

India in the Race of Islamic Banking in South Asia

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Abstract

In South Asia there are few countries where Islamic banking is not in operation. Although each country is trying to make the amendments in banking laws for the commencement of Islamic banking, still some countries having a good Muslim population are in process of doing the same. India is one of the countries, which is eagerly waiting for the amendment in Reserve Bank of India Act 1934. Islamic Banks are treated as Non Banking Financial Companies (NBFCs) in India, which can not issue cheques as are issued by conventional banks. The present paper tries to show when and how many Islamic banks have been started in south Asian countries especially in Muslim countries so that India may rethink over for the same. What amendments should Government of India do in banking laws so that Islamic banking can commence its operations in India. At the end suggestion for the same are also given.

Key words: Reserve Bank of India, NBFCs, India, Banking Laws.

Introduction

In south Asia there are 19 countries and only few are Muslim majority countries. The given below table shows the name of county and Muslim population in each country. An attempt has been made to count the Islamic banks and financial institutions in each country. The data presented here is what

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the author knows about Islamic banks in different countries from two websites¹ which present the number of Islamic banks and institutions in different countries.

Information about Islamic banks in each country has been tried to show in chronological order of their commencement and information of Islamic banks in five countries is presented here.

Country ²	Capital	Muslim Population ³	No. of Islamic Banks
Afghanistan	Kabul	99.7	No Information
Bangladesh	Dacca	89.6	06
Bhutan	Thimpu	1.0	No Information
Brunei	Bandar Seri Begawan	67.2	02
Cambodia	Phnom Penh	1.6	No information
India	New Delhi	13.4	No Islamic Bank
Indonesia	Jakarta	88.2	05
Laos	Vientiane	Less than 0.1	No Information
Malaysia	Kuala Lumpur	60.4	More than 13
Maldives	Male	98.4	No Information
Myanmar	Yangon	3.8	No Information
Nepal	Kathmandu	4.2	No Information
Pakistan	Islamabad	96.3	06
Papua New Guinea	Port Moresby	Less than 0.1	No Information
Philippines	Manila	5.1	No Information
Singapore	Singapore	14.9	No Information
Sri Lanka	Colombo	8.5	No Information
Thailand	Bangkok	5.8	No Information
Vietnam	Hanoi	0.2	No Information

Bangladesh

In Bangladesh there are following Islamic Banks:

1. **Islami Bank Bangladesh Limited.** It was established on March 13, 1983 and it started its work from March 30, 1983. This Bank is the first of its kind in South Asia. With the active co-operation and participation of Islamic Development Bank (IDB) and some other Islamic banks, financial institutions, government bodies and eminent personalities of the Middle East and the Gulf countries, Islami Bank Bangladesh Limited has by now earned the unique position of a leading private commercial bank in Bangladesh.⁴
2. **ICB Islamic Bank Limited** has been incorporated on April, 1987 as a public limited company under the Companies Act, 1913 to undertake and carry out all kinds of banking, financial and business activities, transactions and operations in strict compliance with the principles of Islamic law (Shar'iah) relating to business activities in particular avoiding usury in credit and sales transactions and any practice which amounts to usury. Certificate for commencement of business has been issued to the bank on April, 30, 1987. The Bank has been authorized by the Bangladesh Bank to carry on the banking business in Bangladesh with effect from May 4, 1987. However, actual banking operations commenced on May 20, 1987.⁵
3. **Al-Arafah Islami Bank** started its work in 1995 to introduce a modern banking system based on Al-Qur'an and Sunnah. A group of established, dedicated and pious personalities of Bangladesh are the architects and directors of the Bank. A noted Islamic scholar, economist, writer and ex-bureaucrat of Bangladesh government Mr. A.Z.M Shamsul Alam is the founder chairman of the bank. A group of 13 dedicated and noted Islamic personalities of

Bangladesh are the member of Board of Directors of the bank. They are also noted for their business acumen. Al-Arafah Islami Bank Ltd. has 53 branches and a total of 1080 employees (upto December 2008). Its authorized capital is Taka 2500 millions and the paid-up capital is Taka 1153.18 millions. Due to the good efforts of the directors, Islamic bankers have made Al-Arafah Islami Bank Ltd. most modern and a leading bank in Bangladesh. The headquarter of the bank is at Dhaka, Bangladesh.⁶

