



## AI DRIVEN ISLAMIC BUY NOW PAY LATER (BNPL) – A LEGAL ANALYSIS

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Article Info	Abstract
<p><b>Article History</b></p> <p>Received: 21 May 2023</p> <p>Accepted: 11 June 2023</p> <p>Published: 30 June 2023</p>	<p>Buy Now Pay Later (BNPL) schemes have experienced worldwide rapid growth rates in order to stimulate consumption growth and provide consumers with more options in paying for their items. Traditional consumers were offered for a long time offers where they may purchase products and services and then pay them off over a period of time. BNPL schemes are a new form of electronic installment payment arrangements that permit the purchase of even smaller items and pay them off over a period of time. While installment options were mostly restricted to larger purchases, such as cars and furniture, newer BNPL enable to purchase efficiently even less expensive goods and services. This change in opportunities has attracted merchants and financial services provider in Islamic countries to evaluate BNPL for their business and provide it to their consumers. Islamic law has various forms of contracts that may be utilized for BNPL scheme. However, the most common form is the structure of a Murabaha for financing these schemes. The article outlines the general BNPL structure for Islamic finance and the legal issues that arise from general BNPL schemes. Ensuring the solid connection between goods and services and the financing is paramount for maintaining compliance with Shariah law. The legal analysis outlined several structures that are suitable for BNPL schemes that are Shariah compliant, enabling Islamic finance to strengthen the sector and provide dedicated financing options.</p> <p><b>Keywords:</b> Buy Now Pay Later, Islamic Finance, International Islamic Financing, Legal Analysis, Murabaha.</p>

## INTRODUCTION

Worldwide, including in Australia, the USA, the UK, and other nations, buy now pay later (BNPL) programs have experienced enormous development. Traditional consumers have long had the option to buy products and services and pay for them over time in monthly installments. Consumers can spread out their payments for products through traditional store lay-by plans, and some businesses have long offered interest-free or deferred payment options. 'Buy now, pay later' (BNPL) services, a newer class of electronic instalment payment arrangements, have gained prominence in recent years as their use and acceptance have increased significantly. This represents an opportunity for businesses to increase sales, while making the entire lending process more efficient and linking the purchase to the sold items. The main objective is to provide customers with the means to acquire products and services and pay periodically until the amount is repaid. Hence, with the help of BNPL services, customers can buy products and services by paying a portion of the whole price up front and the remaining amount over the course of several installments to the BNPL provider (Alcazar and Bradford 2021).

In contrast to conventional lay-by, the buyer receives their product right away, and the BNPL provider pays the merchant in full. Customers typically access these services through a mobile app, and payments are deducted from their associated debit or credit card. In exchange for timely payment of all installments, several BNPL companies offer service free of charge (Di Maggio, Williams and Katz 2022). The majority of these BNPL services are accessed online, while some businesses also allow in-person purchases. Virtual cards are another method of providing these services (Fisher, Holland and West 2021).

While in general such services are not new and represent a form of loan to customers, the efficient online transaction process in online form permits to use the service for even smaller items with minimal overhead cost. This transformation in order to enable even smaller amounts to be efficiently transacted for BNPL services (Gerrans, Baur and Lavagna-Slater 2022).

In the context of Islamic Finance, where this expanding market is estimated to be valued US\$2.8 trillion and is expected to increase to US\$4.8 trillion by 2024 (BNY Mellon), there is generally the view that BNPL services may provide significant opportunities for strengthening the Islamic finance environment. Nevertheless, there are quintessential legal questions that arise from the various different ways of BNPL transactions, and a sound legal analysis as well as guideline is critical. BNPL is a powerful financial tool that can create enormous financial value for Muslim customers around the world, but it requires a sound legal framework in order to ensure Shariah compliance and avoid being abused or utilized for the detriment of consumers.

## **LITERATURE REVIEW**

### **Islamic Financing Options**

Islamic banking and finance contains several distinct goods, service and contracts that are different from the conventional banking. The major products can be classified into various forms, such as Wadiah, Musharakah, Murabahah, Ijar, Takaful and Sukuk. Wadiah implies the safekeeping, while Musharakah refers to a joint venture between the financier and creditor. Murabahah is the option of cost-plus financing, while Ijar refers to the leasing of goods, services and contracts. Finally, takaful represents Islamic insurance and sukuk have become a cornerstone of Islamic bonds (Kahf 2013).

A cornerstone of Islamic finance is the forbiddance of riba, which is also known as usury. Riba is defined as the interest charged on types of loans of money. Several questions arise amongst scholars as to whether interest is universally similar to riba. This also relates to the investment in companies that offer products and services that are against Islamic beliefs, such as ark and alcohol. These products and services are haram, and considered to be sinful and considered modern movement of Islamic banking and finance forbids a number of operations to be in accordance with the fundamentals of Islamic law (Shariah) and to be governed by Islamic economics. These are the paying or collecting of interest, and the investment into companies that are engaged in haram activities. Further the charging of additional money if one pays late is a charging of riba. When it relates to paying or collecting interest, then all types of interest are forbidden given they are riba. Forbiddance of using interest is based on the Fiqh al-Muamalat, or Islamic transactional laws. In relation to haram activities, selling pork or alcohol is not permitted for any corporation in addition to the creation of pornography for example (Katterbauer, Syed and Cleenewerck, Financial cybercrime in the Islamic finance metaverse 2022).

