COMPARATIVE ANALYSIS OF THE REGULATORY FRAMEWORK OF ISLAMIC BANKING IN NIGERIA AND MALAYSIA

BY

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DECLARATION

I, RILWANU SULEIMAN, hereby declare that apart from references to other people's work which has been duly acknowledged, this work is the result of my own research and that the research has never in whole or in part been submitted for an award of another degree elsewhere.

Rilwanu Suleiman

CERTIFICATION

The dissertation titled: **COMPARATIVE ANALYSIS OF THE REGULATORY FRAMEWORK OF ISLAMIC BANKING IN NIGERIA AND MALAYSIA** has been read and approved as meeting the requirements of the Faculty of Law, Nasarawa State University, Keffi for the award of Masters of Laws (LL.M) Degree and is approved for its contribution to knowledge and literary presentation.

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DEDICATION

To the Glory of Almighty Allah (SWA); to my beloved parents, Alhaji Suleiman Dahiru, my late mother Kareemah Ahmad Guruza and my wife, Saliha Ahmad Sarki.

ACKNOWLEDGEMENT

All praises are due to Almighty Allah, the beneficent, the merciful. If not for the blessing and favour of Almighty Allah the creator of all creatures this work will not see the light of the day. Allah's Rahma manifested in the beginning and the end of this work. Praise be to Allah, the Lord of the entire universe. He taught me what I did not know and bestowed upon me the ability to write this dissertation. I remain grateful servant to Him. May Allah bless and guide us in this life and the hereafter.

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my boss Dr Abdulkarim Abubakar Kana. They always advice me and guide me in one way or the other during the period of this work. Thank you all and may Allah bless you.

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ABBREVIATIONS

AALCO	Asian-African Legal Consultative Organisation
ACA	Arbitration and Conciliation Act
ACE	Advisory Committee of Experts
AIP	Approval-in-Principle
ADR	Alternative Dispute Resolution
AMCON	Assets Management Corporation of Nigeria
BAFIA	Bank and Financial Institution Act
BBMB	Bank Bumiputra Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negra Malaysia
BOFIA	Banks and Other Financial Institutions Act
BOFID	Bank and Other Financial Institutions Decree
CAC	Corporate Affairs Commission
CAMA	Companies and Allied Matters Act
CBN	Central Bank of Nigeria
CSC	CBN Shariah Council
DFIA	Development Financial Institutions Act
FCMB	First City Monument Bank
GCC	Gulf Cooperation Council
IB	Islamic Banking
IDB	Islamic Development Bank
IFIs	Islamic Financial Institutions
IFSA	Islamic Financial Service Act
KLRCA	Kuala Lumpur Regional Centre for Arbitration

LPELR	Law Pavilion Electronic Law Reports
MDCs	Multi-Door Courts
MFB	Micro Finance Bank
MLJ	Malayan Law Journal
NAICOM	National Insurance Commission
NDIC	Nigeria Deposit Insurance Corporation
NSE	Nigerian Stock Exchange
NIFI	Non-Interest Financial Institutions
NLR	Nigerian Law Reports
NWLR	Nigerian Weekly Law Reports
OIC	Organisation of Islamic Countries
SAP	Structural Adjustment Programme
SAW	Sallallahu Alaihi Wa Sallam
SEC	Security and Exchange Commission
SΛW	Sallallahu Alaihi Wa Sallam
Sh. L. R. N	Sharia Law Report of Nigeria
SWA	Subhanahu Wa Ta'ala

Glossary

Bay Bithaman Ajil - deferred payment sale

Bay'tul-mal - public treasury

Gharar - risk or excessive uncertainty in contracts

Hadith - Report or account of what the Holy prophet (P.B.U.H) said, did or the sayings and actions of others tacitly approved by him.

Hajj – Muslim pilgrimage

Hiba – Gift

Ijara - hire and lease

Ijarah wa itqan -hire and purchase

Istisna - contract of manufacturing

Maysir - gambling or any game of chance

Muamalat- Islamic law of transaction

Murabahah- cost plus financing

Musharaka –Joint venture

Qard - loan or debt

Qard al- Hasan – Benevolent or good loan

Rabb al–Mal –Investor/owner of capital /financier

Riba - Interest or usury

Riba – Al Fadl – Excess usury or excess in barter

Riba al- nasi'ah – Delay usury of credit rushd – discretion

Sharia –Islamic Law

Sharikah - Partnership or company

Skim Perbankan Tanpa Faedah- Interest-free Banking Scheme

Sunnah – Sayings, pronouncements, actions, deeds of the prophet and sayings and actions of others tacitly approved by the prophet (.P.B.U.H).

Takaful – Islamic insurance

Waqaf - charity or endowment

Yang di-Pertuan Agong- The supreme Head or the King, is the Monarch and head of state in Malaysia.

ABSTRACT

Islamic banking refers to a system of banking that was developed based on Islamic law principles that prohibit banking activities that involved *riba*. The origin of Islamic banking dates back to the period of the noble prophet Muhammad (SAW) to the present period even though the banking system underwent so many modifications due to globalisation. In Nigeria Habuib Bank Nigeria PLC introduced for the first time Islamic banking system in 1992 following the promulgation of the Bank and other Financial Decree, 1991. The Decree allowed foe setting up of specialised institution which Islamic bank qualifies as such. In Nigeria, Islamic banking is regulated by the CBN within the applicable laws and regulations of other financial institution as there is no single and separate legislation for Islamic banking. This lack of legislation has left Islamic banking vulnerable to improper regulation; it has to depend on the direction issued by the government of the day. In Malaysia even though Bank Negra Malaysia regulates both Islamic banking and conventional banking, there are laws that specifically deals with Islamic banking. This research is to comparatively analyse the legal and regulatory framework of Islamic banking in Nigeria and Malaysia; the research examines how Islamic banking is regulated in Nigeria and so as to identify challenges facing regulations in Nigeria as well as best practice that can be adopted for the continued growth of the Islamic banking in Nigeria. The research adopt doctrinal method of research which entails consultations of relevant materials in the library; hard copies and online academic materials. It is the finding of this research that there is no separate or specific law that regulates Islamic banking in Nigeria, Islamic banking in Nigeria depends on the guideline issued by the CBN which can be amended or cancelled at any time unlike in Malaysia were there are several legislations that specifically deals with Islamic banking. This research recommends that Nigerian government should enact a distinct, independence, specific and comprehensive law to regulate Islamic banking separate from conventional banking. Islamic banking can play a significant role in the economic development of Nigeria if adequate laws can be enacted to cater for its regulation holistically.

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 Background of the Study

Islamic banking refers to a system of banking that abides by *Sharia* principles and its practical application in all of its activities through its role as financial intermediary between savers and investors.[1] Before the advent of Islam, banking activities has begun in the Arab but its operation has the element of *riba.*[2] Meccan of that time used the money either giving it to another party to be traded through *al- Qirad* or *mudarabah* and the profit is shared by both party or lending the money to gain benefits which consider as *riba.* However, the coming of Islam prohibits all activities that involve *riba.* The origin of Islamic finance dates back to the dawn of Islam 1,400 years ago. Prophet Muhammad (SAW) before the time of his prophet hood was known to be trustworthy, due to his noble conducts and integrity, the Arabs of his time had appointed him as their wealth keeper.[3]

Apart from that, during the time of the Prophet Muhammad (SAW) there was also a man by the name Zubair bin Awwam a companion of the prophet (SAW) one of the famous personalities who was honest and trustworthy was accepting deposit from people as loan and investing the money.[4]

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[1] Ahmad Alharbi, 'Development of Islamic Banking and Finance' [2015] (3) (2) *Journal of Islamic Banking and Finance* 1.

[2] Wan Shahdila Shah and others 'The Historical Development of Islamic Banking' Proceeding of the 4th International Conference on Management and Muamalah 2017 available at <http://conference.kuis.edu.my/icomm/4th/eproceedings/IC%20045.pdf> accessed 29 December, 2017.

[3] Ibid.

[4] Ahmad Alharbi, 'Development of Islamic Finance in Europe and North America: opportunities and Challenges' [2016] (2) (3) *International Journal of Islamic Economics and Finance Studies* 110.

Other than that, it is worthy to note that the development of Islamic banking foundation had started since the time of the Prophet Muhammad (SAW) through the establishment of *Bayt al Mal*, which served as the central bank for Islamic countries.[5] The bank was used to deposit and withdraw money. Furthermore, contract such as *mudarabah, musharakah, bay' al-salam* were practiced in Madinah during the time of Prophet Muhammad (SAW) and benevolent loans *(qard hasan)* which is another form of financing were also encouraged during that time.[6]

The practices continued in Islamic Empire after the demised of prophet Muhammad (SAW) but the practices withered gradually due to the weakening of the Islamic empire, until these practices were replaced by the Western financial model in the early 20th century. However, Islamic financial practices emerged again in the middle of the same century.[7]

Economic globalisation, among other things, has led to western countries adopting Islamic banking. The rapid growth and unique nature of this sector has made Islamic banking and finance an ideal topic for academic research. It is worth noting that Islamic banking is not a new phenomenon. The early history of Islam indicates the non-existence of banks as financial institutions. However, individuals acted as financial intermediaries; for instance money exchangers offered valuable financial services to pilgrims who travelled to and from Mecca and Medina to perform the *Hajj* obligation. These individuals managed to run a system that mobilised the necessary funds to invest in productive transactions that were interest free.[8]

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[5] Ibid
[6] Wan Shahdila Sha Shahaar, Wan Shahzlinda Sha Shahaar , Nooraimi BT Mohd Puad and others 'Proceedings of the 4th International Conference on Management and Muamalah, 2017 p. 505-508 available at <conference.kuis.edu.my/icomm/4th/eproceedings/IC%20045.pdf> accessed 20th January, 2018
[7] Ibid
[8] Ibid

Islamic financing was therefore, successfully run from the early stages of Islam, and although it was not formally organised as such in the last 30 years, between 1940 and 1950, there has been increased agitation for the further development of Islamic banking especially in Muslim countries. This agitation stems from the fact that Muslims are endeavoring to avoid interest based practices and transactions. The avoidance of *riba* (interest) is the fundamental principle underlying Islamic finance. The charging of interest is considered by Islam as unjust enrichment and is condemned in the Quran.[9]

It is argued by proponents of Islamic finance that in today's world, the economic system based on interest has culminated in the concentration of wealth in the hands of a select few, creating monopolies and widening the gap between the rich and poor. Islamic finance, on the other hand, operates in compliance with Sharia law thus it encourages the distribution of wealth.

World attention has turned to Islamic finance because Islamic Banking is the fastest growing financial institution that has extended beyond Muslim or Muslim dominated countries to reach the international market hence the internationalization of Islamic Banking. This means that it is not only Muslims who are subscribing to this form of banking, but others in Western countries and sub-Saharan Africa as well, who have been attracted by the economic opportunities as well as products available in Islamic banking.

Islamic banking has introduced completely different products that use unique tools from those used by mainstream banking institutions to serve the same purpose. Islamic law as an all-encompassing legal system has stringent rules governing commercial transactions. The products and services provided by Islamic banks should not only be "interest free" but also should not be,

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in any way, used to finance Illicit or sinful transactions such as pornography, gambling and dealing in alcohols.

Despite the recognition that Islamic banking can serve a greater role in the banking industry, little attention has been paid to the formulation of a comprehensive framework for the regulation of Islamic banks both at the international and national level. In Nigeria the legal framework for Islamic Banking is not that comprehensive as there is no any separate law regulating Islamic Banking. Islamic Banking is being regulated by the same law regulating conventional banking.

Despite the growth of Islamic banking in Nigeria, the legal and regulatory aspect of the banking sector in its broad sense is largely based on the conventional banking system. Islamic banks operate within the applicable laws and regulations of other financial institutions. The laws in Nigeria does not define or acknowledge the existence of Islamic Banking and does not define its operations. This lack of legislative provision has left Islamic banking vulnerable to improper regulation as it has to depend on the directives issued by the government of the day.

In Malaysia, the body that regulates and supervises financial institutions both conventional and Islamic is Bank Negara Malaysia and security commission. Basically Bank Negara Malaysia regulates and supervises the financial institutions in Malaysia pertaining the law, guidelines, and things related with the money market (eg; deposit and financing), meanwhile Security Commission is given authority to supervise the capital market (eg; Stock and *Sukuk*). Therefore, conventional and Islamic banks must pass on to Security Commission any dealing that has to do with the Stock and *Sukuk*, meanwhile any activities related to the banking and money activities will be referred to the Bank Negara Malaysia (BNM). In Malaysia Islamic Financial Service Act, 2013 specifically applied to Islamic Banking. To some extent even though there is one regulatory

body for both conventional and Islamic Banking, there are so many laws specifically for Islamic Banking.

In light of the above, it is important to evaluate the regulation of the Islamic banking in Nigeria and Malaysia with the aim of identifying the legal, policy and institutional challenges that threaten the very existence of this innovative banking sector. There will also be a comparative study of Islamic banking in Nigeria and Malaysia as both countries operate Islamic banking and can learn a great deal from their experiences. An in-depth analysis of the existing legal and regulatory framework of Islamic banking in Nigeria and Malaysia will be undertaken so as to determine the adequacy of the regulatory framework and to identify the obstacles that hinder the growth and expansion of Islamic banking in Nigeria.

1.2 Statement of the Problem

Over the past 7 seven decades, the growth of Islamic banking and its socially responsible principles have attracted attention the world over. The concept of Islamic Banking, which was introduced in the mid-1940s, now has a global presence. Despite its tremendous growth both in Muslim as well as non-Muslim countries, Islamic Banking faces a number of barriers in fitting in with the regulatory, legal, and supervisory frameworks of these countries. Islamic Banking is practiced in different countries under different Islamic schools of thought and laws, which means that the regulatory and supervisory frameworks vary considerably between countries. This variability has affected the reliability, growth, and worldwide applicability of Islamic Banking as an alternative to conventional banking.

This study evaluates the Islamic Banking regulatory and supervisory structures of Nigeria and Malaysia. All these countries have a Muslim-majority population, but Islamic Banking is

practiced differently in each case and under different regulatory and supervisory frameworks. In this context, the study will look at issues such as historical development of regulatory System in Nigeria and Malaysia, scope of the regulatory authorities in Nigeria and Malaysia, separate regulatory setup for Islamic Banks in Nigeria and Malaysia, role of *Sharia* Board in Nigeria and Malaysia and dispute resolution mechanism in Nigeria and Malaysia.

Despite the growth of Islamic banking in Nigeria, the requisite institutional and regulatory framework needed to govern this sector is inadequate. This inadequacy has hindered the pace of development of Islamic banking in Nigeria as investors are reluctant to set up Islamic banking institutions without the assurance of a defined legal framework within which they can operate.

1.3 Aim and Objectives of the Research

The general objective of this study is to analyze the legal and regulatory framework of Islamic banking in Nigeria and Malaysia with a view of identifying best practices and challenges that need to be addressed. The specific objectives are:

i. To trace the historical background of Islamic banking both in Nigeria and Malaysia and the major concepts, products and services offered by Islamic banking.

ii. To examine how Islamic banking is regulated at Nigeria and Malaysia so as to identify challenges facing regulation in Nigeria and Malaysia as well as best practices that can be adopted for the continued growth of this sector.

iii. To conduct a comparative analysis of Islamic banking in Nigeria and Malaysia with a view of identifying best practices that Nigeria can apply in tackling the challenges it faces in regulating Islamic banking.

In achieving the above objectives the research answers the following questions:

1.3 Research Questions:

i. What is the historical background of Islamic banking in Nigeria and Malaysia and what are the major principles underlying the sector?

ii. How is Islamic banking regulated in Nigeria and Malaysia?

iv. What recommendations can be made for the reform of the regulatory framework of Islamic banking in Nigeria?

1.4 Scope and Limitation of the study

This research is about comparative analysis of regulatory framework of Islamic banking in Nigeria and Malaysia. The discussions of the research are therefore centered on the regulation of Islamic Banking in Nigeria and Malaysia

This research is restricted to regulation of Islamic Banking in Nigeria and Malaysia. In other words, the primary legislations to be referred to in this research are Nigerian legislations and Malaysian legislation that regulates Islamic banking, verses from the Holy *Quran* and *Hadith* will also be referred to for the fact that *Quran* and *Hadith* are the primary sources of Islamic Laws. This however does not preclude references to other countries for the purpose of comparison or analysis. The research will equally examine the historical background of Islamic banking and its products.

NOTE: The research is limited to comparing the banking system in the countries where it is practised. It does not attempt to compare the system of banking with the conventional, western inspired banking system which operations, in Nigeria is law, it was to regulate the activities of the Islamic banking (in Nigeria).

1.5 Significance of the Study

This research is indeed topical for the fact that there has been a remarkable increase in Islamic banking worldwide instigated by the need for a financial system that is protected from the shortcomings of western economies. There is therefore a need to develop insight and education

on Islamic economic and banking systems in light of the legal and regulatory challenges that affect them.

The study can inform legislators as to how Islamic banking has been regulated at the in two jurisdictions level and how this knowledge can be used in Nigeria to develop new and appropriate regulations for the challenges identified.

The study can also inform potential customers in the Islamic Banking sector who wish to obtain concrete understanding of regulatory challenges they anticipate to face before an investment decision is made. This is especially important as consumer protection is one of the rights recognised by the law in Nigeria.

The study will be of great use to banks and other financial institutions which would wish to venture into the field of Islamic Banking but are unaware of the principles and products that are fundamental to this sector as well as the regulatory challenges faced by the Islamic Banks in Nigeria and Malaysia. It will enable them to close the gaps in knowledge and formulate appropriate responses to those challenges. It will add to the existing knowledge in the field of academics and increase the literature on Islamic Banking.

1.6 Research Methodology

when?

