

THE REAL TAWARRUQ CONCEPT

The Product of Islamic Bank for Liquidity Risk Management

By: M. Iman Sastra Mihajat,

Master Student in Finance at International Islamic University Malaysia

Researcher of Islamic Economic Forum for Indonesian Development (ISEFID)

Email: isastra83@gmail.com / sas_inggris@yahoo.com

Phone: (+60) 17 2542253

Safri Haliding

Lecturer of Economic, Universitas Muhammadiyah Makassar-Indonesia

safri@live.com.my

TABLE OF CONTENT

ABSTRACT	3
1. INTRODUCTION	4
2. DEFINITION AND FORMS OF TAWARRUQ	
2.1 DEFINITION OF TAWARRUQ	
2.1.1 LITERAL MEANING OF TAWARRUQ	5
2.1.2 TECHNICAL MEANING OF TAWARRUQ	5
2.2 FORMS OF TAWARRUQ	6
2.3 MODUS OPERANDI OF TAWARRUQ	7
3. THE SIMILARITIES AND DIFFERENCES BETWEEN TAWARRUQ AND INAH	9
4. TAWARRUQ FOR LIQUIDITY RISK MANAGEMENT	11
4.1 TAWARRUQ FOR INTER-BANK MONEY MARKET	11
4.2 TAWARRUQ FOR LIQUIDITY ABSORPTION	13
4.3 TAWARRUQ FOR LIQUIDITY INJECTION	14
5. APPLICATION OF REAL TAWARRUQ CONCEPT: STUDY CASE OF BURSA SUQ AL-SILA' MALAYSIA	15
5.1 BURSA SUQ AL-SILA' STRUCTURE	13
6. CONCLUSION	21
REFERENCE	22

THE REAL TAWARRUQ CONCEPT

The Product of Islamic Bank for Liquidity Risk Management

By: M. Iman Sastra Mihajat,¹

Safri Haliding²

ABSTRACT

Islamic banking product has gained popularity since the last two decades and stole the attention all banking and finance sector industry around the world due to its uniqueness compare to conventional bank and trusted as a solution for the current crisis. However the issue of liquidity risk management is very sensitive in the banking system to satisfy the need of asset and liability. Since Islamic bank is free interest-based system which cannot use conventional product as their liquidity risk management where Islamic bank trusted as one of institutions that become solution for crisis, we need Islamic product that can overcome this issue. One of *'aqd* that we can offer is *tawarruq* concept whereby the Islamic bank A for instance needs liquidity to satisfy the demand of depositors, he can borrows from Islamic bank B who has surplus in liquidity by using *tawarruq* concept. The main objective of this paper is to introduce the real *tawarruq* concept for Islamic bank to manage its liquidity which also can be used for conventional banks if they want to offer Islamic windows. In this paper I will provide the structure how the real *tawarruq* can be work in banking system and how it is compared to organized *tawarruq*.

Keywords: Tawarruw, *BBA*, *Bay al-'Inah*, Scholars view, Liquidity risk management, Bursa *Suq al-Sila'*.

¹ Researcher of ISEFID (Islamic Economic for Indonesian Development).

² Lecturer of University Muhammadiyah Makassar Indonesia.

1. INTRODUCTION

Tawarruq is the most popular product in Islamic banking and finance sector especially in GCC countries which is disputed among the Muslims' scholars. The idea of *tawarruq* came from the classical view of jurists that want to assist the development of Islamic economic, banking and finance and replacing the old concept which is clearly prohibited in Islam. Islam has always coming up with an alternative product and contract to replace the position of the *haram* transactions that will lead into the serious economic problem to the society. Such as, Allah has prohibited *riba* and at the other hand, Allah allowed sale as long as the terms and conditions of sale are followed by counterparty.

However, the ideal concept brought by classical scholars about the contracts has already contaminated by the current banking and finance sector who try to get advantages from the classical concept without following the original structure that mentioned by the classical jurists. At the other hand, we face many issues to implement the real Islamic finance in banking sector which loaded by non-Muslim's players whose their mind-set is originated by capitalism point of view.

In this coming discussion will discuss how Islamic banking product play its role in the real economic whereby there is real transfer of ownership between counterparty compare to conventional product that only play money with money and consider money as commodity. Where in Islam it is not allowed, Islam consider money as a medium of exchange and money cannot be exchanged with money unless has same value. However, to raise value of money we have to change money with commodity and sell it to another party so that we can take advantage differentiation of price between purchase and sale.

