

Evaluation on *Al-Ijarah Thumma Al-Bay'* (AITAB) Facility:

The Case of Affin Islamic Bank Berhad

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Abstract

Al-Ijarah Thumma Al-Bay' (AITAB) is the contemporary innovative product that specifically designed for Islamic hire-purchase facility with compliance of *Shariah* principle. Even though AITAB facility was established more than ten years ago in Islamic banking, there is no Islamic hire-purchase act to regulate this product. As a consequent, there is still a question of whether the operations of AITAB fully abide with *Shariah* principle as Albert Einstein had stated that "*In theory, theory and practice are the same. However, in practice, they are not.*" Therefore, the objective of this research is to identify if there are differences between the theory of AITAB facility based on *Shariah* principle and the real operation practiced by the Affin Islamic Bank Bhd. Also, we seek to identify the similarities (if any) between AITAB and conventional hire-purchase (based on Hire-Purchase Act 1967) in order to investigate whether the similarities in practice have been influenced by the same regulation. This study adopts the research methodology of qualitative approach and content analysis. The explanations given by the Affin Islamic bank's manager regarding the issues and implementation of the chosen practice answers the unsolved issues surrounding AITAB facility for a long time. Towards the end, this study suggests that new guidelines on the Islamic Hire Purchase Act should soon be designed and implemented. Also, both government and Islamic banks should be more transparent in educating the society about the AITAB facility.

Keywords: Islamic Banking; AITAB principle

1.0 INTRODUCTION

Nowadays, the Islamic products have increased significantly in demand year by year. The increased demand by the customers had attracted many conventional banks in Malaysia and other countries to adapt the Islamic concept into their transactions. There are various types of Islamic products being innovatively created with compliance to the *Shariah* law such as *Murabahah* (cost plus), *Musyarakah* (joint venture-profit sharing), *Mudarabah* (trustee profit-sharing), *al-Bai Bithaman Ajil* (deferred instalment sale), *al-Wadiah* (safe custody), *al-Wakalah* (agency), *al-Kafalah* (guarantee), *Istisna'a* (acquisition), *Ijarah* (leasing), *Qard al-Hassan* (benevolent loan) and many more. Despite the many *Shariah* compliance products offered, *Ijarah* financing has faced quite a debatable issue on to what extent the current practice of *Al-Ijarah Thumma Al-Bay'* (AITAB) is consistent to the spirit of *Shariah* as established in the Islamic banking theory. Even though AITAB facility was established more than ten years ago in Islamic banking, there is no Islamic hire-purchase act to regulate this product. As a consequent, there is still a question of whether the operations of AITAB fully abide with *Shariah* principle as Albert Einstein had stated that "*In theory, theory and practice are the same. However, in practice, they are not.*" Therefore, the objective of this research is to identify if there are differences between the theory of AITAB facility based on *Shariah* principle and the real operation practiced by the Affin Islamic Bank Bhd. Also, we seek to identify the similarities (if any) between AITAB and conventional hire-purchase (based on Hire-Purchase Act 1967) in order to investigate whether the similarities in practice have been influenced by the same regulation. In doing so, a case study on Affin Islamic Bank Berhad is conducted as it has offered AITAB facility in 1999 until today.

The remainder of this paper is organized as follows. Section 2 deliberates the literature reviews as well as the development, operation and issues of AITAB facility in Malaysia. Section 3 outlines the methodology. Section 4 presents the research findings, and finally section 5 concludes.

2.0 LITERATURE REVIEW

2.1 Development of AITAB facility in Malaysia

Islamic banking was formally set up in Malaysia in 1983. During that year to 1994, many Islamic products have been created including *ijarah* (leasing) facility but the Islamic hire-

