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**LEGAL ASPECTS OF ETHICAL (ISLAMIC) BANKING
(CASE STUDY OF A MURABAHA CONTRACT)**

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Introduction: the issues of legal regulation of partner (Islamic) banking in Russia took on particular importance under the conditions of economic pressure put on Russia by a number of countries. The issue of attracting investment to the country, from the states of Asia and the Middle East in particular, has become especially essential nowadays. The development of partner banking in Russia is promoted by the fact that the population of Russia includes a significant number of Muslims, who are familiar with Shariah principles being fundamental for Islamic economy. **Purpose:** to analyze the essence and main features of the legal regulation of Islamic banking, the similarities and differences between the major approaches applied in Shariah principles and in Russian legislation, to identify problematic issues, and suggest possible ways of solving thereof. **Methods:** the present study is conducted based on a set of scientific methods, including analysis and synthesis, interdisciplinary approach and comparative legal studies. **Results:** the present paper demonstrates that the implementation of partner banking instruments is constrained by certain current prohibitions and restrictions in Russian legislation. Partner banking instruments are based on the fundamental principles of Shariah and theological doctrine, which in a number of cases do not fully correspond to, and sometimes conflict with, the legislation. The authors have considered the peculiarities of Islamic banking through the example of a Murabaha contract as the main institution of financing based on Shariah principles. The authors have concluded that in Russia there are various approaches to the issue of how to implement the instruments of Islamic banking in the Russian legal system, from zero tolerance to the need for an appropriate regulatory framework. Introduction of alternative, and especially Islamic, financial instruments in the country's economy determines the need to inten-

sify the methods of harmonizing the norms of banking legislation and the Bank of Russia's regulations for arranging banking risk management, for effective banking operations and transactions in the integration processes of forming a single banking market. In this regard, public-law measures and contractual-legal forms of banking activities become the most important factor in ensuring financial stability of credit institutions and banking security. **Conclusion:** in order to create a sufficient legal framework for partner banking in Russia, it is necessary to use the whole toolkit of legal relations combined with the world experience. In order to start implementing the partner (Islamic) banking tools into the country's economy, it is sufficient to make selective changes to legislation that would eliminate the most significant obstacles for the Islamic economy development. Afterwards, when the partner banking development shows its efficiency for the Russian economy, in order to attract foreign investments, a broad-scale legislative change will be needed. Besides, for Russian banks, which are not familiar with the legal peculiarities of partner banking instruments functioning, it is necessary to develop standards for partner banking and related services, standard contract forms and methodological recommendations on how to provide services in partner banking.

Keywords: partner banking; Shariah principles; Islamic financial instruments; implementation; legal system; standards

Information in Russian

ПРАВОВЫЕ ОСОБЕННОСТИ ЭТИЧЕСКОГО (ИСЛАМСКОГО) БАНКИНГА (НА ПРИМЕРЕ ДОГОВОРА МУРАБАХА)

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Введение: вопросы правового регулирования партнерского (исламского) банкинга в России приобрели особую значимость в условиях экономического давления, оказываемого рядом государств на Россию. Актуальна и проблема привлечения в страну инвестиций, особенно из стран Азии и Ближнего Востока. Способствует развитию партнерского банкинга в России фактор значительного количества мусульманского населения, которому близки и понятны принципы шариата, на которых базируется исламская экономика. **Цель:** авторы анализируют сущность и основные особенности правового регулирования исламского банкинга, сходство и различия основных подходов, применяемых в стандартах шариата и в российском законодательстве, выявляют проблемные вопросы и предлагают возможные пути их решения. **Методы:** использована совокупность методов научного познания: анализа и синтеза, междисциплинарного подхода и сравнитель-

