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IMPACT OF MURABAHA TRANSACTION ON INTEREST-FREE BANKS, A NECESSITY FOR LEGAL AND SHARIA PROTECTION

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ABSTRACT

Murabaha transaction is one of the most important financial tools for interest-free banks. Most interest-free banks use this tool because it is risk-free to some extent. However, there are still some issues related to this transaction that impact the interest-free banking industry negatively. Murabaha transaction in interest-free banking depends on the promise. As the client promises the interest-free bank that he will buy the specific item from the interest-free bank after the bank buys it from the supplier of the goods. However, the client sometimes does not fulfill his promise. In this case, the interest-free bank loses an amount of money because the client fails to take the item from the bank. Therefore, this paper will attempt to find solutions for this issue. Thus, there should be a protection law for protecting interest-free banks from default clients. Furthermore, there should be a Fatwa for interest-free banks to keep mortgages from clients and take their losses in the case when the clients do not perform their promises to buy the items on the Murabaha basis. Hence, interest-free banks should be protected by law from losses that occur through Murabaha transactions. In that context, this paper will criticize the Murabaha contract and find out methods for protecting interest-free banks from losses via this type of transaction.

Purpose of the Paper

The purpose of this paper is to determine issues relating to the Murabaha transaction and then find solutions from legal and Sharia experts' points of view.

The Importance of the Study

This study is important because it examines and analyses the legal and Shariah approaches of protecting interest-free banks from default clients. Furthermore, the study is significant because it evaluates the problems of interest-free banks. In addition, the originality of this

study lies in highlighting the effect of legal and Shariah solutions in protecting interest-free banks.

Methodology and Approach

The qualitative method-based is applied for this paper. The study uses various documents and analyses them to achieve the best result. Secondary data is the main source of this paper. Hence, books, academic journals, and reliable websites are used for collecting data for this paper.

Findings

It is found that the Murabaha transaction needs to be reviewed in order to find solutions for the current related issues to this type of transaction. In addition, it is found that legal and Shariah protections are needed to protect interest-free banks from against clients. On the legal side, adopting a piece of legislation is required for protecting interest-free banks from default parties. While on the Shariah side, there is a necessity for issuing Fatwa in favor of interest-free banks to be protected from default customers.

INTRODUCTION

Interest-free banks use different tools and contracts to deal with their customers. Those tools are called modes of finance that vary according to the nature of the customer's desire and situation. Several transactions link interest-free banks to their customers, such as Musharaka, Mudharaba, Murabaha, etc. However, most interest-free banks prefer Murabaha transaction because it has a smaller degree of risk and it is a contract that is based on a fixed margin. Therefore, this paper focuses on the relationship between interest-free banks and their clients according to Murabaha transactions. Thus, this study will attempt to evaluate the relationship between interest-free banks and their customers and then find solutions for the issues related to Murabaha transaction that is used by interest-free banks as a financial tool. The main risk of interest-free banks in using the Murabaha tool is delaying paying installments on time by clients which leads to liquidity risk. Another issue is the unfulfillment of the promise of the client to buy an asset that is demanded by him from the interest-free bank because the fulfillment of promises in netting contracts not be binding on the customer.

Although interest-free banks face some problems by using Murabaha transactions it is still one of the most used tools (Khotijah S. A. and Iswanaji C, 2020) that can be used by clients for buying houses, cars, and some other goods. As the client requires the interest-free bank to buy a car or a house for him in cash from the supplier then the interest-free bank resells the house to the client by installments. The most important point that should be considered in the Murabaha transaction is there should be two contracts. The first contract should be between the supplier of the commodity and the interest-free bank. While the second contract should be between the interest-free bank and the client In case if there is only one contract which is between the suppliers and the interest-free bank's client, then the contract is considered illegal according to Sharia law. In this context, the interest-free bank has a middleman role.

Therefore, there should be two contracts in any Murabaha transaction to be legal under Sharia law.

