

CONCLUSION

The study on derivatives instruments shows that the admission of derivatives contracts in Islamic finance depends fundamentally on the type of contract used, the subject matter of the contract and the way they are traded. Therefore, totally rejecting or accepting these novel strategies of risk management will be wrong. Despite the fact almost all derivatives instruments are totally new to Islamic financial law, the possibility of admitting some these instruments or finding the suitable alternative for others is very high.

Thus, it is submitted in this study that the forward, futures and options contracts in currencies, interest rate and stock indices are not permissible in Islamic law due to the clear involvement of *ribā* or excessive risk which is a form of *gharar*.

Meanwhile, the accommodation of derivatives contracts in shares trading and especially in commodities into Islamic law does contradict any genuine text. However, the issue has been generally marred, so far, by the methodology which seeks to establish for any new issue, a precedent in the prevalent classical interpretations of Islamic law while totally disregarding any other opinion even if it does not contradict any genuine text and more importantly even if it constitutes the view of some early Muslim jurists. The issue is also affected by the disregard of some fundamental jurisprudential principles such as the issue of *ta'līl* recognized by the majority of Muslim scholars as the norm in the area of *mu'amalāt*.

This methodology is reflected in the latest resolution of the Islamic Fiqh Academy no. 107 (1/12) 23–28 September 2000 which maintained in its rejection of the forward contract in commodity that “if the subject matter in the forward contract is a commodity that need manufacturing, the transaction must fulfill the conditions of *'istiṣnā'*. If does not need manufacturing, then the price must be paid in the spot and the transaction must fulfill the conditions of *salam*. However, if the price is not paid at the spot, the transaction will be illegal because it is a kind of *bay' al-kāli' bi al-kāli'*. On the other hand, if the transaction is just a promise and not binding upon either parties or at least one of

them, it will be permissible.”¹ Similar resolution has been adopted by the seventeenth al-Barakah forum, in December 1999² disregarding the great need for this contract by Muslim businessmen and the different grounds that may constitute a valid foundation for the legality of this contract.

It is maintained in the present study that the forward contract in commodities, in particular, is a permissible contract since it does not contradict any clear text of the *shari‘ah* and there is a general need for it either by individual businessmen, companies or even by governments. Moreover, it is clear that the rejection of this contract by many contemporary Muslim jurists on the grounds that it contradicts the “*ḥadīth*” about *bay‘ al-kāli‘ bi al-kāli‘*, the *ijmā‘* which is believed to have materialized upon this “*ḥadīth*” or the principle “do not sell what is not with you” are all weak arguments as explained.

This is because the *ḥadīth* is unanimously agreed that it is a weak *ḥadīth* and therefore, could not be a genuine evidence. Regarding the *ijmā‘* it is unanimously agreed that not all form of sale of debt for debt are illegal or *ḥarām*, therefore, even if we admit the existence of an *ijmā‘* regarding the prohibition of the sale of debt for debt it would definitely include only some forms of sale of debt for debt and not all. However, there are different opinions about what kind of sale of debt for debt is covered by this *ijmā‘*. And it is the principle in Islamic jurisprudence that whenever specific evidence is doubtful it shall be rejected *al-dalīl idha taṭarraqa‘ ilaihi al-iḥtimāl saqata bihi al-istidlāl*. Therefore, it is submitted that even if we accept the existence of an *ijmā‘* it would be limited only to cases of sale of debt for debt involving *ribā* or excessive *gharar* which are definitely not present in case of the conventional forward contract.

On the other hand, it is submitted that the claim that there is no benefit in such contract is unwarranted. It is an established fact nowadays that the forward contract represents the backbone of contemporary international trade and no country or company can ignore its importance in managing its businesses.

Ironically, many contemporary scholars have admitted the legality of *istiṣnā‘* where both countervalues are deferred, typically as it is the

¹ See Dallah al-Barakah *Hawliyyat al-Barakah*, al-Barakah Investment and Development Company General Secretariat, Unified Shar‘iah Board, issue no. 2, December 2000, p. 290.

