



THE LEGAL AND REGULATORY FRAMEWORK FOR MURABAHA

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A B S T R A C T	KEY WORDS
<p>The legal and regulatory framework for Murabaha plays a crucial role in ensuring the compliance and effectiveness of this Islamic finance mechanism. Murabaha, also known as cost-plus financing, is a common transaction structure used in Islamic finance. It involves the sale of a commodity by a bank to a customer at an agreed markup price, which includes the bank's cost and profit margin. The legal and regulatory framework for Murabaha is designed to ensure that the transaction adheres to Sharia principles and guidelines. This article examines the use of murabaha in Islamic finance. It discusses the advantages and disadvantages of murabaha, and it provides an overview of the different types of murabaha contracts. The article also discusses the legal and regulatory framework for murabaha in different jurisdictions. The article concludes that murabaha is a complex but versatile financing structure that can be used to finance a variety of assets. Murabaha can be a useful tool for businesses and individuals who want to finance assets without having to pay interest. However, it is important to understand the risks and limitations of murabaha before using it.</p>	<p>Murabaha, Islamic finance, cost-plus financing, Sharia law, interest-free financing</p>

Introduction

Murabaha is a type of Islamic financing contract that involves a cost-plus sale of an asset between a seller and a buyer. It is commonly used as an alternative to interest-based loans, which are prohibited in Islamic law. However, murabaha also faces various legal and regulatory challenges in different jurisdictions, as it may not be compatible with the conventional laws and standards governing financial transactions. This article aims to explore the legal and regulatory framework for murabaha in four countries: the UAE, Malaysia, Pakistan, and the UK. It will compare and contrast the laws and regulations governing murabaha transactions, as well as the benefits and challenges of murabaha financing. It will also discuss the prospects and opportunities for harmonisation and standardisation of murabaha contracts across different legal systems. The legal and regulatory framework for

Murabaha is primarily guided by Islamic principles, with the aim of avoiding interest-based transactions and promoting fairness and transparency. One of the key sources that shaped the legal and regulatory framework for Murabaha is the teachings of Sharia law. Sharia law forms the basis for the rules and guidelines that govern Murabaha transactions. According to Islamic principles, money and commodities are considered distinct entities and should be treated differently. This principle is applied in the Murabaha framework to ensure that the transaction is compliant with Sharia law. Additionally, the legal and regulatory framework for Murabaha takes into account the practicalities of implementing this financing technique. This includes the role of the finance provider in the management and use of funds, the risk-bearing by the finance provider, and the uncertainty of the rate of return on capital for the finance provider [1]. The cost of capital for the finance user and the relationship between the cost of capital and the rate of return on capital are also considered in the legal and regulatory framework for Murabaha. These considerations help to ensure that the transaction is fair and mutually beneficial for both parties involved.

Furthermore, the legal and regulatory framework for Murabaha addresses the issue of agency in the transaction. It outlines the rights and responsibilities of the parties involved, including the bank acting as an agent on behalf of its customers. This framework ensures that the bank acts in the best interest of its customers, maintaining transparency and accountability throughout the transaction. In terms of regulation, the legal framework for Murabaha transactions varies from country to country. In some countries, such as the GCC countries, there may be specific laws and regulations that govern Murabaha transactions. These laws and regulations ensure that Murabaha transactions are conducted in a transparent and lawful manner, protecting the interests of all parties involved. The legal and regulatory framework for Murabaha is primarily guided by Islamic principles, specifically Sharia law. Sharia law sets the foundation for defining the rules and guidelines that govern Murabaha transactions. It ensures that money and commodities are treated differently and outlines the practicalities of implementing Murabaha. Additionally, Islamic principles emphasize the importance of profit and loss sharing and cooperation between parties. In accordance with these principles, the legal and regulatory framework for Murabaha aims to promote fairness, transparency, and accountability in the transactions. The legal and regulatory framework for Murabaha transactions is essential in ensuring the compliance of this Islamic financing technique with Sharia law, promoting fairness, transparency and accountability. The legal and regulatory framework for Murabaha plays a crucial role in ensuring fairness and compliance with Sharia law in Islamic banking. Furthermore, the legal and regulatory framework for Murabaha addresses the issue of risk management in the transaction. It establishes guidelines for assessing and managing risks associated with Murabaha transactions, such as credit risk, market risk, and operational risk.

