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Financial Derivatives Hedging: A Review of Islamic Finance at Cross Roads

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Abstract: Principles of Islam advocate risk distribution and prohibit speculative activities. Therefore, financial derivatives under Islamic Sharia would achieve hedging in the true sense and could be applied more effectively to reduce risks and speculation. With the increased complexities of financial capital markets, effective financial instruments are required and Islamic financial derivatives may be the answer to averting a similar global financial crisis in the future. Based on various schools of thought and fiqh in Islam, we provide a critique of Islamic Sharia tenets in relation to conventional derivative instruments. We also illustrate how conventional financial derivatives may be integrated into Islamic finance an existing model. The key challenge for Islamic finance is agreement on a universal set of Islamic laws, regulations and principles that are acceptable across all the sects of Islam. As it is there is a non-consolidation of fatwas and a lack of a common Islamic jurisprudence. Our review highlights that the problem lies in the non-acceptance of a universally acceptable Islamic conceptual framework and not in the lack of financial engineering capability.

Key Words: Derivatives, Islamic Finance, Financial Markets, Shariah, Hedging, Futures, Options

JEL Classification:

Introduction

The financial systems of the world were shaken after the worst crisis in global finance since the Great Depression. The financial systems have not completely recovered and attention has been drawn to the part that complex derivative instruments played in the crisis. In response, researchers started to focus on other financial structures for the development of derivative contracts that would be more effective and minimize the

sweeping risks of current instruments (*Rizvi et al., 2014*).

Debates centred around regulation and restructuring were carried on with regard to financial markets and global economies, and Islamic finance was preferred by many scholars to be a viable solution to the problem. Islamic principles are counterintuitive to the greed and personal speculative motivations that had fed the financial crisis and would provide the best use of hedging practices with financial derivatives (*Ayub, 2007; Aglionby,*

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[2009](#); Chapra, [2009](#); Kayed & Hassan, [2011](#)). Evidence shows that the Islamic financial system stayed robust in 2009 and 2010 when other financial systems were facing dislocation of the capital market and a state of deleveraging (*Standard & Poor*, [2010](#)). Further public information reveals that the assets of the top 500 Islamic banks in 2009 expanded to \$822 billion, approximately 28.6% as compared to \$639 billion in 2008.

The Islamic banking system was able to thrive during this crisis and its survival supports the idea that Islamic bodies and mutual funds need to develop more sophisticated financial instruments that minimize countless risk exposures while providing avenues for global investment. As a result, liquidity and trading volume of Islamic securities will grow, transaction costs will reduce, and ultimately Islamic capital markets will become more attractive and less risky (*Ghoul*, [2008](#)). It provides financial engineers with a challenging opportunity to develop derivatives that are Shariah compliant and at the same time achieve effective hedging and risk management so that investors have safer options (*Uberoi & Evans*, [2008](#)). According to Islam wealth of people can be protected by managing risks which can be achieved through hedging. Maqasid al-shari'ah underscores this perspective in its emphasis on wealth preservation (hifz al-mal) (*Ahmad et al.*, [2014](#)).

Background

A derivative is a financial instrument whose value is derived from an underlying asset or another instrument that is already known. And derivatives have been employed at an exponential rate in modern-day financial structures (*Rizvi et al.*, [2014](#)). Islamic financial derivatives are characterized as instruments that have been developed on the basis of Sharia and are compliant with its tenets. Though Sharia is considered the religious law of Islamic structures and characterizes the religious mandate for Muslims, the Sharia jurisdictions can also be incorporated into their secular law (*Jobst*, [2007b](#); [2007d](#)). Risk sharing is the main code of Sharia-based Islamic finance, but it is conditional on certain

prohibitions that are associated with the financial sector.

