

Modern Plastic Money (the Credit Card) and Sharia Alternative (Special Reference to Amana Bank, Sri Lanka)

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Abstract

The plastic money (Credit Card) is the one of the fastest growing mode of payment in today's society, in Sri Lanka. It has achieved a significant growth within the short period of time as an alternative to paper money. The Banking Act No.30 of 1988, Sri Lanka was amended in March 2005 in order to introduce Islamic banking and finance in the country. It resulted in the year 2014, with the operation of a fully fledged Sharia complaint bank along with other twenty four licensed commercial banks in the island. Further, there are number of conventional banks and financing companies are offering Sharia complaint products. Conventional banks in Sri Lanka are undergoing an essential transformation in order to retain their existing customer base as well as to attract new clients with innovative products and competitive prices. Amana Bank operating on Sharia based has to compete with these banks in order to attract new customers as well as reform the bank as core bank for the existing customers. As a result of these it has to offer alternative products to conventional banks which will make the bank to sustain in the competitive market. It faces similar dilemmas and risks to their conventional counterparts. This study is conducted to analyze an alternative Sharia complaint credit card with the features and factors of the conventional credit card with special reference to the faith based segment in Sri Lanka. The result could be used as guidance for other Islamic Bankers in promoting these types of credit cards for their customers.

Keywords: Islamic Financial Institutions, Credit Card, Sharia and Amana Bank.

Introduction

The importance of credit cards in contemporary society and the need to use them is no doubt becomes a matter of necessity in many circumstances. People used credit card for various reason for example to obtain credit facility, cash advance, easy payment, and prestige. Besides that having credit card also may represent the wealth status of a person.

A credit card is a system of payment named after the small plastic card issued to users of the system. A credit card is different from a debit card in that it does not remove money from the user's account after every transaction. In the case of credit cards, the issuer lends money to the consumer (or the user). It is also different from a charge card (though this name is sometimes used by the public to describe credit cards), which requires the balance to be paid in full each month. In contrast, a credit card allows the consumer to 'revolve' their balance, at the cost of having interest charged. Most credit cards are the same shape and size, as specified by the ISO 7810 standard.

Islam itself permits the use of credit card so long it does not involve the element of usury and at the same time it does not contravene with principle of Sharia. Therefore, if the credit card serves as a charge card, where the holders only pay the principle amount plus the service charge, the transaction is permitted because it does not involve with any element of usury.

Research Problem

Any Islamic bank that wishes to operate in a non-Islamic sector has to conduct thorough research of the place and be prepared to offer services that will be both Sharia-compliant and competitive from the marketing point of view. The best illustration of this issue is the credit card. Credit cards have been known in conventional banking for decades. However, while there are many IFIs in Sri Lanka for almost more than a decade, none of them offered an Islamic credit card up to now. This is despite being total deposit and advances of IFIs in Sri Lanka respectively, Rs 35 billion and Rs 27 billion. This paper attempts to propose potential

application of '*Sharia complaint credit card*' in Islamic Financial Institutions in Sri Lanka with special reference to Amana Bank Limited.

Objectives of the Study

The objectives of the study are:

- a) To examine the Sharia concerns of credit cards issued by Islamic financial institutions globally to the extent why it is not viable in the local market
- b) To highlight the pertinent Sharia requirements for lending and borrowing.
- c) To identify the Sharia principle/ concept to offer an Islamic credit card to the market segment of who are faith based customers of IFIs.

Research Methodology

The study will be information collection based and is theoretical in nature. Two types of data are used, namely secondary and primary data. Secondary data taken from bank's website and other source as well as library research while primary data by using the practical experience to emphasize the gray areas in Islamic credit cards and interview of Amana Bank's customer who use conventional credit cards.

This study also employs qualitative method by analyzing data collected through in depth interviews with several internal and external customers of Amana Bank to identify the requirement for Sharia complaint credit card, its features and etc.

