CONFERENCE PROCEEDINGS

THE FIRST ANNUAL CONFERENCE OF ISLAMIC ECONOMICS & ISLAMIC FINANCE

ECO ENA Researches & Policy Analyses

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The First Annual Conference of Islamic Economics & Islamic Finance was held in Toronto University: Chestnut Conference Centre on August 30th & 31st, 2013. The conference has been organized by ECO-ENA: Economics & ECO-Engineering Associate, Inc., Canada

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THE FIRST ANNUAL CONFERENCE OF ISLAMIC ECONOMICS & ISLAMIC FINANCE

Sponsored and organized by ECO-ENA: Economics & ECO-Engineering Associate, Inc., Canada

The conference was held in Toronto University: Chestnut Conference Centre on August 30th & 31st, 2013.

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The First Annual Conference of Islamic Economics & Islamic Finance

<u>Venue</u>: Chestnut Conference Center; University of Toronto, Toronto, Ontario, Canada

August 30th & 31st, 2013

Conference Proceedings

Ottawa, Ontario, Canada

2013

Dear readers:

I am very pleased to present the proceedings of the first annual conference of Islamic Economics & Islamic Finance held at Chestnut Conference Center; University of Toronto on August 30th & 31st, 2013 and organized by ECO-ENA: Economics & ECO-Engineering Associate, Inc., Canada.

The aims of the conference were to collect intellectual research works in the field of Islamic Economics & Islamic Finance, to discuss them in a big international intellectual symposium by experts in the field and to preserve them in the conference proceedings to help other researchers enriching their database, concepts, and thoughts in this domain. Also; the forum of the conference introduces new concepts to the literature and edit existing concepts to keep pace with the present time.

Professors and practitioners from different countries participated to the conference and to its intellectual material. Delegates participated from Canada, USA, UK, France, Belgium, Indonesia, Malaysia, Saudi Arabia, Qatar, Kuwait, Afghanistan, Uganda, Nigeria and Egypt. The conference was unique in presenting different papers and panel discussions in other religious economics and finance as well; i.e., Jewish economics and Christian economics. The conference included papers and articles in economics, micro and macro-finance, business, insurance, risk. The conference helped also to close some gaps between academic and non-academic thinking in this field by presenting some practitioners' works in this area of research and analysis.

This conference was the first of its series. The same conference with different themes in all areas related to Islamic economics, Islamic finance, and religious economics in general will be held every year in Toronto, Ontario, Canada. This series of the conference is aimed to add significantly to the existing literature of this field. Some papers, articles, and summaries of papers presented at the first conference of the series of the annual conference of Islamic economics and Islamic finance were deposited in this conference proceeding which can be viewed and accessed internationally from both the website of the forum and the website of the Library & Archive Canada (LAC's electronic deposits).

Ghada Gomaa

Ghada Gomaa A. Mohamed
The chair of the conference and the founder of the forum

Dear Readers,

We are delighted to be able to present this volume of proceedings from the ECO-ENA's Annual Conference of Islamic Economics and Islamic Finance. We are delighted to have received so many thoughtful and valuable papers which shed light on Islamic approaches to business.

We begin with Prof. Ralph Huenemann's paper on Christian economics, which reaches the conclusion that there is at present no distinctively Christian economics. This reflects the strongly secular approach of business schools both with regard to ethics and with regard to business strategy. This growth of a separate discipline of economics without regard to the religious beliefs of the student of the subject may be a necessity in a world in which personal beliefs of any kind may be hidden to promote the appearance of objectivity and independence and in which religious discussions, outside the narrow circles of theological colleges, may be viewed as a dangerous irrelevance, often associated with deep sensitivities. Yet it is curious that at the same time economists seem to be thoroughly expected to identify themselves as disciples of this or that great economic leader or strict follower of some body of economic or political doctrine and it appears to be little noticed if a university teacher openly espouses the secularized millenarian views of Karl Marx, whereas an appeal to Fifth Monarchist beliefs would appear, at the very least, quaint. It is also not easily forgotten in the Christian context that St Thomas Aquinas was exercised with the theoretical and theological problems of interest on loans or that the publication of *Utopia* by the great Catholic layman St Thomas More represented a great step forward in the development of non-violent socialist model. It may perhaps be hoped that the challenge of studying the effects of religious belief on economics and finance in the Islamic world will lead to a revival in attempts to understand the effects of religious beliefs in general on economic activity and the ways in which religious beliefs may affect the ideals which underlie the economic goals and principles of ordinary people.

Moving on to specifically Islamic financial principles, we present three papers regarding transactions and economic provisions in a state of uncertainty which go to the heart of significant problems exercising economists generally. Mansour Khalili Araghi and Elham Nobahar discuss Gharar transactions, where at least one party is in ignorance of some information relevant to the transaction. The implications of this by no means uncommon situation is presented in game theory terms, with explicit recognition of the possibility that sellers may benefit from strategies of dishonesty by concealment. This problem of asymmetric information is often present not only in the sale of goods but also in respect of financial instruments and in respect of services, where in many cases the quality of the service may be better known to the seller than to the buyer while the buyer's ultimate reaction to the service may be unknown to both.

This makes the Islamic prohibition on Gharar transactions highly relevant throughout past and future history.

