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CAN BURSA MALAYSIA'S SUQ AL-SILA' (COMMODITY MURABAHAH HOUSE) RESOLVE THE CONTROVERSY OVER TAWARRUQ?

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INTRODUCTION

On 30th April 2009, the International Islamic Fiqh Academy of the Organization of Islamic Conference (referred to hereafter as OIC Fiqh Academy), in its 19th Session held in Sharjah, the United Arab Emirates, declared organized *tawarruq* (also known in the market as commodity *murābahah*) to be impermissible. The decision, by the institution considered to be the most prestigious and high-ranking body of Shari'ah scholars in the Muslim world, has stirred much debate amongst industry practitioners and academics alike. On the one hand, many assert that a sudden withdrawal of *tawarruq* from the market would have a negative repercussion on the industry since many Islamic financial institutions routinely use this instrument as a means of liquidity management and to provide customers with working capital facilities. On the other hand, many scholars support the attempt to phase out *tawarruq* from Islamic finance practice since its harmful consequences far exceed the benefits generally cited by its advocates. They further argue that the extensive applications of *tawarruq* in the market today flout the vision and objectives of the Shari'ah (Maqāṣid al-Shari'ah).

Besides the diametrically opposed views just mentioned on the practice of *tawarruq*, there are some who hold that the operation of *tawarruq* needs to be rectified rather than being prohibited outright. This view is based on the fact that concern over the practice of *tawarruq* is not so much about the essence of the contract; rather, it is due to several violations in its application. Consequently, Bursa Malaysia introduced the

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Commodity Murabaḥah House (Souq al-Sila') as a platform to assist Islamic financial transactions. In particular, the Commodity Murabaḥah House offers solutions to transact *tawarruq* based on a real commodity market. This platform is claimed to provide genuine commodity transactions where possession and delivery of the commodity can take place without any hindrance, as opposed to the controversial practice of *tawarruq* using a platform like the London Metal Exchange (LME).

This paper aims at discussing the practice of *tawarruq* using Bursa Malaysia's Commodity Murābaḥah House. Specifically, the study sets out to provide answers to the following research questions:

- What are the main reasons that the OIC Fiqh Academy declared *tawarruq* to be impermissible?
- What are the common violations of Sharī'ah principles in the practice of *tawarruq* by Islamic financial institutions today?
- Can the new platform introduced by Bursa Malaysia address the many concerns raised by contemporary Sharī'ah scholars pertaining to the fictitious nature of most *tawarruq* transactions?

The analysis is based on a comprehensive review of the past literature on *tawarruq*, including all the papers presented during the OIC Fiqh Academy Conference. The remainder of the paper proceeds as follows: the next section highlights the application of commodity *murābaḥah* as one of the most celebrated instruments in the Islamic financial market. Section Three delineates the Sharī'ah rulings pertaining to *tawarruq*. Section Four expounds the OIC Fiqh Academy decision on *tawarruq*. The alternative platform offered by Bursa Malaysia is detailed in Section Five, while the final section contains concluding remarks.

APPLICATION OF *TAWARRUQ* IN MODERN FINANCIAL TRANSACTIONS

The term *tawarruq* is derived from the root word *al-wariq*, which means minted silver (*dirham*). According to Shaykh Muhammad Taqi Uthmani (2009), the word *tawarruq*

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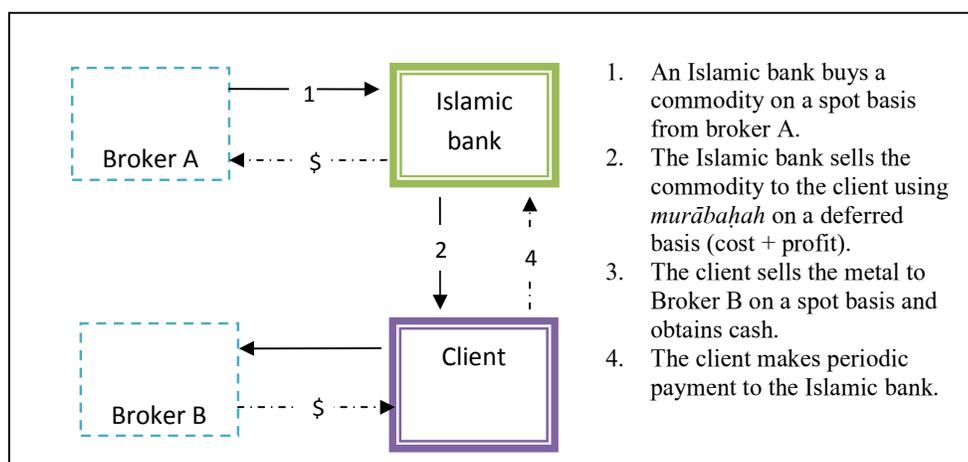
and the verbs derived from *al-wariq* are not directly traceable in the Arabic language; however, past scholars may have invented the term *tawarruq* to refer to the operation used by one who wants to acquire *al-wariq* [money] (Uthmani, 2009).

Technically, *tawarruq* involves a series of sale contracts whereby a buyer buys an asset from a seller for a deferred payment and subsequently sells the asset to a third party for cash at a price less than the deferred price, with the objective of obtaining cash.¹ This transaction is called *tawarruq* because when the buyer purchases the asset on deferred terms, he is not interested in utilizing the purchased asset or benefiting from it as a commodity; rather, he approaches it as a means to facilitate the attainment of liquidity [*waraqah māliyyah*] (M. P. S. Ahmad, 2007).

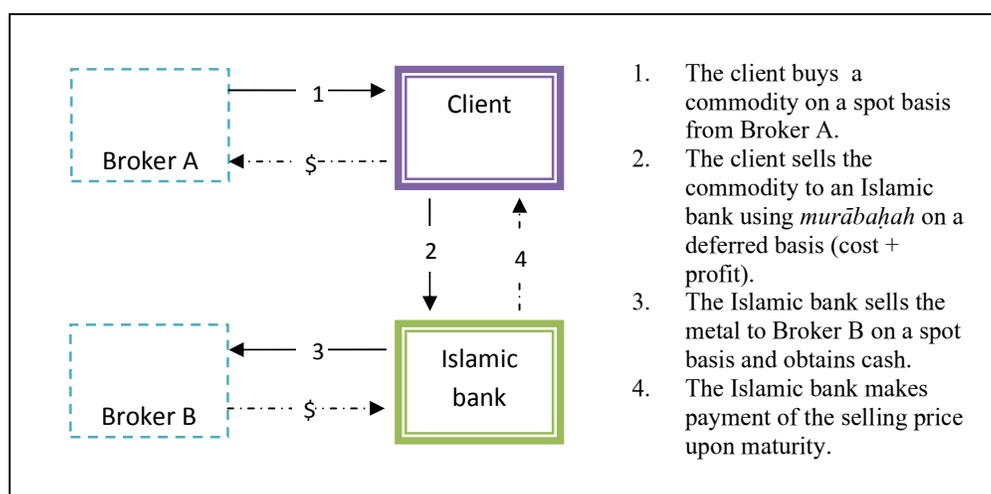
In recent years, Islamic financial institutions have widely employed *tawarruq* on both sides of their balance sheet. It has been extensively used to structure both financing and deposit instruments addressing various liquidity needs of the transacting parties. Furthermore, the concept has also been applied in structuring various risk management tools like hedging instruments. The common term used in the market today to denote *tawarruq* is 'commodity *murābahah* transaction'.

