

Islamic Tradable Instruments

Basic Building Blocks

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ABSTRACT

Because Muslim investors have very few *halal* ways to actively trade in the securities market, there is a dire need to develop actively tradable Islamic instruments. True Islamic instruments can only be developed with three factors in mind: 1) an appreciation of today's securities market; 2) a sound awareness of the essential characteristics for their successful application; and 3) a thorough understanding of the *Shari'ah* principles for their structuring. Although professionals in the securities market are often aware of the first two factors, they lack the knowledge of the *Shari'ah* that is essential for structuring such instruments. This paper focuses on providing simple explanations of some *Shari'ah* concepts that must be understood before developing Islamic tradable instruments. The *Shari'ah* perspectives on partnership, co-ownership, debt transfer, agency, and property are discussed.

I. INTRODUCTION

Islamic finance presently has very few financial instruments through which Muslim investors can actively trade in the securities market. Under specific *Shari'ah* guidelines, trading in company stocks (shares) is allowed. *Shari'ah* scholars allow investment in the shares of companies whose interest-based debt is less than 33% of total debt and interest-based income does not exceed 10% of total income. Of course, investment is forbidden in companies engaged in *haram* activities such as the production of alcohol and pork or gambling. Various funds (established under *Shari'ah* guidelines) do not allow active trading and are mostly avenues of medium- to long-term investment. There is thus a need to develop instrument(s) that would allow Muslims to actively trade in securities while providing opportunities for short-, medium-, and long-term investment.

The term "Islamic tradable instruments" here means securities that can be structured in accordance with *Shari'ah* principles. Under the conventional system, the simplest tradable instruments or securities are shares that are traded in the stock market. This paper will use the trading of shares in a company as a basic example. It will highlight and briefly discuss relationships between different parties involved in share trading. Each element discussed here is a subject in itself. At this stage, it is necessary to start with the very first step—developing an understanding of some vocabulary and concepts of conventional and Islamic law. Grasping the two will assist one in studying, at a more advanced level, the structuring of other tradable instruments that comply with Islamic legal principles.

II. BASIC STEPS IN TRADING SHARES IN THE STOCK MARKET

Assume that a company has listed shares for trading in the stock market. Investors (individuals or corporations) purchase shares of the company from other existing common shareholders through stock-market operations. The stock market also determines the price of shares, which reflect a company's management, demand for its business/services, valuation (as assessed by the market) of company assets, and past, present, and future financial performance. Brokerage houses or individual brokers are authorized agents who assist investors in buying shares from existing shareholders who want to dispose of them in the stock market.

A. Parties Involved in Share Trading

To illustrate these relationships, it is useful to imagine a juristic (legal) person or entity named XYZ Incorporated. Parties involved besides the company include: 1) sponsors who form a company; 2) existing shareholders; 3) a potential investor interested in buying company shares; and 4) broker(s) who assist potential investors in buying and existing shareholders in selling shares. Before going further into the details of these

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relationships, we will briefly examine the conventional and *Shari'ah* definitions of the parties and elements involved in share trading.

1. Company (Legal/Juristic Person or Entity)

a. Conventional Definition

A company is an association of a number of persons for a common purpose, frequently for running a business with a view to profit. The term is, however, often used for associations that are legally partnerships or even sole proprietorships.

Members of a company are constituted by subscribing the Memorandum of Articles of Association or by subscribing of shares by purchasing shares.

A company is managed by a board of directors, which are the trustees of the company's interest and property, but not trustees of shareholders or creditors. They are also the company's agents for transacting business with other parties.

b. Shari'ah definition

In the words of Justice Taqi Usmani, the concept of a juristic person, as envisaged under the modern economic and legal system, has not been common in Islamic law, yet there are precedents from which the basic concept of a juristic person may be derived.

The first precedent is that of *waqf* (charitable trust), which is a legal and religious institution. In *waqf*, a person dedicates some of his property to a religious or charitable purpose. The property as such no longer belongs to its former owner. It seems that Muslim jurists have treated *waqf* as a separate legal entity and have ascribed to it some characteristics peculiar to that of a real person.

The example closest to the concept of a joint stock company as a juristic person is found in the *fiqh* of Imam Shafi'i. According to the Shafi'i school, if more than one person runs his in a common shop, where their assets are mixed with each other's, *zakat* will not be levied on each of them individually but will be paid on their joint stock.ⁱ

According to Imran Ahsan Khan Nyazee, the concept of a corporate (fictitious) personality (*shakhsiyah i'tbariyah*) has been a subject of prolonged debate in Islamic law. Most modern scholars believe that the concept was known to Islamic law, while a minority doubts whether Islamic law was aware it.ⁱⁱ However, in his books *Islamic Law of Business Organizations* and *Corporations and Islamic Law*, Nyazee discusses and suggests the structure of a company as a legal person.