These prohibitions are considered the main pillars of the Islamic system and are Usury (Riba); Uncertainty (Gharar); Gambling (Al-Maysir); doing business in certain economic sectors; and Corruption (Rishwah). With regard to Riba, Islam prohibits Riba in line with other monotheistic religions and this is stated unequivocally in Islam (*Kahf*, [2006](#)). Islam is strictly against the payment of interest on loans and all kinds of Riba and any kind of augmentation, increment or extra addition is linked with Riba (*Rizvi et al.*, [2014](#)).

“And whatever ye lay out as Riba, so that it may increase in the property of (other) people, it shall not increase with Allah” (Quran 30:39).

Gharar (Uncertainty) in Islamic laws is elaborated as the threatening to someone and to his property willingly or the sale of an uncertain object having ambiguous existence and characteristics (*Schoon*, [2008](#)). The most difficult juristic term to contemplate in Islamic finance is Gharar. Gharar encapsulates the concept of contracts, deeds or conditions, where the other party is unaware of the full implications of the specific contract. This state is similar to asymmetric information where incomplete information is communicated to another party. Thus, the concept of Gharar inculcates the prohibition of any kind of cheating, fraud, dishonesty and deception.

Al-Maysir (Gambling) is defined as the game of chance where the profit and loss are set on a bet or on chances. These situations or doings are outlawed in the Islamic system and gambling exists in the circumstances when one party faces the possibility of total loss in a situation. The fourth component is the prohibition of financing of Sharia unlawful industries or economic sectors such as entertainment and pork, among others.

Rishwah is stated as the corruption in any financial instrument or asset or any kind of contract and such state is also prohibited in Islam. Instruments should adhere to the concepts of ethics and morality in investments and contracts.

Financial Engineering in Islamic Finance

In keeping with the tenets of Islam, Islamic finance has not automatically adopted the conventional financial instruments and derivatives existing in financial markets that are not Sharia-compliant. Rather, it has adopted financial engineering to design financial instruments that are aligned with Islamic law or Sharia. Therefore, numerous innovative securities and assets have flooded financial markets that are now adapted from Sharia-compatible instruments (*Munawar, 2005*). Islamic finance in the modern age has become an industry with trillion dollars and many different financial products and derivatives have now been engineered by Islamic bodies (*Clarke, 2009*). With the increased sophistication of financial sectors and markets worldwide, there is a greater need for more sophisticated financial engineering and innovative financial products in Islamic finance. This is more true in the area of financial derivatives if we are to capture the true essence of hedging.

This leads to the need for close collaboration of Islamic financial engineers with scholars of fiqh in Islam. But it is known that there does not exist a single Islamic law. Instead, many different laws and schools of thought are operational and fall in the areas of Islamic rules and regulations (*Vikor, 2005*). These conflicts in ideology and interpretations add to the already acknowledged substantive procedural difficulties arising from the legal uncertainty in Islamic derivative transactions. Legal integrity is affected if practical guidance is unavailable regarding Sharia compliance and confounding interpretations are provided by the various fiqh in respect of derivative transactions. Due to various schools of thought and fiqh, one clear Islamic jurisprudence is still not recognized universally. Moreover, the perspectives of Islamic courts in legal matters may be different from the opinions of prior scholars (*Alsayed, 2009*). Islamic financial instruments remain in a stage of infancy and there is a long way to go before Islamic derivatives are developed and employed that are able to capture the true essence of hedging and risk sharing in Islam.

Sharia Compliant Derivatives

It is questionable as to how a derivative can be termed as Sharia compatible. According to *Jobst (2008)* future, options and swap contracts can be compatible with Sharia-based Islamic law on the following assumptions:

- a. Hedge on the performance of assets that are associated with the interest of direct ownership.
- b. Disown conjoint deferment, without the transfer of actual asset.
- c. Prohibition of sinful activity (Gharar) in order to create a system of equity having distributive justice relative to the public interest (Masalah).

