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Islamic Personal Financing: An Attempt to Engineer Shari'ah- Compliant Instruments

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ABSTRACT

Personal finance, from Shari'ah perspective, is a benevolent provision that should not be offered by Islamic financial institutions for a profit. There are different motives for personal finance whether on individual, corporate, financial institution or government levels and genuine needs for cash may arise under specific circumstances. Current instruments used by Islamic banks to provide personal finance have Shari'ah issues and serious implications and effects on the economy apart from the resulting reputational risk for the industry. This paper is an attempt to explore and present Shari'ah-compliant alternative instruments that fulfil individual needs for which personal finance is usually given. Three profit-based instruments are discussed: (1) Service Ijarah, (2) Murabahah/Service Ijarah Line-of-Credit with Wakalah and (3) Murabahah/Service Ijarah Credit Card. Through these instruments, most individual cash needs are fulfilled. Islamic banks have adequate tools to provide personal finance within the boundaries of Shari'ah particularly for retail customers and they do not need to resort to controversial tools that mimic interest-based loans.

Key Words: Personal finance, Islamic banks, Service Ijarah, Islamic Credit Card

INTRODUCTION

Islamic banks (IBs) are always dragged into a rat race against conventional banks to offer more competitive products and services. Unsurprisingly, some jurisdictions witnessed the invention of substantial number of financial products and instruments including derivatives instruments as Islamic alternatives. Many of these Islamic financial products (IFPs) are frowned upon as being replicas of conventional banking products and not conforming to Shari'ah in essence (El-Gamal, 2007; Dusuki and Abozaid, 2007; Abozaid, 2010a; Garner, 2013; and many others). Islamic personal financing (IPF) is one such product that recently gained momentum in response to the demands and financial needs of IBs' customers and market-driven forces to effectively compete with conventional banks. The present models and current market practices of personal financing (PF) in Islamic banking are, in most cases, not aligned with Shari'ah principles. This is because Islamic finance (IF) cannot provide cash PF for individuals or institutions except through interest-free loans and in contrast to conventional banks providing cash, IF meets the needs for which the money is intended, e.g., if you need a car or real estate, the bank will execute a true purchase and then sell it to you (Abozaid, 2010b).

Are IBs then more concerned about profits than Shari'ah compliance when it comes to demand-based products? One would tend to believe that in the case of Shari'ah issues, non-Shari'ah compliance is cruelly sanctioned by the market, especially by Muslim customers. But, the prevalence of IPF brings us to conclude that present IF contracts are unable to cover all financing needs and, thus, there is a need for Islamic financial engineering to meet contemporary market needs through Shari'ah-compliant means.

Conventional banks do not face any obstacle to cash financing since their business model is different and is established upon loan contracts. The conventional banking system, being interest-based, is concerned only with taking deposits and providing loans against an increment.¹ Conversely, in IF, loan contracts (Qard) are considered as benevolent contracts. There are many Hadiths which encourage giving interest-free loans for which the lender is rewarded not in this world by an increment on the loan, but in the Hereafter. Haron and Shanmugam (2001) argue that, under the Islamic tenets, any lender has only two options in case debtors find themselves unable to repay their debts: one, either extending/delaying the

¹ For the safety, integrity and stability of the monetary and finance system, Central Banks' regulations also require conventional banks to have an objective for each financing transaction, especially with the IMF fight against Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) activities. However, since they accept the idea of loans, conventional banks can finance debts and other cash transactions.

repayment date or duration of the loan, or two, converting the loan to charity. However, there is a third option which is most common in modern practice, i.e., force the debtor to pay even if that ends up bankrupting him/her (either through liquidating the assets given as collaterals or through litigation). In any case, even if a Qard is given or a debt is extended, no increment or return can be collected on it. This implies Qard or a loan contract cannot be a financing instrument offered by Islamic financial institutions (IFIs).

PF is treated as a benevolent contract which is not offered by Islamic financial intermediary institutions and if there is a genuine need for cash, individuals should approach their relatives, friends and charitable organizations such as Zakah and Awqaf (Kahf, 2015). In fact, should IFIs be willing to provide IPF, they would do so by converting the benevolent relationship into a financing one, as evidenced by the many current market practices of IPF (Bay al 'Inah, Salam PF, al Rahn, Commodity Murabahah/Tawarruq PF). Such structures of PF, as meticulously analyzed by Kahf (2015), are not Shari'ah-compliant because these are in substance simply exchange of cash now for a larger amount of debt in future.

In contemporary Islamic banking practice, Qard contracts are used by IBs only in current accounts whereby depositors provide cash to IBs. The provision of cash on the asset side of IBs' balance sheet is a recent practice which seeks to meet their customers' needs and demands for cash. PF products take various structures depending on market conditions and providers but, the objective behind it remains the same: cash provision. There are various reasons presented as justifications for a genuine need for cash and PF needs. But some IBs are catering for these needs under the Service Ijarah model, a structure that allows provision of financing for services. Abozaid (2010b) argues that if you want to acquire what cannot be possessed such as education, medical facilities and travel, IF can provide financing for these through what is known as 'Murabahah for services', whereby the IB buys the service for itself and then sells them to you. IBs working on this concept distance themselves away from suspicions of cash PF and financing for purposes that cannot be executed with other than cash PF is curtailed down by a large extent eliminating the need for such harmful and suspicious practices.

It is acknowledged that there are some financing needs which cannot be accommodated under the Murabahah contract or classical IF contracts, and innovation and engineering modern Shari'ah-compliant products become essential. The complacent behavior of IBs of resorting to Tawarruq and Tawarruq-based structures for any financing not practicable under Murabahah contracts or its similar is detrimental to the industry. Many bad contracts (which often are Tawarruq-based structures with different terms) are driving good and genuinely Shari'ah-

compliant contracts out of the market.² In fact, the acceptance of Tawarruq instruments is blocking the way for other Shari'ah-compliant ways of achieving the desirable objective. This paper is an attempt to rethink on the issue and research for alternative PF solutions that have no Shari'ah issues. It is henceforth divided into two sections and a conclusion. Section One presents a literature review of IPF. PF is conceptualized from an Islamic finance perspective and the purpose for which IPF is provided for retail customers is analyzed. In Section Two, three profit-based alternative instruments that avoid PF are discussed. It reviews the Service Ijarah PF model and expands on its use and application to encompass a broader range of services, refines the existing Murabahah instrument to incorporate financing of services through Murabahah/Service Ijarah line-of-credit with Wakalah and explores Murabahah Islamic credit card as a potential Shari'ah compliant alternative in PF. The conclusion summarizes the paper.

SECTION ONE

Tradition of Islamic Personal Finance

Literature Review

The concept of PF in the practice of IBs refers to “*providing cash to individuals, corporations and government*” (Kahf, 2015). In this study, the term PF is used in the same context and meant to refer to responding to cash provision or simply financing cash.

Amin et al. (2011) argue that two main motives relate to Islamic financing: first, the purpose of channeling resources from surplus units to deficit producing or consuming units; and two, according to Khir et al. (2008), to satisfy human needs of growing one's wealth. IBs are financial intermediaries that fulfill both functions and facilitate channeling money into productive uses that create more value and wealth. The concept of PF in Islamic banking probably did not receive much attention until the last few years, because PF in Islam has always been viewed as a benevolent contract. In fact, in contrast to conventional loans that are provided on interest, the loan/Qard contract in Shari'ah is treated as a contributory or charitable contract (Aqd Tabarru') or non-commutative contract (Aqd Ghair Mu'awadah) on which no increment can be charged to the borrower by the lender.

² Al Suwailem (2013) argues that while development and contribution to real economic activity is a priority in IBs' objectives through partnership contracts, Istisnah, Ijarah and the like with real trade-offs, these goals have dropped after the emergence of organized Tawarruq, replaced by “more realistic” goals and limited to only make a profit by offering present cash for an increase without any impact on goods or real activity and no additional value generated for the economy.

Many researchers investigated the general or specific behavioral intentions towards IFPs as well as different factors impacting customers' perceptions of Islamic banking products or facilities. However, few studies were found on IPF and IPF instruments such as al Rahnu and organized Salam.

Two papers close to this research on IPF were found: Abozaid (2010b) and Yusoff et al. (2016). The chapters on 'Loan & Other Contributory Contracts' and 'Contracts for Personal Finance' from the 'Islamic Finance Contracts' Book by Kahf (2015) are highly relevant to this study. Other qualitative studies were also undertaken on IPF instruments: Najeeb and Lahsasna (2013), Ali (2015) and Farooq and Ghattis (2015).

Abozaid's (2010b) short article on "Personal Finance by Tawarruq and Organized Salam" in Arabic critically analyzed the issue of PF in IBs through Tawarruq and organized Salam contracts. This short article argued that cash PF cannot be a source of earnings for IBs as it violates the very objective of the prohibition of Riba. PF by IBs emerged in an attempt to mimic conventional banking products and this type of financing does not conform to the known contracts of sale of goods and usufructs such as Murabahah, Ijarah, Istisnah and others. But, as long as customers need financing for goods, usufructs and services, IBs can finance them through well-known Islamic contracts.

