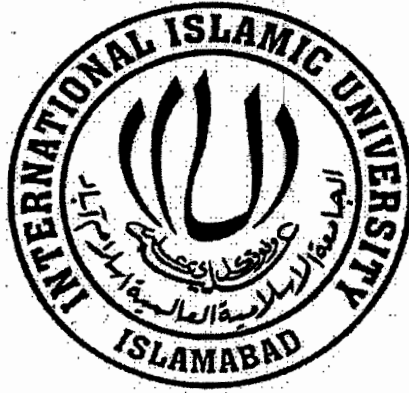


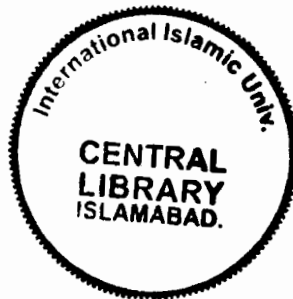
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**COMMODITY MURBAHA: IN THE  
LIGHT OF SHARIAH RULINGS**



*Submitted by:*  
**HAFSA ABBASI**

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**FACULTY OF SHARIAH AND LAW**

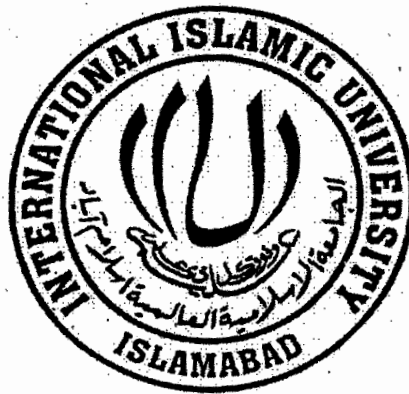
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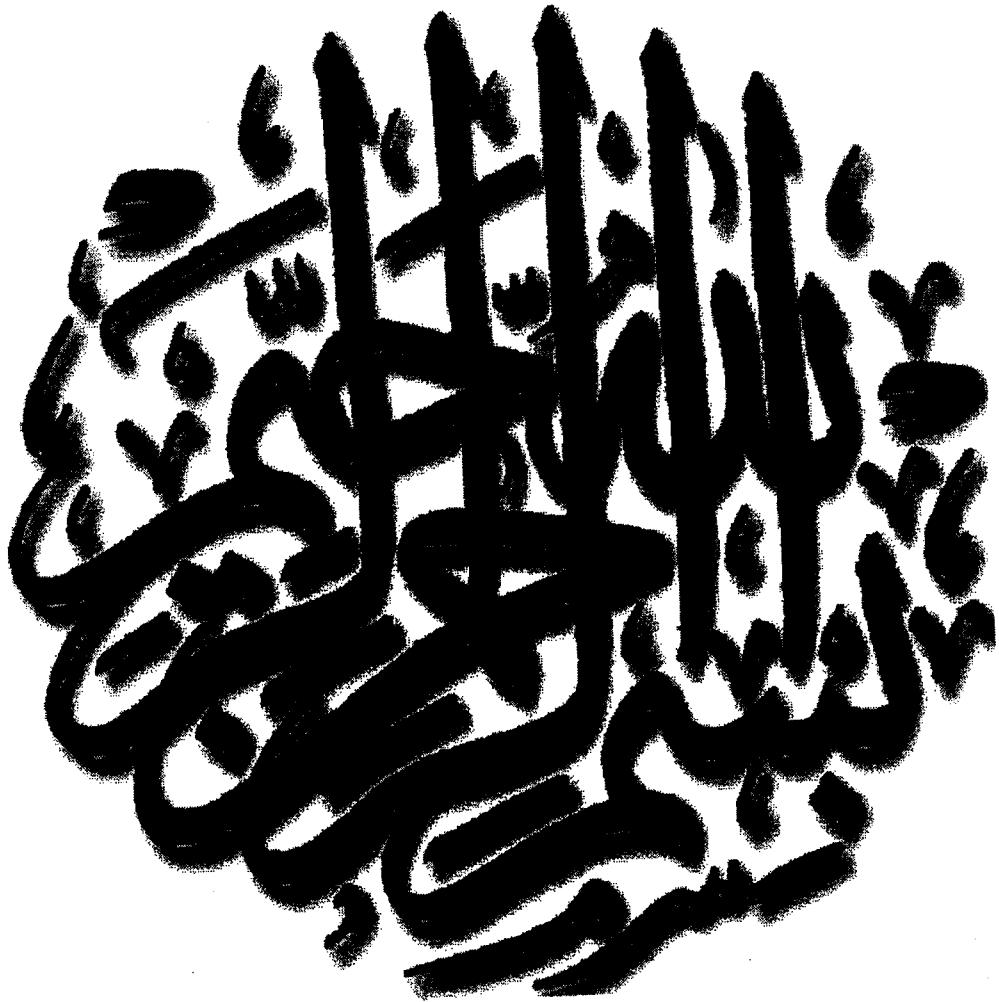
by

Hafsa Abbasi

*A thesis submitted in partial fulfillment  
of the requirement for the degree of  
MASTER OF LAWS  
(Faculty of Shariah and Law)  
in The International Islamic University  
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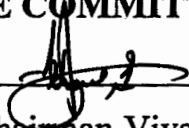
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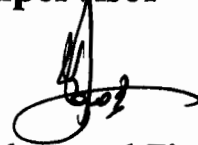
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It is certified that Ms. *Hafsa Abbasi*, student of LLM Islamic Commercial Law, Registration No, 58FSL/LLMICL/F08, International Islamic University Islamabad has completed her thesis titled as “**Commodity Murabaha: Analysis in the Light of Shariah Rulings**” under my supervision.

During the research work, she remained in touch with me and worked with diligence. She carried out her research work under my instructions and supervision. I forwarded this thesis for its submission and evaluation for the awarding of LLMICL degree to her from International Islamic University Islamabad.

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## DECLARATION

I, Hafsa Abbasi, Registration No. 58FSL/LLMICL/F08, student of LLM Islamic Commercial Law in International Islamic University Islamabad, do hereby solemnly declare that the thesis entitled "**Commodity Murabaha: Analysis in the Light of Shariah Rulings**" is submitted in partial fulfillment of Degree of LLM Islamic Commercial Law.

It is my original work and has not been submitted before for obtaining any degree from this or any other university or institution.

Hafsa Abbasi  
LLM Islamic Commercial Law  
Reg. No. 58-FSL/LLMICL/F08

# COMMODITY *MURĀBAHAH*: IN THE LIGHT OF SHARIA RULINGS

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## **LIST OF ABBREVIATIONS:**

1. CMH: Commodity Murābahah Housing.
2. CM: Commodity Murābahah.
3. LME: London Metal Exchange.
4. HSBC: Hong Kong Shanghai Banking Company.
5. MPO: Murābahah to the Purchase Orderer.
6. CPO: Crude palm oil.
7. IIMM: Islamic Interbank money market.
8. OIC: Organization of Islamic Conference.
9. AAOIFI: Accounting and Auditing Organization for Islamic Financial Institution.
10. MATP: Master Agreement for Treasury Placement.
11. IBB: Islamic Bank of Britain.
12. ADIB: Abu Dhabi Commercial Bank.
13. IIFS: International Islamic Financial services.
14. ICFA: Islamic Conference of Fiqh Academy.

## **DEDICATION**

This thesis is dedicated to:

**My Parents**

Who always struggled their level best for the sake of their children. It's just because of their prayers and hard work that Allah (swt) blessed me with what I did not even deserve.

May Allah bless them with long life, in the best of their health, peace and happinesses Ameen.

“My Lord! Bestow on them Thy Mercy Even as they cherished me in childhood.”

(Al-Isra:24)

**My Husband**

For always being there for me, to support and making life easier.

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I with all my heart and soul thank my Lord, who gave me strength to undertake this research work and partially contribute towards the diffusion of knowledge on the very contemporary issue of Commodity *Murābahah*.

I am deeply thankful to my Honorable Supervisor Professor Dr. Muhammad Zia ul-Haq, Dean Faculty of Shariah and Law, International Islamic University Islamabad, for being there for me every time I needed his guidance.

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I am very thankful to all my family members for encouraging me to complete this thesis. Who helped me everywhere I needed.

Modest thanks to my class fellows and friends who were there with me during the work and made it a pleasure for me and gave me moral support to accomplish this work.

Deep thanks to all those who extended co-operation for the compilation of this work.



## ***ABSTRACT***

### **COMMODITY MURĀBAHAH: IN THE LIGHT OF SHARIAH RULINGS**

by

**Hafsa Abbasi**

**Chairperson Dr. Muhammad Zia-ul-Haq:**

Commodity *Murābahah* is a type of a sale in Islamic Banking, which is derived from the Tawarruq contract. Tawarruq Sale being heavily employed by Islamic Banks was greatly criticized by Islamic Scholars. In order to keep the transaction active in Financial Industry it was introduced with the name of Commodity Murābahah. Commodity Murābahah has many similarities with Banking Murābahah as well. As a method of Tawarruq, by way of Murābahah, is also practiced in the Islamic Financial Industry. Murābahah in the classical text basically comes under the head of Trust Sales. Classical Islamic Jurisprudence deals with it in detail. In 1980's a Scholar Sami Hamoud stated on the basis of his arguments that *Murābahah* sale can be utilized in Islamic Banking as a Mode Of Finance. This mode received a very high rate of popularity from all over the globe. It was named as "*Murābahah* to the Purchase Orderer (MPO)". This research consists of the internal picture of MPO being practiced by Islamic Banks.

The next chapter deals with Commodity *Murābahah* which is a utilized as a technique to manage interbank liquidity between the banks. It is new mode of Finance introduced by Islamic Banks. As its older version was *Tawarruq*. The base of this contract is the partly the base of MPO but with the changes that suits the Islamic Banks. The purpose of this sale is to manage the Liquidity between different Banks. It is concluded in two forms i.e. Deposit giving and deposit taking. For the sake of concluding these loans, metals are used as underlying commodities. The deposit gives fixed returns to the Financial Institutions. Islamic Banks conclude these transactions mostly with Conventional Banks. This contract is a great threat to the prestige of Islamic Banking as it is highly criticized. These contracts have increased so much in volume that according to an estimate, 70 billion \$ of Islamic Banks is deposited with Conventional Banks by way of Commodity *Murābahah*. Its volume is increasing up to 1.6 trillion by 2012 and it is increasing by 12 % every year. My conclusion is that Commodity *Murābahah* strictly forbidden under Shariah. The biggest reason is, the commodities that are traded upon are doubtful in their existence. The volumes of these transactions are so big that their existence is not possible. Secondly the commodities do not change hands, nor is the risk of commodities transferred. The commodities traded upon cannot be owned. The purpose of the goods is not to trade upon them but to finance the other party and gain profit over it.

**CHAPTER 1:**  
**INTRODUCTION TO RESEARCH:**  
**SIGNIFICANCE OF COMMODITY *MURĀBAHAH***

Commodity *Murābahah* is a new molded form of *Murābahah* to the Purchase order. It is an innovation of last few years. This transaction created many issues, which were highly debated and it is very critical for the reputation of the Islamic Financial Industry. Presently, it is enormously in practice all over the globe but its legality from *Sharī'ah* perspective is still in question. Commodity *Murābahah* is generally defined as: “a sale of certain specified commodities, through a metal exchange, on a cost plus profit basis. If the customer wants to invest with the bank it will buy goods at cost ‘X’ from Broker A and sell them to the bank at cost ‘X’ and profit plus profit ‘Y’= contract price. The bank will pay the price back over a period of time.<sup>1</sup>

Commodity *Murābahah* is a Mode of Finance currently being practiced in Islamic Banks. The objective of designing this instrument is providing finance to the customer, who is in need of cash for various purposes. Commodity *Murābahah* is practiced when a customer requires a loan. Shariah compliant financial product provider purchases commodity from a supplier including title but not the delivery. This allows customer to

---

<sup>1</sup> Expert 123 beta, *the question and answer encyclopedia*,  
[www.experts123.com/q/what-is-commodity-Murābahah.html](http://www.experts123.com/q/what-is-commodity-Murābahah.html) (accessed Feb 15, 2011)

defer payments.<sup>2</sup> Mostly both the parties, i.e. buyer and seller, are financial institutions. In these transactions the bank sells the goods, which are bought through brokers, to the customer. Commodity Murābahah is a technique mostly used to provide short term inter-bank liquidity.<sup>3</sup> The customer (buyer bank), then appoints the seller bank as his agent to sell away those goods on behalf of buyer bank. Mostly metals are used as underlying commodities because their prices are stable and which decreases the risk of change in price.

#### **1. Mechanism of Commodity Murābahah :**

Commodity Murābahah is practiced in two ways: i.e. when a deposit is needed to be lent by the Islamic Bank or it has some surplus money to invest in order to bring back some useful returns. The other form of Commodity Murābahah takes place when Islamic Bank is in need of cash or they want to borrow loan from a Conventional Bank. In the following structure the mechanism and process of Commodity Murābahah in case of Deposit given is explained. Islamic bank deals with Conventional Bank which is named as counterparty in the following mechanism:

- a) Islamic bank offers the counterparty that Islamic Bank is interested to purchases commodities (metals in form of warrants<sup>4</sup>) as agent of Conventional Bank. Conventional bank accepts the offer.
- b) The counter party after accepting the offer of Islamic bank lets the Islamic bank purchase; the warrants form the seller (commodity broker) for the counterparty.

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<sup>2</sup> Mohammad Ashraf, *Shari'ah-compliant Financial Products*, accountancy, March 15, 2007 <http://www.accountancy.com.pk/articles.asp?id=174>(accessed Feb 15, 2011)

<sup>3</sup> Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus press limited,2009) p. 73

<sup>4</sup> Warrant is the certificate of ownership that is issued by the institution for example London Metal Exchange. These certificates carry the location of commodities and their number for the sake of identification.

c) Title of Ownership of warrants shifts to counterparty from the current owner through Islamic bank. The counterparty pays to the seller for the warrants on spot payment. The counterparty is now the owner of the warrants as paid for them at spot.<sup>5</sup>

d) Counterparty sells warrants to the Islamic bank. The counterparty is now the owner of the warrants and offers to sell them to the Islamic bank against deferred payment. Ownership of the warrants transfers to the Islamic bank.<sup>6</sup>

e) Islamic bank sells warrants to end buyer against spot payment. Islamic Bank after receiving the commodities (which were already with them) sells the warrants to an end buyer and receives the counter value at spot.

f) Payment from Islamic bank to counterparty. This payment takes place in installments at a pre-arranged time in the future and consists of the principal of the original purchase plus a pre-agreed mark up.

The whole process results in a situation that Islamic bank now holds a large sum of deposit, for which the whole setting was initiated, with deferred payments to the counterparty for a pre-agreed cost price plus mark up at a pre-agreed date in the future. Thus a synthetic deposit taken by the Islamic bank is created.<sup>7</sup>

## **2. Reverse Commodity Murābahah :**

The process of Reverse Commodity Murābahah is arranged by the Islamic bank, in order to receive loans or liquidity from the conventional banks. In this type of transaction following steps are involved.

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<sup>5</sup> Natalie Schoon, op. cit., p.72

<sup>6</sup> Ibid.

<sup>7</sup> Ibid, p.73

- a) Counterparty purchases warrants from Islamic Financial institution: The counterparty accepts the offer from the Islamic bank to purchase warrants on a deferred payment basis, where the mark up and the repayment date are already decided.
- b) Title of Ownership of warrants transfer from the Islamic bank to the counterparty.
- c) Counterparty appoints Islamic bank as his agent and authorize him to sell warrants on its behalf: The Islamic bank now acts as an agent to sell the warrants at spot payment to another party (usually a broker). Ownership of the warrants transfers to the end buyer.
- d) Payment from end buyer to counterparty: The counter party will be paid for the commodities at spot. Whether the counterparty appoints the Islamic bank as agent to sell the warrants on their behalf or arrange to sell to a third party themselves, the counterparty will be paid at the spot counter value of the warrants.<sup>8</sup> In other words the counterparty will be paid the deposit it demanded for. The deposit taken by the counterparty is received by it in full.
- e) The return of money by the counterparty to the Islamic bank: This payment takes place at pre-agreed installments in the future and it comprises of the principal of the original purchase price plus a pre-agreed mark up.<sup>9</sup> But it is to be noticed that the payments to the Islamic bank are in installments with fixed profits.

The net result of the above movements of warrants and cash is that the counterparty now holds an amount of money against an offsetting payment to the Islamic bank for a pre-agreed principal plus a mark up at a pre-agreed future date thus creating a synthetic deposit.

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<sup>8</sup> Ibid, p.75.

<sup>9</sup> Ibid.

Commodity *Murābahah* is the second name of a very well known transaction called Tawarruq.<sup>10</sup> Tawarruq can be defined as: “When someone buys a commodity at a deferred price, and then sells it for cash to another party, i.e. at a lesser price than the original purchase price, which is going to be paid on deferred basis. If he sells it to the first seller, it then becomes the prohibited sale of ‘*Inah* (buy back sale). Conversely, if he sells it to a third party, it then becomes *Tawarruq*”.<sup>11</sup>

There are two types of Tawarruq. One is the real form of Tawarruq, which can be called as traditional Tawarruq and the second is the organized Tawarruq, which is prevalent in Islamic Banks.

Banking Tawarruq takes place, when a person purchases certain commodities (mostly metal), from an Islamic Bank on deferred payments. He then makes the Islamic Bank his agent to sell the commodities on his behalf, without receiving them.<sup>12</sup>

As far as the technical procedure is concerned the process of Tawarruq and Commodity *Murābahah* are exactly the same. Tawarruq is also traded on metals. Traditional Tawarruq was a transaction based on avoiding buy back sale. Today this transaction is being utilized by Islamic Financial institutions with the name of commodity *Murābahah*. This research is based on the detailed discussion of practice on *Murābahah* and Tawarruq, which are both one and the same thing.

