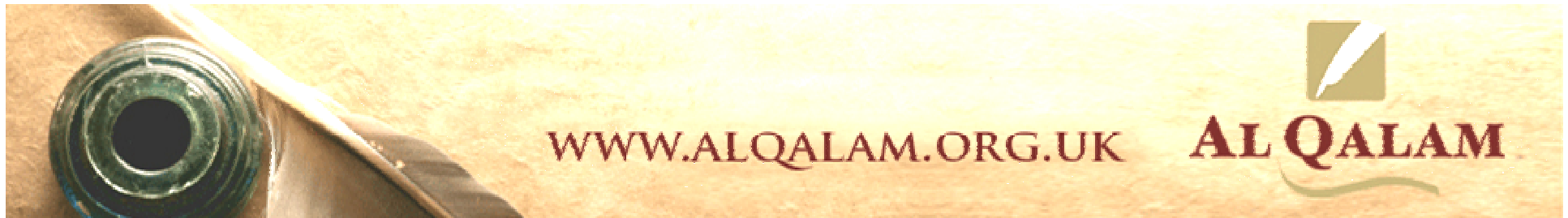


In collaboration with



CONTRACTS OF EXCHANGE

Murabahah & Ijarah



Murabahah – Definition

Murabahah is derived from the root ربح meaning profit.

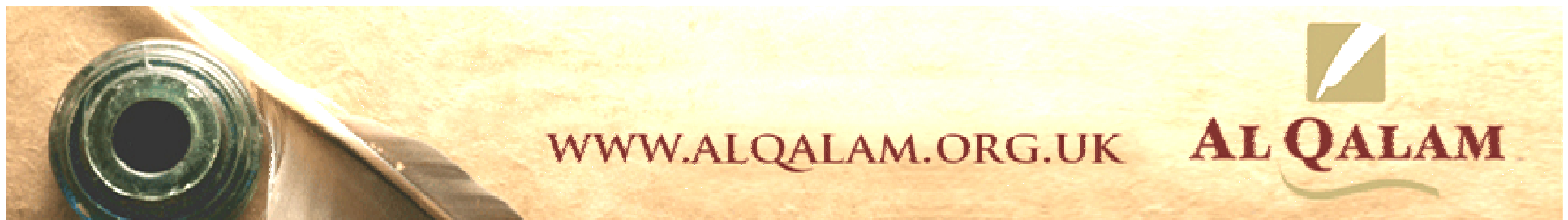
In Fiqh terminology, a sale whereby the vendor sells an asset by disclosing the cost-price and charging a certain profit.

If price is not disclosed, then this will be Musawamah.

Profit may be based on a lump sum or as a percentage.

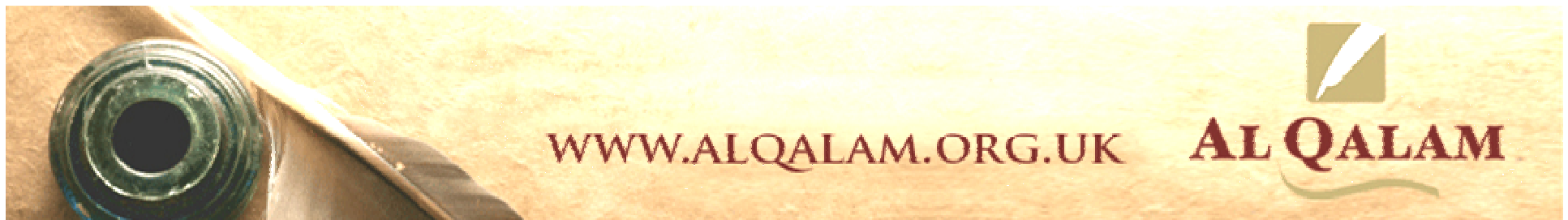
The payment by the buyer may be at spot or deferred to a later date.

In its pure sense, Murabahah is a type of sale and not a mode of financing.



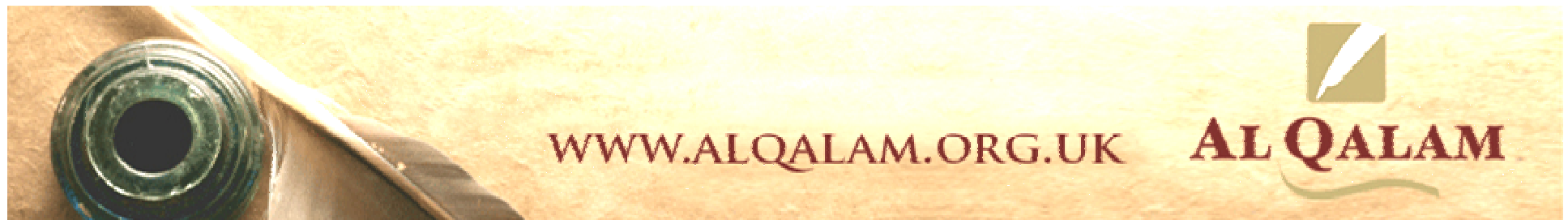
General Rules of Sale

- The subject of the sale, مبيع, must be existing at time of sale.
- The مبيع must be in the ownership and possession of the vendor. The possession may be physical or constructive.
- The sale must be instant and absolute – Sales attributed to future dates or events are not valid.
- The مبيع must be known and identified.
- The price must be made certain at the time of the transaction. Different prices for spot and credit sales only allowed if one is clarified at time of transaction.
- The sale must be unconditional



