

ISLAMIC HOME FINANCING BASE ON DEBT: A REVIEW OF PRACTICES OF ISLAMIC BANK IN MALAYSIA

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ABSTRACT

Nowadays the dual banking system in Malaysia has enable banks to offer two forms of home financing method, the Islamic home financing and the conventional home loan. As we know a house is a everyone needs. They will get by all means by purchase it, renting or build the house themselves. Islamic home financing product is one of the sources that generate profits for the local and foreign Islamic bank in Malaysia. Thus, very few people can afford to purchase a house on a cash basis. As muslim consumers, it is important for them to choose wisely on their financing. This study attempts to analyse the practice of Islamic home financing product base on debt in Malaysia since 2000 till 2016. The study is motivated by few shortcomings of current Islamic home product as well as an increasing the number of shariah instrument contracts among Islamic banking in Malaysia. Islamic home financing in Malaysia can divided into two types, which is debt and equity. *Bai bithaman ajil (bba)* is the most marketable mode of home financing in Malaysia since 1983 but nowadays, many Islamic banks in Malaysia was accepted *musyarakah mutanaqisah (mm)* and *tawarruq* as an alternative to *bai bithaman ajil*. This study uses a qualitative approach. The paper would survey the practice on Islamic home financing in Malaysia base on debt since 2000 until 2016.

Keywords: Islamic home financing, Islamic banking, Islamic instruments

Introduction

Islam is a religion that emphasis the all aspects of a Muslim's life, including the way finance and business dealings are conducted. Forbidden of riba is one of the fundamental issue. However, Islam is not, never was, and never will be a heavy burden on people in terms of their economic and contractual freedom. Islam very responsives to people's needs, remitting and legalising all

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transactions that meet legitimate and lawful needs based on justice and fair compensation in their commutative transactions (Syed Shah Alam, et.al. 2012).

Therefore, financing is allowable in Islam rather than interest or loan. Loan is totally prohibited in Islam and also to the Islamic consumer. Meanwhile, financing the Arabic term for a loan “cured” literally means “cutting-off a portion”, signifying that the person extending the loan is giving the borrower part of his property. It is also called “salaf”, meaning “advance”, to signify that the amount of loan is extended at some point, with the expectation of repayment at a later time (Wahbah, 2002).

Islamic banking is defined as a banking system that is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. The concept of interest however is forbidden in Islamic banks while the concept of profit and loss sharing is allowed and significantly, the prohibition of the collection and payment of any interest. Collecting interest is not permitted under Islamic law. Islamic banking refers a banking activities that is consistent with Islamic law and principles and guided by Islamic economics (Nasser, and Juriah, 2013).

Islamic home financing is an alternative financial product to substitute conventional interest-based home loan modes. In Islamic home financing, the dominant products used in a sale and purchase transaction are *bai' bithaman ajil* (deferred payment sale) and *musharakah mutanaqisah* (diminishing partnership). On the other hand, in the conventional system, home loan is simply giving a loan to the customer. The product is interest-driven, with the interest charged to the customer over the period of payment. *Bba* is a facility provided by the financier; i.e., the bank to a customer to own a house, over a tenor of financing, e.g. 20 years, at a rate (either fixed, variable or mixed) determined by the financier (Rafidah, et al. 2011). The financier initially buys the house from the customer at a price equal to the financing amount and sells it back to the customer at a price plus profit margin (Mydin Meera and Abdul Razak, 2005).

The first Islamic bank in Malaysia, Bank Islam Malaysia Berhad was introduced in 1983 in order to provide shariah compliant financial products and services (Sudin, 1996). In 1993, commercial banks, merchant banks and finance companies were allowed to offer Islamic banking products and services under the Islamic Banking Scheme (IBS). These institutions however, are required to separate the funds and activities of Islamic banking transactions from that of the conventional banking business to ensure that there would not be any co-mingling of funds. Since then until the end of 2003, the numbers of IBS banking institutions have increased to 36, comprising 14 commercial banks (of which 4 are foreign banks), 10 finance companies, 5 merchant banks and 7 discount houses.

