

BAY AL-TAWARRUQ APPLICATION IN MALAYSIAN ISLAMIC BANK: A CRITICAL ASSESSMENT

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ABSTRACT

This paper aims to review the application of *bay' al-tawarruq* contract in offering Islamic banking products and services. The review evaluates to what extent *bay' al-tawarruq* contract able to fulfil the *maqasid* (objectives) of *Shariah* (Islamic law). Two RHB Islamic bank's products (personal financing and deposit), which adopted *bay' al-tawarruq* contract were critically studied. The product structures were analysed and compared with the *bay' al-inah* based product structure. The adoption of *bay' al-tawarruq* contract in creating Islamic personal financing and deposit products comply with *Shariah* principle. The product structure and the operational process did not trigger any *Shariah* issue. However, in terms of fulfilling the *maqasid* of *Shariah*, the paper find out that the application of *bay' al-tawarruq* is not significantly different from *bay' al-inah* based products. Thus, despite the shift from *bay' al-inah* to *bay' al-tawarruq* implemented by most of the Malaysian Islamic banks, criticism regarding how 'Islamic' is Islamic banking remains to be debated. Islamic banking products studied in this paper were limited to RHB Islamic bank of Malaysia only. Hence, the paper is not intended to represent the local Islamic banking industry as a whole. The paper offers *Shariah* assessment on Islamic banking products that adopt *bay' al-tawarruq* contract as their underlying principle. It also provides a valuable addition to the discussion of *maqasid* (objectives) of *Shariah* in the Islamic finance industry.

ABSTRAK

Artikel ini bertujuan untuk menganalisa penggunaan kontrak *bay al-tawarruq* dalam penawaran produk dan perkhidmatan di institusi perbankan Islam. Ia cuba menilai sejauh mana penggunaan kontrak *bay al-tawarruq* dapat mencapai objektif (*maqasid*) *Syariah*. Bagi mencapai tujuan ini, dua produk perbankan Islam (pembiayaan peribadi dan deposit) yang ditawarkan oleh RHB Islamik telah dikaji secara kritis. Struktur bagi kedua-dua produk tersebut telah dianalisis dan dibandingkan dengan produk yang berasaskan kontrak *bay' al-inah*. Hasil kajian mendapati bahawa penggunaan kontrak *bay' al-tawarruq* dalam penawaran produk pembiayaan peribadi dan deposit adalah bertepatan dengan garis panduan yang ditetapkan oleh *Syarak*. Struktur produk dan operasi perlaksanaannya tidak menimbulkan sebarang isu *Syariah*. Namun begitu, kajian ini mendapati bahawa penggunaan *bay al-tawarruq* tidak jauh berbeza dengan penggunaan kontrak *bay al-inah* dari sudut menepati konsep objektif *Syariah*. Walaupun kebanyakan institusi perbankan Islam di Malaysia telah mula beralih daripada penggunaan *bay' al-inah* kepada *bay' al-tawarruq* namun kritikan terhadap 'keIslaman' produk-produk perbankan Islam masih menjadi pertikaian. Kajian ini hanya terhad kepada dua produk yang ditawarkan oleh RHB Islamik. Oleh yang demikian, hasil kajian ini tidak

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menggambarkan keseluruhan industri perbankan Islam di Malaysia. Artikel ini menilai pandangan *Syarak* terhadap produk-produk perbankan Islam yang menggunakan kontrak *bay' al-tawarruq* sebagai dasar kontrak utama. Artikel ini turut memberi sumbangan kepada perbincangan sejauh manakah pelaksanaan dan operasi semasa institusi perbankan Islam menepati konsep objektif *Syariah*.

Key words: Bay' al-tawarruq, Maqasid of Shariah, Islamic finance, RHB Islamic, Malaysia.

1. Introduction

Islamic banking institutions operate within the same structure as conventional banks. They make a profit by extending financing to individuals and businesses. To create financial products that comply with *Shari'ah* principles, many classical contracts such as *murabahah* (mark-up), *ijarah* (leasing), *wakalah* (agency) and *bay' al-inah* (sale and buyback) have been adopted by Islamic banks. Of these classical contracts, *bay' al-inah* is deemed as the most controversial. Its application is seen as *hilah* (legal artifice) to legalize usury (*riba*). Despite the controversy, *bay' al-inah* was adopted widely by Islamic banks in Malaysia before 2013. The Malaysian *Shari'ah* scholars approved the contract mainly based on *maslahah* (public interest). Because of the lack of Islamic financial products available in the market, the *bay' al-inah* was allowed to spearhead the growth of the new industry (SC, 2006). The contract becomes a popular choice of industry practitioners because it is the simplest way of offering *Shari'ah* compliant financial products which are needed by customers.

