

THE INTERNATIONAL



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## Credit Cards from Shari'a Perspective

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# THE FEATURES & USES OF CREDIT CARDS

- Credit Card provides a revolving credit facility within the credit limit and credit period determined by the issuer of the card. It is also a means of payment.
- The holder of a credit card is able to pay for purchases of goods and services and to withdraw cash, within the approved limit.
- The amount of the purchase becomes the cardholder's debt to the credit card issuer.
- The card issuer determines the credit limit and taking into account customer's salary and previous credit rating when deciding on how much credit to give.

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- When purchasing goods or services, the cardholder is billed on a monthly basis and is given a free credit period during which the amount due should be paid and no interest is chargeable. The cardholder is also allowed to defer paying the amount due and is charged interest for the duration of the credit. In the case of a cash withdrawal, there is no free credit period.
  - If using the card overseas, foreign exchange charges and transaction charges may also be applicable.

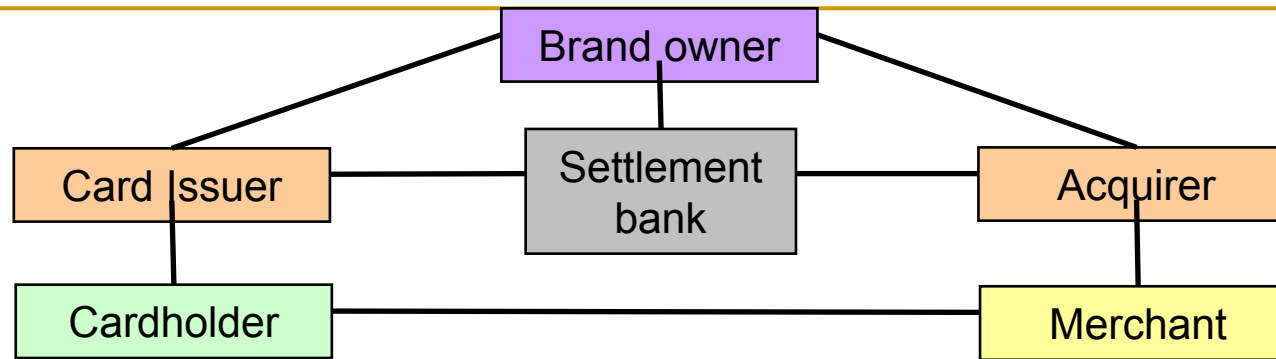
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- Card networks (Visa, MasterCard, DinersClub etc.) are accepted worldwide and allow a cardholder to purchase goods directly.
  - Credit cards can be used online (on the Internet).
  - Also, they can be used to withdraw cash from a bank or ATM.
  - Having a credit card is safer and more practical than carrying large amounts of cash when traveling, or for buying high value items such as jewelry.
  - Credit cards are also useful to make direct debit arrangement for regular bills such as utilities and telephony charges, and for paying in foreign currency when traveling abroad

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- Some cards come with additional services such as medical cover for international holidays, purchase protection and a variety of promotional offers.
  - The interest charges on credit cards are compound and usually much higher than on normal bank loans. As a result, credit cards are considered to be not a good way of financing purchases over a long period of time.
  - Some credit cards charge an annual fee and a membership fee, to entitle a consumer the use of the card.
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- **Issuers of the credit card**

- Businesses (e.g. department store or oil company) to make it easier for consumers to purchase their products.
- Third parties (e.g. bank or financial services company) to be used by consumers to purchase goods and services from other companies.



Brand owner	Payment services company that provides the brand, infrastructure and systems to connect related parties, e.g. VISA, MasterCard, American Express, Diners Club.
Acquirer	Signs up merchants to accept payment for goods and services using the credit card. Merchants claim dues from Acquirer. Usually a licensed financial institution.
Card Issuer	Provides credit card facility to cardholder. Cardholder makes repayment to card issuer. Usually a licensed financial institution in the operating country.
Cardholder	Customer of card issuer who obtains credit card facility based on eligibility criteria set by regulators and card issuer.
Merchant	Merchants who sign up with Acquirer to accept payment of their goods and services using credit cards.
Settlement bank	Brand owner, card issuer and acquirer maintain settlement accounts with Settlement Bank. Settlement process occurs daily.

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## Main payers in credit cards mechanism

- ❑ Card issuer pays membership fees, service charges and other fees to international card regulatory organizations.
  - ❑ Merchant typically pays Acquirer (or the issuer) a fee
    - Usually a percentage of the value of goods and services purchased by the cardholder
    - E.g. Cardholder buys goods worth \$1,000. Acquirer pays merchant \$975; \$25 being Acquirer's fee (2.5%)
  - ❑ Cardholder will be levied (interest) charges for any outstanding balances unpaid after the grace period (typically 1.5 – 2% per month).
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# Credit card, is it halal?