It is stated by the Experts of Islamic Finance that, Banking Tawarruq was a very controversial transaction which was practiced since last decade or more. Despite of its

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<sup>10</sup> Abdul Samad, *Commodity Murābahah*, Al-Huda Centre of Islamic Banking and Economics, December 2010-January 2011, Bi monthly Issue no: 039.

<sup>11</sup> Ibrahim Fadhil Dabu, *Tawarruq its reality and types*, Islamic business research centre, pg 2, [www.kantakji.com/figh/Files/Markets/a\(61\).pdf](http://www.kantakji.com/figh/Files/Markets/a(61).pdf).

<sup>12</sup> Ibid. p.4.

long practice it could not gain the acceptance from most of the experts of Islamic Banking. In order to avoid further criticism this transaction was introduced with the name of “Commodity Murābahah”. It is stated in relevant text of Tawarruq that, transaction of Tawarruq can be practiced in a few ways; one of those ways is Murābahah.<sup>13</sup> In other words it can be said that Commodity Murābahah is “Tawarruq on the base of Murābahah”. So Commodity Murābahah has two sides to be discussed. First one is the Original side of Murābahah because Commodity Murābahah is using the name of Murābahah Transaction. Second side to be discussed is the widely debated topic of Tawarruq. Since Tawarruq is also practiced by way of Murābahah. Commodity Murābahah lies in between both the transaction. i.e Banking Murābahah and Tawarruq. This thesis comprises of two parts first part is relevant to the Classical concept of Murābahah and Banking Murābahah which is named as Murābahah to the purchase orderer.

Chapter two is based on the Classical Contract of *Murābahah*, which was practiced in classic Muslim era. This chapter gives a look over how the original *Murābahah* used to be and how do the Classical Jurists see sale of *Murābahah* as? Most of that chapter is based on the text available in *Badā'i' al-Sanā'i'* by Imam Kasani. Other sources like *Al-Hidāyāh* and *al-Mabsūt* are also consulted in parallel. That chapter mainly consists of Definition of *Murābahah* according different School of Thoughts, Legitimacy of *Murābahah* from Qur'ān, *Sunnah*, *Ijmā'* and Conduct of Companions of Prophet(P.B.U.H). In Conditions of *Murābahah* almost the most of the concept of Classical *Murābahah* is embedded. Classical Jurists have discussed the sale contract of

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<sup>13</sup> Mohammad Taqi 'Usmāni, “ *Ahkām al-Tawarruq uww Tatbīqatuhu-al Masrafiah*”, Research Presented on 17<sup>th</sup> conference of 'al-Majma' al-Fiqh al-Islami, p. 19



*Murābahah*, under the head of its conditions. These conditions are very important to check the boundary of validation of *Murābahah* Contract. The third and the last part of Chapter 2 contains some more necessary concepts of Sale of Classical *Murābahah* e.g. what may be disclosed at the time of *Murābahah* and what is the remedy of breach of trust in case of contract of *Murābahah* etc.

Chapter 3 is dedicated to the Banking *Murābahah* which is introduced as a Mode of Finance. It was first initiated and designed by renowned *Sharī'ah* expert of Islamic Banking, Sami Hamoud.<sup>14</sup> This chapter discusses how the Classical *Murābahah* expanded to Banking *Murābahah*. This chapter discusses in detailed the procedure of *Murābahah* being practiced in Islamic Banks. The purpose of discussing the procedure is, to legally examine validity of *Murābahah* lil-'Āmir bish-Shirā' (MPO) from *Sharī'ah* perspective. This chapter is very significant to check the differences and similarities between Classical *Murābahah* and Banking *Murābahah*. The reason of discussing Banking *Murābahah* and Classical *Murābahah* is because whether the discussion is revolving around Commodity *Murābahah* or Tawarruq both of them are practiced under the name of *Murābahah* contract. Therefore it is very important to let the reader have a picture in mind of what is the real *Murābahah* actually? what is Banking *Murābahah*? What is Tawarruq? The one who do not know Classical *Murābahah* cannot understand Banking *Murābahah*. Similarly the one who do not know both Classical *Murābahah* and Banking *Murābahah* cannot understand the concept of Commodity *Murābahah* in its true sense.

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<sup>14</sup> Sayed Hamid Ābdul-Rehmān *Al-Kāff, Al-Murābahah in theory and practice*, (Karachi: Islamic Research academy, n.d) p.11

Chapter 4 explains the Contract of Commodity *Murābahah* in detail. Mechanism of Contract of Commodity *Murābahah* is also discussed. The end part of this chapter throws light on the international contracts being practiced all over the globe on the topic of Commodity *Murābahah*.

Chapter 5 deals with the very important topic *Tawarruq*. In the beginning of this chapter the types of *Tawarruq* is discussed. Then the debate regarding the permissibility of both the types starts. The end of that chapter deals with the current practice of Banking *Tawarruq* in banking system. There are no doubts about the issue that Commodity *Murābahah* and Banking *Tawarruq* are one and the same things. Both of the transactions are practiced by the way of *Murābahah*. It is stated by Muhammad 'Ayūb in his book "Understanding Islamic Finance":

*"Some Islamic banks use Tawarruq to place and obtain funds. It can give a fixed return to the banks and, hence, it is widely used as Commodity Murābahah or Shares Murābahah in the Middle East. Acceptable Tawarruq arrangements can be executed in the following manner: one bank (in need of funds) and another bank (intends to place funds) select any commodity/stocks which are liquid in nature (such as blue chip stocks); the surplus bank purchases the commodity on cash payment from the market; the deficit bank purchases it from the surplus bank on credit (Murābahah) and after taking delivery, sells it in the market at spot price."*<sup>15</sup>

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<sup>15</sup> Muhammad Ayub, *Understanding Islamic Finance*, (West Sussex: John Wiley and Sons, 2007) p. 351.

Commodity *Murābahah* as stated above is used by Islamic Banks for the Liquidity Management. It is used for the purpose of giving deposits by the Islamic Banks to mostly Conventional Banks. It is used by those financial institutions that are in excess of liquidity or cash, in order to utilize their idle money. This Contract is currently the most practicable in Islamic Banks now a day. There are a number of contracts signed on the base of Commodity *Murābahah*. It is published 4 June 2009, on Islamic Finance Portal:

*“With an estimated value of more than \$100 billion, Commodity Murābahah currently is the most widely used Islamic money market product in the GCC and other jurisdictions for liquidity management purpose”.*<sup>16</sup>

Malaysia’s commodity *Murābahah* House (CMH) is set to launch a palm oil *Murābahah*, in June 2009, which would allow Islamic banks and other financial institutions to create transactions using palm oil contracts<sup>17</sup>. Efforts are being made to standardize the transactions of Commodity *Murābahah*. For that purpose guide lines are issued by many banks e.g. HSBC Bank and Malaysian banks etc

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<sup>16</sup> Suapi Shaffai, Islamic Finance news portal-bringing you the latest updates in global shairah finance, June 4, 2009 set for palm oil *Murābahah* launch March 16, 09 [www.cibafi.org/newscentre/english/details.aspz/=2495](http://www.cibafi.org/newscentre/english/details.aspz/=2495). Also in <http://Islamicfinanceupdates.wordpress.com>(accessed February 15, 2011)

<sup>17</sup> Menafin, *Murābahah -CMH*, Islamic Financial Industry news centre, <http://Malaysia-CMH> set for palm oil *Murābahah* launch. <http://www.cibafi.org/newscenter/english/Details.aspx?Id=2495&Cat=3&RetId=0> (accessed June 1, 11)

Islamic banks can use commodity *Murābahah* as a liquidity management scheme for overnight and short-term deposits. The sector still lacks a *Sharī'ah*-compliant liquidity management scheme that is truly global and fully *Sharī'ah*-compliant. Hitherto, most of the commodity *Murābahah* deals have been done through brokers in London using contracts on the London Metals Exchange as the underlying commodities. The CMH is effectively an alternative to the LME contracts<sup>18</sup>

This is a very important and controversial issue in the field of Islamic banking. It is not in my knowledge that somebody else has worked on this topic from this perspective. It is an important issue to be resolved. It will be a contribution in the field of Islamic finance.

#### **STATEMENT OF THE RESEARCH PROBLEM/ THESIS STATEMENT:**

Commodity *Murābahah*, a new version of *Murābahah* is being questioned by many and needs to be examined from the Islamic perspective.

#### **HYPOTHESIS:**

1. Commodity *Murābahah* is consistent with Shariah rulings.
2. Commodity *Murābahah* is not consistent with Shariah rulings
3. Commodity *Murābahah* is partially consistent with Shariah Rulings.

#### **OBJECTIVES OF THIS RESEARCH:**

The objective of this research is to:

The historical background of Commodity *Murabaha*.

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<sup>18</sup> Ibid

To define commodity *Murābahah* and its types.

To throw light on Mechanism of Commodity *Murābahah*.

To investigate the validity of Commodity *Murābahah* from the perspective of Shariah rulings.

To discuss the impact of Commodity *Murābahah* on the Islamic Financial Market. To discuss the efforts made by different banks in world to make commodity *Murābahah* effective.

#### **LITERATURE REVIEW:**

The Major sources that I have consulted during this research project are many. But a few are important to be mentioned here. Book written by a renowned scholar (Our worthy teacher) Imran Ahsan Khan Nyazee on the topic of “*Murābahah* and Credit Sale” is very helpful and covers many critical aspects of *Murābahah* being practiced in Islamic Banks. This book revolves around the juristic issues arising out of Banking *Murābahah*. It gives a very broad vision to the reader with a flow of very strong arguments based on classical sources by *Imām al-Shāfi‘ī*’s text from *Kitab-al-Umm* and text from *Badā‘i‘ al-Sanā‘i‘* by Imam Kasani etc. May Allah increase his knowledge and bless him for doing very significant research on many fields.

A book by Muhammad Ayub named as “Understanding Islamic Finance” is also a very interesting and reader friendly book. That book consists of very significant and somehow reality based, straight forward material .

Another book written by a writer “Natalie Schoon” with the name of “Islamic Banking and Finance” is worth mentioning here. This is one of the best books on the detailed and internal concept of Commodity *Murābahah*. It explains this

transaction in a best possible way with the perspective of practice in Islamic Banks. It is a very significant book to have a good knowledge about the Mechanism of Commodity *Murābahah* in depth.

Our worthy teacher Dr. Tahir Mansoori has written a very significant book on this topic named as “Islamic Law of Contracts and Business Transactions” it throws light on the classical as well as banking practices on Murabaha contract.

Another book named as “ *‘Amaliat al-Tawarruq wa Tatbeeqatīha al-Iqtisadīah fi al-Masārif al-Islamīah*” by Ahmad Fahd Rūshdi is also very significant on the current banking practices of Tawarruq and Commodity Murabaha.

A Research Article with the name of “al-Tawarruq al-Masrāfi ‘an Tarīq bay‘ al- Ma‘adin” by Khalid bin al-Mashiqih is also a very significant and useful article on the topic of banking Tawarruq. It is consulted in the thesis in the relevant section.

A thesis by a student of Islamic University with the name of “*al-Tawarruq wa dawabītuha al-Shar‘īah*” by Roīati Anwari al-Indonisi under the supervision of Dr. Abdullah Rizq (our respected teacher) is also a very significant work.

**CHAPTER No. 2:**  
**MURĀBAHAH IN CLASSICAL ISLAMIC JURISTIC**  
**RULINGS**

**1. Introduction**

Sale is the most important part of a financial system. *Murābahah* is also one of the types of sale contract in Islamic Jurisprudence. It comes under the head “trust sales”. Trust Sales are those types of sales in which the buyer reposes trust over the customer. Disclosure of first price in all trust sales like *Musawamah*, *Tawliyah*, and *Murābahah* is obligatory.<sup>19</sup> *Murābahah* is most extensively used sale in the current Islamic Banking practices. Another reason is that, the Islamic Banks have adopted many different types of *Murābahahs*. In order to compare contemporary practices of *Murābahah* in Islamic Banks it is very important to discuss the detailed arenas of Classical Jurisprudence on Sale of *Murābahah*.

The reason of compulsory condition of this type of sale was to protect the innocent dwellers of villages who did not know much about the commodity prices being prevalent in the Cities. So the traders coming from cities with different commodities were legally and religiously bound under this contract of sale to disclose the first price

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<sup>19</sup>Abu Bakar Bin Masood Al-Kāsānī, *Badāye al-Sanae' fi Tartīb al-Sharai'* (Berut: Dār Kitāb al-Arabi, 1982) p.5/220.

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of the goods.<sup>20</sup> Classical *Murābahah* is based on certain conditions of its validity. This chapter is based on the concepts of Bay al-*Murābahah* in classical Islamic Jurisprudence.

## 1.1 Definition of *Murābahah*

### Literal meaning

*Murābahah* is derived from the word “Ribh”, which means nourishment and increase.<sup>21</sup>

### Technical meaning:

*Murābahah* is a contract of sale in which a seller is bound to disclose the cost of the goods. The contract of *Murābahah* takes place when the seller reveals cost price and both parties agree on a reasonable amount of profit. It is a sale of anything for the exact cost, at which it was purchased by the seller, plus an addition of a fixed sum by way of profit.<sup>22</sup>

Bay Al-*Murābahah* can also be defined as “It is the sale of goods for a stated cost price plus a stated profit that together form the price. The profit has to be stated with sufficient clarity so that the cost and profit are clearly determined.”<sup>23</sup>

Imam Al-*Sarakhsi* in his Book Al-*Mabsot* states about sale of *Murābahah* that,

”الثلث في بيع المرابحة مبني على الثمن الأول“<sup>24</sup>

”The price in sale of *Murābahah* is based on the first price”

<sup>20</sup>Burhan u-dīn Ali bin-Abī bakr bin-'Abdul Jalīl al-Rushdani *al-Marghīnānī, al-Hidāyah Sharh Bidayat-ul-Mubtadi*, (Maktaba al-Islamia, n.d) p. 3/56.

<sup>21</sup> *Lisan al-Arab* (Berut: Dar al-Sadir, n.d) p. 2/442.

<sup>22</sup> Al-Marghīnānī, op. cit., p.3/56

<sup>23</sup> Imran Ahsan Khan Nayazee, *Murābahah and Credit Sale*, (Islamabad: Federal Law House, 2009), p.9.

<sup>24</sup> Al-Sarakhsi, *al-Mabsot*, (Berut: Dar al-Fikr, 2000), p.11/303

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<sup>24</sup> Al-Sarakhsi, *al-Mabsot*, (Berut: Dar al-Fikr, 2000), p.11/303

Imam Kasani in his book *Badā'i' al-Sanā'i'*, defines Murābahah as

بيع المرابحة وهو مبادلة المبيع بمثل الثمن الأول وزيادة<sup>25</sup>

”ربح

*“Murābahah is the exchange of object (of sale) with the original price along with an excess as profit.” Which means it is the sale for a price (exactly) similar to the first price along with an excess as profit”.*

#### 1.2 Definition of *Murābahah* according to different jurists:

a) The *Mālikī's* define this contract as, the seller reveals to the buyer, the cost at which he obtained the object of sale, and seeks a profit margin either as a lump-sum, or as a percentage or ratio of cost.<sup>26</sup>

b) The *Hanafi's* define it as: it is the transfer of the object he obtained through a prior contract in exchange for the original price plus a profit margin.

c) The *Shafai's and Hanbali's* define it thus: it is selling at the principal plus a profit margin, provided that both parties know the principal (cost of obtaining the object of sale).<sup>27</sup>

<sup>25</sup> *Al-Kāsānī*, op. cit., p.5/135

<sup>26</sup> Ahmed bin Juzi, *Al-Qawaneen al-Fiqhia*(n.d) p.1/292

<sup>27</sup> Ibne-Qudama, *Al-Sharh al-Kabeer ala Matan al-Muqney*, (Dār al Kitāb al-'Arabi Li-Nashar wa Tawzee, n.d) p.4/102.

### 1.3 Legitimacy of *Murābahah* in *Al-Qur'an* and *Sunnah*

The legality of sales of *Murābahah*, *Tawliyah*, and *Wadiyah*, extracted out of a verse of *Al-Qur'an* allows all types of sales. This general texts apply to *bay*, without distinction between one type of *bay'* or another.<sup>28</sup>

a) *Al-Qur'an*:

Allah, the Majestic and Glorious, has said,

فَانْتَشِرُوا فِي الْأَرْضِ وَابْتَغُوا مِن فَضْلِ اللَّهِ وَاذْكُرُوا اللَّهَ كَثِيرًا لَّعَلَّكُمْ تُفْلِحُونَ

*"Then may ye disperse through the land, and seek of the Bounty of God"*<sup>29</sup>

*Murābahah* is expressed here as seeking of the bounty of Allah, through sale. There are many other verses in the *Al-Qur'an* that explicitly permit sales in general, e.g.

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

*"And Allah has permitted trade and prohibited Ribā"*<sup>30</sup>

إِنَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنكُمْ

*"But let there be among you trade by mutual good will"*<sup>31</sup>

<sup>28</sup> *al-Kāsānī* op. cit., p. 5/135.

<sup>29</sup> *Al-Qur'an* 62;10.

<sup>30</sup> *Al-Qur'an* 2;275.

<sup>31</sup> *Al-Qur'an* 4;29

In this regard, cost-plus sales like *Murābahah* are clearly concluded by mutual consent of both the parties.

**Sunnah:**

It is narrated that when the Messenger of Allah (PBUH) decided to undertake the Hijrah, Sayyadna Ābu Bakr (God be pleased with him) purchased two camels. *The Prophet (PBUH) said to him, "Sell one to me." Sayyadna Abu Bakr (R) said to him, "It is yours for nothing." The Prophet (PBUH) replied, "No, not without a price."*<sup>32</sup>

Therefore, from this tradition derivates permissibility of general sales, *Murābahah* is permissible as it comes under sale contract.

