

The Legal System Governing Derivative instruments

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Abstract

In financial economics, derivatives mean a set of Instruments that have common characteristics. This term refers to all instruments traded in the market and out of the market that are related to the trading of securities, currencies, interest rates, commodities, etc. Today, the use of Currency derivatives as one of the financial tools has a key role in managing the foreign exchange market. One of the most important things about derivatives is the laws that govern them in different countries. The purpose of this study is to investigate the legal system governing derivative instruments. This study is a descriptive review and the data collection method is library method. The results of the research show that the legal system of derivatives in Iran is initially affected by the issue of risk and its meaning in Islam. In fact, although the use of new tools of Islamic derivatives in Islamic financial institutions is increasing, but still differences of juridical views along with the difficulty of separating the purposes of risk coverage and speculation in the use of these tools, are among the most important challenges in developing these tools and new products. It needs more research and reflection in this field.

Keywords

derivative Instruments, legal system, religious jurisprudential opinions.

1. Introduction

Financial markets play an important role in the economic prosperity of countries and innovation in these markets has grown significantly in recent years. One of the most important of these innovations is "derivatives", which are more diverse. Contrary to popular belief that derivatives are a mere tool for speculation, derivatives play a key role in the global financial market. Without Derivatives and markets for their trading, the world financial system would not be as Integrity as it is today. (Khozin and Dankob, 2012). A variety of derivatives in the financial and capital markets have been created to develop these markets and help manage risk to prevent shareholder losses. The first record of organized trade in derivatives dates back to the 17th century in Japan. In the 19th century, Chicago became the center of derivatives development in the United States. The year 1985 was a major turning point in the standardization of procurement contracts, the formation of the International Association of Derivatives and World Trade. Since 2002, the association has been officially publishing standardized documents on financial derivatives. In Iran, the financial derivatives market, in which the futures contract and the option contract are offered, has been limited to the prescription of law Section 11, Article 11 of the law, of the Securities Market Law of the Islamic Republic of Iran (approved in 2005). The Base asset in these contracts may be commodities or securities. In this study, we try to compare the differences between these instruments and the legal system governing them in Iran and some countries, including the United States, by examining the concept of derivatives, their history and types, derivatives market actors and how to exit them.

2. Theoretical background

Derivatives are one of the financial instruments traded in the capital market (Pirie, 2017). Derivatives are divided into commodity derivatives, securities derivatives and foreign exchange derivatives by asset base. Despite derivatives, the tendency of knowledgeable and speculative traders is from the cash

market to the derivatives market because for these traders and investors, derivatives are the superior investment tools. (Eftekhar Jahromi and Sahebi pasandideh, 2019). This advantage stems from the leverage nature and low transaction costs; thus, in recent years, there has been a significant increase in the use of derivatives in financial markets. Credit derivatives are used to diversify, transfer credit risk and create leverage. Given the benefits of this type of securities for institutional investors, stockbrokers, low-risk investment funds and insurance companies, the use of these securities is expected to continue to increase. In fact, the use of these tools increases the efficiency of the capital market and increases the motivation and participation of people in financing long-term economic activities. The nature of the modern economy has led to the definition of another function for these markets, and that is risk management and control. However, most financing instruments are limited to stocks and types of debt or asset-based securities (such as certificates of deposit, bonds, and sukuk¹); But modern tools, such as derivatives, have been invented and used to control and minimize risks and ensure the mental security of investors. The experience of the financial markets of developing countries shows that today the exchange of foreign exchange resources is not realized only

¹ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines sukuk as "certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity". Accordingly, sukuk (while sometimes referred to as 'Islamic bonds' because, like bonds, they are for the most part, tradable securities that can be easily rated) can be described more accurately as 'Islamic investment trust certificates'. Whereas bonds evidence a debt the issuer owes to the bondholders, sukuk certificates evidence the investors' ownership interest in the underlying sukuk asset, business, enterprise or project which entitles them to receive a share of the income generated thereby. The origins of sukuk can be traced back to the classical Islamic period (700-1300AD) during which papers representing financial obligations originating from trade and other commercial activities were issued in conformity with verse 2:282 of the Holy Qur'an, which encourages fixing contracts in writing

through the physical movement of currency. Managing the foreign exchange market and addressing the concerns arising from exchange rate fluctuations today is not just about trading in the currency itself. Today, the use of foreign exchange exercises as one of the financial tools plays a key role in managing the currency exchange market.

Derivatives have been created in response to the complex needs of modern human life. As the business environment becomes more complex, new financial products are needed to solve problems. Derivatives are considered as risk management tools in financial markets. Some researchers consider the benefits of hardships as a new means of risk coverage. Diversification and transfer of risk through hardships help to find a fair market price and efficient transfer of funds from lenders to borrowers. The Currency exchange derivatives market is one of the missing financial institutions in the country's financial system, the absence of which has created various costs at the macro level for Currency exchange policy of the central bank and at the micro level for producers, traders, foreign investors. In the absence of such a market, the risk coverage of exchange rate fluctuations is challenged and it will not be possible for economic stakeholders to predict the future course of the exchange rate, even in the short term. Derivatives are generally dual-use; the use of Security for the purpose of risk management and the use of speculation for the purpose of making a profit. The derivatives market also has three major advantages over the cash market, which highlights the need to examine it further; First, the cost of risk management in derivative markets is much lower than in cash markets; Trading in derivatives markets is faster; Some derivatives markets can attract larger Rial² trades without adversely affecting the price of derivatives, meaning that the derivatives market can have more liquidity than the cash market.