After describing the banking operation of Tawarruq and organized Salam transactions, Abozaid discussed how such transactions seek to fulfill the form and technicalities but in substance, amount to financing cash and earning Riba. Abozaid argued that, in practice, sale contracts executed in Tawarruq and Salam are implemented on paper only without any factual effect on goods/commodities or their movement from their places and goods sold on paper are not valid. All parties, whether the IB, the customer or the broker, know that the commodity is introduced in the process for the sole purpose of giving out money from the bank to the client and returning it to it with increase. Although some parties may claim otherwise, the process flow of the overall transaction is such that it facilitates the process of earning returns on cash financing and all parties are aware of it since inception of the contract. The author concluded that IF cannot fulfill cash PF for individuals or institutions because the only correct way for it is through Qard. In his book 'Islamic Finance Contracts', Kahf examined the nature of contributory contracts (loan, gift and Waqf) and in a chapter dedicated to 'Contracts for Personal Finance', Kahf discussed the issue of PF and emphasized that personal loans are benevolent contracts which financial institutions do not offer. He critically analyzed different perspectives pertaining to the need for cash financing, whether on individual, business and corporation or government basis, and concluded that there are no genuine needs for cash particularly for personal loans. Kahf

advocated that the array of IF contracts is sufficient enough to cater for the finance needs of individuals, businesses and governments. He analyzed and debated the current market instruments used by IBs to provide cash: Bay al 'Inah, al Rahn, local and international Tawarruq, Salam PF and Commodity Murabahah. Kahf concluded that these market practices are not Shari'ah compliant.

Yusoff et al.'s (2016) study on "Islamic Personal Financing Instruments in the Malaysian Banking Industries: Issues and Alternatives" reviewed and analyzed the application of IPF instruments in the Malaysian Islamic banking industry. The paper concluded that IPF instruments such as Bay al 'Inah and organized Tawarruq practiced in Malaysia contain unlawful elements that violate Islamic law and its objectives. The paper discussed Bay al 'Inah as an IPF instrument by examining the legality of Bay al 'Inah from the Shari'ah perspective and deliberating the issue of legal device. The authors observed that although some recognized contemporary religious authorities in Shari'ah (OIC Islamic Fiqh Academy and AAOIFI) have prohibited Bay al 'Inah, Malaysian authorities (Shari'ah Advisory Council of Bank Negara Malaysia and the Securities Commission) still support its permissibility. They also discussed Tawarruq and its Shari'ah related issues and affirmed that some schools do not recognize the term Tawarruq as it falls under Bay al 'Inah. However, the reasons provided by Yusoff et al. for the illegitimacy of Tawarruq are insufficient and the solutions proposed to make the Tawarruq model Shari'ah-compliant are insignificant because the sale and possession are not loaded with their own purposive meaning and the commodities are not intended for their own as mentioned by the Makkah Fiqh Academy in its 19th Session in 2007.³

Moreover, Yusoff et al. (2016) examined the Rahn-based Qard IPF instrument where IBs provide Qard against charging a fee for safekeeping Rahn. They opine that Islamic pawn broking is highly controversial because it contains the element of Riba in its modus operandi which becomes worse when the fee is linked to the qard amount. They argued that there are no valid evidences from authentic Shari'ah sources which can invalidate the Rahn safekeeping fee and that the element of similarity on its own cannot invalidate the instrument. However, looking at the whole structure, it becomes clear that Rahn is included in the structure only as a device to make it permissible to charge fees. Two conditions were proposed to make the Rahn PF structure permissible: the storage fee should not reflect the amount of Qard or pledge item

³ Resolutions of Islamic Fiqh Council of the Muslim World League, 19th Session Makkah al Mukarramah (November, 2007) - Resolution IV: Regarding Commodity Murabahah Used Instead of Interest-Earning Deposits. *This transaction is exactly like al 'Inah (which is forbidden) in Shari'ah in that the commodity being sold is not intended for its own self. It therefore has same ruling.* أن هذه المعاملة مماثلة لمسألة العينة المحرمة شرعاً، من جهة كون السلعة المباعة ليست مقصودة لذاتها، فتأخذ حكمها.

value, and, the storage fee should not be seen as gaining benefit from the Qard because the pledger is responsible for bearing any cost related to the pledge item. If practiced this way, al Rahnu may be used but it becomes no more attractive to IBs since they cannot earn on it.

The authors also examined the Qard with service charge model of PF. The issue with this model is that it is purely benevolent and IBs cannot profit from Qard financing. Yusoff et al. (2016) claimed that in Iran, expenses incurred are to be calculated on the basis of directives issued by Bank Markazi Jomhuri Islami Iran and collected from the borrower, whereas in the Pakistan practice, the maximum service charges permissible to each bank are determined by the State bank from time to time. It is accepted generally that IBs are only allowed to charge customers for actual costs incurred. However, most IFIs are not keen to provide PF on Qard basis because the Qard contract by its nature treats any additional money or benefit in excess of the principal amount as interest, and IBs' main concern in providing finance is earning returns.

Yusoff et al. (2016) subsequently discussed and proposed some new alternative instruments for IPF: Hibah-Sale based financing, Hibah for a Reward Financing, and Salam PF. However, these instruments are highly controversial and involve Shari'ah issues. The Hibah-Sale based financing as per the modus operandi presented by Yusoff et al. (2016) would not be Shari'ah-compliant since it amounts to a legal device to obtain cash. The Hibah for a reward financing is a structure through which a bank as a creditor provides cash as Hibah to a customer in exchange for a certain valuable item to be delivered to the bank in deferred payment. Not much was discussed about this model, but it appears to be nothing but a legal trick. The Salam PF model is presented in a simple form and the authors argued that it is a real sale contract that does not entail illegitimate prior agreement and does not consist of Shari'ah prohibitions as apparent in Bay al 'Inah and organized Tawarruq. Salam contract is a sale contract that provides upfront cash to the customer against an item or commodity that will be delivered on a definite future date. Although Salam contract provides full cash payment to the customer, it can be used only if the transaction is real and the contract is used to provide financing for a commodity that is intended for its own sake. The issue with Salam PF product lies in its application because the transaction lacks realism by structuring and adding conditions that guarantee the bank's sale of the goods at profit through commitments imposed on the recipient of cash which makes the goods not intended for themselves.

Najeeb and Lahsasna's (2013) study on "Qard Hasan: Its Shari'ah Rules and Applications in Islamic Finance" analyzed the Qard (loan) contract from Shari'ah perspective and deliberated its contemporary application in IF. They examined Qard structures in different IFPs (deposit products, charge cards/credit cards, bank's financing products, microfinancing products,

government securities/private debt securities and Takaful) and discussed the possible risks of non-Shari'ah compliance in these structures. The authors summarized nine major conditions of Qard contracts, the main ones being: a non-commutative contract that provides divine rewards as opposed to material rewards; the borrower has full right of ownership and disposition over the item borrowed; the borrower assumes full responsibility for the item and is obliged to return its equivalent in full; any returns generated from use of the loaned items are legitimate for the borrower; the lender is not entitled to any kind of predetermined benefit from the borrower as a result of the loan; and the borrower may pay the lender any excess above the principal out of his free will and without any precondition, established custom or understanding or demand by the lender. Najeeb and Lahsasna concluded that profiting from Qard contracts is a sensitive issue and that many institutions are possibly profiting from such contracts by compromising on Shari'ah and using service charges and customary giving of Hibah.

Najeeb and Lahsasna (2013) also affirmed that in the Islamic Republic of Iran, Qard financing is commonly practiced as follows: banks (mostly state-owned) in collaboration with local mosques, religious organizations and sometimes with professional associations provide interest-free loans to small consumers and producers. The Qard fund comprises contributions from financially well-off society members who are guaranteed their capital by banks and are free to withdraw their funds at any time and banks only charge administrative costs from qard recipients. Although Qard-based Islamic microfinancing is not practiced by most IBs, it is widely operationalized by the informal sector in Muslim countries such as Akhuwat foundation in Pakistan, and they opined that Qard micro-financing is a vital financial tool for alleviating hardships and income redistribution among the needy segments in society.

Ali's (2015) research on "Modern Applications of Hibah In The Light Of Shari'ah Objectives of Gift and Donation Contracts (al Tabarru'at)" presented the Shari'ah objectives of Tabarru'at and Hibah and examined the applications of Hibah as a "supporting Shari'ah concept" in four contracts: Interbank Mudarabah Investment Contract, al Ijarah thumma al Bay Contract, Wadi'ah Contract and Qard Contract. He analyzed whether these modern applications of Hibah realize the maqasid of Tabarru'at and Hibah and investigated instances in which Hibah is utilized to serve purposes which are negative in nature such as Riba and bribery (rashwah). He recommended terms and conditions when combining Hibah with other transactions and contracts that will help overcome the violation of the original maqasid of Hibah and Tabarru'at. The relevant part is the discussion on Qard contracts and tying Hibah with Qard. Ali mentioned that the Shari'ah Advisory Council of Bank Negara Malaysia in its 55th meeting in 2005 resolved that the practice of giving Hibah in Qard contract is permissible. He argued that

although application of Hibah by IBs serve the first specific Shari'ah objective of Tabaru'at mentioned by Ibn Ashur (proliferating donations and charitable acts)⁴ and increases benefit for people, tying Hibah with other contracts puts a limit to proliferation of gifts and charitable acts. According to Ali, in practice, IFIs use Hibah only as a “supporting concept” or only in contracts where there is a benefit for the IFIs and the essence of the contributory contract might actually be violated.

