

Some Issues on Murabahah Practices in Iran and Malaysian Islamic Banks

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Purpose – The purpose of this paper is to analyze the nature of *Murabahah* contract in the fully grounded Islamic banking system i.e., Iran and Malaysia.

Design/methodology/approach – The approach taken is descriptive.

Findings – Although the main principle of Islamic financial institutions is prohibition of usury, it is surprised to see that Islamic financial institutions are still practicing usury in their transaction as evidenced in Iran. In the case of Malaysia however, BBA home financing is used by Islamic financial institutions and the profit rate is still dependent on the market interest rate due to arbitrage activities.

Research limitation/implications – There is no transparent framework for *Murabahah* contract in Islamic banks. Indeed there is a need for the banking standard regulators to set a clear and disciplined framework for this type of banking contract.

Originality/value – The study hopes to improve the overall competency and reliability of the Islamic banking system in the world. The finding of this study will be a basis for further research in *Murabaha* with respect to the regulatory environment and *Shari'ah* compliance in particular in Iran.

Key words *Murabahah*, Banking system, usury (*Riba*), Ughods (Principles), *Shari'ah* (Islamic Laws), Halal (Permissible), Batil (Not-Permissible), Sukuk (Security), Iran, Malaysia.

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1. Introduction

The magnificent phenomenon in the recent decades is the emergence of Islamic financial institutions within financial and monetary organizations across the world. Playing a key role in financial transactions, Islamic banks, as significant Islamic financial institutions, have earned much more attention compared to other institutions (Abd Rahman and Zainuddin, 2009). Islamic banks today exist in all parts of the world, and are looked upon as a viable alternative system, which has many things to offer (Sufian and Mohamad Noor, 2009). Islamic banking in the Islamic economic scenario is based on the most important principle of the economic philosophy of Islam, the prohibition of usury or *riba*. The prohibition of usury, however has posed many challenges to Muslim scholars whom are not only obliged to remove usury but also required to present a just system, free of exploitation. Following the verses of the Holy Quran that mandates the prohibition of usury lead to the creation of an elaborate collection of Islamic principles (Ughods). The key success of these Islamic principles depends on fulfilling the exact *Shari'ah's* requirements that focus on justice, risk-sharing, physically realized transactions and direct linked businesses and most of all dealing with the Islamic concept of the *halal* in nature.

The space of most *Shari'ah's* attention to which claims highly controversial issues is Islamic banking. This is for the assurance of the usury free banking practices which defines the main goal of the *Ughods*. In order to install the *Ughods* and deriving its specifications, the *Shari'ah* requires Islamic banks to utilize the different concepts for offering facilities in their banking transactions frameworks. However Al-Salem (2009) believes that Some Islamic products are similar to those provided by conventional institutions, but others are different. One of these concepts is “*Murabahah*” which is a challengeable type of Islamic contracts. *Murabahah* contracts may not individually defy the *Shari'ah* norms but it has been criticized as a superficial contract, when the Islamic banks proceed with no true sale taking place and no real transfer of risk to the buyer of the goods, while charging controversial profit rates as heavy as the free-market interests.

According to an Iranian religious scholar, (Mohammad Javad, 2011), there is *Riba* in the Iranian Islamic banking system which is wrapped up in the contracts. The statistics he refers to involve almost the whole Iranian contracts which sound designated to carry just the Islamic forms rather than the Islamic substance. Currently, the Islamic banking requirements contribute to the superficial Islamic banking transactions in a way that the *Riba-free* banking is not expected any more. It sounds that *Riba* is still in action and it is reported that the Islamic banking system is at present worse than its counterpart, conventional banking system, whereas given facilities charged with high interest rates in permissible term of profit charged to Iranian clients for different purposes than mentioned in the contracts.

The combination of profit and principal in order to calculate the profit for renewing the *Murabahah* contracts at maturity while Iranian customer fails to repay the received credit, recently posed question on the permissibility of *Murabahah* contracts. This has clogged the main goal of the Islamic banking, the avoidance of *riba* and quest for justice, and other ethical and religious goals. The Islamic economic order aims at redistribution of wealth and social justice which maintaining a balance with individual interests (Salar, 2008).

This study therefore, aims to analyze the nature of *Murabahah* contracts in the selected Islamic banks of two countries, Malaysia and in the fully grounded Islamic banking system i.e., Iran. The study hopes to improve the overall competency and reliability of the Islamic banking system in the world. The finding of this study will be a basis for further research in *Murabahah* with respect to the regulatory environment and *Shari'ah* compliance. In other words this paper provides insights into future researches.

2. Literature Review

2.1 Concept of Murabahah

Murabahah is driven from *ribh* which means gain, profit or addition. In English this word is often translated as mark up or cost-plus financing. In *Murabahah*, a seller has to reveal his cost and the contract takes place at an agreed margin of profit. This contract was practiced in pre-Islamic times. Al-Marghinani (1957) has defined *Murabahah* as the sale of anything for the price at which it was purchased by the seller and an addition of fixed sum by way of profit. Thus, the seller should reveal his/her capital involved in the deal or tell the cost to the buyer. This is lawful without any controversy among the jurists.

According to Imam Malik (1985), *Murabahah* is conducted and completed by exchanging goods and price including a mutually agreed profit margin. By definition therefore, it is basic for a valid *Murabahah* that the buyer must know the original price, additional expenses if any and the amount of profit. Accordingly, *Murabahah* is a contract of trustworthiness.

