

## ISLAMIC HOME FINANCING IN MALAYSIA: AN OVERVIEW OF ISLAMIC FINANCE CONCEPTS APPLIED

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### ABSTRACT

Owning a house is an essential decision in one's life. With various house financing products offered by financial institutions, products that adhere to the Shariah principles termed as Shariah-compliant became an alternative for Muslim consumers to avoid being involved in transactions related to usury (*riba*). This paper aims to provide an overview of the Islamic finance concepts applied in Islamic home financing products in Malaysia namely Ba'i Bithaman Ajil (BBA), Musharakah Mutanaqisah (MM) and Tawarruq. This study employs qualitative approach using library research method by examining and analyzing secondary data collected from multiple sources such as journal articles, policy documents, books, resolutions, standards, product disclosure sheets and reports. Results of this study revealed that acceptance of scholars on Shariah finance concept applied in Islamic home financing in Malaysia varies in degree for each concept with MM being the less disputable one among the three. The evolvement trend of these concepts emerges from debt-based BBA to equity-based MM and back to a debt-based one; Tawarruq. The results also found that even when applying the Shariah concept in the operation of Islamic home financing products, banks cannot yet escape from using interest-based benchmarks in calculating their profit. It is concluded that Islamic banks are exerting a commendable effort in providing Shariah alternatives for home financing, however, this effort needs to be improved to provide a Shariah-compliant home financing that carefully observes the Shariah requirement and at the same time more affordable to consumers than conventional loans. The authors suggest that future research will try to propose a less disputable Shariah compliant product for Islamic home financing which are more cost-effective to the buyer and at the same time profitable to the Islamic financial institutions.

**Keywords:** house financing, Ba'i Bithaman Ajil, Musharakah Mutanaqisah, Tawarruq, Shariah

## INTRODUCTION

Owning a house is indisputably a dream of every person. A good and comfortable house is one of the keys to happiness as stated in the hadith

مِنْ سَعَادَةِ الْمَرْءِ الْمَسْكِنُ الْوَاسِعُ، وَالْجَارُ الصَّالِحُ، وَالْمَرْكَبُ الْهَيِّئُ

“Part of a man's happiness is a spacious house, a good neighbour, and a good transport”

Purchasing a house is a big decision for many households, especially considering the high prices of houses these days. In Malaysia, the ratio of housing prices to household earnings, particularly in the Klang Valley and other big cities, has put a burden on each household's obligations<sup>1</sup>. It is then reasonable for financial to be among the top factors that are strongly associated with consumer decision making in purchasing residential property surpassing the association of feature factor<sup>2</sup>.

Despite this fact, Muslim consumers are still observant in opting for Shariah-compliant house financing products to purchase the property they intended as not to violate the religion's principles. Avoiding themselves from being involved in usury (riba) is the general motivation for Islamic banks clients to opt for Islamic banking and finance products despite the risk of this option of being more expensive and requiring more complicated documentations compared to their conventional counterparts<sup>3</sup>. In choosing financiers to fulfil their need to own a house, operations carried out according to Shariah principles and maintaining information privacy are the factors that led to Shariah-compliant banks having an excellent reputation for garnering their clients' trust<sup>4</sup>. A study conducted in 2017 even reported that the religiosity factor even surpasses price and cost factor in the rankings of factors determining Islamic home financing acceptance in Klang Valley<sup>5</sup>.

This study focuses on giving an overview of financial Islamic concepts underlying Islamic home financing product offered by Islamic financial institutions in Malaysia. Islamic home financing in Malaysia can be divided into two types, which is debt-based such as Ba'i Bithaman Ajil (BBA), Istisna', Ijarah and tawarruq (commodity murabahah) and equity-based such as musharakah mutanaqisah

<sup>1</sup> Zairul Mohd, “Housing Dilemma Among Young Starters in Malaysia”, *Elixir Sustain. Arc* 58, (2013): 14926.

<sup>2</sup> Chong Pei Hei and Omkar Dastane, “Buying A Dream Home – Considerations of Residential Property Consumers in Malaysia,” *Singaporean Journal Of Business* 5, no. 9 (2017): 31.

<sup>3</sup> Suhaib Walid Sharaiyra and Maher Haswa, “The Effect of ‘Motive’ on Characterising Organised Tawarruq,” *Arab Law Quarterly* 33, no. 2 (2019): 180.

<sup>4</sup> Shafinar Ismail, Farah Azmi and Ramayah Thurasamy, “Selection Criteria for Islamic Home financing in Malaysia,” *International Journal of Business and Society* 15, no.1 (2014): 105.

<sup>5</sup> Nur Fadhli Bassir, Zarina Zakaria, Haslida Abu Hasan, and Ervina Alfian, “Factors Influencing the Adoption of Islamic Home Financing in Malaysia,” *Transformations in Business and Economics* 13, no. 1 (2014): 17.

(MM)<sup>6</sup>. The following Table 1 shows the summary of Islamic concepts used in Islamic home financing by Islamic banks in Malaysia throughout the year:

**Table 1.** Islamic Concepts Used in Islamic Home Financing Products by Islamic Banks Malaysia

No	Islamic Bank	Islamic Concepts Used in Islamic Home Financing Products		
		As of November 2011	As of March 2016	As of November 2021
1	Affin Islamic Bank	BBA	MM	MM
2	Al Rajhi Bank	Shariah Compliant	BBA	Tawarruq
3	Alliance Islamic Bank	BBA	BBA	BBA
4	AmIslamic Bank	BBA	BBA MM	Tawarruq
5	Asian Finance Bank (Recently known as MBSB)	Shariah Compliant	MM	Tawarruq
6	Bank Islam	BBA	Tawarruq	Tawarruq
7	Bank Muamalat	Shariah Compliant	MM	Tawarruq
8	CIMB Islamic Bank	BBA	Tawarruq	Tawarruq
		Al-Ijarah Muntahiyah Bi Tamlik	Al-At-	
9	HSBC Amanah Malaysia	MM	MM	MM
10	Hong Leong Islamic Bank	BBA	Tawarruq	Tawarruq
11	Kuwait Finance House (KFH)	MM BBA Istisna' Murabahah	Ijarah Muntahiyah Bit-Tamlik	Ijarah Muntahiyah Bit-Tamlik Ijarah Mausufah fi Dzimmah
12	Maybank Islamic	BBA MM	MM Tawarruq	Tawarruq
13	OCBC Al-Amin Bank	Shari'ah-compliant	Ijarah Muntahiyah Bit-Tamlik	Ijarah Muntahiyah Bit-Tamlik
14	Public Islamic Bank	BBA	Ba'i Al-Inah	MM
15	RHB Islamic Bank	MM MM	MM	MM Tawarruq
16	Standard Chartered Saadiq	BBA	MM	MM

This paper will discuss Islamic home financing in Malaysia that uses the Shariah finance concepts Ba'i Bithaman Ajil, Musharakah Mutanaqisah and Tawarruq.

