

Innovations of Islamic Personal Financing Mechanisms in Malaysia

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Since the emergence of Islamic banking in Malaysia in 1984, Islamic personal financing mechanisms have been continuously realised through innovative products. Innovations are essential to maintain Shariah compliant status. Malaysia has its own regulatory framework concerning Islamic finance. Nonetheless, influential institutions in Sharia such as the Islamic Fiqh Academy of OIC, the Muslim World League and the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) are considered giants in international standards providers in Islamic finance. Some controversial products do not comply with the international standards, even though they are considered Shariah compliant in Malaysia. This research analyses Islamic personal financing mechanisms in Malaysia, their conformity with world standards, and current innovations. The paper concludes that Islamic personal financing mechanisms have evolved over time because of disputes concerning the legality of the products. Contemporary Islamic financing mechanisms are anticipated to solve the problems of current applications.

Key words: Islamic personal finance, *Bay' al-'inah*, *Rahn*-based *qard*, *Tawarruq*, *Hibah*.

Introduction

Sharia prohibits moneylending with interest. In order to be Sharia compliant, Islamic banks have provided certain alternatives as underlying mechanisms for personal financing such as *bay' al-'inah* (sale and buy-back), *tawarruq* (commodity cost-plus sale) and *rahn*-based *qard* (moneylending with pledge). In fact, some scholars have proposed *hibah*(gift)-sale financing and *hibah* for a reward. These mechanisms are based on their classical concepts in the writings of past Muslim clerics. However, these mechanisms or concepts need modification to adapt with the current banking operation. Consequently, new products have emerged as innovative financial instruments that differ from their initial forms. Issues of Sharia compliant arise due to aforementioned innovations. This paper analyses these innovations and their compliancy with Sharia.

Bay' Al-'Inah (Sale and Buy Back)

The Malaysian Securities Commission (2007), through its Shariah Advisory Council (SAC), defines *bay' al-'inah* as a trade whereby the seller sells assets to the buyer at an agreed selling price to be paid by the buyer at a later date. After that, the buyer immediately sells back the assets to the seller at a cash price, lower than the agreed selling price. As stated by the SAC of Bank Negara Malaysia (2010), it refers to a contract, which involves sale and buy back mechanisms of an asset by the seller. In these transactions, the seller sells an asset to the buyer on a cash basis and then buys back the asset at a deferred price, which is higher than the cash sale price. It may also be conducted where the seller sells the asset to the buyer at a deferred price and subsequently buys back the asset on a cash basis at a lower price than the deferred sale price. It is evident that the definition of classical *bay' al-'inah* is similar to its modern practice in the Malaysian banking and finance industries (Yusoff, 2017). The process of *bay' al-'inah* is shown in Figure 1.

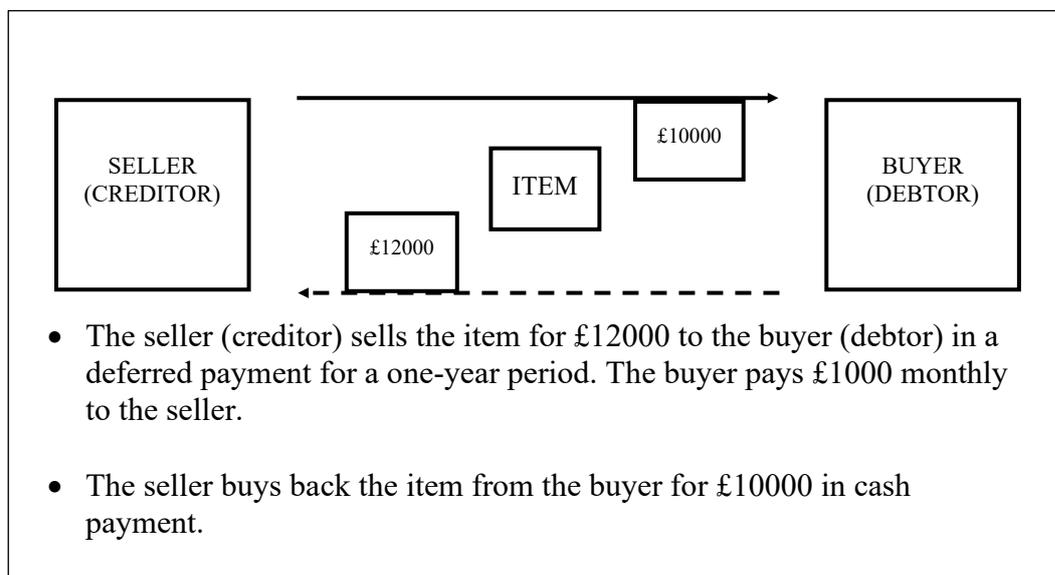


Figure 1: Basic Process of *Bay' al-'inah*

The application of *bay' al-'inah* is claimed to be unlawful according to most Muslim jurists as previously discussed by El-Gamal (2008). Despite the fact that established contemporary religious authorities in Sharia, such as the Islamic Fiqh Academy and AAOIFI (2015), after long research, have banned the concept, legal authorities in Malaysia such as the SAC of BNM and the Securities Commission continue to support its permissibility. The former cannot invalidate the latter's resolution and vice versa, which leads to a stalemate and creates uncertainty surrounding Sharia compliant products (Anderson, 2010).