Murabahah is a pertinent and proper Islamic product to be used by the Islamic banks for commodity finance. This financial instrument is frequently utilized in the exchange transactions in which a trader purchases items required by an end user and sells the same to him after adding agreed profit (Salar, 2008). But *Murabahah* transactions can only be used when a client of a bank or financial institution wants to

purchase a commodity. Banks or financial institutions purchase the commodity and sell at an agreed profit margin. To comply with the *Shari'ah*, it is necessary in *Murabahah* contracts, the commodity to be actually purchased and taken into possession, physical or constructive, by the bank plus the risk of the commodity as far as it remains under bank's ownership and possession (Salar, 2008).

However, Kamal Khir et al. (2008) believe that *Murabahah* refers to a particular kind of sale and has nothing to do with financing in its original sense. If a seller agrees with his purchaser to provide him a specific commodity on a certain profit added to his cost it is called a *Murabahah* transaction. The basic ingredient of *Murabahah* is that the seller discloses the actual cost he has incurred in acquiring the commodity, and then adds some profit thereon. This profit may be in a lump sum or based on a percentage. They also judge based on Tarek El Diwany (2010), *Murabahah* is a form of trust sale since the buyer must trust that the seller is disclosing his true cost. After discussing the true costs, a profit margin may be agreed either on a percentage of cost basis or as a fixed amount. It is very important to remember that the amount of profit earned in this transaction is not a reward for the use of the financier's money. In other words, a financier cannot take the money if he does not perform any services other than the use of his money for the transaction. Such an occurrence would cause the *Murabahah* to resemble charging of interest.

As a result, *Murabahah* is a commodity sale contract with deferred payments, to legitimize the sale payment process; it should be based on the rules of ordinary sale which is mentioned in the *Qur'anic* verse: "But God permitted trade". This verse is interpreted that deferred payment sale can involve some increase in the sale but not the increase in the loan which is interest and forbidden. The increase in deferred payment sale is part of the price of the commodity which can be valued by similarity and that no increase may be charged in the exchange therefore (Abdul Rahman, 2010)

2.2 Murabahah in Islamic banking

Murabahah in ancient Islamic contexts refers to a particular kind of simple sale and has no relevance whatsoever with a transaction of financing. But *Murabahah*, for all practical purposes was recently transformed from the sale transaction to a mode of financing in the troubles point of view and risk visualized in adopting Profit-Loss Sharing (PLS) system of Islamic banking on a large scale. In this mode, the bank, at the request of its client, purchases the specified goods from a third party against payment. Immediately on the transfer of ownership of the goods as also obtaining its physical or, in most

cases, the constructive possession, the bank sells these goods to the client at cost plus an agreed fixed profit margin.

The client then takes physical possession of the goods and undertakes to pay the price to the bank either in installments or in lump sum, at an agreed later date. There many cases where customers of the bank and the seller of the goods are related parties. In many other cases, the customers of the bank purchase the commodities themselves as agents of the bank and then they repurchase the same commodity from the bank for a cost plus profit to be paid at a mutually agreed later date. Therefore, in Iran, *Murabahah* merely carries an Islamic name. In Iran, there would be no objection if a bank, in addition to its Islamic banking services, separately establishes a commercial banking division wherein various types of goods are purchased and then offered for sale to other prospective buyers at a profit.

There are recently serious reservations to the wide spread use of *Murabahah* as a mode of finance where the bank purchases the commodity only after the customer has agreed basically to purchase it from the bank at a profit (mark-up). It must therefore, be appreciated that under *Murabahah*, a trading transaction is being transformed into a mode of finance just to meet the *Shari'ah* requirements (Siddiqui, 2001).

Tarik M. Yousef (2001) claims that Islamic banks work under a disadvantage as the long-term financing with *Mudarabah* or *Musharakah* is far riskier and costlier than the long term or medium-term lending of the conventional banks. It sounds *Murabahah* contracts in Islamic banks is somehow a divergence from the theory of equity-based finance. By examining the *Murabahah* syndrome in Islamic finance through the prism of a systematic analysis of financial structures across the world, Tarik M. Yousef (2001) finds that Islamic banks, as niche providers of capital, do not operate much differently from conventional banks. It is interesting to note that *Murabahah* has been under critics by many scholars at various forums. Kazem & Zamir (2002) in a study about the Iranian Agricultural Bank challenge *Murabahah* contracts as superficial documents which are covered up by the ever problem, the information asymmetry.

2.2.1 Murabahah in Iranian Islamic banks

The Almighty God in Qur'an say "those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: trade is like usury. But God permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for God (to judge); but those who repeat (the offence) are companions of the fire: they will abide therein forever. Therefore, according to the new constitution introduced right after the 1979 Islamic revolution usury is totally banned from the Iranian banking system (Beizae, 2007).

After 1979 Islamic Revolution, there were two different options for the Islamizing of banking services before the Iranian authorities. First, keeping conventional banks but omitting usury and utilizing Islamic financial products. Second, establishing new banks under purely Islamic laws (Ughods). The Iranian authorities chose the second option and the banking system is therefore a transformation of Ex-Revolution commercial banks to purely Islamic grounded banks. Since then the Iranian banks have offered Islamic products over three decades such as *Mudarabah*, *Murabahah* (Installment Sale), *Musharakah*, *Ijarah*, *Qard hassan*, *Salam* and *Jealah* (BMI, 2009).

