

# EXAMINING THE LEGALITY OF NIGERIA DEPOSIT INSURANCE COMMISSION AS INSURER OF CUSTOMERS' DEPOSITS IN ISLAMIC BANKS IN NIGERIA

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## Abstract

The establishment of Nigeria Deposits Insurance Commission ('NDIC') was a major policy shift of the Nigerian government from rescuing the banks from collapsing to saving the deposits of the depositors; and the NDIC insures both conventional and Islamic banks. However, considering the ethical nature of the Islamic financial system, this study examines the legality of NDIC as insurer of customers' deposits within the provisions of Shari'ah by looking into the need for and the extent to which Islamic banks can participate in the scheme. The research used a qualitative method to retrieve data collected from both primary and secondary sources in order to examine the legality of NDIC (as the insurer of Islamic banks' deposits) and its operation through the prism of the Shari'ah. The purpose, functions and operations of NDIC were analysed and it was found that the major aim of establishing the NDIC is in line with the *maqasid al-Shari'ah* but some of the legislative frameworks for its operations contravene the provisions of the Shari'ah. Appropriate Islamic models, suggestions and recommendations, such as introduction of *Mudarabahh* or *Musharakah* arrangement where the parties involved would share the profit and loss in respect of the invested funds and the adoption of an Islamic Deposit Insurance Scheme to ensure that Islamic Banks' participation in Deposit Insurance Scheme is fully shari'ah-compliant were prescribed to amend these lapses and to further improve the standing of NDIC as an insurer of Islamic banks customers' deposits.

**Keywords:** Nigeria Deposit Insurance Scheme (NDIC); *Takaful*; Islamic insurance; Deposit Insurance Scheme (DIS); Islamic banking in Nigeria

## I INTRODUCTION

Customers patronise banks primarily for the security they provide for their deposits.<sup>1</sup> Ironically, recent happenings in both global and local scenes have revealed that this

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1 Asyraf Wajdi and Dusuki, Nurdianawati Irwani Abdullah, 'Why do Malaysian Customers Patronise Islamic Banks?', (2007) 25(3) *International Journal of Bank Marketing* 142.

security is not ordinarily guaranteed when the financial institution encounters a crisis.<sup>2</sup> The need for the mitigation of the dire consequences to customers when this incidence occurs warranted the establishment of deposit insurance.<sup>3</sup> This has also contributed to the growth in the adoption of Islamic finance frameworks which are considered as alternative financial systems following the global financial crisis that has seen the collapse of several giant conventional financial institutions.<sup>4</sup> In spite of the benefits of the Islamic banking framework, both Shari'ah compliant financial institutions and conventional banks require the extra financial security that is provided by deposit insurance for their customers' deposits. This financial security is meant to provide assistance and encourage prudent risk taking to depositors of bankrupt banks.<sup>5</sup> The safety nets created by the deposit insurance avoid disintermediation<sup>6</sup> resulting in bank failures. Deposit insurance helps in maintaining confidence and soundness in the financial sector in countries where it is implemented.<sup>7</sup>

The Nigeria Deposit Insurance Corporation ('NDIC') was created for the protection of the banking industry and other related services that has to do with customers' deposits in Nigeria<sup>8</sup> with a view to promoting financial stability and protecting bank depositors whether in full or in part, from losses caused by the inability of banks to pay debts when due.<sup>9</sup> Nigeria operates both conventional and Islamic banking systems and the government has made it compulsory for operational banks to join the Depositor Protection Scheme as members and pay the required premium.<sup>10</sup> The general importance of the NDIC is to protect the interest of the depositors of deposit-taking financial institutions. This enhances financial security and encourages economic participation.<sup>11</sup> This overall importance suggests that a link exists between the concept of deposit insurance and the *Maqasid al-Shari'ah* (objectives of Shari'ah) which is aimed at promoting benefits and repelling harms and *Maslaha*, which means utility, good, beneficial or advantage.<sup>12</sup> This refers to something good for the public. It also relates to the preservation of faith, life, lineage,

<sup>2</sup> Joseph E Stiglitz, 'The Financial Crisis of 2007-2008 and its Macroeconomic Consequences' [2009] *Financial Market Reforms* 1-34.

<sup>3</sup> Sebastian Schich, 'Financial Crisis: Deposit Insurance and Related Financial Safety Net Aspects', (2009) 2008 (2) *Financial Market Trends* 1.

<sup>4</sup> Edib Smolo and Abbas Mirakhor, 'The Global Financial Crisis and its Implications for the Islamic Financial Industry', (2010) 3(4) *International Journal of Islamic and Middle Eastern Finance and Management* 372.

<sup>5</sup> Edward J Kane, 'Designing Financial Safety Nets to Fit Country Circumstances' (Policy Research Working Paper No. 2453, World Bank, 2000) 2453.

<sup>6</sup> Disintermediation in finance, is the withdrawal of funds from intermediary financial institutions, such as banks and savings and loan associations, to invest them directly. Generally, disintermediation is the process of removing the middleman or intermediary from future transactions. See: 'Disintermediation', *Investopedia* (Web Page, 6 December 2021) <[www.investopedia.com/terms/d/disintermediation.asp](http://www.investopedia.com/terms/d/disintermediation.asp)>.

<sup>7</sup> *Core Principles for Effective Deposit Insurance Systems* (International Association of Deposit Insurers, 2014) 6.

<sup>8</sup> Ademola G. Olukotun, Olusegun O James and Kehinde Olorunfemi, 'Bank Distress in Nigeria and the Nigerian Deposit Insurance Corporation Intervention' (2013) 13(8) *Global Journal of Management and Business Research Finance* 59.

<sup>9</sup> *Ibid*, 56.

<sup>10</sup> Salisu Hamisu and Rusni Hassan, 'Depositors Protection Scheme: Appraisal of Islamic Banks Participation in Deposit Insurance System', (2017) 5(1) *Journal of Islamic Banking and Finance* 15.

<sup>11</sup> GA Ogunleye, 'Deposit Insurance Scheme in Nigeria: Problem and Prospect', [2002] *NDIC Quarterly* 17.

<sup>12</sup> IADI, 'Deposit Insurance from Shariah Perspective', (Discussion Paper, Islamic Deposit Insurance Group of the International Association of Deposit Insurers, 2010) 4.

intellect and property of human beings.<sup>13</sup> However, the basic principle of all Islamic financial transactions is that they must be free from *Riba* (Interest), *Gharar* (Uncertainty), *Maisir* (Gambling) and sale/purchase of unlawful goods and services.<sup>14</sup> Although the goals of the scheme are beneficial to Islamic banking system in Nigeria, the problem of the permissibility of insurance and the methods used in fulfilling this scheme needs to be in line with the Shari'ah to ensure its legality under the Shari'ah. This poses a problem because all financial institutions in Nigeria (Islamic banks included) are expected to be insured by NDIC. There are possibilities of NDIC violating the basic principle of all Islamic financial transactions as it is not Islamic oriented. There is no Islamic deposit insurance scheme in Nigeria to make provision for the peculiarities of Islamic financial system thereby ensuring the provision of an ideal climate for Islamic banks to be insured.

This study intends to look into the potential of deposit insurance (NDIC) in preventing the public from experiencing financial difficulties, instilling public confidence about the safety of deposits, promoting financial stability and maintaining the competitiveness of Islamic deposits while keeping the activities of the insurer in line with the provisions of Shari'ah.

## II ISLAMIC BANKING SYSTEM IN NIGERIA

The establishment of the Islamic banking system is central to the injunctions of Islamic commercial transaction which prevents Muslims and the institutions that serve them from dealing in interests (*Riba*) and transactions considered to be contrary to Shari'ah.<sup>15</sup> This makes the fundamental aim of Islamic financial institutions to be that of offering Shari'ah compliant transactions and activities in all their dealings.