However, new resolutions did emerge from BNM (2010) with stricter conditions:

- The need to contain two independent contracts, namely a purchase and a sale contract
- No stipulation in the contract to resell the transacted item
- Both contracts are finalised separately
- The order of each contract is correct, whereby the first sale contract must be concluded before the conclusion of the second sale contract
- Transfer of ownership of the transacted item and its valid possession is in conformity with Sharia and contemporary business practice

These conditions could not be realised by Islamic banks. Therefore, most banks have migrated from *bay' al-'inah* to other products such as *tawarruq munazzam* (organised commodity cost-plus sale). However, there remain a small number of Islamic banks still practising the *bay' al-'inah* mechanism.

***Rahn*-Based *Qard* (Moneylending with Pledge)**

The mechanism of *rahn*-based *qard* is a contract of Islamic financing based on *qard* (moneylending) by requiring a specific asset as *rahn* (pledge). In the event of a default in the debtor's obligation to pay, a *rahn* safekeeping fee exists for the purpose of compensation in the event of damage (BNM, 2010). Despite its classical financing status, this mechanism is deemed to be a modern tool of financing because of an innovation in its *modus operandi*, which is charging a safekeeping fee as a source of profit.

According to the RHB Islamic Bank (2014), their *rahn*-based *qard*, nick-named Ar Rahnu Facility-i, is an Islamic style of pawn broking that enables gold jewellery to be placed as a security against a *qard*. Practically, the bank as creditor will provide a *qard* to the customer as a debtor, and keep possession of the gold jewellery as a pledge, charging a specific fee for the purpose of safekeeping. The value of the gold jewellery is calculated according to the market price. Nonetheless, the amount of *qard* granted relies on a certain percentage decided by the bank and the category of the gold. The safekeeping duration and fees are prearranged and agreed upon by the contracting parties. At the end of the duration, the debtor is obliged to repay the debt to the bank, along with its remaining safekeeping fee, and the pledge will be delivered to the debtor. No interest will be imposed but if the *qard* is not repaid within the agreed duration, the bank has the authority to auction off the gold jewellery pledged as *rahn*. Other Malaysian Islamic banks such as the Affin Islamic Bank (2014) and CIMB (2014) operate the mechanism in a similar way to the aforementioned *modus operandi*. The *modus operandi* of the mechanism is shown in Figure 2.

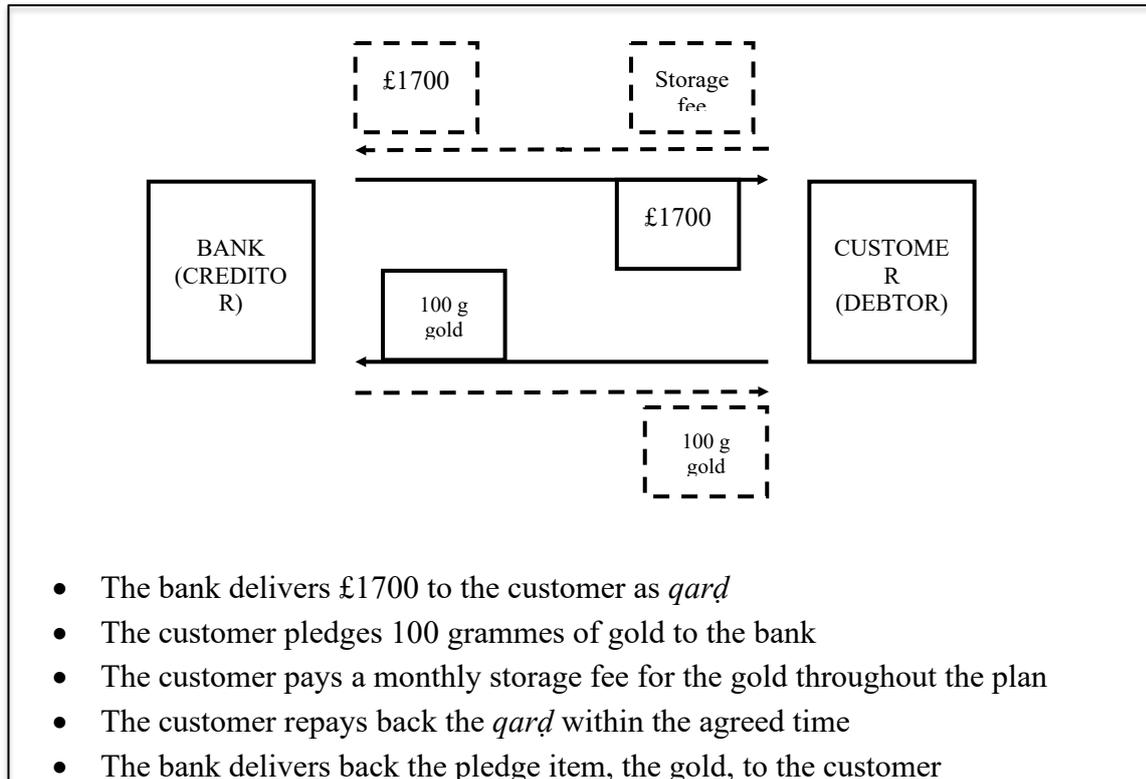


Figure 2: *Rahn*-based *Qard* or an Islamic-style pawnbroking modus operandi

Apart from *bay' al-'inah* and *tawarruq* (commodity cost-plus sale), some Malaysian banking and financial providers utilise the application of *qard* as an Islamic financing tool. In fact, the concept of *qard* has been modified to be a profitable financing product with a combination of *rahn*, producing a *rahn*-based *qard* by charging a fee for *rahn* safekeeping.

