REVISITING THE PERMISSIBILITY OF CRUDE PALM OIL (CPO) FUTURE CONTRACT AS SHARIAH COMPLIANCE: MALAYSIA CASE STUDY

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ABSTRACT

This paper examines the permissibility of crude palm oil (FCPO) contract with respect to shariah principle. In permissibility aspect, groups of Islamic scholars reject FCPO contract as shariah-approved product while the other groups have no disagreement on the subject matter. There are at least four issues related to the future contract includes the issue of bay' al-sarf, the issue of bay' al-dayn, the issue of speculation, gharar and maysir and also the issue of non-existent of counter values. This paper also reviews the resolution of Sharia Advisory Council of Securities Commission (SAC-SC) Malaysia regarding the issues of FCPO arose in Malaysia. In this study, we employed qualitative method with the data was retrieved from secondary resources such as Bursa Malaysia, jurists opinion and SAC-SC resolution. This paper perhaps depicts the clear picture of FCPO contract in shariah perspective.

Keywords: Future, Crude Palm Oil, Shariah-Compliance, SAC-SC, Malaysia

I. INTRODUCTION

Background of Study

The Future Crude palm oil (FCPO) contract can be defined as an agreement between two parties for a transaction of a specific amount of CPO at a specific time in the future for a specific price. The CPO futures[5] contract further known as a standardized forward contract with quality, quantity, delivery date, and location of CPO are arranged in the contract. In the context of Malaysia, FCPO is the most popular commodity futures contract since the inception of FCPO in 1980[6] with the biggest trading volume embedded in this contract. Moreover, Bursa Malaysia Derivatives Berhad is solely institution provides a viable market for price discovery, risk management, and derivatives purposes in Malaysia.

Subsequently, Muslim scholars such as Al-Ghazali, Abdel-Hamid, Monzer Khaqf, Fahim Khan, and Obiyathulla[7] have emphasized the importance of futures market and reminded about the substantial consequences for Islamic business as the business environment become sophisticated and increasingly competitive. Moreover, they argued that this derivative instrument plays important role as tools of risk

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[5] While future contract itself standardized forward contract to buy and sell a specified quantity of goods with delivery at specified future date. The main purpose of future market is to hedge risk.
[6] See The Malaysia Crude Palm Oil Futures Contract-An Overview (Bursa Malaysia, 2010)
[7] See Derivatives Instrument in Commodity Market: An Islamic Analysis (Al-Amine, 2008)

management in modern Islamic finance. Considering the fact that Malaysia is one of the largest CPO producer and exporter in the world, the inception of FCO allowed a number of future commission houses offering overseas commodity futures to the public. Moreover, it will also gives opportunities to local producer for hedging purposes as well as securing their leverage in the determination price patterns.

In this regard, Sharia Advisory Council of Securities Commission (SAC-SC) Malaysia issued the resolution that FCPO under commodity *murabahah*. It is permissible transactions based Islamic investment trading and financing under the principles of *tawarruq*, *murabahah*, and/or *musawamah*[8] (Bank Negara Malaysia (Bank Negara Malaysia, 2010). Initially, CPO with standardized specification is traded at commodity *murabahah* houses (CMH) in ringgit domicile. Moreover, SAC-SC argued that the use of CPO as the underlying asset is assessed as fulfilling the requirement of subject matter of sale transaction it exists and is physically identifiable, is able to be received before sale, and its quality is determinable based on the given specifications in term of its essence, standard, and value.[9]

Albeit some Muslim scholars support the significance of future instrument, however, other Muslim jurists claimed that this instrument may not totally compliance with sharia principles. In hadith its preserved that “do not sell what is not with you”. The Mekkah based *fiqh* academy stated that although this derivative instrument bring some benefits, however, the transaction embedded in this contract against sharia rules such as gambling, exploitation, monopoly, price distortion, and the selling what was one does not own (Al-Amine, 2008). Akram-Khan (1988) in his study also stated that future contract is unlawful because its involve non-existent and does not involve physical delivery of commodity. While Al-salami (1992) obviously declared that the commodity future is *haram* instrument because it does not fulfill the conditions in *salam* contract.

