

Permissibility Of Services Charges Against Loan In Islamic Finance

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Abstract:

A question that is frequently asked is the collection of service charges on loan disbursement. Some people are in favor of their recovery and some are against it. In this regard, there are clear instructions of the Shari'ah in the light of which this question can be answered. This article will examine the cases in which service charges can be charged and in which cases they cannot. It will also be reviewed as to which entities, depending on their objectives, may be allowed to receive their direct expenses and which may not. In the same way, the aspects of justification and illegitimacy of 'Time multiple counter loans' will also be examined.

Keywords: Loan, Service charges, Ijarah, Direct expenses, indirect expenses, IFIs, TMCL

Principle about benefits drawn on loans

It is not permissible for a lender to get any kind of benefit against any loan provided to a borrower, if the lender takes any kind of benefit from the borrower in this regard it would be considered as interest on loan and it is unlawful according to Hadith. So, Prophet Muhammad (PBUH) forbade from it saying:

“Every loan that draws benefit it is interest”¹.

Permissibility to charge for services rendered in loans

There could be no denial to charge for services provided to a borrower for lending him a loan. As these service charges are not in favor of the lender, these are only to cover the expenses incurred. So, Shariah standards for IFIs also allow getting these types of charges, mainly with two conditions. Firstly, these charges should not exceed the actual expenses. Secondly, only direct expenses should be charged, charging indirect

expenses is prohibited.² The reason for the permissibility of the actual charge is that lender is doing a favor and the person doing a favor is not to be penalized. And the reason for the prohibition of excessive charge is that it would be tantamount to 'Riba' on 'Qard' which is not allowed.³

Permissibility of 'Ijarah'

According to all (four) schools of thought 'Ijarah' (Providing the services of a person or usufruct of an asset) is permissible and they defined 'Ijarah' with a little difference in its definitions⁴. Mufti Muhammad Taqi Usmani says:

“ Ijarah” is a term of Islamic Fiqh. Lexically, it means ‘to give something on rent’. In the Islamic jurisprudence, the term ‘Ijarah’ is used for two different situations. In the first place, it means ‘to employ the services of a person on wages given to him as a consideration for his hired services’. The employer is called ‘musta’jir’ while the employee is called ‘ajir’..... The second type of Ijarah relates to the usufruct of assets and properties, and not to the services of human beings. ‘Ijarah’ in this sense means ‘to transfer the usufruct of a particular property to another person in exchange for a rent claimed for him’⁵.

Allama Ibn-e-Qudama and Muhammad bin Abdul Rehman says that there is consensus on the permissibility of 'Ijarah'⁶.

'Service Charges' fall in the definition of ' Ijarah'

According to some jurists, service charges fall in the definition of 'Ijarah' (i.e. to employ the services of a person) So, when 'Ijarah' is permissible according to Shari'ah then taking service charges is also allowed as it is also a kind of 'Ijarah'⁷.

Reason for prohibition of indirect expenses in IFIs

Why IFIs (Islamic Financial Institutions) are prohibited to charge indirect expenses? The reason which comes to mind is that IFIs usually provide different services to their customers including loan. They are also getting profits from various financial transactions like as 'Ijarah', 'Murabaha' and 'Musharakah' etc. So, if they start to compensate their indirect expenses also through loans given to their customers, it will lead them to recover the expenses which do not stand against the money given as loan. In other words, they recover the expenses of their own business, by putting these extra expenses on loans, given to the customers.

Permission for direct expenses to 'not for profit' IFIs

If there is a microfinance institution based on 'not for profit', then is it possible for that institution to charge indirect expenses along with direct expenses from its customers? In my opinion it is possible but only when indirect expenses are in a reasonable figure. If we look at the mutual funds based on the same (i.e. not for profit), we could find that these funds are also charging indirect expenses from their customers. And they do this because these institutions are not established to gain profit, that's why they are allowed to deduct indirect expenses from the total profit. If they do not do so, they would not be able to run the institution and ultimately shut down their practice.

Example:

Different funds have been run by 'NBP Fund Management Limited' (with the supervision of a Shariah board), which is the subsidiary of National Bank of Pakistan. For example there is a fund with the name of 'Nafa Riba

Free Saving Fund' (NRFSF). In this fund the institution (Manager) charges 10% of net income (Min 0.5% p.a, Max 1.25% p.a).⁸ These charges (management fee) include direct and indirect expenses. We could easily come to know the main reason behind this inclusion of indirect expenses. The reason is the same which is mentioned above, that this institution is a 'not for profit' institution that is why it is allowed to charge indirect expenses as well. And it is the main difference between both i.e. 'not for profit IFIs' and 'profit purpose built IFIs'. The charges (Management Fee) of other funds managed by the same IFI are also near to the above mentioned charges with some differences.⁹

Charges on Monthly Basis

The possible way to charge for services rendered in loans is that the lending institution charge on monthly basis. For example if he facilitates thousand people in a month he could charge direct and indirect expenses by equally distributing on these thousand borrowers.

