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A study of the legitimacy of commercial papers and its discount, terms and consequences on Iranian law system

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Abstract

Commercial papers discount in international markets has been one of common methods of financing for merchants for a long time. This body is also considered as an effective financial tool for governments to advance their political and economic goals through applying financial policies. In Islamic banking system and Iranian Legal System, use of financial instruments, in spite of their effective social and economic applications, should be carried out in framework of rules and thoughts accepted in Islam, being in accordance with principles of Interest-free banking system. In explaining religious order of discounting (interest), investigation of jurisprudential opinions shows that some Islamic thinkers and jurists ordered to respect discounting and some others believe in details of religious decree about its different phases. On the other hand, some believe in its absolute legitimacy. One of the most important sources of various opinions is contradiction in inferring way of legal nature of discounting (interest). Unlike controversial opinions of jurists, the commercial papers discounting is recognized as one type of banking services in its internal regulations and currently it has accepted this legal institute as independent contract of paying debt, due to social and economic necessities.

Keywords: Islamic Banking System, Iranian Legal System, Discounting, Commercial Papers, Terms, Consequences

1. Introduction

Nowadays economic issues have developed considerably and wide issues and subjects are developed in every economic discussion. Being familiar with them is first condition of understanding such issues. Discounting is among such issues which has found special place nowadays, being interested both from scientific and applied aspects. Discounting which is used as special term in economy, means purchasing the right of receiving debt in the future. Amount received by seller is usually less than paid debt in the future and it is called discount difference. Although the term "discounting", in its economic and idiomatic sense, has not been entered to our religious sources and judicial texts, a term used in Islamic Law which has similar nature with discounting, is purchase of debt which is referred to as "selling or purchase of debt" in Islamic banking. The issue of discounting has long and deep root in Islamic thought and it has been accepted in Islamic community and its economic history goes back to early Islam and people have acted on it. One of the common businesses in Arab Island which was accepted by Islam with identified terms is purchasing one's debt by other person. The issue is also developed in thoughts of current Muslim thinkers and economists and they debate about it. Purchase of debt is referred to selling one's future timed debt with lower price. In other words, purchase of debt is discounting commercial papers which will mature in the future. It is in the way that, as an example, a seller who purchases his goods for draft, refers to bank and receives his owe in cash but less than mentioned amount. The similarity and sameness of discounting and purchase of debt is clarified as: it is legal to pay timed future debt with fewer amounts with consent of both parties. This in fact is the same thing that is called commercial papers discounting in current dealers term.

According to similar criteria of purchase of debt, debt transfer and discounting, it can be said that the dominant opinion on the nature of discounting is consideration of debt in this regard, in legal thoughts. Civil law says nothing about explaining the legal nature of discounting, not considering such contract among certain contracts. From judicial point of view, first the rule of debt sale should be clarified, then we should proceed on investigation of discounting rule which is in fact selling monetary debt. The most famous and almost overwhelming opinion of Imamia jurists is legitimacy of purchase of debt (whether at the present or future) with debtor

with equal or lesser amount, provided that there is no interest in dealing. Regarding discount (dealing on monetary debt with money) the most famous opinion considers it legitimate provided that the debt is genuine not factitious and no interest becomes necessary. Only some jurists such as Imam Khomeini and Ayatollah Khamenei do not consider monetary debt selling to fewer amounts to third person (indebted person) as legitimate [2], [6-9].

In interest-based economies, financial system and related instruments are generally formed based on interest and it is evolved through time and based on the society and time needs. In this evolution the financial system like every other human made system being influenced by some factors and maintaining its base and foundation (i.e. interest) experiences different changes which are inevitable due to different developments and needs appeared in the societies. In Economic System of Islam which is based on absolute prohibition of interest, the absence of interest and usury is also considered as a basic and fundamental condition in its financial-monetary system. Although prohibition of interest is a necessary condition for Islamic financial and monetary system, it has never been sufficient condition and it cannot describe Islamic financial and monetary system completely. Principally the issue of elimination of usury is negatively considered in formation of financial- monetary system, denying every idea or project which has a trace of interest, but by no means it has mentioned a special solution or thought.

2. Legal Thoughts

Legal authors have not proceeded on the issue of discounting and explanation of legal framework for such contract in their law texts. It can be seen just in a quote that " ... although draft papers are considered as loan in discounting procedures ... " [11].

