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REVISITING THE USE OF TAWARRUQ AS A MEANS FOR LIQUIDITY: ASSESSING FUNDAMENTAL CONCEPTS AND PREVALENT APPLICATIONS

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Despite of its recognition in its basic form by several contemporary bodies of Islamic scholars, different types of tawarruq (monetisation) offered by various Islamic banks remain a heavily discussed issue among scholars in the field. The basic objection to such modes is that the explicit aim being the obtaining of cash against undertaking a future debt for a higher amount, it could insinuate a riba based relationship, the transaction only acting as an unessential formality. The guidelines provided purport to ensure that the structure remains a valid trading mechanism by ensuring the presence of the vital ingredients common to all sales and purchases, especially that the buyer becomes the lawful owner of an identified asset fully entitled and able to utilise it in any way he pleases. The adverse perception coordinated tawarruq could generate regarding the reality of Islamic banking should not be underestimated. Relevant controls should be adopted so that the application of legitimate modes of financing advocated by Shari'ah such as partnership and investment are not pushed even further away from realisation by the widespread adoption of coordinated tawarruq.

INTRODUCTION

Facilitating liquidity on the short as well as long term, where various adaptations of murâbahah were employed by many Islamic banks is also done today on tawarruq, which has provided Islamic banks with a much needed addition to the array of products aiming to facilitate liquidity in ways approved by the *Shari'ah*. Despite of its increasing popularity, there remains some controversy on its admissibility as a genuine Islamic product that could be resorted to constantly by Islamic banks for financing and managing

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liquidity. The introduction of the AAOIFI standards pertaining to tawarruq (monetisation) had filled a perceptible need by providing a practicable set of guidelines banks could abide by in their operations, however, the academic discussion on the subject is on-going. The advice in the Standards that Islamic Financial Institutions should resort to monetisation only when it faces the danger of a liquidity shortage that could interrupt the flow of its operations and cause losses for its clients seems to have largely gone unheeded.[1]

In its basic form, tawarruq has served as a simple trading mechanism that could enable one in need of cash to obtain it without resorting to borrowing. However, formats adopted by the majority of banks involve additional features that were not part of the simple tawarruq as laid out in manuals of Islamic law (which is also called tawarruq fiqhi). Structures employed by Islamic banks and other institutions, which may vary from one to the other, are commonly described hereunder as coordinated tawarruq or regulated tawarruq (usually termed tawarruq munazzam in Arabic), in order to differentiate them from the simple form accredited by jurists.[2] In spite of being considerably more complicated and multifaceted than the original tawarruq, tawarruq practised by Islamic banks is often reduced to the signing of some papers or completing an online procedure and obtaining the cash there and then, usually from the bank itself, while undertaking the obligation to pay a higher amount in instalments. The current paper analyses the nature and essence of coordinated tawarruq assessing the steps involved in its implementation in some of its more commonly used forms and shedding light on the nature of the controversy surrounding it, and attempts to determine the advisability of its use as a funding mechanism.

NATURE AND FEATURES OF COORDINATED TAWARRUQ

Coordinated tawarruq as practised by Islamic banks[3] has been described as follows: Buying a commodity from the bank on the basis of murâbahah to the purchase orderer (i.e. the client) with a

binding promise by the orderer, and after signing the second sale contract to the client for a deferred or instalment price and implementing possession, the bank acting as an intermediary in the sale of the commodity, usually through another intermediation from the first seller, (i.e. the seller from whom the bank had purchased the commodity) to sell the commodity to a new purchaser on cash basis for a lower price, and on receipt of the cash, the bank handing it over to the customer. Islamic Fiqh Academy resolution[4] identifies tawarruq practised by banks as a standard procedure followed by a bank where a commodity (not of gold or silver) in the international commodities market or elsewhere is sold to the seeker of tawarruq (i.e. the client) at a deferred price, while undertaking, through a condition in the contract or based on customary practice, to represent him in its sale to another purchaser for immediate payment, and to forward the payment to the client.