One of the important things about the derivative tool is the laws that govern them in different countries. In Iran, the use of this tool dates back to less than 20

years ago and there is still no general consensus on the laws governing them. There is no provision in commercial law regarding securities or derivatives. Only Section 11 of Article 1 of the Securities Market Law of the Islamic Republic of Iran, without providing a definition of derivative instruments, mentions some examples of derivative instruments, discusses futures contracts and Optional transaction as a new institution (Hosseinzadeh, 2015). According to this law, the derivatives market is a market in which futures contracts and optional transaction based on securities or commodities are traded. This definition is not only sufficient to express the rulings and effects and the definition of derivatives, but also has several Bugs. On the other hand, the legal system of derivatives in Iran is initially affected by the issue of risk and its meaning in Islam. Although Islam opposes gambling, it agrees with risk-taking and, consequently, receiving rewards. Accordingly, this study examines the issues of what are derivatives and what are the most important derivatives? What is the legal system governing derivatives in Iran and other countries (especially the United States)? What are the views of Islamic jurisprudence legislators on the types of derivatives? And what are the challenges and differences in the field of jurisprudential and legal issues of using derivative tools?

Given the complexity of financial environments and the growing demand for new financial markets, as well as the advantages of the derivative market over the cash market, as well as the widespread use of these tools that can be effective in reducing risk, review the legal system and especially recognize Obstacles in this area can be important for all capital market stakeholders. Another point to note is that there is disagreement among jurists about the rules and how to use derivatives in financial markets, and this issue makes it more important to study this issue.

3. Research questions

- 1) What are derivatives and what are the most important derivatives?
- 2) What is the legal system governing derivatives in Iran and other countries?

² Iran's currency

- 3) What are the views of Islamic lawmakers and jurists on the types of derivatives?
- 4) What are the challenges and differences of opinion in the field of jurisprudential and legal issues of using derivative tools?

4. Methodology

This research is applied in terms of purpose and is a descriptive research based on how data is collected, which examines research questions based on library studies and literature review in this field.

5. Previous Studies and Literature

5.1. Previous Studies

Meysamy and Molakarimi (2021) examined the formation of a Currency exchange derivative market in accordance with Sharia in the Iranian financial system. They showed that the proposed model for the formation of currency exchange derivatives market in the Iranian financial system to be implemented will face some challenges and obstacles that need to be addressed to overcome them. Some of the most important challenges are: the development of speculative activities in the economy and the issue of justice, the multi-rate exchange rate, the negative experience in launching the coin futures market, the cash market impact of the foreign exchange derivatives market, the rising exchange rate and the lack of suppliers. Adverse macroeconomic conditions include: international sanctions, high inflation, budget deficit and restrictions on international payment and receipt processes

Abuselidze et al (2020) conducted a review of Global Financial Derivatives Market Development and trading on the Example of Ukraine. He states that Stock market of financial derivatives in Ukraine still develops. There is important to find the way how to use world experience for the domestic implementation. First of all there is a need to improve of legislative base to ensure economic and financial stability. The next way of integration process for domestic stock market of financial derivatives is stock consolidation. Before implementation of foreign experience on the

stock market of Ukraine it is important to take into account of all risks which are connected with this process. This research shows appropriate steps for integration of Ukrainian stock market of financial derivatives into global scale. The article identifies the economic essence of derivatives and their types within market economy. Key trends in global derivatives trading are highlighted. Current state and organizational measures of derivatives market development in Ukraine are discussed. Price risk has become the main feature of contemporary commodity and financial markets. Globalization of world commodity and financial markets leads to rapid changes and uncertain business conditions. Under current circumstances, derivatives market provides efficient ways for price risk hedging within market economy. That is why it is important to take into consideration the contemporary state and perspectives of derivatives market in Ukraine.

Boyle and Mcdougall (2019) in a thematic review entitled *Trading and Pricing Financial Derivatives*; delve into the history of options pricing; simple strategies of options trading; binomial tree valuation; Black-Scholes option valuation; option sensitivities; risk management and interest rate swaps in this immensely informative yet easy to comprehend work.