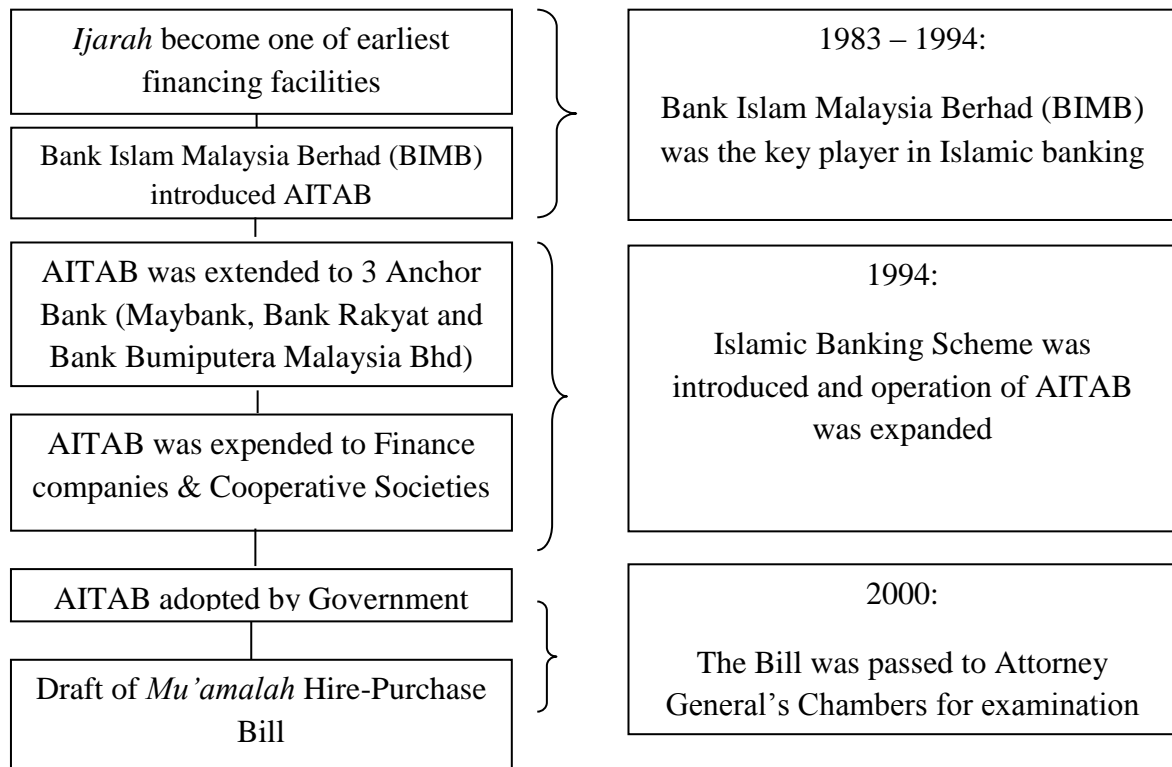
purchase had not been fully developed yet. Consequently, *ijarah* has been developed into Islamic hire-purchase as *al-ijarah Thumma al-Bay'* or *al-Ijarah al-Muntahiyah Bit-Tamlik* (IMBT) and has been accepted as a mode of financing. In Malaysia, the Islamic hire-purchase uses the term of *al-Ijarah Thumma al-Bay'* (AITAB). The only difference between AITAB and IMBT is that upon fully settlement at the end of the contract, the legal title of the asset is transferred to the lessee through the contract of sale for the former; while, it is transferred to the lessee whether through gift, token price, equivalent price or gradual transfer for the later. (Mohd Herwan & Mohd Hawari, 2011)

The implementation of AITAB has received criticism regarding its validity in 1985.¹ Some Islamic scholars have questioned the purchase price of the leased assets is not a real price because it already taking into account the value of the assets and the market condition. They also claimed that AITAB also appears to be similar to a conditional sale in which the owner has to sell the leased asset to the hirer in any situation (Belder, 2004; Saiful Azhar, 2008; Muhammad Taqi Usmani, 2010; Hashim et al. 2012). To this matter, Malaysian *Shariah* scholar also argued that AITAB structure is based on sale and purchase concept made on mutual consent between owner and hirer. However, there is an explanation for the argument as AITAB is strictly aim to protect the owner from risk of default as he will hold the title's asset until the hirer made a full payment. He can also use and dispose the assets as well as he can also sell it to other hirer at any circumstances.

The operation of AITAB has gone through several phases. Initially, it had been offered by the earliest Islamic bank, Bank Islam Malaysia Berhad (BIMB) in 1983. Then, conventional banks which had Islamic Banking Scheme (IBS) followed the step. In Malaysia, the operation of AITAB are governed by few ministries such as the Ministry of Domestic Trade and Consumerism which has exclusive jurisdiction over hire-purchase businesses and the Ministry of Transportation, which handles approval of vehicle's grant and license. Figure 1 summarizes the phases of AITAB operation.

¹ The legitimacy of the AITAB contract has been resolved by a fatwa of the Islamic Fiqh Academy (Jeddah) since 1985. The fatwa was passed in the Islamic Fiqh Academy meeting held on 10-16 Rabi'ul Awwal 1406/28 December 1985. The Academy states an opinion expressed by Ibn Rushd who viewed that Muslim jurists are divided on the issue of combining the *ijârah* and sale contract. For instance, the Malikis have allowed the combination, while the Shafi'is disapproved it (see Islamic Fiqh Academy, 1985).

