# INTERNATIONAL COMMODITIES AND THE (*SHARI'AH*) GUIDELINES ON DEALING WITH THEM

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In the name of Allah, the most Beneficent, the Most Merciful. All praises and thanks are to Allah, the lord of 'Alamin (mankind and the jinns, and all that exists). Peace and blessings of Allah be upon the noble Prophet s.a.w., upon his Household and his Companions.

This study is a contribution on a sensitive topic that is international commodity, in connection with the Al-Baraka Symposium on Islamic Economics. In principle, it (international commodity) is a product that has positive effects, be it in the short or long-term. Nevertheless, it also has negative lasting effects that may occur over the long haul. All these call for the effort of formulating criteria for this sort of transaction, in order to achieve the aim of investing the money and obtaining the needed liquidity, and of course, avoiding elements that are not in compliance with the *Shari'ah*. In the end, these efforts would benefit the Muslim community and prevent the transfer of savings from Islamic banks to conventional banks, under the guise of international commodity. It is Allah Almighty that can guide and lead us to the right path.

## Definition of international commodity

International commodity can be defined as the fundamental commodity that is traded in the financial market (stock exchange); it (can either be) metal, energy product (oil and gas), raw materials and manufactured products, which are transacted in organized commodity markets and traditional ordinary markets, that will be defined soon. Manufactured products that are ready for consumption and use are excluded from the definition of international commodity.

## The difference between international commodity and international trade

International commodity is a special type of international trade. However, there are several differences between the two, with the most important being:

The adjective of (international) in international trade, as reported in the Vienna Convention 1980, is ruled by two criteria:

The first one is subjective - It is when the business centre of the two contracting parties are found in two different countries; and

The second is objective - It is related to transactions and it requires the existence of one of the following conditions -

1. The combination of sale and the transfer of commodity from one country to another;
2. The issuance of offer and acceptance from two different countries; and
3. Delivery of the subject matter (the commodity) is made to a country other than which the offer and acceptance took place.

These rules and criteria are not stipulated in dealing with international commodity because it can be practised between two parties in the **same country**. Usually, (in transactions involving international commodity), delivery and transfer of commodity between countries do not happen. However, the word (international) refers to the international customs that govern these transactions and the fact that it is concluded in specific international stock exchanges. (See: Profitable Sales of International Commodity by Dr. Abdul Haleem ‘Umar, the works of the Conference of Islamic Financial Institutions, Emirate University, page 142, and other matters in its research; page 1423, and from the Review on Financial Markets by Dr. Muniir al-Hiundi, page 327, and Savings, Investment and Mudharabah in Stock Markets by Dr. Ja’far al-Najar, page 231).

## Commodity markets

Throughout the world, there are many stock exchanges for the aforementioned commodities. Some of them are local and a few are of international status. So, verily, international commodities trading is a set of transactions that have been subscribed by parties all over the world, amounting to millions of dollars per day.

The most famous of these stock exchanges is the London Metal Exchange, Chicago Stock Exchange and New York Stock Exchange. The majority of the international commodity transactions that are conducted by Islamic banks are concluded in the London Metal Exchange.

The stock exchanges deal with recognized warehouses, including warehouses that are chosen by the management of the stock exchange, i.e. warehouses that fulfill the criteria required. There are more than 400 warehouses across 32 places, including in the U.S., Europe, Middle East and the Far East. The warehouses would issue the related certificates immediately or through its authorized agent in London, i.e. where the stock exchange is located.

In the year 1999, the London Stock Exchange developed the Electronic SWORD System. It is a system that is designed to accord complete protection and safeguard against disruptions in the day to day dealings. Only the participants can gain access to the system. In the SWORD system, the information is centralized and the issuance of warehouse warrants is centrally executed in electronic form, i.e. by the warehouse manager. Buying and selling is concluded electronically. Though this system, the affiliated warehouses would be able to issue warehouse certificates from anywhere in the world.

Various kinds of sales and contracts have been executed in international commodity stock exchanges, such as different types of futures and various forms of options, and the trading on consumer price index and the operations of trading off swap. However, it is clear that the aforementioned contracts are prohibited in Islam. Therefore, we are not concerned with those, since Islamic banks do not engage in those transactions.

