

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

The most recent and significant development in the banking industry is the emergence of Islamic Banking System and Interest-Free Banks (IFBs) in Nigeria through the CBN guideline on noninterest banking. This is in response to the failure of the conventional interest based banking system to cater for the developmental needs of the country which also apply to other developing economies (Ahmed, 2000).

According to Adebayo (2010), many Muslims are not satisfied with the operation of the conventional interest-based banking system which is against the spirit of their religion and would have prefer a banking system within the Sharia governance framework. They are however incapacitated by the fear of exposing their money to risk of theft should they decide to keep their money at home, or the fact that their wages will be paid to them through the banks, or rather, some other unavoidable transactions with these conventional banks which do not operate in line with the dictate of Allah. Those who opted for current accounts with these banks still stand the risk of moving in the periphery of usurious transaction, as this product has percolated element of interest to customers as well.

The Central Bank of Nigeria recently joined other countries like Turkey, Jordan and Malaysia to come up with specific guidelines and regulations for the establishment of Islamic banks, with the difference that she (Nigeria) opted for non-interest banking just like Turkey which refers to it as "Special Finance House" and it's within the framework of Sharia governance. This gives a sign of relief to the Muslims who were not satisfied with the transaction of the conventional banks, following the replacement of the Banking Law in Nigeria (Banking Act of 1962) with the 1991 Banks and other Financial Institutions Decree (BOFID), which came with the necessary framework for the establishment of Profit and Loss Bank in Nigeria. On March 4, 2009, another Draft Framework for the Regulation and Supervision of Non-Interest Banks (NIBs) in Nigeria was publicised. The objective of the Sharia governance framework is to provide minimum standards for the operation of non-interest banking in Nigeria. Among the issues discussed in guideline include:-

- Meaning of non-interest bank
- Licensing requirements
- Models of non-interest banking
- Non-interest financial instruments
- Corporate Governance
- CBN Shariah Council
- Conduct of Business Standards
- Profit Sharing Investment Accounts,(PSIA)

The independence of the supervisory board in the mission of supervision and the consistency of Shariah ruling can contribute to an efficient Shariah governance framework. The confidence on part of the stakeholders in the product of the Islamic financial institutions generally and the Islamic bank in particular will be enhanced with the existence of an efficient Shariah governance framework. (Hamza, 2013).

The concept of Islamic Banking and Interest-Free Banking are synonymously used in Islamic Economics literature as an alternative banking framework to the interest-based conventional banking practice. Although in technical terms, there is a difference between an interest-free bank and an Islamic bank but they are sometimes used interchangeably. Ahsan (1988) defined an Islamic bank as “a financial and social institution whose objectives and operations as well as principles and practices must conform to the principles of *Shariah* and which avoid the use of interest in any of its operations. It stands for an alternative financial system based on Islamic ideals. It is not only a financier but also a partner in productive economic development”.

While stating the difference between Islamic Banking and Interest-Free Banking, Gusau (2000) argues that “Islamic banking system is supposed to operate completely within the *Shariah* in all its activities both in sourcing of funds and disbursement of the funds. It not only avoids interest in all its ramifications but also it avoids all other Islamically prohibited activities. Interest-free banking system on the other hand, does not engage in interest but there is no reason to suppose that all its other activities will be done strictly according to *Shariah*”.

From the above, three things have become clear, namely: Islamic Bank must;

- 1) Charge no interest
- 2) Conform to *Shariah* principles in all its operation
- 3) Promote Islamic ideals

Thus, it can be seen that interest-free operation is a necessary but not a sufficient condition for a bank to qualify as an Islamic Bank. In addition to non-interest charges, the bank must promote Islamic ideals. Therefore, Interest-Free Banking Window can be described as the provision of Interest-Free Banking services by conventional banks on the basis of profit and loss sharing (PLS) principles. It is an operational strategy adopted by conventional banks in which interest-based banking services are operated alongside Islamic banking services within the same banking hall, for the purpose of meeting increasing demand from customers, improve mobilizations of savings as well as benefit from the new vista of opportunity offered by Islamic banking system. It should be seen as an integral aspect of financial globalization which entails the integration of Islamic financial system with the Western Financial System to produce global financial system.

Jaiz Bank PLC was created out of the ashes of the former Jaiz International Plc which was set up in 2003/2004 as a special purpose vehicle (SPV) to establish Nigeria's first full-Pledged Non-Interest Bank. It is an unquoted public company owned by over 3000 shareholders spread over the six geographical zones of Nigeria.

1.2 STATEMENT OF THE PROBLEM

According to Mannan (1976) who states that Islamic banking is an interest-free financing system essentially based on profit and loss sharing. And its operations are in conformity with Shariah governance. It is therefore, the cornerstone of the Islamic Economic System which is by definition Interest-Free. Siddiqi (1983) conceived an Islamic bank as a financial intermediary mobilizing savings from the public on the basis of *Mudaraba* (profit and loss sharing contract) and advancing capital to entrepreneurs on the same basis. The bank shares the profits of the enterprise according to a mutually agreed percentage and shares these profits with depositors according to a percentage announced by the bank in advance. However, The researcher is out to assess the CBN guideline on non interest banking with a view to seeing its level of conformity with Islamic financial institutions. A juxtaposition of the guideline with the Islamic teachings will reveal some problems in the operation of the interest-

freebanking system shall also be considered

1.3 OBJECTIVES OF THE STUDY

The following are the objectives of this study:

1. To examine the impact of Sharia governance on CBN guidelines on non interest banking system.
2. To analyze the benefits of non interest banking system in Nigeria.
3. To identify the challenges of Islamic banking under the Sharia governance framework

1.4 RESEARCH QUESTIONS

1. What is the impact of Sharia governance on CBN guidelines on non interest banking system?
2. What are the benefits of non interest banking system in Nigeria?
3. What are the challenges of Islamic banking under the Sharia governance framework?

1.5 HYPOTHESIS

H_0 : Sharia governance does not have any impact on CBN guideline on non interest banking system.

H_A : Sharia governance does have any impact on CBN guideline on non interest banking system.

1.6 SIGNIFICANCE OF THE STUDY

This study has the following significance:

1. This study will educate the general public on the CBN guideline for non interest banking system which is within the Sharia governance framework. Also, it will enlighten stakeholders and the general public on the benefits of non interest banking system.
2. This research will also serve as a resource base to other scholars and researchers interested in carrying out further research in this field subsequently, if applied, it will go to an extent to provide new explanation to the topic.

1.7 SCOPE/LIMITATIONS OF THE STUDY

This study on the impact of Sharia governance on CBN guideline on non interest banking system will cover the overview of the CBN guideline for non interest banking, Sharia governance and the highlights of Islamic banking.

LIMITATION OF STUDY

Financial constraint- Insufficient fund tends to impede the efficiency of the researcher in sourcing for the relevant materials, literature or information and in the process of data collection (internet, questionnaire and interview).

Time constraint- The researcher will simultaneously engage in this study with other academic work. This consequently will cut down on the time devoted for the research work.

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