Non-Usury Banking Fits to Obama's Change Strategy, The Solution to Revive the Economy

Bijan Bidabad[1]

Abstract

This paper examines the structural weaknesses of interest-based banking and proposes an operational Profit and Loss Sharing (PLS) banking framework as a non-usury alternative capable of strengthening the linkage between the financial and real sectors of the economy. The analysis argues that divergence between interest rates in financial markets and actual rates of return on productive investment increases risk premiums, raises financing costs, weakens investment incentives, and may contribute to financial instability and liquidity-trap conditions. Under the proposed PLS framework, predetermined interest is replaced by the sharing of actual investment profit and loss among depositors, entrepreneurs, and, where applicable, the intermediary bank. The bank acts primarily as an agent and professional financial intermediary, mobilizing depositors' funds, evaluating investment projects, supervising entrepreneurs, managing capital, and transferring realized returns to fund owners in exchange for service fees. To make PLS operational, the paper develops an institutional structure incorporating project evaluation, trustee supervision, accounting and auditing procedures, collateral and guarantee arrangements, standardized contracts, and detailed operational instructions. It also introduces Mosharekeh and Pazireh certificates and a secondary market for their transfer and trading. Information and communication technology is incorporated to enhance transparency, monitoring, information flows, and settlement among depositors, banks, and entrepreneurs. The proposed framework therefore seeks to transform non-usury banking from a primarily contractual concept into an integrated operational system in which financial returns are directly connected to the performance of real economic activities, thereby reducing financial-sector risk and promoting more stable and efficient financial intermediation.

Keywords: Profit and Loss Sharing (PLS); Non-Usury Banking; Islamic Banking; Financial Intermediation; Risk Sharing; Real Sector Return; Mosharekeh Certificate; Investment Financing; Financial Stability; Banking Supervision.

Introduction

The current economic recession was predictable since few years before, even if its depth cannot be imagined yet. A new solution matching the current turmoil was being confectioned since several years to remedy this type of economic crises. In these crises, the monetary policy would not be efficient enough and fiscal policy is not a fast recovery remedy. Thus, the protectionism policy should be attained to solve the problem for long run. Refection of financial system is the most important step to make.

The Profit and Loss Sharing (PLS) banking is the method to replace actual usuric traditional banking. PLS banking not only can regain the trust of investors and depositors to financial market, but

[1] Research Professor of Economics at Islamic Azad University and Senior Economist.
https://www.bidabad.ir/ bijan@bidabad.ir

also will reduce costs of investment and production by reducing the risks of investment and producing stable markets. In this paper the other positive effects of PLS such as creation of new job opportunities, easy flow of capital and transactions, increase of investments and productivity resulting to Global Wealth and the attenuations of international political complications also equity and peace, will not be explained.

Today, the global economy shows the lowest interest rate and the United States economy's recession is being propagated to west and east of the world, where the recent increase of oil price caused the markup prices grew at global level and the expensiveness has been prevailed in public sustenance, especially for food grains. The bankruptcy and deficits of some western globe banks and higher financial risks at international financial markets and sequential crises in these markets illustrate a crisis similar to 1929 world crisis. However, this one was accelerated by several impacts on the economy such as natural disasters in West and risk-increasing Bush's policies in the East. Based on detailed economic researches it has been proved that the volatilities of financial sector cause the fluctuations of the real economy and starts business cycles. In 1929 crisis, investment and saving inconsistency in western economies especially in the Unites States pushed the globe economy to the phenomena of liquidity trap. There were only negative interest rates that were able to motivate economy to pull it up from the bottom of the cycle. Monetary policy did not work, because interest rate was too low to be pushed to lower rates by increasing money supply. When the economy falls into the liquidity trap, there is no monetary policies solution via either increasing the volume of liquidity or decreasing the interest rate to motivate investment demand to recover the economy back to prosperity. Principally, liquidity trap is caused due to a weak relationship between the rate of return in real sector and the interest rate in monetary sector; when the interest rate moves to lower rates but nominal investment rate of return does not. One reason for such occurrence is the increase of investment risks, which decreases the net return of capital. The risk becomes a wide premium of capital market's interest rate and investment market's return rate. On the other hand, the difference of interest rate and investment rate of return increases.

The president of the United States of America Mr. Barak Hussein Obama's "Change Strategy" is a worthy decision to be taken in this point of time. This decision would change the world economy as well if it becomes successful to change the economic infrastructure of the United States. If his policy ends to monetary sector reform, he will be able to revive the economy from deep crisis; because the business cycle happens because of increase of risk in financial markets due to usury financial systems.

