

Islamic Banking – In Indian Context

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Abstract —

A banking system that is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. Collecting interest is not permitted under Islamic law. Islamic banking is banking based on Islamic law (Shariah). 10 principles of Islamic banking, problems in implementing it in India have also been discussed in this paper. A SWOT analysis for a clearer view of this concept in context to Indian economy has also been done. And a 10 step process to make this practically viable and acceptable by the Indian Muslims as well as non-Muslims has also been suggested by the means of this research paper.

Keywords— *Islamic Banking, Shariah, Banking Sector*

I. INTRODUCTION

Contemporary banking system was familiarized into the Muslim nation at a period when they were politically and economically at low ebb, in the late 19th century. The foremost banks in the home countries of the magnificent supremacies established indigenous subdivisions in the capitals of the subject countries and they accommodated predominantly to the import export requirements of the foreign businesses. The banks were by and large restrained to the capital municipalities and the homegrown inhabitants continued fundamentally safe and sound by the banking system. The home-grown trading community avoided the “foreign” banks mutually for nationalistic as well as religious whys and wherefores. On the other hand, as period passes away on it turn out to be problematic to participate in trade and other accomplishments deprived of making use of commercial banks. Even then numerous restricted their envelopment to transaction accomplishments such as current accounts and money transferences. Borrowing from the banks and depositing their investments with the bank were rigorously sidestepped in order to hang onto not here from big business in concentration which is forbidden by religious conviction.

II. MEANING

A banking system that is grounded on the principles of Islamic law (also known Shariah) and guided by Islamic economics. The two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. Collection of interest is not permitted under Islamic law. Islamic banking is banking constructed on Islamic law (Shariah). It monitors the Shariah, called fiqh muamalat (Islamic rules on transactions). The guidelines and practices of fiqh muamalat came from the Quran and the Sunnah, and other secondary sources of Islamic law such as opinions mutually agreed among Shariah scholars (ijma’), analogy (qiyas) and personal reasoning (ijtihad).

III. REVIEW OF LITERATURE

Interest-free banking appears to be of very recent origin. The original references to the reorganization of banking on the basis of profit sharing rather than interest are found in Anwar Qureshi (1946), Naiem Siddiqi (1948) and Mahmud Ahmad (1952) in the late forties, followed by a more elaborate explanation by Mawdudi in 1950 (1961). Muhammad Hamidullah’s 1944, 1955, 1957 and 1962 literatures too should be included in this category. They have all acknowledged the need for commercial banks and the evil of interest in that enterprise, and have proposed a banking system based on the concept of Mudarabha - profit and loss sharing. In the next two decades interest-free banking attracted more attention, moderately because of the political interest it created in Pakistan and partly because of the emergence of young Muslim economists.

Works specifically enthusiastic to this subject began to appear in this period. The first such work is of Muhammad Uzair (1955). Another set of works developed in the late sixties and early seventies. Abdullah al-Araby (1967), Nejatullah Siddiqi (1961, 1969), al-Najjar (1971) and Baqir al-Sadr (1961, 1974) were the chief contributors. Early seventies saw the institutional contribution. Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, First International Conference on Islamic Economics in Mecca in 1976, International Economic Conference in London in 1977 were the result of such contribution. The contribution of institutions and governments led to the application of theory to practice and resulted in the establishment of the first interest-free banks. The Islamic Development Bank, the inter-governmental bank established in 1975, was born of this process.

IV. SHARIAH PRINCIPLES

All Islamic banks have set up Shariah Committees to guide them on Shariah matters and to make sure that they function in a manner that is in line with the Shariah. The common Shariah principles are as follows:

- A. *Wadiah (Safekeeping)*: Wadiah means custody or safekeeping. In Wadiah prearrangement, you will deposit cash or other assets in bank for safekeeping. The bank assures the safety of the items kept by it.
- B. *Mudharabah (Profit sharing)*: Mudharabah is a profit sharing prearrangement between two parties, that is, an investor and the entrepreneur. The investor will supply the entrepreneur with funds for his business venture and gets a return on the funds he puts into the business based on a profit sharing ratio that has been decided earlier. The principle of Mudharabah can be applied to Islamic banking operations in 2 ways: between a bank (as the entrepreneur) and the capital supplier, and between a bank (as capital provider) and the entrepreneur. Losses suffered shall be borne by the capital supplier.
- C. *Bai' Bithaman Ajil – BBA (Deferred payment sale)*: This refers to the sale of goods where the buyer pays the seller after the sale laid-back with an agreed profit margin, either in one lump sum or by installment.
- D. *Murabahah (Cost plus)* : A Murabahah transaction includes the sale of goods at a price which includes a profit margin agreed by both parties. However, in Murabahah, the seller must let the buyer know the actual cost for the asset and the profit margin at the time of the sale settlement.
- E. *Musarakah (Joint venture)*: In the framework of business and trade, Musarakah refers to a partnership or a joint business venture to earn profit. Profits made will be shared by the partners based on a decided ratio which may not be in the same proportion as the amount of investment made by the partners. However, losses suffered will be shared based on the ratio of funds invested by each partner.
- F. *Ijarah Thumma Bai' (Hire purchase)*: Ijarah Thumma Bai' is generally used in financing consumer goods especially motor vehicles. There are two types of contracts involved: Ijarah contract (leasing/renting) and Bai' contract (purchase).
- G. *Wakalah (Agency)*: This is a contract where a person (principal) asks another party to act on his behalf (as his agent) for a specific task. The person who takes on the job is an agent who will be paid a fee for his services.
- H. *Qard (Interest-free loan)*: Under this prearrangement, a loan is given for a fixed period on a goodwill basis and the borrower is only required to repay the amount borrowed. However, the borrower may, if he so desires pay an extra amount (without promising it) as a way to thank the lender.
- I. *Hibah (Gift)*: This refers to a payment made happily in return for a benefit received.

V. NEED FOR ISLAMIC BANKING IN INDIA

Since the partition in 1947, it has become ever more important for India to stick to its secular, democratic ideals and continue to bridge the gaps that exist within its community. For over a century now, however, the Muslim minority in India has been suffering at the hands of its leaders' inaccuracies and mistakes, exploitation by capitalists, and the relative indifference of the successive Indian governments. The current status of Indian Muslims is worryingly poor with higher illiteracy, higher unemployment, lower income and higher poverty rates than the Hindu majority. This should be of major concern to the Indian government and the people of India at large.

As a secular democracy, all citizens have equal right to a certain quality of life and no specific sub-group of the population should be lagging behind in attaining and exercising that right. It is the responsibility of the government to ensure that lagging minorities have the tools with which they can catch-up to the rest of the nation. One such tool is credit, and only with proper credit can lag minorities' catch-up and decrease the economic inequality between them and the majority. The establishment of full-fledged banks practicing Islamic Finance is one step towards decreasing the economic inequality between Indian Muslims and the rest of their citizens. This is why India needs Islamic banking among various other reasons such as promotion of entrepreneurship in a minority group, the attraction of the middle-eastern investments and social harmony. The most important fact to be recognized at this stage is that Islamic banking is not only for Muslims but also for the masses. This tendency can also be seen in states like Tamil Nadu and Bihar. The reason why this is mentioned here is that such an outflow of Indians, belonging to the lower-end of the income level, shows that there is some sort of inefficiency in the economic system that they find uncooperative. Though, millions of dollars are assigned by the government for the upliftment of such groups, it never reaches the right hands. This is where Islamic institutions can play a major role with their moral and ethical ideals. It also has to be accepted in mind the history of clashes between the Muslims and other religions; this is stated to point out how sensitive the enactment of Islamic banking could become. The obligation of catering to a one billion plus population itself is a challenge. There is much assistance to the development of full-fledged Islamic Banks in India. Those benefits include a potential improving of the condition of India's largest minority, better combination of that minority into secular-democratic India, increased savings

across the country and an increase in the national GDP growth rate. Given the limited admission that Indian Muslim entrepreneurs have to credit, some reform of the banking sector is necessary. Reform by opening of Islamic Banks would be useful for all entrepreneurs who have profitable suggestions but lack security. Those entrepreneurs comprise, but aren't limited to, many economically-disadvantaged Indian Muslims. By helping economically-disadvantaged Indian Muslims build minority businesses, the newly-created Islamic Banks could help to produce wealth for Muslim business owners, create jobs for currently underemployed Muslim workers and will share the profits generated by those minority businesses among all of the depositors who hold Profit/Loss-Sharing (PLS) investment accounts.

