Shari'a Standards No. (8)

Murabaha to the Purchase Orderer *

* This standard was previously issued by the title "Shari'a Rules for Investment and Financing Instruments No. (1) Murabaha to the Purchase Orderer. It is reissued as a Shari'a standard based on the resolution of the Shari'a Board to reformat all Shari'a Rules in the form of Shari'a Standards.

Contents

In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to explain the Shari'a basis and rules for a "Murabaha to the purchase orderer" transaction, the stages of this transaction beginning from the promise to transferring ownership of the goods to the customer, and the Shari'a requirements that need to be observed by Islamic financial institutions(1).

(1) Referred to hereafter as institution or institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard is applicable to the Murabaha to the purchase orderer transaction and its various stages, the issues relating to guarantees before concluding a Murabaha deal such as promise, *hamish jiddiyyah* (security deposit) and issues relating to guarantees for recovery of the debt created by the Murabaha transaction.

This standard is not applicable to deferred payment sales that take place on a basis other than that of Murabaha to the purchase orderer. It is also not applicable to other trust and bargain sales.

2. Procedures prior to the contract of Murabaha

2/1 The customer's expression of his wish to acquire an item through the institution

2/1/1 It is permissible for the institution to purchase the item only in response to its customer's wish and application, as long as this practice is compatible with the Shari'a precepts for the contract of sale.

2/1/2 With due consideration to item 2/2/3, it is permissible for the customer to request the institution to purchase the item from a particular source of supply. However, the institution is entitled to decline to carry out the transaction if the customer refuses offers from other sources of supply that are more suitable for the institution.

2/1/3 The customer's wish to acquire the item does not constitute a promise or commitment except when it has been expressed in due form. It is permissible to prepare a single set of documentation to include both the customer's stated wish that the institution should buy the item from the supplier and a promise to buy the item from the institution, which the customer signs. It is permissible for the customer to prepare such a document, or it may be a standard application form prepared by the institution to be signed by the customer.

2/1/4 The customer may obtain statement of prices from the supplier whether they are addressed to the customer by name, or with no reference to any named customer. In the latter case, the statement is considered as an invitation to negotiate, and not as an offer of sale. It is preferable that the invoice should be addressed to the institution so as to constitute an offer of sale from the supplier effective up to the end of a specified period. Once acceptance comes from the institution, that automatically concludes the contract of sale by the two parties.

2/2 The position of the institution in respect to the application of the

customer for Murabaha to the purchase orderer

2/2/1 When there is acceptance by the customer of an offer from the supplier that is either addressed to him personally, or that has no addressee, then it is not permissible for the institution to carry out Murabaha to the purchase orderer.

2/2/2 It is essential to exclude any prior contractual relationship between the customer who is the purchase orderer and the original supplier of the item ordered, if any, regarding the supply of the item. It is a requirement of Murabaha to the purchase orderer that the transaction between the two parties must genuinely, not fictitiously, exclude any prior contractual relationship.

It is not permissible to transfer a contract that has been executed between the customer and the supplier of the ordered item to the institution.

2/2/3 The institution must ensure that the party from whom the item is bought is a third party, and not the customer or his agent. For example, it is not permitted for a customer to sell an ordered item to the institution and then repurchase it through a Murabaha transaction. Nor may the party that is selling the item be wholly owned by the customer. If a sale transaction takes place and later on it is discovered that it was carried out through such practices, this would render the transaction void.

2/2/4 It is permitted for the institution to purchase the item from a party who has a blood relationship or marital relationship with the customer who is the purchase orderer, and then to sell the item to the customer on deferred payment terms by means of Murabaha to the purchase orderer, provided that this does not amount to a legal device for covering the sale of *'inah*. It is preferable that the institution's application procedures for Murabaha to the purchase orderer be designed to avoid such a practice.

2/2/5 It is not permitted for the institution and the customer to agree to form a musharaka in a project or a specified deal together with a promise from one of them to buy the other's musharaka participation by means of Murabaha on either spot or deferred payment terms. However, it is permissible for one partner to promise to purchase the other's musharaka participation at market selling price or at a price to be agreed upon at the time of sale provided a new contract is drawn up. This sale may be on spot or on deferred payment terms.

2/2/6 It is not permitted to carry out a Murabaha on deferred payment terms where the asset involved is gold or silver or currencies. It is also impermissible to issue negotiable instruments where the underlying asset consists of Murabaha receivables or other receivables. Likewise, it is not permitted to conclude a Murabaha contract on a commodity that was the subject matter of a previous Murabaha contract with the same customer, i.e. to refinance the transaction.

2/3 The promise from the customer

2/3/1 It is not permissible that the document of promise to buy (signed by the customer) should include a bilateral promise which is binding on both parties (the institution and the customer).

2/3/2 The customer's promise to purchase, and the related contractual framework, are not integral to a Murabaha transaction, but are intended to provide assurance that the customer will complete the transaction after the item has been acquired by the institution. If the institution has other opportunities to sell the item, then it may not need such a promise or contractual framework.

2/3/3 A bilateral promise between the customer and the institution is permissible only if there is an option to cancel the promise which may be exercised either by both promisors or by either one of them.

2/3/4 It is permissible for the institution and the customer, after the latter has given a promise but before the execution of the Murabaha, to agree to revise the terms of the promise whether with respect to the deferment of payment, the mark-up or other terms. The terms of the promise cannot be revised unless both parties agree to revise the promise, as the right to do so cannot be given exclusively to one of them.

