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Reconceptualising Smart Contracts as *Sharīah* and Legally Compliant Self-Help for Credit Risk Management in Nigerian Islamic Financial Institutions

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ABSTRACT

This study examines the *Sharīʿah* and legal compliance of smart contracts as self-help mechanisms for credit risk management in Islamic financial institutions. The rapid growth of fintech has increased the use of smart contracts to reduce default rates, enforcement costs, and information asymmetry, yet their legal and *Sharīʿah* status remains underexplored. Using a doctrinal and comparative approach, the research analyses the permissibility of contractual terms and self-help practices under Islamic law and Nigerian law. It also evaluates the enforceability of smart contracts in the absence of comprehensive electronic commerce legislation, with reference to the Evidence Act 2011 and the pending National Digital Economy and E-Governance Act, 2024. The findings show that properly structured smart contracts are consistent with key *Sharīʿah* principles, including transparency, certainty, proportionality, and necessity, and may function as regulated self-help mechanisms rather than unlawful extra-judicial sanctions. The study argues that smart contracts offer a defensible legal and *Sharīʿah*-compliant framework for managing credit risk, provided that excessive automation, unlawful terms, and disproportionate enforcement are avoided. It concludes by recommending an integrated regulatory and *Sharīʿah* governance framework to guide their responsible deployment in Islamic financial institutions.

Keywords: Smart contracts; Self-help; *Sharīʿah* compliance; Credit risk management; Legal framework

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1. Introduction

Blockchain is the fundamental element of the modern, rapidly growing Financial Technology (Fintech). The rapid growth of this element has globally changed the direction of financial services in the modern world. Modern smart contracts widely used across sectors are built on the Blockchain platform (Siddique & Shah, 2021). Though the term "Smart Contracts" has existed for three decades, in 2014, Vitalik Buterin invented the modern smart contract, which is now used in distributed ledger technology (DLT) systems (Patel et al., 2018).

Smart contracts have benefited several financial institutions in several ways. They enable them to craft clever, self-enforcing agreements at a very low cost, reduce monitoring and coordination costs, lower fraud losses, and minimise the need for trusted intermediaries, among other benefits (Moslein, 2019; Sklaroff, 2017).

The Islamic financial industry also needs smart contracts for its growth, as do other financial sectors, especially to serve people in remote areas, reduce service costs, and increase financial inclusion (Siddique & Shah, 2021). According to the Global Islamic Fintech Report 2021 quoted by Siddique & Shah, "Islamic Fintech volume within OIC countries was 49 billion dollars in 2020, which is 0.7% to total market share. Islamic Fintechs are expected to show growth to 128 billion dollars by 2025. Moreover, Islamic Fintech is expected to grow at 21% CAGR as compared to a growth rate of 15% projected for conventional Fintech. As per the gift index, Saudi Arabia, Malaysia, Indonesia, UAE, and the UK are the top five strong ecosystems for Islamic Fintech, whereas Bahrain, Kuwait, Pakistan, Jordan, and Qatar are fast-maturing ecosystems in this regard."

Credit risk is a serious threat to banks' performance and the broader economy, and it may lead to profitability losses, insolvency, and the failure of any financial institution (Ozurumba, 2016; Ugoani, 2016). Islamic banks are not exempted from these threats because they also operate as credit systems through several products, including *murābahah* contracts, *bay bithaman ājil* (credit sales), *ijārah*, *salam*, and *istisnā* (forward contracts) (Baele et al., 2014; Sharif et al., 2013; Siddiqui, 2008).

For Islamic financial institutions in Nigeria, there is a need for legal and *Sharīah*-compliance, as Islamic banking (IB) is practised under conventional banking regulatory laws. Consequently, all banks, including Islamic banks, operate under the regulatory framework of the Central Bank of Nigeria (CBN) Act 2007. However, some guidelines were created to regulate activities of Non-Interest banks, namely specifically: Regulation on the Scope of Banking Activities and Ancillary Matters (2010), Guidelines on Non-Interest Window and Branch Operations of Conventional Banks and Other Financial Institutions (2011), Framework for the Regulation and Supervision of Institutions Offering Non-Interest Financial Services in Nigeria (2011), Guidelines for the Regulation and Supervision of Non-interest (Islamic) Microfinance Banks in Nigeria (2017), Guidance Notes on Regulatory Capital for Non-Interest Financial Institutions in Nigeria (2018), etc. (El-Mubarak et al., 2020). According to Makiyan (2003), the conventional financial system depends on interest.

However, the Islamic financial system differs from its Western counterpart. The Islamic economic system is based upon a number of principles found in Islamic law.

