

# الإطار التنظيمي والتشريعي لعقود المشتقات المالية في مصر، دراسة مقارنة مع أحكام الشريعة الإسلامية والنظم القانونية ذات الصلة في الدول العربية

إعداد

د. رضوى صلاح الدين محمد السمان

قسم القانون التجاري والبحري

كلية الحقوق - جامعة القاهرة



## موجز عن البحث

إن التغير المستمر في كل من البيئة الاقتصادية والمالية والاستثمارية قد أدى إلى ضرورة إيجاد أدوات ومنتجات مالية جديدة، فترتب على ذلك ظهور ما يسمى بـ «الهندسة المالية». ومن أهم منتجات هذه «الهندسة المالية» ما يُعرف بـ «المشتقات المالية»، وهي: عبارة عن أدوات تعتمد على أداء بعض الأصول المالية المحددة. وتتمثل المشتقات المالية في عدة صور؛ منها: «العقود المستقبلية»، و«عقود الخيارات»، و«عقود المبادلة»، و«عقود الآجال». وقد اتُّهمت «المشتقات المالية» بأنها أحد أهم الأسباب التي كانت وراء الأزمة المالية العالمية؛ نظرًا لأنها عقود مستقبلية تقوم بطبيعتها على المخاطرة وعدم التحديد؛ مما دعا بعض الدول (ومنها الدول العربية) إلى مقاومة تنظيم هذه العقود من الناحية القانونية؛ منعًا لانتشارها في الوطن العربي، وتجنبًا لمخاطرها المالية والاقتصادية من ناحية، ومخالفتها أحكام الشريعة الإسلامية من ناحية أخرى. لكن الاحتياجات المالية عادةً ما تفرض نفسها في الواقع العملي دائمًا. ومن ثم بدأ الاتجار في عقود المشتقات المالية في معظم دول العالم، ولكن بشكل غير مقنن؛

وذلك من خلال الأسواق خارج المقصورة Over-The-Counter Markets، وسرعان ما انتقل تبادل هذه المنتجات من الأسواق خارج المقصورة إلى الأسواق المنظمة والبورصات العالمية؛ منعاً للتحايل وضماناً لإيجاد إطار تنظيمي لهذه المعاملات والرقابة عليها. وبناء عليه صدرت تشريعات تحكم التعامل في هذه المنتجات داخل البورصات العالمية، تحت رقابة الجهات الرسمية المختصة وإشرافها، بالشكل الذي يجعل تلك المنتجات قادرة على تحقيق أهدافها في بيئة سوق المال.

وعلى الرغم من تأخر المشرع المصري في اتخاذ هذه الخطوة، فقد صدر القانون (رقم ١٧)، لسنة ٢٠١٨م بتعديل بعض أحكام قانون سوق رأس المال، بالقانون الصادر رقم (٩٥) لسنة ١٩٩٢م؛ وكذلك قرار رئيس مجلس الوزراء (رقم ٢٤٧٩)، لسنة ٢٠١٨م بتعديل بعض أحكام اللائحة التنفيذية لقانون سوق رأس المال، الصادر بقرار وزير الاقتصاد والتجارة الخارجية (رقم ١٣٥) لسنة ١٩٩٣م. ويتضمن هذا التعديل الجديد للقانون، وكذلك اللائحة التنفيذية، إدخال أدوات مالية جديدة للبورصة المصرية؛ أهمها: الصكوك والعقود الآجلة، أو عقود المشتقات المالية. وبذلك أصبح لدينا (لأول مرة) تنظيم تشريعي لعقود «المشتقات المالية» في مصر، وكذلك البورصات التي تتداول هذه النوعية من العقود، التي أطلق عليها القانون «بورصات العقود الآجلة». وقد أعقب إصدار تعديل القانون وتعديل اللائحة (محلّ البحث) إصدار حزمة من القرارات عن الهيئة العامة للرقابة المالية لوضع تعديل القانون واللائحة موضع التنفيذ. ويبدو أن القانون المعدل ولائحته التنفيذية قد انصبّ تركيزهما على عقود المشتقات المالية النمطية، أو التي تُتداول داخل الأسواق المالية المنظمة exchange-traded، وليست عقود المشتقات المالية التي تتداول خارج المقصورة Over-The-Counter، كما سيوضح

## البحثُ لاحقاً.

وبناء عليه، يثير هذا البحث عدة إشكالياتٍ؛ أهمها: الفهم الدقيق للطبيعة الفنية والقانونية للمشتقات المالية بوصفها أدواتٍ مالية جديدة على السُّوق المصري، مما يلزم منه الإحاطة بطبيعتها وآلية عملها؛ وذلك من خلال تقديم تحليلٍ دقيقٍ لتعديل قانون سوق رأس المال الذي نظّم «المشتقات المالية» لأول مرة في تاريخ سوق المال المصري، وكذلك الوقوف على الممارسات في الواقع العملي، وكيفية تعامل هيئة سوق المال المصرية مع عقود «المشتقات المالية»، و«بورصات العقود الآجلة». هذا هو السؤال المحوري الذي يقوم البحث بالإجابة عنه؛ من خلال إجراء دراسة مقارنة بين القانون المصري وقوانين الدول العربية التي سبقت مصر في إصدار قانون لتنظيم عقود المشتقات المالية -- باعتبارها الأقرب للطبيعة المصرية -- يصحبها دراسة تحليلية مفصلة لمدى تأثير هذه الأنظمة بأحكام الشريعة الإسلامية بما لعقود المشتقات المالية من صلة وثيقة بأحكام الشريعة الإسلامية وما يثيره تطبيق هذه المعاملات من إشكاليات شرعية، يضاف إلى ذلك الآثار التي يمكن أن تنجم عن تطبيق هذه القوانين على أرض الواقع، في حالة اتهام بنودها بأنها مخالفة لأحكام الشريعة الإسلامية؛ لما تحمله في طبيعتها من سمات الغرر والمخاطرة وغيرهما. وأخيراً يقدم البحث بعض الملاحظات الختامية حول مدى ملاءمة التنظيم التشريعي الحديث للسوق المصري للأوراق المالية، والمخاطر التي قد تنجم عن آلية هذا التنظيم التشريعي من الناحية القانونية والمالية.

وتنبع أهمية البحث من تعرُّضه لعقود المشتقات المالية كأدوات جديدة أُدخِلت إلى السوق المصري بصورة خاصة، بما تتميز به من خصائص كالتنوع والتجدُّد وانتشارها المتسارع والعمل على وضع ضوابط وآليات لتداولها؛ وذلك للتمكن من الجمع بين

الكفاءة الاقتصادية والمصدقية؛ بالإضافة إلى معرفة ميزات هذه العقود، وخصائصها القانونية، وآلية تنفيذها، والشروط الواجب توفُّرها لدى المستثمر في السوق المالية. ويتتبع البحث «المنهج الوصفي التحليلي»؛ إذ يصف أهم ما أتى به تعديل القانون ولائحته التنفيذية، بالإضافة إلى تحليل قواعده؛ وذلك محاولةً لفهم إشكاليات البحث بشكل دقيق. يُضاف إلى ذلك اتباع منهج دراسة المقارنة (مع قوانين الدول العربية ومع أحكام الشريعة الإسلامية) في محاولة لتقييم أحكام القانون المصري بشكل موضوعي. أخيرًا: يلزم التنويه بأن البحث ينأى تمامًا عن المنهج التاريخي في سرد المعلومات؛ لعدم ملائمة هذا النهج لدراسات سوق المال، والتي يغلب على طبيعتها العملية خاصة.

**الكلمات المفتاحية:** عقود المشتقات المالية، سوق رأس المال، بورصات العقود الآجلة، العقود المستقبلية، عقود الخيارات، عقود المبادلة، المشتقات في التمويل الإسلامي، الهندسة المالية.

## The Legal Framework Of Derivatives In Egypt Comparative Study With Islamic Law (Shari'a) And The Arab Countries

**Radwa Salaheldin Mohamed Elsaman**

Department of Commercial and Maritime Law, Faculty of Law, Cairo University.

**Email:** [r.elsaman@cu.edu.eg](mailto:r.elsaman@cu.edu.eg)

### **Abstract :**

The dynamic change in the economic, financial, and investment environment implies having new financial tools and products, which has resulted in “financial engineering.” One of the essential products of financial engineering is “derivatives.” Derivatives are financial instruments whose value is derived from the value of the underlined assets. Derivatives include futures, options, swaps, and forwards. Derivatives have been accused of being one of the main reasons behind the global financial crisis because derivatives imply a high level of risk and uncertainty. Accordingly, some countries, including the Arab countries, have been resisting regulating derivatives from a legal perspective to avoid the associated financial and economic risks on the one hand and the possibility of being in conflict with Shari'a on the other hand. Nevertheless, trade-in derivatives have started worldwide over the counter and then moved to regulated capital markets and stock of exchanges to avoid fraudulent transactions and to provide control on such transactions. As a result, derivatives in a way that makes such transactions productive.

Though the Egyptian Legislator has been delayed in taking this step, derivatives have been regulated recently by the Law No. 17 of 2018, amending the Capital Market Law No. 95 of 1992 and the Prime Minister's Decree No. 2479 of 2018 amending the Executive Regulation of the Capital Market Law issued by the Minister of Economics and Foreign Trade No. 135 of 1993. The new amendment of the law and the executive regulation includes adding new financial tools to the Egyptian Stock of Exchange, including mainly, (*Sukuk*) and forwards or derivatives. Accordingly, for the first time, Egypt has the legal organization of derivatives and the exchange where such derivatives are traded in. It is also worth noting here that the new law and its executive regulation focus on the regular derivatives that are exchange-traded and not over the counter derivatives, as the research will explain later.

Accordingly, this research addresses a couple of issues, including mainly the understanding of the technical and legal nature of derivatives as new financial tools to the Egyptian market, which implies the knowledge of the working mechanisms of such tools. Such understanding means an accurate analysis of the amended law of the capital market that has regulated derivatives for the first time in the history of the Egyptian capital market, as well as an understanding of the market practice concerning derivative and how the Egyptian Financial Supervisory Authority has been dealing with derivatives. That is the main problem addressed by the research through a comparative study between the Egyptian law and the relevant Arab countries' law that have preceded Egypt in regulating derivatives. A detailed analytical analysis of the impact of Shari'a on the said legal systems follows. In particular, derivatives are always accused of conflicting

with Shari'a due to the risk (*Gharar*) and uncertainty accompanying such types of transactions. Finally, the research provides some concluding remarks on the evaluation of the Egyptian regulation of derivatives to the nature of derivatives transactions and the risks arising concerning such regulation on both legal and financial levels.

The importance of the research lies in presenting derivatives as new tools inserted into the Egyptian market, enjoying the privileges of diversity, novelty, and is widely used. Also, the study explains issues such as the benefits of such tools, their legal characteristics, enforcement mechanisms, and conditions that have to be met. The analysis uses the descriptive-analytical methodology. Also, the research provides a comparative study with both Arab countries' regimes and Sharia in an attempt to provide a reasonable and neutral evaluation of Egyptian law. Finally, it is essential to note that the research does not offer any historical aspects as this is not convenient for the nature of capital market studies, which are usually very practical.

**Keywords:** derivatives, capital market, forwards, futures, options, swaps, Islamic finance, financial engineering.

## 1. INTRODUCTORY CHAPTER

Derivatives are financial instruments which value is derived from the value of the underlined assets and are used to manage risk by hedging a position, by speculating on the directional price trend of an asset, or by profiting from market price fluctuations.<sup>(1)</sup> The derivatives market is very big to the extent that it, sometimes, exceeds the stock market when measured in terms of underlying assets. The value of the assets underlying outstanding derivatives transactions is several times the world's gross domestic product.<sup>(2)</sup> A great deal of commentary and scholarly literature has explored derivatives globally. However, attempts to discover derivatives in the Arab region hardly exist.

***On the one hand,*** the general reasons, as well as specific reasons, call for the importance of exploring the various aspects of doing derivatives in Egypt and the Arab region. As far as the general reasons are concerned, the Arab region, including Egypt, has recently become a dynamic hub for investment. According to the World Bank 2019 Doing Business Report, the United Arab Emirates (UAE) occupies the eleventh place among countries worldwide. Morocco follows, ranking sixty and Bahrain ranking sixty-two. Other large economies in the Arab region are Egypt, Tunisia, and Saudi Arabia.<sup>(3)</sup> Thus, the Arab region is situated in a strategic global position featuring dynamic trade and investment opportunities. Also, the region is one of the world's leading oil and natural gas resources. According to the OPEC, 64.5% of the world's proven oil reserves are located in the Arab region.

Moreover, the growing population gives rise to a demand for foreign investments in the Arab region. The Arab region, together, covers a surface of more than 15 million square kilometers and embracing 6% of the world's population, which is almost the same as the population of the European Union (EU).<sup>(4)</sup> Also, excessive efforts have recently been put by the Arab region's governments to support production outside of oil and gas industries increases business chances across the region. Recently, many countries have amended their legislation to attract foreign investment and privatize the traditional government-owned business.<sup>(5)</sup> For instance, more than forty-three legal and policy reforms have taken place in fourteen countries in the last year. This has mainly taken place in areas such as starting a business, protecting minority investors, amending insolvency rules, launching electronic services, and others.<sup>(6)</sup> Finally, the Arab region has

(١) محمد حسين عبد الرحيم: عقود الخيارات المالية كأداة تشييطية في سوق الأوراق المالية (رسالة دكتوراة

تحت إشراف الأستاذ الدكتور سميحة القليوبي، ٢٠١٨

(2) Hull, John C., Options, Futures, and Other Derivatives (Pearson, 5th ed., 2012), Page 1

(3) World Bank Group, Doing Business (2019), available at :

[https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report\\_web-version.pdf](https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf)

(4) IMF, GROWTH AND STABILITY IN THE MIDDLE EAST AND NORTH AFRICA, available at:

<https://www.imf.org/external/pubs/ft/mena/04econ.htm> (last visited September 11, 2019).

(5) John H. Donbolit & Farnaz Kashfit, Doing Business in the Middle East: A Primer for U.S. Companies, 38 Cornell Int., L.J. 413 (2005).

(6) Supra note 3, the World Bank Doing Business Report.

the least demanding tax system, ranking below the global average. According to global statistics, the UAE and Qatar come in the first place, worldwide, as the most relaxed regimes to pay taxes by businesses.<sup>(1)</sup>

Specific reasons include the fact that the Arab region, as an emerging market, is one of the world's fastest-growing markets in the banking and capital markets sector.<sup>(2)</sup> Thus, the recognized need for increased risk management across the region has led to the development of the derivatives market across the Arab region, particularly the GCC. In 2017, for instance, the regulatory framework of the Dubai Financial Services Authority (DFSA) for central counterparties, such as clearinghouses, was deemed equivalent to that of the EU by the European Commission.<sup>(3)</sup> This is expected to lead to an increase in equity and derivatives trades on the Nasdaq Dubai platform, which is the DFSA-licensed clearing house in Dubai.<sup>(4)</sup> Another example is Saudi Arabia, where the bourse announced, in 2018, that it would start offering exchange-traded derivatives in the first half of 2019.<sup>(5)</sup> Talking more precisely, the development of the derivatives market in the Arab region is hindered by a lack of legislation. Few states managed to get out of this legislative deficiency cycle by issuing new regulations on derivatives. The United Arab Emirates and Egypt have issued a new law on derivatives in 2018. In Morocco, a law was passed recently, but still, several steps are required before it can be fully implemented. Accordingly, to examine derivatives law and market practice in Egypt, a comparison with the Arab countries that have already issued laws to regulate derivatives sounds important.

***On the other hand***, this Research poses the legal issues raised by the applicability of Islamic Finance to derivatives. The importance of examining derivatives from an Islamic perspective is not disputable, knowing that the majority of the Arab region countries consider Islamic law a vital source of their national legislation to the extent that they consider *Shari'a* as the primary and exclusive source of their national laws. Even the countries adopting liberal commercial laws such as Egypt have limited guidance from Civil Codes, and case law means, which sometimes leads to conflicting decisions by courts.<sup>(6)</sup>

---

(1) PwC report (2016), available at <https://www.pwc.com/m1/en/media-centre/2016/press-releases/paying-taxes-2017-middle-east.pdf>, (last visited September 11, 2019)

(2) *Id.*

(3) See generally, Paul Lee, The Regulation of Securities and Islamic Finance in Dubai: Implications for Models of *Shari'a* Compliance, 15 UCLA J. Islamic & Near E. L. 1 (2016).