For a long time, financial derivatives were not acceptable as conforming to the tenets of Islam. However, with time solutions are becoming simple despite the intricate views regarding Sharia-compatible derivatives. In 1997 derivative futures' compliance with Sharia law was questioned widely. But in 1998 the crude palm oil futures contracts were assessed by the Sharia Advisory Council operating in the Securities Commission of Malaysia (SAC) and were declared as being compatible with the principles of Sharia. Moreover, SAC also passed a similar resolution with regard to the composite contract of index futures. Bai-urban was permitted in this resolution that was based on Islamic jurisprudence. Similarly, SAC Malaysia passed a resolution that stock index futures were not in contradiction to the Sharia doctrines. Therefore, since 1998 SAC has allowed the trading of stock indexes and it was ensured that Sharia-compliant securities were followed by the index component of stock trading (*Securities Commission, 2007*).

Futures Derivatives

A buyer and seller may agree to buy or deliver an indicated object or asset at an identified price on a specified future date and would thus execute a futures contract (*Hull, 2007*). Futures are standardized contracts that are highly liquid and can be used to hedge risk. Trading of futures becomes comparatively

inexpensive due to low margin rates and is traded on exchanges (Saunders & Cornett, 2007).

Islamic scholars are critical of these futures contracts mainly because the existence of goods at the time of conventional futures contracts is not mandatory and no delivery of goods and payment of the price is made at the time of agreement. There are delineates of the fundamental conflicts with Islamic law, for example, futures is a short selling contract without the possession of the selling item by the seller; the contract does not meet the requirements of qabd as all purchases and sales are carried out in futures markets without the delivery of physical assets; speculations are involved in future trading that increases gharar and gambling, and when counter values on both sides are deferred to a future settled date, future sales turn into a forbidden sale indicating a debt for one party (bay' al-kali bil-kali) (Kamali, 2005).

Conventional futures contracts are considered invalid by Mufti Taqi Usmani for two reasons. Firstly, Sharia principles clearly state that future dates cannot affect the purchase or sale of the contract. By this principle, Sharia declares forward and futures contracts to be invalid. Secondly, there is a lack of intention of possession or delivery of future commodities. Generally, the only difference in prices is settled at the end of the futures transactions and this act is prohibited under Sharia. Further, futures contracts to hedge risk are misleading as they provide erroneous signals to small farmers who are unaware that these markets are independent and different from cash markets (Khan, 1995). Besides, the farmers are up against professional speculators who are seasoned players in the futures markets.

On the other hand, many other scholars are of the view that commodity derivatives features can be compatible with Sharia teachings with some adjustments (Obaidullah, 2001; Salehabadi & Aram, 2002; Kamali, 2005; Bayindir, 2009). Khan (1995) suggests that despite the futures trading mechanism in its current form, the underlying conditions and rudimentary concepts of futures contracts are

similar to the conditions for forwarding trading laid by Prophet (PBUH). The contract of selling an asset in the future is not forbidden in Islam but certain restrictions have been defined to carry on such an act (Naughton & Naughton, 2000). The commodity should be clearly specified in the agreement as there exists doubt in the delivery of a physical object if its existence cannot be specified clearly. For example, futures of stock indexes do not comply with the requirements of Sharia because index dollar value cannot be specified clearly.

Kamali (2005) discusses how Majd al-Din Azzam suggests that futures derivatives are akin to shibh al-salam - a quasi-salam with a qualification that futures cannot be considered within the category of Salam because in a Salam the price is paid upfront when the contract is prepared (Kamali, 2005). Futures are also considered as promises of exchange contracts by some scholars (Hamoud, 1998), and this act is acceptable in all sales except currency sales. Shaikh Mustafa al-Zarqa elaborates that futures are inconsistent with the Salam contract or bai al-mu'ajjal (deferred sale), when the contract includes the counter value of at least one party at the time of doing the contract, while values are deferred to some future date in futures. Mukhtar al-Salami has emphasized the importance of futures contracts and called upon various scholars to address future jurisprudential matters. Muslim scholars were asked to give judgments and some scholars (Ali Abdul Qadir and Majd al-Din Azzam) opined that future trading was a new mode of commerce according (Kamali, 2005).