² *Ibid.*, p. 274.

case in the conventional forward contract based on *istiḥsān* and need but rejected the conventional forward contract. Perhaps for the simple reason that *istiṣnāʿ* is admitted by the early ḥanafī jurists while the conventional forward contract is not. However, it is submitted that if these contemporary Muslim jurists have opted for the legality of *istiṣnāʿ* based on the ḥanafī's opinion and, putted aside the opinion of the three other schools which regard *istiṣnāʿ* as an illegal contract, due to the need for such an independent contract in contemporary business, they have to accept, similarly, the legality of the conventional forward contract which has the same legal characteristics as *istiṣnāʿ* and which is much needed today than *istiṣnāʿ* itself.

In a similar approach some scholars accepted the permissibility of deferring of the price of *salam* for three days as it is the stand in the Mālikī school or even more than that due to contemporary practical constrain, but rejected the permissibility of deferring the price in the forward contract. It is submitted that if it is permissible to defer the price of *salam* for three days, more or less there is no reason for not applying the same principles with regard to the forward contract.

The main alternative advanced by the opponent for the conventional forward and futures contracts is the *salam* contract. However, it is clearly articulated by a number of honest Muslim economists that *salam* could not solve these problems and there is a genuine need for the forward contract. Therefore, insisting on *salam* as the only alternative to conventional forward contract means putting Muslim businessmen in a disadvantageous position without genuine reason which may encouraging them to invest their wealth in foreign financial institutions for better management and planning even if that will lead sometimes to a clear contradiction with the principles of Islamic law.

Some commentators have proposed the concept of *al-waʿd* (promise) which shall be binding on both parties. However, it is clear that if the promise is binding on both parties, it would be a clear forward contract despite the theoretical differences advanced by the proponent of this argument. Therefore, it is submitted that the conventional forward contract in commodities is a genuinely needed contract. Hence, it is a valid contract because there is no genuine text to prohibit it. Moreover, it is an established principle in Islamic law that prohibition could only be established by means of decisive evidence which is not the case with the forward contract.

Similarly, it is maintained that the forward contract could be based on *bayʿ al-ṣifah* or sale by description especially its concept in the Mālikī's

school where it is possible to defer both countervalues if the subject matter of the contract is well defined.

Despite the fact that the majority of contemporary Muslim scholars are still opposed to the forward contract, the admission of the forward contract into Islamic law is gaining slowly momentum. Thus, we have seen some scholars, who are members of the Islamic Fiqh Academy and regular participants of al-Barakah forum such as Mukhtār al-Salāmī,³ Rafīq al-Masrī,⁴ Hasan al-Jawāhirī⁵ Muhammad ‘Ali al-Taskhīrī,⁶ accepting this contract and rejecting the claim that it is a kind of prohibited sale of debt for debt, the sale of nonexistent, a sale of *gharar* or a sale without benefit.

Meanwhile ‘Abd al-Wahhāb Abū Sulaimān⁷ and Aḥmad ‘Ali ‘Abd Allāh⁸ admitted it by analogy to *bay‘ al-ṣifah* while others such as Nazīh Ḥammād adopted it into Islamic law under the rules of *ḍarūrah* or necessity. Ṣiddīq al-Ḍarīr⁹ on the other hand although he maintained that the forward contract is not governed by the concept of sale of debt for debt and does not involve *gharar*, and it does not involve the sale of nonexistent, yet he abstained from upholding its permissibility for the simple reason that such an opinion will oppose the majority’s stand as it is elaborated earlier.

Regarding trading gold on a forward basis it is maintained that the different approaches taken so far to address the issue are less than convincing. Thus, the present study critically analyzed the opinion that trading gold in exchange of paper money in deferred basis is permissible because paper money are not currencies but a commodities and therefore, there is no case of money exchange or *ṣarf*. Such a stand has

³ Mukhtār al-Salāmī, “Ta’jil al-Badalayn Fi al-‘Uqūd”, Nadwat al-Barakah al-Tāsi‘ah ‘Asharah lil Iqtiṣād al-Islāmī Makkah al-Mukarrah 7–8 Ramadān 1421H, December 2–3, 2000.

