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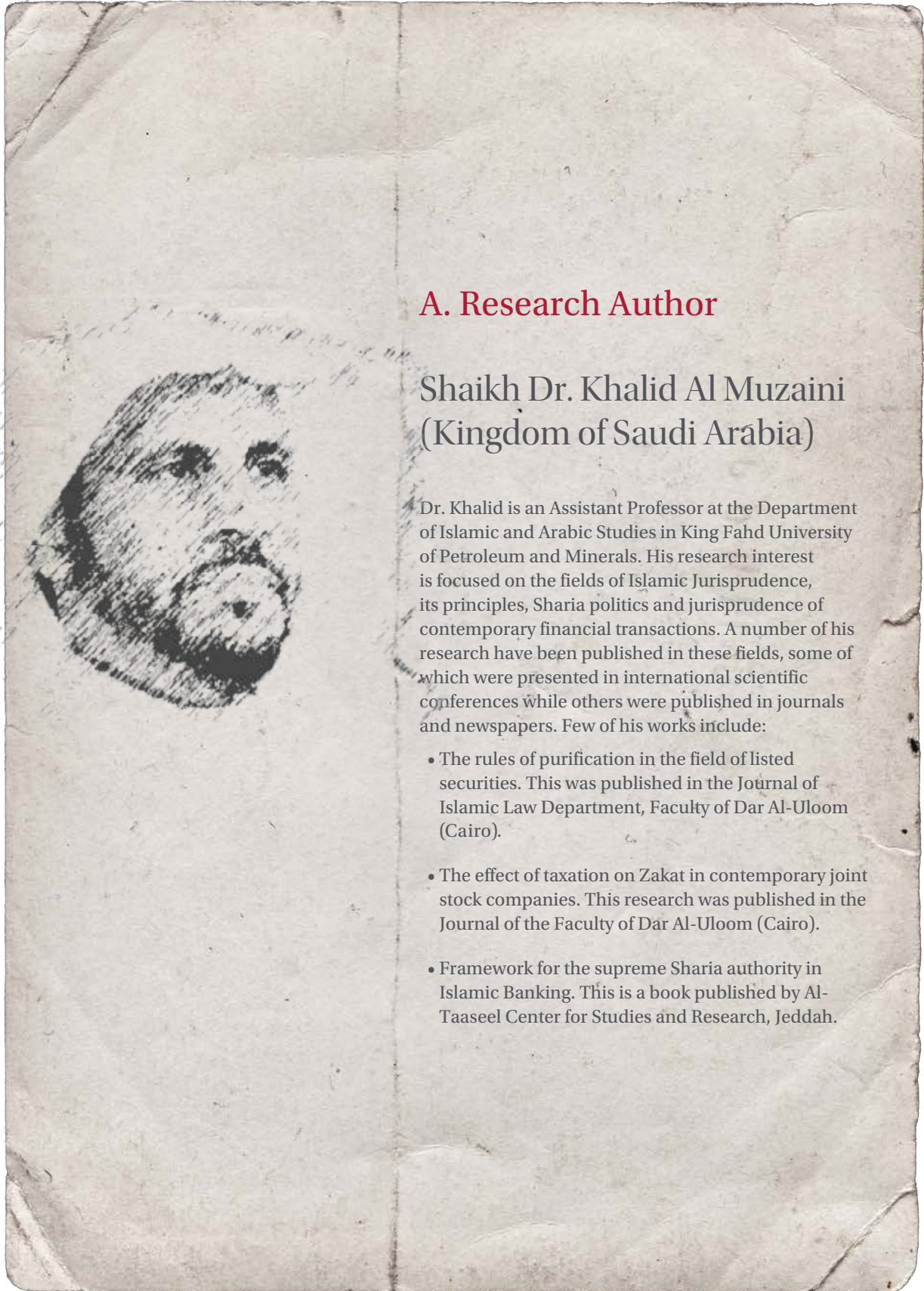
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Introduction

Buy Now, Pay Later (BNPL) is a recent development that has emerged as a popular alternative financing method in recent years. However, its Sharia compliance has become a subject of debate in both media and academic circles. This paper aims to address the key arguments surrounding the Sharia compliant nature of the BNPL model and the late payment penalty, often structured as obligatory donations for delinquent customers.

The paper will explore alternative financing models that align better with Sharia principles. One such option is utilizing Murabaha to Purchase Order (MPO). In this model, the financial institution acts as the intermediary, purchasing the desired goods from the seller. By assuming ownership of the goods, the institution bears the risk. It then resells the goods to the customer at a pre-agreed markup that incorporates potential credit losses. This approach aligns with Sharia principles by establishing a clear sale and purchase transaction between the institution and the customer.



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Dr. Khalid is an Assistant Professor at the Department of Islamic and Arabic Studies in King Fahd University of Petroleum and Minerals. His research interest is focused on the fields of Islamic Jurisprudence, its principles, Sharia politics and jurisprudence of contemporary financial transactions. A number of his research have been published in these fields, some of which were presented in international scientific conferences while others were published in journals and newspapers. Few of his works include:

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- The effect of taxation on Zakat in contemporary joint stock companies. This research was published in the Journal of the Faculty of Dar Al-Uloom (Cairo).
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He also a Sharia Board member for a number of Islamic financial institutions in Tunisia and a member of the Sharia Standards Committees of the AAOIFI in Bahrain. Dr. Elias has made significant contribution towards Jurisprudence, have authored twenty-four books on General Fiqh and Jurisprudence of financial transactions.