ного правоведения. **Результаты:** установлено, что применение инструментов партнерского банкинга сдерживается определенными запретами и ограничениями, предусмотренными в российском законодательстве. Инструменты партнерского банкинга базируются на основополагающих принципах шариата и теологической доктрине, которые в ряде случаев не в полной мере соответствуют, а иногда и противоречат законодательству. Особенности исламского банкинга рассмотрены на примере договора мурабаха как основного института финансирования, основанного на принципах шариата. Авторы заключают, что в России существуют различные подходы к вопросу о возможности имплементации в российскую правовую систему инструментов исламского банкинга, от полного непринятия до необходимости создания соответствующей нормативной основы. Имплементация в экономику страны альтернативных, в том числе исламских, финансовых инструментов обуславливает потребность в интенсификации приемов гармонизации норм банковского законодательства и нормативных актов Банка России для организации управления банковскими рисками, эффективного осуществления банковских операций и сделок в интеграционных процессах формирования единого рынка банковских услуг. В связи с этим публично-правовые меры и договорно-правовые формы организации банковской деятельности становятся важнейшим фактором обеспечения финансовой устойчивости кредитных организаций и банковской безопасности. **Выводы:** для создания достаточной правовой базы партнерского банкинга в России необходимо использовать весь правовой инструментарий правоотношений с учетом мирового опыта. Для начала имплементации инструментов партнерского (исламского) банкинга в экономику страны достаточно внесения точечных изменений в законодательство, устраняющих наиболее существенные препятствия к развитию исламской экономики. Впоследствии, когда развитие партнерского банкинга продемонстрирует свою эффективность для российской экономики, в целях привлечения зарубежного финансирования, необходимо масштабное изменение законодательства. Кроме того, для российских банков, незнакомых с правовыми особенностями функционирования инструментов партнерского банкинга, необходимо разработать стандарты партнерского банкинга и связанных с ним услуг, стандартных форм договоров и методических рекомендаций по предоставлению услуг в сфере партнерского банкинга.

Ключевые слова: партнерский банкинг; принципы шариата; исламские финансовые инструменты; имплементация; правовая системы; стандарты

Introduction

The economic crisis of nowadays and sanctions imposed on Russia by the EU and US make the issues of banking sector development and enhancement of the financial stability of credit organizations as well as attraction of foreign investments from the countries of Asia and the Middle East topical indeed.

The attention of the Russian legislator and business representatives to the economy based on the ethical principles of the Shariah, is also due to the high financial stability of credit and other financial institutions developing this part of the economy. Compared to the negative, even catastrophic consequences of the global financial crisis of 2010-s, which led to the bankruptcy of many Russian and foreign banks, none of the banks working under the Shariah principles has been declared bankrupt, and moreover their financial results were

so good that they haven't even requested for the State's assistance. The high financial stability of "Islamic" banks is due, first of all, to prohibition of excessive risk which so often causes bankruptcies of "traditional" banks.

Therefore, it is no mere chance that the possibility of using Islamic financial instruments in Russia based on prohibition of usury, loan interest, excessive risk and uncertainty, as well as restrictions on investment of funds and income received from prohibited activities such as weapons and alcohol production, gambling, is actively discussed on various forums at this time, so difficult for the economy of our country.

Issues of Practicability of Creating Special Legislation on Islamic Banking in Russia

Islamic banking is based on the ethical principles where entrepreneurs follow norms of morality and decency while pursuing their commercial

interests. So, it can be said that commercial jurisprudence consists of principles and rules that must be followed during those operations that correspond to religious dogmatics.

Agreements of the parties that exclude uncertainty are also of high importance. Moreover, uncertainty or ambiguity which potentially may lead to disputes between participants of commercial legal relations “uncertainties or ambiguities that can lead to disputes may render a contract void under Shariah” [7, p. 5].

The main requirements of Shariah, on which Islamic financing is based, are as follows [1]:

1. Income can be obtained only in two ways: by trading in goods (produced by the seller himself or purchased from others) and by providing services.

2. Prohibition of income in the form of usury interest i. e. Riba. The prohibition of Riba, which means “surplus”, is fundamental in Islamic law and “interpreted as “any unjustified increase of capital whether in the form of loans or sales”, being the basic principle of the system. A common opinion among Islamic scholars is that Riba covers not only usury but also unfair accrual of incomes, which is widely practiced. The prohibition of interests has led to the fact that net debts where interest rates are directly specified are also prohibited now. This ban is based on the arguments of social justice, parity and property rights. Islam encourages profit earning but prohibits taking monetary interest because profits symbolize successful entrepreneurship and creation of additional wealth. In contrast, interest means costs accrued regardless of the results of business transactions and thus cannot create wealth, if commercial losses happen. Social justice requires that borrowers and creditors share both profits and losses equally and that the process of accumulation and distribution of wealth in the economy is fair to reflect the real productivity”¹.

In ethical (Islamic) banking the principle of sharing of the risks and benefits resulting from the financing by shareholders and investors is very important. The principle of partnership participation in

a particular financial instrument radically distinguishes this type of financing from traditional, allowing, and sometimes directly contributing to putting strain on an unsecure debtor who is simply incapable, for various reasons, to pay his debt in time, regardless of the financial result achieved due to the funds previously borrowed. Representatives of Islamic banks emphasize that “Islamic banking helps to promote a more equitable distribution of income and wealth and increase equity participation in the economy”².