Diagram 1 below illustrates a basic structure of *tawarruq* or commodity *murābahah* used in a financing transaction. Simply put, if the client is looking for funding, the Islamic bank buys a commodity (e.g., metals on the London Metal Exchange (LME) or Crude Palm Oil (CPO) in Malaysia) and sells it to the client on a deferred basis. The client, as the owner of the commodity, now sells it to another broker in order to obtain the cash he was looking for to utilize in his operations.

¹ This definition was accepted by the OIC Fiqh Academy in their deliberation on the issue on 1st November 1998 (11 Rajab 1419 AH). See also (Wizarat al-Awqaf wa al-Shu'un al-Islamiyah, 2005).

Diagram 1: Commodity Murabahah Employed in Financing

On the other hand, when using commodity *murābahah* as a deposit mobilizing instrument, since the client has the money and is looking for avenues to place the fund and earn return, he would first buy the metal (using the bank as his agent) and then sell it to the Islamic bank on a deferred basis. Effectively, the client has made a placement that resembles a fixed-income deposit since he will now be receiving a fixed return, i.e., the mark-up charged in the selling price of the commodity. The Islamic bank would subsequently sell the commodity to another broker, get the cash and invest it elsewhere. This structure and mechanism is also known today in the Islamic financial market as reverse *tawarruq* (التَّوَرُّقُ العَكْسِيُّ). The mechanism is illustrated in Diagram 2 below.

Diagram 2: Commodity Murabahah Employed in Deposit Mobilization

In practice, the above mechanisms have been extensively used by Islamic banks in offering various financing products and deposit/investment schemes. For deposit products, as an example, Islamic banks prefer commodity *murābahah* over other commonly structured deposit products because it guarantees profit and principle, which cannot be done using a contract like *muḍārabah* (profit sharing). This is because commodity *murābahah* essentially involves a series of sales contracts in which the selling price (cost plus profit) needs to be ascertained up-front, whereas the *muḍārabah* structure does not allow any guarantee of profits or capital.

THE SHARĪ'AH RULING ON *TAWARRUQ*

Let us now turn the discussion to the Sharī'ah ruling on *tawarruq*. Interestingly, past jurists from the Mālikī and Ḥanbalī schools, who categorically disallowed and nullified *bay' al-īnah*² (a sale and buy-back transaction to obtain cash), did not actually reject *tawarruq* outright. Instead, they were inclined to allow it, mainly arguing that the presumption that the parties intended to circumvent the prohibition of *ribā* was quite remote in *tawarruq* due to its tripartite nature (El-Gamal, 2006). However, two prominent Ḥanbalī jurists, Ibn Taymiyyah and his disciple Ibn Qayyim al-Jawziyyah, departed from the Ḥanbalī School's majority approval of *tawarruq*. They disallowed *tawarruq* and dismissed it as a legal trick (*hīlah*) similar to *bay' al-īnah* (Al-Zuhayli, 1989). In the subsection to follow, the paper reviews past scholars' views on *tawarruq*.

There are generally two major classical views on *tawarruq*; namely, those who allow it and those who deem *tawarruq* a prohibited transaction.

² *Bay' al-īnah* is normally described as an arrangement whereby a person sells an asset to another for deferred payment. Subsequently, the seller buys back the asset from the buyer before the full payment of the deferred price and for cash payment of a lesser amount than the deferred price (Al-Zuhayli, 1989). Most contemporary Muslim jurists are clearly inclined towards the majority view of disallowing and nullifying *bay' al-īnah*, mainly on the basis that it is a legal device (*hīlah*) to circumvent *ribā*-based financing, which in fact opens a 'back door' to *ribā* (Ali, 2007). Those who oppose *bay' al-īnah* basically subscribe to the opinion of classical scholars such as the Ḥanafīs, Mālikīs, Ḥanbalīs and some from the Shafī'ī School who rejected *bay' al-īnah* and held that this kind of sale transaction is forbidden (Central Bank of Malaysia, 2007). This explains the global rejection of the Malaysian practice of *bay' al-īnah* in Islamic financial markets.

The Proponents' View

Among those who approve *tawarruq* and deem it permissible are the Ḥanafī School's Abū Yūsuf, the Shāfi'ī School and the Ḥanbalī School (Al-Zuhayli, 2009). Dr Wahbah Al-Zuhayli summarizes the following main justifications used by the proponents of *tawarruq*:

Qur'anic Evidence

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“Allah permits trade and prohibits *ribā*”³

According to the proponents of *tawarruq*, the word ‘trade’ (*al-bay'*) in the verse—because it is prefixed with the definite article, *al-*—indicates generality; thus, it encompasses all forms of sale transactions, including *tawarruq*. This interpretation is further supported by the legal maxim:

الْأَصْلُ فِي الْأَقْوَالِ وَالْأَفْعَالِ وَالْعُقُودِ وَالشُّرُوطِ الْإِبَاحَةُ .

“The starting assumption for all statements, actions, contracts and conditions is permissibility.”

However, Dr Wahbah al-Zuhaily disputes the appropriateness of applying this legal maxim since the maxim is suitable when there is no evidence from the Qur'an or the Sunnah that forbids a transaction. However, in the case of *'inah* and *tawarruq*, there are specific and explicit evidences from the Sunnah that prohibit them (Al-Zuhayli, 2009).

³ Sūrah al-Baqarah; 2:257.

Evidence from the Sunnah

The proponents of *tawarruq* also substantiate their arguments by quoting the following *ḥadīth*:

أَنَّ رَسُولَ اللَّهِ إِسْتَعْمَلَ رَجُلًا عَلَى خَيْبَرَ ، فَجَاءَهُمْ بِتَمَرٍ جَنِيْبٍ . فَقَالَ : أَكُلُ تَمَرٍ خَيْبَرَ هَكَذَا؟
قَالَ : إِنَّا لَنَأْخُذُ الصَّاعَ مِنْ هَذَا بِالصَّاعَيْنِ ، وَالصَّاعَيْنِ بِالثَّلَاثَةِ . فَقَالَ : لَا تَفْعَلْ ؛ بَعْ أَلْجَمْعَ
بِالدَّرَاهِمِ ، ثُمَّ ائْتِعْ بِالدَّرَاهِمِ جَنِيْبًا .