With regard to documentation, when the commodity has been deposited in the specialized commodity warehouse, this warehouse must issue a warehouse warrant, which is defined as, “A document that confirms the existence and availability of a specific quantity of a commodity with certain qualities in the warehouse that issued the document.” This certificate/document will be considered as the document through which the ownership of the document holder in the commodity stored will be confirmed. (See: Profitable Sales of International Commodity by Dr. Muhammad ‘Ali al-Qurah, Conference on Islamic Banking Institutions, hosted by Al-Shariqoh University, page 1538-1540).

**<u>The differences between organized commodity markets and traditional markets</u>**

In traditional markets, a transaction will usually be concluded upon a true and visible commodity. This runs contrary to modern commodity markets, where the dealings are executed based on the samples of products that are not actually visible and present at the time of transacting. Therefore, the transactions in the modern commodity markets extend beyond the transactions that are concluded in traditional markets.

So, due to its uniqueness, there are specific conditions that must be fulfilled before a transaction in a commodity market can be carried out, as shown below:

a. The subject matter must be long lasting (not perishable goods) and easy to store;
b. The subject matter must be within the same measurement domain (e.g. all in tonnes, not some in tonnes and some in metres), such that its quantity will be specified by measure, weight or by counting it, with the existence of its equivalent in the market;
c. The transactions with the commodity must be sizable and recurring, so that it would constitute specialized trading that are executed by a large number of participants; and
d. The transportation cost must be relatively small, as compared to the total value of the transaction.

The transactions in the traditional markets have little or no direct influence on the price of goods, such that the price is relatively stable, as compared to the commodity markets. This is due to the relatively smaller volume of transactions that are spread across many types of commodities. On the other hand, in the commodity markets (stock exchange markets), there are many recurring transactions and moreover, the transactions are centralized (transactions conducted via one body), thus making it possible for someone to influence the price of commodities. Therefore, it is definitely incumbent upon those who want to deal with a specific commodity to observe the commodity price during their dealings. (See: The Deed of Investment Firms in the Financial Markets by Dr. Ahmad Muhydin, page 223, and from the review of Mahmuud ‘Assaf - Financial Activities Management, page 355 - 142, Yasin Mohammad Sayid, Bursat al-Uqud and Bursat al-Bidhao'ah al-Ahdhirah, 2nd edition, Motba'ah al-I'itimad, Egypt,1951, page 29).

**<u>Types of international commodity operations</u>**

Commodity operations are of two types:

1. International commodity operations in the financial markets - These are called commodity contracts markets, which is named such to differentiate it from the money exchange markets, and stock and bond market; and
2. International commodity operations in non-organized markets - These are called parallel markets. In this market, transactions such as deferred payment sales (*bai' bithaman ajil*) are executed via correspondent banks. The correspondent bank plays the role as an investment agent, albeit a restricted agency arrangement, with the requirement for the correspondent bank (*wakil*) to refer to the *muwakkil* (principal/authorized bank) for the execution of every transaction. Hence, before entering into any transaction, the correspondent bank will refer to the principal (authorized bank) for their approval. Then, the correspondent bank will purchase the commodity from a supplier at spot price. Subsequently, the *wakil* will sell it to another party (third party) on deferred payment sale. Upon the conclusion of a transaction, the correspondent bank will earn a commission, while the authorized bank is entitled to the profit earned from the said transaction. As an incentive, a part of the revenue may be dedicated for the *wakil*. This may be operationalized in the form of a *mudharabah* arrangement.

**<u>Definition of international commodity sale</u>**

It is easy to define international commodity sale in the financial markets as:

1. An organized commodity sale transaction;
2. It is under the supervision of a specific body;

3. It is done through sale and purchase orders, with the utilization of typical dealing contracts that contain various conditions and specifications; and
4. It contains a clause on the delivery time and place, the requirement to deposit a proportion of the transaction value and the need to open a letter of credit (LC) with the agent, which includes the execution of the transaction and the LC.

(*Shari'ah* criteria no. 30 on the matter of commodity sale in organized markets, clause 1/2).

**International commodity contracts**

It has been previously mentioned that international commodity contracts are executed by utilizing standard contracts, where the distinction between the contracts are basically just in terms of the price, delivery date and payment, which may be on cash (spot) or deferred basis.

The parties to the contract will stipulate the delivery period and deposit a proportion of the contracted amount to guarantee the execution of the transaction. In terms of the level of quality of the commodity, it will be determined by the rules/standards in the market.

(Islamic Banks and Financial Markets by Dr. Muhammad al-Khariji, page 23).

