India: Islamic banking and finance review

The last one year can be categorized as a mixed bag for the Islamic banking and finance sector in India with a lot of positive developments and some negative developments as well. Key challenges remain the apathy of the government (including elected representatives and the bureaucracy), a lack of general public awareness and a huge shortage of qualified Shariah scholars and professionals. SAIF AHMED provides an overview of the Islamic banking and finance landscape in India.

INDIA

By Saif Ahmed

As has been mentioned in the previous year's review, India's banking regulations (the Banking Regulation Act, 1949) expressly do not allow Islamic banking and amending these regulations would primarily be a political decision that requires parliamentary approval, which does not seem forthcoming in the near future due to the situation on the ground where the new government has not shown any inclination thus far to understand the concept of Islamic banking and facilitate its introduction.

However, as explained previously, Islamic finance can be implemented to a large extent in India through the non-banking route. It is this opening that is being utilized by various players with several Islamic financial institutions being floated across the length and breadth of the country but primarily focused on the southern and western regions with principal activity centers being the cities of Mumbai, Bangalore, Chennai and Kochi.

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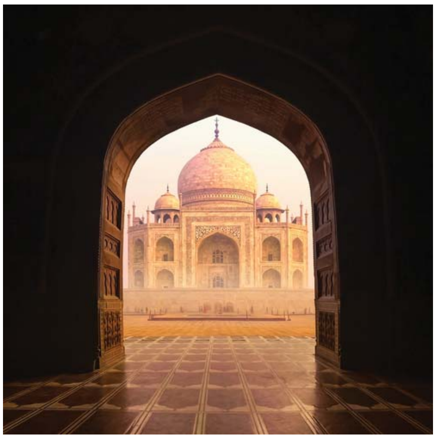
These initiatives are summarized as below:

- Non-banking finance companies (NBFCs): Presently still only one entity exists, namely Cheraman Financial Services with an authorized capital of approximately US$160 million based in the southern state of Kerala which has a large local and non-resident Muslim population. Current NBFC regulations would permit Ijarah-based financing and there remains a lot of scope for players to enter this segment and cater to the retail and corporate segments in areas such as automobiles, medical equipment and construction equipment. Cheraman has reportedly concluded some Ijarah deals in the medical equipment space.



- Cooperative credit societies: These are mushrooming all over the country as they are regulated by the state governments and the regulations allow for flexibility in structuring profit and loss-sharing deposits and offering financing as per various Shariah compliant products including Murabahah, Ijarah, Musharakah, etc.

  Though various entities can be quoted with some opening as many as 20 branches, they are yet to achieve any significant scale and many have been floated by promoters with little understanding of Islamic finance and Shariah compliance. For instance, most of these institutions operate without a formal Shariah board and depend on a service-fee loan model which by its very nature has not been well received by a large section of the scholar community.

- Rotating savings and credit associations (ROSCAs): These are permitted under the Chit Funds Act, 1982 which allows for Shariah compliance. Zayd Chit Funds, based out of Bangalore, has been operating as the first Shariah compliant and registered ROSCA in India since 2012. There is significant potential for other players to enter this segment especially in the southern part of the country where ROSCAs are very popular.

- Takaful operators: Various entities are looking at setting up mutual offering cooperative insurance by filling the void left by the conventional insurance operators who are regulated by the Insurance and Regulatory Development Authority. A key focus area is creating Takaful health plans for various income segments in light of the burgeoning healthcare costs in the country. During the past year, a parliamentary committee heard representatives arguing in favor of introducing regulation to facilitate mutual-based cooperative insurance into the new Insurance Bill that is being formulated with one of the representatives highlighting the concept of Takaful, its key features and global reach.

- Venture capital firms: This is an area where regulations stipulated by the Securities and Exchange Board of India expressly allow for Shariah compliance but still very few players have entered the market. Even some of the larger funds such as the Cheraman Fund with a corpus of approximately US$40 million are yet to show traction on the ground by building up an investment portfolio in what remains a huge market for such investments given the overall size of the Muslim population and the growing demand from Muslim entrepreneurs, industrialists and real estate developers for Halal funding.

- Mutual funds: Though India has one

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of the most developed stock markets in Asia, with two large exchanges namely the Bombay Stock Exchange and the National Stock Exchange, both of which have their own Shariah compliant listed indices, there has been little traction in developing equity markets as a Shariah compliant investment option both at the retail and mutual fund levels. There are still only two relatively small mutual funds that are labeled as Shariah compliant in a large universe, namely the Tata Ethical Fund and the Taurus Ethical Fund.

A significant development in this space was the abrupt decision to defer the launch of the SBI Shariah Equity Fund sponsored by SBI Funds Management, the asset management arm of India's largest retail bank, State Bank of India (SBI) in December 2014. The reason for this deferment, though not acknowledged officially by the sponsors, was the opposition by a well-known right-wing politician from the ruling party who is known for his opposition to Islamic banking with his letter to the prime minister being made available to the public.

This was the single most negative development for the sector in India over the past year as given SBI's huge branch network and reach, there was an expectation that the fund would be well received and marketed to all segments of the Indian Muslim community that is distributed throughout the country, thereby enabling them to participate in the equity markets where their share is much below the national average.

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- Investment management firms: This space has also seen a few entities spring up of late but the dearth of products has been a determent for the more serious players with very few options available. A significant development has been the mushrooming of so-called 'Shariah compliant' Ponzi schemes that target the gullible segment of the Muslim population with promises of high returns in the range of 40% to 60% per annum, which has hindered the operations of the genuine Islamic financial institutions in the country and which poses a danger to the overall well-being of the sector going forward.

- Advisory/training institutions: Given the general lack of awareness on the sector both at the community as well as the mainstream levels, a few institutions are playing a valuable role in disseminating knowledge on the subject through structured training programs, seminars, conferences, awareness programs and information sessions. Some of these firms such as TASIS and Infinity Consultants are also involved in offering Shariah advisory services for both local and foreign clients.

In conclusion, it must be said that for a market like India with its huge 200 million Muslim population, the question is never one of how much demand there is for Islamic banking and finance but in defining and executing the best models to tap this market given the various challenges that exist on the ground.

The growth of the sector will aid the financial inclusion of the Muslim community who will finally be able to get funding and invest as per the requirements of their faith. There also remains a significant potential to structure the first Sukuk in India which is being studied by a few players with various assets on the ground that could be financed.

Saif Ahmed is a former GCC-based Islamic banker based in India and is the managing partner of Infinity Consultants and the managing director of Zayd Chit Funds. He can be contacted at saif@infinity-consult.com.