CHAPTER VII

ISSUES & PROBLEMS OF MURABAHAH FINANCING
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As described in preceding chapter, Murabahah is not the ideal mode advocated by jurists for financing purposes. It is essentially a trading instrument that has been adapted for financing. Thus, several major problems and concerns have arisen in the use of Murabahah for financing purposes, some of which are discussed below with brevity.

7.1 The Difference in Pricing for Cash and Credit Sales:

Since, Murabahah is usually used on differed payment basis i.e. the seller buys the commodity on cash and sells it on credit, while deciding the price, he also considers the period of payment. The longer the maturity of the Murabahah payment, the higher the price. Thus the price in Murabahah contract is normally higher than the market price. Now the question arises as to whether price of credit sale may be higher than that of cash sale or not. Opinions differ. Some approve and others disapprove.¹

Those who do not hold that price of a commodity in cash & credit contract may differ, argue that the increase of price in a credit sale being in consideration of the time given to the buyer, should be regarded tantamount to the interest charged on a loan, because in both cases an additional amount is charged for the deferment of payment. On this basis they argue that the murabahah contracts are no longer different in essence from the interest bearing loans.

This argument was countered by the opponent who see no harm if the price of credit sale is fixed at more than the cash price. M. Taqi Usmani has tried to convincingly counter the stand point of the former and argue that considering the

¹ One may find a detailed discussion on the subject in legal discourses, M. Taqi Usmani has briefly touched upon some details in this regard. He has summed up the arguments of both parties on the subject. See “An introduction to Islamic Finance”, op. cit. pp. 111-118
increased price in credit sale as analogous to interest does not seem to hold good. He also sees that a seller may consider many other good reasons for increasing the price. While arguing, he first tries to explain the difference between money and commodity and clear out the misunderstanding arose from the notion of treating money and commodity the same. He has put forth many points as to how money is different from commodity.\(^2\) He strongly argues that Shari‘ah has treated money and commodity differently. Hence regarding the money and commodity as same owing to outward appearance of some resemblance to each other and thus arguing the case is unjust. The summation of his argument in this regard is as follows:

- In modern commercial transaction, the difference between money and commodity is of no concern. Both are treated at par and thus can be traded in. One can sell one dollar for two dollars on the spot as well as on credit, just as he can sell a commodity in this away. But the Shari‘ah law does not subscribe to this theory.

- Money has no intrinsic utility. Whereas, the commodities have intrinsic utility.

- The commodities can be of different qualities, money, on the other hand, has no such quality except that it is a measure of value or a medium of exchange.

- In commodities, the contract (sale and purchase) is effected on a particular commodity or, at least, on the commodities having particular specifications. Money, on the contrary, cannot be pin-pointed in a transaction of exchange.

He, then argue that in view of these obvious differences between money and commodity, if there is increased price in credit sale, it can not be tantamount to interest. As in the case of currency note which has no intrinsic utility nor a different quality (recognized legally), there would be no excess on either side, and

\(^2\) For more detail, see Usmani, “An introduction to Islamic Finance”, op. cit. p. 111-112
hence not allowed in Shari‘ah. The case of the normal commodities is different. Since they have intrinsic utility and have different qualities, the owner is at liberty to sell them at whatever price he wants, subject to the forces of supply and demand.\(^3\) The supplier may even sell his commodity at a higher price in a cash transaction to different buyers and so does he in a credit sale, subject only to the conditions and ethics of sale.

Usmani, countering to another argument of opponent that the increase of price in a cash transaction is not based on the deferred payment, therefore it is permissible while in a sale based on deferred payment, the increase is purely against time which makes it analogous to interest, he makes the point clear thus: “Any excess amount charged against late payment is riba only where the subject matter is money on both sides. But if a commodity is sold in exchange of money, the seller, when fixing the price, may take into consideration different factors, including the time of payment.” For example:

(a) The seller’s shop is nearer to the buyer who does not want to go to the market which is not so near.

(b) The seller is more trust-worthy for the purchaser than others, and the purchaser has more confidence in him that he will give him the required thing without any defect.

(c) The seller gives him priority in selling commodities having more demand.

(d) The atmosphere of the shop of the seller is cleaner and more comfortable than other shops,

(e) The seller is more courteous in his dealings than others.

Thus, these and similar other considerations may have role in charging a higher price from the buyer. He further, make out the strong case that whatever the

\(^3\) ibid.
reason of increase, the whole price is against a commodity and not against money. Once the price is fixed, it relates to the commodity, and not to the time. Hence, if the customer fails to pay at the fixed time, the price will remain the same and can never be increased by the seller. Had it been against time, it might have been increased, if the seller allows him more time after the maturity.

To argue in another way, any excess in a credit transaction (of money in exchange of money) is against nothing but time because money can only be traded in at par value. For this very reason, if the debtor is allowed more time, some more money is claimed. Conversely, in a credit sale of a commodity, time, at times, may act as an ancillary factor to determine the price but it is fixed for commodity, not for time as once the price is fixed, there can be no increase.

To sum up, when money is exchanged for money, no excess is allowed, neither in cash transaction, nor in credit, but where a commodity is sold for money, the price agreed upon by the parties may be higher than the market price, both in cash and credit transactions.

