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Conventional Futures: Derivatives from Islamic Law of Contract Perspective

Md Akther Uddin¹

Abstract

Islamic finance has emerged as a sustainable alternative of conventional finance for last two decades or so thanks to development of Islamic banking industry and more recently Islamic capital market. As Islamic finance industry is based on the principle of Islamic Law of Contract, there are certain rules that need to be followed in every financial transaction to be compliant with *Shari'ah*. As risk is inherent in business and finance, investors across the world use various risk mitigating tools or instruments including derivative instruments like futures contract. Although, the necessity of this kind of instrument is essential for development of Islamic finance industry but the permissibility of using them is still a debatable issue. In this research paper, a humble attempt has been made to explain the concept of conventional futures contract from Islamic Law of Contract perspectives. It is found in this study that there are arguments for and against the futures contract. On the one hand, majority scholars consider futures contracts are non-compliant with Islamic Law because of selling something that does not exist, deferment in the both counter values, excessive risk taking, uncertainty, pure speculation, and sale of one debt for another. In support of their argument they provided references from the *Quran* and *Sunnah*, also views of classical scholars and Jurists. On the other hand, many scholars argue that futures contracts are permissible while refuting the arguments provided against its impermissibility; while others argue that contemporary business environment demand to use them, so it is considered as custom (*urf*), while others argue it is permissible on the basis of *Istihsan* (*juristic preference*), *maslaha* (*public benefits*), *dharurah* (*necessity*). After analyzing the arguments for and against the futures contract, it can be concluded that contemporary scholars and Jurists in the field of Islamic Law are still divided on this issue as it is quite a new area of research from Islamic Law of Contract perspectives. However, it is safe to assume that conventional futures contracts in its current form do not comply with the Islamic Law.

Key words: *futures contract, derivatives, Islamic Law of Contract, gharar, maysir, riba*

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1. Introduction

Conventional futures are derivatives, which values derive from other financial products. A futures contract is essentially a standardized forward contract, is an agreement between a buyer and seller at time 0 to deliver a specified asset at a certain time in the future for a certain price. Trading volume of futures contracts is often much larger than underlying assets and this is due to speculating activity and gambling in derivatives. Some researchers asserted that those who participate in future contracts are not for risk protecting rather, for speculating and in fact, hardly 1% or 2% percent of traded derivatives instruments are settled by actual delivery of the underlying assets while the rest were ended through cash settlement, not including real sale. The speculation and gambling pictures in futures contracts also reflected in the huge trading volume of derivatives relative for the gross domestic products (GDP) of the world, where the trading volume of derivatives all over the world in the parallel market at end of 2012 amounted to more than \$1.270 quadrillion and in the organized market more than \$52 trillion. Meanwhile, the GDP volume of the world at end of 2012 was only at \$71.9 trillion, and this amount is equivalent to almost 18 times the value of the gross domestic product of all countries in the world.

The question of whether all currently traded derivatives like conventional futures would be valid is quite irrelevant. Obviously instruments that have as their underlying asset items that are *haram* would need no further consideration. Still, the case of derivatives on equity instruments, currencies and *halal* input commodities deserves attention. Though it might seem safer for Islamic scholars to be on the side of conservatism such a position can have costly consequences for Islamic businesses in the long run. In an increasingly competitive and sophisticated business environment denying them the use of a flexible and powerful array of instruments could place them at a disadvantage. Thus, in evaluating the permissibility of derivatives yet another dimension may be needed, that is a social welfare dimension.² Research on derivatives from Islamic Law perspective is still in its early stages. However, because of its complexity and speculative nature, it has not been a mesmerizing topic to be openly discussed by Muslim academicians. Futures contracts are being urged to be reconsidered

² I. B. Obiyathullah, "Derivatives Instruments and Islamic Finance Some Thoughts For A Reconsideration", *International Journal of Islamic Financial Services*, 1(1) (1999): 1-33.

by the ulama' for hedging purposes and still unresolved. Although the issue has been addressed by a number of institutions, such as Makkah-based *Fiqh* Academy, the Islamic *Fiqh* Academy based in Jeddah in different seminars and workshops, the Permanent Research Committee of the Board of Great Scholars in Saudi Arabia, and the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), the outcome of these discussions has been to urge the prohibition of derivatives (U. Chapra; M. T. Usmani; M. A. Khan; M. F. Khan, M. Mahmassani; A. Y. Sulayman; and others). However, these judgments should not be considered the final *Shari'ah* ruling on the issue because certain shortcomings have been associated with these resolutions (Kamali; al-Qadir; M. Din Azzam, al-Khatib, Obiyathullah and others). Consequently, *Shari'ah* Advisory Council of Securities Commission of Malaysia has resolved that commodity futures like Crude Pulm Oil (CPO) futures are *Shari'ah* compliant and also allowed composite index futures and single stock futures. Therefore, fresh discussion on the issue is a must. Reaching a solution is possible given the flexibility of Islamic law on one hand and the broader sphere of the concept of freedom of contract on the other, in particular as it has been pointed out by a recent International Money Fund (IMF) working paper.³

This paper will be presented as follow, Section one will discuss on the introduction of the study. . Section two will cover definition and scope of conventional futures. Section three discusses general principle of contract in *Shari'ah*. Section four gives comprehensive analysis of contract and pillars of contract in Islamic Law. In section five, arguments against conventional futures will be discussed. Section six provides arguments for conventional futures. Finally, section seven study conclusions.

³ Andreas A. Jobst & J. Sole, *Operative Principles of Islamic Derivatives—Towards a Coherent Theory*, (IMF Working Paper, 2012).

2. Conventional Futures: Concepts and Scopes as a Derivative Instrument

Derivatives are financial asset whose values are dependent on underlying asset or known variables. One of the key derivative instruments is futures contract. A futures contract is essentially a standardized forward contract,⁴ is an agreement between a buyer and seller at time 0 to deliver a specified asset at a certain time in the future for a certain price.⁵ The price is competitively determined by “open outcry” on the trading floor or through a computer-based market. The contract, if taken to maturity, is fulfilled by a cash payment of price and actual delivery of the item on the delivery date based on the settlement price for that date.

Although futures can be divided into two types, financial futures and commodity futures, generically, financial futures are not different from commodity futures except the underlying assets of them differ from each other. For example, a particular commodity like metals, vegetables and so on are traded in commodity futures whereas in financial futures, diverse financial instruments like equity shares, debentures, bonds, treasury securities, currencies, etc are traded. Futures contracts were developed to overcome the problems of double co-incident, unfair forward price and country party risks.⁶

In today’s competitive and complicated business environment futures contract plays a vital role and important instrument for managing or hedging against risk in financial markets due to price volatility. Hull states that many participants in futures markets are hedgers.⁷ They want to use futures contracts in order to reduce a particular risk which they face. At present, these contracts are actively traded all over the world.

Futures contracts are normally traded on an organized exchange.⁸ The exchange sets up certain standardized features of the contract. As the counterparties do not necessarily know each other the exchange provides a mechanism that gives a guarantee to both parties that the contract would be honoured. The main role of exchange is to minimize the risk it bears, which is the potential default risk. This exchange achieves by two processes, one known as “margining” and the other as “marking to market”. The exchange requires each party to deposit initial deposits, known as initial margins; when losses occur, it will require the party whose position is losing to

⁴ J.C. Hull, *Options, Futures and Other Derivatives* (New Delhi: Prentice-Hall of India Private Limited, 2007).

⁵ A. Saunders & M.M. Cornett, *Financial Markets and Institutions* (New Delhi: Tata McGraw-Hill Publishing Company Limited, 2007).

⁶ O. I. Bacha, *Financial Derivatives Markets and Application in Malaysia*. (2th edn.). Malaysia: McGraw-Hill (Malaysia).

⁷ *Supra* note 3

⁸ *Supra* note 4

pay up as the losses occur. This is known as a margin call. Marking to market means that the gain or loss in each contract position resulting from changes in the price of the futures (or option) contracts at the end of each trading day is added or subtracted from each account balance.⁹ Another unique feature of futures is the ability of the buyers and sellers to reverse out of their positions before delivery or maturity. Therefore, in commodity futures physical delivery hardly ever takes place, as compared to forward contracts where delivery does take place.

