Issues of Murabaha as a Mode of Islamic Finance

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ABSTRAK

This research endeavor seeks to elucidate the principal concerns associated with Murabaha as a paradigm of Sharia-compliant financing. This investigation represents a scholarly inquiry within the realm of librarianship, employing a descriptive methodology. The primary source of data for this research is secondary literature, specifically the text "Introduction to Islamic Banking and Finance" authored by Kettell. The findings of this analysis have determined that there exist eleven pertinent issues concerning Murabaha, which include the utilization of an interest rate as a standard of comparison, matters pertaining to gharar, stipulations regarding collateral for the murabaha payment, assurances related to the murabaha, repercussions for default, issues of exploitation, the absence of roll-over provisions in Murabaha, rebates for early settlement, the subject matter of Murabaha, the rescheduling of payments in Murabaha, and the securitization of Murabaha

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Introduction

Murabaha constitutes a financing framework rooted in Islamic principles, wherein the seller and buyer mutually consent to the asset's cost and the accompanying markup. This structure is alternatively denoted as cost-plus financing. The markup effectively replaces interest, which is prohibited under Islamic jurisprudence. It is imperative to clarify that Murabaha does not operate as an interest-bearing loan or qardh ribawi. Rather, it is sanctioned as a legitimate form of credit sale within the purview of Islamic law. The buyer does not attain the status of true ownership until the complete repayment of the loan has transpired, akin to a rent-to-own scheme (Young, 2024).

In the context of a Murabaha transaction, the designation of an agent, if applicable, the acquisition of goods by or for the bank and the subsequent sale of these goods to the customer must be treated as distinct and independent transactions, each requiring separate documentation. Nonetheless, a sales agreement may encapsulate all aforementioned events and transactions, thereby facilitating its establishment at the onset of the relationship. Initially, the agent procures the commodity on behalf of the principal, i.e., the financier, and assumes possession in that capacity. Subsequently, the client purchases the commodity from the financier through a process of offer and acceptance. According to Sharia law, the condition of 'possession' is deemed fulfilled when the supplier from whom the bank procured the item transfers possession to the bank or its agent in such a manner that the subject matter of the sale is rendered subject to the risk borne by the bank. In essence, the commodity remains under the risk of the financier during the duration of the agent's acquisition of the commodity and its eventual sale to the client (agent/buyer) alongside its possession by said client. The invoice issued by the supplier shall denote the financier, as the commodity is acquired by an agent representing that financier. It is advisable that the financier directly remits payment for such commodities to the supplier. Upon the conclusion of the sale transaction, the established selling price is immutable (State Bank of Pakistan, 2005).

The Murabaha contract enjoys widespread application within Islamic banking institutions and contemporary Islamic financial entities. These institutions provide a variety of products predicated on the murabaha concept to address the diverse needs of their clientele, including but not limited to home financing, vehicle financing, trade financing, project financing, and goods financing. However, traditional murabaha arrangements are not as prevalent in current Islamic financial institutions. A preference exists for utilizing murabaha in the context of a purchase orderer (MPO). In a traditional murabaha, there exists no requisite prior commitment or undertaking from the customer. The conventional trader acquires a commodity from a seller without any antecedent promise. Thereafter, the trader sells the commodity to any buyer on a cost-plus profit basis. Conversely, the MPO arrangement is predicated upon an initial promise or purchase undertaking from a prospective customer (Blossom Finance, 2020).

Literature Review

Murabaha

Murabaha constitutes a concept within Islamic Fiqh (Islamic jurisprudence). It denotes a specific category of sale that is originally unrelated to financing. In instances where a seller consents to supply a designated commodity to the purchaser, incorporating a predetermined profit margin atop his acquisition cost, such an arrangement is identified as a Murabaha transaction. The fundamental component of Murabaha necessitates that the seller transparently reveals the actual expenditure incurred in the procurement of the commodity, followed by the addition of a profit margin. This profit may manifest either as a fixed sum or as a percentage of the cost (Kettell, 2011).

Legal Foundation of Murabaha

The legal foundation of murabaha is derived from the Qur'an, specifically surah an-Nisa verse 29, Al-Baqarah verse 275, Al-Ma'idah verse 1, and Al-Baqarah verse 280.

Surah An-Nisa Verse 29

> In other words : O you who have faith, refrain from unlawfully consuming one another's wealth, except through a transaction that is conducted with mutual consent among you. Moreover, do not take the life of one another; verily, Allah is Most Merciful towards you.

