

Legitimizing *Ar-Rahnu* Through *Tawarruq*: What Practitioners Have to Say

Nor Fadilah Bahari

Faculty of Management and Muamalah, Kolej Universiti Islam Antarabangsa Selangor (KUIS)
Selangor, Malaysia
E-mail: norfadilah@kuis.edu.my

Zurina Shafii*

E-mail: zurina.shafii@usim.edu.my

Mustafa Mohd Hanefah*

E-mail: mustafa@usim.edu.my

*Faculty of Economics and Muamalat, Universiti Sains Islam Malaysia (USIM)
Negeri Sembilan, Malaysia

Abstract

Effective February 2020, all Ar-Rahnu providers were required to streamline their existing products to the new ar-rahn structure based on the Islamic contract bay al tawarruq and rahn. The action was taken in response to the decision made by the Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM) where they claim that the practise of ar-rahn violates the shariah rules as outlined in the Rahn Policy (BNM, 2019). Nevertheless, the BNM enforcement was effective only for IBs or any institutions governed by the central bank and was not applicable to Ar-Rahnu cooperatives. Recent studies indicate that few studies have addressed the implementation of the new ar-rahn structure, and almost no inductive research has been conducted to seek feedback from Ar-Rahnu cooperatives' practioners related to the current changes in the ar-rahn scheme. This paper attempts to obtain views from cooperative members on this particular issue. Furthermore, this study compares the practise of the former ar-rahn scheme with the new alternative ar-rahn. A case study design was employed, and data was obtained through interviews and document review. Emergent findings from the interviews reveal that the majority of

Ar-Rahnu cooperatives have adapted to the new ar-rahn scheme. However, Ar-Rahnu cooperatives faced several challenges in realising this new structure. Support from the regulator and management of the cooperatives could expedite the implementation of the new ar-rahn structure, thus enhancing the adherence to shariah. This study contributes to the body of knowledge in Ar-Rahnu and has significant implications for policymakers, customers, and cooperatives.

Keywords: *Ar-Rahnu; Tawarruq; Ar-rahn; Cooperatives*

Introduction

Background of the Study

Ar-Rahnu or Islamic pawn broking was established since 30 years ago in the country. Acting as microfinance institutions, Ar-Rahnu institutions provide financial assistance to their customers, especially those who need immediate funds without hassle. Previous studies by Rafidah Mohd Azli, Mohd Rizal Palil & Shifa Mohd Nor (2016) state that Ar-Rahnu customers are satisfied with the financing services provided which meet *dharuriyyat* (basic

needs), *hajjiyat* (intermediary needs), *tahsiniyat* (accomplishment). Findings from Nik Azman & Hj. Kassim, (2018) also prove that Ar-Rahnu provides significant impacts towards financial self-sufficiency for women micro-entrepreneurs in three states, namely Kelantan, Terengganu and Kedah.

Contribution of Ar-Rahnu to the public was continued during the Pandemic Covid-19 crisis. Many local newspapers such as Berita Harian in its news on Mei 5, 2020 reported that the community began to visit Ar-Rahnu and conventional pawnshops during the pandemic for various purposes such as pawning jewellery to get instant cash and extend mortgage periods. Studies by Md Noor et.al, (2020) has proven the contribution of Ar-Rahnu during the pandemic covid-19. At the initial age of the Islamic pawn broking system, Ar-Rahnu was pioneered by cooperatives. Then the numbers of Ar-Rahnu kept growing and currently it is served by various banking and non-banking institutions including several licensed Islamic banks such as Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad (BMMB), and AGRO Bank and institutions under NBFIs

categories such as bank cooperatives and credit cooperatives. In the year 2020, BIMB recorded RM 5481 000 revenue from *ar-rahnu* scheme from its 9 outlets. Meanwhile, BMMB through its 69 branches nationwide generated revenues from *ar-rahnu* scheme of about RM 25.6 billion which represents 3% of the bank's total assets. Agro Bank in its annual report disclosed RM 1,008,978 total *ar-rahnu* financing in year 2020.

For the cooperatives sector, Malaysia Co-operative Societies Commission (MCSC) reported the turnover of the cooperative sector to be RM41.45 billion, comprising 14,629 cooperatives with the strength of 6.51 million people, a shared capital of RM15.81 billion and assets worth RM150.49 billion. The financial services sector was the largest contributor to the overall turnover of the cooperatives movement at 83.16%. Bank Rakyat has captured 60% of the market in the Ar-Rahnu segment with a total of 185 Ar-Rahnu branches and 76 Ar-Rahnu X'Change nationwide. Table 1 demonstrates the Ar-Rahnu Cooperatives performance for five years between 2016 and 2020.

