



STRIVING FOR AUTHENTICITY: ENHANCING SHARIAH-COMPLIANCE IN HOME FINANCING PRODUCTS WITHIN MALAYSIA'S ISLAMIC FINANCE INDUSTRY

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ABSTRACT

Islamic finance, founded on the principles of promoting genuine economic activities through Shariah-compliant commercial contracts, has evolved significantly since its formal institutionalisation in the 1960s. However, the prevailing focus on rule-based Shariah compliance rather than authentic economic engagement has raised pertinent questions about the industry's direction. This study aims to scrutinise the landscape of Islamic finance products employed in home financing within Malaysia and explore avenues to enhance authenticity in Islamic finance. Employing a qualitative approach, utilising the content review method to investigate the subject matter, the research identifies a prevalent reliance on Tawarruq contracts among Malaysian banks' home financing products. This overreliance on Tawarruq prompts concerns regarding the authenticity and Shariah compliance of these financial instruments. The study emphasises the imperative need to address this challenge and offers a set of recommendations to bolster the authenticity and Shariah compliance of home financing products. Key among these recommendations is the call to move away from Tawarruq-based contracts, drawing inspiration from countries like Oman, where Tawarruq is generally prohibited except in exceptional circumstances. This proactive shift towards authenticity can pave the way for Malaysia's Islamic finance sector to offer more genuinely Shariah-compliant financial solutions and align more closely with the industry's core objectives of promoting economic justice and ethical financial practices.

Keywords: Islamic Finance, Shariah Compliance, Home Financing, Malaysia, Financial Industry

Submitted: 13/8/2023

Accepted: 18/9/2023

Published: 11/10/2023





INTRODUCTION

Islamic finance emerged as a financial system to cater to the needs of Muslims seeking a Shariah-compliant alternative that allowed them to conduct financial transactions without involving non-compliant elements present in conventional finance. As it evolved, Islamic finance gained recognition as a genuine alternative to the conventional financial system, offering stakeholders a value-added and ethically sound framework. Over the years, the Islamic financial framework, including Islamic banking, Islamic capital markets, and Islamic insurance or *takaful*, has been expanding its global market share by providing products aligned with market needs and Shariah principles.

According to the Islamic Finance Development Report 2022, the Islamic finance industry demonstrated significant growth and resilience in 2021 (ICD & Refinitiv, 2022). Total Islamic finance assets reached an impressive US\$4.0 trillion, marking a substantial expansion in the industry's size and influence. Regulations for Islamic finance were in place in 47 countries, demonstrating its global reach and acceptance. ESG (Environmental, Social, and Governance) Sukuk outstanding amounted to US\$1,053 million, indicating the integration of sustainability principles into Islamic finance. Notably, the industry witnessed a remarkable year-on-year growth of 17% in assets, showcasing its ability to attract investments even in challenging economic conditions.

Furthermore, the substantial US\$7,546 million in ESG Islamic funds outstanding underscored the industry's increasing focus on ethical and sustainable investments. With a high share of 78%, Islamic finance events transitioned to virtual platforms, enhancing accessibility and participation. The presence of central Shariah committees in 41 countries highlighted the industry's commitment to Shariah compliance. Additionally, 13 countries adopted sustainability guidelines, further aligning Islamic finance with global sustainability trends. The industry's emphasis on transparency and reporting was evident through its average disclosure and ESG reporting indices. With a substantial number of Shariah scholars with institutional representation, robust governance structures were in place. Active engagement in corporate social responsibility, as reflected in the average CSR reporting index and US\$1,223 million in disbursed CSR funds, showcased the industry's commitment to societal impact. Additionally, the production of 3,504 research papers and the presence of 124 Islamic finance journals underscored intellectual growth and knowledge dissemination within the industry. Collectively, these statistics portray a thriving Islamic finance industry poised for continued growth and adaptation to global trends, with an increased focus on sustainability and transparency.

While Shariah-compliant financial transactions have ancient roots, modern Islamic finance is relatively new, tracing its inception to the early 1960s with the establishment of the first full-fledged Islamic banks. During its infancy, Islamic finance faced a significant challenge: the absence of a clear operational framework for all financial intermediaries in an Islamic economic system. However, it was evident that Islamic finance should not involve prohibited elements, such as *riba* (interest), the use of money as a commodity, trading in *haram* (forbidden) items, transactions involving *gharar* (uncertainty), and *maysir* (gambling), all contrary to Shariah principles. Additionally, Islamic finance should perpetually strive to achieve *Maqasid al-Shari'ah*, or the objectives of Shariah, in all its activities. To create a tested working model, Islamic finance experts adopted the "replication approach," integrating Shariah elements into conventional financial products while eliminating non-compliant aspects.