Figure 1: Development of AITAB

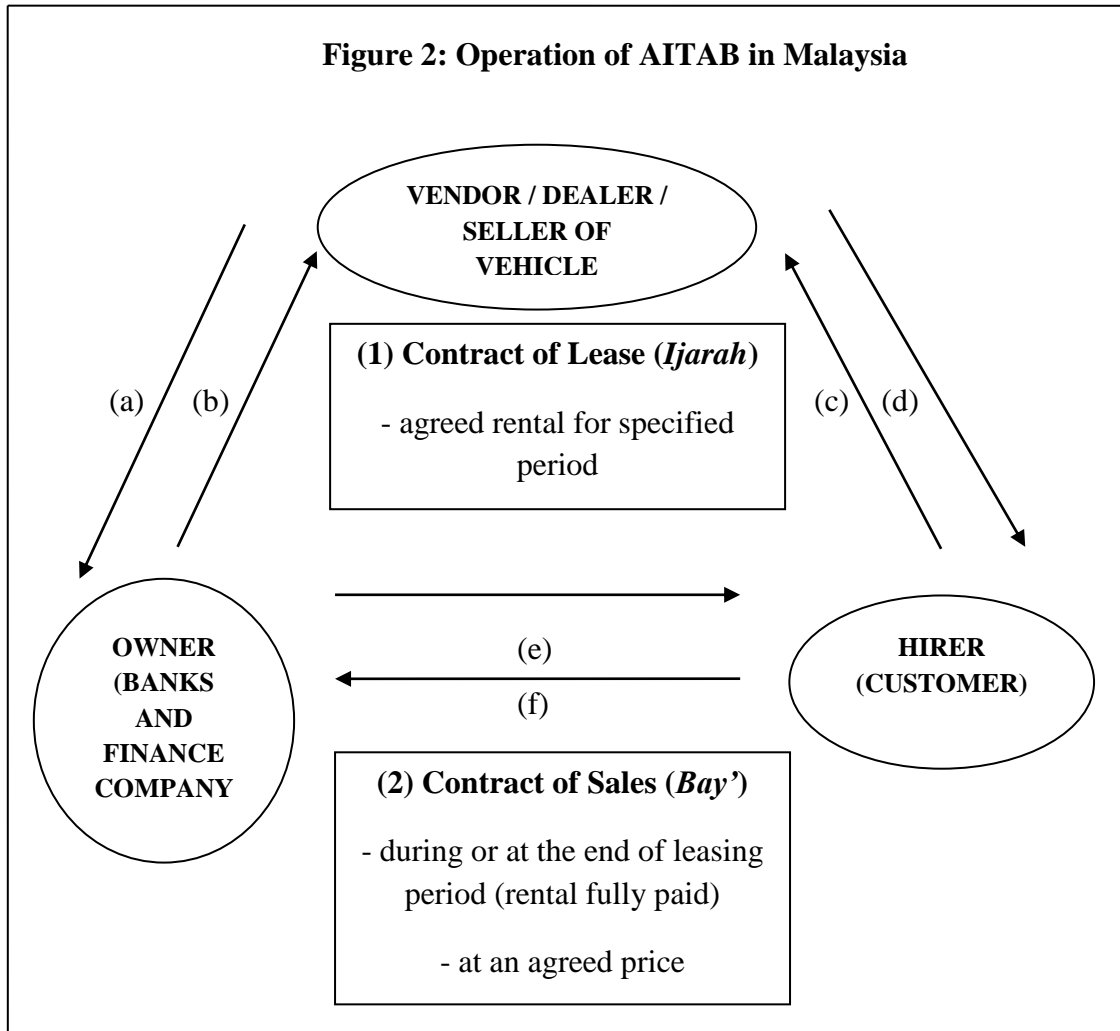


Source: Nurdianawati Irwani & Ashraf Wajdi (2006)

2.2 Operation of AITAB in Islamic Bank

From the definition of AITAB which means “lease followed by sales” combines the lease contract and sales contracts in one trading document. Even though there are two different contracts in one trading but the contract must be handle separately. Under the lease contract (first contract), hirer (customer) leases goods from the owner (banks and finance company) at an agreed rental over a specified period of time. At the end of the leasing contract, the hirer enters into sale contract (second contract) to purchase the goods from the owner at an agreed price. The sale contract also can be done during the leasing contract as long as the rental payments have been fully settled.

AITAB involves three main parties which are customer known as the hirer, banks or finance company known as the owner and vendor or dealer or seller as the middle party between these two mentioned parties. Figure 2 below shows the illustration of common example of car financing by AITAB in Malaysia:



Source: Nurdianawati Irwani & Ashraf Wajdi (2006)

The descriptions of the above illustration of operation of AITAB are as follows:

(I) First Contract : Contract of Lease (*Ijarah*)

- (a) **Vendor or Dealer or Seller** sells the vehicle ordered by the customer to the bank or finance company.
- (b) The bank or finance company pays to the Vendor full amount of the vehicle. Therefore the banks or finance company became the **Owner** of the vehicle.
- (c) The customer paid the deposit payment (mostly 10%) of the full amount of the vehicle to the Vendor. The customer agrees to pay the road tax and insurance coverage. He is also responsible for the maintenance.

(d) Vendor delivers the vehicle to customer. This is done once the bank or finance company approved the customer's application upon in the purpose to purchase the vehicle during or at the end of the contract.

(II) Second Contract : Contract of Sales (Bay')

(e) Owner hires the vehicle to the customer. The customer became the **Hirer**.

(f) He is now responsible to pays the rental or installment to the Owner with the agreed amount until the payment fully paid either during the contract or end of the contract. This is due to financing he obtained (mostly 90%) from the bank or owner.

2.3 Issues on AITAB

According to contemporary jurist and experts on Islamic finance, *ijarah* has a great potential as an alternative to interest in respect of evolving a *Shariah* compliant financial system (Muhammad Ayub, 2007). Although the demand of *Al-Ijarah Thumma Al-Bay* (AITAB) had increased with wide acceptance and great potential, yet there are numerous issues that need to be acknowledged.