<sup>6</sup> Mohd Faisal Ibrahim and Rosila Kamaruddin, "Islamic Home Financing Based on Debts: A Review of Practices Of Islamic Banks In Malaysia," *Labuan e-Journal of Muamalat and Society* 12, (2018): 43.

## RESEARCH METHODOLOGY

This paper employs qualitative approach by using library research method. Data related to the study are secondary data collected from multiple sources such as journal articles, policy documents, books, resolutions, standards, product disclosure sheets and reports. These data are subsequently examined and analyzed to obtain the results. In obtaining the results, this paper analyzes concepts of ba'i Bithaman ajil, musharakah mutanaqisah and tawarruq in theory and after that, how it is applied in Islamic home financing in Malaysia together with issues arises regarding them.

## RESULTS

### Ba'I Bithaman Ajil (BBA)

BBA is the earliest Islamic home financing product that are put in practice by Islamic banks in Malaysia<sup>7</sup>. BBA refers to a sale contract with delayed payment. Middle Eastern countries refers to BBA as *murabahah* while in Malaysia, these two terms are referred differently<sup>8</sup>. BBA is a type of *murabahah* that is used over a long length of time, whereby *murabahah* contracts are usually, even though not necessarily, for a short time<sup>9</sup>. Settlement of the selling price, which comprises the cost and profit margin, is postponed to a future date, whereas delivery of the commodity sold is made immediately<sup>10</sup>. BBA is a debt-based financing rather than equity-based<sup>11</sup>. Despite being the first Islamic home financing product introduced in Malaysia and the formerly type of sale that is the most widely used by Islamic banks in Malaysia, BBA instruments are no longer the major instrument contract as musharakah mutanaqisah and tawarruq or commodity murabahah are becoming more accepted in Malaysia<sup>12</sup>.

BBA financing would allow customers who could not afford to pay cash in advance to be able to purchase the house of their own and pay instalment later<sup>13</sup>. Bank Negara Malaysia stated in their Murabahah policy document that the price in a murabahah contract shall be based on the disclosed acquisition cost and added mark-up which may be determined either in the form of an absolute amount or a

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<sup>7</sup> Selamah Maamor, Nurul Labanihuda Abdull Rahman, and Abu Bakar Hamed, "Determinants of Islamic Home Financing Product Selection among Lower Income Group in Kuala Lumpur, Malaysia," *International Journal of Economics and Financial Issues* 2, no. S7 (2016): 198.

<sup>8</sup> Azwina Wati Abdull Manaf, Siti Marshita Mahyut, and Asfarina Kartika Shakri, "Analysis on Islamic Home Financing in Malaysia," *Journal of Contemporary Islamic Studies* 3, no. 2 (2017): 3.

<sup>9</sup> Mohamed Noordeen Mohamed Imtiyaz, Salina Kassim, and Nor Zalina Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," *Journal of the Malaysian Institute of Planners* 5, no. 4 (2017): 36.

<sup>10</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 3.

<sup>11</sup> Ibrahim and Kamarudin, "Islamic Home Financing Based on Debts: A Review of Practices Of Islamic Banks In Malaysia," 46.

<sup>12</sup> Ibrahim and Kamarudin, "Islamic Home Financing Based on Debts: A Review of Practices Of Islamic Banks In Malaysia," 46.

<sup>13</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 3.

certain percentage of the acquisition cost or a reference rate such as the Base Lending Rate (BLR), the Base Financing Rate (BFR), Kuala Lumpur Interbank Offered Rate (KLIBOR) or Cost of Funds (COF) specified at the time of entering into the contract<sup>14</sup>.

### **BBA Practice in Malaysia Islamic Financial Institutions**

The Council of the Islamic Fiqh Academy, during its sixth and seventh session held in Jeddah, Kingdom of Saudi Arabia agreed on the permissibility of instalment sale. The council stated that different prices for cash and instalment sales are permitted in this sort of arrangement. However, once the contract is finalized there should be only one price, whether the cash or instalment price<sup>15</sup>. Nevertheless, Middle Eastern scholars do not recognize the use of BBA as a means of finance due to the fact that BBA contracts are seen to mimic conventional housing loans<sup>16</sup> and the its operation that resembles the highly disputable ba'i al-'inah.

In Malaysia, the practice of BBA in home financing is as explained in the following diagram<sup>17</sup>:

1. The customer identifies the property that he wants to buy.
2. The consumer buys the property from the developer after paying a deposit or a portion of the purchase price.
  - The property is now under the customer's ownership.
2. The consumer applies for a house financing product based on BBA to an Islamic bank.
3. Under the bank's Property Purchase Agreement (PPA), the customer sells the property to the bank at its cost price (the amount he paid to the developer after deducting the paid deposit). The bank pays the customer in cash to buy the property.
4. Through the bank's Property Sale Agreement (PSA), the bank sells back the property to the customer with a deferred price.  
The bank's selling price for the property would include the agreed-upon profit margin, and repayment would be in monthly instalments of a defined sum over a given period.
5. The purchaser pays the monthly instalment to the bank.

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<sup>14</sup> Bank Negara Malaysia, *Murabahah* (Kuala Lumpur: 2013), 13.

<sup>15</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, "Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiq 'An Munazzamatu At-Ta'awun Al-Islami," (2020), 167.

<sup>16</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 37.

<sup>17</sup> Mohd Fuad Sawari, Nik Azizu Nik Abdullah, Mustafa Mat Jubri, and Akhtarzait Abd Aziz, "Issues of Bai' al-'Inah in the Contemporary Islamic Financial Products and Its Solutions According to the Shariah Principles," *South East Asia Journal of Contemporary Business, Economics and Law* 15, no. 5 (2018): 98; Nuarrual Hilal Md Dahlan, Mohd Sollehudin Shuib, and Fauziah Mohd Noor, "Issues in Bay' Bithaman Al-Ajil Islamic Home Finance ('BBA') in Abandoned Housing Projects In Malaysia: An Examination of 'Gharar'," *Journal of Law, Policy and Globalization* 57, (2017): 122.

The profit rate for the bank in BBA is generated from the difference between the sale price and purchase price from the customer where the customer can only own the house after the full payment of the full tenure has been made<sup>18</sup>.

