

## SHARIAH NON-COMPLIANT EVENTS IN TAWARRUQ PRODUCTS: A MALAYSIAN BANK CASE

Muhammad Zulzhorif Bahrain<sup>1</sup>  
Mastura Razali<sup>2\*</sup>  
Shahirah Said<sup>3</sup>  
Emie Sylviana Mohd Zahid<sup>4</sup>  
Nurfahiratul Azlina Ahmad<sup>5</sup>

<sup>1,2</sup>Academy of Contemporary Islamic Studies, Universiti Teknologi MARA, 40450 Shah Alam, Malaysia

<sup>3,4,5</sup>Academy of Contemporary Islamic Studies, Universiti Teknologi MARA, Pulau Pinang Branch, Permatang Pauh Campus, 13500 Permatang Pauh, Pulau Pinang, Malaysia

\*Corresponding author: mastura458@uitm.edu.my

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**Abstract:** *The widespread use of Tawarruq in Malaysian Islamic banks has led to extensive discussions among Shariah scholars and industry experts due to potential Shariah non-compliance (SNC) issues. This study investigates SNC events related to Tawarruq-based products offered by a Malaysian Islamic bank. The main research problem focuses on SNC events questioning the Shariah compliance of these products. The study aims to analyse the Shariah non-compliant event in products related to Tawarruq concept. Using a qualitative research method, data was gathered through interviews with key experts and a review of secondary sources. Findings show that common SNC events include incorrect sequencing of contracts, incomplete documentation, and issues with the physical presence of commodities. The study highlights the role of regulatory bodies like Bank Negara Malaysia in ensuring compliance through guidelines, policies, and audits. Recommendations include automating processes, implementing detailed Standard Operating Procedures (SOPs), and exploring alternative Shariah-compliant contracts to reduce risks. Insights from this study contribute to developing a robust Shariah compliance framework for Tawarruq practices in Islamic banking, providing valuable guidance for industry players and regulators.*

**Keywords:** *Tawarruq, Shariah Non-Compliance (SNC), Tawarruq Financing, Islamic Banking*

## Introduction

The classification of Islamic contracts consists of sale contract, participation contract and other supporting contracts such as Hibah, safe custody contract and other. The essence contracts of Islamic law can be considered sale contracts as it can be proven by the Quran itself stated on fundamental of sale contracts which make a comparison on what is permitted and what is prohibited or in other words as a wide comparison between usury (*riba*) and sale (*Bai'*) (Shaarani, n.d). The permissibility of sales and trade as a general rule of business is clearly shown in verse 275 of Surah al-Baqarah: "Those who devour usury will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury...".

Islam provides extensive guidance on the fundamental principles of *muamalah*, emphasizing the importance of understanding five key elements to determine the legitimacy of transactions: *maisir* (gambling), *gharar* (uncertainty), *haram* (prohibited), *riba* (usury), and *batil* (invalid). The most critical aspect is the presence of usury in transactions, whether in sales or loans. To avoid engaging in usury when obtaining cash, some individuals use a *Tawarruq* contract (*bai' al-Tawarruq*) for buying and selling (Nurhisam, 2016).

*Tawarruq* comes in two different forms. Classical *Tawarruq* is the first kind, in which a person purchases a good from a bank with a deferred payment plan and subsequently sells it to another individual or bank for cash to have the required liquidity. Organised *Tawarruq* is the second kind, in which a person purchases a good on credit from an Islamic bank and designates the bank as their agent to sell the good, which they haven't yet received. In certain instances, the bank pays the commodity seller to sell the product on the client's behalf, and the client receives the money directly (Dabu, 2007). BNM (2018) states that two distinct sale and buy agreements are involved in a *Tawarruq* transaction. First, a seller sells an asset to a buyer with the option of deferring payment. The buyer then sells the same asset to a third party in order to receive cash payment right away.

Shariah Advisory Council of Bank Negara Malaysia decided that deposit products based on *Tawarruq* are acceptable during its 51st meeting on July 28, 2005. Since then, *Tawarruq* has emerged as one of the most popular ideas in the Islamic banking sector of Malaysia in recent years. This quick acceptance was a reaction to the circular on *Bai' al- 'Inah* (sell and buy-back) issued by Bank Negara Malaysia (BNM), which greatly increased the Shariah (Islamic law) requirements for *Bai' al- 'Inah* products. In just two years, from 2014 to 2016, *Tawarruq* grew by more than 100% to become the largest contributor to Malaysia's Islamic banking financing portfolios, making up 22.4% of the overall financing, according to the 2016 BNM Islamic Finance Development Report. By the end of 2019, 46 percent of all financing in Malaysian Islamic banks (IBs) came from *Tawarruq* finance, an even higher percentage (Ali & Hassan, 2020).

