RESEARCH ARTICLE OPEN ACCESS

A REVIEW ON BANKING WITHOUT INTEREST: "ISLAMIC BANKING" NOT FULFILL THE BANKING REGULATION ACT 1949.

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UGC Net Dec 2018 Certificate No.-182016771

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Abstract

Islamic banking refers to interest free (RIBA) banking system with compliance of Sharia'h law. India has a huge opportunity for Islamic banking. Islamic banking is key booster for Islamic finance. Rapid growth in Islamic banking in developing countries makes the concept interesting. The need of study is to check strength, weakness and opportunity of Islamic banking in respect to India. Various literature regarding Islamic principles and finance are study deeply to get valuable insight about Islamic banking. This paper tries to explain the impact of Islamic banking with SWOT analysis. The paper will focus on barriers faced Islamic banking and opportunity in India.

Key Words: Islamic Finance, Islamic Banking, Sharia'h law, RIBA, Conventional banking,

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I. INTRODUCTION

The concept of Islamic Banking is as old as Islam itself. Islamic banking is helpful to encouraging Islamic finance that is why Islam has its own economic system. The concept of Islamic banking can be traced back to the origin of Islam itself. Proper implementation of Islamic banking took place in 1960s with establishment of MI GHAMAR local saving bank in Egypt. Islamic banking system is part of conventional banking system based on principle of Islamic laws (also known as Sharia'h law). The main principles of Islamic banking are emphasize on ethical and moral values in dealing all economic activities. The principle prohibited RIBA (acceptance and payment of interest). The Islamic banking operates according to the Sharia'h law which gives a complete code of life from production to consumption, income to expenditure etc. The source of Sharia'h law is Quran and therefore Islamic banking confirms with Islam religion.

How Islamic Banking Works: In order to earn money without charging interest, Islamic bank use equity participation system. It means that if bank grants the loan to business, the business pay back the loan without interest, but gives the bank a share of its profit. If the business defaults on the loan or does not earn any profit, the bank does not receive any profit either. Islamic banks work as a trading concern and financial intermediary to perform interest activities purely according to principle of Sharia'h. There are two types of activities performed by Islamic banks:

1- Fund based activity
2- Non fund based activity.

Product of Islamic Banking

1. RIBA- Prohibition of RIBA (interest) based monetary system. It defined as excess compensation without any consideration resulting from sale of good (Riba Al Fadl).
2. Mudarabah- Profit and loss sharing model of business (partnership). In this the capital

provider agrees to share the profit at an agreed ratio.

3. Musharakah- A joint enterprise structure with profit and loss sharing (joint venture). It is a joint enterprise in which all partner share the profit or losses of the venture.
4. Murabahah – This is fixed income loan for the purchase of dual assets with a fixed rate profit decided by the profit margin.
5. IJARAH- It is hire purchase which means lease, rent etc. It is an exchange transaction in which a known benefit arising from a specified asset is made available in return for a payment, but where ownership of the asset itself is not transferred.
6. Istisna- It is contract in advance payment is made for delivery of goods and services. It is agreement to sell or to buy from a customer a non existing asset which is to built according to the need of customer and is to be delivered on specified future date at a predetermined selling price.
7. Waidiah- Bank is deemed as the keeper and trustee of fund. A bank is deemed as a keeper and trustee of funds and become wholly responsible and liable for its safekeeping.
8. Qardhul –hassan- Loans which are interest free and given on goodwill. In this only principle amount was repaid by customer.
9. Takaful- Islamic insurance against interest. It means mutual help and assistance. It is similar to conventional insurance.
10. Halal activities- It prohibits investing in business like alcohol gambling, tobacco, weapons etc.
11. Waqf- It refers to a religious endowment in which ones wealth is used for Sharia'h compliant projects.
12. Sukuk- Refers to Islamic bonds. Sukuk securities adhere to Islamic laws.

