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Commodity Murabahah Programme (CMP): An Innovative Approach to Liquidity Management

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Abstract

Liquidity is an important characteristic of banks. By their very nature, banks transform the term of their liabilities to have different maturities on the asset side of the balance sheet. At the same time, banks must be able to meet their commitments such as deposits at the point at which they become due. Thus, liquidity management lies at the heart of confidence in the banking operation. Customers place their deposits with a bank, confident they can withdraw the deposit when they wish. If the ability of the bank to pay out on demand is questioned, all its business may be lost overnight. The importance of liquidity transcends the individual institution, since a liquidity shortfall at a single institution may invoke systemic repercussion causing harm to the whole financial stability of a country. Therefore it is important for banks to have adequate liquidity potential when it can obtain sufficient funds promptly and at a reasonable cost. For Islamic banks, liquidity risk is a significant risk owing to the limited availability of Shariah-compatible money market instruments and lender-of-last-resort (LOLR) facilities. Hence, the recent introduction of commodity murabahah instrument based on tawarruq concept by Central Bank of Malaysia is deemed as an innovative approach to liquidity management. It certainly adds to the list of instruments for Islamic banks to manage their liquidity more effectively and efficiently. This paper reviews the structure and mechanism of commodity murabahah particularly for liquidity management purpose. As will be evident in this paper, this instrument has its own advantage which appeals to certain practitioners who were previously uncomfortable with Shariah-based instruments.

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INTRODUCTION

Liquidity management lies at the heart of confidence in the banking operation. Customers place their deposits with a bank, confident they can withdraw the deposit when they wish. If the ability of the bank to pay out on demand is questioned, all its business may be lost overnight. In general terms, liquidity refers broadly to the ability to trade instruments quickly at prices that are reasonable in light of the underlying demand/supply conditions through the depth, breadth and resilience of the market at the lowest possible execution cost (Pervez, 2000). A perfectly liquid asset is defined as one whose full present value can be realized, i.e. turned into purchasing power over goods and services, immediately (Tobin, 1987). Cash is perfectly liquid, and so for practical purposes are demand deposits, and other deposits transferable to third parties by cheque or wire, and investments in short term liquid government securities (Abdul-Rahman, 1999). The importance of liquidity transcends the individual institution, since a liquidity shortfall at a single institution may invoke systemic repercussion causing harm to the whole financial stability of a country. Therefore it is important for banks to have adequate liquidity potential when it can obtain sufficient funds promptly and at a reasonable cost (Heffernan, 1996).

The concern over liquidity management is also relevant to Islamic bank that holds illiquid assets while its liabilities are liquid, and holds assets unpredictable in value while guaranteeing the value of its liabilities. Thus, since Islamic banks follow the same structure and characteristics of a commercial banks' balance sheet, they are not immune from liquidity risk. The potential mismatch between deposits and investment financing exposes Islamic banks to liquidity problems. On the other hand, if the banks maintain too much liquidity to avoid getting into the liquidity problems may in turn hurt its profitability. Therefore creating a right balance between the two objectives of safety and profitability is the crux of the liquidity management issue.

In Malaysia, the establishment of the first Islamic Inter-bank Money Market (IIMM) on January 3, 1994 was designed to provide the Islamic banks with the facility for funding and adjusting portfolios over the short-term and hence maintaining the funding and

liquidity mechanism necessary to promote stability in the system. More importantly IIMM provide avenue for Islamic banks to manage liquidity more effectively and efficiently without undermining the principles of Shari`ah.

The development of a vibrant, efficient and effective Islamic Inter-bank Money Market requires the creation of a broad spectrum of innovative Islamic financial instruments and the infrastructure to promote active trading so as to enhance the breadth and depth of the market. Consequently, as part of Bank Negara Malaysia's initiative to support Islamic banking and finance development in Malaysia, Commodity Murabahah Programme (CMP) was introduced to facilitate liquidity management and investment purposes. CMP is a cash deposit product which is based on principle of *tawarruq*. It is designed to be the first ever commodity-based transaction that utilises the Crude Palm Oil (CPO) based contracts as the underlying assets. CMP transaction with Bank Negara Malaysia was first auctioned competitively in the IIMM on 14 March 2007 and marked an extensive effort by the country to become a significant player in Islamic financial market globally (Bank Negara Malaysia, 2007).

This paper provides insights into the structure and mechanism of Commodity Murabahah Programme as an instrument to serve the liquidity need and investment opportunity of Islamic financial institutions. In doing so, the paper also reviews some Shari`ah issues pertaining to the nominate contract used in CMP, namely the *tawarruq* principle. As will be evident in this paper, this instrument has its own advantages and value added which would make it the instrument of choice in meeting specific investment interests and needs.

The structure of the paper is as follows. Section 2 establishes the concept of liquidity management in Islamic financial institution. This is followed in Section 3 by a more detailed discussion on concept and modus operandi of Islamic liquidity management. Section 4 discusses the concept, structure and mechanism of Commodity Murabahah Programme. Section 5 reviews the various opinion of Muslim School of Fiqh on the validity of *tawarruq*-based products as practised in IIMM. The final section contains the concluding remarks.

