A STUDY ON HOW STOCK INDEX FUTURES CONTRACTS CAN BE LEGITIMIZED IN IRAN'S CAPITAL MARKET: A COMPARISON WITH SINGLE STOCK FUTURES CONTRACTS

Mohammad Soltani & Nafise Shooshinasab*

Abstract

Following the 1979 Islamic Revolution in Iran, many Islamic experts believed that capital market transactions should be forbidden because they were similar to gambling practices prohibited by Islam. They argued that *gharar* (uncertainty) and gaming based on chance, as the constituent elements of gambling, are an integral part of capital market transactions, and such transactions are not allowed in Islam. However, a study of the history of the *Sharia* board members' views in Iran's capital market shows that, contrary to the dominant Islamic belief, a variety of transactions—including some types of futures contracts—became prevalent in Iran's capital market. Futures contracts are commitments of parties to buy or sell an underlying asset at a predetermined price on a specific future date. The article reviews the evolution of Islamic jurisprudence towards the legitimacy of "single stock futures contracts" (SSFs) as an example of transactions that were once considered gambling, and compare SSFs with "stock index futures contracts" (SIFs)—a transaction with a similar definition and function that is still prohibited. We argue that the differences between these contracts, including the differences in their underlying assets and settlement procedure, are not fundamental enough to justify *Sharia* board members' distinctive approach to gambling and legitimization issues. We propose that SIFs should be legitimized in Iran's capital market, as the same justifications that were used to legitimize SSFs can partly be applied to SIFs as well. Finally, the paper proposes some additional justifications for SIFs in an effort to cover the distinctive challenges that they create.

Keywords

Futures contracts, gambling, Iran's capital market, Islamic jurisprudence, *Sharia*, SIFs, SSFs, transaction legitimacy

* Mohammad Soltani is an Assistant Professor at the Department of Public Law and Economic Law, Faculty of Law, Shahid Beheshti University, Tehran, Iran. Nafise Shooshinasab is a PhD student at the Common Law Section of the University of Ottawa. She did her first PhD in Private & Islamic Law at the Faculty of Law of the University of Tehran, Tehran, Iran.

1. Introduction

After the 1979 Iranian Islamic Revolution, many Islamic experts believed that capital market transactions were similar to gambling practices prohibited by Islam and should thus be banned.[1] Contrary to dominant Islamic beliefs, however, a variety of capital market transactions have since become prevalent in Iran. In this paper, we analyze the evolution of Islamic scholars' attitudes toward a particular kind of futures contract[2] called "single stock futures contracts" (SSFs)[3]—a transaction that was once considered gambling in Islamic jurisprudence. The paper argues that SSFs have a similar structure as "stock index futures contracts" (SIFs), particularly from the perspective of Islamic rules on the elements of gambling.[4] We examine the reasons why the former has been legitimized by the *Sharia* board members of Iran's Securities Exchange Organization (SEO), while the latter is still considered to be gambling. Considering the major similarities, we ultimately argue that SIFs should *a pari* be legitimized in Iran's capital market.

Maysir (gambling) has been banned in Islamic jurisprudence for centuries.[5] *Gharar* (selling something uncertain that cannot be described in accurate detail) and "gaming" can lead to contracts with gambling features. To eliminate these features from Islamic capital market transactions, we propose that Islamic capital markets should take three main steps for the creation and development of new products: first, establish a *Sharia* board; second, recognize the necessity and function of new products; and third, justify the new products according to Islamic rules.

Islamic finance, like conventional finance, has a need for risk management against unexpected changes in prices.[6] New products and service innovations in Iran's capital market require approval from a *Sharia* board of the SEO (established in 2007) in order to access the market. Board members base their decisions on the legal and financial analyses provided by respective experts. There is often an absence of a uniform interpretation of Islamic law, however—especially when there is no clear

[1] Shahla Keshavarznejad & Ali Saeedi, *Tarikh Bazar Sarmaye Iran*, (Tehran: Bourse Press, 2016) at 436 [translated by author].

[2] A futures contract is a contract between two parties to exchange assets at a determined time in the future at a price on which parties have agreed at the time of the contract. Futures contracts are categorized as derivative instruments. See Dennis W Carlton, "Futures Markets: Their Purpose, Their History, Their Growth, Their Success and Failures," (1984) 4:3 J Futures Markets 237 at 238.

[3] See ICE Futures Europe, "Single Stock Futures Contract" (2017) at 1, online (pdf): *International Exchange* <www.theice.com/publicdocs/futures/Futures_Europe_Single_Stock_Futures_KID.PDF>.

[4] One can buy and sell stock index futures or SIFs based on the performance of an index. See Ian Cooper & Antonio S Mello, "Stock Index Futures: The Case for Markets in a Basket of Securities" in Frank J Fabozzi, ed, *Advances in Futures and Options Research*, vol 4 (Greenwich: JAI Press, 1990) 23 at 23.

[5] M Kabir Hassan & Eric Girard, "Faith-Based Ethical Investing: The Case of Dow Jones Islamic Indexes" (2010) 17 Islamic Economic Studies 1 at 4.

[6] Jonathan Lawrence, Stephen H Moller & Anthony RG Nolan, "The New Islamic OTC Derivatives Contract" (2010) 25:5 J Intl Banking Financial L 305 at 306.

ruling in the primary sources of *Sharia*, such as the Quran. Fortunately, although many product developments in Islamic capital markets gives rise to jurisprudential issues under *Sharia*, the history of capital market developments indicates that there is always the hope that new products can be legitimized. In our view, legal scholarship can contribute to legitimization efforts by introducing new ways, based on Islamic rules, to facilitate the acceptance of new instruments, such as SIFs, in Islamic capital markets.

In this paper, we employ a comparative methodology to examine the evolution of the SEO's *Sharia* board members' opinions toward the legitimacy of SSFs and SIFs in Iran.[7] We supplement the comparative approach with a historical analysis of the legitimization of SSFs. In doing so, we attempt to contextualize why, in our view, SIFs in Iran's capital markets should be similarly legitimized. It is our hope that this mixed methodological approach might serve to persuade both governing bodies and Islamic scholars alike that transactions with similar structures ought to be treated similarly.

There are a range of articles and books in several different languages, including Persian, Arabic, and English, on the Islamic challenges of futures contracts. Works by Zainordin et al,[8] Khan,[9] and Azmat et al[10], for example, provide a fairly comprehensive account of the Islamic futures contracts. These works, however, tend to not engage in jurisprudential debates over Iran's current capital markets, and are largely uncritical of the SEO's *Sharia* board members' perspectives. While there are also some works[11] that highlight the similarities between SSFs and SIFs, there have been no efforts, as of yet, to draw upon these similarities in an attempt to legitimize SIFs. Indeed, using inductive reasoning to legitimize SIFs in Iran's capital market has yet to be considered in legal scholarship.

Our paper proceeds as follows: first, we explain why SSFs and SIFs are structurally similar. We then examine their similarities (and differences) in detail, with particular attention to the gambling elements common in these two types of contracts.

---

[7] Over the last decade in Iran, Islamic scholars have made every effort to use the traditional Islamic institutions to legitimize capital market transactions, but the more they tried to justify these transactions, the less successful they were in introducing new instruments with a different structure from those popular in non-Islamic countries. However, this needs to be scrutinized in a separate essay.

[8] Nur Aqilah Zainordin et al, "Challenges and Opportunities of Islamic Banking and Financial Institutions in Malaysia" (2016) 10:1 South East Asia J Contemporary Bus Economics L 1.

