

THE RISE OF ISLAMIC FINANCE: 2-STEP MURABAHA

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ABSTRACT

The Islamic finance industry should refrain from replicating conventional tools by complicated scams which hold Arabic names. There is enough room for product development within the sphere of Islamic *Shari'ah*. Today, the Islamic finance industry is still heavily recourse to commodity *Murabaha* for liquidity management regardless of prohibition of the practice by Islamic *Fiqh* Academia. This mainly results from the lack of a proper liquidity management alternative for Islamic banks. Although *Sukuk* can serve the purpose to some extent, not only commodity *Murabaha* but also *Sukuk* is not expected to underpin the Islamic finance industry for the future. In this paper, 2-Step *Murabaha* is proposed as a strong alternative to the popular but questionable Islamic resource mobilization/liquidity management tools. It is suggested that the Islamic finance industry healthily rise on 2-Step *Murabaha*. The literature review part of the paper dwells on Islamic finance in the context of resource mobilization/liquidity management. The disbursement procedures in full detail are explained for the 2-Step *Murabaha* transaction in a case of a Gambian importer and an Egyptian exporter of yarn. Then, the structure is evaluated to suggest the 2-Step *Murabaha* to be embedded in stock exchanges in order to facilitate international trade while serving the Islamic finance industry for liquidity management.

Keywords: 2-Step *Murabaha*, commodity *Murabaha*, *Sukuk*, resource mobilization, liquidity management, *Tawarruq*

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INTRODUCTION

A detrimental question for the Islamic finance industry, today, is whether to replicate the entire conventional system by creating instruments identical in substance through “*combining a redundant succession of trade and label with Arabic name*” (Moddy’s, 2008) or innovate and streamline new products compliant to Islamic *Shari’ah*. As evidenced from the literature, the Islamic finance industry today tends to replicate conventional instruments by making it more complicated while stand vulnerable to the flaws of the conventional system. After the 2008 financial crisis triggered by the conventional financial system, Islamic finance with its focus on tangible assets and *Shari’ah* principles was perceived to have the potential to prevent sufferings of the conventional system. However, this perception that Islamic finance is “*immune to the excesses of the financial crisis*” is challenged by recent defaults of the *Sukuk* and gives rise to loss of confidence by investors. In a nutshell, Islamic principles cannot buffer bad investment decisions but *Shari’ah* compliance problems with existing *Sukuk* leads to bad credit risks for *Sukuk* issuances as well. For example, Dana Gas *Mudaraba Sukuk* is an iconic case showing dichotomy of *Sukuk*. In 2017, the *Sukuk* issuer claimed that the *Mudaraba Sukuk* structure in which the Dana Gas *Sukuk* was issued is not *Shari’ah* compliant so as to avoid their obligations. Nevertheless, the *Sukuk* structure, prior to issuance, was approved by the *Shari’ah* advisers paid by Dana Gas.¹ In an ideal world, financial resources should be directed to support sustainable economic development to create more wealth for economically empowering people; which is not the case with the present Islamic finance practices and *Sukuk*. The pitfalls of *Sukuk* urge for alternative resource mobilization and liquidity management tools to be harnessed for economic growth while serving the needs of Islamic financial institutions.

Islamic financial institutions very often avoid borrowing from other banks in order to avoid *Riba* which is prohibited in Islam. As it is obvious from its basic principles, Islamic law introduces many restrictions on commercial contracts in order to ensure justice in the transaction, avoid possible prospective legal disputes, and ultimately give rise to a stable economic and financial system for the society. Traditionally, Islamic Banks recourse to *Sukuk* and Commodity *Murabaha* instruments to

¹ <https://rd.springer.com/article/10.1057/jbr.2014.3> last accessed on 29th of September 2017.

mobilize resources and manage their liquidity. However, recent failures in the *Sukuk* market and common dissatisfaction with the *Tawarruq* based Commodity *Murabaha* urge for development of alternative Islamic resource mobilization/liquidity management tools. Basically, financial resources are needed for project finance and trade finance. Project Investment *Sukuk* can address the resource mobilization problem for project finance. However, the real resource mobilization need comes from huge amounts needed for international and local trade finance. Gundogdu (2016) highlighted that “given that the nature of Islamic finance is about facilitating bono-fide transactions, the trade aspect of the Islamic finance industry should react to develop *Shari’ah*-compliant products to support the increased international trade of the OIC countries, which hit a value of US\$4.12 trillion in 2012.² If Islamic finance cannot develop products which directly link trade and financial resources, pseudo *Sukuk* and commodity *Murabaha* would fill the gap, and, that is what happened.

In this regard, Gundogdu (2009) introduced the 2-Step *Murabaha* concept for resource mobilization in the context of international trade as an alternative to *Mudaraba* and *Sukuk*, which are not *Shari’ah* compliant, as well as commodity *Murabaha*. As explained by Gundogdu (2009), one of the most widely used contract in Islamic finance is *Murabaha*. This paper proposes the introduction of the 2-Step *Murabaha* to replace the commodity *Murabaha* for good and be a good alternative to *Sukuk*. Islamic banks can place their excess funds to refinance the letter of credit under the *Murabaha* agreement between a bank and an importer. Assuming an importer is in Gambia, which needs to import yarn from Egypt by opening a letter of credit through its local bank as requested by the Egyptian exporter, after receiving the financing request from the importer, the local Gambian bank can mobilize resources through an international Islamic bank. The international Islamic bank would buy yarn and sell it to the local Gambian bank with a mark-up in differed payment and the Gambian bank would sell it to the importer. As opposed to the commodity *Murabaha*, in this scheme the Islamic bank manages its liquidity by supporting trade and, hence, contributing to the economic development of a least developed country. As stated above, the objective of this paper is to show how to mobilize resources to be availed for SMEs, particularly in least developed countries, under

² This was a substantial increase (of around threefold) compared to the 2004 level of US\$1.43 trillion. During the same period, world trade only increased by around twofold”.

the direct *Murabaha* Sale transformed into a 2-Step *Murabaha* scheme. The structure of the 2-Step *Murabaha* has already explained by Gundogdu (2009). Practical details are explained in this paper.