Since the concept of *tawarruq* is widely used and accepted by middle east country (GCC), Bank Negara Malaysia (BNM) has revised the concept of *tawarruq* by introducing new concept of using *tawarruq*, the concept introduced by them is '*Bursa Suq Al-Sila*' . This concept organizes between the counterparty how to manage liquidity between the banks and will further discuss in this paper.

Therefore, the objectives of this paper are; first, to provide the definition and forms of *tawarruq*, second, to discuss the differences between *tawarruq* and *bay al-'inah*, third, to provide

the real *Tawarruq* concept for Liquidity risk management, fourth, to provide liquidity risk management structure for Islamic bank and discuss the scheme of Bursa Suq Al-Sila' that basically implementation of real *tawarruq* concept has been implemented by Bursa Malaysia.

2. DEFINITION AND FORMS OF *TAWARRUQ*

2.1. Definition of *Tawarruq*

2.1.1. Literal Meaning of *Tawarruq*

The term *Tawarruq* is derived from the word *al-warq* or *al-waraq*, which means minted dirham or any silver that issued to serve as a medium of exchange, in this concept; it is designated to someone who has an abundance of silver coins. In another term *tawarruq* comes from “*masdar*” the verb *taqarruqa* is said *Tawarruq al-hywan* which it means the animal at the leaves (Bouheraoua, 2009). The term of basically *tawarruq* comes from the word *wariq* (Khayat, 2006) as it mentions in surah Al-Kahfi: 9

“*So send one of you with this silvery coin of yours to the town.*”

Which it means *Dirhams* made of silver. However, there are two different accents in the Arabic language (*wariq-warq*). Furthermore, *Tawarruq* and the verb derived from *al-warraq* are not directly traceable in the Arabic language; linguists mention only variable nouns, as an *al-Iraq* (which applied to become rich) and *al-istiraq* (which applied to a man who is seeking Dirham or money). So the scholars invent the term of *tawarruq* for the one who may be pressure himself on how to obtain “*al-wariq*” or cash money.

2.1.2. Technical Meaning of *Tawarruq*

Tawarruq technically is the purchasing of a commodity on credit by the *mutawarriq* (seeker of cash) and selling it to a person other than the initial seller (3rd party) for a lower price on cash (Dusuki, 2008). Actually, *tawarruq* is a sale contract, whereby a buyer buys an asset from a seller on deferred payment and subsequently sells the assets to the third party for cash, with a price lesser than the deferred price. This transaction is called *tawarruq*, mainly because when the buyer purchases the asset on deferred terms, it is not the buyer's intention to utilize the benefit from the purchased asset, rather to facilitate him to attain liquidity (*waraqh maliah*).

According to Malikis, *tawarruq* means selling something on deferred basis and then buying it back in cash, albeit at a lower price than the deferred price. For example, someone sells his commodity at a price that is already known to be paid by the deferred payment. He then buys it at a lesser price than the deferred price. It is known because of obtaining the money for *sahib al-inah*. This is because *al-ain* is the present property from the money. This is one of the practices of the Hanafis (Khayat, 2006).

According to the Shafi'is, *tawarruq* means selling something on deferred payment, and then buy it back in cash, albeit at a lower price than the deferred price. Furthermore, the Hanbalis said in *kitab Syarh Muntaha Al-Iradat*, known as *Daqaiq Awla An-Nahyu Li syarhi Al-Muntaha* that *bai' al-'inah* by the name of *tawarruq* is the need for cash, buying the equivalent of thousands and more to expand its price and there is nothing wrong with that and it is known as *tawarruq*. In *Muntaha Al-Iradat Fi Jam'i Al-Muqni' Ma'a At-Tanqih Wa ziadat*, "If someone bought something on credit or he did not pay the price, it then becomes forbidden and the sale is invalid to its buyer by cash purchase less than the first price, and it is a tool to the second, except change its feature and it is known as the problem of *'inah*, because the commodity of the buyer in deferred is taken instead of it.

