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SOURCES AND APPLICATION OF FUNDS IN NON INTEREST BANKING REGIME

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INTRODUCTION

In the past two decades, Islamic Banking has grown in size and significance in a large number of countries throughout the world with Balance Sheet estimated at $1 trillion and its annual growth put at 15-20 percent. Rapid development in the Islamic Banking industry has largely accounted for this growth. At present there are over 300 Islamic Banks that are operational throughout the world. Like conventional banking, Islamic banks also need funds to operate its banking activities.

The concept of Islamic Finance is a new phenomenon in Nigeria. However, there was an attempt in the past by Habib Bank to offer Islamic Compliant Asset and Liability products. It is expected that with the licensing of Jaiz Bank (a full pledged Non-Interest Bank) and StanbicIBTC to operate a window of Non-interest banking with some other banks that have shown interest to operate the Non-Interest banking model, we shall begin to see a surge in Islamic products in a Non Interest banking regime.

TYPES OF SOURCES OF FUNDS

- Deposits
- Deposit from other Islamic Bank.
- Banks Equity
- Islamic Investment funds.
- Placement from Bank Treasury.

DEPOSITS: Islamic Banks gets their deposit by offering Current, Savings or Investment deposit products that are compliant with Islamic Jurisprudence. Besides their own capital and equity, Islamic banks rely on two main sources of funds,(a) transaction deposits, which are risk free but yield no return and,(b) investment deposits, which carry the risks of capital loss for the promise of variable. In all, there are four main types of accounts:

1. **Current Account:** This type of deposit is contracted under the principle of Al-Wadiah or guaranteed trust. Under this contract, the Islamic bank guarantees the return of the principal deposit sum. Since deposit is placed under trust, Islamic banks normally do not give any returns for this type of deposits.

2. **Savings Account:** Savings deposits are collected under various principles, namely:

   a. Al-Wadiah – similar to current account except it does not have any cheques facility. Under strict principle of Al-Wadiah, the bank is not supposed to give any returns. Nevertheless, if the bank decides to give some returns, it is given as hiba (gift).

   b. Al-Wadiah and Mudharabah – alternative to Al-Wadiah savings where the bank is not supposed to give any returns, a hybrid of Al-Wadiah and Mudharabah (profit & loss sharing principle) deposit product was introduced. Under this principle, certain portion of the profits derived from the Mudharabah investment is shared with the depositors.

   c. Mudharabah – Investor will be entitled for some profits based on agreed profit-sharing ratio pre-determined on placement of the funds.

3. General Investment Account: Is an investment account with pre-determined profit sharing ratio and maturity period. General investment deposits are contracted under the Mudharabah al Mutlaqa principle, in which the mudarib (active partner) must have absolute freedom in the

KEY DRIVERS	GLOBAL	AFRICA	NIGERIA
Market Size (2011)	$1 trillion	$18 billion	Nil
Market Size Potential	$2.8 trillion	$235 billion	$17 billion
Estimated Muslim Population	1.8 billion	490 million	75 million
No. of Islamic Banks	300	37	3 (no significance)

management of the investment of the subscribed capital. The conditions of this account differ from those of the savings accounts by virtue of: a) a higher fixed minimum amount, b) a longer duration of deposits, and c) most importantly, the depositor may lose some of or all his funds in the event of the bank making losses.

4. Specific Investment Account: is a unique investment product where depositors will be advised on where the funds will be invested, the minimum amount that they can invest, the projected returns and the adherence risk that comes with it. Generally, returns on specific investment account are very much higher, however there are depositors who are keen to place their funds under this type of deposits. Any losses from the project shall be borne entirely by the Investor(Rab-u-mal) except where the loss is due to negligence on the side of the Bank(Mudarib) as such the Bank will be liable.

TYPE OF DEPOSIT POOL

Restricted pool.(Mudaraba Muqayadah)

a. The pool of deposit with specific restriction to a particular project.

b. Deposits sourced from this pool restrict investment channel and risk/return profile.

c. Islamic Investment Funds are generally raised from restricted pool.

Unrestricted pool (Mudaraba Mutalaqa)

a. The pool of deposit without any specific condition of investment in a particular business activity is termed as unrestricted pool.

b. In the case of unrestricted pool Islamic Bank has full freedom of decision making for investment of pooled Funds in any trade or mode of Financing for mix income profile.

c. Islamic Banks raise deposit in common unrestricted pool.

Application of funds

The *mudaraba* and *musharaka* modes, referred to earlier, are supposedly the main conduits for the outflow of funds from banks. In practice, however, other important methods are applied by Islamic banks which include:

Murabaha (mark up). The most commonly used mode of financing seems to be the 'mark-up' device. In a *murabaha* transactions, the bank finances the purchase of a good or assets by buying it on behalf of its client and adding a mark-up before reselling it to the client on a 'cost-plus' basis profit contract.

Bai' muajjal (deferred payment). Islamic banks have also been resorting to purchase and resale of properties on a deferred payment basis. It is considered lawful in fiqh (jurisprudence) to charge a higher price for a good if payments are to be made at a later date. According to fiqh this does not amount to charging interest, since it is not a lending transaction but a trading one.

Bai'salam (prepaid purchase). This method is really the opposite of the *murabaha*. Here the bank gives the commodity first, and receives the money later. Thus, the bank pays the money first and receives the commodity later, and is normally used to finance agricultural products.

Istissanaa (manufacturing). This is a contract to acquire goods on behalf of a third party where the price is paid to the manufacturer in advance and the goods produced and delivered at a later date.

Ijara and *ijara wa iqtina* (leasing). Under this mode, the banks buy the equipment or machinery and lease it out to their clients who may opt to buy the items eventually, in which case the monthly payments will consist of two components, i.e. rental for the use of the equipment and instalment towards the purchases price. Mostly used for Auto and Machinery/Equipment Financing.

Qard hasan (beneficence loans). This is the zero return type of loan that Allah (S.W.A) said in the Holy Quran for Muslims to make available to those who need them. The borrower is obliged to repay only the principal amount of the loan.

Islamic securities. Islamic financial institutions often maintain an international Islamic equity portfolio where the underlying assets comprise ordinary shares in well run businesses, the productive activities of which exclude those on the prohibited list (alcohol, pork, armaments) and financial service based on interest income.

CONCLUSION

The sources and application of funds in Non-Interest Banking discussed above provides another alternative to conventional system of banking of offering product and services. While it may be very wrong to conclude that it is a better option, the opportunity it present must be fully explored especially in Nigeria where the development along this line has been relatively low with hardly any significant growth.