This argument may be extended to new applications of Qard and PF contracts in contemporary Islamic banking practices where financial products are viewed only as a tool for generating profits. Ali affirmed that current market practices of giving Hibah to depositors as a token of appreciation or the borrower giving Hibah at his own discretion to the lender can serve negative purposes and are being misused as an alternative to interest on amount lent or borrowed. Even when Hibah is unknown but is given regularly such that it becomes an expected institutionalized practice, the substance and nature of the transaction is diluted and becomes Riba.

The conceptual research paper by Farooq and Ghattis (2015) on “Qard Hasan, Credit Cards and Islamic Financial Product Structuring: Some Qur'anic and Practical Considerations” investigated the concept of Qard from Qur'an and Hadith and its practical implications for Islamic product structuring. They concluded that some contemporary market practices are not in line with the traditional understanding of Qard especially in designing Qard-based banking products such as current account deposits and Islamic credit cards. The practice of Qard-based products especially in Malaysia is highly controversial because they are benefiting from service charges which in effect amount to interest.

Theorization and Conceptualization of Personal Finance

According to Abozaid (2010b), the customer in cash financing wants cash for some personal needs and does not require any particular commodity such as a car or a house or any other assets that can be financed through the known commodity contracts. IBs have invented different ways of financing cash to individuals but this type of financing remains impermissible in Shari'ah because the objective is to provide cash to customers and earn returns and it is unacceptable in Shari'ah to give money and earn more on it in a guaranteed manner. He discussed that if one wants to earn by way of giving money to another, there is no other option

⁴ This objective was mentioned as a characteristic of contributory contracts and a gift is given without necessarily intending donation or charity.

except to give this money to others on known Shari'ah compliant investment contracts namely Mudarabah, Musharakah and Wakalah bil Istithmar. The loan contract in Shari'ah is a benevolent and contributory contract meaning that earning returns on Qard is not permissible and any additional benefit bestowed on the lender as a pre-condition is deemed Riba. It is possible for IBs to finance goods and services including education, medical and travel as long as they acquire it first and then sell it to the customer.

Contributory contracts are used seldom in IF industry because they do not generate returns to the finance provider and the IF industry is one designed with the objective of earning returns and creating new wealth (Kahf, 2015). Kahf defined the loan contract as “*a benevolent giving of a standardized expendable property to another person with the condition of repayment of its replacement*” and enumerated five characteristics: one, it is an act of benevolence; two, it transfers ownership when the item is handed over implying the borrower's full authority on the item; three, it transforms the lender's property from physical nature to abstract nature; four, the object must be standardized, expendable and consumable and five, the wealth of either party remains unchanged. He discussed the effect of loan transactions and argued that the opportunity cost in giving a loan “*is not a lost cost*” as claimed in conventional economics but rather is “*merely a lost chance to make profit or loss or a degree of freedom of action*”. The Shari'ah makes provision of loans an act of benevolence through which Muslims earn reward from Allah and takes the loan contract away from being a business transaction to the scope of personal relationships and executing them based on humanitarian or convenience reasons. He also expounded lengthily on the components of a loan contract (lending formula, two parties and object of the loan) and the rules governing it as well as discussed its application in Islamic banking. Kahf affirmed that some IBs reschedule and consolidate debts or grant new loan facilities in special cases for businesses/customers struggling with liquidity problems without any charge or returns which is in fact a benevolent action with good spilling effects on the economy.

Cash financing remains a Qard and contributory contract on which returns cannot be earned and justified. IF clearly distinguishes between provision of finance for real goods, services and projects and cash financing; any increment generated on cash financing is interest. It is acknowledged that, in some cases, there are genuine needs to seek cash financing. In his book on ‘Islamic Finance Contracts’, Kahf categorized the entities which may require PF into four groups:

1. Individuals for consumption purposes;
2. Businesses and corporations for bridge funding of their profit making purposes;

3. IBs and other IFIs for either investment or liquidity purposes; and
4. Governments for matching the times of revenues and expenditures, budget balancing, investment projects and governmental branches and departments for infrastructure and projects.

In contrast to profit-making corporations and governments, individuals in many instances can find benevolent lenders from their families, friends and relatives or even charitable organizations if they have genuine cash needs. But the contemporary society setting has promoted a culture of consumerism, causing a shift from needing cash out of necessity to needing cash for other-than-necessities and as a result of which and several other reasons, people turn to financial intermediaries for their financing needs.

Individual cash needs may arise because of either:

- (a) A customer has already executed a transaction for which a debt is due, and he/she wants to transfer it to the IB or convert an interest-based loan to an Islamic one;
- (b) For emergency needs;
- (c) For convenience purposes and nature of transactions (where only cash payment is accepted); and
- (d) The customer does not want to disclose the purpose of financing.

It may be argued that individuals do not have genuine needs for PF as most financing needs can be encompassed through the famous Shari'ah compliant contracts.

For transactions under category (a), IBs cannot refinance transactions and if a customer wants to shift to IF, he/she should finish the interest-based loan and start anew with the IB. According to Kahf (2015), calling on IBs to provide cash financing to pay bills for past services is similar to calling on IBs to give loans to pay for debts arising from goods already purchased. Converting an interest-based transaction to an Islamic one with an increment is similar to a Murabahah transaction in which goods were already purchased by the customer and payment is only effected by the IB to the supplier and the Murabahah debt becomes due; refinancing this debt for another maturity is not permissible in Shari'ah. Kahf argues that it cannot be ruled that cash financing is allowed in IF because it is necessary for those who want to repent from interest-based transactions. Debt transfer can occur but only at face value, i.e., the amount owed by the customer to the conventional bank can be paid off and the customer will be liable to pay the same amount to the new creditor. However, this benevolent action cannot be forced onto IBs that are profit-making institutions. These issues should rather be tackled by social institutions such as Zakah and charity for the needy and Awqaf for others. Individual PF is always based on urgent cash needs and if IBs provide them in exchange for a return or fee,

irrespective of whether the amount is significant or not, it may carry an ethical and moral concern of customer exploitation.

For category (b), this can take the form of profit-based Shari'ah compliant PF instruments and catered for by providing a Wakalah in advance to customers to execute transactions on behalf of IBs. For category (c), customers can use their own funds or IBs can provide free-financing to some category of customers provided payment is made within a short period.⁵ As for category (d), IBs should not provide financing for transactions whose purposes are not disclosed.

Demand for individual cash financing also comes from mismanagement. As a result of over-consumption and many easy credit facilities, individuals purchase goods and services and use them and when bills are due that he/she is unable to pay, they approach a bank for PF. These bills are already debts on the buyer (customer) and cannot be financed by IBs. This transaction and its similar (converting interest-based loan to Islamic loan, debts refinancing) are disconnected from the real market of goods and services. Kahf argues that they do not reflect real normal transactions in any society and such transactions cannot be a mainstream financing process for IFIs.

⁵ Several conventional and Islamic credit cards do not charge interest/profits at all because cardholders pay their outstanding bills in full within a given time period (e.g. American Express cards - Platinum Card, Premier Rewards Gold Card, Gold Card and American Express Green Card; Al Rajhi Bank (Saudi Arabia) Qassit Credit Card allows cardholders to shop and withdraw cash and make flexible payments of only 10% or SAR300, whichever is greater, without any additional cost or commissions).

SECTION TWO

Profit-Based Shari'ah-Compliant Alternative Instruments That Avoid Personal Finance

2.1 Service Ijarah

Service Ijarah can be defined as: *a finance contract in which the IB purchases a service or usufruct from its provider and sells it to a customer on credit at cost plus a markup.*

2.1.1 Shari'ah Base

The Service Ijarah concept, although known and widely practiced across Muslim history, has only recently been incorporated as a financial instrument in Islamic banking and its use remains until now very limited. Few IBs use this structure in their asset mix and those few that use it for financing services limit themselves mostly to medical expenses, travel and tourism, education, wedding and related expenses.

In Fiqh, the term 'Ijarah' is used generally to refer to either of two different types: one, employment of the services of a natural person against payment for his hired services (known as Ijarah al Ashkhas); and two, leasing or using the usufructs of assets and properties against payment of rent (Ijarah al 'Ain or Ijarah al Ashya') (Mansoori, 2005). Kahf (2015) defined Ijarah as "*a contract between two parties, whereby one party sells to the other a well-defined usufruct or service for a given price*" and distinguished between usufruct and service. He deliberated that usufruct relates to use of an asset, machine or land whereas services involve an element of human labour either alone or with asset/machine. He argues that hiring a person to do a job is Ijarah of human services but hiring a machine with its operator makes the transaction as an Ijarah of a service (Kahf, 1995).