CONCEPT OF LIQUIDITY MANAGEMENT

Banks in a business of offering debt contracts for liquid deposits that finance the acquisition of illiquid assets of uncertain value. Banks which hold illiquid assets and issue demand liabilities are one market response to the desires of individuals to improve terms on which they urgent demands to withdraw funds can be met (Lewis, 1991). This transformation of liquid liabilities into illiquid assets necessitates banks to manage their liquidity position effectively and efficiently. Banks must structure their portfolios so that the pattern of asset returns can support the short-term obligations that they issue. Hence, liquidity is parallel to the term 'solvency' which means the ability to meet debts as and when they are due and this is achieved when the current assets of the bank exceed current liabilities (Klein, 1995). Consequently, liquidity risk emerges as one of the most important risks that banks need to address to avoid loss if it is not properly managed. Liquidity risk can be broadly defined as the potential loss to banks arising from their inability either to meet their obligations or to fund increases in assets as they fall due without incurring unacceptable costs or losses (Greuning & Bratanovic, 1999).

Therefore liquidity risk management lies at the heart of confidence in the banking system. Failure to address liquidity problems not only can cause an insolvent bank to runs but may also have contagious effects. The systemic danger is that the failure of an insolvent bank can cause depositors of other banks to withdraw deposits (Bhattacharya & Jacklin, 1988; Diamond & Dybvig, 1983). This can cause a solvent institution to become insolvent because two main reasons: first, a large proportion of bank assets are not easily marketable; and second because a panic may drive down the current value of those assets which are marketable. In the event of a run, a bank is forced to dispose of assets which, because of asymmetric information problems, cannot be sold at par as potential buyers impose a high risk premium in the purchase price (Llewellyn, 1999).

In a normal situation banks and other financial intermediaries facing temporary shortages of reserves and secondary reserves of liquid assets can borrow them from other institutions. In developed country like the United States, a well-organised market for

'federal funds' allows banks short of reserves to borrow them overnight from other banks (Tobin, 1987). Furthermore, the availability money market and inter-bank market i.e. market for short-term loans, is designed to meet short-term cash requirements of banks and other financial intermediaries. Maturities of loan normally range from overnight to one year (Rosly, 2005).

Liquidity risk also applies to Islamic banks, since they are also constrained by illiquid assets to meet their liquid liabilities and financial obligations. According to theory, Islamic banks are less exposed to liquidity risk and therefore to instability than their conventional counterparts. An ideal Islamic banking model is reflected through its balance sheet structure that is dominated by profit-loss-sharing (PLS) on both the assets and liabilities sides (M. Umar Chapra, 1985; M. Umer Chapra, 2000b; Rosly & Bakar, 2003; Siddiqi, 1985; Siddiqi, 2001). In such arrangements, it is believed that the depositors who share the risk with the bank on the liabilities side will naturally absorb any adverse outcomes on the assets side of the bank's balance sheet. In other words, any negative shock to an Islamic bank's asset returns is absorbed by both shareholders and investments account depositors. The value of the depositors' funds represents the real assets value of the banks. Thus, Islamic banking theoretically is deemed to be a good alternative to the conventional system due to its robustness and the potential stability that the system may provide (Khan & Mirakhor, 1987; Siddiqi, 2001)

However, the practices of Islamic banks are found to diverge in important ways from the ideal structures envisioned by the pioneers of Islamic economics. Rather than strictly sharing profits and losses with depositors, the practice of distributions of profits even if there are no or low profits creates distortions and put strains on the equity shareholders. In addition, most retail deposits scheme (current and savings) are based on contracts like *Wadi`ah Yad Dhamanah* (guaranteed safekeeping) or *Al-Qard* (loan), which are guaranteed principal contracts irrespective of the bank's profitability on its assets side. The prevailing practice of giving *hibah* (gift) at the rate equivalent to the rate of return on deposits offered by conventional banks further distort the ideal structure of Islamic banking. Consequently, Islamic banks resort to the second line fixed return techniques

including *murābahah* (cost-plus sale), *bai' bithaman 'ajil* (deferred payment sale), *bai' al-salam* (purchase with deferred delivery), *bai' al-istisna'* (commissioned manufacturing), and *ijārah* (leasing), etc¹ aimed at fixed and secured profits.

Islamic banks are also criticised for not giving priority to long-term development projects over short-term projects aimed at quick profits. This attitude is similar to that of the conventional banks that prefer short-term investments since banks work on the basis of small reserves and hence, must be able to liquidate their assets fairly quickly, if the need arises. The short-term structure of the Islamic banks' assets is even more pronounced with the predominance of debt-based contracts or fixed return modes like *murabahah* and leasing on the asset side of Islamic banks' balance sheet. The structure of deposits on the liabilities side which is not sufficiently long term further accentuates the reluctance of Islamic banks to get involved in long-term projects. Thus, from a substantive standpoint, Islamic banks do not operate very differently from their conventional counterparts.

