

The Principles and Practices of Shariah in Islamic Finance

Shariah Parameter Reference 1

MURABAHAH



BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

Principles and Practices of Shariah
in Islamic Finance

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The Principles and Practices of Shariah in Islamic Finance is a collection of a series of reference documents known as the Shariah Parameter Reference. This document is issued by Bank Negara Malaysia (BNM) to further enhance the understanding on the principles and basis of Shariah contracts and to promote standardisation and harmonisation of Islamic financial practices.

This document serves as a standard for Shariah contracts. The principles and practices included in this document aims to achieve the following objectives:

- i) clarify the concepts, principles and conditions of Shariah contracts and practices;
- ii) provide focus on the features of Shariah contracts and concepts that form the basis of Islamic financial products and services;
- iii) provide the basis for decisions on matters relating to conditions, mechanism and implementation of Shariah contracts or concepts;
- iv) facilitate Islamic finance professionals and practitioners in designing and developing Islamic financial products and services; and
- v) facilitate the formulation of policies and guidelines on Shariah contracts and concepts adopted by the Islamic financial services industry.

In general, this document assists users to understand the nature of a particular Shariah contract and practices by understanding the definition, its rationale and purpose.

In ensuring the completeness of the document, BNM had initiated a robust consultation process and conducted research including compiling various *fatwas*, and incorporating views of several local and foreign Shariah boards. The document was then presented before the Shariah Advisory Council of Bank Negara Malaysia (SAC), before circulating it as a concept paper to the industry, academia and relevant parties including international bodies for feedback and comments.

It is envisioned that The Principles and Practices of Shariah in Islamic Finance will be a useful reference to various stakeholders of Islamic finance such as practitioners, policy makers, scholars, academia, students and consumers. Future series will include principles and practices on *Ijarah*, *Mudharabah*, *Musharakah*, *Istisna'* and *Wadiah*.

Shariah Advisory Council
of Bank Negara Malaysia

The Shariah Advisory Council of Bank Negara Malaysia

The Shariah Advisory Council of Bank Negara Malaysia (SAC) was established in May 1997 as the highest Shariah authority for Islamic finance in Malaysia. Among the SAC's primary objectives are:

- i) to ascertain the Islamic law on any financial matter and issue a ruling upon reference made to it in accordance with Islamic financial business; and
- ii) to advise BNM on any Shariah issue relating to Islamic financial business.

The SAC is entrusted with the authority to ascertain the Islamic law for the purposes of Islamic banking business, *Takaful* business, Islamic financial business, Islamic development financial business, or any other business which is based on Shariah principles undertaken by entities supervised and regulated by BNM. In addition, the SAC also acts as a reference body and advisor to BNM on Shariah matters pertaining to Islamic financial business.

Its members comprise of prominent Shariah scholars, jurists and market practitioners. Members of the SAC are qualified individuals, and collectively have vast experience in the application of Shariah principles and practices in Islamic banking and finance, economics and law.

Members of Shariah Advisory Council of Bank Negara Malaysia 2008/2010

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Section 1: Background and Preamble

1. *Murabahah* is a form of trust-sale that aims to finance acquisition of assets on short or long term basis. In a classical *Murabahah* practice, no financial intermediaries are involved and the customer would purchase an asset from the supplier on cost plus mark-up basis. Payments are made either on a deferred or cash basis. The asset would have already been owned by the supplier and the purchase price is a mark-up price which is made known before the transaction. In modern Islamic financial practice, *Murabahah* sale established itself as a mode of asset financing with an agreed and known mark-up. Being the most prevalent financing mechanism in Islamic finance, the *Murabahah* sale instrument has provided a Shariah-compliant alternative to interest-based financing mechanisms. The *Murabahah* contract has also been applied for deposit taking and issuance of sukuk.
2. The development of *Murabahah* from a sale-based transaction to a financial instrument has raised a number of issues in the local and international market practices. The benefit of a parameter is to provide a more comprehensive and complete understanding of the nature and features of *Murabahah* contracts as a guidance to all finance practitioners, finance professionals, academicians, scholars and regulators. Detailed references to specific Shariah *fatwas*, opinions and standards would facilitate scholars in Islamic finance to expound further the systematic development of Islamic financial products that adopt the *Murabahah* contract.

Section 2: Purpose and Scope

3. The purpose of this Shariah contract parameter for *Murabahah* is to provide reference on the nature and features of the contract to the Islamic financial services industry. This parameter is endorsed by the Shariah Advisory Council of Bank Negara Malaysia (SAC). Specific definition and guidelines on the basis of legitimacy in adopting the *Murabahah* contract are described to facilitate the understanding of the Shariah contract requirements. The features identified in this parameter shall serve to assist the Islamic financial services industry to identify, understand, apply and distinguish the contract from other contracts prevalent in the industry.
4. The features identified and described in this parameter are extracted from the text of *fatwas* opined by Shariah boards or committees of financial authorities and institutions. For each of the *fatwa* on a particular conditionality, activity, situation or context relating to the contract, the underlying concept and principle is deduced and synthesized to guide the development of the Shariah parameter.
5. The features outlined in this parameter may serve as general guidance for the application of *Murabahah* contract. Any practice by the Islamic Financial Institutions (IFI) which is not specified in the parameter can be conducted as long as it does not contradict the features outlined in the parameter.
6. This parameter also takes into consideration relevant mechanisms and contracts such as *Wa'd*, *Wakalah*, *Kafalah* and *Rahn*, where relevant. These are identified and proposed as secondary features mentioned in this parameter.
7. The scope of the parameter is confined to the *Murabahah* contract as endorsed by the SAC and adopted by the IFI under the purview of Bank Negara Malaysia (BNM).