In Islamic law, economic issues are closely tied to *muamalah*, which includes activities such as buying and selling, lending and borrowing, and dealing with debts. Islam provides extensive guidance on the fundamental principles of *muamalah*, emphasizing the importance of understanding five key elements to determine the legitimacy of transactions: *maisir* (gambling), *gharar* (uncertainty), *haram* (prohibited), *riba* (usury), and *batil* (invalid). The most critical aspect is the presence of usury in transactions, whether in sales or loans. To avoid engaging in usury when obtaining cash, some individuals use a *Tawarruq* contract (*bai' al-Tawarruq*) for buying and selling. However, there were serious disputes among academics over whether this

method was acceptable (Bakar & Mansoor, 2020). Some argue that *Tawarruq* is a form of engineered activity, known as *hilah*, which manipulates the process to conceal the element of usury, while its essence remains usurious. Conversely, others consider *Tawarruq* permissible in Islam as a legitimate solution to meet cash needs (Nurhisam, 2016). *Tawarruq* was presented as a substitute for *Bai' Inah* in order to resolve these disputes. As a result, *Tawarruq* is now the fundamental idea underlying a wide range of Islamic financial products, such as financing, deposit products, asset and debt management, and risk management tools. (Ahmad et al., 2017).

Following the decisions or fatwas made by the recognized authorities for fiqh, scholars of Shariah have recently focused on the study of *Tawarruq* and the issues that arise from its use in the Islamic banking system. The *Tawarruq* mechanism was prohibited from being used in contemporary banking by the most recent collective Shariah ruling of the Organization of Islamic Cooperation (OIC) Fiqh Academy. This decision has affected the Islamic banking industry by stating that the *Tawarruq* application is extremely prone to Shariah noncompliance (Mohamad & Ab Rahman, 2014). The structure of *Tawarruq* contracts is also criticised by certain Shariah experts, who contend that it ignores the product and views it as a kind of trickery intended to get around the ban on usury (*riba*). Furthermore, because these contracts diverge from the core goals of legitimate commodities sale and purchase contracts, Islamic banking activities run the risk of not complying with Shariah. Over time, this can harm the Islamic banking sector's reputation (Syahmi, 2022). The improper sequencing of contracts, lack of proper asset specifications, and other Shariah Non-Compliant Events (SNCE) issues have been identified as potential risks in the practice of *Tawarruq* financing. These risks not only challenge the integrity of Islamic banking practices but also undermine the trust of stakeholders in the Shariah-compliance of financial products (Ali & Hassan, 2020).

The Shariah Advisory Council of Bank Negara Malaysia has set guidelines for implementing structured *Tawarruq* in Islamic financial institutions. If these guidelines are not followed, the financial institution risks being non-compliant with Shariah law. The guidelines include making sure that all the legal terms of the *Tawarruq* contract are followed, that each contract in the sale is properly executed, that the arrangement is correct, and that the buyer has the right to take ownership of the commodity. Additionally, the contract should avoid any elements of sale and repurchase (Nor et al., 2019)

This study aims to analyse the Shariah non-compliant event in products related to *Tawarruq* concept. For top management in Islamic banks, this research provides actionable insights into the sources and causes of SNCE in *Tawarruq*-related products. By identifying specific areas of risk and operational vulnerabilities, the findings support management in refining internal processes and ensuring compliance with Shariah principles. Furthermore, the study proposes effective control and mitigation strategies to address compliance issues, enabling banks to maintain their reputation for ethical and Shariah-compliant operations. By enhancing their ability to manage SNCE, Islamic bank leaders can foster greater trust among customers and stakeholders while ensuring the long-term sustainability of their institutions. The insights gained from this study are particularly valuable for strategic decision-making and operational improvements that strengthen Shariah compliance frameworks.

