Utilization Of Tawarruq For Liquidity Management In Islamic Banking Sector Of Pakistan (A Research Article In View Of The Malaysian Banking System)

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Abstract
Islamic banking products have become very popular since the last two decades and drag the attention of world economic system due to its uniqueness as compare to conventional banks, and trusted as a solution for the economic crisis. However, the issue of liquidity risk management is very sensitive in the banking system to satisfy the need of asset and liability sides, particularly in Pakistan, as some other countries have some special products for the same. Although, Islamic banking industry has introduced some product for inter-bank liquidity management, but asset side product are not sufficient to fulfil the liquidity need of current market. We need a particular Shariah compliant product that can overcome this issue. To justify the situation, we can offer concept of Tawarruq (Monetization), whereby the Islamic bank purchase some specific assets from a Supplier, and sell it to the customer on differed basis, and subsequently, the customer will sell the same to a third party to avail liquidity. The main objective of this paper is to highlight the
issue of liquidity management, and to analyze that how can we resolve the problem, along with the comparative study of Islamic banking system in Pakistan and Malaysia in context of offering financial services to mitigate the issue of liquidity management.

**Keywords:** Tawarruq, Monetization, IFI, IBIs, Bay al-Inah, Scholars view, Liquidity risk management.

**Introduction**

It was the early eighties, when top leading Shariah scholars have come forward to Islamize the economy. From the day to date, efforts are being made to promote Islamic banking practices worldwide, and it has proved to be quite successful. But some obstacles are constantly interrupting the way to the goal, in this journey the Islamic banking industry has a strong competition with conventional banking, despite all the Muslim community even some non-Muslims also want to avail an interest-free financial system, but unfortunately, they can’t do so and sometimes seem helpless.

Liquidity management is one of the major issues faced by Islamic banking Institutions (IBIs). Liquidity management is of two types: (a) inter-bank liquidity requirement, (b) need of the costumer to avail financing facility to cater liquidity of his business. In this article, we will discuss the latter and then its permitted solution will be sought. The need of financing for liquidity management is extremely high, and it is impossible to compete the conventional financial sector without fulfilling the same, resultantly the customer switches to the conventional banks, where he is compelled to avail Haram (forbidden by Shariah).

According to “Islamic Banking Industry – Growing amid challenges” By: Ahmed Ali Siddiqui, while he was discussing the main challenges that the Islamic banking industry faces today, he stated that Solutions for Liquidity Management & creation of Islamic Inter-bank Market is one of the important issues. Therefore, Islamic banks are deprived of many potential customers, and so that they cannot compete the conventional banks. This is why the Islamic Banking has grown up to only 19% of overall banking industry of Pakistan in a journey of two decades, and the supreme court of Pakistan is not ready to declare interest (riba) as Haram component, and the government does not outlaw the conventional banking. Because the economy seems to fail without resolving the issue discussed above.

On the contrary, in some other countries like Malaysia, Islamic banking has grown up to 38% of the overall banking industry of the country (Bank Negara Malaysia). In addition to other differences between the banking systems of both the countries, one of the main difference is that, there is a finance facility for liquidity management in Malaysian Islamic banking system, which attracts the customer, whereas it is not available here in Pakistan.

The question is that, what product is being used there in Malaysia to meet the liquidity management of the customer? What the process flow is? What is the opinion of Shariah
Scholars about it? Whether that product could be applied in Pakistan or not? This article answers all these questions.

**The way of financing in Malaysia**

As we have analyzed above that, the ratio of Islamic Banking with overall banking sector in Malaysia is more than that of Pakistan. Islamic banking sector of Malaysia has introduced a number of products of different nature as per the requirement of the customer. Some of these products have been developed on the basis of Tawarruq. These Tawarruq based product have been introduced for liquidity management particularly. Nature of Tawarruq transaction is very close to Inah. We can say that Tawarruq is a refined shape of Inah, so it is better to understand both Inah and Tawarruq side by side.

Inah refers to the process of purchasing a commodity for a deferred price determined through Musawamah (Bargaining) or Murabahah (Mark-up Sale), and selling it back to the same party for a spot price to obtain cash. Inah is of two kinds.

