

## Analysis of Ar-Rahnu Financing Implementation in Cooperative Banking

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### Abstract

*Ar-Rahnu*, also known as Islamic pawn broking, is one of the Shariah-compliant financings implementing the Shariah concepts of *Tawarruq*, *Rahn*, *Wadi'ah*, was founded in Malaysia three decades ago as an alternative to conventional pawn broking. In responding to this matter, Co-opbank Pertama (M) Berhad, one of Malaysia's cooperative banks, has established and offered *Ar-Rahnu* financing since 2018 as one of their products throughout the 29 branches in Malaysia. Thus, this research aims to analyse the implementation of *Ar-Rahnu* financing operations, specifically in the cooperative banking sector. Qualitative analysis through in-depth interviews has been done with two informants who have experience in the *Ar-Rahnu* field and are involved in *Ar-Rahnu*'s daily operations in the cooperative banking sector. The results reveal that the implementation process of *Ar-Rahnu*'s execution in Co-opbank Pertama (M) Berhad is based on the governance laws in Malaysia, and it is one of the cooperative institutions that provides the *Ar-Rahnu* scheme, as one of its products has adapted the Shariah concepts of *tawarruq (murabahah)* and *rahn* in its implementation.

**Keywords:** *Ar-Rahnu* Financing, Cooperative Banking, Governance Laws

### Introduction

The establishment of the pawn shop was started in 1871 to meet the needs of people or households without bank accounts (Bahari et al., 2021). Then, since there have been demands for Islamic financial institutions to be developed, Islamic pawn broking was introduced in the early 1990s to address the low-income earners' needs for the services (Othman & Abdullah, 2019). In January 1992, *Ar-Rahnu* was introduced to society as an alternative to conventional pawn broking. The first *Ar-Rahnu* service provider in Malaysia was introduced by the Majlis Agama Islam dan Adat Melayu Terengganu (MAIDAM) on 23 January 1992, namely Muassasah Gadaian Islam Terengganu (MGIT). Then the growth of this industry was followed by Kelantan state in March 1992. The establishment of Kedai *Ar-Rahnu* Kelantan (KAR), as

Kelantan Capital Berhad's subsidiary, has increased the customers that led to the new branches throughout Malaysia (Rahman & Kassim, 2017).

In Malaysia, four types of regulators supervise *Ar-Rahnu* institutions according to their categories. The first regulator is the Bank Negara Malaysia (BNM), which regulates banking institutions that offer *Ar-Rahnu* under the Islamic Financial Services (IFSA) 2013. The second regulator under the Development Financial Institutions Act (DFIA) 2002 regulated the non-banking institutions that offer *Ar-Rahnu*. The third regulator is the Malaysia Co-operative Societies Commission of Malaysia (MCSC) which regulates the cooperative institutions that offer *Ar-Rahnu*. For example, Cooperative Co-opbank Pertama (M) Berhad and Bank Rakyat. The fourth regulator is the Ministry of Housing and Local Government (KPKT), which regulates the state-linked company and other companies (Shah & Yaacob, 2017).

Banking and finance have pioneered the development of co-operative movement since the 1920s. These co-operatives conduct financial activities such as providing loans to members at reasonable interest rates. Other activities under this function are Islamic mortgage (*Ar-Rahnu*), investment and insurance services. Currently, there are two specific co-operatives which are carrying out banking functions, namely Bank Kerjasama Rakyat Malaysia Berhad and Co-op Bank Persatuan Malaysia Berhad (Malaysia Co-operative Societies Commission). The positive developments in the industry subsequently led to collaboration by Bank Kerjasama Rakyat Malaysia (Bank Rakyat) with Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM) in August 1993 (Osman et al., 2020).

Since the establishment of Skim *Ar-Rahnu* (SAR) through the collaboration of three institutions of BNM, YaPEIM and Bank Rakyat, the demand for this product has kept increasing because *Ar-Rahnu* financing has introduced the preserve the public, particularly the Muslim community, from the interest of transaction (Othman & Abdullah, 2019). In addition, this financing indirectly enhances the socioeconomic structure of Muslims by providing an alternative of cash for the needy to meet their purpose. Thus, most Islamic financial institutions, either banking institutions such as Islamic commercial banks or non-banking financial institutions such as Islamic credit cooperatives, are providing *Ar-Rahnu* as one of their products nowadays (Bahari et al., 2021).

