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Developing a financial model for Islamic credit card for the UK.

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Declaration

I declare that no part of this dissertation has been taken from existing published or unpublished materials without due acknowledgement and attrition, and that all secondary material contained therein has been fully and appropriately referenced to the best of my ability.

Signed _____

Dated 29th March 2006

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Abstract

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This paper attempts to develop a financial model for an Islamic Credit card for the Islamic Bank of Britain for the UK market. Using the basis of existing models for Islamic credit cards that are available in the gulf and Malaysia, it attempts to develop a model that can be used for the UK market.

The main finding is that conventional credit cards are based on agreements that include clauses of interest which is clearly against the shariah. However, many scholars have justified using them by acknowledging the convenience such product offers in day to day life with the intention of the user to make regular payments hence, avoiding riba.

Bank in South East Asia have structured credit cards on bai al inah contracts and these have been rejected by the banks in Gulf as flimsy, controversial, fake and just a means of masking Riba. As is the case with matters of Shariah-compliance, judgments are based on the Shariah board of each financial institution and so what may be acceptable to one board may yet be Haram for another. For many Middle East bankers, therefore, the solutions found by the Asian banks are simply not stringent enough in their interpretation of Qur'anic rules and are only best at rejecting transactions related to bars, gambling, massages and so on for payment with no importance been given to the actual contracts on which these cards are based.

Gulf banks have taken a different approach to structure credit card in line with the beliefs of muslims. The basis of many such contracts is charging for guarantee on payments and recovering such costs as administrative & operational expenses.

The author has proposed two model structures which can form a basis on which Islamic bank of Britain can develop a credit card for UK market and offer it to customers enabling them to use present day payment methods that will be in line with their religious beliefs. These may offer not a complete solution however, can be considered as an important work that could be combined with existing research undertaken by the bank in this field. The first model is based on kafala and can be defined closely to a charge card model and the second model is a combination of tawwaruq & wadiah contracts.

Keywords

Islamic finance, credit cards, halal cards, riba

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Chapter One

Introduction

Plastic payment cards- credit, debit, and charge cards- have quietly revolutionized how we pay for goods and services. They have also revolutionized how we coordinate the timing of when we purchase goods and services and when we pay for them. Among all these cards, much focus is on credit cards which encourage people to spend beyond their means and get mired in debt. However, credit cards have enabled many more of us to achieve a better standard of living (Evans & Schmalensee, 2005)

Credit card or 'plastic money', however, has become a major source of controversy for Muslims in recent years. For the Muslims, the usage of the above mentioned conventional cards has become a question of great concern. Can we use them or can't we? Well, according to some Muslims, we can use the conventional credit cards, as long as we discipline ourselves and pay on time so as not to incur interest. To them, this is not going against the injunctions of Islam, as we are not indulging ourselves in the activities of 'Riba'.

On the contrary, some others are of the opinion that conventional credit cards are by no means Islamic. To them, not only do conventional credit cards engage in Riba-based activities, they also lack Islamic features or elements.

This dissertation aims at developing a suitable financial structure for a credit card for UK market that is shariah compliant and presents this model to the product development team of Islamic bank of Britain for evaluation. All aspects of a Muslim's life are governed by Shariah. Shariah law comes from a combination of sources including the Koran - the Muslim holy

book, the Hadith - the sayings and conduct of the prophet Mohammed, and fatwa's - the rulings of Islamic scholars. (The Shariah: An Introduction, n.d.)

1.1 Aim

The purpose of this dissertation is to present a financial structure for Islamic credit card for UK market.

1.2 Research Questions

This dissertation is based on the following research questions

- Can muslims use the credit cards that are available in the market?
- How does Islam accept the role of credit card as a medium of payment?
- Are the Islamic credit cards that are available in the market halal?
- What are the underlying principles required by the shariah in the functionality of credit cards? And how can these be used to present a model suitable for an Islamic credit?

1.3 Method

This study heavily relies on secondary data available on the websites of banks in Middle East and Malaysia and, various other articles written on this area. Other data sources include E library of Islamic finance (maktabaonline.com), News Horizon (Journal of Institute of Islamic Banking & Insurance London), The Banker Middle East magazine, and other data available on the internet.

Chapter Two

Conventional Credit cards

2.1 Definition of credit card

The credit card is a variable repayment card which offers a line of credit to the cardholder who can spend up to a pre-arranged ceiling level. The extended credit must be settled within a given period, or else interest will be charged on the remaining balance. (Paxson & Wood, 1998)

A credit card is a thin plastic card, usually 3-1/8 inches by 2-1/8 inches in size that contains identification information such as a signature or picture, and authorizes the person named on it to charge purchases or services to his account - charges for which he will be billed periodically. The "smart" credit card is an innovative application that involves all aspects of cryptography (secret codes), not just the authentication we described in the last section. A smart card has a microprocessor built into the card itself. (How Credit Cards Work, n.d.)

A credit card can be used by the cardholder to pay for something or to withdraw cash using a line of credit that has been made available by the credit card issuer. The cardholder is then required to pay back the amount that has been borrowed in accordance with the terms and conditions of the credit card agreement. With most types of credit card you can settle the amount owing in full and without interest (on purchases) within a given period of time, or pay off a portion of the outstanding amount and carry the remaining balance forward with

interest. However, some credit card companies offer a basic, no frills credit card that has no interest-free period but provides a means by which you can borrow up to a given credit limit. These cards usually have a lower APR than would otherwise apply but immediately begin charging interest on purchases and other transaction types.

2.2 History of credit cards

The first form of a credit card system originated in the US in the form of credit documents constructed from card. Later, at the beginning of the twentieth century, embossed metal addressograph plates were used by the Western Union and other banks to identify customers and record their details of their accounts. In 1947, the Flatbush National Bank introduced its 'Charge-it' plan, a monthly charge account restricted to customers of the bank and in 1951 the Franklin National Bank became the first bank to issue credit cards to customers of rival banks (Lindsey, 1980) However, the first modern credit card appeared in 1950, when Diners Club launched the Travel and Entertainment (T&E) card. This was followed by American Express in 1958, which featured a credit period between expenditure and settlement but had no facility for roll-over credit or part payment (Wonglimpiyarat, 2004/2005).

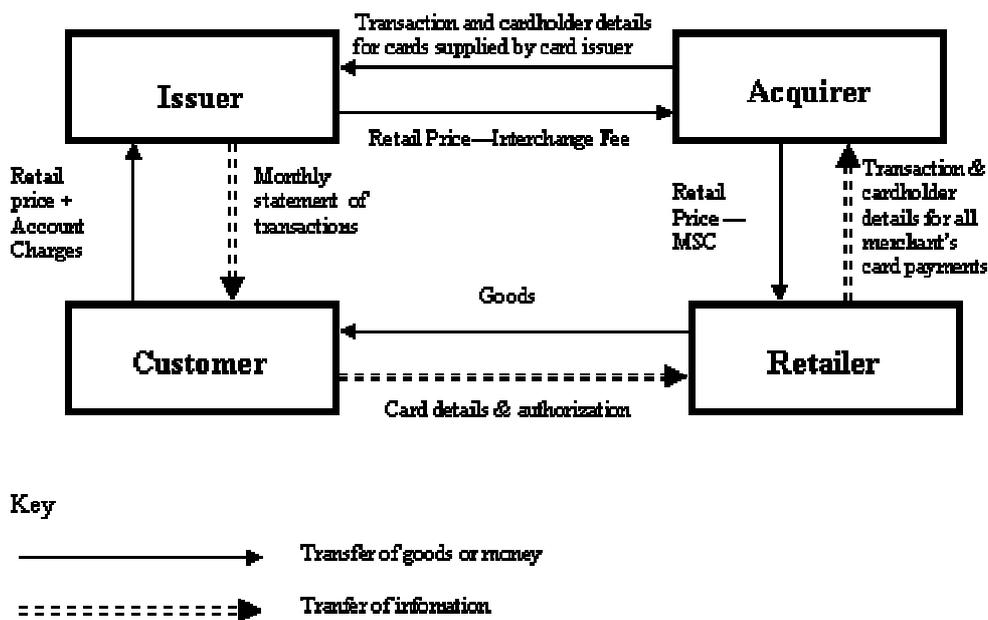
A national credit card was created in 1966 when the Bank of America licensed its credit cards to other banks across US and overseas. Disturbed by the leadership position BankAmericard had created, rival banks joined together in the same year to create a competitive system under the name of Interbank, which later became MasterCharge and then MasterCard (Frazer, 1985; Vartanian, et al, 1998).

