INCEIF®
THE GLOBAL UNIVERSITY OF ISLAMIC FINANCE

11TH
CONVOCATION

7th December 2019 | 21 Rabiulakhir 1441
Grand Ballroom, Level 2, InterContinental Kuala Lumpur.
The coverage of the conference includes, but not limited to:

- Islamic finance and financial inclusion
- Islamic finance and attainments of SDGs
- Inclusive finance and inclusive growth
- Halal economy
- Islamic economy, Islamic finance and digitalisation
- Islamic banking
- Islamic capital markets
- Islamic social finance (Zakat, Awqaf etc.)
- Islamic financial innovations
- Governance and regulatory framework for Islamic finance
- Takaful and wealth management
- Fintech
- Crowdfunding

The paper can be theoretical, empirical or case studies. The paper and presentation can be made in English or Arabic.
Editor’s Note
by Assoc Prof Dr. Baharom Abd Hamid.

Risk Management, Asset Liability Management and Their Impacts on Net Interest Margin (NIM)/Net Profit Margin (NPM): A Comparative Analysis Between Conventional and Islamic Banks
by Dr Raja Shahridatul Dewa (INCEIF)

Does Financial Inclusion Truly Matters?
by Dr Tengku Roziana Tengku Zainal Abidin (INCEIF)

Islamic Financing vs. Conventional Lending: Is There Any Difference in Default Risk?
by Dr Azarahiah Lokman (INCEIF)

1 Million Affordable Homes: Needs & Capabilities
by Dr. Ariff Daud (INCEIF)

Abandoned Housing Projects Financed by Musharakah Mutanaqisah Home Financing: An Analysis on Its Operational Structure
By Dr. Amni Suhailah (INCEIF)

Shariah Non-Compliant Events in the Malaysian Islamic Banking Industry: Shariah and Legal Studies
by Dr. Abdullaah Jalil (INCEIF)

Risk-Sharing Investment Account: A Proposed Model for Islamic Banks in Malaysia
by Subithabhanu Binti Mohd Hussan (INCEIF)
Editor’s Note

Assalamualaikum wbt.

Alhamdulillah! Praises to Allah, for all the blessings that He has given. We are into our 4th issue for 2019. What makes it so special is that this is a special issue in conjunction of INCEIF’s 11th Convocation.

In this issue, we have seven articles which were contributed by our PhD graduates this year. We are glad to showcase their thesis and hoping that this will spark their enthusiasm further in publishing in higher ranking journal in the future. At INCEIF, PhD candidates are actively involved in our applied research activities. This allows them to keep abreast of the recent development of Islamic finance industry which helps them in producing high impact research papers. We are proud to share that one of these research papers was published as a research policy paper by Institute For Research and Development of Policy (IRDP).

On behalf of the Editor’s Board, we wish you a wonderful convocation and good luck in future undertaking!

“Happy Graduation!”

Last but not least my gratitude for all the players who have played key roles in making this special issue of IF HUB a reality, both directly and indirectly. We would also like to thank the readers for the feedback provided.

Feedbacks and comments are most welcome.

Assoc. Prof. Dr Baharom Abdul Hamid
baharom@inceif.org
In the aftermath of the global financial crisis, attempts to determine the main cause of the crisis is very difficult though one of the contributory factors identified was the reliance of banks on short-term funding and adopting massive maturity mismatches in their balance sheets. The basic intermediary function of borrowing short and lending long created the inherent fragility in the banking system which exposed the banks to interest rate risk (henceforth, any reference to interest rate risk includes profit rate risk in the context of IBs). The crisis underscored the importance of establishing robust risk management (RM) strategies. Asset liability management (ALM) is a mechanism in RM employed to address the extent of this mismatch between assets and liabilities to safeguard the stability of the balance sheet. ALM uses a variety of hedging techniques to manage the interest rate risk. Most frequently used technique is the traditional maturity gap management.
Apart from this traditional method, banks use interest rate derivatives, which is a more sophisticated off-balance sheet instruments. Comparative analysis between conventional banks (CBs) and Islamic banks (IBs) may allow banks to investigate the hedging techniques of maturity gap and interest rate derivatives (profit rate derivatives in the context of IBs) and their influence on the hedging decisions of CBs and IBs. This in turn might explain risk management practices and their impacts on respective net interest margins (NIMs) and net profit margins (NPMs).

**What are the roles of maturity gap management and interest rate derivatives in managing interest rate risk?**

As intermediaries, banks faced interest rate risk from the mismatches in the maturity structure and repricing of their assets, liabilities and off-balance sheet instruments. Banks typically borrow short-term to fund long term long-term assets or borrow long-term to fund short term assets. The interest rate risk has potentially negative impact on the earnings and net worth of banks with changes in interest rate. The wider the gap, the greater the impact of the interest rate shock on bank’s net worth. The roles of maturity gap management and interest rate derivatives can be investigated to seek whether these two methods act as substitutes or complements in managing interest rate risk. Increase in the usage of one hedging technique that leads the banks to use less of the other hedging technique is consistent with the notion of the substitution effect. It has also been suggested that an increase in the usage of one hedging technique resulting in the increase usage of the other technique as complementary to one another.
This framework is highly relevant to IBs to distinguish whether these two hedging techniques were substitutes or complementary in light of the limited Shariah compliant tools available in the market. The results would have an impact on the RM and the ALM strategies to be adopted by IBs in managing profit rate risk exposure. If maturity gap is a substitute to derivatives, then the use of maturity gap would not significantly affect the performance of IBs. On the other hand, if maturity gap is a complementary technique to derivatives, the importance of Shariah compliant derivatives to Islamic banking can be made evident. This is to assess whether IBs are indeed disadvantaged from the limited use of Shariah compliant financial instruments in managing profit rate risk.