Several governments have made efforts to create the legal status of smart contracts in their respective jurisdictions. Section (5) of the U.S. Electronic Transactions Act (ETA) stipulated that a signature secured using blockchain technology is to be considered electronic; Article (223) of Law No. (520) of 2016 on bonds emphasised the possibility of issuing or assigning the minion's bonds by an electronic system that allows the authentication of these transactions, following the security conditions issued by the State Council (Aldabousi, 2022). In Nigeria, there is no primary legislation to regulate electronic commerce/transactions. However, since 2009, the Nigerian legislature has before it the Electronic Commerce Bill 37 2009, which is yet to be passed into law (Atagamen et al., 2020). Subsequently, the proposed National Digital Economy and E-Governance Act, 2024 sought to address some of these gaps. Sections 1, 10 and 14 address, respectively, the legal recognition of electronic communications, the formation and validity of electronic contracts, and contracts formed through automated message systems. However, the Act remains a draft Bill, and its provisions cannot be treated as binding law unless its enactment is independently verified. Moreover, the issue of whether an electronic mark will constitute a valid signature required to execute a valid contract is challenging in enforcing an e-contract of agreement because there is a statutory requirement that provides that a contract should be evidenced in writing, and which also requires it to be signed by parties to the agreement in Section 4 of the Statute of Frauds.[1] These issues underscore the need to clarify the relationship between existing contract and evidence laws and the emerging use of smart contracts in Nigeria.

This work examines the *Sharī'ah* and legal status of smart contracts, and their exploitation to mitigate credit risk in Islamic financial institutions in Nigeria. However, the validity of contractual terms and self-help will be analysed under both legal systems, given the lack of direct answers on the *Sharī'ah*-legal status of smart contracts in Nigeria. Moreover, it can be deduced that smart contracts are all about connecting contractual terms with self-help through blockchain technology (Moslein, 2019).

2. The *Sharī'ah*- Legal Status Of Contractual Terms

Generally, the autonomy and freedom of the contractual parties to voluntarily agree on any contractual term are legally respected and strictly applied in the Nigerian legal system, without regard for the hardship that may be caused to parties with unequal bargaining power, except in rare cases (Ilobinso, 2018). In *Attorney General of Rivers State v. Attorney General of Akwa-Ibom State*, the Supreme Court held that:

> 'It is elementary law that where parties have entered into a contract or agreement, they are bound by the provisions of the contract or agreement. This is because a party cannot ordinarily resile from a contract or agreement

[1] Statute of Frauds 1677.

> just because it later found that the conditions of the contract or agreement are not favourable to it. This is the whole essence of the doctrine of the sanctity of contract or agreement.'[2]

According to Oyewunmi & Sanni (2013), this viewpoint is allegedly common in Nigeria's legal system following the decision of the House of Lords in *Photo Productions v. Securicor*,[3] and the Nigerian Supreme Court decisions in all three concerned cases after the English decision including *Akinsanya v. United Bank for Africa Ltd*,[4] *Attorney-General, Bendel State v. United Bank for Africa Ltd*,[5] and *Narumal & Sons v. Niger Benue Transport Company Ltd*,[6] were confirmed with the development in the *Photo Productions* at the case as in favour of the terms of the contract over the rule of law.

He argued that the doctrine of fundamental breach has been considered in several cases before the English courts (Oyewunmi & Sanni, 2013), in *Adel Boshali v. Allied Commercial Exporters Ltd*.[7] The Judicial Committee of the Privy Council held that there was a breach of contract, as the supplied clothes did not conform to their description. On the issue of the exemption clause, it was held, overruling the Federal Supreme Court's, that:

> 'An exemption clause can only avail a party if he is carrying out the contract in its essential respects. A breach that goes to the root of a contract disentitles a party from relying on an exemption clause…'

However, the English case law and Strick's adherence to this key principle of contract law have been subjected to attacks due to their inefficiency in establishing fairness in the realities of modern market practice, where a standard-form contract is ubiquitous (Ilobinso, 2018). According to Sagay (2000, p. 201), "there is, therefore, a compelling need for the Supreme Court to give a clarifying judgment which, as a matter of principle, recognises that contracts in Nigeria are concluded and performed in a totally different socio-economic and cultural environment from that of the United Kingdom."

Standard form contracts cannot be avoided due to their challenges in the modern market, as they are efficient for distance contracts and facilitate large-volume contracts at lower cost (Ilobinso, 2018). Ilobinso described Standard form contracts as "documents containing terms purporting to be the contract, which have not been negotiated by the parties to the contract but drafted in advance on behalf of a party to the contract (usually a

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[2] *Attorney General of Rivers State v. Attorney General of Akwa-Ibom State* (2011) 29 Weekly Report of Nigeria 1 (Supreme Court of Nigeria), p. 9.

[3] *Photo Productions v. Securicor* (1980) 2 Weekly Report of Nigeria 283 (Supreme Court of Nigeria).

[4] *Akinsanya v. UBA* (1986) 4 Nigerian Weekly Law Reports (Pt. 39) 273 (Supreme Court of Nigeria).

[5] *Attorney-General, Bendel State v. United Bank for Africa Ltd* (1989) Nigerian Weekly Law Reports (Pt. 106) 730 (Supreme Court of Nigeria).