Characteristics of Futures in Islamic Finance: Wa'adan

The concept of Wa'adan can be considered as part of the futures contract. The expression of willingness by one person to another regarding a specific matter is connoted by a promise and that promise is termed as Wa'd. Al-Fayyumi (2008) defines wa'd as the indication of good or bad news though it is more so associated with good news. While Nurdianawati (2008) presents it as a commitment of one party to

another regarding a certain undertaking that was considered beneficial to the other party. At the commercial level, it implies dual meanings to a promise: the offer from the offering part is termed as 'promise' and the acceptance from the offering party is also considered as 'wa'd promise'. Thus, the promises are actually bound to the offers themselves and these offers will be enforced in the scenarios when the offering party comes forward and the requirements and conditions made for the acceptance of offers are completely fulfilled (*Ahmad et al., 2014*).

Various scholars are of the view that promise fulfilment is a noble action and its breach is considered forbidden in Islam. The person breaking his promise is called as 'Munafiq' in Islam where such persons are recognized by four qualities: he lies when talks; he does not keep his promises; he betrays his commitments; and he exceeds the limits in arguments (Bukhari, Sahih Bukhari, Kitab al-Iman). Moreover, the importance and significance of wa'd be seen by its repeated emphasis in Quran more than 150 times (*Daghi, 2002*).

The Advisory Council based on Sharia practices in Malaysian Bank 'Negara' shed light on the significance of wa'd and decided to execute unilateral binding promises (wa'd muzlim) on the transactions of forwarding exchange contracts executed by financial institutions. Wa'd muzlim tends to bind the promisor in an agreement to bear the liability of payment of damages if the promise is breached in some situations by the promisor. However, the transaction was allowed only for hedging perspectives (*Bank Negara Malaysia, 2010*). Similarly, it was stated by the Shariah Standard AAOIFI that the contract that binds one part called wa'd muzlim is permitted for transactions regarding foreign exchange. On the other hand, Muwa'adah (bilateral undertaking) is not allowed that intends to bind both parties of interest, not even for hedging purposes (*AAOIFI, 2010*).

Shamsiah (2011) explained that two unilateral (wa'dan) promises as the best-adopted principle when compared to single wa'd. This is because of the opinion that

justice ('adalah) is provided by wa'dan in current practice relative to wa'd. Both the parties in wa'dan are bound by a promise to each other and thus, the possibility and opportunity of default will not be present and both parties will be secured and protected.

Modifications to Futures in Islamic Finance

Futures contracts compatible with Sharia compliances can be developed by further research and financial engineering in the area of three fundamental concepts underlying the futures contracts (*Salehabadi & Aram, 2002*). Firstly, if the contract is based on an undetermined execution such that the contract is considered an obligation regarding some future transaction, then this transaction is not an effective bai (purchase or sale). Since the sale or purchase will be executed on a future date it is not a purchase or sale. A future effective date in case of bai makes it invalid. Secondly, if the contract is based on compromise (solh), that is where two parties show their consent and intention to deliver the commodity and money on a specified date in future, such contracts are permissible in the solh form. Thirdly, if the contract is based on confirmed commitment (Jualah) where the purchaser commits that he will pay the amount of purchase if the commodity is provided at a specified time in the future by the seller. Such contracts based on Jualah are allowed in Islam.

Options Contracts

Options entail an agreement through which the buyer obtains a right but not the obligation to buy or sell the asset or commodity at an indicated price over a time period or indicated date (*Hammad, 2003*). Thus, options contracts provide flexibility to the owner to buy or sell as he has the right but is not bound by any obligation. Further, the vendor and options buyer are the main bodies of the contract and it is obligatory for the vendor but not for the person having bought the rights or options (*Fayyad, 1998*). The options right is dependent on a non-refundable reward existence or a bonus (option price) that is provided by the seller to the buyer. The reward is based on

various aspects for the determination of the price at the time of implementation; like contract durability, commodity type, investment opportunities in monetary as well as capital markets and the level of risk (Balboul, 1992). The options contract states the implementation of the contract at the exact identified time. Profits are made on the part of buyers in all cases if the options are executed at a favourable price during or at the settlement date. With regard to trading, the option right is described as a financial paper derivative with no value and uses another traded security to derive value from the respective security (Fayyad, 1998). There are numerous types of options: call options, put options, and double option contracts.