However, after four decades in an application, the *hilah* of *bay' al-inah* is increasingly seen as an unacceptable practice. As awareness of the *maqasid* (objectives) of Islamic finance is growing, many customers begin to question the validity of financial products offered by the IFIs. They have doubts about the '*halalness*' of financial products that used *bay' al-inah* as the underlying principle. The criticism lies in the similarity between Islamic financial products and their conventional counterparts. Islamic financial products seem insignificantly different in terms of bringing economic injustice and unfairness to the community (Hasan, 2009; Echchabi & Aziz, 2014)). This is different from the *maqasid* (objectives) envisioned by the pioneers of Islamic economic discipline. The duplication approach practised by the industry practitioners has been accused as the root of the problem. They duplicate conventional financial products with 'Islamic' alterations.

Realizing the dissatisfaction, there is an effort to move away from the practice of *bay' al-inah*. The Central Bank of Malaysia has urged all Islamic banks in the country to look into an alternative. Although *bay' al-inah* is still allowed to be implemented, the Central Bank has strengthened its terms and conditions in which to a certain extent has put off its application (BNM, 2013). Therefore, the local Islamic banks begin to adopt *bay' al-tawarruq* or known as commodity *murabahah* in which has gained wider acceptance among their Middle East counterparts. In this paper, we will try to understand the meaning of *bay' al-tawarruq*, its rules and how it is applied to create Islamic financing and deposit products in RHB Islamic bank in Malaysia. Then, we will analyse whether the application of *bay' al-tawarruq* could realize better the *maqasid* (objectives) of *Shariah*. It is worth mentioning that Islamic banking products studied in this paper were limited to RHB Islamic bank of Malaysia only. Hence, the paper is not intended to represent the local Islamic banking industry as a whole.

2. Literature review

Bay' al-tawarruq contract was studied extensively by Muslim classical jurists from the four school of law namely the Hanafis, Malikis, Shafi'is and Hanbalis. They had elaborated in great details the contract in their works. As rightly pointed out by Mohamad and Ab Rahman (2014), the current studies on the subject mainly focus on analyzing *bay' al-tawarruq* rulings found in the classical books. However, a few studies are analysing the

application of *bay' al-tawarruq* in the current practices in Islamic banking institutions. Mayhudin and Che Seman (2014) for instance, found that *bay al-tawarruq* has been adopted by Bank Muamalat Malaysia as an alternative to *bay' al-inah* contract following a direction from Bank Negara Malaysia to move away from the latter contract. The present paper aims to add to the existing literature by providing an appraisal of the extent to which the adoption of *bay' al-tawarruq* able to fulfil the *maqasid* (objectives) of *Shariah*.

The term *tawarruq* is the infinitive (*masdar*) of the verb *tawaraqa*. An Arabic sentence of *tawarraqa al-hayawan* means the animal ate the leaves. Meanwhile, the term *wariq* is derived from the verb *wa-ra-qa* which refers to minted or un-minted silver coins (*dirham*) (Bouheraroua, 2009). This connotation is used in the Qur'an 18:19:

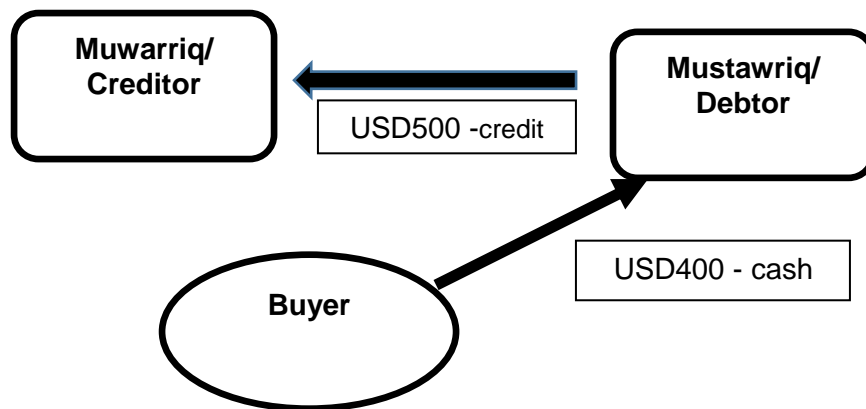
“So send one of you with this silver coin (*wariq*) of yours to the city and let him look the best food...”

