

Option Contracts and The Principles of Sale of Rights in Shari‘ah

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1. Introduction

The Shari‘ah (Islamic law) is a legal system that considers interest or expectations of the contracting parties. It sanctions any mechanism that serves the objectives of the contracting parties. The price risk has become a modern business reality. This axiomatically made risk management a prerequisite for businesses to survive market shocks. A survival of businesses and protection of wealth is a Shari‘ah a requirement. Thus, measures that protect wealth against risks are logically within the teachings of Shari‘ah. This means that a failure to protect investment funds against risks do not comply with requirements of Shari‘ah in which case the entrepreneur may be held liable under the principles of negligence, misconduct and unprofessional management.

In complying with the requirements of protecting wealth, we noted that the jurists had discussed mechanisms of mitigating risks of losses, misrepresentations or product defect. This is exemplified in the number of traditional Shari‘ah options, such as *khayār al-majlis*, *khayār al-shart*, *khayār al-‘ayb*, *khayār al-naqd*, to mention but few. The rationale for allowing these risk management mechanism is to allow the contracting parties a time to think about the contract and to avoid harm that may overwhelm them when the contract continued. The jurists also established principles of guarantees for the same purpose, notably *ḍamān al-dark*, which may be translated as guarantee against market misrepresentation. It is noted that the jurists are not

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in favor of any action that jeopardizes investment objectives so much so that they hold an entrepreneur, such as *mudārib*, liable for embarking on risky investments. Thus, risk management is an evident requirement of Islamic law from various aspects.

2. Assumptions

In order to restrict the discussion in this paper, we have to make three assumptions. One assumption is that options have *fiqh* parallel which is manifested in *arbūn*, *khijār al-sharṭ* and similar terminologies. The second assumption is that there is a contract of sale, at least in the case of shares, but the delivery will take place in the future. The third assumption is that options have no *fiqh* parallel and this necessitates finding a solution to the financial options under the principles of Shari‘ah. The paper is limited to the third assumption. This is because contract of options violates a number of principles of exchange contracts. In addition, we do not dispute the importance of financial options in managing complicated risks, such as management of price increases and falls and other benefits.¹ This paper has excluded currency options from the domain of discussion.

3. Definition and Classification of Shari‘ah Options

Option or *khijār* in the *fiqh* literature means the right of one or both parties to a contract to make a choice between two opposing events: execution of a contract or suspension of a contract. The buyer or the seller is entitled to maintain the concluded contract or cancel it within a particular period due to a particular event. The termination of the contract based on options have various factors including, among others, the contract being not serving the interest of the terminating party, defect in the subject matter of the contract or violation of a stipulated valid condition. Thus, an option in Islamic law gives a party in a contract the right, within certain circumstances, to reverse the contract. The options change the status of a contract from being binding to being “floating”, i.e. non-conclusive. They make a contract flexible. However, entitlement to options to cancel a contract or to perform depends on the nature of the underlying contracts. In some contracts, options give only one party the right to cancel the contract after the commencement of a contract and prior to completion, such as an option to cancel the contract by the worker in a reward-based contract (*ju‘alah* contract).²

Broadly, the Shari'ah options are classified from the perspective of the law and the option stipulator. In other words, some options are created by natural law and others are created following contracting on a tangible subject matter. Options created by the law are those options that exist for the interest of both or one of the contracting parties. These options do not need an agreement for creating them.³ Options that are created by the law include, among others, *khayār al-majlis* (option of session). The contracting parties are entitled by law to terminate the concluded contract as far as they did not disperse from the place of the contract. This form of option is automatically granted to the contracting parties by the saying of the Prophet (pbuh) "both the buyer and the seller (contracting parties) have an option (to terminate the contract) so far as they did not disperse".⁴ Under this category comes the majority of *fiqh* related options, such as *khayār al-'ayb* (option for defect), *khayār al-ru'yah* (on sight option), *khayār al-tadlees* (fraud option) and option for violation of valid conditions stipulated in the contract.⁵

The contractual options are created by the agreement of the contracting parties. These options exist only when the contracting parties choose to attach a particular right to the contract. Example of contractual options is *khayār al-shart* or conditional option. The concept of financial options falls under the category of contractual options, hence many writers on options in Islamic finance tried to compare financial options to contractual options due to their similarities in features and objectives.⁶

4. Basic Features of Shari'ah Options

The large number of options⁷ that are discussed in the *fiqh* literature were allowed by the jurists because they serve certain valid and permissible objectives for the contracting parties. These objectives may be summarized in the following:

1. These options are allowed in order to ponder on the viability of the deal and obtain information on the deal. Generally, the jurists interpret the risk to be avoided by introducing these options in the context of fraud (*ghabn*), misrepresentation (*tadlees*) and misconduct as indicated by Ibn Hibban's case.⁸ However, the general principles of Shari'ah suggest that options are introduced for various purposes provided the stipulation of an option is within the principles of Islamic law. This is because the need for options will differ depending on the time and commodity.

2. They are meant to allow the contracting parties an ample time to avoid risk and damage to the contracting parties. These options are introduced by Shari'ah as tools for defeating damage or loss as a result of hastiness in exchanging offer and acceptance. The contracting parties may not necessarily know that the deal they concluded is viable and meet their expectation. Thus, the Shari'ah has introduced options to deal with regret, damage of injudicious decisions and unpleasant effects and outcome of buying and selling.
3. These options give a party to a contract a legal or contractual right to terminate the contract after its conclusion when it appears not serving the purpose of such a party. On the other hand, some of these options give one of the contracting parties, probably the buyer, a right to acquire discount for defects or a right of settlement.⁹ In this context, Islamic banks and financial institutions need these options to meet their desire to avoid risks and manage unpleasant situations of supply and demand.
4. In principle, the outcome or effect of exchange contracts, such as a sale contract, must take place once a contract is concluded. In a sale, for example, the subject matter of the contract must be transferred immediately, either actually or constructively, to the buyer after which the seller becomes entitled to the price. However, the options negatively affect the commitment of the parties to pay and deliver as well as occurrence of the objective and rule of a contract.¹⁰
5. In principle, Islamic law does not endorse any arrangement that would lead to uncertainty and ambiguity. Uncertainty or *gharar* in contracts means that the subject matter of the contract is not existing. Ambiguity or *jabalah* suggests that the subject matter of a contract certainly exists but its description (*wasf*) or identification (*ta'yeen*) is not clearly known.¹¹ The principles of options violate the prohibition of *gharar* and *jabalah* in contracts because a contract embedded with option is a hanging (unconfirmed) contract, i.e. the contract stands between two opposing extremes of confirmed acceptance and rejection. The contract may or may not be concluded and the ownership to the subject matter and entitlement to the price are floating/hanging till the conclusion of the contract. In other words, the acceptance does not follow immediately the offer due to the duration of the option. In this respect, options introduce *gharar* in contracts. However, options are allowed despite of being involved in *gharar* and *jabalah* for the need to options in contract. Their permissibility is an exception to the general principles of *gharar* and