If *Shari'ah* scholars accept the trading of shares in a company, it implies that scholars do accept a company as a juristic person/entity. However, the subject of limited liability, which is beyond the scope of this paper, remains a debated issue among Muslim scholars.

2. Broker

a. Conventional Definition

A broker is an agent working for his client (investor) and has fiduciary responsibilities. He must act in accordance with his instructions and execute each transaction to the best advantage of his client according to his judgment at the time of dealing. The broker is entitled to indemnity from the client against any liability incurred by reason of his having contracted on the latter's behalf. Contracts of sale and purchase are also often made orally between the broker and the client.

b. Shari'ah definition

The concept of agency (*wakala*) in Islamic law is discussed below in section VI. This is explained in the section "Relationships," where the broker-client relationship is covered. One can notice several similarities between the concept of agency in Islamic and secular law.

3. Shareholders

a. Conventional Definition

Shareholders are the owners of fractional parts of the company, depending on the number of shares they hold. There may be several kinds of shares with different rights attached, particularly respecting the distribution of profits.

b. *Shari'ah definition*

The concept of co-ownership is discussed below in section IV.

4. Securities

a. *Conventional Definition*

Securities are viewed as evidence of money claims and financial assets. Securities are very similar to debt, as both are obligations of one party to pay money or its cash equivalent to another. Whereas loans (a form of debt) are contracts, securities become personal property.

5. Common Stock

a. *Conventional Definition*

Equities, or equity securities, issued as ownership shares in a publicly held corporation are called common stock. Shareholders have voting rights and may receive dividends based on their proportionate ownership.

B. Relationships between Parties Involved in Share Trading

TABLE 1. POSSIBLE RELATIONSHIPS IN SHARE TRADING

Parties	Relationship
1. sponsors of a company	partnership (<i>sharikat al-'aqd</i>)
2. common shareholders and a company	co-ownership (<i>sharikat al-milk</i>)
3. common shareholder selling shares and potential investor	transfer or assignment of debt (<i>hawala</i>)
4. investor and broker	agency (<i>wakala</i>) and lease (<i>ijara</i>)

The sponsors of a company form XYZ Inc. by a partnership (*sharikat al-'aqd*) among themselves. The second relationship (*sharikat al-milk*) exists between common shareholders and XYZ Inc. (or its sponsors). Third, when an existing shareholder transfers a piece of his ownership to a new investor, a transfer or assignment of debt (*hawala*) occurs. Finally, the investor/broker relationship involves agency (*wakala*) on the part of the broker who buys shares for the investor and lease (*ijara*) between the two persons. It is to the *Shari'ah* perspectives on partnership, co-ownership, debt transfer, agency, and property that this paper now turns.

III. PARTNERSHIP

Under secular law, partnership is defined as the relationship that subsists between persons carrying on a business, including every trade, occupation, or profession, in common with a view to making profit. The individuals who constitute partnerships are collectively called the "company" or "firm" and they conduct their business under the firm's name. Partnership is not necessarily created by co-ownership or by sharing gross returns, though sharing

profits and losses is indicative of partnership. Partnership is usually constituted by a written agreement or contract. It is presumed on mutual trust and confidence, and the utmost good faith is required in the relations of partners.

Under Islamic law, there is no single definition that covers the different type of partnerships. The definition of each is based on the conditions and rules that govern the relationship. Partnership refers to the relationship among a company's sponsors. This section discusses partnership through contract (*sharikat al-'aqd*). As soon as there is an investment through capital for profits, *sharikat al-milk* changes into *sharikat al-'aqd*.

TABLE 2. DEFINITIONS OF *SHARIKAT AL-'AQD* IN THE DIFFERENT SCHOOLS

School	Definition	Comment
Hanafi	<i>Sharikat</i> is an agreement between two or more persons for common participation in capital and profits. ⁱⁱⁱ	The Hanafi school mostly discusses partnerships in wealth and/or capital. This definition only discusses partnership through wealth. All other partnerships, including <i>mudaraba</i> , are excluded from this definition.
Hanbali	<i>Sharikat</i> is a partnership of two or more persons in a transaction. ^{iv}	
Maliki	<i>Sharikat</i> is permission, from each of the participants to the others, for transaction in his wealth and on his own behalf, while retaining the right to transact personally (in such wealth). ^v	In this definition, only partnership in wealth is discussed. All other partnerships, including <i>mudaraba</i> , are excluded.
Shafi'i	<i>Sharikat</i> is mixing and technically it is an established, undivided right in a single thing or a contract implying this. ^{vi}	This definition is restricted to co-ownership or participation in wealth because other forms of partnerships are not valid according to the Shafi'i school. This school only accepts <i>sharikat al-milk</i> and a restricted form of <i>inan</i> based on <i>mal</i> .

