

Islamic Banking, Accounting And Finance International Conference– The 9thiBAF 2020

Tawarruq Home Financing: Risk Mitigation or Overconcentration?

Norhazlina Ibrahim

Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai,
71800 Nilai, Negeri Sembilan Malaysia
Tel: +606 798 6314 E-mail: norhazlina@usim.edu.my

Safeza Mohd Sopian

Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai,
71800 Nilai, Negeri Sembilan Malaysia
Tel: +603 798 6330 E-mail: safeza@usim.edu.my

Abstract

Home financing today has played a vital role in banking and contributing a great amount of percentage in the growth of the economy not only in Malaysia but also elsewhere across the international borders. The evidenced of growth in Islamic banking and finance in Malaysia give no exception to Islamic home financing. Many of these products are being accused to replicate and mimicking the conventional products, thus alleged of not living to the spirit of Shariah. Debt-based products offered by Islamic financial institutions (IFIs) was usually viewed as mimicking conventional products rather than offering profit and loss sharing products. There are also concerns that many of the products offered by the IFIs are concentrated on the *Tawarruq* products. Often, concerns received from the regulator are referring to the usage of this product and the associated risks as a result from its utilisation. The purpose of this study is to investigate the usage of *Tawarruq* contract and the types of risk associated with it when it is being used as the basis for home financing products offered by IFIs in Malaysia in 2020. Further investigation was done to study the evolution of the home financing for each bank. The methodology used in this study is through content analysis (website, brochures, Product Disclosure Sheet (PDS), and annual report). The finding shows that around 63% of the Islamic banks offer *Tawarruq* for home financing in 2020. The study also revealed that many banks prefers to use *Tawarruq* in the recent years due to its arrangement that is less risky to the IFIs when it concerned financial risks and Shariah non-compliant risk (SNCR).

Keywords: Islamic finance, Islamic banking, *Tawarruq*, financial risks, Shariah non-compliant risk (SNCR)

1. Introduction

Since the inception of Islamic finance more than 30 years ago, Islamic finance has comfortably set its footing in many Muslim countries and evidenced by tremendous growth especially in Malaysia. The emergence of Islamic banking and finance products that carries significant uniqueness as to compare with conventional banking products has enticed Malaysian to opt for Islamic banking and finance services offered by Islamic banks which includes non-Muslim. This trend has helped to further boost the growth of Islamic banking and finance (IBF) in Malaysia.

In Malaysia, the banking system are operating in dual banking environment, which both systems are operating in parallel. Both conventional and Islamic banks perform the same essential functions nonetheless the modus operandi is different. For Islamic bank, not only they are bound by the same banking regulation as conventional banks, they also required to obey Islamic principles. As they are founded by religion of Islam, their accountability towards society are higher especially on moral and social values. Naturally these banks need to find equilibrium between Shariah requirements and profit making or they are unable to survive in the industry (Aris et al., 2013).

Conventional banks operate through interest or *riba*, however interest (*riba*) is clearly prohibited in the Islamic banks' operation. According to Shariah, any additional money raised from lending or

borrowing is *riba* (interest) based on interest as their income but since interest are prohibited, Islamic banks have to use other means to sustain their operations. This is aligned with the command of Allah stated in Quran that:

Those who devour usury (riba) will not stand except as stand one whom the Evil one by his touch Hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge), but those who repeat (The offense) are companions of the Fire: They will abide therein (forever). (2:275)

Thus, following this prohibition, any transactions must involve trading such as *Mudharabah*, *Murabahah*, *Musharakah*, *Ijarah*, *Istisna'* and *Tawarruq* to replace income from interest as in conventional practices. Similar to their counter party, these Islamic banks offer a comprehensive and broad range of Islamic financial products and services ranging from deposit products (savings, current and investment) to financing products (home financing, personal financing, vehicle financing, trade financing).

Islamic Financial Services Board (IFSB) (2010) highlighted that Malaysia has gone through 4 successful important phases in the development of Islamic Banking and Finance. The first phase was started with the introduction to the basic contracts such as *Wadiah* and *Mudharabah* for deposit products and *Bai Bithaman Ajil* (BBA) for financing products. In 1993, second phase start to roll where corporate, Islamic money and capital market instruments begin to emerge in the industry such as *Murabahah* working capital. The third phase in 1999, many hybrids products start to surface such as *al-Ijarah Thumma al-Bai* (AITAB), *Ijarah* fixed financing and Islamic credit cards. Lastly, in the final phase the emergence of more complex and intense type of products start to capture the financial market such as *Musharakah Mutanaqisah* (MM) and *Mudharabah* financing as well as derivatives and hedging products (Bahari, 2009).

Home financing today has played a vital role in banking and contributing a great amount of percentage in the growth of the economy not only in Malaysia but also elsewhere across the international borders. Jalil et al. (2010) mentioned that in the initial stage, Malaysia home financing was monopolized by the conventional banks which started in year 1830. An economic report published by Ministry of Finance (MOF) for year 2007/2008 showed that home financing is the largest financing type in Malaysia at that time delivering many projects namely *MyBeautiful New Home* (MyBNHome), *Program Perumahan Rakyat* (PPR), *Rumah Mesra Rakyat* (RMR) and *Perumahan Rakyat 1Malaysia* (PR1MA) (Laporan Ekonomi Malaysia, 2017/2018). Jalil et al. (2010) opined that home financing is the type of financing that received the biggest selection by customers due to the economic demand and needs in Malaysia. The evidenced of growth in Islamic banking and finance in Malaysia give no exception to Islamic home financing. According to Jalil and Naharu (2020), the increase of 8.3%, in Islamic banking assets from RM771.8 billion in year 2018 to RM835.2 billion in 2019, was mainly contributed by home financing estimated around RM184.4 billion.

In Malaysia, Islamic banks offer home financing products ranging from *Bay' Bithaman Ajil* (BBA), *Musharakah Mutanaqisah*, *Tawarruq*, *Ijarah* and *Istisna'*. Figure 1 shows the timeline and evolution of Islamic Home Financing in Malay

Bay' Bithaman Ajil (BBA) is the first Islamic home financing products, introduced by Bank Islam Malaysia Berhad (BIMB) in late 1984. BBA is defined as deferred payment, through instalments, on the sale of an asset with a pre-agreed price, payment method and profit. The product become quite popular amongst Islamic banks in Malaysia (BIMB, 2012). Many argued that BBA is presenting a mode of payment rather than contract where the payment is deferred in the future through installment or full payment (Engku Rabiah Adawiah, 2012; INCEIF, 2007; Zaharuddin, 2010). Besides being widely used in Malaysian Islamic banks, BBA also received many critiques from the scholars highlighting on its Shariah and operational issues.

Rosly (2001, 2005); Meera & Larbani (2009) agreed that BBA has some operational and Shariah non-compliant issues which leading to the opening of the back door for *riba*. Undertaking trading as the alternative to *riba* transaction, requires the seller i.e. the bank to hold ownership of the goods and all liabilities comes from it. However, BBA has not evidenced any ownership being held and absence in risk taking thus it violates the very essence of Shariah principles of *al-ghorm bil ghonm* (no reward without risk) and *al-kharaj bil daman* (profits comes with liability). The absence of risk taking in BBA

does not reflect the requirement of *al-bay* (trading) as what has been dictated by Allah S.W.T in the Quran. Accordingly, Rosly (2005) mentioned that Ibn al-‘Arabi (d.543H/1148), opined the element of *‘iwad* (counter value), namely effort, liability and risk must be incorporated for lawful sale. Any additional amount without *‘iwad* is tantamount to *riba*.