The activities of Iranian banks involve all types of trading, commodity finance, real estate development and leasing. Thus, the main financial instruments used are among *Murabahah*, *Mudarabah*, *Musharakah*, *Muqaradah*, *Ijarah*, *Salam* and *Istisna* (Salar, 2008).

There are different types of *Murabahah* which applied by the Iranian banks over three decades and the different forms of *Murabahah* have been defined in the Iranian Islamic economic philosophy. According to the Islamic Hi-Council of the Tehran Stock Exchange (TSE) in 2010 and Mousavian and Zehtabian (2009) there are the following *Murabahah* products in the Islamic niche of the Iranian financial market.

2.2.1.1 Murabahah Security (Sukuk) for Finance

In this model, issuer collects the investors funds, buys the originators' required commodity from a producer (seller) in cash on behalf of the investors, after that sells it to the originator in a higher price and in form of a *Murabahah Bay'* with deferred payment. Originator should undertake for paying the price to the issuer on specific maturity dates. Then issuer gives the originators' payments to the owners of securities through an investment bank. The owners of securities can either wait until the maturity date to obtain marginal return or sell their securities in the secondary market in a lower rate of return. Figure 1 represents the operational model of *Murabahah* Security (*Sukuk*) for Finance in Iran.

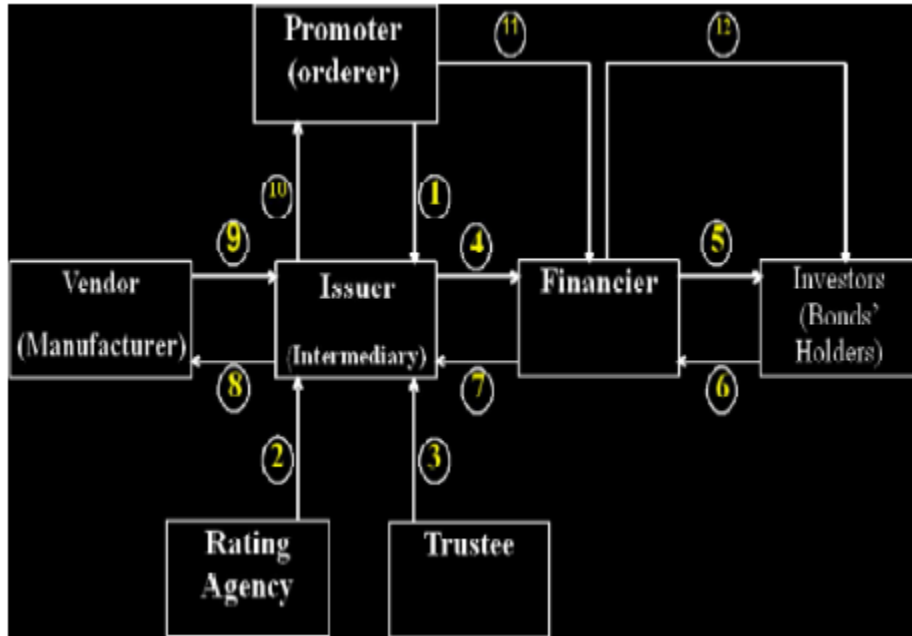


Figure1. *Murabahah* security for finance (Mousavian and Zehtabian, 2009)

The primary and secondary markets for these securities are a combination of *Wakalah*, cash selling, *Murabahah Bay'* with deferred payment, and *Bay' Dayn* (discount) contracts in such a manner in which the issuer collects the funds, buys the originators' required commodity on cash and on behalf of the investors, then sells it to the originator in form of *Murabahah* with deferred payment. Under the jurisprudential point of view, there may be no problem with *Wakalah*, cash selling and *Murabahah Bay'* with deferred payment contracts while, there is a dispute on selling securities in the secondary market (discount), from other hand. Majority of Iranian jurists believe that secondary market based sells are allowed but most of Non-Iranian jurists have rejected it and believe that it is *Batil* (Mousavian and Zehtabian, 2009).

2.2.1.2 *Murabahah* Security (Sukuk) for Liquidity

In this kind of *Murabahah Sukuk*, the issuer should gather the investors funds, buys one of the originators' tangible asset in cash instead of the investors, then sells it to the originator on a higher price in form of *Murabahah Bay'* with deferred price. Originator should commit for price payment on certain dates, in the second stage issuer transfer the funds which have been collected from the originator to the owners of securities via investment banks. As like as financing *Murabahah* security in this type of *Murabahah* security also owners of securities can either wait until maturity date for fully interest

utilisation or sell their securities in the secondary market before maturity. Figure 2 illustrates *Murabahah* security (*Sukuk*) for cash supply.

