An Overview of the Shariah Issues of Rahn-Based Financing in Malaysia

Tinjauan Isu-isu Syariah dalam Pembiayaan Berasaskan al-Rahn di Malaysia

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ABSTRACT

Ever since the establishment of Islamic pawn broking (al-rahn) in Malaysia more than two decades ago, this kind of short-term microfinancing has now become a promising business. The increase in demand for al-rahn based products was contributed by some factors among others low storage charge, service efficiency, religiosity, attitude, low earning and so forth. Despite the positive growth of al-rahn from the demand side on the one hand, some issues have been identified in a number of researches from the other. One of them pertains to Shariah issues on the theory and practice of al-rahn. This paper is an attempt to study the Shariah issues theoretically in the aspects of custodial fee, conflict in the substance of combined contracts, benefitting from al-rahn, financing structure, transaction sequence and some other issues. In identifying and understanding the issues, the literatures will be reviewed and examined using content analysis. It is expected that this paper could shed some thoughts about the Shariah issues in al-rahn-based products theoretically and practically.

Keywords: Microfinancing, Al-Rahn, Shariah Issues
ABSTRAK


Kata Kunci: Microfinancing, Al-Rahn, Shariah Issues

INTRODUCTION

The development of Islamic banking and finance in the last few decades in Malaysia has led to the introduction of various Islamic financing products which are free from the prohibition of riba, gharar and maysir. Ranging from short to long term financing, exchange-based and equity-based, micro financing and a lot more products and services, Malaysia has become one of the leading Muslim countries in the world in which the volume of Islamic finance business has grown rapidly.

Micro financing is one of the means to help the lower income segment of the society to solve their short-term liquidity needs. The importance of helping the needy is made a priority Islam. Therefore, lending to the needy should be the main focus in Islamic finance (Azila 2008). In this context, the Islamic pawnshop (al-rahn scheme) could be the most appropriate mechanism as it provides a financial product for the lower-income group and small businesses which usually have limited capital or have been excluded from the mainstream financial system.

While taking note of its importance to meet the need of certain segment of consumers on the one hand, some theoretical and practical aspects of rahn have been identified to trigger Shariah concerns by the scholars on the other. This paper attempts to overview some of the literatures that highlight a Shariah issues of rahn-based financing with special reference to theoretical aspect of it.
APPLICATION STRUCTURE OF RAHN-BASED FINANCING

The structure of current Islamic pawn broking depends on the underlying contracts adopted. Based on the current market practice of Malaysia, the applicable contracts are wadi’ah yad al-damanah (guaranteed custody contract), qard (interest-free loan contract), rahn (Islamic pawn broking contract) and ujrah (fee) (Shamsiah and Salleh 2008, Mohamed Fairooz, Badri, and Hussain 2012, SKM 2013, Imani and Zambahari 2013, Ahmad Faizal, Mohammad Hatta, and Kamis 2017).

As the customers are in short of cash, they would normally go to the Islamic pawn broking institutions which could be Islamic financial institutions (IFIs) or any other Islamic pawn shop (IPS). Typically, the transaction flow will start with the customers bring the pledged items (marhun) normally in the form of golden jewelry because of its stable market value to the IFIs or IPS. As earlier mentioned, the purpose of customers coming to the IFIs or IPS is to get some cash through micro financing. For that purpose, the pledge is handed in to the IFIs or IPS to be valued at market price for that specific type of gold. Normally the amount of financing approved by the IFIs or IPS is less the market value of pledged gold by certain percentage as a risk mitigation to avoid non-settlement of debt by the customers. The putting up of golden jewelry with the IFIs and IPS is governed by the contract of wadi’ah yad al-damanah.

For keeping up the customers’ pledge, the IFIs or IPS charges some amount of fee (ujrah) – which amount is based on the marhun value – for the risk of taking care the custody of the marhun. However, certain institution namely Muassasah Gadaian Islam Terengganu (MGIT) waive the custodial fee for loan amount below RM 1000 (Nur Hayati and Markom 2014).