This research will adopt doctrinal method of research. The doctrinal method of research involves the use of primary and secondary sources. This entails consultations of the relevant materials in the libraries; hard copies and online academics materials such as books, statutes, law reports, journals, seminar papers, magazines and newspapers. The work will also involve the use of internet to access relevant online materials through various search engines such as Google

scholar, Firefox, ask.com, LexisNexis, Hein online among others. This is because online materials are now gaining popularity and are now acceptable in academic research. The reason for using online materials for this research is because there are academic materials that cannot be accessible without the use of virtual library. So many universities nowadays adopt internet-based research. There are abundant relevant and reliable number of e-books, e-journals, e-newspaper and e-magazines online.

1.7 Organisational Layout

The work is structured into five chapters. Chapter one is the introductory chapter which contains the background of the study, statement of the Problem, aim and objectives of the research, scope and Limitation of the study, significance of the study, research methodology, and organisational Layout.

Chapter two deals with the historical background and concepts of Islamic Banking, where the general historical background of Islamic Banking was discussed and historical background of Islamic Banking in both Nigeria and Malaysia were discussed. The chapter also examined the concept of Islamic Banking and its main products where prohibitions of *riba*, *gharar* and *maysir* were discussed. Islamic banking products such as *Musharaka*, *Mudaraba*, *Murabaha*, *Istisna* and *Ijara* were examined.

Chapter three discusses the general features of Islamic Banking in Nigeria and Malaysia. In the chapter, the Central Bank of Nigeria Act 2007, Banking and other Financial Institutions Act 1999, Nigerian Deposit Insurance Corporation Act 1988, and *Sharia* Board were discussed also Features of Islamic Banking in Malaysia such as the Islamic Bank Act 1983, Companies Act,

1965, Bank and Financial Institution Act, 1987, Islamic financial Service Act, 2013, Central Bank of Malaysia Act, 2009, KLRC Arbitration Rules were discussed.

Chapter four discussed comparative study of the law and practice Islamic Banking in Nigeria and Malaysia items discussed includes historical development of regulatory system in Nigeria and Malaysia, scope of the regulatory authorities in Nigeria and Malaysia, separate regulatory Setup for Islamic Banks in Nigeria and Malaysia, role of *Sharia* Board in Nigeria and Malaysia and dispute resolution mechanism in Nigeria and Malaysia

Chapter five is the concluding chapter, summary of findings, observations, recommendations, contribution to knowledge and suggested case for further studies

CHAPTER TWO

LITERATURE REVIEW

2.1Introduction

The previous chapter is introductory generally. It basically highlights the background to the study, the aim and objectives of this research followed by the research question, the signicant of the research, the scope of the work as well as the methodology adopted in conducting the research.

Very importantly this chapter evaluates the existing literature of the subject of the dissertation. The chapter will discuss general historical background of Islamic Banking, historical background of Islamic Banking in Nigeria and Malaysia, Concept of Islamic Banking such as the prohibition of *Riba,* prohibition of uncertainty (*Gharar*), prohibition of speculation (*maysir*) and the screening of investment activities to ensure whether they are Islamically permissible or not will be discussed. Islamic Banking products and services such as *Mudabara, Musharaka, Murabaha, Istisna, Ijara,* will also be discussed.

2.2 Review of Related Literature

Several scholars have written in various aspects of Islamic Banking and other economic activities related to Islamic finance that covered the legislations and rules regarding the regulatory framework in both Nigeria and Malaysia. Studies covered the historical development of Islamic Banking and the studies on Islamic Banking and its main products. Some of the scholars who contribute in this subject include;

Yahaya Tanko[10] in his book 'A Brief about Business in Islamic Banking' examined the origin and development of Islamic Banking. He contend that no banking system similar to current Islamic Banking did not exist during the period of prophet Muhammad (SAW) or during the time of his companions. However, there was system of banking during the period of prophet Muhammad (SAW) and his companion which later developed into Islamic Banking. The author further contend that during the reign of prophet Muhammad (SAW), Zubair bin Awwam was famous for honesty and trustworthiness, for that people used to deposit their money with him and he accept the money as loan not as deposit because of his fear of using the money and replacing it with another same amount which is contrary to *sharia* rule on deposit. Zubair bin Awwam also issue *As - Suftajah* which is equivalent to present day bill of exchange. He used to collect loans from merchants and write letter to his agents in another place so that they can recollect it back. The author further traced the history of modern Islamic Banking to the pioneering effort of Ahmad bin Naggar who in 1963 established a Banking System in form of saving bank based on profit-sharing in the Egypt town of Mit Ghamar. The author also discussed historical background of Islamic Banking in Nigeria and Malaysia. Islamic Banking products such as *Mudaraba*, *Musharaka*, *Murabaha*, *Ijara* were also discussed by the author. The discussion on the historical development of Islamic Banking particularly discussions on Islamic Banking in Nigeria and Malaysia is relevant to this work, likewise the discussions on Islamic Banking products. However the author did not discuss the features of Islamic banking in Nigeria and Malaysia particularly the regulatory framework. This will be taken care of in this research.

[10] Yahaya Tanko, A Brief about Business in Islamic Banking, (Darul Umma, 2011)

Zulkifilu Hassan[11] in his article 'The Effectiveness of the Legal Framework of the Islamic Banking in Malaysia' examined the historical background of Islamic banking in Malaysia where he traced the history of Bank Islam Malaysia Berhad who first started Islamic banking and subsequently others follow. He further discussed how some conventional banks established free interest banking scheme. The author further asserts that Malaysia has 12 Islamic Banking institutions operating under the Islamic Banking Act. The author further examined the legal framework for Islamic Banking in Malaysia where he discussed the impact of Islamic Banking Act of 1983 (Act 207), Banking and Financial Institution Act 1989 and Central Bank Act, 1958. Other relevant legislations significant in the implementation of banking such as National Land Code 1965, Hire Purchase Act, 1967 and Stamp Act 1949 were analysed. The author argued that a comprehensive legal framework is a vital component to guarantee a success on the implementation of any Islamic Banking System. The work is relevant to this research particularly the regulatory framework and the historical antecedence of Islamic Banking in Malaysia. However, the author limit his work to the historical background of Islamic Banking in Malaysia and also the discussion on the regulatory framework in Malaysia was limited to few laws. This work will discuss the general historical background of Islamic Banking, historical background of Islamic Banking in both Malaysia and Nigeria and the available laws for the regulations of Islamic Banking in Nigeria and Malaysia will be discussed.

[11] Zulkifilu Hasan 'The Effectiveness of the Legal Framework of the Islamic Banking System in Malaysia' available at <https://zulkiflihasan.files.wordpress.com/2008/07/the-effectiveness-of-legal-framework.pdf> accessed 12/12/2017

Muhibat Ayoni Oladimeji, Muhammad Ridhwan Abdulaziz, Khairil Faizal Khairi[12] in their work 'Regulatory Framework and Supervisory Sharia Framwork Governance of Islamic Banking System: A Comparative analysis of Malaysia and Nigeria' examined *sharia* governance system in terms of regulatory and supervisory framework for Islamic Banking in Malaysia and Nigeria focusing on their *Shariah* governance practice. The work centered more on *Sharia* Board, the appointment of *Sharia* Board members, their composition, function and remuneration in both Nigeria and Malysia. The work is useful to the instant research however, the work only focus on *Sharia* Board and fail to analyse other regulatory bodies, hence the need to address other regulatory bodies in the instant research.

Surianom Miskam and Muhammad Amrullah Nasrul[13] in their work '*Sharia* Governance in Islamic Finance' contend that Islamic Financial Institutions have the duty to ensure the compliance with the *sharia* principles in all aspect of their products, instruments, operations, practices and management which will be achieved by the establishment of a proper *Sharia* governance framework. The authors also discussed and analysed the legal framework for Islamic Banking in Malaysia. The Central Bank Act 1958, which was amended in 2003 provides for the establishment of *Sharia* Advisory Council which uplift the position of Islamic Banking and Finance in Malaysia. The authors further argued that the Central Bank of Malaysia Act, 2009 is significant in strengthening Islamic Banking in Malaysia. The Act also provides the function and the qualification of members of the *Sharia* Advisory Council. The Authors further contend that Islamic Financial Service Act, 2013 reinforce the provisions of Central Bank Act, 2009 by

[12] Muhibat Ayoni Oladimeji and Muhammad Ridhwan AbdulAziz and Khairil Faizal Kahairi, 'Regulatory Framework and Supervisory Sharia Governance of Islamic Banking System: A Comparative Analysis of Malaysia and Nigeria' (2015) 1 No. 4 *Journal of Islam, Law and Judiciary*

[13] Surianom Miskam and Muhammad Amrullah Nasrul, Sharia, 'Governance in Islamic Finance: The Effects of Islamic Financial Services Act 2013' available at <https://worldconferences.net/proceedings/wcik2013/toc/papers_wcik2013/WCIK%20112%20SURIANOM_read_shahrul.pdf> accessed 12 December, 2017

providing punishment for failure in the part of Banking Institutions that contravene the provision of the Act. The article is relevant to this work. However the Bank and Financial Institution Act, 1987 and Companies Act 1965 which are relevant to the operation of Islamic Banking in Malaysia were not discussed. And that the analysis was not comparative. This creates a gap which this research will attempt to fill.

Mustafa Daud, Ibrahim Mohd Yussof, Adewale Abideen[14] in their work 'The Establishment and Operation of Islamic Banks in Nigeria: Perception study for the Role of the Central Bank of Nigeria.' The Authors traced the origin of Central Bank to the Central Bank of Nigeria (CBN) Ordinance 1952 then the Central Bank Act of 1958 which was argued that it was the legal framework upon which Central Bank of Nigeria was established. The act was amended in 1969 through the Banking Decree of 1969 which was later repealed by Bank and other Financial Service Decree (BOFID) in 1991. It was argued by the authors that with the coming of the BOFID the CBN became strong and new institutions like Non-Interest Banking emerged. The author further argued that Islamic Banking in Nigeria date back to the 1990 when the idea was first mooted and subsequently license were granted in 1992. However it was in 1999 that Habib Nigeria Bank Limited started Non-Interest Banking Window. The article is useful to this research; however, the author did not exhaustively discuss the regulatory framework for Islamic Banking in Nigeria. More so, the author restricts his discussion to the regulatory framework in Nigerian without discussing the regulatory framework in Malaysia. This work intend to fill the gap

[14] Mustafa Daud and Ibrahim Mohd Yussof and Adewale Abideen 'The Establishment and Operation of Islamic Banking in Nigeria: Perception Study of the Role of the Central Bank of Nigeria,' [2011] 1 No. 2 *Australian Journal of Business and Management Research*

Muhamed Zulkhibiri, Abdulmajid and Reza Ghazal[15] in their work 'Comparative analysis of Islamic Banking Supervision and Regulation Development' examined the strength and weakness of banking regulatory System in selected countries including Malaysia with a view to have a better understanding of common strength, problem and area of global concern. The authors contend that many countries that established Islamic Banking have no specific legislation on Islamic Banking. However there are few countries that have made significant efforts to make laws to regulate Islamic banks distinct from the conventional banks. The authors gave examples of countries like Malaysia, Iran, Sudan, Indonesia and Pakistan. They further argued that for effective operation of Islamic Banking, a legal framework for Islamic banking should take into account the unique characteristic of Islamic Banking and its product. The above discussion is relevant to this research particularly that the study is comparative in nature. However the comparison does not cover Nigeria which is one of the areas of this research.

Mohd Foisal, Nik Mohd Fadil Nik Mohammad, Musa Manjang[16] in their work 'Comparative Analysis of regulation and supervision of Islamic Banking in Malaysia and Gambia' contend that pursuant to Central Bank Act, 2009 Bank Negra Malaysia is the highest body vested with the power to regulate and supervise banking institution in Malaysia, this include Islamic Banking. They further argued that banks either Islamic or conventional apart from banking activities also participate in capital market activities such as stock and bond and therefore, anything that has to do with the capital market banks must refer to Security Commission. Hence Security Commission established by Security Commission Act, 1993 is of paramount importance. The

[15] Muhamed Zulkhibiri, Abdulmajid and Reza Ghazal, 'Comparative Analysis of Islamic Banking Supervision and Regulation Development' [2012] (6) (3) *Money and Economy*

[16] Mohd Foisal and Nik Mohd Fadil Nik Mohammad and Musa Manjang , 'Comparative Analysis of Regulation and Supervision of Islamic Banking Between Malysia and Gambia' [2017] 11 *Labuan e-Journal of Muamalat and Society* available at <http://wwwkal.ums.edu.my/LJMS/index.php/current-issue?download=86:comparative-analysis-of-regutoryframeworkbetweenmalaysiaandgambiya> accessed 12 December, 2017

author also analyse the legal framework for Islamic Banking in Gambia and contend that Section 4 of the Banking act of 1992 is the legal framework for both the Islamic and conventional banking with Central Bank of Gambia as reference and supervisory body saddled with responsibility of accounting and auditing. It was observed by the authors that there is no *Sharia* Advisory Board at the Central Bank of Gambia rather it is the Supreme Islamic Council attached to the Ministry of Interior and Religious Affairs that supervise issues regarding Islam, including the power to act and deal with the matters related to the Islamic banking. They further argued that the regulation and supervision of Islamic banking in Malaysia and Gambia have few similarities with lots of differences. Their study is relevant to this research; however their research is only restricted to comparative analysis between Malaysia and Gambia. This research will feel that gap left by the article.

Huud Shittu[17] in his article posited that interest free banking otherwise known as Islamic Banking is consistent with the stipulation of *sharia* principles as all trades involving unlawful elements are prohibited by Islamic injunction. The author argued that the historical background of Islamic Banking dates back to the era of the noble prophet Muhammad (SAW) where *baitul-mal* was established to ensure effective management and accountability of public fund. The *baitul- mal* perform banking functions such as depositing and withdrawing. The author further examined the Islamic Banking products such as the *Sharikah* and *Mudaraba* and their distinct nature. The work is relevant to this research; however the author restrict himself to Islamic ruling on Islamic banking ant its product and the brief historical background of Islamic Banking without discussing the regulatory framework of Islamic Banking either in Nigeria or Malaysia. This work will discuss generally the historical background of Islamic Banking with particular

[17] Huud Shittu, 'Non-Interest Banking System in Nigeria: Sharia Perspective' [2013] (30) (2) *Journal of Islamic Law and Finance*

emphasis to the history of Islamic Banking in Nigeria and Malaysia. The work will also discuss the regulatory framework in both Nigeria and Malaysia.

Asas Khan, Sarfaraz Tanveer, Abdulqadeer Shah, Raja Ahmed Jamal[18] in their work examined the regulatory framework in four countries; United Kingdom (UK), Bahrain, Malaysia and Pakistan. The authors posited that UK and Bahrain have single regulatory system for whole financial sectors both Islamic and conventional. While in Malaysia and Pakistan, the financial sector is regulated by different regulatory bodies. And that in UK financial regulation is separate from Central Bank. The work is relevant to this research however the comparison does not cover Nigeria. This work will compare regulatory framework in Nigeria and Malaysia

2.3 Historical Background of Islamic Banking

Banking activities has begun in the Arab before the advent of Islam but its operation has the element of *riba.*[19] Meccan of that time used the money by either giving it to another party to be traded through *al- Qirad* or *mudarabah* and the profit is shared by both party or lending the money to gain benefits which consider as *riba.* However, the coming of Islam prohibits all activities that involve *riba.* The origin of Islamic finance dates back to the dawn of Islam 1,400 years ago. Prophet Muhammad (SAW) before the time of his prophet hood was known to be trustworthy, due to his noble conducts and integrity, the Arabs of his time had appointed him as their wealth keeper.[20]

[18] Asas Khan and others 'Comparative Analysis of Regulatory and Supervisory System of Islamic Bank: Evidence from Pakistan, Malysia, Bahrain, and United Kingdom' [2015] (6) (6) *Mediterranean Journal of Social Science.*
[19] Wan Shahdila Shah BT Shahar and others, 'The Historical Development of Islamic Banking' Proceeding of the 4th International Conference on Management and Muamalah 2017 available at <http://conference.kuis.edu.my/icomm/4th/eproceedings/IC%20045.pdf> accessed 29 December, 2017
[20] Ibid

Apart from that, during the time of the Prophet there was also a man by the name Zubair bin Awwam a companion of the prophet (SAW), one of the famous personalities who was honest and trustworthy and was accepting deposit from people as loan and investing the money in trade.[21]

After the demised of Prophet Muhammad (SAW) *baytul-mal* was established by his companions. Some sources indicated that it was caliph Umar who initiated the function of *baytul-mal.*[22] However most of the sources revealed that it was Caliph Abubakar who first established *baytul-mal.*[23] Even though *bayt al-mal* was not created as an institution at the time of Noble prophet Muhammad (SAW) some of the activities and services akin to that of *bayt al-mal* such as keeping records of the public properties of the Muslims like war booties, fifth of the spoils, charity funds, weapons and instruments of the army and so forth were practiced. All of these were registered and stored until disbursement. *Bayt al Mal* served as the central bank for Islamic countries. Furthermore, contract such as *mudarabah, musharakah, bay' al-salam* were practiced in Madinah during the time of the Prophet Muhammad (SAW) and benevolent loans (*qard hasan*) which is another form of financing were also encouraged during that time.

The practices continued with some improvement in Islamic Empire after the demised of the prophet but the practices withered gradually due to the weakening of the Islamic empire, until these practices were replaced by the Western financial model in the early 20th century. However, Islamic financial practices emerged again in the middle of the same century.