[9] M Fahim Khan, *Islamic Futures and Their Markets: With Special Reference to their Role in Developing Rural Financial Market*, 2nd ed (Jeddah: Islamic Research and Training Institute & Islamic Development Bank, 2000).

[10] Saad Azmat et al, "The *Shariah* Compliance Challenge in Islamic Bond Markets" (2014) 28 Pacific-Basin Finance J 47.

[11] "Understanding Stock Index Futures" (2013) online (pdf): *CME Group* <www.cmegroup.com> [perma.cc/HU7C-BAGN]; "Opportunity and Risk: An Educational Guide to Trading Futures and Options on Future" online (pdf): *National Futures Association* <www.nfa.futures.org> [perma.cc/7JEC-3KFL].

At the following stage and with a legal history method, we demonstrate how the criticisms regarding the gambling elements were justified by the SEO's *Sharia* board members when legitimizing SSFs. We then conclude in arguing that analogous criticisms regarding the gambling elements of SIFs can be similarly justified in order to facilitate their legitimization in Iran's capital market.

2. SSFs and SIFs as Futures Contracts

Futures contracts are a type of derivative securities that contain the following five conditions: an underlying asset, the contract size, due date, price, and the delivery or contract offset. They are called "derivatives" because the value of the contract is derived from the value of an underlying asset. Thus, there exists a mutual relationship between the underlying asset and its derivative regarding the fact that the price of the futures contracts is determined by its underlying asset.[12] For example, if we selected gold as the underlying asset, the value of a futures contract would be derived from the market price of gold. However, because a futures contract is a zero-sum transaction[13] between the parties, the net value of a futures contract is always zero.[14] This means that whatever gain the buyer achieves is exactly equal to the loss borne by the seller and vice versa.

Historically, in the US, futures contracts were transacted on commodities. However, in the 1970s, wide fluctuation in the prices of financial assets paved the way for futures exchanges on such assets—a reason that once justified the emergence of the commodity futures markets.[15] Whereas commodity futures require the delivery of a physical commodity, financial futures require the delivery of a financial instrument. The first financial futures contracts were foreign currency contracts introduced in 1972 at the Chicago Mercantile Exchange (CME). Then, interest rate futures were introduced at the Chicago Board of Trade in 1975. Finally, SIFs were introduced in

---

[12] Johan De Beer, "Changes in the Volatility Level and Structure of Shares Post Single Stock Futures Trading" (2009) 7:2 J Corporate Ownership Control 296 at 296.

[13] See Jason Alan Jankovsky, "Basics of Zero-Sum Markets" in *Time Compression Trading: Exploiting Multiple Time Frames in Zero-Sum Markets* (New Jersey: John Wiley & Sons Press, 2010) at 4–5:

> A zero-sum market is one where no transaction results in an exchange of money between the buyer and seller. Transactions are done by either buying or selling the current price in the market. Both the buyer and the seller must be present at a traded price, and both assume the risk of price action for or against the current price in the market. Money actually changes hands when the buyer/seller liquidates the open long/short position by doing an opposite transaction at some later time. No money is ever made or lost in the market; it changes hands based on the difference between the traded prices and the individual's personal account. In other words, say 100 accounts have a total of $100,000 at the start of trading. After trading is over and the market has changed in price, the total amount of money those 100 accounts have is still $100,000. A certain number of the accounts will have more than they started with; that amount will be exactly the amount that the losing accounts will show as a loss.

[14] Jan Röman, "Futures Contracts" (2016) at 4, online (pdf): *Analytical Finance* <janroman.dhis.org/finance/General/Future%20Contracts.pdf>.

[15] Khan, *supra* note 9 at 26–27.

1982 at the CME and the New York Futures Exchange (NYFE).[16] SSFs were not launched in the US until 2002.[17] Currently, futures contracts in US capital markets include shares, bonds, currency, commodities, and index, and the contracts follow daily settlement procedures of the clearinghouse. Conversely, the trend was rather different in Iran's capital market: following the legitimization of the commodities' futures contracts in 2008, *Sharia* board members legitimized SSFs in 2010 while SIFs have yet to be legitimized.

2-1 Similarities between SSFs and SIFs

SSFs and SIFs share many common features.[18] Here, it is worth noting that SSFs in Iran's capital market have the same definition and function as in western capital markets.[19]

2-1-1 Definition

2-1-1-1 *SSFs*

SSFs or single stock futures contracts, also known as individual equity futures, are commitments to buy or sell the shares of a particular company at a specific price at a future date.[20] Put slightly differently, SSFs are "futures contracts on individual stocks".[21] They are contracts for the delivery of a particular company's stocks with a certain contract size on a specific future date.[22] These contracts are transacted based on a single type of share, which is why they are called *single* stock futures contracts.

---

[16] Röman, *supra* note 14 at 3–4.

[17] Joseph KW Fung & Yiuman Tse, "Efficiency of Single Stock Futures: An Intraday Analysis" (2008) 28:6 J Futures Markets 518 at 519.

[18] Similarities in the definitions and functions of SSFs and SIFs does not mean that they are completely similar in these regards. SSFs and SIFs are designed to serve different purposes, which are indicated in the Differences section below. However, since the basics of these contracts are the same, both have the potential to be legitimized from an Islamic perspective.

[19] Nevertheless, the justification for the acceptance of SSFs in Iran's Islamic capital market is different from the western ones. This means that western capital markets have simply accepted that SSFs may not end up delivering the asset to one party in "most" cases—although they have considered the possibility of the delivery—and what mostly happens in these markets is simply the settlement of the prices by the due date. Meanwhile, in Islamic SSFs, parties should "at least" have the intention to deliver the underlying asset when they enter the contract.

[20] Iran, *Art 1 The Directive of SSFs* (2018) [translated by author]. See generally the SEO website, online: <cmr.seo.ir>.

[21] Fung & Tse, *supra* note 17 at 519.

[22] James S Ang & Yingmei Cheng, "Financial Innovations and Market Efficiency: The Case of Single Stock Futures" (2005) 15:1 J Applied Finance 38 at 38.

Similar to commodity futures, SSFs entail both the rights and obligations of the parties to take delivery or to deliver the underlying assets on their expiration dates.[23]

2-1-1-2 *SIFs*

SIFs or stock index futures contracts are agreements to buy or sell a standardized value of a stock index at a specified price at a future date. These contracts contain an overall reflection of market movements, which is used to predict future price fluctuations of the index.[24] Therefore, SIFs are transacted on a particular stock market index as the underlying asset. Investor profit or loss depends on the price of the index on the expiration date of the agreement, or at the time when they close out[25] their position.[26]

In the US, several stock market indices, such as the Standard & Poor's 500 Index (S&P 500), were developed for investors to trace movements in capital market prices.[27] Therefore, through SIFs, traders transfer the expected risk of the price movements of a portfolio of shares to the futures market based on their analysis of the index's movements.

2-1-1-3 *Common Features*

SSFs and SIFs have some basic features in common. Both contracts are based on an underlying asset, can be transferred to a third party if one of the parties prefers to close out their position, and are settled by a due date. The contracts are transacted at a specific price and are based on the specific size of the underlying asset.

Also, in both SSF and SIF agreements, brokers require the traders to deposit as collateral a sum of money called a "margin".[28] The function of the margin is similar in both transactions. A margin is settled daily, and the increase or decrease of the market value is applied to the investor's margin account. The buyer and seller must deposit enough money in the margin account at a brokerage firm to cover the loss at the end of the trading day on a "margin call" from a central clearinghouse, which clears

---

[23] See Art 50 The Directive of SSFs (Iran), *supra* note 20.

[24] Charles MS Sutcliffe, *Stock Index Futures*, 3rd ed (London, UK: Routledge, 2006) at 3–4.

