

ISLAMIC FINANCE: A VERITABLE TOOL FOR DEVELOPMENT

Islamic Finance has emerged in recent years as an exciting alternative to conventional banking and investment products, gaining global recognition not only as the preferred non-interest banking and ethical investment choice but far more intriguingly as a viable and sustainable banking model in the main. The World Bank estimates Islamic Finance market growth to be 10-12% annually with documented Sharia-compliant financial assets valued at about US\$2 trillion (held in various investments in bank and non-bank financial institutions, capital markets, money markets and insurance)¹.

As Nigeria explores fitting sources of funding for the development of critical infrastructure, enlightened industries and institutions would benefit from a better understanding of non-interest financing products and services and the various opportunities which it presents in enriching Nigeria's burgeoning financial markets. Its natural resilience against challenges of the global market such as wide spread excessive risk taking and high global debt levels has earned it significant global attention and it has proven itself over the last decade to be profitable and dynamic. Following the World Bank's early endorsement of Islamic finance as a means of increasing financial inclusion and reducing poverty, the Central Bank of



¹The World Bank Brief, Islamic Finance March 31, 2015

Nigeria (“CBN”) in 2010 made concerted efforts to promote and institutionalize Islamic banking as a part of Nigeria's financial markets. The CBN has since issued a number of guidelines which seek to regulate the establishment and operation of non-interest Banks as well as other non-interest Financial Institutions in Nigeria. Notable among these regulatory enactments are:

- Guidelines for the Operation of Non-Interest Financial Institutions Instruments by the CBN- December 2012;
- Guidelines on Non-Interest Window and Branch Operations of Conventional Banks and Other Financial Institutions- December 31, 2010; and
- Guidelines on Sharia governance for non-interest financial institutions in Nigeria- December 31, 2010.

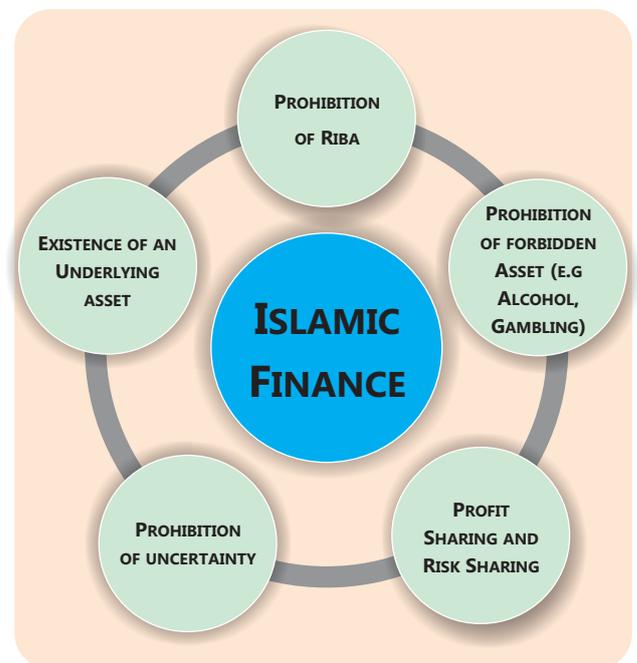
In recognition of religious sensitivities, the overarching emphasis has been placed on 'non-interest' financing which encompasses a range of faith-based banking models. Coincidentally, Islamic Finance receives the most attention arguably because it has gained the most global recognition and momentum by proving its potential with a string of notable transactions and projects such as financing of the construction of the London Shard, the Olympic Village and the EADS aircraft leasing fund. Of particular import is that it has also created global inroads to a significant amount of funding from sources and regions previously untapped.

WHAT IS ISLAMIC FINANCE?

Islamic Finance is non-interest structured finance based upon Sharia principles and guidelines. At its core is the principle that profit should not be earned from lending transactions (interest derived profit) and that capital investments maintain high ethical standards in accordance with Islamic beliefs. This would exclude investments involving gambling, tobacco and alcohol which are considered to be immoral.

Islamic financing investments are substantiated by equity-based assessments tied to tangible assets, as opposed to speculative instruments used in conventional banking and finance models. Returns on investments are directly linked to risk scenarios whereby participating parties share jointly and equally in both profit and loss.