Table 1: Ar-Rahnu Cooperatives Performance

Year	2020	2019	2018	2017	2016
			(RM Billion)		
Ar-Rahnu Income	5 billion	5.69 billion	5.02 billion	3.4billion	4.0 billion
Total Turnover from Co-operative financial sectors	37.88 billion	38.09 billion	35.12billion	3.4070	3.3820
Ar-Rahnu Cooperatives(including Rakyat X-change)	76	76	97	88	88

(Source: SKM, Laporan Ekonomi Sektor Koperasi 2020)

Based on Table 1, RM5 billion in income was generated from the Ar-Rahnu Cooperatives in the year 2020 which was slightly lower compared to 2019 which recorded 5.69 billion. The declining income in the year 2020 was due to the Pandemic Covid-19 Crisis. At the first phase of the

crisis, Malaysia's government has enforced Movement Control Order (MCO) which caused all sectors to close their operation. However, demand and revenues generated from Ar-Rahnu business started to increase in the second phase of the crisis when the Malaysian government allowed key sectors

including Ar-Rahnu sectors to start their operation with high standard operation procedures (SOP) during the crisis. Until now, the business of Ar-Rahnu received fabulous support from the public and has a great potential for socio-economic developments, thus contributing to social obligation.

Along its growth, it is undeniable that several issues arose and were debatable among the scholars. One of the main issues was obedience to shariah rules in the current *ar-rahn* scheme. For Islamic financial sectors, business objectives not only focus on the material aspects but also the obligation to comply with shariah is required. Previous studies Naim, (2004); Mohamad, Salleh, Shamsiah Mohamad, & Safinar Salleh, (2008) and Fairouz & Khir, (2012) triggered several shariah issues involved in the practice of *ar-rahn* scheme related to shariah contracts applied, calculation method of safe keeping fees and the operation of *ar-rahn* that influence to shariah risks. Profit generated in safekeeping fee was considered invalid and found the element of *riba* embedded in the *ar-rahn* scheme.

Hence, several studies suggest improvement and new alternative structures in the *ar-rahn* scheme (Abdul Khir, Bahroddin Badri, & Hussain, 2013); (Sharif, Shaharuddin, Muhamed, Pauzi, & Mohd, 2013). The climax of this issue was when a new ruling on *ar-rahn* scheme was made by the Shariah Advisory Council (SAC) of Bank Negara Malaysia in its meeting on 29 October 2019 and 26 November 2019. They mentioned that the existing *ar-rahn* product in compliance to the *Rahn* policy document, and effective in February 2020 all Ar-Rahnu operators under purview of BNM require streamlining the existing structure. Pursuant to that, BNM provided ruling on *ar-rahn* product based on *tawarruq* and *rahn*.

The enforcement indirectly influenced Malaysia Co-Operative Societies

Commission (MCSC) to take similar action to the cooperatives sectors that were involved in the business of Ar-Rahnu. Several Ar-Rahnu Cooperatives changed their former *ar-rahn* to the new structure effective in May 2021. Implementation of this new alternative among the Ar-Rahnu Cooperatives is still in its infancy stage and little studies were conducted. Discussion on the *ar-rahn* scheme is still limited and requires further discussion among the scholars. Recent studies by Saharan, Jamaludin, Adzahar, & Wagiran, (2021) highlight the issues that make the former *ar-rahn* structure to be no longer syariah compliant and explain the reasons of *tawarruq* contract being taken as the best solution.

Meanwhile, studies by Salwa & Hadi, (2021) examine the practice of *ar-rahn* in Ar-Rahnu cooperatives through document reviews and the application of content analysis. However, there is lacking in the research since there is little to no inductive research that strive for responses from experts in Ar-Rahnu cooperatives regarding the application of *tawarruq* in *ar-rahn* scheme as proposed by Bank Negara. Therefore, to fill in this gap, this study aims to pursue to examine how cooperative members respond to the recent changes. Additionally, the differences between the former and new *ar-rahn* structure- *tawarruq* are also discussed.

