

# Rent Financial Sharing (RFS)

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## Abstract

Rent Financial Sharing (RFS) is one of the financial subsystems of Rastin Profit and Loss sharing (PLS) banking system. This subsystem provides necessary background for depositors and their participation in economic activities of small and large finitude and endless investment projects. RFS works in various fields of business, production, agricultural and revival of deceased assets and exploitation of productive and rental assets; that entrepreneur wills to preserve his proprietorship on the project property, and depositor desires to obtain periodic (such as monthly, seasonal or annual) yield.

The entrepreneur in Rent Financial Sharing (RFS) will put a portion of his asset (productive, service or commercial firm or rentable) at hands of depositor for temporary proprietorship and depositor provides him funds with his deposit. Depositor mortgages his new informal property (in previous step) to entrepreneur. Thus, entrepreneur shares out his asset to the amount of depositor's deposit. Accordingly, depositor receives some amount of the yields of entrepreneur's firm/asset proportional to his share at once at maturity or periodically. New financial innovations of Rastin Certificates are introduced in this subsystem. Depositor receives Rastin digital certificates, which are negotiable in Rastin Certificate Market.

*Keywords:* Rent, Mortgage, Rastin Profit and Loss Sharing, Islamic Banking, Usury-Free Banking, Rastin Certificate

## Introduction and Objective

Financial innovations of Islamic banking and finance need more development to expand non-usury banking around the world. Innovation levels of Islamic financial institutions are low owing to the development of Islamic finance as a new activity.<sup>2</sup> Rent Financial Sharing (RFS)<sup>3</sup> designed as a financial subsystem of Rastin Profit and Loss Sharing (PLS) Banking System<sup>4</sup> to fulfill some of Islamic banking

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<sup>2</sup> Fouad H. Al-Salem, Islamic financial product innovation, International Journal of Islamic and Middle Eastern Finance and Management, Vol. 2 No. 3, 2009, pp. 187-200.

<sup>3</sup> Bidabad, Bijan. Rent Financial Sharing (RFS), a subsystem of Rastin PLS Banking, Planning and Research Department of Bank Melli Iran, Tehran, 2011.

<sup>4</sup> Bidabad, Bijan, et al. Detailed Rastin PLS Banking project. Department of Research and Planning, Bank Melli Iran, 2008.

shortcomings. Instructions, organizations<sup>5</sup>, electronic methods and contracts in this subsystem are executable under Rastin PLS Base System.<sup>6</sup>

The objective of designing RFS is to provide financing conditions for all asset holders, whether a working or not working firm, land, construction etc. In this regard, new financial innovations and instruments are designed and introduced, which have better performances than other competent.

### **Methodology and Scope**

Rent Financial Sharing (RFS) provides necessary background for depositors' participation in economic activities of small and large finitude and endless<sup>7</sup> investment projects in various fields of business, production, agricultural and revival of deceased assets<sup>8</sup> and exploitation of productive<sup>9</sup> and rental assets<sup>10</sup>. When entrepreneur wills to preserve his proprietorship on the project property and depositor desires to obtain periodic (such as monthly, seasonal or annual) yield from his deposit, RFS is a good financing manner.

RFS has many applications to finance the firms<sup>11</sup> that need working capital, or to buy commodities for sale. RFS can also be helpful for those property possessors who want to obtain their rental yields in lump sum at the time of financing and pay back the borrowed sources to the bank (on behalf of depositor) from the periodic rent of their assets.

Innovative financial instruments such as Rastin Certificates are used in Rastin Profit and Loss Sharing banking and bank by issuing these certificates and creating

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<sup>5</sup> Bidabad, Bijan, Safarzadeh Nasaji, Masoud, Aghabeigi, Jina, PLS banking organization. Department of Research and Planning, Bank Melli Iran, 2010.

<sup>6</sup> For more information and full-text documents of Rastin PLS banking see: <http://www.bidabad.com>

<sup>7</sup> Finitude projects are those projects that after completion of construction and by starting utilization period are to be consumed from viewpoints of bank and depositor. Finitude projects are not productive in depositor's viewpoint and do not make value added for depositor, although the depositor in utilization period receives his installments for principal or rent of the project.

Endless projects are those projects that after completion of construction period and starting utilization period are productive in viewpoints of depositor and entrepreneur, and depositor shares in the yield of the project.

<sup>8</sup> Deceased assets are inactive assets including closed firms, uncultivated lands and similar.

<sup>9</sup> Productive assets are those assets, which are productive.

<sup>10</sup> Rentable assets are those assets that can be lend to others.

