

Trade, Tijarah, and Tawheed



An Islamic Examination of
Forex Market Practices

Shaikh Dr. Sajid Umar



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Introduction

As of 2023, the Forex market is an astronomical force in the global economy, with a colossal total value of \$1.93 quadrillion. To put this into perspective, it's about 30 times the size of the US stock and bond markets combined. This market doesn't sleep – it's the only financial market in the world to operate 24 hours a day.

The market's daily turnover, a measure of its liquidity, soared to \$7.5 trillion in April 2022, a significant increase from \$6.6 trillion recorded in 2019. The sheer scale and liquidity of the Forex market provide traders with numerous opportunities, making it a magnet for investors around the globe.¹

Speaking of global traders, let's zoom in on the UK, a focal point for Forex trading. With more than 280,000 online Forex traders, the UK is a leader in the global Forex landscape. In fact, the UK's daily Forex turnover hit a record high of \$3,276 billion in April 2022, marking an 11% increase from the previous year. This statistic alone speaks volumes about the UK's significant role in the Forex trading world.

Forex trading, with its global reach and 24/7 market operations, has drawn participants from all walks of life, all corners of the globe, and all cultural backgrounds, including Muslims. While Forex offers intriguing opportunities, it also presents unique questions for Muslim traders. Is Forex trading compatible with the Shari'ah? How does Forex trading align with the economic ethics envisioned by the Shari'ah? These are important questions given the profound emphasis that is placed on ensuring we have a Halal income gained from permissible transactions.

In this exploration, where faith and finance converge, we will journey through and dissect the structure of Forex trading, ultimately aiming to discern whether this form of trading can be compliant with Allah's laws. We will assume you have read up on the basics of retail Forex trading, as delving into the terminology and concepts is beyond the scope of this article.

¹ 2023 Forex Trading Statistics + Industry Guide [Fact Checked] - <https://www.compareforexbrokers.com/trading/statistics/>

What is Forex and how is it used?

Prior to delving into forex trading as most understand it, it is essential to acknowledge the distinction between various participants in the forex market who have different roles. This encompasses retail forex traders who utilise brokers, large institutions engaged in forex trading for hedging or operational purposes, and currency exchanges. The subsequent sections will thoroughly explore the dissimilarities among these entities.

Forex trading revolves around currency pairs, where one currency is traded against another. The most commonly traded currency pairs include EUR/USD, GBP/USD and USD/JPY, among others. Each currency pair has a base currency and a quote currency. The exchange rate represents the value of one currency relative to another. Forex traders speculate on whether a currency will appreciate or depreciate in value against another, and they take positions accordingly.²

The movement in these currency pairs is measured in 'Pips'. "Pip" is an acronym for percentage in point or price interest point. A pip is the smallest whole unit price move that an exchange rate can make, based on forex market convention. Most currency pairs are priced out to four decimal places, and a single pip is in the last (fourth) decimal place. A pip is thus equivalent to 1/100 of 1%, or one basis point.³ If EUR/USD moves from 1.1050 to 1.1051, that .0001 USD rise in value is one pip.

EUR/USD moves to 1.1051

4th decimal point
represents the pip



The Forex market is influenced by a wide range of factors that impact currency values. These factors include economic indicators (such as GDP, inflation, and employment data), central bank policies, geopolitical events, and market sentiment. Traders analyse these factors to make speculative trading decisions and anticipate potential currency movements.

Forex trading offers several key features for participants. First, it provides opportunities for both buying (going long) and selling (going short) currencies, allowing traders to profit in rising and falling markets. Additionally, the Forex market operates 24 hours a day, five days a week, enabling traders from different time zones to participate at their convenience. Furthermore, Forex trading offers leverage, allowing traders to control larger positions with smaller amounts of capital, potentially amplifying profits (but also increasing risk).

The Pip-Test (Answers below)

- 1 If the EUR/USD currency pair moves from 1.1043 to 1.1057, how many pips has it moved?
- 2 If a trader says they gained 20 pips on a trade, what does that mean in terms of price movement?
- 3 How many pips appear after the decimal point here: 1.0098?

