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# ISLAMIC BANKING IN NIGERIA: ISSUES AND PROSPECTS

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**Abstract**

The Nigerian banking reform precipitated the adoption of Islamic banking and finance in 2009 as additional door to banking mechanism in the country. However, the implementation of the Islamic banking or non-interest banking has generated a lot of debate, specifically because its foundations are based on Islamic religion. This paper briefly reviews the concept, the challenges and prospects of Islamic banking in Nigeria. The paper relies on the secondary sources by reviewing and analysing various works on the subject. A reflection on the size of its population and the developmental opportunities indicates that Nigeria has the prospect of becoming the hub centre of Islamic finance in Africa. Yet there are numerous challenges to the development of the Islamic banking system in the country, including misrepresentation of the system, lack of linkages and investment institutions, lack of adequate knowledge, as well as shroud business ethos and corruption, which is endemic in the country. The paper recommends the need for greater public awareness about Islamic banking and creation of enabling environment (i.e. the legal, accounting and taxation systems) for the working of Islamic financial system.

**Key words:** Islamic banking; non-interest banking; banking reforms; Islamic finance

## 1: INTRODUCTION

Islamic banking (also refer to as non-interest banking) is gradually taking path into the global financial system. The modern Islamic banking has its roots to the Egyptian experiment of a variant of a savings bank based on profit-sharing in the town of Mit Ghamr in 1963, which was spear headed by economist Ahmad ElNaggar. Subsequently, the Nasir Social Bank in Egypt was declared as an interest-free commercial bank in 1971, although its charter made no reference to Islam or Islamic law (*Shari'ah*) (Ariff, 1988). The guiding principle of Islamic banking and finance is to provide banking and financial

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services which are compliant with Shari'ah. The primary source of Sharia'h is the Divine Islamic Law as revealed in the Holy Quran.

The banking system is very significant in the development process of every economy.The orthodoxy of commercial banking is predicated on intermediation and generation of net interest income through two core operations: the collection of deposits on which banks pay interest and the issuing of loans for which banks receive interest income. This translates into the basis of measuring net interest margin - a difference between lending and deposit rates. In short, conventional banking system is interest-based or credit-based. The development of banking has opened new frontiers for commercial banks to expand beyond their traditional role and sources of income to activities that generate non-interest income (such as fee-based activities, licensing, insurance, etc). As the name implies, non-interest income is income that does not originate as interest on loaned funds, and non-interest income typically requires minimal risk for the bank and minimal capital. "*An increase of the non-interest income improves the banking profitability and reduces the risk of the lending operations by more diversification of banking activity* (Hakimi, Hamdi and DJelassi, 2012)".

Today banks generate an increased proportion of their income from non-intermediation and /or non-interest activities. For example, non-interest income now accounts for over 40 per cent of operating income in the US commercial banking industry (DeYoung and Rice, 2004). Indeed, non-interest income has become a key component of the profits of many commercial banks across the world. Consequently, the interest income, which is the primary indicator of the banking profit, has decreased drastically and non-interest revenue increased substantially.

The non-interest income is predicated on the pillar for generating banking (bank and creditor) income primarily from fees. Examples of non-interest income include deposit and transaction fees, insufficient funds fees, annual fees, monthly account service charges, inactivity fees, and cheque and deposit slip fees. Under the non-interest banking frameworks, institutions charge fees that provide non-interest income as a way of generating revenue and ensuring liquidity in the event of increased default rates.

Interest is prohibited by the major religions - Islam, Judaism and Christianity. They had condemned taking "interest" in all its ramifications. The Holy Qur'an explicitly and emphatically forbids taking or giving of interest on transactions. In the Qur'an, in Surah Al-Imran (3:130), Allah says: *"O you who believe! Do not devour Riba (usury) multiplying it over and keep your duty to Allah that you may prosper"*. Same kind of prohibition regarding fixed interest is also stated in Al-Baqarah (2:275-281), Al-Nisa (4:160-161) and Surah Al-Rum (30:39) of the Qur'an. There are numerous *Hadiths* which explain the prohibition of interest (*Riba*) and risk or uncertainty (*Gharar*). Both Riba and Gharar are illegal under Islamic law: Riba refers to fixed rate of interest and Gharar refers to speculation or uncertainty. Also, there is complete unanimity among all schools of thought in Islam that the term "Riba" stands for "interest" in all types and forms (Ariff, 1988).

In the Bible, too, the taking of "interest" is categorically forbidden. Exodus (22:25) says: *"If you lend money to any of my people who are poor among you, you shall not be like a moneylender to him; you shall not charge him interest."* Leviticus (25:35-37) states: *"If one of your brethren becomes poor, and falls into poverty among you, then you shall help him, like a stranger or a sojourner that he may live with you. Take no usury or interest from him, but fear God, that your brother may live with you. You shall not lend him your money for usury, nor lend him your food at a profit."* The Hebrew Bible also regulates interest taking as in Deuteronomy

(23:19) says: "*Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury.*" The term *Usury* is used in the same sense of any amount claimed by creditor over and above the principal advanced by him to debtor.

