



## **EXISTING SHARIAH MODEL OF ISLAMIC HOME LOAN FINANCING: WEAKNESS AND STRENGTHEN**

<sup>1</sup>Sharifah Arni Binti Syed Jaaffar, <sup>2\*</sup>Puspa Liza Binti Ghazali, <sup>3</sup>Bunyamin Bello and <sup>4</sup>Saiful Bahri  
Mohamed

<sup>1,2&3</sup>Faculty of Economic and Management Science, Universiti Sultan Zainal Abidin, 21300  
Kuala Nerus, Terengganu. Malaysia.

<sup>4</sup>Faculty of Informatics and Computing, Universiti Zainal Abidin, 22200 Besut. Terengganu.

\*Corresponding Author

### **ABSTRACT**

Islamic banks in Malaysia offer a wide range of products, for instance from basic Shariah-compliant retail products to insurance, mortgages, investment instruments and large-scale project financing. This article emphasizes on the strength and weaknesses of 3 most top Shariah principles practiced for home financing in Malaysia. The top listed Shariah principles in Malaysia are Bai Bithaman Ajil (deferred payment sale), Musyarakah Mutanaqisah (diminishing partnership) and Tawarruq (direct instrument of debt creation). According to the strength and weaknesses of the existing Islamic home financing, the new model of Islamic home financing must be developed especially for lower incomes earners.

**Key Words:** Islamic Home Financing, Bithaman Ajil, Musyarakah Mutanaqisah and Tawarruq

### **1.0 Introduction**

Buying a house is a major investment decision that is made out of necessity. A good or bad decision will have long term repercussions on a person's ability to service the house including its financing and maintenance. Before the era of Islamic banking, Muslim had no choice to engage in a conventional home financing which based on debt. The basis of conventional home financing is in conflict with the principles of Islam, where riba (usury) and gharar (uncertainty) are integral part of the financing. Islamic banking is defined as a banking system that is based on the principles of Islamic law (also known as Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the

prohibition of the collection and payment of interest. Collecting interest is not permitted under Islamic law (Al Naseer, Muhammed, 2013).

Islamic banking entered Malaysia in the year 1983, and over the past 20 years, it has succeeded in developing a vibrant Islamic financial market. Islamic banks in Malaysia offer a wide range of products, for instance from basic Shariah-compliant retail products to insurance, mortgages, investment instruments and large-scale project financing. On the large scale of Islamic banking activities, Malaysia offers various financial innovations that attract investors to cultivate their investment in Malaysia (Amin, 2008). This article emphasizes on the strength and weaknesses of 3 most top Shariah principles practiced for home financing in Malaysia. The top listed Shariah principles in Malaysia are Bai Bithaman Ajil (deferred payment sale), Musyarakah Mutanaqisah (diminishing partnership) and Tawarruq (direct instrument of debt creation). There are 16 Islamic Financial Institution (IFI) in Malaysia. Table 1 shows the summary of IFI in Malaysia as at March 2016.

<b>Islamic Financial Institution</b>	<b>Name of Home Finance</b>	<b>Shariah Concept</b>
Affin Islamic Bank Berhad	Home Fin. -i	MM
Al Rajhi Banking & Investment Corporation Malaysia Bhd	Home Fin-i	BBA
Alliance Islamic Bank Berhad	i-Wish Home Fin-i	BBA
Am Islamic Bank Berhad	Home Fin-i	BBA & MM
Asian Finance Bank Berhad	Home Fin-I	MM
Bank Islam Malaysia Berhad	Baiti Home Fin-i	Tawarruq
Bank Muamalat Malaysia Berhad	Home Fin-i	MM
Cimb Islamic Bank Berhad	Flexi Home Fin-i	Tawarruq
HSBC Amanah Malaysia Berhad	Home Smart-i	MM
Hong Leong Islamic Malaysia Berhad	Flexi Prop Fin-i	Tawarruq
Kuwait Finance House (Malaysia) Berhad	MM home Fin-i	Ijarah Muntahiah Bi Tamlik
Maybank Islamic Berhad	Home Equity & Maxi Home	MM & Tawarruq
OCBC Al Amin Bank Berhad	Manarat Home-i	Ijarah Muntahiah Bi Tamlik
Public Islamic Bank Berhad	ABBA Home Fin-i	Bai Al Inah
RHB Islamic Bank Berhad	Equity Home Fin-i	MM
Standard Chartered Saadiq Berhad	Saadiq My Home-i	MM

