STOCKS AND SHARES

Equity Trade On Stock Exchange

Conventional trading on the stock exchange is not based on Islamic principles of sale and transfer of possession. Among the prerequisites of a valid sale are the existence of the (i) buyer and seller, (ii) a mutually agreed price, (iii) payment of price, and (iv) transfer of goods to the buyer. However, transactions take place in the stock market every second without actual payment or delivery.
(1) How can we consider some stocks on it permissible to trade in while others are impermissible?
(2) Similarly, isn't commodity trade impermissible as well where, for instance, possession of commodities such as gold and silver does not transfer either?

(1) The four conditions mentioned for a valid stock market transaction are correct and among the conditions that apply. However, it is not correct to state that because transactions are happening every second without actual delivery that they are impermissible thereby. If the sale is at spot, it is not a condition that delivery be immediate for many stocks because the concept of constructive possession applies in such cases, where the rights and responsibility are handed over even if delivery of the actual asset is not immediate. To use a common example, there are many large ticket items that we purchase at spot but do not take delivery immediately such as furniture, property, automobiles, and so on. You can read more about the concept of constructive possession in AAOIFI's Shariah Standards, Mufti Taqi Usmani's Introduction to Islamic Finance, and elsewhere.

(2) Exchange traded stocks, where what is traded is the "price" of an exchange, are not permissible because, among other reasons, no asset or service is trading hands.

Investing in Shares And Government Securities

Is it permissible to invest in shares and government securities?

Mufti Taqi Usmani: Principles of Shariah governing investment in shares and equity funds
Dealing in equity shares can be acceptable in the Shariah subject to the following conditions:

1. The main business of the company is not in violation of the Shariah. Therefore, it is not permissible to acquire the shares of the companies providing financial services on interest, like conventional banks, insurance companies, or the companies involved in some other business not approved by the Shariah, such as the companies manufacturing, selling or offering liquors, pork, haram meat, or involved in gambling, night club activities, pornography etc.

2. If the main business of the companies is halal, like automobiles, textile, etc. but they deposit there surplus amounts in a interest-bearing account or borrow money on interest, the share

holder must express his disapproval against such dealings, preferably by raising his voice against such activities in the annual general meeting of the company.

3. If some income from interest-bearing accounts is included in the income of the company, the proportion of such income in the dividend paid to the share-holder must be given charity, and must not be retained by him. For example, if 5% of the whole income of a company has come out of interest-bearing deposits, 5% of the dividend must be given in charity.

4. The shares of a company are negotiable only if the company owns some non-liquid assets. If all the assets of a company are in liquid form, i.e. in the form of money that cannot be purchased or sold, except on par value, because in this case the share represents money only and the money cannot be traded in except at par.

What should be the exact proportion of non-liquid assets of a company for the negotiability of its shares? The contemporary scholars have different views about this question. Some scholars are of the view that the ratio of non-liquid assets must be 51% at the least. They argue that if such assets are less than 50%, the most of the assets are in liquid form, therefore, all its assets should be treated as liquid on the basis of the juristic principle: The majority deserves to be treated as the whole of a thing. Some other scholars have opined that even if the non-liquid asset of a company or 33%, its shares can be treated as negotiable.

The third view is based on the Hanafi school. The principle of the Hanafi school is that whenever an asset is a mixture of a liquid and non-liquid assets, it can be negotiable irrespective of the proportion of its liquid part. However, this principle is subject to two conditions:

First, the non-liquid part of the mixture must not be of a negligible quantity. It means that it should be in a considerable proportion. Second, the price of the mixture should be more than the price of the liquid amount contained therein. For example, if a share of 100 dollars represents 75 dollars, plus some fixed assets the price of the share must be more than 75 dollars. In this case, if the price of the share is fixed as 105, it will mean that 75 dollars are in exchange of 75 dollars owned by the share and the rest of 30 dollars are in exchange of the fixed asset. Conversely, if the price of that share fixed as 70 dollars, it will not be allowed, because the 75 dollars owned by the share are in this case against an amount which is less than 75. This kind of exchange falls within the definition of "riba" and is not allowed. Similarly, if the price of the share, in the above example, is fixed as 75 dollars, it will not be permissible, because if we presume that 75 dollars owned by the share, no part of the price can be attributed to the fixed assets owned by the share. Therefore, some part of the price (75 dollars) must be presumed to be in exchange of the fixed assets of the share. In this case, the remaining amount will not be adequate for the price of 75 dollars. For this reason the transaction will not be valid.

