

Depositors Protection Scheme: Appraisal of Islamic Banks Participation in Deposit insurance System

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Abstract

Deposit Insurance Scheme (DIS) has assumed the position of universal importance as a consumer protection scheme for the depositors and investors in the banking sector of nations' economy. The role of Islamic deposit insurance is to create a level playing field between Islamic and conventional banks apart from maintaining a foundation for public confidence in the banks it is also to reinforce the consumer protection aspects that are inherent in Islam. However virtually all the existing DISs are established on legal, regulatory and operational framework devoid of any Islamic bias, meanwhile the Islamic banks and their customers are as much in need of this protection, assurance and sustenance of confidence produced by the scheme as their conventional counterparts. The research therefore examines some of the controversies in the operation of Deposit Insurance as well as its compatibility with Shariah rules under which Islamic banks operate. It looks into the needs and the extent to which Islamic banks can participate into the scheme. The paper concludes that objectives of DIS is compatible with Shariah but also finds out that its designs and some of its operations need to be adjusted for Islamic banks to fully integrated without impairing the provisions of Shariah.

Keywords: Deposit, insurance, Deposit insurance, Islamic Deposit Insurance Scheme (IDIS), Protection and Depositors protection.

1.0 Introduction

Deposit insurance is a means of protecting bank depositors, in full or in part, from the likely losses due to a bank's inability to pay its debts when due. (Chaibou Issoufou, 2008) opined that Deposit insurance scheme (DIS) is established to provide some form of assurance to depositors that are at risk of losing their hard earned money in the event of bank failures. It has been established mostly by governments which make it compulsory for banks to join as members and pay the required premium. It is therefore a component of the financial system to create the safety net³ that promotes financial system stability. The evolution of elaborate DIS can be traced to the United States Congress which created the Federal Deposit Insurance Corporation (FDIC) in 1933 following the Great Depression that was experienced worldwide between 1929 and 1933. Before that time, however, it is on record that some form of deposit insurance system had been introduced in Czechoslovakia in 1924 (Ogunleye, 2010) which was applied to revive the country's banking system after devastation of the First World War. DIS is therefore adopted in the aftermath of a banking crisis or when industry conditions are deteriorating and unstable (De Giuli, Maggi, & Paris, 2009). Depositors protection is often described as the most basic reason for banking regulation (Kleftouri, 2014). To this end, therefore deposit insurance system has become an essential component of prudential bank regulation. Conceptually there are essentially two types of DIS; IMPLICIT deposit protection and EXPLICIT protection. Under the implicit DIS no formal structures are evident, the means of funding and the system in place are also not clearly defined along with the coverage limit. All decisions taken under this scheme are also flexible and uncertain.

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³ A safety net is a welfare arrangement by governments to protects citizens especially low income from hardship and poverty.

The explicit DIS is established by legislation or private contract, which clearly spells out the scope of its mandate; powers and governance structure. The rules and regulations guiding participating institutions are clearly defined along with the coverage limit etc. As at the year 2013 there were 189 countries of the world administering the deposit insurance scheme either in the form of implicit or explicit protection system. More countries have continued to introduce explicit deposit insurance schemes in their jurisdiction. Out of the 189, 112 countries (or 59 percent) had explicit deposit insurance as at 2013, having increased from 84 countries (or 44 percent) in 2003 (Asli, Kane, & Laeven, 2014). An Explicit deposit protection can either be 'Pay box' or 'Risk Minimiser'. The pay box function provides payout to depositors in the event of bank failure. It can also be a pay box plus or pay box with extended mandate, in which Countries may combine the DIS function with either or both, the resolution functions and banking supervision (Korea Deposit Insurance Corporation (KDIC), 2012). The Risk-minimiser explicit deposit protection however, was designed with powers to guarantee deposits of all licensed financial institutions that offer deposit products to their customers, monitor their health status through effective supervision, partake in failure resolution processes and liquidate failed insured institutions.

With the rapid growth of the Islamic financial Sector across the globe, there is obvious need that there is an Islamic version of the deposit insurance to cover the Islamic bank as well. This is indeed necessary to create a level playing field for both the conventional and Islamic banks (The Star, 2009). "Islamic deposit insurance (IDI) is an arrangement to protect insured depositors against the loss of their insured Islamic deposits placed with Islamic banking institutions (IBIs) in the event of an IBI's failure" (Md Khairuddin Hj Arshad, 2011). Islamic deposit insurance is put into practice by countries where Islamic deposits are offered to the depositors by the deposit taking financial institutions.