In 1966, Barclays made an arrangement with the Bank of America to issue credit cards in the UK. Barclays imported the entire operation and a computer program change was all that was needed to modify the Bank of America program for UK purposes (Wonglimpiyarat, 2004/2005)

2.3 Credit card system

Visa, Switch and MasterCard all operate four party payment schemes. Any card transaction made through one of these schemes involves four main participants. These are:

- The customer, who makes a payment using the card;
- The card issuer who supplies the card to the customer and operates the account from which payment is made;
- The retailer (or ‘merchant’) who exchanges goods or services for the customer’s card details and consent to make the payment;
- The merchant acquirer who recruits retailers to the scheme, reimburses the retailer and obtains funds from the card issuer. The merchant acquirer often has an existing customer relationship with the merchant, but need not do so. A payment will involve both a flow of assets - money and goods - and also a flow of information about transactions that are taking place. These are shown on the diagram using solid and dashed lines respectively.



Source: Banking Review

Figure: 1 (Cruickshank, 2000) Main parties involved in a credit card system.

The transaction starts with a customer deciding to buy some goods from a retailer at a given price. In the UK, the retailer could, in principle, charge a different price for credit card transactions than for other transactions, though in practice this rarely happens. The customer wishes to pay using a card issued under a particular scheme and the retailer has agreed to accept the scheme's cards. The customer gives his card details to the retailer and confirms his identity, for example with a signature. For some transactions the retailer may be required to seek authorization from the card issuer, for example to check that the card is not stolen or that the transaction would not make the customer breach an agreed credit limit. Visa Debit and Switch have both introduced debit cards which always require authorization, called Electron and Solo respectively. These are targeted at less wealthy and/or inexperienced customers.

The retailer then sends transaction details to the merchant acquirer. Transaction details may either be sent in a batch at the end of the trading day or online. The acquirer in turn forwards

transaction and cardholder details to the relevant card issuers – usually through a telecoms network under the control of the scheme. The merchant acquirer pays the retailer the retail price less a fee, known as a merchant service charge (or MSC). The issuer in turn pays the merchant acquirer the retail price less a further fee known as an interchange fee. The timing of the payment from issuer to acquirer is typically determined by the rules of the payment scheme. The timing of the payment by the merchant acquirer to the retailer is determined by agreement between these two participants.

The final stage is for the issuer to debit the customer's account - this might be a credit card account or a current or savings account, in the case of a debit card. The issuer will typically provide the customer with transaction details through a regular statement. The customer will be debited the retail price, plus any fees specified in the terms of the account.

Once the transaction is completed, the customer ends up with the goods for which he has paid the retail price plus any fees levied by the issuer. The merchant receives the retail price less the merchant service charge, and no longer holds the goods. The merchant acquirer receives the merchant service charge less the interchange fee. The issuer has two sources of revenue for card transactions: revenue from the customer, such as annual fees and interest payments; and interchange fees paid by merchant acquirers. Four party card schemes may be contrasted with three party schemes, in which the same firm deals with both the customer and the retailer (i.e. acts as both the merchant acquirer and the card issuer). This is basically the model used by American Express and Diners' Club. Interchange fees in a three party scheme would essentially be internal transfers within the same firm (Cruickshank, 2000)

2.4 Types of credit cards

Credit cards tend to fall into the following broad groups: Standard Cards, Premium Cards (Gold, Platinum and Black Cards) & Charity/Affinity Cards.

Any credit card that isn't a gold, platinum or black card (i.e. a premium card) is likely to be a standard card. Standard cards are available to anyone over 18, subject to the application being accepted. Premium cards usually offer higher credit limits and have lower interest rates. Many also have extra benefits such as travel insurance, product guarantees and preferential loan rates. Credit card companies offer premium cards to people they consider to be a better credit risk. They are often available to people who have a specified minimum income level which can be quite high. The more exclusive cards tend to have annual fees. Some credit cards are issued on behalf of charities and other organizations such as football clubs and universities. For this type of card the credit card company will generally make a donation to the charity or affinity group when the card is issued and/or each time that the card is subsequently used — at no additional cost to you. (Credit Cards, n.d.)

2.5 UK credit card industry – brief facts

According to the latest annual report from the APACS nearly two thirds of adults have a credit card and multiple card holding is a growing phenomenon in the UK. More than six in ten card holders held more than one card in 2004, with one in ten holding at least five.

Plastic cards in issue reached 190mn in 2004. This works out at an average of 4.1 plastic cards for every adult in the UK. There are more credit cards in the UK than people according to the APACS. At the end of 2004 there were 74.3m credit and charge cards in the UK

compared with around 59 million people in the country. 270 plastic transactions took place every second in the UK in 2004. (Plastic cards in the UK, n.d.)

Chapter Three

Islamic Finance

3.1 Background

Islamic finance is finance under Islamic law (or Shariah) principles. The basic sources of Shariah are the Qur'an and the Sunna, which are followed by the consensus of the jurists and interpreters of Islamic law. The central feature of the Islamic finance system is the prohibition in the Qur'an of the payment and receipt of interest (or riba). The strong disapproval of interest by Islam and the vital role of interest in modern commercial banking systems led Muslim thinkers to explore ways and means by which commercial banking could be organized on an interest-free basis. (Islamic finance: Basic principles, 2006)

3.2 Development

Islamic financial institutions are relatively recent creations: one of the first Islamic banks was set up in Egypt in 1963. Although the origin of modern Islamic banking was in Egypt, it probably would not have developed as an important financial force without the strong support of Saudi investors. The Islamic Development Bank (IDB) was established in 1975 and gave momentum to the Islamic banking movement. It was the first time in modern Muslim history that an international financial institution committed itself to conduct its activities in conformity with the Shariah. Instead of working on the basis of interest, the bank was authorized to levy a service fee to cover its administrative expenses.

Since the creation of the IDB, a number of Islamic banking institutions have been established all over the world and some countries have taken the necessary steps to organize their

banking systems along Islamic lines. The first private Islamic commercial bank, the Dubai Islamic Bank, was founded in 1975. (Islamic finance: Basic principles, 2006)

3.3 The shariah and the shariah board

Islam has a set of goals and values encompassing all aspects of human life, including social, economic and political issues. It is not a religion in the limited sense of the word, interested only in salvation in the hereafter; rather it is a religion that organizes one's life completely. The body of Islamic law is known as Shariah, literally meaning a clear path to be followed and observed.

The Shariah is not a codified body of law. It is an abstract form of law capable of adaptation, development and interpretation. The Shariah does not prescribe general principles of law; instead it purports to deal with specific cases or transactions and sets out rules that govern them. (Hourani)

The Shariah developed through four main Islamic juristic schools (Hanafi, Maliki, Shafi and Hanbali) and is derived from two primary sources, the Quran (the transcription of God's message to the prophet Mohammed) and Sunnah (the living tradition of the prophet Mohammed), in addition to two dependent sources: ijma (consensus) and ijihad /qiyas (individual reasoning by analogy). (Hourani)

One distinct feature of the modern Islamic banking movement is the role of the Shariah board, which forms an integral part of an Islamic bank. A Shariah board monitors the workings of the Islamic bank and every new transaction that is doubtful from a Shariah

standpoint has to be cleared by it. These boards include some of the most respected contemporary scholars of Shariah and the opinions of these boards are expressed in the form of fatwa's. In addition, the International Association of Islamic Bankers, an independent body, supervises the workings of individual Shariah boards while its Supreme Religious Board studies the fatwa's of the Shariah boards of member banks to determine whether they conform to Shariah.

