

Issues of Possession in Murabaha Financing

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Abstract

Possession is an important condition of the Islamic law of contract. Today, numerous banks are operating under Islamic banking principles. Therefore, it is an important requirement of the Islamic financial institutions to carry out transactions in accordance with the rules of Sharia. According to Sharia, any transaction without possession is considered void. On the other hand, possession is an important condition in all the modes of the Islamic finance, especially in a Murabaha contract. The concept of possession is simple; however, its implementation is difficult. This paper aims to discuss the practical issues of possession in execution of Murabaha Financing.

Keywords: Possession, Islamic Banking, Law of Contract, Murabaha

1. Introduction

Islamic financial intuitions have been successfully running their business model for the last couple of decades. Expectations from the Islamic financial markets are very high especially in the Muslim countries where people have reservations about their money and getting the Halal returns. Therefore, certain obligations that must be fulfilled by the Islamic financial institutions like assurance that the actual funds are not being invested in non-Sharia approved transactions. So, they may work to achieve the optimum goals of Sharia i.e. Maqasid of Sharia.

Several banks are now operating under the Islamic banking principles in Pakistan as well as in other countries. Conventional banks are opening Islamic windows such as NBP, Bank Alfalah etc. Even some conventional banks such as Faisal Bank, Summit Bank etc. are converting their set up of the conventional banking into a fully-fledged Islamic bank. Therefore, the responsibility to ensure the compliance of the Islamic financial institutions has also been increasing with time.

It is an important requirement of the Islamic financial institutions to carry out the transactions in accordance with the rules and regulations of Sharia. Risk and possession are the key factors of Islamic banking. Risk can be mitigated as per the sharia but possession is altogether a different phenomenon. Possession is the main component for any transaction according to the teachings of Islam. Possession means “The condition of having or owning something”. It is an unavoidable condition for a transaction. On the other hand, the conventional banks do not pay such attention towards possession because of their Riba based nature. For Islamic Banks possession is very important, Due to the sale without possession, the whole economy suffers damages. That is one of the main reasons why Islam emphasizes on possession. There are many hadiths which mention that a sale without possession is null and void in Islam. Once the Holy Prophet (PBUH) said:

“You must not sell grains before you have your possession on it”.

Hazard Ibn-e-Umar said while he was interpreting this hadith that he thought everything contained the same sharia ruling.

2. Conditions Related to the Subject Matter

- The subject matter must be in the ownership of the seller
- Seller must have power to handover the subject matter to the buyer.
- The subject matter must be valuable.
- The subject matter should be Sharia compliant.
- Tenure of the transaction must be decided.

Thus, possession is an important condition for the subject matter.

3. Sale Before Possession

There are different viewpoints among the scholars of Sharia on this issue.

- Ata Bin Abirabah and Usman Batti
- Imam Shafi and Imam Muhammad
- Imam Malik
- Imam Ahmed Bin Hambal
- Imam Abu Hanifa and Abu Yusuf

3.1. Ata Bin Abirabah and Usman Batti

Ata Bin Abirabah and Usman Batti say that it is generally allowed to sell goods without possession. Hazard Ibn AL Bard says that this point of view is rejected due to the practice of the Prophet Muhammad (SAW). Ibn al Bard also claims that Hazard Ata and Usman have no hadith supporting their view.

3.2. Imam Shafi and Imam Muhammad

Imam Shafi and Imam Muhammad come with the opinion that selling goods without possession is generally forbidden in Islam. This prohibition is related to every type of goods, eatables, moveable, and non-moveable, or measurable. Imam Shafi says in his book al Umm

فمن ابتاع شيئاً كاننا ما كان فليس له ان يبعه حتى يقبضه

For a person who buys something, it is not allowed to sell it out before having the possession.

3.3. Imam Malik

Imam Malik says that all eatables (measurable or weighable) are not allowed to be sold before having possession. If the goods are not measurable or weighable, they can be sold without possession. On the other hand, Some Malki scholars explains a different view that if the goods are eatable and they can be measured or weighed, they cannot be sold without possession.

3.4. Imam Abbu Hanifa & Abu Yousuf

Sale before possession of the moveable goods is not allowed. It is allowed in immovable items like real state etc.

3.5. Imam Ahmed Bin Hanbal

It is not allowed to sell eatables before possession. If goods are not eatables, then sale before possession is allowed.

3.6. Sharia Ruling for Sale Before Possession

Sale before possession is not allowed in Islamic law. Such transaction will become Bai Al-Fasid.

