

# **CRISIL Young Thought Leader 2008**

## **Dissertation on Islamic Banking in India - What is the future potential?**

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**Great Lakes Institute Of Management, Chennai, India**

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The study evaluates the efficiency of the Three factor model to evaluate the stock exchange returns in predicting stock returns and compares it with the CAPM model widely used for the Indian Markets.
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**M.H.S.S College of Engineering, Mumbai University, Mumbai, India**

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- 70.01 % in B.E (**First Class with Distinction**). Maintained a consistent and excellent academic performance.

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**Tata Consultancy Services, Mumbai**

[Oct'05 - Apr'08]

HQ: Mumbai India, Engaged in IT Services, Business Solutions and Outsourcing, Strength: 111500+

*Team Leader & Backup Project Leader, Complaint Management System Project for Tata Communications*

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*Tata Communications (Retail & Enterprise Business Unit), India*

- Roll out, **Implementation of Change Requests** from Customer and **complaints resolution** for Retail Business unit.
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- **VP Education** for **Toastmasters** Club (TCS Thane branch).
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- Implementation of "Sequence of Events Recorder" at **Tata Power Company Ltd.** as part of College Project Work.

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- Presented **paper** on "Evolution of Organized Retail in India and its Impact on Consumer behavior" at **IIMB**.
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## **Executive Summary**

Islamic Banking is currently growing at the rate of 20% annually and comprises 400 institutions with assets under management in excess of US\$ 1trillion. Given the vast potential of growing Islamic Banking Industry, it is essential to evaluate its future potential in India. The dissertation studies the potential market of this rapidly expanding banking system in India. With the enormous Muslim and poor population and significant requirement of capital in the country, there is tremendous scope for adoption of Islamic banks here. The dissertation also throws light on the potential contribution of Islamic Banking to economic growth by attracting FDI's from Gulf countries, offering financial stability & ensuring inclusive growth of the population. The dissertation finally evaluates possible approaches for establishment of Islamic banks in India by considering the models adopted by countries like Malaysia. It concludes with the immediate need for adoption of Islamic banks in the country under the recommendations of coveted Raghuram Rajan committee.

## **Introduction**

Islamic banking is now one of the world's fastest-growing economic sectors that comprise more than 400 institutions with assets under management in excess of US\$ 1trillion. Islamic banks operate in over sixty countries, though mostly concentrated in Middle-East and Asia. Islamic Banking is growing annually at 20%<sup>1</sup> and with \$1.5trillion floating in Middle-East<sup>2</sup> banks such as Citigroup, HSBC and cities like London, Hong Kong and Tokyo are fast becoming hubs for Islamic finance. The world's 100 largest Islamic banks have outpaced conventional banks with an annual asset growth rate of 26.7%<sup>3</sup>.

Islamic banking does not mean a mere lending institution extending interest-free loans, but a package of Shariah-compliant financial services<sup>4</sup> all of which have a tremendous market in India. A study by Grail Research reveals that given favorable regulatory conditions, India holds promising growth opportunity for Islamic finance institutions, whose asset base is expected to more than triple to \$1trillion by 2016. Presently in India, Islamic banking is confined to the co-operative sector. Only 10-15 Islamic banks with deposits of about Rs 75crore were operating all over the country in 2005<sup>5</sup>.

## **Potential of Islamic Banking in India**

The immense potential of Islamic banking in India can be judged through its vast Muslim population of about 150million which accounts for 13% of total Population<sup>6</sup>. However, 80% are financially excluded owing to unavailability of interest free banking<sup>7</sup>. Sachar committee claims that Indian Muslims have a share of 7.4% in saving deposits while they get only 4.7% in credit. According to RBI annual report for 2007-08, Indian Muslims annually loose around Rs. 63,700 crores which is 27% of their deposits. The total amount of interest lying suspended is a whopping Rs. 40,000crore<sup>8</sup>. Muslims avail just 4% and 0.48% credits from NABARD and SIDBI respectively. Islamic banking will provide a channel for Muslim investors to be a part of

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<sup>1</sup> Live Mint: Wall Street Journal Aug 3 2008

<sup>2</sup> Outlook Business December 2007

<sup>3</sup> Zawya Research group 25 march 08

<sup>4</sup> Financial products compliant with Islamic law (Shariah)

<sup>5</sup> Sify Finance 19 Oct 05

<sup>6</sup> Economic Census 2005

<sup>7</sup> Syed Abdul Zahid: Economics of Islamic Banking in India

<sup>8</sup> RBI Legal News and Views – Journal Section 2005/v0 10 Issue No2 April June 2005 Bindu Vasu

the financial sector. As per Mr. Raqeeb, ICIF even if 15% of the Indian Muslim population invest through Islamic Bank, the amount of Investments generated would be *Rs 4000 crore* which is enormous.