Subsequently the IFIs or IPS will loan some amount of monies to the customers, governed by the qard contract. And lastly the contract of rahn will come into the picture as a security for the financial obligation created through this arrangement (Bank Islam 2015, Affin Islamic Bank 2016, Bank Muamalat 2016, Bank Kerjasama Rakyat Malaysia 2018, Agro Bank 2015, YAPEIM 2018, Kedai Ar-Rahn 2017, POS ArRahnu 2018, MAIDAM 2017). Based on the description above, Figure 1 below illustrates the modus operandi of Islamic pawn broking:
Some rahn-based financing structure starts with qard first in which the financial obligation is established prior to the conclusion of wadi’ah yad al-damanah contract. Whilst, the other structure commences with wadi’ah yad al-damanah first before the conclusion of qard contract. Owing to that, the service fee charged for keeping the marhun is justified from Shariah perspective on the ground that the financial obligation is not established yet.

Despite the promising development of Islamic pawn broking business, it is not free from Shariah issues or concerns. Based on the identified literatures, among the concerns raised by the Shariah scholars in regard to rahn-based microfinancing in Malaysia are conflict in the essence of the combined contracts, custodial fee, benefiting from the marhun, and the possible financing structures. The following sub-sections will discuss the abovementioned concerns.

**SHARIAH ISSUES**

This part of writing aims to shed lights on several Shariah issues of Rahn-Financing in Malaysia namely (i) conflict in the essence of the combined contracts, (ii) custodial fee, (iii) benefitting from the marhun, and (iv) possible financing structure.

**Conflict in the Essence of the Combined Contracts**

According to Mohamed Fairooz, Badri, and Hussain (2012) the combination of rahn with wadi’ah yad al-damanah could result in the legal effects of both the contracts are conflicting in terms of returning the pledged and the deposited item. On the same page, Sastra Mihajat (2015) cited AAOIFI in its Standard No. 25 conditions for a combined contracts or hybrid contract to be permissible:

i. Combining contracts should not include the cases that are explicitly banned by Shariah. For example, contracts that combine a sale and a loan into one contract;
ii. Combining contracts should not be used as a ploy to commit riba, such as an agreement between two parties to practice a sale and buyback transaction (bay’ al-inah) or riba al-fadl;

iii. The combination of contracts should not be used as an excuse for practicing riba;

iv. Combined contracts should not reveal disparity or contradiction with regard to their underlying rulings and ultimate goals (essence of the contract).

Apparently, the last condition is pertinent to the issue at hand where the problem arises from the conflict in the underlying rulings and ultimate goals (muqtada al-’aqd) of both contracts. In the light of this condition, the deposited item in wadi’ah yad al-damanah contract needs to be returned at the request of the depositor at any time. As for the rahn, the marhun cannot be taken back by the owner or mortgagors at any time he or she so wishes as that will not serve the purpose of pledge i.e. to secure the amount loaned. The conflict of muqtada al-’aqd between the two contracts contributes to Shariah concern.

In addition, according to Shamsiah and Salleh (2008), the purpose of wadi’ah it for custody while the objective of rahn is as a pledge for financial obligation. Delivery of the marhun to the creditor is not motivated by the intention to keep the same under the pretext of wadi’ah contract. As such, it is not in line with Shariah rulings for wadi’ah yad al-damanah to be employed as the underlying arrangement for Islamic pawn broking.

Nevertheless, the bigger Shariah concern is about the inclusion of wadi’ah yad al-damanah in rahn as to whether it is a kind of hilah or legal trick to circumvent riba. The issue of riba comes into the picture due to the custodial fee that IFIs or IPS impose on deposited item.

Custodial Fee

Generally, the custodial fee charged by IFIs and ISP could be on daily, monthly, and yearly basis. There are three issues concerning custodial fee i.e. (i) issues about the determination of custodial fee, (ii) issues regarding excessive charge of the custodial fee, and (iii) other consequential issues.