In the next section, a literature review on Islamic finance in the context of resource mobilization and liquidity management vis-à-vis *Sukuk* and commodity *Murabaha* is provided. The third section explains the details of the disbursement mechanism for the 2-Step *Murabaha* line provided to local bank in Gambia (Bank-C) from an international Islamic bank (Bank-B) through the 2-Step *Murabaha* Financing. The final section highlights the proposed structure by Gundogdu (2014) and Gundogdu (2016) for liquidity management within an efficient stock exchange and concludes.

LITERATURE REVIEW ON ISLAMIC RESOURCE MOBILIZATION AND LIQUIDITY MANAGEMENT

Gundogdu (2016) unveils the dilemma concerning products developed in the Islamic finance industry concerning liquidity management. He argues that before looking into details, the evaluation should start by checking for compliance with the *Maqasid Al-Shari'ah* and contribution to real economic activities. Specific to liquidity management, he lists *Bai Al-Inah*, *Bai Al-Dayn*, and organized *Tawarruq* as types of contacts used for non-*Shari'ah* compliant products.

However, closing the chapter by merely saying “forbidden” or notorious Arabic equivalent word “*Memnu*” may not be that easy due to liquidity risks. As Waemustafa and Sukri (2016) highlight, Islamic banks maintain higher liquidity than conventional banks against liquidity risks. Dusiki (2007) states: “*Liquidity is an important characteristic of banks. By their very nature, banks transform the term of their liabilities to have different maturities on the asset side of the balance sheet. At the same time, banks must be able to meet their commitments such as deposits at the point at which they become due. Thus, liquidity management lies at the heart of confidence in the banking operation*”. He counts liquidity risks as a significant one for Islamic banks due to limited availability of *Shari'ah* compatible money market tools. Accordingly, he counts introduction of the commodity *Murabaha* based on the *Tawarruq* as an innovative liquidity management tool.

Umer Chapra and Habib Ahmad (2002) addressed the liquidity management difficulties with Islamic Banks in their work of “Corporate Governance in Islamic Financial Institutions”. As they state “two of the primary reasons for this are: the non-availability of adequate Shari’ah compatible investment opportunities and the difficulty of raising liquidity in a Shari’ah compatible manner”.

As indicated by Loqman (1999) the Islamic finance system is characterized by the absence of interest based transactions, short-selling, manipulation, doubtful transactions which may include unlawful activities within the Islamic Jurisprudence. As he defines, the objective of the Islamic financial system, based on the Islamic *Shari’ah*, is to transfer funds from the surplus to the deficit units. In this regard, Islamic finance as viewed by Muslims is an alternative health system to an interest based financial system (Khan, 1992). Siddiqi (2008) highlighted various Islamic finance contracts which exclude interest (*Riba*), avoid major uncertainty (*Gharar*) and does not include gambling features (*Maysir*).

Based on these contracts, although questionable from the *Shari’ah* compliance point of view, Islamic banks have developed products for resource mobilization and liquidity management. Controversial Islamic finance resource mobilization and liquidity management tools have been the *Sukuk* and the *Tawarruq* based commodity *Murabaha*. Both instruments give rise to serious debates on their economic impact and suitability to Islamic principles. A commodity *Murabaha* transaction involves buying and selling of metal commodities to provide conformity with the Islamic *Shariah*. The banks would mobilize resources from Islamic banks through the *Tawarruq*. In real life, an Islamic bank, a conventional bank as an agent, and two separate brokers to effect sales of metal commodities would be the parties in a commodity *Murabaha* transaction. The Islamic bank buys commodity from the first broker, through the agency of commercial bank, and sells it to the second broker with a mark-up in differed payment. This transaction has no purpose more than resource mobilization for the conventional bank and liquidity management for the Islamic Bank. That is, its economic benefit to society is quite questionable as its connection with trade and industry is missed.

The organized *Tawarruq* based commodity *Murabaha*, which unlike the name reveals it as not a real *Murabaha*, was initially used in inter-bank lending. In due course the scope was extended to consumer loans as well as so-called Islamic derivatives.³ To avoid criticism Islamic banks developed the *Tawarruq* based on so called trading of stocks or physical commodities in warehouses. In either of them the result is the same. There is no real economic activity even if these non-moving assets are being traded. Alzaidi and Kazakov (2017) introduced a trading platform to facilitate such practices. However, any platform should better be designed to facilitate economic activity rather than be a lending activity.

