



UNIVERSITI SAINS ISLAM MALAYSIA

جَامِعَةُ الْعُلُومِ الْإِسْلَامِيَّةِ الْمَالِيزِيَّةِ

ISLAMIC SCIENCE UNIVERSITY OF MALAYSIA

Islamic Banking, Takaful and Al Rahn

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- Pawnbroking
- Al Rahnū

Pawnbroking?

- the business of advancing loans that are secured against pledges of personal assets.
- Those assets could include anything from jewellery, diamonds, watches, and gold, to silver, antiques, and fine artwork.
 - No credit checks
 - • Confidential service
 - • Instant cash
 - • Retain ownership of the valuable items

What's wrong with conventional Pawnbroking?

- higher interest rates
- usurious
- exploitative activities
- the decreasing value of pawned goods
- low collateral value during the valuation process

Historical Background of Al Rahnu

- The first Islamic pawn-broking institution, Mu'assasah Gadaian Islam Terengganu (MGIT), was set up by the Majlis Agama Islam dan Adat Istiadat Terengganu in January 1992.
- In March 1992, Kedai Al-Rahn (KAR), a subsidiary of Permodalan Kelantan Berhad.
- On 21 August 1993, the MOF announced the Skim Al-Rahnu through the collaboration of three institutions namely BNM, YPEIM and BKRM
- 1997: BIMB
- 2002: EON bank and AGRO bank

- verse 283 of Surah al-Baqarah:
- (And if you are on a journey and can not find a scribe then let there be a pledge taken (mortgaging) then if one of you entrusts the other, let the one who is entrusted discharge his trust faithfully and let him be afraid of Allah, his lord. And conceal not the evidence for he who hides it. Surely his heart is sinful. And Allah is All-knower of what you do).

- Narrated Aishah r.a the prophet s.a.w. bought foodstuff on credit for a limited period and mortgaged his armour for it [sahih Al-Bukhari, 3/2509].

What is Al Rahnu?

- *Al-Rahnu* or pawn-broking is an activity whereby a valuable item is collateralised to a debt which may be utilised as payment should the debt is not repaid within the agreed period. In the event the debtor is not able to repay the debt, the pawned asset will be sold off to settle the outstanding debt and any surplus will be given back to the owner of the asset. However, if the owner of the asset could not be traced, it is the responsibility of the Islamic pawn-broker to place the fund in the Baitulmal account for future savings should any claims be made for the surplus by the owner or his heir.

Al Rahn

- A combination of three concepts is applied for the short-term financing under Islamic pawn-broking, i.e. *Qardhul Hasan* (benevolent loan), *Al-Rahn* and *Al-Wadi'ah* (custodian).

(1) Qardhul Hasan

- A bank will grant a benevolent loan to the applicant who wishes to pawn his valuable item. The loan will be issued under the concept of Qardhul Hasan, whereby the customer is only required to pay the amount borrowed;

(2) *Al-Rahnu*

- Pledge or security related to loan.
- Prior to disbursement of cash to the applicant, the applicant is required to place a valuable asset as collateral for the loan extended by the bank;

(3) *Al-Wadiah*

- The bank accepts custody of the valuable asset on a Wadiah concept whereby the bank promises to keep the valuable asset in a safe place. The bank will need to take precautionary measure such as providing security and insurance to ensure its safe returns once the customer pays his debt. Under the Wadiah concept, the bank will charge the customer for the services rendered in keeping the valuable asset.

Al Rahn

- The borrower (Al-Rahin) submits an item (gold) for pawning to the lender (Al-Murtahin) as the collateral from which the borrower (Al-Rahin) receives an interest-free loan amounting to 60% of the pawned item.
- The collateral item is held by the lender and a storage fee is charged to the lender during the period of the loan.
- The loan is paid in full or in installment after the maturity date and the lender must return the collateral or the item to the owner.
- In the event of a default on the loan by the borrower; the item is then auctioned.
- The money gained from the auction of the item is used to pay the defaulted loan and outstanding storage fees, while what is left over is given to the borrower

Advantages

- 1. Easy access to credit facility provided the customer possesses the respective recognized asset by the credit granter/financier.
- Through Ar-Rahnu financing, the financial institution is not strict on the credit history or creditworthiness of the clients. The financing is not based on the customer's income as the case of an ordinary personal loan. The important consideration for the granting of the facility is the item pledged itself. The items will be valued and will be the basis of amount granted for the finance.

