

Islamic Credit Union: An Inclusive Financial Institution to Meet the Needs of the Community

Mamode Raffick Nabee Mohomed

AL BARAKAH Multi-purpose Cooperative Society Limited, Mauritius

Abstract

Islam is a practical way of life for humanity with its own systems in every aspect of life whether cultural, social, political or economic. In the economic sphere, Muslim societies around the globe have inherited mostly interest-based feudal, capitalist or socialist economic systems. As there is no working model, Muslim economists and scholars have made considerable efforts to develop their own Shari'ah-compliant economic model and financial institutions. Since 1960's, the Islamic finance industry has grown exponentially to surpass the USD 2.1 tln mark end 2014. The Islamic banking and Sukuk sectors dominate the Islamic finance industry (approximately 80% and 15% respectively) while Islamic microfinance has less than 1% market share. Islamic financial institutions are often criticized for operating or mimicking the capitalist mode for offering nothing more than a modified conventional loan. It is also questioned whether Islamic financial institutions have indeed contributed to achieve the objectives of Islamic economics alongside a healthy and growth-oriented economy where the necessities of life and spiritual peace are available to society at large. The purpose of this paper is to propose an inclusive financial institution model (Islamic Credit Union), based on cooperative and Islamic financial principles, which is a community-based institution. Such a model has so far received only sporadic attention in the market. The paper also presents the status of Islamic Credit Unions worldwide and discusses the legal and operational framework and opportunities of the Islamic Credit Union model.

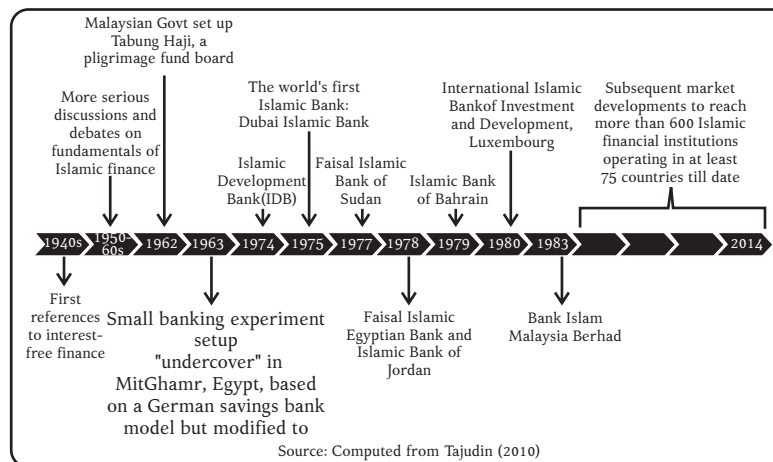
Key words: Islamic Credit Union, Inclusive Model, Financial Needs, Legal and Operational Framework

1. Introduction

1.1 The Islamic Finance Industry

It must be stated at the outset that Islamic finance is not just about financing and investment as conventional financing institutions, but, is an integral part of the belief of Islam. It has a philosophy based on the principles of Shari'ah and it has to evolve and operate within it.

Figure 1: Major developments in Islamic finance worldwide



Islamic banking and finance started in the early 1960's with the initiative of individuals comprising of Islamic

Corresponding Author: Mamode Raffick Nabee Mohomed, email: rafficknm@yahoo.com

economists, bankers and religious scholars whose main concern was to address the problem of Riba. The idea of establishing Islamic financial institutions emerged with the pioneering experiment of MitGhamr in Egypt in 1963 by Dr. Naggar. This experiment combined the idea of the German Savings banks with the principles of rural banking within the principals of Islamic framework.

During the past 40 years, Islamic financial institutions have been growing to a global industry and playing an important role in the modern financial world. Although the share of Islamic trade finance on total global trade finance is still negligible at about 1.5% (Al Qemzi, 2014), statistics evidence the positive growth of the market across all sectors. The growth and spread of Islamic finance has not been restricted to the Gulf Cooperation Council or Muslim-majority countries only. Non-Muslim countries such as Hong Kong, Luxembourg, UK and USA have shown growing interest towards this industry. Odd as it might seem, Singapore, the only non-Muslim majority country, ranks among the top 15 countries for Islamic finance (MAS, 2014). Today Islamic banking, finance and insurance have become a reality and its share in the global market is increasing day by day. According to Mughal (2015), Islamic banking is likely to represent a share of 86% of the industry's USD 2.5 tln market in 2015, followed by Sukuk (6%), Islamic funds (4%), Takaful (2%) and Islamic microfinance (1%). The number of Islamic financial institutions globally as at 2011 was estimated at least at 435 full-fledged institutions and 191 Islamic windows operating in over 48 countries (Sanusi, 2011). The global Islamic finance industry is growing on an average of 15-20% annually.

1.2 Islamic Financial Institutions

The purpose of Islamic financial institutions is to mobilize resources to promote development in a Shari'ah-compliant manner. Several types of business organizations have been formed such as Islamic banks, Islamic funds (Tabung Hajji), Islamic trusts, leasing companies and Islamic finance houses to allocate the resources of the community for productive use. But, it has been noticed that the current Islamic banks / Islamic financial institutions are moving in the same direction as conventional banks in some aspect. The industry is being dominated mainly by Islamic commercial banks and it has been observed that as their conventional counterparts, finance from them mostly tend to go to high-net worth individuals, corporate and institutional businesses. They are doing business on Islamic lines and they are making more and more profits to provide better returns to the shareholders. They have been serving mostly a high-net worth customer base and neglected areas like microfinance and the cooperative sector which have a social as well as an economic purpose based upon cooperation and solidarity between and among members of a community.

Going back to the evolution of Islamic banking, we find that Islamic banking and finance evolved through the cooperative sector. In fact, the cooperative movement acted as a stepping stone for the establishment and development of Islamic banks but it has been abandoned at a certain stage when the Islamic banking market evolved. The modern experiment of profit and risk-sharing business, which is the cornerstone of Islamic banking business, first undertaken in 1963 in MitGhamr, had as purpose the exploration and investigation of the possibilities of mobilizing local savings and credits as an essential requirement for socioeconomic development in the area. (El Naggar, 2006).