Significance of the Study

This study is significant and important to the public, especially clients of Ar-Rahnu cooperatives, regulators, and industry players. The findings provide valuable information, particularly to the society, on the main issues arising in Rahnu that influence changes in previous products, comparisons between former and current *ar-rahn* structures, and the response of Ar-Rahnu cooperatives in improving or modifying their *ar-rahn* financing based on the new alternative structure. Besides, the discussion in this study may provide an

opportunity for the regulator to provide assistance or suitable action to solve several challenges faced by the cooperatives. Since BNM revealed that the prior *ar-rahn* scheme was not shariah compliant, streamlining the former *ar-rahn* product is essential. The improvement of the *ar-rahn* product to the new alternative scheme based on *tawarruq* seems to be the best option to solve the shariah compliance issues in the *ar-rahn* scheme. As a result, prompt action may reflect the cooperatives' seriousness in reacting to the current enforcement and managing their business in accordance with shariah. Indirectly, it will boost the public trust, thus enhancing the good reputation of the cooperatives.

Contribution of the Study

This study contributes to the body of knowledge and policy makers. The feedback from the interviewees provides valuable information and contributes to the field study in Ar-Rahnu. The appropriate shariah contract applied in *ar-rahn* financing is vital to ensure the practices are in line with the shariah. The misuse of shariah contracts in Islamic financial products is one of the main factors of shariah compliant risk. Shariah compliant risk contributes to a negative image and will damage the reputation of Ar-Rahnu as one of the Islamic ancient financial institutions. Therefore, it is important for Ar-Rahnu cooperatives to take immediate action to streamline their *ar-rahn* products to the new shariah contract based on *tawarruq* as the best alternative to solve shariah issues in the former *ar-rahn* scheme.

Besides, comparative analysis between the former and new *ar-rahn* structure in this study provides a significant contribution to the public, especially Ar-Rahnu clients. The public is able to understand the reasons the former product was demolished and immediate changes to be implemented. The real perspectives and insights from the key organs of Ar-Rahnu cooperatives help customers to get a clear picture on the

current modification in the *ar-rahn* product and cooperatives action.

Furthermore, the findings of the study are useful for policymakers, especially Malaysian Cooperatives Societies Malaysia (MCSC), as the main regulator for Islamic cooperatives. This study exposes a number of obstacles that the Ar-Rahnu cooperatives have to overcome in order to implement modifications to their *ar-rahn* product. Nevertheless, the study discovered that, Ar-Rahnu cooperatives have begun to streamline their former products and practise *tawarruq* despite some obstacles. To push overall changes in cooperatives, regulators' initiative in providing guidelines and manual standards for new product structures is needed.

Literature Review

In Malaysia's financial system, the term "Ar-Rahnu" has been used to represent the institutions that provide Islamic pawn broking services. It has been used since the first establishment of Islamic pawnbroking; *Muassasah Gadaian Islam Terengganu* (MGIT) in the year 1992. Ar-Rahnu business in the country was pioneered by the cooperatives sectors since its establishment. At the initial stage, most of previous literature highlights the factors influencing demand on Ar-Rahnu by the local community and contribution of Ar-Rahnu to the socioeconomics of the country especially to the Muslim community.

Studies by Azila, (2011) indicate that the establishment of Islamic pawn broking businesses, or Ar-Rahnu, was influenced by the demand from the Muslim community as an Islamic financing alternative and to prevent them from obtaining financing from conventional pawnshops. Prohibited elements such as high interest charges (*riba* elements) and *gharar* in the operation of conventional pawnshops were among the factors that made the Muslim customers demand the establishment of Ar-Rahnu. This is consistent with the findings of

(Hanudin, Rosita, Hazmi, & Rostinah, 2007) and Abdul Hamid et.al (2016) who discovered that shariah compliance was the primary factor motivating Muslim customers to pawn their jewellery or assets with Ar-Rahnu.

Furthermore, the contribution of Ar-Rahnu to social benefits is revealed by (Mansor et al., 2014);(Azizah, Hashim, & Syahrina, 2012);(Busari & Aminu, 2017). They claim that Ar-Rahnu acts as an important institution that provides financial assistance, especially to the lower and middle classes, during their critical times. Furthermore, Zainal Azim, Mohamed, et.al, (2016) discovered that the majority of customers use the *ar-rahnu* scheme for personal consumption rather than investment. Ar-Rahnu's special characteristics of providing pawning services based on the shariah concept, low service charge, and quality services have proven the potential growth of Ar-Rahnu and remain competitive with its conventional counterparts and other microcredit providers(Abdul Razak, Muhammad, Mohd Hussin, & Mahjom, 2014).