2.2. Forms of *Tawarruq*

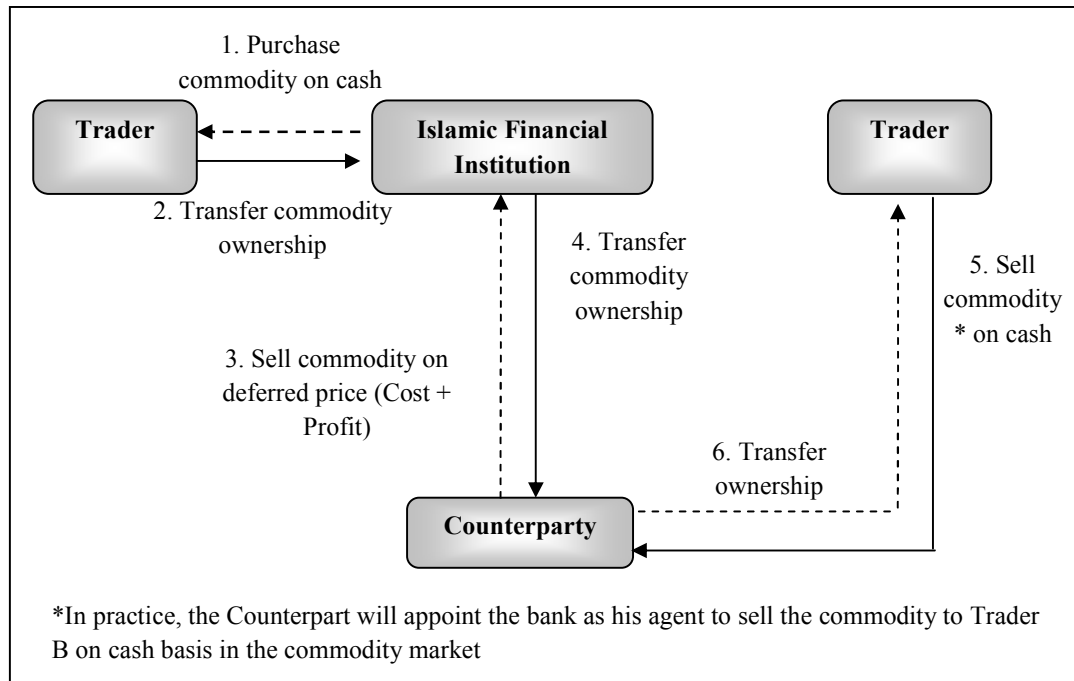
Basically the term of *tawarruq* we can divide into two (Bouheraoua, 2009). The first is classical *tawarruq* (*Al-Tawarruq at-Fardi*) and the second is organized *tawarruq* (*Al-Tawarruq al-Munazzam*). Classical *tawarruq* is defined as the purchase of a commodity possessed owned by the seller for a delayed payment, whereupon the buyer resell the commodity for cash to other than the original seller in order to acquire cash (*al-wariq*).

The contemporary definition on organized *tawarruq* is the transaction that a person (*mustauriq*) buys commodity from local or international market at a deferred price (Fahmy et.al, 2008). Simultaneously, he (*mustauriq*) will ask the financier in his own capacity or through his agent or by special agreement with *mustauriq* to rearrange the sale transaction usually at a lower spot price.

2.3. Modus Operandi of *Tawarruq*

Modus operandi of classical *tawarruq* is shown as following picture:

Figure 1: Classical *Tawarruq*



Source: Fahmy et.all (2008)

The modus operandi of classical *tawarruq* is:

1. The Islamic Financial Institution (IFI) purchases commodity from Trader A in the commodity market on cash basis;
2. Ownership of the identified commodity will then be transferred to IFI;
3. Thereafter, the IFI sells the commodity to the Counterparty (e.g. other Islamic financial institutions, or client) on deferred price, i.e. cost price plus profit margin);
4. The ownership of the commodity will be transferred to the Counterparty;
5. The Counterparty will then sell the commodity to Trader B on cash basis in the commodity market;
6. Finally, the ownership of the identified commodity will be transferred to Trader B.

The point in this structure is that there is real transfer ownership between counterparty and the counterparty has fully right of the commodity. Another important thing that must be underlined is that in the classical *tawarruq* structure, each transaction shall be independence.