2. Concepts of Cooperatives

2.1 The Cooperative Movement

As a social creature, it is the natural urge of man to cooperate with each other. From the beginning of human society, cooperation has always been a vital factor in human and social development. Cooperation conveys the idea of helping each other and making joint efforts to achieve a common goal.

The Cooperative movement has a long history and emerged in the middle of the 19th century by the Rochdale Pioneers. On the 24th October 1844, in Rochdale, Lancashire, England, a group of people faced with economic exploitation and deprivation set up a cooperative store based on the principles of self-help and mutual help. They defined a set of principles which became the basis for the cooperative ideology which soon spread all over the world be it capitalist or socialist societies.

In 1852, Franz Hermann Schulze-Delitzsch set up a cooperative bank in Germany and Friedrich Wilhelm Raiffeisen developed the movement further (Moody and Fite, 1984). By the time of Raiffeisen's death in 1888, credit unions had spread to Italy, France, the Netherlands, Austria, and too many other nations.

The International Cooperative Alliance (ICA) defines a cooperative as: "*an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly*

owned and democratically controlled enterprise."

The cooperative form of organization is based on a set of principles which are:

1. Voluntary and open membership
2. Democratic member control
3. Member economic control
4. Autonomy and independence
5. Education, training and information
6. Co-operation among co-operatives
7. Concern for community

The main objective behind the establishment of cooperatives is the promotion of the economic, social and cultural welfare of its members according to cooperative principles. Cooperatives can be formed in any type of business activity and the most common are: consumer cooperatives, credit unions, producer cooperatives, marketing cooperatives, fishing, housing cooperatives and so on.

2.2 Credit Union / Financial Cooperatives

"A credit union is a particular form of cooperative bank. Specifically, a credit union is a not-for-profit cooperative financial institution that is owned and controlled by its members and operated for the purpose of promoting thrift, providing credit at reasonable rates, and providing other financial services to its members." (Al-Muharrami and Hardy, 2013)

A credit union is, thus, a financial cooperative that may accept savings, deposits, provide credit and other financial services to its members. The first credit union was formed in the 1850's in Germany by Franz Hermann Schulze-Delitzsch to give those lacking access to financial services the opportunity to borrow from savings pooled by themselves and their fellow members. Later he transported the financial cooperative concept to rural Germany. Credit unions are called by various names around the globe. In Africa, credit unions are known as SACCOS (Savings and Credit Cooperative Societies) which emphasizes on the spirit of savings before credit. In Afghanistan, they are called Islamic Investment and Finance Cooperatives (IIFCs), while in Indonesia, Islamic credit unions / Islamic financial cooperatives are known as Bait ulMaalwat Tamweel (BMTs). In Egypt, the Savings and Credit Association is known as the gam'iyah (El Gamal et al., 2011).

The credit union model has throughout history proved on countless occasions that it is a model that may be adapted to the special needs of different population groups, to different cultures, languages and religions, as well as to different legal, political, and economic systems.

According to the Muslim News (2013), the Archbishop of Canterbury, Justin Welby, is in favour of the Church of England setting up its own credit unions as an alternative to high-street and doorstep lenders. He criticized payday lenders such as Wonga on Radio 4's Today Programme and said that interest rates charged by credit unions (although likely to be in the range of 70-80%) would certainly be less harmful to those members of society who sometimes need to borrow in the short-term but for whom traditional lending from banks is not an option.

2.2.1 Credit Unions Worldwide

Credit unions which started in Germany expanded to Europe and were exported to North America early in the 20th century. Later the US government, in 1961, through the Foreign Assistance Act encouraged the idea of development and use of cooperatives and credit unions in developing countries. Credit unions have been in existence in many parts of the world and played an important role in the economic and social development in all of societies for instance capitalist, socialist or Muslim. Today we have 57000 credit unions present in 103 countries with 6 continents serving 208 million people (WOCCU, 2013). The World Council of Credit Union (WOCCU) has played an active role in the development and growth of credit unions globally although what is more distinctive is the setting up of credit unions in Afghanistan (WOCCU began building Afghanistan's first financial cooperatives in 2004).

Figure 2: The spread of Credit Unions Worldwide (Source: WOCCU Statistical Report 2013)



The European Association of Co-operative Banks (EACB) Annual Report 2012 reported 4,000 member cooperative banks and 72,000 branches in the member countries. In the 28 European member countries alone, cooperative banks had 56 million member-owners and served more than 217 million customers. (Al-Muharrami and Hardy, 2013)

Table 1: Credit Unions – Worldwide Membership Statistics

Year	Countries credit unions	with Credit Unions	Members
2013	103	56,904	207,935,920
2012	101	55,952	200,243,841
2011	100	51,013	196,498,738
2010	100	52,945	187,986,967
2009	97	49,330	183,916,050
2008	97	53,689	185,800,237
2007	96	49,134	177,383,728
2006	96	46,367	172,007,510
2005	92	42,705	157,103,072

Source: Statistical Report, World Council of Credit Unions, Inc.

Table 2: Credit Unions – Worldwide Financial Statistics

Savings Year (Million USD)	Loans (Million USD)	Reserves (Million USD)	Assets (Million USD)
2013 \$1,433,306	\$1,135,173	\$171,626	\$1,732,945
2012 \$1,293,256	\$1,083,818	\$161,810	\$1,693,949
2011 \$1,221,635	\$1,016,243	\$141,314	\$1,563,529
2010 \$1,229,389	\$960,089	\$131,659	\$1,459,605
2009 \$1,145,851	\$911,752	\$119,738	\$1,352,608
2008 \$995,741	\$847,058	\$115,316	\$1,193,811
2007 \$987,861	\$847,896	\$115,358	\$1,181,465
2006 \$904,120	\$758,208	\$106,825	\$1,092,135
2005 \$763,819	\$612,201	\$91,557	\$894,454

Source: Statistical Report, World Council of Credit Unions, Inc.