The usual structure employed by Islamic banks is identified in the above as coordinated tawarruq. Some others have differentiated between the two to some extent.[5] According to them, coordinated tawarruq is where a seller sells a commodity to the mutawarriq (i.e. the seeker of tawarruq, also called by some mustawriq) on credit, and thereafter, under an agency conferred by the latter, sells it to a third party and forwards the payment to the mutawarriq, or merely facilitates the second sale by providing information about a potential third party buyer. They observe that apart from înah, which is considered to be an advanced form of coordinated tawarruq, the latter has not been discussed by jurists. Tawarruq as practised by Islamic banks and others who provided Islamic banking services is more complex than the above because of the involvement of a financial intermediary who regulates the process of purchase, possession and sale, and also the payment of the proceeds. Thus, the bank intermediates between the seller and the mutawarriq, and then between the mutawarriq and the buyer, and in the process advances an amount in cash, becoming entitled to a higher amount receivable in the future. However, for the purpose of brevity and ease, tawarruq of Islamic banks is referred to as coordinated tawarruq in our discussion.

OPERATION OF COORDINATED TAWARRUQ

The coordinated tawarruq process is applied by Islamic banks in various situations that call for facilitating liquidity. Primarily, these could be categorised into the areas of personal financing, transactions in the international commodities market for fulfilling short term liquidity needs of the bank, and financing outstanding debts to conventional banks for facilitating transfer to Islamic banking. In addition to these, several other transactions too have been considered by some to fall under coordinated tawarruq. These are transactions such as the bank purchasing assets belonging to the client on cash and then selling / leasing them back to the client on credit, the bank purchasing commodities in the international market on cash and selling them on credit, sale of commodities for cash and buying the equivalent in the commodities market on credit through the intermediation of the bank, sukuk of leased assets and services etc.[6] All these appear to have been categorised under tawarruq possibly because the majority of them happen to be means of facilitating liquidity to the bank itself or to another party, thus falling under the literal meaning of tawarruq. However, this seems to be an unnecessary extension of the scope of tawarruq, as many of the above could fall under other recognised subject headings that are discussed separately. For instance, the first could obviously belong to înah. Similarly, the rest too need not be discussed under tawarruq, as the basic ingredients of tawarruq, i.e. a purchase on credit and a subsequent cash sale to a third party, could be hardly found in these in the required form and order.

We may briefly describe here the layout of tawarruq employed by Islamic banks for personal financing. This complex transaction consists of an agreement of understanding that includes a binding promise, three sale contracts and one or more power of attorney (agency) contracts. The agreement of understanding is based on a similar understanding used in murâbahah with the addition that the bank will also intermediate in fulfilling the third sale contract, very often through the first seller. The first two sale contracts are included in the murâbahah, i.e., the contract between the bank

and the seller of the commodity on cash and that between the bank and the customer for a deferred or instalment price. The third sale contract is between the customer and a fresh buyer who grabs the opportunity of buying a commodity for a cash price that is less than the cash price paid in the first sale contract. Between the first two sale contracts we find an agency contract signed by the bank and the customer, according to which the customer is delegated to perform the task of negotiating the price of the first sale contract and taking delivery on behalf of the bank. The second agency contract takes effect after the second sale contract; it is also between the customer and the bank, and authorises the bank to sell the commodity to a new buyer and receive its price. There is sometimes a third agency contract between the bank and the original seller (e.g. a car dealer) to negotiate the price of the third sale contract and take charge of the actual sale and delivery. Throughout all this process, the commodity normally does not move from its place in the warehouse of the first seller.[7] Often, the commodity could also be taken from the international commodities market. The procedure may barely take the duration of a few minutes.

In most situations, coordinated tawarruq as offered by banks is seen to involve four parties, i.e. the original seller, the bank, the client and the ultimate purchaser. However, the exact process employed by each bank could vary from the above, being more or less in steps. The bank may purchase the commodity initially without a prior promise to purchase being made by the client, and the sale to the client could also take place on the basis of musâwamah, i.e. on an agreed spot price not explicitly related to the bank's cost. In some instances, the commodity is ultimately sold by the bank on the basis of the power of attorney given by the client even to the original seller from whom it was initially purchased. If this happens, the procedure would involve only three parties, i.e. the first three mentioned above without the ultimate purchaser, who happens to be the initial seller himself. Some banks are observed to affect the sale to subsidiary companies, which, although carrying out operations individually and having

an individual balance sheet, are from a factual approach form part of the banking institution. Thus, sale to these is essentially a sale to the bank itself, although conventional legal parlance may dictate otherwise.

MAJOR CONTRACTS THAT CONSTITUTE COORDINATED TAWARRUQ

Coordinated tawarruq mainly involves the following transactions:

1. Purchase of the commodity by the bank on the basis of promise made by the client to purchase it from the bank;
2. The bank selling the commodity to the client on deferred payment basis;
3. The client appointing the bank as his agent for the sale of the commodity on cash; and
4. The bank selling the commodity to a third party on cash.

