Critical Appraisal of Rahn-based Islamic Microcredit Facility From Shari’ah Perspective

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ABSTRACT

The rahn-based Islamic microcredit facility is currently popular among Islamic financial institutions in Malaysia, essentially because of its commercial features, which make it attractive and competitive with conventional pawnbroking. However, the substance of this product triggers some Shari’ah issues, which are mainly centred on the safekeeping fee the bank charges the customer under the principle of ijarah al-hifz (safekeeping fee) and wadi’ah yad al-damanah (guaranteed safe custody). This paper is primarily intended to examine the key Shari’ah issues associated with the structure that is widely accepted at present. It undertakes a case study of two selected Islamic banks that offer a rahn-based Islamic microcredit facility to their clients. The product manual of each bank has been examined to understand the structure flow of the product, payment of the safekeeping fee and other relevant operational aspects of the product. Interviews have also been conducted to gather data related to the operation of this product that was not available in the product manuals of the two selected Islamic banks. It is proposed that the alternative structure must comply with the Shari’ah and meets most of the distinctive commercial features of the rahn-based Islamic microcredit facility to maintain its commercial viability in the industry.

Key words: wadi’ah yad al-damanah, safekeeping fee, microcredit facility

Introduction

The rahn-based Islamic microcredit facility is an increasingly popular financing option among micro-entrepreneurs, lower income groups and gold traders. However, its Shari’ah structure has been sharply criticised by some Islamic scholars despite its popularity among Islamic financial institutions and Islamic pawnshops. Hence, it is undeniable that there are some debatable Shari’ah issues that need further examination and immediate solution. This situation is most likely a result of using the contract of rahn (pledge) in an income-generating product, which obviously contravenes the fundamental purpose of rahn. In fact, rahn is merely a security contract (‘aqd al-tawthiq) that serves as a legitimate guarantee of debt, whether the debt arises from a loan contract (qard) or a deferred exchange contract (bay’ mu’ajjal). Usually, when a loan contract is entered into, the most common Shari’ah issue raised is riba (interest) in the form of bay’ wa salaf (combination of a sale and loan) or qard jarra manfa’ah (a loan with added benefit to the lender). In the case of the rahn-based microcredit product, the imposition of a safekeeping fee that exceeds the actual storage cost is considered the most crucial Shari’ah issue that requires scrutiny. This research seeks to achieve the following objectives:

1) To analyse features and modus operandi of Islamic microcredit facility.
2) To jurisprudentially examine the Shari’ah issues related to the current structure of the Islamic microcredit facility.
3) To explore a potential Shariah contract to substitute the contracts used in the existing model.

This paper embraces discussion on the operational aspects of the current Islamic microcredit facility offered by two selected Islamic banks. This is inclusive of the modus operandi of the current structure, its unique features, formula for calculation of the safekeeping fee, the financing margin, and the redemption mechanism. This paper also highlights in detail the key Shari’ah issues associated with the current structure of Islamic microcredit that require further deliberation. The issues examined in this paper are i) the safekeeping fee; ii) the combination of rahn contract and wadi’ah contract on the same ma ‘qud ‘alayh (subject matter); iii) guarantee in a wadi’ah contract; and iv) bay’ al-wafa’.

This research is generally of a qualitative nature, relying on both primary and secondary sources of data. To understand the structure flow and operational aspects of the rahn-based Islamic microcredit facility, a case study...
approach was adopted whereby the product offered by two Islamic banks in Malaysia was examined. Secondary sources of data include the relevant documents available at the two banks, notably their product manuals and product concept documents (PCD).

The interview method was also adopted as a primary source of data to gather additional information relating to the current operation of the Islamic microcredit facility that was not spelled out in the product manuals and PCD of these two banks. In particular, the additional information sought through the interviews included the essential factors considered by the banks when offering the product, justification for adopting their current product structure and operational and Shari’ah issues related to the current structure. The interview questions also sought elucidation of the formula for calculating the safekeeping fee, the rollover function and process flow of the product. Structured interviews were specifically carried out with officers from the Product Development Department and Shari’ah Department of the two Islamic banks. The information gathered from the interviews were also essential for outlining the unique features of the rahn-based product, which included some particularities that are important for the commercial viability of the product.

The research also focused on the Shari’ah issues associated with the current structure of the Islamic microcredit facility. To examine these issues, the library method was employed to gather the scholars’ opinions on key Shari’ah issues such as the safekeeping charge and conflict in muqta da al-`aqd (nature and implications of the contract) arising from a combination of contracts. The classical books of fiqh from various schools of thought, such as Kitab al-Mughni, Takmilat Radd al-Muhtar, Tuhfat al-Muhtaj and Kitab al-Furuq, were examined to explore the classical scholars’ views on the abovementioned issues. Overall, the data collected through the above methods was critically analysed using deductive and inductive approaches, particularly on the Shari’ah and operational aspects of the product.

