



**A CASE STUDY ON THE IMPLEMENTATION OF THE
QARDHUL HASAN CONCEPT AS A FINANCING
PRODUCT IN AN ISLAMIC BANK IN MALAYSIA**

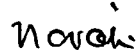
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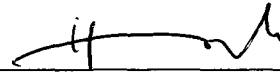
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APPROVAL PAGE

We certify that we have supervised and read this Project Paper and that in our opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a Project Paper for the degree of Master of Business Administration.

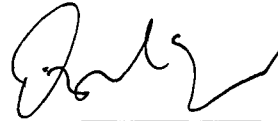


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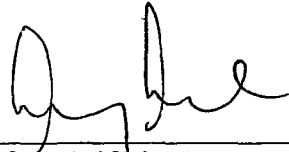
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DECLARATION AND COPYRIGHT PAGE

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I hereby declare that this research is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

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ABSTRACT

Qardhul Hasan is a zero-return financing that Al-*Quran* urges Muslims to make available to those who need them. In addition, *Qardhul Hasan* is an example of a unique interest free instrument that is offered by Islamic Financial Institutions (“IFIs”). The objective of this paper is to study the implementation of the *Qardhul Hasan* concept, as a financing product in an Islamic bank in Malaysia. This study adopted a single case study research. This is the best approach, and appropriate to answer the research questions and to achieve the research objectives. In addition, this is a pilot case study, which can be extended for multiple case studies later. Furthermore, an exploratory case study has been adopted; the study concentrates on one organization only and attempts to explore the reason for the observed practices. As a result, this study found that CALF (Malaysia) Berhad¹ only offers *Qardhul Hasan* financing to its employees. In addition, the facility is limited for certain purposes, which are for marriage, birth of a child, study and inopportune. As there are only three IFIs in Malaysia that offer *Qardhul Hasan*, it is hoped that this study can provide the remaining IFIs or other IFIs in the world with a guideline or basis on how to implement *Qardhul Hasan* financing. It is also believed that this study can be used by regulatory bodies, including Bank Negara Malaysia or the Malaysian Accounting Standard Board, or as a basis for setting up specific accounting and reporting guidelines on *Qardhul Hasan*.

¹ The real name of the organization is not disclosed for reasons of confidentiality.

LIST OF SYMBOLS AND ABBREVIATIONS

BNI	Bank Negara Indonesia
BNM	Bank Negara Malaysia
BULL	Bull
CALF	CALF (Malaysia) Berhad
CAPL	CALF (Australia) Pty Ltd
CSPL	CALF (Singapore) Pte Ltd
CSR	Corporate Social Responsibility
GCC	Gulf Cooperative Council
GP8- <i>i</i>	The Guidelines on the Specimen Reports and Financial Statements for Licensed Islamic Banks
IFIs	Islamic Financial Institutions
MASB	Malaysian Accounting Standard Board
NPF	Non Performing Financing
NPL	Non Performing Loan
<i>Pbuh</i>	<i>Peace Be Upon Him</i>
SOP	Standard Operating Procedure
<i>Swt</i>	<i>Subhanahuwata'ala</i>

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CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

*Qardhul Hasan*¹ is a zero-return loan that *Al-Quran* urges Muslims to make available to the needy. In other words, the borrower only needs to pay back the principal amount without any obligation for an additional amount. However, the borrower is encouraged and may pay an additional or extra amount at his/her absolute discretion as a token of appreciation, so long as it is not stated in the contract between the two parties. In addition, *Qardhul Hasan* is an example of a unique instrument offered by Islamic Financial Institutions (“IFIs”) as compared to their counterparts, the conventional financial institutions. In addition, it is believed that *Qardhul Hasan* is an effective means of economic development and poverty alleviation, and thus achieves socio-economic objectives. Moreover, as emphasized in the *Quran (64:17)*, *Qardhul Hasan* is one of the main elements, (beside *Sadaqah* (charity), *Zakah* and *Waqf*), concerning the redistribution of income and wealth and, therefore, is needed for the welfare of the society.

The prohibition of *Riba* is very significant and is always brought into any discussion of Islamic Finance contracts. As such, generally, *Qardhul Hasan* is urged in Islam not just because of its uniqueness and flexibility but also because of the prohibition and, therefore, no involvement of *Riba*. This shows the spirit of cooperation (*ta’awun*) and brotherhood (*ukhuwah*), which will improve the welfare of society as a whole.

¹ *Qardhul Hasan* is often referred to as “*Gharzul-Hasaneh*” in Persian literature.