## Literature Review

### Concept of Tawarruq

The term "*Tawarruq*" comes from the words, "paper" and "dirham," which denotes silver or currency made from dirham. The plural is "*awraaq*," which translates to "paper money" or "paper replacing monies." It gets its name from the fact that buyers of a certain commodity sell it using paper in order to receive the paper (liquidity) rather than the commodity. Various forms of money are referred to as "paper" in this context (Dabu, 2007). *Tawarruq* is derived from the term "*wariq*," which linguistically translates to "dirham" from silver, according to the second study that was also cited. Thus, pursuing *wariq*, or silver dirham, which stands for money or profitable cash, is what *Tawarruq* denotes. However, the meaning of *Tawarruq* has changed in modern usage to denote the urgent need for money. *Tawarruq*, as used in contemporary economics, is the sale of a particular good in order to raise money (Ismon, 2012). *Tawarruq* is when a person buys a commodity on a deferred basis and subsequently sells it at a cheaper price to someone other than the original seller for cash. Currently, Islamic banking products use the idea of "*mustawriq*," which refers to either the bank or the consumer seeking cash. The bank acts as an agent on behalf of the customer to conduct the sell or purchase transaction with a commodity broker (Mohamad & Ab Rahman, 2014). *Tawarruq* comprises two sale and buy agreements. The initial scenario pertains to the transfer of an asset by a seller to a buyer on a deferred payment basis. The buyer of the initial sale will subsequently sell the identical asset to a third party for immediate cash payment (BNM, 2019).

*Tawarruq* is categorized into two distinct forms based on the involvement of the Islamic Financial Institution (IFI) in the final sale of the commodity. The first form, known as classical *Tawarruq*, occurs when the customer sells the commodity directly to a third party without the involvement of a bank. Conversely, the second form, referred to as organized *Tawarruq*, involves the bank in the sale of the commodity from the client to a third party (Mokal et al., 2024). The term *Tawarruq* can be divided into two categories. The first category is classical *Tawarruq* (*Tawarruq al-Fardi*), and the second is organized *Tawarruq* (*Tawarruq al-Munazzam*). Classical *Tawarruq* (*Tawarruq al-Fardi*), also known as *Fiqhi Tawarruq* or Individual *Tawarruq* is defined by the Islamic Fiqhi Academy as the purchase of a commodity that is obtained and owned by the seller through deferred payment. The buyer then sells the commodity for cash to a third party, other than the original seller to obtain liquidity (Mahyudin & Seman, 2014). Organized *Tawarruq* works like classical *Tawarruq*, but with one main difference, the customer lets the bank (*Mutawarriq*) act as their agent to sell the commodity to a third party. The bank usually charges a service fee for this role (Dewaya, 2024).

### Views of Classical and Contemporary Scholars

There are primarily two groups of early scholars' perspectives regarding the Shariah verdict for *Tawarruq*, those who support it and those who oppose it. Most jurists from Shafi'i, Hanafi, Maliki and Hanbali schools believe that *Tawarruq* is acceptable. According to Abu Mansur al-Azhari, there is universal agreement among jurists regarding the legality of *Tawarruq* (Ali & Hassan, 2020). The Hadith from Bukhari and Muslim is referenced by the scholars who allow *Tawarruq* as proof for *Tawarruq* transactions. According to this Hadith, the Prophet Muhammad (peace be upon him) was presented some premium dates by a Khaibar farmer (Hosen and Nahrawi, 2012). This Hadith outlines a lawful method of trading that avoid usury, without involving any form of *Hilah* or similar practices. It demonstrates that the conditions for permissible trading were met, ensuring the absence of usury in the transaction (Isnon, 2012).



The modern practice of *Tawarruq* has significantly diverged from its classical form, which was widely approved by jurists. Traditionally, *Tawarruq* involved an individual and three parties, with transactions concluded naturally without prior arrangements or promises. In contrast, the modern practice of *Tawarruq* is typically organized by institutions and involves four parties, with fully structured contractual relationships. Contemporary resolutions by AAOIFI and IIFA closely align with historical view on *Tawarruq*. As the majority of classical rulings, both bodies permit individual *Tawarruq* while prohibiting the interference of the first seller in the subsequent sale. However, AAOIFI introduces an additional nuance regarding the role of the first seller in the second transactions. It allows a bank to act as an agent for the *Mustawriq* and sell their product if legal or regulatory restrictions prevent the buyer from doing so. That said, in most jurisdictions where organized *Tawarruq* is practiced, credit sales (*Murabahah* or *Bai Muajjal*) by Islamic banks are permissible, and regulations generally do not restrict clients from selling commodities they own. Once a bank sells the commodities to its client, the clients legally own the commodities and have full rights to dispose of them as they see fit (Ahmed & Aleshaikh, 2014).