In sum, the nature of Islamic bank's balance sheet is similar to conventional banks. On the asset side, Islamic banks offer products which are illiquid and relatively long-term in nature, whereas on the liabilities side Islamic banks accept deposits which are liquid

ISLAMIC APPROACH TO LIQUIDITY MANAGEMENT

One of the most important approaches to liquidity management is the ability of a bank to get access to secondary market such as capital market and inter-bank money market. The latter is generally referring to borrowing and lending activities for periods of a year or less. This money market has become a place for financial institutions and governments to manage their short-term liquidity needs. Thus banks normally expect to derive liquidity from both sides of their balance sheet and maintain an active presence in inter-bank money markets. They look to these markets as a source for discretionary acquisition of

¹ Observers point out that the use of PLS instruments, namely *mudārabah* and *mushārahah* financing have declined to almost negligible proportion. In many Islamic banks' asset portfolios, short-term financing, notably *murābahah* and other debt-based contracts account for the great bulk of their investments. Yousef (2004) refers to the strong and consistent tendency of Islamic banks to utilise debt-like instruments in the provision of external finance as '*murābahah syndrome*'. Also refer to (Iqbal & Molyneux, 2005; Kuran, 2004; Lewis & Algaud, 2001; Yousef, 2004).

short-term funds on the basis of interest-rate competition, a process that can help them meeting their liquidity needs (Greuning & Bratanovic, 1999).

Conceptually, the availability of asset and liability options should result in a lower cost of liquidity maintenance. The costs of available discretionary liabilities can be compared to the opportunity cost of selling various assets, since banks also hold a range of short-term assets that can be sold if necessary. These assets also serve as reassurance to the potential suppliers of funds about the credibility and reputation of the bank, thus enhancing the bank's ability to borrow (Greuning & Bratanovic, 1999).

There are various short-term liquidity instruments in the conventional money market, offering different returns and different. These instruments include treasury bills, certificates of deposits, repurchase agreements, banker's acceptance, commercial papers and inter-bank money deposits (Rosly, 2005). All these instruments have different characteristics pertaining to maturity periods ranging from over night to one year. In a nutshell, inter-bank money market allows surplus banks to channel funds to deficit banks using various instruments, thereby maintaining the funding and liquidity mechanism necessary to promote stability in the system (Fabozzi & Modigliani, 2003). However, most of these instruments used in inter-bank money market are essentially interest-based instruments. Therefore, the establishment of a viable Islamic money market with Shariah-compliant instruments is not only needed for the smooth growth of the industry nowadays but it has already become a necessity.

Initial efforts to overcome the problem of liquidity management have been focusing on creating short-term and long-term debt instruments that are in line with Shariah principles. This was evident, in some jurisdictions, through the issuance of diverse Islamic financial instruments ranging from short-term papers to long-term bonds to meet the liquidity and investment needs of Islamic banking institutions. Perhaps, Malaysia seems to be the pioneer country in such initiatives with the establishment of the first Islamic Inter-bank Money Market (IIMM) in the world.

The IIMM was introduced on January 3, 1994 as a short-term intermediary to provide a ready source of short-term investment outlets and avenue for banks to manage their potential asset and liability mismatch based on Shariah principle. Through the IIMM, the Islamic banks and banks participating in the Islamic Banking Scheme (IBS) would be able to match the funding requirements effectively and efficiently. Since its first inception, there are number of instruments have been developed and introduced to the market, which suit diverse investors' requirements and needs. These instruments include Mudarabah Interbank Investment (MII), Wadiah Acceptance, Government Investment Issue (GII), Bank Negara Monetary Notes-i (BNMN-i), Sell and Buy Back Agreement (SBBA), Cagamas Mudharabah Bonds (SMC), When Issue (WI), Islamic Accepted Bills (IAB), Islamic Negotiable Instruments (INI), Islamic Private Debt Securities, Ar Rahn Agreement-I (RA-i), Sukuk BNM Ijarah (SBNMI)².

Even though some of these instruments are Shariah compatible, others seem to be controversial. The controversies surrounding these instruments are mainly due to the overemphasising on the use of *bay` al-`inah* contract in devising most IIMM instruments. For example, Government Investment Issue (GII) which was initially issued by the Government of Malaysia based on *qard al-hasan* (benevolent loan) principle, now replaced by *bay` al-`inah*, allowing it to be traded in the secondary market via the concept *bay` al-dayn* (debt trading).

Bay` al-`inah is normally described as an arrangement whereby a person sells an asset to another for deferred payment. Subsequently, the seller buys back the asset from the buyer before the full payment of the deferred price and for cash payment which is of a lesser amount than the deferred price (Al-Zuhayli, 1989). In the case bay` al-`inah-based GII transaction, the Shariah-compliant asset (for example GII) will be sold by a financier (for example central bank) to the recipient bank at X price on deferred terms. Then, the recipient bank will sell back the asset (GII) to the financier on cash basis at Y price. The deferred price of X is higher than the cash price of Y, hence the difference is regarded as

² For detailed descriptions of these instruments, refer to <http://iimm.bnm.gov.my>.

profit to the financier. Both sale contracts are executed separately (Central Bank of Malaysia, 2007).