IBs operating as alternative financial institutions to both Muslims and non-Muslims customers are gaining grounds in the mainstream financial system. IBs encounter profit rate risk operating as intermediary that exposes IBs to mismatch in the maturity structure and the re-pricing terms of their assets and liabilities. Important issue for IBs is that risky investments may be permitted as long as they do not fall under the category of impermissible activities under Shariah. Hence, there is a tendency for IBs to increase their profit rate risk exposure by altering the composition of their assets and liabilities as part of their maturity gap management. This is magnified in the absence of active derivatives markets transactions. The rapid growth of IBs operating in the mainstream financial system gives additional pressure in terms of competition as well as facing more complex risk. The broadening of the financial structure demands IBs to provide new financial services and instruments to sustain their profit margins.

Past studies indicated that the use of derivatives lower the exposure of interest rate risk. The use of derivatives as a form of off-balance sheet hedging has become increasingly important vis-à-vis the on-balance sheet method. Hence, derivatives in IBs are therefore well-founded under the RM framework. However, it is acknowledged that IBs faced difficulty in fully adopting derivatives in which certain scholars have highlighted the incompatibility of derivatives with IBs due to gharar (prohibited transaction due to speculation). However, hedging is a process where parties seek to reduce risk. This may be considered as maslaha or public good as it reduces overall risk. Central theme to Islamic principles is the elimination to the zero sum game. Under the Shariah compliant profit rate swap, present value of floating rate payment is equal to present value of fixed payment. At the outset, both parties do not win or lose, hence there is inherent risk sharing as it could go either way. It is further argued that there is no unjust exploitation in the transaction and that both parties either make profit or loss that entails normal trading business.
As a caveat, the Shariah still sees the use of derivatives as a zero sum game but for the sake of public good, it has limited its use for hedging purposes only (tahawut) and not for speculation. It means that only when the business has an exposure and in dire need to protect it from market volatilities, then it is permissible to use Shariah compliant derivatives to protect the business. Hence, Shariah compliant derivatives need to be pursued as a form of RM practices.

**Conclusion**

Interest rate risk is one of the most important forms of risks that have direct impact on banks' performance arising from interest rate risk exposure. The changing landscape in the financial system have required heightened attention to RM and ALM strategies in managing interest rate risk. One of the measures to ensure financial stability by banks include the monitoring of the assets and liabilities structure and evaluate the appropriateness of hedging solutions such as maturity gap management and usage of derivatives to reduce the volatility in the margins. The difference between the repricing of assets amount and the repricing of the liabilities amount in a given period provides the definition of interest rate gap. The change in interest rate during a given period affects this gap which in turn impacts the net interest revenue of the banks. Managing the structure of this gap would enable the banks proactively manage the net interest margin arising from the change in interest rate.

In the wake of the global financial crisis that brought down some of the largest financial institutions indicates the importance of sound oversight by governments and regulators in monitoring the banking systems' ALM policy. The significant role played by Islamic banking despite its relative smaller size in the mainstream international financial system may contribute remedies to the crisis by introducing to the conventional banking system concepts such as profit sharing and linking the financial system with the real economy.

*This article is part of the author’s PhD Thesis (2019).*
Given the recognition of financial system intermediation function in allocating resources, financial inclusion has been nominated as an important and effective tool in transforming our world by 2030 towards zero poverty, peace, safeguard people and the planet, through achieving the Sustainable Development Goals (SDGs). How does it work? Financial inclusion is seen as a mechanism to improve financial resilience where the poorest and less privileged can meet unexpected financial demands and mitigate financial shocks by gaining access to basics financial services such as deposits, payments, insurance and credit. Once the unbanked have secure saving in the financial institution, their record or financial identity are in the system and this expand opportunity for access to credit. What happen to the financially excluded populace? Above all, they will be deprived of the prospect to acquire eligibility for financing which allow them to invest for better future. For instance; cash advancement to purchase machinery that scales up their income, increase chances of surviving economically, hence improve standard of livings and evade poverty.
On that basis, financial inclusion is starred as catalyst in SDGs particularly in relative to eradicating poverty, ending hunger, achieving food security, promoting sustainable agriculture, gaining health and well-being, achieving gender equality and economic empowerment of women, promoting economic growth and jobs, and lowering inequality. Henceforth, policymakers are fully committed to incorporate more unbanked, poor and rural household into the formal financial system, that failure to do so will cause the transformational change planned a tragedy.

How do we propagate financial inclusion?

The policymakers have been identifying the barriers to the multi-dimensional financial inclusion, to deal with and turn them into factors that can act as a booster to ease financial access instead. Barriers may emanate from supply-side and also demand-side of financial inclusion.-Higher income countries synonym with higher financial inclusion. Better standards of living increases growth, thus reinforcing the expansion of bank branches and ATMs which represents the supply-side of financial inclusion that could generate beneficial impacts on deposit and credit penetration, greater vicinity to financial intermediaries and increase public trust towards financial institutions. What about poorly developed banking outreach in developing countries? As an alternative to accommodate this constraint, an increase in secured internet providers as banking infrastructure, unfold more opportunity to improve operability with the financial system at any time and from anywhere. For example, the use of mobile banking as medium of bill payment and money transfer. It is utmost important to value trust given by the users with ensuring their safety and security.

Extra caution by the government and banking industry regarding this issue is needed in the light of growing incidence of various banking fraud.

Whilst barriers from banking operational perspectives mainly due to stringent restrictions on banking activities and entry such as requirement of minimum account and loan balances, fees charged for opening account or loan processing, complicated and tedious documentations, lack of identification, transaction cost imposed and complicated delivery channels. It is for the industry to research and discover the best way to accommodate the absorption of the unbanked into their system concurrently upholding the industry’s stability. Not to mention, when viewed from a different perspective, retail deposits and loans from households help banks remain stable during financial crisis where small depositors and borrowers would continue their banking routines, hence avoiding the possibility of bank runs and large loan losses if they were large depositors and borrowers instead.
From the demand-side, a sine-qua-non factor in the financial inclusion matrix is education. It is an important step into changing the standard of living of the poor. Well-educated society will be more qualified for employment market thus, obtaining sustainable income and becoming more financially capable population. Poor education decreases the prospect of using financial products and services. Inability to understand sophisticated banking products leads to a lack of trust in modern technology, an inhibiting factor in performing mobile or online banking. In concurrence with the scenario of financial illiteracy even amongst population in developed countries, it is also vital to educate these people the importance of being financially literate. An early exposure of financial education would be a good additional effort in producing financial literate society that the young population will be more independent and wiser in making financial decision and preparing for long term financial goal. This indirectly addresses the issue of longevity risk that affect the aging population to be financially excluded and the need to be prepared for longer life span with proper pensions, savings, investments and healthcare plans.