While this approach facilitated the industry's growth, it has faced criticism for potentially not fully embodying the true spirit and objectives of Islamic finance (Laldin & Furqani, 2016). Islam's economic vision extends beyond mere prosperity to encompass social justice and the protection of public interest (*maslahah*) derived from *Maqasid al-Shari'ah*.





Controversial practices, such as using contracts like Bay' al-Inah and Bay' al-Tawarruq to offer products closely resembling interest-based financing, have emerged in the industry. These practices, sometimes justified using Maqasid al-Shari'ah, have led to an industry heavily reliant on debt-based financing contracts rather than equity-based financing, which many believe better embodies the true spirit of Maqasid al-Shari'ah through real economic activities and risk-sharing among parties involved (Abozaid and Dusuki; 2007).

While it was necessary for Islamic finance to replicate conventional finance during its infancy, the industry has grown significantly. It now rivals conventional finance, particularly in countries like Malaysia, where Islamic finance has become prevalent. The question arises: is the approach of replicating conventional financial products, rather than innovating unique Islamic finance products, still valid for further development? While the primary objective of Islamic finance, like conventional finance, is to satisfy market economic needs, Islamic finance is expected to offer more, especially through its alignment with Maqasid al-Shari'ah. In its original form, Islamic finance was intended to be the operational aspect of the Islamic Moral Economy (Asutay, 2014). Some scholars argue that the majority of the values and virtues of Islamic finance are "either lost in the highly technical discussion of the mechanics of all Islamic financial products and services or diluted by the utopian and idealist expectations of Islamic banking and finance" (Bakar, 2019:1). Given these contentions made by scholars, it becomes imperative to assess the practical authenticity of Islamic finance products offered.

This study aims to scrutinise the landscape of Islamic finance products employed in home financing within Malaysia and explore avenues to enhance authenticity in Islamic finance. The choice of Malaysia is deliberate, considering the nation's role as a stronghold for the Islamic finance industry. This paper is divided into five sections. Following this introduction, Section Two presents a literature review; Section Three outlines the research methodology; Section Four presents the main findings and discussion, followed by the final section containing recommendations and conclusions.

LITERATURE REVIEW

The establishment of Islamic banks in the 1960s marked the rapid growth of Islamic finance worldwide. While countries like Sudan and Iran have fully embraced Islamic financial systems, many others successfully operate Islamic finance alongside conventional finance. In fact, in Malaysia in 2018, Islamic bank financing surpassed conventional banking loans through initiatives such as the "Islamic First" strategy (Fitch Ratings, 2019). Islamic banks initially offered interest-free products and services, but, as noted by Warde (2000), a more diverse and innovative generation of Islamic Financial Institutions (IFIs) has emerged, not limited to predominantly Muslim countries.

With its inception, Islamic finance bore the significant responsibility of introducing novel concepts to the market. However, at the outset, the industry benchmarked its operations against conventional banking, as it was the immediate competitor. This approach led to the development of alternative products within the conventional financial industry's framework by adhering to Shariah constraints (Hanif, 2016). This approach, often termed the "replication approach," was employed by the industry to establish a presence in a market dominated by the conventional financial system. According to Laldin and Furqani (2016), this process aimed to be achieved without compromising the ideological and spiritual distinctiveness and uniqueness of Islamic finance.

As a result, any Islamic financial products developed through this process were required to exclude elements prohibited by Shariah, such as *riba* (usury), *maysir* (gambling), *gharar* (uncertainty), and trade involving *haram* (forbidden) elements. While the replication process succeeded in offering competitive products in the market compared to conventional products,





it also led to the proliferation of *hiyal* (legal stratagems), which have been considered necessary for the Islamic finance industry to coexist within the same market as conventional finance. According to Syed and Omar (2017), *hiyal* are implemented based on *maslahah* (public interest) and *dharurah* (necessity) to promote the Islamic finance industry.