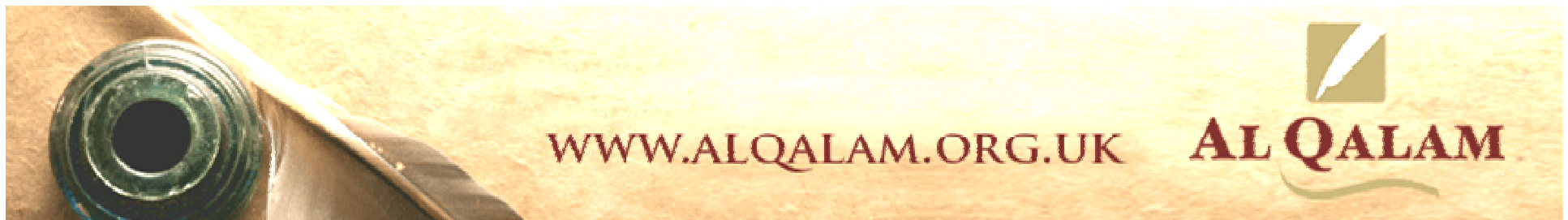
Murabahah – Basic Rules

- Murabahah is where the vendor sells an asset by declaring the cost-price and adding on some profit.
- This profit may be charged as a lump sum amount or a percentage.
- Expenses incurred in purchasing and acquiring commodity can be included in the cost price.
- Murabahah is only valid if the cost of the asset can be ascertained. If the price cannot be determined, then it is not valid to sell such an asset by Murabahah.
- Murabahah sales do not have any specification of the payment to be at spot or on a deferred basis.



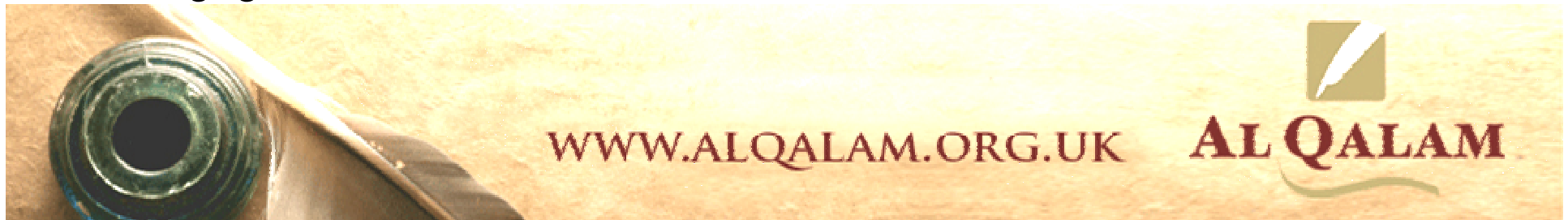
Murabahah – A mode of financing

- Murabahah is a type of sale and not a mode of financing. Ideal modes of financing in Shariah is Musharakah and Mudarabah.
- Murabahah does not fulfil the Maqasid of Shariah (كي لا يكون دولة بين (الأغنياء منكم), however it does allow one to stay away from interest.
- Murabahah is not simply a rephrasing of “interest charge” to profit; rather Murabahah has rules stipulated by Shariah observing which differentiates it from interest.
- These conditions must be followed in order for the transaction to be ‘interest-free’ and therefore acceptable.
- Murabahah when used as a mode of financing, involves deferring payment. The rules of بيع مؤجل will apply.



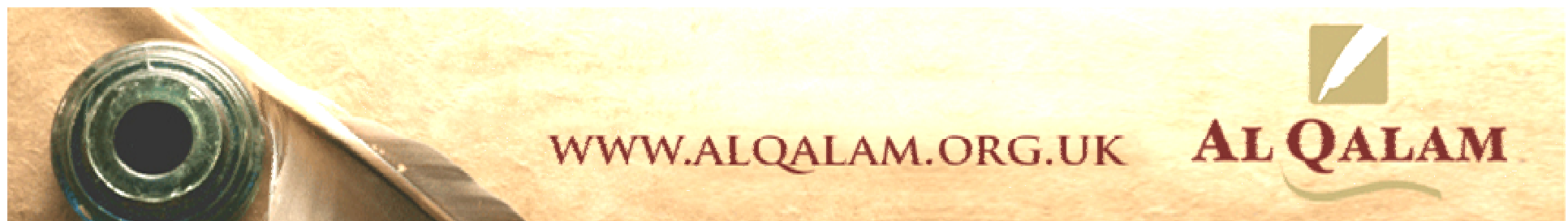
بيع مؤجل – Sale on deferred payment

- When both parties agree to defer the payment of the price.
- Date of payment must be fixed without any ambiguity.
 1. Either with reference to a particular date such as the 1st of January 2011
 2. By specifying a fixed period e.g. six months. If period is fixed, then the period will start from the time of delivery unless agreed otherwise.
- Deferred price may be more than cash price but it must be determined at time of transaction.
- Fixed price cannot be changed in case of default or earlier payment.
- If payment is done by instalments, one may put a condition at the time of transaction that upon failing to pay any instalment, all further instalments will become payable immediately.
- A security may be kept in order to secure payment such as a mortgage.



