

HISTORICAL BACKGROUND OF ISLAMIC BANKING IN NIGERIA

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ABSTRACT

Islamic Banking in Nigeria got approval from the Central Bank in 2011, after several years of attempts by different groups and organisations. A frame work released in the same year spell out guidelines for the establishment, operations, shari'ah governance and supervision of Islamic banks which can be standalone full-fledged institutions, subsidiaries or widows in this paper and attempts is made to discuss "Islamic Banking as a viable alternative to Conventional Banking in Nigeria. Methodology relied on biography appraisal of such studies that ate related to the study. The paper begin with a short background of Islamic Banking in Nigeria and follows with the basis for the introduction of Central Bank of Nigeria and Non interest financial institutions, Central Bank of Nigeria model, different between Islamic banking, challenges and prospect of Islamic banking and ends with suggestion that there should be a sharia supervisory board for any Islamic bank and that board should consists of trust worthy scholars who are highly qualified to issue fatawa on financial transactions.

KEYWORDS: *Islamic Banking, Viable, Alternative, Conventional*

Article History

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INTRODUCTION

Islam is a Universal religion and for times to come. It law is based upon broad principles that admit of interpretation and consensus to cover all the aspects of life and if there be anything essential uncovered, a resource may be lead to the Rule of the Necessity and Need.

Having observed the way economic is being operated in most of Islamic countries contrary to the Islamic Injunction, some Muslim intellectuals in Islamic counties especially in Egypt and Pakistan started aspect of Islamic economy according to the instructions, injunction and guidance from Qu'ran, Sunna Fiqh (Islamic Jurisprudence) in order to get alternative to the conventional banking. As a result of this effort, Islamic banking started to spring up. It started in Egypt with debit 'Bunuk il – idkhar this followed by another one in Pakistan. Bank Nasir Al-Ijtmahiy came up in Egypt was followed by the birth of the Islamic Development Bank in 1974 in Saudi-Arabia. Dubai Islamic Bank in Faisal Islamic Bank, Sudan came to being in 1977. Baitul Tamuwily Kuwait in 1977, Faisal Islamic Bank in 1977, Jordanian Islamic Bank for Financing and Investment started operation in 1978.

Over the last forty years, there has been a rapid expansion of financial institutions that can be characterized Islamic in that they do not deal in interest-based transactions. At present over 60 countries, encompassing the Muslim world, have some type of Islamic banking or financial institution. Nigeria's first Islamic Bank begins business in three

branches on 15th December 2012: Jaiz Bank, Abuja, Kaduna, and Kano. Their early customers were groups of business and individual.

Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Sharia, known as Fiqh al-muamalat (Islamic rules on transactions). The basic principles of Islamic banking are the sharing of profit and loss and the prohibition of riba (interest). Among the common Islamic concepts used in Islamic banking are profit sharing (Mudharabah) and leasing (Ijarah).

Basis for the Introduction of Central of Nigeria and Non-Interest Financial Institutions

Central Bank of Nigeria decided to introduce different category of non-interest financial institutions given the increasing number of requests from persons, bank and other financial institutions desiring to offer non-interest banking products and services based on Islamic commercial jurisprudence in Nigeria, the CBN has developed these guidelines for the regulation and supervision of institutions offering Islamic financial services (IFS) referred to these guidelines.

The Following are the Different Category of Islamic Financial Services (IFS):

- Full-fledged Islamic bank or full-fledged Islamic banking subsidiary of a conventional bank;
- Full-fledged Islamic merchant or full-fledged Islamic banking subsidiary of a conventional merchant bank;
- Full-fledged Islamic microfinance bank;
- Islamic branch or window of a non-bank financial institution;
- A development bank regulated by the CBN offering Islamic financial services;
- A primary mortgage institution licensed by the CBN to offer Islamic financial services either full-fledged or as a subsidiary; and
- A finance company licensed by the CBN to provide financial services, either full-fledged or as a subsidiary.

