

REGULATORY REQUIREMENTS FOR ESTABLISHMENT AND OPERATION OF ISLAMIC BANKING SYSTEM: THE PROPOSED MODEL (PRINCIPAL REQUIREMENTS)

Muhibat Ayoni Oladimeji¹

Muhammad Ridhwan Ab. Aziz²

Khairil Faizal Khairi³

ABSTRACT

Purpose: The purpose of the study is to critically evaluate the regulatory and supervision of Nigerian Islamic banking system in terms of its establishment and operation. The study also proposes a model (principal requirements) as a way forward for the development and for the smooth running of the system.

Methodology: The study employs qualitative approach making use of both the in-depth field interview with regulatory officers, practitioners, academicians who are directly involved in the operations of Islamic banking system in two countries Malaysia and Nigeria. And secondary source inform of documentary review is also employed.

Findings: The study reveals that development of Islamic banking system in Nigeria is facing the following constraints: 1. Lack of government support, 2. Misconception about the concept of Islamic banking system, 3. Religion and ethnic sentiments. Although, a lot has been done by the CBN as the regulator from the findings of the study, but the desired results are yet to be seen. Finally, the study proposed a model of Islamic banking system in terms of requirements by a nation for the establishment and smooth running of the system.

Practical Implication/ Value of the Study: The study will have policy implication to the CBN and other stakeholders in the area of Islamic banking system. Findings of this study will be a source of reference for Nigeria and other countries in formulating the similar concept of Islamic banking system because it provides gap which needs to be filled in order to make the system a success. The research will also have

¹ Lecturer, Crescent University Abeokuta, Ogun State, Nigeria and currently PhD. Student, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM). Corresponding author: muhibat@yahoo.com

^{2,3} Senior Lecturers, Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM).

policy implications to international organizations such as IDB, World Bank, UN and IMF that have been championing the course of financial inclusion.

Keywords: Regulatory requirements, Establishment/operation, Islamic banking system, Proposed model, Principal requirements.

1. INTRODUCTION

The release of the framework for supervision and regulation of non-Interest financial institutions (NIFIs) in Nigeria is important in line with the Nigerian government's vision 20-20-20. Of which one of the cardinal issues contained in the document, is poverty eradication through financial inclusion. Islamic banking products and services and other Islamic finance instruments are expected to serve as a tool that can be used to achieve the Vision (Central Bank of Nigeria, CBN 2011a). As at first week of June, 2011, Jaiz International Bank and Stanbic IBTC have obtained licence to provide full-fledged regional bank and window of interest-free banking services respectively, later followed by Sterling bank. Finally, Jaiz bank commenced operation in January 2012 (Jaiz, 2012). Whilst the Islamic bank is a business and must be profit oriented, it must aim at promoting *Shariah*, Islamic values as well as protecting the needs of Islamic society as a whole, called balanced objective. Therefore, there is a need to learn from the experienced operator that has recorded significant success in the industry for more than three (3) decades such as Malaysia.

Although, in March 2009, the Central Bank of Nigeria (CBN) issued the draft framework for the regulation and supervision of non-interest banks in Nigeria for comments and suggestions by stakeholders. In August 2010, The CBN also released the new banking model which designated non-interest banks among the specialized banks. Finally, In January 2011, the CBN released the Framework for the regulation and supervision of non-interest banking as well as two other guidelines. But the framework's objective is to provide minimum standards for non-interest (Islamic) banking operation in Nigeria this suggests that this is just a step, a lot needs to be done. For instance, according to Dogarawa (2012, p7) Islamic banking has a lot of economic benefits to the Nigerian economy such as fund mobilisation, a means of achieving financial inclusion, employment generation, and exchange of expertise among other things. But for these economic benefits to be actualised, Central Bank of Nigeria (CBN) and bank operators respectively need to address the regulatory and operational challenges that usually follow the introduction of Islamic banking into conventional financial system, thus, the argument for the current study. Therefore, the purpose of the study are to examine the regulatory and supervisory roles needed to be provided by the Central bank of Nigeria regarding establishment and operation of Islamic banking system and to provide useful suggestions on how

Nigerian regulatory authority can regulate and supervise based on Malaysian experience for the development and growth of the system in the country.

Based on the available literature to current researcher, this study will be one of its kinds in the area of investigating Islamic banking system of the country in terms of its regulatory and supervisory practices. Thus, the study tries to provide detailed insights into establishment and smooth running of Islamic banking system. in terms of regulatory and supervisory roles of the apex banks. Therefore, the study will have policy implication to the CBN and other stakeholders in the area of Islamic banking system. Findings of this study will be a source of reference for Nigeria and other countries in formulating the similar concept of Islamic banking system. The research will also have policy implications to international organizations such as Islamic Development Bank (IDB), World Bank, United Nations (UN) and International Monetary Fund (IMF) that have been championing the course of financial inclusion. The study will also add to the pool of available literature available on the subject matter. This paper is structured as follows: it consists of four sections, in section is the introduction and rationale for the study. Section two discusses research methodology applied by the study. Findings of the study in terms of preliminary findings and the principal requirements of the proposed model of Islamic banking system are presented in section three. Section four concludes.

