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Risk Management in Musyarakaṯ Mutanaqisaṯ Home Financing Contract: Analysis in Rhb Islamic Bank Berhad and Affin Islamic Bank Berhad

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Abstract
The *Musyarakaṯ Mutanaqisaṯ* financing contract in Malaysia is still inadequate compared to other countries such as those in the Middle East. In Malaysia, there are 10 Islamic local banks comprise of Affin Islamic Bank Berhad, Maybank Islamic Berhad, CIMB Islamic Bank Berhad, Hong Leong Islamic Bank Berhad, RHB Islamic Bank Berhad and others. As for now, only two local banks in Malaysia offer the *Musyarakaṯ Mutanaqisat* home financing contract. The banks are Affin Islamic Bank Berhad & RHB Islamic Bank Berhad. *Musyarakaṯ Mutanaqisaṯ* home financing contract is less favoured by local banks in Malaysia because it brings higher risk compared to other home financing contracts (Muhammad, 2014). The high risk has to be borne by the banks especially due to the sharing element in *Musyarakaṯ Mutanaqisaṯ* home financing contract (Rulindo, 2009). Is this statement true? If so, what are the actions that banks need to take in order to control these risks? This article aims to identify, analyse, and summarise the risk management in the implementation of *Musyarakaṯ Mutanaqisaṯ* home financing contract in Malaysia. A total of four informants includes the informants from Affin Islamic Bank Berhad and RHB Islamic Bank Berhad as well as two academic experts in the field of Islamic banking are involved in the discussion of risk management in the *Musyarakaṯ Mutanaqisaṯ* home financing contract. Purposive sampling method is used in this study with the semi-structured interview being conducted with the informants. The findings of this study comprise of discussions on the types of risks inherent in the *Musyarakaṯ Mutanaqisaṯ* home financing contract. The risks consist of credit risk, liquidity risk, Syariah risk, operational risk and investment equity risk. The risk management of the *Musyarakaṯ Mutanaqisaṯ* home financing contract by Islamic banking institutions includes three stages namely the early stage of the agreement, the current stage of the agreement and the final stage of the agreement.
Keywords: Musyarakah Mutanaqisah, Musyarakaṯ Mutanaqisaṯ, Musyarakah, Home Financing.

Introduction

Musyarakat Mutanaqisat home financing contracts comprise risks almost similar to other housing finance contracts such *as Bay' Bithaman Ajil*, *Tawwaruq* and others home financing contract. However, different risks may exist in every home financing contract depends on the types of the financing. The *Musyarakat Mutanaqisat* home financing contract covers the elements of partnership which state that the bank and the customer are partners in the agreement. Indirectly, it creates risks which both parties have to bear. One party is exposed to greater risk if the other party violates the agreement. Based on the elements of this partnership, there are several risks involved, such as credit risk, market risk, operational risk and investment equity risk (Rulindo, 2009). However, Investment Finance (2014) states tha credit risk will also ultimately lead to liquidity risk. The risks inherent in the *Musyarakat Mutanaqisat* home financing contract also requires appropriate risk management to anticipate the ancillary risks that will appear throughout the agreement between the customer and the bank. Based on previous studies, research on the risk management in *Musyarakat Mutanaqisat* home financing contracts has yet to be conducted, therefore the purpose of this study is to review the topic of risk management associated with the *Musyarakat Mutanaqisat* home financing contract. Additionally, this study is important for the banks especially in ensuring that risk management will minimize the negative impact on the banking system. In addition, this study emphasizes the concept of *Musyarakat Mutanaqisat* in home financing products which is seen to coincide with Shariah Law and has the potential to be a contract that further helps customers in home ownership.

The contribution of this study also includes two aspects, which are the theoretical and empirical aspects. Theoretical aspects involve the development of knowledge in banking, house financing as well as risk management practices that can be practiced by banks in Malaysia. The empirical aspect involves the implementation of the banking system in managing the risk of *Musyarakat Mutanaqisat* home financing according to efficient measures. Furthermore, it can attract more local banks to offer their own *Musyarakat Mutanaqisat* home financing contracts in the near future. In this regard, this paper aims to review the risk management made by local banks in Malaysia for *Musyarakat Mutanaqisat* home financing contract. The researcher also stated the formulation and suggestion on the implementation of *Musyarakat Mutanaqisat* home financing contract. This paper comprised of five subtopics such as introduction, the concept of *Musyarakat Mutanaqisat*, the types of risk in *Musyarakat Mutanaqisat* home financing contract, discussion and summary.