The banking system has ever been changing with the changes in the societies. Indeed, a variety of banking models have been developed all over the world, but mainly they function on the basis of the interest. The most significant development in the field of banking is the emergence of Islamic banks.

Islamic banking is a system of banking or banking activity that is consistent with Islamic law (*Shari'ah*) principles and guided by Islamic economics. It is a banking system that provides financing and attracts savings on the basis of profit- and loss-sharing (PLS) rather than lending and interest. Therefore, an important part of the system is the prohibition on collecting interest. Another part is on ethical investments by prohibitions on business such as alcoholism, gambling, armaments, pig farming and pornography. Islamic banking system emerged as the major alternative to conventional banking system. Islamic financial products now comprise a broad range of financial services, where for almost all conventional financial products there is nearly always an analogous Islamic finance product (Gait and Worthington, 2007).

The development of Islamic banking and interest-free banking in the 1970s and 1980s, particularly in Pakistan and Malaysia, has propelled great interest in alternative to conventional banking. Indeed, the global financial crisis has provoked scholars, lawmakers and bankers to reassess the opportunities provided by the Islamic finance. Shafique, Faheem and Abdullah (2012) posit that "*the recent global financial crisis forced the developed nation to lower the bank rates and introduce the new financial system that is based on Islamic principles of interest free financial system"*. In fact, even the Vatican (in its daily newspaper *Osservatore Romano*) has put forward the idea that *"the principles of Islamic finance may represent a possible cure for ailing markets* (Totaro, 2009)". And many articles have indicated acceptance by Western governments and bankers of an Islamic financing system (The Brussels Journal, 12-03-2009).

Today more than 105 countries operate Islamic banking with a global market size of more than US$2 trillion of assets, with a growth rate of 17-20 percent per annum (The Economist, 2014). Various jurisdictions have commenced legal and regulatory reforms to pave the way for the offering of Islamic finance in their respective countries while ensuring attention to sustaining financial stability. The UK which is considered as a European hub of Islamic finance and one of the major Islamic finance centres after Malaysia, Bahrain and the UAE started amending its tax laws in 2002 to accommodate Islamic financial arrangements. This approach was followed by many other countries (e.g. France, Ireland and Luxembourg) that have either amended or clarified their tax laws to accommodate Islamic finance. Germany is the first European country to issue a *Sukuk* (Islamic bonds), which is becoming an attractive alternative of funding and investment for several countries across the world (Chermi and Jerbi, 2015). The growth and development of Islamic banking in the Eastern European countries is envisaged to take roots in Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan and Russia in the current decade (BNM, 2015).

The importance and potential of Islamic banking prompted the International Monetary Fund (IMF) to facilitate the establishment of the Islamic Financial Services Board (IFSB) in 2002. The IFSB serves as the Islamic equivalent of IMF towards addressing the need for a suitable regulatory framework, new financial instruments and institutional arrangements for Islamic finance operations (Khan and Bashar, 2008). Earlier in 1990, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established to set the accounting standards for the Islamic financial industry. In 2010, the International Islamic Liquidity Management Corporation (IILM) was established to enhance liquidity management in the Islamic financial system, among others, through the periodic issuance of short-term Shari'ah-compliant financial instruments.

This paper aims at examining the adoption of Islamic (Non-Interest) banking in Nigeria through the introduction of new banking model by the Central Bank of Nigeria (CBN) in 2011. The study reviews and analyses various works on the subject, and recommends the need for creating an enabling environment (i.e. the legal, accounting and taxation systems, as well as awareness) for the working of Islamic financial system. This paper is organised in four sections. Section one is the general introduction, section two reviews banking reforms in Nigeria. Section three discusses Islamic banking in Nigeria, which offers some definitions of Islamic finance and products as well as highlights the prospects and challenges of the new banking system in the country together with recommendations. Section four concludes the paper.

## 2: BANKING REFORMS IN NIGERIA

The Nigerian banking industry is one of the most vibrant in the sub-Saharan Africa, and has witnessed various reforms over the years. The most significant reforms were the 1986 banking reform during the structural adjustment programme (SAP) period and the 2004 banking consolidation reform, which accelerated in 2009 banking reform. These reforms were extensively discussed in different studies (Ojong, Ekpuk, Ogar and Emori 2014; Sanusi, 2012; Dogarawa, 2011; Abdullahi, 2007; Imala 2005; etc), and therefore few related issues will be noted in this paper.

The 1986 banking reform was characterised by the deregulation of interest rates, exchange rates and access into banking business, which precipitated the liquidation of some distressed banks and privatisation of government shareholdings in some (Effiom, Ubi and Okon, 2012). The impact of the reform was visible in the proliferation of banking institutions from mere 50 in 1987 to 120 in 1993, and 155 in 1998. A significant feature of the growth in the number of banking institutions is that the new banks were generally small and undercapitalized. The smallness of banks in Nigeria remained a serious constraint in their ability to finance major investments in the real sector of the economy, a situation that was further compounded by the apparent lack of ethics in their conduct. Indeed, some of the banks had been set up with less ethical motives in mind (Effiom *et al.*, 2012).

