Reviewing the Concept of Shares: Towards A Dynamic Legal Perspective

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This paper argues that there has been a historical evolution in the concept of shares and that shares no more represents a pro rata ownership in the assets of listed companies as reflected in most fatāwā. The legal position in the UK is that shares represent an entitlement to a bundle of rights. Thus, there has been a shift from ownership towards shouldering the liability of risk of the companies. Consequently, any claim against shares has moved away from real rights (a tangible asset) towards personal rights (an intangible asset). Hence, this demands that the fatāwā be reconsidered in relation to shares, as by buying a bundle of rights the dealings are no more asset-backed. Thus, the possibility of ribā, gharar and ghaban may manifest in dealings with shares. Hence, Muslim scholars will have to reconsider how to implement Sharīʿah within a volatile legal system. Two more issues discussed in this paper: firstly, the filtering criteria of the FTSE Islamic Index used on the London Stock Exchange. Suggestions have been made to increase the level of asset–backed limit. Secondly, the possibility of establishing an Islamic Securities House to optimise compliance with Sharīʿah regarding investment on the London Stock Exchange.

1. Introduction

It is argued that equity finance is the most desired way of Islamic finance and investment because it involves the profit and loss sharing mode of finance which is the real Islamic one (Uthmani, 2003:3). Unfortunately, the contribution of stock in the investment world is minimal as compared to other financial products available. In the USA it amounts to 2% only. There are many reasons why the same situation prevails within the arena of Islamic finance. The first one is the existence of differences of opinion among Muslim scholars regarding the permissibility of shares. Secondly, the building of Islamic indexes is a complicated issue. Scholars are still grappling with the filtration criteria and there is demand for further improvements regarding the criteria for incorporating listed companies in the Islamic Indexes. (Zarka, n.d., Resolution 310 of Rajihi Bank, 1419/4/6).

Hence, due to the importance of the stock exchange markets for economic development and for fund raising to develop projects, a deeper study of the abovementioned conflicting views become necessary. Two important questions

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that need attention are: firstly, whether this dilemma of investing in common stocks (shares) need to be resolved or do we accept the views expressed in some conferences and *fatāwā*? Secondly, whether Muslims can invest on the London Stock Exchange Market (or any exchange market) according to the FTSE Islamic Index or should the indices be monitored in a more Islamic way due to the high involvement of *ribā* (interest), *gharar*, (uncertainties and speculation), *ghaban* (fraud and deception) etcetera on the stock exchange markets?

The aim of this study is to analyse the theoretical discussion regarding the conflicting views prevailing among Muslim jurists regarding the permissibility of dealing in shares. This issue needs some discussions as it will impact on the discussion of investing in shares and the *fiqhī* problems that may be raised in establishing an Islamic Index. The second prong of the research will be focused on "filtering criteria" used for the FTSE Global Islamic Index and to suggest some improvements upon the existing filters.

2. An Analysis of the Concept of Stock Exchange and Shares

Due to the role of the stock exchange market in enhancing the economy,[1] Muslim scholars have been looking at stock exchange market from different angles. El Gari (1993) advocates stock exchange market as a necessity for present day economies. However, he argues that it would not be possible to restrict ourselves to identifying the "permissible" transactions and conclude that an Islamic model should be limited to them. He made an attempt to offer solutions to the problem raised in contracts on the stock exchange to suit the Islamic law. However, one wonders if all these are practical because he does not pay attention to the regulatory framework of stock exchange markets, which vary from country to country. What is important to understand is that it is not easy to develop Islamic model outside the secular law. Either one should abide to the law of the land or else one can militate for the amendment of the law as has been the case with removal of the double stamp duty to accommodate the Islamic mortgages in UK. Also, stock exchange market is becoming a globalised transaction due to the fast growing information technology in this field.

Tag El-Din (1996), on the other hand, has tried to be more practical in considering the economic dimension of the stock exchange market. He focuses on the general principles and the special constraints which characterise what he calls the normative Islamic Stock Exchange, and he also deals with the issue of the efficiency hypothesis. But what is more important, is that he raises a very

[1] The role of stock exchange market is important for public limited liability companies' private investors and the economy. Regarding the companies it enables them to raise big sum of money without interest for investment purposes. As far as investors are concerned they can have investment portfolios to suit their pockets. It is also a complement for the banking sector as financial intermediaries.

important juristic issue regarding the permissibility of shares and limited liability companies. It is submitted that this should in fact be the starting point regarding the whole debate surrounding the "Islamicity" of the stock exchange market. He has based his argument on the so called "consensus of jurists" and claims that the maxim "accepted customs is like explicit conviction". It is submitted that this debate has not been settled yet. For example, the All India *fiqh* Academy held a conference on this issue of shares and companies. From the papers delivered it is clear that there is no complete consensus on its permissibility (Mujahidul Islam, 2000:24). Nizam Yaqubi (2000) has elaborated on the different views of the Arab Jurists and still one can see that conflicting views still persist. Uthmani (1999a:182) has dealt with different approaches between the Shawāfī and the Ahnāf. Again it is clear from his writings that according to the original Shawāfi stance shares are not allowed due to the mixing of *ribā* and other prohibited elements a company is involved in (Uthmani, 1999a:185).