jabālah because they serve a valid purpose. They defeat the risk of fraud, misrepresentation, loss and damage. Since individuals are in need to defeat the economic impacts of these events, options are legalized for the superiority of defeating these events over the existence of *gharar* and *jabālah* in the contracts. This is because the underlying objective of options is not to deal in *gharar* and *jabālah*, but rather to minimize the impact of these events on the contractual relationships.¹²

5. Parameters of a Valid Option

The jurists are accustomed to mention certain properties or qualities that are necessary for the validity of options. When one explores the *fiqh* literature in respect to options, it becomes clear that a valid option need to meet certain parameters, among others, the following:

- a) The general view of the jurists is that an option should be a quality that exists simultaneously with the subject matter of the contract at the time of its stipulation. This is because an option portrays a contract and it is not practical to agree on the described (*mansuf*) (the contract) without features or qualities. The Hanafis argued that an option may be stipulated before or after the conclusion of the contract.
- b) The option should be beneficial to the contracting parties or either of them.
- c) The option agreement should not be in conflict of the contract in which it is stipulated.
- d) The option agreement should not violate basic principles of Islamic commercial law, such as *ribā*, *gharar* and exploitation.
- e) The option agreement should bring about benefit to the contract even if it is not relevant to the contract such as deferment of payment or delivery and guarantee. The reason is that the law allows stipulation of these events in the contract.

6. The Risk Management of Sharī'ah Options

The above basic features of Sharī'ah options suggest that these options, if put together, manage a wide range of risks including the following:

- Fraud risk.
- Misrepresentation risk.
- Ownership risk.
- Price risk.
- Market risk
- Commodity risk
- Default risk.

7. Concept and Scope of Financial Options

7.1 Concept of Financial Options

In the language of modern economics, the financial option contracts convey the right to buy or sell at a pre-determined and agreed price. There are various types of financial options. However, all exchange-traded options come in two types, namely call option and put option. A call option entitles the holder the right but not the obligation to buy an asset at a pre-determined exercise price in the future prior to or on the maturity. In contrast, a put option entitles the holder the right but not the obligation to sell an asset at a predetermined exercise price prior to or on the maturity.¹⁵

7.2 Basic Features of Financial Options

From the above concept, one may summarize the basic features of option contracts as follows:

- a) the buyer of option pays as consideration a premium. However, the buyer is not obliged to buy or to sell. This is a mere right that may be exercised or otherwise, depending on whether the deal for which the option is purchased is profitable. When the deal is not profitable, the buyer declines to complete the contract and loose the premium.
- b) Both the seller and the buyer carry market risk.
- c) The financial option practiced in the financial markets is an independent contract from the sale contract. In other words, both the option and the subject matter of the contract are priced independently. The option gives a party a right to buy or sell. In

most cases, the seller of the financial option does not own the subject matter be it share or commodity.

In line with the above concept and features of options, the permissibility or non-permissibility of options may be examined from two Shari'ah aspects. The first principle is to examine options within Shari'ah nominated contracts or concepts that are comparable to options in terms of concept, qualities or properties. The second principle is to consider options as novel financial instrument created due to current circumstances of market volatility and which have no parallel in Islamic commercial law. This means options should be adjusted under the general principle of permissibility and other similar principles.

8. Similarities of Shari'ah and Financial Options

There are similarities between financial options and Shari'ah options. These similarities may be summarized in the following:

1. The Shari'ah and financial options agree on providing a right to either of the parties or both to confirm or to cancel the contract within a stipulated period. In essence, both options give the concerned party some period for re-evaluation of the benefits and costs involved, before giving final consent or accent to the contract.
2. The Shari'ah and financial options are mainly intended to manage a wide range of risks, although it is not ruled out that financial options may be intended for gambling.¹⁴
3. The Shari'ah options are created as a result of asset-based contractual relationship. This also exists in the transactions of financial options that involve shares.
4. The Shari'ah options and financial options agree on that both give the buyer an upper hand to decide on the direction of the contract.

9. The Differences of Shari'ah and Financial Options

The examination of Shari'ah options shows that they differ in substance and form from financial options from various perspectives, although some of the differences may be eliminated. The following are the main differences.¹⁵

1. A Shari'ah option consists of three components, namely the option itself, the contract and the underlying assets. In other words, the

option forms an integral part of the contract and its inclusion in the contract follows the conclusion of the contract or during the conclusion of the contract. This alludes to the fact that a Sharī'ah option is an outcome of the conclusion of a contract in which option was made condition for final endorsement of the contract.¹⁶ For this, the Hanafis argued that an option is a description of a contract that does not possess a financial value.¹⁷

2. In financial option, the subject matter is intangible event against the seller created by a contract of obligation.
3. Sharī'ah options are not subject of speculation and gambling whereas financial options are prone to be used as a gambling mechanism, directly or indirectly. This is because a relatively small percentage of option contracts actually turned to materialize as contracts, as the vast majority prove to be hedging contracts bought or sold back before falling due for settlement. Put simply, financial options are, in general, bought and sold.
4. The investors used financial options to hedge against potential price risks or losses by using the premium as consideration for the party who accepts to bear such risk or losses.¹⁸
5. The financial options are mechanism of investment whereby investors depend on their expectation of the market and issue or buy such options.¹⁹ This is not the case in Sharī'ah options.
6. The period of option in financial options is actually not part of the contract because it precedes the contract. The period in Sharī'ah options is an integral part of the contract.