Section 3: Definition

Murabahah is a sale of an asset at cost plus a known mark-up

8. *Murabahah* comes from the word *ribh* which means increase. Technically, *Murabahah* is the mark-up disclosed to the purchaser as per the seller's purchase price for a trust-sale of a certain specified asset, excluding monetary assets such as cash and receivables. *Murabahah* sale may be contracted on cash or credit basis.
9. In the Islamic financial services industry, *Murabahah* is adopted in a transaction known as *Murabahah* to the Purchase Orderer (MPO) whereby three parties are involved, namely the IFI, the supplier and the purchase orderer. The *Murabahah* credit sale of a specified asset by an IFI to the purchase orderer is at a disclosed mark-up price based on the IFI's cost of financing the purchase.

Murabahah to Purchase Orderer for asset-financing and not cash financing purposes

10. For the purpose of this parameter, the technical definition of *Murabahah* is *Murabahah* to the Purchase Orderer. This *Murabahah* parameter is meant for the purpose of financing acquisition of assets. As such, *Bai' Inah* and *Tawarruq* are not within the scope of this parameter.

Illustration 1: *Murabahah* Financing

A purchase orderer applies to an IFI for car financing under a *Murabahah* sale contract. The IFI does not have the car but will, upon the promise of the purchase orderer to purchase the car on a mark-up basis, purchase the car from a third party, i.e. the supplier. The IFI purchases the car from the supplier, then, sells it to the purchase orderer on a deferred payment basis. The difference between the purchase price paid by the IFI to the supplier and the sale price that the IFI is selling to the purchase orderer is a mark-up for the IFI. For example, the financier purchases the car from the supplier at RM100,000 and sells on credit to the purchase orderer at RM120,000 payable in 5 years. While the supplier earns trading profit, the financier earns the financing profit through a mark-up sale.

11. Essential pillars of a sales contract, which are:
 - (i) legal capacity of contracting parties;
 - (ii) offer and acceptance;
 - (iii) lawful and existing subject matter; and
 - (iv) price known with certainty, apply to the MPO.

12. From an operational perspective, MPO involves four significant components, which are:
 - (i) customer order with *Wa'd* or promise to purchase;
 - (ii) acquisition at known and agreed cost;
 - (iii) sale at mark-up; and
 - (iv) deferred payment. However, various other applications of MPO may be formalized based on the specified technical definition of MPO.

Section 4: Legitimacy of *Murabahah* Contract

Basis of legitimacy

13. The legality of *Murabahah* is deduced from the *Quran*, the *Sunnah* of the Prophet Muhammad (SAW), the consent of the majority of Muslim jurists and *Qiyas* (analogy).

4.1 The *Quran*

General permissibility of sale in the Quran

14. The *Quran* generally allows the sales contract. Among others, the *Quran* says to the effect that "...and Allah permitted trade and prohibited usury" (2:282).

4.2 The *Sunnah* of The Prophet Muhammad (SAW)

General permissibility of sale in the Sunnah

15. There is no direct juristic authority from the *Sunnah* of the Prophet (SAW) on the legitimacy of *Murabahah* sale. It is deemed permissible based on the general permissibility of sale in Islamic law. The Prophet Muhammad (SAW) was reported to have said: "The best earning is what man earns with his own hands and from a permissible trade" (Narrated by Hakim).

4.3 The Consent of The Majority Muslim Jurists

Consent of majority Muslim

16. Islamic jurisprudence literatures indicate that the legitimacy of *Murabahah* is based on the consent of the majority Muslim jurist.

4.4 Analogy (*Qiyas*)

Analogy on the permissibility of Tawliyah sale

17. Since the Prophet Muhammad (SAW) has approved the *Tawliyah* sale (sale based on cost price), the sale on mark-up will be equally permissible on the basis of analogy on the *Tawliyah* sale. The determination of cost and making the cost known to the buyer are common in both the *Tawliyah* and *Murabahah* sale.

Section 5: Features of *Murabahah* Contract

18. *Murabahah* is a contract that comprises several principal features namely:

- (i) price of *Murabahah* sale;
- (ii) asset of *Murabahah* sale;
- (iii) duty of full disclosure of cost and profit; and
- (iv) *Wa'd* (promise) to buy.

Price, asset, disclosure of cost and Wa'd

5.1 Price of *Murabahah* Sale

19. The *Murabahah* sale price shall be determined based on the disclosed acquisition cost with an added mark-up amount or percentage to be determined prior to the conclusion of the *Murabahah* contract.

Murabahah sale price consists of original cost plus a mark-up

20. The mark-up, in the form of an absolute amount or a certain percentage of acquisition cost shall be determined and specified before the conclusion of the *Murabahah* contract. Any benchmark adopted to determine the mark-up shall be specified.

Determination of mark-up

21. The determination of the mark-up may either be based on an agreed percentage of acquisition cost or specified amount for a known and agreed currency.

Certainty of mark-up

22. The agreed mark-up that is determined shall not be subjected to price variation or affected by currency fluctuation as payment due is pre-determined at agreed currency.

Pre-determined fixed mark-up

23. Any mutually agreed benchmark, including but not limited to conventional financial benchmark such as the Base Lending Rate (BLR), may be used to determine the mark-up in the *Murabahah* contract.

**Illustration 2: BLR as Benchmark for Determining
Murabahah Mark-up**

XYZ Bank is an IFI operating in a dual banking system where conventional banking offers similar financial services to the same pool of customers. The BLR of the industry is quoted at 3%. The IFI assesses the expectations of investment and non-investment account holders which are found to be 3.5% in lieu of BLR. In this respect, the pricing of *Murabahah* financing may take into consideration the BLR as the base rate, as a form of competitive price determination.

24. IFI may set the mark-up in a selling price as a ceiling rate for a periodic rebate in instalment payment which is determined based on a mutually agreed benchmark, specified at the inception of the sale.