1. The second sale is pre-stipulated in the first sale.
2. The second sale is not pre-stipulated in the first sale.

The first case is voidable according to all schools of thought. While the second one is permissible only according to Imam Shafi’i, and not according to the other scholars. Majority of the scholars have considered Tawarruq as a type of Inah, because the purpose of this transaction is also to attain money by sale and purchase of a specific object. Only Imam Ahmad ibn Hambal have used the term “Tawarruq”. The literal meaning of Tawarruq is also “to get cash”. The basic process of Tawarruq is “The person who needs the money in cash, buy something from someone else on deferred basis and sell it on cash to a third person”. According to the policy Document of Bank Negara Malaysia, “A Tawarruq consists of two sale and purchase contracts. The first involves the sale of an asset by a seller to a purchaser on a deferred basis. Subsequently, the purchaser of the first sale will sell the same asset to a third party on a cash and spot basis”. The stated process is permissible according to all the schools of thought.

**Background of Tawarruq in Malaysia**

In Malaysia, the people follow the Shafi’i school of thought, and the second type of Inah is valid according to Imam Shafi’i, therefore the model of Inah was adopted in Malaysia from the beginning of Islamic banking. Although the model was subject to the following conditions:

1. Both contracts (buying and selling) should be cleared and unconnected with each other.
2. The condition of buying back should not be included in the first contract.
3. Both contracts should be occurred in two different times.
4. Both contracts should be in order, in a sense that the second contract shall be executed after the completion of the first contract.
5. Transfer of ownership and possession in both contracts should be compliant with the Shariah regulations and customary in society.

Due to the above conditions, Inah became very challenging practically, and led to many noncompliant/interest-based transactions. To address these issues, the Tawarruq was introduced and presented as an alternative to Inah. Meanwhile, Tawarruq has got a lot of acceptance and success in Malaysia. According to the Malaysian banking system, the Tawarruq model differs from Inah as under.

<table>
<thead>
<tr>
<th>Inah</th>
<th>Tawarruq</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The subject matter is returned back to the first seller.</td>
<td>The first seller does not buy anything back in Tawarruq, but it is sold to a third party.</td>
</tr>
<tr>
<td>2. There are only two parties in the Inah: The bank and the customer</td>
<td>While three or four parties take part in Tawarruq: The bank, Customer, Supplier and Broker.</td>
</tr>
<tr>
<td>3. Legal documents contain only two parties: the bank and the customer</td>
<td>Legal documents include two plus Parties.</td>
</tr>
<tr>
<td>4. Two separate contracts are occurring in a close time between the two parties, so the prospect of going to the non-privilege is very high.</td>
<td>As the third party also involves in Tawarruq, so the Shariah noncompliant risk becomes very low.</td>
</tr>
</tbody>
</table>

Tawarruq is generally defined in two types: (a) Classical Tawarruq or Attawarruq alfardi, in this case, an individual buys specific goods and sells it to a third person. (b) The organized Tawarruq, it is also known as (التورق المنظم ). In this case, the purchaser after getting possession appoints the institute as an agent to sell the purchased goods to someone else.

**Tawarruq based products in Malaysia**

The utilization of Tawarruq in Malaysia is more common than in the other countries, because it is permissible for Shwafy (Followers of Imam Shafi’i) to conduct Inah, which
is closer than Tawarruq to the borderline of noncompliance according to the Shafi‘i School of thought, and is noncompliant according to the others, as we discussed above. Therefore, the acceptability of Tawarruq was not disturbed, and is being used for different purposes.

In this context, Bank Negara Malaysia, the central bank of Malaysia has developed and issued a detailed official policy on 28 December 2018. According to the policy, the policy document contains two distinctive parts, namely the Shariah requirements and the operational requirements. The former highlights the salient features and essential conditions of the Tawarruq as specific Shariah arrangement. The latter outlines the operational requirements, which consist of core principles of good governance and oversight, proper product structuring, effective risk management, sound financial disclosure and fair business and market conduct. These operational requirements are aimed at complementing and promoting sound application of the Shariah principles regarding Tawarruq. The policy document supersedes the Tawarruq policy document issued on 17 November 2015.

