Tanvir Ahmed Uddin* and Md Fazla Mohiuddin

Islamic Social Finance in Bangladesh: Challenges and Opportunities of the Institutional and Regulatory Landscape

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Abstract: From the end of World War Two, the core methodology of law and development projects has been to transplant the best legal institutions of Western capitalism to poor and emerging economies. In many post-colonial contemporary Muslim-majority countries, such programs have not adequately engaged with local legal systems, cultures and traditions. Contrary to the restrictive modernist approach to law and development, and inspired by the *Sharia*, there are numerous Islamic social finance mechanisms that can be utilised for poverty alleviation and their existence is evident across Bangladesh. These cover the full spectrum of philanthropic to financing, investments and insurance built upon *Sharia* norms and principles. Unfortunately, the true potential of Islamic social finance is considerably constrained by the weak regulatory and policy environment. Islamic social finance does not feature in national development plans, is regulated through a patchwork framework, and operates at a negligible scale. This paper provides a detailed analysis of the existing regulatory and institutional landscape of Zakah (obligatory almsgiving), *awqaf* (perpetual endowments), Islamic microfinance and microtakaful (micro-insurance) in Bangladesh and examines the potential and challenges for Islamic social finance to reduce poverty. Thereafter, several pertinent policy and institutional recommendations are provided to effectively modernise and advance the effectiveness of Islamic social finance institutions. The methodology employed is a mixed approach incorporating literature review, legal analysis of laws and regulation and contextual analysis and field interviews among industry stakeholders. Ultimately, while private investment and initiatives are always able to support the Islamic social finance sector, this paper focuses on the extent to which the regulatory and policy environment is a crucial enabler for widespread and sustained development impact.

***Corresponding author: Tanvir Ahmed Uddin,** University of Sydney Law School, University of Sydney, New South Wales 2006, Australia, E-mail: tudd0787@uni.sydney.edu.au
Md Fazla Mohiuddin, BRAC Business School, BRAC University, Dhaka, Dhaka, Bangladesh, E-mail: m.fazla@bracu.ac.bd

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1 Introduction

As directed by major multilateral and bilateral development organisations, the field of law and development has led to the sponsorship and implementation of many law reform projects with development objectives.[1] Ordinarily, the methodology has been to transplant the best legal institutions and norms of Western capitalism to poor and emerging economies by way of privatisation and deregulation of the economy.[2] However, the success of law and development programs has been limited and criticisms continue to be made against its limited view of development, inability to connect with local legal systems, cultures and traditions[3] and appropriately adapt to local socioeconomic conditions.[4] To complement national development programs and to fill implementation gaps where religious identity remains strong, alternative poverty alleviation programs and methodologies are essential.

As the fourth largest Muslim country in the world,[5] Bangladesh has featured Islamic social finance[6] institutions and programs since the arrival of Islam in the seventh century AD.[7] Unfortunately, the true potential of Islamic social finance is considerably constrained by the weak regulatory and policy environment. To

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1 Yong-Shik Lee, *General Theory of Law and Development*, 50 Cornell International Law Journal (2017), 415–471, at 418.

2 *Ibid*.

3 See B.Z. Tamanaha, *The Primacy of Society and the Failures of Law and Development*, St. John's University Legal Studies Research Paper Series no. 09-0172 (December, 2009).

4 Lee (2017), *supra* note 1, at 444.

5 Pew Forum on Religion and Public Life, *The Future Global Muslim Population* (2011), available at: <http://www.npdata.be/Data/Godsdienst/PEW/FutureGlobalMuslimPopulation-WebPDF.pdf>, accessed August 15, 2019.

6 In this paper, we adopt the Islamic Research and Training Institute's definition of Islamic social finance as funding mechanisms to enhance welfare through philanthropic or not-for-profit means. However, we note that at least with microfinance, institutions can also be for-profit while focused on philanthropic outcomes. It is possible to expand this definition to include social enterprises which also aspire for social outcomes alongside profit. See Islamic Research and Training Institute, *Islamic Social Finance Report* (2017), available at: <http://www.irti.org/English/News/Documents/IRTI%20Islamic%20Social%20Finance%20Report%202017.pdf>, accessed February 12, 2017.

7 M.A. Karim, "Social History of the Muslims in Bengal" (Dhaka: Asiatic Society of Pakistan, 1958), cited in S. Islam and S. Miah (eds.), *Banglapedia: National Encyclopedia of Bangladesh* (2nd ed., Dhaka: Asiatic Society of Bangladesh, 2012).

realise Islamic social finance's full potential in facilitating short and long-term poverty eradication, a clearer policy framework coupled with enabling regulations is crucial. However, greater focus on robust economic growth-funded infrastructure and economic programs coupled with the recent crackdown on Islamist parties and Islamic organisations, the policy environment is unlikely to change soon. While private investment and initiatives are always able to support the Islamic social finance sector, this paper focuses on the extent to which the regulatory and policy environment is a crucial enabler for widespread development impact.

Responding to criticisms of the Islamic banking and finance (IBF) industry (that it largely replicates conventional finance[8] and has only marginal positive social impact[9]), we examine the potential and challenges for Islamic social finance to reduce poverty. In pursuit of that objective, this paper will examine the regulatory and institutional environment of Islamic social finance in Bangladesh. The methodology employed is a mixed approach incorporating literature review, legal analysis of laws and regulation and contextual analysis and field interviews among industry stakeholders. This paper is structured as follows. First, we provide a background of the IBF sector in Bangladesh as it is a major enabler and funder for *Sharia*-based financial institutions and products. Next, we explore the institutional structures and regulatory frameworks for various Islamic social finance mechanisms. Then, we discuss the challenges of regulatory and policy neglect. Finally, we provide recommendations to enable Islamic social finance to reach its full potential to alleviate poverty at scale.

2 IBF Landscape in Bangladesh

2.1 Background on Bangladesh

Despite recurrent political upheavals from the earliest grim days of her violent birth in 1971, Bangladesh has shown incredible resilience with an economy

8 See M.A. El-Gamal, *Islamic Finance: Law, Economics and Practice* (Great Britain: Cambridge University Press, 2006).
9 See e. g., M. Asutay, *Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Banking and Finance: Examining the Overpowering of Homo Islamicus by Homo Economicus*, 2 IIUM Journal of Economics and Management (2007), 167–176.

growing at over 6% for the past decade.[10] Through the combined efforts of government social programs, private sector investment (especially in the garments sector), remittances and non-government organisations (NGOs), an estimated 50 million people have moved out of poverty between 1991 and 2016.[11] Despite immense progress on various development indicators[12], Bangladesh faces significant challenges with improving living standards equitably and generating dignified employment for all. Innovative programs are required to eradicate poverty and promote sustainable development especially where 87% (2016) of the rural population derive at least some of their income from agriculture.[13] Among development priorities, access to finance for micro, small and medium-sized enterprises (MSMEs) has been cited as a major constraint for employment growth and poverty eradication in Bangladesh.[14]

2.2 IBF Policy Framework

Another feature of Bangladesh's economic landscape has been the emergence of IBF. We first examine the IBF sector as it is a major source of funds and driver of institutionalised Islamic social finance. Bangladesh's Islamic banks have been effective in capitalising on the huge growth opportunities arising from the ready-made garments (RMG) sector and remittance economy. These factors have contributed to

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10 D. Kopf, *One of the World's Happiest Economic Stories Comes from South Asia, but not India*, Quartz (May 28, 2017), available at: <https://qz.com/964114/the-happiest-economic-story-in-the-world-right-now/>, accessed August 24, 2019.

11 *Ibid.*

12 United Nations Development Programme, *Human Development Report 2016* (2017), available at: <http://hdr.undp.org/sites/default/files/2016_human_development_report.pdf>, accessed August 24, 2019. The Multidimensional Poverty Index is a composite poverty index that takes into account non-income dimensions of poverty such as access to public services or type of family housing.

13 The World Bank, *Agriculture Growth Reduces Poverty in Bangladesh* (May 17, 2016), available at: <http://www.worldbank.org/en/news/feature/2016/05/17/bangladeshs-agriculture-a-poverty-reducer-in-need-of-modernization>, accessed August 22, 2019. The agricultural sector is also relatively more vulnerable due to a range of external shocks led by climate change and adverse global food prices. See C.P. Timmer, *Agriculture and Pro-Poor Growth: An Asian Perspective*, Center for Global Development Working Paper Number 62 (2005), available at: <http://siteresources.worldbank.org/INTAFRSUMESSD/Resources/1729402-1150389437293/Timmmer_Ag_and_PPG_CGDEV_WP63.pdf>, accessed August 22, 2019.

14 Z. Bakht and A. Basher, *Strategy for Development of the SME Sector in Bangladesh*, Bangladesh Institute of Development Studies (BIDS) (2015), available at: <http://www.plancomm.gov.bd/wp-content/uploads/2015/02/2_Strategy-for-Development-of-SME-in-Bangladesh.pdf>, accessed August 22, 2019.

make Bangladesh the largest Islamic banking market outside the Gulf and Malaysia.[15] Despite the noticeable prominence of IBF in Bangladesh, in contrast to countries like Indonesia and Bahrain, Islamic finance is not a major policy priority for the government. There is no unified legislation like Malaysia's *Islamic Finance Services* Act (2013)[16] and Indonesia's *Law No. 21/2008 on Sharia Banking*.[17] Islamic finance also does not feature in the Seventh Five Year Plan (2016–2020), the latest national development plan.[18] Supreme Court caselaw also confirmed that Islamic banking is operating under mainstream banking legislation rather than its own regulatory framework.[19] Overall, regulatory neglect could be undermining Bangladesh's IBF sector because financial system regulation has a statistically significant influence on output and growth especially where reliant on international funds.[20]

A major reason for the lack of top-down priority is Bangladesh's complex socio-religious politics that have remained since independence and is exacerbated by the clampdown on religious extremism in recent years. Bangladesh's secular outlook, as extended by the current Awami League alliance government,[21] has generally created a challenge for governments to appease the Muslim-majority populace without being seen to promote religious-based politics. Saleh Uddin Ahmed, the former governor of Bangladesh Bank, argues that due to recent terrorist attacks such as in Holey Artisan Café in Dhaka in July 2016[22] and the general heightened terrorism concerns in a post-9/11 world, any Islamic financial framework would be perceived as "Islamising" the

15 Ernst Young, *World Islamic Banking Competitiveness Report 2016–17* (2017), available at: <http://www.ey.com/Publication/vwLUAssets/ey-world-islamic-banking-competitiveness-report-2016/%24FILE/ey-world-islamic-banking-competitiveness-report-2016.pdf>, accessed June 8, 2018.

16 Islamic Financial Services Act 2013, Act no. 758 of 2013.

17 Law no. 21/2008 on Sharia Banking.

18 General Economics Division (GED) Planning Commission Government of Bangladesh, *Seventh Five Year Plan FY2016-FY2020 Accelerating Growth, Empowering Citizens* (2015), available at: <http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/361/7th_FYP_18_02_2016.pdf>, accessed September 28, 2019.

19 *Islami Bank Bangladesh Ltd and Others v. Abdul Jalil and Others* [2001] 53 DLR 29.

20 Using panel regression techniques, de Serres et al. (2006) showed that financial system regulation has a statistically significant influence on output and productivity growth as well as on firm entry, via the impact on industrial sectors relying more heavily on external sources of funding. See A. de Serres, S. Kobayakawa, T. Sløk and L. Vartia, *Regulation of Financial Systems and Economic Growth in OECD Countries: An Empirical Analysis*, OECD Economic Studies no. 43/2 (2006), available at: <http://www.oecd.org/finance/monetary/40505986.pdf>, accessed July 24, 2016.

21 M.N. Islam and M.S. Islam, *Islam, Politics and Secularism in Bangladesh: Contesting the Dominant Narratives*, 7 Journal of Social Science, no. 2 (2018), 37–54, at 49, available at: <https://www.mdpi.com/2076-0760/7/3/37>, accessed February 7, 2017.

22 S. Hammadi, *Dhaka Café Attack Ends with 20 Hostages among Dead*, The Guardian (July 3, 2016), available at: <https://www.theguardian.com/world/2016/jul/01/dhaka-bangladesh-restaurant-attack-hostages>, accessed October 24, 2017.

financial sector and enabling terrorism to flourish.[23] It could be argued that the recent intense scrutiny of Islami Bank, the largest and most profitable bank of Bangladesh[24], is a vivid illustration of the pro-secular, Awami League government's fear that Islamic economic institutions could facilitate terrorism and extremism. This view was iterated by Azam, a senior office at the Ministry of Cooperative, who highlighted the government's general reticence to engage with Islamic finance.[25]

With the backdrop of enhanced surveillance of opposition parties including Islamist ones and institutions such as banks and businesses believed to be affiliated with them, Islamic banking has become increasingly politicised. When Bangladesh Bank provided adjunct regulatory guidelines to bring Islamic banking within mainstream banking regulation, the sector was seemingly able to avoid attracting much political attention. In contrast, this phenomenon is not apparent in other Muslim-majority countries such as Indonesia and Pakistan where Islamic banking is viewed as an essential feature of a stable, financial sector. Ultimately, the policy ineptitude, as noted by Central Sharia Board of Islamic Banks' (CSBIB) Secretariat Manager, Shakhawat Islam, is proving costly for IBF to increase market share.

Secondly, Bangladesh's successful economic growth and development run (she has reached lower middle-income status[26]) raises the question of whether there is any need for Islamic social finance. In addition to continuous expansion since 1975,[27] Bangladesh is one of the few countries to have made major strides towards the millennium development goals. As noted by Basu, a major difference between Bangladesh and Pakistan has been the empowerment of women within domestic and public spheres.[28] Women empowerment was a key factor in Bangladesh's slower population growth of 1.1% compared to 2.0% in Pakistan.[29] In discussing

23 Saleh Uddin Ahmed (June 26, 2017). Personal interview.

24 J.N. Alo, *Islami Bank: Profit Falls as Bad Debts Rise,* The Daily Star (August 4, 2017), available at: <https://www.thedailystar.net/backpage/islami-bank-profit-falls-bad-debts-rise-1443331>, accessed July 12, 2018.