4. **First Security Islami Bank Limited (FSIB)** was incorporated in Bangladesh on 29 August 1999 as a banking company under Companies Act 1994 to carry on banking business. It obtained permission from Bangladesh Bank on 22 September 1999 to commence its business. The Bank carries banking activities through its Fifty two (52) branches in the country. The commercial banking activities of the bank encompass a wide range of services including accepting deposits, making loans, discounting bills, conducting money transfer and foreign exchange transactions, and performing other related services such as safe keeping, collections and issuing guarantees, acceptances and letter of credit⁷.
5. **Islamic Finance and Investment Limited (IFIL)** was incorporated on February 27, 2001 as a Public Limited Company with the Registrar of Joint Stock Companies (RJSC) under the Companies Act 1994. The Bangladesh Bank (BB) issued license to IFIL to operate as NBFIL on April 12, 2001. IFIL started its commercial operation (investment) on April 19, 2001 with establishment at Noakhali Tower, 55, Purana Paltan, Dhaka-1000, Bangladesh by the 23 Bangladeshi businessman. In August 2001, IFIL shifted its registered office to the present address at

Chand Mansion, 66, Dilkusha C/A, Dhaka-1000. From the very beginning of its operation, IFIL is playing an important role in private sector leasing and real estate business. As a full fledged financial institution it receives deposits and extend Investments through better counseling and effective services to the client for the socio-economic development of the country. The company continued to be a major financier to Industrial sector and has also supported sectors like Real Estate, Trading and other sectors⁸.

6. **Shahjalal Islami Bank Limited (SJIBL)** commenced its commercial operation in accordance with principle of Islamic Shar'iah on the 10th May 2001 under the Bank Companies Act, 1991. During last ten years, SJIBL has diversified its service coverage by opening new branches at different strategically important locations across the country offering various service products both investment & deposit. The headquarter of bank is in Dhaka⁹.

Brunei

Brunei has the following Islamic Banks:

1. **FPerbadanan Tabung Amanah Islam Brunei** was established under Perbadanan Tabung Amanah Islam Brunei Cap 163. TAIB was officially launched by His Majesty Sultan Haji Hassanal Bolkiah Mu'izzaddin Waddaullah ibn Al-Marhum Sultan Haji Omar 'Ali Saifuddien Sa'adul Khairi Waddien, Sultan and Yang Di-Pertuan of Negara Brunei Darussalam, the Present Monarch who is also the Supreme Executive Authority of the Country on the 29th September 1991. The launching of TAIB marked a new beginning for Brunei Darussalam as TAIB was the first Financial Institution that

conducted all its activities in accordance with Islamic faith¹⁰.

2. **Bank Islam Brunei Darussalam**, on 7th July 2005, an announcement was made by the Ministry of Finance that His Majesty the Sultan of Brunei has consented for the proposed merger of Islamic Bank of Brunei Berhad (IBB) with Islamic Development Bank of Brunei Berhad (IDBB). A new company, Bank Islam Brunei Darussalam (BIBD) was incorporated on 10th September 2005. A "Vesting Order" was obtained from the High Court of Brunei Darussalam on 1st May 2006. BIBD was fully operational on 3rd July 2006 as a full fledged Islamic Bank with more than 600 employees.¹¹

Indonesia

In Indonesia there are following Islamic Banks:

1. **Bank Muamalat Indonesia** was established in November 1, 1991, endorsed by the Indonesian Council of Ulama and the Government of Indonesia. The bank commenced its operations in May 1, 1992. Supported by the Indonesian Association of Muslim Intellectuals and a group of Muslim entrepreneurs, the founding of Bank Muamalat also won the support of the general public.¹²
2. **Takaful Indonesia** was established in February 24, 1994 and has been serving the community with insurance services which accord with the principles of Shari'ah, for more than a decade. There are two takaful companies operating in Indonesia, one is Family Takaful Insurance Company (Life Insurance Shari'ah), and the other is General Takaful Insurance Company (Shari'ah Commercial Insurance). The headquarter of the company is at Jakarta, Indonesia.¹³

