

# The Evolution and Role of Ar-Rahnu in Malaysia's Financial System

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## Abstract

This mini-review investigates the development and functional significance of ar-rahnu, Malaysia's Syariah compliant pawnbroking system, within the broader framework of Islamic finance and financial inclusion. Initiated in the early 1990s, ar-rahnu has served as an accessible microcredit facility primarily targeting low-income earners and micro-entrepreneurs. It utilizes gold as collateral and operates without charging interest, adhering strictly to Islamic legal principles. Over time, the model principally operated by cooperatives and Islamic financial institutions has proliferated across the country, establishing itself as a viable ethical substitute to conventional pawnbroking. This review specifically analyzes ar-rahnu's contribution to Malaysia's financial inclusion agenda and assesses the prospective role of digital innovations, particularly AI tools like ChatGPT, in enhancing service delivery. Although AI integration in Islamic finance remains nascent, preliminary findings suggest its potential to support user education, automate routine inquiries, and optimize operational processes. Nonetheless, concerns persist regarding the precision of citations and content completeness. The paper identifies a significant research gap in harmonizing digital innovation with traditional Islamic finance mechanisms and emphasizes the necessity for further inquiry into the ethical, legal, and technological dimensions. Synthesizing key themes from existing scholarship, this review offers insights into the evolving role of ar-rahnu as a pillar of inclusive financial systems in Malaysia, while proposing directions for technological enhancement aligned with Syariah compliant development.

**Keywords:** Ar-Rahnu, Islamic finance, financial inclusion, artificial intelligence.

## 1. INTRODUCTION

Ar-Rahnu, a form of Islamic pawnbroking, has emerged as a crucial element in Malaysia's dual financial architecture, offering a Syariah compliant alternative to traditional pawnbroking services particularly catering to the needs of the Muslim population (Damit, 2023; Abdul Razak & Austy, 2022; Aziz et al., 2020). Originating in the early 1990s with key establishments such as Muassasah Gadaian Islam Terengganu (MGIT) and Kelantan Capitalization Berhad (PKB) (Saiman & Zainuddin, 2022), the ar-rahnu scheme was conceptualized to provide expedient, equitable, and transparent loan facilities while strictly prohibiting interest (riba) as mandated by Islamic jurisprudence (Othman & Abdullah, 2019; Daud et al., 2021). It has gained significant traction among micro-entrepreneurs and economically vulnerable communities due to its ethical orientation and relatively lower financing costs when compared to its conventional counterparts (Hilaluddin et al., 2022; Azman et al., 2020).

The rising popularity of ar-rahnu corresponds with increased public awareness of its benefits within the Muslim community (Ong et al., 2023). However, this growth trajectory is not without challenges. The scheme faces stiff competition from conventional pawnshops that offer higher valuations for pledged items (Muda et al., 2024), along with persistent demands for operational and service delivery enhancements (Mohd Thas Thaker et al., 2021). Furthermore, the preference for conventional alternatives among certain segments of the Muslim population suggests unresolved systemic issues (Saiman & Zainuddin, 2022).

In recent years, digital transformation particularly through the adoption of artificial intelligence (AI) has begun to redefine various financial sectors, including Islamic finance (Pazouki et al., 2025; Roy et al., 2025; Kumar et al., 2024). The application of AI tools, including ChatGPT and similar language models, introduces opportunities to streamline operations, enhance user accessibility, and personalize financial advisory services (Azman et al., 2022; Azman et al., 2024; Chen, 2025). However, compared to other industries, Islamic financial institutions have shown a more cautious approach in embracing these innovations (Ali & Aysan, 2025).

Accordingly, this mini-review investigates the historical development and contemporary function of ar-rahnu within Malaysia's financial landscape, while exploring how AI and digital technologies could shape its future trajectory. The review critically examines recent developments, ongoing challenges, and technological potentials, particularly in customer service optimization, operational streamlining, and enhancing financial sustainability. It also evaluates the ethical and regulatory implications associated with AI deployment in Syariah compliant frameworks. The structure of the article includes a historical overview, current operational context, analysis of digital integration, and a forward-looking discussion on the implications of technological convergence within the ar-rahnu sector.

## 2. RESEARCH METHOD

A comprehensive literature search was conducted using **Scopus and ScienceDirect**. Keywords such as ("Ar-Rahnu" OR "pawn" OR "collateral" OR "Islamic finance") AND ("Malaysia" OR "Malaysian" OR "Southeast Asia" OR "ASEAN") AND ("financial system" OR "banking" OR "economy" OR "microfinance" OR "lending") AND ("shariah" OR "Islamic law" OR "compliance" OR "regulation") AND ("access to

**finance" OR "financial inclusion" OR "credit" OR "loans").** The following inclusion and exclusion criteria were established to ensure the relevance, quality, and rigor of the selected literature.