3. The seller can sell only the goods that he owns (i. e. he is the owner) and which are physically available to him.

4. The principle of sharing risks is closely associated with the principle of prohibition of income in the form of usurious interest. Revenue can only be obtained as a result of commercial activity which is risky in its nature. It means that income cannot be guaranteed, and an entrepreneur has to take on a commercial risk.

It is important that ethical (Islamic) banking has a number of stringent restrictions on commercial activities that are antisocial and harmful to the entire community. In particular, it is forbidden to invest in activities and trade in:

- alcoholic, tobacco products and places where these products are sold.
- weapons, ammunition and their components.
- casino, tote and other gambling.
- prostitution and pornography.

Islamic banks often update this ban list with the following³:

- any other industry where activities are not allowed in accordance with the Shariah;
- any derivative instruments and fixed income instruments, such as options, warrants, swaps, futures, the sale rate for securities, as well as currency options, as well as structured notes for assets;
- any product that is not based on tangible assets.

¹ Available at: <http://islamic-finance.ru/board/14-1-0-82> (accessed 17.06.2017).

² Official website Emirates Islamic. Available at: <https://www.emiratesislamic.ae/eng/islamic-banking/> (accessed 17.06.2017).

³ Official website of Al Rayan Bank. Available at: <https://www.alrayanbank.co.uk/useful-info-tools/about-us/ethical-banking/> (accessed 17.06.2017).

Considering the main prohibitions and restrictions in business and banking activities of commercial organizations, it is also necessary to underline the following principles¹:

- it is unacceptable to make money out of money in Islamic banking. Since money is a purchasing power that is considered the only correct use of money, money cannot be used to make more purchasing power (money) without going through the intermediate stage of their use for purchasing goods and services;

- *garar* (uncertainty, risk or speculation) is prohibited. At the same time, the contracting parties should have a clear idea of the amounts due as a result of the transactions conducted and should be exempt from uncertainty, risk and speculation. In addition, the parties cannot predetermine the guaranteed profit based on the principle of “undetermined benefits”.

Thus, the central place in the doctrine of Islamic finance belongs to the principle that money in itself has no intrinsic value. As a matter of religion, a Muslim cannot give money, or get money from someone, and benefits i. e. interest (known as *riba*) are not allowed. As making money out of money is forbidden, wealth can be created only on the basis of legitimate trade and investment in assets. Money should be used in accordance with the principles of Shariah².

The Islamic financial model is actively used in the world economy being the motive economic force in many countries including the United Arab Emirates, Indonesia, Bahrain, Malaysia, Qatar, Iraq, Iran, Jordan and other countries. In some countries all financial institutions must meet the requirements of Shariah, in others a dualistic model exists that makes it possible to create both Islamic and traditional banks that do not meet the requirements of ethical banking. As I. Zaripov [2, p. 2] points out, the results of Islamic banking are so amazing and it is getting new clients so quickly that even in non-Muslim countries first “Islamic windows” and then full-function branches operating according to the principles of Sharia, began to open. Today, there are about 300 large Islamic financial institutions with assets of about 2 trillion US dollars in the world. Islamic financial centers work in the UK,

Luxembourg, France, Germany, Belgium, USA and other countries. Many international companies, seeking to attract investors from the Middle East and Asia, adapt their own financial products to the requirements of ethical banking. So, it is now known that the methods corresponding to the norms of Shariah, are being introduced by Goldmoney to attract investments from Islamic markets. In January 2017 representatives of the company made a statement that their network accounts and current assets were recognized as Sharia-compliant by the Shariah Supervisory Board of Amanie Advisors. The Shariah Supervisory Board earlier published “fatwas” basing on the gold standards set by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) and developed in cooperation with the World Gold Council. At the moment, all Goldmoney actions pave the way for attracting Islamic investors in matters of instant purchases, savings and transactions in gold on a global scale via their platform of the Islamic window. It is noteworthy that the company, which has an exceptionally large client base, managing assets worth more than 1.7 million US dollars, considers the provision of services in accordance with the norms of the Shariah, the most important step in the perspective of its growth and development³.