Two largest futures exchanges in the United States of America are the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME). The largest exchanges in Europe are the London International Financial Futures and Options Exchange (LIFFE) and Eurex. Other large exchanges include the Tokyo International Financial Futures Exchange (TIFFE), the Singapore International Monetary Exchange (SIMEX) and the Sydney Futures Exchange (SFE).

Nevi Danila identified the following main advantages of futures contracts: a) the futures contracts need less initial costs than other similar instruments, only need to deposit guarantee or margin an underlying asset of greater value, b) the future markets can be used as instruments to cover the risks derived from the fluctuations of cash prices before expiration, c) the existence of an organized exchange and standardized contracting terms gives liquidity and possibility of closing positions on a date before the expiration, and d) participants assume less risk of insolvency; the clearinghouse guarantees the liquidation of the contract.¹⁰

Though futures contracts have been able to overcome the problems of forward contracts, there are three inadequacies that stimulated the search for further product innovation. Firstly, while futures enabled easy hedging by locking in the price at which one could buy or sell, being locked-in also means that one could not benefit from subsequent favorable price movements. Secondly, participants cannot handle contingent liabilities. Thirdly, as futures are standardised, there does not exist futures contracts for all the instruments nor for all the merchandise and they might not cover exactly all the cash positions.¹¹

⁹ M. F. Khan, 'Islamic futures and their markets: with special reference to their role in developing rural financial markets', *Jeddah: Islamic Research and Training Institute*, Research paper no 32 (1996).

¹⁰ N. Danila, 'Derivatives: An Islamic Perspective', *Journal of International Finance and Economics*, 9(3) (2009): 83-90.

¹¹ *Supra* note 1

3. General principles of contract in *Shari'ah*

Islam is rules-based religion.¹² The *Quran* and the *Sunnah* are the root of all rules required for every sphere our life, from cradle to death. Allah (سبحانه وتعالى) mentions the following verse in several places in the *Quran*: وَأَطِيعُوا اللَّهَ وَرَسُولَهُ: “Obey Allah and His Messenger”.¹³ Contracts are the backbones of everyday transactions. Consequently, the general principles of contract are derived from the *Quran* and the *Sunnah*. Allah (سبحانه وتعالى) mentions about contract (عقد) in several places. Allah (سبحانه وتعالى) says: وَأَوْفُوا بِالْعُقُودِ: “O ye who believe! Fulfil (all) obligations”.¹⁴ وَأَوْفُوا بِالْعَهْدِ إِذَا عَاهَدْتُمْ وَلَا تَنْقُضُوا الْأَيْمَانَ بَعْدَ تَوْكِيدِهَا وَقَدْ جَعَلْتُمُ اللَّهَ عَلَيْكُمْ كَفِيلًا إِنَّ اللَّهَ يَعْلَمُ مَا تَفْعَلُونَ يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ “Fulfil the covenant of Allah when ye have entered into it, and break not your oaths after ye have confirmed them”.¹⁵ “O you who believe! Squander not your wealth among yourselves in worthless dealings, but let there be trade by mutual consent”.¹⁶

These verses indicate the sanctity of a various obligations, including, social, political, commercial and not to mention spiritual. Therefore, the word عقد establishes the foundation of contract and attendant liabilities.¹⁷

According to Islamic Law, the word عقد (*'aqad'*) literally means to tie between two ends of something either physically or morally. Generally it covers everything a person commits himself to do which includes unilateral and bilateral action.¹⁸

Al-Zuhayli defines *aqad* as the meeting of offer and acceptance in conformity with the formality prescribed by *Shari'ah*.¹⁹

Razali states that the term *aqad* in general refers to a legal transaction which involves a bilateral declaration namely the offer and acceptance. The *aqad* is a legal transaction which creates a new legal situation.²⁰

Fixed formality is not required to form contract in Islam. Ibn Qudama made a significant statement that Allah permitted sale but did not specify the manner in which it was to be

¹² H. Askari, Z. Iqbal & A. Mirakhor, *Introduction to Islamic Economics: Theory and Application* (Singapore: Wiley, 2015)

¹³ The Quran 8:1

¹⁴ The Quran 5:1

¹⁵ The Quran 16:91

¹⁶ The Quran 4:29

¹⁷ N. Mohammed, 'Principles of Islamic Contract Law', *Journal of Law and Religion* 6(1) (1988): 115-130.

¹⁸ S. R. Razali, *Islamic law of contract* (Singapore: Cengage Learning Asia, 2010):2.

¹⁹ W. Al-Zuhayli, *Financial transactions in Islamic jurisprudence (E.-G. M.A, Trans. Vol. 2)*. (Damascus: Dar al-Fikr:2003)

²⁰ *Supra* note 17

concluded.²¹ Niazi supported this idea and emphasized that there is no fixed formalities in contract under Islamic Law. He further added that what under Islamic Law, the fundamental proof of consent by each party is required as in any other legal system. Consent is discovered by the use of the offer and acceptance methodology. The offer or *ijab* and acceptance *qabul* must meet at the same time and meeting or *majlis*.²²

After giving clear evidence from the *Quran* and various definitions of Islamic jurists, we can firmly state that contract is not an alien concept in Islamic Law. Tahir Mansuri distinguishes most important general principles of commercial contracts and transactions, which we are going to briefly discuss in the following section.²³

3.1. The contract should be by free mutual consent

The consent of the two contracting parties should be the main pillar in any contract under Islamic law. Thus, mutual agreement is the basis of a contract. In Islamic law such concept is based on the *Quranic* verse which states to the effect:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! Squander not your wealth among yourselves in worthless dealings but let there be trade by mutual consent”.²⁴

And it is also refers to several *Hadiths* of the Prophet (صلي الله عليه وسلم) such as:

“The trade should be concluded by mutual consent” and is unlawful for a person to take his brother’s property unless by the pleasure of his soul”

In another *Hadith*, the Prophet (صلي الله عليه وسلم) “The contract of sale is valid only by mutual consent”.²⁵

3.2. The contract should be devoid of *Gharar*

The Arabic word *Gharar* is a fairly broad concept that literally means deceit, risk, fraud, uncertainty or hazard that might lead to destruction or loss. Hanafi scholars have defined *Gharar* as “something which its consequence is undetermined.” While Shafi’i scholars have described it as “something which in its manner and its consequence is hidden. According to Al-Sarakshi, “anything that the end result is hidden or the risk is equally uncommon, whether it exists or not.” Therefore, *Gharar* in Islam refers to any transaction of probable objects whose existence or

²¹ Ibn Qudama as quoted by N. J Coulson in Commercial Law in The Gulf States (London: Graham & Trotman, 1984):39.

²² L. A. K. Niazi, *Islamic Law of Contract* (Lahore: Research Cell, Dyal Singh Trust Library, 1990).

²³ M. T. Mansuri, *Islamic Law of Contract and Business Transactions* (Adam Publishers & Distributors, 2006) 3-16.

²⁴ The Quran 4:29

²⁵ *Ibid.*,

description are not certain, due to lack of information and knowledge of the ultimate outcome of the contract or the nature and quality of the subject matter of it.

Prohibition of *gharar* is another important principle that governs all contracts and transactions in Islamic law of contracts. Risk is inherent in business: no one can predict whether there will be a profit or a loss at the end of the year. But *gharar* does not refer to this. A contract is presumed to suffer from *gharar* if it involves: (a) a thing whose quantum is unknown; (b) a thing about which is not known whether it exists or not; (c) a thing that is not within the knowledge of the parties; (d) the parties are unaware whether a sale will take place or not.²⁶

There is no specific evidence from the *Quran* which connotes *Gharar*, however, Allah (سبحانه وتعالى) mentions:

وَلَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ وَتُدْأَلُوا بِهَا إِلَى الْحُكَّامِ لِتَأْكُلُوا فَرِيقًا مِّنْ أَمْوَالِ النَّاسِ بِالْإِثْمِ وَأَنتُمْ تَعْلَمُونَ

“Eat not your property among yourselves unjustly by falsehood and deception”.²⁷

There are several *Hadiths* where the Prophet (صلي الله عليه وسلم) strictly prohibit *gharar*. For instance, 'Ahmad and 'Ibn Majah narrated on the authority of 'Abu Said Al Khudriy (رضي الله عنه): The Prophet (صلي الله عليه وسلم) has forbidden the purchase of the unborn animal in its mother's womb, the sale of the milk in the udder without measurement, the purchase of spoils of war prior to their distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver.