VI. PROBLEMS BEING FACED BY ISLAMIC BANKING IN THE WORLD IN GENEREAL

Most of the Islamic Banks function on Bai- Murabaha, Bai Muazzal, Bai- Salam, Istisna, Hire Purchase/ Leasing mode of Investment i.e. Islamic Banks always prefer to run on markup/ guaranteed profit basis having Shariah coverage. For this reason some times the orthodox Economists and General people failed to understand the real difference between Islamic Banking and conventional Banking. Mudaraba and Musharaka modes of Investment are best but Islamic Banks are not going in these two modes, the reasons for the above are as follows:

- A. *The problem of forward contact/booking of foreign currency:* The value of US Dollars (\$), Pound Sterling, Euro and others are not fixed in Bangladesh, they are fluctuating from time to time Most of our imports and exports are made in USD and USD being a strong currency always moves upward and the exporters are in healthier position than the importer in our country. In Bangladesh Forward Booking is required to check the exchange fluctuation for import of heavy/project Machineries where it take long time say one year or six months to create the same. But due to the limitations of Shariah we cannot cover the risk of Exchange fluctuation by forward contract as Forward Booking is not permitted by Shariah. As per Shariah, currency, transaction is to be made under certain terms and conditions laid down for "sarf" by Shariah, such as spot ownership of both the currencies by both the parties which is not available in forward Booking. It is also prohibited to deal in the forward money market even if the purpose is hedging to avoid loss of profit on a particular transaction effected in a currency whose value is likely to be declined. This problem involves a solution by Shariah experts.
- B. *Inland Bill Purchase/Foreign Bill Purchase:* The exporters immediately after export of the goods approach to the bank for fund before development of the bills to meet their daily needs. Here the Bank has to arrange billions of Taka each year but how and on what mode of investment. The Bank cannot take anything by providing fund to the exporter excluding collection fee for collection of the Bill, which is very poor.
- C. *Unfamiliarity with the Islamic Banking System:* The first problem is that although the growth of Islamic banks over the last 30 years, many people in the Muslim and non-Muslim world do not understand what Islamic banking actually is. The basic principle is clear, that it is conflicting to Islamic law to make money out of money and that wealth should accumulate from trade and ownership of real assets. A major concern here is that it is the Shariah Councils or Boards at individual Islamic banks that actually define what is and what not Islamic banking is, and what is and what is not the acceptable way to do business, which in turn can confuse assessment of risk for both the bank and its customer. More generally, the uncertainty over what is, or is not, an Islamic product has so far prevented regularization. This is difficult for regulators as they like to know exactly what it is they are sanctioning.
- D. *Portfolio Management:* The behavior of economic agents in any country is determined partly by past experience and present restrictions. The Islamic banks are still rising in experience in many countries. Regarding restrictions, Islamic banks in different countries do not freely choose arrangements, which best suit, their need. As a result, their activities are not demand-oriented and do not react openly to structural shifts in the economic setting as well as to changes in likings. It is known to the bank management that a certain percentage of the short-term fund is normally not withdrawn at maturity; these funds are used for medium or long-term financing. However, a condition for this maturity alteration is that the bank be able to obtain liquidity from external sources in case or unexpected withdrawals. Islamic banks, without having an interest-free Islamic money and capital market, have no sufficient instruments to meet this pre-condition for effective maturity alteration. On the other hand, Islamic banks can improve term alteration if there is an interest-free bond market or a secondary market for Islamic financial papers. Sufficient financial mechanism still has to be developed, without which financial intermediation; especially the risk and maturity alteration is not performed properly.
- E. *The Regulatory environment :* The correlation between Islamic banks and monetary authorities is a delicate one. The central bank exercises authority over Islamic banks under laws and regulations planned to control and supervise both traditional banks. Whatever the goals and functions are, Islamic banks came into survival in an environment where the laws, institutions training and attitude are set to serve an economy based on the principles of interest. The procedures of Islamic banks are on a profit and loss share basis (PLS), which actually does not come fully under the authority of the existing civil laws. If there are disputes to be handled, civil courts are not sufficiently familiar with the rationale of the procedures of Islamic Banking. Regarding the protection of depositors, Islamic Banks are required to let the authorities know the variance between money paid into current accounts and money paid into investment accounts. In non-Muslim counties (i.e., the countries with less than 50% Muslim population) the central banks are

