



**Investigation of Theoretical and Practical Barriers and Challenges
over Islamic Banking System**

Revista Publicando, 5 No 15. (2). 2018, 1094-1122. ISSN 1390-9304

**Investigation of Theoretical and Practical Barriers and Challenges over Islamic
Banking System**

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ABSTRACT

Undoubtedly, enactment and implementation of the law of usury-free banking operations with a short interval of the victory of the Islamic Revolution and the elimination of usury from the banking system will be considered as a major achievement for law designers and banking authorities; it does not mean the end of the work and achieving to a perfect law but it needed to reform, studying and constant completion such as all human rules. Iranian banking system has been encountered to a variety of challenges in recent years. A variety and conflicting approaches have been considered to encounter with these challenges. Identifying and introducing the major challenges of the banking system, this study investigates on theoretical and practical challenges of Islamic banking by a new institutionalism view after review of previous studies in banking system challenges and using experiences in recent years.

Keywords: Barriers, Challenges, Islamic Banking, Usury.



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1 INTRODUCTION

Islam has a specific attention toward economic development but it is confirmed based on Islamic components. In this regard, lack of usury is one of the most important norms of Islamic economy to achieve the economic development. By checking this norm, the reason for the prohibition of usury is determined. Scientific achievement and documents show that monetary interests and usury lead to inflation and unemployment. Therefore, even those countries based on the capital economies are using these scientific achievements to reduce interest rates and even to zero; because in a society where interest, inflation, and unemployment exist, they will be away from the main goals of economic development. In current world, majority of monetary transactions are accomplished by bank branches.

Management of life affairs and also economic activities of the countries rely on existing banks. Regarding banks are introduced as a part of basis of development, it is natural that the provision of services and facilities based on Islamic principles and components can be effective in achieving development.

Usury-free Banks satisfy the least amount due to the number of contracts, and because of the type of contracts, they have been close to the most common banking system. In contrast, some others insist on agreements that have the greatest difference with conventional banking transactions, and a group of usury-free banks also use the combination of these conventions. This difference in laws and patterns is at the expense of zero risk banking in a long term and also it prevents having a broad and unified bank and monetary transactions for Muslims in Islamic countries, but it makes the best choices and also making experience various rules and patterns for usury-free banks.

One of these laws is Iranian usury-free banking operation law which was considered as the most comprehensive usury-free banking law in the period of its approval and it has also succeeded in filling the vacuum created by the removal of the money from the banking system yet; of course, it needed to reform, studying and constant completion such as all human rules. Now that more than twenty three years have passed since the implementation of this law, it is appropriate to identify, reform and compelling its problems and shortages in regard to the experiences of Iranian banking system and other usury-free banks. Providing books, articles and scientific speeches,



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researchers have proposed various models of banking system from the time of improvement and implementation of bank operations. Studying these works, the problems and inadequacies can be classified as following: [3]

1. Problems and inadequacies arising from the rule of usury-free banking operations;
2. Problems and inadequacies arising from the selection of an inappropriate pattern for the operation of the law;
3. Problems and inadequacies arising from the inappropriateness of the structure and operational organization of banks with the law;
4. Problems and inadequacies arising from the implementation of the regulations and executive directives;
5. Problems and inadequacies due to lack of proper training of employees and customers;
6. Problems and inadequacies caused by the lack of consciousness or inability of the officials and agents of the banking system;
7. Problems and inadequacies due to the statehood of the banking system and the impossibility of proper competition between banks;
8. Problems and inadequacies due to the special economic situation and excessive interference by government in the affairs of banks.

It is clear that these cases are not the same and it is required to different solutions and management. Accordingly, this research focuses on problems and inadequacies of the rule of usury-free banking operations and also reforms or completes it using twenty three experiences in Iranian and other usury-free banking systems.

2 RESEARCH LITERATURE

The adoption of the usury-free banking law in the country

Before the victory of Islamic Revolution, “monetary interest” was the basis of banking activities in the country like other conventional banks of the world. Banks, in the form of a variety of bank deposits, tried to absorb savings and surplus on the consumption needs of the people and also paying interests in appropriate to the amount and duration of deposit.

On the other hand, collected payments were provided to consumers, manufacturers and traders in the form of loans and credits with interest. However, with the victory of the



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Islamic Revolution, the revision of banking laws and changes in the system of interest was one of the requirements of the change in banking activities; accordingly, the monetary and credit council removed the interest from the banking system and replaced the "Guaranteed Earnings System and Fee" in the meeting at May 31, 1979 and it was implemented at the beginning of 1979. But the new system also had many legal and economic problems in the area of deposit and loan lending, including:

1. Loaning was legal identity of all types of current deposits, savings and longterm deposits in usury banking system and in fact, the depositor lends to the bank by opening an account and giving funds to the bank. Therefore, the payment of any kind of supernumerary by any name will be regarded as usury; therefore, the determination of the guaranteed profit of 7% or 8.5% for savings and longterm deposits was nothing more than a change in the name of usury and interest to profit.
2. According to the Islamic jurisprudence, banks and institutions such as interest-free funds, which proceed upon granting loans and privileges to natural/legal persons, are authorized to provide personnel costs, facilities, etc. as a fee from the recipients of the facilities. Obviously, this fee should be in relation to the provision of services and in proportion to its costs, and it will be considered as usury and unlawful to take any excessive amount of facilities as fees.
3. In the system of guaranteed benefit system, if it is based on a real fee (ie it is given one or two percent of the facilities), on the one hand, the bank will face a sharp decline in resources, it can not grant profits to the owners of the deposit, (most depositors will receive their funds from the bank and taking to other monetary and financial markets or abroad) and on the other hand, the bank will face a mass of applicants for loans and credits due to low cost of using the facilities or If, in the name of a fee, a significant percentage of are taken from the applicants and giving to the owner of the deposit; although, it will not encounter with granting facilities if having adequate resources but in this case, it has just changed the name of the system of interest but the truth is established and as a result, it is regarded as usury and it will be forbidden. In fact, the new system was only able to reduce the interest rate as the guaranteed interest rate for depositors and the fee rate for a portion of the loan and credit applicants; for this reason, the "guaranteed benefit system and fee" was encountered with the serious objections of