(4) The Economist Intelligence Unit, Industry Report - Financial services - United Arab Emirates (3rd Quarter 2019), available at:

[http://country.eiu.com.ezproxy.bu.edu/FileHandler.ashx?issue\\_id=1008297284&mode=pdf](http://country.eiu.com.ezproxy.bu.edu/FileHandler.ashx?issue_id=1008297284&mode=pdf)

(5) The Economist Intelligence Unit, Industry Report - Financial services – Saudi Arabia (3rd Quarter 2019), [http://country.eiu.com.ezproxy.bu.edu/filehandler.ashx?issue\\_id=1517772935&mode=pdf](http://country.eiu.com.ezproxy.bu.edu/filehandler.ashx?issue_id=1517772935&mode=pdf)

(6) See generally the International Monetary Fund's Working Paper on Overview of Islamic Finance, by Mumtaz Hussain, Asghar Shahmoradi, and Rima Turk, 2015, P. 12

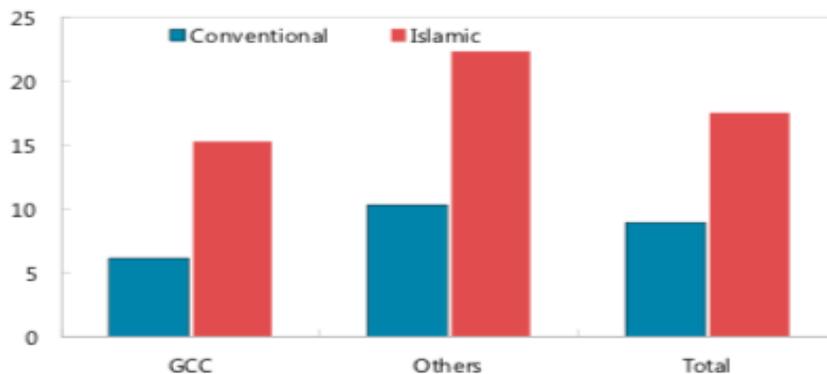
For example, transactions for gambling purposes are void according to Clause 1021 of the UAE Civil Code, with little case law defining “gambling” in the context of financial transactions. In contrast, Dubai Court of Cassation relied on international banking practices to hold that currency futures trading do not violate the Commercial Transactions Code for impermissible risk or uncertainty; emphasis on counterparty being a licensed professional investor.

Nevertheless, three Abu Dhabi court decisions in which foreign currency derivatives were invalidated for speculation. Thus, if a derivative transaction is purely speculative or “excessively uncertain,” there is considerable risk that courts will adopt conservative (due to *Shari’a* implications in some areas). To cut it short, there is always a substantial risk that courts take a traditional approach due to *Shari’a* implications in any country in the Arab region.

Similarly, the market for Islamic finance is growing rapidly.<sup>(1)</sup> The industry's total worth, according to key industry stakeholder organizations, across its three main sectors (banking, capital markets, and *Takaful* (insurance), was estimated to be USD 2.05 trillion in 2017, marking an 8.3% growth in assets in USD terms, and reversing the preceding two years of assets' growth stagnation. Meanwhile, inside Islamic Finance, Islamic banking is the largest sector, contributing to 71%, or USD 1.72 trillion, of the industry's assets. Islamic finance's second-largest market, Saudi Arabia, has 16 Islamic banks.<sup>(2)</sup> Besides, while in the Arab region, Islamic banking assets represent 14% of total banking assets. In the GCC, the market share of Islamic banking crossed the 25% threshold, with Saudi Arabia dominating the region with a 49% share, followed by the United Arab Emirates (19%), Kuwait (16%), Qatar (11%), and Bahrain (5%).

Similarly, Egypt has already launched a derivatives market. This explains the recent cooperation between ISDA and the IIFM that has resulted in various legal instruments, including mainly the ISDA/IIFM *Tahawwut* Master Agreement, as a global master

**Growth of Conventional and Islamic Assets**  
(In percent, compound average growth during 2009-2013)



Source: Ernst and Young (2015).

Note: Countries include Bahrain, Egypt, Indonesia, Kuwait, Malaysia, Pakistan, Qatar, Saudi Arabia, Turkey, and United Arab Emirates.

(1) World Islamic Finance Market Place, available at [www.mifc.com](http://www.mifc.com); التتمية في الأسواق الجديدة (1)

(2) See generally, Nicholas H. D. Foster, Islamic Finance Law as an Emergent Legal System, 21 Arab L.Q. 170 (2007).

agreement for transactions in Islamic derivatives. The document provides the first standard contract document for cross-border transactions in *Shari'a* compliant derivatives. Like the ISDA 2002 Master Agreement on which it is based, the ISDA/IIFM *Tahawwut* Master Agreement is a multiproduct framework agreement. The document has been drafted to document commodity *Murabaha*-based Islamic profit-rate and currency swaps.<sup>(1)</sup>

### **Outline**

Accordingly, this Research is organized as follows: **Chapter I** defines derivatives, explains who trades in derivatives, classifies the different types of derivatives, and finally elaborates on the importance of derivatives. **Chapter II** runs a comparison between derivatives in *Shari'a* (as called Islamic Law by the majority of scholar particularly in the West), and conventional derivatives. In other words, an examination of Islamic Finance understanding of derivatives and the alternatives tools offered by Islamic Finance in case of not recognizing any of the conventional derivatives takes place. That is particularly relevant, knowing that Islamic finance does not support the conventional derivatives. Accordingly, a choice has to take place between conventional derivatives and Islamic derivatives sometimes, depending on the degree of adopting Islamic Law by each country. **Chapter III** is a comparative analysis between derivatives in the Arab countries that have adopted derivative laws and the regulation of derivatives in the Egyptian law. Arab countries have been chosen for the purpose of this comparative study since they represent the legal system that is most relevant to the Egyptian system. Finally, the Research concludes with a description of the degree to which Islamic Law (*Shari'a*) had impacted doing derivatives in general and the potential implications of the Islamic Finance rules on the Egyptian derivatives market, in particular. It also provides some concluding remarks on the degree that the other comparative legal systems of derivative in the Arab region have impacted the Egyptian law.

---

(1) ISDA & IIFM TAHAWWUT MASTER AGREEMENT, available at <https://www.isda.org/book/isda-iifm-tahawwut-master-agreement/> (last visited September 11, 2019).

## 2.CHAPTER ONE: DEFINITION, TYPES, AND IMPORTANCE OF DERIVATIVES

### 1.2- Definition Of Derivatives

Derivatives are financial instruments, which value is derived from the value of the underlined assets, which could be stocks, bonds, commodities, interest rates, or currency-exchange rates, whether involving the delivery of the asset or the payment of an amount calculated by reference to its value.<sup>(1)</sup> Holding a derivative contract allows the transfer of risks and rewards associated with commercial or financial outcomes to other parties by, for example, reducing the risk of adverse market fluctuations like a bond default.<sup>(2)</sup>

The easiest way to understand the definition of derivatives is to use an example. Let us use the example of a *Commodity X* sold for \$10. The \$10 is the spot price of *Commodity X*. Let us assume that the owner of *Commodity X* agrees to sell it to another person, in one month, for \$10. If the price of *Commodity X* goes in three months to \$12, this netted \$2 is not the value of *Commodity X*, rather a value derived from *Commodity X*. This is called the future. Meanwhile, when traded off-exchange, a future is called “forward.” If in our example, if the purchaser is not confident that the value of *Commodity X* would go up and accordingly offers to buy the “right to buy” *Commodity X* in the future rather takes the obligation to buy it, this is called “option.” In this case, the purchase is buying the right to buy.

A future traded off-exchange concerning a tangible product, for example, is called a “forward.” Finally, swaps are a little different.<sup>(3)</sup> In swaps, the two parties agree to periodically exchange the value of one asset for the value of another asset (cash-settled). In our example, if the purchaser anticipates needing 120 units of *Commodity X* in 12 months. Instead of purchasing 10 units each month while facing fluctuation in prices, the purchaser could agree with a swaps dealer to provide a quote for the swap. To explain, the purchaser would agree with the swaps dealer to pay him a fixed price (\$10 per unit) for the 120 units, regardless of the change of prices along the twelve months. In return, the swaps dealer would pay the purchaser a floating price represented in the current price market every month. The purchaser can use this amount to buy the required units of *Commodity X* in the spot market every month. It is common here that the parties have an umbrella agreement that regulates their frequent

(١) مصطفى كامل خليل الحجازي: المشتقات المالية وتداعيات الأزمة المالية العالمية، ٢٠١٨، دار المنظومة، ص ٩٢٩

(2) Supra note, Hull, at Page 8.

(3) Global Islamic Finance Report 2010, Islamic Derivative Theory and Practice, P. 136



transactions, which is usually a standardized agreement known as the ISDA Master Agreement. More explanation of the types of derivatives is provided below in this section.<sup>(1)</sup>

## 2.2- Who Trades In Derivatives

The goal of derivatives is to obtain funding at a preferential rate or to take advantage of a movement in a financial market.<sup>(2)</sup> There are three types of traders in the derivatives markets; being hedgers, arbitrageurs (called dealers or market makers), and speculators. Hedgers use derivatives to offset the risk of fluctuation in the value of an asset (market risk) or the risk of financial exposure due to a fall in creditworthiness (credit risk). Hedgers could be manufacturers, producers, or business entities that are dealers or market makers.<sup>(3)</sup> Arbitrageurs (called dealers or market makers) take advantage of a mid-priced relationship that exists between a derivative and the commodity, currency, interest rate, or security it references.

Arbitrageurs intend to profit from market price fluctuations by, for example, quoting pricing for a swap. They usually make a profit by charging a spread “charge built into the swap by increasing the monthly payment made by the swap counterparty and a fee for being willing to take the other side of the trade”<sup>(4)</sup> Speculators usually profit from anticipating directional price trend of an asset as opposed to a dealer who is willing to transaction on both sides of a market place. All three of these groups, having divergent interests, commercial risks, market views, and financial risk tolerances meet to transact in the derivatives markets that allow them a diversity of derivatives’ products including swaps, futures, forward, or options, with a variety of opportunities offered by each type of the above.

## 2.3- Types Of Derivatives

It is not the purpose of this Research to explain the technicalities of derivatives from a financial perspective. Accordingly, the following explanation is limited to support the scope of this Research including the legal framework of derivatives. Derivatives are classified from two different perceptions. The more relevant classification to the legal description of those transactions is dividing derivatives according to the possibility of being traded-in. The other classification which is more relevant to the accounting and financial aspect of derivatives is dividing derivatives into options, forwards, future, and swaps.

On the one hand, a broad classification of derivatives includes three categories of derivatives, which are listed derivatives, *over-the-counter* (OTC), and cleared OTC derivatives.<sup>(5)</sup> Listed derivatives are traded on an *exchange* with several standardized

---

(1) Kalbaugh, Gary E, Derivatives and Regulation (Carolina Academic Press, 2nd ed., 2018). Pages from 6 - 18

(2) محمد حسين عبد الرحيم: المرجع السابق، ص ١٥

(3) Kalbaugh, Gary E, Derivatives and Regulation (Carolina Academic Press, 2nd ed., 2018). Page 19

(4) *Id.*

(5) Most OTC derivatives’ transactions are governed by the terms of the ISDA Master Agreements

contracts except for one term or more that is negotiated by the parties such as price in futures or the term in swaps contracts.<sup>(1)</sup> OTC derivatives are negotiated and concluded consensually in otherwise private forums, including banks, fund managers, corporations, and large financial institutions. The OTC derivatives allow the relevant parties to customize their contract to meet their expectations rather than going by standardized contracts like the exchange-traded derivatives. Transactions, in this case, do not take place through the exchange rather through dealers, who trade with each other on behalf of the counterparties resulting in higher credit risk that shall be managed by the parties.<sup>(2)</sup> Cleared OTC derivative is a kind of recent which are privately negotiated but booked with a clearinghouse to reduce the credit exposure.<sup>(3)</sup> Meanwhile, some derivatives have underlying assets delivered from the seller to the purchaser, such as agricultural commodities, minerals, currency, and others.<sup>(4)</sup> Some other assets are difficult to provide, such as interest rates, securities indexes, temperatures, and others.<sup>(5)</sup>

On the other hand, derivatives instruments include options, futures, forwards, and swaps (or hybrids of each), and each of these is usually associated with commodities, stocks, bonds, foreign currency, or other values.<sup>(6)</sup>

### (1) Futures and Forwards

Futures and forwards are contracts to buy or sell an asset at a pre-agreed price and future date. When traded off-exchange, in the *over-the-counter-market*, a future is called a “forward”.<sup>(7)</sup> Forward contracts are usually concluded between two financial

published by ISDA. There are two main versions of the Agreement, which are the ISDA 1992 Master Agreement, and the ISDA 2002 Master Agreement which was published in January 2003. Both template agreements imply standard terms as to jurisdiction and governing law (based on New York or English jurisdiction and law, depending on the parties’ choice). Recently, the ISDA published the 2018 Choice of Court and Governing Law Guide that presents new standard clauses that users may choose to include in future transactions. More details about ISDA could be found through ISDA’s official website available at <https://www.isda.org> انظر أيضا صلاح الدين زين العابدين محمد عبد الحفيظ: التنظيم

القانوني لقيود وتداول الأوراق المالية (رسالة مقدمة لنيل درجة الماجستير في الحقوق)، ٢٠١٦، ص ١٤٧ – ١٥٨

(1) Supra note 2, Hull, at Page 3.

(2) See generally, Understanding Derivatives, Markets and Infrastructure, Federal Reserve Bank of Chicago (August 2013)

(3) *Id.*

(٤) مصطفى كامل خليل الحجازي: المرجع السابق، ص ٩٣٠

(5) Timothy E. Lynch, Derivatives: A Twenty-First Century Understanding, 43 Loy. U. Chi. L. J. 1 (2011), page 34 - 47

(6) *Id.*

دينا إبراهيم محمد يوسف الفار: الجوانب القانونية للتداول الإلكتروني للأوراق المالية (رسالة مقدمة للحصول

على درجة الدكتوراه تحت إشراف أ.د. رضا محمد عبيد)، ٢٠١٦، ص ١١٥

(٧) دينا إبراهيم محمد يوسف الفار: المرجع السابق، ص ١٠٩

institutions or a financial institution and one of its clients.

The most common forward contract is known as the forward foreign exchange contract in which the buying party agrees to buy a specified amount of currency A for a specified currency B at a specified date in the future and at a specified exchange rate. The typical maturity dates for such contracts are one week, one month, two months, three months, six and twelve months beyond the spot date.

Unlike forwards, futures are traded in the exchange. To facilitate the process of trade, the exchange specifies certain standardized features of the contract. Under an exchange traded futures contract, the investor (buyer) has to place margin. Initial margin is representing the exchanges view of what the investor could lose on a bad day; it can be likened to a deposit against the following day's losses. Variation margin is the actual movement in the market and must be settled immediately – no built-up value therefore accumulates like a forward contract. Futures contracts are 'marked to market' and therefore futures are regarded as the most transparent derivative instruments.

## **(2) Options**

Options are traded both on exchanges and in the OTC market. Trading in options could be extended to any product that fluctuates in price. There are two types of options; the call options and the put options. While call options mean a party's right to purchase something at a fixed price (strike price) for the agreed-upon time, put options mean a party's right to sell something at a fixed price for the agreed-upon time. Swaps are OTC agreements to exchange cash flows at routine times over a specific time according to the agreed-upon terms. Some explain that a swap is a sequence of forwards.<sup>(1)</sup>

## **(3) Swaps**

Currency swaps involve the exchange of principal and interest in one currency for the same in another currency. It is considered to be a foreign exchange transaction and is not required by law to be shown on a company's balance sheet.