Islamic banking, also known as non interest banking, is defined as a banking system that is based on the principle of Islamic or Shari'ah law and guided by Islamic economics. Two fundamental principles of Islamic banking are the sharing of profit and loss, and the prohibition of the collection and payment of interest by lenders and investors. Islamic banks make profit through equity participation which requires borrower to give the bank a share in their profits rather than paying interest. Islamic banking is guided by the Islamic rules on transactions known as *Fiqh al-Muamalat*, which all banks must follow. According to Investopedia, there are over 300 Islamic banks in over 51 countries around the world, including the United States of America.<sup>16</sup>

Taking the cue from the part of the world where Islamic banking systems were adopted with increasing success, there were desires and agitations in Nigeria as to the implementation of Islamic banking systems in its financial sector, the reasons being Nigeria's high Muslim population, and seeing that the advantageous financial discipline

<sup>13</sup> Tawfiq Al-Mubarak and Noor Mohammad Osmani, 'Applications of Maqasid al-Sharia and Maslahah in Islamic Banking Practices: An Analysis' (International Seminar on Islamic Finance in India, 2010) 4.

<sup>14</sup> Burhan Uluyol and Adam Abdullah, 'Prohibited Elements in Islamic Financial Transactions: A Comprehensive Review' (2016) 21(3) *Al-Shajarah* 140.

<sup>15</sup> Echekoba Felix Nwaolisa and Ezu Gideon Kasie, 'Islamic Banking in Nigeria: A Critical Appraisal of its Effect on The Nigerian Economy' (2013) *Review of Public Administration and Management* 37-48.

<sup>16</sup> Evan Tarver, 'Islamic Banking', *Investopedia* (Web Page, 3 May, 2021) <<http://www.investopedia.com/terms/i/islamicbanking.asp>>.

is one of the characteristics of the Islamic banking system which is needed in the Nigerian economy as it is beneficial not only to the preservation of the Islamic principle among the country's Muslim population, but can also help in stabilising the financial sector of the nation as a whole.<sup>17</sup>

### ***A Customers' Deposits and its types in Islamic Banking***

A customer deposit is a funding component of a banking institution.<sup>18</sup> Customer deposit or bank deposit consists of money placed into banking institutions for safekeeping.<sup>19</sup> The account holder has the right to withdraw deposit funds, as stated in the terms and conditions in the agreement governing the account. Customer deposit refers to the liability rather than the actual funds that has been deposited. When someone opens a bank account and makes a cash deposit, he surrenders legal title to the cash, and it becomes an asset of the bank. In turn, this makes customer's deposit a liability owed by the bank to the depositor.<sup>20</sup>

Customers' deposits are important source of financial strength for Islamic banks as these deposits are used to increase the capacity for financing operations which thereby increase the profit for shareholders.<sup>21</sup> Basically there are four types of customers' deposits in Islamic banking and they are; Current deposits, Savings deposits, Term deposits and Investment deposits.

#### ***1 Current Deposits***

Current deposits permit its customers to deposit and withdraw their money at any time and do not require a minimum balance in the deposit account.<sup>22</sup> It is based on the Shari'ah commercial principles of *Wadiah*<sup>23</sup> or *Qard Hasan*<sup>24</sup>. Under the *Amanah* arrangement, the

<sup>17</sup> Mustafa Daud, Ibrahim Mohd Yussof and Adewale Abideen, 'The Establishment and Operation of Islamic Banks in Nigeria: Perception Study on The Role of the Central Bank of Nigeria' (2011) 1(2) *Australian Journal of Business and Management Research* 14-29.

<sup>18</sup> 'Customer Deposits', *Financial Advisory* (Web Page, 3 May, 2021) <<http://www.financialadvisory.com/dictionary/term/customer-deposit.asp>>.

<sup>19</sup> Julian Kagan, 'Bank Deposits', *Investopedia* (Web Page, 3 May, 2021) <<https://www.investopedia.com/terms/b/bank-deposits.asp>>.

<sup>20</sup> Ibid.

<sup>21</sup> 'Deposits- Islamic Finance', *Financial Islam*, (Web Page, 23 April 2021) <<http://www.financialislam.com/deposits.html>>.

<sup>22</sup> Jeroen P.M.M. Thijs, 'Islamic Banking Products and Operation' (Conference Paper, Conference on Islamic Finance: Structure and Instruments, 26 – 30 September 2011).

<sup>23</sup> Wadi'ah refers to a contract by which an owned asset is placed with another party on the basis of trusteeship (amanah) for safekeeping purposes. See: Bank Negara Malaysia, 'Wadi'ah (Shariah Requirements and Optional Practices)' (Web Page, 20 December 2021) <<https://islamicbankers.files.wordpress.com/2013/12/2013-ed-wadiah.pdf>>; Issa Qaed Mansour Qaed, 'The Concept of *Wadiah* and its Application in Islamic Banking' (2014) 2(11) *Journal of Research in Humanities and Social Science* 70-74.

<sup>24</sup> *Qard al-hasan* is a loan contract between a debtor and creditor whereby the debtor only pays back the principal amount which is borrowed. The debtor can pay more than the amount borrowed so long that it is not stated in the contract. See: Norma Md Saad, Mustafa Omar Mohammad and Mohammed Aslam Haneef, 'Empowering Community Through Entrepreneurship Training and Islamic Micro-Financing: Sharing the Experience of IIUM-CIMB Islamic Smart Partnership (i-Taajir)' in Patricia Ordoñez de Pablos, Mohammad Nabil Almunawar and Muhamad Abduh (Eds.), *Economics, Business, and Islamic Finance in ASEAN Economics Community* (IGI Global, 2020) 57-76.

Islamic banks treat the funds as a trust and cannot use these deposits for its operations.<sup>25</sup> However the Islamic banks do not guarantee the refund of deposits in case of loss resulting from circumstances beyond its control.<sup>26</sup> In *Wadiah*, the bank takes permission from the depositors to use the deposits and guarantees the return of the deposits whenever the depositors demand for it.<sup>27</sup> Current deposits based on the principle of *Qard Hasan* involves the customer giving the bank the authority to use his/her account funds to invest in its operations, and this is considered as a non-interest loan by the depositor to the bank.<sup>28</sup> The bank however is obligated to return the credit balance to the depositor who has no right to receive any profit on the balance.<sup>29</sup>

## 2 Savings Deposits

Savings deposits are similar to current deposits as it also permits customers to deposit and withdraw money at any time they want, however, savings account operates in a different way. Deposits in savings accounts are accepted based on the principle of *Mudarabah*.<sup>30</sup> *Mudarabah* is an investment contract where one party (*Rabb al-mal*)<sup>31</sup> provides the capital and the other party which is the bank (*Mudarib*) provides the skill and experience.<sup>32</sup> In a *Mudarabah* deposit, the depositor acts as the capital supplier while the bank acts as the investor.

## 3 Term Deposits

Term deposits are types of arrangement where the deposits of customers are held for a fixed period of time and these deposits are in turn used to invest in business activities in accordance with the Shari'ah.<sup>33</sup> This type of deposit is commonly structured based on the commodity of *Murabaha*, *Wakalah* unrestricted investment and *Mudarabah* general investments.<sup>34</sup>

<sup>25</sup> Shafi'i Abdul Azeez Bello and Rusni Hassan, 'Savings and Current Account in The Context of Sharia Contract', (2014) 1(12) *Arabian Journal of Business and Management Review* 10.

<sup>26</sup> 'Deposits- Islamic Finance', (n 31).

<sup>27</sup> Abdus Samad and Mohammad Ashraful Ferdous Chowdhury, 'Islamic Banks' Return on Depositors and Conventional Banks' Deposit Interest: Is there Causality? Evidence of Causality from Bangladesh' (2017) 7(5) *International Journal of Economics and Financial Issues* 432.

<sup>28</sup> Farooq, M.O., 'Qardh al-Hasana, Wadiah/Amanah and Bank Deposit: Application and Misapplication of Some Concepts in Islamic Banking' (Paper presented at the Harvard Islamic Forum on April 19 – 20, 2008) 1-24.

<sup>29</sup> Farooq, M.O., *ibid*.

<sup>30</sup> Ayub Muhammad, *Understanding Islamic Finance* (John Wiley & Sons, 2007) 189-190.

<sup>31</sup> *Rabb al-mal* is referred to as the capital provider of funds in a *mudarabah* contract. See: 'Rab-ul Mal', *Investment and Finance*, (Web Page, 5 May 2021) <<https://www.investment-and-finance.net/islamic-finance/rab-ul-mal.html>>.

