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by Ivan Rahmat Santoso

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Musyarakah Mutanaqisah Contract Risk Management in Islamic Banks in Indonesia: Legal and Operational Issues

Ivan Rahmat Santoso¹, Molbi Harsanto², Ismet Sulila³, Agil Bahsoan⁴

Gorontalo State University^{1,3,4}

STEBIS Bina Mandiri

Jl. Jend. Sudirman No.6, Kota Tengah, Gorontalo 96128, Indonesia

Correspondence Email: ivanrahmatsantoso@gmail.com

ABSTRACT

This paper aims to solve the problem in the risk management of the *musyarakah mutanaqisah* contract on housing finance in Islamic banks in Indonesia, especially about legal and operational issues. This study uses a qualitative method using library data collection techniques and interviews. The results of the study found that in legal and operational risk management can be resolved through consensus agreement by rescheduling, adding new conditions, and using new structures without contradictions in terms of both Islamic Shari'a aspects and positive laws in force. The design of the contract through making proof of ownership of some assets that have been agreed upon and the determination of administrative costs by the principle of profit-sharing is needed to minimize the impact of risk for the bank and the customer.

Keywords: Risk Management, *Musyarakah Mutanaqisah* Contract, Legal Issues, Operational Issues

INTRODUCTION

Islamic banking system in its application requires Islamic values as a basic guideline in its operations (Alsmadi & Zarour, 2015) must be able to apply Islamic values in its work procedures and mechanisms so that people feel the real difference between conventional banks and Islamic banks (Buallay, 2019) and affect the level of public confidence in Islamic banking (Salman & Nawaz, 2018). Islamic values derived from the principles of sharia are certainly not only symbolic but must be applied in all Islamic banking activities, especially the implementation of Islamic banking products (El-Ghattis, 2011). Among the sharia banking products that are unique and often contradictory in their application to be discussed is the *musyarakah mutanaqisah* contract which is generally used for housing finance.

The Financial Services Authority as an institution that has the functions, duties, and authorities of the regulation, supervision, inspection, and investigation of financial institutions in Indonesia outlining the specifications of the *musyarakah mutanaqisah* contract (MMQ) in Islamic banking in Indonesia (Otoritas Jasa Keuangan (OJK), 2016a) implemented to finance the purchase of new, old property, take over and refinancing, home financing The property can be: residential, flats, shop houses (Ruko), home offices (Rukan), apartments and condominiums, while in terms of the period, MMQ financing can be intended for financing Medium-Term or Long-Term Financing. This becomes an interesting contract for property financing such as residential and can be an alternative to financing murabaha sharia residential property/*bai 'bi tsaman ajil* (Meera & Razak, 2009). Based on the latest sharia banking statistics in March 2019 specifically for financing housing ownership by sharia commercial banks and sharia business units reaching 73,256 billion with a term financing ratio (NPF) of 1,622

The concept of Profit and Loss Sharing in profit sharing-based partnership financing with the *musyarakah mutanaqisah* (MMQ) contract requires good risk management by Islamic commercial banks, Sharia Business Units, Sharia Rural Credit Banks to be in line with the value religious values (Trad et al., 2017) so that there is no deviation to the agreed Islamic banking regulations (Alam et al., 2019). Moreover, Islamic commercial banks, Islamic business units, and Islamic people's credit banks as institutions must hold their funds from third party depositors. Therefore we need a risk management system that can be effectively applied in the whole MMQ process, but in practice sometimes In the application of MMQ in Indonesian Islamic banking, it is found a gap between practice and theory so that it raises people's perception of Islamic banks that in practice Islamic banks are no more equal with conventional banks. This gap has an impact on the special trust of the public in financing MMQ, so the analysis is to find solutions that are relevant for the company (Ng Yi Wen, Daisy Mui Hung Kee, Koid Wang Ling, Ng Sok Xuang, 2019) like Islamic banks in dealing with these problems is needed as a form of social responsibility (Alfahad & Quttainah, 2018) from a corporate institution based on Islamic values. Discussion on the issue of MMQ Sharia banking products based on partnerships with revenue sharing such as Musyarakah and *Musyarakah Mutanaqishah* in Indonesia currently have not experienced growth when compared to other products. In December 2017 *Musyarakah* financing was recorded to only have a portion of 28.50% of the total Islamic banking financing. The *Musharakah* product should be a superior product of Islamic banking because it has very different characteristics from conventional bank products (Divisi Pengembangan Produk dan Edukasi, 2016). The results showed that the priority problem in terms of constrained product development MMQ Home Financing in the frame of the ANP Method according to Experts, Practitioners and Regulators is a matter of Legal / Structural Issues (Jawab et al., 2018), Besides, no less important about operational issues in MMQ financing related to financing risks (Tursoy, 2018) which is caused by the failure of the Customer in fulfilling his obligations to sharia commercial banks, sharia business units or sharia people's credit banks or if the Customer defaults on the terms of the contract. MMQ financing is included in the category of products with a high-risk profile because capital participation is equated with a portion for profit and loss which means it is also equivalent to risk coverage according to the portion of capital participation of each party. There are three stages in MMQ Financing, namely pre-contract, contract term, and contract completion. Problems that occur when the running of the financing contract, where the emergence of problems during the initial process until the running of the contract. On the other hand, Islamic banking must minimize this situation as a form of service that has a positive impact on increasing consumers of financing products through the MMQ contract (Hanudin, 2014).

