



**UNIVERSITY OF NAIROBI**

**SCHOOL OF LAW**

**THE INADEQUACY OF THE LEGAL FRAMEWORK GOVERNING  
ISLAMIC BANKING IN KENYA**

**BY: NOORMOHAMED SEIDU ISSA ALI**

**REG NO. G62/9280/2017**

**A RESEARCH PAPER SUBMITTED IN PARTIAL FULFILLMENT OF  
THE MASTER OF LAWS (LL. M)**

**OCTOBER, 2019**

## **DECLARATION**

This Research Paper is my original work and has not been presented for a degree or any other award in any other university or college for examination.

Signature \_\_\_\_\_ Date \_\_\_\_\_

Noormohamed Seidu Issa Ali

Reg No. G62/9280/2017

## **APPROVAL**

I confirm that this Research Paper has been submitted for review with my approval as University Supervisor

Signature \_\_\_\_\_ Date \_\_\_\_\_

Dr. Mwanakitina Bakari

School of Law

**To my mother Saida Hajj Mansour,  
A strong and gentle soul who taught me to  
trust in Allah,  
Believe in hard work,  
And that so much can be done with little.**

**To my husband Abdulhakim Ahmad Seif,  
Whose love, patience, perpetual support and  
encouragement has been a source of my  
strength.**

## ACKNOWLEDGEMENT

First and Foremost praise is to ALLAH, The Almighty, the greatest of all, on whom ultimately we depend for sustenance and guidance. I would like to thank Almighty Allah for giving me the opportunity, determination and strength to do my research. His continuous grace and mercy was with me throughout my life and ever more during the tenure of my research.

The Prophet (PBUH) said: “He has not thanked Allah who has not thanked people”. My utmost thanks and sincere gratitude goes to **Dr. Sarah Kinyanjui**, who believed in my abilities and tirelessly assisted me in attaining a scholarship for my study of this Degree. I am sincerely honored to have been selected as the recipient of the **University of Nairobi** Graduate Scholarship.

I am extremely grateful to my supervisor, **Dr. Mwanakitina Bakari**, for her professional guidance throughout the research.

A special and heartfelt gratitude goes to my family and friends for their constant prayers, patience and support throughout the research.

I finally salute everyone who in one way or the other contributed to the successful completion of this work.

## ABSTRACT

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of *sharia* and its practical application through the development of Islamic economics. Islamic banking sectors stem from the fact that Muslims are endeavouring to avoid interest based practices and transactions. The avoidance of *riba* (interest) is the fundamental principle underlying Islamic finance. The charging of interest is considered by Islam as unjust enrichment and is condemned in the Quran. The rapid growth and unique nature of this sector has made Islamic banking and finance an ideal topic for academic research.

This paper scrutinized Islamic banking regulation at the international level and in Kenya, with the aim of finding challenges in Kenyan regulations, in addition to best practices that can be introduced for optimal expansion of Islamic banking. The study also looks into the current realities of Islamic banking in Kenya from the perspective of the regulatory challenges facing the industry which is a big step towards the realisation of the inadequacy of the regulatory framework of Islamic banking in Kenya. This paper will establish the need for a comprehensive legal, regulatory and institutional framework to govern the Islamic banking sector in Kenya.

To sustain the growth and development of Islamic financial system, the resilience of the industry has to be strengthened through evolving legal and regulatory reforms by the regulators. Putting in place an appropriate and effective legal and regulatory framework is particularly important for Islamic financial institutions. This paper recommends components for the development of comprehensive Islamic Banking Regulation in Kenya.

## **LIST OF ABBREVIATIONS**

<b>AAOIFI</b>	–	Accounting and Auditing Organisation for Islamic Financial Institutions
<b>CBK</b>	–	Central Bank of Kenya
<b>DPFB</b>	–	Deposit Protection Fund Board
<b>GAAP</b>	–	General Accepted Accounting Practice
<b>IAIS</b>	–	International Association of Insurance Supervisors
<b>IFRS</b>	–	International Financial reporting Standards
<b>IFSB</b>	–	Islamic Financial Services Board
<b>IIFM</b>	–	International Islamic Financial Markets
<b>INCEIF</b>	–	International Centre for Education in Islamic Finance
<b>IOSCO</b>	–	International Organisation of Securities Commissions
<b>KDIC</b>	–	Kenya Deposit Insurance Corporation
<b>KSMS</b>	–	Kenya School of Monetary Studies
<b>PLS</b>	–	Profit and Loss Sharing
<b>PSIA</b>	–	Profit Sharing Investment Accounts

## TABLE OF CASES

Bank Islamic Malaysia Berhad v Adan Bin Omar (1994) 3 CI J 735.

Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporate Sdn Bhd Civil Appeal No. 02-421-1999 (2003) 1 CI J 625.

Finance Bhd v Taman Ihsan Jaya ASdn Bhd and Others (2008) 5 ML J 632.

Otieno v Ougo and Another Civil Case No. 4873 of 1986 (2008)1 KLR.

## **TABLE OF INTERNATIONAL TREATIES AND CONVENTIONS**

The Basel Committee on Bank Supervision's (BCBS) Banking Regulations:

Basel I Accord

Basel II Accord

Basel III Accord



## **TABLE OF STATUTES**

Central Bank of Kenya Act, Cap 491 Laws of Kenya

The Banking Act, Cap 488 Laws of Kenya

The Constitution of Kenya, 2010

The Judicature Act, Cap 8 Laws of Kenya

The Kadhi's Court Act, Cap 11 Laws of Kenya

The Kenya Deposit Insurance Act, 2012

## TABLE OF CONTENTS

DECLARATION .....	ii
DEDICATION.....	iii
<u>ACKNOWLEDGEMENT</u> .....	iv
<u>ABSTRACT</u> .....	v
<u>LIST OF ABBREVIATIONS</u> .....	vi
<u>TABLE OF CASES</u> .....	vii
<u>TABLE OF INTERNATIONAL TREATIES AND CONVENTIONS</u> .....	viii
<u>TABLE OF STATUTES</u> .....	ix
<u>TABLE OF CONTENTS</u> .....	x
<u>CHAPTER ONE</u> .....	<b>Error! Bookmark not defined.</b>
<u>GENERAL INTRODUCTION</u> .....	1
<u>1.0 BACKGROUND</u> .....	1
<u>1.1 PROBLEM STATEMENT</u> .....	6
<u>1.2 HYPOTHESIS</u> .....	6
<u>1.3 RESEARCH OBJECTIVES</u> .....	6
<u>1.3.1 Main Objective</u> .....	6
<u>1.3.2 Specific Objectives</u> .....	6
<u>1.4 RESEARCH QUESTIONS</u> .....	6
<u>1.5 THEORETICAL FRAMEWORK</u> .....	7
<u>1.6 LITERATURE REVIEW</u> .....	10
<u>1.7 JUSTIFICATION OF THE STUDY</u> .....	13

<u>1.8 METHODOLOGY</u> .....	14
<u>1.9 LIMITATION OF THE STUDY</u> .....	<b>Error! Bookmark not defined.</b>
<u>1.10 CHAPTER BREAKDOWN</u> .....	14
<u>CHAPTER TWO</u> .....	17
<u>EMERGENCE OF ISLAMIC BANKING IN KENYA</u> .....	17
<u>2.0 INTRODUCTION</u> .....	15
<u>2.1 HISTORY OF ISLAMIC BANKING</u> .....	17
<u>2.1.1 Historical Background of Islamic Banking in Kenya</u> .....	18
<u>2.2 FACTORS THAT LED TO THE EMERGENCE OF ISLAMIC BANKING IN KENYA</u> ..	20
<u>2.2.1 Market Demand</u> .....	21
<u>2.2.2 Religious Compliance</u> .....	21
<u>2.2.3 Diverse Product Range</u> .....	23
<u>2.2.3.1 Mudarabah (capital trusts)</u> .....	23
<u>2.2.3.2 Musharakah (full partnerships)</u> .....	25
<u>2.2.3.3 Murabaha (mark-ups on sale)</u> .....	25
<u>2.2.3.4 Bai muajjall (deferred payments)</u> .....	<b>Error! Bookmark not defined.</b>
<u>2.2.3.5 Bai salam (prepaid purchases)</u> .....	26
<u>2.2.3.6 Istisna (manufacturing contracts)</u> .....	28
<u>2.2.3.7 Ijarah (lease financing)</u> .....	28
<u>2.2.3.8 Qard Hassan (benevolent loans)</u> .....	29
<u>2.2.4 As a Response to a Worldwide Trend</u> .....	30
<u>2.3 CONCLUSION</u> .....	29
<u>CHAPTER THREE</u> .....	32
<u>INTERNATIONAL AND NATIONAL REGULATION OF ISLAMIC BANKING</u> .....	32

<u>3.0 INTRODUCTION</u> .....	32
<u>3.1 INTERNATIONAL LEGAL INSTRUMENTS</u> .....	32
<u>3.1.1 Basel I</u> .....	32
<u>3.1.2 Basel II</u> .....	33
<u>3.1.3 Basel III</u> .....	33
<u>3.2 LEGAL AND REGULATORY FRAMEWORK OF ISLAMIC BANKING IN KENYA</u> ...	36
<u>3.2.1 The Constitution of Kenya 2010</u> .....	36
<u>3.2.2 The Judicature Act</u> .....	39
<u>3.2.3 The Central Bank Act</u> .....	39
<u>3.2.4 The Banking Act</u> .....	40
<u>3.2.5 The Kadhi's Court Act</u> .....	47
<u>3.2.6 The Kenya Deposit Insurance Act 2012</u> .....	47
<u>3.2.7 The Prudential Guidelines and Risk Management Guidelines (2013)</u> .....	48
<u>3.3 CONCLUSION</u> .....	48
<u>CHAPTER FOUR</u> .....	52
<u>REALITIES OF ISLAMIC BANKING IN KENYA</u> .....	52
<u>4.0 INTRODUCTION</u> .....	52
<u>4.1 CHALLENGES FACING REGULATION AND IMPLEMENTATION OF ISLAMIC BANKING IN KENYA</u> .....	52
<u>4.1.1 Insufficient Legal Protection for Islamic Banks</u> .....	52
<u>4.1.2 Jurisdiction – Civil or <i>Sharia</i> Court</u> .....	<b>Error! Bookmark not defined.</b>
<u>4.1.3 Disparity in Concepts and Practice</u> .....	56
<u>4.1.4 Ownership of Underlying Assets</u> .....	<b>Error! Bookmark not defined.</b>
<u>4.1.5 Lender of Last resort</u> .....	<b>Error! Bookmark not defined.</b>

4.1.6 Lack of Expertise, Knowledge and Training .....	<b>Error! Bookmark not defined.</b>
4.1.7 Absence of accounting (and auditing) standards pertinent to Islamic banks .....	56
4.1.8 Insufficient Safeguards for Consumer Deposits .....	<b>Error! Bookmark not defined.</b>
4.1.9 Sharia Non-Compliance .....	58
4.2 CONCLUSION .....	61
CHAPTER FIVE .....	65
<u>DEVELOPING AN APPROPRIATE FRAMEWORK TO REGULATE ISLAMIC BANKING IN KENYA</u> .....	65
5.0 INTRODUCTION .....	65
5.1 RECOMMENDATION .....	<b>Error! Bookmark not defined.</b>
5.1.1 Creating a National Legal and Institutional Framework for Islamic Banking..	<b>Error! Bookmark not defined.</b>
5.1.2 Adoption of Global Legal and Regulatory best practices for Islamic Banking .....	65
5.1.3 Appropriate Licensing for Islamic Banks .....	<b>Error! Bookmark not defined.</b>
5.1.4 Ensuring Proper and Adequate Supervision to Improve Compliance and Control	
<b>Error! Bookmark not defined.</b>	
5.1.5 Promoting Transparency and Disclosure in Islamic Banking	<b>Error! Bookmark not defined.</b>
<b>defined.</b>	
5.1.6 Guaranteeing Deposit Protection .....	<b>Error! Bookmark not defined.</b>
5.1.7 Cultivating Human Capital .....	72
5.2 CONCLUSION.....	69
<u>BIBLIOGRAPHY</u> .....	1

## CHAPTER ONE

### GENERAL INTRODUCTION

#### 1.0 BACKGROUND

Islamic banking is commonly characterized as banking structure which is as per the Islam esteems that are represented by the regulations set somewhere near Islamic sharia . Islamic banking is a type of budgetary administration framework where the bank acknowledges cash from contributors and puts it in consistence with Islamic principles set somewhere around sharia and with the assent of the investor. The primary rule is benefit and misfortune sharing which is the place the bank and the contributor share benefits and misfortunes as per the part they play in the business primarily to conform to the boycott of premium (riba). Second, the two gatherings ought to reserve the option to manage the business since it is impermissible for Muslims to take an interest in dubious and unsure exchanges (gharar). Third, investors ought to approach the data on speculation by the bank. This is to advance straightforwardness in the exchanges. Forward, the bank has an obligation not to put resources into precluded ventures, for example, betting, prostitution, erotic entertainment, liquor, pork and medications. Last is the rule of zakat (property charge) which permits the derivation of 2.5% of the cash held in accounts having a place with Muslims every year as endorsed in the Holy Quran for a fair dissemination of riches and to advance social duty. While Islamic banking has a more extensive degree and importance, it is generally known as the conversion of orthodox money lending system into Asset-backed financing transactions conducted by the Financial Institutions.<sup>1</sup>

---

<sup>1</sup>Asma Salman and Huma Nawaz, 'Islamic financial system and conventional banking: A comparison' [2018] 13(2) Arab Economic and Business Journal.

Islamic financial alludes to a structure of banking in consonance with the standards of sharia and its down to earth application through the improvement of Islamic financial matters. Before, Islamic banking was to a great extent rehearsed in nations with huge Muslim populaces. Nonetheless, with the appearance of monetary globalization, in addition to other things, has prompted western nations receiving Islamic banking for the two Muslims and non-Muslims. The quick development and special nature of this fragment has made Islamic banking an embodiment subject for scholastic research because it depends on a far reaching arrangement of morals and virtues coming from the Islamic religion. In contrast to regular fund, Islamic account is established on larger rules that comprise the rules administering any Islamic monetary or money related dealings. It is significant that Islamic banking is definitely not another wonder.

Islamic financing was effectively run from the beginning times of Islam, in spite of the fact that it was not officially sorted out all things considered. Over the most recent 30 years, there has been expanded disturbance for advanced expansion of Islamic banking particularly in Muslim nations. This unsettling comes from the way that Muslims are trying to stay away from intrigue based practices and exchanges. The evasion of *riba* is the crucial standard fundamental Islamic money. The charging of premium is considered by Islam as vile enhancement and is censured in the Quran. Islamic banking operates according Islamic values and belief and is governed by conventional rules and by a regulatory mechanism laid down by Islamic *sharia*.<sup>2</sup> Islamic banking is anticipated to evade

---

<sup>2</sup>Clement M. Henry and Rodney Wilson (Ed.), *'The Politics of Islamic Finance'* (2004) Edinburgh University Press 307.

intrigue based exchanges, maintain a strategic distance from unscrupulous practices and take an interest effectively in accomplishing the objectives and goals of Islam.

