

# INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN BUSINESS & SOCIAL SCIENCES



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To Link this Article: <http://dx.doi.org/10.6007/IJARBSS/v8-i5/4226>

DOI:10.6007/IJARBSS/v8-i5/4226

*Received: 09 April 2018, Revised: 29 April 2018, Accepted: 05 May 2018*

Published Online: 18 May 2018

In-Text Citation: (Idris, 2018)

To Cite this Article: Idris, S. M. (2018). Syariah Risk in Musyarakah Mutanaqisah Home Financing Contract in Malaysia. *International Journal of Academic Research in Business and Social Sciences*, 8(5), 875–884.

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Vol. 8, No. 5, May 2018, Pg. 875 - 884

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## **Syariah Risk in Musyarakah Mutanaqisah Home Financing Contract in Malaysia**

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### **Abstract**

Risks in Islamic banking consist of the usual risks inherent in conventional banking. However, Islamic banking tend to be exposed to a unique set of risks in addition to those, which are the Syariah risks. Equity-based home financing contract (especially *Musyarakah Mutanaqisah* home financing) are exposed to high risks. If so, is Syariah risk considered as one of the risks that affect *Musyarakah Mutanaqisah* home financing contract? In addition, what is the definition of Syariah risk? In this regard, the paper aims to identify and analyse the Syariah risks inherent in *Musyarakah Mutanaqisah* home financing contract in Malaysia. The research design used in this study is explanatory design. The primary data used for this study were conducted through a semi-structured interviewing method which includes purposive sampling. Secondary data involved in this study is from qualitative document research. Three informants specializing in the field of Islamic banking were involved in this study. The findings of the study consist of the definition of Syariah risk inherent in *Musyarakah Mutanaqisah* home financing contract in Malaysia and its impact on Islamic Banking generally.

**Keywords:** Musyarakah, Mutanaqisah, Home Financing, Risk, Risk Management, Islamic Banking

### **Introduction**

Syariah is the basis of Islamic law which covers the aspect of life. Some general principles in Islamic Muamalat emphasize on manners in transaction. For example, a transaction cannot be performed if it involves the elements that are illegal in Islamic law such as Riba' (usury), Maysir (gambling), and Gharar (doubts). These Syariah principles must also be adhered to by the institutions which offer Islamic banking products. Islamic banking products are increasingly popular with the public. However, the needs of the customers and the public in regards to Islamic banking products change according to current economic conditions. However, Islamic banking must follow the Syariah principles even though the state of economy is changing from time to time. The emphasis of Syariah principles comprises of the principles of justice, fairness, reliability and honesty in the transactions conducted. This is in line with Al-Ghazali's statement:

“The very objective of the Shariah (Maqasid Shariah) is to promote the welfare of the people which lies in safeguarding their faith, their life, their intellect, their posterity and their property. Whatever ensures the safeguard of these five, serves public interest and is desirable.” – (Al-Ghazali, 1937)

Based on the statement, the Musyarakah Mutanaqisah home financing contract should be implemented in such a way that it can benefit the community and does not violate the Syariah principles. Musyarakah Mutanaqisah home financing contract should establish a clear connection with the participants’ rights, as well as the other parties involved in the agreement. Any oppression should not occur, as well as avoiding the unlawful elements according to Syariah in undertaking the contract.

### **Literature Review**

There are a few previous studies which have discussed this topic. Among them are the works of Meera and Razak (2009), Lee (2013), Aris et al. (2012), Zainan and Ismail (2013) and Shuib et al. (2011) which emphasizes the fact that the Musyarakah Mutanaqisah home financing contract conforms with Syariah principles in comparison to other home financing. The Musyarakah Mutanaqisah home financing contract is seen as the best alternative contract to replace the Bay’ Bithaman Ajil home financing contract.