In December 1998, the term interest-free banking scheme used for Islamic windows was replaced with Islamic Banking Scheme (IBS) or *Skim Perbankan Islam*. In that year, all banking institutions that have Islamic windows were also required to upgrade the Islamic banking unit to Islamic banking division so as to further expand the Islamic banking industry.

Today, Malaysia has a 16 of full-fledged Islamic banks including several foreign owned entities; conventional institutions who have established Islamic subsidiaries. The creation of 16 Islamic banks in Malaysia will providing a healthy competition in Islamic banking industry.

Starting from 2004, Malaysia now has separate Islamic legislation and banking regulations that co-exist with those for the conventional banking system. Malaysian banks currently offer more than 100 of Islamic financial products and services that use various Islamic concepts - such as

mudharabah, musharakah, murabahah, bay' bithaman ajil (bba), al-istisna', tawarruq, musharakah mutanaqisah (mm), bai' muajjal, ijarah, qard al-hassan, and al-ijarah thumma al-bay'. Generally, Islamic home financing offers fixed payments for the settlement of the financing at the beginning of the payment until settlement.

Research Methodology

This research focus on qualitative approach using document research method. The secondary data was gathered from different variety of sources related to the study, such as journals, online journal in google scholar, books, and few articles related to the study. Secondary data is data gathered and recorded by someone else prior to and for a purpose other than the current project. (Zikmund, 2013).

Literature Review

Accommodation is one of the fundamental rights for by every Muslim. An Islamic perspective a house is a place for relaxation, unwinding our mind and enjoying legitimate worldly delights. Islamic house is a microcosm of Islamic culture and civilization where individuals and families are bred and nurtured, to constitute the fundamental units of the community (Spahic Omer, 2006).

Nowadays, thus fail to understand these new trend will miss opportunities or find themselves (John McIlwain, 2010). In such, to possessed a house in Malaysia nowadays can cause the customer half million for a an average apartment in specific in Klang Valley. Even, a terrace link house in Mantin in Negeri Sembilan, fifty kilometer (km) the nearest state to Klang Valley cost the same price. Therefore, customer preferred to give the chance to have the ability to forecast and planning. It is possible, the customers are taking the planning to take risk to own a house.

Sale of debts at market determined prices amounts to treating them as goods and services. But they are not. Debts are sums of money, to be paid at a future date. Sale and purchase of debt is like sale and purchase of cash now against cash at a future date. That is *riba* prohibited in Islam for reasons of equity and human felicity discussed elsewhere. A financial system that allows sale of debts at market determined prices is no different from a financial system that allows exchange of money now with a different amount of money at a future date. Such a financial system can hardly bring in the advantages on account of efficiency and stability that are hallmarks of Islamic finance (M, Nejatullah, 2006). The debts out of a contract of exchange such as trade financing based on the underlying contracts of *murabahah* or asset sale based on the underlying contract *bba* are securitized (Hanudin, 2007).

Debt financing can divided to two categories. Long term and short term financing. Long term debt financing usually applies to assets a customer's business is purchasing, such as equipment, buildings, land or machinery. With long term debt financing, the scheduled payment of the financing and the estimated useful life of the assets extends over than one year (Zaharuddin, 2014). Short term debt financing usually applies to money needed for the day-to-day operations of the business, such as purchasing inventory, supplies or paying the wages of employees. Short term financing is referred as an operating or short term loan because scheduled payment takes place in less than one year (Zaharuddin, 2014).

In 2015, 43.5% of individual income is to pay debt. For example, Ahmad is having monthly fixed income of RM 10,000. RM 4,350 is to pay debt for instances housing financing, car financing and other financing. However, merely 60% to 87% financing payment to house financing and car financing. The trend housing price is increasing by 137% last ten years (Radzi, 2015). It shows that

most debt financing in Malaysia is long debt financing and because of the price of property is stabilized. Hence, Islamic banking should take more opportunity to offer debt based financing to cater the customer needs.

The retail Islamic banking at present, offers various schemes of home financing based on *al-bai bithaman ajil* (Dzuljastri, et.al., 2008). Nowadays the most famous type of house financing provided by the banks is *bba* home financing based on the findings in 2013. Definitely, the Islamic housing is an alternative financing product to substitute conventional interest-based home financing modes. In Islamic home financing, the dominant products used in sales and purchase transaction are *bai' bithamin ajil* (deferred payment) and *musharakah mutanaqisah* or diminishing partnership (Rafidah, et al. 2011).