2.2.2 Membership / Ownership / Democratic

Credit unions admit people from all walks of life. Individuals may become members of the credit union if they meet the criteria for membership. Membership is based on a common bond shared by savers and borrowers (such as belonging to a specific community, organization, religion or place of employment). It is usually open to all irrespective of considerations of race, creed, class, occupation or political affiliation. Credit unions are owned and controlled by members and are democratic institutions. The principle of one man one vote applies where each member irrespective of the number of shares he holds in the credit union can cast a vote in elections compared to corporate principle of one share one vote. According to Ahmad and Ahmad, credit union clients range from the moderate poor to the vulnerable non-poor, although this depends upon the region and type of credit union.

2.2.3 Capital Formation and Financing

As financial intermediaries, credit unions mobilize their capital from shares, savings and deposits from their members and enjoy financial dignity. They are non profit maximization financial institutions and they charge reasonable rates of interest. The surplus is returned to shareholders in terms of dividend on shares, bonus on purchases, lower fees, reserves and better services.

2.3 Islamic Credit Unions / Islamic Financial Cooperatives

2.3.1 Cooperation is the cornerstone of the Islamic concept of life. Islam has enjoyed cooperation in good works and forbidden cooperation in evil deeds and sin.

"Cooperate with all in what is good and pious. But do not cooperate in what is sinful and wicked."(Al Maida 5:2)

Cooperation in the economic field has great importance and value in Islam. Islam stresses cooperation rather than conflict between those who are engaged in economic activities. Sincere cooperation between the employer and the employee will keep the production process move amiably.

Cooperative or partnership business ventures have been declared good and bountiful. Islamic finance principles highly advocate for profit-and-loss-sharing transactions.

2.3.2 The Credit Union Movement and Islamic Financial Institutions

The keen interest of credit unionists to the promotion of credit unions into Muslim communities dates back to

many years. Considerable efforts were made and dedicated on several fronts, be it on an individual or organizational basis, as evidenced by history.

During the period 1980-1982, Alhaji Saiyadi Ringim, Chairman of the Board of Directors of NASCUN (the Nigerian credit union federation) and also Chairman of the Board of Directors of ACCOSCA (the Panafrican credit union confederation) undertook a mission to Cairo, Egypt whereby he consulted Islamic scholars about the application of Islamic law to economics and finance and about the feasibility of credit unions in Muslim societies (Alhaji, 1982).

According to Professor Rodney Wilson:

"Formal Islamic banking first emerged in the early 1960's through credit unions of Muslim landowners in Egypt and Pakistan who simply pooled their resources and could then in turn draw out funds for agricultural improvements on a non-interest basis."

"The history of Islamic Financial system in Thailand started with the establishment of a cooperative society, Pattani Islamic Saving Cooperative that operates based on Shari'ah in 1987..... These Islamic cooperative societies have successfully established themselves as viable financial institutions in managing and mobilizing Muslims in this region." (Haron&Yamirudeng)

Interest-Free Financial Institutions (IFFI) of India are the forerunners in the history of the global Islamic movement. Adherence to Godly ordains that *"Trade is permitted but interest is forbidden"* has been found to be the major factor contributing to the evolution of institutional form of this ordain. Tracing the history of growth of IFFI in India, it is reported that such organized credit societies had shown their presence as early as the 1890's. According to the directory of Islamic banks in India, such efforts in the organized sector under the style of the Patni Cooperative Credit Society was established in 1942, almost immediately after the adoption of the Indian cooperative Act 1940 (Dr. Rahmatullah).

A recent study conducted by Bagsiraj (2003) shows that there are institutions that have grown to a size of 14 Islamic Cooperative Credit Society (ICCS) in India. It may be noted that these institutions primarily fulfill the casual social needs of the people on a very small scale. Islamic financial cooperatives / Islamic credit unions may be one of the Shari'ah compliant ways of organizing the financial resources of the community and at the same time democratizing the Islamic financial system and reducing the inequality gap to attain the objectives of the Islamic economic system.

In 2006, Imtiaz Ali, founder of Muslim Credit Union Co-operative Society Ltd, Trinidad & Tobago, submitted a concept paper on the 'Cooperatives Development Unit' to the Islamic Development Bank (IDB), Jeddah, Saudi Arabia as an initiative to the promotion of Islamic finance through the cooperative and credit union system. His paper was presented after IDB expressed interests to develop the cooperative system in the Muslim world and more importantly in Muslim communities. Ali's paper examined the concept, operations and scope of cooperatives particularly in Muslim-minority countries. He also examined the possibility of setting up a unit or department within the IDB to promote the development of cooperatives and identified some possible major objectives, functions and the positioning within the organizational structure of the IDB of such a unit.

2.3.3 Islamic Cooperatives and Islamic Credit Unions Worldwide

Generally, conventional cooperatives and credit unions are interest-based financial institutions. Over the past 30 years, Muslim communities in different parts of the world, particularly in Muslim-minority countries, have been making efforts to set up cooperatives and credit unions to meet the challenge of avoiding interest in their financial transactions. An Islamic credit union refers to retail financial services in compliance with Islamic financing principles.

According to Napoleoini and Segre (2009), the ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service. This is in line with Al-Muharrami and Hardy (2013) who strongly believed that an Islamic bank organized along cooperative and in particular credit union lines could be both beneficial and highly consistent with the principles of Islamic finance and would enhance mutuality in business dealings as emphasized by Shari'ah.

Today, Islamic credit unions are growing steadily. UK alone has 22 fully fledged Islamic Investment and Finance Cooperatives (IIFCs) (WOCCU, 2013). During the past 8 years, the World Council of Credit Unions

has built a network of 34 Islamic Investment and Finance Cooperatives across Afghanistan providing

BOX 1: WOCCU's Project for Islamic Credit Unions

WOCCU has undertaken a project to set up Islamic Investment and Finance Cooperatives (IIFCs) in Afghanistan. These IIFCs are the only credit unions within WOCCU system with Islamic financing features. WOCCU believes that the design and delivery of financial products and services is shaped by local customs, religious beliefs, and the economic environment. Successful financial sector development in a predominately Muslim country often requires the application of Islamic law and its guiding principles, as it has with WOCCU's financial cooperative development experience in Afghanistan.