To some extent, the debate in the light of sharia permissibility of future contract is still on going. Albeit most of the scholars declared the prohibition of future instrument in Islamic financial transactions, but others Muslim scholars emphasized the importance of future commodity contract as a tools of risk mitigation in modern Islamic finance. Thus, in turn, it is important to conducting a study on permissibility of FCPO contract in the sharia point of view. This paper will analyze the issue of *bay’ al-sarf*, *bay’ al-dayn*, speculation, *gharar*, *maysir* and also the issue of non-existent of counter values which related to the future contract. We also examine the importance of future market regulation in regards to the Malaysian derivatives industry.

The purposes of this study can be defined as follows: (1). Identify the advantages (*maslahah*) and disadvantages (*mafsadah*) of future instrument in the sharia point of view, (2) Examine the importance of future market regulation in the case of Malaysian derivatives industry, and (3) Critical review of the SAC-SC resolution in regards with FCPO. In this study, we employed qualitative method which means that the meanings, concepts, definitions, characteristics, metaphors, symbols, and descriptions of the matter understudy[10]. It is used content and descriptive analysis to get findings of the study. The data collection was retrieved from Islamic sources: Qur’an, Sunnah and some Islamic literatures, while secondary sources such as Bursa Malaysia, Bloomberg, jurist opinions and SAC-SC resolution. The sources will analyze to answer research problem of the study that will contribute to the development of derivative instruments in Islamic perspective.

[8] The SAC in its 78th meeting dated 30 July 2008 has resolved that the proposed operational structure of commodity murabahah house (CMH) is permissible transaction
[9] See Shariah Resolution in Islamic Finance (Bank Negara Malaysia, 2010)
[10] See Qualitative Research Methods: For the Social Sciences (Bruce L.Berg. 1989)

II. LITERATURE REVIEW

Future Markets and the Contract

2.1 Future contracts

Generally, futures contract is an agreement to buy and sell a specified quantity of commodity or financial instrument at a specified future date and an agreed price. To be precise definition, future contracts defined as "a legally binding commitment to deliver at a future date, or take delivery of, a given quantity of a commodity, or a financial instrument at an agreed price."[11] This agreement engages two parties: a short position -the party who agrees to deliver a commodity - and a long position - the party who agrees to receive a commodity.[12] In general, there are two types of futures contracts. They are commodity futures contract and financial futures contract.[13] In that case the main purpose of the futures market is to hedge risks. Thus futures markets arise due to the price of the commodity are uncertain.[14]

The conditions to be said that future markets is successful are the supply and demand that relate to the underlying commodity must be large, prices must be volatile, the commodity traded should be quantifiable to permit standardization and the market should be competitive and no monopoly.[15] In addition, most of all transactions of futures terminated without physical delivery of the underlying commodities are used as its assets.[16] This means a futures contract is basically buy anything which is there is no intention to take over the commodities. It is make sense as Mark. J powers and David J. Vogel wrote on their book; "*In futures the trader in not buying or selling the commodity but only agreeing to buy and sell it at a later date. In one sense you could look at the purchase or sale of futures as a purchase or sale of the right to participate in price change".[17]*

How it works?

Before entering the future markets, the players have to pay a margin deposit[18] of about 5%-15% from the contract value. The calculation is if the daily transaction peaks at $ 100,000 then at least have to put $5000-$15,000. The process is as follows;[19]

1. It means all parties, farmer and bread maker for instance, who wish to trade on futures markets should start placing funds, as initial margin, to clearing house from 5% -15 % of the total transaction.
2. Now, a wheat farmer wants to secure the sale price for the next harvest time. While a bread manufacturer may attempt to secure the purchase price of raw material. Then the farmers and bread

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[11] J. Legget, in SFC Finance Co. Ltd. v. Masri, *All ER* (1986): 1:44. Kamali, "Islamic Commercial Law, An Analysis of Futures", *The American Journal of Islamic Social Sciences*, vol 13, Summer 1996, no. 2, pp. 201

[12] Futures Fundamentals: How The Market Works**,** http://www.investopedia.com/university/futures/futures2.asp. Retrieved 03/10/2013

[13] Bank Negara Malaysia. (2010). *Shariah Resolution in Islamic Finance: second edition.* Kuala Lumpur: Bank Negara Malaysia.pp 75.