[6] *Narumal & Sons v. Niger Benue Transport Company Ltd* (1989) 2 Nigerian Weekly Law Reports (Pt.108) 739 (Supreme Court of Nigeria).

[7] *Adel Boshali v. Allied Commercial Exporters Ltd* (1961) All Nigeria Law Reports (Part 4) 917 (Privy Council, Nigeria).

business) and presented to the other party (usually the consumer) on a take-it-or-leave-it basis."

The need to protect parties from the effects of unfair terms, especially exclusion clauses, is now receiving due consideration from Nigerian courts, given the pervasive use of standard-form contracts and the rise in exploitation of weaker parties in modern society. Consequently, several kinds of terms may not be accepted by the court, including terms not contained in a contractual document, terms without sufficient prior notice to the adhering party, unfair terms that are accepted due to ambiguities, or terms that override the fundamental obligations of the contract (Ilobinso, 2018).

For instance, in *DHL v. Chidi*[8] concerning a business-to-consumer transaction regarding the courier company's liability for non-delivery of the parcel, Edozie JCA (as he then was) held that the non-delivery of the parcel constituted a fundamental breach of the postal contract and that the exemption clause relied upon by the appellant was inoperative.

There are fragments of statutory provisions relevant to unfair terms. Some of these are found in the Hire Purchase Act, 46 Sale of Goods Act, Contract Law of Anambra State 1863 (Section 198–190), etc. However, they were insufficient to provide adequate protection for victims of unfair terms. To improve the situation, the Unfair Contract Terms Bill was introduced before the National Assembly in 2010, but it has not been passed to date (Ilobinso, 2018).[9]

However, Sections 127, 128 and 129 of the Federal Competition and Consumer Protection Act (FCCPA) 2018 significantly strengthen the legal framework for protecting consumers against unfair contract terms in Nigeria, thereby addressing the inadequacies of the fragmented statutory provisions identified above. Section 127 expressly prohibits undertakings from imposing unfair, unreasonable or unjust prices and contractual terms, particularly where the terms are excessively one-sided, inequitable, based on misleading representations, or have not been adequately brought to the consumer's attention. Section 128 complements this protection by requiring provisions that limit liability, impose risks or obligations on consumers, or require indemnification to be presented conspicuously and communicated in sufficient time to enable consumers to understand them before entering into a transaction. More importantly, Section 129 prohibits contractual terms designed to defeat the purposes of the Act, exclude statutory consumer rights, evade legal obligations or improperly exempt suppliers from liability for gross negligence, and declares any transaction or contractual provision contravening the section void to the extent of the contravention.

In *International Messengers (Nig) Ltd v. Pegofor Industries Ltd*,[10] the court relied on Section 190 of the Contract Law of Anambra State in rejecting an exclusion clause due to its

[8] *DHL v. Chidi* (1994) 2 Nigerian Weekly Law Reports (Pt. 329) 720 (Court of Appeal, Nigeria), p. 742.

[9] ibid.

[10] *International Messengers (Nig) Ltd v. Pegofor Industries Ltd* (2005) 15 Nigerian Weekly Law Reports (Pt. 947) 1 (Supreme Court of Nigeria).

inconsistency with the provision of the section, as the court held that the appellant could not rely on the clause, which was contrary to Section 190 of the Contract Law of Anambra State (Oyewunmi & Sanni, 2013). The section provides that:

> 'Nothing in the foregoing shall be construed as to enable a party guilty of a fundamental breach of a contract, or breach of a fundamental term, to rely upon an exemption clause to escape liability.'[11]

The decisions of Nigerian courts have lost their consistency since the English decision in *Photo Productions v. Securicor*.[12] Therefore, it is necessary to ensure fairness in contractual terms to be on the safe side.

Terms in Islamic law are known as *al-shurūṭ fi al-'aqd*. According to Al-Najdī (1433/2012, p. 126), *al-shurūṭ fi al-'aqd* is a situation where one of the contracting parties obliges the other party on something that will benefit him during the contractual processes.

The status of terms is clearer, straightforward, and consistent in Islamic law. According to *sharī'ah*, terms are generally valid under two conditions: they must conform to the implicants of the contract; and their implementation must not lead to a wrongful act or offence in Islamic law (Al-Najdī, 1433/2012, p. 126).

According to Bin Al-Qayyim (1431/2010, Vol. 1, p. 259), the majority of jurists believe that all contracts and terms are generally valid, except for what is invalidated by the *sharī'ah* or He has forbidden, and this opinion is correct because the ruling on the invalidity of a contract or term implies that it is forbidden and punishable in Islamic law. However, there is no forbidden except what Allah and His Messenger have forbidden, and there is no sin except for what Allah and His Messenger have declared to be sinful. Nothing can be obligatory or forbidden except what Allah has made so. Contracts and transactions will remain valid, under Islamic law until evidence of their invalidity and prohibition is established.