Here are some products, which are briefly described in the above policy document:

1. **Financing**

![Diagram of Financing Process](chart.png)

<table>
<thead>
<tr>
<th>Step</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IFI purchases any asset of RM100, 000 on cash from supplier 1.</td>
</tr>
<tr>
<td>2</td>
<td>IFI pays RM100, 000 to supplier 1.</td>
</tr>
<tr>
<td>3</td>
<td>Subsequently, Bank sells that purchased asset to the customer on a deferred basis with an agreed profit of RM120, 000 (RM100, 000+ profit RM20, 000).</td>
</tr>
</tbody>
</table>

**Table 1**

As discussed above, the Tawarruq was introduced in Malaysia as an alternative to Inah, therefore, now Tawarruq is being used in replacement of Inah. The first benefit of alteration is that the possibility of noncompliance has been reduced. Secondly, the practical difficulties became easier and thirdly, it is a progressive step to a valid activity according to all schools of thought. The purpose of this product is to provide customer financial support. This method consists of six below steps:

1. The bank purchases any asset of RM100, 000 on cash from supplier 1.
2. The bank pays RM100, 000 to supplier 1.
3. Subsequently, Bank sells that purchased asset to the customer on a deferred basis with an agreed profit of RM120, 000 (RM100, 000+ profit RM20, 000).
5. The Customer appoints the bank as an agent to sell the purchased asset to third-party B on cash bases of RM100, 000.
6. The bank receives RM100, 000 from B for the customer, thus the customer gets the required amount.

2. Deposit product

![Diagram of deposit product]

Table 2

Usually, the bank uses this product when it needs to enhance liquidity to invest anywhere. This method consists of six stages as under.

For example, A is a customer who wants to deposit RM100, 000 to the bank under this product.

1. The customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM100, 000.
2. The IFI uses the cash deposit placed by customer to pay for the purchase.
3. Subsequently, the customer appoints the IFI as its agent to sell the asset to the IFI itself at an agreed selling price of RM100, 863 (RM100, 000 + profit RM863 i.e. 3.5% per annum).
4. The IFI makes deferred lump sum payment to customer upon maturity of the deposit placement.
5. Subsequently, the IFI sells the asset to Asset Supplier 2 on spot at selling price of RM100, 000.
6. The IFI obtains cash of RM100, 000 as per the deposit placement.

3. Islamic profit rate swap

The product is used for the customer who agrees with the bank to provide a specific amount continuously for different quarters, for example, RM2 million during a period. This product is also consists of six steps:
Table 3

1. On payment date, the customer appoints the IFI as its agent to purchase the asset from Asset Supplier 1 with selling price of RM2 million.
2. Subsequently, the customer appoints the IFI as its agent to sell the asset to IFI itself at an agreed selling price of RM2 million + KLIBOR x 3 months.
3. The IFI makes lump sum payment and subsequently sells the asset to Asset Supplier 2 on spot at selling price of RM2 million.

Table 4

4. Separately, the IFI purchases the asset with selling price of RM2 million from Asset Supplier 3.
5. Subsequently, the IFI sells the asset to the customer at an agreed selling price of RM2 million + 3.5% per annum.
6. The customer makes lump-sum payment and subsequently appoints the IFI as its agent to sell the asset to Asset Supplier 4 on spot at selling price of RM2 million.

4. Options
Table 5

A customer decides to hedge its receivables of USD1 million by buying a USD/MYR put option. The IFI as counterparty to the option, quotes a strike price of USD1 = RM3.10 and premium of USD5,000 with 3 months maturity. The IFI executes Tawarruq arrangement to effect the option agreement and premium payment.

1. The IFI purchases the asset with selling price of USD1 million from Asset Supplier 1.
2. The IFI pays cash to Asset Supplier 1.
3. Subsequently, the IFI sells the asset to the customer at an agreed selling price of USD1 million + USD5,000 (being the premium for the option).
4. The customer then appoints the IFI as its agent to sell the asset to Asset Supplier 2 on spot as selling price USD1 million.
5. The customer obtains cash and pays the IFI the selling price and premium.