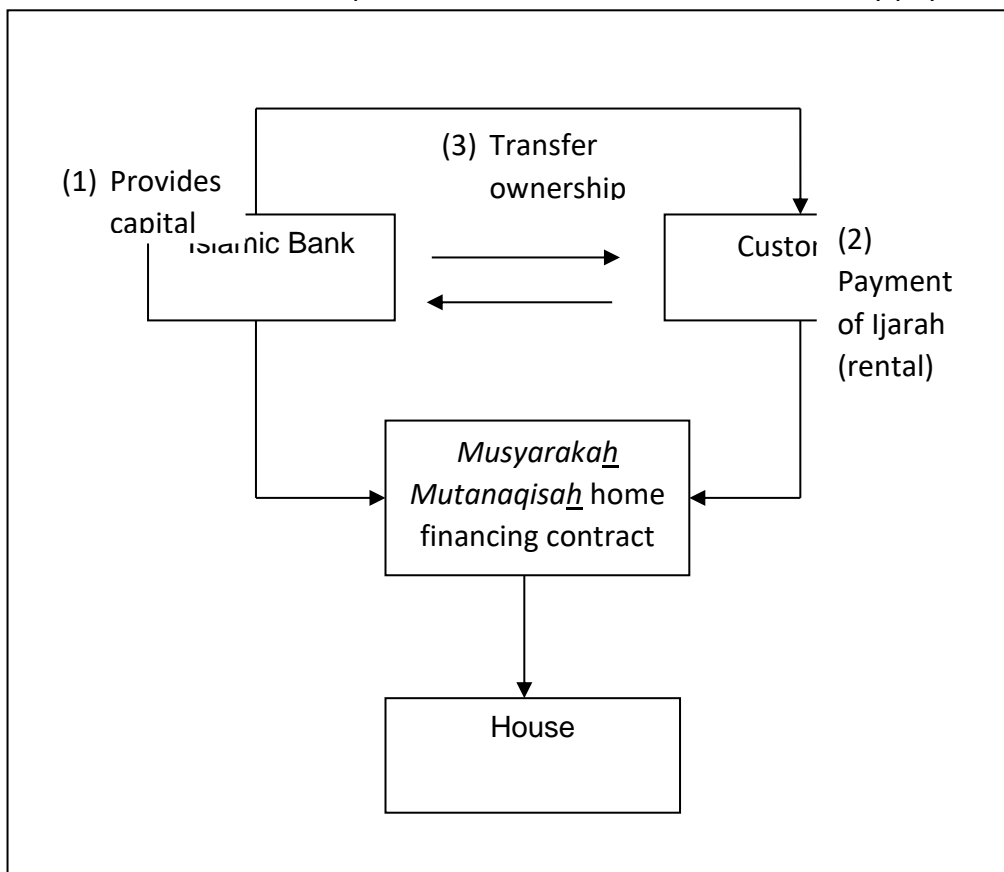
Furthermore, past studies on the risks of Islamic banking cover the various risks inherent in Islamic banking. Ahmed and Khan (2012) and Abedifar, Tarazi (2012) attributed the unique risks of Islamic banking compare to conventional banking. In this regard, Greuning and Iqbal (2008) described the risks inherent in Islamic banking in detail and the measures to be taken into account and addressed the risks inherent in Islamic banking. Among the things raised is that resource constraints caused the Islamic banks to be unable to cover the high cost management required to monitor the risks inherent in Islamic banking. However, no study has discussed how an Islamic banking counteracts the risks inherent in Musyarakah Mutanaqisah home financing contract particularly.

### **Methodology**

This study applies explanatory design to identify the types of Syariah risks inherent in the Musyarakah Mutanaqisah home financing contract. The sampling method was aimed towards the three informants who are experts in the field of Islamic banking. Primary data sources include semi-structured interviews conducted on informants involved. Secondary data is obtained through qualitative document review. The justification of informant selection is based on the expertise of the informants in the field of Islamic banking in Malaysia. The first informer is attached as an officer in Affin Islamic Bank Berhad. While, the second informer and the third informer were lecturers in the Syariah and Economic department at the University Malaya, Malaysia. Based on the information obtained, the researcher adopted textual analysis method in order to obtain information in line with the reviewed topic. Textual analysis is used to identify or describe the purpose of a message based on the texts read (Frey, Botan & Kreps, 1999).

### Musyarakah Mutanaqisah Home Financing Contract

The Musyarakah Mutanaqisah home financing contract is based on a partnership between the bank and the customer. This partnership covers mutual ownership between the bank and the customer over the house involved in the agreement. In the beginning of the agreement, the bank will issue capital for the agreed house purchase between the bank and the customer. Afterwards, the customer will pay to the bank in instalments through the Ijarah (rental) concept where the Ijarah rate is set at current rates. Any payment made by the customer will increase the ownership of the customer while the ownership on behalf of the bank will shrink on any payment received.