Further, it express the constrain in Sharia viewsof non- availability of Sharia complaint credit cards at Amana Bank which are offered at IFIs in Middle East and Malaysia

This type of research with special reference to specific IFI in Sri Lanka should be conducted to increase understanding on Islamic finance as well as to develop a specific product required to the local market which may frequently or occasionally occur in organizational context.

Overview of Credit Card Consumption in Sri Lanka

Sri Lanka is now rapidly moving towards cash-less society with the increase in debit and credit card transactions with retail payments in cash for goods services recording a decline, Further, it disclosed that a large number of consumers are using debit or credit cards for point -of-sale payment and Sri Lanka's next generation of adults will grow up with

debit cards, credit cards and pre-paid cards, bankers predicted according to a newspaper article.¹⁶³

According to Visa International statistics, Sri Lankans are using 11 million debit cards and over 950,000 credit cards at present. The outstanding credit was Rs. 49.3 billion. Pre-paid cards, a new introduction to Sri Lanka, provide multiple applications include toll payments in transportation, payments of bus fare, etc.

Most of Sri Lankan banks including Bank of Ceylon (BOC), Commercial Bank, Hatton National Bank (HNB), HSBC, Standard Chartered Bank, Sampath Bank, Nations Trust Bank, Peoples Bank, etc are issuing debit/ credit cards to its account holders that can be used as shopping cards as well.

People prefer to make payments for goods and services using a debit or a credit card rather than in cash and it has become a status symbol in Sri Lanka, the manager of a BOC branch located in the Colombo suburbs told the Business Times. He added that using cards has become a fashion at present and this trend will grow in the near future.

Banks are offering discounts and other benefits for their credit or debit card customers through their accredited merchants and service providers. These different types of partner merchants that range from Travel and Leisure, Fine Dining Furniture, Accessories and Clothing, etc. entail cardholders to varied discounts throughout the year, he disclosed. This was another reason for the people to embrace plastic cards rather than cash, he added.

Latest market trends show that people like the convenience of using plastic for their shopping, without having to pay cash, and that they like to have a choice between using credit cards or debit cards. However, according to current data the growing numbers of people now prefer to use their existing funds through debit cards for shopping due to current economic conditions.

It is reported that the demand for cards was mainly from the Western Province and added that there is a sizeable community who use credit cards in Kurunegala, Galle, Kandy and Anuradhapura.¹⁶⁴

Interest rates are regulated by the Central Bank in the country; recently the central bank placed a ceiling of 24 percent interest on credit

¹⁶³ The Sunday times, 16th March 2014, "*More debit than credit card holders in Sri Lanka*"

¹⁶⁴ <http://www.sundayobserver.lk/2012/07/15/fin03.asp>

cards. Banking experts says that there would be a considerable demand for cards in the future due to the considerable dips in the interest rate from 36% p.a in the year 2010 to 24 p.a currently and further reduction is highly possible in the future.

According to the 2012 Annual Report of CBSL, the number of credit cards in use per 100,000 persons is 4,684. HSBC has the market leadership with over 45 percent of cards are used in the market

The below table illustrate the rapid growth of credit cards operation in the country;

Table 1: Credit Cards Operations by Licensed Commercial Banks

	2010	2011	2012	2013
No of Transactions	16,451	18,609	20,052	21,623
Value (Rs. bn)	75	93	112	121
No of Total Card in use	778,549	862,340	891,170	Expected to be over 950,000
Outstanding (Rs. mn)	31,616	37,637	44,445	51,172
Default (Rs. bn)	36	4,216	3,976	4,36
No of Cads in Default	87,802	97,774	90,412	76,935

Literature Review

This bit of plastic allows people to enjoy the pleasure of shopping without carrying the cash, convenient for online purchases and to avail discounts at certain selected outlets time to time.

They are based on either a revolving facility or on a ceiling amount. Any user who purchases the item is by virtue of law obligated to pay the amount spent back within a prescribed time period. If not, the user will have to pay back the amount plus interest. However, the problem is that it is unacceptable on religious grounds because there will be an interest payments made when the outstanding balance is not repaid in full.