2. RESEARCH METHODOLOGY

The study employed qualitative research method which consists of personal/ face-to-face in-depth-interview with regulatory officers, practitioners, academicians who are directly involved in the operations of Islamic banking system in two countries Malaysia and Nigeria using a written semi-structured interview questions and the study also employs library work inform of documentary review. Electronic recording devices audio and video camera are used and the voices from the recording devices are transcribed. A total number of twenty-two (22) respondents (from Malaysia and Nigeria) are voluntarily participated in the study. The information generated from the face to face in-depth semi-structure interview conducted with the aim of obtaining primary data for the study was transcribed and analyzed.

3. FINDINGS OF THE STUDY

3.1. PRELIMINARY FINDINGS

From the findings of this study, in terms of basic minimum things, most, but not all of the situations regarding general regulation and supervision in Nigeria are in line with footsteps of Malaysia.. The findings of this study revealed that development of Islamic banking system in Nigeria is facing the following constraints: 1. Lack of government support, 2. Misconception about the concept of Islamic banking system,

3. Religion and ethnic sentiments. And these three constraints have been hindering the progress and development of Islamic banking system. Although, a lot has been done by the central bank of Nigeria as the regulator from the findings of the study, but the desired results are yet to be seen. The operators are still waiting eagerly for the required and satisfied level of achievements or results from the efforts of CBN in addressing all the challenges. From the findings of the study, the study proposed a model in terms of requirements by a nation for the establishment, success and growth of Islamic banking system. The principal requirements part of the proposed model hereby discussed below. The remaining parts of the proposed model are beyond the scope of this paper.

3.2. THE WAY FORWARD: PROPOSED MODEL OF ISLAMIC BANKING SYSTEM: PRINCIPAL REQUIREMENTS

This section provides suggestions on how Nigerian regulatory authority can regulate and supervise Islamic banking system of the country based on suggestions made by the respondents and Malaysian experience. It describes what the study terms as principal requirements if a nation wants to establish Islamic banking system. There are two principal requirements as formulated by the study, they are: comprehensive legal and regulatory framework for Islamic financial system, and public awareness and education project. Model of Islamic banking system can be defined as the necessary machineries and step by step a nation must follow in the course of establishing Islamic banking system in the country. Figure 1 below depicts what the study termed as the principal requirement under the proposed models of Islamic banking system. . This model is majorly based on Malaysian experienced with some modification; certain experiences of other countries like USA, UK, and Indonesia are also incorporated in developing this model. The model makes use of the following: 1. responses of the respondents for the study, and 2. literature reviewed.

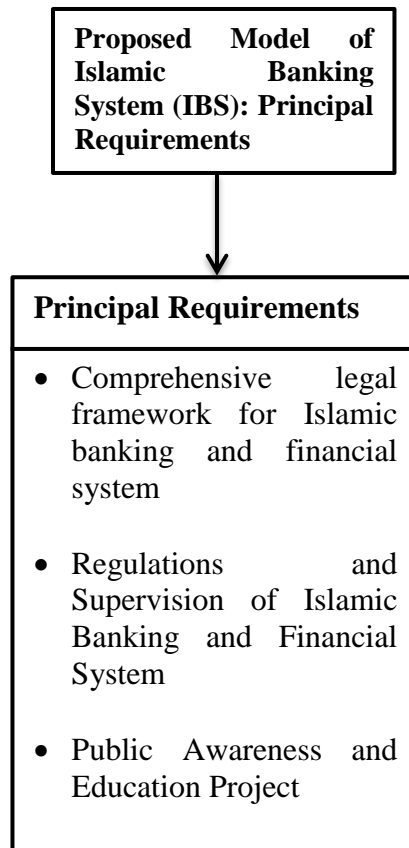
3.2.1. The Principal Requirements

From the responses of respondents R1, R2, R6, R8, R10, R11, R14, R16, R17, R19, R20, R21, R22 more than half of the total number of the respondents are of the same opinion that effective legal and regulatory framework, and publicity campaign (public awareness and education) are the first priority in establishing and operating Islamic banking system. The detailed on this is discussed and depicted in figure1 below.

Comprehensive Regulatory and Legal Framework for Islamic Banking System

Comprehensive regulatory and legal framework for Islamic banking system is classified as the first principal requirement for the establishment and operation of effective and efficient Islamic banking system. And this can be classified into two: 1. Comprehensive legal framework and 2. Comprehensive regulations and supervision framework. In formulating comprehensive and legal framework, the country must bear it in

FIGURE 1: Proposed Model of Islamic Banking System (IBS): Principal Requirements



Source: Researcher (current study)

mind that the system requires government commitment and positive intervention on a continuous basis. Because this is the key element for the successful story of the system in other countries that have established the system before such as Malaysia, Sudan, even United Kingdom (UK) among others. For these requirements the following arms of the government must be involved: Central Bank (CB) of the country will be the major coordinator; Federal Ministry of Finance (FMF); Presidential Office (PO); Debt Management Office (DMO); Taxation authority that is Federal Inland Revenue Service (FIRS); Security Exchange Commission (SEC); National Insurance Commission (NAICOM); National or Nigeria Deposit Insurance Corporation (NDIC); Corporate Exchange Commission (CAC); National Pension Commission (PenCom); Nigeria Accounting Standard Board (NASB); Judiciary Body; Educational Institutions (especially tertiary institutions); and Researchers.