When teenagers of *ashab al-kahfi* woke up from their long sleep, one of them went to the market to buy foods. The teen used *wariq* (silver coins) of the period of Roman emperor Decius which ruled the city approximately 309 years back. The seller was amazed because the silver coins were not the current coins of Theodosius II reign. The silver coins shown became the testimony of the re-awaken of the teenagers of *ashab al-kahfi*. According to the majority of Muslim scholars including Fakhruddin al-Razi (d.1209), the verse clearly shows that the term *wariq* was referred to coins made of silver. The Prophet Muhammad (pbuh) also used the same term (*wariq*) to indicate silver coin or *dirham* (Zuhaily, 2003). In explaining the minimum amount (*nisab*) of silver liable for *zakah* the Prophet Muhammad said, "And (*the nisab*) of silver is 2.5 per cent".

Thus, *tawarruq* is defined as the act of seeking or obtaining silver coins (*dirham*). Over time, people have extended the meaning of *tawarruq*, not only confined to obtaining *dirham* but include any transaction in attaining cash and liquidity. The Hanbali jurist is the only school in Islamic law who used the term *bay' al-tawarruq* in their jurisprudence texts. Al-Mardawi of the Hanbali explained the contract as follows:

If one needs cash, he then purchased something valued at 100 for 150, it was acceptable. It had been validated by Imam Abu Hanifah and his disciples. The problem was called *bay' al-tawarruq* (Mardawi, 1998).

Meanwhile, the other Sunni jurists of Hanafi, Maliki and Shafi'i did not use the term *tawarruq* but explained the contract as one of the sub-topics of *bay' al-inah*. For them, *bay al-tawarruq* is one of the forms of *bay al-inah* transaction. The main purpose of conducting either *bay' al-tawarruq* or *bay' al-inah* is to facilitate cash needed by a person (Al-Haniti, 2012). A classical form of *bay' al-tawarruq* is illustrated in Diagram 1 below:



Source: author's

Diagram 1. Classical form of *bay' al-tawarruq*

The execution of *bay' al-tawarruq* normally involves three-party; (1) *muwarriq*- creditor who supplies commodity in credit, (2) *mustawriq* – a person who in need of cash and (3) buyer who purchase the commodity from *mustawriq* in an open market. As pointed out in diagram 1 above, first the *mustawriq* will purchase a commodity from *muwarriq* in credit, for instance at RM500. He promises to pay the price in a month time. Then, the *mustawriq* will sell the commodity to another buyer in cash. Usually, the selling price in cash is lower, for instance, RM400 than the purchased price in credit. By selling the commodity to another buyer, the *muwarriq* will get the cash needed. However, bear in mind that he still indebted to *mustawriq* for buying the commodity in the first transaction.

It is important to note that, the classical form of *bay' al-tawarruq* requires that the tripartite transactions are conducted in an open market. This means, when *mustawriq* purchases commodity from *muwarriq*, he will bear a certain degree of risk in finding potential buyers in an open market. The cash needed will be only obtained by the *mustawriq* if there is a buyer for the purchased commodity. To mitigate the risk, the *mustawriq* might study the condition of the market i.e. by trading the hot demand items. On this visualization in mind, *bay' al-tawarruq* contract supports financing initiatives with the real sector of the economy. The trading activities take place particularly between the *mustawriq* and the buyer. We shall see in the following discussion that the pre-arranged transactions have become subject of criticism concerning the current application of *bay' al-tawarruq* in Islamic banking institutions.

However, at this juncture, we shall note that the contemporary Muslim jurists have a similar understanding of the classical form of *bay' al-tawarruq*. The International Islamic Fiqh Academy in its 19th meeting in 2009 defined the *bay' al-tawarruq* as:

The purchase of an asset which is possessed and owned by the seller with deferred payment and sells it back to other than a seller with cash for liquidity purposes (International Islamic Fiqh Academy, 2009).

