End of tuwurruq as we know it?

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The enduring thorn in the side of the Islamic finance industry remains tuwurruq. The objection is not just that tuwurruq remains over used and omnipresent in the Islamic finance industry, but its structure and perception ill informs and prejudices the development of Islamic finance. Tuwurruq's permissibility on the basis of the doctrine of “necessity” to facilitate Islamic financial institutions to compete with conventional banks in those areas, where no other Sharia compliant modes of finance can be used, is readily recognised by those within the industry. But, to the less acquainted, it must come as a surprise that this mainstay form of financing is widely objected to. New sovereign entrants to Islamic finance like Oman and its main regulator has not permitted its Islamic banks or Islamic windows to undertake any tuwurruq transactions. And even Qatar, which has permitted Islamic financial institutions to deal in tuwurruq in their interbank dealings, is not readily open to them to extend tuwurruq for corporate financings.

The Islamic finance industry services consumers. Like all service sectors, doubts as to what is being sold leads to dissatisfaction and, equally negative, disinterest. It is too easy to be dismissive of cynical sentiments about modern Islamic banking. Too often lay person declarations that tuwurruq transactions are just interest by another name are refuted by the contention that the commodity murabaha profit is not interest because it is a return from a sale transaction. But step back – the flow of funds is always from the bank to the customer in a tuwurruq transaction. So here lies the nub of the issue – how can there be a profit for the bank if the bank never pays for the commodities? Put differently, if the bank never actually pays in cash for the commodities what is the justification for charging the customer a murabaha profit? Crucially, how can this be presented to the ordinary man and woman on the high street in terms that are logical and transparent. The customer wants financing – it is told to buy commodities that he/she does not want and to sell them to an entity that he/she has no commercial concern with.

After analysing the transactions involved in contemporary tuwurruq transactions, it is difficult not to come to the glaring conclusion that the Islamic finance industry is in a state of denial - ostrich like. Commodity murabaha finance transactions requires a complete quantum shift in thought to achieve transparency and logicality or, put simply, to make sense. The whole premise of this article is founded on what Prophet Muhammad (peace be upon him) said: “actions are but by intentions, and each man will have but that which he intended". The intention here is to progress the tuwurruq discussion by logically articulating to consumers of Islamic finance how tuwurruq can be justified in a transparent way and, in doing so, what distinguishes it from a loan with interest. But, crucially, not on the basis of current thinking. Equally, let us not kid ourselves that contemporary tuwurruq is not justified by the historical use of tuwurruq. That involved a person (A) buying something from someone else (B) and paying B on a deferred basis. Person A then sells to an unrelated third person and realises his/her aim by getting funds immediately, but with person A owing person B the purchase price, both principal and profit, to be paid later as agreed between them.

It is no surprise to recall that the Organisation of Islamic Cooperation’s International Council of the Fiqh Academy in Makkah ruled in April 2009 (Resolution 179) that "organised" tuwurruq and reverse tuwurruq were not permissible, since they were a "trick" to get cash now for more cash paid later. AAOIFI's *Sharia* Standard in respect of tuwurruq transactions seeks to dispense with any "trick" by providing, amongst other things, that the commodity should not return back to the original seller by virtue of prior agreement or collusion between the two parties. AAOIFI's intentions are laudable, but the fact is that there is invariably agreement between all parties to the tuwurruq transaction.

So addressing transparency and logicality square on, contemporary tuwurruq fails on a Sharia compliance conventional analysis. This is because:

- the bank contracts to buy commodities from a commodity broker, but the bank can't pay the broker because that is not the commercial or regulatory deal – the deal is a financing for the customer (whose creditworthiness is the subject of the transaction) in respect of which the bank's risk adjusted capital is allocated;

- the bank sells the commodities to the customer at cost price (which it has not paid for) plus a murabaha profit amount, payable on a deferred basis by the customer – the bank is owed a debt, namely the deferred murabaha sale price payable by the customer;

- the customer obviously doesn't simply want to be left with a debt owed to the bank, so the customer (typically, through the bank) needs to sell the commodities to another broker – this broker agrees to buy those commodities at cost price.

If none of the brokers pay the bank for the sale or purchase of commodities, what justification is there for the bank to disburse the financing directly to the customer? A trick? Current Sharia standards would point to this conclusion as there has to be an agreement between all parties to justify this direct flow of funds. The reality is that there has to be a settlement arrangement in existence between all parties, however documented, so that:

- the bank will not pay cash for the commodities it buys from that broker;

- the second broker will not pay the customer cash for the commodities sold to it.

The "two way" brokers used to transact the commodity murabaha transactions net off their transactions and sell back to square their positions, effectively “paper truncation” of book entry settlement.

This is only possible by an arrangement between the parties that results in a netting off of payment obligations or, analysed differently for Sharia compliance rationale, through hawala transactions, i.e. transferrence of debt between the parties to end up contractually with the above result. Based on current Sharia analysis, this "collusion" is wrong. But to ignore it is to act ostrich like - a state of denial because contemporary tuwurruq operates on this basis, how can it operate otherwise. So, going back to the virtues of transparency and logicality, far from ignoring what happens between the brokers and the other parties in a tuwurruq transaction, isn't it time to look at the whole picture and clearly present the hawala aspects of the transactions so that they make logical and transparent sense. In that way consumers of Islamic finance can be told that the financing is Sharia compliant because:

- the murabaha profit owed to the bank is justified because the bank has sold commodities through a sale transaction to the customer, and not by "renting money";

- the bank can still make a murabaha profit even if has not paid the original broker cash because hawala is a legitimate arrangement entered into between the parties.

This logical and transparent response to the customer is a far cry from the present position which at least obfuscates the role of the brokers – "trickery" is turned into transparency and as AAOIFI state in their standard on hawala " is permitted to facilitate payments and recovery". A quantum shift in thought is not to invite puerile and technical argument but to look at tuwurruq afresh and not with eyes wide shut. In this way we can all give coherent response to cynics armed with the obvious flaws of contemporary tuwurruq.