


**THE RISKS OF FINANCIAL DERIVATIVES AND ALTERNATIVES FROM THE  
VIEWPOINT OF ISLAMIC ECONOMICS**

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ARTICLE INFO	ABSTRACT
<p><b>Article history:</b></p> <p><b>Received</b> 31 January 2023</p> <p><b>Accepted</b> 29 March 2023</p>	<p><b>Purpose:</b> This study aims to introduce financial derivatives and their tools and the risks they cause, with an indication of their relationship to financial crises, which contributes to drawing the broad outlines of the Islamic alternative and determines the reality of the failure of the global financial system in managing risks through traditional financial derivatives.</p>
<p><b>Keywords:</b></p> <p>Financial Derivatives; Risks; Global Financial Crisis.</p> 	<p><b>Theoretical framework:</b> Introduce financial derivatives and their tools and the risks they cause, with an indication of their relationship to financial crises, and alternatives from the point of view of Islamic economics.</p> <p><b>Methodology:</b> The study was based on a qualitative research method, as it collected information from books, reports, magazines, newspapers, and websites.</p> <p><b>Findings:</b> The financial derivatives increased risks and led us into crises. while Islamic Sharia provides an alternative to risk management, which focuses on avoiding fake sales and creating ethical and clean financial markets.</p> <p><b>Research, Practical &amp; Social implications:</b> Financial markets, financial derivatives markets, financial institutions, banks, and insurance companies are considered. And small customers, the most important beneficiaries of these ideas.</p> <p><b>Originality/value:</b> This research is the original work of the authors and differs from other previous studies in that it proves the existence of a disciplined Islamic alternative within the foundations and standards of Islamic economics and shows its feasibility for successful practical application, particularly in the face of financial crises, addressing them during their occurrence and preventing them before they occur.</p> <p>Doi: <a href="https://doi.org/10.26668/businessreview/2023.v8i4.1213">https://doi.org/10.26668/businessreview/2023.v8i4.1213</a></p>

**OS RISCOS DOS DERIVATIVOS FINANCEIROS E ALTERNATIVAS DO PONTO DE VISTA DA  
ECONOMIA ISLÂMICA**

**RESUMO**

**Objetivo:** Este estudo visa introduzir os derivativos financeiros e suas ferramentas e os riscos que eles causam, com uma indicação de sua relação com as crises financeiras, o que contribui para traçar as linhas gerais da alternativa islâmica e determina a realidade do fracasso do sistema financeiro global no gerenciamento de riscos através dos derivativos financeiros tradicionais.

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**Estrutura teórica:** Introduzir os derivativos financeiros e suas ferramentas e os riscos que eles causam, com uma indicação de sua relação com as crises financeiras, e alternativas do ponto de vista da economia islâmica.

**Metodologia:** O estudo foi baseado em um método de pesquisa qualitativa, pois coletou informações de livros, relatórios, revistas, jornais e websites.

**Descobertas:** Os derivativos financeiros aumentaram os riscos e nos levaram a crises. enquanto a Sharia islâmica oferece uma alternativa ao gerenciamento de riscos, que se concentra em evitar vendas falsas e criar mercados financeiros éticos e limpos.

**Pesquisa, implicações práticas e sociais:** Mercados financeiros, mercados de derivativos financeiros, instituições financeiras, bancos e companhias de seguros são considerados. E os pequenos clientes, os mais importantes beneficiários destas idéias.

**Originalidade/valor:** Esta pesquisa é o trabalho original dos autores e difere de outros estudos anteriores na medida em que prova a existência de uma alternativa islâmica disciplinada dentro dos fundamentos e padrões da economia islâmica e mostra sua viabilidade para uma aplicação prática bem sucedida, particularmente diante de crises financeiras, abordando-as durante sua ocorrência e prevenindo-as antes que elas ocorram.