2/3/5 It is permissible for the institution to purchase the item from a supplier on a "sale or return" basis, i.e., with the option to return it within a specified period. If the customer then does not purchase the item, the institution is able to return it to the supplier within the specified period on the basis of the conditional option that is established in Shari'a. The option between the institution and the supplier does not expire by the mere presentation of the item to the customer, but it expires by virtue of the actual sale to the customer.

2/4 Commissions and expenses

2/4/1 It is not permissible for the institution to receive a commitment fee from the customer.

2/4/2 It is not permissible for the institution to receive a fee for providing a credit facility.

2/4/3 The expenses of preparing the documents of the contract between the institutions and the customer are to be divided between the two parties (the institution and the customer), provided they do not agree that the expenses are to be borne by one of the parties, and provided those expenses are fair, that is, they reflect the amount of work involved, so that they do not implicitly include a commitment fee or a facility fee.

2/4/4 If the Murabaha to the purchase orderer is carried out by means of syndicated financing, the institution which acts as the arranger of the syndicate is entitled to claim an arrangement fee to be paid by the participants in the syndicate.

2/4/5 It is permissible for the institution to take a fee for a feasibility study that it undertakes, if the study is based on the request by the customer and is for his benefit, and he agreed to pay the fee from the outset.

2/5 Guarantees related to the commencement of the transaction

2/5/1 It is permissible for the institution to obtain from the customer (the purchase orderer) a guarantee regarding the good performance by the supplier of his contractual obligations towards the institution in his personal capacity and not in his capacity as purchase orderer or in his capacity as an agent of the institution. Hence, if the Murabaha contract is not executed his guarantee would still be valid. This guarantee is required only in cases where the customer has suggested a particular source of supply for the item that is the subject matter of the Murabaha contract.

As a consequence of this guarantee, the customer will be obliged to make good any damage suffered by the institution due to failure of the supplier to provide good performance of his contractual obligations. These obligations concern meeting the specification of the item to be supplied and the exercise of diligence in executing the contract, non-observance of which results in the loss of the institution's time and efforts or property, or in a legal dispute and damage claims.

2/5/2 It is not permitted to impose on a customer who is the purchase orderer a guarantee regarding hazards that may affect the item such as damage and destruction during a period of shipment or storage.

2/5/3 It is permissible for the institution, in the case of a binding promise by the customer, to take a sum of money as *hamish jiddiyyah* (i.e. a security deposit). This is to be paid by the customer at the request of the institution, both as an indication of the financial capacity of the customer and to ensure the compensation of any damage to the institution arising from a breach by the customer of his binding promise. Having taken this *hamish jiddiyyah*, the institution need not to demand compensation for damage as this may be charged against the *hamish jiddiyyah*. The *hamish jiddiyyah* is considered not as *urbon* i.e. earnest money. The amount of money deposited by the customer as security for his commitment can be either held as trust in the custody of the institution, in which case the latter cannot invest it, or it may be held, if the customer permits the institution to invest it, as an investment trust on the basis of Mudaraba between the customer and the institution.

2/5/4 In the case of the customer's breach of his binding promise, the institution is not permitted to retain *hamish jiddiyyah* as such. Instead, the institution's rights are limited to deducting the amount of the actual damage incurred as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party. The actual damage to the institution may not include the loss of its mark-up in the Murabaha transaction, that is, its opportunity loss.

2/5/5 When the customer has fulfilled his promise and executed the contract

of Murabaha to the purchase orderer, the institution must refund *hamish jiddiyyah* to the customer. The institution is not entitled to use any amount of *hamish jiddiyyah* except in the case of breach of promise as laid down in item 2/5/3. It is permissible for the institution to agree with the customer that the amount of *hamish jiddiyyah* will be deducted from the price payable by the customer pursuant to the contract of Murabaha to the purchase orderer.

2/5/6 It is permissible for the institution to take *urbon* (earnest money) after concluding the Murabaha sale with the customer. This may not be done during the contractual stage at which the customer has given his promise to purchase. It is preferable that the institution return to the customer the amount that remains after deducting the actual damage incurred from the *urbon* as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party.

3. Acquisition of title to, and possession of, the asset by the institution or its agent

3/1 The acquisition of the asset or good by the institution prior to its sale by means of Murabaha to the purchase orderer

3/1/1 The institution is prohibited from selling any item in a Murabaha transaction before having acquired the item. Hence, it is not valid for the institution to conclude a Murabaha sale with the customer before concluding the purchase, from the supplier of the item, of the subject matter of the Murabaha, and before actual or constructive possession of the item as a result of the supplier giving control over the item or presenting documents that represent possession (see items 3/2/1-3/2/4. Likewise, the Murabaha is considered as void if the contract with the supplier is void, as in this case the institution would not have complete title to the item.

3/1/2 It is permitted that the contract between the institution and the supplier be completed by means of a meeting of the two parties to discuss the details, at which point the contract may be executed. Likewise, it is permitted that the contract be completed through exchanging the notices of offer and acceptance, either in written form or correspondence by any form of modern communication customarily practiced according to known principles.

3/1/3 The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for the institution to carry out the purchase by authorizing an agent, other than the purchase orderer, to make the purchase; and the customer (the purchase orderer) should not be appointed to act as an agent except in a situation of dire need. Furthermore, the agent must not sell the item to himself. Rather, the institution must first acquire title of the item and then sell it to the agent. In such a case, the provisions of item 3/1/5 should be observed.

3/1/4 In cases when the customer is authorized to purchase the item as the

institution's agent, it is obligatory to adopt procedures which would ensure that certain conditions are observed. These conditions include the requirement that:

(a) the institution itself must pay the supplier, and not pay the price of the item into the account of the customer as agent.