Hence they consider that discounting has a broad nature which is the same as loaning (or loan contract). Moreover, in some legal thoughts the nature of discounting, especially when it is provided as credit service in current account, is considered as a combination of debt and deposit [12]. Also when studying some legal opinions, it can be said that although law writers have not yet mentioned a point clearly on the nature of discounting, it can be inferred from some of their approaches in defining and explaining entries such as purchase of debt or debt transfer, that accepted opinion on legal nature of discounting controls sale contract, in a way that relying on the nature of traded issue in the contract, it is seen as an example of debt purchase. As it can be seen: purchase of debt (selling before maturing): in forward purchase, the buyer sells object (Mabi) to the third person before maturing. This is certain in purchase of debt. The forward purchasing should not be considered as sale of debt. Debt transfer is similar to purchase of debt [1]. In other note it can be seen that: no special contract has been predicted for debt transfer in Civil law. Hence the nature of debt transfer contract depends on the contract which causes it. If debt transfer is in the form of transaction and in change of money, the contract is contract of sale. The seller is obliged for understanding the debt and the option of meeting place along with delay in payment will be related to him. If transfer contract is based on compromise and tolerance, the nature of contract is related to difference of compromise or donation cases. If we assume that the transfer is done with order of debtor to creditor, then rules of transfer should be implemented [4]. Hence, relying on the similar criteria among purchase of debt, debt transfer and discounting it can be said that dominant opinion in the nature of discounting is

consideration of sale in this act in legal thoughts. Civil law has not mentioned anything in explaining legal nature of discounting, not considering this contract from certain contracts. It can be said that article 10 of civil law on uncertain contracts and compromise contract in certain contracts can be considered good criteria for nature of discounting. Although the effectiveness of Article 10 of civil law and compromise contract cannot be ignored in substitution of contracts, the existence of compromise contract and Article 10 of civil law do not devalue other contracts. Hence, discounting in the form of purchase of debt obeys its nature in its judicial root and change in features of present debts it involves terms of purchase of debt which will be consequently ruled based on Islam's inference of the condition of debt, not based on changes in the nature. In addition to common judgment and famous opinion of Imami Jurists who consider discounting as sale, accepting purchase nature in discounting, will be based on terms and characteristics of such legal act. The subject of transaction in this dealing will be monetary debt. Regulation of discounting legal act will be according to the nature of sale contract between parties and subject of transaction. In commercial papers discounting we deal with issues such as debt purchaser, debt buyer, price deal and subject of deal which is monetary debt and we speak of debt owner and ownership transfer [10]. Although issues of ownership and ownership transfer is not exclusive element in sale contract it is subject of other ownership contract also, the main characteristic of discounting deal is the price of deal against monetary debt, in a way that distinguishing feature of sale from other contracts is exchange. Legal opinions of some legal authors about nature of debt transfer contract confirm the issue [3]. What happens in discounting procedure is nothing other than debt ownership transfer from debt buyer's properties through sale contract and the creditor has the right of intervention in his long term monetary claims. Hence regulations of sale contract and its consequences, also, apply for discounting.

3. Investigation of Commercial Papers in Business Law of Iran

Increasing development of business, local and international transactions, necessity of rapid and easy business and the role of circulation of capital in political and economic destiny of the country have made the governments to provide merchants and dealers' tranquility of mind through considering special regulations and rules. Documents such as draft, check and bill of exchange with special characteristics and uses, in addition to playing inevitable role in country's economy, nowadays are considered as the main instruments of business. No dealer can be found that does not involve in such papers everyday. On the other hand the merchant when circulates his capital, needs assurance and legal protect along with two principles of speed and easiness ,the issue which cannot be provided by use of usual methods in Civil Law System. Hence special principles rule paper transactions in domestic and international law system not applying on civil papers. Moreover the major parts of issues related to commercial papers are related to their ruling principles.

4. Discounting and Banking and Monetary Issues

Since discounting is referred to cash buying of timed debt, it is natural that debt price in discounting day will be less than the price inserted in the document and this gap is the same interest in sake of debt till its maturing day. In fact such distance is called discounting when monetary calculation

between the price at discounting day and amount of owed money in maturing (due) date. The claim should be caused as a result of business in capitalism where dealing parties owe and debt to each other as a result of buying and selling goods and services. Moreover the claim should not exceed more than three months. The reason of this condition is that based on individuals' sight deposit, bank gives them short term credits and discounting duration in the form of credit endowment which should not exceed three months which is limit of short term credits ^[13].

5. Roots and Future Prospects for Discounting

Islam decisively is against usury and its modern form i.e. interest. But it has not been determined that it has sufficed only to such negative approach and hence it is unscientific. Public understanding of Islam's financial and economic system is that such system is different from other systems only in prohibiting usury, but such understanding is not correct. Although prohibition of interest-based dealings is not among fixed principles of Islamic economic system, it is not considered as complete and sufficient description of such system.

Hence attempt to find alternative scientific methods and ways which are foundation of positive transaction has been considered by Muslim economists and scientists and since elimination of interest rate is first step in Islamic economy of Muslim countries the institute of interest-free banking has attracted most attention ^[14].

At present, Bank plays an intermediary role between investor and saver and it has important place in formation of economic development, progress and capital. In other words, the main responsibility of banks is allocation and furnishing money and its alternative papers which is executed with accepting deposit and lending (loan) and such role is necessary for social economy and its flourishing life. Studying Islamic thoughts shows that Islam is not against bank and banking, rather Islam opposes interest-based banking. Hence the issues of Islamic banking and founding a legal basis for it have attracted Muslim scientists' attention and some solutions have been presented. Among such solutions is interest-free banking system relying on interest rate or return rate on investment. Interest-free banking system in Islamic Republic of Iran relies on it and it has been analyzed from different theoretical and practical aspects and its operational accordance with Islamic regulations.