<sup>11</sup> William J. Donaldson, Sharecropping in the Yemen, A Study in Islamic Theory, Custom and Pragmatism, 2000, Koninklijke Brill NV, Leiden, The Netherland.

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secondary market for transaction of Rastin Certificates provides new participation conditions for financing economic activities and by increasing financial efficiency, important international infrastructure for absorbing funds from all over the world is prepared. Rastin Certificates as negotiable securities are issued at the internet website of the bank. These papers are of asset types and like a share can be transacted legally and its transaction is Sharia-complied. The owners of these certificates can buy and sell them on internet, therefore, these certificates can be transacted internationally.

In RFS, we introduce a subset of Rastin Certificates for the category of Rent Financial Sharing method. These certificates are defined with periodic and non-periodic maturities and customized for different economic activities.

### **Rent Financial Sharing (RFS)**

Regardless of the bank, being private or government owned, without predetermined interest rate, the rate of return is determined according to the real sector yield. Bank works as intermediary of funds and receives commission while provides capital management services to participate depositor deposit in entrepreneur's economic activity. At the end of sharing activity, the yield and the deposit is paid back to depositor and finally, entrepreneur becomes the owner of the project or property.

By receiving “*jol*” (commission fee), bank provides capital management services to depositor and invests his funds in one of the PLS banking projects – selected by depositor- and gives him: Mortgage Sharing Certificate, Periodic Mortgage Sharing Certificate, Mortgage *Mudarabah* Certificate, Periodic Mortgage *Mudarabah* Certificate, Mortgage *Muzaraah*<sup>12</sup> Certificate, Periodic Mortgage *Muzaraah* Certificate, Mortgage *Mugharasah*<sup>13</sup> Certificate, Periodic Mortgage *Mugharasah* Certificate, Mortgage *Musaqah*<sup>14</sup> Certificate, Periodic Mortgage *Musaqah* Certificate, Mortgage *Istisna* Certificate, Periodic Mortgage *Istisna* Certificate or Rent Certificate.

In RFS, entrepreneur puts a portion of his assets (goods or services productive firm, business entity or rentable building, equipment or installations) at temporary possession of depositor. In return, depositor provides deposit funds to entrepreneur and the depositor mortgages the cited asset portion to entrepreneur and entrepreneur shares out the yield of the asset according to depositor's share -at once or periodically. Bank provides necessary conditions for this participation between depositor and entrepreneur through civil partnership (*musharakat-e-madani*) or other

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<sup>12</sup> *Muzaraah* is participation in farming.

<sup>13</sup> *Mugharasah* is participation in tree planting.

<sup>14</sup> *Musaqah* is participation in fruit gardening.

sharing contracts such as *Muzaraah* and *Musaqah*.

Profit is distributed between depositor and entrepreneur, and bank receives commission. If bank contributes in project funding, he will be in the same position as depositor and obtains profit proportional to his contribution. Entrepreneur may be real or legal entity. Entrepreneur provides bank with suitable guarantees and collaterals for good performance of the job. Trustee unit of the bank supervises the process of Rent Financial Sharing (RFS) on behalf of the bank, and bank is obliged to preserve deposit's rights.

By applying to branch of PLS bank, entrepreneur presents his proposal to bank. While informing the entrepreneur about sharing conditions through information portal of Rastin Certificate Market or information counter of PLS branch, entrepreneur delivers detailed information including written project, which contains economic, technical and financial justification and other information about the project to bank.

The assessment unit of bank will assess the entrepreneur's proposal and his previous records according to instructions; and if he is capable and qualified for conducting the job, his file will be sent to the PLS department. If the preliminary assessment is positive, the detailed assessment of the project proposal will start and the needed amounts of collaterals and guarantees will be specified and informed to entrepreneur. Entrepreneur provides all documents, including the subject of sharing, budgeting, time schedule, sources needed and methods of consuming the resources, method of executing the project, phasing, quality control and reporting and method of delivering project, to assessment unit for detailed evaluation. After signing the contract, requested and agreed funds in the signed contract will be introduced to depositors through the bank's Rastin Certificate Market website and after mobilizing deposits, funds will be paid to entrepreneur according to pre-signed contract. Supervision reports and quality of handling entrepreneur's activities should be delivered to trustee unit of bank periodically according to the pre-determined time schedule. Trustee's reports will be the base for judgment of correctness or falseness activities of entrepreneur. After construction period, the rent and share of the yield of the project and bank's commission will be calculated by accounting/auditing unit. The share of entrepreneur and depositors will be determined by considering the method of funding (whether it is as a rent, or profit or loss sharing) and will be paid to them. The amount of delay and thereof losses will be calculated according to instructions if there is any delay report prepared by trustee unit.

