Islamic Commercial Law: An Analysis of Futures

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Introductory Remarks

The Islamic law of transactions (*mu'āmalāt*) has often been singled out as the most important area of contemporary research in Islamic theses, so much so that, according to some observers, its priority is even higher than that of research in applied sciences and medicine. This status is due to the critical importance of commercial transactions in the wealth generation and productivity prospects of contemporary Muslim countries. New research on issues of conventional *fiqh al mu'āmalāt* is essential for the viability and success of economic development programs in Muslim countries. In recent decades, research interest in *fiqh al mu'āmalāt* has been shifting increasingly to specific themes and development of new operative formulas to stimulate profitable business in the marketplace. Evidently, futures trading is one such theme where original ijtihad is required to enhance the prospects of economic success, especially in farming and agro-based industries in developing Muslim countries.

The futures market is where contracts for future sale and purchase can be concluded for standardized quantities and qualities of commodities, currencies, bonds, and stocks. Ever since the large-scale inception of futures markets in the early 1970s, new products and trading formulas in various trade sectors involving commodities, options, financial futures, and stock index futures, among others, have increased so much that futures contracts currently are available in over eighty commodities, ranging from food grains, oil and oil seeds, sugar, coffee, livestock, eggs, orange juice, cotton, rubber, precious metals, and currencies. In terms of volume, futures trading has far exceeded trading levels in conventional stocks and, currently, is the single most voluminous mode of commerce on the global scale.

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Futures markets allow producers and commercial operators to fix the price of assets in which they trade well in advance of taking or making physical delivery. This facilitates better planning in agriculture and agro-based industries and allows companies to protect themselves against disruptive swings in the key cost and revenue components of their business. Thus, futures trading is a hedging device against volatile price movements in commodities over a period of time, as in the case of agriculture's seasonal pattern from sowing to harvesting time. It is also used by food processors, merchants, and manufacturers to ensure sales and purchase in advance without having to face market uncertainties later on, such as after harvesting or production.

Futures trading can also respond to the growing need for trading and investment vehicles in Muslim countries that can absorb and use surplus funds in local/regional markets. Absence of such adequate investment facilities is a major reason for the continued flight of funds from the oil-rich countries of the Middle East to the West, which has become a worrying phenomenon in recent decades and continues to threaten the vitality and survival of Muslim economies. In a recent article in *The Financial Times* of London, Roula Khalaf wrote that "acceptance of Islamic banking is growing," but that the Qur'anic prohibition of receiving or paying interest has meant that "about 75 percent of Islamic banking funds are invested in short-term commodity (futures) trades." The same report estimated that "funds invested in an Islamic way in the Arab world may amount to $50 bn—much of it is used for commodity trades." To give an indication as to the place of investment and where the money goes, we read further that commodity trading is conducted "in return for a fee by a middleman—often a Western bank, like Citibank—that arranges for a trader to buy goods on the Islamic bank's behalf . . . and the Western banks have always been happy to oblige."[1]

Contrary to all expectation, and in view of the Shari'ah principle of permissibility (*ibāḥah*) that renders all commercial transactions permissible in the absence of a clear prohibition, we are confronted with a rather discouraging form of *taqlīd* (imitation) in the verdict of the Makkah-based Fiqh Academy and also of many Muslim scholars who have proscribed futures trading and declared it totally forbidden. This body of opinion is founded mainly on their determination that futures trading does not fulfill the requirements of the conventional law of sale—turning a blind eye to the fact that futures trading is a new phenomena without parallel in conventional *fiqh al mu'āmalāt*, and therefore should be governed by a different set of rules. This imitative approach also falls short of relating the issues at hand to the normative guidance of the Qur'an and Sunnah, which can support a different caliber of research and an affirmative ruling on the subject.

The title of Khalaf's article, "An Inherent Contradiction," portrays the concern of Islamic banks and investments to observe the letter of the Qur'an on usury but also underscores their failure to act for the benefit and prosperity of the Muslim masses. Part of our problem is that the Shari'ah advisors to these institutions have limited their understanding of the Qur'an only to the clear text and have not applied juristic caliber and imagination to the dismaying economic predicament of the Muslims. In answer to the question of whether Islamic banks may invest in futures, Khalaf tells us that "it depends on the bank's Sharia board, whose members are experts in the Koran but less so in the field of bank options . . . . It is up to each institution to say what is Islamic."[2] This is, of course, an expected result of what Khalaf noted of "the absence of a standard interpretation of the Shari'ah" and, if allowed to continue, "will dampen further development of the industry"[3] as a whole and slow down efforts to enable financial institutions in the Muslim world to enhance and diversify their own resources.

Following a brief review of the existing literature, I will advance a different interpretation of the source materials of the Shari'ah as to how an issue of vital importance to the economic viability of the Muslim world should be tackled, not through facile reliance on the negative positions of taqlid, but through bold and yet upright approaches to research on issues of Islamic commercial law.

What Are the Issues?