The Service Ijarah being discussed here relates to both usufructs and services as defined by Kahf (2015), i.e., buying a usufruct of an asset, hiring a person with assets or machines together and/or employing someone for his/her services against wages or salaries (Ujrah)⁶. This distinction was accepted by AAOIFI in its Shari'ah Standard No. 9 on Ijarah and Ijarah Muntahia Bittamleek (Issued in 2002) that states that the Ijarah contract intended in the Standard is lease of tangible properties or provision of services by institutions (which have

⁶ The Qur'an and Sayings of the Prophet, pbuh, have several examples to prove that it was a common practice to employ the services of others against wages. E.g., "One of the women said: O my father, hire him. Indeed, the best one you can hire is the strong and trustworthy." (Quran 28:26) and Narrated from Abdullah bin Umar that the Messenger of Allah, pbuh, said: "Give the worker his wage before his sweat dries." (Ibn Majah, Hadith No. 2537). In addition, throughout history, hiring someone for his/her services and paying for the services received has always been commonly practiced by all civilizations until today. In fact, this is the usual classical Fiqh definition of services that limits it to man-hours (Kahf, 2015). Service Ijarah is therefore not a new concept or innovation, but the innovative part lies in its adoption and implementation within a financial intermediary framework.

assets and people together) and in its Shari'ah Standard No. 34 on 'Hiring of Persons' issued in 2008. The latter distinguishes between the different forms of services: hiring the services of a private employee (Ajeer Khas), hiring the services of a shared employee (Ajeer Mushtarak) (AAOIFI, 2010). AAOIFI (2010) defines the term 'Hiring of persons' as: *"a contract through which a service/work of a natural or legal person is obtained against a specific amount of pay. The service thus obtained could be present or a future one but always needs to be specified through detailed terms of reference such as educational, health and consultancy services."* AAOIFI Standard 9 stipulates the following regarding the services of institutions:

3/5 – An Ijarah contract may be executed for a well-described usufruct/service provided it is attainable to the lessor/service provider...

The following AAOIFI Shari'ah Standard No. 34 (2010) clauses govern hiring out services:

5/1/6 – Hiring can be for performing a future service that is well described and specified to the extent which leaves no room for ambiguity and dispute. In that case, the service provider does not have to own the required service before signing the contract. Consequently, an agreement may be reached for performing the service at a specific time in the future, with due consideration to the ability of the service provider to own the service and become able to deliver it on time, by himself or through someone else...

Furthermore, in Standard No. 17 on Investment Sukuk (Issued in 2003), AAOIFI differentiated between usufructs and services of existing assets or institutions and usufructs/services of described future assets/institutions. The differentiation between services of existing institutions and institutions to be established, and usufructs of existing assets and usufructs of assets to be built has an implication. In the case of existing assets and service providers, the usufructs and services can be traded by their owners. However, usufructs and services of assets/service providers to be built or established can be bought but cannot be sold to a second party until the assets/service providers exist.

Mansoori (2005) discussed the conditions which should be observed in Service Ijarah contracts, the most important of them are:

1. *"In the contract of hiring services, the work required to be performed should be specifically determined such as the carriage of goods or building house, etc."*
2. *"Performance or work should not be prohibited in the Shari'ah."* He deliberated that it is prohibited to hire the services of people to perform Haraam activities or engage in acts of sin or disobedience such as employing a magician to teach magic, or hiring out a person to kill another or torture him.

3. *“Service required to be rendered should not be a mandatory duty. It is therefore, not allowed for a person to hire a person to pray or to perform hajj because they are mandatory duties so the worker is not entitled to wages if he is hired for any of them.”*

Kahf (2015) also added a limitation on hiring the services of people, i.e., people cannot be employed for their services unless with full consideration to human dignity such as prohibition of hiring for begging or prostitution or use as human shields in war. This concept encompasses services rendered for all Shari’ah prohibited items or activities as well as moral and ethical ones, e.g., child labour, exploitation of workers and denial of their rights, etc.

Ijarah of a service is widely practiced in contemporary life, and may involve more than one party particularly if the service provider and the seller are different entities, e.g., there are many travel agents that work in collaboration with airline companies and tour operators and sell travel and tourism packages, but they are not the original service provider. This same principle can be applied by a financial intermediary to enable provision of financing for these services.

The Service Ijarah financing facility fulfills the realism principle. In IF, the principle of realism means that *“all financing contracts must be founded on real, in contrast to presumed or deemed exchanges of things or services”* (Kahf, 2006b). Realism means dealing with facts and real-life events, not mere abstraction or hypothetical situations and the naked presence of an underlining asset in contracts and transactions is insufficient to render them permissible IF instruments. According to Kahf’s criteria to pass the realism test, a service-based financial product should fulfill two conditions: the service or usufruct by itself should be of value so that its provision will be value-creating and the contractual transaction should be genuine and true, i.e., intended to deliver the intended service. In Service Ijarah financing, the IB, by buying and selling a service or usufruct is entitled to a return which is the price differential of utility or service similar to Murabahah. This is why the IB must own the right to the service/usufruct before selling it at a higher deferred price, or should be in capacity to ensure delivery if the service/usufruct will be provided by an institution/asset that will be established as under Ijarah Mawsufah bil Thimmah (Ijarah on description). Service Ijarah financing is value-adding because it always requires ownership of valued services/usufructs as a fundamental condition of entitlement to a return.

2.1.2 Service Ijarah in Islamic Banking Practice

Service Ijarah within the banking framework comprises three parties (the customer, the IB and the service provider) and the IB acts as a financial intermediary that provides financing for services rendered by the service provider. In other words, the IB will buy the right to the service

from the service provider upon request and promise from its customer and thereafter, sell this purchased right to the services to the customer.

Ajman Bank (UAE) defines Service Ijarah as: *“a transaction where the Bank will purchase the service as requested by the customer and allow the customer, the right to use it and the benefits of the service for a predetermined period of time and in return the customer will pay a pre-determined agreed rent.”* (Ajman Bank, 2017). Alizz Islamic Bank discloses that its Service Ijarah PF product is based on the IF principle of Ijarah for services in which: *“the Bank will have ‘agreements’ with various service providers, whereby the Bank leases the services required by the customer directly from the provider and sub-leases it to the customer on the basis of Ijarah”* (Alizz Islamic Bank, 2017).

In Alizz Islamic Bank’s Service Ijarah Fatwa Certificate (Alizz IB Fatwa, 2017), the following steps are specified:

1. Application and submission of invoice

The Applicant submits an application for financing a specific service to Alizz IB according to the offer price by the service provider to the Bank, specifying the details of the service, its price and any other conditions.

2. Promise to sub-lease

The Applicant promises the Bank to sub-lease from it after the Bank leases the service for him/her from the service provider.

3. Service Ijarah contract between Bank and service provider

The Bank leases the service from the service provider under the Service Ijarah contract.

4. Service Ijarah contract between Bank and customer

The Bank sub-leases the services to the customer under the Service Ijarah contract which determines the fees, method of payment, length of service and all other terms and conditions. The services that will be provided by the Bank are diverse and may include, education, medical and other Shari’ah-permitted services.

Abu Dhabi Commercial Bank (Islamic Banking, UAE) and Al Hilal Bank (UAE) also offer Service Ijarah products. Few other IBs provide Service Ijarah (Al Salam Bank – Sudan; Dubai Islamic Bank and Emirates Islamic Bank – UAE; Jaiz Bank PLC – Nigeria; Maisarah Islamic Banking Services and Sohar Islamic – Oman) but they did not disclose their product process flow and documentations.

Islamic International Arab Bank (IIAB - Jordan) provides financing for education and travel expenses based on Murabahah, namely, ‘Education Service Murabahah Finance’ and ‘Travel

Service Murabahah Finance'⁷. Although the transaction is similar to a Murabahah transaction, i.e., buying from the supplier on prior promise from the customer and thereafter selling it to the customer at a profit margin, it is a service that is bought and sold. Murabahah contracts apply to sale of goods and commodities or may also apply to a basket where tangible goods exceed intangible ones. If the item being traded is purely a service, the relevant Shari'ah concept would be Service Ijarah.

2.1.3 Refining the Service Ijarah Instrument

Incorporating the Service Ijarah product within the IB framework is comparable to Murabahah to the purchase orderer. The IB will only buy the rights to the service or hire the service based on a prior promise to purchase/hire the same from the IB by the customer. In fact, the IB will only act upon its customers' requests and the services and service providers will be chosen by the customers themselves. The conditions governing the Service Ijarah facility are described below.