⁴ Rafīq al-Masrī, *Munāqasāt al-‘Uqūd al-Idāriyyah*, Dār al-Maktabī, Damascus, 1999.

⁵ Hasan al-Jawāhirī ‘*Uqūd al-Tawrīd wa al-Munāqasāt* paper presented to the twelve session of the Islamic Fiqh Academy, Rabat-Morocco. Also see the discussion regarding ‘*Uqūd al-Munāqasāt Majallat Majma‘ al-Fiqh al-Islāmī*, no. 9, vol. 2, pp. 308–309.

⁶ *Majallat Majma‘ al-Fiqh al-Islāmī*, no. 9, vol. 2, pp. 297–306.

⁷ ‘Abd al-Wahhāb Abū Sulaimān, ‘*Aqd al-Tawrīd Dirāsah Fiqhiyyah Tahliliyyah*, paper presented to the twelve session of the Islamic Fiqh Academy, Rabat-Morocco.

⁸ See, Aḥmad ‘Ali ‘Abd Allāh, “al-Bay‘ ala al-Ṣifah” paper presented in *Nadwat Bnak al-Shamāl lita’šil al-‘Amal al-Masrafi*, 20–21 June 1997.

⁹ See, *Majallat Majma‘ al-Fiqh al-Islāmī*, no. 9, vol. 2, pp. 325–333.

no touch with reality because paper money are the real medium of exchange and store of value nowadays and not commodities.

Similarly it is maintained that it is inappropriate to consider paper money like *fulūs* used in Islamic history and which are considered by the majority of scholars as not having the characteristics of gold as a store of value and medium of exchange. It is also submitted that it is inappropriate to ignore the present day reality that gold is no longer the medium of exchange and store of value as it is used to be before. It is inconceivable to admit that the *'illah* or the ratio behind the prohibition of exchanging gold and silver unless they are hand to hand is that they are the medium of exchange or *mutlaq al-thamaniyyah* and to ignore the effect of this *'illah* when it is almost not present, as is the case nowadays, and to insist that gold and silver are currencies by creation without any legal basis. Yet, the present study acknowledges the complexity and sensitivity of the issue and calls for a collective *ijtihād* to resolve this issue. Nevertheless, the concept of promise to sell gold followed by a contract to confirm it during delivery time can be accepted as a temporary solution for gold trading.

On the other hand, arguing for the legality of the forward contract in commodities does not mean any new transaction needed by Muslim traders or businessmen should be admitted even if it contradicts clear text of the Qur'ān or the sunnah. It is based on such an approach that the present study has concluded that in spite of the fact that the forward contract in commodities is legal, such permissibility could not be extended to the forward currency market for reason that this will lead to *ribā* while the *sharī'ah* texts are clear regarding the prohibition of *ribā*.

Considering the fact that a suitable alternative is needed, several proposals have been advanced with the promise to buy or to sell currencies in future as a preferred temporary solution. Some other solutions such as the concept of mutual loan through the setting up of cooperative fund or the basket currencies as means of risk management have also been discussed.

The present study concludes that the development of a viable Islamic future market is possible whether we chose the conventional forward contract or *salam* as the basis for such a market. However, developing a future market based on *salam* requires the resell of the subject matter of *salam* before taking possession or the conclusion of a parallel *salam*. However, the idea of reselling the subject matter of *salam* before taking possession has been rejected by the majority of contemporary Muslim

jurists for the simple reason that the majority of early Muslim jurists has done so.

Here, we are faced once again with a methodology which does not give any due consideration to *al-ijtihād al-intiqā'ī*¹⁰ and fails to benefit from the opinion of Ibn Taymiyyah and his disciple Ibn Qayyim who very successfully expounded that there is nothing in the texts or Qiyās which prohibits the resell of *salam* before taking possession or the Mālikī's opinion that such a transaction is legal if the subject matter of contract is not foodstuff.

Moreover, considering the fact that the main argument against sale prior to taking possession in the work of classical Muslim jurists, is the possibility of *gharar*, the present study argued that such a *gharar* is almost nonexistent in the contemporary futures market with the presence of the clearing house which guarantees the execution of the contract. This is furthermore enhanced by the tight supervision of the market by the exchange authorities by controlling the position of the market participants and the fidelity fund which is established in order to compensate the victim of a default by brokers. Thus, it is concluded that it is permissible to sale before taking possession, in reliance on the opinion of the Mālikī school and that of Ibn Taymiyyah and Ibn Qayyim and the absence of *gharar*.