Critique

Numerous scholars have declared option contracts offensive and objectionable (Hassan, 1986; Sulaiman, 1992; Usmani, 1996; 2002). And scholars have different perspectives on their objections. Hasan (1986) rejects options due to the options maturity stipulation which is unacceptable if it exceeds three days. The author also sees the contract as being unjust and oppressive as more benefits are granted to the option buyer as compared to the seller.

Sulaiman (1992) raises objections based on Bai-Al Urban and declares option contracts to be indefensible for sellers in respect of the premium charge. He criticizes that options are separate from the specific asset. Mufti Taqi Usmani also subscribed to this objection highlighting put option stock contracts are seen as acceptable that charge a fee and with no trading. The such stock was also found to be unacceptable when resold to the issuer at some future settled date, due to the condition placed on the earlier original stock sale.

Obaidullah (1997) stated Gharar to be another objection to the contract of options as these transactions were processed for speculative gains. While many scholars rendered this Gharar argument to be invalid, Obaidullah further stated that mere cash settlements in options contract induce Gharar and increases speculation in the agreement.

Moreover, he added that the gains fall into the area of Maysir if they materialize. It opens doors to the possibility of massive losses on equal terms and a default possibility from the loser, named Gharar. Besides, it was also argued that particular asset value change causes changes in the option contract's value. It does not happen by chance. If option profits are considered 'unearned', then it implies the statement of considering capital gain income to unearned as well.

Modifications to Options in Islamic Finance

Contrary to the above arguments, the most extensive analysis in this regard had been conducted by Kamali (1995). He conducted a study on the option's permissibility in the modern day and also on options trading according to the commercial law of Islam. He analyzed the validity of basic options as well as their parameters; time to maturity, premiums and delivery. He concluded that granting an option is not objectionable and questionable at all inherently, nor exercising the option over a time period or fee-charging on it is objectionable. Instead, this contract trading is permissible like other trades. Obaidullah (2005) in his research article stated options could be used as embedded options in the agreement. These embedded options are permissible in exchange contracts by the contract law of Islam under the head of Al-khiyar. This term refers to an explicit right given to one or both parties that they can withdraw the contract. Al-khiyar is dependent on the contract or the transaction's equity and not on the mutual consent of the parties. Moreover, this contract enables the reduction of gharar to bring it within the scope of Sharia. Besides, various options have been exercised in Islam based on Sharia principles, such as khiyar al-shart, khiyar altayeen, khiyar al-ayb, khiyar al-ruyat and khiyar al-majlis which means option by stipulation, option of determination or choice, option for defect, option after inspection, and the option of the session, respectively.

Swap Contracts

Swaps have been described as the vowed

commitment in which one cash flow or a specific asset is exchanged for another one on the basis of some conditions (Ramadan, 1998). Similarly, it is stated as the agreements that are implemented and established concurrently at period intervals (Henawi, 2002). The series of cash flows exchanged during some future periods between two or more parties is called an agreement called Swaps (Hammad, 2003). Swaps are directed to manage the risks of unanticipated losses related to currencies or interest rates. For example, interest rate swaps are used to hedge against fluctuations in interest rates. Foreign currency swaps are employed to hedge against fluctuations in currency exchange rates. While the securities returns swaps protect profits earned from securities, and this profit is determined by stock index fluctuations (Hourani & Zarai, 2014) and commodity swaps hedge commodity prices against economic instability and increments in prices.

Financial Derivatives & Islamic Finance Synthesis?

