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# What Islamic finance products can do to Nigeria's capital market, infrastructural growth

July 27, 2019 Oladeinde Olawoyin

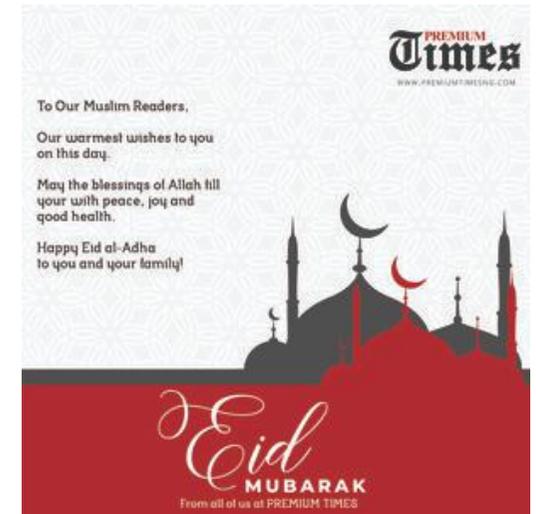
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As the vehicle moved past dangerous potholes along the old Oyo-Ogbomoso road, the passengers murmured a few complaints. Determined to avoid the traffic congestion reportedly caused by an accident involving a truck on the narrow road, the driver swerved onto the uncompleted portion of the Ibadan-Ilorin expressway. Although the Oyo section of the road was deserted, due to recent rehabilitation efforts, the journey from Oyo town to a settlement on the outskirts of Ogbomoso was smooth and hitch-free.

The construction works were, however, terminated at the settlement, located some kilometres from Odo-Oba. Across the far end of the road, an object carrying a bold inscription showing “FGN SUKUK” blew gently against the harmattan wind. A few passengers lauded the Sukuk initiative, saying such finance instruments should be extended to other sections of the road to aid its final completion.

“This is commendable,” a passenger told PREMIUM TIMES reporter.

Like the Oyo-Ogbomoso section of the Ibadan-Ilorin expressway, major roads across Nigeria barely received attention until 2017 when the Nigerian

himself, ex-governors, others

DMO lists N100 billion FGN Sukuk

government issued its maiden N100 billion 7-year debut Sukuk bond, which the Debt Management Office (DMO) said was oversubscribed.

According to the DMO, investors across a broad spectrum comprising pension funds, banks, fund managers, institutional and retail investors subscribed to the FGN offer in an indication of the wide acceptance of the instrument.

The offer attracted a total subscription of N105.878 billion and due to the success recorded, the DMO said another window has been opened for the government to raise funds to close Nigeria's infrastructure gap.

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The Sukuk is one of the instruments of Islamic finance.

### Islamic Finance and Sukuk bonds

Sukuk bonds are generally structured to generate returns to ethical investors without infringing on the Islamic principles which forbid interest payments. It also represents an ownership interest in the asset to be financed rather than in a debt obligation. It is one of the major instruments in the fast-developing world of Islamic finance.

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According to Jude Chiemeka, Divisional Head of Trading Business at the Nigeria Stock Exchange (NSE), the Islamic finance sector has grown noticeably over the years, from about \$1.5 trillion in 2016, to about \$2 trillion in 2018, driven by growth in Islamic banking asset as well as growth in Sukuk issuances on the stock market.

“This growth has largely been concentrated within GCC region and in Asia,” he said. However, recent data suggest that Islamic financing is beginning to take root in Africa, with issuers across The Gambia,



Sudan, Senegal, Ivory Coast, Togo, as well as Nigeria, through the capital market.

“Clearly,” Mr Chiemeka said, “Islamic finance represents a turning point and a new paradigm for the financing of infrastructure in this country.”

The NSE itself has been at the forefront of promoting opportunities offered by Islamic finance products and instruments in recent time. Driven by its belief in the growth potential of the Islamic financial model, the Nigerian bourse has also organised numerous sensitisation workshops to educate stakeholders on the growth potential of such instruments and products.

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Jubril Salaudeen, Managing Director of Citiserve and an expert on Islamic finance, said the sensitisation efforts are necessary due to the various misconceptions that surround Islamic finance instruments introduced in Nigeria's capital market. He also attributed the misconceptions to the dearth of knowledge on the subject. According to him, this is because there are basic principles that define Islamic finance which separate it from conventional financial instruments.