The purpose of this study is to explore effective actions in dealing with issues related to risk management for the special contract of *Musyarakah Mutanaqisah* financing which generally occurs in Islamic financial institutions in Indonesia. The novelty in this paper lies in contributing to the resolution of the problem of the gap between practice and theory that occurs in the current practice of the *Musyarakah Mutanaqishah* in Indonesia, especially with legal and operational issues and solutions for handling these problems. Thus this study provides a new contribution to academics and more specifically to the managers of Islamic banking in solving problems in the MMQ contract.

The rest of the paper is organized as follows: Section 2 reviews the related literature. Part 3 Research methodology and Part 4 Findings and analysis and finally the conclusions of the study.

LITERATURE REVIEW

Discussion of some important practical issues in the *musyarakah mutanaqisah* financing contract (Asadov et al., 2018) has been widely studied in previous papers. Several previous studies that discussed this topic included the *mutanaqisah musyarakah* rental index rates (Mohd, 2016), understand the *musharakah mutanaqisah* Islamic space financing cooperative

(KOPSYA) (Norbaizurah, 2018), Sharia *Musyarakah* Risk *Mutanaqisah* Financing Contract in Malaysia (Idris, 2018), Restructuring the lease component for more innovative sharia compliance products in Islamic home financing (Mahfudz et al., 2016), Implications of *Musharakah Mutanaqisah* at Arena Islamic Banking Malaysia: Legal Documentation Perspective (Mohd Subky et al., 2017), *Musyarakah Mutanaqisah* (MM) Home Financing for Labor Affordability: A Simulation Case Study Approach (Eam et al., 2019)

The previous discussions focused more on the analysis of the problems faced in MMQ financing in the general context of the contract and the solution to its resolution. Meanwhile, for a deeper exploration of the issues in more detail in handling on the ground regarding legal and operational issues that occur in the implementation of the MMQ contract in Indonesia, it needs to be analyzed more deeply.

***Musyarakah Mutanaqisah* Funding**

Understanding *musyarakah* or *syirkah* linguistically means *al-ikhtilat* or merging or mixing. According to the scholars of *fiqh*, *syirkah* in terms of a combination of assets to be used as business capital and the results in the form of profits or losses shared (Sayyid Syabiq, 2000). According to the Shariah Standards of Accounting and Auditing Organizations for Islamic Financial Institutions (AAOIFI), *musyarakah* is "a form of partnership in which one partner promises to buy equity shares from other partners in stages until the rights to equity are truly achieved. transferred to him. This transaction begins with the formation of a partnership, after which the purchase and sale of equity are made between the two partners. Therefore, these purchases and sales should not be regulated in a partnership contract. In other words, buyer partners are only allowed to make promises to buy. This promise must be independent of the partnership contract. Also, the sale and purchase agreement must be independent of the partnership contract. It is not permitted that one contract is entered as a condition for concluding the other (Financial & (AAOIFI), 2008).