25 Azam Sadat (August 29, 2019). Personal interview.

26 World Bulletin, *Bangladesh Becomes Lower-Middle Income Country*, available at: <https://www.worldbulletin.net/asia-pacific/bangladesh-becomes-lower-middle-income-country-h161630.html>, accessed August 28, 2019.

27 GDP Inflation, *Economic Indicators of Countries*, available at: <https://www.gdpinflation.com/2014/05/bangladesh-gdp-growth-rate-from-1972-to.htm>, accessed August 26, 2019.

28 Bangladesh is ranked first among South Asian countries in the Global Gender Gap Index and 48th in the world. World Economic Forum, *Global Gender Gap Report* (2018), available at: < https://www.weforum.org/reports/the-global-gender-gap-report-2018>, accessed August 27, 2019.

29 K. Basu, *Why Is Bangladesh's Economy Booming?*, Livemint, October 1 2019, available at: < https://www.livemint.com/Opinion/6avW0qZka0ZT1cVaT0UEPK/Why-is-Bangladeshs-economy-booming.html>, accessed August 27, 2019.

integrating Islamic social finance within the Ministry of Cooperative's programs and national development programs, Azam said that the government is not concerned about financial resources – a gap which Islamic social finance could potentially fill.[30] With almost $9 billion allocated in the FY20 budget, significant sums of money have been earmarked for development and poverty alleviation programs.[31] Furthermore, the government is confident that the existing national development priorities can achieve economic development aspirations and past policies have achieved much success without the need for Islamic social finance. Arguably, major infrastructure spend, pro-women policies and enablement of RMG exports are likely to have greater economic development and remain domains for policy focus in the foreseeable future.

A third reason for the lack of Islamic financial law is limited understanding of IBF. Ahmed explained that in his dealings with the government, many political leaders and bureaucrats failed to appreciate IBF's differences with conventional finance and its complexities.[32] As a result, they find it easier to lump the two systems together. Mohammad Shamsul Alam, of the Ministry of Finance, explained how he was seeking support from the Islamic Development Bank to conduct training so his staff will be better equipped to develop supportive IBF policies.[33] Consistent with general public perceptions, most policy makers and bureaucrats are largely ignorant of the basic differences let alone the intricacies of Islamic finance. Ultimately, lack of a proper enabling environment for Islamic finance has prevented Bangladesh from marketing itself as an Islamic finance hub. This reduces the potential for foreign investment and the transfer of innovative practices and technologies to the local IBF sector.[34]

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30 Azam Sadat (August 29, 2019). Personal interview.

31 Centre for Policy Dialogue, *An Analysis of the National Budget for FY2019-20*, available at: <https://cpd.org.bd/wp-content/uploads/2019/06/Presentation-on-CPD-Budget-Dialogue-FY-2019-20.pdf>, accessed August 26, 2019.

32 Saleh Uddin Ahmed (June 26, 2017). Personal interview. To bridge the education gap, the Central Sharia Board of Islamic Banks has conducted numerous Islamic banking workshops in recent years with Bangladesh Bank and other related ministries.

33 Mohammad Shamsul Alam (May 18, 2016). Personal interview.

34 The lack of a distinctive regulatory framework has been noted by major foreign Islamic banks such as Dubai Islamic Bank as a reason for not expanding to Bangladesh despite its high market potential. Adnan Chilwan, (August 20, 2016). Address at Cambridge Islamic Finance and Leadership Program, Cambridge United Kingdom.

2.3 Regulation of Islamic Banking and Finance

Without an independent legislative framework, IBF institutions are regulated through a patchwork of conventional banking and finance regulations.[35] This approach constrains IBF's full development because the government's underlying premise is that Islamic financial institutions should be regulated the same as the conventional sector. As the apex body responsible for regulating the monetary and financial system,[36] Bangladesh Bank has issued specific Islamic banking guidelines to support the sector with licensing, reporting and product guidance. Beyond banking, the Securities Exchange Commission regulates Islamic capital markets and the Insurance Development and Regulatory Authority (IDRA) oversees the insurance sector. Islamic bank depositors are also protected by Bangladesh Bank's deposit insurance protection system.[37] Amendments and additional clauses have been incorporated in the *Banking Companies Act* (1991)[38] and the Income Tax Ordinance (1984)[39] so that Islamic financial institutions operate equitably from a regulatory and tax perspective.[40] For instance, Islamic trade-based financing typically involves dual asset sales. Without dispensation, such financing modes would attract double taxation through two sales steps from the vendor to the financial

35 The applicable regulatory schemes are the Bank Company Act 1991; Companies Act 1994, the Securities and Exchange Rules 1987, the Securities and Exchange Ordinance 1969; Securities and Exchange Commission Act 1993; Value Added Tax Act 1991; The Financial Institutions Act 1993, and Insurance Development and Regulatory Authority Act 2010.

36 See Bangladesh Bank, Central Bank of Bangladesh, *About Us*, available at: <https://www.bb.org.bd/aboutus/index.php>, accessed March 25, 2018.

37 All scheduled banks/commercial banks including the branches of foreign banks functioning in Bangladesh are covered under the Deposit Insurance Scheme managed by Bangladesh Bank with effect from August 11, 1984. Membership is now compulsory for all scheduled Banks as provided under Art.4 (Ka & Kha) of The Bank Deposit Insurance Act 2000, Act no. 18 of 2000.

38 Bangladesh Banking Companies Amendment Act 1991, Act no. 14 of 1991. Guidelines include definitions of Islamic banking (s 1), criteria for setting up full-fledged Islamic banks (s 2), the "fitness" criteria of SSCs members (Appendix 1), guidelines on preparation of financial statements (Appendix 2) and the framework for determining the rate of return (Appendix 3).

39 Income Tax Ordinance 1984, Ordinance no. 36 of 1984. This amendment enabled the amount of profit shared by investment clients and profit paid in *mudaraba* deposits in Islamic banks to be considered as 'expenditure'.

40 For instance, as of 2015, Islamic banks can maintain a lower statutory liquidity ratio (11.5%) than their conventional counterparts. Islamic banks can also invest 90 taka per 100 taka of deposits whereas for conventional banks, the limit is 82 taka. These distinct rules enable Islamic banks to invest more of their capital to generate returns while conventional banks can invest in a larger universe of assets. S. Rahman, *Bangladesh Bank Bars Traditional Banks from Islamic Banking*, The Daily Star (July 29, 2015), available at: <http://www.thedailystar.net/business/banking/bb-bars-traditional-banks-islamic-banking-118183>, accessed November 11, 2018.

institution and then the purchaser. The Supreme Court has also ruled that Islamic financial institutions are able to make money claims against defaulters in the *Artha Rin Adalat* (Money Loan Court).[41] The Court explained that the repayment definition under s2(kha) envisages any amount obtained from a bank on condition of repayment regardless of how that is termed under the agreement.[42]

Examining court reports, there is scant guidance on *Sharia* matters pertaining to the operation of Islamic social finance in Bangladesh.[43] The limited judicial treatment reflects limited coverage of *Sharia* matters within the legal system. This in turn is consistent with the relegation of *Sharia* as a personal law system that operates within the broader secular legal framework, a common feature of post-colonial Muslim countries. As highlighted by Menski, the complex socio-politics and transition from colonial regimes to independent nation states lead to challenges in the treatment of religious and customary law.[44] This phenomenon has further generated an impasse in the orderly formation and building of *Sharia* case law across Muslim post-colonial societies and particularly in the multi-ethnic and multi-religious Asian subcontinent. The major domains of *Sharia* in contemporary Bangladeshi society is an extension of the key legislative demarcations from the colonial period and primarily cover personal law matters such as marriage and inheritance law.[45] The lacunae of codified *Sharia* to accommodate contemporary legal issues is most aptly demonstrated by the fact that jurists and barristers continue to refer to legal textbooks such as Principles of Mohammedan Law by Amir Syed[46] on Muslim personal law rather than any cogent jurisprudence based on statutory interpretation and case law.

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41 Artha Rin Adalat Ain 2003, Act no. 8 of 2003, as amended by the Artha Rin Adalat (Amendment) Act 2010, Act no. 16 of 2010.

42 *Alco Hygienic Products Ltd v. Islami Bank Bangladesh Ltd* [2016] 47 DLR 264.

43 Most Islamic finance court reports discuss taxation and debt collection matters as evident from the bulk of Supreme Court cases studied in our sample over the past two decades. For instance, in *K.K.K. Garments Limited v. Islamic Bank Bangladesh Limited And Others* (2009) VI ADC 181, the court recognised the validity of alternative Islamic financing structures and that borrowers are liable to compensate Islamic financial institutions for principal and profits however so characterised in the loan documents.

44 W.F. Menski, *South Asian Muslim Law Today: An Overview*, 9 Sharqiyyat, no. 1 (1997), 16–36.

45 Key pieces of legislation include Succession Act 1925, Act no. 39 of 1925, Muslim Family Laws Ordinance 1961, Ordinance no. 8 of 1961, and Wakf Ordinance 1962, East Pakistan Ordinance no. I of 1962.

46 A.A. Sayed, *Students Handbook of Mohammedan Law* (6th ed., Calcutta: Cotton Press, 1912), available at: <https://ia801306.us.archive.org/15/items/in.ernet.dli.2015.86023/2015.86023.Students-Handbook-Of-Mohammedan-Law-Sixth-Edition_text.pdf>, accessed December 12, 2018.

2.4 *Sharia* Supervision

With no uniform national *Sharia* regulatory framework, Bangladesh's Islamic financial institutions rely on their own *Sharia* Supervisory Committees (SSCs). It is the sole responsibility of each institution's SSC to provide *fatwas* (religious rulings) to assist the institution with *Sharia* compliance in all steps of the product lifecycle.[47] In practice, SSCs appoint *muraquibs* (auditors), bank employees that audit every transaction of every branch including the head office at least once a year.[48] Without standardised rules for most of the history of IBF in Bangladesh, SSCs have tended to directly refer to the *Qur'an* and *Sunnah* as primary sources of religious law coupled with Islamic jurisprudence and scholarship to form their own legal judgments. They occasionally consult international standards-setting bodies such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)[49] and *fatwa* from international scholars such as Sheikh Taqi Usmani.[50] Islami Bank Bangladesh leads other local institutions in audit compliance so far as its international Audit Committee assesses whether their financial statements have followed AAOIFI standards.[51]

Although not applicable to Islamic social finance, the emergence of the CSBIB is leading to greater codification and consistency with *Sharia* guidelines across the Islamic banking sector in recent years. This is partly driven by the

47 Saleh Uddin Ahmed (June 26, 2017). Personal interview.

48 M.A. Mannan, *Islamic Banking in Bangladesh: Progress and Potentials* (2016), available at: <https://islamicmarkets.com/index.php/publications/islamic-banking-in-bangladesh-progress-and-potentials>, accessed July 14, 2019. The *muraquib's* audit report is submitted to the SSC for review, discussion and recommendations through the Member Secretary. The Member Secretary then oversees the proper implementation of the recommendations and submits a report in the subsequent SSC meeting. The SSC's reports are included in the annual report for wider distribution. This process means that SSCs are highly dependent on both the content and the manner with which the *muraquib* gathers information from the organisation. This could compromise the completeness of information and the SSC's independence. Moreover, the process and outcomes can be highly variable from organisation to organisation based on the knowledge, training and interpretation of *Sharia* by SSCs.

49 Created in 1990, AAOIFI has developed 26 accounting standards, 5 auditing standards, 2 codes of ethics and 7 governance standards to generate uniformity in the regulation and reporting of Islamic financial institutions. Including areas such as *Sharia* and ethics, in total AAOIFI have issued 100 standards. See Accounting and Auditing Organization for Islamic Financial Institutions, *About AAOIFI*, available at: <http://aaoifi.com/about-aaoifi/?lang=en#>, accessed January 14, 2015.

50 Joynul Abedin (February 25, 2015). Personal interview.

51 Islami Bank Bangladesh Limited, *Islami Bank Annual Report 2017* (2018), available at: < https://www.islamibankbd.com/annual_report/Annual%20Report%202017.pdf>, accessed May 12, 2018, 308.

voluntary cooperative spirit among leading Islamic banks coupled with Bangladesh Bank's own directive to the sector to standardise *fatwas*. In the absence of legislative imperatives, cordial relationships between the regulator, Bangladesh Bank, and Islamic banks is the key driving force for this development. However, the CSBIB is an independent non-profit organisation and its *fatwas* are only effective to the extent that their members follow it and Bangladesh Bank obligates compliance by Islamic banks. While Islamic finance operates with few restrictions and Bangladesh Bank's guidelines have placed it on an even footing with conventional finance, the policy environment is not particularly supportive for growth and expansion. In the absence of a national policy framework, the lack of systematic standardisation and inconsistent practices undermines the reputation and integrity of the Islamic finance sector in Bangladesh. As will be outlined below, like the lack of an enabling policy framework for IBF, the full potential of Islamic social finance to alleviate poverty cannot be realised in this policy environment.

3 The Role of Islamic Social Finance in Poverty Alleviation

Compared to conventional anti-poverty programs, institutionalised Islamic social finance programs have emerged more recently around the world and in Bangladesh. Without effective policy support and private sector investment, Islamic social finance is disadvantaged in its ability to scale and operate effectively. As a result, innovations in anti-poverty programs in Bangladesh present great competition for Islamic social finance. For instance, Bangladesh has pioneered social enterprises (e. g., BRAC) and microfinance institutions (e. g., Grameen Bank). Despite their smaller aggregate size by assets and scale of operations, Islamic social finance instruments have existed since the arrival of Islam and continue to play an important role across the Muslim world including in Bangladesh. At present there are no complete database records on the number and scale of Islamic social finance institutions in Bangladesh.[52] The principle

52 According to the Association of Muslim Welfare Agencies in Bangladesh (AMWAB), it was noted that at the height of their operations, they had over 350 member organisations. However, their scale of operations has decreased considerably to about 200 today with purportedly many leaving due to increased political and public scrutiny of Islamic organisations (Obaidul Karim (July 16, 2018). Personal interview). See M.M. Salehin, *Islamic NGOs in Bangladesh: Development, Piety and Neoliberal Governmentality* (London/New York: Routledge, 2016).

programmatic institutions that we review below are Islamic microfinance, Islamic *microtakaful* (microinsurance), *zakah* and *awqaf*. Through a systematic recasting of these traditional instruments as complementary modern channels to effect development, the full potential of Islamic social finance could be realised in Bangladesh.