The Prophet (peace be upon him) appointed a man as governor of Khaybar, who [later] presented him with an excellent type of dates (*janīb*). The Prophet asked, “Are all the dates of Khaybar like this?” He replied, “[No, but] we barter one *ṣāʿ*⁴ of this (excellent type) for two *ṣāʿ* of ours, or two *ṣāʿ* of it for three of ours.” Allah’s Apostle said, “Do not do that (as it is a kind of usury); rather, sell the mixed dates (of inferior quality) for money, and then buy the excellent dates with that money.”⁵

The proponents argued that this *ḥadīth* is different from the *ḥadīth* that prohibits *ʿinah*. Obviously, the transaction recommended by the Prophet (peace be upon him), involved two separate contracts. However the second sale was not transacted with the first seller and, therefore, the intention was not to commit usury.

Legal Maxims

In rationalizing the permissibility of *tawarruq*, the proponents also use the following legal maxim to further support their arguments:

الأَصْلُ فِي الْمَعَامَلَاتِ الْإِبَاحَةُ

“The original ruling for *muʿāmalah* transactions is permissibility.”

⁴ A *ṣāʿ* is equal to about 2.75 liters. Al-Zuhaily, *al-Fiqh al-Islami wa Adillatuh*, 1:142.
⁵ *Ṣaḥīḥ al-Bukhārī*, *ḥadīth* no. 2089.

However, according to Dr Wahbah al-Zuhaily, this maxim is only applicable when there is no clear evidence from the Qur'an or the Sunnah prohibiting a transaction. Another maxim provides a variant of the same theme.

الأصل في الأشياء النافعة الإباحة، وفي الأشياء الضارة المنع

“The original ruling for useful things is permissibility, while the original ruling for harmful things is prohibition.”

The application of this maxim would involve looking into the issue of whether *tawarruq* is deemed useful, or is it a harmful tool for circumventing the prohibition of *ribā* (Al-Zuhayli, 2009)?

Rational Proof

Tawarruq is also rationally justified in that it satisfies people's needs and achieves their interests as well as objectives of the Sharī'ah, particularly removing difficulty. This is particularly true when many people today are facing liquidity problems. In order to overcome them without indulging in prohibited usury, *tawarruq* may serve the purpose.

The Opponents' View

Notwithstanding the various justifications used by the proponents of *tawarruq*, some scholars rejected this view and disputed the abovementioned arguments. The scholars who dismissed *tawarruq* and deemed it impermissible include the Mālikī School, 'Umar ibn 'Abd al-'Azīz, scholars from the Ḥanafī School like Muḥammad ibn al-Ḥasan al-Shaybānī and later generations of the Ḥanbalī School, namely two prominent scholars, Ibn Taymiyyah and his disciple Ibn Qayyim al-Jawziyyah. The following summarizes the opponents' arguments in dismissing *tawarruq*.

The Sunnah of the Prophet (Peace Be upon Him)

Ibn 'Umar reported:

أَنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ: إِذَا ضَنَّ النَّاسُ بِالذَّبْنِ وَالذَّرَاهِمِ، وَتَبَايَعُوا بِالْعَيْنَةِ، وَاتَّبَعُوا أَذْنَابَ الْبَقْرِ،
وَتَرَكُوا الْجِهَادَ فِي سَبِيلِ اللَّهِ، أَنْزَلَ اللَّهُ بِهِمْ بَلَاءً، فَلَا يَرْفَعُهُ حَتَّى يُرَاجِعُوا دِينَهُمْ.

The Prophet (peace be upon him) said, “If people hoard gold (*dīnārs*) and silver (*dirhams*), deal with *‘inah*, focus on agriculture, and leave jihad, Allah shall send an ordeal upon them, and He will not remove it until they return to their religion.”⁶

Traditions of the Companions

The most famous narration on the subject from a Companion is the following tradition from 'Ā'ishah, which was collected by al-Dāraquṭnī:

قَالَتْ أُمُّ وَلَدِ زَيْدِ بْنِ أَرْقَمٍ لِعَائِشَةَ: "إِنِّي بَعْتُ مِنْ زَيْدٍ غُلَامًا إِلَى الْعَطَاءِ بِثَمَانِمِائَةٍ، وَابْتَعْتُهُ بِسِتِّمِائَةٍ
نَفْدًا فَقَالَتْ لَهَا عَائِشَةُ: بِنَسِّ مَا شَرَيْتِ وَبِنَسِّ مَا اشْتَرَيْتِ! أَخْبِرِي زَيْدًا أَنَّهُ قَدْ أَبْطَلَ جِهَادَهُ مَعَ
رَسُولِ اللَّهِ، إِلَّا أَنْ يَتُوبَ، قَالَتْ: يَا أُمَّ الْمُؤْمِنِينَ، أَرَأَيْتِ إِنْ لَمْ آخُذْ إِلَّا رَأْسَ مَالِي، فَقَرَأَتْ
عَائِشَةُ: (فَمَنْ جَاءَهُ مَوْعِظَةٌ مِنْ رَبِّهِ فَانْتَهَى فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ) [سورة البقرة: 275]

The *umm walad*⁷ of Zayd bin Arqam said to 'Ā'ishah, “I bought from Zayd a slave for 800 on deferred payment, and then I sold him [to Zayd] for 600 in cash.” 'Ā'ishah said to her: “What a detestable sale and purchase you have made! Tell Zayd that he has spoiled his jihad with the Messenger of

⁶ Narrated by Aḥmad, Abū Dāwūd, al-Ṭabarānī and Ibn al-Qaṭṭān, who all ratified the *ḥadīth* as authentic. Ibn Ḥajar in his book *Bulūgh al-Marām* further reiterated that the men who narrated the *ḥadīth* are trustworthy. Refer to (Al-Zuhayli, 2009).

⁷ *Umm walad* was a term used for a slave woman who bore her master a child. 'Umar bin al-Khaṭṭāb prohibited their sale. *Muṣannaḥ 'Abdul-Razzāq*, 7:287, no. 13210.

Allah, unless he repents.” Zayd’s *umm walad* then said, “O Mother of the Believers, what if I just take my capital?” ‘Ā’ishah replied to her by reciting the Qur’anic verse: “Whoever receives an admonition from his Lord and stops (indulging in *ribā*) shall not be punished for the past; his case is for Allah (to judge)” (Sūrah al-Baqarah: 275).