Afridi provided a definition of *maslahah* by Najmuddin al-Tufi as "that which serves the purpose of the legislator" (Afridi, 2016, page 1). In contrast, Kamali defined *maslahah* as "benefit" or "interest," while *maslahah mursalah* is described as "unrestricted public interest," which lacks regulation by the Lawgiver and lacks textual authority to establish its validity (Kamali, 1991, page 235). This concept is frequently employed in Islamic finance to derive rulings on matters not explicitly addressed in the primary sources of Shariah, namely the Quran and Sunnah.

In contemporary practice, some argue that Shariah principles may not align perfectly with modern circumstances, leading to the application of *maslahah* to determine whether Shariah rulings can be upheld or adjusted to meet the needs and interests of contemporary society (Abozaid & Dusuki, 2007). Within Islamic finance, *maslahah* is often invoked to justify decisions that aim to bolster market confidence and offer alternatives to conventional financing, which is categorically prohibited unless there are no other viable options for the public. For instance, examples of *maslahah*-driven decisions can be found in the Shariah Resolutions issued by the Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM). One such decision allows for a third party to guarantee the capital and, or profits of *mudarabah* transactions, citing the objective of maintaining investor confidence in significant national projects (Shariah Resolutions in Islamic Finance, BNM, 2010, page 39).

Most frequently, *maslahah* is employed in the realm of Islamic finance to argue that it needs to compete effectively with conventional finance, secure a strong market presence, and capture a larger market share. To illustrate, Rafe Haneef, the CEO of CIMB Islamic, pointed out that challenges such as limited market share and playing a secondary role to conventional finance require Islamic Financial Institutions (IFIs), particularly banks, to align not only their pricing but also their risk-reward profiles with those of dominant conventional products. One specific product under scrutiny is *Bay al-Tawarruq*, which currently holds a dominant position in the Islamic finance market in Malaysia despite being banned by scholars from the Gulf Cooperation Council (GCC) due to its resemblance to interest-based loans. Critics contend that contemporary industry practices involve organised *Tawarruq* or *Tawarruq al-Munazzam*, deemed impermissible by the International Council of Fiqh Academy (IFCA) in 2009. The IFCA's resolution justifies this decision by highlighting those simultaneous transactions occur between the financier and the *mustawriq* (party seeking finance), whether explicitly or implicitly, resulting in a financial obligation. This practice is regarded as deceptive, with the intention of obtaining additional funds quickly from the contract, thus introducing an element resembling *riba* (IFCA Resolution 179, 2009; Asni, 2022; Rahmalan & Ramli, 2022).

According to Haneef (2009), while it may not be ideal, the most effective way to gain a larger market share is to continue using Shariah-compliant systems that rely on contracts like *tawarruq*. This is because stakeholders, including Muslims, are not only looking for Shariah compliance but also pricing competitiveness. Without pricing parity, they may revert to conventional financial products. This is where *maslahah* is extensively employed, as it is believed that stakeholders, including Muslims, would shift to conventional finance if they did not have access to products that offer competitive pricing compared to conventional alternatives.

While *maslahah* is being utilised to justify the use of controversial contracts and practices, another concept often associated with *maslahah* is *dharurah*. *Dharurah* refers to 'necessity' and is closely related to the legal maxim in Shariah Law that states, "necessity permits the forbidden" (Abozaid & Dusuki, 2007). Similar to *maslahah*, *dharurah* is frequently





invoked to justify the necessity for Islamic Financial Institutions (IFIs) to employ certain controversial products to ensure the long-term sustainability of the institution in the competitive market.

According to the arguments presented, the concepts of *maslahah* and *dharurah* are frequently invoked in contemporary Islamic finance with the aim of achieving one primary goal: upholding the *Maqasid al-Shari'ah*. However, the question arises as to whether this alignment truly exists in practice. *Maqasid al-Shari'ah*, or the objectives of Shariah, fundamentally revolve around promoting the well-being of all humanity. To quote Chapra (2000), as noted by Abozaid and Dusuki, Imam Al-Ghazali (d.1111) stated that "the objectives of Shariah are to promote the well-being of all mankind, which lies in safeguarding their faith (*din*), their human self (*nafs*), their intellect (*'aql*), their posterity (*nasl*), and their wealth (*mal*). Whatever ensures the safeguard of these five services public interest and is desirable" (Abozaid & Dusuki, 2007, pages 7-8).

With this comprehensive definition, it can be assumed that *Maqasid al-Shari'ah* provides a dynamic and creative framework for practice, aiming to achieve these objectives and establish social justice, protect the public interest, and educate humanity. In pursuing *Maqasid al-Shari'ah*, it is crucial to prioritise textual evidence from Shariah. However, in current practice, these objectives are sometimes used as a justification to emphasise *maslahah* and *dharurah* in the context of public welfare. This is done to promote products and services that may not necessarily align with the original spirit and intent of Islamic finance's establishment.