10. Is There Parallels to Financial Options in Islamic Law?

We are often told that contracting on financial options is a new transaction without explaining the exact meaning of this conclusion. Does this mean that there is no contract in Islamic law which can be compared with contracting on options or does it mean that sale and purchase of options cannot be examined under the principles of Islamic law? Firstly, it is true that contracting on, operations of options in modern stock markets is completely a new phenomenon. However, the essence of contracting on options, if looked under the juristic debate on exchange of right and creation of obligation does exist in the *fiqh* literature. Therefore, it is almost not correct to say that options are pure novel contracts. This is because Islamic law or

fiqh literature has provided a wide range of principles to deal, in one way or the other, with novel issues, whether financial, social or political. It may be admitted that there are no nominated contracts comparable to existing operations of financial options.

For example, Build Operate Transfer (BOT) deals did not exist during the time of the classical jurists. However, such deals contain features of *istiṣnā'*, *iqta* or *ijārah*, hence they are discussed within the principles of these contracts. Construction contract (*muqawala*) is similar to *ijārah* or *istiṣnā'* and for that matter it is discussed within the principles of *ijārah* or *istiṣnā'*. The governments' award contracts for identifying wanted criminals have features of *ju'alah* contract and they are legalized under the principles thereof. In this sense, contracting on options is a new transaction. However, it will fail to be a new contract under the general principles of human dealings. Under these principles, the ruling of financial options would appear clear. The basic requirements of Shari'ah is that mere consent of the parties and the contract being free of fraud and misrepresentation are not enough to make a contract valid and acceptable. The validity of a contract requires that its arrangement match the general principles of Islamic rules and principles of transactions. An examination of financial options shows that they fall under the rules of pure sale and sale of rights.

11. Financial Options and Concept of Sale Contract

The definition of financial options by the experts made them to be associated to a sale contract.²⁰ If the association of financial options to the group of sale is acceptable, then one needs to examine these options under the principles of sale contract. This will explain as to whether financial options fulfil the conditions and requirements of saleable assets. The definition of the majority of the *fiqh* schools concurred that sale is an exchange of property in consideration for property. In order for an action or a transaction to acquire qualities of a valid sale contract, it must fulfil the following general requirements:²¹

1. The exchanged properties must be lawful in the eyes of Shari'ah and the delivery of them is realizable at the time of signing the contract.
2. The exchange must lead to ownership, which means having an actual control over, or ability to use, the subject matter of the sale contract.
3. An exchange between property and usufruct is not called sale in the strictest sense of the word sale (*bay'*, rather this is an *ijārah* contract, although *ijārah* involves sale of usufruct as termed by some jurists.

4. The properties exchanged must not be currencies in which case it is called currency exchange and not a sale contract, in which case the rules of currency exchange must be observed.
5. The subject matter should not be related to cohabiting rights according to Malikis.

12. Financial Options and Floating Contracts

The notion of options is similar to the concept of Shari'ah floating²² contracts, namely *al-ʿaqd al-muʿallaq*²³ and *al-ʿaqd al-muḍāf*. The discussion here would focus on *aqd al-muḍāf* due to being more pertinent to financial option contracts from various aspects. *Al-ʿaqd al-muḍāf* is a contract in which offer is referred to a particular time in the future, such as this item is sold to you in consideration for 1000 *dinars* to be effected at the end of the month.

The majority of jurists, as opposed to Ibn Taimiyya and Ibn Qayyim, disapproved a contract which execution is consequential on a future event or in which the offer is referred to the future. The *ʿillah* or the underlying reasons for this disapproval are as follows:

1. A contract that will be effected when something occurs involves *gharar* or uncertainty. This is because the parties to the contract do not know whether or not the event may happen in which case the contract is finalized or the event may not take place in which case the contract becomes not executable. The parties do not also know as to when the event may happen. Again, the event may happen at a time the parties may have changed their minds. Therefore, consequential contract involves *gharar* from the perspective of whether or not the event on which the contract is tied up could take place. From another aspect, *ʿaqd al-taʿliq* involves uncertainty as to whether the buyer or seller would really fulfil his or her obligation when the event takes place. In this respect, the Hanafi jurists argued that performance of contracts that transfer ownership, such as a sale, a gift, a financial settlement, a marriage etc., cannot be referred to a future event or a condition in the future because such an action involves chance and game.²⁴
2. The concept of *idāfa al-ʿaqd* contradicts principles of a sale contract. This is because sale is a contract of transfer of ownership which should be, in principle, concluded on immediate delivery basis so that the sold item would be transferred to the buyer. The concept of

ta'liq does not allow this immediate transfer of ownership to take place.²⁵

3. In addition, refereeing performance of a contract to future makes the consent of the contracting parties uncertain. This is because unless the date referred to become current the contracting parties are oblivious of whether or not they have consented to the conclusion of the contract. Since this is the case, a contract cannot be concluded on this basis because transfer of ownership cannot be dependent on an uncertain consent.²⁶

On the other hand, Ibn Taimiyya and his student Ibn Qayyim see no wrong with a sale contract consequential on a future event provided this is beneficial to society and the sale does not contradict any explicit source of the Qur'an and Sunnah. The basis for this is their principle that contracts are, in principle, except if explicitly prohibited by the Lawgiver. Therefore, *mudāf* contract is a form of stipulation that is relevant to a sale contract like any valid stipulation. In addition, Ibn Taimiyya argued that there is no report from his contemporaries of the Hanbali school and others that prohibits a sale consequential on a future event. Thus, *mudāf* contract does not involve *gharar* because the *gharar* that is prohibited is that which is related to the subject matter and not the contract, i.e. *gharar* does not occur in contracts per se. Moreover, the *gharar* that is prohibited is the *gharar* that lead to devouring of property of others. This is not happening the sale consequential on a future event. All in all, *mudāf 'aqd* is a contract that takes place on the basis of a particular description in which case if the description happens there is a contract and if not there is no contract. Ibn Taimiyyah further argued that there is no text showing that an immediate delivery of the subject matter is a must in a sale contract, but rather the law allows delay in delivery in accordance with the interest of the contracting parties. Therefore, Ibn Taimiyyah and Ibn Qayyim are of the view that a sale may be concluded on something that is not available at the time of the contract.²⁷

Al-Darir commented that *mudāf* contract may lead to devouring of property of others because the contract would be concluded in the future in which case the contracting parties are not aware of the consequences of the subject matter at the time. The exact price of the contract would fall under *gharar*. One may sell commodities worth 100 dinars on the basis of *mudāf* contract. At the occurrence of the consequential event, the price may fall drastically or increased significantly. In this case, one of the contracting parties is devouring property of others unjustly.²⁸ This is where *mudāf 'aqd* becomes relevant to the financial options. The operation of financial options involves devouring of property of others unjustly because the premium paid

for the option is taken, according to the opponents of financial options, without consideration whatsoever in addition to gambling on price fluctuations.