The Similarity of Tawarruq to the Prohibited Forced Sale
(Bay‘ al-Muḍṭar or Talji’ah)

Talji’ah or *bay‘ al-muḍṭar* is one form of prohibited sale due to its exploitative nature; a person is forced to enter into the sale due to circumstances that have left him with no other option; for example, when a person is forced to sell his house due to his fear of the ruler.⁸ This type of sale is prohibited. Moreover the Ḥanafī School deems the contract as voidable. This is based on the following *ḥadīth*:

نَهَى رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عَنْ بَيْعِ الْمُضْطَرِّ، وَعَنْ بَيْعِ الْغَرْرِ، وَبَيْعِ الثَّمَرِ قَبْلَ أَنْ يُطْعَمَ

“The Prophet (peace be upon him) prohibited forced sales, sales with uncertainty, and the sale of fruits before they ripen.”⁹

Ibn al-Qayyim associates the forced sale (بَيْعُ الْمُضْطَرِّ) with both *‘īnah* and *tawarruq*. According to him,

‘īnah is usually transacted by someone who is forced to seek liquidity, but the counterparty is not willing to provide the liquidity through a loan facility. Instead, the counterparty sells a commodity at a profit to the person in need of the liquidity. If he returns the commodity to the seller, it is known as *‘īnah*; if he sells the commodity to a third person, it is called *tawarruq*; and if he returns the commodity to someone who is involved in the transaction between the forced person and the first seller, then in this case, the person is known to be a culprit in permitting *ribā* (*muḥallil al-ribā*).¹⁰

⁸ Al-Daarul Mukhtar wa Raddu al-Muhtar: 255/4

⁹ Narrated by Imam Ahmad. According to Dr Wahbah Al-Zuhaili, the *ḥadīth* on forced sale is deemed by Al-Khatibi in his Muallim al-Sunnan as weak since the chain contains an unknown man. That is why Shafī’is and Hambalis Schools allow the sale. Nevertheless the majority of jurists rule that the sale is abominable (makruh). Refer to (Al-Zuhayli, 2009).

¹⁰ Ibn al-Qayyim, *I’lām al-Muwaqqi’īn*, 3:182; refer also to Ibn Taymiyyah, *Majmū‘ al-Fatāwā*, 29:446.

In all three of these cases, Ibn Qayyim asserts that the parties were actually involved in *ribā*, except that *tawarruq* is deemed to be a lesser evil than *īnah* (Al-Zuhayli, 2009).

A Ḥīlah (Stratagem) to Ribā

The jurists who disallow *tawarruq* also charge that it is a legal stratagem (*ḥīlah*) to circumvent *ribā*-based transactions; as such, it opens a 'back door' to *ribā*. Imām al-Shāṭibī, in defining legal stratagems, said: "It is generally held that their true nature is to present a deed that is apparently lawful, in order to circumvent a Sharī'ah ruling and transform it on the surface to a different ruling" (Al-Shatibi, 2006).¹¹

The Qur'an vividly recorded how some Jews in the past used a legal stratagem to break their covenant by fishing on the prohibited day. The following verses of the Holy Qur'an refer to the incident:

"وَلَقَدْ عَلِمْتُمُ الَّذِينَ اعْتَدَوْا مِنْكُمْ فِي السَّبْتِ فَقُلْنَا لَهُمْ كُونُوا قِرَدَةً خَاسِئِينَ"

"You well know about those of you who transgressed in the matter of the Sabbath: We said to them, 'Be apes, despised and rejected'" (2:65).

"وَأَسْأَلُهُمْ عَنِ الْقَرْيَةِ الَّتِي كَانَتْ حَاصِرَةَ الْبَحْرِ إِذْ يَعْدُونَ فِي السَّبْتِ إِذْ تَأْتِيهِمْ حِثَائِهِمْ يَوْمَ سَبْتِهِمْ
شُرْعًا وَيَوْمَ لَا يَسْبِتُونَ لَا تَأْتِيهِمْ كَذَلِكَ نَبْلُوهُمْ بِمَا كَانُوا يَفْسُقُونَ"

"Ask them about the town by the sea; how its people broke the Sabbath when their fish surfaced for them only on that day, but on the day they had no Sabbath they came not—We tested them in this way because they were given to disobedience" (7:163).

The above story clearly indicates that *ḥīlah* was a repugnant act intended to circumvent what had been prohibited to the Jews. Therefore, the majority of scholars are against the use of *ḥīlah* to circumvent Sharī'ah prohibitions (Al-Suwaylim, 2009;

¹¹ Refer to al-Shāṭibī, A. I. (2006). *Al-Muwāfaqāt fī Uṣūl al-Sharī'ah*, ed. by 'Abd Allāh Darrāz (vol. 4). Cairo: Dār-al-Ḥadīth, p. 287.

Ibn Qayyim Al-Jawzy, 1973). Among the prominent scholars who argued that *tawarruq* is a form of prohibited *hīlah* were Ibn al-Qayyim, and his teacher, Shaykh al-Islam Ibn Taymiyyah. Ibn Taymiyyah pointed out:

وَالْمَفَاسِدُ الَّتِي لِأَجْلِهَا حَرَّمَ اللَّهُ الرِّبَا مَوْجُودَةٌ فِي هَذِهِ الْمُعَامَلَاتِ مَعَ زِيَادَةِ مَكْرٍ وَخِدَاعٍ وَتَعَبٍ
وَعَذَابٍ ، فَإِنَّهُمْ يُكَلِّفُونَ مِنَ الرُّؤْيَةِ وَالصَّفَةِ وَالْقَبْضِ وَغَيْرِ ذَلِكَ مِنْ أُمُورٍ يَحْتَاجُ إِلَيْهَا فِي الْبَيْعِ
الْمَقْصُودِ وَهَذَا الْبَيْعُ لَيْسَ مَقْصُودًا لَهُمْ ، وَإِنَّمَا الْمَقْصُودُ أَخْذُ دَرَاهِمٍ بِدَرَاهِمٍ ، فَيَطُولُ عَلَيْهِمْ
الطَّرِيقُ الَّتِي يُؤْمَرُونَ بِهَا ، فَيَخْصُلُ لَهُمُ الرِّبَا ، فَهُمْ مِنْ أَهْلِ الرِّبَا الْمُعَذِّبِينَ فِي الدُّنْيَا قَبْلَ الْآخِرَةِ