Additionally, any charges due to late payment are not permissible and applies to transactions that involve Murabahah and other fixed-payment financing options. The only exceptions may be due to when the additional charges are donated to a charitable organization and the buyer is refusing deliberately to pay.

Another critical part of forbidden activities is maisir, which can be interpreted as gambling or speculation. This implies that it is illegal for companies to participate in contracts where the ownership of the good depends on the occurrence of a predefined, unpredictable event in the future. For example, general forward contracts or options are forbidden as they represent gambling.

With respect to Gharar, derivatives, options and futures are not permitted typically. This is due to the part of that ambiguity or uncertainty in the delivery is forbidden. Generally, such derivatives, options and futures are involved into excessive risk and may lead to the encouragement of uncertainty as well as fraudulent behavior. This is similar to derivative instruments that are utilized for conventional banking. Another aspect is that the engagement into business dealings without any material finality, which is due to the fact that both options and most derivatives are not directly linked to the real underlying economic transaction. General debt-based contracts have the requirement that the profits need to have its origin from tangible assets where the borrower owns and also has the right to sell it. The transaction involves the requirement that the risk has to be shared. The main foundation of this concept is that money is a means for the exchange of goods and services, and money cannot create money itself unless linked to real economic activity (K. Katterbauer, H. Syed and L. Cleenewerck, et al., Robo-Sukuk pricing for Chinese equities 2022).

Besides these major restrictions, Islamic banks have the requirement to have a board of Shariah experts that oversee the operations and provide advice on the appropriateness of transactions. This shall ensure that all activities are in alignment with Islamic principles. A challenge in the execution of Islamic financial products is the divergence in terms of Shariah interpretations in multiple jurisdictions, such as Malaysia, Iran, Sudan and Saudi Arabia and the UAE (Kahf 2013).

When it comes to products and contracts, there are three main categories that encompass the various products. The first is the contract of partnership in which both the financier and consumer of finance share the profits and losses. This includes both *musharakah* and *Mudarabah* forms of contracts. The other category is the one of debt-like instruments, which are based on contracts of exchange and are referred to as asset-backed financing. This is in certain circumstances also referred to as trade-based financing and non-PLS financing. These forms have sales structure and incorporated transfer of commodities or money for money, and enable the purchase and hire of goods, assets and services. The payment is deferred based on a fixed-return basis.

In contrast to traditional financing options, there is a profit or markup rate rather than a reference to the interest rate. Generally, participatory modes of financing are highly encouraged in order to share risk and provide more equitable forms of interaction and share joint interest in the project. Islamic banking shall be alternative whenever participatory financing may not be practical. There are various forms, such as *Murabaha*, which are based on a mark-up, *ijara* (leasing) and *salam*, which are cash advances for the purchase of agricultural goods. Finally, *istisna* is another critical element related to advancement of cash for the creation of assets (Shamsuddin and Ismail 2013).

The third group is based on contracts that focus on safety and security, such as wakalah and wadiah contracts. Wakalah are agency contracts, while wadiah are contracts for safe-keeping for current deposits. Such deposits in current accounts enables to outline both trust as well as financial security where the bank promises to refund the money upon request. The products are primarily based on Islamic commercial contracts (also called aqad, which is an agreement between two parties) and contract law. Nevertheless, the contracts may encompass various elements of contracts.

As outlined previously, profit-loss sharing (PLS) are the most preferred financing option as it involves the sharing of risk and equality between the financing partners. The challenge with such instruments is that the risks and cost may be significant if the contracts are not sufficiently standardized and supported.

The Mudarabah contract is one of sharing profits, where one partner, denoted as rabb-ul-mal, is providing funds to another partner, the mudarib, in order to be able to participate in the business venture. The rabb-ul-mal party provides the entire capital, while the mudarib party delivers the managerial skills and competence. The split of the profits may be either in the form of 50-50 or 60-40, where the mudariband receives 60 percent of the profit, while the rabb-ul-mal obtains 40 percent. The rabb-ul-mal will also lose their capital in the event of a loss, while the mudarib will have to forfeit the time and effort they put into the project. When looking at the structure of the mudaraba, then it seems to be akin to that of venture capital and the investor pays the business owner. The business owner offers subsequently management and labor in exchange for a ratio of the profits and risks. This participatory arrangement between capital and labor outlines a core belief in Islamic banking that the user of the capital should not suffer all the risk or expense of failure. This supports a balanced income distribution without leading to a monopoly in control of the economy by the financier (Schoon 2008).

Another form is the Musharakah, which is a partnership where two or more people invest in the company and split the net profit and loss in a proportional manner. As compared to the Mudarabah, the number of partners may be more than two, and the capital has the right but are not compelled to take part in the management. Similarly, the partners divide the profit according to specified percentages and each partner has to bear the loss according to the capital input. Musharakah contracts are frequently utilized for the purchase of real estate and associated types of property, and letters of credit have a similar approach. There is the permanent or diminishing format. A permanent Musharakah is frequently utilized in commercial partnerships, while a diminishing Musharakah is used for financing significant purchase (Schoon 2008).