Eftekhar Jahromi and Sahebi (2019) in the study of jurisprudential analysis of currency derivatives and their effects with the aim of explaining some of the legal issues related to currency derivatives by examining the legal nature, principles and effects of foreign exchange derivatives in the legal system and securities market These instruments have been identified and certified by the Islamic Republic of Iran. The study of jurisprudential and legal sources also indicates that there is no jurisprudential and legal obstacle in identifying and operating these tools and derivatives of currency. Therefore, it seems that the risk of exchange rate fluctuations and maintaining the value of currency assets of the central bank and generally preventing inflammation in macroeconomic variables can be achieved through the use of Currency derivatives. Therefore, the Central Bank can manage the currency exchange market with the cooperation of

the Securities Exchange Organization and with the participation of trusted public and private banks, by issuing foreign exchange bonds and offering them in the securities market.

Chan et al (2019) in a study entitled *Financial Mathematics, Derivatives and Structured Products* explain the concepts of financial markets, derivatives, structured products, and how products are modeled and implemented by experts. This research provides the necessary knowledge about the financial markets needed to work as a product maker, traders, sales or managers.

Bayón (2017) examines major amendments to the new rules governing financial derivatives trade in Spain in a study entitled *An Approach to Regulation on Financial Derivatives in the Spanish Law*. This new regulation is intended to harmonize the treatment of derivative products with the legal standards of international markets in the European area as well as improving their competitiveness by enhancing the trading of new products and business lines in the Spanish markets while reducing the systemic risk associated to the clearing and settlement of derivatives contracts. Including measures regarding the conversion of OTC derivatives into assets quoted on organized markets into Spanish law has made an important contribution to a better regulation, security and transparency of the financial system.

Nabavi (2017) examined the effect of derivatives on stock market contagion and proved that, despite the closure of the economy, sanctions imposed on this country and therefore lack of connection with the global market, the result of the test of financial contagion is statistically significant; This may be due to the existence of indirect channels. It should be noted that if the economy is moving towards openness, according to the results of this study, it is recommended to develop derivatives to reduce volatility and thus reduce financial spread.

Golmoradi (2016) examined the tools and products of derivation in Islamic banking and showed that although the validity and use of all new tools of Islamic derivation is not agreed upon by the majority of schools of thought and Islamic jurists and in some

cases there are explicit objections, but study of experiences of other Islamic countries and institutions in the field of creating new products and tools of Islamic derivation can help to create the necessary ground for thinking and gaining good experiences.

Hosseinzadeh (2015) in examining the legal status of stock index derivatives, rejecting the views that have been expressed so far regarding the invalidity of derivative instruments located on the stock index; Explains the reasons for its invalidity with a different approach. From the results of this research, we can point to the invalidity of stock index contracts due to the impossibility of owning the stock index, its lack of ownership and the lack of a real concept of exchange in these contracts

Bartram et al (2011) examines the effects of derivatives on firm risk and value. They find strong evidence that the use of financial derivatives reduces both total risk and systematic risk. The effect of derivative use on firm value is positive but more sensitive to endogeneity and omitted variable concerns. However, using derivatives is associated with significantly higher value, abnormal returns, and larger profits during the economic downturn in 2001-2002, suggesting that firms are hedging downside risk.

5.2. II Literature review

Definition of derivative instruments

Derivatives are financial instruments used to manage financial risks in international companies and companies with large finances. (Chavoshani et al, 2021). The term derivative refers to a type of financial contract whose value is dependent on an underlying asset, group of assets, or benchmark. A derivative is set between two or more parties that can trade on an exchange or over-the-counter (OTC). These contracts can be used to trade any number of assets and carry their own risks (Amini Harandi, 2016). Prices for derivatives derive from fluctuations in the underlying asset. These financial securities are commonly used to access certain markets and may be traded to hedge against risk. Derivatives means a set of tools that have common properties. This term refers to all instruments traded in the market and out of the market that are

related to the trading of securities, currencies, interest rates, commodities, etc. (Eskiny, 2007) A derivative is a financial asset that does not in itself have an intrinsic value but its value depends on the value of an asset or set of assets (Basic assets). This is why these instruments are listed as derivatives, which derive their value from other assets such as securities, interest rates, exchange rates, stock indices and even commodities.

A variety of derivative tools

Derivatives in a general classification are divided into the following four categories:

- **Future contracts**

A futures contract is a kind of derivative and contractual instrument for making a transaction in the future. (Hull, 2017). In this type of contract, the seller and the buyer undertake to trade a certain amount of an asset at a specified price at the maturity of the futures contract. In this way, the buyer and seller insure themselves against fluctuations in the price of that asset. (Hosseinzadeh, 2015). In this contract, both parties are required to implement the provisions of the contract in the future. One of the important features of this type of contract is that it is traded only in official exchanges and for a certain quality and quantity of a certain commodity, and the delivery date is already known. Characteristics of identical futures contracts are:

- 1) These contracts are standardized for each commodity or financial instrument and only the price is negotiable.
- 2) These contracts have high liquidity because they can be bought and sold.
- 3) The existence of an institution called the Clearing house eliminates the risk of default.
- 4) Any change in the value of the contract will be credited to the parties at the end of each business day, and in fact the lifespan of these contracts is one day.
- 5) The parties to the contract must have a deposit account with the Clearing house during the life of the contract.
- 6) Usually such contracts do not have physical delivery and the settlement is done in cash.