## Literature Review

For the in-depth research on the law (*hukum*) of *Ar-Rahn*, the book of Quranic, hadith and classical text of Islamic jurisprudence specifically should become the priority of references. Based on the surah *al-Baqarah* verse 288 "If you are on a journey and a scribe cannot be found, then a security can be taken. If you trust one another, then 'there is no need for a security, but' the debtor should honour this trust 'by repaying the debt'-and let them fear Allah, their Lord. And do not conceal the testimony, for whoever conceals it, their hearts are indeed sinful. And Allah fully knows what you do." Based on the above verse, Allah SWT has commanded that the *Ar-Rahnu* contract will not be executed if the pledged item is not delivered to the pledgee. In other words, the pledger cannot be forced into the contract; hence explaining the acceptance of the pledged item must be done before it concludes as the *Ar-Rahnu* contract.

Al-Zuhayli refers 'rahn' as the collateral object in securing the payment of a debt. Meanwhile, for the Islamic term, there are few meanings of *Ar-Rahnu* based on the views of classical scholars. Al-Maydani, Ibn 'Abidin and Al-Sarakhsi from the Hanafi sect defined *Ar-Rahnu* as holding an object in lieu of a right which can be redeemed through the object. However, they opined that the collateral object must be valuable without defect (Al-Zuhaili,

2005). Ibnu Qudamah from Hanbali sect interpret *Ar-Rahnu* as the collateral object used can be taken by the creditor if the debtor fails to pay the debt within the agreement period (Al-Zuhaili, 2005). This interpretation was similar to the definition stated by Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI).

In carrying out *Ar-Rahnu* operations, there are five mandatory pillars that must be present to ensure the validity of *Ar-Rahnu* contracts according to Shari'ah. The pillars are: (a) the mortgagor or the person who pledges is the person who owes money.; (b) the recipient of the pledge or the person who holds the pledge, namely the person who gives the loan; (c) pawned goods or pledges (deceased), i.e. valuable goods owned by the pawner and pawned goods to the pawnee. It must be the same valuable item; (d) pledge or amount owed (*marhun bih*); and (e) agreement (*Sighah*) which is an offer (*ijab*) and acceptance (*qabul*) (Hasan & Zain, 2021).

In addition, *Ar-Rahnu* is a contract where a valuable item is used as the collateral for a given debt and the creditor can sell the item to get the debt lent if the debtor does not afford to settle it (Rashid, 2021). In the book of Fathul Qarib 171, al-Iqna' fi hal alfaz Abi Syuja' 297/2 and Hasyiah Qalyubi 352/5, Abi Syuja', Khatib Syarbini and Imam Qalyubi stated; Makes a form of valuable property as collateral for a debt that can be pledged with it if there is difficulty in settling the debt. Apart from that, Islamic pawn broking is a transaction when *Ar-Rahnu* institution gives financing to the customer through the Shariah contract of *qard*, *wadiah*, and *ujrah* (Daud et al., 2020).

Generally, every product with Shariah-compliant status had a Shariah concept developed. According to Hasan and Zain (2021), four Shariah main contracts are used to implement *Ar-Rahnu* in Malaysia. The first contract is *qard al-hasan*, defined as the financing repayment without additional interest as agreed by customers and financial institutions. The second contract is *wadiah*, which it is being interpreted as the financial institution's responsibility toward the pawned item in ensuring safety and good condition. The third contract is *Ar-Rahnu*, which describes the combination of *wadiah* and *qard al-hasan* contracts. Upon the execution of financing, the pawned item automatically becomes a guarantee on the financing amount obtained from the financial institution. The fourth contract is *ujrah*, which refers to financial institution service fees to ensure the pawned item is in a good and safe condition. Nevertheless, the 194th and 195th meetings of the Shariah Advisory Council (SAC) of BNM 2019 had resolved that the *Ar-Rahnu* product structured by the combination of four contracts mentioned above does not fulfill the Shariah requirements in *Ar-Rahnu* policy documents. Thus, the prohibition of *Ar-Rahnu* based on the contract of *qard*, *rahn*, *wadiah* and *ujrah* will be effective on 1 February 2020. Then, according to Bank Negara Malaysia (2020), the 198th and 199th Meeting of the Shariah Advisory Council (SAC) of BNM on 29 October and 26 November 2019 made a ruling that the *tawarruq* and *Ar-Rahnu* based product of the *Ar-Rahnu* structure is permissible due the specific conditions.

