

The Application of Service Ijarah in Islamic Finance

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Abstract

This research aims to explore the current application of Service Ijarah in Islamic Finance across three major sectors of Islamic commercial finance: Islamic banking, Islamic Insurance, and Islamic capital market. Furthermore, this study identifies potential challenges and risks associated with the use of Service Ijarah by comparing it with alternative Shariah contracts. This research employs a qualitative desk review research method to delineate the practical application of the Service Ijarah. The data was primarily collected from the official websites, product disclosure sheets, and annual reports of Islamic finance and banking institutions in different jurisdictions. Additionally, other secondary sources were used, including Shariah Standards, policy documents, journal articles, and other forms of reports. At least 15 Islamic banks globally have used the contract for financing services such as education, marriage, travel, home renovation, green technology, professional services, and Hajj & Umrah in countries including Oman, UAE, Malaysia, Maldives, Bangladesh, Bahrain, Tanzania, and Nigeria. The contract has yet to be practically applied within the Islamic capital market and Islamic insurance (Takaful). However, there is potential for the structuring of service-based Ijarah Sukuk and the development of Takaful products to cover service-ijarah-based financings. The absence of guidelines on Service Ijarah and the difficulty of finding reliable service providers for custom jobs may present challenges for the banks. This research is expected to be beneficial for industry practitioners seeking to explore a contract that remains relatively underutilised in the Islamic finance field and Shariah and regulatory authorities. It also examines the potential for service-based Ijarah Sukuk and AAOIFI's role in facilitating the development of Service Ijarah-based products.

Keywords: Ijarah Al Ashkhas; Service Ijarah; Islamic Finance; Islamic banking; Islamic Capital Market; Islamic Insurance

1. Introduction

It has been observed that contemporary Islamic financial transactions frequently utilise the Murabahah contract in the issuance of financing for goods and assets (Demirguc-Kunt et al., 2013; Hussain et al., 2015; Sadique, 2018). It is, therefore, incumbent upon Islamic banks to extend their services to accommodate evolving customer demands, enabling individuals to obtain financing for a variety of services, including home renovation, education, marriage and other work-based services (Yasser and Kalim, 2021). The verse in Surah Al-Baqarah (275) is a well-known Islamic finance principle. It states that real trade is the basis of Islamic finance and that any service financing structure must ensure the rendering of their services in accordance with Islamic teachings. This contrasts with the conventional counterpart, which offers liquid cash financing for services, as the verse states, "*Allāh has permitted trade and has forbidden interest.*" The Service Ijarah is a sale of a service or labour upon a pre-agreed work, similar to the sale of usufruct of a particular asset. Service Ijarah functions uniquely when it is used to finance the transfer of the full ownership of the asset as a service to the customer, and the subject matter is limited only to the service. As the service in question is intangible, Islamic banks are able to provide their clients with financial solutions which are tailored precisely to meet their specific needs, using a classical approach based on the principles of Muamalat in Islamic Shariah.

Ijarah is broadly divided into two categories which include the sale of the usufruct of tangible assets or Ijarah Al-'Ayn and the use of the Ijarah contract to provide services which is known as Service Ijarah or Ijarah al-Ashkhas. However, the application of Service Ijarah is not widely used (Yasser and Kalim, 2021) due to the lack of proper guidelines and standards that distinguish the two contracts in practice.

One of the advantages of Ijarah for a lessee is that the lessee does not have to bear the depreciating cost of the equipment under normal accounting principles. This allows the lessee to conserve capital and channel it into other income-generating ventures. Service Ijarah transactions refer to hiring professional services (AAOIFI, 2018), and in some cases they include a combination of goods and services, for example: broadband services and medical treatment.

It is therefore evident that the application of trade on services, i.e. Ijarah Al Ashkhas, should be subjected to a broader examination, taking into account the relevant Shariah perimeters and the practical implementation on the ground. The objective of this paper is thus to explore the current application of the Service Ijarah in a number of areas of Islamic finance, including Islamic banking, insurance, and capital markets, with a view to identifying the potential challenges and risks involved. Furthermore, this research compares and contrasts the different Shariah contracts utilized in Islamic finance products, with an aim to enhance the comprehension of the subject matter.

2. Literature Review

The literature review is divided into four major sections where the first section will provide a comprehensive overview of the concept of Ijarah by looking into the definitions provided for the contract in different legal, regulatory, academic and Shariah Standards, it then elaborates on the permissibility of Service Ijarah contract with reference to the historic usage followed by applicable Shariah Standards and Regulations Applicable to Service Ijarah contract and comparison with alternative banking contracts. Lastly, recent advancements and challenges in Service Ijarah are discussed, drawing insights from academic literature to underscore the need for further research and development in this area.

2.1. An Introduction to the Concept of Service Ijarah

AAOIFI (2018: 9) defines Ijarah as “*Service Ijarah transactions includes employment / labor contracts and hiring of professional services and other services-based contracts (not involving tangible assets)*” whereas Ijarah Muntahia Bittamleek is defined as “*a hybrid Ijarah arrangement which, in addition to the Ijarah contract, includes a promise resulting in transfer of the ownership of the underlying asset to the lessee, either after the end of the term of the Ijarah period or by stages during the term of the contract*” (AAOIFI, 2018: 10).

AAOIFI Shariah Standard 9 outlines the basis of Shari'ah rulings on Ijarah and Ijarah Muntahia Bittamleek, beginning with the rules relating to the promise to lease and concluding with the rules relating to the repossession of the leased property by the lessor in the case of Operating Ijarah or the transfer of ownership in the case of Ijarah Muntahia Bittamleek (AAOIFI, 2015). In accordance with the AAOIFI (2015), an Ijarah contract may not be terminated unilaterally and the rent is to be determined by both parties at the beginning of the contract. For an Ijarah contract on a specific asset to be permissible, the lease should be preceded by the acquisition of the asset being leased or its usufruct (the right to use and benefit from the property), for a specified duration in exchange for a predetermined fee (AAOIFI, 2015). Similarly, Bank Negara Malaysia (BNM, 2018: 1) defines Ijarah as “*a contract for hiring of services of a person for a specified period in exchange for a specified consideration*”.

Ethica Institute of Islamic Finance (2017: 318) defines Ijarah Al Ashkhas (Ijarah-tul-Ashkhas) as “*to employ the services of a person on wages given to him as a consideration for his hired services*”. AAOIFI has not explicitly defined Ijarah Al Ashkhas; however, in reference to the AAOIFI Shariah Standard (No 34) Hiring of Persons, hiring of a person is defined as “*contract through which a service/work of a natural or a legal person is obtained against a specific amount to pay. The service thus obtained could be specific or a future one that needs to be specified through detailed terms of reference, such as educational, health and consultancy service*” (AAOIFI, 2015: 844).