Besides issues on the operation of AITAB, there are some *fiqh* issues that seem to be ignored by the practitioner. According to a study by Hashim et al. (2012) which have mentioned four issues related to the *fiqh* matters. There are ownership, maintenance liability, penalty and legal treatment.

Firstly, regarding the ownership, the owner (bank) supposedly would have to face risk, liabilities and responsibilities of the asset. However, the banks would attempt to avoid as much as possible ways of transferring ownership. Secondly, the owner of the assets supposedly remain liable for basic maintenance even though this term is often difficult to differentiate with clarity from operational maintenance in which is the responsibility of the hirer (Belder, 2004). Thirdly, penalty will be imposed for default payment. In reality, an act of default in due payment signifies a breach of contract. When two or more parties enter into a valid contract, they will be bound by terms and conditions in the contract. Breaching any of these terms will cause the innocent party to suffer a loss that needs to be compensated (Baharum, 2000). However, *Shariah* law have allowed this rule of giving penalty for defaults payment due to protecting the lessor of getting late payment and avoid the bad attitude of lessee who like to postpone payment. The purpose of this rule is to protect all parties involved and *maslahah* to all.

Finally, AITAB is detected to be lack of *Shariah* regulatory framework. Any dispute arising from the transaction of Islamic hire purchase will be referred to conventional regulations (Ismail, 1999). This is due to AITAB facility is regulate under Hire-Purchase Act (HPA) 1967 which also goes to conventional hire-purchase. Therefore, the issue of reporting surfaced whereby accounting treatment has been undertaken the same way treated in hire-purchase especially when it comes to asset recognition. This is totally unaccepted as AITAB should be fully regulated and treated in line with the *Shariah* principle.

In terms of empirical research on perception and operation of *AITAB* in Malaysia, so far two studies have been conducted. The first one was a study by Nurdianawati Irwani (2006). She has analysed the practitioners' and non-practitioners' perspective regarding the operation of AITAB. The researcher has highlighted the problems and issues related to AITAB such as customers' attitude, lack of experience among bank officers, lack of awareness and cooperation among the dealers, documentation, competition in the market and lack of *Shariah* framework. The second and a recent one is a study by Hashim et al. (2012). They have analyzed 16 annual reports of Islamic banks which provide AITAB facility, interviewed the bank officer from RHB Islamic Bank Berhad and distributed questionnaires to customers. Their study summarized that most of Islamic banks prefer to use the conventional term such as lease/leasing and hire-purchase instead of *ijarah* terminology. This misrepresented terminology of *ijarah* infers that the current practice of Islamic banks is still lacking knowledge and spirit of the real concept of *ijarah* from the perspective of Islam. On the other hand, the result of the survey questionnaires to the clients shows that most customers are also lack of information regarding *ijarah* and its concept, yet they still prefer to choose the *Shariah* compliant product as compared to the conventional one.

3.0 METHODOLOGY

This is a case study on AITAB facility at Affin Islamic Bank Berhad. In analyzing the issues, we adopt content analysis and qualitative approach. We conducted an interview session with the manager of Hire-Purchase-i department to seek answer on the differences and similarities between the theory and practice of AITAB facility at Affin Islamic Bank Bhd. The interview had taken approximately 60 minutes. The conversation during the face-to-face interview was recorded on a hand phone recorder for analysis purpose. Below are the interview questions and its purpose:

Interview Question (1):

“From your understanding and experience, please explain the operation of Islamic hire-purchase (AITAB) in Affin Islamic Bank (AIB)?

This question is consistent with a main objective of the study which aims to obtain a clear insight of AITAB practice from the provider and practitioner of Affin Islamic Bank.

Interview Question (2):

“Some scholars have criticized that certain practice in AITAB is contrary from the Shariah principle such as:

- (i) Responsibility for the Cost of Insurance*
- (ii) The Unrecorded Assets*
- (iii) Term Charges*
- (iv) Option in the Contract*
- (v) Termination / Repossession Charges*

Against this background, what are the reasons for Affin Islamic bank to continue offering it?”

This question is aimed to obtain the actual reason of the differences between the theory and practice of AITAB and the reason for that practice by the bank.

Interview Question (3):

“Referring to Nurdianawati and Ashrad Wajdi (2006), there were few issues raised from AITAB facility such as below:

- (i) Customers’ Attitude*
- (ii) Lack of Experience among Bank Officers*
- (iii) Lack of Awareness and Cooperation among the Dealers*
- (iv) Documentation*
- (v) Competition in The Market*
- (vi) Lack of Shariah Framework,*

Therefore, from the perspective of Islamic bank, what is your opinion regarding these issues and how do you tackle these issues?”

This question is aimed to know the awareness and point of view of Affin Islamic bank regarding the problems arise that may due to the current practice and the proposed solutions regarding the problems.

Interview Question (4):

“Do you find Hire-Purchase Act 1967 (HPA 1967) adequate to govern the operation of AITAB? Or, do you think Islamic hire-purchase (AITAB) should be governed by a specific Shariah law? Please explain your reason.

This question is aimed to have an opinion from the practitioner regarding the issue of AITAB operation under HPA 1967.