I will summarize the juristic debate over futures trading in five points. The first is that both countervalues in such sales are nonexistent at the time of contract, for no goods are delivered at that time and no price is paid. The concluded contract, therefore, is only a paper transaction and not a genuine sale. It is also said that futures sales consist merely of an exchange of promises made for the sole purpose of speculative profit making. The Shari'ah considers a sale valid only if one of the countervalues is present at the time of contract. Either the price or delivery of the item may be postponed to a future date—but not both. Second, futures trading is said to be invalid because it consists of short-selling, in which the seller does not own or possess the item being sold. The reason given is that the essence and purpose of sale is to transfer ownership of the item to the buyer. However, if the seller does not own the item, its ownership cannot be transferred. Third, it is said that futures sales fall short of meeting the requirements of *qabḍ*, or taking possession of the item prior to resale. Fourth, an issue has also been made out of the deferment of both countervalues to a future date, which effectively turns futures sale into the sale of one debt for another (*bay' al kāli' bi al kāli'*), which is said to be forbidden. And, fifth, it is said that futures trading involves speculation and verges on gambling and *gharar* (uncertainty and risk taking). The gambling element is also said to cause volatility in the price of commodities in the cash market.

Most of these issues proceed entirely from a *fiqhī* perspective concerning the validity of a conventional sale and tend to ignore the operational procedures and rules observed in futures trading. As for the element of gambling, the view recorded in some earlier studies that futures encourage price volatility and tend to destabilize the market has not been confirmed by subsequent studies. More recent research, in fact, has supported the opposite view: Futures trading tends to reduce price volatility and thus has a stabilizing influence on the market.

A trader who enters a futures contract, whether as a buyer or a seller, is required to pay a margin deposit of about 10 percent of the contract value. The actual price is paid when the buyer wishes to take delivery and the countervalues change hands. But actual delivery takes place in only about 2 percent of all contracts, for the rest of the traders usually enter a reverse transaction prior to maturity and settle their accounts with the clearinghouse. In this way, the trader terminates the contract. A profit or loss might be made, but offsetting transactions prior to maturity is a unique feature of futures trading that enables traders to move in and out of contracts and seize the opportunity to make a profit.

For example, suppose that a bakery owner feels wheat prices will rise during the coming months and so decides to lock-in the current market price of wheat at $2.50 per bushel by purchasing four June contracts of five thousand bushels each for December delivery. The baker instructs the broker, who concludes the transaction on the former's behalf and pays a margin deposit of $5,000 in a segregated account in his/her own name. The trader is now long four wheat contracts that are to mature in December. Such a deal has two possible outcomes: either the buyer remains in the open position until maturity and takes delivery in December, or he/she eventually decides to offset his/her position by selling four wheat contracts of the same quantity and delivery month for $2.55 a bushel and makes a profit of $1,000. In fact, this is what usually happens: The parties to a futures contract generally prefer to offset their positions, as this saves on transaction costs, storage fees, and administrative difficulties. They also prefer to enter a reverse transaction if they can realize a profit. After the reversing trade, the buyer's net position is zero. The clearinghouse recognizes this, and the party concerned is absolved from any further obligation.

A trader who enters a futures contract may be either a genuine hedger, as in the earlier example, who buys or sells a futures contract to protect himself/herself from drastic price fluctuations, or (and more likely) a speculator hoping to profit from those price movements. Upon closer examination, however, we find that such a distinction is rather more conceptual than real, for it is difficult to distinguish between the two in categorical terms—hedgers are also speculators who take a certain risk and speculate over likely price movements. Even if traders enter the market in order to hedge a position, later, when the price moves in their favor, they may well decide to sell and then buy again when the prices go down, in which case the traders, for all intents and purposes, have become speculators. Since futures sales do not involve the physical movement of commodities and trading takes place on the basis of a low margin deposit of only about 10 percent of the actual price, they remain wide open to financial speculation and excessive risk taking. This is often said to resemble gambling.

The Futures Contract

In SFC Finance Company vs. Marsi, J. Legget defined the futures contract as "a legally binding commitment to deliver at a future date, or take delivery of, a given quantity of a commodity, or a financial instrument at an agreed price."[4] Teweles described it as a firm legal agreement between a buyer/seller and an established commodity exchange/clearinghouse in which the trader agrees to deliver or accept delivery, during a designated period, of a specified amount of a certain commodity. The commodity so traded must adhere to the quality and delivery conditions prescribed by the commodity exchange on which that commodity is traded.[5]

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. The parties do not negotiate the terms of their agreement, as these are all standardized and advertised in advance, except for the actual price, known as the "exercise price," that is settled on the floor of the exchange. Such standardization enables trading on the market floor to be conducted through open outcry and a series of shouts and hand signals. Upon conclusion of contract, a record of the transaction is made and, following various checks, the contract is registered with the clearinghouse.