13. Financial Options and *Arbūn* Sale

Some modern writers on Islamic law and finance maintained that the objectives of financial options might be achieved through the principle of *arbūn* sale.²⁹ Others argued that the rationale of financial options resembles the concept of *arbūn* in the sense that both manage price risks.³⁰ Some writers even argued that *arbūn* sale is the same as call option.³¹ This necessitates a discussion on the principles of *arbūn* to see whether it is comparable with financial options.

By definition, *arbūn* sale refers to a sale contract in which the buyer reserves a commodity, pays a small part of the price and agrees to forfeit the paid portion of the whole price when the buyer fails to turn up on a particular date for taking the goods and payment of the remaining price. In this respect, AAOIFI Shari'ah standards defined *arbūn* as "an amount of money that the customer as purchase-orderer pays to the institution after concluding the *murābahah* sale, with the provision that if the sale is completed during a prescribed period, the amount will be counted as part of the price. If the customer fails to execute the *murābahah* sale, then the institution may retain the whole amount". The basic elements that this definition encompasses are: (a) *arbūn* takes place after effecting a sale contract, in which the sold item is defined and (b) the effective date of the *arbūn* must be defined.

The jurists differ on this concept from the perspective of the validity of *arbūn* sale itself and on the definition of the period of *arbūn*, i.e. whether *arbūn* may be an open contract or a period for exercising it should be defined. On the first aspect, the majority of jurists, including the Malikis, the Shafi'is and the Hanafis, did not permit *arbūn* sale. It is the view of Ibn Abbas and al-Hassan al-Basry.³² The basis for rejecting *arbūn* sale is that it involves some invalidating factors of a sale contract. One factor is that when the buyer did not to buy the commodity, the amount paid by the buyer would be retained by the seller for no consideration. In this case, *arbūn* sale is a form of devouring of others' property, which is strongly condemned by the Shari'ah.³³

The Hanbalis opted for the validity of *arbūn* sale. They cited a number of legal cases for the validity of *arbūn* sale. This was the practice of Umar Ibn al-Khattab, Ibn Sireen and Justice Shuraih. It is reported that Nafi' Ibn al-Harith

bought a building for using it as prison from Safwan Ibn Umayyah in consideration for four hundred dirham on the condition that the deal would be closed when Umar (R.A.) consented or the four hundred would be retained by Safwan if Umar refuses to endorse the deal.³⁴ Ibn Sireen and Ibn al-Musayyib were reported to have said that “if the buyer did not want the commodity, he or she may return it together with some money. This view was viewed by Imam Ahmad as basis for the concept of *arbūn*.³⁵

Al-Bukhari reported that Ibn Sireen reported that a man requested from Kurayh, a man who operates a caravan for transportation, to prepare a riding camel for a journey. The former promises to pay a hundred *dirhams* if he fails to use Kurayh's services on the designated date for the journey. This case was tested in the court of Justice Shuraih. His judgments was that any party who have voluntarily committed himself is obliged to honour what the other party expects from such a commitment.³⁶ This reveals that Justice Shurayh is of the view that consent of a party to pay, in the absence of duress, an amount of money for violation of the terms of a contract is valid and enforceable. This is the essence of sale of *arbūn*. In addition, the majority of the modern scholars have opted for the validity of *arbūn* sale because it is supported by a number of cases and is the view of a number of *tabi'ūn*. This is reflected in the International Islamic Fiqh Academy when the Academy endorses the validity of *arbūn* sale.³⁷ Therefore, the validity of *arbūn* sale is not disputed in the modern times. The controversy is whether *arbūn* is similar to option contracts, hence their validity on this basis.

13.1 The Similarities and Differences Between Arbūn and Financial Options

As explained earlier, the validity of *arbūn* sale is not disputed by the modern scholars. Now, the question is whether *arbūn* sale is similar to financial option contracts in that whether financial options may be accepted on the basis of *arbūn* sale. Although there is similarity between *arbūn* sale and financial options, the differences between the two is too wide so much so that they are not comparable. The financial options and *arbūn* sale are similar in the following:³⁸

- a) *Arbūn* contract consists of an option that is exchanged with money in case the contract over an asset or usufruct is not concluded.
- b) Among the objectives of *arbūn* contract is the management of market risk or price risks.

- c) The *arbūn* sale entitles the buyer to gain a binding offer from the seller while the buyer is at discretion to accept or reject the offer within the period of offer in consideration for the *arbūn*. This is similar to the call option where the option holder is entitled to buy shares or refrain from doing so against losing the paid premium.

However, the above similarities are not strong enough to make *arbūn* sale a basis for financial options. This is because there are very important differences between *arbūn* sale and financial options, including the following:

- a) The amount that is described as *arbūn* form part and parcel of the price of the sold item³⁹ whereas the premium of financial options is not considered part of the price, but rather a consideration for granting an option to buy or sell.
- b) In the *arbūn* contract, there exists a contract whereas the contract in financial options would be categorized under Shari'ah principles as a mere promise because it does not fulfil the requirements of contract.
- c) The *arbūn* is not tradable and financial options may be traded.

