

The 194th and 195th Meeting of the Shariah Advisory Council (SAC) of Bank Negara Malaysia

The SAC at its 194th meeting on 25 June 2019 and its 195th meeting on 31 July 2019 ruled the following:

Compliance of Islamic Pawn Broking Product (Ar-Rahnu) towards the *Rahn* Policy Document (*Rahn* PD)

SAC Ruling

The SAC at its 194th meeting resolved that the ar-rahnu product structure offered by Islamic financial institutions (IFIs) through the combination of *qard* (loan), *rahn* (pledge), *wadi'ah* (safekeeping) and *ujrah* (fee) does not fulfil the Shariah requirements in *Rahn* PD due to the following:

- (i) The interconditionality and interdependency between the loan contract and the elements of pledge, safekeeping and fee in the product structure gives rise to the issues of *qard jarra naf'an* (loan that benefits the lender) and *bai' wa salaf* (combination of sales contract with a loan) which are prohibited in Shariah. In the ar-rahnu structure, each contract will not take effect without the other contracts. For instance, the loan will only be provided with the condition that customers safekeep their gold with the Islamic financial institution (IFI) where a safekeeping fee is charged. Such structure where the safekeeping fee charged is connected to the loan provided indirectly raises the issue of *qard jarra naf'an*; and
- (ii) The combination between the pledge and the loan contract in the ar-rahnu structure for the purpose of profit generation is not in line with the objective of both contracts (*muqtada 'aqd*) in which the former is for pledging while the latter is for charity.

The SAC at its 195th meeting ruled the following:

- (i) The SAC ruling decided at the 194th meeting on 25 June 2019 regarding prohibition of ar-rahnu based on the above structure will take effect on 1 February 2020;
- (ii) IFIs are temporarily allowed to apply the views of their respective Shariah Committee on the ar-rahnu product structure up until the date of the SAC ruling comes into effect; and
- (iii) Any new and outstanding ar-rahnu financing including the income generated before the above SAC ruling takes effect is allowed to continue until the maturity of the financing, based on the previous decision of the respective Shariah Committee of IFIs.

Background

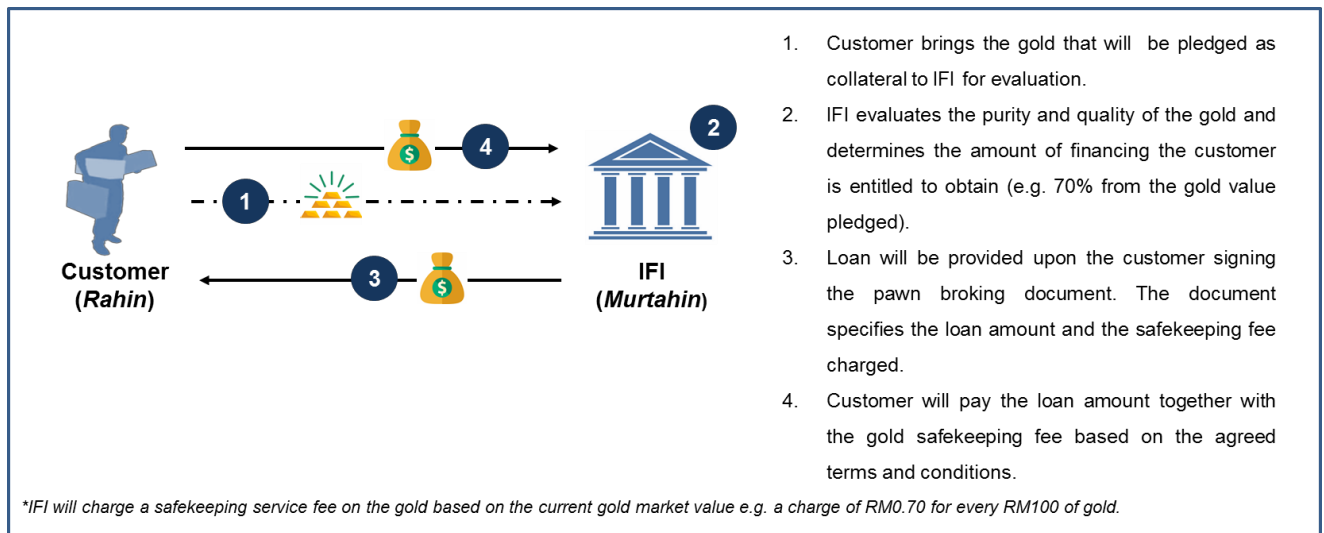
- Ar-rahnu was introduced as an alternative to the conventional interest-based pawn broking product.
- Generally, ar-rahnu products offered by IFIs involve four main Shariah contracts which are loan (*qard*), pledge (*rahn*), safekeeping (*wadi'ah*) and fee (*ujrah*). In ar-rahnu financing, the pledging of gold belonging to the customer is made as a condition for the loan to be provided. IFI will safekeep the collateral based on the concept of *wadi'ah* and a safekeeping fee will be charged on customers for the safekeeping service provided by the IFI.

- The Bank has issued *Rahn* PD (effective on 1 August 2019) that outlines the Shariah and operational requirements related to *rahn* contract. The requirements specified in the *Rahn* PD is applicable to ar-rahnu as *rahn* is the underlying contract for the product.
- *Rahn* PD requires that any charges related to *rahn* shall be limited to the cost directly related to the *rahn* transaction without any profit elements.
- Based on the above, the SAC is referred with regards to the Shariah compliance of the existing ar-rahnu product against the *Rahn* PD requirements.