Additionally, the legal and regulatory framework for Murabaha also addresses the issue of currency conversion in international transactions. In international Murabaha transactions, where currencies are involved, the legal and regulatory framework ensures that transactions are executed in compliance with Islamic injunctions. This includes ensuring that the import Murabaha transaction is conducted in a single currency and allowing for the use of other currencies only in exceptional circumstances with the approval of relevant authorities. The legal and regulatory framework for Murabaha also addresses the issue of documentation and record-keeping. It mandates that all Murabaha transactions be properly documented, including clear agreements and contracts outlining the terms and conditions of the transaction. These documents serve as evidence of the transaction and provide transparency for

all parties involved. The legal and regulatory framework for Murabaha transaction is crucial in ensuring the compliance of this Islamic financing technique with Sharia law.

Murabaha, also referred to as cost-plus financing, is an Islamic financing structure in which the seller and buyer agree to the cost and markup of an asset. The markup takes place of interest, which is illegal in Islamic law. As such, murabaha is not an interest-bearing loan (qardh ribawi) but is an acceptable form of credit sale under Islamic law. As with a rent-to-own arrangement, the purchaser does not become the true owner until the loan is fully paid.

Murabahah, murabaha, or murâbahah (Arabic: مرابحة, derived from *ribh* Arabic: ربح, meaning profit) was originally a term of *fiqh* (Islamic jurisprudence) for a sales contract where the buyer and seller agree on the markup (profit) or "cost-plus" price [2] for the item(s) being sold. [3] In recent decades it has become a term for a very common form of Islamic (i.e., "shariah compliant") financing, where the price is marked up in exchange for allowing the buyer to pay over time—for example with monthly payments (a contract with deferred payment being known as *bai-muajjal*). *Murabaha* financing is similar to a rent-to-own arrangement in the non-Muslim world, with the intermediary (e.g., the lending bank) retaining ownership of the item being sold until the loan is paid in full. There are also Islamic investment funds and *sukuk* (Islamic bonds) that use *murabahah* contracts.[4]

Murabaha is a cost-plus financing structure that is used in Islamic finance. It is a type of sale in which the seller discloses the cost of the asset to the buyer, and then adds a profit margin. The buyer then pays the seller the total price, which includes the cost and the profit margin, in installments. Murabaha is a popular financing structure in Islamic finance because it is compliant with Sharia law. Sharia law prohibits the charging of interest, which is considered to be *riba*. Murabaha does not involve the charging of interest, as the buyer is simply paying the seller the cost of the asset plus a profit margin. Murabaha can be used to finance a variety of assets, including cars, homes, and equipment. It can also be used to finance working capital needs.

There are two main types of murabaha:

- Direct murabaha: In direct murabaha, the bank purchases the asset that the customer wants to finance. The bank then sells the asset to the customer at a price that includes the cost of the asset plus a profit margin.
- Indirect murabaha: In indirect murabaha, the bank does not purchase the asset directly. Instead, the bank enters into a murabaha contract with a third-party supplier. The bank then sells the asset to the customer at a price that includes the cost of the asset plus the profit margin that the bank agreed to with the supplier.

Murabaha is a complex financing structure, and there are a number of factors that need to be considered when using it. These factors include the cost of the asset, the profit margin, the term of the financing, and the repayment schedule. Murabaha can be a useful financing structure for businesses and individuals who want to finance assets without having to pay interest. However, it is important to understand the risks and limitations of murabaha before using it.