**Concluding international commodity contracts**

The contracts are concluded through any of the following methods:

1. By actual exchange, where the variance between the cost of the commodity and the corresponding selling price does is not more than 3%;

2. By payment through the clearinghouse that are based on concluding the contracts, where the contracts will be replaced by other contracts. With regard to this, the clearinghouse may act of behalf of both parties (buyer and seller) and thus, bear the liability of both parts of the transaction; and
3. In case of disputes, the exchange may act as an arbitrator, especially in determining the consideration of the transaction.

(Refer to previous reference 7/1/172).

It is imperative for someone who wants to purchase or sell in the like market to have a current account with the agent bank, so that in the execution of the contracts, the margin can be deducted. The margin will be held in trust and must be given back after liquidation. The margin amount must be added to the account or discounted from it, in case of daily losses, depending on the commodity price.

The agents must act to coordinate the sale and purchase orders. The stock exchange will issue the permission to sell for sellers and the permission to buy for buyers. It is important to note that the name of the third party (seller sells to > buyer sells to > third party) must not be mentioned in the said documents. In this regard, the purchase contract is independent of the sale contract. (The Stocks, Options and Futures Markets, by Dr. Muhammad ‘Ali al-Qira, Majjalat al-Mujma’a, 7/1214).

**<u>Commodity operations with deferred contracts</u>**

Deferred contracts are contracts in which the seller will deliver the commodity to the buyer at a specific time. The payment will thus be made upon delivery of the said commodity. In spite of this, the contracts contain a condition that requires the contracts to be concluded by way of delivery and confirmation of receipt.

Therefore, this condition differentiates it from the futures market. This method is called deferring two exchanges (deliver and receipt) or constructing two liabilities or initiating *al-dayn bi-dayn* (debt with debt) or *bai' al-kali bi-kali* (delayed counter value for another counter value).

**<u>*Shari'ah* guidelines on commodity operations on the basis of deferring two exchanges (deliver and receipt)</u>**

In the *Shari'ah*, specifically in the contract of exchanged items (*mu'aawadhah*), it is prohibited to defer the exchange of two items. This issue was raised during the 29th Al-Baraka Symposium on Islamic Economics, i.e. for a solution to be formulated, even if it is based on exceptions. The symposium concluded to emphasize the following; the deferment of two exchanges in the contracts of exchanged items, which is establishing debt with debt or constructing two liabilities, is unlawful. Such a contract constitutes selling something that is not owned. With reference to a Hadith, it is forbidden to transact on a subject matter that is not in one's possession, except for the contract of *salam.*

The classical scholars unanimously decided that such a contract is prohibited, because of the element of speculation, in respect of the dissimilarities in the price of the goods on the contracting and delivery date. Such a situation would not satisfy the objective of the contracting parties, such as that the buyer cannot get access to the commodity purchased, while the seller is not paid for the commodity sold. The element of *gharar* is also evident in such a contract.

However, there are two exceptions:

The first exception – When facing a *dharurah* (state of necessity), it is lawful to defer two exchanges, in as much as required to conduct productive activities and services in relation to removing hardship (that is if the productive activities of general or private institutions depend on this type of contract due to certain circumstances, such as the inability to purchase substances on advance payment and storing them for long periods of time).

The second exception is with respect to the marketing or more precisely, the salability of products. In situations where **bulk purchases** are the norm, it is difficult to require customers to pay in advance something that they will only get in the future.

Accordingly, the resolution of the symposium included several criteria to restrict such contracts, as they are based on exceptions, as follows:

To prevent the misuse of the aforementioned exceptions, it is crucial for the following criteria to be fulfilled:

a. The existence of a provision that stipulates that the exchanged items must be delivered on the due date;
b. If there is an exchange of commodities of different prices, then there must be no *muqassah* (set-off), where one of the two products are not delivered;
c. The presence of the conditions related to the attributes of the commodity, which is identification of type, quality, amount, period, delivery place, and the possibility of concluding a sale on the due date;
d. The permission to engage in this contract is restricted to production (or marketing), and not for trading with the view to earn a profit;
e. This exception must not contravene the rules and criteria of the contract of *salam* in normal circumstances; and
f. This exception cannot be used in monetary contracts at financial institutions.

(The resolution of Al-Barakah Symposium, no. 19/4, p. 336).

## ***Shari'ah* substitute for the deferment of two exchanged items**

It was reported in the resolution of the OIC Fiqh Academy that the deferred sale contract of two exchanged items can be easily modified by applying the well-known conditions of *salam*, taking into consideration that it is unlawful to sell a commodity purchased on basis of the *salam* contract before that commodity is received.