The Concept of Musyarakat Mutanaqisat Home Financing Contract

Based on the agreement stated in the *Musyarakat Mutanaqisat* home financing contract, customers and banks form a partnership in the house ownership. The bank will issue a certain amount of capital to buy a house that is involved in the advance agreement. Therefore, the bank has full ownership of the house purchased at the beginning of the agreement. Next, the bank will rent the property to customer based on the *Ijarah* concept (rental). Payment of *Ijarah* which will be made by the customer in installments will slowly transfer the ownership of the customer to the house. Indirectly, the bank will also slowly lose the ownership of the house. *Ijarah* payment process continues until the full payment of the house is made by the customer. Finally, the full ownership of the house obtained by the customer (Bank Negara Malaysia, 2015). In addition, there are two conditions of housing that have been used in this contract. First is the ready built house and the other is the under construction house. These two conditions may give different level of risk to the bank as well as to the customer. Joni Tamkin Borhan (Direct Communication, 2016) stated that under construction house may cause higher risks to the customer or bank if the developer did not fulfill the agreement in time. Worst case scenario may happen if the developer totally neglects the construction and abandon the house. The agreement process based on the concept of *Musyarakat̲ Mutanaqisat̲* home financing contract is briefly described in diagram 1.

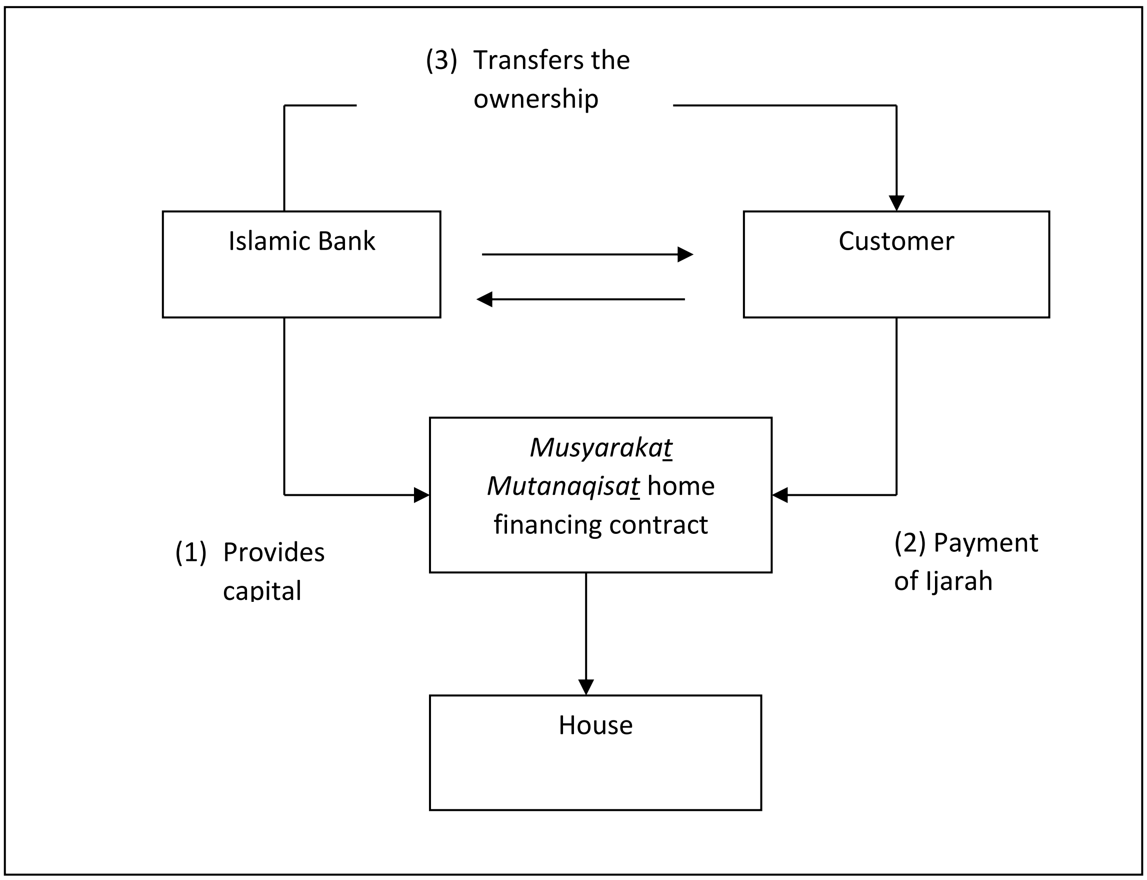

Diagram 1: The Process of *Musyarakat̲ Mutanaqisat̲* Home Financing Contract

The Development of Musyarakat̲ Mutanaqisat̲ Home Financing in Malaysia

An investment bank in Kuwait, which is Kuwait Finance House (KFH) started implementing this contract in 2006. KFH is said to be the first Islamic bank to undertake a *Musyarakat̲ Mutanaqisat̲* home financing contract in Malaysia (KFH Annual Report, 2006). Afterwards, other banks in Malaysia began to offer *Musyarakat̲ Mutanaqisat̲* home finance contracts. Affin Islamic Bank Berhad is the first local bank to undertake a *Musyarakat̲ Mutanaqisat̲* home financing contract with the developers in Penang in 2008. The bank also consistently pursued deals using the *Musyarakat̲ Mutanaqisat̲* home financing contract despite the fact that most other local banks have stopped offering this contract. In addition, other local banks, such as RHB Islamic Bank Berhad, began offering home financing contracts based on the *Musyarakat̲ Mutanaqisat̲* concept in November 2007. The *Musyarakat̲ Mutanaqisat̲* home financing contract replaced *Bay*