If the risk and the profit of investment were shared with depositors, financial enterprises would be confronted with lowest risk, and the risk would be transferred to depositors and debtors both, so the real and the financial sectors will be immunized from volatility. The solution is to peg the interest rate to real economy return rate. Whereas by sharing the risk and the profit, the distance between real sector and financial sector rates is reduced and the premium of the risk will diminish. This will enable investment with lower cost for production. In fact, where the monetary solutions cannot be efficient (like current situation) by application of risk sharing we can balance and revive the economy. This is why theosophically divine religions pose: "Usury is forbidden".

A solution to solve this deficiency has been expressed by religious legislators through deletion of usury from the economy. The religious legislations in Torah and Bible and Quran actually have removed the intermediate monetary market between depositors and investors by prohibition of usury and establishing a proportional relationship between profit and loss of investors (debtors) and the receipts of depositors. Thus, it is not an exaggeration to say that the solution to prevent global crisis similar to the previous century crisis is to change the nature of usury in the monetary sector and establishing profit and loss sharing between depositors and investors (entrepreneurs). Real sector return rate is a stable rate, due to stability of productivity and will not fall down or rise up drastically. Establishment of profit and loss sharing will stabilize the interest rate due to the strengthening of the link between the interest rate in

money market and the rate of return of investment in real sector. Thus, inconsistency between investment and saving and, also the liquidity trap will not happen in the economy to push the economy to crisis. Although, business cycle will not vanish from the economy but the cycles' swings will have narrow volatility domain.

Many countries have taken important steps to establish profit and loss sharing (PLS) banking systems. Regarding to the lower risk of this type of banking some western countries have been interested to test this non-usuric banking system for the sake of risk averting. According to the IMF reports, the Islamic banking has increased 10-15% annual growth in last decade and the same growth is predicted for the future years.

Despite of the interest of bankers for using Profit and Loss Sharing (PLS) banking for the last decades, it has not been prevailed yet executively. The existence of different definitions of Riba, absence of appropriate operational, supervisory and managing mechanism on PLS are some reasons that haven't allowed this kind of banking to be practical yet.

Here, we are going to introduce a practical method for Profit and Loss Sharing (PLS) banking to overcome these problems. In this bank, the basis of determination of interest rate of loans is the real economy sector return. The bank operates as an intermediate that gets commissions and collects saving resources and as an attorney or legal representative of depositor allocate them to investment projects, and supervises the detailed operation of contractor. The yields of investment will be transferred to resources owners who are depositors whatever the profit or loss is.

Profit and Loss Sharing based on Non-Usuric Banking Products.

Despite of many developments and endeavors, the PLS banking has not been settled down operationally. The obstacles are due to needs to apply suitable executive mechanism and operation's procedures. In the way of applying PLS, its procedures all the times has been mixed with usuric banking and even its financial instruments (innovations) as "profit and lost sharing certificate" and "investment deposit certificate" which attracted attention in late 1990’s were left aside. This contamination occurred due to some reasons. The most important one was due to executive and supervision problems on the operation of entrepreneurs who receive the financial resources for PLS, in all financial, economics, technical and executive aspects; because, the banks have not been organized to supervise the detailed operations of the investments. Thus, they were not qualified to do the task of supervision on operations. Therefore, the banks manipulated non-usury rates into interest rate and actually, they entered the interest rate into the calculation - though the existence of usury was not very obvious in the calculations. But by scrutinizing the loan calculations the amount of interest were computable. Another problem is: the juristic inferences about usury in different Islamic sects are different and this subject caused some differentials in usury definitions. Different definitions produced different non-usuric banking products at international level, in a case that some of these products were not consistent with similar products of other banks. Even in Iran, where the consistency was more than other countries the same result happened and also the jurist's and economists' consensus in the time of approving "The law of non-usury banking" in early 1980’s went to conflicts.