For Islamic banks, if they wish to successfully compete with their conventional counterparts, these are the issues to consider. How can a Sharia compliant card be introduced? Furthermore, how can a product be introduced that is both ethical and relatively cheap?

Bearing the above in mind, Islamic banks have created Islamic credit cards based on the following structures:

- a) Ujrah and Ijarah
- b) Kafala
- c) Qard
- d) Bai al-inah/ Tawarruk

In Ujra-based structures, the client simply pays an annual service fee for using the card. The fee can include charges for bank statements, requests for statements and likewise. The fee can be deemed high in comparison with a conventional credit card but still it offers no interest and no hidden charges.

The Kafala model provides that the bank acts as a kafil (guarantor) for the transactions of the card holder. For its services, the card holder is obligated to pay kafala fee.

In the qard structure, the client acts as the borrower and the bank as a lender.

In the case of bai al-ina, it often works together with other structures (e.g. wadiah/ deposit) in a combined Islamic credit card model. The bank sells a product at a certain price which is the pool of means available for the client from its credit card and then the bank repurchases the item from the client at a lower price. The difference between the prices is the income of the bank. In this model, the client would have a ceiling limit of money it could spend.

Discussion of Findings

Credit card has proved to have a large impact on economy. Credit fulfill of capital requirements of individuals, households, SMEs and corporates. Due to a rapid change in the life style of people, some of important factor that have risen need of credit cards. Credit card sector contributes nearly 6% of the payment in the banking system in the year 2013.

Conservative Sharia scholars are against credit cards for many reasons. Some of them are;

- a) It is not Islamic product, it comes from conventional banks.
- b) It is based on the concept of forbidden riba and it work like bai al-ina.
- c) Credit cards are a creation of Western culture, where shopping is regarded as a way of spending time and enjoying yourself

- d) Debt is created without needs and it will be burden on the borrower at the time of repayment.
- e) The simple pleasure of buying now and paying later does not necessarily appeal to Muslim (or just ethical) mentality. It can be seen as tempting faith for the sake of short-lived pleasure and not for satisfying the real needs of a human being

In the card issuer's point of view, several problems occurred. For example not only will the bank make little or no revenue from a credit card if the balance is repaid in full, but in religious terms it will be conspiring in the commitment of sin the contract in paying interest is signed wherein a Muslim agrees to pay Riba in the case of non-payment of the balance. Apart from that, the extension of credit with a view to making profit is not a Qardhul Hassan loan, thus it is unacceptable in religious terms for the creditor as well as the borrower. This situation represent unprofitable for the bank. A membership fee can be charged for the service provided by the card, but otherwise it is more of a value-added service to account holders than a significant retail revenue stream. The result is that the banks are keen to offer a fully-functional and profitable Islamic credit card has been unsatisfied with the debit card alone.

Many Islamic banks ask those who wish to use the credit cards to provide a deposit it is similar to conventional bank's credit card with the higher limit. This is crucial, especially in the case of revolving facilities, where the client can transfer some parts of their monthly income to the bank as a deposit.

Islamic banks, just like conventional ones, offer a grace period for their credit card holders. Nevertheless, they do not charge simple and compound interest on default payment but instead some banks may impose additional fees on the client. This is treated as a voluntary sadaqah. In such a case, the bank will transfer the means obtained from the client to a charity; it will bear no legal title to it.

Arguments on the Structure of Credit Cards used at IFIs.

- I. Ujarah based cards are in line with Sharia principal. However, it is often argued that the fees charged by Islamic banks for Sharia-compliant credit cards are higher than the fee charged by conventional banks. If the customer who pay on or before due date, wishing to use a Sharia-compliant credit card to pay for their

utilities, will end up paying much more than with a conventional credit card.