'Bithaman Ajil's home financing contract in full in June 2008. The changes occur because *Bay 'Bithaman Ajil* financing contract involves in many issues regarding Syariah for example this financing involved in debt financing which profit was determined beforehand. Although some of the scholar in Islamic banking find *Bay 'Bithaman Ajil* contract is permissible in Islam, but this contract still creates doubts among the other scholars. It is because the system involved in *Bay 'Bithaman Ajil's* financing contract seems similar with the conventional system. RHB Islamic Bank Berhad also offers a *Musyarakaṯ Mutanaqisaṯ* based product that aims to finance semi-finished homes. This product was originally offered by RHB Islamic Bank Berhad in October 2008. Until then, *Musyarakaṯ Mutanaqisaṯ* home financing contract only focus on the fully finished house that was offered by RHB Islamic Bank Berhad (Shuib, Borhan & Hussain, 2011). As for 2017, only two local banks in Malaysia offer *Musyarakaṯ Mutanaqisaṯ* home financing contract. The banks are Affin Islamic Bank Berhad and RHB Islamic Bank Berhad.

Studies of the Musyarakaṯ Mutanaqisaṯ Home Financing Contract

Based on the research conducted, researcher found that most of the studies were only limited to the conceptual elements of the *Musyarakaṯ Mutanaqisaṯ* itself and discussion of the common issues in the *Musyarakaṯ Mutanaqisaṯ* home financing contract. Common issues include the discussion of the risks inherent in the *Musyarakaṯ Mutanaqisaṯ* home financing contract. However, these studies do not explain how to mitigate the risks inherent in this contract, thereby managing the risks in *Musyarakaṯ Mutanaqisaṯ* home financing contract in a more cost-efficient practice. This is because the researcher believes that a good risk management will allow the *Musyarakaṯ Mutanaqisaṯ* home financing contract to be offered and widely used in Malaysia. Hence, explanatory research is used to conduct a study on risk management on the *Musyarakaṯ Mutanaqisaṯ* home financing contract. Data collection methods involving semi-structured interviews with informants. The type of sample used in this research is purposive sampling. The sampling’s aim is to produce a sample bound to the objective of study alone (Palys, 2008). The semi-structured in depth interview has been done so that the information obtained is deeper and depends on the discussion held with each informant. This is important for researchers to ensure that ongoing discussions do not conflict with the raised questions (Mathers, Fox & Hunn, 1998). In addition, a review of documents was conducted to review past studies pertaining to *Musyarakaṯ Mutanaqisaṯ* home financing contract as well as risk management in Islamic banking. The method of analyze data is carried out by using textual analysis. This textual analysis is a method by which the researcher identifies or describes the purpose of a message based on the texts (Frey, Botan & Kreps, 1999).