CBN MODEL AND NON-INTEREST FINANCIAL INSTITUTIONS

CBN new banking model allows the establishment of the following banking structure as defined by BOFIA 1991:

- Commercial Banks
- Merchant Banks and
- Specialized Banks

Specialized Banks include non-interestbanks, microfinance banks, development banks, mortgage banks, and such other banks as may be designated by the CBN from time to time. Guidelines for some of the specialized financial institutions, e.g., microfinance banks primary mortgage institutions and finance companies have been issued under a separate cover. Guidelines for other categories of non-interest banking will be issued upon request which shall be consistent with international best practice.

In a nutshell, CBN defines Non-interest Financial Institutional (NIFI) as a bank or Other Financial Institution (OFI) under the purview of the CNB which transacts banking business, engages in trading, investment and commercial activities as well as the provision of financial products and services in accordance with any established non-interest banking principle.

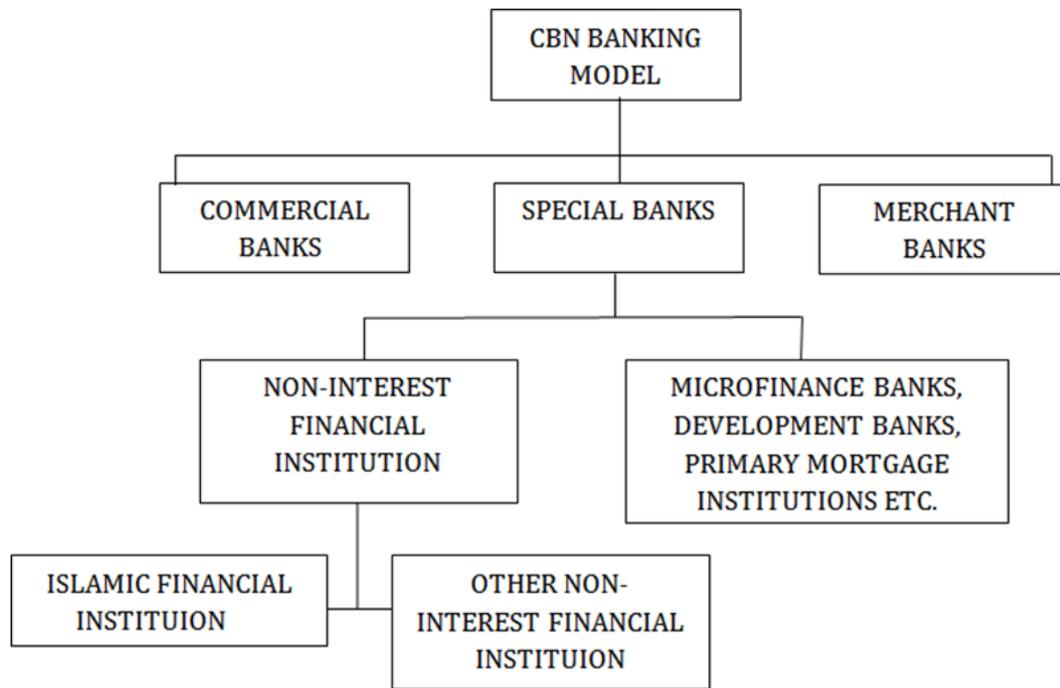


Figure 1

Islamic banking as one of the models of non-interest banking serves the same purpose of providing financial services as do conventional financial institutions save that it operates in accordance with principles and rules of Islamic commercial jurisprudence that generally recognizes profit and loss sharing and the prohibition of interest, as a model.

Difference between Islamic Banking and Non-Interest Banking

Interest-free banking, by contrast, is a narrower concept denoting the number of banking instruments operations which avoid interest. Islamic banking, the more general term, is expected not only to avoid transactions on the basis of interest but also to participate actively in achieving the goals and objective Islamic economy.

In Islamic banking, it is expected that all the transactions and financing operations must be consonant with Islamic law, Shari'ah. It does not involve in any forbidden contracts, sale and trading of certain commodities such as wine or alcohol products, port products etc are prohibited (haram) to Muslims and thus are of business to the Islamic banking, while it may be a profitable business for no-interest banking.