**Diagram 1 : The Process of Musyarakah Mutanaqisah Home Financing Contract**

The agreement process based on the concept of Musyarakah Mutanaqisah home financing contract is briefly described in diagram 1. The concept of a reducing partnership that is applied in Musyarakah Mutanaqisah has the potential to further develop and gain a place in the community (Meera & Razak, 2009). This is because the sharing element that is used in Musyarakah Mutanaqisah home financing contract emphasizes the element of justice if it is conducted in accordance with true Syariah principles. For example, in the event of any harm to the house involved in this agreement, the bank and the customer will bear the risk together.

In spite of that, Musyarakah Mutanaqisah home financing is not yet offered widely compare to other home financing contract such as Bay' Bithaman Ajil. This discussion explores the question: why is the Musyarakah Mutanaqisah home financing contract is not widely offered in Malaysia

when it has the potential to grow because of its coherence with Syariah principles? Hence, the risks inherent in Musyarakah Mutanaqisah home financing contract are identified, specifically the Syariah risks which are perceived as a unique set of risks that only exist in Islamic banking.

### **Syariah Issues in Musyarakah Mutanaqisah Home Financing Contract**

Syariah issues that exist in Musyarakah Mutanaqisah home financing contract is considered as a Syariah risk to Islamic banking. This will serve as constraints to banking institutions in offering the Musyarakah Mutanaqisah home financing contract. Among the issues raised by Abushareah and Naim (2015) is the issue of Shirkat Al-Milk. Shirkat Al-Milk is a partnership without a pre-defined contract. This partnership occurs when both parties combine the shared property together. This indirectly raises the problem where this situation is seen to be in favour of the more dominant party (the one who manages the house). Furthermore, the issue of security of the house involved in the agreement is also highlighted. In other words, the element of partnership in Musyarakah Mutanaqisah home financing contract puts trust between the two parties (bank and customer) in managing the house. Partners are not allowed to guarantee the home or earn profit from the investment made. However, guarantees made against security or damage caused by the disaster is allowed.