Gradually, some of the states of the former Soviet Union, where a large part of the population professes Islam such as Azerbaijan, the Kyrgyz Republic, are also discussing the possibility and expediency of introducing the Islamic financial instruments into the country’s economy and, accordingly, development of an adequate legal regulation. The most advanced among them in the matter of implementation of Islamic banking is the Republic of Kazakhstan, where Islamic financial institutions are regulated by the Law of the Republic of Kazakhstan dated August 31, 1995 No. 2444 “On Banks and Banking Activities in the Republic of Kazakhstan” and the relevant regulatory Acts of the National Bank. The Special Law “On Islamic Banking Activities” was adapted in May 2014 in the Republic of Tajikistan.

For Russia, which is under economic sanctions and where millions of Muslims live, alternative

¹ Official website Emirates Islamic.

² Official website of Al Rayan Bank.

³ Available at: <http://islamic-finance.ru/news/2017-01-30-1685> (accessed 17.06.2017).

forms of financing, including the Islamic financial instruments, may become a driver of economic development and a necessary basis for attracting much-needed foreign investment from the countries of Asia and Middle East.

At the same time the existing significant differences in the basic principles and methods of conducting banking operations and transactions in Islamic banking, the approach to the “identity” of the client, the management of banking risks, control and supervision of the conformity of banking activities not only to normative regulations, but also to the principles of Shariah cause problems in the legal regulation of ethical (alternative) banking.

There are various approaches to the issue of how to implement the instruments of Islamic banking in the Russian legal system, from complete non-acceptance¹ to the need for an appropriate regulatory framework.

To determine the vector of development of the Russian legislation in the sphere of Islamic banking, a working group of the Bank of Russia was established, which approved the Road Map for implementing partner banking in Russia in 2016. Sberbank of Russia, Vnesheconombank and other large banks show a certain interest in its development. As part of the implementation of the Road Map in March 2016 in Kazan the first Russian partner (Islamic) Banking Center was opened. It will work in accordance with the principles of partner financing applied in the countries of Southeast Asia and Middle East.

As an alternative it is considered to be possible to create an ethical (orthodox) system of equity financing of enterprises in Russia also based on the principles of equity financing and prohibiting usurious interest which is reflected in the Old Testament.

According to the idea of the developers, the bank will fulfill the orders of its customers, make settlements between organizations and ensure safe-

ty of funds. At the same time, it will not participate in risky projects, issue loans or organize speculative trading at currency and stock markets. In other words, it will not become interested in usury, which by the way was prohibited by Catholic Christians [6] of the medieval Europe for a long time. To the authors, one of the advantages of the proposed system is that a full-scale reform of the current legislation is not needed.

Introduction of alternative, and especially Islamic, financial instruments in the country's economy determines the need for intensifying the methods of harmonization of the banking legislation norms and the Bank of Russia's regulations for arranging banking risk management, effective implementation of banking operations and transactions in the integration processes of forming a single banking market. In this regard, public-law measures and contractual and legal forms of organizing banking activities become the most important factor in ensuring the financial stability of credit institutions and banking security.

Of course, at the time when population needs affordable financial services of high quality, development of alternative forms of financing based on ethical principles is required, and in this case the ethical (orthodox) system of equity financing of enterprises is a good choice. However, as a set of measures the system has not been developed yet and it will take time to adapt it.

With respect to partner banking, different options are considered such as:

- not to change the law basically but work within the existing legal environment;
- to amend the law and, in particular, Federal Law No. 395-1 of 02.12.1990 “On Banks and Banking Activities”, the Tax Code of the Russian Federation: Part One (Federal Law No. 146-FZ of July 31, 1998) and Part Two (Federal Law No. 117-FZ of August 06, 2000) of the Civil Code of the Russian Federation as well as the normative legal and regulatory acts².

¹ To Bushmin E., Deputy Chairman of the Federal Council, the Bank of Russia and Russian legislation system are not ready to accept Islamic banking. Official website of the Association of Russian Banks: Available at: http://arb.ru/b2b/news/vitse_spiker_sovfeda_tsb_i_rossiyskoe_zakonodatelstvo_ne_goto_vy_k_islamskomu_ban-10013335/?sphrase_id=200099 (accessed 17.06.2017).

² At the period of 2014–2016 a few draft laws were submitted for consideration in State Duma. Their content concerned the issues of regulation of separate elements of partner banking. However they were not approved.

– to create a partner banking “window” within the current legislation of the Russian Federation, develop microfinance and insurance, based on the principles of partner finance.