The clearinghouse now interposes itself between buyer and seller and effectively becomes the other party to all contracts—buyer to all contracts sold and seller to all contracts bought. The seller has a contract with the clearinghouse to sell his/her commodity and to be paid, just as the buyer has a contract with it to receive delivery of the specified commodity at maturity. This arrangement enables participants to trade freely in the market without having to worry about their counterparts' creditworthiness. The success and efficiency of futures is due largely to the clearinghouse's clearance and guarantee functions. All transactions of one day's trading are thus "cleared" before the start of the next, and timely delivery (if desired) to every buyer and payment upon delivery (if desired) to every seller are guaranteed. The clearinghouse guarantees payment, whenever a net position so warrants, on contracts that are to be closed out by offsetting transactions.[6]

The clearinghouse has always performed as promised, partly because it maintains no futures market position of its own, as its prime concern is to balance out transactions and guarantee performance. It eliminates risk over contract performance partly through its daily settlement procedure and also by ensuring that members provide sufficient collateral to cover potential liabilities. The clearinghouse monitors the size of each trading position daily to ensure that traders do not overextend themselves by building up large positions that they will have difficulty serving.[7]

Literature Review

Among commentators who have discussed futures, I refer first to 'Abd al Raḥmān al Jāzirī's description of a voidable sale (*bay' al fāsid*) as one in which a movable object is resold prior to taking position. Thus, when a person buys a quantity of cotton or cloth and then resells it to the original owner or a third party before taking delivery, the sale is voidable. "This also applies," al Jāzirī added, "to the well-known sale of (futures) contracts in our time . . . . When someone buys cotton, for example, and then sells it prior to taking delivery from the seller—whether the second sale is at the same price or lower—the sale is voidable."[8] The sale of such immovable objects as houses and gardens, prior to taking possession of them, however, is valid, as there is no fear of their destruction or loss. (There are exceptions, of course, such as their being exposed to danger—the house is located on the sea shore—in which case the sale would be subject to the same rules that apply to movable objects.)

Clearly, the basic rationale behind taking possession prior to selling is to prevent *gharar* (uncertainly over the seller's ability to deliver in the event of destruction and loss). If *gharar* can be effectively removed, then it follows that the requirement of taking the item into possession may be relaxed or totally omitted.

Umar Chapra is critical of short-selling stocks and securities primarily because "it is a kind of speculation which has no beneficial economic purpose." He adds that this contrasts with short selling in forward and future sales, which involve "sales of certain agricultural commodities or manufactured goods that perform an economic function . . . providing producers as well as users with the assurance that they can sell or receive the goods when ready or needed."[9] Notwithstanding the "beneficial economic purpose" that Chapra has identified in futures, he does not pursue the theme and reverts, somewhat unexpectedly, to the stereotypical and prohibitive opinion of others that "it is generally felt that trading in futures contracts is for purposes other than the exchange of titles."[10] It seems as if he is not convinced of the soundness of what is "generally felt." However, he does not explore the issue but raises matters relating to stock market transactions.

This imitative (*taqlīdī*) tendency is seen in Muhammad Akram Khan's statement that "futures trading is alien to Islamic law as it involves trading without actual transfer of the commodity or stock to the buyer, which is explicitly prohibited by the Prophet."[11] The prophetic hadith cited in support of his view addressed a Companion, Ḥakīm ibn Ḥizām, says "do not sell what is not with you." Khan has not taken this hadith to its logical conclusion and has not explored the juridical meanings of "transfer" and *qabḍ* (taking possession) that have a bearing on the substance of his statement. For example, he has not touched on the Mālikī opinion of *qabḍ* (confined to foodstuffs) or Ibn Qayyim al Jawzīyah's critique of the majority position on the issues of delivery and transfer. Khan shows no awareness of the juristic discourse of the *fuqahā'* and commentators on the issues he has raised, and yet he states categorically that "all the transactions in these chain are unlawful" and "the Islamic position on futures market is quite clear."[12]

In his 1983 publication on the Islamic law of obligations, Ṣubḥī Mahmaṣṣānī stated in passing that "contracts concerning future things (*al ashyā'* *al mustaqbalah*) are basically invalid, for such things are non-existent at the time of contract—except for the fact that the majority of jurists have exceptionally permitted certain contracts such as *salam* (forward sale) and *istiṣnā'* (contract of manufacture)."[13] It is stated further that proprietary contracts (*'uqūd al tamlīk*), which seek to postpone the transfer of ownership of the object specified in the contract, is a form of gambling, which is why they are prohibited.[14]

In his 1982 article entitled "Ra'y al Tashrī' al Islāmī fī Masā'il al Burṣah" (The Shari'ah Perspective on Bourse-Related Issues), Aḥmad Yūsuf Sulaymān reviewed the *fiqhī* rules on such issues as the sale of objects that the seller does not own, sale prior to taking possession, deferred sales, and sale of the nonexistent. He applied the rules for conventional sale on these issues directly to futures and passed prohibitive judgments on almost every issue raised. In support of his views, he relied mainly, like Khan and others, on the earlier quoted hadith. Sulaymān also has not looked into this hadith's meaning and rationale, but instead states that the Shari'ah has validated *salam* (forward sale in which only the price is paid at the time of contract, but delivery is postponed to a future date), and that this is the only framework within which a deferred sale involving a future delivery can be concluded validly.[15]

This is also the position taken by Badr al Mutawallī 'Abd al Bāsiṭ, Shari'ah advisor to the Finance House of Kuwait, whose prohibitive views on futures are based entirely on *salam*. Since futures do not fulfill all requirements of a *salam* sale, they are prohibited. Of course, the point is that in a *salam* sale, one countervalue (the price) is paid on a prompt basis while delivery of the item is postponed to the future. This is the extent, according to Sulaymān and 'Abd al Bāsiṭ, of the Shari'ah's flexibility concerning deferment in a sale. In other words, a sale in which both countervalues are deferred to a future date is *ultra vires* and, in their view, the Shari'ah is closed totally to the prospect of validating futures.

