

## Non-interest (Islamic) Banking in Nigeria: Concept and Implications

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### Concept and Evolution of Non-interest (Islamic) Banking

History has shown that banking system is among the most imperative aspects of any developed and thriving economy and financial system. A functioning banking system helps to create a more successful and efficient society. Banks facilitate in the transfer of resources from those with excess to those who require extra resources to run their businesses. It is a known fact that banks like any other firm are in business to make money and banks major source of income or profit is the difference in interest rates at which they pay to their depositors and the rate at which they lend to companies and entrepreneurs.

Under the Islamic Jurisprudence, depositors' returns are managed not by a predetermined fixed interest rate, but by the size of the bank's return on its investments. When disbursing loans, the bank functions as an investment bank, whereby both the investor and the bank not only share the benefits of high returns on investments, but also share the losses. If return on investment is high, the bank will take a percentage of the investor's profits. This is impossible for conventional banks, which just receive the interest that they themselves fix at the time the loan was made not minding whether the loan receivers made profit or loss.

Non-interest banking can be traced to some young Muslim economists in late forties who believed banking systems should be reorganized on the basis of profit sharing rather than interest rate. They have all recognized the need for commercial banks and the evil of interest in that enterprise, and have proposed a banking system based on the concept of profit and loss sharing.

### CBN Clarifications on Non-interest Banking

The Central Bank of Nigeria (CBN) issued new guidelines for the operation of Non-interest banking in Nigeria. The new guidelines clarify the contextual definition of Non-interest banking which is not restricted to Islamic banking, but also include other form of non-interest banking not based on Islamic principle. This is in accordance with the provisions of Banks and Other Financial Institutions Act (BOFIA) which clearly provide for the two variants of Non-interest banking.

In line with CBN's objective of promoting financial inclusion in Nigeria, individuals and groups wishing to practice non-interest banking based on established rules and principles **other than Islamic** may apply for a license to operate such institutions and the CBN will accordingly issue guidelines pertinent to that type of banking.

In order to clear all forms of doubts, section 23 (1) and section 66 of the Banks and Other Financial Institutions Act (BOFIA) 1991, (as amended) explicitly provides for the licensing of Non-Interest Banks (NIBs). The CBN is obliged, by law, to issue licenses to appropriate entities for the establishment of NIBs provided they meet the regulatory requirements for licenses.

## **Basis for the Introduction of Non-interest Financial Institutions**

CBN decided to introduce different category of non-interest financial institutions given the increasing number of requests from persons, banks 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 in this guideline.

The following are the different category of Islamic Financial Services (IFS):

- 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.