Shariah law is open to interpretation and Shariah boards often have divergent views on key Shariah issues. In this regard, there is no practical guide as to what constitutes an acceptable Islamic financial instrument. A document or structure may be accepted by one Shariah board but rejected by a different Shariah board.

Islamic banks must have a religious committee made up of high caliber religious scholars. This Shariah board has both a supervisory and consultative duty to ensure that the bank's practices are in line with the Shariah.

The prohibition of all sources of unjustified enrichment and the prohibition of dealing in transactions that contain excessive risk or speculation are among the most important teachings of Islam in establishing justice and eliminating exploitation in business transactions. Accordingly, Islamic scholars have deduced from the Shariah three principles that form the benchmark of Islamic economics and that distinguish Islamic finance from its conventional counterpart.

3.4 Principles of Islamic finance

The main principles of Islamic finance include:

1. The prohibition of taking or receiving interest; The prohibition of interest

The essential feature of Islamic banking is that it is interest-free. Islam prohibits Muslims from taking or giving interest (riba) regardless of the purpose for which such loans are made and regardless of the rates at which interest is charged.

Riba literally means increase, addition, expansion or growth. It is however, not every increase or growth which has been prohibited by Islam. In the Shariah, riba technically refers to the “premium” that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity. In this sense, riba has the same meaning and import as interest in accordance with the consensus of all the fuqaha (jurists) without any exception. (Chapra, 1985/1986)

This prohibition of ‘unjustified’ enrichment and advantage is in line with the most important teachings of Islam for establishing justice and eliminating exploitation in business transactions. The Prophet peace be upon him condemned not only those who take riba, but also those who give riba and those who record the transaction or act as witnesses to it. The prohibition of usury or interest (riba) is the most significant principle of Islamic finance.

Riba represents a prominent source of unjustified advantage. All Muslim scholars are adamant that this prohibition extends to all forms of interest and that there is no difference between interest-bearing funds for the purposes of consumption or investment, because Shariah does not consider money a commodity for exchange. Instead, money is a medium of exchange and a store of value.

2. Capital must have a social and ethical purpose beyond pure, unfettered return;

3. Investments in businesses dealing with alcohol, gambling, drugs or anything else that the Shariah considers unlawful are deemed undesirable and prohibited;
4. A prohibition on transactions involving masir (speculation or gambling); and
5. A prohibition on gharar, or uncertainty about the subject-matter and terms of contracts – this includes a prohibition on selling something that one does not own. Gharar

Any transaction that involves gharar (that is, uncertainty and speculation) is prohibited. Parties to a contract must have knowledge of the subject matter of the contract and its implications. An example of an agreement tainted with gharar is an agreement to sell goods that have already been lost.

Because of the restriction on interest-earning investments, Islamic banks must obtain their earnings through profit-sharing investments or fee-based returns. When loans are given for business purposes, the lender, if he wants to make a legitimate gain under the Shariah, should take part in the risk. If a lender does not take part in the risk, his receipt of any gain over the amount loaned is classed as interest. Islamic financial institutions also have the flexibility to engage in leasing transactions, including leasing transactions with purchase options.

- Profit and loss sharing

Profit and loss sharing (PLS) financing is a form of partnership, where partners share profits and losses on the basis of their capital share and effort. Unlike conventional finance, there is no guaranteed rate of return. Islam supports the view that Muslims do not act as nominal creditors in any investment, but as partners in the business (that is, essentially an equity-based financing). The justification for the PLS financier's share in profit is their effort and the risk they carry, because their profit would have been impossible without the investment. If the investment makes a loss, their money is lost.

3.5 Types of Islamic contracts

Islamic scholars have approved certain basic types of contracts as being compliant with the principles of Islamic finance, which Islamic banks can use to attract funds and provide financing in an Islamic way.

Mudarabah (finance by way of trust)

Mudarabah is a form of partnership in which one partner (rab-ul-maal) provides the capital required for a project while the other party (mudarib) manages the investment using its expertise. Although similar to a partnership, a company need not be created, so long as the profits can be determined separately. Profits from the investment are distributed according to a fixed, pre-determined ratio. The capital provider carries the loss in a Mudarabah contract unless it was due to the mudarib's negligence, misconduct or violation of the conditions pre-agreed upon.

In a mudarabah, the management of the investment is the sole responsibility of the mudarib, and all assets acquired by the mudarib are the sole possession of the rab-ul-maal. However, the Mudarabah contract eventually permits the mudarib to buy out the rab-ul-maal's investment and become the sole owner of the investment.

Mudarabah may be concluded between an Islamic bank, as provider of funds, on behalf of itself or on behalf of its depositors as a trustee (this has a different meaning to the English law concept of trustee) of their funds, and its business-owner clients. In the latter case, the bank pays its depositors all profits from the investment, after deducting its intermediary fees. It

may also be conducted between a bank's depositors as providers of funds and an Islamic bank as a mudarib. (Hourani)

Musharaka (finance by way of partnership)

Musharaka is often perceived as an old-fashioned technique confined in its application to small-scale investments. Although it is similar to the Mudarabah contract, it is different in that all parties involved in a partnership provide capital towards the investment.

Profits are shared between partners on a pre-agreed ratio, but losses are shared in exact proportion to the capital invested by each party. This gives an incentive to invest wisely and take an active interest in the investment. Moreover, in musharaka, all partners are entitled to participate in the management of the investment, but are not required to do so.

This explains why the profit-sharing ratio is mutually agreed upon and may be different from the investment in the total capital. (Hourani)

Murabahah (cost-plus financing)

Murabahah is the most popular form of Islamic financing. Within a murabahah contract, the bank agrees to buy an asset or goods from a third party at the request of its client, and then re-sell the goods to its client with a mark-up profit. The client purchases the goods either against immediate payment or for a deferred payment.

This technique is sometimes considered akin to conventional interest-based finance. However, in theory, the mark-up profit is quite different. The mark-up is for the services the bank provides - seeking and purchasing the required goods at the best price. Furthermore, the mark-up is not related to time because, if the client fails to pay a deferred payment on time, the mark-up does not increase due to delay and remains as pre-agreed. Most importantly, the bank owns the goods between the two sales and so assumes the title and the risk of the purchased goods, pending their resale to the client. This risk involves all risks normally contained in trading activities, in addition to the risk of not making the mark-up profit, or if the client does not purchase the goods from the bank and whether they have a justifiable excuse for refusing to do so. (Hourani)

Ijara (leasing)

Ijara is defined as sale of manfa'a (that is, the right to use goods) for a specific period. It is similar to a conventional lease. Under Islam, leasing began as a trading activity and then much later became a mode of finance. Ijara is a contract under which a bank buys and leases out an asset or equipment required by its client for a rental fee.

During a pre-determined period, the ownership of the asset remains with the lessor (that is, the bank) who is responsible for its maintenance so that it continues to give the service for which it was rented. Likewise, the lessor assumes the risk of ownership, and in practice seeks to mitigate such risk by insuring the asset in its own name. Under an ijara contract, the lessor has the right to re-negotiate the quantum of the lease payment at every agreed interval. This is to ensure that the rental remains in line with market leasing rates and the residual value of the leased asset.

Under this contract, the lessee (that is, the client) does not have the option to purchase the asset during or at the end of the lease term because this is considered under the Shariah to be tainted with uncertainty. But this object may be achieved by means of a similar type of contract, known as an *ijara wa iktina* (hire-purchase). In a hire-purchase situation, the commitment on the part of the lessee to buy the asset at the end of the rental period, at an agreed price (with the rental fees paid up to the point of sale constituting part of the price), is established at the outset.

Salam (advance purchase)

Salam is defined as forward purchase of specified goods for full forward payment. This contract is regularly used for financing agricultural production.