### Issues in Ba'i Bithaman Ajil

Despite the fact that the Middle Eastern scholars do not recognize the use of BBA as a means of finance due to the fact that BBA contracts are seen to mimic conventional housing loans, it is authorized in nations such as Malaysia, Indonesia, and Brunei<sup>19</sup>. Among the issues concerning BBA are:

#### 3.1.2.1 Having features similar to the conventional loan

One of the main issues with BBA arises from its features mirroring conventional mortgage loan practices explicitly based on *riba*<sup>20</sup>. This is due to the fact that most Islamic banks base their profit or mark-up pricing for this contract on interest rates as a benchmark<sup>21</sup>. Even in Murabahah policy document issued by Bank Negara Malaysia, given that BBA falls into murabahah category, states that the mark-up price may be determined in the form of a reference rate such as the Base Lending Rate (BLR), the Base Financing Rate (BFR), Kuala Lumpur Interbank Offered Rate (KLIBOR) or Cost of Funds (COF)<sup>22</sup>. Islamic banks charge a profit derived from Islamically lawful buy-and-sell contract rather than charging them interests; however, because the return rate is tied to the market interest rate, it is fairly similar to a conventional loan in terms of computational formulas, where the profit rate tracks the market interest rate<sup>23</sup>.

#### 3.1.2.2 Application of highly disputable Bay' Al- Inah

Other than that, another issue arises more on the Shariah side. Theoretically, BBA is supposed to be a deferred sale contract where a bank sells an asset at a marked-up price for the customer to pay in instalments. From the perspective of Islamic jurisprudence that is discussed earlier in this paper, the majority of Muslim scholars agree on the permissibility of this kind of sale. However, in banking practices, the application of BBA is actually a form of *ba'i al-inah* (BAI) or a buy-back contract<sup>24</sup>.

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<sup>18</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 38; Abu Hasnat, Shahedin Alom, and Kamrul Islam Talukderc, "A Comparative Analysis Between Musharakah Mutanaqisah and Al-Bay Bithaman Ajil Contracts Under The Islamic Home Financing in Malaysia," *International Journal of Development Research* 7, no. 1 (2017): 6.

<sup>19</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 37.

<sup>20</sup> Ibrahim and Kamarudin, "Islamic Home Financing Based on Debts: A Review of Practices Of Islamic Banks In Malaysia," 46.

<sup>21</sup> A. Lahasna, Shariah Issues and Resolutions on Contemporary Islamic Banking and Finance (Malaysia: IBFIM, 2014).

<sup>22</sup> Bank Negara Malaysia, *Murabahah*, 13.

<sup>23</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 37.

<sup>24</sup> Sawari, Nik Abdullah, Mat Jubri, and Abd Aziz, "Issues of Bai' al-'Inah in the Contemporary Islamic Financial Products and Its Solutions According to the Shariah Principles," 98.

According to An-Nawawi, BAI is a transaction where a person sells a product to a customer with a deferred payment and deliver the product to the customer. The seller then buys back the same product from the customer, in cash, with a lower price, before the customer settles the payment for the product<sup>25</sup>. In this transaction, the customer gets immediate cash, whereas the seller benefits from the difference between the two prices. An example of BAI is as follow:

1. A sells a car to B with a deferred payment.
2. The car now is in B's ownership. B is needed to settle the payment afterwards.
3. A buys back the car from B, in cash, at a lower price. The car now is now in A's ownership. B gets the cash payment.
4. B still needs to settle the price for number (2). B can pay instalments.

The BBA practiced in banks applies BAI can be seen when the same asset or property, is bought by the bank from the customer in cash at a lower price and sold back to the customer, by deferred payment, at a marked-up price as explained earlier at the beginning of this article.

Majority of Muslim scholars of Hanafi, Maliki and Hanbali rule out the impermissibility of BAI because it is seen as a mean for usury or *riba*, while the Syafi'e and Az-Zohiri rule out BAI as permissible<sup>26</sup>. Muslim scholars that rule out the impermissibility of BAI argue based on some hadith, among them are:

1. The hadith reported by Ibn Umar who reported that the Prophet p.b.u.h said:

إِذَا تَبَايَعْتُمْ بِالْعِيْنَةِ وَأَحَدُكُمْ أَذْنَابَ الْبَقْرِ وَرَضِيْتُمْ بِالزَّرْعِ وَتَرَكْتُمْ الْجِهَادَ سَلَطَ اللَّهُ عَلَيْكُمْ ذُلًّا لَا يَنْزِعُهُ حَتَّى تَرْجِعُوا إِلَى دِينِكُمْ "

"When you enter into the inah transaction, hold the tails of oxen, are pleased with agriculture, and give up conducting *jihad* (struggle in the way of Allah). Allah will make disgrace prevail over you and will not withdraw it until you return to your original religion."

(Reported by Aby Dawud)

2. The hadith reported by Abu Ishaq As-Sabi'i that his wife entered A'isyah r.a With her wife of Zaid bin Arqam Al-Ansari and another woman. The wife of Zaid bin Arqam Al-Ansari asked A'isyah r.a:

"يا أم المؤمنين، إني بعت غلاما من زيد بن أرقم بثمانمائة درهم نسيئة وإني ابتعته منه بستمائة نقدا. فقالت عائشة،

"بئس ما اشتريت، وبئسما شريت إن جهاده مع رسول الله صلى الله عليه وسلم قد أبطل إلا أن يتوب"

"Oh the mother of believers, I sold a slave to Zaid bin Arqam for 800 dirhams with delayed payment, and then I bought it from him with 600 dirham cash. A'isyah r.a said "What a foul that you bought and what a foul that you sold. His (Zaid bin Arqam) jihad with Rasulallah p.b.u.h had been invalidated unless he repented."

(Reported by Ad-Daruqutni)

<sup>25</sup> Abu Zakariyya Muhyiddin An-Nawawi, *Raudhah At-Talibin wa Umdah Al-Muftiin* (Beirut: Al-Maktab Al-Islami, 1991), 85-86.

<sup>26</sup> Diyan bin Muhammad Ad-Dibyan, *Al-Muamalah Al-Maliyyah Asalatan wa Mu'asaratan* (Riyadh: Maktabah Al-Malik Al-Fahd Al-Wataniyyah, 2011), 452.

3. Hadith<sup>27</sup> reported by Anas r.a, that he was asked about ba'i al-inah, and he replied:

"إن الله لا يُخدع، هذا مما حرم الله ورسوله"

"Allah will not be tricked. This is of what not permitted by Allah and His messenger" Meanwhile, scholars that permit this kind of transaction argue based on the following:

1. Hadith narrated by Abu Sa'id Al-Khudri:

جَاءَ بِلَالٌ إِلَى النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ بِتَمْرٍ بَرْنِيٍّ فَقَالَ لَهُ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ " مِنْ أَيْنَ هَذَا؟ " قَالَ بِلَالٌ، " كَانَ عِنْدَنَا تَمْرٌ رَدِيٌّ، فَبِعْتُ مِنْهُ صَاعَيْنِ بِصَاعٍ، لِنُطْعِمَ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ " فَقَالَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عِنْدَ ذَلِكَ " أَوْهَ أَوْهَ عَيْنُ الرَّبَا عَيْنُ الرَّبَا، لَا تَفْعَلْ، وَلَكِنْ إِذَا أَرَدْتَ أَنْ تَشْتَرِيَ فَبِعِ التَّمْرَ بِبَيْعٍ آخَرَ ثُمَّ اشْتَرِهِ."