However, there are certain people who voluntarily exclude themselves from the financial services, even though they can afford and do have access on the services due to religiosity. It is a well-known obstacle identified specially amongst the Muslims whom quoting heavy concentration on the use of debt-based financing instruments reinforced the perception that Islamic banking in practice is not very different from conventional banking.

There are also involuntary exclusion arising from money poverty, insufficient income, age dependency (young and old), unemployment and gender factor.
In line with SDG (1) which targets zero poverty, the poorer segment of population should be the imminent focus. Wide base of assistance and coaching are required which includes enhancing relevant skills, offering assistance in any ways that could help the poor society especially those involve in the informal sector. Supporting them in term of providing assistance in enhancing their existing skills, introducing them to proper channels, for example to ensure improved efficiency in their agriculture production, with the ultimate aim of ensuring sustainable income of the poor. Thus, this is to a great extent applicable for unemployed female gender too. Consequently, increasing their ability to be economically productive and be financially and socially participative.

Barriers due to age dependency factor might reflect the absence of financial products that meet the needs of different age groups. By understanding the users’ needs, banking industry can benefit more as they will be able to strike on their targeted potential customers. For example, providing more suitable products for younger population, such as savings, takaful and education investments, will encourage them to be financially included. The industry should also re-think about the needs of older population that has the ability to be “bankable” or sustain their category as the “banked” population but failed to be in the system due to all the regulations imposed by banks. Providing smooth and straight forward banking procedures is of utmost importance in providing ease of banking to the elderly as it will lessen the feeling of agitated or fear of not understanding the complicated banking processes.

Conclusion

Previous paragraphs highlight the importance of various factors in influencing financial inclusion that are extremely important to be considered in policy making purposes. The dismantling of barriers to financial inclusion will help create a better enabling environment for accessing financial services. Education should be made affordable to all level of society by offering updated courses that meet employment sectors, to fill the gap of illiteracy so they can achieve better living standards. Government and private institutions should be cognizant of female gender contribution towards human and economic development. Banking industry existence should be of relevance, more observant with demographic factors within the population that require products and services that meet their expectations in order to usher them into subscribing. Implementation of solid cyber rules and regulations to safeguard the security of the people performing online banking transactions should be prioritized. All for the purpose of making financial inclusion matters.
Islamic financing differs from conventional lending in many different ways. One major difference is the fact that interest is strictly prohibited in Islamic financing. This is in accordance to the teachings from the Quran and Sunnah that prohibits riba. In Islam, lending can only be made via the Qardhul Hasan method where no interest can be charged on the amount lent. Islam encourages modes of financing based on profit-and-loss-sharing (PLS) paradigm such as Musyarakah and Mudarabah.

By Dr Azarahiah Lokman
(INCEIF)
However, as Islamic banking sits within a conventional system, it is subject to similar environment, regulations and risks as its conventional counterpart. Due to this, in practice, many Islamic financing tend to be functionally similar to conventional lending. The profit rates\(^1\) of Islamic financing are often similar to the interest rates of conventional lending. Thus, if everything is functionally similar, one may not expect any difference in default risks between an Islamic financing and a conventional loan.

Nevertheless, though functionally similar, they are not necessarily the same. Islamic financing is religion-based while its counterpart is secular-based. Despite the similarities between them, the design of the products differs greatly. Islamic financing is designed in accordance to the Shariah. For one, the contracts used are sale contracts and not lending contracts as in conventional financing. Allah has permitted trading and prohibited riba (Quran 2:275). In addition, not all businesses can be financed by Islamic banks; for example, businesses related to gambling, speculation, alcohol and tobacco. Moreover, in case of default, the penalty or Ta’widh charged is minimal; only to cover the administrative costs of default. Shariah doesn’t allow banks to profit from the defaulters. This is in contrast to the compounded nature of the penalty charged to defaulters under conventional financing; seen as the bank’s way of penalizing the defaulters. In contrast to an overdraft facility that attracts a commitment fee on the unutilized portion, its Islamic competitor, a cash line facility does not attract any. This is because the Islamic cash line facility is designed using a sales contract, not a lending contract. These are some examples of the Shariah spirits that have been translated into the design of Islamic financing products, which have direct economic benefit to the customer. As a result, Islamic banks attract financially prudent customers too.

In essence, because of the values upheld in the design, Islamic financing / banks are able to attract better customers; better in the sense they are relatively more ethical and trustworthy or / and they are financially more prudent. Therefore, lower probability of default can be expected for Islamic financing compared to conventional loans irrespective of the religion of the loan / financing owners. Prior works in the Islamic banking literature indicate mixed results. Weill & Godlewski (2014) suggest no difference in default risk between Islamic and conventional loans whilst Baele et al. (2014) find Islamic financings are less likely to be defaulted than conventional loans. Abedifar et al. (2013) finds small Islamic banks have lower credit risk than conventional banks.

Hence, we investigate the impact of type of financing i.e. Islamic financing and conventional loan on default risk using Malaysian data. Malaysia makes a suitable case for this study as it practices a dual banking system where Islamic banks coexist with their conventional counterparts. The usage of unique and proprietary data from an Islamic bank (IB) and a conventional bank (CB) of a major banking group in Malaysia adds substance to the analysis. This banking group practices a dual banking leverage model, which makes it ideal for this study. This is because both banks are subject to similar credit risk appetite as well as similar credit culture. The same distribution channel offers both the Islamic bank and conventional bank products.