The concept of shares emanated in a given historical context to encourage the heavy oriented risky ventures needed for the expansion of the British economy in the 17th century. However, the reality of the legal persona of a company was devised to limit the risk of entrepreneurs; but nobody was clear about it until 1897 when the House of Lords gave a seminal judgement in the Solomon v/s Solomon Ltd, that the share holders are different persons from the company (Bourne, 1998:9). Further evolution took place since then. Corporate law became one of the most amended laws due to the intricacies associated with the concept of legal personality of company created by subscription of shares. Originally, shares were considered as a pro rata ownership of the assets of the company (Bourne, 1998:35). Based on this concept Muslim scholars have debated the permissibility of shares, and ultimately the issue of stock exchange market. But very few scholars have paid attention to the evolution of corporate law and that the stance regarding shares is changing. In fact experts in corporate law argue that a literal construction of the word "share" is apt to be misleading in relation to present day registered company. The purchase of shares in a company does not mean a shareholder has a "share" in the property of the company. The company's property is owned both legally and beneficially by the company (Goulding, 1996:163). And this is far from being a *mudārabah* as propounded by many sharīʿah experts! So, legally shareholders are not joint owners of the company's assets, nor can a shareholder even be said to have an equitable interest in the company's property. According to the definition of share given by Farwell J in *Borland's Trustee v Steel* (1901 1 Ch 2791) "shares are characterized as a bundle of rights stemming from section 14 contract". No doubt from this bundle of contracted rights the share has emerged as a price of personal rights which is an intangible property, that is to say it is a "chose in action". Therefore, it can be owned, bought and sold, mortgaged and it will form part of the estate of a deceased person. However, in the same case law, the court also pointed out that "[T]he share is the interest of the shareholder in the company measured by a sum money, for the purpose of *liability* in the first place, and of interest in the second" (emphasis added).

The paradigm shift is no more on ownership but on liability. One has to differentiate the legal concept of personal right of the shareholder and the real right of the company. The legal consequences that flow are consequential for Islamic law. This issue has not been debated at length so far in academic works! Hence, it needs to be covered in the debate in considering the permissibility of shares and the corporation because it affects the concept of "dealing in shares" and stock market.

Besides the *fiqhī* and legal aspects of shares and legal persona of corporations, the regulatory framework of listing companies and the development of Islamic indices also warrant a parallel research. Investors need to be protected, and also to ensure that their investments are canalized in the proper Islamic direction. So far, very few articles have been written on this issue. Certain conditions need to be abided to in order to be listed on the London Stock Exchange. The Islamic index as well lays down certain criteria in order to filter companies in formulating the index. Some of these criteria are analysed later as there is still discussion as to the finality of these criteria.

Scholars have discussed the Islamic Stock Exchange Model. But nobody has discussed the possibility of establishing an Islamic Securities House that could operate within the secular stock exchanges where most of the investment takes place! However, based on the article by George (2003) one can work towards this as proposed by Tellner (1425 AH). However, this is outside the ambit of this paper.

3. The Historical Emergence of the Joint Stock Company Share as a New Form Fictitious Capital

As mentioned previously, the starting point for this paper is to elaborate on the nature of shares which emanates from Western legal sources. A brief historical review will be drawn over here.

The first British joint stock companies began to emerge in the sixteenth century. They were not however public in the full modern sense of the term but were more in the nature of extended partnership. The relatively few joint stock companies in existence were divided into very few large denomination shares, and clauses restricting and regulating their transfer were common. Although from the outset shares were sold outside personal acquaintances, there was no basis for a developed public market in them. In the eighteenth century when the stock exchange grew rapidly the basis of its growth in increasing government debt, trade in company shares forming a negligible part of its businesses (Ireland, 1987: 158). The number of companies quoted in the Castaing's course of Exchange actually fell from seven in 1753 to six in 1775 and to five in 1800 (Ireland, 1987:158).

The numerous joint stock canals, insurance and other companies formed in the late eighteenth and early nineteenth centuries generated few changes in this respect.

Studies of the canal companies reveal limited number of relatively large denomination shares, few shareholders and considerable stability of large shareholdings. The prices of canal dock, insurance and water works shares were included in the official list for the first time in 1811, followed later by those of other miscellaneous companies, but "there was no really widespread interest in them as an outlet for savings …., [T]here are no statistics on daily share turnover, [but] indirect evidence suggests that it was very limited" (Gayer, 1953:376). Exchange businesses continued to be concerned almost exclusively with government stock. So far as the legal nature of the share was concerned, the underdeveloped state of the market was crucial.

By this time the great majority of shareholders were simple rentiers who played little active part in management and treated their shares as mere rights to revenue. However, in the absence of a public share market, shares could not develop as fictitious capital with a value in themselves. As a consequence, they inevitably retained a direct link to a company's productive assets and were legally conceptualized not as property in their own right but as equitable interests in those assets realty or personality. In short while the share incorporated title to revenue it was considered to be so inextricably connected to the assets of companies that it could yet be constituted as a separate form of property (Millon, 1990:206). It was rather peculiar legal amalgam of money and legal industrial capital which had yet not been juridically separated within the joint stock company. Such a legal distinction had already been drawn in respect of other titles revenue such as loans. In these circumstances shareholders could not be completely separated from their companies. This was reflected in the contemporary view of joint stock companies, incorporated and unincorporated, as entities composed of shareholders merged into one body; as aggregate of people; as "they". People still formed themselves' into companies (Ireland, 1987:159).

In the period after 1825 the nature of the share was transformed. The principal cause was the rapid development of the railway system. Railways involved massive outlays on fix capital requiring the aggregation of large amount of money capital. The smaller denomination, freely transferable share was the chosen form of centralisation. The railways brought, therefore, a dramatic increase both in the number of shareholders and in the number of shares available for trading. Dealings in railway shares involved an extra-ordinary volume of transactions by previous standard. By the second railway boom of the 1840's the stock exchange had been "perfectly revolutionalised", and was "geared…. To handle a growing range of company securities". Stock exchanges even emerged in provincial centres, and gradually a national investment press developed. Joint stock company shares had become much more widely held:…. A class of property had been, if not created, then vastly expanded" (Mitchell, 1964:331).