By applying to information portal of Rastin Certificate Market or through consulting with expert of PLS counter of the bank, PLS products, conditions and regulations of depositing and withdrawal of funds, are introduced to depositor and he will select a

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specific project. After signing the contract, the system will automatically issue Rastin Certificates related to the selected project. After each financial period, the accounting/auditing unit of bank will calculate profit, or rent of the project and receive it from entrepreneur and pay to depositor according to his share. Bank will receive initial fund from entrepreneur and deliver to depositor at the end of contract. This process is shown by figure 1.

All activities will be carried out according to Rastin PLS banking instructions. The amount of delay and thereof losses will be calculated according to instructions if there is any delay reported by trustee unit. Meanwhile, delays caused by force majeure will be defined and assessed according to instructions. In the case of entrepreneur dissatisfaction of trustee unit report, the case will be solved through arbitration according to instruction.

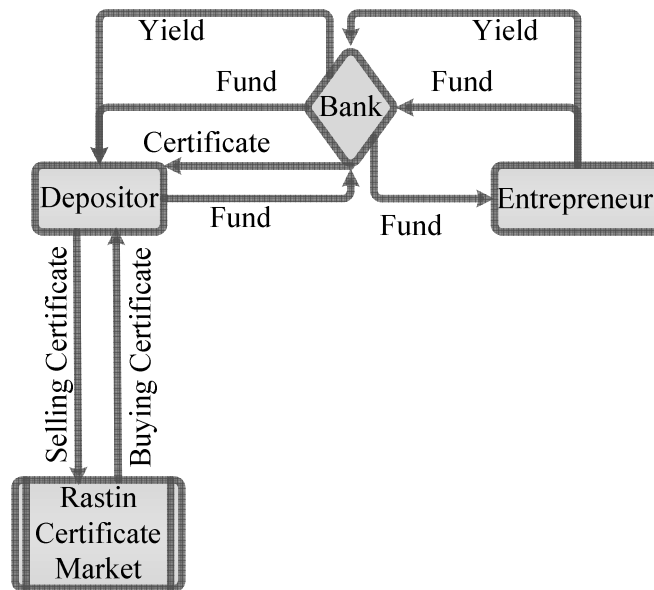


Figure 1. Rent Financial Sharing (RFS) process

### Rent Financial Sharing (RFS) Phases

1. Entrepreneur applies his proposal to bank for financing his economic activity through depositors' participation.
2. Project proposal for Rent Financial Sharing (RFS) includes information on spot

value of entrepreneur's assets and the period he needs the fund with technical, financial and economic justification of the project.

3. If the bank confirms the competency and technical capability of entrepreneur and his project proposal, will firstly assess the spot Dollar value of the project assets according to market prices and norms and the amount of fund and duration of the needed fund.
4. After final confirmation of the project proposal, bank introduce it to depositors and by selling the corresponding RFS Rastin Certificates to depositors, will provide necessary funds and will pay them to entrepreneur under supervision of the trustee unit of the bank.
5. Paying fund to entrepreneur is regarded as giving the possession of the entrepreneur's asset to depositors for the period of contract.
6. Depositor gives (mortgages) his possessed share to entrepreneur and instead, participates in entrepreneur activity proportional to his contribution.
7. Depositor receives profit of sharing during contracted period from productive assets or receives rent for rental assets during that period.
8. Bank receives the profit gained from depositor's funds (at hands of entrepreneur) regarding Periodic Certificates for productive assets during the contract period from entrepreneur, and after deducting commission, pays to depositor. In the case of rental assets, regarding Non-Periodic Certificates at the end of contract bank receives the profit from entrepreneur and after deducting commission, pays the remainder to depositors.
9. At the end of contract, bank receives depositor's funds back from entrepreneur and pays them to depositor and participation contract terminates.

All executive activities in Rent Financial Sharing (RFS) is carried out under the supervision of trustee unit<sup>15</sup> of PLS department of the bank. In RFS, regarding the type of asset (productive asset, or rental asset) and by considering the amount of capital and bank's decision, the entrepreneur can be real person or legal entity, or just legal entity. At the end of RFS, the original funds will be refunded to depositor, but the profit can be paid to him periodically (in periodic certificates), or at the end of contract (in non-periodic certificates) according to the type of contract. The due date of profit or rent payment to depositor starts from the end of the first period and continues until the end of contract in periodic certificates. All these certificates are

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<sup>15</sup> Trustee unit supervises the operations of entrepreneur to make sure the fulfillment of entrepreneur commitments.