### Principles of Islamic Financial Instruments

From a broad perspective, Islamic finance is based on principles and foundations laid down by the Sharia (Islamic law). This comprises of the Quran—Islamic holy book—and the “Sunnah”, sayings and practices of the prophet of Islam, Mohammed. Also central to this are the moral guidance or set of principles practised by Muslims and, ultimately, the Shariah Supervisory Board (SSB). The SSB could be made up of three to five Islamic scholars who would decide on what is compliant or not and interpret based on Islamic jurisprudence, known as “Fiqh”.

The foundation of Islamic finance is built on certain practices which prohibits interest (Riba). This could be Riba al Naseeyah or Riba al-Qura, meaning excess resulting from a pre-determined interest. It could also be Riba al-Fadl and Riba al Hadith, meaning excess compensation without consideration.



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Other prohibitions include avoidance of uncertainty or deceit, known as Gharar, which could come up when final result is uncertain, there is short selling or there is fraud. Gambling, known as Maysir, which could come in form of involvement in speculative and gambling transactions are also prohibited.

For the capital market, Mr Salaudeen noted that there are principles guiding the Sukuk structure and arrangement, which differentiate it from conventional bond. First, he said, Sukuk bonds are always linked to underlying asset, with proof of ownership or beneficial ownership of the asset. Again, Sukuk holders have a right to profits but also losses and they may dismiss Sukuk manager or issuer. In Sukuk, maturity is based on underlying project or activity and the prospectus includes all Sharia'a-related rules.

In the overall, transactions in Islamic finance should be backed by tangible asset while there is an obligation to share to a certain extent, profits and losses.

### Islamic finance instruments, answer to global challenges?

Although it has proven to be particularly successful in the United Arab Emirates, Asia and some parts of Africa, Islamic finance instruments, asset and products have been identified as catalysts for growth among leading economic and development stakeholders from other parts of the western world.

In a November 2015 speech titled "Unlocking the Promise of Islamic Finance", Christine Lagarde, the outgoing Managing Director of the International Monetary Fund, described the principles guiding Islamic finance as 'universal values' necessary for global growth.

The former IMF boss said she regarded inclusivity and stability as the main reasons behind the appeal of Islamic finance and noted its potential to support developing and underserved population, SMEs, start-ups and infrastructure investments. She also emphasised the risk-sharing and asset-backed features of Islamic finance that help to reduce leverage and contribute to greater stability.

"Islamic finance has, in principle, the potential to promote financial stability because its risk-sharing feature reduces leverage and its financing is asset-backed and thus fully collateralised," she said.

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"In addition, besides deposits, Islamic banks offer profit-sharing and loss-bearing accounts that can help mitigate losses and contagion in the event of banking sector distress. This leads, de facto, to higher total loss-absorbing capital, one of the key objectives of the new global regulatory reform."

In 2015, the G20 Antalya Summit supported Islamic finance "to facilitate better intermediation for SMEs and infrastructure investment", with focus on the benefits of its asset-based finance.



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Checks also showed that in Asia and other parts of the United Arab Emirates, various Islamic finance instruments have been used to finance projects in energy and other social infrastructure.

Similarly, the African Development Bank highlighted several infrastructure projects that have been funded through Islamic finance. Other policy materials suggest that Islamic finance could not only help with financing large infrastructure projects across Africa but also help to strengthen the SME and microfinance sector, as well as the capital markets.

There are about 250 million Muslims across the African continent and Islamic finance is present in more than 21 African countries. Kenya, Morocco, Niger, Nigeria, Senegal, South Africa, Sudan and Uganda have established legal frameworks for Islamic finance, with over 50 Islamic finance institutions across Africa.

In the last week of July, the Central Bank of Nigeria confirmed the granting of a licence to Taj Bank Limited as the only lender with regional authorisation. The bank and Jaiz Bank became two Nigerian non-interest banks.

### Products/instruments in the money, capital markets

There are various Islamic finance products and instruments available to investors in the money and capital markets, including Murabaha, Musharaka, Mudaraba, Ijarah, Istisna'a, among others.

