Non-Interest (Islamic) Liquidity Management In The Nigerian Non-Interest Banking: A Legal Study From The Experience Of Malaysia

by

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Abstract

One of the major potential challenges before the nascent non-interest (Islamic) banking product in Nigeria is the absence of adequate and viable Shariah-compliant instruments of liquidity management. The availability of the instrument is a sine qua non in the banking system. Conversely, Malaysia being the global hub of the Islamic banking and finance has successfully developed viable instruments for the management of Islamic liquidity. The Malaysian instruments are comparably in juxtaposition with that of the conventional system in terms of sophistication and development. The article advocates for the adoption and adaptation of the Malaysian model of Islamic liquidity management instruments into the Nigerian banking system as a panacea. The research is a qualitative

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comparative legal study. It aims at proposing solution to the lingering problem of non-interest liquidity management in the Nigeria nascent non-interest banking product.

Keywords: *Non-Interest Liquidity Management, Nigerian, Malaysia.*

Introduction

The breaking of the jinx to the introduction of the non-interest banking and financial product into Nigeria by the licensing of Jaiz Bank International in the year 2011 has led to other challenges. The most prominent among such challenges is the absence of the mechanism for non-interest liquidity management in the country. That is, the absence of *Shariah*-compliant instruments of financial market as a whole and that of the Islamic money market in particular. Money market is a requisite operational segment of the banking system. It is the platform for liquidity management, which essentially enables banks and other financial institutions to discharge their daily obligations towards their customers. Moreover, money market is also important due to the fact that it is the channel from where the Central Bank regulates the banking system and disseminates financial policies. The Central Bank of Nigeria ('CBN') has made effort to develop three non-interest instruments for the system. Nevertheless, a critical examination of the instruments shows that two of the three instruments are not tradable while the remaining purportedly tradable instrument is virtually not in existence. Therefore, this article seeks to propose the adoption, adaptation and introduction of four of the variety of instruments of the Malaysian Islamic interbank money market to the Nigerian system. The proposed instruments are the Malaysian Islamic Treasury Bills ('MITB'), Government Investment Issues ('GII'), *al-Mudarabah* Interbank Investment ('MII') and Accepted Bills-Islamic ('AB-i'). It is believed that the proposed instruments will allow the Nigerian non-interest banking and financial institutions to participate effectively in all the various sectors of the economy, which includes the public, private, local, and international sectors.

Legal And Regulatory Framework Of Money Market In Nigeria

To start with, the available platform for the management of liquidity in Nigeria prior to the introduction of non-interest banking in the country is the conventional interest based money market. Some of the major tradable instruments in the market are the

Treasury Bills, Treasury Certificates, Certificates of Deposits, Commercial Papers and Call Money.[1] However, the instruments are not in conformity with the practice of the non-interest banking product, being operated on the basis of interest.[2] More so, the market participants are the interest oriented financial institutions. As usual, the most prominent among the market players are the commercial bankers. They own more than 80% of the total banking asset. Other significant players are the country's five discount houses that deal in the government short term securities on the basis of discounting and rediscounting, as well as the merchant banks that play the role of providing medium term loan, loan syndication, equipment leasing, project financing and debt factoring. There are other players such as the community banks and the micro-finance banks, which provide micro-finance services to the people at the grass-roots level.[3]

Moreover, the regulation of the money market is vested in the trio-institutions of the CBN, the Securities Commission and the Federal Ministry of Finance. The bodies work concertedly for the formulating of the market policies and their implementation. There are other subordinate regulators such as the Nigerian stock exchange and the money market association. The regulation is governed by the Central Bank of Nigeria Act, 2007 ('CBN Act 2007') and Banks and Other Financial Institutions Act, (Decree) 1991 ('BOFIA 1991') that constitute legal framework of the market. However, the laws do not provide except for only for the interest based practice. For instance, the CBN Act 2007 provides in its s. 30 that the Central Bank is empowered:

> (a) To carry out open market operations for the purpose of maintaining monetary stability in the economy of the country, and without prejudice to the generality of the foregoing, the Bank may also for that purpose issue, place, sell, repurchase, amortize or redeem securities (which shall constitute its obligations) and the securities shall be issued at such rate of interest and under such conditions of maturity, amortization, negotiability and redemption as the Bank may deem appropriate;

Moreover, the CBN Act 2007 clearly states in s. 30 that the Central Bank is vested with the power:

> (b) To issue other forms of securities including treasury bills as it may deem necessary for purposes of liquidity management;
>
> (c) to sell or place by allocation to each bank any securities issued under paragraphs (a) or (b) of this section; and

(d) to repurchase, amortize or redeem in such manner as the Bank may deem appropriate, any such securities.[4]

However, the contention remains that the said securities, which are the money market instruments are interest based. This is clear in the provision of s. 30(a) that 'the securities shall be issued at such rate of interest and under such conditions of maturity, amortization, negotiability and redemption as the Bank may deem appropriate'.[5] More so, in a way of the interpreting of the s. 30 of the CBN Act 2007, the BOFIA 1991 in its s. 15, provides for the 'minimum cash reserves, specified liquid asset, special deposits and the stabilization securities'. It states that:

Section 15:(1) Every bank shall maintain with the Bank cash reserves, and special deposits and hold specified liquid assets or stabilization securities, as the case may be, not less in amount than as may, from time to time, be prescribed by the Bank by virtue of section 39 of the Central Bank of Nigeria Decree 1991.

(2) Where both assets and liabilities are due from and to other banks, they shall be offset accordingly, and any surplus of assets or liabilities shall be included or deducted, as the case may be, in computing specified liquid assets.

Furthermore, pursuant to the above provision of s. 15 of BOFIA 1991, the Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria, 2011 ('Guideline 2011') provides for liquidity management of the Islamic banks. It states in its para. 13.2 that: '*All IIFS are required to put in place appropriate policies, strategies and procedures which ensure that they maintain adequate liquidity at all times to fund their operations*'.[6] Thus, the Guideline 2011 restricts the Islamic banks from investing in interest bearing instruments that are not in conformity with the principles of Islamic commercial law which is the basis of Islamic banking and finance. The Guideline 2011 proves that:

13.2.2 IIFS shall not invest their funds in interest-bearing securities or activities. They are required to invest their funds in eligible instruments for the purpose of meeting the CBN prescribed minimum liquidity ratio. Liquid assets shall be held in line with the provision of section 15 of BOFIA 1991 (as amended), provided they comply with the principles under this model.[7]

Therefore, for the purpose of this requirement, the CBN puts a guideline in place for the non-interest financial institutions, that is, the Guidelines for the Operation of Non-Interest Financial Institutions Instruments, 2012 ('Guideline 2012'). The Guideline 2012 provides for three liquidity management instruments for the non-interest institution, as well as the opening of a non-interest banking window ('NIBW') through the Central Bank[8] for the transacting in the instruments.

Non-Interest Money Market Instruments In Nigeria

Currently, there are three non-interest money market instruments in Nigeria. The instruments are the Central Bank Safe-Custody Account ('CSCA'), CBN Non-Interest Asset Backed Securities ('CNI-ABS') and CBN Non-Interest Note ('CNIN'). Each of the instruments is briefly discussed below.

