FIQH ISSUES AND OPERATIONAL PROBLEMS IN CONTEMPORARY PRODUCTS: SPECIAL FOCUS ON COMMODITY TRANSACTIONS

Dr. Aznan Hasan,
Ahmad Ibrahim Kulliyyah of Laws, IIUM.
Shariah Advisor, Bursa Malaysia
azan98@hotmail.com
haznan@iiu.edu.my
Content:

- Commodities Transactions in both organised and unorganised market
- Tawarruq transaction using commodities as underlying
- The Proposed Bursa Malaysia CMH
- Mapping this proposal with AAOIFI Shariah Standard on Tawarruq
- Conclusion
SECTION 1: Commodities Transactions in both organised and unorganised market

- Commodities transactions happen in both international and domestic level, whether they are in organised or unorganised market
- Various Shariah Rulings must be observed to comply with Shariah
Commodities Market

- Unorganised: OTC based transactions
  - Spot Contract
  - Forward contract
  - Option
- Organised Market
  - Futures Contract
  - Option
  - Swap
- Shariah Rulings
Some Shariah Issues in Commodity Transactions (1)

- Sale Contract in Commodities:
  - All requirement of valid sale contracts
  - Type of Commodities: Spot or Deferred
  - Existence and Ownership when selling
  - Taking of Possession when reselling
  - Ascertainty of SM and price
  - No condition of non-taking of delivery
Some Shariah Issues in Commodity Transactions (2)

- **Forward Contracts:**
  - Not allowed to defer both counter values, except when it is istisna’ contract
  - Deferment in price: BBA
  - Deferment in SM; Salam

- **Future Contracts:**
  - AAOIFI
  - SAC of SC
Some Shariah Issues in Commodity Transactions (3)

- **Option:**
  - Conventional option is not allowed
  - May use urbun to replicate option
  - Also Wa’ad
  - Not tradable: No possibility for organised market
Some Shariah Issues in Commodity Transactions (4)

- Appointment of Agent / mudharib to conduct the trading (buying and selling) ➔ wakalah bi istithmar vis-à-vis mudharabah
- Selling of the commodities to the agent: Issues of right and liability. Also compared with Tawarruq procedure
Commodities based Structured Products
  - Using Salam as contract. Buying and selling of commodities using parallel salam
  - Commodities Indices based Structured Product
    - Using Murabahah contracts where the returns on the investment is linked to commodities indices,
    - e.g. Maybank Structured Islamic Deposit Stride-I, using LME Copper Spot and CBOT wheat spot as reference underlying
    - What about using conventional index, e.g. futures commodities index?
SEC 2; TAWARRUQ TRANSACTIONS UNSing COMMODITIES AS UNDERLYING

- Commodities are also used in the practice of tawarruq transaction.
- The rulings of Shariah are more stringent to avoid the tawarruq munazzam (organised tawarruq) situations.
- The proposed Bursa CMH is used as example here
1. CPO Owner sells Commodity straight to Islamic Bank via Broker (A).
2. CMH guarantees the performance of CPO sellers.
3. Islamic bank (A) sells commodity to its client or another Islamic bank (B)
4. The Client or Islamic bank (B) appoints Islamic bank (A) to sell commodity to CMH via Broker (B)
TO TAKE DELIVERY OF COMMODITY:

- Process flow is the same as shown previously for step 1 – 2
- Step 3 – Buyer indicates to CMH through Broker on intention
- Step 4 – CMH acknowledge and inform CPO owner
- Step 5 – Buyer proceed with licensing under MPOB
- Step 6 - Buyer’s CM-CPO cert endorsed by CMH
- Step 7 – Buyer present CMH endorsed CM-CPO cert to CPO owner to take delivery
APPLICATION OF AAOIFI SHARIAH STANDARD ON TAWARRRUQ FOR THIS STRUCTURE