Islamic sharia forbids 'intrigue' however it doesn't preclude all additions on capital. It is the expansion indicated over the head of a credit or obligation that is disallowed. The restriction of a hazard free return and consent of exchanging makes the budgetary exercises in an Islamic set-up genuine resource upheld.

It is contended by advocates of Islamic account that in this day and age, the monetary framework dependent on premium has finished in the convergence of riches in the hands of a chosen few, making syndications and enlarging the hole between the rich and poor. Islamic money, then again, works in consistence with sharia law in this manner it empowers the appropriation of riches.

World consideration has gone to Islamic money on the grounds that Islamic banking is the quickest developing monetary establishment that has stretched out past Muslim or Muslim ruled nations to arrive at the global market subsequently the internationalization of Islamic banking. This implies it isn't just Muslims who are buying in to this type of banking, yet others in Western nations and sub-Saharan Africa too, who have been pulled in by the monetary open doors just as items accessible in Islamic banking.



Islamic banking has presented totally various items that utilization exceptional apparatuses from those utilized by standard financial establishment to fill a similar need. Islamic law as an all-encompassing legal system has stringent rule governing commercial transactions. The main feature of Islamic banking is the “interest free” banking aspect and the profit and loss paradigm.<sup>3</sup> The products and services provided by Islamic banks should not only be “interest free” but also should not be, in any way, used to finance Illicit or sinful transactions.<sup>4</sup>

In spite of the acknowledgment that Islamic banking can serve a more prominent job in the financial business, little consideration has been paid to the plan of a thorough structure for the guideline of Islamic banks both at the global and national level.

Kenya was the primary nation in the East and Central African locale to present Islamic banking in 2007. Up until this point, a few banks have been only authorized to offer sharia agreeable items with other customary banks opening Islamic financial windows to give sharia consistent items to their Muslim demographic. Islamic banking in Kenya has become massively instructing a consolidated piece of the pie of 0.8% of the financial segment as far as gross resources.

In spite of the development of Islamic banking in Kenya, the lawful and administrative part of the financial segment in its wide sense is to a great extent dependent on the ordinary financial structure.

---

<sup>3</sup> New Horizon, No. 82 (December 1998) 15.

<sup>4</sup>ShamimNjeriKinyanjui, ‘Challenges Facing the Development of Islamic Banking: Lessons from the Kenyan Experience’, 5 (2013) European Journal of Business and Management 95.

Islamic banks work inside the material laws and rules of other cash related associations. Islamic banking in Kenya is thusly prevalently run by banks' inside rules and best practices in the financial business. The Banking Act characterizes the institutional structure for banks and sets out detailing prerequisites. The Act doesn't characterize or recognize the presence of Islamic banking and doesn't characterize its tasks. This absence of authoritative arrangement has left Islamic banking defenseless against ill-advised guideline as it needs to rely upon the mandates gave by the legislature of the day.

Albeit certain exclusions have been made, for example, those identifying with the confinements on exchanging and responsibility for and revealing of premium salary on account of Islamic banks, the Act is seen by Islamic financial experts as inadequate in its extent of inclusion of Islamic banking. Further, Kenya has not achieved the global principles that have as of now been set for Islamic banking under the Basel concurs just as models set by Islamic establishments.

Considering the abovementioned, it is essential to assess the guideline of the Islamic banking at the universal level with the point of distinguishing the lawful, approach and institutional difficulties that undermine the very presence of this creative financial segment. A top to bottom examination of the current lawful and administrative system of Islamic banking in Kenya will be embraced in order to decide the ampleness of the administrative structure of Islamic banking in Kenya.

## **1.1 PROBLEM STATEMENT**

Islamic banking in Kenya is flourishing through running by the banks' internal regulations and best practices in the banking industry. Despite the growth of Islamic banking in Kenya, the essential institutional and regulatory framework required to govern this sector is inadequate. This has hindered the development of Islamic banking in Kenya.

## **1.2 HYPOTHESIS**

1. Emergence of Islamic banking in Kenya is viewed as a positive gesture with several factors leading to its flourishing.
2. The legal and regulatory framework of Islamic banking in Kenya is inadequate and is in need of review so as to meet the required standards of Islamic banking regulation.
3. The absence of a national standard setting organ to govern the Islamic banking sector is a major cause for a weak regulatory framework.

## **1.3 RESEARCH OBJECTIVES**

### **1.3.1 Main Objective**

To show the inadequacy in the legal and regulatory framework of Islamic banking in Kenya.

### **1.3.2 Specific Objectives**

- i. To outline the factors that favor Islamic banking in Kenya.
- ii. To enlist the legal and regulatory framework of Islamic banking in Kenya.
- iii. To discuss the inadequacy and weakness in the legal and regulatory framework of Islamic banking in Kenya.
- iv. To recommend ways in which legislators could develop new and appropriate framework to regulate Islamic banking in Kenya.

## **1.4 RESEARCH QUESTIONS**

- i. What are the factors that favor Islamic banking in Kenya?

- ii. Which is the legal and regulatory framework of Islamic banking in Kenya?
- iii. Are the legal and regulatory framework of Islamic banking in Kenya adequate?
- iv. How can legislators develop new and appropriate framework to regulate Islamic banking in Kenya?

### **1.5 THEORETICAL FRAMEWORK**

The traditional school of Natural law hypothesis, which educates this investigation, expresses that law originates from a non-human source. This way of thinking declares that laws slip from God to individuals through contents. Under this hypothesis, the remarkable highlights of law are to be found in the capacity of law to expand the benefit of all, safe human rights and administer with uprightness. Normal law legitimate scholars, for example, Thomas Aquinas hold that the authority of probably some lawful guidelines essentially infers, from contemplations having to do with the ethical value of those measures.

Islamic banking could likewise fill in as a potential model for Natural Law/morals based guideline. Islamic banking is a lot of banking rehearses dependent on the standards of sharia or Islamic law. As these practices depend on a type of heavenly law, like the meaning of Natural Law upheld by Thomas Aquinas, there is a closer connect to ethical quality than the run of the mill traditional guidelines. Venardos in his article titled 'Islamic Banking and Finance in South-East Asia' propose that parts of Islamic banking, for example, the restriction on usury or premium, might be better than the current regular model as it would prompt increasingly judicious venture and loaning rehearses. Such wise acts are because of a closer connection among lender and financee through hazard sharing or investment. Islamic *Sharia* law, which forms the basis for the regulation of Islamic banks

and *Sharia* compliant products and services descended from Allah to mankind.<sup>5</sup> The incorporation of moral considerations to the laws governing Islamic banking therefore gives merit to the natural law theory which holds that the law must be moral.

The Islamic financial hypothesis holds that monetary equity requires a practical monetary framework upheld by a financial framework that is proficient and dependent on virtues. Defenders of this position, for example, Imran Usmani hold that Islamic banking can accomplish this as it is proficient and guarantees evenhanded conveyance of riches. This hypothesis expresses that the individuals who are qualified for riches incorporate the individuals who legitimately took an interest during the time spent creating riches and the individuals who have an optional right. The last comprises of the individuals who didn't straightforwardly partake in the creation procedure however are gotten together with the makers to make them co-sharers in their riches.

Islamic monetary hypothesis is profoundly determined by moral issues which sway the reasons and goals on which the Islamic financial framework is based. Rather than the industrialist economy, Islamic financial hypothesis finds that decided costs and market powers can't be the main separating components used to disperse and distribute assets. Islamic financial hypothesis includes an 'ethical channel' coordinating potential cases on assets as per social necessities. This procedure abolishes claims that don't help the more extensive network before being communicated in the commercial center. This shows the planned job of morals and profound quality in molding the economy.

---

<sup>5</sup>Abdel Rahman El-Jaziri, 'Islamic Jurisprudence; The Four Schools of Thought' 1(Dar el Takwa 2008) 5.

The Islamic financial code , attempts to adjust among material and good needs of people in order to guarantee accomplishment of financial objectives. Besides, the idea of proprietorship in Islamic law is interesting as Allah (God) is the main total proprietor of all assets accordingly making individual proprietors responsible to God. Any riches earned by any individual is simply depended to him by God as a steward.

On the other hand, the entrepreneur hypothesis holds that riches should accumulate just to the individuals who partake in creating. The primary significant advocate of private enterprise, Adam Smith, was of the view that the nearness of numerous purchasers and venders contending with one another in the commercial center would get rid of inefficient asset distributions. He accepted that the powers of the market would counter self-centeredness through challenge, and as he put it, "the imperceptible hand of the market" would guarantee that general society isn't cheated and that the expectations for everyday comforts for all would rise. By and by, free enterprise has come to be related with singular insatiability and dependence on positioning, that is, class structures. In spite of the fact that private enterprise has significantly impacted financial success, it didn't prompt the ascending of expectations for everyday comforts for everything except for a rare sorts of people who were at the highest point of significant partnerships.

Islamic and industrialist hypotheses contrast on the premise that under the industrialist framework, the business visionary exclusively bears the danger of benefit or misfortune in his business while different variables of creation stay invulnerable to any misfortune. Further, private enterprise takes into account enthusiasm to accumulate to the generation factor of capital. Islam then again holds that the capacity to go for broke ought to be borne by both the business visionary just as the capital. This implies they share benefits and misfortunes and the idea of intrigue is explicitly precluded.

From the prior, the entrepreneur hypothesis can't fulfill the necessity of Islamic banking. In this way this investigation will be educated by the regular law hypothesis and the Islamic monetary hypothesis which fuse moral thought in the creation and circulation of riches.

## **1.6 LITERATURE REVIEW**

The structure of Islamic monetary framework when contrasted with its ordinary partners has two significant qualifications. First the benefit and-misfortune sharing (PLS) system and second the increase financing. PLS is framed from Mudarabah Funds (investible assets) and Musharakah reserves (value reserves). Murabahah (increase financing) and Ijarah (capital renting financing) are loanable assets with Islamic highlights.

The regular bank advances work under the credit framework, whereby monetary premium is intensified and is dependent upon vacillation. Despite what might be expected, in Islamic financing, murabahah or Ijarah, the idea of benefit is instead of intrigue and pleasing by the borrowers as increase financing.

Kinyanjui features the difficulties confronting the improvement of Islamic banking in the Kenya setting. She expresses that the Islamic financial industry has been pursuing for more than two decades to stretch out its scope to carry it in any event to the degree of customary banking. Be that as it may, the nonattendance of sharia consistent legitimate system expected to make premium free banking satisfactory, and make sound money related organizations, is the significant obstruction behind its low infiltration in the monetary market.

Aldohni talks about the tasks of Islamic banks and inspects riba (enthusiasm) from both a sharia and ordinary law point of view. His assessment of premium free banking is for the most part constrained to the United Kingdom and a couple of other Islamic locales, for example, Malaysia. He infers that there is still minimal finished as for the lawful and administrative parts of Islamic banking.

Employable supervision of banks is required in Islamic banks similarly as in ordinary banks. Errico L. what's more, Farah Baksh M. talk about a few principles and best practices set up by the Basel Committee on Banking Supervision which are gainful and offer a significant reference in attempting to arrive at the objective of compelling prudential guideline.

Abdullah is of the view that, similar to every single monetary organization, Islamic money related establishments should be controlled for consistence with precepts of Islamic Finance practice. To accomplish this degree of guideline, he affirms that there is have to have a nation level



administrative position that will create the correct strategies and oversee these foundations. Individual money related foundations moreover

need to have a *Sharia* Board to help the bank plan, execute and evaluate its transactions and certify that they are in line with the *sharia*.

During the third Annual Islamic Banking Summit Africa in Djibouti in 2014, Ismail Omar Guelleh communicated his view that Islamic money is the fate of the landmass. He expressed that Islamic banking can possibly assume a substantial job in supporting the subsidizing holes in Africa while upgrading money related incorporation rates in the area. He anticipated that the Islamic financial section in Africa is set for significant development driven by Africa's enormous and under-served Muslim populace and expanding familiarity with sharia consistent items. He further expressed that Islamic money gives government organizations an elective financing system to help capital consumption needs.

All the above researchers concur that all together for Islamic banking to develop and create to the point where it can adequately contend with its customary partner, there should be set up appropriate lawful, administrative and institutional systems that are committed to the administration of Islamic banks and sticks to the standards of sharia.

The above audit shows that little has been composed as to the lawful and administrative system of Islamic banking in Kenya. This is so in spite of the foundation and development of Islamic banks and services in the country. Further, there has been little information on how Islamic banking is governed in Kenya so as to ensure compliance with *sharia*.

## **1.7 JUSTIFICATION OF THE STUDY**

This research is a contribution to knowledge. It enlightens the Muslim community in Kenya on Islamic Banking system in light of the legal and regulatory framework affecting the system. The study will help financial institutions learn about the factors that contribute to the growth of Islamic banking to help them venture deep into the field. Finally, it will inform legislators on the need to develop new and appropriate framework to regulate Islamic Banking in Kenya.

## **1.8 METHODOLOGY**

This investigation will be both illustrative and explanatory. It will depict the elements that assumed a job in the development and development of Islamic banking in Kenya. The investigation will likewise dissect the legitimate and administrative structure of Islamic banking in Kenya including sharia. The exploration will likewise portray the insufficiency and shortcoming in the legitimate and administrative structure. This data will be sourced from both essential and auxiliary materials.

The essential sources utilized are the Holy Quran, assortments of Hadiths, Constitution of Kenya 2010, the important Kenyan resolutions in regards to Islamic Banking in Kenya, and global bargains concerning Islamic Baking. The primary optional information counseled incorporate reading material, diaries, articles, reports and online materials. In view of restricted research time, both these sorts of information will be gathered from library and online research materials.

## **1.9 LIMITATION OF THE STUDY**

Over the span of research the scientist may go through hours looking for explicit subtleties as valuable information on Internet is constrained. Some of the time distributors are hesitant to part with the total subtleties openly on the web, so information accessibility is commonly limited and fragmented. In certain events, all the necessary information may not be accessible from the equivalent or one source. Information must be painstakingly looked, distinguished and orchestrated to get the total picture. Any missing bit of information must be supplanted with comparable information from other qualified sources. The achievement pace of the venture will be analyzed dependent on the current hypothesis of Islamic banking and suppositions made during the exploration. The essential information will be dissected on the base of real desire of the Islamic banking and its execution.

#### **1.10 CHAPTER BREAKDOWN**

Section One contains the presentation which by and large frameworks the reason and goals of the investigation. It diagrams the issue articulation concerning the deficiency of the lawful system administering Islamic banking in Kenya and makes general theories on how these issues can be fathomed to guarantee the proceeded with development and advancement of this division. The hypothetical structure has caught contentions on the side of the rules that underlie Islamic banking. The part additionally plots the technique utilized for the exploration and the managing research addresses relating to the particular destinations for the investigation.

Part Two follows the verifiable advancement of Islamic banking in Kenya. It likewise diagrams and talks about the main considerations that have prompted the development just as the development of Islamic Banking in Kenya.

Section Three breaks down the guideline of Islamic banking at the universal level just as in Kenya with the point of understanding the insufficiency of the administrative structure of Islamic banking in Kenya.

Part Four takes a gander at the present substances of Islamic preparing in Kenya from the point of view of the administrative difficulties confronting the business because of the inadequacy of the legitimate system overseeing the division.