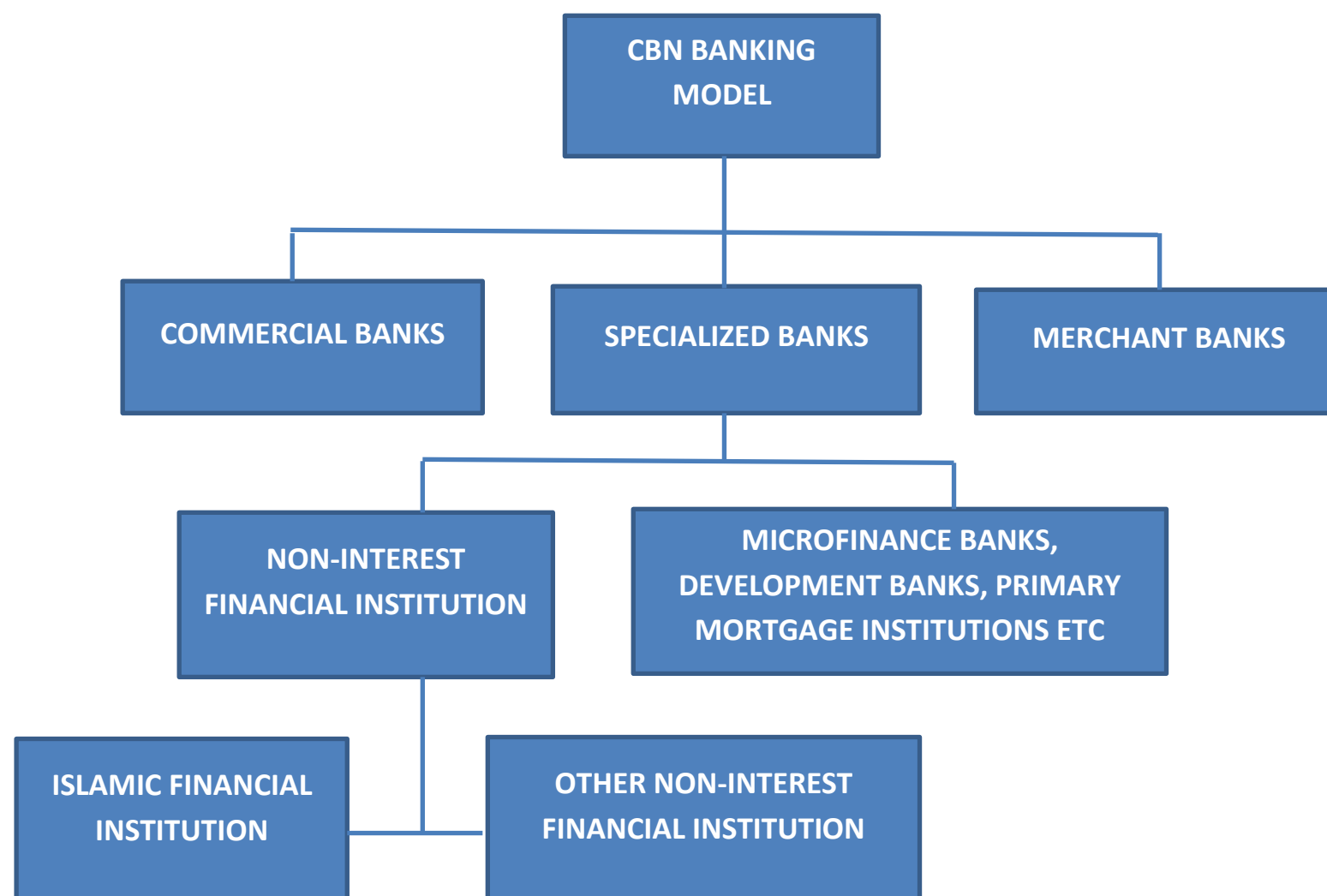
## **CBN Model and Non-interest Financial Institutions**

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

- I. Commercial Banks
- II. Merchant Banks and
- III. Specialized Banks

Specialized 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. 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 an a nutshell, CBN defines Non-interest Financial Institution (NIFI) as a bank or Other Financial Institution (OFI) under the purview of the CBN 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.



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.

## Objectives of the Guidelines

- The objective of these guidelines is to provide minimum standards for the operation of IIFS in Nigeria.
- Accordingly, these guidelines are applicable to IIFS only and do not seek to regulate other non-interest financial institutions which may be established from time to time.

## Legal Framework

### Legal Basis

These guidelines are issued pursuant to the Non-Interest banking regime under Section 33 (1) (b) of the CBN Act 2007; Sections 23(1) 52; 55(2); 59(1)(a); 61 of Banks and Other Financial Institutions Act (BOFIA) 1991 (as amended) and Section 4(1)(c) of the Regulation on the Scope of Banking Activities and Ancillary Matters, No. 3, 2010. It shall be read together with the provisions of other relevant sections of BOFIA 1991 (as amended), the CBN Act 2007, Companies and Allied Matters Act (CAMA) 1990 (as amended) and circulars/guidelines issued by the CBN from time to time.

### Corporate Powers

A non-interest financial institution under this model shall ensure that its Memorandum and Articles of Association (MEMART) state that its business operations will be conducted in accordance with the principles and practices of Islamic commercial jurisprudence.

## Major Principles of Non-interest (Islamic) Banking

The major principles of non-interest banking are summed up as follows:

- Any predetermined payment over and above the actual amount of principal is prohibited i.e. lender should not charge any interest or additional amount over the money lent.

- The lender must share in the profits or losses arising out of the enterprise for which the money was lent. Furthermore, Islamic finance is based on the belief that the provider of capital and the user of capital should equally share the risk of business ventures, whether they are industries, farms, service companies or simple trade deals.
- Making money from money is not Islamically acceptable.
- Uncertainty, Risk or Speculation is also prohibited on any transaction entered into. Contracting parties should have perfect knowledge of the counter values intended to be exchanged as a result of their transactions.
- Investments should only support practices or products that are not forbidden e.g. trade in alcohol, construction of casino, lending money to other banks at interest.
- The policy does not prevent non-Muslims from participating.