(b) the institution should obtain from the supplier the documents that confirm that a sale has taken place.

3/1/5 It is obligatory to separate the two liabilities of risk attaching to the purchased item, namely the liability of the institution and the liability of the customer as agent of the institution. This is achieved by having an interval in time between the performance of the agency contract and the execution of the contract of Murabaha to the purchase orderer, as indicated in the customer's notice of performance of the agency contract to acquire the item and offer to purchase the item by means of Murabaha (see Appendix A), followed by the institution's notice of its acceptance of the customer's offer to purchase and the execution of the Murabaha sale contract (see Appendix B).

3/1/6 The original principle is that all the documents and contracts concerned with the execution of the sale of the item must be in the name of the institution and not in that of the customer, even if the latter acts as the institution's agent in acquiring the item.

3/1/7 It is permissible, at the time when the institution appoints someone as its agent for the acquisition of the item, that the two parties agree to authorize the agent to carry out the acquisition of the item as agent, without disclosing the existence of the agency agreement. In this case, the agent will act as principal in dealing with other parties, and will undertake the purchase directly in his name but on behalf of the institution as principal. However, it is preferable that the agent's role be disclosed.

3/2 The institution's taking possession of the asset or good, prior to its sale by Murabaha to the purchase orderer

3/2/1 It is obligatory that the institution's actual or constructive possession of the item be ascertained before its sale to the customer on the basis of Murabaha to the purchase orderer.

3/2/2 The condition that possession of the item must be taken by the institution (before its onward sale to the customer) has a specific purpose: that the institution must assume the risk of the item it intends to sell. This means that the item must move from the responsibility of the supplier to the responsibility of the institution. Similarly, it is obligatory that the point when the risk of the item is passed on by the institution to the customer be clearly identified, with reference to the stages in which the item is transferred from one party to another.

3/2/3 The forms of taking delivery or possession of items differ according to their nature and different trade customs. Taking possession may be actual in the case of the physical delivery or transportation to the acquirer or its agent, but may also take place constructively by placing

of the item at the acquirer's disposal so as to enable him to deal with it at his will, even though no physical delivery has taken place. Taking possession of an item of real property may also take place by means of the property being vacated and its being placed at the acquirer's disposal; if the latter is not able to have disposal of the purchased item, then the vacation of the property is not considered as conveying possession. In the case of moveable assets, possession will take place in accordance with the nature of the asset.

3/2/4 The receipt of a bill of lading by the institution or its agent, when purchasing goods on the international market, is considered as constructive possession. The same would apply to the institution's receipt of certificates of storage issued by warehouses following appropriate and reliable formalities.

3/2/5 The original principle is that the institution itself must receive the item from the premises of the supplier or from a location that is specified in the delivery conditions. The responsibility for the risk attached to the item is transferred to the institution upon its taking possession of the item. However, it is permissible for the institution to authorize another party to take delivery of the item on its behalf.

3/2/6 Providing insurance cover for the item sold by Murabaha is the responsibility of the institution at the stage of its acquiring ownership. The institution undertakes this responsibility in its capacity as the owner of the item and also bears all the consequential risks. The insurance indemnity, if the need for a claim arises before ownership is transferred to the customer, belongs to the institution exclusively and not to the customer. The institution is entitled to calculate expenses as part of the purchasing cost that may be subsequently built into the price of Murabaha deal.

3/2/7 Agency in carrying out the procedures of obtaining insurance cover for the item at the stage of the institution's acquisition of ownership of the asset is permitted. However, it is obligatory that the institution should bear the cost of insurance.

4. Conclusion of a Murabaha contract

4/1 It is not permitted for the institution to consider that the contract of Murabaha to the purchase orderer is automatically concluded by its mere taking possession of the asset. Likewise, the institution may not force a customer who is the purchase orderer to take delivery of the asset and pay the Murabaha selling price, if the customer refuses to conclude the Murabaha transaction.

4/2 The institution is entitled to receive compensation for any actual damage it has incurred as a result of the customer's breach of a binding promise. The compensation consists of the customer reimbursing the institution for any loss due to a difference between the price received by the institution in selling the asset to a third party and the original cost price paid by the institution to the supplier.

4/3 When the institution has purchased an asset for a deferred price, with the

intention that it will be sold on a Murabaha basis, then the institution is obliged to disclose to the customer that the asset is purchased by the institution on deferred payment basis. The institution has the obligation to disclose to the customer, when concluding the contract of sale, the details of any expenses that it would include in determining the selling price. The institution is also entitled to include any expenses relating to the item if this is acceptable to the customer. However, if the institution failed to disclose any expenses, it is not entitled to include them unless they are customarily considered as normal expenses, such as transportation expenses, storage expenses, fees for letters of credit and insurance premiums.

4/4 The institution is not entitled to include in the base cost of the item, for the purpose of calculating the Murabaha price, any amounts other than the direct expenses that are paid to a third party. It is not permissible, for example, for the institution to add to the cost of the item payments made to its own staff for their work, and the like.

4/5 If the institution has, even after the drawing up of the Murabaha contract, received a discount for the same item that was sold on Murabaha basis from the supplier of the item, then the customer should benefit from that discount by a reduction of the total Murabaha selling price in proportion to the discount.