India also has a *large proportion of poor population*<sup>9</sup> having no access to financial services. As per economic census-2005 there were 51million non-agricultural enterprises in India which required amounts varying from Rs. 25,000 to Rs. 1million which is too small for most lenders. Only 4.2% of the poor sections had credit from formal institutions. There is desperate shortage of financing for micro and small enterprises and less than 3% of net bank credit goes to them.

The growth of Indian economy at 9%(EAC) also highlights *large requirement of capital* by India. The infrastructure capital requirement is estimated at 8.5% for 2007-08 by EAC<sup>10</sup>. The increase in disposable income of an average Indian household to Rs 1.2 lakhs in 2005 and growth rate of 5.3%<sup>11</sup> has increased credit and discretionary spending<sup>12</sup>. This has increased the requirement of housing & other loans and investment capital. There is also a surge of new ventures. This large requirement of capital dictates a strong growth potential for Islamic banks.

### **Contribution of Islamic Banks to Indian Economy**

Islamic Banking has the potential to tame liquidity and inflation problems, and promote inclusive growth. Increase in interest component of GDP over past years with public-debt/GDP ratio of 79.5% for March2006<sup>13</sup> has increased inflation to about 11%. However, equity finance if extended with far lower costs of credit has potential to restrict inflation. Simultaneously the dividend shared by depositors on equity finance helps equitable distribution of income generated by financial sector.

#### *Increased Inflow of Funds*

Islamic Banking will establish an alternative channel for investments from the Gulf Cooperation Council(GCC) Countries not investing under credit method of banking thereby attracting trillion dollars of equity finance. According to Global Investment House, GCC countries have invested

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<sup>9</sup> As per the Economic survey of 2007 -08 the poverty ratio for 2004 -05 is 27.5%.

<sup>10</sup> The total investment amounts to Rs 20,56,150 crores for the 11<sup>th</sup> five year plan

<sup>11</sup> McKinsey Global Institute 2005

<sup>12</sup> Discretionary spending is estimated to be 70% by 2025 as per McKinsey Global Institute

<sup>13</sup> Morgan Stanley Report

around \$406.3million in India which constitutes around 1% of India's total FDI. With the advent of Islamic banks in India, this number is expected to improve considerably. Companies like Kuwait Finance House, Abu Dhabi Investment Company and Qatar investment authority are willing to invest \$50-70 million in Indian companies<sup>14</sup>.

McKinsey Quarterly Report-July06 estimates \$1.5trillion investment from Middle-East owing to rising oil prices and is expected to rise to \$9 trillion by 2020. It highlights the transition of about \$80 billion from US and Europe towards other regions and shift in asset allocation to Asia by 10-30%. McKinsey also estimates the total funds available for investment in Asian countries involved with Islamic banking over the next five years at \$250 billion. Average investment per year comes to \$50 billion. If India is able to acquire atleast 15% of this amount by adoption of Islamic banking, contribution by them to total FDI Inflow will be \$7.5 billion which is about 30% of the total FDI Inflow in India<sup>15</sup> for fiscal year 2008-09 and 22% of the \$35 billion target for 2008-09. This will greatly aid in reducing current account deficit of the country.

Besides these, after 9/11, trillions of petro-dollars are waiting to be invested in India by Islamic Banks. Private equity players predict investment opportunity of \$6 billion petro-dollars in India<sup>16</sup>. Thus, Islamic Banking holds immense potential for attracting huge investments from Gulf countries which is highly important in the light of current global financial crisis<sup>17</sup> when India is looking for alternative sources of capital.

Significant investments are also expected from countries involved with Islamic banking like U.K, Singapore, China, Malaysia and Japan<sup>18</sup>.

#### *Stability to Financial markets*

The strict obligations of Islamic banks prevent the financial and economic enterprises from bankruptcy. The Islamic banking mechanism also strengthens the credit rating system to provide security of funds for depositors and investors. The credit rating under Islamic banking evaluates real term business potential and growth trends, instead of manipulated asset values responsible

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<sup>14</sup> Jayesh Desai, Ernst and Young, India report,

<sup>15</sup> \$24.57 billion for fiscal year 2007-08: Department of Commerce, India

<sup>16</sup> Economic times: 6<sup>th</sup> Sept. 06

<sup>17</sup> Fall of Financial Giants like Lehmann Brothers, Bear Sterns and other Wall Street banks

<sup>18</sup> WIBC – McKinsey Report 2007-08

for latest financial turmoil. The very fact that Islamic banks do not compete for extra credit shares, provides stability in the financial market.

The principle of Islamic prohibits transfer of public deposits to other banks without the permission of depositors. Thus there is no scope for a liquidity crisis to occur.

The insulation of Islamic Banks from the existing financial turmoil justifies the stability of Islamic Banking. This has been acknowledged by the fact that Islamic banks have grown by 20% in the year 2007.<sup>19</sup>

Overall, Islamic Banks are less risky than conventional banks.