Siddiqi (2007) in his position paper presented at the workshop on *Tawarruq: A Methodological Issue in Shariah compliant Finance* examined the impact of the *Tawarruq* on the economy. As he mentions, every *Tawarruq* based transaction for resource mobilizing party (*Mutawarrig*) would create debts which is larger than the cash transferred to the liquidity managing party (which Islamic banks in present practice). In both the Islamic *Tawarruq* and conventional forms, debt paper resulted to repeated financial speculative transactions. Though the *Tawarruq* transactions are supposed to be based on real assets at the start, the link with real assets would be severed without creating any wealth but debt. This process, gives rise to an inverted pyramid of financial instrument underpinned by a small asset base. The *Tawarruq* moves a transaction from real economy to a money (debt) market where the equilibrating mechanism is no longer linked to the real economy. Then, he scrutinized the consequences of this very creation of debt which is larger than the cash generated and counts the harms and benefits of the *Tawarruq* as:

1. It gives rise to creation of debt which tends to accelerate;
2. It emerges as exchange of money with money which is deemed to be unfair in the context of risk and uncertainty involved;
3. It leads to speculation from gambling through debt proliferation;
4. As it is debt financing, the practice seeds instability in an economy. In a debt-based economy money supply is linked to debt which gives rise to inflationary expansion;
5. This practice is likely to deteriorate income distribution and inefficiently allocate resources;

3 Thomson Reuters Report: "Liquidity Management Through Sukuk; Innovative Solutions". (2017)

6. As debt financing, this practice contributes to anxiety in society and destruction of the environment.

As he suggests, the harmful consequences of the *Tawarruq* are much greater than the benefits. He concludes that financial tools whose harm is greater than the benefits shall not be deemed as *Shari'ah* compliant.

Similarly, Shalhoob (2010), studied organized the *Tawarruq* in Islamic Law and suggested that an organized *Tawarruq* as it is the case with the commodity *Murabaha* does not seem to be acceptable in Islamic Law. On the other hand, he counts the organized *Tawarruq* as less unacceptable than usury which is obviously prohibited in Islamic Law. He further states that in case the money needed for an unimportant need, Islamic jurisprudence does not recommend involvement in organized *Tawarruq*.

Iqbal and Molyneux (2005), with reference to the Islamic doctrine of universal permissibility in business practices which revolve around: “*everything is permissible unless it is clearly prohibited*”, explains the causes for rejection of conventional banking in Islamic Law and the establishment of Islamic Banks operating under the profit and loss sharing principle. They introduced the principles and theoretical underpinning for Islamic Banking and its instruments as the *Musharakah*, *Mudarabah*, *Murabaha*, *Ijarah*, *Salam* and *Istisna*. On the other hand, they did not mention the *Tawarruq*, one of the most controversial instrument which has been practiced by Islamic banks regardless of declaration of the Islamic *Fiqh* Academy (*Majma' al Fiqh al-Islami*)’s proceedings which counts the *Tawarruq* as non-compatible with Islamic Law.

Dusiki (2007) highlights the importance of liquidity management for banks and provided some insights of the commodity *Murabaha* as a liquidity management tool for Islamic financial institutions. He also reviewed the *Shari'ah* issues related to the underlying contract of the commodity *Murabaha* namely, the *Tawarruq*. He identified the *Tawarruq* based commodity *Murabaha* as a value added product which can meet investment interests of Islamic financial institutions that are uncomfortable with the *Inah* based instruments. As Al-Zuhayli (1989) explained the *Bay Al-Inah* is an arrangement in which one party sells an asset to another party with deferred payment. Unlike the *Murabaha*, there is no third party and the

selling party buys back the asset from the buying party before the payment of deferred price and for cash of a lesser amount than the deferred price. As Ali (2007) states, the majority of Muslim jurists nullified the *Bay Al-Inah* as it is a red herring to circumvent the *Riba* transaction. Ahmad (2007) highlighted the purpose with the *Tawarruq* based commodity *Murabaha* as attaining liquidity for the buyer and resource mobilization for the other party in the transaction in which the buyer purchases an asset from the other party with a differed payment and subsequently sells the asset to a third party on cash of a lesser amount than purchase price.

Although the form of the *Bay Al-Inah* and alternative the *Tawarruq* based commodity *Murabaha* have different forms, both instruments serve the same economic substance. In both cases, the transaction is liquidity management for one party and resource mobilization for the other. There is no touch to the economy in the form of trade finance, infrastructure development or industrial financing. In this form, both instruments are akin to disguised loans in conventional financing. Accordingly, as it once happened to the *Bay Al-Inah*, the underlying contract for the commodity *Murabaha*, *Tawarruq*, was tackled by Islamic jurists. Two rulings were issued by the Islamic *Fiqh* Academy. In its 15th session, in September 1998, the academy permitted the *Tawarruq* given that the buyer of the asset, the customer of Islamic banks, does not sell the asset to its original seller in order to eschew the *Inah* which has been disallowed as it is perceived to be legal trick for circumventing prohibition of the *Riba*. Nevertheless, the Islamic *Fiqh* Academy in its 17th session, held in December 2003, classified the *Tawarruq* as real *Tawarruq* (*Tawarruq Haqiqi*) and organized the *Tawarruq* (*Tawarruq Munazzam*). The real *Tawarruq* has been allowed but the organized *Tawarruq*, practiced by Islamic financial institutions, disallowed as it is perceived to be synthetic and fictitious like the *Bay Al-Inah*. Mohamad and Rahman (2014) finds that “*the analysis demonstrates that most of the studies on Tawarruq discussed the fundamental theories which concerning the area of jurisprudence, while a few of them did discuss the application aspect in the banking environment. However, none of the operational process is discussed in-depth, whereas the risk of Shari’ah non-compliance might arise in the detail transaction.*” Gundogdu (2014) provided details of the commodity *Murabaha* transactions. It is intended herewith to define a detailed transaction for a product proposed, the 2-Step *Murabaha*, as an alternative to the *Tawarruq* based commodity *Murabaha*.