4. Physical Possession & Constructive Possession

It is the type of possession which occurs physically. For example, A owns a car. He offered B to sell his car. B accepts his offer and comes to A and takes the ownership and possession of the Car physically. This physical transfer of the risk of the car is known as the Physical Possession.

On the other hand, in constructive possession, the buyer can ensure possession by taking rights, liabilities, and other important elements of possession in his risk rather than the actual possession.

Transferring of possession is decided between the supplier and its customer and

depends upon the nature of the transaction. In Islamic banking practice Transfer of the possession is determined at the time of designing of process flow. Normally two types of financing facilities are obtained by the customer in a contract. First, the customer needs financing for a local purchase, and second the client needs financing for import or export purpose.

In the case of Local Transactions, the client places an order to bank for the purchase of goods. Then acting as an agent, the client places an order to the supplier for the purchase of the required goods. Normally, there are two market practices through which risk and possession is transferred.

Goods are transported through the supplier's vehicle and are under the supplier's risk. In this case, the banks can execute contract only when goods are unloaded at the client's premises where the risk is transferred to the bank's client.

In the second case, the goods are carried and transported through customer's/rented vehicle. In this case, the contract is possible only after the lodging of goods by the supplier to the customer's/rented truck, and once the goods are loaded, the risk is transferred to the agent. Declaration will be executed through physical/telephonic confirmation.

It was noted in some cases that the goods are consumed by the client, or execution of contract was signed prior to the delivery of the goods to client which resulted in Bai Qabal-al-Qabz as per the Shariah rules mentioned above.

In both the cases, the shariah auditors check the nature of the business practice of the client, cross check with the process flow, and trace the date of the contract to justify if the transaction is not done under Bai Qabl-Al-Qabz.

In Import cases, the clients order to purchase goods from a foreign country. The supplier loads and dispatches the goods through shipment or other sources and also sends the relevant documents to the bank. Normally, the client/ bank receives documents earlier than goods. After receiving the documents, banks execute contract with the client.

It is important to check the possession in import cases to sign contract. In import scenarios, possession is defined through Inco terms. Inco terms explains the ownership and the risk of the asset purchased. The ownership and risk can be transferred to the client through the following ways:

- Ownership and risk transferred before the issuance of the Bill of lading
- Ownership and risk transferred at the time of issuance of the Bill of lading
- Ownership and risk transferred after the issuance of the Bill of lading

It is observed that the trade departments in banks usually are not very well aware of the Inco Terms and thus sign the process flow without considering the Inco Terms which may result in Bai Qabl-Al-Qabz.

For instance, Inco Terms of the contract were CFR (Ownership and risk transferred at the time of issuance of the Bill of lading) and the bill of lading date was on 23rd October. However, the contract was executed on 14th of October. This minor mistake results in Bai Qabl-Al-Qabz.

Solution: The staff of an Islamic Bank should be aware of that policy and know the importance of possession and special care should be taken by bank staff while executing the transaction.

Moreover, other reviewing and approving staff should review the documents vigilantly to avoid any Shariah issue in Murabaha Transaction. Mufti Taqi Usmani also has mentioned in his book on GhairSoodiBankari that in case of doubt related to possession in the local cases, it is required that the staff of the branch should physically visit the place and verify the possession.

Possession can be taken constructively as it is possible form TAKHLIYA. It means to provide complete authority and remove all hurdles for possessor. Sharia scholars have different viewpoints about possession. According to Imam Shafi in moveable goods, possession cannot take place unless the goods are moved from the seller; it means he considers physical possession. Imam Abu Haneefa comes with the view that physical possession is not required. Possession can be done by the constructive possession (TAKHLIYA). TAKHLIYA means to give the buyer a free space to take possession whenever he wants. When there is no hurdle in taking possession, it will be considered as possession. For example, there is a locked box with some gold in it. If the key of box is handed over then it means the possession is done according to Imam Abu Haneefa's viewpoint. Whereas according to Imam Shafi, the buyer must have to move the box to another place.

Imam Abu Haneefa says that the buyer must have his possession before selling. This is due to the shariah maxim "من ربح مالاً يرضى" Means, there is no profit without

DAMAN (risk). Without TAKHLIYA (risk), there is no possession. If the goods are destroyed then the seller will be responsible, and if the goods are possessed by the buyer and get destroyed then the buyer will be responsible.