Islamic financial cooperatives are very similar to non-Islamic cooperatives. They are locally owned and operated institutions, and the staff and boards of directors represent the membership and community. However, local elders and religious leaders are also consulted about the Shari'ah compliance of the products and services offered to members. WOCCU has developed a number of Shari'ah-compliant products for the IIFCs including al-wadiah safekeeping accounts; working capital loans (Murabahah) for the purchase of inputs on a mark-up basis, financial investment (mudarahah) on a passive partnership basis; financial lease (ijara) for equipment; and hybrid loans (ijarah paired with murabahah). Islamic cooperatives are also encouraged to reinvest some portion of their profits into community development initiatives. Zakat is giving back to the community. In Afghanistan, the Islamic cooperatives have helped rebuild schools and clinics, as well as provide scholarships for students.

The following table summarizes how these IIFCs are meant to combine Islamic and credit union principles:

Islamic Principles	Islamic Financial Cooperative Principles
Prohibition of interest-based transactions.	Emphasize a member's investment by offering an opportunity to purchase shares. Loans are made as financial contracts between borrowers and the cooperative.
Profit and loss sharing.	Establish member-ownership through the purchase of share savings. Share profits among members as dividends
Transactions must be backed by assets rather than financial speculation. Financial contracts must detail the specific product/service being bought or sold.	Provide loans by purchasing a physical asset and either (i) leasing it to the member (ijarah), or (ii) transferring ownership to the member who pays a mark-up (murabahah).
Prohibition of financing activities considered harmful to society.	Lend only to Shari'ah-compliant businesses.

Murabaha, Ijara and a Murabaha-Ijara hybrid product to some 92,456 member-owned cooperatives. The Box below is an excerpt from the IMF Working Paper (WP/13/184) and details WOCCU's efforts in establishing Islamic credit unions in Afghanistan.
Source: Al-Muharrami and Hardy, 2013

2.3.4 Islamic Cooperatives / Islamic Credit Unions in Muslim-majority & Muslim-minority Countries

Credit Union	Country	Year	Main Products / Remarks
Koperasi Muslimin Malaysia Berhad	Malaysia	1980	BaiBithamanAajil; Muslim Welfare Scheme (Al-Abrar); Qard Hassan
Ansar and Islamic Co- operative Housing Corporation Ltd. (ACHC)	Canada	1981	Interest-free home ownership and investment opportunities
Muslim Credit Union Co-operative Society Limited	Trinidad & Tobago	1983	NA
Pattani Islamic Saving Cooperative	Thailand	1987	NA
Muslim Community Cooperative Limited	Australia	1989	Facilitated over \$750 million in Islamic home finance and manages close to \$30 million in investments.
Qurtuba Housing Co-op	Quebec,	1991	Musharaka house financing
Canada			
Loans and Savings Abertawe (LASA) Credit Union Ltd	Swansea, Great Britain	1992	Conventional credit union offering Shari'ah compliant savings and finance products to its members (Hajj Fund, Marriage Fund; Funeral Fund, Murabaha and Wakala)
Ameen Housing Co-operative of California, Inc. (AHC)	California	1996	Investments and home financing
Islamic Co-operative Finance Limited	Australia	1998	Housing and vehicle finance; Hajj fund; QardHasan (Benevolent) fund; Children Education fund; small business finance; finance for other household goods
Al Barakah Multi-purpose Co-operative Society Limited	Mauritius	1998	Murabahah; Istisna; QardHasan; Hajj Savings Account; Cooperative Solidarity Fund/Takaful

The table lists down some Islamic Cooperatives / Islamic Credit Unions operating around the globe:

Takaful T&T Friendly Society	Trinidad & Tobago	1999	Funeral Benefit; Hajj Fund; Investment Fund; Waqf (Cash Waqf, Real Estate Waqf); Property Ownership
FML Multi-Purpose Co-operative Society	Fiji Islands	2004	NA
Balkh Savings and Credit Union	Mazar-e-Sharif, Afghanistan	2004	NA
Jawsjan Savings and Credit Union	Sheberghan, Afghanistan	2004	NA
Manzil Co-operative	Trinidad & Tobago	2006	NA
Al Islamiyah Saving Cooperative	Thailand	NA	NA
Amwal Credit Union	Hong Kong	2009	Ijarah; Murabaha; Istisna'a; Musharakah; Wakalah; and a variety of accounts and wealth management services
Janseva Cooperative Credit Society Limited	India	2010	Various types of Demand and Term Deposits Accounts; Murabaha; Mudaraba; Musharaka; Ijarah and many others
Assiniboine Credit Union (ACU)	Winnipeg, Canada	2010	First bank to offer Islamic mortgage services exclusively at one of ACU's branches
Islamic Credit Union of Canada (ICUC)	Canada	NA	http://www.icucan.ca/home

Table 3: Islamic Cooperatives and Islamic Credit Unions around the world
Source: Computed

Islamic financial cooperatives / Islamic credit unions are growing in pluralistic nations where Muslims are a minority and also making some inroads into Muslim societies.

3. Islamic Credit Unions (ICU)

3.1 Conceptual Framework

The purpose of forming an Islamic credit union is to provide an alternative and assist Muslims who wish to organize and run their financial institution according to the financial principles of Islam and share the benefits of this model with the community. In general, Muslims need financial services just as anyone else; as they need to keep their savings, need credit for housing, consumer goods, medical care, business, education, etc., but they want to obtain them from a financial institution which is according to their faith. But we have been witnessing that most Islamic financial institutions in the form of banks, funds, finance houses, investment companies, etc. are caring for the high net worth clientele and that most economic development have been

focusing on grandiose infrastructure and projects. It seems that Islamic financial institutions are being set up by the rich and caring for the rich only. In that context it is important to set up Islamic credit unions which will be community-based organisations (CBO) and operate in the best interests of the community to meet the financial needs and socio-economic development of the community and share the wealth created by them. In general, the Islamic credit union will enable Muslims to carry on productive economic activities within the framework of Shari'ah.

3.2 Legal Framework

Islamic credit unions through the cooperative sector can be set up and run according to both Islamic and cooperative principles. Muslims in general lack information about cooperatives, how they are organized, managed and operated according to Shari'ah. The Islamic credit union model can be adapted to suit the customs, social and economic laws of Muslims in general and operated according to Shari'ah.