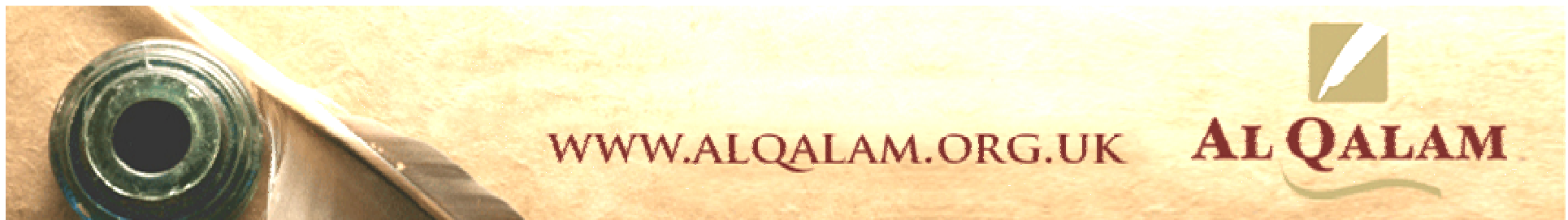
Murabahah – A mode of financing

- Being a sale and not a loan, a Murabahah agreement must fulfil all the conditions necessary for a valid sale.
- Murabahah can only be used where a client needs funds to purchase a commodity e.g. steel, copper, wheat.
- The financier must own and possess the commodity, whether physically or constructively, and therefore assume the risk associated before selling on to client.
- However, financier can take a promise before buying the commodity himself.
- The financier should buy the commodity himself or through a third agent. If it is not possible, then the financier may use the client as an agent to buy the commodity. However, a particular sequence must be followed so that the financier owns the commodity before selling it.



Murabahah – A mode of financing

1. The client and the financier sign an agreement whereby they promise to buy/sell at fixed times on an agreed profit ratio.
2. When the client wishes to buy the commodity, an agreement of agency is signed between the financier and client and the financier appoints the client as an agent for purchasing the commodity.
3. The client buys the commodity on behalf of the financier and takes possession of it on behalf of the financier.
4. The client informs the financier that the commodity has been purchased on behalf of the financier, and then makes an offer to buy the commodity on a deferred basis.
5. The financier accepts and sells the commodity transferring ownership and risk of commodity to client.



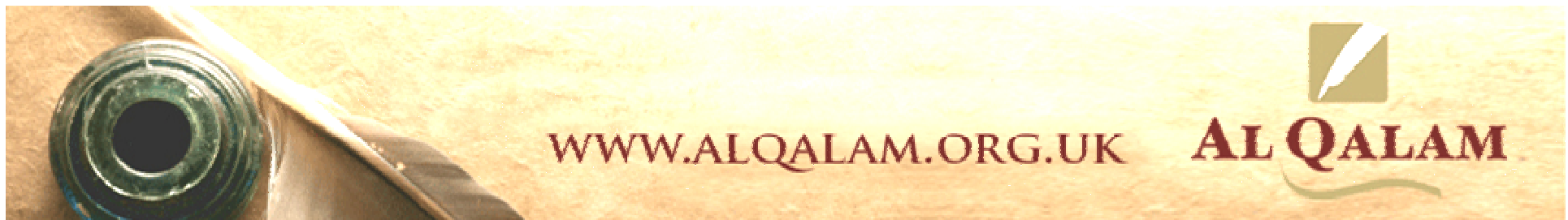
Murabahah – Analogous to interest?

Some scholars have denounced Murabahah financing calling it similar to interest.

- Different prices for at spot and deferred payments
- Longer the maturity of the payment, the higher the price
- Increase in price in consideration of time, therefore similar to interest.

Most scholars are of the opinion that it is permissible.

- Since the exchange is not of two ربيوي products.
- Financier may charge higher at spot or on credit for other considerations as well.
- Although in this case, financier charges more keeping in view the time, however once the price is fixed, the price is paid against the commodity and not time. If the client does not pay on time, financier cannot charge him anything extra.



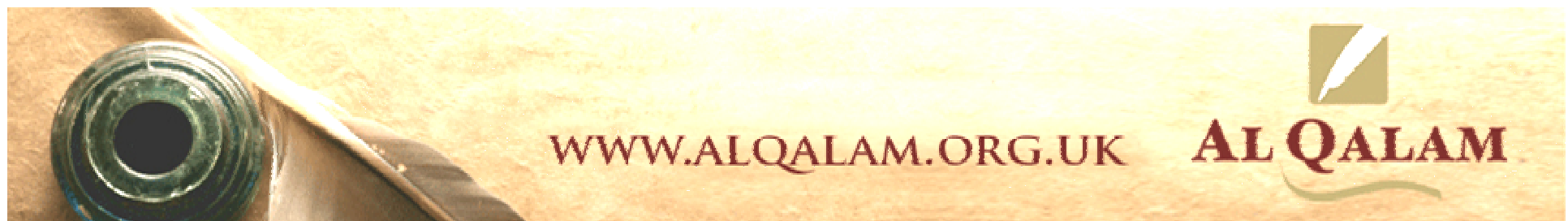
Murabahah – Using LIBOR as a benchmark

Many financiers financing by Murabahah determine their profit ratio on the basis of the prevalent interest rate e.g. LIBOR.