very strict in granting licenses for Islamic banks to operate. In order to be established in those countries Islamic banks must also meet the additional necessities of other government and non-government authorities. (So, apart from legal limitations there are economic measures that result operations of Islamic banks in the non-Muslim world difficult). In Muslim countries also they face economic limitations. In addition to funding, acceptable investment outlets is a major challenge for Islamic financial institutions.

- F. *Absence of Liquidity Instruments:* Many Islamic banks lack liquidity instruments such as treasury bills and other marketable securities, which could be used either to cover liquidity shortages or to manage excess liquidity. This problem is serious since many Islamic banks work under operational procedures different from those of the central banks; the resulting non-compatibility prevents the central banks from controlling or giving support to Islamic banks if a liquidity gap should happen. So the matter of liquidity management must come under active discussion and scrutiny by the authorities involved is Islamic banking.
- G. *Use of Advanced Technology and Media:* Many Islamic banks do not have the variety of products essential to satisfy the growing need of their clients. The significance of using proper advanced technology in advancement of the acceptability of a product and diversifying its application cannot be over emphasized. Given the potentiality of advanced technology, Islamic banks must have to come to terms with rapid changes in technology, and restructure the management and decision-making structures and, above, all introduce modern technology in its operations. Many Islamic banks also lack the necessary expertise and institutional capacity for Research and Development (R & D) that is not only necessary for the awareness of their full potential, but also for its very survival in this age of aggressive competition, cultured markets and an informed public. In addition, Islamic banks have so far not used the media properly.
- H. *Need for Professional Bankers:* The need for professional bankers or managers for Islamic banks cannot be highlighted. Some banks are presently run by direct involvement of the owner himself, or by managers who have not had much introduction to Islamic banking activities, nor are familiar with conventional banking methods. Therefore, many Islamic banks are not able to face challenges and inflexible competition. There is a need to institute professionalism in banking practice to improve management capacity by experienced bankers committed to their profession. Because, the professionals working in Islamic banking system have to face bigger challenge, as they must have a better understanding of industry, technology and the management of the business venture they trust to their clients. They also have to understand the moral and religious suggestions of their investments with the business ventures. There is also a need for banking professionals to be appropriately trained in Islamic banking and finance. Most banks' professionals have been trained in conservative economics. They lack the necessary vision and opinion about the efficiency of the Islamic banking.
- I. *Combination of Approach of Islamic Scholars with the Approach of the Conventional Bankers:* Bankers, due to the nature of their jobs have to be practical or application-oriented. There is and will be trend in the bankers practicing in Islamic banks to mould or modify the Islamic principles to suit the requirement for transactions at hand. Moreover, being occupied in the efforts of day to day banking, they find little time or inclination to do any research, which can make any substantial contribution to the Islamic banking. Islamic Scholars active in researching Islamic Banking and finance, on the other hand, typically have a normative approach, i.e. they are more concerned with what ought to be. A very few of them are well-informed about banking or the needs of the customers.

VII. SCOPE FOR ISLAMIC BANKING IN INDIA

- A. *Working Group Report of RBI:* This is the only serious attempt by RBI on the possibility of the Islamic Banking in India. The 51-page report titled "Report of the working group to examine financial instruments used in Islamic Banking" was prepared by Reserve Bank of India, Department of Banking Operations and Development, Central Office, Mumbai in July 2006. The working group was headed by Mr. Anand Sinha, Executive Director, RBI.