To discuss these arguments in detail is beyond the scope of this essay. But, I note here that the views of Sulaymān and 'Abd al Bāsiṭ have been challenged and refuted, respectively, by two prominent commentators: 'Alī 'Abd al Qādir and Majd al Dīn 'Azzām. 'Abd al Qādir's commentary, which refutes Sulaymān's contentions, was published in the same volume of the *Encyclopedia of Islamic Banks* (in Arabic) that carried Sulaymān's article. 'Azzām's response to 'Abd al Bāsiṭ appeared in the same collection of legal verdicts (*fatāwā*) published by the Finance House of Kuwait. Both commentators criticized the basic approach used by Sulaymān and 'Abd al Bāsiṭ and emphasized, in turn, that futures trading was a new mode of trading that called for a fresh response formulated in light of the operative procedures of futures markets.[16]

A similar analysis of futures has been advanced by yet another author, 'Abd al Karīm al Khaṭīb, who admitted that futures contracts did not fulfill all the requirements of a conventional contract, even though they were regulated carefully and satisfied the basic purpose and rationale of those rulers.[17] 'Azzām, al Khaṭib, and 'Abd al Qādir share the view that the registration and clearance procedures, as well as the guarantee functions of the clearinghouse, are precise and that trading futures are conducted by trained professionals in a highly centralized and controlled market. The contract specifications and its related procedures are such that the prospects of uncertainty and *gharar* were virtually eliminated. Thus, the conclusion is drawn that futures contracts are valid from the Shari'ah perspective.

In its 1985 resolution on stocks and commodities markets, the Makkah-based Fiqh Academy has taken a somewhat ambivalent view of futures. While it acknowledges the benefits of futures to farmers and commodity traders, it fails to reflect that evaluation in its final verdict on the subject. The Fiqh Academy also acknowledged that futures trading has developed into a variety of different transactions, and therefore one ought to look at each individually and evaluate it on that basis, but did not reflect this view in its final resolution, which is prohibitive on futures as a whole and does not attempt to address individual issues. Futures trading in stock indices and currencies, for example, are governed by a different set of rules than trading in commodities. In addition, options and futures options traded on commodity exchanges are altogether different modes of trading that must be addressed separately The Fiqh Academy has not done this, notwithstanding its clear acknowledgment of the availability of a variety of different trading formulas in the futures markets. In sum, its approach to futures is similar to that taken by Sulaymān and 'Abd al Bāsiṭ and has drawn, not surprisingly, the same conclusion: Futures transactions are forbidden, as they involve the sale of things that the seller does not own or possess and are concluded over things that do not exist at the time of contract. The Academy's resolution stated that most futures sales were not genuine sales, in that the parties were not interested in making or taking delivery but were seeking to make a profit from commodity price movements. The conclusion was drawn that buying and selling futures contracts was closer to gambling rather than trading.[18]

A typical example of the approach taken by western scholars is, perhaps, Rayner's 1991 publication *The Theory of Contract in Islamic Law* (originally a Ph.D. dissertation), where she writes in a broad sweep that "the institution of mortgages and insurance, and the combined concepts of share trading, financial futures and spot commodity purchases would clearly be *Bāṭil* on several grounds according to the tenets of the Shari'ah."[19] She continued to specify these "strict tenets" as far as they relate to futures to include "leaving open the payment terms . . . not taking possession of object before resale," and stated that the speculative nature of futures trading brought this line of commerce close to gambling.[20] This is about all one can find in this work (over 440 pages) on the futures contract. Apart from the absence of any specific investigation to support these conclusions, Rayner's comment that futures contracts leave payment terms open is factually incorrect. The fact is that the previous day's closing prices of all futures contracts are quoted regularly in the process and the exact "exercise price" is determined when the deal is struck on the trading floor. The delivery month is specified by the maturity date (usually the third week of that month). There is a certain mechanism involved in the daily adjustment of the price, which is due to a clearance procedure, known as mark-to-the-market or daily settlement, but this is simply a clearance procedure that does not change the substance of our statement that the payment terms, on the whole, are adequately specified and guaranteed by the clearinghouse procedures.

Rodney Wilson exhibited a similar attitude when he wrote that "forward, futures and options dealings are viewed as potentially corrupting by modern specialists in Islamic finance."[21] Apart from any attempt to inquire into the details of his statement, Wilson's observation is also inaccurate insofar as it treats the forward sale (*salam*) on the same footing as futures and options and because *salam* is clearly valid in Islamic law. Therefore, it does not qualify for the description "potentially corrupting." I now turn to a discussion of the hadith that is commonly quoted by those who invalidate futures.

Do Not Sell What Is Not With You

The above heading is a direct translation of the well-known hadith *lā tabi‘ mā laysa indika*, which the ulama and commentators have quoted as the standard authority for many of their rulings on the item of sale: The item must exist and be owned by the seller at the time of contract. Futures trading, which consists of short selling, is therefore contrary to the requirements of this hadith. However, the juristic conclusions drawn, as I shall elaborate presently, consist mainly of their different interpretations, all of which fall short of unanimity and consensus. Their rulings, therefore, may be seen as manifestations of juristic ijtihad that command no finality, and the matter may be said to remain open to further interpretation.