Futures contracts can be classified into four main groups based on underlying assets:

A) Currency futures contract

Pursuant to paragraph A of Article 1 of the By-Laws on Foreign Exchange-Rial Futures Transactions, a foreign exchange futures contract is a contract under which the parties undertake to exchange a certain amount of currency or Rials against a certain amount of Rials or foreign exchange at the future exchange rate at maturity.

B) Stock futures contract

Under this agreement, the buyer and the seller undertake to trade the shares subject to the contract at a specified price and on a certain date in the future.

C- Future interest rate contract

This type of contract was first introduced in October 1975 at the Chicago to cover interest rate risk.

D- Stock index futures contract

In this type of contract, the basic asset is the stock index, which represents the price of a hypothetical portfolio of stocks. In this contract, there are two parties who trade on the stock index. One side is the buying position and the other is the selling position. In other words, buyers and sellers are stock indexes.

- **Forward contracts**

The forward contract is very similar to the futures contract. In a forward contract, as in a futures contract, the buyer and seller agree to make a certain deal at a certain time. The most important difference is that futures contracts are traded on the stock exchange, but the place of forward contracts is the OTC markets. (Hosseinzadeh, 2009) Characteristics of specific futures contracts are:

- 1) These contracts are not formal and cannot be traded in the secondary market.
- 2) There is a risk of non-fulfillment of the obligation of the parties to the contract.
- 3) There is no intermediary in such contracts and no amount is deposited as a guarantee.
- 4) Such contracts result in physical delivery.
- 5) The life of contracts is from the date of conclusion to maturity.

The difference between a futures contract and forward contract is that the futures contract and the forward contract are similar in terms of delivery time and price and are basically the same in nature, but also have some fundamental differences that are mentioned below:

- 1) Forward contracts are a standardized type of futures contracts.
- 2) The forward contract is traded on futures exchanges and through intermediary institutions, while the futures contract is traded on the OTC markets.
- 3) In the forward contract, there is a specific intermediary called a barter company, which plays the role of buyer against the seller and the role of seller for the buyer; therefore, the buyer and the seller are not responsible for each other.
- 4) In the forward contract, in order to ensure the implementation of the contract, the parties pay an amount as a guarantee, which greatly reduces Default risk.

In general, the forward market has a systematic structure and therefore is governed by a contractual framework, which results in high liquidity and less risk. While in the futures contract market, the creditworthiness of the parties is important and due to the lack of strong control laws, the parties' trade based on mutual recognition and naturally the risk of the futures contract is higher than the forward contract; therefore, in futures contracts, only known individuals can enter.

• **Transaction options**

The option is a futures contract under which the buyer and seller agree to trade a certain amount of an asset on a certain date. The date specified in the contract is called the date of application or expiration and the price is also called the price of application. The biggest advantages of discretionary transactions are limited losses and unlimited profits. Since every transaction has two parties (buyer and seller), it also divided the option of the transaction into two categories: the option of buying and the option of selling. The buyer

of the option (purchase or sale) has no obligation to execute the transaction, but the seller of the option is required to enter into the transaction at the request of the other party. (Etesami, 2014)

• **Swap contracts**

A swap contract is a contract under which the parties agree to exchange the proceeds of their financial instruments for the future (Golmoradi, 2016). These types of contracts are usually concluded between companies, in which the terms of the transaction, including the time of payment and how to calculate cash flows, are stated. The first swap was made in the early 1980s between IBM and the World Bank. Swaps are generally used to cover risk and reduce the risk of market changes. In financial markets, there are various market risks such as interest rate risk, currency risk and commodity price risk that can be covered by using swaps. In this contract, we have two types of goods Exchange, which include the following:

- Exchange of fixed rate of contract and floating rate of index and price of special goods.
- Exchange of two types of cash flow, one based on the price index of a particular type of goods and the other cash flow from a money market asset.

The types of swap contracts can also be classified as follows:

- 1) Interest rate swap: This swap is the most common type of swap and involves the exchange of fixed interest payments with floating. They allow two parties to exchange fixed and floating cash flows on an interest-bearing investment or loan.
- 2) Currency swap: This type involves the exchange of interest rate payments in different currencies.
- 3) Commodity swap: This type of swap is based on the average price of an underlying commodity such as oil or other natural resources, and based on that, the fixed price of one commodity is exchanged for another floating price. Profit from a finished product may suffer if commodity prices vary, as output

prices may not change in sync with commodity prices. A commodity swap allows receipt of payment linked to the commodity price against a fixed rate.