In 2004, the CBN commenced another round of banking reform with a view to redressing distress conditions of the banks as clearly manifested in persistent illiquidity, weak corporate governance, poor assets quality, insider abuses, weak capital base, unprofitable operations, and over-dependency on public sector funds, among others (Effiom *et al.,* 2012). The first pillar of the reform was banking consolidation aimed at raising the capital base of banks through mergers and acquisitions as well as capital issues in the stock market. Sanusi (2011) avers that the thrust of the consolidation policy was to grow the banks and position them to play crucial roles in driving development across all sectors of the Nigerian economy, as well as bringing about improvements in their own operational efficiency. At the end of the consolidation exercise the number of the banks reduced from 89 banks in 2005 to only 24 banks as consolidated banks having met the required =N=25 billion minimum paid-up share capital requirement for universal banking.

By 2009, the CBN accelerated the banking reform process with the avowed objective of ensuring that banks rely more on the private sector for funds and, more significantly, by ensuring greater transparency and accountability in the implementation of banking laws and regulation. According to Sanusi (2011), some positive outcomes of the reforms include greater confidence in the banking system with the removal of distress banks and the adoption of a strict code of corporate governance principles in banks and their ability to undertake funding of large projects, especially in infrastructure, and oil and gas sectors, through the new window in the enlarged single obligor limits. The reform brought about the huge increase of the branches of the surviving 24 banks, the number of bank branches has increased from 3,247 in 2003 to over 5,837 in 2011, and employment in the sector also rose from 50,586 in 2005 to more than 71,876 in

2010. Moreover, the reform has also brought about increased widespread use of e-payment services among Nigerians. Besides the recorded increase in commercial banks' branches, there were 816 microfinance banks operating in the country. Despite this phenomenal rise in the number of bank branches, the ratio of bank branch to total population stood at 24,224 persons, indicating a high level of financial exclusion (Sanusi, 2012).

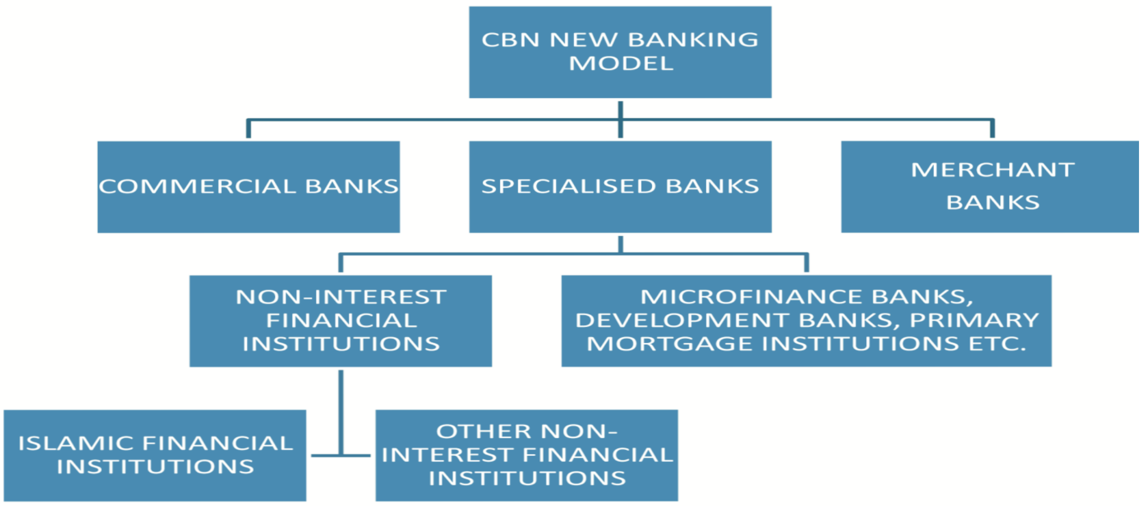
The CBN banking reform discarded the universal banking system, which allowed banks to diversify into non-bank financial businesses. In 2011, it introduced a new banking model with a view to directing banks to focus on their core banking business only. The CBN New Banking Model authorizes the establishment of the following banking structures as defined under the Banks and Other Financial Institutions Act (BOFIA) 1991 as amended: (i) Commercial Banks; (ii) Merchant Banks; and (iii)Specialised Banks.

Accordingly, Specialised Banks include non-interest banks, microfinance banks, development banks, mortgage banks, and such other banks as may be designated by the CBN from time to time. The CBN has developed Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services (IIFS) in Nigeria. The guidelines are focused on financial institutions desiring to offer non-interest banking products and services based on Islamic commercial jurisprudence in Nigeria. This banking model is also called "Islamic Banking".

In the Guidelines on IIFS, the CBN described Non-Interest Financial Institution (NIFI) as a bank or Other Financial Institution (OFI) under its purview, 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 principles. Accordingly, non-interest banking and finance models are broadly categorized into two:

1. Non-interest banking and finance based on Islamic commercial jurisprudence;
2. Non-interest banking and finance based on any other established non-interest principle.