It can be registered under the Cooperatives Act or in certain jurisdictions, under the Credit Union Act. In many parts of the world, cooperatives exist and the Cooperative Act makes provision for the registration of Credit Unions, Savings of thrift, Cooperative Credit Societies. Necessary amendments can be made to make provision for the registration and licensing of Islamic credit unions to boost their development and growth in a Shari'ah-compliant manner.

3.3 Formation & Organization

The formation of the Islamic credit union can start with the initial contribution of a group of founder members who are conscientious and committed people to provide an alternative to the interest-based institution. This Islamic credit union will be for the general welfare of the community whether rich or poor. Within the concept of Islamic brotherhood (Akhouwat), the right attitude and behavior towards other members, mutual help, sacrifice and cooperation will have to be instilled to fulfill the needs of all the members.

3.3.1 Board: Democratic Structure / Management

The Islamic credit union will be run by a board of directors elected at the Annual General Meeting who will be the policy makers of the institution. The concept of Shura/consultation can be applied. Members/shareholders having potential knowledge and commitment can form part of various sub-committees to serve the institution (Marketing Committee, Credit Committee, Education Committee, Shari'ah Supervisory & Advisory Committee, Delinquency Committee, Arbitration Committee). The assistance of Scholars/Ulama can be sought to form the Shari'ah Advisory Committee. It was found by a planned Islamic credit union in Washington State that it is essential to employ some religious advisor or even a local leader, who has credibility among the target population to provide guidance on structuring product and contribute to the success of the Islamic credit union (Williams, 2010).

The Islamic credit union will not only provide access to financial services but can also instill shuratic principles, practices and values in managing the organization. As a member-owned institution, the Islamic credit union can educate members on Islamic values that allow them to embrace shuratic principles and teach them about voting in fair elections and to exercise their vote to ensure accountable management and leadership. Each member/shareholder is an equal owner, regardless of how much shares/money he has in the Islamic credit union and is entitled to one vote. Shareholders/customers, directors and all stakeholders are accountable to Allah (PBTH) in managing the affairs of the institution.

3.3.2 Shareholdings / Membership / Returns

Islamic credit unions are associations of persons and thus membership/shareholding is open to people from all walks of life. The philosophy of the Islamic credit union is that they are financial institutions established by the people, for the people and will benefit them. The Islamic credit union will be a member-owned society where the spirit of ownership and sense of belonging to an Islamic financial institution will be present. In general, cooperatives are built on a common bond. The Islamic credit union can be built on the common bond of Islamic brotherhood (Akhouwat). However provision can be made for admitting non-Muslims, particularly in multi-ethnic and Muslim-minority societies. Non-Muslims will have to abide by the rules and principles of the Islamic credit unions.

The Islamic credit unions will enjoy financial dignity by mobilizing capital from shares, savings and deposits from its own members. As they are not-for-profit-maximization, they will charge a reasonable profit on financing products like Murabahah, Ijarah and Istisnah, and on products like Mudarabah and Musharakah, a

fairer ratio will be distributed between the Islamic credit unions and the member/Mudarib. The surplus created by the Islamic credit unions will be returned to members/shareholders in terms of dividend on shares, bonus on purchases, lower fees, reserves, better services and benefits.

3.3.3 Organs of Control & Audit for Good Governance

The Islamic credit unions shall appoint a Shari'ah Supervisory Committee and an internal controller who shall ensure that the affairs of the institution are conducted in accordance with Shari'ah. It shall also appoint its External Auditor in compliance with the provisions of the Law of the country to audit the financial statements of the institution.

3.4 Marketing

Muslims often inquire about the Islamic credit unions before joining them and the majority of potential customers are in ignorance of Islamic financial products. At the outset itself, proper marketing strategies have to be devised and implemented for the successful promotion of Islamic credit unions. People have to be made aware that an Islamic credit union is not a charitable institution or a benevolent society but a business organization operating on Islamic lines. It has to provide excellent services, overcome competition and remain profitable. Members can play an active role in marketing the institution at places of work, friends and relatives, mosques and educational institutions.

3.5 Education, Training and Location

The Islamic credit union will have an Islamic Finance Education Program (IFEP) for existing and potentially new members to generate personal and social Islamic consciousness and financial literacy to implement Islamic finance. The program can cover a wide scope of topics and aspects such as Conceptual Framework of Islamic Finance, Basic Islamic Financial Laws, Quranic Verses concerning the economic system of Islam, Behavioral Changes, Ethics - honesty, trust, discipline, cooperation, and operation of the Islamic credit union. Members will be educated and trained to take these activities as part of belief and worship. Weekly/Fortnightly education sessions can be organized where members and their beneficiaries/dependents/sureties will be required to attend. Such events and group sessions will make members/clients feel more at ease, procure them with peace of mind, a sense of Islamic brotherhood and a sense of belonging to the Islamic credit union. All of this together will make members more conscious and responsible when dealing with the institution and prompt them to fulfill their obligations in a timely and responsible way, contributing to lower the probability of default.

Mosques, Islamic educational institutions, and centres can be used for these activities. These sessions can also be used as opportunities to conduct financial transactions and other businesses of the Islamic credit union at the same time e.g. application for membership, financing, collection of installments, announcements. Members must be made aware that these programs are important when joining the Islamic credit union and obtaining its services.

A group dedicated to the cause of Islamic finance with a good educational background can be trained to be directors and how to manage the Islamic credit union. Workshops, seminars, conferences and exchange visits can be organized to complement the Islamic financial teachings. The IFEP will help existing and potential members have a better understanding of the practical Islamic way of life after joining the Islamic credit union. The principle of cooperative education can be used by Islamic credit unions to create awareness, popularize and propagate the concepts of Islamic finance.

4. Financing Instruments of Islamic Credit Unions

Conventional banks/credit unions use lending on interest as their major financing tool to suit the requirements of various clients. Islamic banks / Islamic financial institutions cannot use lending on interest as a financing device and they have to find out other modes of financing which conform to the Shari'ah. Some of the financing techniques that can be used by the Islamic credit unions are as follows: Murabahah, Ijarah, Istisnah, Salam, Mudarabah, Musharakah, MusharakahMutanaqisa and Qard-ul-Hasanah.

