



Guidelines on Application of Ḥajah (Need) in Tawarruq-based Transactions

**Islamic Finance Policy Department
State Bank of Pakistan**

Contents

1.	Introduction	1
1.1	Definition	1
1.2	Objectives.....	1
1.3	Scope.....	1
2.	Transaction-Level Requirements — <i>Tawarruq</i>-based Transactions	1
2.1	General Permissibility Conditions:	1
2.2	Eligibility Assessment Requirement	2
2.3	Proper Utilization of Funds.....	2
2.4	IFI acting as Agent:.....	2
2.5	Exposure Limits:.....	2
3.	Governance:.....	3
4.	Other Conditions	3

1. Introduction

In pursuance of the State Bank of Pakistan's mandate to strengthen Shariah governance, ensure uniformity within the Islamic banking sector, and maintain conformity with internationally recognized standards and best practices, these Guidelines shall apply in conjunction with, and in addition to, the AAOIFI Shariah Standard No. 30 – Monetization (*Tawarruq*) and other relevant Shariah standards, as adopted by the SBP from time to time.

These Guidelines stipulate regulatory and operational requirements and outline necessary parameters for the application of the principles of *Hajah* (Need) governing the *Tawarruq* (Monetization) based transactions, including *Commodity Murabaha* (hereinafter to be collectively called as "*Tawarruq*") by Islamic Financial Institutions (IFIs).

1.1 Definition

Hajah (Need): It is a pressing requirement whereby its non-fulfillment will result in distress, hardship, and difficulty; however, that hardship does not lead to the loss of life or property.

1.2 Objectives

- a) To prescribe regulatory instructions governing the Shariah principles of *Hajah* involving *Tawarruq*-based transactions by IFIs.
- b) To establish structured parameters and decision-making criteria for invoking *Hajah in Tawarruq*-based transactions.
- c) To strengthen governance, disclosure, monitoring, and supervisory review relating to *Tawarruq*-based transactions.

1.3 Scope

These guidelines shall:

- a) Apply to all IFIs, covering full-fledged Islamic banks, Islamic windows of conventional banks, Microfinance Banks (MFBs), Development Finance Institutions (DFIs) and Digital Banks offering Islamic finance products (hereinafter to be collectively referred as IFIs).
- b) Extend to product structuring, documentation and Shariah compliance requirements with respect to *Tawarruq*-based transactions.
- c) Apply at both product and transaction levels, and cover structuring, approval, Shariah review, monitoring and reporting.
- d) Include hardships faced by customers as well as IFIs.
- e) Encompass product approval, execution, monitoring, and post-transaction review wherever *Hajah* is invoked.

2. Transaction-Level Requirements — *Tawarruq*-based Transactions

2.1 General Permissibility Conditions:

The IFIs may allow *Tawarruq*-based transactions subject to observing the following conditions:

- a) Application of *Hajah* shall not contradict *Maqāsid al-Shariah* or create equal or greater harm.
- b) Application of *Hajah* shall be exception-based and shall not be treated as general and permanent solution.
- c) It should not be used to meet profitability targets, pricing preference, business convenience, or to justify concessions due to weak governance structure of IFIs.

- d) *Tawarruq*-based transactions shall be allowed only in cases of genuine documented need, where no other practicable alternative Shariah compliant product is available.
- e) The IFIs shall disclose to customers all available Shariah-compliant alternatives along with cost implications and refrain from marketing *Tawarruq* as the easiest or default financing solution.
- f) All necessary conditions and requirements of a valid sale transaction shall be fulfilled, which include that the commodity shall be existing, owned, and possessed by the IFI before selling.
- g) The commodity sold by the IFI shall not be returned to the original seller or the IFI at any stage of the transaction.
- h) *Tawarruq* shall not be used as a stratagem to earn profit in exchange for extension in financing tenure or for rollover / evergreening of existing financing facilities.
- i) The IFIs shall not use *Tawarruq* structures to channel funds—whether directly or indirectly—into interest-bearing instruments or activities. This prohibition covers, *inter alia*, placing funds with conventional banks or transferring liquidity from Islamic Windows to their conventional Head Offices.
- j) The conversion of conventional loans and advances into Islamic financing on the basis of *Tawarruq* shall be permitted on a one-time basis, provided that the IFI's Shariah Board (SB)/ Shariah Advisor (SA), as applicable, certifies that no viable Shariah-compliant alternative exists for the specific conversion.