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nameless and negotiable in Rastin Certificates Market. Market prices of these papers are determined according to supply and demand mechanism in secondary internet market and bank receives 0.05% of transaction value from each side as commission for transaction. Periodic settlement will be carried out with latest certificate owner.

Since entrepreneur works on behalf of depositor, and shares his asset and invests from depositor's fund (deposit), he has a joint right in the asset (in RFS) with depositor. Since there may be risk of losing the asset, the entrepreneur will insure depositor's asset share in the name and benefit of bank. Bank also receives appropriate collaterals and guarantees from the entrepreneur for risk coverage and good performance of him. Insurance coverage is obligatory in Rent Financial Sharing. These insurances are formed in supplementary contracts and are *Sharia*-complied.

### **Rent Financial Sharing Types**

Rent Financial Sharing can be arranged in different fields based on the activity of entrepreneur and kind of asset as follows:

#### **1. Mortgage Sharing and Periodic Mortgage Sharing**

Mortgage Sharing and Periodic Mortgage Sharing are used to finance projects with productive assets including working capital of productive firms. Based on the bank decision, firm can be real or legal, small or large entity. The settlement of Mortgage Sharing project financing with depositor is at the end of contract after deduction of bank commission; but in Periodic Mortgage Sharing, settlement is at the end of each period and the original fund is paid back to depositor at the end of contract. Mortgage Sharing Certificate and Periodic Mortgage Sharing Certificate are issued for these processes.

Mortgage Sharing Certificate is an anonym (nameless) document with a nominal price, which is issued for a certain period by a Rastin PLS bank. Holder of these certificates shares in the yield of the asset of the project proportional to his share to nominal price of the assessed value of the asset considering his participation period. The principal and return of sharing of these certificates will be paid to depositor at the end of contract. Periodic Mortgage Sharing Certificate has all characteristics of Mortgage Sharing Certificate but, the return of the certificate is periodically paid to the certificate holder.

#### **2. Mortgage *Mudarabah* and Periodic Mortgage *Mudarabah***

Mortgage *Mudarabah* and Periodic Mortgage *Mudarabah* are used to finance commercial projects that have productive asset for purchasing and selling commercial financing in small and large firms. Based on the bank decision, firm can be real or legal, small or large entity. Mortgage *Mudarabah* and Periodic Mortgage *Mudarabah* observe regulations of *Mudarabah* Financial Sharing (MFS) financial subsystem in addition to the Base system rules of Rastin PLS banking.

Mortgage *Mudarabah* projects are financed by Mortgage *Mudarabah* Certificates. Settlement will be at the end of the contract, but projects financed by issuing Periodic Mortgage *Mudarabah* Certificates, settlement takes place periodically and the original funds will be paid back to depositor at the end of contract. Mortgage *Mudarabah* Certificates and Periodic Mortgage *Mudarabah* Certificates are similar to Mortgage Sharing Certificate and Periodic Mortgage Sharing Certificate, but these certificates are used for commercial financing services.

### 3. Mortgage *Muzaraah* and Periodic Mortgage *Muzaraah*

Mortgage *Muzaraah* is used to finance agricultural projects, which have productive or uncultivated (unused) assets and is used to finance working capital for planting, harvesting and selling the products in small and large agricultural firms. Firm can be either real or legal entity. If the product (crop) is harvested at once, the settlement time for profit and original fund is at the end of contract after deduction of bank's commission. Quality, transportation, storing, packing and selling products in this financing method are under the regulations of *Joalah* Financial Sharing (JFS) and *Mudarabah* Financial Sharing (MFS) subsystems.

In Mortgage *Muzaraah* projects, which are financed by Periodic Mortgage *Muzaraah*, distribution of profit is periodic after deduction of bank commission but at the end of contract the original funds will be paid back to depositor and the contract is settled. Mortgage *Muzaraah* Certificates and Periodic Mortgage *Muzaraah* Certificates are similar to Mortgage *Mudarabah* Certificates and Periodic Mortgage *Mudarabah* Certificates but for agricultural financing.

### 4. Mortgage *Mugharasah* and Periodic Mortgage *Mugharasah*

Mortgage *Mugharasah* is used to finance tree-planting projects. In *Mugharasah* the asset of entrepreneur (usually including land, technical experience of planting and tree preserving and more), becomes productive. *Mugharasah* includes financing of working capital for planting, husbandry, harvesting, packing and transporting the products of small and large agricultural firms. Bank can decide about personality and size of the firm. If the product (crop) is harvested at once, the settlement time for profit/loss and original fund is at the end of contract after deduction of bank's commission. Quality, transportation, storing, packing and selling products in this type of financing are under the regulations of *Joalah* Financial Sharing (JFS) and



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*Mudarabah* Financial Sharing (MFS) subsystems.