In addition to the above transactions that form the basic stages of coordinated tawarruq, as describe in the preceding paragraph, there are other less noticed steps that also call for enquiry. Some of these are part of the murâbahah sale that takes place initially, and have been come under close scrutiny of researchers who had studied the murâbahah procedure from a *Shari'ah* angle. It is not possible to reproduce this discussion here in its entirety. As clear from the above, murâbahah is but one of the several steps necessitated by the structure of coordinated tawarruq. Although the validity of the common murâbahah structure is generally upheld by many in the field of Islamic finance, its position as an integral component of the more complex tawarruq structure has required the entire procedure to be deliberated on afresh. For better acceptability of murâbahah, a few banks have eliminated from their murâbahah procedure some steps that have been the subject of criticism. Thus, some banks maintain stocks of items in popular demand such as cars, and sell them on murâbahah basis to client without having recourse to purchasing them from external sources based on a demand made by clients and their promise. Thus, the need for the unilateral promise is eliminated,

from both murâbahah as well as tawarruq. However, this is the case only with a small number of banks such as al-Rajihi Co. while the majority of banks purchase externally. In addition to the steps necessitated by murâbahah, towards the end of the transaction, the bank undertakes to collect the proceeds of the cash sale effected in the name of the client. It is also sometimes noticed that the bank provides what could be regarded as a loan to the client until collection of the proceeds. This involves the bank, as the agent of client for the sale of the commodity, making an advance payment to the client, to be settled against the proceeds of the sale when received. It is noted that sometimes the sale to a third party itself may not materialise prior to the bank releasing the so-called payment to the client by depositing the amount into his account. Instead, the bank obtains a promise from the potential buyer to purchase the asset at the price paid by the bank initially. Cash is released by the bank to the client after this promise.

Additional steps that could be involved in the above process are as follows.

1. Overall agreement / memorandum of understanding between the bank and the client for the purchase and sale on murâbahah and the subsequent sale by the bank on behalf of the client. This document includes a binding promise by the client to purchase the commodity subsequently from the bank, and appointing the bank as agent for taking possession of the commodity on behalf of the client and for its sale and transfer of possession and receipt of payment. The client also provides the bank the securities required.
2. The client signing a unilateral promise to purchase the commodity from the bank after it had been purchased by the latter.
3. The bank purchasing the commodity for its subsequent sale to the client on murâbahah basis.
4. The bank obtaining a promise from a third party buyer to purchase the asset, usually at the price the bank had paid for it initially.

5. The bank providing a loan to the client until collection of the proceeds of the sale on behalf of the client.

Monzer Kahf has drawn attention to the fact that there is no standard format followed by banks in the operation of tawarruq. The procedure followed by each bank could be different, based on the nature of the approval given by the *Shari'ah* advisory board of the bank. The procedure could vary also in the practical modus operandi. Some banking institutions resort to structure the tawarruq process on the purchase and sale of metals through the international metals market. Subsequently, under the agency provided by the client, the bank again sells the metal at the international metals market, and deposits the proceeds in the clients account. Other banks offer tawarruq on the basis of commodities purchased at the international commodities market. For minimising possible losses through price fluctuations, some banks purchase baskets of commodities that are then sold to the client. Some others, as mentioned earlier, sell to the client only what is available in their possession. Appointment of the bank itself as the client's agent for sale is found to be optional in some tawarruq packages. Thus, the client is free to effect the sale himself or through an agency. Some restrict that the agency fee should correspond to what is charged usually for similar services, and rule out the possibility of charging a fee as a percentage based on the amount of the facility. Some also require that the bank may not make any upfront advance payment to the client, until the proceeds of the sale to the third party are received. In tawarruq practised by some banks, the commodity is sold by the bank, as the agent of the client, finally to the original seller himself, from whom it had been purchased, on the grounds that the seller in this instance is the client and not the bank as it is merely acting as agent, thus the bank need not be presumed to have effected a sell-back.[8]

COORDINATED TAWARRUQ INVOLVING INTERNATIONAL MARKETS

Banks that offer financing on coordinated tawarruq mostly prefer international commodities markets for its operation, due the ease and ready availability of established procedures. Tawarruq

operations are carried out in commodities such as iron, sugar, flour, wheat, copper and crude oil traded in these markets. This is usually done for financing required by companies that are involved in trading in the international markets, and sometimes for financing clients based locally. Briefly described, such financing could be done in the following methods.