[25] In the US, for example, SIFs are not supposed to be delivered, and parties merely offset their commitments by the due date. These contracts are traded exclusively on electronic trading platforms, such as the CME Globex system in the US. See *CME Group*, *supra* note 11 at 1.

[26] "Introduction to Index Futures and Options" (2008) at 4, online (pdf): *Australian Securities Exchange* <www.asx.com.au/documents/products/intro_to_index_futures_and_options.pdf>.

[27] Sutcliffe, *supra* note 24 at 3.

[28] See generally Michael A Salinger, "Stock Market Margin Requirements and Volatility: Implications for Regulation of Stock Index Futures" (1989) 3 J Financial Services Research 23 at 23; Chen-Yu Chen et al, "Setting the Futures Margin with Price Limits: The Case for Single-Stock Futures" (2017) 48 Rev Quantitative Finance Accounting 219 at 221.

and settles both types of transactions.[29] Clearinghouses can guarantee all transactions by requiring the traders to deposit an amount that is large enough to cover their customers' losses.[30]

2-1-2 Function

SSFs and SIFs have similar functions including risk management, high liquidity, and low transaction costs.[31] Using these instruments, investors can create a wide range of potentially profitable scenarios, regardless of the market direction. SSFs and SIFs provide traders with the flexibility and opportunity to exploit the trends and variations in the market, features absent from traditionally traded contracts.[32]

2-1-2-1 *Risk Management*

Capital market investors' inability to enjoy short positions at low cost is a major challenge leading to market inefficiency. This can be overcome by SSFs and SIFs, which both enable investors to short more easily and achieve a more efficient outcome in the stock market.[33]

SSFs and SIFs are derivative instruments that allow investors to cover their risk against a change in the value of their underlying assets. For example, if someone (i) owns a large number of shares, (ii) follows the price movements of the shares, and (iii) believes that the market is going to fall but they do not want to sell for some reason—including high costs or taxation—they can safeguard the value of their shares or portfolio by entering into an SSF or SIF. Doing so protects their portfolio and helps to manage risk.[34]

---

[29] Chen et al, *supra* note 28 at 221.

[30] Peter Ritchken, "Forward and Futures Markets" (1999) at 16, online (pdf): *Weatherhead School of Management at Case Western Reserve University* <faculty.weatherhead.case.edu/ritchken/textbook/Chapter1ps.pdf>.

[31] SIFs, however, have some other functions that justify the capital market's need for this type of contract. See Necessities below.

[32] *Australian Securities Exchange*, *supra* note 26 at 2.

[33] Ang & Cheng, *supra* note 22 at 1–2.

[34] *Australian Securities Exchange*, *supra* note 26 at 6.

2-1-2-2 *High Liquidity*

Of all the different types of futures contracts, SSFs and SIFs are the most liquid and convenient transaction types for risk management.[35]

Historically, for example, speculators used to purchase and then sell grain in advance, in an attempt to profit from the changes in prices. Most speculators never owned or intended to own the commodity. Their purpose was simply to make a profit by following trading strategies reflecting their predictions of the movement of commodity prices. The high liquidity of futures contracts attracted speculators to these contracts. As a group, they were prepared to buy these contracts from farmers, and to sell them to manufacturers at any time.[36]

The popularity of SSFs and SIFs in many capital markets is due to their high liquidity, derived from their ability to execute short positions. The liquid market in SSFs and SIFs, however, prevents certain financial market anomalies caused, at least in part, by restrictions on shorting.[37] Furthermore, SSFs and SIFs are standardized contracts transacted in organized exchanges. The features of these contracts which contribute to a liquidity increase include daily settlements, margin requirements, the role of the brokerage firms and clearinghouse, and price limiting moves.

2-1-2-3 *Low Transaction Costs*

Transaction costs are reduced in SSFs and SIFs for three major reasons. First, SSFs and SIFs are both categorized and organized as exchange-traded contracts. Second, SIFs specifically allow for more efficient transactions because the underlying asset is a diverse basket of securities,[38] eliminating the need for transacting on each separate stock. Third, the physical transfer of commodities involves at each stage increased human activities, such as packaging, storage, and transport, which naturally increases transaction costs.[39] SSFs and SIFs, however, do not incur such costs as they are contracts in which the investors have the freedom to offset their commitments by the due date without any delivery.

---

[35] Misbahul Islam & Jayanta Chakraborti, "Futures and Forward Contract as a Route of Hedging the Risk" (2015) 5:4 Risk Governance & Control: Financial Markets & Institutions 68 at 69.

[36] Ibrahim Uzaimah, *Commodity Futures Contract: An Analysis in Islamic Commercial Law* (PhD Dissertation, University of Wales, 2000) at 1 [unpublished].

[37] See Frank Partnoy, "Some Policy Implications of Single Stock Futures" (2001) U San Diego L & Econ Research Paper No 10 ("[t]he trading of [SSFs] might ameliorate this anomaly, both by enabling investors to avoid regulations applicable to short sales and by creating a virtually unlimited supply of short futures positions for investors" at 5).

[38] Cooper & Mello, *supra* note 4 at 3.

[39] Muhammad Asif Ehsan, "Futures Contracts in Islamic Finance: A Jurisprudential Analysis" (2014) 10:1 J Islamic Economics Banking Finance 156 at 167.

2-2 Differences between SSFs and SIFs

The differences between SSFs and SIFs lie in the nature of the underlying assets, the settlement processes, and their necessity to capital markets.

2-2-1 Underlying Assets

Both SSFs and SIFs derive their value from that of their underlying assets. However, the assets on which they are transacted are different.

SSFs are issued based on the stocks of a particular company. Therefore, the assets on which SSFs are transacted are shares, which are deliverable if one of the parties intends to deliver or the other party requests this. Thus, the parties to SSF transactions normally deliver the consideration of the agreement, unless they agree to offset by the due date.[40]

In contrast, SIFs are transacted on an index as the underlying asset. An index, by its very nature, is comprised of a portfolio of stocks within the stock market index. In other words, it derives its value from the prices of the securities that constitute the index, and is created to represent the predictions and beliefs of the market as a whole, or of a particular sector of the economy.

By comparison, when a buyer invests in a particular company's stock in SSFs, he or she owns (or can own) the company's stock, forming the basis of the SSF transactions. In other words, the seller of an SSF is committed to delivering the underlying stock on the expiration date, even if the parties decide not to deliver the underlying asset at the due date, and merely clear their commitments. However, in the case of a SIF, the buyer intends to trace the stock price movements of a large number of companies. For example, one of the most popular SIFs, the S&P 500 Index, includes the movements of the shares of 500 companies. This means that the party who made a wrong prediction of the index movements would pay the price difference to the party who made the right guesses. Because of this, the clearinghouse interferes only to offset the commitments of the parties by the due date, and delivery never happens.[41]

Therefore, the major difference between SSFs and SIFs is in terms of the underlying assets. This difference is one of the major reasons why Iran's capital market began to expand its futures market with SSFs rather than SIFs: the subject matter of the contract in SIFs in its western context (index) is fully abstract, while that of SSFs

[40] See *Sharia* Board of SEO, "Detailed Discussions of *Sharia* Board Regarding SSFs" (5 September 2007) at 1, 9, online: *Research, Development and Islamic Studies* <www.rdis.ir/ShariaBoardNegotiationsDerivatives.asp>.

[41] This is one of the most important reasons why SIFs are not accepted as a legitimate contract by *Sharia* board members in Iran's capital market. This will be explained in more detail below.