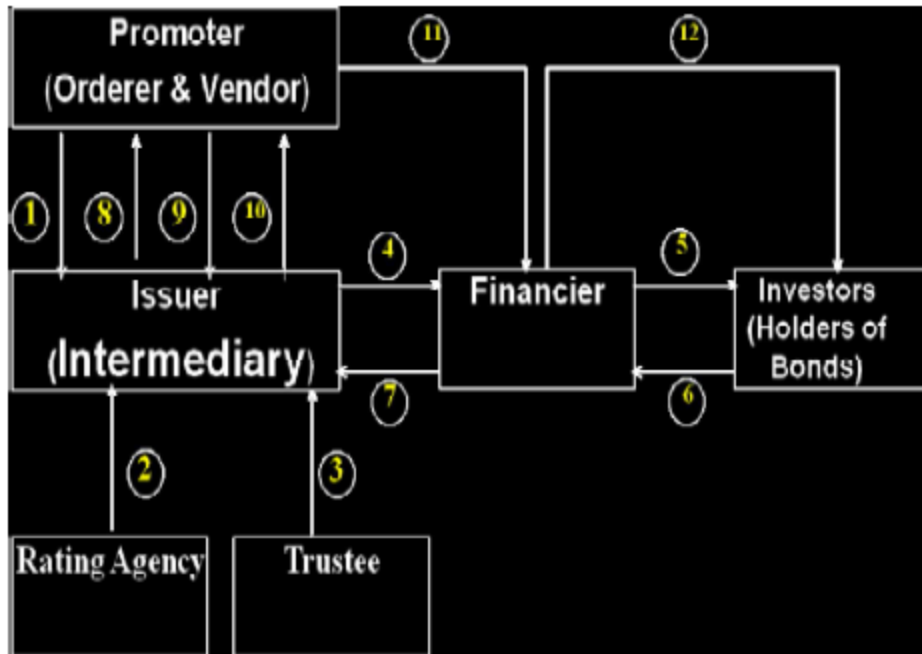


Figure2. *Murabahah* security for liquidity (Mousavian and Zehtabian, 2009)

The primary and secondary markets for these securities are the same as *Murabahah* Security (*Sukuk*) for Finance. Regarding the discount issue, buy and sell in cash and with deferred payment in the primary market which is called *bay'al inah*, shall be of jurisprudential problem and majority of jurists including Iranian and Non-Iranian believe that it is *Batil* and not permissible.

2.2.1.3 Companies Murabahah Security (*Sukuk*)

In this type of *Murabahah*, the issuer of *Murabahah* security (company) on behalf of the investors buys the required commodity of the government, firms, and families in cash from the producers (sellers) after collecting investors' fund, and sells it to the government, firms, and families in form of a *Murabahah* Bay'. The issuer (company) receives the price of the commodity from the debtors (government, firms, and families) on certain maturity dates and pays to the owners of securities in associating with banks. The owners of securities can either wait until maturity date for full return or sell their securities in the secondary market. Figure 3 draws recent model of *Murabahah* security.

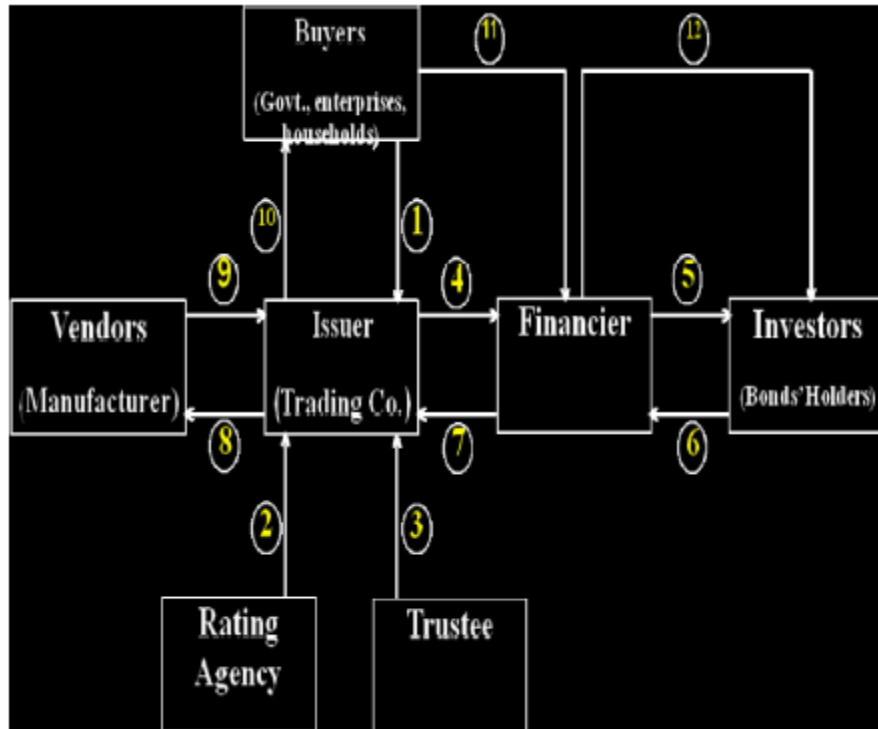


Figure3. Companies *Murabahah* Security (Mousavian and Zehtabian, 2009)

To participate in *Murabahah* type of trading, owners of securities transfer their funds to the company and the company engages in trading in form of partnership instead of the investors. Company buys the required commodities of the government, firms, and families or other types of producers in cash and sells it in form of *Murabahah* with deferred payment, then collects the receivables of the owners of securities in certain maturity dates and at the end of the fiscal year, distributes the profit among the owners of securities after deduction *Wakalah* fee. The owners of securities can sell their own portion of the company's assets whenever they decide to do that. Trades of this kind are combinations of *Wakalah*, *Wakalah* purchase, *Wakalah* selling, and asset selling in the secondary market which are permissible.