Thus, the general solution for establishment of original non-usuric banking needed to revise the whole problem from the basis. The present proposition is the result of tough researches during the last ten years. We did our best to infer the opinion of religion's legislator according to the logic and rationality of theosophy (wisdom). We tried to re-infer the concept of usury from the Torah, Bible and Quran and narrations first. Thus some measures for distinguishing usury from non-usury were defined. These measures explicitly define the non-usuric operations as the following items:

1- The sharing of loaner in Profit and Loss of loanee (debtor)
2- Non conditioning and not predetermination of interest
3- Foreign exchange (without time-based interest) is non-usuric
4- All interests received from consumption loans are usuric

By these measures in the next round we examined the Islamic banking products. Deposit, loan, currency exchange, bonds, valuable papers and metals, receive and payment orders and credit operations were analyzed according to the above usury and non-usury measures. Some products as Foroosh-e-Aqsati, Ijareh-be-Sharte-Tamlik, debt purchase and sale, and composite interest derived from inability of loanee to repay the debt are usuric. Also giving loan facilities through non-interest loan, civil Mosharekeh, legal Mosharekeh, direct investment, Modharabeh, Salaf transaction, Jjiale, Mozaraeh, Mosaghat, Ijarah, according to specific conditions are non-usuric. In all of these products except non-interest loan and Ijarah, which the rate of Ijarah should be predetermined in advance, the interest rate must not be determined and conditioned. Otherwise, the contracts become usuric. Foreign exchange operations in spot and swap transactions (in case of not-existing interest rate in exchange calculations), options (in case of unique interest rate for two currencies), letter of credit are non-usuric. But the foreign exchange operations of futures and time-based transactions, timed swap transactions; options and foreign exchange deposits enter into usury realm. We examined all sale and purchase of bond papers, metals' transactions, receipt and payment order, and banking credit operations and their characteristics from usuric point of view.

NUBankCo; the Ultimate Idea is now feasible

According to the findings of these analyses, the concept of "Non-Usury Bank Corporation (NUBankCo)" introduced which can handle non-usuric banking operations. NUBankCo was proposed as an economic firm where the depositors are her shareholders. This bank is capable to handle non-usuric operations by distributing profit proportionate to the share of shareholders (depositors). If the banks remove different deposits differentials and increase transparency and efficiency of banking operation, by removing the numerous deposit interest rates and increase the participation in economic activities, and if both private and public, legal or real persons were able to participate, this will result to the efficiency of financial intermediary role of the bank in collection and allocation of financial resources.

The growth of information and communication technology (ICT) prepared suitable backbones for development and improvement of this type of banking. Thus, by reanalyzing the problem with ICT considerations the whole problem was revisited. We tried to link financial accounts of loanees to bank databases through IT. In case of establishment of this link, profit and loss calculations, also bank supervision over the investment operations of investors (loanee) becomes feasible. The latter is the main obstacle in designing profit and loss sharing banking. In this stage we tried to design integrated systems through digital channels to encompass all affecting factors in banking operations and supervisions as a chain and the real return of deposits (investment) of depositors to be distributed through secure digital channels. By using Enterprise Resource Planning systems (ERP), Customer Relationship Management (CRM), Supply Chain Management (SCM), Management Executive Systems (MES), Human Resource Management (HRM), Business Process Re-engineering (BPR) and Work Flow Management (WFM) as core banking modules for non-usuric banking we examined this integrated design. By this design, the commercial partners, depositors, banks, central banks, Real-time Growth Settlement System (RTGS) investors, financial markets, digital signatures authorities and also social security organizations and government were linked through information and communication technology systems. This connection could cause transparency of profit and loss sharing banking, and by using an integrated automatic system the information of depositors-bank- investor's triangle might be designed in a way that the sharing in profit and loss of financial operations for the three groups of the triangle happens. But, unfortunately, nowadays weak facilities and equipment of companies were obstacles to make this idea feasible and

operational. This idea will still remain un-operational for all size enterprises up to the time the interested commercial partners establish sufficient development in IT based procedures. But the idea is currently operational for highly developed stock market digitally based companies.

NUBANKCO: The implementation Method

All these findings in these fields by presenting some papers at national and international conferences were discussed and we got elegant comments from these processes. We understood that to solve profit and loss sharing (PLS) mechanism, we should design a new solution to fit nowadays needs and be consistent with contemporary workflows in legal operational and IT aspects. For these reasons, we tried to design a new method for making PLS Banking operations. The new design is as follows:

Disregarding the public or private bank ownership, we should find a solution that interest rate be determined according to the real sector return rate, and the bank becomes as intermediate of resources who receives Haq-ol-Amal (a fee to follow and care the depositors' rights and benefits by offering capital management services to depositor and supervising on the agent's (entrepreneur's) operations who do investment based on deposits of depositor(s)). The bank in position of an attorney or an agent receive capital management services fee and will transfer the investment returns (profit or loss) to the depositor. According to this definition, the agent bank as public or specific attorney by using Mosharekeh contract can use deposited deposits in shape of Moshaa (joint) and/or based on the depositor's request in specific product (of type 1 or 2) or based on banks opinion (in product type 3) invest in the project or projects and distribute the return of investment among depositors. The profit and/or loss will be distributed among them according to the pre-written related instructions. In this relation the bank, does the task of financial intermediary and after deducting her wage, as attorney or agent will pay the depositors' shares to them.