Section Five recommends having a suitable and viable legitimate and administrative structure which is especially significant for Islamic money related foundations. The part at that point prescribes segments for the improvement of far reaching Islamic Banking Regulation in Kenya.

## **CHAPTER TWO**

### **EMERGENCE OF ISLAMIC BANKING IN KENYA**

#### **2.0 INTRODUCTION**

Yet Islamic banking has become rapidly inside the latest thirty years, Islamic fiscal structures have a history that reaches as far back as the eighth Century. Muslims had the choice to develop a game plan of cash that did exclude portion of premium yet had the alternative to enact advantages for back productive activities and purchaser needs. The Muslim society never confirmed eagerness every through it 13 centuries of quality before the control of western wilderness powers. This part separates the genuine progression of Islamic banking in Kenya and diagrams the components that have provoked the ascent similarly as the advancement of the territory.

#### **2.1 HISTORY OF ISLAMIC BANKING**

The idea of Islamic banking is viewed as among the couple of unique and inventive Islamic thoughts that have effectively been attempted as of late. After the Industrial Revolution, the whole financial framework in every single Muslim nation was planned by the western financial model, the last being conflicting with Islamic law. This irregularity fundamentally comes from the dissatisfaction with riba which is enthusiasm for Islam. Endeavors to abstain from managing in premium prompted the introduction of a non-interest banking system, commonly known as "Islamic banking". Islamic banking has a rich legacy and history. The laws that represented Muslims regarding their everyday issues, including money related issues were the heavenly Quran, which is immediate discourse of Allah as passed on by the prophet Mohammed

, and the *Sunnah*.<sup>6</sup> The *Sunnah* contains the traditions, customs and norms of Prophet Mohammed and comes in the form of express verbal instructions, actions and omissions.<sup>7</sup> From the very early stage in Islamic history, Muslims were able to establish a financial system without interest for mobilizing resources to finance productive activities and consumer needs. The system used to finance business activities was based largely on the profit-and-loss sharing (PLS) modes of *mudaraba* (passive partnership) and *musharaka* (active partnership). Deferred trading and interest-free loans, *qurud-hasanah*, were also used to finance consumers as well as business transactions.<sup>8</sup> The system worked quite effectively during the times of Islamic civilization<sup>9</sup> and for centuries thereafter, mainly because the Islamic modes of financing, *mudaraba* and *musharaka*, were able to mobilize the entire reservoir of monetary resources of the medieval Islamic world for financing agriculture, crafts, manufacturing and long-distance trade.<sup>10</sup> In Africa, Islamic banking developed both as a response to the need of the Muslim population that desired a banking system that catered to their faith as well as an economic tool.

### **2.1.1 Historical Background of Islamic Banking in Kenya**

Data on this baby segment of banking in Kenya uncovers that Islamic banking developed as a money related advancement as a result of overall patterns towards Islamic Banking, investor desire for returns and market request from the Muslim populace in the nation. Research coordinated by the Central Bank of Kenya (CBK) found that there was a lot of money accessible for use in the

---

<sup>6</sup>Salah A. Sheikh, 'Factors that led to Emergence of Islamic banking in Kenya and Regulatory Challenges facing the Industry', (unpublished MBA project, university of Nairobi 2009) p. 10.

<sup>7</sup>Abdul Karim Aldohni, '*The Legal and Regulatory Aspects of Islamic Banking: A comparative look at the United Kingdom and Malaysia*', (Routledge 2011) p. 29.

<sup>8</sup>M. Umer Chapra and Tariqullah Khan, 'Regulation and Supervision of Islamic Banks', (Islamic Development Bank and Islamic Research And Training Institute 2000) Occasion Paper No. 3, p. 1.

<sup>9</sup>This is between the 8<sup>th</sup> and 12<sup>th</sup> century.

<sup>10</sup>Udovitch, 1970, pp.180 and 261.

economy that was unaccounted for inside the budgetary system. Further assessment revealed that these monies were connected with the Muslim society who didn't bank their money with standard banks that didn't stick to the models of Islamic sharia regardless, picked to deal with a record with establishments not approved to finish monetary activities, for instance, forex divisions, and Hawalamoney repayment organizations providers. This exposure required the establishment of Islamic banks that would pull in this social affair of people and assurance that their needs were being met.

From the happening to Islamic banking in Kenya in 2007, CBK has so far approved including yet not confined to First Community Bank, Gulf African Bank and Dubai Bank. These banks offer remarkable and specific things when stood out from those gave by conventional money related foundations. There are

however, conventional banks that offer Shariacompliant products alongside their conventional things and organizations. These consolidate Barclays bank, National bank and Standard Chartered bank. The window of Islamic banking in National bank is known as National Amanah. It gives organizations, for instance, Amanah mortgages, which are Sharia pleasing home credits which don't attract excitement on the standard entire and Takaful, which is sharia reliable security. In this kind of security each approach holder pays his enrollment and hardships are isolated and hazard spread by the system pooling structure and the benefits are used in ribafree theories. Standard Chartered bank displayed a sharia window known as Standard Chartered Saadiq which structures Islamic cash related courses of action which are sharia pleasing. Barclays bank opened a sharia agreeable window that offers a benefit financing office known as La-Riba Vehicle Finance and



La-Riba Personal Finance products which enable clients to purchase assets following *sharia* compliant conditions.<sup>11</sup>

Though Kenya aspires to become the East Africa Islamic banking and finance hub, Islamic banks in Kenya do not have a wide scope of operation. This is because the regulatory environment is not favourable as the doctrines of Islamic finance which guide all their activities directly conflict with banking laws in Kenya which are largely based on conventional models which includes the concept of charging interest.<sup>12</sup> However, strides are being made to change the regulatory framework in order to make it favourable towards Islamic banks. For instance, the Finance Act of 2010 amended Section 45 of the Central Bank Act, allowing the CBK to recognize the payment of a return rather than interest on government securities with the aim of opening up a spectrum of *sharia* compliant investment in the country.<sup>13</sup>

## **2.2 FACTORS THAT LED TO THE EMERGENCE OF ISLAMIC BANKING IN KENYA**

In general, there are various contributing factors that have led to the emergence of Islamic banking in Kenya such as market demand, religious compliance, diverse product range and as response to a worldwide trend. Though one can argue that there may be little observable differences between the facilities and services between conventional and Islamic banks, Islamic banks differ substantially in their basic principles and procedures which are heavily based on the teachings of

---

<sup>11</sup>James Makau, 'Barclays Launches Sharia-Compliant financing facility', (Business Daily, 3 February, 2010).

<<http://www.businessdailyafrica.com/-/539552/854418/-/item/0/-/143iw3iz/-/index.html>>.

<sup>12</sup>Roseline Njogu, 'Commercial Bank of God?: Islamic Banking Law and Religion', (Lambert Academic Publishing), p. 6.

<sup>13</sup>Njuguna Ndung'u: The future of sharia compliant banking and finance in Kenya-

Address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the official launch of the National Bank of Kenya's sharia compliant banking "The National Amanah", Nairobi, 29 April 2013

<<http://www.bis.org/review/r130515d.pdf>>.

Islam<sup>14</sup>.

### **2.2.1 Market Demand**

Request alludes to the amount of an item that buyers are willing and ready to purchase at a given cost. Market request is the entirety of individual interest for a specific decent or administration from purchasers in the market. The interest for Islamic account administrations has been expanding because of developing Muslim populace in Kenya. Islamic law restricts Muslims from managing in *riba* (intrigue), which actually implies increment, expansion, rise or development. The Holy Quran describes enthusiasm as unreasonable, severe and exploitative. Henceforth the requirement for an elective financial framework to serve the Muslim populace.

Kenya stays a possibly worthwhile market for Islamic banking and an immense range of Islamic budgetary items keep on being offered by completely fledged Islamic banks and other customary banks. Kenya is situating itself as a money related and venture center point to tap the developing capital inflows into Africa. The development of Islamic banks in Kenya had been a result of the interest by standard financial customers for sharia-agreeable items.

### **2.2.2 Religious Compliance**

Prohibition of *riba* is the most striking feature of Islamic banking.<sup>15</sup> Islamic banking client base is driven by religious compliance and customers' needs were being met based on the *sharia*.<sup>16</sup> The factors that influence development of Islamic banking products in Kenya are purely religious compliance and customers need being met.<sup>17</sup>

---

<sup>14</sup> Wan Ibrahim, W. H., & Ismail, A. G., 'Conventional bank and Islamic banking as institutions: Similarities and differences', <https://doi.org/10.1108/H-09-2013-0056> accessed on 13/12/2018.

<sup>15</sup> Institute of Islamic Banking and Insurance, 'Islamic Financial System' available at <<https://www.islamic-banking.com/explore/islamic-finance>> accessed on 11/1/2019.

<sup>16</sup>Supra (n 33).

<sup>17</sup>Supra (n 33).

Islamic banking is more complex than traditional banking in that products must conform not only to the secular laws of a country but also to interpretations of the holy *Quran* by local Islamic scholars.<sup>18</sup> A central tenet of *sharia* is *riba*, the prohibition of interest, moreover, Islamic law does not permit use of funds for investments or purchases related to activities it deems impermissible (*haram*), such as alcohol consumption or gambling.<sup>19</sup>

More precisely, any positive, fixed, predetermined rate tied to the maturity and the amount of principal (i.e., guaranteed regardless of the performance of the investment) is considered *riba* and is prohibited.<sup>20</sup>

This ban is based on opinions of social justice, equality, and property rights. Islam encourages the earning of profits but forbids the charging of interest because profits, determined ex post, symbolize successful entrepreneurship and creation of additional wealth whereas interest, determined ex ante, is a cost that is accrued irrespective of the outcome of business operations and may not create wealth if there are business losses.<sup>21</sup> Social justice demands that borrowers and lenders share rewards as well as losses in an equitable fashion and that the process of wealth accumulation and distribution in the economy be fair and representative of true productivity.

Amongst the governing principles in Islamic banking are:

- i. The absence of interest-based (*Riba*) transactions.<sup>22</sup>

---

<sup>18</sup>W Guyo and N Adan, 'The determinants of retail consumer choice of Islamic banking in Kenya' [2013] 1(2) International Journal of Social Sciences and Entrepreneurship 601-612

<sup>19</sup> Ibid.

<sup>20</sup> Available at <<https://www.islamic-banking.com/explore/islamic-finance>> accessed on 11/1/2019.

<sup>21</sup> Ibid.

<sup>22</sup> Quran (30: 39), (4: 161), (3: 130-132) and (1: 275-281).

- ii. The avoidance of economic activities involving oppression (*Dhulm*).<sup>23</sup>
- iii. The avoidance of economic activities involving speculation (*Gharar*).<sup>24</sup>
- iv. The avoidance of speculative activities (*Qimar*).<sup>25</sup>
- v. The discouragement of the production of goods and services which contradict the injunctions of Islam (*Haram*).<sup>26</sup>

### 2.2.3 Diverse Product Range

Islamic banks were mostly successful in promoting the importance of applying *sharia* principles in the economic and financial spheres. Islamic banks provided fully Islamic financial products which are in full compliance with *sharia* principles and guidelines. Several financial instruments have been developed and are considered innovations in Islamic finance as discussed below:

#### 2.2.3.1 *Mudarabah*(capital trusts)

*Mudarabah*, is a mode of financing through which the bank, the owner of the capital, or *rabb-al-mal*, provides capital finance for a specific venture indicated by the customer; the entrepreneur or *mudarib*.<sup>27</sup> In other words, *Mudarabah* is a contract between two parties: an investor; individual or bank that provides a second party, the entrepreneur, with financial resources to finance a particular enterprise. Profits are then shared between the two parties, *rabb-al-mal* and *mudarib*, according to some pre-agreed ratio. The investor bears all financial losses and the entrepreneur the operating

---

<sup>23</sup> Quran (2: 193), (8: 39)

<sup>24</sup> Quran (2: 188) and (4: 29).

<sup>25</sup> Quran (3: 90-91) and (4: 219).

<sup>26</sup> This includes activities such as production of alcohol which are prohibited in Islam.

<sup>27</sup> Mohammed Obaidullah, ISLAMIC FINANCIAL SERVICES (2005) available at <http://www.iefpedia.com/english/wp-content/uploads/2009/09/ISLAMIC-FINANCIAL-SERVICES.pdf> accessed on 20/1/2019.

losses; principally the opportunity cost of their own efforts.

### **2.2.3.2 *Musharakah* (full partnerships)**

In Islamic banking, *Musharakah* is seen as a joint endeavor between an Islamic bank and a client or business firm for specific tasks. The Islamic bank can possibly go about as the reserve supplier to back an industry, exchange and any lawful endeavors through either value speculation or direct investment.

*Musharakah* agreements can be built up in one of two different ways. The principal method for these is a changeless agreement which guarantees for its gatherings, the speculator, bank and business person, a fair offer in the yearly benefit/misfortune on pre-concurred terms. This sort of changeless agreement holds consistent for a constrained or boundless period as per the first understanding.

The second sort of *Musharakah* is a lessening contract favored by investors since it enables the bank to decrease a lot of value every year and get intermittent benefits dependent on the diminishing value balance. In this structure, the value portion of the client in the capital of big business increments after some time until the person in question turns into the sole proprietor of the venture.

### **2.2.3.3 *Murabaha* (mark-ups onsale)**

In Murabaha course of action, the client gives the bank the portrayals and costs of the products to be acquired or imported. The Islamic bank contemplates the application and gathers data about the details and costs of the products, concentrating particularly on the cost and conditions for installment. At the point when the bank and its customer concede to the particulars of the arrangement, the bank buys the merchandise or items and exchanges them to the client. The benefit that collects to the bank is commonly settled upon as a net revenue (increase) on the expense of procurement.

The key standards appended to Murabaha are:

- i. goods must be ordered, obviously distinguished by generally acknowledged benchmarks and must exist at the hour of offer;
- ii. goods available to be purchased must be in the responsibility for bank at the hour of offer;
- iii. the cost must be known at the hour of offer and this ought to be proclaimed to the customer. This is particularly the situation if the bank prevails with regards to getting a rebate where the overall revenue is determined on the net price tag. This implies limits additionally give advantages to the customer;
- iv. the time of conveyance of the products and the hour of installment must be indicated.

#### 2.2.3.4 Bai muajjall (conceded installments)

Bai muajjall is a deal on a conceded installment premise that enables business or people to get items now and pay for their incentive later on. Credit deals could incorporate Bai muajjall-Murabaha since all conceded installments are in portions or a singular amount.

There is an accord among Islamic law specialists and researchers about the admissibility of Bai muajjall as a type of account that rejects riba. Islamic legal advisers have for the most part allowed deals where the cost has expanded with postponement, however have prohibited deals where the measure of the obligation expanded with delay.

### **2.2.3.5 Bai salam (prepaid purchases)**

*Bai salam is a deal contract in which the value is paid ahead of time at the hour of contracting against conveyance of the obtained products/administrations at a predefined future date. In Islam the deal and acquisition of nonexistent products are precluded due to gharar. Bai salam is an admissible action that is embraced by the Sunnah to encourage certain exercises in agribusiness and industry.*

*One model is the accompanying Hadith described on the authority of Ibn Abbas: The Messenger of Allah came to Madinah and discovered its occupants entering salam contracts with the value paid ahead of time in organic products for one, two, and three years. He stated: "Whoever goes into a salam contract, let him indicate a known volume or weight, and a known term of suspension". For Bai salam contracts to be permissible several conditions:<sup>28</sup>*

---

<sup>28</sup> Islamic Bankers Resource Centre, Financing: Bai Salam, available at <<https://islamicbankers.me/islamic-banking-islamic-contracts/in-focus-bai-salam/>> accessed on 15/1/2019.