3. **Bank Shari'ah Mandiri**, was established on October 25, 1999 and it started its operations from November 1, 1999. It is one of the leading banks in Indonesia as it is spread over 26 provinces throughout Indonesia. The headquarter of the bank is at Jakarta with 3109 employees as on December 31, 2009 were 3109.¹⁴
4. **Bank Shari'ah Mega Indonesia** started its operations on August 25, 2004. This bank is realized by developing strong capital base through the provision for the development of Islamic banking and economic development of Indonesia in general. Bank Syariah Mega Indonesia, which has the motto "for us all" grow rapidly and become a leading Islamic financial institutions succeeded in obtaining various awards and achievements.¹⁵
5. **Bank Shari'ah Bukopin**. It started its journey started from a public bank, PT Bank Persyarikatan Indonesia, which was acquired by PT Bank Bukopin to be developed into Islamic banks. Bukopin Bank began operations with conducting business based on Islamic principles of Shari'ah operating permit approval from Bank Indonesia on October 27, 2008 and on December 11, 2008 it was inaugurated by Vice-President of the Republic of Indonesia. Full commitment of PT Bank Bukopin as the majority shareholder is realized by adding a capital contribution in order to make PT Bank Syariah Bukopin as an Islamic bank with the best service. And on July 10, 2009 through approval from Bank Indonesia, PT Bank Bukopin has transferred rights and obligations of his Sharia into PT Bank Syariah Bukopin.¹⁶

Malaysia

In Malaysia, the roots of Islamic banking go back to 1963

when the government established Tabung Haji or Pilgrims Management and Fund Board. But the establishment of Bank Islam Malaysia Berhad (BIMB) in July 1983 marked a milestone for the development of the Islamic financial system in Malaysia. Today, Malaysia has a full-fledged Islamic financial system operating parallel to conventional financial system. In terms of products and services, there are more than 40 different Islamic financial products currently available in a country. In this country many conventional banks have Islamic banking window.

1. **Kuwait Finance House**, Incorporated in 1977 as the first bank operating in accordance with the Islamic principles of Shariah, Kuwait Finance House (Malaysia) Berhad (KFHMB) is the first foreign Islamic bank that was granted a licence under the Islamic Banking Act (Malaysia) 1983.¹⁷ It is a wholly-owned subsidiary of KFH. The move to set up an office in Malaysia was on the heels of Bank Negara Malaysia's (BNM's) decision to open up the country's Islamic banking industry to qualified foreign players as recommended under its Financial Sector Master Plan. As the regional headquarters of KFH in the Asia-Pacific region, the bank's main role is to provide innovative Shariah-based financial solutions to its customers. In addition, the bank acts as the intermediary and facilitator to promote two-way investments and trade between Malaysia, Asia-Pacific and the Middle East. Bank's wholly-owned subsidiary, Kuwait Finance House (Labuan) Berhad is licenced to carry on offshore banking business in the Federal Territory of Labuan.
2. **Bank Islam** emerged as Malaysia's maiden Shari'ah-based financial institution when it commenced operations in July 1983. Since then, Bank Islam has become the symbol of Islamic

banking in Malaysia. Its vision to be “The Global Leader in Islamic Banking” illustrates its status as the flag bearer of the country’s Islamic financial services industry. From only RM80 million initially, Bank Islam’s paid-up capital swelled to RM1.73 billion as at June 2009,¹⁸ which was instrumental in making possible the growth of its assets and the implementation of its expansion programmes. Currently the bank stands at 93 locations and 656 terminals nationwide. The bank has its headquarter in Kuala Lumpur.