“Oh Prophet of Allah! A man comes to me and asks me to sell him what is not with me, so I sell him [what he wants] and then buy the goods for him in the market [and deliver]'. And the Prophet (صلي الله عليه وسلم) said: 'sell not what is not with you.’”²⁸

3.3. The contract should be free of riba

Riba is derived from the derivative word “raba-wa” it has certain meanings as “to increase; to grow; to grow up, to exceed, be more than. In the specific sense, Riba is generally translated into English as usury or interest but in fact it has a much broader sense under *Shari'ah*.²⁹

One of the key principles that govern transactions in Islamic law of contract is the prohibition of *riba*. It is unanimously agreed that *riba* is excess in return of which no reward or equivalent counter value is paid, in other words, all unjust enrichment is considered as *riba*. On

²⁶ *Ibid.*, see 22 at p. 6

²⁷ The Quran 2:188

²⁸ Sunan Abu Dawud, No.3503

²⁹ Haqqi, A. R. A. (2009). *The philosophy of Islamic law of transactions*. CERT Publications.

Riba, the direct *Quranic* references are to be found in four surahs or chapters. These verses are an ascending scale which starts with a mere judgment of value, followed by an implicit prohibition, then a limited one and finally, a total and conclusive prohibition (Al-Rum, 30:39; Al-Nisa, 4:161; Ali-Imran, 3:130 and Al-Bakarah, 2:275-9).

Moreover, the detailed varieties of usurious transactions as well as such prohibition have explained and elaborated by the *Sunnah*. For example, the Messenger of Allah (سبحانه وتعالى) has cursed the one who accepted Riba, the one who paid it, the one who recorded it, and the two witness of it, saying they were all alike.³⁰ It is also reported that the Prophet (صلي الله عليه وسلم) has said to the effect:

“(Exchange) gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, measure for measure and hand to hand. If the (exchanged) articles belong to different genera, the exchange is without restraint provided it takes place in a hand to hand transaction.”³¹

3.4. The contract should not contain an attribute of *Qimar* and *Maysir* (gambling and game of chance)

Islam has also categorically prohibited all forms of *Qimar* and *Maysir*. *Qimar* comprises every form of increase or money gaining of which depends entirely on luck on chance, for instance acquiring income as a outcome of lottery or lucky draw. On the other hand, *Maysir* refers to the easy acquisition of wealth by chance, whether or not it deprives the other’s right. There is no difference of opinion between the scholars regarding the prohibition of gambling. *Quran*, Allah (سبحانه وتعالى) clearly prohibits gambling the following verses:

يَسْأَلُونَكَ عَنِ الْخَمْرِ وَالْمَيْسِرِ قُلْ فِيهِمَا إِثْمٌ كَبِيرٌ وَمَنَافِعُ لِلنَّاسِ وَإِثْمُهُمَا أَكْبَرُ مِن نَّفْعِهِمَا وَيَسْأَلُونَكَ مَاذَا يُنْفِقُونَ قُلِ الْعَفْوَ كَذَلِكَ يُبَيِّنُ
اللَّهُ لَكُمْ الْآيَاتِ لَعَلَّكُمْ تَتَفَكَّرُونَ

“They ask thee concerning wine and gambling. Say: “In them is great sin, and some profit for men; but the sin is greater than the profit”.³²

يَا أَيُّهَا الَّذِينَ آمَنُوا إِنَّمَا الْخَمْرُ وَالْمَيْسِرُ وَالْأَنْصَابُ وَالْأُرْزُلَامُ رِجْسٌ مِّنْ عَمَلِ الشَّيْطَانِ فَاجْتَنِبُوهُ لَعَلَّكُمْ تُفْلِحُونَ

“O ye who believe! Intoxicants and gambling (dedication of) stones and (divination by) arrows are an abomination of Satan's handiwork: eschew such (abomination) that ye may prosper.”³³

³⁰ Muslim, Sahih, vol. III, p.1218, hadith no. 1597; al-Bukhari, Muhammad ibn Ismail, (1407/1987), 1st ed., vol. III – al-Shaikh Qasim al-Rifai(edt), Beirut: Dar al-Qalam, pp. 128-9, hadith no.337

³¹ Muslim, Sahih, vol. III, p.1211

³² The Quran 2:219

3.5. The contract should be free from fraud and cheating

Fraud and cheating have been stoutly condemned in the *Quran* and the *Sunnah*. Fraud includes a number of practices such as giving short measures and short weight, false bidding to raise price of an item, false swearing, hiding defects in sale, etc.³⁴ Allah (سبحانه وتعالى) says in Surah al-Muṭaffifīn:

إِذَا السَّمَاءُ انْفَطَرَتْ (١) وَإِذَا الْكُوَاكِبُ انْتَثَرَتْ (٢) وَإِذَا الْبِحَارُ فُجِّرَتْ (٣) وَإِذَا الْقُبُورُ بُعْثِرَتْ (٤) عَلِمْتَ نَفْسٌ مَّا قَدَّمَتْ وَأَخَّرَتْ (٥)

“Woe to those that deal in fraud. Those who, when they have to receive by measure, exact full measure. But when they have to give by measure or weight to man, give less than due. Do they not think they will be called to account on a Mighty Day.”³⁵

3.6. Two mutually inconsistent contracts are not permissible

If there are more than one contract, they must be congruent with each other. The Prophet (صلي الله عليه وسلم) has prohibited two mutually inconsistent contracts, for example, the sale of two articles for two prices, the contingent sale, and the sale of single object for two prices.³⁶

3.7. A contract should not be contrary to *maqasid al-Shari’ah*.

Any transaction or contract that offends or jeopardizes any of the objectives (“*Maqasid*”) of 7. *Shari’ah* is automatically invalid. *Maqasid al-Shari’ah* is alternately referred as ‘Huquq Allah’ (rights of Allah) in Islamic Law.³⁷ The objectives of *Shari’ah* or ‘huquq Allah’ have been mentioned in several verses of the *Quran*:

وَلَكُمْ فِي الْقِصَاصِ حَيَاةٌ يَا أُولِي الْأَلْبَابِ لَعَلَّكُمْ تَتَّقُونَ

“In the law of Equality, there is saving of life to you, o man of understanding”.³⁸

3.8. Entitlement of profit upon liability for risk

Another principle that governs contract and commercial transactions is principle of liability for Loss and entitlement to profit. This principle provides that a person is entitled to profit only when He bears the risk of loss. This principle operates in number of contracts such as contract of partnership, sale, or hire. According to Islamic legal maxim: Al gurm, bil gurmi, “with profit comes liability or risk”.

³³ The Quran 5:90

³⁴ *Supra* note 22

³⁵ The Quran 83:1-5

³⁶ R.H. Nawawi, *Islamic Law on Commercial Transactions*, (Kuala Lumpur CERT Publication Sdn. Bhd; 2009), 59-100.

³⁷ *Supra* note 22 at p. 6

³⁸ The Quran 2:179

This legal maxim provides the rationale and the principle of profit and loss sharing in various types of contracts including *Sharika* (partnership) contract.

3.9. Permissibility as a general rule “What is not explicitly prohibited is permissible”

In *mumamalt* (المعاملات) everything that is not prohibited is permissible. This rule has been emphasized in a number of verses in the *Quran*. Allah (سبحانه وتعالى) ordains:

قُلْ مَنْ حَرَّمَ زِينَةَ اللَّهِ الَّتِي أَخْرَجَ لِعِبَادِهِ وَالطَّيِّبَاتِ مِنَ الرِّزْقِ قُلْ هِيَ لِلَّذِينَ آمَنُوا فِي الْحَيَاةِ الدُّنْيَا خَالِصَةً يَوْمَ الْقِيَامَةِ كَذَلِكَ نُفَصِّلُ
الآيَاتِ لِقَوْمٍ يَعْلَمُونَ

“Say, "Who has forbidden the adornment of Allah which He has produced for His servants and the good [lawful] things of provision?" Say, "They are for those who believe during the worldly life [but] exclusively for them on the Day of Resurrection." Thus do we detail the verses for a people who know.”³⁹

After analyzing the governing principles of Islamic law of contract, we can state that Islam is a complete code of life and it provides governing principles for every aspects of life including commercial transactions. In the following section we are going to discuss the pillars of contract in Islamic Law.