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the clerical scholars, Muslim economists and banking experts who believed to usury-free banking, and this issue has led the Islamic Consultative Assembly to issue a bill in order to remove interest from the banking system in Note No. 54 of Budget Law in the year of 1981 as following:

The government is obliged to carry out the necessary studies and submit the bill to the Islamic Consultative Assembly from the date of the adoption of this law to eliminate usury from banking system and reforming the banking system in the country. However, these studies and the presentation of the bill should not be exceeded more than six months.

After the initial review, the bill of interest-free bank operations was submitted to the government on May 5, 1982 and after passing the bill in the Council of Ministers, it was delivered to the Islamic Consultative Assembly on the 21st of the month,. The bill, which included 5 chapters and 27 articles, was examined at numerous sessions of the Islamic Consultative Assembly and it was eventually approved on Tuesday, August 30, 1984.

On the tenth of August at the same year, it was approved by the Guardian Council with a requested change.

After approval of the regulations and directives by the Board of Governors and the Council for Money and Credit in the winter of 1983, "Usury-free Banking Law" was communicated and implemented in all banks as five chapters included "Chapter 1, Purposes and Duties of the Banking System" "Chapter 2: Equipping money resources", "Chapter 3, Granting Banking Facilities ", "Chapter 4, Central Bank of the Islamic Republic and Monetary Policy," and "Chapter 5 Miscellaneous", and 27 articles since the beginning of 1984. Of course, Article 15 of this law was revised in 2003, and re-approved by the Islamic Consultative Assembly with the addition of two notes to it. [6]

3 THE PROBLEMS OF USURY-FREE BANKING IN IRAN

Here, it is addressed to a brief overview of the challenges and problems of usury-free banking in Iran which has been carried out by Ahmad Mojtahed and Ali Hassanzadeh and practically criticized Iranian banking system: [4]

- Formalism of a part of banking operations due to the conversion of all banking operations into transaction contracts;



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- The low level participation of banks in real projects and more tendencies
- Trading contracts such as installment sales instead of cooperative agreements, such as Mudarabah (Sharing the profit and loss) contracts, partnerships and etc. and also lack of an efficient and standardized accounting system (using a cash accounting approach instead of an accrual method that causes to account repayment of most of the granted or delayed loans to the government);
- Failure to pay real interest to depositors (due to the lack of separation of financial resources from legal entities (depositors) from owned assets (bank assets) and the use of a cash accounting system instead of a commitment that reduces the interest to the depositors);
- Unwillingness to accept the investment risk on the part of the bank and lack of participation of the bank in investment projects;
- The lack of an appropriate method for extending the repayment time of bank facilities; the weakness of monitoring and effective inspection system;
- The weakness of the power and lack of experts in banks to determine the plans with high technical and economic justifications;
- Lack of belief within community in Islamic banking operations;
- Constraints on contracts in the provision of facilities (due to lack of coherent information system).

The problems of Usury-free Banking Law

- Over three decades after the implementation of usury-free Banking Law in the country, a lot of experts believe that some parts of banking activities follow usury or monetary interest due to some problems or disadvantages on usury-free banking law. Accordingly, experts propose ten subsets for abovementioned law in the usury-free banking area which as follow:

3.1. Lack of providing a clear and practical definition of the banking system and clarifying the scope of the law:

An appropriate law should be clear in terms of the scope of the law which is not observed in the current law. Today, various banking and non-bank credit institutions have been established with various names in the country which, on the one hand, have transactions similar to banks and, on the other hand, are not in the name of the bank



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and therefore, they are in conflict with the law. Such as financial institutions, credit cooperatives, leasing companies and etc. which, on the one hand, design a variety of banking tools to fund monetary resources and, on the other hand, allocate those resources in various ways. Although these types of credit institutions are not worrying at first hand due to low levels of activities, but they will be very risky as they expand their operating range, especially when they can affect the volume of liquidity through the creation of money. Therefore, all banking and non-bank credit institutions should be included in the law.

3.2. The influence of the law on economic conditions at the beginning of Islamic Revolution, especially at the view of state-owned banks.

On June 7, 1979, the Islamic Revolutionary Guard Council (the state legislature at that time) passed a bill that declared nationality of the country's banking system. According to the bill, 28 banks, 16 savings and loan companies and 2 investment companies were declared as national ones, dismissing their ownership from private section and transferred to the government. In Article 44 of the Constitution, banking was assigned to the public sector alongside the main industries and large mines. The natural consequence of this attitude to the banking industry was that the rule of usury-free banking operations was implemented in public sectors.

For example, in the second clause about the objectives of the banking system, the activities have been considered as one of the five objectives of the banking system in order to realize the goals, policies and economic programs of the Islamic Republic of Iran with monetary and credit instruments.

According to Article 8, banks are obliged to proceed upon investment on productive and constructive plans and the programme of these types of investments must be approved by the Islamic Consultative Assembly in addition to annual budget bill for the whole country.

According to Article 9, banks provide the customers with the necessary financial resources according to the contract of Mudaraba with priority to legal cooperatives in order to create the necessary facilities for the expansion of business affairs in the framework of the government's business policies.



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In accordance with Article 10, banks create low-cost residential units for the purpose of mortgages or leases on condition of purchase in order to provide facilities for the development of housing with the coordination of the Ministry of Housing and Urban Development.

