



A STUDY ON ISLAMIC FINANCE UNDER INDIAN LEGAL SYSTEM

ABSTRACT

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Islamic Finance (interest-free banking) has been proved successful in several foreign countries and there exist a great deal of research material attesting the feasibility and viability of this institution. Taking advantage of the changed policy scenario, the academic and financial community and particularly Muslims intelligential must take initiative to pressurize the government of India and the Reserve Bank of India, to introduce necessary changes in the legal policy frame work, for officially accommodating interest free banking in to Indian financial system. For a full fledged Islamic bank to operate in India, Legislative changes are imperative. These changes may take a long time to get introduced. But that need not hold the introduction of shariah financing under the existing Legislative regime. This paper highlights the introduction of Islamic finance under the existing legislative regime and analyzes the prospects of India as a destination for Islamic investment.

KEY WORDS: *Islamic Finance, Shariah, Riba, Ijara, Muderaba, Musharaka, Interest Free Deposits.*

INTRODUCTION

Islam as a religion has several commandments for its followers regarding their financial dealings. No other religion in the world has such specific directive to the followers regarding their finance and business dealings.

Islamic finance refers to the financial activities that are carried out in ways which do not conflict with the principles of Islam. The Islamic financial system is founded on the absolute prohibition of the payment or receipt of any pre determined, guaranteed rate of return. This closes the door to the concept of interest and precludes the use of debt based instruments. In essence, the overarching principle of Islamic finance is that all forms of interest are forbidden. However the system encouraging risk sharing, promoting entrepreneurship discourages the speculative behavior and emphasizes the sanctity of contracts.

Today some of the world's largest bank like HSBC and UN Bank offer financial products which are shariah compliant.

OBJECTIVES

The main objectives of the study are;

- ✓ To study the concept of Islamic finance
- ✓ To evaluate the contemporary relevance of Islamic finance in India
- ✓ To identify the legislative changes needed to operate a fully fledged Islamic bank in India
- ✓ To give suggestions on the base of the study

DATA AND METHODOLOGY

Data used in the study are secondary collected from different sources like journals, newspapers, articles and websites. This study reveals the Islamic finance under Indian legal system. Collected data is used descriptive method for drawing the conclusion. On the basis of the study few suggestions are made at the end.



ISLAMIC FINANCE TRANSACTIONS TERMINOLOGY (TYPES OF FINANCIAL CONTRACTS)

- ✧ Ijara: Ijara is a leasing agreement whereby bank buys an item for a customer and then leases it back over a specified period.
- ✧ Ijara wa iqtina : this a similar arrangement except that the customer is able to buy the item at the end of the contract.
- ✧ Muderaba: it offers specialist investment by a financial expert in which the bank and the customer share any profits.
- ✧ Murabahe: it is a form of credit which enables customers to make purchase without having to take out an interest bearing loan. The bank buys an item and then sells it on the customer on a deferred basis.
- ✧ Musharaka : it is an investment partnership in which profit sharing terms are agreed in advance and losses are pegged to the amount invested.

SHARIAH RULINGS IN ISLAMIC BANKING AND INSURANCE

While elimination of “riba” or interest in all its forms is an important feature of the Islamic finance system, Islamic finance is much more. In essence, it aims to eliminate exploitation and to establish a just society by the application of the shariah law or Islamic law to the operations of banks and other financial institutions. To ensure the compliance of the shariah, Islamic banks use the services of religious boards have both supervisory and consultative functions. Since the scholars on the religious board carry great responsibility, only high caliber scholars are appointed to such boards. The religious board reviews the operations of the financial institutions to ensure that they comply with the shariah.

