

The Application of Islamic Ethics and *Aq'dah* on Islamic Home Financing Loan Using the Concept of *Tawarruq*

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Abstract: This paper examines one method of business financing namely *tawarruq*. Particular emphasis is given to the use of such method in home financing. The study suggests that the instrument is useful for business community to get permissible financing specifically on home financing. However, there are disputes by scholars on the underlying contract. Perhaps, further research is needed in scrutinizing the practice in order to improve the instrument. This paper focuses on the basic characteristics of Islamic ethics and *tawarruq*, its implementation in Malaysian banks specifically Bank Islam Malaysia Berhad.

Keywords: 'Aqidah, Business, Financing, Maslaha, Islamic Ethics, Tawarruq.

I. INTRODUCTION

Background of the Study:

In Islam, there are guidelines stipulated by Allah through His Messenger in conducting day to day activities. In addition, tradition of Prophet Muhammad is the secondary source of reference after the Quran in determining the permissibility of any actions. Allah has stipulated what is *halal* and what is *Haram* in order to guide the Muslim towards the happiness in the world and more importantly in the hereafter.

The OIC Islamic Fiqh Academy is concerned on the possibility of non-existence of physical commodities in *Tawarruq* structure as well as an existence of fraudulent trading contracts which may lead to fictitious transaction. If one of these occur in practice, therefore, it is not permissible under *Shariah's* point of view and thus, the contract is *haram* (Islamic Finance News, 2010). It is essential to highlight that the concern raised over *tawarruq* by the jurists is on the application of the concept and not on the concept itself. Since Malaysia is still under transition period where dual banking is a common practice, *tawarruq* is regarded as a better mechanism in avoiding *riba'* (Hasan, 2009). Due to the common practice of conventional personal loan before the emergence of Islamic Banking, *tawarruq* should be the nearest alternative to the Muslim customers in their liquidity management. Home financing is a noteworthy segment of investments in our present banking practices. Islamic banks adopt several products to keep itself free from *riba* or usury. In Malaysia Islamic banks, commonly practiced concepts include *tawarruq*, commodity *murabaha* and *musharakah mutanaqisah*. Several Malaysian Islamic banks prefer *tawarruq* over *al-bay' bi thaman ajil* (BBA), though the latter has predominantly been practiced by all Islamic banks. Accordingly, Islamic financial institutions have introduced a number of *Shari'ah*-compliant modes for home ownership, the dominant of which are the *tawarruq* and *musharakah mustanaqisah*. This paper discusses the definition of Islamic ethics, *tawarruq* concept, its types, *hukum* ruling on the concept of *Tawarruq*. Finally, this paper delve into the implementation of *tawarruq* as home finance in terms of ethics, *aqidah* and *maslaha*.

Review of Previous Studies:

Beekun and Badawi (2005) examined Islamic business ethics from a normative perspective. The important finding claimed that business ethics cannot be separated from ethics in the other aspects of a Muslim's daily life. The Islamic ethical system is balanced, fair, just and benevolent, and seeks to respect the rights of both primary and derivative stakeholders without allowing for exploitation, nepotism and other human ills. Beekun and Badawi (2005) also claimed that mankind must not forget his/her role as God's vicegerent on earth (Supriyatna, 2012). For Muslim understanding practice this ethical system, it also contains its own enforcement.