- i. the commodities sold should not be available at the time of contracting;
- ii. the quality and quantity of goods must be known;
- iii. the date and place of delivery for these commodities should be defined; and
- iv. the purchase cost price should be paid completely at the time of the contract.

### **2.2.3.6 Istisna (manufacturing contracts)**

*2.2.3.7 Istisnais characterized as an assembling contract which enables one gathering to acquire modern merchandise with either a forthright money installment and conceded conveyance or conceded installment and conveyance. It is a moderately new strategy in Islamic banking and it has been made an interpretation of as commission to fabricate generally used to cover work progress in the assembling and building enterprises.*

### **2.2.3.8**

*2.2.3.9 With regards to Islamic banking, people or firms demand their bank to encourage an agreement of generation for a decent, and the bank closes an Istisna contract with a thirdparty, the maker, to create and convey the particular thing under specific necessities. The reasonability of Istisna is embraced by the utilization of similarity (Qiyas) among most Muslim law specialists with the passability of Bai salam. **Ijarah (lease financing)**<sup>29</sup>*

*Ijarah* literally means "...to give something on rent".<sup>30</sup>

There are two forms of leasing in Islamic Finance. Direct leasing finance (*Ijarah*), is whereby the lessor allows the lessee to use capital assets owned by the lessor for a specified period of time

---

<sup>29</sup> F. Khan (1994) points out that leasing would require a bank to deviate from its basic character as a financial intermediary, as it would require it to get involved in purchasing an asset and then keeping its ownership until the asset is disposed of. Disposing of the asset requires not only bearing all risks resulting from price fluctuations, but also some marketing expertise. All this will require the bank to engage in activities beyond financial intermediation.

<sup>30</sup>Supra (n 67).

ranging from a few days to years depending on the type of asset. In return, the lessee pays the rental fee monthly or annually. However, the ownership of the capital assets cannot transfer to the lessee in this type of leasing and insurance on the capital assets remains the responsibility of the lessor.<sup>31</sup>

In contemporary Islamic banking, *Ijarah* has been adapted to provide a form of hire purchase (*Ijarahwa-Iqtina*), whereby an institution or individual customer requests the bank to purchase equipment with the intention of leasing it to the customer. In turn, the Islamic bank rents the asset to the client who pays a certain fixed rent and promises to purchase the asset within a specified period to transfer ownership from the bank to the customer.<sup>32</sup> Furthermore, this could be transformed as a decreasing-value lease that allows the client to pay an installment of the value of the asset plus its rent each period to reduce the lessor's share of ownership until the lessee becomes the owner.<sup>33</sup>

#### **2.2.3.8 Qard Hassan (benevolent loans)**

Islam does not prohibit the lending of money; *ribais* prohibited in the process of lending. *Qard Hassan* means a benevolent loan without interest to assist the needy in an attempt to alleviate hardship.

The amount paid by the lender is considered an interest-free loan from the time of payment until the date of the settlement. The borrower's payment of any amount over and above the principal to

---

<sup>31</sup> Tarek S Zaher and M Kabir Hassan, A Comparative Literature Survey of Islamic Finance and Banking, available at <<https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-a-comparative-literature-survey-of-islamic-finance-and-banking-nov-2001.pdf>> accessed on 20/1/2019.

<sup>32</sup> Al-JarhiMabidali and Iqbal Munawar, 'Islamic Banking: FAQs' [2001] Occasional Paper(4) Jeddah: IRTI.

<sup>33</sup> Supra (n 74).

the lender is permissible so long as it is at the borrower's discretion.<sup>34</sup> It is also permissible for the lender to request assets as collateral and charge administrative expenses on the loan.<sup>35</sup>

#### **2.2.4 As a Response to a Worldwide Trend**

The developing enthusiasm for halal economy given the expanding interest for halal items – as the halal market is non-elite to Muslims alone; and has increased expanding acknowledgment among non-Muslim shoppers. The worldwide halal market is profoundly worthwhile, with an expected yearly development pace of 20% that makes it one of the quickest developing shopper fragments on the planet.

Islamic money related administrations are currently accessible nearby traditional monetary administrations. These advancements underscore an unmistakable and supported pattern in which sharia-agreeable budgetary items and administrations have kept on picking up footing among organizations and people from varying backgrounds.

Actually, the incentives of Islamic account has stretched out past confidence and starting points that intrigue to the worldwide network. It is the inherent characteristics of Islamic money that are multifaceted that have pulled enthusiasm from differing foundations. At the center of Islamic money lies excellencies that include both good and business perspective in determining potential answers for monetary and financial stability. The values and principles that Islamic finance carry have opened new pathways towards achieving economic prosperity while safeguarding the interest

---

<sup>34</sup>Supra (n 65) and (n 74).

<sup>35</sup>Supra (n 67).

of the public. What used to be a novel idea has become mainstream. Indeed, Islamic finance is for all.

### **2.3 CONCLUSION**

Islamic banking has a history that traverses hundreds of years and that has withstood the danger of annihilation by western pioneer powers. Following the autonomy of Muslim states, political, strict and financial variables combined with the craving to be free from clear monetary and social disparities of western economies prompted the reappearance of Islamic banking.

In Kenya, the development of Islamic Banking was as a need to provide food for a specific gathering of individuals whose cash was available for use yet was unaccounted for inside the financial framework. These monies were related with the Muslim people group who didn't bank their cash with ordinary banks that didn't agree to the Islamic religion.

## **CHAPTER THREE**

### **INTERNATIONAL AND NATIONAL REGULATION OF ISLAMIC BANKING**

#### **3.0 INTRODUCTION**

Islamic banking can possibly prosper whenever supported by an extensive legitimate system. Notwithstanding consenting to sharia, Islamic financial offices should likewise hold fast to the nearby administrative system, regardless of whether procedural or specialized; in fact this is the thing that impacts the achievement of Islamic financial arrangements. Islamic money related foundations have the obligation to be sharia consistent just as meet other statutory laws whether generous or not. The accompanying section will investigate Islamic financial guideline at the worldwide level and in Kenya, with the point of discovering difficulties in Kenyan guidelines, notwithstanding best practices that can be presented for ideal development of Islamic banking.

#### **3.1 INTERNATIONAL LEGAL INSTRUMENTS**

##### **3.1.1 BaselII**

The 1980's were alluded to as the 'sparing and credit emergency's period as bank disappointments were common because of their broad loaning, while their nations' outside obligation developed at an unsustainable rate. Subsequently, the low security of global banks expanded their potential for insolvency. In order to counteract this hazard, the Basel Committee on Banking supervision, which contained national banks and supervisory specialists of 10 nations, met in 1987 in Basel Switzerland. A record was drafted to set up a globally acknowledged least degree of capital banks should have. The outcome was the Basel I Accord which happened to strengthen the quality of the universal financial framework while setting up a standard and stable worldwide financial framework to close the disparity hole among global banks. Basel I was a vanguard for characterizing bank capital and the bank capital proportion, which is its fundamental achievement. Nonetheless, the Accord didn't stipulate any contemplations for Islamic financial frameworks, an evil helped by Basel II as it put forward arrangements reasonable to Islamic banks.

### **3.1.2 BaselIII**

Prior to 1999, the Basel Committee for Banking Supervision endeavored to give the Basel II Accord identifying with Banks' capital amplex standard such that mirrored the adjustments in the structure and practice of money related markets and banks. Before giving the Basel II Accord, the Committee examined the reasons for banking emergency in numerous nations and found that one of the most noteworthy is that banks didn't deal with the financial dangers confronting them, notwithstanding the shortcoming of outer and inner supervision. In this way, the new Accord concentrated on taking care of these issues to guarantee banks' quality.

Basel II intended to build up more noteworthy market discipline vital for the strength of the worldwide money related framework. Advancing business sector discipline through more prominent straightforwardness and revelation is said to be another mainstay of Basel II. Six classifications were recognized for budgetary divulgence and straightforwardness: monetary execution, money related position, hazard the board methodologies and practices, chance presentation, bookkeeping arrangements and essential business, the board and corporate government data.

Basel II has been supported by this expansion which thusly has made Islamic banking a universal wonder. By their very nature, Islamic money items are like ordinary banks, for instance common assets, renting organizations, investment organizations and hazard cooperation organizations. The unmistakable structure of the budgetary items are consonant with the global pattern and Basel II.

Basel II re-developed the technique for appraisal of credit hazard. By suggestion this implied Islamic financial strategies were incorporated given that the new configuration of hazard rating permitted similarity for Islamic banks.

### **3.1.3 Basel III**

The Basel III structure was set up with the goal of upgrading the comprehension of key supervisory issues and improving the nature of banking supervision around the world. Basel III has set up measures to reinforce worldwide capital and liquidity rules with the objective of fortifying the strength of the worldwide financial framework. Basel III means to fortify the nature of capital held by banking organizations just as execute the new meaning of administrative capital, which gives more noteworthy spotlight on basic value, while additionally reinforcing the qualification criteria

for other capital instruments.

Basel III has likewise acquainted measures with reinforce capital necessities for exchanging book and complex securitization exposures, just as that for counterparty credit hazard exposures emerging from subsidiaries, repo and protections financing exercises. Basel III presents a Leverage Ratio which is expected to fortify hazard based prerequisites and oblige the development of influence hence relieving the impacts of extreme deleveraging in the financial framework during troubled periods.

The capital necessities gave in Basel III are not as severe as those in Islamic banks. Benefit sharing speculation accounts in Islamic money related organizations couldn't be incorporated as a segment of capital in Basel III as a result of their hazard retaining ability. Further, Islamic banks are not ready to seek after dissemination approaches that are conflicting with sound capital protection standards as banks need to construct capital cradles during prosperous occasions, so they can use them when the economy agreements to retain misfortunes. Basel III contrasts from Basel I and Basel II since it consolidates miniaturized scale and full scale prudential changes to address both establishment level and framework level dangers. Truth be told, the changes incorporate new large scale prudential principles advancing the development of capital cushions in great occasions that can be drawn down in periods of stress.

Basel Accord sees no difference amongst regular and Islamic money related establishments for



capital prerequisites as the Basel Committee didn't consider the one of a kind highlights of Profit Sharing Investment Accounts (PSIA). PSIA resources don't draw in money related dangers for Islamic banks as the hazard is taken by the speculation account investors, yet at the same time PSIA resources are not considered as value capital by the Basel regulators.

Basel III improves the hazard inclusion of capital market exercises, particularly counterparty credit chance on over the counter subordinates and in the exchanging books of banks. Harzi contends that an Islamic bank requires far lesser Risk Weighted Assets than the traditional banks under Basel III since exchanging book business and short selling is denied in Islamic banking.

Regardless of the fame of Islamic account in the universal financial field, Basel III neglects to recognize ordinary banks and Islamic money related foundations. In fact, Basel III has affected the Islamic financial division to a littler degree than ordinary banks, principally in light of the fact that the manner by which business is led in Islamic banks is less creative than the regular banks.

### **3.2 LEGAL AND REGULATORY FRAMEWORK OF ISLAMIC BANKING IN KENYA**

There is a dearth of institutions offering Islamic financial products in Kenya, even with regards to the growing demand for the same by the Muslim population - a fact attributed to the flawed legal and regulatory regime surrounding Islamic finance in Kenya. An examination of the regime is necessary to identify areas of reform.

#### **3.2.1 The Constitution of Kenya 2010**

The Constitution is the grundnorm of Kenyan law and the preeminent rule that everyone must follow, beating every single other law. This amazingness is announced in Article 2(1): "This constitution is the incomparable law of the Republic and ties all people and all state organs at the two levels of government."

As per the Constitution, Parliament has position to administer for the populace in all perspectives, including trade, for the progression of society and the economy. This authority stretches out to other region congregations also. Seemingly, Islamic fund is an incipient territory of business ready for enactment.

The constitution builds up the legal executive and inside it different courts with purview to hear and decide matters concerning private and open law. Article 170 sets up the Kadhi's court whose locale is restricted to deciding issues which fall inside the circle of an individual's close to home law, for example, marriage and legacy. By augmentation, this application can be loaned to other monetary issues including legacy and separation cases. This is on the grounds that when an individual passes on they can desert partakes in an Islamic bank. Along these lines by suggestion, such an Islamic financial establishment would anticipate that Sharia law should be applied in any issue that may emerge among itself and the domain of the deceased.

‘Article 32 (1) and (2) of the constitution states that everyone has the right to freedom of religion, and that a person, either individually or in community with others, in public or private, can manifest such religious belief through worship, practice, teaching or observance.’

This provision could be interpreted to include Islamic finance as the protection of the right “...to manifest any religion or belief through...practice or observance...” allows a Muslim to conduct his affairs according to his beliefs. Therefore, one can choose Islamic finance because it is *sharia* compliant and in line with his or her beliefs. One can further argue that the absence of a framework for Islamic banking that would allow Muslims to conduct their affairs according to their faith is

an infringement of their constitutional right as provided in the above article. However, there has been no judicial consideration of this provision.

The constitution guarantees the right to freedom of association, including to form, join or participate in activities of any kind of association. The right entitles every citizen to open any kind of business e.g. banks and such registration must not be revoked or withheld unreasonably. By implication this means that the legislature must enact laws to provide for a framework for such an association. Further, even if the application of Islamic law is restricted to personal law, Articles 32 (1) and (2) allow people to ‘express their religious beliefs through practice, which necessarily allows parliament to legislate on Islamic banking in compliance with the constitution. ‘Additionally, Article 44 of the Constitution allows people to ‘participate in the cultural life of their choice; one tenet of Islamic culture dictates that all business and commercial activities must be done in accordance with *sharia* principles.’

Article 46 stipulates consumer rights under the Constitution where it empowers consumers to access information necessary for them to gain full benefit from goods and services. This in turn means that potential investors must have access to information allowing them to make informed decisions.

### **3.2.2 The Judicature Act**

The wellsprings of law that are appropriate to Kenya are set out in the Judicature Act at segment 3, which spreads out both the wellsprings of law and the request for matchless quality concerning their relevance in Kenya. The sources recorded separately are as per the following: The Constitution; Primary just as backup enactment; precedent-based law, teachings of value and rules of general application in power in England by twelfth August 1897, which apply just to the extent that the conditions of Kenya and its occupants license and subject to any capabilities important; lastly African standard law. Standard laws apply if the two gatherings are dependent upon them and just if not repulsive to equity and ethical quality or conflicting with any composed law.

