



HARVARD LAW SCHOOL
Islamic Legal Studies Program

and



LONDON SCHOOL OF ECONOMICS

Workshop on

Tawarruq

A Methodological Issue in
Shari`a-Compliant Finance

Thursday, February 1, 2007

London School of Economics
Building Tower #3, 5th Floor (BOX)
London, United Kingdom

HARVARD LAW SCHOOL
ISLAMIC LEGAL STUDIES PROGRAM

FRANK E. VOGEL, Director
PERI BEARMAN, Associate Director

125 Mount Auburn Street
Cambridge, MA 02138

Tel: 617-496-3941
Fax: 617-496-2707
ilsp@law.harvard.edu



ISLAMIC FINANCE PROJECT
S. NAZIM ALI, Director

347 Holyoke Center
1350 Massachusetts Avenue
Cambridge, MA 02138, USA

Tel: 617-496-2296/97
Fax: 617-496-2373
ifp@law.harvard.edu

February 1, 2007

Dear Participant:

The Harvard Law School's Islamic Legal Studies Program (ILSP), in partnership with the London School of Economics (LSE), is pleased to host this workshop on *tawarruq* at the LSE campus right within the historical City of London. As Director of the Islamic Finance Project of ILSP, I would like to express our great appreciation to the LSE for joining us in sponsoring this important and worthy event.

As part of the proceedings that followed the last workshop in April 2006, it was recommended that another workshop be held in Europe, focusing on the issues surrounding a specific Islamic Finance instrument. The impetus for this workshop and the previous one came on the heels of our realization that the meteoric rise of Islamic finance in recent years has created a gap in particular between two professional groups required for its success: *shari`a* scholars and Islamic economists. This current workshop on *tawarruq* is a fulfillment of that vision, and additionally marks the beginning of a formidable partnership between our two academic institutions in the area of Islamic Finance and Economics.

Although both professions have seen significant developments in their respective fields, we felt that there remained a need for further understanding and cooperation between the two. For this reason, we have organized this workshop in order to bring members of these two professions together within an academic environment to discuss an issue that currently engages the Islamic Finance industry. These workshops are not intended to arrive at any religious conclusions; we hope rather that they will serve as an avenue for all participants to freely share their thoughts and opinions.

I thank you for your valuable input and suggestions that have contributed to the preparation of this workshop. Your presence and active participation at this event is indeed pivotal to its success and we hope that you will continue to join in future planned discussions among all participants. Again, I am grateful to the visionary leadership of the LSE that has supported this partnership and I am optimistic that this relationship will give rise to other productive efforts in the future. I would also like to take this opportunity to acknowledge the kind support and encouragement received from the sponsors of this project: Arcapita Bank, HSBC Amanah, and Kuwait Finance House.

We hope that this workshop will fulfill its purpose in creating a meaningful forum for discussion amongst all participants alike and we welcome any suggestions that you may have for future events.

Sincerely,

S Nazim Ali, Director
Islamic Finance Project

OVERVIEW

As a follow-up to the workshop on Select Ethical and Methodological Issues in *Shari`a* - Compliant Finance held on April 21, 2006 on the Harvard Law School campus, the Islamic Finance Project (IFP), a project under the auspices of the Islamic Legal Studies Program at Harvard Law School, and the London School of Economics (LSE) decided to work together to gather a group of influential Islamic legal scholars and Islamic economists for a workshop on *tawarruq*, a transaction that has recently gained prominence in Islamic finance. The goal of the workshop is to address the subject of *tawarruq* specifically while also furthering the conversation between *fuqaha* and economists begun at the earlier workshop.

Tawarruq is a debt instrument that has been approved by some *shari`a* scholars, but as its popularity has increased, so has criticism of it. Although various definitions of *tawarruq* have been offered in Islamic finance literature, it is generally used to describe a transaction in which a financial institution sells a commodity to a customer on deferred payment at cost plus profit, and the customer then sells the commodity on a spot basis to a third party for cash. Critics have questioned whether use of the instrument is permissible under the *shari`a*. Among many issues they have raised are the economic similarities of the transaction to other prohibited transactions and the potentially deleterious effects of *tawarruq* on society.