Resulting to numerous criticisms, several alternatives of home financing are being introduced in the market as a replacement to BBA. One of them is *Musharakah Mutanaqisah* (MM). MM is technically very different from BBA where it is based on diminishing partnership concept. *Musharakah Mutanaqisah* (MM), also known as *Diminishing Musharakah/Partnership* is a partnership contract between two parties where one party’s installments will gradually increase his share in the property till the whole ownership (Subky, 2017; Bank Negara, 2010).

As an alternative to BBA contract, Kuwait Finance House Malaysia Berhad (KFHMB) launched Malaysia’s first equity-based house financing facility under the *Musharakah Mutanaqisah* concept in 2006. The Shariah Advisory Council (SAC) of Bank Negara Malaysia, resolved that the product of MM is permissible in its 56th meeting held on 5th February 2006 (Bank Negara Malaysia, 2010).

KFHMB were commended for offering equity-based financing, rather than relying too much on debt-based financing. Many postulated that a country’s finance that is built on debt-based financing, will not be able to maintain efficiency, stability and growth in the long run (Siddiqi, 1983, 2001; Ahmad, 1984, Smolo and Hassan, 2011; Rosly and Bakar, 2003). Many Islamic banks followed KFHMB switched to *Musharakah Mutanaqisah*, but then many of them discontinued or froze the product and replaced it with more convenient products in terms of maintenance and legal support such as *Tawarruq*, *Ijarah Muntahiyah bit Tamlik* (IMBT) and *Istisna*’. According to Subky (2017) the related banks are Ambank Islamic, Asian Finance Bank, Bank Muamalat, KFHMB, Maybank Islamic and OCBC Al Amin.

Even though it looks promising theoretically but in practice, there are many implementation hurdles, associated with MM. The issues of MM could be classified under 2 major categories; operating and legal. Under operating, the documentations are lengthy, MM have long list of documentation as compared with other products, thus make it more costly (Subky, 2017). The complication of MM contracts accounted to shortage of legal advisors and lawyer who could prepare the MM documents (Shahwan et al., 2013). Even though some argue on the main advantage of MM is the flexibility and revisable of the rental rates but the rates are largely influenced by location, tax regulations, as well as wear and tear (Meera and Abdul Razak, 2005). Additionally, there are also issues such as defaults, termination of contracts and even redemption (Meera and Abdul Razak, 2009).

As a result of the complication in MM, another players in town such as *Tawarruq*, *Ijarah Muntahia Bil Tamlik* (AIMAT) and *Istisna*’ starts gaining its popularity around 2013. However, in the case of *Tawarruq*, also known as *Commodity Murabahah* (CM), the permissibility of this product is being questioned. It has recently become popular in the local Islamic banking industry for liquidity management instruments, or cash liquidity purposes. It can be considered as an alternative instrument to BBA (which has element of *bay‘al-‘inah*), which was adopted in Malaysia a few years back. The arrangement of getting liquidity is more or less has similar style as *bay‘ inah*, missing the elements of genuine transactions. Some said the overconcentration of these attention that most of the products offered by Islamic banks are in *Tawarruq* (Ali, 2017). According to him, the popularity of *Tawarruq* started when BNM issued the circular⁶ on *bay‘ inah* in 2012 to exclude “mandatory buy back” provision in the contract. With the less popularity of MM and BBA, many banks turn to *Tawarruq* in their financing portfolio (Ali, 2017). Basically, many banks prefer *Tawarruq* based on their less risky nature towards the bank’s position in the transaction.

The AAOIFI, FAS 30, *Tawarruq* should only be employed as a last resort when an institution faces a liquidity shortage that could harm its sustainability. It should not be used as a mode of investment or financing for the purpose of profit making. Secondly, the overwhelming use of *Tawarruq* does not

⁶ <https://islamicbankers.files.wordpress.com/2013/12/20121219-implementation-of-shariah-advisory-council-of-bank-negara-malaysia-resolution-on-bai-inah.pdf>

substantially add to the IFI value proposition and economic growth due to debt nature inherent in the concept.

However, the widespread usage of this product has raised uneasiness by Muslim economists and Shariah scholars. This strengthens the view of proponents that many of Islamic banks products are just a mere substitute rather than alternative. Some said that the contract has controversial nature for being non-compliant to the Shariah as the study done by Ahmed et al. (2012), found that *Tawarruq* and *Bai al-Inah* at some point have the element of *shubahah* in them.

Whilst others choose *Tawarruq*, others opt for *AIMAT* and *Istisna'*. However, these 2 products are not short of flaws and shortcomings. With all the criticism, it would be interesting to investigate the current issues surrounding Islamic home financing in Malaysia. These lead to these research questions:

- to investigate the home financing products offered by Islamic Banks in 2020.
- to examine the composition the home financing products for each bank from 2015 to 2019.

This study claims two major contributions out of its investigation. Firstly, exploring the issues and any possible risk exposure of home financing will give a general overview of the recent development in Islamic home financing and its surrounding issues, which is expected to indirectly help policymakers and bankers to design a better policy in dealing with Islamic home financing's issues and risks.

Secondly, the review of literature suggests the common norm of research studies to mainly focus on the survey and interviews but rarely look into the composition of these home financing in details from annual report. It is hoped that the analysis on home financing figure in the study able to shape a better Islamic home financing framework and system in Malaysia.

The structural remainder of this paper is organised as follows: Section 2 and 3 provide details discussion on the structure and process of all Islamic Home Financing offered by the banks alongside with the literature review on Islamic home financing. Section 4 elaborates on the study's research methodology and the data collection method. Section 5 depicts the analytical part of the study, and Section 6, which is also the last, provides the study's concluding remarks.

2. Islamic Home Financing

There are wide ranges of Islamic home financing offered by the Islamic banks in Malaysia, namely, *BBA*, *Musharakah*, *Tawarruq*, *Ijarah* and *Istisna'*. These products could be categorised into 3 main categorizations, namely debt-based financing, equity based financing and leasing.

2.1 Bay` Bithaman Ajil (BBA)

BBA fall under debt-based financing, and often being accused mimicking the conventional products. In Malaysian Islamic bank's practice, BBA apply *Murabahah*.

2.2 Musharakah Mutanaqisah (MM)

Musharakah Mutanaqisah (MM) is a diminishing partnership concept that comprises contracts which are *Musharakah* (partnership) and *Ijarah* (renting). MM which are often been categorized equity based financing.

Meera and Razak (2005) has done quite a comprehensive review on how the MM works principally and technically. In summary, customer and bank will enter into a partnership contract under joint ownership agreement where both customer and bank will co-own the property. This co-ownership agreement entitled the customer 10% ownership of the property which is presented in terms of the down payment made by the customer for the property while the bank has the remaining 90% of the

property ownership. The portion of co-ownership will gradually be increased for the customer and decreased for the bank until the property is fully owned by the customer. At the same time, the rental contract in the forms of *Ijarah* contract will take effect on the 90% ownership by the bank i.e. rental will be charged to the customer through out the financing period. And this rental amount and tenor is representing the share ratio of the property ownership until the ownership is fully transferred to the customer.

2.3 *Tawarruq*

According to Shariah Standard on Mudarabah issued by Bank Negara Malaysia (Refer Section 9.1).

“A tawarruq consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis”.

In essence, *tawarruq* is a hybrid concept that consists of a credit and cash sale, which is similar to the concept of *‘inah*. The credit sale normally contains a profit margin, which is commonly executed under the basis of the *murabahah* concept. *Murabahah* is a cost plus sale, which refers to the sale and purchase of goods at a price with the profit margin agreed by both the seller and the buyer. The common term used in the market today to denote *tawarruq* is commodity *murabahah* transaction. In Malaysia, the common commodity used is Crude Palm Oil (CPO) made available by Bursa Suq al-Sila’, whereas metals are normally used in the London Metal Exchange.