This is corroborated by the stand points of majority of the jurists. They are of the view that the price may differ in case of both cash and credit transaction and seller may fix the different price for cash and credit sales and the latter may be higher than the former, subject to the condition that at the time of actual sale, one of the two options must be determined, leaving no ambiguity in the nature of the transaction.

The Council of Islamic Fiqh Academy of Jeddah which is the largest representative body of the Shariah scholars and is represented by all the Muslim countries, in its 6th convention held at Jeddah, KSA on 14-20 March 1990, has discussed the issue and resolved the following:

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4 Usmani, op. cit. pp 113-118
5 ibid.
First: It is permissible to fix an increased price for a commodity sold on deferred payment, as compared to its cash price. It is also permissible to mention different prices for cash and deferred sales. Even the deferred prices can vary according to the different periods specified for payment, and such variance can be expressly disclosed by the seller to the customer. But the sale cannot take place until the parties agree to contract a particular mode of payment and specify whether the payment is in cash or deferred. Therefore, if the sale takes place without specifying a single particular mode of payment, leaving it uncertain whether the buyer shall pay in cash or in installments, the sale is not valid according to Shari'a.

Second: It is not permissible, in installments sale, to fix the spot price on cash basis, then to charge interest expressly tied with different periods, as separate from the price of the commodity, no matter whether the parties have agreed on a particular rate of interest or have left it to the current market rate.

Third: If the buyer/debtor delays the payment of installments after the specified date, it is not permissible to charge any amount in addition to his principal liability, whether it is made a pre-condition in the contract or it is claimed without a previous agreement, because it is "Riba", hence prohibited in Shari'a.

Fourth: It is prohibited (Haram) for a solvent debtor to delay the payment of the installments from their due dates. However, it is not permissible in Shari'a to impose a compensation in case he delays the payment.

Fifth: It is permissible for the seller to impose a condition in the sale agreement that if the debtor/buyer delays the payment of some installments, all the remaining installments shall be due at once before their agreed date. This condition may be a valid condition, provided that the buyer had agreed to it when entering into the sale agreement.
Sixth: The seller has no right to secure the ownership (of the sold commodity) after the sale has taken place. However, it is permissible for him to impose a condition that the buyer shall mortgage the sold commodity with the seller to secure his right of receiving the deferred installments of the price.\(^6\)

7.2 Rebate in Case of Early Payment:

Sometimes the debtors want to pay early to get discounts as in the case of conventional banking. Can an Islamic bank allow rebate on early payment of Murabaha? This issue has been examined by the classical jurists in detail, and it was concluded that since Murabaha represents the sale of a specific commodity - the price of which is a settled issue - there can be no rebate or discount on voluntary early payment by the buyer. The issue is known in the Islamic legal literature as "Da’ wa ta’ajjal" (Give discount and receive soon).

Some earlier jurists (from Shafi’is, Hanbalis and Ibadis) have held to its permissibility, but the majority of the Muslim jurists, including the four schools of Islamic jurisprudence esp. Malikis sternly disapprove it and do not allow remission (for earlier payment in murabaha operation by banks). Some jurists opine that if the early payment is tied to a discount, it is not permissible. However, if the rebate is not an attraction for pre-payment and is not taken to be a condition for earlier payment and the bank gives an allowance voluntarily, it may be permissible under Sharia.\(^7\)

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\(^6\) Resolution no (51/2/6) concerning 'sales on installments' by The Council of the Islamic Fiqh Academy, Jeddah, in its sixth session held in Jeddah, Kingdom of Saudi Arabia, from 17 to 23 Sha'ban 1410H (corresponding to 14 - 20 March, 1990)

\(^7\) According to Usmani, M.T., ""The view of those who allow this arrangement is based on a hadith in which Abdullah ibn ‘Abbas is reported to have said that when the Jews belonging to the tribe of Banu Nadir were banished from Madinah some people came to the Holy Prophet (PBUH) and said , “You have ordered them to been expelled, but some people owe them some debts which have not matured”. Thereupon the Holy Prophet (PBUH) said to them (i.e., the Jews who were the creditors): “Give discount and receive (your debts) soon.” The majority of the Muslim jurists, however, do not accept this hadith as authentic. Even Imam al-Baihaqi, who has reported this hadith in his book, has expressly admitted that this is a weak narration. Even if the hadith is held to be authentic, the exile of Banu Nadir was in the second year after hijrah, when riba was not yet prohibited. Moreover, al-Waqidi has mentioned that Banu Nadir used to advance usurious loans.
What needs to be understood is that the customer cannot claim it as his right and hence it cannot be made a condition of the Murabaha agreement. Furthermore, the bank will have the sole discretion to decide what remission should be offered to a client in this situation.