The conventional and Islamic deposit insurance have similar features, but with IDI operating under *Shariah* compliant principles. The general desire of deposit insurance whether it is Islamic or conventional is to protect the interests of the depositors of deposit-taking financial institutions, promote their confidence, enhance financial and economic participation, encourage saving, promote inclusive growth and the overall financial system stability. This therefore suggest that a link exist between the concept of deposit insurance and *Maqasid al-Shari'ah*, or the objectives of Shari'ah, that was designed or aimed to "promote benefits and repel harms (Al-Mubarak & Osmani, 2010) and by aligning the whole concept of Islamic banking and finance with the Maqasid al-Shariah or the objectives of Shariah, it was argued that Islamic Finance can be the solution to the policy makers in countries that are serious about enhancing access to finance (Mohieldin, Iqbal, Rostom, & Fu, 2012). In view of this, one may suppose that there is a point of convergence between deposit insurance and the core principle of Islam which lay great emphasis on social justice, inclusion, and sharing of resources between the have and have not's (Mohieldin et al., 2012).

This paper examines the concepts of deposit insurance its application to Islamic banking products for the protection of their depositors. The broad objective of the paper is to examine how compatible is deposit insurance scheme with the operations of Islamic financial institutions. While the specific objective is to identify ways through which Islamic banks participation in the scheme is structured and determined how effective it is. The paper employed the Qualitative method of research, where the data for the research were drawn from secondary method of the data collection. Data for this study were derived; from previous research of scholars, Text Books as well as current journal article that are related to the subject matter Islamic deposit insurance, as the study involved critical analysis of the problem and prospects of Islamic Banks participation in the deposit insurance scheme.

2.0 Concepts and Objectives of DIS

Deposit insurance scheme being one of the main pillars of a financial safety-net arrangement, serves as one of the complementary measures employed by the Regulators of Financial authorities for effective management and orderly resolution of problems associated with both failed and failing deposit-taking financial institutions. It is usually supported by insured institutions themselves and administered either through a government-controlled agency; a privately held one or one that is jointly owned and administered. Over the years, the establishment and adoption of Deposit Insurance scheme have been central on two main motives which turn out to be the main objectives it set out to achieve. These are to provide protection and financial guarantee to the depositors and to ensure monetary stability. These objectives were concisely stated by Senator Robert L Owen on the face of the broad-base opposition on the scheme in 1932 in a session of US house committee on Banking and Industry thus:

"To provide the people. . . . with an absolute safe place and convenient place to put their savings and their deposits is essential to the stability of banking, bank deposits and loans, the checks which function as money and business conditions in every line". (Bradley, 2000)

The objectives have attained a universal acceptability and they are as relevant today, as they were seven decades ago. However, the question as to which objective is primary has remained a debatable subject to date. Whilst, bulk of the researches delved its function of monetary stability and emphasizing it as far greater matter than the function of protecting individual depositors from loss. For instances researches conducted by (De Giuli et al., 2009), (Beck, 2003), (Kim, Kim, & Han, 2014), (Gan, 2013), (Demirg-Kunt & Detragiache, 2002), (Kleftouri, 2014), (Beck, 2003) etc, viewed deposit insurance from the perspective of financial system stability, however, few researches, for example (Umoh, 2003), (Boyle, Stover, Tiwana, & Zhylyevskyy, 2013) and (Ogunleye, 2010) consider DIS specifically important for the protection of especially small unsophisticated depositors. DIS differs from a Conventional Commercial Insurance as follows:

- DIS protects the Banking system while Commercial Insurance protects only policy holder;
- DIS is a tripartite agreement between insurer, member institutions and depositor; while Commercial Insurance is bilateral (insurer and beneficiary/policy holder);
- Compulsory participation under DIS while that of Commercial Insurance is conditional voluntary;
- Amount of coverage often limited under DIS while that of Commercial Insurance may be total.

