

The Ability of Al-Rahn Scheme and Conventional Pawnbroking to Guarantee Security of Gold as Collateral

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Abstract: Al-rahm scheme or Islamic Pawnbroking and conventional Pawnbroking play significant role in helping people for getting short-term loan easily, quickly and at affordable rate. However, based on the type of complaints received by the ministry of housing and local government and also by the National Consumer Complaints Centre, there are common mistakes committed by the pawnbrokers related to the collaterals safety which could lead to customers losses. Therefore, this study aims to compare the ability of Al-rahm scheme and conventional Pawnbroking to guarantee security of the gold as collateral. The basic criterias in measuring the ability of both institutions are protection insurance compensation payment for loss or damage of the collaterals license authorization to running Pawnbroking business and auction notice procedures. The approach used are library research and interview. The study found that both Al-rahm scheme and conventional Pawnbroking are capable in ensuring the security of the collaterals for taking insurance and operating with a valid license. However, Al-rahm scheme is better for customer for its more fairer compensation which is calculated based on the amount remaining after deducting the amount of the loan and keeping charges before loss occurs regardless of any reason. Where as for conventional Pawnbroking, compensation value is calculated as a quarter more than the amount of loan given. In addition, the auction notice procedures of Al-rahm scheme is more clearer and effective which is customer will be notified about the auction of the unredeemed collateral regardless of the loan amount through official letter, phone calls or short messaging services before the expiry of the maximum 10 months. If the sale price exceeds the amount of loan, the institution will refund the excess to the pawner. Meanwhile for conventional Pawnbroking, only collateral for a sum exceeding RM 200.00, customer will be notified by registered letter at least 10 days before the auction date. Collateral that are less RM 200.00 will be owned by Pawnshop automatically. Usually customers are not informed of the auction as Pawnbrokers does not auction the goods off and takes possession of the goods instead. There were also complaints that Pawnbrokers do not return the surplus to the pawners after the goods have been auctioned off.

Key words: Al-rahm scheme, conventional Pawnbroking, gold, collateral safety, Malaysia

INTRODUCTION

Islamic Pawnbroking or Al-rahm is a process of pawning one particular asset as a collateral against a particular debt between 2 parties. It is an alternative form of debt with a guarantor (kafalah) or a debt on the basis of trust without a guarantor by any party. Therefore, the assets being pawned or the collaterals being used are the primary principal and the main subject to be discussed in Pawnbroking activities.

In Malaysia, Al-rahm and conventional Pawnbroking schemes are the main micro financing institutions that are close to the hearts of the community as a solution to easy and fast cash. As of September 2012, statistics show that the states' number of active licenced pawnbrokers was

359 (Chelvan, 2012). Generally, the conventional Pawnbroking scheme in Malaysia accepts all kinds of valuable assets. However for the Al-rahm scheme, most of them accept only golds as collaterals.

Based on the types of complaints received by the National Consumer Complaints Centre and the Ministry of Housing and Local Governments (Chelvan and Sharina, 2012), consumers are highly exposed to the security risk on their pledged collaterals with the conventional Pawnbroking scheme. There are common offences committed by pawn brokers regarding security of the pledged collaterals bringing losses to customers.

For example, the Pawnbrokers do not provide insurance protection on the custody of pledged collaterals from any risk at all times, refuse to be held

liable or pay lower compensation than the value of the pledged collaterals due to damages to the pledge or if the pledge is destroyed or stolen. Furthermore, the Pawnbrokers also conduct illegal businesses without obtaining valid licenses from MHLG and do not send out auction notice in forming the customers if the collaterals are not redeemed with time before expiration date, etc.

With reference to the earlier statements, a question asked in this research is how reliable is Al-rahnu or the conventional Pawnbroking institutions in guaranteeing security to golds as collaterals? Hence, the objective of this research is to compare the effectiveness of Al-rahnu and the conventional Pawnbroking schemes in guaranteeing security to their customer's golds. The comparison is based on the basic criteria, such as insurance coverage, loss payment or compensation for loss or damage of the collaterals, valid licences to operate pawn broking businesses and auction notice procedures.