If the subject matter of the contract is something that needs to be manufactured, then it is allowable for the two exchanged items to be deferred on the basis of the contract of *istisna'*.

(The resolution of the OIC Fiqh Academy in Jeddah, no. 65 (1/7), clause 3/2, Shari'ah Criteria 20 on the issue of the commodity contracts in organized markets, clause 3/3 and its sections).

## **Commodity contracts in organized markets**

Some of the commodity contracts in organized markets are as follows:

Spot contract (*al-'uquud al-haalah*):
It is a contract where price and delivery happens on spot basis. Delays of a day or two, due to market norms, are allowed, as long as the commodity or documents evidencing ownership of the commodity is in the hands of the seller.

This contract is lawful in the sight of the *Shari'ah*, with reference to the following verse, "O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent and do not kill yourselves (nor kill one another). Surely Allah is Most Merciful to you."

It is allowed to apply international conventions or the laws of a particular country on these contracts, as long as there is no element that contravenes the *Shari'ah*. Compliance with international conventions is verily required in the *Shari'ah*, as Allah said, "O you who believe! Fulfill (your) obligations…"

Fulfilling one's obligations come with the exception that one must not legitimize things that are forbidden or forbid things that are permissible, as evidenced in the saying of the Prophet s.a.w., "Muslims are obliged to fulfill their conditions, except a term that legitimates what is forbidden or forbids what is legitimate." [Hadith reported by al-Imam Ahmad in his Musnad 1/382 and Ibn Majah in his Sunnah 2/487, with good authority (*isnad hasan*), and Imam Hakim, Imam Bayhaqi and Imam al-Dar-Qutni].

<u>Forward sale (al-'uquud al-aajilah)</u>

This is a contract where the delivery will be made in the future and payment will be made on delivery. The terms of this type of contract requires that the contract be concluded through the delivery and collection of money on a certain due date.

Such transactions are unlawful. Although it looks similar to *salam*, these transactions are not in compliance with one of the conditions of *salam*, which is advance payment. In this case, the payment is deferred.

It is possible to modify this transaction, in order to ensure its compliance with the essential conditions of the contract of *salam*. It is nevertheless unlawful to sell the commodity bought on the basis of *salam* before that subject matter is procured.

<u>The futures markets (*al-mustaqbaliyyah*)</u>

It is when the contract is based on the delivery of a commodity on a deferred date, and payment will be made on delivery, without including the stipulation that the contract will be concluded upon delivery of the subject matter; rather, dissolution is possible through a counter contract with set-off (*al-muqassah*).

This type of contract is the most widely used contract in the commodity markets. In its original form, this contract is unlawful, for the reason mentioned above, and for the reason that although delivery and receipt are contractual requisites, it is non-existent in this contract. Thus, this will invalidate the contract.

## ***Shari'ah*-compliant substitutes for forbidden transactions in commodities and currencies**

The Fiqh Academy has recommended a substitute for the above, as follows:

A *Shari'ah*-compliant commodity and currency market ought to be established by using (especially) the contract of *salam, sarf* (money changing), and *al-wa'adu bil bay'* (the promise with sale) on deferred basis, *istisna'* and others.

For the above to be done, the Academy feels that there is necessity to research on these substitutes and the methods of applying them in an organized Islamic market.

(The resolution of the International Fiqh Academy, no. 65(1/7) clause 3/4).

## **The methods of administering international commodity operations**

There are numerous methods that have been applied by Islamic financial institutions in operationalizing international commodities. The main ones are as follows:

<u>1- Commodity trading based on agency on investment operations</u>

This is a transaction where another party (agent) is authorized to buy the specified commodity at the current price and subsequently, the agent sells the commodity on deferred payment. As consideration for the execution of this arrangement, the agent will earn a fee, either a fixed fee or a fee that is based on the price of the commodity (percentage). This is considered agency on investment operations (*al-wakalatu bil istithmar*).

a – Investment operations by the agent

After purchasing the commodity for the benefit of the authorizer or principal (*muwakkil*), the agent will then purchase the same from the authorizer by concluding the contract of sale or exchange with two notifications; the first one is for the agent to inform that the commodity is now in possession, and subsequently, making an offer to purchase the commodity (*al-ijab*); the second notification is for the principal/seller to agree on the sale (*qobul*). Sharï'ah criteria no. 8 must be observed on the matter of *murabahah lil aamir bi shiraai* (mark-up sale for the purchase orderer), appendix (a) and (b).

b – The importance of two notifications

The argument on the necessity of issuing an offer to buy (*ijab*) from the authorized agent, i.e. to buy for himself and the notice of acceptance from the authorizer (*muwakkil*) as the seller is based on the need to separate and identify the liability of the authorizer/seller (before the sale takes place), and the liability of the agent/purchaser (after the sale takes place).