Nevertheless, the development of Islamic finance in Malaysia to some extent influences changes in Ar-Rahnu business practices in the market. As one of the Islamic finance sectors, the obligation to comply with shariah matters is mandatory. Previous literatures provide extensive discussion of shariah issues and suggestions for improving the *ar-rahnu* scheme. Studies by Naim, (2004) provide extensive discussion on the practice of safe-keeping fees and claim that the elements of *riba* occur in the *ar-rahnu* product. The issue of linking the *ujrah* fee to the value of the pledge has led to actual *riba*. Studies by Nik Azman, Kassim, & Azman, (2017) conduct comparative studies on pricing practices among the Ar-Rahnu operators and the results indicate that there is not much difference in the pricing practices of the Ar-Rahnu providers.

Meanwhile studies by (Abdul Khir et al., 2013);(Sharif et al., 2013); (Hussain & Ali, 2017) ; (Khairul A.A. et.al, 2019) and (Abdul Khir et al.) highlight shariah issues in the current *ar-rahnu* scheme which involve the issues of the combination of shariah contract, custodial fee, and the excessive charges imposed by the operators, and other related issues including benefiting from the *marhun* by the Ar-Rahnu operators. Several new *ar-rahnu* structures are suggested to minimise shariah and economic issues in Ar-Rahnu. The climax of the issue occurs when SAC, BNM conclude that the former structure is not compliant with shariah and enforcement to apply the new structure was made effective in February 2020.

Recent studies by Saharan, et al (2021) also discuss the conflict in the former *ar-rahnu* structure and provide an explanation of the practise of *tawarruq* in *ar-rahnu* financing. Meanwhile, Salwa & Hadi, (2021) investigate the pre and post implementation of alternative *ar-rahnu* products in Ar-Rahnu cooperatives using content analysis approaches. Nevertheless, a gap is found in recent studies. The acceptance of the new *ar-rahnu* structure based on *tawarruq* from the perspective of cooperative members is not yet explored. Thus, this study extends the work of Salwa & Hadi, (2021) by investigating the perspectives of Ar-Rahnu cooperative members on the implementation of *tawarruq* in the *ar-rahnu* scheme. In addition, the comparison features between the former and the new structure of the *ar-rahnu* scheme are explained. To achieve the objectives of the study, the discussion further explains the methodology of the study.

Methodology

The qualitative research design is chosen as the best approach to enhance understanding of the specific issues and achieve the objectives of the study. The aim of the study was to get real information from the informants, and the case study was found to

be the best approach to fulfil the objectives of the study. A purposive sampling technique was applied to determine the sample for the study. Practically, *ar-rahnu* products are served by different categories of institutions, including Islamic banking institutions and non-banking financial institutions (NBFIs). A sample of the studies was selected among the Ar-Rahnu cooperatives.

To obtain robust results, data triangulation methods were used, and data collections comprised primary and secondary data. Primary data was obtained through interviews with management organs in cooperatives and secondary data obtained

from literatures and related reports from cooperatives and regulatory bodies. The interviews were conducted with the main governance organs in cooperatives involving the Board of Directors (BOD), Shariah committee (SCs) members or shariah officers, and management (Branch managers). Their views are crucial to fulfil the objectives of the study. The information of the interviewees is mentioned in table 3.1. In addition, sources of secondary data such as documents, annual reports, guidelines, policies, and other relevant sources such as formal institutions' websites were gathered. For the data analysis, content analysis and thematic analysis were used as the best approaches.

Table 2: Respondents' Information.

Respondents	Gender	Position
R1	Male	Shariah Committee/ Board Member
R2	Male	Head of Ar-Rahnu Division/ Board member
R3	Male	Head of Shariah / Shariah secretariat
R4	Male	General Manager of Ar-Rahnu
R5	Male	General Manager of Ar-Rahnu
R6	Female	Branch Manager
R7	Male	Head of Shariah / Shariah secretariat

(Source: Author)

Analysis of Finding

Comparative Analysis on the Former *Ar-Rahnu* Product Structure Versus New *Ar-Rahnu* Product Based on *Tawarruq* and *Rahn*.