2.2.1.4 Mortgage *Murabahah* Security (Sukuk)

In mortgage *Murabahah* security, issuer issues *Murabahah* security, collects investors' funds and buys, on behalf of the investors, the originators' (bank or leasing company) mortgage facilities of the *Murabahah* Bay' (installment sales) to the government, firms and families in cash and in a price lower than nominal price, then the originator undertakes to collect the facilities from the debtors (government, firms and families) and give them to the issuer. Issuer also pays the funds received from the originator to the owners

of securities via an investment bank. Owners of securities can either wait until maturity date or sell their securities in the secondary market before maturity (*Shari'ah* Board Resolutions of stock exchange organization, 2010). Figure 4 illustrates the process of this type of *Murabahah*.

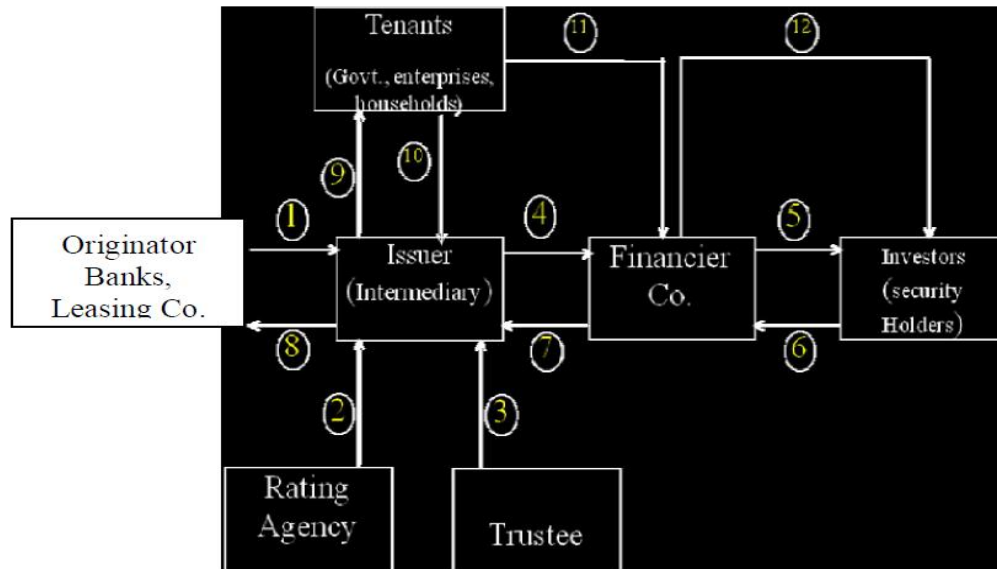


Figure 4. Mortgage *Murabahah* Security (Mousavian and Zehtabian, 2009)

A combination, of *Wakalah* and buy and sell of debt (discount) contracts is the primary and secondary markets of these securities in which investors funds are collected by issuer. Issuer then buys the originators' debts of mortgage facilities in cash on behalf of the investors (owners of securities). Investors can either wait until maturity date or sell these securities in the secondary market (discount). In jurisprudential point of view, buy and sell of debt (discount) is disputable and from the Islamic viewpoint a vast majority of Iranian jurists believe that it is permissible while most of Non-Iranian jurists believe that it is *Batil*, in contrast.

2.2.1.5 Practical Framework of *Murabahah* in Iran

In practice, a mixture of *Murabahah* Security for Finance and Mortgage *Murabahah* Security has been offered by the Iranian banks called so far “Installment Sales Facility” or “Furush Aghsati” for buying commodity. Over the three decades some minor changes have been made with respect to the details of running process to *Murabahah*. In fact bank should buy commodity on behalf of its clients in cash and

delivered it to the client with a higher price which consist of cost of commodity plus a reasonable mark-up. This amount will be paid in deferred time and on certain maturity.

In real transactions of *Murabahah*, clients do the process individually and bring their commodity invoices to banks to obtain facility. This is the point where problem arises, the Iranian banks are just content with commodity invoices which have been prepared merely by customers without seeking for necessary requirements.

There is possibility for customers to change the type of facility to the second type, *Murabahah* for liquidity which is has been jurisprudentially *Batil* and not permissible based on *Shari'ah*. It sounds when Iranian banks only fulfill the forms rather than the substance, *Murabahah* contracts remain superficial. It is seen that customers even go beyond by making fake invoices to obtain funds for other purposes but commodity. According to a member of the Islamic Hi-Council of the TSE, Naser Makarem (2006), if the facility is used under the approved agreement it can be acceptable and *Halal*, but in other cases it is *Batil*. *Murabahah* contracts for financing activities such as developments via fake invoices has been a real practice so far in the Iranian banks due to the lack of a strong surveillance mechanism for Ughods. Habibi (2009) claimed that many of facilities offered by Iranian banks in forms of Islamic products such as *Murabahah* are doubtful for concluding usury (*Riba*). It represents that the Iranian banks are merely carrying Islamic labels not rather than dummy version of Islamic banks.

Another problem which has been condemned by the Iranian jurists is the high rate of profits charged in the forms of different Islamic banking instruments which are not in accordance with *Shari'ah*. The Iranian banks used to calculate the rate of profits through the following equation:

$$p = \frac{s.i.(n+1)}{2}$$

Where:

p is the amount of profit, s is the amount of principle, i is rate of profit and n is the number of payments over the loan time. In this case the payments consist of a lower amount of profit where a higher part belongs to principle.