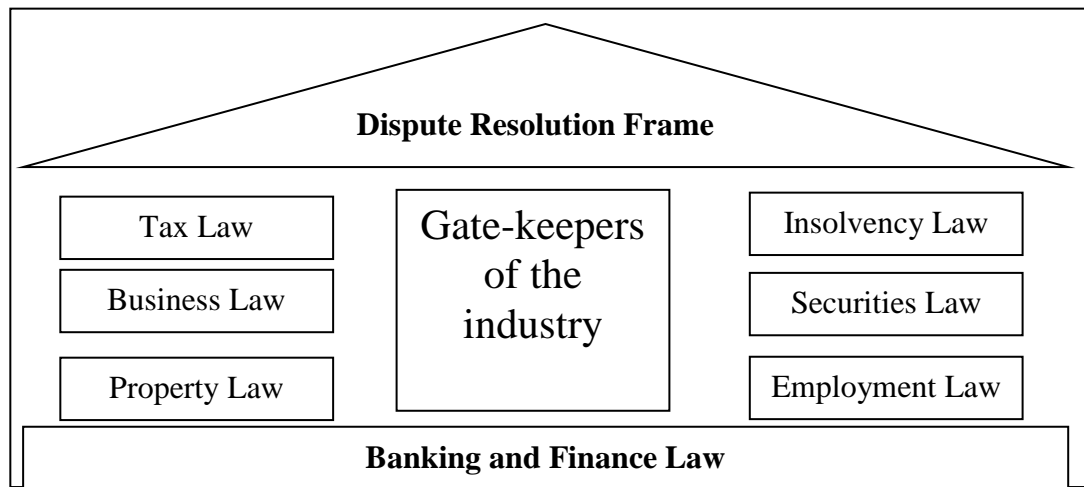
3.2.1.1. Comprehensive legal framework for Islamic banking and financial system

An effective and efficient legal framework for Islamic banking and financial institutions should consist of both an effective and efficient legal system and *shariah* principles in order to create confidence among investors and the public at large. Therefore an effective legal framework should allow and facilitate efficient formation and movement of capital, and fair and efficient operation of markets. Also it should promote the stability of capital markets. In other word such a framework will protect investors, be fair, efficient and transparent, and reduces system risk. For a legal framework to be “comprehensive” and “effective”, naturally it will have the following numerous components as depicted in figure 2 below. Therefore, Islamic finance needs a legal “framework” not only in the form of contract law that recognizes and enforces Islamic financial contracts, but also other law components that are aligned or harmonized with its business model. Among others, these include the following: ISRA (2013, pp. 750-751):

1. Banking and finance law that provides for the licensing, regulation and supervision of Islamic finance business by a credible financial authority;
2. Tax law that provides for some incentives to undertake financing in a shariah-compliant manner or at least neutrality in tax treatment when it comes to Islamic finance documentation and process-flow;
3. Business law that permits an Islamic Financial Institutions (IFI), notwithstanding its fundamental roles as a financial intermediary, to participate in real economic activities such as trading of assets or properties and investment activities, which conventional financial institutions are generally prohibited to undertake;
4. Property law that empowers an IFI to hold properties as assets or receive properties as collaterals;
5. Insolvency law that enables IFIs to enforce their claims against debtors and defend themselves against creditors, as the case may be;

6. Securities law that allows parties to offer or take capital market instruments that are shariah-compliant;

FIGURE .2: Components of a Legal Framework for Islamic Finance



Source: International Shariah Research Academy for Islamic Finance (ISRA) (2013).

7. Employment law that accommodates and facilitates the flow of international talents to meet the industry's demand for highly qualified human capital; and
8. A dispute resolution framework that is well equipped with lawyers, judges and other experts who are competent and knowledgeable in Islamic finance.

Approaches towards the Legal Framework for Islamic Finance

Legal foundation can be informed of formulating new Act for the system or creating some sections in the existing Act to allow the operation of the system. According to ISRA (2013) a nation that wants to establish Islamic financial system is at liberty to choose any of the three approaches towards the legal framework for Islamic banking and financial system as listed in the table 1 below. Any of these three ways can be used but most important is that it must be supported with all the necessary regulatory frameworks, guidelines and circulars.

Table 1: Approaches adopted by Different Countries in relation to their Legal Framework for Islamic Finance

	Approach to Legal Framework	Countries (In alphabetical order)
1	Apply the same existing legal framework (as for conventional finance) to Islamic finance.	Algeria, Australia, Canada, China, Egypt, Germany, Maldives, Saudi Arabia, Singapore, South Africa, Switzerland, Nigeria, Russia, UK, US.
2	Adapt or amend the existing legal framework, mainly through subsidiary legislation or insertion of provisions under existing laws – taking into consideration the specificities of Islamic finance, to accommodate this new area of finance.	Bangladesh, Bahrain, Djibouti, Jordan, Mauritius, Pakistan, Palestine, Qatar, Sri Lanka, Turkey.
3	Create a totally new and separate legal framework, tailored specifically for Islamic finance.	Afghanistan, Brunei, Gambia, Indonesia, Iran, Kuwait, Kazakhstan, Kyrgyz, Lebanon, Malaysia, Philippines, Sudan, Syria, Thailand, Tunisia, UAE, Yemen.

Source: Adapted and summarized from Thani & Othman (2008), updated June 2010. Cited by International Shariah Research Academy for Islamic Finance (ISRA) (2013).

