SHARED RISK & REWARD

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Arcapita's unusual murabaha

On Friday, the bankruptcy court authorized an unusual settlement between Arcapita and Standard Chartered (SCB) with respects to their secured murabaha that matured in March 2012.

Murabaha agreements require up front disclosure of both the cost of the asset, as well as the profit, and the date when the cost plus profit (based on LIBOR) is due. Typically, the intent of a murabaha is to create a debt that finances the activities of the borrower. That is somewhat controversial when the financing is obtained using commodities (through tawarruq), since the intent is to create a debt that is due upon maturity, with a profit to the financier, which replicates a conventional interest-based loan. However, it has its place in Islamic finance where an alternative is unavailable.

In the settlement with SCB, Arcapita is pushing the bounds of murabaha financing to ends that might be necessary within the bankruptcy case, but which has the intent of replicating a part of conventional finance that Islamic finance is widely understood to avoid.

Specifically, there is not supposed to be an excess paid beyond cost plus pre-specified profit if the debt is paid after the maturity date. Yet, in the settlement between Arcapita and SCB, the two parties are entering into a new murabaha facility that builds in accrued but unpaid profit from the period of time between the original maturity and the execution of the new murabaha facility.

The structure of the transaction is not disclosed in the document filed with the court (beyond being a new murabaha), but it will include in the profit both the profit payments going forward, as well as the accrued but unpaid facility after the first murabaha facility matured.

The new murabaha structure is easy to understand (again, another sale with deferred repayment including profit), but the inclusion of profit 'accrued by unpaid' after the first murabaha matured looks like a backdoor way to provide additional gain to SCB on the first murabaha beyond what was specified in the original murabaha.

From the perspective of the form of the transaction, this may be acceptable, but when viewed in totality, it looks like a backdoor way to avoid the restriction on fixing the cost and profit at the outset in the murabaha. In my estimation, it represents a cynical exploitation of the form-based approach towards Islamic finance by ignoring the intent of the parties in entering into another murabaha.

Until next week,
Blake Goud

Reading List

Court order for settlement agreement between Arcapita and Standard Chartered Bank (PDF)

Arcapita bankruptcy case docket (link)

Blog Posts This Week

IILM announces new CEO, no mention of current CEO's departure

How can Islamic finance absorb the human capital from Islamic finance training programs

Accreditation, rules on Shari'ah scholar conflict of interest begins to gain traction

A solar project financed by sukuk in Indonesia

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