Islamic banks may lend money to businesses engaged in Musharaka business transactions by issuing loans with a floating rate, where the floating rate is tied to the business's specific rate of return and the bank's profit on the loan is equal to a predetermined proportion of the business's profits. Generally, permanent musharaka have encountered less interest given its limited flexibility.

The Musharaka Al-Mutanaqisa has been generally preferred for the financing of large purchases, such as real estate. The term refers to a diminishing partnership and conventionally includes the *ijarah* and *bay* contract. The *ijarah* contracts incurs the leasing of its half to the customer, while the *bay* contract implies that the bank gradually sells its share to the customer (Gerrans, Baur and Lavagna-Slater 2022).

The down-payment made by the consumer represents the ownership share of the asset that is acquired, but the bank ownership is considerably larger. The customer then leases or rents the assets from the bank, and the bank charges rent for the usage of the asset. The rent covers both the periodic re-payment of the asset cost and profit, but the bank's ownership gradually decreases. The borrower and bank split the sale revenues of the asset based on the equity ownership levels at the time of the sale, in case the borrower defaults. The form of Musharakah is of significant interest for a variety of cases and has been considered a viable basis for large estate purchases.

### **Asset-backed financing**

Another major form as compared to partnerships are contracts based on backing of assets or debt-type instruments that permit the exchange of one commodity for another. These are the *Istisna*, *Tawarruq*, *Musawamah*, *Salam* and *Murabaha* contract. In the *Murabaha* contract, the buyer and seller must agree on the markup or cost-plus price for the items being sold in order to enter into a *murabaha*. This refers primarily to financing in which the bank purchases a good, such as a home, car, business supplies, etc., at the customer's request and increases the price of that good to resell to the customer in exchange for allowing the customer to defer payment. In Islamic law, a contract with postponed payment is referred to as a *bai-muajjal*.

The *murabaha* has developed into the most common or default form of Islamic finance, and the *murabahah* has been used for the majority of Islamic banks and financial institutions in order to finance the operations, with estimates going up to 80 percent.

However, most Shariah supervisory boards outline that *murabahah* loans are non-ideal forms of financing, and they should only be utilized when more preferable financing options, such as *musharakah*, *mudarabah*, *salam*, or *istisna* are impractical for a variety of reasons (Katterbauer, Syed and Cleenewerck, *Financial cybercrime in the Islamic finance metaverse* 2022).

Murabahah is somewhat comparable to a typical mortgage transaction or hire purchase/installment plan arrangements (for furniture or appliances), in that the financier buys the item themselves and resells it to the customer who pays the financier in installments rather than lending money to a buyer to purchase the item and having the buyer pay the lender back. In contrast to conventional financing, any penalties for late payments go to charity rather than the financier, and the bank is paid for the time worth of its money in the form of profit rather than interest.

The major question is whether the Murabahah is distinguishable from interest-based finance given that there is no true commodity purchasing or selling by most of the banks (Hussain, Shahmoradi and Turk 2016).

Bai'-bithaman ajil, or BBA, is another name for bai' muajjal, which is commonly referred to as a credit sale or a deferred payment sale. This refers to a credit sale and is a sale of goods with deferred payment. The financier purchases the goods or equipment the client requests and then sells them to the client for an agreed-upon price that includes a markup for the bank and is paid either in installments over a pre-agreed-upon period or in full at a later date. The cost of the commodity and the margin of profit must be specifically mentioned in the contract. Generally, there are several similarities to murabahah contracts, but in practice muarabaha contracts are used for short and medium-term financing, while BBA are generally utilized for longer term financing.

Bai' al inah occurs when the financier purchases an asset from the customer on a spot basis. The price paid by the financier serves as the loan. The asset is then sold back to the customer, who pays over time in payments, basically paying back the loan. Since lending money for financial gain is prohibited in Islamic finance, there are divergent views among scholars over whether Bai' al 'inah is permissible. Although Bai' al Inah is used in Malaysia and other countries with comparable laws, the Institute of Islamic Banking and Insurance claims that it is equivalent to a ruse, which is the lending on interest.

The Malaysian Court of Appeals upheld Bai al Inah as a shariah-compliant procedure in 2009, despite the fact that it is not recognized in the Middle East and North Africa (MENA). This outlines a challenge given that it demonstrates a divergence in the Shariah interpretation between the centers of Islamic finance (Hussain, Shahmoradi and Turk 2016).

Another form is the musawamah contract that is utilized when the precise cost of an item that is sold to the bank or financier may not be determined. This is also called a bargaining contract. In contrast to Murabahah, Musawamah does not require the seller to disclose their cost or purchase price, even if they are aware of it. The most prevalent form of trading negotiation seen in Islamic

trade is musawamah (Katterbauer, Syed and Cleenewerck, Financial cybercrime in the Islamic finance metaverse 2022).