#### *Inclusive growth of population*

India's significant growth of about 9% in the recent years cannot be termed equitable. Major part of the population has remained unexposed from organized financial products. With low collateral strength, farmers and poor workers lack access to loans and credits.

Islamic Banking has the potential to provide the desired capital to these sections through its unique method of microfinance called *ijara-wa-iktina*<sup>20</sup> and *morabaha*<sup>21</sup>. These schemes do not transfer the total interest risk onto the borrowers but risks are shared. For example, Islamic Bank provides capital to a farmer who provides labor to achieve the output. Profits are then equally shared between the two parties. Islamic banks strongly judge the credibility of borrower based upon the potential of their business proposals and thus promote rational, sound businesses backed by strong fundamentals.

Introduction of Islamic banking will aid inclusion of Muslims in financial sector. With 31% Muslims living below poverty line and 40% Muslim workers as own account workers, the financial exclusion<sup>22</sup> is apparently a serious economic disadvantage. Islamic banks will enable them to work with other community members cooperatively towards development of economy.

#### *Growth of SMEs*

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<sup>19</sup> Economic Times 05 Feb 2008

<sup>20</sup> Lease-cum-purchase

<sup>21</sup> Cost - plus financing

<sup>22</sup> Refer section Potential of Islamic Banking in India for more details

As per International Trade Centre, lending to SMEs is limited because of the relatively high transaction costs and perceived risks. RBI has acknowledged decline in SME credit from 15.1% in 1990-91 to 6.5% in 2006-07. Islamic banking through its scheme of *Mudaraba*<sup>23</sup> can provide the desired funding to SMEs and also share their financial risk, leaving them with only operational risk. This will ensure sustainable growth of SME's which is essential for the economic growth of country given the fact that SMEs constitute 80% of the total industrial enterprises and have a 40% share in industrial output<sup>24</sup>.

#### *Growth of Capital markets and Corporate Sector*

Equity financing being the chief investment tool of Islamic bank, stock market will be the most preferred avenue for investments by future Islamic banks of India. Parsoli Investments estimate that about 50% of Indian stocks are Shariah compliant. Thus trading activity on the stock markets will boom with Islamic banks. All the listed companies will get additional potential investors who genuinely subscribe their shares instead of indulging in speculator trading. This increased growth opportunities to the corporate sector will further fuel the economic growth.

#### *Countering Money Laundering*

Stringent anti-money laundering measures through Islamic banks have been established in countries like Malaysia, Britain and China<sup>25</sup>. The critical managerial control of the fund desired by Islamic banks may not be available with debt finance under interest-based banking. The universal nature of banking through Islamic Banks prevents surreptitious routes for investments and mutual funds.

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<sup>23</sup> venture funding

<sup>24</sup> Stuti Kacker, IAS Joint Secretary, Government of India, Ministry Small Scale Industries

<sup>25</sup> Syed Zahid Ahmad: Economics of Islamic Banking in India

## **Islamic Banking, The road ahead...**

Concept of Islamic banking in India is still in a very nascent stage<sup>26</sup>. There are many roadblocks towards their development. Following are some of the immediate measures that need to be undertaken.

### *Regulatory Environment*

Existing RBI laws do not permit establishment of interest free banks in India. Growth of Islamic Banks in India is not possible unless proper regulations are put in place to oversee them. Owing to the absence of Regulatory environment, Islamic banks cannot interact completely with conventional banks.

It is essential to resolve these regulatory hurdles for establishment of Islamic banks in India. RBI had instituted a committee under Mr. Anand Sinha to study the prospects of Islamic banks in India but there has been no significant growth in this regard. RBI has to play a key role in establishing a communication channel between Islamic banks and traditional banks and ensure a favorable environment for their functioning. RBI has to ensure transparent accounting practices and regular submission of required information and data by them. It also has to ensure development of secondary markets for Islamic Banks.

### *Banking for All*

Islamic banking has been misunderstood in India as a religious charitable venture restricted to country's economically downtrodden Muslim community. It is essential to shed these inhibitions about Islamic Banking which has more economic rationality compared to religious rigor. Moreover, there are strong possibilities of Islamic banking becoming a political agenda thereby losing its significance.

It is necessary to execute appropriate awareness campaign to convey the purpose and importance of Islamic banking for Indian economy and highlight growth of Islamic banking in non-Muslim

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<sup>26</sup> WIBC and McKinsey 2007-08 Report

countries like Britain, Thailand and Singapore. Islamic banks of Malaysia and Britain have registered non-Muslim customers ranging from 10-40%<sup>27</sup>.

#### *Parallel Track banking and collaboration with other banks*

Government should look forward to implementation of the successful Malaysian model of parallel-track banking<sup>28</sup> which ensures Islamic banks and traditional banks to work in tandem. A feasible option would be to operate Islamic Banks in India through established public sector institutions like SBI, Bank of Baroda, etc. Many private sector banks like HDFC, HSBC, and Citibank have also shown an interest towards such an initiative<sup>29</sup>. Government should also invite the foreign Islamic banks which have gained sufficient expertise to invest in India.