2.2 Eligibility Assessment Requirement

Invocation of *Hajah* shall be supported with written justification, supporting evidence and analysis of alternatives. The IFIs shall establish a documented eligibility assessment checklist to determine whether the case meets the threshold of *Hajah* prior to granting any concession and submission of its case to its SB/SA, where applicable.

2.3 Proper Utilization of Funds

The purpose of *Tawarruq*-based financing shall be specified in the financing application and related agreements. The IFI shall obtain evidence of actual utilization of the financing from the customer.

2.4 IFI acting as Agent:

- a) The customer shall have the choice to take possession of the commodity, sell it by himself or appoint an independent agent (other than the IFI) to sell the commodity on behalf of the customer.
- b) The IFI may act as the customer's selling agent in cases of necessity, provided SB/SA approval for the same is in place.
- c) However, IFI agency shall remain exception-based and shall not be structured through prior arrangement that may lead to *Bai 'Inah* (Buy-back).
- d) The arrangements for using an agency (broker) shall be transparent and documented.

2.5 Exposure Limits:

- a) *Tawarruq* based transactions shall, at all times, remain within 5% of the IFI's gross financing including consumer financing and treasury transactions to calculate the overall exposure limit for *Tawarruq* transactions executed by the IFI.

- b) Furthermore, the consumer financing based on *Tawarruq* shall not exceed 10% of total consumer financing, except any credit card product issued under *Tawarruq*.
- c) A one-time conversion of the conventional loans and advances portfolio into Islamic financing, including commodity financing, shall be exempt from the above limits.

3. Governance:

- a) The IFI shall develop a policy framework duly approved by the BoD on recommendation of SB/SA outlining the structure and rationale for permitting various categories of *Tawarruq*-based transactions.
- b) The BoD shall monitor the overall exposure of the IFI in *Tawarruq*-based transactions. A report shall be submitted by the Management on semi-annual basis to the BoD.
- c) The SB/SA of the IFI shall approve and oversee the mechanism to ensure that *Tawarruq*-based transactions are allowed based on criteria outlined in these Guidelines, after exhausting all other Shariah compliant financing and placement avenues.
- d) The IFI shall develop alternative Shariah-compliant products under the guidance of the SB/SA of the IFI, especially in consumer financing, to reduce the reliance on *Tawarruq*-based products.
- e) The controls shall be devised by the IFIs to ensure Shariah compliance of the *Tawarruq*-based financing products at each stage, to avoid any possibility of returning the asset/commodity to the original seller (directly or indirectly) to avoid *Bai-Inah* (Buy-back).
- f) The Shariah Compliance Department of the IFI shall develop a mechanism to monitor the *Tawarruq*-based transactions on regular basis. The mechanism shall be implemented after approval from the SB/SA of the IFI.
- g) The Shariah Compliance Department shall quarterly report the transactions to the SB/SA along with the rationale for continuous use of *Tawarruq*-based transactions.
- h) The Internal Shariah Audit Unit of the IFI shall conduct Shariah audit of the *Tawarruq*-based transactions / interbank placements on quarterly basis and submit a report to SB/SA of the IFI.
- i) The SB/SA of the IFI shall consider these reports and prescribe appropriate corrective/enforcement action(s) in case of non-compliance.

4. Other Conditions

- a) The approved policy framework, together with the record of *Tawarruq*-based transactions shall be kept for record and made available for SBP onsite inspection.
- b) The instructions earlier issued vide Para E (b) (x) of Annexure-1 of IBD Circular No. 2 of 2008 and IBD Circular Letter No. 02 of 2013 regarding introduction of new products and services shall remain applicable on the *Tawarruq*-based product structures.

These Guidelines shall become effective immediately upon the issuance of this circular. Any prior instructions or approvals concerning *Tawarruq*-based transactions, issued in the form of circulars or letters, stand revoked.