3. **Hong Leong Islamic Bank Berhad (HLISB)**, which is a member of the Hong Leong Group Malaysia, is a wholly owned subsidiary of Hong Leong Bank Berhad (HLB). With its beginning as the Islamic Banking arm of HLB, the division was incorporated as a separate entity on 28th March 2005 and is today a full-fledged Islamic bank with an authorized and paid up capital of RM1 billion and RM500 million,¹⁹ respectively. HLISB is a dedicated brand offering a comprehensive range of innovative solutions covering areas like structured finance, capital market, Corporate & Commercial, personal financial services, bancatakaful and wealth management. The Bank is poised towards reaching out to the needs of customers seeking an alternative to conventional banking.
4. **Asian Finance Bank Berhad**, a full-fledged Islamic Bank that was incorporated on 28 November 2005 and backed by a consortium of shareholders from leading Middle Eastern financial institutions – Qatar Islamic Bank and associates (70%), RUSD Investment Bank Inc of Saudi Arabia (20%) and Financial Assets Bahrain W.L.L (10%). Currently, Asian Finance Bank Berhad (AFB) is one of the three

- foreign Islamic Banks that has been granted a license by Bank Negara Malaysia (The Central Bank of Malaysia) to undertake Islamic Banking business. Asian Finance Bank is regulated and supervised by Bank Negara Malaysia under the Islamic Banking Act, 1983.²⁰
5. **EONCAP Islamic Bank** commenced business operations on April 1, 2006 thus becoming the full-fledged Islamic Bank of a commercial banking group in Malaysia. However, EONCAP Islamic Bank is not new to Islamic banking. The bank has been offering Islamic banking products and services earlier through EON Bank, when Bank Negara Malaysia introduced the window concept in 1993. EONCAP Islamic Bank Berhad is a wholly owned subsidiary of EON Bank Berhad, with an Authorized and Paid-up Capital of RM 1 billion and RM 398 million respectively.²¹
 6. **Al Rajhi Bank**, Leveraging on its established principles and operations in the Middle East, Al Rajhi Bank ventured out as an international bank by setting up its first overseas operations in Malaysia in October 2006. Operating on the same platform as the home bank, Al Rajhi Bank Malaysia extensively uses the latest banking technology to consistently provide customers with speed and convenience in banking. It opened its first and main branch at Jalan Ampang on 16th October 2006. Today, it has 19 branches, 14 in the Klang Valley, one each in Johor Bharu, Melaka, Penang, Kuching and Kota Bharu.²² Al Rajhi Bank is the largest Islamic banking group in the world recognized for being instrumental in bridging the gap between modern financial demands and intrinsic Islamic values. One of the fastest growing and most progressive banks in Saudi

Arabia, it owes its banking excellence to its unwavering commitment to Shariah principles and the use of technology to offer diverse products to meet customer needs. The Group has a vast network of over 500 bank branches, 2,000 ATM machines and over 18,000 POS installed all over the kingdom.

7. **Maybank Islamic Berhad**, a wholly owned subsidiary and the Islamic banking arm of Maybank Group, commenced its operations on 1 January 2008 in conjunction with the transfer of Islamic banking business of Maybank. It was the first commercial bank to offer Islamic banking products and services through a window concept in 1993. The setting up of Maybank Islamic is also in support of the Government's effort to position Malaysia as an international Islamic financial centre through the MIFC (Malaysia International Islamic Financial Centre) initiatives.²³
8. **Standard Chartered Saadiq Berhad** which is an Islamic bank started its operation in 12 November, 2008. Standard Chartered Saadiq Berhad (*Saadiq* means "truthful"), offers products and services to ensure that they are in line with Shari'ah principles. Headquarter of the bank is at Kula Lumpur.²⁴
9. **HSBC Amanah** is the global Islamic financial services division of the HSBC Group. It was established in 1998 with the aim of making HSBC the leading provider of Islamic financial services worldwide. With established and successful operations in the Middle East, Asia-Pacific, Europe and the Americas, HSBC²⁵ Amanah represents the largest and most comprehensive Islamic proposition of any international bank. With the global resources of the HSBC Group at its disposal, and the largest Islamic finance team of any international bank,

HSBC Amanah is uniquely positioned to understand, structure, and distribute financial services that are compatible with the requirements of Shariah (Islamic Law). In February 2008, HSBC Amanah Malaysia Berhad, the new fully fledged Islamic bank wholly owned by HSBC Bank Malaysia was incorporated. In August 2008, HSBC Amanah Malaysia commenced its operations. In November 2008, the first branch of HSBC Amanah Malaysia, located in Bandar Utama, was opened.²⁶