CBN Safe-Custody Account (CSCA)

The CSCA is a *Shariah*-compliant instrument of liquidity management in the Nigerian non-interest banks. The instrument is structured in *al-Wadiah* contract. This is a bailment or safe-custody contract. It is used by the non-interest financial institution for the placing of their surplus funds with the Central Bank. During the placement period, the Central Bank will assume the position of custodian of the fund pending its withdrawal by the depositor bank.[9] Thus, based on the principles of *al-Wadiah* contract, the deposited fund may be utilised by the depositee, that is the Central Bank. However, the depositor bank is not entitled to any return or profit on the fund. Nevertheless, the Central Bank may discretionarily grant a non-binding gift to the bank. Such gift is not mandatory. It is solely at the exclusive discretion of the Central Bank. Moreover, in the situation of the loss of the funds, the depositee will not be liable to any replacement, except if the depositor bank can prove the occurrence of negligence, abuse or recklessness in the part of the depositee. Therefore, the onus of proof rests on the depositor.[10]

More so, in practice, the tenor of the CSCA ranges between overnight, three days or seven days. However, a rollover for the same tenor is allowed. The rollover will become mandatory if withdrawal is not made by the depositor bank by 2.59pm on the day of the maturity period of the fund. The period of the placement of the funds is between 3.00pm and 3.30pm throughout the working days of the week.[11] This instrument is similar to the Bank Negara Malaysia *al-Wadiah* placement ('BNMWP') and the *al-Wadiah* tender in Malaysia.

The BNMWP is one of the instruments used for Islamic liquidity management by the Central Bank of Malaysia. The mechanism of the instrument is that banks will place their surplus cash with the Central Bank based on the agreement of *al-Wadiah* (safekeeping). Thus, the Central Bank will exercise due diligence in the safekeeping of the funds and enable its withdrawal by the bank at its maturity, which is just an overnight. However, the Central Bank may utilise the money within the safekeeping period for investments. But it is not obliged to pay any return to the depositor-banks. Nevertheless, the Central Bank may grant a non-binding discretionary *al-Hibah* 'gift' to the depositor bank.[12] Thus, Bank Negara Malaysia *al-Wadiah* certificate will be issued to the depositor bank during the period to serve as evidence of placement. However, the *al-Wadiah* certificate is not tradable in the secondary market.[13]

Another Malaysian instrument that is similar to the CSCA and BNMWP is the Bank Negara Malaysia *al-Wadiah* tender ('BNM *al-Wadiah* tender'). The difference being that the BNM *al-Wadiah* tender as a 'tender', involves the dissemination of information about its issue through the Fully Automated System for Issuing/Tendering ('FAST').[14] The information will be disseminated in the early morning of its issuance. Thus, it is the Central Bank that will invite for tender from the financial institutions as opposed to the process of the *al-Wadiah* placement which is a placement in the Central Bank by the various Islamic banks. The period of the maturity of the instrument ranges from one week to three months. The amount of the tender is based on the size of the bid as prorated with the issuance size and the issued tender is based on their bid size. However, as in the BNMWP, the payment of returns is solely within the discretion of the Central Bank of Malaysia.[15]

CBN Non-Interest Note (CNIN)

Another non-interest money market instrument in Nigeria is CNIN. The CNIN allows the non-interest financial institution in Nigeria to secure an interest free loan from the Central Bank to meet their obligations in the situation of liquidity mismatch. It is a form of mutual cooperative in which the non-interest financial institutions are participants. The participation of such institutions allow them to secure interest free loan from the Central Bank to meet their needs. The instrument is a financial paper that serves the purpose of evidence of interest-free loan between the Central Bank, which is the borrower and the non-interest financial institution, which is the lender.[16]

Moreover, a non-interest financial institution must invest in the CNIN for a specific maturity period under the programme before it can be entitled to the interest free loan. Thus, it is the Central Bank that will call for the offer of loan from the participating institutions, and it will determine the amount of the loan and its maturity period. Furthermore, the determination of the amount of the loan and its maturity period is based on the situation of the liquidity in the economy as determined by the Central Bank. However, the maturity period cannot be more than 12 months. The minimum amount of the notes is NGN1 million which will carry various maturity periods of either 30 days, 60 days, 91 days or 180 days. In short, only the holders of the instrument are entitled to the interest free loan. The CNIN is transferable on the face value only. Thus, its discounting is not permissible.[17]

CBN Non-Interest Asset Backed Securities (CNI-ABS)