3.1 Islamic Microfinance

Islamic microfinance differs from conventional microfinance as it utilises alternative financing contracts that attempt to avoid the twin *Sharia* prohibitions of *riba* and *gharar*.[53] Although Islamic microfinance makes up less than one per cent of the global microfinance industry,[54] it has expanded rapidly in recent years. A series of studies have noted substantial demand for Islamic microfinance across the Muslim world.[55] This demonstrates immense untapped potential for financial

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53 M.A. Uddin, *Principles of Islamic Finance: Prohibition of Riba, Gharar and Maysir*, International Centre for Education in Islamic Finance, Kuala Lumpur, Malaysia (2015), available at: <https://mpra.ub.uni-muenchen.de/67711/1/MPRA_paper_67711.pdf>, accessed March 5, 2017. For a detailed overview of Islamic microfinance, see, M. Obaidullah, *Introduction to Islamic Microfinance*, IBF Net Limited (2008), available at: <https://ssrn.com/abstract=1506072>, accessed October 14, 2016. *Riba*, or unlawful gain, is a restriction on one party obtaining a higher payoff compared to the other in bilateral contracts without any association with real economic activity, based on an asset of value. It is commonly translated as interest payments which are guaranteed payments that the borrower must pay to the lender with no regard to a physical asset. *Gharar*, is loosely defined as unreasonable uncertainty where there is potential for one party to exploit the other party in terms of limited experience or "chance" outcomes.

54 N. Karim, M. Tarazi, and X. Reille, *Islamic Microfinance: An Emerging Market Niche* (Washington: Consultative Group to Assist the Poor, 2008), available at: <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Islamic-Microfinance-An-Emerging-Market-Niche-Aug-2008.pdf>, accessed January 18, 2017.

55 Surveys commissioned by the International Finance Corporation (IFC) and Frankfurt School of Finance and Management found that 20% of the poor cite religious reasons for not utilising conventional microfinance in Jordan and Algeria. This proportion rises to 40% in Yemen and Syria. Also, a 2008 Consultative Group to Assist the Poor study found similar demand trends in Indonesia, Afghanistan, Pakistan, and the Palestinian territories, and also in the Muslim majority areas of India, Sri Lanka, Cambodia, and the Philippines. Finally, a Bank Indonesia report found 49% of the rural poor in 2000 considered interest non-compliant with *Sharia* and preferred to bank with Islamic financial institutions. See IFC and FINCA, *Business Plan for a Microfinance Institution in Jordan*, Frankfurt School of Finance and Management (Bankakademie International, 2006), IFC and FINCA, *Access to Finance Study in Algeria, Final Report* (Frankfurt: Frankfurt School of Finance and Management, 2016), IFC, *Assessment of MSE Financial Needs in Yemen Final Report* (Washington, D.C.: IFC/The World Bank, December 2007a), IFC. *Syria Microfinance Market Assessment* (Draft Report, Washington, D.C.: IFC/The World Bank, inclusion and poverty alleviation especially where Muslim countries feature large unbanked populations.[56] The demand for Islamic microfinance is similarly very high in Bangladesh. One study found that 80 per cent of respondents prefer *Sharia*-compliant over conventional products. Surprisingly, 45 per cent still prefer Islamic microfinance even if it involves higher borrowing costs.[57] In operational terms, most Islamic MFIs (IMFIs) follow the Grameen "group" lending model.[58] As Obaidullah explains, this model relies on group pressure as an alternative to collateral to mitigate individual default risk.[59]

Islamic banks and Muslim NGOs are the main providers of Islamic microfinance services in Bangladesh. Seeing an untapped opportunity, led by Islami Bank's Rural Development Scheme (RDS), Bangladeshi Islamic banks have rapidly increased their Islamic microfinance services.[60] Meanwhile, Muslim Aid Bangladesh, a leading international charity, uses public donations and subsidised funding from local commercial banks and multilateral organisations, such as the Islamic Development Bank (IsDB), to provide finance to borrowers.[61] As typically subsidised programs, Islamic microfinance products are more affordable for borrowers than conventional ones.[62] RDS' margin rate is 10%[63] while Muslim Aid Bangladesh charges a 12% service charge (*munafa'ah*) for its

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November 2007b), and N. Karim and M. Khaled, *Taking Islamic Microfinance to Scale*, Consultative Group to Assist the Poor (2011), available at: <http://www.cgap.org/blog/taking-islamic-microfinance-scale>, accessed August 2, 2017.

56 L. Klapper and S. Ansar, *Can Islamic Finance Boost Financial Inclusion?* (Brookings Institute, June 8, 2017), available at: <https://www.brookings.edu/blog/future-development/2017/06/08/can-islamic-finance-boost-financial-inclusion>, accessed August 5, 2017.

57 Karim et al. (2008), *supra* note 54.

58 S.H. Bhuiyan, *Social Capital and Community Development: An Analysis of Two Cases from India and Bangladesh*, 46 Journal of Asian and African Studies (2011), 533–545. Islam notes that the similarities in operating models, at least in the case of Islami Bank Bangladesh Ltd.'s Rural Development Scheme extend to group size and formation, meeting frequency, payment modes, and loan durations. See K.M.A. Islam, *Rural Development Scheme: A Case Study on Islami Bank Bangladesh Limited*, 2 International Journal of Finance and Banking Research, no. 4 (2016), 129–138.

59 Obaidullah (2008), *supra* note 53.

60 Social Islami Bank Limited, *Social Islami Bank Limited Annual Report 2016* (2017), available at: <https://www.siblbd.com/annual_report/SIBL%20Annual%20Report%202016.pdf>, accessed March 25, 2019.

61 Islamic Development Bank, *The Fael Khair Program in Bangladesh* (2017), available at: < http://fkprogram.org/>, accessed April 19, 2018.

62 Muslim Aid Australia collects donations around the world and the Islami Bank subsidises RDS through a generous corporate social responsibility budget.

63 K.M.A. Islam (2016), *supra* note 58. RDS charges a profit mark-up of 10% on assets that it re-sells to borrowers. There is a 2.5% rebate in the case of timely repayments.

quard (personal and micro business cash financing) and 13% profit rate for its *bai-muajjal* SME financing product.[64] Unsurprisingly for their low cost, loan recovery rates for RDS[65] and Muslim Aid Bangladesh[66] are typically> 98%.

Due to its scale and influence, almost all impact research has focused on the RDS. Rahman, Jafrullah and Islam's (2008) comprehensive analysis of RDS found that it increased household income and expenditure significantly and clients had a positive opinion of Islamic microfinance due to improving living standards.[67] Hassan and Saleem's (2017) recent study found that the program played an important role in increasing rural women's income and assets.[68] This in turn improved women's financial freedom and self-worth. Other notable benefits of the RDS include their borrower-centric practices that enhance loyalty.[69] During our field interviews, borrowers noted that the distinctive feature of RDS compared to conventional microfinance was the flexibility offered with repayments during hardship and the kind and fair treatment by field officers.[70] In comparing RDS with Grameen Bank using questionnaire data, Bhuiyan (2013) found that the former had a greater positive effect on borrowers' confidence, personal responsibility towards the family, and human capital investments (e. g., sending children to school).[71] Thus, Islamic microfinance can both

64 Muslim Aid Bangladesh, *Annual Financial Reports 2018* (2019). The *quard* product was developed to provide direct cash funding instead of assets/in-kind distribution as is the case of *bai muajjal* and *murabaha*. To cover operating costs, Muslim Aid Bangladesh charges a flat service charge. In comparison the Grameen Bank's general loan product has an annualised interest rate of 20%. See Grameen Bank, *Interest Rate*, available at: <https://www.grameen-bank.net/grameen-bank-interest-rate/>, accessed September 6, 2019.

65 K.M.A. Islam (2016), *supra* note 58.

66 Ariful Islam (July 9, 2018b). Personal interview.

67 M.M. Rahman, M. Jafrullah, and A.T. Islam, *Rural Development Scheme of Islami Bank Bangladesh Limited (IBBL): Assessment and Challenges*, 16 International Journal of Economics, Management and Accounting, no. 2 (2008), available at: <https://journals.iium.edu.my/enmjournal/index.php/enmj/article/view/148>, accessed November 24, 2018.

68 A. Hassan and S. Saleem, *An Islamic Microfinance Business Model in Bangladesh: Its Role in Alleviation of Poverty and Socio-Economic Well-Being of Women*, 33 *Humanomics*, no. 15 (2017), available at: <http://www.emeraldinsight.com/doi/abs/10.1108/H-08-2016-0066?journalCode=h>, accessed June 28, 2018.

69 B. Kustin, *Islamic (Micro)Finance: Culture, Context, Promise, Challenges* (Bill and Melinda Gates Foundation, 2015), available at: <https://docs.gatesfoundation.org/Documents/Islamic%20(Micro)%20Finance%20Culture,%20Context,%20Promise,%20Challenges.pdf>, accessed February 7, 2017.

70 Based on field interviews with RDS beneficiaries in Amin Bazaar in August, 2019.

71 A.B. Bhuiyan and A. Hassan, *Microcredit and Sustainable Livelihood – Empirical Study of Islamic Microfinance in Bangladesh*, 34 Journal of Economic Cooperation and Development, no. 3 (2013), 101–127.

improve social outcomes while potentially addressing the criticisms of conventional microfinance such as notorious heavy-handed debt collection practices.[72]

3.2 Islamic *Microtakaful*

Microinsurance is increasingly recognised as essential to poverty reduction as it protects vulnerable people from risks that could exacerbate poverty. For microcredit borrowers, adequate protection against unforeseen risks can reduce debt obligations and provide capital to assist the breadwinner's family after an insured event such as accident or illness. However, the penetration of microinsurance in Muslim countries is extremely low.[73] One important reason is that many Muslims avoid conventional microinsurance due to their religious convictions.[74] As an alternative, *takaful* operates as a cooperative protection mechanism based on the principles of solidarity and reciprocity.[75] Instead of paying premiums, members make voluntary contributions (akin to donations or *hiba*) into a members' fund to pool risks and jointly guarantee each other's welfare.[76]

72 For criticisms of conventional microfinance, see D. Roodman, *Microcredit Doesn't End Poverty, Despite All the Hype* (Washington Post, 2012), available at: <https://www.washingtonpost.com/opinions/microcredit-doesnt-end-poverty-despite-all-the-hype/2012/01/20/gIQAtrfqzR_story.html?utm_term=.caeeb82c6bef>, accessed October 25, 2016, S. B. Banerjee and L. Jackson, *Microfinance and the Business of Poverty Reduction: Critical Perspectives from Rural Bangladesh*, 70 Human Relations, no. 1 (2016), 63–91, available at: <http://journals.sagepub.com/doi/pdf/10.1177/0018726716640865>, accessed April 13, 2017.

73 International Cooperative and Mutual Insurance Federation (ICMIF), *Microtakaful – Making a Real Difference to People's Lives* (2012), available at: <https://www.icmif.org/news/microtakaful-%E2%80%93-making-real-difference-people%E2%80%99s-lives>, accessed October 24, 2019.

74 H. Ahmed, *Microtakaful: Financial Inclusion and Microtakaful*, Middle East Insurance Review (2014), available at: <http://www.meinsurancereview.com/Magazine/ReadMagazineArticle?aid=35724>, accessed October 24, 2019.

75 See Y. Ali. (trans.), *Qur'an* (Malaysia, Secretariat for Asia Assembly of Ulama, 1995) (chapter 5, v. 2).

76 Erlbeck explains how the core principles of *takaful* avoid major prohibitions as follows: 'The principle of *ta'awun* eliminates elements of *maysir* and *qimar* in *takaful*. Constituents of *gharar* are resolved by the motivation of mutuality and the one-sided contract of donation. The unilateral character of *tabarru* also removes attributes of *riba al-buyu*. *Riba al-nasiah* in addition, is avoided by adherence to *Sharia* confirming investments.' The basic difference between conventional insurance and microtakaful is that the *microtakaful* provider must create two separate funds. One is used to pay administrative and management fees and profits and the other *microtakaful* risk fund is used to pay insurance benefits. A. Erlbeck, *Microtakaful–Insuring the Low-Income People in Accordance with the Islamic Law*, Diploma Thesis in Insurance Economics (Cologne, University of Cologne, 2010), pp. 24–25. See also N.N. Thani, M.R.

Microinsurance in Bangladesh is provided through conventional insurance companies, *takaful* companies, banking and telecommunications companies, and social sector organisations such as NGOs and MFIs. Compared to the total market, *microtakaful's* size and scale remains quite small in Bangladesh.[77] As has been successfully scaled by Allianz-Indonesia,[78] Islamic microfinance-linked *microtakaful* presents a huge market opportunity that remains untapped in Bangladesh. New innovative programs are emerging. For instance, the 2012 tripartite partnership called Bima between Prime Islamic Life Insurance, a leading *takaful* company, Robi, a major telecom operator, and Milvik, a pioneer in emerging markets health services and insurance, was formed to introduce the concept of mobile-based health consultancy and life insurance.[79] In general, *microtakaful* providers face challenges in developing appropriate internal controls and risk management, developing expert human capital and responding to competition amidst increasing underwriting expenses.[80] As is characteristic for much of Islamic social finance in Bangladesh, there have been no major policy developments or endorsements from the Bangladeshi government on *microtakaful*.

3.3 Philanthropic Funding

Zakah and *awqaf* are major sources of funding and contribute greatly to support development in impoverished communities. *Zakah* is one of the five compulsory

Abdullah, and M.H. Hassan, *Law and Practice of Islamic Banking and Finance* (2nd ed., Malaysia: Sweet & Maxwell, 2010), pp. 215–221.

77 A 2007 study revealed that of the 1.8 million new microinsurance policies sold in Bangladesh, only 356,539 were *microtakaful*. See M.S. Alam, *Status of micro insurance in Bangladesh* (n.d.), available at: <https://www.academia.edu/10731676/Status_of_Micro_insurance_in_Bangladesh>, accessed February 8, 2017.

