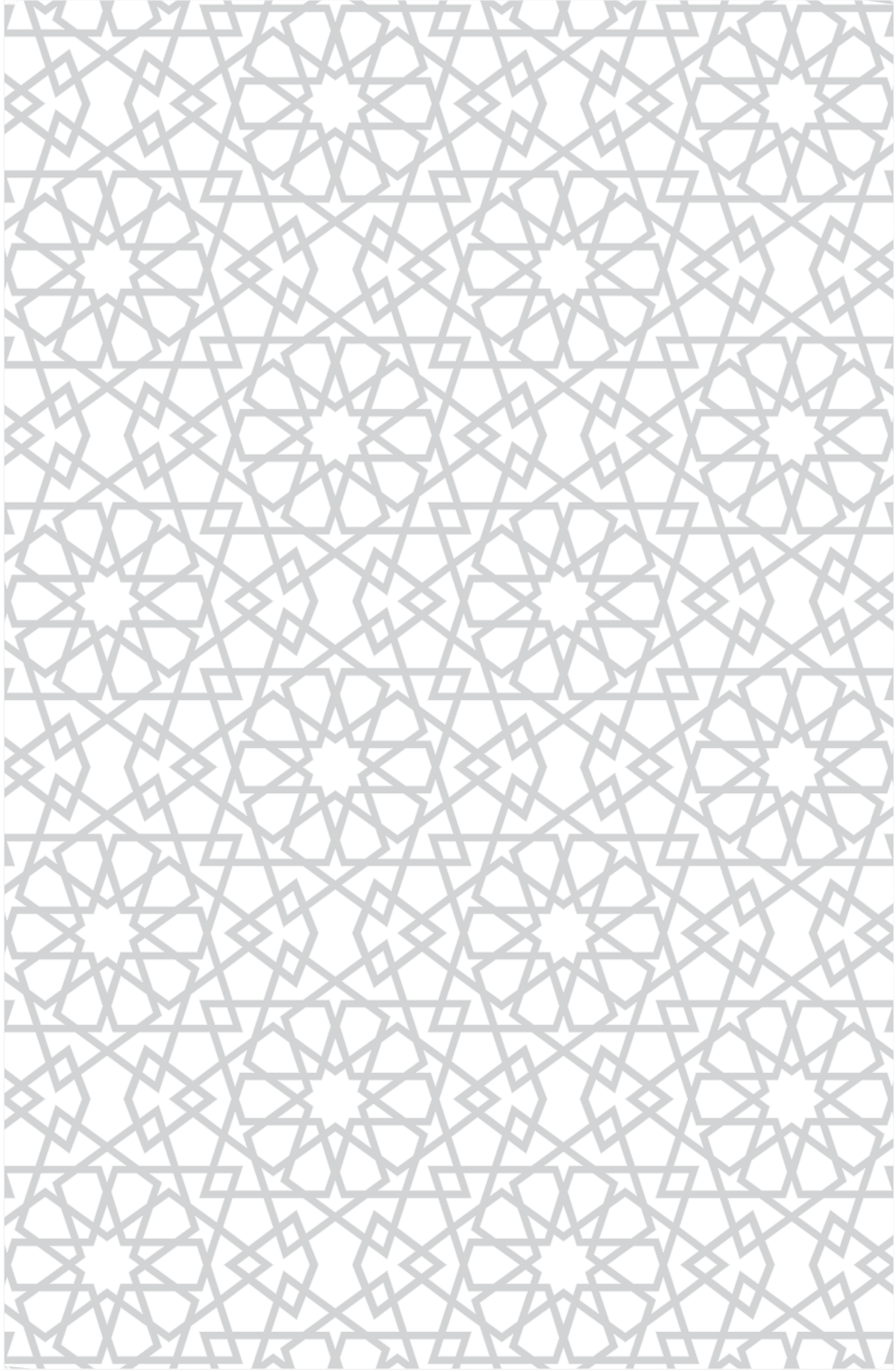


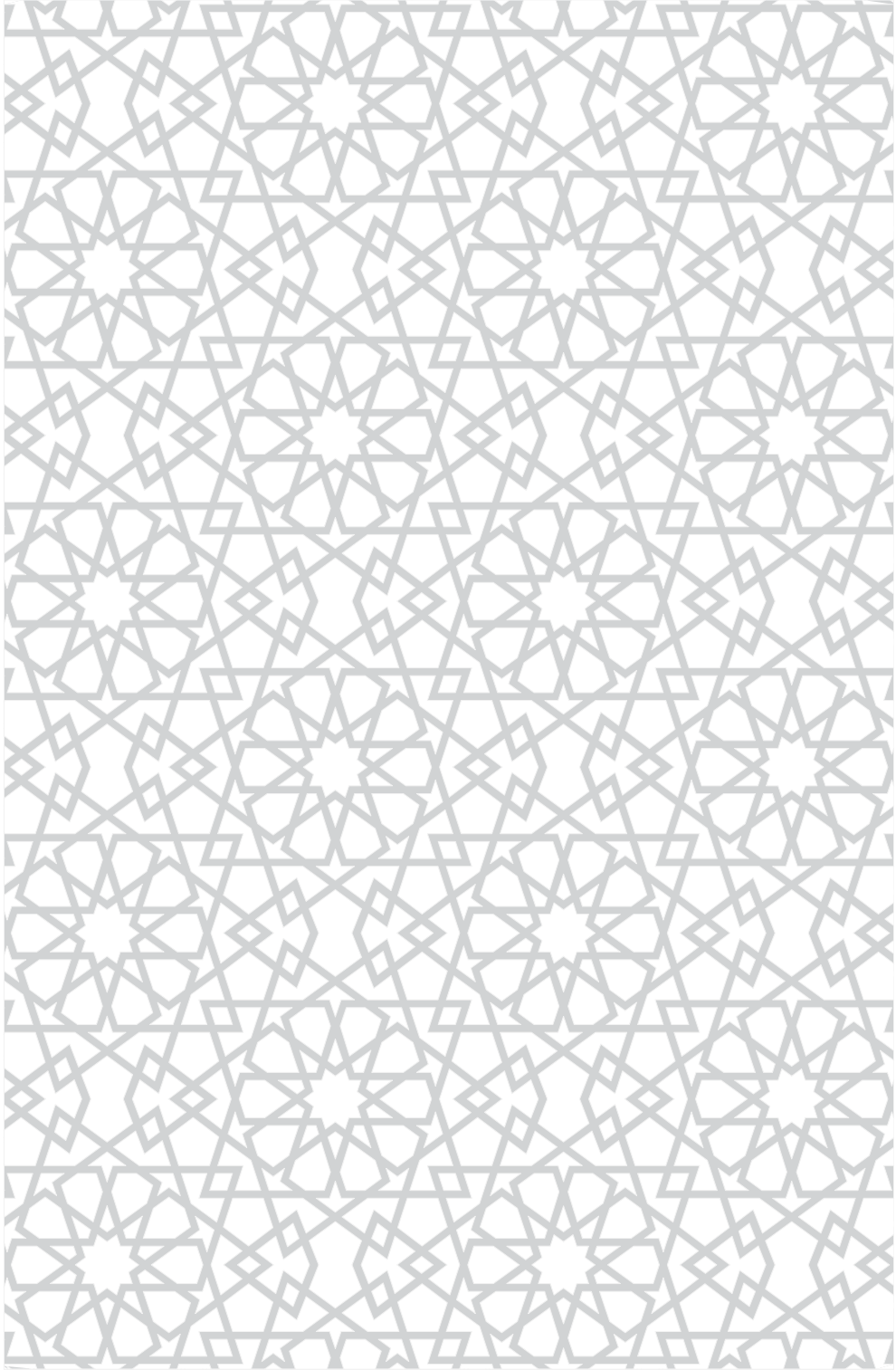
**Shari'ah Standard No. (1)**

**Trading in Currencies**



# Contents

<b>Subject</b>	<b>Page</b>
<b>Preface</b> .....	51
<b>Statement of the Standard</b> .....	52
1. Scope of the Standard .....	52
2. Shari'ah Ruling on Trading in Currencies .....	52
3. Date of Issuance of the Standard .....	58
<b>Adoption of the Standard</b> .....	59
<b>Appendix (a): Brief History of the Preparation of the Standard</b> .....	60
<b>Appendix (b): The Shari'ah Basis for the Standard</b> .....	62



***IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL***

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

The purpose of this standard is to explain the Shari'ah rulings relating to trading in currencies, as well as the conditions and precepts laid down by the Shari'ah as to what is permissible in currency trading and what is not. The standard also explains some of the practices being applied by Islamic financial Institutions.<sup>(1)</sup>

---

(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

## Statement of the Standard

### 1. Scope of the Standard

This standard covers issues of both actual and constructive possession of currencies, the use of modern means of communication in currency trading, exchange of currencies in the context of the bilateral settlement of debts owed by the parties to the exchange, dealing in currencies in money markets, bilateral promises to buy and sell currencies, deferment of the delivery of one of two countervalues in currency trading, and some cases practised by the Institutions.

The standard does not cover the following cases: those where there are no trading in currencies; the effect of goldsmithery in selling gold and silver; transfers of debts that do not involve exchanges of currency; and the discounting of bills of exchange.

### 2. Shari'ah Ruling on Trading in Currencies

**2/1 It is permissible to trade in currencies, provided that it is done in compliance with the following Shari'ah rules and precepts:**

- 2/1/1 Both parties must take possession of the countervalues before dispersing, such possession being either actual or constructive.
- 2/1/2 The countervalues of the same currency must be of equal amount, even if one of them is in paper money and the other is in coin of the same country, like a note of one pound for a coin of one pound.
- 2/1/3 The contract shall not contain any conditional option or deferment clause regarding the delivery of one or both countervalues.
- 2/1/4 The dealing in currencies shall not aim at establishing a monopoly position, nor should it entail any evil consequences to the interest of individuals or societies.

- 2/1/5 Currency transactions shall not be carried out on the forward or futures market.
- 2/2 It is prohibited to enter into forward currency contracts. This rule applies whether such contracts are effected through the exchange of deferred transfers of debt or through the execution of a deferred contract in which the concurrent possession of both of the countervalues by both parties does not take place.
- 2/3 It is also prohibited to deal in the forward currency market even if the purpose is hedging to avoid a loss of profit on a particular transaction effected in a currency whose value is expected to decline.
- 2/4 It is permissible for the Institution to hedge against the future devaluation of the currency by recourse to the following:
- 2/4/1 To execute back to back interest free loans using different currencies without receiving or giving any extra benefit, provided these two loans are not contractually connected to each other.
- 2/4/2 Where the exposure is in respect of an account payable, to sell goods on credit or by Murabahah in the currency of the exposure.
- 2/5 It is permissible for the Institution and the customer to agree, at the time of settlement of the instalments of a credit transaction (such as a Murabahah), that the payment shall be made in another currency applying the spot exchange rate on the day of payment.
- 2/6 Possession in sales of currencies**
- 2/6/1 When a contract is concluded for the sale of an amount of currency, possession must be taken for the whole amount that is the subject matter of the contract at the closing of the transaction.
- 2/6/2 Taking possession of one of the countervalues by one party without taking possession of the other is not enough to make a currency dealing transaction permissible. Likewise, taking partial possession is not sufficient. Taking possession of part

of a countervalue is valid only in respect of the part, possession of which is complete, whereas the remaining part of the transaction remains invalid.

2/6/3 Possession may take place either physically or constructively. The form of taking possession of assets differs according to their nature and customary business practices.

2/6/4 Physical possession takes place by means of simultaneous delivery by hand.

2/6/5 Constructive possession of an asset is deemed to have taken place by the seller enabling the other party to take its delivery and dispose of it, even if there is no physical taking of possession. Among other forms of constructive possession that are approved by both Shari'ah and business customary practices are the following:

- a) To credit a sum of money to the account of the customer in the following situations:
  - 1. When the Institution deposits to the credit of a customer's account a sum of money directly or through a bank transfer.
  - 2. When the customer enters into a spot contract of currency exchange between himself and the Institution, in the case of the purchase of a currency against another currency already deposited in the account of the customer.
  - 3. When the Institution debits – by the order of the customer – a sum of money to the latter's account and credits it to another account in a different currency, either in the same Institution or another Institution, for the benefit of the customer or any other payee. In following such a procedure, the Institution shall adhere to the principles of Islamic law regarding currency exchange.