The term *musyarakah* does not exist in Islamic Jurisprudence, but it was only recently introduced by those who write about Shariah financing schemes which are usually limited to certain types of *syirkah*, namely *syirkah al-amwal* which is permitted by all scholars. *Musyarakah* is a profit-sharing agreement when two or more entrepreneurs who have funds/capital work together as business partners, financing the investment of new or existing businesses. Business partners who have capital have the right to participate in company management, but that is not a requirement (Salehuddin & Saiti, 2016). The parties can divide the work of managing the business according to the agreement and they can also ask for salary/wages for the labor and expertise they devote to the business

² *Musyarakah* is a contract of cooperation among capital owners who mix their capital for profit-making purposes (Nasim & Mediawati, 2019). In *musyarakah*, partners and fund owners, for example, banks, together provide capital to finance a particular business, both those that are already running and those that are new. Furthermore, partners can return the capital, along with the agreed profit sharing in stages or at the same time to the Bank. *Musyarakah* can be permanent or decreasing. In a permanent *musyarakah*, each part of each partner is determined according to the contract and the amount remains until the end of the contract period, while in the *musyarakah* decreases, the share of the capital owner of the fund or bank is transferred gradually to the partner so that the share of the capital of the owner of the fund/bank will decrease and at the end of the contract period, the partner will become the owner of the business. *Musharaka* profits are shared between the parties, either proportionally according to the paid-in capital or by the agreed amount agreed upon by the parties. While the loss is charged proportionally under the paid-up capital

Mutanaqishah Musyarakah Covenant Practices in Islamic Banks

The practice of *musharaka mutanaqishah* (MMQ) has been carried out by Islamic Banks in Indonesia, one of which is the iB Muamalat Home Ownership Credit product owned by Bank Muamalat Indonesia, Tbk. In the iB KPR product, Bank Muamalat offers 2 (two) different contract schemes, namely with the Murabahah contract or with the *Musyarakah Mutanaqishah* contract, the Customer can choose what contract if it matches the wishes and conditions of the customer. This contract can accommodate other things that cannot be accommodated by other contracts such as *murabaha*. The *musyarakah mutanaqishah* contract can be practiced in a financing scheme in a Sharia Bank, especially for asset ownership. An asset that is used as an object of the agreement, one of which is a residence. Broadly speaking the MMQ implementation flow is as follows:

1. The customer chooses the type of house he wants to have through financing in a Sharia Bank with the *musyarakah mutanaqishah* scheme
2. The house recommended by the customer is then carried out by an asset appraisal (asset valuation) by an internal bank or through an external party / third-party / (Property Appraisal Service Office). This assessment is required because the house is used as a dhaman / collateral / collateral/collateral for the financing carried out.
3. If the price is known and the value of the guarantee meets the banking requirements, the customer must complete the financing documents required or requested by the bank, such as personal data, income data, collateral data, etc.
4. If all files have been collected, the bank will verify and analyze the data. Broadly speaking, the analysis conducted is an analysis of the ability to pay customers (cash ratio) and guarantee coverage. Then the bank's internal approval is made for determining the financing ceiling, the number of installments, and the financing period.
5. After financing approval, the Bank sends an Approval Request for Payment (SP3) or Offering Letter (OL) to the customer for later signing.
6. The customer makes a down payment (DP) to the developer/seller of the house. The downpayment is the portion of the customer's *syirkah* in *musyarakah* for homeownership.
7. The customer and the bank enter into a mutually funded *musharaka* financing agreement for the house. The contract used is *musyarakah*, *bai'* and *ijarah*.
8. After the contract is made, the Bank pays the remaining balance for the purchase of a house, which the Customer has previously provided his *syirkah* through the DP. The contract of buying and selling houses has been made by paying 100% of the *syirkah* portion.
9. The customer pays installments every month to the bank for a specified period. The installment functions as:
 - a. Rent money (*ajir* customers for the placement of houses (*musharaka* assets).
 - b. Rent as an object of profit sharing for the *musyarakah* contract, which will be collected according to the portion of profit sharing agreed on in the contract.
 - c. Some of the rent which is profit for the customer by the profit-sharing ratio is not taken by the customer, but for the purchase of a portion of the Bank's ownership of the house. Then each customer pays monthly installments, it will increase the portion of customer ownership and reduce the portion of bank ownership. (*mutanaqishah* implemented)
10. If the period has expired (due), and the customer has paid all of his monthly payments, then the entire portion of homeownership has been transferred to the customer. The customer has a 100% home. Thus, the Underwriting Right on housing guarantees can be released by the Bank (by Roya).

