



Murabaha House-Financing When Deferred Payments Are Not Fixed

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<QUESTION>

There is a financial company here offering house-financing plans based on Murabaha. However, according to their terms and conditions, the deferred payments from the customer are not fixed; rather they are open to increases due to interest rate increases by the Reserve Bank. Is this product Shari'ah compliant?

<ANSWER>

In the name of Allah, Most Compassionate, Most Merciful,

In a Murabaha (cost-plus) contract, it is permitted for the financier/seller to charge the customer a price that is higher than the market price. If a seller increases the price of the commodity due to payments being deferred, then there is no bar against this in Shari'a. However, the condition of permissibility is that at the time of the actual transaction, the full price is determined, leaving no ambiguity in the transaction.

Shaykh Muhammad Taqi Usmani (may Allah preserve him) elaborates on this in his book, *An Introduction to Islamic Finance*. He states:

"...For example, it is allowed for the seller, at the time of bargaining, to say to the purchaser, "If you purchase the commodity on cash payment, the price would be Rs. 100/- and if you purchase it on a credit of six months, the price would be Rs. 110/-" But the purchaser shall have to select either of the two options. He should say that he would purchase it on credit for Rs. 110/- Thus, at the time of actual sale, the price will be known to both parties. However, if either of the two options is not determined in specific terms, the sale will not be valid. This may happen in those installment sales in which different prices are claimed for different maturities. In this case the seller draws a schedule of prices according to schedule of payment. For example, Rs. 1000/- are charged for the credit of 3 months Rs. 1100/- for the credit of 6 months, Rs. 1200/- for 9 month and so on. The purchaser takes the commodity without specifying the option he will exercise, on the assumption that he will pay the price in future according to his convenience. This transaction is not valid, because the time of payment, as well as the price, is not determined. But if he chooses one of these options specifically and says, for example, that he purchases the commodity on 6 months credit with a price of 1100/- the sale will be valid." (*An Introduction to Islamic Finance*, P: 117)

It is clear from the above that in order for a Murabaha contract to be Shari'a-compliant, the full price of the commodity must be fixed and agreed upon by both parties at the time of the actual sale. As a result, the deferred payments disbursed by the customer in regular installments must also be fixed. If the customer fails to pay at the stipulated time, the price must remain the same and can never be increased by the seller/financier.

Furthermore, it is also permitted for the seller/financier to use the interest-rate as a benchmark in determining the profit, as explained by Shaykh Mufti Taqi Usmani (may Allah preserve him). He states:

"Many institutions financing by way of Murabaha determine their profit or mark-up on the basis of the current interest rate, mostly using LIBOR (Inter-bank offered rate in London) as the criterion. For example, if LIBOR is 6%, they determine their mark-up on Murabaha equal to LIBOR or some percentage above LIBOR. This practice is often criticized on the ground that profit based on a rate of interest should be as prohibited as interest itself. No doubt, the use of the rate of interest for determining a Halal profit cannot be considered desirable. It certainly makes the transaction resemble an interest-based financing, at least in appearance, and keeping in view the severity of prohibition of interest, even this apparent resemblance should be avoided as far as possible. But one should not ignore the fact that the most important requirement for validity of Murabaha is that it is a genuine sale with all its ingredients and necessary consequences. If a Murabaha transaction fulfils all the conditions enumerated in this chapter, merely using the interest rate as a benchmark for determining the profit of Murabaha does not render the transaction as invalid, Haram or prohibited, because the deal itself does not contain interest. The rate of interest has been used only as an indicator or as a benchmark." (An Introduction to Islamic Finance, P: 118-119)

As such, if a Murabaha contract is based upon Islamic principles and fulfils all the necessary requirements for a valid transaction, merely determining the rate of profit on the basis of the interest-rate does not render the transaction as Haram.

However, this is only permitted if, after initially determining the profit on the basis of the current interest rate, the full price and the deferred payments are agreed upon and fixed. Once the deferred payments are fixed, they cannot be increased due to any reason, such as the customer defaulting in his payment at the due date, or the rate of interest increasing. The only reason why this transaction has been permitted is that the total price of the commodity is determined at the time of the actual sale. If the price is not determined, then this transaction will not be permitted. (See: Imam Tirmidhi's explanation in his Sunan, Kitab al-Buyu', Hadith number 1231)

In view of this, the Murabaha house-financing plan mentioned by you does not seem to comply with Shari'a guidelines, since the deferred payments from the customer are not fixed, as stated

by you. If the financier increases the monthly payments due to interest rate increases by the Reserve Bank, this transaction will not be permitted.

Contemporary scholars have permitted tying up the monthly rentals with the rate of interest in an Ijara house-financing contract only, but not in a Murabaha contract. There is a fundamental difference between the monthly deferred payments in a Murabaha contract and the monthly rentals in an Ijara contract. As such, some contemporary scholars have allowed, in long-term leases, to tie up the rental amount with a variable benchmark which is so well-known and well-defined that it does not leave room for any dispute. But in Murabaha contracts, there is no room for any change in the price once it is fixed and agreed upon by both parties.

And Allah knows best

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