<sup>32</sup> Abdus Samad and Mohammad Ashraful Ferdous Chowdhury, (n 36), 434.

<sup>33</sup> Issa Qaed Mansour Qaed, (n. 33), 71.

<sup>34</sup> 'Islamic Fixed Deposit-i', *May Bank*, (Web Page, 15 December 2021) <[https://www.maybank.com/islamic/en/deposits/term/fix\\_deposit-i.page?>](https://www.maybank.com/islamic/en/deposits/term/fix_deposit-i.page?>); Sanaa Nazami Maswadeh, 'How Investment Deposits at Islamic and Conventional Banks Effect Earnings Per Share?' (2020) 7 (11) *The Journal of Asian Finance, Economics and Business* 669-677.

#### 4 *Investment deposits*

Investment deposits are based on the principle of partnership (*Mudarabah*) which entails profit sharing and it covers all accounts where the customer agrees to place deposits for a fixed term. In principle the bank is not allowed to provide guarantees for the principal and fixed return except on a voluntary basis.<sup>35</sup> However, banks can arrange a third-party guarantee.<sup>36</sup>

### III DEPOSIT INSURANCE IN THE NIGERIAN BANKING SYSTEM

Nigeria operates a dual banking system of both conventional banking and Islamic/non-interest banking system. A bank Deposit Insurance Scheme ('DIS') is a financial guarantee particularly for customers with smaller income and savings, in the event of a bank failure. Bank deposit insurance schemes developed out of the need to protect depositors, especially the uninformed, from the risk of loss and to also protect the banking system from instability occasioned by uncertainty and loss of confidence. In this regard, Deposit Insurance becomes the tool through which such service can be rendered and they are established to perform functions such as the following, among others:<sup>37</sup>

- i. Insuring all deposit liabilities of all licensed banks and such other deposit-taking financial institutions, such as micro-finance banks operating in Nigeria so as to engender confidence in the Nigerian banking system.
- ii. Giving assistance in the interest of depositors in case of imminent or actual financial difficulties of banks particularly where suspension of payments is threatened.
- iii. Guaranteeing payments to depositors in case of imminent or actual suspension of payments by insured banks or financial institutions up to the maximum deposit insurance coverage.

The banking system has been singled out for special protection because of the vital role banks play in an economy whether developed or developing. For a DIS to be effective in achieving the above objectives, it must be properly designed, well implemented by the agency established to execute the scheme and well understood by members of the public.<sup>38</sup> A well designed DIS contributes to the stability of a country's financial system by reducing the incentives for depositors to withdraw their insured deposits from banks following rumours about financial crises.<sup>39</sup>

<sup>35</sup> Md. Habibur Rahman, 'Guarantee of Investment Deposit in Islamic Banks: Fiqh Analysis' (2015) 1 (3) *Journal of Islam, Law and Judiciary* 37-53.

<sup>36</sup> *Ibid.*, 35.

<sup>37</sup> Ganiyu A. Agunleye, 'Role of Deposit Insurance in Financial Inclusion: The Nigerian Experience', *Nigerian Observer* (Online, 2 June 2015) <<https://nigerianobservernews.com/2015/06/role-of-deposit-insurance-in-financial-inclusion-the-nigerian-experience/>>.

<sup>38</sup> *Guidance for Developing Effective Deposit Insurance Systems* (Financial Stability Forum, 2001) 3.

<sup>39</sup> GA Ogunleye, (n 11), 17.

The establishment of the NDIC brought about the introduction of an Explicit Deposit Insurance Scheme into the Nigerian banking sector. Along with the major function of NDIC which is to insure the deposits of all banks and other deposit-taking financial institutions licensed by the Central Bank of Nigeria ('CBN'), the NDIC is also fashioned to enhance the existing safety-net in the banking sector. The result of this is the boost in confidence of the customers of banks. It was also designed to serve as an additional framework and a substitute to the government support policy (implicit insurance) which was used prior to the creation of NDIC.<sup>40</sup>

Before NDIC was created, the Nigerian government had been trying to put in measures to forestall bank failures because of its adverse effects on citizenry. Because of this, underperforming banks were given government support. However, such direct support (implicit insurance) could not be sustained under the Structural Adjustment Programme introduced in 1986 which, among other implications, deregulated the economy towards market orientations. With the establishment of the NDIC the negative impact of bank failures was minimized while moral hazard associated with direct government support was eliminated.<sup>41</sup>

#### IV THE LEGAL FRAMEWORK OF THE NDIC

The NDIC is regulated by the Nigerian Deposit Insurance Corporation Act, No. 16, 2006 ('NDIC Act'). It empowered the Corporation to insure all deposit liabilities of licensed banks and other financial institutions<sup>42</sup> with the exception of insider deposits counterclaims and deposits held in the off-shore branches of local banks.<sup>43</sup> Section 3(1) of the NDIC Act states that, notwithstanding any provision contained in any other law, no person other than the NDIC shall insure deposit liabilities or guarantee payments to depositors of insured institutions operating in Nigeria.

The NDIC is empowered to come to the aid of an insured bank in case of imminent or actual financial difficulties which may threaten payment to customers.<sup>44</sup> This may be in the form of liquidity support to the banks on agreeable terms, giving guarantees for the banks' loans, or even taking over the management of a wobbling bank until its financial position improves.<sup>45</sup>

In the event that the NDIC exhausts all its protective alternatives and a failing bank still has to postpone payment, the NDIC is obliged to pay every insured depositor up to the insurable limit which is presently five hundred thousand naira (₦500, 000) and two hundred thousand naira (₦200, 000) per depositor per account in Deposit Money Banks

<sup>40</sup> 'About Nigeria', *International Association of Deposit Insurers*, (Web Page, 13 November 2021) <<https://www.iadi.org/ndic/about-nigeria/>>.

<sup>41</sup> BO Iganiga, 'Evaluation of Nigerian Financial Sector reforms using Behavioural Models', (2010) 1 (2) *Journal of Economics* 65-75.

<sup>42</sup> *Nigerian Deposit Insurance Corporation Act No 16 2006* (Nigeria) s 3(1) ('NDIC Act')

<sup>43</sup> *Ibid* s 2(1), 15(1) and 16; Insider Deposit is the deposit of bank staff while counter-claim is a deposit account used as collateral for a loan account in the same bank: *Ibid* s 16(a) and (b).

<sup>44</sup> *Ibid* s 2(1)(b) and 37(2).

<sup>45</sup> Banks and Other Financial Institutions Act LFN 2004 (Nigeria) s 36 ('BOFIA').

(‘DMB’s) and Microfinance Banks (‘MFB’s) respectively.<sup>46</sup> For this reason, adequate financial resources are required to meet the scheme’s obligations and operational costs. In Nigeria, the Act establishing the NDIC recognises four sources of funding the activities of the scheme. These are insurance premium contribution by participating institutions, capital contributions and periodic recapitalisation provided by the owners of the scheme, borrowing facility from the CBN and special contributions or levies imposed on healthy member institutions as and when necessary.<sup>47</sup>

In specific terms, section 17(1) of the NDIC Act states that the assessment rate for premiums by insured banks is set as 15/16 of 1% of the total deposits of member institutions per annum which is about 0.94 percent. For other deposit-taking financial institutions, the premium to be paid is set at 18/16 of 1% of total deposits per annum as at 31<sup>st</sup> December of the preceding year with the possibility of reduction in premium rate when the Deposit Insurance Fund (‘DIF’) is more than 10 times the paid-up capital as provided for in Section 12(2) of the NDIC Act. Section 16(a) to (c) specifies the assessment base as the total deposits of insured institutions except the following deposits: insider deposits<sup>48</sup>, counter claims from a person who maintains both a deposit and loan accounts, with the former serving as collateral for the loan; and such other deposits as may be specified from time to time by the Board of NDIC.