A delay in making the transfer is allowed to the Institution, consistent with the practice whereby a payee may obtain actual receipt according to prevailing business practices in currency



markets. However, the payee is not entitled to dispose of the currency during the transfer period, unless and until the effect of the bank transfer has taken effect so that the payee is able to make an actual delivery of the currency to a third party.

- b) Receipt of a cheque constitutes constructive possession, provided the balance payable is available in the account of the issuer in the currency of the cheque and the Institution has blocked such a balance for payment.
- c) The receipt of a voucher by a merchant, signed by the credit card holder (buyer), is constructive possession of the amount of currency entered as payable on the coupon provided that the card issuing Institution pays the amount without deferment to the merchant accepting the card.

## **2/7 Agency in trading in currencies**

2/7/1 It is permissible to appoint an agent to execute a contract of sale of a currency with authorisation to take possession of and deliver the countervalue.

2/7/2 It is permissible to appoint an agent to sell currencies without authorizing him to take possession of the amount sold, provided the principal or another agent takes possession at the closing of the transaction, before the principal parties are dispersed.

2/7/3 It is permissible to authorise taking possession of the counter-values after the execution of a contract of currency exchange, provided such possession is completed by the authorised agents at the closing of the transaction, before the principal parties are dispersed.

## **2/8 Use of modern means of communication for currency trading**

2/8/1 Bilateral contracting between two parties at different remote places using modern communication means has the same juristic consequences as execution of the contract in one and same place.

2/8/2 An offer made for a stated period, which is transmitted by one of the prescribed means of communication, remains binding on the offeror during that period. The contract is not completed until acceptance by the offeree, and taking possession of the countervalues (either actual or constructive) by both parties, has taken place.

## **2/9 Bilateral promise to purchase and sell currencies**

2/9/1 A bilateral promise to purchase and sell currencies is forbidden if the promise is binding, even for the purpose of hedging against currency devaluation risk. However, a promise from one party is permissible even if the promise is binding.

2/9/2 Parallel purchase and sale of currencies is not permissible, as it incorporates one of the following invalidating factors:

- a) There is no delivery and receipt of the two currencies bought and sold, and thus the contract amounts to a deferred sale of currency.
- b) Making a contract of currency exchange conditional on another contract of currency exchange.
- c) A bilateral promise that is binding on both parties to the contract of currency exchange, and this is not permissible.

2/9/3 It is not permissible for one of the partners in Musharakah or Mudarabah to be a guarantor for the other partner, to protect the latter from the risks of dealing in currencies. However, it is permissible for a third party to volunteer being a guarantor for that purpose, provided this guarantee is not stated in the contract.

## **2/10 Exchange of currencies that are debts owed by the parties**

An exchange of amounts denominated in currencies that are debts established as an obligation on the debtor is permissible, if this results in the settlement of the two debts in place of a bilateral exchange of currencies, and in the fulfilment of the obligations in respect of these debts. This covers the following cases:

2/10/1 Discharge of two debts when one party owes an amount from another party denominated in (say) dinar and the other party owes an amount from the first party denominated in (say) dirham. In this context, both may agree on the rate of exchange between the dinar and the dirham in order to extinguish the debts, wholly or partially. This type of transaction is known as *al-Muqassah* (set-off).

2/10/2 The creditor's making payment of a debt due to him in a currency different from that in which the debt was incurred, provided the settlement is effected as a spot transaction at the spot exchange rate on the day of settlement.

## **2/11 Combination of currency exchange and transfer of money**

It is permissible to execute a financial transfer of money (remittances) in a currency different from that presented by the applicant for the transfer. This transaction consists of a currency exchange effected through actual or constructive possession by delivering an amount of currency that is evidenced by a bank draft, followed by the transfer of the amount using currency that is bought by the applicant for the transfer of money. It is permissible for the Institution to charge a fee for the transfer.