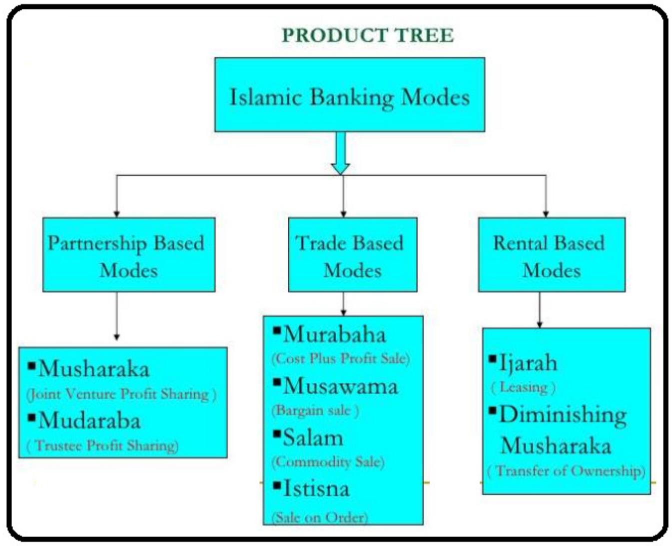


Fig: 01

II. REVIEW OF LITERATURE

Islamic banking system is part of conventional banking system. It is basically defined as interest free banking system. Islamic banking system is based on the principle of Islamic laws (Sharia'h law) and guided by Islamic economics, thus Islamic banking Plays imperative role in Islamic finance. To get valuable insight about the topic, the brief literature has been studied.

1- Mathew, Tiemsani and Siddiqui (2014): They described all the basic facts of Islamic banking. They explain the Islamic economic principle of sharing risk and rewards. They tried to provide all outline of Islamic banking. According to him interest free banks could be a best alternative to interest based conventional banking.

2- Moshin (1982): He presented a detailed frame work of Islamic banking in modern economy. His model adds various non banking services like- trust business, factoring, real estate etc. According to him a interest free banking cannot survive by banking business alone. Moshin model clearly explain that Islamic banking is fit for capitalist economy.

3- Dr. Jeet Singh and Dr. Preeti Yadav (2013): In their study they discussed about factor influence for growth of Islamic banking and explain the various opportunities for Islamic Banking in India. They suggest to increase awareness of Islamic banking as not a religious Institution, but as institution for the poor and backward community.

4- Mohammed Ariff (1988): He carried a survey on growing literature of Islamic banking. He traced the growth and development of Islamic banking and highlights its silent features. He argues that profit sharing can help to allocate resources efficiently. Thus Islamic banking is a best alternative to provide financial services.

HISTORY TRACK

1- Interest free banking and financial system started in early 1900s
2- The first successful example of an Islamic bank was seen in Malaysia. Tabung Haji came it to being with total 1281 depositor which increased to 867220 depositors with deposit over 1 billion Malaysian dollars.
3- In 1960 establishment of MIT GHAMAR local saving bank in Egypt based on ethos and values of religion Islam.
4- In 1970 establishment of financial institution, development of banked own by OIC countries.

Growth of Islamic banking: There are around 300 Islamic financial institutions in 75 countries. The plenty of non-Islamic countries now open Islamic "window" in conventional bank like- China, Germany etc.