### 2.1 Inclusion Criteria

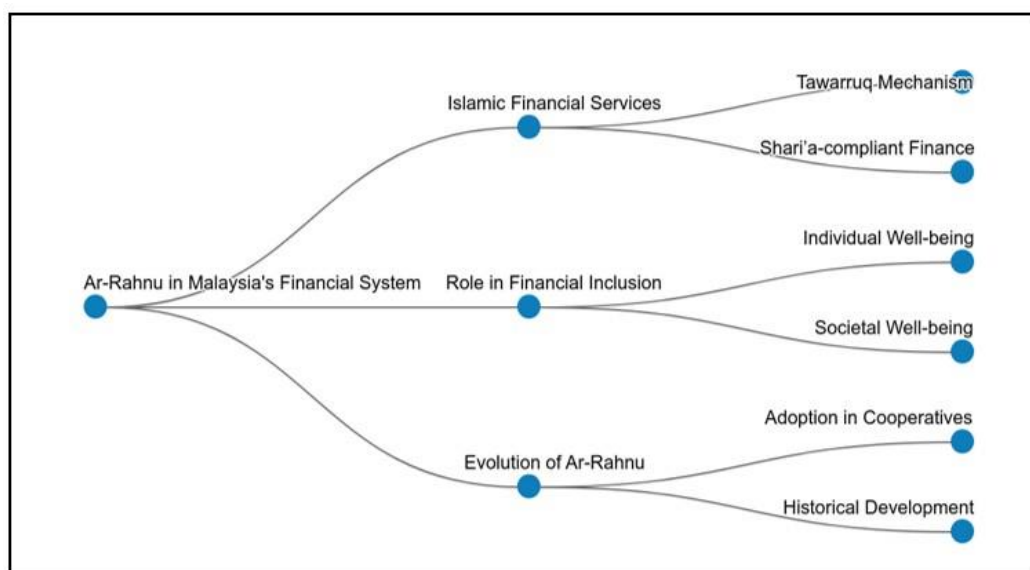
- i. Studies explicitly examining the foundational principles, historical evolution, regulatory frameworks, institutional structures, and socioeconomic contributions of ar-rahnu within the Malaysian context.
- ii. Research focusing on the adoption or impact of digital innovations such as artificial intelligence (AI), ChatGPT, or other digital tools in Islamic finance, particularly in relation to microfinance services or the ar-rahnu model.
- iii. Literature that critically evaluates the efficacy, constraints, and potential of digital or AI-based tools in improving operational performance, service delivery, or user interaction within the Islamic financial system or ar-rahnu institutions.
- iv. Comparative analyses that explore both conventional and technology-driven paradigms in the delivery of Islamic financial services, especially those applicable to ar-rahnu operations.
- v. Only peer-reviewed studies published in English were considered, to maintain analytical consistency and accessibility.

### 2.2 Exclusion Criteria

- i. Articles published in languages other than English were excluded to ensure consistency in comprehension and analysis.
- ii. Studies focusing on Islamic finance or microfinance without explicit reference to the ar-rahnu model were omitted.
- iii. Research discussing ar-rahnu without any consideration of digital technology or AI-based interventions, such as ChatGPT, was excluded from this review.
- iv. Grey literature, including theses, working papers, non-peer-reviewed articles, and conference abstracts, was deliberately excluded to uphold academic rigor.
- v. Literature centered solely on conventional pawnbroking systems or unrelated financial mechanisms lacking direct relevance to Malaysia's ar-rahnu framework was also excluded.

## 3. RESULT AND DISCUSSION

This figure 1 maps the thematic structure of ar-rahnu in Malaysia, highlighting its evolution, role in financial inclusion, integration in Islamic finance, and societal impacts through cooperatives and Syariah compliant mechanisms.



**Figure 1** A General of Ar-Rahnu in Malaysia by Using Scopus AI

### 3.1 Current Status of Islamic financial services and ar-rahnu in Malaysia's Financial System

There are ongoing debates concerning the reliability of AI-generated content in Islamic financial services, particularly due to its close resemblance to pre-existing academic material. These concerns point to issues of potential plagiarism and the risk of producing content that lacks originality or may mislead users. While such

critiques are partially justified, they often neglect the technical intricacies involved in how AI models synthesize and generate information. For instance, biases observed in AI outputs are usually the result of uneven training data distributions, not personalized algorithmic behavior.

