

# The case for & against Tawarruq

Mansoor Jamal Malik of Al Busaidy, Mansoor Jamal & Co discusses the economic circumstances that require lifting the wholesale ban on tawarruq on a case-by-case basis in Oman.



2009, however, the Organisation of Islamic Cooperation (OIC) Fiqh Academy Council declared organised tawarruq (*al-tawarruq al-munazzam*) a “deception” and non-compliant with the principles of *Shari’ah*. As the OIC Fiqh Council’s decision has no binding effect, it left the industry in a state of confusion as to whether or not tawarruq is *Shari’ah*-compliant. In most jurisdictions, the respective regulators left it to the *Shari’ah* boards of financial institutions to determine whether tawarruq should be allowed for the purpose of their Islamic finance operations. Oman was, however, the only jurisdiction which

promulgated a wholesale ban (subject to limited exceptions) on all forms of tawarruq “in any manner whatsoever” under the IBRF.

## WHAT IS TAWARRUQ?

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) *Shari’ah* standard defines tawarruq as a transaction which involves “the purchase of a commodity on deferred payment [but spot delivery] basis by way of either a direct sale or murabaha and the sale of the same commodity by the purchaser to a party other than the original seller” on spot delivery and spot settlement basis.

There are two forms of tawarruq; classical tawarruq (*al-tawarruq al-fardi*) and organised tawarruq

**T**he Islamic banking sector in Oman has experienced impressive growth and development since the introduction of the Islamic Banking Regulatory Framework (IBRF) three years ago. The IBRF, while providing a robust and comprehensive *Shari’ah* governance framework, prohibits Islamic banks and windows from using commodity murabaha or tawarruq, a key liquidity management tool available to Islamic banks across the globe.

Tawarruq is arguably the most prevalent liquidity management tool in the global Islamic finance industry. It is widely used around the globe in credit card transactions, top-up facilities, mezzanine financing, working capital financing, deposits and liquidity management of banks. In April

(*al-tawarruq al-munazzam*). According to the OIC Fiqh Academy, classical tawarruq is a transaction which involves the purchase of a commodity possessed and owned by a seller (the *muwarriq*) on a deferred payment basis, after which the buyer (the *mutawarriq*) resells the commodity for cash to someone other than the original seller in order to acquire cash. Organised tawarruq is distinct from classical tawarruq in that the *mutawarriq* buys merchandise from a local or international market on a deferred price basis and the buyer then arranges the sale of the merchandise to a third party either himself or through his agent.

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Both classical and organised tawarruq are similar in that the initial purchaser of the commodity has no intention to use or hold on to the commodity but is looking to transfer the same into cash. The difference, is that in the case of an organised tawarruq, the original seller of the commodity (*the muwarriq*) manages the process by which cash is acquired and sells the commodity to the final buyer. In a classical tawarruq however the *muwarriq* plays no part

in assisting the *mutawarriq* to sell the commodity on, and the final sale occurs directly between the *mutawarriq* and the end purchaser.

#### THE CASE AGAINST TAWARRUQ

The OIC's 2009 fatwa against organised tawarruq states that tawarruq is a 'deception' and nothing more than a legal trick and should be prohibited for this reason. The opponents of tawarruq argue that it is akin to bay' al-'inah i.e. a sale and buy-back transaction between two parties where one party sells a commodity to another on deferred payment basis following which the seller buys back the same commodity from the buyer before the full payment of the deferred price and for cash payment of a lesser amount than the deferred price.

Another argument against tawarruq is that it increases the proliferation of debt and embodies many risks and harmful effects. This is particularly true as the *mutawarriq* buys a commodity on deferment, paying a higher price than when he actually sells to a third party for cash. Opponents of tawarruq also argue that tawarruq creates a debt and the element of *riba* as opposed to a genuine economic activity.

#### THE CASE FOR TAWARRUQ

A number of senior bankers in Oman have continually lobbied for removing the ban on tawarruq at least on a temporary basis under stringent regulation to ease the problem of liquidity management. The case of Pakistan provides a good precedent for allowing tawarruq on a temporary basis in the formative stages of the industry. Today, Pakistan is considered to be one of the principal Islamic banking centres in the world. A leading Islamic scholar, Sheikh Nizam Yaquby, has argued that tawarruq would permit banks to sell their assets to minimise losses occurring in connection with assets. He has also queried, "How can *Shari'ah* allow something which is burdensome on a person....and not allow something which is organised....and serves the needs of someone in dire need of cash."

The CBO vice president, Ali Hamdan Al Raisi, recently acknowledged that the growth of Islamic banks in Oman is expected to slow in 2016. One of the reasons for this is the lack of liquidity management tools available to Islamic banks. If banks lack ways to manage the funds in the market, this money will be parked until it is deployed and if this coincides with a period of inflation, its value may decline. This would place significant pressure on asset yields for the Islamic banks and render them less competitive than their conventional counterparts.

The prohibition on tawarruq in Oman might spur the development and use of alternative instruments which would be a good development since, given the availability of tawarruq in other countries, the global industry as a whole has not seriously considered developing alternate structures which offer the same solutions as tawarruq. This will, however, take time and the CBO might, therefore, consider whether classical tawarruq (as opposed to organised tawarruq) should be allowed during these formative years for Oman's Islamic finance industry subject to adopting robust checks laid down by AAOIFI. Such a move would align with the legal maxim that tawarruq satisfies people's needs and relieves difficulty as well as meeting the *maqasid* of *Shari'ah* for protection of property. In addition, this would provide a solution to current liquidity management problems and avoid clients falling back on *riba*' based options to meet their needs. 🚀



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