14. Financial Options and the Concept of Property (*Māl*)

It is a necessary requirement that both counter-values of a contract enjoy a proprietary value. Thus, contracting on financial options depends on whether options enjoy monetary value. In this respect, the identification of monetary value of financial options is necessary in order for them to qualify as property, hence tradable. In Islamic law, there are a number of qualities necessary for an object to qualify as subject matter of a sale, some of which have been stated earlier. The jurists differ on these qualities. The Hanafis suggest that an object is qualified as property (*māl*) when such an object fulfils the following conditions:⁴⁰

1. capable of being stored (hoarded)
2. capable of being put to some use
3. capable of being owned and possessed
4. has some value by law
5. such that humans are inclined towards it

6. not prohibited by the Sharī'ah to be owned and used. In this case, wine and pig, for example, are property for Muslims
7. Recognized as property by customary practice prevalent in an area or country
8. Not things of common use of everyone, such as light, air, grass, water, common pasturage and public roads.

The majority of jurists, the Malikis, the Shafi'is and the Hanbalis, have defined property in a very comprehensive manner to include usufructs and rights. The scholars of these schools concurred that the definition of property includes ownership of the thing itself or its usufructs. This is because property is what gives benefit. In this respect, al-Shatibi writes that property "is a thing on which ownership is conferred and the owner, when he assumes it, exercise absolute control over it against interference of others".⁴¹ Imam al-Shafi'i said, "the terminology *māl* should not be construed except as to what has value with which it is exchangeable; and the destructor of it would be made liable to pay compensation; and what the people would not usually throw away or disown, such as *fiṣ* (valueless currency) and similar things that people would usually throw away".⁴² By this definition, al-Shafi'i made two important points. Firstly, whatever is evaluated as effectively giving rise to benefit is regarded as financially valuable property. This means, on the other hand, that whatever is incapable of showing the effect of giving rise to benefit is excluded from the definition of financially valuable property.⁴³

The Hanbali jurist, al-Khiraqi, defined property "as something in which there exists a lawfully permissible benefit without resulting from pressing need or necessity". In his commentary, al-Buhuti, a Hanbali jurist, maintains that al-Khiraqi's definition means that the following are excluded from the definition of property:

1. the things in which there is no benefit in essence, such as insects;
2. where there might exist benefit but it is prohibited by the Sharī'ah, such as wine;
3. there is lawfully permissible benefit but only in situations of dire need, such as keeping a dog, or in situations of necessity, such as the consumption of a carcass when in dire need of survival.⁴⁴

The definition of the majority of jurists suggest that the term property is used to define anything that (a) has monetary value and usufruct in the eyes of society (b) is allowed by the Sharī'ah and is not assigned value due to necessity and need. Thus, a proprietary value evolved from the relationship

between the need to benefit from a thing and individuals.⁴⁵ Therefore, the convincing view is that the usufructs of assets are considered properties that may be exchanged with another monetary value, such as in the case of lease.⁴⁶

15. The Concept Right and Financial Options

The definitions of financial options give an impression that these options are considered rights. Thus, there is need to discuss the concept of right in the *fiqh* literature because this will enable us to see whether Islamic law allows trading in rights. A right philologically connotes something that is recognized in the interest of individuals. In other words, the terminology 'right' connotes something that is established by law in the interest of human being. In Islamic legal literature, the term right has general and specific meaning. One usage is in relation to a tangible asset or an interest that has been given to a beneficiary and he or she is assigned an authority to demand it when necessary, to deter others from taking it, to exchange it, in some cases, with consideration, or to forfeit it. In this sense, the term right is used in relation to (a) assets, (b) ownership itself and, in general, (c) to usufructs and interests, such as accommodation of this house is the right of so and so; evidential oath is the right of the defendant; bringing up or nursing a child is the right of his/her mother; sovereignty over the property of a child is the right of his or her father; pre-emption right; right of passage and adjacent right.

In addition, an examination of the statements of the jurists of all schools indicates that the term right has a specific meaning and the number of rules against exchanging rights with consideration revolves around this meaning. The jurists use the term right in contrast to tangible assets and owned usufructs. In this case, they do not mean the general meaning of right, which points to anything or action that envisage a right created either by law or following an existing contract. This specific usage points to legal rights, i.e. rights that do not exist except by the creation of law and which an individual is not entitled to withhold when demanded. These rights include, among others, pre-emption right, right to approve or disapprove a contract (*kuhūl al-shart*), right to demand payment of debt, right to marry a peer, right to drink water, right of passage of water, right to use a road or street (*haq al-tataruq*), polygamy right, divorce right, conjugal (sex) right, retaliation right, and similar rights.

The Hanafis, based on their definition of property, deny these rights a proprietary quality because they cannot be possessed or owned separately. The other *fiqh* scholars see that rights are property but when they are attached to tangible assets, such as the right of the lessee to use the leased property.

This right may be traded because it is attached to tangible property that may be bought and sold.⁴⁷

The majority concurred with the Hanafis that rights that are similar to a conjugal right are excluded from the definition of property, hence non-exchangeable because they enjoy no financial value. They are only rights assigned by the law to certain individuals. In this respect, the rights are divided to two, namely pure right and non-pure rights. The pure right by definition is an event that is associated with a thing which, if exercised or forfeited, would not neither change the structure of the subject matter nor have any legal effect. The beneficiary is not obliged to exercise such a right as any action in this direction would depend on whether exercising such a right would bring about benefit. For example, the right of pre-emption is nothing but an authority given to the beneficiary to own a building in consideration of the same price the outside-buyer would have to pay to the seller. This right does not add to the ownership of the building any value. The ownership per se is the same prior to and after exercising the right. The same rationale applies to the remaining pure rights.⁴⁸

The non-pure right, on the other hand, is the adverse of pure rights. A non-pure right is that which if exercised would change the rule of its subject matter. It is part of the subject matter and if forfeited would affect the direction of the ruling of the subject matter. For example, the right to retaliation in homicide is connected to the life of the murderer. As far as this right is not forfeited then the life of the murderer is at stake. When this right is dropped, the murderer becomes free. The same applies to divorce right. The right of a woman to deny any conjugal relationship is restricted when she is married and this restriction would stay so long as her husband did not exercise the right to divorce. These rights are described as non-pure rights because they can be exchanged with money such as in the blood money and the right of the wife to buy divorce from the husband, although they are not related to what may be described as property. Thus, this right of law is comparable to financial options.