Based on the definitions, the classical and contemporary Muslim jurists are in the agreement that the main purpose of conducting *bay' al-tawarruq* is to obtain cash and financial liquidity. The contract is conducted by purchasing an asset on credit and sells it back to the third party in cash at a lower price.

3. The classical jurists' views on *bay' al-tawarruq*

The classical jurists were in disagreement concerning the legality of *bay' al-tawarruq*. According to the majority of jurists including Abu Hanifah, Abu Yusuf, al-Shafi'i dan Ahmad Ibn Hanbal in one of his narration, the *bay' al-tawarruq* is permissible (Wahbah Zuhaily, 2003). It is important to note that because of the terminology used, the permissibility of *bay al-tawarruq* per se could only be found in the Hanbali legal texts. Meanwhile, the other schools of Islamic law do not rule on *bay al-tawarruq* in specific. Since the discussion of *bay' al-tawarruq* is not found in the Hanafis, Malikis and Shafi'is *fiqh* texts, Al-Abidi (2008) concludes that his approval is based on the non-existence of prohibited rulings. In other words, since the jurists never issue rulings against the *bay' al-tawarruq*, therefore the contract is rendered permissible by them. The second view of *bay' al-tawarruq* maintains that the contract is discouraged (*makruh*). This view is held by Umar Abdul Aziz, al-Shaibani and Ahmad ibn Hanbal in one of his narration. On the other hand, Ibn Taimiyyah and Ibn Qayyim believe that *bay' al-tawarruq* is unlawful (Bouheraroua, 2009).

Those who support the legality of *bay al-tawarruq* rely on the generality of the verse of 2:275, '*Allah has permitted trade (bay') and prohibited riba'* to support their justification (see Zuhaily 2003, Bouheraroua, 2009, al-Abidi, 2008). According to the jurists, since *al-tawarruq* is one of the forms of trade (*bay'*) transaction, the contract is deemed permissible. The second legal evidence used to support the legality of

the *bay' al-tawarruq* is a hadith narrated by Abu Said al-Khudri and Abu Hurairah. It is reported that the Prophet Muhammad (pbuh) hired a man in Khaibar and he brought a good quality of date (*janib*) to the Prophet and his Companions. The Prophet asked, 'Do you obtain the date of Khaibar like that?' The man replied, 'We exchange one *sa's* (of *janib*) with two *sa's* (of lower quality of dates) and two *sa's* (of *janib*) with three *sa's* (of lower quality of dates). Then the Prophet said, 'Don't do that. Sell the lower quality of date for dirhams and buy the good dates (*janib*) with the dirhams' (Muslim, 1985).

In supporting the *bay' al-tawarruq*, the jurists assert that the above *hadith* illustrates a clear example of acceptable *hilah* (legal artifice) to allow the usurious transaction. Exchanging unequal weigh of dates will lead to *riba al-fadl* (*riba* in a sale) but trading them with currency is considered a *hilah* to obtain a similar result. Viewing *bay' al-tawarruq* as an acceptable practice of *hilah*, the contract is therefore permitted. However, the conflicting jurists argue that the above hadith is used out of its context of revelation. In the hadith, the Prophet did not teach Muslims a *hilah* but demonstrate a more equitable way of doing a commercial transaction. The hadith shows that the use of currency as a medium of exchange is preferred over barter transactions because it could help reduce the possibility of an unfair exchange.

The third legal evidence is based on the rationale of the individual's need to *bay' al-tawarruq* contract. It is generally acknowledged that the need for cash is apparent for some individuals for valid reasons i.e. maintenance of life, health, education, marriage and transportation. In a normal circumstance, it will be hard for individuals to find someone who can always lend money on a charity basis (*qard hasan*). Therefore, the *bay' al-tawarruq* could be the most available option for him to obtain the cash needed. Furthermore, the tripartite transactions of *bay' al-tawarruq* are conducted following the essentials (*arkan*) and the conditions (*shurut*) of the sale contract. The intention of the parties involved is treated as a secondary matter (al-Abidi, 2008).

The literature on *bay' al-tawarruq* did not mention about the legal evidence of the second group of jurists who rule the contract as discouraged (*makruh*). However, one can be safely assumed that the discouraged rule was issued based on the individual's need to *bay' al-tawarruq*. Although *bay' al-tawarruq* resembles *hilah* of *riba*, the pressing need of the contract is also recognized in certain circumstances. Hence, applying the legal maxim of choosing lesser harm between the two evils (*akhhaf al-dharayn*), the rule of *makruh* is seen as the exit (*makhraj*) to solve the problem. However, it is important to note that the rule of *makruh* means *bay' al-tawarruq* can only be applied in the limited situation in which a person has no other option to obtain the cash needed.