Regarding speculation it is submitted that despite the fact the issue is most commonly cited to invalidate derivatives contract, it is almost impossible to get rid of speculation in its broader sense because every business requires a degree of speculation and forecast. It is based on this reality that several Muslim economists such as Fahim Khān, Aḥmad 'Abdel Fattāh, Muhammad Akram Khān, Muhammad Obaitullah and others acknowledge that a limited form of speculation is not only unavoidable but desirable to the good performance of the market. Yet, excessive speculation based on manipulation, cornering and fraud is unIslamic and any possible use of derivatives contracts in Islamic finance must be clear of that kind of speculation.

Furthermore, it has been demonstrated that associating speculation with financial crisis is not always justified. Yet, speculation definitely aggravates the situation but generally the real causes of the problem lies elsewhere. It could weaknesses in the macro and microeconomic

¹⁰ Regarding the concept of *al-ijtihād al-intiqā'ī* see, Youssuf al-Qaraḍāwī, *al-ijtihād fi al-Shar'iah al-Islāmiyyah*, Dār al-Qalam, 1989, Kuwait.

structure of the economies affected as it is the case with the financial crisis of 1997 in South East Asia or due to poor supervision and lack of decisive management of the specific affected market as it is with the crash of the Futures Commodity Market in Malaysia 1984 or the crash of the stock market crash in Kuwait 1984.

The study on options from an Islamic perspective shows that *khiyār al-sharṭ* could serve as a tool of risk management and fulfill some of the benefits associated with conventional options. It could be used in *murābahah*, *ijārah*, and ordinary sale or common stocks trading as a tool of risk management as it has been explained above. Moreover, if we consider the possibility of charging a fee in exchange of giving an option, the benefits of *khiyār al-sharṭ* as a tool of risk management may be parallel to that of the conventional options at least in the primary market. Yet, from the above investigation, there is nothing in Islamic law, which prevents the exchange of such a right for money.

Moreover, the present study reveals that the possibility of Islamically acceptable options through *bay' al-'arbūn* is much promising than it is with *khiyār al-sharṭ*. Thus, *arbūn* as a tool of risk management could be used in commodities and services, share trading, in *murābahah*, *salam* and *istiṣnā'*. Designing a call option through *'arbūn* is already acknowledged by some Muslim economists while the possibility of a put option is also possible through the reverse *'arbūn* as it is defended throughout the present study or through other formulas mentioned above.

Furthermore, the expansion of options trading requires that the right in options must be accepted as a valid subject matter of a contract. Some previous studies have concluded that such a pure right could not be a valid subject matter of contract in Islamic law and therefore, option trading is illegal. This conclusion has been refuted in the present study. First of all, the concept of *māl* or property in Islamic law does include rights according to the majority of Muslim scholars. And since the right in options trading is a property right, it is considered as *māl* and therefore, it could be the subject matter of contract. Secondly, given the fact that there is no single text, which defines the characteristics of a right which should be accepted as a property right, the whole issue is based on custom. Considering the fact that the right in options trading is recognized internationally as a property right, it can be regarded as a valid subject matter of a contract in Islamic law since this does contradict any text.

Moreover, the treatment of numerous cases involving the sale or exchange of rights shows that the right in options trading should not

be an exception, given the fact that there is no text which stipulates certain rights could be exchanged while others could not.

To support this proposition, the present study referred to several cases where a right is sold or exchanged with money, such as, the case of *ḥaqq al-nuzūl ‘an al-wazā‘if*, the right of *shuf‘ah* or preemption, the rights of *irtifāq* or *ḥuquq al-irtifāq*, the right in *badal al-khulu*, the right of precedence over unused land, the right in intellectual property, the right of option in *khiyār al-shart* exchanging one’s right to bargain with something, a wife exchanging her right to have her husband with her, in her journey, dropping her right of *ḥadānah* or custody in exchange of something, or dropping one’s right to recover one’s gift in exchange of something. All these cases show that any property right or *ḥaqq māli* could be sold or exchanged if the prevailing custom allows it. Therefore, the right in options trading could be exchanged by analogy to the above cases and based on the general theory of freedom of contracts and conditions.