Several issues have been raised concerning this hadith, one of which is a certain weakness in its authenticity and transmission. Neither al Bukhārī nor Muslim recorded it in their collections, although others, among them Abū Dāwūd and al Tirmidhī, did. This discrepancy is as follows: Abū Dāwūd, Aḥmad ibn Ḥanbal, and Ibn Ḥabbān state that it was narrated by Ja‘far ibn Abī Wahshīyah, from Yūsuf ibn Māhak, from Ḥakīm ibn Ḥizām, whereas a fourth name, that of ‘Abd Allāh ibn ‘Iṣmah, occurs in other hadith collections between Yūsuf and Ḥakīm. In *al Mizān*, al Dhahabī states that this intermediate name is totally unknown (*lā yu‘raf*). Even the principle narrator of this hadith, Ḥakīm ibn Ḥizām, is said to be "obscure" (*majhūl al ḥāl*). Only Ibn Ḥabbān includes him among reliable narrators (*al thiqqāt*). While al Nasā'ī has recorded one hadith narrated by him, others have said that he is "obscure."[22]

The hadith's precise legal value is open to interpretation. Does it convey a total ban (*taḥrīm*), abomination (*karāhīyah*), or mere guidance and advice of no legal import? The phrase *lā tabi'* (do not sell) could sustain any of these interpretations. Specialists in *uṣūl al fiqh* admit all of these meanings within the purview of a prohibition (*nahy*). Only when a prohibition is espoused with a warning (*wa'īd*) is its meaning reinforced so as to convey a total ban (*taḥrīm*).[23] As there is a weakness in its transmission, as it is not accompanied by a warning or words implying emphasis, and as it is open to interpretation (as discussed below), it seems reasonable to say that it conveys abomination and moral opprobrium (*karāhīyah*) rather than total prohibition. In fact, al Khaṭīb records the view that this hadith conveys moral guidance (*irshād*) rather than a prohibition *per se*.[24]

The full version of the hadith is as follows:

> Ja'far ibn Abī Wahshīyah reported from Yūsuf ibn Māhak, from Ḥakīm ibn Ḥizām (who said): "I asked the Prophet: 'O Messenger of God. A man comes to me and asks me to well him what is not with me. I sell him (what he wants) and then buy the goods for him in the market (and deliver them).' The Prophet replied: 'Do not sell what is not with you.'"[25]

In an attempt to ascertain the precise meaning of this hadith, jurists have advanced three different interpretations.

1. "Do not sell what is not with you" means not to sell what you do not own (*ya'nī mā laysa fi milkik*) at the time of sale. One of the basic requirements of sale, as al Kasānī has stated, is that the seller own the object of sale when selling it, failing which the sale is not concluded, even if the seller acquires ownership later. The only exception is a *salam* sale, where ownership is not a prerequisite.[26] In accord with this interpretation, al Ṣan'ānī has stated that this phrase implies that it is not permissible to sell something before owning it. Ibn al Humām and Ibn Qudāmah have concluded similarly that a sale involving something that the seller does not own is not permissible, even if he/she buys and delivers it later.[27]

The Ḥanafis have ruled, however, that the seller's ownership of the item in question is not a condition of validity (*sharṭ al ṣiḥḥah*) but of effectiveness (*nifādh*) of the sale. Hence, they validate a *bona fide* sale by an unauthorized person (*fuḍūlī*) who does not own the object but sells it nevertheless. In this case, the sale is valid but not effective. It becomes effective only upon obtaining the owner's consent.[28]

2. In general, jurists and hadith scholars hold that this hadith applies only to the sale of specified objects (*a'yān*) and not to fungible goods, as these can be substituted and replaced with ease. Al Baghawī and his commentator, Mullā 'Alī Qārī, al Khaṭṭābī, and many others stated that this prohibition is confined to the sale of objects in rem (*buyū' al a'yān*) and does not apply to the sale of goods by description (*buyū' al ṣifāt*). Hence, when *salam* is concluded over fungible goods that are readily available in the

locality, it is valid even if the seller does not own the object at the time of contract.[29] Imām al Shāfi'ī has ruled that one many sell what one does not own provided that it is not a specific object, for delivery of a specific item cannot be guaranteed if the seller does not own it.[30] Al Khaṭṭābī stated that this hadith refers to the sale of specific objects, for the Prophet permitted deferred sales of various kinds in which the seller did not have the object of sale at the time of contracting. In essence, this prohibition seeks to prevent *gharar* in sales (e.g., a runaway camel, uncertainty over delivery, and sale of someone's property without his/her permission).[31]

Ibn Qayyim al Jawzīyah, commentator of *Sunan Abū Dāwūd*, and al Mubārakfūrī, commentator of *Jāmi' al Tirmidhī*, agreed that this hadith contemplated the sale of specified objects and not the sale by description of goods that are readily available in the market.[32] This would effectively take futures out of the purview of this hadith, for futures trading only takes place in fungible commodities and cannot be expected to apply to specific objects having unique qualities.