Hence, some have criticised Murabahah financing on the basis that the profit based on the rate of interest should be prohibited like interest.

Although basing the profit on the rate of interest is not desirable, as long as the Murabahah fulfils the conditions of a Murabahah transaction, using the interest rate as a benchmark for profit does not make the transaction unlawful.

- Zaid is a butcher and sells Halal meat. He bases his price on the price of meat sold in Morrisons which is Haram. The profit he earns, although benchmarked against the price for Haram meat, is lawful.



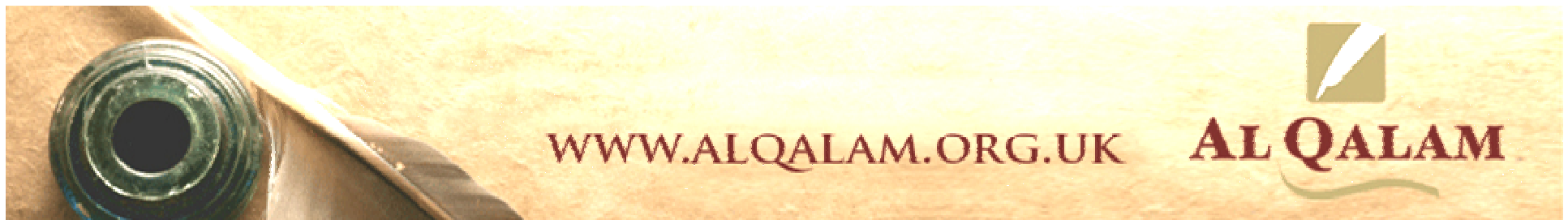
Murabahah – Enforceability of a promise

It is only a moral obligation – general opinion of the Hanafi, Shafiee and Hanbali schools

Moral and legal obligation - opinion of Samurah bin Jundub, ‘Umar bin ‘Abd al-‘Azīz, Ishāq bin Rāhwayh, Imām Bukhārī, and some Mālikī jurists.

Moral and legal obligation if the promisee has incurred considerable liability – this is the opinion of the majority of the Maliki school.

There are also precedents of promises being enforceable in the Hanafi fiqh.

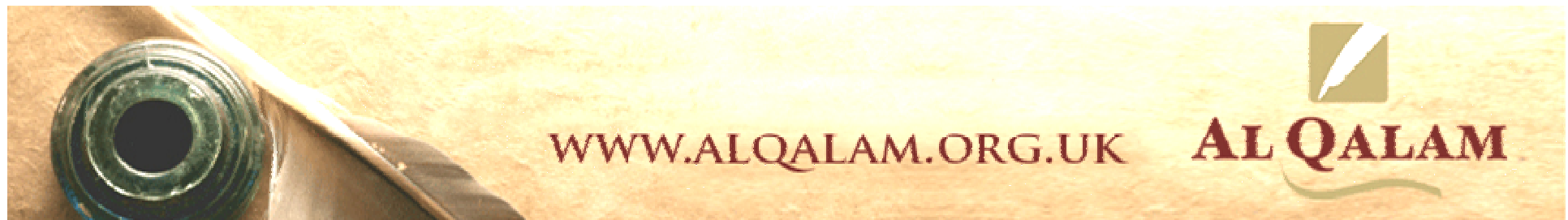


Murabahah – Penalty on Default

In interest-based loans, extra interest is charged upon defaulting on a payment. However, this is not permissible in Murabahah financing. This could allow dishonest people to exploit the situation.

In an ideal situation, where all financial institutions were Islamically run, a system may be developed whereby financially isolating such defaulters and not offering them any services.

In non-ideal situations, some scholars have allowed the bank to charge some compensation.



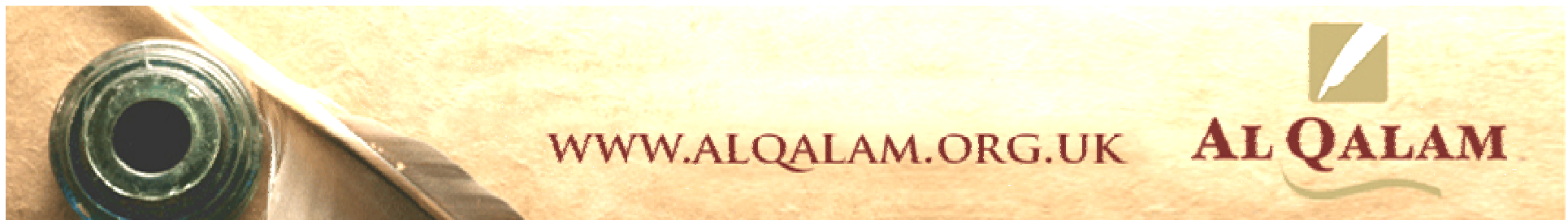
Murabahah – Penalty on Default

Some scholars have accepted that the client must pay compensation to the financier subject to the following:

- The defaulter should be given a grace period of one month where he is not charged, but given regular reminders.
- It is proved that he is defaulting without a valid excuse.
- Only has to pay compensation if depositors in financial institution were paid a profit during that period. If so, he has to pay compensation at the same rate as the profit that was given to the depositors.

