



## **Innovation of new Islamic financial instruments**

M. Razmi<sup>1</sup>, R.Abbaspour<sup>2</sup>

<sup>1</sup>Islamic Azad university, Mashhad branch, Mashhad, Iran; <sup>2</sup> Islamic Azad university, Gonabad branch, Gonabad, Iran



Reference Number: 6-1-12-8390

Name of the Presenter: M.Razmi

### **Abstract**

Innovation of new financial instruments As "derivatives" has led to the development of capital market and Risk coverage due to the reduction of concerns for Manufacturers. Islamic derivatives, including Islamic futures and option contracts, are financial instruments which are designed and adjusted to be compliant with Shariah principles. These are new contracts which did not exist at the time of prophet Muhammad (P.B.U.H).

"Futures" (an agreement not transaction) is one of the derivative instruments, according to which the seller undertakes to sell a certain quantity of a specific underlying asset at an – already – agreed price, and likewise, the other party undertakes to buy such underlying assets with the described specifications at a particular time. "Options" are as the same as futures contracts except that in options contracts, only option grantor should pay margin.

"Futures", which is in accordance with religious orders, is also accepted by the Iranian law and is currently playing a role in Irans stock market as an emerging phenomenon.

"Futures" as a mutual obligation is independent contract and according to article 10 of Civil Low and General Terms of Contract in Islamic Jurisprudence, its accomplishment is obligatory. "Option" is transaction of right that is permissible according to Islamic Jurisprudence.

**Key words:** contract, juridical, trade, Islamic law.

---

## 1. INTRODUCTION

"Futures" as a mutual obligation is independent contract and according to article 10 of Civil Law and General Terms of Contract in Islamic Jurisprudence, its accomplishment is obligatory. "Option" is transaction of right that is permissible according to Islamic Jurisprudence.

The juristic deliberate over futures revolves about the following five points. The first is that both counteract values in such sales are fictional at the time of contract. Second, futures trading is said to be invalid because it consists of short selling, in which the vender does not own nor possess the item he vends. Third, it is said that futures sales fall short of meeting the necessities of *qabd*, or taking possession of the item prior to resale. Fourth, the critics have argued that postponement of both oppose values to a future date turns futures sales into the sale of one debt for another (*bay[ al-kali bi al-kali*), which is said to be prohibited. And, fifth, that futures trading involves speculation that limits on betting and *gharar* (uncertainty and risk taking).

The risk management function of futures is manifested in its use as a hedging tool. Hedging (*al-tahawwut*) as a risk organization tool [1]. The risks are so high that employing sufficient hedging strategies has now become a essential characteristic and theme of financial management [2]. The absence of a risk management mechanism is uniformly right of the Islamic law of dealings. Instability of prices and currencies is by and huge a modern incident, that is why the scholastic *fiqh* literature has not addressed the topic. Because protection of possessions is one of the higher objectives (*maqasid*) of *shari[ah*, it may be argued that failure to protect one's property in the facade of risk and bankruptcy is synonymous to ignore of responsibility which is undesirable from the viewpoint of Islam. "Risk and *darar* may not be possible to reduce but one can reduce them by recourse to risk management strategies and hedging." [3].

The futures contract is defined as "a lawfully binding commitment to deliver at a future date, or take release of, a given quantity of a commodity, or a financial instrument at an agreed price." [4]. The commodity so traded must adhere to the quality and delivery conditions prescribed by the commodity exchange on which it is traded [5]. Futures markets make the economic functions of managing the price risk associated with investment the underlying commodity over a period of time [6]. The clearinghouse interposes itself between purchaser and vender and professionally becomes the other party to all contracts – purchaser to all contracts sold and vender to all contracts bought. The success and efficiency of futures is due largely to the clearing house,s clearance and guarantee functions [7].

## 2. EVALUATION OF ASSOCIATED TEXT

There are generally two views on future contracts :Negative Outlook: [Abd al Rahman al-Jaziri [8], Muhammad Akram khan [9], ahmad yūsuf sulayman [10], muhammad taqi usmani [11]. Positive Outlook: [abd al qadir [12], [abd al karim al khatib [13], Abdel-hamid al-ghazali [14], Mukhtar al-salami [15]. It seems that the futures market is the merely market where large business in commodities is conducted in spite of the negative stance of the *fiqh* academy, Islamic alternatives must be found in order to aid the real reimbursement of these markets particularly in the commodities division.