The implementation of new shariah structure based on *bay al tawarruq* in *ar-rahnu* scheme acts as alternatives to solve the shariah issues arising. Nevertheless, the Shariah Advisory Council (SAC) of Bank Negara Malaysia ruled that *ar-rahnu* structure products based on *tawarruq* and *rahn* are lawful under the following conditions:

- i. For *ar-rahnu* product involving the purchase of commodity in bulk at the beginning of the business day, the *fiqh* adaptation (*takyif fiqhi*) must be clear in relation to the

- cancellation of the commodity purchased from the commodity trading platform provider at the end of the business day;
- ii. In the event of default, the customer's consent shall be obtained prior to the liquidation of the collateral;
- iii. The terms and conditions of the *ar-rahnu* product shall clearly specify the following treatment in cases where a default by the customer leads to the liquidation of the underlying collateral:
 - where the proceeds from the liquidation of the underlying collateral exceed the liability of the customer, the excess amount shall be returned to the customer; and
 - where the proceeds from the liquidation of the collateral

are insufficient to meet the liability of the customer, the Islamic financial institution (IFI) has the right to claim the balance from the customer;

- iv. The customer shall be notified of the description and features of the transacted commodity, including its location, type, quality, and quantity, as well as the calculating methodology; and
- v. It is necessary to adhere to the conditions outlined in Bank Negara

Malaysia's (the Bank) policy documents on *tawarruq* and *rahn*.

The implementation of the new *ar-rahn* scheme based on *tawarruq* is still at its infancy stage. Since its enforcement, several distinctions are found between former *ar-rahn* scheme with the current new structure of *ar-rahn*. Table 1 summarises the comparative analysis between the former and the new *ar-rahn* scheme based on *tawarruq*.

Table 3: Comparative Analysis Between Former and New *Ar-Rahn* Schemes.

Elements	Traditional <i>ar-rahn</i> product structure	New Product structure – <i>tawarruq</i>
Shariah contract	Based on four different shariah contract : i) <i>Qard</i> , ii) <i>wadiah yad dhamanah</i> iii) <i>rahn</i> iv) <i>ujrah</i> .	<i>tawarruq</i> and <i>rahn</i>
Contracting parties	Involve only two parties in the contract (pledgor and pledgee)	Involve more than two parties in the contracts.
Purchase commodity	Not required to sell and buy the commodity in financial markets	Involved selling and buying commodities in the financial market
Financial treatment	Fee-based income	Financing income
Redemption period	No maximum period	Maximum 18 months
Calculation of Safe keeping fees	Safe keeping charge based on the value of <i>marhun</i>	Profit rate charged based on value of financing

(Source: Author)

According to the comparative Table 3, the six identified elements are distinct from the preceding *ar-rahn* process including shariah contract applied, contracting parties, purchase commodity, financial treatment, redemption period and calculation of safe keeping fees. However, there were no substantial differences between the previous *ar-rahn* scheme and the current *ar-rahn* structure in terms of pledged asset types and the auctioning procedure.

In normal procedures, to obtain the *ar-rahn* scheme, clients are required to attend the Ar-Rahnu outlets and bring along a pledged asset or *marhun* and an identification card. All the Ar-Rahnu providers conduct similar approaches, and none of them offer *ar-rahn* schemes based on online systems. All the processes starting from obtaining financing and pledging assets are still conducted manually and must follow the procedures.

However, in terms of payment methods, several cooperatives began to offer online payment services in order to make it easier for their customers to pay their debts.

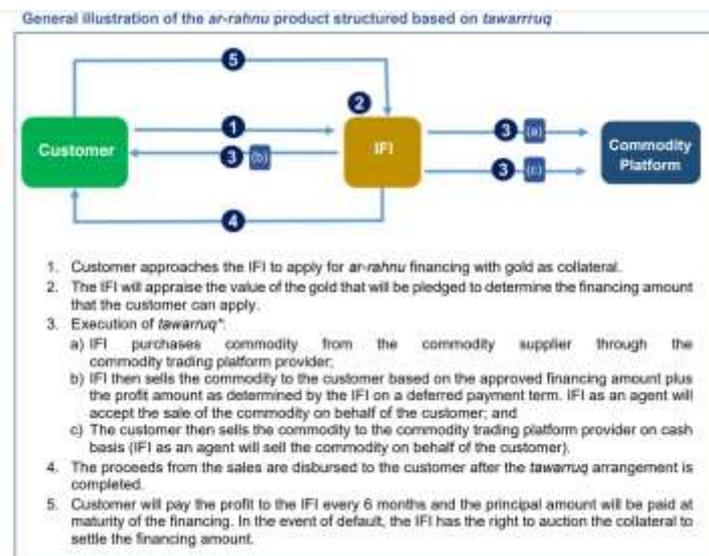
The maximum amount of financing varies among the cooperatives. Typically, the financing margin is set at 60 to 80 percent of the value of the pledged asset. Based on the practice of the previous scheme, the process and procedures to pledge and obtain financing were quite simple and easy. There are only two parties involved, and no trading assets are required. Customers have just pledged their assets to the creditor, and pledged items will be tested using the gold testing tools such as acid test, densimeter and XRF.

