

A REVIEW OF LITERATURE ON THE CHALLENGES OF SHARIAH GOVERNANCE IN ISLAMIC BANKING IN NIGERIA

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ABSTRACT

Many studies have been conducted on challenges of Islamic banking. However, most studies are based on general studies of Islamic banking. This paper focuses on the literature on the institutional and operational challenges of Islamic Banking in Nigeria. The paper employs a doctrinal method of legal research by conducting qualitative content analysis of primary and secondary sources of materials. The study finds that there are many gaps on the literature which this research aims at proving the link in order to promote the growth of the industry. The paper concludes that a sound and effective literature on Shariah governance will give confidence to the general public about Shariah conformity of Islamic Banking in Nigeria.

Keywords: *legal framework, Islamic banking, Shariah governance, Shariah compliance, legal challenges*

INTRODUCTION

Shariah Governance is a tool to ensure Islamic Banks compliance with the Shariah (Ali, E.R.A.E., Odierno, H.S.P. & Ismail, A., 2015: 114-115; Alharbi, A., 2015: 12-25). Islamic Banks must have *de facto* compliance with Shariah in order to meet the objectives of Shariah (Ahmad, I.M., 2016: 216-235).¹ Complying with the principles of Shariah as enshrined in the Holy Quran

¹ Quran 6:162, Imam Ghazali contend that the objectives of Shariah is to promote the welfare of the people which lies in safeguarding their faith, life, intellect, prosperity and property.

and the *ḥadīth* is the essence and *raison d'être* of Islamic banking industry (Abdurahman, S. & Shittu, H., 2016: 26).² Shariah compliance is the most critical aspect of Islamic banking as banking practices cannot be legitimized as Islamic unless it comply with the rules and regulations defined by the Shariah.

Nigeria is the most populous country in Africa and the 8th most populous country in the world located on the West Coast of Africa and with a Muslim population of over 80 million which present a substantial and huge market for Islamic banking system (Daud et al., 2011: 14-15). Although the concept of Islamic banking in Nigeria can be traced back to 1990s (*Ibid.*), the practical implementation only started in 1991 (Yunusa, M. & Nordin, N.B., 2015: 79).³ Islamic banking industry in Nigeria has undergone remarkable growth since 1999⁴ due largely to the supportive policy environment provided by the government through the Central Bank of Nigeria (CBN). Since the introduction of the first Islamic banking window scheme by Habib Nigeria Bank Limited in 1992 and the establishment of the first full-fledged Islamic bank, Jaiz Bank International Plc., in 2011, Islamic banking industry continues to stage an impressive performance (Alkali, M.B., 2015: 146).

In order to promote Shariah Governance (SG) in Islamic banking system in Nigeria, the CBN took two major steps. First, the CBN issued Circular and guidelines on Framework for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria. The Guidelines include: Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria, 2011; Guidelines on the Governance of Advisory Committees of Experts for Non-Interest (Islamic) Financial Institutions in Nigeria, 2015; Guidelines on Non-Interest Window and Branch Operations of Conventional Bank and Other Financial Institutions, 2010; Guidelines for the Regulation and Supervision of Non-Interest (Islamic) Microfinance Banks In Nigeria, 2017; Circular on the Treatment of Hamish Al Jiddiyyah (Earnest Deposit), 2015; and Guidelines on Tax Implications of

² Islamic banking is financial intermediation based on Islamic law, it is guided and codified within the frame of Islamic law called *fiqh al-mu'āmalāt* (Islamic rules on transactions) by the Qur'an, the Sunnah (teachings and practises of Prophet Mohammed) including other secondary sources of Islamic law such as opinions collectively agreed among the scholars (*ijmā'*), Analogy (*qiyās*) and personal reasoning (*ijtihād*).

³ The rise of Islamic banking in Nigeria rooted in 1991 with the promulgation of Banks and Other Financial Institution Acts (BOFIA), which replaced the Banking Acts of 1969.

⁴ This is when the former Habib Nigeria Bank Limited started a non-interest banking window.

Non-Interest Banking In Nigeria, 2013.⁵ Second, The CBN established the Financial Regulation Advisory Committee of Experts (FRACE)⁶ and Advisory Committee of Experts (ACE) (Abikan A.I. & Ahmed I.B., 2017: 303-316)⁷ to ensure that Islamic banks products and services and the processes through which these products are generated comply with Shariah requirements and keep the gates of Shariah governance (Abikan A.I. & Ahmed I.B., 2017: 303-316).⁸

REVIEW OF LITERATURE

Many studies have been conducted on challenges of Islamic banking. However, most studies are based on general studies of Islamic banking. This paper focuses on the literature on the institutional and operational challenges of Islamic Banking in Nigeria.