(shares) can potentially be delivered electronically.[42]

2-2-2 Settlement Process

The settlement process is another key feature that distinguishes SSFs from SIFs. SSFs can be settled either by delivery of the underlying commodities or by offsetting transactions at the expiration date.[43] SSFs, therefore, have two types of settlements: physical and cash settlement. The physical settlement of SSFs means that upon expiration of the contract, the buyer will receive the underlying shares, and the seller will be required to deliver.[44] However, the parties can also agree to a cash settlement. In this model, upon the expiration of an SSF, profits and losses are credited or debited to the account of the relevant party in an amount equal to the difference between the contract price and the final settlement price.[45] On the other hand, the western conception of SIFs involves only one type of settlement, called a "cash settlement". In the cash settlement process, after establishing a long or short position, market participants are subject to a normal "market-to-market" procedure. Since SIFs are not traded on actual stocks but on price movements, the parties need to follow the value of the index and pay or obtain cash for the price difference in order to close the deal by the due date.[46] It is essentially impossible for individual investors in SIFs to deliver the underlying asset because doing so would require handing over a portfolio of shares, such as the shares of 500 companies. Because the delivery cost of such a portfolio is prohibitively high, the subject matter of SIF contracts is never delivered in practice, and the contracts are instead settled in cash.

In summary, the difference in the settlement process between SSFs and SIFs is affected by the issue of "delivery" contained in these contracts, meaning that while SSFs have both types of physical and cash settlements based on what the contract

---

[42] Even some members of the *Sharia* Board of SEO in Iran once believed that electronic assets could not be considered underlying assets because they are not tangible so they cannot be delivered physically. However, the majority of members decided that tangibility differs from physical delivery of assets, and electronic assets also have the potential to be delivered. See *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 12.

[43] Travis Jones & Robert Brooks "An Analysis of Single-Stock Futures Trading in the U.S." (2005) 14 Financial Services Rev 85 at 89.

[44] David G Downey, "Single Stock Futures: An Alternative to Securities Lending" (2018) at 2–3, online (pdf): *US Securities And Exchange Commission* <www.sec.gov/comments/4-590/4590-15.pdf>.

[45] Allen B Paul, "The Role of Cash Settlement in Futures Contract Specification" (1985) at 272, online (pdf): *American Enterprise Institute for Public Policy Research* <legacy.farmdoc.illinois.edu/irwin/archive/books/Futures-Regulatory/Futures-Regulatory_chapter5.pdf>.

[46] But see *Ibid*, at 309:

> Curiously, trading on organized exchanges in the equivalent of a futures contract for the narrowest of stock indexes—namely, for a single stock—already exists. Futures positions now can be taken indirectly in many stocks if one takes a position in both a put option and a call option. Therefore, why not allow delivery of certificates on narrowly based stock index futures contracts? The shorts would not elect to do so if they deemed it too costly."

parties choose, SIFs have cash settlements only. The reason for such an exclusive method of settlement of SIFs is that in western capital markets, which pioneered SIFs, the physical delivery of the underlying asset is not expected, because it is not considered a deliverable asset.

2-2-3 Necessities

2-2-3-1 *SSFs*

SSFs are designed mostly for individual investors, who tend to own a limited type of shares. In early 1995, SSFs were introduced in Hong Kong to respond to investors' needs to manage the risk of price fluctuations of their financial instruments.[47] As a result, SSFs help traders keep ownership of the underlying asset, while being able to prevent a fall in the value of their financial assets.

There are other reasons for the introduction of SSFs as well. For example, an investment bank may acquire shares as an underwriter, which it is banned from selling because of its commitment to the issuer not to sell the shares in a certain time. Additionally, the holder of a sell position in a stock option contract who does not have the right to sell may use SSFs due to the stocks having increased in value. In these cases, the investor may wish to hedge, rather than immediately sell their shares, as protection against price falls.[48] Short sellers can also benefit from cutting costs associated with the stock loan process by investing in SSFs, since the margin requirement is as low as 20%.[49] Finally, in addition to SSFs being an efficient mechanism for opening short positions, they also provide investors with the opportunity to postpone the sale of a particular company's shares, securing their rights to receive a dividend, as well as vote.

2-2-3-2 *SIFs*

SIFs are designed mainly for mutual funds that tend to own a wide variety of shares, such as a portfolio of 500 shares, or for investors whose main activity is to follow the index movements in order to speculate.

Many investors prefer SIFs compared to other contracts such as SSFs for a range of reasons. They offer a historical comparison of the returns on money invested in a wide range of stocks, as against investment in some other types of assets such as

---

[47] Fung & Tse, *supra* note 17 at 519.

[48] Chris Brooks, Ryan J Davies & Sang Soo Kim, "Cross Hedging with Single Stock Futures" (2007) 74:4 J Insurance Risk Management 473 at 474.

[49] Fung & Tse, *supra* note 17 at 520.

government debt or gold. They can also be used as a simple standard by which to monitor the performance of investment fund managers. Since the share price is often treated as a measure of the market's expectations of the cash flows from the company concerned, investors can benefit from the market index, as an indicator of national economic performance, to simply track changes in financial markets.[50] All these needs can be responded to through SIFs. Finally, as Stephen Figlewski notes, "[b]oth market timing (predicting the movement of the market as a whole and adjusting the portfolio's beta accordingly) and stock selection (trying to increase portfolio returns by buying stocks that are undervalued relative to the market) are made easier by the use of index futures."[51]

3. Gambling Elements vs. Justifications: Islamic Perspective

Gambling and other terms such as "gaming" and "games of chance" are derived from the Anglo-Saxon "gamen" and "gamon," which mean sport or play.[52]. The general use of the word "gamble" regards any activity that involves risk and uncertainty: "uncertainty is an imaginary situation where nothing is known about anything and where there are no measurable variables, nor even an idea as to what factors are relevant to a problem."[53] Hence, gambling means to play a game of chance for money, or to take an extremely uncertain position in order to gain some advantage. Gambling has nothing to do with the exchange or production of real goods or services. The gambler merely makes a payment in the hope of gaining a larger sum of money.[54] Thus, "uncertainty" and "gaming" are the core elements of gambling.

Although the prohibition against gambling or *maysir* is very clear in Islam, it is not defined in any of its original sources.[55] However, it is very clear that there is an essential element in gambling, namely uncertainty,[56] or *gharar* as it is termed in

---

[50] Sutcliffe, *supra* note 24 at 3.

[51] Stephen Figlewski, "Hedging with Stock Index Futures: Theory and Application in a New Market" (1982) 5:2 J Futures Markets 183 at 183.

[52] Hussin Bin Salamon, Mansoureh Ebrahimi & Kamaruzaman Yusoff, "Speculation, The Islamic Perspective: A Study on Al-Maisir (Gambling)" (2015) 6:1 J Leg Soc Sciences 371 at 372.

[53] Henry B Arthur, "Economic Risk, Uncertainty and the Futures Market" (1966) at 214, online (pdf): *Mimir Publishers* <legacy.farmdoc.illinois.edu/irwin/archive/books/Futures_Seminar_V3/Futures%20Seminar%20V3_Arthur.pdf>.

[54] Sheikh Morteza Ansari, *Makasib-al-Moharramah* (Qom: Fikr-al-Islamic Press, 1994) at 95.

[55] Atikullah Abdullah, "Islamic Law on Gambling and Some Modern Business Practices" (2017) 7:11 *Intl J Academic Research in Bus Soc Sciences* 738 at 738.

[56] Some scholars have made a distinction between uncertainty and doubt and believe that *gharar* means both an unknown and a doubtful activity. However, it seems that these two terms have the same meanings. See Tahmyna Qazi "Uncertainty & Doubt under Islamic Law" (2 November 2016), online: *Islamic Finance Board* <islamicfinanceboard.com/?p=583>.