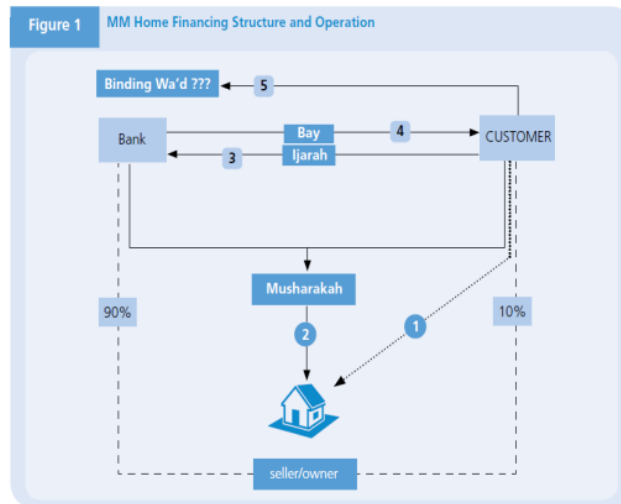


Figure 1. Summarises a Typical MM Home Financing Structure And Operation
(Asian Institute of Finance (AIF), 2013)

1. The customer selects the house and applies for financing from Bank
2. The bank approves the application and enters into a *musyarakah* agreement with the customer to jointly purchase and own the house. [e.g. 90:10 ratio]
3. The customer leases the bank's share in the house (*ijarah*) & makes periodic rental payments
4. The customer buys portions of ownership in the house from the bank until gradually the bank sells all its shares in the house to the customer who then fully owns the house
5. Some banks will ask the customer to give it a binding promise (*wa'd*) to purchase the *Musharakah* asset.

RESEARCH METHODS

This study uses qualitative research methods with qualitative descriptive analysis techniques. Primary data sources include semi-structured interviews conducted with the informants involved. Justification for the selection of informants is based on the expertise of informants in the field of Islamic banking in Indonesia. Secondary data obtained through the review of qualitative documents obtained from *musyarakah mutanaqisah* (MMQ) transaction documents in Indonesia. Textual analysis is used to identify or describe the purpose of the message based on the text read (Frey et al., 2000).

RESULTS AND DISCUSSION

Based on the results of the analysis of legal and operational issues relating to the implementation of *musyarakah mutanaqisah* (MMQ) products in Indonesian Islamic banking, it can be seen in the following table:

Table 1. Legal and Operational Issues of MMQ Agreement in Indonesia

Legal Issues	Operational Issues
<ul style="list-style-type: none"> • The difference in the rules of fiqh with positive law Indonesia related to registration of ownership certificate • The weak legal position of Islamic banks is not can use a debit statement, and mortgage rights (APHT) for transfer of ownership • DSN <i>fatwa</i> and PBI or SEBI Fatwa have not yet been sufficiently complete to regulate the substar of Islamic banking agreements which is required by a notary or sharia bank 	<ul style="list-style-type: none"> • The problem of price independence when financing <i>musyarakah</i> accompanied the transfer of ownership Banks tend to immediately execute collateral due to customers failing to meet obligations rent without the consent of the customer • Transfer of all payment obligations co that havebeen incurred to customers dev from AAOIFI standards and DSN No. DSNMUI / XI / 2008 <i>Fatwa</i>

Source: (Otoritas Jasa Keuangan (OJK), 2016)

Based on the above table related to legal and operational issues of the MMQ contract in Indonesia, where after observing the current implementation of the *musyarakah mutanaqisah* in Islamic Banks and reviewing the general provisions of this contract, we can see that there are gaps in practice and theory including :

1. After the contract is made, the next process is to reverse the name of the house (asset) to one of the parties, namely the Customer. While the Bank also owns the assets, even the initial portion that the Bank includes is much greater than the customer participation. There is no authentic proof of Bank ownership of the *musyarakah* assets on the Asset Certificate. Based on the analysis results, the risk management solution can be completed with the following steps:

When making a contract both parties, the customer, more specifically the bank, needs to make proof of ownership of some of the agreed assets. Compilation of Sharia Economic Law (KHES) Book II Article 46 states that a contract is only valid between the parties that entered into the contract (Solihin & Suarsa, 2019). This means that the MMq contract entered into by the customer and the bank applies to the customer and the bank as legal subjects in the agreement. Furthermore, writing the name of the customer in possession of the asset certificate is only an effort of the shariah to be able to simplify and avoid double costs. So it can be concluded that regarding the problem of ownership of assets in the name of the customer is not a proof that the object of financing has been owned by the customer fully, but only an effort made by the bank and the customer to facilitate customers in the transfer of this object, so that the name for the object. This financing does not need to be done several times, only the first time directly in the customer's name. This is done the principle of freedom of contract and agreement of the parties to the union in agreeing. Whereas written evidence confirming the share of ownership of the Islamic bank to the home assets remains binding until the customer completes his obligation to unemployment the house.

Based on the object of financing through the use of the *mutanaqishah musyarakah* contract or joint ownership, this has consequences for the rights of each owner to

have legal proof of ownership of the asset through a certificate. However, the certificate cannot be made in the name of two legal subjects, so the regulation on this matter is left to the burden itself. The object that is jointly purchased is shared because there is still another portion of Syariah, not just one party.

2. Costs arising from the binding/contract such as Buyer Tax, BPHTB, Change of Name, and others, are fully borne by the customer. Meanwhile, in principle, those who buy assets are 2 (two) parties, namely the Bank and the Customer. Risk Management Solutions for these problems:

Administrative costs can be determined according to the needs of the process of binding the *musyarakah mutanaqisah* contract, so that there is clarity of details regarding the administrative costs and the bank can also be responsible. Costs incurred in the engagement of the *musyarakah mutanaqisah* contract should be shared because they are part of the ownership of the *musyarakah mutanaqisah* object such as notary fees and insurance, for administrative costs based on an analysis of the results of interviews can be charged to customers because these costs are for operational processes before, when, and the binding of the *musyarakah mutanaqisah* contract. It's just for the determination of administrative costs that should not be done based on the percentage of the funding ceiling, which is equal to the profit-taking set in conventional banks on credit financing. For this reason, administrative costs should be determined following the needs of the contract process. Investment decisions and indirect investment decisions can be approved to assess companies (Murniati et al., 2019) that are partners of the loan. So that determining the administrative costs need to be carefully considered by the Islamic bank.

Openness to details of administrative costs is very important in the framework of openness with mutual feelings of pleasure because administrative costs are charged to customers. So that the designation becomes clear and can also be accounted for. Imposing all costs unilaterally to the customer should not be done even though this does not cause the invalid *musyarakah mutanaqisah* contract, but this involves injustice, in which the customer himself has not carried out his business activities but must bear the entire cost burden. This can lead to a decrease in customer capital and also contrary to Islamic economic principles of justice. In the Al-Qur'an surah *al-Nahl* verse 90 Allah says: Meaning: "*Verily Allah commands (you) to act justly and do good, give assistance to relatives, and he forbids (commits) abominable acts, munkar, and hostility. He teaches you so that you can take lessons*".

The meaning of fair is "good and balanced". At the *musyarakah mutanaqisah* agreement between the customer and the Islamic Bank, there was an imbalance in which all costs were borne unilaterally by the customer. These costs should be borne jointly by the customer and the bank because these costs are included in the acquisition cost of the mutant assets of the mutants. Bukhari's hadith from Muhammad bin Abdullah bin al-Mutsanna reads: "*Having told us Muhammad bin 'Abdullah bin Al Mutsanna said, told me Tsumamah bin' Abdullah bin Anas that Anas told him that Abu Bakr radiliallahu'anhu set alms obligations to him as the Messenger of Allah Saw has required it. He said: "And the two men who have mingled (the two livestock) should make peace with the same burden"*". (HR.Bukhārī)

From the hadith above, it can be seen that if two assets have been mixed, both must bear the burden arising from the engagement. Therefore, in the case of an agreement between a customer and a Sharia Bank with a *musyarakah mutanaqisah* contract, the costs incurred jointly should be borne jointly, besides that the *musyarakah*

mutanaqisah contract is also included in the category of the cooperation agreement, which in its implementation should involve the costs and benefits together.