The third available non-interest money market instrument in Nigeria is CNI-ABS. The CNI-ABS is an instrument that represents the securitisation of the Central Bank of Nigeria's *sukuk* stock holdings in the Malaysian based International Islamic Liquidity Management ('IILM'). Nigeria is a member of the multilateral organisation. The instrument is designed to serve as both investment and money market instrument. It is dominated in the Nigerian currency, 'Naira' as well as other reserve currencies such as the dollar, subject to the management of the CBN. The tenor and returns of the instrument are based on the return on the underlying asset of the instrument, while 10% margin of the net returns belongs to the CBN. One of the merits of the instrument is that it is tradable in the secondary market. The tenor of the instrument ranges between short and medium terms, and it is tradable in the secondary market.[18]

In a nutshell, it can be observed from the foregoing discussion that there are three available non-interest money market instruments in Nigeria. However, only the third instrument is tradable. Nevertheless, the said-tradable third instrument is under the management of IILM which is still at the developing stage. It is therefore concluded that the non-interest money market in Nigeria needs to learn from the experience of Malaysia in terms of instrument development. Thus, after insightful study and consideration, four out of the 26 Islamic money market instruments can be adopted, adapted and introduced into the Nigerian non-interest money market. The instruments will allow the new Nigerian non-interest financial institutions to participate all the public, private and the international segments of the economy.

The Proposed Instruments For Nigerian Non-Interest Money Market

As stated in the above, four of the Malaysian instruments of Islamic money market can be adapted and introduced into the Nigerian nascent non-interest money market system. The introduction of the four proposed instrument are important for the operation of non-interest banking in Nigeria. The instruments will give the market players the option of choice of the most suitable instrument for their transactions. It will help the non-interest financial institution to invest and participate in all strata of the Nigerian economy, both locally and internationally. The proposed instruments are as follows:

Malaysia Islamic Treasury Bills (MITB)

The proposed instrument for the adaptation is the MITB which can be adapted as the Nigerian Non-Interest (Islamic) Treasury Bill ('NNITB'). This is due to the importance of Treasury Bills ('TB') to the banking system. TB is a 'short-dated' security that does not bear any formal interest. It is issued by the government at a discount from the redemption price.[19] The MITB is an alternative to the conventional TB which is not *Shariah*-compliant given its operation on the basis of discounting which is regarded as interest under *Shariah*.[20]

The MITB is structured in the contract of *Bay' al-'Inah* (sale and buy back). It represents an asset which is intended to be sold by the Malaysian government through the Central Bank to a financial institution. The buyer of the instrument will buy it on the basis of cash spot payment with discounting from the face value. However, the government will buy back the asset from the buyer instantaneously on the basis of deferred payment at par price.[21]

Should the instrument be adapted as the Nigerian Non-Interest Treasury Bills ('NITB'), it will assist the Nigerian government at all its levels of the federal, states and local governments to meet their short term expenditure on the basis of non-interest practices. It will also help the CBN to control excess liquidity in the system on non-interest basis. The structural flow of the issuance of MITB is illustrated below:[22]

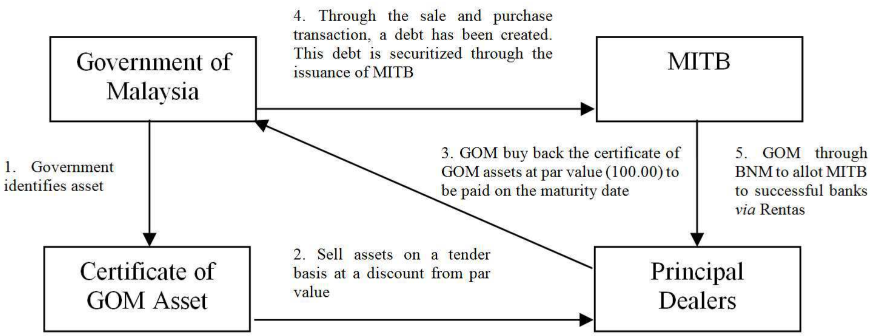

Figure 1: Flow of MITB.