3 98 Pips
2 0.002
1 14 Pips

² What Is Forex Trading? - Forbes Advisor UK - <https://www.forbes.com/uk/advisor/investing/what-is-forex-trading/>

³ What Are Pips in Forex Trading and What Is Their Value? - <https://www.investopedia.com/terms/p/pip.asp>

Retail vs Institutional Forex Trading

Retail Forex trading and institutional Forex trading are two distinct categories within the Forex market that many misunderstand. Here are the key differences between the two:

Participants

Retail Forex trading involves individual traders, small investors, and retail brokerage firms speculating on market movements.⁴ Institutional Forex trading, on the other hand, involves large financial institutions, such as banks, hedge funds, and multinational corporations, where the primary driver of these trades is necessity rather than speculation, although there is usually a specific division for speculative trading, to make this clearer we will refer to the former as execution traders, as they only execute trades on the basis of need rather than speculation and the latter as institutional forex traders. Execution traders may require converting a substantial amount, such as £100 million, into Dollars or Euros to facilitate a transaction. To accomplish this, they engage in institutional Forex trading, utilising the services of the institutional market to execute the currency exchange.

Trading Volume

Institutional Forex trading typically involves significantly larger trading volumes compared to retail trading. Institutional traders execute large trades, often involving millions or billions of dollars, whereas retail traders typically trade smaller amounts.

The interdealer market is only accessible to institutions that trade in large quantities and have a very high net worth. This includes banks, insurance companies, pension funds, large corporations, and other large financial institutions manage the risks associated with fluctuations in currency rates.

In the spot FX market, an institutional trader is buying and selling an **agreement** or **contract** to **make or take delivery of a currency**. A spot FX transaction is a bilateral ("between two parties") **agreement** to physically exchange one currency against another currency.

⁴ What is Retail foreign exchange trading - <https://capital.com/en-int/learn/glossary/retail-foreign-exchange-trading-definition>

This agreement is a contract. This means this **spot contract** is a binding obligation to buy or sell a certain amount of foreign currency at a price that is the "spot exchange rate" or the current exchange rate.

Market Access

Institutional traders, both execution and speculative, often have direct access to the interbank market, where they can trade with other financial institutions and access competitive pricing and liquidity. Trading in the actual spot forex market is NOT where retail traders trade though. Retail traders, on the other hand, access the Forex market through retail brokerage platforms, which act as intermediaries between the retail traders and the liquidity providers. In reality, we can think of the brokerage platforms themselves as the counterparties, as they will always accept retail trade amounts, whereas with institutional trades, a viable counterparty will need to be sought out.⁵

Trading Strategies

Institutional forex traders often employ sophisticated trading strategies, including algorithmic trading, high-frequency trading, and other advanced techniques, execution traders do not employ any of these techniques as they trade based on the activity of their customers and make money through commission. They have access to research and analysis teams, proprietary trading systems, and sophisticated trading tools. Retail traders, on the other hand, may rely on manual trading strategies, technical and fundamental analysis, and may use trading platforms provided by retail brokers.

Costs and Fees

Institutions typically enjoy lower transaction costs and spreads compared to retail traders. Institutions often negotiate better trading terms and have access to lower commissions and fees due to their larger trading volumes. Retail traders, on the other hand, may face higher transaction costs and spreads offered by retail brokerage firms and have to front a margin for their trades.

⁵ Institutional Trading |Finance Magnates - <https://www.financemagnates.com/terms/i/institutional-trading/>

Regulatory Requirements

Institutional Forex trading is subject to specific regulations and oversight, often governed by financial regulatory bodies. Institutional traders may need to meet certain requirements, such as capital adequacy, compliance, and risk management standards. Retail Forex trading also falls under regulatory frameworks but may have different requirements tailored to individual investors.

Market Impact

Institutional Forex trades can have a significant impact on the market due to the larger trading volumes involved. Their trades can influence currency prices and market trends. Retail Forex trades, on the other hand, typically have a smaller impact on the overall market due to the individual nature of retail trading.⁶

It's important to note that these differences are not absolute and that there can be some overlap. For example, some retail traders may use advanced trading strategies and have access to institutional-grade platforms. Additionally, there are professional retail traders who trade larger volumes and have a more institutional approach to trading.

Understanding the differences between retail and institutional Forex trading can help traders and investors align their strategies and expectations with their respective trading environments.