Finally, we designed the operational sketch and Bank Melli Iran (the biggest and oldest Iranian bank) proposed to put one of its important branches to implement the pilot project and test PLS banking at her own cost and risk. The system was designed for three banking products:

1- Mosharekeh (sharing Profit and Loss) on specific projects
2- Mosharekeh (sharing profit and loss) on a basket of some projects
3- Mosharekeh (sharing profit and loss) on the profit and loss of the bank's branch who implements PLS banking.

In a Jiala-based contract, bank will make a contract with depositors to allocate their deposits to one of the above three products according to their requests to get shares in profit and loss of the entrepreneur who implement the project. In other side of the bank, an entrepreneur is who has requested to make a contract with bank in a Mosharekeh-based contract. In this way bank operates as an intermediate that receive Haq-ol-Jialeh or Haq-ol-Amal and allocate the deposit resources of depositors to investors. Depositors in this case are financers and investors are those who do the entrepreneurship of the investment. The profit and loss of this investment will be distributed among depositors, investors and bank. Bank by offering this service can earn some share of profit/loss of these investment project as same as capital services management fees. That is in PLS banking, the contracts between bank and depositors and between bank and investors (entrepreneurs) can be performed based on Karmozd (wage) as well as sharing on profit and loss.

Entrepreneur is a legal person who combines her (cash or none-cash) capital with share of depositors in a Mosharekeh based contract through bank intermediary to arrange a joint investment.

In this method, a trustee agent (Amin) is a unit who supervise the contractor operations on behalf of bank for being honesty in carrying out the project, controlling on executive operations along announced

programs, resources allocation manner, and auditing financial statements. Amin (trustee) is an institution who supervise the PLS process as representative of Bank about the good governance of the project, controlling the implementations according to the declared plans, allocation of resources, optimal use of resources, … by using key indicators and financial sheets auditing.

In Profit and Loss Sharing (PLS) banking the new financial innovations are used. PLS banking will use new financial instruments and innovations such as Mosharekeh (partnership) certificates for projects with specific ends and Pazireh (subscripted) certificates for endless (productive) projects. Establishing of secondary exchange market for transaction of certificates, and various insurance services will play important roles for activating and increasing the efficiency of newly established virtual markets

The bank by issuing and offering the Mosharekeh certificates and creating secondary markets for transacting Mosharekeh certificates and designing baskets of Mosharekeh certificates will efficiently activate this type of baking and also the other related financial institutions. Implementing these arrangements needs particular instructions. We have written the necessary instructions to perform the job. Mosharekeh Certificate is no name papers issued by PLS banking branch with specific nominal price for definite time (project implementation duration). Mosharekeh Certificate holders will share profit and loss of project prorated to their nominal price and time duration of their Mosharekeh (participation). The bank will deliver a certificate of Mosharekeh and/or receive a service fee for capital management services to depositors which will be according to one of the above three products. Mosharekeh Certificate holders can transact these papers through internet or bank counter in cyber environment and thus this certificate can be transacted internationally as a financial asset.

Depositors by accessing through information portal of internet station in secondary market of Mosharekeh Certificates or by going to one of the branches of the bank performing the PLS banking and by receiving the consultation of the bank experts in the information counter will be familiarized with different Mosharekeh products and their conditions and regulations for depositing. Then she will decide to select one of the products of the three mentioned Mosharekeh products. By making the contract and the registration the system will automatically issue the Mosharekeh Certificate and the Mosharekeh Certificate will be accessible for the depositor. At the end of Mosharekeh period (for the products 1 and 2 regarding a single project or a basket of projects), or at the end of the financial year (regarding Mosharekeh in profit and loss of the branch who perform the PLS), accounting/auditing counter by receiving the related information will calculate profit and loss of the project or basket of projects or branch and will distribute the profit and loss of the Mosharekeh and perform account clearing.