- Shari'a principles imply no objection to institutions joining the membership of international card regulatory organizations and paying membership fees.
- Also, no Shari'a objection for the institution issuing the card to charge a commission to the party accepting the card, at a percentage of the purchase price of the items and services purchased using the card.
- Moreover, it is permissible for the institution issuing the card to charge the cardholder membership fees, renewal fees and replacement fees.

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- And, It is permissible for the institution issuing the card to charge a service fee for cash withdrawal.
  - However, credit card remains unlawful as it is very clear that credit cards involve riba.
  - This riba materializes when cardholder pays charges (interest) for any outstanding balances unpaid after the grace period (typically 1.5 – 2% per month). This is a sufficient reason to render credit card unlawful according to Shari'a.

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## Can credit card be made Islamic?

- No doubt that card holder are provided a good and beneficial service that entails its provider for fees.
- However, besides this service provided there is a loan too. Loan in Islam is a contract of gratuity; no way lender can derive from the borrower a monetary benefit for providing him with a loan.
- Therefore, credit card provider is entitled to service fees but not for interest.
- Some may think of increasing the service charge to cater for the granted credit.
- This is a legal trick that contradicts the very Shair'a principles pertaining to loan contract.

- Therefore, these fees must be flat, reasonable and proportionate to the service offered, and not a fee that varies with the amount withdrawn or the card ceiling.
- The same applies to cash withdrawal via credit card; it is permissible for the institution issuing the card to charge a flat service fee for cash withdrawal, proportionate to the service offered, but not a fee that varies with the amount withdrawn.
- Besides, it is not permissible for institutions to grant the cardholder privileges prohibited by the Shari'a, such as conventional life insurance, entrance to prohibited places or prohibited gifts.
- If the above is observed, credit card will be deemed acceptable.
- Source of profit for card issuer is basically the charges (interest) imposed on late payment. Nature of credit card is alien to these Shari'a provisions on credit card.

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## Using Conventional Credit Card Diligently!

- Can Muslims use the conventional credit card and diligently pay on time (thus avoiding interest charges)?

### Argument in support:

- Signing the contract, using it, and making the payments within the grace period and making no cash withdrawals (whenever cash withdrawals generate interest), is permissible because it amounts to a contract that gives you a choice to deal or not to deal with interest.
- Credit cards provide an alternative form of payment which is need in the modern life.

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## Counter argument:

- ❑ Element of *riba* **inherent** in the contract and system of conventional credit cards
- ❑ No absolute **certainty** in ability to pay on time.
  - One may pay on time but many others may not (and will pay interest)
- ❑ Patronage of conventional credit cards represents **support** for that system. (encourages its proliferation).

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# “Islamic” Credit Cards

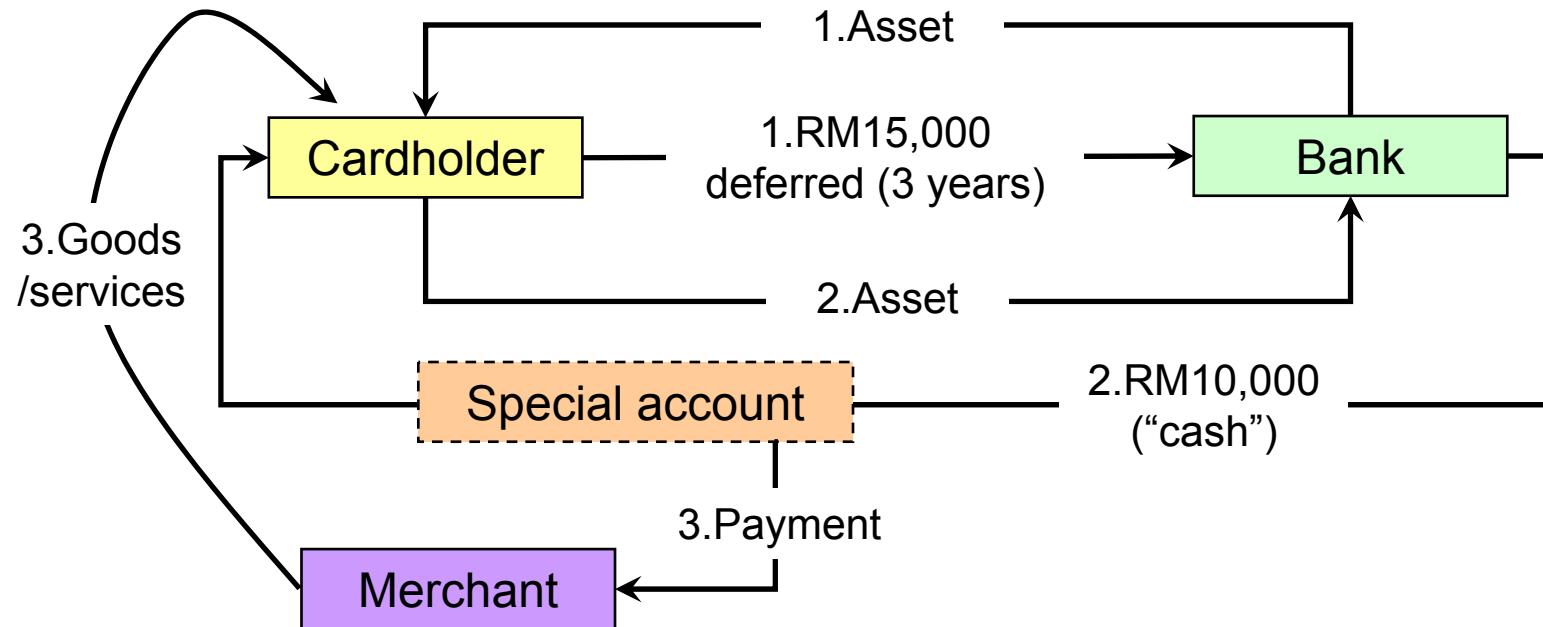
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## Examining the Current Models of Islamic Credit Cards