4/6 It is an obligation that both the price of the item and the institution's profit on the Murabaha to the purchase orderer transaction be fixed and known to both parties on the signature of the contract of sale. It is not permitted under any circumstances to subject the determination of the price or the profit to unknown variations or variations that are determinable in the future, such as by concluding the sale and making the profit dependent on the rate of LIBOR that will prevail in the future. There is no objection to referring to any other known indicators during the promise stage as a comfort indicator to determine the rate of profit, provided that the determination of the institution's profit at the time of concluding the Murabaha to the purchase orderer is based on a certain percentage of the cost and is not tied up with LIBOR or a time factor.

4/7 The institution's profit mark-up in Murabaha to the purchase orderer must be known, and the mere mention of the total selling price is not sufficient. It is permissible that the profit be determined based on a lump sum amount or a certain percentage of the cost price only or of the cost price plus the expenses. This determination is completed by the agreement and mutual consent of the two parties.

4/8 It is permissible to agree on the payment of the price of the item under Murabaha to the purchase orderer either by short or long term instalments, and the selling price of the asset becomes a debt that the customer is obligated to pay at the time agreed upon. It is not permitted subsequently to demand any extra payment either in consideration of extra time given for payment or for delay in payment that may be for a reason or no reason.

4/9 It is permissible for the institution to stipulate in the contract of Murabaha to the purchase orderer a condition that the institution is free from responsibility for all or some of the defects of the asset; this is known as *Bai' al-Bara'ah* (sale on 'as is' basis). In the case of stipulating such a condition, it is preferable that the institution should assign to the customer the right of recourse to the supplier to

obtain compensation for any defects that are established, which would otherwise be recoverable by the institution from the supplier.

4/10 If the institution did not stipulate its exemption from pre-existing hidden defects whose effects appear after the conclusion of the contract, then it is responsible for pre-existing hidden defects excluding any new defects (recent defects).

4/11 The institution is entitled to include, as a condition of the contract, that in case of the customer's refusal, after the execution of the Murabaha contract, to take delivery of the asset at the prescribed time, the institution could revoke the contract or sell the asset to a third party on behalf of the customer and for his account. The institution could then recover from the selling price the amount due to it from the customer under the contract, and would have recourse to the customer for the balance if that price were not sufficient to cover the amount due to the customer.

5. Guarantees and treatment of Murabaha receivables

5/1 It is permissible for the institution to stipulate to the customer that instalments may become due before their originally agreed due dates in case of the customer's refusal to perform or delay in paying any instalment without any good reason. This may take place in one of the following ways:

(a) The instalments automatically become due as a result of a mere delay in a payment, no matter how short the period of delay is.

(b) The instalments become due after a delay in payment exceeding a specified time period.

(c) The instalments become due after the sending of a reminder notice by the institution to the seller giving a specified time period for payment.

The institution is entitled, in these circumstances, to waive a portion of its dues.

5/2 The institution should ask the customer to provide lawful security in the contract of Murabaha to the purchase orderer. Among other things, the institution may receive a third party guarantee or the pledge of the investment account of the customer or the pledge of any item of real or moveable property, or the pledge of the subject matter of the Murabaha contract as a fiduciary pledge (or a registered charge), either without taking possession of the pledged asset, or by taking possession of the pledged asset and then releasing the pledge progressively according to the percentage of the total payment received.

5/3 It is permissible for the institution to require the customer to provide cheques or promissory notes before the execution of the contract of Murabaha to the purchase orderer, as a guarantee of the indebtedness that will be created after the execution of the contract. This is possible on the written condition that the institution is not entitled to use these cheques or documents except on their due dates. The requirement to provide cheques as security is not permissible in countries where they could be presented for payment before their due date.

5/4 It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price. However, it is permissible to postpone the registration of the asset in the customer's

name as a guarantee of the full payment of the selling price. The institution may receive authority from the customer to sell the asset in case the customer delays payment of the selling price, in which case the institution should issue a counter-deed to the customer to establish the latter's right to ownership. If the institution sells the asset as a result of the customer's failure to make a payment of the selling price on its due date, it must confine itself to recovering the amount due to it and must return the balance to the customer.

5/5 In the case of the institution receiving a pledge from the customer, the institution is entitled to stipulate that the customer should make an assignment to the institution to enable it to sell the pledged asset for the purpose of recovering the amount due from the customer without recourse to the judiciary.

5/6 It is permissible that the contract of Murabaha consist of an undertaking from the customer to pay an amount of money or a percentage of the debt, to be donated to charitable causes in the event of a delay on his part in paying instalments on their due date. The Shari'a supervisory board of the institution must have full knowledge that any such amount is indeed spent on charitable causes, and not for the benefit of the institution itself.

5/7 It is not permissible to extend the date of payment of the debt in exchange for an additional payment in case of rescheduling, irrespectively of whether the debtor is solvent or insolvent.

5/8 When there is default in payment by the customer with regard to instalments of the selling price that are due, the amount due is just the amount of the unpaid selling price. It is not permissible for the institution to impose any additional payment on the customer for the institution's benefit. This provision is, however, subject to item 5/6 .

5/9 It is permissible for the institution to give up part of the selling price if the customer pays early, provided this was not part of the contractual agreement.

5/10 It is permissible for the institution and the customer to agree, on the due date, that payment of the debt due on account of Murabaha to the purchase orderer may be made in a currency different from that in which the debt is denominated, provided any such payment is made based on the exchange rate of the day of the settlement. It is also a condition that either the settlement of the debt is completed in full or that the amount agreed be paid in the different currency is paid in full, so that there remains no balance owing in that different currency.

6. Issue date

This Standard was issued on 4 Rabi al-Awwal 1423H corresponding to 16 May 2002 .