(The *Shari'ah* Criteria no. 20 clause 4 and its sections, a research on the transactions for the researcher 4/245. It comes in clause 4/1/4 from the Shari'ah Criteria: It has been stipulated in this applications for the avoidance of *'inah*, which is when the purchaser sells the goods bought on deferred payment to the original seller, at spot, at a price that can either be less or more than the former price).

2- Commodity trading based on *mudharabah* (profit sharing-loss bearing)

This constitutes the appointment of a body to administer the purchase of a commodity at spot price and then selling it on deferred payment, with an agreement that the profit obtained will be shared between the investors and the manager (*mudharib)* of the said body.

3 - Commodity trading that is implemented through institutional bodies

Basically, there are two methods of doing this:

a. An institution purchases a commodity at spot and then sells it to another party on deferred basis. The second buyer will subsequently sell the commodity to its customers; and
b. An institution purchases a commodity at spot on behalf of another party (agency contract). Then, it will buy the commodity from the principal on deferred basis mark-up sale (*al-murabahah al–'aksiyyah).*

4 - Commodity operations for the purpose of *tawarruq*

The following is a *tawarruq* contract for the purpose of getting liquidity: An institution purchases a commodity at spot (at spot price) and then sells it to another party on deferred basis. The second buyer will subsequently sell the commodity to its customers (at a higher price than the spot price).

**Criteria for transacting in international commodities**

Firstly, the General Shari'ah Criteria no. 20 stated on the matter of commodity sales (11), where the elements that are required and the elements that are prohibited in a contract of commodity sales is delineated.

(Refer to a research on the International Trade and International Commodity by Dr. Abdusattar Abu Ghuddah, published in researches of Section/4, which is a study on the criteria of the commodity sales. Refer also to the General Shari'ah

Criteria no. 2, on the matter of the commodity sales in organized markets, clause 4/2 and its sections).

Secondly, in the conclusion section of his research (3), Dr. Muhammad Abdul Halim Umar stated some criteria, of which the details can be summarized, as follows:

1. The purchase and sale of commodities for the customers must involve the actual delivery of the commodities;
2. The execution of transactions via unlawful means must be avoided, e.g. futures, derivatives and the utilization of futures and the like for spot sales; and
3. The *Shari'ah* principles must be observed, e.g. the legality of the commodity, the unlawfulness of selling foodstuff at a mark-up (*murabahah*) before actual possession takes place and the prohibition of using deferred cost plus (*murabahah*) if the subject matter is gold and silver.

(The research on Murabahah in International Commodity by Dr. Muhammad Abul Haliim Umar, page 1434).

Thirdly, Dr. Muhammad Aliy al-Qiraa mentioned under the title, "The *Shari'ah* Criteria for International *Murabahah* (mark-up sale), as follows, "The criteria which is compulsory for international *murabahah* is that the commodities, the contract and the conditions of the contract must be lawful. Such examples of unlawful conditions are as follows: Assuming both sides of a contract, the absence of the condition of possessing before selling, the condition of connecting the price of the commodity with a certain index, not mentioning the delivery place, and the repudiation of the right to obtain the warehouse warrant.
(Research on International Commodity *Murabahah* by Muhammad Aliy al-Qiraa, page 1544).

Fourthly, it is appropriate to apply the *Shari'ah* criteria on the basis of their nature or relationship with the operations of international commodities trading. The operations must be based on the *Shari'ah* criteria for commodity sales.

**First: The *Shari'ah* criteria related to the commodity itself**

Transactions must based on lawful commodities

The nullification of dealing with unlawful commodities is in view of the fact that it is worthless in the sight the *Shari'ah*. So, it is not appropriate to be made the subject matter of a sale.

Identifying and distinguishing the commodity bought from the rest of the stock of the seller:

The act of not allowing the buyer to identify/confirm the commodity that is to be bought is unlawful. This is because doing so will make it difficult for the rights and liabilities of both the buyer and the seller to be differentiated. This is related to two legal maxims, i.e. *al-kharaaj bi damaan* (to be eligible for revenues, one must assume the related liabilities) and *al-ghunm bil ghurmi* (to be eligible for revenues, one must bear the related risks).