1. Operation of the Rahn-based Islamic Microcredit Facility:

The current rahn-based Islamic microcredit facility provided by Islamic pawnbroking and Islamic financial institutions is structured based on a combination of various Shari’ah contracts, namely wadi’ah yad damanah (savings with a protection guarantee), ujrah (fee), qard (loan) and rahn (pledge). Customer approaches an Islamic pawnbroking institution for a financing facility. The Islamic pawnbroking institution then grants a benevolent loan to the client based on the principle of qard, which is interest-free. Subsequently, the customer pledges the gold to the Islamic pawnbroking institution as collateral (marhun) for a certain period of time agreed upon in the contract. The Islamic pawnbroking institution then keeps the gold under the principle of wadi’ah, which requires the institution to be liable for the safety of the gold in its custody. Thus, in the event of any damage or loss of the gold during the storage period, the Islamic pawnbroking institution is liable to replace it or compensate for the damage. A safekeeping fee is imposed on the customer for the storage service. The transaction flow of the product is summarised as follows:

1. The pawnbroking institution grants qard (loan) to the customer.
2. The customer pledges the gold to the pawnbroking institution under the principle of rahn.
3. The bank keeps the gold via storage service with a risk-protection guarantee under the principle of wadi’ah yad damanah.
4. On maturity date, the customer repays all the debt and pays the safekeeping fee for the storage service.
5. The pawnbroking institution returns the gold to the customer.

In the event that the customer fails to fulfill his financial obligation after the maturity date, the Islamic pawnbroking institution may auction off the gold. Any proceed raised from the auction will be utilised to fully settle the loan, the safekeeping fee and the actual administrative costs borne by the institution. In case of a surplus (if there is any), the balance will be returned to the customer.

Unique Features of the Rahn-Based Islamic Microcredit Product:

The rahn-based Islamic microcredit financing facility is currently gaining popularity among Islamic financial institutions, lower income groups and gold investors because of its attractive features that make it competitive with its conventional counterpart. As a result, the preferred structure for this product should accommodate all the peculiar features of this product to retain its competitive and attractive elements. The unique features of this financing facility can be simplified as follows:

i) Security and surety against credit:

This financing facility is significantly secured because the pledged gold bar/jewellery is used as surety against credit. In case the customer fails to meet his debt obligation, the bank as pledgee can dispose of the gold
bar/jewellery at market value to recoup the customer’s outstanding debt. Hence, this product has a low risk profile.

ii) Lucrative business:

This financing facility is very lucrative as the storage fee charged to the customer is relatively high. The storage fee has two different modes: 1) daily storage charge and 2) monthly storage charge. The charge is even higher than the profit the bank earns through its personal financing facility. Personal financing actually serves as one of the main sources of income for Islamic banks in Malaysia instead of products like home financing, motor vehicle financing, etc. However, the profit rate in the rahn-based microcredit facility is higher than that of the personal financing facility. For instance, personal financing facility offered by some Islamic banks for government customers is between 3.25% to 5% per annum (e.g., Bank Rakyat and KF AH) while for non-government customers, the profit rate is up to 11% (e.g., Maybank Islamic). In the rahn-based Islamic microcredit facility, the average storage fee is 1% per month or 12% per year.

iii) Quick approval:

This facility will provide an immediate loan facility for lower income groups to overcome cash-flow needs. It enables them to obtain financing facility within a few hours. This is because the bank does not have to undergo the normal risk assessment on the customer, which is time consuming, since the financing is secured by the pledged gold bar/jewellery. However, the bank usually applies the procedure of KYC (Know Your Customer) to mitigate credit risk.

iv) Rollover functionality:

This facility will also enable the customer to opt for roll-over functionality by extending the payment term, particularly in the event of failure to settle the debt within the agreed time. The spread of the gold price will be used by the customer to top up the outstanding safekeeping charge. Under certain circumstances, this mechanism can also generate profit for the customer if there is a surplus from the spread.

v) Cheaper safekeeping fee:

The safekeeping fee in this product is much cheaper compared to the interest charge in conventional pawnbroking, which makes it attractive not only to Muslims but also non-Muslims clients. For instance, the interest charge under a conventional pawnbroking facility is up to 2% per month while under Islamic pawnbroking the safekeeping charge is approximately 1% per month.

vi) Guarantee of getting back the pledged jewellery:

In a non-default case, the customer is assured of getting back his pledged jewellery. This feature is important because, in many cases, the jewellery has sentimental value to customers. Thus, they usually prefer to repossess it upon settlement of the debt.