The IOC Fiqh Academy⁸, the Shariat Appellate Bench of the Supreme Court of Pakistan, Shariah committee of Islamic banks in the Middle East and shariah scholar in general consider that it would be similar to interest-based installments sale techniques. The AAOIFI’s shariah standard on Murabaha, however, allows a rebate if it is not already stipulated in the Murabaha contract.⁹ Therefore, if the customer makes early payment and there is no commitment from the bank in respect of any discount in the price of Murabaha, the bank may have discretion in allowing the rebate especially if the client is needy. Thus Islamic banks may give somebody a rebate but the contemporary scholar strongly see that it should not made a practice and any such case should be decided on merit in consultation with shariah advisor.¹⁰

Therefore, the arrangement allowed by the Holy Prophet was that the creditors forego the interest and the debtors pay the principal sooner. Al-Waqidi has narrated that Sallam b. Abi Huqaiq, a Jew of Banu Nadir, had advanced eighty dinars to Usaid Ibn Hudayr payable after one year with an addition of 40 dinars. Thus, Usaid owed him 120 dinars after one year. After this arrangement, he paid the principal amount of 80 dinars and Sallam withdrew fi-om the rest. For these reasons, the majority of the jurists hold that if the earlier payment is conditioned with discount, it is not permissible.” See the details in his book: An Introduction to Islamic Finance, p...)

³ According to Usmani, “The Islamic Fiqh Academy, Jeddah in its annual session too has taken the same view meaning that in a murabahah transaction effected by an Islamic bank or financial institution, no such rebate can be stipulated in the agreement, nor can the client claim it as his right. However, if the bank or a financial institution gives him a rebate on its own, it is not objectionable, especially where the client is a needy person. For example, if a poor farmer has purchased a tractor or agricultural inputs on the basis of murabahah, the bank should give him a voluntary discount.” ibid.

⁹ AAOIFI, 2004-5a, p. 132

7.3 Rollover in Murabahah:

“Rollover” in Murabahah means booking another Murabahah against receivables of any previous Murabahah, payment in respect of which has not been made by the client.\(^1\)

Can there be a roll-over in Murabahah?

Some people misconstrue that as in conventional banks a Murabahah amount can also be rolled over by adding the profit for the extended period if the buyer agrees to bear the same.

According to contemporary shari’ah scholars, Murabahah contract cannot be rolled over for a further period. Since it belongs to a specific commodity which has already been sold and hence cannot be sold twice. Muhammad Ayub\(^2\) opines thus:

“This is explicit Riba, as the bank is not entitled to any amount over and above the debt created in Murabahah transaction, as a result of which ownership of the sold goods had already been transferred to the client. Now the bank has no right of re-pricing. Re-scheduling is allowed, but re-pricing and, therefore, rollover is not allowed.

The bank, at its discretion, can reschedule the payment without any increase in the original receivable. Any amount taken from the client on account of the late payment, as per his undertaking in the Murabahah agreement, would go to the

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\(^1\) Ayub, Muhammad G. (2007), op. cit, p. 232

\(^2\) MUHAMMAD AYUB is Director Training, Development and Shariah Aspects at Institute of Islamic Banking & Insurance (IIBI), London. Formerly, he was with the State Bank of Pakistan (central bank) where he headed the Islamic Economics Division and Shariah Compliance Division as Senior Joint Director in the Research and Islamic Banking Departments. He also served as Head of Islamic Banking at National Institute of Banking and Finance (NIBAF), the training wing of SBP. Besides contributing a large amount of material, he has been serving as Master Trainer on theory and practice of Islamic finance. For last two decades, he has been involved in R&D for facilitating I.B. Industry, Products Development, IB Prudential regulations, Risk management and Shariah related controls and audit of Islamic banking institutions.
charity account. However, there is the possibility of a fresh Murabahah facility through the sale of new goods.“\(^{13}\)

It should be noted here that Murabahah is not a loan transaction but the sale of a commodity, the payment of which is deferred to a specific date. Once the commodity is sold, its ownership is passed on to the client (buyer), irrespective of the terms of payment being sight or deferred.

Hence it is no more the property of the seller. As such how can the bank sell a commodity a second time around which is not owned by it any more?\(^{14}\)

Usmani\(^{15}\) opines in this way:

“Murabahah transaction cannot be rolled over for a further period. In an interest-based financing, if a customer cannot pay at the due date for any reason, s/he may request the bank to extend the facility for another term. If the bank agrees, the facility is rolled over on the terms and conditions mutually agreed at that point of time, whereby the newly agreed rate of interest is applied to the new term. It actually means that another loan of the same amount is re-advanced to the borrower.\(^{16}\)

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\(^{13}\) Ayub, Muhammad G. (2007), op. cit, pp. 232-233

\(^{14}\) Suhail Zubairi, Special Gulf News

\(^{15}\) Usmani express disapproval in this way, “Some Islamic banks or financial institutions, who misunderstood the concept of murabahah and took it as merely a mode of financing analogous to an interest-based loan, started using the concept of roll-over to murabahah also. If the client requests them to extend the maturity date of murabahah, they roll it over and extend the period of payment on an additional mark-up charged from the client which practically means that another separate murabahah is booked on the same commodity. This practice is totally against the well-settled principles of Shariah. It should be clearly understood that murabahah is not a loan. It is the sale of a commodity the price of which is deferred to a specific date. Once the commodity is sold, its ownership is passed on to the client. It is no more a property of the seller. What the seller can legitimately claim is the agreed price which has become a debt payable by the buyer. Therefore, there is no question of effecting another sale on the same commodity between the same parties. The roll-over in murabahah is nothing but interest pure and simple because it is an agreement to charge an additional amount on the debt created by the murabahah sale.” See An Introduction to Islamic finance; p.