78 Allianz have mastered the principal-agent model of microinsurance service delivery. Globally, they partner with MFIs, telecom operators, cooperatives, banks and retailers to achieve distribution channel efficiency. See Allianz SE, *Emerging Consumers 2016 Full Year Report* (2017), available at: <https://www.allianz.com/v_1490860084000/media/press/document/Allianz_SE_-_Emerging_Consumers_Report_2016FY_2.4_-_20170403_-_MH.pdf>, accessed February 8, 2017.

79 Milvik, *Milvik Robi Partnership* (n.d.), available at: <http://www.milvikbd.com/robi-partnership.html>, accessed February 8, 2017.

80 N. Gor, *Microtakaful Islamic Insurance for Deprived: Innovation, Sustainability and Inclusive Growth*, 3 International Journal of Business, Economic and Law, no. 2 (2013), available at: <http://ijbel.com/wp-content/uploads/2014/01/KLE3223-NIKUNJ-MICROTAKAFUL-ISLAMIC-INSURANCE-FOR-DEPRIVED.pdf>, accessed February 9, 2017.

"Pillars of Islam" which obliges Muslims to transfer a prescribed portion of their wealth to one of the classes of poor and needy as listed in the Qur'an.[81] *Waqf* (pl. *awqaf*) is an inalienable endowment that generates perpetual proceeds for a specific pre-determined class of beneficiaries and usually for a religious or social purpose.[82] *Zakah* and *awqaf* either operate as distributional welfare or are integrated with Islamic microfinance and *microtakaful*. For instance, *zakah* can be distributed through an Islamic MFI to forgive the debts of struggling borrowers. The Islamic Development Bank's Biniog Shathi model, which is piloting *zakah*-based debt forgiveness with Islamic MFI partners could be established widely in Bangladesh.[83] The United Nations Development Programme (UNDP) is also exploring partnerships in Indonesia for innovative use of Islamic social finance such as working with Badan Wakaf Indonesia, the National Waqf Board, and BAZNAS, the national *zakah* collection body to collaborate on the sustainable development goals.[84] Thus, Islamic MFIs are evolving their models to leverage *sadaqa* (charity), *zakah* and *awqaf* to better meet borrower needs.[85]

81 For a detailed description of eligible beneficiaries and estimation of *zakah*, see Obaidullah (2008), *supra* note 53.

82 *Ibid*., M.M. Gaudiosi, *Influence of the Islamic Law of Waqf on the Development of the Trust in England: The Case of Merton College*, 136 University of Pennsylvania Law Review (1988), 1231–1261. There are two major categories of *awqaf*: *waqf khairi* that includes religious *waqf* such as mosques and philanthropic *waqf* such as charitable social services and family *awqaf* (*waqf al-ahli*) where funds are allocated for the benefactor's children and descendant's in perpetuity. In some instances, surplus funds from *waqf al-ahli* are distributed to the poor after fulfilling the beneficiaries' needs.

83 The Islamic Corporation for Development's model, Biniog Shathi, utilises *zakah* funds to support borrowers who face default due to hardship. Subject to stringent oversight, borrowers find relief when they need it most while lenders' credit is not harmed. See Islamic Corporation for Development, *Biniog Shathi*, available at: <http://www.biniog-sathi.com/>, accessed April 28, 2018. We acknowledge that the integration of *zakah* into microfinance programs raises *Sharia* issues particularly around the obligation to repay funds that are provided as charity. Moreover, various models have been suggested by practitioners, but which may not satisfy *Sharia* compliance requirements. One such example is a *zakah* donation-repayment mechanism. This involves distributing *zakah* to a beneficiary to set up an entrepreneurial activity. The entrepreneur then makes principal repayments on the sum of money which is saved in a *zakah* fund. Only the beneficiary can access in the future when they have made complete repayments on the initial disbursed amount or when they have defaulted.

84 See UNDP, Islamic Finance Partners, available at: <https://www.undp.org/content/undp/en/home/partners/islamic-finance.html>, accessed September 27, 2019.

85 See generally, Obaidullah (2008), *supra* note 1.

3.3.1 *Zakah*

In 2012, it was estimated that the global annual *zakah* potential was between $200 billion and $1 trillion.[86] Many authors such as Ali and Hatta[87] and Hassan and Khan[88] have observed that the scale of *zakah* can substantially contribute to poverty reduction from even a small improvement in the efficient collection and distribution of *zakah*. Based on statistical analysis, Debnath argues that *zakah* should replace microcredit as a better alternative to increase income among the impoverished.[89] An Islamic Social Finance Report study estimated Bangladesh's annual *zakah* potential ranges between USD $2.4–5.9 billion or 1–2% of national GDP.[90] Similarly, Hassan estimated that *zakah* can fully support the government's annual development plan where estimated Zakah was equivalent to 43% of the 2004–05 government budget.[91]

However, in 2010, only $1.4 billion USD in *zakah* was formally collected in Bangladesh. The National Zakat Board, run by the Ministry of Religious Affairs' Islami Foundation, oversees the government's *Zakah* Fund collection and distribution program. The Zakat Board plays a minor role (they collected only 14.2 million BDT)[92] compared to the plethora of NGOs and corporate *zakah* funds in

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86 The New Humanitarian, *A Faith-Based Aid Revolution in the Muslim World?*, The New Humanitarian (June 1, 2012), available at: <http://www.thenewhumanitarian.org/report/95564/analysis-faith-based-aid-revolution-muslim-world>, accessed October 13, 2019.

87 A. Ali and Z.A. Hatta, *Zakat as a Poverty Reduction Mechanism Among the Muslim Community: Case Study of Bangladesh, Malaysia, and Indonesia*, 8 Asian Social Work and Policy Review (2014), 59–70, available at: <http://onlinelibrary.wiley.com/doi/10.1111/aswp.12025/abstract>, accessed March 12, 2018.

88 M.K. Hassan and J.M. Khan, *Zakat, External Debt and Poverty Reduction Strategy in Bangladesh*, 28 Journal of Economic Cooperation, no. 4 (2007), 1–38, available at: <http://library.sesrtcic.org/files/article/240.pdf>, accessed April 22, 2018.

89 S.C. Debnath, *The Potential of Zakah Scheme as an Alternative of Microcredit to Alleviate Poverty in Bangladesh*, 14 Ritsumeikan Annual Review of International Studies (2015), 1–12, available at: <http://www.ritsumei.ac.jp/acd/cg/ir/college/bulletin/e-vol.14/vol.14_01_DEBNATH.pdf>, accessed April 14, 2018.

90 Islamic Research and Teaching Institute, *Islamic Social Finance Report 2014* (2014), available at: <http://www.irti.org/English/Research/Documents/Report-2.pdf>, accessed April 20, 2018.

91 M.K. Hassan, *An Integrated Poverty Alleviation Model Combining Zakat, Awqaf and Microfinance*, Proceedings of Seventh International Conference – The Tawhidi Epistemology: Zakah and Waqf Economy (Malaysia: Institut Islam Hadhari, 2010), pp. 262–281, available at: <http://www.ukm.my/hadhari/wp-content/uploads/2014/09/proceedings-seminar-waqf-tawhidi.pdf#page=262>, accessed January 18, 2019.

92 The Daily Star, *Multibillion-Dollar Zakat Fund Remains Underused: Study*, Star Business Report (March 27, 2014), available at: <https://www.thedailystar.net/multibillion-dollar-zakat-fund-remains-underused-study-17386>, accessed January 16, 2018.

Bangladesh. From a state law perspective, payment of *zakah* in Bangladesh is voluntary. Although the *Zakat Ordinance* is not clear on this matter,[93] some commentators have suggested that the private collection and distribution of *zakah* is illegal.[94] In practice, most donors transfer *zakah* through extended family networks usually in their ancestral village.[95] Lacking policy focus, the *zakah* sector has lacked innovation and its potential as a large, recurring funding source is not adequately utilised.

3.3.2 *Waqf*

Awqaf properties have existed in Bangladesh since the arrival of Islam.[96] Karim and Murad (2010) estimated that there were 123,000 mosque *awqaf* in 1983 and 150,000 general *waqf* properties in Bangladesh in 1986 (the last year a *waqf* census was completed).[97] From the total, only 62% *awqaf* were registered formally in writing and 32% were only verbally affirmed.[98] From first use, *awqaf* properties have facilitated various religious and social services ranging from places of worship and education to graveyards, health centres and agriculture lands.[99] Among the beneficiaries, mosques, *madrasahs* and orphanages receive the greatest share of funding because donors are most concerned about supporting core religious services.[100] The focus on religious services ultimately

93 The Zakat Fund Ordinance, Ordinance no. 6 of 1982.
94 A.S. Kallol, *Zakat Fund Runs Dry*, Dhaka Tribune (July 31, 2013), available at: <http://archive.dhakatribune.com/bangladesh/2013/jul/31/zakat-fund-runs-dry>, accessed January 16, 2018.
95 *Ibid*.
96 A.U.F. Ahmad and M.F. Karim, "Opportunities and Challenges of Waqf in Bangladesh: The Way Forward for Socio-Economic Development," in K. M. Ali, M. K. Hassan and A. E. S. Ali (eds.), *Revitalization of Waqf for Socio-Economic Development* (Switzerland: Palgrave Macmillan, 2019), pp. 193–212.
97 M.M. Ahmad, *Management of Waqf Estates in Bangladesh: Towards a Sustainable Policy Formulation*, available at: <http://www.waqfacademy.org/wp-content/uploads/2013/03/Md.-Mokhter-Ahmad-MA.-Date.-Management-of-waqf-estates-in-Bangladesh.-Bangladesh.-IIUC.pdf>, accessed January 6, 2019>.
98 The 1987 *waqf* census is the only published data available on *waqf* so far in Bangladesh. M. F. Karim and M.W. Murad, *An Analysis of Disbursement of Waqf funds and Their Potential in Bangladesh,* 6 Journal of Islamic Economics, Banking and Finance, no. 4 (2010), 87–106. It is worth noting that around 7,940 (6 per cent) *waqf* estates are traditionally registered with no formal registration with the *waqf* Authority.
99 *Ibid*.
100 *Ibid*.

reduces available resources for long-term poverty alleviation. As noted by Ahmad and Karim, due to lack of innovation, Bangladesh considerably lags countries such as Malaysia and Saudi Arabia[101] in meeting the contemporary *awqaf* needs of its population.[102]

Recently, Bangladesh has witnessed the development of cash *waqf* funds such as university endowments.[103] In order to provide funding to beneficiaries, the cash *waqf* fund is kept in an Islamic bank *mudaraba* investment fund or other similar mode.[104] The profits are periodically distributed to beneficiaries as stipulated in the agreement.[105] It must be noted cash *awqaf* were a controversial development under the Hanafi school of law (which dominates Islamic jurisprudence in Bangladesh) and has historically been the subject of scholarly debate.[106]

Evidently there are a multitude of Islamic social finance institutions, with widespread familiarity and prevalence in Bangladesh, to support community development and poverty alleviation. However, as will be argued below, without an effective policy and regulatory enablement, the full potential of Islamic social finance is underutilised to drive development and reduce poverty.

101 *Ibid*. For instance, multibillion-dollar projects such as the ZamZam Towers in Makkah were financed by a *waqf* structure to meet the growing needs of pilgrims. By using the concept of time-sharing bond or *sukuk al-intifa*, ZamZam Towers utilised a Build, Operate and Transfer (BOT) contract. Under this contract, purchasers would buy a unit based on a 28-year lease (a specific time period) in a specific complex of ZamZam Tower. The complex then generates revenues for the Makkah Authority to benefit pilgrims.

102 Ahmad and Karim (2019), *supra* note 96.

103 *Ibid*.

104 F. Khan, *Waqf: An Islamic Instrument of Poverty Alleviation – Bangladesh Perspective,* Proceedings of Seventh International Conference – The Tawhidi Epistemology: Zakah and Waqf Economy (Malaysia: Institut Islam Hadhari, 2010), pp. 65–96, available at: <http://www.ukm.my/hadhari/wp-content/uploads/2014/09/proceedings-seminar-waqf-tawhidi.pdf#page=74>, accessed January 18, 2019.

105 *Ibid*.

106 See Islamic Banker, *Cash Waqf: Hanafi Position*, Islamic Banker, available at: <https://islamicmarkets.com/education/cash-waqf-hanafi-position>, accessed October 13, 2019. Ultimately, the general permissibility of movable and non-permanent objects such as cash has taken precedence. See A.A. Islahi, *Cash waqf: Is It a Usurious Piety*, Islamic Economics Research Center, King Abdulaziz University (Jeddah, KSA: 2006), available at: <https://mpra.ub.uni-muenchen.de/43610/1/Cash_waqf.pdf>, accessed January 18, 2019.

4 Regulatory Environment of Islamic Social Finance

There is no overarching Islamic poverty alleviation framework or policy that brings together disparate Islamic social finance institutions in Bangladesh. In this lacuna Islamic social finance instruments are regulated by a patchwork of regulations that primarily address basic administrative elements. The central obstacle is that Islamic social finance regulations are not designed to enhance their utilisation as instruments for national development. Before analysing the challenges of regulatory neglect, we explore the key government and *Sharia* regulations of Islamic microfinance, *microtakaful*, *zakah* and *awqaf* below.

4.1 Islamic Microfinance

4.1.1 Government Regulation

With no distinct Islamic microfinance regulation, all Islamic and conventional MFIs are regulated by the *Microcredit Regulatory Authority Act* (2006) and supervised by the Microcredit Regulatory Authority (MRA).[107] The MRA's mandate is to license MFIs, supervise their activities and enforce sanctions on those who breach regulations.[108] While the MRA supervises cooperatives, NGOs (the most common type of MFI), MFI companies and cooperative societies, Bangladesh Bank regulates banks and non-banking financial institutions that provide microfinance services. All MFIs must also comply with the regulatory framework under which they are registered such as company and cooperative laws.[109] Many Islamic MFIs operate as NGO-MFIs because they enjoy tax-free status and can borrow from commercial banks. This privilege increases their capacity for lending and financial sustainability.[110] However, NGOs that wish to receive foreign funding must be registered with the NGO Affairs Bureau (NGOAB). According to Human Rights Watch, NGOAB has been operating in a

107 Microcredit Regulatory Act 2006, Act no. 32 of 2006. S.2(21) stipulates that microcredit organisations are those that are registered under any of the specified laws. It is no longer possible to operate as an MFI if an entity is incorporated under The Charitable and Religious Trust Act 1920, Act No 14 of 1920.
108 *Ibid.*, s.9.
109 The table in Appendix 3 provides a list of different entity structures for MFIs in Bangladesh.
110 Y. Suzuki and M.D. Miah, *A New Institutional Approach in Explaining the Underdevelopment of Islamic Microfinance*, 6 Islam and Civilisational Renewal, no. 4 (2015), 468–488.

non-transparent manner, which has made it difficult to source foreign funding.[111] The strictures of the NGOAB coupled with heightened scrutiny of Islamic organisations, has made it difficult for Islamic social finance institutions such as Muslim Aid to raise capital from abroad. This puts them at a considerable disadvantage compared to the late 1990s and early 2000s when conventional MFIs more easily raised overseas funding.