**<u>Nigeria's Banking Model</u>**




The thrust of this paper is the Islamic banking model. According to Sanusi (2012:8), "*the introduction of the non-interest banking in Nigeria is expected to herald the entry of new markets and institutional players thus deepening the nation's financial markets and further the quest for financial inclusion"*.

Another justification for the non-interest banking is the burgeoning non-interest income contributions to profits of commercial banks across the world.

It is therefore obvious from the CBN definition of business of non-interest banking that for now it is synonymous with Islamic banking or interest-free banking. The CBN guidelines on non-interest banking further clarified the contextual definition of non-interest banking to include other form of non-interest banking not based on Islamic principles. However, the guidelines for operating non-interest banking based on principles other than Islamic are yet to evolve, because of lack of any specific initiatives in such business.

The CBN Framework on Islamic Banking broadly categorised Non-Interest Financial Institutions (NIFIs) as:

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

In general, non-interest banking, interest-free banking, profit and loss sharing banking, now practiced in many countries across continents of the world are classified as "Islamic Banking." Although there are several components of non-interest banking, in this paper our discourse is on the Islamic banking brand. The pertinent questions to our discourse are: (1) What is Islamic banking? (2) What is the progress of Islamic banking? (3) What are the prospects of Islamic banking in Nigeria? (4) What are the challenges of Islamic banking in Nigeria? (5) What are the recommendations to address the challenges of Islamic banking in Nigeria?

## 3: ISLAMIC BANKING IN NIGERIA

The description of non-interest bank by the CBN shows that the bank is required to comply with the principles and rules of Islamic commercial jurisprudence, and thus one can safely state that non-interest bank in Nigeria is synonymous with the Islamic bank. The foundation of Islamic bank is in Islamic finance, which prohibits interest. Therefore, in Islamic finance all type of transactions are interest-free and of risk sharing nature. The prohibition of interest or usury is based on the arguments of social justice and equality (Shafique *et al,* 2012; Fatai, 2012; Wilson 2009; Lodhi and Kalim, 2005). The prohibition is supported by various chapters of the Holy Quran, including chapters 30:39; 4:161; 3:130; 2:275; and 2:281.

Although Islam forbids predetermined or fixed rate of return for a certain factor of production or capital, it permits profit sharing. Whereas the profit sharing ratio is predetermined, the ratio of return is not predetermined. So Islamic banking came into existence to satisfy the financial needs of those who have to observe the prohibition of interest-based transactions. Accordingly, Islamic banks carry out banking business similar to conventional banks, but in line with the principles of Islamic commercial jurisprudence (or *Fiqh al-Muamalat*) or Shari'ah.

Just like conventional banking, the purpose of Islamic banking is to make money for the banking institution but rather than generating return by lending out capital, Islamic banking is a mutual financing system that focuses on generating returns through investment tools which are Shari'ah-compliant and based on sharing the risk. The sharing of risk may arise through trading and investment activities using contracts of various Islamic modes of finance. Islamic banking has been defined as "*banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shari'ah"*. The critical issues in the operations of Islamic banks are the prohibition of interest (*riba*) and the sharing of profits and losses, the compliance with the principles and rules of Islamic commercial law (or *Fiqh al-Muamalat*). The latter is also known as the Islamic Law of Transaction. It deals with the issues of contract and legal effects arising from contracts. The main principles are mutual consent, avoidance of prohibited elements (e.g. interest, gambling and alcoholism), and lawful contractual objectives.

The basic difference between Islamic banking from conventional banking is primarily that the investor in a conventional bank is assured of a predetermined rate of interest while Islamic banks promote risk sharing between provider of capital (investor) and the user of funds (customer). Whereas the rate of interest applied by conventional banks is known as Base Lending Rate (BLR) which fluctuates according to the interest rate, the Islamic banks determine the price upfront, thus clients are free from interest rates risk. In analysing the overall performance of the Islamic banks as compared to the conventional banks, research indicated that Islamic banks generally are fairly stable, profitable and well capitalised (Iqbal, 2001). Also their profitability ratios compare favourably with international standards in banking.

The basic elements of Islamic finance or banking are primarily four: Risk sharing, Materiality, No exploitation, and No financing for sinful activities.

- *Risk sharing* means that Risk is shared among investor, bank and fund user; hence profit and loss sharing ratio is pre-determined in Islamic finance transactions. The risk of loss rests exclusively with the capital and no other factor of production is expected to incur it.
- *Materiality* means a real transaction must exist; it is an asset-backed financing in which each financial transaction must be tied to a tangible, identifiable underlying asset, and thus a financial transaction needs to have a 'material finality', that is a direct or indirect link to a real economic transaction. This is because money is not considered as asset. So the idea is to convert all assets into *gold standard* or its equivalents whose value do not deteriorate over time.
- *No exploitation* means contractual parties should not be exploited; financing and benefit arrangements are clearly spelt out in Islamic finance contracts.
- *No financing for sinful activities* means transaction which is forbidden by Islamic law should not be financed. These include liquor, pork-based products, gambling, pornography, uncertainty and speculation.