Sadegh Bakhtiari discusses another aspect of the economics of uncertainty, namely insurance. Insurance remains a fertile area for religious, ethical, economic and psychological discussion, not least because once again there may be major information asymmetries between the insurer, who may be better informed on averaged risks to the population as a whole, and the insured, who may be better informed on specific insured risks. There is the further probability that insurance will change the behaviour of the insured either by encouraging reasonable behaviour which accepts normal risks in life and business or by encouraging negligent or highly risk-seeking behaviour, which creates the problem of moral hazard. Prof. Bakhtiari's discussion of takaful arrangements for mutual systems of loss guarantees and microtakaful arrangements for poorer people also addresses key issues of mutual insurance for the poor which reflect longstanding mutual self-help ideals in Islamic societies and other societies around the world, which also have the potential to improve the autonomy of poorer sections of society and reduce the dependence of the poor on the wealthy.

Mamdouh Ahmed's paper on the cooperative insurance market in Saudi Arabia also reflects issues in Islamic insurance models and highlights the low penetration of insurance in Saudi Arabia compared with global averages. There are likely to be benefits in developing Islamic mutual insurance models that can be readily understood and recognized by both Muslims and non-Muslims in the Arab world and elsewhere.

The history of applying theological principles and beliefs to the conduct of financial transactions and the growth of financial laws in the West under religious guidance is reflected in Benjamin Geva's account of Jewish and Islamic attitudes to and laws on settlement transactions involving a third party, where issues of privity of contract and personal liabilities were required to be taken into account in assessing the validity of paymaster transactions. This was a key issue in the development of banking and settlement systems in the West and underlies the processing of transactions and the use of promissory notes and paper money in the present-day world.

Rizma Riyandi Rahman and Mutia Taqina Gamat discuss the role of the state in welfare provision and its potential to aid economic development and prosperity in Islamic terms with reference to the Quran and to a longstanding tradition of Islamic scholarship on the subject. Ahmadi Aymen examines credit risk in Islamic and other banks, bank regulation and the effect of profit and risk sharing in Slamic finance and seeks to develop a model for credit risk taking account of management quality and the funding of bank assets. Finally, we present a paper by Sattem Saleh Al Nomay on the subject of what constitutes usury and whether the provision of services to bank customers who are creditors of the bank should be classed as usury, with a recommendation that a government-level Shari'a Banking Board is needed to regulate these services.

We wish to thank all our contributors, including those included in this volume and also Prof. Rodney Wilson, Prof. Amir Kia, Paul Wouters, Cherin Hamadi, Bassem Ghali, Ibranim Aljasser, Dr Ghada Mohamed, whom we also thank, as always, for her energy and efficiency in organizing this conference, and our distinguished keynote speaker, Dr Rashed Ahmad Alolaiwi of Qassim University.

I commend these proceedings to all our readers, regardless of their religious or other beliefs. It is our intention to contribute to the understanding of finance, economics and the human condition and hope that the thoughtful contributions included here will be of interest and benefit.

Yours Sincerely,

Morrison Handley-Schachler.

Morrison Handley-Schachler
Vice President of Research & Policy Analysis
ECO-ENA, Inc.

The First Annual Conference of Islamic Economics & Islamic Finance

Venue: Chestnut Conference Center; Toronto University

Toronto, ON, Canada

August 30th & 31st, 2013

Conference Chair: Dr. Ghada Gomaa A. Mohamed, ECO-ENA, Inc., Canada

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The First Annual Conference of Islamic Economics & Islamic Finance

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Conference Program

Day 1: Friday August 30th, 2013
From 8:30 am to 5:00 pm
8:30 am: Registration and Reception

Presentations in orders

- **"Main concepts in Islamic banking, Islamic finance, & international Islamic finance: An introduction to the conference"**

Presenter: Dr. Ghada Mohamed, ECO-ENA, Inc., Canada

- **"Implications of Basel III for Islamic Banks" and "Islam and Economic Policy"**

Presenter: Professor Rodney Wilson, Durham University, UK & International Centre for Education in Islamic Finance, Kuala Lumpur, Malaysia - *Overseas presentation*

- **"Islam and the stock market: Evidence from the United States"**

Presenter: Professor Amir Kia, Utah Valley University, USA

- **"Re-direct of contemporary Islamic finance from an Islamic wealth management perspective"**

Presenter: Mr. Paul E.E. Wouters, CEO PT Senturiyon Global, Indonesia -*An expert in Islamic Finance - Overseas presentation*

- *Panel Discussion: **Main differences between Islamic banks and conventional banks***

Chaired by: Dr. Rashed Alolaiwi, Professor Amir Kia, Dr. Ahmed Aymen, and Dr. Ghada Mohamed

***1:00 pm - 2:00 pm:** Mediterranean vegetable break*

- **"Developing shari'ah compliant tools for the financier of last resort: The case of Qatar"**

Presenter: Ms. Cherin Hamadi, Qatar Central Bank, Qatar

- **"Comparative study on the factors influencing credit risk: the case of Islamic banks and conventional banks"**

Presenter: Mr. Ahmadi Aymen, University of Angers, France

- **"Cooperative insurance market in Saudi Arabia challenges, growth opportunities & suggestions for development: An empirical study"**