The above shows that a right is either usufruct or interest/benefit for a particular individual. The interest of an individual that constitute a right may be divided from proprietary quality to two categories:

- a) The interest could be attached to a property by definition, such as a right to drink (*haq shurb*) which is attached to land in which case there is no legal objection to sell it, even according to the Hanafis, together with the land. In this case, the right may be assigned price that would be built in the price of the land. The

price of a land together with the right to drink water from its fountain is not the same as the price of a land without such a right.

- b) The interest could be in association to what cannot be defined as property, such as the right to bring up a child and the right to build a higher building adjacent to a neighbour in a manner that would affect the flow of space air to the lower building. These rights are not property by definition as the former is related to the child and the latter is related to a mere stature.

The creation of an interest of an individual may be divided to two as follows:

- a) Legal interest, i.e. interest that are automatically created by law with respect to property or personality, such as the right of pre-emption and bringing up a child.
- b) Interest created by external forces, such as a right of accommodation, right to passage and right to drink water. These rights are created by external forces manifested in the neighbourhood to the land or the will pronouncement.

As indicated earlier, the Hanafi jurists opined that rights, whether they are associated with what can be described as property or not, are not property but rather a sort of dominion (*milke*).⁴⁹ In this respect, they argued that rights couldn't be sold, given out as gift or donation separately because the subject matter of these events must be property and rights are not saleable property when detached from the underlying assets. However, rights may be assigned price when sold together with the underlying assets. This is because a right add value to the assets sold. However, some Hanafis argued that some rights might be separately sold, such as the right to drink. The rationale for this is that the right is considered portion of the water and because there was a need to consider such rights as separable property, especially the right to drink.⁵⁰ However, the prevalent view in the Hanafi school and the majority jurists is that rights that are not related to underlying assets are not subject of sale.⁵¹

Nevertheless, this general approach to trading in rights may be countered by the fact that a financial settlement may be reached for dropping claim to certain rights, such as the right to retaliation and the right to remain married. This is because these are non-pure rights, i.e. these rights are not created for management of harm *per se* against the beneficiary, but rather they exist following certain events, like murder and marriage.⁵² For this reason, Ali al-Khafif concluded that:

“Since some rights could be legally dropped by its owner, there would be logically no objection to exchange such rights for a defined amount on the basis of a contract, i.e. the buyer becomes entitled to it separately by contract. There is thus no objection to regard a right in this respect valuable *by contract*”.⁵³

Thus, Ali al-Khafif sees that rights may be sold separately when they are established by law in the interest of the beneficiary. But this conclusion may be encountered by saying that these rights, can only be dropped and cannot be exchanged for money because they enjoy no monetary value which is a necessary requirement for exchange contracts. Al-Khafif responded to this by saying rights may be assigned monetary value (*mutaqawwim*) by the contract itself. This suggests that there are forms of rights that were not discussed by the jurists. These are rights created purely by mutual agreement of the contracting parties. The question that needs investigation is whether people can create, based on pure contracts, obligations and rights without underlying assets and be traded.⁵⁴

15.1 Why Rights are Not Tradable?

It noted that the jurists are against trading in rights that are created by law, which were termed by one modern scholar as essential rights, such as the right of pre-emption.⁵⁵ In principle, a person is not allowed to interfere with the contracts concluded by individuals on the basis of consent. However, essential rights give the beneficiary a right to interfere in the contract and change the direction of ownership for fear of harm. In other words, essential rights are thus created in the interest of the beneficiary as a defence against any harm that may befall on him. If the beneficiary chooses to sell these rights, it becomes clear that non-exercising of the right is not detrimental to the beneficiary. Hence, the beneficiary is not allowed to transfer it to another person for consideration because this is a restrictive right.⁵⁶

It is noted that rights that the jurists, especially the Hanafi jurists, declared as non-exchangeable with money are meant to remedy a situation of harm (*darar*). The basic features of these rights is compensation for damage sustained by the beneficiary due to inability to benefit from a right given to him or her by the law. It is thus not relevant to draw analogy between non-exchangeability of rights of financial options and rights that are meant to prevent occurrence of damage to the beneficiary. This is because rights created by agreement are not meant to prevent damage in the same way as

the rights discussed by the jurists and concluded that they are not exchangeable.

16. The Shari‘ah Possible Solutions for Options

16.1 *Hāmish Jiddiyah* and Call Option

The term *hāmish al-jiddiyah* is usually observed in the writings on *murābahah* to the purchase-orderer. This is a commitment charge which the institution takes from the customer to start processing the transaction even though a sale contract is yet to be concluded.⁵⁷ This commitment charge is considered permissible by AAOIFI Shari‘ah Standards on *murābahah* and would be considered part of the contract price when the contract is concluded. If the client experience that the conclusion of the contract will cause him losses, he may forfeit this charge. Some scholars suggested that this commitment fee “form a unique form of a call option”.⁵⁸

However, *hāmish al-jiddiyah* could have been a good example of a call option should there be no difference between it and options. The commitment fee is to remedy damage or loss as a result of the customer’s failure to conclude the contract. The institution holds the commitment fee on fiduciary basis. If the commitment fee is more than the loss incurred by the bank, the remaining balance after deduction of the value of the loss or damage must be returned to the customer. In addition, when the customer has fulfilled his promise and executed the contract the institution is obliged to refund the commitment fee to the customer or to consider it part of the price.⁵⁹ On the other hand, the price for options, although it is meant to manage credit risk, is not refundable even if the contract is concluded. Again, the seller is not obliged to show that he or she has incurred losses due to failure of the contract in order to deserve such price.

16.2 *Ijārah* and Financial Options

The essence of the options in the international financial market encompasses the features of offer either from a person who is certain of allocating goods or shares for a buyer. This offer would be according to the price agreed upon (call option). A company may see that it is its interest to offer to sell shares according to the agreed price (put option). It would accept premium for such an offer. This service may be done on the basis of fees for management of the documents involved and finding such goods on the basis of *ijārah* without necessarily connecting the premium paid to finding such goods. In this case, the right to the premium is established by virtue of the

contract of the services provided in any case, i.e. whether the payer of the price for service concludes a contract of sale or not. In this case, the issue that the paid premium must be regarded as part of the sale price is eliminated. In this case, we may create a secondary market for options in the sense that the beneficiary of the services of the offering party may sell it to a third party because the subject matter of sale in this case is the liability to provide services. On the other hand, the offer to provide services may be done through *ijārah mumāzija* or parallel *ijārah* contract, which means the offering party may look for another person to provide him with shares or commodities in order to fulfil the obligation towards the first beneficiary.