Surah Al-Baqarah Verse 275

> The interpretation of this verse elucidates that individuals who engage in the consumption of usurious practices are unable to maintain their composure except in a manner akin to that of an individual possessed by a malevolent spirit due to the affliction of insanity. Their condition is attributable to their assertion that commercial transactions are equivalent to usury, despite the fact that Allah has permitted commerce while forbidding usury. Those who have received the divine injunction from their Lord and consequently cease their usurious activities are permitted to retain what they have previously acquired prior to receiving the prohibition; the resolution of their affairs is ultimately at the discretion of Allah. Conversely, individuals who revert to engaging in usurious practices are categorized as the denizens of hellfire; they shall endure eternally therein.

Surah Al-Ma'idah Verse 1

O believers, fulfill your contractual obligations. It has been made lawful for you to consume livestock, with the exception of those which will be explicitly stated to you. This condition is stipulated without permitting hunting during the period of Hajj. Indeed, Allah establishes legal rulings in accordance with His sovereign will.

Surah Al-Baqarah Verse 280

Moreover, in instances where the debtor is experiencing hardship, it is advisable to provide an extension until they attain financial relief. Furthermore, the act of forgiving part or all of the debt is deemed more favorable for you, should you possess awareness of this principle.

Basic Rules for Murabaha

The subsequent stipulations delineate the regulations governing a Murabaha transaction (Usmani, 2002):

1. The object of sale must be in existence at the moment the transaction occurs. Consequently, any item that does not exist at the time of sale is impermissible for sale, leading to the nullification of the contract.
2. The subject matter must be under the ownership of the seller during the transaction. Should the seller attempt to sell an item that he has not rightfully acquired, the sale becomes invalid.
3. The subject of sale must be either in physical possession or constructive possession of the seller at the time of the transaction. Constructive possession refers to a scenario wherein the possessor has not physically received the commodity, yet it has come under their control, transferring all associated rights and liabilities, including the risk of loss or damage.
4. The sale must be immediate and unequivocal. Thus, any sale that is designated for a future date or contingent upon a future occurrence is rendered void. For instance, if 'A' informs 'B' on January 1st that he intends to sell his vehicle to 'B' on February 1st, the sale is invalid due to its association with a future date.
5. The subject matter must possess intrinsic value. Therefore, items devoid of value cannot be subject to sale or purchase.
6. The subject of sale must not pertain to items intended for unIslamic purposes.
7. The object of the sale must be explicitly recognized and specified to the purchaser. For example, if 'A', the proprietor of an apartment complex, indicates to 'B' that he will sell an apartment, the transaction is void unless the specific apartment is clearly identified to the buyer.
8. The transfer of the sold commodity to the purchaser must be unequivocal and not reliant on any potentiality or randomness.
9. The certainty of the price is an essential requisite for the validity of the transaction. Should the price be ambiguous, the sale is rendered void.
10. The sale must be unequivocal in nature. A sale contingent upon certain conditions is deemed invalid unless such conditions are acknowledged as integral components of the transaction in accordance with established trade practices.

Advantages and Disadvantages of Murabaha Financing

According to Vasilev (2023), murabaha financing presents several advantages, including: first, the involvement of a Guarantor. The framework of murabaha financing engenders a heightened sense of security and accountability, as the participation of a guarantor can significantly augment the trust quotient between the involved parties. Second, the transfer of Asset Ownership. Through murabaha financing, clients attain ownership of the asset, concomitantly assuming responsibility for any defects or issues that may arise concerning the asset. Third, the participation of Multiple Contractors. The engagement of multiple stakeholders in the murabaha financing process can promote transparency and mitigate the potential for concealed costs. Fourth, Default Retention. In the context of murabaha financing, financial institutions frequently retain a portion of the cost by default, which functions as a security measure against instances of default. Fifth, Minimal Down Payment. The structure of murabaha financing typically necessitates only a modest down payment, thereby alleviating the immediate financial burden on the purchaser. Sixth, the absence of Interest Payments. Murabaha financing is meticulously designed to circumvent interest payments, in alignment with the principles of Islamic finance.