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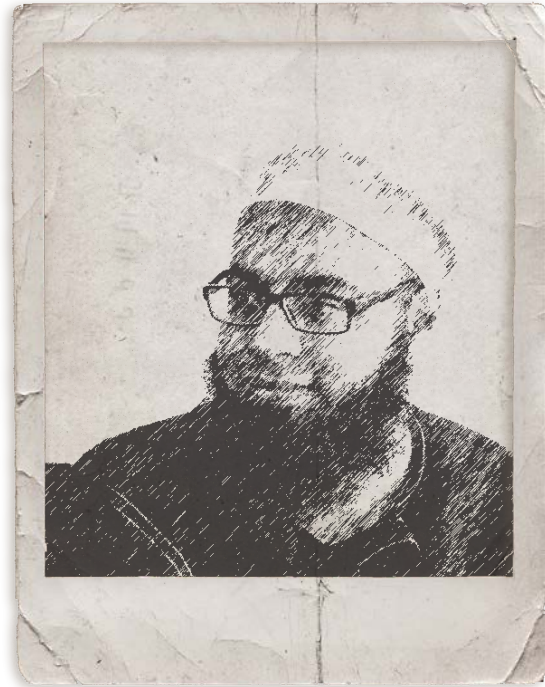
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Mufti Faraz Adam (United Kingdom)

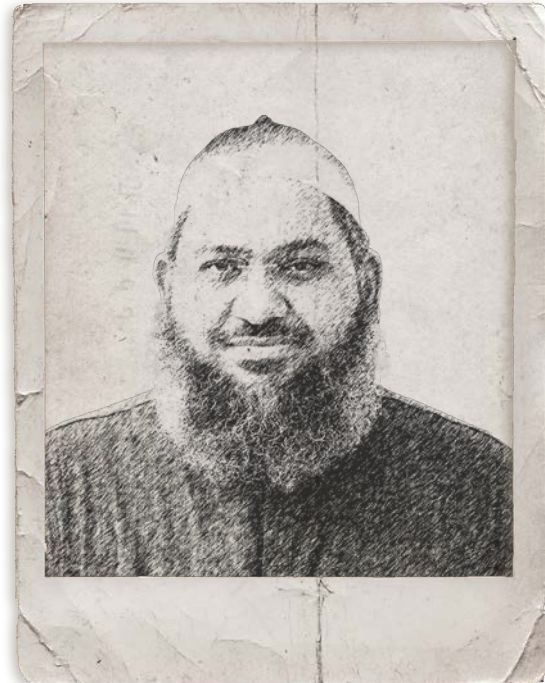
Mufti Faraz Adam is a UK-based Islamic Finance & Fintech consultant, and has over ten years of experience in serving as a Shariah advisor. He advises several global Islamic financial institutions spread across the UK, US, Canada, Malaysia, Singapore, UAE and other countries.

He spent several years studying knowledge of Shariah in Leicester and South Africa, where he specialised in Fiqh and Iftaa. He holds a Master's Degree in Islamic Finance, Banking and Management from Newman University, UK and also holds an ACCA Level 4 Qualification in Accounting and Business. In addition to the above, he has attained various Islamic Finance-industry qualifications such as the IFQ, CIAE, CIFE and is a Certified Shariah Advisor and Auditor (CSAA). He is currently doing his PhD in Shariah governance for Artificial Intelligence.



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Dr. Gapur Oziev is a recognized expert in Islamic finance and serves as Associate Professor in the Department of Economics at the International Islamic University Malaysia (IIUM). Holding a PhD in Fiqh and Usul Fiqh from IIUM, Dr. Oziev leverages his scholarship to contribute extensively to the field through research and publications. These include insightful works on critical areas like cryptocurrency and foreign exchange from a Sharia perspective. His fluency in English, Arabic, Russian, Ingush, Chechen, and Malay further strengthens his ability to connect and contribute to the global Islamic finance discourse.



Shaikh Dr. Mohamed Al-Beltagi (*Egypt*)

Dr. Mohamed Al-Beltagi is a prominent figure in the Islamic finance industry. Currently, he serves as the Vice Chairman of the Shari'a Board at Banque Misr, a leading Egyptian bank. He also holds a position on the Policy Committee of the National Bank for Development.

Dr. Al-Beltagi boasts a rich professional background with experience across various Islamic financial institutions. He has also served as a Banking Programs Manager at the Saudi Arabia Monetary Agency (Saudi Central Bank). He also held leadership positions at Al-Rajhi Banking & Investment Corp, including Head of Planning and Studies. His extensive experience positions him as a respected expert in Islamic finance principles and their practical application within the banking sector.



Preamble

Buy Now, Pay Later (BNPL) schemes offer short-term financing to customers for retail purchases. While attractive due to the absence of additional costs, BNPL exposes financial institutions to credit risk. This risk arises from factors like operational costs, customer defaults (due to delinquency, insolvency, or bankruptcy), and economic downturns.

Islamic jurisprudence acknowledges the reality of credit risk. A Hadith emphasizes the seller's right to reclaim goods from a bankrupt buyer, highlighting the risk borne by the seller: "If anyone sells some goods (on credit) and the one who buys them becomes bankrupt, and the seller does not recover any of the price of his goods, and he then finds his very goods (with him), he is more entitled to them (than anyone else)". However, if the buyer dies, the owner of the goods finds his actual goods he has most right to them¹. Sharia principles recognize the concept of "profit accrues from bearing risk" [legal maxim]. Institutions are entitled to a profit for assuming the risk of customer default, as stated in the Hadith: "The Prophet ﷺ forbade earning from a risk not borne by him²".