Once again, this practice can be traced back to the early adoption of the replication approach during the establishment of the Islamic financial framework. This approach relies on creative interpretations of Shariah compliance to restructure conventional financial products in ways that satisfy Shariah requirements in form but may not fully adhere to the underlying principles and substance of Islamic finance (Alkhamees, 2017).

In the contemporary landscape, modern Islamic finance often justifies its practices by claiming a commitment to achieving *Maqasid al-Shari'ah*, with concepts like *maslahah* and *dharurah* serving as primary vehicles for this justification. However, there is a growing debate about the authenticity of this claim and how far it can be extended to rationalise certain controversial practices within the industry. Islamic finance has come under scrutiny from Islamic scholars, economists, and consumers worldwide due to perceived similarities with conventional financial systems.

Professor Mehmet Asutay, Director at the Durham Centre for Islamic Economics and Finance, highlighted in a lecture on 30 August 2019 that the exceptions *Shari'ah* scholars develop under the banner of 'delusional *maslahah*' are becoming norms within the industry, resulting in Islamic finance moving closer to conventional finance. This critical perspective suggests that the pursuit of perceived benefits through *maslahah* has led to a convergence of Islamic finance with mainstream, conventional banking practices. As a result, questions regarding the essence versus the form of Islamic finance have come to the forefront.

Observations by scholars like Rosly (2019) emphasise the transformation of instruments such as *tawarruq* and *murabahah*, which have started to resemble interest-bearing loans, blurring the lines between Islamic and conventional banking. This convergence raises concerns about whether the industry has maintained its distinctiveness in substance or merely in appearance.

Kamali (2012) also asserts that due to numerous transformations and the industry's increasing resemblance to conventional products, Islamic finance is facing a significant challenge in terms of losing credibility and the confidence of its stakeholders. This erosion of confidence may result from the industry's deviation from its original values, spirit, and objectives.





Furthermore, Laldin and Furqani (2016) highlight that the replication approach, which was initially adopted to compete with conventional finance, may not be sustainable in the long term for an Islamic finance industry that seeks to remain rooted in the true values, spirit, and objectives of Islam.

Hence, it becomes imperative to critically assess the extent of similarities between Islamic finance and its conventional counterpart. While Islamic finance initially aimed to not only fulfil economic needs but also provide a moral and ethical alternative to conventional finance, the evolving landscape and practices within the industry warrant careful consideration and reflection on its alignment with these founding principles.

RESEARCH METHODOLOGY

The research employs a qualitative approach, utilising the content review method to investigate the subject matter. A broad spectrum of secondary sources, including books, academic journals, research articles, industry reports, news articles, magazines, websites, videos, and blogs, is consulted to gain an in-depth understanding of the topic and its practical implications. The primary focus of this study is home financing products offered by Islamic Banks, with a particular emphasis on discerning their Shariah compliance attributes. The research narrows its scope to home financing due to its substantial significance in both the Malaysian Islamic financial market and the global landscape. Additionally, the study aims to uncover any differentiating or converging features of these products compared to conventional financial products, contributing to the evaluation of replication trends in Islamic finance. The analysis encompasses an examination of home financing products offered by 16 Islamic Banks registered with BNM, of which the details are provided in Table 1 (below).

Table 1: List of Islamic Banks in Malaysia

No.	Islamic Banks
1.	Affin Islamic Bank Berhad
2.	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
3.	Alliance Islamic Bank Berhad
4.	AmBank Islamic Berhad
5.	Bank Islam Malaysia Berhad
6.	Bank Muamalat Malaysia Berhad
7.	CIMB Islamic Bank Berhad
8.	HSBC Amanah Malaysia Berhad
9.	Hong Leong Islamic Bank Berhad
10.	Kuwait Finance House (Malaysia) Berhad
11.	MBSB Bank Berhad
12.	Maybank Islamic Berhad
13.	OCBC Al-Amin Bank Berhad
14.	Public Islamic Bank Berhad
15.	RHB Islamic Bank Berhad
16.	Standard Chartered Saadiq Berhad





FINDINGS AND DISCUSSIONS

The fundamental economic requirement of customers, whether seeking conventional loan products or Islamic financing, remains consistent: obtaining funds to fulfil specific needs. In the case of home financing, this need revolves around securing land for home construction or purchasing developed homes from developers. In either scenario, customers seek certain factors that aid their decision-making process. Consequently, banks tailor their products to align with customers' specific needs, aiming to attract them to the offerings. Table 2 shows the main features of conventional loans.

