

Background

Previously, the common Shariah concepts adopted in Islamic finance is *wadiah*, *qardh*, *mudharabah* and others. However, since there is a need to address the contemporary issues and subscribe to the majority opinion of Shariah scholars, the *tawarruq concept* is now introduced. Even though the concept has long been discussed by the Shariah scholars, only recently such concept was being practically implemented. This concept is regarded as an alternative to *baî`inah* concept and is used in product financing, deposits and financial liquidity management.

Issues

1. Deposit and Financing Products Based on *Tawarruq*

Islamic financial institution made a proposal to offer deposit product and financing based on the concept of *tawarruq* or commodity *murabahah*. In brief, the mechanism of commodity *murabahah* deposit involves the following transactions:

- i. The customer (depositor) appoints bank as an agent to purchase metal commodity from metal trader A on cash basis in an established metal commodity market;
- ii. The bank will thereafter purchase the metal commodity from the customer on a deferred sale at a cost price plus profit margin;
- iii. Next, the bank will sell back the metal commodity to metal trader B in the metal commodity market.

As an agent to purchase the metal commodity on behalf of the customer, the bank receives cash from the customer for the price of the commodity which is deemed as deposit in the bank's account. As a result of transaction (ii) above, the bank assumes liability (the cost price of the commodity plus profit margin) to be paid to the customer on maturity. The price of the commodity purchased by metal trader A and the commodity's price when sold to the metal trader B are the same.

³³ *Tawarruq* means purchasing a commodity on a deferred price either in a form of *musawamah* or *murabahah*, later selling it to a third party with the objective of obtaining cash.

With respect to financing mechanism on the other hand, the sequence of transactions would be as follows:

- i. The bank purchases metal commodity from metal trader B on cash basis;
- ii. Thereafter, the bank sells the metal commodity to the customer on deferred price (cost price plus profit margin); and
- iii. The customer may appoint the bank as his agent to sell the metal commodity to metal trader A on cash basis in the metal commodity market.

While the cash sale price by the customer to the metal trader A enables the customer to obtain cash for financing, the deferred sale price from the bank to the customer enables the customer to pay back the financing facility to the bank within an agreed term. The issue is whether the above mechanism of transactions complies with Shariah.

Resolution

The Council in its 51st meeting held on 28th July 2005 / 21st Jamadil Akhir 1426 resolved that deposit product and financing based on the concept of *tawarruq* which is known as commodity *murabahah* is permissible.

2. *Ijarah Sukuk* and Shariah Compliant Securities as Underlying Asset in *Tawarruq* Transaction

There is a proposal to use *ijarah sukuk* and Shariah-compliant securities as underlying asset in *tawarruq* or *murabahah* to manage liquidity in Islamic financial system. The proposed characteristics of *ijarah sukuk* include *ijarah sukuk* which is backed by tangible asset, financial asset and a combination of both tangible and financial asset. For Shariah-compliant securities, the proposed characteristic is that the securities must be endorsed as Shariah compliant. The issue here is whether the use of financial asset like *sukuk* and securities instead of commodity in *tawarruq* is permissible in Shariah.

Resolution

The Council in its 58th meeting held on 27th April 2006 / 28th Rabiul Awal 1427 resolved that the use of *ijarah sukuk* and Shariah-compliant securities as underlying asset in *tawarruq* or *murabahah* to manage liquidity in Islamic financial system is permissible. However, such *ijarah sukuk* shall be backed by tangible asset and not financial asset.

[Please refer to the basis of the Shariah rulings on page 60]