- 4) Stock swap: A stock swap is the exchange of one equity-based asset for another and is often associated with the payment for a merger or acquisition. A stock swap occurs when shareholders' ownership of the target company's shares is exchanged for shares of the acquiring company. During a stock swap, each company's shares must be accurately valued in order to determine a fair swap ratio between the two shares. A set number of shares of one company are swapped with the shares of another as a way of covering costs. (Hosseinzadeh, 2013)

Derivatives Market users

In general, participants in the derivatives market can be divided into three main groups:

The first group are those who, by entering the market, cover the price of the Underlying assets in the face of accidental price changes, that is, minimize the risk of adverse price changes. This category is called risk hedgers. The second category is arbitrage. The concept of arbitrage is to make a Risk-Free Rate of Return by employing non-unit priced assets in two different markets. By conducting simultaneous transactions, i.e. arbitrage in two or more markets, they seek to obtain Risk-Free Rate of Return. The main point is that the arbitrageur exploits the lack of balance between different prices. The third group is speculators. Speculators are those who seek to profit from the price difference in different cash and futures markets, that is, by buying and selling futures, they only pursue profit. If, according to speculative forecasts, the price of an asset falls, it can sell a derivative asset for more profit, and if the forecast is correct, it has made more profit, and if it is incorrect, it has not made a profit and has probably lost. Despite the risks, speculators are increasing the volume of market transactions. Speculators fill the gap created by risk hedgers between buyers and future sales. According to some

researchers, the activity of stockbrokers increases the efficiency of the information system in future markets. (Golmoradi, 2015)

Exit in derivatives markets

Exit from these contracts is done in three ways:

- A) Physical delivery of Commodity, which means the implementation of the contract: If both parties are willing to enter into a contract, both must fulfill their obligations regarding the physical delivery of the price and the object of sale (sold). The subject of futures contracts is similarly the commitment to make a contract of sale in the future; therefore, it is a reciprocal contract and there are two obligations regarding the delivery of the price and the object of sale (sold). This method of termination of the contract is called the method of physical Clearing or fulfillment of the contract through the delivery of the base asset. in the case where the subject of the final contract is currency or stocks; Since the cost of the mentioned problems (exorbitant costs of transportation and warehousing, etc.) do not exist in these cases, often the contract of authority of the transaction leads to the fulfillment of the contract and delivery of the property subject to the final contract.
- B) Cash Clearing, which means receiving and paying the difference between the stabilized price and the market price: At the end of the contract in the form of cash Clearing, the person who must transfer the Transaction option contract is obliged to pay any amount of loss that determines the difference between the Transaction price and the agreed price of Transaction option.
- C) Cancel the transaction, which means making a conflicting transaction: In this method, without the need for the agreement of the other party and the consent of the parties, each of them can leave the market according to market conditions and taking into account their interests and block their trading position. From

a legal analytical point of view, a reverse transaction is a kind of offset that leads to the loss of an obligation. (Hossein zadeh, 2009;2015).

Legal system

Legal systems refer to the set of institutions, organizations, and rules that are created in a coordinated and coherent system to achieve goals. The International Congress of Comparative Law in 1900 divided the legal systems into five categories without considering cultural, political, intellectual, racial and ethnic issues in the countries, and this division is almost valid until now. These 5 categories are:

- Roman German Family Law
- Anglo-Saxon family law
- Latin Law
- Slavic law
- Islamic Law

Legal system of derivatives in Iran

Acceptance of Islam as a universal religion is a wave of restrictions for every Muslim. This has led to restrictions on Muslims doing business under Islamic law (Darabi, and Ash'ari, 2014).

The legal system of derivatives in Iran is initially influenced by the issue of risk and its meaning in Islam. Although Islam opposes gambling, it agrees with risk-taking and, consequently, receiving rewards; thus, risk can be generally classified into three main types, namely: Acceptable risk, illegal risk and Avoidable risk.

Acceptable risk: In fact, it is a risk that is not separate from real transactions and value creation. In other words, it is a risk that is inherently and naturally associated with economic transactions. In general, permissible or tolerable risk has three characteristics: availability, insignificance, and unintentionality.

Illegal risk (Trick or deception): The jurists attribute this risk to the element of excessive uncertainty, or as excessive Trick. There is an element of gambling in this type of risk, which is forbidden by religious law.

Avoidable risk: It is between the two previous types of risk that were mentioned. and is tolerable but avoidable and it is necessary to take measures to be safe against this type of risk. Of course, the tools or methods used to prevent the minimization or protection of the value of the asset against this type of risk, must be in accordance with Islamic law. Therefore, in the light of this type of risk, the appropriate mechanisms and tools of risk management in Islamic finance are discussed. (Farsipour, 2015).

From the point of view of Imami jurisprudence³ and Iranian law, the validity of these contracts has been proven in general and regardless of its (basic assets). But in the meantime, the validity of derivative contracts, the basic asset of which is the stock index, has always been a source of concern. The existence of various financial instruments in the securities market causes more motivation and participation of people in financing long-term economic activities. The variety of financial instruments in terms of the combination of risk and return, the nature of profit and how to participate in risk, attract different groups. However, a different approach to financial instruments is not effective without identifying the types and contexts of their use. (Ismailzadeh and Amiri, 2016). There are different ways to finance business activities that different banks and financial institutions can use to finance companies. The best way to finance long-term investments comes from the size and liquidity of the private sector and through the stock market. The stock exchange can play an important role in directing small savings to productive investments, attracting stagnant savings in production, reforming the structure of economic sectors, increasing national income, increasing government revenue. Achieving these goals requires the expansion of the securities market, which in turn depends on the diversification of financial instruments. The existence of diversity in securities leads to the efficiency of the capital market and the