The harm due to which Allah prohibited *ribā* is present in these transactions (i.e., *‘inah tawarruq*, and the like) with the added [ingredients] of cheating, deception, [extra] effort and pain....[That is] because their objective is not to effect the sale; rather, to exchange money for money. Essentially, they take a longer route to achieve their objectives, eventually falling into *ribā*; thus, making them people of *ribā* who shall be tormented in this world before they are tormented in the hereafter.¹²

Embodiment of Risk and Harm

The wide usage of *tawarruq* increases the proliferation of debt and embodies many risks and harmful effects. This is particularly true as the *mustawriq* (the person who wants liquidity) buys a commodity on deferment, paying a higher price than when he actually sells to a third party for cash (A. R. Y. Ahmad, 2009; Al-Suwaylim, 2009). Apparently, overemphasizing debt-based instruments in the economy would not help to remove injustice, harm, inequity and inefficiency, the removal of which is enshrined among the objectives of the Shari‘ah. It is an established fact that mere debt creation and proliferation via various debt-based instruments accentuates inequality, as it redistributes wealth in favour of suppliers of finance, irrespective of actual productivity of the finance supplied (Mirakhor, 1995; Siddiqi, 2004). Moreover, a monetary system based merely on debt creation and speculative finance based on debt

¹² Majmu‘ al-Fatawa: 445/29

creates *fasād* (harm) that results in inequity in the distribution of income and wealth and contributes to greater instability in the economy (Siddiqi, 2007).

It is important to note that debt as an individual transaction is not illegal from a Sharī'ah point of view.¹³ However, when viewed from a macro perspective on the role of debt in modern-day transactions, it is apparent that it can cause harm to the entire society, so a different ruling is called for. It has been an accepted principle in Islamic jurisprudence that priority is given to public interest (*maṣlaḥah 'āmmah*) over individual interests (*maṣlaḥah khāṣṣah*). Therefore, the benefits of debt-based instruments (such as *tawarruq*) must be overruled in certain circumstances, given the huge public benefits of not proliferating debt.

THE DEBATE OVER *TAWARRUQ*

The issue of *tawarruq* has also been addressed by contemporary jurists. The prominent International Islamic Fiqh Academy of the Organization of Islamic Conference (OIC Fiqh Academy) issued three rulings on the matter. The first opinion was issued in the 15th session of the Academy in September 1998 (Rajab 1419H), whereby they permitted the contract, subject to the condition that the customer not sell the commodity to its original seller, in order to avoid direct evidence of *'imah* as a legal trick to circumvent the prohibition of *ribā*.

However, in its 17th session, held in December 2003, the OIC Fiqh Academy clarified its stand on *tawarruq* by distinguishing between two types: *tawarruq fiqhī*, also known as *tawarruq ḥaqīqī* (real *tawarruq*), and *tawarruq munazzam* or *tawarruq maṣrafi* (organized *tawarruq*). While the former is allowed, the latter form, which is

¹³ Although debt is legitimate from Sharī'ah view point, it is considered undesirable and hence should be avoided, for fear one may not be able to repay his debt. The Prophet (peace be upon him) always cautioned about the negative repercussion of debt. He was even reported to have declined praying over a dead man who was still indebted. In an authentic *ḥadīth* on the issue, Salamah ibn al-Akwa' reported that a deceased man was brought to the Prophet (peace be upon him), who asked, 'Is there any debt on him?' The companions replied, 'Yes.' The Prophet asked, 'Has he left anything (behind to repay the debt)?' The companions replied, 'No.' The Prophet (peace be upon him) told them, 'Pray on your companion.' Abū Qatādah volunteered, 'Messenger of Allah, (the debt) is on me.' Then only did the Prophet (peace be upon him) pray on the deceased. (Refer to al-Bayhaqī, *Ma'rifat al-Sunan*, vol. 10, p. 96.)

widely practiced by Islamic banks today, is deemed to be as synthetic and fictitious as *bay' al-ṭinah* and, hence, disallowed.

The decision was further reiterated in its 19th session, held in Sharjah, United Arab Emirates in April 2009, in which the Academy banned the application of organized *tawarruq* because simultaneous transactions occur between the financier and the *mustawriq*, whether it is done explicitly or implicitly or based on common practice, in exchange for a financial obligation. This transaction is considered a deception, i.e. a dubious transaction in order to get additional quick cash from the contract. Hence, the transaction is deemed to contain the element of *ribā*. In the resolution, the OIC Fiqh Academy also made a clear recommendation that Islamic banking and financial institutions should avoid the instrument as it deviates from the true objectives of the Sharī'ah. It is believed that adoption of such a dubious instrument will cause the Muslim world to face serious challenges and economic imbalances that will never end.¹⁴

Violations of Sharī'ah Principles

The OIC Fiqh Academy's decision was prompted by many criticisms of the manner in which organized *tawarruq* is being structured and transacted in modern Islamic financial transactions. The structure is widely criticized by scholars for lacking sufficient credibility as a true trade. The objections are directed at the modern practice of *tawarruq*, rather than the essence of the contract, due to several violations in its application, which has departed drastically from the form of *tawarruq* approved by classical jurists (A. R. Y. Ahmad, 2009; Al-Suwaylim, 2009; Al-Zuhayli, 2009; Bouheraoua, 2009; Uthmani, 2009). The following summarizes the various violations of Sharī'ah principles in the practice of modern *tawarruq* as highlighted by contemporary scholars who denounce organized *tawarruq*.

¹⁴ Refer to Resolution No.179 (19/5) OIC Islamic Fiqh Academy, available at www.isra.my.

4.1.1 Issues Pertaining to Commodities (السلع)

One of the most important pillars of a sale contract is that the subject matter must meet all the specifications and conditions of good commodities. Good commodities are valuable because they have legitimate uses. In other words, a sale will be deemed invalid if the object of the sale is something which has no value or is used for an illegitimate purpose (Al-Zuhayli, 1989). However, it was observed that many commodities used in the practice of modern organized *tawarruq* are spoiled commodities. For example, Shaykh 'Alī al-Qara Dāghī revealed that he encountered one *tawarruq* transaction using the international commodity market in which the underlying commodity used was actually 'junk', defective aluminum from Russia that had been in storage for more than 10 years. In fact, the broker used that commodity precisely because it could not be sold (Al-Quradaghi, 2008).

Some scholars also raised concerns about the lack of proper monitoring of the practice by certain segments in the market that could lead to the redundancy of commodities being transacted (Abu-Ghuddah, 2008). There is no assurance that the same commodities would not be sold to more than one buyer. This inevitably raises Sharī'ah issues about the extent of genuineness of the contract. These issues pertaining to fictitious commodities are among the main reasons why organized *tawarruq* is deemed a fictitious sale and, thus, disallowed by most scholars.

