

**AN OVERVIEW OF THE WIDE EXTENT OF TAWARRUQ IMPLEMENTATION IN MALAYSIA ISLAMIC BANKING PRODUCTS**

Nurjannah Hasmadi<sup>i</sup> & Abdulrahman Alosman<sup>ii</sup>

<sup>i</sup> (Corresponding author). Master Student, Kuliyyah of Islamic Revealed Knowledge and Human Sciences, International Islamic University Malaysia (IIUM). nurjannahasmad@gmail.com

<sup>ii</sup> Lecturer, Human Sciences Department, International Islamic University Malaysia (IIUM). abdulrahman@iium.edu.my

<b>Abstract</b>	<p><i>The Shariah financing concept tawarruq is dominating Islamic banking products nowadays. Tawarruq concept is underpinning various Islamic finance and banking products and growing its portfolio proportion year by year in Malaysia Islamic banking and finance industry. This paper aims to give an overview of the wide extent of tawarruq implementation in Malaysian Islamic banking products. This study employs qualitative approach using library research method by examining and analyzing secondary data collected from multiple sources such as journal articles, policy documents, books, resolutions, standards, product disclosure sheets and reports. Results of this paper suggest that steps taken by official bodies like issuing a much lenient Shariah standards on tawarruq application than other international standard setting bodies like AAOIFI and Council of International Islamic Fiqh Academy by Bank Negara Malaysia and establishment of Bursa Suq As-Sila to facilitate tawarruq implementation by Bursa Malaysia is much aiding the application of tawarruq concept in Malaysia notwithstanding some issues causing controversies regarding its application. The study also revealed that Islamic banking products such as Islamic personal financing, Islamic home financing, Islamic credit cards and Islamic deposit account are applying tawarruq concept in a wider term in replacing the application of previous Shariah concepts. It is concluded that tawarruq is gaining larger popularity among Islamic finance and banking industry players, however, innovative alterations need to be applied on the current practice of tawarruq to mitigate critiques surrounding it.</i></p> <p>Keywords: <i>Financing, Tawarruq, Islamic, Banking, Products.</i></p>
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**INTRODUCTION**

Islamic financial institutions are distinct from their conventional counterparts in terms of uninvolved with interest, promoting risk sharing and holding on to the principle of profit and loss through trading (Adznan, 2018). In abstaining themselves from being involved in interest (*riba*), Islamic banks needed to ensure both their asset or liabilities are free from interest (Sobol & Dopierla, 2019). Since 1970's, Islamic finance has been developing rapidly especially in Muslim countries (Sobol & Dopierla, 2019). Malaysia belongs to those countries where two financial systems co-exist: the conventional one and the Islamic one (Sobol & Dopierla, 2019). In 1983, the establishment of Bank Islam Malaysia Berhad in marks the cradle of Islamic banking in Malaysia, followed by Bank Muamalah Malaysia Berhad in 1999 (Bahari & Baharudin, 2014).

In the beginning of Islamic banking and finance practice in Malaysia around 1990s, *bay al-inah* is very popular in Malaysian Islamic financing schemes (Asni, 2019). However,

considering the strong arguments about the controversial existence of *riba* elements in *bay al-inah*, Islamic financial institutions introduced the *tawarruq* concept as an alternative (Bahari & Baharudin, 2014; Shafie et al., 2020). Most of the current Islamic derivative's products applied by Islamic financial institutions nowadays are predominantly based on *tawarruq* or also known as commodity *murabahah* (Abd Rahman, 2016). Financing by *tawarruq* grew over 34% to sum up over 22.4% out of overall outstanding Shariah-compliant financing in 2016 (Bank Negara Malaysia, 2016). Bursa Suq Al-Sila commodity trading operation had largely contributed in this growth by reducing costs and risks in *tawarruq*-based transactions (Bank Negara Malaysia, 2016). By the end of 2019, *tawarruq* lead Malaysia's Islamic banking industry financing portfolio's proportion, accounting for 46 percent of overall financing (Bank Negara Malaysia, 2020).

This paper focuses on giving an overview of the wide extent of *tawarruq* implementation in the context of Islamic banking products. The paper will first explain the concept of *tawarruq*, scholars' view on *tawarruq* and issues pertaining the concept of currently applied *tawarruq*. After that, this paper will proceed with discussion on implementation of *tawarruq* in Malaysia Islamic banking and financing sector and subsequently its application in Malaysia Islamic banking products.

## METHODOLOGY

This paper employs qualitative approach by using library research method. Data related to the study are secondary data collected from multiple sources such as journal articles, policy documents, books, resolutions, standards, product disclosure sheets and reports. These data are subsequently examined and analyzed to obtain the results. In obtaining the results, this paper analyzes concept of *tawarruq* in theory including, scholars' view regarding the concept and issues pertaining the concept. After that, this paper examines how the concept is applied in various Islamic banking products in the context of Malaysia.

## RESULTS

### Concept Of Tawarruq

*Tawarruq* is an act of buying an asset for a delayed price finalized through either *musawamah* (bargaining) or *murabahah* (mark-up sale) and selling it to a third party for a spot price so as to obtain cash (AAOIFI, 2015). In the financing world, *tawarruq* is also known as commodity *murabahah* (Bahari & Baharudin, 2014). The transaction is known as *tawarruq* (coin/cash) because the buyer bought the commodity on credit without the intention of using or profiting from it, but instead to sell it for cash (Bank Negara Malaysia, 2010).

There are two types of *tawarruq*: *tawarruq fardi* (classical *tawarruq*) and *tawarruq munazzam* (organised *tawarruq*). *Tawarruq fardi* is the one that is explained previously. In *tawarruq munazzam*, the seller in the first transaction, usually the bank, will become the customer's agent to sell the commodity to a third-party buyer (Omar, 2018). The distinction between classical and organized *tawarruq* is the appointment of the bank as an agent to sell back the asset in the modern application via a representative contract (N. Mohamad & Ab Rahman, 2014). On the other hand, *tawarruq 'aksi* or reverse *tawarruq* is the same as organised *tawarruq* except that the financial institution will act as the customer and the client will act as the beneficiary instead (Omar, 2018).