### **Modus Operandi of *Tawarruq***

In a nutshell, *Tawarruq* is a crucial component of Malaysia's Islamic financial system, addressing liquidity needs and providing versatile financing solutions (Bank Negara Malaysia, 2022).

Shariah Advisory Council of Bank Negara Malaysia states that there are two steps involved in the *Tawarruq* transaction procedure. In the initial phase, the customer buys an item from original vendor on credit. The asset is sold to a third party by the buyer in the second stage for cash. Because the buyer purchases the product on credit with the goal of selling it to raise money rather than using or profiting from the asset itself, the word "*Tawarruq*" is employed. *Tawarruq*, sometimes referred to as commodities *Murabahah*, is frequently utilized in financing, asset and debt management, deposit products, and risk management (Bank Negara Malaysia, 2019).

The *Tawarruq* model for deposit products is a Shariah-compliant way of managing finances based on asset transactions. In this system, Islamic banks act as middlemen, helping customers buy and sell assets in line with Islamic rules. Customers earn a profit through a lump sum payment at the end of the deposit period (Ahmad et al., 2020).

### ***Tawarruq* in Islamic Banking in Malaysia**

In Malaysia, *Tawarruq* is extensively applied across various Islamic banking activities, including deposits, financing, investments, and the capital market. The country adheres to the Fatwa issued by Bank Negara Malaysia's Shariah Advisory Council, which permits the use of organized and reverse *Tawarruq*-based products across all aspects of banking and financial services (Ahmad et al., 2017).

The predominant Islamic banking product in Malaysia is based on *Tawarruq Munazzam* contract. According to Bank Negara Malaysia (BNM) in 2019, 16 Islamic financial institutions (IFIs) offer products utilizing this type of contract. Essentially, it is a hybrid contract derived from traditional concept of *Tawarruq Fiqhi*, which remains a topic of ongoing discussion in Islamic commercial law. The *Tawarruq* contract has been adapted to fit the modern financial system by incorporating features such as *Murabahah li-amir bi al-shira'* (*Murabahah* to purchase order), *Wakalah* (*agency*), the use of readily available and tradable asset, *Ibra'*

(rebate), *Ta'widh* (compensation), *Wa'd* (promise), and measures to mitigate bank risk (Asni & Sulong, 2018).

### Theoretical Framework

This study is supported by Islamic Contract Law (Fiqh al-Mu'āmalāt) to define the criteria for contract validity and identify nullifiers; Principal-Agent Theory to interpret how the wakālah arrangement influences incentives and monitoring in practice; and the Shariah Governance Framework to explain the institutional controls that prevent, detect, and address Shariah non-compliance. Fiqh al-Mu'āmalāt sets criteria for defining a valid sale contract. There are pillars and conditions. The subject must be existing and permitted. Ownership must be transferred. The input has been acknowledged. Elements of usury and ambiguity are avoided. While this concept seems straightforward, technical details become critical in today's context. These include the procedural sequence, verification of ownership, timing of benefit and risk transfer, and documentation that clarifies any ambiguities. Established fiqh sources, such as al-Zuhayli's work, clarify the grounds for valid and invalid contracts, and Shariah rulings in Malaysia provide operational guidance relevant to the local environment (al-Zuhayli, 2003; BNM, 2010). The *tawarruq* structure, as per AAOIFI regulations, requires transaction segregation and prohibits arrangements that imply concealed *'inah*. This helps distinguish genuinely transferable agreements from those that mimic conventional loans (AAOIFI, n.d.). In practice, a principal and an agent are involved. Sometimes, information asymmetry occurs. Incentives and goals linked to numerical outcomes may lead individuals to bypass established protocols. Principal-Agent Theory explains the emergence of agency costs and ways to reduce them through oversight, clear contracts, and aligned incentives (Eisenhardt, 1989; Jensen & Meckling, 1976). In Islamic finance, banks often act as agents for their clients. This introduces practical challenges, such as the timing of transfers, who bears risk at specific moments, and how to document proof of *qabd*. If performance evaluations focus too much on speed or volume, the related jurisprudential norms might be overlooked. Malaysia's Shariah governance framework is highly developed. Official documents detail the roles of institutions, Shariah committees, compliance, audits, and remedies for non-compliance. The principle is clear: ensure compliance throughout all phases, from product design to post-implementation monitoring. Specific guidelines outline requirements for *tawarruq*, including order specifications, actual ownership, verifiable evidence, and escalation procedures for resolving issues (BNM, 2019). This approach repositions fiqh norms and agency concerns within everyday operational practices.