The Murabaha, also referred to as cost-plus financing, is an Islamic financing structure in which the seller provides the cost and profit margin of an asset. This is not an interest-bearing loan (otherwise called "qardh ribawi") but is an acceptable form of credit sale under Islamic law.

Musharaka, meaning partnership, is another instrument that allows two or more financiers provide finance to a project. Here, all partners are entitled to a share in the profits resulting from the project in a mutually agreed upon ratio.

Mudaraba is a trust financing method which allows a partner to provide the investment (rab-ul-maal) while the other partner invests it in a commercial enterprise (mudarib). Ijarah, on its part, is an exchange transaction in which a known benefit arising from a specified asset is made available in return for a payment. Also, Istisna'a is a contract of exchange with deferred delivery, applied to specified made-to-order items.

Although the Sukuk (originally known as "certificate" in Arabic, according to Lotus Capital is perhaps the most popular instrument in Islamic finance in Nigeria, it is just one of the instruments, products and asset available for investors and other stakeholders swayed by the growing interest in Islamic finance.





“In particular, adherents to the Islamic faith are prohibited from investing in non-Shar’iah-compliant investments which within the domestic economy, eliminates this demography from participating in capital market activities, and further serves to undermine the level of savings needed for capital formation,” he said.

“Also, the development of a viable Islamic Economy in Nigeria has far-reaching implications within global markets, for investment managers seeking to achieve portfolio diversification. The ability for fund managers seeking Shari’ah-compliant investment products to diversify into our markets facilitates more foreign inflows which has implications for the economy via the attraction of low-cost funds for development.”

Mrs Largarde made a similar point in her 2015 speech when she noted that Islamic finance has the potential to contribute to higher and more inclusive economic growth by increasing access to banking services to underserved populations. “To this day, a large segment of the Muslim population—who are a primary, but not the only, market for Islamic finance around the world—remain financially underserved, with only one-quarter of adults having access to bank accounts,” she said.

Tesleem Akosile, a market investment advisor, told PREMIUM TIMES that the products will help grow not only the Nigerian Capital Market but address the Nigerian Infrastructural deficit among others at the same time.

“Islamic Finance is embedded with the potentials of engendering floodgate of economic advancement and prosperity for humanity,” he said.

“Let’s take for example the recent Sukuk vis-a-vis FGN Bond. I and some colleagues interacted with an officer of the Debt Management Office, DMO, (a non-muslim) who confirmed to us that the FGN Sukuk aids fiscal discipline, being a finance model that must either be asset-based or asset-backed, in addition to the requirement of an SPV that assumes a Trustee status for the Sukuk holders, oversees the disbursement of the Sukuk funds, etc unlike other conventional instruments.”

#### THE CHALLENGES AND WAY OUT

Despite the huge potential of introducing and strengthening Islamic finance products on the capital market and the larger Nigerian economy, Mr Salaudeen noted that there are still numerous hurdles to cross.

He identified the challenges to include regulatory and tax issues; issues around Sharia scholars and Sharia-compliant products; as well as the dearth of knowledge on Islamic finance products.

Mrs Largarde on her part said the priority is to level the playing field and create an enabling environment for Islamic finance products to develop while being mindful of risks.



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She said: “Leveling the playing field also means harmonizing the tax treatment of Islamic finance products with similar conventional contracts. Income tax systems typically recognise interest gains on debt instruments as a deductible expense.

“This debt bias puts Islamic finance at a competitive disadvantage and discourages risk-shared financing. Some countries can already remedy this disadvantage under their existing tax systems, but others still have to review their tax legislation.”

In September 2017, shortly after the Nigerian government introduced its debut Sukuk offer, the Christian Association of Nigeria (CAN) said the move was part of the “strategies to ‘Islamise’ Nigeria”.

Mr Salaudeen noted that challenges like that could be addressed with adequate sensitisation of the public on the basic principles and provisions of Islamic finance, training and adequate skill acquisition by Islamic bankers and investment professionals, as well as detailed information that will aid mutual understanding by prospective clients.



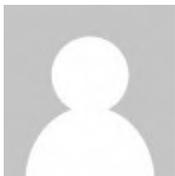
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