**Ijma‘:**

Likewise the people inherited these sales in consecutive periods without denial from anyone. This amounts to consensus (*ijma‘*) about their permissibility.

**Conduct of Companions of Prophet:**

Begin with quoting what Imam *Mālikī* said:

*"Yahiya told me that Mālikī said: there is a consensus of opinion in al-Madinah, regarding cloths bought by a person in a town and then takes them to another town, where he sells it at a mutually agreed profit margin. The money paid to the intermediary (the middle-man) will not be incorporated in the sale-price. The cost of packing and bundling will also not be computed in the cost price. The Personal expenses of business man and the house rent will not be included. As far as the cost of*

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<sup>32</sup> *Al-Zayla ĩ, Nasb al-Rāyah*, (Beirut: Dār kutub ‘Ilmiah, n.d) p. 4/31.

*transportation of the cloth is concerned, it will be incorporated in the basic price but no profit will be added to it unless the seller acknowledges the bargainer about all of them. If it is agreed by them, to let him have profit on all of them after knowing, there is no objection.*<sup>33</sup>

### **1.3 Description of the Sale of *Murābahah*:**

*Murābahah* is a sale of goods in which the exact cost price is disclosed, plus an amount of profit agreed upon between the contracting parties. In *Murābahah*, the seller reveals the cost of the sold commodity. He acknowledges the purchaser that he has purchased commodity, for so and so amount and he wants so and so profit over it. For example he sold the commodity for hundred pounds and that he will charge ten pounds as profit over and above the original price. It is also not objectionable to fix the profit in percentage i.e. 5 %, 10 % of the cost.

Specialty of *Murābahah* is that it is a trust sale. Thus it is morally and legally binding on the seller to be truthful and honest with regards to the facts about the price of the commodity as regards to the price of the goods. If the seller succeeded in obtaining a discount or rebate, he should disclose it for the benefit of the purchaser.<sup>34</sup>

The objective of *Murābahah* in the classic time period was to secure the consumers usually residing in villages and towns. Those consumers being unaware of

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<sup>33</sup> Al-Malik, *Mau'ta Li-Imam Malik*, (Beirut: Dār al Kitaab al-Arabi Li-Nashar wa Tawzee, n.d), p. 80, also in Syed Hamed Abdul Rehman *Al-Kāff, Al-Murābahah in Theory and Practice* ( Karachi: Islamic research academy Karachi n.d) p. 8.

<sup>34</sup> Muhammad Tahir Mansoori, *Islamic Law Of Contracts And Business Transactions* (Islamabad: *Shari'ah* Academy, 2008) p.214.

the market prices in cities and lacking expertise in trade had to be saved, from the tricks and stratagems of cunning traders.<sup>35</sup>

It is important to note here that the modern *Murābahah* takes place mainly between the banks and financial institutions on a deferred payment basis. Upon conclusion of *Murābahah* sale, a receivable is created which is stated as the liability of the customer. As the customer himself is involved one way or the other in locating and purchasing the goods.

#### 1.4 Types of Sale in Islamic Law and Placement of *Murābahah* in it

Sales as exchanges can be classified into five categories<sup>36</sup>:

i) **Sale at agreed prices (*bay' al-Musāwāmah*):** This type of sale is executed at the agreed upon price. In this type of sale, to reveal the original price of the commodity is not a necessary condition. This is the most commonly practiced type of sale.

ii) **Cost-plus sale (*bay'al-Murābahah*):** In this sale, the commodity is sold at the price at which it was purchased including a stated profit margin.

iii) **At-price sale (*bay'al-Tawliyah*):** In this sale, the commodity is resold to the consumer for the same price at which the seller purchased it. The cost price and sale price of this sale is equal as the name of this sale suggests<sup>37</sup>.

iv) **At-price partial sale (*bay' al- Ishrak*):** This type of sale is similar to that of bay al-Tawliya, except that only part of the purchase object of sale is resold to the customer.

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<sup>35</sup> *Al-Hidayah*, op. cit., p.3/56.

<sup>36</sup> Wahbah al-Zuhāī, *Financial Transactions in Islamic Jurisprudence*, (Damascus: Dār al-Fikr, 2001), p. 1/353, also in Nyāzī op. cit., p. 5

<sup>37</sup> Nyāzī, op. cit., p.9. also in Zuhāī, op.cit., p. 1/353.



v) **Sale at a loss (*bay'al-Wadī'ah*):** In this sale at loss. The object is sold to the buyer with a known decrease in the price at which it was obtained.<sup>38</sup>

Among all the above mentioned sales which were being practiced in classical times *bay Al-Murābahah* was one of the type of sales, prescribed in *Shari'ah*. This type of sale was duly practiced by Companions of Prophet (P.B.U.H) and their predecessors. There was no objection in this type of sale subject to certain conditions which are the conditions of validity of almost all the sales. But a few of the conditions are those which are peculiar to sale of *Murābahah* only The explanation of those conditions of sales is described below.

## **2. Conditions of *Murābahah* Contract:**

There are certain conditions of classical *Murābahah* that are very important to abide by.<sup>39</sup>

### **2.1 First Condition: The first price must be disclosed to the second buyer:**

One of the most important conditions of *Murābahah* sale is that *Murābahah* is a sale at the first price. *Murābahah* is a sale at the first price along with an excess as profit.

Disclosure of the first price is a necessary condition of validity of all trust sales i.e. *Tawliya*, *Musawamah*, *Murābahah*. But if it is not revealed, the sale is stated to be as *fasid* (voidable), until it revealed to the second buyer within the session. When it becomes known to the buyer, he has the choice to choose it in this case if he likes, in this

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<sup>38</sup> Ibid.

<sup>39</sup> *Al-Kāsānī*, op. cit., p. 5/220 also in *Nyāzī*, op. cit., p. 16.

case it becomes valid sale contract. He also has the choice to reject it which would make the contract void.<sup>40</sup>

## **2.2 Second Condition: Ascertainment of Price:**

*Murābahah* is valid only where the exact price can be ascertained.<sup>41</sup> For example ‘Mr. A’ purchased computers. He wants to sale it on *Murābahah* with 10% Mark up the exact cost can be ascertained, so the *Murābahah* sale is valid<sup>42</sup>. But *Murābahah* cannot be legalized if concluded in the following situation: ‘A’ acquired a readymade suit with a pair of shoes in one transaction. The amount of both the transactions is stated as a lump sum of Rs 500. “A” can resell the suit including shoes on the basis of *Murābahah*. But he cannot sell both the commodities separately on *Murābahah*. The reason of it is the uncertainty of each commodity’s price individually.<sup>43</sup>

## **2.3 Third Condition: The Profit must be fixed and it must be known as it is Part of the Price:**

Another condition among the conditions is that the profit of the *Murābahah* sale must be known as it is part of the price, and knowledge of the price is a condition for the validity of sales.<sup>44</sup>

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<sup>40</sup> Ibid. also see in *Nyāzī*, op. cit., p. 18.

<sup>41</sup> *Al-Kāsānī* op. cit., p. 5/221, also in Mansoori, op. cit., p. 214.

<sup>42</sup> Mansoori, op. cit., p. 217

<sup>43</sup> *Al-Sarakhsī* op. cit., p.13/151 also in Muhammad Taqi ‘Usmāni, *An Introduction to Islamic Finance*, (Karachi: Idaratul M’arif, 1998), p.104, also in Azhar Shehzad, *Murābahah and its modern application*.<http://www.scribd.com/doc/18270597/Murābahah-Assignment-1> (accessed Jan 1, 2011)

<sup>44</sup> Nayazee, op. cit., p. 21. also in Zuhāfīī op. cit., p. 1/355

#### **2.4 Fourth Condition: The Original price must be a Fungible Commodity:**

It means that the first price of the contract must be measurable by weight, volume or number of other types of homogenous goods. This condition is necessary for both *Murābahah* and *Tawliya*<sup>45</sup>. This condition is necessary whether the *Murābahah* sale is concluded with the initial seller or another party. Irrespective of the fact that profit margin is specified in goods of the same genus as the original price. If the first price is not fungible the objects can not be sold through *Murābahah* to anyone except the owner. This is because price in *Murābahah* the first price must be ascertainable along with the profit margin in *Murābahah*.

If the original price is non-fungible (e.g. a car, dresses etc), than it is to be considered that whether the seller owns the property or not:

1. If the seller does not own the property, *Murābahah* is not permitted, because the value of the property is unknown.

2. If the seller owns the property, then two situations are under consideration<sup>46</sup>:

a) If the profit margin is specified as a known amount of a different good (e.g. copper coins, or some specified dresses) then the sale is permissible. Because the first price is certain and the profit is certain.

b) If the profit is added as the part of initial price (e.g. the profit margin is 20% of the cost price) this type of sale is not permissible because the profit is not

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<sup>45</sup> *Al-Kāsānī* op. cit., p. 5/221.

<sup>46</sup> *Zuhaīlī* op. cit., p. 355.

equally divisible. What is equally divisible is its value. But the value is not actually specified and determined. Only the estimate of value can be made which may vary.<sup>47</sup>

**2.5 Fifth Condition: The First Price in the First Contract must not be a Counter-value for its Own Species that is a Ribā-Bearing Commodity:**

The first price in *Murābahah* should not be exchanged for the same genus of those goods, which are Ribā bearing commodities. For instance, if a commodity which can be measured by weight or volume is sold for the goods of the same species in the same quantity, it is not permissible to sell by way of *Murābahah*. The reason is that *Murābahah* consist of trading at the initial price and an excess. In goods eligible for Ribā, the excess in Ribā bearing wealth amounts to *Ribā*, rather than profit.<sup>48</sup>

When the genus is different, there is no harm in concluding the *Murābahah*. However, if the genus in the initial price is different, *Murābahah* is allowed. The reason is that *Murābahah* is the sale of first price and profit over it. For instance the seller traded for a gold coin for 10 silver coins. It is permissible to sell it by way of *Murābahah* with a profit as one silver coin or a specific dress.<sup>49</sup>

**2.6 Sixth Condition: The First Contract must be Valid:**

Another condition of *Murābahah* sale is that the first contract must be valid. If the object of first sale is concluded on defective basis, the *Murābahah* sale is not permissible. This is because *Murābahah* is sale at the initial price plus an excess as profit. The *fāsid* or defective sale, establishes ownership in exchange for the value of the commodity of sale,

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<sup>47</sup> Al-*Al-Sarakhsī*, op. cit., p.13/166.

<sup>48</sup> Al-*Kāsānī* op. cit.,, p. 5/221

<sup>49</sup> *Ibid*, also in *Nyāzī* op. cit., p. 24.

and not in exchange for its price. Thus, the naming of the price in the *Murābahah* is not valid if the initial sale were defective.<sup>50</sup>

## **2.7 Seventh Condition: Ownership of subject:**

Another Condition is that the commodities to be sold must be in the ownership of the seller at the time of sale. Thus, the commodities not in the ownership of the seller cannot be sold. If he sells before acquiring its ownership the sale is void.<sup>51</sup>

## **2.8 Eighth Condition: Custody of the Subject:**

The Subject of sale must be in the physical custody of the seller when he sales it to other person.<sup>52</sup>

## **3. Other Important elements of sale of *Murābahah***

### **3.1 Concepts of the original price**

The initial price for the goods that are to be sold in *Murābahah* is the capital sum. This is the original amount that the initial buyer owed to the original seller. Initial buyer may in fact pay the initial seller other goods as a substitute for this price that was named in the original sale. Thus, if the initial buyer bought a dress for 10 silver coins, and then

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<sup>50</sup> Al-Kāsānī op. cit., p. 5/222.

<sup>51</sup> Taqi 'Usmāni, op. cit., p. 97, also in Azhar Shehzad, *Murābahah and its modern application*, p. 3 <http://www.scribd.com/doc/18270597/Murābahah-Assignment-1>

<sup>52</sup>Ibid.

made the payment by one gold coin (in lieu of the named price), the principal remains the 10 silver coins named as the original price.<sup>53</sup>

### **3.2 Opinion of different Jurists about what maybe appended to capital sum:**

a) **Hanafi School of Thought:** All type normal expenses that are related to the commodities to be sold in *Murābahah*, which result in increase in the price of the commodity, may be appended with the principal money. This can include the expenses like dying, washing, stitching, intermediation in sales, animal feeding etc.

These costs appended to the *principal* money are not to be stated separately in the end but they are to be charged as a total sum, as a cost of the goods.

However, a number of other expenses incurred may not be appended to the principle sum of the *Murābahah*. These wages include the wages of a doctor; shepherd etc. in these cases, the *Murābahah* must contain the original price only. This includes all those expenses which are not customarily included in the original sum of the *Murābahah* contract following the principle stated in the tradition of Prophet Muhammad SAW.<sup>54</sup>

#### **b) The *Mālikī* School:**

Expenses that can be included to the price are those that have affected the commodity such as dyeing or tailoring. Those expenses which are born on services such as the fare

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<sup>53</sup> Al *Al-Kāsānī*, op. cit., p. 5/222 also in *al-Zuhāīlī*, op. cit., p. 1/356.

<sup>54</sup> *Al-Kāsānī*, op. cit., p. 5/223.

for the transporting or storing the commodities in a warehouse rented, amounts incurred for these purposes can be added to the capital sum but cannot be considered at the time of calculation of profit.<sup>55</sup>

**c) Hanbali and Shafai schools:**

All actual expenses born at the time of as regards the commodity can be appended to capital amount provided that the *Murābahah* purchaser is acknowledged about the amount of these expenses and their origin.

### 3.3 What needs to be disclosed at the time of *Murābahah*:

The issue of disclosing at the time of *Murābahah* pertains to following matters: the first thing that needs to be mentioned here that *Murābahah* is a “trust sale”. In *Murābahah* buyer relies on the seller and his expertise with respect to the first price without relying upon any other evidence or affidavit or oath. So, it must be secured against a breach of such trust, and against all causes of breach as well as suspicion.<sup>56</sup>

As Allah (SWT) said:

*“O you who believe, do not betray the trust of Allah and his Messenger, nor misappropriate knowingly things entrusted to you”.*<sup>57</sup>

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<sup>55</sup> Al-Qurtubi, *Bidayat al-Mujtahid wa-nihayat al-Muqtasid*, (Berut: Dar al-Fikr, n.d) p. 2/163 also in Mansoori, op. cit., p. 217.

<sup>56</sup> Al-Kāsānī op. cit., p. 5/223. Also in Nyāzī, op. cit., p.28.

<sup>57</sup> *al-Qur'an* 8:27

### 3.3 Legal status of the *Murābahah* sale in case of breach of Trust.

If a breach of trust has become evident either after the seller admitted, or if a proof is provided then two facts are considered. First, that the buyer betrayal is related to the characteristic of the object of the sale or the price of the sale:

- If the betrayal of trust is evident on the characteristic of the price, like his buying on the basis of a credit sale and then selling by way of *Murābahah* on the basis of the first price, but without elaborating that he bought it on the basis of a deferred sale. On the second buyer later on it is revealed that it has been bought on deferred sale. He will have an option, on the basis of his approval and consensus of both the parties, to accept it or reject it. It is due to the reason that *Murābahah* is a contract based upon *amanah* (trust), and also because the buyer is dependent the seller with respect to the facts disclosed upon him.<sup>58</sup>
- If the betrayal is disclosed on the amount of the price in *Murābahah*. The seller might have claimed that he bought the goods for 10 thousand and in reality he purchased for less. In this case Imam Abu Hanifa ruled that the buyer has the option whether to keep the goods in exchange for the full price, or to return it.

#### Conclusions:

Therefore, it can be concluded from the above text that: The original price must be exactly the same as that of the second price. This point is time and again emphasized by almost all the renowned jurists like al Kasani and *Al-Al-Sarakhsī*. Therefore it is a very important point.<sup>59</sup>

The commodity must be in the ownership and physical custody of the seller.

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<sup>58</sup> *Nyāzī* op.cit, p. 28

<sup>59</sup> *Ibid*, p. 29.



*Murābahah* is a trust sale, so everything must be disclosed to the second buyer.

Otherwise the contract is voidable on the choice of seller.

The next chapter analyzes the Banking *Murābahah*.

**CHAPTER 3:**  
**MURĀBAHAH IN CONTEMPRORY LEGAL**  
**THOUGHTS AND PRACTISES**

**1. Introduction**

*Murābahah* is known as Cost-Plus Sales. In this sale, the customer is aware of the price at which the seller purchased the object to be financed, and agrees to pay an increase over that initial price.<sup>60</sup> This sale is the one in which commodity is sold on a markup or profit along with the original cost, whereas disclosing the actual price and amount of profit is obligatory. So this sale contains an additional condition along with other general conditions of sale. I.e. seller must disclose the actual price plus profit to the buyer.<sup>61</sup>

**1.1 Banking *Murābahah***

“*Murābahah*” is, one of the types of “trust sales” under Classical Islamic Jurisprudence. Originally, it refers to a contract of sale, which do not have anything to do with

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<sup>60</sup> Muhammad Amin El-Gamal, *A basic Guide to Contemporay Islamic Banking and Finanace*, (Plainfield: Islamic Society of North America, 2000) p. 10-11.

<sup>61</sup> Taqi 'Usmāni, *An Introduction to Islamic Finance*, (Karachi: Idaratul M'arif, 1998), p. 48.

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financing. If a purchaser agrees to buy certain commodities at a known cost price with an agreed profit over it, is a *Murābahah* sale. The basic ingredient of *Murābahah* sale is that the cost price must be disclosed to the purchaser.<sup>62</sup>

Contemporary Islamic banks have introduced a new modified form of contract of *Murābahah*. In this type the bank purchase a good upon the request of a customer and then re-sell those goods to the client in *Murābahah*.<sup>63</sup>

The transaction of Banking *Murābahah* is basically composed of two promises:

- a) A promise by the customer to purchase the object.
- b) A promise made by the financial institution (bank) to sell him the commodities by a *Murābahah* contract.<sup>64</sup>

Modern Jurists using their juristic skill have inferred certain examples from classical Fiqh, and tried to expand the concept of *Murābahah*, to make a beneficial alternative for banking purpose.

