Issues and Challenges in Implementation of Islamic Banking in India

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Though lot of efforts have been made to start the Islamic or Sharia Banking in India where no interest is charged for equitable financing and mortgage but Reserve Bank has set no deadline to introduce Islamic Banking in the country An inter departmental Group has been set up on the instructions and guidelines of Central Government to examine the legal technical and regulatory issues for introduction of Interest free banking In India In Islamic banking the income and profit comes to the bank or financial institution is one time processing services charges or fees paid by the customers.

1. Introduction

1.1 Islamic banking is a banking system in accordance with the *Shariat*. In Islam, money has no intrinsic value – money, therefore, cannot be sold at a profit and is permitted to be used as per *shariat* only. The Islamic Law or *Shariat* prohibits paying any fee for renting of money (called *riba)* for specific periods of time. It also prohibits any sort of investment in businesses that are considered *haraam* or against the principles of Islam. It is largely believed that these principles have been derived from the Quran and have been in practice since then. Though lot of efforts has been made to start the Islamic or Sharia Banking in India where no interest is charged for equitable financing and mortgage but Reserve Bank has set no deadline to introduce Islamic Banking in the country. An inter departmental Group has been set up on the instructions and guidelines of Central Government to examine the legal , technical and regulatory issues for introduction of Interest free banking In India. In Islamic banking the income and profit comes to the bank or financial institution is one time processing services charges or fees paid by the customers when they take loans. Islamic finance is defined as the facility and provision of financials services and rules in accordance with Shariah law which does permit receipt and payment of interest (riba), gambling (maysir), excessive uncertainty (gharar), financing activities or short sales. All these activities in this law are considered to be risky and harmful for the society. Their main vision is that various parties in business transactions must share the risk and reward up to certain level which are for the benefit of real economy as a whole. There should be no speculation and exploitation of any person involve in this commercial transactions.

1.2 Few Co-operative Credit societies like AL Khair in New Delhi is registered as registered under the Multi-State Cooperative Societies Act, 2002, which allows it to function as a cooperative. It is jointly owned and democratically controlled by its members. . "Sharia law encourages minimizing monetary benefits." They also offer certain products that conventional banks do not, such as hajj accounts—deposit accounts for Muslims planning to go on the pilgrimage to Mecca. If borrowers are unable to repay or delay their repayments, the Islamic Bank are more flexible and understanding about it because their expenditure are very less, and this is a voluntary effort. The salaries of staff members are also very meager and they do it out of our own volition, rather than for the money.

2. Objective of the Study

1. To explore and understand the basic concepts and principles of Islamic Banking
2. To study the major issues and constraints in Implementation of Islamic Banking
3. To highlight the present status of Islamic Banking in India.

3. Research Methodology

The research is basically based on secondary data. Secondary data have been collected from the various web sites, and different journals, annual reports, periodicals magazines and weeklies published by the various data collection and research institutes Islamic Financial Institutes, study centres, consultancies firm, various Islamic consultancies conduct surveys from the customer and reports the need of Islamic Banking in India.

4. Research Problem

"In India thousands of crores earn in interest is kept in suspended accounts, as believers do not claim it. The assets controlled by Muslims are estimated to 1.5 trillion dollars and growing at 15% a year. In Kerala alone it is reported that this money could be above 40,000 crores. Research reveals that a handsome bulk of money in India own by the believers is laying idle which if invested in profit sharing basis, and utilized properly can have a major impact on the Indian economy.(According to a report published in RBI legal news and views Journal 2005 / Vol. 10 - Issue No.2) (sabakka) .The the amount of population of Muslim is a ready market for the Islamic banking in India and there is a desperate need for boosting entrepreneurship for which we need more financial services of various types and nature. To enhance and facilitates more and more entrepreneurs we need innovative financial services, so with these questions this paper will try to highlights the role of Islamic banking ,what we can achieve with Islamic banking

5. Review of Literature

Qureshi (1946): The early writers had been simply thinking aloud rather than presenting well-thought-out ideas. Thus, for example, the book by Qureshi on Islam and the Theory of Interest (Qureshi l946) looked upon banking as a social service that should be sponsored by the government like public health and education. Qureshi took this point of view since the bank could neither pay any interest to account holders nor charge any interest on loans advanced.

Qureshi focused on the importance of networking and partnerships between financial institutions, banks and Industry. Corporates and Businessmen take risk where profit or losses are not guaranteed. Is Islamic Banking, there was no mention of profit-sharing.