**Palavras-chave:** Derivativos Financeiros, Riscos, Crise Financeira Global.

## LOS RIESGOS DE LOS DERIVADOS FINANCIEROS Y LAS ALTERNATIVAS DESDE EL PUNTO DE VISTA DE LA ECONOMÍA ISLÁMICA

### RESUMEN

**Objeto:** Este estudio tiene por objeto presentar los derivados financieros y sus herramientas, así como los riesgos que provocan, con indicación de su relación con las crisis financieras, lo que contribuye a trazar las grandes líneas de la alternativa islámica y determina la realidad del fracaso del sistema financiero mundial en la gestión de los riesgos mediante los derivados financieros tradicionales.

**Marco teórico:** Introducir los derivados financieros y sus herramientas y los riesgos que provocan, con indicación de su relación con las crisis financieras, y las alternativas desde el punto de vista de la economía islámica.

**Metodología:** El estudio se basó en un método de investigación cualitativo, ya que recopiló información de libros, informes, revistas, periódicos y sitios web.

**Conclusiones:** Los derivados financieros aumentaron los riesgos y nos llevaron a las crisis. mientras que la sharia islámica ofrece una alternativa a la gestión de riesgos, que se centra en evitar las ventas falsas y crear mercados financieros éticos y limpios.

**Investigación, implicaciones prácticas y sociales:** Se consideran los mercados financieros, los mercados de derivados financieros, las instituciones financieras, los bancos y las compañías de seguros. Y los pequeños clientes, los principales beneficiarios de estas ideas.

**Originalidad/valor:** Esta investigación es un trabajo original de los autores y se diferencia de otros estudios anteriores en que prueba la existencia de una alternativa islámica disciplinada dentro de los fundamentos y normas de la economía islámica y muestra su viabilidad para una aplicación práctica exitosa, en particular frente a las crisis financieras, abordándolas durante su ocurrencia y previniéndolas antes de que se produzcan.

**Palabras clave:** Derivados Financieros, Riesgos, Crisis Financiera Global.

### INTRODUCTION

The financial hedging is necessary to manage the risk of any firm or individual. In short-term policies the risk of the finance is high; in that case, operational hedging does not work (Ullah et al. 2019). Though, capital markets need not hedge their risk of exchanges since investors of this market do it for their purposes. Different kinds of market imperfections are associated with the hedging process of exchange risk, such as taxes, asymmetric information, and many more. (Shakatreh et al. 2022)

The global financial crisis and its attendant precursors highlighted a significant

weakness in the risk management system at the institutional and international levels, and financial derivatives emerged as a financial innovation that contributed to the transfer and coverage of risks, which provided better conditions for protection from risks when compared to traditional means such as insurance, for example, which proved its inability to address changes. And although dealing in derivatives aims to reduce the risks of fluctuations in rates of return, exchange rates and commodity prices, by virtue of the nature of these tools and their relationship to expectations, making them pose risks in themselves. This research will focus on financial derivatives as well as identifying their risks. A variety of financial tools have come into existence to hedge against risk: interest rate and currency swaps, futures contracts, futures operations, buy and sell (options) rights for interest rates, currencies, commodities, and other derivatives.

The use of these derivative instruments in developed country markets has grown over the past ten years. Since the inception of interest rate and currency swaps in the early 1980s, the market for these instruments has grown exponentially, reaching a total outstanding (unpaid) volume of more than \$90 trillion (since June 30, 2000). All of this was a natural result of the era of globalization and the resulting liberalization of global financial markets and the removal of restrictions on capital and institutions by taking advantage of the massive and accelerating communications revolution.

Considering the global financial crises and with the increase in financial risks and complexity, and during this fissure in the global financial system and the collapse of its symbols, derivatives emerged as one of the means of risk management, which proved weak in its performance and expanded significantly and unprecedented.

The need for effective means that contribute to risk management has emerged in many advanced and emerging economies during the past few decades, particularly in the wake of the economic collapses and financial crises that occurred in several East Asian countries, Latin America, and Russia in the nineties of the twentieth century, as well as what the American economy witnessed recently from financial and accounting collapses. The importance of financial derivatives has increased because of the increased risks of fluctuations in rates of return, exchange rates and commodity prices, which has proven impotent and even caused many crises and adverse results, the latest of which is the Corona crisis.