Bia-Salam and Istisna are examples of forward contracts, which are tailored agreements between two parties to purchase or sell an item at a defined price at a future date. These contracts, which are formed before the sale of the goods really occurs, should be as specific as possible to eliminate any room for ambiguity.

Istisna contract refers to a forward contract on a project that, unlike Bia-Salam, can only be a contract for something that has been created, processed, or built and would not have been possible without the contract to make it. Furthermore, unlike bia salam, there is no requirement for upfront payment in full. Payments for financing can be made in installments to buy construction supplies or raw materials for building construction. The bank might be paid back once the finished product or structure has been sold. Before the manufacturer or builder begins, the contract may be unilaterally terminated. The time of delivery need not be set in stone. The Barzan project is an example of a financing operation in the energy sector utilizing istisna and Ijara (K. Katterbauer, H. Syed and L. Cleenewerck, et al., A Distributionally AI Robust Islamic Portfolio Approach-A Case Study of The Impact of Sanctions on The Incorporation of Chinese Stocks into Islamic ETF 2022).

Similar to istisna, bai salam is a forward contract in which an advance payment is made for goods that will be delivered in the future. The contract specifies the nature, price, quantity, and quality of the good as well as the date and location of delivery in sufficient detail to dismiss any potential conflict. Salam contracts were created to meet the needs of small farmers and traders and precede Istisna. The items for sale could be of any kind, barring gold, silver, or money based on these metals. Islamic banks frequently use parallel salam agreements and middlemen. In order to sell the goods for a higher price, two contracts are made. There is one contract with the seller and the other with the buyer. There are several basic characteristics and requirements of a suitable salam contract. In a salam transaction, the buyer must pay the seller (the small farmer, dealer, etc. being funded) the whole purchase price at the moment of sale. The salam cannot indicate that a specific good or service originates from a specific location, such as wheat from a specific field or fruit from a specific tree, as this would add unnecessary uncertainty (gharar) to the contract. Before delivery, the stated crop or fruit could be spoiled or destroyed (Katterbauer, Syed and de Kiev, An innovative AI Blockchain framework for Islamic microfinancing 2022).

Furthermore, the quality and quantity (whether weight or volume) of the commodity acquired must be fully specified with no room for doubt in order to avoid a dispute. Additionally, it is necessary to specify the delivery's precise time and location. Finally, any deferred exchange of



gold, silver, wheat, barley, dates, or salt in the name of Islam is against *riba al-fadl* and is prohibited. In comparison to contracts like *Murahabah* or *Musawamah*, *Salam* is a preferred financing form that bears a higher order of shariah compliance (Mirakhor and Zaidi 2007).

The *Ijarah* contract is another major form. *Ijarah*, which means literally "to give something on rent," refers to a type of Islamic banking and finance that is similar to rent-to-own. It refers to a contract for the employment of individuals or services, or usufruct of property, typically for a set amount of time and price, according to classical *fiqh* or Islamic jurisprudence. *Al Ijarah* is the term to describe a contract that leases property to a customer for a stream of rental and purchase payments, culminates in a transfer of ownership to the lessee, and otherwise complies with Islamic law (Shamsuddin and Ismail 2013).

In contrast to a traditional lease, a sharia-compliant *Ijara* requires the financing party to purchase the asset the customer wishes to lease and to assume some of the commercial risks, such as damage to or loss of the asset. This is more frequently connected with operating leases. There are various forms of *Ijarah*.

*Ijarah thumma al bai'* or the leasing followed by sale refers to a situation in which a client leases a good and then agrees to buy it, paying both the lease charge and the purchase price in installments so that by the conclusion of the lease, it owns the good free and clear. This involves two Islamic contracts, such as an *Ijarah* that specifies the conditions of renting or leasing for a predetermined amount of time, and a *Bai* that specifies the conditions of a sale that must be finished by the end of the *Ijarah's* term.

From the perspective of shariah law, it is crucial that the *Ijarah* and *Bai* remain two different contracts rather than being joined. An illustration would be in an auto finance facility, where a customer signs the first contract and leases the vehicle from the owner, such as a bank, for a predetermined sum of time. The second contract kicks in at the end of the lease period, giving the consumer the option to buy the vehicle at the agreed-upon price.

This kind of deal is comparable to the *contractum trinius*, a legal strategy adopted by European bankers and merchants in the Middle Ages to get around the Church's ban on interest-bearing loans. In a contract, the two parties would enter into three (*trinius*) contemporaneous and interconnected legal contracts, with the overall result of paying a charge for the use of money for the loan's duration. Shariah Law also forbids the utilization of concurrent connected contracts (Katterbauer and Moschetta, *A deep learning approach to risk management modeling for Islamic microfinance* 2022).

*Ijarah wa-iqtina* or lease and ownership, is known as *al ijarah muntahia bitamleek* and also entails an *ijarah* followed by the sale of the leased asset to the lessee. However, ownership is

transferred as soon as the lessee pays the asset's purchase price, which can happen at any time during the leasing period. A valid *ijara wa iqtina* contract according to Islam requires the following three conditions. First, separate legal records should be kept for the lease, as well as the transfer of ownership of the asset or property. Secondly, the signature of the leasing agreement should not be contingent upon consenting to the transfer of ownership. Finally, the unilateral promise to transfer ownership should only be binding on the lessor.