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[21] Ahmad Alharbi, 'Development of Islamic Finance in Europe and North America: opportunities and Challenges' [2016] (2) (3) *International Journal of Islamic Economics and Finance Studies* 110

[22] Muhammad Habibur Rahman, 'Baytal-mal and its Role in Economic Development: A contemporary Study' [2015] (2) (2) *Turkish Journal of Islamic Economics* 25

[23] Ibid

Egypt holds a special place in the modern history of Islamic finance as the first Islamic Bank was established in Egypt. In 1963 Egyptian economist and social activist Dr. Ahmed el-Nagger founded the first Islamic Bank in Egypt by the name Mit Gamar this made Egypt famous world wide as the place where the first Islamic bank that operate within the ambit of *Shari'a* principles.[24] Though it did not carry the label of Islamic financial institution, the bank was the first *Shari'a* compliant one in modern times. In 1967 nine Islamic banks were established in Egypt which was running on the module of *Mudaribah*[25]

In 1974, the Organization of Islamic Countries (OIC) founded an Islamic Bank IB called Islamic Development Bank (IDB), whose aim was to promote economic development in Muslim countries and to provide the funds for the development in accordance with the rules of Sharia. By the end of 1970s, several Islamic banking systems were founded in the Muslim world such as Dubai in 1975, Faisal Islamic Bank of Sudan in 1977 and in Bahrain Islamic bank) in 1979.[26] However, the international development of Islamic finance was spearheaded by country authorities and financial entrepreneurs in Malaysia and the Gulf Cooperation Council (GCC) region.

2.4 Historical Background of Islamic Banking in Nigeria

The emergence of Islamic Banks in some countries ignited the desires and agitations for the establishment of Islamic Bank in Nigeria. The history of Islamic banking in Nigeria dates back to

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[24] Mohammad Iqbal Malik, 'An Introduction to Islamic Banking : Rise and Development [2014] (2) (1) *Journal of Islamic Banking and Finance*, 266

[25] Ibid

[26] Ljerka Cerovic and Stela Suljic Nikolag and Dario Maradin, 'Comparative Analysis of Conventional and Islamic Banking: Importance of Market Regulation' available at <https://search.proquest.com/openview/98ad3ef1445d8f5857717da9ba02e20f/1?pq-rigsite=gscholar&cbl=196177> accessed 19 December, 2017

1983 when a strong delegation of Darul Mali Al Islami led by Saudi prince Muhammad Faisal visited the country in an effort to establish Islamic Bank. Unfortunately it did not succeed.[27]

Promulgation of Banking and Other Financial Institutions Act (BOFIA) in 1991 provided the legal guidelines for the regulation of non-interest or profit/loss sharing banking in the country.[28] This Decree recognized the establishment of banks based on *Mushārakah* (profit and loss sharing).[29] It also recognised the establishment of specialised bank.[30] In 1992 two licenses was granted to Habib Bank Nigeria Limited. Unfortunately, it could not commence operation until 1999 when the former Habib Nigeria Bank Limited (now Bank PHB) started a non-interest banking window.

Real efforts for promoting Islamic banking in the country started in 2009 when Nigeria became a member of Islamic Development Bank (IDB). In the following year (2010) the regulatory frame work of Islamic banking was released by the Central Bank of Nigeria and the first Islamic bank started operations in the country in 2012. The introduction of Islamic banking was part of a drive by the Central Bank of Nigeria, to promote financial inclusion by introducing alternative products.

It is also interesting to state that the recent attempt by the Central Bank of Nigeria at enacting additional provisions for the proper establishment and operation of Islamic banking in the country are indeed a welcome development. Furthermore, the CBN in August 2010 released the new banking model, which categorized non-interest banks as specialized banks. The two models

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[27] Yahaya Tanko op cit
[28] Muhammad Bashir Alkali and Ahmad Hidayat Buang, 'Challenges in Implementing Islamic Banking and Finance in Nigeria: A Legal Insight' [2015] (23) (1) *Sharia Journal* 146
[29] Section 23 Bank and Other Financial Instituions Act (BOFIA) No. 25 1991
[30] Section 63 Bank and Other Financial Instituions Act (BOFIA) No. 25 1991

are: i. National non-interest bank of capital base of N10 billion with operation in every state of the federation including the Federal Capital Territory (FCT); and ii. Regional non-interest bank with capital base of N5 billion and shall operate in a minimum of six states and maximum of twelve contiguous states of the federation.

According to the circular, a Non-Interest Financial Institution (NIFI) is defined as: "a bank or Other Financial Institution 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 are in accordance with *Sharia* principles and rules of Islamic commercial jurisprudence"

In 2004 Central Bank of Nigeria, under the leadership of Charles Soludo granted an Approval-in-Principle License to Jaiz International Bank PLC to carry on business as a Profit and Loss Sharing Bank. Not much was heard of the Bank till January 13, 2011 when the Central Bank of Nigeria issued a Framework on Non-Interest Financial Institutions (NIFI). This was followed with the CBN Governor's, Sanusi Lamido Sanusi's announcement on Monday, June 20, 2011, at a Conference on Islamic Banking in Dakar, Senegal, that it had issued Jaiz International Bank PLC an Approval-in-Principle as the first Islamic Bank.

In September 2010, the Nigeria Deposit Insurance Scheme (NDIC) released its draft framework for a non-interest Deposit Insurance Scheme. Nigerian Stock Exchange (NSE) opened an Islamic window on its trading floor in August 2012 and in the same year Nigeria's first *Shariah* compliant index, the NSE Lotus Islamic Index, was launched as collaboration between the Nigeria Stock Exchange and Islamic investment management firm, Lotus Capital.

In 2013, the Securities and Exchange Commission of Nigeria (SEC) set new rules on Sukuk issuance and in the last quarter of the year, country's first Sukuk was issued. In the same year, the National Insurance Commission (NAICOM) issued guidelines for micro insurance and Takaful to help regulate the sector. The Securities and Exchange Commission (SEC) released a 10-year master plan (2015-2025) in the last quarter of 2014, providing numerous plans for the non-interest finance industry. The overall goal of the master plan was to contribute at least 25% of the overall capital market capitalisation in the next 10 years.

In terms of institutions offering Islamic financial services in Nigeria, presently three banks, i.e. Jaiz Bank Plc, Stanbic IBTC and Sterling Bank Plc, are operational in Nigeria. Amongst these, two banks i.e. Jaiz Bank Plc and Stanbic IBTC are full-fledged Islamic banks while Sterling Bank Plc is offers Islamic banking facilities as a window.

2.5 Historical Background of Islamic Banking Malaysia

The development of Islamic banking industry in Malaysia involved several phases whereby Phase 1 started in 1983 until 1993 and Second Phase began in 1994.[31] In early 80's Bank Negra Malaysia is empowered to regulate and supervise Islamic Banking operation in Malaysia. In 1983 Islamic Banking Act was enacted which paved way for the establishment of Bank Islam Malaysia Berhard as the first full fledge Islamic Commercial Bank in Malaysia.[32]

In July, 5 1993 Bank Negra Malysia (BNM) issued three set of guidelines that allows Commercial Banks, Finance Companies and Merchant Banks to offer Islamic Banking products

[31] Muhibat Ayoni Oladimeji and Muhammad Ridhwan Abdulaziz, and Khairil Faizal Kharil, 'Regulatory and Prudential Supervision Framework of Islamic Banking System in Nigeria: Lesson from Malaysian Experience' [2014] (1) (1) *International Journal of Contemporary Applied Science.* 97

[32] Ibid

and services with caveat that the funds for conventional Banking should be separated from the funds for Islamic Banking.[33]

Malaysia has liberalized its policy on the implementation of Islamic finance by allowing foreign entities to set up Islamic banks in the local market. These staggered developments are facilitated and supported by legal infrastructure through several legislations and directives namely the Islamic Banking Act 1983, the Takaful Act 1984, the Banking and Financial Institutions Act 1989 (BAFIA), The Central Bank of Malaysia Act 2009 and the Securities Commission Act 1993.[34] The first *Shari'ah* board that has been set up was in 1983 by Bank Islam Malaysia Berhad. After 10 years, on 4 March 1993, BNM introduced an interest-free Banking Scheme in which conventional banks may offer Islamic banking products through its windows. With that policy, many conventional banks set up their Islamic windows and at the same time they appoint selected Muslim scholars to be members of the *Shari'ah* board. As part of the effort to streamline and harmonize the *Shari'ah* interpretations amongst banks and *Takaful* companies, the SAC was established on 1st May 1997 under the BAFIA where it is considered as the highest *Shari'ah* authority pertaining Islamic banking, finance and *takaful* in Malaysia.

On 1 October 1999, a second Islamic bank, namely Bank Muamalat Malaysia Berhad (BMMB) commenced operations. The establishment of BMMB was the effect of the spin-off following the merger between Bank Bumiputra Malaysia Berhad (BBMB) and Bank of Commerce (Malaysia) Berhad.[35]

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[33] Ibid
[34] ibid
[35] Zulkifli Hassan, 'The Effectiveness of the Legal Framework of the Islamic Banking System in Malaysia' available at <https://zulkiflihasan.files.wordpress.com/2008/07/the-effectiveness-of-legal-framework.pdf> accessed 13 April, 2018

2.6 Concept of Islamic Banking

2.6.1 Prohibition of *Riba*

Riba in Arabic means excess, increase or addition which according *sharia* law implies any excess compensation without due consideration.[36] In classical Islamic jurisprudence *riba* means surplus value without counterpart. Islam categorically and unequivocally prohibits the practice of charging and receiving interest in all forms not only on loans but on other transactions. The Quran clearly prohibits riba, in Suratul Rum[37] Allah says that: That which you give as *riba* to increase the people's wealth increases not with God, but that which you give in charity, seeking the goodwill of God, multiplies manifold. Similarly, Suratun Nisa[38] says: "That they took usury, though they were forbidden, and that they devoured men's substance wrongfully; we have prepared for those among them who reject faith a grievous punishment." [39]

Suratul al-Imran[40] orders Muslims to refrain from interest for their own good: "O ye who believe! Devour not usury, doubled and multiplied, but fear Allah that ye may (really) prosper." Finally, Surah al-Baqarah[41] clarifies the difference between trade and interest in great detail.

Riba in business is divided into two types: *riba al-nasi'ah* and *riba al-fadl. Riba al-nasi'ah* arises from money-to-money exchanges in which the lender requests an amount that is more than the principal amount when a borrower fails to pay back borrowed money to the lender on the due date. In an Islamic economy, an excess of repayment over the borrowed amount is strictly

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[36] Olanipekun Wahid Damilola and Brimah Aminu, and Ajagbe Suraj Tunde, 'Islamic Banking and Finance Evolution: A panacea for Sustainable Development in Nigeria' [2015] (2) (5) *International Journal for Accounting Research* 11

[37] Quran 30: 39

[38] Quran 4:161

[39] Islamic Sharia Concept Governing Banking Finance available at <http://www.dradamlawfirm.com/pdf/Islamic%20Shari'a%20Concepts%20Governing%20Islamic%20Banking%20Finance.pdf> accessed 12 December, 2017

[40] 3:130

[41] 2: 275-281

prohibited. Although this is called interest in a modern economy, in Islam *riba* is considered a coercive and inappropriate measure.[42]

Riba Al-Nasiah or *riba* of delay is due to exchange not being immediate with or without excess in one of the counter values. It is an increment on principal of a loan or debt payable. It refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of the period the amount originally lent together with an increase on it, in consideration of the lender having granted him time to pay. Interest, in all modern banking transactions, falls under purview of *Riba Al-Nasiah.* As money in present banking system is exchanged for money with excess and delay, it falls, under the definition of *riba*. A general accord reached among scholar about its prohibition

The other type of *riba,*is *riba al-fad* which means an excess value of goods received in trade under a barter system. Under this system, the principle is that goods exchanged must be of the same value. However, if one party receives goods of value greater than the value of goods provided to his/her trading partner, it is considered that the person received *riba* (*riba al-fadl*). One can regard *riba al-fadl* as very similar to income without labor or income from inappropriate transaction, such as fraud.[43]

Riba Al-Fadl (excess) is the quality premium in exchange of low quality with better quality goods e.g. dates for dates, wheat for wheat, etc. – an excess in the exchange of *Ribawi* goods within a single genus. The Concept of *Riba Al-Fadl* refers to sale transactions while Riba Al-Nasiah refers to loan transactions.

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[42] Rika Nakagawa, 'The Evolution of Islamic Finance in Southeast Asia: The Case of Malaysia' [2009] (25) (1) *The Journal of Applied Business Research* 114

[43] Ibid

2.6.2 Prohibition of Uncertainty (*Gharar*)

Gharar originates from the Arabic verb *gharra*, which means to deceive. *Gharar* refers to excessive uncertainty in contracts, where details concerning the sale item are unknown or ambiguous, or there is a lack of information or control.[44] The hadith of the Prophet (SAW) refer to the prohibition or avoidance of gharar in several instances. Ahmad and Ibn Majah, citing Abu Said Al Khudriy, say that, "The Prophet (SAW) has forbidden the purchase of the unborn animal in its mother's womb, the sale of milk in the udder without measurement, the purchase of spoils of war prior to their distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver."

There are so many juristic views regarding the meaning of *Gharar*. The first view is that of Ibn abideen where he argue that *Gharar* applies exclusively to cases of doubtfulness or uncertainty, as in the case of not knowing whether something will take place or not. A second view as posit by Ibn Hazm holds that *Gharar* applies only to the unknown, to the exclusion of the doubtful. This view is adopted by the *Zahiri* School. In view of the above definition *Gharar* in sales take place when the buyer in his on part has no knowledge of what he has bought and the vendor does not know what he has sold.

The third view is a mixture of the two categories discussed above. In this regard, *Gharar* covers both of the unknown and the doubtful. That is to say that *Gharar* obtains where consequences are concealed. This is the view favoured by most scholars.

It has been reported from the Prophet's companions that the Noble Prophet (SAW) has forbidden *Gharar* trading. 'Al-Nawawi has described this Hadith as one of the cardinal principles of the

[44] Camile Paldi 'Understanding Riba and Gharar in Islamic Finance' [2014] (2) (1) *Journal of Islamic Banking and Finance*' 253

law of sale as it encompasses a vast range of questions.'[45] It is the grundnorm of all rules governing *Gharar* contracts.

Islamic Jurist are unanimous that all contracts contained some degree of uncertainty. In fact it is the risk involved that majorly differentiate a profit with interest. Therefore, it is not all *Gharar* that invalidate a contract. For a *Gharar* to invalidate a contract it must be excessive in nature and thereby become capable of causing disaffection amongst the parties.

2.6.3 Prohibition of speculation (*maysir*)

Maisir refers to the easy acquisition of wealth, whether or not it deprives someone else. The Quran uses the term to prohibit gambling:

O ye who believe! Intoxicants and gambling, sacrificing to stones and divination by arrows, are an abominable action of Satan's handwork, so abstain from them that you may prosper.[46]

Satan intends to excite enmity and hatred among you with intoxicants and gambling, and hinder you from the remembrance of Allah, and from prayer; will ye not abstain? (5:91)

They ask thee concerning wine and gambling. Say: 'In them is great sin and some benefit for people, but the sin is greater than the benefit (4:219)

Maysir is regarded by most Islamic scholars as gambling or any games of chance (including lotteries, lotto, casino-type games and betting on the outcomes of animal races). Together, these share a desire for obtaining return through deliberate risk-taking. Both games of chance and gambling are banned by *Sharia*. The *Holy Quran provides as follows*:

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[45] Siddiq Mohammad Al-Ameen Al-Dhareer, 'Al-Gharar in Contracts and its Effects on Contemporary Transactions' (1997), Eminent Scholars' Lecture Series No. 16 *Islamic Research and Training Institute Islamic Development Bank* 11.

[46] Quran 5:91

> O, you who believe! Intoxicants (all kinds of alcoholic drinks), and gambling, and *Al-Ansab* (animals that are sacrificed in the name of idols on their altars) and *Al-Azlam* (arrows thrown for seeking luck or decision) are an abomination of Satan's handiwork. So avoid that (abomination) in order that you may be successful.[47]

The holy Quran further provides that (chapter 2, verse 219);

> They question thee about alcoholic drinks and games of chance (speculation). Say: in this is great sin and some utility for men; but its sin is greater than its usefulness[48].

Even though there is a general consensus among Muslims who believe in the tenets of *Sharia* and therefore do not question the reasons for forbidding the *Maysir,* The reasons underlying the prohibition of games of chance and gambling. They argue that because of the high risk available in these types of transactions, some people win a large amount of money, but others suffer from a loss of their money, and sometimes face bankruptcy. This could lead to greater financial and societal problems. In addition, these games and gambling are unnecessary for society because they cannot add any surplus to societal wealth.[49]

Maysir is considered by Islamic scholars as gambling or any games of chance including lotteries, lotto, casino-type games and betting on the outcomes of animal races. Gambling and games of chance share a strategy for earning a profit through pre-meditated risk-taking

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[47] Quran 5 verse 90
[48] Quran 2 verse 219
[49] Alsadek H. Gait and Andrew C. Worthingto, 'A Primer on Islamic Finance: Definition, Sources, Principles and Methods, University of Wollongong, School of Accounting and Finance Working Paper Series, Available at <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1359&context=commpapers> access 29/12/2017

2.6.4 Screening of Investment Activities to Ensure whether they are Islamically Permissible or not.

It is prohibited for a Muslim to engage in business activities that are not permissible in Islam. Hence Islamic finance encourages people to invest their money is a business that comply with the rules set by *Sharia.* According to Islamic doctrine, some commodities, such as alcohol, drugs, and pork, are strictly forbidden. Thus, people should not use or exchange items banned by the *Holy Quran.* Lewis and Algaoud have pointed out that neither individuals or institutions can trade or finance enterprises that deal in forbidden items. The aim of *Sharia* in this regard is to promote 'ethical' investments that again do not affect people and society adversely through the violation of religious prohibitions.