This has prompted the world to take an interest in Islamic finance. The importance of this study appears in demonstrating the reality of financial derivatives. And the position of Islam from it, and the Islamic alternative to it. As well as in its controls and legal foundations. The

Islamic banks became competitive and posed a significant challenge to the business model of traditional banking schools. The motivation for the phenomenon of commercial banks' transformation is entirely changing the financing philosophy of the bank) or partially (opening windows and branches) due to Islamic banking on the Arab and international levels. (Altameemi et al. 2022)

## LITERATURE REVIEW

Many studies concerned with risk management and the various tools used. To hedge against it, from these studies we mention:

**Belazouz Ben Ali**, "Risk Management Strategies in Financial Transactions," the study is a research paper. The aim of this study is to highlight the role of financial derivatives in hedging against and transferring risks. The study examines regulated and unregulated markets through the total value of assets related to financial derivatives, where the researcher used graphs, and the study concluded that the product units are companies and institutions that do not want In assuming the price risks, you transfer them through financial derivative instruments, to the units that are able to bear these risks. Risks, which are financial institutions and large brokerage sales.

**Noreen Boumediene**, "Financial Engineering Products as an Introduction to Activating the Stock Market Function, Malaysian Case Study from 2005-2011, Ph.D. thesis, Hassiba Ben Bouali University, Chlef, 2012. The aim of this study is to highlight the importance of financial engineering products, in activating and developing the stock market as an important source in financing the economy, where the multiplicity and diversity of financial products traded in the stock market is a fundamental pillar of its efficiency and development. To address the issue, the researcher used the contracts traded in the Malaysian Stock Exchange for derivatives. Financial, the volume of trading in financial derivatives Based on the charts, the study concluded that the inclusion of dealing in financial derivatives in the stock market is an important step in developing dealing in these markets to make it adapt to the desires of investors, through the availability of appropriate financial products, to meet their needs. The efficiency of the stock market.

**Monia Kaziz**, "Financial Derivatives as a Tool to Cover Financial Market Risks, a Case Study of Kuwait", University of Kuwait. Qasidi Merbah in 2011. The aim of this study is to find out the extent to which derivatives contracts contribute to covering the risks of the Kuwaiti financial market. As this study included thirty companies listed on the Kuwait Stock Exchange,

during the period from 2006-2010. The study showed that the accuracy of forecasting and building sound expectations that are based on an accurate scientific study lead to a decrease in the risks of financial market contracts and the achievement of high returns through the formation of a financial portfolio. options.

**Saramah Maryam** "The Course of Financial Derivatives and Securitization Technology in the Crisis of 2008 Analytical Study" University Master's Thesis Constantine 2012. This study aims to clarify the causes of financial derivatives and construction in the events of the global financial crisis, despite the number of the reasons for this crisis, the financial derivatives and the technology of the constraint have played a role and a large and great role in its events and deepening it, so that it did not happen, so that it was possible for the deepening of this. On expectations and use for the most severe purposes of their use to survive and subjugate, in addition to the many expenditures in the markets that are not organized compared to a regulatory market, so the study concluded that bad use of these products and the lack of knowledge of those who deal with the extent of their compatibility and the addition of their uses to use them, so that they can use them. The stability of financial markets has become a tool that helps focus risk.

**Khamisi, Abdelkader 2015**, An analytical study of the development of the use of financial derivatives in financial markets to cover market risks. This study aims to demonstrate the method of managing these Risks, and this study relies on analyzing the volume of transactions in financial derivatives in both The regulated market and the unregulated market, and this study included two main aspects: the first is the theoretical framework for financial derivatives and market risk management, while the second is an analytical study of the role of financial derivatives in managing market risks at the level of industrialized countries tite; Switzerland; Spain and Australia, from which we reached an important set of results.

**Discussion of previous studies:** Through some of the previous studies presented above, it is clear that financial derivatives are a double-edged sword. There are those who see it as a tool to destabilize financial markets and increase risks. In the context of the recent trend, and perhaps the addition that this article highlights are that it deals with the issue of using financial derivatives to manage market risks specifically in view of their high risks within the group of risks of economic activity, in addition to that the study included a comprehensive, The total of the ten industrialized countries, and this was not done in the aforementioned studies.