Presenter: Professor Ahmed, Mamdouh, King Saud University, Saudi Arabia

- **"Social media and retail Islamic finance"**

Presenter: Mr. Bassem Ghali, Head of Client Strategy, Toronto, Canada

Day 2: Saturday August 31st, 2013

From 9:00 am to 4:30 pm

9:00 am: Reception

Presentations in orders

- **"Concepts analysis I-MQ's as standard of application to create takaful Ijtima'i to construct welfare society"**

Presenter: Ms. Rizma Riyandi & Ms. Mutia Taqina Gamat, Padjadjaran University of Indonesia - *Overseas presentation*

- **"Some notes regarding Gharari transactions: A game theory approach"**

Presenter: Professor Mansour Khalili Araghi, University of Tehran, Iran

- **"Takaful and Microtakaful: Islamic instruments for protecting poor and vulnerable groups"**

Presenter: Professor Sadegh Bakhtiari, Islamic Azad University, Iran

- **"Medieval Jewish and Islamic payment instruments"**

Presenter: Professor Benjamin Geva, York University, Canada

A keynote speech by Professor Ralph Huenemann, University of Victoria, Canada
"Perspectives on Christian Economics"

1:00 pm - 2:00 pm: *Mediterranean vegetable break*

- **"Free services offered by banks to checking account holders, Riba or not?"**

Presenter: Dr. Sattam Alnomay, King Saud University, Saudi Arabia - *Overseas presentation*

- **"Islamic banking: Financing instruments used by Saudi banks"**

Presenter: Professor Ibrahim A. Aljasser, King Saud University, Saudi Arabia

- **A keynote speech by Dr. Rashed Ahmad Alolaiwi, Qassim University, Saudi Arabia**

"*Islamic finance in Islamic banking and finance in the conventional banks - Comparison*"

- *Closing Short Speech:* **Summary of the conference, conclusion, and implications**

Dr. Ghada Mohamed, ECO-ENA, Inc., Canada

4:30 pm closing time

7:00 pm - 9:00 pm

The gala dinner

Location: *Hemispheres Restaurant; Metropolitan Hotel, Toronto*

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August 30th & 31st, 2013

Selected Working Papers and Articles

Summaries of some papers are also included.

My Perspective on Christian Economics

Ralph W. Huenemann
University of Victoria, Canada

Although I have taught economics and finance for many decades, I have encountered the term *Islamic finance* only in the past few years. The term is usually contrasted not to *Christian* finance but to *conventional* finance. My understanding is that Islamic finance differs from the conventional kind because the Quran teaches that charging interest on debt is unethical, and perhaps disagrees on other issues as well. I am gradually educating myself to the complexities of this debate in finance. I only encountered the term *Islamic economics* a few weeks ago, when my reading about Islamic finance brought to my attention Muhammad Akram Khan's new book *What Is Wrong with Islamic Economics?* Khan's implied contrast is again not with *Christian* economics but with *conventional* economics. In this context, let me explore two questions.

Question 1: What are the differences (and similarities) between Islamic and conventional economics?

It is important to begin by noting that economics and finance are not identical. Let me set aside the specific issues raised by Islamic finance and focus on economics, as the subject is understood by economists. For western economists, this begins with Adam Smith and his famous book *The Wealth of Nations.* It seems clear to me that Islamic critics of conventional economics assert that the Islamic perspective on economic issues places emphasis on principles of ethics and justice and community, in a way that conventional economics does not, and that this emphasis on issues of right and wrong makes Islamic economics morally superior to the conventional kind. Some conventional economists seem to agree that ethical issues have no place in their subject but, if asked, would probably disagree that this makes the Islamic version superior. For this school, economics is primarily, or entirely, a *positive* science, not a *normative* one. That is, it poses and tries to answer questions of *fact* (such as, if the central bank increases the money supply, what will happen to the price level, or the interest rate, or the rate of unemployment?), not questions of *value* (should the central bank increase the money supply?).

For myself, I find it quite surprising that any economists embrace this viewpoint—since it seems clear to me that conventional economics is both positive and normative. Certainly Adam Smith saw it this way, for he wrote a second, equally important book titled *The Theory of Moral Sentiments.* He thought of himself as a moral philosopher, not an economist. And, to cite one other famous example, Karl Marx (although admittedly a heterodox economist, and a deeply flawed human being) was passionately committed to understanding *and fixing* the shortcomings of capitalism as he saw them. And Smith and Marx were not exceptions. Rather, mainstream economics has always given major attention to what are without doubt normative questions: Should government policy support free trade or protectionism? What social institutions best serve economic efficiency as a goal? Which markets require government regulation and which markets function better with deregulation? The list can easily be extended. But the point seems clear. Economics, even conventional economics, has always been a normative science.

Question 2: Is there such a thing as Christian economics, and if so how is it related to either conventional or Islamic economics?

If we mean by "Christian economics" the teachings of Jesus of Nazareth about economic issues, we are talking about a severely normative school of economics—more radical, I think, than the Islamic writings on the subject. I have in mind the episode of Jesus throwing the moneychangers out of the temple (Matthew 21:12), the teaching that "blessed are the poor" (Matthew 5:3), and so on.

If we examine contemporary economics as an intellectual discipline, and ask how—if at all—it is influenced by Christian principles, I would advance four relatively noncontroversial propositions:

- If asked, some economists would identify themselves as Christian, and some would not. Even within the group that self-identify as Christian, there are intense arguments about whether all the others are legitimately Christian.
- Some economists are relatively conservative (right-wing) in their social and political views, and some are relatively liberal (left-wing).
- Some economists are orthodox, and some are heterodox.
- There is no correlation whatever between these categories (Christian/non-Christian, conservative/liberal, orthodox/heterodox). All combinations are possible.