The above structure is similar to the structure as suggested by Muhammad El-Gari.⁶⁰ The difference between the two is that that El-Gari is considering it only to the put option. In our view, this structure may be applied to both put and call option as explained.

16.3 *Ju'alah* Contract and Financial Options

It is noted that in *ijārah* concept, the period in which the offer remains valid must be determined as rightly observed by Muhammad El-Gari. This is a basic requirement of *ijārah*.⁶¹ This may be managed by the concept of *ju'alah* because *ju'alah* is possible in a number of transactions that cannot be a subject matter of sale or lease. In this case, *ju'alah* contract may solve a number of future contracts because it is permissible to demand payment of fees prior to submission of the subject matter. In addition, ambiguity (*jahalah*) of the subject matter, i.e. services, does affect the contract of *ju'alah*. The parties may agree on the submission of the subject matter without specifying a date. Therefore, *ju'alah* is a good contract to deal with financial options. In this case, both the buyer and seller may issue a public offer specifying reward (*ju'l*) for those who can find shares for prices they are looking for in which case the subject matter of *ju'alah* is to carry out a certain task that would produce a result. The requirement is to produce result and this stand until the result is achieved. This makes the *ju'alah* contract flexible as far as the premium price is concerned. The reward bidder may also enter into parallel *ju'alah* to look for the subject matter of the first *ju'alah* contract.

16.4 Options and Combination of Sale and Contract of Gift

The put option is open for combination of sale contract with gift. If the seller chooses not to sell to the buyer, the amount of money paid to the buyer would be considered as a gift associated with the contract of sale. This involves a combination of contracts that do not conflict in purpose and legal consequences, hence becomes valid. The sale contract is an exchange

contract which is not accepting *gharar* whereas gift contract accepts *gharar*. Hence, put option may be categorized on the basis of combination of sale and gift. This is because the buyer is not entitled to this amount of money except on the basis of gift. Again, association of gift and sale is in line with a case brought before the court of Justice Shuraih. The fact of the case is that a person promises to travel with a transportation company and requested arrangements to be made on the condition that if he fails to travel he is obliged to pay a sum of money. This person failed to fulfil his promise and Shuraih judged that he paid an amount of money as agreed on.

The sale mechanism may be applied in the case of call option. Wahbah al-Zuhaily argued that it is permissible to pay premium, either on the basis of agreement or donation, for the right to exercise call option. This is because Muslims are bound by the agreement they made. Again, payment for exercising call option is in line with the rationale for allowing options in contracts. However, put option cannot be acquired on the basis of payment of money. It is not allowed to pay for blocking the right of option. This is because option is not legalized for trading purposes, but rather it is permitted for management of risk of deceit and price hiking.⁶² Another scholar argued that put option is similar to combination of gift contract and sale contract because the buyer is not entitled to the premium except in a way of gift. This falls under prohibition of two contracts in one.⁶³ However, it is explained above that there is no conflict between exchange contracts and donation based contracts. This combination may be acceptable to deal with put option.

16.5 Financial Options and Payment of Price in Sharī‘ah Options

The Hanbali jurists argued that it is permissible for the seller on the basis of *khiyār al-Shar‘* to require that the buyer pays the price during the period of option so far as this is not intended for *ribā*.⁶⁴ The same stand was adopted by the Hanafis and Shafi’is, except that the Hanafis allow payment of the price of exchange contract if the buyer makes the payment voluntarily, not dependent on condition.⁶⁵ The Malikis disapproved payment of the price during the period of option because, according to them, option makes the contract non-conclusive and any payment leads to combination of sale and loan. It is a sale when the contract is concluded and is a loan when the contract is concluded. This leads to either *ribā* or *gharar* which are prohibited by an explicit source.⁶⁶

In looking for solution to financial options, the view of the Hanbalis and the Shafi’is view may be adopted. This view argued that possession of the price is part and parcel of a contract for which it may be paid during the period of option. Moreover, there is no any harm against the buyer if

payment is made and anything that does not involve damage to either party shall not be rejected as per the principle of Islamic law. This is because the non-delivery of the sold assets is created by the right of option which is chosen by the parties. Thus, it is permissible for the parties to agree on not to deliver or take delivery of the goods for a period. In financial options, this view may be adopted in that the buyer pays full amount for the goods or shares of a particular company. The goods or shares may be identified and delivery is deferred based on options. The seller is given the chance to use the amount of the money for the period of option or before maturity. The buyer is given the chance to think of the deal and measure all risk factors. If the buyer decides not to continue the deal, he may recover his fund without any loss whereas the seller is able to use the money paid during the period of option.

17. Conclusion

The main purpose for the option in Islamic law is risk management in various forms. This objective is available in conventional options. Therefore, there are areas in Shari'ah based options that are comparable to financial options and the differences are many. For this reason, Shari'ah options may not stand strong as basis for financial options. It is necessary to find solutions in other areas of Islamic law. The concept of financial options was examined under the principle of sale. The paper examines the concept of *arbūn* sale that plays a significant role in mitigating risks for both the buyer and the seller. The buyer is given the chance to think about the deal and the seller is protected against the loss of waiting, if a better deal comes up. However, this concept too is not similar to the concept of financial options from many respects.

The concept of sale of rights seems to be a good area of law that may help in the issue of financial options. This area needs thorough investigation from both the Shari'ah scholars and practitioners in order to come up with viable alternatives to risk management tools that are lacking in the Islamic banking and finance. The non-permissibility in exchanging of the rights does not apply without exceptions. Thus, there is possibility to find some principles that meet the objectives of financial options. It is not necessary that we have to allow the financial options in the form they are practiced in the financial markets.