Another example is the Negotiable Islamic Certificate of Deposit (NICD), which has also applied *bay` al-`inah* to produce the Islamic version of NCD. The sale and buy back mechanism (*bay` al-`inah*) is explained as follows: A high net-worth individual client who wishes to deposit RM1 million in NICD with an Islamic bank would normally expect a fixed return from the bank. The bank sells its asset (i.e. its shares certificate) worth RM1 million to the client and get paid on cash basis. The bank now secures RM1 million deposits. Subsequently, the client sells back the share certificates to the bank at a deferred price, which is based on a profit rate; say 7.5 percent for duration of six months ($7.5\% \times 6/12 \times 1,000,000 = 37,500$). The bank now issues the client NICD worth 1,037,500 as the nominal value. The issuance of the NICD is undertaken as evidence of the RM1,037,500 debt that the bank owes the client. At maturity, the NICDs are redeemable at par value where the client gets back the RM1 million deposit plus RM37,500 profit. More importantly this NICD is tradable in the secondary market for liquidity purposes (Rosly, 2005).

In recent times, most of the contemporary Muslim jurists are clearly inclined towards the majority's view in disallowing and nullifying *bay` al-`inah* mainly disputing that it is a legal device (*hilah*) to circumvent *riba*-based financing, which in fact opens a 'back door' to *riba* (Ali, 2007). Those who against *bay` al-`inah* basically subscribes to the opinion of classical scholars such as Hanifis, Malikis, Hanbalis and some Shafiis schools who reject *bay` al-`inah* and opine that this kind of sale transaction is forbidden (Central Bank of Malaysia, 2007). This somehow explains the global rejection of the Malaysian practice of *bay` al-`inah* in Islamic financial market.

Nonetheless, Malaysian scholars who mainly subscribe to the opinion of Shafiis, Abu Yusuff, Abu Daud and Abu Thur, including a report from Ibn Umar are of the view that the *bay` al-`inah* contract is not contrary to Shariah principles, thus it is allowed (Central Bank of Malaysia, 2007). Among their arguments are summarised below:

1. The companion's report relied by those who reject *bay` al-`inah* is considered weak both in terms of its transmission (*sanad*) and wordings (*matan*)³. The proponents of *bay` al-`inah* argue that one of the narrators of the hadith named al-`Aliyah binti Anfa` is unknown (*majhulah*). Al-Dar Qutni regards her as an unknown figure, thus chain of transmission is doubtful and hence the hadith cannot be a proof. The companion's report is also weak in terms of its wordings (*matan*). They claim that Saidatina Aisyah is not in capacity to determine the status and invalidate the rewards for jihad that Zaid had involved together with the Prophet p.b.u.h. in the battle fields since Zaid had conducted an *ijtihad* (rational reasoning) and was of the view that such a sale is permissible (Ahmad, 2007).
2. On the issue of *hilah*, the Malaysian scholars argue that not all *hilah* is rejected. In fact Hanafis and Shafiis school generally approve the use of *hiyal* (a plural for *hilah*) as long as it does not deny the rights of people or involve falsehood (*batil*) or even demeaning the religion. Al-Sarakhsi (as quoted in Ali, 2007) strongly argued that "*Hiyal* as they are produced by the Imam is permissible according to majority (jumhur) of the scholars, and those who detest that (the use of *hiyal*) did so due to their ignorance and lack of observation (*taammul*) of the Quran and Sunnah". Based on this premise, the Shariah Advisory Council of Malaysia argued that *hilah* as evident in the practice of Islamic instruments in IIMM is regarded as a mode to solve problems (*makhraj*) that is much needed by the people, provided that necessary conditions are duly followed in order to avoid any abuse of such contract which may lead to dispute or injustice (Central Bank of Malaysia, 2007).

³ The companion's report is a narration from Saidatina Aisyah: A mother once asked Saidatina Aisyah, she said: "O Mother of the Believers! I have sold a slave belongs to Zaid bin Arqam to `Ata' for 800 dirham. Since `Ata' needed some money, I have bought back the slave before it is due for me to receive 600 dirham". Saidatina Aisyah replied, "How could you execute such a bad sale. You should inform Zaid bin Arqam that his conduct has extinguished all his rewards for participating in jihad with the Prophet p.b.u.h. if he does not repent. The mother said: "What is your opinion if I forgo the profit and take the principal sum only?" Aisyah then recited a verse from which means: "Whoever receives an admonition from his Lord and stops eating *riba* shall not be punished for the past, his case is for Allah (to judge)" (Al-Baqarah: 2:275).

Notwithstanding all the arguments to support *bay` al-`inah* concept, the fear that the practice of *bay` al-`inah* will be used as a camouflage for interest-based transactions cannot be totally neglected. In this regard, Malaysian scholars have warned the market players to strengthen and enhance the operational processes and documentation to comply with the features of *bay` al-`inah* as permitted. Moreover, since *bay` al-`inah* is still regarded as a matter of juristic disagreement among the Shariah scholars, it is advised that Islamic financial institutions to limit its use in products which really face difficulty in structuring them based on other consensually accepted contracts (Central Bank of Malaysia, 2007).

Of late, there have been attempts by Malaysian authorities like Central Bank of Malaysia to provide other alternative mechanisms to meet the need for cash and liquidity, without having to resort to *riba*-based mechanism or the contentious product based on *bay` al-`inah*. The instrument is known as commodity murabahah programme (CMP) which adopts the concept of *tawarruq*. The mechanism and structure of CMP will be discussed in the following section.