In those Mortgage *Mugharasah* projects, which are financed by Periodic Mortgage *Mugharasah* Certificate, distribution of profit is periodic after deduction of bank commission but at the end of contract the original fund will be paid back to depositor and the contract is settled. Mortgage *Mugharasah* Certificates and Periodic Mortgage *Mugharasah* Certificates are similar to Mortgage *Muzaraah* Certificates and Periodic Mortgage *Muzaraah* Certificates but for planting and restoring tree gardens financing.

### 5. Mortgage *Musaqah* and Periodic Mortgage *Musaqah*

Mortgage *Musaqah* is used to finance husbandry and harvest of fruit gardens. The entrepreneur's asset (usually includes tree garden, technical experience of planting and tree husbandry and more) becomes productive by Mortgage *Musaqah*. Mortgage *Musaqah* is used to finance working capital of planting, husbandry, harvesting, packing and transporting production of small and large agricultural firms for either legal or real entities. In Mortgage *Musaqah* projects, which are financed by Periodic Mortgage *Musaqah*, distribution of profit is periodic after deduction of bank commission but at the end of contract the original deposit of depositor will be paid back to him and the contract is settled. Quality, transportation, storing, packing and selling product in this kind of financing are done under the regulations of *Joalah* Financial Sharing (JFS) and *Mudarabah* Financial Sharing (MFS) subsystems.

Mortgage *Musaqah* Certificates and Periodic Mortgage *Musaqah* Certificates are similar to Mortgage *Muzaraah* Certificates and Periodic Mortgage *Muzaraah* Certificates but for maintaining and harvesting fruit gardens financing.

### 6. Mortgage *Istisna* and Periodic Mortgage *Istisna*

Mortgage *Istisna* is used for financing industrial and agro-industrial firms. Mortgage *Istisna* also includes financing working capital of industrial and agro-industrial firms for production and selling products in small and large real or legal firms. Regarding the production whether is produced at one time, or is carried out along a period of time, the payment of profit/loss will be at one time, or periodically; after deduction of bank's commission. Quality, transportation, storing, packing and selling products in this type of financing are under the regulations of *Joalah* Financial Sharing (JFS) and *Mudarabah* Financial Sharing (MFS) subsystems.

In projects that are financed by Mortgage *Istisna* Certificate, settlement is at the end of contract and the original deposit and sharing profit is paid back after deducting bank's commission. Nevertheless, if the contract is Periodic Mortgage *Istisna* Certificate, profit/loss is divided after each period and the settlement of the principal shared asset with depositor takes place at the end of contract. Mortgage *Istisna*

Certificates and Periodic Mortgage *Istisna* Certificates are similar to Mortgage *Muzaraah* Certificates and Periodic Mortgage *Muzaraah* Certificates but for financing industrial and agricultural firms.

### 7. Rent Sharing

Rent Sharing is used for financing the owner of rentable assets such as houses, commercial buildings, office buildings, workshops, gardens, farms or installations. The owner of these assets can be real person or legal entity. While presenting rental documents of these assets (to the third party) and his project to the bank simultaneously, the owner will ask the bank to convince the depositors about the rent income flow of the asset and bank will also assess and evaluate his asset and rental income stream. After signing the contract, the periodic rent will be paid to depositor under the bank supervision. At the end of contract, the entrepreneur will pay back the fund received to depositor in wholesome through the bank.

In projects financed by Rent Certificates, the profit is paid to depositor after deduction of bank's commission at the end of each period and the original deposit will be returned to depositor at the end of contract. Rent Certificate is an anonym document, which is issued with a defined nominal price and for a certain period by Rastin PLS bank. The owner of this certificate shares the rent of asset proportional to its assessed asset nominal price. The original fund plus the rent will be paid to depositor at the end of contract period.

### **Comparison of RFS Mortgage Certificates and Conventional Mortgage Securities**

Valuable papers backed with mortgage loans are those securities issued with mortgage loan guarantees. Mortgage loan the loan for which the ownership document is mortgaged as guarantee by bank. Usually, in conventional mortgage papers, an institution<sup>16</sup> guarantees the payment of interest and principal fund. Guarantees of these loans means guarantee of payment of monthly installments.