Istisna'a (commissioned manufacture)

Istisna'a is a new concept in Islamic finance that offers future structuring possibilities for trading and financing. One party buys the goods and the other party undertakes to manufacture them, according to agreed specifications. Islamic banks frequently use Istisna'a to finance construction and manufacturing projects.

Bai Inah

The first and a very popular mechanism used by Islamic banks in South East Asian countries are based on repurchase or *bai-al-inah*. A *murabahah* can change into *bai-al-inah* if the

identity of the vendor is not different from its client; when the bank purchases a commodity from its client on a spot basis and sells it back to the client at a cost-plus price and on a deferred basis. The rate of profit in this case is indistinguishable from prohibited riba on a conventional loan. (Obaidullah, 2005)

Tawarruq

Tawarruq is another financing product that is cited as a classic case of hiyal, or legal stratagem, but has been permitted by mainstream scholars under certain conditions. Tawarruq becomes a source of funds by combining two separate sale and purchase transactions. An individual in need of funds purchases a commodity on a deferred payment basis from a seller and then sells the same in the market in order to realize cash. This is considered a hiyal, since the individual concerned has no real intention of buying or selling the commodity. He engages in these purchase and sale transactions for realization of cash. (Obaidullah, 2005)

Chapter 4

Islamic perspective on credit cards

4.1 Fatwa's

A big dilemma exists whether or not Muslims can or cannot use credit cards. To some Muslims, it is permissible if certain conditions are met and to some these are by no means Islamic. For the latter kind, some Islamic banks in Malaysia and Gulf have structured and developed credit cards which they say are shariah compliant. However, there is a large group which considers these cards as no less different from the conventional ones.

The author will attempt to address the first issue of whether conventional cards are permissible to muslims and if the credit cards available as Islamic credit cards are really in line with the beliefs of muslims or just another kind of conventional cards under Islamic banner.

We all know of numerous arguments in favor of credit cards for example: they enable you to make large purchases by allowing you to spread payments over a period of time, carrying cash can be dangerous as you can be robbed, sometimes card is a prerequisite for transactions such as internet purchases and rental collateral for hiring cars. The problem for muslim consumers is that the whole concept of the conventional card is unacceptable on religious grounds. Interest payments made when the outstanding balance is not repaid in full are riba payments, and therefore forbidden in Islam.

However, there are various grey areas of interpretation that enable some muslims to believe that credit card usage can be done within religious beliefs by paying off the full outstanding

balance every billing month and never rolling over any balance to next statement period and avoiding cash withdrawals. According to them, by not carrying any outstanding balance to next billing period and avoiding cash withdrawals, riba can be avoided and thus, using a card in this way could be halal.

This argument can be supported further by stating that all deeds are by intention and since the intention is to clear the full balance every time and not withdraw cash, card is halal. However, Shariffa Carlo Al Andalusia, an Islamic scholar, has debated such interpretations as not holding water since the signing of a credit card agreement is the signing of an agreement to pay riba should the cardholder fail to make every repayment in full and on time. In her article on Credit Cards she argues “we are agreeing to commit a major sin, under certain circumstances, which we cannot guarantee will not happen, and which are improbable.”

She further debates that few people who use credit cards stick to making 100% payments every month and due to factors like forgetfulness, changed financial circumstances, people take a huge gamble when they sign this contract by promising to commit a haram act. Apparently, to her if she considers the payment and the intention, it seems like it would be allowable but, stresses the importance of the wording of the contract which makes it totally unacceptable. She asks how many people will consider signing a contract that says “you will commit 36 acts of adultery for every dirham’s worth of what you would have paid as interest at a 10% rate of that you will marry your mother.” She wants to know how many scholars will consider it halal then.(Can a credit card ever, 2003)

Dr. Imran Usmani, a well-known Muslim scholar and a Shariah advisor at Al-Meezan in Pakistan, agrees with Carlo. Dr. Usmani is of the opinion that the interest charged on the card

users when there is a late payment is non-Islamic. “The premium charged constitutes riba... if this element is taken out, the card becomes Islamic”. (An Islamic Plastic Card, n.d.)

Shaykh Ibn ‘Uthaymeen (may Allah have mercy on him) argues that a contract of this type is not permissible, because it involves riba which is the price of the card, and it also means committing to pay interest if payment is delayed. (Shaykh, 2002)

In another fatwa he issued he states that credit card transaction is haraam, because the one who enters into it commits himself to paying riba if he does not pay on time. This is an invalid commitment, even if he believes or thinks it most likely that he will pay it before the time is up, because circumstances may change and he may not be able to pay it off. This is a matter that is in the future, and no one knows what will happen to him in the future. So dealings of this type are haraam. (Shaykh)

Dr. Monzer Kahf, a prominent Muslim economist and counselor describes the credit card as a new invention and Muslim scholars define it as either a guarantee given by the issuer to the seller who accepts it or as a transfer of the debt by the debtor to another party, the issuer. Hence, it falls within the permissible transactions. However, there are two problems, one for the issuer and the other for the user; this relates to the fact that the contract here usually contains an interest article if payment is delayed and if cash is withdrawn. Issuing such a card with this interest condition is not permissible in Shariah. Islamic banks can't issue it with such a condition.(Kahf, 2002)

He gives reasons that the credit card provides convenience and removes hardship. He has wished that the interest condition is not inserted in the contract, but unfortunately in most

countries there are no Islamic institutions that issue such cards, and even those cards issued in some countries are not really satisfactory because they are limited in scope and usability. In other words you are not signing a loan contract with interest but you are signing a contract that gives you the choice to make the interest applied or not. Consequently, if you know for sure that you can use it without incurring any interest you make the interest clause useless and it is permissible to sign such a contract and use the card. (Kahf)

Justice Maulana Muhammad Taqi Usmani, a renowned Shariah scholar, permits the use of credit card by a purchaser and declares that it is allowed in Shariah, no matter whether the card is issued by a banking institution or some other company. However, the following points must be borne in mind in this respect:

(i) The best way of using these cards is to authorize the card issuer to directly debit your bank account for payments to avoid the possibility of default which may in some cases, carry the risk of interest.

(ii) If the system of direct debit is not arranged, one must always be careful to pay the bills within the stipulated time without fail, so that interest may not be imposed.

(iii) The annual fee paid by a card-holder to the card-issuing company is not interest; rather it is a fee charged for certain services rendered by the company for the benefit of the holder. That is why it is charged irrespective of the amount actually spent by the holder.

The second question is whether it is permissible for a seller to accept credit card. This question has been a point of debate between the contemporary scholars of Islamic

jurisprudence. Some of them are of the view that the amount charged by the card-issuing company to the shopkeeper is analogous interest. They say that it is equal to discounting a bill of exchange, hence not allowed in Shariah.

However, some other scholars are of the opinion that it is not interest. On the contrary, it is a fee charged by the company for certain efforts undertaken by it. Firstly, the company has to do a lot of work for the benefit of the seller. Therefore, the commission charged by it is similar to the commission of a broker which is undoubtedly permissible. This commission is different from discounting a bill of exchange, because the rate of discount in a bill of exchange is always tied up with the period of its maturity, while the commission charged by the company from the merchant is not so linked. This commission is determined irrespective of the time on which the card holder shall pay the amount to the company. Therefore, it is just like a commission charged for brokerage services.

In his personal opinion, the second view seems to be more preferable. He argues that it is incorrect to assume that all contracts involving three parties are invalid and prohibited; rather, the permissibility or impermissibility of a contract depends on the actual terms and conditions upon which it is based. (Usmani, n.d.)

According to the majority of the contemporary scholars (fuqaha), the usage of credit-cards is permitted provided the card-holder is sure he has the ability and will actually pay off the debt to the card issuing company before any interest becomes due.