4.1.2 Issues Pertaining to Possession and Delivery (القبض والتسليم)

Another fundamental condition of a sale contract is that the *maḥal al-'aqd*¹⁵ (object of the sale) must exist and be owned by the seller at the time of the contract. This is important because the purpose of a sale contract (مُقْتَضَى الْعَقْدِ) is to transfer ownership of the object of the sale to the buyer and ownership of the price to the seller. If this condition is not fulfilled, the sale contract is deemed to be an invalid sale (*bay' fāsīd*). Jurists since early times have discussed at great length the issue of *qabd* for purchase

¹⁵ Also known as the *ma'qūd 'alaih* in Arabic.

and sale contracts in particular as well as other contracts in general. According to the majority of jurists, it is necessary that the goods be accepted by the buyer's hand or, at least, for the seller to grant the buyer access to the goods without restriction (**التَّمَكُّينُ** (**والتَّخْلِيَةُ**).

However, the current practice of commodity *murābahah* raises doubts whether possession and delivery ever take place. The issue of non-delivery becomes more apparent in certain applications, especially when a legal document embedded with clauses indicates that there shall be no intention by the buyer to take delivery. In some cases, the buyer is restricted from taking any delivery, either explicitly or implicitly, by a standard operating procedure as practiced in the market. This is particularly true in the case of a 'netting arrangement', which has become a standard practice in the market. The following BOX 1 illustrates the netting arrangement in the typical *tawarruq* transaction using the London Metal Exchange (LME) platform.

BOX 1: Illustration of Commodity Murabahah London Metal Exchange (LME) Standard Transaction

10.00 a.m., 10th September 2009:

Seller 1 books 4 tons of aluminum for a deferred sale @ US\$2,500 per ton to the customer, for a US\$10,000 sale. This is done by properly demarcating the 4 tons of metal in Seller 1's warehouse to denote the customer's constructive possession, until Seller-1's netting arrangement is finalized. Demarcation can either be done in two ways: First, simple labelling; say, using a yellow sticker with the customer's details on the relevant metal consignment to confirm customer's ownership of that metal. Second, demarcation can also be done through a robust electronic system. Thus, every transaction involves labelling (either physically by warehouse staff, or electronically) the exact stock of sold metal in every case and subsequently de-labelling it when netting takes place.

10.30 a.m., 10th September 2009:

Customer takes constructive possession (never sees the metal, and may, at the most, simply receive a certificate, usually indicating his consignment is placed in some named warehouse) and then sells the same aluminum to Buyer 1 for, say, US\$8,000, spot price.

11.00 a.m., 10th September 2009:

According to the netting facility, 4 tons of aluminum is netted off between the storage facilities of Seller 1 and Buyer 1, respectively, through some direct or indirect method, without the metal needing to be physically moved at all.

Source: (Khan, 2009)

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The above example clearly illustrates the existence of prior agreement or collusion between the two parties, Seller 1 and Buyer 1, for such deals. Effectively, the transacted commodity (metal) returns back to the original seller as per the netting arrangement; so the metal has never actually moved. Furthermore, according to Khan (2009), what typically happens is a daily and periodic netting, in which, rather than specifically identifying and subsequently 'releasing' the metal for each transaction, all the transactions for a certain day are carried out without such specific demarcation, and hence, even this minimal transfer of constructive ownership does not really happen in most cases. Instead, daily net positions dictate the overall stock balances; that is, how much is encumbered and how much is free to be used for new *tawarruq* transactions (Khan, 2009). This inevitably renders sale transactions in the *tawarruq* structure invalid.

4.1.3 Issues Pertaining to Bay' al-Īnah

The Accounting and Auditing Organization for Islamic Finance Institutions (AAOIFI) in its Sharī'ah Standard No. 30, Article 4/5 states that:

The commodity (object of *tawarruq*) must be sold to a party other than the one from whom it was purchased on a deferred-payment basis (a third party) so as to avoid *īnah*, which is strictly prohibited. Moreover, the commodity should not return back to the seller by virtue of prior agreement or collusion between the two parties, or according to custom (AAOIFI, 2008).

This standard implies that *tawarruq* cannot be fictitiously transacted with the cosmetic involvement of a third party. It should be real; that is, the metal or whatever commodity being traded should genuinely move from seller to buyer. If there is any 'trick' or collusion involved, then the transaction would be deemed as a *ḥīlah* (trick) to circumvent the prohibited *ribā*, which resembles the characteristics of *īnah*. Based on the illustration described in Box 1 above, it is clear that such collusion exists whereby the transacting parties operate a netting facility between their different storage facilities. Thus, in reality, the commodity rarely gets physically transferred from seller to buyer as it should under the requirements of the Sharī'ah.

4.1.4 Issues Pertaining to Agency (التوكيل)

In its guideline on *tawarruq* transactions, AAOIFI, in Article 4/7 to 4/10, further stresses the following requirement:

1. The bank or its agent should not sell the commodity on the customer's behalf if the customer initially bought that commodity from the bank; neither should the bank arrange a proxy third party to sell this commodity.
2. Instead, the client should sell the commodity either himself or through his own agent. At the most, the bank should provide the client the information needed to sell the commodity.

The above standards are squarely in conflict with the current practice of organized *tawarruq*. In modern banking organized *tawarruq*, the customers will not buy the commodity themselves. A customer in need of cash (*mustawriq*) will authorize the agent, who is the bank, to buy it from the market on the customer's behalf. Then the *mustawriq* will buy it from the bank at a delayed price. He will later sell it to a third party. The customary practice adopted in many banks is that the bank will not pay the price to the original seller, but rather, to the *mustawriq*, as he is an agent for them in buying and selling the commodity. In other words, the bank plays its classical role as financial intermediary, arranging the deferred payment purchase of the commodity from an exchange on behalf of the *mustawriq*. Then, by a condition either stipulated in the contract or known by custom, the bank proceeds to act as the *mustawriq's* agent to sell the commodity to another person for cash.

The addition of this *tawkil* (agency) to the *tawarruq* contract, authorizing a party to buy the commodity on behalf of another and then make arrangements to sell the commodity to himself, renders the contract similar to the prohibited *'inah* (Al-Zuhayli, 2009). It further accentuates the issue of transferring ownership or taking possession, which is required as one of the pillars of a valid contract. Therefore, this practice again bears resemblance to the practice of *bay' al-'inah*, which is frowned upon by many as a form of legal trick (*hīlah*); as such, it does not represent the true *tawarruq* (*tawarruq haqīqī*), which was approved by the majority of classical jurists.