⁶ What is Institutional Trading? The all you need to know guide - <https://admiralmarkets.com/education/articles/general-trading/institutional-trading>

The Islamic approach to transactions and economy

The landscape Islam paints with its view on trade and money is one of principled financial dealings and ethical transactions. Rooted in a comprehensive economic vision, it encourages wealth generation through legitimate means and upholds the prohibition of certain financial practices, a key one being Riba (Usury), that compromise moral and ethical integrity.⁷

In this landscape, contrary to how money is treated in forex trading, money is not seen as a commodity to be traded, but as a medium of exchange to facilitate trade of products other than currency. The Islamic financial ethos promotes the creation of wealth through production, sales, and the trading of goods and services. The emphasis is on real economic activity—producing goods and providing services—as a means to earn profit and foster economic growth and societal development. In this terrain, a person cannot expect to earn a profit in business without assuming loss or risk in whatever undertakings they undertake. It is a way of life that business is associated with rewards, profits, risk, and uncertainties. To sum up, there shall be no reward by hoarding money without risk-taking.⁸

Guided by the principle of “everything is permissible unless proven otherwise”, permissibility is the natural state of all matters and will prevail until there is evidence to warrant a departure from that position. The principle posits that all forms of trade are considered halal, or permissible, unless explicitly declared haram, or forbidden. A learned Islamic scholar would need to substantiate through comprehensive reasoning that a particular form of trade is prohibited by establishing the presence of one or more of the following components:

- 1 Riba, which is interest (usury) from an Islamic perspective. This is emphasised because in modern finance and economics, the term “interest” is used to describe some things that do not constitute riba according to Islamic law.
- 2 Gharar, which is an unacceptable degree of ambiguity in the transaction.
- 3 Any form of oppression, whether macro or micro.
- 4 Anything that will credibly lead to one of the above three points.

⁷ Read more about riba in our article surrounding it. Does modern day interest still qualify as Riba? Part I - <https://islamiccouncil.com/does-modern-day-interest-still-qualify-as-riba-part-i/>

⁸ Based on the The legal maxim Al-ghurm bi al-ghunm, meaning “Reward begets Risk”.

⁹ The legal maxim Al-Asl fil-ashya’ al-ibahah, meaning “Everything is permissible unless proven otherwise”.

From this perspective, even if devoid of elements such as riba, gharar, and any oppressive practices, Forex trading might still not be encouraged under the Shariah. This is due to its basis not being in line with value generation but rather treating money as a tradable commodity, which is inconsistent with Islamic economic principles.

Now, this leads us to the question: Can it be substantiated that Forex Trading is Haram?

The Red Flags of Forex

When we look at retail Forex trading, we can see many impermissible factors from an Islamic perspective associated with it, such as:

1 Traders using Leverage and dealing with Riba

Why is overnight funding charged and how is it calculated?

If you hold a short-term trade and want to keep it open overnight, you'll be charged a daily interest fee. This charge will be applied to cash CFD positions held through the daily cut off time. The daily cut off time is 10pm UK time. However this may vary for international markets. For US Shares, the cut off time will be 8pm (New York Time) Monday to Thursday and 10pm (UK time) on Friday.

Note, futures and forwards don't incur overnight funding charges, but they do have wider spreads. These contracts are typically used for longer-term trades.

Leverage is essentially a loan that is provided to an investor by the broker. Without the use of leverage, small Forex traders cannot make sufficient money. It is important to note that this 'loan' is in reality a line of credit where the broker is delivering a risk position to the customer without any money being exchanged.

For example, if you bought £1000 of American Dollars and held it for one month from 30th May 2023 until 30th Jun 2023, you would see a movement in the value of your money of £30, from an appreciation in the price of USD (against GBP), which in the grand scheme of things is not enough value to have been worth the effort if you are investing for 2 months, taking into account all the research time and resources required. If you are using a 2% rule, using no more than 2% of the money in your trading account for a trade, limiting your loss in the event the market moves against you, you would need a capital of £50,000 to take that £1000 trade with a movement of £30.

Modern brokerage platforms allow you to access vast amounts of capital using leverage. You can be offered 100:1 leverage and use your £1000 to take a position worth £100,000.