Interest rate swaps involves an agreement between two parties where one stream of future interest payments is swapped for another based on a specified principal amount. Interest rate swaps often exchange a fixed payment for a floating payment that is linked to an interest rate (most often the LIBOR). An entity will mostly utilize interest rate swaps to manage exposure to fluctuations in interest rates (interest rate risk).

## **2.4- Importance Of Derivatives**

Derivatives matter because they can reduce uncertainty for those for whom uncertainty is undesirable. Thus, businesses can use derivatives to mitigate exposure to unexpected tremors in the markets for key goods and key costs. For example, Hershey's can use derivatives to protect their business from volatile cocoa prices; Southwest Airlines can ensure that rising jet fuel prices won't ground their profits by entering into a

---

(1) See generally, Understanding Derivatives, Markets and Infrastructure, Federal Reserve Bank of Chicago (August 2013).

derivative contract. Companies and investors use derivatives to manage risk, discover prices, secure liquidity, and enhance the efficiency of the market.

Risk Management: derivatives' prices are determined based on their underlying assets, as the value of the derivatives is linked to the value of the underlying asset. For example, an investor may purchase a derivative contract whose value moves in the opposite direction to the value of an asset the investor owns. In this way, profits in the derivative contract may offset losses in the underlying asset. Accordingly, derivatives can be used to manage the risk of owning the asset. In case of decrease of the spot price, the related futures and options contract will also decrease. Speculation in the derivatives market allows an investor seeking to protect a position or an anticipated position in the spot market.

Detecting Prices: Derivative market represents an important source of information about prices. In particular, derivatives are frequently used to determine the price of the underlying asset. For example, the spot prices of the futures can serve as an approximation of a commodity price.

Securing Liquidity: Derivative markets have great liquidity. The transactions costs therefore, are lower. For instance, unlike securities markets that discourage shorting, selling short is much easier in derivatives.

Market Efficiency: Derivatives increase the efficiency of financial markets. By using derivative contracts, one can replicate the payoff of the assets. Therefore, the prices of the underlying asset and the associated derivative tend to be in equilibrium to avoid arbitrage opportunities.

### 3.CHAPTER TWO: DERIVATIVES IN ISLAMIC (SHARI'A)

To understand the impact of *Shari'a* on derivatives in Egypt we need first to elaborate on the primary sources of legislation in *Shari'a*, the main concepts of Islamic Finance, and the most relevant concepts of Islamic Finance that impact derivatives transactions. We can then examine the way that *Shari'a* looks at derivatives and whether *Shari'a* has provided alternatives to conventional derivatives. More details are provided hereinafter.

#### 3.1- Section One: The Main Sources Of Legislation In Shari'a

While the word Islam refers to the principles provided by the Muslims' holy book ("the *Qur'an*")<sup>(1)</sup>, which was dictated word for word by *Allah*<sup>(2)</sup> to his Prophet *Muhammad* (PB)<sup>(3)</sup>, the term *Shari'a* includes the rules-driven from the main sources of Islamic law.<sup>(4)</sup> These sources are of two types, primary sources, and secondary sources.<sup>(5)</sup> While the primary sources include both the rules incorporated in the *Qur'an* and the *Sunna*,<sup>(6)</sup> the secondary or supplementary sources include, most importantly, the *Ijma'* and the *Qiyas*.<sup>(7)</sup> Accordingly, *Qur'an* is the primary source of the *Shari'a*, working as the legal code and a reference for Muslims' behavior. The *Qur'an* is the highest source of the *Shari'a* with rules that are not arguable and cannot be modified by

---

(1) *Glossary of Islamic Legal Terms*, supra note 3, at 99 (the *Qur'an* is the Islamic holy book revealed to Prophet *Muhammad* (PB)).

(2) *Id.*, at 90 (*Allah* is an Arabic word which means God and refers to the Islamic name of the creator, the one and only deity); See also THE *QUR'AN* ("Say: He is Allah, the One; Allah, the Eternal, Absolute, He Begetteth not, nor is He begotten; And there is none like unto Him" (Quoting the meaning of the *Qur'an* 112)).

(3) *Irshad Abdal-Haqq*, *Islamic Law An Overview of Its Origin and Elements*, 7 *J. Islamic L. & Culture* 27 (2002).

(4) MASHOOD A. BADERIN, *INTERNATIONAL HUMAN RIGHTS AND ISLAMIC LAW*, 34 (Oxford U. Press Inc., N.Y.2003).

(5) M. Cherif Bassiouni & Gamal M. Badr, *The Shari'a: Sources, Interpretation, and Rule-Making*, 1 *UCLA J. ISLAMIC & NEAR E.L.* 135, 138-140 (2002) (Defining the *Shari'a* and introducing its sources and methods of interpretation and discussing the possibility of formulating new rules of law to meet the situations that were unknown during previous centuries and currently need to be both Islamic and modern).

(6) *Abdal-Haqq*, supra note 34, at 35 (the word *Sunna* is an Arabic word that refers to the sayings and deeds of Prophet *Muhammad* (PB) and it is referred to sometimes as *Hadit*); M. Cherif Bassiouni & Gamal M. Badr, *The Shari'a: Sources, Interpretation, and Rule-Making*, 1 *UCLA J. ISLAMIC & NEAR E.L.* 135, 139 (2002).

(7) *Glossary of Islamic Legal Terms*, supra note 32, at 99 (*Ijma'* is an Arabic word that literally mans the unanimous agreement or consensus of opinion and it refers to the consensus of opinion of the learned Muslims scholars. Also, *Qiyas* is an Arabic word that literally means analogy and it refers to the process of deducing legal decision on the basis of analogy by reference to the *Qur'an* and the *Sunna*); See also Adnan A. Zulfiqar, *Religious Sanctification of Labor Law: Islamic Labor Principles And Model Provisions*, 9 *U. PA. J. LAB. & EMP. L.* 421, 433-434 (2007) (discussing employees' rights in Islam starting with introducing the different sources of the *Shari'a* rules, explaining the role of Islam in shaping Muslim states, discussing the importance of having labor codes, elaborating on the presence of codes in the Muslim world, and developing a labor code from the sources of the *Shari'a*).

rules derived from any of the other sources of the *Shari'a*.<sup>(1)</sup>

*Sunna*,<sup>(2)</sup> refers to the practice of Prophet *Muhammad* (PB) taking the form of actions, oral statements, or consensus in action by others. Through the *Sunna*, Prophet *Muhammad* (PB) interpreted, explained, and completed principles revealed in the *Qur'an*. Hence, the *Sunna* cannot be contradictory to the *Qur'an*; otherwise, it is not a trusted *Sunna* and should not be considered. Where the *Qur'an* and the *Sunna* do not guide on specific issues, the supplementary sources of the *Shari'a* apply.<sup>(3)</sup> These sources include *Ijma'* and *Qiyas*. *Ijma'* means the convergence of opinion on a particular issue that is not provided by the *Qur'an* or the *Sunna* or that requires further interpretation.<sup>(4)</sup>

*Ijma'* is established through the unanimous opinions of the professional and knowledgeable Muslim jurists of each era.<sup>(5)</sup> In the end, any conclusion reached through *Ijma'* must conform with the primary sources of the *Shari'a*, the *Qur'an*, and the *Sunna*.<sup>(6)</sup>

*Qiyas* is a method of analogical reasoning that aims to govern a new situation with an old rule as long as this new situation is similar to that governed by the old rule.<sup>(7)</sup> *Qiyas* derives its reliability as a source of the *Shari'a* from the *Qur'an* and the *Sunna*.<sup>(8)</sup> To conclude, the analogy is a method of analysis by which a new conclusion is derived from an old rule applied to a similar issue. Bassiouni and Badr gave an excellent example of *Qiyas* that since the *Qur'an* prohibits liquors because of its intoxicating effect on the body, jurists forbid drugs as they have the same impact on the body.<sup>(9)</sup>

Following understanding the main sources of legislation in *Shari'a*,<sup>(10)</sup> a question arises in connection with the degree of adopting the *Shari'a* as a source of legislation in Muslim countries. Muslim countries, according to their reaction toward taking the *Shari'a* as a source of their legislations, are divided into three main categories.<sup>(11)</sup> Countries such as Lebanon and Turkey do not provide for the *Shari'a* as the primary source of their national laws. Thus, the Turkish Constitution provides that “[t]he Republic of Turkey is a democratic, secular and social state governed by the rule of law;

(1) Bassiouni & Badr, *supra* note 36, at 150.

(2) *Glossary of Islamic Legal Terms*, *supra* note 32, at 100 (*Sunna* is an Arabic word which literally means method and it refers to the second source of the *Shari'a* which is the sayings of Prophet *Muhammad* (PB)).

(3) *Glossary of Islamic Legal Terms*, *supra* note 32, at 54.

(4) Bassiouni & Badr, *supra* note 36, at 154.

(5) Abdal-Haqq, *supra* note 3, at 34.

(6) *Id.*

(7) *Id.*

(8) *Id.*

(9) Bassiouni & Badr, *supra* note 36, at 155.

(10) *See generally*, Reyadh Mohamed Seyadi, *Legal Aspect of Islamic Finance*, 29 Arab L.Q. 285 (2015).

(11) NISRINE ABIAD, *SHARIE'A, MUSLIM STATES AND INTERNATIONAL HUMAN RIGHTS TREATY OBLIGATIONS: A COMPARATIVE STUDY* 51 (Brit. Inst. of Int'l & Comp. L. 2008) (Islamic Law Countries are the countries where the majority of the populations are Muslims and where the state is a member of the Organization of the inter-governmental organization of Islamic Conference with its 57 states which represent the collective voice of the Muslim world).

bearing in mind the concepts of the public peace, national solidarity, and justice; respecting human rights; loyal to the nationalism of Ataturk, and based on the fundamental tenets outlined in the Preamble.”<sup>(1)</sup>

Some other countries such as Algeria, Yemen, and Jordan consider the *Shari'a* to be a vital but not exclusive source of their national laws.<sup>(2)</sup> For instance, the Yemeni Constitution provides that Yemen is an Arab Muslim and independent country; that Islam is the religion of the country and Arabic is its official language; that *Shari'a* is the primary source of legislation; and that inheritances must be granted per *Shari'a*.<sup>(3)</sup>

Finally, some countries such as Iran, Bahrain, and Saudi Arabia — recognize the *Shari'a* as the primary and exclusive source of their national laws.<sup>(4)</sup> For example, the Bahraini Constitution provides that: “[t]he Kingdom of Bahrain is a fully sovereign, independent Islamic Arab State whose population is part of the Arab nation and whose territory is part of the great Arab homeland.”<sup>(5)</sup> In addition, the Basic Law of 1992 of Saudi Arabia states that: “[t]he Kingdom of Saudi Arabia is a sovereign Arab Islamic state with Islam as its religion; God's Book and the Sunnah of His Prophet, God's prayers and peace be upon him, are its constitution, Arabic is its language, and Riyadh is its capital.”<sup>(6)</sup> Similarly, the Qatari Constitution provides that “Qatar is an independent sovereign Arab State. Its religion is Islam, and *Shari'a* shall be the main source of its legislations. Its political system is democratic. The Arabic Language shall be its official language. The people of Qatar are a part of the Arab nation.”<sup>(7)</sup>

## **3.2- Section Two: Understanding Islamic Finance and The Main Concepts of Islamic Finance Impacting Derivatives**

### **3.2.1- Money Theory in *Shari'a* and the Concepts of Islamic Finance**

Money theory in Islam “Moderation”, works as a midpoint between “Liberalism,” adopting the concept of absolute possession and disposal of money, and “Totalitarianism,” eliminating the nature of human beings to possess and invest.<sup>(8)</sup> The

---

(1) TÜRKIYE CUMHURİYETİ ANAYASASI OF 1961[Constitution] (Turk.) (translated by Kemal Gozler); see also Kemal Gozler, *Turkish Constitutional Law Material in English*, <http://anayasa.gen.tr/english.htm> (last updated Feb. 9, 2009).

(2) ABIAD, *supra* note 45, at 51.

(3) TRANSLITERATED TITLE OF YEMENI CONSTITUTION May 16, 1991, as amended Sept. 29, 1994, Feb. 10, 2001, arts. 1-3, 23 (Yemen); see also Republic of Yemen Supreme Commission for Elections and Referendum, *The Constitution of the Republic of Yemen*, available at <http://www.scer.org.ye/> (last visited Oct. 8, 2010).

(4) ABIAD, *supra* note 45, at 51.

(5) BAHRAIN [Constitution] 2002, no. 17, art. 1; see also Department of Legal Affairs, *Bahrain Kingdom Constitution*, [http://www.servat.unibe.ch/icl/ba00000\\_.html](http://www.servat.unibe.ch/icl/ba00000_.html) (last visited Dec. 11, 2011).

(6) SAUDI ARABIA [Constitution] 1992, art. 1; see also Saudi Arabia Constitution, [http://www.servat.unibe.ch/icl/sa00000\\_.html](http://www.servat.unibe.ch/icl/sa00000_.html) (last visited Dec. 11, 2011).

(7) ARTICLES OF THE DRAFT CONSTITUTION OF QATAR [Constitution] 2003, art. 1; see also Embassy of the State of Qatar in Washington DC, *Constitution of Qatar*, [http://www.servat.unibe.ch/icl/qa00000\\_.html](http://www.servat.unibe.ch/icl/qa00000_.html) (last visited Oct. 8, 2010).

(8) Muhammad Mostafa Emarah, *Money Theory in Islam*, <http://www.dr-emara.com/Articles/50.pdf> (the Cite is available only in Arabic) (Author translation from Arabic to English).

core of Moderation theory is the idea of *Khilafa*.<sup>(1)</sup> *Khilafa* means that a human being is a successor of Allah and accordingly, his life is “a test of the worth of men in the eyes of Allah”.<sup>(2)</sup> Hence, the ownership of money reverts originally to Allah and people are appointed as successors/trustees to use this money by having nominal ownership. The Muslim writer, Mahmoud Shaltot, explained the fruits of this philosophy by saying that: “The benefits of money must be for all the society to satisfy their needs. Therefore, money is from and to the whole nation with all of its members who serve one with deep notions of social solidarity of the Islamic nation as one body; if any organ suffers, its neighbors would hurry to cure it. As an application to the *Khilafa* principle, and considering the Qur’an as its constitution, Saudi Arabia provides in its Constitution: “Ownership, capital and labor are basic fundamentals of the kingdom's economic and social entity. They are private rights that perform a social function in conformity with Islamic Shari'a.”

Having this understanding in mind, Islam has a very special obligatory charity system called *Zakah*, which to a certain extent is similar to the modern tax system. *Zakah* is a wealth tax focused on compulsory charitable giving for specially designated groups in society. The idea of *Zakah* illustrates how Islam distributes income and wealth in the society to guarantee social security for members in order to maintain business activity on just and ethical lines. Williams and Zinkin argue that the system of *Zakah* applies to both Muslims and non-Muslims who are in need, as Islam allows the latter that are in need to share the wealth of Muslims.<sup>(3)</sup> In their argument Williams and Zinkin refer to the Prophet saying: “The Head of State is the Guardian of him who has nobody to support him.”

Based on the above, it seems that *Shari'a* has a very unique understanding of money as a tool to develop the social welfare of a society. This necessarily implies a unique way of dealing with trade. Thus, trade in Islamic law is not about achieving profits; rather it aims at promoting the social welfare of the whole society. It is now understandable why trade in certain types of items, such as tobacco and alcohol, is prohibited under the *Shari'a*. This is because from the Islamic viewpoint alcoholic drinks are not useful to people due to its intoxicating effect.<sup>(4)</sup> As a result, the *Shari'a* forbids drinking and trading in alcoholic drinks as it does not qualify as *mal*. However, it is imperative to note that the prohibition does not affect all such products; where items are traded for other purposes, such as alcohol used for scientific research, the *Shari'a* is not so restrictive. In short, the purpose and use of an item is just as important as its ingredients.

Moreover, although narcotic drugs are not explicitly mentioned in the *Qur'an*, it is forbidden by virtue of analogy, which is another source of rules derived from Islamic law. Like alcohol, narcotic drugs are not useful and do not qualify as *mal* except for

(1) *Glossary of Islamic Legal Terms*, *supra* note 32, at 89 (*Khilafah* is an Arabic word meaning succession.).