3.3. Incapability to design patterns appropriate to a variety of banking and non-bank credit institutions

The experience of the usury-free banking industry and economic transformations of Islamic societies shows that the rule of banking operations without usury should not be specified in a particular pattern, but should be designed so comprehensive that it can cover any operational model; in other words, any banking or non-bank credit institution can choose to use its tools and solutions in accordance with its goals and nature and operate its credit activities.

For example, if a bank or an institution wants to operate exclusively with profit-making contracts with a determined profit, the law must have the capacity for it. If the bank or institution wants to operate only with cooperative profit-making contracts with an expected and variable profit, the law must have an adequate capacity. If the institution wants to work only with a non-profit contracts (such as free-interest institutes), it will be the same, and if the bank or institution wants to have a combination of all or some of them, the law must have the required capacity.

3.4. Lack of comprehensiveness and inadequacy of the law relative to the goals and desires of depositors

A complete banking system should be able to absorb the surplus funds of all depositors by designing a variety of deposits and facilities. The study of the goals, motives and morale of depositors in Islamic societies shows that we face at least the following people:

- Those who take deposits to use the current account services;
- Those who take deposits in order to contribute to the rewards of free-interest grants;
- Those who take deposits deposit with a view to obtaining facility points;
- Those who take deposits deposit for a certain profit and are not willing to accept the risk;
- Those who take deposits deposit to expect higher returns and are ready to take risks.



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The current usury-free law is also faced with some technical and legal shortcomings, in addition to failing to meet some of these requirements.

3.5. Lack of comprehensiveness and inadequacy of law in relation to the goals and preferences of applicants for facilities.

In the area of granting facilities, the current law is faced with problems and inadequacies; in some cases banks and non-bank credit institutions do not have the necessary solution to provide facilities; in some cases, the existing solution is not fitted to the needs of the customer. As a result, the many contracts are formal and in some cases, there is no possibility of proper implementation in banks or requires high operating costs. While the richness of Islamic jurisprudence and the experience of some usury-free banks show that the vacuum can be filled by entering more appropriate contracts. It is necessary to say that unlike the operating pattern that should be simple and fluid, the law should also be more complete and richer; because, each bank and non-bank institution can select the capacity of law and tools, in accordance with its goals and abilities.

3.6. Lack of comprehensiveness and inadequacy of used monetary policy tools in the law

Regulation of usury-free banking operation law has taken place in Iran when usury-free banking is passing its immaturity in practical/theoretical area and there had not been accomplished many researchs in many aspects of banking, especially in debates of central bank and monetary policies and its instruments. As a result, designers of the Usury-free Banking Law cautiously excluded some legitimate instruments such as the change in the legal deposit rate, the shift in the discount rate and open market operations through Islamic financial instruments, and turned to instruments that, firstly, were in the concept of ambiguity and then, they do not have the required performance.

3.7. Lack of appropriate solution to encounter with delayed demands

One of the most important challenges in current banking industry is the problem of delay in settlement and delay in payment of bank debts. Users of bank facilities do not pay their debts to banks and non-bank credit institutions in determined time due to various reasons, such as bankruptcy, failure to fulfill projected corporate plans, changes in government economic policies, misuse and breach of contract. To prevent of these



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kinds of problems, conventional and usury-free banking laws provide incentives and punitive tools for users of banking facilities in which the current Iranian usury-free law suffers from lack of these tools.

3.8. Lack of communication strategy for banks and non-bank credit institutions of Iran with conventional and usury-free banks of the world

The economic conditions of today societies are so complex and transformative that banks or credit institutes try to operate with high performance, and they probably need to a broad and fast financial communication tools with other banks and credit institutions. Sometimes a bank or credit institution faces a liquidity deficit for several months or days or a few hours while another bank or credit institution has a surplus liquidity at the same time. The existence of appropriate strategies for using each other's resources increases the efficiency and profitability of all banks and credit institutions. The current rule of usury-free banking has not considered any solution to the relationship between Iranian banks and credit institutions with usury-free banks of other Islamic countries and conventional banks of the world, while it can be even interacted with other conventional banks around the world using some religious contracts.

3.9. Lack of an appropriate solution to monitor and legal controlling on the activities of bank and non-bank institutes

All experts believe that usury-free banking operations have a lot of major differences from conventional banking. As a result, it needs to constant and more accurate supervision in order to achieve a complete performance, while in the current law on usury-free banking, there is no specific method or organization for monitoring and controlling banking transactions in order to comply with the new law, and no monitoring and control has been carried out in the implementation of usury-free banks. For example, among thousands of bank frauds and embezzlement cases, there is no case where a bank or a particular person has been penalized for not complying with the legal principles of the contract or violating the usury-free banking operation law. It is also observed that international branches of Iranian banks are openly engaged in usury deals even in Islamic countries without any acceptable justification. Accordingly, there



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are necessary jurisprudential numbers that control the conformity of banking operations based on religious standards.

3.10. Lack of an appropriate solution for research and development of usury-free banking

Knowledge of the economy, especially the branch of the economy of money and banking, is rapidly expanding, so that every year we observe using a range of modern monetary and banking tools. A dynamic law must have required solutions for research and development in itself so that economic activists will not be tight in the long term changing of the law. The current usury-free banking law suffers from lack of this attitude and it is required to revision of the law for any change. According to Article 43, in addition to Article 32, the central bank, bank or non-bank credit institutes can suggest other legal contracts and methods by accomplishment of required researchs and studies and also using it in their interactions by agreement of the jurist committee of Central Bank. It is clear that granting such power to activists of banking industry can help to progress this procedure. For example, according to Article 35 of the proposed law, banks and non-bank credit institutions are allowed to increase their liquidity by using the new bank instruments by the the central bank's authorization to convert their long-term financial assets to usury-free securities and sell them to natural and legal persons.