In Malaysia, the *Sharia* Advisory Council SAC of the Supreme Court plays an important role in certifying and updating the list of securities that have been classified as *Shariah*-compliant securities. This *Shariah*-compliant certification is done through the input and support received from the Security Commission. To classify security as whether *Shariah* comply or not, *Sharia* Advisory Council will analyse the data gathered by Security Commission from various sources including the annual reports and enquiries made to the companies. Based on the latest annual audited financial statements of the companies, the *Sharia* Advisory Council continuously reviews the *Sharia* status of listed companies. The *Sharia* Advisory Council has applied a standard criterion to evaluate the business activities of the companies and companies whose activities are not contrary to the *Sharia* principles will be classified as *Sharia*-compliant securities[50]

[50] Norlita Binti Zainudin and Surianom Binti Miskam and Muna Binti Sulaiman, 'Revised Shariah Screening Methodology for Shariah Compliant Securities: New Standard to meet Global Expectation' available at <http://www.kuis.edu.my/comm2014/eproceedings/C008%20REVISED%20SHARIAH%20SCREENING%20MET

2.7 Islamic Banking Products and Services

2.7.1 *Mudabara*

The concept of profit-and-loss-sharing is based on the old Makkan practice of *Mudaraba* which had been adopted by Islam. In the main form of *Mudaraba* there are two partners: the entrepreneur and the financier. The entrepreneur has the knowledge and necessary skills to undertake an enterprise and the financier has the funds. The entrepreneur has full control of the enterprise; the financier provides only the funds. The net profit of the enterprise is shared by the two parties equally or in a prearranged fashion. When there is a loss, however, the total loss is borne only by the financier.

In *Mudaraba* practice, banks shall use depositors' funds to finance projects of entrepreneurs. There will be three parties: (1) Entrepreneurs; (2) Depositors; and (3) Banks. They will share the profits (or losses) in a pre-arranged ratio. Therefore, the depositors will become the 'investors' and the banks will divide this threesome into twosome: (1) Investors (Depositors) – Banks, and (2) Banks - Entrepreneurs. In the first case the bank is the entrepreneur and in the second case the bank is the financier. So the position of the bank is an investment intermediary.[51]

There are three partners: the depositor, the bank and the entrepreneur. The depositor is a pure financier; he invests his money and plays no further part in the project. The entrepreneur is a pure entrepreneur; he is fully in-charge of the project and invests no money in his capacity as an entrepreneur. The bank, however, is in a peculiar position of investment intermediary (not financial intermediary): it is both an investor—though investing depositors' money and

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HODOLGY%20FOR%20SHARIAHCOMPLIANT%20SECURITIES%20NEW%20STANDARD%20TO%20MEET%20GLOBAL%20EXPECTATION.pdf> accessed 30December, 2017

[51] Mahmood Ahmed, 'Practice of Muharaka in Islamic Finance' available at <http://ibtra.com/pdf/journal/v2_n1_article3.pdf> accessed 31 December, 2017

"multiplying" it – and an entrepreneur to the extent of identifying viable project and ensuring its proper accounting and management. The bank invests neither its own money nor its own ideas, yet it provides a very useful intermediary and trustee and takes responsibility. The bank will be rewarded for this useful role it plays but be punished if it fails.

With the above in mind, we propose an equal share to all three partners when there is a profit. When a loss occurs, the entrepreneur will bear no part of it, but the bank and the investor will share the loss equally between themselves.

2.7.2 *Musharaka*

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by every partner strictly in proportion to respective capital contributions.

The Bank may undertake to finance acceptable projects under the principle of *musharakah.* In this case the Bank together with the initiator or initiators of the relevant project will provide the whole financing for the project in agreed proportions. All parties including the Bank have the right to participate in the management of the project but all parties have the option to waive such right. All parties agree through negotiations on the ratio of distribution of the profits generated from the project, if any. Such ratio need not coincide with the ratio of participation in the financing of the project. In the event of loss in the project all parties bear the loss in proportion to their shares in financing.

Under the concept of *Musharakah* at Corporate Financing level the Bank may for example participate in providing funds as loan to landowners to build. After the landowner built and sale the building, the proceeds of sale of the buildings may then be divided in accordance with what has been agreed between the Bank and the landowner. The Bank may also participate in the equity of quoted and unquoted companies by way of direct participation through joint-venture with customers or indirect participation through purchase of quoted shares.

The governing principles of *musharaka* are as follows

1. Capital may be either cash or kind
2. Capital must be quantified and specified
3. Each party has the right to participate in managing the business enterprise. However both parties can mutually agree to appoint one of them as the managing partner, the other will be a silent partner.
4. Each partner is entitled to terminate the relationship with prior notice or when set conditions have been met.
5. In case of premature termination the venture will be liquidated and proceeds distributed pro rata i.e according to the share, interest, or liability of each partner

2.7.3 *Murabaha*

Murabahah refers to a sale and purchase of an asset where the acquisition cost and the mark-up are disclosed to the purchaser.[52]

The specific inherent nature of the contract of *murabahah* is the sale contract which is based on the element of trust in disclosing the cost and mark-up. The common inherent nature of a sale

[52] Bank Negra Malysia; Central Bank of Malaysia. Issued on 23rd December, 2013 page 9 available at <http://www.bnm.gov.my/guidelines/05_shariah/CP_Murabahah_122013.pdf>

contract is the transfer of ownership of the asset from the seller to the purchaser.[53] Under *Murabahah*, an Islamic bank purchases goods on credit at the request of their customer. Then, the goods are sold to the customer at the purchased price plus the costs of the bank. *Murabahah* is often utilized for purchasing durable goods, such as a computer or a car. Similarly, if the goods are purchased under a deferred payment sale, *Bai' Bithaman Ajil* is applied.[54]

Murabaha is one of the most common modes used by Islamic Banks. It refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, *Murabaha* is not a loan given on interest rather it is a sale of a commodity at profit. The mechanism of *Murabaha* is that the bank purchases the commodity as per requisition of the client and sells him on cost-plus-profit basis. Under this arrangement, the bank is bound to disclose cost and profit margin to the client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sell those goods to the customer on profit.[55] In case of *Murabaha*, the bank sells an asset and charges profit which is a trade activity declared *halal* (valid) in the Islamic *Shariah*. Whereas giving loan and charging interest thereupon is pure interest-based transaction declared *haram* (prohibited) by *Shariah*.

2.7.4 *Istisna*

Literally istisna derived from the Arabic word sana'a meaning making, manufacturing or constructing something.[56] Technically istisna is a contract between two parties whereby one party agree to make or manufacture an article for another party. In this wise the party who agree

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[53] Ibid
[54] Rika Nakagawa opcit
[55] Shatha Abdulkhaliq, 'Comparison of Murabaha and Istisna in Islamic Banking in Jordan' [2014] (5) (9) *Interdisciplinary Journal of Contemporary Research in Business* 603
[56] Ibn Manzur M. Mukarram, Lisan Al-Arab (Daral Sadir, 1955) 208-212

to manufacture the article engage the service of an artist to manufacture the article for a definite price and with a certain quality within a prescribed period.[57]

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well-described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. *Istisna* can be used for providing the facility of financing the manufacture or construction of houses, plants, projects, and building of bridges, roads and highways. This is widely used in the housing finance sector, where the client seeks finance for the construction of a house.[58]

Istisna is a contract whereby a party undertakes to produce a specific thing which is possible to be made according to certain agreed-upon specifications at a determined price and for a fixed date of delivery. This undertaking of production includes any process of manufacturing, construction, assembling or packaging. In *Istisna*, the work is not conditioned to be accomplished by the undertaking party and this work or part of it can be done by others under his control and responsibility. *Istisna*, an instrument of pre-shipment financing and it is a contract where the deal can be referred to something not in existence at the time of concluding the contract. The main objective of the *Istisna* mode of financing is to promote manufacturing capability. This may relate to manufacturing of complete assets in the form of capital goods. These goods may benefit the industrial, agricultural or infrastructure sector. *Istisna* provides medium term financing to meet financing requirement for manufacturing/supplying/sale of identified goods, such as industrial/construction equipment, machinery, cargo vessels, oil

[57] Yahaya Y. Bambale Islamic Law of Commercial Transaction, (Malthouse Press, 2007) 186
[58] Sanusi Lamido Sanusi, Islamic Finance in Nigeria: Issues and Challenges [2011] (4) a Paper Presented at Markfield Institute of Higher Education {MIHE}), Leicester, 4.

tankers, trawlers, dredgers, locomotives, etc., transport equipment, pipelines for water and oil distribution, gas and electricity and their transmission/ distribution lines, electric generators and transformers, telecommunication equipment, oil rigs, hospital equipment, etc. Under this mode of financing, it is possible to finance intangible assets like gas, electricity, etc. It is also possible, unlike under leasing and installment sale, to finance working capital. *Istisna* financing period is determined by the time required for procurement of necessary materials and manufacturing of the goods according to the agreed contract.

It is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well-described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. *Istisna* can be used for providing the facility of financing the manufacture or construction of houses, plants, projects, and building of bridges, roads and highways.

2.7.5 *Ijara*

The term *Ijarah* has been defined as a contract between two parties, the lessor and the lessee, where the lessee enjoys or reaps a specific service or benefit against a specified consideration or rent from the asset owned by the lessor.[59] It is a lease agreement under which a certain asset is leased out by the lessor to a lessee against specific rent or rental for a fixed period. According to Nousheen and Anila[60] *Ijara* in an Arabic word lexically means to give something or to provide some services on rent, but in Islamic Banking, *Ijara* contract is an agreement wherein a lessor

[59] Muhammad Haroon Ameer and Muhammad Saud Ansari, 'Islamic Banking: Ijara and Conventional Leasing' [2014] (2) (9) *Developing Country Studies* 126

[60] Nousheen Abbas Naqbi and Anila Pervee, 'Analysis of Growth of Ijara Investment in Pakistan: A Case Study on Meezan Bank' [2014] (7) (2) *KASBIT Business Journal* 23

mu'ajjir rent out the usufructs of his corporal asset to a lessee *musta'jir* who pays the predetermined rentals *ujrah* for the agreed period of time.

Ijara is one of the most popular modes of Islamic finance. In *Ijara* customers are provided by bank with short to medium-term financing to lease such items which may include; real estates, buildings, equipment, machineries, computers, motor vehicles, and other goods acceptable by the *sharia*.Some feature of Ijara are given below:

1) Lessor transfers the usufruct of the assets not the ownership.

2) Period of lease must be predetermined.

3) Rentals should be specific and must be fixed for the particular period, after this period it can be change with the mutual consent of lessee and lessor.

4) *Ijara* cannot be made for the consumable items such as, fuel, vegetables, oil etc.

5) Rentals cannot be charged before the delivery of assets, if it is charged then will be adjusted with last rentals.

6) Any one party unilaterally promises to buy/sale the leased asset after the expiry of leased term against some specific consideration.

7) Lessor would be responsible for all ownership related expenses and lessee would bear the running cost.

8) In banking practices risk is transferred to insurance company, and in *Ijara* financing by Islamic Bank, it is transferred to Islamic insurance

9) To avoid delay in payment of rent by the lessee a stipulation may be inserted in the Ijarah contract making late payment by the lessee over a period of time liable to a certain amount of which goes to charity account.[61]

10) If the leased asset is stolen or completely destroyed, the conventional leasing company continues charging the lease rent till the settlement of the Insurance claim. Under the Islamic system, rent is consideration for usage of the leased asset, and if the asset has been stolen or destroyed, the concept of rental becomes void, no rentals would be charged by lessor

[61] Islamic Finance available at < http://www.financialislam.com/ijarah.html> accessed 15 March, 2018

CHAPTER THREE

GENERAL FEATURES OF THE LEGAL AND INSTITUTIONAL FRAMEWORK OF ISLAMIC BANKING IN NIGERIA AND MALAYSIA

3.1 Introduction

The previous chapter discussed historical background and concepts of Islamic Banking. The historical background of Islamic Banking is discussed and also the historical background and the evolution of Islamic Banking in Nigeria and Malaysia were discussed. Concepts such as the prohibition of *riba, gharar, maysir*, and screening of investment to make sure it is in accordance with the *sharia* were discussed Islamic banking products and services such as *mudaraba, musharaka, istisna* and *ijara* were discussed. This chapter will discuss general features of the regulatory framework in Nigeria and Malaysia with the aim of making comparison of the regulatory framework in two climes

3.2 Banking and other Financial Institutions Act 1999 as amended

The Supreme Military Council in 1991 promulgated the Banking and Other Financial Institutions Decree No. 25, 199 which for the first time in the history of banking in Nigeria deviates from conventional banking. It provided for a new kind of banking that is based on profit and loss sharing. The Act states that the President, on the recommendation of the Governor of the Central Bank, shall from time to time determine as he deems appropriate the minimum paid up capital of each category of banks. According to Sanusi, Islamic Banking falls under the category of a "specialized bank" recognised by the Bank and Other Financial Institution Act, 1991. On the main, non-interest banking and financial models are broadly divided based on Islamic commercial jurisprudence and non-interest banking and finance based on any other established

law on interest principle. Islamic Banking, as one of the models of non interest banking, serves the same purpose of providing financial services as commercial financial institutions do. The difference is that the former operates on the principles and rules of Islamic commercial jurisprudence that recognises profit and loss sharing and the prohibition of interest, uncertainty and ambiguity relating to the subject matter, as well as terms and conditions. Other prohibitions are gambling, speculation, unjust enrichment, exploitation, and other unfair trade practices.

Also prohibited in the Islamic Banking system are dealings in pork, alcohol, arms and ammunition, pornography, as well as transactions, products, and goods and services which are not compliant with the rules and principles of Islamic commercial jurisprudence. Since Islamic Banking is a peculiar kind of bank, the Bank and other Financial Institution Act (BOFIA) No. 25, of 1991 (as amended) made provisions for a number of exceptions to facilitate the smooth operations of non-interest banking. For example, the non-applicability of the need to display the interest rate in the bank premises of a profit and loss sharing bank. The Act states "Every bank shall display at its offices its lending and deposit interest rates and shall render information on such rates as may be specified, from time to time, by the bank, provided that the provisions of this subsection shall not apply to profit and loss sharing banks."

The Act further states that the Governor of the Central Bank of Nigeria can further exempt the profit and loss sharing bank from any of the provisions of the Bank and Other Financial Institution Act as he thinks appropriate. These provisions are set to exempt the profit and loss sharing banks from some of the shackles that could hinder its smooth operation is indeed a solid foundation that will assist in the successful establishment and operation of Islamic Banking. This move has however left some lacunae that could at the end affect the smooth operation and trust

of the public on the bank. For example, the Act does not require the inclusion of memorandum and articles of association of the prospective Islamic bank which will spell out the establishment, composition, and qualifications of the members of board. The powers of the Governor of the Central Bank to make rules and regulations are restricted to the area of practice and procedure. This will, in the long run, pose a challenge to Islamic Banking. The Act is equally silent on the establishment of the *Shariah* Advisory Board which at a glance does not look like a serious problem, but could be a problem to the bank and its operations; after all, consultation is highly valued by the *Shariah.*

In Nigeria, unlike in Malaysia where there is a special law enacted to regulate Islamic Banking, the BOFIA is the key law which includes granting license to Islamic Banking. A careful perusal of the law reveals that no mention was made in the law of the term "Islamic Banking". In fact, the Act required the written consent of the Governor of the Central Bank for the use of the following terms by prospective banks when applying for registration or incorporation: "...Central, Federal, Federation, National, Nigeria, Reserve, State, Christian, Islamic, Muslim, Quranic or Biblical..."

The Central Bank relying on this provision issued a circular which prohibits the use of the phrase "Islamic Banking". The circular could be ultravires to the BOFIA which has not prohibited the use of the phrase "Islamic Banking"; rather, it restricts and subjects its usage to prior consent and approval by the Governor of the Central Bank. Each such application is expected to be treated on its merit. Approval should be granted if the application is shown to be the aspiration of the majority shareholders and the bank is also satisfied that all the prerequisites of a licensed bank have been met.

Whether or not the word 'Islamic Banking' is used, to a Muslim, the ends justify the means. Under Islamic law, actions are judged according to intentions. Since the bank operates on the Islamic principles of profit and loss sharing and the avoidance of unlawful or forbidden qualities, like wine, pigs, corpse, human blood and *riba*, the non-use of the word 'Islamic' does not provide a significant obstacle to the objectives of the system. It is worth mentioning that before a profit and loss sharing bank could engage in sales or the disposal of real estate transactions, a written approval of the Central Bank Governor would need to be obtained. It is not clear from the Act whether or not such approval is required for every transaction. Suffice it to say, such a restriction is capable of hampering the smooth operation of Islamic Banking products, such as direct investments, *ijarah wa itqan* (hire and purchase), and *murabaḥah* (cost plus financing).

3.3 The Central Bank of Nigeria Act 2007

The Central Bank of Nigeria Act 2007 establishes the Central Bank. It is the apex bank that issues licenses and controls, and supervises the operations of all banking in Nigeria. Therefore, it follows that Islamic Banking is under the control and guidance of the Central Bank just as all other banks in Nigeria. The Central Bank has taken steps to defend its stance by saying that it is obliged by law to issue licenses to appropriate entities for the establishment of non-interest banking provided they meet the regulatory requirements for the said license. As such, the Central Bank issued a Draft Framework to be a guide in the establishment of an Islamic Bank. It provides as follows:

(a) Islamic banks, referred to as non-interest banks, shall be licensed in accordance with the requirements for a new banking license issued by the Central Bank of Nigeria from time to time.

Conventional Banks operating in Nigeria may offer *Shariah*-compliant products and services through their non-interest banking branches or windows. However, such branches or windows cannot offer conventional banking or interest based products and services.

(b) Banks offering non-interest banking products and services shall not include the words "Islamic" as part of their registered or licensed name. This, the draft described as being in line with the provisions of Section 39(1) of the BOFIA. They shall, however, be recognised by a uniform logo to be designed and approved by the CBN. The CBN shall require all the bank's signatures and promotional materials to carry the logo so as to facilitate recognition by consumers.

(c) The Central Bank shall set up an advisory committee on non-interest banking within the CBN to be called the "CBN *Shariah* Council" (CSC), which will be outsourced. The Council shall advise the CBN on Islamic laws and principles for the purposes of regulating non-interest banking business.

(d) All non-interest banks are required to maintain a minimum Risk Weighted Asset Ratio of 10 % or as may be determined by the CBN, from time to time, for the purpose of calculating its Capital Adequacy Ratio (CAR).

(e) All applications must be submitted with the required documents including a Non-refundable application fee of N500, 000.00 and a deposit of minimum capital of N25 billion with the Central Bank of Nigeria.