The effects of these developments on shares, however, were qualitative as well as quantitative. Shares were not only much more numerous, as they were now marketable commodities, liquid assets, easily converted by their holders into money. They were titles to the new revenue capable of being capitalised; a form of fictitious capital separated from the productive capital of the company. Legally, they were judicially redefined as objects of property in themselves. Shares, said Bacon C.J. In 1871, "are not things in action at all but are as much part of a bankrupt's estate as if they had been freehold property" (Ex parte Union Bank of Manchester 12 Eq.354.) Most important of all for the future development of company law with the legal constitution of this new form of property a gulf emerged between companies and their shareholders and between shareholders and shares. Companies owned the productive capital, the actual assets; shareholders own the fictitious share capital, the shares, which they could now sell at will. Shareholders were now "completely separate" from their companies. They no longer form themselves into companies but formed companies, objects external to them. A company was no longer a plural entity, a "they", people merged into one body; it was now a singular entity, an "it", an object emptied of people. Both the company and the share had been reified.

The conditions now existed for the emergence of the modern version of the principle of separate personality, and gradually the meaning attached to incorporation changed. In the 1870's Seward Brice, reflecting on Kyd's 1793 definition of a corporation as a "collection of many individuals united into one body", commented: it is fairly accurate but sufficient stress is not laid upon that which is its real characteristic in the eye of the law, viz. its existence separate and distinct from the individual or individuals composing it" (Ireland, 1987:160). Modern company law was emerging. However, companies can only exist if shares are issued.

Therefore, the nature of shares and its conceptual evolution need to be discussed from an Islamic perspective. However, first the British legal position should be understood in order to make any discourse analysis of the *fatāwā* issued regarding the status of shares in sharīʿah.

4. Nature of Shares in the Light of British Law

At the present day this question is more easily asked than answered (Davies, 2003: 616). As discussed earlier the concept of shares underwent a legal metamorphosis and is still undergoing changes. The case law that laid the foundation in understanding the nature of shares is Borland's Trustees v Steel (1901 1 Ch 2791) where Farwell states that:

> "a share is the interest of the shareholder in the company measured by a sum of money, for the purpose of *liability* in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by the shareholders inter se in accordance with [s 14]. The contract contain in the articles of association is one of the original incidents of the share. A share is not a sum of money…. But is an interest measured by a sum of

money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount." (Emphasis added)

This judgement negates the literal construction of the word "share" as understood by many Muslim jurists. It is apt to be misleading in relation to the present day registered company. The purchase of shares in a company does not mean that the shareholder has a share in the property of the company, nor can a shareholder even be said to have an equitable interest in the company's property (Gouldering, 1996:163)

In the old deed of Settlement Company, which was merely an enlarged partnership with the partnership property vested in trustees, it was clear that the members' "shares" entitled them to an equitable interest in the assets of the company. It is true that the exact nature of this equitable interest was not crystal clear, for the members could not, while the firm was a going concern, lay claim to any particular asset or prevent the directors from disposing of it. Even with the modern partnership, no very satisfactory solution to this problem has been found, and the most one can say is that the partners have an equitable interest, often described as a lien, which floats over the partnership's assets throughout the duration of the firm, although it crystallises only on dissolution. But a sort of proprietary nexus between the partnership's assets and the partners exists (Davies, 2003:616).

At one time it was thought that the same applied to an incorporated company except that the company itself held its assets as trustee for its members. But this idea has been rejected by the court (Davies, 2003: 615).

The definition quoted above characterises the shares as a bundle of rights stemming from s. 14 (Gouldering, 1996:13). A shareholder's legal entitlement may differ significantly from this expectation. But same is true for other stakeholders. For example, employees' expectation in sharing the profits of the company in the form of bonus! Hence, the law is concerned with entitlements (Worthington, 2001:6).

This "bundle of rights" attached to the share entitles the shareholder the following:

a. a right to dividend on shares;
b. generally (unless it is a non-voting share) a right to vote at the general meetings;
c. on liquidation of the company or on a reduction of capital the right to receive assets distributed to shareholders of that class;
d. an obligation to subscribe capital of a given amount which will sometimes be the nominal value if the share is issued at par and sometimes will be in excess of this if the share is issue at a premium;

e. rights of membership attached to the shares as defined in the company's memorandum and articles of association;
f. a right to transfer the share in accordance with the articles of association (Bourne, 1998:81)

5. An Analysis of the *Fatāwā* Regarding Shares in the Light of British Law

After the above brief discussion regarding the nature of shares, now an analysis of shares is warranted from an Islamic perspective due to the importance of stock exchange plays in the modern world. First the *fatāwā* will be discussed followed by the criteria laid down by sharīʿah scholars for allowing the purchase of shares.

As can be seen from the case laws, a share is not a pro rata representation of the ownership vested in the assets of the company. This is a shortcoming in the *fatāwā* as will be discussed soon. A case law will illustrate on this point. In the case Macaura v Northern Assurance Co. Ltd (1925 AC 619) Mr Macaura took an insurance policy against fire on a forest where trees were cultivated. The land was owned by a company which he incorporated and he was the sole shareholder. It so happened that the forest caught fire. He claimed the damages from the insurance company, which refused to pay him. It was held by the court that he was not the owner of the trees but it was the company that owned them. Thus, he did not have an insurable interest in them. Consequently, the insurance company did not have to compensate him! Another interesting case is R v Philippou (1989 89 Cr App R 290) where the court held that a person who owns all the share of a company can still be convicted of stealing from the company!

Therefore, ownership of the company's assets is important to be discussed because Islamic finance emerged as it aims at developing asset-backed transactions in order to eliminate the issue of *ribā*. This is what makes the difference between conventional financing and Islamic financing.

According to British law a share does not entitle a shareholder a right in the assets of the company, but to own a bundle of rights. Hence, a sale of shares is under no circumstance, under present law, an asset-backed transaction per se, but represents the sale of an intangible asset. Legally this means that if one claims that a shareholder owns the assets of a company, then he will be entitled to a real right; and if he claims a bundle of rights then he has a personal right. In other words he cannot make a real claim against a company.

What does this mean in law? A person's claim to an asset may be by virtue of either real right in it or a personal right to it. He has a real right where title to an interest in assets, whether absolute or limited, is vested in him. Thus, the owner of goods (in the sense of the one having the best title to them) has a real right in them, as does a mortgage, a charge, a person holding a defensible possessory title and a person in possession by way of bailment or pledge (Goode, 1982:69).