Adoption of the Standard

The Shari'a standard for Murabaha to the Purchase Orderer was adopted by the Shari'a Board in its meeting No.(4) held on 25-27 Safar 1421H corresponding to 29-31 May 2000.

In its meeting No. (8) held in Mecca on 28 Safar-4 Rabi al-Awwal 1423H corresponding to 11-16 May 2002, the Shari'a board readopted a resolution to reformat **the Shari'a Rules for Murabaha to the purchase orderer in the form of a Shari'a standard.**

Appendix A

Notice from the institution's customer of its performance of the purchase of the asset or good as agent for the institution, and of its offer to purchase the item from the institution according to the contract of Murabaha to the Purchase Orderer

From: (The institution's customer as agent)

To: (The institution)

In the performance of my contract of agency with you, I hereby inform you that I have purchased the item described below on your behalf and for your benefit. This item is in my possession on your behalf.

In accordance with my promise to you, I hereby agree to purchase this item from you for a total price of ....., namely the cost price of ..... plus the mark-up of .....

The payment of this price will be in accordance with the following schedule of instalments:

.....

.....

.....

Please send the acceptance in accordance with this offer.

Appendix B

Notice of the acceptance by the institution of the customer's offer to purchase the asset or good to be acquired, and of the sale of the item by the institution to the customer

From: (The institution)

To: (The customer as the institution's agent)

In response to your notice dated ....., containing your offer to purchase the item described below which is owned by us, we hereby confirm to you our sale of the item to you at a total price of ..... comprising the cost price of ..... plus the mark-up of ....., in accordance with the conditions explained in the general agreement to a contract of Murabaha to the purchase orderer.

Appendix C: Brief history of the preparation of the Standard

In its meeting No. (1) held on 11 Dhul Hijjah 1419H corresponding to 27 February 1999, the Shari'a Board decided to give priority to the preparation of a Standard setting out the Shari'a rules for Murabaha to the purchase orderer.

On Tuesday 13 Dhul Hijjah 1419H corresponding to 30 March 1999, the Fatwa and Arbitration Committee recommended to the Shari'a Board the commissioning of a Shari'a consultant to prepare a juristic study and an exposure draft of the Shari'a Rules for Murabaha to the purchase orderer.

In its meeting held on 13,14 Rajab 1420H corresponding to 22,23 October 1999, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Murabaha to the purchase orderer, and asked the consultant to make the amendments in light of the comments made by the members.

The revised exposure draft of the Shari'a Rules was presented to the Shari'a Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the Shari'a Rules and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dul-Hijjah 1421H corresponding to 4-5 April 2000. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. The members responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Studies Committee and the Fatwa and Arbitration Committee held a joint meeting on 21-23 Muharam 1421H corresponding to 26-28 April 2000 to discuss the comments made about the exposure draft of the Shari'a Rules. The joint meeting made the necessary amendments, which it deemed necessary in light of the discussions that took place in the public hearing.

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421 corresponding to 29 – 31 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee and the Fatwa and Arbitration Committee, and made the necessary amendments, which it deemed necessary. **The standard was adopted with the name of "Shari'a Rules for the Murabaha to the purchase orderer". Some paragraphs were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

The Shari'a Board decided in its meeting No. (7) held in Makkah al-Mukarramah on 9-13 Ramadan 1422H corresponding 24-28 November 2001 to pass a resolution to reformat all Shari'a rules in a form of standards and a committee was formed for this purpose.

In its meeting No. (8) held in Madina al-Munawwarah on 28 Safar-4 Rabi'ul Awwal 1423H corresponding to 11-16 May 2002, the Shari'a Board adopted the reformatting of the Shari'a Rules for Investment and Financing No. (1): Murabaha to the purchase orderer with the name of Shari'a Standard No. (8): Murabaha to the purchase orderer.

Appendix D: Basis of the Shari'a rulings

Preface on the legitimacy of Murabaha to the purchase orderer

Definition of Murabaha

Murabaha is selling a commodity as per the purchasing price with a defined and agreed profit mark-up. This mark-up may be a percentage of the selling price or a lump sum. This transaction may be concluded either without a prior promise to buy, in which case it is called an ordinary Murabaha, or with a prior promise to buy submitted by a person interested in acquiring goods through the institution, in which case it is called a "banking Murabaha" i.e. Murabaha to the purchase orderer. This transaction is one of the trust-based contracts that depends on transparency as to the actual purchasing price or cost price in addition to common expenses.

Legitimacy of Murabaha

The authorities for the legitimacy of Murabaha are authorities on the legitimacy of sale. Among them is the saying of Allah, the exalted, **Allah has permitted trade.**[3] Some scholars has also cited to support the legitimacy of Murabaha the saying of Allah, the Exalted, **it *is no crime for you to seek the bounty of your Lord,***[4] arguing that the bounty mentioned here means profit. The Murabaha is also analogous to a form of sale called tawliyyah (which means to sell as per the purchasing price without making profit). This is because the Prophet, peace be upon him, purchased a she-camel from Abubakar for use as transportation to migrate to Medina. Abubakar had wanted to give it to the Prophet, peace be upon him free of charge and he refused and says "I will preferably take it at the acquisition price". The majority of scholars agreed, in principle, on the legitimacy of Murabaha.