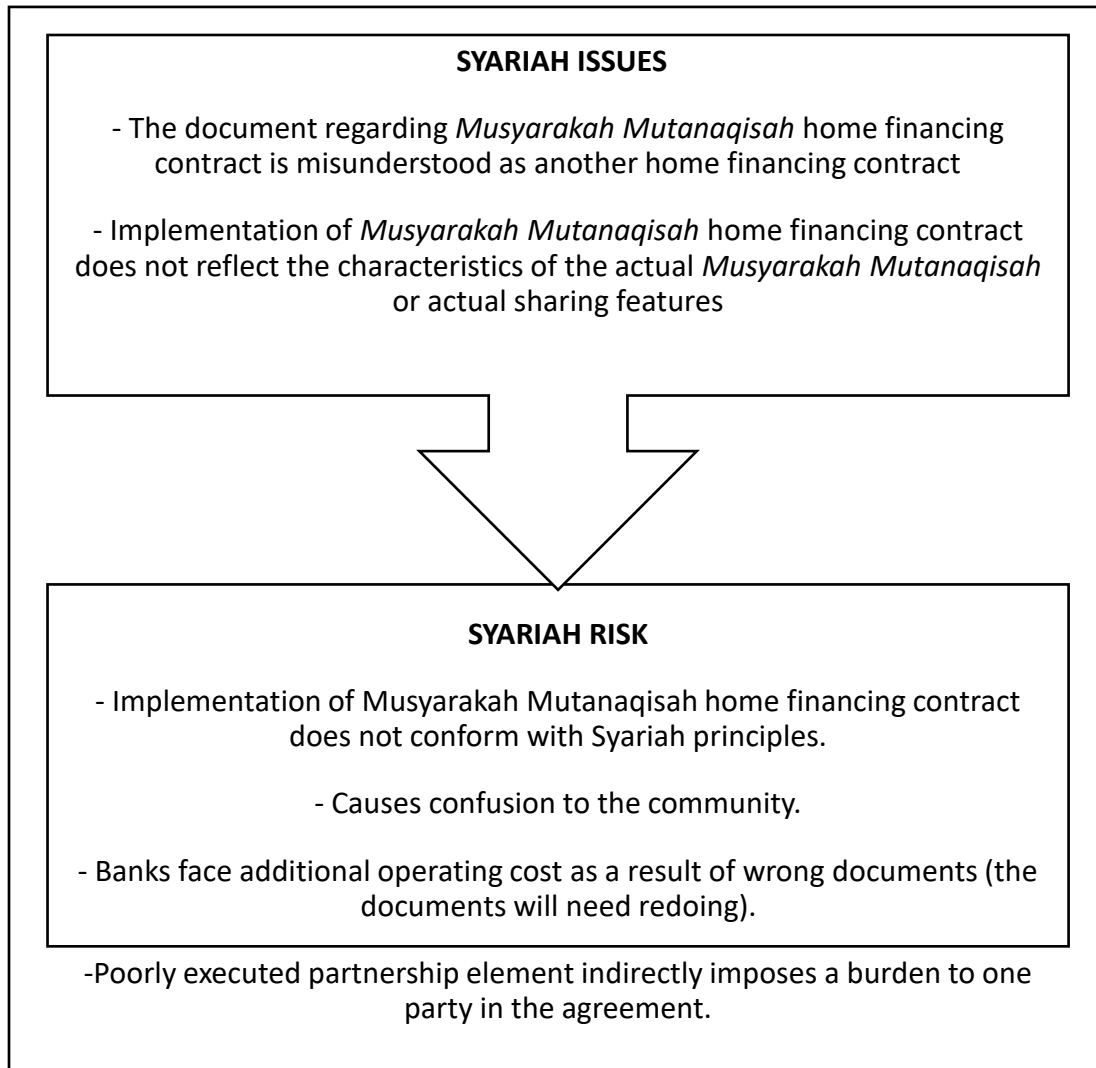
In addition, the issue of fees or charges imposed on customers for legal services under the Musyarakah Mutanaqisah home financing contract is borne fully by the customers (Muhamad et al, 2013). This matter does not conform with the Syariah principles applied in Musyarakah Mutanaqisah home financing contract where it emphasizes the element of partnership. Furthermore, the issue of lack of Syariah lawyers who specialize in understanding the Musyarakah Mutanaqisah home financing contract is not compliant with the basic Syariah principles.

### **Syariah Risk in Musyarakah Mutanaqisah Home Financing Contract**

Syariah issues embodying the Musyarakah Mutanaqisah home financing contract indirectly raises Syariah risk for the bank. Unlike other risks, such as credit risk, Syariah risk exists only in Islamic banking that practice Syariah principles that conform with Islamic law. According to Azlan Shah Nabees Khan (Direct Communication, May 21st, 2016) through interviews conducted, Syariah risk exists when documents executed under the Musyarakah Mutanaqisah home financing contract create confusion in the legal aspects thereby affecting the role of Musyarakah Mutanaqisah itself.

“From the Syariah perspective, it has always been the case where the financing process is implemented as a conventional loan.” (Khan, Direct Communication, 2016).

The above statement indicates an error in the documentation process which indirectly creates Syariah risks to the bank. This is because in order to amend this error, the bank should cancel the existing agreement in Musyarakah Mutanaqisah home financing contract.



**Diagram 2: The Syariah Issues that lead to Syariah risk**

Diagram 2 shows the flow of Syariah issues that leads to Syariah risks in Islamic banking. Khan (Direct Communication, 2016) also stated cases where documents for *Musyarakah Mutanaqisah* home financing contract became confusing when it was stated that 100 per cent of house ownership belongs to the bank while the customer does not gain any ownership. Indirectly, this agreement makes the bank bear the full risk. These issues include many type of cases such as not having a sharing element stated in this contract when the *Musyarakah Mutanaqisah* is supposed to be a sharing partnership contract. Hence, the bank will need to create a new contract in order to ensure that the *Musyarakah Mutanaqisah* contract that is taking place is in line with Syariah principles. Syariah risks may lead to other risks such as operational risk. An example is when the bank is forced to pay for additional costs as a result of changes in the contract. Additionally, any benefits or payments incurred during previous contract (inaccurate documents), is the bank's responsibility to bear. This indirectly causes additional costs to the bank.