Quality of Gold and Assay Procedures:

In general, an Islamic pawnbroking institution accepts jewellery made of gold (that meets a definite standard) to be used as a collateral. In the event that the jewellery contains non-gold components such as diamonds and emeralds, it will also be accepted, but these non-gold components are excluded from the value of the marhUn (collateral). The quality and the fineness of the gold are measured as follows:

<table>
<thead>
<tr>
<th>Fineness of Gold</th>
<th>Carat</th>
</tr>
</thead>
<tbody>
<tr>
<td>999 (99.9%)</td>
<td>24k</td>
</tr>
<tr>
<td>950 (95%)</td>
<td>22.8k</td>
</tr>
<tr>
<td>916 (91.6%)</td>
<td>22k</td>
</tr>
<tr>
<td>860 (86%)</td>
<td>21k</td>
</tr>
<tr>
<td>835 (83.5%)</td>
<td>20k</td>
</tr>
<tr>
<td>750 (75%)</td>
<td>18k</td>
</tr>
</tbody>
</table>

Note: Pure gold is designated 24 karats; therefore, each karat is equal to 4.167 per cent gold content, so that, for example, 18 karats equals 18 x 4.167, or 75 per cent gold. "Fineness" refers to parts per thousand of gold in an alloy; e.g., three-nines fine would correspond to gold of 99.9 per cent purity.
The Islamic pawnbroking institution assays the quality and purity of the gold by using several methods and techniques. A common technique used for this purpose is a chemical test by means of nitric acid and hydrochloric acid. The process starts by lightly rubbing the gold on a black stone, followed by pouring an amount of acid over the rubbing mark. The golden tone colour that appears determines the fineness and the quality of the gold. Another instrument that is popularly used by Islamic pawnbroking institutions is densimeter such as MD-200S/GK300. Other than its reasonable price, this tool is also easy to handle and its measurement accuracy is well recognised. Some Islamic pawnbroking institutions use a more sophisticated equipment of high-powered X-ray technology called X-Ray Fluorescence Spectrometer. However, the number of institutions that use this technology is few because the price is fairly expensive.

The Safekeeping Fee and Margin of Financing:

The margin of financing granted varies from 50% to 70% of the marhUn value. For instance, a customer who pledges gold worth RM10,000 is eligible for a qard (loan) up to RM7,000. Subsequently, the bank charges the customer for the safekeeping service, based on the principle of wadi`ah yad damanah. The safekeeping fee is calculated on the amount of the marhun (collateral) and not the amount of the loan. The total amount of the safekeeping fee is related linearly to the value of the marhun: the higher the marhun, the higher the safekeeping fee. Due to this proportionality, the service charge does not reflect the actual cost of safekeeping but, rather, creates an accrued profit. Table 1.2 below shows that the banks differ in fixing the fee rate and margin of financing.

<table>
<thead>
<tr>
<th>Institutions</th>
<th>Safekeeping Fee for Every RM100 Marhun Value</th>
<th>Financing Margin of Marhun Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank Rakyat</td>
<td>RM0.65-0.75</td>
<td>65%-70%</td>
</tr>
<tr>
<td>RHB Islamic Bank</td>
<td>RM0.70-0.80</td>
<td>70%-75%</td>
</tr>
<tr>
<td>Agro Bank</td>
<td>RM0.50-0.75</td>
<td>50%-70%</td>
</tr>
</tbody>
</table>

Banks tend to use one of two approaches in calculating the safekeeping fee: either on a daily or a monthly basis. Furthermore, the rates also vary subject to the margin of financing and method of calculation, i.e., on a monthly or daily basis. The details are illustrated in the Tables 1.3 and 1.4:

<table>
<thead>
<tr>
<th>Margin of Financing</th>
<th>Safekeeping Fee on a Daily Basis</th>
<th>Safekeeping Fee on Monthly Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; RM1000</td>
<td>RM0.65 per RM100 of marhun value</td>
<td>RM0.10 per RM100 of marhun value</td>
</tr>
<tr>
<td>&gt; RM1000</td>
<td>RM0.75 per RM100 of marhun value</td>
<td>RM0.50 per RM100 of marhun value</td>
</tr>
<tr>
<td>0% (No financing)</td>
<td>RM0.10 per RM100 of marhun value</td>
<td>RM0.50 per RM100 of marhun value</td>
</tr>
<tr>
<td>&gt;51% up to 60%</td>
<td>RM0.60 per RM100 of marhun value</td>
<td>RM0.75 per RM100 of marhun value</td>
</tr>
<tr>
<td>&gt;60 up to 70%</td>
<td>RM0.75 per RM100 of marhun value</td>
<td>RM0.75 per RM100 of marhun value</td>
</tr>
</tbody>
</table>

Note: The margin of financing and the rate offered differ for each bank.