Also, section 11(1) of the NDIC Act indicates the amount of initial capitalisation by the government as 5 billion with provision for periodic recapitalisation in Section 11(3). Also, where the DIF of the NDIC is not sufficient for its insurance obligations, Section 17(5) provides that all participating institutions shall be obliged to pay to the NDIC, special contribution of not more than 200% of the amount of an annual premium. Rules and regulations guiding distress resolution in Nigeria flows directly from the provisions of the BOFIA.<sup>49</sup>

Finally, the day-to-day administration of NDIC is also being funded<sup>50</sup> from the income earned on the investment of the DIF in accordance with the Act. Sections 13(1) to (3) gives the NDIC the power to invest money not immediately required in the Federal Government securities and in such other securities. The income of this investment is to be placed in the NDIC account and be defrayed for administrative expenses of the NDIC. Section 52(1) also gives the NDIC the power to borrow from the Central Bank of Nigeria such monies as it may deem fit for the discharge of its statutory functions, which include:<sup>51</sup> insuring deposit liabilities of licensed banks; provision of financial and technical assistance in the interest of depositors to banks in difficulties; rendering assistance to insured institutions in order to protect the interest of the depositors;<sup>52</sup> guaranteeing payments to depositors in the financial or banking sector in the case of imminent or actual

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<sup>46</sup> NDIC Act (n 42) s 20(1).

<sup>47</sup> *Ibid* s 10(1).

<sup>48</sup> These are deposits of staff including directors of the insured institutions.

<sup>49</sup> BOFIA (n 45) s 38.

<sup>50</sup> NDIC Act (n 42) s 10(1)(a) to (e)

<sup>51</sup> *Ibid* s 2. See also: ‘NDIC Develops Framework for Non-interest Deposit Insurance Scheme’ (Press Release, 12 January 2016) <<https://ndic.gov.ng/ndic-develops-framework-for-non-interest-deposit-insurance-scheme/>>.

<sup>52</sup> GA Ogunleye, (n 11), 17.

suspension of payments by the insured institution; and ensuring orderly and efficient closure of failed institutions.

### ***A Requirements of the NDIC as Insurer of Customer's Deposit***

#### **1 *Licensed banks***

One of the requirements of the NDIC is that once a deposit-taking financial institution is licensed by the CBN as Universal Banks (DMBs), MFBs or Primary Mortgage Institutions ('PMI's), such licensed financial institution automatically becomes a member institution of the NDIC as membership is compulsory as provided under the NDIC Act.<sup>53</sup>

#### **2 *Insurance premium***

All member institutions of the NDIC are required to pay premium annually and the method employed in Nigeria is *Ex Ante* which means the payment is made annually by the members before the event envisaged happens and the payment is based on the formula 15/16 of 1% of the total annual deposits of banks by virtue of Section 1 of NDIC Act.

#### **3 *The maximum deposit insurance limit***

Up until the year 2005, the maximum insurance limit was set at ₦50,000.00 per depositor in the event of a failure of an insured institution.<sup>54</sup> After the NDIC Act in 2006, the maximum coverage increased to ₦200,000.00 per depositor. At inception and up to the recent past, the insurance of deposit services was limited to only conventional licensed banks but that has changed with the extension of coverage to other deposit-taking financial institutions, specifically MFBs and PMIs at a limit of ₦100,000.00 and the reason is to encourage the small investors to improve on their banking habits since they are assured of the safety of the deposit at all times.<sup>55</sup>

## **V SHARI'AH PERSPECTIVE OF DEPOSIT INSURANCE**

Insurance is a form of safeguard against uncertainties and it provides some form of financial recompense for losses suffered due to incidence of unanticipated events, insured within the policy of insurance.<sup>56</sup> In practical definition, insurance is the equitable transfer of the risk of a potential loss, from one entity to another, in exchange for a premium and duty of care.<sup>57</sup> It is a form of risk management primarily used to hedge against the risk of catastrophic financial loss.<sup>58</sup> Globally, insurance has grown into super profitable

<sup>53</sup> NDIC Act (n 42) s 15.

<sup>54</sup> GA Ogunleye, 'Deposit Insurance Scheme in Nigeria: Problems and Prospects' (Conference Paper, Annual Conference of International Association of Deposit Insurers (IADI), May 2002), 8.

<sup>55</sup> NDIC, *Thirty Years of Deposit Insurance System in Nigeria* (Nigerian Deposit Insurance Corporation, 2019) 164.

<sup>56</sup> Insurance Information Institute, *Insurance Handbook-A guide to insurance: what it does and how it works* (Insurance Information Institute, 2010) 1.

<sup>57</sup> Julian Kagan, 'Transfer of Risk', *Investopedia*, (Web Page, 16 November 2021) <<https://www.investopedia.com/terms/t/transferofrisk.asp>>.

<sup>58</sup> Judy Feldman Anderson and Robert L. Brown, *Risk and Insurance* (Society of Actuaries, 2005) 2-3.

commercial enterprise through underwriting and investment of premium collected from the insured by the insurers.<sup>59</sup> The insurer predicts the likelihood that a claim will be made against his policies and prices his products accordingly, using tools of statistics and probabilities.<sup>60</sup>

On the ruling of the permissibility of commercial insurance in Shari'ah, Ibn Abiddin scrutinised maritime insurance practices that was prevalent in his time which has the same characteristics as contemporary commercial insurance and declared it impermissible under Shari'ah because it involved elements of uncertainty (*Gharar*) and interest (*Riba*).<sup>61</sup> Consequently, the same ruling is applied to commercial insurance which has a high level of uncertainty in that payment of the premium occurs when what is being bought is not well defined and in most cases, the amount to be paid or received is not known from the beginning and these activities are also enshrined in the transactions based on interest.<sup>62</sup>

Deposit insurance also shares similarity with cooperative insurance (*Takaful*) which is acceptable in Shari'ah.<sup>63</sup> *Takaful* is an arrangement in which a group of participants mutually agree to help members in the scheme who suffer loss or damage arising from specified risks.<sup>64</sup> In such arrangement, the participants agree to make contributions (*tabarru'*) into a fund to assist members during incidence.<sup>65</sup> The *Takaful* insurance has a similar basic principle as conventional deposit insurance because it provides protection for loss occasioned by the attachment of risk. However, *Takaful* differentiates itself from conventional deposit insurance in a number of ways some of which are as follows:<sup>66</sup>

- i. Risk protection provided by persons who face exposure to the same type of risk through the system of *tabarru'* (donation) into a common pool which is used to provide indemnity on claims<sup>67</sup> unlike conventional Deposit Insurance where risk is transferred to the insurer who provides indemnity in exchange for premiums.<sup>68</sup>
- ii. The money paid by the insured to the conventional insurer in exchange for risk protection belongs to the insurer but the money paid to pool as *tabarru'* belongs to the contributors.

<sup>59</sup> Julian Kagan, 'Insurance Premium', *Investopedia*, (Web Page, 15 December 2021) <<https://www.investopedia.com/terms/i/insurance-premium.asp>>.

<sup>60</sup> Ibrahim Abikan Abdulqadir, 'Islamic Banks' Participation in Deposit Insurance Scheme: A Legal Appraisal' (2011) 21(1) *NDIC Quarterly Journal* 17-43.

<sup>61</sup> Ibn Abiddin, *Hashiyat Radd Al-Mukhtar Ala al-Durar Al mukhtar* (Egypt: Matb'ah Al-Babi Al-Alabi, n.d).

<sup>62</sup> Yusuf Sani Abubakar *et al*, 'Concept of Deposit Insurance: A Comparative Study between Conventional System and Shariah' (2016) 18(10) *IOSR Journal of Business and Management* 94.

<sup>63</sup> Ibrahim Abikan Abdulqadir (n 60), 20-39.

<sup>64</sup> Khairuddin H.A., 'Implementation of an Islamic Deposit Insurance System for the Islamic Financial Services Industry' (Conference Paper, Islamic Financial Stability Forum, 17 November 2011) 5.

<sup>65</sup> 'Shari'ah Approaches for the Implementation of Islamic Deposit Insurance Systems', *International Association of Deposit Insurers*, (Research Paper, 16 November 2021) <[https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/Shariah\\_Approaches\\_for\\_IDIS-for-publication-Nov\\_2014-FINAL.pdf](https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/Shariah_Approaches_for_IDIS-for-publication-Nov_2014-FINAL.pdf)>.

<sup>66</sup> Ibrahim Abikan Abdulqadir, (n 60), 17.