Classical scholars, except Hanbali scholars, haven't coined the term *tawarruq* as it is in their books, instead, the matter is mentioned under discussion of *bay al-inah* (Kuwait, 1983). Hanbali scholars like *al-Bahuti* mentioned the term *tawarruq* in his book *Kasysyaf al-Qina'* (1983), a commentary on the book *Al-Iqna'* by Al-Muqaddasi, stating that:

{وَلَوْ اِحْتِاجَ (اِنْسَانٌ) اِلَى نَقْدٍ فَاشْتَرَى مَا يُسَاوِي مِائَةً وَمِائَةً وَخَمْسِينَ، فَلَا بَأْسَ (بِذَلِكَ نَصَّ عَلَيْهِ) وَهِيَ (أَيُّ هَذِهِ الْمَسْأَلَةُ تُسَمَّى) مَسْأَلَةُ التَّوَرُّقِ (مِنْ الْوَرَقِ وَهُوَ الْفِضَّةُ؛ لِأَنَّ مُشْتَرِيَ السِّلْعَةِ يَبِيعُ بِهَا) .}

“If he (a person) is in need of cash and he buys a commodity priced one hundred with the price of one hundred and fifty, it is permissible (for him to do that), and this (matter is called) *at-tawarruq*, (derived from the word *al-wariq* which means silver, because the buyer of the commodity utilizes the commodity by selling it).”

In the above paragraph, Al-Bahuti elaborated Al-Muqaddasi's words on the situation where a person who needs cash on spot purchasing a commodity with a higher price just to sell the commodity in order to fulfil his need of cash; an example of *tawarruq*. He further stated that this practice is permissible, coining the term '*tawarruq*' for such practice.

One point worth to ponder in discussing the matter of *tawarruq* is the similarity and difference between *tawarruq* and *bay al-inah* considering that classical scholars used to discuss *tawarruq* under chapters of *bay al-inah*. According to An-Nawawi, *bay al-inah* is a transaction where a person sells a product to a customer with a deferred payment and deliver the product to the customer. The same seller then buys back the same product from the customer, in cash, with a lower price, before the customer settles the payment for the product (An-Nawawi, 1991). In this transaction, the customer gets immediate cash, whereas the seller benefits from the difference between the two prices. Thus, it can be concluded that the similarities and differences between *tawarruq* and *bay al-inah* are as follow:

Transaction	Bay Al-Inah	Tawarruq
Similarities	The purchaser in the first sale and purchase transaction does not intend to benefit the commodity by using it, instead, by selling it.	
	The purchaser in the first sale and purchase transaction is in need of cash.	
	The first sale and purchase transaction is in deferred mode.	
	The second sale and purchase transaction is in spot cash.	
	The same commodity is used in both first and second sale and purchase transaction.	
Differences	The seller in the first sale and purchase transaction is the purchaser in the second sale and purchase transaction.	The seller in the first sale and purchase transaction is <u>not</u> the purchaser in the second sale and purchase transaction.
	The commodity will return to the first sale and purchase transaction seller in the end of the process.	The commodity will <u>not</u> return to the first sale and purchase transaction seller in the end of the process, instead, it will be owned by the purchaser in the second sale and purchase transaction.
	The whole process involves 2 parties.	The whole process involves 3 parties.

Table 1: Similarities And Differences Between Tawarruq And Bay Al-Inah

### Scholars' View On Tawarruq Concept

In further discussing the application of *tawarruq* in today's banking sector, it is important to know as how the classical scholars view *tawarruq* concept. Maliki school of thought oppose the practice of *bay al-inah* due to the seller in first sell and purchase transaction being the same purchaser in the second sale and purchase transaction. In listing five conditions where deferred transaction is impermissible, Al-Qurrafi (2010) stated among the situation is:

{ أَنْ يَكُونَ الْمُشْتَرِي ثَانِيًا هُوَ الْبَائِعُ أَوْلًا }

“When the purchaser in the second sell and purchase transaction is the same seller itself in the first sell and purchase transaction”

Seeing that the essence of their ban is the same person being the seller in the first sell and purchase transaction and purchaser in the second sell and purchase transaction, it then can be implied if these two parties are different persons as in *tawarruq*, the impermissibility is hence lifted.

On the other hand, Hanafi school of thought generally impermits *bay al-inah* and permits *tawarruq*. As-Sarkhasi (As-Sarkhasi, 1993) mentioned the impermissibility of *bay al-inah* in his book Al-Mabsut:

{ وَإِنَّمَا أَرَادَ هَذَا إِثْبَاتَ كَرَاهَةِ الْعَيْنَةِ وَهُوَ أَنَّ يَبِيعُهُ مَا يُسَاوِي عَشْرَةَ بِخَمْسَةِ عَشَرَ لِيَبِيعَهُ الْمُسْتَقْرِضُ بِعَشْرَةِ  
فَيَحْصُلُ لِلْمَقْرِضِ زِيَادَةٌ }

“It is meant by this, is the confirmation on impermissibility of *bay al-inah*, where a debtor sells a commodity priced 10 dirhams with the price of 15 dirhams to his debtor, so that the debtor will sell it back to him (the debtor) with the price of 10 dirhams and hence the debtor will benefit from the price difference”

Ibn Al-Humam, on the other hand, when discussing the impermissibility of *bay al-inah* where the same commodity in the end returned to the original seller, mentioned a situation resembling *tawarruq* in his book Fathu Al-Qadir (Ibn Al-Humam, n.d.):

{ أَنْ يَبِيعَ مَا يُسَاوِي عَشْرَةَ بِخَمْسَةِ عَشَرَ إِلَى أَجَلٍ فَيَشْتَرِيهِ الْمَدْيُونُ وَيَبِيعُهُ فِي السُّوقِ بِعَشْرَةِ حَالَةً، وَلَا بَأْسَ  
فِي هَذَا }

“For a debtor to sell a commodity priced 10 dirhams with 15 dirhams with deferred payment and the indebted buys the commodity with the said price of 15 dirhams, and after that the indebted sells it in the market with the price of 10 dirhams in spot cash. There is no objection in this practice”

Shafi’e school of thought ruled out the permissibility of *bay al-inah*, as stated by Ar-Rafi’e:

{ وَلَيْسَ مِنَ الْمُنَاهِي بَيْعَ الْعَيْنَةِ }

“There is no opposing to *bay al-inah*”

Seeing that the *madhhab* even permits *bay al-inah* which only involves two party, it is even more logic that they permit *tawarruq* that involves different purchaser in the second sale and purchase contract other than the seller in the first one. Furthermore, Ar-Rafi’e, in discussing the matter of *bay al-inah*, mentioned a situation if the commodity is sold with a lower price to other than the original seller:

{ لَنَا أَنَّهُ ثَمَنٌ يَجُوزُ بَيْعَ السَّلْعَةِ بِهِ مِنْ غَيْرِ بَائِعِهَا، فَيَجُوزُ مِنْ بَائِعِهَا }

“For us, the school of As-Syafi’e, it is a permissible price (a lower price for the second spot basis transaction) for a commodity to be sold to other than the original seller, hence it is also permissible to be sold to the original seller too”

The situation illustrated here, where the commodity is sold back to other than the original seller, even though not the core essence in his discussion in the context of this paragraph, is resembling the *tawarruq* transaction where a person sold what he had bought to someone other than the seller with a lower price on a spot basis.