3.2.1.2. Regulations and Supervision of Islamic Banking and Financial System

Under Islamic finance system, the regulatory authority such as CBN is expected to play a dual role. First, is to provide prudential supervision especially in the areas of moral hazard considerations, safeguarding the interests of demand depositors and systematic considerations. The second role is to ensure that banks offering Islamic financial products are strictly complying with *Shariah* in their operations and reporting procedure. In terms of regulatory, it needs to be stressed that under an Islamic banking system, the role and operations of the apex bank will be multi-dimensional and complex than the traditional banking system (INCEIF, 2006b) in (Daud *et. al.*, 2011). In order to reduce risks to the soundness of the banking system and enhance bank's role as active players in the development of the economy, effective prudential supervision is just as necessary and desirable in an Islamic banking framework as in conventional banking. Discussion on UK experience regarding Islamic banking system is presented below.

Regulations and Supervision of Islamic Banking and Financial Institutions United Kingdom (UK) Experience

In regulating Islamic financial institutions (IFIs) in the United Kingdom (UK), both the bank of England (BOE) which is the central bank of the UK sometimes known as the “Old Lady” of Threadneedle Street and the Financial Services Authority (FSA) were involved in the establishment of the first shari’ah-compliant retail bank in Europe, the Islamic Bank of Britain, in 2004. The BOE gives full support in giving Muslims and other interested in alternative investment products based on faith principles access to such products – provided they do not clash with the general principles of UK banking and provisions. This coincided with the financial and social inclusion policies of the Labour government of Tony Blair and his then Chancellor, Gordon Brown. Most importantly, the BOE established the Islamic Finance Advisory Group (IFAG) under the leadership of Andrew Buxton, the former CEO of Barclays Bank and the then adviser to Barclays. The IFAG, with the help of entities such as Norton Rose, which did much of the work pro bono, did all the research and explanatory reports that paved the way for much of the recent legislation. Especially in dealing with tax neutrality with the Islamic products such as sukuk murabahah and home-financing products, such as those dealing with the abolition of double stamp duty and risk weighting for Islamic mortgages.

Today, the UK has twenty-two banks that offer Islamic financial products, including five that are fully shari’ah-compliant; twenty sukuk issues raising US\$11 billion listed on London Stock Exchange; seven Shari’ah-compliant exchange-traded funds (ETFs); twenty law firms supplying services in Islamic finance; advisory services provided by the Big Four professional service firms; and several institutions offering educational and training products in Islamic finance. London has particularly become the premier centre for commodity murabahah transactions through contracts traded on the LME. Similarly, efforts elsewhere are underway to create an attractive environmental and regulatory framework for the promotion, distribution and trading of Shari’ah – compliance products in secondary markets ISRA (2013, pp. 661-662).

The legal foundation and the necessary regulatory frameworks and guidelines of a country regarding Islamic banking system should be developed in such a way that they will be able to do the followings:

- To empower the Central Bank (CB) of the country to issue license for the operation of Islamic banking; to establish Shariah Advisory Council for the country to be based at central bank; and also to issue Islamic treasury bill and other Islamic liquidity instruments. In addition, to lower liquidity reserve and statutory requirements for Islamic banks.
- To empower Debt Management Office (DMO) to advise federal government and state government to issue supreme Islamic bond (sukuk), to work with central bank and others to issue sukuk,

Islamic treasury bill, and other Islamic liquidity instruments, and to develop secondary market for these instruments.

- To empower the federal government to issue supreme sukuk and other Islamic financial instruments and to develop secondary market for these instruments for the operations of Islamic banks and other financial institutions.
- To empower the taxation authority that is Federal Inland Revenue Service (FIRS) to provide enabling and level playing ground for Islamic financial transactions and services equal to that of conventional financial transactions and services e.g. stamp duty, VAT and other taxes. And also to facilitate and provide ways to encourage investors (local and foreign) in the area of Islamic banks and financial institutions such as tax incentive.
- To empower Security Exchange Commission (SEC) to license institutions under capital market for the operation of Islamic capital market and to develop framework for the operations.
- To empower National Insurance Commission (NAICOM) to issue license to institutions for the operation of Islamic insurance (Takaful) and to develop framework for its operations.
- To empower National or Nigeria Deposit Insurance Corporation (NDIC) to provide shariah-compliance (Islamic) products for Islamic banks.
- To empower Federal Ministry of Finance (FMF) to provide necessary infrastructure and facilities for the operations of Islamic banking and financial system.
- To empower Presidential Office (PO) to provide all the necessary supports for the operations of Islamic banking and financial system in the country.
- To empower Corporate Exchange Commission (CAC) to recognize in form of registration by allowing auxiliary service providers and complimentary institutions to operation for the development of the industry.
- To empower National Pension Commission (PenCom) to recognize, participate, and involve in the services provided by Islamic banking system.
- To empower Judiciary Body to provide necessary supports in terms of required legal or laws and court services needed for the development of the system.
- To empower Nigeria Accounting Standard Board (NASB) to provide the necessary supports in terms of recording and accounting for the operations and development of Islamic banking system.
- To encourage all the educational institutions (especially tertiary institutions) in the country to consider and offer courses and programs in the area of Islamic financial system. To encourage researchers and research institutes to direct their researches towards Islamic financial system. Also to encourage individual in country to consider and go for courses and programs relating to Islamic finance.