I would add a fifth assertion, perhaps more controversial, that it is entirely possible for an economist to be an ethical human being without holding any religious beliefs whatever. Sadly, I would add the corollary that it is also possible for a human being to be devoutly religious and nonetheless deeply unethical.

In brief, my own view is that Christian economics is neither valid nor invalid, because no such category exists.

Suggested Readings

Aslan, Reza (2013). *Zealot: The Life and Times of Jesus of Nazareth.*

Blom, Philipp (2010). *A Wicked Company: The Forgotten Radicalism of the European Enlightenment.*

Damasio, Antonio (2010). *Self Comes to Mind: Constructing the Conscious Brain.*

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McCloskey, Deirdre N. (2006). *The Bourgeois Virtues: Ethics for an Age of Commerce.*

Rees, John A. (2011). *Religion in International Politics and Development: The World Bank and Faith Institutions.*

Smith, Adam (1759). *The Theory of Moral Sentiments*.

Smith, Adam (1776). *An Inquiry into the Nature and Causes of the Wealth of Nations.*

Vermès, Géza (2012). *Christian Beginnings: From Nazareth to Nicaea.*

Some Notes Regarding Gharar Transactions: A Game Theory Approach

Mansour Khalili Araghi[1]

Elham Nobahar[2]

Prohibition or denial of Gharar is one of the major Islamic economic rules. In this regard, it is very important to study this rule and the consequences of Gharar transactions.

Furthermore, by using the modern economic tools, the logic and wisdom of this Islamic rule can be understood. The main purpose of this paper is to use the game theoretic approach to study the rule of prohibition of Gharar, and why these kinds of transactions are forbidden in Islam.

Definition of Gharar

In financial transactions, Gharar is the uncertainty, which is due to shortages of information or some deficiencies in contracts in a way that limiting and controlling the Gharar transactions is one way of risk management in Islam.

The main source of the rule of prohibition of Gharar is the hadith from the prophet (ﷺ) "نهی النبی عن بیع الغرر" . Foghaha have referred to this rule in their fatwas (فتاوی). However, there are differences in its aspects.

Some are referring it to the conditions of transactions; some for instances of transactions; for some, Gharar transaction is the one that its existence is not known for sure or its quantity is unknown or the one, which there is no power for giving or receiving the deal. To summarize, one could say that Gharar is where there is the probability of loss in a transaction because of ambiguity in some aspects of the transaction, which itself is due ignorance and uncertainty in the transaction.

[1] Professor, Faculty of Economics, University of Tehran
[2] Ph.D. Student, Faculty of Economics, University of Tehran

The Model

In this part, we are trying to model a hypothetical Gharar transaction and study the consequences of such a transaction for the society. In this line of study, we have assumed a transaction in which the quality of the good is not known for one side, i.e. buyer.

Assumptions:

there are two kinds of goods in this market, high quality good (H) and low quality good (L).

(p) percent of the sellers are selling high quality goods and (1-p) percent are selling low quality goods.

The sellers are well aware of the quality of their goods, while the buyers only know the probability distribution of it. That is we are facing an asymmetric information problem.

When there is asymmetric information then comes the problem of transferring the information.

The sellers are sending high price and low price to signal about the quality of their commodities. Thus the different strategies of the sellers are: asking for high price (HP) or asking the low price (LP). On the other hand the buyers have two options, accepting (A) the price or rejecting (R) it.

We assume that each seller obtains the same profit $\pi > 0$, from selling high quality good with high price and low quality good with low price.

The seller of high quality good always asks for high price – there is no reason for selling high quality good for low price. It is assumed that the seller can earn extra profit by selling low quality good with a high price π' $(\pi' > \pi)$.

We assume that each buyer gets the same utility $u > 0$, when buying high quality good with high price and low quality good with low price.

The buyer always accepts low price, there is no doubt regarding the quality of good in this situation. But for the high price, the buyer can accept or reject it. If the buyer does not accept the high price asked by seller, he/she should search for extra information to know about the quality of the good. Searching is costly, time and money which should be spend to obtain more information. This cost will give him/her the disutility by the amount of c. That is, in this situation the buyer's utility would be $u'' = (u - c)$.

Furthermore, the buyer will have the utility of u' $(u' < u)$ when accepting the high price for the low quality good.

It should be noted that $u'' > u'$, because otherwise searching for extra information would have been useless.

Under these assumptions we can model the situation as a strategic game in which the seller has two actions– asking high price or low price, and the buyer has two actions – accepting it or rejecting and spending more time to acquire extra information. Since there is conflict of interests between sellers and buyers and the flow of information is from the sellers to the buyers, we can show the game as an extensive form of signaling game, which is shown in diagram (1).