In the context of practical application, Service Ijarah represents a departure from the traditional approach of hiring or leasing. As the modern financial industry becomes institutionalised, Islamic financial institutions are required to purchase the predetermined service in order to provide the service to the customer as a parallel contract. However, the practical application and implementation of this contract may vary from one institution to another. Therefore, it is important to gain a comprehensive understanding of how the Service Ijarah contract is practiced and how it affects profit generation in Islamic financial institutions.

2.2. The Legitimacy of Service Ijarah Contract

Service Ijarah contracts are founded on the principles of Islamic law. These principles are derived from the Quran, Sunnah, and the consensus of Islamic jurists. The term "Ijarah" is derived from the Arabic word "Al-Ajru", which means compensation. This emphasizes the concept of remuneration inherent in the practice. The Quranic verses highlight the importance of remunerating individuals for their labour, whilst the exemplary actions and teachings of Prophet Muhammad (peace be upon him) emphasize fairness, prompt payment, and transparent contractual agreements. For instance, the Quran narrates the story of Prophet Musa (PBUH) being hired for a specific task, emphasising the need for fair compensation (Quran, Surah al-Qasas, verse 27). Another verse underscores the obligation to reward individuals for their work (Quran, 65:6). Similarly, Hadiths advocate for prompt payment of wages and transparency in contractual arrangements.

Historically, the practice of leasing, akin to Service Ijarah, finds precedence in the Prophet's time, as exemplified by the land of Khaybar being rented to Jews for cultivation (Hadiths in Al-Bukhari and Abu Dawud). Furthermore, the unanimous consensus among Islamic jurists underscores the enduring acceptance of Service Ijarah within the Muslim community.

This rich historical and legal background, rooted in Quranic principles, Sunnah, consensus, and societal interests, solidifies the legitimacy of Service Ijarah contracts in contemporary Islamic finance. As such, the contract stands as a testament to consensus and aligns seamlessly with the values of fairness and equitable compensation upheld in Islam.

2.3. Major Difference between Service Ijarah and Alternative Banking Contracts

The principal contracts employed in Islamic finance alternatives to the service of ijarah would include the debt contract, such as those comprising Tawarruq (commodity Murabahah), Murabahah, Ijarah (asset), Istisna, Jualah. Table 1 is therefore presented in order to illustrate the key differences between the various forms of Islamic finance contracts, with a particular focus on the Ijarah service contract.

Table 1: Comparison of the Alternative Shariah Contracts to Service Ijarah

Features	<i>Ijarah Al Ashkhas</i>	<i>Ijarah Al-‘Ayn</i>	<i>Murabahah</i>	<i>Tawarruq</i>	<i>Ju’alah</i>	<i>Istisna</i>
Type of the Contract	Service/Fee Based	Single-Sale Based	Single-Sale Based	Multiple-Sale Based	Reward Based	Single Sale Based
Nature of the Contract	Bilateral/ Binding	Bilateral/ Binding	Bilateral/ Binding	Bilateral/ Binding	Unilateral/ Non-binding	Bilateral/ Binding
Contracting Parties/ Relationship	Service Provider-Service Beneficiary	Lessor-Lessee	Buyer-Seller	Buyer-Seller-Third Party Buyer	Offeror-Worker	Manufacturer - Buyer
Subject Matter	Determined Service	Usufruct of the Asset	Asset Sold	Commodity Sold	Determined Work and Reward	Manufactured Good
Ownership Transfer	Commencement	Gradual (Usufruct)	Immediate	Immediate	Upon Task Completion (Only Reward)	Upon Completion
Guarantee/ Pledging Applied in Financings	No	Yes	Yes	No	Not Applicable for Financings	Yes
General Banking Use	Liquidity, Personal, and Service Based Financing	Non-Current Asset Financings	Assets and Goods Financings	Liquidity & Personal Financing	Not Practiced	Building & Construction Financing

*Note: The reward (is the definite subject matter) of the Ju’alah contract and it is compensated by the offeror (Ja’il) to the worker (Maj’ul) upon completion of the work

Source: compiled by authors

As presented in the comparison in Table 1, Service Ijarah differs from other contracts in several ways: it is characterised as a single sale contract, which distinguishes it from Tawarruq (Commodity Murabahah), which operates as a multiple sale contract (Ahmad et al., 2020; Ismail, 2021; Subky et al., 2017). The former involves a single transaction between the lessor and the lessee, while the latter involves two or more transactions, including the buyer, the seller and a third party seller (Bank Negara Malaysia, 2018). Another important distinction is the nature of the contract itself. Service Ijarah is essentially a leasing contract, whereas Murabahah, Tawarruq and Istisna are categorised as sales contracts (Ahmad et al., 2020; Ismail, 2021). This implies that Service Ijarah facilitates the transfer of the usufruct or benefit of a service,

diverging from the other contracts that involve the transfer of ownership of an asset, commodity, or manufactured goods (Sultan, 2017).

A notable difference is the absence of any requirement for a guarantee or pledge in Service Ijarah, a feature not found in Ijarah (asset), Murabahah and Istisna, all of which require such security measures (Ismail, 2021). This feature makes Service Ijarah less risky for the lessee but more risky for the lessor. In contrast, the other contracts are more risky for the lessee but less risky for the lessor.

The primary use of Service Ijarah is for personal financing, which could be used to finance assets, manufactured goods, commodities and housing (Ahmad et al., 2020; Ismail, 2021; Subky et al., 2017). More specifically, Service Ijarah offers greater flexibility and convenience to the lessee, while the other contracts offer greater diversity and profitability to the financier.

Service Ijarah and Ju'alah are fundamentally different in nature, with Service Ijarah being a sales-based bilateral contract focused on specific services, whereas Ju'alah is a rewards-based unilateral contract focused on a specific task or work and its reward (Mohamed et al., 2020). This distinction emphasises the diverse nature of Islamic financial contracts and their applicability in different scenarios.

Finally, the comparison between Istisna and Service Ijarah highlights further operational differences. While Istisna requires the contractor to provide his own materials, Service Ijarah requires the client to provide the materials and only compensates the contractor for his labour and expertise. In addition, the right of rejection after inspection in Istisna, which allows the buyer to reject non-compliant goods, contrasts sharply with the absence of such a provision in the Service Ijarah framework (Ethica Institute of Islamic Finance, 2017; Subky et al., 2017).