To assess the accuracy and relevance of AI applications within the Malaysian ar-rahnu framework, a sample query “Explain the role of ar-rahnu in promoting financial inclusion in Malaysia” was submitted. The generated response highlighted ar-rahnu as a provider of interest-free microloans secured by collateral, targeting financially underserved populations, particularly those in rural areas.

This output broadly aligns with empirical findings from institutional reports and academic literature (e.g., Bank Negara Malaysia and articles in the *Journal of Islamic Finance*), which emphasize ar-rahnu’s contribution to financial inclusion. However, the AI-generated responses lacked depth in terms of policy implications, regulatory frameworks, and citation accuracy (Mohd Damit, 2023).

The analysis suggests that AI tools can deliver timely and generally reliable overviews of ar-rahnu’s financial role. Nonetheless, these tools currently fall short in offering detailed, context-specific, and citation-precise insights, which are critical for academic and policy relevant discourse.

### 3.2 Current Status of role in financial inclusion and ar-rahnu in Malaysia’s Financial System

Similarly, concerns have been raised about digital technologies used to examine financial inclusion, particularly their tendency to replicate existing literature without generating novel or nuanced interpretations. Although such criticisms are valid to an extent, they often overlook the structural mechanisms by which AI models retrieve and present information. Any perceived biases usually stem from data limitations, not from intentional distortions.

When asked, “How does ar-rahnu contribute to financial inclusion in Malaysia?”, one AI-generated summary emphasized ar-rahnu’s provision of accessible, Syariah compliant microcredit for individuals lacking access to conventional loans especially in rural or financially marginalized areas.

While this generalization is supported by studies published in journals such as *The International Journal of Islamic and Middle Eastern Finance and Management*, the output overlooks critical variables such as regulatory hurdles, service limitations, and the slow pace of digital adoption (Abdul Razak & Austy, 2022).

Our comparative assessment reveals that although digital tools offer efficient overviews, they lack the analytical depth required to navigate the policy, regulatory, and operational complexities of ar-rahnu institutions. These limitations must be addressed to harness the full potential of such technologies in supporting inclusive financial development.

### 3.3 Current Status of Evolution of Ar-Rahnu and ar-rahnu in Malaysia’s Financial System

Digital tools tasked with summarizing the historical development of ar-rahnu tend to generate content that mirrors established literature, which raises issues related to academic originality and accuracy. However, such critiques often fail to consider the technical challenges involved in data processing and synthesis by AI models. Biases in generated content typically arise from gaps in the training datasets, not from algorithmic targeting of users.

In response to the query, “Describe the historical evolution of ar-rahnu in Malaysia,” AI-generated content typically states that ar-rahnu emerged in the early 1990s as a Syariah compliant alternative to conventional pawnbroking, initially spearheaded by cooperative institutions aimed at offering affordable credit to economically vulnerable groups.

This portrayal generally aligns with documented milestones in academic literature, such as the involvement of Bank Rakyat and other cooperative entities during the foundational stages. However, the AI summaries tend to exclude critical historical events, policy developments, and the evolving role of digital innovation within the sector (Azman et al., 2022).

Thus, while AI tools can provide foundational overviews of ar-rahnu’s evolution, they currently lack the depth and precision necessary for use in scholarly research or policymaking. Enhancing these tools to include richer historical data and regulatory analysis is essential for their broader application in Islamic finance studies.

## 4. CONCLUSION

This mini-review has synthesized key literature surrounding the evolution and functional significance of ar-rahnu within Malaysia’s financial landscape, with particular emphasis on its alignment with Islamic financial principles, contributions to financial inclusion, and responsiveness to digital transformation. Ar-rahnu has established itself as a vital Syariah compliant financing alternative, especially among low-income communities and micro-entrepreneurs, by offering ethically grounded and accessible microcredit solutions. The findings underscore the centrality of ar-rahnu in promoting inclusive financial practices in Malaysia, as well as its potential to evolve further through the integration of emerging technologies. While current applications of digital tools and artificial intelligence offer promising avenues for improving service accessibility and operational efficiency, the review reveals that their adoption remains nascent and fragmented. Challenges such as citation

inaccuracies, lack of contextual depth, and regulatory uncertainty must be addressed to ensure these technologies complement rather than compromise the ethical and operational integrity of ar-rahnu systems. Overall, this review consolidates established knowledge and identifies persistent gaps particularly in the technological, regulatory, and ethical domains that warrant further scholarly exploration. As Malaysia continues to advance its dual financial system, ar-rahnu stands as a case study of how traditional Islamic finance can coexist with, and be strengthened by, contemporary digital innovations. Future research should aim to construct more robust, evidence-based models for integrating AI within Islamic financial services while upholding the core tenets of Syariah compliance and developmental equity.

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