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ABSTRACT

KEYWORDS: ISLAMIC BANKING, INTEREST-FREE, BANKING LAW, ISLAM, FAITH & FINANCE

FROM THE past few decades, the global financial system has been witnessing a period of great churning and distress. The global recession triggered by the collapse of major banks in the U.S.A, has revealed the fault lines of the conventional financial order; thereby drawing attention to an alternate paradigm of financial intermediation – ‘Islamic banking & finance’. Despite being in existence since the mid-20th century, Islamic banking has remained on the periphery of the global financial landscape. However, the recent trends have shown an upward growth in the Islamic banking industry. The new-found relevance and utility of Islamic banking has raised questions pertaining to its governing principles which controls the functioning of the ‘*Shariah*-compliant’ banks. The study is an attempt to understand the Islamic law on banking, and critically analyse its place and application in the existing legal and regulatory order.

The religion of Islam not only codifies the spiritual relationship between the God and the humankind, but it also contains certain sacrosanct values which governs the ‘Islamic way of life’ – social, political, cultural or economic. These values are consolidated into a body of rules, generally referred as the ‘Islamic law’ or ‘*Shariah*’. The Islamic banking is based on certain principles of Islamic law (*Shariah*) – which is an all-encompassing body of rules according to which Muslims are expected to conduct themselves. The Islamic banking system based on ‘interest-free’ banking, permits only profit-sharing participatory banking. The prohibition on interest (*riba*) emerges from various sources of the Islamic law (including *Al-Quran* and *Sunnah*) which mandates that an increase in money, unless backed by a physical tangible asset and without any sharing of risk, is of no value. Moreover, uncertain and speculative financial transactions are also prohibited under the rule of *Gharar* and *Maysir*. While investment in *haram* businesses are proscribed, beneficent lending under *qard*, or *zakat*

are encouraged. Nevertheless, when these ‘faith-based’ principles are applied to statutory and regulatory framework of the State, it presents unique legal and technical challenges to the Govts. and the regulators. In otherwords, conformity with the precepts and practices of Islamic law obligates the banks to operate on an unconventional business model, which is entirely different from the traditional concepts and notions of the banking business.

The Islamic banking is a key banking system of several Muslim majority countries – such as the Middle-East countries (GCC, Iran, and Turkey etc.) and South East Asian countries (e.g. Indonesia, Malaysia, and Brunei etc.). But in recent years, several countries of the West (U.K., France, Luxembourg, and Germany) have embraced the *Shariah*-compliant banking as an alternate system. The existing study has focused on the legal (statutory and regulatory) framework of Islamic banking presently operating in Malaysia and U.K. The Malaysian model has shown steady and sophisticated framework of Islamic banking which is ‘government-driven’ – with separate laws, regulations, and regulator to specifically cater to the needs of the Islamic banks. While, the U.K. has exhibited a case where various instruments of Islamic banking and finance have been accommodated in an otherwise religion-neutral banking framework, without creating separate norms and regulations. Thus, U.K.’s “no favour but no discrimination” approach has allowed the operation of Islamic banking on an ‘equal footing’ with conventional banking.

The introduction of Islamic banking in India has been an evolving discussion since 2000. The RBI and the Govt. of India pondered over the idea of establishing *Shariah*-compliant banks since 2005. The Raghuram Rajan Committee (2007), Mohanty Committee (2015), and several other experts have pointed out the problem of voluntary financial exclusion among Muslims due to absence of interest-free financial products. It has been recommended that the establishment of ‘interest-free’ banks would prove useful in addressing various socio-economic problems. However, the BR Act and other banking laws were enacted at a time when Islamic banking was unknown to the mainstream Indian banking. Moreover, the regulatory framework of India is also interest-bearing and discourages banks from taking risk-positions in the businesses they finance. Thus, the researcher has hypothesised that the existing statutory and regulatory framework was not feasible to accommodate Islamic banking in India. Notwithstanding the absence of any express provisions prohibiting Islamic banking, the BR Act, RBI regulations, and other laws, at several instances conflict with various principles of Islamic banking, which make *Shariah*-compliant financial products unviable.

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