## **2/12 Forms of dealing in currencies via Institutions**

2/12/1 Among the forms that are not permitted is the customer of an Institution entering into currency trading for an amount of money exceeding the amount of money he owns, using credit facilities granted by the Institution which handles the currency trading, thus enabling the customer to enter into a transaction for an amount in excess of what he would otherwise be able to pay for.

2/12/2 It is not permitted for the Institution to lend the customer a sum of money on the condition that currency dealing must be effected with that Institution and not with any other. If there is no such condition, then there is no Shari'ah prohibition.

### **3. Date of Issuance of the Standard**

This Standard was issued on 27 Safar 1421 A.H., corresponding to 31 May 2000 A.D.

## **Adoption of the Standard**

The Shari'ah Standard on Trading in Currencies was adopted by the Shari'ah Board in its meeting No. (4) held on 25-27 Safar 1420 A.H., corresponding to 29-31 May 2000 A.D.

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

In its meeting No. (1) held in Bahrain on Saturday 11 Dhul-Qāḍah 1419 A.H., corresponding to 27 February 1998 A.D., the Shari'ah Board decided to give priority to the preparation of a Shari'ah standard on Trading in Currencies.

On Saturday 11 Dhul-Qāḍah 1419 A.H., corresponding to 27 February 1999 A.D., a Shari'ah consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 13-16 Rabi' I, 1420 A.H., corresponding to 27-30 June 1999 A.D., the Shari'ah Committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the standard in its meeting No. (3) held in Bahrain on 9-11 Rajab 1420 A.H., corresponding to 18-20 October 1999 A.D., and asked the consultant to make some amendments in light of the comments made by the members.

The revised exposure draft of the standard was presented to the Shari'ah Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420 A.H., corresponding to 18-22 December 1999 A.D. The Shari'ah Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29-30 Dhul-Hajjah 1421 A.H., corresponding to 4-5 April 2000 A.D. The Public hearing was attended by more than 30 participants representing central banks, Institutions, accounting firms, Shari'ah scholars, academics and others who are interested in this field. Members of the Shari'ah Studies Committee responded in the

public hearing to the written comments as well as to the oral comments that were expressed in the public hearing.

The Shari'ah Studies Committee held its meeting No. (5) on 22-24 Muharram 1421 A.H., corresponding to 26-28 April 2000 A.D, to discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing and the written comments that were received.

The Shari'ah Board in its meeting No. (4) on 25-27 Safar 1421 A.H., corresponding to 29-31 May 2000 A.D., in Al-Madinah Al-Munawwarah discussed the amendments made by the Shari'ah Studies Committee, and made the necessary amendments, which it deemed necessary. The standard was adopted by the majority vote of the members of the Shari'ah Board, as recorded in the minutes of the Shari'ah Board.

## Appendix (B)

### The Shari'ah Basis for the Standard

#### Available Evidence Pertaining to the Exchange of Currencies

In the Hadiths of the Prophet, there are many Hadiths which govern the rules regarding the exchange of currencies. The best known Hadith is the one reported on the authority of Ubadah Ibn Al-Samit (may Allah be pleased with him) that the Prophet (peace be upon him) said: *"Gold for gold, silver for silver – until he said - equal for equal, like for like, hand to hand, if the kinds of assets differ, you may sell them as you wish provided it is hand to hand."*<sup>(2)</sup> The other Hadith, reported on the authority of Abu Sa'id Al-Khudri, is that the Prophet (peace be upon him) said: *"Do not sell gold for gold except equal for equal and do not sell what is deferred for a spot exchange."*<sup>(3)</sup> These two Hadiths show clearly enough that gold is of one kind and the silver is of another. A few decisions have been issued by Islamic Fiqh organizations<sup>(4)</sup> in accordance with the Shari'ah ruling that has been already accepted amongst the jurists, namely that dinars are of a different kind from dirhams. Contemporary Islamic Fiqh scholars have made an analogy between paper and coin money and gold and silver money referred to in the prophetic Hadith. The currency of each

---

(2) Related by Muslim in his *"Sahih Muslim"*.