Some customers apply for the facility and after some months when they have paid the majority of principle and a minority of profit, they settle their loans. This leads to the banks' losses. Thus the authorities have introduced below the equation for Islamic products.

$$y = \frac{i}{12} \times \frac{s \cdot \left(1 + \frac{i}{12}\right)^n}{\left(1 + \frac{i}{12}\right)^n - 1}$$

Where: y is monthly installments, i is profit rate, s is the principle amount and n is number of payments. In this equation, profit is calculated monthly and installements at the beginning are mostly involved of merely profit rather than principle as long as profit is recovered. The recovery of the considerable amount of profit compared to the principle at the beginning of the Islamic banking services given period may not be in accordance with the economic philosophy of Islam.

Many of the Iranian jurists believe that there are still many significant actions which should be taken for purifying Iranian Islamic banking services from *riba*. It seems that many of activities which are common practice in the Iranian banks are just alike commercial banks. Such activities as deposit accounts, over drafting, business credits, credits on security and mortgage, long term credits, investments in banks and issuing securities by banks. After enacting the *riba*-free banking services in 1983, neither customer nor banks could implement the Ughods.

Customers deposit their funds under the Qardhul-Hassan accounts without expecting any profit, but they could not lend their money to banks without expectations. Therefore a competition arose among different banks to attract the public attention by grand prizes in lottery mode toward the Qardhul-Hassan accounts. The Iranian Banks allocate a part of their income to these bonuses for tempting customers toward the Qardhul-Hassan accounts (Beizae 2007). It seems the banks to cope with these types of expenditures when assigning the high rate of profit to customers' deposits for non- Qardhul-Hassan accounts, have to charge high rate profits to their facilities as much as commercial ones that is not allowed in jurisprudential viewpoint.

Jurists are also concerned with renewing process of facilities contracts when clients failed to pay the installements which given through Islamic products. The combination of profit and principle in order to calculate the profit for renewing the Islamic products contracts at maturity is highly challenging the Islamic scholars. Based on Javadi and Ghouchfard (2009), there are two main bases on which the Islamic banking is grounded, Justice and Profit and Loss Sharing (PLS). According to the Justice concept banks shouldn't charge high rate of profits and in order to follow the PLS, bank and customer should share profits and losses based on their risk and their capability, systematically. A circular of the Central Bank

of Iran asks all banks to penalise customers whom cannot pay their installments on the right time, even if they are bankrupted or in losses. This shows that Iranian banks assign all risk to customers that is *Batil* under the Islamic economic laws.

2.2.2 Murabahah in Malaysian Islamic banks

In the Middle East, some Islamic banks set commodity trading contracts (*Murabahah*) based on the London Metals Exchange (LME) to manage their liquidity over the years. In 2007, Malaysia created and released its own version of commodity trading *Murabahah*. It was done by issuing monetary notes of Central Bank backed by the country's rich crude palm oil resources. Because *Shari'ah*-compliant financial activities must be linked to real economic sector activities and real assets, Malaysia's sizeable inventory of the edible oil, which reached another 17 billion tonnes produced in 2010, has provided a useful alternative to base metals as a foundation on which a range of commodity *Murabahah* financial instruments can be built. The debut of Bank Negara Monetary Notes *Murabahah* (BNMN) in 2007 showed the Government's intent for developing its own brand of money markets' instruments.

Malaysian Islamic banks treasurers had long hoped for a money market instrument that could offer better capital protection and more secured credit. *Murabahah* was meant to fulfil this role. However, in 2010, the majority of the Islamic transactions were still done through a different product, *Mudarabah*, at 212.3 billion ringgit (\$69.6 billion), compared with commodity *Murabahah*, which totalled 58.7 billion ringgit. But the statistics may soon reverse, following Bank Negara Malaysia's teaming up with the Securities Commission and Bursa Malaysia to build market infrastructure to facilitate commodity *Murabahah* transactions to rival trades currently carried on the LME (Lee, 2011).

In Malaysia, short-term credit *Murabahah* is simply called *Murabahah* with payment payable in lump sum. A long-term credit *Murabahah* is known as al-Bai-Bithaman Ajil (BBA). BBA is also known as Bay'Muajjal and *Murabahah* in Pakistan and the Middle-east countries.

BBA is the most predominant mode of home financing in Malaysia since the introduction of Islamic banking in 1983 by Bank Islam Malaysia Berhad. BBA is a deferred installment sale where bank capitalizes its profit up front in the sale of property. The concept is similar to debt financing which is often resulted in high cost. BBA as practiced in Malaysia is seen not to be in compliant with the *Shariah* principle as the bank does not take the risk of ownership and liability on the property (Rosly, 2005 and Sanusi, 2006) and thus not acceptable by international scholars.

In addition, BBA is dependent on market interest rate as its bench mark. This causes problem in product pricing and marketing for Islamic home financing as when the market interest rate is low, the amount financed will be more expensive than the conventional loan. Thus, customers may withdraw from Islamic

banks and transfer its facility to conventional loan. Consequently, when the market interest rate is higher than BBA profit rate, Islamic banks suffer losses as it cannot increase the profit rate in BBA due to its fixed selling price.