3. If bad financing occurs, and sales of the *musyarakah* (house) assets are carried out, the proceeds of the sale are made as follows:
 - a. If the selling price of the house is greater than the remaining outstanding principal (the remaining portion owned by the Bank), the proceeds of the sale are used to cover the remaining outstanding first, then the rest is given to the customer. This is contrary to the principle of profit sharing and loss in *musharaka*. Based on the *musyarakah* principle in which the partners obtain profits based on the agreed ratio at the time of the contract and bear the loss per the proportion of capital than with the conditions of sale of these assets, carried out as follows:
 - Proceeds from sales remain prioritized to cover outstanding principal (bank portion)
 - After that, the rest which is the profit of selling assets is not entirely given to the customer but must be divided according to the proportion of profit-sharing agreed upon at the time of the contract
 - b. If the selling price of the house is less than the remaining outstanding principal (the remaining portion of the bank) then the entire sale proceeds are used to cover the remaining outstanding, if the outstanding remains, then the customer must pay the shortfall or if it is unable, then it becomes the Bank's burden. This also contradicts the principle of profit sharing and loss in *musyarakah*. Based on the *musyarakah* principle in which the partners obtain profits based on the agreed ratio at the time of the contract and bear the loss by the proportion of capital, then with the condition of the sale of these assets, carried out as follows:
 - Proceeds from sales remain prioritized to cover outstanding principal (bank portion)
 - The remaining outstanding which is not covered by the proceeds of the seller must be divided against the two parties, namely the Bank and the Customer following the portion of ownership before selling the collateral (the last portion)

Based on the discussion of several settlements in the MMQ contract above, it has been made clear that to realize cooperation and fulfill the needs of each party, in this case the bank and the customer are required to have their openness and separate strategies for managing risks in Islamic home financing. The bank's responsibility for the completion of the contract is one of the factors that affect the value of a company (Ni Made Sunarsih & Ni Putu Shinta Dewi, 2019), especially banks, has an impact on people's judgment, as a form of trust from people in the company. Therefore, Islamic banks need to involve each stakeholder in the decision-making process (Alsbaity, 2018) financing to improve MMQ contract services for customers. Also, sufficient knowledge capital from the customer is needed to facilitate the customer to interact with the bank when applying for home financing with an MMQ contract.

CONCLUSIONS

Risk management in dealing with legal and operational issues regarding the *musharaka mutanaqisah* contract for housing finance needs to be considered by the parties in this case the customers and the banks. In resolving these disputes, sharia principles must first be resolved by prioritizing deliberations and consensus. Regarding the principle of consensus in the resolution of disputes can be reached by Rescheduling, the addition of new conditions (reconditioning), or the use of new structures (restructuring). In addition to anticipating and minimizing the risks that will occur when the contract is running or when the contract terminates the bank should apply the precautionary principle. The purpose of the application

of the precautionary principle is that banks are always in a healthy condition so that they are always liquid, solvent and profitable. With the application of the precautionary principle, it is expected that the level of public trust in banking is always high so that the community is willing and not hesitant to save their funds in the bank. On the other hand, the customer should first study each contract in *musyarakah mutanaqisah* financing, how to deal with the problematic financing that will be carried out later and must know exactly how the regulations have been given so that in the future no party feels disadvantaged. This research only focuses on risk management issues, especially the legal and operational issues of the *musyarakah mutanaqisah* contract for residential financing. Therefore the scope of discussion in this study does not entirely solve the problems of sharia issues in Islam related to MMQ. Furthermore, the findings in this study are limited to MMQ problems that occur in Islamic banks in Indonesia. To get better and more representative results, further research can focus on the risk management associated with MMQ in other countries. The two future studies can examine the MMQ risk management issues of sharia issues (for example: MMQ objects / goods that are used as collateral, the principle of "two-contract-in-one-item" when the lease and purchase contracts are agreed at the same time, Maintenance costs and asset insurance fully charged to customers, etc).

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