However, this is not accepted by most scholars. This suggestion neither conforms to Shariah nor does it fulfil its purpose.

- Any additional amount charged is Riba. This is similar to the Riba practised in Jahiliyyah.



Murabahah – Penalty on Default

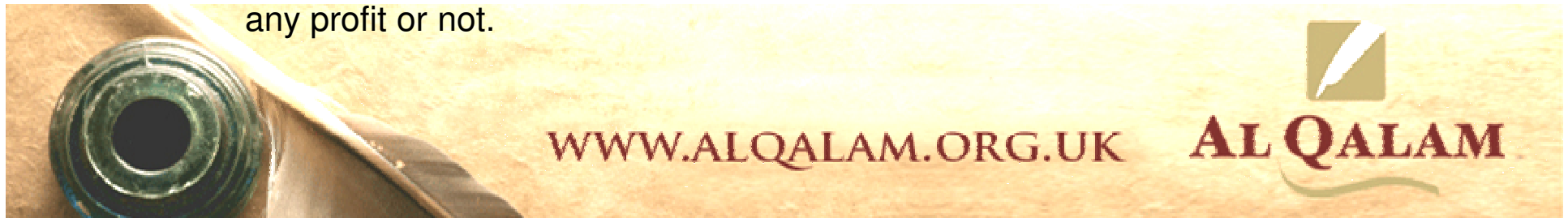
The scholars that allow its permissibility argue that this is not the same as the Riba practised in Jahiliyyah.

There is a one month grace period to make sure that he is defaulting without a valid excuse. He is exempted if he is in financial hardship.

لِيّ الْوَاجِدِ يَحِلُّ عَقُوبَتُهُ وَعَرْضُهُ – this punishment may be inflicted in any form including a monetary penalty.

The scholars against the permissibility of such penalties counter:

- Point number one is impractical and does not serve any purpose. Every debtor may claim financial difficulty, and banks will usually assume all debtors are able to pay unless declared insolvent. In this instance, interest-based institutions will not be able to recover debt.
- Grace period is only a minor concession sometimes afforded by non-Islamic institutions.
- Assuming monetary penalties are considered permissible, they can only be imposed by a judge and paid to the government.
- If such a penalty was permissible, it should be imposed whether depositors paid any profit or not.



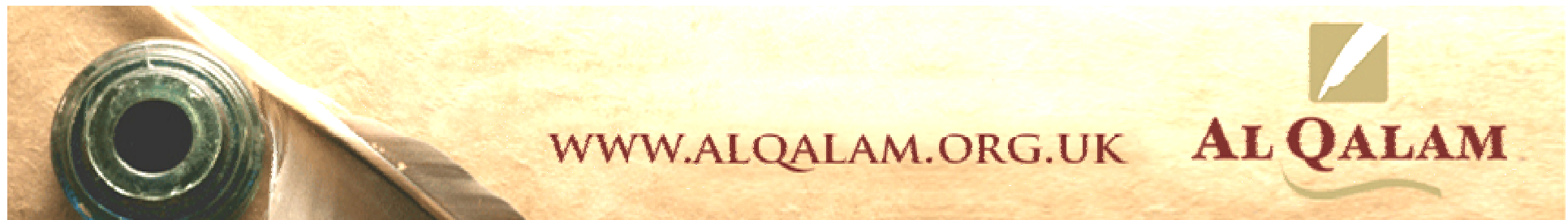
Murabahah – Penalty on Default

An alternative approach suggested is that the debtor makes a vow when signing the original contract to pay a certain % to charity if he defaults.

This donation may not be used by the bank as its own income.

The charity may be donated to a charitable fund held by the bank provided the fund is used for charitable purposes approved by Shariah.

Although such a vow would only be a moral obligation and cannot be enforced by law, some Maliki scholars allow to make it enforceable. In cases of need, this view may be acted upon.



Murabahah – Rollover

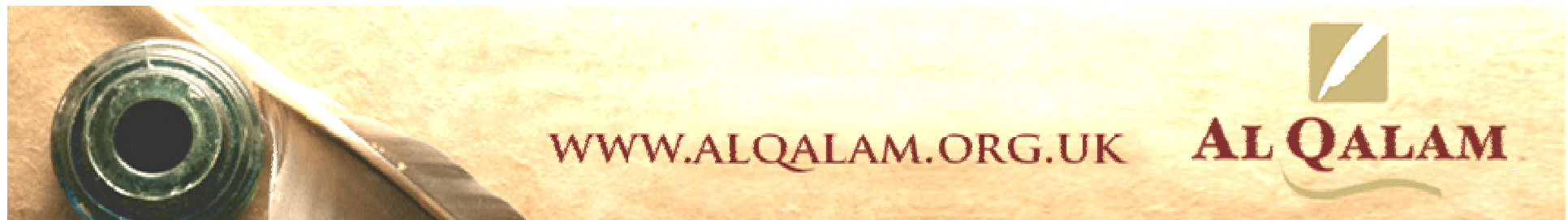
Murabahah transactions cannot be rolled over for a further period at extra cost.

Also no cost can be deducted for earlier payment.

Since Murabahah can only be done when the cost price of the asset can be determined, it is advisable for the financier to purchase and sell the commodity in the same currency.