## **METHODOLOGY**

To achieve the objectives of the research, the descriptive and analytical approach was used, as it is a qualitative study, as the research objective was achieved in defining financial derivatives, then describing and analyzing their risk to the financial system. Meanwhile, the objective explored weaknesses in the current operation of the global risk management system, and a systematic review of the literature was utilized as a data collection method. This method is a reliable source of information, especially high-quality reviews that include relevant studies, that reduces bias (Gough, Oliver, Thomas, 2017).(Marzuki, et al 2022) This method includes four steps: identifying relevant research, systematically critiquing research reports, synthesizing results, and understanding conclusions from research.

## **DISCUSSION AND ANALYSIS**

Considering the available concepts of derivatives, some know them as: they are financial contracts related to off-balance sheet items and their value is combined with the values of one or more assets, tools or basic indicators associated with them (Ibn sanjour, 1995).

(Matar) sub-contracts that are built or derived from basic contracts for investment tools (securities, foreign currencies, commodities....etc) to create derivative investment tools from those sub-contracts within the scope of what is termed financial engineering.

(Subuh, 1998): a security whose market value is derived from the market value of another specific security, such as a common stock or bond, and therefore derivatives do not have direct financial rights on real assets.

The truth is that financial derivatives are contracts, but they are not intended in themselves (which is why they are called derivatives), but they are required because they protect against risks associated with another contract, which is the base contract (Al-qari , 2009).

Derivative contracts are dealt with by hedgers, speculators, and arbitrageurs: There are many financial derivatives, and they include options, future contracts, forward contracts, swaps, or a combination of two of these contracts, which is called derivatives on derivatives, such as swaptions.

The subject of these contracts may be real commodities or specific indicators such as exchange rate, interest rate, securities stocks, bonds, foreign currencies, or even some cash flow. And if risk is a factor that accompanies investment in general, but it is the highest in investing in financial derivatives, and the high risk of investing in financial derivatives arises from the uncertainty surrounding their prices, as they depend mainly on future expectations and the

extent to which their access opportunities are achieved.

In general, derivatives are netting contracts designed to exchange risks. One of its most famous forms is the futures and options trading. The futures are exchange contracts with deferring the two exchanges, such as contracting to exchange a dollar for a euro on a deferred date, for example, after six months. Options are options contracts in which the party wishing the option pays a certain fee for the right to buy a specific stock, commodity or currency at a specific price on a specific date.

The most prominent traditional financial derivatives fall into the category of futures contracts, options and temporary swaps, which are financial instruments whose value is derived from the value of other assets that often take the form of stocks, bonds, currencies and international commodities. The sharia ruling for financial derivatives is based on the legitimacy of the contracts on which they are based.

Derivatives are financial rights that are replaced by other financial rights because the value of the derivative instrument depends on the value of the asset over which the holder is entitled to rights. It includes several financial instruments, the most important of which are futures contracts, future contracts, options rights, and temporary swaps, in addition to a group of hybrid instruments such as swaps, long-term options, leaps and comes. The main function of financial derivatives is to help the investor mainly to guard against risks, and to achieve a degree of stability in the return on investment.

It is known through two types of markets: the first is regulated markets, which are markets that have a specific place in which deals take place and they are called the stock exchange, and the second is unorganized markets that do not have a specific place to execute transactions and it consists of traders and brokerage houses that undertake buying and selling at their workplace through a strong communication network, these markets are characterized by taking the client's demands into consideration when concluding contracts, which gives them a greater ability to compete with organized stock exchanges.

In fact, the types of derivatives include a wide range of financial contracts that vary according to their nature, risks, and terms, ranging from 30 days to a year or more. These tools also vary according to the degree of their complexity. The most important of these derivatives is the option contract, which is a mechanism that enables dealers to transfer Their expectations of a rise or fall in the price of a financial asset to actual implementation through the right to replace a specific asset with another at a specified price and at a specified date in the future, and then the expectations are actually converted to the right to buy or the right to sell, and thus

there are three types of options: A purchase option contract, which is the option of the buyer to buy a certain amount of a certain currency at a specified price during a certain period of time or on the path of a specified maturity, and the put option contract, which is the seller's option to sell a certain amount of a certain currency at a specified price on a specified date or during a certain period of time This choice provides protection for the seller from the risk of a decrease in the market value of the currency being sold, and the first option provides this choice for the buyer to protect his money from the risk of an increase in the market value of the currency purchased.

