



the Shariah-Compliant
Arboon
Short Sale

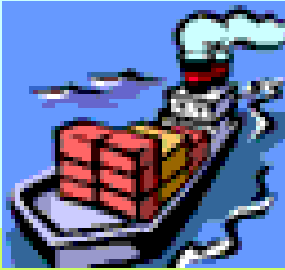
An example, outside of the stock market, of how a Shariah-compliant Arboon Short Sale works

- Imagine an opportunity to buy a shipload of wheat valued today at 100k for a down payment of 10k, when you know that the market price for a shipload of wheat at present is 100k.
- In fact, you are certain that you can find a buyer for that price the very next day.
- The seller, however, stipulates two things:
 - (1) that you must repay in kind, i.e., one shipload of wheat within two months, minus the down payment, and
 - (2) that if you do not sell the wheat then you must return it, and the seller will keep the down payment.

Trade Day

Trade Day +1

Trade Day +60



Trader

Experienced and knows the market

Original Seller

In need of cash and willing to part with cargo for 60 days

Buyer

In need of cargo at market price

Introducing the Opportunity:

A shipment of wheat comes into port on trade day.

Seller 2

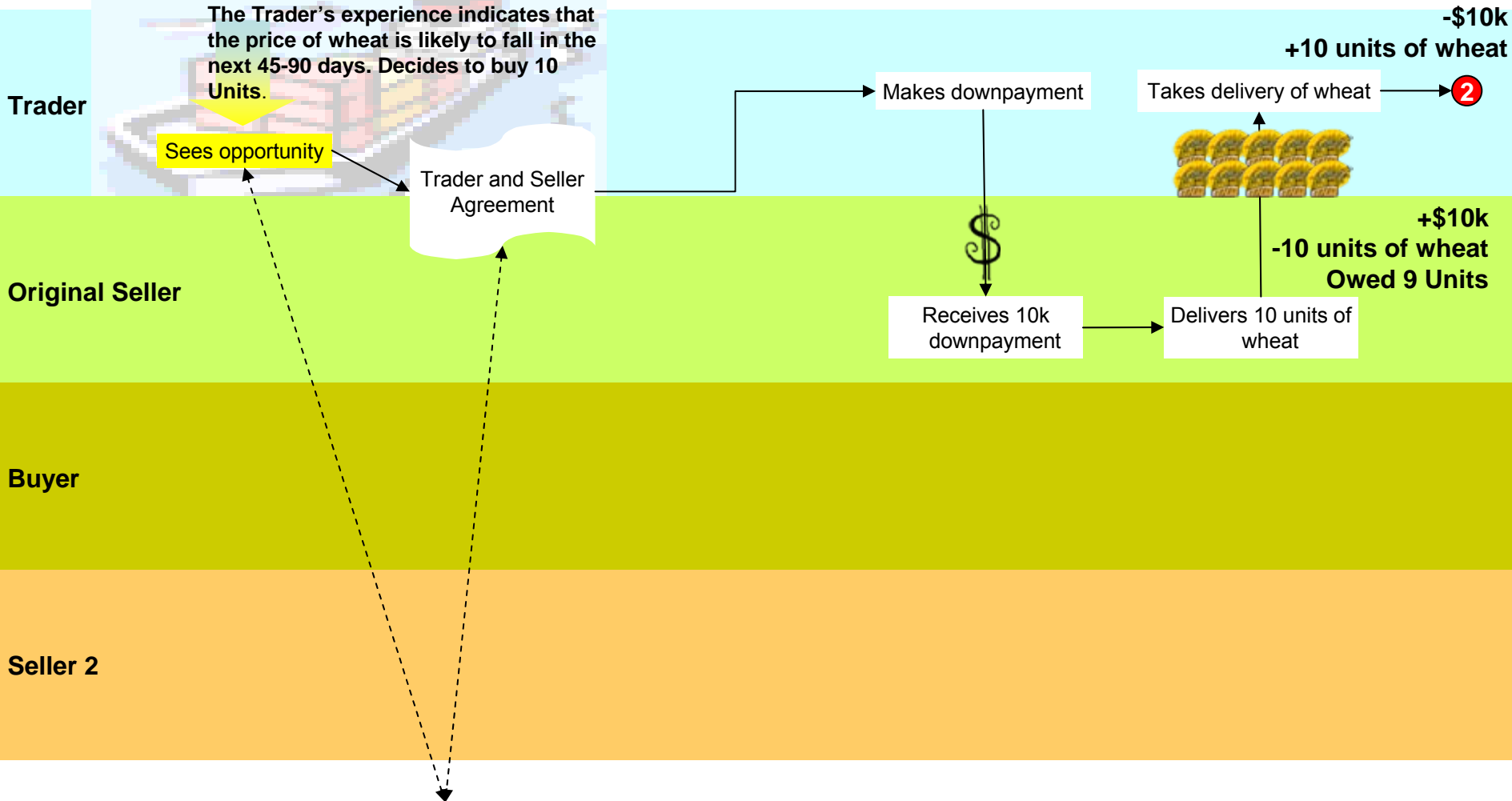
On Trade Day + 60.....Willing to sell at market price