To mitigate credit risk, BNPL institutions employ various preventative measures, collectively known as credit hedging. These measures aim to protect against potential losses from late payments or non-payment. Common strategies include:

- **Credit Analysis:** Assessing a customer's creditworthiness before approving BNPL financing.
- **Guarantees:** Obtaining guarantees from third parties to ensure repayment in case of default.
- **Payment Solutions:** Offering flexible payment options that encourage timely repayment.
- **Customer Monitoring:** Regularly tracking customer performance and following up on potential delinquencies.
- **Insurance:** Exploring liability or credit default insurance options, where applicable.

Effective credit hedging protects the financial stability of BNPL institutions, enhances confidence among stakeholders, and ensures business continuity.

Impact of Default on BNPL Institutions

Customer defaults can significantly impact BNPL institutions. Full default results in a loss of both the principal amount and potential profits. Partial default translates to a loss of some or all of the expected profit margin.

To minimize such losses, BNPL institutions implement various strategies:

- **Customer Due Diligence (KYC):** Thoroughly evaluating a customer's financial background before extending credit.
- **Collateral Requirements:** Requesting collateral that can be liquidated to recoup losses in case of default.

A survey by "Mal" newspaper indicates that non-performing loans in Saudi banks amount to SAR32.7 billion as of the third quarter of 2023. Accumulated provisions amounted to SAR51.3 billion, translating to a sector coverage of 156.8%. Banks have written off SAR10.2 billion of bad debts during the first three quarters of 2023. Within this context, financial markets are still recovering from the pandemic's aftermath, which has affected many businesses and resulted in significant job losses, weakening the creditworthiness of many retail and corporate.

¹ Reported by Malik 2686, Abu Dawud 3520, At Tirmithi 1262.

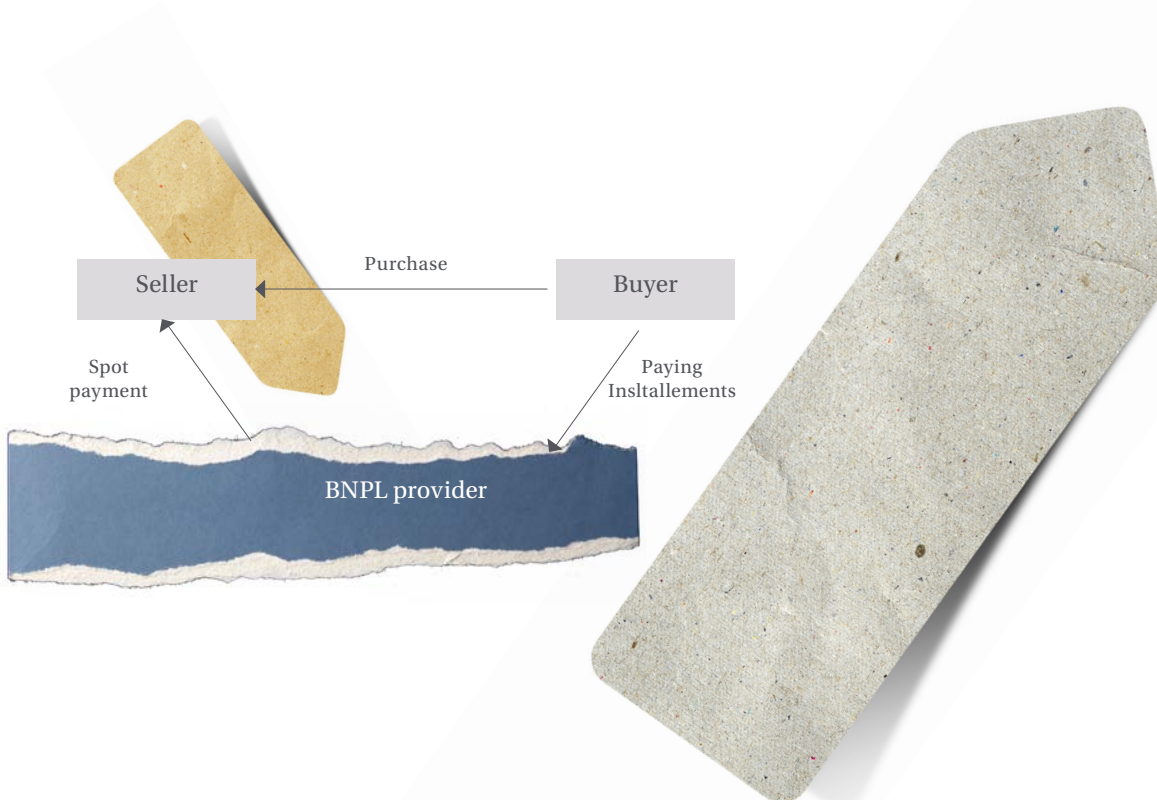
² Reported by Abu Dawud 3504, At Tirmithi p232 v1, An Nasa'i p225 v2

Defining the Mechanism of Deferred Payment in BNPL

BNPL involves short-term consumption financing for individuals without additional costs or interest payments. It covers individuals' and households' consumption needs in terms of daily purchases and other consumables like clothing, electronics, and home appliances.