## Implications and Opportunities of Non-interest (Islamic) Banking

Myriad of implications and opportunities of Islamic banking have been identified which we believe may greatly benefit the economy in the short and the long run:

- Large number of unbanked Muslim community in Nigeria may be attracted to this type of specialized banking system and get bankable.
- Implementation of Non-interest Banking would allow people to have different credit choice among different types of banking structures in Nigeria.
- Development funds: This will allow Nigerian Government and corporate organizations to have access to Islamic Development funds available in the international community to finance infrastructural projects.
- It encourages Muslim communities to invest locally rather than sending their investment to the Middle-East.

## Conclusions

**From the CBN new banking** model and the remark made by financial experts, Islamic banking is just like any of the existing banking techniques such as Microfinance Banks, Mortgage Banks, Development Banks etc. in the industry in which any interested party can participate at any point in time out of their own volition.

It has been established that Islamic Banking is being practiced in Europe, America and part of Asian countries. Britain established The Islamic Bank of Britain sometimes some years back and major banks such as HSBC, Citibank, and Lloyds Bank created subsidiaries or window to provide Islamic Banking to their customers in UK and around the world. As at present there are about eight full fledged Islamic banks in Britain, four in US, two in Germany and one in France.

**In Africa, South Africa** has Islamic banks such as Al-baraka Islamic Bank and others. There are presence of Islamic banks in other African countries such as Senegal, Gambia, Guinea, Niger, Egypt, Kenya and Tanzania while many other countries are in the process of establishing their own Islamic banks. Islamic bank is found as a result of prohibition of interest (Usury) which was espoused by Christianity, Islam and Hindus. In our candid opinion and based on the facts discussed above, Nigerians should allow non-interest banking products so as to harness the opportunities there-in.

**On a final note**, we implore CBN to intensify efforts on public enlightenment on this issue and the legal backing for establishment of Islamic banking in Nigeria should be further spelt out.

## Appendix 1:

**Table 1:** Lists of Major Islamic Banks in Europe, America and Asia

S/N	United Kindom	United States	France	Germany	Malaysia
1	HSBC Amana Finance	Amana Mutual Funds Trust	Arab Bank Corporation	Arab Bank	Standard Chartered
2	Baclays Capital	LARIBA Bank		FAI WEBER	OCBC Al-amin
3	Islamic Bank of Britain	MSI Financial Services			HSBC Amanah Malaysia
4	ABC International	Manzil USA			RHB Islamic Bank
5	Citibank				Unicom Bank
6	Lioyds Bank				Hong Kong Islamic Bank
7	Halal Financial Services				Asian Finance Bank
8	Ahli United Bank				Public Islamic Bank

**Source:** Industry Sources

## Appendix 2:

### Frequently Asked Questions about Islamic Banking

**Q:** Is Islamic banking meant for Muslims only?

**A:** No. Islamic banking is for all individuals regardless of their religious beliefs.

**Q:** What are the differences between Islamic and conventional banking?

**A:** The most important difference between Islamic and conventional banking is that Islamic banking must follow the Islamic Law. Islamic banking must also avoid activities such as usury or excesses. For example, instead of charging interest on financing given out, Islamic banks give financing based on joint venture and will share any profit and loss.

**Q:** How do Islamic banks and Islamic Banking Scheme (IBS) banks reward their depositors since payment of interest is not allowed?

**A:** In *Islamic Law*, there are many ways to share profit or returns between a bank and its customers. For example, in a deposit product, profits from a deposit arrangement will be shared between a bank and its depositors based on an agreed ratio and paid as dividends. *Islamic Law* also allows a bank to give gift to its depositors as it deems fit.

### Contacts:

For enquiries, please contact our offices:

**Lagos:** 8A, Elsie Femi Pearse, Off Adeola Odeku, Victoria Island, Lagos. Tel: 01-2718630

**Abuja:** Plot 2088, Herbert Macaulay Way, Zone 5, Wuse, Abuja. Tel: +234 702 939 0541

**Port Harcourt:** Kabiya Plaza, Plot 69, Stadium Road, Rivers. Tel: +H234 702 940 5992

**Onitsha:** 4, Ridge Road, G.R.A., Onitsha, Anambra State Tel: +234 702 939 0546

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