4.0 FINDINGS AND DISCUSSIONS

This section explains the similarities between the current practice of AITAB and conventional car financing besides discussing the answers towards the questions given during the interview session. Finally, we highlight the differences between the theory and practice of AITAB along with the justifications by the respondent.

4.1 Similarity between AITAB and Conventional Car Financing

Table 1 summarizes the similarities between AITAB and conventional car financing from various aspects.

Table 1

Similarity between AITAB and Conventional Hire-Purchase

Aspect	AITAB	Conventional Hire-Purchase
Types of Goods	Similar to conventional hire-purchase Non-Act goods; industrial goods.	Refer to 1 st Schedule of HPA Non-Act goods.
Period of Financing	Same with conventional hire-purchase. Maximum : 7 years,	Maximum : 7 years, Minimum : 1 year

	Minimum : 1 year	
Maintenance Responsibility	Similar to conventional hire-purchase. Hirer bears the responsibility.	Maintenance responsibility not put on owner because it is not pure lease.
Governing Law	Hire-Purchase Act 1967, <i>Shariah</i> Law, and Guideline from Bank Negara Malaysia.	Hire-Purchase Act 1967 only.
Early Settlement (Rebate/ <i>Ibra'</i>)	Rule 78 (<i>refer to Appendix D</i>). Similar to convention hire-purchase. Bank's right looking into current practice Bank's discretion, cannot declare, if so, bank is obliged to give.	Rule 78 (<i>refer to Appendix D</i>). 3 months' notice. Statutory calculation.
Profit Margin/ Term Charges	Flat rate, similar to conventional. Rental based on profit which is the formula: $(\text{Cost price} + \text{profit}) / \text{No. of instalments}$	Maximum 10% Rental based on interest which is the formula: $(\text{Cost} \times \text{Interest Rate}) / \text{Year}$
Insurance Responsibility	Same to conventional in respect of responsibility to bear insurance cost Islamic insurance (Takaful) Comprehensive. Not involved third-party insurance.	Bank's responsibility during first year. Hirer's responsibility in subsequent years. Involved third-party insurance.
Calculation of Instalment	Fixed rate	Option to choose Variable and Fixed rate

Source: Authors' findings.

4.2 Answers of the Interview Questions given by the Bank Manager

Question 1: Explanation of Operation of AITAB Facility in Affin Islamic Bank Bhd.

Researchers have been informed that “The operation of AITAB in AIB is general for leasing facility which exactly the same with other Islamic banks in Malaysia”. Therefore, the information gained briefly could be seen at Figure 2, operation of AITAB in Malaysia.

Question 2: Explanation for Reasons of certain Practice which seems contrary from *Shariah* principle such as responsibility for the cost of insurance, the unrecorded assets, term charges, option in the contract, termination/ repossession charges.

The respondent said, “The cost of insurance should be liable to the lessee as the lessee is the current user of the asset. For the asset, the banks did not record or put into account due to they own many lease assets that are impossible to record all in one account or in a statement”. The real rate should actually be based only on transaction, but current practice is based on profit gain from the financing activities as well because the bank intends to increase the rate. For the option in the contract to either proceed or terminate the asset (*Khiyar al-‘ayb*), the respondent mention that “there is no such option given as the bank considered and assumed that they are dealing with serious lessee with purpose of buying the asset at the end of the lease period as per agreed by both parties. The termination and repossession of the lease asset would be charged to lessee as the facility follows the Hire-Purchase Act 1967”. (Detail explanation is in section 4.3)

Question 3: Opinion regarding existing issues related to AITAB Facility such as customers’ awareness, lack of experience among bank officers, lack of awareness and cooperation among the dealers, documentation, and competition in the market and lack of *Shariah* framework.

The bank manager admits that in reality, there are still lacking in customers’ awareness, experience of bank officers and cooperation among the dealers regarding AITAB facility. This is due to the fact that the knowledge of the AITAB operation is not strong among the three parties. At the same time, AITAB facility has to compete with the conventional car financing as they tap the same market. For the documentation issue, the respondent said that “There should not be an issue since the bank has not yet received any comment regarding that matter”. The respondent admits that AITAB facility is still lack of *Shariah* governance framework; however, according to him HPA 1967 is enough to control and tackle the

problem of AITAB facility at the moment as there is no serious problem arises. Otherwise, he mentioned that “There should be the authorities (Bank Negara Malaysia and regulatory bodies) who should play the role to create and regulate the new *Shariah* framework for better guidelines to all Islamic products, not the Islamic banks as the market players”.

Question 4: Opinion Regarding AITAB under Hire-Purchase Act 1967

The manager answers by saying that “The Hire-Purchase act 1967 seems perfect enough to govern any hire-purchase operation. This is due to the fact that the act seems to be ‘universal’ as the provisions been made is truly fair to all parties involved. Nevertheless, if the regulator intends to have a new one, it is better as it can to stimulate improvement to the current practice of AITAB”.

4.3 Differences between Theory and Practice of AITAB by Affin Islamic Bank Bhd.

The major similarities of the current practice of AITAB and conventional car financing raise a debatable issue of whether the product is truly *shariah* compliant? Table 2 summarizes the differences between the original concept of *ijarah* hire-purchase (AITAB) and its practice in Affin Islamic Bank Bhd.