Given the abovementioned, no doubt Islamic law is incorporated under the fourth classification as all laws applying to Kenyan locals were viewed as African standard law. Leaving it in this position however, makes it powerless as it is lower in the order and is subordinate to other composed laws. This issue is shown by the Islamic financial segment as Islamic banks are constrained to observe regular financial laws that are frequently opposing to its sharia essentials for example the prohibition on riba under Islamic law and the boycott of simply theoretical exercises. Dealing with these two assorted methods of banking under one enactment with practically comparable guidelines and rules when the objective of every mode is diverse must be likened to an out of line and out of line arrangement of organization in this manner the requirement for a positive oppressive type of enactment for Islamic financing in Kenya. The goals of Islamic law or the customs Islamic financial should be suited inside the structure of Kenyan Banking law and systems. Also, African standard law contrasts from Islamic law as it is caught in the Quran and Sunnah, while standard law is verbally passed down generationally.

The Banking Act in Kenya doesn't contain Islamic financial standards got from Islamic law in any case, the Act itself isn't hazardous as any enactment that was established to cover Islamic financial law would be equivalent in position to laws overseeing traditional banks. The separation and order is actually solid yet lawmaking body must cause arrangement for Islamic banks as they to work on an alternate arrangement of center principles, to guarantee that they work on an equivalent balance with ordinary banks.

### **3.2.3 The Central Bank Act**

This is an Act of Parliament that was sanctioned to set up the Central Bank of Kenya and accommodate its activities. The Act gives that the chief object of the Bank is to figure and execute money related approach coordinated at accomplishing and keeping up a general degree of costs dependability and to cultivate the liquidity, dissolvability and legitimate working of a steady market-based financial system.

Segment 4A of the Act sets out the elements of the bank, which influence both regular and Islamic banks. They incorporate detailing and execution of remote trade arrangement; permitting and overseeing approved vendors; defining and actualizing approaches that best advance the foundation, guideline and supervision of proficient and viable installment, clearing and settlement frameworks; and giving cash notes and coins.

The Act enables the bank to permit, direct and examine the books of, and exhortation people participating in the matter of outside trade. The Act additionally permits obtaining by the banks against treasury bills or other government protections. In any case, treasury bills work by method for premium and in this manner repulsive to Islamic banks as premium (riba) is explicitly illegal bysharia.

The Act makes arrangements that enable the Central Bank to set least degrees of capital holds that banks are required to store with it for motivations behind keeping up liquidity of the bank and ensuring investors. In any case, this arrangement represents an issue with Islamic banks since they fundamentally exchange resources and value alternatives, not at all like traditional banks which as a rule exchange money. Thus, Islamic banks have a negligible degree of liquidity however remain monetarily steady. Given the significance of liquidity, Islamic banks have needed to improve other liquidity the executives apparatuses including ware murabaha(a conceded deal or portion credit deal which utilizes ware as a fundamental resource for the exchange), interbank situation of assets under different benefit sharing game plans and Islamic common assets. It merits referencing that it is conceivable to direct an item murabahabetween a bank and a national bank as occurred with Bank Negara of Malaysia. Given the abovementioned, it is important to alter the Act so as to suit sharia-consistent liquidity apparatuses as formulated by Islamic banks.

#### **3.2.4 The Banking Act**

The key demonstration administering banking business in Kenya, which means it applies to Islamic banks too since there is no devoted statutory system for Islamic banks.

The incongruence is stamped and seen as right on time as the definition which stipulates the foundations that might be alluded to as banks as "... an institution which carries on banking business..." Banking business is defined in Section 2 as:

'The tolerant from the individuals from people in general of cash on store repayable on request or at the expiry of a fixed period or after notice; The tolerant from individuals from the general population of cash on current record and installment on and acknowledgment of checks; and the utilizing of cash hung on store or on current record, or any piece of the cash by loaning, venture or in some other way for the record and at the danger of the individual so utilizing the money.'

Islamic banking requires assent of the client for utilization of their cash in venture, which has all the earmarks of being conflicting with the meaning of the financial business in the Act, not requiring contributors' agree to utilize cash saved in the bank. The legally binding course of action in Islamic banks implies that banks and contributors are co-speculators, sharing benefit and misfortunes disseminated between the gatherings to the understanding, instead of paces of return. Furthermore, an elucidation of the definition shows that the weight of the speculation hazard falls fundamentally on the contributor, in spite of Islamic banks' act of benefit and misfortune sharing where the bank and its clients similarly share the weights and compensations of ventures.

Under the Act, banks are precluded from connecting alone or with others, in discount or retail exchange, including the import or fare exchange, aside from over the span of the fulfillment of

obligations because of it; and any exchanging premium carried on by an establishment at the beginning of the Act will be discarded by the foundation inside such time as the Central Bank may permit. Thus, banks may not take part in exchange which is in opposition to the fundamentals of Islamic banking. Islamic banks

offer numerous facilities which place the bank in the position of trade including:

- a) *Murabaha*, where the bank purchases goods and resells them to the client;
- b) *Ijara*(leasing) contracts where the bank takes the place of the lessor by purchasing the property and leasing it to the customer;
- c) *Salam* where a bank pays a customer for the future delivery of a specified quantity of goods.<sup>36</sup>

These exchanges incorporate the bank taking part in retail or discount exchange in this manner the prohibition on banks taking part in exchange will block the advancement of the Islamic banks; rendering the lawful guideline of exchange and trade for banks critical. In this manner a devoted rule to manage Islamic banking is significantly increasingly fundamental in order as far as possible for the discount and retail exchange. Along these lines banks can keep up the base liquidity to flourish. Financial specialists will thusly be attracted to the banks as they will be certain that the banks won't embrace superfluous dangers because of the laws restricting them. Right now, the lacuna urges banks to take part in a wide range of exchange with the main check against foolish speculations being their inner sharia board.

Area 12(b) confines a bank from getting or holding, legitimately or in a roundabout way, any piece of the offer capital of, or generally have a gainful enthusiasm for, any monetary, business, farming,

---

<sup>36</sup> Supra (n 112).



modern or other endeavor where the estimation of the foundation's advantage would surpass in the total 25% of the center capital of that organizations. In any case, the usual way of doing things of Islamic banks is venture as sharia law disapproves of salary not in fact earned. They contribute monetary capital as thought for part possession in a business and they partake in the benefits and misfortunes of the venture. As a general rule, the bank's possession premium lessens with every installment until full installment of the capital. This area is along these lines restrictive of the method of activity of Islamic banks and Mudaraba(the bank gives the capital and the business visionary gives the business insight) is constrained just as Musharaka(joint adventure). Islamic banks can't completely work under standards applied to customary banks as an item like Mudaraba is restricted, which is one of the most widely recognized items related with Islamicbanks.

Area 12(c) restricts banks from buying or getting or holding any land or any premium or right in that aside from such land or enthusiasm as might be sensibly essential for the motivations behind directing its business, or for lodging or giving pleasantries to its staff, where the aggregate sum of such venture doesn't surpass such extent of its center capital as the Central Bank may endorse. This implies Islamic banks can't give contracts as they are involved buy and resale of the property at cost in addition to increase. This likewise avoids Murabahaand Ijaracontracts (where the great rented is land).

Section 14 of the Banking Act provides that:

*'No institution, other than a mortgage finance company, shall, make loans or advances for the purchase, improvement or alteration of land, so that the aggregate amount of those loans or advances exceeds twenty-five per cent of the amount of its total deposit liabilities.'*

Be that as it may, Islamic banks work by propelling cash for speculation which incorporates land and this area puts them off guard because of the course of action of organization with their customers.

Because of the two segments hampering Islamic banks from appropriately offering their administrations, an alteration was affected by the Banking Act with segment 53 giving that the pastor may, by notice in the Gazette, absolved an organization from the arrangement of section 12 or 14 subject to such conditions as the bureau secretary thinks about fundamental. Originating from this, the Cabinet Secretary for the National Treasury absolved First Community Bank from the arrangements of area 12(a) and (c), and the Bank got formal endorsement from the CBK on May 29th 2007. The Gulf African Bank was fused on August ninth, 2006 and began activities as a business bank in January eighth 2008, in a noteworthy occasion, where it was conceded the nation's first completely fledged business banking permit as a committed Islamic bank. Thus, the two banks turned into the first in the nation to be represented by the essentials of Islamic sharia. This arrangement supports the premise whereupon Islamic banks in Kenya manufacture their training on, anyway frail it is - shortcoming emerging from the way that working of Islamic banks is dependent on the impulses of bureau priests and official mandates and not on established enactment. As a result, the requests might be effectively disavowed as happened with the Hawala(money settlement benefits) that were gazetted and later shut down because of doubts of subsidizing fear based oppressor systems.

The foregoing is a clear illustration of the stark contrast between Islamic and conventional banking, as Islamic banking and finance is an entire system that needs a separate and concrete legal framework in order to thrive. The mere definition of banking business as a fundamental acts

as a hindrance to banks offering Islamic banking products and staggered exemptions and gazette notices are not enough to cover trade, liquidity leasing, insurance all which take different models in Islamic banking. The lack of pertinent legislation will invariably lead to Islamic banks offering secular products, which is contrary to sharia law, or ultimately the end of Islamic banks in Kenya.

### **3.2.5 The *Kadhi's Court Act***

This Act sets out procedures in the court, rendering it a procedural demonstration that owes its power to the constitution. Area 4(3) attests the matchless quality of the High Court and segment 5A further expresses that Kadhi's court will have and practice purview in deciding inquiries of Muslim law identifying with individual status, including marriage, separation or legacy in procedures in which every one of the gatherings proclaim the Muslim religion. This segment doesn't constrain the locale of the High Court or any subordinate court in procedures that precede it.

As per the precedent-based law, individual status is comprehended to mean how an individual carries on with their life, their qualities and conventions. Therefore, for it to apply to somebody that individual more likely than not submitted to the Islamic way of life and statement of faith and the two gatherings attribute to the Islamic religion. Apparently, how somebody directs their budgetary issues and ventures falls inside the umbrella of individual law. At the point when an individual bites the dust and their home is in an Islamic bank, the progression matter will be best heard in the Kadhi's court where standards of Islamic financial will be examined. Additionally, while deciding upkeep following disintegration of marriage, the Kadhi's court must consider Islamic financial issues if the advantages are held in an Islamic bank.

Nonetheless, notwithstanding the abovementioned, Islamic financial exchanges don't generally emerge between Muslim steadfast and accordingly the Kadhi is limited from practicing locale. Additionally, as an issue of work on banking matters are taken care of in business courts applying common banking and agreement laws. In this way the Act quells the authority of the court and practicing locale in banking questions might be viewed as *ultra vires*.

Moreover, as the authority of the Kadhi's court is gotten from the constitution, any revision to the Act would be void stomach muscle initio and unlawful.

The main way in this way the job of the Kadhi's court can be extended to remember matters of Islamic banking for the Act is just if the constitution is changed to grow the purview of the court.

### **3.2.6 The Kenya Deposit Insurance Act2012**

This Act was consented to by the president in May 2012 to change the Deposit Protection Fund Board (DPFB), whose command is to shield client stores in part money related establishments. The Act sets up the Kenya Deposit Insurance Corporation (KDIC) as a corporate body that would assume control over the forces, commitments, resources and liabilities ofDPFB.

The features of the Act include: expanding of the command of KDIC in this manner enabling it to embrace supervision and issue goals capacities; improving the corporate administration of KDIC by giving a more extensive board sythesis in the method for a non-official administrator; expound arrangements for the investigation of part foundations as a team with the Central Bank and implementation moves that might be made to cure breaks; arrangement for arrangement of KDIC as beneficiary or outlet in examples where an organization has been announced wiped out or occupied with acts of neglect or exercises that are in opposition to the arrangements of Kenyan or other relevant law.

Store protection has pulled in a great deal of enthusiasm for the Islamic budgetary world as to understanding its admissibility from a sharia perspective. Islamic store protection has been created in nations, for example, Malaysia to ensure guaranteed contributors against the loss of their safeguarded Islamic stores set with Islamic financial foundations in case of their disappointment. The store protection framework built up by this Act still doesn't consider Islamic banks which are sharia agreeable. Accordingly it is hard for KDIC to direct Islamic banks given the difference in structure between the two sorts of banks; hence evaluation gauges will likewise vary. Also, the absence of an administrative system to oversee Islamic banks makes it hard for KDIC to screen consistence in this way making them intensely dependent on the sharia sheets of separate banks whocan give one-sided suppositions inclining towards the bank. Because of the norm, there is a need for the Central Bank to build up an arrangement of store insurance complying with the banks' measures. A case of this framework would incorporate an uncommon council inside the KDIC contained researchers of sharia who might inform the KDIC on resistance regarding Islamic saves money with sharia just as help the KDIC structure a framework to be pursued to guarantee clients in Islamic banks are secured.

### **3.2.7 The Prudential Guidelines and Risk Management Guidelines(2013)**

The CBK gave another arrangement of Prudential Guidelines and Risk Management Guidelines which came into power on first January, 2013 and they apply to banks, budgetary establishments and home loan fund organizations. These guidelines manage a wide scope of issues including corporate administration, liquidity the board, authorizing necessities, board arrangement, capital sufficiency prerequisites, stress testing, remote trade presentation limits, precluded business, buyer insurance, requirement of banking laws and guidelines, specialist banking and delegate workplaces.

The Central Bank set up these rules because of improvements in the national, territorial and worldwide field with the point of proactively reinforcing the administrative system for banks and different organizations that have been authorized as per the Banking Act. Basel I and II rules structure a reason for a considerable lot of the standards in the Guidelines, particularly with respect to capital ampleness. The presentation of the Prudential Guidelines mirror Kenya's proceeded with endeavors towards fortifying its financial condition so Kenya canattain its objective under Vision 2030 to be a global money related focus. The prudential rules imply that Islamic banks are managed in an indistinguishable way to traditional banks, no simple accomplishment given that the administrative capacities vital for Islamic banks are unique in relation to those of customary banks. Matters, for example, discount and retail exchange restricted the ordinary set-up structure the center business of Islamic banks. In this manner the burden of comparative administrative benchmarks would prompt a finding of resistance with respect to Islamicbanks.

There are parts of Islamic banks that warrant prudential guideline to a comparative degree as customary banks. The significant one includes moral peril contemplations which emerge from the hazard sharing nature of speculation stores, in which investors give the assets that the bank puts resources into the exercises it considers productive. Under Islamic banking, contributors share the danger of benefit and misfortune with the bank, implying that the bank can pass a considerable piece of the speculations' misfortunes onto investors. This position introduces the likelihood that banks might be actuated to attempt ventures with higher dangers than if they needed to ensure all stores, as in regular banks. In any case, the assurance of stores is a logical inconsistency of the center of speculation accounts in Islamic banks.

### **3.3 CONCLUSION**

Islamic banking in Kenya is working right now through what is named as a 'window' of Islamic banking inside the traditional financial framework. The revision of the Banking Act to give exceptions to Islamic banks from the guidelines that administer customary banks was the initial step to what is ideally the start of appropriate administrative arrangements for the Islamic financial area. The current lawful system is insufficient and thusly offers meet people's high expectations as talked about in the following section. By the by, to support the development and improvement of Islamic money related framework, the flexibility of the business must be reinforced through advancing lawful and administrative changes by the controllers. Setting up a different, suitable and successful legitimate and administrative system is especially significant for Islamic money related organizations. This will guarantee that Islamic banks can be on equivalent balance with customary banks, which will empower them to contend successfully.