But claim to an asset can also be made by one who has no existing real right, merely a personal right to have the assets delivered or otherwise transferred to him. Such a person has a mere *jus in personam ad rem* or more shortly, a *jus ad rem*, as opposed to a jus in re.

In a nutshell, in a real right one has a right against the commodity itself, while in a personal right it is against a person. The share registered in a registered company remains personal property regardless of the kind of property owned by a company. So, even if the company's only asset is real property, the shares will still be considered as personal property (Goulding, 1982:163). Section 182 of the companies Act 1985 confirms this by stating that the shares or other interests of any member in a company are personal estate and are not in the nature of real estate. So definitely this situation does not reflect an asset-backed scenario!

It seems that this is not the way the nature of shares is reflected in most *fatāwā*. Some Muslim scholars have taken the view that shares are mainly for the purpose of creating a joint-stock company which is a partnership (*shirākat al-musāhamah*) (Zuhayli, 2003:529), while others have considered it as a *muḍārabah*; where the directors are considered as *muḍārib* (Mujāhidul Islam, 2000:101).

The main stream Muslim scholars have considered shares as a contribution towards an asset in the view of sharing the profit like in a partnership or *muḍārabah*. This was the case with the concept of Joint Stock Company in the initial stage (Millon, 1990:216). Thus, share was representing a pro rata ownership in the assets of the company. But now the court no more adopt this stance as discussed earlier.

However, modern scholars have realized that shares are also a property but not a property discussed in the previous books of *fiqh*. Hence, they have tried to elaborate on the nature of shares on three levels.

5.1. Preliminary Arguments to Explain the Nature of Shares

There are three issues raised by scholars to determine the permissibility or non-permissibility of shares: *māl*, *bayʿ* and *milkiyyah*.

First, whether it is *māl* (property). Briefly stated, the scholars have described *māl* into three categories. The first category consists of those things which are well defined in sharīʿah such as gold. The second category consists of those things that the scholars have moved towards the lexicography (*lūghah*) to find a meaning. In the Arabic language the word *māl* is derived from two root words: one consists of the three alphabets "*mīm*" "*yaa*" and "*lām*" which gives the meaning of everything towards which man's heart inclines. The second is the root "*mīm*" *waw*" and "*lām*" which gives the meaning of a thing which has value. The third category is defined according to 'ʿ*urf* (custom). This method is adopted when something is not known in sharīʿah, and that the lūghah also is not clear about it (Mujahidul Islam, (1990:71).

Muslim scholars have divided the *māl* or '*ayān* (property) into three classes: first, those assets from which man derives benefit from the assets themselves, i.e. They are tangible assets. The second are those assets that exist in the form of an intangible benefit only. They do not exist on their own but are connected to a tangible asset. For example a lease is a benefit that one enjoys through a tangible asset.

The third class consists of those assets that exist in the form of rights. These exist in two subclasses: those that are linked to an asset, for example right of crossing over a land (*ḥaq al-Murūr*); and those that are not linked to the asset. For example, the right to be nurtured (*ḥaq al-Hadānah*). From the literature available from Islamic Jurisprudence it can be gauged that this issue of rights has hardly been discussed in the way the secular law has evolved.

The scholars have no problem with the first two classes. But, regarding the third class, differences of opinion prevail. It is argued that a person cannot sell the right to be nurtured or a woman cannot sell her right of *khula*' (i.e. To claim her divorce from the husband by offering him compensation). The main advocates that this type of rights is not *māl* proper are the Ahnāf. They claim that this is *māl al-mujarradah*, hence they are not subject to sale. In the Māliki school of law it would seem that from the subsidiary rulings (*furu'i masāil*) there can be a chance that they are saleable. Regarding the Shawāfi and Hanābila there is no restriction on the sale of such rights.

This classification of *māl*, became important because of the concept of *bay*ʿ (sale) in Islam. So, this is the second issue that the Jurists have discussed before pronouncing on shares. The definition of sale is given as the exchange of *māl* for *māl* (*tabādal al-māl bi al-māl*) in Islamic law. Therefore for something to be a *māl* it must have three essentials. First it must be permissible in sharīʿah, secondly there is benefit out of its use. Third is that the customs accept it as *māl* for their dealings.

The third issue raised is what consists of *milkiyyah* (ownership). Some scholars in the past have stipulated that there should be *qabzah* (take possession for the article sold) for the transfer ownership in the goods to take place. Others have argued that ʿ*urf* plays a role here as well.

All these questions were answered in the light that shares are special types of *māl* (property) and that the *bay*ʿ (sale) of it can be compared to intangible commodity and that milkiyyah (ownership) will pass over according to the rule and procedure of the stock exchange. However, they did not discuss the issue of personal rights involved in it and whether it is really asset backed.

The pertinent question is whether a shareholder can sell this personal right vested in the bundle of rights he is entitled to, on an open market. Here again there are differences of opinion among Muslim scholars. Some say it is permissible while others negate the permissibility on the basis that it is *huqūq al-mujarradah*.

This discussion should be analysed in the light of British law because the law of the land that prevails. In law, sale of personal rights falls within the ambit of voluntary assignment of contractual rights and liabilities (Furmston, 2001:156). In other words its owner can expressly assign the right created by a contract to a third party. In our case the contractual relation between a company and a shareholder gives rise to a bundle of rights as discussed. Can one sell this right on the Stock Exchange market; put differently can an assignee bring an action on his own initiative against a recalcitrant debtor? Does an assignment bind the debtor as well as the assignors? This topic is generally described as the assignment of "chose in action".

"Chose in action" is a known legal expression used to describe all personal rights of property which can only be claimed or enforced by action, and not taking physical possession (Furmston, 2001:521). It is a term that comprises a large number of proprietary rights, such as debt, negotiable instruments and includes shares! Many of these have been made assignable by statute. Shares are one of them. It is sold online as an intangible asset.