According to the “Rules for Regulating Buy-Now-Pay-Later (BNPL) Companies” issued by the Saudi Central Bank⁴ in November 2023, BNPL is defined as “a type of financing that allows a consumer to purchase goods or services without a term cost payable by the consumer.” This financing method has become prevalent in recent years, particularly in Saudi Arabia and the Arab region. A factor aiding its spread is that it is not provided by legacy financial institutions like banks and credit institutions. Other researchers define this service as “a financial transaction between two parties in which one party makes an agreement with a specialized intermediary to bear the cost of purchases on a spot basis or at a specified timeframe while the other party pays the full price to the intermediary on an installment basis.” The BNPL model allows retailers to shift the credit risk to the BNPL provider, limiting their exposure to customer defaults.

In its terms and conditions, Tabby, a KSA based BNPL platform, states that it pays the purchase cost on behalf of the customer while the customer is obligated to pay the full amount in installments⁵. Thus, the customer remains the buyer, and the store owner is the seller, while the BNPL provider loans the customer the purchase cost and then collects installments as agreed. In exchange for bearing this risk, the BNPL provider takes a commission from the seller as a discount from the original price.



⁴ https://www.sama.gov.sa/en-US/RulesInstructions/FinanceRules/BNPL_rules_en.pdf.

⁵ <https://tabby.ai/en-SA/toc>

Sharia characterization of BNPL

Sharia characterization of the work model

The following table depicts the relationships that can be observed from the modus operandi depicted in Exhibit 1.

	Store	Buyer	BNPL provider
Merchant	-	Seller	Marketing client
Customer	Buyer	-	Borrower
BNPL provider	Marketer	Lender	-

Following is an explanation of these relationships:

1. The relationship between the BNPL provider and the customer is that of a lender and borrower.
2. The BNPL provider acts as a facilitator between the customer and the merchant. In return for this service, the store typically pays the BNPL provider a commission. This commission is often structured as a discount on the purchase price that the BNPL provider settles upfront on the customer's behalf.
3. The relationship between the merchant and the customer is that of a seller and buyer although the BNPL provider pays the cost of purchase to the store.

Thus, the BNPL provider acts as a lender to the customer, paying the purchase cost on his behalf and then collecting the same amount (without any increases) in installments. The BNPL provider does not own the goods and services sold; ownership is transferred directly from the merchant to the buyer. The BNPL provider is a marketing intermediary for the merchant, earning a marketing commission. It is also an agent for the customer, making the payment to the store. The marketing contract in this situation is a form of hire (Ijarah 'ala 'amal) or reward (Ju'ala) for work, both undoubtedly allowed. The agency relationship between the BNPL provider and the customer as a payment service provider does not include any objectionable elements as the agency (Wakalah) contract is permissible by the consensus of Islamic jurists. Almighty Allah said:

فَابْعَثُوا أَحَدَكُمْ بِوَرِقِكُمْ هَذِهِ إِلَى الْمَدِينَةِ فَلْيَنْظُرْ أَيُّهَا أَزْكَى طَعَامًا فَلْيَأْتِكُمْ بِرِزْقٍ مِنْهُ وَلْيَتَلَطَّفْ وَلَا يُشْعِرَنَّ بِكُمْ أَحَدًا
[الكهف (19)]

"So send one of you with this money of yours to the town and let him find out which is the good lawful food and bring some of that to you. And let him be careful and let no man know of you."

It is important to note that in a Sharia compliant model, the BNPL provider receives a discount from the merchant for promoting their products, not from the customer. If the BNPL provider was charging a fee or commission directly from the customer then this would raise the purchase cost and potentially violate Sharia's prohibition on interest (riba).

Another possible characterization of the model

Some researchers characterize the model as a form of sale of debt (Bay' al-Dayn), whereby the seller sells the debt the customer owes to the BNPL provider, transferring the credit risk associated with the customer. Based on this characterization, they infer that this model is impermissible, citing the ruling on discounting bills of exchange, which represent a debt on the holder. The prohibition on discounting bills of exchange is agreed upon by contemporary scholars.

Arguments against this characterization

This characterization seems unfounded for the following reasons:

1. The BNPL provider pays the price of goods and services directly to the seller before the customer becomes indebted.
2. The BNPL provider has a direct relationship with the customer without any involvement from the seller.
3. The rate used for discounting bills of exchange follows the prevailing interest rate, while the discount granted to the BNPL provider varies depending on the agreement with the merchant.⁶
4. Contemporary collective Ijtihad accepts that the remuneration in this model is a commission for marketing provided to the merchant by the intermediary, similar to the commission charged to the merchant by the bank issuing the credit card. This is also captured in the resolution of the OIC Fiqh Academy Resolution No. 108 (2/12) Unsecured Credit Cards on 28 September 2000, which states: "The issuing bank is permitted to charge a commission on the trader's (merchant's) goods or services purchased by the cardholder provided that such goods or services are sold at the same price whether in cash or credit."⁷



⁶ Refer to the comments of Mufti Taqi Usmani, OIC Fiqh Academy Journal, Issue 10 v3 p111.

⁷ Refer to Albaraka forum resolutions and recommendations; The resolutions of the Sharia board of Al Rajhi Bank (2/687) resolution no. 464; Resolution of Bank Albilad no. 16; AAOIFI Sharia Standard no. 61, Standard's Sharia basis.