2.4. Advancements and Challenges in Service Ijarah

In recent years, Service Ijarah has received little but growing attention in the academic literature, despite its unique structure and role in Islamic banking and finance. Recent studies on Service Ijarah have focused on its potential use in Islamic finance and banking. Adeinat et al. (2019) examine customer satisfaction within the context of Ijarah financing, emphasising the mediating role of clarity and accuracy in the services offered. The study highlights the importance of transparent and precise communication regarding Ijarah transactions to enhance customer satisfaction. Adeinat et al. (2019) also found that clear understanding and accurate information provision positively influence customers' perceptions, contributing to overall satisfaction with Ijarah financing services. While not exclusively focused on Service Ijarah, Ahmad et al. (2020) explore the possibility of replacing Tawarruq-based Islamic banking products with alternative approaches. The research contributes to the broader discourse on

Islamic finance by examining potential substitutes for traditional financing mechanisms. By highlighting the need for innovative approaches within Islamic banking, this study indirectly supports the exploration and development of Service Ijarah as an alternative and viable financing option.

Dieng (2019) investigates the applicability of Ijarah Al-Mawsufah Fi Al-Dhimmah in Malaysia, shedding light on legal and practical considerations. The study offers insights into the implementation of Ijarah contracts within the Malaysian context, addressing regulatory frameworks and operational challenges. By examining the practical aspects of Ijarah utilization, this research provides valuable guidance for practitioners and policymakers seeking to promote Shariah-compliant financing solutions, thus indirectly supporting the development and implementation of Service Ijarah within diverse regulatory environments.

Zafar (2012) discusses the practical difficulties associated with the Ijarah contract, emphasising the importance of ethical considerations and operational challenges. The study highlights potential discrepancies between theoretical principles and practical application, underscoring the importance of aligning contractual arrangements with Islamic ethical norms. By identifying the difficulties and proposing solutions, this research contributes to the ongoing discourse on ethical practices in Islamic finance, including Service Ijarah. This underscores the significance of ensuring ethical conduct and adherence to Shariah principles in the provision of Ijarah-based services, thus supporting the promotion and acceptance of Service Ijarah within Islamic financial institutions.

3. Research Methodology

This research is primarily based on the qualitative desk review research method in identifying the detailed procedures of the practical application of the service of Ijarah. Secondary sources such as websites, product disclosure sheets, Shariah Standards, policy documents, annual reports, journal articles and other forms of reports were used as part of the critical review of the use of Ijarah in theory and practice. Qualitative research methods are common in the study of contracts in Islamic finance, for example: Abdul Khir and Mohamed (2023) used desk research in exploring the concept and behaviour of risk taking in Islamic financial transactions, whereas Yustiardi et al. (2020) used library or desk research methods as forms of qualitative research to investigate application of Shari'ah agreements. Qualitative desk research allows researchers to explore a wide range of topics and gather valuable data from a variety of reliable sources, which suits the exploratory nature of this study. Additionally, qualitative desk review research method is cost-effective and time-efficient (Bassot, 2022). In order to obtain a comprehensive picture of the practical application of Service Ijarah, all available public domain websites of Islamic banks and

Islamic financial institutions in different jurisdictions and all available policy disclosure sheets were reviewed. The terms Service Ijarah, Ijarah Al Ashkhas and Ijarah Service Financing were used to search for the application of the contract.

4. Results and Findings

The result and findings is divided into majorly three areas where the first will be focusing on the comparison of Ijarah contract with alternative banking and financing contracts followed by the application of Service Ijarah in the three major sectors of Islamic finance and issues that may arise in using the contract.

4.1. Application of Service Ijarah in the Islamic Banking

Service Ijarah contract has been seen as a vital Shariah contract used in several Islamic banks either directly with the name of the contract or indirectly that stated Ijarah for services. The following are the practical applications of Service Ijarah in Islamic banks around where the information are extracted from the official website of the banks and otherwise stated.

1. Abu Dhabi Islamic Bank, UAE

In the United Arab Emirates, the Abu Dhabi Islamic Bank offers financing for services related to education and travel based on the Ijarah concept. Upon the customer's request, the bank provides education financing in the form of leasing the educational services from education providers and subleasing them to the customer, with an added profit for the bank. In the case of travel financing, the bank provides leasing services to service providers and subleases them to customers, again with an added profit for the bank (Abu Dhabi Islamic Bank, 2023). It should be noted that the bank does not possess a predefined catalogue of vendors from which it selects. Rather, it considers requests from customers for financing services on a case-by-case basis.

2. Affin Islamic, Malaysia

In its AFFIN Education Financing-i programme, Affin Islamic Bank employs the concept of Service Ijarah, which enables the bank to provide financial assistance to students pursuing their studies at approved universities and colleges. The product disclosure sheet does not explicitly mention that the product is a Service Ijarah. Instead, it states that the product is based on Ijarah, whereby the coursework programme will be a defined service/benefit undertaken by the lessor (bank) to be delivered to the lessee (student) according to an agreed specific timeframe (Affin Islamic, 2024). This meets the definition of Service Ijarah.

3. Ahli Islamic Bank, Oman

The Ahli Islamic Bank in Oman offers personal financing structured using the Service Ijarah contract, which provides financing for services such as travel and education.

According to the bank, when a customer requests a service, the bank acquires that service from a third party and subleases it to the customer (Ahli Islamic, 2022). The bank has issued an exclusive document entitled "Service Ijarah Agreement" that includes details of the operation of the financing facility. According to the document, the Service Lessor (Islamic bank) is required to enter into a memorandum of understanding with the Service Provider for the provision of the service. Furthermore, the agreement stipulates that a 0.5% interest rate shall be applied annually to the outstanding balance owed to the Service Lessor (Islamic Bank), calculated with respect to the period of the delay. Additionally, the Service Lessee (customer) is obliged to pay a service price in instalments, as specified in the agreement. In the event of a default, a number of consequences will ensue, including the termination of the agreement, the set-off of outstanding amounts, and the enforcement of collaterals or guarantees (Ahli Islamic, n.d).

4. Ajman Bank, UAE

In offering personal financing, the Ajman Bank applies the Islamic contract of Service Ijarah. This contract is used to broadly include education financing and Hajj and Umrah financing as services for both locals and foreign nationals living in the UAE. According to the official Ajman Bank website, the Service Ijarah contract stipulates that the bank will purchase the specified service on behalf of the customer. The customer is then granted the right to use the service and enjoy the benefits associated with it, provided that the customer pays a predetermined amount in exchange for the services (Ajman Bank, 2023).

5. Al Baraka Islamic Bank (AIB), Bahrain

The Al Baraka Islamic Bank in the Kingdom of Bahrain provides financial services for education through ten different universities and schools, which sell their educational services to the bank. The bank then assigns these services to customers through a signed service lease agreement that states the required service, period, and agreed rental instalment (Al Baraka, 2023a). Additionally, the bank provides Medical Ijara finance that finances patients accessing their medical necessities from eighteen different local hospitals and clinics in Bahrain (Al Baraka, 2023b).

