



Innovation in Islamic finance: Review of organized banking Tawarruq

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Article Info

Article History

Received : 2024-06-30

Revised : 2024-08-25

Accepted : 2024-09-09

Published : 2024-09-12

Keywords:

Commodity Murābaḥah,
Tawarruq, Organized Tawarruq,
Innovation, Islamic finance

DOI:

<https://doi.org/10.20885/RISFE.vol3.iss2.art7>

JEL Classification:

G21, G23, O31, P43, Z12

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Paper type:

Theoretical paper

Abstract

Purpose – This research aims to discuss innovation in Islamic finance and banking products by analyzing organized banking Tawarruq as a sample of innovation. Innovation in Islamic finance is to provide Shari'ah-compliant solutions for the actual needs of the industry. Studying organized banking Tawarruq was essential because it was a practical solution for cash financing as an alternative to riba-based loans. This approach helped identify the challenges and opportunities for the development of Shari'ah structures and set innovation boundaries, goals, and impacts.

Methodology – This is an analytical qualitative study. It analyzed contemporary research papers from three major markets: Indonesia, Malaysia, and the GCC. The focus was on organized Tawarruq because its innovation was for liquidity and cash purposes, which is a vital matter for financing and a challenge for Islamic banks.

Findings – The organized Tawarruq and international Commodity Murābaḥah detailed applications may vary in different regions. There have been attempts to improve these shortcomings and provide a remedy to Shari'ah non-compliance. Standardizing pragmatic filters to avoid non-Shari'ah compliance and focus on moral and ethical guidelines is necessary to preserve the growth and reputation of Islamic finance. Integrating Islamic finance and Islamic social finance can create new opportunities for socially responsible innovations.

Implications – These calls for Islamic banks to invest more in innovation. Create R&D funds to provide innovative, viable, and Shari'ah compliant liquidity solutions.

Originality – Evaluating the organized Tawarruq and commodity Murābaḥah from an innovation perspective is a unique approach to learn from existing shortcomings and avoid reproducing the same mistakes.

Cite this article:

Dewaya, M. A. (2024). Innovation in Islamic finance: A review of organized banking tawarruq. *Review of Islamic Social Finance and Entrepreneurship*, 3(2), 199-211. <https://doi.org/10.20885/RISFE.vol3.iss2.art7>.



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Introduction

Innovation to find practical solutions to customers' financing needs is a renewable demand in Islamic banking (Haron & Mohamed, 2023). Islamic banks worldwide are constantly witnessing growth. Innovation can be in the shape of technology to create easiness to fulfil modern financial needs. However, the development of Shari'ah structures to form financing products remains a major area of innovation in Islamic finance (Yusoff & Yahaya, 2020). It is important to review such innovations to understand the dynamic factors and their impacts. Tawarruq through the international commodity Murābaḥah is one such product that has always been a hot topic of discussion (Aprianto & Nazilah, 2023). Its discussion is always present among practitioners vis-à-

vis researchers in their research papers and articles. Hence, it is an important renewable energy topic (Ghazali et al, 2023). Nevertheless, what makes the argument unique in this study is that it discusses the whole matter from the innovation lens, which is a desirable goal (Mohamad & Ab Rahman, 2014).

Research has focused on analyzing the innovation of Islamic banking products and understanding the parameters of Shari'ah risks and control when structuring products by clubbing two or more Shari'ah contracts together with some supporting and guaranteeing documentation (AAOIFI Shari'ah Standard No. (25) Combination of Contracts).

This is done to meet the financing requirements of Islamic banking products. In this context, research questions are related to the innovation aspects in the structure of the financing product, its validity, and examination of the possibility of becoming null and void due to the violation of Shari'ah principles. Accordingly, how to treat the elements of non-Shari'ah compliance, if found in it. (Yusoff & Yahaya, 2020).

The innovation in the organized Tawarruq is that its initial and end aims are to provide cash through retail, wholesale, interbank, and treasury products. Islamic banks consider that cash financing or personal finance is the major challenge faced to serve their customers when compared to conventional banks' cash loans. However, the challenge is that there is no form of cash lending with profit, as it will definitely turn into ribā. This issue was one of the motivations for innovation in organized banking Tawarruq (Yusoff & Yahaya, 2020).

This study used the qualitative method as a unique approach to evaluate organized Tawarruq from different aspects of innovation. It provides insight into the background, challenges, and UpToDate situation regarding organized banking Tawarruq development as a tool for liquidity and cash financing (Sālūs, 2010). In this context, research analyzed the split in opinions about the Shari'ah compliance of the process of international commodity Murābahah or Tawarruq al Maṣrafi al Munazzam to provide cash. (Sālūs, 2010, Haron & Mohamed, 2023). Hence, it helped to create an understanding of what was wrong in terms of execution and impact (Ahmed, & Mohammad, 2014).