Addressing concerns made by some researchers against BNPL



Objection:

BNPL results in interest (riba) since the commission charged by the BNPL provider is associated to the loan contract. As the provider pays on behalf of the customer, it is granting him a loan, and when it discounts the specified commission from the price, it is tantamount to imposing a remuneration for the loan it has granted. The aggregate is a loan with remuneration, which is unanimously prohibited. Several counter arguments can be made here.

First:

Combining Contracts in Sharia

The Sharia prohibition does not apply to every situation where contracts are combined or implemented sequentially, even if conflicting features are observed. Prohibition applies only when the transaction involves a prohibited element, such as riba, gharar, or gains without risk, or if it results in probable detriment. Combined or successive contracts, which are originally permissible, do not lose their permissibility for a mere resemblance to a prohibited act unless the essence of prohibition is present. Therefore, it is paramount to accurately establish the existence of a cause to apply the general rule (of prohibition) to an individual case (Tahqiq al-Manat). Imam Ahmed bin Hanbal stated: "Analogy (Qiyas) involves two cases that are similar in all situations. If this similarity is not consistent, the analogy becomes invalid." This is supported by the reason for the impermissibility mentioned in the Hadith: "It is not lawful to lend and sell" because the remuneration is paid by the borrower, as mentioned by Imam ibn Hanbal: "Because he may lend him then charges him a higher price in the sale contract." Abu Al Abbas ibn Taymiyah stated: "Because if he lends him then makes a sale contract in which the borrower is pressured to lower the price." Sharia prohibits structuring contracts that combine elements of sales and charitable loans (Qard) in a way that unfairly benefits the lender. However, this prohibition doesn't apply to BNPL schemes where customers pay the original agreed-upon price to the BNPL provider, incurring no additional charges.

Second:

Focusing on Contractual Terms, not External Factors

Sharia principles determine the permissibility of contract combinations based on the explicit terms within the contracts themselves, not on external circumstances. Even if associated circumstances might render the contracts invalid, the focus lies on the contractual stipulations.

Commercial activities inherently involve negotiation and seeking advantageous terms. Buyers aim to acquire goods at a lower price, and sellers aim for higher profit margins. Sharia permits both purchase and sale contracts even when the same party participates in both, as long as they are distinct transactions. This can be inferred from the following guidance of the Quran:

﴿إِلَّا أَنْ تَكُونَ تِجَارَةً حَاضِرَةً تُدِيرُونَهَا بَيْنَكُمْ﴾

"Except when it is an immediate transaction which you conduct among yourselves."

Allah (SWT) states:

﴿يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبُطْلِ
إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ﴾

"O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent."

The Quran also speaks about protecting oneself from commercial loss so long as such protections are free from prohibited elements:

﴿وَتِجَارَةٌ تَخْشَوْنَ كَسَادَهَا﴾

"Business you worry about".

Therefore, arranging the transactions profitably for the trader is not objectionable in Sharia as long as the contracts are separated.

Third: Multiple Contracts

The nature of commercial activities involves conducting many contracts in parallel and succession, unlike the case for individual consumers who need simple direct contracts. Commercial activity requires fast-moving cash flows and cannot be restricted to simple and straightforward contracts. Modern corporations are not interested in the outcomes of individual contracts; they seek to maximize profit. Therefore, if the form of an individual contract is impermissible, the solution is to make a new structure with multiple separated contracts so that each party has segregated relationships. This is the guidance the Prophet ﷺ provided to Bilal, as mentioned in the Hadith: "Allah's Messenger ﷺ appointed a man over Khaibar, and he brought him dates of a very fine quality. Allah's Messenger ﷺ asked, "Are all the dates of Khaibar like this?" He replied, "I swear by Allah that they are certainly not, O Allah's Messenger. We take one Sa' of this kind for two and even for three (of lesser quality)." So Allah's Messenger ﷺ said: "Do not do so. Sell the mixed dates for Dirhams, then buy the very fine dates with the Dirhams." He said that the same applies when things are sold by weight."⁸



8 Reported by both Bukhari 2021, and Muslim 1593

Fourth: Contemporary Business Practices

Contemporary business practices often involve combining different contracts to maximize profit and manage risk. This raises questions about the compatibility of these practices with Sharia principles. However, contemporary Islamic scholars (Ijtihad) have allowed certain combinations of financial and hedging products, even though they involve structuring multiple contracts.

The key consideration lies in the subject matter being distinct. Contracts like Murabaha (sale with markup), Tawarruq (commodity trade financing), and parallel Salam (forward sale) are examples. In these cases, the intention to generate profit from a second contract might exist when entering the first contract, but the contracts themselves remain separate.

This separation principle allows permissible outcomes even when combining contracts would be prohibited. For instance, Sharia forbids combining Wakala (agency) and Kafala (guarantee) in one contract due to conflicting features. However, the agent can act as a guarantor if the contracts are separate. In this case, terminating the agency contract doesn't affect the guarantee contract.

This principle is further illustrated by Sharia Standard No. 10 on Salam and parallel Salam. While linking obligations under two Salam contracts is impermissible, the standard allows a buyer to conclude a separate parallel Salam with a third party to sell the same commodity acquired through the first Salam. Here, the key is that the contracts are independent with distinct obligations and rights.

The permissibility of separate contracts is also applied in the Istisna' (manufacturing finance) contract and Sharia Standard No. 12 regarding company partnerships. Separating a management contract from a company contract allows a partner to be appointed as a manager for a fixed salary. Similarly, Sharia Standard No. 12 allows for a diminishing partnership (Musharaka Mutanaqisa) where one partner buys out the other's share in installments. This is permissible because the buying and selling agreement is independent of the partnership contract.