- AAOIFI has issued Shariah standard on the application of tawarruq (Shariah Standard No. 30)
- Definition: Procedures where two contracts will be executed. First contract involves the purchasing of commodity on deferred (murabahah or musawamah). Second contract involves the selling of the commodity to third party on cash basis. (Standard no 30 -2).
Illustration

Mutawarriq (Client)

Sells Commodity (contract 1)

Pays deferred

Sells Commodity (Contract 2)

Buyer

Seller (Bank)

Pays cash
Two Examples of Application (No 30/3)

- 1) When the financial Institution is the mutawarriq (e.g. interbank placement or murabahah deposit)
- 2) When the client is the mutawarriq (e.g. personal financing)
When Financial Institution is the mutawarriq (e.g. interbank placement)

1. Bank A buys on spot basis RM 5M worth of CPO from Supplier
2. Bank A pays RM5 M cash
3. Bank A sells CPO to Bank B at RM5 M plus profit payable on a deferred payment basis
4. Bank B sells on spot basis RM 5M worth of CPO to CH
5. CH pays RM5 M cash
When Financial Institution is the mutawarriq (e.g. Murabahahah Deposit)

1. Bank A buys (on behalf of the depositor) on spot basis RM 5M worth of CPO from Supplier

2. Bank A pays RM5 M cash

3. Depositor sells CPO to Bank A at RM5M plus profit payable on a deferred payment basis

4. Bank A sells on spot basis RM 5M worth of CPO to CH

5. CH pays RM5 M cash
When the client is the mutawarriq (e.g. personal financing)

1. Bank A buys on spot basis RM 5M worth of CPO from Supplier

2. Bank A pays RM5 M cash

3. Bank A sells CPO to client at RM5 M plus profit payable on a deferred payment basis

4. Client appoints Bank A to sell on spot basis RM 5M worth of CPO to CH

5. CH pays RM5 M cash
### Application of the AAOIFI Shariah

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<thead>
<tr>
<th>Conditions (AAOIFI)</th>
<th>Application</th>
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<tr>
<td>The commodity must be specified and all specifications must be mentioned clearly</td>
<td>The commodity is specific and identifiable</td>
</tr>
<tr>
<td>All conditions for sale contracts (murabahah or musawamah) must be fulfilled</td>
<td>Yes</td>
</tr>
<tr>
<td>Must be deliverable and the parties are able to take possession (al-qabd), actual (Haqiqi) and constructive (Hukmi)</td>
<td>Deliverability and taking possession are two main features of the contract</td>
</tr>
<tr>
<td>The two contracts must be concluded separately, and shall not be made contingent one to another</td>
<td>Yes</td>
</tr>
<tr>
<td>The parties must be able to take delivery</td>
<td>Yes, the structure will allow for the taking of delivery. In fact all parties can take delivery after they buy the commodities</td>
</tr>
<tr>
<td>Conditions (AAOIFI)</td>
<td>Application</td>
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<tr>
<td>The client may be charged the cost of delivery, but must not change the price</td>
<td>Yes, the client is charged the cost of delivery, but this would not effect the price.</td>
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| The client should not delegate the institution or its agent to sell, on his behalf, a commodity that he purchased from the same institution and similarly the institution should not accept such delegation | Two situations:  
1) If the client is another bank, that bank can sell directly to the market, and the structure will allow such practice  
2) If the client is not a bank, the client must appoint the bank the be its agent to contract, because the client has no access to the market.  
⇒ Some Practices                                                                                                                                 |
| If, however, the regulations do not permit the client to sell the commodity except through the same institution to so after he, actually or impliedly, receives the commodity |                                                                                                                                                                                                           |
| The facility should not be extended to non IFI                                   | Only Islamic FI has the right to deal with the market                                                                                                                                                     |
| IFI should not resort to this facility except in case whereby other avenues are not possible | For the respective bank and its Shariah advisors to determine                                                                                                                                              |
THANK YOU
WASSALAM