Another form is the forward *ijarah* or *ijara mawsoofa bi al dhimma* Islamic contract. In such a form, the service or benefit being leased is well-defined. but the unit that provides the service or benefit is not specified. Therefore, the contract is not null and void if the unit providing the service or benefit is destroyed. *Ijara mawsoofa bi al dhimma*, as used in modern Islamic finance, refers to renting out a building that has not yet been built or manufactured, like a house, office, or factory. This implies that the construction of whatever it is that will offer the service or benefit is covered by both the *ijara mawsoofa bi al dhimma* contract and an *Istisna* contract. The creation of the asset is financed by the financier, and after delivery to the party, the asset is first leased. Although sharia prohibits ahead sales in general, they are permitted when done so through *ijarah* as long as the rent or lease doesn't start until after the consumer takes possession. Sharia also mandates that the asset be precisely described and that its rental rate be precisely established.

There are several challenges such as that some rules are ignored in practice, such as those that hold the lessor accountable if the rental property is destroyed due to an unforeseen circumstance. Furthermore, *Ijara* offers weaker legal standing and consumer protection for foreclosure than conventional mortgages and less flexibility for clients who want to sell property, such as a car, and repay the loan before it is due.

Both a normal loan and a reverse *murabaha*, also called *tawarruq*, give a customer cash in exchange for deferred repayment, but while a conventional loan is easier to understand and has less fees, a *tawarruq* does not, in the opinion of some jurists, violate sharia law. A *Tawarruq* contract or product is one where a client customer can raise instant cash to be paid back later by purchasing an asset that is easily sellable, paying a marked-up price with deferred payment, and then immediately selling the commodity to raise cash.

While *tawarruq* closely resembles a cash loan, which is prohibited by traditional Islamic law, and is more complicated than a typical bank loan, its proponents contend that it complies with sharia because of the real assets that underlie the transactions. However, some people disagree with the contract and financiers are highly tempted to forego *Tawarruq*'s commodity trading because it had little practical use.

These contracts focus on primarily investments or financing, and charitable lending shall be only a last resort to support the individuals. Such benevolent loans are called Qardh-ul Hasan, which is a Shariah compliant loan. This refers to loans that are given to those in need. Instead of Islamic banks, private parties, social service organizations, or businesses providing benefits to employees frequently make these loans.

The lender may not receive any advantage or benefit from the loan, in addition to not charging interest or any premium above the actual loan amount. The borrower may be permitted to pay an additional amount if it is voluntary and not required under the contract. Some financial organizations provide lenders with qardh-ul hasan products, which do not charge interest but do have a separate management fee. There are other savings account products called qardh-ul hasan, where the debtor may pay an additional sum over the loan's principle amount as a sign of appreciation to the depositor. This is known as a hibah and a gift to the creditor. If the additional payment was not pledged or made in advance with the loan agreement, they also do not contravene traditional Islamic law (Mirakhor and Zaidi 2007).

There are several other contracts that focus on helping individual and business customers to keep their funds safe. Hawala contracts are popular, unofficial value transfer system for moving money from one location to another. It is not based on the exchange of physical money or on computer or telegraph wire transfers between banks, but rather on a vast network of money brokers spread out across the Muslim world. The IMF claims that in a hawala transaction, money value rather than actual currency is often transferred from one nation to another.

Although it predates regular banking, financial channels, and remittance systems by many centuries, the hawala network operates alongside or in addition to them. It was gradually replaced by the tools of the traditional banking system in the first half of the 20th century, but in the late 20th century as Muslim workers started to migrate to wealthier countries in search of employment, it became a substitute for many banking products as they looked for ways to send money to or secure a loan taken out by their family back home.

When it comes to hawala transactions, each hawala transaction is conducted purely on the basis of good faith, and because the system is not reliant on the enforceability of claims under the law, it can function even in the absence of a legal or judicial framework. Membership in a hawaladars network is frequently based on belonging to the same family, village, or ethnic group. Cheating is penalized by effective excommunication and loss of honor, which can have a serious negative impact on one's ability to earn money. Small business owners who moonlight or side-gig at hawala are known as hawaladars. The foundation of hawala is a short-term, negotiable,

discountable promissory note known as a Hundi. One debtor to another receives the Hawala debt. The first debtor is released from responsibility once the debt is transferred to the second debtor.

Another format is the kafala, which refers to a guarantee. An existing liability is assumed by a third party, who then assumes responsibility for satisfying it. used interchangeably with za'amah and himalah at least occasionally. The five Conditions Of Kafala are the Guaranteed, Guarantor, Object of Guarantee, Creditor, and Sigah For Constituting the Contract. There are various varieties of kafala, including kafalah bi al-dayn (guarantee for debt), kafalah bi al-taslim (guarantee for delivery), and kafalah bi al-dark (financial guarantee). There are also numerous sorts of kafalah bi al-nafs (physical guarantee) and kafalah bi al-mal (financial guarantee).