Table 2: Features of conventional loans

<i>Feature</i>	<i>Description</i>
<i>Contract</i>	Loan with interest
<i>Asset Ownership</i>	Customer (asset collateralised)
<i>Risk Taken by Bank</i>	None
<i>Loan Rate</i>	Variable
<i>Penalties</i>	Compound Interest charged on each late payment

Source: Author's own

In conventional banks, the majority of product structures revolve around a central feature: interest rates. Conventional banks strive to provide competitive rates in their product offerings to maintain a competitive edge. However, these products lack a foundational structure that directly contributes to genuine economic activities, and the banks do not bear any risk.

Contrastingly, Islamic banks need to establish a justifiable level of risk sharing between themselves and customers, grounded in Shari'ah contracts. This is due to the application of legal maxims such as "al-kharaj bil daman" (in any benefit lies a liability) and "al-ghurm bil ghum" (no reward without risk) in Islamic finance. These principles necessitate Islamic Financial Institutions (IFIs) to engage in real economic activities devoid of speculation and undertake certain risks and liabilities to legitimately declare profits.

To explore the extent of risks undertaken by Islamic banks in the Malaysian market and the significant distinctions in product structures compared to conventional finance, an analysis was conducted on the home financing products of 16 registered Islamic banks. These findings are juxtaposed with those of four Islamic banks from foreign jurisdictions, as detailed in Table 3 and Table 4.





Table 3: Analysis of Home Financing Products of Islamic Banks in Malaysia

	Product Name	Underlying Shari'ah Contract	Asset Ownership	Risk Taken by Bank	Fixed / Floating Fin. Rate	Penalties (Ta'widh)
Affin Islamic	AFFIN Build-i Home	Musharakah Mutanaqisah	Bank & Customer (based on ratio)	Shared but minimal - due to Purchase Undertaking (Wa'ad)	Floating Rate Base	Revision of Ijarah Rate: BR+4.35% on outstanding principal after three failed payments. For impaired facilities, the rate is revised to BR+6.35% on outstanding principal - the revised rate will not be more than the Ceiling Ijarah/Profit Rate Ta'widh During Tenure: 1% p.a of overdue instalment Ta'widh After maturity: Sum equivalent to IMM rate on balance principal outstanding No Compounding applied
Al Rajhi	Structured Financing-i Home	Commodity Murabahah	Customer (asset collateralised)	None	Floating Rate Base	1% p.a of overdue instalment or total recovery of actual collection cost (whichever is lower) - Bank may increase financing rate after three failed payments No Compounding applied
Alliance Islamic	i-Wish Financing-i Home	Bai Bithaman Ajil (BBA)	Customer (asset collateralised)	None	Floating Rate Base	During Tenure: 1% p.a of overdue instalment After maturity: Sum equivalent to IMM rate on balance principal outstanding - Bank may increase the financing rate to be not more than 3% per annum above the prescribed rate after three failed payments. No Compounding applied
AmBank Islamic	Home Financing-i	Commodity Murabaha	Customer (asset collateralised)	None	Floating Rate Base	During Financing Tenure: 1% per annum of overdue instalments calculated on a daily basis After maturity: Sum equivalent to IMM rate on balance principal outstanding calculated on a daily basis After legal judgement: IMM rate on the basic judgement sum No Compounding applied
Bank Islam Malaysia	Baiti Financing Home	Commodity Murabaha	Customer (asset collateralised)	None	Floating Rate Base	During Financing Tenure: 1% p.a of overdue instalment After maturity: Sum equivalent to IMM rate on balance principal outstanding No Compounding applied
Bank Muamalat	Property Financing-i	Commodity Murabahah	Customer (asset collateralised)	None	Floating Rate Base	During Financing Tenure: 1% p.a of overdue instalment After maturity: Sum equivalent to IMM rate on balance principal outstanding No Compounding applied
CIMB Islamic	Variable Financing-i Home	Commodity Murabahah	Customer (asset collateralised)	None	Floating Rate Base	During Financing Tenure: 1% p.a of overdue instalment After maturity: Sum equivalent to IMM rate on balance principal outstanding - Gharamah over and above Tawhidh applied when necessary - routed to charity No Compounding applied
Hong Leong Islamic	CM Flexi Property Financing-i	Commodity Murabahah	Customer (asset collateralised)	None	Floating Rate Base	During Financing Tenure: 1% p.a of overdue instalment After maturity: 1% p.a on outstanding principal + accrued profit After maturity: Sum equivalent to IMM rate on balance principal outstanding After legal judgement: IMM rate on the basic judgement sum No Compounding applied