The work of Khan and Nisar (2004), Naim (2004), Khir (2011) and Sharif et al., (2013) reveals that the practice of *rahn*-based *qard* still carries the element of *ribā* (usury or interest) in its modus operandi. There is no doubt that the mechanism represents the permissible contract of *qard*, but charging a fee for *rahn* safekeeping, when added to the contract, resembles charging interest on the *qard* principal. The problem becomes worse when the fee is linked to the amount of the *qard*. In contrast, Sabri et al. (2013) assert that the fee does not represent the interest-bearing *qard* because it is based on the *ujrah* (service charge) concept for keeping the *rahn* under the creditor's guardianship, which is permissible in Sharia. Alternatively, Khir (2011) has proposed the application of *wadi'ah bi ajr* (the combination of trust and fee) and *tawarruq-rahn* (the combination of *tawarruq* and *rahn*), but the mechanisms may also contain the element of *riba* indirectly, as well as *hilah* (legal ruse). A combination of *murabahah* (cost-plus sale) and *rahn* could be an alternative to the concept, as suggested by Mukhlas (Sharif et al., 2013). However, Mukhlas' model obviously constitutes *riba* because gold bars are being used as a medium of exchange in a deferred payment. Perhaps using a non *ribā*-related item such as platinum could solve the issue.

The mechanism of *rahn*-based *qard* is a combination of several Sharia commercial law mechanisms. It includes the mechanism of *qard* (moneylending), *rahn* (pledge), *ujrah* (fee) and *wadi'ah* (safekeeping). These mechanisms are permissible if executed separately. Similarly, the combination of *qard*, *rahn* and *wadi'ah* in a contract is unanimously permissible in Sharia. However, adding the mechanism of *ujrah* into the *rahn*-based *qard* to acquire profit renders it questionable in terms of Sharia compliance, because there has been no precedent for such a practice in Sharia, and the *ujrah* is claimed to be similar to interest. Its practice has violated the newly issued policy document of *qard* (2018), which states that:

*15.2 In relation to paragraph 15.1, the identified services, benefits, facilities or privileges must be Shariah compliant and must **not in any way be related** to the qard contract.*

15.3 The lender must not charge ujarah for providing the identified services, benefits, facilities or privileges that relate to the qard contract.

And from the policy document of *rahn* (2018):

16.1 Expenses in rahn are categorised into –

- (a) expenses incurred that are directly related to the maintenance of collateral; and*
- (b) all other expenses incurred that are **directly related** to the rahn contract including safekeeping, documentation, liquidation and discharging of collateral.*

The product, namely *rahn*-based *qard*, which is based on an interest free loan and a pledge has been nullified and deemed non-Sharia-compliant by the Shariah Advisory Council (SAC) of Bank Negara Malaysia. Every loan that brings benefit to the lender is prohibited in Sharia since it constitutes *riba* (usury). Charging safekeeping fee for the pledged item is tantamount to *riba*.

Tawarruq (Monetisation)

i- Classical Tawarruq

From the descriptions of classical *tawarruq* from various *madhhab* (schools of law), we could conclude that it is a monetisation mechanism, whereby someone who needs cash money buys merchandise from a seller, normally at a mark-up price, with a deferred payment, then sells it to the market or someone else other than the seller at a lower price, for cash, without any connection or agreement between the first seller and the second buyer (Yusoff, 2019). This modus operandi exists in the spirit of preventing the prohibited *riba* (usury) by engaging in a sale contract rather than an interest-producing *qard*. The process of classical *tawarruq* is shown

in Figure 3.