In Hanbali school of thoughts, the preferred opinion is permissibility of *tawarruq* as stated by Al-Mardawi;

{ لَوْ اِحْتِاجَ إِلَى نَقْدٍ، فَاشْتَرَى مَا يُسَاوِي مِائَةً بِمِائَةٍ وَخَمْسِينَ. فَلَا بَأْسَ. نَصَّ عَلَيْهِ. وَهُوَ الْمَذْهَبُ. وَعَلَيْهِ الْأَصْحَابُ. وَهِيَ مَسْأَلَةُ التَّوَرُّقِ }

"If a person is in need of cash and he buys a commodity priced one hundred with the price of one hundred and fifty, it is permissible. This is what is agreed upon and it is the opinion of the madhhab. This is the opinion hold onto by the scholars, and it is called at-tawarruq"

Even though so, there is one opinion transmitted from Imam Ahmad Ibn Hanbal mentioning the *karahah* of the practice. This is as mentioned by Ibn Muflih (2003) when mentioning the ruling of tawarruq:

{ وَعَنْهُ: يُكْرَهُ }

"It is transmitted from Ahmad bin Hanbal that the practice is not favored (*makruh*)"

In conclusion, almost all of classical scholars permit the practice of *tawarruq* in it's traditional form (*tawarruq fardi*).

### Issues On Current Practice Of Tawarruq

Even though tawarruq is permitted by majority scholars, the current practice of tawarruq in Islamic financial institutions nowadays gathered a largely debatable phenomenon. In fact, renowned Malaysian Islamic finance figure, Zaharuddin Abd Rahman (2016) even labelled *tawarruq* as the Achilles heel of the *Shariah*-compliant derivatives products. This is because the *tawarruq* that is applied in Islamic banks today is not the *tawarruq* in its classical form i.e *tawarruq fardi* that is deemed permissible by majority scholars as it does not interest modern Islamic banks (Yusoff et al., 2016).

Instead, Islamic banks tend to implement *tawarruq munazzam* or organized *tawarruq*, in which the bank that act as seller in the first transaction, will become the client's agent to sell the commodity to another buyer (Omar, 2018; Yusoff et al., 2016). This practice brings to surface numerous issues that lead to the controversies surrounding the operation of organized *tawarruq*, among them are i.e usury and legal stratagem, dual agency and pre-arrangement.

Bilal and Mydin Meera (2015) argued that most contemporary *tawarruq* practice or *tawarruq munazzam* are indeed stratagem to circumvent interest taking. This can be seen from the operation of the *tawarruq munazzam* or also known as commodity *murabahah* by Islamic banks via the following steps (BMB Islamic, 2016):

1. Customer who is in need of cash, undertakes to purchase a commodity from the bank.
2. Bank subsequently purchase the commodity from a supplier (Broker A) in cash and sells it to the customer at cost plus profit on deferred payment basis.
3. Upon completion of the purchase, bank will act on customer's behalf as an agent to sell the commodity at a lower price to a buyer (Broker B) for immediate cash.
4. Towards the end, the customer obtains cash from the commodity market (from step 3) with an obligation to pay the debt to the bank (from step 2).

As can be seen in the steps above, the final result of this process is obtaining lower amount cash money by paying higher amount deferred money. Majority scholars prohibit the controversial organized *tawarruq* mainly due to the issue of usury and legal stratagem, i.e., gaining money for money, where the essence of the prohibition is similarly ruled for *bay al-inah* (E. F. Ahmad et al., 2017; N. Mohamad & Ab Rahman, 2014, p. 491). The real intention of the contract, as seen above, is to create debt obligation, hence the underlying commodity traded is rather a route to mobilize money with none of the contracting parties have the intention to actually acquire or hold the commodity transacted, notwithstanding

the option given to customer to take physical delivery of such commodity (Shafie et al., 2020).

Another issue arises around the practice of *tawarruq* in Islamic banks is the implementation of dual agency. In current practice of Islamic banking in Malaysia, the Islamic bank doesn't only act as an agent to sell the commodity on behalf of the customer to a broker, but a dual agent (Zulkepli & Mohamad, 2020). In simple words, dual agency or known by the scholars as *bay al-wakeel linafsih* is a situation where the goods are sold by the agent to himself (Shaharuddin et al., 2020). The way dual agency happens in deposit-based *tawarruq* products that also employs reverse *tawarruq*, for example, is as follow (Shaharuddin et al., 2020):

1. Customer approach Islamic bank to deposit their money based on *tawarruq* principle. Bank agrees and act as an agent for customer to purchase a commodity on his behalf.
2. Bank will then act an agent to sell the commodity to itself on behalf of the customer for a deferred price.
3. To complete the transaction, the bank then sell the commodity to another broker to obtain cash.

In this situation, dual agency happened in step 2 where the bank act as an agent to sell the commodity to itself. Meanwhile, dual agency happens in financing-based *tawarruq* product as follow (Shaharuddin et al., 2020):

1. Customer approach Islamic bank for financing product based on *tawarruq* concept. Bank agrees and purchase a commodity from a broker.
2. Bank sells the commodity to itself as an agent for the customer at a deferred price.
3. On behalf of the customer, bank sells the commodity to another broker on a spot basis.

In this situation, dual agency happened in step 2 where the bank act as an agent on behalf of the customer to sell the commodity to itself. Majority scholars of *madhhab* Maliki, Hanafi, Shafi'e and Hanbali disallow dual agency as it may cause conflict of interest (Kuwait, 1983). Notwithstanding Bank Negara Malaysia (BNM) in their *tawarruq* policy document had allowed *tawarruq* transaction based on dual agency, this practice is however in contrast with AAOIFI Shariah Standard 23 that prohibits an agent to conduct deals with his own self, his child who is still under his guardianship or with his partner in the same contract (AAOIFI, 2015; Bank Negara Malaysia, 2018b).