Issues About the Determination of Custodial Fee

As far as market practice is concerned, the custodial fee is determined by calculating certain percentage on the value of marhun, but not on the amount loaned. If it is charged on the amount loaned, it will result in charging interest (riba) on the amount loaned. So far, there is no standard charge for custodial fee as it may range from RM 0.10 to RM 0.85 per RM 100 marhun so long as the maximum charge per month is 1 percent of the marhun value. (SKM 2013, Nur Hayati and Markom 2014). In drawing a parallel, the closest case in the IFIs pertaining to charging cost on pledge is the safe box in which the customers keep their valuables. However, the storage cost of the safe box is much lower than that of pawn broking (Mohamed Fairooz, Badri, and Hussain 2012,
Dziauddin et al. (2013). Nevertheless, in comparison to conventional pawn broking, rahn financing scheme’s charge is much lower than that of the former (Bhatt and Sinnakkannu 2008).

As a suggestion, Abdul Nasir (2013) opined that custodial fee should be determined in the form of fixed amount rather than in percentage rate in addressing the concern that the lender might charge excessive custodial fee and consequently earn extra benefit or profit from the same. Nonetheless, charging a fixed amount of custodial fee does not necessarily mean that the lender has no room to impose hidden charges. As such, determination of custodial fee at an actual cost remains a challenging issue.

**Issues Regarding Excessive Charge of the Custodial Fee**

According to Mohamed Fairooz, Badri, and Hussain (2012), the amount of fee chargeable is relatively higher than the financing charges of IFIs with special reference to Personal Financing-i. Furthermore, charging of fee in the context of rahn financing is deemed as a kind of benefit arising from the loan. Subscribing to this view, Ahmad Faizal, Mohammad Hatta, and Kamis (2017) suggested that there is a direct link between ujrah imposed with the loan given to the customers. Despite a fixed rate of ujrah, inflated fee is applicable on the charge i.e. the higher the amount of marhun the higher amount of loan the customer will get and consequently the larger amount of ujrah is chargeable. According to them, this practice is much similar to loan given by conventional bank in which the higher the loan, the higher profit bank will get due to interest charge on the loan.

Unless the derived benefit or charge reflects the actual cost of the lender, the benefit or charge is considered riba (AAOIFI 2015, Standard No. 9/1). The concern on attainment of benefit from loan contract is indicated in the hadith which reads:

كل قرض جر نفعا فهو ريبا
Every loan which gives benefit (to the creditors) is considered riba.

(Abu al-Jahmi, Juz’, No. 92; Al-Harith, Musnad al-Harith, No. 437; al-Daylami, al-Firdaus, No. 4778)

According to Shamsiah and Salleh (2008), ujrah on the marhun is not justifiable from Shariah point of view on the ground that the pledgee is entitle to the actual cost but not fee. Charging the actual cost of maintenance (nafqah) for the marhun is acceptable based on a hadith cited by al-‘Asqalani which was reported from Ḥammad bin Salamah in his Jami’ that reads:
If a sheep is pledged, the pledgee can drink its milk as much as the price of feed, if he drinks the milk above the price of fodder, it is riba.
(Fath al-Bari, Kitab al-Rahn, Bab al-rahn markub wa mahlub, No. 144)

The above hadith indicates that the lender’s entitlement over the pledged item is compensated with the cost that he has incurred. Based on this hadith, Abdul Nasir (2013) attempted to define actual cost (al-taklifah al-haqiqiyah) as equivalent as the original cost (al-taklifah al-asliyyah) forgone in producing goods and services but not the retail or market value. In the avoidance of doubt, actual cost should be distinguished from expenses as well. The former represents the entire cost whereas the latter are part of the former. Any residual balance after deducting expenses from the actual cost is recognized as asset. However, the relationship between the actual cost defined by him and the actual cost for custodial fee is not clearly explained. Azman and Haron (2016) proposed only actual incurred cost can be imposed on rahn financing.

Other Consequential Issues

Another concern that arises is as to whether wadi’ah yad al-damanah justify the charge of ujrah. According to Hanafi, ujrah is not applicable to wadi’ah since wadi’ah is not a job but a trust to keep the deposited item, which is why it should be wadi’ah yad al-amanah all the time instead of wadi’ah yad al-damanah.