- In Malaysia, most common model:
  - *Bay' al-eina* Model
  
- In the Gulf, the dominant model:
- Prepaid-fee model

## Credit Card *Bay' al-eina* Model



1. Bank sells asset to cardholder, payment deferred
2. Cardholders sells back same asset to bank, in cash, but paid into a special account
3. Object is to create debt liability

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4. When cardholder purchases goods from merchant, merchant is paid from the special account
    - When cardholder makes repayment to the bank, the amount in special account is “topped up” (revolving credit)
    - If cardholder makes payment after grace period, bank accrues profit (up to maximum of RM5,000)
  5. 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.

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## *Bay' al-eina* Model - Issues

- Acceptability of *bay' al-eina*
    - All schools of Fiqh rejected *bay' al-eina* considering it as haram when used as a legal trick to obtain riba.
    - Sale and buy back used as merely a legal trick, no actual sale has taken place
    - Misunderstanding of some jurists' position on *eina*
  - Justification for bank's accruing of profit
    - Is there a valid basis for the bank to accrue profit simply because the cardholder makes payment after the grace period?
  - Lack of clear and well-understood linkage
    - Vague or loose relationship between *eina* arrangement and the actual purchase of goods by the cardholder
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## Prepaid-fee Model

- Some Islamic Banks in the Gulf offer a Visa Classic Card but then debit the balance automatically from the holder's current or savings account every month. In effect this is a debit card, as officially no credit is extended to the consumer and so no injunctions against Riba have been broken.
  - Some banks suggested charging a fixed upfront fee for issuing a credit card as a service provided to the customer.
  - This is acceptable in principle; however, the question that rises here is: Is it permissible for this fee to be tied with the card ceiling?
  - It is not permissible for the issuance of a credit card to increase the service charge to cater for the granted credit.
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## General Observations on Islamic Credit Cards

- All credit cards advocated models have **unresolved *fiqh* issues**
  - Seem to indicate that the credit card, within the *Shari'ah* framework, is not a viable or acceptable product
  - Control on card utilization is not sufficient to render credit card acceptable.
- Looking beyond *fiqh* issues, important to also consider **economic and societal implications** of credit cards
  - Encourages consumers to spend beyond their means (impulsive or unplanned consumption)
  - Could possibly go against Islamic concept of moderation and rationality in consumption

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- **Credit card** is **incongruous** with Islamic prescriptions in respect of debt
    - ❑ Debt should only be undertaken in cases of absolute necessity
    - ❑ Debt is something that should be avoided, rather than encouraged
    - ❑ Banks earn more profit if cardholders delay repayment
    - ❑ But Islam tells us to expedite the repayment of debt
    - ❑ Credit card issuers even hold promotional campaigns that encourage cardholders to intentionally maintain outstanding balances, enticing them with attractive prizes!

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## The alternative

- ❑ Despite the many undesirable features of the credit card, it does have some valid functionality
  - Serves as a convenient mode of payment
  - Provides the added element of security
- ❑ Debit card serves exactly the same purpose save credit facility.
  - A plastic card serving as a substitute for carrying cash
  - Functions as a payment mode, rather than consumer credit
  - Cardholder only allowed to charge to the card up to actual amount of cash held on account
- ❑ Islamic debit card differs from the conventional debit card in the restrictions put on card utilization

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