Though in law one can assign this right, but in sharīʿah there is difference of opinion. Uthmani (1999b:160) has attempted to do a classification of the concept of rights in Islamic commercial law and has elaborated on this issue by trying to develop some *fatāwā* on the question of personal rights in assets. It is here that the Ahnāf have difference of opinion. According to them this will tantamount to *ḥuqūq al-mujarradah* and most unlikely can be subjected to sale. However, Uthmani has argued this differently. He tried to prove that there are exceptions regarding *huqūq al-mujarradah* in the Ḥanafī *fiqh*. But other great scholars such as Mufti Mehmood Hassan Gangohi,2 have rejected the sale of shares on this basis that one cannot sell the *huqūq al-mujarradah*.

The problem is, if one says that he can sell his personal right on the stock exchange, then can one sell his other benefits as well? On the basis of the "chose in action" and voluntary assignment one should be able to do so as discussed earlier. Then, logically this will imply that an employee, as a stakeholder in the company, can also develop a secondary market for selling his right for a bonus pay! Yet, this analogical deduction will not meet approval of scholars! This is a debatable issue that will lead to *gharar* and *ribā*. This is important to consider because the employees also are stakeholders in the company. In fact their claim is above that of the shareholders in the case of insolvency! Therefore practically, the issue of *huqūq al-mujarradah* does hold some weight, at least from a ḥanafī point of view.

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[2] (The previous grand Mufti of India). It should be pointed out that in his Fataaawaaa Mahmoodiyyah he originally gave permission for the purchase of shares. But when he was explained about the modern approach he changed his view.

Another point to consider regarding *bayʿ* of *huqūq al-mujarradah* is that it involves the sale of something unidentifiable. Hence, there is an element of speculation involved because as it stands there is a lack of information on shares certificates. The share is supposed to disseminate information on the company. The ‘*ʿurf* on the market is that people do not know what really is happening in the company. It is just a reliance on the share indices. Therefore due to this lack of information there is an element of *gharar* that should be taken into account. This information asymmetry can also implicate *ghaban*.

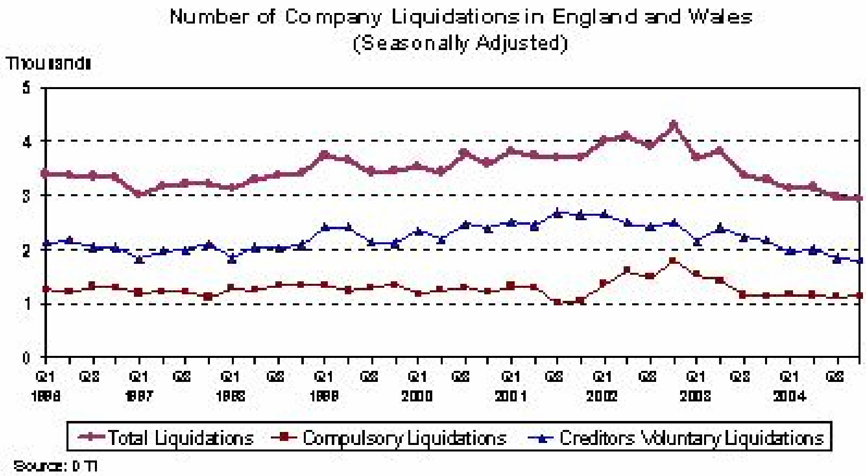
The next issue that needs to be elaborated upon is whether sale of shares is asset-backed?

British law however, does consider share as a property of a sui generis nature. But the sale of such property is still ambiguous when one ponders on its asset-backed aspect. There is no solid proof that it is asset backed in the light of section 182 of the Companies Act 1985 as mentioned previously. However, it can be argued that section 107 of the Insolvency Act 1986 provides:

“Subject to the provisions of this Act as to preferential payments, the company’s property in a voluntary winding up shall on the winding up be applied in satisfaction of the company’s liability pari passu and subject to that application, shall (unless the articles otherwise provide) be distributed among the members according to their rights and interests in the company.”

Prima facie this provision seems to make a share asset-backed. But one has to look at reality and not only at the words of the law. This is because law is a dynamic subject prone to changes according to the demand of the market forces. In reality only about 1% of companies in England and Wales go in compulsory liquidation due to insolvency and not voluntary insolvency, which is evidenced in figure 1.

Figure 1:



Source: DTI (Department of Trade and Industry, UK, 4 February 2005, Available at: <URL: http://217.154.27.195/sd/insolv/index.htm>

Thus, there is nothing left for the shareholders as residual assets! Also in the winding up process the ordinary shareholders are entitled to the entire surplus of assets remaining only after payment of the liabilities of the company including any payment to employees who is a stakeholder in the company just as a shareholder, under the Insolvency Act 1986, s.187 and after the return of the capital of all classes of shares, unless preference shares are given the right to participate in the distribution of those surplus assets (Morse, 2002: 6.02). Therefore it is just an expectation in realty. The Islamic view on the issue of liquidation can be ramified in two legal maxims: *Al-Nādir Mulhiqun bi al-ʻAdam*, something remote is equated to non-existence. The second one is *Al-ʻIbrah li al-Ghālib al-Shāʼi lā li al-Nādir*, consideration is taken of the well spread majority and not of the rare (elements) (Zarqa, 2001: 236). Hence when one considers the reality of liquidation of listed companies there is not strong proof for claiming that sale of shares is asset-backed from an Islamic point of view. It can be argued still that in case of voluntary liquidation there may be an asset. But as the statistics are proving it, this too is very little in percentage to give a *fatāwā*. Also most listed companies do not go for voluntary liquidation.

Another issue that needs further discussion is that in the process of liquidation of companies; assets are usually sold and if anything is left in the form of cash, then it is the cash that is handed over to the insolvent and not the assets per se. It can be argued that from the shareholder's point of view that this is similar to doing transaction with a bank that works your capital by investing it and give you money at the end.