Siddiqi mentioned:

“The condemnation and prohibition of *Riba* in *Quran* is almost always accompanied by urging the believers to give. That includes both charitable grants (*Sadaqah*) and *Qardhul Hasan*, lending with no obligation to the borrower more than returning the principal. This fits in with Islam’s overall vision of life as a cooperative venture aiming at passing the test for which the Creator launched the enterprise of life and death (67:2)”. (2004, pp. 48)

Moreover, many Muslim scholars point out that Islam’s prohibition of *Riba* has two reasonable dimensions; one is to promote equitable risk-sharing contracts for business and commercial purposes and the other, to consider lending as a benevolent act worthy of bringing blessings (*barakah*). Conversely, *Riba*-based lending has far-reaching consequences.

In addition, Mohamed Ibrahim mentioned:

“At the very basic level, it can be said that Islamic organizations (whether business or otherwise) differ from their conventional counterparts by having to adhere to certain *Shari’ah* principles and rules and also try to achieve certain socio-economic objectives encouraged by Islam.” (n.d., pp. 2)

Based on the above, it is clear that in order for the Islamic banks to achieve certain socio-economics objectives, it is important for Islamic banks to provide *Qardhul Hasan* products. Moreover, this will enhance the corporate social responsibility (“CSR”) of the Islamic banks. This concern over CSR is of relevance in the Islamic Banking Industry, which regards social responsibility as being more enduring since the practices are based on divine revelation.

However, it is interesting to note that *Qardhul Hasan* has been so far neglected by the Islamic banks in Malaysia, as compared to other products or services. Very few Islamic banks offer this product – as confirmed by the study made by Mohd. Ariffin & Adnan, (2009). As per the study, only 23.1% (3 out of 13) of Islamic Banks in Malaysia offer *Qardhul Hasan* as a mode of financing. In addition, the total amount of *Qardhul Hasan* only captured less than 0.2% of the total net financing amount reported during the year, as shown in Table 1.

In implementing *Qardhul Hasan*, in the present Islamic Banks, and since the *Qardhul Hasan* concept is essentially benevolent in nature, the *Shari’ah* Advisory Council of Bank Negara Malaysia is of the opinion that it is improper to implement *Qardhul Hasan* in commercial transactions with profit orientation. Hence, based on the Resolution of the *Shari’ah* Advisory Council of Bank Negara Malaysia, the Council in its 51st meeting, held on 28 July 2005/21 *Jamadil Akhir* 1426, resolved that the word “*Hasan*” should be removed after the word *Qardh*

implying that *Qardh* is an obligation for borrowers to pay back their financing to lenders.

Table 1: Review of Annual Reports

No.	Full-fledged Islamic Banks	<i>Qardhul Hasan</i> (Y/N)	Amounts Reported	
			2007 RM '000 <i>Qardhul Hasan</i> Amount	2007 RM '000 Total Net Financing
1	Affin Islamic Bank Berhad	N		
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Y	2,841	1,866,779
3	AmIslamic Bank Berhad	N		
4	Asian Finance Bank	N		
5	Bank Muamalat Malaysia Berhad	Y	5,652	5,585,247
6	Bank Rakyat Malaysia Berhad	N		
7	BIMB Holdings Berhad	N		
8	CIMB Islamic Bank Berhad	N		
9	EONCAP Islamic Bank Berhad	N		
10	Hong Leong Islamic Bank Berhad	N		
11	Kuwait Finance House (Malaysia) Berhad	Y	33	3,162,310
12	Maybank Islamic Berhad	N		
13	RHB Islamic Bank Berhad	N		

(Source: Mohd. Ariffin & Adnan, 2009)

However, the term *Qardh* and *Qardhul Hasan* will be used interchangeably in this paper to provide a better understanding and for achieving the objectives of the research concerning the implication of *Qardhul Hasan* rather than arguing about the different terms used by different organizations or different scholars.

1.2 Objective of the Study

The study has a main objective, which is to study the implementation of the *Qardhul Hasan* concept in relation to Islamic Finance, as a financing product in an Islamic bank in Malaysia.

1.3 Research Questions

Based on the objective of the study, the following research questions have been formulated:

Main Research Question

How do Islamic Banks implement *Qardhul Hasan* as a mode of financing to the various stakeholder(s)?