The Islamic credit union will mobilize funds from its members/shareholders and supply these funds to them using the various financial instruments compatible with Shari'ah. The types of financing structure used will depend on the type of activity or need for which the member/client is seeking finance.

4.1. Murabahah (Mark-up financing)

Murabahah is the most popular and widely used Islamic financing technique. It is estimated that a major part (80 – 90%) of the financing of Islamic banks / Islamic financial institutions belong to this category. Murabahah/Bay'al-Murabahah is the equivalent to cost-plus financing. In a Murabahah agreement, the Islamic credit unions will purchase the commodity requested by the member/client and sells it to him with a profit margin. The goods are delivered immediately and payment is deferred to a date agreed upon by the Islamic credit unions and the member/client. In this way, the member/client can get the commodity and pay for it at a later date as agreed in the contract of Murabahah. Murabahah has to go through the mechanics of the contract to be Shari'ah-compliant.

4.2. Ijarah (Leasing)

Ijarah or Islamic leasing is another method of financing that can be applied by Islamic credit unions. It is a contract between two parties, the lessor (Ajir/ Mujir) and the lessee (Mustajir) whereby the lessee acquires the possession and the benefits of using an asset for a known time period from the lessor/owner of the asset against payment of predetermined rentals at frequent intervals. Ijarah will ensure an income to the Islamic credit union. Ijarah can offer an advantage over other Islamic financial techniques as there is the potential of tax savings in certain jurisdictions since no sale which is being made.

4.3. Istisnah (Construction finance)

Istisnah is a contract to manufacture goods at the behest of the buyer and of the specifications determined by him, at an agreed delivery date and at an agreed price with the seller. It is a contract where a party orders a manufacturer to manufacture a specific commodity for the buyer. It is necessary for the validity of the contract that the price is fixed; delivery date and payment date are all settled between the parties in the contract.

Istisnah can be used in the Islamic credit unions for providing finance in certain transactions (e.g. home financing, warehouses, traders' financing) to members. It will be used by the Islamic credit unions which will consist of two separate Istisnah contracts (Parallel Istisnah). The first contract will be between the member/client and the Islamic credit union in which the price payable by the member/client in agreed installments is specified and the Islamic credit union undertakes to deliver the requested commodity at an agreed date. The second contract will be between the Islamic credit union and the contractor/manufacturer to manufacture the product according to specifications provided by the member/client in the first agreement.

4.4. Salam (Forward purchase of a commodity)

A Salam contract is an agreement to purchase at a predetermined price a specified kind of commodity not available with the seller, which is to be delivered on a specified future date in specified quantity and quality. The Islamic credit union, as the buyer, makes full payment of the purchase price upon execution of a Salam contract and the client takes delivery of the commodity in future. This mode of financing is used in agricultural financing.

4.5. Mudarabah (Passive Partnership)

Mudarabah is a contract of partnership involving two parties where one party provides the funds (known as rabb-ul-maal) and another party deals with management of the investment (known as Mudarib).

The Islamic credit union can finance members through Mudarabah. Several economists and theorists of Islamic banking and finance have opined Mudarabah to be an ideal mode of financing. Mudarabah represents a combination of financial means and human resources according to Shari'ah. Mudarabah is also known as Muqarada or Qirad. Profits are shared between the two parties in accordance with the ratio agreed upon at the time of the contract. The financial loss is to be borne by the capital provider.

The Islamic credit union will act as the Rabb-ul-Maal and the member/client as the Mudarib and finance projects of the member/client. It will provide opportunities for new entrepreneurs because of possibilities of risk sharing.

4.6. Musharakah (Joint venture)

Musharakah (partnership) is another technique of financing in Islamic finance. In Musharakah, two or more financiers provide financing for a project. It refers to commingling of funds for the purpose of sharing in

profits. All partners are entitled to share in the profits of the project according to a ratio which is mutually agreed upon. Losses are to be shared in proportion to capital contribution. All partners have a right to participate in the management of the project. The Islamic credit union can enter into partnership with members and finance their projects. Musharakah financing looks promising towards small scale and development projects. Individual members of the Islamic credit union with their expertise in certain areas can benefit from the capital and expertise of the Islamic credit union and in the long run, gain efficiency.

4.7. Musharakah Mutanaqisa (Diminishing Musharakah)

Diminishing Musharakah, recently developed, is a contract between a financier and a beneficiary/customer in which the two parties agree to enter into a partnership to own an asset. The difference between Musharakah and Diminishing Musharakah is that in the latter, there is a condition in the initial contract that states that the customer will purchase from the bank/financier the bank's share at agreed intervals until he becomes the sole owner of the assets.

Diminishing Musharakah looks promising towards small scale & development projects of members of the Islamic credit union. It allows equity participation and share of profits on a pro-rata basis. Islamic credit unions can assist entrepreneurs into finding profitable avenues to expand their business.

4.8. Qard-ul-Hasanah (Interest-free loan)

The Qard-ul-Hasanah is a type of loan provided free of interest charges. The Qur'an exhorts Muslims to provide interest-free loans to the needy and promises manifold returns from Allah. Islamic credit unions can give interest-free loans to members for educational and medical purposes to ease hardships arising from unemployment and accidents.

The Islamic credit union can accept contributions from benefactors who wish to grant Qard-ul-Hasanah through the Islamic credit union for specific purposes as they want to get reward from Allah. Islamic credit unions can also allocate a certain percentage of the shareholdings for Qard-ul-Hasanah. The funds can be deposited in the Qard-ul-Hasanah Fund (QUHF). As administering the Qard-ul-Hasanah Fund involves some costs to the Islamic credit union, a service charge can be claimed from the borrower to defray such costs.

5. Reserves and Other Funds

5.1 Statutory Reserve

In many jurisdictions, cooperative societies are required by law to maintain a Reserve Fund into which shall be paid a certain percentage of its surplus as may be provided in its rules or may be approved by the general assembly. In that context, the Islamic credit unions can maintain this fund and it can be utilize it in its business.