3.0 Operation of DIS from Islamic Perspective

In the history of Islam, regardless of any change in circumstances the Prophet was never in his intention to rigidly fix the structure of conduct and action for all time. Alternatively, to adjust to varied circumstances, the Prophet only provided his Companions with general guidelines (Trakic, 2013). The point of reference for an IDI has at all times been the consideration of the public interest (*maslahah*). *Maslahah*, as discussed earlier, “means utility, good, beneficial or advantage, i.e. something good for the public. It relates to the preservation of faith, life, lineage, intellect and property of human beings” (Cebeci, 2012). There is an element of public interest in Deposit insurance scheme, and this made it is acceptable under Shariah. This element can be portrayed in various ways, which could also serve as the rational for the need of a deposit insurance scheme.

First, deposit insurance protects the public from losing money that they place in a bank when the bank fails. Its implementation is a noble initiative as it prevents the public from facing financial difficulties, especially those people who have limited financial resources, who could be exposed to social problems as a result. Islam urges its followers to avoid poverty as this could lead them to disobey Allah. Islam always wishes every creature to have a good and convenient life without having to face any difficulty. It also urges its followers to prepare themselves to face any possible disasters, which includes finding a means to protect their wealth (Chaibou Issoufou, 2008; Elvan Syaputra et al., 2014; IFSB, 2014). As such, the setting-up of a deposit insurance system represents the Muslims’ response to the urge to protect their money when a bank fails. Muslims are also urged to help each other in good deeds. In line with this principle, the government introduced deposit insurance as an initiative to assist the public in protecting their wealth. Such arrangements may also be made privately with the same intention of helping the public. Second, (Jennings, 2016) opined that deposit insurance can instil confidence among the general public as regards the safety of their bank deposits. This reduces the likelihood of panic among depositors in the event of a rumoured or real bank failure.

The effectiveness of deposit insurance in instilling public confidence is evidenced by the establishment of Federal Deposit Insurance Corporation (FDIC) in 1933 as this, to a great extent, helped reassure the American public about the safety of their bank deposits during the Great Depression. This in turn contributed to the recovery of the US financial system. Undoubtedly, the financial system is the backbone of a country’s economy. For example, banks make funds available for companies to set up or grow their businesses, which create employment and contribute to the wealth of the nation. By instilling public confidence, deposit insurance could prevent the failure of a bank and contagion to the entire financial and economic system, thereby contributing to financial stability. Islamic deposit insurance could contribute in the same way, especially when the Islamic financial system is significant in size and has integrated well with the overall financial system. Islamic deposit insurance protects Islamic deposits (Md Khairudd in Hj Arshad, 2011).

And therefore helps maintain the competitiveness of Islamic deposits vis-à-vis conventional deposits. It can thus prevent any outflow of Islamic deposits from IBIs to conventional banks and help spur the growth of Islamic deposits and the Islamic financial system. Furthermore, another factor that could influence the permissibility of deposit insurance is the acceptance of the insurability of Islamic deposits. Islamic deposits are accepted by IBIs based on Shariah principles. They are offered under various Shariah contracts such as safe-keeping (*wadiah*), loan (*qard*), cost-plus (*murabahah*) and profit-sharing (*mudharabah*). With the exception of the profit-sharing contract, none of these contract types has given rise to major concerns over the protection of deposits. The deposits accepted under a profit-sharing contract (known as a profit-sharing investment account or (PSIA) are *Mudharabah* placements made by an investor (PSIA holder) with an IBI, which acts as entrepreneur. The IBI will invest the fund for Shariah-compliant business activities, such as the provision of financing and investment in *Sukuk*. Any profit from such activities will be shared between the PSIA holder and the IBI according to an agreed profit-sharing ratio. Any losses are borne by the PSIA holder, except in the case of the Islamic Financial institution's (IFI) mismanagement or negligence, where losses are borne by the IFI. Since losses are borne by the PSIA holders, some have argued that PSIA holders should not enjoy protection.

There are two categories of PSIA: restricted and unrestricted. Some countries may not protect holders of the former, as they are regarded as investors (rather than depositors) who understand well the risk/reward relationship of their placement or investment. This is purported to exert market discipline among the restricted PSIA holders when placing or investing their money. By contrast, holders of unrestricted PSIA's may be protected as they behave like depositors (rather than investors). The question of whether the PSIA should be treated as a deposit or an investment, and whether PSIA holders should be protected under deposit insurance, continues to be a subject for debate among the Islamic financial community. This shall be more elaborated in the subsequent section.