6. Alizz Islamic Bank, Oman

The Alizz Islamic Bank in Oman applies the concept of Service Ijarah under the personal financing category. This encompasses financing for unexpected medical conditions, education, and marriage. As stated in Alizz Islamic Bank's (2023) published information, the bank utilises the Shariah contract in collaboration with various service providers. This enables customers to acquire services at competitive rates. This process involves the bank leasing services directly to providers and then subleasing them to customers. The financing is available to both local residents and foreign nationals residing in Oman (Alizz Islamic Bank, 2023).

7. Bank of Maldives (BML) Islamic, Maldives

The Bank of Maldives Islamic employs the Service Ijarah contract as a financing structure for a range of services. These include personal financing, education service financing, life-style (home renovation) services, and green technology financing, as outlined in the 2024 Bank of Maldives annual report. In offering Ijarah-based financial services, the bank maintains a list of service providers registered for customers. The bank purchases the service based on the customer's specifications and subsequently sells it to the customer, with the condition that the service will be provided in the future. The bank has listed 444 vendors across the country as authorised dealers in issuing financing for both Murabahah assets and services provided by the vendors (BML Islamic, 2024a).

Education financing based on the Ijarah service is available for higher education both domestically and internationally, covering tuition fees, living costs and other related expenses. The repayment period is deferred until the successful completion of the academic programme, and is treated as a service provided by the bank with a pre-agreed fee, which is based on the service provided and requires an asset as collateral security (BML Islamic, 2023). Lifestyle financing encompasses services related to home renovation, which is a short-term financing facility provided by the bank with monthly instalments paid for the services (BML Islamic, 2022a).

Green financing is available to personal and business customers for the purpose of providing financing for renewable energy and investment in sustainable projects, such as the installation of solar panels (BML Islamic, 2022b). Furthermore, the bank offers personal financing and financing facilities structured using the Service Ijarah, which do not require collateral security (BML Islamic, 2024b). Alternatively, the option is available to eliminate the need for personal guarantees, and there is no requirement for a deposit or advance payment. Furthermore, the bank offers its customers the option of acting as an agent to purchase the service on their behalf in instances where the service may be unique or not listed by the service providers.

8. Dubai Islamic Bank, UAE

The Dubai Islamic Bank in the UAE employs the Service Ijarah contract in the provision of personal finance, offering customers the opportunity to finance their education, travel, healthcare and marriage. In the Ijarah service contract, the bank leases services from a third-party supplier and subsequently sub-leases them to the customer. The payment on the Ijarah service contract is deferred, with the customer paying in instalments as per the contract (Dubai Islamic Bank, 2024).

9. Emirates Islamic Bank, UAE

Emirates Islamic Bank in the UAE provides financing for a range of services, including wedding services, travel services, Hajj and Umrah services, medical

services, and educational services. The bank purchases the services from the service providers and resells them to customers on an installment basis for repayment (Emirates Islamic Bank, 2024). The banking product is categorised as a goods and services offering, although the specific Islamic financing principles of Murabaha and Ijarah are not explicitly stated. However, the product details indicate that the financing facility employs these principles, with all goods purchased on Murabahah, which is the Islamic principle of buying and reselling services.

10. HSBC Amanah Bank, Bangladesh

The HSBC Amanah Bank in Bangladesh offers personal finance based on the Islamic financing mechanism of Ijarah, which is used to provide financing for education, weddings, and medical services. The operational procedure of the financing product is as follows: the bank leases services from various providers and subsequently sub-leases them to customers for monthly rentals until the end of the service. As stated by the HSBC Bank Bangladesh (2023), the Ijarah structure obviates the necessity for personal guarantees or cash security, as the bank also relies on Ijarah for personal financing facilities in relation to all services requested by the customer, with the exception of Murabahah for goods requiring ownership transfer (HSBC Bank Bangladesh, 2023).

11. Jaiz Bank, Nigeria

The Jaiz Bank in Nigeria designated Service Ijarah as a mode of financing under corporate and structured financing, with the objective of providing customers with access to financing for services such as school fees, rent, hospital bills, and medical expenses. In this arrangement, the bank assumes responsibility for service procurement, and the customer purchases it on a deferred payment basis over a 12-month tenure period (Jaiz Bank, 2023). No additional product disclosure sheet or information sheet pertaining to Service Ijarah and its application in financing products has been made available by the bank.

12. KCB Sahl Bank, Tanzania

The KCB Islamic Bank in Tanzania provides Islamic banking customers with financing through the Ijarah service contract, which covers tax, clearance costs, and salary payments (KCB, 2023). The lease contract allows for the provision of services in exchange for agreed consideration, such as the services of a lawyer, clearing agents, tax payments, or insurance payments. These payments are financed with deferred repayment. The bank does not offer similar financing to other services, such as education or travel, which are commonly provided by many other Islamic banks.

13. Maisarah Islamic Banking Services, Oman

Headquartered in Oman, Maisarah Islamic Banking Services applies the Service Ijarah contract in providing financing for travel, which includes airfare, car rentals,

transportation, accommodation, and package tours. Additionally, the bank offers Hajj and Umrah financing based on the Service Ijarah contract (Maisarah Islamic Banking Services, 2023). No additional product disclosure sheet or information sheet pertaining to the Service Ijarah contract and its application in financing products has been made available by the bank.

14. Sharjah Islamic Bank, UAE

The Sharjah Islamic Bank in the UAE utilises the Service Ijarah contract for financing services related to education, medical treatment, travel, and umrah within the personal financial category of the bank (Sharjah Islamic Bank, 2022). It should be noted that there is no mention of a definitive list of service providers that the banks accept. Instead, the banks are described as being more flexible in nature, whereby financing is provided upon the customer's request, provided that the service in question fulfils the criteria set out by the bank.

15. Sohar Islamic Bank, Oman

Sohar Islamic Bank in Oman also utilises the Service Ijarah contract in providing financing solutions to individuals for education, travel, healthcare, and marriage finance. By entering into agreements with service providers, the Islamic bank establishes a framework for the leasing of services from these providers, who subsequently sub-lease them to customers, thereby addressing a diverse range of financial needs (Sohar Islamic Bank, 2024). No additional product disclosure sheet or information sheet pertaining to the Service Ijarah and its application in financing products has been made available by the bank.

