IFB and Conventional Banking Services in a Branch: Its Challenges and Possible Ways

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Introduction

- Ethiopia is the only country (except Liberia) in Africa that was never been colonized during the colonies era. As a result, the country has established its own Bank many years back like 1906, where the first bank called Abysinia Bank established by Emperor Minilik II. Later, the National Bank of Ethiopia was established in 1963 by proclamation 206 of 1963 and began operation in January 1964 (Reference: Web site of NBE);
- Since Banking service commencement in Ethiopia, it is ONLY a conventional banking (i.e. banking based on computation of interest) that was fully operated in Ethiopia up un till recent period;
- In 2008, a directive has been issued from NBE that allow Banks to render IFB (Interest Free Banking) services in a window;
- In 2011, the actual operational directive has been issued as to how IFB service can be rendered by Bank ;
- Now few Banks have started rendering IFB together with conventional banking at branches

Back ground

1. What makes IFB different from conventional Banking

- Entire IFB service operation should comply Sharia principles (Islamic Finance Principles);
- Not possible to take or give interest (riba) from/ to customers;
- Time value of money is not relevant i.e. money can not create another money unless it is involved in trading;
- Conditional contract is not allowed. Speculation based or uncertainty (gharar) based deal is not allowed;
- There is a share of profit between customers and banks;
- Accounts/ booking records of IFB and conventional should be distinct though the service is being rendered at branches;
- There are two basic financing contracts and also non-fund based:
  - Equity Financing: Mudarabah and Musharakah;
  - Debt Financing: Murabah, Istisnah, Ijarah, Selam etc;
  - Non-Fund Financing: Kafalah (guarantee), Wakalah (LC) etc

Back ground … contd.

2. Possible ways of IFB service delivery

CHALLENGE

I. Full fledged ONLY IFB service e.g. Britain Islamic Banking, Banks at Iran, Sudan etc;

II. With a Subsidiary Bank (sister company) e.g. HSBC Amanah, Standard Chartered Saadiq;

III. Separate branch in a conventional banking e.g. ABN AMRO – middle east branch;

IV. With a window within conventional branch e.g. UBS Islamic Finance (Switherland), Banks in Ethiopia etc

SIMPLICTY

Few Key Challenges - IFB in a branch window

1. IFB Account segregation from Conventional:

As part of ABB (Any Branch Banking) and basic principles of trading, separating accounts of IFB with Conventional is not simple unless taken care of seriously. For both, it should be always: **A = L + C**

For instance:

I. IFB account holder receives fund transfer from conventional account holder (same branch): Possible Entries e.g. 1

II. IFB account holder at Branch A withdraw cash from Branch B that does not have IFB accounts: Possible Entries e.g. 2

III. IFB account holder withdraw cash from ATM: Possible Entries e.g. 3

IV. IFB account holder FT using Online or Mobile Possible Entries e.g. 4

Few Key Challenges - IFB in a branch window … cont.

2. **Profit sharing scheme:**

   As discussed, Customers can share profit with Banks when they are entered into Mudarabah or Musharakah contract with Bank. How is the profit sharing be computed?

   Profit sharing flow example

Few Key Challenges - IFB in a branch window … cont.

3. **Cost or expense allocation in a branch:**

   IFB service needs to be delivered at a branch where Conventional service is being rendered. How can we allocate expense of IFB in relation to staffs salary expense, rent expense, utility (electric etc) expenses etc?

   If this cost or expense allocation (both direct & indirect) of IFB is not done properly, income or profit of IFB might be inflated or exaggerated unnecessarily.

Possible ways to curve out challenges

- Proper Chart of Account Definitions:
  - The top level of the chart of account in the tree can be those A, L, C, I, E and M but next level in the tree structure for both IFB and Conventional chart of Accounts should be different. This is relevant in order to segregate accounts of both and also to consolidate the resulted balance sheet and profit/ loss statements at Bank level;
- Proper CORE banking system implementation: **Case by Case Sol^{n}**
  - The deployed core banking application should be able to handle both IFB and Conventional banking services;
  - OR…the Bank might go with two different CORE banking instances (one for IFB and another for Conventional) but these two needs to be interfaced to one another;
  - The IFB Core banking application should have proper PDM and all other equity and debt financing services;
- Proper and fairly presented Cost/ Expense allocation scheme should be devised so as Profit will not be unnecessarily exaggerated either for IFB or Conventional banking products.

Conclusion

Rendering Conventional and IFB services at a branch window has many challenges that needs to be addressed carefully with respect to each cases.

However, if there are good systems (CORE banking and MCB Applications) that can take care of each issues, it is still doable and possible!!

Thank You