Ibn Taymiyyah and his disciple, Ibn Qayyim reject the application of *bay' al-tawarruq* mainly because of the *hilah* issue. Since the application of *bay' al-tawarruq* possibly leads to *riba*, they view that the contract should be avoided based on *sad dhari'ah* (blocking the means). They do not differentiate between *bay' al-tawarruq* and *bay' al-inah* (Ibn Qayyim, 1973). According to them, both contracts bring similar consequence to lending money with interest. As such, the *athar* of Aishah which becomes the evidence to rule out *bay' al-inah* is also used to support the prohibition of *bay' al-tawarruq* (Zuhaily, 2003).

4. Modern jurists debate on *bay' al-tawarruq*

The first discussion on the issue of *bay' al-tawarruq* was held in Mecca in 1998 organized by the Islamic Fiqh Council under the Muslim World League (Al-Abidi, 2008). During the meeting, a resolution was issued as followed:

Indeed the *bay' al-tawarruq* is permissible, as said by the majority of ulema, because the original rule of the sales contract is permissible based on verse 2:275, 'Allah has

permitted trade and prohibited *riba*'. There is no indication that the sale (*bay' al-tawarruq*) is *riba* in terms of its intention and its form. Yet, there is a need for the contract such as to repay debt, marriage and others.

The permissibility of the contract comes with a condition that the buyer does not sell the commodity less than the purchased price back to the first seller directly or through an agent. If he does that, then *bay' al-inah* transaction will take place and it is prohibited because it involves *hilah* of *riba* (Islamic Fiqh Council, 1998).

The resolution received overwhelming attention from practitioners in the Islamic banking industry. As approval from one of the highest Muslim authority is obtained, the *bay' al-tawarruq* is adopted widely in designing financial instruments. The contract is used not only to facilitate the supply of cash to customers but also to guarantee a pre-determined rate of return to their terms depositors. *Bay' al-tawarruq* becomes the main contract in creating Islamic personal financing, fixed-rate deposit product and money market instruments, particularly in the Middle East. However, the way *bay' al-tawarruq* is applied by Islamic financial institutions has raised considerable criticism from *Shari'ah* scholars. In the light of the current practice of *bay' al-tawarruq*, the Islamic Fiqh Council re-visited their previous resolution in 2003. It has appeared that the *bay' al-tawarruq* which is implemented in most of the Islamic financial institutions is called organized *tawarruq* (*tawarruq munazzam*). The following resolution is issued regarding the organized *tawarruq*:

The Islamic Fiqh Council in its 17th meeting which was held in Mecca on 13-17 December 2003 had examined the practice of *bay' al-tawarruq* in some of the Islamic banks. After listening to the research on the topic, and the discussion followed the Academy observes that *bay' al-tawarruq* in Islamic banks is conducted when a bank sells an asset to client (*mustawriq*) on deferred payment with condition that the bank will be appointed as client's agent to sell the asset to another buyer on cash basis and delivers the money to the client. The Academy views that the described *bay' al-tawarruq* is impermissible (Islamic Fiqh Council, 2003).