\(^1\) Many argue on the interest-based profit rate of Islamic financing. However, this is currently inevitable as Islamic banks are subject to similar risks as conventional banks. It is important to note that interest-based is not the same as interest. Islamic banks are allowed to take profits as in other businesses.
After Ohlson (1980), most of the academic literature use logit models to predict default. Logistic regression analysis is also the most frequently used method for company default prediction modelling adopted by banks and credit rating agency (Ciampi, 2015). Using logistic regressions, the result indicates there is a difference in default risk between an Islamic financing and a conventional loan. The results appear to suggest Islamic financing tend to have lower default risks than conventional lending irrespective of the 

In conclusion, understanding default risk is imperative for banks to better manage their risks especially in light of BASEL III stringent capital requirements. Practitioners may be able to develop better internal risk rating models, which has a direct influence on the determination of banks’ capital requirements. This may enable banks to be more efficient in allocating their capital. Regulators need to know so they can better assess the adequacy of the banks’ default models. For researchers, it is hoped that this study will ignite interest amongst researchers to further explore the unconventional dimensions of Islamic finance and examine their influence on risks.

The study validates the acceptance of non-Muslims on Islamic financing and Islamic banks. It validates the religious and ethical branding often associated with Islamic finance. This may suggest Islamic finance is gaining foothold as a religious and ethical brand for the wider society more than it is to fill the void for Muslims to adhere to their religion. This by itself can be seen as an acknowledgment of the achievement of Islamic finance. It shows that Islamic finance is not only for Muslims but for all. Moving forward, more efforts should be directed towards improving and promoting Islamic financial services by country governments throughout the world, especially Malaysia.

REFERENCES

Despite the similarities between them, the design of the products differs greatly. Islamic financing is designed in accordance to the Shariah.

This short article is adapted from the doctoral dissertation of Azarahiah Lokman entitled Default Risk of SMEs in Malaysia: The Role of Religion.
Introduction

One of the main manifestos of the current government of Malaysia is a promise to build 1 million affordable homes in 10 years. More than a year has already passed, and the time may be used by the Government in formulating a strategy for this huge program. According to the statement by the Minister of Housing and Local Government, the government will build 54.6% of this amount, and the rest will be built by private developers. However, there are various parties who questioned the need for the Government to build up to 1 million affordable homes as these will exacerbate current overhang problem. Some also questioned whether the plan is realistic and achievable.
Is it true that we need up to 1 million affordable homes? Where is the data showing this amount? Do we have the capacity and ability to build 1 million affordable homes?

Do We Need 1 Million Affordable Homes?

Malaysia’s total population is estimated to be 32.58 million. Of these, 29.4 million are citizens, and 3.2 million non-citizens.\(^1\) With an average household size of 4.1, at least 7.9 million units of housing is required. However, there are only 5.6 million units of housing in the whole of Malaysia.\(^2\) This means, there is a deficit of around 2.3 million units of housing that should be built to accommodate the increasing population.\(^3\) Analysis of each states indicates there are surplus of homes for WP Kuala Lumpur and Pulau Pinang, while other states are showing deficit, especially in Sabah, Sarawak and Kelantan.\(^4\)

Although Kuala Lumpur and Pulau Pinang recorded a surplus, high housing price in both states may force people to live outside the state. This may explain why an increase in the number of residents in Selangor and Negeri Sembilan (people who work in Kuala Lumpur), and Perak and Kedah (for people who work in Pulau Pinang). This in turn resulted in the prevailing deficit of these four states.

<table>
<thead>
<tr>
<th>States</th>
<th>No of People</th>
<th>No of Houses Required</th>
<th>Total Housing Stocks</th>
<th>Surplus (Deficit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>W.P. Kuala Lumpur</td>
<td>1,780,700</td>
<td>434,317</td>
<td>482,009</td>
<td>-47,692</td>
</tr>
<tr>
<td>W.P. Putrajaya</td>
<td>103,800</td>
<td>25,317</td>
<td>12,612</td>
<td>-12,705</td>
</tr>
<tr>
<td>W.P. Labuan</td>
<td>99,300</td>
<td>24,220</td>
<td>12,530</td>
<td>-11,690</td>
</tr>
<tr>
<td>Selangor</td>
<td>6,528,400</td>
<td>1,592,293</td>
<td>1,540,905</td>
<td>-51,388</td>
</tr>
<tr>
<td>Johor</td>
<td>3,764,300</td>
<td>918,122</td>
<td>818,326</td>
<td>-99,796</td>
</tr>
<tr>
<td>Pulau Pinang</td>
<td>1,774,600</td>
<td>432,829</td>
<td>511,613</td>
<td>78,784</td>
</tr>
<tr>
<td>Perak</td>
<td>2,512,100</td>
<td>612,707</td>
<td>482,055</td>
<td>-130,652</td>
</tr>
<tr>
<td>Negeri Sembilan</td>
<td>1,130,300</td>
<td>275,683</td>
<td>272,100</td>
<td>-3,583</td>
</tr>
<tr>
<td>Melaka</td>
<td>930,700</td>
<td>227,000</td>
<td>193,367</td>
<td>-33,633</td>
</tr>
<tr>
<td>Kedah</td>
<td>2,180,600</td>
<td>531,854</td>
<td>330,701</td>
<td>-201,153</td>
</tr>
<tr>
<td>Pahang</td>
<td>1,674,600</td>
<td>408,439</td>
<td>275,737</td>
<td>-132,702</td>
</tr>
<tr>
<td>Terengganu</td>
<td>1,245,700</td>
<td>303,829</td>
<td>100,637</td>
<td>-203,192</td>
</tr>
<tr>
<td>Kelantan</td>
<td>1,885,700</td>
<td>459,927</td>
<td>80,626</td>
<td>-379,301</td>
</tr>
<tr>
<td>Perlis</td>
<td>254,400</td>
<td>62,049</td>
<td>26,008</td>
<td>-36,041</td>
</tr>
<tr>
<td>Sabah</td>
<td>3,903,400</td>
<td>952,049</td>
<td>216,232</td>
<td>-735,817</td>
</tr>
<tr>
<td>Sarawak</td>
<td>2,812,800</td>
<td>686,049</td>
<td>256,215</td>
<td>-429,834</td>
</tr>
<tr>
<td><strong>MALAYSIA</strong></td>
<td><strong>32,581,400</strong></td>
<td><strong>7,946,683</strong></td>
<td><strong>5,611,673</strong></td>
<td><strong>-2,335,010</strong></td>
</tr>
</tbody>
</table>