Aprianto and Nazilah (2023) stated that "Tawarruq is an exciting problem to study" based on what they called as "The so-called Tawarruq transaction has become a debate by some parties regarding its halalness". along with OIC fatwa They also mentioned Fatwa from Indonesia, which banned Tawarruq (Aprianto & Nazilah, 2023). This added significance to the subject because the number of other Islamic countries has also banned Tawarruq. It is not wise to leave such a topic unattended because of its impact on the reputation of the Islamic finance industry (Ghazali et al, 2023).

Based on a literature review, several studies have been conducted on Tawarruq, including Yusoff et al (2019), Syahmi et al (2022), Ghazali et al (2023), and Aprianto and Nazilah (2023). However, this research does not merely discuss the Tawarruq al Maṣrafi al Munazzam per se, which is the case in most studies (Ahmed & Mohammad, 2014). It is a levelled playing field in which the subject matter is discussed from all dimensions. To highlight, by way of contrast, the challenges and opportunities in Islamic finance innovation. The aim was to raise awareness of the importance of the right innovation. This broadened the scope for further research and development on the platform of innovation in Islamic finance.

Literature Review

Islamic finance and banking products are developed in combination of Islamic theory of contract ('Aqd pl. 'uqūd) in light of the Shari'ah transactions law (Fiqh al-Mu'āmalāt) and the modern banking system (Mat & Ismail, 2008). Innovation of fiqhi structures to form modern products and services that suite contemporary finance and social and economic circumstances is conditional on being free from Shari'ah repugnant elements such as Ribā, 'Īnah, sale of debts, unclarity, uncertainty, wasting resources (israf), etc. This approach is in compliance with the Shari'ah objectives (Dewaya, 2024).

Conventional banks provide innovative products depending on the concept of interest-based borrowing and lending. On the other hand, Islamic banks require diverse products and innovative solutions that are customer-centric in a Shari'ah compliant way, along with impacts that should meet ethical, moral, and welfare requirements (Ali & Hussain, 2021). Islamic products must exhibit transparency, fairness, and justice. It should comply with Shari'ah committee resolutions and the country's legislation (Adaletey et al, 2019). Islamic financial product offerings are supposed to achieve their commercial goals with Shari'ah compliant and economy-friendly contracts (Syahmi et al, 2022).

The best innovation practice is the integration of commercial institutions' goals with Islamic social finance (Maulina et al, 2023). Islamic social finance includes Islamic philanthropy and infāq such as ṣadaqah, zakāt (māl and fitrah), waqf, and Islamic microfinance (Siswanto & Ikhwan, 2024). Similarly, demand has increased for innovation in Islamic financing products by using financial technology, such as blockchain and smart contracts, and applying it to create smart innovative organized Tawarruq (Roslan et al, 2020).

Innovation path to Murābaḥah to the purchase orderer

The banking Murābaḥah or Murābaḥah to the purchase orderer is an example of banking innovation that uses a simple Murābaḥah sale contract. It is used for retail products, including vehicles and Murābaḥah goods. They are also actively used to finance working capital, exports, imports, and corporate financing. Shares Murābaḥah and Sukuk Murābaḥah are innovations that meet customers' cash financing. It is also used in the structuring of the clubbed structure of organized banking Tawarruq or the Tawarruq al Maṣrafi al Munazzam (Dewaya, 2024).

Murābaḥah is known as ('Bay' al Amānah) because the price, cost and profit are declared upfront by the seller ('Usmānī, 2008). For example, in the case of Murābaḥah, the cost of the car and the profit earned by the bank are disclosed and agreed upon by the customer and bank. Murābaḥah is a transparent trust-based contract. It is based on selling goods as per the disclosed purchasing price, cost, and profit markup. The profit markup can be a lump-sum amount or percentage of the selling price.

An ordinary murābaḥah is concluded without prior promises to buy. If a prior promise to buy was submitted for acquiring goods through the institution, it forms a "banking Murābaḥah" and called Murābaḥah to the purchase orderer." (Shari'ah Standard No. 8, p. 221).

Murābaḥah has many differences that distinguish it from interest-based transactions when implemented under necessary conditions. Once fixed, prices cannot be increased or reduced. According to 'Usmānī (2008), some financial institutions increase the Murābaḥah price in the case of late payment, this is not permissible in Shari'ah. Similarly, roll-over of the Murābaḥah in case of default is not permissible because once the goods are sold to the customer, they cannot be sold again to the same customer ('Usmānī, 2008).

According to Usmānī, (2008), Murābaḥah was not the original mode of financing; it was allowed for financing purposes only where Mushārakah was not possible. "This allowance should not be taken as a permanent rule for all sorts of transactions and the entire operations of Islamic banks should not revolve around it." ('Usmānī, 2008). To avoid confusion, researcher thinks that by Murābaḥah, 'Usmānī (2008) meant the Tawarruq al Maṣrafi al Munazzam that is also known as International commodity Murābaḥah and organized banking Tawarruq.