Meanwhile, Vasilev (2023) posits that murabaha financing exhibits several disadvantages, specifically: first, the Disclosure of Costs and Profit. It is imperative that all costs and profits associated with murabaha financing are transparently communicated to the client, which may complicate the overall process. Second, the Lack of Flexibility. The inherently rigid architecture of murabaha financing may lack the adaptability required to accommodate evolving financial conditions. Third, the potential for Legal Consequences and Defaults. Instances of default within murabaha financing can instigate legal proceedings and/or overdue repayments, potentially engendering financial distress for the involved parties. Fourth, Cost Retention by the Bank. Financial institutions frequently retain a substantial portion of the cost in murabaha financing, which may be perceived as a financial disadvantage for clients. Fifth, the Down Payment Requirement. Murabaha financing generally necessitates a down payment, thereby imposing the obligation on clients to provide a predetermined amount upfront. Sixth, the Higher Cost for Banks. The operational framework of murabaha financing can incur elevated costs for banks, attributable to the complexity of the involved processes and administrative overhead.

Previous Research

Several prior studies pertaining to Murabaha have been conducted by researchers, including: The research conducted by Khalidin et al. (2023) concludes that the implementation of murabaha financing executed by sharia banks in Indonesia is not entirely consistent with Sharia Economic Law and the Fatwa of DSN MUI. Fundamentally, murabaha financing represents a modality of buying and selling predicated on a profit margin system; however, its application frequently resembles that of a credit system embedded with interest, akin to the practices of conventional banking institutions.

Next, The study by Alam et al. (2023) concludes that both internal and external factors contribute to the challenges associated with murabaha financing in BMT. Internal factors encompass the inaccuracies associated with BMT in the 5C framework (Character, Capacity, Capital, Collateral, and Condition), a deficiency in supervision, procedural violations, inadequacies in facilities and infrastructure, and a lack of human resources (HR). Conversely, external factors comprise problematic customers, unforeseen circumstances affecting customers, insufficient customer income, inflationary pressures, and government policies. The measures undertaken by BMTs to address the issues related to murabaha financing include the application of BMT guidelines for prospective clients, proactive and reactive supervision, the adoption of a democratic leadership style, the imposition of penalties, the rescheduling and restructuring of debts, the reconditioning of write-offs, the auctioning of collateral, and legal recourse.

Next, The research conducted by Khotijah & Iswanaji (2020) concludes that murabaha financing exerts a beneficial influence on economic growth within the agricultural sector.

Murabaha products offered by Islamic banking represent one of the most straightforward alternatives for financing activities in the agricultural domain. Due to its inherent simplicity, this financial instrument has gained considerable traction, resulting in a predominant portion of fund distribution occurring through murabaha contracts. However, it is noteworthy that the murabaha scheme pertaining to the agricultural sector possesses distinct characteristics when compared to other sectors, as farmers are only able to fulfill installment payments subsequent to the harvest period. Consequently, Islamic banking institutions must secure appropriate funding sources for this type of financing, such as mudharabah muqayyadah. Furthermore, it is imperative to acknowledge that not all agricultural financing endeavors necessitate the utilization of the murabaha contract, as its implementation should be aligned with specific conditions and the duration of funding, thereby allowing Islamic banks to employ alternative contracts that may be more suitable.

Next, The study conducted by Musaroh et al. (2020) reveals that, on a partial basis, operational costs exert a positive and statistically significant impact on murabaha margin income, while third-party funds demonstrate a negative and statistically significant effect on murabaha margin income. Additionally, the volume of murabaha financing positively and significantly influences murabaha margin income, whereas the interest rate set by Bank Indonesia and inflation do not significantly affect murabaha margin income. Next, The research undertaken by Widarjono & Misanam (2023) concludes that the murabaha financing rate adversely impacts murabaha financing, whereas the Industrial Production Index does not exhibit any significant effect on murabaha financing. The method of asymmetric effect indicates that both the murabaha financing rate and the Industrial Production Index asymmetrically influence murabaha financing.

Next, The investigation by Faizin & Djayusman (2023) concludes that the sharia compliance of murabaha financing is based on four distinct approaches: the ‘aqd approach, the maqashid sharia approach, the documentation approach, and the accounting and financial reporting approach. The ‘aqd approach stipulates that murabaha transactions should be conducted bona fide among independent parties (supplier, buyer, and financier) and must not involve any guaranteed profit. In accordance with the maqasid sharia approach, in addition to ensuring the overarching objectives of sharia in wealth (which encompass its circulation, clarity, preservation, stability, and justice), murabaha should also serve the public interest and contribute towards alleviating hardship. The documentation approach mandates that the form and content of the murabaha contract must adhere to the principles and stipulations of Islamic law and should be subject to oversight by the Sharia Supervisory Board during the drafting process. Lastly, the accounting and financial reporting approach requires that information disclosure encompass the value of assets at the time of murabaha execution, clarifications that murabaha receivables are assessed at cost, that profits from murabaha are recognized upon contracting, that deferred profits are not deducted from murabaha receivables, that there exists an absence of clear procedures for early repayment if it occurs, and that there is no definitive handling protocol for instances of customer insolvency or payment delays, if applicable.