The Brokerage will allow you to 'borrow' the money to trade, and if you lose more than your £1000, the brokerage will attempt to close out your position, maximising your loss to £1000. However, in the case where they could not close the position out quick enough, you would be liable for any loss over your £1000 initial capital, resulting in you being on the hook for returning more money than you initially had in your account.

One other problem with leveraging is the cost. You can pay borrowing costs on positions that you keep open overnight in addition to paying to open and close each leveraged position. The broker will always make money as you do this and is willing to 'lend' you the money for doing so.¹⁰ In that sense, overnight financing is essentially an interest payment to cover the cost of your leveraged position.

2 Speculative Trading

Forex CFDs: the essentials

Before getting started, there are some key things all traders should know about the forex market and CFDs as a way to trade financial markets. Here are the five essentials to know:

What's the difference between forex and CFDs?

Forex is one of the many markets you can trade with us. When trading forex, you're speculating on the value of one currency against another – for example, EUR vs USD. CFDs – short for contracts for difference – is one of the methods you can use to get exposure to forex with us. When trading with a CFD account, you don't take ownership of physical currencies. Instead, you'll use the derivative to speculate on price movements.

Forex CFD

A contract for difference (CFD) is a financial derivative. Derivative products track the market price of an underlying asset so that traders can speculate on whether the price will rise or fall. The price of a CFD is "derived" from the underlying asset's price. A CFD is a contract, typically between a CFD provider, in our case the retail broker, and a trader, where one party agrees to pay the other **the difference** in the value of a security, between the opening and closing of the trade. In other words, a CFD is basically a bet on a particular asset going up or down in value, with the CFD provider and you agree that whoever wins the bet will pay the other the difference between the asset's price when you enter the trade and its price when you exit the trade.

A forex CFD is an agreement ("contract") to exchange the difference in the price of a currency pair from when you open your position versus when you close it. A currency pair's CFD price is "derived" from the currency pair's price on the spot FX market. (Or at least it should be. If not, what is the CFD provider basing its price on?) Trading forex CFDs gives you the opportunity to trade a currency pair in both directions. You can take both long and short positions.

If the price moves in your chosen direction, you would make a profit, and if it moves against you, you would make a loss. In the EU and UK, regulators decided that "rolling spot FX contracts" are different from the traditional spot FX contract. The main reason being is that with rolling spot FX contracts, there is no intention to ever take actual physical delivery ("take ownership") of a currency, its purpose is to **simply speculate on the price movement in the underlying currency**.

The objective of trading a rolling spot FX contract is to gain exposure to price fluctuations related to the underlying currency pair **without actually owning it**. So, to make this differentiation clear, a rolling spot FX contract is ruled as a CFD. (In the U.S., CFDs are illegal so it's known as a "retail forex transaction"). Outside the U.S., retail forex trading is usually done with CFDs or spread bets.

This means that there is no real exchange or ownership of any money taking place as virtually all retail forex platforms have CFD accounts. For example, if I had bought £1000 worth of dollars and the price moved, I would still have the dollars in hand and could change them back to GBP. However, in retail forex trading, essentially a 'bet' is made on the value of a currency pair; if successful, I would make money, and I would lose if I were not. I do not tangibly own any assets in either currency.

Retail forex trading is considered **speculative**. This means traders are trying to "speculate" or make bets on (and profit from) the movement of exchange rates. They're not looking to take physical possession of the currencies they buy or deliver the currencies they sell.

In summary, when trading forex you're speculating on the value of one currency against another—for example, EUR vs USD because with Forex, currencies are always traded in pairs. You're always buying one currency and selling the other in the pair, based on which currency you think is going to appreciate against the other.

¹⁰ What Is Leverage? | How Leverage Works - <https://www.forex.com/en-uk/trading-academy/courses/how-to-trade/uk-introduction-to-leverage/>

How does forex trading work?

In forex trading, currencies are always traded in pairs, called 'currency pairs'. That's because whenever you buy one currency, you simultaneously sell the other one.

Each currency pair is made up of two parts:

- Base currency: the first currency listed in the quote and always equal to 1
- Quote currency: the second currency listed in the quote

This type of speculation would be classified under Islamic Law as 'gharar', representing an unacceptable level of uncertainty in a transaction from a Shariah perspective, as it essentially involves wagering on market fluctuations without possessing any tangible ownership in either of the assets being traded.