Government Investment Issues (GII)

GII is another instrument that needs to be adapted to Nigeria. It is similar to the MITB, in the sense that it is an instrument which can be used to aid the government short term financial mismatches. The Malaysian GII can be adapted as Nigerian Government Investment Issue ('NGII'). The instrument will be utilised for liquidity management in the system through the intermediary of the Central Bank of Nigeria between the banking industry and the government.

The instrument is currently unique to Malaysia. It was created by the country's Government Investment Act 1983 or the management of liquidity of the Islamic banks. GII is structured in the contract of *Bay' al-'Inah* (sale and buy back), like that of the MITB. Its mechanism is that the Malaysian government through the Central Bank will undertake to sell an identified asset to a financial institution and the institution that succeeded in the purchase of the asset will make payment by cash on spot basis. However, the Central Bank will purchase the asset back from the institution instantaneously on the basis of deferred payment with the addition of profit margin.[23]

Thus, the main difference between the MITB and the GII is that MITB is sold at discount and repurchased at per price, while GII is sold at per price and repurchased at par price with profit margin. However, both instruments are similar in the sense that they are both structured in the sale and buy back contract of *Bay' al-'Inah*. More so, both instruments are tradable in the secondary market on the basis of the contract of *Bay' al-Dayn* (debt trading).[24] It is believed that if this instrument is adapted to the Nigerian banking system as suggested, it will complement the rapid growth of the non-interest banking system in the country through government support. The structural flow of the instrument is illustrated below:[25]

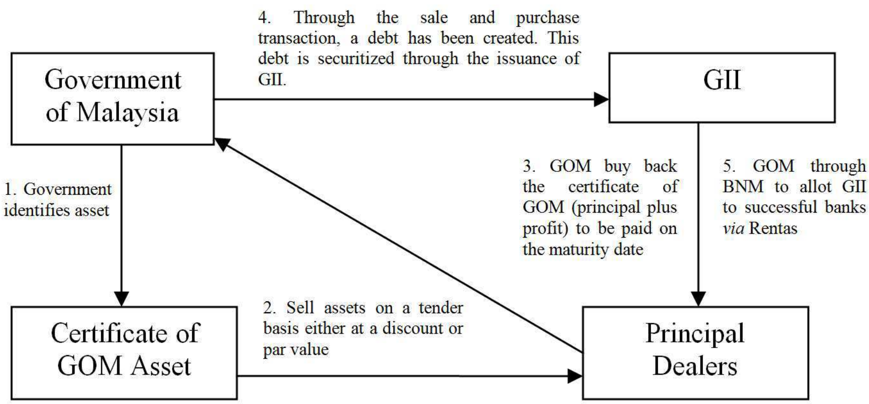

Figure 2: Flow of GII.

Al-Mudarabah Interbank Investment (MII)

For the purpose of interbank trading amongst the Nigeria non-interest banks and the non-interest windows in the conventional banks, there is a need for the adaptation of the Malaysian MII into the Nigerian system. In Malaysia, the instrument allows both the Islamic banks and the conventional banks that operate Islamic windows to enter into a profit sharing investment amongst themselves through the intermediary of the Central Bank.[26] The instrument serves as a non-interest alternative to Certificate of Deposit ('CD')[27] which is an interest bearing investment of the conventional money market, and which is the dominant instrument in the market of the conventional system. It also allows an Islamic bank or conventional bank with Islamic window to invest in another bank on the basis of *al-Mudarabah* (profit and loss sharing) contract.[28]

This is due to the fact that the trading of the CD in the conventional interbank market is not *Shariah*-compliant given its direct trading in cash balances between transacting banks.[29] That is, the creditor-debtor lending transaction, as opposed to the MII in which the relationship is that of investor-entrepreneur relationship.[30] The parties to the transaction are the surplus bank and the deficit bank while the Central Bank acts as a regulator and the facilitator. The operational flow of the instrument is illustrated below:[31]