The one-month calendar is counted on a point-to-point basis from the date of execution of the contract. For instance, if the date of contract execution is 1st January, 2012, the one-month calendar is fixed at 1st February, 2012. Should the customer opt for a monthly basis calculation during the execution of the contract but later redeems the pledged gold earlier than the particular month; the bank has the right to claim a full month of safekeeping fee. Therefore, in this situation, the daily basis calculation gives more advantage to the customer should he redeem the pledged gold/jewellery earlier than the maturity period because the safekeeping fee will be calculated at the daily rate.

Calculation of the Safekeeping Fee on a Monthly Basis:

Computation of the safekeeping fee on a monthly basis is illustrated as follows:

- Quantity of marhun: 50 gm
- Market price: RM200 per gram
- Value of marhun: RM10,000
- Margin of loan: 70%
- Total loan amount: RM7,000 (70% of the marhun value)
Scenario A:

Assuming that a customer pledges 50 gm jewelery (24 carat/999 grade) for the current price of RM200/gram, the marhun value is RM10,000. Therefore, he is eligible for 70% financing margin, which is equivalent to RM7,000. Given that RM0.70 is charged for every RM100 marhun value, the safekeeping fee charged to the customer is RM70 per month. Hence, the total charge for the 6-month period from Jan 1st to July 1st, 2012 is RM420 as computed in the following formula:

\[
\text{Safekeeping fee} = \frac{\text{RM}0.70 \times \text{RM}10,000 \times 6 \text{ months}}{\text{RM}100} = \text{RM}420 @ \text{RM}70 \text{ per month}
\]

Note: In substance, the bank indirectly charges RM70/month for RM7000 loan given, which is equivalent to 1% per month or 12% per year of the loan amount.

On the maturity date of July 1st, 2012, the customer should redeem the pledged gold. To exercise this, he has to repay the full amount of the loan and subsequently pay the safekeeping fee, i.e., a total amount of RM7420:

\[
\text{Total redemption} = \text{Total amount of loan} + \text{Safekeeping fee} \\
= \text{RM}7,000 + \text{RM}420 \\
= \text{RM}7,420
\]

Scenario B:

In the event that the customer redeems a few days earlier than the maturity date (e.g., June 15th, 2012), the customer still has to pay the 6-month safekeeping fee, which is equivalent to RM420. However, in the event that customer redeems his gold after the maturity date (e.g., July 14th, 2012), he has to pay an additional 1-month safekeeping fee on top of the 6-month fee, as shown below:

\[
\text{Safekeeping fee} = \frac{\text{RM}0.70 \times \text{RM}10,000 \times 7 \text{ months}}{\text{RM}100} = \text{RM}490
\]

Calculation of the Safekeeping Fee on a Daily Basis:

| Quantity of marhun | 50 gm |
| Market price       | RM200 per gram |
| Value of marhun    | RM10,000 |
| Margin of loan     | 70% |
| Total loan amount  | RM7,000 (70% of the marhun value) |
| Safekeeping fee    | RM0.75/100 (the monthly rate when calculated on a daily basis) |
| Charge date        | Jan 1st, 2012 |
| Maturity period    | 6 months |
| The maturity date  | July 1st, 2012 |

Scenario C:

Assuming that the customer performs the redemption on July 1st 2012, the safekeeping fee is calculated as follows:

\[
\text{Safekeeping fee} = \frac{\text{RM}0.75 \times \text{RM}10,000 \times 12 \times 181 \text{ days}}{\text{RM}100 \times 365 \text{ days}} = \text{RM}446.30
\]

Note: The actual number of days from Jan 1st to 1st July 2012 is 181 days.
**Scenario D:**

In the event that the customer redeems his gold earlier than the maturity date (e.g., June 15\textsuperscript{th}), the safekeeping fee is calculated as follows:

\[
\text{Safekeeping fee} = \frac{\text{RM0.75 x RM10,000 x 12 x 165 days}}{\text{RM100 x 365 days}} = \text{RM406.85}
\]

*Note: The actual number of days is from Jan 1\textsuperscript{st} to June 15\textsuperscript{th} 2012 is 165 days.*

**Scenario E:**

Similarly, should the customer redeem the gold on July 15\textsuperscript{th}, which is later than the maturity date, the safekeeping fee is RM480.82 as follows:

\[
\text{Safekeeping fee} = \frac{\text{RM0.75 x RM10,000 x 12 x 195 days}}{\text{RM100 x 365 days}} = \text{RM480.82}
\]

In this scenario, though the daily basis rate is higher, the safekeeping fee is still lower than the monthly basis rate, which is RM490 as illustrated in the **Scenario B**.