2.4 *Ijarah*

Ijarah Mausufah Fi Zimmah means an *ijarah* contract which is executed for an asset undertaken by the lessor (Bank) to be delivered to the lessee according to accurate specifications, even if the asset is not owned by the lessor. During the period that the leased asset/property is under construction, the lessor may ask the lessee (Customer) to pay a certain portion of pre agreed lease rental as a forward lease. The forward lease rental payment will be considered as a debt to the lessor until the delivery of the leased asset to the lessee. The Customer undertakes to purchase the asset/property upon the end of the lease period or full payment the asset/property price or in the event of default, subject to agreed terms and conditions. Ownership will be transferred to customer at the end of leasing period (or upon full settlement) by way of ‘sale’.

3. Literature Review

Studies on Islamic home financing usually looking at the perception of the customers in adopting Islamic home financing products. In Malaysia context, being a multi-racial country, several studies such as Shah (2012) and Amin et al. (2014) agreed that the choice of selecting Islamic home financing among Malaysian depends on several important factors such as marital status, ethnic, occupation, religion, attitude and perceived behavior are among the highest influential factors as to compare to gender, academic qualification and monthly income. Thus, it is crucial that Islamic banks in Malaysia to have various types of Islamic home financing products that are competitive enough to be offered to the customers in order to compete and received equal share together with their conventional counterpart. Others look at a specific review on certain product of home financing to discuss its advantages and drawbacks.

Aris et al. (2013), in their study disclosed the home financing products by 6 Islamic banks but only confined to BBA and MM only. They argued that even a single contract could have several variant, in term of rate, tenure and coverage, consequently creating a complex and complicated

environment for the customer and greater monitoring tasks for regulators. Nonetheless, they admitted that varieties implied more options for the customers to choose from.

All 16 Islamic banks in Malaysia are equally offering similar types of home financing products. Various types of Islamic home financing products have been extended to the customers such as BBA financing, MM, *Istisna'*, *Murabahah*, *Ijarah Mausufah Fi Zimmah*, *Ijarah Muntahiyah*, *Al-Ijarah Muntahiyah Bi Tamlik* and *Tawarruq*. Studies done by Shahwan et.al (2013) shows that out of 23 home financing products offered by the Malaysian Islamic banks, 65.23% using BBA concept, 21.75% using MM and 4.34% using *Tawarruq*, *Istisna'* and *Murabahah*. From the statistic, obviously BBA received the highest usage in Malaysian Islamic banks as reported by Bank Negara Malaysia where BBA is the main type of contract endorsed amounting to 67,672.9 million Ringgit Malaysia followed by *Al-Ijarah Thumma Al-Bai'* (AITAB) (BNM, 2011). Even though, BBA received critiques from many scholars on its operational and Shariah issues, its technical simplicity has made it the main choice by the Islamic banks in fulfilling the needs for Malaysian home-owner despite its rejection in most of Arab countries (Shahwan et.al, 2013).

MM partnership is another famous type of contract for Islamic home financing in Malaysia. According to Haneef et.al (2011), the introduction of MM into the market was first approved in 1991 during a workshop that was co-organized by Islamic Research and Training Institute (IRTI) and the Sudanese Estates Bank held in Khartoum. Whereas in Malaysia BNM and Shariah Advisory Council (SAC) conquered MM on 5th February 2006 (BNM, 2010). On the overall studies done in Islamic Home Financing, less studies look at the composition of the Home Financing in details.

4. Methodology

As to answer the research questions, the study adopts several steps. Firstly, as to gather information on the current home financing products, content analysis is applied. The data of are gathered through banks' websites and brochures from the bank. In some instances, the Product Disclosure Sheet (PDS) and annual report to clarify any unclear information from the banks' websites.

Table 1: Data collection and methodology

Research Questions	Data Collection	Method
to explore the current home financing products offered by Islamic Banks in 2020	Website, PDS, annual report	Content analysis
to examine the composition of the home financing products for each bank from 2015 to 2019	Annual report	Descriptive analysis and graphical

The second step is to collect the data of the products offered by all Islamic Banks in Malaysia. As of January 2020 there are 16 Islamic Banks in Malaysia, under BNM⁷ purview comprises of 11 local and 5 foreign banks (Refer to Table 2).

5. Analysis and Findings

Based on Table 1, many of the banks offer Tawarruq product as compared with other products.

⁷ Accessed <http://www.bnm.gov.my/index.php?ch=li&cat=islamic&type=IB&fund=0&cu=0> on 4th Mac 2020.

Table 2: Home Financing products offered by Islamic banks in Malaysia in 2020

No	Islamic Banks	Ownership	Home Financing				
			BBA	Tawarruq	MM	Ijarah	Istisna'
1	Affin Islamic Bank Bhd	Local		x	x	(s)	
2	Al Rajhi Banking & Investment Corporation (Malaysia) Bhd	Foreign		x			
3	Alliance Islamic Bank Bhd	Local	x				
4	AmBank Islamic Berhad	Local		x			
5	Bank Islam Malaysia Bhd	Local		x			
6	Bank Muamalat Malaysia Bhd	Local		x			
7	CIMB Islamic Bank Bhd	Local		x			
8	HSBC Amanah Malaysia Bhd	Foreign			x	(s)	
9	Hong Leong Islamic Bank Bhd	Local		x			
10	Kuwait Finance House (Malaysia) Bhd	Foreign				x	
11	MBSB Bank Bhd	Local		x			
12	Maybank Islamic Bhd	Local		x			
13	OCBC Al-Amin Bank Bhd	Foreign				x	
14	Public Islamic Bank Bhd	Local			x	(s)	
15	RHB Islamic Bank Bhd	Local		x	x	(s)	
16	Standard Chartered Saadiq Bhd	Foreign			x	(s)	
	Percentage		6.25%	62.5%	31.25%	12.5%	-

Note: BBA is Bai Bithaman Ajil, MM is Musharakah Mutanaqisah/Diminishing Partnership, Tawarruq (Commodity Murabahah), Ijarah (AIMAT or Ijarah Mausufah fi Zimmah)

S denotes the supporting contracts, appear in the PDS

It seems that most of the banks are offering *Tawarruq* for Home financing in 2020. Based on their websites, out of 16 banks 10 offers *Tawarruq*. There are few banks for example disclose in their website as *Murabahah*, however after close examination on their PDS, the product is actually Commodity *Murabahah* or *Tawarruq*.

Clearly from Table 1, a total of 10 out of 16 banks or 62.5% choose *Tawarruq*, followed by MM (31.2%), *Ijarah* (12.5%) and BBA by 6.25%. Based on the findings, in 2020 none of the banks offer *Istisna'* home financing.

It seems that more banks are adopting *Tawarruq* because based on Hanuddin Amin (2018), as of January 2018, only 6 out of 16 Islamic banks are offering their mortgages on the basis of *Tawarruq* home financing.

However, it would be interesting to know the amount of this *Tawarruq* home Financing in value to see the impact. Further findings are revealed from the annual report from 2015 to 2019 of these banks.