The bank could purchase a commodity from the international market on cash and sell it on murâbahah to the client at a higher price. Here the bank undertakes to sell the commodity on behalf of the client. The sale proceeds are forwarded to the client, who pays the higher amount in instalments or as agreed. This process involves the employment of brokers active in the international market, who are appointed by the bank for the purchase of the commodity and its subsequent sale. Brokerage is paid for every transaction. This procedure is followed sometimes also for providing liquidity to the clients of the bank who require funds for mudârabah investments.

Another format could be employed for facilitating liquidity to other banking institutions. The bank deposits a sum of money with overseas banks. Based on an agreement between the parties, the overseas bank is requested to purchase a commodity from the international market on cash as agent, and then to sell it to itself (i.e. the overseas bank itself) of deferred payment basis. Thereafter the overseas bank sells the commodity again in the international market on cash for obtaining liquidity. The bank is enabled through this process to earn an addition on its deposits in the name of international murâbahah, instead of charging interest from the overseas bank. The alleged operation known as tawarruq here involves transfer of the required funds to the overseas bank and thereafter receiving a return corresponding to the prevalent interest rate.[9]

AREAS WHERE COORDINATED TAWARRUQ OF BANKS VARIES FROM THE SIMPLE FORM OF TAWARRUQ

Major dissimilarities in this regard could be enumerated as follows:

1. Coordinated tawarruq involves four parties, while in simple

tawarruq only three parties are involved.

2. Coordinated tawarruq involves an additional purchase prior to the two basic sales forming simple tawarruq, based on a demand made by the client and his promise to purchase.
3. Coordinated tawarruq involves signing of an overall agreement / memorandum of understanding delineating the procedure to be followed.
4. Coordinated tawarruq involves signing of a unilateral promise to purchase by the client (in the case of some Islamic banks).
5. Coordinated tawarruq involves the client appointing the bank as his agent to carry out the second basic tawarruq sale.
6. Simple tawarruq seems to have envisaged the two basic sales giving rise to complete transfer of possession physically after each contract. In coordinated tawarruq, transfer of possession is only limited to signing of the contracts of sale that include clauses on transfer of rights and liabilities pertaining to the items. Thus, transfer of possession throughout the procedure is only held to materialise constructively.

REASONS CITED TO JUSTIFY COORDINATED TAWARRUQ

Practitioners of coordinated tawarruq and certain contemporary writers who uphold the legality of its procedure as currently implemented in banks from a *Shari'ah* angle primarily do so based on the validity of each component therein. They argue that when each of the individual contracts and processes involved happens to be valid, there is no reason to consider the whole procedure unacceptable. According to them, tawarruq procedure consists of the following contracts and transactions, each of which could be justified individually.[10]

1. The bank purchasing of a commodity from the commodities market and taking possession of it constructively through the necessary clauses in the transactional documents, on the basis of the promise to purchase made by the client.
2. The bank selling the commodity to the client on murâbahah and the latter taking possession constructively.
3. The client appointing the bank as his agent in the sale of the commodity.
4. The bank selling the commodity to a third party.
5. The bank handing over the received price to the client.

With regard to the first transaction above, being a contract of purchase, it is essentially permissible. The legal nature of the promise to purchase the commodity subsequently that is made by the client has been a subject of disagreement among the jurists, in that whether such a promise could be legally enforceable or not. If both parties involved in the transaction make a mutual promise to carry out a sale between them subsequent to the initial purchase by one of them, Imam al-Shâfi i has ruled that the transaction is invalid. However, a unilateral promise made by one of the parties to purchase the item subsequently would not involve this drawback. It is due to this reason that many of the banks require the client to make a unilateral promise by undertaking to purchase the commodity, without, however, any such promise made by the bank to sell it to him. However, whether the client could be legally required to honour his promise is an issue of controversy. Many jurists have upheld the position that promises may not be legally enforced. However, taking the needs of the current commercial environment into consideration, many contemporary scholars have endorsed the position that promises could be legally enforced in commercial contexts subject to certain conditions, which is similar in essence to the preferred position of some Mâliki and other jurists. This being an issue that is of tremendous importance to murâbahah as practised by Islamic banks, it has been thoroughly discussed in that context.[11]

The bank's sale of the commodity to the client forms the second component of the process. This sale usually takes place on murâbahah basis, i.e. on cost plus mark up, where the item is sold to the client with an agreed element of profit added to the cost undertaken by the seller. Payment by the client is usually agreed on instalment basis. As discussed under murâbahah, jurists in general recognise the validity of a sale transaction where the commodity is sold for price higher than its usual cash price, due the sale taking place on credit, provided all the necessary ingredients of a sale are fulfilled.[12] Many of the contemporary scholars in the field of Islamic finance too have upheld this position.