According to Sharif et al (2013) in a modern economy, there is no doubt that banks play a major role in generating economic and financial growth. The individuals, the communities and the organizations are reliant on banks for their financial resources and necessities fulfilment. Their dependence on the banks has led them to engage in a variety of contracts, especially debt-based contracts. This contract required them to bond with the banks for a long period. Therefore, the various innovation products are designed to ensure the debtors are able to engage in an Islamic way and the banks are able to attain their income generation at the same time (Sharif et al., 2013). The reason why financing is getting demanded by society, particularly among the micro-entrepreneurs, is due to their businesses' enlargement

and capital rolling necessity (Yahaya, 2021). Besides, the outbreak of Covid-19 in March 2020 has worsened the economic sector in our country, whereby the implementation of the Movement Control Order (MCO) has dramatically impacted the micro-entrepreneurs in their financial resources (Sha'ari et al., 2021). In this regard, *Ar-Rahnu* financing became one of their choices in obtaining cash financing. Suruhanjaya Koperasi Malaysia (2020), the most successful cooperatives in Malaysia are those involved in banking and credit, whereby Co-opbank Pertama and Bank Rakyat are two cooperative banks with prominent banking and listed activities among Malaysia's top 100 cooperatives. The Malaysia Co-operative Societies Commission or known as Suruhanjaya Koperasi Malaysia (SKM), has regulated Garis Panduan Aktiviti Pajak Gadai Islam (Ar-Rahnu) (GP25) as the rules and regulation of *Ar-Rahnu* product implemented by cooperatives in Malaysia (Hadi & Ahmad, 2021).

### **Research Method**

The researcher will employ an interview session as the primary methodology to obtain the findings data based on the research objectives. According to Barrett and Twycross (2018), an interview is the most direct and accessible method of acquiring detailed and comprehensive data on a specific scope of the study. The semi-structured interview enables the informants to respond with open-ended questions, which allows more flexibility in answering the questions (McInstosh & Morse, 2015).

The technique to choose the informants in this research was purposive sampling. Two informants were selected for the interview session. Therefore, the criteria for each informant should be established. The criterion for informant was experience in *Ar-Rahnu* field and involves in *Ar-Rahnu* daily operations. The interviews were conducted to obtain detailed and thorough information of implemented *Ar-Rahnu* in Co-opbank Pertama in terms of its overall Shariah contract adapted and the objective of *Ar-Rahnu* establishment in the company. Moreover, the interview will also clarify the details of the *Ar-Rahnu* product provided by the company, and the financing structure applied. The interviews' findings have helped the study analyse the implementation of *Ar-Rahnu* operations in cooperative banking.