The promise from the purchase orderer

- The basis for the permissibility of responding to the application of the customer that the institution buys the commodity from a particular supplier is because such a demand will not affect the acquisition of the commodity by the institution, especially in view of the fact that this demand is not binding. The institution is entitled to acquire the commodity from another supplier provided the commodity complies with the desired specification. The customer may be forced to fulfil his obligation on the basis of general sources of the Qur'an and Sunna that require fulfilment of obligation and undertaking. The International Fiqh Academy has issued a resolution endorsing a unilateral binding promise.[4] The same was adopted in a fatwa for Kuwait Finance House,[5] Qatar Islamic Bank [6] and others.
- The basis for allowing price quotations be submitted in the name of customer is because such an act has no contractual effect if there is no acceptance by the customer. The basis why is preferred that the quotation be submitted in the name of the institution, is to avoid confusion and this is what was endorsed by the

(3) Al-Baqarah verse 198
(4) The International Fiqh Academy's Resolution No. 40-41 (2/5 and 3/5).
(5) Fatwa No. (49)
(6) Fatwa No. (8)

Fatwas of Qatar Islamic Bank [7] and Kuwait Finance House. [8]

- The basis for not allowing a Murabaha deal when the customer accepts the deal directly from the supplier is because, by this, a sale contract has taken place between the customer and the supplier in which case the commodity enters into ownership of the customer. This ruling will not be affected whether or not the customer has paid the price. This is because payment is not a condition for the validity and conclusion of a contract as payment of the price is but a consequence of a contract and is not principal requirement or a condition for regarding a contract valid.
- The basis for the requirement that there must not be any contractual commitment between the customer and the supplier is to safeguard against the contract being a mere interest-based financing. Therefore, the lack of any commitment between the customer and the supplier is a basic condition for the validity of executing a Murabaha to the purchase orderer transaction by the institution.
- The basis for the requirement that the customer must not have any (business) connection with the supplier is to avoid involving in an *inah* (sell and buy back) transaction that is prohibited by Shari'a.
- The basis for the permissibility that the supplier may be a relative of the customer or a husband or wife to the customer is because both parties have independent legal liability unless it has come to be that they are involved in an *inah* transaction, in which case the transaction is prohibited. This is to defeat a potential intentional arrangement to evade formalities of the transaction. The Fatwa of Kuwait Finance House supports this.[9]
- The basis for not allowing a partner to promise to buy the shares of another partner on a Murabaha basis is because this will lead to the buyer guaranteeing the share of other partner and this is riba.
- The basis for not allowing dealings in gold, silver and currencies on deferred Murabaha basis is the saying of the Prophet, peace be upon him, in respect to exchange of gold with silver that such exchange take place *hand to hand* [10], i.e. without delay in delivery, and the rules of currencies are subsumed under the ruling for gold and silver. This ruling is endorsed by the resolution of the International Fiqh Academy[11]
- The basis for the prohibition of Murabaha tradable securities or refinancing of a Murabaha transaction is because these fall under the heading of sale of debt that is prohibited by Shari'a.
- The basis for not allowing a bilateral binding promise is because it amounts to a contract prior to acquisition of the item to be sold. The International Fiqh Academy has issued a resolution in this respect.[12]
- The basis for the permissibility of the agreement to amend the terms of the promise is because a promise is not a contract and as such the amendment of the

(7) Fatwa No. (35)
(8) Fatwa No. (87)
(9) Fatwa No. (55)
(10) The hadith is reported by Muslim in his Sahih.
(11) The International Fiqh Academy's resolution No. 63 (1/7).
(12) The International Fiqh Academy's resolution No. 41(3/5).

profit margin and the duration will not amount to rescheduling of debt which is prohibited by Shari'a.

- The basis for using options when buying on Murabaha is the case of Hibban Ibn Munqidh when the Prophet, peace be upon him, suggested to him *stipulate, if you buy, a condition that there is no cheating and that you have a three day period for any of the goods bought, if you are satisfied, then keep it and if you are not satisfied, return it to the buyer.* [13] The ruling on the application of option in Murabaha is endorsed by a resolution issued during the second Fiqh Forum organised by Kuwait Finance House.
- The basis for the impermissibility of a commitment fee is because such a fee is in exchange for the right to contract, which is a mere intention and wish that is not a subject of exchange.
- The basis for the impermissibility of a facility commission is because it is not allowed to receive commission in the event of giving out a loan facility itself. It is therefore a logical conclusion to disallow commission for a mere readiness to finance the customer on a deferred payment basis.
- The basis for allowing that the expenses of preparing the document of contracts between the institution and the customer be borne by the two parties is because both parties will equally benefit from this, and moreover there is no any impermissible act involved. The basis for the permissibility that those expenses may be borne by one of the parties is because this is a form of condition that is permissible.
- The basis for the legitimacy of the customer guaranteeing the good performance of the supplier is because this guarantee secures rights and does not adversely affect any rules of the Murabaha to the purchase orderer transaction.
- The basis for not allowing that the customer guarantee the risk of transportation of the goods is because the safety of the goods is the responsibility of the owner and the customer is not the owner. Hence, the owner must bear the risk since the right to profit is associated with bearing risk.
- The basis for the permissibility of security deposit (hamish jiddiyyah) is because it is a form of guarantee for any financial damage that may occur.
- The basis for the permissibility of obtaining the earnest money to secure performance is the practice of 'Umar Ibn al-Khattab, may Allah be pleased with him, in the presence of some companions of the Prophet , peace be upon him[14] which has been permitted by Imam Ahmad. A resolution has been issued in connection with the legality of earnest money (down payment) by the International Islamic Fiqh Academy.[15]

Acquisition of title to, and possession of, the asset by the institution or its agent

- The basis for the prohibition of selling a commodity before taking possession is the saying of the Prophet, peace be upon him *do not sell what you own not* [16] and the

(13) The hadith is reported by Ibn Majah (Sunan Ibn Majah 2788).
(14) The source of the hadith has been stated earlier.
(15) Resolution No. 72 (3/8) in respect of earnest money (down payment).
(16) The hadith is reported by al-Tirmidhi (Sunan al-Tirmidhi 3534).

hadith in which the Prophet, peace be upon him prohibits a person from selling what he does not own [17].