There have been several studies done on Al-rahnu and the conventional Pawnbroking schemes on their respective advantages and disadvantages. However until this study is done, the researcher has yet to find a specific study comparing the performance and effectiveness of Al-rahnu and the conventional Pawnbroking scheme in guaranteeing collaterals security in particular gold. One study (Abdul Ghafar and NurAzura) finds that the current regulations of Pawnbroking industry suggest that the policy makers are only interested in dealing with the legislative issues of the institutions and less on monitoring activities. There is also no on-site and off-site inspections to address the high risks, offences committed by the Pawnbroking operators and even the contract of security to protect consumers and their collaterals. The study also touches on the issue of insurance coverage which comprises of cash management, cash transfers, fire protection, theft protection and others, insurance coverage for workers and goods stored.

According to Adnan (2005), frequent malpractice conducts reported are as such; devaluation of pledges (jewellery loss in weights or becomes shorter in measurement) when redeemed, pledges being auctioned off without informing the pawnners, notice of auction not widely advertised and the auctioned surplus funds not refunded to pawnners, etc. Most pawnners are not aware that their collaterals are being auctioned off. The advertisements on notices of auctions are usually published in the Chinese and English newspapers only. As a result, most pawnners often miss the opportunity to redeem their collaterals. The same subject is also discussed regarding the aspect of disparity between the

Islamic Al-rahnu system and the conventional Pawnbroking system implemented in this country.

A study by Mustafa finds that the conventional Pawnbroking system is a profit motivated business. Therefore, the rates to be charged are high and the benefits to be used as a source of return to the Pawnshop owners. More often than not, the Pawnshop owners would steal the gold collaterals and if not paid or redeemed on a specific date it will be auctioned off and the surplus money is not refunded to the pawnners. There are also cases of Pawnshops closed, moved and operated without licences.

Malaysia Islamic Economic Development Foundation through research finds that the main attraction factor for usage of Al-rahnu scheme is a low service charge, no element of riba, the jewelery is kept safe, no element of fraud when weighing jewelry collaterals and reasonable length of repayment. While another study finds that the level of customer satisfaction in the Al-rahnu scheme is high. This satisfaction level is influenced by the bank's compliance dimensions of its syariah operation. Similarly, customers' perception on security in terms of politeness, safety, integrity and confidence in the services promised by the banks.

MATERIALS AND METHODS

The methods used to gather information regarding this study are as follows:

Literature review: Literature review performed by the reading of materials related to this study. Data obtained from these, dissertations, books, working papers, magazines, journals, proceedings, documents, acts, reports, brochures, newspapers and websites related to the study conducted.

Field research: Face to face interviews and on the phone conversations methods used in this study to obtain a direct and more accurate information from the respective respondents. The individuals interviewed are officers of the data management and budget unit, head of operations department and officers of YaPEIMAr-Rahnu Planning Department. Additional information regarding edicts and the implementation of Al-rahnu scheme obtained from officers of the research and planning division of Malaysia Islamic Development Department. Whilst, information regarding conventional Pawnbroking obtained from the senior officer of Pawnbroking unit, Head of Special Investigation Unit, Deputy Secretary of Money Lending Department, Ministry of Housing and Local Government and a Pawnshop operator in Bangi. Information regarding

illegal money lenders obtained from the Head of Special Action Unit of Illegal Money and Scratch and Win, Muslim Consumers Association of Malaysia (PPIM).

RESULTS AND DISCUSSION

Security insurance: Based on sub sections 23 (1 and 2) of Pawnbrokers Act 1972 [Act 81] and Regulations, Pawnbrokers must insure every pledge in his custody from any risks. Any person who violates this subsection is deemed to committing an offence under these regulations.

Every pledge is covered by insurance owned by the Pawnbrokers (PPG). If the pledge in his custody is lost or damaged, the pawner is entitled to compensation of one quarter in excess of loan amount. According to MHLG, consumers who use the service of unlicensed pawn broker is at risk of losing their pledged collaterals having no security insurance against all risks at any time (Chelvan and Sharina, 2012).

For Al-rahn activities, the subject of insurance has been decided in the 77th Muzakarah of Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia stating that Al-rahn Pawnbrokers must take Islamic insurance protection (Takaful) and are not permitted to involve in conventional insurance activities.

