

## **A REVIEWS ON THE REGULATION AND CONFLICTING ISSUES OF AR RAHNU OPERATION IN MALAYSIA**

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### ***ABSTRACT***

Since 25<sup>th</sup> year's operation of Ar Rahnu institutions in Malaysia, pawn broking industry received tremendous support in the Malaysian market, especially amongst micro, small and medium entrepreneurs. The prominent function of Ar Rahnu is to serve the customers who need immediate capital or cash through pawning their gold or jewellery to the institution. Simultaneous with the effort of the Malaysian government to promote the development of Islamic pawn broking industry, the demand for Ar-Rahnu services increase continuously. The industry has actively contributed to the Muslim economy as a means of community service that fulfil the desperate needs of low income families. To date, the numbers of pawn broking players increase over the year. Ar Rahnu institutions not only applicable to the low income group but currently increase demand from all level of income customers as potential place to obtain immediate fund and carrying investment in gold. Pawnbroker Act 1972 was set up in order to control and supervise the activities of pawnshop. Nevertheless, the operation of conventional pawnshop and Ar Rahnu are separately regulated. In term of legislation, the Ar Rahnu system is subject to certain laws. Each of the Ar Rahnu institutions regulated under the different regulations according to the types of those institutions. The absence of standardize regulation among the Ar Rahnu institutions has affect the operation of Ar Rahnu and create several issues that highly discuss among the scholar and community on the current practice of Ar Rahnu. As one of the Islamic financial institutions in the country it is envisaged to carry the Islamic values and adhere with Shariah compliance. Hence, this paper attempt to review the regulations involved in Ar Rahnu industry and discuss several issues pertaining Ar Rahnu operations in Malaysia as discussed from the previous literatures.

**Keywords:** Ar Rahnu, Regulation, Issues

### **INTRODUCTION**

Pawn broking industry is not new in the market. Previously, pawn broking industry in Malaysia act as an informal institution and play important roles in the country. Pawn broking institutions provide retail loan by taking gold as collateral and they played as a middleman. Before the establishment of Islamic financial institutions in Malaysia, financial market in the country was dominated by conventional system including pawn broking industry. Pawn shop are very important institution to the Malaysian especially low level income of group. These customers turn to pawnshop for credit because they are not eligible to borrow fund from formal financial institutions. Others customer used pawnshop for their convenient such as

household and emergency. Following the financial liberalization in 1980s, banks increasingly introduced charges on several services. Since people without bank accounts would find it extremely difficult, and most likely impossible to obtain bank or finance company loans, the trends may indicate an increase in the percentage of the population forced to turn to pawnshops to meet short-term credit needs. However, the demand pawn broking industry continues until today as one of the sources of capital to the society

The introduction Bank Islam Malaysia Berhad in 1983 create positive impact on the demand for Islamic pawn broking system. The Muslim community urge the Malaysian government to establish Islamic pawn shop in the country. Hence, in 1992, the first Islamic pawn broking institution in Malaysia was established known as *Muassasah Gadaian Islam Terengganu* (MGIT) and followed by *Koperasi Permodalan Kelantan* in the same year. The Shariah based Islamic pawn broking known as Ar Rahnu and to date, Ar Rahnu being an active institution that provide instant cash to the needy. Those borrowers transact their pawned items for quick cash for the purpose of emergency or capital for business. Furthermore, Ar Rahnu provides an alternative to access an interest free and low cost short term cash advance (Bhatt and Sinakkannu, 2008).

In the early years of establishment, majority customers of Ar Rahnu including housewives, private and public officers especially from low income group. They used Ar Rahnu based on their own satisfaction likes for household expenditure and emergency case (Rugayah, 1986; Ismail & Ahmad 1994). The demand on Islamic Ar Rahnu stimulate by several reasons;

- i. the current system of charging interest rate in the credit market has been criticized as harmful to low-income consumers because financial institutions under this system tend to allocate credit to only the most creditworthy borrowers, who generally belong to middle- or high-income groups (low risk borrowers). Through Ar Rahnu, customers only require to place valuable asset as collateral to obtain loan. Ar Rahnu concept provide surety or for pledge to the creditor to ensure the repayment of debt (Mohd Roslan Mohd Nor, 2012). This will eliminate the need to distinguish high-risk and low-risk borrowers.
- ii. a higher interest rate imposed by conventional banking and pawnshop would shift the credit from the mainstream credit market to pawnshop.
- iii. the customers might prefer the Islamic-based pawnshop which is less expensive and a convenient credit to all. The cost involved in Ar Rahnu is simpler and the cheaper way compared to commercial banks
- iv. the jewellery and pawned asset will be kept safely whereby the Ar Rahnu institution will give guarantee on safety matters and responsible on the pawned asset. All the items tendered would be kept in a secure place under government insurance protection.
- v. Transparency aspect. Pawned items will be valued in front of the customer. Every customer would also be told in a monthly notice everything concerning the item submitted including the date of the final day before surrendering the item, excess money from the sale of the item, and whatever else.
- vi. Another benefit of Ar-Rahnu is that if the customer does not want to claim back the item, then the item would be sold by Ar- Rahnu, and any excess from what they owed Ar-Rahnu would be returned to the customer (Rugayah, 1986; Abdul Ghafar, 1997).