Other than that, the issue of pre-arrangement also bring notable dispute on the practice of *tawarruq*. Pre-arrangement is the main feature that differentiates modern organized *tawarruq* and classical *tawarruq* (BMB Islamic, 2016). In deposit based *tawarruq* products, for example, pre-arrangement exists when the bank already arranged the purchaser for the commodity and profit margin in the application stage by the customer (Zulkepli & Mohamad, 2019). Such pre-arrangement may lead to other shariah non-compliant incidences in executing *tawarruq*.

According to Ali and Hassan (2020), two most frequent shariah non-compliant events occurring in Islamic banks in executing *tawarruq*-based products is improper sequence of sale contract, i.e the asset is sold to the customer before the bank purchases it from a broker and advance disbursement of the facility before complete execution of the *tawarruq* transaction. These incidences will not happen if not for pre-arrangement done by the bank even in the application stage by the customer. The issue of pre-arrangement that exists in organized *tawarruq* made the concept somewhat similar to *bay al-inah* structure (BMB Islamic, 2011).

From the perspective of the Islamic financial institutions, pre-arrangement is vital to ensure fixed profit rate that will attract customers and subsequently enhance their trust in Islamic financial institutions (Zulkepli & Mohamad, 2019). However, because of the

intention to obtain cash prevails over the structure of *tawarruq*, the indictment of back door *riba* exists through this practice of pre-arrangement (BMB Islamic, 2016).

Despite the controversies surrounding organized *tawarruq*, it is widely applied due to its ease of execution and flexibility in acquiring liquidity, thus pacifying the needs of Islamic banks that are always dragged into a rat race against conventional banks to offer more competitive products and services (BMB Islamic, 2016; Kahf & Mohamed, 2017). However, in the long run, emphasizing organized *tawarruq* carries a handful of disadvantages. Continuity in practicing organized *tawarruq* will damage the reputation of Islamic banking industry due to due to massive critics and disputes among the prominent scholars (Shafie et al., 2020).

Dependency on *tawarruq munazzam* practice also can be a counterattack to Islamic financial institutions for not being able to create more innovative products but instead replicating the conventional counterparts albeit some corners here and there (Shafie et al., 2020). On the other hand, from the perspective of society wealth improvement or generating economic substance, *tawarruq munazzam* is bringing more harm than benefit as it promotes redistributions of wealth in favour of the creditors, which is clearly parallel to traditional loan (Shafie et al., 2020).

### **Implementation Of Tawarruq In Malaysia Islamic Banking And Financing Sector**

In 2005, BNM resolved that financing and deposit products based on the concept of *tawarruq* is permissible (Bank Negara Malaysia, 2010). In the following year, the bank issued permissibility of *sukuk ijarah* and Shariah compliant shares application as the underlying asset in *tawarruq* transaction to manage liquidity in Islamic financial system (Bank Negara Malaysia, 2010). The BNM officially issued a policy document regarding *tawarruq* in 2015. Another issue of *tawarruq* policy document was issued by the bank in 2018, superseding the former issue.

Some restrictions were embedded in this policy document in the operational structure of *tawarruq*. Among those restrictions are the seller in the first sale and purchase contract shall not be the purchaser in the second sale and purchase contract in the same *tawarruq* (Bank Negara Malaysia, 2018b). Regarding the asset to be used as the subject matter of a *tawarruq*, it shall be the seller's owned existing tangible or intangible Shariah recognized asset in terms of being valuable, identifiable, and deliverable (Bank Negara Malaysia, 2018b). In this policy document, the bank also issued that dual agency may be implemented in *tawarruq*, taking form in one of the following (Bank Negara Malaysia, 2018b):

- (a) an action of one of the contracting parties who acts as an agent to purchase an asset on behalf of the other contracting party, and subsequently acts as an agent to sell the asset on behalf of the same contracting party to himself; or
- (b) an action of one of the contracting parties who acts as an agent to purchase an asset from himself on behalf of the other contracting parties, and subsequently acts as an agent to sell the asset on behalf of the same contracting party to a third party.

In this matter, BNM seems to be more lenient in issuing permissibility of *tawarruq* to be practiced by Islamic banks in Malaysia compared to international bodies like AAOIFI and Council of International Islamic Fiqh Academy. The dual agency matter, for example, contradicts with AAOIFI Shariah Standard No. 23 that that prohibits an agent to conduct deals with his own self, his child who is still under his guardianship or with his partner in the same contract (AAOIFI, 2015).

Other than that, compared to other bodies, it is fair to say that BNM is lenient in ruling the permissibility of organized *tawarruq*. This can be seen in its proposed mechanism of *tawarruq*-based financing product, stating that "The customer appoints the Islamic financial institution as his agent to sell the metal commodity to metal trader B on cash basis in the metal commodity market (Bank Negara Malaysia, 2010)." This clearly

contradicts AAOIFI, in their Shariah Standard No. 30 clause 4/7 (AAOIFI, 2015), that states “the client shall not delegate the Institution or its agent to sell, on his behalf, a commodity that he purchased from the same Institution and, similarly, the Institution shall not accept such delegation”. Notwithstanding, the clause added an exception; “If, however, the regulations do not permit the client to sell the commodity except through the same Institution, he may delegate the Institution to do so after he, actually or constructively, receives the commodity.”

Further, clause 4/8 states (AAOIFI, 2015) “the Institution should not arrange proxy of a third party to sell, on behalf of the client, the commodity that the client purchased from the Institution.” In other words, AAOIFI originally does not favour the practice of bank being an agent on the behalf of the customer to sell a commodity that the customer bought from the bank itself. Considering that the main distinction between *tawarruq fardi* and *tawarruq munazzam* is the appointment of the bank as an agent on behalf of the customer to sell back the asset as explained previously, hence, the author is also of the view that AAOIFI, subsequently, does not favor implementation *tawarruq munazzam*.

Nevertheless, the Council of International Islamic Fiqh Academy imposed a stricter decision regarding *tawarruq*. Even though the academy permits *tawarruq fardi*, they are consistent in their view of *tawarruq munazzam*'s impermissibility in their 2003's 17<sup>th</sup> meeting and 2009's 19<sup>th</sup> meeting without any exceptional clause (Majma' Al-Fiqhi Al-Islami Ad-Duwali, 2020).