Next, The research conducted by Sari et al. (2023) concludes that in the disbursement of Murabaha financing, both Bank Kalbar Syariah and Bank Syariah Mandiri adhere to the stipulations established by Bank Indonesia, and furthermore, there exists a discrepancy in the total number of financing installments between the two banking institutions. While Bank Syariah Mandiri offers a more economical option for Murabaha financing relative to Bank Kalbar Syariah, it is noteworthy that customer interest in financing is greater at Bank Kalbar Syariah. The underlying reason for the higher level of enthusiasm at Bank Kalbar Syariah compared to Bank Syariah Mandiri can be attributed to the expedited financing process, particularly regarding the requirements and decision-making timeline. Then, The investigation by Maruly (2023) ascertains that credit risk can be effectively managed through the enhancement of a comprehensive checklist referencing business partners, focusing on their character and historical performance, as well as incorporating a robust database.

Next, The study conducted by Syahputra & Ningsih (2020) concludes that the variables pertaining to Islamic bank Murabaha financing do not exert a significant effect on the Gross Domestic Product (GDP), whereas variables associated with Islamic bank financing display a significant influence on GDP. Moreover, it is noted that both Islamic bank Murabaha financing variables and Islamic bank Musyarakah financing variables collectively exert a significant impact on the Gross Domestic Product (GDP). Then, The research by Bulutoding et al. (2021) concludes that leverage does not have an impact on Murabaha funding; however, it does influence profitability. Additionally, capital adequacy demonstrates a significant increase in outgoing funding, albeit it does not enhance stock equity. It is established that Murabaha funding is crucial to the equity of Islamic banks. This study suggests that Murabaha funding is expensed, notwithstanding the increase in liabilities within Islamic banks.

Next, The findings of Ijaiya et al. (2021) indicate that the exposure to credit risk originating from Murabaha transactions tends to enhance the financial performance of banks. Consequently, the study advocates for Islamic banks to elevate their financing in Murabaha transactions to augment profitability and mitigate the impacts of elevated credit risk exposure. Then, Moosa (2023) concludes that the contracts utilized by Islamic banks, particularly emphasizing the Murabaha contract which is predominantly employed, warrant examination. The structure of the Murabaha contract is elaborated upon, alongside critiques documented in the existing literature. Subsequently, the accounting treatment of the Murabaha contract is elucidated, followed by a simulation intended to demonstrate the accounting process and its implications for financial statements. This research contributes to the ongoing discourse regarding the necessity for Islamic accounting standards pertinent to Islamic financial institutions.

Next, The study by Rahmat & Ernawati (2021) determines that the risk factor associated with profit-sharing financing constitutes the principal consideration for Sharia banks when opting for Murabaha financing, whereas the profit-sharing rate received is regarded as a secondary factor following the assessment of risk. The financing risks encountered by Sharia banks in Kendari City manifest as issues related to financing. In contrast, the profit-sharing rate factor significantly influences murabaha-oriented behavior, which is motivated by the comparatively lower return rates associated with results compared to those of Murabaha financing. Then, The study by Arwanto et al. (2023) concludes that the resolution of problematic financing at BMT Agam Madani can be categorized into two distinct modalities; in instances where the customer exhibits a good faith effort, a rescheduling of payments is implemented. Conversely, if the customer fails to demonstrate sufficient goodwill, a warning letter will be issued up to three times, ultimately culminating in enforcement actions involving the submission of debt guarantees. This procedure is necessitated by the fact that the guarantee letter, duly signed by the involved parties, is formally recognized as a deed of acknowledgment of debt, qualifying it as an authentic deed, with the execution serving as a mechanism for the enforcement of monetary obligations.