On operational matters, Islamic MFIs must comply with standard MRA regulations such as interest rate ceilings[112], reserve fund requirements[113] and restrictions on the use of the entity's operational funds.[114] Ariful Islam from Muslim Aid Bangladesh notes that due to advances in data recording software and optionality in accounting rules, they are not concerned about reporting *Sharia*-based products within MRA reporting requirements.[115] For instance, Muslim Aid Bangladesh has developed accounting and reporting mechanisms to translate revenue from financing as "service charges" for their *quard* (loan) product.[116] Also, Ariful suggested it is possible to record the earnings from *mudaraba* and *musharaka* as "retained earnings". This is a "work around" solution because MRA's Executive Director stated that the MRA Regulations do not allow profit-and-loss-sharing products. Overall, standard MFI accounting frameworks are not elegant as all financing modes are still recorded under the header of "Loans to Members (Investments)" which is contrary to their *Sharia* definition. In general, it is not uncommon for Islamic MFIs to record their profit mark-ups and member *mudaraba* profit earnings as "interest".[117] Consequently, Islamic MFIs produce financial and audited reports in similar ways to other MFIs with no standardised *Sharia*-based reporting as is the case with Islamic banks.

111 Human Rights Watch, *Bangladesh: Withdraw Restrictive Draft Law on NGOs* (July 5, 2014), available at: <http://www.hrw.org/news/2014/07/05/bangladesh-withdraw-restrictive-draft-law-ngos>, accessed October 12, 2018. The NGOAB was established under the Foreign Donations (Voluntary Activities) Regulation Ordinance, Ordinance no. 46 of 1978.
112 Microcredit Regulatory Authority Rules 2010, art. 18(2).
113 *Ibid.*, art. 20(1).
114 *Ibid.*, art. 19.
115 Ariful Islam (August 25, 2019). Personal Interview. However, Arif did concede that there is no direct mention of profit-and-loss schemes under the MRA Regulations. If Muslim Aid Bangladesh decides to introduce profit-and-loss products such as *musharaka*, they would need to develop a new reporting mechanism.
116 Ariful Islam (June 26, 2018). Personal Interview.
117 A. Nadeem, *Islamic Business Contracts and Microfinance-A Case of Mudaraba* (2010), available at: <https://mpra.ub.uni-muenchen.de/27194/1/Islamic_Business_Contracts_and_Microfinance-A_case_of_Mudaraba.pdf>, accessed March 12, 2017.

When asked about any challenges with Islamic microfinance operations under the MRA Act, both Ariful of Muslim Aid Bangladesh and Mujibur of RDS are not particularly concerned by the regulatory framework.[118] Nonetheless, they note that some amendments would better support Islamic microfinance such as the removal of excise duties on asset financing. Also, as RDS operations are regulated by Bangladesh Bank, they are required to conduct credit bureau searches which is not the case for conventional MFIs. Both Muslim Aid and RDS also expressed a desire for specific regulations to recognise Islamic microfinance at least symbolically to promote their activities in the public domain. Mujibur noted that under the current Islami Bank leadership, some discussions have commenced with Bangladesh Bank to carve out distinct regulations for RDS' Islamic microfinance activities. However, an independent Islamic microfinance framework could take many years to eventuate due to its low priority.

4.1.2 *Sharia* Regulation and Compliance

Due to lack of an overarching national *Sharia* framework, Islamic MFIs make decisions on *Sharia* matters in consultation with independent *Sharia* advisors. Other than commercial banks such as Islami Bank, most non-profits Islamic MFIs including Muslim Aid Bangladesh[119] do not have SSCs and utilise advisors only when required to save costs.[120] Across the IBF sector, the lack of central oversight creates looser standards and inconsistent practices. For instance, where Bangladesh Bank Islamic banking guidelines make it optional to form a SSC,[121] ultimate responsibility for *Sharia* compliance falls on the institution's board of directors.[122] With respect to adopting well-regarded international guidelines, a

118 Enamul Hoque (December 10, 2016). Personal Interview.

119 Ariful Islam (August 25, 2019). Personal Interview. Ariful noted that in fact, the Microcredit Regulatory Authority discouraged them from forming a SSC as there is no dispensation under MRA regulations. The MRA instead suggested that Muslim Aid Bangladesh should arrange independent *Sharia* advisors.

120 M. Obaidullah and T. Khan, *Islamic Microfinance Development: Challenges and Initiatives*, Islamic Research & Training Institute Policy Dialogue Paper no. 2 (2009), available at: <http://dx.doi.org/10.2139/ssrn.1506073>, accessed July 20, 2018.

121 Bangladesh Bank, *Guidelines for Conducting Islamic Banking*, November, 2009, available at: <https://www.bb.org.bd/aboutus/regulationguideline/islamicbanking/islamicguide.php>, accessed July 21, 2018, s. 3. The section states, "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 *Sharia* compliant. The Board *may* form an independent *Sharia* Supervisory Committee with experienced and knowledgeable persons in Islamic Jurisprudence" (emphasis added).

122 *Ibid*.

study of 7 Bangladeshi Islamic banks' financial reports in 2011 showed that only 44.68% of AAOIFI guidelines were followed.[123] For example, the amount of "doubtful" income[124] is also not reported by some institutions.[125] A 2013 study of 17 private commercial banks with respect to AAOIFI governance standards compliance also found significant discrepancies.[126]

At the Islamic microfinance level, the discrepancies are even more stark between NGOs and Islamic banks. While RDS must adhere to guidelines issued by Islami Bank's own SSC and CSBIB fatwas, Muslim Aid Bangladesh relies on a loose set of *fatwas* that their staff have gathered. This has resulted in the latter offering the *quard* product which is not common among Islamic MFIs.[127] In practice, Islamic MFIs adapt standard contracts, such as *bai muajjal* and *murabaha*, that are widespread in the IBF industry. Where the MRA Act does not make any references to Islamic microfinance, Mazedul Haque, the MRA Executive Director, notes that the MRA is thus unable to provide any guidance or directive on *Sharia* matters for Islamic MFIs.[128] Deficiencies and inconsistency in *Sharia* standards make it difficult for lay people and experts to assess and trust the integrity and efficacy of Bangladeshi Islamic financial institutions. The success of the Grameen Bank and BRAC and limited perceived difference

123 See H. Ullah, *Compliance of AAOIFI Guidelines in General Presentation and Disclosure in the Financial Statements of Islamic Banks in Bangladesh* (2013), available at: <https://www.researchgate.net/publication/263847931_Compliance_of_AAOIFI_Guidelines_in_General_Presentation_and_Disclosure_in_the_Financial_Statements_of_Islamic_Banks_in_Bangladesh>, accessed July 24, 2018.

124 Doubtful income constitutes any revenue generated from partaking in forbidden economic activities involving interest or industries such as alcohol, pork, adult entertainment.

125 According to FAS 1, doubtful income refers to non-performing financial assets to indicate the credit risk of a financial institution. *See* AAOIFI. *Shari'a Standards*. Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions, 2010.

126 M. Ahmed and M. Khatun, *The Compliance with Shariah Governance System of AAOIFI: A Study on Islamic Banks Bangladesh* (2013), available at: <https://ibtra.com/pdf/journal/v9_n3_article9.pdf>, accessed July 26, 2018.

127 Muslim Aid's *quard* product generates revenue from a "service charge" which is designed to cover their operational costs. This is based on an opinion that their staff noted from the renowned IBF scholar, A.L.M. Abdul Gafoor, who stated: "The question comes up time and time again about the service charge and whether it's 'riba'. But this is just common sense and not a question of the Sharia. "Riba" is defined as what the lender receives. The Service Charge covers the operational cost and does not go to the lender so it is 'riba – free'." Fatwa document provided by Ariful Islam (August 25, 2019). Personal interview.

128 Mazedul Haque (August 27, 2019). Personal Interview.

between conventional and Islamic microfinance by policy makers, also inhibits more focused attention by policymakers on *Sharia* operational issues.[129]

4.2 *Microtakaful*

Compared to microcredit, microinsurance in Bangladesh suffers from an underdeveloped regulatory environment which has impeded its ability to scale. The Insurance Development and Regulatory Authority Act (2010) was passed to create a new regulatory authority.[130] However, there are neither specific provisions for microinsurance nor *microtakaful* in this legislation. The Act does not permit any entity to conduct any insurance business in Bangladesh unless the IDRA has provided it with a registration certificate.[131] In practice, many NGOs provide microinsurance without IDRA registration[132] because the MRA Act permits MFI-based microinsurance.[133] Hasan notes that policy makers recognise the need for a separate microinsurance regulatory framework but have yet to enact relevant laws.[134]

More than regulation, there are major social and reputation factors that limit the insurance industry's expansion in Bangladesh. The broader social safety net from family and friends tends to provide considerable support in times of crisis. There is also a great deal of mistrust of insurance companies due to lack of transparency and prior breaches of public trust. Reza and Iqbal explain that lack of awareness of the full potential of Islamic insurance and negative propaganda,

129 In his autobiography, Yunus has argued that where borrowers are joint owners of the Grameen Bank, paying interest into pooled funds is not the same forbidden usury in *Sharia*. He notes that Islamic scholars endorse this view without providing any references to specific scholars or *fatwas*. From a *Sharia* perspective, which examines the contract between the borrower and the MFI, the Grameen Bank general loan transaction involves uncertainty and the exchange of unequal funds which is the core of *Riba* – i. e., repayment of interest on top of the loan.

130 Insurance Development and Regulatory Authority Act 2010, Act no. 12 of 2010.

131 *Ibid*., s. 15.

132 See R.A. Hasan, *Microinsurance Facts in Bangladesh* (n.d.), available at: <http://inafiasia.net/download/new/Microinsurance%20Resources/2.pdf>, accessed August 4, 2018.

133 Microcredit Regulatory Act 2006, Act no. 32 of 2006, s. 24(2)(h). This product is typically a credit insurance product to protect beneficiaries and in turn the MFI from default risks. Sophisticated insurance products are not always used. For instance, Muslim Aid Bangladesh charges a 1% risk premium for all member financings to fund a loss provision fund. This is akin to creating a mutual pool for members who voluntarily guarantee each other for default built on the concept of reciprocity and solidarity (*ta'awun*).

134 Hasan (n.d.), *supra* note 132.

such as perceptions of fraud, have limited widespread uptake.[135] Finally, there is widespread disagreement among scholars whether Islamic insurance is in fact different from conventional insurance.[136] Such debates generate confusion and undermine the integrity of the industry. Overall, *microtakaful* is still nascent in Bangladesh and requires a more robust regulatory framework to encourage investment and uptake by customers.

4.3 *Zakah* and *Awqaf*

4.3.1 *Zakah*

Matters of administration and regulations pertaining to *zakah* collection and distribution are governed by the *Zakah Fund Ordinance* (1982). The primary function of the *Zakah Fund Ordinance* is to stipulate the roles and authorities of the Zakat Board and its subsidiary entities in each locality with respect to collection and distribution. The regulation has limited relevance to non-government entities who collect and manage *zakah*. The paucity of regulation demonstrates how little attention the government provides to *zakah* as a redistributive mechanism for poverty alleviation.

4.3.2 *Awqaf*

The *Waqf Ordinance* (1962) as amended by the *Waqf (Transfer and Development of Property) Special Provisions Act* 2013 promulgates rules for the registration, administration and de-registration of *awqaf*.[137] The *Waqf* Administrator fulfils principal supervisory functions as a public officer appointed by the Ministry of Religious Affairs.[138] He or she acts on advice of the *Waqf* Committee,[139] which is the apex *Sharia* and administrative authority responsible for overseeing all *awqaf* in

135 S.M. Reza and M.M. Iqbal, *Life insurance marketing in Bangladesh*, 2 Daffodil International University Journal of Business Economics, no. 2 (2007), 87–103, cited in I. Khan, N.N.B.A. Rahman, M.Y.Z.B.M. Yusoff, and M.R.B.M. Nor, *History, problems, and prospects of Islamic insurance (Takaful) in Bangladesh*, 5 Springer Plus, no. 785 (2016), 1–7.
136 See I. Khan, *Juristical Study of Takaful and Its application in Bangladesh* (University of Malaya: Dissertation, 2015), cited in *Idib*.
137 Waqfs (Transfer and Development of Property) Special Provisions Act 2013, Act no. 5 of 2013.
138 Within the meaning of the Code of Civil Procedure 1908. See *Ibid*., s. 10.
139 *Ibid*., s. 19.

Bangladesh. The *Waqf* Committee's role is to assist and advise the Administrator in supervising *awqaf* and their proceeds.[140] Whilst all formally-registered *awqaf* are regulated centrally,[141] in the case of informal community *awqaf*, the *mutawalli* (*waqf* trustees), beneficiaries and community leaders consult local religious leaders (such as imams) to deliberate on *waqf* matters. A third category of *awqaf* are created as private trusts and also not registered with the Waqf Administrator.[142] Despite scant *Sharia* regulations in the principal legislation, Bangladeshi courts are willing to recognise the importance and influence of *Sharia* sources when adjudicating on *waqf* matters. In *Md. Hafizuddin vs. Mozaffor Mridha & Others*,[143] the Supreme Court relied on the inalienability of *waqf* property as reasoned by Hanafi school *fiqh* to nullify the sale of a duly registered *waqf* property.[144] The Supreme Court's application of widely accepted *Sharia* principles as codified in statute demonstrates how law-making can help support the effective development of Islamic social finance institutions.