3. A third position is that sale of "what is not with you" means the sale of what is not present and what the seller cannot deliver. This is Ibn Taymīyah's view, who stated that the emphasis is on the seller's inability to deliver, which entails risk taking and uncertainty (*mukhāṭarah wa gharar*). If the hadith were taken at face value, it would proscribe *salam* and a variety of other sales. But this is obviously not intended. The Prophet forbade Ḥakīm ibn Ḥizām to sell the particular objects either because he did not own them or because of uncertainty over his ability to deliver. The latter reason is the more likely one for the prohibition.[33] The Mālikī jurist al Bājī has recorded a similar view and stated that "what is not with you" means "a specific object that is not in one's ownership and one's power to deliver."[34] It is quite possible that the seller owns the object but is unable to deliver it, or that the seller possesses the object but does not own it. In either case, the seller would fall within the purview of this hadith. Therefore, its emphasis is not on ownership or possession, but rather on the seller's effective control and ability to deliver. And so the prohibition's effective cause (*'illah*) is *gharar* on account of one's inability to deliver.

Such contemporary writers as Yūsuf Mūsā, 'Alī 'Abd al Qādir, and Yūsuf al Qaraḍāwī have drawn attention to the fact that the marketplace of Madīnah during the Prophet's time was so small that it could not guarantee regular supplies at any given time. Therefore, the hadith only prohibited the sale of items that were not available at the time of sale. This is indicated, perhaps, as Mūsā added, by Ḥakīm ibn Ḥizām's statement that people would ask him to sell to them items that he did not have. In other words, they wanted to secure goods that they could not find in the market due to uncertainty over supplies. In contrast, modern markets are regular and extensive, which means that the seller can find the goods at almost any time and make delivery whenever required. With reference to futures trading, Mūsā observes that futures contracts normally operate on a deferred basis, which gives the seller a fair amount of time to buy what is required in order to make delivery, if necessary, within the contract period.[35] When we compare the Madinan market to its modern counterparts, we are faced with a different reality. Given currently available means and facilities, the fear of not being able to find the goods and make delivery (the basic rationale of the original prohibition), is now irrelevant.[36]

Short selling of items that are not owned by the seller takes place in the futures market with the assurance that identical contracts over the item can be bought and sold on an almost instantaneous basis. Normally, there is no fear that the seller will be unable to find an equivalent contract with which to offset his/her position or to find and deliver the item in the event he/she wishes to make delivery. The seller, in other words, is not faced with the prospect of searching for the item in the open market or of making detailed preparations for delivery. The clearinghouse guarantee function in this context precisely means that delivery of the exact quantity and grade (or of the nearest grade) is guaranteed. Even if the short seller does not own the item when selling a futures contract, his/her ability to make delivery is nevertheless assured beyond any doubt. This is a peculiarity of futures trading that provides systematic guarantees over delivery and payment, something that the open market does not provide.

Sale Prior to Taking Possession (*Qabḍ*)

One requirement of a valid sale in *fiqh al mu'āmalāt* is that the purchaser may not sell the goods purchased until they are in his/her possession. In support of this ruling, jurists have referred to the authority of the hadith that I shall discuss presently. The main purpose of this inquiry is to ascertain whether futures trading can be validated within the given terms of the hadith and whether the concerns of the ulama in conjunction with the conventional contract of sales are equally relevant to futures contracts.

Literally, *qabḍ* means taking and holding something in one's hands. In its juristic sense, *qabḍ* implies legal custody and possession in a proprietary capacity, even if it does not involve the physical act of holding. The seller must deliver the goods sold, and the buyer must pay the price. The buyer, however, is not obliged to receive the goods or take possession, as it is his/her right/privilege, which he/she may or may not choose to exercise.[37]

The following three hadiths need to be reviewed on the subject of *qabḍ*.

> 'Abd Allāh ibn 'Umar reported that the Prophet said: "He who buys foodstuff should not sell it until he has received it (*man ittibā' ṭa'āmān fa lā yubi'uhu ḥattā yutabi'uhu*)."[38]

> According to another report by 'Abd Allāh ibn 'Umar, the Prophet said: "He who buys foodstuff should not sell it unless he is satis-

fied with the measure with which he has brought it" (*man ittibā' ṭa'āmān fa la yubi'uhu ḥattā yastawfih*).[39]

Ibn 'Abbās has also reported the following hadith from the Prophet: "He who buys foodstuff should not sell it until he has taken possession of it." Ibn Abbas said: "I think it applies to all other things as well" (*man ittibā' ṭa'āmān fa la yubi'uhu ḥattā yatabi'uhu, wa aẓunnu kull shay'in mithlahu*).[40]

As we note, all reports are substantially concurrent. The only variation is concerned with the use of words that may be said to be synonymous: the word *yaqbiḍahu* (takes possession) in the first hadith is substituted with *yastawfihi* (obtains full measure). This variation does not seem to change the substance of the message, which is conveyed in all three reports. The third hadith has an added element that is clearly not a part of the original hadith and represents an addition by Ibn 'Abbās. The word *ṭa'ām* (foodstuff) occurs in precisely the same way in each report and constitutes the only subject matter thereof.