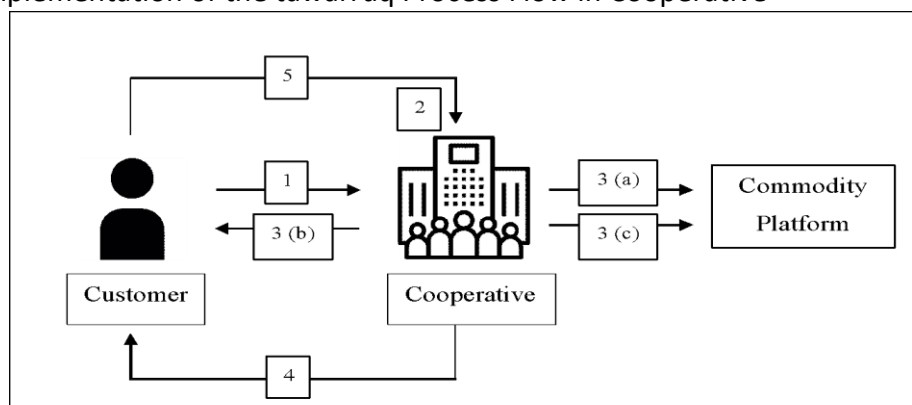
### **Discussion**

Co-opbank Pertama (M) Berhad (CBP) was established in 1950, known as The Province Wellesley Co-operative Banking Union Limited, located at Bukit Mertajam. The initial activities of the early establishment were engagement with agricultural yields, estate land, cooperative activities and stock ventures. Then the development continuously grew until it became an Islamic banking system in 1994 through consultation of Bank Islam Malaysia Berhad (BIMB). Following the vision of "To be the best Shariah-compliant Co-operative Bank in Malaysia", currently CBP has widened its branches throughout Malaysia with five main products offered and developed successfully (Co-opbank Pertama, 2021). *Ar-Rahnu* financing was established in Co-opbank Pertama (M) Berhad in 2018, applying the contract of *qard*, *wadiah*, *rahn* and *ujrah* as the Shariah concept in the execution process. Nevertheless, following the MCSC and the requirement of Shariah resolution from BNM, the *Ar-Rahnu* 2.0 Financing Product was launched on 1 January 2021 based on the concept of *tawarruq* and *rahn* as the Shariah concept.

The core difference between Ar Rahnu Financing Product 2.0 and the previous *Ar-Rahnu* scheme offered at CBP is the Shariah concept applied in practise. The initial scheme of Ar Rahnu was applied *qard*, *wadiah yad dhamanah*, *rahn* and *ujrah* as the Shariah contract in the execution of the product. However, the Shariah resolution of *Ar-Rahnu* products structured

by these contracts does not fulfil the Shariah requirements in the Rahn Policy Document. The safekeeping fee (*ujrah*) imposed was based on the marhun, and the fee will be affected by the volatility of gold prices. In this regard, CBP has introduced the *Ar-Rahnu* Financing Product 2.0 as an initiative based on the Shariah concept of *tawarruq* and *rahn*. In the meantime, the operations of *Ar-Rahnu* 2.0 were still under the supervision of the Shariah Committee of CBP, and every Shariah issue had been resolved. As shown in Figure 1, there are five stages of *tawarruq* process flow implemented in executing the *Ar-Rahnu* product.

Figure 1: Implementation of the *tawarruq* Process Flow in Cooperative



Source: Hadi and Ahmad (2021)

1. The customer will go to the cooperative to apply Ar rahn financing.
2. The cooperative will provide documents that the customer must complete for the approval process;
  - (a) The financing process will be carried out through the *tawarruq* system platform.
  - (b) The customer appoints the cooperative to purchase the commodities through the *tawarruq* platform.
  - (c) The customer also appoints the cooperative to sell the commodities to the third parties through the *tawarruq* platform.
3. After the *tawarruq* transaction is completed, the customer will receive the financing.
4. The customer has to make monthly payments to the cooperative as agreed by both parties in the financing agreement according to the stipulated terms and conditions.

Informants' views regarding the financing product offered at CBP can briefly be defined as stated below

"*Ar-Rahnu* financing is one of the financing products offered at Co-opbank Pertama (CBP). This financing allowed gold/jewellery to be pledged as the guarantee for the financing given based on the types and margin determined by CBP. Among the benefits of this product is Shariah compliance-based, high financing margins offered, free service of washing jewellery and a fixed profit rate based on the financing value." (Informant A)

In this regard, CBP has introduced the *Ar-Rahnu* Financing Product 2.0 as an initiative based on the Shariah concept of *tawarruq* and *rahn*. The operations of *Ar-Rahnu* 2.0 was still under the supervision of the Shariah committee of CBP, and every Shariah issue resolved.

"*Ar-Rahnu* financing product in CBP is fully Shariah-compliant and free from elements of *riba'* and *gharar*. The Shariah concept applied for this financing is *Tawarruq* (*Murabahah*) and *Rahn* contract. *Tawarruq* refers to buying and selling commodity transactions based on



deferred payment with the *Murabahah* concept (cost plus profit). Then, the seller, the agent's buyer, will sell the commodity to the third party on a cash basis. Meanwhile, *rahn* refers to the mechanism of a valuable item (usually gold) is placed as the guarantee for the financing received if someone does not afford to repay the financing received." (Informant A)

The eligibility requirement to apply for *Ar-Rahnu* financing according to information by informant

"The applicant must be a Malaysia citizen or permanent resident with an identification card. The reason why non-Malaysian citizens are not allowed is due to the requirement of applicant thumbprint during the *Ar-Rahnu* procedure and financing approval process. Then, the applicant must be 18 years old and above and does not declare as bankrupt." (Informant B)

*Ar-Rahnu* can be the simple and easy financing to apply for based on the applicant's eligibility mentioned above. It is because the requirement and eligibility do not require to meet specific criteria such as personal financing. For example, personal financing requires the latest three months of payslip to determine the applicant's qualification, either approved or rejected. In contrast, the applicant does not need to provide a payslip to apply for *Ar-Rahnu* financing. Thus, this financing benefits the public, especially those who need immediate money for a particular purpose, such as business capital for the micro seller.