(2) Geoffrey Williams & John Zinkin, *Islam and CSR: A Study of the Compatibility Between the Tenets of Islam and the UN Global Compact*, 51 J. BUS. ETHICS 520 (2009).

(3) *Id.*, at 526.

(4) Bassiouni & Badr, *supra* note 36, at 156.

scientific research or where used for medical purposes. One should therefore expect a fierce war against the illegal drug trade in Egypt, which is absolutely outlawed but is practiced on large scale due to the substantial failure of police to enforce the law, particularly in the period following the revolution.

Tobacco trading is another complicated issue. It does not qualify as *mal* in Islam because it is forbidden: As a general rule, anything that negatively affects a person's health is forbidden.<sup>(1)</sup> Therefore, the tobacco industry and trade is prohibited under Islamic law. Yet, this conflicts with the situation in Egypt — home to millions of smokers — where the tobacco industry is quite successful. As a result, it is not expected that tobacco will be banned since most smokers are addicted but it is reasonable to expect restrictions on smoking, particularly in public places. Nevertheless, according to some Islamic scholars, the prohibition of such businesses aims to protect life and health by avoiding their harmful effects on society.<sup>(2)</sup>

### 3.2.2- Second: The Mains Concepts of Islamic Finance Impacting Trading in Derivatives

*Shari'a* has its concept of trade<sup>(3)</sup>. The word *Mal* in *Shari'a* refers to objects that can be owned and traded among people.<sup>(4)</sup> An object has a value only if it is useful for people, and the perspective of Islamic law informs this finding. Accordingly, some objectives that can otherwise be subject to property rights and traded in comparative legislations will be forbidden under Islamic law. This means that trade in Islamic law societies is not about achieving profits; rather, it aims at promoting the social welfare of the whole community.<sup>(5)</sup>

Accordingly, trade in certain types of items, such as tobacco and alcohol, is prohibited under *Shari'a*.<sup>(6)</sup> This is because, from the Islamic viewpoint, alcoholic drinks are not useful to people due to its intoxicating effect.<sup>(7)</sup> As a result, *Shari'a* forbids drinking and trading in alcoholic drinks as it does not qualify as *mal*. However, it is imperative to note that the prohibition does not affect all such products; where items are traded for other purposes, such as alcohol used for scientific Research, *Shari'a* is not so restrictive. In short, the purpose and use of an item are just as important as its

---

(1) The Islamic Jurisprudence derives evidence from the Qur'an and the Sunnah to that effect. The *QUR'AN* provides: "Those who follow the Messenger, the unlettered prophet, whom they find written in what they have of the Torah and the Gospel, who enjoins upon them what is right and forbids them what is wrong and makes lawful for them the good things and prohibits for them the evil and relieves them of their burden and the shackles which were upon them. So they who have believed in him, honored him, supported him and followed the light which was sent down with him - it is those who will be the successful." (Quoting the meaning of the *Qur'an* 7:157).

(2) Williams & Zinkin, *supra* note 59, at 523.

(3) *Glossary of Islamic Legal Terms*, *supra* note 32, at, 97.

(4) FATHI AL-DURAINI, *HAQQ AL-IBTIKAR FI AL-FIQH AL-ISLAMI AL-MUQARAN* [THE RIGHT TO PATENT IN THE COMPARATIVE ISLAMIC JURISPRUDENCE] 23-39 (1984).

(5) Williams & Zinkin, *supra* note 59.

(6) *Id.*

(7) Bassiouni & Badr, *supra* note 36, at 156.

ingredients.

Moreover, although narcotic drugs are not explicitly mentioned in the *Qur'an*, it is forbidden by virtue of analogy, which is another source of rules derived from Islamic law. Like alcohol, narcotic drugs are not useful and do not qualify as *Mal* except for scientific Research or were used for medical purposes. One should, therefore, expect a fierce war against the illegal drug trade in Egypt, which is outlawed but is practiced on a large scale due to the substantial failure of police to enforce the law, particularly in the period following the revolution.

Tobacco trading is another complicated issue. It does not qualify as *Mal* in Islam because it is forbidden: As a general rule, anything that negatively affects a person's health is forbidden.<sup>(1)</sup> Therefore, the tobacco industry and trade is prohibited under Islamic law. Yet, this conflicts with the situation in Egypt — home to millions of smokers — where the tobacco industry is quite successful. As a result, it is not expected that tobacco will be banned since most smokers are addicted, but it is reasonable to expect restrictions on smoking, particularly in public places. Nevertheless, according to some Islamic scholars, the prohibition of such businesses aims to protect life and health by avoiding their harmful effects on society.<sup>(2)</sup>

### 3.2.2.1- Interest Rate in Shari'a

In Islam, usury, called *Riba*, is strictly prohibited.<sup>(3)</sup> *Riba* means “increase,” and it refers to “the premium paid by the borrower to the lender along with the principal amount as a condition for the loan or an extension in its maturity.”<sup>(4)</sup> This is prohibited in Islam for “the moral, social and economic well-being of society since it creates profit without work, and it does not share the risk between the lender and the borrower.” In this context, the *Qur'an* provides:

That they took usury, though they were forbidden; and that they devoured men's wealth wrongfully; We have prepared for those among them who reject faith a

(1) The Islamic Jurisprudence derives evidence from the *Qur'an* and the *Sunnah* to that effect. The *QUR'AN* provides: “Those who follow the Messenger, the unlettered prophet, whom they find written in what they have of the Torah and the Gospel, who enjoins upon them what is right and forbids them what is wrong and makes lawful for them the good things and prohibits for them the evil and relieves them of their burden and the shackles which were upon them. So they who have believed in him, honored him, supported him and followed the light which was sent down with him - it is those who will be the successful.” (Quoting the meaning of the *Qur'an* 7:157).

(2) Williams & Zinkin, *supra* note 59, at 523.

(٣) منذر قحف: أساسيات التمويل الإسلامي، الطبعة الثانية، ٢٠١٥، ص ١٩٨

(4) See J. Michael Taylor, *Islamic Banking- the Feasibility of Establishing an Islamic Bank in the United States*, 40 Am. Bus. L.J. 385, 387 (2003) (Discussing the importance of considering Islamic banking practices in the United States the, starting with introducing the effect of Islam on Muslims' life including their financial affairs, elaborating on the characteristics of Islamic finance and then searching the possibilities of establishing Islamic banking institutions in the United States). According to Taylor, the Islamic alternative method to *Riba* is the *Qrde Hasan* (benevolent financing) which means that the lender provides the borrower the loan free of charge as if he is providing financial assistance and in return the borrower is committed to repay the loan, provide a collateral if required, and pay some small administrative charges sometimes.

grievous chastisement.”<sup>(1)</sup> But Allah hath permitted trade and forbidden usury. Those who after receiving admonition from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge), but those who repeat (The offense) are Companions of the Fire: they will abide therein (forever).<sup>(2)</sup>

The prohibition of the *Riba* led Islamic banking institutions to make use of supervisory boards that provide religious guidance for the bank’s activities.<sup>(3)</sup> This allowed the development of some tools that belong only to Islamic Finance, which are *Murabaha*, *Ba’i Bithaman Ajil*, *Ijara*, *Musharaka*, *Mudaraba*, and *Qarde Hasan*.<sup>(4)</sup>

In brief, the *Murabaha*<sup>(5)</sup> is an installment sale agreement by which the bank works as an intermediate, buying goods and then selling them to the customer at the acquisition cost (in addition to some profits paid in installments).<sup>(6)</sup> Hence, the bank owns the goods before the ownership is transferred to the customer.<sup>(7)</sup>

In *Ba’i Bithaman Ajil* (“deferred payment financing”), the bank, at the request of its customer, buys certain assets and then resells them to the customer on a deferred payment schedule.

*Istisna* is similar to the *Ba’i Bithaman Ajil*, but where the bank pays a contractor to complete specific work for the customer’s benefit.

*Ijara* is a rent-to-own agreement encompassing a leasing arrangement whereby the bank buys the goods and then leases them to customers, a tool that is often used for equipment.<sup>(8)</sup>

*Musharaka* is a kind of partnership agreement that allows the bank to provide its

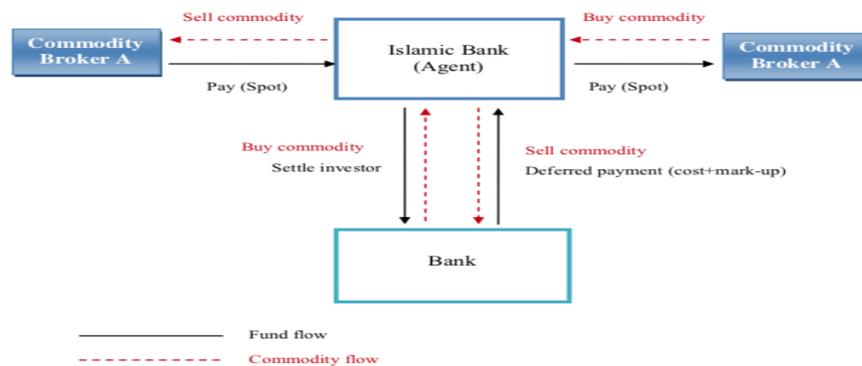
(1) Quoting the meaning of the *Qur’an* 4:161.

(2) Reyadh Mohamed Seyadi, *Legal Aspect of Islamic Finance*, 29 Arab L.Q. 285 (2015), P-287

(3) Taylor, *supra* note 72, at 393-99.

(4) Reyadh Mohamed Seyadi, *Legal Aspect of Islamic Finance*, 29 Arab L.Q. 285 (2015), P 289

(5) The International Monetary Fund has issued the following diagram to explain the internal *Murabaha* transaction, See the IMF Working Paper on Monetary Policy in the Presence of Islamic Banking, by Mariam El Hamiani Khatat, 2016, p. 34



(6) Roberta Mann, *Is Shari'ah's Castle Deductible?: Islam and the Tax Treatment of Mortgage Debt*, 17 WM. & MARY BILL RTS. J. 1139, 1148 (2009)

(7) Taylor, *supra* note 72, at 393-99.

(8) Mann, *supra* note 78, at 1148.

customers with the required capital on condition that the bank shares the customer's profits and losses. Customers also usually contribute small shares of capital, effort, and know-how.

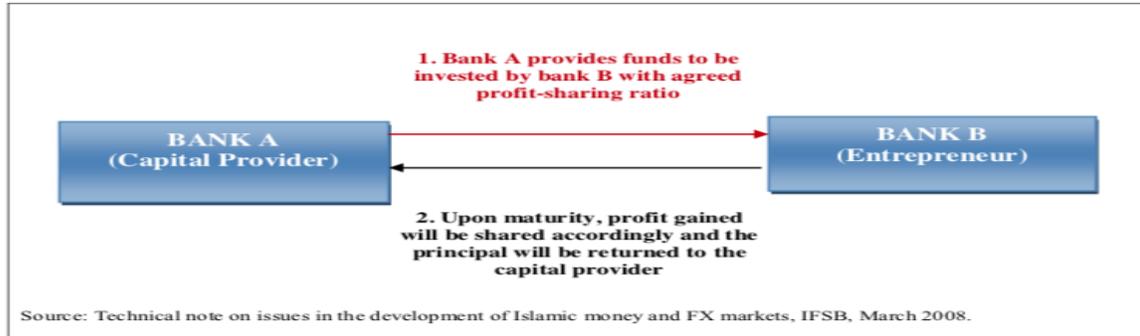
In *Mudaraba*,<sup>(1)</sup> the bank provides the entire amount of money, while customers only provide know-how.<sup>(2)</sup> *Qarde hasan* allows banks to offer interest-free loans in return for an unconditional commitment to pay the bank back after providing collaterals.

### 3.2.2.2- Risk in Shari'a

The concept of *Gharar* prohibits,<sup>(3)</sup> as a general rule, those transactions whose subject-matter is not available at the time of contracting to protect consumers.<sup>(4)</sup> Similarly, a transaction that involves significant uncertainty and risk is not permitted. For instance, this rule prohibits gambling and other games of chance.<sup>(5)</sup> This is because, in Islam, wealth must be acquired by working and benefiting society. Gambling does not qualify as work because it is a game of chance: A lucky person may acquire massive wealth, while an unlucky person may lose all his wealth. Accordingly, gambling redistributes wealth based on pure chance.<sup>(6)</sup>

Gambling also involves social dangers since it can be addictive. A gambler who

(1) The International Monetary Fund has issued the following diagram to explain the internal *Murabaha* transaction, See the IMF Working Paper on Monetary Policy in the Presence of Islamic Banking, by Mariam El Hamiani Khatat, 2016, p. 33



(2) Taylor, *supra* note 72, at 393-99.

(٣) منذر قحف: أساسيات التمويل الإسلامي، الطبعة الثانية، ٢٠١٥، ص ٢٢٦

(4) Haider Ala Hamoudi, *The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law*, 56 AM. J. COMP. L. 423, 441 (2008).

(5) The *QUR'AN* provides: "They ask you about wine and gambling. Say, In them is great sin and [yet, some] benefit for people. But their sin is greater than their benefit." And they ask you what they should spend. Say, The excess [beyond needs]. Thus, Allah makes clear to you the verses [of revelation] that you might give thought." (Quoting the meaning of the *Qur'an* 2:219). Another verse of the *Qur'an* provides: "O you who have believed, indeed, intoxicants, gambling, [sacrificing on] stone alters [to other than Allah], and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful. Satan only wants to cause between you animosity and hatred through intoxicants and gambling and to avert you from the remembrance of Allah and from prayer. So, will you not desist?" Id, at (5:90-91).

(6) See generally, Reyadh Mohamed Seyadi, *Legal Aspect of Islamic Finance*, 29 Arab L.Q. 285 (2015).

achieves a big profit on one occasion may be tempted to play repeatedly to earn money without spending much effort. Similarly, a gambler who loses money may feel compelled to do so again to recoup his losses. Regardless of their reason for doing so, the more gamblers play, the more they lose. The real winners are those lucky people in whose hands the wealth concentrates. Furthermore, for many people, incentives to gamble may exceed incentives to work and benefiting society.<sup>(1)</sup>

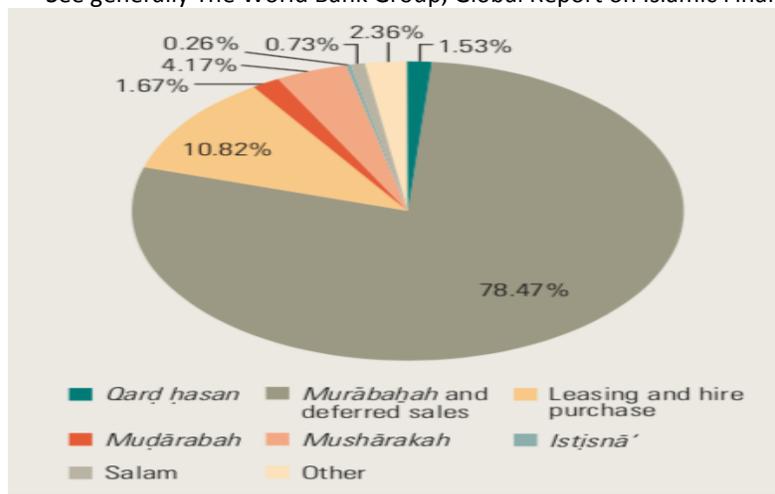
### 3.3- Section Three: Derivatives in Shari'a Vs. Conventional Derivative

Islamic Finance recognizes alternative tools to derivatives. These include: i) *Salam* (Prepaid Forward Sale), ii) *Istisna* (Commission to Manufacturer), iii) *Urban* (call option), iv) *Khiyar al-shart* (Options). In addition, some scholars argue that *Shari'a* has recognized swaps as well.<sup>(2)</sup>

#### 3.3.1- Salam (Prepaid Forward Sale)

The general rule in relation to sales in Islam is the prohibition of the sale of nonexistent properties and sale of properties that are not in the seller's possession at the time the sale is concluded.<sup>(3)</sup> By way of exception, Prophet Muhammed (PB) improved specific type of sale where sellers at that time concluded one to three years forward sale of fruits with prices prepaid at the time of the conclusion of the contract.<sup>(4)</sup> That time, the Prophet approved this type of sale on certain conditions including mainly: i) considering the general prohibition of trade in certain types of items, such as tobacco and alcohol, ii) the subject matter of *Salam* is fungible movable objects which are also

(1) Islamic modes of finance by Islamic banks are summarized by the World Bank to include the following, See generally The World Bank Group, Global Report on Islamic Finance, 2016, P. 69



(٢) منذر قحف: المرجع السابق، ص ٤٢٣

(٣) عبد الرحيم عبد الحميد الساعاتي: المرجع السابق، ص ٥٧

(٤) منذر قحف: المرجع السابق، ص ٧٦

specified in the genus, type, quality, and quantity, iii) full payment of the price has to take place at the time of conclusion of the contract to avoid any speculation in the future.<sup>(1)</sup> The rationale behind these conditions is to avoid the element of speculation since the *Salam* seller benefits if the spot price at delivery is lower and buyer benefits if it is higher.<sup>(2)</sup>

It is worth noting here that it is not allowed to sell the subject of *Salam* before its receipt. According to Islamic scholars, this guarantees to avoid the *Gharar*. In return, forward contracts where price and delivery are stipulated as future liabilities are not accepted under *Salam*. *Salam* is the closest Islamic tool to the conventional forward contract. Thus, the purchaser pays the money and is promised to receive a particular object at a specified future date, the proper *Salam* price is today's spot price. However, the price in *Salam* is usually lower than the spot price. Unlike a conventional forward, where no money changes hands until the contract's expiration, the *Salam* buyer's capital is immediately paid over, exposing the buyer to the risk that the seller will not deliver in the future. A discount on the spot price would compensate for this credit risk.<sup>(3)</sup>

### 3.3.2- Urban or Down-Payment Sale (call option)

*Urban* means a down payment from a potential buyer to a prospective seller toward the purchase of a particular property. If the buyer decides to complete the transaction, the *Urban* counts towards the total price; otherwise, the seller forfeits the *Urban*. Similar to a call option, *Urban* shall be fixed term to avoid making an indefinite contract.