3. The Legal And *Sharīah* Status Of Self-Help

According to US Legal Forms (n.d.), "self-help, in a legal context, refers to the act of individuals taking action to enforce their rights or seek relief without involving the court system. This can include actions like repossessing a car for missed payments, recovering borrowed items, or collecting owed money. While self-help is permissible, it must be conducted in a manner that does not disrupt the peace or break any laws."

The legal status of self-executory, according to writers, is relative due to overlapping concerns. Self-help is beneficial when properly implemented, but it can be abused and pose a danger to society. Self-helpers effectively act as judges of their cause. In that process, they may misconstrue the law due to bad faith, motivated cognition, or reliance on congenial

[11] Anambra State Contract Law 1986.

[12] *Photo Productions v. Securicor* (1980) 2 Weekly Law Reports 283 (House of Lords).

interpretive methods or theories of law. However, the use of self-help to remedy the wrongdoing of others, in advance or in lieu of a mediated process, may serve to prevent such wrongdoing from occurring in the first place, reduce administrative costs, facilitate speedier redress, and promote autonomy-related values.. In most areas of domestic law, the implementation of self-help is subject to judicial review of its legality (Pozen, 2014).

The right to self-help may be truncaed due to the availability of legal remedies. However, a legal remedy cannot be denied in any case, as self-help remedies are available. There are some rights that cannot be defended unilaterally, and the court must provide the standard legal regimes necessary for their defence (Epstein, 2005).

> 'There is no provision in the Penal Code Law which punishes self-help. Conversely, some provisions allow a complainant to resort to private defence and or defence of property. This is provided in sections 59 and 60 of the Penal Code. The Sections provide respectively that nothing is an offence which is done in the lawful exercise of the right of private defence and that every person has a right, subject to the restrictions therein after contained, to defend: his own body and the body of any other person against any offence affecting the (a) human body; the property whether movable or immovable of himself or of any other person against any act, mischief or criminal trespass, or which is an attempt to commit theft, robbery, (b) mischief or criminal trespass. Such self-defence or defence of property would have been resorted to, especially under section 60(b), by the respondent if he was around on the premises. That would have resulted in an ugly incident. Thus, although a resort to self-help has been left to go unpunished, it is an open invitation to resort to conflict, violence, and perhaps blood-shedding. That would be animalistic in any civilised society. '[13]

However, the right to exercise self-defence has been restricted to the condition of reasonability in Section 32(3) of the Criminal Code Act,[14] which provides that:

> 'A person is not criminally responsible for an act or omission if he does or omits to do the act… when the act is reasonably necessary to resist actual and unlawful violence threatened to him or another person in his presence.'

Self-help that fulfils all conditions is still not encouraged by the law to maintain order and prevent lawlessness in society. However, being discouraged doesn't mean that it is not legitimate, as stated in *Spiess v. Oni*:

> 'Where the law has absolved a person who takes the law into his hands in the defence of property, the court cannot criminalise it beyond mere condemnation. Since the law does not criminalise resorting to self-help, the court cannot extend the frontier of the law to criminalise it. This is so because

[13] *Spiess v. Oni* [2016] 14 Nigerian Weekly Law Reports (Pt. 1532) 236 (Supreme Court of Nigeria).

[14] Criminal Code Act (1990), c. 77, § 32(3) (Nigeria).

> a defence of a bona fide claim of right made in good faith in respect of property is absolute and negatives any element of mens rea. The conduct of the appellant in the instant case is highly reprehensible, though not criminal. If it was a civil matter, then the law would have taken its course.'[15]

Pozen described reasonableness as the basic substantive standard governing all self-help laws in every mature system of self-help regulation. According to him, reasonableness means proportionality as a global norm, commensurateness, or the like. Moreover, he also mentioned other standards, including notice and demand requirements (with exceptions for cases of urgency), time limitations, avoidance of dangerous or irreversible measures, and entitlement to claim the cost of self-help in court.

Under Islam law, self-defence against an unlawful attack on one's self, property, and dignity is also considered a lawful act. According to the jurist, self-defence is a right of the victim and may even be obligatory, especially in cases involving life and dignity. Consequently, exercising Self-defence cannot be an offence in Islamic law, and its omission may be an offence ('Awdah, 1431/2010).

According to Bun-Hazm (1431/2010, Vol. 11, p. 341), whoever is compelled to defend himself righteously, it is obligatory upon him to ward off injustice from himself and others, to the best of his ability. From his weapon or someone else's weapon, and if he does not do so, then he is thrown into his own hands to destruction, and this is forbidden for him.

According to Al-Zuhailī (1433/2012, Vol. 4, pp. 2857–2858; Vol. 6, pp. 4837–4838), if a person assaults another with life, money, or offer, connections against him, he unjustly wants his money or himself, or he wants a woman to commit adultery with her, or an animal consummate sexual intercourse with him, then the victim, or the third party has the right to prevent the aggression to the extent necessary to ward off the assault based on his most likely assessment. However, they should start with the lightest, then the lighter, if possible. Therefore, if the assault can be prevented with voice, then it is forbidden to use a stick, and if pushing is enough to prevent it, then killing is forbidden. Because self-defence is allowed based on the doctrine of necessity, and necessity must be estimated according to its required measure.