3 Brokers are the Counterparties

There is a false understanding regarding retail forex brokers, in which they are seen as an intermediary who will find two parties who want to trade a certain currency pair at a certain price and will 'pair' these two parties together and execute a trade on behalf of its clients. This is not the reality in terms of the topic at hand, because a retail forex broker is more of a giant market counterparty as far as a client with an account is concerned.¹¹ As such, we need to think of the term 'Forex Broker' as more of a marketing phrase, as a 'Forex Broker' is actually a 'Forex Dealer' who buys and sells goods on their own portfolio. Accordingly, all retail forex brokers regulated in the U.S. are formally referred to as "Retail Foreign Exchange Dealers" or RFEDs.¹²

The main point is that if we wanted to be technically accurate, we should be using the phrase 'Forex dealers'. "Client" and "customer" are words that are often used interchangeably by brokers; however, the implications are different as the broker is

not marrying your trades to another party every time you transact a trade. All orders and trades entered through your broker's trading platform are NOT executed on an external trading venue but are executed by the broker itself. Your "broker" is taking the opposite side of your trade. This is known as being the **counterparty**, with you as their **customer**. The only way to close out your position is by taking an equal and opposite position with the same broker as you do not own any physical assets and your only exposure is with a specific brokerage. This results in a money for money transaction with no ability to have any underlying currency physically delivered. This is the essence of a ribawi transaction.

Each trader trades directly ("bilaterally") with the broker and only the retail broker, every trade is a bet with this broker. Retail forex traders do not trade with each other. A broker's trading book will be constantly changing, and the their risk will be managed through offsetting risks by trading out their positions in the institutional FX Market, where there are actual counterparties wanting to trade for various reasons. Despite their management of their own risk, it does not impact the origin of their risk which is each trade (or bet) the trader is making with them.

In Islamic contracts, attention is given to the objectives and operational reality of transactions and not to the descriptive words and forms associated with them. The truth of the matter is that every time you speculate on a currency pair and execute a trade on a retail brokerage platform, you are placing a bet against the broker on the price of a CFD. The broker can see market sentiment from all its own clients and can choose to hedge that risk in the institutional FX market if they need to.

¹¹ How Forex Brokers Manage Their Risk and Make Money - <https://www.babypips.com/learn/forex/how-forex-brokers-manage-risk-make-money>

¹² Retail Foreign Exchange Dealer (RFED) Registration - <https://www.nfa.futures.org/registration-membership/who-has-to-register/rfed.html>

The Islamic Ruling on Forex Trading

This toxic combination of *riba*, *gharar*, and a structure that embodies gambling would act as compounded impermissible factors.

As mentioned previously, the reasons Forex is impermissible are as follows:

- 1 Traders requiring leverage and consequently dealing with *riba*.
- 2 Every trade is a gamble with the broker on the price of a currency spread as retail traders do not own the physical currencies.
- 3 Speculative Trading.¹³

Therefore, when we refer to retail forex trading of currency pairs, we can see that this form of trading fails to qualify as 'Shariah compliant' and, as such, is an impermissible (forbidden) form of trade or wealth generation according to the Shari'ah.

But what about 'Islamic Forex Trading Accounts'

Islamic forex trading accounts aim to provide a 'solution' to the impermissibility of trading in forex by focusing on the *riba* on overnight leveraged positions. Their solution would be to create 'swap-free' accounts where there is no payment or receipt of any interest rates on currency pairs held overnight. This is implemented in various methods, one may be to close out all positions before the interest deadline in the evening, for example 10pm, and reopen these positions in the morning, to avoid any interest and subject you to the price change during the night. The brokerage would then take a management fee for this activity. Despite the improvement, this does not eliminate speculation on price fluctuations by using CFDs, which is the fundamental element that makes Forex trading itself impermissible.

Accordingly, even if all the money used to trade was earned in a halal manner and there was no leverage, and therefore no borrowing of money or any margin on positions held overnight, the act of betting on the price of a CFD contract will be impermissible due to the impermissibility of gambling in Islam. This would be akin to someone convincing a Muslim that they will let them borrow money without interest to gamble on a football match while allowing the Muslim to stay true to his faith by not engaging in a *riba*-bearing transaction.

