Discussions /Dialogues – Islamic Economic Forum
Topic: Contra Trading
Compiled by: M. Khalid Hasani
Date: 10/10/2016

Summary of the Discussions on

Contra Trading held in

Islamic Economic Forum

Started on 10th Oct, 2016

Brief Introduction of Islamic Economic Forum:

The Group with title of "Islamic Economic Forum" is for Islamic Economic Professionals – Sharia Scholars, Economists, Professors/Researchers and IF Practitioners for the purpose of positive discussions on various issues and challenges, facing the Islamic Economic Industry in order to explore ideas and solutions, pertaining to Islamic Economic from an economic as well as Sharia perspective. Since there are already various forums devoted to Islamic Economic, this forum is expected to have more emphasis on critical analysis as well as to make ensure you're up to date with the latest market movements, analysis, and research. The ideas generated will be for the benefit of the Islamic Economic Industry globally.

Administrative Committee of the Forum:

Dr. Abdul Bari Mashal (Head of Committee)

Dr. M. Burhan Arbouna

Sheikh Ashraf Gomma Ali

Dr. Yousuf Azim Siddiqi

Dr. M. Iman Sastra

Sheikh Ibrahim Musa Tijani

M. Khalid Hasani (Founder of the Forum)

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Preface: The discussion on the topic "Contra Trading" initiated by Sheikh Ashraf Gomma Ali

What is Contra Trading?

Contra trading is the trading of stocks without paying for them.

Brokerages do not require you to deposit cash with them before buying a stock.

Rather, after the date of a transaction, investors are given three days – known as the contra period – to transfer the cash to the brokerage as payment for the stock.

If an investor sells the shares before the end of the contra period, the trades will be offset by the brokerage. The investor will be paid any profits he made from the trades; If he incurred losses, he will have to pay the brokerage.

This buying and selling of the stock within the three-day period is known as contra trading.

Contra trading is unique to Singapore and Malaysia.

In most other countries, stock buyers have to have cash deposited upfront with their brokers. Or they would need to settle the full payment within a shorter period after the purchase.

Why is it important?

Many traders use contra trading to take punts on shares without putting money upfront. But this can be a risky enterprise.

Investors must be careful they do not buy more stocks than they can afford, as losses can be heavy if the market moves against them. (Source: sgforums.com)

Business Dictionary defines contra trading as;

Barter arrangement between two parties who exchange goods or services without any cash changing hands.

(businessdictionary.com)

Contra Trading from Sharia Perspective:

Sheikh Ashraf Gomma Ali: Respected forum members. I am currently researching the issue of "contra trading" from a sharia perspective which is basically buying and selling stocks within the T+x settlement window without having to pay the price of the shares. I would appreciate any legal/sharia resources, as well as any feedback that the respected members could give on this issue. JazakumAllahuKhair.

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Sheikh Ashraf Gomma Ali: Thanks, My main concern right now is whether the concept is sharia compliant and whether it is permissible to sell the securities before settlement has happened?

Dr. M. Burhan Arbouna: if one owns securities which settlement or payment is set for a month for example the buyer can sell the securities and receive payment now and pay the previous seller on the settlement date. settlement is not a necessary requirement to be able to sell.

Sheikh Ashraf Gomma Ali: The issue is does he actually own the securities upon buying them in a T+2 environment. If you buy today, title to the shares only transfers after 2 days. So the question is whether you can sell it before legal title has transferred to you. Also, since some jurisdictions allow you to sell the stock before settlement, are you selling something that you do not own or are you merely promising to sell (muwaa3ada)

Dr. Yousuf Azim Siddiqi: As per AAOIFI Sharia Standards, you can sell shares before settlement. Since ownership transfers with execution of Sell and Buy

Dr. Humayon Dar: In actual practice, up to T+3 settlements all the Fatwas I have come across for fund managers allow selling of stocks during this period, if the fund manager has to sell the stocks.

Mufti Irshad Ahmad Aijaz: In Pakistan Shari'ah scholars don't consider mere execution of transaction as possession. Possession will be considered on settlement date when shares appears in books of custodian company. Selling before settlement is considered as sale before taking possession [بيع ما لم يقبض/البيع قبل القبض]. Therefore, Islamic funds do not sell such shares before settlement date.

Sheikh Ashraf Gomma Ali: The AAOIFI standards don't really cover this issue deeply, even in the research papers the issue isn't addressed at all. In the US, selling the shares before settlement is considered illegal and is a violation according to my understanding. What is the general scholarly position about requiring possession before selling stocks. Of course, there is almost agreement about selling food before possession but does the same apply to stocks. I have seen opinions on both sides.

Dr. Asmadi Mohamed Naim: If I'm not mistaken at T day all rights and liability of the share have been transfered except payment settlement and legal right. As what I heard thru briefing by regulator, new buyer has to bear losses if the price goes down. As he has to bear the risk, he has all right to transact. T + 2 is merely the flexibility practices in shares trading.