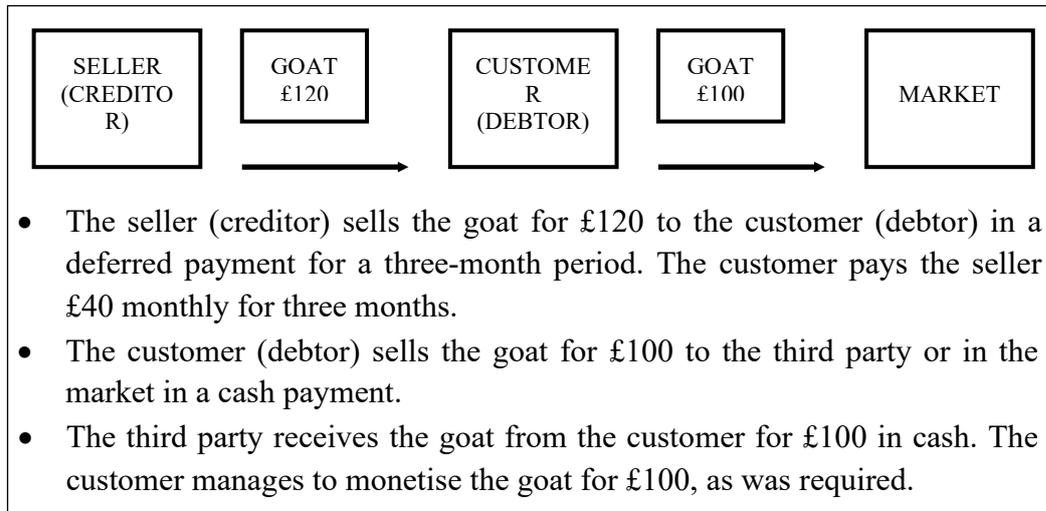


Figure 3: Basic process of classical *tawarruq*

Tawarruq was introduced by al-Ḥanabilah as a new term for a modified version of *bay' al-'inah* as an alternative mechanism to it (El-Gamal, 2008). Other *madhhab* (school of law) do not recognise the term, since the discussion of the subject lies within the discussion of *bay' al-'inah*. *Tawarruq* is similar to *bay' al-'inah* except that the commodity involved in the mechanism is sold to a third party rather than to the creditor (Shanmugan & Zahari, 2009). The customer obtains money by selling the commodity to the third party and it remains his obligation to pay the deferred sale value to the creditor. The mechanism is permissible according to the majority of Muslim schools of law, including al-Ḥanafiyyah, al-Malikiyyah, al-Shafi'iyyah, al-Ḥanabilah, al-Ja'fariyyah, al-Zaydiyyah, al-Zahiriyyah and al-Ibadiyyah. The Fiqh Council of the Muslim World League in Makkah, Saudi Arabia, issued a fatwa in 1998 permitting the practice as an alternative to interest-based lending (El-Gamal, 2008). *Tawarruq* is permissible, provided that the debtor does not sell back the traded item to the creditor, such as to a bank (Robbins, 2009). The concept is widely used and has become increasingly popular in Saudi Arabia, the United Arab Emirates (UAE) and other Gulf Cooperation Council (GCC) countries in recent years (Lubetsky, 2010).

The work of El-Gamal and Robbins states in detail the concept of *tawarruq* as an alternative to *bay' al-'inah*. They assert that Sharia has approved the practice with strict conditions due to the close relationship between *tawarruq* and *bay' al-'inah*. Even though their studies are related to classical opinions of *tawarruq*, the descriptions concentrate on modern *tawarruq* without any attention to the classical financing model.

ii- Organised *Tawarruq*

The application of classical *tawarruq* does not interest modern Islamic banks. In fact, there is no applied model, currently. Despite its legitimacy in Sharia, Islamic banks tend to isolate the concept by implementing the complicated version, the organised *tawarruq*. The application has been modified and currently does not conform to classical *tawarruq*.

Eventually, after comprehensive research, the Fiqh Academy of OIC in 2009, through declaration no. 179 (5/19), and the Fiqh Academy of the Muslim World League (2011) in 2003 through declaration no. 2 in their 17th session, forbade the currently applied *tawarruq*, as it is not properly executed according to Sharia. The mechanism violates the obligation to deliver the traded item and the requirement to possess it. Moreover, the concept is widely abused when the bank itself executes the sales as an agent to the third party, when the sale should have been exercised by the customer. Hence, it was nothing more than the prohibited and controversial *bay' al-'inah* (Warde, 2009). The modified concept is called organised *tawarruq* (Shinsuke, 2012). Despite being banned, the SAC of BNM (2010) continue to support its application through a resolution in its 51st meeting, dated 28 July 2005, which resolved that financing products based on the concept of organised *tawarruq* is permissible.

Many current studies on organised *tawarruq* support the declaration of the illegitimacy of the mechanism by the OIC, AAOIFI and the Muslim World League. The justifications for this are based on the similarity between *bay' al-'inah* and organised *tawarruq*, the involvement of illegitimate *hilah* (legal ruse) and the invalidity of the sales contract involved (Robbins, 2009). For example, some London Metal Exchange (LME) brokers sell the same commodity to multiple buyers, which render the sales invalid (Khniifer, 2009). According to Kahf, the mechanism might be valid with some adjustments or alterations to the concept or modus operandi, as long as it adheres to the requirements of Sharia mechanisms (Uzair, 1980).

Fundamentally, the concept of organised *tawarruq* does not differ from classical *tawarruq*. However, the modus operandi makes the former differ from the latter. The elements of conditions to sell back and agency in the contract render organised *tawarruq* different from classical *tawarruq*. Both elements are non-existent in classical *tawarruq*. Instead of executing the sale process independently to a third party, the customer agrees to appoint the bank as an agent to carry out the task.

According to BIMB, after a client (debtor) applies for Islamic financing based on an organised *tawarruq* concept from the bank, it processes the application and, once successful, the bank proceeds with the transaction. The bank buys a commodity such as iron at the LME through a broker. Afterwards, through a cost-plus sale contract, the bank sells the commodity to the client at the bank's mark-up price on a deferred payment. Through a *wakālah* (agency) contract, the client appoints the bank to sell the commodity in the market on the client's behalf. Acting as

the appointed sale agent for the client, the bank sells the commodity through a broker. Afterwards, the bank transfers the earnings from the sale of the commodity to the client's account. The client is responsible for settling the amount of the deferred payment to the bank, according to an agreed instalment payment. The modus operandi of organised *tawarruq* is shown in Figure 4.