(Ahmad l952): Ahmad, in Chapter VII of his book Economics of Islam, envisaged the establishment of Islamic banks on the basis of a joint stock company with limited liability. In his scheme, in addition to current accounts, on which no dividend or interest should be paid, there was an account in which people could deposit their capital on the basis of partnership, with shareholders receiving higher dividends than the account holders from the profits made. Like Qureshi, above, Ahmad also agreed with possible partnership arrangements with the industry who seek capital from the banks. However, the partnership principle was not left undefined, nor was it clear who would bear the loss if any. It was suggested that banks should cash bills of trade without charging interest, using the current account funds.

Mohsin (l982): Mohsin has presented a detailed and elaborate framework of Islamic banking in a modern setting. His model incorporates the characteristics of commercial, merchant, and development banks, blending them in novel fashion. It adds various non-banking services such as trust business, factoring, real estate, and consultancy, as though interest-free banks couldnot survive by banking business alone. Many of the activities listed certainly go beyond the realm of commercial banking and are of so sophisticated and specialized a nature that they maybe thought irrelevant to most Muslim countries at their present stage of development. Mohsin'smodel clearly was designed to fit into a capitalist environment; indeed he explicitly stated thatriba-free banks could coexist with interest-based banks.

Siddiqi (1968): A pioneering attempt at providing a fairly detailed outline of Islamic banking was made in Urdu by Siddiqi in l968. His Islamic banking model was based on *mudaraba* and *shirka* (partnership or *musharaka* as it is now usually called). His model was essentially one based on a two-tier *mudaraba* financier-entrepreneur relationship, but he took pains to describe the mechanics of such transactions in considerable detail with numerous hypothetical and arithmetic examples. He classified the operations of an Islamic bank into three categories: services based on fees, commissions or other fixed charges; financing on the basis of *mudaraba* and partnership; and services provided free of charge. His thesis was that such interest-free banks could be a viable alternative to interest-based conventional banks.

Chapra (l985): The point that there is more to Islamic banking than mere abolition ofinterest was driven home strongly by Chapra. He envisaged Islamic banks whose nature, outlook and operations could be distinctly different from those of conventional banks. Besides the outlawing of riba, he considered it essential that Islamic banks should, since they handle public funds, serve the public interest rather than individual or group interests. In other words, they should play a social-welfare-oriented rather than a profit-maximizing role. He conceived of Islamic banks as a crossbreed of commercial and merchant banks, investment trusts and investment-management institutions that would offer a wide spectrum of services to their customers some scholars have put forward economic reasons to explain why interest is banned in Islam. It has been argued, for instance, that interest, being a pre-determined cost of production, tends to prevent full employment (Khan L968; Mannan l970). In the same vein, it has been contended that international monetary crises are largely due to the institution of interest (Khan,), and that trade cycles are in no small measure attributable to the phenomenon of interest (Ahmad l952). None of these studies, however, has really succeeded in establishing a causal link between interest, on the one hand, and employment and trade cycles, on the other. Others, anxious to vindicate the Islamic position on interest, have argued that interest is not very effective as a monetary policy instrument even in capitalist economies and have questioned the efficacy of the rate of interest asa determinant of saving and investment (Ariff l982).

6. Basic Principles and Concept of Islamic Banking

The basic principles of Islamic banking are

Profit and Loss Sharing: The lender and the borrower in business or partnership share both profits and losses arising from the business venture with the money obtained from the lender. The basic view is that the general community should benefit from such activities.

Prohibition for participating in Unethical Businesses: As the Islamic Law prohibits investing in unlawful businesses like businesses regarding selling and produce media for, gossip, pornography; and gambling.

Prohibition of Riba (Interest): Islamic Law prohibits the receiving and giving interest The disclosures coming to light for prohibitions of interest by Islamic Laws are: The interest deprives someone from the blessings of Allah ‘as it leads to taking away of property actually belonging to someone; The Law prevents taking of any type of agreed and prearranged amount over and above the actual principal amount from the borrower. And in case the borrower is unable to repay the principal then they should also forgo their demand for principal The Islamic Law condemns not only those who demands interest but also those who pay interest. The interest free banks have no issue in the principles. However, individual banks differ in their application. These differences can be because of several reasons including the laws of the country, objectives of the different banks, individual banks circumstances and experiences, the need to interact with other interest-based banks, etc.