In international trade where this is not possible then

1. One may ask the client to purchase the commodity in the same currency with which commodity is bought.
2. If not, then the exact amount of prevalent currency used to convert into second currency may be taken as the cost price.



Ijarah – Definition

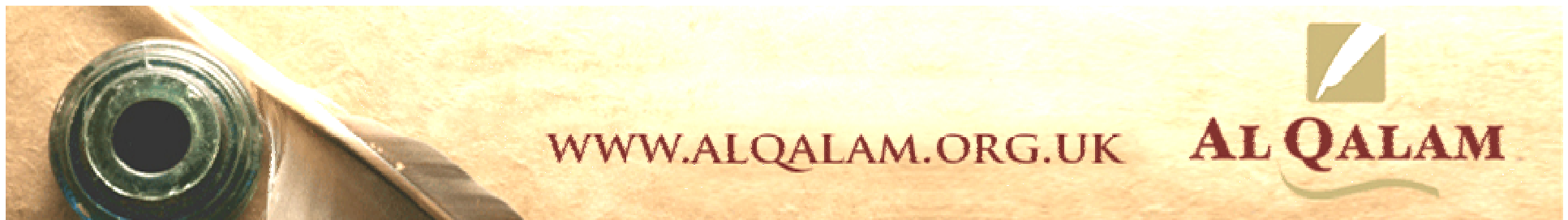
Ijarah lexically means ‘to give something on rent’.

In Fiqh terminology, this may be of two types:

- To employ the services of a person. Wages are given in consideration of the hired services e.g. doctor, carpenter, teacher etc.
- Transfer the usufructs of an asset to another person in exchange for a rental payment e.g. leasing a house etc. It is this type of Ijarah that is commonly used as a mode of financing.

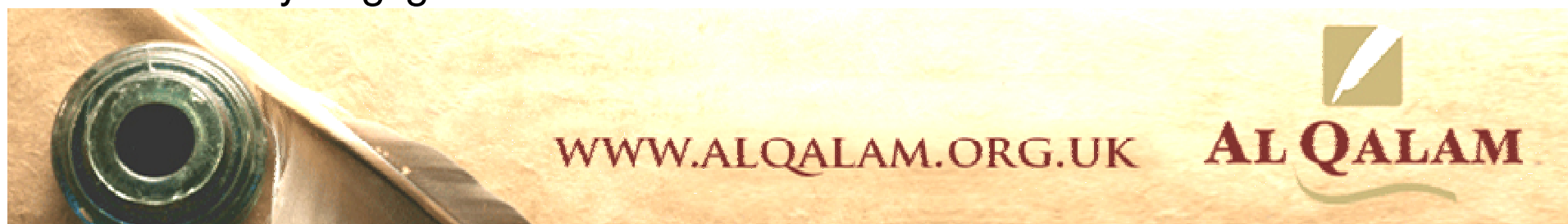
Similar conditions to normal sales as in both cases a right is being transferred in consideration of a payment. In a normal sale, the corporeal property is transferred whilst in Ijarah, the usufruct is transferred.

Ijarah is also not originally a type of financing, rather it is just a normal business activity.



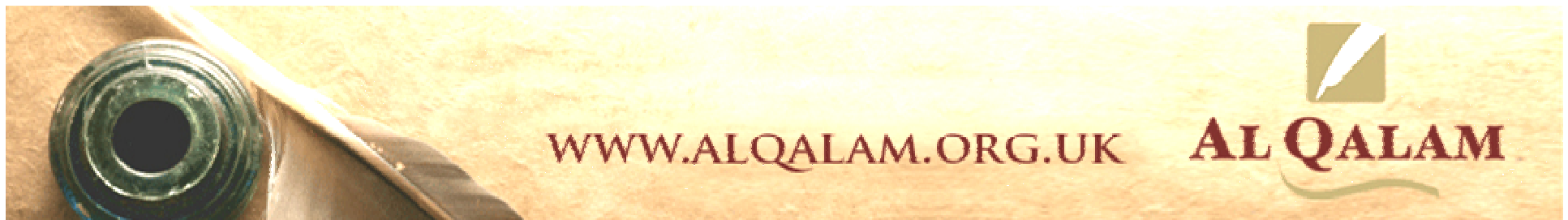
Ijarah – Basic Rules

- Usufruct transferred by owner to someone else for agreed time and consideration.
- Corporeal property remains in lessor's ownership, only usufruct is transferred. Therefore consumables cannot be leased.
- Liabilities linked to ownership will be borne by lessor whilst expenses will be borne by lessee.
- The leased asset and the period must be clearly specified.
- Rental income must be determined at time of contract for the whole period.
- The lessee can only use the leased asset for the purpose specified in the lease agreement.
- The lessee must compensate the lessor for any harm to the asset caused by negligence or misuse.



Ijarah – Basic Rules

- The overall risk of the asset will be borne by the lessor. Any harm or loss caused by uncontrollable factors will be borne by lessor.
- Jointly owned properties may be leased with the rental income distributed between all the joint owners according to their share.
- The lessor cannot increase the rent unilaterally.
- The lease period will start upon delivery of the asset to the lessee.
- Payments may be paid in advance and shall be adjusted towards the rent after being due.
- Once the leased asset has lost its function, the lease will terminate.



