

# Chapter 46

## Islamic Finance in India: Financial Regulations Challenges and Possible Solutions

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### ABSTRACT

*In order to provide financial services effectively to almost 1.21 billion people, India has adopted a comprehensive financial system governed under a number of financial regulations. These regulations, through regular amendments, are kept updated and inclusive of modern financial concepts that emerge in national and international markets. Islamic finance is one of such modern concepts emerged at global level. Growing with an annual growth rate of 15-20 percent the Islamic finance industry is holding total assets, value estimated to be more than USD 1.6 trillion. Hence, the authors, in this paper tried to study the feasibility of providing Islamic financial services in India, especially in the areas of Retail banking, Microfinance, Venture Capital financing. The objective of this paper is to identify the major regulatory challenges facing Islamic finance and to propose the possible solutions so as to make this emerging industry an internal part of the Indian financial system.*

### INTRODUCTION

India is a home to almost 1.21 billion people (Ministry of Home Affairs, Government of India[GOI], (2011) out which more than 500 million are estimated to be living as ‘*unbanked*’ one (Chakrabarti, K.C., 2012). To tackle this issue the Government of India (GOI), under the policy of ‘*financial inclusion*’ has launched a number of programs to provide financial services to this financially excluded population. Despite all the efforts, there still exists a gap from Demand & Supply perspective. To bridge this gap

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the GOI should think of utilizing the alternative modes to provide financial services to these ‘*unbanked*’ people.

India, on the other side, has emerged as an important economic player and is standing along with the nations such as United States of America (USA), the United Kingdom (UK), Europe, Russia and China at global economic platforms. To retain this position in long run, the policy makers are targeting an annual Gross Domestic Product (GDP) growth rate of around 10 percent in coming years. To achieve the targeted ‘*double-digit*’ GDP growth India needs to upgrade its infrastructure facilities (energy & power projects, water projects, telecommunication, transportation, technology, etc). And, this process requires USD 1 trillion of investments in different sectors (Ministry of Finance, GOI, 2014). One of the most preferable ways to fulfill this huge capital requirement is to invite foreign investments using Venture Capital financing modes.

Islamic finance emerged as one of the profitable industry in global financial market, especially after the global financial meltdown. Due to the potential abilities it holds, the practices of Islamic finance has been adopted by a number of modern economies such as Indonesia, Malaysia, USA, UK, UAE, etc, as an internal part of their financial system.

It is in this context that this topic has been chosen by the authors. The objective of current study is to identify the major regulatory challenges facing Islamic finance in India and to propose the possible solutions to the identified issues.

## **BACKGROUND**

Islamic finance is not a new concept in India. The researches available on this subject show that the origin of Islamic finance here goes back to the 1890s when an Interest-free loan providing institution was established in southern part of India. But the first formal Interest-free credit society was believed to be established in the year 1923 in Hyderabad (Zamir Iqbal & Abbas Mirakhor, 2011).

Initiated as the small community based institutions scattered in different parts of the nation, the Islamic finance practices have developed considerably in Indian market, especially in the last one decade. The establishment of Alternative Investments and Credits Limited- an asset financing company in Kerala (2000), establishment of Al-Khair Co-operative Credit Society- an interest-free microfinance institution in Bihar (2002), policy level discussions in the Anand Sinha Committee (2006)- a working group formed by RBI to examine the financial instruments used in Islamic banking under the chairmanship of Mr. Anand Sinha, the Raghuram Rajan Committee (2008)- a high level committee on financial sector reforms formed by the GOI under the chairmanship of Dr. Raghuram Rajan, launch of the Secura India Real Estate Fund- an Islamic Venture Capital Fund in Kerala (2009 & 2012), establishment of Sahulat Microfinance- a society established to promote the interest-free microfinance practices in India located in New Delhi (2010), launch of BSE-TASIS 50 *Shariah* Index- a *Shariah* Compliant Equity Index developed under the partnership of Bombay Stock Exchange and Taqwaa Advisory & *Shariah* Investment Solutions in Mumbai (2011), Cheraman Financial Services Private Limited- an NBFC under the partnership of M/s Kerala State Industrial Development Corporation in Kerala (2011) are some of the success stories.

Regardless of all these developments, the existence, operations and growth of formal Islamic Finance Institutions (IFIs) in Indian market is still a question that needs thorough exploration.

At the outset it is opined that due to the unfavorable legal framework it is impossible to provide Islamic finance services in India. Hence, the current study attempts to study the feasibility of providing

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