- The basis for preferring that the institution appoint an agent other than the purchase orderer in case of the need to do so is to avoid a fictitious transaction that shows on paper that the acquisition is made on behalf of the institution. This is necessary in order that the institution appear as the real purchaser and in order to demarcate the liabilities of the parties: the liability of the institution and the liability of the purchase orderer after the sale contract.
- The basis for the requirement that the institution pay the supplier directly is to avoid the risk of the contract degenerating into mere interest-based financing.
- The basis for the requirement that the liabilities of the parties—in case the institution acquires the goods through agency—is to demarcate the two liabilities.
- The basis for the requirement that documents be directed to the institution is because the purchase is taking place on behalf of the institution.
- The basis for the requirement that the agent explain to the supplier his agency status is so as to control the transaction and to determine the party to be referred to for the execution of the contract.
- The basis for the requirement of possession before a sale contract is to ensure that the institution becomes liable for the risk of destruction of the commodity before it is entitled to sell it.
- The basis for separating an agency contract from a Murabaha transaction is to be sure that there is no any intentional arrangement to connect the two contracts.
- The basis for the rule that constructive possession is sufficient to meet the requirement of possession and that possession is according to the nature of the items is because the Shari'a did not state a particular form for possession. Rather this is left to the customary practices. Again, the purpose of possession is to enable one to have control over something. Therefore, any procedure that serves this objective would be regarded as possession.
- The basis for the requirement that the contract of agency be separate from the contract of sale on a Murabaha basis is because of the risk that the contracts may be connected to each other.
- The basis for the rule that the institution bear the expenses of insurance is because these expenses follow ownership of the goods.

Conclusion of a Murabaha contract

- The basis for the rule that the institution is entitled to compensation in case of breach of a binding promise by the customer to buy the goods is because of the damage that may be inflicted on the institution due to the act of the customer. This is because the customer has caused the institution to enter into a deal that it would not have concluded in the absence of the promise. The International Islamic Fiqh Academy has issued a resolution in this respect.[18]
- The basis for the rule that the institution's rights are limited, in case of breach of

(17) The hadith is reported by al-Tabrani (al-Mu'jam al-Awsat 5/66), Dar al-Haramayn, Cairo, 1415 H.
(18) The International Islamic Fiqh Academy's resolution No. 40-41 (2/5 and 3/5).

promise, to the difference between the cost of the item to the institution and its selling price to a third party is because the lawful right in a guarantee is limited to the amount that compensates for the damage suffered and because the institution's right to recover loss of its mark-up is irrational since there is no mark-up unless there is actually a Murabaha transaction and in this case there is no such transaction.

- The basis for the requirement of transparency as to the cost price is because Murabaha is a trust related contract that requires disclosure of the amount and the currency of the cost price because a price in a deferred payment sale is higher.
- The basis for allowing normal expenses to be included in computing the selling price of the commodity is because these expenses are paid to a third party.
- The basis for entitlement of the buyer to benefit from the discount acquired by the institution is because Murabaha is a mark-up sale. Therefore, if the previous purchasing price decreases then the cost price is the amount that remains after the discount and this price is the cost price for the purpose of the Murabaha.
- The basis for the requirement that the price and the profit in Murabaha must be determined is to avoid uncertainty and lack of knowledge.
- The basis for the requirement that the profit must be separately disclosed from the cost price and that it is not allowed to be calculated as a single amount for the customer is because Murabaha is a sale with a profit margin. Therefore, it is necessary this profit be disclosed separately to ensure that the customer will agree to it.
- The basis for the permissibility of instalment payment is because Murabaha is one of the sale contracts that are subject to spot payment, deferred payment or instalment payment. The basis for the impermissibility of requesting an additional sum of money for delay in payment is because this is the prohibited riba.
- The basis for the permissibility of stipulating a defect exclusion clause is because a buyer is entitled to require guaranteeing hidden defects which are related to the sold commodity by the seller. However, the buyer may relinquish this right by agreeing to a defect exclusion clause, as stated by a number of scholars.[19]
- The basis for the permissibility of stipulating that the contract would be terminated for default in payment is because the original principle in respect to stipulations is validity and permissible. In addition, this clause does not render permissible an impermissible act or prohibit a permissible act. Hence, this clause falls under the hadith that says *Muslims are bound by the conditions they made, except a condition that renders permissible an impermissible act or prohibits a permissible act.* [20]

Guarantees in Murabaha and treatment of Murabaha receivables

(19) See al-Kasani, Badai al-Sanai 5/279ff; al-Muwwaq, al-Taj wa al-Iklil 4/439; al-Shirazi, al-Muhadhab 1/284; Ibn Qudama, al-Mughni 4/128; al-Bahuti, Kashaf al-Qina' 3/228ff.

(20) This tradition has been reported by a number of the companions and it was narrated by Ahmad in his Musnad (1/312) ; Ibn Majeh through a good chain of transmission (2/783, printed by Mustafa al-Babi al-Halabi, Cairo, 1372H/1952 A.D. ; al-Hakim (printed in Hyderabad, India, 1355H) ; al-Bayhaqi (5/70, 150, 1/133, printed in Hyderabad, India, 1355H) and al-Darqutni (4/228, 3/77, printed by Dar al-Mahasin li al-Tiba'ah, Cairo, 1372H/1952A.D.).