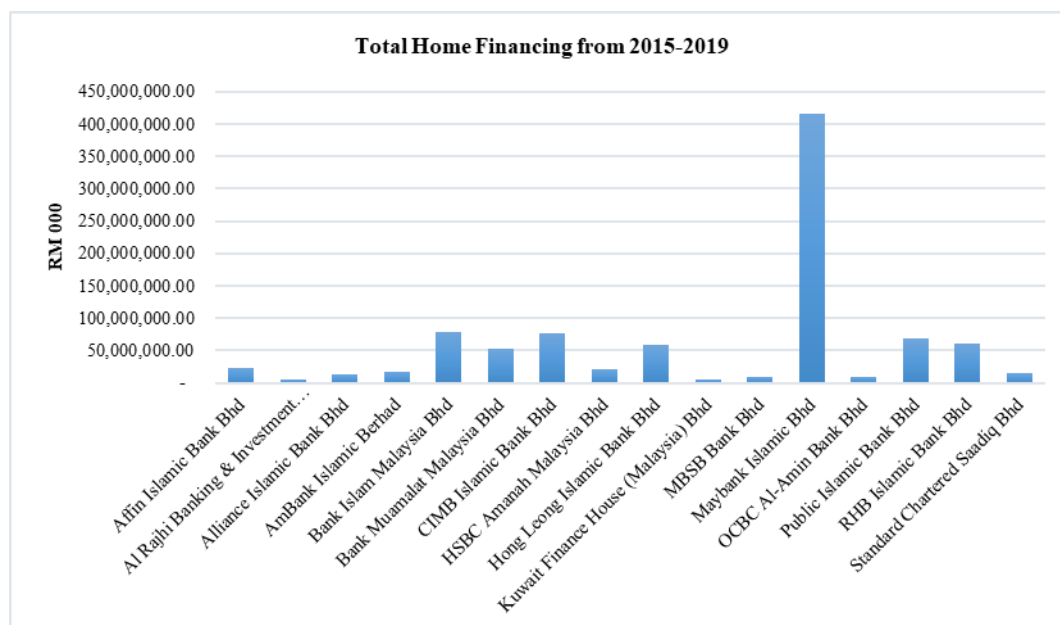


Fig. 2: Total Home Financing

From the data, Maybank Islamic lead the pack by quite extensively more than 400 billion (45%), 5 times more than Bank Islam around 79 billion, which come second providing home financing.

Table 3: Total financing for each bank

Banks	Financing (RM 000)	Percentage
Affin Islamic Bank Bhd	23,138,717.00	2%
Al Rajhi Banking & Investment Corporation (Malaysia) Bhd	5,315,263.00	1%
Alliance Islamic Bank Bhd	12,956,100.00	1%
AmBank Islamic Berhad	18,072,167.00	2%
Bank Islam Malaysia Bhd	79,519,802.00	9%
Bank Muamalat Malaysia Bhd	51,932,846.00	6%
CIMB Islamic Bank Bhd	77,497,623.00	8%
HSBC Amanah Malaysia Bhd	21,500,709.00	2%
Hong Leong Islamic Bank Bhd	57,987,782.00	6%
Kuwait Finance House (Malaysia) Bhd	4,538,312.00	0%
MBSB Bank Bhd	9,338,160.00	1%
Maybank Islamic Bhd	415,489,406.00	45%

OCBC Al-Amin Bank Bhd	9,804,503.00	1%
Public Islamic Bank Bhd	69,501,311.00	7%
RHB Islamic Bank Bhd	61,516,722.00	7%
Standard Chartered Saadiq Bhd	14,173,281.00	2%
TOTAL	932,282,704.00	100%

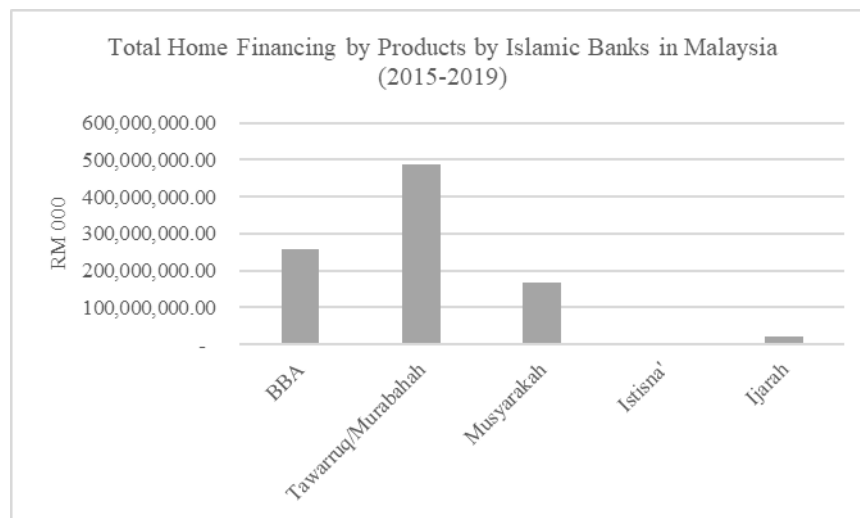


Fig. 3: Total Home Financing by products

Table 4: Total financing by products

Product	Financing (RM 000)	Percentage
BBA	256,684,858.00	28%
Tawarruq/Murabahah	488,035,057.00	52%
Musyarakah	166,530,357.00	18%
Istisna'	371,764.00	0%
Ijarah	20,660,668.00	2%
Total	932,282,704.00	100%

It could be noted in the annual report Maybank for example classify the Commodity *Murabahah* as *Murabahah* categorization. Is the amount of *Murabahah* home financing is mainly coming from Maybank Islamic. However, if we look at the PDS of Maybank Islamic, the term *Murabahah* is referring to *Commodity Murabahah* which is *Tawarruq*.

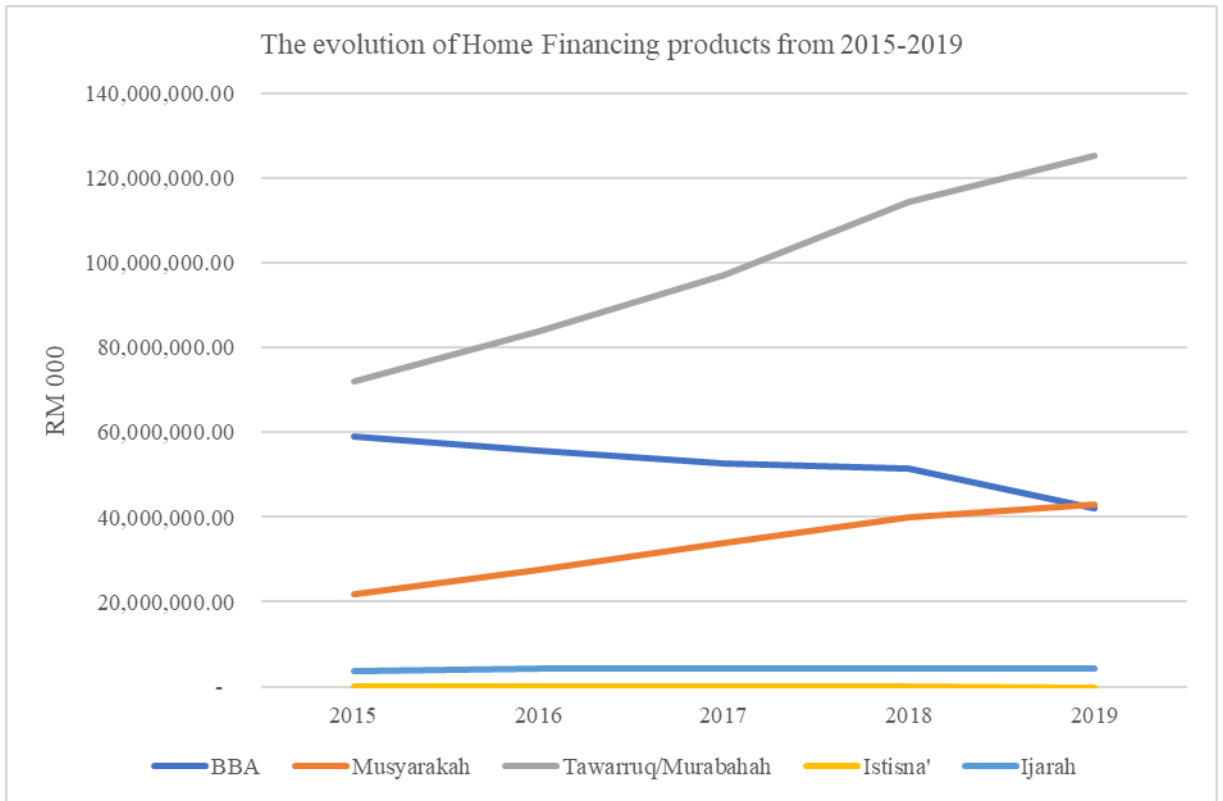
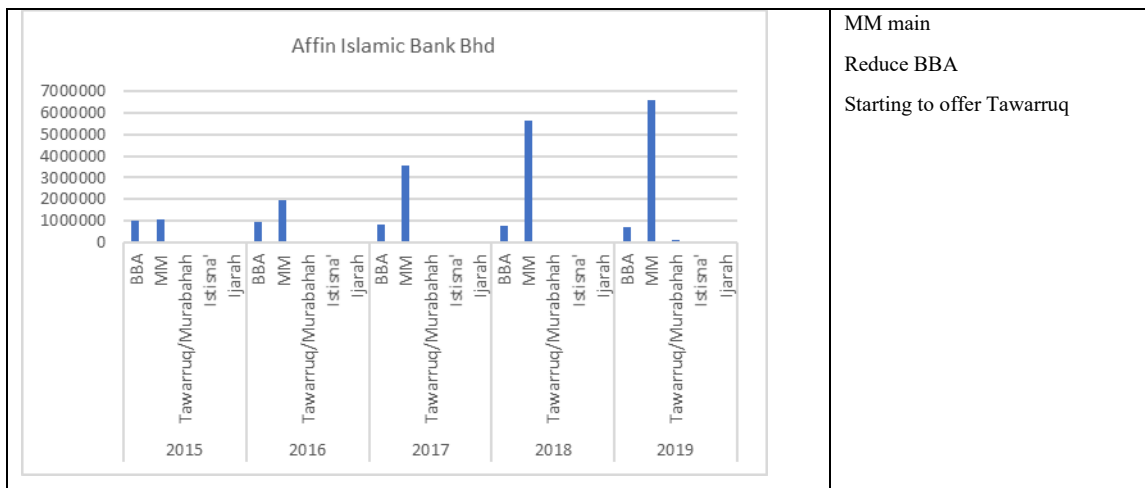