According to RBI, this report is an in-house research work for their own consumption and done in routine way to improve the knowledge level within organization, and report of such groups are generally not placed in the public domain. The group was established in June 2005 and within a year in July 2006 it submitted its report. After two years of correspondence with RBI, we were able to get it for the first time in April 2009 through Right to Information Act (RTA) 2005.

- B. *Legal Opinion:* The Group also wanted legal opinion from the Legal Department of Reserve Bank of India. The Legal Department detected that Islamic Banking has different modes of financing and in most of these kinds; the bank involves itself in the trading or business activities of the borrower or will be based on equity contribution of the bank, which is very much unlike the conventional banking. In Bai'-Mu'ajjal, the bank resorts to purchase and resale of properties, which is not allowable as per the provisions of Sections 8 and 9 of Banking Regulation Act, 1949. The equity participation in the form of joint venture is one of the major methods of financing (Musharakha) whose acceptability will have to be examined in each case in the light of limitations contained in Section 19 (2) of Banking Regulation Act, 1949. Further, risk sharing forms the basis of all Islamic financial transactions in the place of charging interests on loan amount.

In terms of provisions of Section 6 of Banking Regulation Act, 1949, in addition to the business of “banking”, banks are allowable to engage in business as prescribed under clauses (a) and (o) thereof. In the case of Islamic banking, the very business of “banking” itself includes the bank in active trading, purchase and resale of properties and investment etc., which is not allowable under the Banking Regulation Act, 1949.

Section 5(b) of the Banking Regulation Act, 1949 defines “banking” to mean “the accepting for the purpose of lending or investment of deposits of money from public, repayable on demand or otherwise”. Thus, “banking”, expects inter alia, lending of deposits of money from public, but in Islamic Banking, the bank accepting deposits of money from public is not promised in lending or the pure financial activity in the conventional manner, but is promised in equity financing and trade financing (Musharaka and Mudaraba), i.e. taking risk of sharing profits or losses as against lending (where there is no risk of loss and only profit in the form of interest at a specified rate). Therefore, the banks doing Islamic banking would not be doing “banking”, to that level, as expected in Section 5 (b) of Banking Regulation Act, 1949.

As regards the regulatory sides, there may be restrictions as the bank rate, maintenance of CRR and SLR as per the provisions of Banking Regulation Act, 1949 etc., involve the concept of interest. The issues of liquidity shortage or excess may have to be handled differently in the case of Islamic banking, since ban on interest rules out help to the money market and the Central Bank.

All these bring out to the fore that the concept of Islamic banking should be split with as an absolutely different sector with separate norms to address the specific structure and contents of the financial instruments in Islamic banking.

In view of the above, if the banks in India are to be allowed to do Islamic banking, suitable amendments are required in Banking Regulation Act, 1949 and separate rules and regulations may have to be framed to license them to do the business in view of the special characteristics of financing they adopt.

Thus, in the current statutory and regulatory framework, it would not be possible for banks in India to undertake Islamic banking activities in India or for branches of Indian banks abroad to undertake Islamic banking activities there.”

VIII. FUTURE OF ISLAMIC BANKING IN INDIA

In 2010 it looked as though the first Islamic bank in the country was about to be set up in Kerala with the energetic involvement of the Kerala government through the Department of Industries for Kerala. A high level meeting held at Kozhikode on August 12 2010 accepted a project report prepared by Ernst & Young. Kerala State Industrial Development Corporation (KSIDC), which is the nominated agency for the establishment of the bank, would hold an 11% stake in the proposed bank. According to government executives, it would be registered as a non-banking finance company, before being transformed into a fully-fledged Shari'ah-compliant bank. The project planned to raise an initial capital of Rupees 500 crore (crore is 10million in the Indian numbering system) from leading non-resident Indians (NRIs) and Indian business houses. According to sources close to the development, leading NRI businessmen such as Mohammed Ali, MAYusuf Ali, CKMenon and other Kerala-based industrialists such as Azad Mooppan had shown keen curiosity in the venture. Purely based on Shari'ah principles, the bank would avoid interest-based business activities. The proposed Kerala-based bank would invest funds in infrastructure projects and two instruments, bay' al-salam (deferred delivery) and instisna, have been recognized for such investments. The bank would capitalize all its funds in wealth-generating investments and distribute profits to its shareholders. It would also set apart a social fund & provide interest-free loans to Gulf returnees to set up businesses or small scale ventures.