The scope of self-help is wider than self-defence in Islamic law because self-defence requires the victim to be in the state of defence before being eligible to exercise it, and the state of defence is a result of the advent of an assault, unlike self-help, which does not require that. However, self-help used as the medium of fulfilling self-defence is as important as self-defence based on the *sharīʿah* maxim; something obligatory is not done without it is obligatory. However, such self-help should not be carried out through unlawful acts due to a lack of necessity ('Awdah, 1431/2010; Al-Zuhailī, 1433/2012, Vol. 4, pp. 2857–2858; Vol. 6, pp. 4837–4838).

[15] *Spiess v. Oni* [2016] 14 Nigerian Weekly Law Reports (Pt. 1532) 236 (Supreme Court of Nigeria).

Exercising self-help outside the influence of necessity is also permissible under Islamic law, except in some cases, including the enforcement of punishments when there is a likely outburst of disorder and rights not unanimously recognised by the jurists. An example of a right that can be retrieved through self-help is the right to debt relief (Wizārat Al-Awqāf Wa Al-Shuū'n Al-Islāmiyyah, 1431/2010, Vol. 18, pp. 46–47).

Generally, it is permissible for someone to claim his property from the possession of another person who has been procrastinating in returning it or denying the debt, by using self-help. Moreover, some also stipulate that the equitable property must be in the same category as its indemnity. However, Shafi'ī and Abū hanīfah held that the victim is entitled to retrieve his right from every kind of property with fairness (Al-Zuhailī, 1433/2012, Vol. 4, pp. 2857–2858; Vol. 6, pp. 4837–4838).

Consequently, self-help is recognised under both Nigerian law and Islamic law as a legitimate means of protecting certain rights and preventing or remedying unlawful conduct, particularly in matters involving self-defence, property and debt recovery. However, its exercise is subject to legal restrictions, reasonableness, proportionality and necessity, and must not result in unlawful violence, excessive force or the infringement of others' rights. While Islamic law permits the recovery of certain rights through self-help, such action must be limited to the extent necessary to prevent or remedy the injustice. Therefore, self-help should be exercised cautiously and in good faith, with recourse to judicial remedies wherever unilateral action would create a risk of abuse, disorder or injustice.

4. The Role Of Smart Contracts In Enforcing Contractual Terms

Smart contracts have been described by various writers with several expressions that indicate the combination of contractual terms with their self-executory status stored in a computer program, namely, the blockchain (Gilcrest & Carvalho, 2018; Nzuva, 2019). Smart contracts can contribute to, verify, or implement the performance of contractual negotiations or agreements, and ensure the credibility of transactions by making them trackable and irreversible (Aldabousi, 2022; Gilcrest & Carvalho, 2018; Nzuva, 2019; Rejeb, 2021).

Blockchain is a core element of Financial Technology (Fintech), which is growing rapidly and has changed the way financial services are delivered worldwide (Siddique & Shah, 2021). According to Nzuva (2019), "blockchain is a chain of transaction records, usually referred to as blocks, that grows autonomously, with all records linked together to form a chain and secured through cryptographic techniques. A block may contain one or more records, and each block holds the hash function of the preceding block, the transaction data, and the timestamp. Once the block is completed and committed, it is chronologically added to the blockchain and cannot be modified." Blockchain has enabled technology that communicates directly with the largest number of people, ensuring that information is not repeated or leaked through the network. Due to blockchain's ability to eliminate the need for

a central third party, which was required by earlier technologies, blockchain can store information about the network itself (Aldabousi, 2022).

Generally, smart contracts are contracts in a digital, automated form and are not restricted to blockchain technology. However, in the contemporary financial convention, it applies to blockchain contracts. Smart contracts were introduced to digitalise and automate legal contracts (Capocasale & Perboli, 2022; Zou et al., 2019).

Various authors have identified several benefits of smart contracts. It enables agreement enforcement at a very low cost, reduces monitoring and coordination costs, mitigates business uncertainty, minimises the need for trusted intermediaries, and facilitates effective service (Moslein, 2019; Sklaroff, 2017).

The technologically enforcing nature of smart contracts does not imply that they are legally enforceable or *Sharī'ah*-compliant. The power to decide on the validity of a smart contract is a duty embedded in court jurisdictions. Moreover, their enforcement can still be subjected to legal review in any court of law, which may lead to their confirmation or invalidation. Accordingly, it is necessary to explore the legal items relevant to its confirmation or otherwise in the competent court of law (Moslein, 2019).

Perceptions are at variance concerning smart contracts in different jurisdictions. This contributed to inconsistent decisions in smart contract cases and to differences in legislation enacted on smart contracts across countries. In some countries, legislative provisions regulate the use of different smart transaction systems in different contexts. For example, smart contracts that underpin transactions in ICOs (Initial Coin Offerings) may be illegal in some jurisdictions. In contrast, a smart contract that handles intra-institutional banking and other financial transactions may be legal in similar jurisdictions or elsewhere (Patel et al., 2018).