Concept of murabaha transaction

Interest-free banks use the Murabaha transaction as their primary scheme of financing, covering about seventy-five percent of their wealth (Amir V et al., 2015) Murabaha contract is a sale and purchase contract in which the profit margin has been determined and mutually agreed upon between the supplier of the commodity or seller of the goods and the purchaser of the commodity. (Amir V et al., 2015) Thus, Murabaha transaction can be defined as “a particular kind of sale where the seller expressly mentions the incurred cost of the sold commodity, add a profit to the cost of the commodity, and declares the profit he has earned on the commodity to the buyer. Thus, Murabaha is not a loan given on interest, but it is the sale of a commodity for cash or deferred price” (Islamic Bankers) Therefore, there are three parties in the Murabaha transaction, buyer, Interest-free bank, and seller. The Interest-free bank buys a specific type of goods according to the buyer’s request for the seller in cash, then the Interest-free bank sells the goods to the buyer according to the pre-agreed price. (Jobst A .A and Solé J., 2020) Hence, the price of the goods is the real price plus a profit. The Interest-free bank buys the commodity from the provider in cash and sells it to the buyer in installments. The demanded item by the client is attached with a promise to purchase it with the down payment in ensuring that the customer is serious and has sufficient payment to complete the sale contract.(Ghozali M, 2018) For the Murabaha transaction to be legal under Sharia legal system there should be several conditions:

The product must exist at the time of the contract.

The product should be in the possession of the supplier at the time of the contract.

The product must be in physical or determined possession of the seller. (Abdul Rahman A, 2007).

There should be certain of the products’ delivery to the purchaser.

The price of the product, on which the parties have agreed upon, must not increase under any circumstances, even in cases of default.

The time of delivery and the payment schedule must be specified in the contract. (Iqbal M and P Molyneux, 2005)

The sale must be unconditional because a conditional sale is invalid unless the condition is recognized by both parties according to the trade custom. (Meezan Bank, 2002)

It is, therefore if one of the aforementioned conditions does not exist in the Murabaha contract, then the contract is invalid and unacceptable under Sharia

principles. Even if the Murabaha contract is conducted and one of the conditions is not performed, the contract should be canceled.

Murabaha Transaction In Interest-Free Banks

There are three parties in the Murabaha transaction, the supplier of the goods, the seller, and the purchaser. In the case of Interest-free banking, the transaction of Murabaha is between Interest-free banks and customers, in which the Interest-free bank purchases the commodity that is demanded by the client and sells it to the client with a specified mark-up or profit agreed upon by two parties. (Purwanto T. A., 2019) Hence, the transaction payment of Murabaha can be paid on a deferred or installment basis. (Ghozali M., 2018).

It is noted that the Murabaha transaction starts with the client, which the client gives the order to an Interest-free bank to purchase an asset. (Dalel G. and Bessem T., 2013) Then the bank purchases the goods from the original seller and enters a contract with him. The second contract will be between the Interest-free bank and the client who demands the item. Thus, there should be two contracts, one between the original seller and the Interest-free bank, and the second contract will be between the Interest-free bank and the purchaser or the customer. The Interest-free bank buys the commodity in cash from the supplier which the price is known by both the client and the Interest-free bank. After that, the Interest-free bank resale the commodity to the client in installments or in deferred prices that they agree upon in their agreement. Hence, the price of the commodity is the original price plus mark-up. The three parties benefit from the Murabaha transaction according to the agreement.