A partnership has several basic elements. Its purpose of a partnership may be trading, a business venture, or something else. The underlying relationship may be by way of capital or skills. Each partner may contribute one or the other or both. While a partnership can not be formed without an agreement or contract, for co-ownership it is not necessary to have an agreement or contract.^{vii} The contract must indicate the main purpose of forming the partnership: sharing profits/income, trading, etc.

IV. CO-OWNERSHIP

Co-ownership in Arabic is called *sharikat al-milk* or *musha'*. According to Islamic law, there are three basic kinds of alliances (*sharika*): *sharikat al-ibaha* (common sharing of things); *sharikat al-milk* (co-ownership); and *sharikat al-'aqd* (partnership through contracts). Furthermore, under Islamic law there is no single definition that covers the different types of partnerships. The definition of each is based on the conditions and rules that

govern the relationship. Trading in shares is governed by the concepts of both co-ownership and partnership. As soon as there is an investment through capital for profits, *sharikat al-milk* changes into *sharikat al-'aqd*.

Co-ownership in *'ayn* (ascertained property; discussed below in VI. Property) is defined as “the joint and exclusive ownership of two or more persons resulting from the cause of ownership, like purchase, inheritance, or by the mixing (*khalt*) of their property in a manner that does not accept distinction of separation.”^{viii}

The concept of *sharikat al-milk* is very important to understand for business purposes for two reasons. First, it is not a partnership; it is co-ownership. The co-owner is a stranger (*ajnabi*) with respect to the share of the other co-owner, and therefore cannot use or dispose of the shares of the co-owner without his or her permission. Second, according to the Hanafi jurist Ahmad bin Mohammad Al Qaduri, “*Sharikat al-milk* can occur when two or more people inherit or purchase anything together.”^x No party may dispose of any other’s portion without that other party’s permission. Each of them is a stranger in regard to the portion of his colleague(s).

According to Sarakhsi, *sharikat al-milk* occurs when two or more people are partners in the possession of property. This can be of two types. One, the partnership becomes effective without any action on anyone’s part, such as in the case of inheritance. Two, the partnership becomes effective through the parties’ own actions, as in the acceptance of a gift.

Sharikat al-milk (co-ownership) is an extremely important concept. Under it, the division of revenues always follows the ratio of shares. When *sharikat al-'aqd* (partnership through contract) is either unenforceable (*fasid*) or void (*batal*), the rules for the sharing of earned profits and the division of property revert to the rules for *sharikat al-milk*.

TABLE 3. DIFFERENCES BETWEEN CO-OWNERSHIP AND PARTNERSHIP

Co-Ownership (<i>Sharikat al-Milk</i>)	Partnership (<i>Sharikat al-'Aqd</i>)
The division of revenues and usufruct always follows the ratio of shares.	The profit- or loss-sharing ratios can be altered.
The relationship between the co-owners is that of strangers (<i>ajanab</i>), but if authority is granted, the rules of agency take over.	The contract of partnership establishes an agency relationship.
Sharing of profits is not necessary.	The partnership contract causes profit sharing.
The co-owner may sell his or her interest to a stranger. When the shares of co-ownership are partitioned or apportioned, sale by a co-owner becomes possible without the permission of the other co-owner(s). ^x	A partner may not sell his or her share in the partnership without the permission of the other partners. ^{xi}
Co-ownership is terminated as soon as the mixing of shares (<i>khalt</i>) is destroyed.	A partnership contract requires a formal termination.

On the one hand, the co-ownership relationship between common shareholders is that of strangers since shares are issued (partitioned) and owned (apportioned) in a specific number and a common shareholder can sell

them without the permission of the other co-owner(s). Co-ownership is terminated as soon as the shares are sold. On the other hand, the relationship is also governed by the contract of partnership. Shares are proof of an individual's investment in a company, and this "contract of partnership" causes the sharing of profits (i.e., dividends). Depending on the type of shares, profit sharing can be altered. At a sponsorship level, the partnership contract most often does not allow a sponsor to sell his or her shares without the permission of other sponsors. Also, under the sponsor/partnership contract, existing sponsors usually have the first right of refusal to buy shares from another sponsor who is selling them.

V. DEBT TRANSFER

Ownership in a corporation is represented by shares, which are claims on the corporation's earnings and assets. Securities or shares are like debt. Both are obligations of one party to pay money or its cash equivalent to another. Both can also be viewed as evidence of money claims and financial assets.^{xii} The main distinction between them is that debt is less amenable to trading than securities. Whereas loans are contracts^{xiii}, securities become personal property.