Islamic banks have developed many new financing structures using Murābaḥah in combination with Tawarruq. Innovative new products are mainly known as the international commodity Murābaḥah (ICM), ICM London Metal Exchange (ICM-LME), and Organized Banking Tawarruq. In Arabic, it is known as Tawarruq al Maṣrafi al Munazzam. However, banks call the al Tawarruq al Maṣrafi al Munazzam or the organized banking Tawarruq product with Fiqhi terminologies, mostly Murābaḥah, in their declarations, which is tantamount to misrepresenting the information that circulated common confusion among stakeholders, including customers and scholars (Dewaya, 2024).

Innovation path from fiqhi Tawarruq to organized banking Tawarruq

The non-organized banking Tawarruq also known as the fiqhi Tawarruq and the individual Tawarruq (Al Tawarruq Al fardī) is acceptable as a valid sale contract. In the classical fiqhi individual Tawarruq, an individual purchases goods from one party on credit. After getting possession and becoming the owner, he sells them in the market to any third party to obtain cash. Classical fiqhi Tawarruq is permissible according to the jurists of three out of the four madāhib namely Mālikīs, Ḥanafīs and Shāfi'ī. Except the Ḥanbalī jurists, who considered the fiqhi Tawarruq mere a trick to charge usury/Ribā (Fisol et al, 2017).

However, the situation is different in the case of organized banking in Tawarruq. The Organization of Islamic Conference (OIC) Fiqh Academy, in April 2009, via resolution number 179 (5/190), declared Tawarruq Ḥarām. (Sālūs, 2010, Fisol et al, 2017, Ghazali et al, 2023, Aprianto & Nazilah, 2023). The Indonesian Majelis Ulama Indonesia (MUI) fatwa body Dewan Syariah Nasional (DSN) issued Fatwa with reference number DSN-MUI No. 82/DSN-MUI/VIII/2011. They declared Tawarruq Munazzam as Ḥarām based on mentioned Islamic Fiqh Academy fatwa that prohibited the practice of Tawarruq Munazzam. This explains why Tawarruq was not an investment or financing scheme. It also stated that Tawarruq Munazzam is doubtful because of shadowy (shubuhah) and unclear (gharar) elements. This means that it does not meet the conditions of transparency and clearance from the elements of fraud and ambiguity. Accordingly, it is not allowed as a banking product in Indonesia or in other countries. However, it allowed limited use of it based on the necessity (Ḍarūrah and Ḥājiyyah), it also urged to replace it with other products based on Muḍārabah, Wakālah or mutual funds (Aprianto & Nazilah, 2023).

Tawarruq innovation as practiced in the International Commodity Murābahah (ICM) and organized banking Tawarruq has created unlimited doubts about involvement of usury and forbidden 'Īnah, that lead to declare it Ḥarām as per the Fiqhi council Fatwa (Sālūs, 2010, Fisol et al, 2017). The excessive use of organized Tawarruq will have long-term implications for the Islamic economy and the reputation of Islamic banks. (Syahmi et al, 2022).

Ṣiddīqī, (2007) explained that the impact of organized Tawarruq is to promote debt-based markets under an Islamic banner. He cautioned that organized Tawarruq is a debt instrument and that it steers Islamic banks' affairs with glitches that are comparable to capitalist speculative financial activities. His paper titled "Economics of Tawarruq: How it's Mafāsīd overwhelm the Maṣāliḥ?" warned that the organized Tawarruq demolished the moral base of Islamic economics. It was concluded that this product is against Maqāṣīd al Sharī'ah because its harmful impacts are much greater than its benefits, and it is recommended to ban it (Ṣiddīqī, 2007, Ṣiddīqī, 2009).

The advocates of organized banking Tawarruq claimed that Tawarruq al Maṣrafi al Munazzam product and their practice of commodity Murābahah Tawarruq is a form of a valid 'sale contract' (bai'iy) (Fisol et al, 2017). Hence, they quote the verse of Qurā'n: "Allah has permitted sale and forbidden usury (Ribā)" Surat al Baqarah, 275.

They also claimed that this product is applied based on necessity (al Ḍarūrah), to resolve basic financing needs, hence, claimed to comply with the 'Maṣlahah' and Maqāṣīd al Sharī'ah. According to them, it provides a legitimate way for people to obtain cash as an alternative to ribā-based interest loans (Fisol, 2017). They argued that, to avoid ribā-based loans, it is permissible to choose the lesser of the two evils. Tawarruq al Maṣrafi al Munazzam is acceptable as a solution to avoid falling into Ribā transactions that are explicitly prohibited. According to Fiqhi maxim (qawā'id al-fiqhiyyah) "A greater harm is eliminated through a lesser harm" (الضرر الأشد يزال بالضرر) / al-Ḍarar al-Ashaddu Yūzāl bi al-Ḍarar al-Akhaf.