Conditions for Service Ijarah based on prior promise to purchase/hire

1. The service to be provided should be permissible in Shari'ah, i.e., activities or services related to prohibited items (tobacco, alcohol, gambling, pornography, armaments, etc.) as well as acts of sin or disobedience (e.g., teaching witchcraft, pilgrimage to places of worship for other gods) and any moral or ethical issue that violates Shari'ah teachings (e.g., child labour) will not be financed.
2. The service required to be financed should be known and well-defined including the price, type and duration of the service and any other specifications. The service can be in terms of a specific work to be rendered, a specific period of service or of both.
3. The final user (customer) should utilize the service of the service provider as per the Shari'ah conditions agreed upon.
4. The IB cannot sell the service to the customer before it hires the service or secures the right to the service from the service provider except in the case of described standard services which can be sold and then bought from service providers as mentioned in the following point.
5. The IB can sell a standard service, i.e. a well-defined and determined service that will be made available at a specific time in future, to the customer without owning the right

⁷ Education Service Murabahah Finance: "Finance for education service is a finance that ... gives you the opportunity to pay university tuitions through Murabahah by buying these services from the bank after adding a known and agreed profit by the bank." and Travel Service Murabahah Finance: "This finance allows you to travel with your family based on the principle of ownership and selling it to you through Murabahah Program." (IIAB, 2011)

to the service now on condition that it will be able to hire the service and perform the contract as per pre-agreed terms and conditions by itself or through another party.

6. If the service providing institution is to be established and does not exist at the time of contract, the second sale contract (IB selling to the customer) cannot be effected until the institution exists, i.e., any one party may buy the service/usufruct but cannot sell it.⁸
7. The IB can appoint the customer as its agent to act for and on its behalf to take delivery of the service.
8. There should be no prior arrangement to benefit from the service by the customer before the sale contract is executed between the IB and the service provider so that the transaction does not simply become a financing for past services.

2.1.4 Structure, Process Flow and Transaction Dynamics

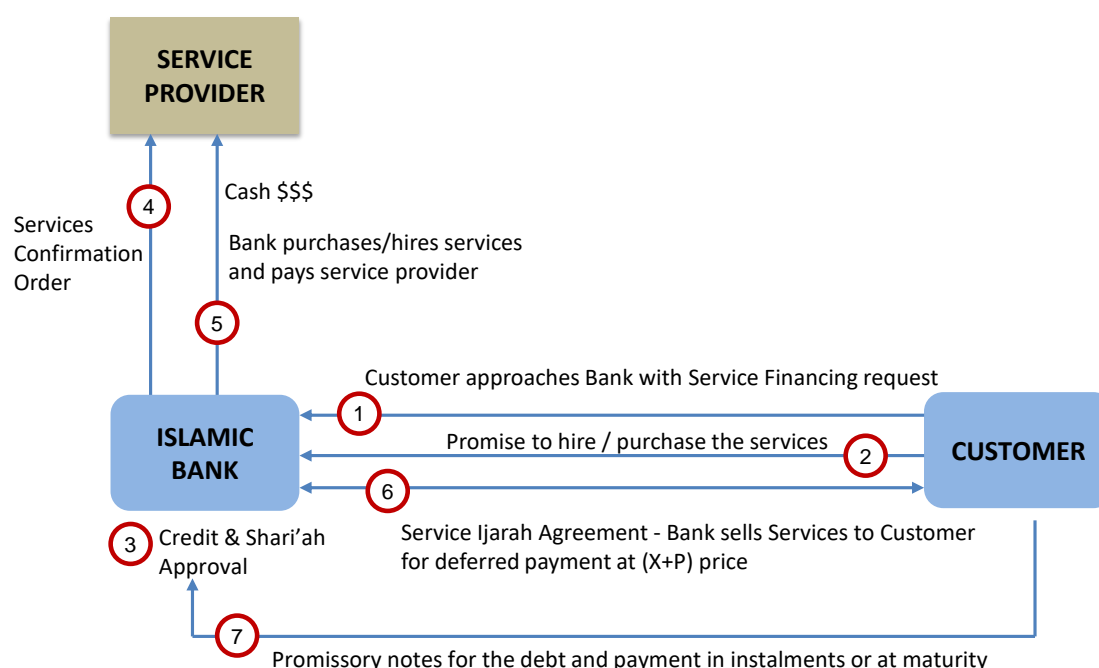


Figure 1: Service Ijarah (Source: Authors)

The steps and process flow of Service Ijarah, as illustrated in Figure 1, are herewith detailed:

1. Customer approaches the Bank with a request for Service Ijarah facility.
2. The Customer submits an application form and promises to purchase/hire the services. He/she, in most cases, will have already found a service provider of his/her own choice and the service to be procured before approaching the Bank. He/she will provide a quotation/proforma invoice containing details, specifications and descriptions of the

⁸ The OIC Fiqh Academy, in its 21st session held in Riyadh in 2013 - Resolution No. 196 (21/2) resolved that in leasing of described future usufructs/benefits, which the lessee will obtain in future, rent does not become due until the lessee is given full access to such benefits. If the lessee is not enabled to obtain the benefits during the period agreed upon, no rent will become due. (OIC Fiqh Academy, 2013)

service in the name of Bank or on behalf of the Bank. He/she negotiates with the Bank the terms of finance (including profit margin and payment facilities) and requests the Bank to finance the services and promises to purchase/hire the services from the Bank once these are purchased by the Bank from the service provider by way of Service Ijarah.

3. The Customer's Application will be reviewed by the Credit department and seek Credit and Shari'ah approval.
4. The Bank verifies the genuineness of the quotation/proforma invoice for the transaction and issues a services confirmation order addressed to the service provider whereby the Bank offers to purchase the services from the service provider as per quotation/proforma invoice (the confirmation for purchasing the service from the service provider can also be done through email, fax, SMS or phone call and followed by a signed document).
5. Upon the service provider's acceptance, the service provider issues the invoice in the Bank's name or the Customer's name on behalf of the Bank (if the customer is acting as agent for the Bank). The Bank purchases/hires the service from the service provider as per quotation/proforma invoice and effects payment directly to the service provider.
6. Once the Bank has purchased the services from the service provider, it executes the Service Ijarah Agreement between itself and the customer whereby it sells/hires out the service to him in consideration of the service fee payments or contract price (Ujrah, i.e., cost plus profit) payable by the customer as per the payment schedule agreed upon.
7. The Customer uses the service and makes payment for the debt due according to the pre-agreed payment schedule.

In case where the customer is appointed as an agent (Wakeel), the Bank will sign an Agency (Wakalah) Agreement with him/her for taking delivery on behalf of the Bank as its agent. The Bank will thereafter effect payment directly to the service provider.

Documents required for the Service Ijarah facility

- (a) Application Form (promise to purchase/hire) – to be issued by the Customer in favor of the Bank. This should include a promise to buy same from the IB and should be accompanied by the offer or proforma from the service provider.
- (b) Offer Letter to be issued by the Bank to the Customer describing the main terms and conditions of the facility such as facility amount, tenor, services procured, profit margin and Bank's selling price, payment period and amount, collateral and guarantees and any other terms and conditions and its acceptance by the Customer.

- (c) Services Purchase Order (from the Bank) to service provider.
- (d) Acceptance from service provider.
- (e) Agency (Wakalah) Agreement between the Bank and the Customer.
- (f) Service Ijarah Agreement between the Bank and the Customer.
- (g) Statement of receipt of the service by the Customer to the Bank.

2.1.5 Expanding the Service Ijarah Facility

Some IBs are providing financing for services using the Service Ijarah model but it is presently restricted to cover expenses only for education, travel & tourism, rent, medical, wedding & related expenses. The financing needs served by this model can be further expanded to include provision of all kinds of services as long as these are Shari'ah-compliant such as transportation services, professional and consultation services, conference and events organization, vaccination service for poultry and similar, rent for house/apartment/office, amongst others.

These services should be well-defined in the contract including the length of service and types of services and this will vary depending on the nature of the service itself. For instance, for education financing for a degree program in a particular faculty, the IB will purchase the education services on promise to purchase/hire from the customer. The contract will describe a definite number of credit hours with definite period, program of study, etc. The IB will purchase the number of credit hours required for the study and sell them to the customer who will use them himself or his beneficiary (e.g., his/her child). In the case of events organization, the IB will purchase/hire these services (which may include rent of fully-furnished hall, catering services, etc.) for the time period requested and thereafter sell/lease them to the customer. Similarly, breeders can be financed for vaccination or veterinary services for their animals, i.e., the IB will purchase the right to these services from the service provider and sell them to the breeders.

2.1.6 Advantages & Disadvantages of Service Ijarah

The Service Ijarah mode has its advantages as well as some drawbacks as a model of PF.

Advantages:

- (a) Undergoes moral and Shari'ah screening

Only services that are Shari'ah compliant can be financed and since the IB needs to acquire/hire the services first from the service provider before selling/leasing to the customer, it will ensure that the moral and Shari'ah screening criteria are fulfilled.

- (b) Finance is linked to exchange and real market for services

Service Ijarah financing is linked to the real market for services in contrast to other products such as Bay al 'Inah and Tawarruq. It signals producers that there is a demand for their services from an end user and not simply as a speculation tool.

(c) Fulfills the realism principle

The services financed are demanded by the customer for his/her own use and do not serve merely as a vehicle to make the transaction fulfill the technicalities of a Shari'ah compliant contract. The customer since inception approaches the IB with a genuine intention to benefit from these services. The Service Ijarah product thus fulfills the realism principle.