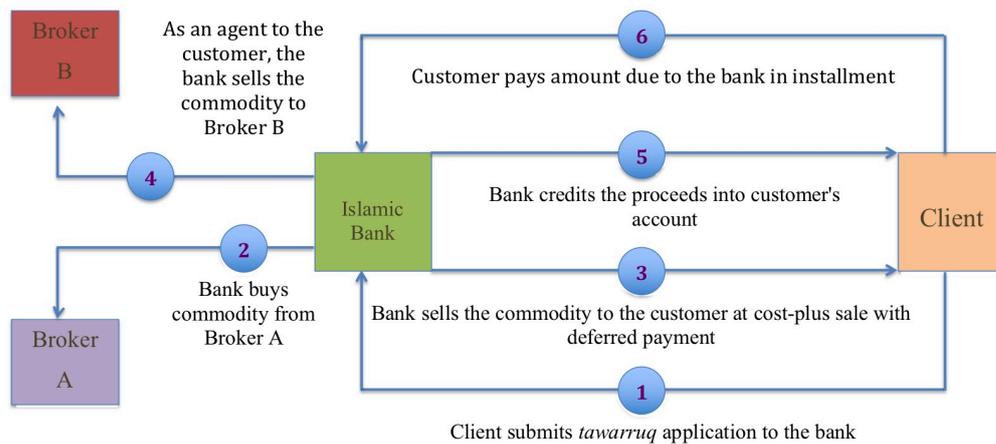


Figure 4: Organised *tawarruq* by Bank Islam Malaysia Berhad

Source: Bank Islam Malaysia Berhad's website

Prior to a *tawarruq* transaction, a prospective customer (debtor) who needs cash money approaches a bank (creditor) to discuss the arrangement. During the discussion, the bank will brief the customer on how the instrument would be carried out, including the process of buying a commodity at a deferred payment by the customer and selling it to a third party at a lower price through the bank as an agent. This is where the issue is deemed controversial. The modus operandi resembles the prohibited *bai' al-ṭinah* because the commodity sold to the customer is bought by a third party through the bank as agent of the customer. The resemblance is not precise, since the commodity is not sold back to the bank, but nevertheless the Islamic Fiqh Academy of OIC and MWL have banned the instrument. The resemblance factor does not really represent strong evidence on the impermissibility of organised *tawarruq*. Instead, the element of a sale for a sale, a sale for a *qard* and an invalid condition materialising in the contract render the instrument non-Sharia compliant.

According to the modus operandi of *tawarruq* at BIMB, the bank needs to instruct the customer to sell the traded item, with the bank acting as the agent, to a third party for liquidity. This is

the essence of executing a prohibited sale for a sale. The practice is definitely prohibited if the agreement contains the requirement for the customer to sell back the traded item. It is evident in BIMB and in the Alliance Islamic Bank's product disclosure sheet that the customer must appoint the bank as his agent to sell the item to the third party as one of its terms and conditions. The instrument of organised *tawarruq* also contains the element of a sale for a *qard*, since the customer is required to buy the traded item in a deferred payment in order to procure the *qard* from the bank. This element is prohibited because of it being a conditional sale contract. Despite all these criticisms, the SAC of BNM approve such practice and assert that it does not raise any Shariah issues at all, according to their resolutions and policy documents on *tawarruq*.

iii- Straight-through Processing (STP) *Tawarruq*

The modus operandi of STP includes the sale and purchase contracts that will be executed automatically after submitting a collection of transactional data, which includes all asset purchase information, to the online system of the commodity trading platform provider. This is an improvement to the existing modus operandi of organised *tawarruq*. It improves the efficiency of *tawarruq* execution and has proven to be more practical for the execution of high-volume transactions. Hence, it is anticipated to mitigate operational issues that might cause Shariah non-compliance issues (BNM, 2019).

There are two modus operandi of STP:

(i) The implementation of STP based on a step-by-step execution:

- The sale and purchase contract in *tawarruq* will be executed upon receiving instruction from the IFI to execute each sale and purchase contract step-by-step, in accordance with the proper sequence as required in the *tawarruq* policy document.
- The IFI, as an agent to the customer, executes the sale and purchase contracts, similar to the existing *tawarruq* arrangement.
- There is a time interval for each sale and purchase contract that allows the customer to take delivery of the transacted asset as an option.

(ii) The implementation of STP through a blanket execution:

- The combination of all three sale and purchase transactions in *tawarruq* will be submitted by the IFI into the STP system.
- The IFI will act as the agent to the customer to execute the second sale and purchase contract (on behalf of the customer to execute the sale from IFI) and the third sale and purchase contract (on behalf of the customer to sell the asset to the broker).
- The customer's option to take delivery of the asset is only revealed before the execution of sale and purchase contracts in *tawarruq*. There is no option to take delivery of the asset after the execution of the sale and purchase contracts.

- All contracts in *tawarruq* will be executed by the STP system with great efficiency (in several milliseconds or nanoseconds) (BNM, 2019).

Hibah-Sale Financing

A new mechanism of Islamic financing has emerged that is viable as an alternative to *bay' al-'inah* and organised *tawarruq*. This new mechanism represents a *hibah*-sale based financing. Based on the conditional *hibah* (gift), there are two things involved in debt financing, namely *hibah* and contract of sale and purchase. The new mechanism is a combination of *hibah* and sale contracts between a customer as a debtor and a bank as a creditor. When a customer needs to borrow money from a bank, they would approach the bank to deliver a certain asset as a *hibah*. The bank will sell the asset back to the customer in a deferred payment. Subsequently, the bank delivers a certain asset to the customer as a *hibah*. The bank will buy back the asset in cash payment (El-Seoudi et al., 2012). From these transactions, the objective of the customer and the bank to be involved in an unequal exchange of money without being involved in *bay' al-'inah* and organised *tawarruq*, could be achieved. The modus operandi of the new mechanism is shown in Figure 4.