Another major instrument of Islamic financial institutions for resource mobilization and liquidity management is *the Sukuk* that is the plural of the word *sakk*. In Arabic it means “legal instrument, deed, check” for “*any document representing a contract or conveyance of rights, obligations or monies done in conformity with the Shari’ah*” (Sukuk.me, 2010a). It is also known as an Islamic equivalent of a bond. As a fixed income or interest (*Riba*) bearing bonds are not permissible in Islam, the *Sukuk* are securities to comply with Islamic Law. Although the *Sukuk* were extensively used in medieval Islam for transferring obligations originating from commercial activities including trade, in modern times the *Sukuk* relates to asset securitization. In its simplest form, the *Sukuk* transforms future cash flow of an asset, existing or to be available in the future, to present cash flow. It is a certificate of usufruct or ownership of an asset which entitles the owner to get a return generated from the asset, **at least in theory**. This certificate is issued through a Special Purpose Vehicle (SPV) which acquires the asset and declares a trust in favour of the holder of the certificate. The certificate might present ownership of the asset or entitlement of rental income (Sukuk.me, 2010b). Therefore, this certificate provides returns to a holder from either profits from rental, profit of sales or combination of both. In return the certificate owner takes the credit risk of the underlying asset, again at least in the theory of it (Sukuk.me, 2010c).

In theory, the *Sukuk* should be based on mainstream Islamic contracts as the *Musharaka*, *Mudaraba*, *Salam*, *Murabaha*, *Ijara*, *Istisna*. However, today a chunk of *the Sukuk* is based on the unacceptable *Bai Al-Inah*, *Bai Al-Dayn* and the commodity *Murabaha* or a hybrid of these contracts with permissible ones. As Valente (2009) states, the Islamic finance industry is dominated by the *Sukuk* and at least much of academic literature revolves around the *Sukuk*, *Shari’ah* compatibility of most of which is questionable, as opposed to the possible permissible products.

Since the first issuance in late 1996, there have been several *Sukuk* failures of defaults, though there is no clear definition of the *Sukuk* default in *Shari’ah*. However, from a technical perspective it is basically the inability of the obligor with the *Sukuk* to make payments on the due date. The *Sukuk* itself implies the presence of an underlying asset owned by the certificate owner so an entire failure is not perceived to be possible. In case of *Sukuk* default, the obligor seeks a rollover on payments or restructuring, or otherwise embark on a litigation process. However, defaults of real-estate

development the *Sukuk* post-2008 and the 2017 Dana Gas *Mudaraba Sukuk* unveil the problems with the modern *Sukuk* issuance. In case of the Dana Gas, the issuer itself declares that the *Sukuk* structure is not *Shari'ah* compliant in order to avoid its obligation towards *Sukuk* holders.⁴ The *Sukuk*, in theory, is intended as an investment tool for long-term project finance, hence, it is not much extendable to fulfill the liquidity management need of the Islamic finance industry. Then why is the so called *Sukuk*, unrelated to real economic investment, used in liquidity management and resource mobilization? Haque et al. (2017) with an empirical study present that the *Sukuk* issuances are not perceived to be different than conventional securitized bonds in the market and most of them may not be deemed *Shari'ah* compliant. The *Sukuk* can be categorized as Asset-Backed and Asset-Based. In case of the asset-based *Sukuk* there is no access to the underlying assets in case of default but future cash flow. That is how *Sukuk* defaults happens. Even in case of the asset-backed *Sukuk*, access to underlying assets by *Sukuk* holders might not be straight forward (Salah, 2010).

DISBURSEMENT PROCEDURE FOR THE 2-STEP MURABAHA

In international trade, very often exporters would ask for Letter of Credit as a condition precedent to the shipment. A standard Letter of Credit transaction flow would be:

1. An export contract would be signed between the importer and the exporter.
2. The importer fills a standard application form requesting his bank (Bank-C in this particular case) to issue an irrevocable Letter of Credit in favor of the exporter overseas.
3. The importer's bank (Bank-C) issues its irrevocable L/C in accordance with the importer's instructions and sends to the advising bank (usually the exporter's bank)
4. The advising bank notifies the credit to the exporter.
5. Upon notification, the exporter ships the goods based on the L/C terms and conditions and presents the shipping documents, including Bill of Lading, to the negotiating bank.

⁴ <https://rd.springer.com/article/10.1057/jbr.2014.3> last accessed on 29th of September 2017.

6. The negotiating bank checks the documents and if everything is in order, pays the exporter. Then, it refers to the issuing bank for reimbursement. The issuing bank would reimburse to the negotiating bank given the documents are in compliance with the L/C terms.
7. The importer collects the document from the issuing bank (Bank-C in this particular case) and takes possession of the goods for custom clearance.

Under the 2-Step *Murabaha* financing, the importer can open an L/C in the Bank-C and Bank-C transmits a copy to an international Bank-B.⁵ Excerpt of the content of L/C in disbursement under 2-step *Murabaha* is shown in Table 1 below. The main body of such an L/C would be indicated in Appendix A. For the purpose of demonstration, the importer from Gambia applies to Bank-C for opening of L/C in favour of the exporter in Egypt to import wool and polyester yarn under the Two-Step *Murabaha* Financing provided by international Bank-B.