Illustration 3: Variation of Mark-up

An IFI provides a *Murabahah* working capital financing facility to its customers. Customer A requests the IFI to finance the purchase of foodstuff with a shelf life not exceeding 3 months. IFI agrees to purchase from the supplier in cash and sell to the customer on credit, based on *Murabahah* contract with a mark-up of 10% of the purchase price, to be paid in full at the end of three months. On the other hand, Customer B requests IFI to finance regular purchase of motor vehicle spare parts on demand basis with an inventory turnover that varies between three to six months. IFI agrees to purchase in cash from distributor and sell to the customer on credit, based on the *Murabahah* contract. The mark-up takes into consideration credit risk factors including customer type, goods and period of financing. The mark-up ranges from 8% to 12% depending on the types of spare parts and terms of financing. The different mark-up may be applied because the *Murabahah* contract for each customer is separately executed.

25. In an agreement where several *Murabahah* contracts are separately concluded and executed, each *Murabahah* contract mark-up may be priced differently.
26. If several commodities in several *Murabahah* contracts are sold to the same purchase orderer, the total acquisition cost plus the total mark-up may be stated in one clause in the Master agreement, provided that the details of each asset's acquisition cost and mark-up must be appended to each sales contract.

27. At the time of concluding a *Murabahah* contract, both the IFI and purchase orderer may mutually agree to vary the financing tenure and adjust the mark-up that was initially promised in the *Wa'd* undertaking.

Illustration 4: Variation in the Original *Murabahah* Terms

A customer's order to purchase equipment estimated at RM50,000 for a financing period of 5 years is specified and promised to an IFI. IFI agreed to finance the order at 10% mark-up as per the order. Upon acquisition, the actual price of purchase is RM60,000 and both the customer and IFI renegotiate the term and mutually agree that IFI will finance through *Murabahah* at 10% for a period of 6 years to enable the customer to meet regular instalment payments of RM11,000 per year.

28. The acquisition cost, which forms the cost portion of the *Murabahah* price may include direct expenses which refer to costs incurred to enable the acquisition of goods by the IFI and delivery of the goods to the customer. This includes expenses such as transportation, storage, assembly, taxes, insurance or *Takaful* or any valid expenses established by customary practice.
29. Indirect expenses such as staff wages, labour charges, which are not part of the cost of acquisition, shall not be included in the acquisition cost.

30. Cost of services integral to an asset such as installation cost may form the cost portion of the asset acquired.

Illustration 5: Cost of Services Rendered as Part of Cost Price

A customer seeks IFI financing to acquire and install machinery valued at RM1.2 million. The supplier of the factory plant and machinery provides the components to be assembled at the customer's factory site. Assembly and customization services cost an additional RM300,000. With the given cost structure and a mark-up of RM500,000, the IFI's *Murabahah* selling price is RM2 million for a 3-year financing period for the components, assembly and customization of the plant and machinery to be installed at the customer's site.

31. Whenever a purchase order involves a transaction requiring the issuance of a Letter of Credit (LC), commission for issuing the LC shall not be part of the acquisition cost. The IFI may include the commission as part of the total selling price.
32. Upon acquisition of an asset and until the ownership is transferred to the purchase orderer, the IFI is liable for the asset, and may obtain *Takaful* coverage on the asset acquired before selling it to the purchase orderer. The *Takaful* contribution paid by the IFI may be added to the cost of acquisition.

*Inclusion
of Letter of
Credit's fee
in selling
price*

33. Alternatively, the two parties may negotiate to exclude *Takaful* contribution from the cost and be charged separately.

Illustration 6: Inclusion of *Takaful* Charges for *Murabahah* Financing

An IFI finances a customer for the purchase of a property valued at RM250,000 at a mark-up of 10% per annum for a period of 10 years. Hence, the *Murabahah* selling price is RM500,000 if a straight-line method of calculation is used. In addition, the customer is required to insure the property against fire as well as to take up a Mortgage Reducing Term *Takaful* (MRTT). Both parties agreed that the *Takaful* contribution shall be paid separately by the customer to the *Takaful* operator via the IFI. The contribution paid to the *Takaful* operator for fire insurance and MRTT shall be additional costs borne by the customer in addition to the selling price.

34. Any additional direct expenses not specified in the agreement relating to a *Murabahah* contract which is incurred post-conclusion of the *Murabahah* contract shall be borne by the customer, provided that such a clause to that effect is already incorporated in the contract. These additional charges, however, shall not be taken into consideration in determining the *Murabahah* sales mark-up.

Illustration 7: Additional Cost of the *Murabahah* Contract

An IFI has fulfilled its contractual obligations with a purchase orderer by purchasing empty shipping containers. However, the purchase orderer failed to claim his assets on the stipulated delivery date, causing the IFI to incur additional port expenses. Empty containers located inside the port have a grace period of 10 days, after which charges of USD1,000 per day will be levied. The aforementioned charges are to be borne by the purchase orderer after being notified of the arrival of his shipment. These extra charges should not be part of the cost price.

35. IFI may levy a service charge for additional services rendered by IFI as requested by the purchase orderer such as to conduct a feasibility study on business needs.

36. Any discount on cost of acquisition obtained upon purchase by IFI shall be reflected as a reduction in the acquisition cost.

Illustration 8: Discount Benefit to Purchase Orderer

A supplier offers a 10% trade discount to its purchasers for any purchase worth RM50,000 and above. The IFI, based on the promise by the purchase orderer, purchases an asset worth RM50,000 from the supplier. The client, being the purchase orderer, subsequently purchases the asset from the IFI at RM50,000 with a mark-up of 20% via a *Murabahah* contract. Although there is no contractual relationship between the supplier and the purchase orderer, the latter should enjoy the benefit of this discount. Without the discount, the *Murabahah* sale price payable by the client is (1.2 X RM50,000) RM60,000. However with the 10% discount, the *Murabahah* sale price payable by the client is (1.2 X RM45,000) RM54,000.