### 3.3.3- Khiyar Al-shart (Option)

In *Khiyar Al-shart*, one party receives the choice to confirm or undo a contract. Thereby parties may protect themselves against not only movements in the underlying asset price but also events that may be completely unrelated to the underlying asset. For example, "an airline company may purchase by *Istisna'* one hundred planes for \$5 million each on a date five years in the future, giving the manufacturer an option, which it agrees to exercise only if the airline does not source all of its intervening plane requirements from the manufacturer."

### 3.3.4- Swaps

Some scholars and professionals argue that *Shari'a* has also recognized swaps in its own ways. The challenge in the Islamic finance is to generate cash flows, which are similar to a conventional currency swap, but within a *Shari'a*-compliant framework. To this end, one can use reciprocal *Murabaha* transactions, whereby the parties enter into

(1) See generally Muhammad al-Bashir Muhammad Al-Amine, Risk Management in Islamic Finance, An Analysis of Derivatives Instruments in Commodity Markets, BRILL (2008) PP 44 to 78

(2) El-Gamal, Islamic Finance, Law, Economics, and Practice [Cambridge University Press], 2006 pp 81-82

(3) Bashar H. Malkawi, Financial Derivatives in the West and in Islamic Finance: A Comparative Approach, 211 the Banking Law Journal, Volume 128, Jan 2011

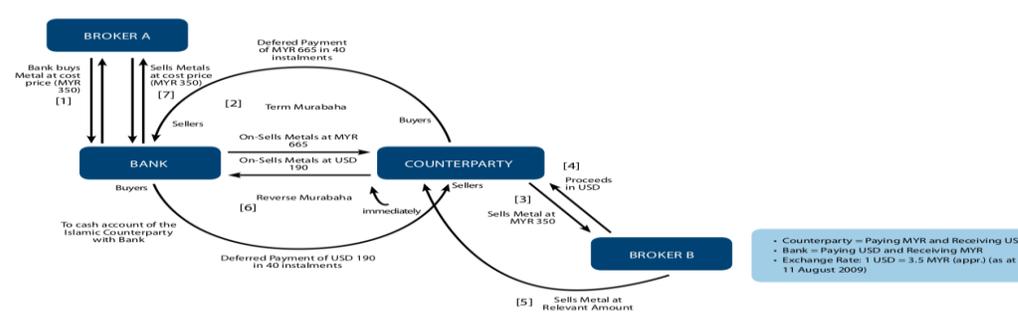
*Murabaha* contracts (as a Primary Term) and then into a Secondary (Reverse) *Murabaha* to sell *Shari'a*-compliant assets to each other for immediate delivery but on deferred payment terms.<sup>(1)</sup> In other words, the first step is that a bank sources commodity from a broker (Broker A) at Cost Price (step one) and then sells these commodities to the swap counterparty (step two). The value of commodities bought and on-sold are denominated in currency. Meanwhile, the payment by the counterparty for the commodities purchased under the Primary *Murabaha* is on a deferred basis, in instalments payable on pre-agreed payment dates. Each instalment represents a portion of the pre-agreed profit element, with the exception of the final instalment, which also includes payment in full of the Cost Price. The commodities are delivered on the date on which the transaction is entered into. On receipt of the commodities, the Counterparty promptly sells the commodities to a different commodity broker (Broker B) to generate a Currency B (US\$) payment (step 3 and step 4).

The Secondary (Reverse) *Murabaha* starts with purchasing commodities from Broker B and makes payment in Currency B (step 5), and immediately sells these commodities to the Bank for immediate delivery (step 6). The commodities sold under the Secondary *Murabaha* should have the same value as those purchased under the Primary *Murabaha*. Also, the payment by the Bank is on a deferred basis in instalments in Currency B, such instalments to represent a portion of the pre-agreed Secondary *Murabaha* profit element. Instalment payment dates under the Secondary *Murabaha* mirror those under the Primary *Murabaha*. Finally, upon the receipt of the commodities the Bank immediately sells these to Broker A (step 7) to generate a Currency A payment. The same concepts could be followed in profit rate swap.

### 3.3.5- Istisna (Commission to Manufacturer)

In *Istisna*, the buyer pays the price to the seller to manufacture him particular objects.<sup>(2)</sup> *Istisna* is also an alternative to forwards. Nevertheless, the main differences between *Istisna* and *Salam* are mainly that in *Istisna* the buyer does not have to pay the price (manufacturing fees) once in advance. Rather he can pay in the form of installment. Moreover, the subject matter of *Istisna* is *nonfungible*, unlike *Salam*. The seller of an *Istisna* 'contract in an Islamic arrangement usually cannot do anything with

(1) See Global Islamic Finance Report 2010, Islamic Derivative Theory and Practice, P. 136.



(2) عبد الرحيم عبد الحميد الساعاتي: المرجع السابق، ص ٦٨

the progress payment except use it for the production of the goods. He cannot use it for hedging or other market purposes, such as investing in other goods.<sup>(1)</sup> Moreover, because the items are customized, the seller cannot properly hedge (achieve a riskless contract) by entering into another offsetting contract.<sup>(2)</sup>

---

(١) منذر قحف: المرجع السابق، ص ٧٨

(2) Supra note 93, Malkawi.

#### 4.CHAPTER THREE: THE LEGAL REGULATION OF DERIVATIVE IN EYPT COMPARED TO THE ARAB COUNTRIES' LEGAL SYSTEMS

The recognized need for increased risk management across the Arab region resulted in the development, to a certain extent, of conventional and Islamic derivatives market in some countries. Nevertheless, such growth has always been hindered by a lack of legislation. In most Arab countries, derivatives trading is a commercial banking activity and accordingly regulated under banking laws. Examples include Qatar and Bahrain. In other countries, derivatives are capital market activities and accordingly concluded under capital market law. Examples include Egypt and Morocco.

In Egypt, derivatives market is still small. Egypt has been witnessing a lack of legislation on derivatives.<sup>(1)</sup> The Egyptian Capital Market Law No. 95/1992 was amended by the Law No. 17/2018, which was published in the Official Gazette on 14 March 2018. The Amending Law No. 17/2018 brought significant amendments to capital market activities in Egypt, mainly: i) regulating the issuance and trade-in *Sukuk*, ii) authorizing the establishment of exchange to trade in derivatives, iii) simplifying public offering procedures, and iv) updating penalties for capital market crimes. Following the issuance of the Amending Law No. 17/2018, the Prime Minister Decree No. 2479/2018 was issued to amend the relevant Executive Regulation (previously issued by the Minister of Economy and Foreign Trade Decree No. 135/1993), which was published in the Official Gazette on 22 November 2018.

Moreover, the Board of the FRA (Egyptian Financial Regulatory Authority)<sup>(2)</sup> has issued the Decree No. 33/2019 on the Licensing Conditions and Procedures for Derivatives Exchange. Similarly, the FRA Chairman's Decree No. 371/2019 issued a standard Articles of Association that has to be adopted by any company applying for a license to establish the Derivatives Exchange. Finally, the Board of the FRA has issued Decree No. 49/2019 on the Requirements and Conditions of Brokerage Activities in the derivatives market.

The common feature about derivatives market whether in Egypt or the rest of Arab countries is that derivatives are not appropriately tested since the derivatives market is a kind of recent market. The other common feature is that in most countries, if a derivative transaction is purely speculative, there is always a probability that courts

---

(١) أحمد إبراهيم شبل حجازي: الأبعاد القانونية للرقابة على التداول في بورصة الأوراق المالية المصرية (رسالة

للحصول على درجة الدكتوراه تحت إشراف أ.د سميحة القليوبي)، ٢٠١٧، ص ٧٠ - ٧٣

(2) The Egyptian Financial Regulatory Authority is the authority responsible for supervising and regulating non-banking financial markets and instruments, including capital market, insurance activities, financial leasing activities, factoring and securitization activities, and mortgage finance activities. The FRA was established by virtue of the Law No. 10/2009 and assigned with the role of not only regulating the above activities but also ensure the market stability and competitiveness, reducing risks resulting from lack of coordination. More information on the FRA could be found on its official website: [http://www.fra.gov.eg/content/efsa\\_en/efsa\\_pages\\_en/main\\_efsa\\_page\\_en.htm](http://www.fra.gov.eg/content/efsa_en/efsa_pages_en/main_efsa_page_en.htm)

will adopt a conservative approach. Particularly, limited guidance from the civil and commercial codes exist, which implies that there is a difficulty in predicting court interpretation of a derivative transaction and its enforceability.<sup>(1)</sup> Some countries, such as Egypt, Morocco, UAE, Bahrain, Kuwait, have issued laws on derivatives. Some other states do not regulate derivatives had derivatives mentioned in one of their laws without details, such as Qatar. Finally, some countries are silent, with no active market on derivatives. More details are provided hereinafter.

#### **4.1- Section One: Derivatives In Egypt**

The scope of application of the Amending Law No.17/2018 and Decree No. 2479/2018 include only *exchange-traded* derivatives, rather than *Over-The-Counter* derivatives. Thus, the Law comprises, explicitly, three categories of derivatives, namely, futures, options, and swaps. However, the law does not include substantive rules on the types of derivatives or their working dynamics, rather their definitions.

The Law mainly addresses formal issues related to the establishment of the potential exchange where derivatives are traded. According to the Law, this exchange shall be an Egyptian joint stock company that meets all the requirements stated by the Law. Alternatively, this exchange could be the Egyptian Stock Exchange (EGX)<sup>(2)</sup>. In the same context, the Law addresses, in detail, the rules of licensing brokerage companies in the derivatives market.

In addition, the Law does not regulate clearing and settlement; rather, it refers to both processes to the Central Depository Law No. 93/2000 and its executive regulation. Though the Law explains that derivatives value could be driven from assets, securities, or commodities, the Law has a particular set of rules on commodities as underlying assets. Thus, the Law regulates, in detail, the establishment of a unit entrusted with monitoring warehouses for commodities.

##### **4.1.1- First: Scope of Application and Types of Derivatives Regulated Under The Egyptian Law**

According to Article 26 *bis* of Egypt Law No. 17/2018, Derivatives Exchange is an exchange established to trade the contracts that drive their value from an underlined asset, securities, commodities, whether in the form of futures, options, swaps, or any other similar standard contracts. Accordingly, the scope of application of the law includes future contracts, option contracts, and swap contracts. It is understood that forwards are excluded from the scope of application of the Law since the Law regulates only *exchange-traded* derivatives rather than *Over-The-Counter* (OTC) derivatives. However, in the past, an FRA Board decree (Decree No. 17/2017 dated 8 February 2017) used to regulate trading in OTC securities. The intention to regulate OTC derivatives is not clear yet.

According to Article 26 *bis* of Egypt Law No.17/2018, futures are standard

(1) K&L Gates LLP, An Update on Worldwide Derivatives and Related Regulatory Initiatives (2014)

(2) More information about the EGX could be found through EGX official website available at [http://www.egx.com.eg/en/Chairman\\_Message.aspx](http://www.egx.com.eg/en/Chairman_Message.aspx)

contracts to purchase or sell assets, commodities, securities, or other financial instruments at a specified time in the future and a predetermined price --as approved by the FRA. Future standard contracts shall be issued by the potential Derivatives Exchange, once it is established. The standard agreements have to reflect the specifications, quality, quantity, and place of delivery.

In the same context, options contracts mean contracts with similar conditions to futures as long as they grant the buyer the right to purchase or sell specified amounts of commodities, securities, or other financial instruments, at a specified time, and predetermined price. The same Article requires swaps contracts to reflect the price, date of exchange, and termination date.

#### **4.1.2- Second: The Regulatory Authority and Derivatives Exchange**

The relevant regulatory authority with monitoring derivations activities is the FRA. In addition, Egypt Law No.17/2018 provides for the establishment of Derivatives Exchange where derivatives could be traded in, under the auspices of the FRA. Articles 26 of Egypt No.17/2018 and Article 109 of the Decree No. 2479/2018 grant the FRA Board the right to license the establishment of a private Exchange, which must take the form of a joint-stock company, to trade in the various types of derivatives, being futures, options, swaps, or similar standardized contracts.

The establishment of such an Exchange shall take place per rules, conditions, and licensing procedures by the FRA as included in the Decree No. 33/2019, and Decree No. 371/2019.

Alternatively, Egypt No.17/2018 and the Decree No. 2479/2018 authorize the EGX to establish its own joint-stock company to trade in derivatives. Moreover, the EGX could also trade in derivatives related to its listed securities directly without establishing any company.

##### **4.1.2.1- Alternative One: The Establishment of A Private Derivatives Exchange**

In case of establishing a new Exchange by a private company, the following shall apply:

Capital: the issued and paid capital of the joint-stock company shall not be less than 20,000,000 Egyptian Pounds (or its equivalent in foreign currency). Also, a security equivalent to 5% of the issued capital shall be paid.

Venue: the main headquarter of the joint-stock company shall be inside Egypt.

Shareholders: at least 75% of the shareholding capital shall be contributed by financial institutions, other exchanges, or companies licensed to operate within capital markets. All founders, board members, executives, and employees of the joint-stock company (possible exchange) shall enjoy a good reputation (excluding anyone that has been sentenced in an infamous crime in the five years preceding the submission of the licensing request.

Board: the board composition shall last for three renewable years considering corporate governance rules listed in the FRA's Board Decree No. 107/2016.

Application: to be licensed by the FRA to carry out the activities of trading in derivatives in Egypt, Article 26 *bis* (2) of Egypt Law No.17/2018 requires the applying company to submit to the FRA the following documents, in addition to any other

materials or information requested by the FRA:

- application request (adopting the standard articles of association issued by the FRA as per the Decree No. 371/2019);
- types of derivatives contracts that will be traded in;
- the method according to which the potential exchange would obtain the relevant values or prices of the related assets;
- the financial criteria that will be applied by the possible exchange to set a balance between stakeholders;
- a description of implementation procedures till clearance takes place;
- trading regulation;
- standard contracts that the potential exchange would adopt;
- the procedures followed by the possible exchange in case of breach of any of membership rules or trading rules within the exchange;
- a copy of the code of ethics that clarifies the obligations or the board members and the employees; and
- fees determined by the FRA Board (with a maximum ceiling of 100,000 Egyptian pounds).