Mufti Irshad Ahmad Aijaz: Sale before settlement depends on methodology of sale and purchase in that stock market. If the transactions are executed on real time basis (or what is called 'STP=straight through processing) where movement of shares takes place immediately at execution of sale then there is no issue in intra day trading. But there is a time leg between T day and settlement day then this is where scholars are not comfortable with buy-sell method. Although rules of stock trading require transfer of risk and rewards at T day when transaction takes place but legal title doesn't transfer. We asked stock brokers and related people how it is possible to transfer risk and rewards while the title is legally transferred? This issue is still under debate and lawyers here are of the view that legally title does not transfer on T day and the practice of transferring rights and liabilities is just a market practice. So the important point from Shari'ah perspective is that if any rule provides movement of risks and rewards on T day without transferring legal title will this practice be a valid practice? Till now Shari'ah opinion is against this practice of considering risks and rewards transferred before legal title transfer. Correction: We asked stock brokers . . . while the title is legally not transferred?

Sheikh Ashraf Gomma Ali: Thank you Br. Irshad. Yes, this is the operative clause in the AAOIFI standard and the main issue is definitely the liability. The AAOIFI research papers do not explain this ruling deeper in light of contemporary realities. Also, what about the requirement of qabd? Possession. Would it be safe to say that AAOIFI is taking the position here that possession (since this only happens at settlement) is not required before selling the shares as long as liability transfers at the trade date?

Just to clarify, this is a violation if you have not paid for the shares and sell them before paying for them. It's called "free riding". I'm not sure if the same rule exists in other justifications. The rationale is basically that you must take liability of the shares by actually paying for them (assuming you are using a cash account and not a margin account). Only then can you make profit from them. If you never paid for the shares then this is like their version of ربح ما لم يضمن

Dr. Asmadi Mohamed Naim: actually, no issue of legal transfer is not required becoz the regular already put a regulation that legal transfer must be petfotmed at T2.

*the regulator already put

daman is there as the seller has to bear the fluctuation of the price. I think no one said that we could not sell something that we yet to pay such as credit sale.

Dr. Hurriya El Islamy: I am rushing to attend to something at the moment. the answer is very simple, both from legal as well as shariah view point. do not focus on the problem focus on the substance. we want to have legally binding and shariah compliant transaction. so focus on the pillars, check if the pillars for valid transaction from shariah view point is met. Ownership does not always require physical possession/transfer. If all pillars are met and one is deemed the owner (despite delay in payment as acceptable practise in such area and provided both parties in the previous sale are agreeable to the delay, then we've settled shariah parts. now from legal view point, most jurisdiction applies basic contractual requirements akin to that in shariah (especially in the GCC countries as the Civil Code/Law is modelled after the Mejelleh al Ahkam). what's shariah compliant is most likely legally binding. but there may be some regulatory restrictions applicable in some jurisdiction. That the next thing you need to check. The approach in one jurisdiction may not be the same in this regards. Be specific which jurisdiction you are looking at then we may be able to share our view accordingly.

Sheikh Ashraf Gomma Ali: I believe the rationale of the US regulators is that if you buy shares and don't pay for them, the broker remains liable to pay since he is acting on your behalf with the exchange. If you sell the shares and make a profit without ever paying for it, you are making a profit on the back of the broker without ever paying for the shares. This presents a systemic risk since if the customer loses and doesn't cover the loss (or can't cover the loss) the broker will be on the hook , and if the broker can't cover the loss, then there will be a systemic risk. It seems that from a Sharia perspective, generally the practice would be ok since liability transfers on the trade date (assuming possession Is not a requirement for sale) but it is up to the regulator to set rules to minimize systemic risk.

Dr. M. Burhan Arbouna: not necessary. you can sell and make profit although you did not pay. payment is not the criteria for possession or ownership. once ownership is established it means liability is transferred and hence selling prior to payment is valid.

Sheikh Ashraf Gomma Ali: Thank you for your feedback. I am saying this from a regulatory perspective in the US, not a sharia perspective.

Please find the regulatory response below:

https://www.sec.gov/answers/freeride.html

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Dr. M. Iman Sastra: There are some points I want to comment regarding this contra trading, its a brother/sister of short selling if I can say that...
From sharia or legal point of view, there are some point we have to ensure, this is also to avoid systemic risk on that transaction.

1. We have to ensure first is the broker oblige the participant in this contra trading to have enough fund to do this transaction? If yes, I have no issue then. If no, then the transaction is just like speculation (this is need more discussion).
2. In normal transaction with the broker, we dont need to pay at the beginning, they will just set off our position, either we are in loss or in profit, if we are in loss, they will deduct our account, if we are in profit, they will add our account. So there is no need for payment at the beginning
3. The risk in this transaction is the same risk that applied in normal buying and selling, but constrained with the time (T+3), if the participant not well-informed pertaining to the shares that he wants to buy, he will incur big loss or vice versa
4. From sharia, to what extent sharia allow speculation? (This is need also more discussion)
Because Bursa Suq Al Sila Malaysia they are also doing transaction based on T+3, where the buyer will receive the legal ownership of the asset after maximum 3 days
5. The issue of Qabh (القبض) either hukmi of haqiqi, this is also discussed by sharia scholars, from the discussion it is agreed that, the concept pf qabh it will be depend on the practice of that particular jurisdiction. There is also T+3 months (maybe more) in case of Lc export import from the different countries that also acceptable, and depend from the decision of that particular Sharia Boards
This topic also good if someone make research on it either from legal, sharia pr economic