**The Redemption and Auction Process:**

A customer may redeem his gold/jewellery at any time before, during or after the maturity date, provided that they are not yet registered in the auctioning list. If the customer requests to re-pledge (rollover) the same gold/jewellery for an additional six months, the bank may approve the application provided that all safekeeping fees of the previous six months are paid. Even though payment in cash is preferable, some banks allow any other mode of payment such as credit card, bank draft or personal cheque. When a personal cheque is the mode of payment, the pledged gold will only be released after the cheque has cleared. The redemption can only be performed at the branch where the rahn contract was originally executed.

In normal practice, the bank will issue a reminder notice weeks before the maturity informing the customer of the expiry date. At the maturity date, the customer has to repay the entire loan in addition to the safekeeping service charge to redeem the pledged gold. The maturity might be extended by some banks for up to three months. If the customer fails to turn up for redemption of his gold/jewellery, an extension of two to three months is granted. If he still fails to redeem the pledged items after the three-month extension, an additional period of two months may be granted by the bank provided that the customer appeals for the extension and pays the entire outstanding safekeeping fees. In case the customer doesn’t submit any application for extension, the bank will take action to claim for the loan granted to the customer.

If the customer does not turn up for the full settlement of the loan during the extension period, (9 to 11 months after the execution of the contract) the bank will proceed to auction off the pledged gold for cash. Cash raised will be used to fully settle the loan and the safekeeping fee as well as covering the actual administrative costs borne by the bank. In case of a surplus (if there is any), the bank will return the balance to the customer.

**Shari‘ah Issues related to the Structure of the Rahn-based Microcredit Facility:**

There are two structures currently adopted by the two Islamic banks that were interviewed. The difference lies mainly in the contract sequence of the structures. The first structure begins with a loan contract prior to the execution of the *wadi‘ah yad al-damanah* contract while the second structure begins with the execution of *wadi‘ah yad al-damanah* before the loan contract is entered into. Despite the abovementioned difference, both structures are the same in actual practice because the second structure is practiced based on the process flow of the first structure. The transaction flow of the structure is illustrated in the following diagram for the purpose of exploring the key Shari‘ah issues related to it:
1. The bank gives a loan to the customer based on a *qard* contract. The maximum loan amount offered to the customer is 70% of the market value of the pledged gold.

2. The customer then places his gold at the bank under the principle of *al-rahn*. At this stage, the gold assumes the status of *marhun* (pledged gold) which is kept in the bank’s custody under the principle of *wadi‘ah yad al-damanah*. On this premise, the customer is required to pay a safekeeping fee. The fee will be paid by the customer during settlement of the loan, which is usually done after six months. During the storage period, the bank is liable to guarantee the pledged gold in case of damage, etc. (interview with the Islamic financial institution).

3. On the maturity date, the customer makes full settlement of his loan plus the safekeeping fee to the bank.

4. The bank then returns the pledged gold to the customer.

Practically, the above modus operandi of the Islamic microcredit facility scheme involves the following steps:

1. The customer executes a loan transaction at the Islamic pawnbroking institution as per the normal method.

2. The Islamic pawnbroking institution provides financing to the customer.

3. The financing amount will be credited into the customer’s saving account. The customer will then be provided with an ATM card.

4. The customer can withdraw the total financing from his saving account by using the ATM card.

5. The customer must pay the safekeeping fee during the financing period. Payments can be done by deduction from their saving account or by cash deposit.

6. At the end of the financing period, the customer is required to pay the total amount of financing as well as the safekeeping fee.

The modus operandi of the current structure gives rise to three (3) key Shari’ah issues that require scrutiny and extensive deliberation. They are as follows:

**A. The Issue of the Safekeeping Fee (Storage Charge):**

This is the most debatable Shari’ah issue associated with the current structure because the safekeeping charge is directly linked to the value of the pledged gold. Although this direct linkage is established to escape from the prohibited linkage between the safekeeping fee and the financing amount, this mechanism is not safe from the above prohibition because the storage fee will not be imposed without the execution of the *rahn* contract. Furthermore, it is acknowledged that the *rahn* contract is executed merely to secure the debt arising from the *qard* contract. In fact, the whole chain of the arrangement is solely derived from the execution of the *qard* contract, which indicates that the *qard* is given on the condition that the customer agrees to pay the safekeeping fee, which exceeds the actual storage cost incurred by the bank. It is argued that if the actual safekeeping cost for the pledged gold in this structure is equal to that of all other pledged goods, then the inflated fee is a legal trick (*hilah*) to circumvent the prohibition of *riba* (Asmadi, 2004, 50). Therefore, it is important to thoroughly examine the Shari’ah issues arising from imposition of the safekeeping fee in the Islamic microcredit facility scheme. The Shari’ah issues related to the safekeeping fee are as follows:

**B. The Issue of Bay‘ Wa Salaf (Sale Contract with Loan):**

In this scheme, cash disbursement will be done by the Islamic pawnbroking institution to the applicant while the applicant is required to place his valuable good as collateral for the loan. As mentioned earlier, the current structure entails that the safekeeping fee, which is labelled *ujrah*, is charged to the customer based on the
principle of wadi`ah yad damanah (interview with Islamic bank). However, it is argued that the term uyrah signifies that the contract of ijarah is embedded in this arrangement as enabler for profit generating while the contract of wadi`ah yad damanah has no relation at all with the storage charge (interview with Islamic bank). It should be noted that in Islamic jurisprudence, the ijarah contract is considered a form of sale contract that is known as bay` al-manfa`ah (sale of usufruct). In reality, this procedure involves stipulation of a sale contract in a loan contract because the Islamic pawnbroking institution will only give the applicant the loan on the condition that he pays the safekeeping fee. This deal is strictly banned by the Shari`ah because it comes under the prohibition of bay` wa sala`f (a sale contract combined with a loan). Al-Baji asserts that there is scholarly consensus regarding the prohibition of sale contract combined with a loan (al-Baji, n.d., 5:29). Al-Qarafi also transmitted the same legal consensus. He says: “By the consensus of the Ummah, it is permissible to conduct a sale and a loan separately, but it is forbidden to conduct them in combination because that is a means to riba” (al-Qarafi, n.d., 3:266).

The prohibition of combining a sale contract with a loan is inferred from many items of revealed evidence such as this hadith: “It is not permissible to execute a loan contract (in combination with) a sale contract” (Abu Dawud, n.d., 3:283; al-Tirmidhi, 1395 AH, 3:527; al-Nasa`i, 1406 AH, 7:288). The hadith explains clearly that it is illicit to combine a loan contract and sale contract in a single transaction. This is generally understood to mean that it is illegal to stipulate a sale contract in a qard contract.

C. The Issue of Qard Jarr Manfa`ah (a Loan with Added Benefit to the Creditor):

It is absolutely acknowledged that any debt arrangement that grants additional benefit unjustifiably to the creditor is forbidden. This in fact has become a notable fiqh principle which is generally known in Islamic jurisprudence as it has been transmitted by many scholars using various wordings; for example: “Every loan which gives benefit (to the creditors) is considered riba” (al-Zayla`i, 1418 AH, 4:60; Ibn al-Mulaqqin, n.d., 6:621; Ibn Hajar, 1416 AH, 3:79). Although the statement is not considered authentic as a hadith, its meaning constitutes a widely accepted fiqh principle derived from the consensus of all Muslims (al-Shirazi, 1428 AH, 5:452).

In the Islamic microcredit scheme, the safekeeping fee is much higher than the service charge imposed on the customer for a normal safe deposit box. This indicates that the customer should use the normal safe deposit box service if he really intends to keep his gold or valuable items safe rather than paying more for a higher service charge in the Islamic microcredit facility. This situation reveals the actual motive of the customer that he subscribes to the Islamic microcredit facility merely for the purpose of obtaining the financing facility, and in return, he agrees to pay more than the financing amount and the actual storage cost. This is because the amount charged for the safe-keeping service is more than the actual cost incurred by the Islamic pawnbroking institution, which further substantiates the presence of the riba element embedded in this scheme.

D. The Issue of Combining a Rahn Contract and Wadi`ah Contract on the Same Subject Matter:

In this structure, the rahn contract is executed in combination with a wadi`ah yad damanah contract on the same item. This form of contract combination is invalid and impermissible because the legal effects of the two contracts are not harmonious; some of them are contrary to one another.

One of the most significant differences is the time in which the pledged/custodial good must be handed back to its owner. For instance, the original ruling of wadi`ah requires that the good must be returned back to its owner whenever he requests it. In contrast, the original ruling of the rahn contract is that the pledged good (marhun) must be handed back to its owner after the pledger (rahin) has fulfilled his entire debt obligation. This is because the holder of the pledge (murtahin) in a rahn contract is authorized by the Shari`ah to hold the marhun as long as the rahn has not settled his debt, as the rahn contract is primarily intended to secure the debt (istithqaq). If the marhun must be returned to its owner upon his request, as in the case of wadi`ah, the purpose for which the rahn contract was legislated is defeated. Al-San`ani mentions these differences in his statement: “[The pledgee] is permitted to retain the pledged item until he gets his money back, even if the owner (of the marhun) dislikes it or asks for it back” (al-San`ani, n.d., 3:234).