10. **Public Islamic Bank**, this bank started its operation from November 1, 2008. With the commencement of the new entity, the Islamic banking business of Public Bank which has been conducted through the window concept was transferred to Public Islamic Bank Berhad. Customer of the this bank can perform Islamic Banking transactions at all 242 Public Bank branches and 26 hire purchase centres in Malaysia.²⁷
11. **Alliance Islamic Bank**, a subsidiary of Alliance Bank Malaysia Berhad (ABMB), Alliance Islamic Bank Berhad (AIS) is well-positioned to tap the huge potential in the Islamic banking industry in Malaysia. The subsidiary is helmed by Tuan Haji Yahya Ibrahim following the successful development of the Islamic banking division under ABMB previously. AIS, with its holistic banking scope, focuses on consumer banking, commercial banking and SMEs to grow the business. It leverages on existing conventional banking sales and distribution channels to market and promote its products and services. This also presents a unique opportunity for Alliance Financial Group to focus and grow the Islamic investment banking segment especially in the wealth management and capital market sectors. Among its portfolio, AIS is offering Alliance i-Wish

Home Flexi, Malaysia's first Islamic deposit-linked home financing facility which allows Malaysians to own their homes faster, and Alliance CashVantage Personal Financing-i, a new two-tiered personal financing that offers 35% lower repayment for the first year. On the wealth management front, the Alliance Dana Adib Fund and Alliance Islamic Money Market Fund were ranked top 10 in the world in the Islamic funds category by Eurekahedge, the world's largest independent hedge-fund research company, in 2006.²⁸

12. **CIMB Islamic Bank Berhad**, headquartered in Malaysia, CIMB Islamic Bank is the Islamic banking arm of the CIMB Group. An award winning Islamic financial solutions provider, CIMB is a universal Islamic bank which provides Islamic investment banking solutions to corporations, financial institutions, government and high-net worth individuals as well as offering Islamic consumer banking services through our extensive branches nationwide.²⁹
13. **Bank Kerjasama Rakyat Malaysia** operates as an Islamic cooperative bank. It offers investment accounts, financing certificates, and savings accounts; personal and home financing, education financing, hire purchase, and pawn-broking; and accidental and disability insurance products. The company also offers ATM, bill payment, and electronic banking services, as well as personal financing for senior citizens.³⁰

Pakistan

Pakistan has the following Islamic Banks:

1. **Al Baraka Islamic Bank (AIB)** has the honour of being the pioneer of Islamic banking in Pakistan and

has been operating in the country since 1991. Over the years, the bank has successfully developed and maintained its identity as one of the leading providers of a host of banking products and services in strict compliance with Shari'ah principles. Currently operating with **29 branches in 17 major cities** in Pakistan, **Albaraka Banking Group** is the biggest Islamic banking group listed on the Bahrain Stock Exchange in terms of capitalization. It has been rated by Standard & Poor's as BBB- with a short-term rating of A-3. ABG offers retail, corporate and investment banking and treasury services strictly in accordance with the principles of the Shari'ah.³¹

2. **Meezan Bank Limited** is a publicly listed company offering Islamic Banking in Pakistan. It was first incorporated on January 27, 1997, starting operations as an Islamic investment bank in August of that year. In January 2002, Meezan Bank was granted Pakistan's first full-fledged commercial banking license dedicated to Islamic Banking, by the State Bank of Pakistan. The Bank's main shareholders are financial institutions, including the Pak Kuwait Investment Company, the Islamic Development Bank of Jeddah, and the Shamil Bank of Bahrain.³²
3. **Bank Islami Pakistan Limited**, the second full-fledged Islamic Commercial Bank in Pakistan, was incorporated on October 18, 2004 in Pakistan. Bank Islami Pakistan Limited was the first Bank to receive the Islamic Banking license under the Islamic Banking policy of 2003 on March 31, 2005. The Bank envisioned to focus primarily on Wealth Management as the core area of business in addition to Shariah compliant Retail Banking products, Proprietary and Third party products, and Integrated