Sub Research Questions

1. What is the relationship between *Qardhul Hasan* financing and Non Performing Financing (NPF)?
2. What motivates the Islamic Banks to promote/offer *Qardhul Hasan*?
3. Who are the recipients of *Qardhul Hasan*? Why is it restricted to those recipients only?
4. Why were the recipients given the loan (*Qardh*)?
5. What are the *Shari'ah* issues raised prior to implementing the *Qardhul Hasan* concept in any product?
6. What are the accounting entries for *Qardhul Hasan*?
7. How is *Qardhul Hasan* being reported?

1.4 Motivation of the Study

The concept of *Qardhul Hasan* is simple and well known among the members of society. However, no specific study has been made on how the Islamic bank applies the concept as a mode of financing. Thus, this situation motivates the researcher to fill the gap. Furthermore, several issues concerning *Qardhul Hasan*, including the *Shari'ah* issue and reporting issue have not been addressed specifically in any research.

1.5 Contribution of the Study

The number of Islamic banks is increasing rapidly, particularly in Malaysia. However, a recent study conducted by Mohd. Ariffin & Adnan, (2009) revealed that only three out of thirteen Islamic banks in Malaysia offered *Qardhul Hasan* financing. Thus, this study intends to provide the remaining Islamic banks, or other Islamic banks in the world with a guideline or basis on how to implement *Qardhul Hasan* financing.

In addition, at the moment, there is no specific guideline or standard on *Qardhul Hasan* in Malaysia. As the study also addresses the accounting entries and reporting of *Qardhul Hasan*, this study can be used by the regulatory bodies, including Bank Negara Malaysia and the Malaysian Accounting Standards Board (“MASB”), or as a basis for setting up specific accounting and reporting guidelines on *Qardhul Hasan*.

1.6 Organization of the Study

This study has been organized into five chapters including this chapter. Chapter One provides a general idea about the study, covering the background, objective and research questions, as well as the motivation and contribution of the study. It is followed by a discussion on the practices of *Qardhul Hasan* in Malaysia and the previous research on *Qardhul Hasan* in Chapter Two. Chapter Three discusses the research methodology adopted for this study, the research objectives and research questions, introduction of the background of the company and explanation of the methods of data collection. The analysis and discussion of the findings are explained in Chapter Four. Finally, the conclusion of the study will be covered in Chapter Five.

CHAPTER TWO: *QARDHUL HASAN* PRACTICES IN MALAYSIA

2.1 Introduction

This chapter explains the practices of *Qardhul Hasan* in Malaysia and it is structured as follows: First, it covers the general understanding of *Qardhul Hasan*, which also covers the emphasis to practice *Qardhul Hasan* from the Holy *Quran* and the *Sunnah*. Second, this chapter also covers the definition of *Qardhul Hasan* from various sources and the development and issues on *Qardhul Hasan*, especially Malaysian practices. Then, this chapter discusses the previous research that has been conducted. Lastly, the conclusion of the chapter is presented.

2.2 General Understanding of *Qardhul Hasan*

In establishing an Islamic Economic vision in the building models of Islamic Economics, the first reference will be made to the primary sources of *Shari'ah* – the *Quran* and *Sunnah*. The same stages are applied to understand *Qardhul Hasan*, for which the best and main reference in Islamic literature is the Holy *Quran*.

There are at least six verses of the *Quran* addressing *Qardhul Hasan*. The verses are cited in Table 2.

Table 2: References to *Qardhul Hasan* in *Quran*

(2:245)	<i>Who is he that will lend Allah a Qardhul Hasan so that He will multiply it for him (the lender) many times over ...?</i>
(5:12)	<i>And certainly Allah took a covenant from children of Israel and we raised up amongst them twelve captains, and Allah said "verily. I am with you if you keep up Salat, pay Zakat, believe in my messengers and support them, and lend Allah a Qardhul Hasan. I will certainly wipe of your sins and I will certainly cause you to enter the gardens in which rivers flow..."</i>
(57:11)	<i>Who is it that will lend Allah a Qardhul Hasan which He will multiply for him (the lender) many times and for him shall be a generous recompense?</i>
(57:18)	<i>Verily charity-giving men and women who loan Allah a Qardhul Hasan, shall have it multiplied for them and they will receive a generous recompense.</i>
(64:17)	<i>If you lend Allah Qardhul Hasan, He will multiply it for you. Allah is the most appreciating, the most forbearing.</i>
(73:20)	<i>... so recite from it (the Quran) as you can easily, and establish Salat and pay Zakat and loan Allah a Qardhul Hasan. What so ever good you send for yourself beforehand, you will find it with Allah. This is the best and greatest reward.</i>

(Sources: Hossein, Zamir and Abbas, 2008)

In the *Quran*, Allah places great emphasis on *Qardhul Hasan*, which can be seen from the many verses, as simplified by Hossein, Zamir and Abbas (2008), which indicate that:

1. When a person lends *Qardhul Hasan* to someone in need, without expecting any return above the principal, in which the obligation is however obligated to the debtor (borrower) to repay, Allah (swt) promises a reward exceeding the amount many times, and will receive "*Ajrun Kareem*", a generous recompense, beyond imagination (57:11, 57:18).
2. In addition, Allah (swt) will certainly erase the sins (grant forgiveness) of the lender and promises that the lender will enter into Heaven (5:12).