Bilal brought Barni (a kind of date) to the Prophet p.b.u.h and the Prophet p.b.u.h asked him, "From where have you brought these?" Bilal replied, "I had some inferior type of dates and exchanged two sa'(a measurement) of it for one sa of Barni dates to give it to the Prophet to eat." Thereupon the Prophet p.b.u.h said, "Beware! Beware!

This is riba (usury)! This is Riba (Usury)! Don't do so, but if you want to buy (a superior kind of dates) sell the inferior dates for money and then buy the superior kind of dates with that money."

### 3.1.2.3. Issues pertaining to default or early redemption

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<sup>28</sup>. In this case, the recent case of Affin Bank versus Zulkifli said to be a signpost of BBA<sup>29</sup>. Other than that, the absence of such a term in the BBA transaction that provides protection to the consumer against losses due to abandonment of housing project, which led to the existence of *gharar al-fahish* (exorbitant uncertainty) in abandoned housing projects<sup>30</sup>.

### 3.1.2.4. Unaffordability issue

A study conducted in 2017 showed that financing balance after 10 years in BBA is higher compared to conventional home loans<sup>31</sup>. In terms of unaffordability of BBA which makes it difficult for low-income households, due to a lack of collateral and a higher risk of default, such households are in a weaker position to negotiate favorable terms, which has led Islamic financial institutions to prefer fully

<sup>27</sup> Abu Abdullah Muhammad ibn Abi Bakr Ibn Qayyim, *Tahzib Sunan Abu Daud* (Beirut: Maktabah Al-Ma'arif, 2007), 338.

<sup>28</sup> Sharifah Arni Syed Jaaffar, Puspa Liza Binti Ghazali, Bunyamin Bello, and Saiful Bahri Mohamed, "Existing Shariah Model of Islamic Home Loan Financing: Weakness and Strength," *International Journal of Advanced Engineering and Management Research* 2, no.4 (2017): 1223.

<sup>29</sup> Syed Jaaffar, Ghazali, Bello, and Mohamed, "Existing Shariah Model of Islamic Home Loan Financing: Weakness and Strength," 1223.

<sup>30</sup> Md Dahlan, Shuib, and Mohd Noor, "Issues in Bay' Bithaman Al-Ajil Islamic Home Finance ('BBA') in Abandoned Housing Projects In Malaysia: An Examination of 'Gharar'," 122.

<sup>31</sup> Hasnat, Alom, and Talukderc, "A Comparative Analysis Between Musharakah Mutanaqisah and Al-Bay Bithaman Ajil Contracts Under The Islamic Home Financing in Malaysia," 6.



collateralized instruments such as BBA which earns them attractive returns without assuming the roughly equal risks<sup>32</sup>. As a result, this practice by Islamic banks will gradually move low-income consumers away from the formal housing market, as they see little to no financial motivation in providing these households with lower-than-market Islamic home financing products. Study by Md Zabri and Haron illustrated an example of BBA operation of a property priced RM 350,000 purchased by a customer, after he paid the 10 per cent down payment, being price-marked up to RM584,733, which almost double the price of the property<sup>33</sup>.

### **Musharakah Mutanaqisah (MM)**

Introduced in 1976 by Samy Hamoud in his thesis, musharakah mutanaqisah (MM) is a diminishing partnership in which one partner promises to buy the equity share of the other partner step by step until equity title is completely under his name<sup>34</sup>. In MM contract, Islamic bank and customer enter a partnership under the concept of *Shirkat-al-Milk* (joint ownership) of a house and then the bank leases its share of the house ownership to the customer<sup>35</sup>. The amount of rental during the period of the contract will be jointly shared between the bank and client according to the portion shareholding at the times of signing the contract, which keeps altering as the client purchases the share of the financier and subsequently, as a result, after each rental payment the share portion of the customer would increase due to the periodic redemption until eventually fully owned by the client<sup>36</sup>. The MM concept is based on the extremely successful Islamic cooperative housing organisation in Toronto, Canada, which was founded in 1981 out of a need to prevent the Muslim community from indulging in *riba*<sup>37</sup>. Being a contemporary hybrid contract, MM comprises the concept of partnership (*musharakah*), sale (*ba'i*), rent (*ijarah*) and promise (*wa'd*)<sup>38</sup>.

The MM concept is intended to solve prior contentious issues and vulnerabilities embedded in BBA that caused problems for purchasers, banks, and regulators<sup>39</sup>. While BBA is a debt type financing that resembles a conventional loan, MM is a joint

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<sup>32</sup> Mohd Zaidi Mohd Zabri and Razali Haron, "A comparative analysis of financial affordability in Islamic home financing instruments in Malaysia," *International Journal of Housing Markets and Analysis* 12, no.9 (2019): 1096.

<sup>33</sup> Mohd Zabri and Haron, "A comparative analysis of financial affordability in Islamic home financing instruments in Malaysia," *International Journal of Housing Markets and Analysis* 12, no.9 (2019): 1100.

<sup>34</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 6; Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), *The Accounting and Auditing Organization for Islamic Financial Institution Shari'ah Standards* (Manama: Dar Al-Maiman, 2015), 346-347.

<sup>35</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between *Al-Bay' Bithaman Ajil* and *Musharakah Mutanaqisah*," 37.

<sup>36</sup> Ibid.

<sup>37</sup> Ibid.

<sup>38</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 5-6.

<sup>39</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between *Al-Bay' Bithaman Ajil* and *Musharakah Mutanaqisah*," 37.

ownership of the property<sup>40</sup>. Unlike the highly controversial structure of BBA due to different interpretations by Malaysian and Middle East scholars on bay' al'inah, the permissibility of MM is agreed by majority of scholars and the concept has been widely used in several Asian countries including Malaysia, Brunei and Indonesia<sup>41</sup>. It has been opined that the MM-based house financing concept is advantageous to the BBA because it has been shown to enhance the well-being of the customers as well as the accomplishment of Maqasid al-Shari'ah because the outstanding balance of financing at any point in time never surpasses the original price of the asset, even if it yields less return to the Islamic financial institution offering it<sup>42</sup>.

### **MM Practice in Malaysia Islamic Financial Institutions**

In 2001, the Council of International Islamic Fiqh Academy, in its 13th session held in 2001 decided to delay the issuance of resolutions regarding musharakah mutanaqisah until enough research is done<sup>43</sup>. Subsequently, in its 15th session held in 2004, the council ruled the permissibility of musharakah mutanaqisah if its shariah guidelines are being observed<sup>44</sup>.

In 2006, the Shari'ah Advisory Council of Bank Negara Malaysia in its 56th meeting ruled the permissibility of musharakah mutanaqisah, citing that it is a "form of contemporary contract recognised by fiqh scholars in order to fulfil the contemporary needs of Islamic mu'amalah<sup>45</sup>."