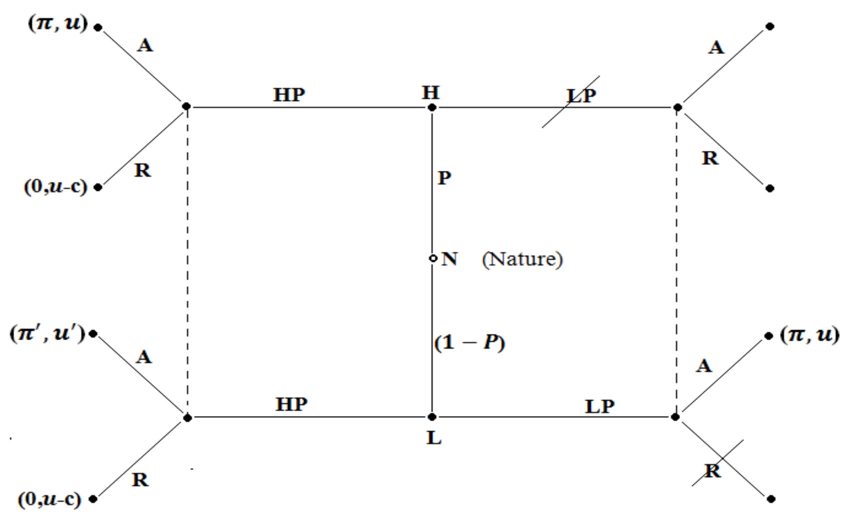

Diagram (1)

For the honest society and with no Gharar transaction, the solution would be (π, u).

But when the seller sends mixed signals, i.e. high and low price for low quality good, there is the possibility of loss for at least one side, Thus this model can be categorized as a Gharar transaction. We can show the actions and reactions of the players as follows:

The sellers pursue the honesty strategy (T) and send the correct signals or they can pursue the opposite strategy (F). On the other hand the buyers can accept (A) any price that the sellers are asking, or reject (R) them and try to acquire extra information.

Buyer

		$A(q)$	$R(1-q)$
Seller	$T(z)$	π, u	$(1-p)\pi,\ p(u-c)+(1-p)u$
	$F(1-z)$	$p\pi+(1-p)\pi',\ pu+(1-p)u'$	$0, u-c$

Table (1)

Nash Equilibrium

To find the Nash equilibria of this game we can construct the best response functions.

Seller's best response function:

If q=0, then the best response for the seller is z=1; If q=1, then the best response for the seller is z=0.

The seller is indifferent between choosing T and F, if:

$$q\pi+(1-q)(1-p)\pi = q[p\pi+(1-p)\pi'] \rightarrow q = \pi/\pi'$$

Buyer's best response function :

If z=1, then the buyer's best response would be q=1.

If $z = 0$, in this case the buyer's best response depends on the values of $u - c$ and $pu + (1-p)u'$.

If $pu + (1-p)u' < u - c$, then the buyer's best response would be $q = 0$;

If $pu + (1-p)u' > u - c$, then the buyer's best response would be $q = 1$; and

If $pu + (1-p)u' = u - c$, then the buyer would be indifferent between choosing A and R.

So, If $pu + (1-p)u' > u - c$, in this case the buyer's best response would be $q = 1$, for all the values of z. But if $pu + (1-p)u' < u - c$, then the buyer is indifferent between A and R if

$$z = \frac{pu + (1-p)u' - (u-c)}{pu + (1-p)u' - (u-c) - pc} = z^*$$

Equilibrium

Given the best response functions of the players, if $pu + (1-p)u' > u - c$, then the pair of pure strategies (F,A) would be the unique Nash equilibrium of this game. Under this condition, the buyer always loses and the seller gets extra profit, however one cannot say anything regarding the total utility of the society.

But if $pu + (1-p)u' > u - c$, in this case the unique equilibrium of the game is in mixed strategies, with $(z, q) = (z^*, q^*)$, where

$$z^* = \frac{pu + (1-p)u' - (u-c)}{pu + (1-p)u' - (u-c) - pc}, q^* = \pi / \pi'$$

The expected payoffs for the buyer and the seller at the equilibrium are

$$U^B(z^*, q^*) = u - \frac{cp(u'-u)}{u' - (u-c)} \qquad \rightarrow \qquad U^B(z^*, q^*) < u$$

$$\pi^S(z^*, q^*) = \pi - \left[p\pi\left(1 - \frac{\pi}{\pi'}\right)\right] \qquad \rightarrow \qquad \pi^s(z^*, q^*) < \pi$$

Then (z^*, q^*) is not a Pareto situation and then not a social optimum. Thus, if the quality of the goods are known for both parties, or from our point of view there be no Gharar transactions, the payoffs for all would increase and we will have Pareto improvement.

Conclusion

What can be concluded is that by having more transparent society and reducing or removing the problem of asymmetric information which lowers c (information cost), the probability of having Gharar transactions would be reduced and the total utility will increase.

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Takaful and Microtakaful: Islamic Instruments for Protecting Poor and Vulnerable Groups

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Abstract

The lives of the poor in developing countries are characterized by constant economic insecurity. Poor are vulnerable and situations such as illness, accident, and family death and so on can push them deeper into poverty.

Microinsurance is one way of alleviating the impact of such uncertainties. It, gives people with low income an opportunity to buy appropriate insurance for small premiums and thus to provide themselves for their own futures. This makes it easier for them to cope with crises. Since majority of Muslim population are poor and meanwhile they believe that conventional insurance is un-islamic so they are not ready to participate in any insurance program

In Islamic countries another form of insurance established based on Islamic values and called takaful. the present paper argue that takaful and microtakaful which are a kind of cooperative insurance could be considered as a substitute, and effective instruments for poverty reduction in Islamic societies.

