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Murabaha Documentation & Application of Murabaha



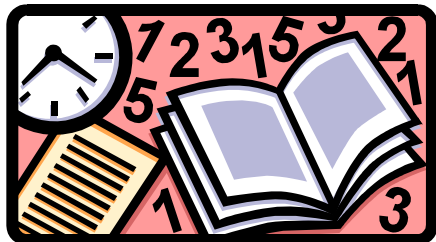
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Part II

Murabaha Documentation & Practical Issues





Murabaha Documentation

There are a number of documents involved in a Murabaha financing transaction. The most essential of these documents are:

- Master Murabaha Financing Agreement
- Agency Agreement
- Order Form / Draw Down Notice
- Declaration
- Purchase Evidences
- Demand Promissory Note
- Payment Schedule



Murabaha Documentation

Master Murabaha Financing Agreement (MMFA)

- Its an agreement between the client and the Bank whereby the client agrees to purchase goods from the Bank from time to time as per the terms and conditions of this agreement.
- This is an over all facility agreement under which various Sub-Murabahas may be executed from time to time.
- Hence it needs to be signed once at the time the facility is sanctioned.



Murabaha Documentation

Agency Agreement

- Through this agreement, the Bank appoints customer its agent to select and procure specified goods for the Bank.
- This agreement needs to be signed once between the client and the bank to cover the specified agency period. The disbursement of funds is done under this agreement.
- The customer should define a comprehensive list of assets and commodities that he may procure during the course of business from time to time.



Murabaha Documentation

Order Form

- This document is executed at the time of each sub-Murabaha request i.e. each time when the customer requires Murabaha for purchase of assets.
- Through this document customer requests the bank to purchase the assets from the supplier and undertakes that it will purchase the assets from the bank once the bank acquires them from the market.
- The customer also undertakes to compensate for the actual loss the bank may suffer in case that he fails to purchase the assets from the bank.



Murabaha Documentation

Declaration

- This is the most important part of the Murabaha process.
- Declaration is to be signed by the customer immediately after the purchase of goods as Bank's agent but before the actual consumption.
- This document establishes the actual sale transaction, i.e. transfer of ownership of goods from the Bank to the customer
- At this stage the specific details of the assets must be known i.e. quantity, quality, cost etc.



Murabaha Documentation

Declaration

- Purchase Evidences in the form of bills, sale invoice, sales tax invoice must be furnished along with the Declaration specifying the full details of the goods purchased.
- The cost of goods must be inclusive of all cost including sales tax, transportation and handling etc.
- Proper timing of declaration is extremely important especially in cases of perishable or immediately consumable commodities.
- Murabaha price (Cost of Goods + Profit) should be determined at this stage and stated clearly in the Declaration.



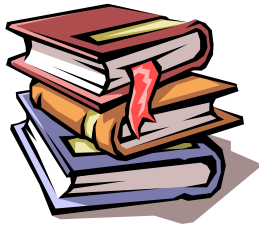
Murabaha Documentation

Payment Schedule

- The Payment Schedule specifies the amount that the Client will make from time to time or at once towards the payment of Murabaha price.
- This shall be executed after the execution of Declaration.
- The dates mentioned in the schedule corresponds to the day when the payment becomes due on the client.



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Practical Issues in Murabaha



Issues in Murabaha

1. Timing of 'Offer & Acceptance'
2. Rollover in Murabaha
3. Rebate on Early payment
4. Penalty in Late payment
5. Subject Matter
6. Purchase Evidence
7. Direct Payment
8. Profit recognition
9. Training of Customer & Bank staff
10. Process of Murabaha differ from product to products



Issues in Murabaha

1. Timing of 'Offer & Acceptance'

- A Murabaha financing arrangement consists of a series of documents to be executed at various stages, the sequence and timing of which is extremely important.
- Through this, client and the bank execute an important step of a valid Murabaha sale i.e. Offer & Acceptance.
- This is to be signed by the customer when it has purchased and taken possession of the goods as the Bank's agent.
- Offer & Acceptance must be signed while the goods are still in existence and have not been used in the production process or sold to some other entity.



Issues in Murabaha

2. Rollover in Murabaha

- Rollover in Murabaha is not allowed since each Murabaha transaction is for the purchase of a particular asset. A new Murabaha can only be executed for the purchase of new assets.
- It is advisable that whenever practicable there must be a gap of 1-2 days between maturity of the previous Murabaha and disbursement of the new one.



Issues in Murabaha

3. Rebate on early payments

- If the customer makes early payment and there is no commitment from the institution in respect of any discount in the price of Murabaha, than the institution has the sole discretion in allowing them the rebate.
- It is not recommended to make it a practice and must be avoided in normal course of business. Such issue, if arises, should be brought in the knowledge of Shariah advisor



Issues in Murabaha

4. Penalty on late payments

- As soon as the Murabaha is executed, the Murabaha price becomes a receivable (Dayn) for the Bank. Hence, any amount charged over and above the “dayn” amount will be Riba.
- However, it is permissible to have an undertaking from the customer to pay an amount of money or a percentage of the debt to be donated to charitable causes in the event of delay in payment/installments.