The way MM works in home financing is as follows<sup>46</sup>:

1. The customer identifies the property to be purchased.
2. The customer applies to the bank for home financing under the musharakah mutanaqisah contract.

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<sup>40</sup> Nasrun Mohamad and Asmak Ab Rahman, "Tawarruq application in Islamic banking: A Review of The Literature," *International Journal of Islamic and Middle Eastern Finance and Management* 7, no. 4 (2014).

<sup>41</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 6; Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 36.

<sup>42</sup> Ahmad Kameel Mydin Meera and Dzuljastri Abdul Razak, "Home Financing Through Musharakah Mutanaqisah and Al-Bay' Bithaman Ajil Contracts: A Comparative Analysis," *Journal of King Abdulaziz University Islamic Economics* 22, no.1 (2009): 124.

<sup>43</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, "Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami," 383.

<sup>44</sup> Ibid, 440.

<sup>45</sup> Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (Kuala Lumpur: 2010), 44.

<sup>46</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 6; Mohd Zabri and Haron, "A comparative analysis of financial affordability in Islamic home financing instruments in Malaysia," *International Journal of Housing Markets and Analysis* 12, no.9 (2019): 1102.

3. The bank and the customer jointly buy and own the property (*shirkah al-milk*).
4. The Islamic banking institution leases its share of the property to the customer (*al-ijarah*).
5. The monthly instalment paid by the customer to the Islamic banking institution consists of:
  - **Rent** for the usage of the bank's share of the property
  - **Redemption** to gradually increase customer's share of the property
6. With the share purchase made by the client, the bank's portion of the property is lowered from time to time over the financing term.
7. When the bank's share of the property has completely been bought by the customer, the customer becomes the sole owner of the property.

In MM contract, the profit to the bank is the rent of the property paid by the clients to the bank, which does mean the client can be the sole owner of the property if he had redeemed all the principal sum and hence, doesn't need to pay the rent to the bank anymore<sup>47</sup>.

### Issues in Musharakah Mutanaqisah

There are however several issues being raised with regards to MM.

#### 3.2.2.1. Property rental rate

One of the main issues is regarding the rental rate. In the current practice of MM, most Islamic financial institutions offering MM house financing products base the property's rental rate on interest-based indices such as the London inter-bank offered rate (LIBOR) in the United Kingdom and the Malaysian bank's base rate<sup>48</sup>. In fact, a study by Lee reported that after calling in personally to all local and foreign banks in Malaysia offering home financing products using the concept of MM, he found out that all these banks are using the base financing rate (BFR) to calculate the rental rate<sup>49</sup>. It is worth noting that the base financing rate actually has the same value as the base lending rate (BLR) used by conventional banks. As a result, the payment schedule of MM becomes fairly similar to the conventional effective

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<sup>47</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 38; Hasnat, Alom, and Talukderc, "A Comparative Analysis Between Musharakah Mutanaqisah and Al-Bay Bithaman Ajil Contracts Under The Islamic Home Financing in Malaysia," 6.

<sup>48</sup> Alam Asadov, Zulkarnain Muhamad Sori, Shamsheer Mohamad Ramadilli, Zaheer Anwer, and Shinaj Valangattil Shamsudheen, "Musharakah Mutanaqisah Home Financing: Issues in Practice," *Journal of Islamic Accounting and Business Research* 9, no. 1 (2018): 92.

<sup>49</sup> Lee Ching Lung, "Musharakah Mutanaqisah Partnership in Malaysia: A Comparison Between Theory and Practice," *American Journal of Economics and Business Administration* 5, no. 3 (2013): 95.

interest rate method<sup>50</sup>. The concern here is this home financing product that professed to be an Islamic one still relies on the conventional bank interest rate as a benchmark in a situation where they should be using only rental rate<sup>51</sup>. Notwithstanding that it is not impermissible in Shariah to link rental or profit rates to market interest rates, it is important to underline that such a practice is undesirable, and Islamic banks and financial institutions should seek to avoid it<sup>52</sup>. Using actual rental rather than interest-based benchmark is favorable in the opinion of Shari'ah jurists and Islamic finance experts, even though the suggestion may not entice banks because of two reasons; in most situations, interest-based benchmarks are higher than rental rates and the cost of funds for a bank is determined by the market interest rate<sup>53</sup>.

#### 2.2.2.2. Early settlement in theory versus in practice

In theory, an early settlement should be one of MMP's advantage because as soon as the customer redeem the bank's principal sum, he can own the house without having to compute the rebates<sup>54</sup>. However, Lee in his study reports that in practice, most Islamic banks in Malaysia, in the case of early settlement in MMM whether by finishing off all the payment or refinancing, will charge 2 to 3 percent penalty with a lock-in period ranging from 3 to 5 years<sup>55</sup>. The exception is only applied by Maybank Islamic, Hong Leong Islamic Bank and Asian Finance Bank.

#### 3.2.2.3. Promise (*wa'd*) in musharakah mutanaqisah

Another important issue is the promise (*wa'd*) from the customer to pay the monthly payment until the conclusion of the MM contract and to irreversibly commit to eventually acquiring the bank's share, notwithstanding in the occurrence of default, until he owns the entire property<sup>56</sup>. Regardless of the different views among Islamic scholars in ruling whether upholding this promise is required or encouraged, both the Council of International Fiqh Academy and Bank Negara

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<sup>50</sup> Asadov, Muhamad Sori, Mohamad Ramadilli, Anwer, and Shamsudheen, "Musharakah Mutanaqisah Home Financing: Issues in Practice," 92.

<sup>51</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 7.

<sup>52</sup> Taqi Usmani, *An Introduction to Islamic Finance* (Idara Isha'at-e-Diniyat, 1999), 82.

<sup>53</sup> Mydin Meera and Abdul Razak, "Home Financing Through Musharakah Mutanaqisah and Al-Bay' Bithaman Ajil Contracts: A Comparative Analysis," 137; Lee, "Musharakah Mutanaqisah Partnership in Malaysia: A Comparison Between Theory and Practice," 100.

<sup>54</sup> Mohamed Imtiyaz, Kassim, and Harun, "*Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah*," 38.

<sup>55</sup> Lee, "Musharakah Mutanaqisah Partnership in Malaysia: A Comparison Between Theory and Practice," 104.

<sup>56</sup> Asadov, Muhamad Sori, Mohamad Ramadilli, Anwer, and Shamsudheen, "Musharakah Mutanaqisah Home Financing: Issues in Practice," 98.

Malaysia's Shariah Advisory Council resolved that a promise is legally binding<sup>57</sup>. However, enforcing such a promise as a binding one, regardless of if the default was not due to the customer's negligence, violates the basic rules of musharakah, the primary concept used in MM agreements since the musharakah concept requires that any loss be shared by all partners except if it is clearly the result of one partner's negligence<sup>58</sup>.