#### *Developing technical expertise*

Indians lack required financial depth, infrastructure and technical knowledge for managing Islamic banking in India. It is thus necessary to execute appropriate education programs to increase the knowledge and awareness of Islamic banking among the public. Aligarh Muslim University and IIBF, Hyderabad has taken an initial step by starting training programs on Islamic banking.

#### **Conclusion**

Islamic Banking is a powerful economic instrument capable of creating multi-sectoral impacts and should therefore be invited in India. It will contribute to greater financial stabilization, help real economy significantly, provide significant funds for expansion and more than anything act as a powerful antidote to poverty sans huge subsidies and grants that are making a big dent in our fiscal framework. It would open the doors for financial inclusion faster and quicker. There is vast evidence to support this from across the globe.

Today, Islamic banking is the buzzword in the global financial world with all the essential ingredients of modern day banking. Its credibility has been timely acclaimed by various research sources like McKinsey, KPMG, BCG and it has enjoyed the recommendations from various

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<sup>27</sup> H Abdur Raqeeb, Indian Centre for Islamic Finance

<sup>28</sup> Refer Malaysia model for development of Islamic Banking in Appendix

<sup>29</sup> Sify Finance 19 Oct 05

imminent personalities. The latest recommendation from Raghuram Rajan committee Sept 08 including Mr. R Ravi Mohan, MD&CEO CRISIL as a member strongly supports establishment of Islamic banking in India.

India has already paid a price for being late in catching the globalization bus in 90's. It should not repeat the same with Islamic Banking and develop a quick and agile strategy towards its adoption.

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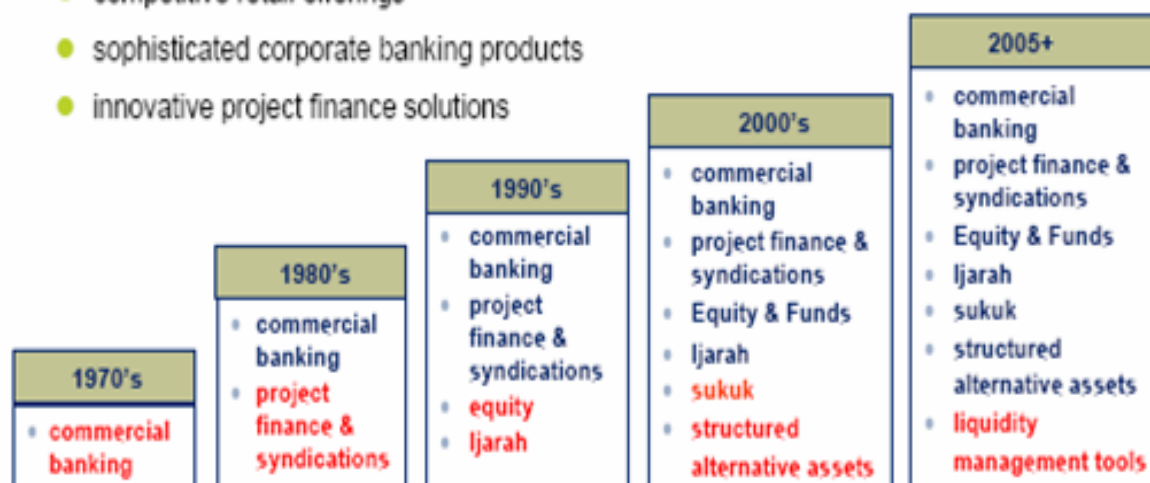
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- Articles from Economic Times of India, Times of India, The Hindu, Deccan Herald, Indian Express, Outlook Business
- [www.islamicfinancenews.com](http://www.islamicfinancenews.com)
- [www.mas.gov.sg/news\\_room/statements/2008/speech\\_by\\_mr\\_tai\\_boom\\_leong\\_executive\\_director](http://www.mas.gov.sg/news_room/statements/2008/speech_by_mr_tai_boom_leong_executive_director)

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## APPENDIX A: Growth Stages of Islamic Banking

### ■ A natural progression of the Islamic finance industry

- competitive retail offerings
- sophisticated corporate banking products
- innovative project finance solutions