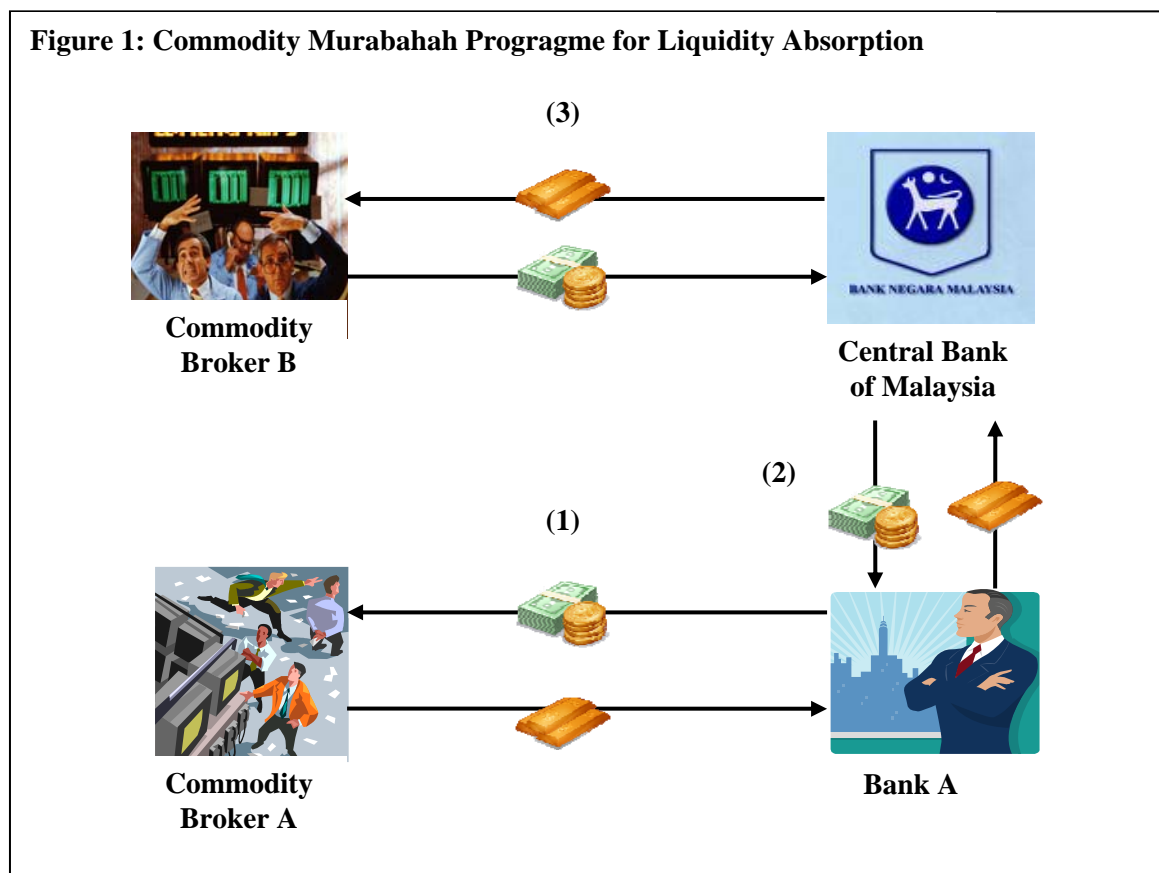
COMMODITY MURABAHAH PROGRAMME (CMP)

Commodity murabahah is one of the most popular techniques used to manage short-term liquidity in the Gulf region (especially Saudi Arabia and United Arab Emirates) (El-Gamal, 2006). It is based on commodities traded on the London Metal Exchange (LME) on a spot basis with 100 per cent payment of the purchase price, then selling the purchased commodities to a third party on a Murabahah (cost-plus sale) basis for a deferred payment with a maturity from one week to six months, and with spot delivery of the sold commodities.

In Malaysia, commodity murabahah programme (CMP) was designed to be the first ever commodity-based transaction that utilises the Crude Palm Oil (CPO) based contracts as the underlying assets. Even though the concept which is based on *tawarruq* contract has long been discussed by the Shariah scholars worldwide, only recently such concept was being practically implemented. It was officially endorsed as a permissible instrument to

be used in financial market and IIMM by the Shariah Advisory Council of Central Bank of Malaysia on 28th July 2005. The main purpose is to offer Islamic financial institutions a new instrument in managing liquidity in the IIMM. CMP provides certainty of returns as it is undertaken based on pre-agreed 'margin' or 'mark-up' from the sale and purchase of the underlying asset (Bank Negara Malaysia, 2007).

The structure of CMP for liquidity management (both to absorb and inject liquidity) comprising several activities are depicted in Figure 1 and Figure 2, respectively.