By guaranteeing the principal and interest of loans by institutes and using insurance for mortgage-backed securities, these loans will be negotiable in secondary market. The existence of secondary market will develop the primary mortgage market, which is long-term loan market. In this way, bank uses free resources to increase his own loan extending capability. By supplying mortgage securities in the secondary market, banks absorb new resources.

In the process of asset securitization (including mortgage loans) to valuable papers (securities), the company or firm who needs financing establishes an intermediary

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<sup>16</sup> - For example in America: the Government National Mortgage Association.

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company. The intermediate company issues papers and offers them to investors. Then, the intermediate company buys bank's financial assets from these funds. The possessors of these papers/securities will gain monthly profit for their purchase from the cash payment caused by periodical (monthly) loan re-payments. Thus:

1. Bank extends loan to client and receives installments on pre-determined periods.
2. Bank sells its claims (receivable documents) to intermediate company and receives money.
3. The intermediate company will issue valuable papers (securities) based on these claims, and sells them to investors and pays the obtained funds to the bank and receives commission.
4. Again, bank uses the new resources for extending new loans.

Practically, in this method, bank loan is shifted to intermediate company. This means that bank sells its long-term claims and finances. Mortgage papers have defined and fixed return and the asset remains at possession of the bank until the last installment (periodic rent) is paid, or bank can receive its equivalent as mortgage.

Money and Credit Council on November 17<sup>th</sup>, 2007<sup>17</sup> approved debt purchase activities based on the Provisional Regulation of Discounting Commercial Papers. Notable Islamic jurists believe that if debt purchase paper has been raised from real transaction, which means has been raised from extended loan for buying an asset, this debt can be transacted and sold to other people. Therefore, discounting commercial papers (debt purchase), for example in Installment Sell (*Foroosh-e-Aghsati*) based on Installment Sell Contract has no problem from jurisprudential point of view.<sup>18</sup> On the other hand, notable Shiite scholars believe that purchase of debt by debt and "*Kali beh Kali*"<sup>19</sup> transaction are not right. Therefore, the papers should be in such a way that it would not be involved in this subject. For example, the intermediate company should not start debt purchase before issuing paper, but should issue paper after defining the kind and amount of debt, discount rate and other effective variables, and then start to publish debt paper and by the acquired money from, starts to buy debts<sup>20</sup>. The Stock Exchange Jurisprudential Committee believe

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<sup>17</sup> - Musavian, Abbas, 2007, *Islamic Financial Instruments (Sokuk)*, Islamic Thought and Culture Research Center, Tehran, Iran

<sup>18</sup> - Jurisprudential Specialized Committee of Stocks Exchange and Valuable Papers Organization, 2007.

<sup>19</sup> - *Kali-beh-Kali* is a transaction that seller sells specific amount of a commodity to be delivered in future; and buyer purchases the commodity to be received in future.

<sup>20</sup> - Jurisprudential Specialized Committee, Stocks Exchange and Valuable Papers Organization, 2007.

that since debts are raised from Installment Sell contract, therefore, asset documents should be transferred to intermediate company (who issues papers) and since, when bank extends these facilities to intermediate company, in fact, should transfer all documents to the issuing company. In this way, issuing valuable papers backed by mortgage loans by considering the above conditions have no problem from the Stock Exchange Jurisprudential Committee viewpoint. But, since Installment Sell itself is a *Reba* contract<sup>21</sup>, the recent reasoning and maneuvers face problem<sup>22</sup>.

*Murabaha* Mortgage Security or Installment Sell Mortgage Security is one of the kinds of mortgage securities. In this case, by securitizing its claim from extended loan alongside with the mortgage, the bank which has transferred his resources to others by *Murabaha* mortgage or Installment Sell mortgage, can renew his funds. That is to say, bank transfers the asset to client by Installment Sell and receives installments, then can change the securities of this installment into money and provide new fund for new clients. Therefore, by applying to custodian and establishing intermediate company, will ask him to issue mortgage securities equal to the extended loan and thereof, transfers his claim to investors who buy the securities. By arranging a prospectus and obtaining credit rating agency confirmation, intermediate company publishes and sell *Murabaha* Mortgage Securities to public, and then on behalf of the claimers (security holders) will buy the asset from the bank and is replaced with bank in Installment Sell contract; and from that time, collects installments through financing company and distributes it among security holders.<sup>23</sup>

In the case of “*Ijarah bi Sharte Tamlik*” (Rent Conditioned to Possession) mortgage securities, bank transfers the asset to others by *Ijarah bi Sharte Tamlik* Contract and receives the rent periodically, and can sell the *Ijarah bi Sharte Tamlik* mortgage securities and refund his resources. Detail of this procedure is similar to *Murabaha* or installment sell mortgage securities.