The relationship between the card-holder and the card-issuing company, from a juristic (fiqhi) point of view as described by Muhammad (2005) has many ingredients. The

relationship has an element of brokerage/agency (wakala), guarantying payment (kafala) and lending money (iqradh). The company undertakes and guarantees payment on behalf of the card-holder; hence this would form the relationship of Kafala. There is also a promise from the card-issuing company to give the card-holder a loan, and when the card-holder actually uses the card, the relationship of agency (wakala) and actual giving of loan comes into play. The company pays the seller on behalf of the card-holder; hence the company would be considered an agent on behalf of the card-holder, and also forwarding a loan to him. All these three relationships (i.e. agency, guarantying payment, and giving of a loan) are permitted in Shariah, as mentioned in detail in the books of Fiqh. Thus, there is nothing that would make this contract unlawful. As for the relationship between the card-holder and the seller of goods is concerned, contemporary scholars state that the relationship here would be that of the debtor passing on the responsibility of payment of his debt to a third party, known in Islamic jurisprudence as Hawala. Here, the card-holder passes the responsibility of paying for the goods to the card-issuing company. This transferring of responsibility comes into existence when the card-holder signs on the receipt of purchase. Hence, the seller would be obliged to take payment from the one to whom the buyer passed on the responsibility. This contract of Hawala is also permitted and discussed in detail in the various books of fiqh. Lastly, the relationship between the card-issuing company and the seller has been a matter of debate between the contemporary scholars. Some scholars had reservations on the usage of credit-cards due to the uncertainty of this relationship. However, as Shaykh Taqi Usmani and others have explained, this relationship is also one of agency, in that the issuing company acts on behalf of the seller also. The company has to do a lot of work for the benefit of the seller; hence it charges the seller commission for the service provided. Thus, the card-issuing company would be considered a broker and the amount charged by the company is like a commission charged for brokerage services. There is nothing wrong with this relationship

also, neither is it unlawful for the company to charge the seller a commission in return of the service provided.

From the card issuer's point of view there are several obvious problems. Bank will make little or no revenue from such a card if balance is paid in full and also in religious terms it will be colluding in the commitment of sin if it arranges and signs a contract wherein a Muslim agrees to pay riba in the case of non-payment of the balance. (Can a credit card ever, 2003)

Despite these complexities involved, banks in MENA and Asia decided that 250 million muslims who want and need financing options are too big an opportunity to pass up on and offered credit cards that aren't credit cards at all in a conventional sense but simple debit cards from functionality point of view.

4.2 Islamic alternatives to conventional credit cards

Banks that are keen to offer a fully-functional and profitable Islamic credit card have been unsatisfied with the debit card alone and so have sought ingenious ways of constructing Shariah-compliant card agreements and repayment structures. These structures one might very loosely describe as falling into either the Asian school of thought or the Gulf school of thought.

4.2.1 The South East Asian Solution – Credit cards structured on Bai Inah contracts

Banks in Malaysia offer Islamic Credit cards to their customers and prominent examples are the Al Taslif Credit Card, Launched in December 2001, from AmBank in Malaysia (formerly the Arab Malaysian Banking Group) and the Bank Islam Card (BIC), launched on 23rd July 2002, Bank Islam Malaysia.

These cards are structured on the Shariah principle of Bai' Al Inah that covers installment repayments over a fixed period. Cardholders are charged 1.25% per month or 15% per annum on the outstanding balance, with nothing to pay if the minimum payment requested is made on time. The Bai' Al Inah contract works on the basis of two 'akad' agreements. The first is the bank's agreement to sell an item to the customer at an agreed price, with the second agreement covering the customer selling back to the bank at a lower price. The difference is the bank's profit on the transaction and is a predetermined amount. Though a percentage repayment is being made, this differs from conventional structures in that payment of the minimum balance only does not trigger interest repayments for the outstanding balance. Just from spending on the card, consumers are also helping charities via the AmBonus scheme. For every RM100 spent on the Al Taslif card, an AmBonus of RM1 is earned that goes to pay off the annual card fee. Once that fee has been repaid, however, all future AmBonus points are donated to charities by the bank.

The Al- Taslif credit card uses bay al-inah in which two separate contracts, namely al-bay' al-mutlak (cash sale) and bay al-bai bithaman ajil (deferred sale), both of which are carried out after one another. However there are times where the deferred sale precedes cash sale but this is not an issue because the end result is the same. (Ma'sum Billah, 2004)

For example, the bank sells an asset to the customer and the buyer is required to pay on equal installment for a specific time period (deferred sale). The installment sale by the bank saw the buyer to execute his rights to sell back the asset to the Bank on cash basis (cash sale). The deferred sale should be higher than the cash sale in order for the Bank to gain profit from the transaction.

Bai al inah - Concept in practice 1. AmBank's Al Taslif Islamic Credit card.

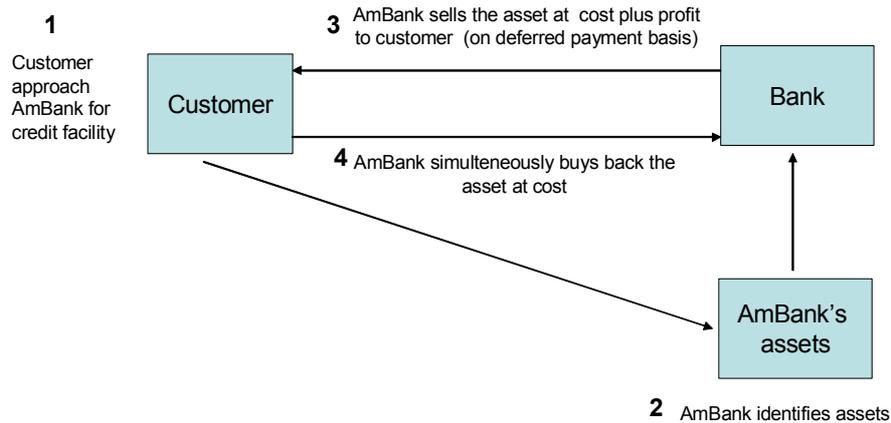


Figure: 2 AmBank's Al Taslif Islamic Credit card

Source: (Ma'sum Billah, 2004)

The customer who wishes to apply for credit card facility will approach any counters of AmBank Bank Berhad or AmFinance Berhad. They will complete standard form and the application will be processed thereon. If the standard requirement is fulfilled by the applicant, then the process of bay al-inah will commence. AmBank will identify collective or individual assets owned by AmBank, whereby the market value of the assets is equivalent to the credit facility. For example if the credit facility worth RM10,000 then the value of the identified assets must equivalent to RM10,000 too. Here the criteria of the assets or the subject matter under Shariah compliance shall be taken into the considerations such as:

- The subject matter should exist at the time of the contract. However exception is given to some types of contracts such as Salam, Istisna', Jualah and Ijarah
- The subject matter must be legally owned
- The subject matter should bring benefit or significant result for the contracting parties
- The subject matter should have commercial value.

After that, AmBank will sell the identified assets to the customer. The selling price is the sum of cost and profit (which is normally quoted in percentage). The next contract will be

executed when the AmBank buys back the asset at cost and cash will be given to the customer. Customer will then use this cash to buy goods and services using the credit facility provided. (Ma'sum Billah)

Bai al Inah - Concept in practice 2 - Bank Islam Card

In the operations of Bank Islam Card (BIC), there are 3 main Shariah contracts being used, namely: bai al inah, wadiah and qardhul hassan. Bai Inah comprises two agreements (akad) which are same as discussed for Al taslif card. The Bank disburses the cash proceeds of the second agreement into the customer's Wadiah BIC account created and maintained by the bank. Then after, the customer can use his BIC for retail purchases and cash withdrawals just like a conventional credit card, except that each transaction will be backed by the cash held in his Wadiah BIC account. Qardhul Hassan is a facility by which the Bank may, at its own discretion, allow the customer to use more than the available balance in his Wadiah BIC account. The cardholder will not be levied with extra charges or fees but will be required to repay the over limit amount used. For BIC, the monthly profit is calculated on monthly basis based on outstanding due or total transaction made for that particular month. This profit is not compounded as compared to conventional card where the interest is compounded. The total monthly profit could not be more than the total profit earned by the end of the contract, as it was determined upfront during the "akad". The cardholder will be able to know the maximum profits which will be imposed within the contract period while the conventional credit card interest charged is undetermined. Cash Withdrawal Fee for BIC is RM12 for every RM1000 or below for withdrawal made at Bank Islam ATM, while conventional credit card is 3% or RM50 (whichever lower) of the withdrawal amount. For BIC, cardholder will have to perform new "Akad" /Contract while conventional credit card is solely based on the

MCI/ Visa agreement. Transfer Balance is treated as retail transactions where customer is given 20 days grace period to pay back the minimum repayment. (Bank Islam Card - i, n.d.)