Fig. 4: The evolution of Home Financing from 2015-2019

It is quite interesting to explore the evolution of the Home Financing for each bank. Figure 5 revealed that for the banks that started using Tawarruq will then continue and the usage are increasing over the past 5 years. This trend can be clearly seen in several banks for example AmBank Islamic, Maybank Islamic, Bank Muamalat, Hong Leong Islamic, CIMB Islamic, RHB Islamic and MBSB.



<p style="text-align: center;">Al Rajhi Banking & Investment Corporation (Malaysia) Bhd</p> <table border="1"> <thead> <tr> <th>Year</th> <th>BBA</th> <th>MIM</th> <th>Tawarruq/Murabahah</th> </tr> </thead> <tbody> <tr> <td>2015</td> <td>~1,100,000.00</td> <td>~100,000.00</td> <td>~100,000.00</td> </tr> <tr> <td>2016</td> <td>~1,100,000.00</td> <td>~100,000.00</td> <td>~100,000.00</td> </tr> <tr> <td>2017</td> <td>~1,000,000.00</td> <td>~100,000.00</td> <td>~100,000.00</td> </tr> <tr> <td>2018</td> <td>~900,000.00</td> <td>~100,000.00</td> <td>~100,000.00</td> </tr> <tr> <td>2019</td> <td>~800,000.00</td> <td>~100,000.00</td> <td>~100,000.00</td> </tr> </tbody> </table>	Year	BBA	MIM	Tawarruq/Murabahah	2015	~1,100,000.00	~100,000.00	~100,000.00	2016	~1,100,000.00	~100,000.00	~100,000.00	2017	~1,000,000.00	~100,000.00	~100,000.00	2018	~900,000.00	~100,000.00	~100,000.00	2019	~800,000.00	~100,000.00	~100,000.00	<p>BBA main, but at the declining rate</p>
Year	BBA	MIM	Tawarruq/Murabahah																						
2015	~1,100,000.00	~100,000.00	~100,000.00																						
2016	~1,100,000.00	~100,000.00	~100,000.00																						
2017	~1,000,000.00	~100,000.00	~100,000.00																						
2018	~900,000.00	~100,000.00	~100,000.00																						
2019	~800,000.00	~100,000.00	~100,000.00																						
<p style="text-align: center;">Alliance Islamic Bank Bhd</p> <table border="1"> <thead> <tr> <th>Year</th> <th>BBA</th> <th>MIM</th> <th>Tawarruq/Murabahah</th> </tr> </thead> <tbody> <tr> <td>2015</td> <td>~2,500,000.00</td> <td>~1,000,000.00</td> <td>~2,800,000.00</td> </tr> <tr> <td>2016</td> <td>~2,500,000.00</td> <td>~1,000,000.00</td> <td>~2,800,000.00</td> </tr> <tr> <td>2017</td> <td>~2,400,000.00</td> <td>~1,000,000.00</td> <td>~2,800,000.00</td> </tr> <tr> <td>2018</td> <td>~2,400,000.00</td> <td>~1,000,000.00</td> <td>~2,800,000.00</td> </tr> <tr> <td>2019</td> <td>~2,800,000.00</td> <td>~1,000,000.00</td> <td>~2,800,000.00</td> </tr> </tbody> </table>	Year	BBA	MIM	Tawarruq/Murabahah	2015	~2,500,000.00	~1,000,000.00	~2,800,000.00	2016	~2,500,000.00	~1,000,000.00	~2,800,000.00	2017	~2,400,000.00	~1,000,000.00	~2,800,000.00	2018	~2,400,000.00	~1,000,000.00	~2,800,000.00	2019	~2,800,000.00	~1,000,000.00	~2,800,000.00	<p>BBA incline to 2017 but then increase</p>
Year	BBA	MIM	Tawarruq/Murabahah																						
2015	~2,500,000.00	~1,000,000.00	~2,800,000.00																						
2016	~2,500,000.00	~1,000,000.00	~2,800,000.00																						
2017	~2,400,000.00	~1,000,000.00	~2,800,000.00																						
2018	~2,400,000.00	~1,000,000.00	~2,800,000.00																						
2019	~2,800,000.00	~1,000,000.00	~2,800,000.00																						
<p style="text-align: center;">AmBank Islamic Berhad</p> <table border="1"> <thead> <tr> <th>Year</th> <th>BBA</th> <th>MIM</th> <th>Tawarruq/Murabahah</th> </tr> </thead> <tbody> <tr> <td>2015</td> <td>~1,400,000.00</td> <td>~1,000,000.00</td> <td>~2,000,000.00</td> </tr> <tr> <td>2016</td> <td>~2,000,000.00</td> <td>~1,000,000.00</td> <td>~2,000,000.00</td> </tr> <tr> <td>2017</td> <td>~2,800,000.00</td> <td>~1,000,000.00</td> <td>~2,000,000.00</td> </tr> <tr> <td>2018</td> <td>~3,000,000.00</td> <td>~1,000,000.00</td> <td>~2,000,000.00</td> </tr> <tr> <td>2019</td> <td>~2,800,000.00</td> <td>~1,000,000.00</td> <td>~3,000,000.00</td> </tr> </tbody> </table>	Year	BBA	MIM	Tawarruq/Murabahah	2015	~1,400,000.00	~1,000,000.00	~2,000,000.00	2016	~2,000,000.00	~1,000,000.00	~2,000,000.00	2017	~2,800,000.00	~1,000,000.00	~2,000,000.00	2018	~3,000,000.00	~1,000,000.00	~2,000,000.00	2019	~2,800,000.00	~1,000,000.00	~3,000,000.00	<p>BBA increasing, but after 2019, declining Tawarruq increasing</p>
Year	BBA	MIM	Tawarruq/Murabahah																						
2015	~1,400,000.00	~1,000,000.00	~2,000,000.00																						
2016	~2,000,000.00	~1,000,000.00	~2,000,000.00																						
2017	~2,800,000.00	~1,000,000.00	~2,000,000.00																						
2018	~3,000,000.00	~1,000,000.00	~2,000,000.00																						
2019	~2,800,000.00	~1,000,000.00	~3,000,000.00																						