COUNTRIES HAVE A DEVELOPED ISLAMIC ECONOMY FOR ISLAMIC FINANCE

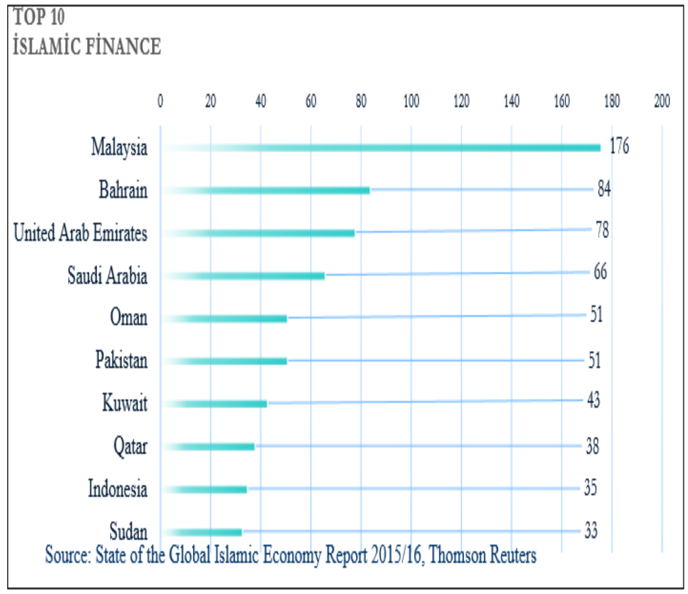


Fig: 02

- The fig: 02 explain the top 10 Islamic finance country according to their contribution in Global Islamic Finance. In this Malaysia topped and followed by Bahrain and UAE.

III. ACCOUNTING FRAMEWORK OF ISLAMIC BANKING

AAOIFI- The accounting and auditing organization for Islamic financial institution is an Islamic international autonomous non for profit corporate body that prepares accounting, auditing, governance, ethics and serial standard for Islamic financial institution and the industry.

Table: 01 Islamic Financial System Balance Sheet

Assets	Liabilities
1. Trade financing (Mudarabah)	1. Demand deposit
2. Partnership (Mudarabah and Musharakah)	2. Investment by depositor
3. Securities investment	3. Capital
4. Fees	

Key points

1. They have depositor and investor rather than lenders.
2. Risk sharing through profit and loss sharing.
3. Assets and liability are matched have ethical and social responsible assets.

Table: 02 Stylized Balance Sheet of Islamic Bank

Assets	Liabilities
1. Trade financing (Salaam, Murabahah)	1. Demand deposit (Amanah, Waad)
2. Leasing/rental (Ijarah/ Istisna)	2. Investment account (Mudarabah)
3. Profit and loss sharing investment (Mudarabah)	3. Special investment account (Mudarabah)
4. Fees for services	4. Capital equity and reserve

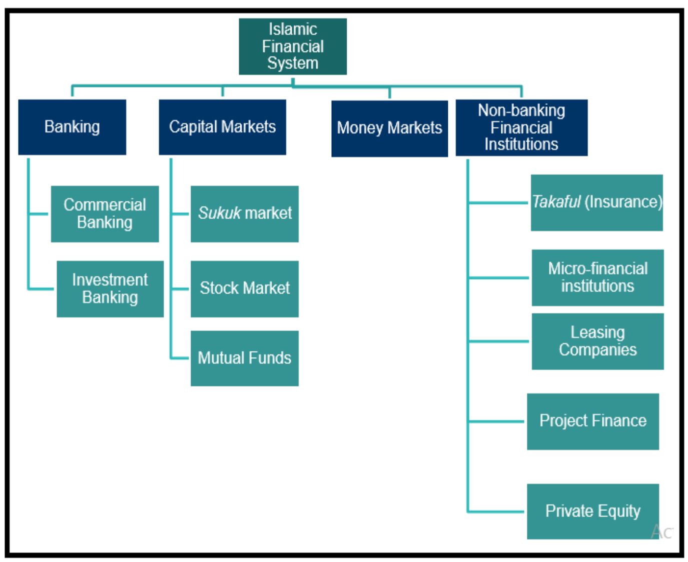
AUDITING STANDARD OF AAOIFI:

AS 1- Objective and principle of Auditing
AS 2- Audit Report
AS 3- Terms of Audit Engagement
AS 4- Testing for compliance with Sharia'h Rules and Principle by an External Auditor
AS 5- The Auditor's responsibility to consider the fraud and error in an Audit of Financial Statement.

GOVERNANCE STANDARD:

GS 1- Sharia'h supervisory board, report and suggestions.
GS 2-Sharia'h review
GS 3-Internal Sharia'h review
GS 4- Audit and governance committee, for Islamic Financial Institution.
GS 5- Independence of Sharia'h supervisory Board.
GS 6- Statement on governance principle and disclosure for Islamic financial intuitions.
GS 7- Corporate social responsibility, conduct and disclosure for Islamic financial institution.

