
Structuring Islamic Syndication Financing

Tariq Ali
Managing Director
Trident Financial Consulting W.L.L
Bahrain

Types of Islamic financing structures used for syndications

Murabaha agreement or trust sale

- A contract, where the cost price plus the mark up or profit is disclosed and agreed when entering into the transaction.
 - *Murabaha is sometimes termed "cost plus profit Financing"*
 - *For Murabaha transaction to be sharia compliant a valid sale need to be fulfill the following considerations;*
 - The object must exist at the time of sale,
 - It must be owned by the seller at the time of offering to sell it
 - It must have value
 - It must be delivered to the buyer
 - There should be price certainty as price could not be determined at future date
 - Sale must be unconditional
-

True Murabaha

True Murabaha

- Involves a real purchase and sale of an object

Structure

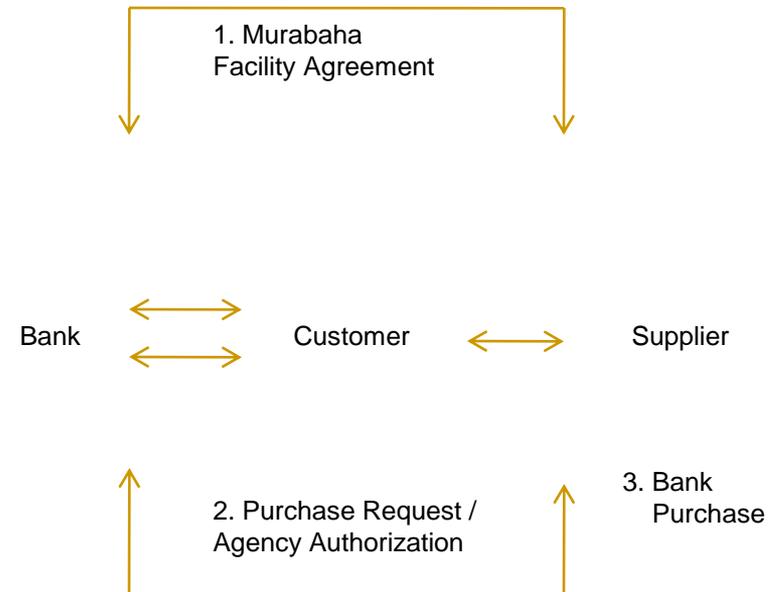
- Bank will purchase Goods for its corporate customer
- Corporate acts as the undisclosed agent of the bank
- Bank will sell the goods to the customer at a sale price comprising the cost price plus profit on a deferred payment basis

Repayments

- Terms of the deferred payments are subject to negotiations and can be in;
 - Installments
 - Ballooned payments
 - Bullet payment
-

True Murabaha

1. The customer and the bank sign a *Murabaha Facility Agreement (MFA)* in which, amongst other things, the customer undertakes/promises to buy from the bank the object to be purchased by the bank at its cost price plus profit on deferred payment terms.
2. When the object is required by the customer, the customer requests the bank to purchase it by authorizing the customer to act as the bank's undisclosed agent to enter into the sale contract with the supplier.
3. The customer buys the object as the bank's agent -the bank purchase stage -and risk and title to the object passes to the bank as undisclosed principal.
4. The customer notifies the bank that it has purchased the object and the bank makes an offer to sell it to the customer.
5. The customer accepts the offer and the sale is concluded -the *murabaha sale stage* -with title and risk transferred from the bank to the customer. The customer owes the bank the sale price payable on deferred payment terms in installments or bullet payment.