Conversely, in a wadi`ah contract, if the consignor wants to take back his good, the custodian is obliged to return the consigned good to him. Ibn Hazm says: “It is obligatory upon the consignee who was entrusted with a wadi`ah to keep it safe and to return it to its owner when he asks for it” (Ibn Hazm, n.d., 7:137). Ibn al-`Arabi elaborated on the same point as follows: “In wadi`ah, it is not compulsory to return it (to the owner) until it is asked for...while in rahn it is not compulsory to return it until the owner has settled his debts” (Ibn al-`Arabi, n.d., 1:571). The reason is that the wadi`ah contract is a non-binding contract which can be terminated by either party to the contract at any time. This is mentioned by Ibn Qudamah: “It is a non-binding contract executed by both parties. Whenever the consignor (mudi`) wants to take back the consigned goods, it is compulsory for the guardian to return it” (Ibn Qudamah, 1388, 6:436).
The above arguments indicate that the current practice of combining a rahn contract and wadi‘ah contract on the same item violates one of the essential features of wadi‘ah. The owner (mudi‘) cannot claim his good on consignment because the good is at the same time pledged, which grants the pledgee the right of retention. Thus, the owner can only claim the good after repaying his debts to the creditor/trustee (muqrid/mustawda‘).

In essence, inclusion of the wadi‘ah contract in the rahn contract in this procedure is unnecessary. This is because the purpose of the wadi‘ah contract is to safeguard the consigned goods, and this purpose is already served in the rahn contract. Thus, it is obvious that the unnecessary inclusion of wadi‘ah contract in rahn contract is actually a legal trick (hilah) to materialize an illegal motive or to acquire an unjustified benefit. A study shows that the unnecessary inclusion of a contract in a deal is an indicator of the presence of a Hilah element (Mohamed Fairooz et. al, 2010), as was mentioned by Ibn Taymiyyah: “Hilah, in toto, are of two types: they either include in the subject matter what is not intended, or they include in the contract another contract that is not intended” (Ibn Taymiyyah, 1416 AH, 29:27).

**E. The Issue of Guarantee (Yad Daman) in a Wadi‘ah Contract:**

As indicated in the previous discussion, this structure is a combination of a rahn contract and wadi‘ah yad al-Daman (guaranteed custody) contract. Interestingly, the combined contracts in this structure give rise to of muqtaḍa al-‘aqd. Trusteeship (yad amanah) constitutes one of the original principles of the wadi‘ah contract. It entails that the custodian is not liable to guarantee the consigned item in his custody in case of damage or loss of the item as long as that is not due to his negligence (taqsir) or transgression (ta‘addi). Therefore, the question raised in this regard concerns the justification for changing the original feature of wadi‘ah from being a trust-based contract to being a guarantee-based contract.

It is found that in the current practice of the Islamic microcredit facility, the trust (amanah) element in a wadi‘ah contract changes to a guarantee element (daman) on account of the service charge imposed by the bank for safekeeping the goods for its customer. This is based on the opinion of the majority of Hanafi scholars that whenever a fee is imposed for custodianship to keep the wadi‘ah items safe, the original status of wadi‘ah as a trust contract (amanah) is changed to a guarantee-based contract (daman).

Al-Sarakhsi explains the above situation by saying: “Its meaning is that the custodian (muda‘) volunteers to keep the owner’s good. The voluntary act (tabarru‘) does not oblige its doer to guarantee (the item). Hence, its damage when it is with the custodian is treated similar to its damage when it is in the owner’s custody. This is the meaning of the jurists’ saying, ‘The hand of the custodian is like the hand of the owner’. The ruling is the same whether the damage is due to an avoidable or unavoidable cause. This is because the damage that is due to an avoidable cause is similar to a defect in safekeeping, but freedom from defect is required only in an exchange contract, not in a charitable contract.” (al-Sarakhsi, 1414 AH, 11:109).

The above text implies that if an exchange element is incorporated in the wadi‘ah contract, the custodian would be held liable to guarantee. Ibn ‘Abidin explicitly states the rule: “This entails that the fee charged changes the original status of wadi‘ah from being trust-based (amanah) to being guarantee-based (daman)” (Ibn ‘Abidin, 1306, 8:470).

As mentioned above, the opinion of the Hanafi School is that the imposition of a safekeeping fee in a wadi‘ah contract changes its essential character to yad daman. If this opinion is accepted in this structure, then the issue of conflict between the nature and implications (muqtaḍa al-‘aqd) of the combined contracts (wadi‘ah yad daman and rahn) in one deal comes into the picture. This is because the muqtaḍa al-‘aqd of the rahn contract is that it is primarily based on amanah, which definitely does not admit any form of guarantee (daman), while the muqtaḍa al-‘aqd of wadi‘ah yad daman obliges the custodian to guarantee the consigned item kept in his custody as a counter-value for the fee paid by the customer for keeping his valuable item safe.