<sup>67</sup> Ramin Cooper Maysami and John Joseph Williams, 'Evidence on the Relationship between *Takaful* Insurance and Fundamental Perception of Islamic Principles', (2006) 2(4) *Applied Financial Economics Letters* 2.

<sup>68</sup> Simon Archer, Rifaat Ahmed Abdel Karim and Volker Nienhaus (eds.), *Takaful Islamic Insurance: Concepts and Regulatory Issues* (Wiley 2011) 25.

- iii. The conventional Deposit Insurance may make any kind of investment including interest bearing ventures but a *takaful* operator may only invest in Shari'ah compliant businesses and may not involve itself in interest bearing investments.<sup>69</sup>

In view of this, it has been suggested that Islamic financial services being inseparable from the general principles of the Shari'ah, must base their foundations on the *maqasid al-Shari'ah* which is aimed at promoting benefits and repelling harm to ensure the distinction from conventional finance.<sup>70</sup> Thus, the Deposit Insurance Scheme employed by Islamic banks must be free from the elements that Islam strictly prohibits, which is why Muslim communities aspire for a deposit insurance system that meets Shari'ah requirements. This has led to the creation of Islamic Deposit Insurance Scheme in some Muslim dominated countries for Islamic banks.<sup>71</sup>

### ***A The Requirements of Shari'ah for a Deposit Insurance Corporation***

The basic principle of all Islamic financial transactions is that they must be free from prohibited elements such as interest (*riba*), uncertainty (*gharar*), and gambling (*maysir*).

#### ***1 Interest (Riba)***

The concept of interest occupies a significant position in the economic system of Shari'ah.<sup>72</sup> Interest in Arabic is referred to as *Riba* which in classical Islamic Jurisprudence means surplus value without counterpart or to ensure equivalence in real value.<sup>73</sup> Interest (*Riba*) is strictly prohibited in Islam as dealing with interest-based transactions means declaring war with Allah and His Messenger (Muhammad, peace be upon him).<sup>74</sup>

One of the moral principles behind the banning of interest is the need to forbid inflated interest which is an instrument of injustice and this injustice stems from the fact that interest-based transaction encourages an imbalance in the share of power and wealth between the lender and the borrower.<sup>75</sup> The result of this is that interest-based transactions give the lender the capacity to exploit the needs of the borrower and to dictate the rate of return, leading to the potential of the lender maximizing his profits to the detriment of the borrower and in some cases impoverishing the borrower even more.<sup>76</sup> Interest exists in any financial transactions when there is an unequal exchange of two interest-based commodities or an exchange of money for money with different quantities, different

<sup>69</sup> Maryam Dikko, 'An Analysis of Issues in Takaful (Islamic Insurance)' (2014) 6(15) *European Journal of Business and Management* 1-5.

<sup>70</sup> Mirza Vejzagic and Edib Smolo, 'Maqasid al-Shari'ah in Islamic Finance: An Overview' (Conference Paper, Islamic Economic System Conference 2011 (iECONS 2011), 4-5 October 2011) 8-9.

<sup>71</sup> 'Deposit Insurance from the Shari'ah Perspective', (Discussion Paper, International Association of Deposit Insurers, February 2010) 3-4.

<sup>72</sup> Muhammad Zubair and Sadia Khattak, 'Concept of Riba (Interest) in Islamic Law: Its Impact on Society' (2015) 27(4) *Sci.Int.* 3601-3603.

<sup>73</sup> Abu Umar Faruq Ahmad and M Kabir Hassan, 'Riba and Islamic Banking', (2008) *Journal of Islamic Economics, Banking and Finance* 2.

<sup>74</sup> Al-Qur'an, Baqarah (2) verse 279.

<sup>75</sup> Muhammad Zubair and Sadia Khattak, (n 89), 3603.

<sup>76</sup> *Ibid.*

values and at different times. Interest obviously gives an advantage to people with a surplus of money, who receive a premium on their money lent out to people faced with a deficit of money.<sup>77</sup>

Another reason for forbidding interest on a societal level is because it damages the spirit of cooperation among people, gives birth to enmity, hatred and is inherently a principal agent of class formation which creates a class of people whose money increases without them making any effort.<sup>78</sup>

Classical jurists opined that interest is prohibited outright and it includes both *Riba an Nasiyah* (interests on loans) and *Riba al fadhil* (interest through unfair sales).<sup>79</sup> Interests on loans is practiced under the conventional banking system, it refers to duration of time which is given to the borrowers for the repayment of loans in return for extra over the principal amount.<sup>80</sup>

Islamic banking is different from conventional banking because Islamic banks are not allowed to offer a fixed rate of return on deposits and are not allowed to charge interest on loans.<sup>81</sup> Based on this guiding principle in Islamic financing on the prohibition of interest, Muslims are not permitted to receive or pay interest and are therefore barred from conducting business with conventional banks.<sup>82</sup>

In a DIS where banks pay premium to the deposit insurer and are reimbursed when the need arises, the technicality of labelling the acts as an interest-based transaction has raised debates. DIS does involve the exchange of money for money and it occurs with different values and at different times. Hence, some Shari'ah scholars would argue that it is an interest-based transaction and therefore non-permissible.<sup>83</sup> The interest element could occur also when the deposit insurer while carrying out activities like protecting deposits, investing the deposit insurance funds, lending to troubled banks, and obtaining external funds (when in deficit), carry out such activities in an interest-based system.<sup>84</sup>

## 2 Uncertainty (*Gharar*)

Uncertainty exists when either the object or the subject matter of a transaction or activity is uncertain. It can occur either naturally or through a deliberate act by parties involved in the contract. All transactions and activities including deposit insurance may contain the element of uncertainty. Shari'ah scholars distinguish two categories of uncertainty:

<sup>77</sup> M Shodiq, 'Sharia Compliance in Deposit Insurance', *Jakarta Post* (Online, 2 August 2016) <<https://www.thejakartapost.com/academia/2016/08/02/sharia-compliance-in-deposit-insurance.html>>.

<sup>78</sup> Abdulrahman Haitham Shoukat Kabbara, *The Foundations of Islamic Economics and Banking* (Partridge Singapore, 2014) 110; Sayyid Abu Ala al-Maududi, *Economic System of Islam*, Ahmad, K. (ed.) Translated by Husain, R. (Islamic Publications, 4<sup>th</sup> ed., 1997) 187-188.

<sup>79</sup> Imran Ahsan Khan Nyazee, *The Concept of Riba and Islamic Banking* (Niazi Publishing House, 1995) 17-21.

<sup>80</sup> Md Akther Uddin, 'Principles of Islamic Finance: Prohibition of Riba, Gharar and Maysir' (MPRA Paper No. 67711, Munich Personal RePEc Archive, November 2015).

<sup>81</sup> Beng Soon Chong and Ming-Hua Liu, 'Islamic Banking: Interest-Free or Interest-Based?' (2009) 17(1) *Pacific-Basin Finance Journal* 125-144.

<sup>82</sup> Mohamed Ariff, 'Islamic Banking' (1988) 2(2) *Asian-Pacific Economic Literature* 46-62.

<sup>83</sup> Jocelyn Grira, M Kabir Hassan and Issouf Soumaré, 'Pricing Beliefs: Empirical Evidence from the Implied Cost of Deposit Insurance for Islamic Banks', (2016) 55C *Economic Modelling* 152-168.