financial planning services.³³

4. **Dubai Islamic Bank Pakistan Limited (DIBPL)**, commenced its operations in 2006. Since then, DIBPL has undertaken major initiatives to expand its branch network across the country. Under its consumer banking division, the bank is offering state-of-the-art Shari'ah, compliant products that effectively compete with those being offered in the market by conventional banks. It also has expertise in providing Retail, Private, Small and Medium Enterprises, Corporate, Investment Banking and Advisory services. The Bank launched Pakistan's first Islamic Visa Debit Card and introduced financial products covering Home Financing, Auto Financing, and Depository products. DIBPL is 100% owned by Dubai Islamic Bank PJSC (Public Joint Stock Company) and its nominated shareholders. The parent company is a listed company in Dubai.³⁴
5. **Emirates Global Islamic Bank Limited (EGIBL)**, started operations as a licensed Islamic Bank in February 2007 with sponsors from the United Arab Emirates and Saudi Arabia, and a business model to deliver Shariah compliant financial instruments through an urban/rural branch network, supported by quality customer service. The bank has its headquarter in Pakistan at Karachi. The network of the bank comprises of 60 on-line branches in 36 cities and towns, staffed by a work force driven by customer satisfaction, and enabled by the latest technology in Customer Relationship Management.³⁵
6. **Dawood Islamic Bank Limited (DIBL)**, Pakistan's sixth full-fledged Islamic commercial Bank officially commenced its operations on Friday, April 27, 2007. The Bank is the result of an initiative of the First Dawood Group who teamed up with Islamic

Corporation for the Development of the Private Sector (ICD) Jeddah, Unicorn Investment Bank - Bahrain, Al Safat Investment Company - Kuwait, Gargash Enterprises (LLC) - Dubai, Mr. Azam Essof Kolia - a Singapore based entrepreneur and Shaikh Abdullah Mohammad Al-Romaizan, an entrepreneur from the Kingdom of Saudi Arabia.³⁶ The bank has its headquarter in Karachi, Pakistan.

Indian Scenario

Globalization and convergence of financial services is set to give tough competition to Indian banks including conventional banks. Further vast scope for Islamic Banking exists in India as it requires large funds in the Infrastructure Sector. However, Islamic Banking has to be positioned as professional banking and not religion-based banking which can have serious political implications. Therefore, the Indian regulatory authorities have to be dealt with patience and logical reasoning. It must, however, be borne in mind that India offers great promise for the development of Islamic Banking and Finance. For instance, the Indian capital market is the most liberalized in the world and has good financial infrastructure. India is the second largest country in the world as far as population is concerned. It has been estimated that in July 2009, India has 1.17 billion populations. In India, Muslim population has been estimated to be 13.4 percent. Banking in India is totally base on interest and in this country 88 scheduled commercial banks (SCBs) - 27 public sector banks (that is with the Government of India holding a stake), 31 private banks (these do not have foreign banks. They have a combined network of over 53,000 branches and 17,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.

As far as Muslim population is concerned, India is the third largest country in the world. But India is also a country where Islamic banking is not allowed to function because of the regulatory aspect. Bangladesh has less Muslim population compared to India but still there are more than four full-fledged Islamic banks. Following table clearly indicates the Muslim population and Islamic Banking status.

Countries in the world with majority Muslim populations and their Islamic banking status

Rank in Population	Name of Country	Muslim Population	Status
1	Indonesia	207,000,105 ³⁷	2 Islamic banks
2	Pakistan	167,430,801 ³⁸	6 Islamic banks
3	India	156,254,615³⁹	No Islamic Bank
4	Bangladesh	140,446,365 ⁴⁰	4 Islamic banks
5	Turkey	70,800,000 ⁴¹	4 Islamic banks
6	Egypt	70,530,237 ⁴²	2 Islamic banks
7	Nigeria	64,3805,994 ⁴³	No information
8	Iran	64,089,571 ⁴⁴	15 Islamic banks
9	Algeria	32,999,883 ⁴⁵	1 Islamic bank
10	Morocco	32,300,410 ⁴⁶	No information
11	Afghanistan	31,571,023 ⁴⁷	No information
12	Saudi Arabia	26,417,599 ⁴⁸	2 Islamic banks

Although some banks/institutions are working on the Islamic banking principles in India, but they are treated as Non Banking Financial Companies (NBFCs). NBFCs are doing functions akin to that of banks; however there are a few differences:

- i) A NBFC cannot accept demand deposits (demand deposits are funds deposited at a depository

institution that are payable on demand — immediately or within a very short period — like your current or savings accounts).