In order to pledge, an item must be valuable because if the pledger could not repay their financing, then the pledged item can be sold by the pledgee to cover the financing given. Thus, the stability of gold price in the market makes it valuable and suitable as a pledged item. In addition, most institutions accepted gold only as the pledged item in their *Ar-Rahnu* financing. In this regard, CBP has accepted a few criteria of gold or jewellery as the pledged item.

"CBP accepts solid and hollow gold jewellery with 999, 950, 916, 875, 835 and 750. Next, the gold coins, wafers and gold pieces are also accepted with a certificate of authentication. No maximum weight can be pledged as long as it does not exceed the maximum daily and accumulated financing limit." (Informant B)

However, there are some cases when the customer or pledger could not redeem the pledged gold for certain reasons. In this regard, there are some procedures for auction by CBP towards the pledged gold, as agreed by the customer in the financing agreement.

"After the first six months, if the customer does not redeem the pledged gold, it is automatically listed in the auction listing. The profit rate, takaful fees, and late payment charges are imposed continuously until it is redeemed. After a year not redeemed, the pledged gold will be auctioned on the 14th month. However, the customer will be informed by a registered notice from CBP 21 days before the auction starts. The customer may redeem the pledged gold within 21 days, along with the fee and charges of late. The sales revenue will cover the customer's financing and fees if the pledged gold is successfully sold. If there is an excessive amount, it will be returned to the customer. However, if the sales revenue is insufficient, then the customer has to pay the balance needed." (Informant B)

Table 1

*Implementation of Ar-Rahnu Financing Product in Co-opbank Pertama (M) Berhad*

Elements	Criteria
Eligibility	<ul style="list-style-type: none"> <li>● Malaysian citizen/ Permanent resident</li> <li>● 18 years old and above</li> <li>● Not declare as bankrupt</li> </ul>
Shariah concept	<ul style="list-style-type: none"> <li>● Tawarruq (murabahah)</li> <li>● Rahn</li> </ul>
Type of gold	<ul style="list-style-type: none"> <li>● Any solid and hollow gold jewellery with a quality of 999, 950, 916, 875, 835 and 750</li> <li>● Gold coins, gold wafers and gold pieces (with a certificate of authentication)</li> </ul>
Financing amount (maximum)	<ul style="list-style-type: none"> <li>● Daily financing limit: RM50,000 per customer</li> <li>● Accumulated financing limit: RM350,000 per customer</li> </ul>
Financing margin	<ul style="list-style-type: none"> <li>● 75% (Currently 80% due to the Ar-Rahnu campaign held from June to August 2022)</li> </ul>
Profit rate	<ul style="list-style-type: none"> <li>● 8.5% from 75% of marhun value (for the period of six months)</li> <li>● 9.6% from 80% of marhun value (for the period of six months, due to the Ar-Rahnu campaign held from June to August 2022)</li> </ul>
Matured period	<ul style="list-style-type: none"> <li>● Six months up to 12 months</li> </ul>

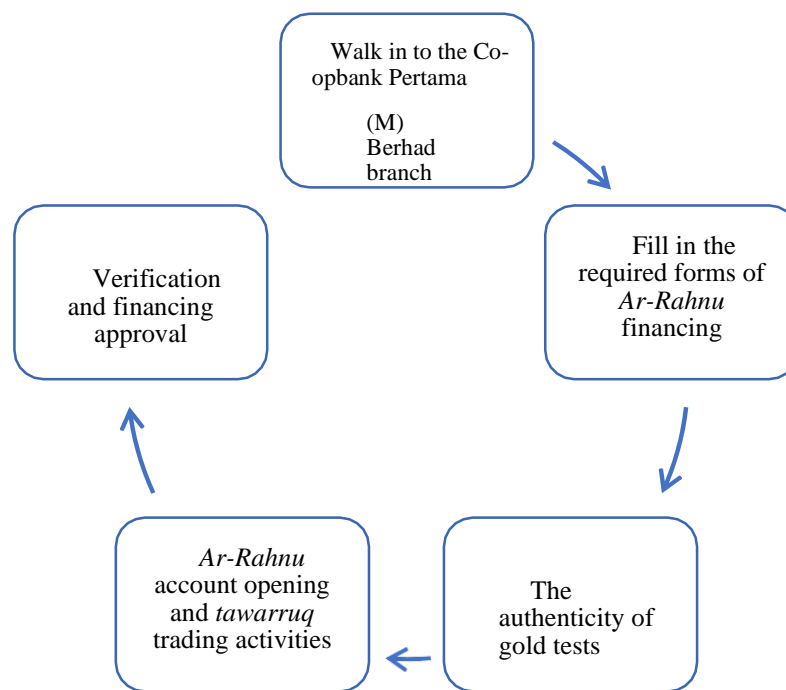
*Source:* Summarization from interview and coop-bank website