Through this workshop, it is hoped that a better understanding of *tawarruq* in theory and in practice and of its advisability will be achieved. This way, dialogue between the various experts in the field of Islamic finance will be further enhanced.

STRUCTURE

Initial Assumptions

- Participants all have an advanced understanding of the definition of *tawarruq* and its basic structure
- Participants are all familiar with the factual events that led toward *tawarruq*'s permissibility and its current authorized use

Objectives

1. Identify the issues and areas of concern
 - To gain a better understanding of how *tawarruq* is currently applied in the market
 - To gain a better understanding of the specific issues that affect the following parties in its actual use and application:
 - Practitioners
 - Economists
 - *Shari`a* scholars
 - Consumers of Islamic finance
 - Society in general
2. To critically evaluate *tawarruq*'s performance
 - *Tawarruq*'s performance vis-à-vis:
 - current practice
 - intended practice
 - future practice
3. To consider possible restrictions to *tawarruq*'s application and/or alternatives that fulfills its same purpose. To also consider any other specific solutions to the issues and concerns raised
4. To further the conversation among the various parties present by enhancing mutual understanding and links between their methodologies and approaches. Explicit attention will be given to this aspect throughout the more concrete discussions of *tawarruq*
5. To make specific proposals of channels and venues through which to continue this conversation, including workshops on the development of other future products

WORKSHOP AGENDA

MODERATOR

Frank E. Vogel, Founding Director, Islamic Legal Studies Program; The Custodian of the Two Holy Mosques Adjunct Professor of Islamic Legal Studies, Harvard Law School

PARTICIPANTS

Khurshid Ahmad, Member State of Pakistan, Islamabad, Pakistan
Iqbal Asaria, Consultant, Lloyd Bank and Bank of England Committee, London, United Kingdom
AbdulKadir Barkatulla, Shari'a Supervisor; London, United Kingdom
Gohar Bilal, BNP Paribas, London, United Kingdom
William Blair, Professor of Law, London School of Economics, London, United Kingdom
M.A. Mohaimin Chowdhury, European Islamic Investment Bank Plc, London, United Kingdom
Ross Cranston, Centennial Professor of Law, London School of Economics, London, United Kingdom
Humayon Dar, Managing Director, Dar Al Istithmaar; London, United Kingdom
Mohammed Elgari, Shari'a Supervisor & Professor, King Abdulaziz University, Jeddah, Saudi Arabia
Essam M. Ishaq, Shari'a Supervisor; Manama, Bahrain
Husam El-Khatib, DentonWildeSapte, London, United Kingdom
Razi S. Fakih, Acting Chief Executive Officer, HSBC Amanah, Dubai, UAE
Michael R. Hanlon, Former Managing Director, Islamic Bank of Britain, London, United Kingdom
Hussein A. Hassan, Vice President, Deutsche Bank AG; Dubai, United Arab Emirates
Rafe Haneef, Islamic Banking Division, Citibank, Kuala Lumpur, Malaysia
Hussain Hamed Hassan, Shari'a Supervisor, Dubai Islamic Bank, Dubai, United Arab Emirates
Mabid Al-Jarhi, President, IAIE and Financial Expert, Emirates Islamic Bank, Dubai, UAE
Baber Johansen, Acting Director, Islamic Legal Studies Program; Affiliated Professor, Harvard Law School, Cambridge, Massachusetts, USA
Iqbal A.Khan, Co-Chairman, Shari'a Compliant Investments, Equity Planet, London, United Kingdom
Kamal Mian, Head, Islamic Finance, Bank Saudi Hollandi, Riyadh, Saudi Arabia
Basil Moustafa, Oxford Centre for Islamic Studies, Oxford, United Kingdom
M. Iqbal Nadvi, Shari'a Supervisor; Toronto, Canada
Aamir Rehman, Global Head of Strategy, Shari'a Compliant Inv., Equity Planet, New York, USA
Mansoor Shakil, Associate Director, Global Shari'a Compliance, HSBC Amanah, Dubai, UAE
M. Nejatullah Siddiqi, Independent Researcher and Consultant; Milpitas, California, USA
M. Imran Usmani, Shari'a Supervisor; Karachi, Pakistan
Frank E. Vogel, Founding Director, Islamic Legal Studies Program; The Custodian of the Two Holy Mosques Adjunct Professor Islamic Legal Studies, Harvard Law School, Cambridge, Massachusetts, USA
M. Muhammed Al-Awan, Professor, INCEIF, Kuala Lumpur, Malaysia
Rodney Wilson, Professor of Economics, University of Durham, Durham, United Kingdom
Nizam Yaquby, Shari'a Supervisor; Manama, Bahrain
Anas Zarqa, Shari'a Supervisor, The International Investor, Kuwait
S. Nazim Ali, Director, Islamic Finance Project, ILSP, Harvard Law School, Cambridge, Massachusetts, USA