<sup>84</sup> Wan Marhaini Wan Ahmad, "Some Issues of *Gharar* (Uncertainty) in Insurance" in Bakar M.D and Engku Ali, E.R.A. (Eds.) *Essential Readings in Islamic Finance* (Cert Publications, 2008) 247-268.

permitted and prohibited under Shari'ah. Shari'ah prohibits uncertainty when, for example, its existence is excessive, which could lead to undue losses for one party or disagreement between the transacting parties.<sup>85</sup> The uncertainty element exists in deposit insurance in respect of the failure of a bank. Nevertheless, such uncertainty may not be prohibited as it is unavoidable and naturally embedded in deposit insurance. The setting-up of a deposit insurance system is in line with the government's strategy that it must always be ready to face the failure of a bank and to protect insured depositors. Some Shari'ah scholars have disapproved of the deposit insurance model arguing that it entails excessive uncertainty as the insured risk might not materialize.<sup>86</sup>

According to another argument, such uncertainty is not prohibited as it does not provide an avenue for one party to gain while another to suffer loss. There is no issue of uncertainty in deposit insurance with regard to, for example, the deposit products covered, the amount to be reimbursed to insured depositors, and when they would be reimbursed, as an explicit deposit insurance system would address these through government regulation.<sup>87</sup>

## VI PERMISSIBILITY OF NDIC AS INSURER OF CUSTOMER'S DEPOSIT FROM THE PERSPECTIVE OF SHARI'AH

Islamic banks like all other banks operating in Nigeria are mandated to participate in the DIS as stipulated by section 15 of the NDIC Act and non-compliance amounts to a criminal offence which makes the erring bank liable to a fine of five hundred thousand naira (₦500,000) on conviction for each day the offence continues.<sup>88</sup> The scheme aims at protecting the banking system and offering financial guarantee to the depositors.<sup>89</sup> In promotion and sustenance of public confidence in the banking system, the NDIC is empowered to come to the aid of an insured bank in case of imminent or actual financial difficulties which may threaten payment.<sup>90</sup> This may be in the form of liquidity support to the banks on agreeable terms, giving guarantee for the banks' loans, or even taking over the management of a wobbling bank until its financial position improves.<sup>91</sup> DIS is allowed in Shari'ah based on the following authorities:

...help ye one another in righteousness and piety but do not help one another in sin...<sup>92</sup>

Evidence is also contained in the hadith narrated by Abu Hurayra that:

<sup>85</sup> Ibid.

<sup>86</sup> Ebrahim M. A., *Risk Management in Islamic Financial Institutions* (MBA Dissertation, The University of Manchester, 2011) 24.

<sup>87</sup> Wan Marhaini Wan Ahmad, (n 102), 247-268.

<sup>88</sup> NDIC Act (n 42) s 15(1), (2) and (3).

<sup>89</sup> PN Umoh, 'Bank Deposit Protection: The Nigerian experience', (2003) 13(4) *NDIC Quarterly* 34.

<sup>90</sup> 'Mandate, Powers & Functions', *Nigerian Deposit Insurance Commission*, (Web page, 19 August 2021) <<https://ndic.gov.ng/about-ndic-3/mandate-powers-functions/>>.

<sup>91</sup> NDIC Act (n 42) s 2(1)(b) and 37(2).

<sup>92</sup> Qur'an, *Al-Mai-dah* (5) verse 2.

Once two women from the tribe of Huzail were fighting each other and one hit the other with a stone which killed her alongside the foetus in her womb. The Prophet (S.A.W) ruled that the compensation for foetus was freeing a male or a female slave and the compensation for the woman's life was blood money (*Diyah*) to be paid by the former's clan (*Aqilah*).<sup>93</sup>

The prophet's ruling that the clan should take responsibility was relied upon by scholars as evidence to support the coming together of persons to secure themselves from financial problems in the form of DIS.

With this in mind, Hamisu and Hassan argued that most of the basis of reference considered in justifying the permissibility of DIS has always been on the matter of public interest (*Maslaha*).<sup>94</sup> However, they opined that in many countries practicing an explicit Islamic Deposit Insurance system like Malaysia and Nigeria (NDIC), it is in a form of a tripartite arrangement, where the depository institutions (banks) perpetually pay yearly premiums while the deposit insurers on behalf of the government insures the depositors.<sup>95</sup>

This arrangement has been argued to breach the principle of *al-Ta'awun 'ala al-birr* (helping each other in good deeds) because of the fact that, the participation in the scheme was made mandatory by an act or a legislation and the financial institutions perpetually pay yearly premium, without any plan for a plough back of the premium or even a premium holiday at some point, even when the financial institution does not show any sign of weakness or failure.<sup>96</sup> Meanwhile the depositor who is being insured shares no risk in the arrangement. In Islamic social relationship both *ta'awun* (mutual help or cooperation) and *tabarru'at* (willingly relinquishing individual right for collective benefits) exist under willing and mutual agreement for cooperation towards achieving certain collective benefits.<sup>97</sup>

In another opinion, it has been argued that although the objectives of DIS is compatible with the *Maqasid al-Shari'ah*, some of the laws establishing it need amendments and likewise its operations need adjustments for Islamic banks to be fully integrated without going contrary to the principles of Shari'ah.<sup>98</sup> In view of this, the NDIC has created a framework which is the Non-Interest Deposit Insurance Scheme ('NIDIS') that caters for non-interest banking in Nigeria which takes into consideration the core nature and rules that guides their transaction.

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<sup>93</sup> Al Bukhari, '*Sahih Al Bukhari*', Hadith No. 2172.

<sup>94</sup> Salisu Hamisu & Rusni Hassan, (n 10), 17.

<sup>95</sup> *Ibid.* 15-25.

<sup>96</sup> Mohammed Khnifer, 'Toward a Universal Islamic Deposit Insurance System' *Islamic Bank & Finance* (December 2010) 26.

<sup>97</sup> Hairul Suhaimi Nahar, 'Insurance vs Takaful: Identical Sides of a Coin?' (2015) 13(2) *Journal of Financial Reporting and Accounting* 247-266.

<sup>98</sup> Ibrahim Abikan Abdulqadir, (n 74), 17-43.

### A Islamic Provisions for Deposit Insurance

Under the government regulation approach, the government, in the absence of a Shari'ah-compliant approach, implements the deposit insurance system by giving priority to the socio-economic benefits of the system over the way it is conducted. Such a view is strengthened by the fact that there is hardly any alternative to deposit insurance as a means to satisfy the legitimate need for deposit protection. In this regard, the government regulation approach tolerates the existence of any forbidden elements that are inherent in the deposit insurance mechanism. Other approaches are used where the government, in consultation with Shari'ah scholars, believes that the public interest argument alone is insufficient to justify a Shari'ah compliant deposit insurance system.<sup>99</sup>

A contract is the best available means, be it in Islamic or conventional legal systems, to reflect the intention and consent of contracting parties.<sup>100</sup> In the Quran, there are over 40 verses on several types of commercial contracts. Among the contracts that have been applied to Islamic financing and deposit products are loan (*qard*), cost-plus (*murabahah*), profit-sharing (*mudharabah*), profit and loss sharing (*musharakah*), leasing (*ijarah*), safe custody (*wadi'ah*) and agency (*Wakalah*).<sup>101</sup> For a DIS which is in compliance with the Shari'ah (Islamic Deposit Insurance Scheme ('IDIS')), applicable contracts include 'guarantee with fee' (*kafalah bil ujr*) and 'donation' (*tabarru*).<sup>102</sup>

There is an ongoing debate about the adoption of the guarantee contract in any financial transaction, owing to the existence of the fee element in the contract.<sup>103</sup> On the one hand, a number of classical Shari'ah scholars are of the view that charging a fee for a guarantee is not allowed based on the argument that the contract is voluntary in nature.<sup>104</sup> On the other hand, some Shari'ah scholars recognise the need to allow it, based on the current needs of the community.<sup>105</sup> They argued that receiving a premium in the form of a fee in deposit insurance is indeed necessary; as it is used to fund the operations of the IDIS. Besides reimbursing insured depositors in the event of failure, the fund is also needed to cover the deposit insurer's operating and development costs. Another justification of the need to collect premiums is that it is not feasible to develop an IDIS that is solely financed by the government or by private funds.<sup>106</sup> Deposit protection

<sup>99</sup> 'Sharia Approaches for the Implementation of Islamic Deposit Insurance Systems', *International Association of Deposit Insurers*, (Research Paper, November 2021) <[https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/Shariah\\_Approaches\\_for\\_IDIS-for-publication-Nov\\_2014-FINAL.pdf](https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20-%20Discussion%20Papers/Shariah_Approaches_for_IDIS-for-publication-Nov_2014-FINAL.pdf)>.

<sup>100</sup> 'Different Persons Definition of Contract', *Law Teacher*, (Web Page, 18 August, 2021) <<https://www.lawteacher.net/free-law-essays/contract-law/different-persons-definition-of-contract-law-essay.php>>.

<sup>101</sup> 'Shari'a Approaches for the Implementation of Islamic Deposit Insurance Systems' (n 99).