Keywords: Microinsurance, Microtakaful, social protection, vulnerable groups

1- Introduction:

Poverty is a social problem and affects every culture and society dimensions. Poverty involves limiting access to services on education, health, decision making and lack of community facilities such as water, sanitation, roads, transport and communications.

Since population of Islamic countries are more than 2 billion and majority of them, are poor and some of the Islamic scholars believe that conventional insurance is prohibited based on Islamic law, so the majority of the traditional Muslims do not accept the conventional insurance, while takaful insurance is a kind of solution for this problem and it is acceptable by all Islamic scholars from different sects.

Takaful and Microtakaful are flexible and powerful instruments that could reduce vulnerability and mitigate the negative effects of external shocks on poor households. These Islamic instruments try to protect the poor and vulnerable by empowering them to find a way out of their poverty and give them a real hope of being financially self-sufficient.

Based on the above facts the present paper after a short introduction explain the relationship between poverty and development with particular attention to Millennium Development Goals. Then explain the theoretical foundation of the paper or the interconnection between poverty, vulnerability, risk and insurance. The following section presents some evidence regarding poverty and insurance in Islamic Countries. Based on the realities of Islamic countries, the paper introduced Takaful and Microtakaful as effective instruments for poverty reduction in Muslim societies. Finally presents some concluding remarks.

2- Poverty and Development

“Eradicating extreme poverty continues to be one of the main challenges of our time, and is a major concern of the international community. Ending this scourge will require the combined efforts of all, governments, civil society organizations and the private sector, in the context of a stronger and more effective global partnership for development. The Millennium Development Goals set time bound targets, by which progress in reducing income poverty, hunger, disease, lack of adequate shelter and exclusion — while promoting gender equality, health, education and environmental sustainability — can be measured. They also embody basic human rights — the rights of each person on the planet to health, education, shelter and security. The Goals are ambitious but feasible and, together with the comprehensive United Nations development agenda, set the course for the world's efforts to alleviate extreme poverty by 2015." [3]

In 2000, after a decade of United Nations conferences and summits, world leaders came together at UN Headquarters to adopt the United Nations Millennium Declaration, whereby they committed their Governments to a global partnership. The overarching objective of this partnership is to reduce extreme poverty and set out a series of time-bound targets - with a deadline of 2015. These time-bound goals have since become known as the Millennium Development Goals.

The Millennium Development Goals (MDGs) are eight goals to be achieved by 2015 that respond to the world's main development challenges. The MDGs are drawn from the actions and targets contained in the *Millennium Declaration* that was adopted by 189 nations-and signed by 147 heads of state and governments during *UN Millennium Summit* in September 2000.

❶ Eradicate extreme poverty and hunger

❷ Achieve universal primary education

❸ Promote gender equality and empower women

❹ Reduce child mortality

❺ Improve maternal health

❻ Combat HIV/AIDS, malaria, and other diseases

❼ Ensure environmental sustainability

❽ Develop a global partnership for development

[3] United Nations Secretary-General Banki-moon cited in http://www.un.org.jo/index.php?page_type=pages&page_id=358

The key for achieving the MDGs of the United Nations is poverty alleviation. So any strategy that alleviate poverty and assist vulnerable groups it could help achieving sustainable development and MDGs.

3- Poverty, Vulnerability, Risk and Insurance (Some Theoretical Foundations)

Risk is a state of uncertainty where some of the possibilities involve a loss, catastrophe, or other undesirable outcome. The poor lacks capacity to cope with the consequences of a shock. The anticipated risk events make it harder for the poor to build up reserves, key to coping with such events (Cohen & Sebstad 2006,). Low-income people are vulnerable to numerous perils as they live in risky environments, however, the poor are more vulnerable to risks than the rest of the population, because they are the least able to cope when a crisis occur. Poverty and vulnerability are related to each other. There is low take up of poor on income-generating opportunities that might reduce poverty due to their uncertainty about the possibilities of risk might occur (Churchill 2006, Botero et al. 2006).

According to Cohen and Sebstad (2006) it is very difficult for the poor to get above the poverty line when there is a minor shock. Financial stresses associated with separation, divorce, similar to the death of a spouse, school fee payments, and bad debts create a high degree of vulnerability and financial stress for the poor (Cohen & Sebstad 2006,).

The theory of asymmetric information provide theoretical base for insurance markets. The basic idea of asymmetric information (it is part of the discipline, known as economics of information) is that, in many markets particularly in insurance markets, information is asymmetrically distributed and is costly to acquire. These markets are not spot markets where buyers and sellers meet and decide on prices. According to Stiglitz (1989) financial contracts include elements that lead to the basic problems of adverse selection and moral hazard. This idea emerged in the 1960s, when economists started to claim that because of high information and enforcement costs, some markets will not exist and other markets will not even be approximately competitive. One of the pioneers in this area, who worked on the problem of adverse selection, was Akerlof (1970). In this work, he argues that in certain markets doing business is difficult because of the adverse selection problem. His basic model, analyses a market in which sellers offer different qualities of products and are aware of these differences. Buyers, however, are unable to distinguish between products and they therefore offer a price that reflects the perceived average quality of the products – treating all products as if the quality is the same. This may force sellers who offer high quality goods to withdraw their goods from the market. Hence the market for these high quality goods can fail to clear, although all agents are acting rationally.