Tawarruq in Pakistan

The above detail made it clear that how to deal with the lack of liquidity in Malaysia and how to use Tawarruq as a product. However, to compare the banking system in Pakistan with that in Malaysia, we cannot ignore the fact, that there are two different Schools of thought in both the countries. People of Malaysia follow Imam Abu Abdullah Muhammad ibn Idris al-Shafi’i (767 AD to 820 AD) in their religious matters. While here in Pakistan,
the People follow Imam Abu Hanifa al-Numan ibn Thabit (699 AD to 767 AD). Both the Imams have their different opinions about Inah, but the concern seems same about Tawarruq. Now let us come by the fact, which is the actual aspect to our core issue “Is it possible to use Tawarruq as a product for liquidity management in Pakistan as it is in Malaysia”. To take any decision, we have to review the views of Hanafi scholars and Islamic banking Shariah experts in Pakistan.

**Tawarruq according to Ahnaaf**

Hanafi scholar (Fuqha) did not use the term “Tawarruq”, but considered Tawarruq also as a type of Inah, although it was recognized as a valid and permissible case of Inah. This term “Tawarruq” was used by only Imam Ahmad bin Muhammad bin Hanbal, Abu Abd Allah al-Shaybani (780 AD to 855 AD), which was later adopted in all religions. Therefore, in the Hanafi literature, the term “Tawarruq” has not been particularly discussed, but considered as among the other types of Inah.

Allama Ibn Abidin Shami (1784 AD to 1836 AD) discussed in Radd Al-Muhtar about the same situation of Inah, which is later called Tawarruq. He had summarized the views of various scholars, and then ruled out the validity of the attribute of Yaqub ibn Ibrahim al-Ansari better known as Imam Abu Yusuf (738 AD to 798 AD). Finally, summarizing the discussion of Fath ul-Qadir about Inah, he declared that if the sold goods were sold back in a whole or a part of it to the first seller, then the situation will be abhorrent and illegitimate, and if there is a case, where the sold goods do not come back to the first seller any way, but it is sold to a third person, it will be permissible, but not an ideal.

"ثم قال في الفتح ما حاصله: إن الذي يقع في القلبي أنه إن فعلت صورة يعود فيها إلى البائع جميع ما أخرجه أو بعضه كعود الثوب إليه في الصورة المارة وعود الخمسة في صورة إقراض الخمسة عشر فيكره يعني تحريما، فإن لم يعد كما إذا باعه المدينون في السوق فلا كراهة فيه بل خلاف الأولى، ",

الدر المختار وحاشية ابن عابدين (رد المحتار) (5/326)

**Shariah Standard of Tawarruq**

As the Islamic banking community in Pakistan also follows the Standard prepared and published by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), it is very important to review the Shariah Standard prepared for Tawarruq by AAOIFI. Shariah Standard # 30 with the title “Tawarruq” released in 2006. The standard has declared Tawarruq as a valid transaction according to the principles of Islamic jurisprudence (Fiqh). The standard has also included Shariah restrictions along with administrative constraints in terms for quality control, which has made the process of Tawarruq little bit difficult and complicated. After defining general rules, some boundaries
have been fixed separately for the institutions. Specifically, it is not allowed for everyone at any time, but only in the situations, where all other products are Unable to meet the requirements.

The reasons for the imposed restrictions have been determined in concerned deliberations. Where it has been stated that this is only to prevent Islamic banks to turn away from their ideal and basic principles. The goals of Islamic banking and relationships of customer and bank have been kept in mind during the preparation of this standard. It was expected that might customers depend totally on Tawarruq and the core products of the Islamic banking become suspended, so it has been permitted with certain conditions at the time of need.

**Banking Practice in Pakistan**

Meezan Bank’s Guide to Islamic Banking Stats:

“Tawarruq means, “to buy on credit and sell at spot value.” This transaction is nowadays being used by many Islamic banks for liquidity management and as a mode of financing especially for personal financing and credit cards.”