However, the Interest-free bank in some cases may face problems in applying Murabaha transaction as the customer may not pay upon the agreed time or maybe he does not buy the commodity from the Interest-free bank while the bank already bought the commodity from the seller and the item is in the bank's possession. In this case, there should be a solution that protects the Interest-free bank from losses. Thus, Interest-free banks may require a guarantee to protect themselves against possible defaults by borrowers. (Adamu I. Y., 2018) Therefore, taking Arbun from the customer can be a solution if the bank did not pay according to the agreement. Accordingly, in the case of Arbun, may be used toward the purchase of the good, and if the purchase is canceled, part of the Arbun may be used for the Interest-free bank. (Ethica, 2020) In that context, the penalty can be imposed by the Interest-free bank on the client item on the Murabaha basis if he did not buy from the bank or he did not pay installments on time. Thus, when customers fail to make payments for the goods on time, the Interest-free bank left unprotected by a law that could protect it, is naturally stuck waiting for the money. (Holden K., 2006) However, the amount of penalty for default in prompt payment recovered cannot be included in the income of the Interest-free bank in any case and must be spent for charity. (Usmani, T.M., 2002) Thus, in all cases, the Interest-free bank losses an amount as the penalty should be given to charity. Therefore, there should be solutions for Interest-free banks to be protected from the losses that occurred through the Murabaha transaction.

In this context, the penalties imposed on default clients should be back to the Interest-free banks instead to be spent on charities. Therefore, there should be a Fatwa that allows Interest-free banks to take their losses from the Arbun. The central Sharia Board in any country can have their role in protecting Interest-free banks from losses that occurred via Murabaha. Besides, there should be a law for protecting Interest-free banks that compensate the bank in case of losses in applying the Murabaha transaction. Therefore, Sharia scholars should have an important role in this case. Besides, central banks and lawmakers should have their role in enacting a law that protects Interest-free banks.

Issuing Fatwa

The role of the Sharia scholars of the Sharia supervisory boards in Interest-free banks is to supervise Interest-free banks and ensure that all transactions are under the Sharia principles. (Rammal H. G., 2006) However, there is the most important role for scholars to be performed is issuing Fatwa according to Sharia principles. Thus, Sharia scholars must have the ability to issue Fatwa to protect both Interest-free banks and their customers. It can be seen that customer protection is always focused on when talking about banking transactions in general and Interest-free banking in particular. However, it is important to talk about Interest-free banking protection, as Interest-free banks have an important role in developing economies.

In the case of the Murabaha transaction, it can be noted that sometimes the customer does not fulfill his promise to buy the asset from the Interest-free bank while the asset is bought according to his demand. (Nor A. M. et al., 2020) Thus, there should be a method to compensate the bank as it has conducted a contract with the supplier of the commodity. There is a penalty imposed on the default client but the penalty is not given to the Interest-free bank because it is considered illegal under Sharia law. In this case, the central Sharia board or Sharia supervisory board of Interest-free banks can issue a Fatwa to allow Interest-free banks to receive the penalty and do not spend for the charity. It can be said that keeping the penalties by Interest-free banks is interest (riba) according to the Islamic legal system. However, if for instance, an Interest-free bank conducts 30% of its contract basis on Murabaha with its clients and 20% out of this 30% did not fulfill their promise and did not buy the commodity from the Interest-free bank while these commodities are bought by the bank on their demand. In this case, the Interest-free bank loses a big amount of money. Therefore, maybe in a few years, the Interest-free bank will face insolvency. Consequently, the principle of Maqasid Shariah took from the belief that the divine law is revealed to protect human interests could be applied. (Safian Y. H. M., 2010) In this context, and according to the principle necessities may permit some forbidden things (الضرورات تبيح المحظورات) Muftis should issue a Fatwa that Interest-free banks can benefit from the penalties that are imposed on the default customers of Murabaha transaction. Thus, the Sharia supervisory board of the Interest-free bank can determine the amount that can be taken by the Interest-free bank and remain can be spent for charity. this is the case of the Sharia Advisory Council in

Malaysia which decided that compensation is permitted and recognised as income on the basis that it is imposed based on the actual loss incurred by Interest-free banks. (Abdullah A., 2018) it can be said that the Sharia members of the Sharia supervisory board are not qualified to issue a Fatwa, then the members of the board can contact any Fatwa committee in the world to take their opinion.

