

Contra trading in Bursa Malaysia Securities Berhad: a Sharī'ah and legal appraisal

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Abstract

Purpose – The purpose of this paper is to analyze the practice of contra trading in Bursa Malaysia Securities Berhad. Through a critical examination of the practice, it aims to discuss the issues from the angles of Sharī'ah and Malaysian common law.

Design/methodology/approach – The paper uses a qualitative research methodology. The information on the practice of contra trading is obtained through the Bursa Malaysia Securities Berhad's website and literature as well as series of meetings and discussions held with Bursa Malaysia Securities Berhad. In comprehending and dissecting the Sharī'ah and legal issues, classical along with contemporary Sharī'ah literature including local and international Sharī'ah advisory bodies' resolutions and standards have been referred to. The Sharī'ah analysis of these issues is further supported by reference to the statute and by-laws of Bursa Malaysia Securities Berhad as well as other related legal literature.

Findings – This paper finds that contra trading involves a real sale and purchase of shares; the shares are not taken into the possession of the contra trader, neither physically nor constructively; the liability of shares is not transferred to the contra trader; though the practice of profiting in contra trading may contradict the prohibition on profiting without bearing liability, the permissibility of contra trading could still be argued from the contextual approach of public interest (*maṣlahah*) and needs (*hājah*); and contra trading is not gambling.

Research limitations/implications – This paper is limited in its analysis to only Sharī'ah and legal perspectives. It does not cover a thorough empirical and quantitative investigation that would measure the extent of the public needs for contra trading and the real benefits that contra trading brings about to the society in the long run. Such studies will further demonstrate whether contra trading deserves a relaxation from the strict Sharī'ah ruling thus affirming the issue of permissibility of contra trading. Moving forward, this paper recommends ways to address the predicaments faced in the contra trading practices as well important research areas that could be taken up in future.

Originality/value – This paper provides an in-depth investigation of the practice of contra trading at the Bursa Malaysia Securities Berhad from the angles of Sharī'ah and common law.

Keywords Legal, broker, exchange, contra trading, shares

Paper type Research paper

Introduction

Contra trading refers to an activity that allows a buyer to contra or offset its obligation to purchase shares with its broker before the settlement/maturity of the contract. The benefit of



contra is that it enables the buyer to exit the contract earlier. The end result of contra is the netting off between the amount the broker has to pay to the original seller for the price of the shares and the amount the broker receives from the new buyer for the price of the shares.

Although contra trading is claimed to facilitate the efficiency and liquidity of the market, the manner in which it is being carried out attracts Sharī'ah scrutiny. The need to investigate the compliancy of contra trading practices is timely as at present the Sharī'ah Advisory Council of Bursa Malaysia has yet to issue any resolution on its permissibility.

Sharī'ah and legal issues affecting contra trading

This paper analyzes and discusses seven issues that are found in the practice of contra trading at Bursa Malaysia. The issues relate to:

- (1) the shares' ownership before the Settlement Day;
- (2) whether the contra transaction is a pseudo or real sale of asset;
- (3) the possession of the sold shares (*qabḍ al-mabī' – قبض المبيع*) and transfer of liability (*intiḳāntiqāl al-ḍamān – انتقال الضمان*);
- (4) deferment of both counter-values (*ta'jīl al-badālayn – تأجيل البدلين*);
- (5) selling something before taking it into possession (*bay' al-shay' qabla qabḍihī – بيع الشيء قبل قبضه*);
- (6) profiting without bearing liability (*ribḥu ma lam yaḍman – ربح ما لم يضمن*); and
- (7) gambling (*muqāmarah/maysir – المقامرة/الميسر*).

The discussion of the first issue is based on the question of whether, at the time the buyer enters into the contra trading, he is already the real owner of the shares and thus entitled to sell them. From the Sharī'ah perspective, for the shares to be transferred and owned by the buyer, the transaction that is evidenced by the Contract Note must fulfil the requirements of a valid contract. The underlying principle is that ownership of the subject matter of a sale is transferred to the buyer upon the conclusion of a sale contract regardless of whether the subject of sale has been delivered to the buyer or the price has been paid to the seller (*al-Mawṣū'ah al-Kuwaytiyyah*, 9/36). The discussion of the issue of ownership refers also to the position of the law that raises some predicament with respect to the limitation of the right of the buyer over the shares.