The purpose of *murabaha* is to finance a purchase without involving interest payments, which most Muslims scholars consider *riba* (usury) and thus *haram* (forbidden).[5] *Murabaha* has come to be "the most prevalent" [5] or "default" type of Islamic finance. [2]

Using the table below we can understand the advantages and disadvantages of the Islamic banking financing system:

Table 1. The advantages and disadvantages of the murabaha

Advantages	Disadvantages
It involves a guarantor.	All the cost and profit has to be disclosed to the client.
Asset ownership gets transferred to the client hence all the defects on the shoulders of the clients.	The process does not involve flexibility.
It comprises multiple contractors	In case of defaults, it involves legal consequences and/or repayments of overdue.
Almost fifty percent cost gets retained by the bank by default.	No such things happen here.
Only a down payment required	Without a down payment, no loan got granted.
There is no interest payment involved.	It tends to be costlier for banks.

A proper *murābahah* transaction differs from conventional interest-charging loans in several ways. The buyer/borrower pays the seller/lender at an agreed-upon higher price; instead of interest charges, the seller/lender makes a religiously permissible "profit on the sale of goods". The seller/financer must take actual possession of the good before selling it to the customer, and must assume "any liability from delivering defective goods".[6] Sources differ as to whether the seller is permitted to charge extra when payments are late,[7] with some authors stating any late fees ought to be donated to charity,[8][9][10] or not collected unless the buyer has "deliberately refused" to make a payment.[11] For the rate of markup, *murabaha* contracts "may openly use" *riba* interest rates such as LIBOR "as a benchmark", a practice approved of by the scholar Taqi Usmani.[12]

Conservative scholars promoting Islamic finance consider *murabaha* to be a "transitory step" towards a "true profit-and-loss-sharing mode of financing", [1] and a "weak" [13] or "permissible but undesirable" [14] form of finance to be used where profit-and-loss-sharing is "not practicable." [1][2] Critics/skeptics complain/note that in practice most "*murābahah*" transactions are merely cash-flows between banks, brokers, and borrowers, with no buying or selling of commodities; [15] that the profit or markup is based on the prevailing interest rate used in *haram* lending by the non-Muslim world; [2] that "the financial outlook" of Islamic *murabaha* financing and conventional debt/loan financing is "the same", [16] as is most everything else besides the terminology used. [17]

While orthodox Islamic scholars have expressed a lack of enthusiasm for *murabaha* transactions, [18] calling them "no more than a second best solution" (Council of Islamic Ideology) [19] or a "borderline transaction" (Islamic scholar Taqi Usmani), [20] nonetheless they are defended as Islamically permitted.

According to Taqi Usmani, the reference to permitted "trade" or "trafficking" in Quran aya 2:275: [21] "... they say, 'Trafficking (trade) is like usury,' [but] God has permitted trafficking, and forbidden usury .."

refers to credit sales such as *murabaha*, the "forbidden usury" refers to charging extra for late payment (late fees), and the "they" refers to non-Muslims who didn't understand why if one was allowed both were not:[20]

the objection of the infidels ... was that when they increase the price at the initial stage of sale, it has not been held as prohibited but when the purchaser fails to pay on the due date, and they claim an additional amount for giving him more time, it is termed as "riba" and haram. The Holy Qur'an answered this objection by saying: "Allah has allowed sale and forbidden riba." [20]

Usmani states that while it may appear to some people that allowing a buyer more time to pay for some product/commodity (deferred payment) in exchange for their paying a higher price is effectively the same as paying interest on a loan,[20] this is incorrect. In fact, just as a buyer may pay more for a product/commodity when the seller has a cleaner shop or more courteous staff, so too the buyer may pay more when given more time to complete payment for that product or commodity.[20] When this happens, the extra they pay is not *riba* but just "an ancillary factor to determining the price". In such a case, according to Usmani, the "price is against a commodity and not against money" — and so permitted in Islam.[20] When a credit transaction is made *without* the purchase of a specific commodity or product, (i.e. a loan is made charging interest), the added charge for deferred payment is for "nothing but time", and so is forbidden *riba*. [20] However according to another Islamic finance promoter—Faleel Jamaldeen -- "murabaha payments represent debt" and because of that are not "negotiable or tradable" as Islamic finance instruments, making them (according to Jamaldeen) unpopular among investors.[21]