Case for Bai al inah

Why this transaction is not considered as usury? The reason being is that the mark-up price is based on trade and services not on loan. Any transaction which is backed by assets is permissible under the Shariah in Malaysia. Therefore in the theoretical sense, an Islamic credit card is not based on lending but rather business in trade and services, whereby the Bank sell and buy back at lower cost to gain profit. In credit card transaction, the doctrine of Bai Al-Inah is used to validate the transaction. The argument of validity of bai al Inah is debated between Muslim. The doctrine of bai al-Inah or buy back sale is not recognized by some scholars including the Ulama from the Middle-East. But in Malaysia, the doctrine of Bai Al-Inah is recognized, and is used as one of the basis to justify the implementation of credit card under the Shariah discipline. Here are some reasons to analyze the grounds for the Islamic scholars in Malaysia to base the implementation of Islamic credit card as pointed out by Ma'sum Billah (2004).

In the general sources of Islamic Law start with Al Quran and Sunnah of Prophet (s.a.w.). The two sources are vital for other secondary sources to be derived like Ijma, Al Masalih Al Mursalah, istihsan as those secondary sources must be in the boundary of two primary sources. Allah mentioned in the Holy Quran

“O you believe! Obey Allah and Obey the Prophet and those charged with authority among you. If you differ in anything among yourselves, refer it to Allah and His

Messenger, if you do believe in Allah and the last Day: that is the best, and most suitable for final determination.” (Al Quran, 4:59)

In the primary sources there are no clear indications of validity in Bai Al-Inah transaction. But there is one hadith saying that this type of transaction is not valid however the authentic of the hadith and the class of the hadith is unknown. Since the Quran and Sunnah are silent about Bai Al-Inah Transaction, Islamic scholars use second sources of rulings to justify the validity of Bai Al Inah. Ulama in Malaysia consider all the aspects from primary sources to the socio economy and practicality of bai Al Inah in the modern environment. Deriving the secondary sources however will be harmonize with primary sources. (Ma'sum Billah)

In the context of bai Al Inah, the use of doctrine Al Masalih Al Mursalah is adopted in order to justify the using of such transaction in the credit cards or personal financing in the case of Bank Rakyat. In the new era of globalization, many financial dealings were not exactly the same to the practice in time of prophet (s.a.w.). Innovation of financial products was evolved due to the changes in the technology and time. People try to innovate a new thing that can make life better off. This is not only goods and service innovation but to the financial products as well. The idea was to ensure a comfortable life, which is also a wish of Allah(s.w.t.) as evident in the following ayat: “Allah (s.w.t.) intends every facility for you; He does not want to put you to difficulties.” (Al Quran, 2:185)

According to Ma'sum Billah (2004), the use of Masalih Al Mursalah can be applied in the credit card transaction, since Allah wants us to have easiness in the life but off course to be harmonized with the Quran and Sunnah so it will not deviate from the Shariah teaching. In the credit card transaction among the advantages of using it is convenience to the buyer,

security wise, and cost effective are considered to benefits the user in term of giving comfortable life. Although the usage of credit cards is unlimited especially in the digital world, issues surrounding the applications of credit cards need to be addressed so that the acceptance among Muslims can be improved. However the intention is not to give answers as views among the members of Fuqaha differs.

Case against Bai al Inah

Structure of Bai Inah

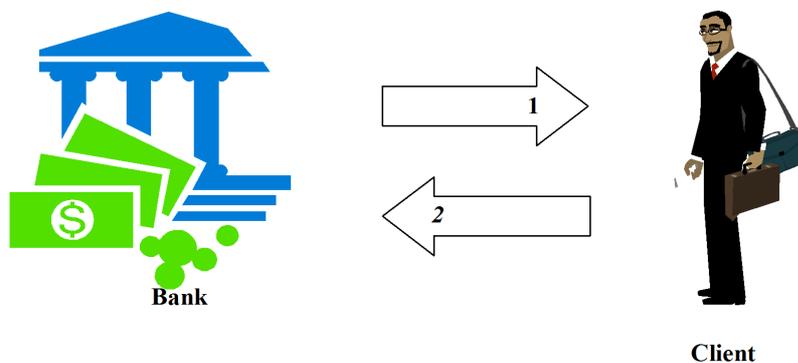


Figure: 3 Source: (Obaidullah, 2005)

Activities involved:

1. Client in need of an amount C sells commodity X to Bank for a price of C on a cash basis. Client buys commodity X back at an inflated price $C+I$ on a deferred payment basis.
2. Client pays $C+I$ on maturity to Bank.

Structure of Interest based loan

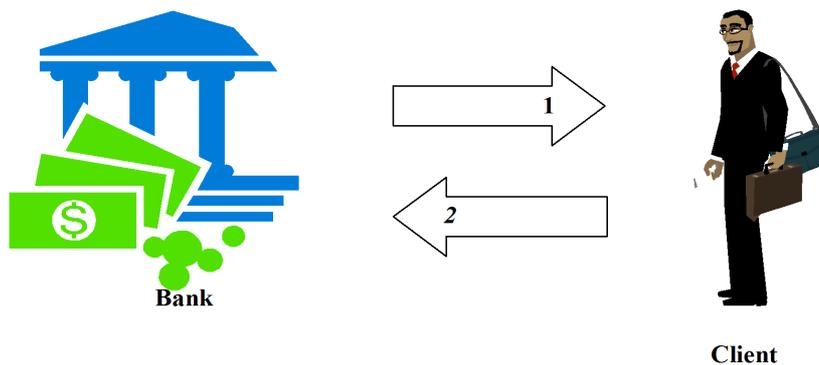


Figure: 4 Source: (Obaidullah, 2005)

Activity 1: Client borrows an amount C now from Bank

2. Client pays $C+I$ on maturity to bank.

The amount I constitutes *riba* under both structures. You may note that activity 1 in the above exhibit involves a mere debt creation exercise; there is no sale in the real sense, as the commodity does not move from the client to the bank or vice versa. The net result of the above two activities are similar to the conventional loan transaction. Also further it can be noted that under *bai-al-inah*, the market price of the commodity need not bear any relationship with the amount effectively borrowed. There is no genuine trade and exchange in *bai-al-inah*. The values C or $C+I$ need bear no relationship with the market price - cash or deferred of commodity X . On the contrary, the cash sale in *bai-al-inah* may be for the amount that the client needs to borrow. The deferred repurchase may be for the loan amount plus interest. (Obaidullah, 2005)

Islamic banks in South East Asia have liberally used the mechanism of *bai-al-inah* for their financing activities. The mechanism allows banks to extend a loan similar to conventional loan without any kind of constraints. Interestingly, such financing is possible even when the client does not own any asset. A piece of land with the bank could form the basis of unlimited

and unconstrained lending. And when BBA + Bai-al-Inah mechanisms may be renewed any number of times and may be executed without any reference to the fair market value of the underlying asset, the effect is similar to conventional loans with “compounding of interest”. (Obaidullah)