6. Proposed Theory of Interest-Free Banking Based on Discounting

In theory of interest-free operational mechanism based on discount, banks and different monetary and financial institutes have special account called discount account, in addition to different accounts such as interest-free loaning account and current account and the main part of allocation and furnishing is done by it.

Furnishing is in the way that since all deposits of such account is used to discount debts; some interests are allocated to them based on discount interests which is paid after deducting banks' share of profit and its commission. Deposits of such account can be short term, medium term and long term. Moreover the interest of such accounts is based on discounting of monetary debts not based on interests obtained from projects where such deposits are used in (like what is done in current cooperative condition), in a way that in banking mechanism condition even the interest can be calculated at the end of each day and its needed information and statistics can be accessed.

In allocation, debt of owners including individuals, companies and government can be discounted with their referral to banks and financial and monetary institutes and related amounts and credits are allocated. The act of allocation can be legislated and planned from different aspects.

Regarding positive results of this theory it can be summarized that: the act of balance mechanism is formed under recession and inflation conditions. In recession condition where more money and credit is needed and supply and production is surplus to demand, firstly more people act to create debts and use of debt documents and transactions by creating debt documents and this makes more demand for money. Secondly, in this condition interest rate increases due to lack of money, hence fewer people become volunteer to present debt papers for discounting and consequently this decreases excessive demand for money and thirdly, under such conditions the debts and debt papers stay in one part of transaction, this prevents rising increase of demand for money. In inflation conditions these three states apply but reversely.

Moreover active monetary policies are taken by country's monetary institute and central bank for influencing money market and investment. In recession condition, not only central bank decreases discounting rate and rediscounting interest, it buys debt papers and under inflation conditions it becomes reverse.

It is, of course, worth mentioning that every idea, propose and suggestion has its own difficulties in implementation procedure when it comes to practice and the idea proposed in this article is not exceptional, also. Hence they should be minimized by accurate planning, legislation and ideas.

7. Positive Effects and Consequences of Discounting in the Field of Economy

Prevailing discount in debts against reduce of maturing time has various positive economic consequences, some of which are:

7.1 Increased Power of Financial Institutes:

Paying debts earlier than their due time enables financial institutes to develop their activities and invest in different fields.

7.2 Motivation for Paying Debts

In this case the debtors try at least to pay their debts earlier than their due time to enjoy discount.

7.3 Developing Timed Transactions

If discounting is prevailed in debts, timed transactions develop accordingly, which increase in turn economic growth rate and social welfare ^[5].

The Strategy Selected by Central Bank of Iran (for purchase and sale of debt):

The strategy has been developed based on debt selling and buying or discounting. In some cases the customer is not able to afford commodity price in cash and purchases it on credit and gives a timed draft for seller. Now if the seller wants to cash the amount for any reason earlier than its due time, he can sell it to bank through deducting a certain amount of draft (discounting it) and cash it. At the time of maturation, bank refers to the debtor (commodity customer) and cashes the amount of draft. The reduced price which is called discount is bank's interest of this transaction which is determined based on market interest rate (which is called banking interest rate in ordinary banking) and time duration remained to draft maturation.

8. Conclusion

Purchasing commercial papers and negotiable instruments to lower nominal price is called debt buying. Commercial papers and negotiable instruments are referred to those negotiable papers, regulations of which show debt caused by commercial transactions and by nominal price, we mean the price which has been mentioned in the text of commercial papers and instruments, showing debt amount which should be paid at due time by obliged party.

Commercial papers and negotiable instruments which can be purchased in banks are: drafts, bill of exchange (after being accepted by obliged) and timed export papers interest rate of which, is identified by money and credit counsel. The debt mentioned in commercial papers and negotiable instruments should be genuine, resulted by a commercial credit transaction between obliged party of papers and their sellers to the bank. Purchase of debt is an appropriate plan to support country's production and industry section. Although sale of credit and debt in current account can be better solution for most industrial problems, predetermined rate of such contract confronts its implementation with difficulty. Debt purchase is considered as an exchange contract, rate of which is determined by the government. So if the government release debt purchase of rate limitation and let the rate of such contract be determined in competitive market, then it can be hoped that banks will solve such serious problems in competition field. Thinkers of the plan believe that implementation of such plan requires floating interest rate for debt purchase contract. Doing so, the needed absorption will be provided for banks to use such contracts and also monetary extension caused by lower interest rate of exchange contracts which bears inflation, is prevented. On the other hand correct implementation of such contract is bounded to banks supervision on correctness of existing commercial papers and negotiable instruments and considering that most transactions are carried out by check at the moment, the probability of unrealistic and factitious papers is increased which causes increase of banks delayed claims.

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