In Nigeria, there is no legislation specifically regulating electronic contracts. The Electronic Commerce Bill 37 2009 has been sponsored since 2009. However, the Nigerian legislative Parliament did not pass it into law (Atagamen et al.). Likewise, the National Digital Economy and E-Governance Act was proposed in 2024 to strengthen the legal framework for digital transactions. In particular, section 1 proposes that electronic communications should not be denied legal effect, validity or enforceability solely because they are in electronic form, while section 10 addresses the formation and validity of electronic contracts. Section 14 further proposes to recognise contracts formed through automated message systems, even where no individual reviews or intervenes in each automated action. These provisions are relevant to smart contracts because they address electronic contracting and automated contract formation. However, the Act is still a draft Bill, its provisions should not be presented as binding law unless its enactment is independently verified. Consequently, the provisions of the Evidence Act on the admissibility of a computer-generated document are relevant to some extent in regulating smart contracts in Nigeria, given that smart contracts are a form of computer-generated document (Omolaye-Ajileye, 2021). According to Mason, quoted by Omolaye-Ajileye (2021),

electronic evidence is defined as: "Data that is manipulated, stored or communicated by any man-made device, computer or computer system or transmitted over a communication system, that has the potential to make the factual account of either party more probable or less probable than it would be without the evidence."

The admissibility of a smart contract as evidence in a Nigerian court can only be determined after the fulfilment of the conditions stated in Section 84 of the Evidence Act. In *Kubor v. Dickson*,[16] the Supreme Court held that a party seeking to tender in evidence a computer-generated document must do more than simply tender it from the bar; it must also satisfy the conditions set out in Section 84(2) of the Evidence Act 2011 (Aldabousi, 2022; Atagamen et al., 2020; Sklaroff, 2017; Zou et al., 2019). However, the understanding of the admissibility conditions stated under section 84(2) of the Evidence Act reveals that electronic evidence needs only to be reliable, as it is used to ensure the reliability of the electronic evidence in question. According to several writers, blockchain is transparent and reliable due to its decentralised and self-executory nature (Omolaye-Ajileye, 2021; Aldabousi, 2022; Putri & Nikmah, 2022; Sklaroff, 2017).

According to Sklaroff (2017), "Storage and execution using a blockchain makes smart contracts secure and provides a natural check against bad-faith manipulation of contract terms. But this decentralisation also prevents a contract from executing until nodes agree that its conditions have been satisfied. Thus, when a smart contract fails to consistently "produce the same output based on a given input" across all participants in the system, it won't be executed at all."

Based on the Islamic law perspective, many jurists have affirmed smart contract validity. They also argued how it can even be instrumental in aiding Islamic financial institutions to be more *Sharīah* compliant, as it reduces elements of *gharar* while contracting with unknown parties, it guarantees *Sharīah* compliance by making *Sharī'ah* laws to form smart contract conditions, and its inherent nature of promoting transparency and trustworthiness enhances Islamic ethics in Islamic financial institutions (Antova & Tayachi, 2019; Putri & Nikmah, 2022; Siddique & Shah, 2021).

Based on the previous sections, it can be further argued that the nature of smart contracts makes them more acceptable and valid than ordinary self-help, as some jurists allow self-help only if it will not lead to lawlessness and disorder in society. Moreover, smart contracts are always formed in a manner that hardly causes lawlessness and disorder in society. However, smart contracts need to be *sharī'ah*-compliant by excluding unlawful elements. Consequently, unlawful terms must not be included, and it must not be used for unlawful purposes.

[16] *Kubor v. Dickson* (2013) 4 Nigerian Weekly Law Reports (Pt. 1345) 534 (Supreme Court of Nigeria), p. 574, para. D–E.

5. Validity Of Using Smart Contract To Mitigate Credit Risk

Commercial banks are considered to be one of the most important contributors to national economic growth and development. The operation of the credit system in Commercial banks is one of the most significant elements that constitute the mighty worth of Commercial banks in every nation. Commercial banks serve as intermediaries between borrowers and depositors, ensuring the usefulness of the surplus in the surplus economic unit for the benefit of the deficit economic unit, which led to the introduction of a credit system. This influences the level of the money stock, the allocation of funds, the direction and use of resources, and the advancement of productivity in the economy (Olusanya et al., 2012; Witkowska & Chrzanowska, 2005).

Islamic banks, among the commercial banks recognised in Nigeria, also operate in a redefined way, as needed, like their counterparts. The credit system is also available to them. However, Islamic banks differ from conventional banks, and their operations are based on Islamic law principles, unlike conventional banks, which are based on Western culture (Makiyan, 2003).