An existing shareholder (C) may dispose of (sell) its share to a potential investor (B). This introduces the concept of debt transfer, which in Arabic is called *hawala*.^{xiv} The term literally means "to turn over or transfer a debt." A *hawala* can also be defined as "transfer of a claim of debt" by shifting the responsibility from one person to another. It is an assignment of debt and is a way of eliminating an obligation by transforming it into a new one. The *hawala* is an agreement by which a debtor is freed from his debt by another's becoming responsible for it.

A comparative analysis between buying shares issued by a company and buying shares in (portions of) a house is provided primarily to indicate that the company being treated as a legal person is a separate entity and is treated as such as a person in the *hawala* concept. By contrast, a house is just an asset in which an individual may buy shares. Since the house is a non-entity, relationships exist only between buyer(s) and seller(s).

TABLE 4. A SAMPLE COMPARISON AND CONTRAST

Buying Securities Issued by a Company	Buying Shares in a House
Relationships exist among the company (A), potential investor (B), and existing investor (C).	Relationships exist between the owner/shareholder(s) (A) and the potential investor (B).
A company is an entity, an artificial person. It is not an asset, but rather owns assets.	A house is not an entity but an asset.
<i>Hawala</i> applies only to a simple triangular situation: there can only be 3 parties.	There can be any number of parties.
A owes money to C. ^{xv} As proof of this liability, A gives securities to C.	The house (a nonentity) does not owe any money to C or B.
If B, in addition to C, is allowed to buy shares of A, then the liability of A will increase. ^{xvi}	If B wants to buy shares of the house, it simply becomes a co-owner in the house.
How does B buy shares of A? Follow the <i>hawala</i> rule:	How does B buy shares in the house?

<p>If A owes C and B owes A, then B owes C.</p> <p>A “turns over” B to C in a <i>hawala</i> transaction. That is, A assigns B to pay off C, and thus securities from C are transferred to B, making A now an obligor to B.</p>	<p>It simply acquires the shares from C.</p>
<p>The securities are traded in the market at face value.</p>	<p>The real estate market determines the house’s worth at the time its shares are bought.</p>

A. Fundamental Principles of *Hawala*

Hawala transactions must comply with several rules to ensure that they are valid under Islamic law. First, the debt must be both determined and due. Second, *hawala* is restricted to type of assignment: A is indebted to C for precisely the same amount that B is indebted to A. Third, *hawala* is valid when it is contracted as a result of mutual consent between the debtor (*al-muhil*), the delegated payer (*al-muhal ‘alayh*), and the creditor (*al-muhal*). Fourth, no obligation may be left without being paid. Thus, in case of death or bankruptcy of the delegated payer, the obligations to pay the debt return to the transferor.^{xvii}

B. Participants in *Hawala*

1. *Al-Muhil*

The debtor, or the one who owes, is designated A in this discussion. A company or a corporation is an artificial person, a legal entity, and a juristic person that is created by or under the authority of the law. Because it is distinct from the individuals who comprise it (i.e., its shareholders), a company survives the death of its investors. A company therefore has a personality and existence distinct from those of its members.

2. *Al-Muhal ‘Alayh*

The delegated payer is here designated B. When B wants to buy shares in A, it becomes a delegated payer who is willing to pay the amount owed to C by A. In other words, B is “turned over” to C.

3. *Al-Muhal*

The creditor, or the one who is owed, is designated C. When an investor buys the securities issued by a company, the ownership of money is transferred to this entity. Thus, the investor is like a creditor and the corporation is like a debtor. Securities issued are represented on the liability side of the corporation’s balance sheet. Moreover, the investor receives the securities, which constitute proof of investment. The money is a credit that the investor has given to the company. The securities are also the investor’s proof to seek returns from the company.^{xviii}

C. Can Shares Be Pledged? An Introduction to *Hawala*

Pledging is defined as “transferring property as a collateral for an obligation.” A pledge does not involve a transfer of title. Suppose A pledges shares to B and borrows money against these shares. A has transferred to B the right to claim money from the issuing company. Since ownership of the underlying property is not transferred, it is the transferor’s obligation to pay the debt.^{xix}

D. Fundamental Rules For Sale

Several basic rules apply to *hawala* (debt-transfer) transactions. Debt (what one owes) can not be sold, but it can be transferred. Credit (what one lends) can be neither sold nor transferred. The Prophet Muhammad is reported to have said, “Do not sell a thing that is not with you.” Thus, a vendor must be able to deliver the sold commodity to the purchaser, and any commodity that is non-existent or not deliverable may not be transacted.^{xx}