## 1.2 **Murbaha to the Purchase Orderer:**

### 1.2.1 **Definition of *Murābahah* lil- ‘Āmir bi-Shirā’ (*Murābahah* to the Purchase Orderer MPO).**

It is a sale in which two parties or more negotiate and promise each other to execute an agreement according to which the orderer<sup>65</sup> asks the purchaser<sup>66</sup> to purchase an asset of

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<sup>62</sup> Taqi 'Usmāni, op. cit., p. 48.

<sup>63</sup> Zuhāli, *Financial Transaction in Islamic Jurisprudence*, (Damascus: Dar al-Fikr, 2001) p. 1/360.

<sup>64</sup> Ibid.

<sup>65</sup> Orderer is the customer of bank/financial institution “bank who requests to the bank to purchase the specific commodity and promise that he will purchase the same commodity from the bank after acquire and taking possession from the seller.

<sup>66</sup> Purchaser is the financier (bank/financial institution “bank”) of the customer who purchase on *Murābahah* to the Purchase Orderer from the supplier/ seller and then sells the same commodity to the purchase orderer.

which the latter will take legal possession.<sup>67</sup> The orderer promises the purchaser to purchase the asset which will be purchased by the orderer from the purchaser on cost plus pre-agreed profit. The two parties would conclude a sale after the possession of the asset is taken by the profit. However, the purchase orderer may or may not be obliged to conclude the sales.<sup>68</sup>

### 1.2.3 Explanation:

In Islamic banks the transaction of *Murābahah* does not only include *Murābahah* transaction. But there are many more contracts that take place within that transaction. Other contracts are aimed at completion of the *Murābahah* contract. That is why the whole process is called as “*Murābahah*”.<sup>69</sup>

The theorists of Islamic Banking states that, if a person is in need of money for some purpose or purchasing some commodities. If he seeks help from any conventional bank, the bank would lend him money on *Ribā*. On the other hand, Islamic banks would appoint him as his agent, to buy the goods on his behalf. Later on the bank will sell the goods to the same customer who bought them. The sale contract would be on deferred payment basis with specified mark up/profit.<sup>70</sup>

The Technicalities of buying and purchasing from Islamic banks are described in the next section of this chapter. It is said that Islamic banks unlike conventional banks assist the customer in purchasing the goods. The bank will give the authority to the customer in need to buy the goods as an agent of the bank. After taking the possession of

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<sup>67</sup> See Accounting and Auditing Organization for Islamic Financial Institutions' *Shari'ah* Standard, Manama, 2003, p.134.

<sup>68</sup> It may, however be noted that the promise (if it is one sided) is binding and enforceable in Court of law.

<sup>69</sup> I'jāz Ahmed Samdānī, *Islami Banko mai raej Murābahah ka tareeka kar*, (Karachi: Idara Islamia, 2006), p. 22.

<sup>70</sup> Ibid .

the goods being purchased by the customer, the bank will sell those goods to the customer on the base of *Murābahah* sale i.e. cost plus profit basis. The sale can be deferred or spot.

Before purchasing the commodity, the bank obtains an undertaking from the customer whereby the customer promises that the commodity will be purchased by the customer from the bank. Under this arrangement the bank discloses its cost and profit margin to the customer. In other words rather than advancing money to a borrower, which is how the system would work in a conventional banking agreement, the bank will buy the commodity from a third party (seller) and sell those commodity on to the customer for a pre-agreed price.<sup>71</sup>

## **2. Procedure of *Murābahah* in Islamic banks**

For the sake of completing practical procedure of banking *Murābahah* client has to go through many stages. The details are as follows

### **2.1 First Stage: Application of client and its acceptance.**

At this stage, the client who is in need of the goods gives an application to the bank, in order to get benefited from the *Murābahah* Mode of Finance. The customer along with application provides with the required information. The information is regarding the specifications of the goods, their quality and quantity, sources of the goods, methods and modes of transportations<sup>72</sup> etc.

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<sup>71</sup> Samdānī, op. cit., p. 25.

<sup>72</sup> Ahmed Al-Suwaidi, *Finance of International Trade in the Gulf*, (London: Graham and Tortman, 1994) p. 99.

For accepting this application Islamic banks check and study the documents submitted to it. This process is same as “credit studies” conducted by the conventional banks before giving the loan.

## **2.2 Second Stage: Fixation of the Limit and Preliminary Agreement**

When the above mentioned study of Islamic Banks is complete and the bank is satisfied with the credit assessment and good will of the customer. Application of the customer is accepted. Then comes the stage of fixation of ‘limit’<sup>73</sup> i.e. limit of financing the customer. There are two types of limits accepted by banks

- 1) Comprehensive limit.
- 2) Limit for one transaction only.

Sometimes a bigger limit is granted to the client such as rupees one million, which means a bank has agreed to buy up to this limit and to sell it on *Murābahah*. But the client does not need to buy all the goods in one single transaction. He has to buy the goods at different timings with different amounts. Therefore, he requests the bank to issue him a comprehensive limit and he may be allowed to buy the commodities within that limit.

The second situation is when the client prefers a certain limit of amount he actually needs. In this case he applies for the transaction he actually needs.<sup>74</sup>

The limit is accepted through a general agreement. That General agreement shows the ‘limit’ as well as terms and conditions being settled between the bank and the client.

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<sup>73</sup> Limitation: This limit is granted through a general agreement. The agreement of the limit shows the prescribed ‘limit’ of financing the customer with certain terms and conditions.

<sup>74</sup> Samdānī, op. cit., p.16.

### **2.3 Third Stage: Buying of Goods**

At this stage Islamic banks are recommended to buy the goods from the market at their own, or banks can appoint agent other than client to buy goods. The Islamic banks do allow appointment of client as an agent. Or if required the client can be appointed as an agent (*Sharī'ah* Standard)

The issue that arises here is that whether the Islamic Financial Institution is permitted from the Shariah perspective to appoint the client as his agent.

### **2.3 Fourth Stage: Contract of *Murābahah***

a) Taking the Possession of the goods and telling the bank:

If the client is appointed as an agent for buying the required goods, than the client after buying the commodities, takes the possession of the goods. After taking the possession client acknowledges the bank about it.<sup>75</sup>

b) Execution of *Murābahah*:

After this the client offers the bank to sell the goods on specified amount in which the profit of the bank is included. Client will return the amount at once or after a specified time. When the bank accepts the offer the contract of *Murābahah* take place. The payment becomes due on the client. Bank in return of the amount due on client takes some collateral. The above procedure is summarized as the contract of *Murābahah*.<sup>76</sup>

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<sup>75</sup> Samdānī, op. cit., p. 27

<sup>76</sup>Ibid

### **2.5 Fifth Stage: Payments:**

Usually bank buys the goods from the bank on cash. Therefore when client being the agent of bank buys the goods, the bank pays the supplier at once.

Although for *Murābahah* it is not necessary that bank sells those goods to the client on credit/loan but it can also sell on spot payment basis. But the client wants finance from the bank so usually the client buys those goods from bank on deferred payment basis and pays back the price to the bank in installments or at once in the end. Whatever terms and condition (situation) decided client will be bound on that.

### **3. Expansion of Classical Contract of *Murābahah* in to Modern Banking *Murābahah***

Modern Islamic Bankers using their juristic skill have inferred certain examples from classical Fiqh, and tried to expand the concept of *Murābahah*, to make a beneficial alternative for banking purpose. It is stated that Scholar Dr. Sami Homoud gave the idea of *Murābahah* lil aamir bi shira for the first time in 1979. He inferred the idea relaying on the text of *Imām al-Shāfi ʿī* in forming the basis of modern banking *Murābahah*.<sup>77</sup>

This transaction is validated by the Sayings of Imam Al-*Al-Shāfi ʿī* in Al-Umm:

*“If a person shows another person a commodity telling him: purchase this (for me) and I shall give you such and such profit margin. This deal is lawful. The person who offered the profit margin enjoys the option of either completing the deal or leaving it incomplete. Similarly, if he tells: purchase for me a commodity which he specifies or any commodity you*

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<sup>77</sup> al-Kāff, op. cit., p. 8.



*choose and I shall give you such and such profit margin, this is all the same and the first deal is lawful.*

*He, in what he gives from his free will, shall enjoy option (to complete the deal or not).... If they conclude the deal on the condition that both commit themselves to the first deal, it shall be null and void for two reasons. First because they conclude the deal before the seller obtained the ownership (of the goods in question). Secondly because he (the would-be seller) is exposed to risk (in view of your condition): if you purchase at such and such a price I shall let you have such and such a profit margin".<sup>78</sup>*

The above mentioned text is taken from volume 3 of Kitab al-Umm by *Imām al-Shāfi'ī*. This text is discussing permissibility of general buy back sale. If a person purchases some commodities on credit and buys those commodities at lower prices, then it is allowed. This is a general buy back sale. This transaction is designed on credit sale or spot payment as required. Imam explaining this says that a person says to another "if you purchase this I will give you on profit on it". He may later on say it can be spot payment or deferred.<sup>79</sup>

For making the option (khiyaar) given by Imam Shafai in deferred sale, which makes it a non binding. Non Binding sale of *MPO* was not practical for Islamic Banks. So another ruling was taken from Maliki Fiqh. Ruling of Ibne Shabramah from the *Mālikī* School was taken out for this. It is "any promise that does not result in permitting something that is forbidden or forbidding that which is permitted is binding.

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<sup>78</sup> *Al-Shāfi'ī's, Al-Umm*, (Berut: Dār al-Fikr li-Ta'aba wa nashr' wa-Tauwzee, 1983) p.3/39.

<sup>79</sup> Nyāzī, op. cit., p. 55.

It means promise for permissible acts is binding. *Mālikī* use this principle to make promise binding especially in the cases where, the promise leads another entity to undertake a financial obligation. So it is basically Talfiq done on *Murābahah* lil aamir bi shira.<sup>80</sup>

The rulling from *Mālikī* School of thought is taken just to make MPO useful for banking practice.

There are three inferences coming out of the above mentioned text and juristic approached applied on it.

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<sup>80</sup> *al-Zuhaīlī*, op. cit., p. 1/361.

## CHAPTER NO. 4

### THE PRACTICE OF COMMODITY *MURĀBAHAH* IN CONTEMPORARY ISLAMIC BANKING

#### 1. Introduction:

Some banks in the Middle East and the West have started using commodity *Murābahah* on international commodity exchanges as a source of liquidity management and treasury operation. This is a very crucial mode of finance and needs a special attention of Islamic jurists.<sup>81</sup> It involves a short-term placement mechanism which includes purchase and sale of goods in the global market e.g. London Metal Exchange (LME)<sup>82</sup>. Internationally, Islamic banks have depended mainly on this mode for liquidity management. The banks use *Tawarruq*<sup>83</sup> and appoint a broker to buy goods usually any

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<sup>81</sup> Muhammad Ayub, *Understanding Islamic finance* (West Sussex :John Wiley and Sons, 2007) p.233

<sup>82</sup> London Metal Exchange is an institute offers commodities for future contracts and contract of commodity *Murābahah* . They issue warrants which according to them are enough for the customer to claim the ownership. see more details in [www.lme.com](http://www.lme.com)

<sup>83</sup> *Tawarruq* can be defined as: ““When someone buys a commodity at a deferred price, and then sells it for cash to another party, i.e. at a lesser price than the original purchase price, which is going to be paid on deferred basis. If he sells it to the first seller, it then becomes the prohibited sale of ‘*Inah* (buy back sale). Conversely, if he sells it to a third party, it then becomes *Tawarruq*”.”<sup>83</sup>

type of metal and then sell the same on deferred payment to any other broker on the same date. Usually, Islamic banks make an agent of a conventional bank to purchase on their part any metal from broker A against spot payment and then sell the same to broker B on deferred payment. Here, nobody takes care whether any actual transaction has taken place or not, and at which point in time risk was transferred to the bank. It has been doubted that the quantity of metal is sufficient to cover the transaction volumes. As the brokerage cost makes the product less competitive, there is a chance that no actual transactions might be taking place. There is an immense need that Islamic banks must understand that the Tawarruq arrangement, even in its genuine form, should be used in extreme cases where no option is available to avoid *Ribā*. It has not been approved by all scholars. Widespread use of such products is harmful to the Islamic banking industry in the long run.<sup>84</sup>

Commodity *Murābahah* is turning out to be the most popular modes used to manage short-term liquidity in the Gulf region. It is based on commodities traded on the London Metal Exchange (LME) on a spot basis with full payment of the purchase price, then selling the purchased goods to a third broker on a *Murābahah* (cost-plus sale) basis on deferred payment basis with a maturity time from one week to six months, and with spot delivery of the sold commodities.<sup>85</sup>

In Malaysia, Commodity *Murābahah* Program (CMP) was designed to be the first ever commodity-based transaction that utilizes the Crude Palm Oil (CPO) as the underlying commodity in commodity *Murābahah*. Though this concept is based on Tawarruq contract which has long been discussed by the *Shari'ah* scholars worldwide.

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<sup>84</sup>Muhammad Ayub, op. cit., p. 233

<sup>85</sup>Asyraf Wajid Dusuki, "Commodity *Murābahah* Program (CMP): An Innovative Approach to Liquidity Management" *Journal of Islamic Banking*, p.3/ 1.

Now recently this concept was implemented with the name of commodity *Murābahah*. The main purpose of designing this form of contract is to offer Islamic financial institutions a new instrument in managing liquidity in the Islamic Interbank Money Market (IIMM). CMP gives certainty of returns as it is undertaken. It is based on pre-agreed 'margin' or 'mark-up' from the sale and purchase of the underlying commodities.

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## 2 Commodity *Murābahah*.

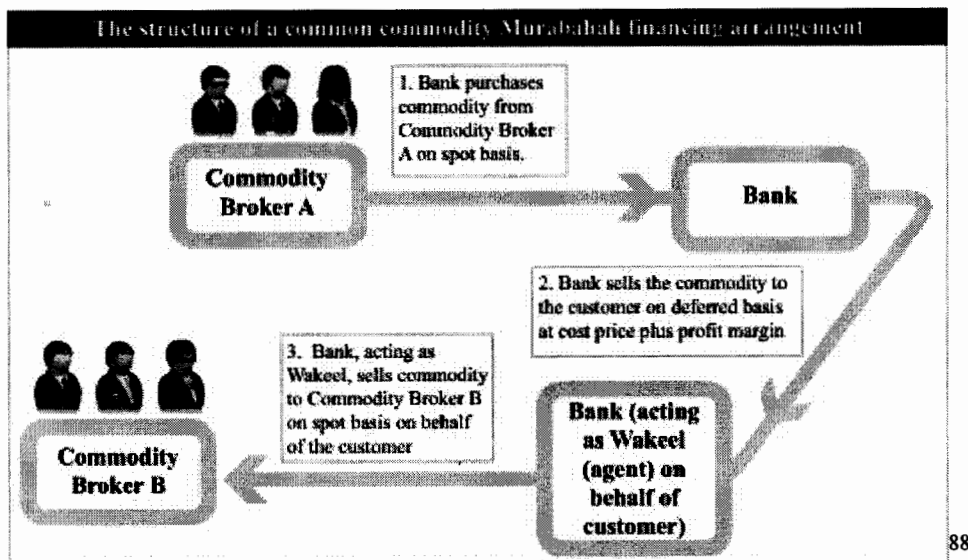
### 2.1 Definition

When an Islamic bank uses commodity *Murābahah* to give out financing, it will first buy an asset from a Commodity Broker, which it then sells to the borrower. The borrower then sells the commodity to a third party (also a commodity Broker) using the bank as its agent. The borrower bank receives finance it had demanded.<sup>87</sup> The lender bank in return receives fixed mark-up in the name of *Murābahah*.

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<sup>86</sup> Ibid.

<sup>87</sup> <http://www.reuters.com/article/idUSKLR43272420090728> Malaysian bourse eyes *Murābahah* trading system as debate rages. (accessed January 30, 2011)



The most extensively used but with very little conformity. In summary, the depositor (financial institution) attains metals with their deposit money. Later on the depositors sell the metals on spot delivery but with deferred payment, to a commodity broker. More frequently, the depositor appoints the deposit-taking institution as agent to enter into the initial purchase and subsequent sale of the metals on behalf of the depositor.<sup>89</sup>

The amount of the deferred payment is equal to the cost price of the metals plus a profit, taken as return on the deposit. The party buying the metals from the depositor liquidates the metals for its cash value. A conventional money-market index, such as LIBOR, is invariably the benchmark for agreeing the markup.

The variations in this product arise from the variations in the document, variation in the use of agents to purchase/sell metals, the markets from which metals (e.g. London metal exchange, oil markets in gulf region etc) are bought to the number of brokers

<sup>88</sup> [http://www.Islamicfinanceasia.com/10\\_Murabahahh.php](http://www.Islamicfinanceasia.com/10_Murabahahh.php) FEATURE (accessed January 30, 2011)

<sup>89</sup> Simons & Simons (International law firm), *Islamic Liquidity Management*, [www.simmons-simmons.com/docs/islamic\\_liquidity\\_management.pdf](http://www.simmons-simmons.com/docs/islamic_liquidity_management.pdf) (accessed February 15, 2011)

used, the provision of promissory notes and “netting” arrangements etc.<sup>90</sup>

## 2.2 MECHANISM:

### 2.2.1 Inter-bank Liquidity:

The commodity *Murābahah* is the technique most commonly used by Islamic banks to provide short term inter-bank liquidity.