[14]Hans R. Stoll, Robert E. Whaley, *Futures and Options Theory and Applications*, Southwestern Publishing Co, 1993, p.77.

[15] Robert E.Fink & Robert B. Feduniak, *Futures Trading Concepts and Strategies*, New York Institute of Finance, 1988, pp.14-16; Edward J Swan (editor), *Derivatives Instruments Law*, Cavendish Publishing Limited pp. 60-61.

[16] Futures Fundamentals: How The Market Works**,** http://www.investopedia.com/university/futures/futures2.asp. Retrieved 03/10/2013

[17]Powers, Mark. J. And David, J. Vogel. *Inside The Financial Futures Markets.* John Wiley & Son Inc. Singapore. 1981. pp. 27

[18] Margin-also called good faith-is the number of funds that have to have maintained by a client to the broker clearing member of an exchange or by the broker to the clearing house to guarantee the broker or clearing agency concerned against any loss that may occur to open contract.

[19] Futures Fundamentals: How The Market Works**,** http://www.investopedia.com/university/futures/futures2.asp. Retrieved 03/10/2013

maker into a futures contract. Then the deal was made that farmers would sell 5,000 bushels of wheat to producers in June at a price of $ 4 per bushel.

3. Having futures contract was agreed, loss and gain in the futures contract depend on the daily movements of the market and is calculated based on the daily basis as well. For example, say the futures contracts for wheat increases to $5 per bushel the day after the above farmer and bread maker enter into their futures contract of $4 per bushel. The farmer, as the holder of the short position, has lost $1 per bushel because the selling price just increased from the future price at which he is obliged to sell his wheat. The bread maker, as the long position, has profited by $1 per bushel because the price he is obliged to pay is less than what the rest of the market is obliged to pay in the future for wheat.
4. When the day occurs, the agreement has to be executed as agreed. Here, Supposed to be an exchange, but it is rarely happens, most of what happens is it deal in cash settlement. It means that there is no transfer of goods there but for the loser had to pay to gain the win by debited and credited the margin which it was installed in the clearing house.
5. For instance, when the price of wheat due $5 per bushel (up $ 1per bushel) farmer loses $ 5,000 in the futures contract (margin accounts decreased $ 5,000) and bread maker has an additional amount $5,000 in this contract (margin accounts grows up $ 5,000).
6. When the margin is in the clearing house at the minimum threshold, the futures clearing will issue a margin call in order to return the account to meet the required minimum limits. For example, from the example above the minimum limit is $ 7,000, and then the farmer must add $ 3,000 to cover the shortcomings that still margin $ 10,000.

Cash settlement

Loss and profit in the futures contract depend on the daily movement of the contract market and is calculated based on the daily basis as well.

Agreed price	=$4x 5000 bushel	= $20.000,-
Settlement date	=$5x 5000 bushel	= $25.000,-
Cash settlement	=$1x 5000 bushel	= $5.000,-

It means there is no either delivering commodity to the bred maker or payment of money to the farmer. But here the farmer's account is debited $5,000 and the bread maker's account is credited by $5,000. This transaction is called as cash settlement.

2.2 Crude Palm Oil Future Contract (FCPO)

Crude palm oil future contract (FCPO) is a contract where crude palm oil as an underlying instrument of it. The FCPO is a deliverable contract which is traded electronically on Bursa Malaysia's trading platform. The trading mechanism is similar to other futures. There are some benefits of FCPO; **1) to manage price risk –** plantation companies, refineries, exporters and millers can use the FCPO to manage risk and hedge against the risk of unfavourable movements in the price of FCPO in the physical market. 2) **To speculate –** traders can use the FCPO to gain leveraged exposure to movements in CPO prices. 3) **To gain immediate exposure into the commodity market –** via FCPO, global fund managers and proprietary traders are able to be part of the active commodity market instantaneously.[20] As mention on their brochure, there are three scenarios of trading such as speculation, hedging and trading.