VI. AGENCY

The relationship between a common shareholder (investor) and a broker (brokerage house) is a principal-agent relationship where the investor hires (or leases by *ijara*) the services of the brokerage house. An agency

(*wakala*) is a contract by which one person represents another as the latter's agent. A *wakala* contract can be void at the will of either party. For Hanbalites, it does not even require a notice. However, according to Hanafi law, it can only be revoked after the agent learns of the termination.^{xxi}

To distinguish between the rights and responsibilities of the principal (*muwakkil*) and the agent (*wakil*), the Hanafi school goes into more detail.^{xxii} In this school, the rights of performance (*huquq*) belong to the agent, while the effects of the contract (*hukm*) belong to the principal. *Huquq* refers to the means adopted to achieve the main objective. Thus, carrying out the orders of the principal is the responsibility of the agent. For instance, if an agent buys shares for a principal, then the delivery of the shares is the responsibility of the agent. The principal cannot be sued for poor performance. *Hukm* means the effects that follow the actions of the agent. As such, in the case of share trading the title of the shares will always pass on to the investor. The liability (*dhimma*) of the agent is not affected. If the principal does not make payment for the shares, the agent is not liable.^{xxiii} The agent, under Islamic law, cannot be sued for the principal's non-payment.

A. Services Hired by the Investor from the Stockbroker

The investor hires (leases) the services of the broker. Lease/hire known as *ijara*, *kira*, or *iktara* is a bilateral contract of tenancy. It derives its names from the terms *ajr* (rent) and *ujra* (salary). Lease is defined as the transfer of usufruct (*manfa'a*) for a consideration. The consideration can be rent (*ajr*), such as in case the object hired is a car or house, or wages (*ujra*), if a skill (such as of a brokerage house) or a person (e.g., a driver) is hired.

The hirer or lessee is called the *ajir*, *mawjir*, *mukari*, or *muktari*. The person who receives the rent, the lessor, is the *mustajir*. A lease is a bilateral contract where one object is exchanged for another. Receiving the object sold (shares) engenders the obligation to pay an equivalent (brokerage fee). In *ijara*, the brokerage fee is considered equivalent to receiving the object.

An *ijara* contract is a valid one because the Prophet Muhammad said, "Pay the hiring his wages before the sweat on his brow has dried." At another place he stated, "If a person hires another, let him inform the other of the wages he is to receive." Furthermore, an *ijara* contract is a *darura* (necessity) and is thus *isthisan* (admitted for practical purposes because it is a general economic necessity).

There are two kinds of *ijara*: *manfa'a al 'ayn* (lease of property or capital assets, such as houses, cars, factories, and machinery); and *manfa'a al 'amal* (employment of labor or services, such as engineering, banking, or carpentry work).

Five fundamental rules apply to leasing services (*manfa'a al 'amal*). First, the leased assets must be fully identified by both the lessee and the lessor. In the case of brokerage services suggested in Table 4, the use of *manfa'a al 'amal* would entail defining the responsibilities of the broker (as agent) and the investor. Second, the property/asset—the enjoyment or use of which is the object of the contract—must exist. Shares are considered personal property. Third, the nature of the usufruct (*manfa'a*) must be defined, be it the use of property or the services of a person. Fourth, rent or wages must be specified. Finally, the time period for the hire/use must be clearly spelled out.

TABLE 5. EXAMPLES OF THE TWO KINDS OF *IJARA*

	Renting Property (<i>Manfa'a al 'Ayn</i>)	Employment of Labor (<i>Manfa'a al 'Amal</i>)
Object	a house	brokerage services
Purpose	Renting	to buy shares of a company
Tenure	1 year	usually the same day
Price	\$50/month	agreed brokerage commissions

B. Can Shares Be Rented?

To answer this question, one would have to review the principles governing *ijara*. For purposes of argument, suppose that shares can be rented. Then the *ijara* rules can be applied as in the following hypothetical situation.

TABLE 6. APPLICATION OF *IJARA* RULES TO STOCK SHARES

	Renting Property (<i>Manfa'a al 'Ayn</i>)	Comments	Permissible
Parties	Shareholder and lessee (X).	Okay as per rules of <i>ijara</i> .	Yes
Object	Shares are not tangible property (<i>'ayn</i>). Rather, shares are <i>dayn</i> , which is like a claim or proof of co-ownership.	For the shareholder, shares are just an evidence of money claim on the company. A claim can not be rented.	No
Purpose	Say, to earn the dividends of the company.	The company may or may not have an income during the respective year. This introduces an element of uncertainty or chance (<i>gharar</i>).	No
Ownership	Assuming that the shareholder is the co-	If the assets of the company are destroyed, the shareholder can not	No

	owner, all liabilities emerging from ownership are owner's responsibility	charge rent from X. Doing so would be an unjust gain (<i>riba</i>).	
Tenure	1 year	The rental period agreed upon between the shareholder and X.	Yes
Rent	\$100/year	See comments for Purpose. If the company pays no dividend, the rent is an unjust gain (<i>riba</i>) to the lessor.	No