---

1. Demographic Statistics Q2 2019, DOSM
2. Property Stock Report H1 2019, JPPH
3. 5.6 million units are formal housing. This data is different from Census Data 2010, which include informal housing in the calculation
4. These three states have higher proportion of informal housing
For example, there are 1.45 million workers in Kuala Lumpur, while total population of Kuala Lumpur is only 1.78 million (total population includes senior citizen, children, teens and babies who are not counted as workers)\(^5\). With a gross estimate of 2.5 workers per household, Kuala Lumpur still lacks about 100,000 homes. This do not take into account houses that are converted into home stays and Airbnb, in addition to intentionally left vacant as investment and transit home.

Clearly, there is a need to increase the number of homes, in particular affordable homes. And the government needs to plan and make decisions based on data, not political rhetoric. Extensive research needs to be conducted on the location, quantity and type required, as well as the appropriate price.

**Do We Have Ability to Build 1 Million Affordable Homes?**

From 2014 to 2018, on average, less than 70,000 home units were launched annually. To fulfill the promise of 1 million affordable homes in ten years means we must build around 100,000 to 125,000 units affordable homes per annum. This exclude premium and luxury houses that are built by private developers. Perhaps with the construction of affordable housing will reduce the number of construction of houses outside affordable housing category, but a significant number will still be built. Assuming 20,000 to 30,000 units a year, means around 150,000 units of housing will be launched every year, more than double the number of units launched currently. This means the resources that are used to build the house must also be doubled. However, do we have the resources (labor, materials, land, money, etc.) to fulfill this aspiration?

In Dasar Rumah Mampu Milik “DRMM” (National Affordable Housing Policy), there are two type of houses specified: strata and terrace. For strata houses, the recommended density is 120 units per acre for the city (Selangor, Pulau Pinang, Johor and Kuala Lumpur), and 150 units per acre for the TOD (Transit Oriented Development). For terrace houses, the density is set at 15 units per acre. With an average of 50 units per acre, a total of 20,000 acres of land is needed to build 1 million affordable homes. Where is it?

To fund construction and financing of 1 million affordable homes will of course require huge funding. For example, with an estimated construction cost of RM150,000 per unit, about RM150 billion is required! And these houses need to be financed. With an average sale price of RM200,000 per unit, RM200 billion is required! Does the banking system have the ability to fund and finance the projects of this scale?

**Recommendations & Solutions**

It is almost impossible to find 20,000 acres of land in city area. Therefore, there is an urgent need to identify the housing corridors that can be developed. This corridor needs to be planned properly and integrated with current public transport systems. For example, for the construction of affordable housing for people who work in Kuala Lumpur, housing corridor should be developed where people can reach Kuala Lumpur in less than an hour of travelling. With this criteria, KTM Komuter line from Kuala Lumpur to Tanjung Malim, and Kuala Lumpur to Rembau can be utilized. Of course, KTM Komuter need to be upgraded first, and become more reliable.

\(^5\) Economic Census 2016, DOSM
In addition to that, the project with this scale will certainly need thousands of engineers, quantity surveyors, architects, accountants, and many more workers. This will provide excellent job opportunities for graduates and young Malaysian who are unemployed and underemployed.

Besides, given the huge amount of construction required each year, there is an economic scale to adopt modern construction techniques. This includes pre-cast, prefab, industrialized building system, and 3-D printing. Local skills can be built through research and collaboration of industry and university.

A further initiative that can be made in the implementation of the 1 million affordable homes project is using the concept Built to Order (BTO), combined with the concept of Build Then Sell (BTS). Based on BTO concept, project will only commence construction if it reaches at least 70% of the reservation. This is to ensure that there is a real demand for an individual housing project, rather than an estimated demand from the developer.

Funding source is another issue of great concern which should be given serious attention by the Government. In addition to funds for the construction process, funds for home financing by the buyer should also be considered. In addition to that, there are many people who are not eligible to obtain financing due to low income, low credit scores, and so on. Rental scheme or rent to own scheme should be established to address this problem. And this require huge funding. To address this issue, institutional investors who manage huge amount of fund is among the best candidate to invest. This is especially for pension fund which has a long period of investment and focus on the assets that is secure. Since affordable homes are categorized as socially responsible investment (SRI), a shariah compliant funding model can be structured to tap institutional investors who have appetite for SRI and shariah compliant investment.
Previous mistake of building affordable housing far from facilities and public transport which resulting in unsold units should be avoided.

Summary

The promise of 1 million affordable homes will require thorough and meticulous planning, in addition to strong political will to push the project through. A year has already passed, and the people are still waiting for the government to fulfill this promise. Economic benefit of this mega project is huge and will create thousands of employment opportunities for the people.

Affordable homes must be built where the demand is. Previous mistake of building affordable housing far from facilities and public transport which resulting in unsold units should be avoided. The price of the house should be reduced, in order to achieve the level of prices aspired by the Government.

More importantly, affordable homes must be planned with urban design in mind. This includes access to public transport, public facilities (schools, hospitals, parks) and so forth like what have been outlined in DRMM. This is to ensure that the cost of housing as a whole is low, when these aspects are measured in totality.

This megaproject with good socio-economic benefit will require huge amount of funding. As this is align with Islamic finance principle, Islamic finance practitioners should proactively look into ways to help the government in structuring shariah compliant funding model for this project.