Islamic law.[57] *Gharar* is not defined precisely by *Sharia* either. However, it is agreed that whenever there is the risk a contract will have unknown consequences, it is likely that such a transaction could lead to an illegal unpredictable loss of individuals' earnings,[58] and thus, it is *gharary* (uncertain). Therefore, any contract that includes uncertainty in either the possibility of delivery of the subject matter, the quality or quantity of the subject matter, price, payment time, or existence of the subject matter, would be considered *gharary*.[59]

To sum up, from an Islamic point of view, "uncertainty or *gharar*" as well as "gaming based on chance" in an activity, constitute the core elements of gambling or *maysir*. It should be noted that these two elements together[60] can constitute "gambling," however one of them separately does not denote "gambling"; they must be found together.

3-1 Comparison between SSFs and SIFs in terms of the Gambling Elements

The challenges from an Islamic perspective with respect to SSFs and SIFs are "*gharar* or uncertainty in delivery" and "game of chance", which have been raised by *Sharia* board members when these contracts have been proposed for introduction into Iran's capital market.

3-1-1 *Gharar* (Uncertainty in Delivery)

Delivery is an important factor in sales contracts from an Islamic perspective. It is the possibility of eventual delivery that determines the prices of financial derivatives.[61] However, *gharary* sales are linked to the ability to deliver the goods subject to sale.[62]

Historically, the key reason for including any asset in the futures market was the possibility of fluctuations in its prices—in other words, uncertainty.[63] Therefore, the reasoning underlying the creation of these markets was to promote the exchange of goods by the redistribution of the risks created by the uncertainty of prices. When futures trading was popular only for commodity markets, and the delivery of goods was binding, this trade served the purpose of distribution and management of risk for

[57] Abdullah, *supra* note 55 at 741.

[58] Mohamed Ali El-Gari, "Towards an Islamic Stock Market" (1990) 1:1 Islamic Economic Studies 1 at 6.

[59] Mohammad Hassan Najafi, *Javahir-al-Kalaam* (Qom: al-Milani Foundation Press, 2011) at 387.

[60] Contracts that have only one of these elements are void from an Islamic perspective. However, such contracts are not considered "gambling" if one of the elements does not exist.

[61] Ehsan, *supra* note 39 at 166.

[62] El-Gari, *supra* note 58 at 6.

[63] Carlton, *supra* note 2 at 242.

the sake of enhancing production and, thus, exchange.[64] However, when delivery was no longer a binding obligation, the primary concern became to manage and manipulate the risk. Over time, risk management became the objective rather than the means.

Gharar is a standard that helps clarify whether the parties' transaction is based on a certain subject matter, and whether they can reasonably anticipate what they give and what they receive in a certain contract. In this regard, *Sharia* scholars discuss the legitimacy of each western contract before it is introduced to the market, to make sure that they prevent almost every possible dispute about the subject matter between parties.[65] In other words, they try to make a distinction between reasonable and unreasonable *gharar*, where the former involves "economic benefit" while the latter does not.

Therefore, the concept of *gharar* focuses on the fact that both parties to the agreement should clearly know what they will give and receive in a contract. The issues surrounding *gharar* can be studied in the context of the high-risk activities that caused the 2008 financial crisis in the US—an environment in which risk and uncertainty are the norm.[66] As Covitz et al note, "[t]he US asset-backed commercial paper (ABCP) market erupted in late summer of 2007 and played a pivotal role in the global financial crisis."[67] In such a market, the issuance of papers without any corresponding underlying assets led to the paper crisis.[68] In other words, the proliferation of derivative transactions, such as credit default swaps (CDSs), without any underlying assets of the same value, led to *gharary* transactions. Moreover, there were third party purchasers who gambled on CDSs because they believed that the borrower would not default on the loan payment. These gambling transactions formed a new market for CDS papers without any underlying assets. In these *gharary* transactions, it was not clear what the sellers paid and what the purchasers received in consideration.

When futures contracts were introduced to Iran's capital market for the first time in 2007, *Sharia* board members studied the issue of uncertainty and believed that futures contracts should be forbidden due to uncertainty in delivery, using an Islamic

---

[64] Khan, *supra* note 9 at 26-27.

[65] Ansari, *supra* note 54 at 186.

[66] Stephen C Nelson and Peter J Katzenstein, "Uncertainty, Risk, and the Financial Crisis of 2008" (2014) 68:2 Intl Organization J 361 at 362.

[67] Daniel M Covitz, Nellie Liang & Gustavo A Suarez, "The Evolution of a Financial Crisis: Panic in the Asset-Backed Commercial Paper Market" (2009) at 2, online (pdf): *Divisions of Research & Statistics and Monetary Affairs Federal Reserve Board* <www.federalreserve.gov/pubs/feds/2009/200936/200936pap.pdf>.

[68] See Austin Murphy, "An Analysis of the Financial Crisis of 2008: Causes and Solutions" (2008) online (pdf): *Oakland University School of Business Administration* <www.sba.oakland.edu/files/news/financial_crisis.pdf> ("[u]nrealistic assumptions led to serious problems in mispricing in the massive unregulated market for credit default swaps that exploded upon catalytic rises in residential mortgage defaults" at 1).

rule that bans *bay-al-kali-bi-kali*[69] (sale of debt) to justify the exclusion.[70] Under this rule, both final payment and item delivery cannot be deferred in a sale contract. Otherwise, it leads to *gharar* because there is a high risk that one of the parties will fail to fulfill their commitment in the future, or simply avoid it.

In 2007, *Sharia* board members argued that SSFs were just a tool of speculation and represented a formalistic agreement in which parties do not actually intend to deliver the subject matter of the contract,[71] using statistics to bolster their claim. They argued that it had been estimated that approximately 1% of all transactions are actually settled by a customer making or taking delivery of physical commodities,[72] strengthening the view that SSFs are merely a means of speculation. *Sharia* board members held that speculation is unacceptable because it involves high uncertainty, which is one of the main elements of gambling that is strictly forbidden by the Quran.[73] They considered SSFs as a high-risk activity based on chance rather than calculation. Therefore, *Sharia* board members argued the problem of "uncertainty" or *gharar* in SSFs from two perspectives: first, the final payment and item delivery in a sales contract cannot be deferred until the due date (*bay-al-kali-bi-kali*), as this increases the risk of parties' failure to meet their commitments; and second, parties may not have any real intention to deliver the subject matter at all—rather, their real intention is to arbitrate.

In SIFs, the index, as the underlying asset, is not considered a property and has no value per se from an Islamic law perspective.[74] In 2016, *Sharia* board members argued that the subject matter in SIFs is the movements of the index, and investors try to speculate and benefit from the price differences without performing any real transactions on any particular asset. In other words, *Sharia* board members believe that SIFs incorporated absolute speculation on prices, and parties merely benefited from the differences in prices, without having any serious intention of exchanging any goods or products. They argued that investors in SIFs intended to make an income simply by making good guesses with no intention to receive, deliver, or produce goods.[75]

---

[69] *Bay-al-kali-bi-kali* is the deferment of both final payment and item delivery. See generally Mohammad Hashim Kamali, "Commodity Futures: An Islamic Legal Analysis" (2007) 49:3 Thunderbird Intl Bus Rev 309 at 313, 317.

[70] *Sharia* Board of SEO, "Detailed Discussions of *Sharia* Board Regarding Futures Contracts" (28 November 2007) at 1, 12.

[71] See *Ibid*.

[72] *Sharia* Board of SEO, "Detailed Discussions of *Sharia* Board Regarding SSFs" (23 July 2008) at 26.