4.1.1 Summary of the Findings on Application Service Ijarah in Islamic Banking

This section presents a summary of the findings on the application of Islamic banks around the world, with a focus on the types of financing services that have been used by the bank. The summary provides a comprehensive overview of the practical application of the contract, which explicitly mentions the usage of the Service Ijarah or Ijarah Al Ashkhas in their service financings.

Table 2: Major Usage of Service Ijarah Contract in Islamic Banking

Financing Purpose				Education	Medical	Travel	Marriage	Hajj & Umrah	Green Technology	Home Renovation	Professional Services
	Bank Name	Region	Country								
1	Abu Dhabi Islamic Bank	Middle East	UAE	√	-	√	-	√	-	-	-
2	Affin Islamic	South East Asia	Malaysia	√	-	-	-	-	-	-	-

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3	Ahli Islamic Bank	Middle East	Oman	√	-	√	-	-	-	-	-
4	Ajman Bank	Middle East	UAE	√	-	-	-	√	-	-	-
5	Al Baraka Islamic Bank	Middle East	Bahrain	√	√	-	-	-	-	-	-
6	Alizz Islamic Bank	Middle East	Oman	√	-	-	√	-	-	-	-
7	Bank of Maldives Islamic	South Asia	Maldives	√	-	-	-	-	√	√	-
8	Dubai Islamic Bank	Middle East	UAE	√	√	√	√	-	-	-	-
9	Emirates Islamic Bank	Middle East	UAE	√	√	√	√	√	-	-	-
10	HSBC Amanah Bank	South Asia	Bangladesh	√	√	-	√	-	-	-	-
11	Jaiz Bank	Africa	Nigeria	√	√	-	-	-	-	-	-
12	KCB Sahl Bank	Africa	Tanzania	-	-	-	-	-	-	-	√
13	Maisarah Islamic banking Services	Middle East	Oman	-	-	√	-	√	-	-	-
14	Sharjah Islamic Bank	Middle East	UAE	√	√	√	-	√*	-	-	-
15	Sohar Islamic Bank	Middle East	Oman	√	√	√	√	-	-	-	-
Total				13	7	7	5	5	1	1	1

Note: The services financed by the bank may not be limited to only these categories using Service Ijarah & *Sharjah Islamic Bank, UAE only offers Umrah

As presented in Table 2, a total of fifteen Islamic banks applied the Shariah contract of Service-Ijarah to offer their financing including 5 Islamic banks from the UAE, 4 from Oman, 1 from Maldives, 1 from Tanzania, 1 from Nigeria, 1 from Malaysian, 1 from Bahrain, 1 from Bangladesh. An analysis of the data reveals that ten of the fifteen Islamic banks offering the Service Ijarah are situated in the Middle Eastern region.

A total of 13 Islamic banks worldwide have utilized the Ijarah contract to provide financing for educational services, including university courses and school programs. This finding in line with the findings of Shujau et al., (2023) that six Islamic banks around the world used Ijarah for education financing; however the study does not

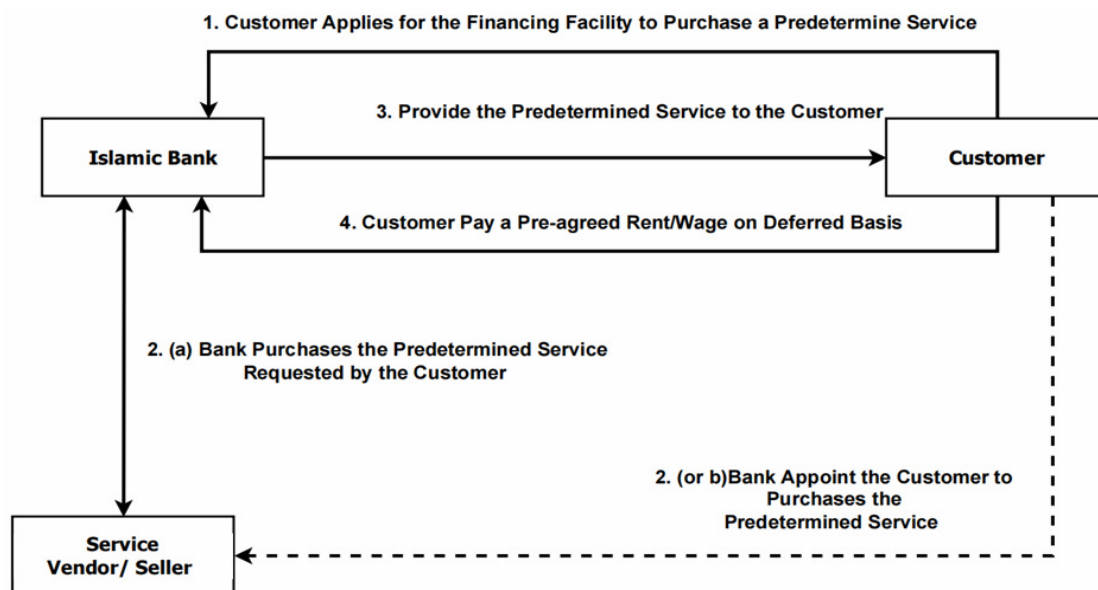
specify whether the underlying contract used in Service Ijarah. Furthermore, seven Islamic banks offer financing for marriage and travel through the Ijarah contract, which allows for flexibility in meeting customer needs. The financing of marriage, Hajj and Umrah is provided by five Islamic banks to their respective customer bases; however, Sharjah Islamic Bank in the UAE only offers Umrah for its customers. Interestingly, as a financial institution, Bank of Maldives Islamic banks offer two distinctive services within their financing portfolio: the first of these is Ijarah, which encompasses home renovation (referred to as lifestyle financing) and the second is Green Financing, which is associated with projects focused on the production or expansion of renewable energy sources. Furthermore, it is pertinent to highlight that the KCB Sahl Bank in Tanzania offers a distinctive range of professional services. These include legal counsel, clearing agents, and tax payment assistance, all of which are provided in a manner that sets it apart from other Islamic banks.

All the banks, with the exception of Affin Islamic Bank and Emirates Islamic Bank, explicitly stated that the underlying contract was used in Service Ijarah. Furthermore, these banks only mentioned Ijarah as a mode of financing for services. However, upon examination of the procedural aspects of the banks' operations, it became evident that they followed a similar pattern to those that follow a Service Ijarah contract, whereby the customer specifies the desired service from a vendor, and a subsequent deferred payment is made. Moreover, there is no explicit mention of the necessity for any form of guarantee or mortgage of assets as a security for the financing facility offered by the bank, as the majority of financing is provided under the personal finance category by the banks.