Source: <http://www.iifm.net/>

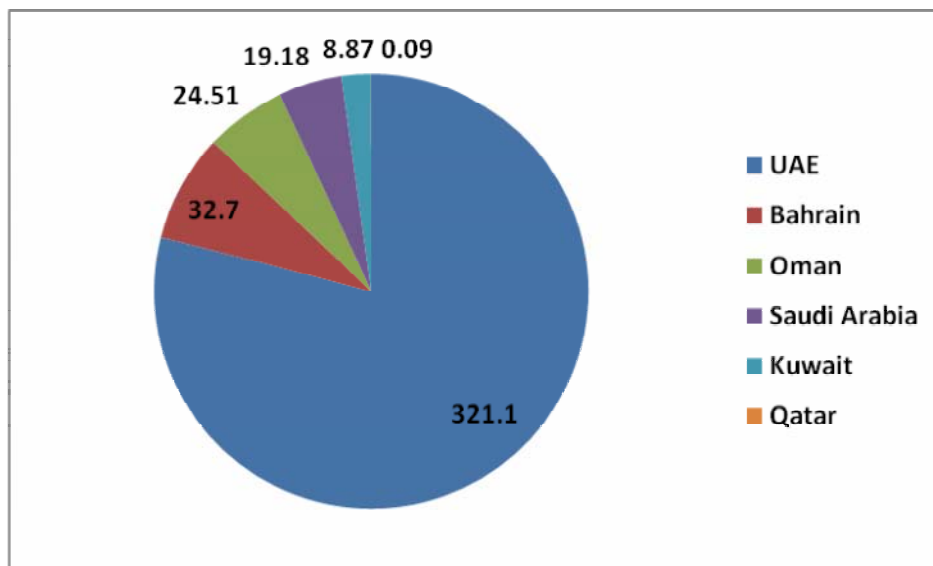
### Significant Established and Proposed Islamic Finance Deals in India

Date	Projects	Obligator	USD Million	Lead Arranger
December 2007	Economic Development Zone (EDZ)	State of Maharashtra	10,000	Gulf Finance House
November 2007	SREI Projects	SREI Infrastructure Finance Ltd.	50	HSBC Amanah / KFH
August 2007	Bearys Global Research Triangle	Bearys Groups	20	SEDCO
July 2007	Velcan Hydro Electric Dam	Velcan Energy Holdings	275	National Bank of Dubai
October 2007	Energy City of India	State of Maharashtra	2,000	Gulf Finance House

Not Decided	3 separate private Equity funds	NA	2700	Abraaj Capital
Not Decided	Balanced Infrastructure Fund	NA	500	Ithmaar Bank
Not Decided	Pre IPO Fund & Buy Out Fund	NA	1000	Global Investment House
Not Decided	Buy Out Fund	NA	3000	Dubai Islamic Bank

Source: Economic Times, Wednesday Jan 30 2008

**Investments by Middle East in India in 2008**



Figures are in \$ millions.

Source: Economic Times, Wednesday Jan 30 2008

## APPENDIX B: Principal Islamic Banking Products

1. **Musharaka (Equity finance):** A joint enterprise or partnership structure with profit/loss sharing implications that is used in Islamic finance instead of interest-bearing loans.
2. **Mudaraba (Agency finance):** Mudarabah is an arrangement or agreement between the bank, or a capital provider, and an entrepreneur, whereby the entrepreneur can mobilize the funds of the former for its business activity. The entrepreneur provides expertise, labor and management. Profits made are shared between the bank and the entrepreneur according to predetermined ratio.
3. **Murabaha (Working Capital finance):** This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin. The bank is not compensated for the time value of money outside of the contracted term however, the asset remains as a mortgage with the bank until the Murabaha is paid in full.
4. **Ijara (Hire purchase):** Ijarah means lease, rent or wage. Generally, Ijarah concept means selling benefit or use or service for a fixed price or wage.
5. **Bai Salam (Advance purchase):** It means a contract in which advance payment is made for goods to be delivered later. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract.
6. **Wadiah (Safekeeping):** In Wadiah, a bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it
7. **Quard Hasan (Rehabilitation finance):** This is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor.
8. **Takaful (Mutual Insurance):** Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals.

9. **Sukuk (Asset based -Bonds):** Sukuk is the Arabic name for a financial certificate but can be seen as an Islamic equivalent of bond. However, fixed-income, interest-bearing bonds are not permissible in Islam.

*Source:* Investopedia, Wikipedia

## **APPENDIX C: Recommendations for Islamic Banking**

1. While interest free banking is provided in a limited manner through NBFC's and co operatives, committee recommends that measures be taken to permit delivery of interest free finance on a larger scale, including through banking system. This is in consonance with the objectives of inclusion and growth through innovation. The committee believes that it would be possible through appropriate measures to create a framework for such products without any adverse systematic risk impact – **Dr Raghuram Rajan Committee Sept 08**
2. Conventional banks have since inception, had only one product – that is loan with interest, Shariah has unlimited products to suit every customer and every project under any circumstances - Dr. Hussein Hamid Hassan, Chairman, Shariah Board, Dubai Islamic Bank
3. Sir Gordon Brown, PM wants to make Britain “ Gateway to Islamic Finance & Trade”
4. Dr Rowan Williams Arch Bishop of Canterbury: “Islamic Law governs marital law, *financial transactions* and family disputes.”
5. Lord Chief Justice Lord Philip: “Islamic Legal Principles could be employed to deal with family and marital arguments and to *regulate finances.*”
6. “I want to turn Singapore into a center for Islamic financial services.”- Goh chok Tong, former Singapore Prime Minister and chairman of the Monetary Authority of Singapore (MAS).
7. “A presence in Islamic Banking is key to becoming a leader in the Asian Capital Market.”- Jackson Thai, CEO, DBS.
8. “Equity-based finance in an ethical banking model has proved its advantages over interest-based lending in the region’s experience and can be considered for emulation in India also” - Mr R Seetharaman, CEO of Doha Bank
9. “All Arabs will prefer Islamic banking” Dr Hussein Hamid Hassan