A second problem, which also arises as a result of informational asymmetries, is moral hazard. Arrow (1963) was one of the first contributors to the theory of moral hazard. He focused on the influence contracts between parties have on the behavior of the relatively which more informed party. This gives rise to the principal-agent literature, analyses a situation where one party, known as the principal, enters into a contract with another party, known as the agent. In this situation, the principal may not be able to observe the agent's behavior (actions or decisions). The term moral hazard is applied because the actions taken by the agent are based on his own self-interest and not necessarily on the best interest of the principal. Therefore, the principal wants to devise a contract that will induce the agent to undertake actions that are not in conflict with his interest.

In insurance the moral hazard may be defined as the tendency of insurance policy holders' less effort protecting those goods which are insured against theft or damage (Frank, H, 1991:193). Moral hazard also refers to situations where one side of the market can't observe the actions of the other. For this reason it is sometimes called a hidden action problem (Varian, H. R, 1990: 589). Moral hazard arises when individuals, in possession of private information, take actions which adversely affect the probability of bad outcomes (McTaggart vd 1992: 440). A moral hazard problem also occurs when actions taken by the insured affect the probability of a loss but cannot be observed by the insurer. In this case, the insurer cannot apply correct prices premium and indemnity that depend on the actions of the insured, leading to a market failure (Kangooh, L, 1992)

The various forms of financial markets try to tackle the asymmetry of information problem differently. The formal financial institutions tend to deal with the selection and incentive problem by imposing stringent collateral requirements or restrictive covenants, or by requiring borrowers to provide carefully documented evidence, showing their intention and ability to repay (Floro and Yotopoulos, 1991). Those who get credit from the formal financial institutions are usually firms and institutions that are active in the formal business sector; they have the necessary collateral, credit history, and/or use a reliable accounting system.

However, the credit needs of the majority of the poor in developing countries. They are not satisfied by the supply of credit of formal financial institutions. These people are unable to provide collateral, they have no documented credit history from the formal financial sector, and they lack accounting records. At the same time, the informal financial market, will also not be able satisfy the credit needs of the poor. On the other hand, access to credit from the Micro Finance Institutions (MFIs), uses mechanisms that make credit arrangements possible without the use of the traditional methods employed by the formal financial institutions. By using mechanisms such as social networks, social ties and social sanctions, MFIs are in a position to reduce the selection, incentive and enforcement problems inherent to credit transactions, which may not be effectively handled in formal financial institutions.

Vulnerability to risk is a key aspect of poverty. Health problems, death of livestock and natural disasters all affect the poor disproportionately. By helping the vulnerable groups to manage risk, microinsurance can assist them to maintain a sense of financial confidence even in the face of significant vulnerability. A key aspect of microinsurance is to explore ways of significantly increasing the number of poor households that have access to insurance while enhancing the benefits.

Microinsurance represents a key tool for sustainable development with tremendous potential for mitigating risk factors to low-income households. With estimates that less than 5% of the world's poor benefit from insurance, these households remain highly susceptible to risks posed by a wide range of issues including sickness, loss of livestock and catastrophic climate events. On the one hand, a policy that offers value to the client requires that premiums remain low and benefits for policy holders as high as possible. On the other hand, insurers in this context need to reach large numbers of low-income clients to achieve profitability.

Most fundamentally, the availability of insurance enables risk averse individuals and entrepreneurs to undertake higher risk, higher return activities than they would do in the absence of insurance, promoting higher productivity and growth. For example, a manufacturer might produce only for the local market, forgoing more lucrative opportunities in distant markets in order to avoid the risk of losing goods in shipment. Transport insurance can mitigate this loss exposure and enable the manufacturer to expand.

4- Some Evidence Regarding Poverty and Insurance among Islamic Countries

Nearly one-fourth of the world's population today is Muslim. The Muslim population is a diverse community of believers spanning the globe. Over fifty countries have Muslim-majority populations, while other groups of believers are clustered in minority communities on nearly every continent. Although Islam is often associated with the Arab world and the Middle East, fewer than 15% of Muslims are Arab.

Table 1- Top Ten Countries with Largest Muslim Population in 2012

Rank	Country	Capital City	Total Population	Muslim Population
1	Indonesia	Jakarta	237641326	204852000
2	Pakistan	Islamabad	181565000	178092000
3	India	New Delhi	1210193422	177291000
4	Bangladesh	Dhaka	152518015	148602000
5	Egypt	Cairo	82999000	80029000
6	Nigeria	Abuja	166629000	75723000
7	Iran	Teheran	75149669	74809000
8	Turkey	Ankara	74724269	74665000
9	Algeria	Algiers	37100000	34785000
10	Morocco	Rabat	32765300	32376000

Source: http://www.mapsofworld.com/world-top-ten/world-top-ten-countries-with-largest-muslim-populations-map.html

The countries in the rank of 11 to 20 are: Iraq (30 million), Sudan (30 million), Afghanistan, (28 million), Ethiopia (28 million), Uzbekistan (26 million), Saudi Arabia (25 million), Yemen (23 million), China (22 million million), Syria (20 million) and Russia (16 million). Muslims make up a majority of the population in 49 countries around the world.