A contract of commodity *Murābahah* resembles basic *Murābahah* transaction. As it is based on a deferred payment sale or installment credit sale utilizing metals (commodities) as underlying asset for the transaction. In the basic form of commodity *Murābahah*, the transaction involves two financial institutions(banks), one as the buyer of a commodity and one as the seller as can be seen in the figure shown below

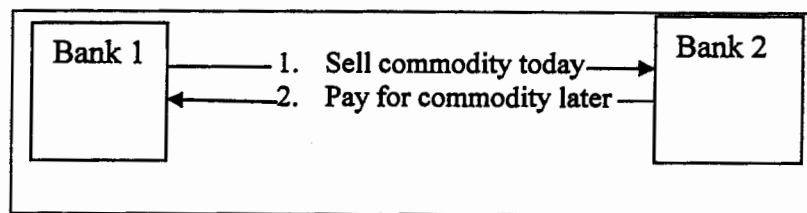


Figure 1. Simple form of Commodity *Murābahah* structure

In the *Murābahah* sale, the price of the commodity, the profit, the date of the delivery and the date of repayment of price are agreed up front. The purpose of this contract is to replicate conventional money market transactions (i.e. the inter-bank market), and the banks do not actually hold the underlying metals nor have a

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<sup>90</sup> Ibid.

requirement for it. The underlying metals are purchased and sold only to facilitate interbank liquidity in accordance with Shariah principles.<sup>91</sup>

Two types of commodity *Murābahah* transactions are introduced in Islamic banks, deposit given and deposit taken. The details of both of them are given below. Due to the fact that commodity *Murābahah* transactions are fixed rate, they are usually short term with a maximum term of one year.<sup>92</sup>

The criteria for commodity used as underlying asset in commodity *Murābahah* is that it must be non perishable, freely available and can be uniquely identified. The commodity that are originally considered as a means of exchange or money e.g. gold, silver, barely, date, wheat and salt- are not permissible to be used underlying asset in commodity *Murābahah*. The majority of users of commodity *Murābahah* and Tawarruq transactions pursue LME base metals as an asset since they cover all criteria of a commodity and are easily identifiable and available via warrants.<sup>93</sup>

#### **2.2.2.1 Deposit Lent:**

The purpose of the commodity *Murābahah* is for the Islamic financial institution to provide a deposit to their counterparty to generate a return. The process of cash flow is as follows

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<sup>91</sup> Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus press limited,2009) p.73

<sup>92</sup> Ibid

<sup>93</sup> Warrants are the certificate of the specified metals present in ware houses of London Metal Exchange (an international institute carrying out forward contracts on the basis of commodities, which is metal). These warrants are later on used to carry out contract. The certificates are issued to the clients, as a proof of being the owner of the commodity for the time being only.



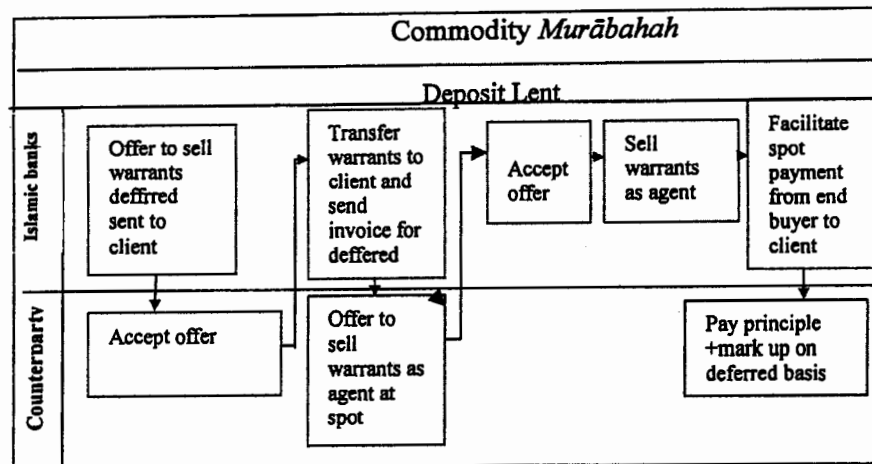


Figure 2. commodity *Murābahah*- deposit given<sup>94</sup>

In this structure, the following actions take place:

- a) **Counterparty purchases warrants from Islamic Financial institution:** The counterparty accepts the offer from the Islamic bank to purchase warrants on a deferred payment basis, where the mark up and the repayment date are already decided.
- b) **Title of Ownership of warrants transfer from the Islamic bank to the counterparty:** The counterparty becomes the owner of the commodities without even getting the possession and without even seeing them. The goods do not change hands and place. The counterparty is now the owner of the warrants but does not make a payment until a later date.
- c) **Counterparty appoints Islamic bank as his agent and authorize him to sell warrants on its behalf:** The Islamic bank now acts as an agent to sell the warrants at spot payment to another party (usually a broker). Ownership of the warrants transfers to the end buyer.

<sup>94</sup> Natalie, op. cit., p. 74.

- d) **Payment from end buyer to counterparty:** The counter party will be paid for the commodities at spot. Whether the counterparty appoints the Islamic bank as agent to sell the warrants on their behalf or arrange to sell to a third party themselves, the counterparty will be paid at the spot counter value of the warrants.<sup>95</sup> In other words the counterparty will be paid the deposit it demanded for. The deposit taken by the counterparty is received by it in full.
- e) **The return of money by the counterparty to the Islamic bank:** This payment takes place at pre-agreed installments in the future and it comprises of the principal of the original purchase price plus a pre-agreed mark up.<sup>96</sup> But it is to be noticed that the payments to the Islamic bank are in installments with fixed profits. As the *Murābahah* as we studied earlier do not involve delay. Delay is permitted in ordinary credit sale. But *Murābahah* and credit sale if amalgamated is a ditto copy of conventional loans lent on *Ribā*.

The net result of the above movements of warrants and cash is that the counterparty now holds an amount of money against an offsetting payment to the Islamic bank for a pre-agreed principal plus a mark up at a pre-agreed future date thus creating a synthetic deposit.

The flow of cash and warrants in a commodity *Murābahah* is as follows:

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<sup>95</sup> Ibid, p.75.

<sup>96</sup> Ibid.

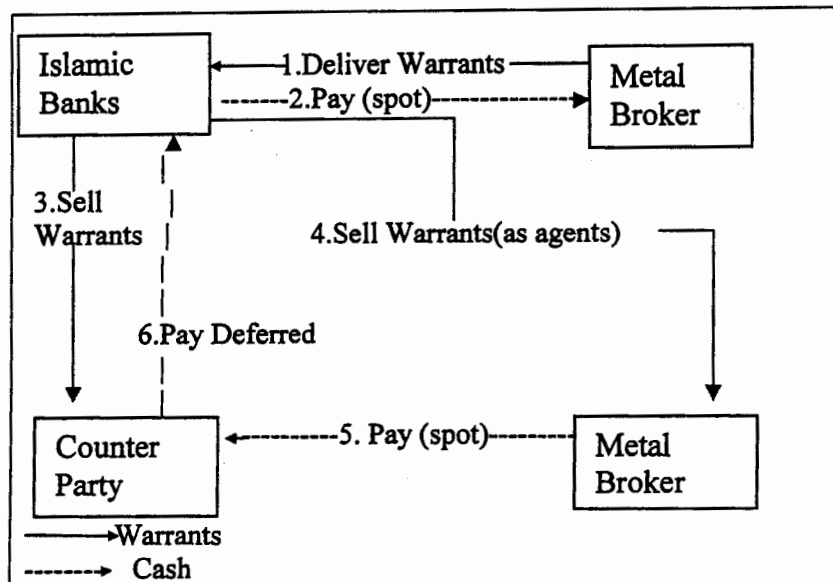


Figure 3. Flow of Cash and warrants in the process of Commodity

*Murābahah*<sup>97</sup>

In step 1-3 the Islamic Financial institution purchases the warrants as a principal and later on sells them to the client on a deferred payment basis. The client appoints the Islamic bank as agent to act on his behalf to sell the warrants on the spot payment in market. The Islamic bank resells the commodities to a commodity broker. The whole process results into synthetic inter-bank deposit placed by the Islamic bank with the customer.

**2.2.2.2 Deposit Received:**

This process is called reverse commodity *Murābahah*. The purpose of reverse commodity *Murābahah* is for the Islamic financial institution to take a loan from the client (usually a conventional bank) and to return it in installments which are pre-planned and agreed time, including a mark up. The process flow is as follows:

<sup>97</sup> Natalie op. cit., p. 75

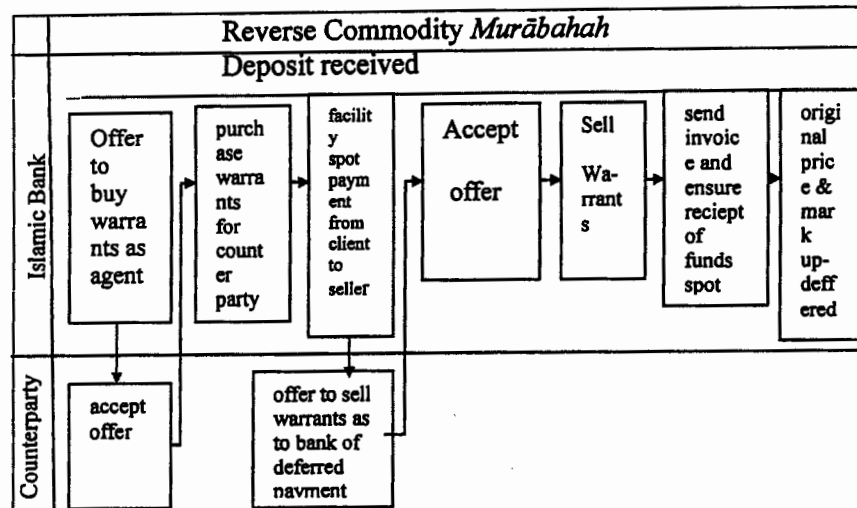


Figure 4: Reverse Commodity *Murābahah*: deposit taken<sup>98</sup>

In this structure, the following actions take place:

- a) **Islamic bank purchases warrants as agent of counterparty:** The other party accepts the offer from the Islamic financial institution to buy warrants on their behalf. So the Islamic bank purchases warrants for the sake of counter value.
- b) **The counter party accepts the offer of Islamic bank:** The Islamic bank purchases the warrants form the seller for the counterparty.
- c) **Title of Ownership of warrants shifts to counterparty from the current owner through Islamic bank.** The counterparty pays to the seller for the warrants on spot payment. The counterparty is now the owner of the warrants as paid for them at spot.<sup>99</sup> Here the ownership of the warrants is transferred to the counterparty on the papers and there is doubt about the existence of metals as the

<sup>98</sup> Natalie, op. cit., p. 76

<sup>99</sup> Natalie, op. cit., p.72

volumes of commodity *Murābahah* taking place are very large. It is doubtful that this much amount of metal cannot exist.

- d) **Counterparty sells warrants to the Islamic bank.** The counterparty is now the owner of the warrants and offers to sell them to the Islamic bank against deferred payment. Ownership of the warrants transfers to the Islamic bank.<sup>100</sup> Here another issue is critical that the goods were originally bought by the Islamic bank. So in other words it is a type of a buy back sale which is strictly prohibited in the eyes of all the jurists on the basis of strong evidences. Imam Shafai is the only jurist who allow buy back sale, strictly on a condition that the sequence of buy back sale is not pre-arranged and conditional otherwise void.<sup>101</sup>
- e) **Islamic bank sells warrants to end buyer against spot payment.** Islamic Bank after receiving the commodities (which were already with them) sells the warrants to an end buyer and receives the counter value at spot.
- f) **Payment from Islamic bank to counterparty.** This payment takes place in installments at a pre-arranged time in the future and consists of the principal of the original purchase plus a pre-agreed mark up.
- a. The whole process results in a situation that Islamic bank now holds a large sum of deposit, for which the whole setting was initiated, with deferred payments to the counterparty for a pre-agreed cost price plus mark up at a pre-agreed date in the future. Thus a synthetic deposit taken by the Islamic bank is created.<sup>102</sup>

The flow of cash and warrants in a reverse commodity *Murābahah* is as follows:

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<sup>100</sup>Ibid.

<sup>101</sup> *Imām al-Shāfi'ī's, Al-Umm*, (Berut: Dār al-Fikr li-Ta'aba wa nashar' wa-Tauwzee, 1983), p. 3/39

<sup>102</sup> Natalie , op. cit. p.73

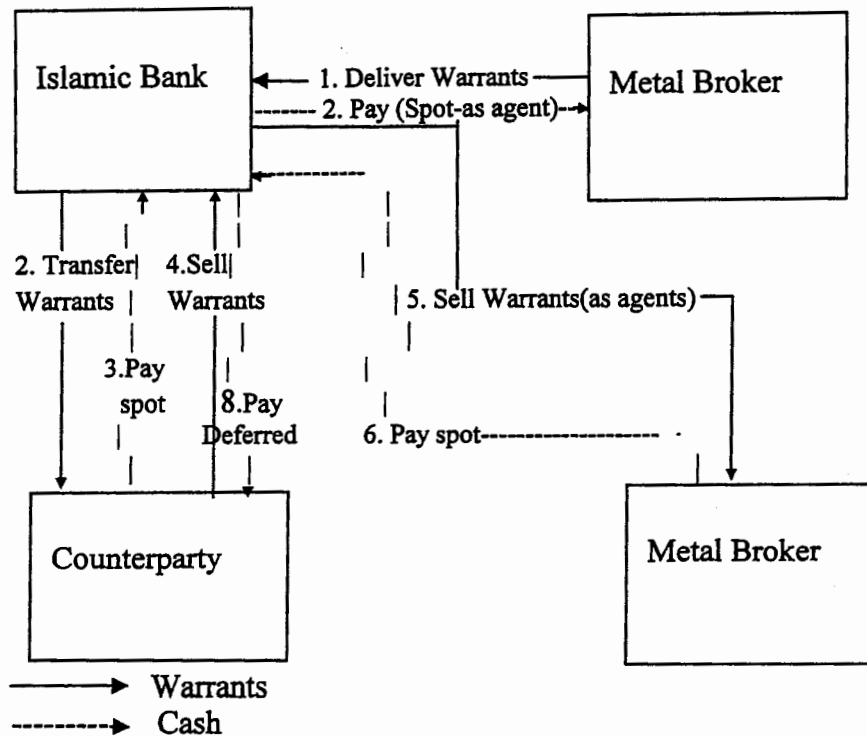


Figure 5: Commodity *Murabahah*, Cash and Warrant flow<sup>103</sup>

In step 1-4 the Islamic bank is acting as an agent on behalf of the client. The client then has the warrants in his ownership, and then he sells them to the Islamic bank on principal to principal basis, against a deferred payment of the principal plus a mark-up. The Islamic bank, being the owner of the warrants, later on sells them to a metal broker on cash payment resulting in a synthetic inter-bank deposit placed by the client with the Islamic bank.

### 2.3 Variations on Commodity *Murabahah*:

Just as commodity *Murabahah*, Tawarruq is also a commodity based transaction for inter-bank liquidity objectives. The Tawarruq also has a lot of *Sharī'ah* issues just like

<sup>103</sup> Ibid.

commodity *Murābahah*. The main *Sharī'ah* issue with Tawarruq transactions is related to the fact that the intention behind the purchase of the commodity is not to own and use the commodity. Instead, the commodity is sold instantaneously in order to obtain the required funds<sup>104</sup>.

It is therefore very important to discuss the concept of Tawarruq as it is closely related to the concept of commodity *Murābahah*, and stated to be the same according to many scholars.

Commodity *Murābahah* is based on the concept of Tawarruq that is, receiving cash for a debt of a higher amount. The structure attracted considerable attention when, in 2003, the OIC Islamic Fiqh Academy likened commodity *Murābahah* to “organized” Tawarruq which it deemed a synthetic and fictitious transaction and therefore impermissible under *Sharī'ah*.<sup>105</sup>

Despite the ruling by the OIC Islamic Fiqh Academy, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) proceeded to issue a standard guideline on the requirements of Tawarruq (*Sharī'ah* standard no 31).<sup>106</sup>

### **International Contracts based on *Murābahah* Transaction:**

According to a report published in Arab News, on 18<sup>th</sup> June, 2007, which says that Commodity *Murābahah* has reached \$ 1.2 trillion globally. This large amount of funds is followed by a large number of contracts internationally, claiming to be signed under

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<sup>104</sup> Exactly same is the case with commodity *Murābahah*.

<sup>105</sup> Imran Ahsan Khan Nyāzī, *Murābahah and Credit sale*, (Islamabad, Federal Law House, 2009), p. 90

<sup>106</sup> Ibid.

the contract of Commodity *Murābahah*. Following are the few examples of such types of contracts being practiced all over the globe.