10. India did not make any distinction between Islamic banking and any other model of banking.” - Mr. P Chidambaram, Union Finance Minister

Source: H. ABDUR RAQEEB, Convener, Indian Centre for Islamic Finance (ICIF)

## APPENDIX D: Islamic Banking Institutions in World

### MIDDLE EAST

#### Bahrain

Bahrain Islamic Bank  
ABC Islamic Bank (E.C.)  
Shamil Bank  
Noriba Bank  
Gulf Finance House  
Albaraka Bank Bahrain  
Citi Islamic Investment Bank E.C  
First Islamic Investment Bank  
Al-Amin Bank, Bahrain

#### Iran

Bank Melli Iran  
Bank Saderat Iran  
Bank Mellat  
Bank Tejarat  
Bank Sepah  
Bank Refah  
Export Development Bank of Iran  
Bank Sanaat o Maadan  
Bank Keshavarzi  
Bank Maskan  
Karafarin Bank  
Saman Bank  
Bank Eghtesad-e-Novin  
Bank Parsian

#### Jordan

Jordan Islamic Bank  
Islamic International Arab Bank

#### Kuwait

The International Investor  
Kuwait Finance House

#### Lebanon

Al-Baraka Bank Lebanon

#### Qatar

Qatar Islamic Bank  
Qatar International Islamic Bank  
Qatar Islamic Insurance Company

#### Saudi Arabia

Islamic Development Bank  
ICIEC  
Al Baraka Investment & Development Co  
Al Rajhi Banking & Investment Corporation  
National Commercial Bank  
Bank Al-Jazeera

#### UAE

Dubai Islamic Bank  
Abu Dhabi Islamic Bank  
National Bank of Sharjah  
Emirates Islamic Bank

### SOUTH-EAST ASIA

#### Brunei

Islamic Bank Brunei  
Tabung Amanah Islam Brunei (TAIB)  
Islamic Development Bank of Brunei (IDBB)

#### Indonesia

Bank Muamalat  
Takaful Islamic Insurance International

#### Malaysia

Bank Islam Malaysia Berhad  
Bank Muamalat Malaysia Berhad  
MNI Takaful  
Syarikat Takaful Malaysia

#### Philippines

Al-Amanah Islamic Bank

### INDIAN SUBCONTINENT

#### Bangladesh

Islami Bank Bangladesh  
Social & Investment Bank Limited  
Islamic Finance and Investment Limited

#### India

Seyad Shariat Finance  
Al-Barr Finance House Limited (India)  
Al-Ameen Finance & Investment Corporation  
Parsoli Corporation  
Idafa Investments

**Pakistan**

Meezan Bank  
Islamic Investment Bank Limited, Pakistan  
Al-Baraka Bank Pakistan  
Grindlays Modaraba

**AFRICA****Algeria**

Banque Al-Baraka d'Algérie

**Gambia**

Arab-Gambian Islamic Bank

**Sudan**

Al Baraka Bank  
Sudanese Islamic Bank  
Omdurman National Bank Sudan  
Tadamon Islamic Bank Sudan