4 DECUPLE CHALLENGES OF USURY-FREE BANKING IN BANKING NETWORK OF THE COUNTRY

4.1 Breach of regulations of banking system

Over three decades after passing usury-free banking operation law, it has not been changed in appropriate to global changes and increasing level of needs and also broadening application of monetary and banking section. It must be claimed that the problems of banks' performance to implement usury-free banking system is not only due to problems in weakness of bank clerks, inadequency in monitoring or lack of economic saving to monitor, but a major part of problems stems from lack of comprehensiveness of the collection of banking laws. These laws include regulations and rules of the banking system that support the banking system legally. For example, in the letters by the central bank, it is explicitly stated that the interest rate is assured,



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or it is used the guaranteed interest rate which means that the banking laws themselves also allow the banking system to move at the oppose of the contracts.

4.2 Formality of the contracts and incorrect implementation

The true implementation of the contract is the red line that leads the customers or banks to usury abyss if it is not be regarded whole time, because the difference of Islamic contract is hidden in its nature and if the contract parties are not awared about the nature of the contract, what happened in reality is a loan with supernumerary which is undoubtedly prohibited.

One of the major reasons of banking system for moving toward formalism of banking contracts is high costs of appropriate implemmentation of Islamic contracts in the banks. For example, participatory contracts, such as Mudaraba's civil partnership, as well as direct investment, require an appropriate structure and expert human resources so that the bank can ensure its economic justification by accurate studying the plans and continuously monitor the operations of the beneficiaries during the implementation and operation of the facilities.

4.3 The role in understanding of Islamic banking and banking contracts

Correct implementation of legal contracts in baking system requires that managers and bank clerks correctly understand the definitions and nature of these contracts so that they can easily to explain them to the clients in a simple way.

4.4 Lack of realization of Real Participation in Collaborative Contracts

One of the main obstacles to eliminate the usury from the banking system is the refusal of the bank to accept its share in the potential losses in the partnership agreement. This is a symptom of the fact that the partners do not intend to a real participation and it can be argued that what actually occurs in practice is, in some cases, loan with excessive amount of privilege which is strictly prohibited. Evidence of this claim is the inclusion of certain clauses in bank contracts; for example, the bank submits a share of capital to the applicant as part of a profitable business activity instead of paying usurious rates of interest.

In accordance with the nature of the company's contract, the bank and client should be partners in losses or benefits of the contract but there is a condition in which the partner



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is obliged to pay money as contribution share to the bank in addition to instrumental profit.

4.5 Non-computation of the difference between the interest on the profit and the definitive interest

Interest on the profit is declared by banks as expected one for the depositors which is needed to declare during auditing of definitive interest after end of the year and it can be different from definitive interest. But the announcement of interest rates at the beginning of each period and the granting of the same rate as the profits made for deposits has added another challenge to the banking system's challenges. This has led to usury-free banking operations similar to that of usury banking in other countries, and people feel that interest rate is paid at a fixed and predetermined amount of money in the banks of the country which is not related to economic activities. Interestingly, the problem of paying for profits does not work in countries that operate on profit-oriented basis, nor in many Islamic countries have usury-free banking system.

4.6 Levied fine of delayed payment with the approach of deadline for customer

To obtain supernumerary as delayed fee is another problem which makes usury for banking system; Of course, there is a controversy between jurists about the legal jurisprudence of fined fees. The Guardian Council has been authorized to receive delayed fines in the form of an obligation as a condition for concluding contracts, but some people as religious sources of imitation have been protesting against it, and believe that this condition allows banks to receive a sum in the event of non-payment of installments and debts promptly in addition to religious debts as delayed fees. It means that banks allow the borrowers to postpone their repayment and pay off their debt by receiving money with additional amounts later than the deadline.

4.7 Receiving unconventional fees in providing banking services

The lexical meaning of handling fee is payroll and what is religiously important in this regard is that the fee should be commensurate with the services of the bank. In other words, the handling fee for the provision of services should be received as fees versus costs such as documenting, maintaining accounts and etc. which emerges in providing free-interest facilities and in the opinion of all jurists, it is problematic if the receipt of



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a fee for the granting of such facilities is unconventional and does not take into account the remuneration of services.

4.8. Providing interest-free facilities in the form of a interest-free deposits

Providing such facilities means to lend money which is deposited by customers to them after a certain period of time only if it is not beneficial and the bank itself does not intend to do so. The process of interest-free grant facilities may be such that, in accordance with the accepted condition, the applicant for the first facilities must lend a certain amount to the bank so that it can lend him twice and in this case, the granting of a loan to the applicant is conditional on lending it to the bank, which is commonly used in fiqh as "loan on loan condition", if it is included in the text of the contract, it is definitely a usurious loan. Of course, the interest-free facility is not legally problematic in itself, provided that it is according to a contract law, not a loan.

4.9. Lack of organized legal monitoring in banking system

Monitoring on Islamic banks, due to its nature, finds certain dimensions in some cases, one of which is the risk of sharia, which is the danger that threatens the banking system from the area of non-conformity with the principles of sharia.

Investigating the experience of religious supervision and minimizing the risk of sharia at the international level indicates that most of the banks and active Islamic institutions in other countries have dealt with such methods as the Specialized Jurisprudence Council, the Sharia Islamic Jurisprudence Council, and so on.