In April 2007 different banks syndicated to sign Commodity *Murābahah* contract under the head naming, Commodity *Murābahah* Program (CMP). The names of the participants are Bank Negara Malaysia, Securities and Exchange Commission Malaysia, and Bursa Malaysia (the stock Exchange) and other industry players. They have launched Commodity *Murābahah* which will be a liquidity management scheme for Islamic Banks overnight. These banks will use crude Palm Oil as the underlying Commodity. These banks signed a master agreement the total of eight Islamic Banks.<sup>107</sup> The Daily Express Malaysia, reported about new Commodity *Murābahah* House Mechanism which was established by the securities commission and other stake holders from the industry. It will also utilize crude palm oil as the underlying commodity for *Murābahah* and Tawarruq.<sup>108</sup>

On July 15<sup>th</sup> 2010 a news release was issued by Nomura, a first Japanese Global Investment Company, stating that their Commodity *Murābahah* facility was closed above target as US \$ 70 Million using syndication. The Target of this facility was 50 million but it was concluded at 70 million due to great demand by different stake holders. The Participants were ABC Islamic Bank, Islamic Development Bank (IDB), Samba Financial Group, Sumitomo Mitsui Banking Corporation, Europe Limited and Ahli United Bank.<sup>109</sup>

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<sup>107</sup> Mushtak Parker, *Commodity Murābahah attracting Investors*, Arab News, <http://archive.arabnews.com/?page=6&section=0&article=97627&d=18&m=6&y=2007> also in <http://www.Islamicfinance.de/files/Islamicfinance22.pdf> (accessed January 30, 2011)

<sup>108</sup> <http://www.Islamicfinance.de/files/Islamicfinance22.pdf>

<sup>109</sup> Nomura's Commodity *Murābahah* Facility closes above target at US\$70 million, news release Nomura, [http://www.nomuraholdings.com/news/nr/europe/20100715/20100715\\_b.html](http://www.nomuraholdings.com/news/nr/europe/20100715/20100715_b.html)



On February 1<sup>st</sup>, 2008, it was stated by the staff writer of Arabian Business.com that the instrument of Commodity *Murābahah* is misused very gravely and i.e. it is hurting the industry of Islamic Finance. They stated that the transaction of commodity *Murābahah* is concluded on the commodities which do not change hands or there are perceptions that this large quantity of metals do not exist. So this transaction is merely a cash flow between the banks. “The situation is somewhat embarrassing for the industry” said Ruggiero Lomonaco, head of Middle East and Islamic private investor products, ABN Amro Markets, speaking at the Islamic Finance Forum in Dubai. Ruggiero said that “You will see very shortly when *Ribā* rates go down, back to 2003 [levels], people will find alternatives.”<sup>110</sup>

A recent report estimated the global Commodity *Murābahah* market to be worth more than 1 trillion USD.<sup>111</sup>

Globally the transaction of Commodity *Murābahah* is being standardized, by International Islamic Fund Management (IIFM), in order to avoid costly bilateral arrangement and to attain standardized approach. The name of the standardized document is Master Agreement for Treasury placement (MATP).<sup>112</sup>

Commodity *Murābahah* is also used in the form of skulk. Great number of contracts signed on the basis of *Murābahah*-backed Sukuk. For example in 2005, Arcapita Bank B.S.C (c) Announced US \$ 200,000,000 *Murābahah* backed Sukuk. Boubyan Bank (K.S.C), Bumiputra – Commerce Bank (L) Limited, Natexis Banques

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<sup>110</sup> <http://www.arabianbusiness.com/misused-Murābahah-hurts-industry-122008.html>

<sup>111</sup> [http://www.olamonline.com/attachments/newsroom/20090506\\_release.pdf](http://www.olamonline.com/attachments/newsroom/20090506_release.pdf)

<sup>112</sup> <http://www.iifm.net/media/PDF/presentation-paper/MATP-TMA.pdf>

Populaires, Raiffeisen Central bank Oesterreich Aktiengesellschaft and The Arab Investment Co. (OBU) joined the *Murābahah* facility as lead arrangers.<sup>113</sup>

In August 2009, Islamic Bank of Asia joined with Guoco Land Partners to offer the facility of Commodity *Murābahah* for the SGD, 50 million. This news report test Islamic financial industry based on this mode as 1 trillion US \$.<sup>114</sup>

Islamic Bank of Asia announced another contract based on commodity *Murābahah* in coalition with Park way Life REIT in August 2009, for SGD 50 million over a period of 3 years, where Parkway is Asia's largest listed healthcare Reith by asset size.<sup>115</sup>

Modern Islamic Bankers have introduced *Murābahah* in EMV<sup>116</sup>, which is stated by them to be secure. They have acquired bundles of explanations regarding the validity of that contract.

International Commodity *Murābahah* is now being introduced as an electronic transaction, which can be concluded with a few clicks. The whole transaction is made digital on the basis of digital assets.<sup>117</sup> There is no concept of the commodities changing hands or the ownership, or even the risks transferring from one party to the other.

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<sup>113</sup> [http://www.arcapita.com/media/press\\_releases/2005/Murābahah-Backed%20Sukuk%20-%20English%20Press%20Release.pdf](http://www.arcapita.com/media/press_releases/2005/Murābahah-Backed%20Sukuk%20-%20English%20Press%20Release.pdf)

<sup>114</sup> <http://www.guocoland.com.sg/Documents/PressReleases/2009/IBAsia-GuocoLandJointPressRelease5Aug09.pdf>

<sup>115</sup> [http://plifereit.listedcompany.com/newsroom/20090806\\_174045\\_C2PU\\_147086E64FF5FB7D4825760A002C7E7A.1.pdf](http://plifereit.listedcompany.com/newsroom/20090806_174045_C2PU_147086E64FF5FB7D4825760A002C7E7A.1.pdf)

<sup>116</sup> <http://www.isg.rhul.ac.uk/~cjm/eetsmt.pdf>

<sup>117</sup> [http://www.misys.com/cds-portfolio/digitalAssets/6/4068\\_US\\_Opics\\_Plus\\_Islamic\\_Treasury\\_FS\\_24\\_11\\_09\\_Final\\_Lowres.pdf](http://www.misys.com/cds-portfolio/digitalAssets/6/4068_US_Opics_Plus_Islamic_Treasury_FS_24_11_09_Final_Lowres.pdf)

The European Islamic Investment Bank signed with the Islamic Bank of Britain (IBB) as a facility of commodity *Murābahah* designed to assist IBB in managing its liquidity profile. The date of report was March 11, 2007.<sup>118</sup>

Alliance Bank JSC, Kazakhstan received a commodity *Murābahah* facility on the basis of syndicated Wakalla, up to the amount of 150 million US \$. 19 Banks were joining the facility. Abu Dhabi Commercial bank and ADIB joined on the top-tier MLA level. The maturity of this contract is 370 days.<sup>119</sup>

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<sup>118</sup> <http://www.Islamicfinance.de/files/Islamicfinance22.pdf>

<sup>119</sup> <http://www.Islamicfinance.de/files/Islamicfinance22.pdf>

## CHAPTER NO 3

### Tawarruq

#### 1 Introduction

Tawarruq and Commodity *Murābahah* are the most extensively used and discussed topics in Islamic banks in the recent times. The purpose of heavily employing these techniques is to generate liquidity, which is lifeblood of Islamic banks. Normally Islamic banks appoint conventional bank as their agent, to buy commodity on their behalf on cash and reselling it to another broker on deferred payments.<sup>120</sup> As a result Islamic banks earn profit on the price of metal bought on its behalf without doing anything. In these transactions very little attention is being paid on whether the transaction took place or not, or at which point in time the risk was transferred to the bank. It is also being doubted that such a huge amount of quantity is not available as to cover the volume of the transaction. The brokerage cost makes the product less competitive there is a chance that no actual transaction is taking place.<sup>121</sup>

In the Islamic Banking practices many transactions are legalized by utilizing *Hiyal*<sup>122</sup>. Tawarruq is one of those transactions which has been originated by utilizing *Hiyal*.

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<sup>120</sup> Muhammad Ayub, *Understanding Islamic finance* (West Sussex :John Wiley and Sons, 2007) p. 234

<sup>121</sup> Ibid.

<sup>122</sup> Certain stratagems and subterfuges used in order to avoid Ribā.

## **2 Hiyal in Islamic Banking:**

Islamic banking practices are highly debated by a group of Shariah scholars, who do not believe that Islamic banking is genuine. The major objection raised by these scholars is that Islamic Banking is highly dependent on “Hiyal”. “Hiyal” are certain stratagems and subterfuges which are designed in order to circumvent certain Shariah prohibitions especially those of Ribā. The purpose of mentioning Hiyal here is that, the transaction of Tawarruq is legalized by Islamic Shariah Scholars in Islamic banking, by way of “*Hīla*”. Tawarruq is said to be a legal device. In order to legalize Tawarruq in Islamic Banking, the ground of permissibility is taken out from Hiyal. Therefore it is very important to briefly throw light upon the concept of Hiyal in Islamic Law.

### **2.1 Concept of Hiyal in Islamic Law:**

Hiyal: singular *Hīlah*, which literally means an artifice, device and stratagem. It protects the person who would otherwise have had no choice but to act against the provisions of sacred law, to arrive at the desired result while actually conforming to the letter of the law. Thus, Hiyal (legal artifice) constitute legal ways through which a person can reach desired results without violating Shariah principles.<sup>123</sup>

In Islamic Law *Hīla* is expressed in two ways. Firstly it is a tricky solution to difficult problems without frustrating the purpose of law. These are clever methods in law in order to attain the purpose in a legitimate way. Hiyal are utilized to avoid inconvenience in law. *Hanafī* and *Hanablī* jurist prefer to call them mākharij i.e outlets rather than Hīlas. Secondly, as a device and subterfuge to circumvent certain Shariah prohibition or

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<sup>123</sup> Tahir Mansoori, Lecture for “Use of Hiyal in Islamic Finance and its Shari’ah Legitimacy,” International Research Institute, 2011.

to evade certain obligation. Such Hiyal are declared unlawful by the Islamic Jurists.

The requirement of Islamic law in the exchange of dates with dates is that dates on both sides should be equal. Now if a person wants to exchange his inferior quality dates superior quality, he has to ignore quality difference and exchange it on the basis of equality in weight on both sides. Any difference in the quantity will make the transaction, a transaction of *Ribā al-Fadl*. The solution to this problem is to sell inferior quality in market and buy from the proceeds of sale required superior quality. In this way the parties can overcome a difficulty without jeopardizing the letter of Islamic law. All the school of thoughts permit Hiyal to be used, subject to the difference in the leniency and strictness in different school of thoughts in Islamic Jurisprudence.<sup>124</sup>

### **Tawarruq as unlawful Hila in Islamic Banks:**

Tawarruq and Commodity Murabaha are the unlawful Hiyal being heavily employed by Islamic banks.

## **3 Definition of Tawarruq**

### **3.1 Linguistic definitions at-Tawarruq**

This term is derived from the word paper and dirham coined from silver or money minted from dirham. Its plural is '*awraaq*' i.e. 'paper replacing monies/paper money'.<sup>125</sup> It was so called, because the buyers of a certain commodity sell that commodity using paper, with the purpose of getting the paper (liquidity) and not the commodity. The term 'paper' here means different types of money.

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<sup>124</sup> Tahir Mansoori, Lecture for "Use of Hiyal in Islamic Finance and its Shari'ah Legitimacy," International Research Institute, 2011.

<sup>125</sup> *Lisan al-Arab*, (Berut: Dār Sadir, n.d), p. 10/374 also in *Al-Misbah al-Munir*, (Al-Maktaba al-Asaria, n.d) p. 1/338.

### **3.2 Technical meaning/Definitions of *Tawarruq***

This is when someone buys a commodity at a deferred price, and then sells it for cash to another party, i.e. at a lesser price than the original purchase price, which is going to be paid on deferred basis. If he sells it to the first seller, it then becomes the prohibited sale of '*Inah* (buy back sale). Conversely, if he sells it to a third party, it then becomes *Tawarruq*.<sup>126</sup>

#### **Definitions of *Tawarruq* in Shariah:**

According to Fiqhi Encyclopedia of Kuwait's Ministry of Auqaf and Islamic Affairs, the term of *Tawarruq* is used only by Hanabalies only. They have defined it as: purchasing and selling of goods with deferred payment and selling it to a person other than the buyer for a lower price with immediate payment. A similar definition came in other than the Hanabalies in the chapters that deal with Bay' al '*Inah* and *Ribā*.<sup>127</sup>

*Tawarruq* can also be defined as: it is a transaction in which a person needy of cash, purchases certain goods from a certain person, and later on sells it in the market on cash at a price less than the one at which he purchased from its owner. It is called *Tawarruq* because the purpose of this transaction is to obtain wariq ( silver) i.e money or finance by a needy person. An example of this can be if a person 'X' is in need of 5000 \$ he approaches a person 'Y' with the request to sell him some commodity on credit. Y sells X his electronic devices of worth 5000\$ in 6000\$. X takes it to the market and sell it for 5000. X gets money and is indebted to Y for 6000\$.

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<sup>126</sup>Ibrahim Fadhil Dabu, *Tawarruq its reality and types*, Islamic business research centre, pg 2, [www.kantakji.com/figh/Files/Markets/a\(61\).pdf](http://www.kantakji.com/figh/Files/Markets/a(61).pdf).

<sup>127</sup> Monzer Kahf, Outline of a brief framework of *Tawarruq* (Cash Procurement) and Securitization in Shariah and Islamic Banking, p.1.

[http://monzer.kahf.com/papers/english/a\\_brief\\_framework\\_of\\_Tawarruq\\_and\\_Securitization.pdf](http://monzer.kahf.com/papers/english/a_brief_framework_of_Tawarruq_and_Securitization.pdf). last accessed June 8, 2011)

#### **4 Relationship of Tawarruq and Murabaha: in the light of application of Tawarruq in Some Islamic Financial Institutions:**

In some Islamic Banks Tawarruq becomes: Buying a commodity (let's say a computer) on the basis of Murabaha to the purchase orderer with the binding promise by the orderer and after signing the second sale contract on the basis of deferred payments and taking the commodities in possession, the bank will intermediate in the sale of the commodity, usually through another intermediation from the first seller (the car dealership) to sell the car to a new purchaser on cash basis for a lower price, the bank receive the cash and handed it over to the customer.<sup>128</sup>

The above mentioned transactions consist of an agreement of understanding including binding promise, three sale contracts and two agency contracts. The agreement of understanding is exactly the same as in contract of Murabaha with the addition that the bank will intermediate in third sale contract. First sale is between the Islamic Financial institution and the seller of the goods for currency. Second sale is between the financial institution and the client on the basis of installment (i.e deferred payment). Third sale contract is between the client and fresh purchaser who utilize the opportunity of purchasing goods for cash on lower price than original cash price which appears in the first sale contract. Between the first two sale transactions another contract of agency is signed by the bank and client according to which the client is authorized to perform the duties of negotiating price of first sale contract and taking delivery on behalf of the bank. The contract of agency takes effect after the second sale contract; it is also between the

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<sup>128</sup> Ibid. p.2



client and the bank to authorize the bank to sell the commodity to a new buyer and receive its price. There is sometimes a third agency contract between the bank original purchaser(car dealership) to negotiate the price of the third sale and take charge of actual sale and delivery. During all this transaction, the goods normally does not move from the first place i.e warehouse of the first seller.<sup>129</sup>

## **5. Types of Tawarruq**

There are two types of Tawarruq. One is the real form of Tawarruq, which can be called as traditional Tawarruq and the second is the organized Tawarruq, which is prevalent in Islamic Banks

### **5.1 Real Tawarruq**

It happens when a person purchases commodity from someone on deferred basis. He then sells it to another person other than the seller, to increase from the price<sup>130</sup>.

It can be observed from the definition that there is no concept of agency involved in this definition in which the purchaser appoints the seller as his agent to sell it to another person or broker as in the other prevalent type of Tawarruq in Islamic banks. The above mentioned definition amounts to a kind of deferred sale. Tawarruq in Islamic Banking is called “organized Tawarruq” or “reverse commodity *Murābahah*” includes a lot of more types of contracts in one single Tawarruq sale. So the present type of Tawarruq would not have been acceptable for any of the jurists.

#### **5.1.1 Juristic views on the legality of original concept of Tawarruq**

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<sup>129</sup> Ibid. p.3.

<sup>130</sup> Khalid bin Ali Al-Masheeqi, *al-Tawarruq an' Tareeq bay' al-Ma'adin*, majallah Jamia Umul Qura Li-Ulum Al-Shari'ah wa lughat-ul-Arabia wa adaabiha, vol 18, ain 30, 1425Hijri. p. 135

The Juristic views about Tawarruq are divided. Some scholars permit it; others stipulate certain conditions for its acceptability; while others prohibit this type of transaction altogether, considering it a ruse by which Islamic banks provide legal sanction for usury/*Ribā*, which is unanimously agreed to be prohibited<sup>131</sup>. A considerable number of Muslim jurists hold it invalid. In the opinion of these jurists the motivating cause of the transaction is to get loan against certain increase. It is a subterfuge and a legal device to obtain money against a certain increase subterfuge and a legal device to obtain money against a certain increase. Besides, it is an exchange of money for money with surplus from one side. It is stated to be based on the legality of sales founded on mutual consent, as well as the presence of a third party that excludes it from the form of the prohibited *Inah* sale.

Maliki School holds Tawarruq invalid. The authoritative Maliki text Mukhtasar Khalil explains Maliki's position on Tawarruq. The author writes:

"if a person asks the other: Lend me eighty and I will return to you one hundred". The other person says it is not lawful: but I will sell you a commodity worth eighty for one hundred. This is disapproved in Maliki School<sup>132</sup>.

Hanafi School has two divergent positions on Tawarruq. Zayla'i identifies Tawarruq as bay al-*Inah* and disallows it. He says:

The form in which bay al-*Inah* is practiced is that a need person approaches a merchant and requests him to lend him some money. The merchants want to earn from the transaction but at the same time he does not want to be indulged in *Ribā*. So he sells him

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<sup>131</sup> Khalid Al-Masheeqi, op. cit., p.140 also in Ibrahim Fadhal Dabu, *Tawarruq: its reality and types*, Islamic Business Research Centre, p.2. [www.kantakji.com/figh/Files/Markets/a\(61\)](http://www.kantakji.com/figh/Files/Markets/a(61)). (accessed February 15, 2011)

<sup>132</sup> Mohammad Abdullah al-Khirashi, *Sharh al-Khirashi*, (Bairut: Dar al-Fikr wa-Taba'a wa-Tauzi', n.d), p.5/106.

a cloth worth ten for fifteen on credit so that could sell it for ten on cash and meet his need. This is unlawful and reprehensible.<sup>133</sup>

Ibn Humam another Hanafi jurists allowed it though considered it as Makrooh (less preferable).<sup>134</sup> Ibnul-Hummam states that 'Inah is restricted to a situation where the commodity is sold back to the person from whom it was purchased; if it is sold in the market, the transaction is valid and permissible. This position stands with regard to the original concept of Tawarruq but the ruling changes if the transaction is infiltrated by some other element<sup>135</sup>

The Hanabli and Shafai jurists mainly do not see any problem in the permissibility of Tawarruq. But there are two traditions about Hanabli Fiqh. Majority of Hanbali jurists allow Tawarruq, their reasoning is based on the ground of permissibility of sale. But Ibn Taymiah and Ibn Qayyim have held it as impermissible.