Ar-Rahnu is clearly seen as a source of capital for small- and medium-size traders as well as companies that are just beginning, and as a source of capital injection for companies that have already been set up. An individual who has a lot of gold items is more inclined to choose Ar-Rahnu because their business is done much faster and is much easier compared to the normal banking system.

The Malaysian Gold Association (MGA) stated that the Islamic Pawn broking Industry in Malaysia has grown to almost RM5 billion a year (sources) and proposed to the government to consider pawn shop business changing into one stop gold centre, which would enable pawn shops to buy and sell gold bars, gold dinars and possibly sell gold jewellery in the future (The Sun Daily, 25 Mac 2015). Hence, if this proposal come into action, it is important point to government to relook and reinforce the fast action to provide a standardize regulations and procedure of Ar Rahnu business among the banks, cooperative and private companies. This crucial in order to ensure the model of Ar Rahnu and their operation fulfil the shariah compliance. Study by Nur Hayati Rasmin et al., (2014) found that no specific law for Ar Rahnu enacted, but some cooperative institutions such as Bank Rakyat and MAIDAM has legislative policy and administrative guideline on Ar Rahnu. The operations of Ar Rahnu institutions are excluding from Pawn Brokers Act 1972, with its provision for the taking or interest that was forbidden in Islam. Ar Rahnu institutions are governed by various overlapping statutes and guidelines depending on the registration of the institutions. The absence of standardize regulation among the Ar Rahnu institutions arise conflict several issues. Hence, this paper attempt to review the act and regulations involved in Ar Rahnu industry and to disclose several issues pertaining Ar Rahnu operations in Malaysia.

## **LITERATURE REVIEW**

S. A. Bashir Ahmad, Norudin Mansor et al. (2012) examines the factors influencing the customer acceptance towards Islamic pawn broking offered by MAIDAM in the state of Terengganu. They suggest that the Islamic-based pawnshop must stress the importance of customer service in order to strengthen the customer base, in addition to “Syariah” view concern. They postulated that management practices were the most dominant factor that contribute towards customer acceptance of Ar-Rahnu MAIDAM in Dungun. In addition, Santhi Appannan and Gaithry Doris (2010) state that the operation for Islamic pawnshop transaction is quite similar with the conventional but the only difference is in the contractual terms (*aqad*) that is based on Islamic jurisprudence.

A study by Azizah O. et al. (2013), discovered that the total number of customers that pledged with MGIT from year 2007 until 2011 was 190,810 customers with 9 total numbers of outlets. Johari, Sanusi and Rais (2007) found that the main reasons customers preferred to pawn with Islamic pawnshops was because of lower storage charges as compared to conventional pawnshops as practiced by *Muasassah Gadaian Islam Terengganu* (MGIT). This finding shows that Ar Rahnu services increase demand from customers in Terengganu and MGIT had indeed played a vital role in the economic development of Terengganu. However, studies by Appannan and Doris (2011) found that majority of the Indian community in Sungai Petani was not aware of the existence of Ar Rahnu scheme.

Despite lower storage cost, Azizah, Hashim, & Syahrina, (2012) conducted research to verify levels of customer satisfaction and service quality for the pawn-broking company Ar-Rahnu in Kelantan, Malaysia. Results of the research found that many of the respondents needed

quick cash by pawning their gold items at the Ar-Rahnu shop because they like to settle unexpected problems and to obtain working capital for their business operations.

Hanudin Amin, et al. (2007) develop the model of Islamic-based pawnshop, a theoretical framework to explain the factors influence respondents' acceptance of Islamic-based pawnshop in Labuan. For that purpose, the authors proposed six constructs namely religion, pricing, pledged asset, service, location and acceptance. The model called as an Ar-Rahnu Shop Acceptance Model (ARSAM). Result from the research, Shariah view is a stronger factor influences the acceptance of Islamic pawnshops, followed by pledge asset and customer service.