Table 2: Differences between Theory and Practice of AITAB

Aspect	Theory / Concept (of <i>Ijarah</i> /AITAB)	In Practice
Responsibility for the Cost of Insurance	Lessor (bank) is responsible to bear the cost of insurance	Lessee (customer) is responsible to bear the cost of insurance
The Unrecorded Assets	Should record in bank’s book/statement	No assets have been recorded
The Profit Margin / Term Charges	Rental rate based on profit gain from the transaction only.	Rental rate based on profit gain from the financing activity.
Option in the Contract	<i>Khiyar al-‘ayb</i> or, give lessee an option to accept or reject the asset at the	Give lessee no option but have to be the buyer of the leased asset at the end of

	end of the period.	the period.
Termination / Repossession Charges	No charges been made by lessee.	Lessee will be charged to certain amount.

4.3.1 Responsibility for Cost of Insurance

Based on Islamic principle of *ijarah*, lessor (bank) is responsible to bear the cost of insurance (Islamic insurance called *takaful*) of the vehicle due to the reason that the lessor was claimed to be the owner of the asset. However, in the current practice, it shows that lessee (customer) is the one who is responsible to bear the cost of insurance (*takaful*) of the asset since the customer is the one who is using the leasing asset. This practice is totally different from the real spirit of *ijarah* regarding the responsible party to bear the cost of insurance.

Reasons of the Current Practice based on the Interview Session - The manager said it is because AITAB's facility does not have specific *Shariah* guidelines or act in order to regulate the facility. Thus, AITAB facility is still under HPA 1967 which allowed the practice as mentioned in Section 26 HPA as below:

Section 26 – Insurance of goods comprised in hire-purchase agreements

- (1) An owner shall cause to be insured in the name of hirer -
 - (a) Motor vehicles comprised in a hire-purchase agreement, for the first year only;
 - and
 - (b) All other goods comprised in hire-purchase agreement, for the duration of time that the goods remain under hire-purchase, against any risk that he thinks fit.

(2) Where the goods comprised in a hire-purchase agreement is motor vehicle, it shall be the duty of the hirer to cause the said vehicle to be insured in respect of the second and all subsequent years that the motor vehicle remains under hire-purchase.

From the Section 26 HPA 1967 above, we can summarize that according to Section 26 (1) HPA has stated that owner of the vehicle (bank) is compulsory to bear the insurance cost of the vehicle for the first year under lessee's name. Meanwhile, Section 26 (2) HPA has stated that lessee (customer) is responsible to bear the insurance cost of the vehicle for the next two years and the following years as long as the vehicle is under leasing.

In practice, all insurance amounts to be paid will be part of the hire purchase price, then in principle the tenant/lessee shall bear and pay the cost of insurance for the vehicle.

Section 26(4) HPA is as follows:

(4) An owner who fails to comply with subsection (1) and a hirer who fails to comply with subsection (2) shall be guilty of an offence under this Act.

Under the concept of ownership according to *Shariah*, it is the responsibility of the bank as the owner to bear the cost of insurance. However, it is opposed to the designation under the HPA Section 26 (4) which states any failure to comply with the designation under subsection 26 (1) and (2) HPA shall be guilty under the HPA.

If the provisions of Section 26 (1) and (2) HPA is about to excluded from force in AITAB Agreement, it will cause the agreement to be void and of no effect.

Section 34 (g) – Avoidance of certain provisions

Any provision in any hire-purchase agreement whereby–

(g) except as expressly provided by this Act, the operation of any provision of this Act is excluded, modified, or restricted, shall be void and of no effect.

Based on the provision contained in Section 34 (g), HPA which states that any provision in any of the hire purchase agreement (unless expressly permitted by HPA) are excluded, modified, restricted or any provision of the HPA will be void and of no effect.

In this case, if the responsibility to bear the insurance cost is imposed to the lessor (bank/owner) for vehicles financed using AITAB facility are subject to HPA for *Shariah* compliance is applicable, it would be contrary to the provisions of the HPA, that will cause financing agreement under AITAB be invalid and of no effect.

AITAB financing that is subject to full compliance with the HPA cannot apply the principles of *Shariah* from the real concept of *ijarah*. It is bound to the HPA which impose different obligations on the *Shariah* principle of the parties involved. Therefore, this is the reason of the difference between the AITAB's facility in theory, which based on *ijarah* concept but in practice it duplicates the conventional practice or merely follow the HPA which the provisions have stated a contrary practice from the *Shariah* principle.

4.3.2 The Unrecorded Asset

Generally in *Ijarah* contract, specifically in AITAB, the subject asset is owned by the bank and the usufruct is leased to the lessee (customer). Therefore, the leased asset need to be recorded in the bank's book/statement and all the related expenses as an owner of the assets needs to be recorded. AITAB should be different with the conventional hire-purchase or leasing financing in which "*it involves the effective transfer of all risks and rewards associated with the ownership to the lessee*" (Muhammad Ayub, 2009). By right, in term of risk and reward as an owner, the assets are owned by the lessor (bank). In term of the title of

the asset, it is registered under the name of the bank, but surprisingly, they were not recorded under the fixed asset of the bank, but only recorded under AITAB car financing, conjecturing an increase of credit risk exposure of the bank if the client defaulted.