³ Ja'fari jurisprudence (Arabic: الفقه الجعفري; also spelled Jafarite), Ja'fari school or Ja'fari fiqh, [note A] is the school of jurisprudence (fiqh) in Twelver and Ismaili (including Nizari) Shia Islam, named after the sixth Imam, Ja'far al-Sadiq. In Iran, Ja'fari jurisprudence is enshrined in the constitution.

optimal allocation of capital, and enables the participation of a wide range of members of society in investing. (Hosseinzadeh, 2013)

The viewpoint of Islamic jurists about derivatives

1) Futures contracts

A. Opposite opinions: Futures contracts and contracts based on interest rates, such as interest rate futures contracts, are generally prohibited. When an asset has a hypothetical index such as a future index, it is actually a kind of gambling. Futures are forbidden in Islam if their Underlying assets are money and currency, because money and currency are not commodities but are a means of exchange

B. Agree on: According to this view, in Iran, Islamic futures contracts are accepted on the condition that physical delivery of goods take place, and a futures market is created for goods such as coins, stocks, currencies and some other products. In Malaysia, the Sharia Board of the Malaysian Securities Commission has also authorized the futures contract of palm crude oil and the futures contract. There is also a kind of futures contract for some Live animals in Turkey

Futures contract in Imami jurisprudence and civil law

A futures contract is a contract in which both the price and the object of sale are Duration⁴, which in general jurisprudence is called "sale of relation to relation"⁵. Therefore, based on the principles of four hundred and sixty-seven of the Constitution of the Islamic Republic of Iran, it may be stated that the issue should be extracted from valid Islamic sources and valid

⁴ payable at maturity

⁵ Sale of relation to relation in jurisprudence refers to a transaction in which the price and the object of sale are both general, late and Duration. In other words, the the price and the object of sale surrender sometime after concluding the sale contract. Although this term does not appear in Iranian civil law, there is no article that invalidates that.

judicial decree (Fatwas)⁶, and as mentioned in the previous section, the majority of jurists believe that "sale of relation to relation" is invalid and ineffective. (Rezaie, 2000). The legislature has stipulated in matter 10 of the Civil Code that "private contracts are valid for those who have concluded them, unless it is expressly contrary to the law. On the other hand, a matter 223 of the law states that any transaction that takes place is valid; "Unless proven otherwise."

2) (Transaction) options

Given the right of the subject of the transaction in this type of contract, the validity of this transaction is based on whether this right can be traded or not. Another opinion about the validity of the authority is that this transaction is very similar to the insurance and according to the validity of the insurance contract, it can be said: the Transaction options is also correct and the slight difference between insurance and it does not harm its validity.

3) swap

In Iran, despite the increasing use of swap contracts in the oil and petrochemical industry, no specific law has been set so far, and it is international trade custom that is the criterion for action in this regard. The jurisprudential council of the Islamic Accounting and Auditing Organization has considered the combination of contracts in a contract subject to the following permissible conditions:

- 1) The composition of contracts should not include items that are prohibited by law, such as the composition of the sale of a loan.
- 2) The combination of contracts should not be a factor in earning usury (unlawful profit).
- 3) The composition of the contracts should not conflict with their ultimate goals.

Legal system of other countries

Under the laws of the United States and the laws of most other developed countries, derivatives have certain legal exemptions that make them an attractive form of credit. However, the strong support of lenders from derivatives, combined with their complexity and

⁶ Fatwa means the expression of the rule of Islam by the jurist

lack of transparency, can help capital markets reduce credit risk. This can help boost credit and increase systemic risks. In fact, the use of derivative instruments to conceal credit risk from third parties while protecting derivatives reciprocity contributed to the 2008 financial crisis in the United States.

Also in Futures and Options on Russian Trading System (FORTS) are traded on stocks, stock indices, commodities, currencies and bonds. In this exchange, three separate markets are considered for derivatives trading of stocks, commodities and currencies. The most important foreign exchange futures contracts in the Russian stock market are: US Dollars to Russian Rubles, Euros to US Dollars, and Euros to Russian Rubles and British Pounds to US Dollars. The size of the dollar-to-ruble futures contract is \$ 1,000, and the settlement can only be made in cash by paying in Russian rubles. In South Korea, the foreign exchange derivatives market includes three types of foreign exchange futures (yen to won, euro to won and US dollar to won). The size of these contracts is US \$ 10,000. The interesting thing about the South Korean derivatives market is the possibility of physical delivery. This means that unlike many international derivatives markets, the Korean Stock Exchange provides the physical delivery of the underlying assets of derivative contract. Turkey's experience in forming a foreign exchange derivatives market is also significant. In fact, after 2001, the plan to carry out comprehensive economic reforms was on the agenda of Turkish policymakers, one of the most important of which was to launch a foreign exchange derivatives market with the aim of covering risk and attracting foreign investment. The Turkish foreign exchange derivatives market has been operating since 2005 and now the US dollar futures contract against the Turkish lira is one of the most important instruments traded in this market. The standard size of this contract is \$ 1,000 and the settlement is done only in cash and by paying in lira. (Meysamy, and Molakarami, 2020).