Thus, only ijarah or wakalah justify the charging of ujrah. If the charge is recognized as ujrah, it will result in the combination of sale of usufruct or ijarah with qard or bay’ wa salaf which is prohibited in Islam (Mohamed Fairooz, Badri, and Hussain 2012, BNM 2016, Standard 14.1 (a)). This is clearly indicated in the hadith below:

لا يحل سلف وبيع

It is not permissible to execute a loan (salaf) contract (in combination) with a sale contract.
(Majmu’ al-Fatawa, No. 29/528)

A parallel can be drawn between bay’ wa salaf and qard jarra nat’an. This is because, in the former, loan that generates benefit for the lender comes from the sale contract. The price of sale contract would normally constitute cost price plus profit. Thus, the profit portion of sale price is the extra benefit the lender i.e. IFIs or IPS will gain out of the salaf or qard loaned to the customers.
In the same vein, Ahmad Faizal, Mohammad Hatta, and Kamis (2017) opined that the combination of qard with sale may also take the form of takaful subscription by which the customer will purchase the takaful to cover the pledged item. However, this opinion is not valid as the aqd that underlies takaful subscription is not a sale but a tabarru’ contract. In addition, the prohibition of bay’ wa salaf is understood as the benefit that the lender will reap from the combination of both contracts which is not the case in subscribing takaful for the pledged item as it eventually benefits the customer or pledgor.

**Benefitting from the Marhun**

Another Shariah issue arises from practice of rahn is benefitting from the marhun by the IFIs and IPS. As the underlying contract used is wadi’ah yad al-damanah, it somehow resembles qard contract. However, since the financial obligation is not yet established between the IFIs or IPS and the customers in the first place, most possibly wadi’ah yad al-damanah contract is used instead. But after the financial obligation was established by the IFIs or IPS through the loan or qard, the question arises as to why the wadi’ah yad al-damanah still goes even after the establishment of financial obligation. The contract of rahn should start to take effect after the qard contract was concluded keeping in view that the item pledged should be kept as a marhun.

Keeping in view that wadi’ah yad al-damanah is deemed as qard contract, it looks like two qard contracts were concluded here. First between the customer and the IFIs or IPS via wadi’ah yad al-damanah contract where the former deposited his property with the latter on guarantee basis. Second, the qard contract is conversely established between the IFIs or IPS and the customer where the former loans some amount of monies to the latter. This arrangement gives a debt offset effect or muqaṣṣah in view of both the parties loan to each other.

However, to claim that the wadi’ah yad al-damanah is akin to qard in this case is not accurate. This is because the pledge does not fully meet the criteria of item used for qard contract. In other words, the item for qard contract is something typically fungible or mithli and consumable. But in the case of golden jewelry put up as a pledge, it meets the criteria of mithli but it doesn’t fall in to the category of consumable. It is not consumable as the IFIs and IPS has guaranteed to keep the pledge. Thus, it is not completely accurate to say that qard contract in the form of wadi’ah yad al-amanah is appropriately applied here. As such, the issue of back-to-back qard does not arise.

So, what makes the IFIs or IPS still interested to adopt wadi’ah yad al-damanah instead? On the one hand, wadi’ah yad al-amanah is adopted as assurance and guarantee that the pledged item will be safe under the custody of IFIs or IPS (Ahmad Faizal, Mohammad Hatta, and Kamis 2017). On the other hand, another possible answer to this question would be to justify the charging of custodial fee on the customer. Therefore, it ends up with the IFIs or IPS earn benefit from the marhun through custodial fee. However, the practice of benefitting from qard contract via a fee in this context is against Standard 15.3 (b) of the Rahn Policy Document by BNM (2018, 7).
Possible Financing Structure

The structure of rahn financing with the combination of qard and wadi’ah yad al-damanah is deemed problematic due to concerns on riba it causes. Eventually, the idea of altering the financing structure by substituting the underlying contracts has become an important agenda. There are two possibilities coming out from this idea i.e. either by (i) substituting the entire structure or by (ii) maintaining the original structure with alterations on any of the underlying contracts.