Furthermore, Sharia Standard No. 61 allows an issuing bank to charge fees to merchants accepting cards, even exceeding the actual cost, as long as no additional charges are imposed on the cardholder. This approach is adopted by various Sharia boards, including Bank Albilad.



Parties Involved in BNPL Transactions

BNPL providers utilize various operational models. The most common model in KSA and other GCC countries involves three participants: customer, merchant, and BNPL provider.

The Transaction Process:

1. **Purchase Initiation:** The customer selects an item at a physical or online store that accepts the BNPL provider as a payment option.
2. **Payment Selection:** At checkout, the customer chooses to either pay immediately or utilize the BNPL option. Upon selecting the BNPL option, they choose their preferred installment plan.
3. **Transaction Processing:** The BNPL provider verifies the customer's eligibility and approves the purchase.
4. **Settlement with Merchant:** Upon approval, the BNPL provider pays the merchant the full purchase price. The merchant receives their payment based on the agreed-upon settlement process.
5. **Customer Payment:** The customer then repays the BNPL provider in installments according to the chosen plan. Importantly, the seller receives their full payment upfront regardless of the customer's adherence to the installment schedule.

Comparison with Installment Sales

BNPL shares similarities with installment sales, as defined by the previously repealed statute on installment sales issued on 13/4/2005, which characterized it as "a form of deferred payment sale in which the seller and the buyer agree to pay the price in several payments."

Similarities

Both BNPL and installment sales facilitate deferred payment purchases for goods and services.

Differences

- **Price and Term:** Installment sales typically involve larger purchase amounts, a higher price than the spot price, and a longer repayment term.
- **Number of Parties:** Installment sales generally involve only two parties (seller and buyer), while BNPL involves three (customer, merchant, and BNPL provider).
- **Additional Charges:** BNPL transactions typically do not include additional charges over the original purchase price, unlike installment sales which may involve interest or other fees.
- **Payment Flexibility:** BNPL customers typically have more options for repaying their installments compared to traditional installment sales.

In the above arrangement (operational in KSA), all three parties benefit from the transaction. The customer benefits by obtaining goods and services without additional charges, even without the ability to pay the full amount. BNPL also provides cashback offers for customers who comply with payment schedules.

In addition, BNPL providers accept credit and debit cards without requiring a new account and accept other payment providers like Apple Pay and Mada. The seller benefits from the arrangement with increased sales and customer purchasing power, translating into increased profits. The BNPL provider benefits from the arrangement through the commission earned from the difference between the payment made to the seller and the amount collected from the customer in installments.



Risks associated with BNPL

While BNPL offers benefits like increased sales, domestic consumption, and expanded seller capabilities, it also introduces potential risks. Research suggests that BNPL users might be younger, have less credit experience, and lower incomes compared to traditional credit card customers. This could lead to higher default rates compared to credit cards, as seen in the US⁹.

Recognizing these risks, regulatory authorities are implementing BNPL regulations to mitigate the financial risks associated with rapid credit expansion, especially for individuals with lower creditworthiness. Unregulated growth could increase non-performing loans, posing a systemic risk to both consumers and the market.

BNPL providers often argue that their services are more user-friendly and accessible compared to credit cards, personal loans, or vehicle financing. This is attributed to the ease of use and the lack of explicit late payment interest in some instances. However, a crucial concern lies in the potential for excessive debt accumulation.

Some BNPL providers define responsible customers solely based on timely installment payments, regardless of the funding source. This approach can be dangerous, especially for low-income customers, as it normalizes the concept of perpetual credit dependence.

It's important to note that BNPL providers do experience operational and credit risks. While some providers used late payment penalties or "obligatory donations" to manage these risks, such practices have been discontinued, at least in KSA.

Regulatory Limits on BNPL Providers

RSAs stipulate several conditions to regulate the activities of BNPL providers and create responsible spending habits. In its "Rules for Regulating Buy-Now-Pay-Later (BNPL) Companies," SAMA stipulates¹⁰ that the ceiling for finance using BNPL should not exceed SAR5000 for each individual customer and that the number of installments should not exceed 12 as a maximum. BNPL providers must obtain a license before they can operate. Filing for a license includes documentation of founding partners, a list of shareholders and their shares, and a non-revocable bank guarantee. The minimum capital required is SAR5,000,000, in addition to complying with companies' law and the responsible lending principles for individual customers issued by SAMA.

The principles include that the company should follow an objective method to assess the creditworthiness of the customer and his ability to pay, analyze his credit history with his consent, and require the customer to disclose in writing any other credit liabilities he has, including loans from employers, friends, and family, in addition to an analysis of merchants' books. For this reason, Tabby included in its contract a clause¹¹ stating: "You agree that Tabby may at any time make inquiries about you and request any information about you that Tabby requires to provide you with its Service, including but not limited to your credit score or a credit indicator relating to you that Tabby considers appropriate from any financial institution, credit bureau or reference agency (including the Al Etihad Credit Bureau) or any other source that Tabby considers necessary to assess your eligibility to use the Tabby Services. A credit score may also be requested in connection with an extension or increase of your spending limit, account renewal, account collection action, or dispute investigation." In addition to other conditions and licenses required for this activity, these criteria enhance the efficiency of these operations and reduce the cases of default as much as possible.