Al-rahn institutions have high security criteria; insurance protections on the premises and pledges. Therefore, to venture into Al-rahn business requires huge capital of around RM 2-4 millions to guarantee security and high quality services (Baharum, 2005). Takaful coverage on Islamic Pawnshops gives confidence to consumers that they are not unaided if there are mishaps. Security guarantee means the pawners will get back their collaterals without any corrosion on their jewellery committed by the conventional Pawnshop owners, causing devaluation due to physical structural changes to the goods.

The same applies to the implementation of Al-rahn scheme run by cooperatives which stipulates that the Pawnbrokers must take full responsibilities on the transaction confidentiality and security of the pledged collateral including taking adequate insurance coverages while the pledge (marhun) is in their custody (Islamic Pawnbroking (Ar-Rahn) Orders of UiTM Staff Cooperative Ltd., and Ar-Rahnu Orders of Pahang Darul Makmur Government Officers Cooperative Ltd.).

Compensation: Based on section 2 (3) of the Pawnbrokers Act 1972 [Act 81] and regulations, regarding any pledge that is damaged or broken caused by or in sequence of

fire, negligence, omission, theft, stolen or as such, the value of the pledge for the purpose of compensation to the pawner is to be calculated as one quarter more than the amount of the loan. This provision means that the pawn broker must pay compensation one quarter more than the principal loan sum on any loss or damage of pledge in the event of robbery, fire or other catastrophes to the Pawnshop.

On the contrary with Al-rahn scheme, if the pledge is stolen, damaged or as such, the Al-rahn pawn broker must pay compensation on the difference of the pledge value when it was first assessed. The compensation will be the difference amount less the loan amount and the storage fees before the loss of pledge, regardless of reasons of loss or damage.

As example (Malaysia, 2010), there was the case of burglary at the Al-rahn premise of Kota Bahru Branch, Jalan Temenggung on August 9th, 2008 when four masked men broke into the shop and escaped with customers' jewellery. Kelantan Capital Ltd. (PKB) paid in full the difference while Takaful Malaysia paid RM 5 million on the insured jewellery.

In Islam, pawn broker is the trustee of the pledge. If the pledge is damaged not because as a result of the pawnbroker's wrong doing or negligence, he is not liable to pay compensation for the collateral in his custody. The pawner's debt is also not reduced as in return to partial or full damage of the pledge. There won't be write-offs on the pawners' debts because the Pawnbrokers act only as a trustee.

Valid licence: According to sub sections 7 (1 and 2) of the Pawnbrokers Act 1972 [Act 81] and regulations, no one is allowed to operate a Pawnbroking business unless after obtaining a valid licence provided under this act. Anyone who operates a business as a pawn broker without a valid licence or continue doing business after the licence has expired or suspended or revoked, he is committing an offence and if convicted can be fined not <20000 ringgit but not more than one hundred thousand ringgit or imprisonment of not >5 years or both and for the second offence or subsequent offences committed, shall be liable to whipping in addition to such punishment.

Sub sections 10 C (1 and 2) further states that a licensee shall at all times display his licence in a conspicuous part of his premise where he carries on his Pawnbroking business. Anyone who contravenes this sub section is committing an offence.

According to MHLG, every new licence application will be given a 6 month, conditional approval and if the ministry is satisfied with the premise and service of the

pawn broker, only then full licence will be issued (Chelvan, 2012). This is to ensure that the pawn broker abides by the stipulated rules. Nevertheless, quite a number of pawn broker business operates without a valid licence. The consequence of dealing with unlicensed Pawnbrokers is that the customers will be facing with frauds, loss or damages to the pledged collaterals.

This was proven in 2010 when MHLG received complaints regarding the Pawnbroking business operating without a valid license, 23.9% while the offense of imposing high interest, 31.1% (MHLG, 2010). MHLG does not compromise with the Pawnbroking premises conducting business without licenses and will confiscate all of their goods and actions will be taken against them according to the existing laws.

MHLG also discovered during their operation on all Pawnbroker and goldsmith premises in Miri that almost all of the premises in the city conducted illegal business under the pretence as money lenders or goldsmiths. From the operation also, only one pawn broker premise was found to be operating legally. Illegal pawn broker business in this state is self-evident as compared to the business of money lenders.