Technical requirements: according to the Decree No. 33/2019, the exchange joint-stock company shall meet some other requirements, including the most important, an electronic system for trading, a guiding code for procedures to secure transparency, having an electronic connection between the relevant stakeholders (FRA, clearance and settlement company, and brokers).

Licenses Amendment and Suspension: Once the license is issued by the FRA to the exchange, the exchange cannot amend any of its regulations, rules, procedures, or standard contract, except after obtaining the consent of the FRA. Also, the exchange is required to notify the FRA with any changes that might affect its ability to carry out its activities.

Moreover, Articles 118 – 119 *bis* (1) of the Decree No. 2479/2018 regulate the situation where the exchange – voluntarily -- requires the suspension of its activities. The suspension takes place following the submission of a request by the board of the exchange and after obtaining the approval of three fourth of the extraordinary general assembly of the exchange. The same Articles provide for attaching some data to the suspension request, including reasons for the suspension, fiscal clearance certificate, a statement with all financial and non-financial pending obligations, a list of any ongoing lawsuits for or against the exchange, financial auditors report, and others. The FRA's decision regarding suspension requests may take one of two forms:

- approving suspension of the exchange's operation after setting a date for suspension; or
- requiring the exchange to continue operating until its activities are transferred to the EGX or another licensed exchange (within maximum one year).

The exchange is required to publish the FRA's final decision according to the Board of the FRA. The exchange is obliged to fulfill any requirements by the FRA for suspending its activities.

#### **4.1.2.2- Alternative Two: Trading in Derivatives by the EGX**

In case the EGX establishes a new joint-stock company to trade in derivatives or trade-in derivatives related to its listed securities, the following shall apply:

- meeting the same technical requirements mentioned above;
- allocating 20,000,000 Egyptian Pounds;
- doing the necessary technical and administrative amendments to separate between its activities in securities and its activities in derivatives; and
- establishing a committee to monitor the activates.

#### **4.1.3- Third: Trading and Clearing Rules**

According to Article 126 *bis* (3) of Egypt Law No.17/2018, trading in derivatives shall take place per the terms and conditions set by the FRA. The FRA did not issue trading rules yet. In addition, Article 126 *bis* (5) of Egypt Law No.17/2018 provides that clearing shall take place by a specialized company, in accordance with the Central Depository Law No. 93/2000 and its executive regulation.<sup>(1)</sup> We refer here to the Central Depository Law No. 93/2000, since it has a context from the subject matter of this publication.

#### **4.1.4- Fourth: Brokerage Rules**

Brokerage in the derivatives market is regulated by Articles 126 *bis* (9 – 17) of Egypt Law No.17/2018 and the Decree No. 49/2019, as per the following rules:

Licensing Brokerage Activities: to be licensed to carry out brokerage activates, a company shall meet specific requirements stipulated in the Decree No. 49/20019, including the most important:

- having an issued and paid capital of not less than 10,000,000 Egyptian Pounds (or its equivalent in foreign currency);
- Corporations shall contribute 50% of the shareholding capital of the company and 25% provided by financial institutions (as defined above);
- having a convenient headquarter that meets the technical conditions stipulated in the Decree No. 49/2019;
- enjoying good reputation by board members (with similar criteria to those mentioned above in connection with the Exchange company);
- paying security (as specified in the Decree); and
- existing brokerage companies, licensed in the securities market, may carry out brokerage activities in the derivatives market, but on condition of meeting the same requirements of derivatives brokerage companies.

Duration of Operation License: the operation license is issued for three renewable years on condition of maintaining the same technical conditions.

Obligations of Brokerage Companies: the Decree No. 49/20019 provides for many obligations for brokerage companies acting in the derivatives market, including most importantly:

---

(1) An English copy of the law could be found through the website of Misr for Central Clearing, Depository, and Registry at <http://www.mcsd.com.eg/mcdr/English/Showpage.aspx?pageid=82>

- keeping records and documents related to the company for five years (in case of *in-print* copies), and for fifteen years (in case of electronic copies);
- keeping records and documents related to the company's clients for the same period mentioned above;
- enabling the FRA to review the said documents when required;
- providing clients information and standard contract to the FRA;
- abiding by any rules issued by the FRA;
- protecting the confidentiality of the clients' data;

**Obligations Towards Clients:** brokerage companies are obliged to disclose to each client all relevant risks to a transaction. They are also required to provide the client, at least an annual basis, with a statement explaining trading in derivatives, relevant procedures, advantages, risks arising. In any event, brokerage companies are prohibited from issuing any of the clients a guarantee that no risk will take place or having a maximum ceiling for risks.

**Broker-Dealer Rules:** like some other jurisdictions, Egypt Law No.17/2018 allows broker-dealers activates. Thus, Article 126 *bis* (12) of the Law allows a broker, in addition to working for customers, to work for their interest, but on conditions of:

- disclosing to the Derivatives Exchange and the FRA any transaction for the broker's benefits or any of its employees;
- giving priority to customers order to the broker's interest; and
- refraining from entering into any transaction with any of the customers without obtaining his prior approval.

#### 4.1.5- Fifth: Commodities' Warehouses

As mentioned above, Egypt Law No.17/2018 has a separate particular set of rules (Articles 26 *bis* 6 – 8) on commodities, as an underlying asset of derivatives. These rules regulate the establishment of a specific unit to monitor accredited commodities warehouses "*Commodities Accredited Warehouses Monitoring Unit.*" According to the previous Chairman of the FRA, setting special rules for commodities as derivatives underlying assets is just a reflection of the old law of Egypt's cotton exchange, which was canceled in 1966 by President Gamal Abdel Nasser. At that time, Egypt used to have one of the biggest three cotton exchanges in the world, together with New York and Liverpool Exchanges.

The primary role of the Commodities Accredited Warehouses Monitoring Unit includes issuing licenses for the warehouses as well as licensing expert commodities classification. The Unit's function also includes inspecting warehouses and monitoring relevant experts' work.

The Commodities Accredited Warehouses Monitoring Unit shall have a board of trustees that includes representatives from the Ministries of Supply, Trade, and Industry, Finance, and from the Central Bank; from the FRA; from the potential Derivatives Exchange; and three technical experts in the relevant industry. Also, the financial resources of the Unit come from any money allocated by the state, license fees by the registered warehouses, fees for services provided, and investment done by the Unit. The Unit shall have a separate budget.

#### 4.1.6- Six: Precautionary Measures

Article 26 bis 15 of Egypt Law No.17/2018 provides that the FRA, in case of emergency as estimated by the FRA itself, shall have the right to require the potential Derivatives Exchange or the clearing and settlement entity to take any measures necessary to maintain the stability of the derivatives market and to settle any derivatives contracts. Meanwhile, the Board of FRA keeps the right to suspend or cancel the license of the Derivatives Exchange in case breaching the rules of the Law or any of the FRA's decisions.

### 4.2- Section Two: Derivatives In The Arab Countries

#### 4.2.1- First: Countries That Have Issued Laws on Derivatives

##### 4.2.1.1- The United Arab Emirates

The laws applicable to business transactions in the UAE vary depending on whether it falls within the mainland of the UAE or in one of the free zones. On the federal level, the Emirates Securities & Commodities Authority "ESCA" has issued a decision regulating derivatives contracts requiring the entities dealing in derivatives to regularize their positions within six months from the date of enforceability of the decision.<sup>(1)</sup> In addition, derivatives transactions in the free zones are subject to some special rules.<sup>(2)</sup> Examples include transactions concluded in the Dubai International Financial Center and Abu Dhabi Global Market.<sup>(3)</sup>

Also, derivatives in the UAE are subject to the UAE Netting Law.<sup>(4)</sup> The Law addresses close-out netting and applies to contracts that are otherwise legal,

---

(1) Chairman of The Esca Board Of Directors' Decision No. (22 /R.M) Of 2018 Concerning The Regulation Of Derivatives Contracts

(2) For instance, transactions in the DIFC are carried out primarily mainly in USD, and not in the local currency.

(3) *The DFSA Rulebook General Module (GEN)Rule A2.1.3, issuance date July 24, 2017*

*Derivative has the meaning given in GEN Rule A2.1.3. Similarly, Abu Dhabi Global Market has implemented the common law as it should be adopted in its entirety rather than in codified form, precedents were to be found in legislation in Hong Kong and Singapore. A legislative framework that accommodates and facilitates all types of commodities markets, such as precious metals and stones, oil and gas. It encompasses both physical markets and financial commodity derivatives markets. To meet evolving market needs, the ADGM framework is underpinned by the direct application of common law (including on contract formation and remedies for non-performance) and the introduction of specific United Kingdom statutes (including the UK's Sale of Goods Act 1979, the Supply of Goods and Services Act 1982 and the Carriage of Goods by Sea Act 1992). This approach allows ADGM to host and facilitate the operation of an ADGM commodities market, including the sale, purchase and potential freight of commodities, without the need to create bespoke legislative mechanisms that requires constant review to keep pace with evolving market standards and practices. In addition, ADGM's Insolvency legislation applies international insolvency law principles, as well as the ISDA Model Netting Act 2006 to allow for an efficient ADGM commercial environment that provides the benefits of: i) ability for payment and delivery obligations to be set-off resulting in a single 'net' amount being due from one party to the other; and ii) application of netting provisions irrespective of a party being subject to insolvency proceedings.*

(4) Federal Law No. 10/2018 on Netting for Derivatives Contracts and Other Qualified Financial Contracts.

valid, and binding under UAE law. The UAE Netting Law confers legal enforceability on pre- and post-insolvency close-out netting procedures under netting agreements concerning natural and legal persons located in the UAE. The UAE Netting Law also contemplates legal enforceability for collateral arrangements that support netting agreements.<sup>(1)</sup> Meanwhile, some derivatives in the UAE are traded over-the-counter or directly between banks.<sup>(2)</sup> Also, the Emirates Securities and Commodity Authority (the SCA) is the UAE's securities regulator that is relevant to derivatives activities.

Moreover, the Central Bank of the UAE supervises on a federal level all banks. The UAE Netting Law follows vital concepts set out in the International Swaps and Derivatives Association's (ISDA) 2006 Model Netting Act. In doing this, the UAE Netting Law confers legal enforceability on pre- and post-insolvency close-out netting procedures under netting agreements about natural and legal persons located in the UAE (but outside of the ADGM and the DIFC). The UAE Netting Law also contemplates legal enforceability for collateral arrangements that support netting agreements.

The UAE Netting Law applies across the United Arab Emirates, except inside the country's two commercial-free zones: the Abu Dhabi Global Market (ADGM) and the Dubai International Financial Centre (DIFC). The ADGM and the DIFC each have their netting laws under their separate respective jurisdictions on civil and commercial matters.<sup>(3)</sup>

---

(1) Administration of the UAE Netting Law is the responsibility of the Ministry of Finance. Clause 7 calls for a Committee for Designation of Qualified Financial Contracts (the Netting Law Committee) to be formed and chaired by the Ministry of Finance and consisting of two representatives from each of the financial sector regulators in the UAE: (a) the Central Bank, (b) the Securities and Commodities Authority and (c) the Insurance Authority. The Netting Law Committee will have power to give opinions on topics related to Qualified Financial Contracts and to add, remove or replace contracts from the list of Qualified Financial Contracts.

(2) The Chairman of the Securities and Commodities Authority Board of Directors' Decision No. (22/R.M) of 2018 determines some conditions regarding the mandatory reporting of derivatives contracts and clearing of OTC derivatives contracts.

(3) On 14 December 2014 the DIFC Law No. 2 of 2014, or the "Netting Law of 2014" (the "Law"), came into force as a law in the Dubai International Financial Centre ("DIFC") following its enactment on 7 December 2014 by His Highness Mohammed bin Rashid Al Maktoum, Ruler of Dubai. The Law ensures the effectiveness of a netting provision in any qualified financial instrument, or netting agreement that includes a collateral arrangement, and recognizes the enforceability of such arrangement in the event of insolvency of a party. Its enactment has made DIFC a netting jurisdiction on par with other leading jurisdictions with sophisticated financial markets around the globe. The Law once again reaffirms the status of the DIFC as the leading financial hub in the region and underpins its objective to provide an attractive business environment in the regional financial market. Abu Dhabi Global Market is now an ISDA recognized netting jurisdiction. The recognition reinforces ADGM's position in providing a robust legal framework for financial institutions and corporates. Part 7 of the Insolvency Regulations (Financial Markets and Netting) provides for two key protections for parties to financial transactions in the event of the insolvency of one counterparty. These provisions will be familiar to derivatives and financing markets since they are based upon the ISDA Model Netting Act 2006 and are supplemented by provisions derived from the UK's Financial Collateral Arrangements (No.2) Regulations 2003, which

On the other hand, Dubai courts decided that futures transactions on currency do not violate the Commercial Transactions Code for impermissible risk or uncertainty; emphasis on counterparty being a licensed professional investor. Nevertheless, other court decisions determined that spread betting is prohibited in the UAE and is against public policy. If determined to be a form of gambling, the contract will be deemed null and void, and any debts that arise from these transactions are not recoverable.<sup>(1)</sup> On the other hand, other court decisions in Abu Dhabi held that foreign currency derivatives were invalid for speculation. It seems that if a derivative transaction is purely speculative or excessively uncertain, there is considerable risk that UAE courts will not recognize or enforce such a transaction.

In essence, the UAE market for derivatives is still developing. The most common derivative products include margin trading, equity swaps, and cross-currency/commodity swaps. There are limitations to derivatives trading because of Sharia law prohibition of *Gharar*. Moreover, the UAE civil code prohibits contracts for gambling purposes.<sup>(2)</sup> Further, contracts where there is no subject matter or deals with goods, the identity of which is uncertain at the time the agreement is made, are not permitted.<sup>(3)</sup> Finally, the Federal Penal Law makes gambling an unlawful criminal activity.<sup>(4)</sup> There are issues as to whether such a prohibition applies to speculative derivative transactions.

#### **4.2.1.2- Bahrain**

Bahrain is one of the oldest, most active markets, and intensively regulated legal system in terms of trading in derivatives in the region. The Central Bank of Bahrain issues most of the rules that govern derivatives. Thus, in 2012, the Governor of the Central Bank of Bahrain issued the Regulation on trading in financial tools in the Bahraini capital markets.<sup>(5)</sup> This Regulation mentions options as well as any type of derivatives as part of the traded-in securities and financial instruments within the Bahraini Capital Market. The Regulation clearly explains the conditions of listing and trading in derivatives, procedures, mortgage, and others. In addition, in 2014, the Central Bank of Bahrain issued the Close-Out Netting rules, which includes derivatives.<sup>(6)</sup> Finally, the Central Bank of Bahrain has issued a complete book on the treatment of derivative contracts in banking in Bahrain.<sup>(7)</sup>

---

themselves implement the EU Financial Collateral Directive.

(1) The Dubai Court of Appeal (No. 514 of 2014, dated 10 January 2015)

(2) Art. 1021 of the UAE Civil Code

(3) Art. 199-206, UAE Civil Code

(4) UAE Federal Penal Law No. 3 of 1987

(5) Governor of Central Bank of Bahrain's Decision No. 17/2012 on the Regulation of the Rules and Procedures to List and Transfer Licensed Securities and Financial Tools by the Bank, available in Arabic at <http://www.legalaffairs.gov.bh/LegislationSearchDetails.aspx?id=6547#.XiTQny2B01J>

(6) Governor of Central Bank of Bahrain's Decision No. 44/2014 on Promulgating a Regulation for Close-Out Netting under a Market Contract, available at: <http://www.legalaffairs.gov.bh/Media/LegalPDF/RBCB4414.pdf>

(7) The Central Bank of Bahrain Book on the Treatment of Derivative Contracts in the Banking in Bahrain, available at [https://cbb.complinet.com/cbb/display/display.html?rbid=1820&element\\_id=2591](https://cbb.complinet.com/cbb/display/display.html?rbid=1820&element_id=2591)

On the other hand, in 2002, Bahrain had a law that regulates the Islamic Capital Market.<sup>(1)</sup> The primary purpose of the Islamic Capital Market is to establish a Council that promotes Islamic Finance in the Muslim world. The Council is composed of fifteen members, where membership is limited to central banks, regulatory authorities, and financial institutions in the Muslim world. The Council deals with all Islamic Finance tools, as explained above. Meanwhile, the Council has a *Shari'a* compliance committee that authorizes Islamic Finance tools in general and decides upon compliance with *Shari'a* rules.