<p style="text-align: center;">Bank Islam Malaysia Bhd</p>	<p>Tawarruq increasing BBA declining Istisna' only small portion</p>
<p style="text-align: center;">Bank Muamalat Malaysia Bhd</p>	<p>Tawarruq increasing BBA declining However sudden drop in 2019</p>
<p style="text-align: center;">CIMB Islamic Bank Bhd</p>	<p>Tawarruq increasing BBA declining Ijarah declining</p>
<p style="text-align: center;">HSBC Amanah Malaysia Bhd</p>	<p>MM with no trend</p>

<p style="text-align: center;">Hong Leong Islamic Bank Bhd</p> <p>The chart displays financial data for Hong Leong Islamic Bank Bhd from 2015 to 2019. The y-axis represents values from 0 to 12,000,000.00. For each year, there are six bars representing different financial instruments: BBA, MM, Tawarruq/Murabahah, Istisna', Ijarah, and a combination of BBA and MM. Tawarruq/Murabahah shows a general upward trend, while BBA shows a downward trend.</p>	<p>Tawarruq increasing BBA declining</p>
<p style="text-align: center;">Kuwait Finance House (Malaysia) Bhd</p> <p>The chart displays financial data for Kuwait Finance House (Malaysia) Bhd from 2015 to 2019. The y-axis represents values from 0 to 1,200,000.00. For each year, there are six bars representing different financial instruments: BBA, MM, Tawarruq/Murabahah, Istisna', Ijarah, and a combination of BBA and MM. Ijarah shows a significant and steady increase over the period, while MM is shown as zero from 2016 onwards.</p>	<p>Ijarah increasing MM stopped/discontinued</p>
<p style="text-align: center;">MBSB Bank Bhd</p> <p>The chart displays financial data for MBSB Bank Bhd from 2015 to 2019. The y-axis represents values from 0 to 3,500,000. For each year, there are six bars representing different financial instruments: BBA, MM, Tawarruq/Murabahah, Istisna', Ijarah, and a combination of BBA and MM. Tawarruq/Murabahah shows an overall increasing trend, while BBA shows a declining trend.</p>	<p>Tawarruq increasing BBA declining</p>
<p style="text-align: center;">Maybank Islamic Bhd</p> <p>The chart displays financial data for Maybank Islamic Bhd from 2015 to 2019. The y-axis represents values from 0 to 80,000,000.00. For each year, there are six bars representing different financial instruments: BBA, MM, Tawarruq/Murabahah, Istisna', Ijarah, and a combination of BBA and MM. Tawarruq/Murabahah shows a strong upward trend, while BBA and MM show a downward trend.</p>	<p>Tawarruq increasing BBA declining MM declining</p>

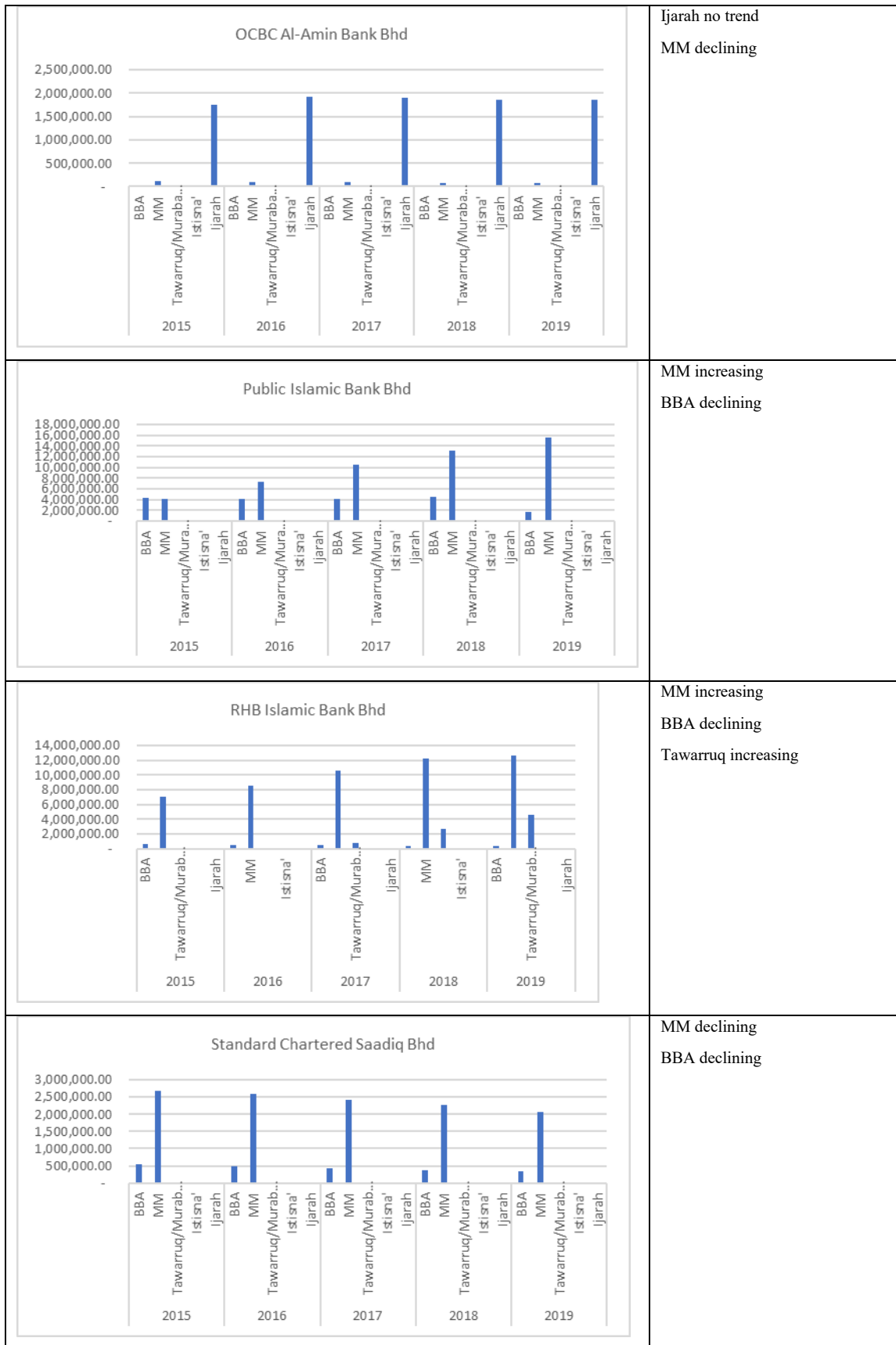


Fig. 5: The Home Financing for each bank from 2015-2019

5.1 Why *tawarruq* becomes popular?

Bank Negara Malaysia (2016) reported that *Tawarruq* financing grew over 34 percent that has been largely spurred by the commodity trading operation of Bursa Suq Al-Sila, which has reduced costs and risks associated with *Tawarruq*-based transactions including Islamic home financing.

Bank Islam Malaysia Berhad (BIMB) indicates that its *tawarruq* home financing is well-performed. Evidently, on 31st December 2014, the bank managed to reap a financing value of RM3.9 billion and increased to RM9.5 billion on 31st December 2016 (Bank Islam, 2014; 2016).

Nonetheless, the development of banking *Tawarruq* shows the concerns and recognition by some of the jurists globally of the need to find alternatives for solving the problem of liquidity shortage faced by Muslims around the world (Dusuki, 2007). While some scholars (e.g. Mohamad and Rahman, 2014) commented that *tawarruq* could be the most suitable concept for banking products that require cash-based dealing.