### Methodology

This study employs a qualitative research method to provide a comprehensive analysis of the research objectives. The research utilizes an exploratory and to understand the reasons behind any Shariah non-compliant events.

Semi-structured interviews will be conducted with two individuals who are highly experienced and knowledgeable in Islamic banking particularly with regard to *Tawarruq*. One of the interviews via voice chat for the Participant A and direct interview for participant B. In addition to primary data, this study incorporated secondary data through library research. A comprehensive review of existing literature, including academic journals, books, and articles, conducted to gather relevant secondary data on *Tawarruq* and its Shariah compliance. This will be supplemented by analysis of relevant documents such as Shariah compliance reports, bank policies, and regulatory guidelines. The examination of Product Disclosure documents from the particular Islamic bank will identify products utilizing *Tawarruq* and other related Shariah contracts, including the *Tawarruq* Policy Document, will be included.

Thematic analysis will be employed to analyse the data obtained from interviews. The interviews will be manually transcribed using Microsoft Word, and the responses from the voice note and face-to-face interview will be sorted according to the themes aligned with the research objectives. The thematic analysis identifies and explores key themes from the interviews and secondary data, aligned with the research objective.

### **Analysis and Discussion**

For Shariah non-compliant events in *Tawarruq*-related products, the highlight of several critical issues identified through the interviews and aligning these with the literature review findings, including assesses the control and mitigation methods implemented to address Shariah non-compliant events in *Tawarruq*-related products.

#### **Improper Sequence of Contract**

According to past research, the sequence of contracts is a fundamental aspect of Shariah compliance. Improper sequencing can render the entire contract invalid and lead to Shariah non-compliance (Zaharudin & Abdullah, 2022; Ali & Hassan, 2020). This issue is well-documented, which emphasizes the importance of adhering to the correct sequence to maintain the validity of the contracts. This is consistent with the interview findings, where a participant noted,

*“The usual issue of SNC in Tawarruq especially if being done manually is the sequence of the contract, where the second contract is being signed before the first contract so that will render the whole contract as invalid.”*

In practice customer entering a *Tawarruq* transaction are primarily interested in obtaining liquidity rather than acquiring the commodity. As a result, some bank officers may overlook the proper sequence of the contract and the transfer of ownership of the commodity (Ali & Hassan, 2020). This scenario can be cited as a relevant example to illustrate the operational challenges leading to SNC events. If a transaction with an improper Sequence occurs and the customer has already received the facility, the income derived from it must be forfeited and purified.

According to the Policy Document on *Tawarruq* (2018), “payment of any amount of the deferred selling price should not be made to the seller before entering into the sale and purchase contract.” This emphasizes the need for strict adherence to Shariah principles to avoid SNC events.

#### **Improper Underlying Asset: Documentation and Identification**

Another critical issue is the improper identification of the underlying asset. The literature review highlights the need for proper documentation and clear identification of the underlying assets in *Tawarruq* transactions to ensure transparency and avoid ambiguity (Ali & Hassan, 2020). This is essential for maintaining Shariah compliance, as ambiguity can lead to disputes among contracting parties. This was confirmed by the interview findings, where Participant A explained,

*“Among others, the underlying asset sometimes is not determined properly, where all the details of the asset should be specified, but they are not.”*

*“For example, property, the location of the property, and all the details. If it is a vehicle, it is according to the type of the vehicle and all other details related to the registration of the vehicle.”*

This example illustrates the importance of detailed asset disclosure in preventing SNC events.

### **Ownership of Commodities and Restriction on Delivery**

Ensuring the actual presence and proper transfer of ownership of commodities is fundamental in *Tawarruq* transactions to avoid non-compliance. The literature review highlights the significance of the physical presence of commodities, stating that any restriction on the delivery of commodities can invalidate the sale (Ali & Hassan, 2020; Roslan et al., 2020; Nor et al., 2019). This aligned with the interview findings, where Participant B mentioned,

*“The sale of commodities must follow the pillars of sale which was free from delivery restrictions circumstances. If there is restriction of delivery, the sale of commodities will be invalid.”*

And expand the explanation towards an example,

*“For financing, the bank will observe on the purpose of financing. For example, when buying a house, the customer will not get the cash. The cash will be held by the bank in the financing account”*

This illustrates the practical approach taken by banks to manage ownership and delivery in financing transactions.