**South Africa**

Albaraka Bank South Africa

**REST OF THE WORLD****Turkey**

Albaraka Turkish Finance House

**UK**

Islamic Bank of Britain  
Dallah Al Baraka

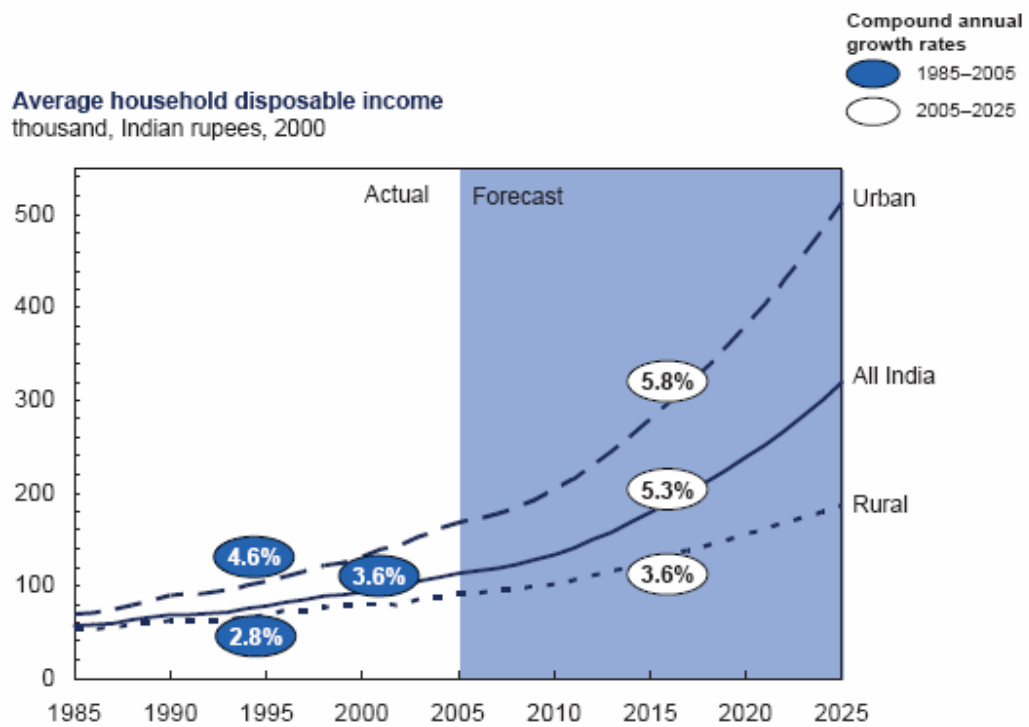
**USA**

Amana Mutual Funds Trust  
American Finance House, LARIBA Bank  
MSI Financial Services Corporation  
Manzil USA

*Source:* <http://islamic-finance.net/direc.html>

## APPENDIX E: India – Changing Demographics and Credit Requirements

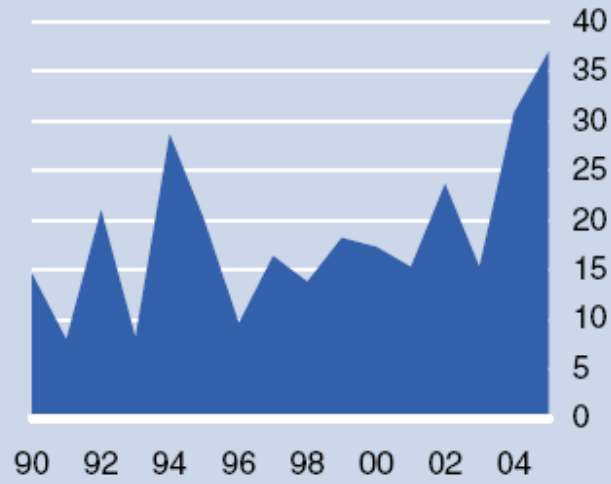
### HOUSEHOLD INCOME GROWTH WILL ACCELERATE ACROSS INDIA



Source: McKinsey Global Institute

### Credit growth is surging...

% yoy



Source: Reserve Bank of India

**11**

**Table 24: Non-food Bank Credit - Sectoral Deployment**

(Amount in Rupees Crore)					
Sector/Industry	Outstanding as on May 23, 2008	Year-on-Year Variations			
		May 25, 2007		May 23, 2008	
		Absolute	Per cent	Absolute	Per cent
1	2	3	4	5	6
<b>Non-food Gross Bank Credit (1 to 4)</b>	<b>21,74,767</b>	<b>3,65,814</b>	<b>26.4</b>	<b>4,22,418</b>	<b>24.1</b>
<b>1. Agriculture and Allied Activities</b>	<b>2,64,787</b>	<b>54,038</b>	<b>32.2</b>	<b>42,745</b>	<b>19.3</b>
<b>2. Industry (Small, Medium and Large)</b>	<b>8,58,515</b>	<b>1,41,280</b>	<b>26.4</b>	<b>1,82,075</b>	<b>26.9</b>
Small Scale Industries	1,76,282	26,387	29.5	60,398	52.1
<b>3. Personal Loans</b>	<b>5,28,046</b>	<b>87,944</b>	<b>23.9</b>	<b>72,607</b>	<b>15.9</b>
Housing	2,62,486	41,066	21.6	31,735	13.8
Advances against Fixed Deposits	42,220	6,237	19.0	3,128	8.0
Credit Cards	26,596	4,411	45.0	12,375	87.0
Education	21,352	4,903	46.5	5,914	38.3
Consumer Durables	8,297	1,661	23.2	-534	-6.0
<b>4. Services</b>	<b>5,23,249</b>	<b>82,551</b>	<b>26.1</b>	<b>1,24,821</b>	<b>31.3</b>
Transport Operators	35,248	7,922	45.5	9,927	39.2
Professional & Other Services	31,942	8,999	56.8	7,108	28.6
Trade	1,22,438	23,319	28.4	16,902	16.0
Real Estate Loans	61,045	19,010	69.7	14,750	31.9
Non-Banking Financial Companies	71,974	12,401	38.7	27,549	62.0
<i>Memo:</i>					
<b>Priority Sector</b>	<b>7,39,964</b>	<b>1,20,463</b>	<b>23.9</b>	<b>1,14,666</b>	<b>18.3</b>
Industry (Small, Medium and Large)	8,58,515	1,41,280	26.4	1,82,075	26.9
Food Processing	50,493	6,758	22.1	13,126	35.1
Textiles	93,916	19,223	32.9	16,259	20.9
Paper & Paper Products	13,826	2,243	24.5	2,435	21.4
Petroleum, Coal Products & Nuclear Fuels	47,289	9,884	51.6	18,250	62.8
Chemicals and Chemical Products	65,397	6,511	14.2	12,982	24.8
Rubber, Plastic & their Products	11,116	1,938	28.0	2,261	25.5
Iron and Steel	78,834	13,554	27.2	15,460	24.4
Other Metal & Metal Products	25,112	5,447	36.3	4,658	22.8
Engineering	52,551	8,553	25.1	9,959	23.4
Vehicles, Vehicle Parts and Transport Equipments	30,015	5,267	28.6	6,324	26.7
Gems & Jewellery	24,826	2,572	12.3	1,403	6.0
Construction	26,082	6,632	49.2	5,959	29.6
Infrastructure	2,03,331	35,292	32.6	59,811	41.7
<b>Note:</b> 1. Data are provisional and relate to select scheduled commercial banks. 2. Data also include the figures of Bharat Overseas Bank, which was merged with Indian Overseas Bank on March 31, 2007.					

