IIFM Master Collateralised Murabaha Agreement

The MCMA is to be used for interbank transactions, and is intended to be useful to Islamic financial institutions looking to manage their liquidity. This note examines the structure of the MCMA and how it may be used by Islamic financial institutions.

Submitted 18 November 2014
Applicable Law Global , Sharia , Qatar , Saudi Arabia , United Arab Emirates
Topic Banking
Capital Markets & Derivatives > Islamic finance
Sector Focus Financial Institutions

Contact Ahmed Butt, Muneer Khan

On 16 November 2014, the International Islamic Financial Market (the IIFM) published a standard Master Collateralised Murabaha Agreement (the MCMA). The MCMA is to be used for interbank transactions, and is intended to be useful to Islamic financial institutions looking to manage their liquidity. This note examines the structure of the MCMA and how it may be used by Islamic financial institutions.

Background

The IIFM is a standard-setting body based in Bahrain, which focuses on the capital and money market areas of the Islamic finance industry. It has already published standard documents such as the ISDA/IIFM Tahawwut Master Agreement, which is used as a master agreement to transact Shariah compliant derivatives, and the Master Agreement for Treasury Placement, which is used to transact Shariah compliant inter-bank deposits.

Islamic financial institutions have limited options available to manage their liquidity. Furthermore, few governments offer Shariah compliant liquidity management solutions to banks established in their jurisdiction. This is however an increasingly important issue, and even the Bank of England will shortly commence feasibility work in this area. In the meantime, Islamic financial institutions must resort to the inter-bank market in order to manage their liquidity.

Conventional institutions have recourse to repurchase agreements (also known as repos), yet these instruments are not compatible with Shariah principles for several reasons. The main reason is that the liquidity under a repo is provided on an interest-bearing basis, and the repurchase of the securities at the maturity of the repo is categorised as a sale-and-buy-back transaction. Such transactions are prohibited according to the majority of the Islamic schools of thought.

The MCMA seeks to replicate the economic terms of a repo using Shariah compliant principles.

Transacting a Murabaha under the MCMA

The MCMA is a framework agreement pursuant to which collateralised Murabaha contracts may be transacted. The

IIFM has also published an Operational Guidance Memorandum to provide clarity on the operational aspects of the MCMA.

The liquidity is provided under the MCMA by one party (the Seller) to the other party (the Buyer) through a commodity Murabaha transaction. The Seller sells commodities to the Buyer with immediate delivery, but the payment of the sale price by the Buyer is deferred. The sale price payable by the Buyer is higher than the purchase price paid by the Seller, and the difference is typically calculated with reference to a conventional benchmark (such as LIBOR plus a margin).

The Murabaha is transacted pursuant to the MCMA through the typical exchange of an offer from the Seller and an acceptance from the Buyer.

Posting collateral under the MCMA

As security for the Buyer's obligations under the Murabaha contract, the Buyer is required to mortgage specified securities in favour of the Seller, and assign rights in relation to them in favour of the Seller. The securities are to be released from the mortgage and the assignment following the settlement of all of the obligations of the Buyer under the MCMA.

Collateral posted under the MCMA may be substituted at the Buyer's request.

Following an event of default in respect of the Buyer, the Seller may sell all or part of the collateral posted by the Buyer and then apply the disposal proceeds towards discharging amounts owed by the Buyer under the MCMA.

Margining

The MCMA also has standard margining provisions requiring the Buyer to post additional cash for securities depending on whether the value of the posted collateral is less than a specified percentage of all amounts outstanding under the MCMA. The Seller is also required to return cash or securities where the value of the posted collateral is greater than a specified percentage of all amounts outstanding under the MCMA.

The valuation of the posted collateral is determined by a Valuation Agent, which may be the Seller, the Buyer or a third party but would typically be the Seller.

Limitations of the MCMA

The MCMA is a framework agreement that is meant to be adapted depending on the commercial terms agreed between the Seller and the Buyer (subject to compliance with Shariah principles). The MCMA does not specify a governing law, although it has been prepared on the assumption that the governing law would be English law.

Given the wide range of countries in which Islamic finance is practiced, and the various jurisdictions in which potential collateral, such as Sukuk and listed equities, are located, the standard MCMA may not be appropriate in the relevant circumstances. For example, the security available over the relevant collateral would be determined by the laws in the applicable jurisdiction of the securities. In these circumstances, the relevant provisions in the MCMA relating to the mortgaging of the securities and the corresponding assignment should be removed and the relevant charge / pledge should be documented separately.

The Murabaha transacted in the MCMA assumes that the parties will enter into a single Murabaha transaction as part of a specific arrangement. Accordingly, the arrangement will have a fixed mark-up to reflect the principle that a Murabaha

is a fixed price transaction. This makes the MCMA appropriate for arrangements with a short-term tenor. For longer tenors, the fixed price nature of the Murabaha transaction may be uneconomical. However, a number of Shariah scholars allow parties to enter into a series of Murabaha transactions to allow one Murabaha transaction to repay a prior Murabaha transaction but with a different mark-up on the purchase price. Over the course of the arrangement, the parties achieve a floating mark-up using a series of fixed price Murabaha transactions. If the parties require such a mechanism, the MCMA will need to be amended to allow for this.

The MCMA specifically restricts the Seller from using in its business any securities held as collateral pursuant to the MCMA. Conventional finance institutions are used to having this right in conventional repo transactions. Without a right to rehypothecate the securities posted as collateral by the Buyer, the Seller may reflect this restriction in its pricing of the transaction. As an alternative, the Buyer may transfer title to the securities outright to the Seller as security, rather than relying on the mortgage and assignment. The MCMA would need to be amended to allow for such an arrangement. Some Shariah scholars have approved this arrangement as it would allow the Seller to rehypothecate the securities.

Conclusion

The MCMA is a welcome development in the growing universe of standardised documents for the Islamic finance industry. At a time when liquidity management is increasingly important for Islamic finance institutions, the MCMA is a useful framework for discussions between market participants. However, as noted above, careful consideration of the commercial requirements of the parties, the applicable laws and local requirements for perfecting security should be taken into account before the MCMA is adapted and agreed between the parties.

This document (and any information accessed through links in this document) is provided for information purposes only and does not constitute legal advice. Professional legal advice should be obtained before taking or refraining from any action as a result of the contents of this document.

© Simmons & Simmons LLP 2019. All rights reserved. Registered in England & Wales Registered Number OC352713

elexica Limited, CityPoint, One Ropemaker Street, London EC2Y 9SS