Another form is the rahn, which is a collateral or pledge contract. The contract that secures a financial obligation is also referred to by this term, with the real tangible collateral having a different name. The goal of rahn is to turn a piece of property into a security for a claim whose full payment from the property is allowed. According to hadith tradition, the Islamic prophet Muhammad used credit to buy food while offering his armor as rahn (K. Katterbauer, H. Syed and L. Cleenewerck, et al., Robo-Sukuk pricing for Chinese equities 2022).

Similar to a power of attorney, a wakalah is a contract whereby a person (the principle or muwakkel) chooses a representative (the agent or wakil) to carry out transactions on his or her behalf. When the principal lacks the necessary time, skills, or understanding to complete the assignment themselves, it is used. Wakalah is a non-binding agreement with a set fee that can be terminated at any time by mutual agreement, unilateral termination, discharging the obligation, destroying the subject matter, and the death or loss of legal capacity of the contracting parties. The agent may offer a variety of Islamic products, such as Musharakah, Mudarabah, Murabaha, Salam, and Ijarah, as well as lending, borrowing, debt assignment, gifting, litigation, and payment processing (Schoon 2008).

From the perspective of depositors, Islamic banks' Investment Accounts resemble conventional banks time deposits because they are based on profit and loss sharing and asset-backed financing. In both these conventional and Islamic accounts, the depositor consents to keeping the money on deposit with the bank for a specific period of time (K. Katterbauer, H. Syed and L. Cleenewerck, et al., A Distributionally AI Robust Islamic Portfolio Approach-A Case Study of The Impact of Sanctions on The Incorporation of Chinese Stocks into Islamic ETF 2022).

## **RESULT & DISCUSSION**

### **Restricted and unrestricted investment accounts**

There are two primary types of investment accounts offered by Islamic banks for people investing especially in profit and loss sharing modes. Customers can choose the investment

mandate and the underlying assets that their funds may be invested in through restricted investment accounts (RIAs), Unrestricted investment accounts (UIAs) do not, giving the bank or investing institution free discretion to invest funds however it deems fit without regard to the account's funds' use, distribution, or purpose. A UIA fund may combine/commingle pools of funds that invest in broad portfolios of underlying assets in exchange for more accommodating withdrawal rules.

Some have criticized UIA accounts for their lack of transparency, disregard for Islamic banking principles, and lack of client participation on the board of governors. Some institutions have used "profit equalization funds" or "investment risk reserves" (which are made from profits made in prosperous periods) to cover up the poor performance of their UIAs. The UIAs only learn that their deposits have decreased over time when an Islamic financial institution is on the verge of going bankrupt. Islamic banks also provide "demand deposits," or accounts that promise the convenience of releasing funds to depositors on demand, but in exchange typically yield little to no return on investment and/or incur higher costs.

Demand deposits typically yield little to no return, and Qard al-hasana loans may not have any "stipulated benefit" in accordance with orthodox Islamic law, hence the Qard mode is a common Islamic finance structure for demand deposits. According to this concept, qard al-hasan refers to "deposits whose repayment in full on demand is guaranteed by the bank," with client deposits acting as "loans" and the Islamic bank acting as a "borrower" who receives no compensation (no "stipulated benefit")—conforming to orthodox Islamic law.

The fact that at least some conventional banks do pay a moderate interest on their demand accounts adds another layer of complexity. Islamic banks occasionally offer an incentive called a Hibah (literally, a "gift") on the amount of the clients' savings accounts in an effort to compete with them. For example, grant of prizes in cash or kind, reductions in or exemptions from service charges or agents' fees payable to banks, and giving priority in the use of banking finances are all acceptable substitutes for interest under Iran's qard al-hasanah deposit accounts. In Islam, hibah is not time-limited and cannot be legally guaranteed or stipulated, like dividends on stock.

Wadi'ah (meaning "safekeeping") and Amanah (literally "trust") are two additional contracts that Islamic finance institutions may utilize for pay-back-on-demand accounts in place of qard al-hasanah. (The Jordan Islamic Bank uses the Amanah (trust) mode for current accounts and demand deposits. The bank may only use the funds in the account at its "own risk and responsibility" and after obtaining the account owner's approval.)

On the definition of these two contracts, sources differ. Sometimes wadi'ah and amanah are used interchangeably, and "often the same words are used by different banks and have different

meanings." In relation to Wadiah, there is disagreement about whether these deposits must be held unused with a 100% reserve or are only required to be bank-guaranteed.

However, there is a contract known as Wadia yadd ad daman that is used by Islamic banks "to accept current account deposit" and in which the bank "guarantees repayment of the whole or part of the deposit outstanding in the account when repayment is due" without mentioning the lack of rights of disposal.

### **Sukuk (Islamic bonds)**

The Arabic term for financial certificates created as an alternative to traditional bonds is sukuk (plural of sakk). The terms "Islamic" and "sharia-compliant" bonds are frequently used to describe them. Depending on the project the sukuk is financing, many varieties of sukuk are based on the various structures of Islamic contracts.