The second issue deals with the legal-Sharī'ah conundrum about the status of the buyer/ contra trader as the owner of the shares during the onward sale. The law clearly stipulates that true and ultimate beneficial ownership is with the person in whose name the shares are duly registered with the Central Depository. This paper is, however, of the view that from the Sharī'ah perspective the contra trader is the real owner of the shares that he onward sells to a third party. The purchase transaction done by the contra trader fulfils all the pillars and conditions of a valid sale and purchase transaction.

On the issue of possession, this paper is of the view that shares represent one's ownership of the capital of the company and the rights associated with it; thus, owning shares can never entail physical possession. Therefore, in the case of buying and selling of shares, the possession involved is argued to be constructive possession. The question that follows this proposition is whether the purchaser has constructively taken the shares into his possession on the transaction day, i.e. T + 0. In general, constructive possession is attained by removing impediments to the buyer accessing the commodity (*takhliah*) and enabling him to deal with it as he wills (*tamkīn*). Therefore, the liability for loss of the asset will transfer to the person who has taken the asset into his constructive possession ([Islamic Finance](#)

Knowledge Repository, 2017). Based on this, the paper argues that “*takhliyah*” and “*tamkīn*” as mentioned by jurists for constructive possession are not fulfilled before the delivery of the shares on T + 3, as the buyer has not been given access to the shares or any power over them, except the buyer’s ability to sell them. A mere legal right to sell the shares and to gain profit from the sale does not suffice to constitute constructive possession for the buyer when the benefits and liabilities of the asset (i.e. the underlying company) are still vested with the original seller. Additionally, the paper argues that being legally allowed to sell an asset and being liable to its price movement does not at all mean that the liability of the asset has actually transferred to the buyer.

The fourth issue on the deferment of both counter-values (*ta’jil al-badalayn*) involves the discussion of *gharar* (uncertainty) due to the non-delivery of counter-values in the contract session. The question that is asked is whether contra trading involves the element of *ta’jil al-badalayn*. The paper is of the view that in *ta’jil al-badalayn* the issue is not about when the transaction takes place but, rather, about when the subject matter is delivered and the price is settled. This will only happen and appear in the accounts of both parties three days after the transaction. Thus, the three-day delay for the delivery of both counter-values could be evidence for the conclusion that share trading does involve *ta’jil al-badalayn*. However, the paper takes the view of the Mālikī School that the three-day deferment can be deemed as minor and tolerable (Ibn Rushd, 1988, 2:28). In addition, the three-day deferment in shares trading has been accepted as the international industry convention (*urf ahl al-ṣanā’ah*). That could constitute a strong basis of need (*ḥājah*) that justifies a relaxation of the general prohibition of *ta’jil al-badalayn*.

On the fifth issue, selling something before taking it into possession, the discussion turns on whether shares are considered a food item. Obviously, they are not. If so, shares would fall outside the prohibition of selling food before taking it into one’s possession.

The sixth issue deals with Prophet Muhammad’s (ﷺ) prohibition on taking profit from something for which one does not bear liability (al-Nasā’ī, 1986). The question that leads the discussion is whether the buyer is entitled to the profit made from the contra trading (prior to taking possession of such shares and when the buyer has yet to bear any liability for them). Despite the practice in the market that allows the contra traders to profit, the paper finds reason to question this norm due to the governing trading law and the cash settlement procedures. In the event of failure to deliver the shares, the rights, entitlements and liabilities are accorded based on the owners’ names registered in the shares registration record. The buyer (contra trader) is not a registered shareholder/beneficial owner of the shares; thus, he will not be able to benefit from the rights and entitlements arising from the shares nor be liable for the liabilities arising from them. Therefore, making profit from contra trading is viewed as prohibited.