- The basis for the condition that all instalments will become due if there is delay in payment is the hadith of the Prophet, peace be upon him: *Muslims are bound by the conditions they made*, and because payment on a deferred basis is the right of the buyer, and the buyer may choose to pay before time and relinquish the deferral of the date of payment entirely or make payment of all instalments contingent on default on payment of one instalment.
- The basis for demanding collateral to secure payment is because such a requirement does not affect the contract, rather it consolidates performance and such guarantees are relevant to contracts involving credit.
- The basis for not allowing a stipulation that delays transfer of ownership is because such a stipulation is against the effect of a sale contract, which is immediate transfer of ownership. The basis for allowing the institution to hold up registering the commodity in the name of the customer until payment is realised is that such an action does not affect the transfer of ownership to the buyer.
- The basis for the permissibility of stipulating a condition, whereby the debtor in case of default is obliged to donate a sum of money in addition to the amount of the debt to be spent by the institution on charitable causes, is because this has been considered as an instance of the commitment to make a donation, which is well established in the Maliki school of law. This is the opinion of Abi 'Abd. Allah Ibn Naffi' and Muhammad Ibn Ibrahim Ibn Dinar, among the Maliki jurists. [21]
- The basis for the prohibition of additional payment over the principal debt in consideration for extension of time is because such action is a pre-Islamic form of riba.
- The basis for the permissibility of discount or rebate for earlier payment is because discount for early payment is a form of settlement between the creditor and the debtor to pay less than the amount of the debt. This is among the settlement that are endorsed by Shari'a as stated in the case of Ubay Ibn ka'b may Allah be pleased upon him (and his debtor) where the Prophet peace be upon him suggested to him in words: *write off a portion of your debt.* [22] The International Islamic Fiqh Academy has issued a resolution in support of this rule.[23]
- The basis of the permissibility of payment of debt in another currency is that this would entail the settlement of the debt by discharging it. This does not involve any prohibited transaction pertaining to debts either with regard to sale or purchase.

As for some of the forms mentioned in the standard, there are texts to support them, *inter alia*, the tradition reported on the authority of Ibn 'Umar (blessing of Allah be upon him) who said "I have met the Prophet (prayers and peace of Allah be upon him) at the house of Hafsah (blessing of Allah be upon him), and I said to him 'O Prophet of Allah, I would like to ask you: I sell a camel in al-Baqi' for a price quoted in *dinar* but I take *dirham*, and I sell for a price quoted in *dirham* but I take *dinars*, I take this from this and I give this from this'. The Prophet (prayers and peace of Allah be upon him) replied: *There is no objection to your taking the other currency based on the price of the day, provided you do not leave each other with*

(21) See the book entitled **Tahrir al-Kalam fi Masa'il al-Iltizam** by al-Hattab. This rule has been endorsed by the resolutions and recommendations of the Fourth Fiqh Forum organized by the Kuwait Finance House.
(22) The hadith is reported by al-Bukhari, Sahih al-Bukhari 1/179, 2565.
(23) The International Islamic Fiqh Academy's resolution No. 64 (7/2).

something remaining owed as a debt between you.[24] Some of the forms in the standard are a kind of set-off and this is permissible.

(24) Narrated by Abu Dawood, al-Tirmidhi, al-Nisaa', Ibn Maiah and al-Hakim, who is considered it a sound Hadith, as confirmed by al-Dhahabi. It was also narrated without a chain of narrators, quoting only Ibn Umar (Al Talkhees Al Habeer 3/26).

Appendix E :Definitions

Murabaha to the purchase orderer

The type of transaction, which involves the customer's promise to purchase the item from the institution, is called Murabaha to the purchase orderer. By this it is distinguished from the normal type of Murabaha which does not involve such a promise by the customer. The Murabaha to the purchase orderer is the sale of an item by the institution to a customer (the purchase orderer) for a pre-agreed selling price which includes a pre-agreed profit mark-up over its cost price, this having been specified in the customer's promise to purchase. Normally, a Murabaha to the purchase orderer transaction involves the institution granting the customer a Murabaha credit facility.

A Murabaha to the purchase orderer transaction typically involves deferred payment terms, but such deferred payment is not one of the essential conditions of such transaction. A Murabaha can arranged be with no deferral of payment. In this case, the mark-up will only include the profit the institution will receive for a spot sale and not the extra charge it will receive for deferral of payment.

Commitment fee

A commitment fee is the percentage or amount which the institution takes from the customer to start processing the transaction even though a sale contract may not be concluded).

Urboun

The term *urboun* means an amount of money that the customer as purchase orderer pays to the institution after concluding the Murabaha sale, with the provision that if the sale is completed during a prescribed period, the amount will be counted as part of the price. If the customer fails to execute the Murabaha sale, then the institution may retain the whole amount.

Syndicated financing

A syndicated financing is a partnership relationship for financing a particular project which two or more parties has interest to finance. They will distribute the profit or revenue as per agreement. In other words, syndicated financing is the acceptance of a number of companies (financial institutions) to enter into a joint investment transaction through one of the lawful investment instruments with an understanding that one of the parties assumes leadership of the deal. During the period of the transaction, the transaction would enjoy an independent liability separated from their companies.

Credit facility

A credit facility is an upper limit for a customer's Murabaha transactions. This credit facility may be restricted to a specified type of item, or to a specified time period.