¹³ There is often the argument that the nature of the trade is research-backed, trend-based, calculated, or strategic and not a speculation or a gamble. This does not change the act of betting on the price movements of a contract permissible despite the calculations.

The exclusion of paying *riba* on the leverage would only exempt the account from the first point above and it would still be impermissible as points 2 and 3 would still remain true.

The Islamic Ruling on Foreign Currency Exchange

Many people equate retail Forex trading with buying currency to use abroad on vacation. When looking at exchanging currencies to use abroad, whether physically at a money exchange or online with a card such as Monzo or Revolut, this is a very different kind of transaction that fulfills the requirements for exchanging money according to the Shari'ah. The 'spot' element of the transaction and the instantaneous transaction from one currency to another currency that you can physically use, whether by debit card or cash, is quite different from taking a speculative trade on a currency pair. Currency exchangers trade underlying physical currencies (even if digital) as a spot transaction, one of the requirements of trading currencies in the Shari'ah. They do not offer futures or derivatives and would for example exchange £1000 for \$1280.

Engaging in currency exchanges through platforms like Monzo and Revolut to utilise multi-currency wallets or cards and subsequently using the converted funds to send money internationally is permissible due to it being a spot transaction where ownership of an underlying currency is exchanged without leverage.¹⁴ This practice resembles the institutional Forex marketplace, where multinational corporations may need to transfer significant amounts between currencies to fulfill orders or make payments in other countries. These transactions arise from genuine operational needs and are not driven by speculative motives. Furthermore, these transactions involve the physical delivery of currency, as they are not financially settled in the same currency in which they were initiated.

A note should be taken about using platforms like Monzo and Revolut to invest in precious metals. When buying Gold or Silver, these are classified as currencies in the Shari'ah and would need to be able to be either physically delivered with the delivery being spot or instantly without delay, or a regulated certificate from the platform will need to be given at the time of the transaction, proving the liability of the gold that is to be transferred to you actually being transferred. It is not sufficient to have representational value in a digital wallet for these commodities without actual spot delivery or a transfer of liability having taken place.

¹⁴ Read more about *riba* in our article surrounding it. Does modern day interest still qualify as *Riba*? Part I

Get Rich Quick Schemes and FOMO Syndrome (Fear of Missing Out)

There is a prolific rise in Muslims taking an interest in and asking about the permissibility of Forex Trading. Forex trading's appeal to a broad spectrum of investors, including Muslims, can be attributed to a multitude of factors.

The primary allure comes from clever marketing strategies that frame it as an avenue for easy wealth accumulation. Advertisements and promotional content often paint an enticing picture of quick, substantial returns that inevitably attract aspiring traders.

Another significant factor is the promise of getting rich quickly. Forex trading, with its volatile market fluctuations, appears to offer a path to significant financial gains in a relatively short time. This potential for rapid profit, though often overstated, can be a powerful motivator.

Moreover, the concept of trading on margin, or leverage, which allows people to trade large amounts of currency with relatively little of their own money, is another key feature that attracts individuals. It gives the perception that trading is accessible to everyone, regardless of their initial capital.

However, it's crucial to remember that, from an Islamic perspective, there are more genuine and acceptable routes to trading. Instead of speculating on CFD currency fluctuations, Muslims should invest directly in non-controversial assets like commodities and halal stocks.

This kind of investment should be undertaken without the use of leverage, which is essentially borrowing money to trade and can lead to debt, a concept frowned upon in Islam as debt is an instrument of necessity as per the collective guidance of the Qur'an and Sunnah. It should also steer clear of futures or options, which are considered forms of gambling under the directives of the Shari'ah due to their speculative nature.

Investors are advised to adopt a 'long-only' strategy, meaning they invest strategically with a view to holding onto their investments for a longer-term. This kind of investment is more in line with the Islamic principles of patience, risk-sharing, and promoting real economic activity.

AND ALLAH KNOWS BEST.



3rd Floor, London Muslim Centre
92 Whitechapel Road, London E1 1JQ

+44 (0)208 610 9870
info@ifadvisory.org

www.ifadvisory.org