It is necessary to understand how to improve the domestic legislation in order to develop partner banking which is most important for the economic recovery of Russia. Another important task is the legislative (normative) adaptation of the features of Islamic banking products (services), which are traditionally divided into three following types¹ according to the principle of their formation:

- based on partnership (or “sharing profits / profits and losses”): *mudaraba* and *musharaka*;
- based on participation in transactions (or “transaction / business debt”): *murabaha*, *ijara* (leasing), *salam*, *istisna*, *istijrar*, *kardul-hasan*, *vadiya*;
- based on payment of fees (tariffs) of the bank (or “commission” products): *vakala* (letter of credit).

Accordingly, for Russian banks that are not familiar with the legal peculiarities of the partner banking instruments it is necessary to develop standards for partner banking and related services, standard contract forms and methodological recommendations on services in the sphere of partner banking. Particular attention is paid to these issues in the Roadmap for the development of partner banking and related financial services in the Russian Federation approved by the Bank of Russia’s working group.

The partner banking instruments are based on the fundamental principles of Shariah and theological doctrine. December 7, within the framework of the annual 15th conference of the Organization of Accounting and Audit of Islamic Financial Institutions (AAOIFI) and the World Bank on Islamic Economy and Finance, agreements were signed on the translation of the entire text of the organization’s Sharia standards into Russian and French. Some of the standards have already been translated². However, when translating and adapting, some legal problems arise.

First, the standards are not a normative act of direct action, and secondly, they are extremely dif-

ficult for perception by a wide range of legal practitioners, including banking and law specialists, because they contain concepts and legal categories that are inconsistent with the Russian law, and some sound too uncertain (for example, the phrase “until the parties go their separate ways” to designate a time interval). To understand these texts it is necessary to know the norms of Sharia, the doctrine of Islam and the opinions of theological scholars, often inaccessible to the Russian law enforcers. Therefore, it is necessary to develop scientific comments or specifications to clarify a number of terms used in partner banking.

Proper use of the terminology of Islamic finance in Russian legislation and law enforcement, standardization of Islamic financial transactions is very important. As noted by M. Kalimullina, “at present Islamic financial standards contain concepts that can be easily and effectively transmitted via Russian-language equivalents (for example, a *mudaraba* transaction can be classified as trust management), and specific terms and concepts that do not have a direct common analogue in the Russian language (for example, *sukuk*, the best performance of the obligation, intentional delay in debt payment” [3, p. 122].

This means that “success of the further development of the young branch of Islamic finance both in Russia and in the CIS depends mainly on correct translation and implementation of terminology” [3, p. 123].

The Main Features of Financing under a *Murabaha* Contract in Islamic Law

Islamic law offers various ways of financing but one of the most popular is *murabaha* [9, p. 6]. Initially, *murabaha* was defined as an exchange transaction in which the buyer purchases items from the seller at a certain price paid to the seller. It was assumed that the seller would disclose his expenses so that the profit (margin) can be agreed accurately. Consequently, this type of sale is a form of “trust sale”, since the buyer has to believe that the seller is disclosing the real value. If a trader is acting on behalf of the other party in the purchase of goods, the mark-on can be considered as a payment for the trader’s service in the search, transportation and delivery of goods. As researchers say, however, this type of sale of goods for money should be distinguished from the transaction in which a bank or financial institution buys

¹ The official site of the Islamic Center for the Competence of Islamic Business and Finance in Russia: Available at: <http://ibfd-fund.ru/about-islamic-banking> (accessed 17.06.2017).

² Shariah AAOIFI standards will translate into Russian and French languages. Available at: <http://www.muslimeco.ru/onevs/2305/> (accessed 17.06.2017).

real estate and simultaneously sells it with the benefit for the customer. This operation is called “Murabaha of purchase – in favor of the customer”. For some commentators, murabaha of purchase in favor of the customer is a controversial method, as it can easily be used as a means of avoiding the ban on riba. The goal here is to withdraw money, not to trade commodities, and in most modern Islamic financial transactions the goal is achieved via a combination of other halal contracts¹.

The contract of murabaha is the “backbone of Islamic banking” [8, p. 13]. Traditionally, murabaha is used to perform some active operations of the bank for the purposes of export-import financing and working capital financing. As part of the transaction, a sale is made by the bank with a mark-up of a certain asset, previously purchased by the bank, in favor of the customer. The income of the bank from this transaction is the mark-up specified in the contract concluded with the client².

The requirements to be met when concluding a murabaha contract are stipulated in Shariah Standard No. 8 “Murabaha”³ (hereinafter – Standard No. 8). However, implementation of this financial instrument in the countries of non-Islamic law is possible only if it is not contrary to the legislation of the country in which it will be used.