Reasons of the Current Practice based on the Interview Session – The manager replied by saying that it is impossible for the bank to take the asset into account due to the reason of having numerous of vehicles leased to the customers. Therefore, the reason of the practice is to avoid too many records in the bank’s statement and making easier for the bank’s transactions. Intuitively, we can say that the bank does not really own the risk and reward as an owner of the asset (except the credit risk). On the other hand, in reality the client who is not supposed to bear the risk as a lessee does bear the risk. As some scholars mentioned that credit risk not a justification for counter value (*iwad*), this issue may jeopardize the sustainability and reputation of the Islamic banks if someone highlights this issue as non-*shariah* compliant.

4.3.3 Profit Margin or Term Charges

For Islamic hire-purchase, the profit charged by the bank to the customers must be based on rental rate and must not be based on interest calculation as per conventional bank. Indeed, there is a difference between the rental rate and interest rate in which the former will be based on the real assets and the real price while the latter is independent from such factors.

Ahamed Kameel Mydin Meera and Dzuljastri Abdul Razak (2009) mentioned that *“the rental is most suited for use in Islamic finance since it is measured from the true usufruct of the asset, unlike interest charges that are apparently not tied to the asset’s usufruct. Hence the rental rate can differ among houses within a same row of houses or among different*

floors within a condominium block. But interest rates are generally independent from such factors.” To apply their context to the car financing, we can infer that rental car rate can differ among cars of different brands and different engine powers. Nonetheless, the current scenario shows that the rental car rate is closely related to the interest rate.

The real service offered by the financial institutions is to give the financial assistance to the customers. In conventional, the extending of financing is done via the borrowing and financing activities but in Islam it is being done through the business based transactions. As to complement the conventional car financing, AITAB is being issued in order to match the modern's demand, though the risk taking spirit does not really materialized in practice.

Reasons of the Current Practice based on the Interview Session – The manager acknowledged the reputational risk issue arises if the rental rate is closely related to the movement of car financing interest rate. However, he believes in a dual banking system, Islamic banks have no choice since the AITAB facility has to compete with the conventional facility as they tap the similar market. The calculation of interest rate is not based on the real assets value, but depending on the demand and supply of the loanable fund in the economy. In theory, the AITAB car rental rate should be different from the interest rate. However, surprisingly, the car rental rate not only similar to the interest rate, but also it is funny to realize that the interest rates for imported and luxurious cars are cheaper than local cars. The rationale for that is because people who can afford to purchase imported cars as assumed to have high credit worthiness as compared to the ones who own local cars. This difference proves the opposite scenario, whereby it is expected that luxurious cars should have higher rental rates can compared to cheaper ones. Theoretically, the calculation of rental amount should be charged depending on the real assets value in which the rate will be determined by the market forces.

4.3.4 ‘Option of defect’ in the Contract

In AITAB, the client needs to sign up two agreements separately, at the beginning of the contract which is leasing (*Al-Ijarah*) contract and at the end of the contract, which is sale (*Al-Bay’*) contract. Theoretically, the purpose of the dual signing contract is to ensure the lease assets will be transferred to the lessee at the end of the leasing period. Thus, this transaction is seemed to be not much different with the conventional transactions, inferring the elimination of risk.

This binding process in the second contract has led to a serious problem. The elimination of *khiyar al-ayb* or ‘the option of defect’ to the purchaser or in this case is the lessee. At this stage, the owner (bank) is supposed to give a buyer (lessee) ‘an option of defect’, which is the right to reject or cancel the transaction. According to Article 336, *Mejelle/ Al-Majalah al-Ahkam al-Adaliyya* (1877) “any buyer in Islamic law has an automatic implied warranty against latent defects in the goods purchased”.

Reasons of the Current Practice based on the Interview Session – According to the manager, the bank is believed to have a serious customer to deal with. For this matter, the bank wants the customer to have the responsibility to own the leased asset at the end of the agreement (via *wa’d* contract) as per understanding of the contract of AITAB, which is begin with lease and ended with sale. Therefore, the bank gives no option to the customer as per agreement that both parties will end the leased asset with selling. In the case of defect or accident, *takaful* will cover the repairing cost to make it sellable at the end of the contract. However, according to some Islamic scholars, the elimination of *khiyar al-ayb* or option of defect, which is the right to reject or cancel the transaction (with or without intention), is jeopardizing the completeness of Islamic sales transaction as it creates injustice to the buyer.

4.3.5 Termination or Repossession Charges

In *Ijarah* agreement, once it is being signed, the lessor (bank) and the lessee (customer) are not allowed to terminate the contract unilaterally without any condition. This scenario has violated the principle of equity and justice of *Maqasid Shariah*. Nonetheless, an agreement can be done with condition that there is a mutual consent between these two parties without affecting the rights.

The contract of *Ijarah* will be automatically terminated once the asset is damaged and the lessee could not enjoy the usufruct or benefit of the asset. At this stage, the lessor has to replace the asset to a new one or make some adjustments in the asset for the lessee to gain benefit from the leased asset.