Model of Financing in Islamic Banking

Unlike conventional banking which bases its major function on the interest rate on the loan, Islamic bank it owns peculiar ways of financing projects and investments most of which will be mentioned below:

- **Mudarabah:** This is a financing technique in which the owner of capital provides funds to the capital some productive activity on condition the profit generated will be shared between them. The loss, it incurred in the normal process of the business and not due to neglect or misconduct on the part of the user is borne by the capital owner. The ratio in which profits are distributed is fixed and predetermined, a known in advance to both parties.
- **Musharakah:** This is a financing technique in which a capital-owner finances investment in another business. Additional finance is provided to the party (individual or group) which already had some fun investment. The finance provider provides the additional funds on the condition that shares in the business. The ratio in which the finance-provider shares the profits of the business with the party additional fund is fixed and predetermined, and made known in advance to all concerned. The loss, be shared in the exact proportion of the capital invested.

The techniques (Mudarabah and Musharakah) are very similar because the provider of finance share directly and is contracted to bear the losses, if any, to the extent of his investment. That is why these two techniques are categories together as profit-and loss-sharing (PLS).

According to the logic of the theory, the norm for an Islamic bank will be to assess the profitability of a mid-back those projects with the highest rate of profit, are safest, and most socially beneficial. Projects for through PLS are expected to be selected primarily on the basis of their anticipated profitability rather creditworthiness of the borrower. The relationship between the finance and business is transformed interests of the two come together, with both needing to work jointly to create more wealth.

- **Leasing/Ijarah:** Leasing certainly is, or can function as, a financing technique. An individual short may approach another with a surplus (the financier) to fund the purchase of the productive asset. The financier may do so by buying and renting it out to the one who needs the asset. This certainly is a financing technique that the investor's financial difficulties (with respect to purchasing the required asset) are overcome. He only the rent and does not have to incur the capital investment involved in the purchase of the asset.
- **Hire Purchase (Ijarah wa Iqtina):** This is a hire-purchase agreement between the bank and its elk bank agrees to buy and rent a building, equipment or another facility for the client, in conjunction with undertaking by the client to make incremental payments into an account at the end of each year, added to the installments paid to purchase equipment or facility. The client becomes an owner of the financed equipment and cont.
- **Bai'al Mu'ajjal as a Financing Technique of Islamic Banking:** Literary, it refers to a sale on a deferred basis. Delivery of goods, inputs or implements is made immediately while the price agreed is paid by the purchaser at a given date in the future. The price includes the cost, plus a reasonable margin of profit, administrative costs. As the Islamic bank, for instance, sells inputs to farmers on a deferred-payment the transaction is a sale and not a loan. Islam permits the sale of goods for cash or on credit on the condition price, once agreed upon between the parties at the time of bargain, is not changed even if the payment made on the date it is due.

Benefits of Islamic Banking

- There is a need for alternative to conventional finance whose interest-based factor has promoted capital rather than elevates poverty.
- It reduces exploitation of the conventional bank that charges interest.

- It attracts other idle money, tinny Muslims do not see saving banking is operating they will be encouraged to bring in their money consequently more money to economic development.
- It enchances the creation of employment, owing to its mode of operation which gives more chance to unget direct access to financial opportunity more than conventional banks through Musharakah, Mudarabah etc.
- Islamic banking finance adopts asset-backed finance. This involves the transfer of assets and is not like a money making from money alone as is the case with interest-based transactions. Namely, these were Musharakah, Mudarabah, Salam, Istina, Murabana, and Ijarah.
- Analysts have always believed that non-interest banking would have a significant impact on the Nigeria system and the economy as a whole.
- The introduction of non-interest banking will herald the entry of market and institutional players such as Islamic Money Market, Islamic Asset Management Companies (Islamic Insurance) companies and so on, thus deepening the financial market.
- It allows a larger proportion of the Nigerian population to actively and effectively participate on economic development, owing to its nature and ability to offer an array of products and services that cater to the needs of the banking public
- An interest-based economy has a built-in tendency towards inflation because the creation of money linked to productive investment. By contract, in the Islamic banking system, so Islamic economists class inflation will be at its lowest since the monetary supply will be proportionate to and correlated with e' activities. For example, Mudarabah and Musharakah techniques finance production not consumption, not contribute to inflation.
- Islamic finance, though based on religious law, is not just a religious activity that adherents are expected people who engage in it. It is a business activity opens to all segments of the society.
- Islamic bank provides an opportunity for businessman and investors by financing their projects through partnership (Musharakah, Mudarabah, Ijarah, etc.). Thus, contributes or generate employment opportunity.
- Poverty does not only depend on resource endowments, population, economic and social policies, but also on the kinds of economic activities that are being undertaken. What significant is the sort of policies, which are formulated to eradicate poverty, and to what extent their implementations are sufficiently successful in meeting the objectives. Thus, Islamic Banking based on economic activities such as Zakah etc. is capable of reducing or eliminating poverty in society.
- The Islamic Banking and Finance Institute Nigeria (IBFIN) is approved by the Federal Ministry of Education of the Federal Republic of Nigeria and incorporated with the Corporate Affairs Commission, Nigeria as a limited liability company, a subsidiary of Social Sciences and Islamic Resource Institute Limited.

