com/index.php?option=com_content&view=article&id=3900:central-bank-moves-to-amend-islamic-bond-rules-&Itemid=65 accessed September 30, 2011

³⁷ http://www.thefinancialexpress-bd.com/more.php?news_id=144891&date=2011-08-03 accessed September 30, 2011

³⁸ Ibid

³⁹ <http://www.dailynayadiganta.com/~ndiganta/details/1479> accessed September 30, 2011

⁴⁰ Ibid

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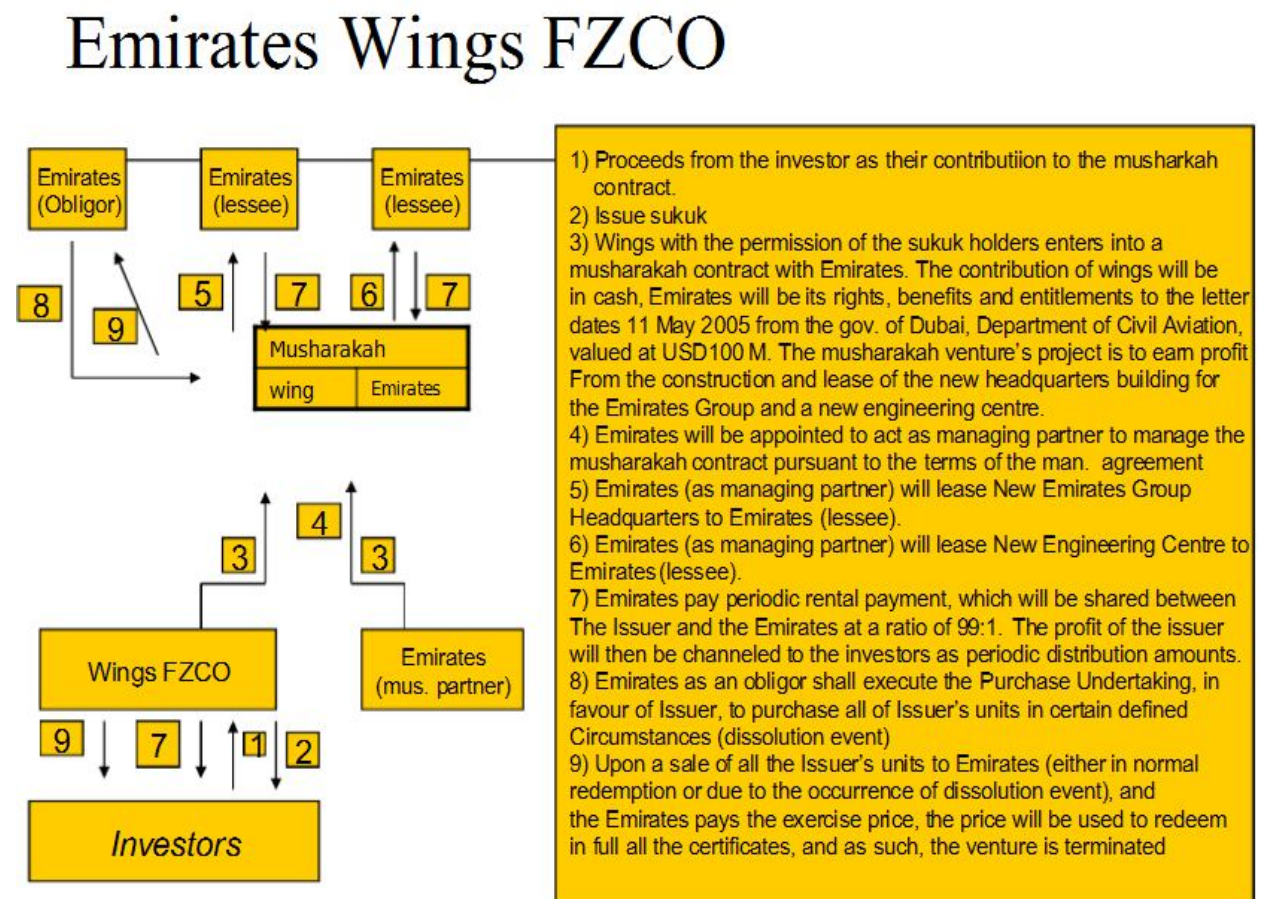
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Appendix

Example of Sukuk Al Musharakah :



Source : Hasan, Aznan, Partnership Contract in Islamic Banking and Finance, Ahmad Ibrahim Kulliyah of Laws, International Islamic University Malaysia, < <http://www.scribd.com/doc/54920174/26/Sukuk-al-Musharakah> >