Several mechanism of CMP for absorbing liquidity as depicted in Figure 1 can be further illustrated as follows:

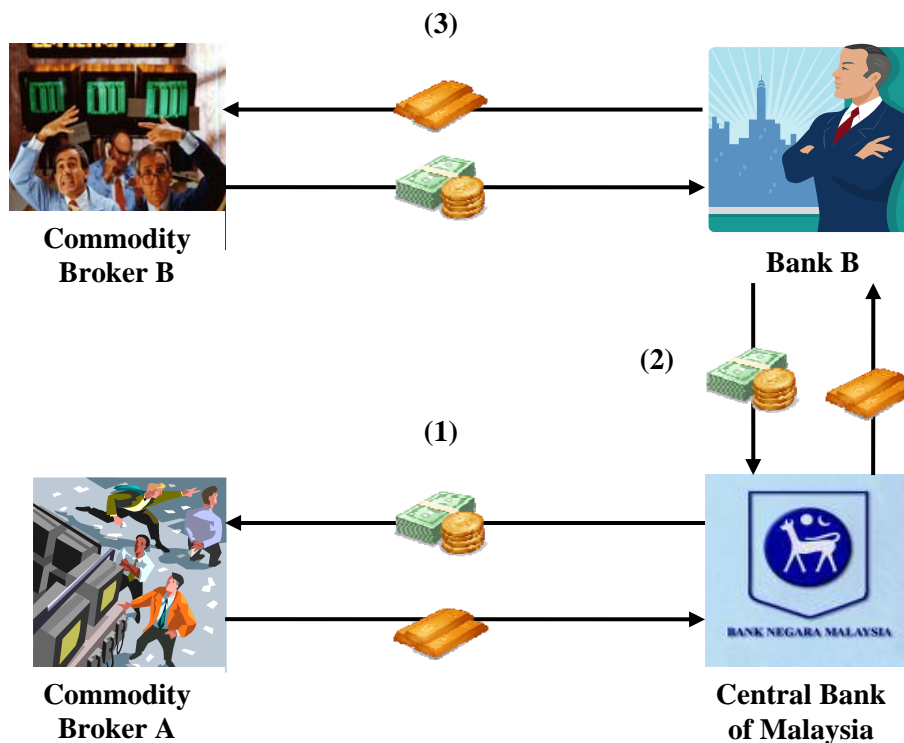
- (1) Bank A that faces excess liquidity can manage their liquidity by purchasing commodities from Broker A on cash basis. For example, RM 1 million.

- (2) Thereafter, the bank sells the commodities to Central Bank of Malaysia on deferred price (cost price plus profit margin). For example, RM 1 million (cost) plus 7.5 profit margin for a duration of six months ($7.5\% \times 6/12 \times \text{RM}1 \text{ million} = \text{RM} 1,037,500$).
- (3) Central Bank of Malaysia sells the commodity to Broker B in on spot at the original price to net off the commodity position that it holds when it purchased from Bank A. The Central Bank of Malaysia may appoint the bank as his agent to sell the commodities in the commodity market.

On maturity date, Bank A will be receiving the amount equivalent to the principal plus the net yield as agreed beforehand. In the final analysis, CMP provides avenue for Islamic banks that face excess liquidity to manage their funds productively, while the Central Bank of Malaysia can obtain funds immediately enabling an efficient and effective cash liquidity management.

On the other hand, if any bank faces temporary liquidity problems due to mismatch between assets and liabilities, they can also benefit from this CMP instrument. Several activities of CMP in injecting liquidity to problematic banks are depicted in Figure 2.

Figure 2: Commodity Murabahah Programme for Liquidity Injection



As depicted in Figure 2 above, a bank that faces temporary liquidity problems can use CMP based on the following steps:

- (1) Central Bank of Malaysia purchases the commodities from Broker A on cash basis. For example, RM 1 million. Alternatively, the Central Bank of Malaysia can appoint Bank B (that faces temporary liquidity problem) as its agent to buy the commodities from commodity market. Bank B will receive the funds for the purchase of commodities on spot basis. The ownership of the commodities is then transferred to the Central Bank of Malaysia.
- (2) Thereafter, the Central Bank of Malaysia sells the commodities to Bank B on deferred price (cost price plus profit margin). Hence, the ownership of the commodities is now transferred to Bank B.
- (3) Bank B sells the commodities to Broker B in on spot at the original cost price to net off the commodity position that it holds when it purchased from Central Bank.

On maturity date, Bank B will have to pay Central Bank for the funds equivalent to the principal plus profits. In the final analysis, Bank B obtains funds on spot which is required to manage its liquidity effectively and efficiently.

THE POLEMICS OF TAWARRUQ-BASED TRANSACTIONS

After highlighting the structure and mechanism of commodity *murabahah*, we now turn our discussion to the various Shari`ah issues pertaining to the transaction. Obviously, commodity *murabahah* involves contract of *tawarruq*. *Tawarruq* is actually a sale contract whereby a buyer buys an asset from a seller with deferred payment and subsequently sells the asset to the third party on cash with a price lesser than the deferred price, for the purpose of obtaining cash⁴. This transaction is called *tawarruq* mainly because when the buyer purchases the asset on deferred terms, it is not the buyer's interest to utilize or benefit the purchased asset, rather to facilitate him to attain liquidity (*waraqah maliah*) (Ahmad, 2007).

Hence, *tawarruq* and *bay`al-`inah* are similar as far as the substance is concerned. Both *tawarruq*- and *bay`al-`inah*-based instruments are serving exactly the same contractors' purposes, and share exactly the same economic substance and consequences, albeit their form may be different. The differences are mainly in two aspects. First, while the latter does not involve third party, the third party intermediary is present in the case of *tawarruq*. Second the sale of object in *bay`al-`inah* is returned to the original owner, whereas in *tawarruq*, there is no such condition (Central Bank of Malaysia, 2007).