Organized banking Tawarruq can help Islamic banks increase the liquidity needed in urgent circumstances. In addition, it can free banks from the obstacles faced by financial accounting provisions in their balance sheets. This helps banks pay attention to the principles of capital adequacy and manage bad debts. Furthermore, it can add liquidity, which is beneficial for Islamic banks and increases customer loyalty. It is also helpful for the community if there is an emergency

or an urgent need for cash. Therefore, helping *Mustawriq* gain cash without falling into usury (Aprianto & Nazilah, 2023).

The AAOIFI *Sharī'ah* Standard has given permissibility to a *Tawarruq* done on the correct and righteous basis of the original *Fiqhi Tawarruq*. AAOIFI calls *Tawarruq* as Monetization, according to *Sharī'ah* Standard “Monetization refers to the process of purchasing a commodity for a deferred price determined through *Musawamah* (Bargaining) or *Murābahah* (Mark-up Sale), and selling it to a third party for a spot price to obtain cash.” (*Sharī'ah* Standard No. 30, p. 758).

Additionally, the *Tawarruq* arrangement should be executed with the essential elements of a real sale transaction. Mainly the possession and ownership of the commodity and assuming the risks accordingly. Contract requirements should be observed and fulfilled. In this situation, the principal should be known in the commodity sale and purchase transaction to reflect a true sale as well as the payment or debt conditions. It is not recommended to utilize *wakālah* contract that presents artificial *Tawarruq* mechanisms that mimic *Īnah* where the commodity is deliberately organized to be returned to the original seller (Ghazali et al, 2023).

To clear doubts, all the *Fatwas* and standards emphasize the differentiating between the original *Fiqhi Tawarruq* and the organized banking *Tawarruq* known as the *Tawarruq al Maṣrafi al Munazzam*.

Research Method

This study followed an analytical research approach as part of the qualitative research method. The qualitative method is suitable because of discussions that include *Fiqhi*, *Sharī'ah*, and theories analysis (Blakie, 2000). Data for analysis purposes were collected from multiple sources, such as libraries, online platforms, and desktops. Contemporary articles were searched in databases, such as Emerald-Insight, Brill, ScienceDirect, and Scopus. While there was no limitation for the time due to the involvement of some books, the focus was to find relatively recent studies and research papers so that the literature was more relevant to the banking practices of *Tawarruq* and its modern innovative practical aspects (Mohamad & Ab Rahman, 2014). The analysis of the reviewed literature laid the background for the subsequent analysis of innovation and contribution the development of acceptable *Sharī'ah* compliant products of Islamic finance.

Result and Discussion

Banking *Tawarruq* was introduced in the late 90s' as the main tool for the conversion of banks to Islam. Additionally, *Tawarruq* was a temporary solution in situations where the overall economic landscape and the governing law and regulation were yet to be conducive to cater to Islamic finance, in which *Tawarruq* might become a way out (*makhraj*). The boundaries of the application of *Tawarruq* in financial activities, especially, those involved with multiple series of *Tawarruq* were restricted only for the need based situations (*al Ḍarūrah* & *al ḥājah*). Examples of such needs were to overcome any legal or regulatory restrictions, or any operational difficulties, or in a situation where cash-based transactions were not available, such as interest-free loans (*qard hasan*) or other modes of financing such as investment (*istithmār*), sale, partnership (*Mushārahah*), investment (*muḍārabah*), and lease (*Ijarah*), which were impossible either from the perspective of the customer, financial institution, or other stakeholder limitations (Ghazali et al, 2023).

Nevertheless, *Tawarruq* has taken over the industry as a standard product of financing. Rapidly organized banking *Tawarruq* or *al Tawarruq al Maṣrafi al Munazzam* and International Commodity *Murābahah* through the LME became the main structure in many Islamic banks. Some newly formed, full-fledged Islamic banks, or *Maṣraf*, adopted the organized *Tawarruq* widely in its structuring of products to boost its profitability in competition with other Islamic banks. *Tawarruq* became the main structure for personal finance, credit cards, *ṣukūk*, and even term deposit accounts. They used the *Tawarruq* product to provide cash to customers and recover it with profit.

The AAOIFI *Sharī'ah* standard warned that a transaction may become an interest-based conventional loan. (AAOIFI *Sharī'ah* Standard no. (25) Combination of Contracts). It is clear that

the spread of this product is due to major dependency on fictitious paperwork and avoiding the hustle required in dealing with real assets. It was not the right approach to ignore the various Sharī'ah filters and turn the Tawarruq into a standard product.

According to [Ahmad et al. \(2020\)](#) “The widespread use of Tawarruq has made Islamic banks to be re-named as “Tawarruq banks” and some even call Tawarruq as the “magic lamp” of the industry” ([Ahmad et al. 2020](#)). As a result, Tawarruq al Maṣrafi al Munazzam has grown as a snowball and now needs to find new innovative solutions to fix it and save Islamic banking and finance from the short- and long-term impacts of prohibited elements.