The mechanism of bai-al-inah as discussed above allows for total flexibility in financing any specific amount for any maturity that would provide a definite and certain profit to the bank. It is no wonder therefore, that the same mechanism is extended to design a credit card. It is interesting to note how Bank Islam can engage in repeat buy and sale of land with each individual customer. Some questions that naturally arise are: How large is the portfolio of plots of land owned by Bank Islam? Is it a separate plot of land for each customer? Does the sale value of land hold any relationship with fair market value or with the credit card limit sanctioned to the customer? Are stamp duties and other levies usually associated with land deals levied here? (Obaidullah)

“The extension of credit with a view to making profit is not a Qard Hassan loan and thus is unacceptable in religious terms for the creditor as well as the borrower”. (“Can a credit card ever”, 2003)

Critics of Bai' Al Inah contract say that it is ethically flimsy when applied in this manner as the sale transacted is a fake sale and thus just a means of masking Riba. As is the case with matters of Shariah-compliance, judgments are based on the Shariah board of each financial institution and so what may be acceptable to one board may yet be Haram for another. For many Middle East bankers, therefore, the solutions found by the Asian banks are simply not stringent enough in their interpretation of Qur'an rules. One Bahrain-based banker who

prefers to remain anonymous believes that the Asian interpretation boils down to an injunction against using the card to purchase Haram items and services, and indeed the BIC card will reject transactions related to bars, gambling, and massages and so on for payment. The depth of the Shariah-compliance of the card contracts, he believes, is less important to the banks than the avoidance of involvement in any blatantly Haram transactions. (Can a credit card ever, 2003)

4.2.2 The Gulf solution – Credit cards structured on Tawwaruq contracts

Gulf banks do appear to be taking a different tack in their approach to credit card contracts. In September 2002 Shamil Bank in Bahrain announced the launch of the first Islamic credit card to be launched by a bank in Bahrain and probably in the world. The word 'probably' is a fair caveat in this statement, since as has become apparent there are multiple views on what might constitute an Islamic credit card and certainly several claimants to the laurels for launching the first one.

The development process started with the Shamil Card, effectively a convenience charge card. The bank charged fees to cover administrative and processing costs and the collateral was the balance in the cardholder's account. Progress began, however, when the bank began to see its relationship with the cardholder in terms of guarantees. In the case of the charge card, the customer has guaranteed himself and his purchased with the balance of his deposits, the bank making money purely off the fee structure. (Can a credit card ever, 2003)

From this viewpoint, the bank was then able to change tactics when exploring the possibility of an Islamic credit card. It decided that the solution to Riba avoidance was to exercise the acceptable right of charging for the provision of a financial guarantee as there must be cost

elements involved in making that guarantee and in honoring the guarantee those costs are staff costs, processing costs and so on. The guarantee system works by agreeing that the card issuer is guaranteeing the cardholder's payment to the acquirer in any transaction undertaken. That guarantee holds sway in the time lag between the issuer's payment and the acquirer's receipt of funds. The result of this research is the Al Rubban MasterCard, available in Bahraini dinars, Saudi riyals or US dollars. No Wadiah deposit is required as the collateral comes from a direct salary transfer rather than a balance. The payment system works by treating total card spend during any given month as being payable over 12 monthly installments. So, for a balance generated of BD100, 12 equal monthly installments of BD8.34 will be due. The revenue comes from a 5% fee for the provision of the guarantee and administrative costs that is levied on the first statement containing the transaction. This fee must be settled by the due date on that statement and there is a fixed fee for cash advances that must also be repaid in full on the due date of that first statement. The repayment period is set at 12 months for ease and convenience. The key point, he says, is that there is no link between the fees charged and the repayment period as in the case for conventional card repayments.

At about the same time that Shamil launched Al Rubban, fellow Bahrain-based institution, ABC Islamic Bank, also released details of its Al Buraq credit card. The bank had firstly set up a subsidiary called the Islamic Credit Card (ICC) company. The issue of Al Buraq cards began with bank employees and corporate clients and is now available to individuals through ICC participating banks.

Neither Shamil nor ABC Islamic Bank is unique in their investigation of Shariah-compliant cards. Al Rahji Banking & Investment Corporation (ARABIC) in Saudi Arabia, for example, also offers Shariah-approved Visa and MasterCards. The question doesn't appear to be

whether Halal credit cards should be created; rather the focus is on exactly how they can be designed to be profitable and cost effective for customers while also being Shariah-compliant. If the efforts of pioneers such as Shamil and ABC prove a success, we can expect to see more design ingenuity applied to the issue so that the local banks really can meet the demands of local customers, however mountainous the challenge of meeting those needs might at first appear to be.

Tawwaruq – Concept in practice: Tayseer Al-Ahli by National Commercial Bank

Tayseer Al-Ahli is a new Islamic financial instrument introduced by The National Commercial Bank for its customers that are in need for cash finance. The product involves buying a commodity from the International Market that is known for its non-fluctuated price and selling it

to the customer (on a deferred payment basis and) then reselling it back to the International Market. This product is to cover the need of cash for a segment of The National Commercial Bank customers through an Islamic mechanism based on Al-Tawarruq (approved by the Convention of Islamic Fiqh in its fifth meeting at Makkah Al Mukarramah.) The terms of Tayseer Al-Ahli are the same credit terms of the different segments of the personal finance programs at The National Commercial Bank. (Obaidullah, 2005)

A Tawarruq-Based Credit Card

A credit card has recently been designed by an Islamic bank that uses the concept of tawarruq. The mechanism begins with the bank advancing a certain amount of funds to the customer under tawarruq. The bank then creates under wadiah principle a guaranteed deposit account for the customer for the safe custody of the amount. Now the customer can use his card for retail purchases and cash withdrawals just like a conventional credit card except that

the cash held in his wadiah account now backs each transaction. At the end of every month, the value of total transactions by the customer is computed. A fresh tawarruq for this value is undertaken to replenish the deposit account. Needless to say, this card is essentially similar to the Bank Islam Card with the replacement of bai-al-inah by tawarruq.

Structure of Tawwaruq

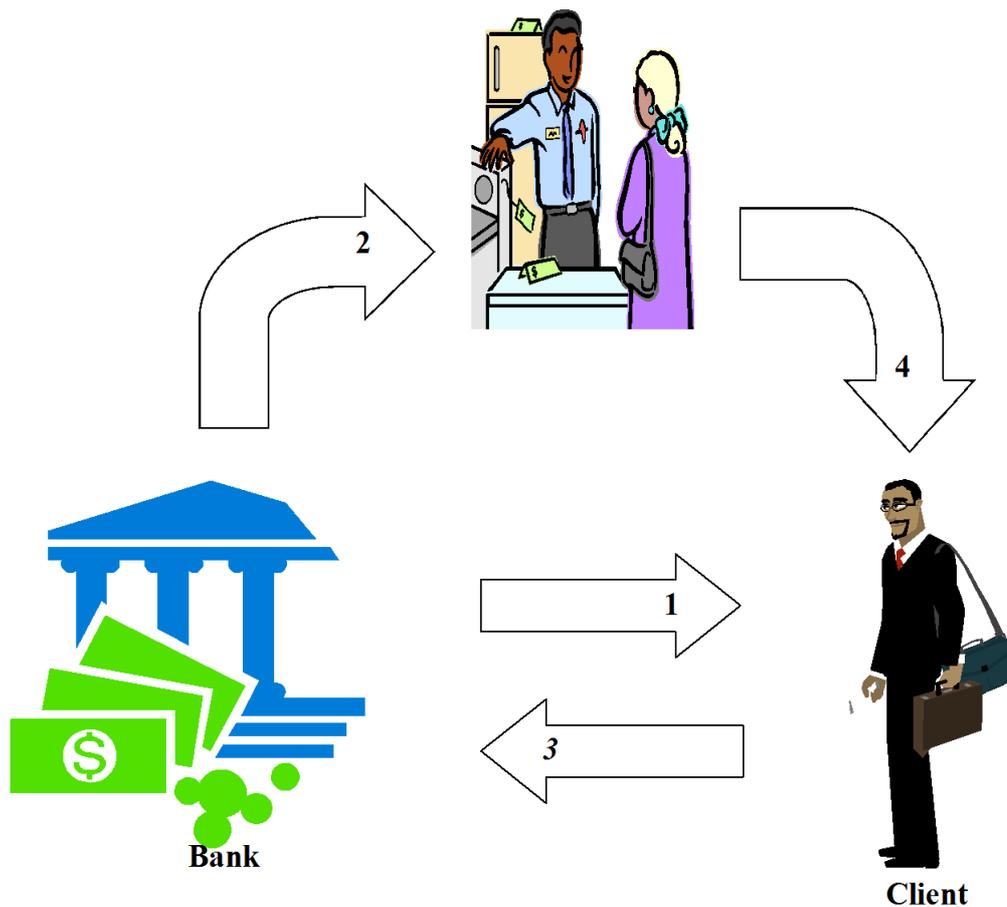


Figure : 5 Source: (Obaidullah, 2005)

Activities involved :

1. Client approaches Bank with a specified need for cash.
2. Bank purchases commodity X of value equivalent to the Client's need, (say P) from Vendor.
3. Bank sells commodity X to Client on a deferred basis for P+I.