A contract of agency forms the third component. Here the client who has become the owner of the commodity appoints the bank as his agent to sell. Agency is a valid Islamic contract which could be done either on a fee basis or free of charge. There could be no bar to the purchaser appointing the seller himself as his agent to sell, as the parties being capable, a contract of agency could take place between them without a hindrance. Since the client is entitled to sell the item himself, he is legally at liberty to appoint any other as his agent for the purpose. The agent appointed thus, in this case the bank, could carry out the sale and forward the proceeds to the principal, i.e. the client, when received, in fulfilment of the duties of agency.[13]

Justification of coordinated tawarruq is sought along the above lines, insisting that the structure offered by Islamic banks is essentially similar to the simple tawarruq recognised by the jurists. The vital aspects of the classical tawarruq procedure are fully available in the tawarruq of Islamic banks, only that the latter happens to be organised and the procedure smoothened, so that the whole process could conclude in a short period of time. The swiftness of the procedure could not be regarded as a shortcoming necessitating its invalidity. Similarly, tawarruq taking place on the basis of metals could not be a reason for its rejection. The additional aspects involved in tawarruq could be considered similar to the introduction of a unilateral promise to purchase to the traditional murâbahah contract. The simple tawarruq itself has been presented

by Islamic banks in a manner that ensures convenience and swiftness of execution. Thus, they argue that treating modern tawarruq as an individual entity that should be studied apart from simple tawarruq is unjustifiable, in that the former is but a modern manifestation of the latter, presented in line with the prevalent commercial trends and environment. Similarly, it may not be claimed that adoption of tawarruq for facilitating liquidity could move Islamic banks further away from advancing other genuine modes of financing. This is because, in addition to tawarruq, there has always existed other modes such as salam and istisna that are not investment modes in themselves. The addition of tawarruq to such products that are already available could not be regarded as detrimental. If tawarruq is prone to be misused, such misuse should be prevented by taking appropriate measures, as such possibility exists with regard to any financial product. Banning tawarruq completely may not be the solution in such an instance.[14]

Reasons cited in support of simple tawarruq too are also resorted for substantiating the practice of coordinated tawarruq, based on the premise that both are identical in essence. Thus, proponents of coordinated tawarruq justify it as a valid structure banks could legally employ for facilitating liquidity. It could be effective in realising the economic philosophy of Islam and could fulfil the needs of individuals and institutions. It is an important avenue that could be employed by states for financing trading deficit and obtaining necessary liquidity, in place of bond instruments involving prohibited ribâ.

CRITICISM OF COORDINATED TAWARRUQ FROM A *SHARI'AH* ANGLE

A number of contemporary Islamic scholars have taken the position that coordinated tawarruq as offered by banking institutions falls short of meeting vital *Shari'ah* requirements. As mentioned above, the Jeddah based Islamic Fiqh Academy had issued a resolution censuring coordinated tawarruq after a detailed deliberation on the issue. It is noteworthy that the same body had earlier upheld

the legality of tawarruq in its simple form. The negative *Shari'ah* aspects of coordinated tawarruq as put forward by its critics are summarised as hereunder.

A principle shortcoming observed in coordinated tawarruq is that it could not be enumerated under any of the three tawarruq forms discussed by jurists.[15] In the case of the first two forms, this is too obvious to require any description. The third, which in spite of some difference, the majority had accepted as valid, is observed to differ from coordinated tawarruq in several aspects. Although the commodity being sold to the mutawarriq for a price higher than its cash price is common to both, coordinated tawarruq differs with regard to the condition that is found in many of its forms that the commodity would be sold by the mutawarriq at the price for which the bank had originally purchased it. This means that the mutawrriq is to sell it at a price lower than what he had bought it for. Also, the bank is essentially conferred with the right to carry out this sale to whomever it wishes, under an agency from the mutawarriq. As far as simple tawarruq is concerned, it is the mutawarriq himself who undertakes to sell the commodity that he had purchased, without any intervention from the seller. The mutawarriq is free to sell it at any price, higher or lower than the purchase price. This is seen to convert tawarruq into an înah for all practical purposes. The bank, who had sold the commodity at first on credit, is fully entitled to carry out its subsequent sale and takes charge of all aspects of the tawarruq process, which is not dissimilar to its purchasing the commodity back. The client is found to do little other than expressing the amount of cash required by him.[16]