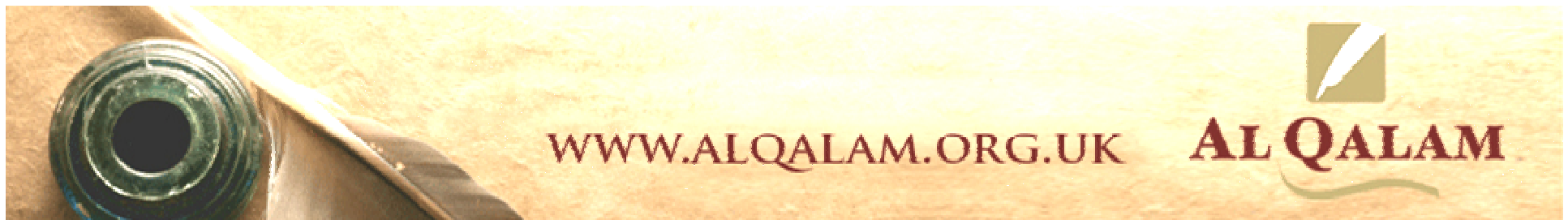
Ijarah – Commencement of lease

Unlike normal sales, assets may be leased for a future date.

However, the rental period will start after the delivery of the asset to the lessee.

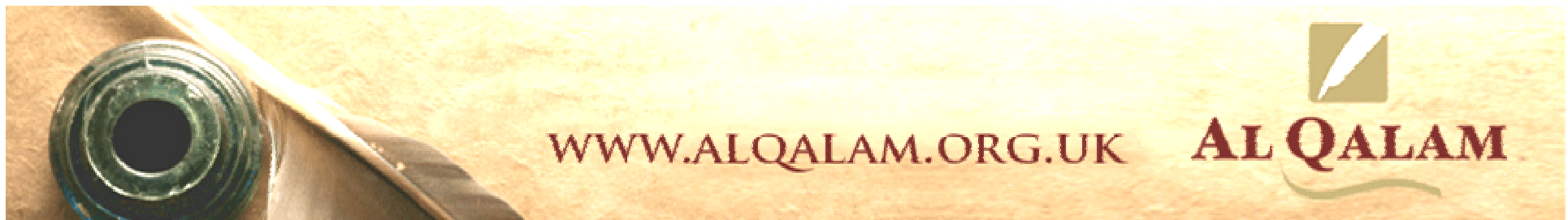
It is common for financial institutions to make the lessee an agent to buy the asset.

In such cases, the rental payments will only be charged from the time when the asset is delivered to the client and not from the signing of the agreement.



Ijarah – Expenses and Liabilities

- All expenses and liabilities incurred due to the purchase and procurement of the asset must be borne by the lessor, e.g. custom tax, delivery charges.
- The lessee may be held accountable for any losses incurred due to his misuse or negligence.
- He may also be made liable for any wear and tear to the asset through use.
- However, any losses incurred as a result of uncontrollable factors must be borne by the lessor.
- If the leased property is insured on a Takaful basis, then this should be done at the expense of the lessor and not the lessee.



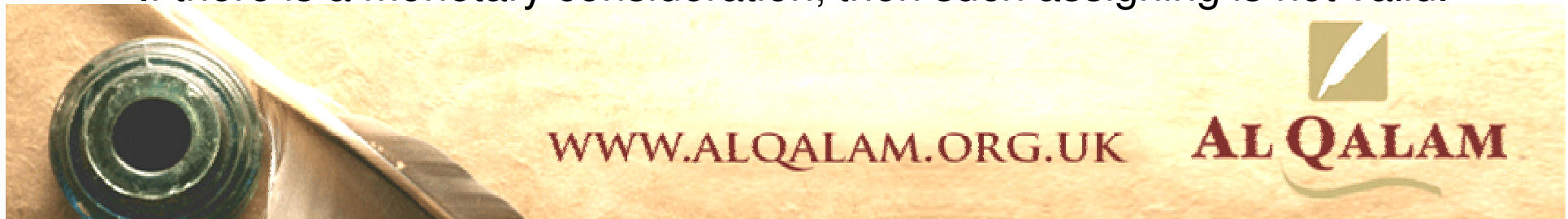
Ijarah

Default in payment

- The issue for defaulting in payment is similar to that of Murabahah.
- The lessor cannot charge a penalty for defaulting in payment.
- The lessee may take a vow at the start of the lease to donate money to a charity maintained by the lessor in case of defaulting.

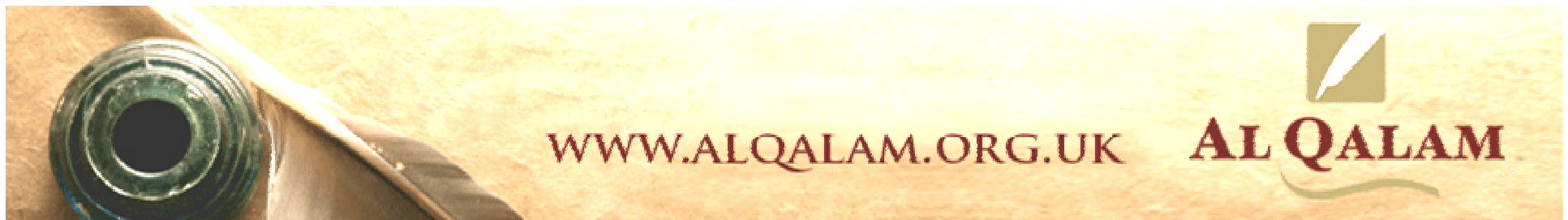
Assigning lease

- The lessor may sell the property to a third person and a relationship of lessor and lessee may be developed with the new owner.
- The lessor may also assign the rental payments to a third person without transferring ownership without any monetary consideration in return.
- If there is a monetary consideration, then such assigning is not valid.