From the above facts the question is, can one advocate the permissibility of sale of shares on the basis that it is asset-backed, and which is mere expectation of shareholders should there be a liquidation? It is submitted that this matter should be reconsidered as there may be an element of *ribā* involved in that!

Another point to consider regarding the sale of shares is that if a company is sold as a "going concern", however, then the shareholders are not entitled to this residual value, nor to control of its disposition, even after all other legal obligations have been met (Warthington, 2001:313). This raises the issue of *milkiyyah* over the issue of the assets. This is another area that the Muslim Jurists have not touched upon. It can be argued that the shareholders have a hope that the sale will be to their benefit. But this is not a concrete argument to prove that a share is asset-backed. Then employees as well can have the same expectation as discussed earlier!

In fact in the case of Short v Treasury (1948, 1 KB 116 LA), the court refused to value the share of Short Bros "as between a willing buyer and a willing seller". They were valued on the basis of the quoted share price, but the shareholders argued that, since all the shares were being whole undertaking should be valued and the price thus determined apportioned among the shareholders, or the value should be the price which one buyer would give for the whole block, which should then be similarly apportioned. This case proves that a shareholders expectation is not in his hands (Davies, 2003:617).

From the above discussions one can gauge that the sale of shares is approved by all school of laws. Each one can have their own proofs. However, it can be seen that the sharīʿah scholars have not revisited their *fatāwā*. The law is clear that shareholders are not owners of assets, it is mere expectation that they will have something upon liquidation if the articles of association stipulates it and that there is some *gharar* involved in the sale of shares (Hassan, 2000). The objective of this discourse analysis is to show that the matter of sale of shares is not final and that the sharīʿah scholars will have to give a second thought as to what a share really is? If it is not asset-backed from a legal and practisal point of view then there may be *ribā* involved in such a transaction. However, in the light of the Shawāfi, Hambali and Maliki School of jurisprudence there seem to be a leeway for the sale of shares if the necessary conditions to prove asset-backed transaction are met and developed. But from the Ahnāf point of view, there seems to be some cloud over this issue. But again 'ʿ*urf* as a source of law should be considered, given the importance of the stock exchange markets. Another point to consider is that on an accounting point of view shares are considered as an asset for shareholders. Hence, this also should be used when reconsidering the nature of share and its sale on the stock exchange.

Based on the assumption that sale of shares is asset-backed and that share is a *māl*, the sharīʿah scholars have developed specific criteria to allow the sale of shares on the stock exchange. An analysis of those criteria will be made and some suggestions will be made to improve upon these criteria.

6. Criteria for Creating an Islamic Share Index

As discussed above one of the main features of Islamic finance is to develop asset-backed financial products. This golden thread should be reflected in the sale of shares as well. To this end sharīʿah scholars have established some criteria that pave the way for such a transaction to be sharīʿah compliant. However, these criteria need to be assessed as the earliest ones have undergone changes already; and scholars are still discussing as to how to improve this grey area due to its embryonic stages. One of the earliest criteria formulated were done for the Dow Jones Islamic Market Index in 1999.which is fairly recent. The FTSE Islamic Index followed thereafter in 2000.

The purpose of Islamising the indexes is to enable the 1.2 billion Muslims to explore other avenues of *halāl* income. Hence one would expect the FTSE Islamic Index (used on the London Stock Exchange) to be a low-debt, non-financial social-ethical index in the broad sense. To become eligible for inclusion in the FTSE a company should undergo three screening filters:

6.1 *Ḥalāl* Business Area

The Qur'ānic rationale for this criterion is that one should not help towards sinning. However, it has been argued that Imam Abu Hanifa's view is that if the deal is with non-Muslim, e.g. In a state where most companies are owned by non-Muslim, then with a strong abomination it would be permissible to invest in such companies.

However, in Sahibain's[3] view this is not right and the *fatāwā* is on their opinion. (Mujahidul Islam, 2000:102). It is stated in *fatāwā* Hindiyyah (vol. 4, p. 333) that if a Muslim enters a contract of *muḍārabah* with a Christian and the latter makes some profits by means of alcohol or swine, then Abu Hanifa's view is that, it is appropriate for the Muslims to give that ratio of profit in *ṣadaqah*. However, this is in the case when he did not know of the transaction beforehand.

From this discussion it can be argued that in modern context where the western world is leading the investment market, one has to consider the extent of investment to be done with them. Islam has not really forbid partnership or joint ventures with non-Muslims except under certain circumstances which are mainly ethical.

[3] Imam Abu Yusuf and Imam Muhammad al-Shaybani.

6.2 A Company Must Meet Specific Financial Constraint

Once a company with acceptable primary business activities has been eliminated from the universe, the remaining stocks are tested according to three filters:

First, exclude companies if Total Debt divided by Trailing 12-month Average Market Capitalisation is greater than or equal to 33%. (Note that Total Debt= Short term debt + Current portion of long term debt + Long term debt.). In simpler language the debt equity ratio must not exceed 33% (Yaqubi, 2000). The rationale behind this criterion is that many joint stock companies sometimes resort to leverage at a certain interest for expanding their business activities or to meet their emergency cash requirements and this means paying interest to lending parties. Although the dividend of these companies do not include explicit interest payments (because in this case they are paying interest), nevertheless, this does not mean that they are not dealing in unlawful activities, i.e. In this case usury-based loans. Hence, the debt ratio to the shareholders equity should be as low as possible. However from an accounting point of view this criterion is wrongly formulated because debt does not necessary mean loans, it includes other liabilities such as creditors' items in the balance sheet. This does not always involve interest and most manufacturing companies will have a high percentage of purchase on credit reflected in the balance sheet. This is not reflected in this ratio. May be in practice, only the interest bearing loans are taken into account. However, it is suggested that a new formula be devised for the purpose of these criteria, or else many companies can be excluded from the listing in FTSE Islamic Index (or other Islamic indices for that purpose). A possible solution could be to devise loan equity ratio because the purpose is to limit interest in the dealings while the equity ratio is a leverage ratio to calculate the extent to which a firm relies on debt. Other things being equal, a higher leverage ratio indicates a riskier firm, because the debt payments are fixed even if the earnings of the firm fluctuate. As a result, should the cash flow diminish excessively, the firm might miss its debt payments deadline, putting it in technical default, and at times interest is charged. However, this is of a less concern to us as compared to the interest on loans per se.