37. Any asset purchased in local or foreign currency by an IFI may be sold to the purchase orderer in any other agreed currency. The acquisition cost shall be based on the exchange rate on the day IFI purchases the asset from supplier.

Purchase of asset by IFI in foreign currency

Illustration 9: The Effect of Currency Volatility on Murabahah Transactions

On the order of its client, the IFI purchases a car from France for an amount of USD50,000 to finance the client for *Murabahah* car financing at an agreed mark-up of 10% in Malaysian currency. On the purchase day, the exchange rate was USD1 to RM3.50, but on the day of the sale of the car to the purchase orderer, the Dollar has depreciated to RM3.20. In principle, this depreciation has no effect on the *Murabahah* sale contract, and the payment should be made according to the rate prevailing on the day the IFI purchased the asset from the supplier. The *Murabahah* selling price payable by the client is $(1.1 \times \text{USD}50,000 \times 3.5)$ RM192,500.

38. The IFI may reward a purchase orderer who honours the terms of the *Murabahah* contract by waiving part of the price.
39. The IFI and the purchase orderer may agree to make settlement in a currency which is different from the currency specified in the contract at the prevailing exchange rate on the day of payment.

Rewarding the purchase orderer for good payment

Full settlement of debt in a different currency

40. Rescheduling of debt in another currency is not permissible. However, full settlement of outstanding debt in another currency is permissible and it shall be executed based on the exchange rate of the settlement date.

Illustration 10: Settlement of *Murabahah* in Another Currency

A purchase orderer currently owes an IFI a sum of Euro70,000 for a house financed under *Murabahah* sale two years ago. Given the fact that the purchase orderer's income is paid in US dollars, and being mindful of exchange rate risk exposure, the purchase orderer requested the IFI to fully settle his debt in USD instead of Euro. The exchange rate during the time of concluding the contract was Euro1 to USD1.10, but at the time of the proposed full settlement of the debt, the rate rose to USD1.20. The amount to be settled in USD is converted at USD1.20 per 1 Euro which is USD84,000.

5.2 Modes of Payment

41. The IFI shall make payment directly to the supplier. Alternatively, such payment may be made through the purchase orderer who has been appointed as an agent of the IFI.
42. The IFI may consider, at the time of pre-payment or early settlement, waiving part of the outstanding payment in the form of a discount to the purchase orderer for settlement before the maturity date.
43. Alternatively, both the IFI and the purchase orderer may incorporate a pre-agreed clause in the contract for such a discount or rebate in the case of early settlement.

Direct payment of purchase or cost price to the supplier

Non-contractual discount on early payment

Contractual discount on early payment

Illustration 11: Determination of Settlement Amount

An Islamic bank provides *Murabahah* financing for the purchase of equipment that cost RM100,000. A 10% deposit was paid by the customer to the bank when the purchase order was made. The bank sold to the customer at RM117,614.36 for a financing period of 3 years at 12% per annum. The mark-up after deducting the deposit is RM17,614.36. The following table summarises the financial data.

Purchase Price	RM100,000.00
Deposit (10%)	RM10,000.00
Disbursement (90%)	RM90,000.00
Financing Rate (12% per annum)	
Period (36 months)	
Monthly Payment	RM2,989.29
Selling Price	RM117,614.36
Mark-up	RM17,614.36

At the end of 24 months the payment schedule is reported as follows:

Month	Payment	Income	Principal Balance	Deferred Profit
24	RM2,989.29	RM362.71	RM33,644.67	RM2,226.79

The customer wishes to settle the whole debt on the 24th month. The total amount payable including deferred profit is RM35,871.46. The bank may allow a rebate of RM2,226.79.

Rescheduling
of payment
schedule

44. The payment of the *Murabahah* may be rescheduled to suit the financial position of the purchase orderer or for any other reason except an increase in amount to the selling price due to the extension of time or market condition is not permissible.

5.3 Disclosure of Purchase Price (Trusteeship)

Cost
disclosure

45. The purchase cost of the asset payable by the IFI to the seller shall be disclosed to the purchase orderer before concluding the *Murabahah* contract. The cost shall include the purchase price and expenses related to the acquisition of the assets or goods.

Effect of
non-disclosure
of cost

46. The failure of the IFI to properly disclose the purchase price as cost to determine the mark-up to the purchase orderer shall render the *Murabahah* contract null and void ab initio.

Illustration 12: Intentional Misrepresentation of Purchase Price

An IFI agrees to provide *Murabahah* financing of RM150,000 for a vehicle at a disclosed cost of purchase of RM100,000 and mark-up of RM50,000. Additional information obtained by the customer from the supplier indicates that the cost of vehicle is RM90,000. The *Murabahah* contract is null and void ab initio due to the failure of disclosing the actual cost of purchase.

47. In the event where the purchase orderer is appointed as the agent of the IFI based on a *Wakalah* contract, where several quotations are given by the purchase orderer for the IFI to consider, the IFI shall clearly specify to the purchase orderer the quotation which the IFI has chosen.

Disclosure of specific quotation selected for the cost

Illustration 13: Disclosure of Purchase Price

A purchase orderer requested an IFI to finance a purchase of specified equipment. The purchase orderer who has specialized knowledge of the equipment was required by the IFI to provide several quotations of such equipment by different suppliers to ascertain a fair value of cost of purchase. Based on established industry standards of the equipment, the IFI agreed to purchase the specified equipment based on one of the few given quotations. The quotation thus becomes the purchase cost in the *Murabahah* sale to the purchase orderer. This selected quotation shall be disclosed to the purchase orderer.