[20] Bursa Malaysia. Crude palm oil (FCPO). http://www.bursamalaysia.com/market/derivatives/products/commodity-derivatives/crude-palm-oil-futures-fcpo. Pp.2

Shari'ah Perspective Towards Futures Contracts

3.1 Five issues on future markets

There are numbers of issues inherent in the futures contracts. These issues have become the basis ground of majority Islamic scholars to prohibit the usage of futures contracts. ISRA (2012) provides five major issues in the futures contract as follow:

1) The Issue of **Bay' As-Sarf**

Bay' as-sarf itself is defined in *fiqh* literature as an exchange involving *thaman haqiqi* (defined as gold and silver), which served as the principal medium of exchange for almost all major transactions. Related to present day, there is the pros and cons. The proponents of current paper money believed that the exchange of present currencies among different nations/ countries is similar as *bay' as-sarf*. While the opponents of this view however point out that the exchange between all types of currency (*thaman*) at the present time can't be categorized as *bay' al-sarf* (Obaidullah, 1999)

In the context of commodity futures whereby one of the two items exchanged is not currency, the basic feature of transaction will be slight different in compare to the exchange on currency. In this type of transaction, one of the items will be a commodity that is commonly used in trading such as: grains, soya, meats, cotton, coffee, sugar and lumber (Coyle, 2000).

In case of Malaysia, the commodity that is used in the future exchange is Crude Palm Oil (CPO) since this country is recognized as the leading producer of CPO in the world. The new question arises whether the prohibition of majority scholar towards currency future will automatically affect the rulling of commodity futures? Makkah-based *Fiqh* Academy as quoted by Kamali (2007) asserts that even though futures contracts is generally not permissible in the shari'ah perspective, we needs to evaluate each kind of futures contract with regards to its variety of transactions.

2) The Issue of **Bay' Al-Dayn (Bay' Al-Kali bi Al-Kali)**

Future sales is a sale of one debt for another. Imam ibn Hanbal, ruled that common consensus (ijma' an nas) has forbidden the sale of debt for debt, *bay' al-dayn bi al-dayn* or *bay' al-kali bi al-kali* on several grounds. The prohibition applies to all such contracts where the obligations of both parties are deferred to a future date, including contracts involving exchange of currencies (Obaidullah, 1999). Shaikh Mahmud Ahmad notes that **Imam Malik** explains the meaning of such *bay'* in these words:

> *"A person sells cloth or some other goods on the promise of payment by the buyer after one month. A month passes and the buyer, being unable to make the payment, asks the seller to sell his debt of one month for a debt of two months, and raise the quantum of debt. This is the sale of debt in exchange for another debt."* (Obaidullah, 1999)

Hence, majority of scholars which consider such exchange as another type of *bay' al kali bi al kali*, decline the usage forwards and futures in Islamic transactions. Obaidullah (2001) as quoted in Kunhibava (2010) further stated that since the parties involved are able to offset their transaction by selling the "debts" to other parties before the delivery date, the prohibition towards futures contract has to be applied. The disagreement is that this feature amounts to sale of a debt and is, thus, not allowed by Sha'riah.

However, in term of commodity futures, Kamali (2007) argued that this type of futures can't be considered as unlawful transaction since there is no conclusive proof in the Sunnah on its prohibition.

3) The Issue of speculation, uncertainty (**gharar*****) gambling (*****maysir or qimar*****)***

In the context of *shari'ah*, contract can be considered as valid and permissible supposed it does not involve the elements *maysir* of excessive *gharar* beyond the acceptable limits. Some of the requirements that must be met in order to avoid *gharar* are specification in quantity, price, time and place of delivery on the subject matter. Danila & Jeffers (2009) in their paper assert that the existence of g*harar* is related to time and the condition of the subject matter. The uncertainties exist as the parties involved in the contract do not know whether they will be still in the agreement until the maturity time.

Mufti Taqi Usmani as quoted in Bacha (1999) stated that the modern day futures contracts are not valid by two reasons. *"Firstly, it is a well recognized principle of the Shariah that sale or purchase cannot be affected for a future date. Therefore, all forward and futures transactions are invalid in Shariah;*

secondly, because in most of the futures transactions delivery of the commodities or their possession is not intended. In most cases the transactions end up with the settlement of difference of prices only, which is not allowed in the Shariah."