## **CHAPTER FOUR**

### **REALITIES OF ISLAMIC BANKING IN KENYA**

#### **4.0 INTRODUCTION**

It is evident that Islamic banking in Kenya succeeds by dint of the various banks' in-house mechanisms and industry conventions. In spite of the burgeoning industry, the requisite regulatory structures required are insufficient, subsequently resulting in several issues riddling it. The problems plaguing the sector are discussed below.

#### **4.1 CHALLENGES FACING THE REGULATION AND IMPLEMENTATION OF ISLAMIC BANKING IN KENYA**

##### **4.1.1 Inadequate Legal Protection granted to Islamic Banks**

A far reaching lawful and administrative system must help Islamic money, with the goal for it to flourish.

As analyzed in the past section, there is a deficiency of clear guideline to oversee Islamic banks in Kenya right now. Truth be told, exceptionally essential laws spread the smooth activity of Islamic financial exchanges and agreements, on the off chance that they exist by any means.

Right now, there is no lawful help for Islamic financial framework because of the nonappearance of corporate laws adequate for the utilization of Islamic banking and monetary agreements. Accordingly, both the national bank and pertinent controllers must update the laws concerning organizations, business, venture, lawful methods and the legal framework in consistence with the

prerequisites of Islamic financial foundations. Kenyan organization law vigorously alludes to intrigue and bonds, to the detriment of cooperation deeds and benefit. Further, organization and banking law necessities enigmatically characterize banking exercises, restricting its degree to customary parameters.

Beside a couple of shallow changes made to the present financial framework, Islamic banking has remained to a great extent unregulated against the scenery of banking laws at first impacted by customary financial practices preceding the coming of Islamic fund. This implies the whole present structure must be overturned to conform to the precepts of benefit/misfortune sharing, just as joint investment and organizations.

#### 4.1.2 Jurisdiction – Civil or Sharia Court

The present practice saw in the nation is to allude any Islamic banks' questions to the standard courts working under ordinary arbitration – a confused practice given the remarkable idea of the Islamic legitimate framework. While Kadhi's Courts are sacred courts commanded to mediate on close to home issues between parties pronouncing the Muslim confidence, they are right now not prepared to deal with questions emerging from Islamic financial exchanges. Distressed gatherings should then discover change in the mainstream courts, whose lawful framework is very surprising. This goes about as a block to the development of Islamic account in Kenya.

By adding the Islamic segment to the financial business, the segment turns into the predominant feature, and the only law that should be applied is Islamic law. In Malaysia, it has been argued that with the presence of a dual judiciary system, the role of civil courts in these disputes can be challenged by *sharia* courts. In *Bank Islamic Malaysia Berhad v Adan Bin Omar*, the defendant argued that the civil court had no jurisdiction over the case and it should be resolved in a *sharia* court. The court, however, rejected this argument and cited the Federal Constitution which clearly sets the issues that will be subject to Islamic law.

There must be no element that is not acceptable to the dictates of Islam within Islamic banking transactions. However, the courts' approach in dealing with disputes has not always been guided by this principle. Judicial precedent shows that the manner in which disputes are resolved differ from one case to another. In the Malaysian case of *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporate SdnBhd*, the disputed issue was security charged under the loan, which the National Land Code provides. Although the judge recognized that the court was looking at an Islamic banking facility, he did not explore whether the disputed matter would be considered an element that is not approved by the religion of Islam.

On the other hand, in *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya SdnBhd and ors*, the High court determined that a court should consider the application of Islamic law in the context of banking and finance, and that by doing so the court is not acting as a *sharia* court.

Any enforcement of Islamic agreements in courts are hampered by the lack of Islamic banking legal and regulatory framework due to the additional costs and effort required. In order for there to be a substantial Islamic legal system, the existing laws that are wildly at variance with Islamic principles

must be amended so as to facilitate speedy resolution of disputes through special courts.<sup>37</sup>

---

<sup>37</sup> *Supra* (n 16)

### **4.1.3 Disparity in Concepts and Practice**

All monetary and money related exchanges in Islamic fund depend on moral exchanging and evenhanded support, in view of a model of benefit and misfortune sharing. An advance is possibly permitted in the event that it is 'kind' (Qardh Al Hasan). Islamic banks act like budgetary conductors, with the speculators enduring the worst part of the benefit or misfortune emerging from the advantage. Islamic banks exchanges are completed based on certain hypothetical ideas and highlights yet the truth on the ground is extraordinary. The primary battle confronting Islamic banks is the compromise of their job as agents in exchanging and renting, with the completion of the Islamic ideas and highlights.

### **4.1.4 Ownership of Underlying Assets**

Customary sharia statutes recommend that benefits assume a urgent job in evaluating the legitimacy of an exchanging or renting exchange. Any advantage proposed to be utilized as a center resource in Islamic exchanges (for example receivables, concessionary right, trademarks, budgetary rights, copyrights, existing resources or gear for renting purposes, property to be built on account of Istisnaetc) must have an unmistakable provenance before the office is even offered to the client. Sharia decides additionally endorses that all benefits utilized should either be out appropriately claimed or the client must have clear authority from the proprietor to execute business with them. Be that as it may, it is hard to follow proprietorship and demonstrate resources are unhampered. A hole in the structure that neglects to address this may refute numerous Islamic banks exchanges stomach muscle intio.

#### 4.1.5 Lender of Last hotel

Islamic banks are helpless against liquidity issues, like customary banks. In any case, dissimilar to regular banks they can't appreciate the Lender of Last Resort office accessible to standard banks in case of unanticipated money related emergency. The office is vigorously affected by intrigue which is inconsistent with sharia statutes as Islam prohibits any exchanges with a component of intrigue (usury). This renders the Islamic banks increasingly powerless against liquidity challenges in examination with regular banks.

#### 4.1.6 Lack of Expertise, Knowledge and Training

There is an absence of mindfulness on how Islamic banking works both by purchasers and arrangement producers in Kenya. Shoppers have little information on how the items work, on the off chance that they think about them by any stretch of the imagination. Also, the individuals who do think about the items expect they are just accessible to Muslims and see them to be excessively intricate. A branch of this is the shortage of prepared proficient staff gaining practical experience in Islamic Finance and Contracts who might be important to comprise sharia Boards. Also, there aren't sufficient Islamic financial specialists to go around as supply has lingered behind the blast of Islamic banking. Preparing can be applied to local banks, both Islamic and non-Islamic, and outside banks too.

An administrative structure that is hearty energizes open confidence in the Islamic money related framework, enables specialists to enhance modern items to meet the many-colored buyer requests. Moreover, it permits an arrangement of question settlement that considers the particular highlights of Islamic budgetary exchanges.

#### **4.1.7 Lack of accounting (and auditing) standards relevant to Islamic banks**

Vulnerability in bookkeeping standards includes income acknowledgment, revelations of bookkeeping data, bookkeeping bases, valuation, income and cost coordinating, among others. There are no rules set up to survey hazard for credit offices, potential attainability studies and task assessment, given that the organization of 'loaning' in Islamic banks is venture overwhelming and not founded on the leaser indebted person relationship of customary credit offices. Therefore, the aftereffects of Islamic financial plans may not be satisfactorily characterized, especially benefit and misfortune shares credited to contributors.

Islamic foundations assume an indispensable job in empowering monetary flourishing for social soundness where individuals live with solid strict convictions. This animates the desire for Islamic Banks to convey high caliber fiscal reports since Muslim society anticipates that they should hold fast to the standards of Sharia. The revival of Islamic Banks which offer a wide scope of items that contrasts from regular monetary items and thus request Islamic bookkeeping gauges in a way that is steady with Islamic money related items. The improvement of bookkeeping models for Islamic Banks will satisfy the craving of Muslims to apply Islamic standards in all parts of their lives including their financial exchanges.

In creating Islamic bookkeeping measures, Islamic bookkeeping researchers uncover that the fundamental standard of Islamic bookkeeping is responsibility to God. As per Napier, with responsibility to God, two fundamental qualities of Islamic bookkeeping are total honesty and social responsibility, which are contradictory to the thoughts of innovative bookkeeping, window dressing and detailing legalities over substance. To be responsible to God, it is basic for Islamic monetary establishments to increase open trust and certainty by revealing a dependable portrayal of the financial exchanges or occasions that it indicates to speak to. The exchanges must be accounted for as per the substance just as type of sharia gets that oversee these exchanges or occasions. Furthermore, an extraordinary organization issue (in reference to revering God) has showed up in Islamic banks that requests for data unveiled ought to mirror the Islamic exchanges condition. Earlier writing recommends that the advancement of an extraordinary arrangement of Islamic bookkeeping measures can address issues experienced by Islamic banks identifying with the lacking of customary bookkeeping gauges, for example, International Financial Reporting Standards (IFRSs) or nearby General Accepted Accounting Practice (GAAP) in representing Islamic Banking exchanges.

#### 4.1.8 Insufficient Safeguards for Consumer Deposits



The law in Kenya accommodates a Deposit Insurance Fund (the Fund) that gives protection assurance to investors in case of the disappointment of a part money related organization. The Fund is overseen by the Kenya Deposit Insurance Corporation (KDIC), built up under the Kenya Deposit Insurance Act, 2012 (the Act). All organizations authorized to take stores including business banks, budgetary establishments, contract fund organizations, building social orders and miniaturized scale account foundations must take out participation . While the Fund enables investors of bombed banks to recuperate up to a specific measure of cash from the foundation, the structure depends on traditional banks and isn't significant to sharia based banks because of the Fund permitting premium based exchanges. Furthermore, the store is sick prepared to give spread to Islamic based items.

Right now, the main alternative Islamic banks have is to move the misfortune legitimately to the contributor, which thusly prompts dread of saving and subsequently stagnating improvement of the banks. It is valuable to build up a different investors' reserve inside the system of the KDIC, taking into account premium free protection for contributors.

#### **4.1.9 Sharia Non-Compliance**

The premise of Islamic banking is the adherence to sharia standards, in this way sharia consistence which must be continually observed. The adherence of sharia standards is essential to the advancement of Islamic banks and foundations. This is urgent for a couple of reasons; supporting the change of conventional banks to Islamic establishments, loaning trust and validity in the activity of these foundations with their clients. In reality, for most Muslim clients, this is the sole explanation behind their choice to manage an account with Islamic banks - the way that sharia standards are pursued. Be that as it may, the observation that Islamic items are just ostensibly following sharia principles is picking up footing; a plausible indication of the absence of guideline to help Islamic banking.

Translations may vary with respect to different items which thusly implies there can be no institutionalization as one sharia board may dismiss a money related instrument that is endorsed by another board, as the decisions of these sharia sheets depend on their comprehension of the fundamental sharia standards. Fluctuating ways of thinking have developed emerging from contrasting societies and Islamic social orders.

The nonappearance of general principles and lucidity muddles the idea of Islamic banking to regular controllers. Each Islamic bank designates their own Islamic sharia board of trustees to survey the Islamic feasibility of the bank exchanges and different exercises. All the more desperately, a standard glossary of terms is required in the jargon of Islamic financing, financing instruments and their documentation and valuing recipes for Islamic items. For instance most Islamic banks utilize the term Murabaha to mean financing by method for deal on conceded installment while some call it Bai muajjall (Deferred Payment Financing). Sharia ought to encourage advancement and innovativeness instead of upset it.

Chaperon to this test is the nonappearance of a National Sharia Supervisory Board. While the International Islamic Rating Agency has set out components of sharia consistence necessities that banks need to meet so as to complete sharia agreeable financial exercises , Kenyan banks all have contrasting capabilities and participation benchmarks for their inward sharia sheets. This represents a test as the criteria used to select a person to a board isn't unmistakably accommodated and one is uncertain with respect to whether individuals from a specific board have the imperative skill to direct the bank in maintaining standards of Islamic sharia. This is additionally intensified by the way that the sheets are supported by the banks themselves, making a fruitful ground for irreconcilable circumstance and subjectivity when checking on cases.

The constitution of a National Sharia Supervisory Board for better institutionalization and combination of items, set capability and accreditation of Banks' Sharia Board individuals and set standards for sharia control. This ought to be done together with key promoting, where the banks make attention to the items being offered and simultaneously serve to bring issues to light of the reality of the national sharia supervisory board - the two of which will impart more trust in potential clients.

## **4.2 CONCLUSION**

The Islamic financing industry must be continued by guaranteeing the advancement of lawful and administrative changes by the controllers. Upholding a hearty and effectual legitimate and administrative structure is key for Islamic money related foundations. Winning conviction is that prompting significant and sound structure will empower a supporting situation for partners which guarantees solid advancement and development of the money related framework.

Various sharia consistent and fund items including sukuk (sharia agreeable security) and organized items (speculation instruments extraordinarily made to address explicit issues that can't be met from the institutionalized monetary instruments accessible in the business sectors) that are perplexing in nature and constantly requests for developments of Islamic budgetary items and activity which pull in different kinds and level of hazard profiles very particular from the customary ones. Along these lines, guideline, supervision and oversight of the Islamic financial items and tasks need to address this unconventional nature.



## **CHAPTER FIVE**

### **DEVELOPING AN APPROPRIATE FRAMEWORK TO REGULATE ISLAMIC BANKING IN KENYA**

#### **5.0 INTRODUCTION**

Kenya's lawful system for Islamic banks is deficient. This opens a window for Islamic banks to self-direct which can prompt maltreatment of intensity by sharia sheets just as deviation from standards of Islamic sharia. The insufficiency has prompted the absence of an institutional system. Albeit Islamic banks have a sharia board that guarantees that the activities of the banks are sharia agreeable, these sheets are to a great extent unchecked and there is no general body that guarantees that these sheets are practicing their position appropriately. This has raised worries that these sheets have been abusing their forces and that a portion of the activities of these Islamic banks are not sharia consistent. This part thusly looks to suggest segments for the improvement of thorough Islamic Banking Regulation in Kenya.

#### **5.1 RECOMMENDATION**

##### **5.1.1 Creating a National Legal and Institutional Framework for Islamic Banking**

The Kenyan government needs to put resources into the financial part by making a self-ruling lawful administrative and institutional system for Islamic banking agreeable with sharia. This would involve the establishment of laws that explicitly oversee Islamic banks. This is significant on the grounds that the Banking Act is extremely restricting with respect to the open doors it has made for Islamic banks. For instance, Section 12(a) states that a bank will not connect alone or with others, in discount or retail exchange, including the import or fare exchange, aside from over the span of the fulfillment of obligations because of it; and any exchanging premium carried on by a foundation at the beginning of the Act will be discarded by the establishment inside such time as the Central Bank may permit. This implies banks may not exchange purchasing and selling products which makes this arrangement diverge from Islamic banking. For instance, Islamic banks offer Murabaha, where the bank purchases products for resale to the customer; and Ijara (leasing) contracts whereby the bank rents the property to the client in the wake of getting it for that reason just; at last, Salam which incorporates the bank paying a client for conveyance later on for specific merchandise where a bank pays a customer for the future delivery of a specified quantity of goods. All these transactions require the bank to participate in either discount or retail exchange in this way such a denial can be devastating to Islamic banks.