[73] Abdullah M Al-Awadhi & Ahmad Bash, "Islamic Asset Pricing and Speculation Restrictions" (2018) 6:1 J Islamic Banking Finance 45 at 45.

[74] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 12.

[75] Khan, *supra* note 9 at 46.

Ultimately, *Sharia* board members concluded that *gharar* clearly exists in SIFs as sales contracts, because the underlying asset of the contract is undeliverable. They argued that even if the parties intended to deliver the subject matter, it would not be possible to do so, because the movement of the share price or index is not deliverable.[76] This means that the parties to a SIF are unable to fulfill their obligation to deliver the underlying asset on the expiration date, simply because the subject matter cannot be possessed.[77]

In sum, the *Sharia* board members considered the problem of "uncertainty in delivery" in SIFs from two perspectives: SIFs are a means of speculation, and the subject matter is undeliverable.[78]

3-1-2 Game of Chance

Another element of "gambling" is its characterization as a "game of chance". The term "game of chance" refers to an activity where the participant pursues monetary gain without using any skills and information. It is, therefore, appropriate to use the term "gambling" for games of chance. Thus, if one uses the term "game of chance" to describe transactions on the stock market, it implies that the trader in the transaction did not and could not have any specific skills or use any special information.[79]

Another feature of the "game of chance" is the lack of mutual benefit, meaning that in such activities, one of the parties is always the loser and the other is always the winner.[80] Mutual benefit is any direct or indirect economic benefits, directly or indirectly, that both parties of the contract may enjoy when entering a contract, ranging from monetary profits and loss avoidance, to the mental comfort derived from the risk management that a contract offers. On the other hand, in a "game of chance" both parties are aware of the fact that one of them will ultimately be the loser. In legitimate beneficial contracts, there is the possibility that both parties will benefit, and both parties expect some gain when they enter the contract.[81]

---

[76] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 13.

[77] Ehab MM Injadat, "Futures and Forwards Contracts from Perspective of Islamic Law" (2014) 1:2 J Economics Political Economy 241 at 243.

[78] The third one is also similar to those two other reasons at heart, which will be explained below in the next section.

[79] Reuven Brenner, *Gambling and Speculation: A Theory, A History and A Future of Some Human Decisions* (New York: Cambridge University Press, 1990) at 90.

[80] Abu-al-Qasem Mousavi Khoei, *Mesbah-al-Feqahi*, vol 1 (Qom: Khoei's Works Publication, 1996) at 377.

[81] T Henry Dewey, *Legislation Against Speculation and Gambling in the Forms of Trade: Including Futures, Options, and Short Sales* (New York: Baker, Voorhis & Co Press, 1905) at 5.

However, many Islamic scholars argue that SSFs and SIFs do not serve a mutually useful economic purpose, but rather are a cover for gambling activities.[82] The purpose of Islamic financial rules is to ensure that all parties involved in a transaction are protected against losing money in exchange contracts that are risky and uncertain. Therefore, *Sharia* board members have argued that, in SSFs and SIFs, the contracting parties intend to benefit from the price difference.[83] Such contracts are based on chance, contain no intention to deliver, and have one party who loses their money in favour of the winner. Thus, in *Sharia* board members' view, they should both be considered gambling.

3-2 Why Allow SSFs While Prohibiting SIFs?

In 2007, out of economic necessity, Iran's SEO established a *Sharia* board to decide the legitimacy of capital market transactions.[84] *Sharia* board members employed various Islamic institutions to justify the legitimacy of different transactions. They did this in order to help Iran's capital market keep pace with modern capital market developments. *Sharia* board members argued that the diversity of transactions had become a necessity to attract more investors.[85] Thus, they made every effort to expand Iran's capital market and increase the diversity of contracts.

In essence, the futures market is an institution to help promote the exchange of goods. Since this institution can help improve efficiency in production and trade by redistributing risks, the nature of this market cannot be declared as intrinsically against *Sharia*. Thus, in 2008, *Sharia* board members made every effort to legitimize futures transactions as a whole, and SSFs in particular. After many discussions regarding the potential illegitimacy of SSFs, *The Directive of SSFs in Iran* was enacted in 2010.[86] Today, SSFs are recognized—and are quite popular—in Iran's capital market. A considerable number of SSFs transactions in Iran's capital market demonstrate the radical shift in beliefs in this regard.

---

[82] El-Gari, *supra* note 58 at 5.

[83] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 1.

[84] Iran, Art 1-10, *The Directive of Establishment and Duties of Sharia Board* (2007). See generally, online: <cmr.seo.ir/>. The *Sharia* Board is a committee that is established by Iran's SEO. This board works under Iran's SEO's supervision. It has eight members, including five Islamic religious experts, one finance expert, one legal expert, and one economist. The decisions are made only by the five Islamic religious experts. The board duties include, among other things, making decisions about the legitimacy of new financial instruments, evaluating well performance of the already legitimized financial instruments, introducing new Islamic financial instruments to Iran's capital market, and cooperating to hold conferences regarding Islamic finance.

[85] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 1.

[86] See generally, online: <cmr.seo.ir/> It is noteworthy that this directive was further replaced by *The Directive of SSFs* (2018), *supra* note 20.

In the following section, we address the two gambling elements mentioned in the previous section in order to explain how *Sharia* board members tried to justify elements of SSFs to legitimize these contracts. Also, using the comparisons made between SSFs and SIFs in the previous sections, we discuss how these justifications can likewise be applied to SIFs, in part. We discuss the response to "*gharar*" or "uncertainty in delivery" in the following sub-section, "Interpretation," and the response to "game of chance" under the subsequent sub-section, "Hedging and Speculation vs. Gaming".

3-2-1 Interpretation

When SSFs became a necessity in Iran's capital market, *Sharia* board members employed "Interpretation,"[87] as an Islamic rule, to view the definition of these Islamic institutions from a different perspective.

In 2007, when *Sharia* board members decided to discuss the legitimacy of futures contracts as a whole and SSFs in particular, they started with the problem of *bay-al-kali-bi-kali* (sale of debt), which leads to *gharar*. They argued that the underlying concept of futures trading is simply to enable commodity exchanges. From an Islamic perspective, commodity exchange always entails some risk elements, and the risk element is particularly significant if the commodity to be exchanged requires time for its production or supply. Their interpretation was that SSFs are promises to sell, rather than sales contracts. In contrast to a sales contract, in which either the payment or the delivery should occur on the contracted date, in a promise to sell, both the payment and the delivery can be postponed until the due date. They concluded that if SSFs are promises to sell and not sales contracts, deferment of both considerations do not expose the contract to *gharar*, as it is only the parties' promises to buy and sell and not a concluded sale (*bay-al-kali-bi-kali*).[88]

Regarding the second element of *gharar*, where SSFs are a means of speculation rather than a contract in which the parties have a real intention to deliver the subject matter, *Sharia* board members resorted to "Interpretation" again. They followed the opinions of some Islamic scholars who offered a narrower definition of gambling.[89] The latter group argued that speculation has wrongly been considered

[87] But see Usman Hayat & Adeel Malik, *Literature Review: Islamic Finance: Ethics, Concepts, Practice* (Charlottesville: CFA Institute Research Foundation, 2014) ("[a] frequent criticism is that Islamic finance, at least the manner in which it is currently practiced, is a legalistic phenomenon. The "Islamic" in Islamic finance is "Islamic" in legal form only and "conventional" in economic substance" at 68).

[88] *Sharia* Board of SEO, "Detailed Discussions of *Sharia* Board Regarding SSFs" (10 October 2007) at 10.