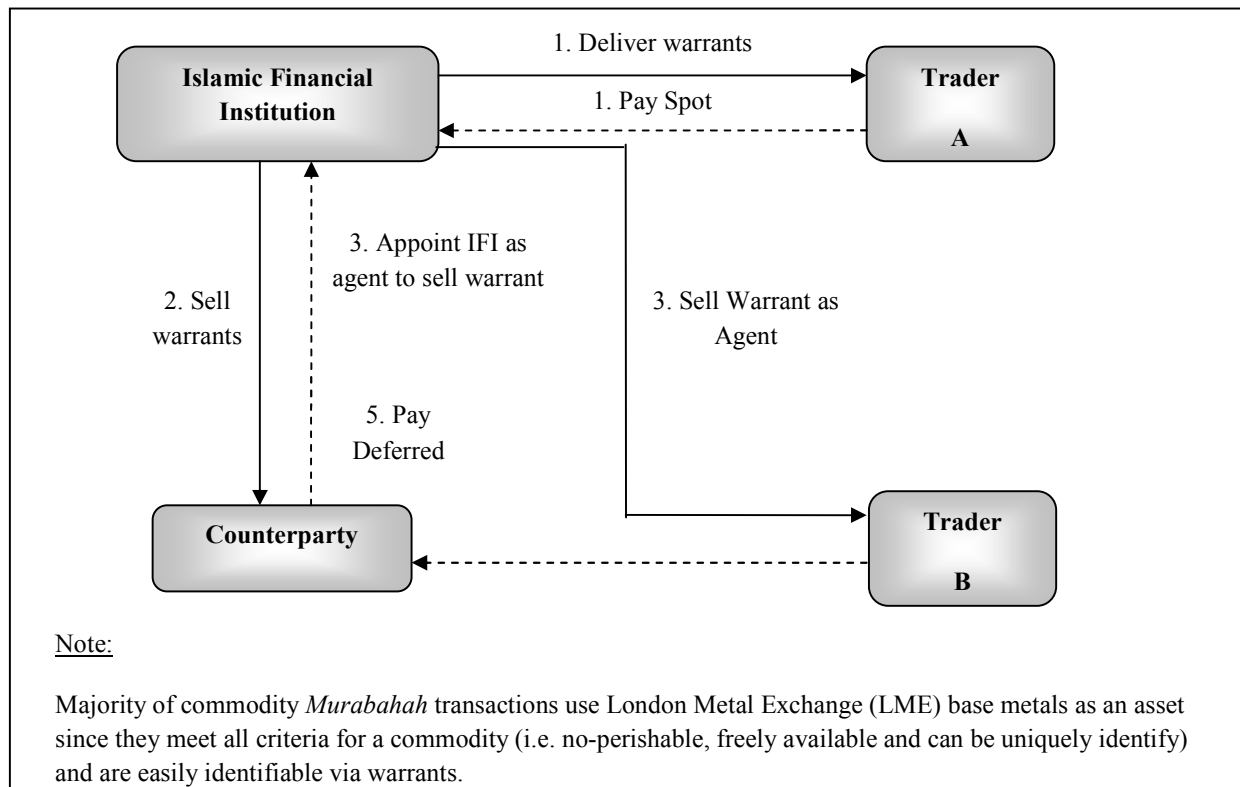
Nevertheless, in practice, to achieve cost effectiveness, IFI will be appointed as an agent to sell the commodity to third party on behalf of the Counterparty; that is called organized *tawarruq*.

The organized *tawarruq* is usually practiced on the commodity *murabahah* which is the most commonly used in liquidity management instrument by IFI. This is because IFI can get a fix return from this instrument. Furthermore, following figure illustrates how organized *tawarruq* works in the case of commodity *Murabahah* when an IFI provides funds to its counterparty to earn profit.

The description of organized *tawarruq* is as following steps:

1. IFI purchases warrants from Trader A and pay spot.
2. IFI will then sell the warrants to the Counterparty. The Counterparty accepts the offer from the IFI to purchase warrants on a deferred payment basis, where the mark-up and the repayment date are pre-agreed.
3. The Counterparty appoints IFI as an agent to sell warrants on its behalf. The IFI now acts as an agent to sell the warrants at spot to another Trader B. Alternatively; the Counterparty could sell the warrants in the open market.
4. Payment made to the Counterparty; ownership of warrants transfer to the end buyer. In most of the case, whether the Counterparty requests the IFI to sell the warrants on its behalf or arrange to sell to third party by itself, the Counterparty will be paid the spot counter value of the warrants.
5. Deferred payment will be made by the Counterparty to the IFI. This payment takes place at a pre-agreed time in the future and consists of the principal of the original purchase plus a pre-agreed mark-up (Fahmy et.all, 2008).

Figure 2: Organized Tawarruq



Source: Fahmy et.all (2008)

The net result of the above movements of warrants and cash is that the counterparty now holds an amount of money against an offsetting payment to the IFI for a pre-agreed principal plus a mark-up at a pre-agreed future date, thus creating a synthetic deposit.