WORKSHOP STRUCTURE

8:30 a.m.	Reception and Coffee
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Openings

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| 9:00 a.m. | Opening Remarks by LSE Deputy Director and Professor of Law, Professor Sarah Worthington |
| 9:10 a.m. | Opening Remarks on behalf of the Harvard Law School, Islamic Finance Project, Professor Frank Vogel |

Part 1: Evaluation of Current Practice and its Effects

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|----------------------------------|---|
| 9:15 a.m.
(25min max) | <p>Current Practice of <i>Tawarruq</i> by Professor Mohammed A. Elgari</p> <p>Presentation to provide participants with an initial setting for the discussion from the point of view of <i>sharī'a</i> advisors, covering:</p> <ul style="list-style-type: none"> ▪ Definitions, doctrine, trends, contemporary <i>fatwas</i> and opinions; ▪ <i>Sharī'a</i> advisors' views on how it is applied in current practice, and how it should be applied in practice (if at all different); ▪ Provide a list of possible solutions to any of these concerns |
| 9:40 a.m.
(10min max) | <p>Current Practice of <i>Tawarruq</i> by two other <i>Sharī'a</i> Scholars</p> <p>Opportunity for these scholars to add any further points to Professor Elgari's paper, in particular:</p> <ul style="list-style-type: none"> ▪ Their views on how it is and should be applied and utilized in current practice; ▪ Highlight any of their own concerns regarding its usage and application (if any); and ▪ Provide a list of possible solutions to any of these concerns |
| 10:05 a.m.
(25min max) | <p>The Economics of <i>Tawarruq</i> by Professor M Nejatullah Siddiqi - An Economist's view on the <i>Masalih</i> and <i>Mafasid</i> of <i>Tawarruq</i></p> <p>Presentation to provide participants with an initial setting for the discussion from the point of view of economists, covering:</p> <ul style="list-style-type: none"> ▪ Explanation of economists' understanding of how <i>tawarruq</i> is being used; ▪ Explain <i>tawarruq</i>'s effects and inherent problems; ▪ Address economists' and the public's concerns and issues regarding its usage (if any); and ▪ Provide a list of possible solutions to any of these concerns |

10:30 a.m. **Current Practice of *Tawarruq* by two other Economists**
(10min max)

Opportunity for these economists to add any further points to Professor Siddiqi's paper, in particular:

- Their views on how it is and should be applied in current practice;
- Highlight any of their own concerns regarding its usage (if any);
- Bring to light any alternative products that serve and provide for the same purposes as *tawarruq* (if any)
- Provide a list of possible solutions to any of these concerns

10:40 a.m.	Tea/Coffee Break
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11:00 a.m. **Market Response to the Current Practice of *Tawarruq***
(15min max)

Two or three chosen financial practitioners will:

- Provide specific examples of recent transactions where *tawarruq* is used to demonstrate current actual use;
- Address and critically self-evaluate how *tawarruq* is actually being applied;
- Address financial practitioners' concerns and issues regarding its application (if any); and
- Provide a list of possible solutions to any of these concerns