4.10. The lack of effective legal instruments for monetary policy

After victory of Islamic Revolution, the ban on the issuance of bonds was suspended as monetary policy instrument. Therefore, it was essential the existence of a tool with similar functions which was not legally prohibited. But the constraints on legitimate monetary policy tools have led the Iranian monetary authorities to look for discretionary and non-partisan tools such as determining the order of interest rates and network bank deposits to regulate and control the money market. In this regard, participatory bonds were the most ones which were chosen aimed to control liquidity and providing financial sources for constructive plans from private section. Collected funds in bonds must be spent in targeted projects based on the nature of the contract.



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Therefore, in the primary market these securities are used as instruments of fiscal policies and monetary policy is implemented through buying and selling in the secondary market by the central bank. However, the purpose of the issuance of Central Bank's participating bonds is to apply the contractional monetary policy which means that the collected funds by these securities are held by the central bank and are withdrawn from the cash flow of the economy in order to control the monetary base in this way. Consequently, there is a conflict between the nature of the company's contract and withdrawing money which it will bring the interest of the bonds with usury. If these securities are used to apply monetary policy, without their funds being used to carry out economic projects, their distribution is problematic in religious terms and converts its nature into bonds.

Also, one of these tools which is used for monetary policy making in the country, will be open a special deposit in Central Bank which has been passed by Money and Credit Council in year of 1998.

The major objective of this plan is to apply appropriate monetary policies in order to control liquidity by absorbing surplus resources of banks. According to Central Bank's declaration, this bank pays interest to special deposits of banks based on specific rules. Lack of clarity about the basis contract of this deposit and paying interest to banks is another ambiguous problem in the light of Islamic banking [5].

5 Practical and Theoretical Challenges of Islamic Banking

If we look at implicit concept of interest-free banking from a theoretical point of view at the micro and macro level, there will be a series of potential questions and problems. Here is a list of topics that Islamic banking faces at a macro and micro levels.

5.1 Practical challenges in macro level

5.1.1 Liquidity and investment

Islamic banking is based on participation in loss and benefits and it has higher risks in compared to traditional banks due to the nature of discriminatory and less reversible investments which must need to more liquidity and savings. Critics state that Islamic banks can not use the advantages and supports of the central bank; in other words, they can not use the central bank as lender (due to the repayment of the interest). Therefore,



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Islamic banks, in the eyes of legislators, need higher liquidity requirements and asset risk than traditional banks.

Theoretically, the liquidity of Islamic banks' assets is realized much less probable than traditional ones. Also, more fluctuations in liquidity rate significantly affect the ability of Islamic banks to provide credits for private sector, and this issue shows more degree of liquidity for any type of investment and deposits in Islamic banks rather than traditional ones. In general, the capital requirements of Islamic banks should be higher in order to protect depositors against unpredictable losses of total investments, because the increase of legal and precautionary savings will provide more safety. [7]

Islamic banks in the world should pay attention to the issue of liquidity based on three main reasons as follows:

1. Lack of secondary markets for assets;
2. Short-term maturity of some deposits;
3. The absence of a final lender, such as the Central Bank [8]

5.1.2 Validation of bank's assets

There is a critical idea on Islamic banking about lack of fixed rate of return and Islamic banks may suffer a loss in the value of their assets and without the insurance of deposits. Islamic banks may have problems in the stability of the system and liquidity crises and they are faced with a dual risk:

Ethical Risk: Lack of honesty of fund receivers to declare losses

Business Risk: it will be made by an unexpected behavior in the market

To realize saving or precautionary requirements, it must be considered transferring profits or loss of investments to the depositors. Because in Islamic banking, profits and losses are fully reflected in the value of the bonds, banks will transfer all risks to their depositors, which will reduce investment in Islamic banks.

Another problem is the determination of profit and loss and its division among depositors of Islamic banks, especially in long-term investments such as Mudaraba and participation. Changing expected liquidity makes fluctuation in longterm investment value like the cost of investment opportunity and valuation process will be costly or undetermined in the absence of active market in such investments. [9]



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Islamic scholars consider the importance of the role of risk management in Islamic banking. Risk management is a process which is obtained by financial institution in order to determine risks which are faced with. Risk management includes instruments, methods and the implementation process of risk strategy in banks. The nature of risks in Islamic Bank and the unlimited ways to provide Islamic finance lead to many problems in risk assessment, realization of income, adequacy of security and disclosure standards of financial operations.[2]

5.1.3 Creating credit and monetary policy

In the view of the opponents of Islamic banking system, most of the traditional policy making tools of the central bank are ineffective under Islamic banking which include:

- Minimum cash reserve requirements;
- Liquidity requirements;
- Total credit ceilings on the activities of granting banks facilities;
- Compulsory purposes of financial providing for special sections

In the conventional repricing operation ways, if there is no religious buying/selling in the central bank, according to all the authorities, it can not be permissible in the banking system. According to the emergence of the central bank's supporting on banks in financial crises and emerging alternative tools to control the mount of money, Islamic economists have suggested some alterative ones:

1. The central bank can grant required funds to the banks at the time of liquidity shortage through mudarabah or participation with Islamic banks;
2. The central bank can maintain part of deposited funds of the banks as legal reserve to grant interest-free funds to the banks in lack of liquidity;
3. The central bank can give a loan if the bank faces a shortage of liquidity, provided that after the bank can repay the same amount (in addition to repaying its debt) to the central bank after ending of the problem;
4. Islamic banks can create a shared fund at the central bank, and each bank holds a percentage of its current deposits and savings, so that when it faces liquidity shortage, it can borrow from this fund



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5.1.4 Financial consistency

Conventional banking system considers fixed value obligations based on interest for depositors which the value of these assets can be lesser than fixed debt and making bankruptcy due to lack of deposit insurance. In other words, individual welfare depends upon the other's actions. Islamic banking system critics believe that this issue will be more obvious due to investment on risky projects. Deposit insurance will reduce the financial problem, but it will cause inefficiency in the process. Also, the lack of insurance coverage can be considered a problem for Islamic banks, and the depositors will not remain in the Islamic banks as a result of the hectic market of capital and losses caused by the lack of insurance coverage.