The current *awqaf* regulatory framework places much responsibility on the central. The sheer volume of *awqaf* may prove difficult to manage unless the Ministry of Religious Affairs funds more staff and enhances digital systems to simplify registrations, administration and reporting. Another limitation is that the Ordinance defines *waqf* as only permanent movable and immovable property dedicated to pious, religious or charitable purposes.[145] This definition does not contemplate other *awqaf* forms such as cash[146] and intellectual property,[147]

140 The core staff of the *Awqaf* Board include the Administrator, two Deputy Administrators, six Assistant Administrators, eighteen *Waqf* Supervisors, eighteen *Waqf* Auditors, and fifty-four other staff members which brings the total number of staff to ninety-eight. M.F. Karim, *Problems and Prospects of Awqaf in Bangladesh: A Legal Perspective* (Kuala Lumpur: International Islamic University Malaysia, 2010), available at: <http://*waqf*academy.org/wp-content/uploads/2013/02/PROBLEMS-AND-PROSPECTS-OF-*AWQAF*-IN-BANGLADESH-A-LEGAL-PERSPECTIVE-Muhammad-Fazlul-Karim.pdf>, accessed December 11, 2017.

141 Section 47 of *The Waqf Ordinance* (Ordinance no. 1 of 1962) mandates that all *waqf* are to be registered with the *Waqf* Administrator.

142 Ahmad and Karim (2019), *supra* note 96.

143 *Md. Hafizuddin v. Mozaffor Mridha & Others* (Hasan Foez Siddique, J.) 10 SCOB [2018] 12.

144 The Bengal Waqf Act 1934, Act no. 13 of 1934.

145 *Ibid*., s. 2(10).

146 See A.A. Rahman, *Peranan wakaf dalam pembangunan ekonomi umat Islam dan aplikasinya di Malaysia*, 17 Journal *Sharia*h (2009), cited in S.A. Shukor et al., *Muslim Attitude towards Participation in Cash Waqf: Antecedents and Consequences*, 18 International Journal of Business and Society (2017), 193–204. Rahman notes that traditionally *awqaf* were divided into two forms: immovable property (*aqar*) and movable property (*manqul*) which did not encompass fungible money itself. However, after some debate, the Malaysian National Fatwa Council decided that cash *waqf* is permissible.

147 In Indonesia, Law no. 41/2004 on Waqf, art. 16(3)(e), includes intellectual property in its definition of assets eligible for *waqf*. The key condition is that it cannot be reduced through which may allow a wider scope for generating funds and use such as *awqaf*-linked microfinance.[148] Notwithstanding the juristic controversies (for instance, the eligibility of intellectual property), changes in contemporary economic circumstances and financial practices under the juristic principles of *maslaha* (public interest) and *darurat* (essential need) may require exploring alternative *waqf* forms. This is essential where land scarcity limits further land-denominated *awqaf* in densely populated countries like Bangladesh.

5 Challenges Impeding the Success of Islamic Social Finance

The discussion of the policy and regulatory landscape in the previous sections revealed that the patchwork of frameworks is not effectively operating in sync to promote social advancement in Bangladesh. Below, we evaluate the state of Islamic social finance institutions and programs from the angle of policy and regulatory challenges that limit their full potential.

5.1 Lack of Active Government Support

The Bangladesh Government has not shown much enthusiasm for creating a distinct enabling environment for Islamic social finance institutions to thrive. The priority has been on policy guidance to work with NGOs and MFIs in general rather than specific Islamic social finance mechanisms. For example, Chapter 4 of the Seventh 5-Year Plan, which outlines poverty reduction strategies, does not mention Islamic social finance despite calling for greater use of microcredit and private sector participation in poverty alleviation.[149] The lack of governmental policy attention also curtails interest from major donors such as the World Bank

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consumption. For general discussion about intellectual property in Islam see S. Beltrametti, "The Legality of Intellectual Property Rights under Islamic Law," in T. Mach et al. (eds.), *The Prague Yearbook of Comparative Law* (Prague: Anglo-American University, 2010), pp. 55–94. Beltrametti argues that while intellectual property rights are not regulated by Islamic law and jurisprudence per se, a *Sharia*-based system is flexible and adaptable to be used for contemporary intellectual property purposes.

148 For example, *awqaf* funds could be used to subsidise microfinance operating costs to offer low-cost funds for poorer beneficiary segments.

149 Government of Bangladesh, General Economics Division (GED) Planning Commission (2015), *supra* note 18.

and the United Kingdom's Department for International Development. Islam's interviews with leading donors revealed the common perception that since the microfinance sector is considered "mature" and there's little government interest, additional funding and support for Islamic microfinance from multilateral and bilateral agencies will be limited.[150] Such perspectives disregard the fact that Islamic microfinance in Bangladesh is still in its infancy, with limited scale and lacks effective regulatory support.

Regardless, while microfinance is well developed in Bangladesh, microinsurance still has potential for expansion. Specifically, Islamic *microtakaful* models could help expand existing government welfare programs because they emphasise social solidarity over commercial objectives. For instance, government-backed microinsurance pilot projects such as weather index-based crops,[151] fishery livelihoods,[152] and social health insurance[153] could be significantly expanded if *microtakaful* funds were popularised around Bangladesh. Even the government's flagship rural development program, 'One village, One Cooperative', which has the objective of promoting self-help through a single cooperative organisation in each village[154] could benefit from Islamic social finance models. As noted by van Schendel, two major challenges with rural development programs is the inability to protect beneficiaries from the existing stark inequalities (e. g., perpetuation of agricultural "middle-men" and money-lender negative influence) and enhance democratic decision-making.[155] To

150 M.T. Islam, *Prospect of Islamic Micro Finance in Bangladesh in the Context of Regulatory and Funding Perspectives*, Poverty Reduction of Vulnerable Households Through Entrepreneurship Development (PROVED) (DFID PPA program, March 2014).

151 Star Business Report, *Crop Insurance Helping Farmers Weather Storm*, The Daily Star (April 6, 2017), available at: <https://www.thedailystar.net/business/crop-insurance-helping-farmers-weather-storm-1386964>, accessed May 29, 2018.

152 The World Bank, *Bangladesh Livestock Development-based Dairy Revolution and Meat Production Project Pre-Appraisal Mission (Aide Memoire)* (2017), available at: <http://pubdocs.worldbank.org/en/459781506534511528/BD-DRMP-Aide-Memoire-26September2017.pdf>, accessed May 29, 2018.

153 R. Zaman, *Why Illness Needn't Mean Bankruptcy: Lessons from Piloting Social Health Insurance in Bangladesh*, Oxford Policy Management (June, 2018), available at: <https://www.opml.co.uk/blog/why-illness-neednt-mean-bankruptcy-lessons-from-piloting-social-health-insurance-bangladesh>, accessed May 28, 2018.

154 Government of Bangladesh Social Security Policy Support (SSPS) Programme, *Comprehensive Village Development Programme (CVDP) 'One Village One Cooperative' Model*, available at: <http://socialprotection.gov.bd/en/2017/03/04/comprehensive-village-development-programme-cvdp-one-village-one-cooperative-model/>, accessed September 20, 2019.

155 W. V. Schendel, *After the limelight: Longer-term effects of rural development in a Bangladesh Village*, 13 Bulletin of Concerned Asian Scholars, no. 4 (1981), 28–34.

address these challenges, in addition to leveraging latent resources via *awqaf* and *zakah*, the social capital that is required to sustain rural cooperatives could build on religious identity and solidarity-cum-brotherhood (*ta'awun* and *jama'ah*) that are cornerstones of Islamic teachings. We have observed through field interviews in Amin Bazaar and Savar that group membership and the support base, as curated by Islamic MFI staff, was a major basis for group loyalty.[156] Evidence from other countries show how the regulatory environment can support Islamic social finance to thrive. Just as it did for the broader IBF sector, Malaysia's Bank Negara launched an important Discussion Paper in 2016 to examine areas of appropriate regulation to support microinsurance and *microtakaful* development.[157] To realise the benefits of Islamic social finance completely, the Government must recognise it as a set of complementary tools in its national development programs.

Much to the concerns of public interest media and civil society, the milieu of socio-political injustices and over-balance of constitutional powers in Bangladesh in favour of the executive, severely restricts the ability for policy reform via the judiciary. While in other common law jurisdictions such as the United States and India, judicial activism tempers the harshness or incompleteness of statute and precedent, this is unlikely in Bangladesh. Hoque's comprehensive assessment of judicial activism in Bangladesh reveals that there is generally judicial "under-activism".[158] A poignant illustration of this characteristic is the tax exemption treatment of *zakah* under s29(1)(XXVII) of *Income Tax Ordinance*.[159] Lacking broader regulatory reform of *zakah* collection in contemplation of the growing prominence of corporate and non-human legal personhood, the Supreme Court ruled strictly that Islamic financial institutions are not entitled to tax exemptions for paying *zakah* on behalf of their customers.[160] It formulated this ruling on the basis that corporate entities are not obligated to pay *zakah*. Thus, any hope for policy change falls upon political lobbying and submissions for judicial reform via parliament.

156 Muslim Aid Bangladesh (Savar) and Rural Development Scheme (Amin Bazaar) Islamic Microfinance (August 26 and 28, 2019). Beneficiary field interviews.

157 Bank Negara Malaysia, *Microinsurance and Microtakaful*, Discussion Paper 7 (2016), available at: <http://www.bnm.gov.my/guidelines/50_others/dp_microinsuranceandmicrotakaful_Apr2016.pdf>, accessed May 20, 2018.

158 R. Hoque, *Judicial Activism in Bangladesh: A Golden Mean Approach* (1st ed., Newcastle: Cambridge Scholars, 2001).

159 Income Tax Ordinance 1984, s. 29(1).

160 *Islami Bank Bangladesh Ltd v. Commissioner of Taxes* 14 BLC (AD) 145.

5.2 Regulatory Complexities and Roadblocks

The current intertwined regulatory framework adds to the complexity of implementing Islamic social finance. For the microfinance industry, the establishment of the MRA was a major step in simplifying microfinance regulations. However, it did not provide an adequate solution for Islamic MFIs as there are no distinct guidelines like Bangladesh Bank's *Sharia* Banking Guidelines. As a result, Islamic NGO-MFIs have no *Sharia* requirements beyond self-regulation and potential public scrutiny. Moreover, compared to conventional microfinance, the bulk of Islamic microfinance is provided by Islamic banks which are governed by banking regulations. According to Rahman, this creates some disadvantages compared to conventional MFIs such as the imposition of excise duties and credit bureau search fees.[161]

Regulatory simplification and clarity are also required for the development of integrated social finance programs. For instance, existing MRA[162] and Bangladesh Bank[163] rules also do not encompass the incorporation of *zakah* and *awqaf* programs into MFI activities. Instead, government administration boards oversee institutions undertaking solely *zakah* and *awqaf* activities and are incapable of supporting institutions that integrate these social finance instruments. Even so, government administrative functions lack sufficient human resources to manage existing institutions let alone support innovation.[164] Today, there are few examples of successful *zakah*-enhanced Islamic microfinance such as the Centre for Zakat Management[165] and Islami Bank's Zakat House.[166] Beyond regulatory limitations, there is certainly no support or awareness to encourage the use of *zakah* and *awqaf* in long-term development.

161 Mujibur Rahman (August 29, 2019). Personal Interview.

162 Microcredit Regulatory Authority, *MRA Regulations – Unofficial Translation* 2006, available at: <https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-bangladesh-microcredit-regulatory-authority-act-2006-2006.pdf>, accessed March 22, 2019.

163 Bangladesh Bank, *Guidelines for Conducting Islamic Banking*, November, 2009, available at: <https://www.bb.org.bd/aboutus/regulationguideline/islamicbanking/islamicguide.php>, accessed December 22, 2017.

164 Ahmad and Karim estimate that there are an only 98 officers and employees managing nearly 100,000 *awqaf* estates in Bangladesh. Ahmad and Karim (2019), *supra* note 96.

165 Centre for Zakat Management, *Mudareeb – Enterprise Development* (n.d.), available at: <http://czm-bd.org/?page_id, accessed November 2, 2017.

166 M. Hossain, *Zakat Based Poverty Eradication in Bangladesh: The Millennium Development Goal Is Exceedable* (Institute of Hazrat Mohammad (SAW), n.d.), available at: <https://www.researchgate.net/publication/283545868_The_'Ushr_Management_in_Rural_Areas_of_Bangladesh_The_Maqasid_al-Shari'ah_The_objectives_of_Shari'ah_Perspectives>, accessed April 22, 2017.

5.3 Lack of Institutional Standardisation and Professionalisation

Islamic social finance institutions suffer from lack of standardisation of concepts, products and *Sharia* supervision. This has led to inconsistency in *Sharia* compliance and hindered innovation and establishment of operational best practices. Unlike Malaysia and Bahrain, there is no regulatory framework in Bangladesh to establish minimum professional standards. For international investors, the lack of standard rules creates uncertainty and risks with IBF in Bangladesh.[167] Furthermore, without standardisation, best practices are not rolled out at scale and this can limit the poverty alleviation impact of Islamic social finance.

Also, Islamic social financial institutions lack the capabilities to effectively meet the needs of customers compared to better trained and managed conventional institutions such as BRAC and Grameen Bank. Dean notes that *Sharia* aspects are severely lacking in microfinance training programs.[168] She observes that while the Association of Muslim Welfare Agencies in Bangladesh (AMWAB) organises Islamic training sessions, their high attendance costs usually result in low attendance. Particularly, Bangladeshi Islamic social finance institutions do not capture the latent funding potential from domestic and international sources. Not only are philanthropic institutions unable to leverage Islamic social finance products to maximise impact, they do not utilise innovative products such as cash *waqf* and *microtakaful*-linked *microtakaful*.

6 Seizing Untapped Opportunities: Policy Recommendations for Islamic Social Finance in Bangladesh

From the overview of the Islamic social finance regulatory and institutional landscape and the key challenges that institutions face, we present three ideas that could enhance the sector's potential to alleviate poverty at scale.