In a study of why Islamic financial institutions (IFIs) are reluctant to adopt *Istisna* in Malaysia, Hasmawati and Mohamad (2019) concluded the following; first, a construction project has high levels of uncertainty and risk which may affect completion time and quality; second, other instruments such as BBA and MM are easier to implement than *Istisna*. In other words, Malaysian IFIs consider financing construction projects to be a risky investment. This suggests that an Islamic bank is more risk-averse than its conventional counterpart (Dieng, 2019).

5.2 Risk perspectives

It is often being misunderstood by many, that IFIs should not have many risks as all his operations are complied with the Shariah Principles. In reality is actually the opposite where due to many forms of Shariah contracts and the complexity of financing instruments, IFIs possessed unique types of risk compared to its conventional counterpart. In Islamic financing, other than financial risks, the exposure of risks can be seen from two perspectives: Operational and Shariah perspectives. The sources of operational risk are based on human errors, system or technology related and non-compliance to the governance and regulations (BCBS, 2003). And the latter is where most of the Shariah issues were rooted from. Indeed, the IFIs has different orientation towards risks which the risks are more based on the structure of Shariah contract used (Akkizidis & Khandelwal, 2008). Thus, IFIs are facing multiplicity of risks and strictly abided to its permissible and non-permissible attributes outlined by the Shariah is crucial. This including no forbidden element such as *Riba*, *Gharar*, *Maysir* and harmful subject matter that could violate the sanctity of Shariah are allowed.

As discussed earlier, to date *Tawarruq* has become the most common and well-known mode of financing arrangement which has been used for deposit, liquidity as well as personal financing in many Islamic banks in Malaysia. It was first endorsed by the SAC of BNM in July 2005 as a permissible instrument to be practised in financial market especially for personal financing (Dusuki, 2007) and the following years many Islamic banks has started to used *Murabahah* financing via *Tawarruq* arrangement or so called *Commodity Murabahah* (Zukri, 2009). Despite its element of *shubahah* that were argued by Ahmed et al. (2012), compared with other Shariah contracts, it is permissible by some scholars and agreed that from the practical aspect, *Tawarruq* is the safest types of arrangement that favours the IFIs in terms of minimal risk exposures (Ismon, 2012).

The increased in *Tawarruq* usage was triggered by the Shariah issues surfaced from BBA financing that consist *Inah* element. *Inah* was viewed as trick aimed at getting around the prohibition of *Riba* (Ismon, 2012). This issue of Shariah has gave birth to Shariah non-compliant risk. Rosly and Sanusi (2001) has clearly discussed the criticism and arguments on BBA with *Inah* content. *Inah* normally argued on the basis it resembles loan contract where both contracting parties ignore the real intent of purchasing the subject matter. For instance, the subject matter is purchased for the purpose of consumption and the party who purchased the subject matter will later sell it with the aim to receive profit. This obviously against the condition for valid sale as prescribed in the law of contract where the

subject matter must offer benefits (*manfaah*) to both contracting parties (Rayner, 1991). This has raised serious Shariah concern to many Islamic finance scholars since it will give harmful implication to the purchasing party where will be subjected to similar legal measures as a borrower who enter into interest-bearing loan contract. Eventhough *Inah* is valid by al-Shafi'i's school of thought, it however unanimously rejected by most Muslim jurist. Nevertheless, the differences in opinion is only methodological in nature (Rosly & Sanusi, 2001).

Therefore, *Tawarruq* was brought to town to mellow down the fiasco of disagreement among the practitioners and scholars on BBA-*Inah* issues. Many proponents' review has been recorded for the past years on *Tawarruq*. The reviews come from both scholars and several authorities or organisations that are supporting the operations of Islamic finance globally. Some of the views are as follows (Ismon, 2012):

- *Tawarruq* is a type of sales where it involves purchasing of commodity with deferred payment and selling it to third party in order to obtain cash. This is acceptable by referring to Allah's words in the Quran ".....Trade is similar like *riba* and Allah has allowed trade but prohibits *riba*" (*Al-Baqarah* 2:275)
- *Tawarruq* has conformed to the conditions of Islamic law of contract where the actual possession of the commodity has taken place before the second sales.
- *Tawarruq* arrangement is based on mutual consent among the contracting parties conformed with the injunction in the Quran "O you who believe! Do not squander your wealth among yourselves in vanity, except it be a trade by mutual consent"(*An-Nisa*' 4:29).
- *Tawarruq* consist no harmful implication to the contracting parties as how it was narrated by Ibn Mas'ud ruled that no harm is inflicted in declared lump sum or percentage of the profit margin.
- *Tawarruq* is free from *Riba* where the arrangement is involving selling commodity to the buyer at a high price through debt and the buyer will sell the commodity at a lower price to the third party at the same price in order to earn profit.

Table 5: Summary of tawarruq reviews

No.	Organization	Ruling
1	Islamic Fiqh Academy	Supporting <i>Tawarruq</i> , on one condition, that the purchaser, or <i>Mutawarruq</i> , does not resell the item he has bought to the original seller at a lower price, either directly or indirectly. If or when this condition is not adhered to, the <i>Tawarruq</i> transaction is categorized as usurious, which is forbidden (Hosen and Narawi, 2012).
2	Islamic Judicial Assembly, a branch of the World Muslim League during its Conference of Rajab, 1419H	Decided the permissibility of <i>Tawarruq</i> .
3	Accounting and Auditing Organization for Islamic Finance (AAOIFI)	Issued Shariah standard on the application of <i>Tawarruq</i> on Standard No.3. The procedure will take place when two contracts will be executed. First contract involves the purchasing of commodity on deferred which call as <i>Murabahah</i> or <i>Musawamah</i> . Second contract involves the selling of the commodity to third party on cash basis which was stated in Standard No 30 (2).
4	Fatwas Permanent Committee for Scientific Research	The issue of <i>Tawarruq</i> is mentioned in it as, "When someone buys a commodity on credit, so that he can sell it in the market to the non-debtor, which he can benefit from its amount, if the debt becomes payable, it will be paid to its owner who bought it on credit". The sale by installment is allowed, the saying that it is disallowed should not be considered.

5	Shariah Advisory Council of Bank Negara Malaysia (SAC) in its 51st meeting held on 28th July 2005	Resolved that deposit product and financing based on the concept of <i>Tawarruq</i> is known as <i>Commodity Murabahah</i> is permissible. The standard agreement for <i>Tawarruq</i> deposit accounts also was launched between banks and corporate which aim to remove the barrier to the sector's growth.
---	---	--

Source: (Ismon, 2012) with some modifications

Based on the above, the permissibility of *Tawarruq* has been well recognized by both scholars and highest authorities in Islamic finance however it is still subject to specific condition to ensure its validity according to the Shariah.

6. Conclusion

Based on the study done, it is clearly that the *Tawarruq* is the most popular product in Islamic Home Financing, since more than 60% of the banks use them. The trends also showed that those banks that use *Tawarruq*, the proportion are keep on increasing. Thus, the question whether the Islamic financial products are actually an alternative to the industry are also deemed futile as they are similar to the conventional, debt-based financing.

Nonetheless, the issues arise as to no better alternative products that could replace *Tawarruq*. What the industry really need is the constructive criticism as to be able to give a proactive solution to the current problem in the industry. Even though *Tawarruq* are not really well accepted by some, but at this point there are no better alternative product better than can replace *Tawarruq*. Thus, its features that supposedly guarded the IFIs towards financial risk and treated as risk mitigation tool has resulted to an overwhelming level of usage that highlighted the issue of overconcentration. Will *Tawarruq* remain effective in the long run in protecting IFIs against financial risks? This question requires further analysis and exploration, and perhaps future research could be done to spark new ideas and innovation for new Islamic home financing products.