Table 1: Content of L/C in Disbursement under 2-Step Murabaha

<p>40A: Form of Documentary Credit IRREVOABLE 20: Documentary Credit Number CEN/92040198 31C: Date of Issue Date: 100330 40E: Applicable Rules UCPURR LATEST VERSION 31D: Date and Place of Expiry Date: 100630 Place: IN EGYPT 50: Applicant THE IMPORTER, ADDRESS OF THE IMPORTER, ACCOUNT NUMBER OF IMPORTER WITH BANK-C 59: Beneficiary Name &Addresss: THE EXPORTER ADDRESS OF THE EXPORTER TEL:XXXXX 32B: Currency Code, Amount Currency Code: US Dollar Amount: US\$ 312,750.00</p>

Source: Specimen prepared by the author based on draft provided by IDB Group

5 Unlike Direct *Murabaha* Sale, not the importer but Bank-C makes the disbursement request through a standard “**Form of Offer**” which indicates the first “**Sale Price**”. Upon the receipt of this form, Bank-B responds to Bank-C with a standard “**Form of Acceptance**” indicating the “**Purchase Price**”.

After receiving the above copy of the L/C, Bank-B issues an ICR (Irrevocable Commitment for Reimbursement) and sends the ICR to:

- A. The negotiating bank
- B. The issuing bank (Bank-C)
- C. Its Paying Agent Bank

by which Bank-B agrees to reimburse the negotiating bank the amount under the L/C opened by the importer from Bank-C. After the shipment by the exporter, Bank-B's paying agent honours the claim from the negotiating bank based on the satisfactory shipment documentation, such as Bill of Lading, invoice, *etc.*, identified in the L/C. Details of the transaction can be found in the Figure 1.⁶

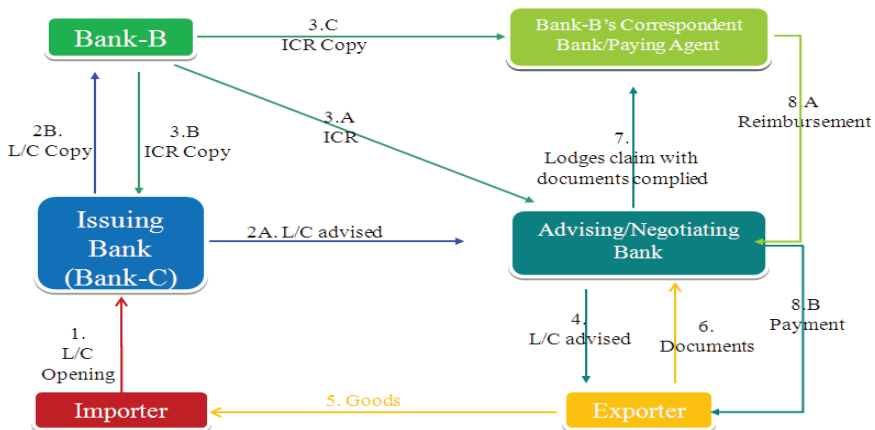


Figure 1: Disbursement Procedure under L/C

(Source: As Cited from Gundogdu, 2009)

In many cases, the L/C issued by a bank in Least Developed Countries is not perceived to be solid by exporters in other countries as these exporters are not convinced about the capacity of banks in these countries to honour their obligations tied to the L/C issued. Very often, exporters ask the L/C confirmation from another bank outside the country which generates an additional L/C confirmation cost for importers in Least Developed Countries. Hence, there is a potential for trade facilitation opportunities in this areas by reducing additional confirmation cost. For example, the European Bank

6 In (8.A), Paying Agent would reimburse at the date of maturity (i.e. 90 days from the date of Bill of Lading) if the L/C is not at Sight.

for Reconstruction and Development with its Regional Trade Facilitation Programme, which is network of banks enjoying EBRD's guarantee, have addressed this issue since 1998. The EBRD provides guarantee to confirming banks and undertakes the political and commercial payment risk of issuing banks in developing countries.⁷

As the content of the ICR indicates in Table 2, it acts as a replacement to the L/C confirmation. Table 2 shows the SWIFT message sent from Bank-B to its paying agent to inform and instruct an upcoming payment claim. Bank-B sends a message to her paying agent bank with the copy of its commitment (ICR) sent to the exporter's bank assuring the payment, upon successful negotiation of the shipping documents by the exporter, to be done through the paying agent. With the issuance of the ICR by Bank-B, the Gambian Bank-C does not need to seek confirmation to its L/C from international banks: the exporter's bank would not ask for the L/C to be confirmed. Hence, this 2-Step *Muarabaha* structure, in addition to availing trade finance, can be a remedy for difficulties associated with the L/C confirmation for many Least Developed Countries.

⁷ Available at: <http://www.ebrd.com/work-with-us/trade-facilitation-programme.html> accessed on 30 September 2017.