(3) Related by Al-Bukhari in his *"Sahih Al-Bukhari"*.

(4) Among other examples is the one issued by the General council of Fatwa in Kuwait as follows: It is permissible to sell currencies that are different from each other because every currency is considered as a kind of money on its own, like that of gold and silver, and therefore it is permissible to sell a particular currency such as dollar, for another currency such as Indian Rupee even for inequality as it is permissible to sell gold for silver for a different weight, provided the bilateral taking possession of the two counter values ( two currencies) must take place in the session of the contract. However, if a certain amount of a particular currency is sold for the same currency such as Indian rupee for Indian rupee, then the inequality is impermissible (*"Majmu'at Al-Fatawa Al-Shar'iyyah"*, Adminsitration of Fatwa of Kuwait 3/160 no. 788).



country is considered as being of a kind that is different from that of other countries as they are 'constructive money' according to the decision of the International Islamic Fiqh Academy.<sup>(5)</sup> Therefore, these currencies differ in kind according to the authority that considers them as money.

On this basis, it has been a condition, in the exchange of currencies that are of the same kind, that equality in amount as well as taking possession of the two countervalues before the two contracting parties depart the place of the closing of the contract. However, if the kind of the currencies to be exchanged is different, then it is permissible for the amounts to be different, but the condition of taking possession of the countervalues before the two contracting parties leave the place of signature of the contract shall prevail.

#### **Shari'ah Ruling on Trading in Currencies**

The original ruling on trading in currencies is that it is permissible, as it falls under the general Islamic provisions regarding the permissibility of selling gold, silver and money because this is one means of earning a profit. This ruling is applicable as long as there is no reason for considering the dealing as prohibited or objectionable. The basis of this ruling is the Hadith that are available with regard to exchange of currencies and the general ruling that is derived from these Hadith as decided by the jurists in the chapter on currency exchange. Whenever one of the Shari'ah precepts is not met, then the dealing is not permissible.

#### **Stipulation of Equality and Taking Possession**

While equality of the countervalues and concurrent taking of possession are required in the exchange of two similar kinds of currencies, only bilateral taking of possession is required in the exchange of two dissimilar kinds, based on the basis stated in (1) above.

#### **Constructive Possession**

Constructive possession –as in the forms mentioned in the standard– is on an equal footing with actual possession, because the Shari'ah never prescribed a particular method for taking possession. Therefore, reference must be made to the prevailing custom in the business community which

---

(5) The International Islamic Fiqh Academy Resolution No. 21 (9/3).

results in the ability to dispose of the currency for the intended purpose and transfer of the risk of the currency to the transferee, as in the forms mentioned in the standard.

As for the various forms of constructive possession, there is a decision issued by the International Islamic Fiqh Academy,<sup>(6)</sup> and the various Fatwa Committees have added to these forms some others, such as the credit card settlement coupon.<sup>(7)</sup>

The Ninth Seminar of Al Baraka<sup>(8)</sup> has confirmed the prohibition of giving a guarantee by one of the parties in Mudarabah or Musharakah transactions to the other party, to indemnify him against currency risks.

#### **Agency in Exchange of Currencies and Issue of Taking Possession**

Agency in exchange of currencies is permissible because agency is permissible with regard to an activity that the principal could undertake personally. As one could undertake the exchange himself, then it is also permissible for him to authorise its undertaking by others on his behalf. However, since taking possession of the countervalues immediately after concluding the contract has been a juristic condition, the juristic requirement in the case of agency would be the taking possession by the parties to the contract of exchange, whether through principal or agent. When the agency is for the purpose of taking possession only, the juristic rule relates to the leaving of the place of execution of the contract by both principals before possession is taken, and not to the agent's doing so.

#### **Use of Modern Means of Communication for Trading in Currencies**

The International Islamic Fiqh Academy<sup>(9)</sup> issued a decision on the subject of those means of communication. This is a reinforcement of what has already been approved by the jurists on the permissibility of concluding

---

(6) International Islamic Fiqh Academy Resolution No. 53 (3/6); *"Majallat Al-Majma"*, vol. 6 [2: 785].