5. Murabaha Financing

Murabaha is a specific type of sale that is in conformity with the Islamic laws of contract. Murabaha is a sale in which the seller explicitly declares the cost that he has incurred on the sale of the commodity and adds some percentage/mark up or profit which is known to the buyer. There are three types of sale in which there is a requirement of Shariah for the "honest declaration of the cost" and Murabaha is one of those three types. The other two types are tawliyah (sale at cost) and wadiah (sale at specified loss). There is another type of sale which is quite similar with Murabaha i.e. Musawamah. The difference between two of them is of the disclosure of the cost. In Murabaha, it is required that the cost of the product should be disclosed which is aforementioned. However, Musawamah is a simple sale in which there is no requirement to disclose the cost to the buyer.

Murabaha in AAI OFI is defined as the selling of a commodity as per the purchasing price with an agreed profit mark up. This mark-up may be a percentage of the selling price or lump sum". So, in short Murabaha is a profit-making sale transaction which is now commonly used by the banks as modes of finance. According to the verse of the Holy Quran from Suarah Baqarah, "It is no crime offer for you to seek the bounty of your lord", some jurists believe that this verse is stated to support the permissibility of Murabaha and here the word "bounty" means to earn profit. Payment terms of Murabaha transaction are of two types: On spot/cash payment basis which is known as simple Murabaha transaction in which the cost is disclosed, profit is added, later payment is made on spot or cash basis. Deferred payment-based transaction (Credit sale) is classified as Murabaha Muajjal in which the payment is made on deferred basis. Normally, all Islamic banks deal in both the types of Murabaha.

Murabaha is one of the most popular debt-based modes used by the Islamic banks to promote Riba-free transactions. Typically, banks use Murabaha in asset financing, property, microfinance, and commodity import-export etc. In conventional banks, advance money is given to borrower based on loan and later conventional bank charge pre-determined rate of interest which is classified as Riba. But in the Islamic banking, banks sell products on Murabaha contract. Today in Islamic banks world-over, 66% of all the investment transactions are made through Murabaha. Murabaha is a debt-based transaction which is very easy to

operate. The return of this mode of finance is fixed, and the risk related to this transaction is quite low. Therefore, banks are keen to use such types of financing which offers more predictable income stream. According to Mufti Taqi Usmani, if we truly want to have the benefits of Islamic economics, banks should move forward from trade-based products like Murabaha to partnership-based products like Mudarabah or Musharakah (SBP). Although Murabaha is not a partnership mode but still there is a doubt over its Shariah compliance (GairSoodiBankari). There are, however, certain practical guidelines in place which aim to ensure that the Murabaha transactions between the bank and the customer are used for trade purpose and not merely for the financing purpose. For example, the bank must take constructive or actual possession of the good before selling it to the customer. In short, this can be concluded that Murabaha is one of the most commonly used modes of financing by the Islamic Banks and financial institutions.

Although Murabaha is a specific type of sale, yet the Islamic banks are using Murabaha as a mode of finance in situations where they will deal with their clients to purchase raw materials, goods, or equipment etc. and sell these commodities to a client at the cost plus a negotiated profit margin which normally is to be paid in instalments. With Murabaha, the Islamic financial institutions no longer share profits or losses, but instead bear the risk of credit sale.

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5.1 Step by Step Murabaha Financing

Before providing Murabaha financing facility to the client, process flow related to client and product is prepared by the product development/ Shariah department incorporating all the necessary details relating to the customer which include but are not limited to as listed below:

- name, address, and introduction of the client
- major suppliers
- mode of payment
- inventory holding period
- timing of delivery
- payment terms
- types of product etc.
- Process flow is the important aspect of product designing as all details related to the client must be done in accordance with the process flow.

Besides Process flow, certain documents need to be prepared to execute Murabaha transaction. As per AAIOFI standard on Murabaha, it is permissible to prepare one set of documentation from the customer stating the request to the institution to purchase an item from certain source of supplier. It is also permissible to add a promise clause from the client to purchase that item in the said document.

- The client and the institution sign an overall master agreement, whereby, the institution and the client promise to sell and buy the commodity from time to time on an agreed ratio of the profit added to the cost.
- After the master Murabaha agreement, agency agreement is signed by both the parties in which the Islamic financial institution works as the principle and its client works under the capacity of agent.
- The client requests the Islamic bank to purchase the commodity. This document is known as the order form.
- The client purchases and takes possession of the commodity on behalf of the institution under the agency agreement.
- The client informs/declares the institution that he/it has purchased the commodity and instantaneously makes an offer to purchase it from the institution.
- The institution accepts the offer and the sale is concluded whereby the ownership as well as the risk is transferred to the client.