- 2. Items/assets assigned to the financier will be returned once payment is made for the amount borrowed.
- The assets which are pledged to the financial institution will be returned back to the client provided that payment is made for the amount lend by the financial institution together with the safekeeping fee (rental charges). In a sense money is not created by the financial out of thin air but in exchange for the value of the asset (items pledged).

- 3. In event of inability to pay, the asset will be sold and amount above the borrowed amount and rental fee will be returned to the customer
- In the events of defaults and inability of the customer to pay the amount borrowed, the items will be auctioned with the market gold value as the reserved price. Proceeds from the auction will be used to settle off the amount borrowed together with the safekeeping fee. The balance of the amount after deducting the borrowed sum and payment of related fees will be given to the customers. This is normally the case as the initial financing is only given base on a maximum of 60 percent of the items value.

- 4. The items assigned to financier are gold, thus value will be stable and fluctuation in gold value is not erratic.
- The pledged items are in gold of different grades. Unlike other asset such as houses or cars, gold value is more stable as fluctuation of its value is not erratic. As been observed property value such as houses can be high in a period and may be low in another. Cars on the other hand depreciate highly especially after the first year (such an example is a first hand car). With respect to the stable gold value both the financier and the customers will not be exposed to a high risk in the event of such items needs to be auctioned off.

- 5. Less/No risk from fluctuating interest rate as the facility is not associated with interest rate.
- Another advantage of the financing facility is that the facility is not as much related to any changes in the market interest rates. The main exposure of the financing facility is the value of gold rather than the prevailing interest rate. The main income to the financier will be in the form of documentation/processing fees and safekeeping (rental) fees.

- 6. Contribution on social welfare of the society eradicating unjust pawning
- In the normal pawning activity, the items pawned are surrendered totally to the pawn shop and ownership is transferred to the shop. If the owner wanted to redeem the items, he/she have to pay a much higher price for the items compared to the initial pledged amount. The valuation of the items is also subjective, as it I based on the pawn shop valuation of the items and not based on the real value of the items. By Ar Rahnū facility the owner of the items can have access to funds while at the same time redeem the items with the respective amount borrowed through with the payment of the safekeeping fee. Valuation is also made based on the value of the gold item rather than subjective valuation.

Disadvantages

- 1. Takaful bore by the financier for safekeeping of the assets/items: The amount covered is the whole value of the items (though initially financing is only given to a maximum of 60 percent of the gold value).
- 2. Customer need to have assets particularly in gold: For those whom do not have these items, they are not eligible to subscribe to this product.
- 3. Disadvantage if initial contract on higher gold value and auction is made on a lower gold value: should the future price of gold decreases and at the same time the customer are not able to repay the amount, the reserve price of the gold will be at a lower market value.
- 4. Associations of rental / safekeeping fees with the financing: Association of rental fees with the advanced amount might lead to the understanding that the monthly rental fee/charge is indirectly based on some percentage of the financing amount. This is similar to conventional finance where the charges (interest) is based on the principal amount lend.

Fatwa on al Rahn

- The 77th Muzakarah of the Fatwa Committee of the National Council held on 10th -12th April 2007:
- 1. The working capital for Islamic pawn broking shop (ar-Rahn) must be gained from Islamic banks or lawful (halal) sources and free from usury(riba), gambling, uncertainties (gharar) and other activities that do not meet the Shariah requirements
- 2. The pawnbroker should subscribe to Islamic insurance coverage and is not allowed to get involved with conventional insurance
- 3. If the collateral is lost, stolen, damaged or alike, the pawnbroker has to pay compensation for the remaining value of the collateral at the time of valuation
- 4. The pawnbroker should appoint internal Syariah legal advisor to supervise the operation and activities of ar-rah.

Parameters of of al Rahn

- 1. The borrower (Al-rahin) should submit the item or the collateral to the lender (Al-murtahin), where the lender can forgo the item (like returning back to the borrower) but not vice-versa.
- 2. Any property which can not be traded according to the syariah law can not be used as Al-rahnu.
- 3. The borrower must pay the loan after the maturity date and the lender must return the collateral or the item to the owner. If the borrower fails to repay the loan, the lender receives the right to recover his loan form the collateral and he must return to the borrower if any thing remained.

- 4. The lender is responsible for the collateral for any damage caused by his wrong doings but not otherwise and in the later case the borrower remains owing the loan to the lender.
- 5. The collateral (Al-rahn) can be submitted to third party if both sides have confidence with him.
- 6. If the borrower rejects the selling of the collateral in the case of default or the lender conditions that he will take the collateral if the borrower default to pay him such transactions can not be counted as Al-rahnu.