Shariah issue

Does the existing ar-rahnu structure fulfil the Shariah requirements?

Illustration of Ar-Rahnu Product Structure



Key Highlights of the SAC Discussion

Interdependency and interconditionality between the loan and safekeeping service for the collateral

- The loan is only offered to customers in the ar-rahnu product who pledge and safekeep the gold to the IFI and the safekeeping fee charged is based on the gold value.
- Based on this structure, it is viewed that the current practice has an element of interconditionality and interdependency between the loan and the safekeeping service contracted between the IFI and the customer.

Element of profit in the safekeeping fee of the collateral

- In the current practice, the service fee charged by IFIs to safekeep the gold is based on the value of gold pledged. The method in determining the safekeeping fee is deemed to have element of profit and is not in line with Shariah requirements which only allows the safekeeping fee to be charged based on costs that are directly related to the *rahn* transaction only.
- Typically, the financing products offered by IFIs in the Islamic banking industry apply the concept of sales (*bai*) or lease (*ijarah*) which generates income and profit. In such cases, the profit generated from both underlying contracts is permissible in Shariah.

- This is different in the case of the existing ar-rahnu structure which applies the contract of *qard* (loan) as the main underlying contract. From a Shariah perspective, the lender must not receive more than the loan amount provided (directly or indirectly) as it creates financial benefits to the lender.

Basis of Ruling

Compliance of Ar-Rahnu Product

- The combination of both the loan and the pledge contract for the purpose of income generation is not in line with the objective of the contracts. The loan contract is a *tabarru`at* contract (charitable contract) and *rahn* is a pledge contract. The objective of both types of contract is not for profit generation as in the case of sales contract (*bai`*), investment (*mudarabah*, *wakalah bil istithmar*) or service fee (*ujrah* or *ijarah khadamat*).
- The *Rahn* PD specifies that the fee that may be charged to the pledgee is limited to the cost directly related to the safekeeping of the collateral.¹ Any charges beyond the direct cost are not permissible as it may lead to profit generation which is contradictory to the real objective of *rahn* contract.²
- The interconditionality and interdependency between the loan, pledge, safekeeping and fee contracts in the product structure may bring about the issues of *qard jarra naf`an* (loan that gives benefit to the lender) and *bai` wa salaf* (combination between loan and sales contract) which are prohibited in Shariah.

عن علي رضي الله عنه قال: قال رسول الله صلى الله عليه وسلم: كل قرض جر منفعة فهو ربا

“From Ali r.a who said, that Rasulullah SAW said: Every loan which brings benefits (to the creditor) amounts to *riba*.”³

- In addition, the charging of the safekeeping fee based on the value of the gold (collateral) is deemed to have the element of profit to IFI. This also brings about the issues of *qard jarra naf`an* and *bai` wa salaf* which are prohibited in Shariah.

Rationale and Impact of the Enforcement of the SAC Ruling

- The SAC ruling with regards to the compliance of ar-rahnu product with the *Rahn* PD will take effect on 1 February 2020. This ruling is based on the consideration of preserving the public interest (مصلحة عامة) and to ensure the continuity and stability of *mu`amalat* transactions (*istiqrar ta`amul*).
- Any new and outstanding ar-rahnu financing offered before the effective date of the SAC ruling may be continued until the maturity of the financing and the income generated may be recognized in Shariah. The ruling to allow the offering of ar-rahnu product takes into consideration the decision of the Shariah Committees of respective IFIs (which is applied before the issuance of SAC ruling). This ruling is also based on the discretion of the SAC as the authority in ascertaining Shariah rulings in Islamic finance businesses.

¹ *Rahn* Policy Document, Paragraph 16.1:

Expenses in rahn are categorised into–

(a) *expenses incurred that are directly related to the maintenance of collateral; and*

(b) *all other expenses incurred that are directly related to the rahn contract including safekeeping, documentation, liquidation and discharging of collateral.*

² *Rahn* Policy Document, Paragraph 5.2:

“direct cost” *refers to costs that are directly related to the rahn transaction, either based on actual or estimated amount, without any profit or mark-up element;*

³ Ibnu Hajar al-Asqalani, *Bulugh al-Maram min Adillah al-Ahkam*, Matba`ah al-Salafiyyah, 1928, h. 176.

- The consideration for the SAC ruling to not give a retrospective effect towards the ar-rahnu products offered before the effectivity of the SAC ruling is based on *maslahat* and to remove extreme difficulty (*raf' al-haraj*).

Impact of the SAC Ruling

- Ar-rahnu products must be reviewed and restructured to ensure that the products comply with the requirements of Shariah as outlined in *Rahn PD*.
- The existing ar-rahnu products are allowed to be offered throughout the transition period and the profit generated from the facility may be recognized by IFIs as Shariah compliant income.

This ruling will take effect on 1 February 2020 for the Ar Rahn product based on the above structure.

An IFI shall comply with this ruling pursuant to section 28(1) of the Islamic Financial Services Act 2013 or section 33D(1) of the Development Financial Institution Act 2002, as the case may be.