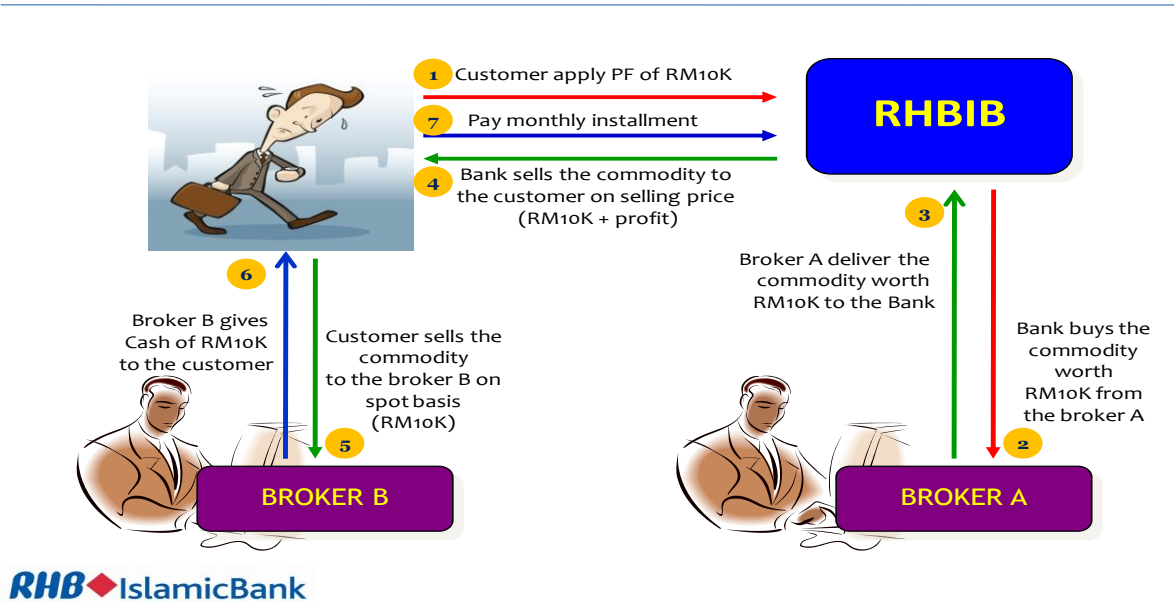
According to the Islamic Fiqh Council, the organised *tawarruq* as implemented in Islamic banks is not congruence with the classical *bay' al-tawarruq* approved by the majority of jurists. By appointing the bank as the client's agent who will sell the underlying asset to the third party and disburses the cash to the client, the organized *tawarruq* seems no different from *bay' al-inah* contract. In addition to that, the condition of receipt (*qabd*) is often neglected in the course of the transaction. It is found that in many instances the underlying asset is sold to the third party before *qabd* is confirmed by the client. The *Shari'ah* scholars of the Islamic Fiqh Council also concern with the debt created through the organized *tawarruq* transactions (Al-Qari, 2003). Unlike the classical *bay' al-tawarruq* which promoted trading of a commodity in the real sector of the economy, the organised *tawarruq* is merely a financing tool to increase debt in the society. Under the current structure of organised *tawarruq*, the underlying asset will eventually be returned to the bank to be used repeatedly to create debt to other clients.

In the following discussion, we will examine how *bay' al-tawarruq* is adopted by RHB Islamic bank in Malaysia. As mentioned earlier, the introduction of *bay' al-tawarruq* is relatively new in the country as compared to its practice in the Middle East. However, the advancement made by the Malaysian authority concerning the application of *bay' al-tawarruq* is significant. The Malaysian government establishes *Bursa Suq as-Sila'* to organise commodity trading systematically and efficiently. However, as the discussion of *Bursa Suq as-Sila'* is beyond our scope of discussion, we will focus on two banking products namely Islamic personal financing and commodity *murabahah* deposit.

5. The application of *bay' al-tawarruq* in RHB Islamic, Malaysia

In this section, we will examine the application of *bay' al-tawarruq* in RHB Islamic bank. The bank is selected to be a case study for two main reasons. First, RHB Islamic is the first ‘Islamic window’ which has been upgraded to an Islamic bank subsidiary. By transforming into a subsidiary, the bank is granted greater autonomy by its parent bank (RHB Group) to run its own business. It is interesting to look at how the bank can capitalize on Islamic banking potential to the fullest extent. Second, RHB Islamic is unique in the sense that the bank does not adopt *bay' al-inah* contract since its establishment in 2005. *Shari’ah* committees of the bank disallowed the contract to be used in creating financial products to its customers. Alternatively, the commodity *murabahah* which is similar to *bay' al-tawarruq* is used widely in the bank. Diagram 2 below illustrates the modus operandi of Islamic personal financing product which supplies cash to individuals.