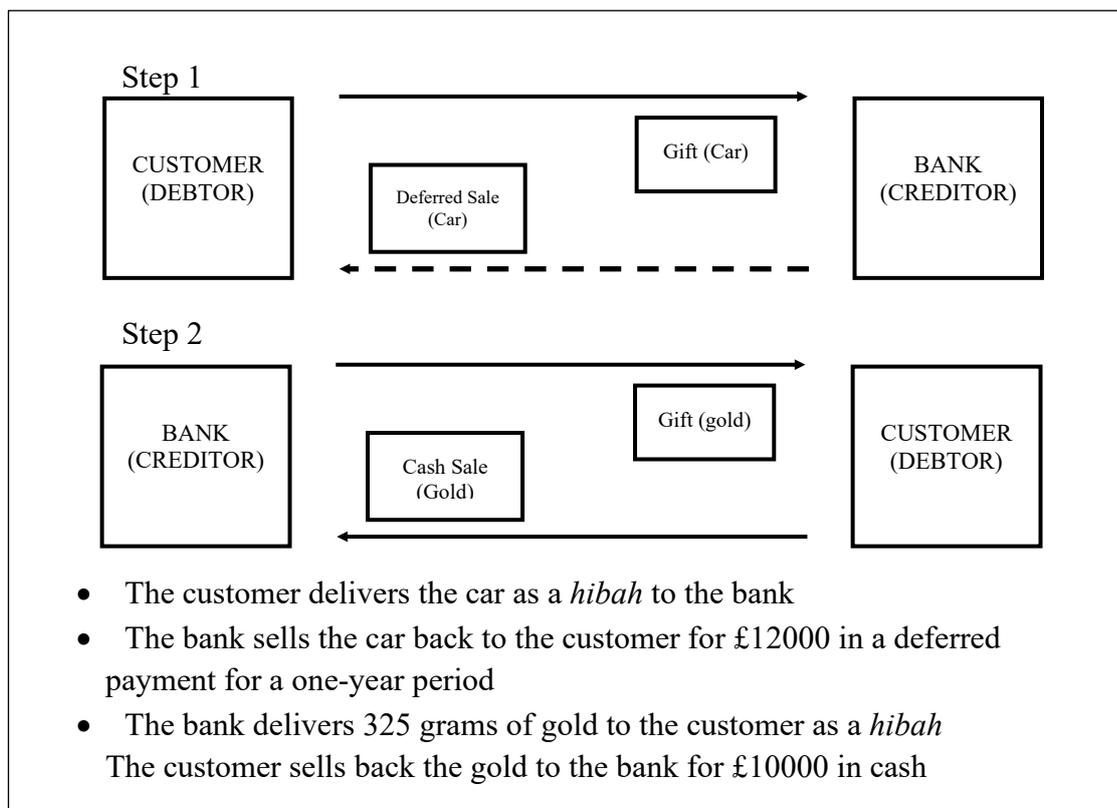


Figure 4: Modus operandi of *hibah*-sale-based financing

According to El-Seoudi (2012), the mechanism of *hibah*-sale-based financing is based on the mechanism of conditional *hibah* that requires a specific reward. It is the *hibah* that requires a reward to the donor. As stated by al-Mardawiy (n.d.), this ruling is based on one of Ahmad's

views, reported by Abu al-Khaṭṭab. Ahmad maintains that the reward is considered a *hibah* rather than a sale contract. This is the preferred opinion among al-Hanabilah (Ahmad's school of law), in the opinion of al-Harithiyy and Abu Ya'la. According to El-Seoudi's model, the customer stipulates a reward of their *hibah* to the bank in the form of selling it back to the customer in a deferred payment. Similarly, the bank stipulates a reward of its *hibah* to the customer in the form of selling it back in cash payment. Therefore, the mechanism of *hibah*-sale-based financing has its legitimacy among al-Hanabilah.

It is important to note that according to El-Seoudi, the mechanism is deemed Sharia compliant if the second *hibah* is unconditional and not expressed in the contract. By implementing this mechanism, it is not considered a *hibah* for a *hibah*, and it involves two separate items in the contract, which differs from *bay' al-'inah* and organised *tawarruq*. The conditional *hibah* occurs only between *hibah* and the sale contract.

Muslim jurists agree that *hibah* is originally a benevolent act that does not require a worldly reward or exchange. However, if *hibah* is delivered for an intended reward or known as conditional *hibah*, there are several opinions of Muslim jurists related to this issue. Based on El-Seoudi's model, the buy-back of the *hibah* from the bank is considered a reward since the customer stipulates that the bank must sell the *hibah* back to him. However, what is the status of the reward as an exchange to the *hibah* and the mechanism as a whole?

According to al-Ḥanafīyyah, al-Hanabilah, al-Zahiriyyah and al-Zaydiyyah, if someone gives a *hibah* with the condition not to sell or give it to someone, or else the item must be given back or sold to the giver, the *hibah* is valid but the conditions are void, because it contradicts the objective of the *hibah*. This is due to the fact that an invalid condition does not invalidate the contract (al-Mardawīyy, n.d.). In this case, according the aforementioned *madhhab* (schools of law), El-Seoudi's model is inapplicable because the customer stipulates that the bank must sell the *hibah* back to the customer. The condition, which is to sell the *hibah* back to the customer, is void but the *hibah* is still valid. Therefore, the customer's *hibah* belongs to the bank. However, the customer can retract their *hibah* with the bank's consent but the act is *makruh* (reprehensible), according to al-Ḥanafīyyah (al-Samarqandiy, 1984). The same principle applies to the bank's *hibah* to the customer and the bank's buy-back of the *hibah* item from the customer.