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Some scholars even go further to argue that the inclusion of *tawkīl* in the *tawarruq* contract makes it similar to usurious finance because the *mustawriq* will take the smaller amount from the bank, while the higher amount will be paid by him when the fixed time lapses. This issue of *tawkīl* (authorization) may make the contract agreement either *maḥzūr* (prohibited) or *makrūh* [disliked] (Uthmani, 2009).

BURSA MALAYSIA'S SUQ AL-SILA' (COMMODITY MARKET)

The preceding sections have delineated various violations of Sharī'ah principles that eventually led to the OIC Fiqh Academy's resolution that organized *tawarruq* is impermissible. It is important to note that contemporary scholars do not dismiss *tawarruq* absolutely; rather, due to several violations in its practice. If the transaction is properly executed, the Sharī'ah requirements are fulfilled and all the above mentioned violations are eliminated, *tawarruq* may be deemed permissible. This corresponds to a legal maxim:

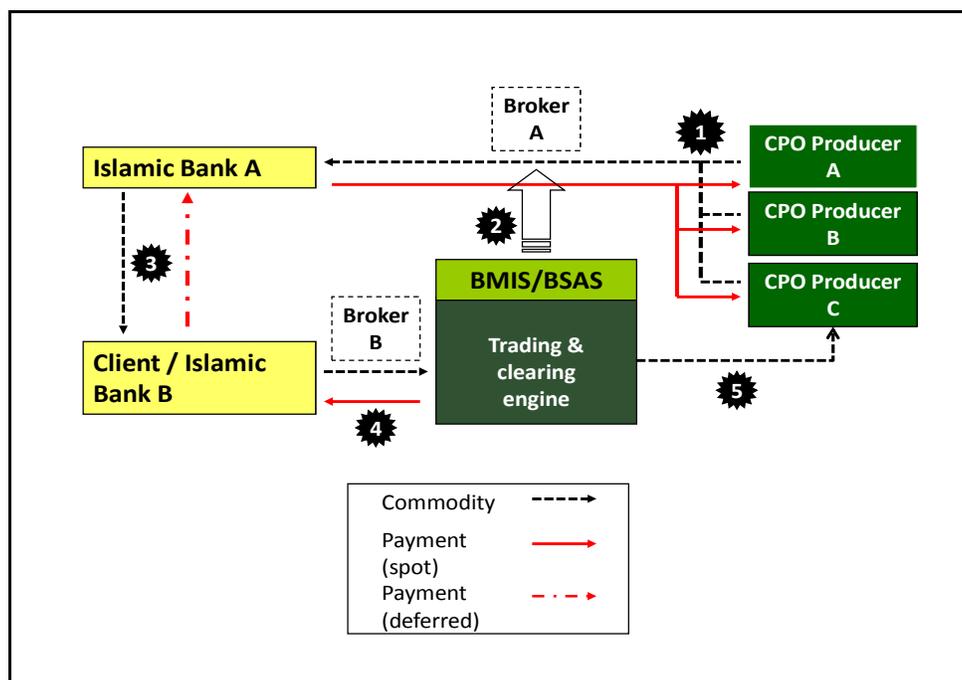
إِذَا زَالَ الْمَاعِ عَادَ الْمَمْنُوعُ

“When obstacles that impede (permissibility) are removed, then the activity which was previously forbidden becomes permissible.”¹⁶

Consequently in 2009, Bursa Malaysia introduced Bursa Malaysia Suq Al-Sila' (BSAS), a purposefully designed exchange-traded platform to facilitate *tawarruq* transactions, particularly for Islamic banks, while addressing the scholars' concerns about violations in the existing practice of organized *tawarruq* using various international commodity platforms. At the outset, BSAS will start out by trading in local crude palm oil (CPO) but move on to other Sharī'ah-approved commodities including cars, air conditioning units, oil, copper and aluminium. The process and mechanism used in the Bursa Malaysia Suq Al-Sila' (BSAS) is illustrated in Diagram 3 below:

¹⁶ See Muṣṭafā al-Zarqā: *Sharḥ al-Qawā'id al-Fiqhiyyah*, vol. 1, p. 188; Legal Maxim No. 23.

Diagram 3: Mechanism of BursaMalaysia Suq al-Sila' (BSAS)



The discussion based on Diagram 3 is depicted in Box 2 below:

BOX 2: Illustration and discussion of Bursa Suq al-Sila' (BSAS) based on Diagram 3

1. Before the market opens:
 - bids by banks and offers by CPO suppliers are lined up; orders will be randomized upon market opening.
 - When the market opens at 10.30 am, trade starts with order matching by the BSAS engine.
 - The CPO Supplier sells the commodity straight to an Islamic Bank (via Broker A).
2. Bursa Malaysia Islamic Services (BMIS) ensures the performance (delivery) of CPO suppliers, in order to avoid strict Know-Your-Customer (KYC) appraisal by Islamic banks.
 - At this stage, trade confirmation is sent to all parties.
 - Islamic Bank A pays the price by crediting the BMIS account.
3. Islamic Bank A sells the commodity to its client or another Islamic bank by a deferred *murābahah* contract.
 - Trade is reported to BSAS for change of ownership in depository.
4. Client or Islamic Bank B sells the commodity to BMIS via an agent of Islamic Bank A or directly (may use Broker B).
 - BMIS pays party B by instructing Islamic Bank A to debit its account in favor of B.
 - Commodity ownership transfers to BMIS.
5. Sale by BMIS to CPO supplier is on a random basis, and matching is based on bids by suppliers replicating the real market.
 - Once ownership is back to a supplier, all unencumbered commodities may or may not be re-offered into the BSAS market for other trades.
 - Last purchase order: 5.30 pm; market closes at 6.00 pm.

Source: Bursa Malaysia's Presentation on Bursa Malaysia Suq al-Sila' (BSAS)

Based on the above illustration, let us now discuss the issues raised concerning the practice of organized *tawarruq* as highlighted in the preceding section and relate them to the mechanism of Bursa Malaysia Suq al-Sila'.

5.1 Issues Pertaining to Commodities (السِّلْع)

To recapitulate, one of the major concerns raised by scholars pertaining to the fictitious practice of organized *tawarruq* is the issue of the commodity. As mentioned earlier, some scholars have cast doubt over the genuineness of the commodity used as the underlying asset in the existing platform for an organized *tawarruq* transaction. It is claimed that BSAS has adequately addressed this issue by having real and valuable commodities transacted on the platform. In particular, Bursa Malaysia Suq al-Sila' only allows real commodities which have value, such as crude palm oil (CPO), to be transacted on the platform. With regards to potential redundancy in the commodities used, BSAS provides a fully electronic system that will recognize and verify ownership through e-certificates. Furthermore, contract specifications will also be given to every single asset and will be made known to all parties (Mansor, 2009). Nevertheless, many industry players are still skeptical about the amount of CPO available for banks to transact, especially in the case of treasury operations, which normally involve huge volumes of transactions. To address this, Bursa Malaysia has tried to engage other commodity suppliers to be involved in the platform. This includes the latest attempt by Bursa Malaysia to trade metal and add new specifications for CPO in order to facilitate the increased volume of transactions resulting from a huge growth in local and foreign interest in commodity *murābahah* transactions (Bernama, 2010).