4.1.2 A General Structure of Service Ijarah Based Financings for Islamic Banks

The results of the investigation into the applicability of the Ijarah service as a means of providing financing to customers have led to the creation of a generalised representation, depicted in Figure 1, of the structure of Ijarah-based financing. As illustrated in Figure 1, the customer's approach to the bank is characterised by a determined service, whereby the bank appoints the customer as an agent or the Islamic bank itself purchases the asset from the vendor and provides the service to the customer on a deferred payment basis. Islamic banks utilise the Ijarah service as a financing tool for all the aforementioned services. Prior to entering into the financing facility, the customer must specify the service. The arrangement of payment may vary from one bank to another or with regard to the type of service. For instance, a bank that provides financing for education is typically for the long term, while services such as marriage and travel are typically short-term to medium-term financings. It is important to recognise that in practice, these arrangements differ and are usually based on mutual agreement or customary practice in issuing financing in a particular jurisdiction.

Figure 1: General Application of Service Ijarah in Islamic Banks



Source: author's own work

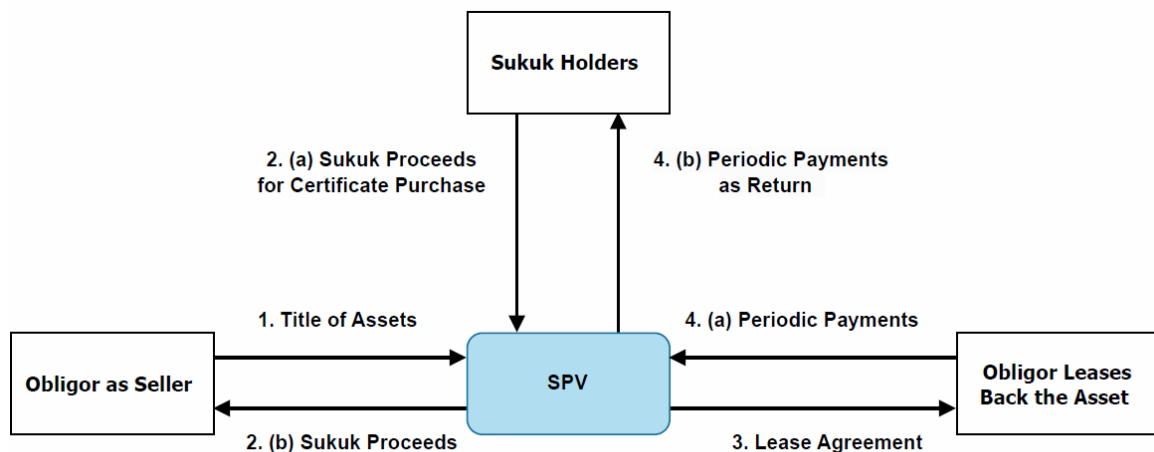
Modus Operandi:

1. Islamic banking customer applies for the financing facility a predetermined service from a supplier
2. The bank accepts financing to the customer and (a) the IB themselves buys the predetermined service directly from the vendor/service provider or (b) appoints the customer as an agent to purchase the pre-determined by the customer.
3. The Islamic bank provides the predetermined service as the request of customers within the agreed period.
4. Customer pays back the pre-agreed wages or Ujrah (fee) on a deferred basis to the Islamic bank for the services provided.

4.2. Application of Service Ijarah in Islamic Capital Market

There is no evidence of the usage of Ijarah Al Ashkhas in Islamic capital market instruments. However, a wide range of Ijarahtul al-Aiyan (or Leasing of assets) has been used in the issuance of Sukuk (Islamic bonds). Nonetheless, the contract of Service Ijarah has the potential to be used to structure Islamic capital market products since the contract is a classical contract which makes it unique to Islamic finance. Figure 2 below illustrates the basic structure of how a conventional Ijarah contract has been employed as the underlying contract in the design of a Sukuk product.

Figure 2: Sukuk Ijarah Structure



Source: Adapted from Papazian (2010, p. 223)

Modus Operandi:

1. The obligor as seller forms an SPV and transfer the ownership of the underlying asset.
2. (a)(b) The Sukuk holders purchases Sukuk certificates representing the leased asset.
3. SPV forms a lease agreement with obligor to lease back the same asset that gives the beneficial ownership.
4. (a)(b) Periodic payment will be paid to the SPV as rent for the usage of asset by obligor and Periodic Ijarah income will be shared and paid to the Sukuk holders on their investment and upon the maturity of Sukuk, the Sukuk holders will get principal of their certificates by disposing or selling the asset to the originator.

As illustrated in Figure 2, Papazian (2010) posits that the Special Purpose Vehicle (SPV) serves a vital role in the case of an Ijarah Sukuk (lease Sukuk) instrument. The SPV, acting as an agent and/or trustee, utilises Sukuk proceeds to purchase the underlying asset from the primary obligor. Thereafter, it leases this asset back to the obligor, receiving rentals that serve to make Sukuk payments to holders. It is crucial to emphasise that the SPV, as an entity, is not liable for these payments nor provides any form of guarantee. Instead, the SPV serves as a conduit within the framework of a Shariah-compliant Sukuk structure. When a Sukuk is listed on an exchange, the SPV is recognised as the legal issuer. However, regulatory authorities typically consider the primary obligor to be the entity responsible for reporting, rather than the SPV. This practice is widely observed across various jurisdictions and regulatory bodies. The SPVs have no financial or reporting obligations; their role primarily revolves around being a legal entity that acquires and leases the underlying asset from the primary obligor, legally serving as the issuer of the Sukuk, and appointing relevant entities to manage and administer the transaction. Furthermore, they do not engage in cash management or assume any financial responsibilities (Papazian, 2010).

Consequently, the proposition of service-based Ijarah Sukuk represents a dynamic and innovative avenue for the advancement of Islamic finance. The utilisation of the classical Ijarah contract, in conjunction with the concept of intangible assets or services, allows financial institutions to adapt to the evolving requirements of investors and issuers by structuring Sukuk in a manner that aligns with the contemporary emphasis on services and intellectual property. This expansion in the range of Sukuk products facilitates the unlocking of financial resources in sectors that are limited by a lack of physical assets, thereby providing opportunities to invest in a diverse range of areas. With the application of careful structuring and adherence to Shariah principles, service-based Ijarah Sukuk has the potential to attract a diverse range of investors seeking exposure to innovative and socially impactful investments.

4.2.2 AAOIFI Empowering Service Ijarah Based Sukuk

AAOIFI has been instrumental in facilitating the development of Service Ijarah-based Sukuk. The utilisation of the Ijarah contract in structuring underlying assets has paved the way for the incorporation of services within Sukuk arrangements, fostering innovative solutions within the Islamic financial industry.