5.1.5 Ownership of banks

The discussion about the ownership of banks basically refers to distributive effect on the society. Particularly, the power to create credit for commercial banks with a marginal rate of funding would stimulate debate public or the privatization of banks. [3]

5.1.6 Lack of investment market or financial tools

Critics believe that Islamic banks, which operate under framework of traditional banking system in various countries, have not market or required capital instruments to invest on their surplus funds. While having such markets helps to grow these banks and it will be led to financing for government by these banks. Sometimes, banks are faced with excessive sources; in this case, the holding of funds in cash is costly at the expense of the bank or depositor.

5.2 Related issues to implementation in a macro level

5.2.1 High cost of information

Muslim scholars agree on this issue that there are more costs to write and enforce contracts in Islamic banks and it is more difficult to control than banks with a system of interest. Also, when the economies of countries are not transparent to Islamic banking and also determined by the market and information flaws, the greater pressure on these problems increases the cost of information; this high cost of information can lead to a failure in the efficiency of the PLS system.



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5.2.2 Control the cost of funds

Interest-based banks maximize their profits with respect to the cost of funds; they predict the amount of profit in the short run and also estimate long-term profit with surface constraints. But in the Islamic banking system, we do not prioritize the cost of funds and it will be paid a proportion of undetermined interest to the depositor. In this case, if it is not realized expected interest rate for depositors, Islamic banks will face with more uncertainties due to reduction of depositors' funds. The expectation of depositors is that Islamic banks will periodically calculate the rate of return on PLS deposits.

5.2.3 Financing according to added price

It is obvious that there is very small difference between the surplus price charged by Islamic banks under the overhead markup and the interest by traditional banks. The added-priced method by banks on its financing, in place, is a tool that provides an escape from the Islamic banking laws without disturbing the system. Some analysts believe that the real alternative to the interest rate in the Islamic financial system is interest-free (Qarz al-Hassaneh) method, and there are other methods such as Murabahah, mortgaging, and renting, which there are ways for escaping from usury can not be meaningful in reaching the economic goals of Islamic banks. Islam has denied interest because it inherently is associated with many injustices, that is, the holder of capital funds is confident of the fixed returns, while all risks are borne by the user of the funds. Therefore, if the holders of funds are also looking for profits, they should be partners with the entrepreneur in profit and loss.

5.2.4 Overemphasis on Murabaha (Trading contracts)

There are many critiques on Islamic banking which refers to overemphasis on Murabaha in financing. Although the Murabaha contract is not legally prohibited and it is accordance with Sharia, it is not free from deliberate or inaccurate deception. People consider Murabahah as a pre-determined rate of return, but Murabahah can be differentiated from the interest rate it is not against the Shari'a if it has the following status:

A: margin of profit: or surplus price which is charged by banks and it must be agreed upon by the parties;



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B: the demanded goods must be placed in the physical possession of the bank before being sold to the customer;

C: Exchange between the bank and the seller must be done separately from the bank and the buyer exchange, that is, two independent contracts.

In the first exchange, the customer asks for the purchase of the goods from the bank and the bank makes the purchase. This request is not legally binding and the customer has the right to change his mind and not to buy the goods from the bank. Therefore, the bank may be at risk of losing money.

The second trading is associated with selling items to customer based on delayed payments and this trading has its own problems or risks. Unfortunately, banks violate the condition of physical ownership and this issue makes some legal problems in the contract.

5.2.5 Using interest rate as marginal profit in Murabahah contract

There are many criticisms of Islamic banking, according to which Islamic banks use interest rates as criteria for using profits in the Murabaha contract. There is no known way of avoiding this alleged connection in coexistence between Islamic and traditional banks. Therefore, Islamic banks should avoid using current interest rates and apply accounting and special methods to determine the surplus in the Murabahah method.

5.2.6 Lack of positive reaction to providing financial requirements of the government

Obviously, modern governments always require to funds for their helpful projects. For example, construction of schools, roads and etc. there is criticism on Islamic banking that the governments issue treasury bills with interest rates in line with traditional banks. But Islamic scholars have taken practical steps to overcome this problem, which are being implemented in some Islamic countries. Islamic banks can redeem governmental financing requirements through the use of issuance of Islamic securities such as bonds, mortgage bonds, lease notes and equity bonds, and benefit from an investment in unused liquidity.



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5.3 Why does the Islamic Banking have no support in the realm of execution?

The bill on bank changes was a hope for the implementation of Islamic banking after 30 years, but the misuse of the banking system last year has led the bill to be transferred to the government and the Ministry of Economy, and the central bank only has an independent bill of the bank's development plan under the banking law to give the government. Each year, an Islamic banking convention is held in the country, but not much. Over the past years, the economic development plan, especially the bank's development plan, has been created in the minds of economists and bankers, which is surely the focus of a special attention to Islamic banking, but unfortunately, the development plan has not yet come to an end. Eyvazlou, the economists, gives many comments and he has specific views on Islamic bankin system.

Twenty-nine years performance of our country on the area of Islamic economy and Islamic banking system show that the change which has been took place in the country is usury-free banking operation. This law should be changed in its nature after 5 years which it has not been occurred yet; Of course, a new bill has recently been set up indicating progress and also deficiencies.

Given that this is a comprehensive law, we can not expect that all performances are regulated in the same framework. We need to have a system. In the banking system, the institution of law is one of the institutions. Usury-free banking system requires a type of synergy in behaviors and structures as well as in complementary systems such as insurance, accounting, auditing, monitoring and major legislations, that is, those systems are also in accordance with this goal. In general, it can provide a complete model for usury-free banking system.