Beware and take caution

According to ISRA (2013 p.754): An Islamic finance law could be tabled before a legislative assembly that is totally ignorant of Islamic finance, passed on and then expected to be implemented by an executive body that does not have adequate training and skills in Islamic finance, resulting in it triggering a dispute later on that lands it in a court of judiciary, presided over by a judge who is not equipped with any knowledge of Islamic law and jurisprudence. A situation such as this would certainly be disastrous. Therefore, there is a need for the relevant authorities, especially the central bank or monetary authorities, to ensure that specific awareness and enlightenment programs are afforded to the members of the legislative, executive and judiciary branches to gain at least some basic understanding of Islamic finance, before an Islamic finance law or legal framework is adopted. Continuing training and education programs need to be crafted, especially for relevant members of the executive body and judiciary who are more likely to deal with Islamic finance issues on a frequent basis. In support of this below is discussion on public awareness and education project.

3.2.1.3. **Public Awareness and Education Project**

Despite of all the wonderful performance of Islamic banking institutions around the world, the initiative of Nigerian Central Bank to accept non-interest banking system under its supervision has been so far witness mixed reaction from both Muslims and Non-Muslims, especially from Christians. For example in *A Nigerian National Newspaper, The Inside Edge issue of 29th June 2011, p.2*, “The initiative has also met with religious controversy. The prominent Anglican Bishop of Enugu, Reverend Emmanuel Chukwuma told media that ‘a religious bank would pose a serious threat to the unity of the country, and that his church opposed the move due to its religious connotations’ ”. According to Sanusi (2011), “there is a lot of misperception about Islamic banking in Nigeria”. This may be due to ignorant about the system, or lack of awareness. The most important about this issue is educating and understanding, the Nigerians need deep knowledge of the system through public awareness and education. In support of this, Jaiz Bank Plc, Chairman, Board of Directors, Alhaji Umaru Mutallab, (the former chairman of First Bank Plc) 2013, said “I am confident that as we (Jaiz Bank Plc) continue to expand and ***create the much needed knowledge and awareness of Islamic finance***, people will begin to understand and accept it *nigeriapoliticsonline* Nov. 2013.

According to Enhancing Financial Innovation & Access (EFInA) (2013) lack of awareness is reported as a barrier to using non-interest banking products. As depicted in figure 3 the pie chart below 38.3% of the adult population are not aware while 19.9% are ignorant about the system this implies that almost three quarter 3/4 of the adult population are either not aware or ignorant. In essence this is a clear evidence to prove that non-interest (Islamic) banking in Nigeria needs an effective and efficient public awareness and

education programs in a continuous basis. Therefore, the second principal requirement is the creation of a body; it could be a consultancy firm which will be responsible for: 1. Creation of public awareness, 2. educating the public and 3. Enlighten the public regarding misconception about the system. The current study proposed a consultancy firm to do this project for two reasons:

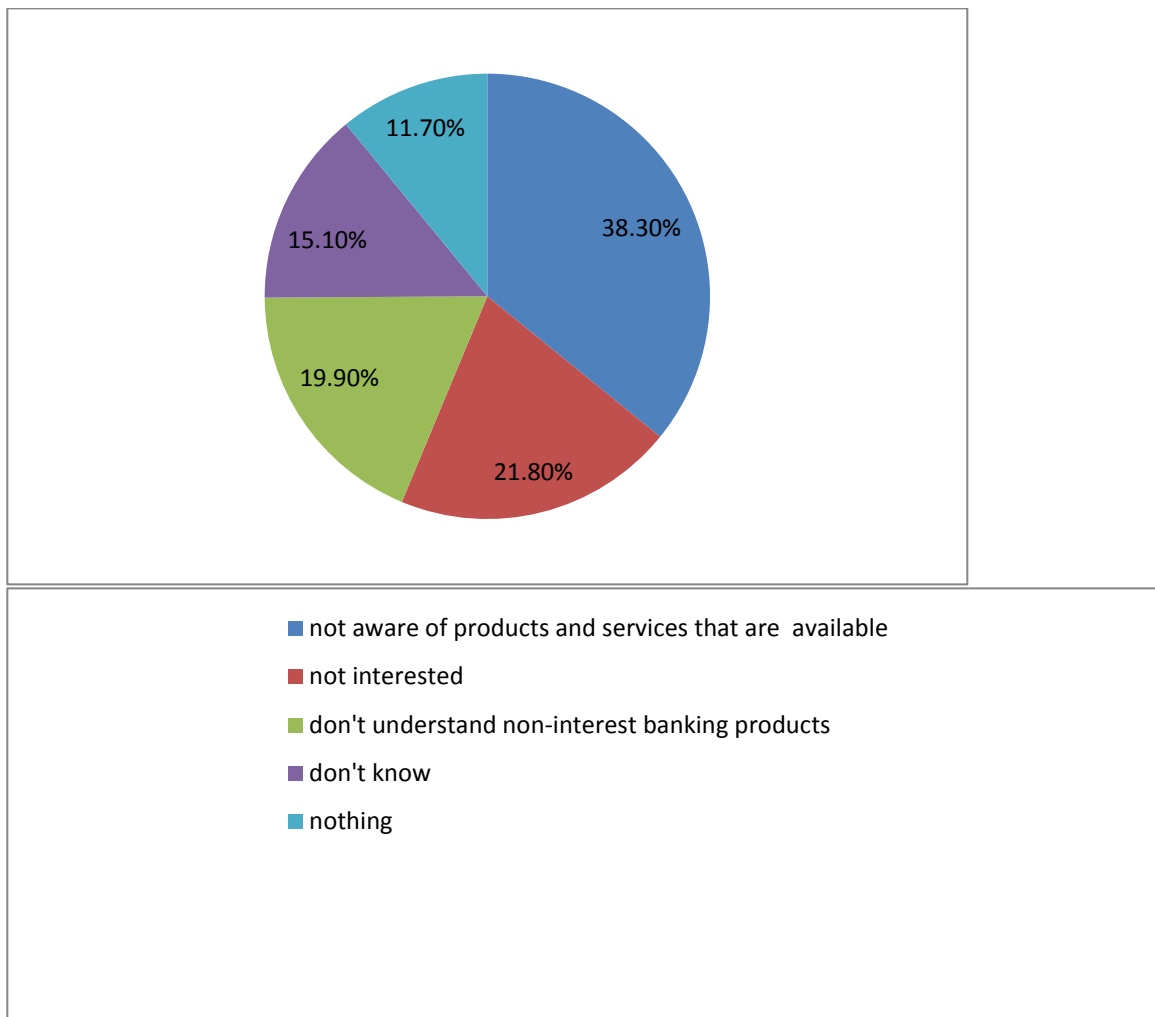
1. Especially in a country that is a multi-religion like Nigeria, it would be better to use an external consultancy firm reason being that if any regulatory agency is doing this it would be like favoring one religion above another/others. But the project will be sponsored by the regulatory authorities, Islamic banks and other Islamic financial institutions, Islamic societies, corporations, individuals in the society etc. For example, since the central bank of Nigeria (CBN) unveiled plans to introduce Islamic banking services in the country Islamic banking has been a hot issue. Christian groups have strongly opposed the move, the governor of CBN Mallam Sanusi Lamido Sanusi was accusing by these groups of favoring on religion above another. To extent that the umbrella Christian Association of Nigeria (CAN) threatened a legal action unless the CBN withdraws its license to Jaiz to launch Islamic banking services, OnIslam.net. February 2, 2012.
2. The second reason is that the external firm will be richer and well equipped in terms of research, materials, resources, and other facilities required for the successfully implementation of the project.