### Tawarruq

Tawarruq or also known as commodity murabahah, is an act of buying an asset for a delayed price finalized through *musawamah* (bargaining) or *murabahah* (mark-up sale) and selling it to a third party for a spot price so as to obtain cash<sup>59</sup>. The transaction is known as tawarruq because the buyer bought the commodity on credit without the intention of using or profiting from it, but instead to sell it for cash<sup>60</sup>. Currently, the concept is used to underpin a variety of banking products offered by Islamic banks, with the person needing cash being either the bank (in reverse tawarruq) or the customer (in regular organized tawarruq) and the bank will be appointed as an agent for the customer to complete the sale or purchase transaction with a commodity broker<sup>61</sup>.

There are three types of tawarruq; tawarruq fardi or the classical tawarruq, tawarruq munazzam or the organised tawarruq and tawarruq 'aksi or the reversed tawarruq. The classical tawarruq is the one that is explained previously. In organized tawarruq, the seller in the first transaction, usually the bank, will become the customer's agent to sell the commodity to a third-party buyer<sup>62</sup>. The distinction between classical and organised tawarruq is the appointment of the bank to sell back the asset in the modern application via a representative contract, an evolution needed because the clients lack the capability to carry the process out by themselves<sup>63</sup>. On the other hand, tawarruq 'aksi or reverse tawarruq is the same as organised tawarruq except that the financial institution will act as the customer and the client will act as the beneficiary instead<sup>64</sup>.

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<sup>57</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, *Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami*, 523; Bank Negara Malaysia, *Wa'd* (Kuala Lumpur: 2017), 5; Bank Negara Malaysia, *Musarakah* (Kuala Lumpur: 2015), 15.

<sup>58</sup> Asadov, Muhamad Sori, Mohamad Ramadilli, Anwer, and Shamsudheen, "Musharakah Mutanaqisah Home Financing: Issues in Practice," 98.

<sup>59</sup> AAOIFI, *The Accounting and Auditing Organization for Islamic Financial Institution Shari'ah Standards*, 758.

<sup>60</sup> Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance*, 94.

<sup>61</sup> Mohamad and Ab Rahman, "Tawarruq application in Islamic banking: A Review of The Literature," 486.

<sup>62</sup> Nurasmaa Hawa Omar, "Pelaksanaan Sistem Pembiayaan Bai' al-Tawarruq Pada Bank Islam Malaysia Berhad (BIMB) Cabang Selangor Dalam Perspektif Hukum Islam (Analisis Akad Baiti Home Financing)" (Master diss., Universitas Islam Ar-Raniry Banda Aceh, 2018), 38.

<sup>63</sup> Mohamad and Ab Rahman, "Tawarruq application in Islamic banking: A Review of The Literature," 490.

<sup>64</sup> Omar, "Pelaksanaan Sistem Pembiayaan Bai' al-Tawarruq Pada Bank Islam Malaysia Berhad (BIMB) Cabang Selangor Dalam Perspektif Hukum Islam (Analisis Akad Baiti Home Financing)," 38.

Traditional tawarruq is permitted by the vast majority of contemporary scholars, but organised tawarruq is prohibited by the majority of them due to the legal stratagem issue, which is its operation similar<sup>65</sup>. In reality, organized tawarruq is nothing more than a strategy for obtaining spot cash in exchange for deferred cash with a surplus; however, the sale is only included in the transaction as a medium, with no obvious exchange of the commodities that were used in the transaction<sup>66</sup>. While the act of selling is permitted in Shariah, it is intended to facilitate trade and the circulation of commodities rather than to be used to achieve an end that is in violation of the general principles of Shariah, as is the case in the organized tawarruq<sup>67</sup>.

### Tawarruq Practice in Malaysia Islamic Financial Institutions

The Council of International Islamic Fiqh Academy had a series of resolutions regarding tawarruq<sup>68</sup>. The academy's resolution is consistent in ruling the permissibility of classical tawarruq and impermissibility of organized tawarruq. These resolutions are concluded as following Table 2<sup>69</sup>.

**Table 2.** Council of International Islamic Fiqh Academy Resolutions Regarding Tawarruq

Year	Session Number	Resolution Conclusion	Resolution Explanation
1998	5th	Tawarruq (classical) is permissible.	<ul style="list-style-type: none"> <li>- Tawarruq is the purchase of an asset where the ownership of the commodity is transferred to the purchaser with a deferred price. The purchaser will then sell the asset to a third party other than the seller with cash payment in order to obtain cash.</li> <li>- The condition for this permissibility is the purchaser is not to sell the asset to the same seller in the first contract by any means; whether directly or through an agent. If he does so, he then had committed the prohibited Ba'i al-'Inah due to its ruse for usury.</li> </ul>
2003	17th	Tawarruq (organised) is impermissible.	<ul style="list-style-type: none"> <li>- The act of obligating the purchaser customer, whether by making it a clear condition or a regular practice, to make the seller (bank) an agent to sell the asset to another purchaser is an act resembling it to the prohibited Ba'i Al-'Inah.</li> <li>- This transaction, in most of its cases, leads to the absence of al-qabd al-syar'i condition that is a must for a valid transaction.</li> <li>- The reality of this transaction is for the customer to obtain bank's cash financing through added profit from the bank selling and buying that often only happen on papers. The objective of the bank is to obtain the added profit by providing cash to the customer.</li> <li>- This type of tawarruq is not the real tawarruq that are ruled permissible by the academy in its' last resolution regarding the</li> </ul>

<sup>65</sup> Mohamad and Ab Rahman, "Tawarruq application in Islamic banking: A Review of The Literature," 491.

<sup>66</sup> Sharaiyra and Haswa, "The Effect of 'Motive' on Characterising Organised Tawarruq," 196.

<sup>67</sup> Sharaiyra and Haswa, "The Effect of 'Motive' on Characterising Organised Tawarruq," 196.

<sup>68</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, *Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami*, 203-204.

<sup>69</sup> Ibid.

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			matter.
2009	19th	Tawarruq (organised and reversed) is impermissible.	- Reverse tawarruq, in where the bank and the customer reverse their roles, is also prohibited.

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AAOIFI Shari'ah Standard No. 30 issued some Shari'ah standards in Tawarruq arrangement that need to be observed by practicing Islamic banks where the execution of Tawarruq principle is bound to strict regulations and conditions<sup>70</sup>.

Meanwhile, in Malaysia, the Central Bank of Malaysia's Shariah Advisory Council in its 51st meeting dated 28 July 2005, has resolved that financing product based on the concept of tawarruq is permissible<sup>71</sup>. The council proposed the financing mode to be as follow:

1. The Islamic financial institution purchases metal commodity from metal trader A on cash basis in a recognised metal commodity market
2. The Islamic financial institution sells the metal commodity to the customer on a credit basis at a cost price plus profit margin; and
3. The customer appoints the Islamic financial institution as his agent to sell the metal commodity to metal trader B on cash basis in the metal commodity market.