	Product Name	Underlying Shari'ah Contract	Asset Ownership	Risk Taken by Bank	Fixed Floating / Fin. Rate	Penalties (Ta'widh)
HSBC Amnah	Home Smart-i	Musharakah Mutanaqisah & Istisna'	Bank & Customer (based on ratio)	Shared but minimal - due to Purchase Undertaking (Wa'ad)	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment calculated on daily rests - After maturity: Sum equivalent to IMM rate on balance principal outstanding calculated on daily rest - No Compounding applied
Kuwait Finance House	Asset Acquisition Financing-i	Ijarah Muntahiah Bi Tamlik & Ijarah Mausufah Fi Zimmah	Bank (transferred to customer at maturity)	None. Customer is required to pay back the full amount to the Bank in any extenuating circumstance (Wa'ad)	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - Revision of financing rate - No Compounding applied
Maybank Islamic	Home Financing-i	Commodity Murabahah*	Customer (asset collateralised)	None	Fixed, variable/floating or a combination of both	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to IMM rate on balance principal outstanding - Revision of Financing Rate: BR+2.50% p.a on outstanding principal after three failed payments. - No Compounding applied
MBSB Bank	Standard Home Financing-i	Commodity Murabahah	Customer (asset collateralised)	None	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to IMM rate on balance principal outstanding - No Compounding applied
OCBC Amin	Al-Manarat Home-i	Ijarah Muntahiah Bi Tamlik	Bank (transferred to customer at maturity)	Shared but minimal - due to Purchase Undertaking (Wa'ad)	Fixed / Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to IMM rate on balance principal outstanding
Public Islamic Bank	Home Equity Financing-i	Musharakah Mutanaqisah	Bank & Customer (based on ratio)	Shared but minimal - due to Purchase Undertaking (Wa'ad)	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to the Bank's Average Financing Rate (Ta'widh and Gharamah) rate on the balance principal outstanding - Legal Judgment before Maturity Date: 1% p.a on the remaining outstanding balance
RHB Banking	Term Financing-I for Home/Property	Commodity Murabahah	Customer (asset collateralised)	None	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to IMM rate on balance principal outstanding - No Compounding applied
Standard Chartered Saadiq	Saadiq My Home-i	Musharakah & Ijarah	Bank & Customer (based on ratio)	Shared but minimal - due to Purchase Undertaking (Wa'ad)	Floating Base Rate	- During Financing Tenure: 1% p.a of overdue instalment - After maturity: Sum equivalent to IMM rate on balance principal outstanding - No Compounding applied

* The contract under which the largest portion of house financing offered (as per Annual Report 2018) has been chosen for analysis

** Maybank Islamic does offer the same product under Musharakah Mutanaqisah. However, as of 31 December 2018, the majority of the House Financing is offered through Murabahah (RM 65,870,117,000), while Musharakah was at (RM 2,140,367,000). Therefore, the CM product was chosen for the analysis





Table 5: Analysis of Home Financing Products in Bahrain, Oman, Pakistan and the United Kingdom

Name of the Bank	Product Name	Underlying Shari'ah Contract	Asset Ownership	Risk Taken by Bank	Fixed / Floating Fin. Rate	Penalty (Ta'widh)
Al Baraka (Bahrain)	Property Finance	Ijarah Muntahiah Bi Tamlik	Bank & Customer (based on ratio)	Risk shared. Bank's portion of assets being put on their Balance sheet, exposing to depreciation risks, etc	Floating Rate	During Financing Tenure: 15% on instalment amount (paid to charity accounts)
Meethaq Islamic Banking (Oman)	Meethaq Home Financing	Diminishing Musharakah	Bank & Customer (based on ratio)	Risk shared. Bank's portion of assets being put on their Balance sheet, exposing to depreciation risks, etc	Information Not Available	Information Not Available
Meezan Bank Limited (Pakistan)	Easy Home - Islamic Housing Finance	Diminishing Musharakah	Bank & Customer (based on ratio)	Risk shared. Bank's portion of assets being put on their Balance sheet, exposing to depreciation risks, etc	Fixed for 1st year, re-priced annually	Based on actual charges*
Al Rayan Bank (United Kingdom)	Home Purchase Plan	Diminishing Musharakah	Customer	Risk shared. Bank's portion of assets being put on their Balance sheet, exposing to depreciation risks, etc	Discounted Variable / Fixed	Fixed fees until costs are covered, any additional fees charged are routed to charity.