\(^{16}\) Usmani, M. Taqi, op. cit. p
7.4 Rescheduling for Additional Payment:

Some times customer is not able to pay according to the dates agreed upon in the murabahah agreement, so he requests the seller/ the bank for rescheduling the installments. At times, rescheduling of installments is seen as a way out in the face of default. In conventional banking, loan rescheduling is accompanied by additional interest charge for the timing differences. This is not possible in murabahah payments. In Murabahah such rescheduling is not allowed as no additional amount can be charged for the same. But if the installments are rescheduled, no additional amount can be charged for rescheduling. The amount of the murabaha price will remains unchanged.17 Some banks attempt to circumvent this by changing the unit of currency. Needless to say, this is not permissible.18 They proposed to reschedule the murabahah price in other than a currency in which initial transaction effected. Usmani Says:

“Some Islamic banks proposed to reschedule the murabahah price in a hard currency different from the one in which the original sale took place. This was proposed to compensate the bank through appreciation of the value of the hard currency. Since this benefit was proposed to be drawn from rescheduling, it is not permissible. Rescheduling must always be on the basis of the same amount in the same currency. At the time of payment however, the purchaser may pay with the consent of the seller, in a different currency on the basis of the exchange rate of that day (i.e. the day of payment) and not the rate of the date of transaction.”19

\[17\] Usmani, op. cit. p.
\[19\] Usmani, op. cit. p.
7.5 Murabahah Financing with Tawarruq (commodity Murabahah):

Islamic financial institutions made a proposal to offer deposit product and financing based on the concept of tawarruq or commodity murabahah.

Tawarruq involves buying something on deferred credit and selling the item on to get cash. As a result, cash has been obtained without taking out a loan and paying interest.

Tawarruq is actually a sale contract whereby a buyer buys an asset from a seller with deferred payment and then sells the asset to the third party on cash with a price lesser than the deferred price, for the purpose of obtaining cash.

This transaction is called tawarruq because when the customer buys the asset with deferred payment, he has no intention of using or getting benefit from it, but merely to facilitate him to obtain cash or attain liquidity (waraqah maliyyah).

Thus, the aim of the contract, for the buyer, is to obtain money or cash, so he does not buy the commodity to use it for any purpose. The contract includes two transactions: the first, the purchase of the commodity for a deferred payment, and

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20 Tawarruq means a sale contract in which the buyer obtains merchandise on credit and then sells it for cash. Thus, in this contract, the seller sells a commodity which is normally under his ownership and belongs to his business, to the buyer for deferred payment, and the seller delivers the commodity to the buyer to be under his full possession and responsibility. Then, after the commodity is received by the buyer, he sells it to a third party, who is not the seller, for immediate payment. Later, Tawarruq got developed into other forms.

21 In commodity Murabahah the profits are made on the buying and selling of a commodity, usually metal, such as copper, aluminum, or lead. A buys the metal at the spot price, or the current price, then sells the metal to B on a deferred payment basis, say for three months, at the spot price plus a mark-up or profit for doing so. B will then immediately sell the metal to a broker or another institution for the spot price. In this way, A makes a profit from the mark-up, while B raises funds for its investments.

22 Commodity murabahah is one of the most popular techniques used to manage short-term liquidity in the Gulf region (especially Saudi Arabia and United Arab Emirates) (El-Gamal, 2006, Islamic Finance: Law, Economics and Practice.). It is based on commodities traded on the London Metal Exchange (LME) on a spot basis with 100 per cent payment of the purchase price, then selling the purchased commodities to a third party on a Murabahah (cost-plus sale) basis for a deferred payment with a maturity from one week to six months, and with spot delivery of the sold commodities.

23 This definition is accepted by the OIC Fiqh Academy in their deliberation on the issue on 1st November 1998 (11 Rejab 1419H). See also (Wizarah al-Awqaf wa al-Syu’un al-Islamiah, (2005) Al-Mawsu’ah al-Fiqhiyyah, vol. 14, p. 147.)
then the second, the sale of the same product for immediate payment; the first price normally is more expensive than the second price. In addition, there are more than two parties involved in the contract; the first party is the seller who sells the commodity in a deferred sale, the second party is the first buyer, and the last party is the second buyer who buys the commodity from the first buyer for an immediate payment. The first buyer who buys the commodity by deferred payment is the seller in the second transaction which is for immediate payment.\(^{24}\)

Discussion among the majority of classical jurists on tawarruq was done simultaneously with bai` al-`inah. They do not differentiate the discussion on tawarruq and bai`-`inah; except the scholars of Hanbalis who have distinguished it. In the main, tawarruq and bai`-`inah are similar in terms of its objective to obtain cash through the selling and buying transactions, but they are different in two aspects.

Firstly, bai`-`inah does not involve third party as purchaser of the object of sale (asset/commodity), while tawarruq involves third party. Secondly, the sale item in bai`-`inah is returned back to the original owner, whereas in tawarruq, there is no such condition.

### 7.5.1 The Ruling of Tawarruq

Most of the Muslim scholars have cited the same authorities on the legality or permissibility of tawarruq and bai`-`inah, looking into the similarities of both transactions. Only the scholars of Hanbalites have stated the terminology of tawarruq and deliberate it separately.