Besides, the present study concluded that the claim that options trading involves the combination of two contracts in one transaction is unwarranted. None of the interpretations given to the *ḥadīth* about this kind of sales falls within the purview of options trading. In addition, it is demonstrated that the claim that options trading is a kind of gambling is unfounded.

However, since the derivatives instruments discussed above are just the fundamental forms of derivatives available in the international market and considering the fact that it is possible to create an infinite variety form of derivatives instruments¹¹ the present study will attempt to advance some of the Islamic contracts with derivatives potential for future consideration.

The contract of *istijrār* for instance, offers a great potential for risk management. It is a contract which differs from the ordinary sale by virtue of the fact the price in *istijrār* may not be exactly known at the time of conclusion of the contract, as it is in ordinary sale, but determined according to market price. In other words, it is a contact of buying a specific commodity in a regular basis, according to market price, with the price settled at the end of the deal or has been placed as a deposit with the seller. The exact price of the commodity could be known during

¹¹ See Iqbāl Afzal “Engineering Islamic Finance”, *Islamic Banker*, November 1996, p. 241.

the period of *istijrār* if the price of the commodity is stable. It could be also a flouting price such as the market price in specific day if it is well defined and could not lead to dispute. The contract is not widely applied. However, according to Obaidullah cases of *istijrār* are introduced by the Muslim Bank of Pakistan and by Dār al-Māl al-Islāmī group.¹²

According to the *istijrār* contract the sale price of the commodity that is traded, is computed as the average of the market prices during the financing period. To illustrate the situation let us take the following example. A firm needs a short term financing for its raw material purchases for a specific period, say six months. The firm approaches an Islamic bank to finance this purchase. The sale price is not set at the conclusion of the contract but rather it is determined at the end of the financing period. The sale price is set at the average of series prices of the material during the period of financing. *Istijrār* can include an option or *khiyār al-sharṭ* for either party to the contract.

On the other hand, innovations in derivative trading in the conventional system is growing fast. One of the recent innovations is swaps contracts. There are interest rate swap, currency swap, equity swap and commodity swap. Definitely interest rate and currency swaps are out of Islamic finance due to the clear involvement of *ribā* as it is the case with interest rate swaps or the deferred delivery in currency swap which also a kind of *ribā*.

However, some Muslim economists propose commodity swaps, as an instrument that could be accommodated into Islamic finance. It is maintained that commodity swaps are more naturally fit into Islamic financial system which promote trade. This is justified on the basis that swap agreement is simply a series of forward contract and the legality of forward is already established.

Commodity swaps are used by many consumers and producers of commodities to hedge price rises over a long term period. Consumers and producers are often linked to long terms contracts to buy or sell where the delivery price is determined by price index price. This means that the price at delivery is not known until a short time beforehand or until the actual delivery date.¹³

¹² Obaidullah, "Financial Engineering with Islamic Options", *Islamic Economic Studies*, p. 93.

¹³ The Reuters Financial Training Series, *An Introduction to Derivatives*, p. 136.

Energy swaps for oil products, in particular, has been increasingly more important in the derivatives markets since 1991.¹⁴ Thus, it is suggested that “for countries whose economies are heavily dependent on the sale or purchase of a commodity such as oil producing Muslims countries of the Persian Gulf, commodity swap can offer price protection against futures price variations and can provide better control and forecasting in the futures”.¹⁵

Despite the fact the proponents of commodity swap maintain that it is a series of forward contracts, one of the fundamental differences between the two contracts is that in the forward contract there is clear commitment of taking delivery while in the commodity swap there is no possibility of any physical transfer. This issue may stand as a stumbling block in the admission of this new type of derivatives instrument into Islamic finance.

¹⁴ Ibid.

¹⁵ Zamir Iqbal, “Financial Innovation in Islamic Banking”, p. 14.