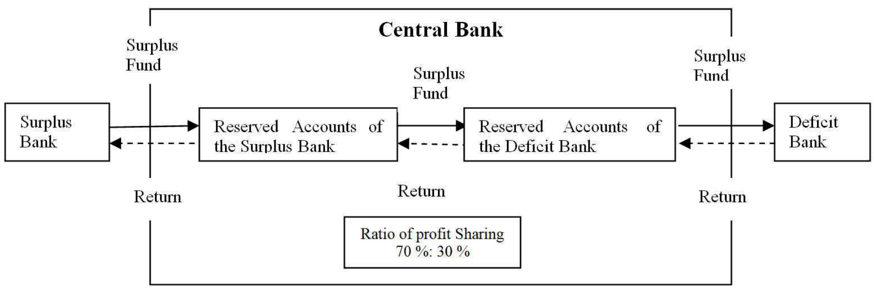

Figure 3: Flow of MII.

Accepted Bills-Islamic (AB-i)

Other instrument that needs to be adapted to the Nigerian non-interest system due to its importance for international transaction is the Malaysian AB-i. The instrument will serve the purpose of international transaction as well as that of the liquidity management through short term international trade. Thus, goods and commodities such as the Nigerian oil and gas can form the underlying asset of the instrument.

In the conventional system, an Accepted Bill is either a time draft or bill of exchange. It is a representation of the intention of a drawee to pay at maturity. Bill of exchange is drawn by a seller of goods, who is considered as the drawer, and will be accepted by the buyer, who is considered as the drawee. The bill is payable at the drawee's bank. That is the acceptor's bank, at maturity. Upon the acceptance of the draft, he will be paid by the acceptor that is the drawee's bank on its tenor without qualifying conditions.[32]

However, the practice in the conventional system involves transaction in interest which is prohibited in Islam.[33] This is the rationale behind the creation of the alternative *Shariah*-compliant bill, which is known as AB-i. It is also a bill of exchange like that of the conventional system. It is utilised in Malaysia by the Islamic financial institutions as an instrument of liquidity management and it is a short term security which is issued to finance foreign trade. Its mechanism is that, since an importer does not pay an exporter in cash but in a bill payable usually in three or six months. The instrument can be sold in the discounted market to provide for immediate cash for the supplier. Even if the customer is not well known, the bill can be made marketable by acceptance of a merchant banker, who will add signature to it to guarantee payment if the issuer happens to default.[34]

Thus, the main difference between the Islamic bill and the conventional bill is that the Islamic bill is *Shariah*-compliant. The bill is structured in either *al-Murabahah* (cost plus profit) or *Bay' al-Dayn* (debt trading), and it can be drawn through two methods. Firstly, it can be drawn by the bank while the importer, that is the buyer of goods from abroad, accepts the bills. Under such process, the bill will be structured in the contract of *al-Murabahah* 'cost plus contract'. Secondly, the bill can be drawn by the exporter who is the seller of the goods from abroad while his bank will accept it, and it will be structured in the contract of *Bay' al-Dayn* (debt trading).[35] The instrument is tradable in the secondary market on the basis of *Bay' al-Dayn* contract, as it constitutes a debt that was drown on the bank.[36] In short, the adaptation of the instrument to Nigerian non-interest system will pave way for the country's non-interest institutions to participate in the international trade effectively.

Conclusion

To sum up, the foregoing discussion adduced the major laxity in the non-interest banking system in Nigeria. That is, the absence of adequate and appropriate non-interest money market instrument from the system. The instruments are crucial to the liquidity management in the non-interest institutions. However, the adoption, adaptation and the introduction of some of the Malaysian Islamic money market instruments is proposed to bridge the gap. The proposed instruments are the MITB, the GII, the MII and the AB-i. The introducing of the instruments to Nigeria is important for the fact that the MITB and the GII will allow the government to participate and benefit from the non-interest financial practices, the MII will enable the deficit banks and surplus banks to transact amongst themselves to cater for their liquidity mismatch, and the AB-i will enable the banks to engage in the international trade. Finally, the instrument will aid the function of the Central Bank in control of the excess liquidity in the economic system through non-interest platform.