Similar to the utilisation of Ijarah for the structuring of underlying assets, services can be designed to facilitate Ijarah-based activities, such as educational investment. This may prove crucial for the growth of the Islamic financial industry as a whole. AAOIFI's Standard No. 17 acknowledges the potential for the use of predetermined services to issue Sukuk. Furthermore, under the section on the types of Investment Sukuk, it specifically mentions certificates of ownership of services, highlighting the versatility of Sukuk structures. In particular, the Service Ijarah is considered the most applicable contract for the ownership of services, which is realised upon service fulfilment. Sukuk investments based on the Ijarah principle are considered a more favourable option for long-term investment compared to the Musharakah Mutanaqisah principle, as demonstrated by various studies (Ahmad et al., 2020; Mohamed et al., 2020; Subky et al., 2017). For investors seeking long-lasting investments, Sukuk issued under the Ijarah principle is usually preferred over Musharakah Mutanaqisah. A review of the Shariah rulings in the AAOIFI standard reveals that the permissibility of trading in securities of services is acknowledged, although this practice is not widely adopted. With regard to these sections, there is no such practice where the underlying service is used as the value of the Sukuk in the practice of issuing Sukuk, although it is allowed by AAOIFI.

In proposing the service-based Ijarah Sukuk, it is important to contextualise within the framework of the recently released AAOIFI exposure draft Standard 62. This standard represents the latest advancements in AAOIFI's Sukuk guidelines, which aim to establish a robust framework for Sukuk issuance management. The updated requirements, which emphasise governance, transparency, and Shariah compliance, set

a higher standard for Sukuk structures than previously. Rather than viewing these requirements as barriers, they should be regarded as catalysts for innovation. By aligning service-based Ijarah Sukuk with the principles outlined in Standard 62, issuers can not only ensure compliance but also enhance transparency and investor confidence. This alignment not only demonstrates a commitment to Shariah principles but also positions service-based Ijarah Sukuk as vehicles for sustainable and ethical investment in the evolving Islamic finance landscape. Nevertheless, achieving this alignment necessitates a careful navigation of the complexities within Standard 62, which requires expertise and strategic structuring in order to capitalise on the opportunities presented by this new standard.

These findings indicate that the potential application of Ijarah Al Ashkhas is not being tested for issuing Sukuk, as a predetermined service is not considered to be an asset unless it is realized. While the Ijarah Sukuk service offers a Shariah-compliant financing solution for asset recycling transactions, it is important to consider the potential drawbacks and challenges that may arise. According to the World Bank (2023), asset-backed Sukuk is more commonly used than asset-based Sukuk because investors can take possession of the assets backing the Sukuk, thereby providing them with a greater sense of security. In contrast to asset-backed Sukuk, Service Ijarah Sukuk typically involves a lease agreement in which investors do not have direct control or ownership of the assets. This limited transfer of control and reliance on lease payments from the obligor may influence market perception and demand for Service Ijarah Sukuk. Furthermore, the intricacies of the structures, the compliance challenges related to Shariah principles, the liquidity concerns, and the risk associated with the asset performance all contribute to these challenges. Nevertheless, with the implementation of meticulous structuring and robust risk management practices, Service Ijarah Sukuk remains a viable Islamic financing option for asset recycling transactions.

4.3. Application of Service Ijarah in Takaful (Islamic Insurance)

A review of the Takaful (Islamic Insurance) products and services (both family and general) revealed no evidence of the usage of Service Ijarah as a primary or secondary contract. This may be attributed to the nature of the Takaful operation, which provides protection contingent on the occurrence of a future event. Nevertheless, the contract can be employed by Islamic wealth management firms to sublease services based on Service Ijarah with a profit in the service, where the Takaful operators assume the responsibility of protecting the income, damages and failure to provide a service by the wealth firms.

Similarly, Islamic banks may also provide Takaful protection to customers using the Ijarah contract in the event that the bank is unable to fulfil the customer's service requirements. This is in accordance with section 5/1/11 of AAOIFI Shariah Standard

17, which concerns investment Sukuk, it mentions that: *“It is permissible for the issuer or the certificate holders to adopt permissible methods of managing risk of mitigating fluctuations of distributable income profits (profit equalization reserve), such as establishing an Islamic insurance fund with contributions of certificate holders, or by participating in insurance (Takaful) by payment of premiums from the income of the shares of Sukuk holders or through donations (Tabarru'at) made by the Sukuk holders.”* This ensures that similar to any Investment Sukuk, protection can be taken for a service ordered using a classical Service-Ijarah contract after payment for the service (which premiums or donations for the case for Sukuk) by the virtue of the Shariah standard.

It can be concluded that the service of Ijarah is not applicable in the primary dealing and structuring of Takaful products, both in general and family Takaful. However, it can be used to protect the income, damages and failure to provide a service based on the Service Ijarah by wealth management firms and banks as a financing facility.

4.4. Possible Limitations for Service-Ijarah based Products and Financings

Service-Ijarah-based products and financings are subject to a number of limitations. These include the need for the development of standardised guidelines, challenges in identifying suitable service providers, and increased monitoring requirements. In order to overcome these limitations, it is necessary for the Islamic finance industry to collaborate in order to establish and implement clear standards. Furthermore, it is essential that effective risk management and due diligence processes are developed in order to address the distinctive characteristics of Service Ijarah contracts. The following sections will elaborate on the major limitations in offering products utilised in the contemporary financial sectors of Islamic finance.

4.4.1 Lack of Contractual Standards and Harmonization

One of the limitations is that there is a lack of clear guidelines or Shari'ah standards for Service Ijarah. In Islamic finance, compliance with Shariah principles is of the utmost importance. In the absence of clear guidelines or universally accepted standards, Islamic banks may encounter challenges in ensuring the full compliance of their Service Ijarah contracts. Furthermore, the regulatory frameworks for Islamic finance vary significantly from one jurisdiction to another. At present, there is no specific guideline on Service Ijarah-based financing. The absence of uniformity in current standards presents a significant challenge for Islamic banks seeking to implement consistent Service Ijarah practices across multiple regions. This lack of harmonisation may result in inconsistencies and inefficiencies in their operations.

4.4.2 Finding Reliable Service Providers

Another challenge is sourcing reliable service providers, especially for renovation or custom jobs. Unlike traditional Ijarah contracts where the asset is tangible and

relatively easy to source and maintain, Service-Ijarah involves intangible services. Islamic banks need to find service providers who not only meet Shariah compliance but also have the expertise to deliver the required services. This can be particularly challenging in the case of customs or specialised services, where finding qualified providers can be more time consuming and costly.