[89] Ahmad Abdel Fattah El-Ashkar, "Towards an Islamic Stock Exchange in a Transitional Stage" (1995) 3 Islamic Economic Studies 79 at 82.

gambling, and is different[90] because speculation may involve a great deal of computation, and chance can hardly influence it.[91] From some Islamic scholars' opinions, an SSF agreement is a legitimate type of speculation because it is based on information, analyses, and computations, rather than mere chance.[92] They argue that one should make a distinction between the two types of speculations: one is a speculation activity that is not related to any real activity and is meant to be monetary, non-productive, based on chance, and beneficial to only one of the parties (the winner); and the other involves some real activities, which contribute to partly shifting the risks from the traders who believe that they cannot afford to bear all the risk to those who believe that they can afford to bear it.[93] *Sharia* board members concluded that SSFs are contracts of the second type of speculation and are therefore not *gharary*.[94]

The same reasoning can be applied in response to the alleged illegitimacy of SIFs. It can be argued that although speculation always involves an attempt to predict the future outcome of an event, the process may or may not be backed by the analysis and interpretation of relevant information. *Sharia* board members decided that the former case is consistent with Islamic rationality,[95] as almost all legitimate business decisions involve some degree of speculation. Therefore, they believed that when speculation is based on information, it is not only permissible, but desirable. It is only the absence of relevant information, or the conditions of excessive uncertainty, that make speculation resemble gambling. As a result, SIFs, as transactions in which information and precise analyses play an important role,[96] can be approved from this perspective.

Another *gharary* feature of SIFs is the impossibility of delivery. However, SSFs and SIFs are not comparable in this regard. While in SSFs there is the possibility of delivery of the subject matter, this is not possible in SIFs. Accordingly, this paper offers three solutions to this problem—two of which are different from the justifications presented for SSFs[97]—so that SIFs can be allowed in Iran's Islamic

---

[90] But see Rafic Yunus Al-Masri, "Speculation between Proponents and Opponents" (2007) 20:1 King Abdulaziz U Islamic Economics Institute 43 (it seems that "speculation is a form of gambling, whereby a minority wins what the majority of investors lose" at 43).

[91] *Ibid* at 83.

[92] Al-sheikh Javad Tabrizi, *Ershad-al-Taleb*, vol 1 (Qom: Mehr Publication, 1979) at 218.

[93] Khan, *supra* note 9 at 46.

[94] See *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding Futures Contracts, *supra* note 70 at 14.

[95] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 12.

[96] See generally Hans R Stoll & Robert E Whaley, "The Dynamics of Stock Index and Stock Index Futures Returns" (2009) 25:4 J Financial Qualitative Analysis 441.

[97] The reason why the first two solutions are studied in this part is that these solutions need a "customization" of the SIFs so that they can work according to the rules of an Islamic capital market. We believe that "customization" requires some "Interpretations" of the subject matter, and that is why these two solutions are discussed under the title of "Interpretation".

capital market. The third solution is one which was previously discussed with respect to the legitimacy of SSFs.

The first way to address the *Sharia* board members' concern on the issue of the "impossibility of the delivery of the subject matter" in SIFs is to consider the nature of SIFs more precisely. For example, the subject matter of a SIF on the S&P 500 is not actually the index itself, but the shares of 500 companies. Therefore, although the number is large, it is still limited. As a result, it is not impossible to deliver the subject matter in SIFs if the buyer asks for delivery. Such a delivery will be more feasible, with lower transaction costs, if this role is played by a mutual fund that owns the portfolio of shares and represents the investors in SIFs.

A second approach would be a smaller contract size, such as a portfolio made of 50 stocks, which could reasonably be delivered.[98] This could create popularity for SIFs among individual investors in conjunction with mutual funds and, at the same time, make delivery possible. Although SIFs, in their original form in western countries, contain no delivery, changing this contract in Iran's Islamic capital market to one in which delivery is expected would contribute to the legitimacy of SIFs under Islamic law. This change would also allow investors with less capital to access SIFs.[99] Such investors could benefit from the advantages of SIFs in order to follow price movements, and at the same time, deliver the subject matter in cases where a buyer wishes to do so.

Unlike the above approaches, the third solution is restricted to situations where the parties do not own the portfolio but intend to manage their future risk and profit from price differences. In other words, this solution could help introduce SIFs in their western context to an Islamic capital market. This third solution offers a different interpretation of the nature of SIFs compared to the two previous solutions.

With respect to the problem of *gharar* in SIFs, due to the "impossibility of delivery" or "lack of parties' intention to deliver", this solution suggests that SIFs should not be analyzed based on the regulations governing sales contracts, where delivery plays an important role. Rather, *Sharia* board members should consider categorizing them as a type of contract under Article 10 of *Iranian Civil Law*,[100] in which parties agree to cover the other party's risk in cases of fluctuations in prices; a contract in which delivery is not a condition at all. In other words, SIFs are not a

---

[98] See *Art 1-38 The Directive of SSFs*, *supra* note 20. Iran's capital market approved such transactions in 2017. However, the directive does not mention that the transaction on a basket of shares has something to do with SIFs and considered it as regular stock transactions that are based on a portfolio of shares.

[99] But see Jędrzej Białkowski & Jacek Jakubowski, "Determinants of Trading Activity on Single Stock Futures Market" (2012) 19:3 J Derivatives 29 at 33: the application of large-size contracts to hedging or speculation can result in compromising a degree of precision in matching positions. On the other hand, reducing the contract size increases a trading cost, as both brokerage commissions and exchange fees are mostly quoted per contract independently of a size.

[100] It provides that: "[p]rivate contracts are valid regarding the parties of the contract, unless these contracts are explicitly against the law" [translated by author].

promise to sell, and are not supposed to be a sales contract either. Rather, they are a contract in which one party pays a sum of money to the other party by the due date in exchange for achieving security for probable future purchases of stocks.

Such contracts are not unprecedented in Iranian Islamic law. For example, insurance agreements have a rather similar role in Iran, where one party pays an amount of money to the other party so that the latter covers the probable risks of the former and provides the former with economic security. In insurance agreements, the indemnity is the effect of the insurance contract and not its consideration.[101] Islamic scholars have held that an insurance agreement is not a sales contract, but rather an agreement in which the insured party achieves security in consideration for the money paid to the insurer. They have argued that it is reasonable—and not *gharary*—if someone, based on some calculations and information, undergoes a smaller loss to cover a probable bigger loss. They also explained the issue of *gharar* by holding that parties of the insurance agreement are aware of the type of damages that should be compensated by the insurer, the maximum amount to be paid by the insurer, and the amount that the insured party should pay to the insurer. Therefore, parties can anticipate the consequences of the insurance agreement to a certain degree. Finally, Islamic scholars have found that a reasonable degree of certainty, based on the common practices of the general public, is enough for a contract not to be *gharary*, and such a degree exists in insurance contracts.[102]

3-2-2 Hedging and Speculation vs. Game of Chance

Sharia board members responded to another gambling element in SSFs, the "game of chance", by making a distinction between "hedging and speculation" and "game of chance". This justification can be similarly applied to SIFs: if *Sharia* board members justified SSFs because they are not a "game of chance", but rather a tool for hedging or a legitimate speculative activity, they should accept the same reasoning for SIFs.

Stock prices are highly volatile, with the owners of stocks bearing a substantial risk. Thus, hedging as a function of SSFs and SIFs helps investors reduce their risk.[103] As Ghosh notes, "[u]ntil 1982, market participants could not control the market risk of their portfolios. The introduction of [SIFs] offer[ed] them an opportunity to manage the market risk of their portfolios without changing the portfolio composition. The objective of hedging is to minimize the risk of the portfolio for a given level of return."[104] Therefore, hedging uses the potential of futures markets

---

[101] See generally Samir Mankabady, "Insurance and Islamic Law: The Islamic Insurance Company" (1989) 4:3 Arab Law Quarterly 199 at 200.