The discussion on the last Sharī’ah issue, gambling, is based on the resolution of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Sharī’ah standard no. 21 on financial papers that allows for speculative trades (AAOIFI, 2015). The paper further argues that contra trading is not between two parties betting on a same bet, which will end up with one of them winning and the other losing. Instead contra trading is about selling an asset at the market price, whereas the other party may want to keep the shares for a long investment because the price may keep on increasing.

Research findings

This paper finds that contra trading involves a real sale and purchase of shares. It further finds that from the Sharī’ah perspective, irrespective of the legal requirement for the share’s legal ownership, at the time when the contra trade is executed, the contra trader is the real

owner of the shares that he onward sells to a third party. The reason is that the purchase transaction done by the contra trader fulfils all the pillars and conditions of a valid sale and purchase transaction.

With regards to the issue of delivery and possession of shares as well as the transfer of liability of shares during the onward sale, contrary to the stance of AAOIFI, this paper finds that the shares have not been taken into the possession of the contra trader, either physically or constructively. This paper further finds that the liability associated with the shares has not been transferred to the contra trader.

On the issue of deferment of both counter-values, which many scholars as well as AAOIFI do not allow, this paper finds that it is not a fundamental issue in Sharī'ah. It is further viewed that the deferment of three days can be considered as minor, hence tolerable. Related to this issue is the question of possession and transfer of liability in the sale of shares before possession. Based on the views of many Muslim scholars that allow selling before possessing the sold item so long as the item is not food, the paper concludes that selling shares before the buyer possesses them is allowed.

In relation to the issue of profiting without bearing liability, the paper finds this practice to be clearly prohibited by Prophet Muhammad (ﷺ). Therefore, the practice of profiting in the contra trading, when the shares are yet to be in the buyer's possession and when liability of the shares has yet to be transferred to him, transgresses this prohibition. Having said that, this paper argues that the permissibility of contra trading could still be argued from the contextual approach of public interest (*ma ślahah*) and need (*hājah*).

Finally, the paper concludes that there is no element of gambling in contra trading. Gambling allows one party to gain at the expense of the other, and this is not so in the case of contra trading. In contra trading, the broker will always make a profit from the brokerage fee and not the price movement, i.e. the chargeable fee when a trader purchases shares and executes a contra trade, regardless of whether the onward sale is profitable or bears a loss. The sale itself could also be profitable to all the sellers, including the original seller and the onward sellers (contra traders), if the price of the shares keeps on increasing and also to the ultimate buyer who decides to keep the shares and does not onward sell them. If the price decreases and the contra trader makes a loss, it does not amount to gambling either, as it is a normal risk that any trader has to take.

Conclusion and recommendations

The paper has deliberated in length the issues of contra trading, analyzing them from the angles of Sharī'ah and common law. The findings of the paper reveal that there are some identified issues in contra trading that require future in-depth deliberation. On that basis, the paper makes two recommendations.

First, it recommends a change in the formula of cash settlement for failed contracts. Currently, the liability for any failure in delivering the shares is solely borne by the original seller to the ultimate buyer. The onward sellers (in between the original seller and the ultimate buyer) will not bear any of these compensations and charges, and they are allowed to keep the profits that they have received. Therefore, to address the prohibition of profiting without bearing any liability, the paper proposes that in the case of default in delivery, all sellers including the original seller and the subsequent onward sellers shall collectively pay the compensation and charges to the ultimate buyer in proportion to their earned profit.

Second, the paper recommends that further empirical and quantitative studies be carried out in future for the purpose of ascertaining the extent of the public need for contra trading and the real benefits that contra trading brings to the society. These studies would serve as

indicators of whether contra trading deserves a relaxation from the strict Shari'ah ruling and, on that basis, be considered permissible.

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Further reading

Al-Mawṣū'ah al-Fiqhiyyah al-Kuwaitiyyah (1427AD), 1st ed, Maḍābi' Dār al-Ṣafwah.

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