On the legal framework of Islamic banking in Nigeria, Yasin, N. (2006) opined that Islamic banking system without the law is futile and meaningless. He argued that legal reforms are necessary and needed for the purpose of facilitating the smooth running and operation of Islamic banking system. Chapra, M.U. (2009) said that “All financial institutions and not just the commercial banks need to be properly regulated and supervised so that they remain healthy and do not become a source of systemic risk”. Obiyo, O.C. (2008: 227-234) noted that Nigeria needs to reframe her banking laws before Islamic banking can be successfully implemented in the country. Zubair, A. and Alaro, A.A. (2009) observed that the operation and activities of Islamic finance in a diverse country like Nigeria must face some unavoidable challenges such as legal challenges. Sanusi, L.S. (2011a: 5; 2011b: 1-5) observed that a distinct and comprehensive legal framework can assist the Islamic financial institutions to have a smooth running of their activities in line with the *maqāṣid al-sharī‘ah* (the objectives of Shariah). He observed that

⁵ The Guidelines are required to align with Banks and Other Financial Institutions Act (BOFIA), Companies and Allied Matters Act (CAMA), the Islamic Financial Services Board (IFSB) Guiding Principles and other international best practices on corporate governance.

⁶ FRACE is the central Shariah governing body established at the CBN level with the mandate of oversight function on Islamic banking in Nigeria. FRACE also advises other regulatory agencies in the Islamic banking industry in Nigeria.

⁷ ACE is established at the level of the Banks offering Islamic banking in Nigeria.

⁸ In Malaysia, the two organs are known as Shariah Advisory Council (SAC) and Shariah Advisory Board (SAB).

the challenges of Islamic banking in Nigeria are inadequate manpower, lack of Shariah - compliance liquidity management instruments, lack of Islamic insurance (*takāful*),⁹ lack of knowledge of accounting and auditing standard required by Islamic financial institutions, inadequate legal framework,¹⁰ lack of Shariah scholars knowledgeable in conventional economics, law, accounting, banking and finance which places severe constraints on the regulatory Shariah-compliance mechanism, problem of multiple taxation (Adeniran, L.M., 2014: 21-27),¹¹ lack of tax relief on Islamic profits (Gafoor, A.I. & Abdul, M., 1995),¹² and misperception of Islamic banking in Nigeria (Adeniran, L.M., 2014: 21-27).¹³

Buang, A. H. (2007: 317-340) opined that the challenges facing Islamic banking in Malaysia (just as in Nigeria) springs from the paucity of man power in the judiciary to handle Islamic banking litigations and the limited jurisdiction of the Shariah Court of Appeal to try cases related to it. Also,

⁹ Absence of Islamic insurance (*takāful*) and capital market to protect investments in Islamic banks against unforeseen hazards and smooth the progress of the growth of the industry respectively. Closely connected with this challenge is the lack of a deposit insurance scheme for the protection of depositors of Islamic banks.

¹⁰ Lack of robust and comprehensive legal framework., especially at the level of adjudication of conflicts involving Islamic finance contracts, products or entities.

¹¹ Double taxation that would be levied on Islamic banks as a result of stamp duties and capital gains tax that is deductible upon asset transfer, Islamic banks face a tremendous challenge in this respect because their financial intermediation is asset based. In home financing for example, the Islamic banks take possession of the asset either through sale or construction contract, and they pay stamp duty for that. When they resell the asset to a customer through a mark-up sale or a lease ending with ownership contract, another stamp duty is charged for the asset transfer. Other jurisdictions, including the UK and Luxembourg have modified their tax laws to exempt Islamic banks from double taxation on assets they acquire for financing purposes.

¹² Tax laws are against the Islamic philosophy and pose a great challenge.

¹³ There are lot of misconception about Islamic banking in Nigeria, and with the ethno religious diversity of Nigeria, it makes it imperative to create mass awareness and acceptance. This is in view of the fact that religion has become a volatile issue over the years. Misinterpretation of the concept might jeopardize its success. Lack of standard interpretation on various instruments by the various jurists. Currently, there is much confusion regarding which transactions that are allowed and which are not because of the different rulings by various boards. Islamic institutions elect their own religious board consisting of religious scholars from the various schools of opinion. Therefore, a transaction may be considered Islamic at one institution and may not be at another, hence causing confusion and incompatibility.

