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Contemporary Issues In Interest Free Banking.

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Abstract:

Banking Plays an important role in country's economic development. Banks accept deposit from customer and gives Loans and advances to needy persons. Bank charges interest on Loans and advances. In various secular muslim countries special financial Houses were established to offer intrerest free products and services. The special financial Houses only providing financial products and services based on Islamic principles.

KEYWORDS:

Banking, Economic, Interest, Loans, Products and Services.

INTRODUCTION :

In secular muslim Country Turkey there is interest free Banking. The Muslims Holy Book in Quran explicitly deals with economic matters and how they apply in Islam. The sharia the Islamic Law of human conduct is dervied from the Quran. Interest free Banking as a concept was developed as a result of the religious prohibition of the payment or receipt of interest. The interest free banking started in the mid 1960's . The idea continued to develop theoretically until 1975 when the Islamic Development Bank was established as an international financial institution for economic development and Social progress in its member countries as well as economic co-operation among them. This principle followed by many banks all over the world. Since then interest free banking has become a vebrant alternative to conventional banking in the world. In Iran, Pakistan and Sudan all banks and financial institutions have adopted interest free banking in 1980 now the market size of interest free banking is estimated to be growing at the rate 15% per annum. At present interest free banking are in 75 Countries for example Malaysia, Indonesia, Bangladesh, Jordan, Egypt and Turkey.

The Current position is that there are more than 200 Islamic financial institutions all over the world with investment funds in excess of \$ 250 billion. The annual growth rate of Islamic banking industry world-wide is 15% +. In some Muslim countries, total or partial transformation has taken place in favour of Islamic banking. Islamic banking has also gained approval by international financial institutions. Professional bankers and the academia.

Islamic banking has established its identity. Alhamdolillah it is here to stay, grow and develop into a competitive alternative to interest-based financial architecture. AAOIFI has done commendable unification effort.

STANDARDIZATION

Standardization is urgently needed in the following respects: (1) vocabulary of Islamic financing, (2) Financial instruments and their documentation and (3) pricing formulas for Islamic financial products.

VOCABULARY OF ISLAMIC BANKING :

There is no universally followed terminology for Islamic financing. One finds interbank differences in the use of terms. For example while majority of Islamic banks use the nomenclature Murabahah to stand for financing via sale on deferred payment, some label it Bal. Thamah bil Ajil-Quite interestingly, these latter institutions also offer Murabahah financing products.

PRICING FORMULAS FOR ISLAMIC FINANCIAL PRODUCTS :

Any financing operation by an Islamic bank will involve accommodation of interests of the bank's principals, the bank staff and the fund-seekers. These concerns are addressed mainly through "pricing" of the financial products. Of Course, security for financing also matters (see below). Standard pricing formulas, in the light of Shariah Principles, are needed for those on the front desk for efficient working of the Islamic financing model. Their development will also help promotion of Islamic financing in academic and professional circles.

PUBLIC AWARENESS

Islamic financial model is feasible. This is mainly due to unfamiliarity with the various Islamic modes of financing. This problem is likely to be solved over time. But pace of development of Islamic banking can be expedited through the following. (1) Public education campaigns, 2) inclusion of Islamic banking concepts in school curriculum; (3) Making Islamic financing course a part of business administration programs and (4) offering full fledged degree programs in Islamic financing. There is already some progress on (3) and (4)

Training of Banking professionals in the Use of Islamic Financial Products.

Lack of qualified manpower is one of the biggest hurdles in the advancement of Islamic banking. Pioneers in Islamic banking developed their financial instruments and painstakingly trained their staff. There is no training institute to meet manpower needs of existing and future Islamic banks. Some of the reasons for this lacuna are understandable.

It is pertinent to note here that bank staff shall need a different orientation in the Islamic framework. At present, financial institutions are mainly interested in safe recovery of their principal along with a return. Evaluation criteria for processing funding requests and security provisions in agreements with clients, serve this purpose. But the said Goals and process have resulted in a particular psyche and business culture in the financial world.

Emphasis on Shari'ah Audit instead of Reliance on Shari'ah Supervision

In the early phase of Islamic banking professional bankers took the lead. But they were not well-versed in the Shari'ah. Therefore, Islamic banking model emerged as "Banking under Shari'ah supervision".

In view of the above, it will be more fruitful if the following approach is adopted :

- (1) The Islamic financial instruments should be properly and fully developed, accommodating all relevant factors.
- (2) Principals of Islamic Banks should set economic and Shari'sah parameters for providing bank financing.
- (3) Bank officials at the branch level should be given full freedom for making routine financing decision, of course, in the light of the above mentioned parameters.
- (4) There should be both random and regular, either biannual or annual, shari'ah audit of all financing operations.
- (5) The Prospects of shari'ah compliance should be enhanced through introduction of penalties for the bank staff and shari'ah –rating of the bank.

ESTABLISHMENT OF REAL MARKET LINKS.

Trading modes of financing require contact with suppliers in the case of murabahah financing and marketing channels for disposing of merchandise produced in the name of financial institutions under salam financing. Similar considerations also arise in other Islamic financing modes, for example leasing.

RISK MANAGEMENT.

Islamic banks can reduce it through the following action:

- (1) Invasive collateral arrangements, third-party guarantees and credit rating of clients by specialized institutions.
- (2) Choice of an appropriate financial instrument available in the Islamic setup.
- (3) Pricing of Islamic financial products.

Some implications of this point for accounting purpose are as follows :

- (1) Income is not realized when it accrues but when it is materialized. In the case of murabahah financing, therefore, there is need to bring in new steps whereby banks acquire claims of the parting depositors to the funds tied in financing.
- (2) The Shari'ah is relevant for the cost side also. When depositors offer funds to the banks on partnership basis, they are dealing with the legal person "Bank" that is personified by infrastructure of the bank, its staff, etc.
- (3) In the shari'ah costs are associated with acquisition of property rights. If this understanding is correct, then costs should normally be payments to third parties in lieu of acquisition of ownership of some thing of exclusive rights to some service.

REGULATION AND CONTROL OF ISLAMIC FINANCIAL INSTITUTIONS.

This is a vast subject. We restrict our observations to regulation and control of Islamic Banks.

Regulation and control of Islamic banks would be necessary to ensure that they remain financial institutions. That is, their role should not go beyond plugging financial gaps that bar real transactions from taking place in the economy. To allow Islamic banks to go beyond this would be sowing the seeds for monopolies and oligopolies in the economy. To allow Islamic banks to go beyond this would be sowing the seeds for monopolies and oligopolies in the economy. Something against the express Desire of Allah SWT.

CONCLUSION :-

Interest free Banking started in the 1970. The pioneers included committed and resourceful individuals professional bankers, Islamic economists and religious scholars. This change started in seventies and early eighties for the need to develop a free financial system in Iran, Sudan, Pakistan and Malaysia. Interest free bankers also organized themselves through international Association of Islamic Banks. For achieving standard they stated establishment of AAOIFI in Islamic banking Practices. It is not possible of identical documentation for all Islamic financial institutions in a given Islamic financial instrument. This is because Practical needs are not same and financial innovation in emergent situation will always remain open. There has to be some measures of standardisation in the world.

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