Analysis of Shariah Contracts

Reviewing the Shari'ah contracts used in Malaysia, as shown in Table 4, it becomes evident that the predominant Shari'ah contract employed by 9 out of 16 banks is the Commodity Murabahah or Tawarruq contract. This particular contract has not been without controversy due to its perceived similarity to conventional loans, despite its permissibility, according to the Shari'ah Advisory Council (SAC) of Bank Negara Malaysia. However, a deeper examination of the data reveals certain nuances in the application of this contract.

In the case of organised Tawarruq or Tawarruq Munazzam, it is noteworthy that the risk exposure borne by the bank is virtually non-existent. While technically, the asset may rest with the customer, it is often collateralised by the bank, further diminishing its risk exposure. This practice, though compliant with prevailing guidelines, raises questions about the faithful application of crucial Islamic finance principles such as "al-kharaj bil daman" (profit and loss sharing) and "al-ghurm bil ghum" (bearing loss in return for gain). These principles, essential for ensuring the absence of riba (usury) in Islamic finance, may not be fully realised in contracts where the bank assumes minimal risk. This situation parallels some of the criticisms directed at the al-bai-bithaman ajil product, which also lacks substantial bank liability in these types of contracts.

A similar pattern emerges when examining other prevalent contract structures, including Musharakah Mutanaqisah (Diminishing Musharakah) and Ijarah (lease) products. In the case of Ijarah, although the bank technically maintains ownership, various liabilities that would typically be assumed by the lessor are shifted to the customer. Likewise, in Diminishing





Musharakah, the bank often employs a Wa'ad (promise) from the customer to mitigate market and credit risks associated with joint ownership. While these practices have been sanctioned by the SAC of Bank Negara Malaysia, they have not been immune to criticism within the Islamic finance industry.

In light of this analysis, it becomes evident that the Malaysian Islamic finance industry may benefit from a reevaluation of its adherence to Shariah principles, particularly in the context of the prevalent contracts used in home financing. The study's findings suggest that there is room for greater alignment with the economic substance of these contracts, ensuring that they reflect the principles of "al-kharaj bil daman" and "al-ghurm bil ghunm" more faithfully. This alignment could help dispel perceptions of undue similarity to conventional financial instruments and enhance the authenticity of Islamic finance products.

Moreover, as the international analysis of home financing products in Bahrain, Oman, Pakistan, and the United Kingdom shown in Table 5 illustrates, there are alternative contract structures that prioritise risk-sharing and align more closely with Shariah principles. Therefore, the recommendation stemming from this study is to consider adopting and innovating upon such contracts that promote authenticity, Shariah compliance, and equitable risk-sharing. This approach could contribute significantly to the enhancement of home financing products within Malaysia's Islamic finance industry, aligning them more closely with the principles of Shariah and ensuring their continued growth and acceptance.

Analysis of Financing Rates

An insightful observation stemming from the analysis of home financing products in Malaysia, as detailed in the table, is that a significant proportion of these products feature variable financing rates. This variability is a notable characteristic of the Effective Profit Rate (EPR) associated with these facilities. Meanwhile, the Ceiling or Capping Profit Rate (CPR), which tends to remain fixed, typically at an average of 10%, offers a certain degree of stability.

The dynamism in these home financing products' EPR is primarily tethered to the Base Rate, which is determined by each respective bank. It is interesting to note that many of these banks draw upon conventional benchmarks, such as the Kuala Lumpur Interbank Offered Rate (KLIBOR), to establish their Base Rates. This approach bears a striking resemblance to the mechanisms governing conventional financial products, where interest rates fluctuate in response to market-driven changes.

Comparatively, in foreign jurisdictions, a greater degree of flexibility is often afforded to customers in the form of choosing between fixed or variable financing rates. This contrast underscores the adaptability and diversified options available to customers in those regions, a feature that the Malaysian market could potentially explore to cater to a wider array of preferences and risk tolerance levels.