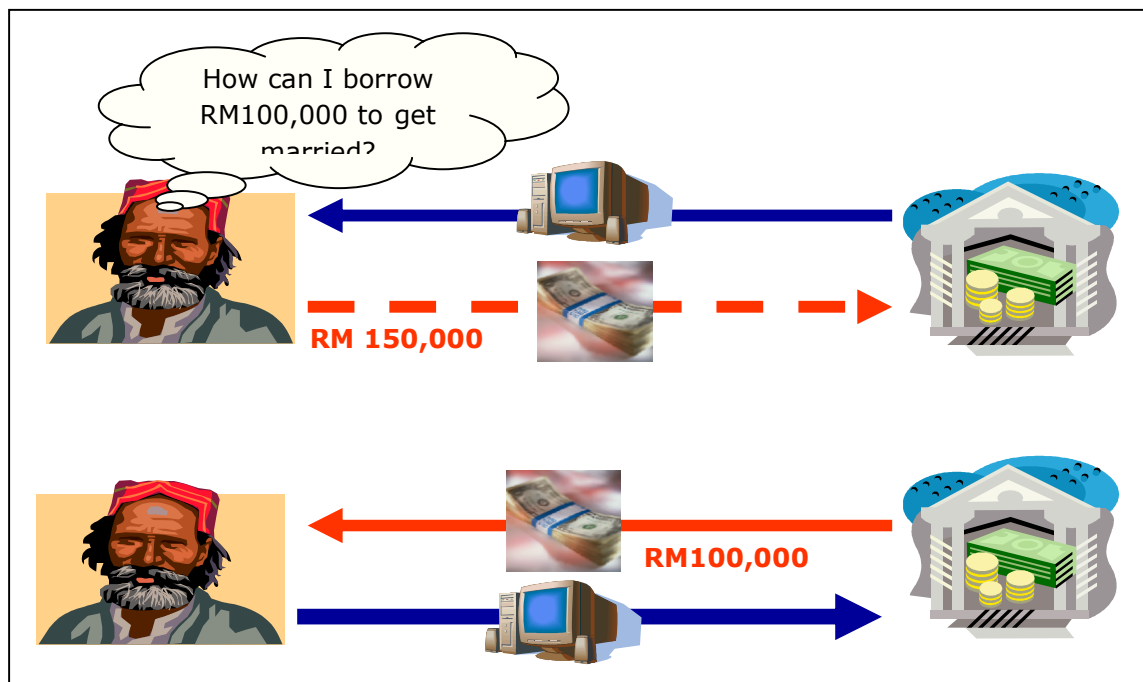
From the description, the *tawarruq* process seems to be very simple. However, extra intention should be taken while undertaking such transaction, and it should be ensured that the transaction does not become a mere exchange of papers between two brokers, and one or two financial institutions. IFI needs to understand that *tawarruq* arrangement should be used in extreme cases where no option is available to avoid interest. Widespread use of this *tawarruq* is harmful to the industry in the long run. Therefore, Shariah Board needs to strictly monitor all *tawarruq* based transaction which includes the commodity *Murabahah*.

3. THE SIMILARITIES BETWEEN *TAWARRUQ* and *BAY AL-'INAH*

Basically, *Tawarruq* and *'Inah* has the same objective whereby the counterparty intent to acquire cash money for his need, for me it is both concept are the same either only involve two parties or

four parties or might be more. Generally, the modus operandi of *'inah* in the current banking system is as following picture:

Figure 3: Modus Operandi of *'Inah*



Source: Dusuki (2008)

From the figure describes that *tawarruq* and *'inah* are congruent in terms of the purpose behind them, which is to acquire cash. In addition, they are also congruent in that they result in the payment of a greater amount of immediate cash in consideration of the delay (Bouheraoua, 2009).

However, *tawarruq* and *'inah* differ in terms of the return of the commodity sold. The requester of *'inah* will return the commodity back to the seller, whereas the *mutawarriq* in the individual form of *tawarruq* will sell the commodity to a new buyer other than the first buyer with neither the arrangement nor the knowledge of the first seller. However, in organized *tawarruq* he arranges with the first seller to sell it to a third party or return it to its first seller.

4. TAWARRUQ FOR LIQUIDITY RISK MANAGEMENT

Liquidity risk is the potential loss to banks arising from their inability either to meet their obligation or to fund increases in asset as the fall due without incurring unacceptable costs or losses (Dusuki, 2010). Where the bank will incur systemic risk at this moment either bank runs or financial instability.