Entrepreneur also by going to the PLS banking branch will offer her investment Mosharekeh project to the bank. The bank by declaring the conditions and regulations of Mosharekeh to the customer through the information portal of bank's Mosharekeh Certificates or information counter located in the PLS branch pays a document fee (according to its instruction) and bank will receive the proposal of the project with detailed economic, technical and financial feasibility reports and other related information. Entrepreneur evaluation unit according to the background of the entrepreneurs and according to specific instructions will evaluate the entrepreneur and in case of positive evaluation of technical ability and expertise of entrepreneur will send the related reports to the project evaluation unit. In case of positive evaluation of the project, project evaluation unit will determine the type and amount of collaterals, guarantees and Mosharekeh share according to the specified instructions. The arrangement will be transmitted to entrepreneur. After making contract the requested and approved resources will be paid to entrepreneur through the contracted Mosharekeh contract. The whole documents (according to related instructions) including: budgeting, timing plan, resource needs and resource consuming manner, project implementation, phasing, quality control, reporting, ending and delivering of the project should be delivered to Amin (trustee) of the project by entrepreneur. The reports of supervision on the project and

the quality of performance of the entrepreneur should be delivered to the accounting/auditing bureau of the bank according to the predetermined time schedules. It is obvious that the reports of the Amin of the project will be the criteria of the following payments of the bank to entrepreneur. At the end of the project and according to the instructions and formulas relating to the amount of profit and loss of the project and the Karmozd (wage) of the bank or her share will be calculated by the software of accounting/auditing bureau. The share of the entrepreneurs and the depositors will also be determined and will be transferred to their accounts. In the case of reports of Amin regarding stop or delay of the project, the amount of delay and the loss caused by delay will be calculated according to the given instructions.

NUBankCo: Structures and Instruction Codes

All of activities in this method will be done based on compiled instructions. The framework and the organization of PLS banking is organized has been analyzed in forms of required committees, units and departments tailored for the above definitions. All the operations will be done according to following prewritten instructions:

1- Instruction for evaluating the entrepreneur's ability including some guidepost about technical capabilities and financial background, grouping of entrepreneurs regarding the type of project and types of collaterals and guarantees and previous commitments and share of investment of the entrepreneur, in three class of green, yellow and red
2- Instruction for guarantees, hypothecs and initial capital
3- Instruction for necessary documents for evaluation of the project
4- Instruction for receipts of bank
5- Instruction for standards and obligations for supervision
6- Instruction for reporting of entrepreneurs
7- Accounting and auditing instructions
8- Instructions for changes in timing and cost, including inflation effects on income and cost and net return of project, and also the negligence of entrepreneurs resulting in delay of commitments and changes in timing of the projects
9- Instruction for new Mosharekeh (increasing the capital during implementation of the project)
10- Instruction for clearing and the accounts settlement of entrepreneur
11- Instruction for arbitration
12- Force majeure instruction
13- Instruction for writing the PLS contract including Mosharekeh Certificate and the contract between bank and depositor, bank and Amin, Bank and entrepreneur
14- Instruction for capability of Amin
15- Instruction for dispensing of depositors and premature account clearing
16- Instruction for transforming Mosharekeh Certificate into corporation share in production projects
17- Instruction for transacting Mosharekeh Certificate
18- Instruction for Mosharekeh Certificate secondary market internet platform including information portal, registration and membership, proposing purchase/sale, communicating between seller and purchaser of Mosharekeh Certificate, registration and inquiry

The structure and organization of PLS banking regarding the above definition will be done within a frame of:

- Strategic decision making committee in PLS Banking.
- Expert group for interpreting and revision of regulations and processes of PLS banking
- PLS office including:
  - Legal bureau
  - Project evaluation bureau

- Auditing/accounting bureau
- Financial engineering management bureau (back office)
- Amin (trustee) bureau
- PLS branch
- Information and consulting services bureau
- Cash bureau

To facilitate the Mosharekeh certificate operations a bill of "Regulations of issuing Mosharekeh certificate for PLS banking" has been written to be ratified and be approved by government. Auxiliary financial instruments and innovations are about Mosharekeh Certificates Baskets regarding risk determination in economic activities and determination of the weights of economic activities in the basket; and classification of Mosharekeh Certificate Baskets; and Mosharekeh Certificate Insurance; and typical contracts and usable forms in PLS banking.

In pilot stage, test of this type of banking can be done by establishing a corporation inside a branch of an ordinary bank, or by establishing a new branch for executing this type of banking. In the first case the banking activity of PLS will be done in parallel with other activities of the branch but all financial, accounting, organizational and structural operations are separated from legal point of view and are due to the newly established institute/corporation.

We are convinced that the current PLS system and NUBankCo will serve the entire humanity and contribute to increase of wealth and abundance in the entire globe.

Direct Research Background on This Project

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