There is also an option contract to buy and sell stock indices, which are options contracts concluded on stock indices. In every stock exchange or financial market in all countries there are stock indices that give clues to the price trends of traded stocks and the requirements for dealing in stock indices option contracts similar to the requirements of dealing in common stock option contracts .

Types of financial derivatives by purpose:

1) Derivatives held for trading purposes: Most of the derivatives held for trading are related to sales, position taking, and exchange rate balancing. Sales relate to offering products to customers and banks to enable them to transfer, modify or reduce current and future risks. Position taking is about managing the risks of market positions with the expectation of profiting from positive changes in prices, rates or indices. The exchange rate balancing is concerned with identifying and taking advantage of the differences in exchange rates between different markets or products in order to obtain profits from that.

2) Derivatives acquired for risk hedging purposes The Bank follows a comprehensive system for measuring and managing risks, part of which relates to managing the risks to which the Bank is exposed as a result of fluctuations in foreign exchange rates and commission rates and to reduce currency and commission rate risks to be within the acceptable levels determined by the Board of Directors based on the directives issued by Monetary Agency. The Board of Directors has set certain levels of currency risk by setting limits for dealing with third parties and for currency position risks. It monitors currency positions daily and uses hedging strategies to ensure that currency positions remain within established limits. The Board of Directors has also set a certain level of commission rate risk by setting limits for gaps in commission rates for the prescribed periods. The gaps between commission rates for assets and liabilities are



reviewed periodically and risk hedging strategies are used to reduce the gap between commission rates within the established limits. As part of its asset and liability management, the Bank uses derivatives for hedging purposes in order to reduce its exposure to currency and commission rate risks. This is usually done by hedging specific transaction risks as well as using a hedging strategy for the statement of financial position as a whole. Strategic hedges are not subject to hedge accounting, and the related derivatives are accounted for as derivatives held for trading.

But the most common types of derivatives traded in the financial markets are three:

1) options contracts. An agreement between two parties, one of whom is the buyer of the option, and the other is a seller, called the option writer. They are contractual agreements whereby the seller (the issuer of the option) grants the right, but not the obligation, to the buyer (the option buyer) to sell or buy a currency, commodity, or financial instrument at a predetermined price on a specified future date or at any time during the period ending on that date.

A. Purchase rights options: they are summed up in the fact that a party has the right to buy from another party a specific asset at a specific price during a specified period, that is, that he has the freedom to exercise this right or not to exercise it, and the purchaser's enjoyment of this right comes when he pays the other party who sold him this right an "appropriate" price or a premium.

B. Options. Selling rights: the work of this is very similar to the work of. Purchase option.

2) Exchanges: They represent obligations to exchange one set of cash flows for another. As for commission rate swaps, other parties usually exchange commission payments at a fixed rate and a floating rate in the same currency, without exchanging the principal amount. As for currency swaps, commissions are exchanged at a fixed rate with the principal amount in different currencies. In the beginning, exchange operations were limited to central banks in the sixties, then commercial banks became dependent on this method to cover short-term risks. Banks carry out exchange operations for various purposes, including:

- making a profit: as well as achieving better asset management.
- facing the various banks' obligations, especially the future.
- it can be used by monetary authorities in certain circumstances to feed the banking system with local liquidity.

Under this agreement, the buyer has the right to buy (if he desires without being obligated to) from the other party (the liberator) or sell (if he wishes without obligation) to the other party (the liberator) a specific asset or financial instrument at a specific and specified price on the date specified or during a specific period as agreed.

This is in return for the purchaser of the option right to pay a premium or bonus to the other party, the seller (the editor) in return for his obligation to implement in the event that the purchaser considers exercising the option right.