Full policy paper version was published in Bahasa Malaysia at https://www.irdp.my/research/pr5-merealisasi-janji-1-juta-rumah-mampu-milik
Abandoned Housing Projects (AHPs) have plagued the Malaysian housing industry since the 1970s (Dahlan, 2014). A 2016 report of Ministry of Urban Well-Being Housing and Local Government (MUHLG) states that there are 226 housing projects abandoned in Malaysia as of 31st August 2016, comprising of 60,941 units and affecting 40,866 homebuyers (MUHLG, 2016). This poses a great concern to the housing industry and to the banks themselves when buyers are not protected. The issue of claiming the full financing amount by banks in the event of customer default in situations of abandoned projects is seen as unfair and unjust. Cases like these have given rise to sceptics who question the realities of Islamic Finance. Home financing products offered by Islamic banks should more importantly be assessed to ensure that the main objectives of Shariah is fully reflected, guaranteeing the well-being and protection necessary, not just for the bank but also its customers.
This study focuses solely on 
musharakah mutanaqisah
home financing facility,
analysing its operational structure from the 
Shariah perspective.

**Musharakah Mutanaqisah**

**Modus Operandi for House Under Construction**

*Musharakah mutanaqisah* (MM) is a contract of equity, a mode long suggested by scholars during the initial introduction of Islamic banking. Jurists and scholars alike express their support to move from sale-based contracts to more equity-based contracts. MM financing facility has received overwhelming response from the market, as it is believed to avoid the Shariah issues of BBA. The operation of *musharakah mutanaqisah* financing of houses under construction or yet to be constructed is illustrated in the following diagram:

![Diagram](image-url)

**Fig.1** Musharakah Mutanaqisah Financing for House Under Construction.  
(Source: Writer’s Own Illustration).
Structural and Operational Analysis of Musharakah Mutanaqisah

In the structure above, musharakah contract is first contracted between the customer and the bank in the first leg of the contract. Thus, the profit and losses should be borne together. The inclusion of *al-ijarah mawsufah fi al-dhimmah* (AIMAD) here will not be possible without going into the *istikna’* contract, inorder to ensure the legitimacy of the forward rental to be received by the bank, once the ‘forward benefit of house under construction’ is purchased by the bank through *istikna’* (when customer is the initial seller/sani’) and then leased out or when the share of the bank is leased out to the customer (when customer is the agent). However, here the customer is also not the real sani’ (developer), regardless when the customer is appointed as the agent or acts as a seller of the *istikna’* contract. The real sani’ is the developer, and the bank has no relationship with the developer. The bank comes in only later, independent of the contract between the customer and developer. Being the ‘sani’ here (seller or agent), the customer is liable to deliver the property fully completed to the bank. The risk of ownership as well as the liability of non-completion and defects have been shifted to the customer after the commencement of the *istikna’* contract.
From the Shariah perspective, the bank and customer should share the losses in accordance to their respective capital contribution ratio of the partners.

The use of *istikna*’ here can be seen as a *hilah* to enable the bank to collect rental payment based on AIMAD. It is not the bank that actually wants to purchase the house under construction and that the customer is for sure not a *sani*’ (manufacturer/developer). Therefore, in the case of non-completion of the house, customers have no other option. Some banks also mention that failure of the customer as a seller here, to complete and deliver the property is considered an event of default and the failure to fulfil obligations as the seller and procurement party is considered negligence. It is suggested that the forward rentals paid by the customer be returned as no property is basically being delivered, and thus, the banks should not obtain any rental for the non-completed usufruct from the lessee (customer). This is the view from the Shariah perspective since the benefit gained by the bank must be *halal* and legitimate and genuinely based on real transactions.

Being a *musharakah* partnership from the very beginning, the bank together with customer should jointly share the risk of the house’s non-completion and defects that comes with it, this includes the losses associated. From the Shariah perspective, the bank and customer should share the losses in accordance to their respective capital contribution ratio of the partners.

This is clear in BNM’s Standards (2016: 161) on MM No. 34.6 “The minimum losses to be borne by the IFI arising from the incompletion of asset under construction shall be based on the capital contribution ratio between the partners.”

The BNM Shariah Standards No.33.4 & 33.5 (2016:160) clearly state that in the case of using MM in acquiring an asset under construction, IFI shall undertake IFI shall undertake due diligence to assess the capacity of the developer or manufacturer to fulfil its contractual obligations; and also identify trigger events for construction risk (such that the developer is behind schedule) and establish a replacement procedure for a new developer to replace the non-performing developer, where applicable. S 33.5 also states that IFI shall monitor the progress of the asset construction up to its completion in order to facilitate timely delivery of the asset by the developer or manufacturer.

The standards reflect the importance of the Bank’s involvement in the financing e.g. to check the developer’s progress and to take necessary precautions and measures in case the developer cannot deliver the property on time. This reflects the real nature of the activities being a true *musharakah* and *istikna*’ driven operations.
Thus, from both the structure and operation of MM financing for house under construction, the following are concluded:

1. The use of istisna’ contract in the structure is seen as an initial requisite to allow the bank to operate MM分别地, as it involves a non-existent asset.

2. The role of the supporting contracts plays very important roles in shifting the ownership's liability and risk to the other counterparty, the customer.

3. Customers, who are initially the interested buyer, turn 'developers'. This allows the banks to be indemnified in circumstance of non-completion or abandonment.

4. It is of the view that should istisna’ be used as the sole contract structure throughout, with the bank as the sani'i (manufacturer/developer) the structure is favourable as it meets Shariah requirements and provides the necessary protection for consumers in case of abandonment. However, the banks see this as risky as they are not willing to give the option of defects for properties under construction entitled to customers, should they not meet any requirements or in the case of abandonment.

5. In the case of ijarah under AIMAD, it is suggested that the forward rentals paid be returned to the customer as there is no basis to accept the ijarah as permissible because the future benefit does not accrue to the customer.