Innovation prohibitions: Ḥīlah, Muwāta'ah and Ribā

Innovation in Islamic finance product has to be clear from the possible involvement in prohibited practices namely bad sale (ʿĪnah), tricks (ḥīlah), false pre-arrangement (Muwāta'ah) that leads to Ribā. Muwāta'ah means the hidden agreement of the tricks between the parties, which have intentions and aims to reach Ribā indirectly by using some documentation and structures similar to ḥīlah. Innovation violations become severe when structuring products that aim to achieve impacts like Ribā, and in this case, it is rendered null and void. Example for ḥīlah is the ruses of Aṣḥāb al-Sabt, who were barred from fishing on Saturday, hence, they created fish traps and hunted those fish next day as mentioned in the Qur'ān ([Dewaya, 2024](#)).

According to Sharī'ah Standards (2017), prohibition of Muwata'ah for devising Ribā tricks is because Muwata'ah in this case is a mean used for practicing Ribā. Consequently, if the end objective (Ribā) is prohibited, the means used to achieve it are prohibited. As indicated in the fiqhi maxim (al-Qawa'id al-Fiḥhiyyah), means are discarded due to the discarding of objectives. This is supported by “al-Furūq” by Al Qarafi [2:33]; and “al-Qawa'id al-Kubra” by Al-'Izz Ibn 'Abdul-Salam [1:161 and 168] (AAOIFI Sharī'ah Standard, 2017).

Another maxim is known to block means (Sadd al Darāe'). This maxim is mainly quoted to stop all tricks and to avoid reaching Ribā. Tricks that leads to Ribā are summarized into two situations: 1- A ḥīlah by topping up or adding to one of the exchanges means (ʿAwadain), i.e. money or the goods which were not intended to be part of the original sale, or 2- addition of one contract to other which was not intended per se. In short, tawarruq leads to the exchange of less money with more money determined in accordance with the deferment period ([Ibn Taimiyyah, 2004](#); [Askar, 2013](#)).

The International Commodity Murābaḥah ICM is used to achieve interest-based lending under Islamic finance labels. Such practices have drawn criticism from prominent scholars and have created a bad reputation for Islamic banks. ([Dusuki, 2007](#); [Suwailem, 2009](#); [Sālūs, 2010](#); [Soualhi, 2015](#); [Jarhi, 2016](#)). Some state explicitly that Tawarruq is not a sale rather it is clear contemporary usury, Ribā and ʿĪnah ([Abozaid, 2010](#)).

According to [Fisol et al \(2017\)](#), the conspiracy around organized Tawarruq and the contradictory explanations among Sharī'ah scholars reflect disordered Islamic finance structuring and product development. They refer to Fiqh council fatwa that rendered organized banking Tawarruq as Ḥarām and that it is tantamount to usury and forbidden ʿĪnah. Having a product that is against Maqāṣid al Sharī'ah creates misperceptions among Islamic bank employees and customers ([Fisol et al., 2017](#)).

Organized Tawarruq connection with ʿĪnah

According to AAOIFI ʿĪnah refers to the process of purchasing the commodity for a deferred price, and selling it for a lower spot price to the same party from whom the commodity was purchased.” (AAOIFI Sharī'ah Standard No. 30, p. 758).

The scholars who expressed impermissibility of bay' al-ʿĪnah quote the following Ḥadith:

((إذا تبايعتم بالعينة وأخذتم أذناب البقر، ورضيتم بالزرع، وتركتم الجهاد سلط الله عليكم ذلا لا ينزعه حتى ترجعوا إلى دينكم))

This is an authentic (ṣaḥīḥ) Ḥadīth, narrated by ‘Abdullah ibn ‘Umar, and compiled in al-Silsilah al Saheehah, No.: 11. [Al-Mubarak & Osmani, 2010](#))

The literal meaning of the Ḥadīth is that if you deal in ‘Īnah sale, hold the tails of cows, get satisfied with agriculture, and left jihad. Allah shall impose disgrace on you, and he will not remove it until you return to your religion.

It is worth mentioning that the researcher thinks that the wording of this Ḥadīth doesn't imply ban on the ‘Īnah categorically. The argument is that if the ‘Īnah is Ḥarām by virtue of this Ḥadīth, then livestock and agriculture are also Ḥarām because they are mentioned in the context of the same Ḥadīth. Nevertheless, no one said that having a cow farm or engaging in agricultural activities was Ḥarām. Hence, quoting Ḥadīth as saying that the ‘Īnah sale is Ḥarām does not seem accurate. The Ḥadīth meaning is that if the Muslims give priority to such activities over jihad, they will be punished with a disgrace “zul” which will not be removed until they return back to their religion. So, the inverse understanding is, do not let these activities make you go away from jihad and fulfill your religious duties ([Dewaya, 2024](#)).