KEY PRINCIPLES UNDERLYING ISLAMIC FINANCE



Islamic finance products and services are accessible by any individual or institution irrespective of religious belief or affiliation. It has garnered particularly strong patronage from small and medium sized enterprises and some governmental institutions as it offers attractive long and short term finance solutions given recent down turns in global financial markets. Some of these products include:

- ***Ijara*** (Leasing Agreement): Ideal for purchase of property and/or mortgage under favourable ethical principles.

- **Murabaha** (Purchase Cost Plus a Mark-up): Initially registered under the name of the buyer, the mark up is deemed a reward to the lending institution for the risk incurred. The mark-up is typically a pre-determined amount. This instrument is regularly used for the purchase of equipment.

- **Musharaka** (Joint Venture): Investor and bank provide funds to contribute towards an investment project and agree to share the profit and loss in agreed proportions agreed in advance.

- **Sukuk** (Sharia-compliant Bonds and Certificates): Bonds representing a share in tangible assets and structured in such a way as to permit the investors to also generate returns.

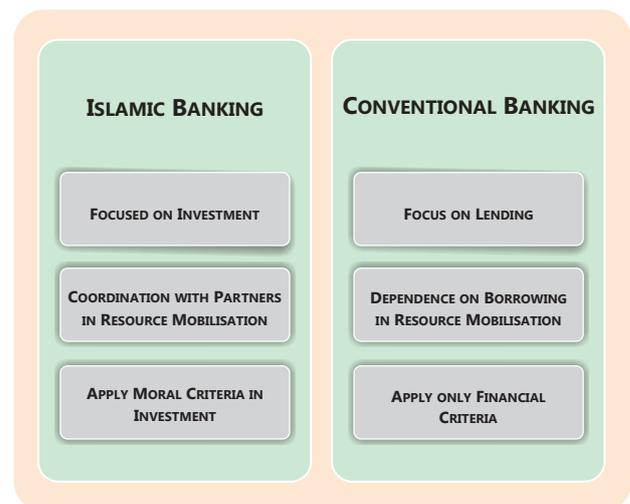
- **Takaful** (Insurance): Individuals make regular contributions to a fund to be used as financial aid in the event of unforeseen loss.

ISLAMIC FINANCE & BANKING IN NIGERIA

With a population of about 160 million people, a rapidly growing small and medium scale sector, 20 commercial banks and several other non-banking financial institutions operating within a rapidly developing financial market, non-interest banking incorporated into existing product offerings immediately presents exciting opportunities in project finance, infrastructural development, mortgages and venture partnerships in Nigeria. Early indications show that the concept of non-interest financing accords with the personal and social principles of formidable potential investors who are excited to transact business on that basis within Nigeria. With Jaiz Bank leading the pack with the establishment of a full service non-interest banking operation and other leading banks including Stanbic IBTC and Sterling Bank working out modalities for operating a non-interest banking window; including the pioneering work of Lotus Capital with *Sukuk*

(*Islamic bonds*) through the Osun State Government, it may be said that Nigeria is on the cusp and very well-positioned to fully exploit the full benefit of an enhanced non-interest financing framework.

DIFFERENCE BETWEEN ISLAMIC BANKING AND CONVENTIONAL BANKING



ISLAMIC FINANCE IN THE UNITED KINGDOM

Non-interest financing has flourished significantly in the United Kingdom (UK) and its originating presence in the UK financial markets dates back to 1982 with the establishment of the defunct Al-Baraka Bank. Interestingly, there has been no opposition based on the fear of 'islamisation' such as is the case in Nigeria, but instead non-interest banking in the UK is largely driven by regulation. The UK publicly declared its mission to be the global leader for Islamic finance products and services and the UK market's adoption of Islamic finance as an acceptable financial innovation was propagated and strategically positioned to attract all classes of investors and has propelled the UK forward as a preferred destination for specialized investment banking solutions². In October 2015, the UK further entrenched its image as a formidable leader and champion in Islamic Banking

²Song I and C Oosthuizen, "Islamic Banking Regulation and Supervision: Survey results and challenges", IMF Working Paper WP/14/220, December 2014, p.7

by launching a worldwide 'roadshow' which included a UK delegation visit to Nigeria led by Alderman Alan Yarrow, Lord Mayor of London. The delegation pronounced the benefits of Islamic Finance and brought forth capacity building efforts, advanced partnership opportunities with the Securities and Exchange Commission and other governmental agencies. The direct testimonials were an epiphany for many stakeholders seeing for the first time the promise which this sub-sector could hold for Nigeria's financial landscape.