i. Why this Project is classified as the Second Principal Requirement

This project is very important in a country with multi-religions like Nigeria, made mentioned of Islamic in banking and financial system of such a country will be viewed by some people (especially the other religions in the country) like the country will now be for one religion (Islam) only. Although, it is cleared that the opportunities abound for the growth and development of Islamic banking in Nigeria, but in order to achieve these, all the stakeholders in the area of Islamic banking system in Nigeria need to strive to address the ten (10) challenges as identified by Sanusi, 2011, pp. 19 -21. One of the ten challenges is that there is a lot of misperception about Islamic banking in Nigeria, and with the ethno- religious diversity of Nigeria, it makes it imperative to create mass awareness and acceptance by the regulatory authorities. This is in view of the fact that religion has become a volatile issue over the years. Misinterpretation of the concept might jeopardise its success. In support of this ISRA (2013 p.754) stated that: “An Islamic finance law could be tabled before a legislative assembly that is totally ignorant of Islamic finance, passed on and then expected to be implemented by an executive body that does not have adequate training and skills in Islamic finance, resulting in it triggering a dispute later on that lands it in a court of judiciary, presided over by a judge who is not equipped with any knowledge of Islamic law and jurisprudence. A situation such as this would certainly be disastrous. Therefore, there is a need for the relevant authorities, especially the central bank or monetary authorities, to ensure that specific awareness and enlightenment programmes are afforded to

the members of the legislative, executive and judiciary branches to gain at least some basic understanding of Islamic finance, before an Islamic finance law or legal framework is adopted. Continuing training and education programmes need to be crafted, especially for relevant members of the executive body and judiciary who are more likely to deal with Islamic finance issues on a frequent basis”.

FIGURE 3: Barriers to using non-interest (Islamic) banking products



Source: Adapted from EFINA Access to Financial Services in Nigeria 2012 Surveys in EFINA (2013).

In addition, the responses of most of the respondents for the study were also in support of this. Below are some of these verbatim responses (R stands for respondent):

R22: Lack of investors awareness is a challenges, so much more, a lot of people do not know, when you say Islamic banking or interest free banking does it mean I'm getting money for free, a lot of people still think is charity, a lot of people say Islamic financials give you money you don't need to pay back, you take that money, and you go away, not mind second thought worthwhile and you are happy. No, we still have that mindset and is an issue we deals with. I have money from Islamic bank, I got new wife they do not feel like I oblige to pay back. So it is interest free, is not free. So a lot need to be done, on investors' awareness and education a lot.

R22..Hen, things like that, so that when any policy is going to be introduced. You will have massive campaign. So we believe in that kind of enlightenment, so if there is no enlightenment people will wonder and feel jittery. What is it all about? Is it a plan to Islamize Nigerian? You know, what policy is this? Because people need to know, and information should be freely accessible, so that they are things regulators can also do.....

R22.. ...If Central Bank of Nigeria (CBN) provide enlightenment for Islamic banking we are not bank, but it will rob on us. So the enlightenment will be key. They have the resources and manpower to do that. ...Supports, the same things we required from all the regulators. Yes, really the enlightenment supports, because we are breaking new ground, we need our regulators too. Some of the things are never done before. So of course, we need their supports.