The avoidance of prohibited *'inah*

The following type of '*inah* must be avoided: A purchases a commodity from B on deferred basis and then immediately sells the commodity on cash basis to A (original owner) or to another party that is related or under the control of A.

The avoidance of mere formalism

The following must be avoided: Transactions on commodities without the presence of the commodities, which are done through illusive documentation or via multiple sales, i.e. one commodity is sold to many parties **at the same time.**

The right to obtain the relevant documents, especially the warehouse warrant

The contractual documents have the role of authenticating certain things. The documents will determine the legitimacy of the transaction. Therefore, it is compulsory for Islamic financial institutions to insist on their right to obtain those documents and reject any condition that prohibits them from doing so, especially with regard to the warehouse warrant. This is because the warehouse warrant is a document that proves that the commodity does exist.

**Second: The *Shari'ah* criteria related to information**

The necessity of fixing the price and the impermissibility of giving a discount without declaring the amount

It is unlawful to conceal the information on the agency fee. In other words, it must be disclosed and not included/'hidden' in the purchase price (that is specified on general gross amount) without specifying it. Here, transparency is key.

The evidence that supports the prohibition of doing the above is based on the ruling on *ujr,* that is, "Whoever employs an employee must inform the employee of his salary". So, the rule that is applied on *ujr* in a leasing contract must also be applied on the agency fee in the contract of international commodities trading. After the information on the fee has been disclosed, both parties can agree that the agent can acquire his fee, either by deducting it from the purchase price (gross amount) or from the premium that is charged upon the purchase price. This is because it is allowed to stipulate that the amount over and above the purchase price would constitute the agency fee.

The necessity of mentioning the delivery place

If the commodities are not present at the time of contracting, then it is necessary for the delivery place to be specified. Even though the contracting parties regard the delivery of the commodity as being part and parcel of the contract, this element must not be taken for granted. This is because it leads to uncertainty (*gharar*). The *gharar* may manifest itself in many ways. For instance, the contract may not be concluded with the possession of the commodity transferring from the seller to the buyer (as no specific delivery place was named). Furthermore, if no delivery place was specified, there is a risk of dispute with regard to the cost of delivery, i.e. on the party that will bear the cost of delivery.

<u>The prohibition of the condition of connecting the price with an index</u>

Within the context of international commodities trading, most sales are made on deferred basis. Sometimes, the contract duration may be long and the price will be set by taking into account the interest index and its variables. In this regard, the price of the subject matter must be specified and it cannot be linked to such an index. However, the contracting parties may refer to the index as a guide. Nevertheless, they are not allowed to link it to the said index. In such a case, the price will fluctuate according to the index.

## Third: The criteria related to contracts that are not concluded

<u>Concluding contracts based on mere offer or *ijab* (without full acceptance or *qabul* from the counterparty)</u>

It is impermissible for the agent of the institution to purchase the commodity for himself on deferred payment basis, based on his mere notification to the institution without full acceptance by the seller (institution). This is because the offer to purchase is made by virtue of the agency contract and not the sale contract (here, there is also an issue with regard to the separation of contracts). So, the offer occurs before full possession on the part of the institution takes place, which amounts to selling something that is not possessed.

The conditions of non-delivery

It is unlawful to stipulate in the general operational framework of the commodities that the buyer has no right to receive the commodities. Therefore, such a condition must be removed and the contract must clearly state that the buyer has the right to collect the commodity. This is because stipulating non-delivery will cause the non-fulfillment of the purpose of the contract. It may consequently lead to the contract becoming invalid.

Despite that, there are some scholars that opine that the conditions of non-delivery can be stipulated if the purchase is made not for the purpose of utilizing it but to conduct trade with it. This is because for a trader, he would like to avoid paying for the delivery cost; hence, the conditions of non-delivery. This view is rejected because what are important are the *Shari'ah* requirements, and not the intention of the contracting parties.

Stipulating a condition that the bank/institution will only pay if the investment agent fulfills his promise to purchase the commodity

It is unlawful for the institution to stipulate that payment will only be made if the agent presents a guarantee (guarantee letter) that he will purchase the said commodity. This is because the commitment of the principal to pay the price is separate from his promise to the agent to purchase the commodity for him.