Table 2: Content of ICR in Disbursement under 2-Step Murabaha

<p>ATTN: TRADE FINANCE SERVICES WE HAVE ADVISED ADVISING/EXPORTER'S BANK, ADDRESS OF ADVISING/ EXPORTER'S BANK, SWIFT CODE, AS FOLLOWS: -</p> <p>QUOTE ATTN: DOCUMENTARY CREDITS DEPT. OUR REF: DS/BANK-B/GAM 0001 (PLS QUOTE IN ALL CORRESP.) WE HEREBY ISSUE OUR IRREVOCABLE COMMITMENT FOR REIMBURSEMENT OF CLAIMS UNDER FOLLOWING L/C PRESENTED TO OUR PAYING AGENT BANK, UPTO A MAXIMUM OF US\$ 312,750 (UNITED STATES DOLLAR THREE HUNDRED TWELVE THOUSAND SEVEN HUNDRED FIFTY ONLY) PROVIDED THE NEGOTIATING BANK CERTIFIES TO THEM BY AUTHENTICATED MESSAGE THAT ALL TERMS AND CONDITIONS OF L/C HAVE BEEN COMPLIED WITH. WE HAVE SENT A COPY OF THIS MESSAGE TO OUR PAYING AGENT BANK AUTHORIZING THEM TO HONOUR CLAIMS FROM THE NEGOTIATING BANK AFTER 3 (THREE) WORKING DAYS OF RECEIPT BY THEM OF THE NEGOTIATING BANK'S CERTIFICATE AS NOTED ABOVE.</p> <p>L/C DETAILS:</p> <ol style="list-style-type: none">1. L/C NO.: CEN/920401982. ISSUED BY: BANK-C (CENTRAL BRANCH) BANJUL, THE GAMBIA (SWIFT CODE OF BANK-C)3. BY ORDER OF: THE NAME OF THE IMPORTER, ADDRESS OF THE IMPORTER, TEL: XXXXX4. FAVOUR: THE NAME OF THE EXPORTER, ADDRESS OF THE EXPORTER, TEL: XXXXX5. AMOUNT: US\$ 312,7506. EXPIRY: 30.06.20107. LATEST SHIPMENT: 09.06.20108. ADVISING BANK: SWIFT CODE OF ADVISING/EXPORTER'S BANK, ADDRESS OF ADVISING/EXPORTER'S BANK9. PAYMENT: AT SIGHT10. BANKING CHARGES: ALL BANKING CHARGES OUTSIDE THE GAMBIA ARE FOR ACCOUNT OF THE BENEFICIARY. <p>IN THE EVENT THERE ARE ANY DISCREPANCIES IN OR AMENDMENTS TO THE ABOVE MENTIONED L/C DETAILS OR TO (I) THE COUNTRY OF ORIGIN, (II) THE DESCRIPTION OF GOODS, (III) THE QUANTITY OF GOODS AND (IV) THE INSURANCE CLAUSE, THE PRIOR APPROVAL OF THE BANK-B MUST BE OBTAINED IN ORDER THAT THIS COMMITMENT REMAINS OPERATIVE. ANY OTHER AMENDMENTS ISSUED BY THE L/C. ISSUING BANK DO NOT REQUIRE THE APPROVAL OF THE BANK-B.</p> <p>UNQUOTE.</p> <p>KINDLY HONOUR TO THE DEBIT OF BANK-B US DOLLAR CALL ACCOUNT NO.3400000002 CLAIMS FROM THE NEGOTIATING BANK AGAINST THEIR TESTED MSG CERTIFICATE OF COMPLIANCE AS ABOVE. YOUR AUTHORITY TO PAY UNDER THIS COMMITMENT IS VALID FOR ONE MONTH AFTER THE EXPIRY DATE OF THE L/C.</p>

Source: Specimen prepared by the author based on draft provided by IDB Group

The 2-Step *Murabaha* trade financing through the ICR can not only be an effective tool to avail more financing in Least Developed Countries but also play a trade facilitation role by eliminating the need for additional L/C confirmation outside the country. Diffusion of the 2-Step *Murabaha* would create substantial means for Least Developed Countries to promote their trade.

CONCLUSION

It should not be surprising to know the unwillingness of international banks in taking the risk of importers in an unknown market to them. They are more comfortable to assume the risk of another financial institution in another country rather than small companies (Gundogdu 2009). The 2-Step *Murabaha* Financing Mechanism can be used to mobilize resources from financial institutions to serve least developed countries. Under this mechanism, international banks avail funds to the banks of least developed countries, which then provides it to SMEs. In this scheme, international banks would take the risk of a local bank in need of necessary foreign exchange funds to support local SMEs. As we call the international bank as Bank-B and the local bank as Bank-C, the system works in such a way that Bank-B purchases the goods and sells it to Bank-C for a mark-up on a predetermined maturity date. Then, Bank-C sells the goods to the importer/SME as per another *Murabaha* agreement between them.

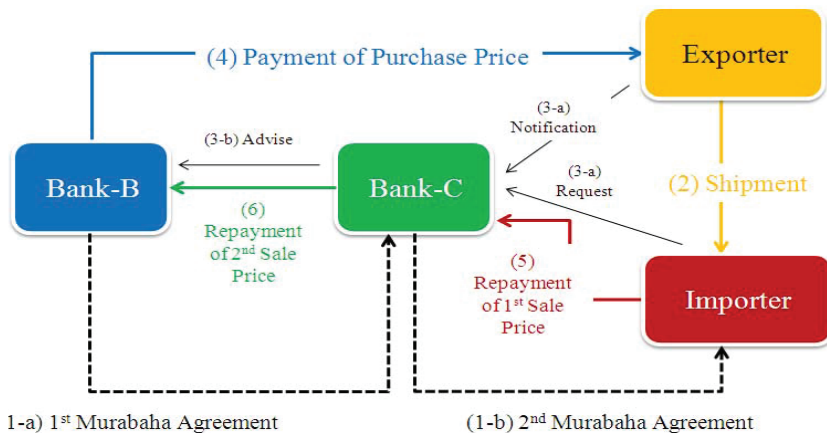


Figure 2: Two-Step Murabaha in the Context of International Trade

(Source: Gundogdu, 2014)

The existence of two separate Murabaha sales increases the merit of the structure. Bank-C can buy goods on a 12-month tenor with a four (4) per cent mark-up from Bank-B and can sell the goods at a three (3) month tenor with a five (5) percent mark-up to the importer. Upon the receipt of the sale price from the importer, Bank-C can use the money for 9 months at its disposal for other transactions up until paying back Bank-B. With such a mechanism, banks would fulfill their mandate of collecting excess funds from those have and placing them in areas where funds are needed to support bono-fide economic activities.