MODUS OPERANDI – BAY’ TAWARRUQ



Source: RHB Islamic Bank

Diagram 2. Modus operandi of personal financing-i

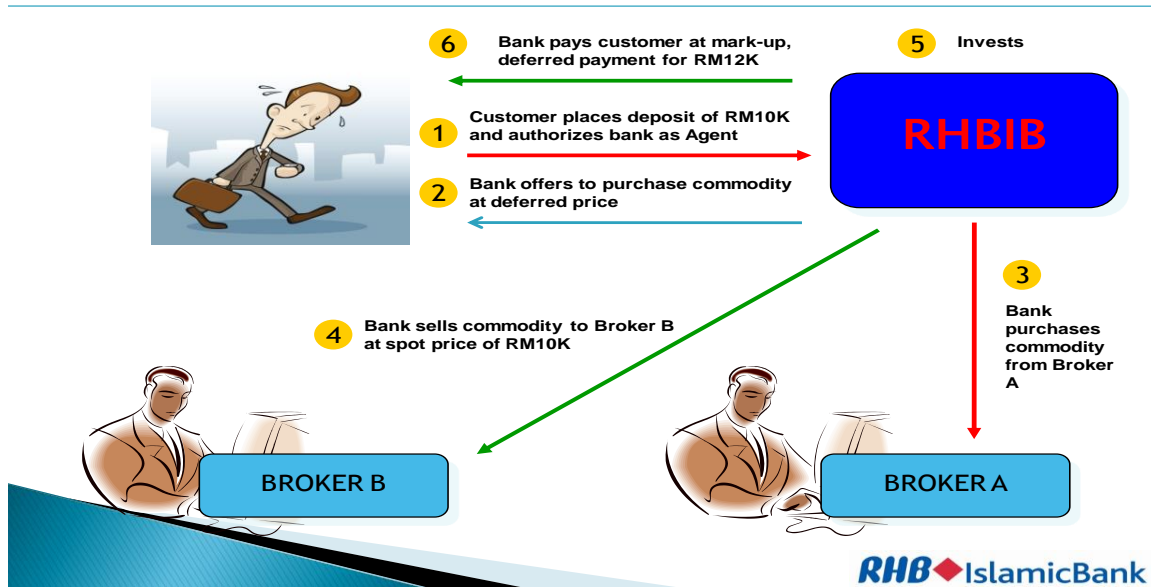
Personal financing is a short term financing facility offered to individuals for personal consumption. The product advances financing of minimum RM5,000 to a maximum of RM150,000 for a period between 2 to 7 years. When a customer applies personal financing of RM10,000 for example, the bank will purchase a commodity worth the same amount from broker A. Then, the broker will deliver the commodity to the bank. Next, the bank sells the commodity to the customer on selling price which consists of RM10,000 of cost and profit. The sale between the bank and the customer is agreed on deferred payment. After that, the customer will sell the commodity to broker B on a spot basis. By selling the commodity to broker B, the customer shall receive cash needed. Meanwhile, the bank makes a profit from the sale of commodity and shall receive instalments from the customer within the agreed period.

Commodity Murabahah Deposit

While personal financing product supplies cash for customers, commodity *murabahah* product brings in

funds to the bank. Since its inception, the product has increased the deposit tremendously in RHB Islamic bank. The key feature of the product is the pre-determined rate of return guaranteed by the bank which could be paid either upfront or periodically or upon maturity. The minimum deposit is RM5000 for the period between 3-60 months. The longer the tenure the higher rate of return will be offered. Diagram 3 below illustrates the process flow of the commodity *murabahah* deposit.

CM DEPOSIT – i PROCESS FLOW



Source: RHB Islamic Bank

Diagram 3. Modus operandi of commodity *murabahah* deposit-i

Suppose a customer chooses to place a deposit of RM10,000 in commodity *murabahah* product. Besides depositing money, the customer will be required to authorise the RHB Islamic bank as his agent. The agency appointment is essential to facilitate the buying and selling of commodity which forms the basis of fixed and guaranteed profit of this product. Acting on behalf of the customer, the bank will then purchases a commodity from broker A. Legally as the owner of the commodity the customer has absolute right over it. However, since the customer does not want to keep the commodity, he then sells the commodity back to the bank on a deferred payment basis. Let say, the deferred payment agreed is RM12,000, which comprises of RM10,000 of cost and RM2000 of profit. Next, the bank will sell the commodity to broker B at a spot price of RM10,000. The bank sells the commodity to broker B because it too does not want to keep the commodity but wants cash. The cash received from the selling of commodity will be used by the bank for investment purpose. On the maturity date, the bank will pay the deferred payment to the customer. As mentioned earlier, in RHB Islamic the customer is allowed to take his profit upfront. However, the principal has to be kept with the bank until the maturity date.