In Malaysia, the operation of banking and financing practices using *tawarruq* as an underlying concept is highly facilitated by Bursa Suq Al-Sila' (BSAS). BSAS is a commodity platform specifically dedicated to facilitating Islamic liquidity management and financing by Islamic banks (BMB Islamic, 2016). It is an innovative initiative to enhance Islamic finance industry while embracing Shariah principles by integrating the global Islamic financial and capital markets together with the commodity market through one single engine (Michael, 2021). In 2008, BNM's Shariah Advisory resolved the permissibility of proposed operational structure of BSAS which was formerly known as Commodity Murabahah House (Bank Negara Malaysia, 2010).

In the next year, BSAS was officially launched on 17 August 2009, established from the collaboration of Bank Negara Malaysia, Securities Commission Malaysia, Bursa Malaysia and Islamic financial industry players (BMB Islamic, 2016). BSAS operations are managed by Bursa Malaysia Islamic Services Sdn. Bhd (BMIS), a wholly owned subsidiary of Bursa Malaysia (Othman, 2016). An illustration of how BSAS operates in facilitating *tawarruq* based financial and banking practices is as follow (Bursa Malaysia, 2014):

1. Commodity suppliers in BSAS sell commodity directly to Islamic Bank A on cash basis.
  - Ownership of commodity is transferred to Islamic Bank A.
  - BSAS ensures delivery of commodity to Islamic Bank A upon request.
  - e-Certificate is generated by system detailing trade information to verify the transaction.
2. Islamic Bank A sells commodity to its client or Islamic Bank B at a marked-up price (*murabahah*) on deferred payment basis.
  - Ownership of commodity is transferred to client or Islamic Bank B and an e-certificate is generated.
3. Client or Islamic Bank B sells the commodity to Bursa Malaysia Islamic Service (BMIS) on cash basis.
  - Ownership of commodity is transferred to BMIS and an e-certificate is generated.
4. BMIS offers to sell and suppliers bid to purchase. The sell and purchase are matched on random basis.
  - Ownership of commodity is transferred to the supplier once matching is done.

During the early introductory phase of BSAS, the only commodity available to facilitate transactions is crude palm oil (CPO) (Michael, 2021). There are up to 22 types of commodities that can be offered for trade in BSAS including aluminium, coal, plastic resin, crude palm oil and rubber to name a few (Bursa Malaysia, 2014). Until now, there are seven type of commodities available for trade under BSAS platform; CPO, refined, bleached and deodorised (RBD) palm olein, softwood timber, hardwood timber, plastic resin A, plastic resin B and plastic resin C (Michael, 2021).

Commodities traded must met some general requirements set up by BMIS; such as definite existence, unencumbered commodity, specifically located, deliverable and have definite specification (Bursa Malaysia, 2014). BSAS accepts the use of up to 22 currencies including US Dollar, Malaysian Ringgit, Kuwaiti Dinar and Saudi Arabian Riyal (Bursa Malaysia, 2014). In 2018, BSAS Shariah committee approved the improvement of randomisation process of selling the commodity back to the market where the selection of the commodity supplier automatically excludes selling back to the same original commodity seller (Michael, 2021).

There are several factors contributing to the wide application of *tawarruq* in Islamic banking products in Malaysia, be it from the industry player's perspective or from customers' perspective. From Islamic financial institutions' perspective, *tawarruq* is widely used in the Islamic banking practices in Malaysia and has become a popular alternative among IFIs as a product to replace the controversial *bay al-inah* based product (Shafie et al., 2020). Muhammad et. al (2018), in their study, cited that the banks they interviewed resorted to using *tawarruq* as an underlying contract in their products due to the difficulties they faced in complying with the Shariah Standard in the policy document issued by BNM of the previous contracts such as *bay al-inah*.

In *bay al-inah*, they face difficulties to comply with the inter-conditionality restriction. Other than that, in terms of offering banking products familiar to the customer, the concept has gained wide acceptance from IFIs due to the embedded characteristics in the *tawarruq* concept which can offer various features similar to conventional products (Ali & Hassan, 2016).

From the customers' perspective, the acceptance of *tawarruq* concept, specifically in deposit account product, may be contributed by it's features that offer upfront fixed return to depositors, it's easy execution and bearing no risk of losing capital to depositors as they are protected under the Malaysian Deposit Insurance Corporation guarantee (Shafie et al., 2020). On the other hand, in order to cater to the demand of investors who are familiar and inclined towards a fixed rate of return on investments, many Islamic banks opt to use the *tawarruq* concept to achieve the purpose (BMB Islamic, 2011).

## **Tawarruq In Malaysia Islamic Banking Products**

### **1. Personal Financing**

According to Kahf (2015), personal financing concept in the practice of Islamic banks is to provide cash to individual, corporations and government. Up until 2021, personal financing in Malaysia Islamic banks reached a total of RM 58 million (Bank Negara Malaysia, 2021c). Nik Abdullah (2014) and Ahmad (2014) agreed on the factors attitude and religious obligations to be significantly influencing the intention to use Islamic personal financing along with other factors. Ahmad (2014) further noted that the pricing of Islamic personal financing was found to be an insignificant factor.

It is indeed important for Muslims in Malaysia to have an Islamic alternative for personal loan. Study by Rosele (2017) shows that personal financing has become a necessity (*al-hajah*) and also able to take place up to compulsion (*al-darurah*) level in certain condition. Beginning with the concept of *bay al-inah*, its application has undergone several strong critiques that have prompted the introduction of *tawarruq* (Abdul Rahman, 2014). *Tawarruq* personal financing is one of the most profitable Islamic finance products to Islamic financial institutions (Thaidi et al., 2014). The *tawarruq* personal financing modus operandi is as follow (Jamaludin, 2018):

- i. The customer and the Islamic financial institution enter into an arrangement where the customer promises to buy a commodity or asset from the bank. The customer at the same time appoints the bank as his agent to sell the said commodity or asset.
- ii. The bank buys a commodity or asset from Broker A on a spot basis.
- iii. The bank sells the same commodity or asset to the customer on deferred basis at cost plus profit.
- iv. The bank, as an agent to the customer, sells the same commodity or asset to Broker B on a spot basis.
- v. The bank pays the customer the sale proceeds in a lump sum basis.
- vi. The customer pays the bank the purchase price of the commodity or asset on a deferred installment basis