In addition, Hisham, Shukor, Salwa, & Jusoff, (2013) provide a review on Ar-Rahnu's concept and challenges faced by Islamic pawn shops in Malaysia. Instead of that the studies also reveal several advantages of Ar Rahnu as compared to conventional pawn broking system such as imposing lower services charge to the borrower.

## **REGULATION OR GUIDELINE RELATED WITH AR RAHNU INSTITUTION**

Pawn broking system in Malaysia established since the immigration of Hakka Chinese trader to Malaya and started to growth until today. Pawnshop institutions were actively contributing to the Malaysia market as a lender of last resort to borrow money and less stringent as compared to borrow fund from banking institutions. Among the states which have the most conventional pawn broking shops are Perak, Selangor, Johor, Kedah and Penang. Before the introduction of Pawnbrokers Act 1972, pawn broking system supervised by nine different enactments in Malaysia (Azizan Abdul Hamid, 2006). The nine enactments/ ordinance were;

- i. Pawn Broker Ordinance S.S Cap 216.
- ii. Pawn Broker Ordinance F.M.S cap 85) applicable for state of Pahang, Selangor, Perak, and Negeri Sembilan
- iii. *Enakmen Pemegang pajak Gadai Negeri Johor* No. 36
- iv. *Enakmen Pemegang pajak Gadai Negeri Kedah* No. 71
- v. *Enakmen Pemegang pajak Gadai Negeri Terengganu* No. 42
- vi. *Enakmen Pemegang pajak Gadai Negeri Perlis* No. 5
- vii. *Enakmen Pemegang pajak Gadai Negeri Kelantan* No. 8
- viii. *Ordinan Pemegang Pajak Gadai Negeri Sabah Perkara* 94

Pawnshop businesses operate as one-stop financial centres for their customers. These pawnshops are mostly privately owned and operated for profit. Previously, the operation of pawn broking industry supervised by the Pawn Brokers Act 1972 and under the purview of the ministry of housing and local government. However, the current practice, both conventional - and Islamic-based pawnshops, are separately regulated.

The operations of *Ar Rahn* institutions are excluding from Pawnshop act 1972, due to the existence of non-compliance section in Pawnshop act 1972. Imposing interest charge on the borrower has caused this act not practicable to Ar-Rahnu. Therefore, Ar Rahn institutions are governed by the various overlapping statutes and guidelines depending on the registration of the institutions.

In the early 1990s, the Islamic-based pawnshop owned by a charitable group, cooperative bank, private entities and state government. The pioneer Ar Rahnu institutions in Malaysia

such as Yayasan Pembangunan Ekonomi Islam Malaysia (YAPEIM), Bank Kerjasama Rakyat, Permodalan Kelantan Bhd and Muasasah Gadaian Islam Trengganu (MGIT) were allowed to open branches throughout Malaysia, Kelantan and Trengganu, respectively (Ismail & Ahmad, 1997).

At present, Ar Rahnū operators can be categories into four categories:

- i. Banking institutions – RHB Bank, CIMB, Bank Muamalat
- ii. Non Banking Institutions – Development Financial Institutions (bank Kerjasama Rakyat, Agro Bank, Ar Rahnū Exchange)
- iii. State linked company - Mu'asasah Gadaian Islam Terengganu (MGIT) and Permodalan Kelantan Berhad (PKB)
- iv. Cooperatives under foundation - YAPEIM

In terms of legislation, the Ar Rahnū system is subject to certain laws (Ismail, A. G. and Maamor, S. (2007). Each of the above categories conducts their own practice and applies different guideline in the country. Table 1 shows the related regulations or guidelines involved in Ar Rahnū institutions.