Taliep et al. (2010: 239) identified lack of legal framework and governance in implementing Islamic banking in South Africa. They observed that, though there is no legislation that caters for Islamic banking, the South Africa banking regulatory framework ensures a rigorous environment of finance accountability, transparency and legitimacy through the efforts of the regulatory organs on Islamic Banking and Finance (IBF).¹⁴

Chiroma, M. *et al.* (2016: 245-253) observed that Islamic banking practices since inception in Nigeria is dangling due to lack of suitable legal framework in place. He identified the need to have a specific and distinct regulatory framework for the Shariah governance, which can be independent and distinct from the current and shadow legal framework provided by the CBN Guidelines/Regulations (Yussof, 2011: 155). Malami, H.U. (1992: 308-316) said that the existing banking laws in many so called countries like Nigeria is mainly applicable to the interest based conventional banks constitute the most serious challenge to the operation of interest free banking. He opined that Islamic banking operations in Nigeria will largely be inhibited by a number of banking laws and regulatory directives such as companies Act, Banking Act, and Central Bank Ordinance. Abikan, I. A. (2012: 20-39) examined the legal provisions of the financial institutions and regulatory laws in Nigeria in order to determine their amenability, or otherwise to the principles and practices of Islamic banking in Nigeria. Nkwatoh, L.S. *et al.* (2014) observed that Nigerian courts are not sufficiently acquainted with the rationale of the operation of Islamic Banking especially at the level of disagreement adjudication involving Islamic financial contracts, products or entities.

Alkali, M.B. (2015: 141-166) discusses the legal atmosphere that will enhance the smooth operation of Islamic Banking and Finance for the benefit of the people in Nigeria. He identified the legally-based complaints against Islamic Banking and Finance in Nigeria and proffered legal solutions such as provision of statutory amendments, mass mobilization and scriptural legal provisions in order to remove religious bias against Islamic banking. Ali, S.S (2007: 1-52) attributed operational challenges to include weak enforcement mechanism, poor internal control, irresponsible management, insider trading and lack of competence. Olad, M.M. (2015)¹⁵ opined that the operations of Islamic banks are on a profit and loss share basis (PLS), which actually does

¹⁴ The regulatory organs on IBF in South Africa are South African Reserve Bank (SARB), Banking Association of South Africa and Financial Services Board (FSB).

¹⁵ For example, if there are disputes to be handled, civil courts are not sufficiently acquainted with the rationale of the operations of IIFSIs.

not come fully under the jurisdiction of the existing civil laws. Bello (2014: 25) holds that the operational challenges that may prevent the successful establishment and management of Islamic banking in Nigeria are religious and cultural differences, Shariah related issues, and inadequate awareness. According to Mohammed, B.Y. (2011: 10-11), the challenges are in the form of regulatory and supervisory aspect. He said bank operators on their part face operational challenges. Nkwatoh, L.S. and Mallum, A. (2014: 3) identified the institutional and operational challenges of Islamic banking in Nigeria. The institutional challenges include inappropriate legal framework, inadequate institutional framework, and absence of a secondary Islamic financial market and lack of tradable financial instruments.

The operational challenges include inadequate human resources/financial innovations, cash requirement/profit sharing challenges and competition with conventional banks. They found that these institutional and operational challenges retard the growth of Islamic banking in Nigeria. Iqbal, Z. and Mirakhor, A. (1987: 67) opined that the challenges hindering Islamic banking are institutional as well as operational. The institutional challenges are poor institutional framework, inadequate legal framework and supervisory policies, poor supervisory framework, disparity in accounting standard, lack of equity institutions, absence organized secondary financial market, and lack of short term market placement of funds. While the operational challenges are improper financial engineering, lack of teaching, training, research and development in this institution, lack of profit sharing finance, inability to adequately mobilize deposits, competition, and globalization.

On the need to create legal infrastructure conducive for the working of Islamic system, Abdullahi, N.A. (2016: 14) suggested an exclusive regulatory framework for Islamic banks and financial institution which will provide for regulatory treatment for various Islamic products. Abdurahman, S. and Shittu, H. (2016: 35) posit that the nature of the existing banking and company laws is a major challenge to Islamic banking in Nigeria. They found that the existing banking and company laws contain provisions that narrowly define and prohibit the scope of Islamic banking activities within conventional limits. They suggested a comprehensive review of the existing laws in such a manner that the laws regulating conventional banking will not be the same law that will regulate Islamic banking. They suggested that in order to suit the needs of Islamic banks, Nigeria policy makers will have to amend existing laws to be Shariah (Islamic Law) compliant, create special courts through which disputes regarding Islamic banking and finance can be settled and the modification of

existing company and banking laws in order to create a level playing field for Islamic banks.

CONCLUSION

Islamic banking is a non-conventional financial institution that mobilises financial resources into a profitable portfolio in an attempt to achieve pre-determined social and financial growth in line with the principles of Islamic commercial jurisprudence (Sani, H., 2016). There is no doubt that a sound economic system could only be achieved if there is effective legal framework that effectively spelt out the modus operandi of each and every unit of economic activities with a view to providing conducive environment for all to participate in the economic thrives. Effective legal framework is therefore a sine qua-non for the industrial take off, transformation and the eventual economic prosperity (*Ibid.*). The review have shown that legal framework of the financial institution does not contain a panacea to the emerging challenges that face the industry, which obviously pose a threat to the depositors' fund and those that want to carry on business in Nigeria (*Ibid.*).

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