Substituting the Entire Structure

As far as the first possibility is concerned, the entire structure need to be substituted with the contract which could serve the purpose of rahn and wadi’ah yad al-damanah. From the perspective of fiqh al-muamalat, the nearest contract which shares common features with rahn is bay’ al-wafa (Demetriades and Effendi 2000). Bay’ al-wafa is a contract in which the owner of the asset sells it to the buyer with the conditions that the buyer will fulfill (wafa) the agreement to sell back the asset to the owner or seller. Putting bay’ al-wafa in the context of rahn financing, the customer acts as the seller while the IFIs or IPS is the buyer. The legal consequence created from this arrangement is that the ownership of asset is transferred from the seller (the customer) to the buyer (the IFIs or IPS), which entitles the latter the benefit of using the asset as well as incurring loss. (Majma’ al-Fiqh al-Islami, 1992) in its Resolution number 68/4/7 has decided that bay’ al-wafa is not permissible due to its resemblance with qard jarra naf’an. Nonetheless, in the author’s understanding, bay’ al-wafa will become interest bearing if it operates like bay’ al-inah, in which one of the parties will gain benefit. However, bay’ al-wafa would be permissible if it generates no benefit or profit to the parties or in other words there is no change in the price of first and second sale.

Hence, it appears that substituting rahn with bay’ al-wafa is unable to solve the issue of gaining extra benefit as the buyer can use the item sold. However, according to Mohamed Fairooz, Badri, and Hussain (2012), this possible arrangement is less worse than the current structure of rahn financing that adopts wadi’ah yad al-damanah since the amount of sale back is as same as the amount of purchase. In other words, there is no monetary gain from bay’ al-wafa unless the benefit of using the item sold. Yet, making it more complicated is the item used in context of rahn financing is golden jewelry. Shariah wise, can golden jewelry be transacted as the item of bay’ al-wafa? As far as transaction of gold is concerned, it should comply to its prescribed rulings without which the transaction of gold is considered ribawi or interest-bearing. The answer is negative in the sense that the transaction of gold in bay’ al-wafa arrangement is done on spot basis and the transaction amount is the same in two legs of the sale.

Another option is by substituting the qard contract with other types of financial obligations, the debt of which might be resulting from sale-based contract such as bay’ al-tawarruq via commodity murabahah (Azman and Haron 2016). However, the application of bay’ al-tawarruq is subject to its permissibility according to the different view of Shariah scholars. As far as Malaysian jurisdiction is concerned, bay’ al-tawarruq
is acceptable as a mode of financing (BNM 2010). On that note, the custodial fee charged for holding the pledge is Shariah justifiable on the ground that profit is normally inherent in sale contracts.

If sale-based contracts are applicable as mode of financing, it means the sale-based contract other than bay’ al-tawarruq is equally applicable for example the idea of applying bay’ al-sarf as suggested by Mohamed Fairooz, Badri, and Hussain (2012). By bay’ al-sarf it means the sale of currency which could also take the form of gold bar. The gold bar (extendable to golden jewelry as well) is sold to the IFIs on spot or cash at a price slightly lower than the market price. Later, through the mechanism of wa’ad min tarf wahid (unilateral undertaking from one party), the IFIs may or may not sell back the gold bar to the customer at a cash price slightly higher than the first sale price. Generally, it looks like a sale and buy back arrangement like that of the controversial bay’ al-wafa or to certain extent bay’ al-inah. However, the insertion of wa’ad min tarf wahid in the second leg of the transaction differentiate this type of bay’ al-sarf from bay’ al-wafa or even bay’ al-inah. This is because wa’ad min tarf wahid could address the issue of interconditionality between the first leg and the second leg of bay’ al-sarf by which the IFIs or IPS is not obliged to sell the same gold bar or jewelry to the customer. Nevertheless, this arrangement might be problematic if the customers insist to repurchase the same jewelry.

