SHARED RISK & REWARD

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An Ijara Services Sukuk for Student Loans

One of the areas where Islamic finance has not found a good solution for financing is in education. There are few options for Shari'ah-compliant financing of education. This is surprising and disappointing because education is one area where promoting increasing access can have broad benefits for both the student and the rest of the economy. There is, however, an option that I think should be developed, but will require significant work, primarily in developing the 'supply' of financing.

In the US, for example, there are no options available for education financing, which has led many students to either pass up on education (or delay it while they study to be able to save enough to pay in cash), or to use interest-based financing on the grounds of it being a necessity. A middle ground strategy is for students to take federally subsidized student loans, where the US government subsidizes the students by paying the interest on the loans while the student is in school. To avoid paying interest, students will save up (from working during school) to be able to pay off the loan before the subsidy disappears 6 months after graduation.

This is not a solution to the lack of availability of education financing, and there are few others elsewhere in the world. For example, the UK government is considering developing a commodity murabaha-based financing option. According to an article from 2008, the Islamic Bank of Britain offered a commodity murabaha based student loan product, but I could not find it on their website, so it may have been discontinued. The benefits of this approach is that making something available is better than nothing, although using commodity murabaha should be seen as a stop-gap option.

What about elsewhere in the world? Malaysian Islamic banks offer a bay' al-inah product for education financing, but given the lack of acceptance of bay' al-inah outside of Malaysia, this is unlikely to be adopted by Islamic banks in the rest of the world. In Egypt, National Bank for Development, working with Abu Dhabi Islamic Bank (which itself offers the same product) provides financing using an ijara for services structure.

In an asset-based ijara, a bank will buy an asset and lease it to the customer with the bank profiting from the rent paid for the use of the asset during the term of the financing, with the lease ending with the customer taking ownership of the asset (ijara muntahia bittamleek). In education financing there is no tangible asset that can be bought and leased, but the ijara contract can still be used but

Reading List

DFM Standard for Issuing, Acquiring and Trading Sukuk (PDF)

UK: Update on securing alternative finance provision for university tuition and fees and living expenses (PDF)

NPR: Sharia Student Loans (link)

Blog Posts This Week

Egypt finishes draft sukuk laws

World Council on Credit Unions may take lessons from Afghanistan to Libya

Qatar Islamic equity index

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with an intangible asset (an education).

In the ijara services structure, the bank pays the educational expenses (i.e. tuition) up front and enters into an ijara services contract for a longer term (in the case of the NBD ijara services product, it can be for as long as 60 months). It is unclear why the ijara services product is not used by more Islamic banks, but it may present more of a risk since it is an unsecured financing product (after an education is bought by the bank, if the customer defaults, the bank cannot take possession of the underlying asset because it is an intangible asset).

The risk of lending to an individual student may be the reason the product is not widely available from Islamic banks, but is there a way to make a more diversified portfolio through a sukuk that can be sold to investors? The new draft Sukuk Standards from the Dubai Financial Market describe:

> "These Sukuk represent for their holders a common share in the ownership of services that could be either ascertained or established as a liability by description (from a specific or nonspecific service provider). The provider of these services commits himself to provide them to others against a determined fee, whether in person or through what he undertakes to provide of facilities, means, equipment, devices or other things. […] These Sukuk grant their holders the right of subleasing the service against a determined fee, which constitutes the return of these Sukuk."

Securitizing student loans would provide greater diversification, which would be important for unsecured creditors. The conventional analogue to an ijara services sukuk are student loan securitizations, where student loans are bought and combined into a single financial product. When I was speaking to people who study sukuk, the main questions for an ijara services sukuk for education financing were around getting the sukuk rated and generating demand for the sukuk.

It is never going to be enough to develop a sukuk structure that accomplishes a useful social purpose for it to succeed. It will always have to demonstrate financial sense to attract the demand by investors to make for a successful sukuk issuance. And with education financing making up such a small part of the Islamic banking industry, it will unfortunately not be forthcoming in the near-term, and that is unfortunate.

Until next week,
Blake Goud

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