The structure of coordinated tawarruq employed by Islamic banks strongly indicates a willing cooperation for facilitating cash against a higher credit obligation. Thus, the principle dictating assessment of actions on the basis of their intended objectives becomes relevant in this context. The intention of the client to gain immediate cash at the cost of paying a higher amount in the future takes a tangible and evident form readily expressed to the bank through the contractual documents, agencies and the

memorandum of understanding. The express purpose of tawarruq here is to obtain liquidity, which is also applicable to simple tawarruq. However, the role played by the bank is not limited to being an intermediary in the process of acquiring real goods, as is the case in murâbahah. The banks is effectively involved in earning a return through facilitating liquidity, against deferred debts of a higher amount than the amount of cash received by the client. The bank has no interest in providing the commodity to the client itself. Thus, two objectives have come together in coordinated tawarruq in a plainly visible manner, namely, the intent of the bank to part with cash against a higher amount receivable in the future, and the client's intent to receive cash against a future debt of a higher amount. Thus, the strong resemblance borne by tawarruq to a hîlah for attainment of ribâ appears prominent. Throughout the process, the bank is found to act only as an intermediary, who is not primarily interested in the purchase of commodities or entering international markets. The client, too, has no real interest or, as in most cases, any knowledge, of the commodities involved. The objective only happens to be obtaining cash from the bank against undertaking a debt to be settled in instalments. Critics see this situation as bordering on a ribawi transaction.

Critics declare that coordinated tawarruq violates several prohibitions appearing in hadith. In the case of some banks who practise this mode, it takes an explicit form of înah, due to the commodity being returned to the original owner, against a commission received by him. Thus, it could fall under "two sales in one sale" prohibited in hadith[17]. Another hadith that could be violated here is where "a sale with an (unrelated) condition" is prohibited. Critics observe that in tawarruq as practised by banks, if the bank had not expressed its willingness to facilitate the sale of the commodity on behalf of the client thus ensuring his immediate receipt of cash, it is improbable that the client would agree to the transaction. Thus, if not for the immediate cash coupled with concessionary payment in the future, the client would not have opted for it. Similarly, if the process did not give higher future

gains against a lower amount of cash, the bank would not have offered it. Therefore, opponents see clear evidence of the presence of a sale with a condition in coordinated tawarruq. The prohibition of "a sale and a loan" is also relevant here. It could be observed that this prohibition is based on the possibility of the sale acting as a means of earning a return through the loan provided. The mere possibility has occasioned a prohibition here, due to the serious nature of ribâ. In the case of coordinated tawarruq, this possibility is an expressed reality, in that the purpose of the whole process is to facilitate the exchange of cash against a higher debt. Consequently, it could be said that coordinated tawarruq could not qualify as an alternative to financing on the basis of interest based lending, as it is essentially not dissimilar to the latter.

In response to a possible argument that coordinated tawarruq, as a last resort, could be justified under înah as upheld by Shâfi i jurists, critics observe that it could not be included under the specific form of înah as recognised by Imâm al-Shâfi i. This is because the validity of înah presumes the non-existence of any definite correlation between the two contracts, i.e. the sale against deferred payment and the sale against cash.[18] It is also necessary that the objective of gaining liquidity not find expression outwardly. Both of these requirements are not met in coordinated tawarruq. The correlation between the contracts is starkly evident in the transactional documents. It is the bank that sells the commodity first at a higher deferred price, and then undertakes its subsequent sale at a lower price to be forwarded to the client. As observed before, if not for this fact, the client would not have accepted to purchase the commodity at a higher price in the first place. As for expression of intention, this is only too obvious on all descriptions of the process circulated by the banks concerned. Therefore, recognition of înah by Imâm al-Shâfi i could not be invoked in a bid to gain credence to coordinated tawarruq.[19] Thus, the major basis on which înah is categorised as prohibited by the majority of jurists, i.e. the connivance of the parties for facilitating cash against a higher amount in debt, is clearly found in coordinated tawarruq in explicit terms in the documents involved. This is a

necessary part of coordinated tawarruq, as the transactions could not be carried out speedily and the cash handed over if not for the cooperation of all the parties concerned – the bank, the commodity sellers and the purchasers. Therefore, invoking the primary permissibility of contracts in coordinated tawarruq appears untenable, as it comprises the objectionable aspects of înah.