5.2 Issues Pertaining to Possession and Delivery (الْقَبْضُ وَالْتَسْلِيمُ)

BSAS also allows for delivery of the commodity, which eliminates another concern about the fictitious nature of organized *tawarruq*. According to the BSAS procedure of delivery, the buyer needs to indicate to BMIS directly or through a broker of this intention. Once acknowledged by BMIS, the commodity supplier will then be

notified. The delivery by the commodity supplier to the buyer will take place within seven days upon receipt of the commodity certificate endorsed by BMIS. This delivery will also incur an additional delivery processing fee. This additional charge raises a further issue, however: What is the rationale for charging such a delivery processing fee? The fee should actually be embedded in the selling price. Having two separate prices, i.e. one for those who want to take delivery and a second for a non-delivery transaction, will inevitably cast doubt on the purity of the whole sale transaction. Essentially, a sale must effect delivery. If one has no intention to effect delivery from the very beginning when structuring a product, it will be rendered a fictitious sale.

5.3 Issues Pertaining to *Bay' al-Īnah*

Another major concern raised by scholars is that the commodity must not be sold to the party from whom it was purchased. This is in line with AAOIFI's guidelines, which require the purchased commodity to be sold to a third party so as to avoid *Īnah*, which is strictly prohibited. Moreover, the commodity should not return back to the seller by virtue of prior agreement or collusion between the two parties, or according to custom. To overcome this issue, BMIS has outlined clearly that the sale to the commodity supplier is done on a random basis. The suppliers are required to bid for the best price which replicates the real market. As illustrated in Diagram 3 and explained in Box 2 above, once ownership goes back to a supplier, all unencumbered commodities may or may not be re-offered into the BSAS market for other trades. This will inevitably reduce the possibility of mirroring the prohibited *bay' al-Īnah* transaction, which has become a major concern raised by scholars in detesting the modern practice of *tawarruq*.

5.4 Issues Pertaining to Agency (التوكيل)

BSAS has no specific measure to address the issue of authorization since the issue lies largely in the hands of the platform users. Thus, a customer who needs personal financing, for instance, can go the bank that offers a *tawarruq* financing facility. The

bank will then have to purchase the CPO from a supplier on the BSAS platform and subsequently sell it to a customer for a deferred price. The customer can then appoint the bank to sell the CPO back to a supplier using the BSAS platform. In this case, the appointment of the bank as an agent to act on behalf of the customer to sell the commodity back to the market is deemed unacceptable under the AAOIFI ruling. However this arrangement is beyond the control of the BSAS, since the decision is exclusively the right of the contracting parties, whereas BSAS is merely serving as a platform to facilitate the transaction. Therefore, the issue of authorization detested by *tawarruq*'s opponents remains unresolved.

6. CONCLUSION

This paper has comprehensively reviewed the decision passed by the OIC Fiqh Academy on *tawarruq*, which is one of the main Islamic finance instruments for liquidity management and financing instruments. As evidenced in the discussion, the contemporary scholars do not dismiss *tawarruq* outright; rather, due to the many violations of Shari'ah principles in its modern application. This assertion is in fact congruent with the position of AAOIFI, which has never detested *tawarruq*. Instead, AAOIFI published its Shari'ah Standard No. 30 to outline the Shari'ah guidelines and requirements for *tawarruq*. Needless to say, even when AAOIFI permits *tawarruq*, the Islamic financial institutions are bound to follow all the strict requirements to ensure contract validity and permissibility. However, this paper has shown that the organized *tawarruq* or commodity *murābahah* transaction that is currently practiced by many Islamic financial institutions is deemed to be in violation of the *tawarruq* version approved by AAOIFI.

Consequently, Bursa Malaysia took the initiative to introduce what is known as Suq al-Sila' or Commodity Murabaḥah House as a platform to facilitate the *tawarruq* transaction. Although it is claimed that BSAS has overcome the various Shari'ah issues concerning the prevailing practice of *tawarruq* on the international market, there are still some pending issues that remain unresolved; in particular, with respect to the additional processing fees charged to parties who intend to take delivery. This

may create suspicion as to the integrity of the transaction, as it gives the impression that delivery is not encouraged in such a *tawarruq* deal. Furthermore, the unresolved authorization issue embedded in the *tawarruq* transaction on the Bursa Suq al-Sila' platform raises further Sharī'ah concerns about the *tawarruq* operation. In the final analysis, the only difference the examiner may find is in the technicalities and procedural aspects while, in essence, the substance is still replicating the organized *tawarruq* prohibited by both the OIC Fiqh Academy and AAOIFI.

After a deep deliberation on the foregoing discussion, this paper concludes that despite the criticisms and some unresolved Sharī'ah matters entangling the practice of *tawarruq*, the effort made by Bursa Malaysia to introduce a platform such as BSAS is commendable. Furthermore, since the nature of modern organized *tawarruq* may not strictly comply with Sharī'ah principles, the reasons behind using this facility should be carefully taken into consideration, especially in situations of real urgency and cases of need. However, proper control should be put in place by Islamic financial institutions when applying *tawarruq*-based instruments. As AAOIFI has made clear in its Sharī'ah Standard Number 30 Paragraph 5/1, *tawarruq* should only be resorted to as a last option when an institution faces the danger of a liquidity shortage that could harm its viability and sustainability. AAOIFI has also stressed that *tawarruq* should not be used as a mode of investment or financing with the aim to make more profits.

In a nutshell, Islamic financial institutions should strive hard for better alternatives. If Islamic financial institutions make the intention of bringing their dealings in *tawarruq* to a gradual halt, they have to demonstrate some tangible commitment and willingness to move in this direction. However, such a move necessitates a total paradigm shift that challenges the very basis of the existing financial architecture and would require strong political will to institute. Indeed, the current trend appears to be an increasing demand for such a revision, particularly in the aftermath of the recent financial turmoil. Otherwise, Islamic financial institutions will continuously appear as practitioners of mere semantics, their functions and operations essentially no different from the conventional space, except in their use of euphemisms to disguise *ribā* and circumvent other Sharī'ah prohibitions.

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