Charging of Ta'widh

The information presented in the table offers valuable insights into how late payment penalties are handled in Islamic finance. Specifically, it sheds light on the application of the Ta'widh system, a key feature of Islamic financial transactions. In this system, late payment penalties are usually capped at a reasonable rate of 1% per annum of the overdue instalments, as mandated by the regulatory framework established by Bank Negara Malaysia. This approach reflects a core principle of Islamic finance, which is to ensure fairness and transparency in financial dealings.

What sets this approach apart from conventional banking practices is its fundamental difference in dealing with late payments. In conventional banking, late payments are typically





penalised through the application of compounded interest. This means that if a borrower falls behind on their payments, the interest charges continue to accumulate on the outstanding balance, potentially snowballing into a substantial financial burden. Such practices can result in borrowers facing significantly higher financial penalties, making it challenging for them to catch up on their payments and potentially leading to financial distress.

In contrast, the Ta'widh system in Islamic finance is designed to be more equitable and considerate of borrowers' financial well-being. By capping the late payment penalty at a fixed percentage of the overdue instalments it ensures that borrowers are aware of the maximum penalty they might incur. This approach aligns with the broader principles of Islamic finance, which emphasise fairness, ethical conduct, and the avoidance of practices that may lead to financial exploitation or hardship for individuals.

RECOMMENDATIONS AND CONCLUSION

Based on the research findings regarding home financing products within Malaysia's Islamic finance industry, it is evident that a significant portion of these products relies heavily on Tawarruq contracts. This prevalence of Tawarruq raises important concerns about the authenticity and Shariah-compliance of these financial instruments. The study highlights the need to address this issue and offers several recommendations to enhance the authenticity and Shariah-compliance of home financing products:

- **Move Away from Tawarruq:** The research underscores the necessity of reducing the reliance on Tawarruq-based contracts in the Malaysian Islamic finance sector. Lessons can be drawn from countries like Oman, where Tawarruq is generally prohibited except in truly exceptional circumstances. Paragraph 2.4.3 of the Islamic Banking Regulatory Framework 2012 of Oman states that: “Commodity Murabahah or tawarruq, by whatever name called, is not allowed for the Licensees in the Sultanate as a general rule” (Central Bank of Oman, 2012). Further, paragraph 2.5.5 of the Islamic Banking Regulatory Framework 2012 states that:

Commodity Murabahah Transaction (CMT) or tawarruq, by whatever name it is called, is not allowed for the Licensees in the Sultanate as a general rule. The only exception may be a real emergency situation defined as follows: If a Licensee's survival is genuinely threatened, or in case of a conventional bank's conversion into Islamic where no other alternative mechanism exists to convert part or all of its portfolio, as determined by the bank's Shariah Supervisory Committee. In such a situation and on a case-to-case basis, the Central Bank may allow the use of CMT after the approval of the respective Shariah Supervisory Board on a one-off basis for a specified time period no longer than three months.

Malaysia should consider adopting similar measures to promote greater authenticity in its Islamic finance offerings.

- **Promote Equity-Based Contracts:** Rather than replicating conventional financial products, the industry should focus on developing and promoting equity-based contracts. These contracts align more closely with Shariah principles and can help establish a more genuine Islamic finance landscape.
- **Enhanced Market Awareness:** Both customers and Islamic financial institutions (IFIs) need to be better informed about the importance of Shariah compliance and authenticity in financial products. Awareness campaigns and educational initiatives can play a pivotal role in achieving this objective.





- Value-Based Approach: IFIs should transition towards a value-based approach, emphasising ethical and social values derived from Maqasid al-Shari'ah. This shift in perspective can lead to the creation of financial products that not only comply with Shariah but also contribute to social welfare and wealth redistribution.
- Utilise Social Financing Tools: The Islamic finance industry should explore and leverage social financing tools such as Waqf and Zakat. These tools have the potential to address pressing social issues, including poverty and financial injustice while promoting Shariah-compliant financial practices.

In conclusion, striving for authenticity in home financing products within Malaysia's Islamic finance industry is of paramount importance. The overreliance on Tawarruq-based contracts should be reconsidered, and the industry should explore innovative and Shariah-compliant alternatives. By embracing equity-based contracts, raising market awareness, adopting a value-based approach, and harnessing social financing tools, Malaysia's Islamic finance sector can move towards greater authenticity and contribute significantly to the community's social justice and financial well-being.

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