Hadith also supports use of credit-sales transactions such as *murabaha*. Another scholar, M.O.Farooq, states "it is well-known and supported by many hadiths that the Prophet had entered into credit-purchase transactions (*nasi'ah*) and also that he paid more than the original amount" in his repayment.[22]

Usmani states that "this position" is accepted "unanimously" by the "four [Sunni] schools" of Islamic law and "the majority" of the Muslim jurists.[20] *Murabahah* and related fixed financing has been approved by a number of government reports in the Islamic Republic of Pakistan on how to eliminate Interest.

Usmani presents a theory of why sellers are allowed to charge for providing credit to the lender/buyer, but are guilty of *riba* when charging for late payment. In a true (non-riba) *murabahah* transaction (Usmani states) "the whole price ... is against a commodity and not against money" and so "... once the price is fixed, it relates to the commodity, and not to the time". Consequently "the price will remain the same and can never be increased by the seller." If the price had "been against time", (which is forbidden) "it might have been increased, if the seller allows ... more time" for repayment when the bill is past due.[20]

(Usmani and other Islamic finance scholars [6][22] agree that not being able to penalize a lender/buyer for late payment has led to late payments in *murabahah* and other Islamic finance transactions. Usmani states that a "problem" of *murabahah* financing is that "if the client defaults in payment of the price at the due date, the price cannot be increased".[2] According to one source (Mushtak Parker), Islamic financial institutions "have long tried to grapple with the issue of delayed payments or defaults, but thus far there is no universal consensus across jurisdictions in this respect." [23])

In its 1980 *Report on the Elimination of Interest from the Economy*, [24] the Council of Islamic Ideology of Pakistan stated that *murabahah* should

- be undertaken only when the borrower wants to borrow to purchase a some item
- must involve
 - the item being purchased by the bank;
 - coming under the ownership and possession of the bank;
 - which must assume the risk for that item;
- the item then being sold to the customer through a valid sale;
- be used to the "minimum extent" and
- only in cases where profit and loss sharing is not practicable. [19]

Murābahah is one of three types of *bayu-al-amanah* (fiduciary sale), requiring an "honest declaration of cost". (The other two types are *tawliyah*—sale at cost—and *wadi'ah*—sale at specified loss.)

According to Taqi Usmani "in exceptional cases" an Islamic bank or financial institution may lend cash to the customer for a *murābahah*, but this is when the customer is acting as an *agent* of the bank in buying the good the customer needs financed.

Where direct purchase from the supplier is not practicable for some reason, it is also allowed that he makes the customer himself his agent to buy the commodity on his behalf. In this case the client first purchases the commodity on behalf of his financier and takes its possession as such. Thereafter, he purchases the commodity from the financier for a deferred price. [2]

The idea that the seller may not use *murābahah* if profit-sharing modes of financing such as *mudarabah* or *musharakah* are practicable, is supported by other scholars that those in the Council of Islamic Ideology. [1][2]

But these involve risks of loss, profit-sharing modes of financing cannot guarantee banks income. *Murabahah*, with its fixed margin, offers the seller (i.e. the bank/financier) a more predictable income stream. One estimate is that 80% of Islamic lending is by *murabahah*. [25] M. Kabir Hassan reports that *murabaha* accounts are quite profitable. As of 2005, "the average cost efficiency" for *murabaha* was "74%, whereas average profit efficiency" even higher at 84%. Hassan states, "although Islamic banks are less efficient in containing cost, they are generally efficient in generating profit." [26]