However, in practical terms, this is merely a theoretical possibility, because it is difficult to imagine a situation where a price of the share goes lower than its liquid assets.

Subject to these conditions, the purchase and sale of shares is permissible in the Shariah. An Islamic equity fund can be established on this basis. The subscribers to the fund will be treated in the Shariah as partners “inter se.” All the subscription amounts will form a joint pool and will be invested in purchasing the shares of different companies. The profits can accrue either through dividends distributed by the relevant companies or through the appreciation in the prices of the shares. In the first case (i.e. where the profits are earned through dividends), a certain proportion of the dividend which corresponds to the proportion of interest earned by the company must be given in charity. Contemporary Islamic funds have termed this process purification.

Shariah scholars have different views about whether the purification is necessary where the profits are made through capital gains (i.e. by purchasing the shares at a lower price and selling them at a higher price). Some scholars are of the view that even in the case of capital gains the process of purification is necessary because the market price of the share may reflect an element of interest included in the assets of the company. The other view is that no purification is required if the share is sold, even if it results in a capital gain. The reason is that no specific amount of price can be allocated for the interest received by the company. It is obvious if all the above requirements of the halal shares are observed, most of the assets of the company are halal and a very small proportion of its assets may have been created by the income of interest. This small proportion is not only unknown, but also negligible compared to the bulk of the assets of the company. Therefore, the price of the share, in fact, is against the bulk of the assets, and not against such a small proportion. The whole price of the share therefore, may be taken as the price of the halal assets only.

Although this second view is not without force, yet the first view is more cautious and far from doubts. Particularly, it is more equitable in an open-ended equity fund because if the purification is not carried out on the appreciation and a person redeems his unit of the fund at a time when no dividend is received by it, no amount of purification will be deducted from its price, even though the price of the unit may have increased due to the appreciation in the prices of the shares held by the fund. Conversely, when a person redeems his unit of the fund at a time when no dividend is received by it, no amount of purification will be deducted from its price, even though the price of the unit may have increased due to the appreciation in the prices of the shares held by the fund. Conversely, when a person redeems his unit after some dividends have been received in the fund and the amount of purification has been deducted there from, reducing the net asset value per unit, he will get a lesser price compared to the first person.

On the contrary, if purification is carried out both on dividend and capital gains, all the unit-holders will be treated at par with regard to the deduction of the amounts of purification. Therefore, it is not only free from doubts but also more equitable for all the unit-holders to carry out purification in the capital gains. This purification may be carried out on the basis of an average percentage of the interest earned by the companies included in the portfolio.

The management of the fund may be carried out in two alternative ways. The managers of the fund may act as mudaribs for the subscriber. In this case a certain percentage of the annual profit accrued to the fund may be determined as the reward of the management, meaning thereby that the management will get its share only if the fund has earned some profit. If there is no profit in the fund, the management will deserve nothing, but the share of the management will increase with the increase of profits.

The second option of the management is to act as an agent for the subscribers. In this case, the management may be given a pre agreed fee for its services. This fee may be fixed in lump sum or as a monthly or annual remuneration. According to contemporary Shariah scholars, the fee can also be based on a percentage of the net asset value of the fund. For example, it may be agreed that the management will get 2% or 3% of the net asset value of the fund at the end of every financial year. However, it is necessary in the Shariah to determine any of the aforesaid methods before the launch of the fund. The practical way for this would be to disclose in the prospectus of the fund on what basis the fees of the management will be paid. It is generally presumed that whoever subscribes to the fund agrees with the terms mentioned in the prospectus. Therefore, the manner of paying the management will be taken as agreed upon on all the subscribers.

Permissibility Of Gold ETF GLD

Is the gold ETF GLD traded on the New York stock exchange Shariah-compliant?

More details about the specific documentation of the fund is required for an accurate answer. However, for your information, exchange-traded funds that invest in commodities, or exchange-traded commodities, track the performance of an index and their prices rise and fall like a stock. The entity investing on behalf may own the commodity, but the investor in the entity's shares does not directly own anything except a share that tracks the index. It is a condition for an Islamic investment to be Shariah-compliant that the investor have direct ownership in the asset or service. For example, a stock in a permissible company provides direct ownership in that company, whereas a stock in an exchange-traded commodity only provides ownership in a share that tracks, not owns, the asset.