As discussed, shares are similar to debt. Also, under Islamic law, debt can be neither sold nor rented. Thus, shares can not be rented. From a different perspective, the only reason one may possibly rent shares is to earn the dividends of a company. If the company does not declare any dividend for the period the shares are rented, the rental income earned by the lessor would constitute *riba*. Also, since the company can not beforehand specify its future dividends, the resulting element of uncertainty (*gharar*) is a possible disadvantage to the lessee (i.e., the person who rents shares in this example). Thus, shares can not be rented.

VII. PROPERTY

Property in Arabic is called *mal*. The word *mal* is related to *mulk* and implies the exercise of ownership rights over things owned. Three of the different schools of Islamic law define ownership as follows.

1. The Hanafi school considers it "the right of absolute and exclusive control and disposal of a thing."^{xxxiv}
2. In the Hanbali school, ownership is "a legal authority justifying the right of disposal."^{xxxv}
3. The Maliki school considers "ownership as a legal authority that allows a person or his delegate to process the use of ownership rights, and also to accept compensation in case of transfer of owned properties or use rights to others."^{xxxvi}

A. The Spectrum of Legality

The concept of property in Islam embraces everything that God permits. Hence, it is necessary to understand what is permissible or allowed in Islam. Which acts, rights, obligations, and objects are permissible? What can be owned and possessed? What must be avoided, what is not preferred, and what is completely prohibited? Islam defines five degrees of permissibility and applies it to everything from personal affairs to commercial dealings.

TABLE 7. DEGREES OF PERMISSIBILITY

Category	Arabic Term	Comments
mandatory	<i>wajib</i>	A Muslim must do <i>wajib</i> acts and will be punished for neglecting them. This includes obligations such as prayers and <i>zakat</i> .
recommended	<i>mustahab</i>	<i>Mustahab</i> activities are preferable to do. There is reward in doing them, but no punishment otherwise. This category includes

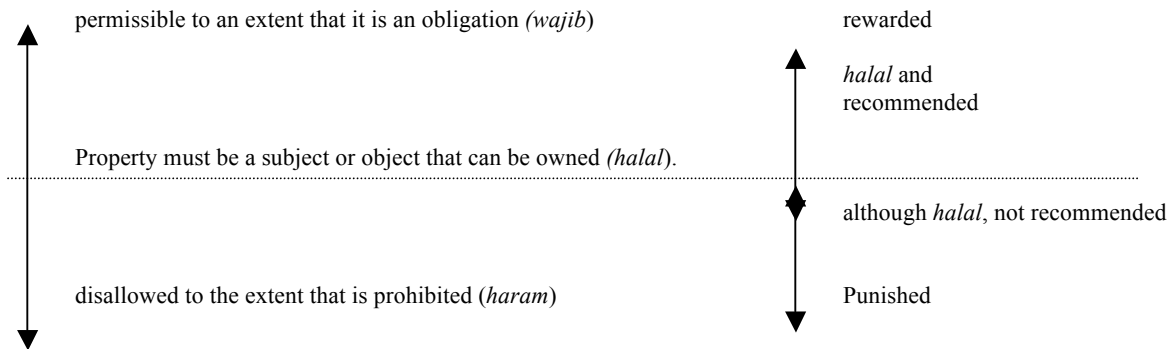
		charity and <i>nafl</i> prayers after the obligatory prayer.
permissible	<i>mubah</i>	The <i>mubah</i> category comprises acceptable/legal private and public dealings and objects. There is no reward or punishment.
not recommended	<i>makruh</i>	It is better to avoid what is <i>makruh</i> : those who engage in what is <i>makruh</i> will not be punished, but people who avoid it will be rewarded.
prohibited	<i>haram</i>	<i>Haram</i> actions and things must be avoided. If they are not, one is punished.