Islamic banker and author Harris Irfan writes that use of *murabaha* "has become so distorted from its original intent that it has become the single most common method of funding inter-bank liquidity and corporate loans in the Islamic finance industry." [1] A number of economists have noted the dominance of *murabahah* in Islamic finance, despite its theological inferiority to profit and loss sharing. [26][27][28] One scholar has coined the term "the *murabaha* syndrome" to describe this. [29] The accounting treatment of *murābahah*, and its disclosure and presentation in financial statements, vary from bank to bank. If the exact cost of the item(s) cannot be or are not ascertained, they are sold on the basis of *musawamah* (bargaining). [4] Different banks use this instrument in varying ratios. Typically, banks use *murabaha* in asset financing, property, microfinance and commodity import-export. [30] The International Monetary Fund reports that, *Murābahah* transactions are "widely used to finance international trade, as well as for interbank financing and liquidity management through a multistep transaction known as *tawarruq*, often using commodities traded on the London Metal Exchange" (LME). [6]

The basic *murabaha* transaction is a cost-plus-profit purchase where the item the bank purchases is something the customer wants but does not have cash at the time to buy directly.[30] However, there are other *murabaha* transactions where the customer wants/needs cash and the product/commodity the bank buys is a means to an end. In addition to being used by Islamic banks, *murabahah* contracts have been used by Islamic investment funds (such as SHUAA Capital of Saudi Arabia and Al Bilad Investment Company), and sukuk (also called Islamic bonds)(an example being a 2005 sukuk issued by Arcapita Bank sukuk in 2005).

Bay' bithaman 'ajil

(Also called *Bai' muajjal* [31] abbreviated BBA, and known as credit sale or deferred payment sale). Reportedly the most popular mode of Islamic financing is cost-plus *murabaha* in a credit sale setting (*Bay bithaman 'ajil*) with "an added binding promise on the customer to purchase the property, thus replicating secured lending in `Shari'a compliant` manner." The concept was developed by Sami Humud, and shortly after it became popular Islamic Banking began its strong growth in the late 1970s. [32]

Another source (Skrine law firm) distinguishes between *Murabahah* and *Bay' bithaman 'ajil* (BBA) banking products, saying that in BBA disclosure of the cost price of the item being financed is not a condition of the contract.[33]

One variation on *murabahah* (known as "Murabahah to the Purchase Orderer" according to Muhammad Tayyab Raza) allows the customer to serve as the "agent" of the bank, so that the customer buys the product using the bank's borrowed funds.[2] The customer then repays the bank similar to a cash loan. While this is not "preferable" from a Sharia point of view, it avoids extra cost and the problem of a financial institution lacking the expertise to identify the exact or best product or the ability to negotiate a good price.[34]

Bay' al-Ina

(Also *Bay' al-'Inah*). This simple form of *murabahah* involves the Islamic bank buying some object from the customer (such as their house or motor vehicle) for cash, then selling the object back to the customer at a higher price, with payment to be deferred over time. The customer now has cash and will be paying the bank back a larger sum of money over time. This resemblance to a conventional loan has led to *bay' al-ina* being criticized as a ruse for a cash loan repaid with interest.[35] It was used by a number of modern Islamic financial institutions despite condemnation by jurists, but in recent years its use is "very much limited" according to Harris Irfan.[2]

Tawarruq (also called a "reverse *murabaha*"^[14] and sometimes a "commodity *murabaha*") [36] also allows the banking customer to borrow cash instead of finance a purchase,^[56] and has also been criticized by some jurists.[37] Unlike a *bay al-ina* it involves another party in addition to the customer, Islamic bank and seller of the commodity. In *Tawarruq* the customer would buy some amount of a commodity (a commodity which is not a "medium of exchange" or forbidden in *riba al-fadl* such as gold, silver, wheat, barley, salt, etc.)[4] from the bank to be paid in installments over a period of time and sell that commodity on the spot market (the commodity buyer being the additional party) for cash.[1][38][39] (The commodity buying and selling is usually done by the bank on behalf of the customer,[4] so that "all that changes hands is papers being signed and then handed back" according to one researcher).[40] An example would be buying \$10,000 worth of copper on credit

for \$12,000 to be paid over two years, and immediately selling that copper to the third party spot buyer for \$10,000 in cash. There are additional fees involved for the commodity purchases and sales compared to a cash loan, but the additional \$2000 is considered "profit" not "interest" and so not *haram* according to proponents.