It has been also observed by some critics that commodities taken as vehicles for the exercise of coordinated tawarruq, especially where international market is involved, reflect to a great extent the characteristics of commodities of ribâ specified in hadith. It could be seen that commodities where ribâ, especially *ribâ al fadl*, i.e. exchange in unequal quantities, was banned were those that enjoyed ready markets and could be converted into money with ease. These were the monetary commodities of the day where prices were stable, mostly in the short term, and any quantity could be readily disposed of. Thus, these were at times used as substitutes for money. Conditions imposed for transactions that are similar to those required in monetary transactions such as immediate possession, counter values being equal, are seen to address this aspect. International commodities enjoying a highly regulated market are observed to share these characteristics, which could require consideration of the *ribâ al-fadl* aspect too.

Islamic Fiqh Academy has aptly summarised the negative aspects found in coordinated tawarruq in its resolution referred to above.[20] It observes that the undertaking of the seller to act as the agent for the sale of the commodity to another purchaser or to arrange such a purchaser, irrespective of the undertaking being in the form of a condition or based on custom and practice, makes tawarruq resemble the prohibited înah contract. The process involved in most instances lacks in fulfilling the requirements of delivery and possession necessary for validity. The procedure results in providing cash against a higher (obligation) to who is termed as mustawriq (i.e. seeker of tawarruq from the bank) through purchase and sale transactions that are superficial in most instances, the purpose of the bank being a higher return of the amount of financing provided. This operation is other than the genuine

tawarruq known to jurists recognised as permitted by the Academy in its fifteenth session when carried out through genuine transactions and subject to specific conditions, due to a number of differences. Genuine tawarruq comprises the genuine purchase of a commodity at a credit price which enters the ownership of the purchaser and which is taken possession by him properly, thus undertaking its liability, and thereafter its sale on cash for fulfilling his need, the possibility of sale being not assured.

ECONOMIC ASPECTS THAT CALL FOR A REVIEW OF COORDINATED TAWARRUQ

Observed from a financial and economic point of view, it is evident that the direct cost to the customer and the social cost of the transaction are higher than the cost of interest based lending. The reason is that the complexity of the transaction involving various steps and contracts and the potential legal and economic changes during its period take much more than murâbahah, which in itself is costlier than interest based lending. In addition, due to the fact that the only way to reduce its cost is to apply it in a formal and artificial manner resulting in the procedure resembling a ribâ based loan, however, with more paper work, it could encourage carrying out fictitious transactions, instead of implementing the details required by *Shari'ah* guidelines. Thus, coordinated tawarruq while embodying all the drawbacks associated with interest based lending, does not bring any social, economic or equity advantage.[21]

Where the procedure involves operations in the international market, it is noted that these do not contribute towards boosting local economy in any manner, as no funds are injected to the local market in this process, and no trading takes place locally. As such, it only serves investors in international markets overseas who are based in major capitals. The essential purpose, as evident, happens to be earning of income on deposits made with other banking institutions. The intervening complicacies only facilitate the purpose of hiding the true nature of the transaction. Such operations between banks are observed to result in gains only to the international brokers involved. Its effects on local markets could

only be judged to be negative. Where the overseas bank happens to be an interest based bank, the documentary aspects involved in the coordinated tawarruq operation are undertaken by the Islamic bank, that forms the only difference to an interest based operation. Apart from a superficial endorsement of these documents, that need not necessarily be in tangible form, the other party does not in essence find a variance to borrowing on interest.[22]

The application of legitimate modes of financing advocated by *Shari'ah* such as partnership and investment could be pushed even further away from realisation by the widespread adoption of coordinated tawarruq. It is an observable fact that those who procure funds or enjoy bank facilities prefer a free hand in using funds without any interference from the bank. Therefore, coordinated tawarruq that provides the funds necessary without the need for any accountability would prove to be an attractive choice, far exceeding that of mushârakah, mudârabah and murâbahah, etc.