This study examined ethics from Islamic viewpoint. The issue of SMEs from Islamic business ethics is scarce to be found in the study, only the above mentioned extracted discussions are relevant to the current study. It is argued here, Islam and business relate to each other. A study conducted by Rice (1999) revealed that knowledge of ethics in practice is vital to the international manager. Rice (1999) also discussed the business ethics among the Egyptian people. In more detail, the illustration of Egypt shows considerable diversities between philosophy and practice; diversities which if understood, can provide a foreign executive with ideas on how to negotiate with Egyptians and even what kinds of products or services might be appreciated. Rice (1999) also mentioned the importance of unity (*tawhid*), justice (*adalah*), trusteeship (*khilafah*) in dealing with businesses. According to Abeng (1997), all business practices involve explicit or implicit harm and injustice to the contracting parties or to the public at large are disapproved by Islam. Further, in order to build a good business, any businesses must have a good Muslim business leader that will drive the business into a lawful business as intended by *Shari'ah*. Abeng (1997) also noted that there are six components needed to be understood by Muslim business leaders. Among others are fulfilled of promises, exactness in weights and measures, truthfulness, efficiency, selection of merit and investigation and verification. By incorporating these components, all business practices will be treated as permissible as required by *Shari'ah Islamiyyah*. This study, indeed, provides general guidelines for the current study in identifying measures that better reflect SMEs (Wan Hamat et al, 2013). There is an extensive literature in every major ethical issues - Christianity, Islam and Judaism on the values, legal codes of conduct on the managing of business, the workplace and the accumulation and use of wealth. For example, in Islam, the basis of these codes and laws is the holy scripture, The Quran, whose teachings are exemplified in the sayings and life of the Prophet Mohammed. The same is true for each of other scripture based faiths. In Christianity, the basis is the Old Testament and The New Testament. For Judaism, the sources are the Torah or the Tanakh and the Talmud and the Midrash. This study have consulted the general writings of scholars writing on ethical issues pertaining to business from the various faith perspectives.

Definition of Tawarruq:

Literally, it is derived from the word *al-warq* or *al-wariqu* or *al-waraqqa*, which means '*darahim madrubah*'. *Wariqah* means the *kitab* or tree and trade for money and *awraqa* means much money or Dirham and the word of *tawarruq* is taken from this, which means lots of money. Technically, as defined by OIC, *tawarruq* means the commodity was bought by somebody (*mustawriq*) at a deferred payment and sells it to the other person other than the first seller at a discount price and with immediate payment (Tijani, 2013.). In practice, *tawarruq* is also known as commodity *murabahah*. It is a financial product structured to satisfy customer cash needs in accordance with *Shari'ah*.

Hukm of Tawarruq:

According to the Malikis, *tawarruq* is impermissible, however, is more accepted with the *Hanbali*, *Hanafi*, and *Shafi* Schools. Among the contemporary scholars who said that *tawarruq* is impermissible are As-Syaikh Abdullah bin Muhammad bin Hassan As-Said. Their justifications are as follows:

Their evidences:

1. It is like *bai' al-'inah*, which is prohibited by most scholars. The objective of buying and selling does not exist in *tawarruq*. The purpose of this transaction is to obtain money, instead of selling.
2. It leads to creation of debt, the volume of which is likely to keep increasing.
3. It results in exchange of money now with more money in the future, which is unfair in view of the risk and uncertainty involved.
4. Through debt finance, it leads to greater instability in the economy.
5. It results in inequity in the distribution of income and wealth.

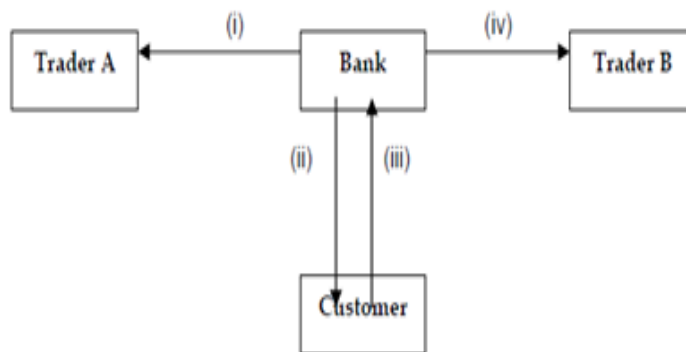
On the other hand, the 15th Session of the *Majma' Fiqh* which was held on Saturday, 11 *Rajab*, 1419 *Hijriah*, stated that *bai' at-tawarruq* is permissible according to the *Shari'ah*, like the opinion of most of the scholars. This is because the original ruling on sale is permissibility, like what was mentioned by Allah in the Qur'an, "Allah permits trading and forbids usury". This type of *bai'* is in the line with the *Shari'ah* because the buyer does not sell the commodity directly at a cheaper price than what he purchased from the first seller. If that were to happen, then it is *bai' al-'inah*, which is impermissible because it consists of the trick of *riba* and leads to the prohibited *aqad*.