The concept has widespread support among the Muslim community of the state, where a large number of rich Muslims practice strict Shari'ah principles in business. A large percentage of these individuals do not have a bank account, so the formation of an Islamic bank would be good news for them. According to sources, the biggest challenge facing the Kerala-based bank will be the establishment of a Shari'ah supervisory board due to the shortage of suitably qualified scholars. In 2010, however, a rather more immediate problem raised its head, when Dr Subramaniam Swamy, president of India's Janata party and a former government minister, prospered in putting the project on hold, issuing a writ in the High Court arguing that the involvement of government agencies in setting up an Islamic bank runs conflicting to the secular principles preserved in the Indian constitution.

In February 2011 The Kerala High Court dismissed the writ, detecting that they had no objection to KSIDC carrying on a business that was in accordance with Shari'ah law in addition to fulfilling with the laws of the country. They also stated that, although the institution was based on religious principles, its aim was not to spread religion and the state's participation in it was based on purely commercial reasoning.

There are also moves in Jammu and Kashmir, India's most northerly state, where Jamiat Ahladith is planning to introduce Islamic banking, but they will need the consent of the Indian government to do so. This state, however, has special position conferred by article 370 of the constitution and the state can pass the resolution for Islamic banking in the state legislative assembly with little alteration from the central government, so there is an expectancy that this state will also commence Islamic banking in the not too distant future.

As this issue of New Horizon went to press Turkey's Bank Asya were reported to be expecting the RBI to rule within 45 days on their request to open a branch offering Shari'ah-compliant lending facilities in India.

IX. PROBLEMS IN IMPLEMENTING THE PROFIT AND LOSS SHARING SCHEME IN INDIA

Some writers have attempted to show, with fluctuating degrees of success, that Islamic Banking based on the concept of profit and loss sharing (PLS) is ideally superior to conventional banking from different angles. However from the practical point of view things do not seem that healthy. Our concern here is this latter feature. In the over half-a-decade

of full-scale practice in implementing the PLS scheme the problems have begun to show up. In the following points we will try to set down some of the major difficulties.

- A. *Financing*: There are four main zones where the Islamic banks find it difficult to finance under the PLS scheme:
- 1) Joining in long-term low-yield projects,
 - 2) Financing the small entrepreneur,
 - 3) Permitting non-participating loans to running businesses, and
 - 4) Financing government borrowing.
- B. *Legislation*: Current banking laws do not permit banks to engage directly in business enterprises using depositors' funds. But this is the basic asset getting method of Islamic banks. Therefore new legislature and/or government authorization are necessary to establish such banks. In Iran a complete legislation was passed to establish Islamic banks. In Pakistan the Central Bank was certified to take the necessary steps. In other countries either the banks found ways of using current regulations or were given special accommodation. In all cases government interference or active support was necessary to establish Islamic banks working under the PLS scheme.
- C. *Re-training of staff*: The bank staff will have to attain many new skills and learn new procedures to operate the Islamic banking system. This is a time consuming process which is serious by two other factors. One, the total number of persons that need to be re-trained and, two, the supplementary staff that need to be recruited and trained to carry out the increased work.
- D. *Tax*: The bank is a big business and it has to declare its profit and loss and is legally essential to present an audited account of its operations. Once the bank's accounts are identified it doesn't take much for the tax collectors to figure out the share of the businesses financed by the bank under the PLS scheme. Thus it's no wonder that businesses are not too very happy about the situation. The fact that recommendations have been made to use the banks to collect taxes due has not helped the matter either.