4. *Aqad* and the fundamental pillars of Islamic Law of Contract

The discussion of the theory of contract constitutes the cornerstone of Islamic commercial law. Contract is the essential mode of acquisition of ownership transferred from a party to another. Therefore, it deals with the types of contracts to effect the transfer and their legal effects with the function of meeting the needs of the society with regard to dealings and transactions.⁴⁰

The word *aqd* (pl. *uqud*) in the Arabic language originally means tying tightly, as in tying a rope. In the dictionary of *Lisan al ‘Arab*, it is defined as “*aqad al ‘ahd*” to mean ‘make a covenant’ and “*aqad al yamin*” to mean ‘give an oath’. Therefore, ‘*aqad*’ carries the meanings of covenant and fulfillment.

The word contract in Islamic jurisprudential usage means an engagement and agreement between two persons in a legally accepted, impactful and binding manner.

³⁹ The Quran 7:32

⁴⁰ Securities Commission Malaysia, *Islamic Commercial Law* (Petaling Jaya: LexisNexis, 2009), 64.

An expression of the matching between a positive proposal made by one of the parties and the acceptance of the other party in a way which has an impact on the subject matter of the contract.⁴¹

In its technical sense, contract has been defined as the obligation which is the result of an offer given by one party and the acceptance given by the other party, in a way where its legal effect is expressed on the thing contracted upon.

According to Majallat al-Ahkam al-Adliyyah (Civil Code of the Ottoman Empire promulgated in 1876), contracting is the connection of an offer with an acceptance in a lawful manner which marks its effect on the subject of that connection. It is further explained that as a result of this connection, both parties are under an obligation to one another.

From the above definition of the contract, we can say that Islamic contract law requires certain conditions to be fulfilled in order to be valid. Fundamental pillars of contract include: (i) *Sigha* (statement or a form), (ii) two contracting parties and (iii) the subject matter of contract.⁴² Allah (سبحانه وتعالى) emphasises the requirement of mutual consent in all trades and transactions and prohibits explicitly taking the property of others without their consent by illegal means.

As quoted earlier Al Nisa 4:29 Allah (سبحانه وتعالى) says: “O you who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will: nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful.”⁴³

Al-Nisa 4:160-161 Allah (سبحانه وتعالى) also blamed the Jew for taking others property in a wrongful way.⁴⁴

The sanctity of property ownership and requirement of consent in transferring the property to another party in the form of a contract is further supported by the *Sunnah* of the Prophet (صلي الله عليه وسلم). It is reported that the Prophet (صلي الله عليه وسلم) said ‘the property of a Muslim is prohibited (from being acquired by others) unless by his free will’.⁴⁵

⁴¹ Ala al-Din Kharofa, *Transactions in Islamic Law* (Kuala Lumpur: A.S. Noordeen, 1997), 11.

⁴² *Supra* note 35

⁴³ The Quran 4:29

⁴⁴ The Quran 4:160-161

⁴⁵ *Supra* note 39

4.1. *Sigha* or the statement

The significance of the statement or *sigha* is supported by majority Muslim jurists as it utters the mutual consent of both parties involved in a contract. In absence of this the contract is considered void.⁴⁶

Sigha is created through valid *ijab*(offer) and *qabul*(acceptance). The offer made by the first party to the contract is called *ijab* because it gives and confirms the freedom of acceptance to the second party. If the second party agrees, then his statement is called *qabul*. The coming together of *ijab* and *qabul* makes up the contract.⁴⁷

Offer and acceptance can be performed in various ways, such as, by words, gesture or indication and by conduct. The acceptance must be made to correspond with the proposal. It is compulsory that the acceptance must conform to the offer in all its details irrespective of whether such conformity is express or implied. If this conformity does not exist, there will be no consent. This conformity could either be explicit or implicit.⁴⁸

An offer made must be made in the same meeting i.e. *Qyar al-Majlish* (unity of session). The doctrine of session of contract states that in order for offer to be conformed to the acceptance, both parties should be present in the same session.⁴⁹

There are different opinions among scholars whether a contract is obligatory instantaneously following an offer and acceptance, or parties are allowed to delay for further thinking about it until the end of the session. Majority of scholars (except Hanafi and Maliki) uphold that both parties are endorsed to rethink and delay until end of the session. This view could be supported by a *Hadith* which narrates: “Both seller and purchaser have the choice (to revoke the contract) unless they have separated from each other”.⁵⁰

4.2. Contracting parties

Legal capacity of both the contracting parties is the second most important requirement that is obligatory to have a valid Islamic contract. The parties who have the legal capability to enter into a contract must have the following attributes; (i) puberty, (ii) sanity, and (iii) maturity.⁵¹

⁴⁶ *Supra* note 40

⁴⁷ Abdurrahman Raden Aji Haqqi, *An Islamic Legal Framework Input in the Validity of Electronic Contracts, Electronic Transactions Conference*, (Brunei Darussalam: 2000).

⁴⁸ Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, (Kuala Lumpur: 2007).

⁴⁹ *Ibid.*,

⁵⁰ *Ibid.*,

⁵¹ *Supra* note 35

In the *Quran*, Allah(SWT) says:

وَابْتَلُوا الْيَتَامَىٰ حَتَّىٰ إِذَا بَلَغُوا النِّكَاحَ فَإِنْ آنَسْتُمْ مِنْهُمْ رُشْدًا فَادْفَعُوا إِلَيْهِمْ أَمْوَالَهُمْ

“Make trial of orphans until they reach the age of marriage; if then you find sound judgment in them, release their property to them”.⁵²

The sanity of both contracting parties is must in Islamic law of contract. The capacity for the parties to make the contract is when s/he attains full mental growth and maturity. Puberty is considered as a standard criteria.⁵³ However, reaching puberty alone is not sufficient evidence that a person has obtained capacity of doing business independently. Moreover, one must possess maturity of action to conduct not only financial matters but also religious matter (ibadha).⁵⁴

Subject matter is another vital pillar of contract in Islamic Law without which no contract can be performed. Subject matter can in the form of goods or property. The following conditions of the subject matter are required in Islamic law of contract: 1) legality or suitability, 2) precise determination of the subject matter, 3) existence of subject matter, and 4) certainty of delivery.⁵⁵ First of all, the subject of sale must have the value. The goods must have a clear material value, which is verified by the market. Goods without real value cannot be subject of sale or purchase. In addition, the subject matter must be permissible article in *Shari'ah* viewpoint. Legitimacy of subject matter also entails ownership (it must be possessed).

4.3. Subject matter

Lastly, legality of subject matter also requires that there should be no hindrance or right attained to it. The subject of sale should not be a thing used for un-Islamic intentions.⁵⁶

The subject matter must be accurately determined by both parties. All scholars generally agree that both parties must know in details the particulars about subject matter. The general principle in Islamic contract law is that the subject matter must be exactly determined in relation to its nature, quantity and value. Likewise, if the subject matter is an obligation or performance, it must be precisely determined at the time of the contract or else the contract will be invalid.⁵⁷ The subject must be specifically known and identified to the buyer. If the goods are not specified and agreed to up-front, the sale is void, as the goods may differ from goods agreed at the initial point of agreement. If the goods are not agreed initially upon entering the contract there is

⁵² The Quran 4:6

⁵³ *Ibid.*, see *Supra* note 45

⁵⁴ *Ibid.*, see *Supra* note 45

⁵⁵ *Ibid.*, see *Supra* note 45

⁵⁶ *Supra* note 46

⁵⁷ *Ibid.*, see *Supra* note 46

likelihood of gamble and cheating. The quantity and attributes of the subject matter must be also precisely known and agreed upon together with the certainty of the timing for completion and delivery of the contractual obligations. The price of the subject must be definite and becomes a necessary condition to the validity of the sale contract. If the price is uncertain, the sale is void.⁵⁸ Islamic contract law also uphold that the subject matter for transactions should be in actual existence at the time of contract and should be competent of being obtained and delivered to a prospective buyer in the future. The subject must exist at the time of the sale. If subject matter does not exist at the time of the sale, it cannot be transferred and its non-existence makes the contract void.⁵⁹

The subject must be in the full ownership. If something is not fully owned, the contract that takes the place becomes void. In addition, the subject must be in physical possession of the owner when he transfers it to another person.⁶⁰

Further necessity in Islamic contract law is that the sale must be instant and absolute. The sale of goods at a future date or event is void except for exceptional conditions that allowed by Islamic Law of contracts as in *salam* or *istisna* transactions.⁶¹

The common rule related to deliverability is that the subject matter must exist at the time of contract and must be owned and in possession by the seller before it can be transacted. The delivery of the subject of sale must be certain, not depending on a possibility or chance.⁶²

After discussing general principles of transactions and fundamental pillars of Islam, it is clear that in order to be compliant with Islamic Law of contracts; any financial products must have these principles. If there is any discrepancy, the contract is generally considered as void. In the following section, we are going to discuss why many Jurists argue against the use of futures contract.