167 This was noted by CEO of Dubai Islamic Bank, Adnan Chilwan at an address at Cambridge Islamic Finance and Leadership Program, Cambridge United Kingdom in August 2016.
168 R.A.R.F. Dean, *Challenges and Solutions in Islamic Microfinance*, 29 Humanomics, no. 4 (2013), 293–306.

6.1 Islamic Microfinance Apex Body

A relatively simple and immediate solution is to institute an apex body to develop standards and practices, lobby for government policy change and attract institutional funding.[169] As the most regulated form of Islamic social finance, we propose setting up an apex Islamic microfinance body that supports all entity types including banks, for-profit companies and NGOs. The microfinance apex body's scope should include *zakah* and *awqaf*-linked models. To that extent, the Islamic microfinance apex body should cooperate with other apex bodies such as the National Waqf Advisory Board proposed by Ahmad and Karim.[170] There are three key roles that the apex body could capably fulfil as outlined below.

6.1.1 Develop Minimum Standards and Promote Best Practices

Within Bangladesh's secular constitutional framework and current socio-political environment, an independent apex organisation is best placed to develop *Sharia* standards and operational best practices for members. This is like the model where the CSBIB collaborates with Bangladesh Bank but remains independent. Streamlining operations will be essential to ensure consistent practice across the sector which will build confidence with the public and government. Particularly for the poorest segments of society, misrepresentation and misconduct by staff can generate negative reputational risks. Political "contagion" was one of the major causes of the Andhra Pradesh microfinance sector crisis where politicians instructed borrowers to stop repaying MFIs due to brewing negative public sentiment.[171] Field interviews among borrowers highlight that loyalty is based on trust that takes years to build.[172]

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169 It must be noted that widespread use of these models does not always require an apex body as demonstrated by Muslim Aid Sri Lanka's leadership. As the largest IMFI, they took the lead in creating a partnership with Amana Takaful to provide a credit-life and health insurance product for Islamic microfinance borrowers. This proved so successful that other IMFIs are also now able to use this *takaful* product.

170 Ahmad and Karim (2019), *supra* note 96, at 210.

171 M.A. Ghiyazuddin, and S. Gupta, *Andhra Pradesh MKI Crisis and Its Impact in Clients,* Centre for Microfinance and MicroSave (2012), available at: <http://www.microsave.net/files/pdf/AP_MFI_Crisis_Report_MicroSave_CMF_Ghiyazuddin_Gupta.pdf>, accessed April 5, 2017.

172 Muslim Aid Bangladesh (Savar) and Rural Development Scheme (Amin Bazaar), *Islamic Microfinance* (August 26 and 28, 2019). Beneficiary interviews.

Further, an apex organisation helps to promote best practices to lift the standards of all its members. Best practices for knowledge management and capacity building from conventional (such as the Pakistan Microfinance Network and Bangladesh's own Credit and Development Forum) and Islamic (such as Dewan Syariah Nasional-Majelis Ulama Indonesia and the Centre for Zakat Management in Bangladesh) peak bodies should be studied.[173] The Centre for Zakat Management, responsible for coordinating *zakah* collection and distribution, is a model example of how the private sector improved the functioning of *zakah* outside government support. They also advocate on *zakah* issues to government authorities and publish materials to educate individuals and companies about *zakah* best practices.[174]

6.1.2 Lobby for Policy Change

An apex organisation is capable of effectively lobbying for policy and regulatory changes that enhance the sector. Based on interviews with Muslim Aid Bangladesh and RDS, it is clear that there is no coordinated government engagement to date among the largest Islamic MFIs. As will be elaborated in section C below, there are numerous regulatory changes that could enhance the effectiveness of Islamic social finance institutions. By facilitating outreach events, building institutional capacity and knowledge management and conducting research, the conventional microfinance sector's Credit and Development Forum has been effective in advocacy and lobbying in Bangladesh. Similarly, the Centre for Zakat Management has been engaging with government officials to seek amendments to tax provisions and promote *zakah* and *awqaf* as tools for poverty alleviation.[175] These cases demonstrate the effectiveness of a political engagement function within the apex Islamic microfinance body.

173 The creation of the informal Bangladesh Islamic Microfinance Working Group is a necessary start but it is yet to formalise into a permanent institution. According to a founding member, Sheikh Moinur Rahman, meetings have been sporadic so far. However, there are plans to develop an apex body in conjunction with the MRA. 13. Sheikh Moinur Rahman (June 29, 2018). Personal interview.
174 Centre for Zakat Management, *Exploring Potential of Zakat* (n.d.), available at: <http://czm-bd.org/>, accessed December 24, 2017.
175 Khondoker Zakaria Ahmed (January 5, 2016). Personal interview.

6.1.3 Channel External Funding

An apex organisation is also capable of promoting investment opportunities into the sector among domestic and international investors. For instance, PBMT Social Ventures was established in Singapore to facilitate greater international philanthropic funding for poverty eradication in Southeast Asia. It was set up by PBMT Indonesia, an apex body that has 150 Islamic MFI members covering 550 branches.[176] Meanwhile, Afghanistan's microfinance sector grew considerably when it set up the Microfinance Investment Support Facility for Afghanistan (MISFA) in 2003 to manage donors and operate as a vehicle for funding and technical support. Reportedly, MISFA has ensured more tailoring to local priorities, technical assistance to build capacity and stronger member performance monitoring.[177] A systematic and institutional approach to capital raising could generate more funds and utilise innovative investment opportunities such as *sukuk* issuances and allow Islamic MFIs and social finance actors to reach more beneficiaries in Bangladesh.

6.2 Integration of Islamic Finance into National Development Plans

Islamic social finance institutions can play effective complementary roles to government efforts to reduce poverty. They can unlock additional funding resources and provide direct mechanisms to tackle poverty challenges. Recent government planning documents have envisaged that the private sector will play a greater role in poverty reduction[178] and help scale up microcredit programs.[179] A 2014 Bangladesh Bank Circular stressed the need for banks and financial institutions to introduce corporate social responsibility initiatives.[180]

176 Asian Venture Philanthropy Network, *PBMT Social Ventures* (n.d.), available at: <https://avpn.asia/organisation/pbmt-social-ventures/>, accessed December 22, 2017.

177 Microfinance Investment Support Facility for Afghanistan, *History* (n.d.), available at: <http://misfa.org.af/history/#>, accessed October 12, 2019.

178 Government of Bangladesh, General Economics Division (GED) Planning Commission, *The Fifth Five Year Plan FY1997-FY202002* (2012), available at: <http://www.plancomm.gov.bd/site/files/87d366f2-20ff-4d0f-8ee7-539b44f48f19/5th-Five-Year-Plan>, accessed October 13, 2019.

179 UNDP, *Scaling Up Islamic Microfinance in Bangladesh through the Private Sector: Experience of Islami Bank Bangladesh Limited (IBBL)* (2013), available at: <http://www.undp.org/content/dam/undp/library/Poverty%20Reduction/Participatory%20Local%20Development/Bangladesh_D10_web.pdf>, accessed March 22, 2018.

180 Bangladesh Bank, *Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR)*, DOS Circular no. 1, January 19, 2014, available at: <https://www.bb.org.bd/mediaroom/circulars/dos/jan192014dos01e.pdf>, accessed October 12, 2019.

Another Circular has restricted loan application fees for Cottage, Micro, Small and Medium Entrepreneurs (CMSME) and removed additional fees for adjusting the maturity of loans.[181] This regulation was designed to lower borrowing costs for CMSMEs and reduce barriers to financing. With input from commercial banks, Bangladesh Bank is also developing a lending collateral database. The system was set to be effective from 2019 so that any person or institution can verify prior collateral information to prevent lending against the same asset.[182] New funds have also been established to mobilise capital for rural and women entrepreneurs such as the Palli Sanchay Bank[183] and Challenge Fund[184] respectively.

In addressing the above opportunities, Islamic social finance offers two major benefits. Firstly, Islamic social finance institutions can mobilise a greater pool of resources from commercial and philanthropic sources. These are two sources that the government's Seventh 5-year development plan has stressed are crucial to eradicate extreme poverty.[185] As even the record $9 billion social welfare budget set for 2019–20 cannot meet the requirements of all vulnerable populations and can take years to transfer to targeted beneficiaries,[186] traditional Islamic social funding sources such as *zakah* and *sadaqa* can complement revamped *awqaf* and cooperative-*takaful* funds to meet the long-term needs of impoverished communities in Bangladesh.

181 Bangladesh Bank, *Relating to Schedule of Charge*, BRPD Circular no. 2, March 13, 2017, available at: <https://www.bb.org.bd/mediaroom/circulars/brpd/mar132017brpd02.pdf>, accessed October 12, 2019.

182 S. Islam, *Bangladesh Bank Developing Collateral Database to Stop Lending on Forged Documents*, The Financial Express (August 16, 2017), available at: <https://thefinancialexpress.com.bd/trade/bangladesh-bank-developing-collateral-database-to-stop-lending-on-forged-documents-1502943618>, accessed June 20, 2018.

183 Prothom Alo Economy, *Palli Sanchay Bank to Open Branches in All Upazilas by March*, Prothom Alo February 24, 2018, available at: <http://en.prothomalo.com/economy/news/171539/Palli-Sanchay-Bank-to-open-branches-in-all>, accessed December 8, 2018.

184 Star Business Desk, *Second Round of UK Aid's Challenge Fund Launched*, The Daily Star (April 26, 2016), available at: <https://www.thedailystar.net/business/second-round-ukaids-challenge-fund-launched-1215520>, accessed December 8, 2018.

185 Government of Bangladesh, General Economics Division (GED) Planning Commission (2015), *supra* note 18, at 58.

186 The Government of Bangladesh provides a wide range of welfare support such as gratuitous relief, vulnerable group development and food for work. See Government of Bangladesh, Social Safety Net Programs-Budget 2018 (Revised) and Budget 2018–19 (n.d.), available at: <https://mof.portal.gov.bd/sites/default/files/files/mof.portal.gov.bd/page/672e3d4d_09bb_4205_9afd_843de55481d1/Safety%20net_English_18-19.xl.pdf>, accessed November 22, 2018.

Secondly, Islamic social finance offers a wider set of tools to tackle poverty alleviation ranging from direct welfare distribution to entrepreneurship financing. For example, in addressing the "Lagging Regions" program,[187] the government could help steer a special investment fund that brings together *zakah*, *awqaf* and Islamic microfinance funding from Islamic banks, Islamic MFIs, NGOs, and the private sector. The fund would provide *zakah* and corporate social responsibility funding for activities such as sanitation and healthcare, Islamic financial institutions' "doubtful income" discretionary grants, *qard hasan* loans and subsidised microfinance to individuals and small enterprises to enhance livelihoods. *Awqaf* structures could also be set up to provide ongoing discretionary funding to lagging regions. The programs could be staged based on beneficiary needs as per their level of development. Initially, *zakah* funds are used for nutrition and healthcare, and then Islamic MFIs provide *awqaf*-subsidised microcredit to spur entrepreneurship.[188] The diversity of microfinance contracts can also help meet the specific needs of different borrowers with *musharaka* for retailers, *salam* for paddy farmers and *ijara* for manufacturers and processors who require capital equipment.

By way of demonstration, Indonesia has been reaping the benefits of a national IBF program that is promoted as integral to sustainable development. Bank Indonesia is spearheading this strategy and promoting it internationally. The Bank of Indonesia's view is that Islamic products and instruments deliver economic benefits and enhance systemic financial stability.[189] A UNDP report observed that Indonesia's Islamic microfinance sector grew because the government responded to the demands of *Sharia* scholars for Islamic products in the 1990s.[190] The most prominent group of Islamic MFIs, called Baitul Mal Wa Tamwil, received national support from President Suharto who characterised

187 Government of Bangladesh, General Economics Division (GED) Planning Commission, *Sixth Five Year Plan FY2011-FY2015 Accelerating Growth and Reducing Poverty Part-1 Strategic Directions and Policy Framework* (2012), available at: <http://plancomm.portal.gov.bd/sites/default/files/files/plancomm.portal.gov.bd/files/83300734_9ba4_4a36_baef_d7e83509e556/SFYP-Final-Part-1.pdf>, accessed October 13, 2019. Lagging regions are identified as *monga* prone (facing greater annual cycle of hunger and poverty), and include coastal areas, under-penetrated areas in the Chittagong Hill Tracts, and remote areas of Habiganj and Sunamganj of Sylhet.

188 See Hassan (2010), *supra* note 91.

189 Bank Indonesia, *The Blueprint of Islamic Banking Development in Indonesia* (2002), available at: <http://www.ruralfinanceandinvestment.org/sites/default/files/Blueprint__of__Islamic_pdf.pdf>, accessed July 18, 2017.

190 UNDP, *Poverty Reduction: Scaling Up Local Innovations for Transformational Change* (July 1, 2011), available at: <https://www.undp.org/content/dam/undp/library/Poverty%20Reduction/Participatory%20Local%20Development/ScalingUp_en_Br.pdf>, accessed October 12, 2019.

them as a national movement for empowering the poor through institution building and small business development.[191] Bangladesh's national development program can stand to achieve greater success by co-opting the Islamic social finance sector. Thus, policy makers need to make this critical connection to achieve mutually shared objectives.

6.3 Development of a Parallel Islamic Social Finance Regulatory Framework

The importance of an enabling regulatory environment cannot be understated. As noted by the Indonesian Financial Services Authority Commissioner, top-down regulatory support is key to, "promote market development and sound prudential practices."[192] A fresh comprehensive Islamic social finance regulation may be the most efficient solution where existing laws are either outdated (e. g., *Waqf Ordinance*) or insufficient to contemplate national social development (e. g., *Zakat Fund Ordinance*). Among a range of regulatory options, there are two major regulatory changes that could significantly empower Islamic social finance institutions to reduce poverty. Firstly, we advocate the development of a separate *Sharia* division within the MRA with jurisdiction to regulate Islamic banks' microfinance activities and secondly, urge the amendment of *awqaf* and *zakah* laws to support greater integration into Islamic microfinance. The MRA's *Sharia* division would operate like Bangladesh Bank's Islamic Banking Division where guidelines are prepared through industry and scholarly engagement. Such a division will provide regulatory guidance as well as supervision to ensure consistency and best practice operations. The MRA *Sharia* division should ensure three critical outcomes as discussed below.