### 3. HADITH

This title is a direct translation of the famous *hadith la tabi[ ma laysa [indak* [16], which the commentators have interpreted to mean that the subject matter of sale must exist and be owned by the vender at the time of contract. Futures trading, which consists of short selling is, consequently, different to the necessities of this *hadith*. In an attempt to determine the precise meaning of this *hadith*, muslim jurists have advanced three dissimilar interpretations.

1. "Sell not what is not with you" means not to vend what you do not own (*ya[ni ma laysa fi milkik*) at the time of sale [17]. 2. In general, jurists and *hadith* scholars hold that this *hadith* applies merely to the sale of specified objects (*a[yan*) and not to fungible goods, as these can be substituted and replaced with ease [18]. 3. A third position is that sale of "what is not with you" means the sale of what is not present and what the vender cannot deliver [19].

### 4. SALE PREVIOUS THAN (QABD)

prevailing money-making customs in futures trading have made personal supervision over weight and measurement needless and unfeasible. It would appear that *qabd* in such commodities takes place by obtaining the representative storehouse receipt, rather than by constant re-measuring and reweighing. so it is clear that normal practice has a role in determining the manner in which the legal necessities of *qabd* and delivery may be satisfied. Provided that the processes adopted are free of doubt, unwarranted *gharar*, and potential for dispute, it would be satisfactory. It is quite imaginable that modern technology and computerization may bring further changes into the predictable methods of *qabd*, which may gain popularity and customary approval. This would be satisfactory from the *shari[ah* perspective if it fulfills the basic rationale of *qabd*, which is to prevent uncertainty and *gharar*. No case of failure of a futures transaction has in fact been well-known due to *gharar* over perishing or destruction of foodstuffs.

### 5. SUBJECTS OVER THE SALE OF DEBTS (BAY[ AL DAYN BIL DAYN ) AND GHARAR

the *fiqh* concept of *bay[ al-dayn* referred to transactions over debts in the open market without any guarantee. *Bay[ al-dayn* essentially envisaged sale over an unpaid debt involving either two, or in some cases, three parties. The basic foundation of the ban of *bay[ al-dayn* was over uncertainty in its repayment [20]. Mukhtar al-salami has rejected the claim of *gharar* leading to disputes in the postponement of both counter values [21]. Masoomi nia furthermore rejects the idea of *gharar* [22].

It may be concluded then that *bay[ al-dayn*, which is incurred in futures, is in the nature of the fulfillment of exceptional obligations and of debt repayment by the debtor. This is evidently allowable and conforms to the *qur'anic* norm on the fulfillment of contracts (cf. Al-ma'ida, 5:1).

### 6 A REVIEW OF THE QUR'ANIC ĀAYAT AL-MUDAĀYANAH

The *qur'an* validated deferred transactions involving future obligations as follows:

When you deal with each other in transactions involving future obligations for a fixed era of time (*idha tadayantum bi daynin ila ajal in musamman*) put them in writing. Let a scribe jot down faithfully as between the parties (2:282).

it seems that the *[ulama'* have interpreted *dayn* in a variety of ways. while some have restricted it to certain types of debts [23], others have applied it usually to all deferred liability transactions that can fall within its broad meaning [24]. obviously, the *qur'an* has not specified the general meaning of *dayn* or *mudayana*, and there is no forceful proof to warrant departure from this position. Our analysis furthermore concurs with the conclusions of al [attar in his *nazariyah al ajal* (theory of deferment in *shari[ah*) [25]. The preferred view would appear to be that the text's language should convey its universal and unqualified meaning. Even if we accept ibn [abbas's interpretation, it may be said that his interpretation was based on the occasion of revelation (*sha'n al nuzul*) of the *ayat al mudayana*. According to the rules of *usuul al fiqh*, a text's *sha'n al nuzul* may be specific, but that does not unavoidably limit its general purport and ruling. so, it may be concluded that even if the text were revealed for *salam*, its language is general and appropriate to all debts. This would imply the basic legality, in the eyes of the *shari[ah*, of all deferred transactions.