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7.5.2 Those Who Reject Tawarruq

There is a view from Imam Ahmad ibn Hanbal which states that tawarruq is prohibited (haram).\(^{25}\) Another view from Imam Muhammad bin Hasan al-Shaibani a Hanafites held that tawarruq is discouraged (makruh).\(^{26}\) Imam Ibn Taimiyah has considered tawarruq as an exceptional dealing which is permitted in the case of necessity (dharurat), where the person is really in need of cash. The authorities used by those who reject tawarruq are as follows:

Hadith: “Ali has stated: Ibn Musa has said that this is what we have been told by Hushaim. The Prophet PBUH has said: A time is certainly coming to mankind when people will bite each other and a rich man will hold fast what he has in his possession (his property), though he was not commanded for that. Allah the Almighty said: (and do not forget liberality between yourselves), and then those who are forced will contract sale while the Prophet PBUH has forbidden forced contract, one which involves some uncertainty and the sale of fruit before it is ripe.”\(^{27}\)

Imam Ahmad ibn Hanbal has envisaged that *bayʿ al-ʾīnah* is allowed in the case of necessity when people are really in need of cash and the rich are reluctant to lend it to them. As such, the needy people who are in need of money will perform *bayʿ al-ʾīnah* and tawarruq. With the transactions, they will be getting cash by putting higher price on the deferred payment against the lower price in cash.\(^{28}\)

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\(^{27}\) Hadith narrated by Abu Daud.

\(^{28}\) Interestingly, past jurists from Malikis and Hanbalis schools who categorically disallowed and nullified *bayʿ al-ʾīnah* transaction, do not actually reject *tawarruq* outright. Instead, they were inclined to allow it mainly arguing that the presumption that the parties intended to circumvent the prohibition of *riba* was quite remote in *tawarruq* due to its tri-partite nature (El-Gamal, 2006, op. cit.). However, two prominent Hanbali jurists, namely Ibn Taimiyah and his disciple Ibn Qayyim Al-Jawziyyah departed from the majority Hanbali school’s approval of *tawarruq*. They disallowed tawarruq and dismissed it as a legal trick (*hilah*) similar with *bayʿ al-ʾīnah* (Al-Zuhayli, 1989, *Al-Fiqh Al-Islami Wa Adillatuhu* (Third ed.), Beirut: Dar al-Firk.)
7.5.3 Those Who Accept Tawarruq

Those who have approved tawarruq esp. the Hanbalite viewed that it is a permissible mode of transaction. Their view is supported by the following arguments:

- **Al-Quran**: “Allah has permitted sale and prohibited riba”

  The permissibility of tawarruq may be deduced from the general meaning of the verse and considered an allowed sale transaction. Such a deal may be exercised with the intention of getting cash with the knowledge of all the parties concerned or without the knowledge of the parties who have sold the object with deferred payment. This transaction may also be employed because of need and necessity or because it is an accepted mechanism of commercial dealing, which is normally practiced in the society or institution. One of the arguments put forward to justify the case is their adoption of Shafi‘i’s view in legalising tawarruq *i.e.* public interest consideration (maslahah).

- **The Recent Fatwa**

  Dr Rafik Yunus al-Misri has stated that some of the Muslim scholars have approved the tawarruq without any justification in details on its permissibility. In
his view, the ruling of *tawarruq* may vary depending on the following circumstances:

i. If all of the three parties involved have known that the main objective of the customer for entering the *tawarruq* transaction is to obtain the cash money, then all of them are sinful.

ii. If two of the parties have known that the seller has used the transaction for getting the cash, both of them are sinful. However, if they do not know the real intention of the seller, then they are not sinful.

iii. A person is allowed to do *tawarruq* in the case of necessity.\[33\]

However, *Majma' al-Fiqh al-Islami* in its 15th meeting\[34\] has permitted the practice of *tawarruq*. The decision on the permissibility of *tawarruq* was actually arrived on the basis that the *tawarruq* is executed without prior arrangement of the parties involved. Though, in its 17th meeting,\[35\] the decision made was to prohibit the practice of *tawarruq*.\[36\]

The latest decision is applicable to the practice of *tawarruq* that are adopted by the financial institutions which is known as *al-tawarruq al-munazzam* or *al-tawarruq al-masrafi* (pre arranged *tawarruq*).\[37\] The justification for rejecting such *tawarruq* is that its *modus operandi* resembles *bai'-`inah*; whereby the financial

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\[33\] Dr. Rafik Yunus al-Misri, *Bai' al-Taqsit Tahliil Fiqhi wa Iqtisadi*, p. 120.

\[34\] In the Circle 15th, Makka, 1998

\[35\] In the Circle 19th, Makka, 2003

\[36\] Islamic Fiqh Academy has two resolution relevant to this issue the first resolution does not prohibit traditional *tawarruq* and the second resolution prohibits organized *tawarruq*, the reason for that is the differences between the two contracts. However, the Council in its 51st meeting held on 28th July 2005 / 21st Jamadil Akhir 1426, resolved that deposit product and financing based on the concept of *tawarruq* which is known as commodity *murabahah* is permissible. For more details see al-Qiri, *al-Tawarruq Kama Tujrih al-Masarif al-Islamiiya*, MBFM, 1426, n. 67, pp. 38-41; Al-Mushaiqih, *al-Tawarruq al-Mas}rifi*, 1425H, MOQ, v. 18, no. 30, pp. 187-188. As cited by SALAH AL-SHALHOOB op. cit.