5. Arguments against conventional futures in Islamic Law of Contract

5.1. Sell something that does not own

According to the *Mejelle*, the Ottoman Civil Code, Art. 197 provides that the “the thing sold must be in existence”. Art. 205 further provides that “the sale of a thing which is not in existence is void”.⁶³

⁵⁸ Muhammad Ayub, *Understanding Islamic Finance*, (West Sussex: John Wiley & Sons Ltd, 2007), 99-127.

⁵⁹ *Supra* note 35

⁶⁰ *Ibid.*,

⁶¹ *Ibid.*,

⁶² *Supra* note 46

Futures contracts include that does not own, where this sale lead to *gharar*. Dawabah,⁶⁴ and Obaidullah,⁶⁵ stated these contracts contain sale of underlying asset does not exist on their ground and not in the seller ownership as well.

Ibn Qudamah (1401H) and Al-Sanani (1353H) prohibited sell does not own in Islamic law.⁶⁶ Al-Sywasi (n.d) and Ibn Abdeen (n.d) considered this sale is void for the lack of ownership.⁶⁷ Imam al-Shafi also considered it contract involves *gharar* (Al-Mazni, 1321H).⁶⁸ In addition to that, Ibn al-Qayyim and Ibn Taymiyah argued that sell does not own is a part of *qimar* and *maysar* (gambling).⁶⁹

Moreover, this sale is also considered as *al-ma'adum* (non-extant) sale where futures contracts concerning things are basically invalid on the account of non-existent items.⁷⁰ In this regard, Mahmassani has stated that all contracts, except *salam* and *istisna*,⁴³ for selling future goods are invalid under *Shari'ah* law because of the state of non-existence. In the case of *salam*, or even *istisnā* , contracts, only one counter-value is deferred at the time of sale which is allowed under *Shari'ah* law. However, non-existence of both counter-values, in the case of futures contracts, amounts to *gharar* or unwarranted risk-taking due to uncertainty about the prospects for fulfillment.⁷¹

Organisation of the Islamic Conference (OIC) Islamic *Fiqh* Academy also agree with the opinion of Mahmassani. During its 7th session in 1412 H (9-14 May 1992), the Islamic *Fiqh* Academy made the following resolution:⁷²

. . . where the contract provides for the delivery of described and secured merchandise at some future date, and payment of its price on delivery. It also stipulates that it shall end with the actual delivery and receipt of the merchandise. Thus contract is not permissible because of the deferment of the two elements of the exchange. It may be amended to meet

⁶³ C.R. Tyser, D.G. Demetriades, I. Haqqi Effendi (trans.), *The Mejlle English Translation of Majallaj El-Ahkam-i-Adilya and a Complete Code on Islamic Civil Law*, (Petaling, Malaysia: The Other Press, 2001).

⁶⁴ A.M. Dawabah, *Studies in Islamic Finance*, (Cairo: Darussalam, 2007).

⁶⁵ M. Obaidullah, "Islamic Risk Management: Towards Greater Ethics and Efficiency", *International Journal of Islamic Financial Services*, 3 (4) (2002)..

⁶⁶ As quoted in Ehab M. M. Injadat, "Futures and forwards contracts from perspective of Islamic Law", *Journal of economics and political economy* 1(2) (2014): 241-252.

⁶⁷ *Ibid.*,

⁶⁸ *Ibid.*,

⁶⁹ As quoted in S. Kunhibava & B. Shanmugam, "Shariah and Conventional Law Objections to Derivatives: A Comparison", *Arab Law Quarterly* 24.4 (2010): 319-360.

⁷⁰ *Ibid.*,

⁷¹ Mahmassani as quoted in M. H. Kamali, "Islamic Commercial Law: An analysis of futures", *The American Journal of Islamic Social Sciences*, 13(2) (1996): 197-224.

⁷² OIC Islamic Fiqh Academy, "Resolution and Recommendations of the Council of the Islamic Fiqh Academy 1985-2000"

the well-known conditions of ‘salam’ (advance payment). If it does so, it shall be permissible.

The above discussed opinions are based on a number of *Hadith* and the opinions of the majority jurists. According to Al-Zuhayli,⁷³ top scholars from all the schools of Islamic jurisprudence have agreed that the sale of non-existent goods, and goods that might cease to exist, is invalid: e.g., the “the sale of fruits and plants, before they appear:

[. . .] sale of pearls in shells, milk in udder, wool of the back of sheep, and a book before it is printed”.⁷⁴

Examples of *Hadiths* that prohibit the sale of non-existent goods are:

Jabir narrated that the Messenger of Allah (صلي الله عليه وسلم) forbade the selling of fruits until they ripen.⁷⁵

Abu Bakhtari reported: “I asked Ibn Abbas about the selling of dates. He replied: ‘The Prophet (صلي الله عليه وسلم) forbade the sale of dates until they became fit for eating and could be weighed.’ A man asked: ‘What to be weighed?’ Another man sitting beside Ibn Abbas replied: ‘Until they are estimated’.”⁷⁶

Ibn Abbas reported: “The messenger of Allah (صلي الله عليه وسلم) prohibited the sale of fruit before its quality is known, the sale of wool on the back of sheep, and the sale of milk in an udder”.⁷⁷

5.2. Sell prior to taking possession (Qabd)

In conventional futures transactions, the majority of buyers and sellers reverse their positions before delivery or maturity of the contract. This means that, for futures, physical delivery hardly ever takes place.

The word *Qabd* denotes taking and holding something in one’s hands.⁷⁸ In its juristic application, “*qabd*” refers to lawful custody and ownership in a proprietary capacity, even if it does not entail the material operation of holding.⁷⁹ The seller has obligation to bring the goods sold, and the buyer have to pay the price.

⁷³ *Supra* note 18

⁷⁴ *Ibid.*,

⁷⁵ *Saḥīḥ Muslim*, Vol. 1. *The Translation of the Meaning of Summarized Saḥīḥ Muslim*,

⁷⁶ *Ibid.*,

⁷⁷ Al-Tabranī as quoted in Al-Zuhaylī, *Supra* note 16

⁷⁸ M.H. Kamali, “Islamic Commercial Law: An analysis of futures”, *The American Journal of Islamic Social Sciences*, 13(2) (1996): 197-224.

⁷⁹ M.H. Kamali, “Commodity Futures: An Islamic Legal Analysis”, *Thunderbird International Business Review*, 49(3) (2007): 309-339.

Futures contracts include selling items prior to taking possession.⁸⁰ The lack of real possession (sale prior to taking possession) making these contract not valid.⁸¹

Current futures contracts are prohibited because the contracts include selling item prior to taking possession. At its 7th Session held in 1412 H (9-14 May 1992), No. 63/1/7, the OIC Islamic *Fiqh* Academy opined as follows:

. . . the contract provides for the delivery of described and secured merchandise at some future date, and payment of its price on delivery. Th contract, however, does not stipulate that it shall end with the actual delivery and receipt of the merchandise, and thus it may be terminated by an opposite contract. Ths type of contract is the most prevalent in the commodity markets. It is not at all permissible” [. . . moreover] “it is not permissible to sell a merchandise purchased under ‘salam’ terms with advance payment unless the merchandise has already been received.

