

# OUTLINES OF A BRIEF FRAMEWORK OF TAWARRUQ (CASH PROCUREMENT) AND SECURITIZATION IN SHARIAH AND ISLAMIC BANKING\*

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## **Definition of Tawarruq In Shari'ah**

According to the Fiqhi Encyclopaedia of Kuwait's Ministry of Awqaf and Islamic Affairs, Tawarruq is a term used by the Hanbalites only. For them, it means buying a commodity with deferred payment and selling it to a person other than the buyer for a lower price with immediate payment. A similar definition came in other than the Hanbalites literature in the chapters that deal with Bay' al 'Inah and Riba.

## **Definition of Tawarruq as Used In Practical Application of Some Islamic Banks**

The actual application in a few Islamic banks took this definition, as it is, but added the intermediation of the bank in all the components of this complex transaction.

Hence In Islamic Banks, Tawarruq becomes: Buy a commodity (e.g., a car) on the basis of Murabahah to the purchase orderer with a binding promise by the orderer and after signing the second sale contract for a deferred or installments price and implementing the subsequent formal possession, the bank will intermediate in the sale of the commodity, usually through another intermediation from the first seller (the car dealership) to sell the car to a new purchaser on cash basis for a lower price, the bank receive the cash and handed it over to the customer.

It is then a complex transaction that consists of an agreement of understanding that includes a binding promise, three sale contracts and one or more power of attorney (agency) contracts: The agreement of understanding is based on the similar understanding used in Murabahah with the addition that the bank will also intermediate in fulfilling the third sale contract, very often through the first seller. The first two sale contracts are those known in Murabahah, one between the bank and the seller of the commodity for cash and the second is between the bank and the customer for deferred or installment price. The third sale contract is between the customer and a fresh buyer who grabs the opportunity of buying a commodity for cash but lesser than its original cash price that appears in the first sale contract. Between the first two sale contracts we find an agency contract signed by the bank and the customer according to which the customer is delegated to perform the task of negotiating the price of the first sale contract and taking delivery on behalf of the bank. The second agency contract takes effect after the second sale contract; it is also between the customer and the bank to authorize the bank to sell the commodity to a new buyer and give receive its price. There is sometimes a third agency contract between the bank and the original seller (car dealership) to negotiate the price of the third sale contract and take charge of the actual sale and delivery. Throughout all this process, the commodity normally does not move from its place in the warehouse of the first seller.

## **Empirical Forms of Tawarruq**

We can detect six forms of Tawarruq that are actually practiced by Islamic banks that deal in it. These are as follows:

1. Buy deferred and sell cash with the intermediation of the Islamic bank
2. Buy cash by the Islamic bank with lease/sale to the same seller

3. Buy commodities cash and selling them for a deferred price in the international market for the bank itself
4. Sell commodities cash and buying exact equivalent deferred in the commodity market with the intermediation of the bank
5. Sukuk of leased assets
6. Sukuk of services (service bonds)

It is worth noticing that in the forms 1, 2 and 4, the bank provides cash to its customers while in the form 3 the bank provides cash to international companies and traders in the international market. In the form 5 the Islamic banks gets the cash or if the Sukuk are issued by a government it also gets the cash. The form 6 is not practiced by Islamic banks but certain companies practice it and the most common form of it is the phone and gift cards that are issued for a future service or purchased that will be made by the card purchasers.

#### 1. **Buy deferred and sell cash with the intermediation of the Islamic bank**

There are Islamic banks that announce and advertise its service of Tawarruq financing. Very often, and for obvious reasons new cars are used as a commodity-medium in consumer Tawarruq. The car does not leave its lot in the dealership and all transaction are made on the keys! Several cars may be contracted if the amount of financing happens to be larger.

The corporate version of it is normally done on large inventory at an associate company to either the Islamic bank or the customer corp.

From a financial and economic point of view, the direct cost to the customer and the social cost of this transaction is certainly much higher than the cost of interest-based lending. The reason is the complexity of the transaction and its several steps and contracts in addition to the potentiality of legal or economic changes during its period. It takes much more than Murabahah that is already more costly than interest-based lending. Besides, since the only way to reduce its cost is to apply it in a formal not real way so that it becomes exactly like a Riba-based loan but with more paper work, it gives the attraction to fake the transaction instead of implementing its details required by its Fiqhi description. Finally it has all the drawbacks that are associated with interest-based lending while it does not bring any social, economic or equity advantage.

#### 2. **Buy cash by the Islamic bank with lease/sale to the same seller**

In this form of Tawarruq, the Islamic bank buys from its customer a real long-lasting asset, often real estates, for a cash payment, then it sells/lease the same back to the customer on installment basis for either fixed or variable installments. The Price is normally the same original price of the purchase from the customer and the Islamic bank earns the rent of the part that is not sold. Once the customer fulfills all its obligations the ownership of the property is returned to it. Some Islamic banks restrict the use of this

type of financing for cash or replacing interest-based loan the customer had with another party.

3. **Buy commodities cash and sell them for a deferred price in the international market for the bank itself**

Almost all Islamic banks practice this kind of Tawarruq, or rather Tawriq, under the name of international Murabahah as a means for using their excess liquidity. This transaction consists of parallel contracts each pair of them consists of cash purchase and deferred sale.