(f) Not later than six (6) months after the grant of an A.I.P (Approval In Principle), the promoters of a proposed bank must submit an application for the grant of a final banking license to the

Director of Banking Supervision with a non-refundable licensing fee of N5 million in bank draft payable to the CBN and other required documents.

The controlling powers of the Central Bank of Nigeria over Islamic Banking are seen from various angles. According to the Central Bank Act, the Central Bank can issue guidelines, rules, and regulations for the operation of banks or any institution engaging in financial services as well as for enforcing rules and regulations. The Central Bank equally gives approval and disapproval annually of the appointment of the Auditor by all banks, appoints Directors of banking, supervision, and removes ailing bank managers, staff, and directors. This is in addition to the Central Bank's power to issue an order for special examinations or investigations of any bank. However, such an exercise of power is made in the interests of the public or upon an application of a director, shareholder, depositor, or creditor of the bank.

3.4 The Central Bank

The Central Bank Nigeria is statutorily empowered to regulate and supervise banks and other financial institutions in Nigeria either Islamic or Conventional. BOFIA is the primary legislation for the regulation of banks and other financial institutions.[62] In Nigeria there is no any separate legislation that regulates Islamic Banking. As such Central Bank of Nigeria applies the provision of BOFIA 1991 (As Amended) in the regulation of banks and other financial institutions include Islamic Bank. Central Bank of Nigeria has powers to regulate Islamic Banking which include power to issue licence, to revoke the licence, to issue regulations, to supervise Islamic Banking and power to take over control of failing Islamic Banks

In Nigeria, only a company duly incorporated by the Corporate Affairs Commission (CAC) can carry on any banking business and such company must have a valid banking licence issued to it

[62] BOFIA 1991 (As Amended)

in accordance with the requirement of the law.[63] It is therefore, an offence, punishable on conviction for up to 10 years imprisonment or fine of N2,000,000.00 or both, for any person to undertake banking business without a valid banking licence.[64].

Central Bank of Nigeria is the body responsible for issuance of banking licence through its Governor, after the satisfaction of all conditions for the issuance of the licence by the applicant[65].

It was in exercise of the statutory function and in line with the relevant provisions of BOFIA[66] that the Central Bank Nigeria issued the Guidelines for the regulation of non-interest (Islamic) banking which culminated into issuance of the first full-fledge Islamic Banking licence in Nigeria. This however, was greeted with mixed reaction amongst the Nigeria populace as to the legality/constitutionality of the issuance of such licence.

Although there are no judicial pronouncements on the legality of Islamic Banking in Nigeria, the only matter that was instituted at the Federal High Court to challenge the power of the Central Bank of Nigeria Governor to issue Islamic Banking licence was in the unreported case of *Godwin Sunday Ogboji v Governor of the Central Bank of Nigeria & Ors.*[67] The Applicant in the matter sought for, among other things: a declaration that the operation of Islamic Banking in Nigeria is unlawful and inconsistent with the provisions of the Central Bank of Nigeria Act and BOFIA; and the withdrawal of the license of the Ja'iz Bank by the Central Bank of Nigeria. However, the matter was struck out by the Court for lack of *locus standi* by the Applicant.

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[63] Section 2(1) of BOFIA 1991 (As Amended)
[64] Section 2(2) of BOFIA 1991 (As Amended)
[65] Section 3 of BOFIA 1991 (As Amended)
[66] See Section 33(1)(b) of the CBN Act; Section 23(1), 52, 55(2), 59(1)(a) and 61 of BOFIA
[67] (unreported) File No. FHC/ABJ/CS/710/2011

However, the learned judge in his obiter dictum observed that the Central Bank of Nigeria lacks power to designate Islamic Banking as a specialised bank and that the Guidelines issued by the Central Bank of Nigeria to that effect has no statutory basis upon which its legality could be maintained. The learned Judge gone further to state that had the Applicant possessed the requisite *locus standi* he would have gone ahead to revoke the license of Ja'iz bank. He asked the Attorney General to remedy the situation and ensure that CBN carries out its operation within the confines of laws.

Although, the above statements of the learned Judge have no legal effect whatsoever, they appear to be damning to the powers of the CBN. Neither the Applicant nor the CBN appears to have appealed the matter. Perhaps due to the fact that the Applicant realised that he indeed lacks *locus standi* to institute the matter, while CBN realised that it cannot formulate a ground of appeal base on obiter dictum as decided in plethora of decided authorities. On this note, the Court of Appeal in the case of M*ainstreem* B*ank* R*egistrars* L*td V* E*tim*[68] while relying on the Supreme Court's decisions in the cases of D*airo v UBN*[69] and *AIC v NNPC*[70], rightly observed that:

> *No ground of appeal can arise from an obiter dictum of the Court. There is a distinction between ratio decidendi and Obiter dictum of a case. The ratio decidendi, is the principle or the ground upon which the Court based its decision on the point in the issue, but Obiter is a passing remark which is not necessary in determining the issue in controversy.*

[68] (2016) LPELR -40556(CA) 18 a-c
[69] (2007) 16 NWLR (Pt.1059) 99
[70] (2005) 1 NWLR (Pt.937) 563 at 589

As it stands now the licensing of Islamic bank in Nigeria by CBN is legal and valid. In granting such licence the Governor may impose certain condition which he also has power to revoke, vary or issue fresh conditions while the bank is in operation[71]. Failure to comply with such directive is a criminal offence punishable with fine.

More so, the CBN has power to issue rules, regulations and guideline to all institutions under its supervision. BOFIA provides as follows.[72]

> *(1) The Governor may make regulations, published in the Gazette, to give full effect to the objects and objectives of this Act.*
>
> *(2) Without prejudice to the provisions of subsection (1) of this section, the Governor may make rules and regulations for the operation and control of all institutions under the supervision of the Bank.*

Non-interest banks are some of the institutions under the supervision of CBN. Consequently, in exercise of the above power vested on the Governor and in order to effectively regulate non-interest banking, the CBN issued the following:

1. Guidelines on Non-Interest Window and Branch Operations of Conventional Banks and Other Financial Institutions, 2010;
2. Guidelines for the Regulation and Supervision of Institutions offering Non-Interest Financial Services in Nigeria, 2011;
3. Guidelines on the Governance of Advisory Committees f Experts for Non-Interest (Islamic) Financial Institutions in Nigeria, 2015

[71] Section 3 of BOFIA 1991
[72] Section 57 of BOFIA 1991

4. Circular to all Non-Interest (Islamic) Financial Institutions on Treatment of

It is worthy to note that failure of Islamic bank to comply with any of the above Guidelines or any other relevant rules, regulations, circulars or guidelines issued or to be issued by the CBN may attract penalty of not more than N2,000,000.00 against the defaulting bank or suspend the license of such bank[73].

The Central Bank of Nigerian Governor has power to, by order in writing, remove any officer, manager or director of any Islamic bank where the bank is likely to: become unable to meet its obligation; it is about to suspend payment; it is insolvent; or is in grave danger.[74] The Governor may also appoint any person or persons as a director or directors of the bank and may also appoint any person to advise such bank in relation to proper conduct of its business.

Although there was no report on removal of any officer, director or manager of Islamic bank in Nigeria, however such power was exercised by the CBN Governor with respect to conventional banks. In 2009 the then CBN Governor removed chief executives of 5 banks in Nigeria and appointed other person to take over the control of the banks[75].

The removal was challenged by the shareholders of Union Bank in the case of *Union Bank Plc. & 4 Ors V Central Bank of Nigeria & 14 Ors*[76] were it was held that the CBN Governor was right to have done that. In delivering his judgement, Honourable Justice Idris of the Federal High Court Lagos, has this to say:

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[73] Section 64 of BOFIA 1991
[74] See Section 35 of BOFIA 1991
[75] The CEOs removed were those of Afribank Plc, Finbank Plc, Intercontinental Bank Plc, Oceanic Bank plc and Union Bank Plc.
[76] Supra

In my view, by the combined effect of section 33 and 35 of BOFIA, the CBN Governor ... can also intervene in the affairs of a bank by removing and replacing the directors of a bank found to be in a grave situation; to hold otherwise is to impair the legislative intent underpinning the provision, which is the ability of the CBN Governor to provide a failing bank with necessary managerial and operational support to facilitate the bank's turn around.

In the same vein, Honourable Justice Achibong of the Federal High Court Lagos while delivering judgement in the unreported case of *Shofolahan Sunday & 4 Ors v Bank PHB & 14 Ors*[77] filed by the shareholders of the defunct Bank PHB challenging the revocation of bank's licence and takeover of its assets and liabilities by Assets Management Corporation of Nigeria (AMCON), observed that the CBN has authority to revoke banking licence where the depositors funds are in danger.

From the above pronouncement of the learned judges, it is not in doubt that the CBN Governor has the power to remove any director or officer of any bank that is distressed and also appoint any person to be a director or adviser of such bank.

Recently, the CBN appointed some director to take over the control of the board of Sky Bank Plc[78]

3.5 Nigerian Deposit Insurance Corporation Act 1988

In 1983 a committee was set up by the by the Board of Central Bank of Nigeria to examine the operation of Banking System. The committee report highlighted the need for the establishment of

[77] unreported FHC/L/CP/303/11

[78] CBN Sacks Board of Skye Bank, 'Business News Reporters' <http://www.businessnewsreport.com.ng/cbn-sacks-board-skye-bank/> accessed 9 December, 2016

Depositors Protection Fund.[79] It was the aftermath of the committee report that the Nigerian Deposit Insurance Corporation was established through Decree 22 of 15th June, 1988.

Section 1 of the Nigerian Deposit Insurance Corporation Act 2006 establishes the Nigerian Deposit Insurance Corporation (NDIC) as a government owned Insurance Corporation. The NDIC is established to protect the banking industry and provide financial guarantees to depositors. Towards the promotion and sustenance of public confidence in the banking system, the corporation is empowered to come to the aid of an insured bank in case of imminent or actual financial difficulties which may threaten payments. This may be in the form of liquidity support to the banks on agreeable terms giving guarantees for the bank's loan or even taking over the management of a faltering bank until its financial condition improves. In the event that the corporation exhausts all its protective alternatives and a failing bank still has to postpone payments, the corporation is obliged to pay every insured depositor up to the insurable limit. All licensed banks and other financial institutions engaged in business of receiving deposits is required to mandatory insure their deposit liabilities with the NDIC failure of which attract a maximum fine of Five Hundred Thousand for each day the offence is committed and the officers liable for the contravention shall be convicted for three years imprisonment and a fine of not more than Five Million Naira or both fine and imprisonment[80]

It is important to mention that some of the relationships between Islamic Banking and the Nigeria Deposit Insurance Corporation have the element of *riba* and are hence contrary to Islamic law. For example, investment of the scheme's funds into the federal government's security has elements of *riba*. Also, insurance businesses generally are in conflict with the

[79] Mahan Malang Mafuyai and Ibrahim Mohammed, 'The Nigerian Deposit Corporation (NDIC) and its Role in the Stability of the Nigerian Banking Industry, [3013-2014] 3 *Abuja Journal of Private and comparative Law* 211
[80] Section 15 (10-(3) NDIC Act

principles of the *Sharia* for it has elements of gambling (*qimar*), uncertainty (*gharar*), and unspecified and unknown elements (*jahala*). It is therefore important for the NDIC Act to be amended so that its dealings with Islamic Banking will be in consonance with the *Sharia*. This is a precedent towards the attainment of harmony in Nigeria as the Muslim majority will be able to perform economically within the realm of their religion as their constitutional rights.

3.6 Sharia Board

In Nigeria, the authority to establish the Islamic Financial Institutions (IFIs) and their *Sharia* governing bodies emanates from the authority and mandate conferred on the CBN by various laws of the Federation. The *Sharia* governance for the Islamic Financial Institutions in Nigeria, which otherwise known as "the *Sharia* supervision", has been carried out by the *Sharia* Advisory Boards within individual financial institutions and that of the Central Bank of Nigeria at the central level. The committees among other things are responsible for advising the Islamic Financial Institutions on *Sharia* matters and give sanction on products and services offered by such institutions to consumers as well as undertake routine internal *sharia* compliance audit. However, the CBN *Sharia* Advisory Committee, which is currently addressed as "the CBN Council of Experts", serves as the highest authority on *sharia* -compliance matters and has been given the responsibility to scrutinise and endorse the rulings of individual Islamic bank's *sharia* supervisory bodies. This is in order to promote harmonistion and uniformity of *shariah* rulings, while allowing innovation by permitting individual banks to develop their own products based on the advice of their individual *sharia* supervisory bodies.

In Nigeria, it is a fact that the full fledged operation of Islamic banking entails the carrying out banking activities in accordance with the principles of Islamic jurisprudence. However, the Central Bank of Nigeria (which is conventional in nature) still remains the mother and regulator

of all banks in the country. It regulates and supervises the activities of all banks including Islamic financial institutions in the country. Thus, the CBN has designed a regulatory framework for Islamic banking in the country with a view to assisting the going concern of such banks and their *Sharia* Advisory Councils.

As mentioned earlier, following the amendment of the CBN regulations in line with the provision of BOFIA; the name *Shariah* Advisory Council" was renamed as "the CBN Council of Experts". Such amendment was considered and made as a result of criticisms by some citizens in the country. [81]

Although, the CBN Guidelines have provided for the establishment of the committee of experts responsible for the *Shariah* governance supervision in the CBN and other Islamic Financial Institutions however, such a committee has always been considered as a subordinate to CBN, hence it shall be bound by the CBN dictates at all times. The committee was formally addressed as "the CBN *Shariah* Council", and was later changed to "the CBN Council of Experts" due to legal hurdles. This is to enable the CBN comply with the provision of the laws of the Federation which disallowed the financial institutions including Banks to use any word or phrase or term that has a religious label or inclination or government patronage. The essential duty of the Council is to advise the CBN on Islamic laws and principles for the purposes of regulating non-interest banking business.

[81] Magaji Chiroma and Aishatu Kyari Samdabe and Abdul Habeeb Ansari, 'Legal Framework Regulating Islamic Finance in Nigeria: A Critical Appraisal of Hurdles Against the Effectiveness of Sharia Governance.' 232-234 available at < http://www.unimaid.edu.ng/oer/Journals-oer/Law/Private%20Law/19.pdf> Accessed on 10 January, 2018

3.7 Features of Islamic Banking in Malaysia

The regulatory framework and features of Islamic Banking in Nigeria were discussed above. Features in Islamic Banking in Malaysia such as the Central Bank of Malaysia Act, 1958 which play a vital role in the regulation, supervision and monitoring of the implementation of Islamic Banking will be discussed. The Act also provide for the establishment of Sharia Advisory Board for Islamic Banking in Malysia. Islamic Bank Act of 1983, Bank and Financial Service Act of 1989 and Islamic financial Service Act, 2013 will be discussed as the legislation are relvant to the regulations of Islamic Banking in Malaysia

3.7.1 The Central Bank of Malaysia Act, 1958

Central Bank Act of 1958 play a vital role in the regulation, supervision and monitoring of the implementation of IB. Section 16B of the Act provide Sharia Advisory Board for Islamic Financial Institution including Islamic Banks. However the Act was amended in 2003. The amendment mandated civil court to refer to SAC in any matter pertaining to Islamic Finance, the effect of which is that any deliberation by the SAC binds civil court and any of such decision should be followed by all Islamic Financial Institutions. The 2003 amendment was meant to provide a better position on the National *Shariah* Advisory Council whereby it uplifts the position of Islamic banking and finance in the country.

The provision further provides that where in any proceedings relating to Islamic banking business and Islamic financial business which is based on *Shariah* principles before any court or arbitrator any questions arises concerning a *Shariah* matter, the court or the arbitrator may refer such question to the *Shariah* Advisory Council for its ruling. Any ruling made by the *Shariah*

Advisory Council pursuant to a reference by a court, be taken into consideration by the court and if the reference was made by an arbitrator, be binding on the arbitrator.

3.7.2 Islamic Bank Act 1983

Islamic banks in Malaysia are licensed and regulated by Bank Negra Malaysia under a separate legal framework which is the Islamic Act 1983. Section 3 of the Act provides that Islamic Banking Business shall only be conducted by a company duly license by the Minister of Finance. Section 3 (5) provides that Bank Negra Malaysia or the minister shall not recommend the grant of license unless he is satisfied that the aims and operation of the banking business will not involve any ingredient that goes contrary to Islam. The company is obliged to make provision for the establishment of *Sharia* advisory body in it article of association

Section 2 of the Act defines Islamic Banking as any company which carryon Islamic Banking business and hold a valid license. And that Islamic Banking Business means banking business whose aim and operation do not involve any element which is not approved by Islamic religion. From the above definition the meaning of banking business is omitted. Therefore from the meaning given to Islamic banking one may be correct to say that an Islamic Banking may commence banking business activities using the replica of conventional banking business and Islamise its operation by taken away elements which are contrary to the provisions of Islamic law. The definition makes operation of Islamic banking wider and flexible as the definition covers conventional banking activities which do not go contrary to *sharia* principles.

Section 3 (5) of the Islamic Banking Act provides for the Sharia Advisory Board to advise the bank on the operation of its banking activities in order to make sure that the its business activities does not contravene the ethics of *Sharia*. However the Act does not provide how *Sharia*

Advisory Board will perform it duties. It is worthy to note that there is no similar provision for the establishment of *Sharia* Advisory Board for Banks and Financial Institutions license to transact Islamic Banking business under the Bank and Financial Institution Act rather by the provision of Section 124 (3) of the BAFIA it is mandatory for any bank license carrying on Islamic Banking business under the BAFIA to seek advice of the *Sharia* Advisory Council of Bank Negra Malaysia

By the provision of Section 31 the Central Bank of Malaysia has the power to investigate under condition of secrecy the books of account and transaction of any Islamic bank and of any branch of Islamic Bank agency or office in or outside Malaysia.