Notwithstanding, Kamali (2007) argued that basically, speculation is something lawful. Its tendency towards gambling must be prevented by tight supervision and effective position limits that would lessen excessive speculative risk done by the parties.

4) The Issue of non-existent of both countervalue

The word "non-existance" here refer to the condition when the object of sale is not in the possession of the seller. The condition of "possess the goods prior to resale (*qabd*)" is not fully met in the futures transaction. The counter values in this exchange, the money and the goods, are deferred and often inexistent at the time of the contract. Hence a genuine sale does not exist. Moreover, majority scholars believe that a sale can only be valid in *Shari'ah* either the price or the delivery is postponed but not both. Islam recognizes the type of contract that defers one of the counter values at the time of transaction in the name of *salam* contract. Ja'far ibn Abi Wahshiyah reported from Yusuf ibn Mahak, from Hakim ibn Hizam (who said):

> *"I asked the Prophet: 'O Messenger of God. A man comes to me and asks me to sell him what is not with me. I sell him (what he wants) and then buy the goods for him in the market.' The Prophet replied: 'Sell not what is not with you.'"*

As quoted in ISRA (2012) the scholar Mahmassani stated that *"contracts to sell future things, except for the salam and istishna contracts, are invalid in Shari'ah since such things are nonexistent".*

Notwithstanding, Kamali (2007) argued the above prohibition by released his own view that:

> *"The requirement of qabd in the hadith is clearly confined to foodstuffs, and extending it to other commodities is not supported by the text. But even in foodstuffs, it probably contemplated perishable foodstuffs that are not the focus of commodity futures.*

The issue on *qabd* is related to the question of liability for loss. Since the delivery and *qabd* are not prevailing element in futures, it is submitted that the question of liability and loss should be determined not by reference to *qabd* but by reference to the contract (Kamali, 2007).

3.2. Resolutions of Shariah Advisory Council of Securities Commission Malaysia (SAC) on Crude Palm Oil Futures Contract

In 1997, SAC[21] issued a resolution for the commodity futures contract, specifically the crude palm oil futures contract. The resolution permitted the FCPO as it compliant with the *shari'ah*. SAC clarify that the contract mentioned can be defined as exchange-traded agreement to buy and sell a commodity in an actual market (cash market) in a standard quantity, at a future date and at a determined place of delivery. SAC explain the basis of ruling on permissibility of crude palm oil futures contract as follows:

1) *Gambling* (maysir)

The SAC resolved that the trading of crude palm oil futures contract does constitute the elements of gambling because the fluctuation of the value occurs due to the change in demand in the crude palm oil futures market. Beside gambling activities depend solely on luck and are not related to demand and offer. Therefore, it is not fair and correct to judge a contract whose value fluctuates due to the changing demands for crude palm oil futures market as a gambling activity.

***2) Uncertainty* (gharar)**

The issue of uncertainty arises due to the uncertainty in obtaining goods that have been bought and in receiving potential profits. The SAC argued that gaining profit or loss by businesses is a common factor but a trader should take steps to minimize the loss. As mentioned in al-Quran Surah Fatir, verse 29, in the meaning, "*For them, they secretly and openly hope for a commerce that will never fail."*

Here, the other important point is when a crude palm oil futures contract is offered, specifications such as quantity, type, price and delivery date are made known to the market players. Therefore there is no

[21] Resolutions of the Sceurities Commission Shariag Advisory Council Second Edition, 2006

element of *gharar* in the contract. All specifications are made clear in the contract, and surveillance and regulation are provided to ensure there is no cheating.

3) Principle of buying something that does not exist **(bay' ma'dum)**

Ibn Qayyim in his study clarified that the prohibition of *bai` ma`dum* was actually due to presence of the element of uncertainty to hand over the goods sold. However, it does not happen in the crude alm oil futures contract. The SAC said that the contract can be settled in cash before the due date or settlement by delivery on the due date. In addition, the clearing house ensures the delivery and settlement of a transaction. Thus, the element of *gharar* is insignificant.