Currently, almost all of Islamic banks licensed by Bank Negara Malaysia offer personal financing product based on the concept of *tawarruq* as can be seen in the following table:

Table 2: Islamic Concept Applied in Islamic Personal Financing Products by Malaysia Islamic Banks

No	Islamic Bank	Islamic Concept Applied in Islamic Personal Financing
1	Affin Islamic Bank Berhad	Tawarruq
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	BBA
3	Alliance Islamic Bank Berhad	Tawarruq
4	AmBank Islamic Berhad	Tawarruq
5	Bank Islam Malaysia Berhad	Tawarruq
6	Bank Muamalat Malaysia Berhad	Tawarruq
7	CIMB Islamic Bank Berhad	Tawarruq
8	Hong Leong Islamic Bank Berhad	Tawarruq
9	HSBC Amanah Malaysia Berhad	Tawarruq
10	Kuwait Finance House (Malaysia) Berhad	Tawarruq
11	Maybank Islamic Berhad	Tawarruq
12	MBSB Bank Berhad	Tawarruq
13	OCBC Al-Amin Bank Berhad	Not found
14	Public Islamic Bank Berhad	Bay Al-Inah
15	RHB Islamic Bank Berhad	Tawarruq
16	Standard Chartered Saadiq Berhad	-

(Source: Respective banks' product disclosure sheets and websites)

## 2. Home Financing

Purchasing a house is a big decision for many households, especially considering the high prices of houses these days. Financial factor had become among the top factors that are strongly associated with consumer decision making in purchasing residential property surpassing the factor association of feature (Chong & Dastane, 2017). Notwithstanding various housing policies implemented by the government, affordability of housing is still an issue in Malaysia whereby the housing price keeps increasing and the effectiveness of these affordable housing policy is inconclusive (Wong & Aralas, 2019). Up until 2021, total impaired and non-performing home financing loans in commercial and Islamic banks in Malaysia reached around RM 8 million, the second highest among loans of other purposes (Bank Negara Malaysia, 2021).

Despite this fact, Muslim consumers are still observant in opting for Shariah-compliant home financing products to purchase the property they intended as not to

violate the religion's principles. Sharaiya and Haswa (2019) pointed out that avoidance from being involved in usury (*riba*) is the general motivation for Islamic banks' clients to opt for Islamic banking and finance products despite the risk of this option of being more expensive and requiring more complicated documentations compared to their conventional counterparts. In choosing financiers to fulfil their need to own a house, operations carried out according to Shariah principles and maintaining information privacy are the factors that led to Shariah-compliant banks having an excellent reputation for garnering their clients' trust (S. Ismail et al., 2014). The study conducted by Bassir et al (2014) even reported that the religiosity factor even surpasses price and cost factor in the rankings of factors determining Islamic home financing acceptance in Klang Valley.

Islamic home financing in Malaysia can be divided into two types, which is debt-based such as bay bithaman ajil (BBA), *istisna'*, *ijarah* and *tawarruq* and equity-based such as *musharakah mutanaqisah* (MM) (Ibrahim & Kamarudin, 2018). Previously, the concept BBA is dominating Islamic home financing products offered by Islamic banks (Ibrahim & Kamarudin, 2018). However, in banking practices, the application of BBA is actually a form of *bay al-inah* (Sawari et al., 2018).

This is among one of the controversies surrounding BBA that led to the implementation of *tawarruq* concept to replace BBA (Amin & Abdul Hamid, 2018). Amin and Abdul Hamid (2018) further reported in their study that product attractiveness, quality of *maqasid* compliance, financial recommendation, attitude and perceived behavioural control are jointly related to the willingness to choose *tawarruq* home financing. An illustration of how *tawarruq* is practiced by Islamic financial institutions in Islamic home financing is as follow (Mahyudin & Che Seman, 2014; Md Dahlan, 2018; M. T. Mohamad et al., 2018; Omar, 2018):

- i. The customer identifies the property that he wishes to buy.
- ii. By applying a home financing scheme based on *tawarruq*/ commodity *murabahah*, the customer requested that the bank buy a commodity at a price that was equivalent to the price of the property that he wished to purchase.
- iii. The bank will buy the commodity from the commodity trader, in the case of Malaysia, this will be done in the Bursa Suq As-Sil'ah (BSAS) at the price equivalent to the property price. The commodity trader will transfer ownership of the commodity to the bank, which will be accomplished through the use of a transfer certificate to the bank.
- iv. Bank will then sell the commodity to the customer at a mark-up price. The customer will repay the markup price in monthly instalments to the bank until full settlement.
- v. The customer will appoint the bank as his agent giving the bank permission to resell the commodity to a commodity trader with the price equivalent to the price of the property. Payment received by the bank will be used by the customer to finance the purchase of the property.

Currently, other than BBA and MM, more banks are implementing *tawarruq* for their Islamic home financing products. This can be seen in the table below:

Table 3: Islamic Concept Applied in Islamic Home Financing Products by Malaysia Islamic Banks

No	Bank	Islamic Concept Applied in Islamic Home Financing
1	Affin Islamic Bank	MM
2	Al Rajhi Bank	Tawarruq
3	Alliance Islamic Bank	BBA
4	AmIslamic Bank	Tawarruq
5	MBSB Bank	Tawarruq

6	Bank Islam	Tawarruq
7	Bank Muamalat	Tawarruq
8	CIMB Islamic Bank	Tawarruq
9	HSBC Amanah Malaysia	MM
10	Hong Leong Islamic Bank	Tawarruq
11	Kuwait Finance House (KFH)	Ijarah Muntahiyah Bit-Tamlik Ijarah Mausufah fi Dzimmah
12	Maybank Islamic	Tawarruq
13	OCBC Al-Amin Bank	Ijarah Muntahiyah Bit-Tamlik
14	Public Islamic Bank	MM
15	RHB Islamic Bank	MM Tawarruq
16	Standard Chartered Saadiq	MM

(Source: Respective banks' product disclosure sheets and websites)

### 3. Credit Cards

Being the most widely used payment card in Malaysia, an average of 349 million credit card transactions was made annually over the past decade (Bank Negara Malaysia, 2019). According to AAOIFI, credit card is a mean of payment providing a revolving credit facility within the credit limit and period determined by the issuer of the card (AAOIFI, 2015). AmBank Malaysia Berhad was the first to introduce an Islamic credit card back in 1996, followed by Bank Islam Malaysia Berhad in 2002 and subsequently Bank Simpanan Nasional in 2006 that employs the concept of *bay al-inah* in their credit card products (Bilal & Mydin Meera, 2015; Uddin et al., 2018). This is before a wider issuance by Maybank Islamic, CIMB Bank, Bank Rakyat Islamic Bank and HSBC Amanah all in 2008 (Balarabe et al., 2020). Islamic concepts embodied in the application of credit cards include *bay al-inah*, *ujrah*, *murabahah*, *hiwalah* and *tawarruq* (Uddin et al., 2018).