R21: Even in the area of what is difference between interest and Profit, is very thin line, so you don't say, how can you charging us, why are you saying you are charging us, and you are interest free, people still have that mentality, is one of those things.

R1:Inadequate awareness about the operations and products of Islamic banks by members of the public.

R17....., if you remember when Islamic banking commencing in Nigeria before it was rounded the kind of bad publicity the polity was heated so much to the extent that once that licensed is issued nobody can go on the street without saying kalmatu shahada. It tells you how myopic and how Nigerians can be so sentimental about, blindfolding themselves to the real issue on ground.But here we give it a different color, make it so bad and say all sort of things on dallies. But beyond that should CBN wants to try to issue the halal or Islamic Treasury bill the controversy will be on that point in time they say we want to use these assets to back it let say for example CBN 's headquarter uses their building which is a massive piece of assetIt is heavy investment, should they say it is fine we want to raise Treasury bill against this building we will transfer the title of this building to the Special Purpose Vehicle (SPV) so that the SPV can now issue the instrument sukuk instrument against this asset, the whole country will go fuelled. Because *they will say federal government have sold the original asset to the Muslims*, meanwhile, should they do

that the instrument that they are bringing in to the market is not just going to be restricted to Islamic finance just like Osun State sukuk not only Islamic banks invested other investors invested on, so it is an instrument if anybody has faith in he can invest.

R17.....*That is emotion that people have, to them if you call it non-interest, it should be charity.* If you can have someone more or less a scholar, at an International Conference Centre a lady who is working at shariah court thinking Islamic bank should buy a house for her for free, need to stood up, challenge and attack the bank, “these people what they are doing is un-Islamic”, attention was drawing, how do you arrive at this doctrine, as a case, “I can give an instances, they are selling properties of government; where the civil servants are live in” “it is being monetized”, she said she was asked to pay rental monthly on the house she owned, meaning that, she does not understand Islamic bank products. And surprisingly, this is the same person that brought money to do Mudarabah investment expecting profit on monthly basis, and she worked in shariah court thinking Jaiz bank will buy property for her for free.

R16: One other problem I think we may face is this lack of basic knowledge,.....

R2: What we need to do for the banks to be aggressive in establishing their presence in the market, to educate people, to enlighten them on their product.....

R14: The major challenge is that,People still do not understand the workings of Islamic banking, some people are still skeptical in bring their money, so this is another challenges.....

R14: Industry can be move forward with enlightenment. Enlighten the public.by the time we increase awareness campaign, and by that time more people will come in to establish these types of banks then this will develop inter-banks money market.

R19:.....customers call me yesterday that they needed money cash for something, we spoke for like thirty (30) minutes, we spoke and spoke, definitely they need knowledge, because the knowledge is not there.....

Furthermore from Malaysian Experience: “*Islamic finance seemed to have been equally accepted by both Muslims and non-Muslims in many countries due to continuous awareness programmes and customer experience*” RHB Islamic Bank Bhd Malaysia Managing Director, Abdul Rani Lebai Jaafar (2012).

According to Enchik Ismail Mhayudin, one of the respondents for the study **R6**..... Although in the initial stage it was difficult for us, because we had most of our population could be in business and our customers are non-Muslims. So we were fearful that Islamic banking may not be acceptable. *But we did a lot, creating awareness among the people, so we give talks everywhere; in the towns, to the Muslims, to the non-Muslims, in the villages to meet them, to make sure they accept Islamic banks, Alihamdulilahi, we were very successful.* I was heading the international banking trade finance, so my area I thought was very difficult because most of people involve in commercial activities imports, export, manufacturing, are non-Muslims, but later I founded out that concern of Islamic banking is very very acceptable to the non-Muslims because I think that they understand the workings of Islamic banks, they understand the basic concepts, there is no hidden agenda, everything is clear and transparent, they are very happy. So I was

heading the trade finance, *more than sixty-five (65%) per cent of my customers are non-Muslims* because they understand what we do.....

R6: I will advise Nigerians promoters of Islamic banking to continue building vigorous awareness,...Create public awareness with education and enlightenment.

R8: Create awareness.....

R10: Education play major rules for public awareness, you got to educate the masses how to differentiate how they should bank with Islamic bank, this are the kinds of things you need to put upIslamic banks and regulatory as well..... there must be a lot of initiative to supports all this kind of things.

In country where the commitment of the government is at stake or is not there, the most vehicles to get the commitment and intervention of both the government and people at large is through this type of project: public awareness and education programs. This project is capable of creating real, deep and wide understanding of the system (Islamic banking system). The theory, principles and operations of the system, the reasons and benefits of the system will be spread among the people and chances will be given to individuals to ask questions in case of any doubt or a need for any clarification. With this project there is a possibility that the information will has positive impact on the individual people in the society even before the government. The interest and desire of the people in the society regarding Islamic banking system will be used to pressurize the government or awaking the interest of the government. For instance if the investors, the customers etc. shown their interest or desire for the system the government will not have choice other than to commit itself and provide positive intervention for the system.