Concepts

Amongst the common Islamic concepts used in Islamic banking are

Profit Sharing (Mudarabah): Islamic Banks offer savings and time deposits in the form of investment accounts under the system of *mudarabah*. The depositors of such accounts share profits and/or losses of the institutions under an agreed-upon formula. The depositors in mudarabah accounts are the suppliers of capital, rabb al-mal, who entrust their funds to the bank, mudarib, in the tradition of Western style investment banking, subject to dealings with only noninterest bearing instruments. The mudarib, acting as money manager or agent, invests the money and then distributes the profits and/or losses on the basis of the agreed-upon contract. The following conditions must be met:

Profits to be shared must be proportional to the funds contributed to the mudarabah account and these cannot be in lump sums or in guaranteed amounts. The loss to the depositor (contributor of funds) cannot be more than the amount of deposit.

Demand Deposits (Checking Accounts): The non interest bearing deposits are checking the conventional accounts in modern commercial banks but we know Islamic Institutions shun interest rate based dealings and most of them offer such demand deposit accounts. Ideally, Islamic Banks should not be charging any fees on checking accounts as they are free to employ the depositors ‘money, subject to the reserve requirements. In practice, however, this is not always the case. Depending on the size of the deposit, service charges and fees get collected to meet operating costs.

Joint Venture (Musharakah): The third instrument used by Islamic Banks is musharaka*h*, which is a form of equity financing through joint ventures. Unlike the case of mudarabah, here the bank not only participates in the supply of capital to the venture, but also in its management. Thus, the Islamic Banking Institutions assumes the role of an entrepreneur aswell as that of a financier

Cost Plus (murabahah): The fourth instrument, *murabahah* (or more specifically, baimujal murabah -cost plus financing), used by the Islamic Banks consist of transactions where the institution buys a product (e.g., a car or a machinery) on a client‘s behalf and then resells this with a mark-up to a client, the borrower.

Leasing (Ijarah): The fifth instrument used by the Islamic Banks is *ijarah* or leasing. Two types of leases are used. In one, the lessee pays the lessor installment payments that go towards ultimate purchase of the equipment by the lessee. This type of lease/purchase agreement is known as ijarah Wa-iqtina. The second type of lease maintains the ownership of the lessor as per the lease contract

7. Issues and Challenges of Implementation of Islamic Banks in India

First, if we keep proper consideration regarding the hurdles of Islamic finance and various supervisory and regulatory challenges involved in the matter and the basic matter is that Indians have no experience in this field of these issues and challenges. Secondly, certain faith forbids the use of financial instruments that pay interest. The non-availability of interest-free banking products results in many problems regarding poor strata of society and even we consider situations economically. It’s unable to access services and banking products due to reasons of trust issues.

In 2005, the RBI constituted the Anand Sinha Committee to explore the potential for implementing Islamic finance in Indian markets. After year’s of-long inquiry, the committee published a report that concluded it would be unfeasible to implement Islamic finance in India because it would require too many amendments and new regulations to the Banking Regulation Act.

In 2014, the State Bank of India was set to launch Sharia Mutual Fund, which would invest in sharia-compliant companies. This, however, was deferred at what Mr. Subramanian Swamy called the “eleventh hour,” because he wrote a letter of concern to Prime Minister Narendra Modi, arguing that Islamic banking would be “economically and politically disastrous” for India. He even said that this may lead to dubious funds in the Middle East entering into our country through legally baptized channels of Sharia compliant financial institutions.

Many meetings were undertaken with Dr Raghuram Rajan”—by then the RBI governor—“who had a good judgement sense, recommended the introduction of interest-free banking windows,” a compromise that would allow people to access several sharia-compliant products in conventional banks. The RBI submitted a proposal to the finance ministry in February 2016, stating that “Islamic banking may be introduced in India in a *gradual* manner.” The government, however, took no action on this proposal.

8. Road Ahead

Indian government should recognize Islamic finance in a formal capacity, as has already been done in over 60 countries, including the United Kingdom, Indonesia, Switzerland and Malaysia. While efforts to lobby for Islamic finance have been robust, and developments in the past decade have at times seemed promising, success for its advocates remains elusive. H Abdur Raqeeb is the General Secretary at the Indian Centre for Islamic Finance said, “According to the Islamic principle of zakat, alms are to be provided by the rich to the poor. But in the case of interest, as exemplified by traditional banking systems, money only going from the poor to the rich,. He further said that “it is not Muslims alone” who believe in the fundamental values of Islamic finance ithin the scriptural ambits of almost all religions—take Christianity, Judaism, or Hinduism—interest and usury have been abhorred.” While the precepts of Islamic finance are not universally agreed upon, they generally involve interest-free banking and the prohibition of investment in items or activities deemed un-Islamic, such as gambling, prostitution, alcohol and pornography. In addition to this, many people believe that sharia prohibits speculation, so trading that is considered overly risky or uncertain is generally proscribed.