Analysis of Standard No. 8 allows us to conclude that the implementation of murabaha is carried out in several stages, including various actions and transactions, such as: the client comes to the creditor with a request to purchase the goods; then the client promises to buy out the goods; the creditor purchases the goods; murabaha contract is signed.

According to the Standard No. 8, the first three stages precede the conclusion of a murabaha contract.

The stage when the client *comes to the financial institution*⁴ (hereinafter referred to as a creditor or bank) with a request to purchase a certain product from the supplier on his behalf (hereinafter referred to as the application) is initial. It is an obligatory condition for the purchase of the goods

by the bank from the supplier for the subsequent sale of this product to the customer under a murabaha contract.

Standard No. 8 does not specify any counteraction from the lender.

The promise given to the bank i.e. to buy out the goods purchased (hereinafter – the promise) is the next stage which is however not mandatory when murabaha is performed, but in practice, as a rule, it is always fulfilled. According to clause 2.3.2. of Standard No. 8, the promise is not a part of the murabaha contract.

According to Standard No. 8 it is possible for both parties to cancel their promises. *The lender* cannot make the customer purchase the goods that were bought for him at his request.

In view of the foregoing, it can be concluded that the client’s actions are not interrelated whether it is addressing the bank or his promise to buy out the goods or a murabaha contract. None of them is regulated which may lead to disputes.

Standard No. 8 just specifies general rules of the client’s behavior when coming to the bank and promising:

- the client’s visit to the bank and his promise to buy out the goods can be shaped as separate documents or as one general document (clause 2.1.3);
- a certain source of goods supply can be specified in the application form and document proving the client’s intentions (promise);
- the “promise” document may contain a provision on deferment of payment (clause 2.3.4.) and a mark-up on the goods (Section 2.3.4.), if needed;
- the document to be presented in a proper form (clause 2.1.3.) in writing;
- prepared at random or in the standard form of the bank (clause 2.1.3.);
- the document must be signed by the customer (clause 2.1.3).
- the terms of the client’s promise to purchase the goods before the conclusion of the murabaha contract can be changed by agreement of the parties if they relate to the deferral of payment, mark-up or other terms and conditions (clause 2.3.4.).

The purchase of the goods by the bank as property is the third stage of murabaha.

The content of this contract is similar to that of an ordinary contract of sale.

Standard No. 8 stipulates the following basic conditions of goods purchase:

- in respect of the goods, there must be no consent from the client to the supplier’s offer to purchase the goods;

¹ Available at: http://www.islamic-finance.com/item_murabaha_f.htm. (accessed 17.06.2017).

² Available at: <http://islamic-finance.ru/board/8-1-0-11> (accessed 17.06.2017).

³ Shariah Standard No. 8 was adopted by the Shariah Board at Meeting No. 4, held from 25 to 27 of Safar in the year 1421 of Hijra, which corresponds to May 29-31, 2000. It was published on 4th of Rabi al-Awalaal 1423 of Hijra that corresponds to May 16, 2002.

⁴ Authors’ note: Under Standard 8 any financial institutional can become the creditor within a murabaha contract. However in this document “the creditor” is related only to banks.

- any previous contractual agreements related to the delivery of the goods must be canceled;
- the goods cannot be purchased with the right of repurchase for the client;
- the price of the goods when being bought by the bank from the supplier must not exceed the market price;
- as a general rule, the bank must purchase the goods independently.

The conclusion of a murabaha contract is the fourth stage.

From the general meaning of Standard No. 8 it follows that the murabaha contract is an agreement under which the bank undertakes to transfer to the client the property (goods) previously purchased by the bank itself into its ownership at the request of the client, and the client undertakes to accept and pay for the goods with a pre-agreed mark-up on the price.

Murabaha from the Arabic language is translated as a sale at a profit [1, p. 49]. In this regard, from the legal point of view, a murabaha contract in itself is similar to an installment trade contract. However there is a difference between these two: credit payment for goods means that interest for using the credit will be paid, which is not allowed under a murabaha contract.

This prohibition is based on the following rules of the chapter “The Cow” (verse 275) of the Quran: “Allah has permitted trade and banned usury”¹. It should be noted that the ban on usurious interest (riba) is fundamental in Islam, as earning income in the form of riba is a serious sin.

According to murabaha, the bank receives profit from the difference between the acquired and sold asset to the client. The client, in turn, receives an alternative option for purchasing the goods by using the financial mechanism of the bank [5, p. 56].