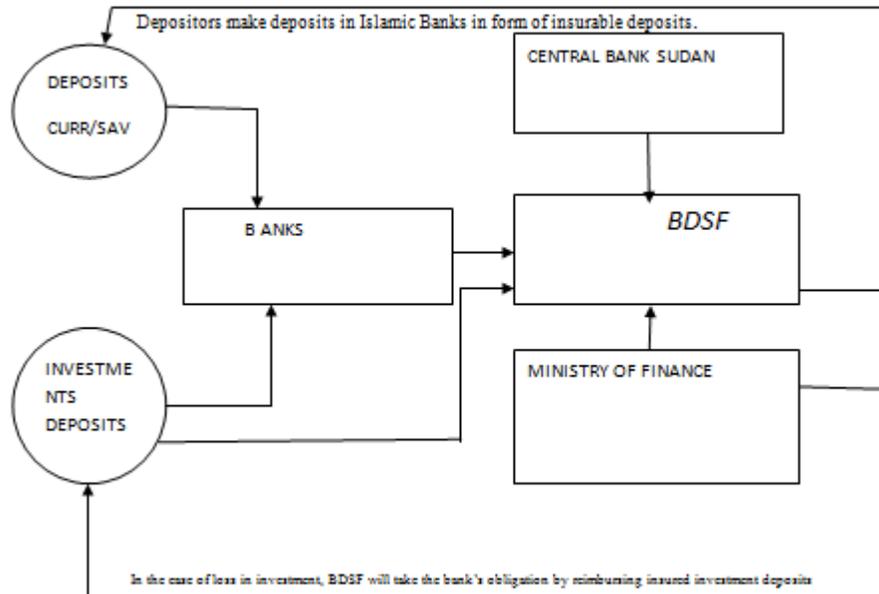
4. Needs for IDI in IFIs

A bank safety net refers to a set of policies and mechanism designed to prevent or reverse widespread disintermediation from banks, losses in bank capital and it is more of generally banks failure. It is often argued that the safety net is essential for a healthy banking system and the economy for its role in; 1. Curtailing the effect of disruptions in bank credit supply and a breakdown of the payments system which may have large spill over effects for the rest of the economy; 2. Protection of small, unsophisticated depositors: (a) by guaranteeing small deposits, the insurance agency relieves account holders of any need to worry about whether a deposit institution will meet its obligation to depositors; (b) providing regulation and supervision avoids duplicating monitoring efforts and reduces opportunities for institutions to exploit depositors informational disadvantage. Islamic finance has globally experienced what is referred to as phenomenal⁴ growth or development. Islamic finance is not restricted to Muslims but also being enjoyed by non-Muslims. This progressive growth is also distinctly penetrating the Western world, while still expanding so fast in Muslim countries (Mohamad, Akram Laldin, Hafas, 2013). An estimate by (Ernst & Young, 2014) revealed that Islamic banks serve approximately 38 million customers worldwide. With such a large number of customers, obviously deposits and other consumer matters related to financial activities would also increase.

With the rapid growth of the Islamic financial Sector across the globe in general, there is obvious need that there is an Islamic version of the deposit insurance as a mode of safety-net to cover the Islamic banks depositors as well. This is indeed necessary to create a level playing field for both the conventional and Islamic banks (The Star, 2009). Islamic deposit insurance (IDI) is aimed to protect insured depositors against the loss of their insured Islamic deposits placed with Islamic banking institutions (IFIs) in the event of an IBI's failure (Md Khairuddin Hj Arshad, 2011). In a jointly report by IFSB-IRTI-IDB titled entitled *Islamic Finance and Global Financial Stability* in 2010, the need for financial safety net arrangements in the IFSI was stressed. This report identified eight building blocks aimed at further strengthening the Islamic financial infrastructure at the national and international levels to promote a resilient and efficient Islamic financial system. The need and mechanism of financial safety-net comprising Islamic Lenders of last resort (ILOR) and IDIS, was captured in the third building block of the report. A highlight in a report from the IMF Staff discussion suggest that only few countries with Islamic banks have a full-fledged Islamic deposit insurance scheme (IDIS) with contributions invested in *Shari'ah*-compliant instruments, and that, safety nets and resolution frameworks for Islamic financial institutions is still underdeveloped.