As for the hadith's basic rationale, the *Hidāyah* states that the Prophet prohibited the sale of items, especially perishable ones, that the seller did not possess, because of uncertainty and doubt over their delivery. All leading *fuqahā'* have held, consequently, that one cannot sell foodstuff before taking possession of it. According to Imām Shāfi'ī, one cannot sell anything (e.g., foodstuff, land, or a garden), before taking possession. Imām Abū Ḥanīfah and Aḥmad Ibn Ḥanbal opined, however, that possession is not a requirement in the sale of real property, as there is usually no fear of destruction and loss.[41] Possession is not required for the sale of foodstuffs and real property if ownership of the goods in question was the result of a gift or inheritance, for these involve no financial exchange and the seller is not committed to paying a price to someone else.[42]

A recent resolution of the Fiqh Academy has confirmed that "the effective cause (*'illah*) of the prohibition of sale prior to taking possession is *gharar*, or the possible failure to deliver the goods purchased. The buyer takes the risk of not receiving the goods, as the seller may delay the delivery or wish to revoke the contract." The resolution stated further that while such *gharar* tended to be of general application, there was an additional element of *gharar* in the sale of foodgrains and agricultural crops—they may perish or be destroyed due to climatic factors and disease.[43]

According to the Ḥanifis, *qabḍ* is not an essential requirement (*rukn*) of sale but rather a subsidiary condition, namely, that of effectiveness (*sharṭ al nifādh*). This ruling led al Kāsānī to point out that a valid sale can be concluded prior to the seller's taking possession but that it will remain in abeyance until *qabḍ* has taken place.[44] To this, al Sarakhsī added that *qabḍ* signifies the effect or outcome of the contract that materializes after its conclusion. Therefore, *qabḍ* is not a prerequisite of a valid contract, and it is perfectly lawful to postpone delivery and *qabḍ* to a later date. Only in the case of sale of currency for currency (*ṣarf*) is *qabḍ* elevated to a prerequisite of a valid contract.[45] Imām Mālik confined this hadith's application to foodgrains, which means that non-foodgrain items (i.e., cotton, palm oil) may be sold prior to taking possession.[46] Ibn Rushd confirmed this and stated that "there is no disagreement in the Mālikī school that only foodgrains (mainly wheat and barley) cannot be sold prior to *qabḍ*." Imām Mālik also validated the sale of foodstuffs in lump sum (*juzāfan*), that is, without weighing and measuring, prior to taking possession,[47] for liability for loss and destruction (*ḍamān*) in this case is transferred to the buyer at the moment of contract and not upon taking possession.

Ibn Taymīyah, the renowned Hanbalī scholar, departed from the majority position by opening up the concept of *qabḍ* to considerations of prevailing custom. He criticized the majority, which confined the meaning of *qabḍ* to holding and retention (*ḥabs*) or evacuation (*takhlīyah*) and the like, and stated that neither the Arabic language nor the Shari'ah has given a specific meaning to *qabḍ*. In his words, *takhlīyah* varies from object to object, and the manner in which it occurs is not always the same. The precise meaning of *qabḍ*, therefore, is to be determined by reference to prevailing custom.[48] Ibn Qudāmah stated that *qabḍ* in all things refers to an appropriate manner of taking possession. The Shari'ah stipulated *qabḍ*, but the manner in which it is accomplished is determined by custom. It may consist of holding and retention, taking into custody (*ḥirz*), evacuation (*takhlīyah*), or separation (*tafarruq*). *Qabḍ* is necessary for all fungible goods sold by weight, measurement, and number, as responsibility for loss (*ḍamān*) in such commodities is transferred to the buyer after *qabḍ*, which, in respect of such goods, takes place when they are weighed and measured. Goods not sold by measurement and weight (e.g., clothes and livestock) may be sold prior to *qabḍ*, for the responsibility for loss in such items devolves upon the buyer upon conclusion of the contract (prior to *qabḍ*).[49]

As seen above, *qabḍ* has been understood as a relatively open concept amenable to the changing influences of commercial reality and custom, for it has meant evacuation, taking into custody, separation, measurement, identification (*ta'īn* or *tamyīz*) and viewing (*mushāhadah*). With the exception perhaps of the Shāfi'īs, no other school requires *qabḍ* prior to resale in the case of immovable objects. The Mālikīs confined *qabḍ* to foodgrains only. *Qabḍ* in foodstuffs occurs when they are weighed and measured. In at least two varieties of sale, namely, *salam* and *istiṣnā'*, the requirement of *qabḍ* has been waived by the express authority of hadith. This exemption extends to all items, including foodgrains. *Salam* and *istiṣnā'* were validated on the grounds of utility and convenience for the people.[50]

We can say, perhaps readily, that *qabḍ* is not a requirement in futures trading in such nonfoodstuff items as cotton, rubber, and tin. In addition, measurement and weighing, the recommended mode of *qabḍ* in foodstuff sales, was designed to ensure propriety in weighing and to prevent fraud. This is not an issue in futures trading, for such foodgrain contracts are bought and sold in standardized quantities and packages that are weighed and measured once. After this, the packages are sealed, labeled accordingly, and do not need to be reweighed each time they are sold, as the relevant documents provide sufficient evidence of the total weight. Thus, prevailing commercial customs in futures trading have made personal supervision over weight and measurement unnecessary and unfeasible. It would appear that *qabḍ* in such commodities takes place by obtaining the official warehouse receipt, rather than by constant remeasuring and reweighing.