Past jurists from Hanbali schools who categorically disallowed and nullified bay' al-'inah 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 Ribā was quite remote in Tawarruq due to its tri-partite nature. However, two prominent Hanbali jurists, namely Ibn Taimiyyah and his disciple Ibn Qayyim Al-Jawziyyah departed from the majority<sup>136</sup>

Hanabli Jurists, however, lay down certain conditions for its validity. These are:

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<sup>133</sup> Zayla'ī, Tabyin al-Haqa'iq, (Beirut: Dar al-Fikr wa-Taba'a wa-Tauzi', n.d) p.4/163. Also in Tahir Mansoori, Lecture for "Use of Hiyal in Islamic Finance and its Shari'ah Legitimacy," International Research Institute, 2011.

<sup>134</sup> Ibn Humām, Sharh Fath al-Qadir, (Beirut, n.d) p. 7/212&148.

<sup>135</sup> Ayub. op. cit., p.250

<sup>136</sup> Asyraf Wajid Dusuki, "Commodity Murābahah h Programme (CMP): An Innovative Approach to Liquidity Management" Journal of Islamic Banking, Volume 3, No. 1, [www.asyrafwajdi.com/download.php?f=0004](http://www.asyrafwajdi.com/download.php?f=0004)(downloaded...asyrafwajdi (accessed February 15,11)

1. There is a dire need for the transaction. The person undergoing the sale of Tawarruq needs money and he is unable to get deposit from any source. However, if he is able to manage the loan, then he is not allowed to enter Tawarruq.
2. The contract in its form should not be similar to a Ribā contract. This occurs where the seller expressly mentions that he is selling one thousand (which is the real price) for twelve thousand, because this amount to exchange of money for money with excess. It is, however, lawful if he appraises the prospective debtor of its real price and his profit margin.
3. The debtor (buyer of commodity) should not sell it before taking its possession.
4. The commodity should not be sold to the same creditor (seller in this case) at a less price.

## 5.2 Organized Tawarruq

Organized Tawarruq has been heavily employed by the Islamic banks offering Islamic Financial services (IIFSs) in substantial volumes for many years. The main purpose is liquidity management (often referred to as ‘Commodity Murabaha’).

The First Global Investments, an Islamic investments firm, defines Tawarruq as, reverse *Murābahah*. “As used in personal financing, a customer with a genuine need buys something on credit from the bank on a deferred payment basis and then immediately resells it for cash to a third party. In this way, the customer can obtain cash without taking a *Ribā*-based loan,”<sup>137</sup>

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<sup>137</sup> <http://news.brunei.fm/2010/03/14/sukuk-alternate-solution-to-tawarruq/> ‘Sukuk alternate solution to tawarruq’

Tawarruq, the mechanism used to execute commodity *Murābahah* transactions, involves the sale of an asset to a purchaser with deferred payment terms. The purchaser then sells the asset to a third party to get funds.<sup>138</sup>

In this is type of Tawarruq sale when a person purchases certain commodities (mostly metal), from an Islamic Bank on deferred payments. He then makes the Islamic Bank his agent to sell the commodities on his behalf, without receiving them.<sup>139</sup>

It can be observed from the above definitions that the difference between organized and real Tawarruq is that the customer in organized Tawarruq does not deal with the commodities i.e. does not receive it nor sell it further. But in real Tawarruq the customer has the option of keeping the commodities or selling them further. Islamic banks according to some scholars give this option as well to the customer, but merely as a formality because it is not possible for the customer to take possession of such a large amount of metals.<sup>140</sup> The commodities which are the subject matter of organized Tawarruq are placed in warehouses in which only the receipts of the commodities are issued to the customers. The customer doesn't even know which commodities he had transacted on.<sup>141</sup> So all this forces the customer to appoint the bank as his agent.

The OIC's (Organization of Islamic Conference) international Council of Fiqh Academy (ICFA) in Makkah ruled in April 2009 that organized Tawarruq and reverse Tawarruq were not permissible, since they were a 'trick' to get cash now for more cash paid later.

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<sup>138</sup> Ibid.

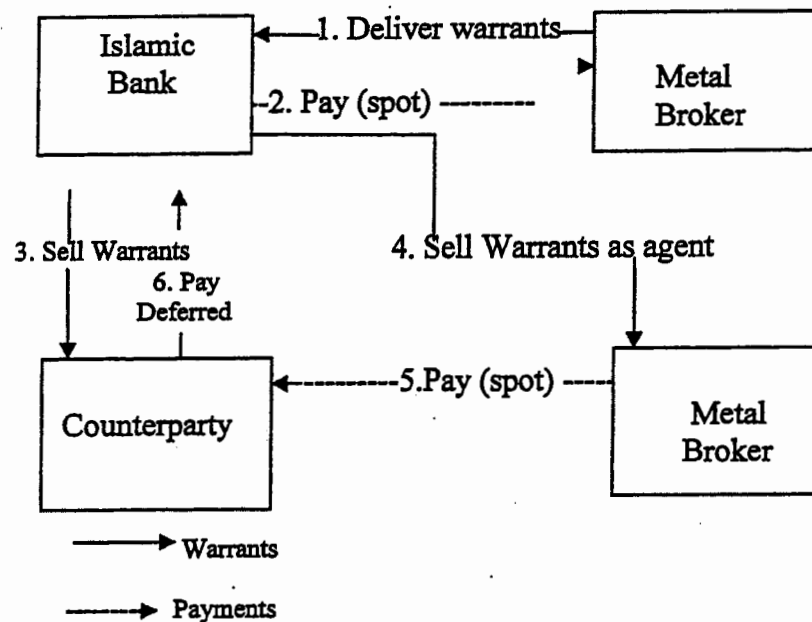
<sup>139</sup> Ibrahim Fadhil Dabu, *Tawarruq: its reality and types*, Islamic Business Research Centre, p.4. [www.kantakji.com/figh/Files/Markets/a\(61\).pdf](http://www.kantakji.com/figh/Files/Markets/a(61).pdf),

<sup>140</sup> Ibrahim op. cit., p.4

<sup>141</sup> Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus press limited, 2009), p.78

Among the various critics who have questioned the validity of the ICFA pronouncement, some have made the specific point that, inter alia, the judgment goes against the AAOIFI's ruling on the permissibility of Tawarruq, as laid out under AAOIFI Shari'ah Standard 30.<sup>142</sup>

### 5.2.1 The Mechanism of Organized Tawarruq in Islamic Banks:



#### Tawarruq

1. Islamic Bank pays (on spot) to the Commodity broker and the metals are transferred to him.
2. Islamic Bank then sells the warrants to the other bank.
3. The other bank i.e Counterparty appoints the Islamic bank as its agent to sell the goods in the market.
4. Islamic bank sells them to the other commodity broker.
5. The commodity broker then pays the counterparty upfront.

<sup>142</sup> Salman H. Khan, "Organised Tawarruq in Practice: A Shari'ah Non-Complaint and Unjustified Transaction", NewHorizon, (October-December 2010) p. 16.

6. The counter party owes a debt to the Islamic bank which is to be paid on deferred payment basis.

### **6. Use of Tawarruq for Liquidity Management and its relevant concepts:**

Islamic banks use Tawarruq to place and obtain funds. It can give a fixed return to the banks and, hence, it is widely used as Commodity *Murābahah* or Shares *Murābahah* in the Middle East. Acceptable Tawarruq arrangements can be executed in the following manner: one bank (in need of funds) and another bank (intends to place funds) select any commodity/stocks which are liquid in nature (such as blue chip stocks); the surplus bank purchases the commodity on cash payment from the market; the deficit bank purchases it from the surplus bank on credit (*Murābahah*) and after taking delivery, sells it in the market at spot price.

The Tawarruq process seems to be very simple. However, extreme care should be taken while undertaking such transactions and it should be ensured that the transaction does not become a mere exchange of papers between two brokers and one or two banks. Islamic banks need to understand that Tawarruq arrangements should be used in extreme cases where no option is available to avoid *Ribā*. Widespread use of such products is harmful to the Islamic banking industry in the long run. *Sharī'ah* boards need to strictly monitor all Tawarruq-based transactions.<sup>143</sup>

### **7 Concept of organized Tawarruq**

In Tawarruq or Commodity Murabaha, the commodities underlying sale, are international

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<sup>143</sup> Muhammad Ayub, op. cit., p.351

commodities which is normally a metal. The bank indicates the cost, markup, and other details to the client. This clearly manifests that it is a markup sale (bay' al-*Murābahah*)<sup>144</sup>. This transaction also includes deferred sale. So there is amalgamation of two sales in one. That is deferred sale and *Murābahah* sale. In the end of the sale contract the bank facilitating the customer becomes his agent and sells on the client's behalf the price is credited to the account of client.<sup>145</sup>

The Arab National Bank states while discussing on the Tawarruq sale, that the customer applying in the bank for this type of sale automatically authorizes that bank to sell it on his behalf.<sup>146</sup>

Al-Said states in defining organized *Tawarruq* that financial institutions purchase quantity of minerals from international markets; they have agents to act on their behalf. He further states that the commodities lay in international stores, warehouses<sup>147</sup>. The company selling the commodity provides certificate of storage, claiming institutions ownership of them. Then, the company, which sold the commodities to the institutions, provides a certificate of storage to the institutions containing a description of the commodities, their amount, the place of storage, their reference number and the institution's ownership of them.<sup>148</sup> It is also said about the commodities that they are placed in international warehouses, those commodities are meant for the only purpose of these sales like Tawarruq and commodity *Murābahah* or other future contracts. The writer also states that it is unknown that how many sales have taken place on the same

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<sup>144</sup>Salah al-shalhoob, *organised tawarruq in Islamic Law*, Published by Faculty of King Fahad University of Petroleum and Minerals home page., p. 3. [http://eprint.kfpun.edu.sa/14894/1/Organised\\_Tawarruq\\_in\\_Islamic\\_Law.pdf](http://eprint.kfpun.edu.sa/14894/1/Organised_Tawarruq_in_Islamic_Law.pdf)

<sup>145</sup> Ibid

<sup>146</sup> Salah al-salhoob op. cit., p. 4

<sup>147</sup> Ibid.pg 5

<sup>148</sup> Ibid.



commodities<sup>149</sup>

The warrants underlying the commodity *Murābahah* are not traded on the exchange, but are traded on the counter<sup>150</sup>

Therefore, it can be concluded from the organizes Tawarruq that

1. Organized Tawaruq is a sale contract
2. Its purpose is to finance people.
3. Process begins in the International local markets.
4. Where certificates of ownership are attained by the financial institution.
5. The clients then enter into another agreement to empower the financial institution to sell the commodities in the market.

It can easily be observed that the contract of commodity *Murābahah* and Tawarruq are similar type of sales. The bank buys the commodities (metal in both cases) from the broker of international market, it doesn't make the difference. Then the bank sells the commodities to the client on deferred payment basis along with the fixed mark up. The client gives the authority to the bank to sell it further in the market. The bank then sells commodities on behalf of the client as the agent.

Here two very crucial issues arise i.e. the issue of appointing bank as the agent of the client. Secondly the goods are bought and sold not to use the commodities or trade but the purpose is making money out of money. It serves the exact purpose of buy back sale which is not permitted. Goods are sold in papers through warrants are like

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<sup>149</sup> Natalie, op. cit., p.113

<sup>150</sup> Ibid.

certificates, identifying the goods<sup>151</sup>. No one knows how many contracts are being done on the same goods. The ownership of the commodities transfers in papers. There is no physical change in possession of the commodities. The commodities merely serve as a tool to legalize profit over loan. Otherwise neither the loan can be made beneficial nor can the contract be labeled as Islamic. The process of Tawarruq and commodity *Murābahah* may take place in just one click of a mouse. The whole process is finished in a day to avoid the risk of price change. The process of Tawarruq is all electronic.

If the Mutawarriq appoints the bank as his agent to sell the commodity after he will purchase from the bank for Tawarruq. If the agency is stipulated, and the sale is conditioned, the sale is not valid then.<sup>152</sup>

If the transaction of Tawarruq or commodity *Murābahah* is carried out through national or international commodity exchange, wherein only brokers are doing everything and the goods never changed hands and stay wherever they were, it is vulnerable to violation of *Shari'ah* rulings because number of sale contracts are lacking.

Widely used as a financing and liquidity management tool, Tawarruq is an asset sale to a purchaser with deferred payment terms. The purchaser then sells the asset, such as a commodity, to a third party to get cash. Under organized Tawarruq, the transactions are organized through banks which are appointed as agents to sell off the asset, in what has been criticized as a mere paper trail circumventing Islamic law and blurring lines between the purchaser and the third party.<sup>153</sup>

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<sup>151</sup> Natalie, op. cit., p 114.

<sup>152</sup> Ayub, op. cit., pg, 350.

<sup>153</sup> <http://islamicfinancenews.wordpress.com/2009/07/23/organized-tawarruq-is-permissible-sheikh-nizam-yaquby/organized-tawarruq-is-permissible>: Sheikh Nizam Yaquby.

The issue of Tawarruq is also tackled by contemporary jurists. A prominent OIC Islamic Fiqh Academy issued two rulings on the matter. The first opinion was issued in the 15th session of the academy in September 1998 (Rajab 1419H), whereby they permitted the contract subject to the condition that the customer does not sell the commodity to its original seller, to avoid direct evidence of 'Inah as a legal trick to circumvent the prohibition of Ribā. However, in its 17th session, held in December 2003, the Academy clarified its stand on Tawarruq by distinguishing and classifying it between Tawarruq Haqiqi (real Tawarruq) and Tawarruq Munazzam or Tawarruq Masrafi (organized Tawarruq). While the former was stated allowed, the latter form which is widely practiced by Islamic banks today is deemed to be synthetic and fictitious as bay' al-'Inah and hence disallowed. The main justification for disallowing 'organized Tawarruq' is that its mechanism resembles bay' al-'Inah; whereby the Islamic financial institution who is acting as an agent to the customer (mutawriq) who need cash sells the asset which was initially purchased from the same institution to the third party. In many cases, this type of transaction would result in non-satisfaction of receipt conditions (qabad) that are required for the validity of the dealing. The reality of this transaction is extension of monetary financing to the party characterized as a Tawarruq customer, and the buying and selling operations of the bank are most often just mean for appearances, but in reality aim to provide the bank an increase in compensation for the financing it provided. Therefore, this practice bears resemblance to the practice of bay' al-'Inah, which is frowned upon by some as a form of legal trick (Heelah) to legalize Ribā.<sup>154</sup>

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<sup>154</sup> Asyraf Wajid Dusuki, "Commodity Murābahah h Programme (CMP): An Innovative Approach to Liquidity Management" *Journal of Islamic Banking*, p. 3/1.

The International Council of Fiqh Academy (ICFA) jurists clearly stipulate in Resolution 179 that:

*"It is not permissible to execute both organized and reverse Tawarruq because simultaneous transactions occur between the financier and the Mustawriq, whether it is done explicitly or implicitly or based on common practice, in exchange for a financial obligation. This is considered a deception, i.e. in order to get the additional quick cash from the contract. Hence, the transaction is considered as containing the element of Ribā."<sup>155</sup>*

Clearly ICFA's concern is with a hidden Buy back contract, where the commodities (metals) are utilized as a prop to legalize a transaction in which the real purpose is very clear, which is no doubt to exchange currency now for more currency later.

## **8 Relationship between Inah and Tawarruq**

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

Hence, Banking Tawarruq and bay' al-Inah are similar as far as the substance is concerned. Both Tawarruq- and bay al-Inah-based instruments are serving exactly the

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<sup>155</sup><http://www.zawya.com/story.cfm/sidZAWYA20090622032559/?relcontent=ZAWYA20100915070321> also in <http://www.thefreelibrary.com/Tawarruq+resolution+raises+many+questions.-a0202176552> (accessed December 31,10)

same purposes, and share exactly the same economic substance and consequences, albeit their form may be difference in the names. The difference between both of these contracts is from the perspective of involvement of third party. The bank appoints the same party i.e the customer to be the agent of the bank and complete the processes of the Tawarruq. These types of transactions make it exactly similar to the buyback sale in the procedure as well as the substance.

### **9 Shariah standard on Tawarruq:**

Tawarruq-AAOIFI standard number 30 say in Article 4/5

*“The commodity (object of monetization) must be sold to a party other than the one from whom it was purchased on a deferred payment basis (third party), so as to avoid e’na which is strictly prohibited. Moreover, the commodity should not return back to the seller by virtue of prior agreement or collusion between the two parties or according to the transaction”*

As far as the practice of contract of Tawarruq is concerned the article 4/5 is not considered. Other than that article 4/5, 4/7, 4/8, 4/9, 4/10 all are the not fulfilled in the banking practice of Tawarruq. Summarizing Article 4/7 to 4/10 which state the following points:

The Islamic Financial Institution should never sale the commodities on the behalf of his client, if the client in the beginning bought the commodities from the financial institution, the bank then should not arrange an alternate third party.

Instead the customer, should sell the goods either himself or through his own agent.