Next, The study by Karmila & Mahdani (2023) posits that the deployment of small financing through KUR (Kredit Usaha Rakyat) at the Bank Syariah Indonesia Branch Office possesses considerable potential to foster economic development within the community, particularly benefiting micro, small, and medium-sized enterprises (MSMEs). Such initiatives are likely to invigorate the local economy and facilitate access to capital for the community, thereby contributing not only to the enhancement of communal welfare but also to a prospective increase in the sales turnover for Bank Syariah Indonesia. The favorable results documented from the execution of People’s Business Credit Financing utilizing Murabaha agreements at the Bank Syariah Indonesia Blangpidie Branch Office indicate the promise for an expanded implementation of Sharia-compliant financing paradigms aimed at supporting MSMEs. These findings accentuate the critical importance of advancing Islamic financial instruments as a strategy to invigorate local economies.

Then, The study by Bakhit et al. (2024) elucidates that Murabaha transactions have made a substantial contribution to the expansion of Al Rajhi Bank's business operations and have significantly enhanced its operational efficiency throughout the duration of the study. Next, The study by Abbasi & Aziz (2023) asserts that the contract of commodity Murabaha fails to satisfy the requisite conditions for a valid sale, rendering it impermissible under Shariah law. Numerous additional factors contribute to its prohibition. The execution of commodity Murabaha transactions occurs through an exceedingly rapid exchange process, resulting in thousands of sales being executed within mere minutes via electronic means. Such contracts often lack realism, as the actual delivery of commodities to the buyer is rarely realized. Furthermore, in commodity markets, the precise specification of commodities proves infeasible due to the aggregation of thousands of tons within a single warehouse, leaving uncertainty regarding the volume of transactions associated with any given commodity. The inclusion of commodities in this contractual framework serves as a circumventive mechanism to facilitate financing at an inflated cost. Even in instances where Tawarruq and commodity Murabaha transactions are conducted correctly and all Shariah stipulations are adhered to, the societal ramifications are profoundly detrimental, particularly concerning Islamic Banking.

Next, The study by Arfionita & Sa'adati (2023) concludes that BOPO exerts a positive and statistically significant influence on murabaha financing. In contrast, both FDR and CAR demonstrate no discernible effect on murabaha financing. Furthermore, the outcomes of the MRA test reveal that Third Party Funds do not possess the capacity to moderate the relationship between FDR, CAR, BOPO, and murabaha financing. Then, Research conducted by Audria & Adinugraha (2023) concludes that in the execution of murabaha contracts for buying and selling, it is imperative that both parties comprehend the agreed-upon benefits, and the element of usury is strictly prohibited. The implementation of such contracts must satisfy the foundational pillars and conditions as prescribed by sharia principles. The goods that are traded must not fall within categories that are deemed impermissible according to Islamic law. However, it is noteworthy that there exist certain modifications in the execution of the murabaha contract that have been made in relation to its application.

Next, The study by Mamlouk (2022) indicates a significant correlation between the efficiency of murabaha financing and the return on assets within Islamic banks operating in Syria, which serves as a positive indicator of the heightened demand for murabaha financing, consequently enhancing the volume of investments and assets of the bank, thereby reflecting in the anticipated future returns. Furthermore, the research identifies a statistically significant influence of murabaha financing on the return on equity in Islamic banks within the same operational context in Syria. This suggests that the bank possesses the capacity to effectively utilize its assets; however, the efficiency of murabaha financing does not exert a considerable impact on the financial performance of Islamic banks in Syria. This can be attributed to the fact that robust policies concerning murabaha financing directly promote an increase in bank profits, as well as influence the financing strategies of the bank. Then, The investigation conducted by Walisma (2023) determines that the execution of the murabaha contract at the BSI Nagan Raya 2 sub-branch office adheres to several stipulations pertaining to pillars, conditions, and contractual agreements.

Research Methodology

This academic inquiry employs a library research methodology utilizing a descriptive analytical approach. The primary source of data for this study consists of secondary data, specifically the book "Introduction to Islamic Banking and Finance" authored by Kettell (2011).

Results and Discussion

Use of an Interest Rate as a Benchmark

Numerous institutions engaged in financing through Murabaha establish their profit or mark-up based on the prevailing interest rate. This practice frequently faces criticism on the grounds that profits derived from an interest rate should be deemed impermissible as they constitute interest itself.

Undoubtedly, the application of the interest rate for determining a permissible profit is not regarded as favorable. It certainly renders the transaction reminiscent of interest-based financing, at least superficially. Considering the gravity of the prohibition against interest, even this superficial similarity should be evaded to the greatest extent possible. However, it is crucial to recognize that the most essential requirement for the validity of Murabaha is that it constitutes a genuine sale accompanied by all requisite Islamic elements and consequences.