For the Al-rahnu institution that wants to operate a pawnbroking business, they need to get a licence from the local government authority. Nevertheless according to Azila, Islamic Pawnbrokers facing a problem of getting license from the local authority due to political reasons which creates an obstacle in front of the expansion of the Islamic Pawnbroking. For operational aspect of Al-rahnu, its activities are monitored by the internal regulations of the institution offering the scheme be it a bank or cooperative institution. In the view that there is no specific law to monitor the activities of Islamic Pawnbroking businesses, the institution applying to implement an Islamic Pawnbroking business is also licensed under the Pawnbrokers Act 1972 [Act 81] and pawn brokers (Control and Licensing) Regulations 2004.

In this respect, the MHLG has issued (Guidelines to the Implementation of Islamic Pawnbroking (Al-Rahnu) Business) which has been passed under the Pawnbrokers Act 1972 [Act 81] and Pawnbrokers (Control and Licensing) 2004 as a specific guide to the modus operandi implementation of Islamic Pawnbroking businesses.

From the legal aspect, Al-rahnu is subjected to the Pawnbrokers Act 1972 [Act 81] but in its operation, a few adjustments are made to the contradicting provisions to the Islamic jurisprudence. For the purpose of administration and management, Al-rahnu institutions have their own respective regulations. For instance, the

Terengganu Islamic Pawnbroking Institution (MGIT) has Islamic Pawnbroking Institution Regulations 1991 created under the Administration of Islamic Religious Affairs Enactment 1986. These regulations were enforced on June 1st, 1992.

The normal implementation practice of Bank Rakyat Al-rahnu scheme, for example has shown most of the main principles of Islamic Pawnbroking are adhered to. As mentioned in the manual guidelines, all transactions require gold as collateral and after the transaction, the collateral is under the responsibility of the pawnbroker. This is clearly mentioned in sub section 6.1.5 which states that any loss or damages caused by the al-murtahin (pawnbroker) will be refunded by the bank according to the current value of the collateral in Malaysian Ringgit. In addition, sub section 6.2.1 states that the collateral must be examined and valued in the presence of al-rahin (pawner) to ensure the collateral is in good condition and to ensure the al-rahin is satisfied with the loan amount provided by the bank according to the Qardhul Hassan concept.

Auction notice procedure: According to section 23 (1), Pawnbrokers Act 1972 [Act 81] and regulations if any pledge is not redeemed before the expiration date of 6 months from the date of pawning or for a period longer than agreed upon by both parties pawnbroker and pawner or as provided under section 19, then the pledge (a) if pawned for an amount not exceeding 200 ringgit will become the property of the pawnbroker or (b) if pawned for <200 ringgit will be disposed off by auction to be conducted by a licensed auctioneer.

According to the act, a loan amount of <RM 200 will automatically become the property of the pawn broker. If the loan amount exceeds RM 200 it can only be disposed off through public auctions by a licensed auctioneer. What is normally experienced by the customers of conventional Pawnbroking scheme is that they were not informed by the Pawnbroker (PPG) that their pledge would be auctioned off. Pawnshop operators often keep mum on the news of auction in order to make profit through the sale of the pledge without much fuss. What often happens is that they do not auction it off but continue to take over the possession of the pawner's pledge.

According to MHLG in 2010, there were 39 reports of Pawnbrokers who failed to deliver auction notices. That was the highest offence of pawn brokers among other offences committed after the offence of illegal Pawnbroking business operation without a licence. Other reports received from the customers include loan application form not conforming with the act, buying

Table 1: Comparison between YaPEIM ArRahnu scheme and conventional Pawnbroking

Subject	YaPEIM Ar Rahnu scheme	Conventional Pawnbroking scheme
Insurance	Al-rahnu pawn broker is required to subscribe to Islamic insurance protection (Takaful) and prohibited to engage in any conventional insurance activity	Section 23 (1) Pawnbrokers Act 1972 [Act 81] and regulations, pawn broker must at all times insure all pledges in his custody against all risks
Compensation payment on a loss or damaged pledge while in custody of pawn broker	Al-rahnu pawn broker is required to pay compensation on the difference of the pledge value when it was first assessed regardless of reasons of loss or damage	Section 22 (3), pawn broker has to pay only one quarter more of the loan amount to the pawner as compensation
Valid licence	Required to obtain licences from the local government authority	Section 7 (1), pawnbroker is required to obtain a valid licence provided under this act (obtain a valid licence from MHLG)
Auction notice procedures	Al-rahnu activities are governed by internal regulations of Al-Rahn institutions Pawners will be given notice regarding the pending auction for all unredeemed collaterals regardless of loan amount through official letters, phone calls or short message services before the expiration of maximum 10 months from the date of pawning	Section 23 (1), before the expiration of 6 months or of such longer period agreed by both pawn broker and pawner, pawner would be given auction notice for unredeemed collaterals valued >RM 200.00 by the way of registered letter not <10 days before the auction date. For collaterals valued <RM 200.00 it would automatically become the property of the pawnbroker