Regarding this matter, Dr. Mohamed Ali Elgari (2007) have stated in his presentation in The Sixth Conference of the *Shariah* Board of Financial Islamic Institutions, AAOFI , with title ‘Special Features of the Right of Usage and Consequence of Its Transfer (Selling Usufruct and Selling Contracts) as “*The usufruct is specified by making clear the specification of its source. If a specific tangible asset is leased, then the usufruct will be realized from the specific tangible asset; thus, if it is destroyed the lease becomes null. However, if the lease is for the usufruct of something meeting certain specifications which (the lessor) assumes liability to provide, then the destruction of its source after it has become specific imposes on the lessor the duty to supply a replacement since the origin of the usufruct has not been specifically stipulated; it is anything matching certain specification which (the lessor) has assumed liability to provide.*”

In theory, when the lessee is not able to settle the payment, he or she needs to surrender the asset to the lessor with a mutual consent between two parties in order to terminate the contract. The lessor will not charge any further charges to the lessee.

However, practically in AITAB implementation, a lessee is charged by the lessor to pay the rental up to the period of the repossession, indeed, all the cost of the repossession. According to Hashim Bin Ahmad Shiyuti, Delil Khairat, Mahamat Al Mourtada & Muhammad Abdul Ghani (2012), to determine the outstanding value in which the lessee needs to pay is by with below calculation:

$$\text{Outstanding value (by clearing the contract)} = \text{Total AITAB Financing} - \text{Ijarah installments} - \text{all related cost (repossession related cost)} - \text{revaluation of the asset.}$$

Intuitively, the bank should use the original purchase price of the asset plus the profit gain by the bank minus the *ijarah* payment and all related cost and minus the revalue amount in order to get the net figure of the outstanding value.

This different practice of calculating the outstanding value at the end of the termination contract has raised some issues in AITAB financing as follows:

- (a) The calculation of termination is seemed similar to the normal conventional financing.
- (b) The basis of loan calculation is being used in determining the financing settlement, although it is different from the true calculation for Islamic product as it is actually based on financing not based on loan.

Reasons of the Current Practice based on the Interview Session – Besides the responsibility to bear the cost of insurance, the bank will also put charges of termination or repossession of the contract to the customer. This is due to the reason of that the customer is the one who gain benefit from the assets; thus, the charges to terminate the contract will be considered as ‘penalty’ to them as not taking seriously to own the leased asset with making sudden unplanned decision. Even though all scholars of all times and places have agreed

upon the permissibility of leasing (Abdul-Rahim Al-Saati, 2003), this current practice of AITAB seems to duplicate the conventional collection and repossession procedure for hire-purchase financing, instead of following the existing *ijarah* concept. This is obviously against the original theory as Islam, which does not teach Muslim to overcome usury by competing with usurer at his own game (Mahmood Mohamed Sanusi, 2012).

5.0 CONCLUSION AND RECOMENDATION

Certain practices of AITAB facility by Affin Islamic Bank seem contrary to *Shariah* principle. This could give a bad effect to the lessee. For example, they have to be responsible to the insurance cost and being charged for termination or repossession of the lease asset. Also, they are not provided with *Khiyar al-'ayb* or option either to proceed or terminate the leasing asset if the asset is considered defect and etc. In addition, the information given to the clients on the actual AITAB operation by the Islamic bank is not enough. The respondent admits that most of the bank officers failed to explain the distinction between AITAB and conventional hire-purchase accurately. Consequently, they are unable to highlight the advantages of AITAB as compared to conventional hire-purchase. This leads to the lack of awareness of the car dealers as they might be promoting the customers to choose the conventional hire-purchase more instead of AITAB.

Generalizing the differences of AITAB in theory and practical for the case of Affin Islamic Bank bhd, there are several unresolved issues in AITAB that does not abide to the true *ijarah* concept. The main issue in accounting of *ijarah* is recognition of asset by the lessor (bank). Therefore, issues such as insurance cost and termination charges have to be borne by the lessee even though it should be the responsibility of the lessor (bank) as an owner. The similarity practice between AITAB and conventional hire-purchase have showed that most of the practice by AITAB is influenced by the conventional regulation and existing practice since AITAB is fully govern under Hire-Purchase Act 1967 especially in legal issues. The explanations regarding the issues arise in AITAB and the reason of chosen practice by the respondent gives a very clear understanding of why the current practice of AITAB is not tally with the real basic theory of AITAB. One possible solution is that, we suggest new guidelines on the Islamic Hire Purchase Act should soon be designed and be

implemented in reality in order to solve the existed problems. Not only that, both government and Islamic banks should be more transparent in educating the society about the AITAB facility in Malaysia. Hopefully, with the new guidelines and more transparent documentation, AITAB facility will grow rapidly in the future. Initiative taken to minimize the debatable *shariah* non-compliant issues in AITAB is crucial for the sustainability of the Islamic banking industry as failure to do so would increase the *shariah* non-compliant risk, reputational risk, legal risk, withdrawal risk, and insolvency risk exposure of the Islamic banks.

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