TABLE 8. REWARD AND PUNISHMENT POSSIBILITIES

Category	Reward Possible	Punishment Possible
required/wajib	X	X
recommended/mustahab	X	
permissible/mubah	No reward	No punishment
not recommended/makruh	X	
prohibited/haram	X	X

An object or subject of property must be at least permissible (*mubah*). That is, it must be Islamically allowed/accepted, justifiable/proper, legal/authorized, and legitimate/rightful. For example, both wine and pork are allowed, justifiable, legal, and legitimate under secular law.^{xxvii} However, under Islamic law, both objects fall into the last category of prohibited items and actions.^{xxviii}

FIGURE 1. RELATIONSHIP BETWEEN DEGREE OF PERMISSIBILITY AND CONSEQUENCES



Under conventional law, property can be real or personal, tangible or intangible, and visible or invisible. Physical property at a basic level is divided into two categories: real and personal. Real property is a fixed, immovable, and permanent thing, whereas personal property is readily mobile, often easily consumed and destroyed, and is regarded as something impermanent or transient. Other characteristics that property in secular law might have include interest or rights, a value in exchange, and usufruct (the legal right to use something).

B. Property Classifications

Islamic law, strictly speaking, does not define property as real/personal or tangible/intangible. It categorizes property that is visible, existing, specific, and unique as *'ayn*, while something invisible, such as an obligation, a responsibility, or a claim, is called *dayn*. *'Ayn* is a specific, existing thing and is considered a unique object. *Dayn* is a property that is not an *'ayn* that, for instance, a debtor owes now or in the future.

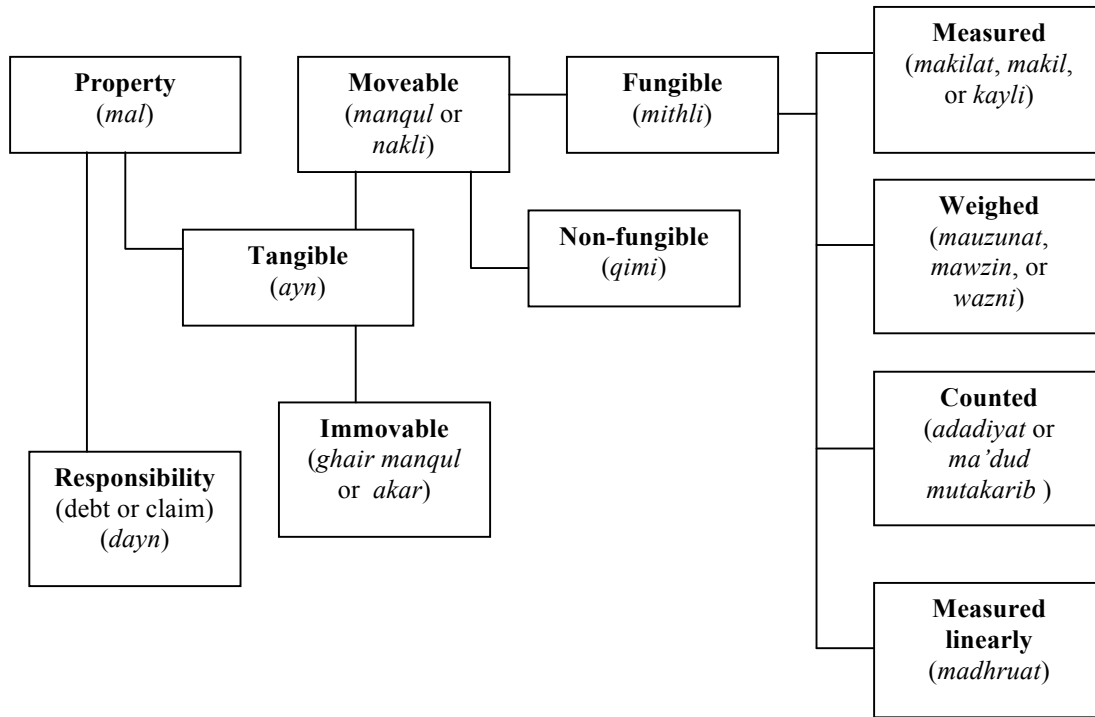
Dayn literally means debt. In *fiqh* it refers not only to an obligation per se but also to property that is the subject of the obligation and is already owned by the creditor.^{xxix} Examples of *'ayn* are “my house” and “my brown bag.” An example of *dayn* is “the claim on the book for which I have lent \$100 to Ayesha.” The Arabic for obligation is *dhimma* (liability), which literally means compact, bond, obligation, responsibility, protection, or security. Vogel and Hayes also define *dayn* as “property subsisting in the *dhimma*” of the obligor.

An *'ayn* (property) can be movable (*manqul* or *nakli*) or immovable (*ghair manqul* or *akar*). For example, “my car” is movable property, whereas “my house” is immovable. Movable property can be fungible (*mithli*) or non-fungible (*qimi*). For example, a fungible could be “one hard cover Webster’s Dictionary (1st edition) printed by publisher X.”^{xxx} A non-fungible could be “a brown horse.”^{xxxi}

Fungibles are divided into four categories—those that are:

1. measured, such as dates and wheat;
2. weighed, such as oil, gold, silver, and metals;
3. counted, such as eggs by the dozen; and
4. measured by linear standards, such as cloth by the yard.