Interestingly, past jurists from Malikis and Hanbalis schools who categorically disallowed and nullified *bay`al-`inah* transaction, do not actually reject *tawarruq* outright. Instead, they were inclined to allow it mainly arguing that the presumption that the parties intended to circumvent the prohibition of *riba* was quite remote in *tawarruq* due to its tri-partite nature (El-Gamal, 2006). However, two prominent Hanbali jurists, namely Ibn Taimiyyah and his disciple Ibn Qayyim Al-Jawziyyah departed from the majority

⁴ This definition is accepted by the OIC Fiqh Academy in their deliberation on the issue on 1st November 1998 (11 Rejab 1419H). See also (Wizarat al-Awqaf wa al-Shu'un al-Islamiyah, 2005).

Hanbali school's approval of *tawarruq*. They disallowed *tawarruq* and dismissed it as a legal trick (*hilah*) similar with *bay`al-`inah* (Al-Zuhayli, 1989).

The issue of *tawarruq* is also tackled by contemporary jurists. A prominent OIC Islamic Fiqh Academy issued two rulings on the matter. The first opinion was issued in the 15th session of the academy in September 1998 (Rajab 1419H), whereby they permitted the contract subject to the condition that the customer does not sell the commodity to its original seller, to avoid direct evidence of *`inah* as a legal trick to circumvent the prohibition of *riba*. However, in its 17th session, held in December 2003, the Academy clarified its stand on *tawarruq* by distinguishing and classifying it between *tawarruq haqiqi* (real *tawarruq*) and *tawarruq munazzam* or *tawarruq masrafi* (organized *tawarruq*). While the former is allowed, the latter form which is widely practiced by Islamic banks today is deemed to be synthetic and fictitious as *bay`al-`inah* and hence disallowed.

The main justification for disallowing 'organised *tawarruq*' is that its mechanism resembles *bay`al-`inah*; whereby the Islamic financial institution who is acting as an agent to the customer (*mustawriq*) who need cash sells the asset which was initially purchased from the same institution to the third party. In many cases, this type of transaction would result in non-satisfaction of receipt conditions (*qabad*) that are required for the validity of the dealing. The reality of this transaction is extension of monetary financing to the party characterized as a *tawarruq* customer, and the buying and selling operations of the bank are most often just mean for appearances, but in reality aim to provide the bank an increase in compensation for the financing it provided (El-Gamal, 2006). Therefore, this practice bears resemblance to the practice of *bay`al-`inah*, which is frowned upon by some as a form of legal trick (*hilah*) and does not represent the true *tawarruq* (*tawarruq haqiqi*) which has been approved by the classical jurists⁵.

⁵ Despite the objection by many quarters towards *tawarruq munazzam* (organised *tawarruq*), such practice has been approved by a few contemporary scholars such as the leading Saudi jurist, Syeikh Abdullah Sulaiman al-Mani', Dr. Musa Adam Isa, Dr. Usamah Bahr and Dr Sulaiman Nasir al-Ulwan (Central Bank of Malaysia, 2007).

Consequently, many banks in Saudi Arabia have begun to emphasise that all commodities used for *tawarruq* are bought and sold in domestic markets, with real merchants delivering the goods and reassigning their ownership as dictated by trade. This is specifically done to address the concerns of the Academy on the issue of bona fide sales and purchases with corresponding ownership (*qabd*) and transfer of commodity risks. However, the attempt is again seemed to be more emphasizing on forms and legal technicalities rather than the economic substance, implying the predominant juristic approach of form-over-substance used in devising instruments in Islamic finance today.

Despite the criticisms towards *tawarruq*, the product has been generally perceived and received more favourable and positive than *bay` al-`inah* transaction, at least by a majority of past and present scholars. Unlike *bay` al-`inah* which is widely used in Malaysia and Brunei, *tawarruq*-based transaction has been spreading quite rapidly in GCC region especially Saudi Arabia, Bahrain and UAE. This development shows the concerns and recognition by some of the jurists globally of the need to find alternatives for solving the inherent problem of liquidity risk faced by Islamic financial institutions due to their balance sheet structure and nature.

As reviewed in the earlier part of this paper, liquidity risk is a very important issue need to be addressed by financial institutions. Failure to manage the liquidity risk prudently and effectively, inevitably leads to severe impairment of the viability and sustainability of the banks. More importantly, it has been proven both theoretically and empirically that a result of one bank's failure may have systemic effect leading to entire financial system at menace (Diamond & Dybvig, 1983; Greuning & Bratanovic, 1999; Llewellyn, 1999). Therefore, the controversy which surrounds the Shariah compatibility of the new product for liquidity management as in the case of commodity murabahah programme, should be surmounted by taking the systemic stability issue into right perspectives.