In the recent study, earlier scholars in contrast criticize *bba* openly without suggestions for betterment (Mydin & Abdul, 2009). Yet, based on detailed examination, the *bba* meets the Maqasid al-Shariah and proves to be permissible (Yaakob & Abdul Rahim, 2009). This is also supported by the National Shariah Advisory Council and the Securities Commission proves the permissibility of the *bba* (Hanudin, et al., 2014). This evidence shows that financial institutions *bba* permissible.

There is a felt need for evaluation of what has gone by during the last three decades in the field of Islamic banking and finance. More important than focusing on its growth, commercial performance and market share is the need for evaluating it in terms of its contribution to introducing and promoting the understanding of the economic and financial aspects of the overall Islamic way of life (M. Nejatullah, 2006).

Customers are apparently not happy with the current implementation of *bba* home financing as many of its features mirror that of conventional mortgage loan. Thus, it is importance to recommend a few things for future studies on debt-based financing with other contract as *tawarruq*, *istisna'*, *ijarah* and *murabahah*. For instance, *istisna'* giving more options for customer to plan and taking manageable risk. *Al-istisna'* considered permissible within Islamic law (Mohd Faisol & Rosila, 2014). *Istisna'* concept is a mechanism of buying and selling, thus this method of transacting business may overcome the element of usury or interest on any advance payment or loan provided by either party to a contract, which is prohibited in Islam (Muhammad Ridhwan, 2013). The contract of *istisna'* places a moral obligation on the manufacturer to manufacture the goods. Either party may cancel the contract before any work begins after giving enough notice. However, the contract cannot be cancelled unilaterally if work has begun (Zaharuddin, 2008).

Discussion

Table 1 shows the five types of Islamic home financing instruments bases on debt such as *bai bithaman ajil*, *murabahah*, *istisna'*, *ijarah* and *tawarruq* instruments during 2000 until 2016. Meanwhile, Islamic home financing based on equity is only one instrument which is *musyarakah mutanaqisah* since 2004-2016. Nowadays, *bai bithaman ajil* instruments is not predominant as main instrument contract because *musharakah mutanaqisah* and *tawarruq* or *murabahah* are most acceptable in Malaysia. In short, the activities in Islamic banks giving more options to the customers. They can choose better service and other add value features of the Islamic home financing product and service.

Table 1: Islamic Home Financing Base on Instruments in Malaysia 2000-2016

Bil	List of Islamic Banks	Ownership Status	Islamic Instruments
1.	Affin Islamic Bank Berhad	Local	<i>musharakah mutanaqisah</i>
2.	Al-Rajhi Banking & Investment Corporation (Malaysia)	Foreigner	<i>bay' bithaman ajil</i>
3.	Alliance Islamic Bank Ber had	Local	<i>bay' bithaman ajil</i>
4.	AmIslamic Bank Berhad	Local	<i>bay' bithaman ajil</i>
5.	Asian Finance Bank Berhad	Foreigner	<i>tawarruq Istisna'</i>
6.	Bank Islam Malaysia Berhad	Local	<i>tawarruq</i>
7.	Bank Muamalat Malaysia Berhad	Local	<i>tawarruq Istisna'</i>
8.	CIMB Islamic Bank Berhad	Local	<i>Murabahah/tawarruq</i>
9.	Hong Leong Islamic Bank Berhad	Local	<i>tawarruq</i>
10.	HSBC Amanah Malaysia Berhad	Foreigner	<i>musharakah mutanaqisah</i>
11.	Kuwait Finance House Malaysia Berhad	Foreigner	<i>Ijarah muntahia bi al-tamlik Ijarah mausufah fi al-zimmah</i>
12.	Maybank Islamic Berhad	Local	<i>musharakah mutanaqisah murabahah</i>
13.	OCBC Al-Amin	Foreigner	<i>Ijarah muntahia bitamleek</i>
14.	Public Islamic Bank Berhad	Local	<i>bay' bithaman ajil</i>
15.	RHB Islamic Bank Berhad	Local	<i>musharakah mutanaqisah</i>
16.	Standard Chatered Saadiq Berhad	Foreigner	<i>musharakah</i>