The cash sale by the customer to metal trader B will enable the customer to obtain cash for financing, while the deferred credit sale from the Islamic financial institution to the customer will create a financial obligation that must be paid by the customer within an agreed term<sup>72</sup>.

Meanwhile, an illustration of how tawarruq is practiced in home financing is as follow<sup>73</sup>:

1. The customer identifies the property that he wishes to buy.
2. By applying a home financing scheme based on tawarruq/ commodity murabahah, the customer requested that the bank buy a commodity at a price that was equivalent to the price of the property that he wished to purchase.
3. The bank will buy the commodity from the commodity trader, in the case of Malaysia, this will be done in the Bursa Suq As-Sil'ah (BSAS) at the price

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<sup>70</sup> AAOIFI, *The Accounting and Auditing Organization for Islamic Financial Institution Shari'ah Standards*, 758-760.

<sup>71</sup> Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance*, 96.

<sup>72</sup> Ibid.

<sup>73</sup> Nuarrual Hilal Md Dahlan, "Commodity Murabahah Islamic Home Finance in Dealing With Abandoned Housing Projects in Malaysia: Features, Issues & Prospects," *International Journal of Education, Islamic Studies and Social Sciences Research* 3, no. 1 (2018): 2; Mohammad Taqiuddin Mohamad, Mohd Najdi Aminuddin, and Muhammad Husni Hasbulah, "Pembiayaan Perumahan Berasaskan Komoditi Murabahah: Kajian Kes di CIMB Islamic Bank," *International Journal of Islamic and Civilizational Studies* 5, no. 3 (2018): 73; Omar, "Pelaksanaan Sistem Pembiayaan Bai' al-Tawarruq Pada Bank Islam Malaysia Berhad (BIMB) Cabang Selangor Dalam Perspektif Hukum Islam (Analisis Akad Baiti Home Financing)," 53; Mohd Izuwan Mahyudin and Azizi Che Seman, "Bay' Al-Tawarruq dan Aplikasinya di Bank Muamalat Malaysia Berhad," *Journal of Muamalat and Islamic Finance Research* 11, no. 1 (2014): 91.

equivalent to the property price. The commodity trader will transfer ownership of the commodity to the bank, which will be accomplished through the use of a transfer certificate to the bank.

4. Bank will then sell the commodity to the customer at a mark-up price. The customer will repay the markup price in monthly instalments to the bank until full settlement.
5. The customer will appoint the bank as his agent giving the bank permission to resell the commodity to a commodity trader with the price equivalent to the price of the property. Payment received by the bank will be used by the customer to finance the purchase of the property.

### Issues in Tawarruq

There are however several issues being raised with regards to MM.

#### 3.3.2.1. Tawarruq as a stratagem for usury.

The assets traded in tawarruq contracts are typically not delivered to the purchaser, meaning that these assets are not needed for themselves but are merely used to form a complex model to bypass a conventional debt contract, as is the case with Islamic banks in Malaysia that practise organised tawarruq<sup>74</sup>. This is the same reason that led to the impermissibility of organised tawarruq and reverse tawarruq by the International Islamic Fiqh Academy<sup>75</sup>.

#### 3.3.2.2. Encouraging the proliferation of debt

The widespread use of Islamic debt instruments such as tawarruq contributes to the debt escalation<sup>76</sup>. This is especially true when the mustawriq (the person seeking liquidity) purchases a commodity on credit and pays a higher price than when he sells to a third party for cash<sup>77</sup>. Inequality, harm, disparity, and inefficiency will not be removed by overemphasizing debt-based instruments in the economy whereas the removal of these elements is institutionalized among the goals of Shariah<sup>78</sup>. Private debt growth at this rate is unsustainable and points to an impending crisis<sup>79</sup>

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<sup>74</sup> Habeebah Simisola Fa-Yusuf and Ndeye Djiba Ndiaye, "Issues with the Use of Tawarruq in Malaysia," *Journal of Islamic Banking and Finance* 5, no. 2 (2017): 32.

<sup>75</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, *Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami*, 203-204.

<sup>76</sup> Asyraf Wajdi Dusuki, *Can Bursa Malaysia's Suq Al-Sila' (Commodity Murabahah House) Resolve the Controversy Over Tawarruq?* (Kuala Lumpur: International Shari'ah Research Academy for Islamic Finance, 2010), 12.

<sup>77</sup> A. R. Y. Ahmad, "Al-Tawarruq: Mafhumuhu wa Mumarasatuhu wa Athar al-Iqtisadiyah al-Murattabah 'ala Tarwijihi min Khilal al-Bunuk al-Islamiyyah," (2009).

<sup>78</sup> Dusuki, *Can Bursa Malaysia's Suq Al-Sila' (Commodity Murabahah House) Resolve the Controversy Over Tawarruq?* 12.

<sup>79</sup> Fa-Yusuf and Ndiaye, "Issues with the Use of Tawarruq in Malaysia," 34.



### 3.3.2.3. Issue in the bank as an agent

Bursa Suq Al-Sil'ah, a commodity platform launched in 2009, is introduced as a solution allowing for real commodities which have real value to be transacted such Crude Palm Oil<sup>80</sup>. As explained previously in this article about the modus operation of tawarruq, a customer who needs a financing facility based on tawarruq can go to the bank that offers the related facility. The bank will then have to purchase the commodity, in the case of BSAS, crude palm oil (CPO), from a supplier on the BSAS platform and subsequently sell it to a customer for a deferred price. The customer then appoints the bank to sell the commodity back to a supplier using the BSAS platform. In this case, the bank's appointment as an agent to act on the customer's behalf in reselling the commodity to the market is considered misaligning with the AAOIFI Shariah standards on the matter which states that "The client shall not delegate the Institution or its agent to sell, on his behalf, a commodity that he purchased from the same Institution and, similarly, the Institution shall not accept such delegation<sup>81</sup>."

### 3.3.2.4. The use of interest-based benchmark as a benchmark

In the majority of cases involving variable rate financing for Tawarruq-based products in Malaysia, an interest-based benchmark is used to determine the issuer's profit<sup>82</sup>. The bank's effective profit rate (EPR) will be based on the base financing rate (BFR) or base rate (BR). An example of this can be seen in Affin Islamic Bank's Islamic home financing product named Tawarruq Term Financing-i<sup>83</sup> that uses BFR and Bank Islam's Islamic home financing product named Property Financing-i (Tawarruq) Baiti Home Financing<sup>84</sup> and MBSB's Islamic home financing product named My First Home Scheme-i – First Time House Buyer<sup>85</sup> that uses BR. Though it is not forbidden in Islam to connect rental or profit rates to market interest rates, it is necessary to underline that such a practice is undesirable, and Islamic banks and financial institutions should seek to avoid it<sup>86</sup>. Profitability being determined by

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<sup>80</sup> Ellida Fauziah Ahmad, Mariyam Shihama, Nur Sulaim Ashikin Mohamad Tarmizi, Saidu Mudi Jibril, Samia Ibrahim Djama and Aishath Muneza, "Tawarruq as a Product for Financing within the Islamic Banking System: A Case Study of Malaysian Islamic Banking System," *International Journal of Management and Applied Research* 4, no. 1 (2014): 39; BMB Islamic, *Global Islamic Finance Report 2011* (United Kingdom: 2011), 44.