The advocates of Islamic banking system argue that it is less exploitative than the conventional banking system. For example, in the case of losses, the burden is shared, and thus the evils of debt problems would not arise in such a system. Whereas the opponents argue that there is "no difference at all" between Islamic banking and conventional banking. Because in practice, the Islamic banks seem to use the interest rate practices by the conventional banks as a benchmark in developing their banking products. Consequently, by applying these benchmarks, the Islamic banks make their transactions "similar" to interest-based transactions, which bring about doubts on their compliance with the principles of Islamic commercial jurisprudence (or Shari'ah-compliant). In accordance with Islamic principles, any payment or receipt of interest is strictly prohibited. The Islamic banks also offered more or less similar products and services which are similar to those offered by conventional banks, such as, current accounts, credit cards, investments in securities, and cheque collection.

Shaikh Ziyaad Mahomed, CEO of Islamic Finance Institution of South Africa (FISA), observed that *"while conventional or interest-based banking focuses on the money itself to make more money (interest) from it, non-interest banking on the other hand focuses on investing the money in the system where people are actually working into to provide infrastructure, amenities and other services"*. He further contended that *"conventional banking is focused on the money itself, trying to make more money from the money, but Islamic banking focuses on trade"*. The major difference is that Islamic banking is based on investment and sharing of risks rather than intermediation or interest.

The development of Islamic banking or finance is based upon the productive use of money for growth of the economy and the benefit of the community. It is an asset based system of investment. The thrust of Islamic banking is the prohibition of taking and giving of interest in all form of banking and financial transaction. The Islamic form of financing promotes the profit-loss-sharing module instead of an assured return on loan amount by the interest rate in the conventional banking system. Taking a risk is the only provision that entitles one to profit, if there is no risk of loss then there is no assurance of profit to the depositor or the financier. Therefore, profit should be made by means of either trade in tangible assets or on the basis of a profit-and-loss-sharing model (Mohamad, Salah, Mokhtar and Alwi, 2015).

In general, the framework of Islamic finance is the same framework used by the conventional finance practices. These frameworks are, *inter alia*, legal and regulatory framework, taxation framework, and accounting and auditing standards, though Islamic Financial Institutions are expected to be guided by AAOIFI rather than the IFRS or other accounting and auditing standards. The raison d'être of Islamic finance is that all transactions must be Shari'ah-compliant. It is the objective of the CBN to develop the non-interest (Islamic) banking system parallel to the conventional system in Nigeria. The CBN introduced a concept of 'Islamic window' which allows the existing conventional banks to introduce Islamic banking products of customers.

***Islamic banking products***

The growth and development of the Islamic financial system provides a variety of financial products that meet the different needs of the economy of a country. Such financing products offered in Islamic finance include syndicated financing, equity financing and venture capital. There are also a wide range of investment and treasury instruments, as well as fund and wealth management products for the management of portfolios of businesses. In the sector of Islamic insurance or *takaful*, there is also a broad range of products, including *takaful* coverage for physical properties and assets of businesses, as well as protection for employees.

A customer of an Islamic bank can make earnings on his or her deposit through:

- Return on his or her capital when that capital is invested in a business venture;
- Sharing of profit when his or her capital or part of capital is invested in a partnership; or
- Rental earnings on an asset that has been partially financed by his or her capital.

The basic principle of Islamic banking is based on risk-sharing which is a component of trade rather than risk-transfer as in the conventional banking. Islamic banking introduces concepts such as profit sharing (*Mudaraba*), safekeeping (*Wadia*), joint venture (*Musharaka*), cost plus (*Murabaha*), leasing (*Ijara*), Islamic bonds (*sukuk*) and good loan/benevolent loan *(Qardul-hassana)*. In practice, Islamic banking products are characteristically categorised into two major models: Profit and Loss Sharing (PLS) financing and Non-Profit and Loss Sharing (NPLS) financing. The PLS banking products are: *Mudaraba, Musharaka,* and *Sukuk*. While the NPLS financing include: *Murabaha, Ijara, Musawama* and *Qardul-hassana.*

A major requirement for Islamic banks and institutions that offer Islamic banking products and services is the establishment of a Shari'ah Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the banking institutions comply with the Islamic law (i.e. Shari'ah principles).

**4: PROSPECTS OF ISLAMIC BANKING IN NIGERIA**

A reflection on the size of its population and the developmental opportunities indicates that Nigeria has the prospect of becoming the hub centre of Islamic finance in Africa. The underlining prospects of the Islamic banking in Nigeria may emerge from the following:

1. *World wide growth*
   The burgeoning trends of Islamic banking in the world, particularly in countries with largely Muslim population like Malaysia, Pakistan, Indonesia, Bangladesh, Bahrain, Saudi Arabia, Egypt, Sudan, Qatar, Kuwait, and Iran indicate the potentials of the Islamic banking in Nigeria. With globalisation the Islamic banking has expanded to non-Muslim countries, including UK, USA, Canada, Germany, Luxembourg, Spain, and Russia which is an indicative that the burgeoning Islamic banking will prosper in future. So there is the need for greater patience from the potential investors and users of non-interest financial services in Nigeria.