If we assume that the main demand in Islamic banking is usury-free banking system, these complementary works have not be done and in this regard, it is appropriate that our officials will evaluate the issues and in the next step, we discuss that the usury-free banking approach is a false and incomplete one.

Until the year of 1990, this law could have been useful for the first step, but then, following the Constitution's framework and the demands of our leader, it was necessary to follow the pattern of Islamic banking. in this case, the bodies such as the Ministry of Economy and the Central Bank in they were in charge of completing the measures in



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this framework during these 30 years; In this regard, we should not only expect the Ministry of Economy and the Central Bank. The parliament and the judicial authorities were also responsible for the formal request for institutionalization, modeling, the production of content and the planned implementations.

It is worthy that after 30 years after conferences, there will be also held meetings and conferences to review the entire 30 years so that we do not get used to it. We must always have the dynamism and innovation in these areas. This requires a glimpse of the past to see what the main demand is and where we are now and what should be done. (Interview with Eyvazlou, 2015)

5.4 The emergence of legal basis on Islamic banking

It should be noted that those banks which do not have usurious activities and only operate on the basis of Islamic contracts with all forms of legalization without any formulation or the like, are lawful, but such actions and activities are forbidden based on the appearance of Islam and Islamic contracts such as Mudaraba and Ja'alah, and in fact, by factoring or justifications.

3 PLANNING FOR NEW USURY-FREE BANKING LAW IN NINTH AND TENTH PARLEMENTS

In the final days of the ninth parliament, some delegates tried to approve the new draft of the usury-free banking system since May in last year; this plan was examined after a large conflict in a special panel in the ninth parliament and eventually was announced by the Board of Directors of the Parliament with 13 chapters and 205 terms under Article 85 of the Constitution in order to become a test case, but some members of the Economic Commission refused to attend the commission meetings until they were approved for the final approval of the plan. The plan was ultimately submitted to the tenth parliament despite of contest by the government, the central bank, some representatives and many experts. The plan was supposed to be submitted by the government to the parliament after an investigation to remove the current barriers and problems of the usury-free banking system. In addition to the problems on the current rule of usury-free banking, the reasons for a new plan were: "Removing the usurious absurdities of banking operations", "Improving microfinance", "Managing banking resources towards manufacturing units" , "Some problems with the banking network,



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such as how to deal with bank debtors," "Eliminating legal deficiencies resulting from the current old law", "Updating the banking rules of the world's Islamic banking" , "Banking Criticisms" and "Avoiding Negligence in Depositing Profit".

On the one hand, the government and the central bank have proposed the following reasons as opposed to early adoption of the plan:

- Firstly, the bill must be presented by the law enforcers (the government) to the parliament, and since the government has not submitted to Parliament a bill on the matter that it is preparing, it is possible to neglect many issues and minor goals in the plan presented by the parliament which, if approved and implemented, could create problems for the banking system and the economy of the country.

- Secondly, the government believes that the pace of approval of the plan as well as the formation of a juridical council could create possible risks for the independence of the central bank and also creating a kind of interference in the work and prevent the major decision makings by the central bank.

- Thirdly, the government believes that, despite the fact that it has passed about 27 years of the current rule of usury-free banking, the banking system remains in its own place. Critics and opponents of the project also believed that adoption and implementation would lead to a parallel increase in the money market with ambiguities and deficiencies due to the ambiguities in the plan as follows:

- The lack of an all-encompassing and comprehensive look at the plan
- Lack of attention to the structural problems of the banking system and reforming the banking system
- Lack of attention to the necessity of separating banks into commercial, developmental, specialized, investment, regional, virtual ones
- The confusion of the new banking system
- Parallelism in the banking system
- Lack of attention to the types of risks in banking system, which could seriously endanger the proper management of the country's economic system.
- Lack of clear direction about the central bank independence
- Weakening the position of the monetary and credit council and embedding the dual system in the banking system by formation of a juridical council



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- Failure to maintain the mechanism for the formation of interest rates in the mentioned scheme

- Microfinance through specialized agencies and etc.

In line with the government's performance in changing the banking system, it was suggested the replacement of the Supreme Court and the Fiqh Council instead of the Money and Credit Council as a draft included 80 terms for the structural reform of the central bank's law which has been faced with considerable changes in compared to the government's bill and Islamic banking and monetary law approved in the year of 1972. The Banking Committee of the Economic Commission headed by Hojatoleslam Mohammad Hussein Hosseinzadeh Bahraini prepared the urgent plan of the central bank of the Islamic Republic of Iran to change the structures of the banking system in the country. In this plan, the central bank's mission has undergone a change, although it has been raised the control of inflation and preservation of price stability as in the past, issues such as the stability of the banking system as well as economic growth and employment are also part of the central bank's duties and actions. Thus, it can be seen that, although in the past the central bank only announced employment rates and economic growth and economic indicators, the focal task of the central bank was to control inflation. But in this plan, the issue of economic growth and labor, which had not previously been the central bank's mission, has also been added.

Also, there are various changes like introduction of board of directors of the central bank and head of the organization, Juridical Council, and Financial Stabilization Coordination Council which it seems to remove Money and Credit Council and also using the ideas and actions of Juridical Council and Financial Stabilization Coordination Council.

The structure of the board of directors, Juridical Council, committees, the Financial Stabilization Coordination Council, etc., is fundamentally different from the previous structure of the central bank, and also issues such as the independence of the central bank are not considered. Also in this plan, the head of the central bank must submit monetary drafts and bills of the government and central bank in front of the parliament, as well as he requests for participation of the chairman at Economic Commission without voting rights in the meetings of the Board of Trustees, and accordance with



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Article 57 of the Fiqh Council, the formation of a juridical council including five jurisprudents (mujtahid in the field of jurisprudence of transactions and an expert on banking and monetary issues), a lawyer, an economist and two excellent banking specialist to monitor and comment on the design of monetary instruments and banking, operating methods, regulations, directives, contracts and implementation for compliance with the principles of Islamic jurisprudence at the central bank.