We have shown that customary practice has a role in determining the manner in which the legal requirements of *qabḍ* and delivery may be fulfilled. Provided that the processes adopted are free of uncertainty, unwarranted *gharar*, and potential dispute, it may be acceptable even if it transforms the initial concept of physical delivery and *qabḍ* into an altogether different procedure. It is quite conceivable that modern technology and computerization may bring further changes into the conventional concept of *qabḍ*, which may gain popularity and customary approval. This would be acceptable from the Shari‘ah viewpoint if it fulfills the basic rationale of *qabḍ*, which is to prevent uncertainty and *gharar*.

Our analysis of *qabḍ* would apply naturally to futures transactions involving holding the contracts until maturity and then taking delivery. As trading in stock indices, financial futures, and currencies does not involve any physical exchange of assets, delivery and *qabḍ* are matters of debiting and crediting accounts. As for the bulk of futures contracts, in which the contracting parties close out their position by entering a reverse transaction, this is another issue that must be addressed separately. Since, in principle, the Shari‘ah validates the sale of a physical object (*bay‘ al ‘ayn*) and the sale (involving exchange) of debts (*bay‘ al dayn*), delivery and *qabḍ* in the latter case are no longer a matter of physical delivery or retention of an actual asset, but rather one of appointment (*ta‘īn*) and computation of a debt established on the person (*dhimmah*) of the debt's bearer. This is the subject to which we now turn.

Debt Clearance Sale (*Bay‘ al Dayn bi al Dayn*)

An offsetting transaction in futures consists essentially of sales involving a debt that one party owes to another and its settlement through the modality of sales and purchases. This subject is somewhat technical, and juristic writings are not consistent on either its nature or its validity in the Shari‘ah. Many types of sales have been included under *bay‘ al duyūn* (lit., sale of debts [also known as *bay‘ al kāli’ bi al kāli’*]), and it has been disputed as to whether they in fact qualify as "sale of debts." Some instances of this transaction are as follows:

1. Person A borrows two tons of wheat for his/her personal needs from Farmer B. This amount is returnable in six months. Prior to the expiration date, Farmer B sells the wheat, which is a debt on Person A, to Person C in exchange for a ploughing machine to be delivered in one month. This sale

consists of an exchange of debts and is considered unlawful due to uncertainty over delivery and the resulting likelihood of *gharar*.[51]

2. Person A borrows $2,000 from Person B for a period of one year but, before repayment is made, Person B suggests to Person A that he/she will rent Person A's house in exchange for the sum owed to Person B. This is also held to be unlawful, as it involves selling one debt for another and no delivery on either side. If the proposed exchange is advantageous to one party, it will also involve unlawful gain amounting to *ribā*.[52]

3. Person F is indebted to Person G for 20 ounces of gold, and Person G owes Person H 150 ounces of silver. Persons F and H may not settle their debts directly, for this would amount to the sale of one debt for another (Person F is personally indebted to Person G [and the latter to Person H], and his/her *dhimmah* can only be released by repaying the creditor directly). The Hanbalīs forbid such a clearance of debts only if the two items are different, whereas the Shāfi'īs forbid it even if they are identical in genus and quantity, in which case it would amount to a simple clearance of mutual debts (*maqāṣah*).[53]

4. Person A sells a garment to Person B for 100 dinars, payable in one month, and then buys from Person B the same or a similar garment for 120 dinars, payable after two months. This transaction (*'īnah*), although validated by the Shāfi'īs, is invalidated by other schools on the grounds that it involves *ribā* and, according to others, because it is a debt clearance sale.[54] It is stated in *Mughnī al Muḥtāj* that the sale of a debt to a third person is null and void (i.e., a person other than the debtor), but a second opinion validates this practice on the condition that the debtor acknowledges his/her debt and is willing to repay it.[55]

General consensus (*ijmā'*) is said to have materialized on the prohibition of *bay' al kāli' bi al kāli'*. Imām Ibn Ḥanbal ruled, perhaps somewhat vaguely, that common consensus (*ijmā' al nās*) has forbidden it. But evidence shows that such an *ijmā'* is unfeasible, bearing in mind that the ulama do not agree on the definition of this transaction or on the various forms it can take. The legal schools have recorded divergent rulings, which means that the claim of *ijmā'* on this issue is unfounded.[56] Then there remains the evidence in the Sunnah: Mūsā ibn 'Ubayd reported from 'Abd Allāh ibn 'Umar simply that "the Prophet prohibited *bay' al kāli' bi al kāli'*."[57]

This hadith only appears in some collections, such as al Darquṭnī's, and al Shawkānī reproduced Darquṭnī's version in *Nayl al Awṭār* only to say that many prominent scholars consider it unreliable. Its precise meaning is also subject to doubt, as *kāli'* is somewhat unfamiliar even to native Arab speakers. However, it is generally understood to mean the sale of one debt for another. According to al Shawkānī, only Mūsā ibn 'Ubaydah al Rabdhī reported it and its authenticity is weak. Imām Aḥmad Ibn Ḥanbal said that he knew of no other hadith transmitted by Ibn 'Ubaydah and that no one else transmitted it. Imām al Shāfi'ī said that the hadith scholars considered