A sukuk holder receives part-ownership of an asset from which they earn income either from profits generated by that asset or from rental payments made by the issuer as opposed to getting interest payments on loans as in a conventional bond.

In order for sukuk holders to be able to receive the property's earnings as rent, a sukuk security, for instance, may contain a portion of ownership in a building constructed by the investment company looking to raise capital from the sukuk issue (and held in a Special Purpose Vehicle). Sukuk are similar to equity instruments in that they represent ownership of real assets, but unlike equity they do not, at least in theory, guarantee the return of the initial investment. Instead, like bonds, periodical payments stop when the sukuk matures. The majority of sukuk, however, are "asset-based" rather than "asset-backed" in actuality; this means that their assets are not actually owned by their Special Purpose Vehicle, and their holders, like those of conventional bonds, have recourse to the originator in the event of a payment shortfall.

Around 2000, the sukuk market started to boom, and as of 2013, sukuk made up 0.25 percent of the world's bond markets. At the end of 2014, there were \$294 billion worth of outstanding sukuk, with \$188 billion coming from Asia and \$95.5 billion from the Gulf Cooperation Council nations (Katterbauer and Moschetta, A robo-advisory framework for Islamic and Environmental, Social and Governance (ESG) compliance—A benchmark study on the S&P 500 stock index 2022).

### **Takaful (Islamic insurance)**

The difference between traditional insurance and takaful is that takaful is based on mutuality, meaning that the risk is shared by all the insured rather than only the insurance firm. The insured contribute to a pooled fund that is managed by a manager instead of paying premiums to a business, and they are paid any profits from the fund's investments. Any extra money in the

collective pool of accumulated premiums ought to be given to the insured. Funds must not be invested in haram activities like interest-bearing instruments, businesses that deal in alcohol or pork (Kahf 2013).

### **Islamic credit cards**

There is disagreement as to whether a credit card that complies with shariah is actually available. There are various challenges that arise from the credit card regulations that adhere to Islamic principles. There are credit cards that are Shariah compliant based on various arrangements. A bank issues a line of credit to the cardholder and levies monthly or annual usage fees that are proportional to the line of credit's outstanding balance. Furthermore, a consumer may use a card to make a purchase, but as soon as the transaction is approved, the bank buys the item and then sells it to the cardholder at a higher cost. Finally, there is an arrangement whereby the bank retains ownership of the purchased item up until the cardholder makes the last payment.

Another option for Islamic credit cards is based on several components. First, the customer only has to pay an annual service charge to use the card, which is called Ujra. Then the credit card is used as a leased asset for which it makes regular installment payments, being in the form of Ijara.

The bank serves as a kafil (guarantor) for the cardholder's transactions. The cardholder is required to pay kafala bi ujra (fee) in exchange for its service, and the client serves as the borrower while the bank serves as the lender in qard.

Finally, the bank provides a product at a set price which is the client's pool of accessible funds from its credit card. Then, at a reduced price, the bank buys the item back from the client. The bank's income comes from the pricing discrepancy (Bilal and Mydin Meera 2015).

### **Islamic funds**

Islamic mutual funds, which are professionally managed investment funds that pool the funds of many investors to buy securities that have been checked for compliance with sharia law, have been contrasted with socially responsible mutual funds. Both seek a combination of high returns and low risk, like conventional funds, but also screen their holdings in accordance with non-profit seeking criteria. Unit trusts, which are slightly different from mutual funds, can also be Islamic funds. The money may be invested in stock, sukuk, or real estate (Katterbauer and Moschetta, An innovative artificial intelligence and natural language processing framework for asset price forecasting based on islamic finance: A case study of the saudi stock market 2022).

Before a fund can purchase a company's shares or other holdings, the company must be screened in accordance with sharia to weed out any businesses that engage in activities that are

against Islamic law, such as those involving alcohol, tobacco, pork, adult entertainment, gambling, weapons, conventional banks, and insurance companies.

The company's financial ratios must be scrutinized to ensure they fulfill certain financial benchmarks to ensure the corporation is not engaged in prohibited speculative transactions (involving uncertainty or gambling). Such activities are conventional which are likely leveraged with debt.

Most Islamic funds exclude companies with debt-to-market capitalization below a specific threshold (set by the industry at 33%) and the fact that a stock's price changes a company's debt-to-market capitalization ratio, a fund may be forced to sell stocks regardless of whether doing so was the best investment strategy. This may lead to a fund being forced to engage in buying high and selling low as a result.

### **Microfinance**

By offering small loans to business owners who are too tiny and unprofitable to attract the interest of non-microfinance institutions, microfinance aims to aid the underprivileged and promote economic growth (Katterbauer, Syed and de Kiev, An innovative AI Blockchain framework for Islamic microfinancing 2022). Its approach fits with the "guiding principles" or goals of Islamic finance as well as the requirements of Muslim-majority nations, which are home to a sizable portion of the world's poor, many of whom are small business owners in need of funding (Katterbauer and Moschetta, A deep learning approach to risk management modeling for Islamic microfinance 2022).