Although the above statement shows that Tawarruq is being used in many banks, but the fact is that, the ratio of Tawarruq in financing to other financing products is not as much as required by the community. Tawarruq has not been encouraged in Pakistan since the Islamic banking system has stepped in the industry. Although the scholars have declared it permissible, but also discouraged it by recommending, free of cost lending of money instead of Tawarruq. Sharia Board of Meezan Bank Limited has also stated the same concept “The transaction is valid and permissible. However, lending money (without interest) is more preferable.”

The statement of Meezan Bank’s Guide to Islamic Banking also seconds the above concept, where it was stated that “However, if all the conditions of a valid sale are properly observed, the transaction may be valid, but its extensive use is not advised.”

The reason is that the top leadership of Shariah Scholars in Islamic banking industry of Pakistan aims to build and move the Islamic banking gradually towards real basis of trade i.e. partnership and Mudarabaha. On the other hand, increasing practice in Tawarruq takes the Islamic banking away from the proposed goal. This is because the most of Shariah Scholars does not allow it.

The other reason to discourage Tawarruq transaction is its similarity to Inah transaction. A minor laxity, may convert Tawarruq into Inah, which is strictly void according to Hanafi School of thought. On the other side Inah was being used in Malaysia, and later on Tawarruq was introduced as an alternative to Inah. Although there are too many chances in this transaction to mix-up with Inah, but the case is not too sensitive in Malaysia as it is here in Pakistan, due to the validity of Inah according to Shafi’i school of thought.
After the above detail, we also observed that there is a wide use of Tawarruq in Inter-Bank Treasury Department. The term Commodity Murabahah is not, but a transaction of Tawarruq with difference in label. However, this facility is not provided to the customer.

Shariah Board of Dubai Islamic Bank has issued a fatwa for a product with title “Dubai Islamic Personal Finance” dated 25 November 2015. As per the given process flow of the product, the underlying product is completely based on Tawarruq concept, although the bank has declared it a “Musawamah” based product. Based on the same fatwa DIB has been offering this product for different purposes, according to their website “The financing facility can be availed and utilized for financial needs such as education, marriage, medical expenses, credit card loans settlements, conventional loans settlements or meeting any other emergency needs in “HALAL/ISLAMIC” way.”

In early 2021, Faysal Bank Islamic has introduced Noor card based on Tawarruq transaction, but they also claimed that the transaction is based on “Musawamah”. Noor card is a Shariah compliant alternative to conventional credit card. The guideline to Islamic banking issued by Meezan bank limited referring to the same as we have discussed above.

The above transactions wetness that Tawarruq transaction is a valid transaction according to the Shariah scholars of banking sector, but for some managerial issues they avoid to use Tawarruq with the same name.

**Tawarruq in the local markets of Pakistan**

However, in the local markets of Pakistan, the Tawarruq is normally being practiced among the people. In this regard, the fatwa houses (Dar ul Ifta) of all over Pakistan have issued Ftawa (Shariah Rulings), and declared Tawarruq as a valid transaction from Shariah perspective.

**Conclusion**

During the research, we observed that Shariah scholars in Pakistan and AAIOFI have agreed upon the validity of Tawarruq from Shariah perspective. In view of these opinions, IBIs are using Tawarruq in inter-bank transactions for liquidity management of the financial institutions, and some IBIs have launched credit cards and financing products for consumer finance. We also observed that the process and concept of Tawarruq is being used by the IBIs, but they avoid using the title of Tawarruq.

In view of the above details, we are of the view that it is also possible to use Tawarruq as a product here in Pakistan, and it is predictable to solve the liquidity issue in Pakistan. Although at initial stage of Islamic banking, some Shariah scholars had an opinion to avoid Tawarruq, but now when the Islamic banking in Pakistan has an age of more than twenty years with a successful financial history, and a number of products have availed
acceptability in the market, experts should rephrase their opinion about Tawarruq to use it as a regular product for liquidity need of customer. As the Tawarruq transaction can be an easy and Shariah compliant solution for the issue. However, the regulator may set specific controls and special approvals from Shariah Supervisory board of an IBI. The same will be very helpful in the promotion of Islamic banking industry and if the state intends to convert the overall banking sector to Islamization.

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