Notes

- ¹ On the details of the benefit of financial options, see El-Gari (1993).
- ² See AAOIFI (2004), pp. 269-271.
- ³ See Abu Ghuddah (1985), p. 50.
- ⁴ Muslim, *Sahih*, vol. 3, p. 1164, Hadith No. 1532.
- ⁵ See al-Buhuti, *Kashshaf al-Qina'*, vol. 3, pp. 200-202. For details of these options, see Abu Ghuddah (1985).
- ⁶ See Obaidullah (2001); Islamic Fiqh Academy (1990) pp. 1273-1385; and Islamic Fiqh Academy (1992), pp. 73-355. These pages discussed rules of financial markets, including options and some of the papers investigate options from the perspective of *khiyār al-shart*.
- ⁷ There are more than thirty-five forms of options in the *fiqh* literature. The juristic details of these options are provided in Abu Ghuddah (1985).
- ⁸ See Ibn Majah, vol. 2, p. 789.
- ⁹ The jurists did not dispute the fact that option for defect is exchangeable in monetary terms because the defect has an effect on the pricing of the subject matter.
- ¹⁰ See Abu Ghuddah (1985), p. 68.
- ¹¹ See al-Qarafi (1923), vol. 3, p. 265.
- ¹² See Abu Ghuddah (1985), pp. 87-94.
- ¹³ See El-Gari (1993).
- ¹⁴ See El-Gari (1993).
- ¹⁵ See al-Qurahdaghi (1992), p. 181.
- ¹⁶ See Abu Sulayman (1992), p. 314.
- ¹⁷ Abu Ghuddah (1985) p. 100.
- ¹⁸ See El-Gari (1990), p. 1613-1614.
- ¹⁹ Ibid.
- ²⁰ See El-Gari (1990) and also Obaidullah (2003).
- ²¹ See, al-Zailai (undated), vol. 4, p. 2; al-Dassuqi (undated), vol. 3, p. 2; al-Ghazali, Abu Hamid, *al-Wajeez*, vol. 1, p. 80; and al-Buhuti (undated), *Sharh Muntaba al-Iradat*, vol. 2, p. 139.
- ²² By floating it means the contract stands between being executed or being dissolved. The outcome of the contract would depend on the occurrence of an event or a future effective date of the contract.
- ²³ This contract is, in legal language, a contract in which performance is tied to occurrence of another potential event in a particular manner, such as this item is sold

to you with 1000 *dinārs* provided so and so sell to me his house. Thus, a consequential contract revolves around an event that is not in existence at the time of contracting, but which may potentially exist in the future. This is different from *mudāf* contract which takes place in the future time.

²⁴ See Ibn Abidin, *Hashbiya Ibn Abidin*, vol. 4, p. 324.

²⁵ See Ibn Abidin, *Hashbiya Ibn Abidin*, vol. 4, p. 324.

²⁶ See al-Darir (1990), p. 160.

²⁷ See Ibn Qayyim (1973), vol. 2, pp. 27-30; and al-Darir (1990), p.p. 157-168. This view is espoused by some modern scholars such as Ali al-Khafif, Mustafa al-Zarqa, and Muhammad Salam Madhkur.

²⁸ Ibid.

²⁹ See El-Gari (1993).

³⁰ See Kamali (2001), p. 357 as quoted by al-Amine (2005), p. 75.

³¹ See Vogel (1998), p. 126.

³² See al-Zuhaily (1982), vol. 4, p. 449.

³³ See al-Zuhaily (2000), p. 10.

³⁴ Ibid.

³⁵ Ibid.

³⁶ al-Bukhari, vol. 2, p. 981; Ibn Qayyim (1973), vol. 3, pp. 388-389.

³⁷ See Islamic Fiqh Academy (2000), the resolution number 72 (3/8).

³⁸ See al-Amine (2005), p. 75-77.

³⁹ See al-Shawakani (undated), vol. 5, p. 173.

⁴⁰ See Ibn Abidin (1986), vol. 4, p. 501; al-Khafif (1952), pp. 31-32.

⁴¹ See al-Shatibi (undated), vol. 2, p. 17.

⁴² See al-Shafi'i (1961), vol. 5, p. 160.

⁴³ See al-Dabbo (1997), p. 226.

⁴⁴ al-Buhuti (2003), vol. 3, p. 152.

⁴⁵ See al-Dabbo (1997), p. 227.

⁴⁶ See al-Khafif (1952), p. 33.

⁴⁷ See al-Marghinani (undated), vol. 3, p. 46.

⁴⁸ See al-Khafif (1952), p. 35.

⁴⁹ See Ibn Abidin (1986), vol. 5, p. 51.

⁵⁰ Ibn al-Humam (1970), vol. 6, p. 428; al-Marghinani (undated), vol. 3, p. 46; Ibn Nujaim (1993), vol.6, p.88.

⁵¹ Ibid.

- ⁵² See Ibn Abidin (1986), vol. 5.
- ⁵³ al-Khafif (1952), p. 36.
- ⁵⁴ In our view, *Shari'at al-Wujoob* is similar to trading in obligations.
- ⁵⁵ See Usmani (1998), p. 77.
- ⁵⁶ See Ibn Abidin (1986), vol. 4, 518, 520.
- ⁵⁷ See AAOIFI (2004), p. 134.
- ⁵⁸ Khan, Tariqullah (2000).
- ⁵⁹ See AAOIFI (2004), pp. 116-117.
- ⁶⁰ See El-Gari (1993).
- ⁶¹ See AAOIFI (2004), Sharia Standards on *Ijārah and Ijārah Muntabia Bitamleek*.
- ⁶² See al-Zhaily (1990), p. 1331.
- ⁶³ See al-Shareef (1999), vol. 1, p. 98.
- ⁶⁴ See Ibn Qudama (1983), vol. 3, p. 593.
- ⁶⁵ See Shubir, Muhammad, "Khiyār al-Naqd wa Tatbeeqatihi fi Muamalat al-Masarif al-Islamiyyah", in *Bubuth Fiqhiyyah fi Qadayah Iqtisadiyyah Mua'sirah*, vol. 2, p. 698-735.
- ⁶⁶ See Ibn Rushd (1952), vol. 2, p. 210.

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