6. As an exit to the agreement, it is suggested that the forward rentals paid by customer should be returned and the losses of the incomplete infrastructure be borne also by the musharakah parties (bank and customer), according to their capital contribution in the partnership.

7. The appointment of the customer as the agent, should be analysed further. It is not adequate that he is considered negligent since the property is not completed or abandoned, where the fault is due to unforeseen circumstances usually involving the developers.

The content of this article forms part of the author’s PhD Dissertation entitled Consumer Protection in Malaysian Islamic Home Financing Facilities from the Shariah Perspective: With Special Reference to Abandoned Housing Projects.
Shariah non-compliant (SNC) events in selected Malaysian Islamic banking institutions are examined in this study. Shariah compliance is the core of Islamic finance and is the most significant feature for any Islamic financial institutions. It is the very objective of Islamic financial institutions in all their operations, products and affairs. With the enforcement of Islamic Financial Services Act 2013 (IFSA), penalties and consequences of not following Shariah compliance can be severe. Notwithstanding all the efforts that have been taken to strengthen the Shariah compliance framework and mitigate the occurrence of Shariah non-compliance at the Malaysian Islamic banking institutions, incidences of Shariah non-compliance do still emerge and materialize. This study is an effort to examine the subject of Shariah non-compliant (SNC) events in selected Malaysian Islamic banking institutions.
The researcher attempts to explore the nature and framework of SNC events in the Malaysian Islamic banking industry by giving emphasis on the four main aspects of SNC events i.e. (i) detection, (ii) rectification, (ii) implication and (iv) cause. This research is a qualitative study in nature. Data was collected using in-depth interviews and focus group discussion. The selected interviewees and participants are individuals who are involved directly with the day-to-day Shariah non-compliance management at the Malaysian Islamic banking institutions.

The first chapter dealt with the introduction to this study, covering the objectives, problem statements, research questions, motivation and significance of the study. Then, the second chapter elaborated on the main SNC elements from Islamic legal perspective as well as the development of Malaysian Islamic banking system based on the principles of Shariah compliance. The third chapter reviewed previous literature related to Shariah non-compliance in Islamic banking and finance.
The fourth chapter described the methodology adopted to realise the objectives of this study namely interview, focus group, triangulation and content analysis. The fifth chapter discussed the results of the interviews and focus group discussion. Then, the sixth chapter presented the main findings of this research based on its four objectives. Both chapters five and six constitute the findings of this research. The final chapter concluded the study with several implications and recommendations.

This study found that SNC event could be detected by both internal and external parties of the Islamic banks. However, the non-existence of ESA (External Shariah Audit) within the detection mechanism for SNC event forms a credible threat. This study concluded that a comprehensive rectification framework of SNC events involves (i) regulatory reporting, (ii) Shariah deliberation and decision, (iii) corrective action, (iv) preventive and control measures as well as (v) punitive action.

The implications of SNC event could be viewed from two main perspectives: (i) form of the implication and (ii) level of the implication. A critical SNC event causes negative financial implication, invalidity of primary underlying Shariah contract, regulatory penalty or bad reputation.
In terms of cause, this study found that SNC event is a contract-oriented event from the Islamic legal perspective and a human-oriented event based on the operational view. This means that SNC events are mostly caused by human factors and usually related to the corruption and invalidity of the Shariah contracts. The scope and interpretation of Shariah compliance and Shariah non-compliance held by any Islamic banking institution influence their practice in SNC event management. Lastly, this study recommended the improvement of SNC event detection through Shariah compliance culture, the automation of Shariah contracts execution and provision of SNC event interpretation and management guideline by regulators especially BNM (Bank Negara Malaysia).

The researcher proposes the establishment of a specialised National Muamalat Court for assurance of end-to-end Shariah compliance, in line with the spirit of IFSA 2013 and the five recommendations made by the Law Harmonisation Committee. Furthermore, the authors support the suggestion made by Hasshan, Zahid, and Ruzianmarkom (2017) for the establishment of an International Muamalat Court which could be in the similar fashion with the Singapore International Commercial Court (SICC) for the conventional disputes.

According to Buang (2018), specialisation usually becomes necessary at the high court level. In 2007, the government established the special Intellectual Property Court in 2007 in response to complaints from the international community. The specialised court was set up to reduce the backlog of IP cases in the courts. Later in February 2011, 18 special courts for corruption cases were established. These courts, named Corruption Sessions Courts and Corruption High Courts, were necessary to speed up the hearing of corruption cases. In 2016, the Malaysian government once again established Cyber Court to deal with offences such as online gambling, spying, bank fraud, defamation, document falsification and pornography (Buang, 2018).

Therefore, the establishment of specialised courts for Muamalat cases at the national and international level would be significant landmarks in the Malaysian Islamic banking and finance industry. Such moves could also furthermore position Malaysia as the frontier of Islamic banking and finance practices. Specialised courts are not peculiar to the Malaysian legal system.

This article is part of the author’s PhD Thesis (2019).
RISK-SHARING INVESTMENT ACCOUNT:

A Proposed Model for Islamic Banks in Malaysia
One of the objectives of the implementation of the Islamic Financial Services Act 2013 (IFSA) is to promote greater risk-sharing in the Islamic financial industry. Accordingly, IFSA has distinguished the two major sources of funding for an Islamic banking institution, i.e. deposits and investment accounts. However, more than five years into the implementation, the Act is deemed to have failed in terms of upholding its risk-sharing values, where change could only be observed in the statutory position of investment account. The way IAs are currently operationalised points to a model that retain most of risk-transfer characteristics.

At the same time, the practitioners’ concerns cannot be ignored. Operationalising a risk-sharing investment fund necessitates an Islamic bank to manage various risks. It includes maturity mismatch, liquidity, competitiveness of the returns and equity investment risk. Hence, our first motivation is to identify and comprehend the risks that the Islamic banks are exposed to in operating a risk-sharing IA. This would make the IA model more robust, thus sustainable in the long-term. We also believe this will enhance the buy-in especially among the Islamic banks which are yet to launch an IA. For those banks that have already launched one, they may consider realigning between their IA products and the proposed model.