\[37\] There are, however, differences between the traditional *tawarruq* and organised *tawarruq* (*al-tawarruq al-munazzam*). In the traditional *tawarruq*, the first party who sells the commodity in a deferred sale does not know that the second party who buys the commodity in a deferred sale plans to sell the commodity to obtain cash, or at least the seller does not arrange the second transaction. As a result, the only one who is involved in both transactions, whether directly or indirectly is the first buyer. On the other hand, the financial institution arranges the contract from the beginning by offering the commodity to the client until the end by crediting the price in the account of the client.
institution who is acting as an agent to the customer (mustawriq) who needs the cash is selling the asset commodity which was initially purchased from the same institution to the third party.

This practice seems to be resemble to the practice of bai‘-‘inah (which is prohibited in Islamic law according to the majority scholars) and does not represent the true tawarruq which has been regarded as accepted by the jurists.

Secondly, this kind of contract, in many cases, does not reflect the concept of possession in Islamic law. Thirdly, the reality of this type of contract is to finance the client (al-mustawriq) who applies for some money and to charge him extra; the financial institute arranges the procedure of the contract, by obtaining the commodity and selling it in the market on behalf of the client, to achieve this purpose. However, that is not the real form of tawarruq which has been indicated in the traditional fiqh, and previously Okayed by the Islamic Fiqh Academy, Jeddah.38

On the other hand, the Shariah Supervisory Council of ABC Islamic Bank in their decision has approved tawarruq for liquidity purposes.39

Furthermore, despite the objection by many quarters towards tawarruq munazzam (organised tawarruq), such practice has also been approved by a few contemporary scholars such as the leading Saudi jurist, Syeikh Abdullah Sulaiman al-Mani‘, Dr. Musa Adam Isa, Dr. Usamah Bahr and Dr Sulaiman Nasir al-Ulwan.40

40 (See Shamsiah Mohamad, Bai‘ Al-Inah & Tawarruq; as cited in http://www.mific.com/publication/srif/15_rulings.pdf)
Dr. Asyraf Wajdi Dusuki opines in his paper⁴¹:

"Despite the criticisms towards tawarruq, the product has been generally perceived and received more favourable and positive than bay‘ al-‘inah transaction, at least by a majority of past and present scholars. Unlike bay‘ al-‘inah which is widely used in Malaysia and Brunei, tawarruq-based transaction has been spreading quite rapidly in GCC region especially Saudi Arabia, Bahrain and UAE. This development shows the concerns and recognition by some of the jurists globally of the need to find alternatives for solving the inherent problem of liquidity risk faced by Islamic financial institutions due to their balance sheet structure and nature."

7.6 Murabahah Securitization:

Can Murabaha receivables be securitized? The majority of contemporary shariah scholars disapprove this arrangement but some people hold the view that a part of Murabaha receivables may be securitized. The noted contemporary Shariah scholar, Usmani, M. Taqi says:

"Murabahah is a transaction which cannot be securitized for creating a negotiable instrument to be sold and purchased in secondary market. The reason is obvious. If the purchaser/client in a murabahah transaction signs a paper to evidence his indebtedness towards the seller/financier, the paper will represent a monetary debt receivable from him. In other words, it represents money payable by him. Therefore transfer of this paper to a third party will mean transfer of money. It has already been explained that where money is exchanged for money (in the same currency) the transfer must be at par value. It cannot be sold or purchased at a lower or a higher price. Therefore, the paper representing a monetary obligation arising out of a murabahah transaction cannot create a

negotiable instrument. If the paper is transferred, it must be at par value. However, if there is a mixed portfolio consisting of a number of transactions like musharakah, leasing and murabahah, then this portfolio may issue negotiable certificates subject to certain conditions more fully discussed in the chapter of "Islamic Funds".**42

Muhammad Ayyub comments on ‘Securitization on the basis of Murabahah’ thus:

“Any paper representing a monetary right or obligation arising out of a credit sale transaction by banks can not create a negotiable instrument. Therefore, Murabahah receivables can not be securitized for creating negotiable Sukuk to be traded in the secondary market. The purchaser on credit in a Murabahah transaction signs a note or paper to evidence his indebtedness towards the seller. That paper represents a debt receivables by the seller. Transfer of this paper to a third party must be at par value. ..........

A mixed portfolio consisting of a number of transactions, including Murabahah, may issue negotiable certificates subject to certain conditions. For this purpose, the pool of the assets should consists of Ijarah or other fixed assets valuing more than 50% of its worth.”**43

Dr. M.N. siddiqi examines this issue citing the opposing views & arguments as follows:

“The juristic objection to sale of debts resulting from murabahah, etc. is the same as in case of selling a debt created by a money loan. If I buy for 90 an IOU worth 100 after a year, I am doing so in order to earn 10 as interest. They see no reason to distinguish between IOUs created by murabahah and IOUs created by lending money. This seems to be underlying the Islamic Fiqh Academy resolution on the subject that states: ‘It is not permissible to sell a deferred debt by the non-