Four shariah contracts are involved:

- i. *Qard* – shariah contract used when the creditor grants financing to the borrower.
- ii. *Rahn* – the shariah contract is applied when the borrower pawns their valuable asset/ jewellery.
- iii. *Wadiah yad dhamanah* – contract applied when the valuable asset/ jewellery is under the creditor's custody and the creditor guarantees the safety of the pledged items.
- iv. *ujrah* – fee for a services render.

Once all the gold or jewellery has been appraised and authenticated, the creditors will directly credit the money or loan to the

customer's account. Safe keeping fees will be calculated based on the value of the *marhun* and paid by the customer either in a lump sum, or on a monthly or daily basis. Under the *tawarruq* arrangement, commodity trading will be done before credit is granted to the customers. The process of selling and buying commodities on the *tawarruq* platform is compulsory before the disbursement of funds to the customers. Trading assets on the *tawarruq* platform may involve more than two contract parties. The modus operandi of the *tawarruq* contract in the *ar-rahn* scheme is illustrated as follows:



Source: Bank Negara Malaysia

Figure 1: The Flow of *Ar-Rahn* Financing Based on *Tawarruq*

Based on the above illustration, after the *tawarruq* arrangement is finalised, the proceeds from the sale will be disbursed to the customer's account. The profit computation is charged based on the amount of financing, which contradicts from the previous structure. In the previous scheme, the *ujrah* charge was calculated depending on the value of the collateral or *marhun*. Any return received from the business of *ar-rahn* is treated as financing income in the financial report, in contrast to the previous scheme, which classifies profit or any fees from *ar-rahn* as fee-based income. Once the *aqad* and contract are

settled, the *Ar-Rahn* providers will hold *marhun* as collateral and return it at the maturity date.

In the new *ar-rahn* structure, the maximum period of financing is up to 18 months. After the 6-month maturity period, if the customer intends to continue the contract, customers may appeal for an extension up to 18 months. The process will be begun again as an initial process. The *marhun* will be revalued according to the current gold rate and a new amount of financing will be calculated. In contrast with the previous *ar-rahn* scheme, customers can continue the

contract for several months or years without the requirement to revalue the *marhun* and customers only have to pay the *ujrah* fee if they intend to renew the financing. This finding is based on the following quotes:

[..] Yes it is quite different. Prior to this, for instance, the funds would be credited straight into the customer's account. However, in a *tawarruq* contract, the transaction must be completed on the *tawarruq* platform before funds are credited to the customer's account.[..](R5)

[..]For the former practice, customers were permitted to extend their contracts for several months or years, depending on their needs. But in the current *ar-rahn* scheme, the maximum period is 18 months, and if the customers intend to continue the financing, the proses will start as the initial procedure. The pledged asset will be revalued. [..](R6)

In the event of default, an auction process will take place. However, neither the previous nor current *ar-rahn* auction structures have changed. The first notice will be issued one week prior to the expiration date as a reminder and second notice will be sent one week after the expiration date. Notification of the auction will be provided in a variety of ways, including by mailing an auction letter to the client's address, by telephone, and via email. At the maturity period, customers are required to repay the total loan amount together with the service charge. However, if the consumer does not claim the goods following the second and third reminders, Ar-Rahnu will auction them off to licensed auctioneers. The auction will be conducted through public auction and close auction.

The auction will consist of a public auction and a private auction. Proceeds from the auction will be utilised to repay customers' debts, and if there is a surplus, it will be returned to clients by crediting their deposit accounts or be made available for cash collection at Ar-Rahnu locations. However, if the surplus fund is not collected by the customers, it will be transferred to *baythul mal* or transferred to unclaimed money in Bank Negara.

The next section presents practitioner insights on the current implementation of *tawarruq* in the *ar-rahn* system. This study seeks their feedback to establish the extent to which action has been taken and their level of acceptance of the new *ar-rahn* structure.

Insights from Industry Practitioners on the Applications of New Contract in Ar-Rahnu Financing.

This section will address findings from interviews with key governance organs of Ar-Rahnu Cooperatives regarding the implementation of a new alternative to the *ar-rahn* scheme based on *tawarruq*. Different viewpoints were obtained, and the findings indicate that cooperative members were aware of the issue and all consider the implementation of *tawarruq*-based contracts inside the *ar-rahn* system. The following quotations express these viewpoints:

[..] Yes, the *ar-rahn* product is not in line with shariah because the lender and asset custodian are similar parties. This obviously contradicts shariah[...](R1).