⁴ Extraordinary and exceptionally fast

Chart 2: Sudan's IDIS mechanism



When an Islamic bank fails, BDSF will take the bank's obligation by reimbursing insured deposits

6. Issues associated with IDI for IFIS

The provision of deposit insurance protection to Islamic banks comes with several structural and operational challenges. Some of the challenges include the appropriate Shariah compliant underlying structure to be adopted for the scheme; the treatment and insurability of some of the deposits accepted by the banks especially under *Mudarabah* (profit-sharing contracts); and the role of the deposit insurance fund in resolution. These issues are elaborated as follows:

1. Issues with Underlying Shariah compliant structure for an IDI

a. Issues with Takāful model

Some of the issues with *Takāful*-based structured IDIS include:

- **Ownership of the *Takāful* Fund(s):** The concept of "*Takāful*" is based on the idea of mutual cooperation and solidarity among the participants, who commit to contribute a certain amount of money into the *takāful* fund in the form of a donation (*tabarru'*)" (IFSB, 2014). Hence, the main issue of concern here is who essentially the owner of the *takāful* fund is. Thereby, in the event of probably liquidating the IDIS, what treatment could the funds be given? In this respect, various diverse *Shari'ah* positions on who has an ownership claim on the fund's residual value were deduced, depending on the jurisdiction. For instance, in Jordan, the resolution of Fatwa Council of Islamic Studies and Research is that the *Takāful* fund is not owned by any of the entity participating in the scheme and as such, in the event of its liquidation, the funds are to be deposited with the national *Zakāh* fund under the Ministry of Endowment and Islamic Affairs. However, other views are of the opinion, that the actual ownership of the fund lies with the participants (the IIFS participating in the scheme) of the *Takāful*-based IDIS, implying that the fund's residual value can be distributed to the participating IIFS on the basis of *hibah*.
- **Protection Given to IAHS by the SCDIS:** In the context of *Takāful* based model can an IFI provide contributions to IDIS order to extend protection coverage to placements by IAHS? The general *Shariah* Issues in respect of *Mudarabah* deposits are discussed in the subsequent section on the issues with insurable deposits.
- **Recoveries/Subrogation in *Takāful*-Based IDIS:** from the circumstance or arrangement leading to the protection by the IDIS, Can it therefore have resort to the member financial institutions to recover funds that have been disbursed to depositors? From a *Shari'ah* perspective, majority of the opinion is that the beneficiaries of the arrangement are the IIFS participating in the *Takāful*-based IDIS. Even though, it has always been a tripartite, the fact is that there is no any contractual relationship between the *Takāful* fund and the depositors. Rather, the contractual relationship is between the *Takāful* fund and the participating IFIs.

Moreover, the relationship between the depositors and the IFIs is that of a lender and borrower, and the latter is liable to return the entire deposited amount under all circumstances. This means that, regardless of whether or not there is a deposit insurance scheme, the depositors are entitled to receive their deposits. Having said that, the concept of *Takāful*, which is based on mutual cooperation, providing protection to participants does not require the beneficiary IFIs to pay back the assistance received if the failure of the IFIs was not caused by the negligence or misconduct of the management. Hence, applying the concept of subrogation in a *Takāful*-based IDIS will create a complication in terms of the ability of the *Takāful* fund to recover the losses incurred by paying the depositors of the failed IFIs.

b. Issues with Kafālah bi al-Ajr model

In the *kafālah bi al-ajr* based DIS arrangement, a guaranteed cover is provided to the participating IFIs by the deposit insurer in the event that it becomes solvent. An obligation that a prescribed limit on all it insured deposits will be reimbursed to its depositors and in return, pays a yearly fee to the deposit insurer for this guarantee (IFSB, 2014). However, majority of scholars⁵ frowns at this arrangement and prohibits charging fee for a guarantee contract. Such a guarantee ought to be on a voluntary basis without a monetary value. In addition, by taking a fee the contract has now becomes an exchange contract. Consequently, this transaction would be a back door *ribawi* contract (Mohd Noor & Haron, 2011) in such a way that it results into an exchange of money for money (when the depositors of failed IFIs were paid by the deposit insurer, from the pool contributed by the failed IFIs), and an additional benefit for the deposit insurer is embedded in the initial fee paid for providing this service, which is obviously prohibited in *Shari'ah*. Thus, with this possibility that the transaction or such arrangement is likely to result in the exchange of money for money becomes the basis for nullifying it by majority of scholars. (IFSB, 2014) quoted in (OIC Fiqh Academy, 1985) that "On that basis, the International Islamic Fiqh Academy in its Resolution No. 12 (12/2) resolved that it is prohibited to charge a fee for a guarantee and that the guarantor can only charge the guaranteed the actual expenses that are directly linked with the issuance of the guarantee".