There are two different types of *tawarruq*, as follows:

1. Individual *tawarruq* (al-fardai): A pure *tawarruq* whereby a buyer buys a commodity from seller on deferred term and later sells it to other person for immediate cash.
2. Organized *tawarruq* (*munazzam*):

According to OIC Fiqh Academy, organized *tawarruq* can be defined as the bank arrangement of the transaction where it sells the commodity to the customer by installment (cost plus profit) and at the same time the bank will act as an agent to the customer, finding the new buyer who is willing to pay at the cash basis at the lower price. Then, the bank will transfer the funds to the customers. (Hadad D. A., 2010).

A simple mechanism in a *Tawarruq* financing is illustrated below:



1. The bank buys commodity from trader A in the commodity market on cash basis.
2. Thereafter, the bank sells the commodity to the customer on deferred price (cost price plus profit margin).
3. The customer may appoint the bank as his agent to sell the commodity to trader B on cash basis in the commodity market.
4. The bank then sells the commodity as agent of customer, to trader B on cash basis in the commodity market.

Table 1: Comparison between Conventional and *Tawarruq* Financing.

Price of house is 222,222.22		
Financial provider 200,000		
	Conventional loan	Tawarruq contract
Monthly payment	RM 1249	RM 1260
Total payment in 20 years	299,760	302,400

Table 1 shows the difference between conventional and Islamic home financing in terms of monthly charges. Monthly payment for conventional loan is RM 1249 while for *Tawarruq* is RM 1260. This indicates that monthly payment for the conventional loan is lower than *tawarruq*. The total payment balance under the conventional loan is RM 299,760 which is lower than the Islamic banking loan which is RM 302,400. The loan has to be paid within 20 years for both products that is offered by May bank and Islamic bank.

II. BODY OF ARTICLE

Maslaha in Tawarruq:

Maslaha is benefit or public interest according to *Shari'ah*. All of the jurists define *maslaha* in literally means benefit or interest. Technically, it means unrestricted public interest in the absence of regulation by the Allah and when no textual authority can be found on its validity or otherwise. *Maslaha* placed some conditions to the contract as essential action to achieve the objective of *Shariah* from two aspect, firstly product based the contract for liquidity purpose of financing in economy system and secondly to avoid from engaging *riba*. *Tawarruq* has been used for customer debt financing products. As shown in Table 1, the monthly payment for *tawarruq* is higher than conventional bank (Maxi) which contradicts the *maslaha*. However, some of the justification of Islamic bank is, due to the cost of the house, the cost of fund, supplier and the material that is used to construct the house. On the other hand, the customers argue the higher charge is a burden on them. Therefore, for *maslaha* purpose, Islamic bank has to be fair and revise the pricing of the product they offer to the customers. They should minimize the profit in order to avoid burden the customer to pay back the debt. Unfortunately, the large profit that is obtained by Islamic bank, it will be distributed to their shareholders, consultants, managers etc. On the other hand, the customers suffer to pay back the high charges that is imposed on them by the bank. That is against welfare (*maslaha*) principle. The *maslaha* should be in way that charges that is imposed by Islamic bank has to be always lower than the conventional. Otherwise, customers will shift to the conventional bank to satisfy their need. As result, Islamic bank has to balance between the profit and the ability of the customer to pay back the debt. Islamic bank system, aimed at achieving well-being of the *ummah*, universal brotherhood, justice and equitable distribution of income. As result, that implementation of *tawarruq* has to be in line with *maslaha*.