4) Speculation

By definition, speculation means to make profits out of the price movements of goods. The SAC stressed that speculation exists in all forms of businesses and is not limited to futures transactions. Thus, the concern is whether it is excessive or conducted under normal circumstances.

5) Principle of no exchange of goods **('iwadh)**

'Iwadh refers to the exchange in buying and selling, but in this context no purchase of goods in the actual sense has occurred. Therefore, there is no increase in the value of economic activities. The SAC explained that the present Islamic scholars supported that the issue of *`iwadh* does not occur in crude palm oil futures transactions. The SAC added that crude palm oil futures contract trading, in actual fact, gives an increase in value to market players. For instance, when producers of crude palm oil hedge, they make an effort to cut costs. This will indirectly improve company profits and make their products more competitive.

III. FINDINGS

Revisiting the Permissibility of FCPO Future Contracts

Actually, long discussion has been made from decades ago. There are pros and cons regarding to this issues. Nevertheless there are some issues overlooking and some of it over and over. That why, the discussion here will see from slightly difference of point of view and will into detail as possible.

a) How the contract works.

As defined above, the future contract on crude palm oil is the same with the conventional futures contract. In this case, the first thing step of the permissibility of FCPO is due to the underlying asset is palm oil which is no problem with the *shari'ah* compliant. Then as explained above on SAC resolution of FCPO, free from impediment of *shari'ah* such as gambling, uncertainty, speculation etc. now let look deeper into how the contracts work. There are three scenario of trading in regard of this FCPO future contracts. Let analyze one by one these scenarios.

First is hedging. Hedging is to eradicate the risk exposure in the market. That means the hedger tries to minimalize his risk in the future so enter the future market. We can see here, the hedger, for example palm oil companies, in the future, let say next month, will crop the palm oil. When the day comes, the hedger of course will sell it into the real market. But he worries the declining price of palm oil in the next month. Due to this prediction, the hedger is entering futures market. In o ther word, the hedger is doing two transactions, in the future and real market. In regard to this reason SAC permitted the FCPO. An effort to avoid the risk is natural. But when the way or method to avoid the risk is more danger, it will cause another problem. Second is speculation scenario. For this transaction is absolutely against the *shari'ah* principles as explained before where speculation is main core or the main intention to doing this transaction. It can be categorize as excessive speculation which not allowed by shari'ah principles. Implicitly, the SAC resolution is also against the excessive speculation. So, it support that FCPO is not shari'ah compliance. Third is trading. As discussed early, this transaction is involves the trading *bai' kali bil kali* where the price and the commodity delivered at future date. it just commitment to do contract in the futures. Moreover the problem rises is reselling this contracts to other parties, while the seller does not owned the commodity. Or is commonly known as offsetting.

b) *Offsetting*, is it happen in FCPO?

One of the privileges the futures market is it very liquid compared to the spot market. Why do such things happen? It happens because the players of these markets do not need to wait until the maturity and also do not need to know who the opponent is. Although the real delivery can occur as a manifestation of the fulfillment of the contract, but the majority of futures contracts are generally settled by "off-set" before due time. "Offset" is a transaction (buy / sell) for the same futures contract, and the amount and for the same delivery month, as opposed to the "open" position previously held futures contracts (buy / sell contract)[22]. So, from the *maslahah* and *mafsadah* point of view, the *mafsadah* is bigger than *maslahah*.

Furthermore, once the order is entered, then the settlement will be handled by the clearing house. Likewise when they want to deny that they did before the transaction or offsetting/reversal need not worry as once again clearing house will solve it. In this way, the player who did offsetting does not have to worry about whether his opponent will be able to pay or not in regard that clearing agency will pay it.

From this exposure, it is clear that the behavior of the player unmoral according to Islamic teachings. They violate the code of ethics of agreements they made.[23] There is no intention to fulfill the agreement that they have did. Business ethics are filled with moral values are not reflected at all in this transaction.

From this transaction, it is clearly showing that what the real motives and goals they enter into these agreements. The objective is to get the benefits without the costs of fictitious transactions which they deny. This is not in accordance with the principle of al - *khoroj bidh* - *dhoman* (results appear venture with costs). So, the attempt to gain profit by such offsetting is violated *Shari'ah* rules and transactions, it should be prohibited in order to maintain morality and human ethics.

c) Is it an Exchange or a Cash settlement?