5.2 Dividend Equalization Fund

The Islamic credit union can also create a Dividend Equalization Fund that can serve as a buffer between a certain dividend level and profits available. Sums are transferred to this reserve account in good years, and withdrawn from in poor years to maintain the dividend amount.

5.3 Profit Equalization Reserve

The Islamic credit union can maintain a Profit Equalization Reserve where savers and depositors who are shareholders will authorize the Islamic credit union to deduct from the net income a Profit Equalization Reserve contribution for payment into the PER. The PER contributions will be made by all on a combined mutual basis in support of improving distributable profits. The maximum percentage to be deducted will be limited to a certain percentage of the net income. The Islamic credit union will exercise reasonable discretion as to when the PER may be used to improve the distributable profits. It can follow the guidance of its Shari'ah advisors.

5.4 Takaful Ta'awuni Fund

Takaful Ta'awuni is a system of mutual cooperation for financial assistance and protection based upon the Quranic principle of Ta'awun or mutual assistance. Takaful means mutual help among the group, that is, each member of the group pools resources and efforts to support the needy within the group.

The Islamic credit union can set up a micro Takaful Ta'awuni Fund. As an Islamically acceptable alternative to conventional insurance, the Takaful Ta'awuni Fund will enable every participant to have solid financial protection and savings for himself and his family. The objective of setting up the Takaful Ta'awuni Fund will be

to provide credit cover to debtors who have been financed by the Islamic credit union. It will be able to recover its financial obligations which can befall on the debtor to whom financing was granted by settling off the debt balance due in case of the debtor's death or disability while indebted to the institution. At the same time, it will ease the financial burden of the sureties and dependents of the victim. This micro Takaful Ta'awuni Fund will diffuse a spirit of benevolence and solidarity among the shareholders.

The Prophet Muhammad (PBUH) said: *"The Believers, in their affection, mercy and sympathy towards each other, are like the body, if one of its organs suffers and complains, the entire body responds with insomnia and fever."* (Muslim)

He (PBUH) also said: *"Whoever removes a worldly hardship from a believer, Allah (PBTH) will remove from him one of the hardships of the day of Judgment."* (Muslim)

5.5 Zakah Fund

Zakah is a tool which can play a central role in poverty alleviation. The Islamic credit union can maintain a Zakah Fund where shareholders can deposit their zakah. It can also collect zakah from the Muslim community at large. With this Zakah Fund the Islamic credit union can have an Islamic Micro Finance Programme for the lowest strata of the Muslim Community and for those who deserve it according to the injunctions of the Quran. This Zakah Fund will also act as an instrument of distribution of wealth. The beneficiaries will have to be educated, trained and assisted in productive work and micro projects so that over the medium and long-term, they can become self-dependant. Once they attain the level of Sahib-un-nisaab (owner of wealth above the level of nisaab), they can join the Islamic credit union as shareholders and enjoy all the financial benefits and services of the Islamic credit union. Finally they will turn into zakah payers instead of beneficiaries.

6. Challenges

There are various challenges that have to be addressed for the smooth development and expansion of Islamic credit unions.

6.1 Challenges at Various Levels

6.1.1 Individual Level

At an individual level, if the aims and objectives of Islamic economics and finance are to be achieved, there should be a change in the mindset of people. Individuals, whether on a personal or professional basis, should be able to perceive and appraise Islamic finance from an Islamic perspective rather than looking from conventional binoculars.

6.1.2 Organizational Level

Islamic credit unions must enhance and double their efforts towards marketing and informative advertising campaigns. In addition, Islamic organizations such as education institutions, charitable organizations, welfare associations and others can play a key role in society towards the promotion of Islamic credit unions by either setting up Islamic credit union on their own or they can be fervent supporters of such institutions. It would be in the best interests of the Islamic financial system to secure greater cooperation among Islamic financial institutions.

6.1.3 Community Level

There should be mass education and awareness programmes from the grass-root level to enlighten and educate the community on the concepts, goals and principles of Islamic finance. People have to learn to live a modest and balanced material and spiritual lifestyle to attain success (falah). Islamic organizations and mosques could be a gateway to propagation of principles of Islamic finance and expansion of Islamic credit unions among Muslims. Scholars have the ability to influence their audience to join Islamic credit unions. Overall, the whole community will benefit if they take the initiative to bring about the desired change as Allah says:

"...Indeed, Allah will not change the condition of a people until they change what is in themselves..." (Ar-Ra`d 13:11)

6.1.4 Government Level

The challenges at this level would be to create a level-playing field for Islamic credit unions in terms of legal

framework and policy-making. In many countries, credit unions are governed by the Credit Union Act although the global trend is moving towards the regulation and supervision of credit unions by the Central Bank. For instance, in Trinidad and Tobago, the Central Bank is the prudential regulator for credit unions while credit unions in the Republic of Ireland are regulated by the Central Bank of Ireland.

Similarly, in December 2005, the Credit Unions Act was amended to bring credit unions under the regulatory umbrella of the Central Bank of Belize. The same policy can be applied for the regulation and supervision of Islamic credit unions.

6.1.5 International Bodies

Due to the prevalence of Islamic credit unions globally, there is a need for international bodies such as AAOIFI, ISRA, IFSB and IDB to at least establish a special unit or department for the development of this sector. WOCCU, the leading international trade association and development agency for credit unions and cooperative financial institutions, has already taken the lead in this perspective by first establishing Islamic investment and finance cooperatives in Afghanistan (2004–2012) and afterwards, becoming the first to publish the Islamic Finance Manual (a first known guide for establishing Shari'ah-compliant credit unions in the developing world). Now, WOCCU is shifting its attention to Libya.

6.2 Economic Potential

Islamic credit unions can play an important role in society by mobilizing funds from all classes of the community and offering financial services to those who lack access to financial services, thereby enabling the lower strata of society to climb up the ladder and realize their full economic potential.

6.3 Human Resource

There is currently a dearth of human resource in this sector and investment in human resources capacity is very important. Skilled labor with specialized knowledge in credit unions and cooperatives and Islamic finance would definitely be a plus for the development of Islamic credit unions. In the short term, tertiary and accredited institutions can provide specialized trainings and courses to meet pressing market needs while proper education programs and syllabuses can be devised at tertiary level on a later stage for long term market needs.