### **Shariah compliant Buy Now Pay Later**

Buy Now Pay Later have attracted significant attention in several Islamic countries with several of these enabling BNPL schemes to encourage consumption and business activities. This aligns with the objective to strengthen the FinTech sector in order to stimulate economic growth and nurture the sector. There are several challenges that arise from conventional BNPL models. The first is that interest is forbidden, which is typically a major component in conventional BNPL schemes where interest is charged for late payments or a part of the monthly installments over the re-payment time period. Furthermore, current BNPL is not limited on the kinds of products and services that are purchased, which has to be assessed in the context of Shariah law. The current BNPL transactions lack in most instances a solid Shariah-compliant legal foundation, given that the underlying transaction is an interest-bearing loan with all associated fees connected to it. Another challenge is the insurance framework that is utilized, which may not conform with Shariah principles. Specifically, credit insurance plans are not permitted in Shariah law, which form the majority of BNPL insurance schemes.



In order to overcome these challenges, there are several potential alternatives for the BNPL scheme to be Shariah compliant. The first is that solely goods and services that are approved under Islamic law are acquired by the client from the BNPL provider that obtains these from the merchant. Either a cost-plus financing structure, such as a Murabaha, or a no-cost plus financing structure, such as Tawliyah, may be utilized. This would subsequently be Shariah-compliant for the BNPL.

In order to charge the service fee, which has to be set and predefined, the client has to obtain a separate service contract, such as Ujrah, with the BNPL provider. This ensures that the BNPL provider is compensated for the management of the transaction on behalf of the client. If necessary, the client may obtain an Islamic indemnity coverage, such as a takaful, in order to cover for credit default and any warranties arising for the goods and services. For the Shariah-compliant Murabaha transaction to be finalized and efficiently executed, the client has to sign two separate, approved agreements that are in line with Shariah law.

The BNPL will have a separate shariah agreement to purchase the goods/services from the merchant under a legitimate purchase/sale arrangement (Musawamah) that complies with Islamic law, as well as a Wakalah (agent) mandate to manage the following sale or purchase to the end user customer.

An example of such a Shariah compliant BNPL transaction is that the BNPL financial cooperation grants the client a credit permission, where the client then utilizes the BNPL Murabaha in order to acquire the good. The merchant sells the goods to the BNPL provider for a specified price, which is the Musawamah. The BNPL provider then subsequently resells the goods to the client with a price plus markup, which includes the service fee. This is also part of the Murabaha contract. The seller, BNPL provider, represents the Wakeel of the client and oversees the transaction or sale. The client then repays the BNPL provider for the goods over the specified time period.

When offering Shariah-compliant BNPL schemes, then there are several core areas that have to be looked at. These are the terms and conditions, the Shariah approval and certification as well as the audit and review. The terms and conditions should be maintained universally Shariah compliant, and the BNPL provider should get a reputable Shariah board in order to certify the program and also issue a Fatwa in order to support it. Additionally, Shariah audits and review have to be carried out on a regular basis in order to ensure adherence and legitimacy of the Shariah compliance. Furthermore, the taxes and accounting assessments in connection with Shariah law have to be ensured properly. Furthermore, the marketing material has to be ensured to comply with Shariah law, and any penalty fees have to be assessed in the case of a severe default and

donated to charity. The portion that has to cover legitimate administrative cost can be deducted from the fees.

### **BNPL in Saudi Arabia**

BNPL has been of critical interest given the recent permission by the Saudi Arabian Central Bank (SAMA) that permitted BNPL schemes. The central bank instituted a “MIS forward” permission to implement the BNPL solution, which permits customers to make purchases from merchants without having to pay term financing fees. The main attempt is to attract new types of investors and businesses in order to improve the operational efficiency of the sector. Nevertheless, the standards in terms of regulatory and supervisory have to be strictly adhered to and will be supervised by SAMA. The main objective of SAMA is the focus on assisting both banks and FinTech companies to enhance operational effectiveness and support the financial inclusion for the country (Saudi Central Bank 2023).

### **CONCLUSION**

Buy Now Pay Later (BNPL) schemes have experienced worldwide rapid growth rates in order to stimulate consumption growth and provide consumers with more options in paying for their items. Traditional consumers were offered for a long time offers where they may purchase products and services and then pay them off over a period of time. BNPL schemes are a new form of electronic installment payment arrangements that permit the purchase of even smaller items and pay them off over a period of time. While installment options were mostly restricted to larger purchases, such as cars and furniture, newer BNPL enable to purchase efficiently even less expensive goods and services. This change in opportunities has attracted merchants and financial services provider in Islamic countries to evaluate BNPL for their business and provide it to their consumers. Islamic law has various forms of contracts that may be utilized for BNPL scheme. However, the most common form is the structure of a Murabaha for financing these schemes. The article outlined the general BNPL structure for Islamic finance and the legal issues that arise from general BNPL schemes. Ensuring the solid connection between goods and services and the financing is paramount for maintaining compliance with Shariah law. The legal analysis outlined several structures that are suitable for BNPL schemes that are Shariah compliant, enabling Islamic finance to strengthen the sector and provide dedicated financing options.

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