Protection Law for Interest-free Banks

Interest-free banks face credit risk the same way as conventional banks, for example in the Murabaha transaction the client does not buy the commodity which is bought by the bank in cash according to his demand. In this case, Interest-free banks need protective laws and regulations in the same way as conventional banks, and the current lack of such laws and regulations is the result of the lack of any special Interest-free banking law. In conventional banks, if the client fails to return a loan to the bank at the pre-agreed time, there is a law to protect the banks from loss. For Interest-free banks, the situation is different because there is no such legislation. For instance, in Murabaha, if the customer fails to pay the bank, or delays the payment, the bank is not protected by any means of law. This is because, under Sharia law, the client is not legally bound so there is no legal case, (Ayinde O. L., 2012) even if the client does not buy the commodity that has been bought by the bank for the client. In such a situation, the commodity remains with the bank and the bank may face losses and logistical problems.

However, there are some protection laws in certain countries like Pakistan and Iran, that have special Interest-free banking laws. In these countries that have a special law for Interest-free banks, the banks can do business more reliably. In general, in most countries in the world, the lack of such rules and protection law leaves Interest-free banks vulnerable and unprotected. As a result, there is no motivation for Interest-free banks to work effectively, and there is no protection to keep them from insolvency. There is thus a necessity for adopting default-protection law, as Iran and Pakistan have. (Holden K., 2006) Some Shariah scholars on the opinion that the defaulting client should pay compensation for the default, but that this amount of money should not go to the bank and instead should be used for charity purposes (Gulf News 2021) Therefore, enacting laws for protecting Interest-free banks from default by the clients is necessary. It is not conditioned that any country that has a special Interest-free Act has a protection law for protecting Interest-free banks from default. It is the responsibility of lawmakers, central banks, and central Sharia Board in any country to attempt to have laws and regulations for Interest-free banks to be protected from default by customers. Adding some provisions to the Islamic banking law is another way to protect interest-free banks from default parties. Provisions can be part of the Islamic banking law or can be part of the general banking law. In this case, Islamic banking law should be amended to protect interest-free banks in case of default in Murabaha transactions.

It is important to be mentioned here that Interest-free banks should recognise their customers well and conduct a Murabaha contract with only trusted customers.

CONCLUSION

Interest-free banks use several tools and transactions for investment, such as Musharaka, Salam, and Murabaha. (Mustafa A. O., 2020) Murabaha transaction is the most reliable instrument for Interest-free banks as a method of finance. The reason behind using Murabaha is because this transaction has less risk. However, it cannot be said that Murabaha transaction is risk-free due to the default by clients. Sometimes customers do not pay installments on the agreed time according to the agreement between the Interest-free bank and the customer. Besides, sometimes Interest-free banks purchase the goods according to the client's demand then the client does not buy the commodity from the Interest-free bank. Therefore, Interest-free banks may face insolvency in the long term. Thus, there should be solutions for these issues that face Interest-free banks during using the Murabaha transaction. The first solution is issuing Fatwa to allow Interest-free banks to receive penalties that are imposed on the defaulting party. Otherwise, the Interest-free bank can receive part of the penalty and another part could be spent on the charity. This Fatwa can be issued on the Sharia principle necessities may permit some forbidden things (الضرورات تبيح المحظورات). The Fatwa can be issued by the central Sharia board or the Fatwa Committee.

Another solution for protecting Interest-free banks from insolvency due to the default customer in the Murabaha transaction is enacting a protection law. The protection law could be drafted by central banks and enacted by lawmakers. The protection law could be a protector of Interest-free banks from default parties in the case of the Murabaha transaction. The law could be part of the general banking law as some provisions, or as a part of Interest-free banking law if the country has specific Interest-free banking law. Therefore, Interest-free banks should have to be protected from insolvency by central banks and the central Sharia board.

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