All leading Jurists agree that selling items prior to taking possession is prohibited sale (Al-Shafei, 1321H; Al Sarkhasi,1986).⁸² When elaborating this decree, Muslim scholars have relayed to the authority of the following *Hadiths*.

1. Hakim b. Hazzam relates that he asked the Prophet (صلي الله عليه وسلم): “A man comes to me and asks me to sell him something that I do not have. Should I sell it to him and then go and acquire it for him from the marketplace?” The Prophet (صلي الله عليه وسلم) replied: “Do not sell what you do not have.” [Sunan al Tirmidhi (1232), Sunan Abu-Dawud (3503), Sunnn al-Nasa’i (4611), and Sunan Ibn Majah (2187)].⁸³
2. Ibn Abbās narrated that the Messenger of Allah (صلي الله عليه وسلم) said: “He who purchases food should not sell until he takes possession of it.” Ibn Abbas said: “Every sale is subjected to this condition.”⁸⁴
3. Abu Hurairah asked Marwan: “Have you legalised usury?” Marwan said: “No”. Then Abu Hurairah said: “You have legalised selling promissory notes whereas the Messenger of Allāh (صلي الله عليه وسلم) forbade selling foodstuff unless received by the seller.”

⁸⁰ M. F. Khan, “Islamic Futures and Their Markets”, *Islamic Research And Training Institute – IDB*, Research Paper No. 32 (1996).

⁸¹ M. T. Usmani, “Futures, options, swaps and equity investments”, *Institute of Islamic Banking and Insurance, New Horizon*, (1996): 59.

⁸² As quoted in S. Kunhibava & B. Shanmugam, "Shariah and Conventional Law Objections to Derivatives: A Comparison", *Arab Law Quarterly* 24.4 (2010): 319-360.

⁸³ Quoted in S. Al-Suwailem, “Fatwā Archives Commerce and Employment”; http://www.islamtoday.com/show_detail_section.cfm?q_id=737&main_cat_id=5.

⁸⁴ Saḥīḥ Muslim, *supra* note 27

Marwan then addressed the people and forbade selling such notes. Sulaiman said: "I saw the guards taking them away from the hands of people."⁸⁵

In addition, the delivery of the item (underlying assets) in sales contracts is required, and if the seller is unable to deliver it, the transaction would entail *gharar*, gambling and risk.⁸⁶

5.3. Bay al Kali bil Kali

The exchange of a debt for a debt also known as *bai' ud-dayn bi l-dayn* or *bai' ul-kali bi l-kali* has generally been found to be prohibited in Islamic law by Islamic scholars.⁸⁷

The deferment of both final payment and item delivery is another criticism for conventional futures contracts.⁸⁸ This is due to the fact that these contracts include *bay' al-kali bil kali*, (*bay' al-dayn*) (sale of debt) where both parties - seller and buyer - agree to defer both price payment and delivery of item in the future.

The consensus of Muslim scholars prohibited *bay' al-kali bil kali* (Ibn Taymiyah 1385H; Ibn al-Qayyim, 1973; Ibn Qudamah, 1401H; Ibn Rushd, n.d; Al-Dharir, 1967).⁸⁹

This general prohibition has been prescribed to futures, where it is concluded that the sale of futures contracts, where the parties can offset their transactions by selling the 'debts' owed them to other parties before the delivery of the underlying asset, will amount to a sale of a debt and is therefore prohibited. And the prohibition of *bay' al-dayn* is a logical consequence of the prohibition of *riba*⁹⁰. Ibn Taymiyah and Ibn al-Qayyim considered *bay' al-kali bil kali* (*bay' al-dayn bil dayn*) as a means to *riba*, and thus not a valid legal benefit, and leads to conflict between parties, *gharar* and excessive risk.⁹¹

5.4. Not a genuine sale and *gharar* and *maysir*

Futures are generally considered as paper transaction not a genuine sale in order to make speculative profit. According to al-Zarqa, any contract that includes false contract (*suwari*) or fake does not intend to deliver item and price is void contract.⁹² This fully applies to

⁸⁵ Sahih Muslim, *supra* note 27

⁸⁶ Al-Zuhayli, *Supra* note 18

⁸⁷ Al-Zuhayli, *Supra* note 18

⁸⁸ A. Salehabadi & M. Aram. "Islamic Justification of Derivatives Instruments", *International Journal of Financial Services*, 4(3) (2002).

⁸⁹ As quoted in S. Kunhibava & B. Shanmugam, "Shariah and Conventional Law Objections to Derivatives: A Comparison", *Arab Law Quarterly* 24.4 (2010): 319-360.

⁹⁰ *Supra* note 80

⁹¹ Kamali *Supra* note 75

⁹² Al-Zarqa as quoted in Ehab M. M. Injadat, "Futures and forwards contracts from perspective of Islamic Law", *Journal of economics and political economy* 1(2) (2014): 241-252.

conventional futures contracts where many of these contracts are not intended to be settled by delivery or by making real possession or even real ownership and thus, it is not a genuine contract.

Instead, it is considered a type of prohibited speculation activity aimed to exploiting price fluctuations to achieve capital gains.⁹³ The reason can be traced to leverage features in derivatives contract, where the buyer and the seller are required to deposit only a fraction of the contract value which enables them (speculators) to enter into more contracts than spot market. This causes the market to be more liquid, consequently increasing the speculative volume in derivatives market.

As result, International Islamic *Fiqh* Academy (1992) and Islamic *Fiqh* Academy of Muslim World league (1984) indicated that these contracts are forbidden because the ultimate goal from that is just for paying and receiving price differences between sellers and buyers and is considered as gambling and is therefore impermissible.⁹⁴

5.5. Selling of *al-A'ayans*

The consensus of Muslim scholars prohibits selling of *al-A'ayans* (assigned item) on credit sale. It is not permissible to sell *al-a'ayans* on credit, for technical considerations in Islamic *fiqh*.⁹⁵ For example, it is not accepted to sell an assigned car (this car) on credit but it is accepted to sell a car inclusive of characteristics of such and such on credit sale. Additionally, stocks trading on credit sale (futures on stocks) is prohibited because the stocks are *a'ayans*, which is not permitted for selling on deferring base, and the postponement of delivery of stocks has no valid purpose.⁹⁶

5.6. Non-halal underlying assets

Futures contracts conducted on prohibited underlying asset are definitely considered as impermissible such as when underlying asset is interest rate such as futures interest rate contracts. And when underlying asset is hypothetical such as futures and forward index are prohibited and are considered as a form of gambling.⁹⁷ The prohibition occurs on these contracts also when the underlying asset is money (currencies) such as futures and forward currencies

⁹³ S. L. Gupta, *Financial Derivatives: Theory, Concepts and Problems* (New Delhi: Prentice-Hall of India Private Limited, 2006)

⁹⁴ *Supra* note 80

⁹⁵ M. S. M. Al-Sulayman, *Provisions of Dealing in Contemporary Financial Markets* (Riyadh: Dar al-Konoz Ishbiliah, 2005).

⁹⁶ *Ibid.*,

⁹⁷ International Islamic Fiqh Academy. *Qararat al-Majma'*, *Seventh Session, Resolution 1 Financial Markets*. (Jeddah: International Islamic Fiqh Academy, 1992).

contracts since currencies are not considered as a commodity for selling and buying rather, it is a method for trading.⁹⁸ The currencies must be traded on spot rather than on deferment basis so it is not accepted in futures and forward contracts. Currencies should only be traded hand to hand on spot basis, not on deferment basis.⁹⁹

Furthermore, International Islamic *Fiqh* Academy (1992) and Islamic *Fiqh* Academy of Muslim World league (1984) considered deferring currencies are prohibited because it is *riba al-nasiah*. Conventional futures contracts are used for speculation and gambling purposes.¹⁰⁰ Where many of these contracts are not intended to be settled by delivery or by making real possession or even real ownership and thus, they are not genuine contracts.¹⁰¹

Trading volume of futures contracts is often much larger than underlying assets and this is due to speculating activity and gambling in derivatives.¹⁰² Al-Suwailem stated that based on the office of the comptroller of currency (OCC), only 2.7 % of derivatives transactions used by end users for hedging ended by actual delivery while the majority, 97.3 %, is used for speculation by speculators and dealers which ended by cash settlement.¹⁰³ Some researchers asserted that those who participate in future contracts are not for risk protecting rather, for speculating and in fact, hardly 1% or 2% percent of traded derivatives instruments are settled by actual delivery of the underlying assets while the rest were ended through cash settlement, not including real sale.¹⁰⁴

The speculation and gambling pictures in futures contracts also reflected in the huge trading volume of derivatives relative for the GDP of the world, where the trading volume of derivatives all over the world in the parallel market at end of 2012 amounted to more than \$1.270 quadrillion and in the organized market more than \$52 trillion. Meanwhile, the GDP volume of

⁹⁸ N. Danila & A. E. Jeffers, "Derivatives: An Islamic Perspective", *Journal Of International Finance & Economics*, 9 (3) (2009): 83-90.