48. The IFI shall disclose to the purchase orderer the mark-up to be added to the purchase price. The mark-up could either be a fixed amount or a percentage of the purchase price.
49. Any defect caused by force majeure in the asset which is discovered by the IFI or the purchase orderer before delivery of the asset shall be communicated to the other contracting party. Both the IFI and the purchase orderer may either mutually agree to adjust the terms of the contract or rescind it.

Defect disclosure

Eligible assets
for *Murabahah*

Assets for valid
and enforceable
sale

Legal or
beneficial
ownership
of asset

5.4 Asset

50. Assets such as traded goods, production materials, property, equipment and fixtures, and other intangible and non-monetary assets, are eligible assets for sale provided that they are not specifically prohibited in the *Quran* and *Sunnah* such as usurious items in the category of medium of exchange, liquor and flesh of swine.
51. Assets to be purchased for *Murabahah* sale shall be assets which are in existence, valid and can be considered for an enforceable sale. Assets under construction are not eligible for *Murabahah* sale.

Illustration 14: Invalid Assets for *Murabahah* Transaction

A customer requested an IFI to finance the purchase of an unoccupied property. Upon communication with the potential seller, it was found that the property was registered in the name of a foundation and is designated as *Waqf* property. Since *Waqf* property is meant for the society and not subject to commercial sale, financing for the identified property is not permissible and not valid from the view point of Shariah principle.

52. Asset meant to be sold to the purchase orderer on *Murabahah* basis shall be legally and/or beneficially owned by the IFI prior to the *Murabahah* sale to the customer.

53. Physical possession or constructive possession by the seller of an asset is required for the asset to qualify for a *Murabahah* contract. Constructive possession shall be proven via existence of physical evidence of effective transfer or receipts such as warehouse receipt, etc.

Physical or constructive possession of asset by the supplier

Illustration 15: Constructive Possession of *Murabahah* Asset by IFI

An IFI receives a customer's application for financing to purchase goods worth RM150,000 to be delivered to the customer's warehouse with a purchase undertaking. Based on the promise, the IFI disbursed payment to the supplier upon receipt of the third party warehouse certificate as evidence of constructive possession that the goods have been received. The IFI then executes the *Murabahah* sale at a mark-up price of RM200,000 to the customer, payable in 3 months' time. The customer immediately accepts delivery since the goods are available in the customer's warehouse as specified.

54. Transfer of ownership from the IFI to the purchase orderer shall take place upon execution of the *Murabahah* contract and this could be manifested by way of abandoning the right of ownership (*takhliyah*) by the IFI or enabling the purchase orderer to make full use of the asset, assuming full liability (*tamkin*).

Transfer of ownership to the purchase orderer

55. The *Murabahah* sale shall exclude any sale of currencies and debt for a deferred payment.

Murabahah sale excludes currencies and debt

Shares as
subject
matter of
Murabahah

56. Shariah-compliant shares may be made as asset of a *Murabahah* transaction.

Illustration 16: Purchase of Shares as a *Murabahah* Transaction

An entrepreneur, seeking funding to purchase certain Shariah-compliant stocks, draws up a *Murabahah* contract with an IFI to purchase for him shares at RM10 per share. After buying the shares, the IFI sells them to the entrepreneur at a mark-up price of RM12 per share.

Intellectual
properties
as subject
matter of
Murabahah

57. Intellectual properties such as trademarks, brands, patents and copyright, also qualify as assets of *Murabahah* transaction.

Illustration 17: Purchase of Goodwill as a *Murabahah* Transaction

A customer seeks financing from an IFI to purchase a brand name of a distributor known as "Fitforall" valued at RM500,000 that will enable the customer to be part of the retail chain to sell the goods under the brand name. The brand provides product quality assurance to existing and potential brand-loyal customers, as well as an established international distribution network. The IFI may purchase the brand name and sell it to the customer at a mark-up price of RM750,000 to be paid over a period of 5 years.

Usufruct
as subject
matter of
Murabahah

58. Usufructs such as air tickets qualify as assets to be purchased and sold on *Murabahah* basis.

59. A *Murabahah* sale shall not take effect between the same contracting parties on the same asset. The revolving facility using *Murabahah* contract may involve separate contracts on different assets between the same contracting parties.

Illustration 18: *Murabahah* Revolving Facility

A master *Murabahah* agreement to provide a working capital financing facility at a mark-up of 10% per annum for a period of 2 years was agreed between IFI and its customer in January 2007. The following transactions were effected in the first year as follows:

- a. *Murabahah* financing of RM250,000 worth of office equipment at RM25,000 mark-up was transacted in February 2007 to be paid 12 months later.
- b. *Murabahah* financing of RM150,000 worth of office supplies at RM15,000 mark-up was transacted in April 2007 to be paid 12 months later.
- c. Payment of RM262,500 was made to settle the *Murabahah* financing of RM250,000 with 50% rebate on mark-up. The payment was received six months earlier in August 2007.
- d. *Murabahah* financing of RM350,000 worth of fixtures at RM17,500 mark-up was transacted in September 2007 to be paid in 6 months.

In April 2008, full payment was received for financing in April 2007 (transaction b) but there was a request for the transaction in September 2007 (transaction d) to be rescheduled. Thus the fixtures were bought and sold again at the same mark-up to the customer. This transaction does not comply with *Murabahah* requirements. The purchase and resale of the fixtures to the customer to reschedule the financing is prohibited as it involves the same asset, even though the facility is available in the second year.