The financial instrument can be a stock, bond, interest rate, currency price, future contract, or any financial instrument traded in global markets. Accordingly, the option contract is one of the tools that investors use to protect against the risks of price change and volatility. It is also used by speculators with the aim of making profits. Therefore, the essence of the matter in it is that it gives one of its parties the right to buy or sell (if he desires) a specific asset or financial instrument at a price agreed upon in advance in exchange for the seller's commitment (the choice editor) to implement.

3) future contracts. Contracts that give the right to buy or sell a quantity of a specific asset at a predetermined price, provided that delivery will take place at a later date in the future. Both parties (the seller and the buyer) are obligated to deposit a percentage of the contract value with the broker who deals with him, either in the form of cash or in the form of securities in order to protect each party from the problems that may result from the inability of the other party to fulfill its obligations (Hindi, 1994).

They are contracts through which a financial asset is delivered and received at a specific time in the future, and the price is determined at the time the contract is created.

Dealing with future contracts expanded in the eighties and nineties, and financial markets were established for them to regulate the rules of trading in future contracts.

Types of future contracts:

Futures contracts: they are contractual agreements to buy or sell a specific currency, commodity or financial instrument at a specific price and date in the future. Futures contracts are contracts that are specifically designed to meet specific needs and are traded outside the regulated financial markets. As for future foreign exchange contracts and future contracts for commission rates, they are dealt with according to specific prices in the regular financial markets, and changes in the value of future contracts are paid daily.

Forward price agreements: they are future contracts of commission rates that are traded outside the regular financial markets and stipulate that the difference between the contracted

commission rate and the market price shall be paid on a specific future date for the principal and during the agreed period.

Derivatives in one form or another have been available over the past several years. Also, financial engineers have been developing new and complex derivative products, which seem difficult if not impossible to understand, as j. Lipen said in an article in the wall street journal in 1993, "I did not know a subject that people did not know as much as derivatives" (Alhindi, 2003)

Unfortunately, however, the loss of public understanding of these tools did not solve the users' involvement in derivatives speculative transactions, and thus exposure to unsustainable levels of risk. (Markaz, 1996 )

Therefore, the call today is not only to celebrate the technical victories of the derivative product market, and to be enamored of its ability to respond to all needs. But also, to note that it is considered one of the greatest risk factors for the current financial, as it has caused many crises, and here it is possible to recall the lessons of the black Monday crisis, where accusations were leveled against the derivatives markets, as being a major cause of the crisis, in addition to the Barings brothers and company tragedy. Bank»» which was blown by the winds of derivatives.

This is in addition to the crash of the German group "mellall gesellschaft" in 1994 due to futures trading. The list expands to include other facilities such as: Cargill, mead, and greetings chemical. We even find the American manufacturer dell, who, after a loss estimated at \$ 23 million, announced in 1994 to withdraw from the derivatives market.

And if there is a disagreement about whether derivatives are the main cause of the black Monday crisis, everyone agrees that the collapse of Barings bank was caused by derivatives, and therefore we will present the details of this collapse: it was on Sunday, February 26, 1995, when a group of commercial banks called Barings was placed under the watchful eye of the bank of England, the central bank. After trying to arrange who buys this bank failed. The bank was exposed to huge losses, caused by the entry of one of its officials specialized in derivatives trading in unlicensed transactions through a company in Singapore called "Barings futures" affiliated to a securities company owned by Barings in the name of Barings securities "which is the executing arm of the market-making group in the group. ( Iidarat ,1995 ).

In 1992 the bank appointed a 28-year-old named Nicholas Leeson, whose reputation and competence preceded him, leaving him with the responsibility of designing and managing derivative contract operations in Singapore. It is strange that he started his activity in 1994 with

operations that are supposed to have limited risks, it is the arbitrage between future contracts on the Nikkei 225 index, and the Osaka stock exchange index, which is trading on the Singapore stock exchange, on the basis that they are two indicators that are almost substitutes for each other, so he was selling future contracts on the Nikkei 225 index, for example, when its price rises, to buy future contracts on the Osaka stock exchange whose price did not rise to the same extent, operations are difficult to be exposed to risks, but see what happened:

The Kobe earthquake occurred on January 16, at a time when Leeson had bought a huge number of futures contracts on the Nikkei, which had fallen due to the earthquake by 10% from 20,000 points on January 1 to 18,000 points after the earthquake. Hoping that the prices of those contracts will rise again, he hastened to buy more of them at the low price, with the aim of reducing the average value of the contracts, hoping to reduce his losses faster. However, the Nikkei index began to decline further until it reached 17,000 points and with all a decrease in the value of the index increases losses.