⁹⁹ A. Jobst & J. Sole, *Operative Principles of Islamic Derivatives – Towards a Coherent Theory*. Paper presented at the meeting of International Monetary Fund (2012).

¹⁰⁰ M. Obaidullah, "Financial Contracting in Financial Market. An Islamic Evaluation", *International Journal of Islamic Financial Services*, 3(3) (2001).

¹⁰¹ M A. El-Gamal, *Islamic finance: Law, economics, and practice* (Cambridge: Cambridge University Press, 2006): 82.

¹⁰² I. B. Obiyathullah, "Derivatives Instruments and Islamic Finance Some Thoughts For A Reconsideration", *International Journal of Islamic Financial Services*, 1(1) (1999): 1-33.

¹⁰³ S. I. Al-Suwailem, *Hedging in Islamic Finance* (Jeddah: Islamic Development Bank- Islamic Institute for Research and Training ,2007).

¹⁰⁴ *Supra* note 87 & 92

the world at end of 2012 was only at \$71.9 trillion, and this amount is equivalent to almost 18 times the value of the gross domestic product of all countries in the world.¹⁰⁵

5.7. Offsetting sales and purchases

Another criticism is the availability of offsetting sales and purchases in the futures markets as whole. Where, the sale of underlying asset in *Salam* contract prior to possessing it is prohibited.¹⁰⁶

Reasoned that the repeated sale of the same underlying asset in the chain while none of the participants took possession will add burden to the customers by adding the extra profit of repeated sale to the commodities' price and the burden of having to pay this extra profit is passed to the customers.¹⁰⁷

International Islamic *Fiqh* Academy in 1992 stated that futures contracts are different from *salam* contracts, where the price in futures contracts is deferred to expiration date, while in *salam* contracts the price paid during the contract session or can be delayed until three days further, El-Gari indicates that commodity futures contracts include selling prior to taking possession which is not the case in *salam* contract.¹⁰⁸

6. Arguments in favor of futures contracts

Futures contracts have important role in risk management and hedging. Where, some Muslim jurists have differing opinions of futures and forwards contracts. Mohammad Hashim Kamali¹⁰⁹ and El-Gari¹¹⁰ concluded that Futures contract is permissible when it does not violate a decisive principle, is clear of *riba* and gambling, and does not include excessive *gharar*. In the following section, major arguments in favor of futures contracts will be discussed.

6.1. Arguments against the criticism of *sale does not own*

The first criticism pertaining to *gharar* results from the sale does not own. The *Hadith* of Prophet Mohammad (صلي الله عليه وسلم) that prohibits sale does not own applies only to the sale of

¹⁰⁵ Ehab M. M. Injadat, "Futures and forwards contracts from perspective of Islamic Law", *Journal of economics and political economy* 1(2) (2014): 241-252.

¹⁰⁶ *Supra* note 96

¹⁰⁷ As Al-Zarqa as quoted in Injadat see *Supra* note 104

¹⁰⁸ M. A. El-Gari, "Towards an Islamic Stock Market", *Islamic Economic Studies*, 1 (1) (1993): 1 -20.

¹⁰⁹ M. H. Kamali, "Commodity Futures: An Islamic Legal Analysis", *Thunderbird International Business Review*, 49(3) (2007): 309-339.

¹¹⁰ *Ibid.*,

underlying assets in rem (*bay' al-a'ayans*), not to fungible goods.¹¹¹ Further, Ibn Al-Qayyim (n.d) concluded the *Hadith* is related to a specific item, not for described goods and also Ibn AlQayyim (n.d) and Ibn Taymiyah (1398H) the *Hadith* is related to sale of what is not present and what the seller cannot deliver.¹¹² The *Hadith* that prohibit "sale does not own" applies only to sales that include specific objects and not to fungible goods, and the futures contracts normally proceed over fungible goods.¹¹³

6.2. Arguments against the criticism of sell prior to take possession

Also, for selling prior to taking possession, some Muslim scholars have differing opinions on the possession of other items where for these scholars they do not require the possession of non-food stuff Ibn Rushd (n.d) stated selling non-food item before taking possession is acceptable.¹¹⁴ The *ilah* (causality) of prohibited sale does not own and sale prior to taking possession, is *gharar* (dispute) due to the seller's inability or failure to deliver underlying assets, where if he ensured the delivery, then the existence or possession of the subject-matter is no longer an issue and the prohibited thing is the inability to deliver.¹¹⁵ Further, selling nonexistent items but whose existence is certain in future is permissible.¹¹⁶

There is clear sanctity of the sale of goods or financial securities before taking possession, for the presence of usury and *gharar* however, if there is no *riba* and *gharar*, it becomes permissible as in *salam* contract, but it is better to take possession on the commodities (financial securities) before the sale. Apart from that, the food is excluded from that, must be possessed before selling, but if the food is a preserved-type food, it can be sold before taking possession.¹¹⁷

6.3. Arguments against the criticism bai al-kali bil kali

For the deferring of delivery of price payment and underlying item, some Muslim experts in Islamic finance accept that deferring. Deferring both price and subject matter is accepted in the forward markets for the underlying commodities only, while for financial securities, it is

¹¹¹ *Supra* note 107

¹¹² *Supra* note 104

¹¹³ M. H. Kamali, "Prospects for an Islamic Derivatives Market in Malaysia", *Thunderbird International Business Review*, 41(4/5) (1999): 523-540.

¹¹⁴ Ibn Rushd as quoted in Kamali see *supra* note 108

¹¹⁵ *Supra* note 64

¹¹⁶ M. T. Mansuri, *Islamic Law of Contract and Business Transactions* (Adam Publishers & Distributors, 2006) 3-16.

¹¹⁷ K. Hattab, *Futures Commodity From the Perspective of Islamic* (Working paper). *International Conference of the Financial Markets and Stock Exchanges*, (Makkah, Umm Al-Qura University, 2007).

impermissible.¹¹⁸ Meanwhile, Hamoud stated deferring both in exchange is accepted based on *muawadhah*.¹¹⁹ This type of contracts which include selling debt for debt is in the needs of traders and industrialists, so based on *hajah* (needing) and *dharurah* (necessity), it can be used as soon as it retains the legal standard. Deferring is accepted as long as it does not include foodstuff asset or any form of *gharar*.¹²⁰

There are some contemporary specialists in Islamic finance who accepted deferring (postponement) in both price and item, under certain conditions.¹²¹ In fact, the reason for this flexibility is that there will be no available room for speculation in price differences, unlike the futures and forwards contracts, since the products cannot be easily found in the market place.¹²² A part from that, there is no conclusive proof in the *Sunnah* on prohibition sale of debts Al-Albani (n.d) stated the *Hadith* of *bay' al-kali bil kali* is weak.¹²³ The *Hadith* that talks about the prohibition of selling debt by debt is weak and thus cannot be used as inference for prohibition, and for the contract and its effects, it is right but the obligation to be contacted urgently, there is no evidence for that.