Jobst (2007a) illustrates how Islamic principles may be integrated into conventional financial derivatives models through the use of the Options model. The author suggests that from an economic perspective, the lending settlements of Islamic finance regarding ‘creditor-in-possession’ imitate in a religious sense the interest income of lending transactions by conventional banking. Based on this notion, the three main kinds of Islamic finance may re-characterize the interests of conventional banking in different ways as in the options put-call parity. This occurs due to the economic advantages that are derived from the real and temporary proprietorship of the contractible asset. This is shown in Fig. 1, taken from Jobst (2007a, pp. 9).

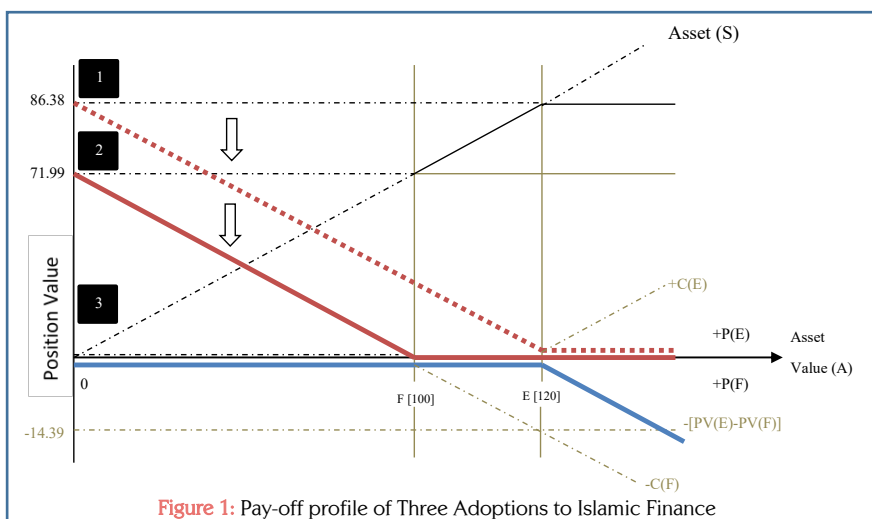


Figure 1: Pay-off profile of Three Adoptions to Islamic Finance

1. Ex ante lender payoff L1 (full recourse) [asset-based and “plain vanilla” debt-based (sale-buyback/negative short sale)]
2. Ex ante lender payoff L2 (with limited recourse) [debt-based (sale-buyback with a payment-delivery mismatch or back-to-back sale)]
3. Ex ante lender payoff L3 (no recourse) [equity-based (profit-sharing/trust-style agreement)]

Jobst (2007a) shows how in Islamic finance dealing with assets for the purpose of trade or investment, the lender may lease to the borrower one of several assets denoted as A whose value is shown at S. The former now

permits the (re-)gaining of ownership of asset A to the borrower, at time period T, through a call option denoted as C(E). The strike price for this option is E indicating the state of the promise of full payment of strike price E

(through a put option shown as +P(E)). It includes a form of rental payment through an agreed premium that is available over the investment period. Moreover, taking into consideration the lender's (exante) position, the present value may be derived as: $PV(E) = L_t = S - C(E) + P(E)$ and it is equal to the original amount's present value as well the interest on a conventional loan.

More realistically, the call and put options that are combined at the same invariant strike price E actually represent the series of discrete forward contracts on asset a that are valued at S, over the period of time on a sequence of rental payments. Hence;

$$L_{-1} \wedge = \text{E}[(1+r)^{-t} \varphi]^{-T} PV(E) \quad (1)$$

Where, the risk-free rate of interest analogue and the market price in the pre-specified repayment of loaning transactions are denoted by r , φ and φ . Basically, the call-put agreement of Islamic finance related to assets provides cash-neutral and forward (risk-free) hedges related to credit exposures.