The essence of buying and selling is as well the exchange of ownership of the goods with goods of money with goods. As far as it known how to play the futures market, a futures contract is an agreement to buy and sell a certain amount of a commodity or financial instrument at a specified price and a future date has been determined. But in fact at the end of a contract that does not happen.

> *But participating in the futures market does not necessarily mean that you will be responsible for receiving or delivering large inventories of physical commodities –remember, buyer and seller in the futures market primarily enter into futures contract to hedge risk or speculate rather than to exchange physical good*[24]

This statement was written by players of futures for new players. Here it can be seen that the end of the contract, there is no transfer of ownership from the buyer to the seller and the seller the buyer. The essence of this transaction has violates the shariah. Here what happens is that the cash settlement contracts with cash to cash. That can be seen in the difference between the contract price of the real price at maturity. In addition cash settlement is none other than a zero sum game again which is prohibited by the shari'a as one's advantage over another person's loss.

d) Maslahah or mafsadah

According to (Bacha, 2012), basically there are three types of market players in Future Crude Palm Oil (FCPO) Contract, namely hedgers, arbitrageurs and speculators. Hedgers are people who really own or involve in the businesses that use FCPO contract and other derivatives instruments to manage business risk. In contrast, arbitrageurs refer to people who do not own or involve in any particular businesses but to earn profit by taking advantage of price differentials between markets and they use derivatives

[22] http://www.bappebti.go.id/pengawasan/sebelum-transaksi.asp

[23] See *Al-Israa'* ; 34. And Al-Maidah ; 1

[24] "*Futures* fundamentas tutorial". http://www.investopedia.com/university/*futures*/ diposting 01/25/2006 Hal 1

instruments to engage in arbitrage activities. In addition, speculators are people who take positions based on their expectations of future price movements.

As using FCPO contract as tools in managing business risks are concern, the FCPO contract should be approved as shariah-compliance product based on the principle of public interest (maslahah mursalah). This is important in order to help the Muslim businesses to manage their business risk more efficient as to compare with non-Muslim competitors who able to reduce their business risk much better by using FCPO contract or any other Futures contracts. On top of that, in this modern business environment, sophisticated risk management solutions such as Futures contract are needed to help businesses overcome complex business risk. Nowadays, the use of FCPO contract in managing business risk become tradition (urf) among businesses especially among Malaysian businesses as Malaysia is one of the larger producer of palm oil in the world.

No doubt that FCPO contract carries some disadvantages such as it is vulnerable to arbitrage and speculate activities in which these activities are unlawful with respect to shariah principle. However, in today's context, it is believed that the existence of FCPO contract would bring more benefits (*maslahah*) than harms (*mafsadah*) to the society. In his book (Bacha, 2012) mentioned that it is not the use but the misuse of derivatives instruments that caused problem and lead to the spectacular losses. Thus, it is highly not recommended to approve FCPO contract as shariah compliance product. Apart from that, Ali (1998) mentioned that CPO future prices have major impact on cash prices. In turn, he further suggested that the physical palm oil owners should embark on better forecasting and proper hedging. They should use KLCI as an effective price discovery and reliable hedging tools. Moreover, Ali also stated that by establishing a counterbalancing positioning the KLCI, physical palm oil owners would be able to compensate any loss in the cash market with a profit in the KLCI and vice versa.

IV. CONCLUSION

This paper has comprehensively reviewed the decision passed by the SAC resolution on *FCPO*, which is one of the main Islamic finance instruments for liquidity management and financing instruments. As evidenced in the discussion, there are pros and cons on future contracts.

In our finding, the FCPO is one of kind future contracts that there is no different trading mechanism. Regarding to FCPO, in term of subject matter, there is no violation to the shari'ah principles. But in regard to trading mechanism, still there are many questions to answer and clarify the mechanism of FCPO future contract. In our opinion, if the mechanism of it exactly the same with the conventional one then this product is not shari'ah compliant due to many violation with shari'ah principle as explained above.

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