Another important point to keep in mind is that the percentage of 33% is arbitrary, some scholars have used 30%, and others have used 33%. This is deduced from a sharīʿah principle a third is much. This principle is used to determine the minimum and maximum limits. Scholars have been accustomed to rule in many issues, that what is less that one third is the criteria of a small percentage. This inference is analogous to what is reported from the Prophet (s) as saying "one third and one third is too much."

However this dictum was an advice given to a Ṣaḥābī who wanted to bequeath his whole estate and leaving nothing for his children. The Prophet (s) wanted to bring him from the maximum to the minimum level in the process. On the other hand, in the case of the debt equity ratio, the objective is to find a maximum that can be allowed. Hence, from a *qiyās* point of view it can be argued that the criteria of 33% can still be debated.

Another issue that needs our attention is that the valuation and definition of shareholders' equities is multifaceted. Different companies have different ways to computerise these equities, e.g. some look at the market value of stocks or paid up capital or the net asset values on total assets. Each company has its own criteria. And different countries may have different standard accounting principles or nomenclatures for tax or legal reasons. Hence, it is submitted that the sharīʿah scholars must try to standardize this issue to bring in more certainty.

The second financial constraint is to exclude companies if the sum of cash and interest bearing securities divided by trailing 12-month Average Market Capitalisation is greater than or equal to 33%. Other scholars have expressed exclusion on the basis of debt and cash money forming 50% of the existing assets. This criterion is not mentioned for the FTSE Global Islamic Index.

Islamically a debt cannot be sold to a third party, neither sale of cash for cash (of same denomination) (Uthmani, 1999a:38). Therefore contemporary scholars stipulate that equities of companies, the business activities of which are lawful may be traded if total cash and debts in their balance sheets do not exceed the total value of other assets, that is, real assets, and not debts and cash, should constitute the majority of their assets. In other words there must be some illiquid assets so that the sale of shares is asset-backed in order to avoid *ribā* (Hakim,2002:4). Or else sale of assets should be at par value, which is virtually impossible to calculate exactly.

However, due to the globalisation (Chorafas,1992:22) effect on the stock exchange these need to be revisited. The multi listing of companies raise the issue of currency and also it has been argued that sale of debt can be allowed by some academics (Kamali, 2002:348). Seeing the importance of the stock exchange it is submitted that this criteria demands a revisit.

The rationale for this criterion is the legal maxim "the majority deserves to be treated as the whole of things".

Besides the 33% or 50% ratio, there is also a third view based on the Ḥanafī school is that whenever assets are combinations of liquid and illiquid assets, dealings can be negotiable irrespective of the proportion of the liquid ratio. However, this principle is subject to two conditions:

Firstly the illiquid part of the combination must not be in an ignorable quantity. It means that it should be in a considerable proportion. The proportion needs to be determined, and above than 50% has been stipulated, due to the maxim elaborated earlier.

Secondly, the price of the combination should be more than the value of the liquid amount contained therein. Or else this type of transaction falls within the purview of *ribā* and is disallowed. This is in line with what was discussed above, that is Islamic finance is asset-backed. This aspect seems to be more elaborate, but according to the shawafi this cannot be done (Uthmani, 2003:209)

The third financial constraints is that interest (or unlawful gains), should represent less than 5% of total revenue. This criterion has been and is still a bone of contention among Muslim scholars. This criterion as well has not been used by the FTSE Global Islamic Index. It is still a rod in the wheel because as expressed in a *Ḥadīth* that a time will come when interest will be so rife that nobody will be left but as eater so interest even one does eat interest its dust will reach his nostrils.

Thus, under modern commercial norms virtually all listed companies are directly involved in interest either by way of deposits or loans. Thus Muslim scholars have struggled with this condition. Nizam Yaqubi has dealt with the differences of opinion of Muslim Scholars of the Arab world. In summary his research reveals that their discussion rotates around four legal maxims:

a. What is independently impermissible is permissible when done together with the permissible acts.
b. The general need takes the rule of the specific necessity.
c. Mixture of negligible unlawful part with major lawful part is allowed.
d. What is inescapable is tolerable.

In the light of the above juristic principles, which have been used by different scholars to derive contradictory results, it would seem that there is still room to debate the issue of interest involved in dealings of shares. However, the main stream scholars and the *fiqh* academies have moved in the direction of allowing sale of shares subject to the criteria under discussion.

6.3 Submission of Accounts

Another criterion developed is the submission of accounts. Hence, the sharīʿah scholars sitting on the sharīʿah board of firms developing Islamic index have made a condition that the audit report and accounts of the listed companies should be submitted to them at regular interval. It is submitted that even the accounts recording of subsidiary companies of the listed companies as well should be reviewed by the scholars because often the accounting system does not reveal all transactions of the subsidiaries which may be in line with the ratios. The holding company does have more than 50% in these companies thus they are liable. They cannot claim their irresponsibility at the AGM as shareholders do have a responsibility to voice out anything un-Islamic in the AGM.