Table 2 shows that 16 of Islamic banking institution was established in Malaysia since 2000-2016 and currently 12 of 16 Islamic banks in Malaysia are offered Islamic home financing product base on debt. Meanwhile only five Islamic banks are offered Islamic home financing product base on equity. This data shown that the Islamic home financing base on debt more preferable and acceptable by Islamic bank in Malaysia. In other words, debt based financing are predominat the whole financial institution in Malaysia. Meanwhile, Maybank Islam Berhad is the only bank offered both types of Islamic home financing.

Table 2: Islamic Home Financing Base on Debt and Equity in Malaysia

No.	List of Islamic Banks	Ownersh ip Status	Islamic Instruments based on debt	Islamic Instruments based on equity
1.	Affin Islamic Bank Berhad	Local	-	<i>musharakah mutanaqisah</i>
2.	Al-Rajhi Banking & Investment Corporation (Malaysia)	Foreigner	<i>bay' bithaman ajil</i>	-
3.	Alliance Islamic Bank Ber had	Local	<i>bay' bithaman ajil</i>	-
4.	AmIslamic Bank Berhad	Local	<i>bay' bithaman ajil</i>	-

5.	Asian Finance Bank Berhad	Foreigner	<i>tawarruq istisna'</i>	-
6.	Bank Islam Malaysia Berhad	Local	<i>tawarruq</i>	-
7.	Bank Muamalat Malaysia Berhad	Local	<i>tawarruq Istisna'</i>	-
8.	CIMB Islamic Bank Berhad	Local	<i>murabahah tawarruq</i>	-
9.	Hong Leong Islamic Bank Berhad	Local	<i>tawarruq</i>	-
10.	HSBC Amanah Malaysia Berhad	Foreigner	-	<i>musharakah mutanaqisah</i>
11.	Kuwait Finance House Malaysia Berhad	Foreigner	<i>Ijarah muntahia bi al-tamluk</i> <i>Ijarah mausufah fi al-zimmah</i>	-
12.	Maybank Islamic Berhad	Local	<i>murabahah</i>	<i>musharakah mutanaqisah</i>
13.	OCBC Al-Amin	Foreigner	<i>Ijarah muntahia bitamleek</i>	-
14.	Public Islamic Bank Berhad	Local	<i>bay' bithaman ajil</i>	-
15.	RHB Islamic Bank Berhad	Local	-	<i>musharakah mutanaqisah</i>
16.	Standard Chatered Saadiq Berhad	Foreigner	-	<i>musharakah</i>

Meanwhile, there are five types of debt based contracts such as *bai bithaman ajil* (deferred payment), *murabahah*, (mark up price), *istisna'* (booking), *ijarah* (leasing) and *tawarruq* (third party). Then, equity based is still dominant by *musharakah mutanaqisah* (diminishing partnership). Other equity based types that overlooked by the financial institution is *mudharabah*. In 2016, Islamic home financing based on debts are predominant the whole 16 financial institution.

Islamic home financing is progressing on debt based. However, keep promoting the Islamic concept so the muslims consumer are well versed with the concepts. As muslim we are not allowed to enter home financing that involved with *riba* or interest-based. Somehow or rather, this Islamic concepts still hard to digest by them. Furthermore, there is "room for improvement."

Conclusion

Debt financing contract is evolving rapidly. Currently *tawarruq* contract is majority of the instrument base on debt. *Istisna'* instruments is only one of the bank used. New instruments such as *tawarruq* and *murabahah* is used by the Islamic bank. Many Islamic banks in Malaysia was accepted *tawarruq* as an alternative to *bai bithaman ajil*. Analysis of the data related to Islamic home financing for the year 2000 to 2016 has provided the following:

- There are a few number of Islamic instruments on Islamic home financing offered in Malaysia.
- Most of Islamic bank in Malaysia prefer to use debt financing instrument. *Tawarruq* and *bai bithaman ajil* is the major instrument preferred by the banks.

- A few Islamic bank are using mixed financing which debt based and equity based.

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