Today's Market Price for wheat is \$10k/Unit



- Since you have traded wheat for years, your specialized knowledge of the market tells you that in two months the price of a shipload of wheat will have fallen to 90k or even lower.
- Therefore, you agree to the deal.
 1. You pay 10k down for the first shipload and
 2. sell it to the buyer, a third party, for 100k on the same or the next day.
- At this point in the transaction, you have paid out 10k, but then you have taken in 100k, netting you 90k, and leaving you with an obligation to deliver a shipload of wheat (minus the down payment) to the original seller in two month's time.
- When two months pass, you discover that your knowledge of the market was correct and that you will be able to buy, for only 90k, a shipload of wheat to fulfill your obligation to the original seller.
- You buy the replacement shipload for 90k and you fulfill your obligation. In the process, you earn 9k on the trade.

Trade Day

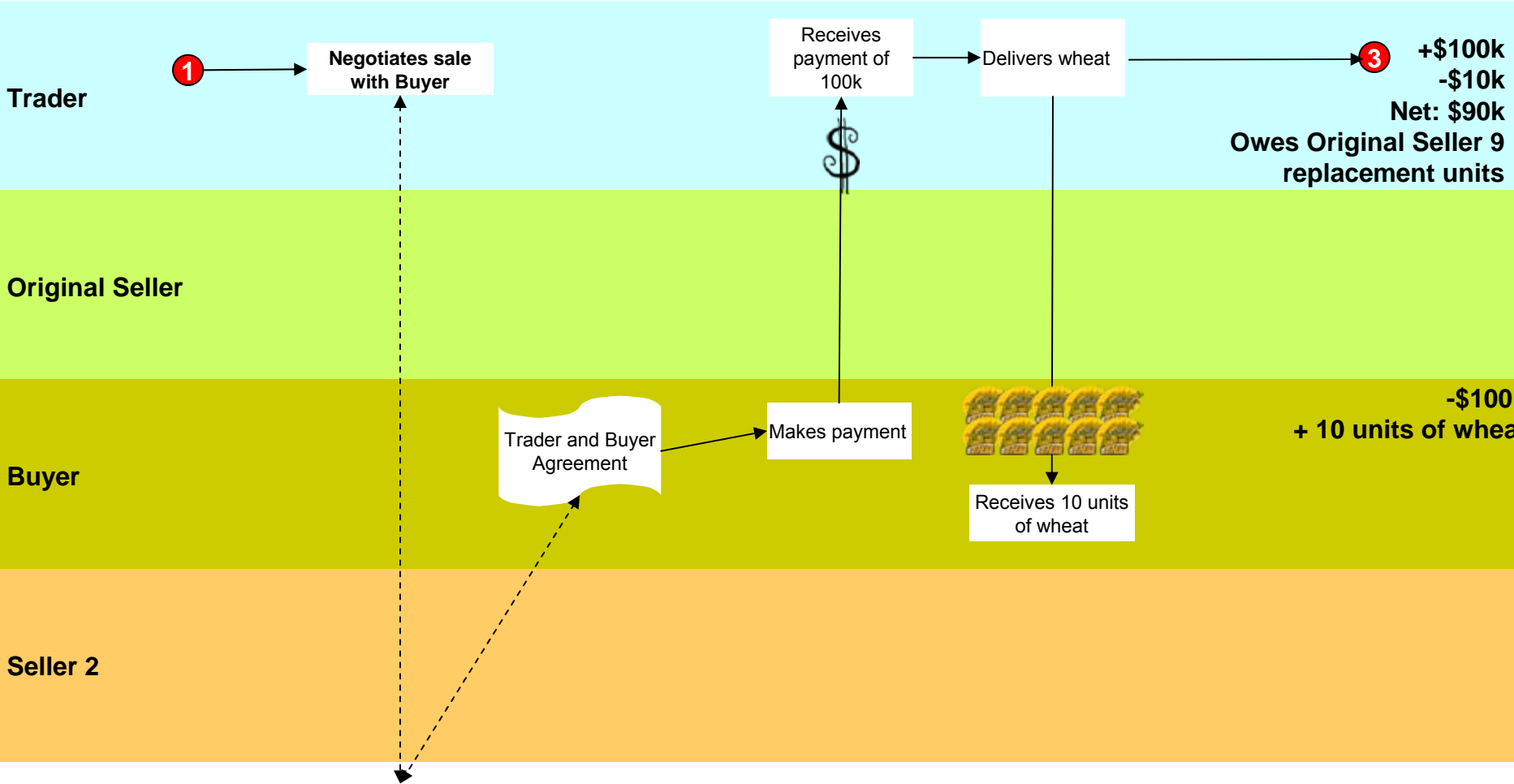


- **Conditions of Sale:**
- Price is 10k/unit of wheat
- Trader's downpayment to **Original Seller** = price of one unit of wheat (\$10k)
- IF **Trader** sells wheat within 60 days,
 - **Original Seller** will keep downpayment (= 1 unit of wheat)
 - **Trader** will repay **Original Seller** in kind for remaining 9 units of wheat within 60 days
- IF wheat is not sold within 60 days,
 - **Original Seller** will keep the down payment of \$10k (= 1 unit of wheat)
 - **Trader** will return 10 units of wheat to **Original Seller**

Today's Market Price for wheat is \$10k/Unit



Trade Day + 1

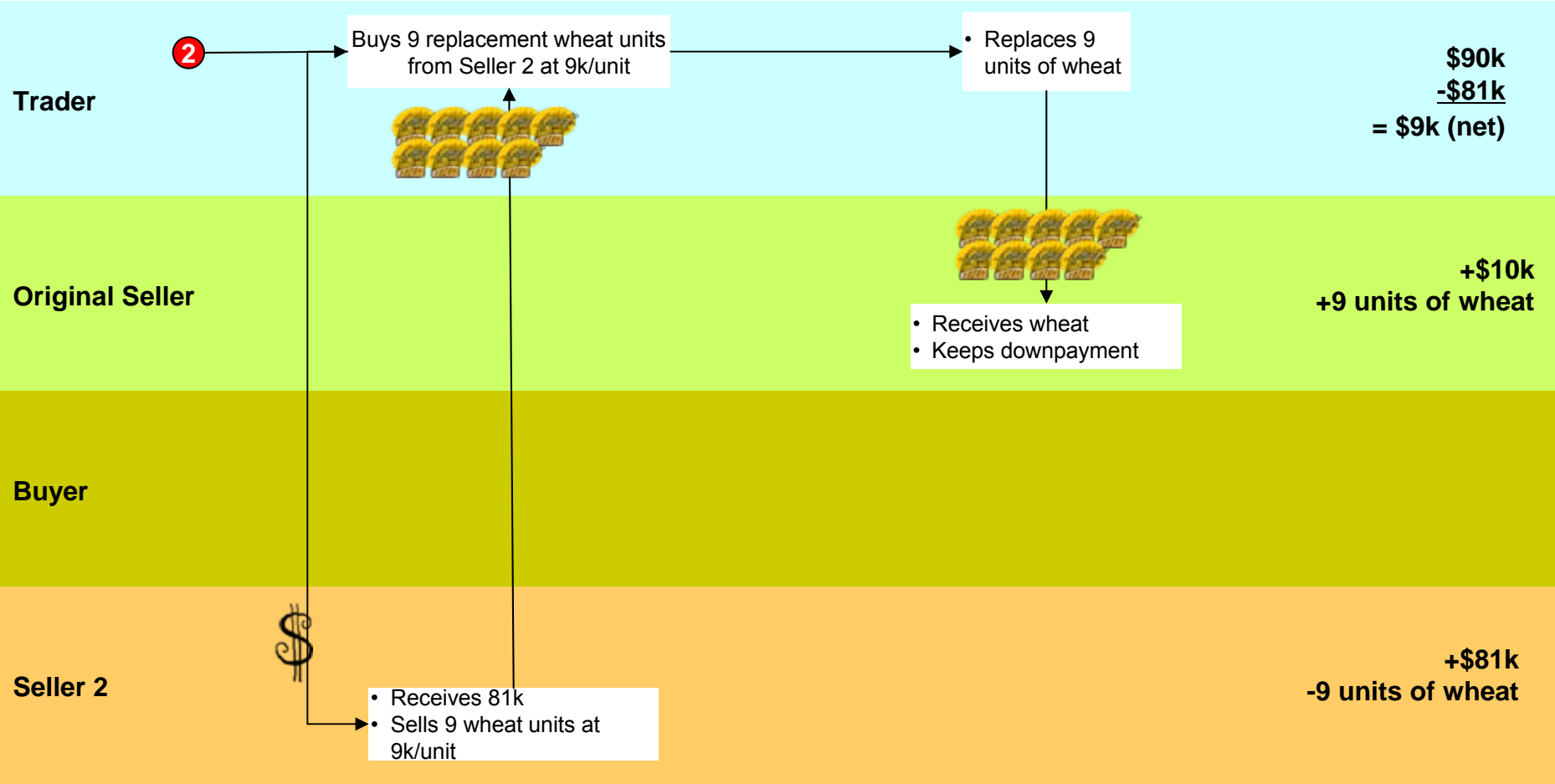


- **Conditions of sale:**
- 10 units of wheat at 10k/unit
- Cash for immediate delivery