Note 1: Juridical Council is a pillar of the central bank and its members are appointed by the proposal of the Qom's Seminary Management Council and the Supreme Leader. Other members are appointed by the Central Bank Executive Board and elected by the governor of the central bank.

Note 2: The approvals of Islamic Juridical Council at the central bank are binding on all institutions of the banking system. The central bank monitors the implementation of the council's resolutions.

Note 3: The jurisprudential approvals of the Council will be approved by the majority of the jurisprudents; in all other cases, the benchmark will be chosen by the majority of all members.

Note 4: Islamic Juridical Council of the central bank can comprise specialized juristic committees.

Note 5: All banks and credit institutes are obliged to establish a legal supervision unit under the auspices of the Islamic Juridical Council of the central bank. How to formulate and describe the duties of the religious supervision units, in accordance with the instructions provided by the central bank and communicated to the banks after the approval of Islamic Juridical Council.

In the tenth parliament, the usury-free banking system was finally resolved after years of conflict between the government and the parliament to propose a bill or plan by economists. To study the plan, two juridical and economic committees were set up between parliamentary economists. According to this plan, investment in productive activities is carried out using participatory contracts by investment firms; banks do not play a role in this process and they can invest in equity investment firms; as a result, the business is separated from banking activities and the provision of capital for productive activities are done by investment firms. Instead of banks, the manufacturers



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will refer to capital financing institutions in the event of the final approval of the plan, and the required capital will be given to them using Islamic contracts in these investment institutions.

4 CONCLUSION AND SUGGESTIONS

Unfortunately, despite the 35-year history of Islamic banking in our country, the current situation in the banking system and the performance of banks is such that it is a source of serious concern among religious leaders, as well as a reduction in public confidence in the soundness of the performance of banks in terms of compliance with religious law. The distance between our banks and Islamic banking has led to increased speculative activities and misuse of the resources of people's deposits in banks and increasing the amount of deferred demands in banks. Certainly, one of the prerequisites for the exit from the economic downturn is to reform the banking system and implement the proper implementation of Islamic banking, as the prosperity of Islamic banking will open the way for close engagement of artisans and economic activists with banks, and this will be the beginning of a massive and ideal move towards social justice. Islamic banking is considered as a very important system, because it pays profits or losses caused by participation in economic activities to the depositors and it is not based on pre-determined interest rates. If participatory contracts are correctly implemented, they will be developed along with increasing prices or value of assets, because it deals with a real section of economy. But critics of Islamic banking believe that in the face of Islamic banking, there will be real problems in the macro-level of society. The impossibility of creating money and credit, and the way of ownership in Islamic banking are the other problems in Islamic banking which the problems of creating credit or monetary policies are solved by the central bank, maintaining legal savings and open market operations by selling or buying Islamic properties. Also, Islamic banks can change all sources into profitable ones through allocating of surplus sources to purchase of the securities such as Islamic properties (Sukuk).

Generally, Islamic banking operations in Iran or other Islamic countries have been dramatically succeeded and this issue has been considered by asset owners or agents and it has also observed many western thinkers toward this matter. Anyway, Islamic banking system is encountered with some barriers or problems which they will be



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solved by modifying old law and to codify a new one for banking law. Some of other problems are to monitor banking system and employees that it will be solved by changing structure and re-organization, training of employees, privatization, competitiveness among banks, effective and more accurate supervision on banks by the central bank, and making attempts by policy makers and also managers of banking system in the country.

The active supervision of the central bank is to ensure the goals of the Islamic economy in practice and to prevent the operation of processes, methods and methods that conflict with the generalities of Islamic banking, although they lack the legal issue. To overcome the challenge associated with usury-free banking law:

- a. Legal separation of interest-free accounts from non-interest loans.
- b. Legal development of Islamic financial instruments in the field of resource allocation.
- c. Providing legal tools suitable for communication with conventional and Islamic banks at the international level.

Violations in understanding the generalities of Islamic banking and banking contracts for the formation of juridical committees in the central branches of all active banks in the country's economy (like most active Islamic banks in other countries). One of the important tasks of these committees is the introduction of various contracts to the stakeholders of the banking system and conducting training courses for managers and bank employees by the Islamic Banking Advisory Committee at the central bank.

It is suggested that the central bank provide the preparation of reinforcing institutions in the Islamic banking system in the country with the cooperation of the government such as agencies for monitoring the implementation of various contracts, the institutions for delayed payments and so on. Education and research institutes of the central bank must provide the field of reforming education system at economy and financial management study fields through conducting complementary periods for students and specialized periods for managers.

In the end, to succeed Islamic banks in the future, the Islamic World Bank should be formed that this idea has been raised to some extent and arrange for Islamic banks to deposit a percentage of their funds with this bank so that when depositors will not be



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faced with a lack of liquidity and bankruptcy due to difficulties in receiving their funds; in other words, these banks will be insured by Islamic World Bank. Also, it must be formed standard accounting methods for these banks in line with international auditing standards in order to correctly calculate the division of profits and transaction operations.

In addition, the management of banks should be customer-oriented, innovative, creative and flexible in possible market changes. Islamic banks need to refine management plans and train their personnel in order to be able to assess, control, and execute the project auditors and can apply risk management in all its dimensions. Islamic banks need technically qualified specialists and managers to address liquidity and risk issues that they believe in the implementation of Islamic banking.

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over Islamic Banking System**

Revista Publicando, 5 No 15. (2). 2018, 1094-1122. ISSN 1390-9304

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