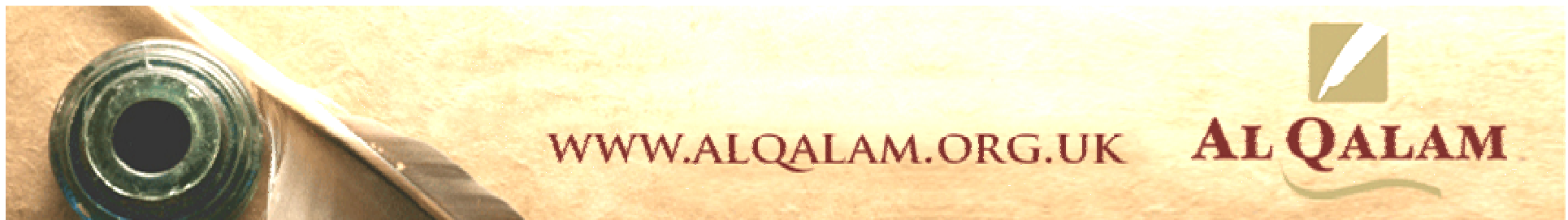
Ijarah – Sub Leasing

- The lessee must ask the express permission of the lessor to sub-lease any assets.
- If the lessor permits, there is no harm in sub-leasing.
- Permissibility of sub-lease payments:
 - If the rental paid by the sub-lessee is less than or equal to that paid by the lessee, the sub-lease is permissible unanimously.
 - If the rental charged to the sub-lessee is higher than that paid by the lessee, then according to the views of Imam Shafi and Ahmed, the sub-lease is valid.
 - According to Imam Abu Hanifah, the surplus cannot be used and donated to charity. However, if the lessee has developed the asset before sub-leasing or the sub-lease payment is paid in another currency to that of the lease, then the surplus may be used.



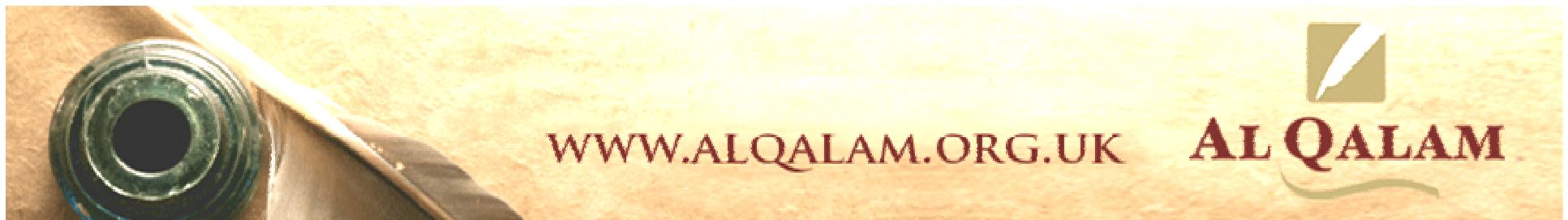
Ijarah – Variable rental in long-term leases

- In long term lease arrangements, it would not be beneficial for the lessor to fix one rate of lease. He may:
 - He can lease on a condition that the rental payment will increase by a specified amount after a specified time.
 - Have shorter period lease contracts and renew the lease with new terms mutually.
- Some contemporary scholars have allowed basing it on a variable benchmark which is well-defined leaving no room for dispute e.g. rate of inflation, government taxes, LIBOR etc.
- Does this make it similar to interest?
- Does it imply Jahalah and Gharar?



Ijarah – Variable rental in long-term leases

- In long term lease arrangements, it would not be beneficial for the lessor to fix one rate of lease. He may:
 - He can lease on a condition that the rental payment will increase by a specified amount after a specified time.
 - Have shorter period lease contracts and renew the lease with new terms mutually.
- Some contemporary scholars have allowed basing it on a variable benchmark which is well-defined leaving no room for dispute e.g. rate of inflation, government taxes, LIBOR etc.
- Does this make it similar to interest?
- Does it imply Jahalah and Gharar?



Ijarah – Variable rental in long-term leases

- Financial institutions sometimes transfer the corporeal ownership of the asset to the lessee at the end of the lease period as a gift or at a token price.
- It is not permissible in Shariah to have a condition to this effect within the lease contract, otherwise صفقة في صفقة would be present.
- The lessor may out of his own accord gift the leased asset or sell it at a token price at the end of the lease period.
- Contemporary scholars have allowed Ijarah wa iqtina:
 - The lessor effects a contract of lease with the lessee with a fixed rental period and payment.
 - The lessor makes a unilateral promise to gift or sell the asset at a token price to the lessee at the end of the lease period.
 - The lessee is not bound to buy the leased asset at the end of the rental period.