This profit of the bank is included in the price of the goods.

Standard No. 8 sets the following basic requirements for the price of the goods for which the goods are sold by the creditor to the client;

- the price must be indicated in the murabaha contract (clause 4.6.);
- it cannot depend on an unknown variable or variables, the values of which will be determined in the future, depending on the LIBOR rate or another variable value and should be calculated as a percentage of the price of the goods for which the bank purchased the goods from the supplier (clause 4.6.);

– it cannot be changed after the conclusion of the murabaha contract (in this connection some questions arise when it comes to prolongation);

– it includes the price at which the bank purchased the goods from the supplier (clause 4.7.), and the mark-ups on the goods (bank’s profit);

– only expenses disclosed by the bank can be included in the price of the goods (clause 4.3.), otherwise the bank has no right to take into account such expenses, except usual expenses (transportation costs, commission on letters of credit and insurance premiums);

– it is mandatory to notify the client of all payment terms and conditions, incl. if the bank purchases goods on repayment deferral conditions;

– in case of receiving discounts from the supplier, the bank is obliged to reduce the price of the goods by the discount amount (clause 4.5.);

– the bank’s mark-up is to be clearly reflected in the goods price and separately specified in the murabaha contract (clause 4.6.);

A mark-up in its legal nature is a sort of payment for financing which cannot be expressed in percentage.

The mark-up must comply with the following rules:

– it includes direct expenses paid by the bank to a third party (clause 4.4.), e.g. insurance of the goods at the stage of ownership acquisition and in the future (clauses 3.2.6., 4.3.), other expenses, if the client find them acceptable (clause 4.3.);

– it cannot depend on an unknown variable or variables, the values of which will be calculated in the future based on the LIBOR or any other variable value (clause 4.6.);

– it can be specified in the murabaha contract as a fixed amount or as a percentage of the cost of the goods or the value plus the bank’s expenses (clause 4.7.).

A murabaha contract is signed in the bank under the control of the Shariah board. Such control on the part of Shariah experts is required in order to provide confirmation to investors that the money they invested is used only in businesses permitted by Shariah.

The goods purchased by the bank with an intention of further resale to the client should also meet the Shariah requirements as follows:

– it cannot be gold, silver, currency or securities, whose assets consist of receivables (clause 2.2.6); tobacco, alcohol products, pork meat and products made of it, weapons and ammunition, gambling products, as well as other types

¹ The Quran; Trans. I. Yu. Krachkovsky. Ed. 18th. Rostov-on-Don: Phoenix, 2016. 39 p.

of entrepreneurial activities, financing of which is prohibited by the Board on the principles of Islamic finance;

- it cannot be the subject of another murabaha contract, since refinancing is not allowed;
- at the time of conclusion of the murabaha contract the goods must be beneficially owned by the creditor, and all documents and contracts must be drawn up on behalf of the bank.

Methods used in murabaha to ensure fulfillment of obligations.

Deposit (*Hamish Jiddiyah*) is a sum of money which guarantees compensation to the bank for any damage arising as a result of the client's breach of his promise (clause 2.5.3). It is calculated as the difference between the prime cost of the goods and the price of its sale to a third party (it cannot be calculated as a missed margin in a murabaha transaction (clause 2.5.4).

Caution (*Urban*) is a sum of money deposited by the client to ensure compliance with his obligations i.e. payment of the goods. It is calculated as the difference between the price of the goods when bought by the bank and the price of resale to a third party (clause 2.5.6.).

Pledge of property:

- pledge of cash on an investment account (clause 5.2.);
- pledge of immovable or movable property (clause 5.2.);
- pledge of goods purchased under a murabaha contract without taking possession of the pledged asset, or by taking possession of the pledged asset with the subsequent gradual release of the subject of pledge in proportion to the percentage of the total payment received (clause 5.2.).

Not all provisions of this clause can be applied by Russian law practitioners, since Russian law does not provide for a fiduciary pledge and gradual release of the subject of the pledge from encumbrance (for real estate).

The following conditions can also be related to the ways of ensuring the fulfillment of obligations in order to minimize the risks of the creditor:

- when the client gives authority to the bank to sell the goods in case of a delay in payment and hands over change of condition form as part of a murabaha contract making the bank the owner of the goods (clause 5.4.) – if agreed;
- a condition according to which the client concedes title to the goods to the bank which makes

it possible later to sell the pledged goods without going to the law (clause 5.5.) – if agreed.