Malaysian commodity *Murabahah* enables the lenders to create financing transactions that involve specific assets, fulfilling Islam's demand that all deals must involve real economic activity. In Malaysia, when an Islamic bank uses commodity *Murabahah* to offer financing, it will buy an asset to then sell it to the borrower. The borrower then sells the commodity to a third party using the bank as its agent, and it receives payment and secures the financing it had sought. Commodity *Murabahah* and some forms of *tawarruq* have drawn sharp criticism from several clerics who say the structures fall foul of Islamic principles.

Some Malaysian Bankers believe commodity *Murabahah* deals can be a sham with no true sale taking place and no real transfer of risk to the buyer of the goods. This shows the *Murabahah* version of Malaysian is yet matured and needs more attention by *Shari'ah* Scholars.

Malaysian Islamic banks recently, launched a standard agreement for commodity *Murabahah* deposit accounts between banks and corporates, aiming to remove a key barrier to the sector's growth. Based on this agreement, under a commodity *Murabahah* deposit account, a company which wants to place surplus funds with an Islamic bank will appoint the bank as its buying agent. The bank then buys commodities such as metal or palm oil on behalf of the company.

The bank then offers to buy the commodities from the company on a deferred cash payment basis, with the sale price including a profit to the company from the sale. However, some jurisdictions actually do not recognise commodity *Murabahah* and believe that, this is the responsibility of the *Shari'ah* scholar's to resolve the gap. Figures 5 and 6 represent the *Murabahah* in Malaysiaan context.

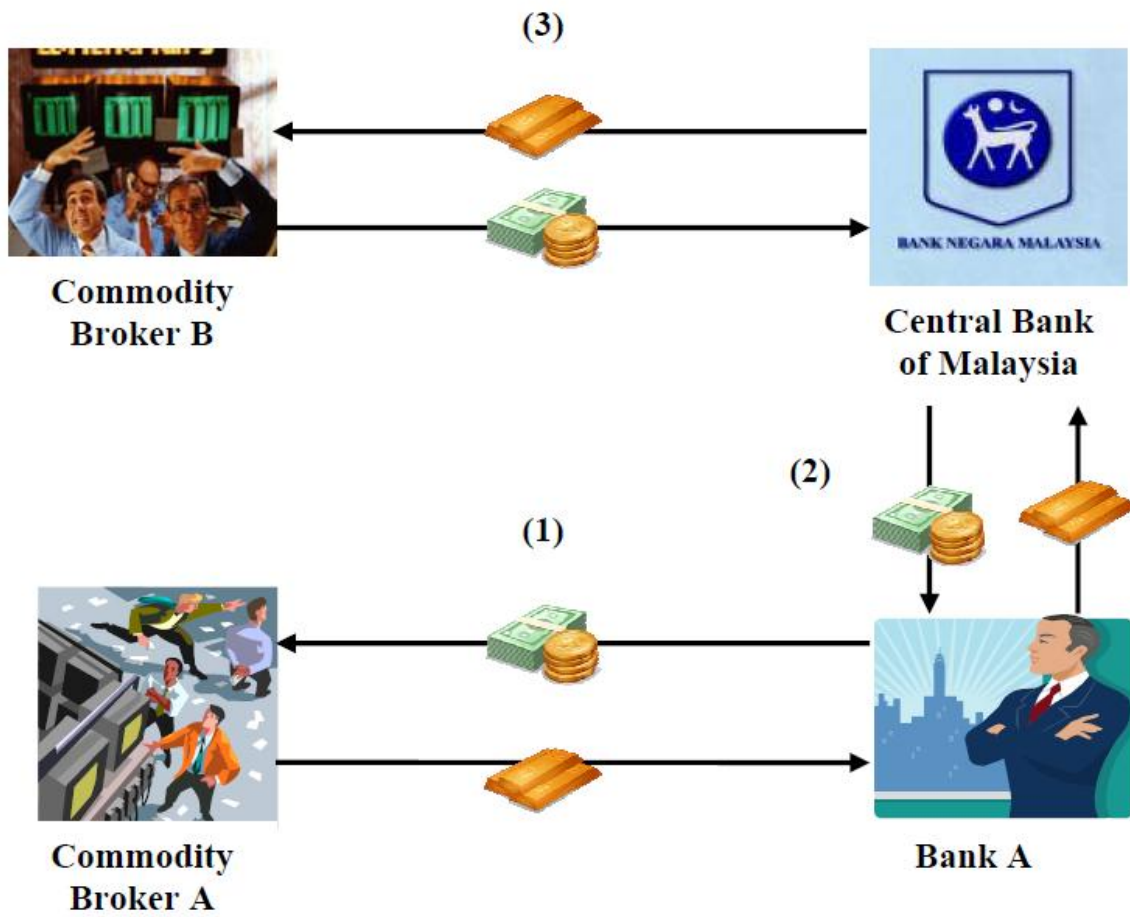


Figure 5. Commodity *Murabahah* program for liquidity absorption (Asyraf Wajdi Dusuki, 2008)