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<sup>21</sup> - Bidabad, Bijan and Abulreza Harsini, Non-usury bank Corporation and contemporary usury and non-usury banking operations. Proceeding of the 3<sup>rd</sup> biennial Islamic economics conference (Islamic economic theory and Iranian economy), pp. 193-224, Economic Research Institute, Tarbiat Modares University, Tehran, Iran, 24-25 Dec. 2003.  
<http://www.bidabad.com/doc/sherkat-sahami-bank.pdf>  
<http://www.bidabad.com/doc/sherkatbank.ppt>

<sup>22</sup> Debt transaction is accepted in Malaysia from Sharia point of view (Islamic Financial Instruments Research Group of Malaysia, the 8<sup>th</sup> meeting session, 1996. Valuable Papers Commission of Malaysia, 2006. See: Soroush, Abouzar, Mortgage Sharing Papers as a New Instrument for Banks Financing. Islamic Economy Scientific Research Quarterly Journal, Vol. 8, No. 29, Spring 2008, pp. 163-188.

<sup>23</sup> See: Soroush, Abouzar, Mortgage Sharing Papers as a New Instrument for Banks Financing. Islamic Economy Scientific Research Quarterly Journal, Vol. 8, No. 29, Spring 2008, pp. 163-188.

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By studying the juristic dimensions of *Murabaha* mortgage securities and *Ijarah* mortgage securities, Jurisprudential Committee accepted them in accordance to *Ijarah* and *Murabaha* papers, and approved their issuance, but with precaution. While Installment Sell and *Ijarah bi Sharte Tamlik* (Rent Conditioned to Possession) contracts are superficial Islamic contracts, that invented to escape from *Reba* - this is because both these contracts involve pre-fixed interest rates.<sup>24</sup> As far as these two contracts use pre-fixed interest, they involve *Reba* and the papers issued on their basis create doubt of *Reba* involvement, which means that *Reba* contract papers are being transacted.<sup>25</sup>

Sharing mortgage securities are those sharing papers issued for purchasing mortgage loans by intermediate company. Mortgage loans are those banking loans based on debt with maturity of more than one year and are extended to purchase land and building.<sup>26</sup> In mortgage sharing securities, similar to mortgage-loan-backed papers, the right of using the benefits (yield) of an asset which is transferred to another person by installment sell, will be transferred from bank to another person for a certain price and pre-determined installments. Mortgage sharing securities have the meaning of joint sharing and are negotiable in secondary market at market price. In mortgage sharing securities, the intermediate company starts to issue and sell papers, and absorbs fund and then, starts to buy debt purchase on behalf. This means that on behalf of the buyers, the issuer is allowed to use their funds jointly for buying debt from the bank and instead, bank will transfer some of his claims for which the bank has mortgaged possessory documents to the investing company after discounting. These kinds of papers are also doubtful concerning *Reba* involvement because of application of Installment Sell Contract.

In fact, in Rent Financial Sharing, the owner of the asset will mortgage a portion of his asset to depositor through bank and depositor shares the profit (yield) of that asset

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<sup>24</sup> Bidabad, Bijan, Economic-juristic analysis of usury in consumption and investment loans and contemporary jurisprudence shortages in exploring legislator commandments. Proceeding of the 2<sup>nd</sup> International Islamic Banking Conference. Monash University of Malaysia, 9-10 September 2004. Reprinted in: National Interest, Journal of the Center for Strategic Research, Vol. 2, No. 1, winter 2006, pp. 72-90. Tehran, Iran. <http://www.bidabad.com/doc/reba-en.pdf>

<sup>25</sup> Bidabad, Bijan and Abulreza Harsini, Non-usury bank Corporation and contemporary usury and non-usury banking operations. Proceeding of the 3<sup>rd</sup> biennial Islamic economics conference (Islamic economic theory and Iranian economy), pp. 193-224, Economic Research Institute, Tarbiat Modares University, Tehran, Iran, 24-25 Dec. 2003. <http://www.bidabad.com/doc/sherkat-sahami-bank.pdf>  
<http://www.bidabad.com/doc/sherkatbank.ppt>

<sup>26</sup> Stocks Exchange and Valuable Papers Organization, 2008.

until the end of the contract. There is no involvement of *Reba* in this method.