3. Apparently, *Qardhul Hasan* is different from *Sadaqah* (charity) and *Zakah*. Furthermore, the importance of *Qardhul Hasan* is placed by Allah in the verses in which He places it at the same level as the mandatory *Salah* and *Zakah* (73:20).
4. There is no involvement of the *Riba* element, as only payment of the principal is involved (30:39, 2:276-280).
5. The extension of benefits of *Qardhul Hasan*, not only in this world, but to the hereafter (5:12, 73:20).
6. The *Quran* creates a strong incentive for funding *Qardhul Hasan* (73:20).
7. It is also understood that Allah (swt), in His teachings throughout the *Quran*, encourages Muslims to help other Muslim brothers and sisters (2:280).
8. *Qardhul Hasan* consistently refers to the symbolic transaction between Allah and the believers (Muslim), especially in terms of Muslims who grant it solely in the path of Allah (2:245).

In viewing the *Qardhul Hasan* from the second main source of *Shari'ah*, which is the *Hadith*, Farooq stated:

“Based on 9 collections of *Hadith* (Bukhari, Muslim, Abu Dawud, Nasai, Ibn Majah, Tirmizi, Muwatta, Musnad Ahmad and Darimi), in no *Hadith* does the expression of *Qardhul Hasan* appear unlike as it does in the *Quran*. In *Hadith*, *Qardh* is referred to as *Qardh*, no additional expression of *Hasan*”. (2008, pp. 13)

However, as mentioned by Antonio (1999) there is one narration of *Hadith* by Ibn Majah, Ibn Hibban and Baihaqi. The *Hadith* strongly urges Muslims to lend something of their own to other Muslims.

Meanwhile, Sheikh al-Tantawi (as cited in Farooq, 2008) stated that:

Anas narrated that the Prophet (*pbuh*) said:

“I saw on the night of *Isra*’, written on the door of paradise: charity is multiplied ten-fold, and *Qardh* are eighteen-fold. I asked Gibriel, “Why is a *Qardh* better than charity?” He said: “One may ask for charity while having property, but the borrower only borrows out of need”. (Narrated by Ibn Majah and Bayhaqi). (2008, pp. 11)

Based on the above verses from the *Quran* and *Hadiths*, it is clearly affirmed that there is no involvement of *Riba* (interest) in *Qardhul Hasan*, as it only involves the repayment of the principal amount. Thus, on this basis, the loan in Islam is not to become a tool for business purposes to gain profit, as business is meant to gain profit and may suffer loss. Instead, *Qardhul Hasan* is an honourable deed, which gains no material profit for the practitioner. In addition, the *Qardhul Hasan* might improve the redistribution of income and wealth system in society, and, therefore, it assists in meeting the socio-economic objectives.

In addition, O. Ahmed (2005) added the following conditions that must be observed in ensuring the validity of the *Qardh* contract:

1. The lender must not impose any extra payment in the contract.
2. The borrower must not promise in the contract to pay anything extra.

As mentioned above, the lender is prohibited from requesting an increase in the *Qardh* amount from the borrower. There is a consensus (*Ijma'*) among Muslim jurists based on the tradition from the Prophet (*pbuh*) that any stipulation for increase in a loan contract is usury (*Riba*), even when it is agreed by the customer. In classifying it, the increase in *Qardh* can be categorized as *Riba* on credit (*Riba al-nasiyyah*).²

However, if the borrower desires to give an increase on his own discretion without any condition from the lender, then there is no harm in taking that increase because that is considered good manners in repayment. Abu Rafi' reported that the prophet (*pbuh*) had lent a young female camel to the man as settlement of the *Qardh*. I said to him, "I could not find among the camels except a female camel which is ready for pregnancy". The prophet (*pbuh*) said, "Give it to him; indeed, the good person among you is he who settles *Qardh* with something better".³

² *Riba al-nasiyyah* refers to the additional fixed amount, which a debtor agrees to pay to his creditor in consideration of the time given to use the creditor's money.