Section 55 provides that Islamic Bank is incorporated under the Company Act, 1965 and that subject to the provision of the Company Act, 1965 and Islamic Act 1983 where there is any conflict between the provision of the Company Act and Islamic Banking Act, the Islamic Banking Act shall prevail over the Company Act.

3.9.3 Bank and Financial Institution Act, 1989

Bank Negra Malaysia (BNM) issued guide line in 1993 pursuant to Section 126 of the Bank and Financial Institution Act (BAFIA) 1989. In 1996 an amendment was made to Section 124 of BAFIA. This amendment formalised the carrying on of Islamic banking and financial business by license institutions established under BAFIA and to establish SAC.

Section 124 (1) with some restrictions allow licensed institution to carryon Islamic banking business with consultation of the BNM. In the Act Islamic banking business has the same meaning as in Islamic Banking Act. Section 124 (2) clearly exclude Islamic Bank Act from

regulating Islamic banking business carrying on by conventional banks which is based on the BAFIA.

Section 124 (3) makes it mandatory for any licensed institution carrying on Islamic Banking or Islamic Financial Business to from time to time seek the advice of the *Sharia* Advisory Council. It is therefore, mandatory for the banks to seek the advice of the SAC for its Islamic Banking activities or Islamic financial operation but not mandatory for the BAFIA license institution to have an internal *Sharia* Advisory Council. However there is no law that restricts BAFIA license institution from having their own SAC.

3.9.4 Islamic Financial Service Act, 2013

The rule relating to *Shariah* governance is provided under section 30 until section 36 of Islamic Financial Service Act, (IFSA) 2013 whereby the existence of these provisions highlighted the intention of the law maker, in focusing to the matters pertaining to appointment and qualification of the *Shariah* Committees members in Islamic financial institution. Unlike the Central Bank of Malaysia Act 2009 which merely touched the surface of the matter by highlighting the general requirement for financial institution to have a *Shariah* Committee, the current provision provides a more specific requirement which requires an institution to apply directly to the Central Bank for the establishment of *Shariah* Committee.[82] This will enable the Central Bank to know the members of the *Shariah* Committee in an Islamic financial institution, at the same time, to ensure a proper supervision of the activities of the Bank.

Another issue under the new *Shariah* governance legal provision is the criteria of the members of *Shariah* Committee. A clear standard of requirement pertaining to the appointment of such

[82] Section 30 Islamic Financial Service Act , 2013

committee is highlighted under section 31 which is to be crossed referred with section 29 (2) (a) which states that only those who are really fit and qualified may be appointed as the *Shariah* Committee members. This leads to the notion that members of *Shariah* Committees in every financial institution must be chaired by those who meet the requirements as stated by the Central Bank. Availability of such clause would be vital in ensuring the products and services introduced by the Islamic financial institution complied with the *Shariah* principles via the supervision of competent members.

Section 32 of Islamic Financial Service Act 2013 contributes to the significance of *Sharia* Committees in every institution through the introduction of the *Sharia* governance which not only set out the duties of the *Shariah* Committees in the institution, but rather blends into the structure of the company itself. By extending the powers of *Sharia* .governance into certain aspects in a company such as matters involving the board of directors and internal *Shariah* compliance, we can understand that *Sharia* governance would be one of the integral parts in an institution up to the point that *Sharia* Committee may no longer be treated as a minor part or division of a company, what more against the idea of abandoning such governance rules.

The introduction of *Sharia* Advisory Council under section 33 and 34 of Islamic Financial Service Act, 2013 on the other hand, enables the Central Bank to continuously be updated by the institution of its *Shariah* Committee members. In order to maintain its aim of ensuring that only those who really qualifies entitled to be the members, the provision set out the clause relating to the cessation of the members including situations which would disqualifies from becoming *Sharia* Committee members.

By setting out a more precise rules and features of the *Sharia* committee members, the IFSA 2013 under section 35 has made it compulsory for management in charge of the company to provide information to the *Sharia* Committee in exercising its task and duties. While the Act did not mention the type and degree of information required, it can be assumed that the *Shariah* Committee is authorised to obtain such information that would assist them in carrying out their duties. In addition, section 36 marks the trust which has been given by the legislation over the *Sharia* Committee to hold any type of information including the confidential ones provided such information is not being relayed to the other persons. While maintaining the duty of confidentiality, the *Sharia* Committees are also vested with the protection under the qualified privilege which prevents them from being taken a legal action by the Islamic financial institution, if it can be proven that such duties was conducted in good faith.

The provision clauses as to the *Sharia* governance is one of the major features being introduced under the IFSA 2013 which contribute to boost the authorities as well as roles of the *Sharia* Committee, thus ensuring the activities of the Islamic financial institution to be under *Sharia* compliance thus maintaining a sound and robust *Sharia* governance framework in Islamic financial industry in Malaysia.

The development of Islamic banking in Malaysia gave rise to the establishment of *Shariah* Advisory Council of Bank Negara Malaysia as the highest authoritative body in ascertaining the *Sharia* matters relating to Islamic finance in Malaysia. The *Sharia* Advisory Council has been given the mandate to ascertain the *Sharia* compliance relating to matters which include Islamic banking, Takaful, Islamic financial business or any other business that are based on *Shariah* principles. In addition, the *Sharia* Advisory Council advises the Central Bank of Malaysia and the Islamic financial institutions on any *Sharia* issues pertaining to Islamic financial business.

Provision related to *Sharia* Advisory Council was made available under the Central Bank of Malaysia Act 2009 and the repealed Islamic Banking Act 1983 with a general information as the status and overviews which were regarded as rather generic and in need for a better enlightenment.

The newly enforced Islamic Financial Services Act (IFSA) 2013 seeks to redress this matter by providing a more significant authority towards *Shariah* Advisory Council which at the same time regulates the Islamic financial institutions throughout Malaysia with the latest provisions within its respective jurisdiction. If we are to compare between the previous and current authorities of *Sharia* Advisory Council, reference to the Central Bank of Act 2009 needs to be made whereby section 52(1) mentioned that, The *Sharia* Advisory Council shall have the following functions which includes, to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it, to advise the Central Bank on any *Sharia* issue relating to Islamic financial business, as well as to provide advice to any Islamic financial institutions. However, the IFSA 2013 has reinforced the matter by introducing new provision pertaining to *Sharia* compliance. According to section 28, an institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with *Sharia*. Any irregularities or non-compliance with the *Sharia* requires the institution to inform the *Sharia* Advisory Council so that necessary steps can be taken. A rather distinct rule which was introduced is the reinforced penalty clause whereby failure on part of the institution to comply with the above provision shall be liable to imprisonment not exceeding eight years or to a fine not exceeding RM 250 million or both. Compare to the provision under section 46 of the Islamic Banking Act 1983 which only set penalties on directors and managers of an Islamic bank who fails to take all reasonable steps to secure compliance with the requirements of this act as well as section 50 which provides a fine

not exceeding fifty thousand ringgit, this is a clear cut display of the regulator's intention in addressing the matter in a more serious manner. In the other words, the new Act highlights the duty of institution to ensure stricter *Shariah* compliance and imposed a more severe punishment under the law for the financial institutions who infringes it.

Furthermore, the Act under section 29 empowers the Central Bank to spell out standards on *Shariah* matters. The Act states that, Islamic financial institution is required to comply with *Shariah* standards issued by the Central Bank in accordance with the advice of the *Shariah* Advisory Council. The requirement to abide by the standards issued by the Central Bank is also imposed on the directors of the financial institutions, the chief executive officer, senior officers and members of the *Shariah* Committee of the financial institutions. Again, the same penalty clause as the above is enforced for failure to comply with any standards specified, which shall be liable for imprisonment for a term not exceeding eight years or to a fine not exceeding twenty-five million ringgit or both.

Sharia compliance and *Sharia* governance provisions under the *Sharia* Advisory Council is among the latest features being made available under the IFSA 2013 which empower the authorities of *Sharia* Advisory Council itself as well as posing a more diverse practicality over the main aspects in Islamic financial institution while maintaining the status as the highest supervision power over the Islamic financial institutions in Malaysia.

3.9.5 Central Bank of Malaysia Act 2009

The Act was passed to provide for the continued existence of the Central Bank of Malaysia and for the administration, objects, functions and powers of the Bank, for consequential or incidental matters. The most significant provision of the newly passed legislation is Part VII under the

heading "Islamic financial business". Part VII is divided into 2 chapters i.e. Chapter 1 *Shariah* Advisory Council Section 51 to 58 and Chapter 2 Section 59 -60 Powers of the Bank. Part VII directly provides for the Islamic financial business which is defined under section 2 as any financial business in ringgit or other currency which is subject to the laws enforced by the Bank and consistent with the *Sharia*.

The *Sharia* Advisory Council on Islamic Finance shall be established by the Central Bank of Malaysia by virtue of section 51 and the Council shall be the authority for the ascertainment of Islamic law for the purposes of Islamic financial business. The Council is given authority to determine its own procedures in carrying out their duties under the Act. The functions of the *Shariah* Advisory Council are listed under section 52 and it includes the following:

(a) to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with Part VII of the Act.

(b) to advise the Bank on any *Shariah* issue relating to Islamic financial business, the activities or transactions of the Bank;

(c) to provide advice to any Islamic financial institution or any other person as may be provided under any written law in force in Malaysia; and

(d) such other functions as may be determined by the Bank.

The members of the *Sharia* Advisory Council shall be appointed from amongst persons who are qualified in the *Sharia* or who have knowledge or experience in the *Sharia* and in banking, finance, law or such other related disciplines and the appointment shall be made by the *Yang di-Pertuan Agong* on the advice of the Minister of Finance after consultation with the Central Bank as provided by section 53.

Section 55 further stipulates that the Bank shall consult the *Sharia* Advisory Council on any matter relating to Islamic financial business; and for the purpose of carrying out its functions or conducting its business or affairs under this Act or any other written law in accordance with the *Sharia,* which requires the ascertainment of Islamic law by the *Sharia* Advisory Council. In executing its duties and responsibilities, the *Sharia* Advisory Council shall examine and endorse the validity of application of *Sharia* in Islamic financial products which are submitted by Islamic financial institutions under the supervision of the Central Bank of Malaysia.

Section 55 (2) also provides that any Islamic financial institution in respect of its Islamic financial business, may refer for a ruling; or seek the advice, of the *Shariah* Advisory Council on the operations of its business in order to ascertain that it does not involve any element which is inconsistent with the *Shariah.*

The requirement for reference to *Shariah* Advisory Council for ruling from court or arbitrator is expressly provided in section 56 (1) which states that:

> Where in any proceedings relating to Islamic financial business before any court or arbitrator any question arises concerning a *Shariah* matter, the court or the arbitrator, as the case may be, shall
>
> (a) take into consideration any published rulings of the *Shariah* Advisory Council;
>
> Or
>
> (b) refer such question to the *Shariah* Advisory Council for its ruling.

The provision requires the judge or arbitrator who is presiding over any dispute arising from Islamic financial business to refer to the published rulings of the *Sharia* Advisory Council or to

request for advice from the Council to determine any issue concerning a *Sharia* matter before them.

Any request for advice or ruling of the *Sharia* Advisory Council under this Act or any other law shall be submitted to the secretariat which is established under section 54. In case of conflict between ruling issued by a *Sharia* committee of an Islamic financial institutions and ruling issued by the *Sharia* Advisory Council, the ruling of the *Sharia* Advisory Council shall prevail and be applicable.

In order to ensure that any deliberation of the *Sharia* Advisory Council will bind the courts and not only the financial institutions and the arbitrator as provided under the repealed Act, section 57 comes into play. It provides that any ruling made by the *Sharia* Advisory Council pursuant to a reference made under Chapter VII shall be binding on the Islamic financial institutions under section 55 and the court or arbitrator making a reference under section 56. The provision clearly states that any ruling made by the Council will be binding on the civil court and the arbitrator which means the court and the arbitrator must follow the ruling to arrive at their decision and the ruling shall form part of the judgment of the court in Islamic banking and finance cases.

The new legislation is intended to resolve the issues which have arisen before the coming into effect of the Act especially the legal effect of the rulings issued by the *Sharia* Advisory Council. However, there still exist certain issues which need to be addressed such as the issue of reasonability and equality and most important, public perception towards Islamic banking products and Islamic financial system itself.

In 2005, the Central Bank has prepared the Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institutions that regulates the governance of *Shariah* Committee of an Islamic financial institution. These Guidelines shall be applicable to all Islamic Financial institutions regulated and supervised by Malaysia Central Bank including the Islamic bank licensed under the Islamic Banking Act 1983 (IBA); financial institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) which participates in the Islamic Banking Scheme; development financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) which carries on Islamic Banking Scheme; and *takaful* operator registered under the Takaful Act 1984 (TA). The guidelines set the role, scope of duties and responsibilities of the *Shariah* Committee and its members and the relationship between the *Shariah* Committee of the respective Islamic financial institutions and the *Shariah* Advisory Board of the Central Bank.

The guideline has now been superseded by the *Shariah* Governance Framework for the Islamic Financial Institutions which was issued by the Central Bank in January 2011 which requires all Islamic financial institutions to comply with the framework within six months from the date of its issuance. The guidelines provides for the establishment of two-tier *Shariah* governance infrastructure comprising two vital components namely the *Sharia* Advisory Council at the Central Bank and an internal *Sharia* Committee formed in each respective Islamic financial institution.

The Framework requires that that the *Sharia* governance framework of an Islamic financial institution shall consist of the board oversight on *Sharia* compliance aspects of the Islamic financial institution's overall operation, a *Sharia* Committee, effective management

responsibilities in providing adequate resources in the implementation of *Sharia* governance, an internal *Sharia* review, a regular *Sharia* audit, a *Sharia* risk management process to identify all possible *Sharia* non-compliance risks, an internal *Sharia* research team as well as issuance and dissemination of *Sharia* decisions to the relevant stakeholders.

It is therefore important to point out that an Islamic financial institution is required to set out the accountability and responsibility of every key functionary involved in the implementation of *Sharia* governance framework. In this aspect the Board of Directors is ultimately responsible on the overall *Sharia* governance framework and *Sharia* compliance of the Islamic financial institutions and the board is expected to perform diligent oversight over the effective functioning of the *Sharia* governance framework. The *Sharia* Committee shall be responsible and accountable for all its decisions, views and opinions related to *Sharia* matters and the Board is expected to rely on the *Sharia* Committee on all *Shariah* decisions, views and opinions relating to the business of the Islamic financial institution. The *Sharia* Committee is expected to disclose sufficient information in the Islamic financial institution's annual financial report on the state of compliance of the institution. At the same time the management is entrusted with the responsibility for observing and implementing *Sharia* rulings and decisions made by the *Sharia* Advisory Council and the *Sharia* Committee. The management is under the duty to develop and adopt a holistic culture of *Sharia* compliance within the organisation.

3.9.5 Kuala Lumpur Regional Center for Arbitration Rules

The Kuala Lumpur Regional Centre for Arbitration has in 2007 set up the machinery for the arbitration of Islamic Financial Business disputes. This is in order to solve the problem of civil court jurisdiction over the Islamic commercial contract. It has published Guideline for such

arbitration.[83] The Rules are the Rules for Islamic Banking and Financial Services Arbitration 2007. It also provides a Model Arbitration clause which reads as follows:

> *Any dispute, controversy or claim arising from Islamic banking business ,Takaful Business, Islamic financial business, Islamic development financial business, Islamic capital market products or services or any other transaction orbusiness which is based on Shari'ah principles out of this agreement/contractshall be decided by arbitration in accordance with the Rules for Arbitration ofKuala Lumpur Regional Centre for Arbitration.*[84]

So there is a new formal infrastructure available for the settlement of disputes involving Islamic banking and finance matters by arbitration. There are few disputes that have already been submitted to arbitration under these Rules and it is hoped that more parties will avail themselves of this procedure. The Centre makes it possible to obtain rulings by Islamic finance experts conforming legally and substantively to the provisions of *Shari'ah*. Thus, KLRC will be enhanced to serve as a platform to deal with cases involving Islamic banking and finance and also to extend these services beyond Malaysia border.[85]There are 23 panelists for Islamic Banking Arbitration one of the panelists is from Singapore[86] The Centre makes it possible to obtain rulings by Islamic finance experts conforming (legally) and substantively) to the provisions of Islamic Law.

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[83] Jasri lamal and Nor Aziah Mohd and Kamal Halili, 'Alternative Dispute Resolution in Islamic Finance: Recent Development in Malaysia' [2011] (3) (1) *International Journal of Social Science and Humanity Studies* 194 available at < http://www.sobiad.org/ejournals/journal_ijss/arhieves/2011_1/jasri_jamal.pdf > Accessed 13 January, 2018

[84] Rule 1 paragraph 3 Rules for Islamic Banking and Financial Services Arbitration, 2007

[85] Jasri Jamal op cit

[86] Umar A. Oseni and Abu Umar Faruq Ahmad, 'Dispute resolution in Islamic Finance: A case Analysis of Malaysia,' 8th International Conference on Islamic Economics and Finance, p3 available at <http://www.oja.coj.go.th/doc/data/oja/oja_1461032068.pdf> access on the 15 January, 2018

CHAPTER FOUR

COMPARATIVE STUDY OF THE LAW AND PRACTICE ON ISLAMIC BANKING IN NIGERIA AND MALAYSIA

4.1 Introduction

This chapter will compare the laws and practice of Islamic Banking in Nigeria and Malaysia. Historical development of the regulatory framework will be dissected to examine how the laws evolved in the two climes. In Nigeria and Malaysia Islamic Banking was established through laws and guidelines and these laws and guidelines evolve with time and undergo several modifications and amendments. These laws and guidelines provide for the regulatory and supervisory bodies saddled with the responsibility of licensing and control of the Banks. The Central Bank of Nigeria regulates banking activities of both conventional and non interest bank or profit and loss sharing banks or Islamic banks under the same laws while in Malaysia Bank Negra Malysia regulates the activities of the banks both Islamic and Conventional under separate laws. In Malaysia even though Islamic Bank and Conventional banks have same regulatory body they operate on different laws.