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**42 Usmani, M.T. op. cit., p.
**43 Ayyub, M. (2007), op. cit, p. 405
debtor for a prompt cash, from its type or otherwise, because this results in Riba
(usury). Likewise it is not permissible to sell it for a deferred cash, from its type or
otherwise, because it is similar to a sale of debt for debt which is prohibited in
Islam. There is no difference whether the debt is the result of a loan or whether it
is deferred sale'. However, the view equating, in this context, money loans and
debts resulting from credit has been challenged. There are reasons to treat the two
differently, say Chapra and Khan: ‘The debt is created by the murabahah mode
of financing permitted by the Shariah and the price, according to the fuqaha
themselves, includes the profit on the transaction and not interest. Therefore, when
the bank sells such a debt instrument at a discount, what it is relinquishing, or
what the buyer is getting, is not interest but rather a share in profit'. In other
words, a debt resulting from murabaha has an element absent from a debt arising
from borrowing money-- the mark up on spot price. Sale and purchase of
murabaha-based debt would take place on this extra profit margin.

The problem with this proposition is that what was a profit margin for the
seller of goods and services (on a murabahah basis) may not necessarily remain so
when the same seller ‘sells’ the IOU arising from that transaction. Some of the
factors involved in the determination of the mark up on spot price in murabahah
may be different from those involved in the sale of the resulting IOU at a discount.
Furthermore, the extra profits earned in murabahah sale, over and above those
carnable on selling for cash, are still against sale of goods and services. But the
part of it that goes to the buyer of the murabahah based IOU (according to the

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44 Islamic Fiqh Academy, 2000, Resolutions and Recommendations of the Council of the Islamic Fiqh
Academy 1985-2000, Jeddah, Islamic Research and Training Institute, Islamic Development Bank, p.234
45 Chapra, M.U and Tariquullah Khan (2000), Regulation and Supervision of Islamic Banks, Jeddah, Islamic
Research and Training Institute, Islamic Development Bank, p.78
above mentioned rationalization) has no goods and services corresponding to it. It is money for money, with a difference of dates.\textsuperscript{46}

7.7 \textbf{Imposing penalty on default payment:}

In credit facilities extended by conventional banks, the loan is invariably tied up with interest that continues to grow with the passage of time. If the client fails to settle the loan upon maturity, this results into the interest burden becoming even larger, and if the delay is unacceptable, sometimes high penal rates of interest are applied. In addition to increasing the income of the lender, this process also acts as a deterrent to defaulting.

In the Islamic system where the Murabahah price is fixed at the outset, no increase may take place in the liability of the client due to delay in settlement. The financier is entitled to claim only the original Murabahah price, irrespective of when it is paid. This could result in some clients purposely delaying settlement in order to avail of free credit period.

This situation could be easily overcome in a place where all financial institutions provide only Islamic facilities, as clients who habitually default could be blacklisted and deprived of further facilities. However, this could be done only with the cooperation of all banks.

When this is not the case, can the financial institution require compensation from defaulting clients after providing sufficient warning, when it is assured that defaulting was deliberate and was not due to poverty? The majority of the contemporary scholars answer in the negative, based on the clear Shari’ah principle that any additional amount charged from the debtor is Riba. Such compensation has no parallel in Islamic Shari’ah. Opportunity cost is not

recognised by Islam. The delay in settlement cannot be construed to have caused a genuine loss to the creditor as money need not necessarily result in a return.

Therefore, in order to discourage defaulting an alternative method could be employed. The client could be made to undertake at the outset of the Murabahah transaction that if he defaults in payment, he would pay a specified amount to a charitable fund maintained by the bank. Such an undertaking to impose a charity on oneself is similar to a vow and therefore is permissible. This would ensure the presence of the necessary deterrent while avoiding charging of interest.

It should be ensured that the client is made to pay this amount only if his defaulting was not due to unavoidable factors, and that the amount thus collected in the fund is only used for charitable purposes approved by the Shari’ah. No portion of it should be added to the income of the bank, nor should it be used for setting off liabilities of the bank.

7.8 The client undertaking to purchase:

The Islamic Shari’ah does not recognise the validity of forward sales where an item currently not in the possession of the seller is sold through sale transaction that becomes effective on a future date. Consequently, the financier in Murabahah may not enter into a forward transaction of sale when the client seeks a Murabahah facility. In this situation, the financier is compelled to purchase the required article from a third party, take possession of it, and thereafter sell it to the client on Murabahah. However, if the client refuses to purchase the article from the bank after the bank had purchased it from the supplier, this could possibly result in the bank being left with an undisposible item.

To avoid this situation that would inhibit financiers from embarking on Murabahah transactions, especially when these involve consumer specific items, the client could be made to enter into a unilateral promise that he would purchase the asset when it is acquired by the financier. A bilateral contract where both the
financier and the client bind themselves to enter into a contract of sale on a future date would be construed as a forward sale, and should be avoided.

It is true that the unilateral promise made by the client in the form of an undertaking to purchase is still a promise, which is not legally enforceable according to most jurists. However, in order to ensure fidelity in commercial transactions, promises made in commercial contexts have been held binding subject to certain conditions, especially when the promisee has incurred some liability on the basis of the promise. If the promisor fails to stand by his promise, he may be legally compelled to fulfil the promise or to compensate the actual loss incurred by the promisee.