<sup>81</sup> AAOIFI, *The Accounting and Auditing Organization for Islamic Financial Institution Shari'ah Standards*, 758-760.

<sup>82</sup> Fa-Yusuf and Ndiaye, "Issues with the Use of Tawarruq in Malaysia," 35.

<sup>83</sup> Affin Islamic Bank, *Affin Islamic Tawarruq Term Financing-i Product Disclosure Sheet* (Kuala Lumpur: 2015).

<sup>84</sup> Bank Islam, *Property Financing-i (Tawarruq) Baiti Home Financing Product Disclosure Sheet* (Kuala Lumpur: 2021).

<sup>85</sup> MBSB Bank, *My First Home Scheme-i – First Time House Buyer Product Disclosure Sheet* (Kuala Lumpur: 2021).

<sup>86</sup> Usmani, *An Introduction to Islamic Finance*, 82.

what happens in the conventional banking sector means that the Islamic finance industry and the conventional will move in lockstep<sup>87</sup>.

## DISCUSSION

Islamic home financing products offered by Islamic financial institutions had evolved through the years from ba'i bithaman ajil to musharakah mutanaqisah and eventually tawarruq or commodity murabahah. In terms of the nature of financing modes, the former predominant mode, BBA, is a debt-based financing. Following the many controversies surrounding BBA, Islamic banks begin to introduce equity-based MM which is a joint ownership. In more recent years, tawarruq, a financing mode based on debt also, is begun to be offered more in banks. It can be seen here that even though the popularity of debt-based BBA is later replaced by MM, the trend is going back to a debt-based one; tawarruq. In a larger view over this trend, elements of inequality, harm, disparity, and inefficiency will not be removed by overemphasizing debt-based instruments in the economy, contradicting with the fact that the removal of these elements is institutionalized among the goals of Shariah<sup>88</sup>.

From another point of view, the Shariah issues surrounding all three types of financing have a different level of dispute. It may be safe to say that among the three, musharakah mutanaqisah (MM) hold the least and most minor dispute compared to its counterparts, at least when looking into the permissibility issued in each financing type. Notwithstanding that all the three types of financing is resolved as permissible by Bank Negara Malaysia's Shariah Advisory Council<sup>89</sup>, BBA is controversial among Middle Eastern scholars<sup>90</sup>, while tawarruq, or specifically organized tawarruq, is ruled impermissible by the Council of International Islamic Fiqh Academy in both its 17th and 19th sessions<sup>91</sup>. Musharakah mutanaqisah, on the other hand, is agreed by majority of scholars<sup>92</sup> and ruled permissible by the Council of International Islamic Fiqh Academy when observing the Shariah's restriction<sup>93</sup>. When the issue is further dug, the disputes arising around BBA and tawarruq hold the same essence; the issue of usury stratagem. Both BBA and Tawarruq is seen to, finally, resemble the highly disputed Ba'i al- 'Inah (BAI). BAI is declined by the majority of scholars because it is seen as a tool to circumvent usury. This is a heavy

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<sup>87</sup> Fa-Yusuf and Ndiaye, "Issues with the Use of Tawarruq in Malaysia," 35.

<sup>88</sup> Dusuki, *Can Bursa Malaysia's Suq Al-Sila' (Commodity Murabahah House) Resolve the Controversy Over Tawarruq?* 12.

<sup>89</sup> Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance*, 44, 96, 112.

<sup>90</sup> Mohamed Imtiyaz, Kassim, and Harun, "Perceived Fairness in Islamic Home Financing: Comparison Between Al-Bay' Bithaman Ajil and Musharakah Mutanaqisah," 37.

<sup>91</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, *Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami*, 203-204.

<sup>92</sup> Abdull Manaf, Mahyut, and Shakri, "Analysis on Islamic Home Financing in Malaysia," 6.

<sup>93</sup> Majma' Al-Fiqhi Al-Islami Ad-Duwali, *Qararat wa Tausiyyat Al-Majma' Al-Fiqhi Al-Islami Al-Munbathiqu 'An Munazzamatu At-Ta'awun Al-Islami*, 440.

dispute as usury (riba) is one of the big sins a believer is warned not to commit. The shariah disputes regarding MM concepts, on the other hand, is not on the concept itself, but on the side issues such as the binding promise and rental rates. The core essence of MM, musharakah, is an accepted concept in Shariah.

However, it is worth noting that even though all of these three financing modes are using different instruments and are named differently in banks as an Islamic home financing product, the profit calculation made by offering Islamic banks are still tied to an interest-based benchmark such as base rate (BR) and financial base rate (FBR). The return or the profit gained by the banks for these three financing modes may be different i.e in BBA and Tawarruq, it's the bank's selling price whereas, in MM, it is the rental paid to the bank by the customer. Nevertheless, in calculating this selling price or rental price, when using an interest-based benchmark, the price that the customer needed to pay will not differ much from each of these different contracts or conventional housing loans. Here, the advantage lies with the MM contract in cases where the customer redeemed the principal sum early and became the sole owner of the house, he will not need to pay the rental anymore. However, banks generally will impose a 3 to 5 years lock period and 2 to 3 percent penalty for this early settlement

## Conclusion

Islamic banks have made a commendable effort in offering Shariah-compliant home financing products. These efforts provide a way out for the society, or specifically Muslim society, to opt for a Shariah compliant mode of financing to own their houses rather than resorting to conventional loans. Even though some of these products are raising disputes in terms of Shariah compliance, it is a commendable attempt to further evolve Islamic home financing products. In this case, it can be seen that the disputes lingering BBA and tawarruq revolves around the concept itself unlike MM that do not raise issues relating to its concept but minor practical issues. Even though the effort to provide a Shariah compliant alternative for home financing in Malaysia is a commendable one, the trend, from debt-based BBA to equity-based MM, is finally back to debt-based one; tawarruq which this pace is not moving towards freeing the economy from harm, inequality, disparity, and inefficiency. Notwithstanding the emergence of these three products are a proof of ongoing innovation attempt in the Islamic finance and banking, all these three products seem not yet capable to be free from referring to interest-based rates as the benchmark to calculate their profit and hence, the problem of house unaffordability still cannot be solved. Shariah aspects in designing these products must be observed carefully to make sure not only it does not violate the Shariah principle, but also to make sure it promotes the welfare of society in their ability to own house.

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