Nonetheless, the chance of applying this possibility might be thin as it could trigger another Shariah concern especially when it comes to combining the sale contract with the loan contract which could result in the net effect of bay’ wa salaf. This is especially when sale contract – namely bay’ al-tawarruq, bay’ al-sarf etc. – is combined with wadi’ah yad al-damanah (which is equivalent to qard according to BNM (2010, 101)). Ultimately, this arrangement would lead to the prohibited bay’ wa salaf. However, if only rahn contract is used to collateralize the financial obligation arising from bay’ al-tawarruq and wadi’ah yad al-damanah contract is removed from the arrangement, the concern on bay’ wa salaf will not arise. Hence, there is no need for the IFIs or IPS to charge any custodial fee at all as the profit can be earned from the tawarruq arrangement (Azman and Haron 2016). As for the proposed bay’ al-sarf structure, the issue of loan with profit will be resolved and the arrangement is considered free from riba if wadi’ah yad al-damanah is excluded from the financing arrangement. Even the application of rahn is not relevant in this structure.

Maintaining the Original Structure with Minor Alterations

The second possibility is also extendable to the case in which the entire rahn-based financing structure’s status quo is maintained. As the main Shariah concern is about earning extra monetary gains in relation to qard contract, a thinkable way of avoiding from this gain is by making the fee or ujrah unconditional. This is the approach being practiced in rahn financing scheme offered by MAIDAM (2017). However, Shariah concern may arise if the unconditional hibah is commonly granted to the extent of becoming a customary practice in the market. Any action which is unconditional but widely practiced in the society could make it a condition according to the established
legal maxim “al-ma’ruf ‘urfan ka al-mashrut shartan”. After all, applying unconditional hibah would be much more feasible for non-profit organization like MAIDAM but not to the commercial IFIs or IPS.

The issue of commerciality also arises if the rahn financing is designed based on its original structure i.e. by applying rahn as a supporting contract to the main contract of qard. Under this financing structure, any maintenance cost and benefit coming from the pledged item belong to the pledgor or customer as indicated in a hadith:

لا يغلق الرهن من صاحبه الذي رنه، له غنه، وعليه غرمه

A pledge does not become the property of mortgagee; it remains the property of its owner who mortgaged it; he is entitled to its benefits and liable for its expenses.
(Al-Muwatta No. 2/278; Al-Um, No. 4/346; Al-Marasil, No. 186)

Despite the IFIs or IPS may have all the cost in keeping the pledged item covered by the pledgor or customer, charging hidden income from the cost should not be the idea as the former can only recover the cost, but not income, from the latter.

Another proposition is suggested by Azman and Haron (2016) in doing away from imposing extra charge on the customers. This can be done within the existing structure of rahn financing by arranging the third party to keep the pledged item and the custodial fee is payable to him. Again, commerciality issue might arise as the IFIs or IPS have no room to generate income from such arrangement.

CONCLUSION

In conclusion, the Shariah issues on the theory and practice of rahn in Malaysia is still ongoing so long as the original structure of rahn-financing (in reference to Figure 1) is operative. As mentioned earlier, the main concern is the benefit that the lender earns from extending the loan or qard. Based on the previous writings, altering the financing structure is the best option to address this Shariah issue. There are two options in altering the structure, the first of which is substituting the entire financing structure and the second is maintaining the original structure but with minor alterations on its contracts.

Bearing in mind that IFIs and IPS are profit driven entities, the second option might not be feasible for the same to adopt since it gives no room for them to generate income from rahn-financing business. Therefore, other mechanism needs to be considered to address the concern on ribā, for example by adopting sale-based contracts specifically bay‘ al-tawarruq and bay‘ al-sarf to create indebtedness between the IFIs or IPS and the customer so that extra charge in the form of profit is Shariah justifiable. Looking from the commercial point of view, the first option would be more practical for the IFIs or IPS.
As for the second option, adopting the original structure with minor amendments is expected to address the concern on ḫirāb i.e. the issue of earning extra benefit through the custodial fee. In this financing structure, the function of ḫān is more of a supportive contract which safeguards financial obligation rather than generating income for the IFIs or IPS. Apparently, this option is not ‘practical’ for the IFIs or IPS to adopt. However, this might be a more attractive option for customers with lower income considering that there is no need for them to pay extra charges. On that note, the second option is feasible if it is operationalized by non-profit organizations. In other words, this type of organizations needs to be financially backed-up by a third party - the government for example - in running their business as they make no profit from extending loan to the lower income customers.

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