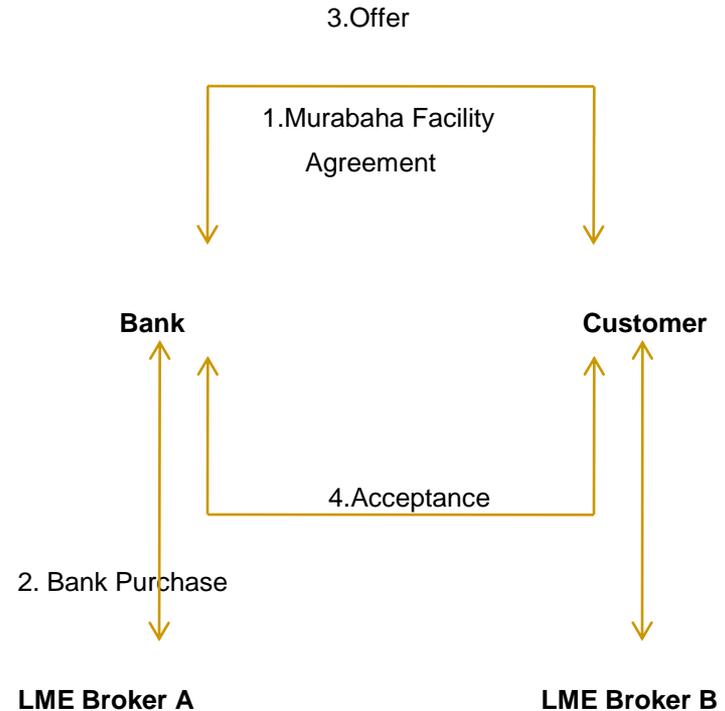


Commodity Murabaha

- In Commodity Murabaha the parties' interest does not lie in object to be bought and sold *but rather their cash realisable value by immediately selling them*. So it is a *tuwarruq transaction*.
 - This transaction is the subject of substantial *Shariah scholarly debate*.
 - Some scholars take the view that it is acceptable, because Sharia allows trading
 - Other take contrary view that because the object of the sale is wholly irrelevant to the intended purpose of the transaction, "intermediating" an object for sale does not legitimise the result of the transaction: extension of credit
 - A third view is that it is permissible under certain conditions i.e a person in financial need cannot satisfy that need by other Sharia-compliant means
-

Commodity Murabaha

- No difference with a "true". murabaha ,
- The bank contracts with the LME broker and buys the commodity from the LME broker - the bank purchases stage and title to the commodity passes to the bank
- The bank makes an offer to Sell the commodity
- The customer accepts the offer and the sale is concluded -the murabaha sale stage -and title is transferred to the customer. The customer acquires the commodity and owes the bank the sale' price payable on deferred payment terms in Instalments or by bullet payment
- To realise cash, the customer sells the commodity to LME broker B (either directly or by appointing the bank as its agent for this purpose



Murabaha Syndication Cont'd

- *Shariah* scholars review the transaction for the sale and purchase contracts, offer, acceptance of the commodities the date of transfer of title and Delivery
 - Physical delivery seldom occurs. A book entry "exchange" is recorded
 - The cardinal rule that an entity cannot sell what it does not own cannot be violated.
-

Murabaha Syndication

Pre-payment by the customer

- In a *murabaha* transaction, the full amount of the sale price, comprising the cost price plus the full amount of profit, needs to be paid -even if the payment is made prior to the scheduled deferred payment date.
 - To discount the deferred sale price payable on account of early payment would render the *murabaha* transaction as one involving *riba*: time value of money or interest considerations
 - the customer may be given a rebate on the sole discretion of the financiers but there is no obligation to rebate.
 - The rebate is not binding but a matter of trust built on relationship between financier and the customer.
-

Murabaha Syndication

Acceleration of the due date

- Acceleration of the due date for payment of the deferred sale price so that it becomes due and payable immediately or on demand, following the occurrence of an event of default is permissible. The rationale for permitting acceleration is that customers are bound by the conditions that they agree to.
 - Events that trigger accelerations are default (non-payment, breach of financial covenants, breach of other obligations, misrepresentation, insolvency proceedings etc
 - In syndicated transactions a majority banks decision rule is followed.
-

Murabaha Syndication

Security & Guarantees

- Securing the customer's obligations is acceptable *Shariah* as it acts as incentive for customer to comply with agreed terms.
 - Default interest charge encourages timely payment in conventional finance. In Islamic finance a reasonable "late payment" charge may be levied against the customer, but the proceeds must be paid, on behalf of the customer, to a charitable cause that is *Shariah* acceptable.
-

Ownership obligations

- Sharia compliant transactions requires bank to own asset either directly or through agent. Such ownership brings with it contractual or legal liabilities.
 - Contractual responsibilities may be excluded to the extent permitted by law. However statutory liabilities may not always be avoided.
 - Taxes liabilities that may arise on sale and purchase include sales, turnover or value added tax types or income taxation as a result of buying and selling an asset. Professional legal advise is required
 - Some regulators may preclude banks to own or trade assets or commodities irrespective of how short a time period and however indirectly, assets or commodities are owned. This impact Murabaha transactions.
-

Murabaha Syndication

- In *murabaha* transactions payment of profit can be benchmarked to LIBOR. It is not interest but a comparison of return to conventional bank's earnings. Conventional loan is merely a "renting" of money. In a *murabaha* transaction there is a sale of an object from which profit is derived.
 - The risk for the financier in a *murabaha* transaction is that, during the ownership, however momentary, if the object of sale is lost or destroyed, then it is a risk assumed by the financier, justifying the profit reward, because in a Shariah-compliant sale the object must be owned, exist and have value at the point of sale.
 - There is no such risk in conventional loan.
-

Governing Law

Islamic syndicated transactions are governed by Sharia principles. This creates some legal issues.

English law is mostly favoured due to its clarity and is considered creditor friendly.

The Rome Convention provides that a contract shall be governed by "the law chosen by the parties". Courts consider this choice as "Law of a Country" and not an international system of law as Sharia.

In Shamil Bank of Bahrain v Beximco Pharmaceuticals case (2004) The Court held that *Sharia* principles did not apply and that the financing was enforceable under English law.

-
- It is perfectly open to the parties to a contract to incorporate some provisions of foreign law into an English contract, but only where the parties had sufficiently identified specific provisions of a foreign law or an international code. The general reference to principles of *Sharia* in the governing law clause did not identify those aspects of *Sharia* which were intended to be incorporated into the contract. The Court held that it was insufficient for borrowers to contend that the basic rules of *Shariah* applicable.
-

Thank You