This problem—of Islamic finance being seen as a threat to the country’s secular fabric—has dogged its supporters for years now. If Islamic finance were “presented as an attempt to bring ethics into the existing banking and financial system,” Syed told me, “there would have been more acceptances from majority community leaders.” He said that Economic Initiatives, as well as other Islamic-finance organizations, have lately been avoiding the word “Islamic” to describe their programmes, preferring terms such as “interest-free and equitable financing,” “micro equity” and “mutual insurance.”

Introduction of Interest Free and Equitable financing in India is feasible and can be a great success story with regulatory changes in Banking Regulations Act, 1949. Re-thinking of the new designed operations and format of Islamic banking has now been generally accepted globally. The stigma of association Islamic banking with sharia principles and terror financing is discarded on the basis that devastating effect of the global financial crisis on the giant financial institutions all over, Islamic banking system was marginally or not affected. In its annual report for 2015-16, the Reserve Bank had said that some sections of Indian society have remained financially excluded for religious reasons that preclude them from using banking products with an element of interest.

Towards mainstreaming these excluded sections, RBI has proposed to explore the modalities of introducing interest-free banking products in the country in consultation with the government of India. Challenges to Islamic banking can be addressed only through the help of Reserve Bank of India, religious bodies, and Islamic banking institutions by creating adequate awareness about the needs, objectives and the advantages of the institutions.

In a major move on 12thNov, 2017, the Reserve Bank of India (RBI) has decided not to pursue a proposal for introduction of Islamic banking in the country. . Sharia Banking is a finance system based on the principles of not charging interest, which is prohibited under Islam. The issue of introduction of Islamic Banking in India was examined by the RBI and the government of India, it said.

9. Recent Developments

“Taking into account, the wider and equal opportunities available to all citizens to access banking and financial services, it has been decided not to pursue the proposal further,” the Central Bank said The RBI was asked to provide details of steps being taken for the introduction of Islamic or ‘interest-free’ banking in India. Prime Minister Narendra Modi had on 28 August 2014 launched Jan Dhan Yojana, a national mission to bring about comprehensive financial inclusion of all the households in the country.

A committee on Financial Sector Reforms was formulated in late 2008 and this committee was headed by former RBI Governor Raghu ram Rajan. The Committee focused and had stressed on the need for a closer look at the issue of interest-free banking in the country. Certain faiths prohibit the use of financial instruments that pay interest. and the non-availability of interest-free banking products resulted economically degrade to many strata of society, and unable to access services and banking products because of trust issues and,” the committee told that lately on the instruction of the central government, an inter-departmental group (IDG) set up in the RBI acknowledged the technical, legal and regulatory issues for introducing interest free banking and has submitted its report to the government in India

The RBI had in February last year sent a copy of the IDG report to the finance ministry and recommended an “Islamic window” in conventional banks for gradual introduction of Sharia-compliant banking. “In our considered opinion, given the complexities of Islamic finance and various regulatory and supervisory challenges involved in the matter and also due to the fact that Indian banks are inexperienced in managing the Islamic Banking System .it is suggested that Islamic Banking may be introduced in India in a phased manner. Initially, a few simple products which are similar to conventional banking products may be considered for introduction through Islamic window of the conventional banks after necessary notification by the government,” it had said in a letter to the ministry. The letter further reads: It is also a general understanding that interest free banking for financial inclusion will require a proper process of the product being certified as Sharia complaint will be required both on the asset and liability side and the funds received under the interest free banking could not be mingled with other funds and therefore, this banking will have to be conducted under a separate window.”

10. Conclusion

It shall be in the interest of India to allow Islamic banks to operate and expand their network in the country along with traditional banks as their main focus is on social well-being and wealth generation activities in the society. It is hoped that their participation in Indian banking will lead to further infrastructural development in India. Considering the present status, Islamic banking is not possible in India as per the present banking regulation. But with the effort from government and reserve bank of India it is possible. . Islamic Banking' should be looked as 'Interest Free Banking' through the broad economic kaleidoscope and not a narrow religious prism.

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