4.4.3 Additional Monitoring Requirements

The monitoring requirements of a Service Ijarah may differ from those of a traditional Ijarah agreement. In a traditional Ijarah, the bank leases a tangible asset and may not require extensive ongoing monitoring. However, in a Service Ijarah, the bank is not only leasing a service but also relying on the service provider to maintain and deliver the service as agreed upon in the contract. This may necessitate continuous monitoring and oversight by the bank to ensure that the service is being provided in compliance with the contract terms. The necessity for additional monitoring may result in increased operational costs and complexity for Islamic banks.

5. Conclusion

The Service Ijarah is a distinctive Islamic financing method whereby the full ownership of an intangible service is transferred to the customer, differentiating it from other forms of ijarah that involve tangible assets. There is a consensus on the application and the definition and understanding of the contract as a classical Shariah contract, as a worker is remunerated for an agreed amount for a service that is pre-determined in an agreed time to provide to a customer. The contract is considered to be a single-sale-based lease contract, in which the benefit of a service is transferred rather than ownership of assets, commodities, or goods. Unlike commodity, asset, or usufruct-based Ijarah, Service Ijarah focuses solely on intangible services and is distinct from other contracts. It does not require guarantees or pledges, making it less risky for the lessee but riskier for the lessor.

The current application of the Islamic finance contract of Service Ijarah, or Ijarah Al Ashkhas, in Islamic banking is evidenced by its use in 15 different Islamic banks. These include banks in the Middle East, such as those in the UAE, Oman, and Bahrain, as well as banks in South Asia, the Maldives, and Bangladesh; Southeast Asia, Malaysia; and Africa, Nigeria, and Tanzania. The contract is particularly prevalent in the Middle East, where 10 of the 15 banks are located. A general structure of the application of Service Ijarah by all these banks in practice is presented in Figure 1. The Service Ijarah contract has been employed primarily in the field of educational financing for universities and schools, where the components of the programme are specified. Medical and travel services financing are also offered by seven of the banks, with five banks offering marriage and Hajj and Umrah services financing. However, home renovation and green technology services financing is only offered by a

Maldivian bank, Bank of Maldives, while professional services are only offered by a Tanzanian bank, KCB Sahl Bank.

A review of the literature reveals no Sukuk issuance based on Service Ijarah in Islamic capital market instruments. This is due to the fact that predetermined services are not considered assets until they are realized. Nevertheless, it is possible to design Sukuk instruments to facilitate Ijarah-based activities, such as educational investments, which may benefit the Islamic financial industry. However, additional research may be required to identify the feasibility of this approach.

Islamic insurance or Takaful, which is based on the concept of mutual assistance, does not commonly employ the Service Ijarah as a primary contract in Takaful products. This is due to the nature of Takaful operations, which provide protection based on the occurrence of future events. However, there is potential for Service Ijarah to be employed in personal wealth management firms, acting as agents for predetermined services. These services can include educational and marriage services. Takaful operators may play a role in providing protection to customers for receiving predetermined services in the future, provided that the customer has made the requisite payment and indicated their intention to receive the service. While Service Ijarah is not a primary component of Takaful products, it has the potential to protect against income loss, damages, or failure to provide a service based on Service Ijarah.

The primary challenge in the utilisation of Service Ijarah-based financing is the absence of a comprehensive guideline or Shariah standard. This represents a significant obstacle for Islamic banks in their efforts to implement these standards across various jurisdictions, where the regulatory framework may vary. Secondly, Islamic banks encounter difficulties in identifying dependable service providers, particularly in instances where the customers require customised solutions to suit their needs. Thirdly, it is possible that the bank may be constrained in its ability to provide finance on the basis of the Service Ijarah, due to the necessity for additional monitoring of the service providers.

6. Recommendation

As the use of service-Ijarah-based financing gains momentum, with Islamic banks around the globe employing the contract for personal financing, it is crucial to foster further collaboration within the Islamic finance industry. Likewise, countries can utilize Service Ijarah to facilitate financing for well-defined and predetermined services. For instance, Pakistan, Bangladesh, Sri Lanka, and the Maldives, which participate in all three major Islamic commercial financial sectors and serve the Muslim population within a dual financial system (Hassan et al., 2024) could use this contract in the banking sector. This collaboration should concentrate on developing and implementing transparent Shariah Standards, specifically designed for the Service

Ijarah contract. Furthermore, it is vital to implement effective risk management and due diligence processes in order to ensure the successful provision of financing, while addressing the distinctive characteristics of the Service Ijarah contract.

It is recommended that Islamic capital market practitioners consider incorporating services as underlying assets for issuing Sukuk. This novel approach has the potential to facilitate real economic transactions by integrating services into the underlying financial instruments. Islamic finance differs from conventional finance by promoting real economic activities through partnerships or exchange contracts for profits and rentals, whereas conventional finance generates income by charging interest (Hassan et al., 2022). By adopting such practices, Islamic capital market participants can enhance the efficiency and effectiveness of Sukuk structures, thereby contributing to the development and growth of the Islamic finance industry.

In light of the potential identified in Service Ijarah for Takaful, it is clear that further exploration and experimentation are needed in order to integrate such contracts within Takaful products. There is a clear opportunity for Takaful operators and Islamic wealth management firms to collaborate in the development of new and innovative Takaful products which utilise Service Ijarah contracts to protect against income loss, damages, or failure to provide services. The implementation of research and pilot projects in this area could help to unlock new opportunities for both Takaful providers and customers.

7. Future Research

Further research could be conducted on the educational services providers in OIC (or Muslim majority) countries to ascertain their willingness to accept Islamic educational finance based on the Service Ijarah. Another study could also be conducted on the use of alternative contracts to Service Ijarah for financing services. Research could also be focused in identifying limitations that may surface during its implementation and offering Service Ijarah based financings. Notable issues in the adoption of Service Ijarah-based financing include the necessity for clear Shariah guidelines or standards specifically tailored to Service Ijarah, the practical challenges of identifying reliable service providers, especially for customized renovation projects, and the potential need for enhanced monitoring when engaging with service providers.

Service Ijarah represents a unique approach which focuses on the transfer of ownership of services. Its intangible nature allows Islamic banks to cater to customers' tailored financial requirements within the framework of Islamic Shariah and Muamalat principles. The Shariah Standards, such as the Shariah Standard 34 of AAOIFI, offer insights into the permissibility of sub-hiring, aligning with the practice of Islamic banks in offering services to customers with deferred payments. However, it is crucial to consider the applicability of such standards in the context of Service Ijarah financing. These standards were primarily intended to govern the hiring of personnel between institutions and individuals or other institutions. Further research and

adaptation of existing standards may therefore be necessary to refine the guidelines for Service Ijarah financing.

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