**Fourth: The *Shari'ah* criteria related to guarantee**

The prohibition of undertaking two parts of a contract

In international commodities trading where the agent purchases commodities for the benefit of the institution and subsequently **sells the commodities to himself, the second leg of the transaction (sale transaction) must not be done without the proper exchange** of the notice of offer and acceptance by the agent and the institution. This is to ensure that the rights and liabilities of each party can be distinguished. (e.g. before the institution issues the notice of acceptance, the customer still assumes the role as the institution's agent. Therefore, he is liable if the commodities are damaged, albeit certain factors must be considered)

The combination of the two guarantees/liabilities is forbidden (i.e. without the proper exchange of offer and acceptance), as it contravenes the principle of 'loss is burdened on those who have acquired profit' (*al-Ghunmu bil Ghurmi*). There is also a jurisprudential controversy on the matter of one person undertaking two roles in a contract, e.g. he is the agent for purchasing a commodity + he is the buyer that will sell the commodity purchased earlier to himself, without offer by the principal and acceptance from the agent. This could lead to the abuse of power on the part of the agent, whereby he will sell the commodity to himself at the lowest possible price, rather than acting in the best interest of his principal, i.e. selling at the highest possible price. However, the prohibition of combining both guarantees will eliminate disagreements and necessitate the exchange of both notifications (the offer from the agent and the acceptance from the institution), as mentioned in the Shari'ah Criteria for Murabahah.

<u>The need to follow the sequence of transactions</u>

It is forbidden for the agent that has purchased certain commodities on behalf of the institution to subsequently sell it before he enters into a *murabahah* contract with the institution, i.e. to purchase the commodities. This is because if he sells the commodities without first buying it from the institution, then he is actually selling something that he does not possess. In fact, he has abused the power that has been given to him. The implication of this is that strictly speaking, the agent must compensate for his misuse of power (which falls within the ambit of 'causing damage to the commodities') by paying to the institution an amount that is **equal to the current value** of the commodities, and not the contracted price. This is because the amount is compensatory in nature and not judged within the context of a sale contract. (See: The *Shari'ah* Criteria no. 20 on the matter of commodity sales in organized markets, clause 4/2 with its sections, page 342).

<u>The prohibition of stipulating that the agent must guarantee the debts of the clients</u>

Stipulating that the agent must guarantee the debts of the clients is in any circumstances, forbidden. On the other hand, it it allowed to stipulate that the agent is liable for negligence and violations of the conditions within the agency contract. Nevertheless, in the interest of risk management, it is permissible to stipulate that the clients must present a guarantee, such as collateral. Please refer to Shariah Standard no. 5 in relation to guarantees.

[The resolution of the International Fiqh Academy, no. 59(10/6) dated 1990, with reference to the symposium held in Ar-Ribaat in the year 1989 on Financial Markets. See: The Fiqh Academy Journal (no. 6, volume 21, year 1373 AH) and (no.7 volume 1, year 1373 AH)].

**<u>The necessity of reforming the international commodities market</u>**

The non-compliant practices in the international commodities market do not mean that the market itself is unlawful from the *Shari'ah* perspective. In this matter, it is appropriate to mention the resolution of the Fiqh Academy concerning the issues prevalent within the financial markets, as follows:

In light of the Shariah Standard that is premised upon permissible revenue, investment of liquidity, promoting reserves that is based on the Islamic partnership of risk and rewards, facing risks, such as risk of indebtedness.

For the role of financial markets in the exchange of fungibles and their role in promoting investment; the studies that are done with respect to the rules on fungibles will be done in response to the urgent needs of the people, to make them understand their religion as regards to contemporary issues and be in line with the classical scholars' prudent efforts in clarifying the monetary rules, in particular the rules of markets and the system of *hisbah* (weights and measures control) in the market.

This will include the secondary markets that paved the way for the investors to be familiar on how to enter the primary market and it will present an opportunity to acquire liquidity and give them more confidence in their ability to invest, with the ability to leave the market when necessary.

After knowing about the studies that have been done with respect to the system and the laws of the financial markets, and their mechanism and tools, the Shari'ah Committee has decided on the following:

Firstly, the financial markets have a duty in preserving capital and as an investment avenue, with the purpose of satisfying the general needs of the society and fulfilling money-related goals, such as with respect to religious or worldly needs.

Secondly, the current practices of the conventional centric financial markets are not good examples of how *Shari'ah*-compliant investment should be undertaken. So, collective research efforts between the modern jurists and economists need to be implemented to review the bases in which the current system is built upon. Doing so would ensure that they would attain the knowledge of the mechanism and tools that are currently used in the existing markets and subsequently modify them in light of the resolutions of Islamic law (the *Shari'ah*).