11:15 a.m. **Open floor – Opportunity for anyone else to add any further points missed**
(20min max) **in this session (Frank Vogel to chair)**

- Note: This is only to add or clarify points. Actual debate/discussion can occur after the summary

11:40 p.m. **Summary - Frank Vogel to provide a summary of all the points of view**
(10min max)

11:50 p.m. **General Discussion – Frank Vogel to direct questions to participants and**
(60min max) **control the following debate:**

Some guiding questions:

- Based on this morning's presentations, what are the fundamental concerns about *tawarruq* that all participants can agree on? What are those concerns that participants do not agree on?
- Is *tawarruq* living up to its intended use and application?
- Is *tawarruq* financially useful to *shari'a* compliant financial institutions? Why?
- What are the positive/negative effects or outcomes associated with its application in both the short and long term?
- Do these effects differ by type of *tawarruq* transaction? How?

12:50 p.m.

Lunch

2:00 p.m.
(10min max)

Summary - by M. Nejatullah Siddiqi

- Re-highlight the key issues and concerns discussed in the morning session
- Refine or add to synopsis of the morning's discussion
- Define the main area(s) to be the focus of the remainder of the workshop

Part 2: Boundaries and Restrictions to *Tawarruq* (if needed)

2:10 p.m.
(60min max)

General Discussion – Frank Vogel to direct questions to participants on the following

Organizing basic question: Taking into consideration the *maqasid al-shari'a* and this morning's briefings, should there be any practical restrictions placed on *tawarruq*'s usage? Due to:

- **Socio-economic variables**, for example:
 - Should it be used only for the poor and not for wealthy businesses?
 - Where do we draw the line as to who can use it?
 - Should "pressing need" (*haja*) be a precondition or not?
- **Eventual outcome**, for example:
 - Will heavy use of this product add to the inequalities between rich and poor?
 - Is this just another tool for businesses to transact with interest without calling it such?
 - Do the harms outweigh the benefits?
- **Popular perceptions**, for example:
 - Many Muslims perceive that this product resembles a transaction with interest. In order to avoid market confusion and such negative publicity, should *tawarruq* be restricted on these grounds even though it may be legally permissible as an instrument?
- **Best-fit alternative products**, for example:
 - Should it be restricted purely to the case in which there are no alternative products available that are less controversial?
 - In which occasions should these alternatives be used?
 - Given the choice, how can such restrictions be enforced in actual practice?

3:10 p.m.
(5min max)

Summary - Summarize the key issues and concerns discussed in the last session and highlight the discussion, if needed by Frank Vogel

3:15 p.m.
(45min max)

Continue Discussion on Part 2

4:00 p.m.

Tea/Coffee Break

4:25 p.m.

(5min max)

Summary - Frank Vogel to provide a summary of all the key issues and concerns of the last session

Part 3: Future Application

4:30 p.m.

(60min max)

Recommendations - Frank Vogel to direct participants to the following

Overarching questions: Taking into consideration today's discussion, how do participants, individually or where possible by consensus, sum up their views:

- On *tawarruq*. What are the areas in which we can safely utilize *tawarruq* going forward?
 - What should be the guidelines for its future use, if any?
 - Are there any over-arching guidelines that are applicable to other similar debt-based products?
- On the background issue. The issue of whether various inputs, methodologies and criteria for the approval and implementation of Islamic finance products (e.g., *fiqh* and economics) should be better coordinated, and if so how?

Action Plan: Participants to assist Frank Vogel in drafting a workshop summary of all the key issues and concerns as well as any agreed solutions

- This is an interactive session to help everyone clarify their thoughts
- To put together a working draft to be distributed to all parties after the workshop and highlight areas for future discussion
- To reflect on this workshop and discuss holding future workshops with the same participants

5:30 p.m.

End of Workshop

Notes

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Holyoke Center 347
Cambridge, MA 02138, USA

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E-mail: *ifp@law.harvard.edu*

Web: *http://ifp.law.harvard.edu*