4. Bank as Agent of Client sells X back to Vendor for P* on cash basis.

In activity 3 & 4 there is flow of funds.

Note that P* may be different from P if prices are fluctuating in the market and there is a time gap between the various activities. The client receives P* - an amount that closely matches its financing need.

Tawwaruq - Issues in Product Management

Risk Exposure

Scholars have permitted tawarruq since it fulfills a genuine need – the need for funds. It is permitted as long as it does not violate the norms of Shariah. Hence, all care should be taken to ensure that it does not involve riba. The first and foremost requirement is the involvement of a third party in the transactions. The client must sell the commodity in the market place to a third party. Otherwise, it would be a case of bai-al-inah. More important than this however, is the requirement that there must be a time gap between the sale by the bank to client and sale by the client in the market. This is in addition to the time gap between the purchase by the bank and its sale to client as in case of all permissible murabaha. This time gap is essential to expose the parties to price risk and ensure that the gains from the transaction(s) are a reward for risk borne and hence, free from riba. It is quite possible to visualize a scenario under which all the three activities cited above or any two of them occur together.

Consider the following:

1. Client approaches Bank with a specific need for cash.
2. Bank purchases commodity X of value equivalent to the Client's need, (say P) from Vendor.
3. Bank sells X to Client on a deferred basis for P+I.

4. Bank as Agent of Client sells X back to Vendor for P on cash basis

Note that bank would be able to sell back X to vendor at P if price of the commodity X is unchanged between activities 2 and 4. If there is no time gap between the activities and all are undertaken during the same session, the transactions would result in risk-free profits equivalent to I – a clear case of riba.

Prior-Arrangement between Parties

Another condition of a valid and permissible tawarruq is the absence of any pre-arrangement between the three parties. You may recall here that under bai-al-inah, the market price of the commodity need not bear any relationship with the amount effectively borrowed. In tawarruq too, the three parties involved – bank, client and vendor may enter into a prior agreement under which the values P or P* or P+I need bear no relationship with the market price - cash or deferred of commodity X. On the contrary, the deferred sale to client (activity 3) may be for the loan amount plus interest, while the cash purchase from vendor (activity 1) and cash sale to vendor (activity 4), may be for the amount that the client needs to borrow. Indeed, in an arrangement in which all parties connive, the sequence of activities does not matter. In tawarruq, therefore, one needs to exercise extra care and subject the product to an additional dose of investigation before accepting it as Shariah compatible. More so, when the bank asserts that the terms of the tawarruq based product are same as the credit terms of other conventional financing products. How can a product that is exposed to market risk offer same terms as are available on other products that are not? (Obaidullah, 2005)

Based on the above given structures, one can think that developing structures for credit cards that are shariah compliant has been no easy task for banks and without controversies.

However, this should not deter from making further efforts in research and development in this area.

4.2.3 Proposed models for UK

At present there is no credit card in UK offered by any bank or card issuer that claims to be shariah compliant. Keeping in mind this fact and that UK has a muslim population of approximately two million, this opportunity cannot be ignored. Besides the fact that muslims look forward to such products that are in line with their beliefs and Islamic Bank of Britain has already endeavored to cater to such needs. A few options can certainly be explored for UK market in initial stage

The author proposes two models that can be tested by banks.

First model – Kafala based.

This is the simpler of the models and falls more closely to be defined as a charge card. A card can be offered to customers who use credit cards to avail of interest free period and like to clear full outstanding balance by direct debits thereby carrying no balance to forward billing period. For the bank it is better to offer such customers a product like charge cards. The bank can earn revenue in terms annual fees (fixed) and interchange fees. Though it is quite difficult to visualize that customer in UK will accept to pay annual fees on credit cards since banks that offer conventional credit cards do not charge any fees. However, the bank can offer the product in such a way that it includes various other associated benefits like card protection (takaful), payment protection (takaful), discounts & marketing deals, takaful (travel / death & burial) and etc. It will have a good chance of being a success and at same time earn revenue for the bank. The basis of charging the annual fees will be the charge for the guarantee as in the case of banks in the gulf. The bank will exercise the acceptable right of charging for the

provision of a financial guarantee as there is cost elements involved in making that guarantee and in honoring the guarantee. These those cost as explained earlier are staff costs, processing costs and so on. The guarantee system works by agreeing that the card issuer is guaranteeing the cardholder's payment to the acquirer in any transaction undertaken. That guarantee holds sway in the time lag between the issuer's payment and the acquirer's receipt of funds. This model is similar to one of Al Rubban Mastercard and can also be applied to offer a business charge card.

Obaidullah (2005) describes guarantee or kafala as a well-known contract in fiqh and states that classical texts of fiqh report a complete consensus that kafala is a voluntary service and no fee can be charged for the same. At best, the guarantor may recover or claim back the actual expenses incurred in offering the service. The guarantee itself is a free service. However, some contemporary scholars feel that since the Qur'an or the Sunnah does not explicitly prohibit the charging of guarantee fee, it may be permitted on the grounds of necessity or darura. Needless to say, guarantee has become a necessity, especially in trade where the sellers and the buyers do not know each other as cannot meet face to face like purchases made over telephone, internet and etc. Therefore, an Islamic bank can charge or pay a fee to cover expenses incurred in the process of issuing a guarantee.

Second model – Tawwaruq / Murabahah based.

Activities involved :

1. Client approaches Bank with a specified need for cash.
2. Bank purchases commodity A of value equivalent to the Client's need, (say V) from Vendor.

3. Bank sells commodity A to Client on a deferred basis for V+I.
4. Bank as Agent of Client sells A back to Vendor for P* on cash basis or client can directly sell A in open market.

In activity 3 & 4 there is flow of funds.

Note that P* may be different from P if prices are fluctuating in the market and there is a time gap between the various activities. The client receives P* - an amount that closely matches its financing need.

5. The bank then creates under wadiah principle a guaranteed deposit account for the customer for the safe custody of the amount. Now the customer can use his card for retail purchases and cash withdrawals just like a conventional credit card except that the cash held in his wadiah account now backs each transaction. At the end of every month, the value of total transactions by the customer is computed. A fresh tawarruq for this value is undertaken to replenish the deposit account. Needless to say, this model is essentially similar to the Bank Islam Card with the replacement of bai-al-inah by tawarruq or murabahah.

These two model structures can form a basis on which Islamic bank of Britain can develop a credit card and offer it to customers enabling them to use present day payment methods that are in line with their religious beliefs. These may offer not a complete solution though however, can be considered as an important work that could be combined with existing research undertaken by the bank in this field. In his book "An introduction to Islamic finance", (Usmani, 2005) has spoken about shariah having specific principles about concessions with the basic purpose of avoiding clear prohibitions by adopting a less preferable line of action to be availed in the transitory period where the Islamic institutions are working under pressure of the existing legal and fiscal system.

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