4.2 Historical Development of Regulatory System in Nigeria and Malaysia

In Nigeria, modern Islamic Banking can be traced back to 1991 when Banks and Other Financial Institutions Decree (now Act) was promulgated. The Act paved way for the establishment of profit and loss sharing banks.[87] Section 23 of the Act recognised the establishment of bank based on profit and loss sharing. Section 63 of the Act recognised the establishment of interest free bank which comprised Islamic Bank. Consequences to the enactment of the Act, in 1992 two conventional banks were given provisional license to operate interest free banking. In 1999

[87] Olokoba Saka Muhammed, 'Taxation of Islamic Banking Products Under the Nigerian Law: Issues, Problems and Prospects' [2014] (4) (1) *Ilorin Journal of Religious Studies* 73

Habib Bank started interest free banking window. In 2005 CBN issued guide line and directive for the operation of non interest banking

More so, in June, 2011 CBN issued new guideline for the regulation and supervision of institutions offering non interest financial services in Nigeria.

The decision to establish Islamic banking in Malaysia was the result of the Muslim demands to have a sound banking and financial system which was in accordance with the *Sharia*. Before this, majority of the Muslims in Malaysia were utilizing the existing conventional banking products which are driven on making profit through interest. This was indeed the basic needs of the Muslims in this modern world whereby they require financial assistance to acquire homes, vehicles and also the expansion of businesses. Seeing the areas of possibilities to set up an Islamic banking system in the middle of the well established conventional atmosphere, Malaysian government has taken proactive effort in setting up an Islamic bank in Malaysia.

A steering committee then was formed by the government in 1981 to study the establishment of an Islamic bank in Malaysia. As a result, Islamic Banking Act 1983 was passed and Bank Islam Malaysia Berhad has been set up as the first Islamic bank in South East Asia. 10 years later, BNM introduced *Skim Perbankan Tanpa Faedah* (Interest-free Banking Scheme) for conventional banks to offer Islamic banking products through its windows and for that purpose, section 124 (7) of the Banking and Financial Institutions Act 1989 was introduced.

The development of Islamic banking industry in Malaysia involves several phases whereby Phase 1 started in 1983 until 1993 and Second Phases began in 1994. Malaysia is now in the midst of liberalising its policy on the implementation of Islamic banking so as to enable us to

lead the sector. This staggered development is facilitated and supported by legal infrastructure through several legislations and directives namely Islamic Banking Act 1983, Banking and Financial Institutions Act 1989, Central Banks Act 1958, other relevant statutory legislation, Bank Negara Malaysia (BNM) and Securities Commission's directives and also to the Court's structure.

4.3 Scope of the Regulatory Authorities in Nigeria and Malaysia

In Malaysia, separate Islamic legislation and banking regulations exists side-by-side with those of the conventional banking system. However, different legislation applied for the Islamic banks. In Malaysia, Islamic Financial Service Act, 2013 specifically applies to Islamic banks, and Financial Service Act, is an Act for conventional banks.[88] It differs from Nigeria, where both Islamic banks and conventional banks are using the same Act which is The Bank and other Financial Institutions Act 1999.

4.4 Role of *Sharia* Board in Nigeria and Malaysia

In Nigeria Islamic banking falls under the category of "specialized bank" recognised by the Bank and other Financial Institutions Act, 1989 on the main, non interest banking and financial models are broadly divided into

1. Non-interest banking and finance based on Islamic commercial jurisprudence; and

[88] Mohd Faisol Ibrahim, and others 'Comparative Analysis of Regulation and Supervision of Islamic Banking Between Malaysia and Gambia' [2017] (11) *Labuan e-Journal of Muamalat and Society*, available at <http://wwwkal.ums.edu.my/LJMS/index.php/current-issue?download=86:comparative-analysis-of-regulation-and-supervision-of-islamic-banking-between-malaysia-and-gambia> Accessed 27/3/2018.

2. Non-interest banking and finance based on any other established law on interest principle.[89]

The Central Bank of Nigeria had issued a guideline regulating the activities of interest free financial institutions which include Islamic Bank. The guideline provides for the establishment of the committee of experts who should be responsible for *Shariah* governance supervision. The committee was formally addressed as the Central Bank of Nigeria *Shariah* Council and was later changed to the CBN Council of Experts[90] to enable the CBN comply with section 39 (1) of the BOFIA. The Central Bank of Nigeria (CBN) had, as well, inaugurated Advisory Council of Experts on Islamic Banking and Finance in January, 2013. This council supervises all Islamic financial issues regulated by the CBN, Securities and Exchange Commission (SEC), Ministry of Finance and Capital Market.

In Nigeria CBN Council of Experts serves as the highest authority on *Sharia* -compliance matters and has been given the responsibility to scrutinize and endorse the rulings of individual Islamic bank's *Sharia* supervisory bodies. This is in order to promote harmonisation and uniformity of *Sharia* rulings, while allowing innovation by permitting individual banks to develop their own products based on the advice of their individual *Shariah* supervisory bodies.

Malaysia is ahead in terms of the *Shara* governance for the Islamic financial services industry. The Central Bank of Malaysia Act 1958 provides for the setting up of the *Sharia* Advisory Council which plays the role of a *Sharia* apex body. The Islamic Banking Act 1983 provide for the establishment of the institutional *Sharia* body at the Islamic banking industries. The body

[89]Sanusi, L. S.: 'Islamic Finance in Nigeria: Issues and Challenges', *Lecture delivered at Markfield Institute of Higher Education*, Leicester, UK, June 17, 2011 Pp. 6-7

[90] Article 9.1 CBN Guideline for the Regulation and Supervision of Institution Offering Non-Interest Financial Services in Nigeria 2011

will refer to the *Sharia* Advisory Council for its resolutions on a *Sharia* issue.[91] The Central Bank Act of Malysia 2009 also makes provisions regarding *Sharia* Advisory Council and provides for it functions as listed in section 52 of the Act as follows;

(a) to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with Part VII of the Act.

(b) to advise the Bank on any *Shariah* issue relating to Islamic financial business, the activities or transactions of the Bank;

(c) to provide advice to any Islamic financial institution or any other person as may be provided under any written law in force in Malaysia; and

(d) such other functions as may be determined by the Bank.

Members of the *Sharia* Advisory Council shall be appointed from amongst persons who are qualified in the *Sharia* or who have knowledge or experience in the *Sharia* and in banking, finance, law or such other related disciplines and the appointment shall be made by the Yang di-Pertuan Agong on the advice of the Minister of Finance after consultation with the Central Bank[92]

The requirement for reference to *Sharia* Advisory Council for ruling from court or arbitrator is expressly provided in section 56 (1) which states that:"Where in any proceedings relating to Islamic financial business before any court or arbitrator any question arises concerning a *Sharia* matter, the court or the arbitrator, as the case may be, shall

(a) take into consideration any published rulings of the *Shariah* Advisory Council;

Or

[91] Muhammad Zulkhibiri Abdulmajid and Reza Ghazali, 'Comparative Analysis of Islamic Banking Supervision and Regulation Development' p. 3 available at < http://jme.mbri.ac.ir/article-1-51-en.pdf> Accessed 26/3/2018

[92] Section 53 Central Bank of Malaysia Act 2009

(b) refer such question to the *Sharia* Advisory Council for its ruling."

The provision requires the judge or arbitrator who is presiding over any dispute arising from Islamic financial business to refer to the published rulings of the *Shariah* Advisory Council or to request for advice from the Council to determine any issue concerning a *Shariah* matter before them.

In order to ensure that any deliberation of the *Sharia* Advisory Council will bind the courts and not only the financial institutions and the arbitrator section 57 provides that any ruling made by the *Shariah* Advisory Council pursuant to a reference made under Chapter VII shall be binding on the Islamic financial institutions under section 55 and the court or arbitrator making a reference under section 56. The provision clearly states that any ruling made by the Council will be binding on the civil court and the arbitrator which means the court and the arbitrator must follow the ruling to arrive at their decision and the ruling shall form part of the judgment of the court in Islamic banking and finance cases.

In 2005, the Central Bank prepared the Guidelines on the Governance of *Shariah* Committee for the Islamic Financial Institution that regulates the governance of *Shariah* Committee of an Islamic financial institution. These Guidelines shall be applicable to all Islamic Financial institutions regulated and supervised by Malaysia Central Bank including the Islamic bank licensed under the Islamic Banking Act 1983 (IBA); financial institution licensed under the Banking and Financial Institutions Act 1989 (BAFIA) which participates in the Islamic Banking Scheme (BAFIA IBS bank); development financial institution prescribed under the Development Financial Institutions Act 2002 (DFIA) which carries on Islamic Banking Scheme; and *takaful* operator registered under the Takaful Act 1984 (TA). The guidelines set the role, scope of duties

and responsibilities of the *Shariah* Committee and its members and the relationship between the *Shariah* Committee of the respective Islamic financial institutions and the *Shariah* Advisory Board of the Central Bank.

The guideline has now been superseded by the *Shariah* Governance Framework for the Islamic Financial Institutions which was issued by the Central Bank in January 2011 which requires all Islamic financial institutions to comply with the framework within six months from the date of its issuance. The guidelines provides for the establishment of two-tier *Shariah* governance infrastructure comprising two vital components namely the *Sharia* Advisory Council at the Central Bank and an internal *Sharia* Committee formed in each respective Islamic financial institution.

The Framework requires that that the *Sharia* Governance Framework of an Islamic financial institution shall consist of the board oversight on *Sharia* compliance aspects of the Islamic financial institution's overall operation, a *Sharia* Committee, effective management responsibilities in providing adequate resources in the implementation of *Sharia* governance, an internal *Sharia* review, a regular *Sharia* audit, a *Sharia* risk management process to identify all possible *Sharia* non-compliance risks, an internal *Sharia* research team as well as issuance and dissemination of *Sharia* decisions to the relevant stakeholders.

It is therefore important to point out that an Islamic financial institution is required to set out the accountability and responsibility of every key functionary involved in the implementation of *Sharia* governance framework. In this aspect the Board of Directors is ultimately responsible on the overall *Sharia* governance framework and *Sharia* compliance of the Islamic financial institutions and the board is expected to perform diligent oversight over the effective functioning

of the *Sharia* governance framework. The *Sharia* Committee shall be responsible and accountable for all its decisions, views and opinions related to *Shariah* matters and the Board is expected to rely on the *Sharia* Committee on all *Shariah* decisions, views and opinions relating to the business of the Islamic financial institution. The Shariah Committee is expected to disclose sufficient information in the Islamic financial institution's annual financial report on the state of compliance of the institution. At the same time the management is entrusted with the responsibility for observing and implementing *Sharia* rulings and decisions made by the *Shariah* Advisory Council and the *Sharia* Committee. The management is under the duty to develop and adopt a holistic culture of *Sharia* compliance within the organisation.

4.6 Dispute Resolution Mechanism in Nigeria and Malaysia

The Constitution of the Federal Republic of Nigeria 1999 vested judicial powers in the various courts of the country.[93] The same constitution established the courts and confers on them the jurisdiction to entertain matters. Section 272 of the Constitution of the Federal Republic of Nigeria, 1999 established state High Courts and confer on it a very wide jurisdiction subject to section 251 (1) which deals with the exclusive jurisdiction of the Federal High Court. The decision of the Supreme Court in *Jamal Steel Structures vs ACB Ltd*[94] and *Bronik Motors Ltd vs Wema Bank*[95] resolved that Banking under Section 7 (1) (b) (iii) of the 1973 Federal High Court Act (now Section 25 (1) (d) of the Constitution of the Federal Republic of Nigeria 1999 did not include an ordinary Banker relationship.

[93] Section 6 Constitution of the Federal Republic of Nigeria 1999
[94] [1973] All N.L.R] 258
[95] [1983] 3 S.C 158

More so, the decision of the Supreme Court of Nigeria in *Nigeria Deposit Insurance Corporation v. Okem Enterprises Limited & Anor*[96] explicitly settled the jurisdictional problem between the Federal High Court and State High Court on banking matters which serves as a watershed in the dispute resolution of banking matters in Nigeria. In a unanimous judgment of the full court, the Supreme Court held that even though the Federal High Court generally has exclusive jurisdiction in banking matters, when the matter involves a transaction between banks however the in a matter between an individual customer and his or her bank, both the State High Court and Federal High Court have concurrent jurisdiction.

From the above, matters relating to banks, an Islamic bank inclusive is to be adjudicated by either the Federal High Court where the matter is between two banks or the State High Court where the matter is between a bank and a customer.

The difference between the State High Court and the federal High Court's Jurisdiction is that while the State High Court has jurisdiction to entertain disputes between individual customers and banks the Federal High Court has power to entertain disputes between banks or between banks and the Central bank of Nigeria.

The only superior court established by the constitution to entertain Islamic law matter is the *Sharia* Court of Appeal.[97] Its jurisdiction is appellate and the matters to be entertained are matters relating to Islamic personal law which include marriage contracted in accordance with the principle of Islamic law, divorce, guardianship of children and *waqaf* (charity or endowment)

[96] [2004] 10 NWLR pt 880 p 234
[97] Section 277 Constitution of the Federal Republic of Nigeria, 1999

established by the Muslim organisation,[98] succession or will where deceased or testator is a Muslim.[99] This is in addition to any other jurisdiction that could be added to the *Sharia* Court of Appeal by the state House Assembly.[100]

It is worthy to note that, the constitution has restricted the jurisdiction of the *Sharia* Court of Appeal to matters of Islamic personal law. These are issues of Islamic personal law. Similarly, the jurisdiction of the court over persons is restricted to only Muslims. That means the *Sharia* Court of Appeal does not have jurisdiction over non-Muslims except where non-Muslim consent to the jurisdiction of the court.

With the introduction of Islamic *Sharia* Law by some states in the Federation, the jurisdiction of the *Sharia* Court of Appeal was expanded by some of the states to include issues of Islamic law of crime and Islamic Banking Finance; both as a court of first instance and of appellate jurisdictions. In these states, the *Sharia* Court of Appeal has the jurisdiction to entertain matters of Islamic Banking and Finance. But the validity of the additional jurisdictions issued has not been tested before the Court of Appeal or the Supreme Court. It is however important to state that the Court of Appeal while interpreting the issue of additional jurisdiction to the *Sharia* Court of Appeal under Section 242(2) (e) the 1979 Constitution stated in the case of Ummara Fannami v Bukar Sarki[101] that the increment of the jurisdiction of the *Sharia* Court of Appeal must remain within the confines of issues relating to Islamic personal law. If this decision were to be extended to the 1999 Constitution, it will mean the *Sharia* Court of Appeal's additional jurisdiction does not extend to the issue of Islamic Banking.

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[98] Shafi'I Abdulazeez Bello and Norshahima Mohammad Yasin' 'Jurisdiction of Courts Over Islamic Banking in Nigeria and Malaysia'[(2015] (2) (3) *Journal of Islamic Law and Judiciary* 63
[99] Section 277 of the Constitution of the Federal Republic of Nigeria 1999
[100] Section 279 of the Constitution of the Federal Republic of Nigeria 1999
[101] [1961-1989] 1 Sh. L. R. N 194

Assuming that the State House of Assembly has the power to extend the jurisdiction of the *Sharia* Court of Appeal, still it will bring about another constitutional issue regarding the power of the Court of Appeal to entertain an appeal from *Sharia* Court of Appeal. This is because the Court of Appeal has power to entertain an appeal from *Sharia* Court of Appeal only on issues of Islamic personal law.[102] By implication the extension makes *Sharia* Court of Appeal the court of last resort on matters of Islamic Banking. Since Islamic banking does not fall within the domain of Islamic personal law, that means the Court of Appeal cannot entertain appeals relating to those issues. The appeal from the decisions of the *Shariah* Court of Appeal cannot, logically, rest in the Supreme Court because the constitution has clearly mentioned that the Supreme Court only entertains appeals from the Court of Appeal.[103]

Apart from the court, Alternative Dispute Resolution (ADR) is in place to arbitrate on commercial disputes. The relevant law which forms the legal basis of modern commercial arbitration and alternative dispute resolution mechanism in Nigeria is the Arbitration and Conciliation Act Cap A18 Laws of the Federation of Nigeria (2004) (ACA 2004).

The Act is described in its recital as:-

> "An Act to provide a unified legal framework for the fair and efficient settlement of commercial disputes by arbitration and conciliation; and to make applicable the Convention on the Recognition and Enforcement of Arbitral Awards (New York Convention) to any award made in Nigeria or in any contracting State arising out of international commercial arbitration".

[102] Section 244 Constitution of the Federal Republic of Nigeria 1999
[103] Section 233 (1) Constitution of the Federal Republic of Nigeria 1999

In view of the significance of ADR, some courts in Nigeria,[104] have established Multi-Door Courts (MDCs) system where any case that is brought before the High Court, the court will first refers the case to an ADR judge who is appointed by the Chief Judge of the State to oversee all ADR cases in the State. Similarly, parties can, on their own, apply before the MDC for their cases to be settled through ADR. In both situations, the terms of settlement will be endorsed by the court as a sealed order of the court, hence having the weight of a court decision.[105]

In Malaysia Islamic banking is under Federal List since it refers to as commercial dealings although it actually falls under the purview of Islamic law. Thus, it is within the jurisdiction of the parliament to pass any law governing the Islamic financial institutions.[106] However Islamic law matters are state issues according to the Federal Constitution and Islamic finance disputes are classified under the jurisdiction of the High Court. These explain the reason at the early stage of Islamic banking in Malaysia; matters pertaining to Islamic Banking were handled in Conventional manner by emphasising the civil and technical aspects, without tackling the issue of *Shari'ah* compliance.[107] However, as the Industry diversified its products, questions were raised with regard to their compliance to *Shari'ah* Law and courts were dragged into further examination of the practices of Islamic banking to rule on whether they were compliant or contrary to principles of Shari'a. A particular case of interest is the case of Arab-Malaysia v Taman Ihsan Jaya Sdn. Bhd. & Anor.[108] In that case, the Appeals Court in 2009 revoked the decision made by the High Court to announce that the contract of *Bay*

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[104] Hadiza D. S. Magaji, 'Promoting Alternative Dispute Resolution through Court Rules: The Borno State High Court (Civil Procedure) Rules in Perspective' p131 Available at <http://www.unimaid.edu.ng/oer/Journals-oer/Law/Private%20Law/11.pdf> accessed 12/5/2018.