The adverse perception coordinated tawarruq could generate regarding the reality of Islamic banking should not be underestimated. Adoption of coordinated tawarruq brings the role played by the bank closer to that of interest financing, a fact that could undermine the perception of Islamic banking activity. Islamic banking operations would deteriorate to the position of being regarded as an externality carried out strictly for legal compliance rather than for the sake of their essence. This risk has been noted even by some proponents of tawarruq who see it necessary that this product not be aggressively marketed. In the case of murâbahah, concerned bodies had insisted on the adoption of various precautions so that it is not abused, making it lose its objective of financing asset purchases. When it was discovered that some seller had connived with a murâbahah client for the repurchase of the asset, their names were black listed. Where clients had resorted to selling assets purchased on murâbahah immediately, such clients were treated with caution in the future, as requirements of sale were usually not adhered to in such transactions, and because the genuineness of the initial transaction itself became

uncertain. Coordinated tawarruq far exceeds such misdemeanours occasioned in the case of murâbahah.

CONCLUSION

A careful analysis of the above aspects would reveal that seeking to legitimise coordinated tawarruq arguing on the basis of the validity of its constituents such as the cash purchase, murâbahah sale and agency, appears to be a simplistic approach that fails to comprehend the macro aspects involved. Fundamental recognition of the validity of such contracts in *Shari'ah* does not result in the acceptability of any process incorporating them. As shown above, vital differences exist between simple tawarruq and coordinated tawarruq of the banks, both in contracts and transactions involved as well as in approaches of the parties and their objectives. The drawback in coordinated tawarruq is not simply that it is not essentially a financing mode as compared with other financing modes. The validity of the structure itself is in question, whether it is tantamount to a process resulting in ribâ more or less. As a premeditated procedure carried out by the connivance of parties who recognise the express objective to be the exchange of cash against a higher future debt, coordinated tawarruq undeniably appears to contain the ingredients of a ribawi transaction, irrespective of the multifarious steps and externalities involved. In addition to objections of a legal nature, careful attention should also be paid to the negative material aspects discussed above. As such, Islamic banks that seek to implement financing modes acceptable in *Shari'ah* would do well to refrain from adopting this questionable procedure. Instead of methods that complement interest based lending mechanisms, such products should be developed that reflect the spirit of Islamic guidelines on trading and finance, and bring Islamic economic objectives closer to reality.

Notes

1 AAOIFI *Shari'ah* Standards 2010, p. 526.

2 For a detailed analysis of the nature and scope of traditional tawarruq, see Muhammad Abdurrahman Sadique, "Tawarruq in Islamic Law: an

appraisal of its admissibility and criteria in the context of private transactions," Journal of Islamic Law Review, Vol. 11, No. 1, June 2015, pp. 77-92.

3 Monzer Kahf, "Outlines of a brief framework of tawarruq (cash procurement) and securitization in *Shari'ah* and Islamic banking", written for AAOIFI seminar in Bahrain, 15th February 2004.

4 Islamic Fiqh Academy resolution, 17th Session held in Makkah, 3 – 19 Shawwal 1424H (13 – 17.12.2003)

5 Monzer Kahf and Imad Barakat, "al-Tawarruq fî al-Tatbîq al-Mu âsir", paper presented at the 14th Annual International Conference of Islamic banking Institutions, University of United Arab Emirates.

6 Monzer Kahf, op. cit.

7 Monzer Kahf, op. cit.

8 Monzer Kahf ibid.

9 Monzer Kahf and Imad Barakat, op. cit.

10 Muhammad al-Sallami, "Bahth al-Tawarruq", paper presented at the 24th Albaraka Conference, Makkah, 25 – 27 October 2003

11 See for details Muhammad Taqi Usmani, *An Introduction to Islamic Finance,* pp. 120 – 126.

12 Ahmad Fahd al-Rashîdi, *Amaliyyât al-Tawarruq wa Tatbîqâtuha al-Mu âsirah*, p. 125

13 Al-Rashîdi, op. cit.

14 Al-Rashîdi, op. cit.

15 For a description of these three forms see Muhammad Abdurrahman Sadique, "Tawarruq in Islamic Law: an appraisal of its admissibility and criteria in the context of private transactions," Journal of Islamic Law Review, Vol. 11, No. 1, June 2015, pp. 77-92.

16 Al-Siddîq al-Darîr, op. cit.

17 Reported by Tirmidhi and others.

18 Al-Shâfi î, *al-Umm*, vol. 3, p. 69.

19 Al-Siddîq al-Darîr, op. cit.

20 Islamic Fiqh Academy resolution, 17th Session held in Makkah, 3 – 19 Shawwal 1424H (13 – 17.12.2003)

21 Monzer Kahf, as above.

22 Mukhtâr al-Sallami, as above.