Leeson was able to hide his losses on his superiors in a taking account number 88888, where the losses amounted to 59 billion yen, which is then equivalent to 610 million dollars. However, if he was able to hide the losses on his bosses, he could not hide them from the market, because of the loans he obtained from the banks, since dealing in derivative contracts requires depositing an initial margin with the broker, which may be in the form of cash or in the form of government securities. . And if the actual margin from the impact of losses falls to a level less than the margin of protection or maintenance, then it requires the party that suffered losses to deposit cash, and nothing else until the actual margin rises not to the level of the margin of protection but to the level of the initial margin, and Leeson was able to meet those extra deposits of bank loans.

Bank officials in London began to realize the reality of a crisis, as the 15 Japanese banks demanded the recovery of the value of loans, which amounted to \$ 715 million, most of which were aimed at covering margin requirements. Thus, because of almost safe operations on derivative contracts, the bank was subjected to a violent shock. The bank of England preferred to save the bank by buying it from another bank, or a banking group. The question now is: why did all these crises occur, including the global financial crisis? And what does it mean to the investor? The answer put forward in the financial newspapers is that derivatives were the reason, as they are said to be complex and high-risk securities that lead young people to a financial losing end. This is the general perception today about derivatives.

It is noteworthy that the use of derivatives may expose banks and other financial

institutions to several risks, namely:

1. Credit risk.
2. Market risks such as changing derivatives prices.
3. Settlement risk.
4. Operational risks arising from lack of control.
5. Liquidity risk.
6. Legal risks (the illegality of some derivative contracts).

The opinion of Islam on derivatives (Al-baali, 1999)

The objective of dealing with financial derivatives is to transfer the risks of the asset from one party to another. In the case of a future contract to exchange the dollar for the euro, the goal of the contract is to fix the prevailing exchange rate when contracting for the contract term, so that if the term comes to an end, the two parties are entitled to exchange the two currencies regardless of the exchange rate prevailing at the time, whether it rose or fell from the prevailing rate at the time of the contract, and the same in options, where the party owning the option has the right to buy the currency or the stock at the price specified at the time of the contract, regardless of the prevailing price at the time of expiry.

Since the intention of these contracts is to transfer the risks from one party to another, the general majority (99% in the futures) is that the contract is settled when the term comes (or before that) by paying the difference between the prevailing price at the time and the price fixed in the contract, the contract ends with settlement on price differences without transferring the ownership of the assets on which the contract is based, and that is why these contracts are called derivatives, that is, they are derived from the assets associated with them, but they are not intended to transfer their ownership, but rather the settlement of their price differences.

Derivatives in this way are not legally permissible, and in this regard came the decision of the international Islamic Fiqh academy of the organization of the Islamic conference no. 7/1/65 in its seventh session in May 1992. To represent the sale of goods by the method of futures, which reads: "the fourth method is for the contract to be based on the receipt of a commodity described in the custodianship." On a deferred date and payment of the price upon delivery without the contract including the condition that the actual delivery and receipt ends, but it can be liquidated by an opposite contract, and this is the most common type in commodity markets, and this contract is not permissible according to shariah.

As stated in the same decision: the options contracts, as they take place today in the global financial markets, are invented contracts that do not involve under any of the so-called

sharia contracts, and since the contracted is neither money, benefit, nor a financial right that may be substituted for it, it is a contract that is not legally permissible. Since these contracts are not permissible initially, it is not permissible to trade them.

As for dealing with indices (i.e. Index numbers that show cases of dealing in stock exchanges), the same decision states the following: “an index is an arithmetic number calculated in a special statistical method, intended to know the size of the change in a specific market and sales are conducted in some global financial markets, it is permissible to buy and sell the index because it is purely gambling and it is an imaginary sale that cannot exist.”