References

- Ahmed, E. R, Yahaya, S & Harashid, M. (2012). Shubuhah on Matter of Bai' alinah and Tawarruq. *International Journal of Business and Technopreneurship*. 2(1), 85-101.
- Ahmad, E. F.; Shihama, M.; Mohamad Tarmizi, N. A.; Jibril, S. M.; Djama, S. I. and Muneza, A. (2017), "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*, Vol. 4, No. 1, pp. 31-43. <https://doi.org/10.18646/2056.41.17-004>
- Akkizidis, I. & Khandelwal, S.K. (2008). *Financial Risk Management for Islamic Banking and Finance*. Palgrave Macmillan, UK.
- Ali, M. (2017). Retrieved from <https://www.nst.com.my/news/2017/03/225846/tawarruq-new-kid-islamic-banking>
- Amin, H., Rahim Abdul Rahman, A. & Abdul Razak, D. (2014). Consumer Acceptance of Islamic Home Financing. *International Journal of Housing Markets and Analysis*, 7(3), 307-332. <http://doi.org/10.1108/IJHMA-12-2012-0063>
- Aris, N. A., Othman, R., Azli, R. M., Sahri, M., Razak, D. A., & Rahman, Z. A. (2013). Islamic banking products: Regulations, issues and challenges. *Journal of Applied Business Research*, 29(4), 1145-1156.
- Bank Negara Malaysia (2010). Shariah Resolutions in Islamic Finance. Malaysia Deposit Insurance Corporation, [Online] available from: http://www.bnm.gov.my/microsite/fs/sac/shariah_resolutions_2nd_edition (accessed on 20 July 2016).
- Bahari, Z. B. (2009). The Changes of Product Structure in Islamic Banking: Case Study of Malaysia. Paper presented at the Two-Day Conference on Islamic Perspectives on Management and Finance, United Kingdom organized by School of Management, Leicester University, 2-3 July 2009. <https://core.ac.uk/download/pdf/11940593.pdf>
- Bank Negara Malaysia (BNM). (2011). Buletin Perangkaan Bulanan (Monthly Statistical Bulletin). Bank Negara Malaysia (BNM). Kuala Lumpur.
- Bank Negara Malaysia (BNM). (2010). Shariah Resolutions in Islamic Finance. Bank Negara Malaysia (BNM). Kuala Lumpur, Malaysia
- Basel Committee on Banking Supervision (BCBS). (2003). *Sound Practices for the Management and Supervision of Operational Risk*. Bank for International Settlements (BIS)
- Bouheraoua, S. I. (2013), "Tawarruq in the banking system: a critical analytical study of juristic views on the topic", presented in: 19th Session OIC Fiqh Academy, United Arab Emirates, [Online] available from: <http://www.iefpedia.com/english/wp-content/uploads/2009/10/Tawarruq-In-The-Banking-System-A-Critical-Analytical-Study-Of-Juristic-Views-On-The-Topic.pdf>

- BIMB. (2012). Application of Shariah Contracts In Islamic Banking Products And Services. In B. I. M. B. (BIMB) (Ed.). <http://www.bankislam.com.my/home/assets/uploads/BIMB-Shariah-Book-240613-FA.pdf>
- Devlin, J.F. (2002). An Analysis of Choice Criteria in the Home Loans Market. *International Journal of Bank Marketing*, 20(5), 212-226.
- Dusuki, A.W. (2007). - Commodity Murabahah programme (CMP): an innovative approach to liquidity management. *Journal of Islamic Economics, Banking and Finance*, 1-22
- Engku Rabbiah Adawiah, E. A. (2012). Structuring Sale Based Products in Islamic Banking and Finance. Paper presented at the Structuring Islamic Financial Products, Kuala Lumpur, Malaysia.
- Haneef, R., Kunhibava, S., & Smolo, E. (2011). Musharakah Mutanaqisah And Legal Issues: Case Study of Malaysia. *ISRA International Journal of Islamic Finance*, 3 (June): 93-122
- Hosen, M. N. and Narawi, A. (2012). Comparative Analysis of Islamic Banking Between Malaysia and Indonesia. (Journal). *International Journal of Academic Research in Economic and Management Sciences*. 1.
- INCEIF. (2007). The Application of Bay' Bithaman Ajil (BBA). INCEIF CIFP Module on Applied Shariah In Financial Transactions. INCEIF Kuala Lumpur, Malaysia
- Islamic Financial Services Board (IFSB). (2010). Islamic Finance and Global Financial Stability (pp. 27). IFSB, IRTI, IDB. Jeddah
- Ismo, N.Y (2012). Legality of Tawarruq in Islamic Finance. *Tazkia Islamic Finance and Business Review*, 7(1), 81-108.
- Jalil, M.I.A, Remali, Y. & Roslinah, M. (2010). Selection Factors of Customer towards Islamic and Conventional Home Financing: A Case Study in Johor, Malaysia. MPRA Paper. <https://mpra.ub.uni-muenchen.de/68433/>
- Jalil and Naharul (2020). Retrieved from <https://themalaysianreserve.com/2020/02/03/islamic-banking-continues-to-expand-in-2019/>
- Kementerian Kewangan Malaysia. (2017/2018). Laporan Ekonomi, ms 7. <https://www.parlimen.gov.my/ipms/eps/2017-10-27/CMD.26.2017%20-%20LAPORAN%20EKONOMI%202017%202018.pdf>
- Loke Ke Wei, K., & Mohd Thas Thaker, H. (2017). A qualitative inquiry into islamic home financing: Evidence from malaysia. *Qualitative Research in Financial Markets*, 9(2), 147-167.
- Meera, A.K.M & Larbani, M. (2009). Ownership effects of fractional reserve banking: an Islamic perspective. *Humanomics*, 25 (2), 101-116.
- Rayner, S.E. (1991). The Theory of Contracts in Islamic Law. Graham & Trotman, Limited pp. 131-132 and 154.
- Rosly, S.A. (2001). Iwad as a Requirement of Lawful Sale: A Critical Analysis. *IJUM Journal of Economics and Management*, Vol 9 (2), 187 – 201.
- Rosly, S.A. (2005). Critical Issues on Islamic Banking and Financial Markets. Author House.
- Rosly, S., & Sanusi, M. (2001). Some issues of bay' al-'inah in malaysian islamic financial markets. *Arab Law Quarterly*, 16(Part 3), 263-280.
- Shahwan, S., Mohammad, M. O. & Rahman, Z. A. (2013). Home Financing Pricing Issues in the Bay' Bithaman Ajil (BBA) and Musharakah Mutanaqisah (MMP). *Global Journal Al-Thaqafah*, Vol 3(2), 23-36
- Syed, S.A. (2012). Is Religiosity an Important Factor in Influencing the Intention to Undertake Islamic Home Financing in Klang Valley. <https://www.semanticscholar.org/paper/Is-Religiosity-an-Important-Factor-in-Influencing-Alam/b063f7885f2fb56cb7e2f4d3d3e427de2236fdf8> DOI:10.5829/idosi.wasj.2012.19.07.292. Corpus ID: 14594465
- Subky, K. H. Liu, J. Y., Abdullah, M. Farhan Mokhtar, Z. and Faizrahman, A. (2017). The Implication of Musharakah Mutanaqisah in Malaysian Islamic Banking Arena: A Perspective on Legal Documentation. *International Journal of Management and Applied Research*, Vol. 4, No. 1, pp. 17-30. <https://doi.org/10.18646/2056.41.17-003>
- Zaharuddin, A. R. (2010). Contracts and The Products of Islamic Banking. CERT. Kuala Lumpur, Malaysia.
- Zukri, S. (2009). Debate Over Commodity Murabahah. Malaysia:TheStar Retrieved from: <https://www.thestar.com.my/business/business-news/2009/01/21/debate-over-commodity-murabahah>