First, the *Sharia* division must establish minimum standards for all *Sharia*-compliant financial products. This is necessary to help beneficiaries distinguish them from conventional financial products and prevent fraudulent practices. Secondly, *Sharia* governance guidelines are necessary to ensure robust monitoring and evaluation of *Sharia* practices within Islamic MFIs. The qualifications, roles and activities of SSCs need to be clearly stipulated. The State Bank of Pakistan provides a useful model where it requires Islamic microfinance banks

191 *Ibid.*
192 M.D. Hadad, *Keynote Speech Chairman of Indonesia Financial Services Authority at the Microtakaful Conference Indonesia* (Inclusive Insurance Asia, April 24, 2014), available at: <http://www.inclusiveinsuranceasia.com/docs/MDH%20-%20Keynote%20Speech.pdf>, accessed July 7, 2018.

to provide their *Sharia* Advisor details in its application for a full-fledged Islamic microfinance license.[193] Where the Islamic MFI is unable to afford a SSC, they should be able to refer *Sharia* matters to a specialist MRA *Sharia* advisory unit. As noted by Islam, the CSBIB is willing and capable of supporting the MRA to develop Sharia capabilities and resources to serve the microfinance sector.[194]

Finally, the MRA *Sharia* unit needs to assist the MRA to develop specific reporting guidelines that better reflect Islamic MFIs' full suite of financial services (such as saving, lending and insurance). This will allow the public to easily compare the performance and level of compliance of different Islamic MFIs. For instance, financial reporting needs to take account of profit-and-loss sharing rates, profit mark-ups and *mudaraba* deposit returns. As correctly identified by Karim et al.,[195] both *musharaka* and *mudaraba* schemes require diligent reporting and a high level of transparency to ensure fair profit distribution between the Islamic MFI and entrepreneurs.[196] The potential moral hazard and asymmetric information challenges for profit-and-loss schemes need to be addressed to prevent harm to financiers and beneficiaries. Thus, as noted by managers at Muslim Aid Bangladesh and RDS, distinct Islamic microfinance regulations will lead to greater awareness, uptake of services, and funding support from domestic and international funding sources to grow the sector.[197]

Meanwhile, to effectively leverage *zakah* and *awqaf*, the existing ordinances require amendments to allow a wide spectrum of organisations to collect and distribute them.[198] The *Zakat Ordinance* must decentralise and permit private sector organisations to raise and distribute *zakah*. Further, it should encourage competition by establishing minimum standards like national microcredit regulations (e. g., corporate and *Sharia* governance, financial reporting, etc.). Meanwhile, the *awqaf* ordinance needs to facilitate the development of *awqaf*-backed *microtakaful* to support a wider class of vulnerable beneficiaries.

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193 State Bank of Pakistan, Islamic Banking Department, *Guidelines for Islamic Microfinance Business by Financial Institutions* (2012), available at: <http://www.bu.edu/bucflp-fig/files/2012/01/Guidelines-for-Islamic-Microfinance-Business-by-Financial-Institutions.pdf>, accessed November 19, 2018.

194 Shakhawat Islam (August 27, 2019). Personal interview.

195 N. Karim et al. (2008), *supra* note 54.

196 *Ibid.*

197 Ariful Islam (June 26, 2018). Personal Interview and Enamul Hoque (December 10, 2016). Personal Interview.

198 It must be noted that while Islamic microfinance operators are open to integrating *zakah* and *waqf* funds, they still consider large-scale commercial sources such as banks and philanthropic organisations as easier and more reliable funding sources. Ariful Islam (June 26, 2018). Personal Interview.

Furthermore, any proposed guidelines should be prepared by the MRA's *Sharia* division in consultation with the Zakat Board and National Waqf Committee. Through regulatory clarification and enablement, the closer integration of *zakah* and *awqaf* into Islamic MFIs will greatly enhance their use and effectiveness in poverty alleviation.

7 Conclusion and Further Research

For much of the twentieth century, the default approach to development has been to transplant the best legal institutions and norms of Western capitalism to poor and emerging economies by way of privatisation and deregulation of the economy.[199] Contrary to the restrictive modernist approach to law and development, and inspired by the *Sharia*, there are numerous Islamic social finance mechanisms that can be utilised for poverty alleviation and their existence is evident across Bangladesh. In addition to legislation and case law, scholars are increasingly recognising the existence and influence of norms from informal rules to shape people's lives.[200]

However, the lack of an enabling policy framework to enhance their effectiveness in contemporary society and regulatory neglect is undermining Islamic social finance's full potential. While *zakah* and *awqaf* have been a part of Bangladeshi society since the arrival of Muslims, today Islamic microfinance and *microtakaful* are increasingly deployed to enhance access to finance and provide financial protection. Despite the potential to leverage a wider source of funds for development and its large Muslim population, Islamic social finance institutions currently play a marginal role in Bangladesh. Islamic social finance does not feature in national development plans, is regulated through a patchwork framework, and operates at a negligible scale. Bangladesh's secular orientation coupled with the current heightened scepticism of Islamic institutions means that the government is unlikely to promote Islamic social finance through a top-down policy prescription.

Islamic social finance institutions in Bangladesh face numerous challenges that prevent them from achieving their full potential compared to mature Muslim-majority jurisdictions such as Indonesia and Pakistan. Islamic social

199 *Ibid.*
200 Lee (2017), *supra* note 1.

finance institutions in Bangladesh face stiff competition from conventional programs and innovative financial technologies. The limited regulatory framework hinders the effectiveness and ability of Islamic social finance institutions to innovate such as in the development of integrated *microtakaful*, *waqf* and *zakah*-linked microfinance. The poor policy and regulatory environment also create barriers to raising philanthropic and investor capital to scale their operations and compete with conventional institutions. The lack of institutional standardisation prevents Islamic social finance institutions from applying consistent *Sharia* rules, products and best practices which undermine their integrity and hinders operational efficiency.

To better address the above challenges and realize their potential for poverty alleviation, we have provided three policy and regulatory recommendations. First, an apex Islamic microfinance body must be set up to help standardize *Sharia* regulations, products and best practices as well as streamline funding for Islamic MFIs. Next, the government needs to harness the potential of Islamic social finance and integrate it as a complementary tool in national development plans. Finally, regulatory amendments such as the creation of a *Sharia* division within the MRA and modernisation of the Zakat and Awqaf Ordinances will help to better integrate traditional *zakah* and *awqaf* funding with microcredit, microinsurance and other social financing programs. Arguably, the absence of a cogent regulatory framework will not hinder private and social sector organisations (subject to public demand) from experimenting and innovatively utilising Islamic social finance mechanisms. However, as evident from the policy vacuum and the challenges that this has created in Bangladesh, realising the full potential of Islamic social finance requires a comprehensive policy framework akin to other peer regional Muslim jurisdictions such as Malaysia and Indonesia. In modern Muslim nation states with vibrant capitalist economies, the "light-touch" informal approach as the case of Islamic personal laws will be ineffective to scale Islamic social finance instruments.

While preparing for this paper, we have identified several research gaps that must be filled to develop more coherent and empirically driven policies for development in Bangladesh via Islamic social finance. Firstly, a comprehensive survey of the landscape of development programs needs to be conducted to quantify the reach and scope of Islamic social finance activities, evaluate their effectiveness and assess future market potential. Secondly, a deeper socio-legal study is required of the understanding and utilisation of Islamic social finance among the population. Whereas market participants are most likely to make pragmatic decisions based on convenience and economic outcomes, the proposition of *Sharia*-based activities and the translation of *Sharia* principles into institutional programs must be assessed from a beneficiary and provider perspective to ensure greater uptake and success. Finally, a thorough regulatory landscape review needs to be conducted to identify lacunae and propose recommendations to attract greater private sector investment.

With reductions in and distrust of traditional charity mechanisms and growing critiques of conventional microfinance, organisations in Muslim-majority countries may explore innovative ways to leverage the potential of Islamic social finance to reduce poverty at scale. The full potential of Islamic social finance mechanisms in Bangladesh is yet to be realised. However, with steps towards greater institutional sophistication and regulatory enablement, it can make a considerable contribution to the more inclusive and sustainable development of Bangladesh.

APPENDICES

APPENDIX 1: Differences between conventional and Islamic microfinance institutions

	Conventional MFIs	Islamic MFIs
Source of Funds	Foreign donors, multilateral and national agencies, government, central bank, savings clients	Religious institutions, Islamic charitable sources, savings of clients, foreign donors, national agencies, private sector
Mode of financing	Interest-based	Non-interest-bearing financial instruments
Financing the poorest	The extreme poor are usually left out of the financing model	The extreme poor are integrated in the financing model by integrating the *zakah* (Act of giving) principles in the model
Funds transfer	Cash	Goods
Deduction at inception of contract	Percentage of funds deducted from principle	No deductions from principle
Methods of dealing with defaults	Group/centre pressure	Group/spouse guarantee and Islamic ethics
Social development programme	Secular, ethical and social development	Religious which includes behaviour, ethics, and social values

Source: H. Ahmed, *Financing microenterprises: an analytical study of Islamic microfinance institutions*, 9 Islamic Economic Studies, no. 2 (2002), 27–64; cited in UNDP, *Poverty reduction: Scaling up local innovations for transformational change* (July 1, 2011), available at: <https://www.undp.org/content/dam/undp/library/Poverty%20Reduction/Participatory%20Local%20Development/ScalingUp_en_Br.pdf>, accessed October 12, 2019.

APPENDIX 2: Common Islamic Microfinance Contracts

'*Murabaha* Sale (cost plus mark-up credit sale)
Murabaha is an asset-based sale transaction used to finance goods needed as working capital. Typically, the client requests a specific commodity (tangible good) for purchase, which the financier procures directly from the market and subsequently resells to the client, after adding a fixed "mark-up" for the service provided. However, ownership of the commodity (and the risk inherent thereto) strictly lies with the financier until the client has fully paid the financier. In most cases, clients repay in equal instalments. The mark-up is distinct from interest because it remains fixed at the initial amount, even if the client repays pats the due date.

Musharaka and *Mudaraba* (profit and loss sharing)
The profit and loss sharing (PLS) schemes are the Islamic financial contracts most encouraged by *Sharia* scholars. Musharaka is equity participation in a business venture, in which the parties share the profits or losses according to a predetermined ratio. *Musharaka* can be used for assets or for working capital, *Mudaraba* denotes trustee financing, in which one party acts as a financier by providing the funds, while the other party provides the managerial expertise in executing the project. In *mudaraba*, profits are shared according to a predetermined ratio; any losses are borne entirely by the financier. If the *mudaraba* joint venture results in a loss, the financier loses the contributed capital and the manager loses time and effort.

Ijarah (leasing)
Ijarah is a leasing contract typically used for financing equipment, such as small machinery. Duration of the lease and related payments must be determined in advance to avoid any speculation. For the transaction to be considered Islamic (and not a sale with camouflaged interest), the ijarah contract must specify that the ownership of the asset and responsibility for its maintenance remains with the financier. An ijarah contract may be followed by a sale contract, in which event the ownership of the commodity is transferred to the lessee.

Takaful (mutual insurance)
The equivalent of Islamic insurance, takaful is a mutual insurance scheme. The word originates from the Arabic word "*kafala",* which means guaranteeing each other or joint guarantee. Each participant contributes to a fund that is used to support the group in times of need, such as death, crop loss, or accidents. Paid premiums are invested in a *Sharia*-compliant manner to avoid interest.

Source: N. Karim, M. Tarazi and X. Reille, *Islamic Microfinance: An Emerging Market Niche* (Washington: Consultative Group to Assist the Poor, 2008), available at: <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Islamic-Microfinance-An-Emerging-Market-Niche-Aug-2008.pdf>, accessed January 18, 2017.

APPENDIX 3: Alternative Microfinance Institution Legal Structures in Bangladesh

Institution	Registration Framework	MFI Activity Regulator	Examples
Commercial bank	*Banking Companies Act* (1991) *Companies Act* (1994)	Bangladesh Bank	Islami Bank Bangladesh Limited (IBBL); Social Islami Bank Limited
Non-banking financial institution	*Financial Institutions Act* (1993)	Bangladesh Bank	Lanka Bangla Finance Ltd; IDLC Finance Ltd;
Cooperative	*Cooperative Societies Act (1985)*	MRA	BRDB (Bangladesh Rural Development Board)
Non-government organisation microfinance institutions (NGO-MFIs)	Registered under one or more: i. *The Societies Registration Act* (1860) ii. *The Trust Act* (1882) iii. *The Voluntary Social Welfare Agencies (Registration and Control) Ordinance* (1961) iv. *Companies Act* (1994)	MRA	Association of Social Advancement (ASA); Bangladesh Rural Advancement Committee (BRAC); Shakti, Caritas Bangladesh (CB); Muslim Aid Bangladesh.
Special microfinance bank	*Grameen Bank Ordinance* (1983)	MRA	Grameen Bank (GB)

Source: Adapted from T. R. Noor, *Fine tuning the microfinance sector under regulatory control in Bangladesh: Imminent issues and challenges*, Bangladesh Economic Association 2013, available at: <http://bea-bd.org/site/images/pdf/082.pdf>, accessed April 8, 2017.

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Cooperative Societies Ordinance, Ordinance No. 1 of 1985.
Foreign Donations (Voluntary Activities) Regulation Ordinance 1978, Ordinance No. 46 of 1978.
Grameen Bank Ordinance, Ordinance No. 46 of 1983.
Income Tax Ordinance, Ordinance No. 36 of 1984.
Insurance Development and Regulatory Authority Act, Act No. 12 of 2010.
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The Bank Deposit Insurance Act, Act No. 18 of 2000.
The Charitable and Religious Trust Act, Act No 14 of 1920.
The Financial Institutions Act, Act No. 27 of 1993.
The Societies Registration Act, Act No. 21 of 1860.

The Trust Act, Act No. 2 of 1882.
The Voluntary Social Welfare Agencies (Registration and Control) Ordinance, Ordinance No. 46 of 1961.
The Waqf Ordinance, Ordinance No. 1 of 1962.
The Zakat Fund Ordinance, Ordinance No. 6 of 1982.
Value Added Tax Act, Act No. 22 of 1991.
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