2. *Role in corporate social responsibility*
   The potential role of the Islamic banking in the corporate social responsibility may propel its socioeconomic contributions to the economy, especially in the provision of free services to the indignant under the philanthropic sector activities. From its pedigree, the Islamic banking has great potentials in fostering development in the social sector by participation in financing of socio-economic programmes like youth skills acquisition programmes, women empowerment, and micro and small-scale industrial development programmes.

3. *Mainstreaming the unbanked*
   The Islamic banking has the potentials for mainstreaming the large number of unbanked Muslim community in Nigeria as they may be attracted to this type of specialized banking system and get bankable. Even non-Muslims may be attracted by the business nature of the Islamic banking activities which provide investment resources rather than fixed interest facilities to customers. Islamic banking is interest (*riba)* free and trade oriented banking system, and it is based on profit and loss sharing mechanism. The Islamic banking system also has the potential to provide greater access of financial services to all segments of society. Accordingly, Islamic banks would meet the differential demands of low income communities and provide support to entrepreneurial activities. Therefore, it can promote greater financial inclusion in line with the current goal of the Central Bank of Nigeria. More significantly, mainstreaming the unbanked or the unserved communities into the economic mainstream through the financial intermediation process would contribute towards poverty alleviation, job creation and more equitable economic growth.

4. *Fostering flow of development funds*
   The growth of Islamic banking in Nigeria will foster flow of development funds from Islamic banking system of the world. Special mention is the Islamic Development Bank (IDB) which provides development funds for infrastructural projects in member countries. Nigerian Government and corporate organizations would have access to Islamic development fund available in the international community to finance infrastructural projects. Such development resources will flow through the local Islamic banking system to the beneficiaries. This is buttressed by Sanusi (2011) that the introduction of Islamic banking is to create an enabling environment for attracting the multi-billion dollar global Islamic finance industry to Nigeria and to enable Nigerians benefit from Shari'ah-complaint banking services and products. It is therefore expected to attract new foreign direct investment (FDIs), especially from development institutions like the Islamic Development Bank (IDB).

5. *Providing citizens with different credit choice*
   The emergence of non-interest banking in Nigeria as complementary alternative to conventional banking would allow citizens to have different credit choice among different types of banking structures in the country, and it is expected to deepen and diversify the financial system for the benefits of all. Because from the CBN new banking model, non-interest banking is just like any of the existing banking techniques such as microfinance banks, mortgage banks, development banks and merchant (investment) banks in the industry in which any interested party can participate at any point in time out of their own decision. More significantly, Muslim and non-Muslim population majority of which yearn for Islamic finance services would have the opportunity of the availability of the non-interest banking services. One can safely speculate that major conventional banks in Nigeria would join the bandwagon of alternative banking through the adoption of Islamic banking products by opening window, separate branches, or even subsidiary companies as provided by the new CBN Guidelines on Non-Interest Banking in Nigeria.

6. *Developing micro credit schemes*
   Islamic banking is expected to contribute significantly in developing micro credit schemes towards improving the overall communities. Micro credits schemes have greater tendency to alleviating poverty by fostering income generation activities and reducing unemployment rates among the poor in communities.

7. *Variety in Islamic banking model*
   The policy of allowing conventional banking institutions to offer Islamic banking services by opening a window, separate branch or a subsidiary is expected to be the most effective means for facilitating the growth and development of Islamic banking in Nigeria, because the policy is capable of increasing the number of institutions offering Islamic banking services at the lowest cost and within the shortest time frame. This model is not novel as it was practiced in many countries, such as Malaysia which adopted the model after a decade of introduction of the Islamic banking towards accelerated growth of the system (Mokhtar, Abdullah and Al-Habashi, 2006).

8. *Dual banking systems*
   The Islamic banking is envisaged to co-exist with the conventional banking in Nigeria. This is not novel, as similar dual banking system operates in countries such as Malaysia, whereby Islamic and conventional banking systems co-exist and run concurrently in the financial system. The evolution of non-interest banking in the country will in the long run lead to the development of separate regulatory and supervisory requirements for the dual banking.

9. *Sukuk (Islamic bonds) opportunities*
   The huge infrastructure requirement poses *Sukuk* (Islamic bonds) opportunities in Nigeria, besides other Shari'ah-compliant investment opportunities. Since the late 1990s the *Sukuk* market has emerged as an important form of intermediation in Islamic finance. Government and the private sector may draw developmental resources through issuance of *Sukuks,* which could finance critical infrastructure investment in the utilities sectors, in particular for water and power projects, and in the services sector, in education, healthcare and transportation, as well as in the agricultural sector.