(d) A profit-based Shari'ah-compliant alternative

Service Ijarah is a profit-based mode of IF for services. IBs through this mode do not give cash to the customer but pays for the services to its service provider and sells/leases the right to the customer against a price to be paid in future. It is a flexible and attractive tool as it can accommodate financing for different kinds of services. It can generate an increment to the financier because the user benefits from using the service now for deferred payment.

Disadvantages:

Disadvantages of Service Ijarah seem similar to other IFPs although some additional points are worth mentioning. In Service Ijarah financing, IBs cannot put a lien on the purchased (financed) item as practiced in Murabahah contracts. IBs have to take other securities such as guarantees or collaterals.

A service is a factor of time and prices may change particularly those service sectors that are affected by seasonality like travel and tourism. If the banking processes of credit and Shari'ah approval are long, customers may lose the benefit of promotional offers.

Service Ijarah financing has another drawback if the service providing institution is not in existence at the time of contract or is to be built. The service/usufruct can be bought but cannot be sold to another party because it is still not in existence. Accordingly, IBs cannot execute Service Ijarah contracts for services of non-existing service providers and may then only use Wa'd but cannot realize any earning until the existence of the service provider and assurance of its ability to provide the promised service.

2.1.7 Securitization of Service Ijarah Contracts

Services or usufructs that may be financed by IBs are recognized as full-fledge properties since they represent a right to the service and can be securitized and sold in the market. However, Service Ijarah contracts in a banking context implies that the contract is executed based on a

prior promise to purchase/hire from the customer, i.e., once the service is purchased/hired from the service provider by the IB, it is immediately sold to the customer. The result is that the customer owns the right to these services and the IB only has a debt on the customer, which means that Service Ijarah certificates are similar to Murabahah certificates and the IB cannot trade Service Ijarah receivables except at face value.⁹

2.1.8 Nature of Risk

Shari'ah Risk	<ul style="list-style-type: none"> • If service to be provided is not Shari'ah compliant. • The service provider does not exist at the time of contract. • The step-wise process flows are not followed. E.g., the customer may already have purchased the services for which only a debt is due.
Legal Risk	<ul style="list-style-type: none"> • Purchasing/hiring the services before selling/leasing them to the customer may entail legal complications and requirements regarding clarity of transactions and their treatment under the law will depend upon the jurisdiction where the instrument is used. • The service to be purchased/hired or the work required to be performed will also be governed by additional laws and regulations which makes the transaction more complex e.g., in the case of an employer seeking Service Ijarah financing for payment of employee wages.
Operational & Technical Issues	<ul style="list-style-type: none"> • IBs cannot put a lien on the purchased (financed) item as practiced in Murabahah contracts. • The service purchased or work required to be performed is not as per the customer's requirements as defined in the contract. • Exposure to risk of loss of income and legal risk if the service can no longer be provided by the service provider.

⁹ It is different from the case of Service Ijarah Sukuk, such as Zamzam Tower Sukuk developed on time-sharing where the investors (owners) own the right to use/lease particular types of rooms for a period of one or two weeks depending on the type of Sukuk bought. Similarly, other types of Sukuk may be developed such as Sukuk giving Sukuk holders the right to a number of credit hours of university education (to finance construction of a university or its expansion), or right to specific types of medical facilities for a period of time, right to discounted pricing or limited free tickets for specific destinations (to finance airline companies or tour operators).

	<ul style="list-style-type: none"> • Treatment of income received/payments made by the customer if the service does not exist yet and/or the service provider is yet to be established.
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2.2 Murabahah/Service Ijarah Line-of-Credit with Wakalah

The Service Ijarah financing model does not carry the flexibility of meeting emergency needs for goods and services especially if these are immediate or short-notice financing. IBs can come up with innovative solutions such as providing Wakalah to their customers to execute transactions on their behalf. An IB can provide a line-of-credit to its customers with Wakalah assigning the customer as agent to buy goods and services for the IB, take delivery for the IB and on its behalf, and then sell to itself and take delivery of the goods and services. The Murabahah/Service Ijarah line-of-credit is a very useful tool to fulfill different financing needs particularly those of corporations, IFIs and governments.

2.2.1 Shari'ah Base

Murabahah line-of-credit is established on the same Shari'ah concept as Murabahah. The only difference is that in a Murabahah line-of-credit facility, there is an upper limit to a customer's Murabahah financing transactions which is usually in terms of a limited financing amount for a specific period of time.

2.2.2 Murabahah Line-of-Credit

Murabahah Line-of-Credit can be defined as *“a master agreement between an IB and a customer for a series of Murabahah transactions to be undertaken by the customer on Wakalah for a certain period and within a finance upper limit”*. The Murabahah/Service Ijarah Line-of-Credit with Wakalah will combine provision of goods and services under a single Master contract within a limit amount of financing and for a specific time period as agreed by the customer and the IB. This mode of financing is convenient for financing several items or working capital and enables the customer to quickly and easily repeat Murabahah/Service Ijarah for purchase of goods and services within the approved credit limit and time period.

Kahf (2015) adds that this model can be used for corporates working capital financing which includes Murabahah and Service Ijarah,¹⁰ when the laws of the land allow it and it is practical to do so for purchasing transportation services, insurance services, storage services, outsourced

¹⁰ For purchasing services, the transaction takes the form of two Service Ijarah contracts: a Service Ijarah contract between the service provider and the IB through its agent, and another Service Ijarah contract between the IB (which becomes the new owner of the services by the first contract) and the customer. The process flow and concept are the same as Murabahah but the terms used are Ijarah and wages, salaries or rent or service fee because it involves human services.

services and its similar. Financing some other services may be impractical because of legal complications such as payment of wages for employees because employment laws and contracts are associated with employee injuries and compensation, termination conditions, end-of-service allowances, etc. Murabahah-cum-Service Ijarah line-of-credit facility can be extended to individuals for purchases of goods and services and provide Wakalah to them to execute Murabahah/Service Ijarah transactions on behalf of the IB and sell to themselves.

2.2.3 Conditions for Murabahah Line-of-Credit

All conditions mentioned under the Service Ijarah instrument will apply as well as conditions governing Murabahah transactions and the following:

1. The Master Agreement determines the maximum amount of the financing facility and duration of the facility.
2. The Master Agreement sets the terms and conditions for the facility including markup, maturity date, maximum amount of each Murabahah transaction, conditions of payments, collaterals and securities, permission to agent to sell to itself as per Master Agreement conditions, types of goods and services that can be purchased, etc.
3. For each Murabahah transaction, there will be a stated maturity date and each is a stand-alone contract. The Master Agreement may contain a set of maturity periods each with different profit rates¹¹ or varying profit rates according to type or category of purchased goods, e.g., a profit rate may be charged on hardware machines, a different one on electronics, etc. The IB can also determine that different profit margins may apply at different suppliers/service providers (if they can easily be distinguished as being in specific lines of business).

¹¹ Varying the profit margin according to payment period is permissible because the customer is deriving utility from using the goods now and paying later; the longer he delays payment the more benefit he derives without paying.

2.2.4 Structure, Process Flow and Transaction Dynamics

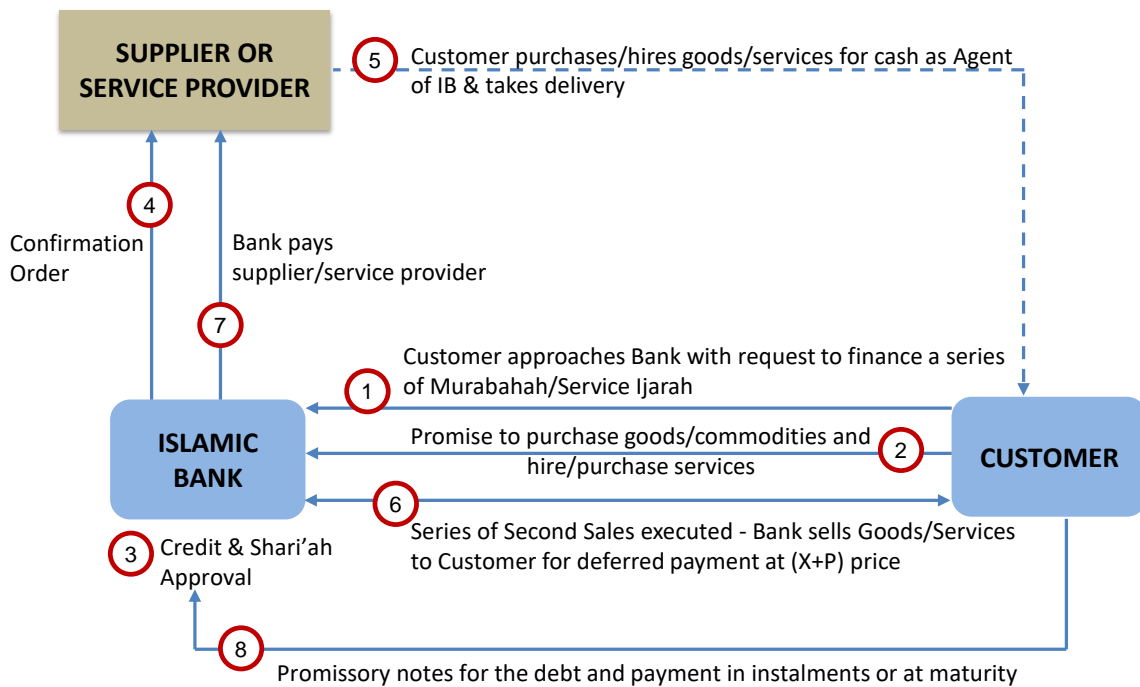


Figure 2: Murabahah Line-of-Credit (Source: Authors)

1. The Customer approaches the Bank with a request to finance a series of Murabahah transactions and they will negotiate the terms and conditions of the financing facility.
2. The request is approved by Credit and Shari'ah departments.
3. The Bank through an Agency Agreement appoints the Customer as its agent to execute transactions on its behalf.
4. The Customer purchases for cash as agent and takes delivery on behalf of the Bank.
5. The Customer performs the second sale (Murabahah contract) with itself as agent of the Bank and takes delivery of the second sale.
6. The Bank effects payment directly to the supplier.
7. The Bank may take promissory notes from the Customer or may simply debit its records.
8. The Customer will make payment on maturity or as per agreement.