Different cases were also raised by the informants of this study regarding Syariah risks in *Musyarakah Mutanaqisah* home financing contract. According to Borhan (Direct Communication,

2016) the issue of house auctions involved in the agreement also creates Syariah risk in Musyarakah Mutanaqisah

“If a customer cannot afford the rental rate within a given time frame, the house will be auctioned. Therefore, after auctioning the house, bank must return the payment made by the customer. This is the true Syariah-compliant process.” (Borhan, Direct Communication, 2016)

The following statement is in line with the study conducted by Abdullah (2012) which emphasizes that the Syariah concept must be applied in certain situations. For example, if the developer does not complete the house construction within the stipulated time frame, then the bank is responsible for obtaining another new house to replace the abandoned house in the agreement. Nevertheless, the reality of this situation puts the full risk on the customers. Such a matter should be changed so that Syariah risks in Musyarakah Mutanaqisah home financing contract do not arise while applying Syariah principles in this contract.

The element of justice also emphasizes that the Musyarakah Mutanaqisah home financing contract is not favourable to one party in the course of the ruling. The application of Musyarakah Mutanaqisah home financing contract does not only give an advantage to bank, but also to the customers (Mohamad, Direct Communication, 2016).

### **Conclusion**

The Syariah risks inherent in the Musyarakah Mutanaqisah home financing contract begins with Syariah issues which do not emphasize the true Syariah principles. These Syariah issues conflict with Syariah principles thus bringing risks to the bank and customers involved in the Musyarakah Mutanaqisah home financing contract. The cases that create Syariah risk in Musyarakah Mutanaqisah home financing contract are discussed in this study. Hence, good Syariah risk management is able to develop the potential of Musyarakah Mutanaqisah home financing contract in Malaysia. This is because a true Musyarakah Mutanaqisah home financing contract will be able to get a place in the community because of its criteria which reflect the true Syariah concept (Khan, Direct Communication, 2016). There are three aspects that were contributed by this study. First, implication on the theoretical study. Second, implication on the stakeholders such as banking institution and lastly, the implication on the community acceptance on Musyarakah Mutanaqisah home financing contract. Theoretical implication includes the expansion of study regarding Islamic home financing especially on Musyarakah Mutanaqisah home financing contract. Furthermore, it can add a new study on the risks in Musyarakah Mutanaqisah home financing contract. Exposure to the risk of Musyarakah Mutanaqisah home financing contract is able to give insight into how to deal with the risks inherent in this contract. This study also shows that the Musyarakah Mutanaqisah home financing contract is able to gain a place in society compared to other home financing contract. Hence, good risk management by the bank in dealing with the risks in Musyarakah Mutanaqisah home financing contract will be able to increase the demand and supply of this contract.

### Acknowledgement

My deep gratitude goes first to Universiti Sains Malaysia and Centre for Islamic Development Studies (ISDEV), Universiti Sains Malaysia for giving me the opportunity to present this paper in the 12th ISDEV International Graduate Workshop 2017 (INGRAW, 2017). I would like to extend my appreciation to my supervisor Associate Professor Zakaria Bahari and my co supervisor Dr. Fadzila Azni Ahmad for their support and for sharing their knowledge in academic writing with me. My appreciation also goes to the informants, Professor Joni Tamkin Borhan and Dr. Taquiuddin Mohamad from Universiti Malaya and Mr. Azlan Shah Nabees Khan from Affin Islamic Bank Berhad for their willingness to participate in this study and share their opinion regarding this research. Above ground, I am indebted to my family whose always give their support. Finally, I acknowledge the journal HRMars who are willing to consider my paper to be published for references.

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### **Interview List**

- Interview with Azlan Shah Nabees Khan, Bank Officer in Affin Islamic Bank Berhad, at 21<sup>st</sup> May 2016 through telephone call.
- Interview with Joni Tamkin Borhan, Senior Lecturer in Department of Syariah and Economics, Universiti Malaya, at 14<sup>th</sup> July 2016, through telephone call.
- Interview with Taqiuddin Mohammad Senior in Department of Syariah and Economics, Universiti Malaya, at 15<sup>th</sup> July 2016, through telephone call.