However, the ‘Ulama have given other fiqhī justifications for prohibition of ‘Īnah. According to [Ibn Taimiyyah \(2004\)](#), the ruling (Ḥukm) about ‘Īnah forbiddance was reached using an analogy (Qiyās and Maṣlaḥah). ‘Īnah forbiddance is in accordance with the Sadd al Dara’eh, to avoid falling into Ribā. Sharī’ah has forbidden some means so that it does not lead to Ḥarām, even if the intention was not to do the Ḥarām or Ribā transaction. Even if there was no hidden agreement for Ribā between parties, ‘Īnah stayed forbidden due to strong tendency to convert to Ribā ([Ibn Taimiyyah, 2004, Askar, 2013](#)). Sharī’ah has cursed and declared war on Ribā dealers and consumers. According to Ibn Jawziyyah, ‘Īnah ticks carry greater sin than Ribā ticks because they have the same impact and built-in Mafsadah of Ribā ([Askar, 2013](#)).

According to [Suwailem \(2009\)](#), organized Tawarruq is a set of tricks to conduct sale of debt in violation of Sharī’ah prohibition of sale of debt (bay‘ al-kālī’ bi-al-kālī’). Similar to the sale of ‘Īnah, organized Tawarruq in Islamic banking is a trick to sidestep the restriction of Ribā, hence, these practices are against Maqāṣid al Sharī’ah ([Suwailem, 2009](#)).

In a surprising approach, it is noticed that some countries have commenced to use the Tawarruq al Maṣrafi al Munazzam as alternative to the ‘Īnah. According to [Aziz and Noh \(2014\)](#), prior to 2009 some Islamic banks used Baiy‘ Bi Thaman ‘Ājil or deferred payment. Later, the Tawarruq al Maṣrafi al Munazzam product was imported from GCC countries as a new alternative method of financing for banks that were practising buying and selling back or zḥnah, which Sharī’ah scholars criticized. Despite that the organized Tawarruq (Tawarruq Al Munazzam) being controversial method, it was adopted because it was thought to be less evil and less controversial compared to sale of ‘Īnah ([Aziz & Noh, 2014](#)).

Modus operand of organized banking Tawarruq

Organized Tawarruq as a retail product has a completely different process from that of Murābaḥah and classical Tawarruq. Organized Tawarruq is a systematized purchase of commodities purchased from the international commodity market or other markets and is sold to customers on deferred payment ([Fisol et al, 2017](#)).

Some banks’ portfolios established the majority of their products on International Commodity Murābaḥah (ICM) through the London Metal Exchange (LME). In practice do not sell physical assets to Islamic Tawarruq banks. It is a process in which certificates with serial numbers for commodities are exchanged between banks and brokers at the London Metal Exchange (LME). Obviously, none of the Islamic banks have the intention, expertise, or specialty to deal with the trading of commodities in the LME. Neither the bank nor the client has any control over the so-called commodities in the pre- or post-execution of the transaction. There is no intention to take possession by any of the parties involved in this type of transaction, and this has become a norm ([Sālūs, 2010](#)).

Moreover, LME practices are a pre-agreement and arrangement that falls under “Muwāta’ah” between the customer and bank to reach cash transactions. Muwāta’ah is prohibited due to devising Ribā tricks (AAOIFI Sharī’ah Standard, 2017).

As per the actual exercise, the bank (financier) organizes the sale agreement, arranges for the paperwork instantaneously, executes the transactions on behalf of the customer (Mutawarrīq), brokers, etc., and instantaneously disburses money to the customer account and records it as a debt payable in equal monthly instalments (EMI). The transactions are designed based on the difference between the spot price and the different prices that represent the bank’s profit. Brokers’ fees are charged to the customer separately under different labels. By doing so, the bank provides funds to customers’ accounts and claims the markup on it. Banks complete this process without being blamed for the ribā. (Sālūs, 2010).

The Tawarruq Bank counter performs all deals through serial numbers claimed to represent some commodities in the LME. Commodity certificates are issued by brokers who claim to be dealing with London metal exchange (LME) commodities. Paperwork involves sending notices to two brokers who play the roles of broker (A) and broker (B). The bank assumes that it bought bulks of commodities as per the routine deal of paperwork. This nullifies certificates whenever required. Banks involved in organized Tawarruq or International commodity Murābaḥah (LME) mostly dealt with two brokers, DowneyDays (DD) and Condor. Interestingly, the majority of ownership of these brokers is for the same party. The process forms a cycle of prohibited ‘Īnah sale, whereby on the paperwork the commodity journey begins from one broker A and reaches to the second broker B. However, this is assumption based theoretical cycle because there is no physical movement of the asset (Sālūs, 2010).

Islamic banks, while showing the label of ‘Maṣraḥ’ and ‘Islamic’ to denote that their transactions are ‘Sharī’ah-compliant’ channel a lot of money from the pockets of customers to these brokers. It is free money for these brokers for simple paperwork that has no obligations or risks. The fee charged for the processing of some paperwork is one of the reasons why customers of Islamic banking complain that Islamic banking transactions are more expensive than conventional bank transactions.

