Impact of Changing Regulatory Scenario on Feasibility of Islamic Finance in India

2013

By-M.H.Khatkhatay

For Co-operative Societies

Depending on the effectiveness and vigour of lobbying with state government regulators of co-operatives, it has been possible since the mid-seventies to run Shariah compliant demand deposit and service charge based loan schemes under co-operative credit societies.

In the mid-eighties AP government passed the Multi-Activity Co-operative Societies Act which made it theoretically possible for co-operative societies in that State to liberally invest in a wide range of non-interest earning avenues and thus offer Shariah compliant deposit and profit based loan products.

This was followed in early part of first decade of 21st century by central legislation giving wide powers for co-operatives to manage their affairs autonomously, paving the way for liberalized acts for co-operatives in a number of states.

These and the Multi State Co-operatives Societies Act of the central government have made it possible for co-operatives to invest in other than interest-based loans, deposits and securities and offer Shariah compliant for-profit deposit and profit-based loan schemes.

Mutual Funds

In the early nineties, GOI agreed to liberalisation of regulation and to doing away with monopoly on mutual funds by government-controlled UTI (which did not offer any Shariah-compliant mutual fund).

This led to entry of private players in this sector, with the theoretical possibility of floating Shariah compliant mutual funds. This in turn paved the way for the first effectively Shariah-compliant mutual fund from Tatas in 1996.

Much later, in 2008, SEBI approved the first explicit Shariah compliant mutual fund from Taurus.

Recently, SEBI has released some tentative rules preparatory to allowing Real Estate mutual funds, which could provide another Shariah compliant option in this sector in the near future.

Venture Capital / Alternative Investment Funds

Specific regulations were brought out to encourage venture capital funds towards middle of the first decade of this century. These were ideal vehicles to provide compliant avenues of investment to middle and higher middle income investors, as well as sources of funding for compliant entrepreneurs.

SEBI also approved the first explicitly Shariah compliant venture capital fund in 2008.

However at the beginning of the current decade, fresh regulation has raised the threshold of investment for individuals drastically. Due to the passage of the LLP Act a couple of years earlier, a ray of hope still remains of using LLPs as intermediate consolidation vehicles and keeping this avenue open.

Partnerships and NBFCs

This field has seen progressive throttling of avenues of Shariah compliant investments by the regulator, RBI. In late 1980's regulation tightened control over the possibility of deposit acceptance by partnerships for investment in Shariah compliant manner.

This was followed by a complete choking off of such deposit acceptance by partnerships about a decade later.

Similarly, in case of NBFCs, after allowing fairly liberal deposit acceptance by certain category of NBFCs in mid-1980's, RBI progressively closed avenues of raising funds by NBFCs - as (profit-sharing) deposits and convertible debentures.

By the turn of the century it had made Shariah compliant NBFCs quite unviable by insisting on declaration by them of specific rates of interest on their deposits.

Since several years now it has not even been registering deposit-taking NBFCs.

With the AICL case, RBI has shown its open bias against Islamic Finance by opposing even investment by NBFCs on variable returns basis.

Its unstated campaign against Islamic Finance continues. Its latest and very recent salvo appears to be its insistence on an NBFC to eschew the Islamic practice of donating to charity any penalties charged from customers on delayed payments – in the guise of concern for the NBFC's financial viability.

Stock Market Investment

The concept of business compliant investments in quoted and traded stocks was initially publicly promoted by the Barkat Investment Group in the late 1980's.

Its lead was followed by Idafa Investments with additional financial screening in the early years of the previous decade.

Then in 2008 TASIS, India's first corporate Shariah investment advisory firm pioneered systematic stock screening and stocks-related Shariah investment advisory services including calculation of interest purging for stock portfolios.

In _____, S&P began providing two Shariah Index for the Indian stock market.

This was followed in 2011 (?) by BSE TASIS Shariah 50, which proved quite successful and popular with investors.

Now NSE is also providing its own Shariah index based on its Nifty 50, in collaboration with TASIS for Shariah compliant investors.

Insurance

An existing window under the earlier Insurance Act - in the form of possibility of forming mutual insurance societies and mutual insurance companies - for a possible introduction of Takaful operations in future shut down with introduction of IRDA Act towards the close of the previous century.

Hope of introduction of Shariah compliant insurance ignited briefly with the clearance by IRDA in 2008 of the first potentially fully compliant pension investment scheme.

However a year later as a result of a turf war between regulators, entry to additional investors in that scheme was barred. Since then Shariah compliant insurance remains a major void in the Shariah compliant finance landscape of India.

Banking

Shariah compliant retail quasi-banking options exist in the form of co-operative societies and societies upto the scale of small co-operative banks.

These are under threat from proposed unfavourable RBI regulation in the guise of control and monitoring of the microfinance sector.

Regular Islamic banks remain a distant dream for pro-Shariah compliant finance lobbyists.