9 Buy now, pay later: a cross-country analysis, Giulio Cornelli, BIS Quarterly Review, p61.

10 https://www.sama.gov.sa/en-US/RulesInstructions/FinanceRules/BNPL_rules_en.pdf.

11 <https://tabby.ai/en-SA/toc>

The Sharia Ruling on the Use of BNPL Services

The prevailing view of BNPL operations (in KSA) is that they are permissible because they share similarities with installment sales, which are sanctioned by the following verse in Surah al Baqarah:

﴿ يَا أَيُّهَا الَّذِينَ ءَامَنُوا إِذَا تَدَايَنْتُمْ بِدِينٍ
إِلَىٰ أَجَلٍ مُّسَمًّى فَاكْتُبُوهُ ۚ

البقرة: 282

“O you who believe! When you contract a debt for a fixed period, write it down.”

This is further supported by a narration from Ibn Abbas, who reportedly said: I testify that a sale with a deferred payment is allowed in the book of Allah then he recited this ayah.¹² Al Bukhari narrated from Aisha that: “The Prophet ﷺ purchased food grains from a Jew on credit and mortgaged his iron armor to him.” He also narrated from Anas that: “He (Anas) went to the Prophet ﷺ with barley bread having some dissolved fat on it. The Prophet ﷺ had mortgaged his armor to a Jew in Medina and took from him some barley for his family.”¹³ It can be inferred from these texts that installment sale is allowed. Towards this end, for the arrangement to be free of any prohibited element, the following should be observed:

- Each contract within the three-party arrangement (customer, merchant, BNPL provider) must comply with Sharia standards. Additionally, the sale or purchase contract between the merchant and the customer and the method of collecting installments from the customer must adhere to Sharia principles. Moreover, the combination of contracts must be congruent to overall Sharia compliance practices.
- All forms of riba should be avoided in all BNPL procedures, including those between the provider and the seller and those between the provider and the customer.
- Only Sharia-compliant goods should be transacted by the BNPL provider. It is not allowed to finance the purchase of prohibited goods. In case of doubt, the Sharia board of the company should be referred to.
- For transactions involving gold, silver, or currency exchange, immediate delivery and payment are required. In case of any ambiguity regarding the permissibility of such a transaction, the assigned Sharia board must be consulted.



¹² Ibn Qudamah, Al Mughni p207, v4.

¹³ Al Bukhari 2068-2069

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Late Payment Fees

Customers utilizing BNPL services become debtors to the provider. Under Sharia principles, debtors are only obligated to repay the principal amount. Charging additional amounts for delayed payment is strictly prohibited. This includes financial compensation (penalty clauses) in cash or kind, regardless of purpose (such as but not limited to opportunity cost, lost profit, currency devaluation), and regardless of whether it's stipulated in the contract or imposed by court order.

Imam Ibn Al Munthir states that "there is a consensus that any stipulation by a creditor for an extra or a gift as a condition for a debt makes the transaction usurious (riba). Furthermore, the resolutions of Fiqh academies, Sharia board fatwas, and Sharia standards all support this view including OIC Fiqh Academy¹⁴ which passed the following resolutions:

- **Resolution No. 85 (2/9) on Salam Sale:** "It is not permissible to include a penalty clause for delayed delivery of a commodity sold through Salam, as it is considered a debt."
- **Resolution No. 109 (3/12) on Penalty Clause:** "Penalty clauses are permissible in financial contracts except for debt-based transactions. Imposing penalties on delayed debt repayments constitutes riba."
- **Resolution No. 51 (2/6) on Installment Sales:** "If a buyer delays installment payments, charging any additional amount beyond the principal is prohibited, regardless of whether it's pre-condition in the contract or a later claim. This constitutes riba."

However, the OIC Fiqh Academy allows obligating delinquent customers to pay litigation costs associated with the collection of debt.

¹⁴ Refer to the comments of Mufti Taqi Usmani, OIC Fiqh Academy Journal, Issue 10 v3 p111

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Charitable Donations as a Late Payment Remedy