Although in initial stages of the Islamic credit cards in Malaysia, many were based on the *bay al-inah* structure, over the past few years, it has evolved into the *tawarruq*-based model and today, credit cards are increasingly being issued and modelled based on *tawarruq* and *ujrah* (Kahf & Mohamed, 2016). Bank Negara Malaysia regulated in their Credit Card-i policy document that credit cards issued based on the concept of *tawarruq* to comply with the *tawarruq* policy document issued (Bank Negara Malaysia, 2019).

*Tawarruq* credit cards are competitive as long as their prices are not higher than that of their conventional counterparts (Sillah, 2017). In their Shariah standards regarding credit cards, AAOIFI stated that it is not permissible for an institution to issue credit cards that provide an interest-bearing revolving credit facility, whereby the cardholder pays interest for being allowed to pay off the debt in instalments (AAOIFI, 2015). Bank Negara Malaysia further regulates some general conditions for credit cards issued based on *tawarruq* concept:

- (a) The issuer purchases an identified commodity from a commodity broker and sells the commodity at an agreed selling price (cost plus profit) on a deferred basis to a cardholder;
- (b) The cardholder then sells the commodity to another commodity broker at cost and on a spot basis through the issuer as an appointed agent;
- (c) The proceeds from the sale of commodity shall constitute the cardholder's credit limit for the purpose of utilisation by the cardholder; and
- (d) The issuer shall charge actual profit to the cardholder based on the utilisation of the credit limit by the cardholder and must grant *ibra'* (rebate) to the cardholder on the unutilised portion.

In terms of practice, Islamic banks used organized *tawarruq* in Islamic credit card structure. The structure of the organized *tawarruq* contract comprises of three transactions between the customer, the bank and the broker (Bank Islam Malaysia Berhad, 2021; Bilal & Mydin Meera, 2015):

- a) In the first transaction, the bank will buy a commodity for a price from Broker A.
- b) Immediately afterwards, the bank sells the commodity to the customer on deferred payment at the bank's sale price on *murabahah* basis (cost plus profit).
- c) As the sale agent for the customer, the bank then sells the purchased commodity to a commodity purchaser for a cash price at cost price.
- d) Proceeds from the transaction will be credited for customer's utilization in customer's credit card account (*wadiah*) maintained by the bank. The customer is obliged to pay the amount due from the *murabahah* transaction as per the agreed terms.

The application of *tawarruq* concept, however, is not really wide in Islamic credit cards. Out of 16 Islamic banks licensed by Bank Negara Malaysia, only two of them underpinning this concept in their Islamic credit card product. Other concepts are more widely used such as are *ujrah* and *qard*. The summary of Islamic concepts applied in Islamic credit card products by Islamic banks can be seen in the table below:

Table 2: Islamic Concept Applied in Islamic Credit Card Products by Malaysia Islamic Banks

No	Islamic Bank	Islamic Concept Applied in Islamic Credit Card
1	Affin Islamic Bank Berhad	Tawarruq
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	-
3	Alliance Islamic Bank Berhad	-
4	AmBank Islamic Berhad	Ujrah and Qard
5	Bank Islam Malaysia Berhad	Tawarruq
6	Bank Muamalat Malaysia Berhad	-
7	CIMB Islamic Bank Berhad	Ujrah
8	Hong Leong Islamic Bank Berhad	-
9	HSBC Amanah Malaysia Berhad	Ujrah
10	Kuwait Finance House (Malaysia) Berhad	-
11	Maybank Islamic Berhad	Ujrah and Qard
12	MBSB Bank Berhad	-
13	OCBC Al-Amin Bank Berhad	-
14	Public Islamic Bank Berhad	Ujrah
15	RHB Islamic Bank Berhad	Ujrah
16	Standard Chartered Saadiq Berhad	-

(Source: Respective banks' product disclosure sheets and websites)

### Deposit Account

The Islamic Financial Services Act 2013 (IFSA) distinguishes investment account from Islamic deposit, where investment account is defined as the application of Shariah contracts with non-principal guaranteed feature for the purpose of investment usually governed by Shariah concepts of *mudarabah*, *wakalah* and *musharakah* while Islamic deposit guaranteed the principal to be returned or repaid in full (Bank Negara Malaysia, 2013, 2017). Beginning on 1 July 2015, Islamic deposits and investment accounts are required to be designated separately (Bank Negara Malaysia, 2018a).

Deposits can be defined as amounts owed to creditors which are not negotiable in the sense that there are restrictions on the transfer of their legal ownership and thus not

marketable (Sobol & Dopierla, 2019). Deposits are considered to be one of the most important sources of funding for both conventional and Islamic banks (Maswadeh, 2020; Sobol & Dopierla, 2019). As a financial intermediary, the main sources of funds for Islamic bank are mobilized through various forms of deposit products (Amin, 2013; A. G. Ismail et al., 2013). By the end of 2018, deposit accounts made up a total of nearly RM 660 million in the Malaysian Islamic banking system, a much larger proportion than its investment account counterpart that made up nearly RM 83 million (Bank Negara Malaysia, 2018a). This may be due to the fact that Islamic deposits have maximum flexibility in withdrawal and amount guaranteed by Malaysia Deposit Insurance Corporation or better known as Perbadanan Insurans Deposit Malaysia (PIDM) (Adznan, 2018).

Types of deposit accounts include saving account, current account and term deposit (Bank Negara Malaysia, 2014). Saving accounts and current accounts are accounts that allow the depositor to do basic banking services at low or no cost (Bank Negara Malaysia, 2009). Current accounts have an additional feature over saving accounts of allowing withdrawal by third party designated by the customer through, for example, cheque payment (BMB Islamic, 2011).