2.2.5 Advantages and Disadvantages of Murabahah Line-of-Credit

It is useful to cater for purchases of goods and services which occur at different times and better suits the needs of corporations and governments. It is easier when customers have different purchase needs to give Wakalah for them to execute transactions on behalf of the IB. The returns in this instrument are fixed and predictable.

One disadvantage of this instrument is that it can be abused. There should always be real goods or services that are purchased by the IB for the purpose of selling them to its customers in

Banking Murabahah line-of-credit (when offered to IFIs), as argued by Kahf (2006a), otherwise it can be a form of Tawarruq or Buy-back ('Inah). Murabahah-based instruments also requires setting a fixed date of payment for every transaction or group of transactions, and once the payment date is set, it cannot be altered for an additional increment.

2.2.6 Nature of Risk

For Service Ijarah transactions, the same risks will apply as cited above. For Murabahah transactions, an IB may face the following risks:

Shari'ah Risk	<ul style="list-style-type: none"> • Goods/services to be purchased are not Shari'ah compliant. • The step-wise process flows are not followed. E.g., the customer may already have purchased the goods/services for which only a debt is due.
Legal Risk	<ul style="list-style-type: none"> • Purchasing/hiring goods/services before selling/leasing them to the customer may entail legal complications and requirements regarding clarity of the transactions and their treatment under the law will depend upon the jurisdiction where the instrument is used. • Compatibility of Murabahah with the legal system as it is a sale transaction and may attract VAT.
Operational & Technical Issues	<ul style="list-style-type: none"> • Difference in acceptability and compatibility of Murabahah transactions across different jurisdictions especially regarding the requirement of prior purchase of assets by the Bank. • In some cases, invoices may not be issued in the name of the Bank due to customs duties and clearance of goods from ports etc. • Transactions within a Master Agreement may be difficult to monitor and follow-up with client especially if they are many small transactions occurring recurrently.

2.3 Murabahah/Service Ijarah Credit Card¹²

Credit cards provide cardholders with a credit facility during a specific period of time within a contractually pre-agreed credit limit. For individuals, the credit card may be more useful and convenient than normal Murabahah-cum-Service Ijarah line-of-credit and involves less time and paperwork. Islamic credit cards based on Murabahah/Service Ijarah can be developed and can also be very convenient for corporations and businesses.

Credit card is a very useful instrument although like any other innovation, if used unwisely, may entail serious consequences. It is a tool of PF because once a credit card is issued by an issuing bank, the customer is allowed to use up to a credit limit as and when he wants which includes cash withdrawals and payment for purchases at different points of sale. In fact, credit cards may be viewed as a more flexible and convenient mode of PF because they may be used for payments for any transaction. Kahf and Nabee Mohamed (2016) define the credit card as: *“a payment card issued by a bank or finance company to a cardholder enabling him either to pay for goods and services directly at points of sale or online or to obtain cash advances up to an agreed credit limit to be repaid in future.”* They concluded that Islamic credit cards should fulfill four conditions to pass the Shari’ah compliance threshold: a necessary condition of devoid of Riba, and three sufficient conditions which are: it should be a sale or lease/hire-based structure to legitimize profit charges on the amount paid to merchants; fees or charges cannot be imposed on cash withdrawals; and credit cards’ usage should be limited to Shari’ah compliant purposes only.

Murabahah credit card structure is based on the same concept of Murabahah line-of-credit agreement except that it is implemented through a credit card. The cardholder acts as the issuing IB’s agent and executes transactions on its behalf. It gives the customer, as agent of the Bank, the right to execute several transactions and can be used for all permissible goods purchases. Service Ijarah can be added in the same card (Service Ijarah and Murabahah combined in one credit card and one agreement) because the transaction is similar to Murabahah with the exception that it is based on the concept of services and usufruct facility. There will be an agreement with a Wakalah assigning the customer as agent to purchase/hire services, goods and usufructs for the IB, take delivery for the IB and on its behalf, and then sell/lease to itself and take delivery of this last sale.

¹² In addition to profit-making Islamic credit cards, the idea of ‘zero interest credit card’ (that enables cardholders the privilege of making purchases without any interest charges) for a grace period is advantageous and is a facility to customers that enhances customer loyalty. The grace period has a unique advantage of serving as a source of PF and helps cardholders make purchases with free debt. This kind of credit cards requires customers to pay their outstanding bills in full within a given time period.

2.3.1 Shari'ah Issues in Islamic Credit Cards

Finance only Shari'ah compliant items

Islamic credit cards, although seeks to fulfill customer needs in a similar way as conventional credit cards, are restricted to the boundaries of Shari'ah. All purchase transactions should be for permissible goods and services and therefore, credit card payments for non-Shari'ah compliant goods and services should be blocked (e.g., purchasing goods such as tobacco, pork and alcohol, or services like tattoos or using the credit card at bars, casinos, night clubs, concerts, on-line gambling, online trading on Forex trading platforms and similar). It is possible to block payment for non-Shari'ah compliant purchases in most cases except where a non-permissible item is sold within stores selling many permissible items (e.g., tobacco and alcohol sold by hypermarkets amidst many other products, restaurants and hotels with bar services). IBs can also make in the Master Agreement a count of all Haraam items that the customer cannot purchase. Kahf and Nabee Mohamed (2016) deliberate that an IB may make it a contractual clause in the credit card agreement that purchases of non-Shari'ah compliant items will not be recognized by the issuing IB, requiring purchase details and developing a software program that allows detecting such items and excluding them. They discuss that an Islamic credit card issuer can block all non-Shari'ah-compliant usages and products on two levels: one, the merchant level, by building a database for all approved merchants and making it easily available to customers,¹³ and two, the product level, by blocking payment access for non-Shari'ah-compliant product codes. All products have codes or identification numbers in stores and different outlets and a software or operation can be developed to exclude non-Shari'ah-compliant products by indicating an operator error when the Islamic credit card is swiped, i.e., indicating that a wrong barcode is included or a non-permissible product is identified by the program.

Purchase of gold, silver and foreign currencies

Islamic credit cards have another blocked usage which is the exclusion from buying gold, silver and foreign currencies because these items must be purchased on cash basis. The first transaction is permissible, i.e., the IB purchases gold, silver or foreign currencies and pays the supplier immediately, but the second sale between the IB and the customer is effected for deferred payment which violates the condition of hand-to-hand. One possible solution is to

¹³ This can be done through several means. One innovative way is practiced by Masraf Al Rayan (Qatar) through the 'Merchants Discount Program', a program whereby the Bank's debit and credit cardholders benefit from special discounts when using their Bank cards to make purchases at the participating merchants. The Bank updates its customers about the merchants list and discount details through its website as well as informs customers of new offers through SMS and website.

exclude such purchases from the second sale and require the customer to make payment for them within the grace period.

Cash Withdrawals

Profit-based credit cards cannot be used for cash withdrawals unless it is done without any profit charges. IBs can easily offer the cash withdrawal facility free of charge which will be an additional benefit to customers. For instance, Qatar Islamic Bank (Qatar) allows cardholders of its three types of Islamic credit cards (QIB Infinite, Gold and Platinum credit cards) to withdraw cash up to 100% of available limit without any cash withdrawal fees. However, if cash withdrawals are not paid on time, 3% is charged on the outstanding dues of which 2% is charity fees (QIB, 2016). The issue of abuse by customers, i.e., some customers may choose to make cash withdrawals and pay for their purchases if the former is free of charge to avoid profit charges, may be curtailed by imposing a limit on cash withdrawals transactions per day and as a percentage of the credit limit (e.g., cash withdrawals limited to 10-20% of credit limit). This limits the amount of cash withdrawals of cardholders with profit-based Islamic credit cards.