LEGAL PROVISIONS

Islamic banking in India is not possible unless the govt of India make RBI amend the Banking Regulations Act. Though Islamic banking needs amendments, under prevailing acts in India, interest free banking is quite possible. Because there are already following provisions in the prevailing act

1. Section 17(1) of the RBI Act 1934 states that the bank shall be authorized to accept money as deposit without interest from and the collection of money for the central and state governments, local authorities, banks and other persons.
2. Section 45 w (1) of RBI Act 1934 states that RBI has the power to regulate transactions in derivatives, money market instruments etc in public interest or to regulate the financial system of the country to its advantages determine the policy relating to interest rates or interest rate products and give directions in that behalf to all agencies or any of them, dealing in securities, money market instruments, foreign exchange, derivatives or other instruments of like nature as the bank may specify from time to time.
3. Section 21 and 21A of the Banking Regulations Act 1949 states that RBI has the power to control advances by banking companies. Every banking company shall be bound to comply with any directions given to it under this section. RBI's policy or banks practice of charging interest cannot be pulled to judicial discretion. Reserve bank may give directions to banking companies, either generally or to any banking company or group of banking companies in particular as to
 - a) The purpose for which advances may or may not be made
 - b) The margins to be maintained in respect of secured advances
 - c) The maximum amount of advances or other financial accommodation which having regard to the paid up capital, reserves and deposits of a banking company and other relevant considerations may be made by that banking company to any one company, firm, association of persons or individual.
 - d) The maximum amount up to which having regard to the considerations referred to in clause (c) guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual and

- e) The rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given. Considering the above legal provisions for deposits without interest and RBI's power to regulate policies related to advances and interest rates, RBI seems to be in a position to allow interest free deposits and advances with zero rate. RBI as sole monetary regulator of India is very much in a position to allow the banks accept deposits without interest and lend loans and advances with zero interest. RBI can allow transactions of interest free deposits and lending through specific windows in existing scheduled commercial banks at least on pilot basis. It will help achieve target of financial inclusion of those who are just excluded because they don't like to indulge into any interest based transactions. The existing statutory regime provides enough leeway to follow the law and shariah at the same time. Thus it is possible to carry on financing activity based on shariah by constituting;
- a) A cooperative credit society or a non deposit accepting non banking financial institution or
 - b) A trust or a company registered with SEBI operating as domestic venture capital fund or
 - c) A foreign venture capital fund registered with SEBI or
 - d) Run takaful business (Islamic insurance as a cooperative society where the cover is available to members only) or
 - e) Open an Islamic window in a conventional bank without awaiting any change in the existing laws and regulations and without contravening any of the existing laws or regulations.
- 2) RBI can just allow acceptance of deposit without interest and with object to financial inclusion may also frame a special credit policy for poor by allowing credits at zero interest rate to those who do not seek interest on their deposits
 - 3) Islamic investors around the world have become financially highly sophisticated. Launching of globally accepted benchmark like the share indices would help to buy the foreign investment into India
 - 4) Derivatives appear to be more at odds with the Islamic principles of finance which also prohibits speculation
 - 5) Appropriate amendments are required in banking regulation act, 1949 and separate rules and regulations will have to be framed to permit the business of Islamic banking
 - 6) There is sufficient scope for a conventional bank to open a specialized counter to carry out shariah financing activity and introduce products and services that comply with the extent laws and the rules and regulations, directions issued under and shariah
 - 7) The easiest way to introduce Islamic financial system in the Indian financial market is to start doing whatever is permissible within the extend laws and get noticed.

CONCLUSION

While Islamic finance has been growing and evolving, there have been efforts from certain quarters of diluting the basic characteristics of Islamic finance to make it suitable to the current scenario and make it more productive and profitable. The Islamic investment requires that the investors can pool in their money and invest it to earn halal (shariah compliant) profits but in India, there are no well known established banks, which are engaged in Islamic banking. In India wherever it is prevalent, it is done at a very small scale at local levels. Therefore there is an urgent need to develop and promote the growth of Islamic financial system in India. Hence necessary initiatives should be taken in this regard by ministry of finance, Indian stock exchanges, SEBI and Mutual fund management.

FINDINGS AND SUGGESTIONS

- 1) Islamic banking business in India is not possible unless the government of India and RBI amend the Banking Regulation Act.

We shall conclude this paper by drawing your attention to the observation made by Dr. Najatulla sadique an acknowledged authority on interest free banking “getting rid of interest from transactions is like keeping alcohols out of drinks. It is good who so ever does it.”

India can begin by issuing banking license to a few companies owing to function without interest

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