10. *Greater public confidence in banking system in Nigeria*
   The increased public confidence in the banking system that ensued from the recent banking reform will no doubt bolster interest in the Islamic banking, and emerging Islamic banks and financial institutions are expected to benefit from the greater public confidence in the financial system and institutions.

**5: CHALLENGES AND RECOMMENDATIONS**

The adoption of Islamic brand of non-interest banking in Nigeria suggests the need to analyse the potentials and challenges of the newly embraced banking model with a view to proffering recommendations for the accelerated growth and development of Islamic banking in the country. Some of the identified challenges and their possible solutions are as follows:

1. *Misrepresentation of Islamic banking system*
   Since the announcement of the first licence of Islamic bank in Nigeria, there has been hue and cry on the implications of the new banking system. Despite its existence in even western countries of the UK, US, France, Germany and Sweden, ethno-religious sentiments were employed to discredit the Islamic banking system. The introduction of the non-interest banking has been given a religious connotation, whereby the wrong perception and stiff resistance to the policy could potentially deter prospective investors in the banking industry (Sanusi, 2012). Paradoxically, if Islamic bank can exist in the western world, especially in the UK, Germany and the US, then why not in countries like Nigeria, where there is larger potential market for the Islamic finance products because of its majority Muslim population (Bello and Abubakar, 2014). The misconception of Islamic banking calls for concerted efforts among the institutional stakeholders, regulatory bodies (e.g. CBN and SEC), religious bodies, and Islamic banking institutions through promotion of greater understanding and awareness about the objectives and the benefits of the Islamic finance and its products in the economy.

2. *Lack of skilled and trained human resource*
   There is lack of skilled and trained human resource in Islamic banking. Indeed, it is obvious that even the conventional banking that operated for more than a century in the country still faced the problem of shortage of skilled and trained banking personnel. Furthermore, the lack of knowledge of accounting and auditing standards applicable to Islamic financial institutions is another impediment in the development of Islamic banking in Nigeria. The balance-sheet structure of Islamic banks is unique. Although the work of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) on accounting and auditing standards for Islamic banking products is available, accountants and auditors would have to be trained in the application of such standards. The shortage of skilled and trained human resources for Islamic banking in Nigeria can be addressed by collaboration among regulatory institutions, Islamic finance institutions and the academic institutions, as well as the professional bodies for continuous training of bankers and researchers. The Financial Reporting Council of Nigeria (FRC) and the relevant professional bodies such the Association of National Accountants of Nigeria (ANAN), Chartered Institute of Accountants of Nigeria (ICAN), Chartered Institute of Taxation of Nigeria (CITN), and Chartered Institute of Bankers of Nigeria (CIBN) need to train accountants and auditors in financial reporting and standards for Islamic banking, finance and insurance.

3. *Rulings of the advisory committee of experts (ACE)*
   In many countries that are practicing Islamic banking, there is the divergence in rulings, where one Shari'ah supervisory board will declare a certain transaction as Shari'ah-compliant while another prohibits. The divergence in rulings is likely to manifest in Nigeria as the development of the Islamic banking progresses. This challenge can be addressed by establishing a broad and well encompassing Central Advisory Committee of Experts (CACE) for Islamic Banking in Nigeria, which will be charged with the general responsibility of making decisions on suitability or otherwise of any proposed products into the market. The CACE should be complemented by the individual Advisory Committee of Experts of Islamic financial service providers, and independent Advisory Consulting Firms that will offer advisory services to the institutions offering Islamic financial services. This will no doubt redress the serious concern about issue of independence, impartiality and conflicts of interest that may arise in case of local Advisory Committee of Experts (ACE) of individual provider of Islamic finance. The CBN should accredit, licence and keep a data base of professional firms that will be responsible, on outsourcing basis, to provide the required advisory or rulings on suitability or otherwise of new Islamic products. Cooperation between the members of these ACEs and the practitioners plays an important role to make sure the Islamic financial institutions achieve their objectives; otherwise lack of harmony may cause the rulings of these committees to be contradictory. Hence, there is the need to create a platform that will harmonise rulings of the Advisory Committee of Experts (ACE) or Consultants of Islamic financial institutions in order to have unified rulings on products and services. Accordingly, the work of research institutions such as the International Shari'ah Research Academy for Islamic Finance (ISRA) on rulings (or *fatwas*) of Shari'ah boards, and the continuing efforts of the Islamic Development Bank (IDB), the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for

Islamic Financial Institutions (AAIOFI) on cross-border engagement among practitioners and Shari'ah scholars would contribute to the harmonization process.

4. *Lack of linkages and investment institutions*
The nascent Nigerian Islamic banking market is underdeveloped and therefore the lack of linkages and investment institutions is very obvious. At present, only one bank, Jaiz Bank Plc, is authorised to carry a full pledged Islamic banking in Nigeria. Notwithstanding that Jaiz Bank is about five years in operations; the bank is battling with start-up challenges and savings mobilisation and investment challenges. This trend is not novel because it is the same experience in Pakistan, Malaysia and Bangladesh and many other frontrunners in the new phenomenon of Islamic banking. However, the Central Bank of Nigeria and Securities & Exchange Commission (SEC) could accelerate the development of investment institutions and instruments for Islamic finance.