Endnotes:

1 See 'Money Market and Its Institutions', viewed at *http://www.onlinenigeria.com/finance/?blurb=561#sthash.LgmiIMF0.dpuf*, retrieved 3 March 2013.

2 Banks and Other Financial Institutions Act, (Decree) 1991, ss. 15, 16.

3 See *http://www.onlinenigeria.com/finance/?blurb=561#sthash.LgmiIMF0.dpuf*, retrieved 3 March 2013.

4 See CBN Act 2007, s. 30.

5 *Ibid*, s. 30(a).

6 Paragraph 13.2, Guidelines for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria, 2011 (emphasis added).

7 *Ibid*.

8 Central Bank of Nigeria (CBN), Guidelines for the Operation of Non-Interest Financial Institutions Instruments by the Central Bank of Nigeria, 2012, at 6.

9 *Ibid*.

10 Guidelines for the Operation of Non-Interest Financial Institutions Instruments by the Central Bank of Nigeria, 2012, at 6.

11 *Ibid*, at 5.

12 Financial Sector Talent Enrichment Programme, Islamic Treasury Operations, Islamic Money Market, at 20.

13 See 'Technical Note on Issues in Strengthening Liquidity Management of Institution Offering Islamic Financial Services: The Development of Islamic Money Markets', Islamic Financial Services Board (IFSB), March 2008, at 25.

14 See *https://fast.bnm.gov.my/fastweb/public/MainPage.do*, retrieved 26 September 2011.

15 Financial Sector Talent Enrichment Programme, Islamic Treasury Operations, Islamic Money Market, at 21.

16 Guidelines for the Operation of Non-Interest Financial Institutions Instruments by the Central Bank of Nigeria, 2012, at 6.

17 *Ibid*, at 6-7.

18 Guidelines for the Operation of Non-Interest Financial Institutions Instruments by the Central Bank of Nigeria, 2012, at 7.

19 John Black, *Dictionary of Economics*, at 476.

20 Osman Babikir Ahmed, 'Islamic Financial Instruments to Manage Short-Term Excess Liquidity', (Jeddah, Islamic Development Bank, Islamic Research and Training Institute, King Fahd National Library Cataloging-in-Publication Data), research paper No. 14, at 33.

21 FSTP, 32.

22 *Ibid*, 33.

23 FSTP, 34.

24 Sam R. Hakim, 'Islamic Money Market Instruments' in M. Kabir Hassan and Mervyn K. Lewis (Eds.), *Handbook of Islamic Banking*, at 167.

25 FSTP, 36.

26 Financial Sector Talent Enrichment Programme, Islamic Treasury Operations, Islamic Money Market, at 17.

27 CD is a certificate of deposit, a promissory note that is issued by a bank. It is a time deposit that restricts holders from withdrawing funds on demand. Although it is still possible to withdraw the money, this action will often incur a penalty. See http://*www.investopedia.com/terms/c/certificateofdeposit.asp#ixzz1fx5IwKTl*, retrieved 7 December 2011.

28 FSTEP, at 17.

29 *Supra*, n. 24 at 36.

30 Sam R. Hakim, 'Islamic Money Market Instruments' in M. Kabir Hassan and Mervyn K. Lewis (Eds.), *Handbook of Islamic Banking*, at 166.

31 FSTEP, at 17.

32 *Encyclopedia of Banking and Finance* (1983), at 931.

33 *Supra*, n. 24 at 24.

34 John Black, *Dictionary of Economics*, at 33.

35 FSTP, 37.

36 *Ibid*.