It should be noted that the brokers play an integral part in both personal financing and commodity *murabahah* deposit products. A question arises then; what is the incentive that makes the brokers engage in the *tawarruq* transactions? In the case of personal financing; what make broker B willing to purchases the commodity from a customer? Similarly in commodity *murabahah* deposit; what make broker B agreeable to purchase the commodity from the bank?

The answer is organised *tawarruq*. The commodity which becomes the underlying asset in *bay al-tawarruq* is traded in the closed market organised by the bank. The brokers are from the same group of companies although they are not connected technically. Both brokers A and B will square each other position in the selling and buying of the commodity. Money credited to broker A will be transferred to broker B to be disbursed either to customer (in personal financing) or bank (in commodity *murabahah* deposit) products (Aminuddin, 2010). This is the crux of criticism raised by the scholars of International Islamic Fiqh Academy on the organised *tawarruq*. Although it can be proved that the receipt (*qabd*) is taken place and the tripartite transactions are done in the correct sequence but the fundamental argument remains unresolved. Trading of the commodity in an organised *tawarruq* does not connect with the real economy but a *hilah* for debt creation.

6. Bay' al-tawarruq and maqasid (objectives) of Islamic finance

Nejatullah Siddiqi one of the eminent scholars in Islamic economics launched a resolute objection concerning the application of *bay' al-tawarruq* in Islamic financial institutions. According to him, the harms (*mafsadah*) of the contract are much greater than the benefits (*maslahah*), thus the contract should not be recognised as *Shari'ah* compliant (Siddiqi, 2007). His main argument is that *bay' al-tawarruq* promotes debt creation in the economy which does not increase the net wealth of society rather redistribute it in favour of creditors (IFIs) involved. A similar view is shared by Abbas Mirakhor who criticizes the weak relationship between the Islamic financial sector and the real economy as a result of concentration on short term, highly liquid and low-risk instruments. He urges the industry to re-think its current configuration and strive to serve the risk-sharing characteristic envisioned by the pioneers of Islamic finance (Mirakhor, 2010). According to both of them, the organised *tawarruq* practised by Islamic banks is not significantly different from the *bay' al-inah* based products. Islamic financial instruments created through the application of both contracts do not generate economic substance as desired by the pioneers of *the riba-free* economy.

However, *Shari'ah* scholars who are advising Islamic financial institutions maintain with their view that the adoption of *bay' al-tawarruq* in creating financial products complies with *Shari'ah* principles. Furthermore, they assert that the compliance with *Shari'ah* means that the products are in congruence with *maqasid* of *Shari'ah* (Bakar, 2016). Despite the criticism, the contract of *bay' al-tawarruq* is considered as the most practical option for Islamic bankers to come out with alternatives for interest-free based financial products. In other words, given the prevailing banking regulatory requirements and settings, *bay' al-tawarruq* contract is the best available solution in fulfilling the financial needs of Muslim customers. It is also argued that by creating Islamic financial products contribute to the real economic sector. For instance, Muslim customers will participate in the housing and building construction when home or property financing that is *Shari'ah-compliant* made available to them.

Hence, based on these two different perspectives or the way things were analysed, debate on whether the adoption of *bay' al-tawarruq* meets the objectives of *Shari'ah* will likely to continue. With the absence of a workable alternative to replacing *bay' al-tawarruq* contract in satisfying Muslims' financial needs in avoiding interest (*riba*), academia and industry practitioners will remain in constructive engagement.

7. Conclusion

The article examines the issue of *bay' al-tawarruq* in the Islamic finance industry. The contract is introduced in Malaysia due to criticism raised by the Middle East *Shari'ah* scholars on *bay' al-inah* contract which is predominantly used in the country. To comprehend a solid understanding of the *bay' al-tawarruq*, the classical jurists' definitions and rulings related to the contract were rigorously studied. Then, resolutions issued by the Islamic Fiqh Council were analysed to grasp modern jurists' view about

the contract. It is found that the organised *tawarruq* practised by most Islamic banks including RHB Islamic of Malaysia to be insignificantly different from the *bay' al-inah* contract. Both products create debt instruments. This leads to criticism especially among Muslim economists who view that the adoption *bay' al-tawarruq* does not support the achievement of *maqasid* of Shari'ah. However, for Islamic finance practitioners, the contract is the best available solution in providing interest-free products under the current banking settings.

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