The following main features of financing under a murabaha contract can be mentioned:

- before a murabaha contract is concluded, first, the client goes to the bank with his request, then he promises to buy out the goods from the bank, after that the bank purchases the goods from a supplier. The promise and purchase are not included in the subject of the murabaha contract;
- the nature of the murabaha contract is similar to this of an installment purchase agreement, with the exception of the possibility of obtaining a gain in money (*riba*) from the client such as: interest, commissions and penalties;
- a fee for the murabaha financing is a mark-up on the goods;
- the return of funds comes from the risks that are shared by both lender and client, including the obligation of the lender to purchase the goods in his property before selling it to the client;
- the return of funds (money) provided to the client is carried out through various traditional methods of ensuring the fulfillment of obligations, pledge, guarantee, surety.

Conclusions

The analysis has shown that in modern economic conditions there is a high potential in Russia for application of various partner banking tools.

The following factors determine the possibility and practicability of developing partner (Islamic) banking: a considerable part of Russia's population that profess Islam; the interest in attracting foreign investments from the countries of Asia and Middle East; forming the halal product market the financing of which requires relevant financial tools.

Therewith, for application of such tools in Russian economy, it is necessary to create a certain legal framework being a legislative system that would regulate the legal regime of the tools and the legal status of subjects applying thereof.

A widely spread opinion that the use of financial tools can be regulated by Shariah standards only is erroneous.

Through the example of murabaha contracts, it is well seen how much the requirements of Shariah standards do not correspond, and sometimes are in direct contradiction, to Russian law. The Standards themselves often lack the specifics

necessary for univocal application in the economy, and in some cases, they even lack the analogue in Russian law.

In this context, the activity of the Bank of Russia in developing the road map and, correspondingly, a complex of measures for working out the legislation necessary for developing partner (Islamic) banking is crucial.

At the first stage, now, it is important to determine the legislation development vector (and to decide whether the legislative changes will be selective or broad-scale), and then it is necessary to start a more precise work over regulatory acts.

The depth of the correction of the current Russian legislation in order to use the partner banking instruments in the economy depends on the ultimate goal mainly. In our opinion, in order to acquire the first experience and knowledge about partner banking, it is really enough to introduce point-by-point changes that make it possible to use partner banking instruments in a certain territory as a pilot project. This will make it possible to understand the peculiarities of the functioning of partner banking in the Russian reality and to determine what changes in legislation are necessary for their effective use countrywide.

In the future, making such changes, in our opinion, is necessary for the full-fledged use of partner banking instruments, economic development and attracting foreign investment, including from the countries of Asia and Middle East. Changes may involve banking operations and transactions, insurance based on the principles of partner finance, securities market procedures.

Particular attention should be paid to the development of a mechanism for resolving disputes related to the provision of related services, as well as to reforming of the banking supervision over the activities of financial institutions operating on the basis of the principles of partner finance, including compliance with legislation on combating the legalization (laundering) of proceeds from crime, and the financing of terrorism, because “the effectiveness of the national regime of combating against money laundering and financing of terrorism depends on how strictly the relevant standards are observed by all financial intermediaries, including financial institutions and other persons providing access to the financial system” [4, p. 9].

At present, the Russian economy “has a serious potential for the development of Islamic finance in the field of banking, insurance, financial markets in Russia, but it is not easy to put it all in practice. And the result will definitely depend on

the interest of companies in development of Islamic finance, position of the Government and attitude of mind of the population. The existing Islamic financial institutions in Russia prove that it is possible” [3, p. 20].

At the present time, the efforts made by the Bank of Russia, as well as by all interested parties, could mean that the potential will be unlocked and therefore it is difficult to overestimate the relevance and importance of creating sufficient, consistent and non-conflicting legislation that would become a way to resolve existing problems rather than their source.

Of course, to create a sufficient legal framework for partner banking it is necessary to use the entire legal toolkit of legal relations in this area with the world experience taken into account in order to create a stable and efficient financial system, meet the population’s needs for banking and other financial services.

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Federatsii; UNIZARAK CONSORTIUM IBFD FUND Center of competence in Islamic business and finance of Russia [Feasibility Study on the Establishment of Islamic Bank or Islamic Banking Window in the Territory of the Republic of Tatarstan as a Pilot Region for the Launch of Islamic Banking and Finance in the Russian Federation. Prepared by UNIZARAK CONSORTIUM IBFD FUND, the Center of Competence in Islamic Business and Finance of Russia]. 2015. 416 p. (In Russ.).

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