Therefore, on the basis of the undertaking to purchase, the client may be legally enforced to purchase the asset from the bank as promised, or, when this is no longer feasible, to pay actual damages to the bank.

Followings are based on the writing of M. Taqi Usmani.

7.9 The use of Interest-Rate as Benchmark

Many banks settle on their profit or mark-up on the basis of the current interest rate, mostly using LIBOR (Inter-bank offered rate in London) as the criterion.

The critics have recourse to disapprove Murabahah on this ground. Contemporary shari’ah scholars though not advise or encourage to use such benchmark but in the absence of viable Islamic bench-mark they not see wrong in using LIBOR as it is merely mean to have a completive market price and does not involve interest transaction at all.

7.10 Promise to Purchase (Binding or Non-binding)

Another important issue in Murabahah financing which has been subject of debate between the contemporary Shari’ah Scholars is whether promise to
purchase is considered to be binding or otherwise. There has been differing opinion among classical jurists on this issue and hence, contemporary Shari’ah scholars also differ. Taqi Usmani has discussed in detail the opinion of classical jurists and analyzed the issue. According to him:

“Many of classical jurists are of the opinion that 'fulfilling a promise' is a noble quality and it is advisable for the promisor to observe it, and its violation is reproachable, but it is neither mandatory (wajib), nor enforceable through courts. This view is attributed to Imam Abu Hanifah, Imam al-Shafi’i, Imam Ahmad and to some Maliki jurists. However as will be shown later, many Hanafi and Maliki and some Shafi’i jurists do not subscribe to this view.

A number of them are of the view that fulfilling a promise is mandatory and a promisor is under moral as well as legal obligation to fulfill his promise and thus promise can be enforced through courts of law. This view is ascribed to Samurah b. Jundub, the well known companion of the Holy Prophet Umar b. Abdul Aziz, Hasan al-Basri, Sa’id b. al-Ashwa’, Ishaq b. Rahwaih and Imam al-Bukhari. The same is the view of some Maliki jurists, and it is preferred by Ibn-al-‘Arabi and Ibn-al-Shat, and endorsed by al-Ghazzali, the famous Shafi’i jurist, who says the promise is binding, if it is made in absolute terms. The same is the view of Ibn Shubrumah. The third view is presented by some Maliki jurists. They say that in normal conditions, promise is not binding, but if the promisor has caused the promise to incur some expenses or undertake some labor or liability on the basis of promise, it is mandatory on him to fulfill his promise for which he may be compelled by the courts.”

He further contends that: “This is not a question pertaining to Murabahah alone. If promises are not enforceable in the commercial transactions, it may seriously jeopardize commercial activities. If somebody orders a trader to bring for him a certain commodity and promises to purchase it from him, on the basis of

47 Usmani, op.cit., p.122
which the trader imports it from abroad by incurring huge expenses, how can it be allowed for the former to refuse to purchase it? There is nothing in the Holy Qur’an or Sunnah which prohibits the making of such promises enforceable.**

However, the opinion in favour of its bindingness has been resolved by the Council of Islamic Fiqh Academy Jeddah with stipulated conditions.

Securities against Murabahah Price

Another issue is that whether the bank is liable to ask the client to furnish a security in the form of a mortgage or a hypothecation or some kind of lien or charge etc. to its satisfaction or not. Because the Murabahah price is payable at a later date, hence the seller naturally wants to make sure that the price will be paid at the due date. Shari’ah scholars allow it but strongly recommend o fulfill necessary rules.

According to Taqi Usmani, basic rules about this security that must, be kept in mind may be stated as:

"The security can be claimed rightfully where the transaction has created a liability or a debt. No security can be asked from a person who has not incurred a liability or debt. However, the financier can for a security after he has actually sold the commodity to the client and the price has become due on him, because at this stage the client incurs a debt. However, it is also permissible that the client furnishes a security at earlier stages, but after the Murabahah price is determined.

It is also permissible that the sold commodity itself is given to the seller as a security. Some scholars are of the opinion that this can only be done after the purchaser has taken its delivery and not before."

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** Usmani, M. Taqi, op. cit, p.125
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It is also permissible that the sold commodity itself is given to the seller as a security. Some scholars are of the opinion that this can only be done after the purchaser has taken its delivery and not before."^49

7.12 Guaranteeing the Murabahah

The seller in a Murabahah financing can also ask the purchaser/client to furnish a guarantee from a third party. In case of default in the payment of price at the due date, the seller may have recourse to the guarantor, who will be liable to pay the amount guaranteed by him. The rules of Shari'ah regarding guarantee has been dealt in detail in the discourse of Islamic fiqh.

However, some contemporary scholars are considering the problem from a different angle. They feel that guarantee has become a necessity, especially in

^49 Usmani, op.cit, p.127
international trade where the sellers and the buyers do not know each other, and the payment of the price by the purchaser cannot be immediate with the supply of the goods. There has to be an intermediary who can guarantee the payment. It is very difficult to find the guarantors who can provide this service free of charge in required numbers. Keeping these realities in view, some Shari'ah scholars of our time are adopting some different approaches to have the solution which is subject of debate and needs further research as how to resolve this problem rather making a definite ruling to make it a compulsory condition to execute the transaction.

50 Usmani, op.cit pp. 129-131