“We started to use *tawarruq* in our *ar-rahn* product [..](R2, R3,R5)

[..] this issue has been the subject of scholarly controversy since its

formation. We are aware that rahn is a supporting contract and cannot serve as the primary contract. [...] (R3)

[..] "We have not revised our product yet but will start as soon as possible because we received an order from MCSC to do so...and for your information, we are in the process of submitting a proposal to our JKS on the ar-rahn product structure based on *tawarruq*." [..](R4)

The response shows they were clearly aware of the shariah issue in the former *ar-rahn* product and supported the decision made by the regulator even though there is no clear guideline or guidance on the new product structure proposed by the Malaysian Cooperatives Society Commission (MCSC) at the moment. This is based on the following quotes:

[..] there is still no guideline on *tawarruq* by MCSC. However, we already conduct internal research and bring it to our shariah committee and fatwa council for approval.[..] (R4)

In addition, there was a cooperative that took the initiative to streamline their *ar-rahn* scheme based on the *tawarruq – musawamah* which differs slightly from the industry practice. The implementation was effective before the central bank issued a new ruling on *ar-rahn*. This evidence is based on the following statements by the head of shariah officer in one of the Ar-Rahnu cooperatives;

[..]We started to revise *ar-rahn* products before the central bank made their announcement on the new structure for Ar-Rahnu. In the year 2018, we applied

tawarruq with the contract *bay al musawamah* for *ar-rahn* product, and if compared to the current practise in the industry, our execution is slightly different from others because we considered our staff experience and customers' acceptance [..]. (R3)

Additionally, the discussions held with interviewees revealed several major concerns relating to several issues and challenges encountered by the Ar-Rahnu cooperatives throughout the implementation of the new *ar-rahn* based on *tawarruq*, which are summarised as follows;

First is the high cost involved in streamlining the new product structure. Cost is the main concern for small scale cooperatives. The implementation of the new structure will involve the conversion of several things such as changes in system, administration cost and calculating of services fee. Several factors must be considered. Respondents remarked that:

[..]We need to change everything, including the financing system, safekeeping fee calculation, and we need to get assistance from the vendor to change the whole system according to the new *tawarruq* concept. The cost of restructuring the system is estimated at almost fifty thousand ringgit. This will possibly incur a huge cost and affect profit, especially for the small cooperatives. [..](R4)

[..] Implementation of *tawarruq* structure in *ar-rahn* product incurred cost to the cooperatives especially to the small scale co-operatives. [..](R2)

[..]We are still considering this new structure because most of our customers are among the underprivileged, and they can't afford to bear all the cost. I have been informed that setting up a new structure involves a high cost. So we are still under discussion [..](R1)

In contrast, a comment from one of the head of shariah in cooperatives asserts that cost should not be the primary concern.

[..].if we see the financial performance of the 100 best cooperatives, money is not the issue... because ar-rahnu performs well and receives demand from the public even during a pandemic crisis. Their performance is not much different than before the crisis. So for me, cost is not the issue... Cooperatives are not willing to spend and we don't have the right tools. [..]"(R3)

The second challenge was the level of competency among the cooperative members. Competency is vital to ensure effective governance in a firm. Knowledge and experience are two competency elements that must exist in cooperative members. Practicing *tawarruq* requires knowledge and understanding to execute the contract. Findings reveal that, cooperatives under the banking group received advantages and were easier to restructure *ar-rahnu* based on *tawarruq*. This is because knowledge transfer has occurred. Information and experience in conducting and dealing with *tawarruq* contracts were transferred from banks to their cooperative. They are guided by the experts in the bank, and any issue can be referred to them. Furthermore, their board members are typically bank employees or former bank

employees. Having experienced and being knowledgeable top management members help the cooperatives in making decisions and immediately streamlining the former product. In addition, for any shariah matter, the shariah department may occasionally convey the information if there are any new or important matter related to shariah aspects that need to be known or improved.