Some contracts that involve deferring for both price and item were accepted such as supply and *istisna* contracts, where supply contract is permitted.¹²⁴ International Islamic *Fiqh* Academy concluded that *istisna* contract is permissible contract and can be used to defer price payment.¹²⁵

6.4. Arguments against the criticism bai al-a'ayan

For futures and forwards as a form of *al-a'ayan* sales, Fdad (2000) declare the consensus of Muslim scholars accepted the sale of *al-ayan al-gha'ibah* (absent sale) as soon as underlying item is fully described, not of *al-ma'adum* sale, as well as owned by seller at contracting period. In fact, there are many scholars who accept *al-a'ayan* sales, however, many of them stipulated granting the buyer right to perform the contract after seeing the underlying item.¹²⁶

¹¹⁸ A. M Ahmad, *Securities markets and its development effects in Islamic economic*. Saleh Kamel Series for University Theses. (1995).

¹¹⁹ S. Hamoud, *The Development of Banking Business Consistent with Islamic Shari'ah*, (Amman: Maktabat al-Aqsa, 1976).

¹²⁰ *Supra* note 18

¹²¹ *Supra* note 78

¹²² *Supra* note 64

¹²³ As Al-Albani quoted in Kamali see *Supra* note 78

¹²⁴ Al-Masri, R. Y. (2007). *Jurisprudence of Financial Transactions*, (2th ed.). (Damascus: Dar al-Qalam, 2007).

¹²⁵ *Ibid.*,

¹²⁶ As Fdad is quoted in Injadat see *Supra* note 104

There is some level of needs for speculation activities for the purpose of market enhancing even though many Muslim jurists prohibit speculation. Al-Amine stated that some financial and economic experts believe that speculation has good reflection with regard to allocation of resources, decreasing price fluctuations in markets, restoring equilibrium between demand and supply and minimizing periodic gluts and shortages, it creates efficiency in the market.¹²⁷

6.5. Arguments against the criticism of offsetting transaction

In the matter of offsetting transaction, the opinion that speculation causes the offsetting of transaction which adds burden to the customers is not true. Instead, it is improper to assume that everyone in the chain of sale makes profit when in fact people can make profit and also can make losses, and also some people may need to resort to a reverse transaction before taking delivery on the same point.¹²⁸ Apart from that, the validity of offsetting must be based on (*ibahah*) which means that the reverse trade must not include any contravention of Islamic law to be considered lawful.¹²⁹

6.6. Futures contract like bay al-sifah

Forward contracts are in line with *bay' al-sifah* (sale of description) where the sale of item that is not present at the time of contracting is very well described and is to be delivered at later date and thus, the sale is accepted by Hanafi, Maliki and Hanbali scholars.¹³⁰ On the other hand, other Muslim scholars see forwards and futures contracts as being similar to *bay' salam* and *bay' istisna*, which are Islamic contracts accepted by Islamic law.

6.7. Futures contract in the form of sulh

Khomeini stated that, because we define the futures contracts as those that two parties settle on a future transaction, seller agrees to deliver the commodity in a future date to the buyer and buyer agrees to pay the price to the seller at that future time and as such, those futures contracts are in the form of *sulh* and are permissible.¹³¹ Apart from that futures contracts are permitted if they are adjusted according to the Islamic rules, especially since these contracts

¹²⁷ M. A. M. Al-Amine, "Risk and Derivatives in Islamic Finance" in *Contemporary Islamic Finance: Innovations, Applications and Best Practices*. Hunt-Ahmed, Karen, ed. (John Wiley & Sons, 2013), 331-352..

¹²⁸ As Azzam quoted in Injadat see *Supra* note 104

¹²⁹ M. H. Kamali, "Fiqhi Issues in Commodity Futures", In *Financial Engineering and Islamic Contracts*, M. Iqbal, & T. Khan, ed. (New York: Palgrave Macmillan, 2005): 20-57.

¹³⁰ *Supra* note 104

¹³¹ *Supra* note 87

reallocate risks, and collect and distribute information about the future course of prices in the spot market in order to achieve price stability in future.¹³²

6.8. Futures contract is accepted under dharurah

Apart from that, Bacha considers futures trading is accepted in Islam based on *dharurah* (necessity) and need, where some futures contracts should be applied in Malaysia's derivatives market. Further, based on *Syariah (law)* Advisory Council of Securities Commission, Malaysia's opinion about futures trading of commodities is that it is acceptable as long as the underlying asset is not prohibited.¹³³

The Securities Commission (SC) *Shari'ah* Advisory Council (SAC) has approved single stock futures (SSF) as a *Shari'ah*-compliant instrument, provided that the underlying stocks of the SSF are *Shari'ah*-compliant. SSFs were approved by the SAC on the basis that the instruments are free of elements pertaining to *muqamarah* (gambling), *bai' ma'dum* (buying and selling something which does not exist), *jahalah* (ignorance) and *gharar* (uncertainty). The instrument is traded in clear quantities and pricing is based on market demand and supply.¹³⁴

¹³² *Supra* note 78

¹³³ *Supra* note 5

¹³⁴ Securities Commission, *Resolutions of the Securities Commission Syariah Advisory Council* (Kuala Lumpur: Securities Commission, 2007): 71-79.

7. Conclusion

Conventional futures contracts are widely used financial derivatives around the world for hedging purposes. Researchers argue that only 1 or 2 percent of traded derivatives instruments are settled by actual delivery of the underlying assets while the rest were ended through cash settlement, not including real sale. The speculation and gambling pictures in futures contracts also reflected in the huge trading volume of derivatives relative to the real GDP. It is evident that certain features of futures contract rise questions whether it is permissible under Islamic Law of Contract. Islam is a complete code of life and every sphere of our life is dominated by rules and principles of the *Quran* and *Sunnah* of our Prophet (صلي الله عليه وسلم) and financial transactions are not exception. One of the fundamental concepts in financial transactions from Islamic Law perspective is contract. Contracting is the connection of an offer with an acceptance in a lawful manner which marks its effect on the subject of that connection. It is further explained that as a result of this connection, both parties are under an obligation to one another. There are generally accepted principles in *Shari'ah* regarding contract to be valid, such as contract must be devoid of *riba*, *gharar*, *qimar*, *maysir*, *jahala*, fraud and cheating, most importantly, contract must not contradict with *maqasid al-Shari'ah*. In addition to the above given general principles all contract must have three fundamental pillars namely: two contracting parties, subject matter and offer and acceptance.

Contemporary scholars have differing opinion regarding permissibility of conventional futures. Majority of the scholars argue that conventional futures are not permissible under Islamic Law because of its some features, such as, sale that does not own, delay in both counter values, sale of one debt for other, excessive uncertainty, speculation and gambling. Many contemporary Jurists give evidence from *Quran* and *Sunnah* and also arguments from classical Jurists in order to support their views. On the other hand, many scholars try to justify the permissibility of futures contract based on *istihsan*, *maslaha* and *dharurah* principles, as they argue current financial world is too complicated and *Hadiths* which opponents of futures contract provide were meant to be for different purposes and circumstances. Moreover, many leading institutions in *Shari'ah* research issued resolutions giving their opinion. It is found that futures contracts are considered *Shari'ah* compliant only in Malaysia and approved by *Shari'ah* Advisory Council of Securities Commission. On other hand, OIC *Fiqh* Academy and Islamic *Fiqh* Academy resolved that futures contract not to be permissible under Islamic Law. Even

though arguments in favour of futures provided by Mohammad Hashim Kamali and others are quite persuasive but counter arguments provided by scholars like Taqi Usmani, Mohammad Akram Khan and others seem to outweigh the previous.

Therefore, it is safe to assume that conventional futures contracts in its current form do not comply with the Islamic Law. Consequently, followings are the necessary recommendations in order to be compliant with Islamic Law of Contract. Firstly, Futures contract must not include any prohibited element such as *riba*, *gharar*, and gambling (*maysir*). Secondly, the intention of such contract must be for genuine buy and sale (economic activity) and all transactions must be on delivery basis and not on cash basis, intended for hedging purpose. Thirdly, ownership and possession of underlying assets before entering into futures contracts that include something default or unreal is not acceptable. Fourthly, Futures contract do not include currencies assets to avoid *riba* and they are only traded on spot market hand to hand. Fifthly, futures contract must be conducted on *halal* products or on assets that are accepted in Islamic law (*halal* commodities). Sixthly, the contracts do not include deferring both items (price and subject matter) and offsetting contract before expiration date is not allowed. Finally, the clearinghouse must be included in all transactions as guarantee to all parties in an attempt to eliminate *gharar* resulting from counterparties' risk and ensure underlying asset delivery.

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