However, some contemporary scholars allowed charging fee for guarantee like Sheikh Yusuf al-Qaradawi, Sheikh Nazih Hamad, Sheikh Abdullah Mani' and the SAC of Bank Negara Malaysia, some of their bases on its permissibility was due to *Maslahah* (necessity and public interest), because in the current context it is unrealistic to obtain a free-of-charge guarantee (IFSB, 2014) as quoted from (Al-Zuhailī, n.d., 6:4178). Moreover, some scholars like *sheikh Nazid Hamid* opined that there it is possible to convert *tabarru* (donation) contract to *Mu'awadah* (exchange contract) so long as the contracting parties consented, this thus, create an opening in the use of *tabarru* in the operations *Kafalah bil al ajar* in DIS (Mohd Noor & Haron, 2011). Another popular opinion on the permissibility of charging fee for a guarantee is by assuming it similar to the taking rewards for some good deeds like teaching Al-Quran, for instance also the example of where the companions receive reward for "*ruqyah*" healing by using Al-Quran, and it was approved by the Prophet (PBUH).⁶ Although the *kafālah bi al-ajr* model, unlike the *Takāful* structure, addresses the issue of ownership of funds and subrogation. However, it is necessary to explore better structures of IDI that is less controversial and more generally acceptable as a more compatible Shariah compliant option by the experts.

a. Issues on the Insurable Deposit

Sources of funds in Islamic banks can be classified into four main categories: Deposits from customers; Islamic retail banking funds; corporate banking activities; and treasury operations or placements. The Islamic financial services board (IFSB) in its report IFSI financial stability report 2015 estimated that financial institutions offering Islamic financial services is about 1.8 trillion, with the banking sector holding up to 80% as at 2014. In an efforts of determining which type of customers' deposits should be guaranteed, there were several debates in past, and still issue of insurability of some deposit remain controversial. Before examining these deposits, it's noteworthy to understand that that Islamic bank operates general and special investment deposits accounts, savings accounts and demand deposits.

⁵ See, for instance: Al-Kāsānī, 1986, 6:11; Al-Haṭṭāb, 1992, 4:391; Al-Māwardī, 1999, 6:443; and Ibn Qudāmah, 1968, 4:244.

⁶ Sahih al- Bukhari no. 1670

Current accounts or demand deposit and savings accounts are usually under a *Wadiah* (safe custody or safe keeping with guarantee) or *Qardul Hassan* (benevolent loan) contractual arrangements, while general and specific investment accounts are based on *Mudarabah* contracts. The NDIS has also included *Musharakah* as one of the insurable deposits in its framework.

➤ **Insuring Wadiah**

Wadiah is generally classified into two categories *Wadiah yad Amanah* (Safe custody based on trust), that is where the custodian is entrusted to assume responsibility of the property same with his own. While, the second one is *Wadiah Yad Dhamanah*, where the nominal value is guaranteed, Islamic banks play the role of guarantor or custodian of the customers' deposits, such as demand deposits. With this product, depositors no longer avail funds with an aim to earn a fixed income, and can withdraw their funds at any time. Depositors keep deposits for protection. As such, banks shall not use these funds as a source of financing and investment into risk-bearing projects (Qaed & Qaed, 2014). However, in reality they do. Ordinarily the trustee is not responsible for any damages except due his negligence. Structure.... It is hard to identify the number of banks that use *Wadiah* accounts, but some banks provide a token of appreciation known as *Hibah* (gift) to depositors for banking with them.

➤ **Insuring Mudarabah-Profit and Loss Sharing (PLS) Deposits**

The profit and loss sharing (PLS) or *Mudarabah* contribute a very high percentage of Islamic deposits. The permissibility of PLS was and still is remain a debatable issue on multiple levels. To start with, the PLS arrangement is the substitute of the prohibited interest bearing transaction in Islamic banking, whereby the rate of return on financial assets held with banks is in the form of an ex-post rate, in which it is neither fixed nor known before undertaking the contractual agreement or acceptance of the deposit. The PLS arrangement is a partnership structure. Guarantee is not allowed for capital protection or a fixed income. This structure is operated under the principle of sharing equity. Unfortunately, the underlying contract which is based on profit-loss sharing system makes it a risky product for depositors.