Today's Market Price for wheat is \$10k/Unit



Trade Day + 60



Today's Market Price for wheat is \$9k/Unit



Trade Day

Trade Day +1

Trade Day +60

Trader

Sees opportunity

Agree to conditions

Makes down payment
Takes delivery of wheat

Wheat

Wheat

Receives 100k and delivers wheat to Buyer 1

Buy 9 replacement wheat units at 9k/unit

Delivers wheat

Original Seller

10k

+10k
-10 units of wheat

100k

Wheat

+10k
+10 units of wheat

Buyer

conditions

Receives 10k downpayment
Delivers wheat

Wheat

Receives wheat
Keeps downpayment

Seller 2

Pays Trader 100k and receives wheat

81k

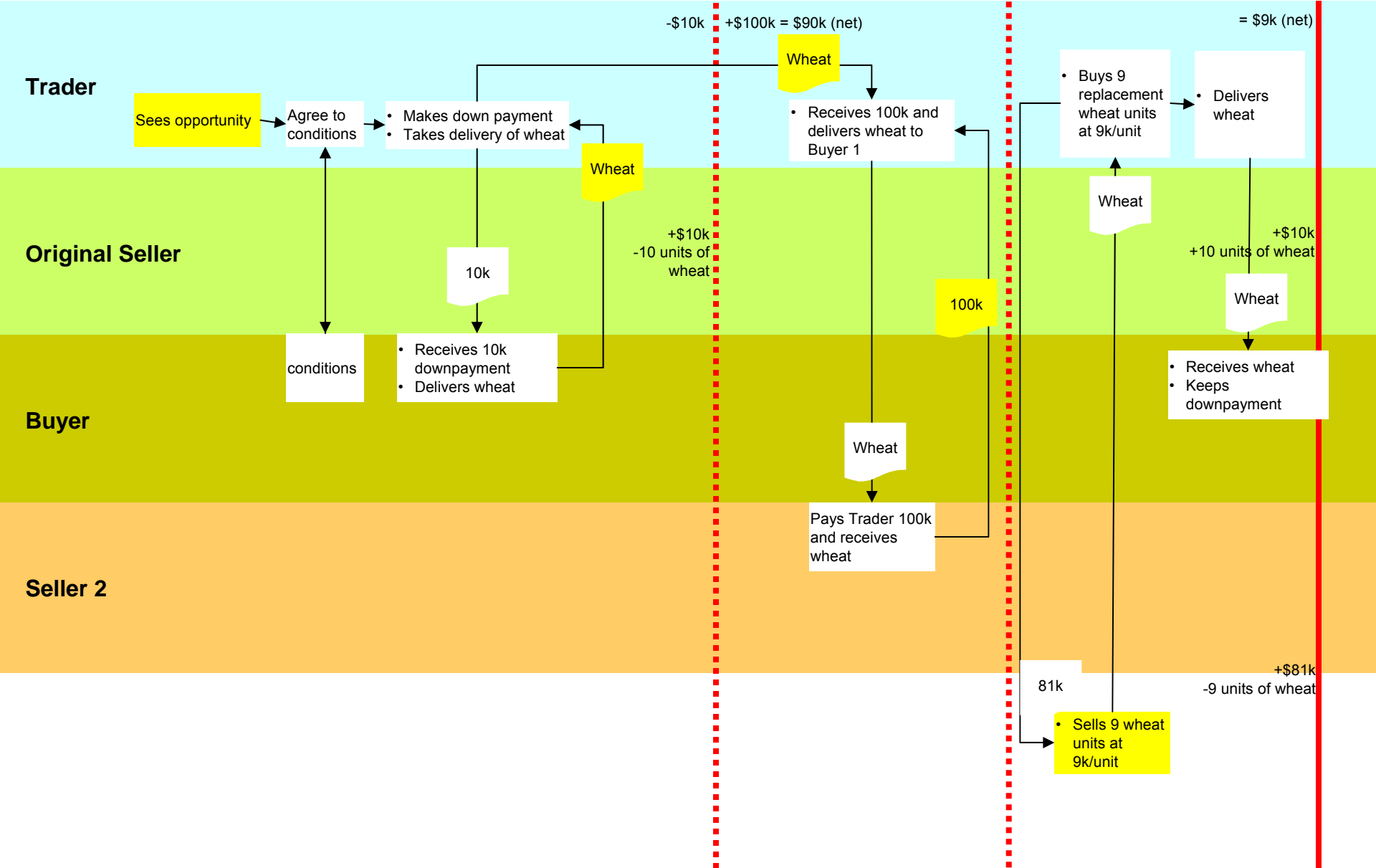
Sells 9 wheat units at 9k/unit

+81k
-9 units of wheat

-\$10k

+\$100k = \$90k (net)