There is a maxim of Islamic jurisprudence which can be used in dealing with this matter, that is: "*Neither harm nor reciprocating harm*" (*La Darara Wa La Dirara*). This principle is based on an authentic hadith narrated by Ibnu Majah and ad-Daaruruqi and

others on the authority of Saad bin Malik Al-Khudari, who mentioned that the Messenger of Allah (p.b.u.h), said: “*There should be neither harming nor reciprocating harm*” (Al-Suyuti, 2003). Imam As-Suyuti based on his famous book ‘*al-Ashbaah wan Nazhoor*’ asserts that this hadith is very significant as it embodies the fundamental principles and maxims of Islamic jurisprudence. Based on this principle, there is a need (*hajiyyat*) to adopt some controversial contracts like *bay` al-`inah* and *tawarruq* as tools for liquidity risk management, without having to resort to conventional *riba*-based borrowing. This is supported by another maxim of Islamic jurisprudence: “*Severe harm is avoided by a lighter harm*” (*al-darara al-ashaddu yuzalu bi darari al-al-akhaffu*) or “*choosing between the lesser of two evils*” (*akhhaf al-dararyn*).

Within the context of our discussion, the choice is actually between having to resort to liquidity management instruments which imbued with clear-cut *riba* elements, or the alternative practice of contentious *tawarruq*-based instruments. Hence, based on the maxim, it is thought that to choose what is still disputed or doubtful (*shubhah*) is of lesser evil than to opt for transaction that is clearly prohibited (*haram*). Following the same, both the Shariah Advisory Council (SAC) of the Securities Commission of Malaysia and the Shariah Advisory Council of the Central Bank of Malaysia had officially endorsed both *bay` al-`inah* and *tawarruq* to be used for liquidity management purposes. One of the arguments raised to justify the support their adoption of Shafi`i's view in legalising *bay` al-`inah* and *tawarruq* is public interest consideration (*maslahah*)⁶, which is to overcome the problem of liquidity shortage in the country, without resorting to conventional *riba*-based liquidity instruments and transactions (Ali, 2007).

⁶ *Maslahah* is one of the juristic devices that have always been used in Islamic legal theory to promote public benefit and prevent social evils or corruption. The plural of the Arabic word *maslahah* is ‘*masalih*’ which means welfare, interest or benefit. Literally, *maslahah* is defined as seeking the benefit and repelling harm. The words *maslahah* and *manfa`ah* are treated as synonyms. *Manfa`ah* (benefit or utility), however, is not technical meaning of *maslahah*. What Muslim jurists mean by *maslahah* is the seeking of benefit and the repelling of harm as directed by the Lawgiver or *Shari`ah*. Amongst the major school of Islamic jurisprudence, Imam Malik is known to be the leading proponent of upholding *maslahah* as one of the sources of *Shari`ah*. He uses the term “*al-masalih al-mursalah*” to connote interests which have not been covered by other sources of *Shari`ah*. On the other hand, the majority of other jurists reject it as a source of *Shari`ah* though, they practiced it without theoretically admitting its authority as an independent source of the *Shari`ah*. However, Al-Ghazali (who is from the Shafi`i school), uses the term *istislah* (seeking the better rule for public interest) but never claim it as the fifth source of *Shari`ah*. He also restricts its application to situation which is deemed to be of necessary to serve the interest of the public. For detailed discussin, refer to (Al-Khoyat, 2000; Nyazee, 2000).

CONCLUSION

Overall, this paper constitutes a preliminary attempt at gaining a holistic and integrated understanding of structure and mechanism of commodity murabahah programme (CMP) as an innovative liquidity management tool applied in Malaysian Islamic Inter-bank Money Market. As delineated in the beginning of the paper, Islamic banks are presented with a liquidity management problem since they must structure their portfolios so that the pattern of asset returns can support the short-term obligations that they issue on the liability side of their balance sheet. Therefore, efficient and effective liquidity management in Islamic finance is paramount to ensure smooth-running and safety of the whole financial system.

The effectiveness and efficiency of liquidity management mechanism partly depends upon banks' ability to resort to high quality coupled with Islamically accepted financial instruments that are tradable and marketable in the inter-bank money markets. Thus, the introduction of commodity murabahah instrument based on *tawarruq* concept by Central Bank of Malaysia is deemed as an innovative approach to liquidity management. It certainly adds to the list of Shariah-compliant instruments for Islamic banks to manage their liquidity more effectively and efficiently. Under this CMP mechanism, if Islamic banks face liquidity risk in the form of short-term funding difficulties, they can always raise funds on the money market based on Shariah principles. More importantly, since it is based on the internationally accepted structure, CMP has the potential to be marketed abroad which further supports cross-border transactions of Islamic financial institutions in a globalised world and to ensure market liquidity.

In the light of some controversies highlighted in the paper pertaining to the contentious mechanism of CMP which is structured based on *tawarruq* contract, this paper suggests that Islamic financial institutions should not feel contented with the existing condition. Instead, efforts should be magnified to continuously devise more desirable Shariah acceptable and workable alternative structures that can hedge themselves against mismatches and liquidity problems. Nevertheless, until and unless other alternative

structures can be innovated, Islamic banks are encouraged to use the CMP which is less controversial. At least they are structured based on tawarruq contract which is not as precariously contentious as *bay`al-`inah*.

In a nutshell, Islamic banks should do away all the controversial contracts that may impede the growth and progress of Islamic banking and finance industry. Indeed Islamic banking system has the potential to become one the promising sector to realize the noble objectives of Shariah, as it resides within a financial trajectory underpinned by the forces of Shariah injunctions. These Shariah injunctions interweave Islamic financial transactions with genuine concern for just, fair and transparent society at the same time as prohibiting involvement in illegal activities which are detrimental to social and environmental well-being.

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