Under a *Mudarabah* contract, the depositor contribute funds and place a specified sum of money to the bank as a partner to contributes its expertise in managing the fund, while the investment profit is shared according to a mutually pre agreed ratio. When the investments is flourishing profits are realized, meanwhile capital may also decrease in value or even diminish if the investment is no longer profitable. Losses are limited to the bank capital if there is an established carelessness and mismanagement from the bank. Contrary to the conventional banks practice of guaranteeing capital and a specified rate of return, the Islamic banking practice do not allow such provision to PLS depositors. It was the argument of some practitioners in the industry that insuring a deposit goes against the PLS principle. Hence, depositors do not bear any risk, in contradiction to the basic concept of *Mudarabah*. It is the opinion of some researchers that protecting Muslim depositors' funds, by providing guarantee on PLS contracts, have the likelihood to erode *Shari'ah* principles.

Furthermore, from the perspective of majority of *Shari'ah* scholars, based on *Shari'ah* requirements for profit- and loss-sharing contracts, a *mudārib* (entrepreneur) may not provide any sort of direct or indirect guarantee to the *rabb al-māl* (capital providers). Allowing that will violate the principle of the legal maxim; "liability accompanies gain" (ISRA, 2013). Consequently, Islamic banks are not allowed to guarantee its own investment accounts by paying premiums to a deposit insurance scheme, because the *mudārib* becomes liable to indemnify the IAHs for any losses that affect their capital on the basis that the losses were proved to be as a result misconduct or negligence.

Some scholars however are still of the opinion that, PSIA holders should be protected, because of the following reasons;

- (1) The *Mudarabah* contract does not permit the IFI to protect the PLS holder, but protection by third party (e.g. the deposit insurer) is allowable;
- (2) The PLS holder protection effected only in the event of an IFI's failure and not during the regular course of business; and
- (3) Protection will enhance the stability of the financial system. If the PLS holder is strategically important in the financial system,

As discussed earlier under the permissibility of deposit insurance that none of these contract types has given rise to concerns over the protection of deposits as much as the profit-sharing contract (*Mudarabah*).

Although, the SAC had before gave a ruling that *Mudarabah* can be insured under IDIS, the MDIC however announced that effective July, 2015 they will no longer offer protection for all kinds of *Mudarabah* deposits arrangement (IFSB, 2014). Nigeria still have provision for insuring *Mudarabah* by the NDIC. The Nigerian *Ulamas* being very stringent when it comes to the matter of Halal and Haram will surely still argue that PSIA holders should not enjoy protection since losses are borne by the PSIA holders under *Mudarabah*. NDIC and banks offering Non interest banking services needed to work in harmony with the *Ulamas* to ensure that these views does not send wrong signals to the volatile Nigerian depositors.

b.Mandatory Participation in DIS

Most of the basis of reference considered in justifying the permissibility of IDI has always been on the basis of public interest (*Maslahah*). However, in most countries practicing an explicit Islamic Deposit Insurance system like Malaysia and Nigeria, it is in a form of a tripartite arrangement, where the depository institutions (banks) perpetually pays yearly premiums while the deposit insurers on behalf of the governments insures the depositors. This arrangement has been argued to breach the principle of *Al- Taawuni alal birri* or the help each other in good deeds, because of the fact that, the participation in the scheme was made mandatory by an act or a legislation and the financial institutions perpetually pay yearly premium, without any plan for a plough back of the premium or even a premium holiday at some point, even when the financial institution does not show any sign of weakness or failure. Meanwhile the depositor who is being insured share no risk in the arrangement. In Islamic social relationship both *ta'awun* (mutual help or cooperation) and *tabarru'at* (willingly relinquishing individual right for collective benefits) are existing under willing and mutual agreement for cooperation towards achieving certain collective benefit (Nahar, 2015).

c. Capacity Inadequacy in the area of IDI

Another major issue of concern is the scarcity of knowledgeable and skilled resources in the area of IDI operations. This is due to the fact that IDI is relatively new and the countries that have implemented IDIS are still in the process of developing such resources. Therefore, it is very important that regulators/supervisors acquire more requisite skills. There are thus the needs for *Shariah* experts and well-equipped/trained personnel who can supervise and analyze Islamic banking portfolios.