= \$9k (net)



- Divide the shipload of wheat into 10 units. When you agree to buy the shipload at 100k, each unit is valued at 10k.
- When you actually buy the shipload, you make a down payment of 10k, which is applied to the purchase of one unit.
- In addition, when you buy the shipload, you agree to replace the remaining 9 units in two months, or to return the 1 unit and forfeit your down payment.
- At this point in the transaction, you have spent 10k and you have earned 100k on the sale, netting you 90k and leaving you with an obligation to replace 9 units.
- When the price of wheat falls to 90k for a shipload in two months, you buy 9 units at 9k per unit, spending 81k to do so. In this way, you have earned 9k on the entire transaction, the difference between 90k and 81k.
 - If the price had fallen more, you would have earned more. For example, if the price had fallen to 8k per unit, you earn 18k on the transaction, the difference between 90k (the price you paid the original seller) and 72k (the cost of replacing the wheat that you return to the original seller).



How this Sale Works

Trader sells on Trade Day+1 at 10k/unit receiving 100k

Trader profits if wheat price drops on Trade Day +60

Trader loses if wheat price rises on Trade Day +60

Trader
Buys 10 units of wheat at 10k/unit from Original Seller

Unit Value
\$10k

Unit Value
\$9k

Unit Value
\$11k

Units owed by Trader to Original Seller

9 units

9 units

9 units

Trader's cost to replace units

\$81k

\$99k

Trader's profit/loss

\$9k

-\$9k

10k + 81k or the down payment + the replacement cost subtracted from 100k earned from the sale to Buyer on Trade Day +1....OR

10k + 99k or the down payment + the replacement cost subtracted from 100k earned from the sale to Buyer on Trade Day +1

How does this transaction illustrate what happens in a Shariah compliant short sale?

- The terms of the sale of the shipload of wheat above are exactly the terms of a transaction known in classical Islamic jurisprudence (*fiqh*) as an arboon. In an arboon sale, the buyer agrees to purchase goods by paying earnest money against an agreed sale price. Under the arboon sale, if the buyer does not complete the purchase within the time period specified, he must return the goods and forfeit the down payment of earnest money.

بيع العربون The Arboon Sale

- The sale between the Trader and the Original Seller is an **Arboon Sale**.
- The buyer agrees to purchase goods by paying earnest money, or Arboon, against an agreed sale price.
- If the buyer does not complete the purchase within the time period specified, the goods must be returned and the down payment will be forfeited. (See The **Conditions of Sale** at the bottom of the **Trade Day** slide above.)
- The great Imam, Ahmad ibn Hanbal cites as an example that Nafi ibn Abdul Harith purchased a building on such terms from Safwan ibn Umayyah at the request of the Caliph Umar. Since this incident shows that the Caliph Umar approved of the Arboon, the Imam Ahmad ibn Hanbal accepted it as proof of the validity of the Arboon sale.
- Recognizing the value of this transactional model for applications in modern finance, the OIC Fiqh Academy approved the arboon for use by modern Islamic banks and finance houses in the purchase of goods or shares of stock. This was documented in the **Journal of the Islamic Fiqh Academy**, vol. 1, number 8, p. 641.

The Al Safi Trust and Shariah Compliance

- All managers on the Al Safi Trust platform are contractually obligated to buy and sell stocks exclusively through Barclays Capital Prime Brokerage.
- The Arboon Short Sale Equivalent allows Barclays to process trades initiated by the platform's hedge fund managers in a Shariah-compliant manner that avoids all the prohibited elements (interest, prohibited terms, prohibited transactions, prohibited fees) that are present in prime brokerage contracts commonly used for conventional hedge funds.
- By means of a refined Shariah screening process utilizing proprietary screening metrics and software, managers on the Al Safi Trust platform choose only from a universe of Shariah-compliant stocks.
- Every fund on the Al Safi Trust platform is subject to the same contractual obligation to invest according to the guidelines established by the Shariah Supervisory Board and subject, as well, to the same Shariah oversight and auditing.

The Al Safi Trust Shariah Supervision

- The Al Safi Trust is subject to oversight by a panel of internationally reputed Shariah scholars. The same scholars oversee all investments made by Sub Trust managers.
- The Shariah Supervisory Board has reviewed the structure and the operations of the Al Safi Trust and has certified, by means of fatawa, that these comply with the principles and precepts of the Shariah.
- The Shariah Supervisory Board has established clear **Investment Guidelines** for each hedge fund manager, and has appointed an Executive Representative to monitor, on a full-time basis, the trades and operations of the Al Safi Trust and each of the Sub Trust managers.
- By means of daily **Exception Reports** prepared by the Prime Broker, purchases of any stocks not on the list of approved stocks can be reversed before these are cleared for inclusion in a manager's portfolio.