Accordingly, Bahrain derivatives market is an active market. Meanwhile, Bahrain has various laws that regulate derivatives on both substantive and framework level. Nevertheless, derivatives in Bahrain are subject to the restrictions of Islamic *Shari'a*. Notably, as explained earlier, the launch of the Tahawwut Master Agreement was officially announced in Bahrain under the patronage of the Governor of the Central Bank of Bahrain. This has taken place under the guidance and approval of the International Islamic Financial Market *Shari'a* Advisory Panel.

#### 4.2.1.3- Kuwait

Earlier, derivatives were regulated by the Securities Law, which required trading in securities by the Kuwait Stock Exchange that, in its turn, issued some decisions on dealing in options and forwards.<sup>(2)</sup> Nevertheless, The Securities Law was substituted in 2010 by a new law that was amended various times (CMA Law).<sup>(3)</sup> In addition, the CMA Law was complemented by some Bylaws and Modules.<sup>(4)</sup> The new CMA Law required the Kuwaiti Capital Markets Authority to establish a new stock exchange (currently named Boursa Kuwait) to replace the Kuwaiti Stock Exchange.<sup>(5)</sup> All the decisions of the

(1) The Law No. 23/2002 on the Establishment of the Islamic Global Capital Market, available in Arabic at <http://www.legalaffairs.gov.bh/Media/LegalPDF/L2302.pdf>

(2) Law No. 31/1990 on Trading In Securities And The Setting Up Of Investment Funds. Article 2 of the said law stipulated that "Listed Securities in the Kuwait Stock Exchange shall be traded in, transferred, and disposed of in accordance with the rules and procedures as determined by the Kuwaiti Stock Exchange Committee"

(3) The Securities Law was amended by the Law No. 7 /2010 on the Establishment of the Capital Markets Authority and Regulating Securities Activities (Official Gazette on February 28, 2010, which was amended by the Law No. 108/ 2014 (issued on July 23, 2014 and published in the Official Gazette on August 10, 2014) and the Law No. 22 /2015 (issued on May 4, 2015 and published on May 10, 2015. Available at:

<https://www.cma.gov.kw/documents/20622/347647/Law+No.+7+of+2010+-+new+logo/8468eb04-a890-4caa-81b1-0826adf37df8>

(4) Resolution No. 72/2015 issuing the Executive Bylaws of CMA Law and the extra 16 modules on: Glossary and Definition, Capital Markets Authority, Enforcement of the Law, Securities Exchanges and Clearing Agencies, Securities Activities and Registered Persons, Policies and Procedures of Licensed Persons, Clients' Funds and Clients' Assets, Conduct of Business, Mergers and Acquisitions, Disclosure and Transparency, Dealing in Securities, Listing Rules, Collective Investment Scheme, Market Conduct, Corporate Governance, and the Anti-Money Laundering and Combating Financing of Terrorism, available at <https://www.cma.gov.kw/en/web/cma/-bylaw-documents>

(5) The CMA issued its decision No. 90/2016 by establishing Boursa Kuwait to replace the Kuwaiti Stock Exchange

previous Stock Exchange remained in force, including those related to trade in derivatives.<sup>(1)</sup>

Nevertheless, on the one hand, in 2016, the CMA issued a new resolution, which ceased dealing in financial derivatives, **Banned Derivative Transactions**.<sup>(2)</sup> On the other hand, banks and financial institutions are allowed to hedge against currency, interest, and capital risks and other derivative transactions so long as such transactions are not for speculation purposes. The Central Bank of Kuwait issued many circulars and instructions concerning banks and financial institutions' dealings in derivatives. Accordingly, both the legislative framework and the practice in derivatives is not clear in Kuwait.

However, recently in 2019, Boursa Kuwait organized a workshop<sup>(3)</sup> to survey derivatives. It could be argued that derivative products will be allowed again in the Kuwaiti market. They might also be regulated in the next phase of the development of the market in Kuwait. The CMA announced a four stages plan on developing the market, three phases of which have already taken place successfully as planned. Boursa Kuwait has conducted due diligence on certain derivatives products. During the workshop, it addressed many questions and inquiries to financial institutions and banks on the possible success of such products in Kuwait.

#### **4.2.1.4- Morocco**

The primary institutions which regulate and monitor capital market activity are the Conseil Déontologique des Valeurs Mobilières (CDVM), the Moroccan stock exchange (Stock Exchange), the Ministry of Finance (MOF), Bank Al-Maghrib (Central Bank) and the *Commission de coordination des organes de supervision du secteur financier* (Joint Supervision Commission). A significant number of necessary legislative and regulatory reforms of the regulation of capital market activity in Morocco have been undertaken recently. Specifically, some of the primary institutions regulating the capital markets are being reformed to increase their independence and supervisory powers; efforts to introduce Islamic finance products.

Recently, Morocco has issued its law that regulates derivatives in 2014.<sup>(4)</sup> This law is a substantive law that explains futures, options, swaps, and forwards in detail as well as the rules for trading, listing, and the like. The law provides that the regulatory authority

---

(1) Article 8 of the Decision 90/2016 stipulated: "except as otherwise canceled or amended by this decision, all decisions, instructions, policies and procedures of the Kuwaiti Stock Exchange Company in force as of the date of the decision shall remain valid and in full force and effect until any of them is amended or cancelled in accordance with the CMA Law no 7 for the year 2010 and its executive regulation".

(2) Resolution No. 76/2016 provides that: "(i) Dealing in Futures and Forward shall be ceased starting from September 1, 2016, (ii) Starting from September 1, 2016, the existing Futures and Forward contracts may be extended for a period or similar period, provided that the end date of such contracts shall not be after October 31, 2017 in any case, and (iii) New options contracts whose periods end after October 31, 2016 shall not be concluded.

(3) [https://cis.boursakuwait.com.kw/Portal/BoursaReports/BK\\_PR\\_2019\\_A\\_11920198317608.pdf](https://cis.boursakuwait.com.kw/Portal/BoursaReports/BK_PR_2019_A_11920198317608.pdf)

(4) Law No. 12.42 on Forwards and Futures Financial Tools, available in Arabic at:

<http://adala.justice.gov.ma/production/legislation/ar/Nouveautes/السوق%20الأجلة%20للأدوات%20المالية>

dealing in the derivative is both the Central Bank of Morocco as well as a unique Council on forwards and futures which role is to supervise and control derivatives activities in Morocco. Meanwhile, according to ISDA, Morocco is one of the few Arab countries that are currently considering netting law.

#### **4.2.2- Second: Countries That Are in The Process of Issuing Laws on Derivatives**

##### **4.2.2.1- Qatar**

Not so much information is available about the derivatives market in Qatar. The Financial Markets Authority, Law as well as the Central Bank Law mention derivatives as part of traded securities. However, neither law provides any details on what derivatives are, how they would be traded, or any other legal rules.<sup>(1)</sup> In addition, Qatar Financial Centre has Netting Regulations and the supporting provisions in the QFC Insolvency Regulations, provide legal certainty in the QFC as to the enforceability of close-out netting for financial transactions such as derivative transactions in specified circumstances, including in the case of insolvency of a party to the transaction.

Recently, ISDA has recognized the Qatar Financial Centre as an effective netting regime and published a positive legal opinion recognizing the QFC as a netting friendly jurisdiction. ISDA has confirmed that financial netting arrangements under the ISDA Master Agreements are enforceable in the QFC.<sup>(2)</sup>

##### **4.2.2.2- Saudi Arabia**

The Kingdom of Saudi Arabia (KSA) is the largest Arab country with almost 20% of the world's petroleum reserves, ranking as the largest exporter of petroleum and playing a lead role in OPEC. Recently the Saudi government started pursuing economic and legal reform to attract and promote foreign investment. Thus, the Saudi Arabian General Investment Authority grants foreign investors various incentives, including foreign ownership of property, low capital requirements, tax incentives, and others. Meanwhile, *Tadawul*<sup>(3)</sup> is the licensed Saudi Stock Exchange that works under the supervision of the Saudi Capital Market Authority, as per the Capital Market Law.<sup>(4)</sup> Qualified foreign investors (banks, brokers, fund managers, and insurance companies with a minimum threshold) are allowed to invest in shares listed on the Saudi.

Narrowing down the discussion to derivatives, KSA does not have a law on derivatives. Nevertheless, the Saudi Capital Market Authority's relevant persons announced recently that the Authority is currently working on establishing its derivatives market. The derivatives market is expected to be one of the initiatives to develop the financial sector in Saudi as part of the KSA's financial 2030 vision, which

(1) Law No. 13/2012 Issuing Qatar Central Bank Law and Law No. 8/2012 on Qatar Financial Authorities Law.

(2) See <https://www.qfc.qa/en/MediaCenter/News/Pages/ISDA.aspx>

(3) <https://www.tadawul.com.sa/wps/portal/tadawul/home?locale=ar>

(4) Royal Decree No. M/30 on July 31, 2003, available in Arabic at : [https://cma.org.sa/RulesRegulations/CMALaw/Documents/CMA\\_Law.pdf](https://cma.org.sa/RulesRegulations/CMALaw/Documents/CMA_Law.pdf)

reflects the country's commitment to increase contributions by foreign investors.<sup>(1)</sup>

Nevertheless, in KSA, Islamic law is the primary source of legislation with all laws and regulations as driven by the Qur'an and Sunnah. Meanwhile, royal decrees come second as subordinate to *Shari'a*. This implies that any rule, even those driven from Western systems, are interpreted based on the *Shari'a* law, with the result that interpretation of laws by judges are affected by Islamic jurisprudence with all the outcomes of lack of certainty. Having said so, it is challenging to expect an active derivatives market in Saudi. The risk of annulling such transactions, if any, by Islamic jurisprudence remains very high.

#### **4.2.2.3- Oman**

Oman does not have legislation on derivatives.<sup>(2)</sup> In essence, trade-in derivatives are not common in Oman. Nevertheless, any potential derivatives activities, if arising, would be regulated by the Omani Capital Market Authority as the relevant entity.<sup>(3)</sup> Currently, Oman is witnessing a statutory revolutionary movement to encourage foreign investments (direct & indirect) to the Omani market either through amending the existing laws or introducing new laws. In 2019, Oman issued and changed several laws in response to the global challenges in areas such as companies, investment, privatization, and public, private partnerships.<sup>(4)</sup> Like, Saudi, Islamic *Shari'a* interpretation remains one of the risks facing the derivatives market in Oman when existing.

---

(1) <https://www.argaam.com/ar/article/articledetail/id/568555> (only in Arabic)

(2) On July 9, 2019, Mohammed Said al Abri; the Vice President of the Capital Market Authority explained that a new law on derivatives should be issued shortly, *See generally*, <https://www.omanobserver.om/new-law-to-spur-growth-of-securities-market-in-oman/>

(3) Capital Market Authority is the competent authority to issue any regulations pertaining Derivatives and supervising Derivatives activities, including Muscat Securities Market, Muscat Clearance and Depository Company, Listed public stock companies, Mutual Investment Funds, Companies Operating in the Securities field and their agencies, Insurance companies, agents and brokers, and Credit Rating Companies.

(4) Commercial Companies law No. 18 /2019 and Foreign Investment Law No. 50/2019 . Also introducing new laws such as Privatization Law No. 51/2019 and Public Private Partnership Law No. 52/2019.

## 5. CONCLUDING REMARKS

The problem with derivatives from an Islamic perspective is that derivatives, as explained earlier, are based on hedging. Meanwhile, the term *hedge* implies an investment strategy that seeks to minimize risk, often by transferring it to another party. Nevertheless, Islamic finance involves risk sharing, rather than risk transfers. As sharing is what justifies the returns to investors, hedging activity would appear at first glance to be off limits to investors seeking *Shari'a* compliance. As explained earlier, transactions for gambling purposes are void according to the Civil Codes of the majority of the Arab countries, with little case law defining “gambling” in the context of financial transactions. This grants judges and Islamic jurists a broad discretionary power to decide upon the compatibility of certain transaction with Islamic *Shari'a*.

To get out of this maze, on **March 1, 2010, the** International Islamic Financial Market, *IIFM*, and the International Swaps and Derivatives Association, Inc., *ISDA*,<sup>(1)</sup> issued the ***Tahawwut (Hedging) Master Agreement***. The *Tahawwut* Master Agreement is an initial step towards the globally standardized documentation for privately negotiated Islamic hedging products. The *Tahawwut* Master Agreement is the first financial industry framework document that is applicable across all jurisdictions where Islamic finance is practiced. This *Tahawwut* Master Agreement consists of the Master Agreement and an Explanatory Memorandum, both of which are part of the official *Shari'a* Pronouncement. The *Tahawwut* Master Agreement provides the structure under which institutions can transact Islamic hedging transactions such as profit-rate and currency swaps, which are estimated to represent most of today's Islamic hedging transactions. It is an entirely new framework document though the structure of the document is similar to the conventional ISDA Master Agreement. However, the fundamental mechanisms and provisioning such as early termination events, closeout, and netting are developed based on the Islamic *Shari'a* principles.<sup>(2)</sup>

The *Tahawwut* Master Agreement is based on two main concepts. Parties understand that no interest shall be receivable, and no settlement based on valuation or without tangible assets is allowed. Moreover, the counterparties to the *Tahawwut* Master Agreement make representations as to the fact that they enter into *Shari'a* compliant transactions only. The IIFM *Shari'a* Advisory Panel has considered the *Tahawwut* Master Agreement to be a necessary step forward for promoting global standardization for Islamic financial product standards because of the absence of worldwide *Shari'a* compliant standardized agreement may lead to a negative effect in the industry.<sup>(3)</sup>

**In addition, in June 2016, the** IIFM and the ISDA published two new standards for Islamic forward foreign exchange products for use in Islamic hedging transactions. This has been a part of an ongoing initiative by the two associations to provide the Islamic finance industry with documentation and product standards to mitigate risk arising from currency and rate-of-return mismatches. The ISDA/IIFM Islamic Foreign Exchange

(1) *Supra* note 14, Foster.

(2) <https://www.isda.org/2010/03/01/iifm-and-isda-launch-tahawwut-hedging-master-agreement/>

(3) The *Tahawwut* Master Agreement is available at [www.iifm.net](http://www.iifm.net), and [www.isda.org](http://www.isda.org)

Forward is intended to help minimize the exposure of Islamic financial institutions to foreign exchange volatility. The standards can be used to mitigate currency risk associated with capital markets instruments, as well as trade finance and corporate banking activities. The IFX Forward falls under the **Tahawwut** Master Agreement.<sup>(1)</sup>

The recognized need for increased risk management across the Arab region has led to the development of derivatives markets in some countries. However, this development is still hindered by a lack of legislation/regulation/ISDA netting opinions. The common feature of these laws is that they are very recent, which implies that the derivatives market in the Middle East is a kind of new and untested one. Besides, most of these laws regulate trade in derivatives rather than any substantive rules on what derivatives are and transaction dynamics. The Arab region is still an unsophisticated market with very initial and undeveloped types of derivatives, including mainly margin trading, and equity swaps and interest rate swaps. Meanwhile, it is notable that this market is “commercial banking activity”; the relevant regulatory body must license counterparties unless all conduct with transactions is conducted outside competent jurisdiction

Most importantly, the derivatives market, as well as the legal framework in the region, is subject to *Shari'a* implications. For instance, most civil codes in the region prohibit transactions for gambling purposes with limited guidance of case law on defining “gambling” in the context of financial transactions. Meanwhile, dealings where a contract has no subject matter or deals with goods, the identity of which is uncertain at the time the agreement is made is not permitted. In some areas such as the UAE, conflicting courts’ decisions exist. Finally, netting and close-out netting hardly exist in the region.

Talking specifically about the Egyptian market, it seems also that Egyptian companies do not utilize derivatives extensively. It is very common to find derivatives mentioned in the financial statements of Egyptian companies. For instance, a recent study on derivatives usage in Egypt has found that within 45 useful annual financial statements analyzed of listed Egyptian companies, 10 financial firms used derivatives and held derivatives for trading purposes. Only 6 non-financial firms used derivatives for hedging purposes. This was effectively 13.3% of the total 45 useful firm results.