Alternatively, if the *hibah* and the buy-back are unconditional, the mechanism is valid because both contracts occur separately and are unrelated to each other. However, this financing mechanism is deemed inapplicable without prior agreement between the bank and the customer. It is highly unlikely that unconditional *hibah* occurs between a customer and a bank because there is no point for the customer to give *hibah* to the bank if the customer is not convinced that the bank will sell the *hibah* item back. Similarly, the bank would not give a *hibah* to the customer if it were not convinced that the customer would buy back the *hibah* item

from it. The element of promise could be used in this mechanism to make it conditional and not binding according to Sharia. However, the issue of promise might be binding in a court of law, as discussed in the issue of *bay' al-'inah*.

As stated by Malik, al-Shafi'iyyah and al-Zahiriyyah, if someone gives a *hibah* with the condition not to sell it or not to pass it on to another person as *hibah*, the act is invalid since it contradicts the objective of the contract, which is to transfer the ownership to another person and maintain the receiver's absolute right of the property (Malik, n.d.; al-Nawawiyy, 1985; Ibn Hāzīm, n.d.). Even though there is no mention of *hibah* for a sale from Malik and al-Shafi'iyyah, it is understood that the sale contract for a *hibah* contradicts the objective of the *hibah*. Only al-Zahiriyyah evidently states the nullification of *hibah* for a sale. In this case, El-Seoudi's model is void from the beginning because the customer stipulates that the bank must sell back the *hibah* to the customer.

From the aforementioned arguments, the majority of Muslim jurists agree that the stipulated sale contract in the mechanism of *hibah*-sale based financing is invalid and should be terminated. Since the sale contract is considered one part of the mechanism, its nullification causes the whole mechanism to be inapplicable in the modern banking and finance industries. Muslim jurist's justification is based on the fact that the *hibah* contradicts its objective, which is to transfer ownership to another person. If the act is allowed then there is no significant point of *hibah*. In this case, the customer might as well give the money to the bank directly instead of giving *hibah* and buying back the item from the bank. The same principle applies to the second step of the mechanism.

El-Seoudi's approach in linking the mechanism with conditional *hibah* is out of context. Conditional *hibah* is a contract whereby a contributor gives *hibah* to another person with an intention to get a reward as an exchange for his *hibah*. According to the majority of Muslim jurists, conditional *hibah* is not a *hibah* at all. In fact, it is a sale contract since the contract represents an exchange of certain items (al-Sarakhsiyy, n.d.). Moreover, a conditional *hibah* requires an exchange of two trade items. It does not constitute an exchange of an item with a sale contract. For example, a person gives a bicycle to his friend with a condition that he gives him a CD player as a reward. If the reward of the *hibah* represents a sale contract rather than an item, the contract could be described as a sale for a sale, which is prohibited in Sharia. For example, a person gives a bicycle to his friend with a condition that he sells his CD player to him. In this case, based on the opinion of the majority of Muslim jurists, the bicycle is traded for the selling of CD player. This contract evidently represents the prohibited two sales in a deal or a sale for a sale.

Conditional *Hibah* for a Reward

Since the mechanism of *hibah*-sale-based financing is not Sharia compliant, it could not be applied in current Islamic banking and finance in Malaysia. Modification of the mechanism is necessary to achieve Sharia compliance. If the concept of conditional *hibah* is to be retained, the element contrary to the objective of the contract should be eliminated completely. The proposed new model is called '*hibah* with a reward' financing.

In a structured mechanism of conditional *hibah* for a reward, a bank offers *hibah* to its customer, for example £1000, and stipulates that the customer gives a specific reward as an exchange, for example 56 grams of platinum, which at the time of writing is equal to £1186, in a deferred payment (BullionByPost, 2020). In this way, both parties achieve the required financing through a legal means. However, the bank has to monetise the platinum in order to obtain cash money. Initially, it is an exchange of £1000 for £1186, which is prohibited in Sharia because of *riba* (usury). The mechanism becomes Shariah compliant when structured on the concept of conditional *hibah*, since the majority of Muslim jurists approve the concept. It is no longer an exchange of £1000 for £1186, but £1000 in exchange for 56 grams of platinum that costs £1186. The modus operandi of conditional *hibah* for a reward is shown in Figure 5.

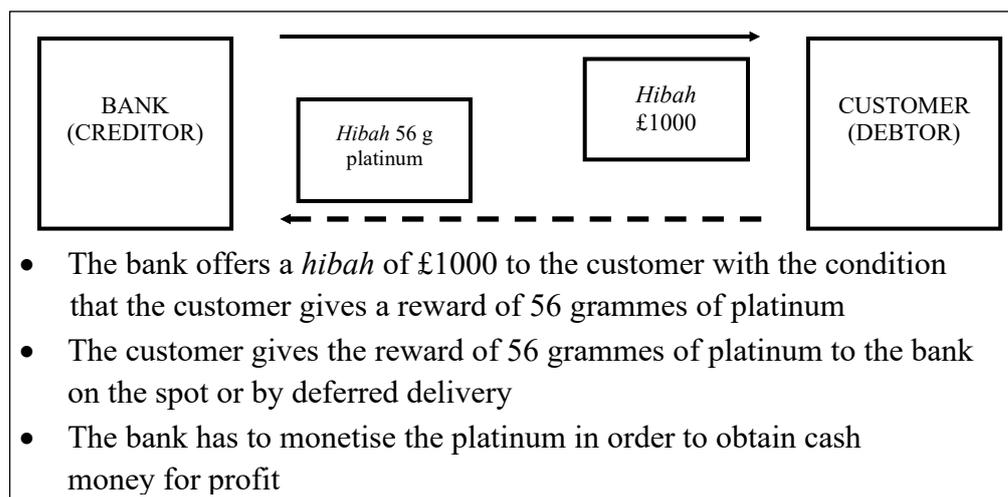


Figure 5: Proposed conditional *hibah* for a reward financing

The mechanism of *hibah* for a reward is not originally designated as a financing tool in the way a loan is. There is also no specific evidence in the Quran or Hadith on its validity and authority as a financing tool either. The objective of *hibah* is to show closeness, friendship and compassion among individuals in a community. Therefore, structuring the mechanism as an Islamic personal financing mechanism could be eventually based on uncertified public interest according to the principles of Islamic jurisprudence.