7. Conclusion

The Islamic credit union is in line with both cooperative and Islamic principles. It can easily play an effective role in the life of the community by providing access to financial services. It will enable people from all strata of the community to join the institution, empower them, and strengthen their abilities to make investments. It will provide the community with opportunities to manage the wealth of the community in a Shari'ah compliant manner and promote economic freedom. Setting up Islamic credit unions, will assist to build up a robust community-based financial institution, spread ownership of business and reduce concentration of wealth. Members/shareholders can be empowered with a sense of Islamic spirit so that their standard of living can be improved (hayyattayyiba) as a result of combining self-reliance together with collective action and participation at community level. It will strengthen their Islamic identity along with promotion of economic and social development. Simultaneously, greater risk sharing across the community (the members/owners) especially with the involvement in savings products that participate in the upside and downside risk to which the institution is exposed to strengthens incentives for its good governance and therefore makes it more resilient.

The members should also be enlightened that they are not to be interested only with the economic benefits of the institution but also with the spiritual and conceptual part and prepared also to face challenges, inconveniences or difficulties that will be avoidable at the infant stage of the institution. Finally, the Islamic credit union can embark everyone as a stakeholder in the project. It will be the job of everybody – the layman & the scholar, the rich and the poor, the business community to forge ahead with an Islamic vision of finance in practice, and to bear witness to it through active participation and spreading it to other communities for the good of the society as a whole.

References

- Ahmad, Abu Umar Faruq & Ahmad, A. B. Rafique. Islamic Microfinance: A Case Study of Australia. Journal of Islamic Economics, Banking and Finance. Available from: <http://imfn.org/images/report02.pdf>.
- Alhaji, Saiyadiringim. "The Report of My Journey to Cairo in Connection with the Investigation of the 'Interest' Charged on Loans Which the Moslems Called 'Riba'". World Council of Credit Unions, 1982.
- Ali, Imtiaz, 2006. The Concept of a Shari'ah-Compliant Co-operatives Development Unit. Submitted to Islamic Development Bank.
- Al-Muharrami, Saeed & Hardy, Daniel C., 2013. *Cooperative and Islamic Banks: What can they Learn from Each Other?* IMF Working Paper Monetary and Capital Markets (WP/13/184). Available from: <https://www.imf.org/external/pubs/ft/wp/2013/wp13184.pdf>.
- Al Qemzi, Hussain, 2014. *Opening session on Wednesday October 29 2014, 10th World Islamic Economic Forum, Dubai*: WIEF Foundation and the Dubai Chamber of Commerce & Industry.
- Bagsiraj, M.G.I., 2003. Islamic Financial Institutions of India, Jeddah, Scientific Publication Center, King Abdulaziz University.
- El Gamal, M, El-Komi, M, Karlan, D, & Osman, A, 2011. Bank-Insured RoSCA for Microfinance: Experimental Evidence in Poor Egyptian Villages.
- El Naggat, Ahmed A., 2006. "Islamic bank in Egypt: A model and the challenge." In AtaulHuqPramanik (ed). Islamic Banking: How Far Have We Gone? Kuala Lumpur: International Islamic University Malaysia, 2006; 247-259.
- Haron, Sudin & Yamirudeng, KuMajdi. Islamic Banking in Thailand: Prospects and Challenges. International Journal of Islamic Financial Services Vol. 5 No.2. Available from: <http://www.nzibo.com/IB2/IFThailand.pdf>. Islamic Finance Journal
- International Cooperative Alliance (ICA), 2014. <http://ica.coop/>.
- Moody, J. Carroll & Fite, Gilbert C., 1984. The Credit Union Movement: Origins and Development 1850 to 1980, Kendall/Hunt Publishing Co., Dubuque, Iowa.
- Monetary Authority of Singapore (MAS), 2014. *Islamic Finance – Continued Growth*. Welcome Remarks by Mr. Ravi Menon, Managing Director, Monetary Authority of Singapore, at the 5th World Islamic Banking Conference Asia Summit, 3 Jun 2014. Available from: <http://www.mas.gov.sg/News-and-Publications/Speeches-and-Monetary-Policy-Statements/Speeches/2014/Islamic-Finance-Continued-Growth.aspx>.
- Mughal, Zubair, 2015. *Rise of Islamic finance and banking 'to reach new heights in 2015'*. Out-Law.com. Available from: <http://www.out-law.com/en/articles/2015/january/rise-of-islamic-finance-and-banking-to-reach-new-heights-in-2015/>.
- Muslim News, 2013. *Muslims should start credit unions*. Available from: <http://www.muslimnews.co.uk/newspaper/comment/muslims-should-start-credit-unions/>.
- Napoleoini & Segre, 2009. Vatican's official newspaper *L'Osservatore Romano*, March 3, 2009. Available from: <http://rassegnastampa.mef.gov.it/mefnazionale/PDF/2009/2009-03-04/2009030412006886.pdf>. Taken from: IMF Working Paper (WP/13/184).
- Rahmatullah. IFFI's of India in Crisis. Available from: <http://www.janseva.in/articles/IFFIs%20of%20India%20in%20Crisis.pdf>
- Sanusi, Lamido Sanusi, 2011. "Islamic Finance in Nigeria: Issues and Challenges," lecture delivered by the Governor, Central Bank of Nigeria, at Markfield Institute of Higher Education (MIHE), Leicester, UK, 17 June 2011.
- Tajudin, Azrul Azwar Ahmad, 2010. *Overview of Islamic Finance: Islamic Finance Course - Structure & Instruments*. Bank Negara, Malaysia and Islamic Development Bank.
- Williams, Todd, 2010. Islamic Legal Authority in a Non-Muslim Society: The Islamic Credit Union of Bellevue, Washington 15-25 (August 16, 2010). Available at: <http://ssrn.com/abstract=1660210>.
- Wilson, Rodney. *The Evolution of Islamic Banking and Emerging Trends in Islamic Finance*. 135 Mamode Raffick Nabee Mohomed
- WOCCU, 2014. 2013 Statistical Report.
- WOCCU (World Council of Credit Unions), 2015. <http://www.woccu.org/>.
- The Holy Qur'an and Hadith