Area 12(b) limits a bank from obtaining or holding, straightforwardly or in a roundabout way, any piece of the offer capital of, or generally have an advantageous enthusiasm for, any money related, business, farming, mechanical or other endeavor where the estimation of the establishment's advantage would surpass in the total 25% of the center capital of that foundations. Islamic banks are arranged towards speculations as sharia law avows the inexcusable quality of unmerited pay. Banks front the money related capital in return for incompletely owning the business, while likewise being associated with misfortune and benefit of the activity. As a rule, the bank's enthusiasm for the venture lessens until the capital progressed is completely reimbursed. This arrangement of the Banking Act in this manner substantially restricts the activities of Islamic banks. It influences Mudaraba (the bank gives the capital and the business person gives the business keenness) and Musharaka (joint adventure). On the off chance that Islamic banks are administered by the standards applied to traditional banks, they won't have the option to offer items, for example, the Mudaraba, a most loved in the Islamic financing business.

Area 12(c) denies banks from obtaining or gaining or holding any land or any premium or right in that with the exception of such land or enthusiasm as might be sensibly fundamental for the motivations behind directing its business, or for lodging or giving civilities to its staff, where the aggregate sum of such venture doesn't surpass such extent of its center capital as the Central Bank may recommend. This area blocks Islamic banks from offering contracts as their model is predicated on buy and resale of the property at the expense in addition to benefit. In this manner, the Murabaha and Ijara contracts (which incorporates renting of the benefit) are excluded.



This uncommon example of Islamic financial items and establishments that are let alone for the traditional banking legitimate structure renders the update of laws important. The law must design approaches to cover the exchanging and venture exercises did by Islamic financial foundations, particularly since it is hard for them to keep working under the pretense of current laws that don't respect the complexities of Islamic financial practices. Extraordinary laws are expected to cover situations of purchasing, renting, deal and ventures on a hazard premise to empower Islamic banks to completely work.

The National Islamic banking lawful, administrative and institutional structure should enhance the customary financial framework and be worked in a manner that would cling to the kind of Islamic financial framework and the orderly dangers.

### **5.1.2 Adoption of Global Legal and Regulatory best practices for Islamic Banking**

As Islamic financial keeps on turning into a universal pattern, it is significant that Kenya embraces worldwide models that oversee this industry to empower it to connect with and contend on the worldwide circle with different nations which have executed Islamic banking. Column 2 (3) (I) of the Basel II accord for example expected to build up more prominent market discipline through expanded straightforwardness and divulgence that would empower better checking of banks' exercises in this manner guaranteeing banks don't arrive at the purpose of breakdown. Guideline An and B of the Basel III accord then again set up measures for reinforcing worldwide capital and rules on liquidity so as to fortify the strength of the financial segment. The utilization of these guidelines, in spite of the fact that not explicitly made for Islamic banks, would go far in guaranteeing the development and soundness of Islamic banks.

There are likewise measures and rules set by Islamic organizations that would extraordinarily profit Islamic banking in Kenya. For instance, there are measures and rules gave by the Islamic Financial Services Board issues and managing values ordered for the reasons for expanding the adequacy of the Islamic monetary administrations industry.

The monetary market foundation is upgraded by the capacity of controllers and bosses of Islamic money related organizations to coordinate the International prudential gauges inside the sharia structure of Islamic banking to have a precise hazard based system. The legitimate, administrative and institutional structure must be on consonance with worldwide measures proclaimed by the Basel Committee, International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) with those of Islamic Financial Services Board (IFSB), the Accounting and Auditing Organization for Islamic Financial Institutions (AIOFI) and International Islamic Financial Markets (IIFM). One this is accomplished, it will guarantee an empowering situation vital for the sound advancement, productivity and development of Islamic budgetary markets.

### 5.1.3 Appropriate Licensing for Islamic Banks

The Central Bank of Kenya through a Sharia Advisory Committee ought to be liable for permitting of Islamic Banks in Kenya. The Sharia Advisory Committee's job is to guidance on whether every single strict condition essential known as Fiqh al-Muamalat (Islamic guidelines on exchanges), for instance, preclusion of interests in organizations giving merchandise or administrations that are

disgusting to sharia standards (haram - taboo) just as denial of riba, to work an Islamic bank are available for a foundation to be authorized.

For better administration of banks by supervisory specialists, suitable permitting systems are vital in an Islamic financial structure. Establishments wishing to be authorized to embrace Islamic financial business must direct the entirety of its exercises, tasks and exchanges as per sharia rules and principles, for example, maintaining a strategic distance from enthusiasm, evading ceaselessly from theoretical exchanges and being straightforward in the entirety of its dealings.

#### 5.1.4 Ensuring Proper and Adequate Supervision to Improve Compliance and Control

The point of the administrative and supervisory structure is to guarantee that financial establishments adequately meet commitments through a successful and proficient control framework. Consistence need not be religion-based, rather center around sanctioning a hazard based administrative system. Meeting this element implies having an improved and effective supervisory procedure that promptly recognizes any hazard gives that would then be able to be overseen as needs be.

Systems ought to be set up to guarantee that budgetary establishments undertaking Islamic financial business are sharia agreeable. These incorporate the prerequisite for an inward sharia review work and an inner sharia warning board - which Islamic banks have embraced to comprise in Kenya and an arrangement for a Central Sharia Advisory Board inside the Central Bank of Kenya. Oman has

effectively set up these components and has seen enormous improvement of the Islamic financial area in the nation.

The Sharia warning board must be free of every single other capacity of the budgetary establishment and ordered to prompt, favor and survey the exercises of the Islamic monetary organizations to guarantee that they are sharia agreeable. It would likewise be responsible for regulating the sharia review work.

The Central Sharia Advisory Council's obligations incorporate favoring items offered by the money related foundations undertaking Islamic monetary business and exhorting on their guideline.

The jobs of the Sharia board are three: fatawa (nonbinding legitimate feeling on a point of Islamic law given by a sharia learned individual) issuance, supervision (raqabah), and review (mutabaah).

The sharia board at the bank has the fundamental capacity of exhorting on sharia issues to guarantee it never conflicts with the parameters set by sharia law, surveying applicable documentation for items and administrations and strategies, manuals and promoting exercises. The board additionally guarantees that every one of its choices are appropriately executed. The sharia board at the national bank's level goes about as the most elevated sharia expert for the separate Islamic Banks.

#### 5.1.5 Promoting Transparency and Disclosure in Islamic Banking

The essential component in guaranteeing buyer assurance and monetary proficiency is straightforwardness. Shopper mindfulness and monetary proficiency are fundamental segments that go connected at the hip at whatever point buyer insurance is having an effect on everything.

Straightforwardness furnishes clients and the overall population with all significant data, encounters, approach choices and item and administrations in a reasonable and open way. It gives clients viable exposure of vital data expected to settle on an educated choice. It assists clients with getting all the more monetarily proficient and settle on monetary choices that stay away from further obligation and damage.

Straightforwardness enables clients of various monetary classes, particularly those with lower instruction and pay levels. The more straightforward the foundation is, the more profound the client relationship. Straightforwardness creates increasingly faithful learned clients. The more mindful the organization is on the fulfillment of the clients, the more information they have on what should be known to people in general and the degree of straightforwardness expected to improve relations with purchasers.

At the point when a Muslim picks one bank over another, this decision depends on their degree of certainty that the bank will keep up capital at a sensible level for dissolvability. What's more, the bank's capacity to acknowledge paces of profits proportionate with the expected venture chance for the two its investors and the speculation account holders is likewise significant in basic leadership. A nonappearance of this confidence may mean Muslims will quit managing the Islamic banks out and out. One wellspring of this data is budgetary reports arranged by principles worthy to Islamic banks and laws overseeing them.

#### 5.1.6 Guaranteeing Deposit Protection

Islamic store protection is a course of action to secure guaranteed contributors against the loss of their safeguarded Islamic stores set with Islamic financial organizations in case of their disappointment. It is executed where Islamic stores are offered to the general population. It is essential to have a different legitimate system for Islamic banking in Kenya with the goal that Islamic Deposit Insurance can be fused into the law.

Per Islamic convention, it was not the expectation of the Prophet to inflexibly fix the structure of direct and activity forever, oblivious of the adjustment in conditions. Rather, he just left broad guidelines for the Muslims to modify as suitable. The premise of reference has consistently been the thought of the general population intrigue (maslahah). Store protection contains the component of open premium, and accordingly is allowable under sharia, showed in a couple of ways-first, store protection shields the general population from losing cash that they place in a bank when the bank falls flat. Its execution is considerate as it guarantees individuals don't lose their stores and battle monetarily - particularly those with restricted money related assets.

Second, store protection can ingrain certainty among the overall population as respects the wellbeing of their bank stores. This lessens the probability of frenzy among contributors in case of a supposed or genuine bank disappointment.

### **5.1.7 Cultivating HumanCapital**

Islamic banking is a generally new event in Kenya, there are relatively few individuals who have the necessary ability to comprehend and execute the rules that underlie this type of banking. This can bring about banks implying to be Islamic banks yet they don't adhere to the guidelines of Islamic sharia and there is nobody to scrutinize their exercises. The improvement of experts in this division will along these lines guarantee banks that offer Islamic financial items hold fast to sharia. This undertaking will depend vigorously on an upgraded administrative limit of the Islamic financial part which would give clear rules on the essential capabilities required by experts in this segment. In Kenya, the Central Bank has been finding a way to promote Islamic banking by teaming up with the International Center for Education in Islamic Finance (INCEIF) to structure a confirmation program for senior bank and Sacco authorities on the administration of Islamic

exchanges and items to be offered at the Kenya School of Monetary Studies (KSMS). KSMS will utilize that ability INCEIF has developed during that time to convey an all inclusive perceived testament in Islamic banking. The Central Bank of Kenya ought to likewise urge colleges to show Islamic Finance.

## 5.2 CONCLUSION

The present substances of Islamic banking in Kenya from the point of view of the administrative difficulties confronting the business is a major advance towards the acknowledgment of the insufficiency of the administrative system of Islamic banking in Kenya. This paper has built up that there is requirement for an extensive legitimate, administrative and institutional system to administer the Islamic financial area in Kenya.

The development of Islamic Banking in Kenya was as a need to cook for a specific gathering of individuals whose cash was available for use yet was unaccounted for inside the financial framework. These monies were related with the Muslim people group who didn't utilize regular banks not agreeing to the Islamic religion. Different variables that prompted the development of Islamic banking in Kenya were advertise request, various item extend and as an overall pattern.

This paper examined Islamic financial guideline at the universal level and in Kenya, with the point of discovering difficulties in Kenyan guidelines, notwithstanding best practices that can be presented for ideal development of Islamic banking. In spite of the development of Islamic Banking in Kenya, the basic administrative system required to oversee this division is deficient as no genuine



endeavor has been made to change the current regular financial laws to oblige Islamic banking with the exception of a couple of corrective changes presented. Thus, there must be all out update of the whole lawful structure to guarantee the requirements of Islamic financial framework are met.

The inadequacy of the legitimate structure overseeing Islamic banking has offered meet people's high expectations in the tasks of Islamic financial segment in Kenya. This paper has brought up the obvious difficulties, for example, inadequate lawful insurance for Islamic banks; a disarray in the ward of courts; dissimilarity in idea and practice; responsibility for resources; burdened as far as monetary security; absence of skill, information and preparing; absence of bookkeeping (and inspecting) norms important to Islamic banks; lacking shields for buyer stores and sharia resistance.

For the sustenance of advancement and development of the Islamic monetary framework, the industry flexibility must be strengthened through development of legitimate and administrative changes by the controllers. Establishing a fitting and powerful lawful and administrative structure is key for Islamic budgetary foundations. This paper suggests parts for the advancement of far reaching Islamic Banking Regulation in Kenya which are: making a national lawful and institutional system for Islamic banking; selection of worldwide legitimate and administrative prescribed procedures for Islamic banking; proper authorizing for Islamic banks; advancing straightforwardness and exposure in Islamic banking; ensuring store assurance and developing human capital.

Setting up a lawful structure for Islamic banks that is isolated from that of ordinary banks and clings to standards of Islamic Sharia will guarantee that an appropriate administrative framework will be set up with the vital foundations set up so as to guarantee the proceeded with development and

advancement of Islamic banking in Kenya.

## BIBLIOGRAPHY

### Books

1. Aldohni A., '*The Legal and Regulatory Aspects of Islamic Banking*' (Routledge, 2011)
2. El-Gamal M, '*A basic Guide to Contemporary Islamic Banking and Finance*' (Rice University, Houston, USA 2000).
3. El- Jaziri A., '*Islamic Jurisprudence: The Four Schools of Thought*' (Darel Takwa, 2008)
4. Hayman L., Levit N. and Delgado R., '*Jurisprudence Classical Contemporary: From Natural Law to Postmodernism*' (2<sup>nd</sup> edn., American Casebook Series, West group)
5. Hassan M., '*Basel III and Regulatory Framework for Islamic Banks*' (University of New Orleans)
6. Henry M. and Wilson R., '*The Politics of Islamic Finance*' (Edinburgh University Press, 2004)
7. Imran M., '*A Guide to Islamic Banking*' (Darul- Irshad, Pakistan, 2002)
8. Kettle B., '*Introduction to Islamic Banking and Finance*' (John Wiley and Sons, Ltd., Publication, 2011)
9. Khan S. R., '*Profit and Loss Sharing: An Islamic Experiment in Finance and Banking*', (OUP 1987)
10. Lewis K. and Algonid M., '*Islamic Banking*' (Edward Elgar Publishing, 2001)
11. M. Iqbal and P. Molyneux, '*Thirty Years of Islamic Banking : History, Performance and Prospects*' (Palgrave Macmillan, New York, 2005)
12. N.G Mankiw, '*Principles of Economics*' (5<sup>th</sup>edn. , USA, 2009)
13. Njogu R., '*Commercial Bank of God: Islamic Banking Law and Religion*' (Lambert Academic Publishing)

14. Paul J. Omonyi, ‘ *Key Issues in Jurisprudence , an In-depth Discourse on Jurisprudence Problem*’ (Law Africa Publishing Ltd)
15. Sejpal S. and Doshi M., ‘ *Banking Regulation*’ (Global Legal Group, 2009)
16. The Holy *Quran*.
17. Usmani M. Ashraf, ‘ *Meezan Bank’s Guide to Islamic Banking*’ (Darul-Ishrat , 2002)

### **Encyclopedia**

1. Einnar Himma K., ‘Natural Law’ *Internet Encyclopedia of Philosophy*
2. Zaher F., ‘How Basel I Affected Banks’ *Investopedia*
3. Karimi, A. J., ‘Challenges Facing Islamic Banks’ *Islamic Economic & Finance Pedia*

### **Journal Articles**

1. Abdullah I., ‘The Islamic Windows in Conventional Banks: The Kenyan Experience’ (2007)
2. Abdullahi M., ‘The Legal and Regulatory Framework of Islamic Banking in Kenya: Theory and Practice’ (2016)
3. Eisler R., ‘The Real Wealth of Nations: Creating a Caring Economics’ (2007)
4. Errico and others, “*Islamic Banking-Issues in Prudential Regulations and Supervision*”, (International Monetary Fund, 1998).
5. Guyo W. and Adan N., ‘ The Determinants of Retail Consumer Choice of Islamic Banking in Kenya’ *International Journal of Social Sciences and Entrepreneurship* (2013)
6. Hassan Z., ‘The Effectiveness of the Legal Framework of the Islamic Banking System in Malaysia’ *Islamic University College of Malaysia*
7. Hashad N., ‘ Islamic Banking and Basel II: Challenges and Opportunities’