When speculation is applied to futures trading, the problem is whether financial speculation in futures exposes the other party to risk and, if so, whether it furthermore involves unlawful gain and appropriation of someone else's property. clearly, there is no misappropriation of another's property in futures, for the purchaser in such a contract is occupied in a transaction aimed at making profit through trading and not through the dishonest appropriation of another's property. Speculative risk taking in commerce, which involves investment of property, labor, and skill, is not forbidden; what is forbidden is extreme *gharar* and gambling. Financial risk taking is likely to involve gambling if it is staged and created for its own sake, but not if it is incidental to useful activity and trade [26]. Typical descriptions of *qimar* and *maysir* furthermore suggest the involvement of two parties in a combative game played for the sole purpose of winning at the expense of one's opponent. One party's gain is equal to the other's loss. The gain accruing from such a game is unlawful, as is the act of playing it, for it diverts one's attention from productive occupation and virtuous conduct [27].

## 7. FINAL REMARK

The argument of the *hadith* "sell not what is not with you" led to the conclusion that it applies merely to sales involving specific objects and not to fungible commodities. Since futures, as a rule, merely apply to fungible commodities, they fall outside the purview of this *hadith*. To this, i have added that the above *hadith* is concerned not so much with ownership or possession, but with preventing *gharar* due the vender's ability to deliver. Since delivery and fulfillment are forever guaranteed by the clearinghouse procedures, the vender's ability to deliver is not a subject of concern in futures trading.

in addition, the necessity of *qabd* in the *hadiths* reviewed is limited clearly to foodstuffs, and extending the same necessity to other commodities is not supported by the text. But even in foodstuffs, it is most likely concerned with perishable foodstuffs that are usually not fit for futures transactions. *Qabd* is related to the question of liability for loss. Nevertheless, since delivery and *qabd* are not dominant factors in futures i submit that the question of liability and loss should be determined not by reference to *qabd* but by reference to the contract.

My analysis of the sale of debts particularly of *bay[ al kali bi al kali* led to the conclusion that there is no conclusive evidence in the *sunnah* on its prohibition. The manifest text in *ayat al mudayana* furthermore accommodates an assenting ruling on futures trading. I have also revealed that a direct

correlation between futures sales and conventional sales which the critics have attempted is not justified, mainly because trading procedures in futures provide in-built safeguards against *gharar* that reduce doubt over delivery and payment. and finally, my analysis of financial speculation indicates that speculation is basically lawful and that the subject over its propensity toward gambling must be tackled through constant supervision and effective position limits that would put a check on speculative risk taking.

present trade has witnessed a large number of new and unprecedented modes of trading which were not known in previous times. To endorse the people's prosperity through trade is distinctively beneficial and in principle represents an eminent *maslaha* of our time. For those who take unduly prohibitive views of these varieties of trade simply because a certain mode of trading was not recognized to the *fuqaha'* of earlier times and then pass negative judgments on speculative grounds without clear *shari'ah* evidence is tantamount to acting contrary to the objectives (*maqasid*) of *shari'ah*. The basic norm and maxim of *shari'ah* is prohibition (*al-hazar*) in the realm merely of *[ibadat* (worship matters) and it is permissibility (*ibahah, idhn*) in *mu'amalat* and commercial transactions. nothing in this latter area must be declared prohibited without decisive and indisputable proof. Since there is no decisive proof on the prohibition of futures, then it's permissibility in *shari'ah* is established. A transaction is valid from the *shari'ah* perspective when it does not violate a decisive principle, it is clear of *riba*, and it does not partake in extreme *gharar*. When these conditions are met, the transaction in question is valid and may be practiced in spite of as to whether or not it agrees with the discourse of the *fuqaha'* on transaction and contract. The general guidelines of the *qur'an* must certainly be applied separately of the time-bound discourses of the *fuqaha'* of earlier times. The *qur'an* upholds the people's needs and *maslaha* at all times and in manners that may be appropriate to their conditions, provided that none of its decisive principles are violated. Commodity futures fall under the basic principle of permissibility, with the proviso that we engage ourselves in a continuous process to improve vigilance and develop more refined safeguards against abuse, extreme speculation, and *gharar*.