*Liability
for lost or
damaged
asset*

*Segregation
of assets
purchased
by IFI*

*Murabahah
on asset
owned by
the customer*

60. The liability for loss or damage of asset acquired for the purchase orderer while in the possession of IFI shall be borne by the IFI.
61. Any asset purchased by the IFI for *Murabahah* financing to the customer shall be specified and differentiated from similar or other goods in the same shipment based on customary practice. This is to ensure effective delivery of specified goods.
62. *Murabahah* to Purchase Orderer sale by the IFI to the customer is not valid if the IFI purchases an asset from the customer and subsequently sells the same asset to the customer. The contract is also not valid if the asset purchased by customer from supplier is subsequently purchased by the IFI and sold to the customer based on MPO.
63. The IFI shall not sign the *Murabahah* contract with the purchase orderer prior to the purchase of assets or goods to be acquired.

64. The IFI shall be deemed to have ownership right on the assets to be sold based on *Murabahah* upon receipt of documents attesting to the ownership transfer to the IFI which include, among others, shipment and storage certificates.

Ownership of Murabahah asset

65. The purchase orderer may request the IFI to purchase the assets intended for the *Murabahah* financing from a specific market place or a supplier. However, the IFI may decline this request for whatever reason deemed reasonable by the IFI.

Asset from specific market

66. The purchase orderer would apply to the IFI, an order to purchase an asset with identified specifications. The purchase orderer may provide the IFI with information pertaining to the asset specifications in terms of price, availability and market location. However, the IFI reserves the right to conduct its own assessment on the asset ordered to be purchased.

Asset specification by the purchase orderer

67. Assets purchased by the IFI according to the purchase orderer's requirements may be delivered to the purchase orderer prior to the conclusion of the *Murabahah* contract.

Delivery of asset to the purchase orderer prior to Murabahah contract

68. Loss or damage of goods in the possession of the purchase orderer prior to the conclusion of the *Murabahah* contract due to negligence of the purchase orderer shall be borne by the purchase orderer.

Liability of purchase orderer

Recourse
for defect

69. The purchase orderer has a recourse to the supplier through the IFI for any defect of asset or good delivered to the purchase orderer based on the defect option (*Khiyar al-'Ayb*).

Illustration 19: Defective Asset Not Valid as the Object of *Murabahah*

A purchase orderer requests for an IFI to finance the purchase of a completed residential property identified by the purchase orderer under a *Murabahah* contract. After processing the application, it was found that the property was certified not fit for occupancy by building authorities due to structural defects. The object of sale is found to be of non-satisfactory quality and hence would not qualify for the IFI to provide *Murabahah* financing to the customer until and unless rectification to the property is carried out by the supplier to obtain the certificate of fitness.

Waiver clause
on defects

70. Alternatively, the IFI may incorporate in the contract to exempt itself from any defect in the asset. The IFI may, upon agreement by the purchase orderer, assign the right of recourse against the supplier for the defect to the purchase orderer.

Pre-agreement
between
purchase
orderer and
supplier

71. The IFI shall reject a *Murabahah* application by the purchase orderer who has already established a contractual relationship with the supplier aimed at acquiring cash rather than trading the goods under transaction.

5.5 Enhanced Features of The Contract

Wa'd (Promise) by Purchase Orderer to Purchase The Asset on Murabahah Basis

72. The *Wa'd* (promise) by the purchase orderer to purchase the asset from the IFI upon the latter's acquisition of the asset shall be binding on the purchase orderer.
73. The *Wa'd* shall be separately executed prior to the execution of *Murabahah* contract.
74. During the purchase requisition, the purchase order application shall contain the promise which must be duly signed by the purchase orderer.

Binding force of unilateral Wa'd

Execution of Wa'd prior to Murabahah contract

Duly signed promise

*Breach of Wa'd
(Promise) to
receive the asset*

75. The purchase orderer who promised to purchase and to take delivery of asset but refused to enter into the *Murabahah* transaction upon purchase made by the IFI as per agreed terms shall be held liable for breach of *Wa'd* and shall compensate for related actual costs incurred by the IFI for the disposal of the asset to a third party and the shortfall in the disposal price compared to the purchase price.

Illustration 20: Liability of Purchase Orderer on *Wa'd*

A purchase orderer applies to an IFI to acquire a machine which costs RM50,000 through a *Murabahah* contract. The IFI approved his application and requested the purchase orderer to sign a unilateral promise to buy the machine after the acquisition of the machine by the IFI. After the IFI purchased the machine, the purchase orderer refused to buy the machine from the IFI and hence breached the promise (*Wa'd*). IFI disposed of the asset at RM45,000 and incurred an additional disposal cost of RM2,500. IFI shall be compensated for RM7,500 by purchase orderer.

*Purchase
orderer as Kafil
for timely
delivery of asset*

76. The purchase orderer at the stage of *Wa'd* may act as a *Kafil* (guarantor) to the IFI to guarantee the safe delivery of the asset by the supplier to the IFI. Any loss incurred due to late delivery of the asset to the IFI shall be borne by the purchase orderer as the *Kafil*. Damage or defects that arise after the delivery of the asset to the purchase orderer shall not be covered under this guarantee arrangement.

*Benchmarking
the Murabahah
sale price to
a certain
benchmark*

77. During the *Wa'd* stage, determination of mark-up in a *Murabahah* sale price may be based on a benchmark such as the BLR.

78. Amendments to the terms of the binding promise shall not be permitted without the consent of the other party.

79. During the *Wa'd* stage prior to executing the *Murabahah* contract, the IFI and the purchase orderer may mutually agree to modify the terms, for example the maturity date of payment or a new mark-up as well as to change from *Murabahah* contract to other financial transactions.

Modification of contract terms during Wa'd stage

80. At the time of *Murabahah* contract execution, details of the transaction shall be incorporated and documented even though these specifications were already stipulated during the *Wa'd* stage.