If a Murabaha transaction meets all stipulated conditions, the mere utilization of the interest rate as a benchmark for determining the profit of the Murabaha does not invalidate the transaction, nor render it haram or prohibited, as the transaction itself does not encompass interest. The interest rate has merely been employed as a reference or benchmark.

Gharar Issues

A significant concern within the framework of Murabaha financing, which has provoked extensive discourse among contemporary Sharia scholars, pertains to the inability of the bank or financier to engage in an actual sale at the moment the client requests Murabaha financing, as the requisite commodity is not yet possessed by the bank at this juncture. This matter elicits inquiries regarding what is referred to as gharar (contractual uncertainty). According to Sharia principles, it is impermissible for an individual to sell a commodity that is not owned by the prospective seller, nor can the financier execute a forward sale. Consequently, the bank is obligated to procure the commodity from the supplier. Only after this acquisition can the bank subsequently sell it to the client once it has secured either physical or constructive possession of the commodity.

The dilemma for the financier arises in the scenario where the client is not legally bound to acquire the commodity subsequent to the financier's procurement from the supplier. This circumstance may result in the financier incurring substantial costs to obtain the commodity, only to encounter the client’s refusal to proceed with the purchase. The nature of the commodity may be such that it attracts no alternative buyers in the marketplace, thus complicating the financier’s capacity to liquidate the asset. In such instances, the financier may endure a significant and unacceptable financial detriment.

To address this predicament, a solution is sought within the Murabaha framework by requiring the client to execute a promise to purchase the commodity upon its acquisition by the financier. This arrangement deviates from a bilateral contract typically associated with a forward sale and manifests as a unilateral promise from the client, thereby binding the client rather than the financier. As a one-sided commitment, it distinguishes itself from a bilateral forward contract.

Nevertheless, this resolution must be considered in light of the critique that a unilateral promise engenders a moral obligation, yet lacks enforceability through Sharia-compliant judicial mechanisms. This raises the pertinent question of whether a unilateral promise holds enforceability within the Sharia. The prevailing consensus among numerous scholars suggests that it does not. However, it is essential to scrutinize this perspective through the lens of the foundational texts of Sharia.

A comprehensive examination of the pertinent literature within the domain of Islamic jurisprudence would reveal that the fuqahah (Muslim Jurists) maintain divergent opinions on this matter. A substantial number of scholars assert that honoring a promise constitutes a virtuous trait, advocating that the promisor should adhere to it, while its breach is considered blameworthy; however, it is neither obligatory nor subject to enforcement through legal channels. This perspective is attributed to Imam Abu Hanifah, Imam al-Shafii, Imam Ahmad, and certain Maliki Jurists. Conversely, numerous other Hanafi, Maliki, and select Shafii Jurists do not share this viewpoint.

Collateral Provisions Against the Murabaha Payment

A significant concern pertaining to Murabaha financing pertains to the deferred nature of the Murabaha payment. The seller or financier, understandably, seeks to ensure that the payment will be remitted by the due date. To this end, he may require the client to provide an acceptable form of security. Such security may manifest in the form of a mortgage, hypothecation, or an alternative lien or charge. This prompts the inquiry as to whether the security can be justifiably claimed when the transaction has engendered a liability or debt. The Sharia principle governing this matter stipulates that security cannot be solicited from an individual who has not incurred a liability or debt. The Murabaha financing procedure encompasses various transactions executed across distinct stages, as previously elucidated.

During the initial stages of this procedure, the client does not assume a debt obligation. It is only subsequent to the sale of the commodity to the client on credit by the financier that the creditor-debtor relationship is established. The appropriate course of action in a Murabaha transaction dictates that the financier request security only after he has formally sold the commodity to the client and the payment obligation has matured, as it is at this juncture that the client incurs a debt. Nevertheless, it is permissible for the client to provide security at earlier stages, conditional upon the determination of the Murabaha price. In such instances, should the security be held by the financier, the risk associated with it remains with him. Consequently, if the commodity is rendered inoperative prior to the formal sale to the client, the client will be compelled to either remit the market price of the mortgaged asset and annul the Murabaha agreement or to sell the requisite commodity to the client and deduct the market price of the mortgaged asset from the proceeds of the transaction.