The 2-Step Murabaha transfers the direct credit risk of the importer SME to a local bank which would be considered for exposure by international banks. It can be discerned that this mechanism can be used to boost Small and Medium Size Enterprises (SMEs) in least developed countries to turn on the engine of growth. As presented by Gundogdu (2016), the 2-Step *Murabaha* scheme can further be embedded into stock exchanges as an alternative to the *Sukuk*, and the commodity *Murabaha* so as to support real economic transactions. Migrating the scheme to an electronic platform can decrease the cost of trade finance for least developed countries by creating a competitive 2-Step *Murabaha* market under stock exchanges by which Bank-C can mobilize resources, based on pre-specified stock exchange terms and conditions, from competing banks which pursue liquidity management. Given the trillion-dollar magnitude of trade finance, there is a huge potential for a streamlined 2-Step *Murabaha* in stock exchanges in pursuit of availing resources of Islamic finance for economic development as opposed to the speculative commodity *Murabaha* and *Sukuk*. As the literature review reveals both the commodity *Murabaha* and *Sukuk* give rise to serious concerns as being instruments for embedding Islamic finance to the conventional financial system. In order to keep Islamic finance aligned with the real economy and divert more funds from speculative financial instruments to bono-fide transactions, cooperation among Stock Exchanges of OIC counties is essential after streamlining the 2-Step *Murabaha* on an electronic trading platform. In this way, Islamic finance can rise in a real Islamic way.

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APPENDIX A:

Content of L/C in Disbursement under 2-Step Murabaha

40A: Form of Documentary Credit
IRREVOABLE
20: Documentary Credit Number
CEN/92040198
31C: Date of Issue
Date: 100330
40E: Applicable Rules
UCPURR LATEST VERSION
31D: Date and Place of Expiry
Date: 100630
Place: IN EGYPT
50: Applicant
THE IMPORTER,
ADDRESS OF THE IMPORTER,
ACCOUNT NUMBER OF IMPORTER WITH BANK-C
59: Beneficiary
Name &Addresss: THE EXPORTER
ADDRESS OF THE EXPORTER
TEL:XXXXX
32B: Currency Code, Amount
Currency Code: US Dollar
Amount: US\$ 312,750.00
41A: Available With ... By ...
Identifier Code: SWIFT CODE OF ADVISING/EXPORTER'S BANK ADDRESS OF ADVISING/
EXPORTER'S BANK
By: PAYMENT
43P: Partial Shipments
ALLOWED
43T: Transshipment
NOT ALLOWED
44F: Port of Loading/Airport of Departure
ANY PORT IN EGYPT
44C: Port of Discharge/Airport of Destination
BANJUL, THE GAMBIA
45A: Description of Goods and/or Services
45,000 KGS COUNT NM 60/2 PW 60/40 BLEND 21.5 MICRON WOOL AND 2.5 DEN
POLYESTER-YARN WORSTED COLOUR TBG

AS PER PROFORMA INVOICE NO.7196 DATED 01/02/2010
.
UP TO AGGREGATE AMOUN OF: US\$ 312750.00 AS CFR VALUE (UPTO US\$ 310500.00
AS FOB VALUE AND UPTO US\$ 2250.00 AS FREIGHT CHARGES)
46A: Documents Required