- 7. If both sides disagree how much the loan was the judge will consider the words of the borrower with swearing unless the lender comes with evidence.
- 8. If the lender claims that he returned the collateral to the borrower and the borrower rejects the latter's words will be considered with swearing unless the lender comes with evidence.
- 9. The lender can get a benefit from the pledged assets if they were submitted as collateral for example he can raid the horse or use the milk of the cow by feeding them but he should be fair so he can not use more what he spent on them.

- 10. If the lender feeds the animal in the case used as Al-rahm without the information and acceptance of the borrower he can't claim any thing about that.
- 11. If the lender maintains the collateral for example like when the house collapses or close to collapse and is maintained by the lender. The lender can claim the irremovable things such as stones and woods where it is impossible to remove from the house.
- 12. If the borrower dies or become bankrupt, the lender should be privileged among other lenders. He has a right to sell the collateral to discover his loan if the collateral is not enough for the loan he will remain one of those waiting repayment from what the dead man has left or the bankrupted borrower still owns

Al Rahnū Products

- YPEIM
- Agro Bank
- Bank Rakyat
- BIMB
- Affin Islamic Bank

Al Rahnū

- Collateral: Only gold
- Margin: rm10k-rm25k or not more than 65% of the collateral value.
- Period: 6 months

Collateral

- In the Islamic-based pawnshop, gold is the only permitted item.
- Firstly, gold is easily resold and so there is potentially auctioning the collateral should the borrower not redeem the pledge.
- Secondly, gold's purity can be easily determined and so the risk of mispricing the collateral can be minimized.
- Thirdly, gold chains and rings typically require only a small flat envelop for storage and so can be kept securely in the bank safe at little additional cost.
- Finally, women often receive gold chains and bracelets as wedding gifts and generally retain personal ownership of these items especially in Malaysia

Safekeeping Fees

- The storage fee is based on the value of gold and not on the amount of the loan,
- RM100.00 – for the first 3 months is 0.60% per month
RM1, 000.00 – for the next 3 months is 0.70% per month
- RM1, 001.00 – for first 3 month is 0.65% per month
RM 5, 000.00 – for the next 3 month is 0.80% per month
- RM5, 001.00 – for the first 3 months is 0.80% per month
RM10,000.00 – for the next 3 months is 0.90% per month

Safekeeping Fees

Asset value	PMK	BKRM	MGIT
RM1-RM400		0.60	No charge
RM1-RM1,000	0.65		No charge
RM401- RM2,000		0.85	No charge
RM1,001- RM5,000	0.75	0.95	No charge
RM5,001- RM50,000	0.75		No charge

Legal Frameworks

- S 46 of the Pawnbrokers Act 1972: The following persons shall be exempted from the provisions
- of this Act—
- (a) any bank licensed to carry on banking business in Malaysia;
- (b) Bank Pertanian Malaysia established under the Bank
- Pertanian Malaysia Act 1969 [Act 9]; and
- (c) any co-operative society registered under any written
- law in force in Malaysia relating to co-operative societies.

Legal Frameworks

- *Al-rahnu* scheme in BKRM is subject to different acts:-
- 1. the Bank Kerjasama Rakyat (M) Berhad Act 1978,
- 2. the Co-operative Societies Act (1993)
- 3. the Development Finance Institutions Act 2002.
- 4. Occupational Safety and Health Act for workers who are exposed to acid for the gold test and the Weight and Measurement Act, in which the gold weighing device has to be licensed every year.

Operational Aspect

- Islamic pawnbrokers would prefer the customer to redeem their collateral within 6 months. However, if there is no repayment, there is an extension period of 3 months after which the client is informed that the item will be sold by auction within a further of 2 months period.
- any surplus from the sale of the gold over the amount owed to the pawnbroker, including accumulated deposit fee and any costs related to the sale, has to be returned to the customer. In case the customer cannot be located, the surplus will be forwarded to the *Baitulmal* from which the customer is entitled to make future claims.

Syariah Issue

- 1. maintenance of the pledged asset
- Upon the borrower
- The lender can not make profit out of it.

Syariah issue

- 2. al intifa bi al marhun
- The lender can not use the pledged asset except with permission

Syariah issue

- 3. safekeeping fees.
- Fees must be actual cost
- The lender however makes profit through this fees.
- Eg. Loan RM5000.00 pledged asset value RM10000.00, fees, ($RM0.45 \times 100 = RM45.00$).
If 6 months RM270.00 ($RM45.00 \times 6 = RM270.00$).

Thank You

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