In Malaysia, most Islamic institutions practice the *Ar-Rahnu* financing similarly due to the same Shariah concept applied in its execution. However, there are still differences in management implementation, procedure and operation guidelines. Based on the *Garis Panduan Operasi* (GPO) of CBP, the application of *Ar-Rahnu* financing requires the customer to physically walk to the nearest branch of CBP. This financing cannot be applied through an online system because it involves the *marhun* as the pledged item and the requirement of the customer's thumbprint to accomplish the financing application. In this regard, there are a few procedures for a new customer to apply for *Ar-Rahnu* financing. The procedures have been explained by informant below

"As a customer, there are five stages of *Ar-Rahnu* financing procedure in Co-opbank Pertama. Firstly, the customer has to walk to the nearest branch of CBP. *Ar-Rahnu* officer will attend to the customer and explain the conditions and requirements needed to apply for *Ar-Rahnu* financing. Secondly, *Ar-Rahnu* officer will look first at the quality (999, 950, 916, 875, 835, 750) of pledge gold/jewellery. If the customer has met the requirement and the quality of gold exists, then the customer has to open *Ar-Rahnu* account with a deposit of RM20.00. Customers need to thumbprint and fill in a few forms before proceeding to the next step. Among the form that must be filled out is the Customer Information Form (CIF), Nominee/Heirs Form of Ar- Rahnu, Akta Perlindungan Peribadi 2010 (APDP) form, consent authorization of CTOS form, Signature Specimen Card form and *Ar-Rahnu* 2.0 product sheet. Thirdly, the pledged gold will undergo 2-3 tests of authenticity. If any test is not passed, the pledged gold will not be accepted, and the financing application will be rejected immediately. Fourthly, if all the tests are passed, *Ar-Rahnu* officer will register the customer's account and

make a trade. Fifthly, the transaction will be verified by *Ar-Rahnu* officer, Assistant Branch Manager, Branch Manager of CBP. Then the customer needs to thumbprint again before the financing cash is given along with Surat Akuan Gadaian (SAG) for the redemption purpose later." (Informant A)

Figure 2: The Procedures of *Ar-Rahnu* Financing application by the Customer



Source: Summarization from interview

Many Islamic financing sources are accessible in Malaysia, such as Islamic personal financing, Islamic micro-financing, Islamic home financing, *Ar-Rahnu* financing and more. Following the financing mentioned, *Ar-Rahnu* financing is the fastest financing in obtaining quick cash due to the uncomplicated financing process. Besides, *Ar-Rahnu* financing approval process in Co-opbank Pertama (M) Berhad may take less than a day, approximately 15 minutes to 1 hour, depending on the situation. Therefore, society, either Muslims or non-Muslims, should be aware of the existence of the *Ar-Rahnu* financing due to the benefits gained for both parties. The consumers obtain immediate cash, and the company achieves the goal of increasing sales revenue.

## Conclusion

Presently, *Ar-Rahnu* is one of the financing products developed and widely known by society. In Malaysia, many institutions provide and offer this product, including Co-opbank Pertama (M) Berhad. As an alternative to the conventional pawn broking, the research has explained the implementation of *Ar-Rahnu* in Co-opbank Pertama (M) Berhad by adapting the Shariah concept as well as the guidelines from BNM and SKM. The criteria for implementing *Ar-Rahnu* financing have influenced the customer's preference to choose Co-opbank Pertama (M) Berhad over other institutions. In addition, the promotional campaigns indirectly approached the customers in applying the *Ar-Rahnu* financing. Furthermore, the *Ar-Rahnu* implementation in Co-opbank Pertama (M) Berhad complies with the Shariah guidelines stipulated in executing the financing product.



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