Aq'dah in Tawarruq:

Aqidah relates to all matters of faith in Allah, the Creator. Individuals may only use Allah's resources, which they temporarily own (Mirakhor, 1995). There are many issues regarding Islamic banks today. One of the major issues that is faced by Islamic banking was shortage of Islamic leaders in market. This indicates that the market is dominated by conventional mindset. As result, their thinking, consideration and principles are totally conventional. For example, regarding the pricing of *tawarruq*, the mechanism that is used to price *tawarruq* is based on conventional mechanism system. This system does not put much consideration on human capability to pay the cost of the products. The cost of home financing of Islamic banking and conventional is not much different to each other this is due to both of them use same mechanism to price their products. Therefore, Islamic banking administration should conduct more research to come out with their own system of pricing to price their product fairly and that considers the ability to pay their debt. In short, Bank Islam management has to have an Islamic mindset not a conventional perspective on pricing their own products. Besides that, a Muslim should be able to differentiate their own needs and the enjoyment of life. Having the knowledge of *fiqh al awlawiyat* in order to able to prioritize their own needs and wants.

Ethics for Tawarruq:

Akhlaq has two meanings, first *akhlaq* (ethics) means the science that deals with the standards of right and wrong of human conducts, particularly what humans ought to do. Ethics refers to the study of the ethical conduct and behavior. Second, *akhlaq* means "good character" or good human behavior. Ethics is the human character that prescribes to refrain from immoral conducts such as cheating. This study finds that the price of *tawarruq* is higher than the conventional bank. However, it is not ethical because it may lead up to default or debt. The increasing number of bankruptcies and consumer debt financing among the people have put them in a dangerous situation. Islamic bank must be aware that its operations, policies and preferred transactions must not by default ends up with wealth circulating amongst the wealthy only. Islamic banks give priority of financing only to customers who are able to offer good collateral (Rosly, 2003).

Besides that, the principle of moderation therefore precludes the Islamic bank from adopting profit maximization as its principle objective. Islamic bank is required to adopt human welfare maximization as an objective instead of profit maximization. Furthermore, Islamic banking has to treat their customers fairly. This means justice in the relationship between bank and customers; justice in the allocation of risks between banks and customers, and justice in the clauses of the legal agreements between bank and customers. In short, the issue of the price that is being offered by Islamic bank which is higher than conventional bank won't be solved unless there is a political will behind it. If there is a political will

International Journal of Novel Research in Interdisciplinary Studies

Vol. 4, Issue 2, pp: (6-10), Month: March – April 2017, Available at: www.noveltyjournals.com

in way that to reduce the price, profit and come out with real mechanism that is used to price Islamic banking products and in particular home financing. There has to be some kind of sacrifice in reducing the profit .Reducing will be in way that, to reduce the salaries of the consultantcies and certain percentage of the profit that is giving to the central bank .The surplus profit of Islamic bank should be allocated to conduct more research to improve and innovate Islamic banking products and service in order to be competitive with their conventional counterparts.

III. CONCLUSION

It can be concluded that *tawarruq* transaction practiced by Islamic banks is according to *Shari'ah* guideline. Even though there are different views and stands towards the legality of *tawarruq*, the *fatwas* from major scholars confirmed that the products are permitted to be used in current practice. However, Islamic banks have to ensure that product is permissible to be used i.e. no elements of *riba'*, *gharar* and *maysir* . However the conditions are subject to some limitations according to contemporary scholars when they argue on another aspect of *tawarruq* to be valid. One of the conditions are the purpose should be for investment to gain profit and to keep money supply linked to the needs of the real sector of the economy in order to keep inflation under control. The majority of scholars permit it because for public interest (*maslaha*) and for the basic principle is the permissibility of things, and no clear text exists prohibiting such a transaction. Even though, *tawarruq* is permissible, in long run alternative to *tawarruq* has be to be found. *Musharakah mustanaqisah* might be an alternative to the *tawarruq* concept. *Musharak mutanaqisah* is based on equity and debt financing and hybrid contract.

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