Notwithstanding the low levels of derivative use, the main risks hedged were currency risks utilizing currency swaps and forwards (60%). Interest rate risk was hedged

---

(1) Two versions of the IFX Forward standard confirmations have been published as follows: 1) Single **Wa'ad** Structure: where only one party is the buyer who grants the **Wa'ad** in favor of the other party; and ii) Two **Wa'ad** Structure: where each of the parties grants a unilateral **Wa'ad** in favor of the other party, and a party's right to exercise the other party's **Wa'ad** is subject to an exercise condition being satisfied on the exercise date. Each **Wa'ad** carries a different trigger condition and therefore does not constitute a contract. The availability of both versions of the IFX Forward standard confirmations is in response to *Shari'a* preferences by some market participants for each party's **Wa'ad** to be separately documented, as well as a reflection of the existing use of single **Wa'ad** structures by other market participants. See generally, <https://www.isda.org/2016/06/06/iifm-and-isda-publish-islamic-foreign-exchange-forward-standards/>

using interest swaps (40%). No observations were made about futures as there is no futures exchange in Egypt.

Nevertheless, having a legislative regulation of derivatives is a good step to develop the derivatives market in Egypt. According to the FRA's Chairman, a committee has been established to study the best international practices in connection with derivatives, and accordingly to issue any relevant rules and decrees in connection with derivatives Exchange. Despite these facts, derivatives market in Egypt is not tested yet. Most importantly, confusion continues in connection with derivatives traded OTC.

In addition, it is not clear whether the development of this market and the maintenance of its stability would depend on the regulatory authority authorized to oversee its dynamics and react immediately to issues that arise, or on the legislator. Furthermore, guidance on Islamists' perception of derivatives implications in the Egyptian market hardly exist. Sometimes, stakeholders, including courts, adopt a conservative interpretation of the relevant laws and regulations if a transaction is purely speculative or "excessively uncertain" for *Sharia* implications.

## 6. Bibliography

1. Articles of the Draft Constitution of Qatar [Constitution] 2003, Embassy of the State of Qatar in Washington DC, Constitution of Qatar, [http://www.servat.unibe.ch/icl/qa00000\\_.html](http://www.servat.unibe.ch/icl/qa00000_.html) (last visited Oct. 8, 2010).
2. Bahrain [Constitution] 2002, Department of Legal Affairs, Bahrain *Kingdom Constitution*, [http://www.servat.unibe.ch/icl/ba00000\\_.html](http://www.servat.unibe.ch/icl/ba00000_.html) (last visited Dec. 11, 2011).
3. Bashar H. Malkawi, Financial Derivatives in the West and in Islamic Finance: A Comparative Approach, 211 *the Banking Law Journal*, Volume 128, Jan 2011
4. Bernard K. Freamon, Slavery, Freedom, and the Doctrine of Consensus in Islamic Jurisprudence, 11 *Harv. Hum. Rts. J.* 1 (1998)
5. Chairman of The Esca Board of Directors' Decision No. (22 /R.M) Of 2018 Concerning the Regulation Of Derivatives Contracts
6. Commercial Companies law No. 18 /2019 and Foreign Investment Law No. 50/2019
7. El-Gamal, *Islamic Finance, Law, Economics, and Practice* [Cambridge University Press], 2006
8. FATHI AL-DURAINI, *HAQQ AL-IBTIKAR FI AL-FIQH AL-ISLAMI AL-MUQARAN* [THE RIGHT TO PATENT IN THE COMPARATIVE ISLAMIC JURISPRUDENCE] (1984).
9. Federal Law No. 10/2018 on Netting for Derivatives Contracts and Other Qualified Financial Contracts.
10. Geoffrey Williams & John Zinkin, Islam and CSR: A Study of the Compatibility between the Tenets of Islam and the UN Global Compact, 51 *J. Bus. Ethics* 520 (2009).
11. Glossary of Islamic Legal Terms, supra note 3, at 99 (the Qur'an is the Islamic holy book revealed to Prophet Muhammad (PB))
12. Governor of Central Bank of Bahrain's Decision No. 17/2012 on the Regulation of the Rules and Procedures to List and Transfer Licensed Securities and Financial Tools by the Bank, available in Arabic at: <http://www.legalaffairs.gov.bh/LegislationSearchDetails.aspx?id=6547#.XiTQny2B01J>
13. Governor of Central Bank of Bahrain's Decision No. 44/2014 on Promulgating a Regulation for Close-Out Netting under a Market Contract, available at: <http://www.legalaffairs.gov.bh/Media/LegalPDF/RBCB4414.pdf>
14. Haider Ala Hamoudi, *The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law*, 56 *AM. J. COMP. L.* 423, 441 (2008).
15. IMF, GROWTH AND STABILITY IN THE MIDDLE EAST AND NORTH AFRICA, available at: <https://www.imf.org/external/pubs/ft/mena/04econ.htm>
16. Irshad Abdal-Haqq, Islamic Law An Overview of Its Origin and Elements, 7 *J. Islamic L. & Culture* 27 (2002)
17. ISDA & IIFM TAHAWWUT MASTER AGREEMENT, available at : <https://www.isda.org/book/isda-iifm-tahawwut-master-agreement/>
18. J. Michael Taylor, Islamic Banking: the feasibility of establishing an Islamic Bank in the United States, 40 *Am. Bus. L.J.* 385, 389 (2003)
19. John H. Donbolit & Farnaz Kashefit, Doing Business in the Middle East: A Primer for U.S. Companies, 38 *Cornell Int., L.J.* 413 (2005).

- 20.K&L Gates LLP, An Update on Worldwide Derivatives and Related Regulatory Initiatives (2014)
21. Kalbaugh, Gary E, Derivatives and Regulation (Carolina Academic Press, 2<sup>nd</sup> ed., 2018)
- 22.Kuwait Law No. 31/1990 on Trading In Securities And The Setting Up Of Investment Funds.
- 23.Law No. 108/ 2014 (issued on July 23, 2014 and published in the Official Gazette on August 10, 2014) and the Law No. 22 /2015 (issued on May 4, 2015 and published on May 10, 2015. Available at, <https://www.cma.gov.kw/documents/20622/347647/Law+No.+7+of+2010+-+new+logo/8468eb04-a890-4caa-81b1-0826adf37df8>
- 24.Law No. 12.42 on Forwards and Futures Financial Tools, available in Arabic at : <http://adala.justice.gov.ma/production/legislation/ar/Nouveautes/السوق%20الآجلة%20للأدوات%20المالية.pdf>
- 25.Law No. 13/2012 Issuing Qatar Central Bank Law and Law No. 8/2012 on Qatar Financial Authorities Law.
- 26.Law No. 7 /2010 on the Establishment of the Capital Markets Authority and Regulating Securities Activities (Official Gazette on February 28, 2010)
- 27.M. Cherif Bassiouni & Gamal M. Badr, *The Shari'a: Sources, Interpretation, and Rule-Making*, 1 UCLA J. ISLAMIC & NEAR E.L. 135, 138-140 (2002)
- 28.MASHOOD A. BADERIN, INTERNATIONAL HUMAN RIGHTS AND ISLAMIC LAW, 34 (Oxford U. Press Inc., N.Y.2003).
29. NISRINE ABIAD, SHARIE'A, MUSLIM STATES AND INTERNATIONAL HUMAN RIGHTS TREATY OBLIGATIONS: A COMPARATIVE STUDY 51 (Brit. Inst. of Int'l & Comp. L. 2008)
- 30.PwC report (2016), available at: <https://www.pwc.com/m1/en/media-centre/2016/press-releases/paying-taxes-2017-middle-east.pdf>
- 31.PwC, Banking and Capital Markets, available at <https://www.pwc.com/m1/en/industries/banking-capital-markets.html> (last visited September 11, 2019)
- 32.Resolution No. 72/2015 issuing the Executive Bylaws of CMA Law and the extra16 modules, available at <https://www.cma.gov.kw/en/web/cma/-bylaw-documents>
- 33.Roberta Mann, *Is Shariaf's Castle Deductible?: Islam and the Tax Treatment of Mortgage Debt*, 17 WM. & MARY BILL RTS. J. 1139, 1148 (2009)
- 34.Royal Decree No. M/30 on July 31, 2003, available in Arabic at [https://cma.org.sa/RulesRegulations/CMALaw/Documents/CMA\\_Law.pdf](https://cma.org.sa/RulesRegulations/CMALaw/Documents/CMA_Law.pdf)
35. SAUDI ARABIA [Constitution] 1992, Saudi Arabia Constitution, [http://www.servat.unibe.ch/icl/sa00000\\_.html](http://www.servat.unibe.ch/icl/sa00000_.html) (last visited Dec. 11, 2011).
- 36.The Central Bank of Bahrain Book on the Treatment of Derivative Contracts in the Banking in Bahrain, available at [https://cbb.complinet.com/cbb/display/display.html?rbid=1820&element\\_id=2591](https://cbb.complinet.com/cbb/display/display.html?rbid=1820&element_id=2591)
- 37.The Chairman of the Securities and Commodities Authority Board of Directors' Decision No. (22/R.M) of 2018
- 38.The Decision 90/2016

39. *The DFSA Rulebook General Module (GEN) Rule A2.1.3, issuance date July 24, 2017*
40. The Dubai Court of Appeal (No. 514 of 2014, dated 10 January 2015)
41. The Economist Intelligence Unit, Industry Report - Financial services - United Arab Emirates (3rd Quarter 2019), available at:  
[http://country.eiu.com.ezproxy.bu.edu/FileHandler.ashx?issue\\_id=1008297284&mode=pdf](http://country.eiu.com.ezproxy.bu.edu/FileHandler.ashx?issue_id=1008297284&mode=pdf)
42. The Economist Intelligence Unit, Industry Report - Financial services – Saudi Arabia (3rd Quarter 2019),  
[http://country.eiu.com.ezproxy.bu.edu/filehandler.ashx?issue\\_id=1517772935&mode=pdf](http://country.eiu.com.ezproxy.bu.edu/filehandler.ashx?issue_id=1517772935&mode=pdf)
43. The Law No. 23/2002 on the Establishment of the Islamic Global Capital Market, available in Arabic at:  
<http://www.legalaffairs.gov.bh/Media/LegalPDF/L2302.pdf>
44. The Tahawwut Master Agreement is available at [www.iifm.net](http://www.iifm.net), and [www.isda.org](http://www.isda.org)
45. The UAE Civil Code
46. Timothy E. Lynch, Derivatives: A Twenty-First Century Understanding, 43 Loy. U. Chi. L. J. 1 (2011)
47. TRANSLITERATED TITLE OF YEMENI CONSTITUTION May 16, 1991, as amended Sept. 29, 1994, Feb. 10, 2001, arts. 1-3, 23 (Yemen), the Republic of Yemen Supreme Commission for Elections and Referendum, *The Constitution of the Republic of Yemen, available at* <http://www.scer.org.ye/>
48. TÜRKIYE CUMHURİYETİ ANAYASASI OF 1961 [Constitution] (Turk.) (*translated by Kemal Gozler*); see also Kemal Gozler, *Turkish Constitutional Law Material in English*, <http://anayasa.gen.tr/english.htm> (last updated Feb. 9, 2009).
49. UAE Federal Penal Law No. 3 of 1987
50. Understanding Derivatives, Markets and Infrastructure, Federal Reserve Bank of Chicago (August 2013)
51. World Bank Group, Doing Business (2019), available at  
[https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report\\_web-version.pdf](https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf)
52. Paul Lee, The Regulation of Securities And Islamic Finance in Dubai: Implications For Models of Shari'a Compliance, 15 UCLA J. Islamic & Near E. L. 1 (2016).
53. Nicholas H. D. Foster, Islamic Finance Law as an Emergent Legal System, 21 Arab L.Q. 170 (2007).
54. Reyadh Mohamed Seyadi, Legal Aspect of Islamic Finance, 29 Arab L.Q. 285 (2015).
٥٥. مصطفى كامل خليل الحجازي: المشتقات المالية وتداعيات الأزمة المالية العالمية ، ٢٠١٨ ، دار المنظومة .
٥٦. عبد الرحيم عبد الحميد الساعات: نحو مشتقات مالية إسلامية لإدارة المخاطر التجارية ، مجلة جامعة الملك عبد العزيز، الاقتصاد الإسلامي، ١٩٩٩ .

٥٧. صلاح الدين زين العابدين محمد عبد الحفيظ: التنظيم القانوني لقيود وتداول الأوراق المالية (رسالة مقدمة لنيل درجة الماجستير في الحقوق تحت إشراف أ.د سميحة القليوبي)، ٢٠١٦.

٥٨. محمد حسين عبد الرحيم: عقود الخيارات المالية كأداة تنشيطية في سوق الأوراق المالية (رسالة مقدمة لنيل درجة الدكتوراة تحت إشراف أ.د سميحة القليوبي)، ٢٠١٨.

٥٩. دينا إبراهيم محمد يوسف الفار: الجوانب القانونية للتداول الإلكتروني للأوراق المالية (رسالة مقدمة للحصول على درجة الدكتوراة تحت إشراف أ.د رضا محمد عبيد)، ص ١٠٩، ٢٠١٦.

٦٠. أحمد إبراهيم شبل حجازي: الأبعاد القانونية للرقابة على التداول في بورصة الأوراق المالية المصرية (رسالة للحصول على درجة الدكتوراة تحت إشراف أ.د سميحة القليوبي)، ٢٠١٧.

٦١. التمويل الإسلامي: التنمية في الأسواق الجديدة، World Islamic Finance Market Place Available at, [www.mifc.com](http://www.mifc.com)

٦٢. أ.د منذر قحف: أساسيات التمويل الإسلامي، الطبعة الثانية ٢٠١٥.

## 7. Table of Contents

Abstract.....	1582
1. INTRODUCTORY CHAPTER .....	1588
2. CHAPTER ONE: DEFINITION, TYPES, AND IMPORTANCE OF DERIVATIVES. ....	1592
3. CHAPTER TWO: DERIVATIVES IN ISLAMIC (SHARI'A) .....	1597
3.2.1- Money Theory in <i>Shari'a</i> and the Concepts of Islamic Finance .....	1599
3.2.2- Second: The Mains Concepts of Islamic Finance Impacting Trading in Derivatives .....	1601
3.2.2.1- Interest Rate in Shari'a.....	1602
3.2.2.2- Risk in Shari'a .....	1604
3.3.1- Salam (Prepaid Forward Sale).....	1605
3.3.2- Urban or Down-Payment Sale (call option).....	1606
3.3.3- Khiyar Al-shart (Option).....	1606
3.3.4- Swaps .....	1606
3.3.5- Istisna (Commission to Manufacturer).....	1607
4. CHAPTER THREE: THE LEGAL REGULATION OF DERIVATIVE IN EYPT COMPARED TO THE ARAB COUNTRIES' LEGAL SYSTEMS .....	1609
4.1.1- First: Scope of Application and Types of Derivatives Regulated Under The Egyptian Law .....	1610
4.1.2- Second: The Regulatory Authority and Derivatives Exchange .....	1611
4.1.2.1- Alternative One: The Establishment of A Private Derivatives Exchange .	1611
4.1.2.2- Alternative Two: Trading in Derivatives by the EGX .....	1613
4.1.3- Third: Trading and Clearing Rules.....	1613
4.1.4- Fourth: Brokerage Rules .....	1613
4.1.5- Fifth: Commodities' Warehouses .....	1614
4.1.6- Six: Precautionary Measures .....	1615
4.2.1- First: Countries That Have Issued Laws on Derivatives .....	1615
4.2.1.1- The United Arab Emirates .....	1615
4.2.1.2- Bahrain .....	1617
4.2.1.3- Kuwait.....	1618
4.2.1.4- Morocco .....	1619
4.2.2- Second: Countries That Are in The Process of Issuing Laws on Derivatives.....	1620
4.2.2.1- Qatar .....	1620
4.2.2.2- Saudi Arabia .....	1620
4.2.2.3- Oman .....	1621
5. CONCLUDING REMARKS .....	1622
6. Bibliography .....	1625
7. Table of Contents.....	1629