### **Ta'widh as Late Payment Charges (LPC)**

Issues related to *Ta'widh* (compensation) as Late Payment Charges (LPC) were also identified. The literature review points out that both *Ta'widh* or LPC must reflect actual losses to be compliant with Shariah principles (Ali & Hassan, 2020). Any improper calculations that exceed actual losses can lead to non-compliance. This aligns with the interview findings where Participant A noted,

*“The Ta'widh is compensation that can be taken by the parties that have to bear the consequences of the mistake in Tawarruq. So Ta'widh has to be the actual losses.”*

Participant B also shared an example related to LPC,

*“There is one event related which the amount of charge exceeds the actual losses. The calculations of the charge breached the Policy Document. Therefore, if actual losses more than 1%, the bank will only take up to 1%”*

Adhering the prescribed limits for *Ta'widh* or LPC is critical for maintaining compliance. The literature review and interviews also discussed Shariah non-compliance in relation to specific products, such as *Ar-Rahnu*. Participant B explained,



*“If the case is Ar-Rahnu products using Tawarruq, reporting as SNC Ar-Rahnu Tawarruq but must view the event occurred such as Ta’widh that not related to the aqad of Tawarruq.”*

This indicates that non-compliance events can arise from factors unrelated to the *Tawarruq* contract itself, such as the implementation of *Ta’widh*.

### **External Factor**

In addition to the issues highlighted in the literature review, the interviews revealed new findings that were not previously discussed. One such finding is the impact of external factors on Shariah compliance. For example, Participant B mentioned that the presence of SNC events could be influenced by the external factors, such as changes in regulatory guidelines or market conditions.

*“Sometimes the SNC events not specifically in the product of Ar-Rahnu Tawarruq, for example late payment charge (Ta’widh). The real issue Ar-Rahni supposedly did not charge with Ta’widh but the parameter of the system allowed to be charged of late payment charge.”*

### **Control and Mitigation Methodology in Tawarruq**

In regards of those highlighted Shariah non-compliant events, several strategies identified through the interviews and aligning these with the literature review findings.

#### **Automation of Tawarruq Processes**

One of the primary methods for controlling and mitigating Shariah non-compliant events is the automation of *Tawarruq* processes. The literature review highlights the benefits of automation in reducing human error and ensuring the correct sequence of contracts (Zulkepli et al., 2021). Automating processes helps manage the sequence of transactions and minimizes the risk of manual errors that can lead to non-compliance. This was supported by the interview findings, where a participant emphasised,

*“Bank need to automate the Tawarruq processes. Nowadays, most of the banks especially Malaysia already embarked on the automatic process. Therefore, there will be less issue when it is automated because the system will take care of the sequence of the Tawarruq transaction.”*

Automation ensures that all steps and requirements are fulfilled, reducing the likelihood of non-compliance events.

#### **Strengthening SOPs (Standard Operating Procedures)**

In addition to automation, proper Standard Operating Procedures (SOPs) are essential for mitigating Shariah non-compliant events, especially when processes are done manually. The literature review stresses the importance of having detailed SOPs to guide staff in executing transactions correctly and ensuring compliance with Shariah principles (Nor et al., 2019). This aligns with the interview findings, where a participant noted the necessity of SOPs,

*“If it is done manually, then it should be a proper SOP intact in order to ensure all the steps, sequences and requirements are being fulfilled.”*

SOPs provide a clear framework for staff to follow, reducing the risk of errors that could lead to non-compliance.

### **Role of Shariah Governance in Banks**

The role of Shariah Councils is crucial in addressing issues related to *Tawarruq*. The literature review highlights the importance of Shariah Councils in overseeing transactions, providing guidance on compliance issues, and ensuring that contracts are executed correctly (Nor et al., 2019). This was corroborated by the interview findings, where Participant A stated,

*“The role of Shariah Council to ensure the issue related to Tawarruq is being addressed. Sometimes among the issue is the bank make the mistake in the sequence of the contract when it comes to financing and placement of the product.”*

Shariah Councils play a vital role in monitoring transactions and providing the necessary oversight to maintain compliance.