[102] Asadollah Lotfi, "*Gharar* in Insurance Agreements" (2015) 15:2 Islamic L J 101 at 118 [translated by author].

[103] Figlewski, *supra* note 51 at 183.

[104] Asim Ghosh, "Hedging with Stock Index Futures: Estimation and Forecasting with Error Correction Model" (1993) 13:7 J Futures Markets 743 at 743.

to avoid risk. Figlewski gives as an example that "…by selling futures on the [S&P 500 Index], an investor can hedge against systematic risk by locking in a known return on the market component of his portfolio without selling any of his stocks."[105] Therefore, "[p]ositions are hedged by taking an equal but opposite position in the futures market."[106]

With respect to SSFs, *Sharia* board members have argued that the owner of the shares could reduce their risk through hedging, as hedging makes sense when the seller owns the shares or where there is the possibility they own them.[107] Therefore, in this case, there is no "game of chance" because the seller's real intention is to manage the risk of a fall in their real property prices. In other words, concerns regarding the illegitimacy of speculation do not make sense here. The same reasoning can be applied to SIFs, where mutual funds, which are the most common traders of SIFs in western capital markets, or a retail investor owns the portfolio of shares. Consider a situation where a mutual fund owns a portfolio of 500 shares, the value of which is $100. Subsequently, the seller sells their portfolio for a price of $110. If, by the due date, the value of the portfolio is $120, both parties will benefit. The seller would sell the portfolio for $120, gaining $10 as their own profit, and the buyer would also gain $10 in profit. This can be considered a legitimate beneficial activity, because of the possibility that both parties will benefit at the end of the contract date. In this situation, SIFs act as a hedging tool and not as a "game of chance", because "mutual benefit" exists.

In cases where the seller does not own the property, or the underlying asset is not regarded as a property at all,[108] investors may choose to "speculate". As *Sharia* board members determined regarding SSFs where the seller does not own the subject matter, to control or reduce the risk of an asset or a portfolio of shares, the speculator must analyze the information and determine the optimal speculation ratio.[109] This ratio can differ significantly depending on the estimation technique used.[110] These techniques are so sophisticated that some argue that with the emergence of each new product in the capital market "questions such as whether investors understand the risks of the novel products they are investing in, whether the products are too complicated for retail investors, or whether those selling them or the regulators themselves

---

[105] Figlewski, *supra* note 51 at 183.

[106] Joost ME Pennings & Matthew TG Meulenberg, "Hedging Efficiency: A Futures Exchange Management Approach" (1997) 17:5 J Futures Markets 599 at 600.

[107] See *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 15. However, *Sharia* board members used "hedging" and "speculation" terms interchangeably and did not pay attention to the subtle difference between these two terms.

[108] This is regardless of the fact that it can be argued that an Index can be considered property according to Islamic rules—but this issue needs a separate essay.

[109] *Sharia* Board of SEO, Detailed Discussions of *Sharia* Board Regarding SSFs, *supra* note 40 at 15.

[110] Ghosh, *supra* note 104 at 743.

understand them" are hard to answer.[111] Clearly, speculation, under this analysis, is different from a "game of chance", where information and skills play no role. SIFs not only lack a "gaming" element, but also involve the possibility of mutual benefit. Consider a situation where the index price is $100. Subsequently, the seller sells their position for a price of $110. If by the due date, the value of the index is $120, both parties will benefit. The seller has reduced his risk for probable future purchases, meaning that the seller's loss would be $10 instead of $20, which can be considered as a gain of $10 for them, and the buyer makes a profit of $10.

4. Conclusion

Using a comparative methodology, this paper discussed the similarities and differences between SSFs and SIFs: they are similar in terms of their definition and function, while different in their subject matter of the contracts, settlement procedures, and their necessities to capital markets. While the subject matter of SSFs are the shares of one particular company, the subject matter of SIFs (in their Western conception) is the price movements of the index. Further, while SSF contracts can be settled by delivery of the subject matter, delivery of (Western) SIFs never happens. Finally, while SSFs are, among other things, a tool for selling short with less cost, SIFs act largely as an indicator of national economic performance. Therefore, SSFs and SIFs are fundamentally similar except for the fact that while the subject matter in SSFs (the stocks of a particular company) is deliverable, the subject matter in SIFs is the index, which cannot be owned or delivered—even in the future.

Using a legal history method, this paper also analyzed the legitimacy of SSFs and SIFs under Islamic law through a study of the views of *Sharia* board members. Until 2010, the board believed that SSFs and SIFs were illegal because these types of contracts contained gambling elements, including "*gharar*" and "gaming" based on chance. Accordingly, board members believed that these contracts were "*gharary*" (uncertain) because, even if delivery of the subject matter is considered possible, both payment and delivery of the subject matter are deferred in these contracts. This constitutes *bay-al-kali-bi-kali*—a type of *gharary* contract in Islam. Indeed, the parties do not really intend to deliver the subject matter in SSFs, as their real intention is to speculate. Thus, the board considered these contracts to be a "game of chance", in which skill and information play no role, and in which one party of the contract is always the loser and the other the winner.

However, changing needs of capital market investors made *Sharia* board members change their views on SSFs. Board members' views evolved to interpret SSFs as a *promise to sell* rather than a sales contract, and thus, responded to the problems of *bay-al-kali-bi-kali*. Further, board members used the "Interpretation" rule as an Islamic institution to expand their understanding of the concepts of *gharar* and

---

[111] Mary Condon, "A Discipline in Search of Itself? Contemporary Challenges for Securities Law in Canada" (2014) 65 UNBLJ 341 at 346–47.

speculation. In their current view, speculation was wrongly considered gambling. It is different from gambling and game of chance because speculation may involve a great deal of computation, and chance can barely influence it. As such, in 2010, *Sharia* board members approved "*The Directive of SSFs in Iran*," which formally provided that SSFs are not a mere tool of speculation.

We have argued in this article that the problem of "*gharar*" in SIFs can similarly be addressed by "Interpretation" of speculation as a legitimate activity based on skill and information. The only remaining issue is the impossibility of delivery of the subject matter in SIFs. We presented three solutions to remedy this problem: first, mutual funds can act as the parties' representatives—owning the shares of 500 companies and delivering the shares in case the buyer of the SIF wishes so; second, we proposed customizing these contracts based on Iran's Islamic capital market needs to launch these agreements based on 50 shares, the ownership and delivery of which, by the seller, is more feasible; and third, with respect to limited cases in which the delivery of the subject matter is impossible, *Sharia* board members should not consider a SIF agreement as a sales contract or a promise to sell, but rather a contract based on Article 10 of *Iranian Civil Law*, the subject of which is to cover the risk of the other party for future purchases in consideration for a sum of money.

Finally, we addressed the concern of the "game of chance" element in SSFs by proposing they be considered a "hedging tool", which means that parties cannot make profits unless they own the subject matter, intend to cover the risk of their property, and have certain skills and information so that they can analyze the future price of the share. We argued further that SSFs involve the possibility of mutual benefit and, thus, cannot be gambling. The same argument can be applied to SIFs, as such contracts are a means of hedging, by use of which parties try to manage their risk on a portfolio of shares when they own the portfolio. In cases where the seller does not own the portfolio of shares, it is considered a speculative activity which may entail mutual benefit for both parties, and thus, is not a "game of chance".