6.4. The Articles of Association Should Provide for the Shareholders to Have Residual Assets

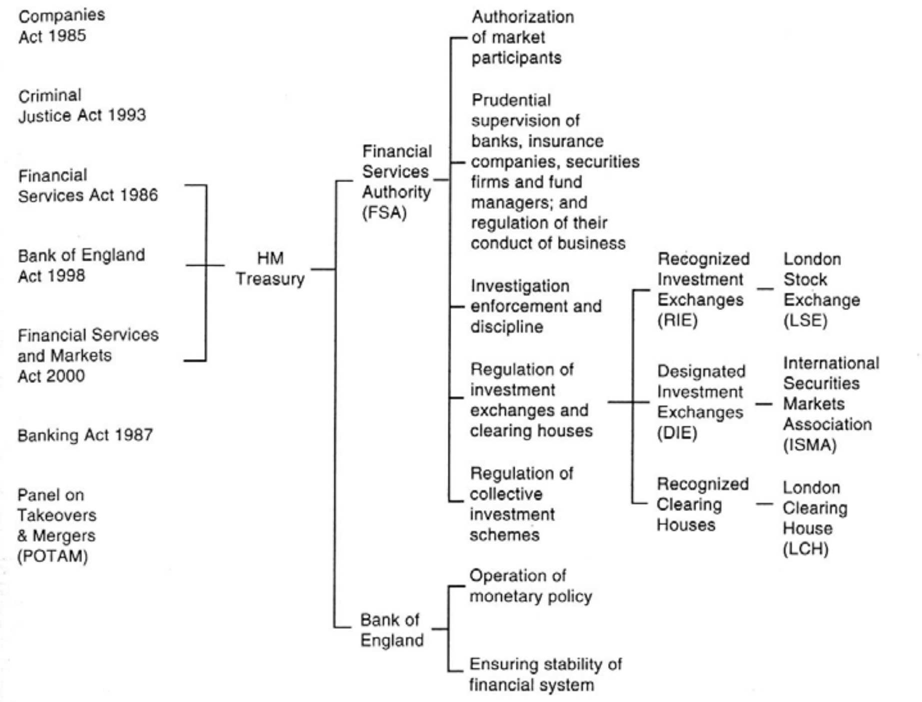
The Insolvency Act 1986 does provide that the share holders will be entitled to residual assets only if the articles of association provide for it. It is submitted that this should be a criterion, as well as a safety valve, despite most listed companies will have this provision in their articles of association. Hence, this should be a condition in accepting companies on Islamic index to consolidate the asset-backed aspect.

6.5 Disclosure of Nature of Share Transactions by Sharīʿah Audit

Generally speaking people accept assumption made in the 1960's or 1970's in many disciplines without taking into account the changes that may have taken place. In other words they depend on accepted ‘*ʿurf*. But this is acceptable Islamically when ‘*ʿurf* is strong; but if ‘*ʿurf* is not strong as is the case with legal dynamism, when the law of court applies, then, it is imperative to convert the ‘*ʿurf* into a *sharṭ* (condition). This must be made explicit in the dealing of shares. People must be informed of the contract they are entering into. Therefore to improve on the filtering criteria, the sharīʿah audits of international equity fund should inform the buyers of shares that their ownership is confined to a bundle of rights and not necessarily to the assets of the company. This will make the deal more efficient at the level of *gharar* due to a decrease in the information asymmetry.

This was a brief analysis to show that there is still improvement warranted in the “filtering” criteria.

7. Regulatory Control of the UK Financial System



Source: Blake, 2000: 45

A detail analysis of the regulatory framework is outside the ambit of this paper. However, regulations pertaining to listing on the London Stock Exchange are usually discussed in what is called the yellow book. The London Stock Exchange is the only stock exchange in the United Kingdom and has been listed since July 2001. The above chart depicts the regulatory framework in the UK.[4] The most actively traded shares on the London Stock Exchange is traded via the electronic order book systems SETS (Stock Exchange Electronic Trading Service), whereas other U.K. Shares are traded via the electronic quotation system SEAQ (Stock Exchange Automated Quotation System) and non-U.K. Shares in a similar way via the electronic quotation system SEAQ International.. The London Stock Exchange's main segment is called the "Main Market". The Alternative Investment

[4] From May 1, 2000, the supervisory functions of the London Stock Exchange were transferred from the H.M. Treasury to the financial Services Authority which, acting as the competent authority for listing, is referred to as the U.K. Listing Authority. (Harrer, 2002:370).

Market (AIM), with its more flexible regulations created for all smaller companies, has been in existence since 1995 (Reuters, 2002:59).

From the statistics available from the LSE, it is encouraging to see that there are valid reasons to launch an Islamic Securities House (ISH). This is because the reasons for floating companies on the London Stock Exchange are not for speculation.

Main Reasons for seeking a market flotation	Proportion of respondents
Raise Funds to continue growing the business	71%
Increase company's profile and credibility	11%
Allow exit of venture capital investors	11%
Use shares for future acquisitions	5%
Provide share options for directors And staff	5%

Source: London Stock Exchange Website

8. Conclusion

This paper is an attempt to demonstrate that shares are just entitlements to a bundle of rights, which means that they represent only personal rights and not real rights. Consequently dealings with shares of listed companies are not asset-backed. This may lead to problems of *ribā* and *gharar*. Even the filtering criteria to purchase shares demand further improvement as suggested.

Given the volatility of the stock exchange market, it would be more appropriate to establish Islamic Securities House to monitor and advise investment on such a market. Islamic indexes are not enough, there are many other issues that need to be taken into account besides shares – regulations, *fiqhī* issues, investment appraisal, monitoring of indexes.

Islamic finance is still in its infancy as compared to conventional finance. However, the stock exchange market is a magnet that pulls all types financial institutions either to invest their liquidity or to raise funds. Hence, extra care should be taken when dealing with such markets. Law can change any time but some Islamic principles are immutable. This dichotomy of secular and Islamic legal system needs further debate as there is more dependence of Islamic finance over secular law. This is an arena that needs further attention. If secular law is accepted as ‘*ʿurf* (customs), then there must be a *sharṭ* (condition), to make it a strong ‘*ʿurf* due to the dynamism in the commercial world.

In concluding, it should be pointed out that the “filters” used in Islamic finance for shares are designed to remove companies with high debt, therefore, by definition there should be lower risk inability to pay in a wind up. It is vital that statistics compare like-with-like to establish a sensible analysis. Hence, this is an area which the sharīʿah scholars can consolidate if they want to rely on the liquidation aspect to substantiate the asset-backed position of shares.

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