Risks in Musyarakaṯ Mutanaqisaṯ Home Financing Contract

Financial risk is divided into systematic risk and non-systematic risk. Systematic risk is categorized as an external factor that affects financial institutions while non-systematic risk typically affects the specific sector for example, technology in an institution (Hacioglu & Dincer, 2014). Based on Rulindo's (2009) statement, there are four types of risks inherent in the *Musyarakaṯ Mutanaqisaṯ* home financing contract namely credit risk, market risk, operational risk and equity investment risk. However, the Investment and Finance (2014) adds that liquidity risks will arise through other risks. This statement is supported by the four informants involved in the study. This is because certain risks can lead to new risks coming into existence. In other words, the risks are not standalone risks, but may also lead to more relevant risks, which will further jeopardise the *Musyarakat Mutanaqisat* home financing agreement (Khan, Direct Communication, 2016; Borhan, Direct Communication , 2016 & Mohammad, Direct Communication, 2016). Accordingly, this study examines the five types of risks inherent in the *Musyarakat Mutanaqisat* home financing contract. The five types of risks comprise of credit risk, operational risk, liquidity risk, Syariah risk and equity investment risk.

Credit Risk

Credit risk is classified as the dominant risk in banking either in Islamic banks or conventional banks. Credit risk is associated with the ability of the customer to repay the amount of financing that has been made in accordance to the terms of the agreement. Credit risk will arise if the customer fails to repay the bank within a certain period of time. Credit risk is also able to create other risks such as liquidity risk (Nasir, Written Interview, 2016). Credit risk occurs when the financial instruments owned by the bank fail to meet the prescribed conditions (for example banking investment bonds) (Febianto, 2012).

Operational Risk

Operational risk is a burden that involves bank operations in managing arrears or customer debt (Khan, Direct Communication, 2016). This includes documentation, laws and others. Banks are forced to spend extra money on managing the payment due to customers failed to repay the rent in the *Musyarakat Mutanaqisat* home financing contract (Khan, Direct Communication, 2016). Indirectly, the risk of this operation can lead to the presence of other risks. For example the cost bear by the bank may inherent operational risk and it can affect the liquidity in the bank. It may cause liquidity risk and this problem will create another risk (Rulindo, 2009).

Liquidity Risk

Liquidity risk occurs when the bank is experiencing a lack of cash flow that reduces the ability of the bank to reach the level of liability available. In other words, losses or costs incurred by the bank will result in the bank failing to achieve a balance between total assets and liabilities (Febianto, 2012; Mohamad, Direct Communication, 2016). The imbalance of total assets and liabilities usually occur when the total liabilites exceed the total of assets. This result may affect the bank's cash flow.

Syariah Risk

Syariah Risk often occurs in Islamic banking due to improper documents along with Shariah principles and confusions raised about the legal aspects of the Muamalat which indirectly affects the undertaking of the contract (Khan, Direct Communication, 2016).

Equity Investment Risk

Equity investment risk occurs when a bank equity investment hold is carried out during a non-reduction economic situation. This is a result of poor market conditions (Hassan & Yusuf, t.t). This risk is inherent in the *Musyarakat Mutanaqisat* home financing contract because of the element of partnership involving partner equality. If a partner violates a predetermined agreement, the bank is vulnerable to investment equity risk.

Based on the interviews conducted on the informants, all informants stated that credit risk is the dominant risk in *Musyarakat Mutanaqisat* home financing contract. The recorded statements are as below.

> *"From the perspective of the bank in particular, credit risk is the most dominant risk. This risk usually occurs when customers cannot pay a pre-determined rental rate." (*Khan, Direct Communication, 2016)

> *"When Ijarah arise, issues such as credit risk will be borne by the bank when the customer can not afford to pay."* (Mohammad, Direct Communication, 2016)

> *"Credit risk is the most dominant risk because the customer's credit profile may change over time due to debt commitments and so on. In addition, rental rates that are changing according to market prices also increase the debt burden on customers."* (Nasir, Written Interview, 2016)

The impact on the bank when the customer fails to repay the prescribed rental rate also includes liquidity risk. This is because the bank's revenue will be severely affected as the investment used by the bank comprising deposits of depositors will be affected. It takes into account in the unstable economic situation where the depositors withdraw their money, thus affecting the cash flow of the bank. The lack of revenue may affect the balance of assets and liabilities of the bank (Mohamad, Direct Communication, 2016).

> *"Banks need to maintain its financial stability because the use of money by banks is not fully from the bank's property. The money is from the depositors."* (Mohammad, Direct Communication, 2016)

Additionally, the failure of customers to repay the *Ijarah* will cause a risk in operations. This is because the situation that gives losses to the bank will indirectly create additional costs to the bank. The additional costs incurred by the bank is an operational risk which will be a burden to the bank financially. Other risks arising from operational risks also often occur in the *Musyarakat Mutanaqisat* home financing contract. Among them, is the Shariah risk that occurs when the documents used in the contract deal creates confusion regarding the Syariah law (Idris & Bahari, 2017).