- ii) It is not a part of the payment and settlement system and as such cannot issue cheques to its customers; and
- iii) Deposit insurance facility of DICGC is not available for NBFC depositors unlike in case of banks.

Taking the above differences into consideration, Islamic banks/institutions are not becoming popular in India and that is why maximum population is unaware about the working of Islamic banks. Also these institutions/banks have not showed good performance compared to conventional banks may be due to Government and public support.

To introduce the full fledged Islamic banks in India, Government has to make necessary amendments in banking laws.

RBI and Islamic Banking

In the straitjacket world of Indian banking, something as fascinating as Islamic banking is a distant dream. Nonetheless, countless advocates of Islamic banking have been trying their best over the years to propagate the concept. In furtherance of this propagation the Reserve Bank of India (RBI) constituted a committee in 2007⁴⁹ to examine the issue but viewed that Islamic banking cannot be offered by banks in India as well as the overseas branches of local banks under the present legal framework. Except a basic offering like current account, almost no other banking product in India can be modified to meet the conditions of Islamic banking. As a genre of financial services, Islamic banking shuns the very idea of interest rates, and rests on profit-sharing principles. Based on the Shariah law, it abhors the business of making money out of money, upholding the belief that wealth is generated through actual trade and investment.⁵⁰ The RBI has not put the report in the public

domain.⁵¹ While the final form of the report is not known, from the newspaper reports it can be collected that the members had pointed out how Indian banking laws come in the way of various Islamic banking principles. These are as follows:

Indian banking laws do not explicitly prohibit Islamic banking but there are provisions that make Islamic banking almost an unviable option.

The financial institutions in India comprises of Banks and Non Banking Financial Institutions.

Banks in India are governed through Banking Regulation Act 1949, Reserve Bank of India Act 1934, Negotiable Instruments Act 1881, and Co-operative Societies Act 1961.

Certain provisions regarding this are mentioned below:

- Section 5 (b) and 5 (c) of the Banking Regulation Act, 1949 prohibit the banks to invest on Profit Loss Sharing basis -the very basis of Islamic banking.
- Section 8 of the Banking Regulations Act (BR Act, 1949) reads, "No banking company shall directly or indirectly deal in buying or selling or bartering of goods..."
- Section 9 of the Banking Regulations Act prohibits bank to use any sort of immovable property apart from private use -this is against Ijarah for home finance
- Section 21 of the Banking Regulations Act requires payment of Interest which is against Shari'ah.

As regards to partnership by Islamic banks in a firm, the bank has to make sure that the manager does not avoid his responsibilities or obtain other non-pecuniary benefits at the expense of non-participating partners and ensure the veracity of the profit statements. Monitoring of data about firms in which Islamic bank invests would involve exorbitant cost. However, Islamic banks need to set up monitoring cell to keep them informed of the internal function of their joint venture. The implication is that banks and entrepreneur have to function

very closely.

Islamic banking needs to introduce corporate governance with transparent accounting standards. It needs to perform detailed evaluation before embarking Profit Loss Sharing Scheme, which demand a pool of highly trained professionals. The imparting of professional training is costly. Detailed principles are still to be laid down and techniques and procedures evolved to carry them out. It is only after the satisfactory achievement of these that proper training can begin.

It is observed that inability to evaluate a projects' profitability has tended to act against investment financing. Some borrowers frustrate the banks appraisal efforts as they are reluctant to provide full disclosures of their business. These exercises are not limited to relatively few large loans but need to be carried out on nearly all the advances made by the bank. Yet, widely acceptable and reliable techniques are yet to be devised. Moreover, the borrowers do not observe business ethics which make it difficult to establish close bank-clientele relationship - a condition for successful Islamic banking. Adverse selection has been one of the major impediments in the world of Islamic banking.