The nature of derivatives in the American legal system

Derivatives refer to products or financial instruments whose prices are determined by the price of the Underlying assets. Underlying assets include stocks, bonds, foreign currency or interest rates. The simplest and most basic type of derivative instrument is the futures contract, which has complex types such as optional contracts, futures contracts and sub-types of these contracts. Derivative securities are also called Future sale. Financial derivatives have certain characteristics. The value of a derivative instrument is determined by reference to other assets. Derivatives are also used as a tool to transfer risk from risk-averse investors to Risky investors. In addition, the financial derivative instrument creates a commitment to interest rates and prices at a future date, or in some way prevents price or exchange rate fluctuations, thereby reducing the severity of financial risk. Derivatives in the American legal system are of various types, each created under certain conditions and to solve problems. The Forward contracts began in 1972, and in 1975 the Chicago Board of Trade made the first Forward contracts on securities. There are two types of Forward contracts:

- 1) Forward contracts Currency Rate: A method of reducing Currency rate risk, the most important of which is the International Monetary Exchange, which is affiliated with the Chicago Mercantile Exchange and was first established in 1972.
- 2) Interest Rate Forward contracts: This contract is used for government securities, in the United States and in most countries, fixed income securities are traded by these contracts.

To determine the nature of these contracts, we need to look at some of the contracts in US law, such as Brent crude in the UK, the futures market in Europe, the futures market for crude oil and petroleum products in the US, and the secondary market in Dubai. (Same futures contracts) are performed. To determine the nature of these contracts, we need to look at some of the contracts in US law, such as Brent crude in the UK, the futures market in Europe, the futures market

for crude oil and petroleum products in the US, and the secondary market in Dubai. (Same futures contracts) are performed.

The nature of the Transaction option

In addition to two examples of buying and selling options, there are two other types of Transaction option:

- 1) American option: This means that the option to trade before maturity can be applied at any time.
- 2) European option: which can be applied only on the expiration date.

The explanation of the American option states that it can be performed in any period of time and at any moment from the time it was created until the moment of expiration. To identify and introduce the nature of the option, several items must be specified, including: the asset in question, the type of option (purchase or sale), the agreed price, expiration date, and the name of the stock market. As a result, the option is a transaction between the seller and the buyer of the pledged asset, in which the holder has the right to buy or sell the asset at a specified price on a specified date in the future.

The nature of the swap contract

Swaps are one of the newest developments in the derivatives product set and have become an important component of derivatives markets. The pricing of swaps illustrates how financial securities are valued in a competitive market. Swaps are a key tool for asset-liability managers for all types of firms and complement the derivative instruments available in futures and options markets (Moles, 2011). This contract was designed in 1979 in London. A swap contract is a set of fixed-rate cash flows and a set of floating-rate cash flows that Exchange. Thus, people who are looking for price fluctuations in a constant cash flow and other market participants who take advantage of these opportunities by accepting risk through their profession, choose a floating cash flow. Swap contract was used more than other derivative tools due to its ease of use and efficiency in covering risks and even reducing costs, as well as finding

conditions with more opportunities from the time of introduction to application.

In this contract, there are two types of product swaps, which include:

- 1) Exchange of fixed rate of contract and floating rate of index and price of special commodity.
- 2) Exchange of two types of cash flow, one based on the price index of a particular type of commodity and the other cash flow from a money market asset.

A review of US jurisprudence on derivatives and the study of financial markets in various countries, especially in developed and developing countries, shows the high focus of capital markets on the presentation of financial products and instruments on stock exchanges. The pervasive process of merging stock exchanges as well as the provision of various financial instruments by them has become an inevitable process for the development of the capital market. High executive and regulatory costs, the ability to use comprehensive software platforms to cover a wide range of financial instrument transactions, the benefits of concentrating assets in investor risk calculations, and facilitating the investment process if financial instruments are concentrated in a single trading platform lead to merger of exchanges and products into single systems. For example, the integration of European stock exchanges (London with Italy, Euronext, OMX, etc.), American stock exchanges (Intercontinental stock exchanges, ICE Chicago Stock Exchange, Toronto stock exchange, US and New York stock exchanges, Brazilian stock exchanges, etc.) , Asian stock exchanges (Japan, South Korea, Turkey, Hong Kong, etc.); and intercontinental stock exchanges (New York with Euronext, Australia with Taiwan, New York with Deutsche Scholarship suspended under EU antitrust rules), all of which It shows the serious determination of capital market operators in developed countries to increase their capacity, strengthen their competitive position and diversify the supply of their financial products. A process that in recent years has also affected less developed countries such as Vietnam and Pakistan. The Intercontinental Exchange was launched

in 2000 as the largest and most famous stock exchange in the United States due to the need to create an electronic trading platform with high transparency and capability in the energy markets. Products and financial instruments traded on the intercontinental exchange, including futures and options for agricultural products, futures contracts, credit futures, futures and options for derivatives, futures and options for derivatives, various types of futures and options for foreign exchange. Many large countries of the world, different types of futures contracts, land and sea transportation, different types of futures contracts on short-term, medium-term and long-term interest rates, futures contracts on various metals and futures contracts on gases. It becomes a greenhouse in European countries and the United States.