Sālūs (2010), studied the International Commodity Murābaḥah through the London Metal Exchange LME. He stated that, as per his research, all of the Tawarruq done through the LME is ḥarām and impermissible. It does not meet the main conditions related to the possession of commodities. The intention, possession, and transfer of ownership risk of the subject of sale have due consideration for the permissibility and validity of the sale. It is mandatory for valid transaction to meet the condition of Sharī’ah that stated “do not sell what you do not possess.” He also found that ICM-LME does not meet the condition of “Al kharāj bi-Ḍamān” which means reward is permissible due to the risk assumed. In banking Tawarruq, risk is absolutely zero in the ownership of any commodity. They lack the physical capacity to deliver commodities or take possession. This nullifies any risk or obligation by any party that normally arises from commodity ownership. In the case of ICM, no party assumes any risk related to price, safety, or storage owing to taking real or constructive possession. Both the customer and bank have no intention of taking possession of the commodity physically or constructively; they do not bother whether it exists or not. Seeking profit without taking risks turns the transaction into a ribā. (Sālūs, 2010).

The basic requirement for the validity of Murābaḥah is that the commodity is purchased by the financier, which means he assumes the risk of the commodity before selling it to a customer. The claimed profit is the reward for the assumed risk. In an interest-based loan, no such risk is assumed (Usmānī 2008). One of the common Sharī’ah audit observations is that in the Tawarruq transactions, the bank provided cash to customers without practically any involvement of commodities or certificates of ownership. Additionally, the bank was providing cash to customers without exchanging any timely offers and acceptance with brokers for owning commodities or updating certificates of ownership. It was found that deals were performed using serial numbers of expired certificates. According to the organized Tawarruq process, commodities did not exist at the time of executing the transaction or providing cash to customers.

The most famous organized *Tawarruq* application is in treasury. It is used to address liquidity shortfalls, overcome operational difficulties, and minimize customer losses. The surplus bank gets an order from the deficit bank to buy goods, the surplus bank then buys commodities from the market with cash, and then sells them to the deficit bank with the *Murābahah* contract instalment payment system. Then, deficit banks re-sell these commodity goods to a defined broker to obtain cash. In its concept, the prohibited arrangement is that the first Islamic bank(s) define the purchasing broker, and goods are resold to the same. This is non-Sharī'ah compliant, because it is similar to *bai al-Īnah*. The proper concept is to buy goods from the market and sell them to third parties without reselling them back to the originator (Aprianto & Nazilah, 2023).

Despite Fatwa declaring organized banking *Tawarruq* as *Ḥarām*, and despite the ongoing debate about its non-permissibility, Malaysian banks are highly dependent on organized banking *Tawarruq* (Roslan et al, 2020). However, there have been attempts to improve organized commodity *Murābahah* in Malaysia by identifying commodities in the local market. The advantage, in this case, will be that Muslim banks will not depend on London metal exchange and turn their focus to Islamic countries' markets. Dusuki (2010) mentioned that the main purpose of the Commodity *Murābahah* Program (CMP) main purpose was interbank liquidity management for Islamic banks in Malaysia. CMP organized *Tawarruq* model trades in Crude Palm Oil (CPO) as the main commodity. Nevertheless, *Īnah* issues are also present in this product (Dusuki, 2010).

Moreover, some banks have started using the reverse commodity *Murābahah Tawarruq* for fixed-return offerings on customers' fixed-term deposits. For example, the CIMB Islamic Bank introduced Fixed Return Investment Account-I (FRIA-I) as deposits with a fixed return system. It uses a hybrid structure that employs an organized *Tawarruq* contract and a *Murābahah* contract (Aprianto & Nazilah, 2023). This innovation literally means the end of the theory of profit- and loss-sharing. It will end the use of *Muḍārabah* cum *Mushārahah*-based investment accounts that use the profit calculation and distribution based on the *Mushārahah* and *Muḍārabah* mechanisms. According to Sālūs, (2010), the practice of reversed commodity *Murābahah Tawarruq* is tantamount to *Ribā*. (Sālūs, 2010).

Recommendations

Innovation in Islamic finance requires pure *niyyah*, as it is an obligation to implement *sharī'ah* in financial life. It also requires sincere collaboration between institutions and the government to drive collective efforts towards the standardization of parameters. It requires a mindset that adheres to the principles of *Sharī'ah*.

The restriction about *Ribā*, *Ḥīlah*, *Muwāt'ah*, *Īnah* should be taken as opportunity to think for solutions out of the box. It is apparent that cash lending with profit restrictions has closed the door of *Ribā*, but at the same time opened thousands of opportunities to create sales and partnership-based sustainable solutions. Gradually, the *Tawarruq al Maṣrafi al Munazzam* should be changed to alternative *Sharī'ah* compliant structures such as *Muḍārabah*, *Mushārahah*, various sale types, *Ijarah*, *Salam*, *Istiṣnā'*, *Wakala*. They should seek support from industry experts in this regard.