Incorporation of contract details in Murabahah contract

Event of Default and Recovery of *Murabahah* Financing

81. The customer shall ensure timely and prompt payment of the *Murabahah* financing as per the payment schedule agreed with the IFI.

Payment obligation

82. The outstanding liability after the demise of the customer may be waived by the IFI. In cases where the waiver is not given, the IFI may claim the outstanding debt from the estate of the deceased.

Liability of the payment after the demise of the purchase orderer

83. The IFI may include a clause in the *Murabahah* contract, stipulating a "compensation for late payment" as determined by the relevant authorities, which is claimable by the IFI from the customer as income. Alternatively, the IFI may include a clause stipulating late payment penalty which shall be channelled to charity. The IFI may also require the customer to prove any claim of non-delinquent insolvency in order to be exempted from penalty.

Compensation/penalty clause for a customer who defaulted

IFI's purchase of the Murabahah asset from the customer who defaulted

Extension of time for settlement of debt

Compensation for actual damage caused by the customer who defaulted

Early settlement of all instalments by customer who defaulted

Grace period for settlement prior to recovery procedures

84. If the customer defaults, the IFI may purchase the same asset or part thereof from the customer in default, in cash, based on a mutually agreed price. The proceeds of which may be used to settle the outstanding debt on the basis of set-off (*Muqasah*). Upon acquisition of the asset by the IFI, the asset may be leased to the purchase orderer on the basis of lease with an option to purchase (*Ijarah Muntahia Bi Al-Tamlik*).

85. A customer in default may be granted an extension to settle his debts, provided no additional charges on the financing amount are imposed. For the purpose of rescheduling the outstanding debt, the IFI may demand additional securities from the purchase orderer.

86. The IFI may impose on the customer in default to bear all costs accrued to recover the payment defaulted, including the costs of judicial proceedings and legal fees which the IFI would have incurred to recover the outstanding payment.

87. The contract of *Murabahah* may contain a clause, binding the customer to settle all outstanding obligations before the maturity date if he defaults on any instalment.

88. The IFI may grant the customer in default a grace period to settle the debt after sending notice of reminders before commencement of debt recovery measures. However, any increase in the selling price due to rescheduling of the contract or due to inability to pay on time is not permissible.

Agency in *Murabahah*

89. The IFI may appoint the purchase orderer as its agent (*Wakil*) to purchase the asset from the supplier on behalf of the IFI.

*Purchase orderer
as IFI's agent*

Illustration 21: Purchase Orderer Buying on Behalf of Seller

An international company requests an IFI to finance the import of raw materials from Finland. Due to the inability of the IFI to conduct a market survey for the best quotations, the IFI appointed the same company to conduct the market survey and purchase the asset on its behalf. This arrangement requires two separate contracts. Firstly, the IFI signs a *Wakalah* (agency) contract with the company so that the latter would act as an agent for the IFI. Subsequently, the IFI would enter into a *Murabahah* contract with the company. Both contracts are separate as the parties involved are acting in different capacities.

90. As a purchasing agent of the IFI, the customer may advance his own money for partial payment of purchase price to the supplier. The amount advanced shall be off-set by the IFI from the selling price to be concluded with the customer.
91. The appointment of the purchase orderer as an agent by the IFI based on a *Wakalah* contract to acquire the asset from the supplier shall be in a separate contract from the *Murabahah* contract.

*Appointment
of the
purchase
orderer as
an agent to
purchase
on behalf of
the IFI*

Agency leading to money lending or waiver of IFI's liability

Procurement of quotations by agent in the name of IFI

Procurement of quotations as agent of IFI in the name of purchase orderer

Supplier as IFI's agent

Separate contract of agency appointment for supplier to purchase on Murabahah on behalf of the purchase orderer

92. The purchase orderer, as a purchasing agent of the IFI, shall not waive the effective transfer of assets or goods from the IFI to the purchase orderer. The IFI which appoints the purchase orderer as a purchasing agent shall not waive its liability on the purchased asset. Such a waiver may lead to money lending or cash financing.
93. As a purchasing agent of the IFI, the purchase orderer may obtain quotations on asset price in the name of the IFI.
94. As a purchasing agent of the IFI, the purchase orderer may obtain quotations from the supplier under his name subject to acceptance from the IFI.
95. The IFI may appoint the supplier as its selling agent to conclude the *Murabahah* contract with the purchase orderer provided that the IFI has taken possession of the asset.
96. The supplier may be appointed as the agent of the purchase orderer to purchase the goods on *Murabahah* basis from the IFI provided that the supplier was not appointed as a selling agent by IFI to conclude sale with customer. This agency contract is a separate contract, independent from the sale contract of the supplier to sell and deliver the assets to IFI.
97. The purchase orderer cum promisor may be the sole authorized agent to purchase or import a particular asset from the supplier or exporter. The relationship between the purchase orderer and supplier and the fair value of the purchase price must be made known to the IFI.

98. The name of the purchase orderer who is appointed as an agent of the IFI to conclude the *Murabahah* contract may be disclosed in all documents.

Name of purchase orderer as agent in all documents

Guarantee/Security

99. The IFI may require assurances in two stages of MPO arrangement. The first is assurance at the stage of *Wa'd* from the purchase orderer and the second is assurance at the stage of *Murabahah* contract. The assurance at the *Wa'd* stage is to ensure actual purchase of the asset by the purchase orderer from the IFI while the assurance at the *Murabahah* contract stage is to ensure full payment of the selling price at the date of maturity. These assurances may include a security deposit, a third-party guarantee, a pledge of any asset or real or moveable property, or a pledge of the asset of the *Murabahah* contract, cheques or promissory notes, or any security measure deemed legal and lawful.
100. At the stage of acquisition from the supplier, the IFI shall not require the purchase orderer to subscribe to a takaful policy on the asset of *Murabahah* so that IFI could secure the full payment which will be due on the purchase orderer.
101. A third-party guarantor shall be of good financial standing and is capable of making good the instalments defaulted by the purchase orderer.
102. Securities of non-Shariah approved companies such as shares of conventional banks shall not be pledged as collateral for *Murabahah* transaction.