(7) Fatwa No. (12/6) of Al Baraka Seminar No. (12), stating: A payment slip signed by the cardholder is tantamount to receipt, by means of a cheque. In this respect it is stronger than a cheque, as stated by experts, because it is binding on the trader and it discharges the cardholder of the debt immediately, and he may not protest the collection of the amount thereof.

(8) Al Baraka Seminar No. 9 (9/5).

(9) The International Islamic Fiqh Academy Resolution No. 52 (3/6).

a contract via writing and communications that can be understood. This would cover all contemporary means such as telex, fax, internet, etc.

### **Bilateral Promise in Exchange of Currencies**

The prohibition of a binding bilateral promise in an exchange of currencies is supported by the majority of Shari'ah jurists, because binding bilateral promises from two parties are equivalent to a contract, and also for the reason that the bilateral promise is not immediately followed by taking possession of the countervalues, since it is not the wish of the parties to take possession at that time.

Financial Institutions have a customary practice of treating promises as binding, even when formally they are not. A promise from one party only (as opposed to a bilateral promise) is permissible in currency exchange, even if it is binding.

### **Exchange of Currencies that Are Owed by the Parties**

The basis of the permissibility of an exchange of amounts denominated in currencies that are debts established as an obligation of the debtor, on the condition that the two obligations are thereby settled, is that this would entail the settlement of the debt by discharging it. This does not involve any prohibited transaction pertaining to debts either with regard to sale or purchase.

As for some of the forms mentioned in the standard, there are texts to support them, inter alia, the Hadith reported on the authority of Ibn Umar (may Allah be pleased with him) who said: "I have met the Prophet (peace be upon him) at the house of Hafsa (may Allah be pleased with her). And I said to him: 'O Prophet of Allah, I would like to ask you; 'I sell a camel in Al-Baqi' for a price quoted in dinar but I take dirham, and I sell for a price quoted in dirham but I take dinars, I take this from this and I give this from this.' The Prophet (peace be upon him) replied: *'There is no objection to your taking the other currency based on the price of the day, provided you do not leave each other with something remaining owed as a debt between you.'*"<sup>(10)</sup> Some of the forms in the standard are a kind of set-off and this is permissible.

---

(10) Related by Abu Dawud, Al-Tirmidhi, Al-Nassa'i, Ibn Majah and Al-Hakim, who deemed it a sound Hadith, as confirmed by Al-Dhahabi. It was also narrated without a chain of narrators, quoting only Ibn Umar (*"Al-Talkhis Al Habir"* [3: 26]).

### **Combination of Currency Exchange and Transfer of Money**

The basis of the permissibility of the combination of currency exchange and transfer of money is the achievement of constructive possession by virtue of a bank draft for the amount that is given in one currency in return for an amount paid in another currency for the purpose of its transfer. In this regard, there is a decision by the International Islamic Academy of Fiqh that reads: "If a transfer of money is to be made in a currency different from the currency of the amount paid by the applicant, then the transaction is based on currency exchange and transfer of money. The currency exchange takes place before the transfer, that is, the customer pays the amount of money to the bank and the bank, after agreeing on the currency exchange rate that is printed on the receipt delivered to the customer, issues a bank draft on the basis of transfer of debt in the sense that has been mentioned."<sup>(11)</sup>

### **Forms of Trading in Currencies**

The following form is not permissible: providing a type of financial facility to a customer who wishes to engage in currency trading which enables him to deal in amounts that he does not own and to sell amounts that he does not own. An alternative and permissible form is that the Institution lends the money to the customer so that the latter would then deal in amounts that he owns. However, this would not be permissible if the Institution made it a condition of the loan that the customer must carry out the currency trading with the Institution, as this would involve a combination of both loan and contract of exchange. This is not permissible because it results in a benefit to the lender. Where no such condition is imposed, there is no prohibition.



---

(11) International Islamic Fiqh Academy Resolution No. 48 (1/9)