5. Subject matter of Murabaha

- Goods must exist at the time of execution of Murabaha.
- Murabaha cannot be done in all commodities, e.g. such as currencies, gold, silver.
- Murabaha cannot be used for paying utility bills, wages, overhead expenses, etc.
- General rules of sale related to subject matter must be followed



6. Purchase Evidence

- In order to ensure that the customer actually purchased the assets as claimed, the customer is required to submit asset purchase evidence along with Offer & Acceptance.
- The purchase evidence must confirm that the asset purchase took place after the agency agreement.
- Asset purchase may be in the form of Invoices, delivery orders, truck receipts etc.



6. Purchase Evidence.....(Contd)

- In some cases, however, it may be too burdensome for the client to submit all the invoices as the number of invoices may run into hundreds.
- For example, cotton purchases are generally in small quantities from various sources and hence for each Sub-Murabaha there may be too many invoices to submit. It is suggested to furnish considerable sample of invoices along with summary of all purchases.



7. Direct Payment in Murabaha

- In many cases, the disbursement is made to the customer as an agent of the bank.
- In order to ensure transparency of the Murabaha, it is preferable that disbursement / payment be made directly to the supplier.



8. Profit Recognition in Murabaha

- Generally in Murabaha transaction there are in two stages:
 - Investment Stage (Agency to Purchase)
 - Financing Stage (Declaration to payment)
- The profit for the Murabaha transaction can be recognized after the goods are sold by the bank to the customer.



9. Training of Customers & Bank staff

- Proper training & understanding of is very important for
 - Bank staff dealing with the Murabaha
 - Customers purchase officers & accounts staff.



10. Process of Murabaha differ from product to product

- Application of Murabaha is not simple for all products
- Its application differs from products to products like
 - ✓ Sugar cane
 - ✓ Shares
 - ✓ Leather
 - ✓ Cotton
 - ✓ Gas
 - ✓ Petrol

Therefore the RM/RO dealing with the customer needs to understand and define step wise process flow along with the credit approval for each new customer/industry



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Customers' Responsibility



Customers' Responsibility

- Ensure that goods are purchased after the execution of Agency agreement as bank's agent & Order form.
- Proper Fund utilization under agency – as client is acting as a **trustee/ameen** on bank's behalf. However, it is more preferable that direct payment is made to the supplier.
- Actual purchase of goods and its timely intimation to the bank.
- Timely submission of purchase evidence/invoice. At this moment the bank may conduct a physical inspection of the goods.



Customers' Responsibility

- Purchase of goods from the bank with a help of valid **offer and acceptance** via Declaration before their consumption.
- Timely payment of the agreed Murabaha price.
- A request for disbursement of new Murabaha for payment of old debt is not allowed and should be strongly avoided.
- Murabaha should not be used for paying utility bills, wages, overhead expenses, etc.



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Bank / Relationship Manager's (RM) Responsibility



RM's Responsibility

- Ensure that Customer's need & purchase process cycle is fully understood and conforms to the approved Murabaha processes.
- Define a step wise process for Murabaha for each customer in view of the specific industry requirement, product nature involved, supplier payment terms (credit or cash etc).
- Ensure that the Credit proposal must define the process flow clearly and have Shariah Advisor's approval.
- Ensure that customer is properly briefed about the requirement of Murabaha
- Ensure that MMFA & Agency agreement are executed before any disbursement to the client.



RM's Responsibility

- Ensure that payment is made directly to the supplier of goods. In cases where funds are disbursed to the client under Agency, it must be ensured that they are properly utilized for the actual purchase of the required goods.
- Once the goods have been purchased by the Client and declaration is forwarded to the bank, the RM must ensure the presence of goods at client end. (at least via telephonic verification at the factory, warehouse etc)
- A random physical inspection of the goods to be done by RM to verify the same. (at least in 10%-15% cases).
- The relevant purchase invoices must be collected as soon as the client makes purchases of the goods.



RM's Responsibility

- The Declaration must be executed immediately, before consumption of goods, to transfer the ownership to the client. The timeline given for Murabaha Declaration should be taken as maximum time allowed for declaration receipt.
- Murabaha should not be used for paying utility bills, wages, overhead expenses, etc.
- A request for disbursement of new Murabaha for payment of old debt is not allowed and to be strongly avoided.



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Credit Admin Officer (CAD) Responsibility



CAD Responsibility

- Ensure that the Credit proposal have Shariah Advisor's approval before disbursement.
- Ensure that MMFA & Agency agreement are executed before any disbursement to the client and are properly filled and witnessed
- Description of assets in the Agency Agreement is complete
- Filled Order form from the customer must be available before disbursement of funds and declaration
- The goods described in the Order form confirms to the Agency agreement.



CAD Responsibility

- Ensure that goods are purchased after the execution of Agency agreement as bank's agent and Order Form.
- The declaration for Murabaha is available as per the policy guidelines provided.
- The goods described in the declaration form confirms to the Agency agreement.
- The declaration must be properly filled, signed and witness. (including cost, profit etc)
- No Murabaha is disbursed just to settle old Murabaha debt (see Rollover in Murabaha section)
- Check invoice and Purchase evidence thoroughly.



Murabaha Checking & Monitoring

Purpose:

The purpose of implementing Murabaha-Monitoring Mechanism (MMM) is:

- To improve the quality of Murabaha transactions,
- To reduce the gap between disbursement and purchase evidence,
- To avoid delays in declaration and to streamline Murabaha transactions in Commercial Banking, Corporate and at all branch level.