<sup>102</sup> Hairul Suhaimi Nahar, (n 97), 247.

<sup>103</sup> Zamir Iqbal, 'Challenges Facing Islamic Financial Industry' (2007) *Journal of Islamic Economics, Banking and Finance*, 1-14.

<sup>104</sup> Ibid.

<sup>105</sup> Ramin Cooper Maysami and W Jean Kwon, 'An Analysis of Islamic Takaful Insurance – A Cooperative Insurance Mechanism' (1999) 18 (1) *Journal of Insurance Regulation*, 109-132.

<sup>106</sup> Mher Mushtaq Hussain and Ahmad Tisman Pasha, 'Conceptual and Operational Differences Between General Takaful and Conventional Insurance' (2011) 1 (8) *Australian Journal of Business and Management Research*, 23-28.

through blanket guarantee could be costly to the government, which in turn would place a direct or indirect financial burden on the public.<sup>107</sup>

Another approach that can be adopted is the combination of both the government regulation and contract. Under this mixed approach, the deposit insurer will first find the most suitable contract which is the contract whose conditions match some or most of the deposit insurance operations.<sup>108</sup> Any aspect of operations that is not in line with the conditions will be addressed by government regulation. For instance, in Sudan, the government has assessed and decided to adopt a *takaful* contract for its IDIS. As a *takaful* contract involves voluntary contributions or premium payments from the Islamic banking institutions, the government could issue a regulation making premium payments mandatory.<sup>109</sup>

### **B NDIC Framework for Non-Interest Deposit Insurance Scheme**

Nigeria does not operate a standalone Islamic Deposit Insurance Scheme, though Section 10(2) of the NDIC Act,<sup>110</sup> empowers the NDIC to develop a standalone framework for insuring the deposit liabilities of Islamic Banks. In the beginning, Islamic banks, essentially Ja'iz Bank, and conventional banks running non-interest packages (Stanbic IBTC and Sterling Banks) were not covered under NDIC DIS. Following the provision of Section 10(2) of the NDIC Act,<sup>111</sup> the NDIC developed a framework for insuring their deposit liabilities. The Maximum Deposit Insurance Coverage ('MDIC') for the Non-Interest Banking Institutions is set to be the same as the conventional banks, that is, five hundred thousand naira (₦500, 000) and two hundred thousand naira (₦200, 000) per depositor per account in DMBs and MFBs respectively.<sup>112</sup> The following Non-Interest Deposits are covered under the scheme: Safe Keeping Deposit, Interest Free Deposit for Investment, Profit Sharing/Loss Bearing Deposit, Profit and Loss Sharing Deposit; and any other deposit type that is Non-Interest Based and approved by the CBN.<sup>113</sup>

The following financial products are however not covered under the scheme: insider deposits; counter-claims from one person who maintains both a Deposit Account and a non-interest-bearing loan account and or a loan based on *murabahah* financing where the deposit account serves as a collateral for either or both of the loan accounts and inter-bank takings.<sup>114</sup>

<sup>107</sup> 'Shari'ah Approaches for the Implementation of Islamic Deposit Insurance Systems', (n 99).

<sup>108</sup> 'Deposit Insurance from the Shari'ah Perspective', (n 71), 14.

<sup>109</sup> Ramin Cooper Maysami and W Jean Kwon, (n 105), 109-132.

<sup>110</sup> NDIC Act (n 42) s 10(2) states that 'The Corporation shall have the power to establish a separate Deposit Insurance Fund (DIF) for each category of insured institution in which all assessed premium shall be deposited and which fund the cooperation will utilize for the respective insured institutions'.

<sup>111</sup> Ibid.

<sup>112</sup> 'NDIC Develops Framework for Non-interest Deposit Insurance Scheme', (n 51).

<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

## VII THE LACUNA IN THE PROVISIONS OF THE NDIC ACT FROM THE SHARI'AH PERSPECTIVE

Some of the provisions of the NDIC Act contravene the rules governing Islamic banking, which are mentioned in the following paragraphs.

### ***A Encouragement of Interest Based Investment by the NDIC Act***

Section 13(1) of the NDIC Act empowers the NDIC to invest its funds in Federal Government securities:

- (1) The Corporation shall have power to invest money not immediately required in Federal Government Securities or in such other securities as the Board may from time to time determine".<sup>115</sup>

The NDIC protects the DIF in safe but liquid financial instruments such as Treasury Bills, Federal Government Bonds and instruments of similar nature.<sup>116</sup> This type of transactions and investments by the NDIC is not allowed by the Shari'ah as the investment in Federal Government securities introduce elements of interest which goes against the principles of Islamic Banking.

### ***B Penal Interest of Section 15 of the NDIC Act for Membership Defaulter***

Section 15 of the NDIC Act states that:

- (1) All licensed banks and such other financial institutions in Nigeria engaged in the business of receiving deposits shall be required to insure their deposit liabilities with the Corporation.
- (2) Any licensed bank or such other deposit-taking financial institution which contravenes the provisions of subsection (1) of this section shall be guilty of an offence and be liable to a maximum fine of ₦500, 000.00 for each day the offence is committed.
- (3) All principal officers of such licensed bank or deposit-taking financial institution which contravenes subsection (1) of this section commits an offence and is liable on conviction to a term of imprisonment for 3 years or a fine of not more than ₦5,000,000 (five million naira) or to both.

Membership is compulsory under the NDIC Act and an Islamic bank desirous of operating in Nigeria has no choice but to be a participant in the insurance scheme, failure of which attracts penalty. This arrangement has been argued to breach the principle of *Al-Ta'awuni ala al-birr* (helping each other in good deeds).<sup>117</sup> Islamic social relationship of *Ta'awun*

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<sup>115</sup> NDIC Act (n 42) s 13(1).

<sup>116</sup> 'Deposit Insurance', *Nigerian Deposit Insurance Commission*, (Web Page, 20 August, 2021) <<https://ndic.gov.ng/deposit-insurance/#tab-1-2>>.

<sup>117</sup> Ibrahim Abikan Abdulqadir, (n 60).

(mutual help or cooperation) and *Tabarru'at* (willingly relinquishing individual right for collective benefits) are existing under willing and mutual agreement for cooperation towards achieving certain collective benefit without compulsion that can lead to a potential strain on the participating institutions.<sup>118</sup>

### **C Interest charged on default of payment of premium**

Section 17(7) of the NDIC Act provides that:

- (7). Any premium payable by an insured institution and which remains unpaid for more than three months after a demand notice had been served on such institution, shall attract interest at a rate equivalent to the prevailing Minimum Rediscount Rate (MRR) of the Central Bank of Nigeria.

In a situation where a bank fails to pay its annual premium at the prescribed time, interest is to be paid on the premium for the default. Prohibition of Interest in Islam is not only in respect of receiving it, Muslims are enjoined to move away from both collection and payment of interest. However, because membership in the NDIC has been made compulsory, any bank (including Islamic Banks) that fails to comply with the time stipulated for payment of premium would be penalised by paying Interest which Islam abhors. The Prophet (S.A.W) has been reported to have cursed: ‘the one who consumes *riba* (interest), the one who gives it to others, the one who writes it down and the one who witnesses it’.<sup>119</sup>

### **D Interest based financial assistance**

The provision of Section 37(2) of the NDIC Act states:

- (a) Grant loan on such terms as may be agreed upon by the Corporation and the failing insured institution;
- (b) Give guarantee for a loan taken by the insured institutions;
- (c) Accept an accommodation bill with interest for a period not exceeding 90 days maturity exclusive of days of grace and subject to the renewals of not more than seven times.

Provided that interest rates applicable to facilities extended to the failing institution shall not exceed the minimum Rediscount Rate of the Central Bank of Nigeria.

The pumping of money into ailing banks (including Islamic banks) by the NDIC is interest based. The liquidity support provided by the NDIC to financial institutions is interest-based, at the prevailing Minimum Rediscount Rate of the CBN.<sup>120</sup> This practice is open contradiction to the prohibition of interest in transactions under Islamic Law and

<sup>118</sup> *Hairul Suhaimi Nahar*, (n 97), 247.

<sup>119</sup> *Sahih al-Muslim*, Kitab Musaqah, Hadith 1598.