IBFIN is an Institute dedicated to providing a one-stop solution for Consultancy, Research, and Training in the field of Islamic Banking, Islamic Insurance (Takaful) Islamic Finance, Islamic Wealth Management, Islamic Business, and Islamic Economic. It is Nigeria's first effort at providing professional and formal training, research and consultancy services in these areas.

IBFIN provides result-oriented services through a very holistic and comprehensive approach, which ensures that customers' strategic goals are achieved. IBFIN provides a complete A to Z consultancy and training as well as other complimentary services to its corporate and individual clients through a wide range of services, such as Consultancy, Training, Advisory, Research and Development, Project Supervision, Feasibility Studies, etc. all in the field of Islamic banking, insurance, finance and economics.

Challenges and Prospects of Islamic Banking

Modern Islamic banking is a recent development in the financial world and had to compete with the Western banking system. Although certain factors pose as challenges to the implementation and operations of Islamic banking institutions, especially in a non-Islamic environment. These challenges are enumerated below.

Unfavorable Legal Environment

The unfavorable legal environment in many countries forces the Islamic bank to concentrate its asset portfolio in short-term operations. As Islamic banks do not hold Western government Securities as part of their liquid assets, they cannot be registered in Western Europe or the USA as fully-fledged commercial banks. One possible solution in the West is to act as a kind of building a society, lending to Muslims for house purchases. This approach has been adopted by First Path Financial services of Michigan and Ontario, the leading Islamic retail financial institution in North America.

In England, Islamic banks are regarded as investment companies rather than deposit-takers. The Islamic financial institutions in London are mainly engaged in the finance of Euro-Arab trade. One new development has been for Western commercial banks to offer Islamic financial services to their Muslim clients. The Union Bank of Switzerland, for example, offers an Islamic Investment fund. The Saudi International Bank in London offers Islamic trade finance and is also offering Islamic portfolio management services for clients of substantial means. Citibank has offered Islamic banking services since 1994, its Bahrain branch being the center of these activities. The interest-free banking is also becoming a vogue in most Western Countries, including the United States. Notable banks like ANZ Group, ABN AMRO, Goldman Sachs, HSBC, and the Standard Chartered Bank Group, among others, have established either full interest-free subsidiaries or "indoors" that deal with interest-free products.

Dearth of Trained Personnel

There is a challenge of the dearth of personnel trained in Islamic banking activities. Besides, the educational system of most countries where Islamic Banks operate still remains heavily influenced by the Western educational system. However, with the establishment of International Institute of Islamic Banking and Economics in Cyprus as well as Institute of Islamic Banking and Insurance (IIBI) in London, a cadre of personnel in Islamic banking can be produced. The teaching of Islamic economy and Banking in many institutions worldwide will also increase the numbers of graduates in Islamic banking. This will meet expansion programmes of the system.