- A) FULL SET OF CLEAN ON BOARD OCEAN BILL OF LADING ISSUED OR ENDORSED TO THE ORDER OF BANK-C IN 3-ORIGINALS AND 3 NON-NEGOTIABLE COPIES INDICATING NAME AND ADDRESSES OF SHIPPING CO'S REPRESENTATIVE IN GAMBIA MARKED FREIGHT PREPAID DATED NOT LATER THAN 09.06.2010 NOR PRIOR TO THE DATE OF THIS SWIFT, INDICATING SHIPMENT BY CLASSIFIED VESSEL FROM ANY PORT IN EGYPT TO BANJUL, THE GAMBIA
- B) SIGNED COMMERCIAL INVOICES IN 3 ORIGINALS, 1 OF WHICH CERTIFIED BY EGYPT CHAMBER OF COMMERCE AND INDUSTRY AND LEGALIZED BY GAMBIAN CONSULATE, PLUS 1 EXTRA COPY ALL INCLUDING BNF'S STATEMENT THAT GOODS HAVE BEEN SHIPPED IN STRICT COMPLIANCE WITH THE CONDITIONS STIPULATED IN RELATED PROFORMA INVOICES AND THE SUBSEQUENT AMENDMENT THERETO IF ANY.
- C) SIGNED CERTIFICATE OF ORIGIN CERTIFIED BY EGYT CHAMBER OF COMERCE AND INDUSTRY LEGALIZED BY GAMBIAN CONSULATE, IN 1 ORIGINAL CONFIRMING GOODS ORIGINATED IN EGYPT, PLUS 2 COPIES.
- D) SIGNED DETALED PACKING LIST IN 3 COPIES
- E) THE ORIGINAL INSPECTION CERTIFICATE ISSUED NOT PRIOR TO BILL OF LADING DATE BY APPOINTED COLLATERAL MANAGEMENT AND MONOTORING COMPANY(CMMC) OR ITS AGENT LETTERHEAD CERITFYING THAT THE QUALITY, QUANTITY AND PACKING OF THE GOODS LOADED ARE STRICTLY COMPLYING WITH SPECIFICATION OF THE GOODS INDICATED IN THE RELATIVE PROFORMA INVOICE AND THE L/C AND ANY AMENDMENTS MADE THERETO AS PRESENTED TO THE CMMC BY THE APPLICANT/EXPORTER IN 1 ORIGINAL AND 1 COPY. SUCH PRESHIPMENT INSPECTION CERTIFICATE SHALL VERIFY THAT THE GOODS ARE IN CONFORMITY WITH GAMBIAN STANDARDS AS MENTIONED IN PROFORMA INVOICE AND CERTIFEID BY EGYPT CHAMBER OF COMMERCE AND INDUSTRY (INSPECTION CHARGES SHALL BE PAID BY THE APPLICANT/EXPORTER).
- F) A DECLARATION SIGNED BY THE SHIPPING CO. OR ITS AUTHORIZED AGENT STATING THAT THE CARRYING VESSEL IS A CLASSIFIED ONE PLYING ON REGULAR LINER SERVICES IN 1 ORIGINAL AND 2 COPIES.
- G) SIGNED FREIGHT INVOICES ISSUED BY THE SHIPPING CO., THE CARRIER OR ITS AUTHORIZED AGENT IN 1 ORIGINAL WHICH TO BE CERTIFIED BY EGYPT CHAMBER OF COMMERCE AND INDUSTRY PLUS 1 COPY.
- 47A: Additional Conditions
- 1) NEGOTIATION RESTRICTED TO THE ADVISING BANK
 - 2) ALL DOCUMENTS SHOULD INDICATE:
 - A) APPLICANT'S NAME AND FULL ADDRESS AS THE NOTIFY PARTY
 - B) L/C NO. CEN/92040198 AND REG.NO. OF60801341
 - C) INSURANCE CO'S NAME OF: ISLAMIC TAKAFUL COMPANY (for illustration purpose), POLICY NO.4/0106/109971/9999/016000/1388
 - D) CUSTOMS TARIFF NO OF: 55095200
 - 3) INSURANCE EFFECTED IN GAMBIA
 - 4) THIRD PARTY SHIPPING DOCUMENTS NOT ACCEPTABLE
 - 5) THE ISSUANCE DATE OF ALL DOCUMENTS SHOULD BE WITHIN THE VALIDTY DATE OF THIS CREDIT.

- 6) THE REQUIRED DOCS. SHOULD BE FORWARDED TO BANK-C, CENTRAL BRANCH NO.1701, BANJUL, THE GAMBIA BY DHL IN TWO SEPARATE SETS.
- 7) NEGOTIATION DATE OF DOCUMENTS SHOULD BE INFORMED TO BANK-C BY SWIFT.
- 8) A HANDLING CHARGES OF US\$50 WILL BE DEDUCTED FROM PROCEEDS FOR EACH DISCREPANT PRESENTATION (DISCREPANCY FEE).
- 9) ALL DOCUMENTS MUST BE ISSUED IN ENGLISH.
- 10) CHARTER PARTY BILL OF LADING NOT ACCEPTABLE.
- 11) PLEASE SEND ALL YOUR SWIFT MESSAGES TO BANK-C SWIFT AS 'BANKCGMBCEN' (for illustration purpose)

71B: Charges

ALL BANKING CHARGES OUTSIDE THE GAMBIA ARE FOR ACCOUNT OF THE BENEFICIARY/EXPORTER

48: Period for Presentation:

21 DAYS FROM THE DATE OF BILL OF LADING WITHIN THE L/C VALIDITY

49: Confirmation Instructions

WITHOUT

53A: Reimbursing Bank

SWIFT CODE FOR THE PAYING AGENT OF BANK-B

ADDRESS FOR THE PAYING AGENT OF BANK-B

78: Instructions to the Paying/Accepting/Negotiating Bank

THIS L/C IS SUBJECT TO THE ICC UNIFORMED CUSTOMS PRACTICES 2007 REVISION (BROCHURE 600) AND URR LATEST VERSION AND **THIS L/C IS TO BE REFINANCED UNDER REFINANCING 2-STEP MURABAHA AGREEMENT DATED 03/8/2017 WITH REF BANK-B/2017/TF3/GAM/0001 BETWEEN BANK-C AND BANK-B FOR A PERIOD OF 360 DAYS. UPON RECEIVING THE DOCS. AND CERTIFYING TO US THAT THE TERMS AND CONDITIONS OF THE CREDIT HAVE BEEN COMPLIED WITH, YOU ARE AUTHORIZED HEREBY TO REIMBURSE YOURSELVES FOR YOUR PAYMENT UNDER THIS L/C ON BANK-B US DOLLAR ACCOUNT WITH BANK-B'S PAYING AGENT ON DUE DATE.**

72: Sender to Receiver Information

THIS IS A CC MESSAGE FOR YOUR NOTIFICATION AND THE ORIGINAL ONE SENT TO ADVISING/EXPORTER'S BANK, ADDRESS OF ADVISING/EXPORTER'S BANK, SWIFT CODE OF ADVISING/EXPORTER'S BANK.

BEST REGARDS,
CENTRAL BRANCH