Shariah risk is a serious matter for Islamic banks (Archer & Haron, 2007). It affects confidence in the Islamic financial system and the credibility of the Islamic banks. It could lead to reputational damage that is irreversible (M. Abdullah, Shahimi, & Ismail, 2011). This warrants a need to address the prevailing inconsistencies in the implementation of risk-sharing IAs. Accordingly, our second motivation is to review and rectify the structural flaws in the product features of an IA which refrain it from being operationalised as an actual investment.

Experience has shown that a risk-transfer financial system passes on the risks to customers, governments and public at large (Kuala Lumpur Declaration, 2012).1

---

Thus, risk-sharing is a salient characteristic of not only equity but all Islamic financial contracts

The many financial crises from the past serve as grave reminders on the harms of debt (Reinhart & Rogoff, 2009) and interest-based finance (Ashfaq, 2016). One recommendation is for risk-sharing to be made the operating modality of Islamic banks. In Islam, prohibition of interest means liability is inseparable from the right to profit. Thus, risk-sharing is a salient characteristic of not only equity but all Islamic financial contracts. So, our third motivation is to identify an operating model that allows an IA being operationalised as an investment in Malaysia.

Besides, IFSA is intended to provide an enabling environment for the Islamic banks to pursue their role as investment intermediaries. According to BNM, the aspiration is to transcend Islamic banking beyond financial intermediation, to include real economic sector participation.

In short, this dissertation aims to motivate Islamic banks to move away from continuing risk-transfer practices, by proposing a risk-sharing investment account model (including its operationalisation) for the consideration of the Islamic banking industry in Malaysia. The proposed model in principle is a means to transition the industry towards a true risk-sharing banking model.

In addition to contributing towards a resolution to address an actual industry-wide problem, the desire is also to assist the transition of the industry towards a true risk-sharing banking model.

2 Exclusive interview with Datuk Nor Shamsiah Mohd Yunus, Former Deputy Governor, BNM, who was instrumental in the development of the IFSA to maintain soundness of Malaysia’s Islamic finance marketplace, Malaysia Islamic Finance Marketplace Gains Clarity and Certainty Through IFSA, 2013.
The uniqueness of the proposal relates to structuring and operationalising a risk-sharing investment account in a manner that addresses the inherent maturity mismatches and liquidity risk. In acknowledging that retaining investors longer than they intend to would make an investment account lose its competitiveness and relevance, we propose for the listing of the investment account fund in the secondary market. In our view, the proposed model is the least disruptive risk-sharing investment account model that has so far been proposed for consideration.

The Proposed Model, if adopted for implementation, would ultimately reshape the Islamic banking landscape. The eventuality is, as we envisage, an end-to-end risk-sharing Islamic banks, where not only their IA is risk-sharing but also their financing and deposit products. For this, there must be clear regulation with an appropriate incentive structure to initiate the required change. Regulatory lead on this is a pre-requisite. Supervisory oversight is also essential to instil a check on the governance aspects. This is critical to gain market confidence and to ensure long-term sustainability of the model.

This article is part of the author’s PhD Thesis (2019).
JAN • JUNE • SEPT 2020 INTAKES

Masters in Islamic Finance Practice (MIFP)
R/343/7/0045

Executive Masters in Islamic Finance (eMIF)
R/343/7/0112

Professional Certificate in Islamic Finance (PCIF)
N/KIP/00202

Master of Science in Islamic Finance (MSC)
R/343/7/0071

Doctor of Philosophy in Islamic Finance (PhD)
R/343/7/0055
R/343/8/0056

Scholarships/Bursaries available for qualified students.

INCEIF

INCEIF is a private university specialising in Islamic finance, established by Bank Negara Malaysia in 2005, to develop professionals and specialists in Islamic finance to chart the future of the global Islamic financial industry. Over time, INCEIF has grown to be recognised as a key industry reference point. Our faculty members are global leaders in their respective fields. Their main objective is to provide an outstanding educational experience for all our students. In addition to that, they oversee the quality and integrity of our academic programmes to ensure that students are provided with the knowledge and scholarly practices of the highest standard within the academic arena as well as the financial industry.

Apply now at www.inceif.org

International Centre for Education in Islamic Finance (INCEIF) (Company No:718735-K)
LorongUniversiti A, 59100 Kuala Lumpur, Malaysia.
University Registration Certificate No.: DU618 (W)

+603 7651 4000  marketing@inceif.org  www.inceif.org
Twitter@INCEIF  Facebook@INCEIF  LinkedIn@INCEIF  Youtube@INCEIF2011  Instagram@INCEIF MY
Bursaries up to RM10,000*

INCEIF is offering qualified students with bursaries amounting to RM10,000* for the Jan 2020 intake.

**Masters in Islamic Finance Practice**  
R/343/7/0045

**Executive Masters In Islamic Finance**  
R/343/7/0112

**Master of Science in Islamic Finance**  
R2/343/7/0071

**Doctor of Philosophy in Islamic Finance**  
R2/343/8/0055  
R2/343/8/0056

<table>
<thead>
<tr>
<th>Fee Schedule</th>
<th>Malaysian</th>
<th>International</th>
</tr>
</thead>
<tbody>
<tr>
<td>Masters in Islamic Finance Practice</td>
<td>RM 26,600</td>
<td>RM 30,800</td>
</tr>
<tr>
<td>Executive Masters In Islamic Finance</td>
<td>RM 28,010</td>
<td>USD 10,420</td>
</tr>
<tr>
<td>Master of Science in Islamic Finance</td>
<td>RM 27,300</td>
<td>RM 33,600</td>
</tr>
<tr>
<td>Doctor of Philosophy in Islamic Finance</td>
<td>RM 52,000</td>
<td>RM 64,000</td>
</tr>
</tbody>
</table>

* First come first served basis.  
* Terms and conditions apply.

Apply now at [www.inceif.org](http://www.inceif.org)