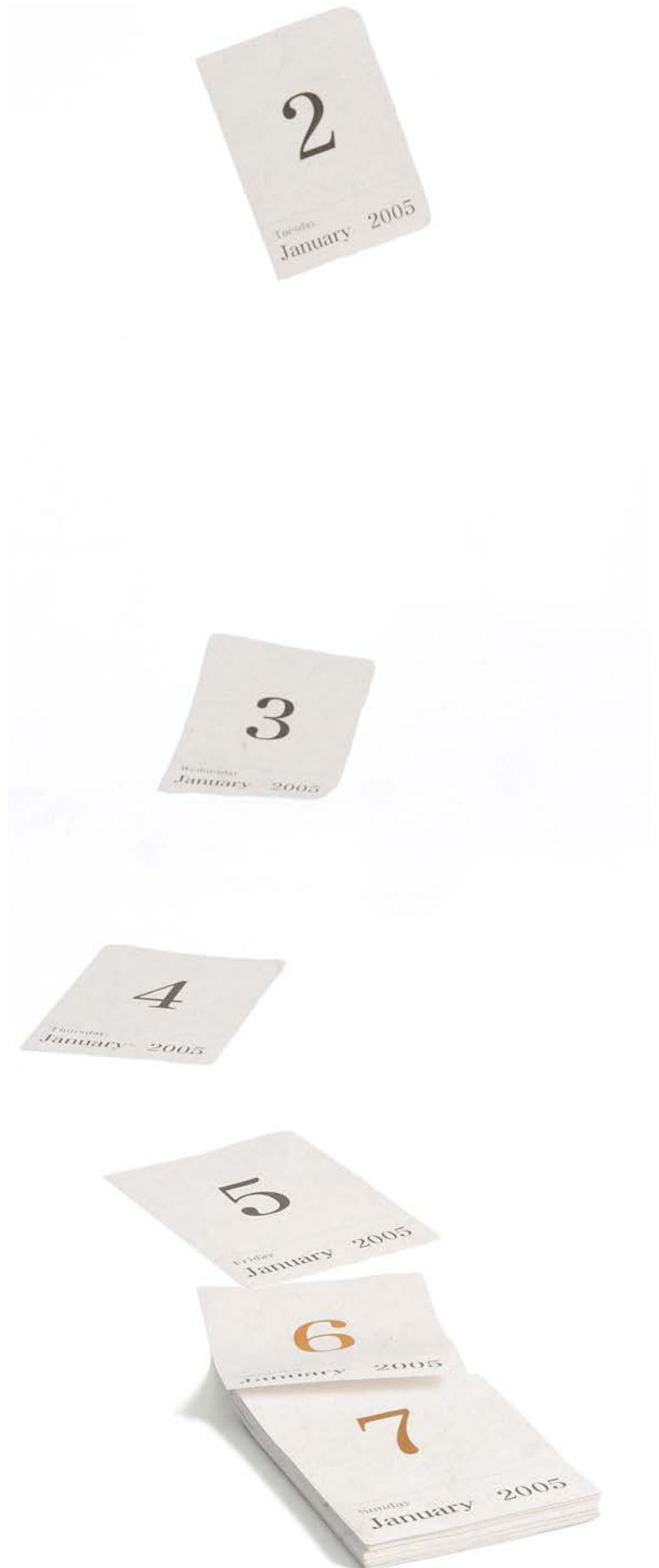
Previous discussions focused on late payment penalties that benefit the creditor. However, channeling such penalties towards charitable causes raises different legal opinions. There are two main opinions on this matter:

- Permissible:** This view allows stipulating a charitable donation in case of delinquency. Proponents include respected and esteemed scholars like Mufti Taqi Usmani, Dr. Wahba Az Zuhaili, and Sharia boards of many institutions. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Sharia Standard No. 3 also exemplifies this approach, permitting “an undertaking by the debtor to donate an amount or a percentage of the debt to charitable causes” in case of delayed payment.
- Prohibition:** This view maintains that obligating defaulters to make charitable donations is not permissible. It is supported by the Permanent Committee for Fatwa in Saudi Arabia (Fatwa No. 299998) and scholars like Dr. Ahmed Fahmi and Rafiq Al Masri.

The 12th Al Baaraka Forum Fatwas¹⁵ allows “a flat penalty or a percentage of the due amount” for charity “provided that the creditor makes no benefit from such amount.” Similarly the 1st Contemporary Fiqhi Issues Conference uses the following term “paying an amount of money to be spent in charitable causes” for defaults “without an acceptable justification.” Moreover, Saudi Arabia’s Finance Companies Control Law (Article 35/a) allows a “financial penalty” not exceeding double the potential profit, to be deposited in a charity organization account.

It is clear that Sharia scholars hold differing opinions on whether BNPL providers can require charitable donations from delinquent customers. While some prohibit it, others consider it permissible under specific conditions. Understanding these viewpoints is crucial for designing Sharia-compliant solutions for addressing late payments in BNPL transactions.

¹⁵ Refer to Albaraka forum resolutions and recommendations; The resolutions of the Shariah board of Al Rajhi Bank (2/687) resolution no. 464; Resolution of Bank Albilad no. 16; AAOIFI Shariah Standard no. 61, Standard’s Shariah basis.



Exploring Alternatives

Possible alternatives specific to BNPL providers include an arrangement of Murabaha to the purchase order (MPO), whereby the BNPL provider makes an MPO agreement with the customer to buy the goods from the seller and then sell them to the customer after becoming the legal bearer of the risk, charging an agreed-upon markup. This markup will offset part of the credit loss resulting from customer default.

Some other alternatives can be as follows:

1. Agreeing on protective settlement tools: contracts may include clauses to protect the creditor, like a bank guarantee, a performance guarantee, collateral, assignments on financial assets, and insurance covers.
2. Diversifying payment methods: financial institutions should accept multiple payment methods, including mobile applications, banks' payment networks, bank transfers, cash settlements, etc., to avoid delays and late payments. It has been established that diversifying payment methods reduces credit risk.
3. Continuous communication and follow-up with customers: good communication and clear messaging from the financial institution encourage the customer to adhere to the payment schedule.
4. Stipulating that when the customer defaults on an installment, an equal number of installments become due. This is an exceptional measure consistent with Sharia standards and prevailing regulations in KSA.
5. Making a parallel plan by reducing the debt in exchange for early settlement and other arrangements.
6. Requiring a guarantor to ensure the good performance of the customer.
7. Adding the name of the procrastinating customer to the blacklist and providing his data to credit bureaus like SIMAH.
8. Filing a lawsuit and demanding the procrastinating customer to pay immediately.



Disclaimer

This is a preliminary Shariah research and is by no means a definitive conclusion or fatwa on the aforementioned subject. This paper was written to develop knowledge and research on this complex subject from a Shariah perspective. We hope that this paper will prompt and engage global Islamic finance bodies, Shariah scholars and Muslim economists to analyze, comment and build upon the arguments expressed.

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