Shariah compliant assurances are permissible

Purchase of Takaful policy by purchase orderer for payment guarantee

Third party guarantor

*Insolvency or
bankruptcy
of purchase
orderer*

103. If collateral consists of a mixture of principal amount and interest amount, only the principal amount is allowed to be taken by the IFI in the case of customer default.
104. The guarantee for payment of customer's outstanding liability to IFI for purchase of assets or goods under *Murabahah* contract shall not take effect until the actual *Murabahah* contract is duly executed.
105. Upon default or declaration by the court that the customer is insolvent or bankrupt, all outstanding amounts due from a *Murabahah* contract is claimable from the guarantee, collateral or other securities to settle the debt.

Security Deposit

*Requirement
for placement
of security
deposit by
purchase
orderer*

106. The IFI, as a financier, may impose on the purchase orderer an amount of money as security deposit (*hamish jiddiyyah*) to compensate against losses incurred in the event that the purchase orderer breaches the promise or *Wa'd*.

*Unutilized
security
deposit*

107. The security deposit to compensate against losses incurred due to purchase orderer's breach of promise, shall be returned to the purchase orderer fully or partially, depending on its utilisation.

108. This security deposit may be treated as part of the payment of the agreed selling price under the *Murabahah* contract and hence is not refundable.

Use of security deposit as partial payment of Murabahah selling price

Illustration 22: Refund of Purchase Orderer's Deposit

A customer promises to purchase and places 10% of cost of purchase as a deposit with an IFI to finance the purchase of RM50,000 worth of textiles. The financing is based on *Murabahah* at a mark-up selling price of RM75,000 for a 6 months financing period. Upon receipt of goods by the customer the outstanding amount payable to the IFI is RM70,000 (less RM5,000 security deposit).

On the other hand, in the case where goods are purchased but the customer does not take delivery, the IFI incurs disposal costs of RM2,000 and is able to dispose off the goods at RM49,000. The loss on disposal and the disposal costs amounting to RM3,000 is deducted from the security deposit and the balance of RM2,000 is returned to the customer. If the goods are disposed at RM55,000, the refund to the customer is RM3,000. There will be no refund to the customer if the disposal value is RM52,000.

109. Any form of deposit such as *Wadiah*, deposited by the purchase orderer with the IFI, may be used as a pledge to fulfil the liabilities of the purchase orderer under the *Murabahah* contract. In the event of default, the IFI may use the pledged deposit to redeem the payment based on an off-set mechanism.

Wadiah deposit as a pledge

110. If the purchase orderer breaches the *Murabahah* agreement or defaulted in payment of the *Murabahah* contract, a portion or all of the property charged as collateral may be disposed, or cheques deposited by the purchase orderer may be encashed at an equivalent value to compensate for the total outstanding amount.

*Postponement
of asset
registration*

111. To safeguard the interest of the IFI, the IFI may defer the registration of the asset in the name of the purchase orderer until full settlement of selling price. However, this practice does not and shall not deprive the purchase orderer's right of ownership to the asset.

Dissolution/Termination of Contract

*Maturity of debt
and natural
termination of
contract*

112. Upon settlement of the outstanding debt owed to the IFI by the purchase orderer without any encumbrances, the *Murabahah* contract is dissolved.

*Mutual
agreement
to dissolve*

113. The IFI and the purchase orderer may mutually agree to dissolve the contract at any point in time prior to maturity date unless stated otherwise in the relevant documents of the *Murabahah* contract.

*Down payment
(*'urbun*)*

114. The IFI may take a down payment (*'urbun*) from the purchase orderer after signing the contract. This payment may be forfeited by the IFI should the purchase orderer were to terminate the contract.

GLOSSARY

Terms	Definition
<i>`Urbun</i>	Earnest money.
<i>`Urf</i>	Customary practices which are in compliance with Shariah.
Acquisition Cost	Cost to purchase or acquire an asset including its price and direct expenses.
Constructive Possession	A state where a person does not have actual possession, but has the legal rights to control an asset.
Direct Expense	Costs or expenses incurred to directly enable the acquisition of goods by the IFI and delivery of the goods to the customer.
<i>Hamish Jiddiyyah</i>	Security deposit.
Indirect Expense	Expense indirectly incurred and not directly chargeable to a specific acquisition, project or task.
<i>Kafil</i>	Guarantor.
<i>Khiyar al `Ayb</i>	Option arising from defect; the option of dissolving the contract on discovery of defect in the goods purchased.
Monetary Assets	Generic term for accounts receivable, cash, and bank balances i.e. assets that are realizable at the amount stated in the accounts.
<i>Muqasah</i>	Set-off.
Physical Possession	A state where a person has actual possession and the rights to control an asset.

Terms	Definition
Purchase Orderer	A person who enters into an arrangement with a financial institution to place an order for a particular good and undertakes to subsequently purchase the said good upon acquisition by the FI.
<i>Takhliyah</i>	Relinquishing or abandoning the rights of ownership.
<i>Tamkin</i>	Enabling the person who has the ownership of asset transferred to him, to make full use and assume liability of the asset.
<i>Tawliyah Sale</i>	Sale of goods at its cost price.
Trust-sale	Sale where the buyer depends and relies totally on the integrity of the seller with regard to the cost and profit that the latter disclosed to the buyer.
<i>Wa`d</i>	Promise or undertaking.
<i>Waqf</i>	Endowment or assignment of an asset for religious or charitable purposes in a form of trust where the asset may not be used for another purpose.