Meanwhile, term deposit is a type of deposit held at a bank that has a fixed term, generally short ones with maturities ranging anywhere from a month to a few years that requires withdrawal to be allowed only by the end of the term or by giving a predetermined number of days' notice (A. G. Ismail et al., 2013). Term deposits offer the bank with the greatest level of confidence in its credit operations (Maswadeh, 2020).

Since the IFSA 2013 does not allow Islamic banks to use *mudarabah* and *wakalah* as underlying contracts for principal guaranteed deposit account, there is a need to create a new product which complies with the IFSA 2013 (A. G. Ismail et al., 2013). In this context, the *tawarruq* concept becomes an alternative and achieved a wide usage as underlying concept in Islamic deposits. In 2016, Islamic deposits based on *tawarruq* increased by 7.5%, reflecting higher demand for fixed rates of return on deposits offered under *tawarruq* contracts (Bank Negara Malaysia, 2016).

By the end of 2019, 63 percent of deposit accounts are those of *tawarruq* concept, making up more than half of the sum (Bank Negara Malaysia, 2020). In October 2021, Malaysia Islamic banking system's total *tawarruq* fixed deposit reached about RM 384 million, the largest among other types of deposit (Bank Negara Malaysia, 2021b). Typically, a deposit structure based on *tawarruq* concept is as follow (Shafie et al., 2020; Sobol & Dopierla, 2019):

1. Customer appoints Islamic bank as an agent to purchase Shariah compliant commodity from a broker via Bursa Suq Al-Sila' Malaysia (BSAS) on cash basis.
2. Islamic bank purchase the commodity on behalf of the customer. The customer now is the owner of the commodity.
3. Customer sells the commodity to Islamic bank on a deferred basis.
4. Islamic bank sells the commodity to another broker via BSAS on cash basis.
5. Proceed from the sale in number 4 will be utilised for the Islamic bank's funding purposes.

Currently, all of Islamic banks in Malaysia apply the *tawarruq* concept for their Islamic deposit account products except one Islamic bank. Some Islamic banks offer Islamic deposit product either by *tawarruq* or *qard* concept. This can be seen in the table below:

Table 2: Islamic Concept Applied in Islamic Deposit Account Products by Malaysia Islamic Banks

No	Islamic Bank	Islamic Concept Applied in Islamic Deposit Account
1	Affin Islamic Bank Berhad	Tawarruq Qard

2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Tawarruq
3	Alliance Islamic Bank Berhad	Tawarruq
4	AmBank Islamic Berhad	Tawarruq
5	Bank Islam Malaysia Berhad	Tawarruq Qard
6	Bank Muamalat Malaysia Berhad	Tawarruq
7	CIMB Islamic Bank Berhad	Tawarruq
8	Hong Leong Islamic Bank Berhad	Tawarruq
9	HSBC Amanah Malaysia Berhad	Qard Murabahah
10	Kuwait Finance House (Malaysia) Berhad	Tawarruq Qard
11	Maybank Islamic Berhad	Tawarruq
12	MBSB Bank Berhad	Tawarruq
13	OCBC Al-Amin Bank Berhad	Tawarruq Qard
14	Public Islamic Bank Berhad	Tawarruq Qard
15	RHB Islamic Bank Berhad	Tawarruq Qard
16	Standard Chartered Saadiq Berhad	Tawarruq Qard

## DISCUSSION

The implementation of *tawarruq* in Malaysia is corely backed by official bodies such as BNM's Shariah Advisory Council (SAC) and Bursa Malaysia. BNM's SAC played a vital part in ruling permissibility of *tawarruq*. The body even rule permissibility of several practices in *tawarruq* ruled impermissible by international bodies like AAOIFI and Council of International Islamic Fiqh Academy i.e appointment of bank as an agent on the behalf of customer to sell commodity bought from the bank itself and the practice of dual agency. This leniency opens wider doors for *tawarruq* implementation in Malaysia's Islamic banking and finance industry.

On the other hand, Bursa Malaysia through its wholly owned subsidiary, Bursa Malaysia Islamic Services (BMIS) action in managing BSAS that facilitate banking and financing practices using *tawarruq* by providing a commodity platform that observes Shariah principles while integrating global Islamic financial and capital markets together through one single engine proves the seriousness of Malaysia Islamic finance and banking industry to bring *tawarruq* practice to a higher level.

The application of *tawarruq* concept in Islamic banking products is mainly the result of evolution from previous Shariah concepts underpinning the products. In Islamic personal financing, home financing and credit cards, for example, the services was previously dominated by *bay al-inah* concept. However, following strong critiques and controversies, new concepts needed to be introduced, hence, *tawarruq* took the spotlight in replacing its place. In the case of deposit products, since the IFSA 2013 does not allow Islamic banks to use *mudarabah* and *wakalah* as underlying contracts for principal guaranteed deposit account, *tawarruq*-based deposit products came into the lime light. It can be seen here that *tawarruq* was somehow brought up as a solution to problems arised in previous application of Shariah concepts underpinning these products and subsequently dominating the Islamic finance and banking industry.

Nevertheless, even in acting as a solution, the critiques following *tawarruq* operation in banks are not little. Critiques pertaining the issue of legal stratagem to gain usury, for example, is the heaviest of all since usury or *riba* is a grave sin a believer is

strongly prohibited to commit. It is even the same essence of critique on the practice of *bay al-inah* that subsequently led to its replacement with other Shariah financial concepts. Meanwhile, in the issue of pre-arrangement and dual agency, they seem to be impossible to be separated from current practice of *tawarruq* considering that it will become difficult for Islamic banks to carry out *tawarruq* without these two practices. However, by continuing these two practices, it will just be a proof that *tawarruq* that are being practiced today indeed aimed towards usury, i.e. gaining money with money. In this context, a more innovative alteration in the operation of *tawarruq* needed to be come up with.

## CONCLUSION

*Tawarruq* is gaining larger popularity in Malaysia Islamic banking and finance industry. Year by year, *tawarruq* is comprising larger percentage in Malaysia Islamic banking portfolio. Islamic banking products such as personal financing, home financing, credit cards and deposit accounts are underpinning *tawarruq* as their base operational concept. However, the practice of *tawarruq* is not free from heavy critiques. Innovative alterations need to be applied on the current practice of *tawarruq* to mitigate these critiques. Otherwise, the application of *tawarruq* can be considered as a good effort in the share of Islamic banking and finance player to bring the industry to a higher level.

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