8. Harzi A., 'The Impact of Basel III on Islamic Banks: A Theoretical Study and Comparison with Conventional Banks' King Abdul Aziz University (2012)
9. Henry C. M. and Wilson R., 'The Politics of Islamic Finance' (2004) Edinburgh University Press
10. Hussain G. R., 'The importance of Sharia supervision in Islamic financial institutions' Corporate Ownership and Control (2006)
11. Ibrahim W,W.H and Ismail, ' Conventional Bank and Islamic Banking as Institutions: Similarities and Differences'
12. Karbhari Y. and others, 'Problems and Challenges Facing the Islamic Banking System in the West: The Case of the UK' Thunderbird International Business Review (2004)
13. Khattak, N., & Rehman, K. 'Customer Satisfaction and Awareness of Islamic Banking System in Pakistan', African Journal of Business Management (2010)
14. Kinyanjui S., 'Challenges Facing the Development of Islamic Banking: Lessons from the Kenyan Experience' EJBM (2013)
15. Kumar M., 'Liquidity Risk Management in Bank: A Conceptual Framework' AIMA Journal of Management & Research (2013)
16. Malkawi B. H., 'Shari'ah Board in the Governance Structure of Islamic Financial Institutions' The American Journal of Comparative Law (2013)
17. Metwally M., ' Economic Consequences of Applying Islamic Principles in Muslim Societies' Journal of Islamic Banking and Finance(2006)
18. Miles L. and Zhang Z., 'Improving Corporate Governance in State-Owned Corporations in China: which way forward?' Journal of Corporate Law Studies (2006)

19. Mohamed N. F. and others, 'Accounting Standards and Islamic Financial Institutions: the Malaysian Experience' Journal of Islamic Banking and Finance (2016)
20. Nafis, A., 'Impact of Regulatory and Supervisory Structures on Bank Risk and Efficiency: Evidence from Dual Banking System' Asian Journal of Finance & Accounting (2012)
21. Nasim F., 'Prospects of Islamic Banking: Legal and other Challenges' Thesis submitted at Cardiff Law School (2004)
22. Obaidullah M., 'Islamic Financial services' (2005)
23. Rice G., 'Islamic Ethics and the Implication for Buisness' JBE (1999)
24. Salman A. and Nawaz H., 'Islamic financial system and conventional banking: A comparison' [2018] Arab Economic and Business Journal
25. Sejpal S. and Doshi M., "Banking Regulation", Global Legal Group (2012)
26. The Centre of Capitalism and Society, 'Theory of Capitalism'
27. 'The Legal and Regulatory Framework of Islamic Banking in Kenya: Theory and practice' University of Nairobi , School of Law
28. Wan A. and Hafizah M., 'Perception of Non-Muslims Towards Islamic Banking: Revisited SEM Approach' Mediterranean Journal of Social Sciences(2016)
29. Zaher T. and Hassan M., 'A Comparative Literature Survey of Islamic Finance and Banking' Blackwell Publishers (2001)

#### **Unpublished theses**

1. Abdalla F.F., 'An Investigation into the Compatibility of Islamic Banking with Conventional Banks: A Study of Two Commercial Banks in Nairobi City' (Master of Arts in Sociology (Entrepreneurship Development), University of Nairobi 2015).

2. Abdullahi M. A., 'The Legal And Regulatory Framework Of Islamic Banking In Kenya: Theory And Practice' (MBA, University of Nairobi, 2016)
3. Faisal Nasim, 'Prospects of Islamic Banking: Legal and other Challenges and Issues', (Cardiff Law School 2003- 2004).
4. Hemed N., 'Factors affecting the adoption of Islamic Banking in Kenya by Banks' sited in Mutua C., 'Factors Affecting the Growth of Islamic Banks in Kenya' (GEMBA, Unites States International University, 2017).
5. Sheikh S. A., 'Factors that led to Emergence of Islamic banking in Kenya and Regulatory Challenges facing the Industry', (unpublished MBA project, university of Nairobi 2009)

### **Newspaper Report**

1. Charles Mwaniki, 'KCB joins rush for Islamic banking with July launch', Business Daily (12<sup>th</sup> March, 2014)
2. George Ngigi, 'CBK rules outlaw 'hawala' money transfer system' Business Daily (29<sup>th</sup> April, 2013).
3. John Gachiri, 'CBK unveils training in Islamic banking', Business Daily (10<sup>th</sup> March, 2014)
4. Kamau J., 'Barclays Launches Sharia-Compliant Financing Facility' Business Daily (3<sup>rd</sup> February, 2010)
5. New Horizon, No. 82 (December 1998) 15

### **Websites**

1. Adel Harzi, "The impact of Basel III on Islamic banks: A theoretical study and comparison with conventional banks",  
<http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CDMQFjAA&url=http%3A%2F%2Fiei.kau.edu.sa%2FGetFile.aspx%3Fid%3>

[D143465%26Lng%3DEN%26fn%3DSorbon8.pdf&ei=dgT9UrPbMIa47Aapu4G4CA&usg=AFQjCNHrJmhTWsgzPmlThgvXHHuC\\_6vbBw>](https://www.imf.org/external/pubs/ft/wp/2014/wp14219.pdf) accessed on 7/2/2019

2. Alejandro López Mejía and others, 'Regulation and Supervision of Islamic Banks' (2014) IMF Working Paper WP/14/219 available at <https://pdfs.semanticscholar.org/f222/62adf5d0e825afe41aad179df2a5456fa5eb.pdf> accessed on 28/8/2019
3. Bernardo Vizcaino, 'Oman Sets up Central Sharia Board in Move to Boost Islamic Finance' <https://www.reuters.com/article/oman-islam-financing/oman-sets-up-central-sharia-board-in-move-to-boost-islamic-finance-idusl6n0s305j20141008> accessed on 5/9/2019
4. Charles Mwaniki, 'KCB joins rush for Islamic banking with July launch', (Business Daily 12 March, 2014), <http://www.businessdailyafrica.com/KCB-joins-rush-for-Islamic-banking-with-July-launch/-/539552/2241418/-/item/1/-/stl4vp/-/index.html> accessed on 9/9/2019
5. "Deposit Insurance from the Sharia Perspective", (Discussion Paper Prepared by the Islamic Deposit Insurance Group of the International Association of Deposit Insurers) 2010 available at [https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20%20Discussion%20Papers/DP-DI\\_From\\_Shariah\\_Perspective\\_\(Final\)\\_Sep2011\\_to\\_IADI.pdf](https://www.iadi.org/en/assets/File/Papers/Approved%20Research%20%20Discussion%20Papers/DP-DI_From_Shariah_Perspective_(Final)_Sep2011_to_IADI.pdf) accessed on 23/7/2019.
6. Fadi Zaher, "How Basel I Affected Banks", <http://www.investopedia.com/articles/07/baselcapitalaccord.asp> accessed on 2/2/2019
7. Financial Islam, 'Regulation and Supervision'



- <http://www.financialislam.com/regulation-and-supervision.html>> accessed on 3/9/2019
8. Financial Islam - Islamic Finance, ‘Deposits’,  
<<http://www.financialislam.com/deposits.html> accessed on 20/2/2019> accessed on 3/9/2019
  9. Gulf African Bank, “Islamic Banking”,  
<<http://www.gulfafricanbank.com/index.php/about-us/gab-profile/islamic-banking>>accessed on 22/2/2019
  10. Huma Ayub, “Basel Accord III –Implication for the Financing Behaviour of Islamic Banks”, <<http://conference.qfis.edu.qa/app/media/7054>> accessed on 9/9/2018
  11. Institute of Islamic Banking and Insurance, ‘Islamic Banking’, <[http://www.islamic-banking.com/what\\_is\\_ibanking.aspx](http://www.islamic-banking.com/what_is_ibanking.aspx)> accessed on 20/10/2017
  12. Institute of Islamic Banking and Insurance, ‘Islamic Financial System’ available at  
<<https://www.islamic-banking.com/explore/islamic-finance>> accessed on 11/1/2019
  13. Islamic Finance, ‘Industry Must Seize on New Trends for Next Phase of Growth’ (2017) available at <<https://www.islamicfinance.com/2017/10/islamic-finance-must-seize-new-trends-next-phase-growth/>> accessed on 27/1/2019
  14. Iwona Sobol, “Liquidity Management Practices in Islamic Banking Liquidity Management Practices in Islamic Banking”, p. 571  
<[http://zif.wzr.pl/pim/2013\\_2\\_1\\_46.pdf](http://zif.wzr.pl/pim/2013_2_1_46.pdf) > accessed on 20/2/2019
  15. Islamic Bankers Resource Centre, Financing: Bai Salam, available at  
<<https://islamicbankers.me/islamic-banking-islamic-contracts/in-focus-bai-salam/>>  
accessed on 15/1/2019.
  16. John Gachiri, ‘CBK unveils training in Islamic banking’, (Business Daily 10 March, 2014)

- <http://www.businessdailyafrica.com/CBK-unveils-training-in-Islamic-banking/-/539552/2238438/-/13u7qy6/-/index.html>> accessed on 9/9/2019
17. Karimi, A. J., 'Challenges Facing Islamic Banks. Islamic Economic & Finance Pedia', (2009) available at <http://www.nzibo.com/IB2/Challenges.pdf>> accessed on 17/7/2019
  18. Kettle B., 'Introduction to Islamic Banking and Finance' <http://onlinelibrary.wiley.com/book/10.1002/9781118467299>> accessed 9/11/2017
  19. Keynote address by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Global Islamic Finance Forum 5.0 "Future of Islamic Finance: Delivering actions today for a sustainable tomorrow", Sasana Kijang, Kuala Lumpur, 11 May 2016 available at <https://www.bis.org/review/r160517c.pdf>> accessed on 2/2/2019
  20. Making Finance Work for Africa Partnership, 'Remittances from Kenyan migrants up 9%' <http://www.mfw4a.org/news/news-details/article/1784/djibouti-bets-on-islamic-finance.html>> accessed 20/11/2017
  21. Mohammed Obaidullah, ISLAMIC FINANCIAL SERVICES (2005) available at <http://www.iefpedia.com/english/wp-content/uploads/2009/09/ISLAMIC-FINANCIAL-SERVICES.pdf>> accessed on 20/1/2019
  22. Mutalip, A. L. A, 'Practical Legal Issues in Islamic Banking' available at [http://www.azmilaw.com/archives/Article\\_13\\_Practical\\_Legal\\_Issues\\_in\\_Islamic\\_Banking-020508\\_00116640\\_.pdf](http://www.azmilaw.com/archives/Article_13_Practical_Legal_Issues_in_Islamic_Banking-020508_00116640_.pdf)> accessed on 21/7/2019
  23. Nabil Hashad, "Islamic Banking and Basel II: Challenges and Opportunities", online Article <https://www.scribd.com/document/81015619/Islamic-Banking-BaselII-Challenges-Opportunities>> accessed on 5/2/2019

24. National Bank, 'Takaful (Sharia Compliant Insurance)', <<http://nationalbank.co.ke/amanah/takaful/>> accessed on 24/11/2017
25. Njuguna Ndung'u: The future of sharia compliant banking and finance in Kenya- Address by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at the official launch of the National Bank of Kenya's sharia compliant banking "The National Amanah", Nairobi, 29 April 2013 <<http://www.bis.org/review/r130515d.pdf>> accessed on 2/7/2018
26. Noella Lubano, Testing the safety net in banking: Is deposit insurance adequate? Available at <<https://www.oraro.co.ke/2018/06/26/testing-the-safety-net-in-banking-is-deposit-insurance-adequate/>> accessed on 21/7/2019
27. Omar M, Islamic Banking and finance <<https://ebookcentral.proquest.com/lib/haaga/reader.action?docID=1336760>> accessed on 5/6/2018
28. Riane Eisler, 'The Real Wealth of Nations: Creating a Caring Economics', 2007 <<http://www.parnershipway.org/Economics-Politics/building-a-new-economics/partnerism-not-capitalism-or-socialism>> accessed on 20/11/2017.
29. Salman Syed Ali, 'Islamic Modes of Finance and Associated Liquidity Risks' Paper prepared for Conference on Monetary Sector in Iran: Structure, Performance and Challenging Issues in Tehran, 2014 <[http://www.sbp.org.pk/departments/ibd/lecture\\_6\\_Islamic\\_modes\\_finance\\_liquidity.p df](http://www.sbp.org.pk/departments/ibd/lecture_6_Islamic_modes_finance_liquidity.pdf)> accessed on 8/9/2019.
30. Sekoni A, 'Legal and Regulatory Issues and Challenges Inhibiting Globalization of Islamic Banking System' (2015) available at <<https://mpr.ub.uni->

[muenchen.de/62332/1/MPRA\\_paper\\_62332.pdf](https://muenchen.de/62332/1/MPRA_paper_62332.pdf)> accessed on 17/7/2019

31. Standard Chartered Bank, 'About Standard Chartered Saadiq Kenya', <<https://www.sc.com/ke/saadiq/about-us.html>> accessed on 24/11/2017.
32. Tarek S Zaher and M Kabir Hassan, A Comparative Literature Survey of Islamic Finance and Banking, available at <<https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-a-comparative-literature-survey-of-islamic-finance-and-banking-nov-2001.pdf>> accessed on 20/1/2019.
33. Technical Note on Issues in Strengthening Liquidity Management of Institutions offering Islamic Financial Services: The Development of Islamic Money Market (2008), Islamic Financial Services Board, <[http://www.ifsb.org/docs/mar2008\\_liquidity.pdf](http://www.ifsb.org/docs/mar2008_liquidity.pdf)> accessed on 20/2/2019.
34. The Center on Capitalism and Society, 'Theory of Capitalism', <<http://capitalism.columbia.edu/theory-capitalism>> accessed on 20/11/2017
35. The Financial Sector Stability Report 2012, (Issue 4, December 2012) <[http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&cad=rja&uact=8&ved=0CCsQFjAC&url=http%3A%2F%2Fwww.cma.or.ke%2Findex.php%3Foption%3Dcom\\_docman%26task%3Ddoc\\_download%26gid%3D254%26Itemid%3D102&ei=RIV0VePuHY3boASm1oWwBw&usg=AFQjCNGhaUk-VCBfr9PdMJ-uRUzIpWPBww&bvm=bv.95039771,d.cGU](http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&cad=rja&uact=8&ved=0CCsQFjAC&url=http%3A%2F%2Fwww.cma.or.ke%2Findex.php%3Foption%3Dcom_docman%26task%3Ddoc_download%26gid%3D254%26Itemid%3D102&ei=RIV0VePuHY3boASm1oWwBw&usg=AFQjCNGhaUk-VCBfr9PdMJ-uRUzIpWPBww&bvm=bv.95039771,d.cGU)> accessed on 22/2/2019
36. United Nations Conference on Trade and Development, 'World Investment Report 2018' (United Nation Publication 2018) available at <[https://unctad.org/en/PublicationsLibrary/wir2018\\_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf)> accessed on 13/12/2018

37. Wan Ibrahim, W. H., & Ismail, A. G., 'Conventional bank and Islamic banking as institutions: Similarities and differences', <<https://doi.org/10.1108/H-09-2013-0056>> accessed on 13/12/2018.