In case of Nigeria, all the ten (10) challenges of Islamic banking system in Nigeria identified by the then Governor of the Central bank of Nigeria, (now the Emir of Kano), Mallam Sanusi Lamido Sanusi, these challenges that have negative impact to the growth and development of Islamic banking system in Nigeria can be solved through this project. Some of these challenges will be taken care of voluntarily without any intervention from any other external or internal bodies. For examples misperception about the system, absence of Takaful insurance, bureaucracy which normally existing in the public service establishment, this usually causing delay in treatment of any matter with urgency. All these will be eliminated with the interest, desire and commitment of individuals in the society especially among those officers that will be involved in the processing of any matter relating to Islamic banking system. While other challenges will be solved through little intervention from external or internal bodies.

ii. *Reasons for Central bank of Nigeria (CBN) and Other Regulators to Sponsor this project*

The Principal Stakeholder Theory: The Central Bank (CB) is the principal who must ensure that other banks like the commercial banks and Islamic Banks conduct their affairs in line with the rule of the game and particularly to protect the interests of the customers and the economy as a whole. The CB (CBN inclusive) by virtue of its role of control, regulation and supervision is considered as the *principal stakeholder* who ensures that the financial system remains healthy and vibrant at all times, so as to avoid systemic collapse of the economy. Thus, it could safely be argued that the role of the CB is very crucial and of enormous importance to the survival of the financial system, especially the banking industry, which Usman (2003, p. 41) in Fatai *et. al.* (2011) described as: “at the heart of every robust economy is a sound banking system”.

Poverty reduction and improvement of living conditions with strong focus on optimal distribution of wealth and financial inclusion should take a front seat in many developing and underdeveloped economies such as Nigeria. Thus, if all the necessary supports are given to Islamic banking and financial services, a new industry in Nigeria, the industry is capable of projecting financial inclusion, poverty reduction and improvement of living conditions programs (as laid down by the international bodies). Therefore, Nigeria as a country, other international bodies (such as United Nations, International Monetary Fund, World Bank etc.) and other concerned organizations such as Enhancing Financial Innovation and Access (EFInA), UK Department of International Development (DFID), The Ford Foundation, the Bill and Melinda Gates Foundation etc. should employ Islamic Bank and Financial system to achieve the aims and objectives of Financial inclusion, poverty reduction and improvement of living conditions programs. According to Luca Errico and Mitra Farahbaksh (1998) “Regulatory authorities in conventional systems ought to approach Islamic banking with an open mind realizing the potential gains that this already sizable and growing market could bring to the global economy in general and to selected counterparties in particular.” INCEIF chair of Islamic finance, Professor Dr. Abbas Mirakhor (2012),”in ISRA (2013). The authorities must have a strong commitment in a way that appeals to pluralistic society to ensure progress for Islamic banking and finance”.

Although, the viability of Islamic (Non-Interest) banking in Nigeria is faced with a lot of challenges but the benefits are significant and numerous enough that the opportunity cannot be neglected easily. Thus, if the challenges are adequately taken care of, in form of the government playing an important role in providing a conducive environment for the Islamic banks to operate, introduction of appropriate rules and regulations to protect both banks and customers, creation of mass awareness and so on, Islamic banking can be workable in the foreseeable future. Therefore, in order to facilitate the rapid growth of this new industry (Islamic

banking) and to play a more meaningful role in the economic development of Nigeria. CBN should provide full support for this project.

iii. Benefits of the Project to the new Industry and Nigeria Economy at Large

Due to the enormous market prospects, Nigeria has the potential to become Africa's hub on Islamic banking and financial services. Of course, this would translate to multiple benefits for Nigeria that would have a salutary impact on the economy. This project is capable of projecting the image of this new industry. Apart from financial gain from this project in terms of potential investors and interested individual parties to invest and patronize the services of the industry, strategically this project will also serve as invitation to both local and foreign potential new entrants (that is potential Islamic banks and other financial institutions) as well as other interested parties to enter the market. Both in the short and long terms, this will be in the best interest of the industry and Nigeria economy at large.

4. CONCLUSION

The broad area of the study under which this study falls is in the area of establishment and smooth running in terms of regulatory and supervisory of Islamic banking system. As Nigeria is started to implement the establishment and operations of its Islamic banking system, analysis of implementation of Islamic banking system in the area of regulatory, and supervisory roles of Bank Negara Malaysia (Central Bank of Malaysia) and Central bank of Nigeria would be suitable to serve as a basis to develop a model. The study tried to address the issue of challenges to Islamic banking system of Nigeria by studying Islamic banking system of both Malaysia and Nigeria. Finally, the results from the study were used to develop on a model of Islamic banking system for Nigeria, taking in to consideration the Nigerian peculiar and unique characteristics environment. From the findings of this study, in terms of basic minimum things, most, but not all of the situations regarding general regulation and supervision in Nigeria are in line with footsteps of Malaysia.

In addition to ten challenges identified by the governor of the central bank of Nigeria (CBN) the findings of this study revealed that development of Islamic banking system in Nigeria is facing the following constraints: 1. Lack of government support, 2. Misconception about the concept of Islamic banking system, 3. Religion and ethnic sentiments. These three constraints among others have been hindering the progress and development of Islamic banking system. Although, a lot has been done by the central bank of Nigeria as the regulator from the findings of the study, but the desired results are yet to be seen. The operators are still waiting eagerly for the required and satisfied level of achievements or results from the efforts of CBN in addressing all these challenges. The findings of the study revealed that creating public awareness,

enlightenment, and education about Islamic banking system is capable of providing solutions to some challenges without or with minimum efforts and intervention.

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