This conditional mechanism is necessary to operate as an alternative to the conventional loan for the general public and the prohibited *bay' al-'inah*. It has proven to be an effective alternative since the concept has been a traditional Shariah mechanism since the time of the Prophet. The mechanism is also classified as a person to person based transaction, which is open to innovation. In addition, the mechanism does not violate any ruling, principle or objective of Sharia. These criteria enable the mechanism to operate under uncertified public interest.

The legal basis for conditional *hibah* for reward does not represent an impermissible legal ruse because the modus operandi is directly based on a specific source of Sharia. There is no alteration to the modus operandi by using an unrelated application such as a sale contract. The mechanism does not violate the prohibition of providing a loan for a sale, a sale for a sale, selling an unavailable item, having an illegitimate prior agreement and benefit-producing loan.

The conditional *hibah* for a reward requires the beneficiary (customer) to reward the donor (Islamic bank) with the specified item as agreed. Any failure to adhere to the contract allows the donor the right to terminate the contract and retrieve the *hibah*. This is in accordance with al-Hanafiyah, whose opinion is based on the ruling that a conditional *hibah* for a reward is considered *hibah* at the beginning, until both the contracting parties take delivery of the *hibah* and the reward. This means that the donor has the right to terminate the contract and retrieve the *hibah* before the beneficiary rewards the donor. Once the reward is delivered, the contract becomes a sale contract that cannot be terminated. Even though the contract could be terminated at the beginning or at the *hibah* stage, the act is considered impermissible (al-Sarakhsiyy, n.d.; Ibn Nujaim, n.d.). However, according to al-Malikiyyah and al-Shafi'iyah, the donor can retrieve the *hibah* if the beneficiary has not rewarded the donor after the occurrence of *qabd* (possession), or has not agreed to reward. Once the beneficiary agrees to reward the donor at the donor's specific request, and even if the donor has not taken delivery of the reward, the contract becomes *lazim* (sealed). The contract can then no longer be terminated by the contracting parties, because the *hibah* contract has transformed into a sale contract. The beneficiary could be forced to reward or pay the donor in a court of law ('Ulaish, 1989; al-Nawawiyy, 1985). This opinion is more practical to be applied in the current Malaysian banking and finance industries to safeguard the rights of Islamic banks that use this mechanism, in the event that the customer fails to reward the bank. It means that the customer is still obligated to deliver the agreed reward item because the contract is considered a sale contract.

It is noted that according to al-Ja'fariyyah, the beneficiary has an option to pay the value of the agreed item (al-Hiliyy, n.d.). If the opinion of al-Hanafiyah were to be applied, the Islamic bank would not make a profit from this mechanism if the customer fails to reward the bank. This is because the contract is considered a *hibah* rather than a sale contract until the customer delivers the reward to the bank. At this stage, the bank could terminate the contract and retrieve its *hibah*, but it cannot procure profit because the mechanism remains as *hibah*.

According to al-Malikiyyah, al-Shafi'iyyah and al-Zaidiyyah, conditional *hibah* for a reward does not require delivery or possession of the subject of the contract in order to be valid as a binding agreement. The offer and acceptance between the contracting parties are sufficient to conclude the contract (al-Malikiyy, 1991; al-Nawawiyy, 1985; al-Murtada, n.d.). In contrast, al-Hanafiyah requires both the contracting parties to take delivery of the *hibah* and the reward (al-Sarakhsiyy, n.d.; Ibn Nujaim, n.d.).

In terms of the duration of the contract, in *hibah*-based financing the debtor is responsible for rewarding the donor until the donor is satisfied with the reward (Ibn Qudamah, 1984). This means that there is no specific duration during which to reward the donor, but both the contracting parties could specify a certain date of delivery as agreed between them.

In terms of its application in the current Malaysian banking and finance industries, the mechanism is applicable and provides more options for Islamic banks and customers to choose from, according to the nature of the mechanism that suits the contracting parties. However, the mechanism requires a combination of *tawarruq*, in order to monetise the precious metal used as an item of exchange.

Conclusion

The development of Islamic personal financing mechanisms is a continuous process and involves meticulous analysis of Islamic law in order to be Shariah compliant. To date, there is no specific mechanism that is free from controversial issues related to Shariah. The migration from *bay' al-'inah* to organised *tawarruq* represents evidence of non-Shariah compliance, as well as the newly banned pledge-based loan. However, the degree of non-compliance is gradually decreasing over time with the development of new mechanisms. The non-compliance issues resulted from innovations that neglected prohibitions related to Islamic commercial law. Islamic banks should consider adapting real trading mechanisms rather than focusing on appearance. The substance of Islamic commercial law, not its form, should have the priority. New alternatives to the current mechanisms are anticipated to fully comply with Shariah and embrace the real trading element.

Acknowledgement

This research is sponsored by Universiti Kebangsaan Malaysia under Geran Galakan Penyelidik Muda GGPM-2017-002.

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