Among the other disincentives from the borrower's point of view is the need to disclose his accounts to the bank if he were to borrow on the Profit Loss Sharing basis. However, many small-time businessmen do not keep any accounts, leave alone proper accounts. And large conglomerates do not like to disclose their real accounts to anybody. The widespread lack of business ethics among certain business community will be another major hurdle in the path of Islamic banking in India.

The practices in use by the Islamic banks have evoked questions of morality. Some critics view *sukuk* (Islamic Bond) as unislamic in nature. Others criticize that financing through the purchase of client's property with a buy-back agreement and sale of goods to clients on a mark-up, involved the least risk and are closest to the old interest-based operations. *Bai'*

mu'ajjal (sale with deferred payment) and *Murabaha* (cost-plus financing) are permitted in the Shari'ah under certain conditions. What is being done in many countries are fictitious deals which ensure a predetermined profit to the bank without actually dealing in goods or sharing any real risk. This is against the letter and spirit of Shari'ah.

The BR Act even disallows an Indian bank from floating a subsidiary abroad to launch such products, or offering these through a special window. Thus, the upshot of the findings is that such banking experiment is impossible without a new law or multiple amendments to the RBI Act.

Another important consideration is the tax procedures. While interest is a passive income, profit is defiantly an earned income which is treated differently. If principles of Islamic banking are incorporated then how does it comply with the tax procedure is the moot question. Further RBI cannot act as the lender to such banks because such accommodation by the monetary authority is also interest based. Islamic banks cannot interact with conventional banks based on principles of interest.

Suggestions

India is eyeing a stake in the booming Islamic banking industry with its proposed implementation being assessed with great interest by the Indian policymakers. But they have to substantially modify the legal framework which governs the Indian banking system prior to offering Islamic banking financial services in the country.

- Under the current Indian banking laws, it is almost impossible for Islamic banking to be carried out in India due to the mandatory requirement for interest payments on deposits. The concept of profit-loss sharing or partnership is alien to the conventional banking framework of India and thus not allowed under the law. The tax treatment of Islamic finance products, unless reviewed, would be the biggest

hindrance to the implementation of Islamic banking in India.

- India is ready to make waves in Islamic banking but not without their Government's permission to the conduct of Islamic banking in the country.
- With 150 million Muslim populations, India stood to gain advantage to pool around one trillion dollars Islamic investment funds from Gulf countries compared with its other non-Muslim counterparts. This will help the national current account and fiscal deficit in check.
- Regulators are still in doubts about the scope of Islamic banking, having understood that from a mere religious perspective. A committee to analyse the impact of Islamic banking to the Indian communities not withstanding their religious faith was never established. Thus, the potentials of Islamic banking to resolve India's real economic problems were not realized.
- The prejudices about Islamic banking still remained as there was not yet report on economic viability of Islamic banking and its impact on inclusive growth.
- There was also a fear that Muslims may dominate the Islamic banking industry in India. Islamic banking requires a professional expertise beyond one's religious belief because it deals with commercial projects than mere monetary credit and debit transactions. While Indian Muslims may have an edge in terms of Islamic ethics required for Islamic banking but they lack professional exposures to manage modern commercial banking on Islamic ethics.
- There would be viable opportunities to energise the Indian economy with the participation of Muslims in Shariah compliant banking who were previously

excluded and the availability of funds for developments in India. It would help the poor and vulnerable as it allows the manufacturing and retail enterprise of unorganized sector and agriculture to obtain equity finance.

- The equity financing would also help India to fund irrigation, dams, roads, electricity, and communication projects along with other public infrastructure. These are areas where public finance is insufficient and debt finance may be a cause of deficit to the government.
- Islamic banking has one of the objectives as 'equal distribution of income', which in other words mean complete eradication of poverty. But it can be achieved only if Islamic banking is fully implemented in India.
- Government of India has allowed NBFCs (Non Banking Financial Companies) to work as per Islamic principles from 2011 and first bank of this kind will commence in Kerala this year. Although in India full fledged Islamic bank is not allowed but with the permission of first NBFC in Kerala, necessary arrangement for the bank will be done.

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