In 2014, the UK became the first Western country to issue Islamic bonds (*sukuk*). Subsequent to this, the Bank of England joined the Islamic Financial Services Board (IFSB), one of the most influential standard-setting bodies for Islamic finance, thereby becoming the second Western regulator to do so after Luxembourg³. In 2001, Clifford Chance secured the £1.25bn funding of the London Shard through non-interest financing⁴. The UK has through Islamic Finance funded landmark projects including notable infrastructural breakthroughs such as the 2012 Olympic Village. The UK is reported to hold in excess of \$19bn in Islamic Finance assets.

³Reuters UK Edition, Bernardo Vizcaino December 9, 2015

⁴E Hammond, "Construction: Investors transform UK horizon" Financial Times May 11, 2012 <http://www.ft.com/cms/s/0/3dbd26fe-7aa1-11e0-8762-00144feabd0.html#axzz3v4LWMDWJ>

EDITORIAL

To achieve deeper financial inclusion in Nigeria, increase market penetration in the global financial markets and close the enormous dearth in available finance for critical infrastructural developments proposed by the present administration, steps need to be taken by the country's financial institutions to creatively harness the opportunities Islamic finance presents. The era of non-creative financing and

banking is gone. The thinking that Islamic finance is the exclusive preserve of the Muslim community is not only myopic but it is as out-dated as the facsimile machine. The advent of a well-structured non-interest financing framework has not only opened up opportunities for an alternative to rigid traditional funding models for infrastructural and personal finance solutions, it also creates a sub-sector which appeals to the social context of many previously unserved investors. Banks and other financial institutions are challenged to rapidly advance their services and product offerings in line with the global transition and the demands of the present day business.

For leaders, heads of governments and forward thinking organisations within the public and private sector committed to innovative approaches towards bringing about the needed change for their countries and corporations, the rewards and benefits of Islamic finance are undisputed with an added confidence provided by the successful models illustrated across financial

NOTABLE TRANSACTION

In 2014 European Aeronautic Defense and Space Company (EADS) maker of Airbus, in conjunction with International AirFinance Corp and the Islamic Development Bank launched a \$5 billion sharia compliant aircraft leasing fund. EADS' stake was generated by Quantum Investment Bank and Palma Capital, two Dubai-based financial institutions. Capitalising on the availability of said leasing fund, Saudi Arabian Airlines embarked on the largest ever aircraft leasing deal to acquire 30 Airbus planes and lease another 20 aircrafts.

markets and countries the world over. With the United Kingdom positioning itself as a global leader in this sector and utilising Islamic finance to change the infrastructural landscape and skyline of its capital city; with the United Arab Emirates remaining a pride to its citizenry and a model to the world; and infrastructural development that were once thought impossible to finance dotting major cities in the world, there is great potential for Islamic Finance to be the stepping stone for African states and their leadership to kick-start their economies and herald a new dawn for the rising Continent.

Islamic Finance Desk

The Islamic Finance Desk (IFD) is under the Corporate Commercial Group of Aina Blankson LP. The IFD is specially directed at providing holistic legal, regulatory advice and support to its clients leveraging on opportunities in Islamic financing. The Desk encompasses local and international legal and financial advisers and Islamic Finance experts. Our service to our clients is founded on the depth of our industry knowledge, which enables us to act effectively as a value added extension of our clients' legal and business teams.

This Newsletter was written by Olayinka Olojede-James and Chinelo Agom-Eze, both with Islamic Finance Desk, Aina Blankson LP.

Aina Blankson, LP

5/7 Ademola Street
South-West Ikoyi, Lagos

19 Kolda Street
off Adetokunbo Ademola Crescent Wuse II,
Abuja FCT

Plot 3, Mitchell Alamina Street
Amadi Ama Extension, off Sir Peter Odili
Road, Rainbow Town, Port Harcourt,
Rivers, Nigeria

Tel: +234 1 8980882 – 3
Fax: +234 1 2710566
Email: publications@ainablankson.com
www.ainablankson.com

Disclaimer: This document serves merely as a note and is not intended to provide legal advice to any person or group of persons whether natural or corporate regarding the issues discussed herein. All persons desirous of legal advice should therefore contact a lawyer. Aina Blankson LP shall not be liable for any breach or loss resulting from reliance on any part of this newsletter.