However, this significant role makes commercial banks one of the strongest targets of credit risks, which may arise from the partial or total non-redemption of outstanding loans (Ozurumba, 2016; Witkowska & Chrzanowska, 2005). According to Ozurumba (2016), "bank loans are regarded as risk assets because the monies advanced as loans by the banks belong to depositors and the risk arises in the sense that in case of massive defaults, depositors' monies may not be available on demand. Banking and indeed lending may therefore suitably be regarded as high-risk businesses. The subject matter of risk and uncertainty assumes considerable importance in determining business success or failures." Therefore, credit risk is the risk that a borrower may default on a loan or fail to meet repayment obligations, thereby exposing a bank to potential financial losses and impairing its ability to meet depositors' withdrawal demands.

Credit risk and non-performing loans are serious threats to banks' performance and the broader economy, and they may lead to profitability losses, insolvency, and the failure of any financial institution. Credit risk is the major and most common cause of non-performing loans (Ozurumba, 2016; Ugoani, 2016). According to the Central Bank of Nigeria, "a credit facility should be deemed as non-performing when any of the following conditions exists: (i) Interest or principal is due and unpaid for 90 days or more; (ii) Interest payments have been capitalised, rescheduled for over 90 days or rolled over into a new loan" (Ugoani, 2016; Yusni et al., 2021).

According to John, "in 1993, insolvent banks accounted for about 20 per cent of banking system assets and about 22 per cent of deposits. In 1995, almost half of the banks reported being in financial distress, during which about 25 banks were liquidated as a result of a non-performing loans portfolio" (Ugoani, 2016).

Consequently, it is a crucial role of an active and efficient board of directors of a bank to develop credit procedures, policies, analytical capabilities, and credit risk management

strategies to continuously improve its bank lending performance and mitigate the adverse effects of its credit risk. This will enable its safe and profitable operation (Olusanya et al., 2012).

Kolapo et al. (2012) believe that banks should be able to identify, generate, track, and report on risk-related data in an integrated manner, with full audibility and transparency, and create the opportunity to improve their risk management processes based on the international principles and regulations guiding the operations of banks to ensure soundness and stability under the Basel Accord. Muhammad discovered that most financial institutions prefer to resolve credit risk and non-performing loans outside the courts, rather than in court, due to their lower costs and faster timeframes. However, they will also need to resort to legislative avenues after all attempts to resolve them through non-litigation means fail (Yusni et al., 2021).

The nature of Islamic banks makes it impossible to make a profit from a direct loan, as, under Islamic principles, a loan must be a *qard hasan* (benevolent loan or interest-free loan). The only lawful way for Islamic banks to make a profit is through risk-sharing or equitable contracts under *mushārakah* (equity participation contract) and *mudarabah* (silent partnership contract). The risk-sharing nature of both models makes them unlike conventional lending contracts in banking (Baele et al., 2014; Uhomoibhi & Alio, 2008). However, the emergence of several models of indirect loans enables Islamic banks to benefit from loan contracts remodelled as sales, leasing, and other non-equitable contracts, based on the principle of *hiyal sha'iyyah* (*Sharīʿah*-compliant trick). The remodelled loans include *murābahah* contract, *bay bithaman ājil* (credit sales), *ijārah*, *salam*, and *istisnā* (forward contracts), etc. (Baele et al., 2014; Sharif et al., 2013; Siddiqui, 2008).

For instance, in a *murābahah* contract, the bank buys a good or asset on behalf of its client, which has agreed to repurchase it from the bank on credit under a separate contract at a marked-up price. This contract is permissible because it was operated in trade form. However, *bay bi-thaman ājil*" (credit sales) is a *murābahah* contract that is not executed on the spot (Baele et al., 2014; Siddiqui, 2008; Uhomoibhi & Alio, 2008). The *ijārah* (leasing contract) applies to transactions in real estate and equipment. This contract is usually practiced in different forms but in most resemble form with the conventional loans, the bank will buy an asset and then lease it to a customer for a certain period at a fixed rental charge in lieu of his enjoyment for the usufruct of the good while the bank bears the risk of ownership with an agreement to transfer the ownership of the asset to the customer at the end of the lease contract, either for free or at a pre-agreed price (Baele et al., 2014; Siddiqui, 2008).

Based on the above-mentioned elements of the credit system available in Islamic banks, it is arguable that Islamic banks are also among the major targets of credit risk. Consequently, they are not exempted from the need for risk management strategies in their system.

The significant role of smart contracts in establishing risk management strategies capable of resolving credit risk and non-performing loans outside litigation is highly

significant for modern financial institutions. However, their implementation in Islamic financial institutions in Nigeria needs to be compliant with Nigerian and Islamic legal frameworks, unlike conventional financial institutions, which need to observe only Nigerian law.