### **Comparison of Rent Certificates in RFS and Ijarah Sokuk**

Generally, various types of *Sokuks* are valuable papers, which are issued based on contract, and show the joint ownership of the owners of these papers on the asset subject of *Sokuk* issuance. The asset can be movable, or immovable. Originator is a legal entity, which offers his asset for *Sokuk* issuance and these papers are issued to finance him. Intermediate<sup>27</sup> is formed as a legal entity to redeploy the assets on behalf of the *Sokuk* papers owners. In *Sokuk* process custodian is a legal entity who is responsible to supervise the whole process on behalf of the *Sokuk* owners to keep their interests. Custodian can be a bank or a non-bank financial institute. Likewise, prospectus is an information collection that the issuer of the papers has to provide for the supervisory organization (stock exchange) and *Sokuk* buyers. *Sokuk* follows Stock Exchange Organization regulations.

In the process of *Ijarah Sokuk*, the originator starts by dividing a portion of his asset and gives its ownership to the intermediate (SPV). SPV assigns a custodian and the asset is valued. He also provides the prospectus and by issuing *Sokuk* papers starts *Ijarah Sokuk* subscription. A credit rating agency will assess the *Sokuk* paper price. *Sokuk* buyers will jointly possess the asset. In the next phase, on behalf of the owners of the papers (*Sokuk Ijarah Papers*), intermediate will lend the asset to originator and receives periodic rent, and pays it to *Sokuk* papers holders. At the end of *Ijarah* contract, SPV stops rent payments to *Sokuk* papers holders. If the *Ijarah* contract is with *Ijarah bi Sharte Tamlik* (Rent Conditioned to Possession), the intermediate will transfer the ownership of the asset freely or with a substitute to the originator according to the pre-signed *Ijarah* contract. And, if it is an ordinary *Ijarah*, he will receive the asset and sell it in the market and will divide the result between the *Sokuk* owners (after deducting the lawyer's fee, custodian commission and credit rating agency of the *Sokuk*).

The problem in issuing *Sokuk* is that the *Ijarah* contract can be arranged superficially to conceal *Reba*. While the contract seems to be correct (*Reba*-free) and does not show *Reba* involvement, it can be a superficial *Ijarah* contract and in fact the rent has been calculated by interest rate and application of *Sokuk* is just a juristic factitive cover or juristic slyness (deceit). Occurrence of this case in the subsystem of RFS is seldom occurs because in the process of issuing *Ijarah* Certificate, after possessing the asset of the contract, the entrepreneur will not rent it from the bank, but he has to

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<sup>27</sup> Special Purpose Vehicle (SPV), Special Purpose Entity (SPE), Especial Purpose Company (EPC).

## Rent Financial Sharing (RFS)

present his rental contracts with the lessees to the bank. In this case, the possibility of *Reba* occurrence is very low.

Custodian and intermediate are two different entities in *Sokuk* papers, but in *Ijarah* (Rent) Certificate (in RFS) the intermediate is PLS department of the bank, and custodian is the trustee unit of the PLS bank. Meanwhile, pricing and thereof, credit rating agency is not necessary in *Ijarah* Certificate (in RFS) because *Ijarah* (Rent) Certificate is transacted in primary market of Rastin Certificate Market at a nominal price and according to the supply and demand mechanism in the secondary market of Rastin Certificate Market. In *Sokuk* paper, the asset can be sold after the end of *Ijarah* contract and the obtained fund can be distributed to *Ijarah Sokuk* holders. In this case, since the originator knows that he will not possess the asset at the end of contract, he uses the asset vigorously and depreciates it. This problem does not occur in *Ijarah* Certificate, because at the end of *Ijarah* contract, the asset is delivered back to the original owner, and entrepreneur (originator) gives the borrowed funds of the certificate holder back to him (depositor). Regarding the fact that a third party becomes lessee (tenant), the owner of the asset himself is responsible to taking care of the asset. Therefore, in this case, in contrary to *Sokuk*, the entrepreneur and depositor benefits are preserved. In addition, in order to prevent violation of commitment to return the principal fund, bank receives necessary collaterals from entrepreneur.

## Conclusion

Rent Financial Sharing (RFS) is a flexible financial subsystem of Rastin PLS banking from economic activities viewpoint. Any asset holder can use this financing method to expand and develop his asset or activity. RFS can be used to revive deceased assets including closed firms, uncultivated lands and similar, and productive and rentable assets of any kind and size with any legal and real personalities. This subsystem and its certificates do not suffer from the disadvantages of conventional mortgage loans and *Sokuks* and is *Reba*-free. The system is completely adoptable by all banks and financial institutes.

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