³ Narrated by Muslim in his authentic *Hadith*.

Furthermore, loans in Islamic law can be classified into *Salaf* and *Qardh*, the former being a loan for a fixed time and the latter being a loan payable on demand by the creditor. *Qardh* is in fact, a particular kind of *Salaf*. Based on the general definition of the two terms, it can be said that unlike *Qardh*, *Salaf* is a loan that cannot be called back before it is due.

However, *Qardh* is not the same as another term in Islamic Finance known as *Dayn* (debt), as the latter is a broader concept. *Dayn* may arise differently; out of a contract such as the price of a sold item in a sale contract or the rental in a rent contract. *Dayn* may also arise when a person lends his money to others.

Whereas *Qardh* is more specific, in that it may only arise through a loan contract. In short, every *Qardh* is a *Dayn* but not vice versa.

In summary, Islam encourages helping others by way of giving financing (*Qardh*), as the lender is very likely to be wealthy and the borrower is poor. Islam commands that the creditor should demonstrate benevolence and charity and grant the debtor a *Qardhul Hasan*. In consequence, the stability in the economy and the gap between the poor and the rich can be reduced by helping others who are in need by giving *Qardhul Hasan*.

2.3 Definition of *Qardh*

In defining the term “*Qardh*” and “*Qardhul Hasan*”, there are several opinions from the scholars and from the various sources including books, and Internet sources, etc. These differences in opinions will be provided and discussed in this section, and, at the end, only one source of definition will be used for the entire paper.

The word *Qardh* in Arabic literally means "cutting off". When the moneylender lends to someone, he actually cuts off some of his money and gives it to the borrower. Meanwhile, the word *Hasan* in Arabic means splendid or beautiful. Thus, combining these two words together means a “beautiful loan”. In other words, in general, *Qardh* means to give money to someone that may benefit from it and pay back the same (the principal amount only).

Ayub further elaborated that:

Legally, *Qardh* means to give anything having value in the ownership of the other by way of virtue so that the latter may avail himself of the same for his benefit with the condition that the same or similar amount of that thing will be paid back... The repayment of *Qardh* is obligatory. (2007, pp. 492)

Iqbal and Abas (2007) define *Qardhul Hasan* as charitable loans with no interest, or a zero-interest bearing loan, with low expectations of return of capital. While Hossein et al. (2008) further extended the meaning by stating that “*Qardhul Hasan* is a loan extended without interest or any other compensation from the borrower. The lender expects a reward only from God”.

Hossein et al. then added:

... while the debtor is obligated to return the principal, the lender is urged, according to a number of sayings of the Prophet (*pbuh*), not to press the debtor if he or she is unable to repay at the specified deadline. (2008, pp. 199)

Abdul Rahman (2007) defines “*Qardh* as the transfer of an asset or money from the original owner to others on condition that the asset or money will be returned to the owner in the same condition/form/value as when it first received by the other party from the owner”. Furthermore, he added that “Borrowing or *Qardh* in Islam is a contract, which is based on the concept of mutual help (*tabarru'*) and contemplation for others' well being especially the people in need”.

According to AAOIFI (2008), “*Qardh* is the transfer of ownership in fungible wealth to a person on whom it is binding to return wealth similar to it”. The *Shari'ah* Standard No 19 of the AAOIFI (2008) further explained that the *Qardh*

contract is concluded through offer and acceptance by the use of the word *Qardh* and *Salaf* or any other word or act that conveys the same meaning as *Qardh*.

Although many definitions are given, in relation to this paper, the term *Qardh* is defined and used in accordance with the definition in the Annual Report 2008 of Calf (Malaysia) Berhad (“CALF”).⁴ It is believed that this is the most relevant source and can be considered as the comprehensive meaning:

“The *Qardh* is another gratuitous contract which is a benevolent loan. This could be referred to a financing given by a person (lender) to the borrower without any expectation of extra returns or also be referred to a non-interest bearing financing. The borrower is only obliged to pay the *Qardh* at its original amount to the lender within the agreed or stipulated period of time”. (2009, 107)

2.4 Development and Issues on *Qardhul Hasan*

As mentioned earlier, the use of *Qardhul Hasan* as a mode of financing is merely for the needs of helping the needy and, at the same time, achieving the corporate social responsibilities or the socio-objective of the institution.

⁴ The real name of the organization and its division are not disclosed for reasons of confidentiality. The actual names of the programmes have also been replaced with fictitious names.