Guaranteeing the Murabaha

In the context of Murabaha financing, the seller may also require the purchaser or client to obtain a guarantee from a third party. In the event of default concerning the payment at the stipulated due date, the guarantor will assume the obligation to remit the amount guaranteed by him. However, the Sharia regulations concerning guarantees, as delineated in the corpus of Islamic Fiqh, impose specific and stringent constraints associated with such guarantees, which are not to be undertaken lightly.

Penalty of Default

Murabaha constitutes a sale transaction, regardless of the payment modality, with the sale price being predetermined. Consequently, if a client fails to fulfill the payment obligation by the due date, the sale price remains immutable. This presents a significant challenge in Murabaha financing, as a defaulting client is not subjected to an escalation of the sale price. In contrast to interest-bearing loans, where the principal amount escalates in accordance with the duration of the default period, Murabaha financing maintains a fixed price post-agreement. This Sharia-compliant stipulation is occasionally manipulated by unscrupulous clients who intentionally postpone their payments, cognizant that they will not incur any supplementary charges due to default.

Diverging from conventional financial practices, the notion of compensation in such scenarios is largely repudiated by contemporary Sharia scholars. It is their well-founded assertion that the principle of compensation is incongruent with Sharia tenets and fails to address the issue of default effectively. Proponents of imposing compensation contend that the Prophet condemned individuals who procrastinate in settling their debts without justifiable reasons. According to an established Hadith, he declared: The affluent individual who postpones the settlement of his obligations exposes himself to retribution and dishonor.

The underlying premise of this argument is that the Prophet sanctioned the imposition of punitive measures on such individuals. These punitive measures may encompass various forms, including the levying of a financial penalty. However, this argument neglects the critical point that, even under the assumption that the Sharia permits the imposition of fines or monetary penalties, such penalties must be adjudicated by a competent court of law and are typically remitted to the state. It is exceedingly rare for a wronged party to unilaterally impose a penalty for personal gain absent a judicial ruling. Consequently, this gives rise to an incentive for debtors within the context of Murabaha to default, thereby underscoring the necessity for guarantees and collateral provisions as a form of security.

Upon timely repayment of the financing, the transaction is deemed concluded. In instances of delayed repayment, scholars assert that, given the nature of the transaction as a sale and purchase, the seller is precluded from claiming any amount exceeding the pre-agreed price. Nevertheless, to deter intentional delays by clients, numerous banks impose a penalty for breach of commitment, commensurate with the average return rate of the bank's Mudaraba accounts, with the stipulation that the proceeds be allocated for charitable endeavors and qard al hasan (benevolent loans). It is important to note that no punitive interest, akin to that typically levied by conventional banks, is applied, nor is the penalty clause articulated in the Murabaha Agreement enforced should the delay arise from circumstances beyond the client's control.

Exploitation Issues

It is widely acknowledged that certain factions have deliberately capitalized on this Sharia'a restriction, fully cognizant that their obligation to repay an Islamic bank will remain unchanged, notwithstanding any postponement in repayment. The issue concerning the Murabaha contract, as delineated by contemporary Jurists, is their reluctance to assign a distinct value to the deferral component of the price. Consequently, if an individual procures an asset at a deferred price on the initial day, payable over a span of ten years, and subsequently declares bankruptcy on the following day, the individual becomes accountable for the entire amortized purchase price, despite the fact that only one day has transpired since the inception of the contract. In contrast, under conventional financing frameworks, the individual would be liable solely for one day's interest, rather than ten years' worth of interest, as would be the scenario when evaluating a deferred price independently of the temporal element. In a resolution enacted by the Organisation for Islamic Conference (OIC) Fiqh Committee, it was stipulated that in such circumstances, the involved parties may negotiate the debt to a discounted rate post-bankruptcy, yet are prohibited from reaching an agreement prior to bankruptcy in accordance with an amortization schedule.

This particular scenario culminates in a bilateral monopoly, affording the creditor unwarranted leverage not only over the debtor but also in relation to other creditors whose debts are of a shorter duration, thereby permitting long-term debtors to secure a more substantial claim on the bankrupt's estate than they would normally be entitled to. Paradoxically, if a mandate for immediate repayment is enforced upon bankruptcy without discounting the debt to present value, the creditor might, in certain instances, find it more advantageous for the debtor to declare bankruptcy.