d.Lack of Investment Avenue

Because most of the guidelines for investment of IDIS funds that empowers most Deposit insurance agencies to only invest into zero risk government securities which mostly are *Shariah* non compliant. Therefore, growth of fund or financing Islamic deposit Insurance scheme may face difficulties given the dearth of a *Shariah* compliant money/capital Market Avenue for Islamic funds in most governments, efforts should be made to establish one. There is need for an Islamic interbank market where short term liquidity needs can be met and also investments, example for Sukuk (Islamic bonds).

e. Lack Global Standard as a model for a *Shariah* compliant DIS

The international Association of Deposit Insurers (IADI), which is a deposit insurer's association consisting of members from around the world that gather to share their expertise and knowledge, introduces educational programs and trainings, and also come out with research and regulations on issues relating to deposit insurance. They sets out guidance to enhance the effectiveness of the scheme taking into account peculiarities in different circumstances, settings and structures. However, it was yet to incorporate IDI into its latest revised *Core Principle of Effective Deposit insurance System* released on 1st November 2014. Since IDI has to comply with these international standards, it is therefore necessary to exercise due care and improvise solutions for the likelihood conflict between the specificities of Islamic finance and these core principles.

7.Conclusion and Recommendations

The concept of Islamic deposit insurance as a form of depositor protection scheme under the deposit insurance system is relatively new in the Islamic financial industry, Malaysia was the first country to institutionalized IDI, and it established the scheme in September 2005, to provide equivalent protection for insurable Islamic deposits.

Few countries have implemented deposit insurance (Md Khairuddin Hj Arshad, 2011), and unlike the conventional deposit insurance little has been written about its development and implementation. Out of the 189 countries practicing deposit insurance system only 10 (ten) implemented Islamic deposit insurance scheme, and among these 10 only Malaysia and Nigeria were operating fully institutionalized dual window deposit insurance, with other countries such as in Sudan practicing fully Islamic deposit protection scheme, operating under conventional deposit insurance in turkey, Singapore and United Kingdom, or operating voluntary Islamic deposit insurance e.g. Jordan. However there were several controversies (Mohammed Khnifer, 2010) over its permissibility, for instance, in the areas of insurability of some deposits, especially in the issue of guaranteeing Mudarabah (the profit sharing contract) deposits. There were also divergent views on the underlying contract to be applied for the operation of the scheme, however the GCC adopted the *Tabarru* (donation) structure and permit the arrangement of an in-house deposit insurance by the depository institutions, meanwhile the Malaysian deposit insurance corporation adopted the *Kafalah bil ujur*⁷ as the most viable structure (Mohammed Khnifer, 2010), which was also assumed by Nigeria.

However, there were two divergent views regarding adopting *Kafalah bil ujur*, while Bank Negara Malaysia (BNM) consider it permissible other *fatwa* issuing bodies like AAOFI, *Majamaa* and others in the GCC allow it only with varying conditions (Laldin, Khir, & Parid, 2012). The issues of mandatory participation for the Islamic financial institutions, who contributes perpetually into the scheme on behalf of the depositors, without any share of gain from investment on the IDIS funds, or a provision to plough it back into some developmental projects, seems to negates the zero-harm principle of Islamic teachings. Furthermore, for a deposit insurance system to exist effectively it should be unambiguously and clearly defined in law and regulation, which should be known to, and understood by, the public so that bank customers can take actions to protect their interest (Garcia, 1999). In addition, it was considered to promote financial inclusion, public confidence and financial system stability; however researchers suggested that many people were still not aware of such protection scheme (Chaibou Issoufou, 2008; Nor Hazim, H; Syadidawati, 2010). Much as DIS would be permissible under the Islamic law (*Shariah*), some of its operations and provisions of the law seems inimical to the principles and philosophy of Islamic banks.

The objectionable areas are the underlying structure for its operations, insurability of some deposit products and the distribution of investment profits or loss and perpetual payment of premium. Very important also is the general lack of awareness of the scheme and capacity in adequacies in many jurisdictions. In view of the above therefore, it is recommended that there is the need for researches to establish more empirical evidences against the divergent opinions in the operations of IDIS for Islamic financial institution. Many countries are desirous to adopt an IDIS in their various jurisdictions, thus, effort should be made at the establishment of a common ground in the administration of an IDI, such that a point of consensus under Shariah is reached and the point of disagreement is minimized or even eliminated.

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⁷ Kafalah bil ujur is a contract under Islamic law meaning guarantee with fee.

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