- II. In Kafala based cards, the bank charge a fee as a guarantor of the payment. The issue is this fee is linked to the amount, time and tenor. It is not permitted by the Sharia scholars.
- III. In Qard based cards, are not viable for commercial banks to offer all the segments. It is simply because any excess/increase over the principal amount of the loan/ Qard as a condition of the contract will tantamount to Interest.
- IV. The structure of Bai-Inah, it is criticized by most of the Sharia scholars and not acceptable to the local Scholars due to invalidity of this contract.

Proposed Structure for Execution of Credit Card at Amana Bank Limited

This product will be a Hybrid product with the combination of Qard and Ijarah. The relationship between the bank and the cardholder at the time of issuing the card will be "Service Provider" and "the Customer" respectively where the bank will charge a flat fee for providing the service which is the issuance of the credit card. By using the card, the cardholder will be able purchase the goods and services at merchants who accept it and may withdraw cash for emergency.

Ujrah is the fee, will be charged to issue a credit card and to use of the card. The proposed fee for this model is to be in line with conventional credit card fee to attract the customers. The fee charged is not linked to the credit period or the amount/ limit and it is not only to provide credit facility in the future. The fee will be charged irrespectively whether the customer uses the card or not and whether he has credit balance in his account or not.

The relationship between the merchant and the bank could be Kafalah whereas the bank will not charge anything as a Kafalah fee or it could be merely the bank is issuing a legal tender which is the payment coupon signed by the customer. It is based on the AAOIFI view of that receiving the signed coupon by the customer, is a taking constructive position of price. Whereas AAOIFI recognized that the payment coupon signed by the customer could be a price which is the legal tender.

In case where the cardholder withdraws cash from ATMs, the relationship between the bank and the cardholder will be based on Qard.

If the card is used to purchase goods and services through POS (point of sale), the bank will pay the

merchant on demand where the bank as a guarantor and the relationship between the bank and the cardholder will be based on Qard.

It has to be in mind that the objective of Sharia complaint credit card based on Qard/ Kafalah is services orientation only. It is not to earn money simply by granting a loan because Islamic bank cannot charge anything above the principal amount of the loan except actual expenses incurred in granting the loan. It is similar to service of Air filling is provided by fuel station in Sri Lanka where they don't charge a fee and normal water is offered as a free of charge at the restaurants. It is considered an additional service to the customers with cross selling of other products. In my view, the credit card should be applied in the same manner at IFI.

In Islamic financial transaction, there are many underline principles and concept laid down by Quraan and Sunnah. However, all these principles and concept are not to make money. There are some contracts only on voluntary and to assist each other such as Qard, Rahn, Iarah, Kafalah and etc.

Mitigation of Default Risk

A different type of card should be introduced for set of the people who may not settle full amount on due date. The features of this card are;

- a) In addition to the joining fee or annual fee, this card may be loaded with per transaction or monthly fee similar to some Islamic bank credit cards in Middle East.
- b) The card will be automatically terminated on the third day from due date upon not settlement.
- c) To renew the card, a flat fee will be charged irrespective of overdue amount and the tenor as per the below table;

Table 2: Fee structure based on limits

Limit of the Card (SLR)	Fee (SLR)
Up to 50,000	1000
50,001 to 99,999	1500
100,000 and above	2000

Conclusions

This study recognize that Islamic financial institution have huge potential to attract Muslim communities and those interested in ethical banking. This group of clients will be looking for a bank with a more moral approach that will offer those services at a similar level of quality and price. The issue of price is the real challenge for Islamic banks that cannot be disregarded and swept under the carpet. The time is right for entering new markets and this can only be done with products that are both Sharia compliant and price aware.

Thus Amana bank and other IFIs should take care prior to launching a Sharia complaint credit card to reduce the credit risks from large-scale willful defaults. Finally, a hybrid model with innovative features is proposed in this paper for the feasible application. The ultimate objective of the proposed model is to develop such a system that will eliminate the prohibited interest form the entire economy.

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