Further, the author explains how in Islamic finance dealing with debt, the indebtedness of the borrower from the sales agreement of repurchase of an asset having a current value of PV(E) indicates that the lender receives extra payment for the funds used by the borrower over the time horizon T. While lender also receives the same investor pay-off L_1 in terms of Islamic finance dealing with assets. However, due to the delay of investor recourse, some debt-related financing like istisna or salam suggest markets risk or counterparty from lost recovery value. If it is assumed that such contingency risks would be inherent in the disparity between the F & E contract strike prices, the additional payments in terms of present value would be evidenced as $+ [C(F) - C(E)]$ in the salam contract. However, on the same forward assets, the put option worth of investor recourse in an istisna contract having a deferred delivery might be $- [P(F) - P(E)]$. This reduced value of repayment known as collateralization, for desired funding, ultimately bounds the exante lender's pay-off. Hence,

$$L_2 = S - C(F) + P(E) = PV(E) - [PV(E) - PV(F)] + C(F) - C(E) \quad (2)$$

While in the former case, the higher reliant claim of borrowers on the repurchase of asset ultimately results in

$$L_2 = S - C(F) + P(E) = PV(E) - C(F) - C(E) \quad (3)$$

In the third case, in the case of Islamic finance dealing with equity (profit-sharing agreements), the lender gets a payment based on a pre-agreed ratio of disbursement. This happens only if enough profits are generated by the investment projects so that the initial amount of investment is ultimately repaid at time T along with additional payment. In Islamic finance, as all losses are for lenders, thus they do not have any claim/options in the amount of +P(E), in case of lack of collateral. Hence, the exante pay-off of an investor having 100% equity interest might be;

$$L_3 = S_T - \frac{\sum_{t=1}^{T-1} C_{t,t+1}(E)}{\prod_{t=1}^T [(1+r_f)(1+\varphi)]^t} \frac{E[(1+r_f)(1+\varphi)]^{-T}}{PV(E)} - \frac{\sum_{t=1}^{T-1} P_{t,t+1}(E)}{\prod_{t=1}^T [(1+r_f)(1+\varphi)]^t} \quad (4)$$

Moreover, from a financial lease perspective related to the asset; "rent-to-buy", the lender's pay-off is L'_1 . This is particularly relevant to mortgages in Islamic finance and is similar to the L_3 payoff. Eventually, borrowers receive their equity portion of S as a portion of their rentals paid in such agreements. Therefore, with time the call-put future contracts with the strike price E decline, as the fraction of equity owned by borrowers increases until they land up owning the underlying asset at maturity. Hence;

$$L'_1 = S_T - \left[\frac{\sum_{t=1}^{T-1} C_{t,t+1} [E - t \frac{E}{T}] - \sum_{t=1}^{T-1} P_{t,t+1} [E - t \frac{E}{T}]}{\prod_{t=1}^T [(1+r_f)(1+\varphi)]^t} \right] = \frac{E[(1+r_f)(1+\varphi)]^{-T}}{PV(E)} - \frac{\sum_{t=1}^{T-1} P_{t,t+1} [\frac{tE}{T}]}{\prod_{t=1}^T [(1+r_f)(1+\varphi)]^t} \quad (5)$$

Challenges for Islamic finance derivatives

The key challenge for Islamic finance is agreement on a universal set of Islamic laws and regulations and principles that are acceptable across all the sects of Islam. As it is common Islamic jurisprudence is not acceptable across countries and different

Islamic schools of thought due to the non-consolidation of fatwas. The split opinions conveyed by the boards of institutions of Islamic finance regarding financial matters and specifically financial derivatives are impeding the progress in the development of Islamic financial derivatives. The introduction of new risk management instruments is affected by controversies regarding Islamic finance and the prevailing fragmented judgements and rulings on the Sharia-compliant principles that are applicable to derivative instruments. There is a strict need for establishing benchmarks for emerging Islamic derivatives. This is because of the current practices prevalent in financial

markets as well as the lack of a unified process of approval from Sharia principles. Additionally, the lack of uniform guidance on Sharia compliance common canons is a source of affecting the transactions' legal integrity when there is dispute resolution (*Malkawi, 2013*).

These challenges should be addressed by Islamic jurisprudence and courts of law, regarding Sharia-based compliance procedures to strengthen the footings and implementation of financial derivatives in modern-day Islamic finance.

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