The
Shariah-Compliant
Arboon
Short Sale
Equivalent





Trade Day +1

Trade Day +60

Trader

Hedge Fund
Manager

Original Seller

An investor willing to divest
holdings in ABC Company

Buyer

Investor willing to buy ABC at
market price

Introducing the Opportunity:

Sophisticated financial analysis indicates that
the price of ABC company's stock will fall
within the next 60 days.

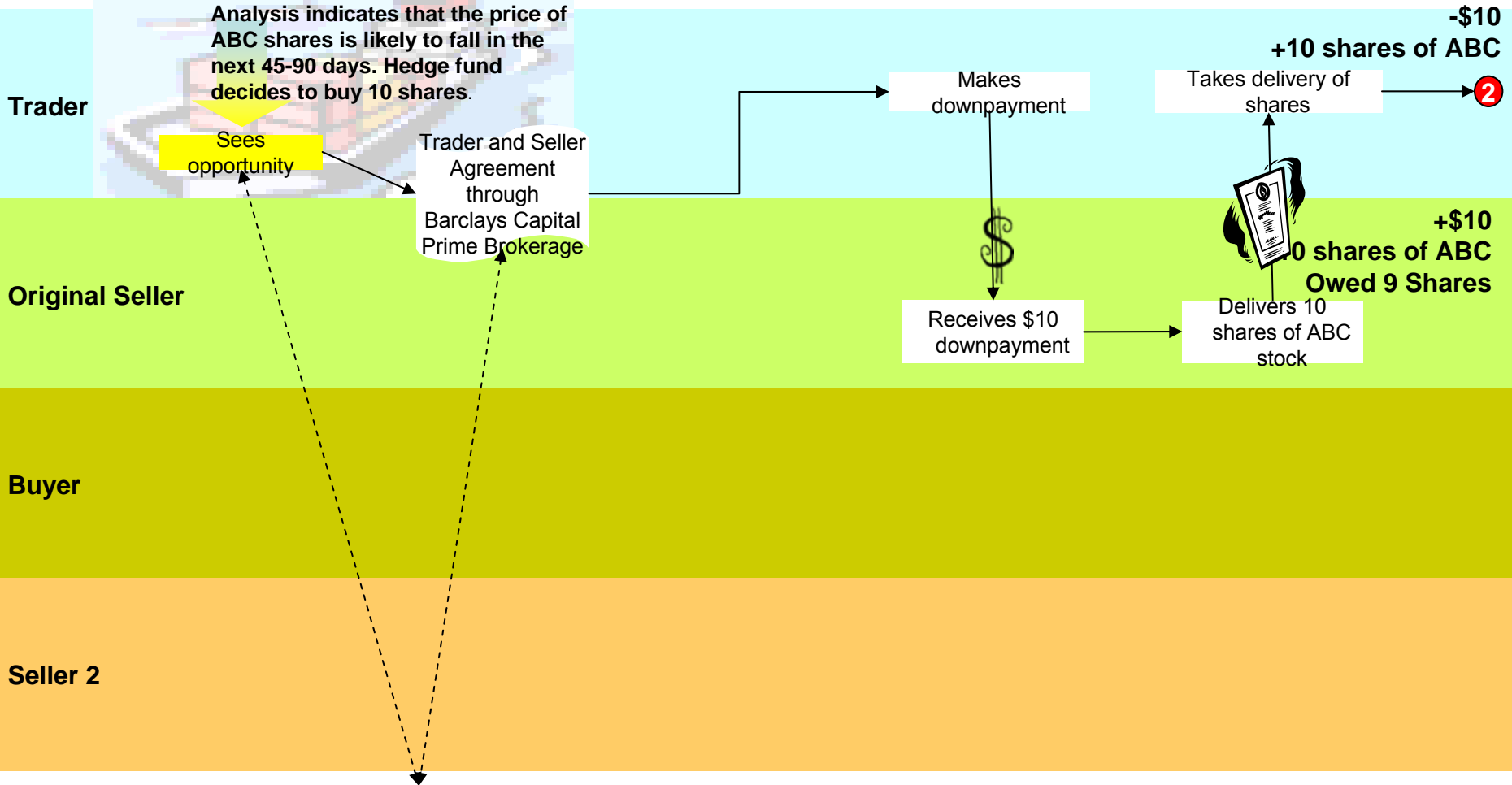
Seller 2

On Trade Day + 60.....Willing to sell ABC at market price

Today's Market Price for ABC stock is \$10/Share



Trade Day

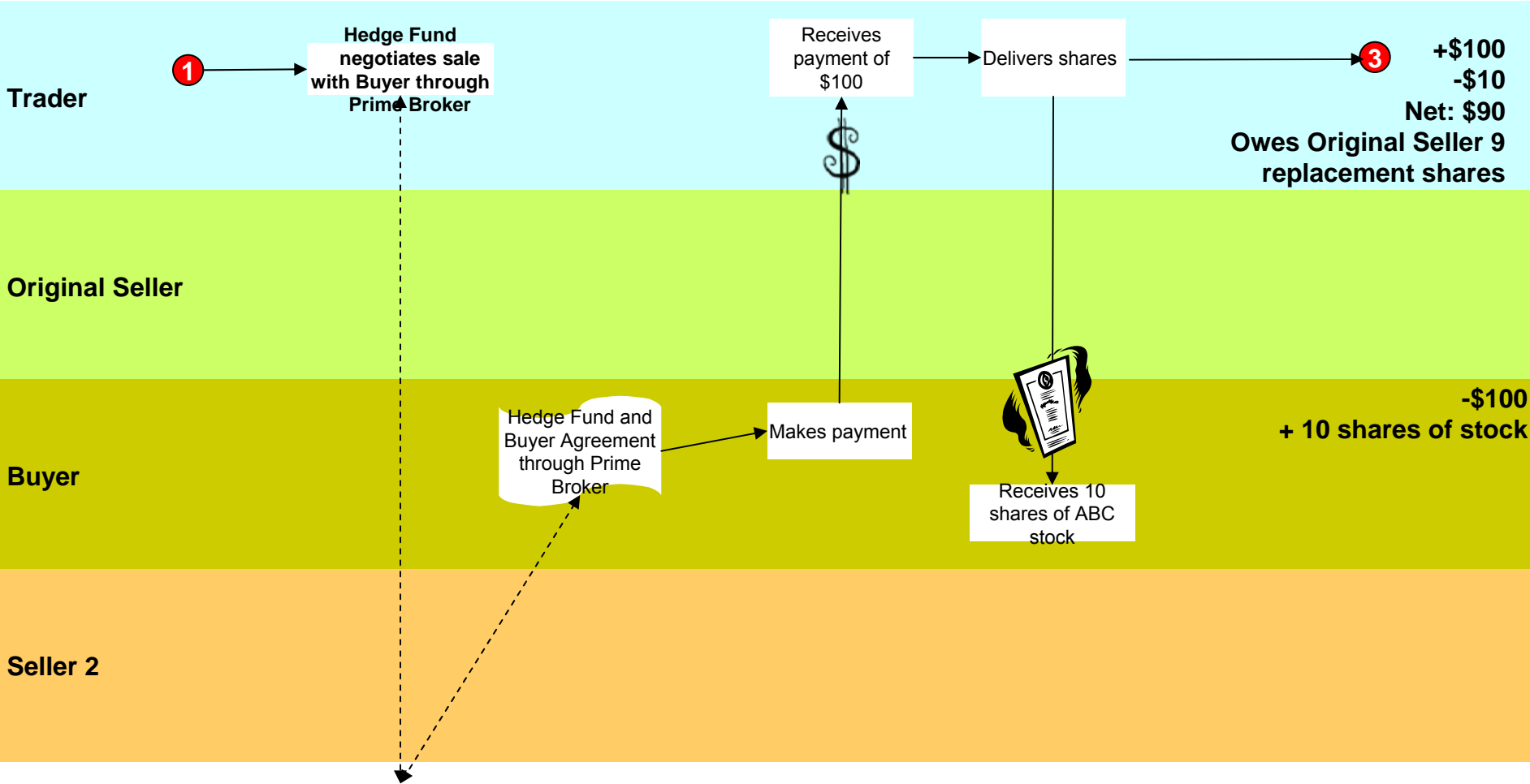


- **Conditions of Sale:**
- Price is \$10/share of stock
- **Hedge Fund's** downpayment to **Original Seller** through **Prime Broker** = price of one share of stock (\$10)
- IF **Hedge Fund** sells stock within 60 days,
 - **Original Seller** will keep downpayment (= 1 share of stock)
 - **Hedge Fund** will repay **Original Seller** in kind for remaining 9 shares of stock within 60 days
- IF stock is not sold within 60 days,
 - **Original Seller** will keep the down payment of \$10 (= 1 share of stock)
 - **Hedge Fund** will return 10 shares of stock to **Original Seller**