Table 1: Summary of Islamic Home Financing in Malaysia

## **2.0 Bay Bithaman Ajil (BBA)**

The most popular type of financing by almost every Islamic bank in Malaysia used is Bai Bithaman Ajil. Bay Bithaman Ajil means a "deferred payment sale". It is a mode of Islamic financing used for property, vehicle, as well as financing of other consumer goods. BBA house financing is basically a trading transaction. In order for a trading transaction to be valid from an Islamic perspective, it must fulfill the following conditions and tenets: *the existence of two parties who are capable of entering into contracts*, that is, they must be mature and sane; an offer (Ijab) and acceptance (Qabul); a legal (Sharie) basis of union between the two declarations and the contractual obligations; and *free from all prohibited factors* (Ayub, 2007). In general, Muslim jurists hold that, intrinsically, the essential elements of a contract are threefold and if these elements are not found properly, the contract is invalid. These are the form, that is, offer and acceptance (sighah), the contracting parties ('aqidain) and the subject matter (ma'qud 'alayh).

BBA is said to be popular in countries like Malaysia, Indonesia and Brunei. However, it has proven to be quite unsatisfactory to the customers and bankers (Meera and Abdul Razak, 2006). Customers are particularly unhappy when it comes to early redemption or in the event of default as BBA carries a higher financing balance as compared to the conventional housing loan. To support the above, in recent years, the Islamic financing facility under the concept of BBA has attracted numerous judicial considerations (Mohamed, 2008) with the recent case of Affin Bank versus Zulkifli said to be a signpost of BBA. Further to that, the Middle Eastern Shari'ah scholars disapprove BBA contract, mentioning that BBA contract is similar to the conventional loans.

## **3.0 Musyarakah Mutanaqisah (MM)**

Conceptually it has been argued that house financing concept based on MM is more superior to the BBA. The argument is based on the advantages of MM which is seen to promote the welfare of the people as the outstanding balance of financing at any point in time never exceed the original price of asset (Meera and Abdul Razak, 2005). However, MM is not favorable among practitioner. It is less attractive to bankers because the MM does not charge interest of advance profits. As such the banks cannot make money. MM is purely based on rental payment (Aris, Othman, Azli, Arshad, Sahri & Yaakub 2011). It is less attractive for the banks since the MM would bring lower profits to the Islamic banks. By using BBA mode of finance, Islamic banks earn higher profits with less risk and efforts invested in the projects.

However, following basic economic theories, as the price of the products/services decreases (in this case MM mode of financing) the demand for that service would increase. Therefore, while the banks may lose some profits by implementing MM, compared to the BBA financing, it will gain some extra profits and therefore offset some of that loss, by initial increase in demand for their services (i.e. MM). At the same time, as the rental rate increase, it may be difficult for the bank to convince the customer that now he/she has to pay higher rental on the property. Legal amendments may be needed especially with regards to the tax structure. This means that the law

should be there to make sure that the customer is not taxed twice for the same property. Land laws and the laws related to the Islamic banking and finance (i.e. Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989) may have to be amended in order to allow banks to become legal co-owners of properties.

#### **4.0 Tawarruq**

Tawarruq is one of the Shari'ah-compliant modes used for cash-based financial instruments due to the nature of the Tawarruq mechanism, that is, to provide cash liquidity. Therefore, the concept suits most of the facilities provided by conventional banking, such as deposit loan, bond and money market instruments. This mode of cash-based instrument, which is widely known in the Gulf Region, has recently become popular in Malaysia as an alternative to *bay' al-'inah*, which was adopted in the early days. Tawarruq have two main stages, Murabahah stage and Asset liquidation stage. Murabahah stage is when the bank and the customer enter into a commodity Murabahah contract that is governed by the Murabahah rules of the Shariah Supervisory Board. The customer will own either physically or constructively the assets subject of the Murabahah contract. Whereas Asset liquidation stage is customers can choose either to sell/liquidate the commodity directly in the market on his own or through an agency agreement through the bank.