## REFERENCES

- [1] Al-sa[ati, “*nahw mushtaqat maliyya islamiyya*,” n. 2, p. 63.
- [2] Id.
- [3] Id., p. 71.
- [4] J. Legget, in *sfc finance co. Ltd. V. Masri*, *all er* (1986): 1:44.
- [5] R.j. Teweles and frank j. Jones, *the commodity futures game*, 2nd. Ed. (new york: mcgraw hill, 1987), 22.
- [6] Lockhart j. In *sydney futures exchange ltd. V. Australian stock exchange ltd.* (1995) 13 acl 369.
- [7] New york institute of finance (nyif), *futures: a personal seminar* (new york: 1989), 79; r.j. Parker, “the role and organization of the clearing house” (paper presented at the kuala lumpur commodity exchange [klce] workshop held in johor bahru, malaysia, 28 september 1985, 3ff.
- [8] [abd al rahman al-jaziri, *al-fiqh [ala al madhab al-arba[ah* (istanbul: kahikat ketabevi, 1991), 3:191.
- [9] Muhammad akram khan, “commodity exchange and stock exchange in an Islamic economy,” *the american journal of Islamic social sciences* 5, no. 1 (spring 1988): 91.
- [10] Ahmad yūsuf sulayman, “ra’y al tashri[ al islam fi masa’il al bursa,” *iya* (cairo: al ittihad al duwali li al bunūk al islamiya, 1402/1982) 5:387ff.
- [11] Muhammad taqi usmani, *buhūth fi qadaya fihiyya mu[asira*, karachi: maktaba dar al-[ulūm, 1414/1995, pp. 140-142.
- [12] For the text of sulayman’s opinion and [abd al qadir’s response, see their respective articles in *al mawsu[ah* 15, 387ff and 438 ff. The text of [abd al basit’s opinion and [azzam’s response can be found in bayt al tamwil al kuwayū, *al fatawa al shar[iyah fi masa’il al iqtisadiyah*, 2nd ed. (kuwait: 1405/1985), 113-130.
- [13] [abd al karim al khatib, *al siyasah al maliyah fi islam wa sillatuha bi al mu[amalat al mu[asirah*, 2nd ed. (cairo: dar al fikr al [arabi, 1976), 170 ff.
- [14] Abdel hamid al-ghazali in *majallat majma[ al-fiqh al-islami* 1, no. 7 (1991), p. 639 as quoted in muhammad al-bashir al-amine, “futures trading contracts in commodity markets: an Islamic analysis,” unpublished ph.d thesis, international Islamic university malaysia 2001, p. 170.
- [15] Id., p. 626; al-amine, n. 31, p. 170.
- [16] Abū dawūd sulayman ibn ash[ath al sijistani, *sunan abū dawūd*, ed. Muhammad muhiy al din [abd al hamid (beirut: dar al fikr, n.d.), “kitab al buyū[ fi bay[ al rajul ma laysa [indah.”
- [17] [ala’ al din al kasani, *bada’i al sana’i[ fi tartib al shara’i[* (cairo: matba[ah al jamaliyah, 1328/1910), 5:146.
- [18] Abū muhammad al husayn al baghawi, *sharh al sunnah* (damascus: al maktab al islami, 1974), 8:140-141; abū sulayman hamd ibn muhammad al khattabi, *mafalim al sunan*, edited by muhammad hamid al faqi (cairo: matba[a al sunnah al muhammadiya, 1368/1949), 5:143.
- [19] Taqi al din ibn taymiyya, *majmu[ah fatawa shaykh al islam ibn taymiyya*, compiled by [abd al rahman ibn al qasim (beirut: mu’assassat al risalah, 1398 a.h.), 20:529; ibn qayyim al jawziyah, *iflam*, 1:399, note 44.
- [20] Cf. Muhammad taqi usmani, *buhuth*, n. 26, p. 136.
- [21] Muhammad mukhtar al-salami, “ta’jil al-badalyn fi’l-[uqud,” paper presented in nadwa al-baraka, 2-3 december 2000, p. 3; al-amine, “futures trading,” n. 31, p.
- [22] Masoomi nia, “derivatives an economic and jurisprence study”, cultural and Islamic though research center publication (2010), p.242
- [23] Fakhr al din ibn [umar al razi, *tafsir al kabir*, 2:364, note 88.
- [24] Al shafi[i, *al umm*, note 42, p. 3:81.
- [25] Al [attar, *nazariyat*, note 87, p. 127.
- [26] Cf. Rafiq yūnus al misri, *al maysir wa al qimar, al musabaqat wa al jawa’iz* (damascus: dar al qalam, 1413/1993), 35; “maysir,” *the encyclopedia of islam*, new ed. (leiden, e.j. Brill, 1965), 3:156.
- [27] Cf. Al misri, *al maysir wa al qimar*, 71; “maysir”, *the encyclopedia of islam*, new ed., 3:156; j.l. Patton, “gambling”, *encyclopedia of religion and ethics*, edited by james hastings (edinburgh: 1913), 6:163 ff; franz rosenthal, *gambling in islam* (leiden: e.j. Brill, 1975), 48-50.