In practice, organized *Tawarruq* products formed a grey area from the *Sharī'ah* compliance and *Maqāṣid al Sharī'ah* perspectives. The intention of customers and banks for these types of products is to deal with cash, similar to lending and borrowing. In return, the bank aims to recover the principal plus and extra amounts without being called *ribā*. Impact-wise, organized *Tawarruq* leads to debts, compounding debts, speculations, tricks, and ruses. Innovation in new banking products should not form ironies with religion. Often, tricks are worse than when dealing with *Ribā*.

Innovation in Islamic finance should avoid *Sharī'ah* non-compliant fictitious financing structures. The innovation in organized *Tawarruq* and International Commodity *Murābahah* should not form attempt to twist around *Īnah*, or to reach to borrowing and lending of cash loan by using tricks or undercover agreements. There are situations where Islamic banks are required to

enter into organized commodity *murābaḥah* based on the necessity to meet urgent liquidity matters, which can sometimes be justified. However, when organized banking *Tawarruq* is used as a standard product for retail and corporate cash financing, it cannot be fit under necessity-based financing.

Tawarruq al Maṣrafi al Munazzam created confusion about classical *fiqhi Murābaḥah* or *Tawarruq*. Hence, there is a need for clear segregation of the terminology of innovative new financing structures and the original *Shari'ah* contracts, such as *Murābaḥah*. Given the highly disputable *Shari'ah* compliance position of International Commodity *Murābaḥah* LME, banks should avoid falsely listing practices of *Tawarruq al Maṣrafi al Munazzam* under *Murābaḥah* or Other *Murābaḥah*, as found in the audited financials and notes of some Islamic banks (*Maṣraf*). As per transparency requirements, Islamic banks should highlight in their financial report how much of its Assets, Liability and income consisting of International Commodity *Murābaḥah* / organized banking *Tawarruq* (*al Tawarruq al Maṣrafi al Munazzam*). This is important to make stakeholders aware of the level of permissibility and suspicious (*shubuhāt*), *ḥalal*, and *ḥaram* transactions. This point should be scrutinized through external audits and regulatory examinations.

Innovation should fulfill the *Maqāṣid al Shari'ah* related to money, namely clarity (*al-wuḍūḥ*), stability (*al-thabāt*), justice (*al-adl*), and accessibility (*al-rawāḥ*). In this context, as a suggested remedy, it should be made mandatory that the organized *Tawarruq* deal with real assets from local markets that fulfil the condition to provide possession subject to regular and agile audit/*Shari'ah* audits. At the same time, consider achieving *Shari'ah* objectives, ethics, and impacts.

Innovation parameters may change, subject to the financial and economic landscape and differing contexts and circumstances. However, there is a difference between innovation and imitation. In this context, an evaluation from the viewpoint of *Maqāṣid al Shari'ah* might be essential for future innovation. It should focus on providing innovative services aligned with Islamic principles that reflect the creativity, easiness, dynamics, and ethical characteristics of *Shari'ah* structures. Several studies have developed indices for this purpose.

This goal should be developed to facilitate other *Shari'ah*-compliant modes. Cash can be injected using innovations to develop alternative products, based on *Mushārakah* and *Muḍārabah*. Integrating with Islamic social finance to provide interest-free loans (*Qarḍ Ḥasan*) should not be completely ignored to prevent customers from going for Organized *Tawarruq* transactions and *Ribā*. (Ghazali et al, 2023).

Impact-wise, innovation should not lead to a *ribā* debt chain. Innovation should aim to enable Islamic financial institutions to move away from *Ribā* and stop mimicking conventional practices. It should also not expose the deposits of customers in Islamic banks to huge risks due to the absence of real assets that can be taken as collateral.

Conclusion

The research concludes that the *Tawarruq al Masrafi al Munazzam* or organized banking *Tawarruq* discussions have reached a level that makes no space for ambiguity, and that some regulators have enforced the fatwa by imposing a complete or partial ban on banking *Tawarruq*. The objective of the analytical research was achieved by highlighting the filters that should prevent innovation from becoming non-*Shari'ah* compliant and making the innovation viable in terms of its impacts. The study of organized banking *Tawarruq* has set the scope of innovation as a balanced approach between relaxations designed for necessity and firm commitment to follow the *Shari'ah* principles. On the one hand, *Shari'ah* supports in general creating ease and gaining benefits in the shape of innovation; on the other hand, it is very clear about compliance with the *ḥalal* and avoiding the *ḥaram*. The different stakeholders of Islamic finance should respect this balanced approach to maintain its reputation and sustain the growth of financial, ethical, and *Shari'ah* compliance aspects. The study is limited to a single product; however, it sets a good pitch for the importance of conducting innovation analysis on various products, services, and technological developments in Islamic finance. This study calls for collective research and development efforts to lead innovation

efforts and calls for innovative solutions to Islamic finance. Future research should keep highlighting any breaches and lack of compliance, as it is a tool to bring the necessary reform to any malpractice and think out of the box for more commercially viable Shari'ah compliant innovative solutions.

Author contributions

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