[..]For cooperatives under banks, it is easy to get advice from their experts, product guidelines on *tawarruq*, and a ready system. In the bank, there are products that use the *tawarruq* contract. So they are familiar with that and, thus, cooperatives have an advantage in understanding how the process works.[..](R2)

[..]Our board members and SCs are among the prominent scholars and also scholars in central banks. So we have advantages on that. [..] (R3)

On the other hand, for some cooperatives, the main challenges were the lack of expertise, and understanding in implementing *tawarruq* transactions. They found that the practise of *tawarruq* is quite technical and complicated compared to the former scheme. As a result, the members of the cooperative need to participate in training in order to improve their knowledge and skill about products based on *ar-rahnu tawarruq*. This is evidenced in the quotes below:

[..].The implementation of *tawarruq* is highly challenging because it involves technical issue.[..](R4)

[..]. when among the board

have little to no knowledge about the operation, it's hard to be implemented. The board member in cooperatives must be someone who is competent and know about the operation. (R2)

[..] the business of Ar-Rahnu is not too complex, it is just that the human capital then caused the issue not to be managed efficiently. (R3)

“We have been implementing this *ujrah*-based Ar-Rahnu system for 25 years, so the implementation of this new concept initially experienced difficulties in the aspects of knowledge...so training needs to be added from time to time”.(R7)

In several cases, the senior management of cooperatives lacks of knowledge and experience in operation, thus leaving it to the management. In short, it encourages cooperatives to acquire franchise services as the quickest and most convenient option. Through franchise services, franchisees have a right to duplicate the franchisor's services, to use branding, or a trademark owned by the franchisor to market and promotes the products. Consequently, franchisees are required to pay certain fees set by franchisors. The findings from the interviews reveal pro and cons cooperatives attached with the franchisor. Positively, they assist franchisees in establishing their businesses without requiring them to provide any facilities. In contrast, if a franchisee is unable to generate a profit from the business, the cooperative would incur expenses and suffer significant losses. According to the assertion of one interviewee:

The fastest way is by subscribing franchise services. But the long effect was, they need to pay back a certain amount to the franchisor. This will incur cost to the cooperatives especially small capital cooperatives.[..](R2)

Several suggestions were made by the interviewees for further improvement in the Ar-Rahnu cooperatives. One of the suggestions was that a proactive role played by the cooperative's regulator. They suggest that the regulator of cooperatives, MCSC, should play a proactive role in providing acts and guidelines that suit the current competitive environment. For instance, MCSC should provide clear guidelines on the *tawarruq* structure in the *ar-rahn* scheme, similar to what BNM had done, so that the cooperatives have a clearer understanding of how to execute it. Cooperatives may take immediate action if they have proper guidance from the regulator. This action can assist Ar-Rahnu cooperatives, especially small-scale cooperatives, in accelerating the transition from former *ar-rahn* structures which is no longer shariah compliant to the new shariah compliant Ar-Rahnu. In addition, they assert that the current acts and regulations are out of date and do not adequately reflect the actual situation. The quote is as follows:

[..]Ar Rahnu's regulation is still lame. We already pointed out this matter and gave our feedbacks to SKM. The guideline and the standard are no longer suitable and suit with current competitive environment [..](R2)(R3)(R5)

Other options include enhancing the structure of shariah governance in cooperatives and at the level of regulation. They focus on the importance of Shariah Committees (SCs) at SKM so that internal

Shariah Committees may report any shariah-related matters to SKM Shariah Committees. Currently, all shariah-related issues will be resolved by SCs in ANGKASA. With the large number of cooperatives under one SC, it must be challenging to monitor the shariah issues in cooperatives entirely. Furthermore, interviewees affirm the significance of having a shariah control function in cooperatives and enhancing internal shariah expertise. They commented;

[..]“ we need to enhance our governance structure. We can't operate without shariah review function' [..] (R2)

[..]For me, having a shariah control mechanism is necessary, especially since we have implemented the *tawarruq* contract. But the issue here, it is not supposed to employ shariah officers. I mean that our internal staff, such as branch managers, must have shariah experience or expertise. It must be administered in an Islamic manner not only as a label.

[..]

Based on the above comments and suggestions, it is found that, they are aware of the current issue in *ar-rahn* and, although they encounter several challenges, they are able to take immediate action to rationalise *tawarruq* in the *ar-rahn* scheme to comply with shariah rules.

Conclusion

The recent ruling on *ar-rahn* by BNM has undoubtedly pushed MCSC to take similar action to restructure their *ar-rahn* scheme for the cooperatives sector. However, no doubt, several cooperatives are still in the process of making it happen. The results from the study indicate that having a good shariah governance structure and

competency among the cooperative members may influence cooperatives to speed up the implementation of new *ar-rahn* scheme and conduct business efficiently. This study has laid the groundwork for several strands of future research. Since this study only involved cooperatives, it cannot generalise the whole practice of Ar-Rahnu institutions. Future research could expand the scope of the study to encompass all Ar-Rahnu suppliers in the country, including private firms and Islamic banking sectors.

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