FIGURE 2. TAXONOMY OF PROPERTY



In legal terms, ownership of a corporation is represented by shares, which are claims on the corporation's residual earnings and assets. As such, securities would most likely be classified as *dayn* in Islamic law. Common shareholders equity is a contingent liability on the company. Shares, like debt, are evidence of money claims. Debts in the forms of loans are mostly in contracts, whereas securities are personal property.

VIII. CONCLUSION

The concepts presented here are some of the necessary elements that one should understand while one studies tradable instruments. For more research on Islamic tradable securities, a further understanding of concepts such as *sharikat al-milk* (co-ownership) and the different forms of *sharikat al-'aqd* (partnership through contract) is essential. Additionally, one would have to review other important elements in the study of asset-backed securities, such as *amana* (trust), *kafala* (guarantee), and *dhimma* (liability). Finally, the notion of juristic personality and limited liability would have to be closely examined.

ⁱ Chairman of Islamic *Shari'ah* council in Pakistan. Extract from the article "The principle of Limited Liability from the *Shari'ah* viewpoint" printed in Journal of Islamic Banking and Finance.

ⁱⁱ Islamic Law of Business Organizations (partnerships) by Imran Ahsan Nyazee, Pg. 316. Published by the International Institute of Islamic Thought and Islamic Research Institute, Islamabad, Pakistan.

ⁱⁱⁱ *Majallah* 1329, see Nyazee p. 18.

^{iv} Ibn Qudamah, *al Mughni*; see Nyazee p. 19.

^v See Imran Ahsan Khan Nyazee. *Islamic Law of Business Organization Partnership* p. 18.

^{vi} Definition of *sharikat* by Shams al Din Muhammad ibn Abu al-Abbas Shihab. See Nyazee p. 19.

^{vii} As discussed below, co-ownership could be a result of inheritance.

^{viii} According to the Journals (*Majallah*).

^{ix} Udovitch, Abraham L. *Partnership and Profit in Medieval Islam*. 1970, p. 18.

^x The Prophet Muhammad is reported to have decreed the partners (*al-shuraka*) the right of preemption in property that had not been divided up. When boundaries are fixed between them, then there is no right of preemption. According to another Tradition, the Prophet is reported to have granted preemption to the partner in every case of undivided (joint) property. If, however, the boundaries of the property have been demarcated or fixed, there is no preemption.

^{xi} The Pakistan Partnership Act.

^{xii} Assets in the form of bank balances (cash), rights (receivables), certificates, bonds, and so on are called financial assets, as distinguished from physical, tangible, real assets such as property.

^{xiii} One could however won rights of the contract (which becomes personal property).

^{xiv} The word is derived from *al-thawwul* or *al-tahwil*, which means change of locality from one person to another or change from one situation to another.

^{xv} The investment of C is a liability on A. Investment in shares is classified as contingent liability.

^{xvi} If a company does not issue only a fixed number of shares, its liability will continue to increase.

^{xvii} Ali b. Abi Talib.

^{xviii} The company might use the funds raised through the investor to acquire assets. The income generated from these assets could be shared with the investors.

^{xix} Usually, the shares pledged have a higher market value than the sum borrowed against those shares (over-collateralization). In case the value decreases, the financial institution usually asks the borrower to make up for the shortfall.

^{xx} *Salam* sales by farmers are an exception to this general rule of Islamic law.

^{xxi} This issue could be resolved using the contract of *ijara* with the contract of *wakala*.

^{xxii} The other schools do not make this distinction.

^{xxiii} According to SEC requirements, the brokerage firm is always responsible for making the payment. A brokerage firm has internal contracts so as to have recourse to the investor.

^{xxiv} The words of Ibn Al Humam.

^{xxv} In the words of Ibn Taymiyyah.

^{xxvi} In the words of Ibn Al Shati.

^{xxvii} However, even under secular law, the purchase and consumption of alcohol is only allowed only for those above a certain age.

^{xxviii} Islam allows the consumption of *haram* objects only in a matter of life and death, such as starvation or medical necessity.

^{xxix} Vogel, Frank E. and Samuel L. Hayes III. *Islamic Law and Finance*, Chapter on "Islamic Law of Usury, Risk and Property." The Hague: Kluwer Law International, 1998, p. 94. This book is hereafter referred to as Vogel and Hayes.

^{xxx} Notice that it is necessary to replace like for like.

^{xxxi} Although the horse may be of the same breed and age, two horses can not be exactly the same.