<sup>120</sup> PN Umoh, (n 89), 57.

the basis of the prohibition is the commandment of the Law Giver where He says; ‘O you who believe! Be afraid of Allah and give up what remains (due to you) from *Riba* (from now onward), if you are really believers. Failure to heed to this commandment attracts a promise of war against practitioners by Allah and His messenger’.<sup>121</sup>

### **E *Distribution of profit obtained from investment of the premium***

The profit obtained from the investments of the premium is shared between the Federal Government of Nigeria and the NDIC without any share given to the banks who pay the money and this runs contrary to the Islamic principle which states that ‘there should be no infliction or reciprocation of harm’. This arrangement sidelines the banks which is the most important entity in the transaction and their depositor. This arrangement can be termed unjust especially in instances where the NDIC accrue a large profit.

### **F *The issue of continuous payment of premium***

Because of the nature of the DIS in Nigeria which is *Ex-Ante* (premium paid periodically in anticipation of future banks failure), banks are mandated to pay and this is a continuous payment whether or not the envisaged event occurs in years. This means that the banks keep losing a part of their money without trace or account or possibility of recovery of the same where no bank failure occurs. The financial institutions enjoy no plan for a plough back of the premium or even a premium holiday at some point, even when the financial institutions do not show any sign of weakness or failure. This also breaches the Islamic social relationship of mutual help or cooperation and exempts the banks from the profit and loss sharing in the transaction.<sup>122</sup>

## **VIII CONCLUSION AND RECOMMENDATIONS**

The fundamental objective of all Islamic financial institutions is to offer Shari’ah compliant transactions and activities in all their dealings. A central tenet of this is that they must be free of interest-based transactions and all other activities considered by Shari’ah as unlawful. This injunction by inference also applies to all other institutions which take part in direct transaction with Islamic financial institutions, an example being an agency which insures their customers’ deposits.

It has been established that the NDIC scheme is in line with Shari’ah. There are links that exist between NDIC and *Maqasid al-Shari’ah* which is aimed at promoting benefits and repelling harms and *Maslahah*, which refers to something good for the public. Deposit insurance protects the public from losing money that they place in a bank when the bank fails. Its implementation is a noble initiative as it prevents the public from facing financial difficulties, especially those people who have limited financial resources, who could be exposed to social problems as a result. Islam urges its followers to avoid

<sup>121</sup> Qur’an al-Baqarah (2): 278-279.

<sup>122</sup> Hairul Suhaimi Nahar, (n 97), 247.

poverty as this could lead them to disobey Allah.<sup>123</sup> Islam always wishes every creature to have a good and convenient life without having to face any difficulty.<sup>124</sup> It also urges its followers to prepare themselves to face any possible disasters, which includes finding a means to protect their wealth.<sup>125</sup> As such, the setting-up of a deposit insurance system represents the Muslims' response to the urge to protect their money when a bank fails.<sup>126</sup> Muslims are also urged to help each other in good deeds. In line with this principle, the government introduced deposit insurance as an initiative to assist the public in protecting their wealth. Such arrangements may also be made privately with the same intention of helping the public.<sup>127</sup> Nevertheless, the principle of Shari'ah is that all transactions of Islamic financial institutions must be free of interest, uncertainty, gambling, and sale/purchase of unlawful goods and services.<sup>128</sup>

In this research, attempts have been made in examining the importance, the features, the operations as well as the permissibility of the DIS. Distinctions were made between DIS and conventional insurance and similarities between the former and cooperative insurance permitted under Islamic law were highlighted. The research has shown the effectiveness and importance of the DIS in the protection of depositors in many countries. The establishment of the NDIC has gone a long way in ensuring that depositors in financial institution do not suffer any kind of loss resulting from the failure of a bank and also helps in regulating and supervising the activities of these financial institutions when the need arises. The NDIC insures both conventional and Islamic banks in Nigeria and a framework for NIDIS schemes have been developed to cater for Islamic Banking. However, based on the findings of this research, it is concluded that although the aim and objectives of the NDIC is in line with the Shari'ah and so is permissible, there still exists Shari'ah-compliance hurdles in the operation of the NDIC preventing the full participation of Islamic Banks and these hurdles are in form of interest based earnings, liquidity support and penalty. This research concludes that the NDIC operation as insurer of Islamic banks is both constitutional and legal. This is because it is set up by a legitimate government for the good of the general public and to the advantage of Islamic banks. An approach to insuring Islamic banks is through regulation by the government where there is no suitable DIS by Islamic contracts or one is yet to be developed due to constraints. This is the case in the Nigerian system. Islamic banks will be vulnerable to distress if they do not participate and will also discourage intending customers. This study therefore proffers the solutions and recommendations below to ensure that the operations of the NDIC are Shari'ah-compliant.

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<sup>123</sup> Salisu Hamisu and Rusni Hassan, (n 10), 17.

<sup>124</sup> Elvan Syaputra *et al*, 'Maslahah as an Islamic Source and its Application in Financial Transactions' (2014) 2(5) *Journal of Research in Humanities and Social Science* 66-71.

<sup>125</sup> Issoufou Chaibou 'Deposit Insurance Scheme: A Comparative Study Between Conventional and Islamic Banking' (MCL Dissertation, International Islamic University Malaysia, 2008), 3 and 23.

<sup>126</sup> 'Deposit Insurance from the Shari'ah Perspective', (n 71).

<sup>127</sup> Tawfique Al-Mubarak and Noor Mohammad Osmani, (n 13), 4-6.

<sup>128</sup> Burhan Uluyol and Adam Abdullah (n 14), 140.

### A Recommendations

- i. The NDIC should target a benchmark on the amount in which a premium must reach and once this benchmark is reached, the profit generated from the investments of the premium paid by the Islamic banks may be shared among the premium payers and the NDIC. Islamic banks as corporate institutions are bound by the Islamic jurisprudential principle: ‘there shall be neither harm nor reciprocating harm’ and as much as NDIC stands for an equitable distribution of wealth and resources, they are equally legally restrained from allowing injustice to be done to their shareholders from which the premium is being paid.
- ii. There should exist a type of premium tax holiday where Islamic banks do not pay premium for certain number of years in a situation where they do not experience failure for a specific period of time (our recommendation is 10 years). The reason behind this suggestion is for the times where the banking system enjoys stability for a considerable length of time and the NDIC’s fund is not used for the object of its creation, a continued withholding of excessive liquidity after a while will amount to hoarding which negates the principle of equitable distribution and circulation of resources.
- iii. There should be a profit and loss sharing arrangement in order to prevent interest-based operations. The Shari’ah prohibits the collection and payment of interest in any transaction but the principle of sharing profit and loss is allowed in Islam and this can be done by way of introducing a *Mudarabah* arrangement with the insured banks in respect of invested funds. In this case, the NDIC’s share of the accruing profit would be a pre-agreed percentage and in case of loss, it bears no further responsibility than forfeiture of its managerial efforts and where the NDIC’s funds forms part of the investment fund, a *Musharakah* arrangement would be appropriate where both the NDIC and insured banks would share both the profit and loss. The former will be based on a pre-agreed ratio which may not necessarily follow the ratio of contribution while the latter will be shared based on the percentage of the partners’ contribution to the fund.
- iv. Amendment of some sections of the NDIC Act (penal and interest-based dealings) to be in line with certain principles of Shari’ah. The following sections of the NDIC Act need amendments. Section 13(1) should be amended in a way that will involve investment of the Non-Interest Deposit Insurance Funds (NIDIF) in *Sukuk* bonds instead of just Government Treasury bills which is suitable for only DIF. Section 15 should be amended in such a way that it will only make membership voluntary and not mandatory. Section 17(7) should include a proviso that will exempt Islamic banks from paying interest on default in the payment of premium and to prescribe some other penalty. This reform will help reduce if not completely eliminate the hindrances restraining Islamic banks from the full enjoyment of the operations of the NDIC.

- v. The Nigerian Government should adopt an Islamic Deposit Insurance Scheme (IDIS) and efforts should be made at the establishment of a common ground in the administration of an Islamic Deposit Insurance (IDI) to minimise and eliminate disagreements such that a point of consensus under Shari‘ah is reached.

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