It is also expressly stated in Standare 30 that

*“if these conditions are not fulfilled then one cannot practice Organized Tawarruq”*

In short the essence of the above mentioned article by AAIOFI is that there should not be a contract between two parties with the artificial involvement of third party. The transaction must be actually taking place i.e the objects must be moving from the buyer to the seller, there should be no tricks, no fixed embedded returns.<sup>156</sup>

## **10 Empirical forms of Tawarruq:**

It can be investigated from the contemporary practices of Islamic banks that Tawarruq is practiced in six forms:

1. By deferred payments and selling money with the intermediation of the Islamic Financial Institution.
2. In order to purchase cash by the Islamic Financial institution with the lease/sale to the same seller.
3. Purchase commodities cash and selling them for a deferred price in the international market for the bank itself.
4. Sell commodities cash and buying exact equivalent deferred in the commodity market with the intermediation of the bank.
5. Sukuk/Bonds of leased assets.
6. Sukuk/Bonds of services (service bonds).<sup>157</sup>

It is to be important to note that in form number 1, 2 and 4 the Islamic bank lends cash to its clients. While in the form 3, Islamic Bank lends cash in international companies and trades in the international market. In the form 5 Islamic Bank receives money or the Sukuk issued by the government it also gets the cash. The

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<sup>156</sup> Salman H. Khan, "Organised Tawarruq in Practice: A Shari'ah Non-Complaint and Unjustified Transaction", *NewHorizon*, (October-December 2010) p. 16.

<sup>157</sup> Monzer Kahf, *Outline of a brief framework of Tawarruq (Cash Procurement) and Securitization in Shariah and Islamic Banking*, p.1.  
[http://monzer.kahf.com/papers/english/a\\_brief\\_framework\\_of\\_Tawarruq\\_and\\_Securitization.pdf](http://monzer.kahf.com/papers/english/a_brief_framework_of_Tawarruq_and_Securitization.pdf).

form 6 is not applied by the Islamic Bank but certain companies practice it and the most common form of it is the phone and gift cards that are issued for the further service or purchase that will be made by the card purchaser.

**1. By deferred payments and selling money with the intermediation of the Islamic Financial Institution:**

In these days many Islamic Financial Institutions announce and advertise the services of Tawarruq. Many times, for obvious reason cars are used as a commodity. The car does not leave its showroom or ware house and all transactions are made on the basis of keys. Now adays metals are also used as underlying commodities. In Pakistan commodities like eatable, cereals or crops are being utilized.

In corporate sector the investments are done on very large scale at an associate company to either Islamic Bank or the customer corporation.

From the perspective of economics, the direct cost to the customer and cost price of the whole transaction is much higher than cost of interest-based lending. The reasons are that the transaction involves many steps. It cost is even higher than Murabaha that is already more expensive than interest-based lending.

**2. In order to purchase cash by the Islamic Financial institution with the lease/sale to the same seller:**

In this type of Tawarruq, the Islamic Financial Institution purchases commodities which are stated to be real and long-lasting, at the spot payment. Then the bank then sells it to the customer on installments on the basis of deferred installments. The price is usually similar to that of original price of the customer and the Islamic bank

earns the rent of the part that is not sold. The moment the customer fulfills all its obligations the ownership of the property is returned to it. Some Islamic Financial Institutions restrict the use of this type of financing for cases or replacing interest-based loan the customer had with another party.

**3. Purchase commodities cash and selling them for a deferred price in the international market for the bank itself:**

Almost all the Islamic banks apply this technique of Tawarruq, under the name of International Murabaha as a tool for using their excess liquidity. This transaction comprise of parallel contracts, each pair of which consists of cash purchase and deferred sale.

**4. Sell commodities cash and buying exact equivalent deferred in the commodity market with the intermediation of the bank:**

This is utilized by Islamic Financial Institutions as a tool to provide money to their clients. The contract comprises of number of agency contracts between the bank, its international correspondent, international broker, and the customer. The customer normally only sign a bunch of papers that it does not know their content and get cash from the bank and pays for it a higher amount in the future.

**5. Sukuk/Bonds of leased assets:**

The Sukuk of leased asset is actually a real life investment transaction although some of the versions are used as a tool of Tawarruq.

**6. Sukuk/Bonds of services (service bonds).**

These types of sukuks are offered in some western universities. Those universities are offering sale of future credit hours that parents can buy for their children's



education. While the increase in the price of the education in future, the cost of education at that time would be guaranteed at affordable prices today. These bonds can be negotiated and can it can be issued by Islamic Bank that can buy these services in bulk from the service provider, thus financing its projects, and shall the service Sukuk to the public.<sup>158</sup>

### **11 Conditions for Validity of Commodity *Murābahah* or Tawarruq**

1. That the bank must be the owner of the commodity (base metal) before selling it to the customer.
2. The bank must not sell the commodity before getting the possession of the commodity.
3. That the customer must not sell the commodities back to the selling bank.
4. That the commodity must be Halal and must be existing.
5. That the commodities must not be gold or silver.
6. That the period of deferment of sale must be known.
7. That the commodities must be specified and certain.

The next chapter 6 will explain the above mentioned conditions in detail regarding their applicability in Commodity *Murābahah* or Tawarruq in Islamic Banks.

### **Conclusion:**

Following conclusions have been drawn by the above chapter: Commodity Murabaha and Tawarruq are not permissible under Shariah, due to the fakeness of procedure

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<sup>158</sup> Ibid, p.5

involved in all stages of the contract. It is accepted by the most Shar'iah Scholars of Islamic Finance that Tawarruq is not used as a Heela to evade from interest but it is used as a Heela to complete the transaction on interest. The scholars of all levels must realize what injury one may inflict on the Islamic positions if interpretations of the facility principle rely on stretchy, irreversible presumptions.

The bank managers' eagerness to expand the market fast presumably also contributed to the lapse on the *Shari'ah* front. Islamic finance is no longer seen much different from other businesses operating in the economy. The Islamic economic system has social implications related to economic development.

It can be stated without any doubt that (CM) is a buy back sale. Because the bank takes the commodity back from the client and sells it to other metal broker being an "agent". i.e both the sides of the transactions are completed by the Islamic Bank.

Keeping in view these points it can be summarized that CM or Tawarruq is impermissible under Shari'ah rulings.

## CHAPTER 6

### CONCLUSIONS AND FINDINGS

As we have studied before that the sale of commodity *Murābahah* and Organized Tawarruq are one and the same contracts as far as the procedure and mechanism is concerned. In fact the very famous transaction of Tawarruq is named as commodity *Murābahah*.<sup>159</sup> However, Tawarruq is being stated time and again as a reverse commodity *Murābahah*.<sup>160</sup> Real Tawarruq is the type of Tawarruq which was used historically. Most of the jurists permitted it. But, Organized Tawarruq is the new mode of real Tawarruq, to be applicable, more beneficially in Islamic banks.

Commodity *Murābahah* and Organized Tawarruq are both a best alternative to the conventional modes for liquidity production and generation. The mechanism and concept of both the sales have been discussed in detail in the previous chapter. This chapter will contain the conclusions and findings about them.

The structure of Commodity *Murābahah* and Tawarruq are widely being criticized by different *Sharī'ah* experts. There are many reason of it, first of all is that it

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<sup>159</sup> Abdulu Samad, *Commodity Murābahah*, Al-Huda Centre of Islamic Banking and Economics, December 2010-January 2011, Bi monthly Issue no:039.

<sup>160</sup> Natalie Schoon, *Islamic Banking and Finance* (London: Spiramus press limited,2009), p.77. also in Muhammad Ayub, *Understanding Islamic finance* (West Sussex :John Wiley and Sons, 2007) p 349.

does not fulfill the general conditions of validity of sale. These conditions are being discussed one by one as follows

**1. That the bank must be the owner of the commodity (base metal) before selling it to the customer.**

In commodity *Murābahah* the banks do not own the commodities as they get the warrants from an institution called London Metal Exchange (LME). The status of warrants is stated as the ownership certificate by LME. The institution of LME was made in 17<sup>th</sup> century in London, keeping in view the growing needs of commodities to be used for business transactions and future contracts.<sup>161</sup> Warrant are basically the receipts containing the details of locality of the commodities.

The commodity present in LME, do not give the status of true ownership because those commodities are meant for using for the same purpose time and again. Secondly, the holder of warrants is not capable of taking the possession of the goods, nor he can sell them anywhere else. Commodities cannot be moved from where they are. In true sense commodities in LME can be stated as acquired as a tool to legalize Rība. So this way Islamic Banks sell what they don't have. The whole contract proceeds, in papers or electronically. The Commodities do not exchange hands. It is not clearly stated where the risk transfers from one party to another.

**2. The bank must not sell the commodity before getting the possession of the commodity**

This is also a one of the most important condition of sale that the property must exist

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<sup>161</sup> Natalie, op. cit., p. 113.

and owned by the seller.

According to the principles of Islamic Jurisprudence the seller shall hand over the goods to the buyer, or grant access without any restriction. Our Prophet (P.B.U.H) has prohibited the sale of what one does not have our own.

This Hadith is narrated by Hakim bin Haizam with the text:

"لا تبع ما ليس عندك"

According to a narration of Hakeem Ibn Hizaam-may Allah mercy upon him- which he reported that, "O Prophet of Allah, a man comes to me requiring the purchase of a commodity that I do not have, do I conclude the sale and purchase for him from the market? He ( S.A.W) replied: "Do not sell what you do not have".<sup>162</sup>

However the current Commodity *Murābahah* gives rise to doubts whether permission and delivery ever take place. The permission and delivery is technically impossible as stated above that the commodities do not move from the warehouses and the transaction ends in a few minutes. Lets say all this happen even then the customer do not have the ownership because he can not take the possession and cannot sell it further.

Mohammad Ayub in his book "Understanding Islamic Finance" states that  
*"Nobody cares whether any actual transaction has taken place or not, and at which point in time risk was transferred to the bank. There are doubts about the quantity of metal being sufficient to cover the transaction volumes. As the brokerage cost makes the product less competitive, there is a chance that no actual transaction might be taking place".*<sup>163</sup>

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<sup>162</sup> Abu Eesa Al-Tirmidhi, *Sunan Al-Tirmidhi*, Tradition number 1153, (Mauka'a Al-Islam n.d) p. 5/9.  
<http://www.al-islam.com>.

<sup>163</sup> Mohammad Ayub, op. cit., p. 233.

These issues seem to be of more authentic when the law of the land tells that there shall be no intention of the buyer to take the delivery. In most of the cases as we studied earlier that the customer will only be to sign on papers claiming that he is the owner of the commodities. After selling the commodities only the price will be credited in his account. The above mentioned contract is a mere case of *Ribā* because the customer does not get anything other than cash.<sup>164</sup>

There is no concept of taking the possession of the goods. The reasons of this are many one is that the contract of commodity *Murābahah* is ended up in a single day in order to avoid market price risk. Secondly these sales are done electronically. Third reason is that the brokers are responsible for these contracts. So these processes and sequence of this type of sale is much more unreliable.

### **3. That the customer must not sell the commodities back to the selling bank.**

#### **Concept of Agency:**

Regarding the Tawarruq transaction *Sharī'ah* Standard no 30 of AAI OFI stresses that :

1. The Bank or its agent should not sell the commodity on the customers behalf if the customer initially bought that commodity from the bank neither should the bank arrange a proxy third party sell this commodity.

2. Instead the client should sell the commodity either through himself or through his own agent.

These above mentioned texts form the *Sharī'ah* standards are in clear inconformity with the practical implication of commodity *Murābahah*. In practice if a

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<sup>164</sup> Abdul Samad, *Commodity Murābahah*, Al-Huda Centre of Islamic Banking and Economics, December 2010-January 2011, Bi monthly Issue no:039.

bank wants to finance a bank on the base of commodity *Murābahah* or Tawarruq, he buys commodities from a broker, and then on the base of those commodities lends money to the deposit taking bank. The deposit taking bank will appoint the financier bank his agent to sell the goods on his behalf. In this way the financier bank is handling both the sides of sale. Though the deposit taking bank never had any contact with the goods. Or for example if a person demands financing on the basis of al-Tawarruq, the bank do not own the commodity he will buy it from the market. He will authorize the agent who is al-Mutawarriq, to buy it from the bank on the deferred payment basis. He will later sell it to a third party. As per custom all the payments will be made to the bank, which is al-Mutawariq as he is agent for them in buying and selling the commodity. Due to this agency agreement the contracts become something similar to usurious financing, because al-Mustawriq will take smaller amount from the bank, while the bigger amount of money will be paid to him at the lapse of time, which was fixed.<sup>165</sup>

If a bank appoints al-Mustawriq as their agent to purchase the commodity on their behalf, he later on purchases it for himself; this type of transaction is invalid, because the agent is not permissible to manage both sides of the sale.<sup>166</sup>

This type of contract amounts to exactly like selling the commodities back to the selling bank. This whole procedure of Commodity *Murābahah* is ingeniously designed because the Islamic banks actually wanted some type of procedure which do not involve taking of possession. The process is given in the hands of the brokers, whose job is to conduct a number of these types of contracts in a day. So they don't bother about taking

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<sup>165</sup> Ibid.

<sup>166</sup> Ibid.

of possession. Another problem regarding the possession of the goods was to take the commodities back from the client. Since the commodities are not the object in the sale as the purchaser did not need them. So it was practically impossible for the Customer bank to take the possession of the commodities. As a result, commodities are given back to the selling bank appointing him as his agent (though the selling bank also does not have much contact with the commodity).

**4. That the commodity must be halal and must exist.**

The subject matter of the sale is one of the most important elements of sale. It must fulfill all the important elements and conditions of a good subject matter. In Commodity *Murābahah* banks never do the inspection of the commodities because the purpose of sale contract is not to buy the goods but only to make it *Sharī'ah* compliant. This amounts the contract to be contract of lending the money on *Ribā*. The customer does not see the commodity and does not know have knowledge about it<sup>167</sup>.

Another issue regarding the subject matter arises when the question of existence of subject matter is concerned. Existence of metals is doubtful because it has been mentioned time and again by many critics that the volume of sale contracts is so large that it is difficult to ascertain that this amount of metal do really exist.

**5. That the commodities must not be gold or silver.**

The commodities underlying Commodity *Murābahah* contract are not gold and silver but they are serving the same purpose for which gold and silver are forbidden. Purpose of avoiding gold and silver was to avoid *Ribā* or Interest. Commodity *Murābahah* is

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<sup>167</sup> Ibid.



such a tricky contract designed that it is a *Hīla* for legalizing benefit from Ribā. The Ribā being earned from this sale is Ribā-an-Nasihah. First of all, it is a known fact now that all the transaction is a paper transaction, done on papers or completed electronically. Let's assume that the process alleged to be adopted for the completion of commodity *Murābahah* is true. But the contract of agency is very critical because it is serving the exact purpose of buy back sale. Buy back sale is forbidden because the commodities should not go back to the seller and the seller earning mere profit over the commodities. Here putting the label of ownership to the bank 2. 1<sup>st</sup> bank is conducting buy back sale. 1<sup>st</sup> bank (seller) gets the commodities back from the buyer bank 2. 1<sup>st</sup> bank sells it to commodity broker in the market.

**6. That the period of deferment of sale must be known.**

This condition is for the general credit sale. Merging the contract of Commodity *Murābahah* into credit sale is very without any valid reasoning and is in clear inconformity with the classical literature of *Murābahah* as stated in first chapter.

**7. That the commodities must be specified and certain.**

This is also a critical point because the commodities are not identified properly. The warrants that are issued from the ware houses of London Metal Exchange are just the receipts telling the number of the certain commodities. It is unknown that how many sales are concluded on the same volume of commodities. It is also debated that the volume of sale contracts of commodity *Murābahah* are so big that this much amount of existence of metal is doubtful.

## **AAIOFI:**

According to AAIOFI *Sharī'ah* Standard no. 30, article 4/5 stated that

“Commodity (object of Tawarruq) must be sold to a party other than the party from whom it was purchased on a deferred payment basis (a third party) so as to avoid Inah”.

This standard makes it very clear that Tawarruq cannot be fictitiously transacted with the cosmetic involvement of third party. There should be a surety that the goods are originally moved from one party to another. If there is any Legal Device ( *Hila*) involved, the transaction would resemble the buyback sale(Inah). In Commodity *Murābahah* the commodity rarely changes hands, or it rarely transferred from one party to the other party. For example in Commodity *Murābahah* in car, the bank purchases car from the exhibition centre. The financial institution then sells it to the client on credit. The client appoints exhibition centre to sell the car. The car than will be sold by the exhibition centre to the financial institution. Then the bank will resell it to another client. This way the papers of the car moves between the bank and the customer many times, without the move of the car even one inch. In real sense this is mere exchange of money with money. The goods only entered in it by deception.<sup>168</sup>

### **Dealing with conventional banks**

In Commodity *Murābahah* the Islamic banks are mostly dealing with conventional banks through Commodity *Murābahah*. Conventional Banks are always dealing with *Ribā* without paying heed towards the modes and mechanisms which is designed to make this

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<sup>168</sup> Ibid.

sale “*Sharī‘ah* compliant”. They do not bother about what they buy, its quality and how the contract should be executed in the first place.<sup>169</sup>

So it can be concluded that since the contract of commodity *Murābahah* do not fulfill the conditions of valid sale. so it is not permissible under *Sharī‘ah*.

## Summary

In short many reasons can be summarized to disallow commodity *Murābahah*.

1. Commodity Exchange in the sale of Commodity *Murābahah* are the shortest way for processing the fastest sales, thousands of sales are transacted in a day in few minutes. These sales are concluded through computers in seconds. These contracts are not realistic, as the commodities are not delivered to the buyer.
2. In commodity Markets proper specification of the commodities is not possible because thousands of tons are kept in one ware house. No one even knows how much transactions are concluded in one commodity.
3. Placement of commodity in this contract is just a stratagem; otherwise this contract is just lending money on *Ribā*.
4. Even if the Tawarruq and commodity *Murābahah* transaction is properly executed and *Sharī‘ah* compulsions are fulfilled, its impact on the society is very harmful and particularly very harmful for the Islamic Banking. It is time to apply Sad-al-Dharma to close the doors of *Ribā* in all over the society.

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<sup>169</sup> Ibid

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