pawn ticket, pledge not available for redemption, customers' dissatisfaction with pawn broker's treatments, etc.

As a matter of fact, the pawn broker should inform the pawner by a registered letter regarding the unredeemed pledge at least 10 days before the auction date. Every auction must be performed at a place and time approved by the MHLG within the first 7 days of the month. The auction must be held and witnessed by a Pawnbroker inspector appointed by the ministry. The Pawnbroker may also bid to buy the pledge.

Pursuant to section 25 (1), a pawn holder is entitled to receive surplus of the auction sale price if the pledge value is higher than loan amount. A registered notice must be sent to the pawner within 7 days after the auction is completed. Pawner can make claims on the surplus (if any) of the sale auction against the Pawn broker within 4 months from the date of receipt of notice sent to him producing to the pawn broker the pawn ticket and pawner's identification card. However, there have been reports on the failure of Pawnbrokers in handing over the auction surplus claimed by the pawners. According to Azila, a vast majority of Islamic Pawnshop customers (92.3%) received a surplus from the auctioning process compared to only (7.7%) from conventional pawnshop customers. By right, all auction surplus (if any) should be returned to the pawners after deducting the interest charges.

For Al-rahnu scheme, if the pawner fails to redeem within 6 months before the expiry date, the institution can extend the redemption period up to 2 months (first extension) without application of the pawner. If the pawner still fails to redeem within the extension period, the redemption period will be extended to another 2 months (second extension). After a maximum period of 10 months, if there is no application to extend the

redemption period or a non-payment of storage fee, the institution shall give notice to the pawner notifying him that the pledge will be auctioned off and thus the expiration of repayment.

Al-rahnu institution also carries out public auction on unredeemed pledges regardless of loan amounts. The institution does not confiscate pawners pledges on their failure to redeem their properties within the time schedule. If the auction sale price is more than the loan amount, the pawn broker will return the surplus to the pawners.

In summary, Table 1 shows a comparison of YaPEIM Al-rahnu scheme and the conventional Pawnbroking scheme in each party's ability to guarantee pledge security based on four criteria discussed earlier, i.e., insurance coverage, compensation on damages and loss of pledge, approval licence to operate a Pawnbroking business and auction notice procedures (Yaacob *et al.*, 2012).

CONCLUSION

This research finds that in general, Al-rahnu and conventional Pawnbroking schemes can guarantee the security of gold as collateral with the protections of insurance coverages and valid licences. However, there are 2 criteria which Al-rahnu scheme has advantages over the conventional Pawnbroking scheme, i.e., fairer compensation payments and effective and clear auction notice procedures. Offences committed by the conventional Pawnbrokers, such as no insurance protection on the pledge in custody and operates without valid licences from the MHLG; usually operated by unlicensed pawn broker operators under the pretence operating as goldsmiths or money lenders. Even though, the element of deception in the conventional Pawnbroking scheme has been minimized by the pawnbrokers Act 1972 [Act 81] and Pawnbrokers (Control and Licensing)

Regulations 2004, this practice is not in line with the syariah principles. When it concerns security of the pledge, the issue arises whether consumers are willing to take the risks of losing their collaterals as a result of non transparencies of transactions? Furthermore, how about the virtues and advantages of transparent and fair transactions Al-rahn scheme offers to the consumers? Al-rahn scheme operates based on the Islamic principles which are more transparent, fair and with integrity. Al-rahn assists those in needs of cash to obtain a fast and honest financial assistance in accordance to Islamic teachings and provides guarantee to the creditors. When it is centred on the principles of Islam, there won't be any doubtful feeling or syubhah (dubious) on the halal status.

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