According to Islamic banker Harris Irfan, this complication has "not persuaded the majority of scholars that this series of transactions is valid in the Sharia." [1] Because the buying and selling of the commodities in *Tawarruq* served no functional purpose, banks/financiers are strongly tempted to forgo it. Islamic scholars have noticed that while there have been "billions of dollars of commodity-based *tawarruq* transactions" there have not been a matching value of commodity being traded. [41] The IMF states that "*tawarruq* has become controversial among Shari'ah scholars because of its divergence of its use from the spirit of Islamic finance". [6] But some prominent scholars have tolerated commodity *murabaha* "for the growth of the [Islamic finance] industry". [1] Irfan states that (at least as of 2015) Sharia boards of some banks (such as Abu Dhabi Islamic Bank), have taken a stand against *Tawarruq* and were "looking at 'purer' forms of funding" (such as *mudarabah*). [1] To "counter the obvious violation of the spirit of the *riba* ban", some banks have required the complication (and expense) of two additional commodity brokers in addition to the customer and financier.

On the other hand, Faleel Jamaldeen states that "commodity *murabaha*" contracts are used to fund short-term liquidity requirements for Islamic interbank transactions, although they may not use gold, silver, barley, salt, wheat or dates for commodities as this is forbidden under *Riba al-Fadl*. Among the Islamic banks using *Tawarruq* (as of 2012) according to Jamaldeen, include the United Arab Bank, QNB Al Islamic, Standard Chartered of United Arab Emirates, and Bank Muaamalat of Malaysia.

Murabahah - cost plus profit agreement. *Mudarabah* transactions are commonly practised by the Islamic Corporation for the Development of the Private Sector (ICD) and local commercial banks. Where such transactions are financed by the ICD, the local commercial bank issues a guarantee as security for the performance by the borrower of its obligations to the ICD. *Mudarabah*-based transactions are subject to conventional sale and purchase rules specified in the Civil Code, which defines a sale and purchase agreement as an agreement 'whereby a seller undertakes to transfer a commodity into the ownership of another party (buyer), and the buyer undertakes to accept such commodity and pay for it. [46]

Conclusion

As a conclusion we can see some advantages and disadvantages of *Murabaha*

There are a number of advantages to using *murabaha*, including:

- Compliance with Sharia law: *Murabaha* is a Sharia-compliant financing structure, which means that it does not involve the charging of interest. This is important to many businesses and individuals who want to avoid interest-based financing.
- Flexibility: *Murabaha* can be used to finance a variety of assets, including cars, homes, and equipment. It can also be used to finance working capital needs.
- Transparency: In a *murabaha* transaction, the buyer knows the exact cost of the asset that they are buying, as well as the profit margin that the seller is making. This transparency can help to reduce the risk of fraud and misunderstanding.

Disadvantages of Murabaha

There are also a number of disadvantages to using murabaha, including:

- **Cost:** Murabaha can be more expensive than other forms of financing, such as conventional loans. This is because the seller needs to add a profit margin to the cost of the asset.
- **Complexity:** Murabaha is a complex financing structure, and it can be difficult to understand all of the terms and conditions of a murabaha contract. This complexity can lead to misunderstandings and disputes.
- **Risk:** Murabaha involves some risk, as the buyer is not actually purchasing the asset until the full purchase price has been paid. This risk can be mitigated by using a murabaha contract that includes a guarantee from the seller.

Murabaha is a cost-plus financing structure that is used in Islamic finance. It is a popular financing structure because it is compliant with Sharia law and can be used to finance a variety of assets. However, it is important to understand the advantages and disadvantages of murabaha before using it.

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