### **Shariah Rulings Harmonisation**

In addition to strategies identified in the literature review, the interviews revealed new findings that were not previously discussed. One such finding is the importance of harmonising Shariah rulings when transactions involve multiple jurisdictions. Participant B mentioned,

*“If transaction involved other countries, we would harmonise the ruling according to which country that applies for the transaction.”*

This highlights the necessity of aligning Shariah principles across different regulatory environments to ensure compliance in international transactions.

### **Alternative Shariah Contracts**

Another new finding is the use of alternative Shariah contracts as a strategy to reduce reliance on *Tawarruq*. This is aligned with the literature review which reducing *Tawarruq* contracts usage is crucial and suggested to be limit to certain range of 20% financing portfolio (Asni & Sulong, 2018). Participant B suggested exploring other Shariah concepts such as *Ijarah bil Khadamat*, *Bai' Dain bis Sila* and *Murabahah*,

*“Reduce Tawarruq use other Shariah contract such as Bai' Dain bis Sila for trade financing. Murabahah in CASA, Ijarah Bil Khadamat as viable replacements for Tawarruq in financing products.”*

This approach aims to diversify the range of Shariah-compliant products and mitigate the risks associated with over-reliance on *Tawarruq*. Participant A mentioned,

*“Tawarruq is widely used, but regulators are exploring alternative Shariah contracts to diversify Islamic finance products and reduce Tawarruq dependency”*

This aligned with literature review which also suggested other alternatives contract replacing *Tawarruq* in banking products (Hasan, 2024).

## Recommendation

Future research should explore the impact of automation on compliance in Islamic banking, the feasibility and effectiveness of alternative Shariah-compliant contracts, and the challenges and solutions for harmonising Shariah rulings across different regulatory environments. Additionally, examining the role of market conditions and regulatory changes in Shariah compliance can provide valuable insights for practitioners and policymakers. Furthermore, there is a need to investigate the role of digital commodities, such as SEDANIA, in *Tawarruq* transactions. Understanding how digital commodities can be opportunities for innovation and efficiency in Islamic banking.

Consumer awareness and education play a vital role in the successful implementation of Shariah-compliant financial products. Future research should explore the impact of consumer education on Shariah compliance in *Tawarruq* transactions and propose initiatives to increase understanding and trust among consumers regarding Islamic finance products. Lastly, assessing the long-term sustainability and economic impact of *Tawarruq* as a financing tool is imperative. Future research should evaluate how *Tawarruq* contributes to the overall objectives of Islamic finance, proposing strategies for its sustainable development and ensuring it aligns with the broader goals of the industry.

It is crucial to recognize that despite the extensive research on *Tawarruq*, there are still gaps that need to be addressed. For instance, there is limited empirical evidence on the impact of digital commodities in *Tawarruq* transactions and how they can be integrated to enhance Shariah compliance. Additionally, the effectiveness of alternative Shariah-compliant contracts in different economic environments remains underexplored. Addressing these gaps in future research will provide a more comprehensive understanding and contribute to the evolution of *Tawarruq* practices within the Islamic banking sector. These future research directions aim to address the current challenges in *Tawarruq* practices and contribute to the development of a more robust and compliant Islamic financial system.

## Conclusion

The research revealed several significant insights into the practice of *Tawarruq* in Islamic banking, *Tawarruq* is identified as a versatile and effective Shariah-compliant financial instrument used to obtain liquidity without engaging in interest-bearing loans. The findings have significant implications for the field of Islamic banking and finance. They highlight the importance of rigorous compliance measures, continuous evaluation of Shariah-compliant contracts, and the need for regulatory oversight. The research underscores the necessity of diversifying Shariah-compliant products to reduce reliance on a single financial instrument like *Tawarruq*. These insights contribute to the existing body of knowledge and provide guidance for practitioners and policymakers. Comparing the findings with existing literature reveals areas of alignment and divergence. The research confirms previous studies highlighting the importance of proper contract sequencing, documentation, and compliance with Shariah principles. It also introduces new insights into the impact of external factors and the role of internal audits, which have not been extensively covered in previous literature. The study has several limitations that should be acknowledged. The sample size of interviews may limit the generalizability of the findings. Additionally, the research primarily focuses on the Malaysian context, which may not fully capture the practices and challenges of *Tawarruq* in other regions. Future studies could address these limitations by including larger and more diverse samples and exploring *Tawarruq* practices in different jurisdictions.

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