5. *Lack of adequate knowledge*
Lack of adequate knowledge of the Islamic banking will hamper its growth in Nigeria. The low awareness about the Islamic banking system and products in the general public affects the efforts at developing the system in the country. Both investors and users of Islamic banks have remained very apprehensive on the success of the Islamic banking in Nigeria. Some people still have a wrong understanding or perception of Islamic banking. These include serious concerns that: Islamic banking is only for Muslims, Islamic banking is not profitable because no interest is charged, or Islamic banking is only offered in Islamic states. Therefore, greater education and knowledge on Islamic banking should be delivered to the public so as to create better awareness among the citizenry that Islamic banking is not only an alternative financial approach but also in some aspects provides better value propositions to the consumers. The responsibility of public awareness on the Islamic banking system no doubt is saddled on licensed providers of Islamic banking services and the financial regulators (e.g. CBN and SEC) that have significant roles to play in promoting the non-interest banking model. This can be achieved by launching a massive education and training programme for bankers and their clients and an effective campaign through media for the general public to create awareness about the Islamic financial system, including specialised courses and organised seminars as in the case of conventional banking.

6. *Double taxation issue*
The tax statutes would require amendments to consider the non-interest (Islamic) banking services; otherwise there is a portent danger for double taxation that would be levied on Islamic banks as a result of stamp duties and capital gains tax, which are deductible upon asset transfer. Islamic banks face a tremendous challenge in this respect because their financial intermediation is asset based. Already some countries (e.g. the UK and Luxembourg) have modified their tax laws to exempt Islamic banks from double taxation on assets they acquire for financing purposes (Fatai, 2012). The Nigerian tax laws should be amended to accommodate non-interest (Islamic) banking, finance and insurance services.

7. *Business ethos and corruption*
Shroud business ethos will be serious impediments to the growth of Islamic banking in Nigeria. Because the business community may be averse to doing business with banks on

the basis of profit- and loss-sharing (PLS) or risk-sharing, and thereby share their true profits and business privacy with banks. More so, dishonest clients may exploit the instrument of Islamic banking (i.e. *musharaka*) by not paying any return to the financiers, possibly through connivance with the representative of the financier. They may withhold profit and claim that they have suffered losses in which case not only the profit, but also the principal amount will be jeopardised. This is more so as a result of the fact that corruption is endemic in the country. It is important that the Nigerian government accelerates its fight against corruptions. Also, the banks should due greater due diligence on their customers and on the character of their prospective employees before employment.

8. *Legal, accounting and taxation system*
   The creation of legal infrastructure conducive for working of Islamic financial system is very obvious. Therefore, the Islamic banking should be supported by the legal, accounting and taxation systems. There should be an exclusive regulatory framework for Islamic banks and financial institutions, which will provide for regulatory treatment for various Islamic products, also for capital adequacy ratio purposes. The Financial Reporting Council (FRC) of Nigeria should also embrace the fundamentals of International Accounting and Auditing system as issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in reporting of financial statements of non-interest (Islamic) banking institutions in the country.

## 6: CONCLUSION

The primary difference between Islamic banking system and conventional banking system is that *an Islamic bank is a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic law (Shari'ah) and forbids of the receipt and payment of interest on any of its transaction.* It is essentially a banking system that provides financing and attracts savings on the basis of profit- and loss-sharing (PLS) rather than lending and interest.

The Central Bank of Nigeria (CBN) began major banking reforms in 2004 towards a more robust banking sector aimed at ensuring that banks rely more on the private sector for funds and, more significantly by ensuring greater transparency and accountability in the implementation of banking laws and regulation towards achieving international best practices. A major plank of the reform is the "Review of Universal Banking Model" with a view to directing banks to focus on their core banking business only. The New Banking Model, among others, gives way for the introduction of non-interest banking under Specialized Banking (i.e. microfinance, mortgage, development, non-interest banking) framework.

The most common variant of non-interest banking is the Islamic banking brand, even though the CBN gives the contextual definition of non-interest banking to include other form of non-interest banking not based on Islamic principles. The CBN Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria issued in 2011 states that Guidelines for other categories of non-interest banking will be issued upon request which shall be consistent with international best practice. Judging from the huge size of its population and the developmental opportunities in the country, Nigeria has the prospect of becoming the hub centre of Islamic finance in Africa. Yet there are myriads challenges to the development of the Islamic banking system in the Nigeria, such as misrepresentation of the system, lack of linkages and investment institutions, lack of adequate knowledge, as well as shroud business ethos and corruption, which is endemic in the country. As a way forward this paper recommends the need for greater public awareness about Islamic banking and creation of enabling environment (i.e. the legal, accounting and taxation systems) for the working of Islamic financial system.

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**<u>Also see:</u>**

http://www.worldbulletin.net/index.php?aType=haberArchive&ArticleID=37814 and http://www.brusselsjournal.com/node/3819

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