4. **Sell commodities cash and buy exact equivalent deferred in the commodity market with the intermediation of the bank**

This is used by Islamic banks as a vehicle to provide cash to their customers. The transaction consists of a series of agency contracts between the bank, its international correspondent, international broker, and the customer. The customer normally only sign a bunch of papers that it does not know their content and get cash from the bank and pays for it a higher amount in the future. The only basic difference from interest lending is that the amount of increment above the advanced cash is not determined by a general rule announced to every body but rather by the price differential of the commodity at the time of the transaction in addition to the commissions of all intermediaries.

5. **Sukuk of leased assets**

The creation and sale of the Sukuk of leased assets is essentially a real life investment transaction although some of its versions may be used as a tool of tawarruq.

If a government wants to build a new airport or connecting two cities with a railroad for a construction cost of 200 million Dinar, and the government desires to keep the management in its hands while finance the project from the public, it can issue, say, 2 million title deeds, each one of them represents the ownership of only 1/2,000,000 of the project and sell these Sukuk for 100 Dinar for each sukuk (in fact for each share of the project), and the government pledges to rent these assets for a given known rent and a given long term period. The proceeds of sale will be used to construct the project and put it on its feet ready for delivery to the lessee.

It is obvious that these Sukuk are negotiable for a market price because they represent a part of a real estate. And it is obvious too that they provide the owners with a pre-determined earning fixed and known in advance. It is obvious too that the same can be done by an Islamic bank instead of a government.

The same also can be applied to already existing projects or real estates owned by the government or the Islamic bank if the government or the bank decides to sell them and lease them from the new owner. The proceeds of the sale may be needed to establish another developmental project.

These Sukuk can be used as a vehicle for Tawarruq when the government or the Islamic bank offers already existing long-lasting assets, represented by Sukuk, for sale with the condition of not only leasing them from the new owners but also to buy them back too through installment payments along with the lease payments so that by the end of the lease period ownership goes back to the government or the Islamic bank. Under this, added condition, the apparent objective of the government is to acquire the cash now and return it with a surplus or increment over a period of time.

#### **6. Sukuk of services (service bonds)**

Some universities in the West actually started offering for sale future credit hours that parents can buy for their children's education. With all prices going up over time, the cost of future education can be guaranteed at affordable prices today. The university can use the funds for its developmental projects. These well-defined service bonds are also negotiable and can be issued by an Islamic bank that can buy these services in bulk from the service provider, thus financing its projects, and sell the service Sukuk to the public.

#### **Bundles (Baskets) in Tawarruq and Securitization**

Creating bundles or baskets means putting together a set of fixed and real assets with cash and debts (receivables) and sell them together as one bundle for a market price that can be either cash or deferred. The satisfaction of the well-known condition that the majority must be in real assets and the total of cash and debts must only be a minority can easily be satisfied.

Bundles are very similar to shares and common stocks of companies since the latter can also be sold at a market price that does not have to be equal to its nominal price. Selling a common stock is no more than selling a share of ownership in a corporation that includes the share ownership of all its assets, be they physical, tangible, intangible, cash and debts. We must note that common stocks are in fact a form of securitization based of bundling

#### **Forms of Bundles:**

There are two types of bundles that are the following:

#### **7. Combining Debts, Cash and Physical and Intangible Assets and Creating Sukuk**

The Islamic bank puts together lease financing contracts that represent real assets, and Murabahah financing contracts that represent pure debts in one bundle and sells them to an investor for a price that is different from the total of the nominal prices of the contracts. The price will be determined in consistency with the date of payment, it may be higher or lower than the total nominal price if payment is before the maturity dates of the sold contract or higher if it is after it.

The same still applies if the bundle includes a sum of cash too as long as the majority remains for the real assets in the bundle.

8. **Financing a Bundle of Purchases and a Cash Sum for a Consumer/Corp**

The Islamic bank provides its customer with a line of credit to buy real goods for the bank on the basis of agency, the Islamic bank may also add certain services such as the services of brokerage in the stock market, Mutual insurance, etc. and also a sum of cash. Once all the ingredient of a bundle are ready, the Islamic bank sells the whole bundle on Murabahah basis to the customer for a deferred price that is higher than the total cash values of the bundle's components, keeping the majority of the bundle in real assets and services. It is noted that the Islamic bank provides the bundle, including the cash, for a deferred price that is higher than its cost.

**Opinion**

I think that while Ijarah Sukuk in all its forms and kind should be encouraged and expanded, as the market really needs some investment security that can serve as a bottom line or determinant of a prime rate that can only be provided by the Ijara Sukuk that are to large extent secured and with fixed income, Tawarruq must be limited because it may be economically worse than interest. This is in addition to the Fiqhi views about it because even in the Shafi'i and Hanbali schools the correctness of the component contract is something that is different from the true judgment on the complete transaction, and "leaving the intention to God" does not mean its intention is acceptable.

I therefore would argue that it must be limited to public (common stock) corporate use for companies under liquidity stress that have no other alternatives only. It should be only a very strict last resort even after exploring the possibility of Qard Hasan.

For individual consumers it must be completely out of the Islamic banking practices and the needs it may satisfy must be left to a special fund for goodly loans that every Islamic bank should be called on to establish as a partial compensation of the seniorage privileges given by the system and the government to a bank.