**Table 1: Guidelines in Ar Rahnū Institutions**

Banking Institutions – RHB, CIMB, Agro Bank, BIMB	<ul style="list-style-type: none"> <li>- IFSA</li> <li>- Shariah committee</li> </ul>
Non-Banking Institutions – Development Financial Institutions Bank Kerjasama Rakyat Malaysia Berhad	<ul style="list-style-type: none"> <li>- Development Financial Institutions 2002</li> <li>- GP 25 Garis Panduan Pajak Gadai Islam Ar Rahnū</li> <li>- Bank Rakyat Ar Rahnū manual guide</li> </ul>
State Linked Companies/Cooperatives – Muasasah Gadaian Islam Terengganu (MGIT)	<ul style="list-style-type: none"> <li>- Establish under Majlis Agama Islam dan Adat Melayu Terengganu (Maidam), Terengganu</li> <li>- Badan Berkanun negeri</li> <li>- <i>Tatacara Pengurusan Skim Ar Rahnū, Majlis Agama Islam dan Adat Melayu, Terengganu</i></li> </ul>
Cooperatives under foundation – YAPEIM	<ul style="list-style-type: none"> <li>- Propose by Prime Minister Malaysia to promote Ar rahnū in Malaysia. Control under Malaysia government.</li> <li>- Provide manual guide on Ar Rahnū</li> <li>- GP 25 Garis Panduan Pajak Gadai Islam Ar Rahnū</li> <li>- Undang – undang kecil Koperasi</li> <li>- Aturan Ar Rahnū</li> </ul>

## ISSUES ON AR RAHNU

### i. Pawned Item

Imani Mokhtar et al. (2013) mention practically the assets that can be pledges at Ar Rahnū are only gold and jewelleryes. Ar Rahnū institutions presently only allow gold bar and

jewelleries as guarantee for the loan borrowed and the amount lent depends on the value of the gold. This is due to the reason gold and jewelleries carry a strong and stable value and demand (Sharif, Shaharuddin, Muhamed, Pauzi, & Mohd, 2013). This is contrast with the application of Ar rahn in the era of prophet Muhammad p.b.u.h in which the pledge item can be accepted from any goods that has strong own value. The innovative Islamic pawnshops should be able to diversify the pledge asset for business, which is not just limited to gold but can be other valuable assets such as silver and Rolex watch, which are expensive in the contemporary business (Hanudin, Rosita, Hazlan, & Rostinah, 2007).

### **ii. Amount of Financing**

Study by Azila (2011), the researcher observed that with respect to conventional pawn broking, customers could negotiate the loan amount with the officers in relation to the perceived value of the collateral. In some conditions, the amount of loan obtained could be up to 85% to 90% of the jewellery value. In contrast with the Ar Rahn, majority of the operators provide a lower margin of financing of about 65% to 80% from the value of marhun.

### **iii. Safe Keeping Charged**

The issue of Shari'ah perspective in Ar Rahn is the absence of a clear justification of the *ujrah* fee rate charged by the bank and pawnshop. The interest rate and other charges are determined by each pawnbroker. In the market, conventional pawn broking impose interest rate fixed at 2 per cent per month as stipulated in the Pawn Brokers Act 1972. This rate is expected to increase if the maturity of the loan is more than one month. However, for Ar Rahn institutions safekeeping charge is different among the types of Ar Rahn operators. As current practice, Ar-Rahn is the only product that requires the collateral and yet the *ujrah* fee rate is much higher than the others which it has not. The amount 12.85% a year with a strong back up by the pledged item obviously not reach into a level that it has a good competitive rate. The solution could be made is to adjust the rate by increasing the maximum amount of loan and extending the period of repayment (Sharif, Shaharuddin, Muhamed, Pauzi, & Mohd, 2013).

Furthermore, in most transactions, the maturity of Ar Rahn financing is up to six months. In the event of default, customer will be given the option of the extension for another 6 months to repay the loan. Nevertheless, another 6 month of extension period is given only when the *ujrah* fee for the first 6 month of period is being settled. This will lead to a double charge of *ujrah* fee as it is imposed for a second time in the sixth month extension period contract. It is commonly understood for customers to renew these loans by paying extra fees or interest on the loan extension. In certain circumstances, customers may redeem within a week or two. In fact, as mentioned by Bouman and Houtman (1988), there are cases where money is borrowed not once but repeatedly and loans are made piecemeal for extremely short periods.

## **CONCLUSION**

The discussion on the regulation and current issues related with Ar Rahn is one of important effort to ensure the Ar Rahn institution sustain and applicable in the Islamic Financial Market. As one of the Islamic financial institution, it seems crucial to Ar Rahn institutions to comply with Shariah compliance in their operation. Hence, new act or regulation from regulator to standardize the operation of Ar Rahn in Malaysia is crucial to be introduced. The existing Ar Rahn in Malaysia helps to reduce Muslim community from obtaining fund from illegal lender such as loan shark. Based on the roles of Ar Rahn, it is cannot be denied

that pawnshop institution has a big impact to the social development and hence contribute to economic growth. However, to ensure the sustainability of Ar Rahn industry, the issues arise in Ar Rahn must be cater efficiently. Ar Rahn operators are advisable to have their own Internal Shariah Legal Advisors to ensure the validity of Ar Rahn operation accordance to Shariah principles.

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