6. Conclusion

Risk is an integral part of economic activity. The complexity and instability of financial markets and the consequent expansion of the range of market risks have increased the need for new risk management tools. Derivatives have been considered as one of the new risk management tools, despite their newness. These tools must be free from issues such as usury, gambling and deception if they are to be accepted by Islamic law. In principle, hedge seekers seek to reduce risk, while speculators seek to take risks in order to gain more profit. This difference in goals can reduce the possibility of problems related to the usual financial difficulties, namely financial and economic crises in the Islamic financial system. In general, hedge seekers seek to reduce risk, while speculators take risks in order to gain more profit. This difference in goals can reduce the possibility of problems related to the usual financial difficulties, namely financial and economic crises in the Islamic financial system.

Although the economic effects of Islamic practices similar to those of similar products are common in financial markets; however, the underlying structure of these products is different from what is common in terms of compliance with the rules of Islamic law. Derivative products and tools used in Islamic financial institutions are not necessarily accepted and approved

by all Islamic jurists and jurisprudential societies. Much of the reason for these differences of opinion has to do with the nature of the use of derivatives, as evidence shows that most market participants enter the market for speculation and arbitrage purposes, and their share of risk-takers is low. In summary, it can be concluded that although the use of new tools of Islamic practice in Islamic financial institutions is increasing, but still differences of jurisprudential views along with the difficulty of separating the purposes of risk coverage and speculation in using these tools, are among the most important new challenges in developing these tools. They are considered to need further research in this field. Given that the Iranian legal system is derived from Islamic law and the main challenges in this field are related to conflicts related to the conflict of derivatives with these laws and especially the scandal related to the existence of gambling in them, it is suggested that specialized working groups be formed by experts and examine the futures and interests of derivative markets in different areas of the stock and foreign exchange markets and change the procedure in relation to existing laws in this field. On the other hand, despite the existing legal restrictions in this field, the issue of public culture is an important issue. In fact, the general public of Iran (unlike many other countries) is familiar with the purchase of currency and coins in cash with goals such as: maintaining purchasing power, investing to make profits and speculation in the short term; But there is not enough knowledge about the correct presence in the currency and coin derivatives markets to achieve these goals. Of course, futures trading in the capital market has been implemented for many years, and in the informal foreign exchange futures market, there is limited experience in derivatives trading, but in order to launch derivatives markets in general, there is a need for cauterization; Therefore, policymakers need to use new educational and advertising methods to create a culture of derivative transactions. It is also suggested that future research examines the framework for the formation of a foreign exchange derivatives market solely under the central bank's foreign exchange systems, and also based on the views of

lawyers, financial experts, researchers and religious jurists to provide an appropriate and indigenous model of the legal derivatives system.

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نظام حقوقی حاکم بر ابزارهای مشتقه

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چکیده

در اقتصاد مالی مشتقات به معنی مجموعه ابزاری است که دارای خصوصیات مشترک است. این واژه بر کلیه ابزارهای قابل معامله در بهابازار و خارج از بهابازار که مرتبط با معامله اوراق بهادار، ارز، نرخ بهره، کالا و غیره باشد، اطلاق می‌شود. امروزه استفاده از مشتقات ارزی به‌عنوان یکی از ابزارهای مالی در مدیریت بازار ارز نقش اساسی دارد. یکی از موارد مهم در باره ابزار مشتقه قوانین حقوق حاکم بر آنها در کشورهای مختلف است. هدف این تحقیق بررسی نظام حقوقی حاکم بر ابزارهای مشتقه می‌باشد. این مطالعه از نوع مروری تشریحی است و روش گردآوری داده‌ها، روش کتابخانه‌ای است. نتایج تحقیق نشان می‌دهد که نظام حقوقی ابزارهای مشتقه در ایران در شروع متأثر از موضوع ریسک و معنی آن در اسلام است. درواقع گرچه استفاده از ابزارهای نوین مشتقه اسلامی در مؤسسات مالی اسلامی در حال افزایش است اما هنوز اختلاف نظرات فقهی به همراه سختی جداسازی مقاصد پوشش ریسک و سفته‌بازی در استفاده از این ابزارها، ازجمله مهم‌ترین چالش‌های توسعه این ابزارها و محصولات نوین به شمار می‌روند که نیازمند تحقیق و تدبیر بیشتر در این زمینه است.

کلمات کلیدی

ابزار مشتقه، نظام حقوقی، نظرات فقهی.