## CONCLUSION

The Islamic banking philosophy considers that money is not producing anything of value unless mixed with work based on the philosophy of real investment in economic transactions. In other words, it is investing cash to deliver goods and services rather than lending money to create cash, as is the philosophy of commercial banking. The fundamental rules of the Islamic banking philosophy differ from commercial ones in terms of employment, investment of financial resources, service provision, and product. This Islamic philosophy presents a significant challenge in the commercial credit market, changing the traditional banking model and modernizing its business model, particularly the credit market (Risfandy et al., 2020). The success of the Islamic banking industry and its expansion through more than 505 banking institutions in more than 69 countries (Islamic Finance Development Indicator, 2018) is a result of oil revenues in the countries of the Arab Gulf and the Islamic communities' effort to spread Sharia principles across all economic activities (Bitar et al., 2019)

The solution, it begins with reviving the Islamic market, following his sunnah, may god's prayers and peace be upon him: he did not step, run, or hit his honorable leg, may god's prayers and peace be upon him, the market in Madinah and he said: “this is your market, so they do not detract from it, nor do they strike a kharja on it” (Ibn majah ), At a time when transactions and the market were teeming with the colors of usury, fraud, consuming people's money unlawfully, and parasitic mediation, and what is similar today to yesterday, and what we needed to revive the sunnah of the messenger, may god bless him and grant him peace, by establishing a clean Islamic market that guides goodness to people and purity in transactions.

The market during his time, may god's prayers and peace be upon him, enjoyed his care and attention, until the polytheists mocked that by saying: as the Qur'an narrated: “and they said, ‘what is the matter with this messenger that he eats food and walks in the markets?’ Al-

Furqan 7.”- and after him his companions, may God be pleased with them, and Muslim rulers and rulers throughout the ages and times and in various places, and the market with its etiquette, rules and systems was the basis for an Islamic economic system based on justice. The jurists were also interested in the rulings of the market and classified literature and books in it, and historians and travelers like ibn jubayr, ibn Battuta and others were interested in them. Alexandria and Baghdad were the ones who decided prices for the world in that era. 400 a.h. - 1010 a.d. (Metz 1967).

The Islamic market, with its tools and formulas, has become an urgent demand. For example, but not limited to sharia alternatives to options, such as (Qarar,1992.): conducting contracts with the option of the conditional (with the fulfillment of the required conditions of the existence of the subject and the like) and there is no objection to specifying the term of the conditional option according to custom. The Istisna’ contract solves for us the problem of the existence of the contract and the ignorance of the work, so it is possible to arrange contracts, deeds and certificates related to Istisna’ in the future. the contract of compensation, and the Salam contract and the sale of the term in installments or less solve the problem of the non-existence of the Muslim in it in the first contract and its conditional postponement and the absence of the price and its postponement in the second contract.

## RESULTS

The results obtained can be summarized as follows:

- 1- The objective of derivative strategies is to reduce exposure to interest rate risk, exchange rate and price fluctuations. By entering these contracts, banks or other institutions can cover the market risks they are exposed to.
- 2- Derivatives witnessed a continuous attack on them as tools that exaggerate speculation, and therefore they expose users to levels of risk that cannot be tolerated. It is not surprising that the well-known problems in front of the public, which were exposed to a group of establishments, have shed the necessary lights on the consequences arising from the misuse of derivatives.
- 3- While derivatives bring many advantages to banks, they must be used in a deliberate manner. This requires looking not only at the positives of the reserve, but also at the risks associated with derivative instruments.
- 4- Islamic Sharia provides an alternative to risk management, which focuses on

avoiding fake sales and creating ethical and clean financial markets.

## RECOMMENDATIONS

- 5- Banks and other institutions must maintain their role as custodians and stay away from the role of speculators.
- 6- It is necessary to study the risks associated with derivative instruments, through measurement methods.
- 7- And predict these risks and try to manage them.
- 8- Banks should also understand the supervisory requirements for derivative activity, including the current requirements that must be met, but also follow up on developments in this regard. It is possible that new ratios of capital will be imposed on the bank if it deals with derivatives, within the existing directives to weight the risks, in addition to the necessity not to exceed the lending ceilings, especially in small banks.

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