Hostile Banking Environment

In many countries, particular the non-Islamic states, the Islamic bank is still like a drop of water in an ocean. In the economy of such countries, an Islamic bank will forfeit interest on its deposits in Central Bank while the interest-commercial institutions would receive such interests. Besides, under such system, an Islamic bank will be at a considerable disadvantage in facing competition with interest-bank because they will not have access to the monetary markets and may even face hostility from the interest-bearing banking in these markets. Nevertheless, these inhibitions can be removed

through the adoption of policies in favor of Islamic banking. Such policies should include; creation of specialized departments in Central bank to guide and supervise operations of Islamic banks and particularly the different new functions that are being undertaken by these banks. Perhaps, with the establishment of interest-free product in many conventional banks coupled with the introduction of the Islamic capital market, the future of Islamic banking is bright.

Absence of Non-Interest Securities

This is directly related to the above problem. The financial securities such as Treasury bills, Treasury certificates, bond and stocks in many countries are interest-oriented. To counteract this challenge, the monetary authorities should foster the development of financial instruments which are interest-free. This will enable Islamic banks to meet statutory liquidity requirements. Islamic banks will also need short-time profitable investment opportunities for excess liquidity. Although with the introduction of Islamic bond (Sukuk) in some market, there is a prospect for Islamic banking.

Insecurity in Profit Declaration

Islamic banks may face the problem of insincerity on that part of businessmen who will understate their profit, or even show losses with a view to surrendering a smaller part of their profits to the banks, or even avoid rendering profit at all. This they may do in view of the condition that banks can him only a share of actual profit of business and, in case of a loss, have to bear the entire loss. However, the competence of modern techniques of critical audit and accounts will be used to eliminate the possibility of cheating from the system. Apart from the fact that such practices will destroy the creditworthiness of businessman, the moral standards of Islam are sufficiently high as to counteract such tendencies towards cheating and fraud.

Low-level Awareness

The ignorance and misconception about Islamic banking in some countries, especially in Nigeria emanate from low-education and awareness of the essence and philosophy of the system. This problem can as well be removed through adequate enlightenment campaign education on Islamic banking, especially in Nigeria.

Obstacles before Islamic Banking in Nigeria

Since the establishment of Islamic banking in Nigeria will be a variant with aspects of the existing financing system, it is therefore obvious that the banking system would be faced with the following problems. First, the unfavorable legal environment on Shariah contract may force the bank to restrict its operation to short-term. Second, the banking system may be faced with the problem of inadequate personnel trained in Islamic banking activities. Insincerity on the part of businessmen to declare or understate their profit is another obvious problem before Islamic banking. In addition, Islamic bank may be at a considerable disadvantage in facing competition with conventional banks because they may not have access to the monetary markets and may even face hostility from the conventional banks in these markets.

The absence of standard Islamic accounting and auditing and Islamic securities such as sukuks (bonds) may also inhibit the operation of Islamic banking. Finally, Islamic banking may face the problem of lack of familiarity with businessmen and entrepreneurs with the requisites of Islamic business ethics. In view of these problems, however, the following suggestions are proffered as a policy recommendation.

SUGGESTION

These should be a *sharia* supervisory board for any Islamic bank and that board should consist of trustworthy scholars who are highly qualified to issue *fatawa* on financial transactions.

CONCLUSIONS

The institution of interest has been controversial throughout history and continues to be so. The aim of Islamic banking is to promote modern banking services and facilities in strict compliance with the *shariah*. The multipurpose services in Islamic bank include demand and investment deposit-taking, hajj and housing deposit, *mudawabah* or capital trust, *musharaka* or equity participation, *murabaha* or markup on sale, *ijara* or lease financing, *mozarah* or agricultural financing, *musaqat* or *Quard Hassan* or welfare loan, collection and distribution of *Zakat*.

Islamic capital market is one of the new financial services emerging from the Islamic financial market. The uniqueness of Islamic banking law lies in its comprehensiveness of principles. The principal sources from which the banking law can be drawn are the *Qur'an* – sitting at the apogee and the *Hadith*. The sources of the law are: *Ijma*, *Qiyas* and *Ijtihad* while the subsidiary sources are the *Istilsan*, *Istidlah*, *Istishab*, and *Vrfu tam'u* – statutory law that conforms to the spirit of *shariah* can also be uphold as a source of Islamic banking law.

However, the future of Islamic banking is right due to the increasing number of graduates of Islamic banking, and development of Islamic securities (e.g. Sukuks or interest-free bonds), research and awareness about the concept.

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