> *"From the Shariah point of view, there has been a case where Musyarakat Mutanaqisat home financing process is implemented as a conventional lending process."* (Khan, Direct Communication, 2016)

Based on the above statement, the confusion in the document will lead to Shariah risks and it is required that the agreement be made into a new agreement to ensure that the applicable contract is Shariah-compliant. In addition, issues will arise from the Shariah perspective when there is a case in regards to the auction of a house. The issues arise when the customer can not pay the *Ijarah* according to the agreement. When the house is auctioned because of that, in accordance with the true Shariah concept, the customer is still entitled to get a portion of the auction revenue based on the ratio paid (Borhan, Direct Communication, 2016).

Discussion

Bank Negara Malaysia (2015) notes that an efficient risk management framework embraces the three main stages in the *Musyarakaṯ Mutanaqisaṯ* home financing contract. The stage comprises the initial stage of the agreement, the current stage of the agreement, as well as the final stage of the agreement.

The preliminary stage of the agreement includes bank actions to identify customer information such as customer background, customer status whether it is eligible to receive the financing, and whether the customer's information is accurate and comply with the stipulated conditions. This process is made in the early stages of the agreement to ensure that risks to the bank can be avoided. The process of profiling the customer is a step by the bank to identify more about the quality and potential of customers. This is because in the *Musyarakaṯ Mutanaqisaṯ* home financing contract, the client does not only serve as the party that receives the financing offered by the bank, but is also a partner to the bank. In addition to monitoring customers, the bank also conducts monitoring of housing developers involved in the *Musyarakaṯ Mutanaqisaṯ* agreement. This step is also important to ensure that the houses involved in the *Musyarakaṯ Mutanaqisaṯ* home financing contract are free from any problems such as unprepared houses or developers breaching the agreement (Mohammad, Direct Communication, 2016).

Subsequent to the agreement, the bank should take precautionary measures and constantly monitor the ongoing financing of the *Musyarakaṯ Mutanaqisaṯ* home financing contract. Credit management principles cover long-term relationships between customers and banks (Mishkin, 2015). This can be seen from the steps taken by the bank to ensure that the possible risks in the *Musyarakaṯ Mutanaqisaṯ* home financing contract can be minimised during the agreement. The operating system of the bank should not focus on customer monitoring only, but on all aspects seen as potential risks to the *Musyarakaṯ Mutanaqisaṯ* home financing contract. Out of all aspects, focusing on managing the parties involved (developers and customers) in the *Musyarakaṯ Mutanaqisaṯ* home financing contract will reduce the common problems that occur in this contract such as unprepared housing issues (Borhan, Direct Communication, 2016).

However, good risk management also covers the whole phase of the agreement. In other words, the final stages of the agreement are also important for the bank in risk management. The monitoring process needs to be carried out and the current status of the subscribers need to be recorded. Documents relating to the transfer of inter-bank house and customer rights should also be carefully reviewed so that no confusion arises during the house transfer process (Idris & Bahari, 2017). In addition, legal aspects involving the documentation process should be submitted to a specialist in the legal jurisdiction. This is because the bank must always be sensitive to matters involving the law, so it is very important for the bank to obtain a certified service so that the final stage of the *Musyarakaṯ Mutanaqisaṯ* home financing contract goes well (Bank Negara Malaysia, 2015). Risk management measures for *Musyarakaṯ Mutanaqisaṯ* home financing contract are vital to increasing the interest of local banks in offering this contract.

Furthermore, through the research conducted by the researcher, the *Musyarakat Mutanaqisat* home financing contract has great potential to be implemented extensively in Malaysia. This statement is supported by the informants involved in this study.

> *"The Musyarakat Mutanaqisat* home *financing contract has huge potential but it comes with a huge risk. Therefore, good risk management will provide more profitable returns. "(Nasir, Written Interview, 2016).*

> *"Home financing management in Islamic banking should highlight the Shariah concept as well as Shariah compliance. If the risk management is Shariah-compliant, then the Musyarakat Mutanaqisat* home *financing contract can be further expanded in Malaysia. "(Borhan, Direct Communication, 2016)*

Figure 2 shows the formulas for the findings of risk management studies in *Musyarakat Mutanaqisat* home financing contract.