X. S W O T ANALYSIS

- A. *Strengths*
- 1) 14.3 % residents of India is Muslim
 - 2) Can bridge the rising income difference in India
 - 3) Demand for niche products is growing in India
 - 4) Islamic banking will seem to be safer because of recent economic confusion's
- B. *Weaknesses*
- 1) Lack of knowledge
 - 2) Outdated Banking Act Regulations
 - 3) Differences in Islamic philosophy on shariah
- C. *Opportunities*
- 1) Push to real estate
 - 2) Addresses the issues of financial attachment
 - 3) Large no. of Muslims who are considered worthless of credit from commercial banks point of view can be targeted
- D. *Threats*
- 1) Could be a political weapon
 - 2) Against the materialistic fabric of the nation
 - 3) May bring financial isolation
 - 4) Micro finance is a good contestant

From above, it is clear that it faces many challenges in India. Banks will have to come out of religious set up and offer products of wider range to a wider audience. It's a challenge to provide a solution that follows to the basics of the Islamic finance concept and at the same time remains flexible enough to meet the demands of the changing environment. There is a need to guide Islamic banking so that it can be used by non – Muslims as well.

XI. CASE STUDY

- A. *Raghuram Rajan Committee Report*: The report of the Committee on Financial Sector Reforms (CFSR) of the Planning Commission, GOI to formulate a report on the next generation of Financial Sector Reforms. The Committee involved of 12 members, who were called by Dr. Raghuram Rajan, "some of the finest financial and legal minds of the country" and the report was an awesome display of true public-private partnership. The committee referred 16 virtual members and 38 relevant players in the financial sector arena. An initial draft report was placed in the public domain (website) for comments. The committee received a large number of comments directly

& through the press. Some individuals and institutions both within and outside the country placed the comments as well as submitted personally to the committee for including Islamic Finance and Banking in the report. Upon these submissions and representations the following commendation was included in the final report of the CFSR which is as follows:

“Another area that falls broadly in the ambit of financial infrastructure for inclusion is the provision of interest-free banking. Certain faiths prohibit the use of financial instruments that pay interest. The non-availability of interest-free banking products (where the return to the investor is tied to the bearing of risk, in accordance with the principles of that faith) results in some Indians, including those in the economically disadvantaged strata of society, not being able to access banking products and services due to reasons of faith. This non-availability also denies India access to substantial sources of savings from other countries in the region.

While interest-free banking is provided in a limited manner through NBFCs and cooperatives, the Committee recommends that measures be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system. This is in consonance with the objectives of inclusion and growth through innovation. The Committee believes that it would be possible, through appropriate measures, to create a framework for such products without any adverse systemic risk impact.”

- B. *Shari'ah Compliant Investment Product for Hajj Pilgrimage*: The recommendations of a high level committee set up by Prime Minister's office, chaired by Mr. Rahman Khan, Deputy Chairman; Rajya Sabha is under the attention of Government of India favouring a Shari'ah-compliant mutual fund to provide investment option to the Muslim community was submitted in July 2006. The PM has established a Committee of Secretaries headed by the Cabinet Secretary to look into the suggestion of this high level committee. The Committee had specially recommended a Shari'ah Compliant Investment Scheme to fund Hajj Journey as in Malaysia. Malaysia had set up a journey fund and formed a board called TABUNG HAJI.
- C. *Kerala Shows the Way*: Lately, the Government of Kerala launched a Shari'ah-compliant financial institution and wished to establish it by 2010 with the objective to grow into a full-fledged Global Islamic Bank. This institution will be started with a share capital of Rs.1000 crores and the Kerala State Industries Corporation will have 11% share and remaining 89% from private financiers. Already Ernst & Young has given a probability report and the financial institution will be set up on the basis of recommendation of that report. Additional study is being done through Ernst & Young to analyze the consequence of the Central, State and Municipal taxes for this Islamic financial institution.
- D. *Interaction with Deputy Governor, RBI*: When it was learnt that RBI is considering conversation on a few recommendations of Dr. Raghuram Rajan Committee on Financial Sector Reforms (CFSR), ICIF contacted the Governor RBI and sought an appointment to beg for the case of the recommendation of CFSR regarding Interest-free banking. Accordingly a delegation of ICIF met the Deputy Governor Dr. K.C Chakrabarty on September 11, 2009 and presented a letter along with the following important documents. According to the Deputy Governor: RBI, which has plans to increase the reach of banking system to more people, will welcome to announce interest-free banking, provided the Government takes a decision.

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