No Roll-Over in Murabaha

In the realm of interest-based financing, should a bank customer find themselves unable to fulfill their payment obligation by the due date for any reason, they may solicit the bank to extend the financing facility for an additional term. This option is commonly referred to as a roll-over. If the bank consents, the facility is rolled over under the terms and conditions that are mutually established at that juncture, whereby the newly negotiated interest rate is applied to the new term. The practical implication of this process is that an additional loan of equivalent amount is re-advanced to the borrower.

Conversely, a Murabaha transaction cannot be extended for an additional period. Murabaha is characterized not as a loan, but as the sale of a commodity for which the price is deferred until a specified date. Once the commodity has been sold, its ownership is transferred to the client, thus ceasing to be the property of the seller. The legitimate claim of the seller is restricted to the agreed-upon price, which has now become a debt owed by the buyer. Therefore, the prospect of conducting another sale on the same commodity between the same parties is unequivocally precluded. Any attempt at rolling over a Murabaha arrangement, it is contended, would essentially constitute pure interest, as it involves an agreement to impose an additional charge on the debt engendered by the Murabaha sale.

Rebate on Earlier Payment

Occasionally, a debtor may express a desire to fulfill their payment obligation prior to the predetermined due date. In such instances, the debtor typically seeks to obtain a reduction on the previously agreed-upon deferred price. The pertinent inquiry is whether it is permissible to grant the debtor a rebate for the act of early payment.

This inquiry has been extensively examined by classical Jurists. The matter is recognized within Islamic legal literature and is translated from Arabic as 'offer the discount and receive promptly.' The predominant view among Muslim Jurists, encompassing the four established schools of Islamic jurisprudence, is that such a rebate is not permissible if it is contingent upon the act of early payment.

In a Murabaha transaction executed by an Islamic financial institution, such a rebate cannot be incorporated into the contractual agreement, nor can the client assert it as an entitlement. Nevertheless, should the bank or financial institution voluntarily extend a rebate to the client, such an action is not considered objectionable, particularly in cases where the client is in a state of financial need. For instance, if a financially constrained farmer has acquired a tractor or fertilizer through a Murabaha arrangement and wishes to repay the loan early, it is advisable for the bank to extend a voluntary discount.

Subject Matter of Murabaha

Any commodities that can serve as the subject matter of a sale with a profit motive are eligible to be the subject matter of Murabaha, as it constitutes a specific category of sale. Conversely, transactions involving items that cannot be the subject matter of sale are excluded from the Murabaha framework. For instance, Murabaha cannot be executed in the context of currency exchanges, as such transactions must occur spontaneously or, if deferred, at the exchange rate that is applicable on the transaction date. Likewise, commercial paper, which represents a receivable debt for the holder, cannot be transacted except at its par value. Consequently, no Murabaha transactions can be conducted with respect to such commercial paper. Any commercial instrument entitling its holder to receive a specified monetary amount from the issuer cannot be traded; the only permissible method of sale is via transfer at face value. The implication is that this category of commercial paper is not amenable to Murabaha transactions.

Rescheduling of the Payments in Murabaha

In circumstances where the purchaser or client engaged in Murabaha financing is unable to fulfill their payment obligations in accordance with the dates stipulated in the Murabaha agreement, they may petition the seller or bank for a rescheduling of the payment installments. In conventional banking practices, loans are typically rescheduled with the imposition of additional interest. However, this practice is not applicable to Murabaha payments. Should the installments be rescheduled, no supplementary charges may be levied for this adjustment. The Murabaha pricing must remain unchanged.

Securitisation of Murabaha

Murabaha represents a type of transaction that is inherently incompatible with the process of securitisation, thus hindering the creation of a negotiable instrument that could be transacted within the secondary market. This conclusion is substantiated by the preceding analysis. In the event that the purchaser or client engaged in a Murabaha transaction executes a financial document to manifest his obligation to the seller or financier, such documentation will signify a monetary debt owed by him. In essence, it encapsulates funds that are due from him. Consequently, the assignment of this commercial paper to a third party would entail the conveyance of financial liabilities. As previously articulated, when currency is exchanged for currency (denominated in the same unit), the transaction must occur at its nominal value. The commercial paper is prohibited from being transacted at any price deviating from this nominal value. Consequently, the commercial paper that embodies a financial obligation, which emanates from a Murabaha transaction, is precluded from constituting a negotiable instrument. Should the commercial paper undergo transfer, it is imperative that this occurs at its nominal value.

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