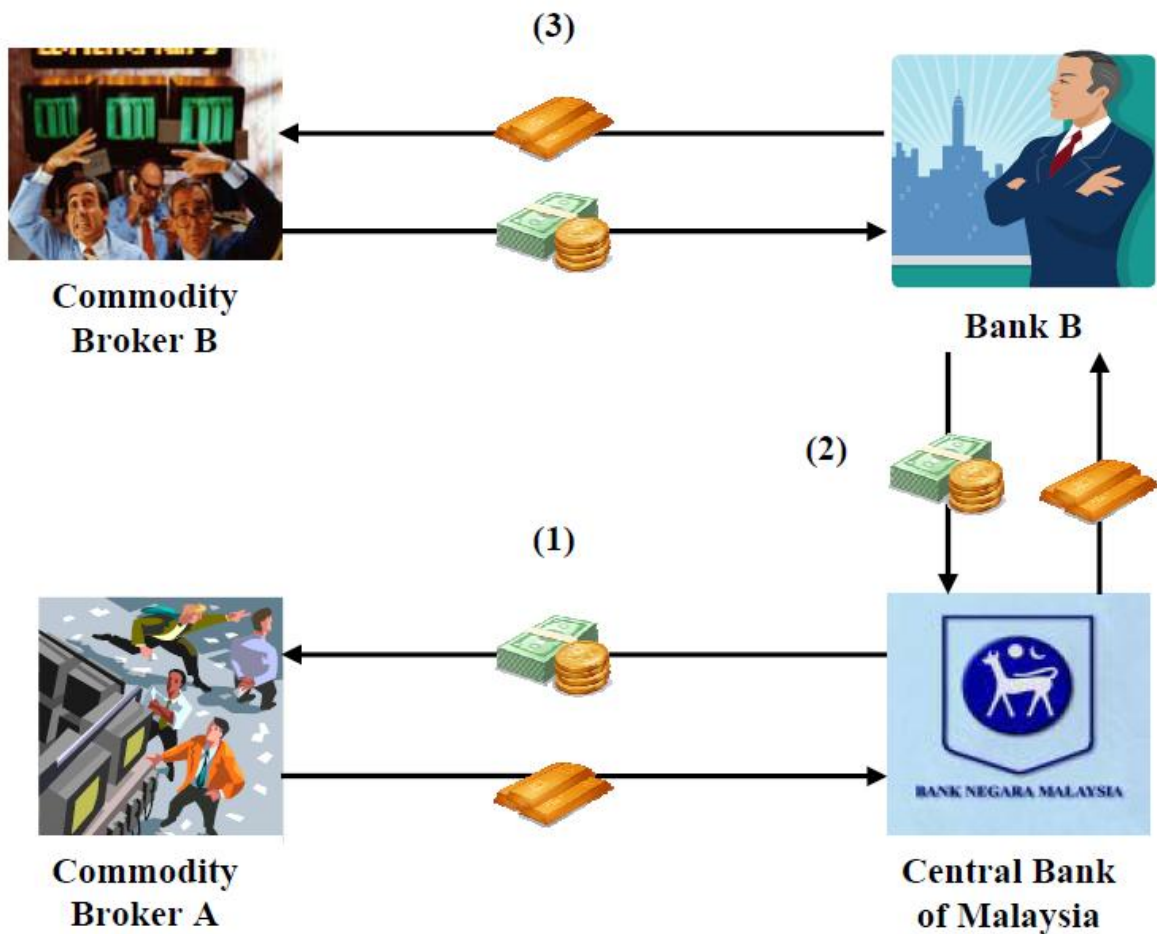


Figure 6. Commodity *Murabahah* program for liquidity injection (Asyraf Wajdi Dusuki, 2008)

3. Conclusion

The main principle of Islamic financial institutions is prohibition of *Riba* or usury. *Riba* is prohibited because it will lead to injustice and harm to the society. However, it is surprised to see in practice that Islamic financial institutions are still practicing *Riba* in these *Murabahah* transactions as evidenced in Iran. Many of the Iranian jurists believe that there are still many significant actions which should be taken for purifying Iranian Islamic banking services from *riba*.

In the case of Malaysia, BBA home financing is used by Islamic financial institutions and the profit rate is still dependent on the market interest rate due to arbitrage activities. Therefore, it is similar to the conventional mode of financing. The current difference between the fixed-rate BBA and the conventional mode is that once the profit rate is fixed in the BBA, say at 7% per annum, it will remain the same for the

entire duration of financing. This, in fact, causes problems for the financiers as it is difficult to estimate accurately the cost of funds and profit rate over long periods like 20 years, due to the volatility of economic conditions. The situation encourages customers to refinance their home from BBA home financing to conventional home financing during low interest periods and vice versa. The foregoing discussion has highlighted some of *Murabahah* features that have contributed to dissatisfaction or controversies among the consumers. Islamic financial institutions should strive to provide financial facilities that comply with *Shari'ah*. It is expected that the primary objective of Islamic banking is not to maximize the profit as the interest-based banking system does, but rather to render socio-economic benefits to the Muslims.

Eliminating *Riba* in the banking system is an indispensable part of Islamic business principles. Management and staff of this system are bound to conduct their business with conformity to Islamic business principles in addition to the normal objective of profit maximization. These principles include honesty, justice and equity as ordained by Allah and practiced by Allah's Prophet. It is suggested that Islamic banks that have the *Murabahah* financing to practice true *Murabahah* in order to prevent *riba* in the transactions and to achieve *Maqasid Al Shari'ah* (objectives of *Shari'ah*). The existence of Islamic benchmark could be the solution for this to replace the conventional benchmark which is still using rate of interest.

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