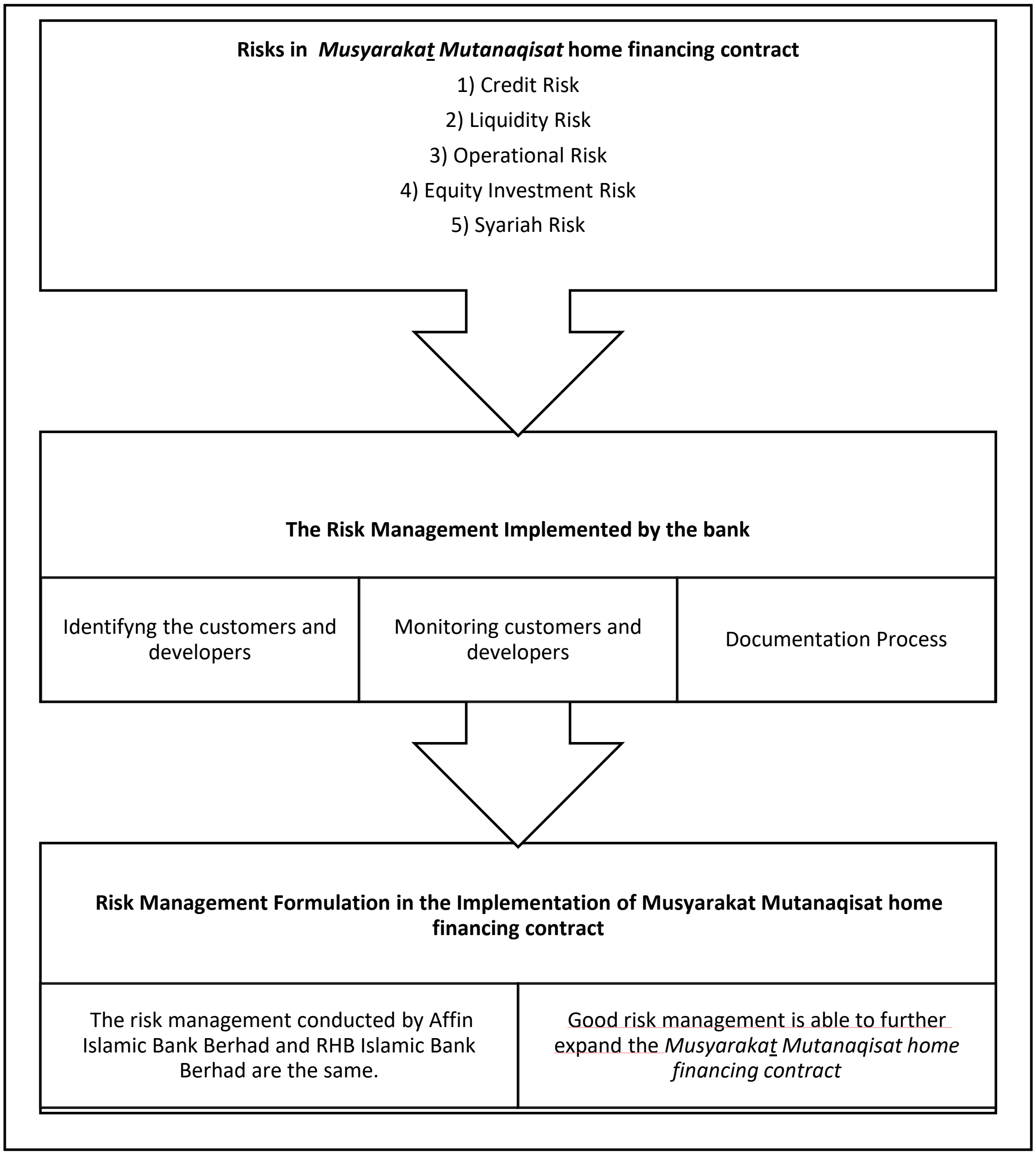

Diagram 2: Summary of Risk Management in The Implementation of *Musyarakat Mutanaqisat* Home Financing Contract

Summary

Risk management plays an important role in promoting *Musyarakat Mutanaqisat* home financing contracts in Malaysia. Additionally, the poor supply of *Musyarakat Mutanaqisat* home financing products can be managed if good risk management is carried out by banks according to the true Shariah principles. This will allow the *Musyarakat Mutanaqisat* home financing contract to be better developed in Malaysia especially among local banks. In this regard, banks are encouraged to carry out the efficient and true Shariah risk management so that the risks in *Musyarakat*

Mutanaqisat home financing contract can be overcome thus attracting other banks to offer *Musyarakat Mutanaqisat* home financing contract more extensively.

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