Use of 'TMCL' in Islamic Micro financing banking system

Definition of 'TMCL':

'Time multiple counter loan' is a system of counter loans. Asif Iftikhar writes:

"...TMCL model suggests that for every loan given by the bank, the borrower should return the bank an equivalent loan value, which would be a fraction of the amount of loan received, the difference being covered by a multiple of time. This procedure is based on the concept of Equivalent Credit Value. For example, all the following amounts of loan have Equivalent Credit/Loan Values:

Rs 1000 borrowed for 1 year

Rs 500 borrowed for 2 year

Rs 250 borrowed for 4 year

Rs 100 borrowed for 10 year¹⁰

Now if 'A' goes to the bank and ask for the loan amounting Rs 1000 for one year, banks will also ask him to give the bank a counter value loan amounting for example Rs 200 for five years. Profits earned by 'A' and the bank on both the amounts would be entirely in the separate ownerships of 'A' and the bank.

Opinions about permissibility of counter loans:

Sheikh Mahmood Ahmad:

Sheikh Mahmood Ahmad is of the view that counter loan is a favour 'Ehsaan'.¹¹ He argues with a verse of Quran in which Allah (SWT) says:

"Is there any reward for goodness other than goodness?"¹²

Some people say that we could name counter loan as 'justice' not 'Ehsaan'. And if you look at the Shariah commandments you could easily find that these commandments have been changed whenever a condition is put into it. Returning the loan by Prophet (PBUH) with excessive amounts was also unconditional.

Some other scholars say that TMCL should not be used as a permanent alternative to the interest based system. However these loans could be provided by the banks to poor people who already hold accounts with them, for personal and non-productive purposes when desired. Appropriate procedure and regulations may be evolved in this regard.¹³

Opinions about impermissibility of counter loans:

Ibn-e-Qudamah (Hanbli):

According to Allamah Ibn e Qudamah counter loan is impermissible because of a hadith in which prophet (PBUH) forbade from conditional combination of loan and sale.

Ibn e Qudamah writes:

“If the lender puts a condition that the borrower in return will rent out his home to the lender or sell something to him or lend him money second time (i.e loan against loan), it is not permissible as Prophet (PBUH) forbade from conditional combination of loan and sale; and as he put in this agreement a condition of another agreement which is prohibited and it will be considered as he sells his home to a person on the condition that the second one will also sell his house to him”¹⁴.

The hadith referred by Ibn-e-Qudamah is as under:

“It is not permissible to combine sale and loan; and not two conditions in a sale; and not the profit of anything without bearing its risk; and not to sell anything which is not in your possession”¹⁵.

But the question arises here that the hadith referred, prohibits from the conditional combination of loan and sale. Likewise this hadith instructs that two conditions in a sale are not allowed. But this hadith is silent about the commandment of loan against loan. So, the argumentation of Ibn-e-Qudamah about impermissibility of loan against loan is incomplete.

Imam Hattab (Maliki):

Imam Hattab writes in his book ‘Al-Mawahib’ that there is no disagreement in prohibition of this, that a person lends to a person with a condition that the second one will also lend him in return.¹⁶

Imam Dirdir (Maliki):

Imam dirdir is also on the point of view that loan against loan is unlawful¹⁷ as in a Hadith Prophet (PBUH) equate every loan that draws benefit as ‘Riba’. So, Prophet (PBUH) said:

“Every loan that draws interest is ‘Riba’”¹⁸.

Imam Bahuti:

Imam Bahuti says that loan against loan is like two sale agreements in one agreement which is prohibited in Hadit. So, loan against loan will also be prohibited in the light of this narration.¹⁹

The same questions arises here that Prophet (PBUH) forbade in this narration also from two sale agreements in one agreement. Prohibition of loan against loan is not mentioned here in this narration, So, the argument of Imam Bahuti is irrelevant to the issue.

Imam Navavi (Shafi):

Imam Navavi says that if lender puts the condition of getting something in return from the borrower as loan, then the loan agreement will complete but the condition will not be stipulated to this agreement. It is similar to a situation in which a person gifts a piece of cloth to another person with the condition of getting gift in return from the same person.²⁰

Some other scholars also have the same opinion that loan against loan is prohibited in Islamic law.²¹

Conclusion:

It is permissible to charge for services provided to a borrower for lending him a loan. As these service charges are not in favor of the lender, these are only to cover the expenses incurred. Shari'ah standards for IFIs also allow getting these types of charges, mainly with two conditions. Firstly, these charges should not exceed the actual expenses. Secondly, only direct expenses should be charged, charging indirect expenses is prohibited.

According to some jurists, service charges fall in the definition of 'Ijarah', so, when 'Ijarah' is permissible according to Shari'ah then taking service charges is also allowed.

IFIs providing different services to their customers including loan are not allowed to compensate their indirect expenses through loans given to their customers.

For institution based on 'not for profit', it is permitted for them to charge indirect expenses along with direct expenses from its customers only when indirect expenses are in a reasonable figure. If they do not do so, they would not be able to run the institution and ultimately shut down their practice.

Counter loan is also impermissible because of the conditional combination of two loans which is prohibited in Islamic law.

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