6. Discussion and Conclusion

This study has examined smart contracts through the combined lenses of Islamic law and Nigerian legal doctrine, reconceptualising them not merely as technological instruments but as regulated forms of self-help capable of mitigating credit risk in Islamic financial institutions. The analysis demonstrates that smart contracts, when designed as conditional, transparent, and proportionate enforcement mechanisms, are consistent with *Sharīʿah* principles governing contractual terms (*al-shurūṭ fi al-ʿaqd*), doctrine of necessity, and reasonableness, while also fitting within the Nigerian legal framework on contractual autonomy, electronic evidence, and lawful self-help. Unlike unregulated self-help remedies, smart contracts embed pre-agreed conditions and automated execution in a manner that reduces arbitrariness, opportunism, and post-contractual disputes.

The findings further reveal that Islamic financial institutions in Nigeria face a dual compliance challenge: adherence to *Sharīʿah* norms alongside operation under a conventional regulatory architecture that lacks a comprehensive, dedicated framework for electronic contracts and smart contracts. While existing provisions under the Evidence Act 2011 provide partial support for the admissibility of smart contracts, the absence of primary legislation on electronic transactions creates legal uncertainty, particularly regarding enforceability, signatures, and regulatory oversight. Nonetheless, the doctrinal analysis confirms that neither Nigerian law nor Islamic law inherently prohibits smart contracts, provided they exclude unlawful terms, avoid excessive or disproportionate enforcement, and remain subject to judicial review.

In light of these findings, the study also recommends that Islamic financial institutions adopt smart contracts primarily as preventive and corrective credit risk management tools, rather than punitive enforcement mechanisms. Embedding proportionality, notice requirements, and override mechanisms within smart contract architecture would align technological automation with both *Sharīʿah* ethics and legal reasonableness, while preserving access to judicial remedies where disputes arise.

Further, the study recommends the establishment of a specialised regulatory framework for smart contracts in financial institutions. This should include the constitution of a government-backed supervisory board operating in coordination with the Central Bank of Nigeria and other relevant financial regulators, composed of *Sharīʿah* scholars, legal practitioners, consumer protection specialists, and financial technology experts, to certify, audit, and license smart contracts prior to deployment. Such a body would ensure *Sharīʿah* compliance for Islamic financial institutions while safeguarding legality, consumer protection, and systemic stability across the financial sector.

In view of the existing legislative gaps and the proposed National Digital Economy and E-Governance Act, Nigeria should prioritise the enactment of comprehensive legislation governing electronic transactions and smart contracts. The proposed National Digital Economy and E-Governance legislation should be developed, where necessary, to provide a clear and effective legal framework for digital transactions. Any such framework should expressly address the legal recognition and enforceability of smart contracts, electronic signatures, and blockchain-based transactions, while establishing appropriate safeguards for legal certainty, consumer protection, and dispute resolution.

Beyond the enactment of the National Digital Economy and E-Governance Act, Nigeria should consider adopting a dedicated Smart Contracts and Digital Financial Transactions Act or incorporating a comprehensive smart contract framework into the pending National Digital Economy and E-Governance Act. Such legislation should expressly define the legal status of smart contracts, recognise blockchain-based transactions and electronic signatures, establish standards for automated execution, and provide mechanisms for judicial intervention where execution results in injustice, fraud, mistake, technical malfunction, or *Sharīʿah* non-compliance. To ensure fairness, accountability, transparency, and inclusiveness, the proposed supervisory framework should operate through a dual-governance structure comprising regulatory authorities, *Sharīʿah* advisory bodies, financial institutions, consumer protection agencies, and technology experts. For Islamic financial institutions, the framework should mandate pre-deployment *Sharīʿah* certification, periodic compliance audits, transparent disclosure of smart contract terms, notice requirements before enforcement, accessible dispute-resolution mechanisms, and human-override safeguards where strict automation may cause hardship or injustice. Such measures would preserve contractual certainty while ensuring that technological innovation remains consistent with the objectives of *Sharīʿah*, principles of equity and consumer protection, and the constitutional commitment to equal access to justice. Through this balanced approach, Nigeria can create a legally certain, technologically innovative, and *Sharīʿah*-compliant ecosystem capable of supporting sustainable growth in Islamic finance and broader digital commerce.

This study contributes to the growing literature on Islamic fintech by advancing the novel argument that smart contracts should be understood not merely as digital contracting tools but as regulated forms of self-help whose legitimacy depends on compliance with both *Sharīʿah* principles and legal safeguards against abuse. Beyond mitigating credit risk, the responsible deployment of *Sharīʿah*-compliant smart contracts has the potential to enhance financial inclusion by reducing transaction costs, expanding access to Islamic financial services, and facilitating participation in formal financial systems by underserved communities. However, future studies may empirically assess the effectiveness of smart contracts in reducing non-performing financing in Islamic banks, examine consumer protection implications in automated enforcement, or explore cross-jurisdictional regulatory models for *Sharīʿah*-compliant fintech governance. Ultimately, the effective regulation of smart contracts presents an opportunity for Nigeria to position itself as a leading jurisdiction

for *Sharīʿah*-compliant fintech innovation in Africa while strengthening legal certainty, consumer protection, financial inclusion, and sustainable economic development.

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AI Usage Declaration

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