Today's Market Price for ABC stock is \$10/Share



Trade Day + 1

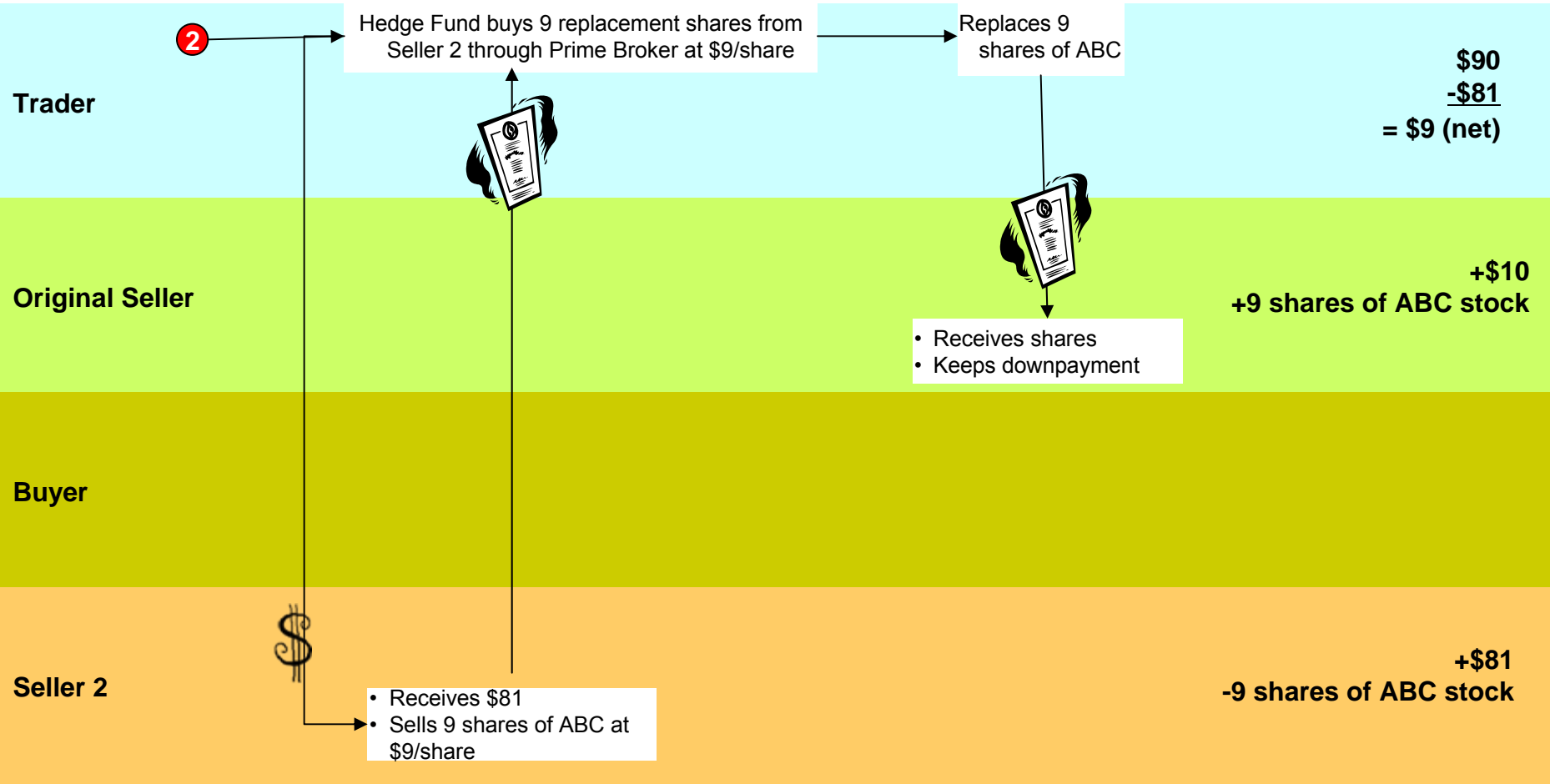


- **Conditions of sale:**
- 10 shares of stock at \$10/share
- Cash for immediate delivery

Today's Market Price for ABC stock is \$10/share



Trade Day + 60



Today's Market Price for ABC stock is \$9/share





How the Arboon Short Sale Equivalent Works

Hedge Fund sells on Trade Day+1
at \$10/share, receiving 100k

Hedge Fund
profits if share
price drops on
Trade Day +60

Hedge Fund
loses if share
price rises on
Trade Day +60

Share Value
\$10

Share Value
\$9

Share Value
\$11

Units owed by Hedge Fund to Original Seller

9 shares

9 shares

9 shares

Hedge Fund's cost to replace units

\$81

\$99

Fund's profit/loss

\$9

-\$9

\$10 + \$81 or the down payment + the replacement cost subtracted from 100k earned from the sale to Buyer on Trade Day +1....OR

\$10 + \$99 or the down payment + the replacement cost subtracted from 100k earned from the sale to Buyer on Trade Day +1