**F. The Issue of Bay‘ al-Wafa’:**

The substance of the current structure can also be legally characterized as bay‘ al-wafa‘ even though it is externally structured on a combination of various financial contracts. The sale price in bay‘ al-wafa‘ can be characterized as an amount loaned to the customer on the condition that the jewellery must be returned when the customer reclaims it by paying the price (loan amount) of the jewellery to the bank. According to al-Mawsu‘ah al-Fiqhiyyah al-Kuwaytiyyah, bay‘ al-wafa‘ is defined as a sale contract executed on the condition that the buyer must return the purchased item if the seller pays the price on the ground that the buyer must fulfil his promise (wafa‘) (Wizarah al-Awqaf wa al-Shu‘un al-Islamiyyah, 1427 AH, 9:48) and meet the contractual obligation arising from the stipulated condition. Jurists are not unanimous on the legitimacy of bay‘ al-wafa‘.

Most of them hold the view that bay‘ al-wafa‘ is impermissible on the premise that it resembles the contract of rahn in which the buyer (murtahan) benefits from the sold asset. A rahn contract is similar to bay‘ al-wafa‘ with regard to its objective and legal implications. In terms of objective, both rahn contract and bay‘ al-wafa‘
are executed by the contracting parties to meet their liquidity needs. The seller who is characterized as rahn (pledgee) in bay‘ al-wafa' pledges his asset with the buyer as surety against a financing (loan) facility obtained from the buyer. The buyer is characterized as a muhtatith and lender (muqrid) who benefits from the pledged asset. The added benefit that he enjoys from the pledged asset (marhun) is considered riba in the form of a loan that draws benefit. In addition, the contractual effects of both structures are also similar because the sold item (in bay‘ al-wafa‘) and the pledged item in (a rahn contract) are returned back to the original owner upon repayment of the price of the sold item (in bay‘ al-wafa‘) and return of the pledged item (in the rahn contract).

Similarities between both contractual arrangements in objective and contractual impact are shown in the following table:

<table>
<thead>
<tr>
<th>Contract</th>
<th>Objective</th>
<th>Contractual Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Rahn</td>
<td>Giving a loan with collateral</td>
<td>The pledged item will be returned to the pledger (rhhin) if he repays the debt.</td>
</tr>
<tr>
<td>2) Bay‘ al-Wafa’</td>
<td>Giving a sum of money in exchange for a temporary transfer of ownership of a commodity.</td>
<td>The sold item will be returned to the seller if he repays the price of the sold item.</td>
</tr>
</tbody>
</table>

However, it is important to note that the current structure can be considered worse than bay‘ al-wafa‘ in terms of the ribawi element embedded in it. This is because in bay‘ al-wafa‘ the sold asset is returned to its owner if he pays the same purchase price to the first buyer. In contrast, in the current structure, the customer pays a financing amount with an increment, i.e., the safekeeping charge.

The International Fiqh Academy in its seventh session has resolved that bay‘ al-wafa‘ is not a valid sale contract on the premise that it is in fact a loan contract that draws benefit. Hence, this arrangement serves as a back door to riba as argued by the majority of scholars. The selling price of the sold jewellery comprises the marhun’s value plus profit, which is equivalent to the safekeeping fee. However, it is important to note that the above arrangement is only applicable in case the subject matter is jewellery. In contrast, if the subject matter is a gold bar, the contractual arrangement is automatically characterized as a currency sale (bay‘ al-Sarf) and, hence, the rules of currency sales shall apply to the transaction. The International Fiqh Academy, in the same session, ruled that this contract is impermissible (Resolution No. 68/4/7, Majma‘ al-Fiqh al-Islami, 7th session, 1992).

Conclusion:

In conclusion, it is acknowledged that the current structure of rahn-based Islamic microcredit facility require immediate enhancement, particularly with regard to Shari‘ah compliance. The current procedures need to be restructured in accordance with Shari‘ah principles in both their form and substance. This is because there are a few Shari‘ah issues related to the current structure and their implementation, such as the issues of riba and muqtada al-`aqd. Taking into account all the Shari‘ah issues relevant to the current structure, this research concludes that long as qard (loan) contract becomes an underlying contract, this product remains controversial. The reason being is that the bank offers this product to generate profit from another contract which is linked to the loan contract. Hence this paper suggests that any alternative structure proposed to replace the current structure must depart solely from the use of loan contract. If the proposed structure involves a combination of different financial contracts, the specific parameters for contract combining must be totally complied with to avoid the illegal consequences of combined contracts such as riba and injustice. Instead, the proposed structure should have two essential features namely; 1) Shari‘ah compliance and 2) commercial viability. It is suggested that sarf contract be used as underlying Shariah principle in Islamic microcredit facility.

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