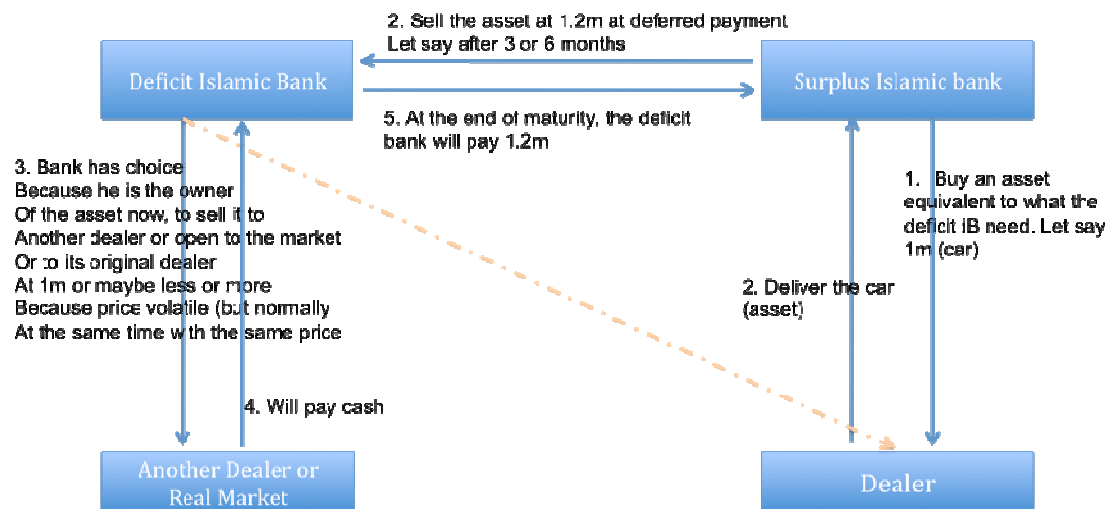
Liquidity risk management is play important role in banking sector. Since the bank play with other people's money, managing the liquidity to satisfy the demand of asset and liability is the key of survive of the bank and ensure that the bank always has liquidity to pay the depositors' money. Otherwise, the depositors will rush to the bank to take their money back namely bank run. If let say one bank collapse it will lead other banks will collapse (systemic risk) as happened in Asian crisis 1997-1998. Therefore, the role of treasury department in the banking like 'heart', if they cannot manage in appropriate way, automatically the bank will collapse.

The concept of tawarruq is basically to propose Islamic bank to use this 'aqd in managing their liquidity.

4.1 Tawarruq for Inter-bank Money Market

Modus Operandi of Tawarruq for Inter-bank money market is shown as following figure:

Figure 1. Tawarruq concept for Liquidity management inter-bank money market



2. Transfer ownership

By: M. Iman Sastra M

From the figure we can describe:

1. The surplus Islamic financial institution (IFI) purchases commodity from the market on equal money that the deficit bank wants to borrow. Let say, deficit bank wants to borrow US\$ 1 million, so the surplus bank purchases an asset such land equal to US\$1 million on cash basis;
2. Ownership of the identified commodity will then be transferred to IFI;
3. Thereafter, the surplus bank sells the commodity to the deficit bank at cost price plus profit margin on deferred price.
4. The ownership of commodity will transfer to the deficit bank and it will be paid let say after 6 months or 1 year.
5. Since the ownership of commodity has already transferred, the deficit bank will sell the commodity to the market without any obligation to sell back the commodity to the broker who has relationship with the surplus bank at the market price.
6. Finally, from the last transaction deficit bank will get cash money and can use it for satisfying the needs of depositors etc.

In addition, the most important point in this structure is there is no relationship between the surplus bank and the market which will lead in to fictitious contract and will place ‘*hilah*’ that organizing *riba* with the name of Islamic name of contract. Another point in this structure is that whereby the two banks are involved in the real economic whereas transfer of commodity plus its ownership to the real buyer and seller which will create well-economic growth in the system.

4.2 Tawarruq for Liquidity Absorption

The concept of tawarruq can be used also by the central bank to manage the distribution of money in the country. Since money supply management consider as the one of role of central bank, tawarruq concept also appropriate ‘*aqd*’ to be utilized by central bank especially in the area of Islamic financial institutions (IFI’s). Generally, the *modus operandi* of tawarruq for liquidity absorption is as following structure:

Figure 2. Tawarruq concept for Liquidity Absorption