Source: Zamir Iqbal, PHD (The World Bank global Islamic finance development centre Istanbul, Turkey)



Components of Islamic Financial System
Fig: 03

Table: 03 Difference between Islamic banking and conventional

ISLAMIC BANKING	CONVENTIONAL
1. Operates on the basis of profits loss sharing	1. Operates on the basis of interest(payment and receipt)
2. Islamic banking deals with Halal products and services. All transaction must be in Sharia'h compliance.	2. Conventional bank invest their deposit in interest based model.
3. No provision to charge any extra money from defaulter.	3. Can charge additional money in case of defaulter.
4. Cannot have to guarantee of all its deposit.	4. Have the guarantee for all its deposit.
5. Based on **Sharia'h** compliant principle	5. Based on manmade principle.
6. Encourages assets based financing and based on commodity trading.	6. Based on money trading.

IV ADVANTAGES

1. **Financial inclusion-** Islamic banking could open new doors for the Muslims enabling the betterment affairs community and achievement of the goal of financial inclusion for all.
2. **Substantial flow of funds-** Islamic banking helps in continuous flow of fund in the market. It will help in mobilize large amount of money from Muslims. And also increase participation of Muslims community in GDP growth.
3. **Funds from gulf countries-** Islamic banking will also help in raising funds from gulf countries that India currency losing to other country. It could helps to boost in dealing with Muslims dominated countries.
4. **Prohibition of Haram activities-** Islamic banking prohibits in investment in Haram activities like gambling, alcohol, weapons. It promotes investment in real economic activities that leads to social welfare.

V Barriers in Developing Islamic Banking in India

1. Contradict to banking regulation act 1949

Islamic banking do not follow many rules and regulation of banking regulation act 1949 like

i) Section 5(b) and section 5(c) of the banking regulation act 1949 prohibits the banks to invest on profit loss sharing activity.

ii) Section 8 of banking regulation act 1949: "No banking company shall deal directly or in directly in buying and selling of product".

iii) Section 21 requires payment of interest which is against Sharia'h law.

2. In ability to maintain capital adequacy-

Islamic banking is interest free banking system thus would be unable to interact with interest. Thus it leads to inability to maintain capital adequacy.

3. Tax procedure-

Another important barrier for Islamic banking is tax procedure. If Islamic principles are incorporated then how does it comply with tax procedure is the most questions. Furthermore RBI cannot act as lender to such bank and cannot supervise such bank.

4. Lack of qualified Sharia'h expert-

The main barrier for Islamic banking in India is lack of qualified Sharia'h expert which leads to lack of confidence among investor. Without qualified Sharia'h expert frame work can't be established.

VI SWOT Analysis

Strength-

1. Islamic banking has become very popular across world.
2. Islamic banking are more stable.
3. Great emphasis on inclusive growth and poverty alleviation.

Weakness-

1. Lack of provision of interest free banking as per banking regulation act.
2. Desires greater level of business ethics and India that is yet to evolve.
3. Lack of close bank client ale relationships.
4. Lack of Sharia'h experts.

Opportunity-

1. Huge market size in India. As 10 million people are belongs to Muslims community.
2. Funds from gulf countries.
3. Helps in financial inclusive growth.
4. Islamic microfinance has huge potential to contribution to GDP increase.

Threats-

1. Threats to secularism and may result in political turmoil.
2. Having two parallel banking give rise to communalism.
3. Conduit of terrorism.

VII CONCLUSION

In India the scope of Islamic banking is very large because 140 million Muslims leaves in India. This concept will provide great opportunities for growth and development of Muslim community. Conceptually an Islamic bank has an equity based model structure. Islamic finance covers several types of financial contract that varying equity and profit loss sharing. India has a huge opportunity in operating Islamic banking, but main barrier is it contradiction with preamble of Indian Constitution and Banking Regulation Act 1949. Under the current Indian banking laws it is almost impossible for Islamic banking to be carried out in India due to mandatory requirements for interest payment on deposit. The concept of profit loss sharing not allowed in Banking Regulation Act 1949. In India this concept is only used as NBFCs.

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