Classical Muslim jurists are divided on the issue of Shar'iah permissibility of Tawarruq. There is a view from Imam Ahmad Ibn Hanbal that Tawarruq is prohibited (haram). Another view from Imam Muhammad Hasan al-Shaibani, Imam Malik and of the two opinions narrated on behalf of Imam Ahmad Ibn Hanbal held that Tawarruq is discouraged (makruh). Imam Ibn Taimiyyah has considered Tawarruq as an exceptional dealing which is permitted in the case of necessity (*darura*), where the person is really in need of cash. Contemporary Muslim jurists are also divided on the issue of Shari'ah permissibility of Tawarruq. Central Bank of Malaysia (Bank Negara Malaysia) Shariah Advisory Council at its 51st meeting on the 28th July 2005 resolved that as a deposit product and financing based on the concept of Tawarruq, which is known as Commodity Murabahah, is permissible. The Shariah Advisory Council, Central Bank of Malaysia also resolved in 2006 that the use of *ijarah sukuk* and Shariah-compliant securities as underlying assets in Tawarruq or Murabahah to manage liquidity in the Islamic financial system is permissible.

The OIC Islamic Fiqh Academy ruled in its 19th session in April 2009 (Resolution 179 (19/5) in relation to Tawarruq: its meaning and types (classical applications and organized Tawarruq) that it is not permissible to execute both Tawarruq (organized and reversed) because simultaneous transactions occurs between the bank and the client, whether it is done explicitly or implicitly or based on common practice, in exchange for a financial obligation. This is considered a deception, i.e. in order to get the additional quick cash from the contract. Hence, the transaction is considered as containing the element of *riba*. To ensure that Islamic banking and financial institutions adopt investment and financing techniques that are Shariah-compliant in all its activities, they should avoid all dubious and prohibited financial techniques, in order to conform to Shariah rules and so that the techniques will ensure the actualization of the Shariah objectives

(maqasid Shari'ah). Furthermore, it will also ensure that the progress and actualization of the socio-economic objectives of the Muslim world. The OIC Fiqh Academy also ruled to encourage the banks to provide Qard Hasan (benevolent loans) to needy customers in order to discourage the banks from relying on Tawarruq instead of Qard Hasan. Islamic banks are equally reproached the large reliance on Bay al Inah (Sairally, 2002) and Tawarruq, which is a direct instrument of debt creation (Siddiqi, 2007) and that do not conceptually and practically differ much from the conventional. In addition, it is an indirect way of obtaining funds without involving in sale transactions and their implications (Sairally, 2002).

## **5.0 Discussion**

The setting up of Bank Islam Malaysia Berhad on 1983 saw the development and growth of Islamic banking products using various concepts such as (cost plus) for working capital, Bai Bithaman Ajil (BBA) (deferred installment sale) for home financing and Ijarah (leasing) for equipment and vehicle financing. The BBA scheme however bring up a controversial as it transaction is suspicious an away from Shariah guide. Whilst on MM, it has been argued throughout the paper that the MM, if implemented widely, would have several advantages over the BBA mode of financing as well as conventional loan. It has been shown that this mode would offer relatively cheaper financing to the customers and help them fulfill their needs in an easier way while complying with the teachings of Shariah. This is in line with the objectives of Shariah since it leads to the removal of the hardship.

The period of financing will be shortened which is beneficial for both, the financier as well as the customer. In addition to that, this mode would reflect the market movement and the price would never exceed the original price at any point of time. The interest rate (*riba*) can be totally avoided and the financier will be less vulnerable to the market movements (Smolo and Hassan, 2011). The Islamic financial instruction (IFI) rarely used this scheme as this scheme may not be attractive to the banks since this may reduce their earnings. Tawarruq practiced by IFI nowadays is known as organized Tawarruq which is there are 3 parties to make the transaction successful. But due to that there so many argument that relate to Bay al Inah which is another Shariah theory that is almost similar to conventional banking. If it is good why there's so many argument to justify the harmful to IFI in Malaysia.

## **6.0 Conclusion**

The basis of Islamic home financing must avoid the *riba* (usury), *maisir* (gamble) and *gharar* (uncertainty) are the vital part of the financing. In the discussion, the existing Islamic home financing such as Bai Bithaman Ajil, Musyarakah Mutanaqisah and Tawarruq have many weakness comparing to the strengthen f the models. Therefore in the future, we need to develop a new model of Islamic home financing especially for lower incomes earners.

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