2.3.2 Structure, Process Flow and Transaction Dynamics

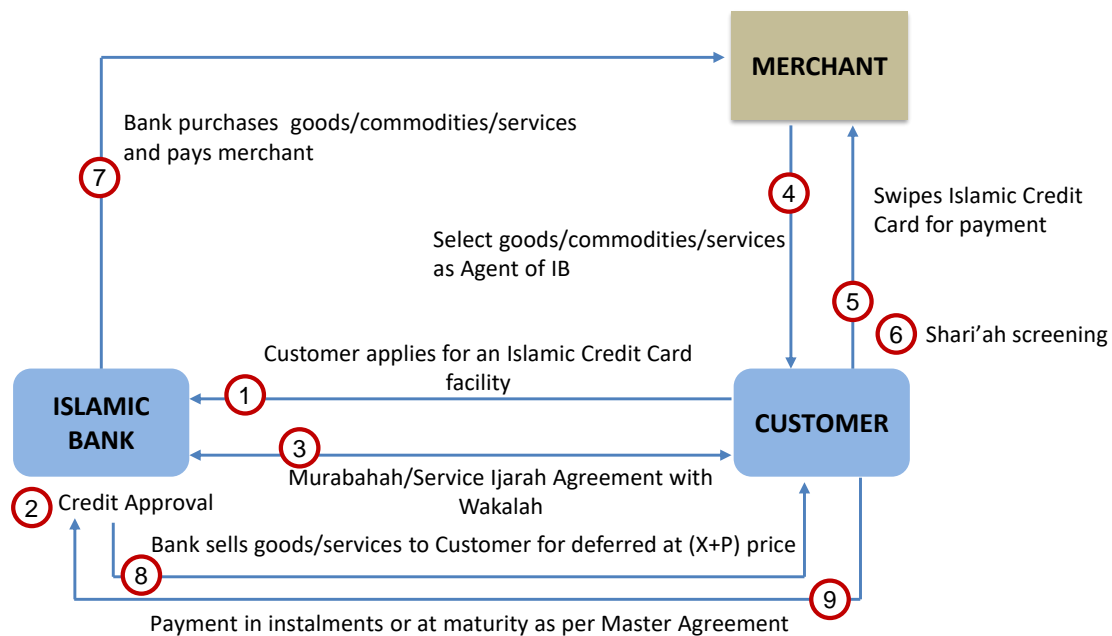


Figure 3: Murabahah/Service Ijarah Structure for Islamic Credit Card

(Source: Authors)

The Murabahah/Service Ijarah Credit Card, as illustrated in Figure 3, works as follows:

1. Customer approaches the Bank, submits an application form and makes a request for an Islamic Credit Card. The relationship officer enquires regarding the purpose of the

credit card¹⁴ and the customer negotiates all terms and conditions of the credit card including credit limit, profit charges, payment terms.

2. The Islamic credit card will be issued after the IB approves the customer's request.
3. The IB and the customer sign a Murabahah/Service Ijarah Credit Card Agreement with a Wakalah assigning the cardholder as the IB's purchasing agent to make purchase transactions for the IB, take delivery for the IB and on its behalf and then sell to itself and take delivery of this last sale.

As and when the cardholder purchases goods/commodities/services and wants to effect payment via the Murabahah/Service Ijarah card, the following scenario will occur.

4. The Customer selects the goods/commodities/services as agent of the issuing IB.
5. At check-out, the Customer presents the credit card for payment (the card is swiped and the transaction is authorized and executed).
6. The goods/commodities/services may be screened through a special program or the IB may not recognize purchases of non-Shari'ah compliant items.
7. The IB purchases the goods/commodities/services and remits payment to the merchant immediately.
8. Once payment is approved and the transaction is completed, the IB is legally the owner of the goods/commodities/services and the cardholder takes possession of the goods/commodities/services on behalf of the IB as its agent. The IB sells the goods/commodities/services to the cardholder as per pre-agreed terms and conditions. The cardholder purchases the goods/commodities/services from the issuing IB by using the authority given to him/her by the IB to sell to himself/herself and take immediate delivery. The IB sends a confirmation to the cardholder that the goods/commodities/services are sold to him/her (the sale confirmation from the IB can be done through email or SMS). The sale confirmation will contain details such as cost price of purchased goods/commodities/services, the Bank's selling price and payment amount and period.
9. The cardholder pays the Bank's selling price (i.e., cost price plus profit) according to the pre-agreed schedule in the Agreement.

The cardholder can execute unlimited purchase transactions up to the credit limit extended by the issuer. For every purchases payment that the cardholder effects with the credit card,

¹⁴ When an IB issues a Murabahah/Service Ijarah credit card, it informs the customer that the credit card should not be used for buying other than goods/commodities/services permissible in Shari'ah. The IB can block usage by specified outlets and monitor any non-Shari'ah compliant items.

the same scenario will take place. Each transaction is independent of each other and their payment terms are independent of each other, i.e., if the agreement says that each sale is payable over 3 months, then a purchase payment effected today will be paid over 3 months while a purchase payment effected two weeks from today will be settled by the cardholder two weeks later than the first sale payment. Once payment for a particular transaction is settled, the cost price of that transaction becomes an additional credit line that the cardholder may use conditional that the credit card is still valid.

The purchaser, i.e. the cardholder of the Murabahah Credit Card, is authorized to determine the payment date of each buy or group of buys in accordance with the guidelines agreed on in the Master Agreement (Kahf and Nabee Mohamed, 2016). In other words, the cardholder can choose the maturity period and subsequently, the IB calculates the sale price as per the pre-agreed profit rate and informs the customer through periodical/monthly bill (which can be in the form of SMS or emails). The cardholder fulfills his contractual obligation by effecting payment on their due dates.

2.3.3 Advantages & Disadvantages of Murabahah/Service Ijarah Credit Card

Advantages:

The main advantage of this Islamic credit card model is that IBs can finance cardholders' purchases for a profit margin at their own convenience. IBs can finance services particularly in case of travel and tourism services and generate Shari'ah compliant returns. IBs may charge different profit rates according to different range of purchase transactions or category of purchased goods or merchants and payment options and provide customers with multiple easy payment plans as long as the purchase transactions are still within the available credit card limit.

Cardholders can execute an unlimited number of purchase transactions up to the credit limit and have an increase in their ability to spend. Customers benefit from the ability to purchase both goods and services with the same card. They can own goods, usufructs and services that they may otherwise not be able to access on a cash-and-carry basis and payment is deferred. It can be used to effect payment for a variety of services including payment in hospitals, hotels, restaurants, ticket booking, car rentals, online service purchases and similar as long as these are Shari'ah compliant and is very convenient for customers especially when travelling overseas. It is also useful for customers who need to finance a number of small one-time purchases which might be rejected for inconvenience purposes under normal financing facilities offered by IBs.

Disadvantages:

Conversely, this credit card structure comes with the inconvenience of impermissibility of altering maturity once established and rolling over outstanding balances (Kahf and Nabee Mohamed, 2016). If a cardholder is unable to make payment in full within the due date or as per agreement, the issuer cannot charge any amount over and above its original selling price and may only spread the original installment amount over a longer time period to ease payment. The card can be used only for payment for any goods purchased or services provided so long the supplier/service provider accepts credit card payments especially in restaurants and food courts.

Cash withdrawals cannot be entertained or if the IB wishes to allow it, it will be without any profit charges, i.e., the profit rates charged on purchase transactions cannot be imposed on cash withdrawals. IBs can only charge a fixed amount of money as a fee to provide the service of withdrawing at ATMs which cannot be conditional upon the withdrawn amount or time period until payment and also must be equal to actual out-of-pocket cost of replenishing the cash. It must not hide any interest. Customers may have the incentive to withdraw and pay for their purchases because it entails only a fixed fee, in contrast to credit card purchases on Murabahah which will be at a higher profit margin.

CONCLUSION

This paper deliberated the issue of PF from Shari'ah perspective with reference to a literature review on existing studies on IPF instruments and conceptualized IPF. The purpose behind individual cash needs was analyzed and this study attempted to present Shari'ah-compliant alternative instruments that fulfil contemporary individual needs for which PF is usually given. Three profit-based instruments were discussed: (1) Service Ijarah, (2) Murabahah/Service Ijarah Line-of-Credit with Wakalah and (3) Murabahah/Service Ijarah Credit Card; through which most individual cash needs can be fulfilled. The Shari'ah basis or Shari'ah issues and conditions of these instruments were mentioned and their structure, process flow and transaction dynamics outlined. The pros and cons of these instruments were also discussed as well as the unique types of risk that may arise from using the Murabahah and Service Ijarah structures. These instruments can help minimize to a large extent the need for individual cash financing except in rare instances which involve giving cash money such as cash loans or in debt settlement or debt refinancing. Service Ijarah can encompass financing of all forms of services including services where benefits of usufructs and man hours are combined as long as they are permissible in Shari'ah. Murabahah/Service Ijarah line-of-credit would also be

convenient and the Murabahah/Service Ijarah Islamic credit card can cater for emergency needs for goods and services. These instruments are innovative alternatives to Tawarruq-based structures and instruments or their similar that are not genuinely Shari'ah compliant and can be refined to comply with existing legal systems in which IBs operate.

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