Source: Economic Advisory Council Report 2007-08

## APPENDIX F: Shariah Compliant Stocks in India

Shariah compliant stocks in India:

Parameter	NSE	BSE 500
Number of Companies Listed	1,331	500
Number of Shariah compliant companies	405	257
% of Shariah compliant market cap of total	61.4	60.44

Top Shariah compliant sectors at the BSE

Top Sectors	Number of Companies	Market Cap (Rs Crore)
Computer Software	36	442,310.95
Telephone Services	4	316,974.73
Infrastructure and Real Estate	26	227,965.31
Drugs and Pharmaceuticals	27	135,499.31
Finished Steel	5	119,842.37
Trading	10	112,404.58
Cement	11	97,039.16

*Source:* Parsoli Corporation

## **APPENDIX G: Malaysia Islamic Banks Development Model**

### ***First Stage: small Islamic institutions begin operations***

In 1963, a small Islamic financial institution was allowed to operate: this was an Islamic savings fund, which managed small funds for individuals preparing for their pilgrimage to Mecca. A few years later, after the enactment of the 1983 Islamic Banking Act, the first Islamic bank (Bank Islam Malaysia Berhad) was granted a full-fledged banking license and started operations. To facilitate the liquidity management of this bank—but also as part of the strategy to develop Islamic finance in general—the government started issuing Shariah compatible investment certificates under the 1983 Government Investment Act.

### ***Second Stage: conventional banks begin to operate Islamic windows***

Under a pilot program, three conventional banks were allowed to open Islamic windows under certain restrictions, such as no commingling of funds. By relying on their wide branch networks, conventional banks could offer Islamic products to larger segments of the population than if they were only allowed to open one Islamic branch. In January 1994, Bank Negara Malaysia established the Islamic Interbank Money Market to allow Islamic institutions to adjust their portfolios according to their short-term financing needs.

### ***Third Stage: some conventional banks fully convert to Islamic banks***

After a certain period of operating Islamic windows, some conventional banks accumulated a sufficient critical mass of Islamic customers to make viable a full conversion of the bank into an Islamic institution. In October 1999, the second fully Islamic bank (Bank Muamalat) was created as a result of the merger between Bank Bumiputra and Bank of Commerce, which had been operating Islamic windows. The Islamic assets and liabilities of the merging banks were transferred to the newly created Bank Muamalat.

### ***Fourth Stage: introduction of other Islamic financial institutions and markets***

In 2001, the government established the Islamic Capital Market, where several kinds of Islamic securities could be issued and traded in a secondary market. In June 2005, the Dow Jones launched the 15 Islamic Malaysia Index, which tracks over 45 Shariah-compliant companies. Also in 2005, the Malaysian Parliament approved the creation of the Perbadanan Insurans Deposit Malaysia (PIDM) to administer the deposit insurance system. The PIDM covers conventional and Islamic deposits alike, and it will undertake the resolution of failed conventional and Islamic banking institutions, when needed. Finally, as a reward for all these efforts, the country has witnessed the full integration of the domestic Islamic banking system into the international financial community.

*Source:* IMF working paper Introducing Islamic Banks into Conventional Banking Systems *Juan Solé*