[105] Order 17 Borno State (High Court Civil Procedure) Rules, 2012

[106] Zulkifili Hassan, 'The Effectiveness of Legal Framework of the Islamic Banking System in Malaysia'p.3 Available at <https://zulkiflihasan.files.wordpress.com/2008/07/the-effectiveness-of-legal-framework.pdf> Accessed 26/3/2018

[107] Aida Mata, 'Arbitration of Islamic Financial Dispute' [2014] (2) (1), *Annual Survey of International Comparative Law* 40-41 available at< http://digitalcommons.law.ggu.edu/annlsurvey/vol20/iss1/7> accessed 22/5/2018

[108] [2008] 5 MLJ 631

Bithaman Ajil (deferred payment sale) was null and void based on a religious compliance basis. The Appeals Court held that matters of Shari'a principles are not to be decided by civil court judges, but by Shari'a judges who are experts in Islamic law. This landmark decision contributed to the passing of the Central Bank of Malaysia Act in 2009 which established a central bank *Shari'ah* Advisory Council and provided that courts and arbitration tribunals shall refer to this council before giving any judgment concerning *Shari'ah* matters.

In 2003 the Malaysian judiciary established a *Muamalat* Bench for Islamic financial matters at the Kuala Lumpur High Court.[109] With the establishment of the *muamalat* bench all cases of Islamic finance can be instituted in one court i.e the *Muamalat* Bench of the Commercial Division.[110] The bench is specifically designated for Islamic financial matters. Usually judges appointed to sit on *muamalat* bench are those learnered in both Islamic financial service and conventional finance even though the judges are common law trained judges.[111] Despite the fact that the establishment of the *muamalat* bench is a welcome reform, however, the applicable procedural law in the court is adversarial and based on the English law of evidence.[112]

Apart from the court another mechanism for dispute resolution in Malaysia is through alternative dispute resolution. In this wise Kuala Lumpur Court Mediation Centre, Kuala Lumpur Regional Center for Arbitration KLRCA and Financial mediation bureau play important role.

The Kuala Lumpur Regional Centre for Arbitration (KLRCA) is a dispute resolution body established under the auspices of the Asian-African Legal Consultative Organisation (AALCO)

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[109] Practice Direction No. 1 of 2003
[110] Code 22A Practice Direction No. 1 of 2003
[111] Umar A. Oseni 'Dispute Resolution in the Islamic Finance Industry in Nigeria' [2015] (40) (3) *European Journal of Law and Economics* 552
[112] Ibid

in 1978.[113] It provides institutional support as well as a convenient venue for domestic and international arbitrations. It introduced the Rules for Arbitration of Kuala Lumpur Regional Centre for Arbitration (Islamic Banking and Financial Services) in 2007 to encourage the use of arbitration for disputes emanating from Islamic financial services. The Rules shall be applicable for the purposes of arbitrating any commercial contract, business arrangement or transaction which is based on *Shariah* principles.[114]

In August 2011 Kuala Lumpur Court Mediation Center was established to enhance access to justice and promote out of court settlement coordinated by judges.[115] The procedure used by the courts is that once a case is instituted at the high court, the case is referred to the Kuala Lumpur Court Mediation Centre for mediation. The center is akin to a multi door court house. When the parties settled the matter, it will be adopted by the court as a consent judgment but where there is no settlement by the parties, the matter is referred back to court for adjudication.[116]

[113] Umar A. Oseni and Abu Umar Faruk, 'Dispute Resolution in Islamic Finance: A Case Analysis of Malaysia' [2015] (4) *Ethics, Governance and Regulation in Islamic Finance* 130
[114] Rules 1 (3) Kuala Lumpur Regional Centre for Arbitration (Islamic Banking and Financial Services) 2007
[115] Ibid
[116] Ibid

CHAPTER FIVE

SUMMARY, OBSERVATIONS, RECOMMENDATIONS, CONTRIBUTION TO KNOWLEDGE, SUGGESTED AREAS FOR FURTHER RESEARCH AND CONCLUSION

5.1 Summary of Findings

Modern Islamic banking in Nigeria can be traced back to the year 1999 when the Bank and other Financial Institution Decree was promulgated

In early 80's Malaysia adopted the approach of gradually implementing a dual financial system of Islamic and conventional Banking system. Bank Negra Malaysia is empowered to regulate and supervise Islamic Banking operation in Malaysia. In 1983, Islamic banking Act comes into being in Malaysia. With the enactment of Islamic Banking Act, 1983, the first Islamic Bank in Malaysia that is Bank Islam Malaysia Berhad was established in 1983 which is a full fledge Islamic Commercial Bank set up in July, 1983.

In July 5, 1993 Bank Negra Malaysia issued three sets of guidelines one each for the Commercial Banks, Finance Companies and Merchant Banks. The scheme allowed commercial banks to offer banking products and services with the caveat that the funds for Islamic banking must be separated from other funds to avoid co-mingling of funds. In 1st October, 1999 a second Islamic Banking named Bank *Muamalat* Malaysia Berhad was established.

Islamic banking in Nigeria is established through a Guideline issue by the Central Bank of Nigeria in 2011 pursuant to the Bank and Other Financial Institution Act, 1999. The Guideline established, among other banks, a specialised bank. That specialised bank include Non-interest Bank otherwise known as Islamic Bank. Non-interest Bank and finance models according to the

CBN Guide are broadly categorised into two: the non-interest banking and finance based on Islamic commercial jurisprudence; and the Non-interest banking and finance based on any other established non-interest principle.

Islamic banking as one of the models of non-interest banking, has the same function as in the case of conventional banking of providing financial services except that Islamic banks operate in accordance with principles and rules of Islamic commercial jurisprudence that generally recognise profit and loss sharing and the prohibition of interest, as a model. The bank considers some transactions as non- permissible transactions. These include transactions that are not in conformity with Islam. It is also provided by the guideline that a license to undertake Islamic banking business operations may be issued by the CBN upon such terms and conditions which authorize the operation of a non-interest financial institution on a regional or national basis for banks, or any other basis for other financial institutions.[117]

The CBN also provide for the *Sharia* Advisory body to be called CBN Advisory Council of Experts to advise the CBN on matters relating to the effective regulation and supervision of Islamic Banking in Nigeria. However the qualification, duties, responsibilities of members of the Council are contained in guidelines to be issued by the CBN

Islamic banking in Malaysia has achieved a great feat. The achievements undergoes a gradual process were laws were made and amended to be in tune with the best practice of Islamic banking. The Central Bank Act of Malaysia 1958 play a vital role in the regulation, supervision and monitoring of the implementation of Islamic Banking in Malaysia. Section 16B of the Act provides *Sharia* Advisory Board for Islamic Financial Institution including Islamic Banks and

[117] Article 4.2 of the CBN Guideline 2011

the decision of the *Sharia* Advisory Board is binding on the court in case an Islamic Banking matter is taken to court and on an arbitrator in case the matter is taken to arbitration. The Islamic Banking Act of 1983 creates an Islamic Bank in Malaysia: Section 3 of the Act provides that Islamic Banking Business shall only be conducted by a company duly licensed by the Minister of Finance. Section 3 (5) provides that Bank Negra Malaysia or the minister shall not recommend the grant of a license unless he is satisfied that the aims and operation of the banking business will not involve any ingredient that goes contrary to Islam.

The Act itself was amended in 2003. The amendment mandated civil court to refer to SAC in any matter pertaining to Islamic Finance, the effect of which is that any deliberation by the SAC binds civil court and any of such decision should be followed by all Islamic Financial Institutions. The 2003 amendment was meant to provide a better position on the National *Shariah* Advisory Council whereby it uplifts the position of Islamic banking and finance in the country.

The Malaysian government took a further step in enhancing the framework of *Shariah* governance by passing the Central Bank of Malaysia Act 2009. This new legislation, unlike the Central Bank of Malaysia Act 1958, inserts new provision in which covers provision pertaining to Islamic financial business and enhances the framework of *Shariah* governance in Malaysia.

Malaysia is well advanced in terms of progress and development in the area of dispute resolution in Islamic Banking. The policy makers of the country assigned dedicated judges to deal with Islamic banking matters. In 2003 the Malaysian judiciary established a *Muamalat* Bench for Islamic financial matters at the Kuala Lumpur High Court. With the establishment of the muamalat bench all cases of Islamic finance can be instituted in one court i.e the *Muamalat*

Bench of the Commercial Division. The bench is specifically designated for Islamic financial matters. Usually judges appointed to sit on *muamalat* bench are those learnered in both Islamic financial service and conventional finance even though the judges are common law trained judges.

In terms of alternative dispute resolution the Kuala Lumpur Regional Center for Arbitration (KLRCA) and Financial Mediation Bureau are available to handle disputes on Islamic banking and finance. The procedure used by the courts is that once a case is instituted at the High Court, the case is referred to the Kuala Lumpur Court Mediation Centre for mediation. The center is akin to a Multi-door Court House. When the parties settle the matter, it will be adopted by the court as a consent judgment but where there is no settlement the matter is referred back to court for adjudication.

In Nigeria the High Courts and the Federal High Court were saddled with the jurisdiction to handle banking matters, Non-interest Banking inclusive. The High Court and the Federal High Courts are manned by judges that are not learnered in Islamic law and the applicable laws of the court are not Islamic. Therefore the matter that has to do with Islamic banking must be instituted at the Federal High Court or High Court of the state to be entertained by judges who does not have the knowledge of Islamic law and to apply for the purpose of adjudication civil law. There is no special legislation for Islamic Banking and there is a dearth of qualified Judges and Justices to handle Islamic Banking litigations in the Common law based superior courts of record as *Sharia* courts have no jurisdiction to handle banking matters.

5.2 Observations

From the research carried out on the topic the following have been observed

I. It is observed that In Nigeria there is no any specific law enacted to regulate Islamic Banking like the Islamic Banking Act 1983[118] of Malaysia (now Islamic Financial Services Act 2013). In Nigeria, Bank and other Financial Institution Act, 1989 is the key law regulating Islamic Banking which includes granting license to Islamic Banks. A careful perusal of the law reveals that no mention was made in the law of the term "Islamic Banking." In fact, the Act required the written consent of the Governor of the Central Bank for the use of some terms by prospective banks when applying for registration; such words include 'Islamic. The Central Bank in 2011 relying on this provision issued a circular which prohibit the use of the phrase "Islamic Bank" even though the name can be used with the consent of Central Bank Governor. In Nigeria, the Islamic Banking institutions and their activities operate under the control and supervision of the Central Bank of Nigeria and within the purview of the conventional laws and regulations to be enacted in the country from time to time.

II. The laws that regulate banking activities in Nigeria are the Central Bank Act and the Banks and other Financial Institution Act. these Act where not in any way mentioned Islamic rather it was a guideline issued by the Central Bank Governor pursuant to the powers conferred on him by the Central and Bank Act and Bank and other Financial Institution Act made mentioned of Islamic Banking and its modes of operation. Even

[118] Act Number 276 1983

though guideline was drafted pursuant to the law, the guideline is not a law it can be changed at anytime.

III. The guideline did not provide for the qualifications, duties, and the responsibilities of members of the CBN Advisory Council of Experts.

IV. It is also observed that adjudication of Islamic Banking issue in Nigeria is done in either High Court of a state or Federal High court depends on the nature of the case. And these courts are not manned by Muslim judges. Even where the judge of the court may happen to be a Muslim the law that applies to the court is not Islamic law and the judge may not be learned in Islamic law. The courts that have the power to adjudicate on Islamic law matters are the Area Courts, *Sharia* Courts by the amendments of Penal Codes in some northern States and the *Sharia* Court of Appeal. The power of these courts to adjudicate on Islamic law matters is restricted to only Islamic personal law which does not include Islamic law of transaction.

Recommendations

Based on the above observations the following recommendations were proffered;

I. It is recommended that the Nigerian Government should enact a distinct, independent, specific and comprehensive law to regulate Islamic Banking separate from the conventional Banking, like the Islamic financial service Act of Malaysia. In the alternative the existing laws should be amended to clearly include Islamic Banking. This is because the current law on Islamic Banking is weak for smooth running of the Islamic financial institutions in line with the objectives of *shariah*. Islamic Banking should not continue to operate under Central Bank of Nigeria Policies which can be easily changed.

II. It is recommended that guideline for the regulation and supervision of institutions offering non-interest financial services Islamic bank inclusive be replaced with a law because a law is more reliable than the guideline. Guideline may change at anytime but law has to undergo a very rigid procedure before it can be amended or repealed.

III. The qualifications, duties, and the responsibilities of members of the CBN Advisory Council of Experts should be clearly stated in the guideline or in the alternative a law should be enacted to provide the qualifications, duties, and the responsibilities of members of the CBN Advisory Council of Experts and their remuneration.

IV. The constitution has to be amended to confer jurisdiction to the *Sharia* Court of Appeal on Islamic Banking matters in the alternative State High Court should establish a Malaysian type of *Muamalat* Bench in the High Court and the Federal High Court to entertain Islamic Banking matter. Judges must have special training on deciding Islamic Banking matters.

5.4 Contribution to Knowledge

This research contributed to knowledge by making a comparative analysis of the regulation of Islamic Banking in Nigeria and Malaysia by exploring the regulatory frame work in the two different jurisdictions. In the research, regulatory authorities of Islamic Banking in Nigeria and Malaysia such as the Central Bank of Nigeria and Bank Negra Malaysia were examined. Most of the researches in Islamic Banking regulations on Nigeria and Malaysia were not comparative. In this research work the researcher tried analyse the Nigerian regulation of Islamic banking and compare it with the regulations in Malaysia.

The research contribute in the area of historical background of the regulatory framework of Islamic Banking in Nigeria and Malaysia, the scope of the regulatory framework and, most importantly, the role of the *Sharia* Board in Nigeria was also analyse.

The research also examined dispute resolution mechanisms in Nigeria and Malaysia where the role of courts and arbitrators in the resolution of Islamic Banking dispute was analysed. In this regard the research identifies lack of specific legislation on the resolution of issues regarding Islamic Banking in Nigeria and the lack of courts to adjudicate on Islamic Banking issues. The courts that entertain issues regarding conventional banking is the same court that entertain issues regarding Islamic Banking notwithstanding whether the judge is lernered in Islamic Banking or not.

Suggested Areas for Further Research

As the with most research works, it will be impossible to discuss exhaustively the regulation of Islamic banking in Nigeria and Malaysia rather the research was able to provide a brief analysis of the laws regulating Islamic Banking in Nigeria and Malaysia. The research could not enumerate extensively the regulations of Islamic Banking in Malaysia particularly the regulation pertaining *Sharia* Advisory Councils and its role in advising Islamic Banks as to compliance with the rules of Islamic jurisprudence in its activities. There is the need for further research on the role, duties, appointment and removal of a member of the *Sharia* Advisory Council with a view to compare same with what is obtainable in Nigeria.

The researcher also suggests that future research should also focus on adjudication of Islamic Banking matters in Nigeria and Malaysia; this is with the view to addressing the issue of adjudicating Islamic Banking by judges that are not qualified. Malaysia has in its High Court a

Muamalat Bench as a division of the High Court saddled with the responsibility of adjudicating Islamic Banking matters. However, *Muamalat* Bench is only located at the nation capital Kaula lumpur. It will go along way if a research can be made toward establishing a separate court that will adjudicate on Islamic law in each state in order to cater for the growth of Islamic banking.

Regulation plays important role in determining the growth of Islamic banking. Further research needs to be conducted to discover other factors that may influence the growth of Islamic banking in Nigeria with the view to make Islamic Bank vibrant in Nigeria.

Essentially, the research recommends the enactment of law that will properly cater for Islamic Banking separate from the law that regulates conventional banking

5.7 Conclusion

Wherever Muslims live they want to follow and obey the dictates of their religion in whatever they do. This is reflected in their commercial activities, hence the agitation for an Islamic financial system based on religion convictions. It was this increasing demand for Islamic finance that led to the proliferation of Islamic Banking in Muslims and non-Muslims countries, Nigeria and Malaysia inclusive.

Islamic Banking is a banking activities implemented in compliance with principles of Islamic law and practice. The main sources of these principles are the glorious *Quaran*, the *Hadith* i.e the tradition of the noble Prophet Muhammad (SAW), the consensus of opinion of Islamic scholars and the analogical deduction of reasoning of Islamic jurists.

The main principles of Islamic finance is the prohibition of usury (*riba*), prohibition of uncertainty (*gharar)*, and prohibition of speculation (*maysir*) in a transaction and these are the features of conventional banking. In Islamic banking, transactions and products are screened to ensure whether such products and transactions are Islamically permissible or not. Islam enjoined Muslims to engage and invest in business activities that are only permissible in Islam. It is worthy to note that the aim of *Sharia* in this regard is to promote 'ethical' investments that do not affect people and society adversely through the violation of religious prohibitions.

It is for the above mentioned reason that the regulatory authorities in Nigeria and Malaysia established *Shariah* Advisory Councils to screen and certify Islamic Banking products so as to determine whether the product complied with *Shariah* or not.

It is submitted that Islamic Banking can play a significant role in the economic development of Nigeria if adequate laws can be enacted to cater for the regulation and supervision of Islamic Banking holistically. In this regard the law should fully and effectively incorporate the Islamic Banking system into the Nigerian financial system. This will help in the eradication of poverty and creation employment.

This work a practical dispute resolution framework for Nigeria through best practices can be borrowed from Malaysia some unique mechanisms that have stood the test of time. For Nigeria which has to be able to attract foreign direct investment into its nascent Islamic finance industry requires a strong and versatile judicial system and dispute resolution mechanism that is efficient and responsive.

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