Thirdly, financial markets are premised upon managerial and procedural systems. To ensure compliance with the *Shari'ah*, the application of those systems will depend on the application of the maxim *masalih al-mursalah* (extended analogy), as long as it is based on the general sources of the *Shari'ah* and not contrary to a text or to a *Shari'ah* maxim (*qawa'id Shari'iyyah*). It is understandable that establishing financial markets is such a huge undertaking, such that it cannot be done by individuals but by the government. Having said that, it is unlawful for anyone to dissent against the government's orders, as long as the financial markets adhere to the criteria and principles of the *Shari'ah*.

**<u>Perils of extending the operations of the international commodities trading</u>**

The intensiveness of the operations of international commodities trading is considered as one of the shortcomings that requires immediate systematic rectification, as is stated in the introduction of the recommendations made during the 24th session of the Al-Baraka Symposium, as follows:

There is lack of effort towards addressing the issues that are faced by the *ummah*, including poverty, unemployment and underdevelopment. At the same time, the Islamic banks do not perform this role; rather, they conduct transactions which effectively transfer the funds of depositors and investors to other countries, i.e. through international commodity markets and through dealings in the stock markets.

Thus, the following recommendation (*tawsiyyah*) is reported in resolution (*qarar*) 2/24 of the 24th Session of the Al-Baraka Symposium:

Collectively, there are many banks that invest in a number of sectors. So, when these financial institutions establish certain rules and regulations to ensure that the investments are carried out in a *Shari'ah*-compliant manner and ensure that proper risk management practices are in place, this will assure the investors that their money is protected and they will earn some returns on their investment.

Hence, this will serve towards preventing the outflow of money to other markets, such as the international commodity markets.

This recommendation includes a request for the creation of an entity that will be a substitute to the current conventional-based markets. The experience of certain financial institutions in this area will help towards realizing this. For instance, we can benefit from the experience of the Islamic Development Bank, the Liquidity Management Centre in Bahrain, At-Tawfeeq Funds and Investment Company, and others.

In light of economic analysis, it is reported that, "The transactions of Islamic financial institutions in international commodities, in its complete form, will work towards exporting the savings (*mudakharoh*) of Muslims (who is in serious need of the commodities) to outside parties.

The *Shari'ah* boards of Islamic financial institutions have also been cautioned against dealing in international commodities, as the related contracts are full of *Shari'ah* discrepancies. Based on that forewarn, the resolutions and legal opinions are as follows:

1. What has been stated in the *fatwa* of the Shariah Board of Islamic Western Bank in Sudan, "As for the famous international commodity transactions in international stock markets, their transactions are mere form and not in compliance with the *Shari'ah*. Therefore it is compulsory to avoid them, except if the transactions are not mere form and it complies with the *Shari'ah*;
2. The *Shari'ah* adviser of the Al-Baraka Group of Companies said, "The speed of the investment operations casts more doubts on the international commodities, which in itself are full of uncertainties."
3. In one of the researches of one of the jurists, it was reported that when he mentioned the illegitimate forms of international commodities trading in the

*Shari'ah*, namely futures and derivatives, he said, "These transactions include spot sales that do not fulfill the conditions set by the *Shari'ah*, such as identifying the subject matter (*mahallul 'aqd*), distinguishing between subject matter and non-subject matter and fulfilling the condition of ownership before sale. Nevertheless, several sales happen through the exchange of papers. In most cases, these operations do not represent a specific commodity;

4. The Shariah Board of Al-Rajhi Investment Company issued several *fatwas* on the issues of dealing in international commodities; it was stated in the last verdict, i.e. no. 153 that the Board looked at the provision in the contracts of international commodities with wariness, "Deferred sale: commodities, metals and livestock. Verily, the board fears that if a great percentage of sales are concluded through dealings that involve the exchange of commodities, then this activity would not be compatible with the conditions stated in resolution no. 135 in the year 1412 AH, that is transactions/activities that are allowed based on exception must only be undertaken in as much as necessity demands it (not more than that). This is because the excessive application of such transactions will result in the non-realization of the main functions of Islamic banks and the non-realization of the aims of Islamic economics, despite the fact that those transactions (in form) may seem to be in line with the *Shari'ah*. We must also remember that *fatwas* may differ, due to differences in time, place and circumstance. The reality of it is that the stock exchange causes damages that are uncalled for.

(Muraabahaat as-Sila'u ad-Dawliyah, by Dr. Muhammad Abdul Haleem 'Umar, 'former reference' p. 1432-1435).

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