- The most essential element of the transaction is that the goods must come in the risk of the bank during the period between the third and the fifth stage which refers to possession.

To summarize, the following are the main documents that are used in Murabaha financing:

- Master Murabaha Financing Agreement
- Agency Agreement
- Purchase Requisition/Order Form / Draw Down Notice
- Declaration
- Payment Schedule
- Murabaha Contract

We must understand that this process flow must be followed as per these guidelines to avoid any issue related to Sharia or banking laws etc. Almost all financial Islamic institutions including banks have the same process for Murabaha transaction. Financing is provided to a customer through Murabaha mode of financing.

It is observed that sometimes bank's Trade department is not competent to understand the dynamics of Inco Terms as result they signs the process flow without considering the Inco Terms which may result in Bai Qabl-Al-Qabz.

For instance, dates of signing agreement can become a shariah issue, if inco Terms of the contract were CFR (Ownership and risk transferred at the time of issuance of the Bill of lading) and bill lading date was on 23rd November. However, Murabaha Contract was executed on 14th of November. This minor mistake resulted in Bai Qabl-Al-Qabz.

As a Solution we can say this that the staff of Islamic Bank should be capable to understand the policy and know the importance of Moreover, other reviewing and approving staff should review the documents vigilantly to avoid any Sharia issue in Murabaha Transaction. Mufti Taqi Usmani also has mentioned in his book *GhairSodiBankari* that in case of doubt related to possession in local cases, it is required that the staff of branch should physically visit the place and verify the possession.

6. Conclusion

Possession is an important part of Islamic law of contract. It is one of the conditions of subject matter. That is why Islamic financial products are designed with the intension to ensure possession. Keeping its important in mind it was expected that this condition should be enforced accordingly but it is noticed that possession related issues often occurs, in modern day Islamic banking practice. following are some key finding regarding possession in contemporary banking practice:

- Islamic financial products are designed with the intension to ensure possession. but it is found that in practical banking operations there are numbers of shariah observation regarding possession. This is mainly due to the incompetency of the banker. As mostly Islamic bankers comes from conventional banking system with the academic background MBA or BBA with no understanding of Islamic finance. On the other hand, banker works under the pressure to meet their business targets. So, their main focus remains to get more and more business. One banker told that he cannot sleep properly due to the unbearable pressure. As a combine result of these two reasons, banker have minimum understanding and intension to ensure shariah compliance along with possession. we normally sing documents with the client just to “fulfill formality” as explained by one banker. It is due to this bad practice it is noted in some cases that goods are consumed by the client, or execution of Murabaha contract was signed prior to the delivery of the goods to client which resulted in Bai QablulQabz.
- The complex nature of contracts makes it difficult to ensure possession. Such is the case in commodity Murabaha. The situation becomes even more complicated, when the subject matter is a non-differentiate able commodity by its nature, such as oil. Ensuring possession in oil is difficult, when numbers of oil tanker are entering an oil storage facility in which oil in few selected tankers is the subject matter for commodity Murabaha. Later the oil from these tankers is transferred into a big tanker. Thus, this leads to a mixture of commodity Murabaha oil with the other oil. Under such explained scenarios Islamic banks ensure possession by taking possession of the tanker, at the time of the entrance of the tanker into the oil storage facility. Although with this control the possession is ensured yet it is a difficult to practice as practically a raw of tanker enters the facility at one point of time, on the other hand, mostly the security staff along with tanker drivers are not educated to understand the complexity of the situation. if a single Murabaha tanker enters into the facility without possession, this can

potentially lead towards a shariah issue. To further strength this control banks can appoint their representative on gates who will ensure possession himself, but this practice can poetically increase banks cost.

So, it is suggested that the complexed natured products should be avoided, and simple natured products should be adopted. These shariah compliant products should be easy to understand and easy to practice.

- Shairah Compliance & Shariah Audit departments had an important role to ensure possession. The auditors need to check the nature and business practice of the client, cross check with process flow, and trace the date of contract to justify transaction are not done under Bai Qabal-UI-Qabz. It is found that sometimes the complex nature of subject matter makes ensuring possession difficult, thus more attention on said issue becomes necessary. Following are some suggested controls for possession:
 - Possession can ensure with the additional support of bills, goods receiving notes etc.
 - Possession can ensure with a physical inspection of an agent of the bank
 - Possession can ensure with the supporting evidence of photos and video etc Possession can ensure through a surprise check other than planned checking, either by checking the documents or by the inspection of actual assed.

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