Table 2: World Muslim population in 2012 and estimation for 2013

Continent Population *(in million)*	Total Population in 2013 *(in million)*	Muslim Population in 2013 *(in million)*	Muslim Percentage
Africa	1070.3	568.55	53.12 %
Asia	4284.7	1364.79	31.92 %
Europe	739.81	55.8	7.54 %
North America	464.9	7.97	1.8 %
South America	483	2.04	0.41 %
Oceania	36.54	1.5	0.38 %
Total	7079.25	2000.65	28.26 %

Source: http: www.muslimpopulation.com/World

As it can be seen The total Muslim population in 2012 is 2.01 Billion and it is estimated for 2013 to be equal 2.04 Billion, but the fact is that a large portion of this population (about 44 percent) should be considered as poor. Accordance to the World Bank (2000), among all 57 Islamic countries, 29 countries are low-income ones (with less than $760 per capita income); 16 countries are low-medium-income nations (between $760 and $3030); 8 countries are high-medium-income ones (between $3030 and $9360); and only 4 countries are high-incomes (more than $9360) (World Development Report, 2000). Islamic countries contain 23 percent of the world area. The major activities of them are agriculture and services, and industrial activities have a little share in those economies. Real per capita income of such Muslim nations as Sierra Leone, Comoros and Guinea-Bissau, has decreased over time and the growth rate of their real GDP has been negative. In many Islamic countries a relatively high proportion of people are below the poverty line, so that the percentage of people living on less than $1 a day in some Islamic countries has been as follow: Uganda 82.2 (1996), Mali 72.8 (1994), Nigeria 70.2 (1997), Niger 61.4 (1995), Burkina Faso 61.2 (1994), Gambia 59.3 (1998), Sierra Leone 57.0 (1989), and Bangladesh 36.0 (2000) (World Bank, 2003).

The fact is that a large proportion of Muslims are considered as poor and that highlights the need of some effective strategies for poverty reduction.

During the last 50 years, different strategies have been used for poverty reduction and to assist the poor and vulnerable groups. Most of these programs failed. In fact lack of saving and limited access to finance are the key constraints for the poor. The poor are not qualify to get funds from formal institutional sources due to lack of collateral, too much risk or too costly. "Microfinance" initiated in the mid-1970s appears to be the 'new paradigm' to eradicate poverty

Microfinance is also the idea that low-income individuals are capable of lifting themselves out of poverty if given access to financial services. Although many studies indicate that microfinance can play a major role in the battle against poverty, but certainly it is not the only tool for ending poverty.

Access to financial services is only one of a series of strategies needed to reduce poverty. Financial services need to be complemented by access to education, health care, housing, transportation, markets, and information.

Access to insurance, as part of a broad range of essential financial services, is especially important for poor households in order to smooth consumption, build assets, absorb shocks, and manage risks associated with irregular and unpredictable income. Under conventional insurance, insurance for the poor is called microinsurance.

The CGAP Working Group on Microinsurance notes Microinsurance is the Protection of low-income people against specific perils in exchange for regular monetary payments (premiums) proportionate to the likelihood and cost of the risk involved. As with all insurance, risk pooling allows many individuals or groups to share the costs of a risky event".

Moreover, in the last ten years a good deal of pioneering and experimentation in the field of Micro-insurance has been conducted, which resulted in a growing confidence that insuring poor people is actually possible. As microfinance has shown that the poor are bankable, Micro-insurance is showing that they are insurable as well.

Swiss Re, Sigma (2012), **:** provided information concerning insurance penetration based on premiums as a % of GDP in 88 countries in 2011and also in different continents

Table 3: Insurance Penetration: Premiums as a % of GDP All over the world in 2011

Ranking	Country	Total Premiums	Life Premiums	Non-life Premiums
1	North America	7.9	3.5	4.4
2	Europe	7.1	4.1	3.0
3	Oceania	5.9	2.8	3.1
4	Asia	5.8	4.3	1.6
5	Africa	3.6	2.5	1.2
6	Latin America & Caribbean	2.8	1.2	1.6
	World	6.6	3.8	2.8

Source: World Insurance in 2011, Swiss Re, Sigma, No 3/2012, p 39

Table 4: Insurance Penetration: Premiums as a % of GDP in Selected Countries in 2011

Ranking	Country	Total Premiums	Life Premiums	Non-life Premiums
1	Taiwan	17.0	13.9	3.1
2	Netherlands	13.2	3.7	9.5
3	South Africa	12.9	10.2	2.7
4	United Kingdom	11.8	8.7	3.1
5	South Korea	11.6	7.0	4.6
6	Hong Kong	11.5	10.1	1.4
7	Japan	11.0	8.8	2.2
8	Switzerland	10.0	5.5	4.5
9	Finland	9.6	7.7	1.9
10	France	9.5	6.2	3.3
46	Lebanon	2.9	0.8	2.1
49	Morocco	2.9	0.9	2.0
52	Bahrain	2.4	0.6	1.8
56	Jordon	2.2	0.2	2.0
62	United Arab Emirate	1.8	0.3	1.5
64	Tunisia	1.8	0.3	1.5
67	Indonesia	1.7	1.1	0.6
68	Morocco	1.6	1.2	0.4
72	Iran	1.8	0.2	1.6
78	Oman	1.1	0.2	0.9
80	Bangladesh	0.9	0.7	0.2
81	Saudi Arabia	0.9	0.1	0.8
82	Egypt	0.7	0.3	0.4
83	Kazakhstan	0.7	0.1	0.6
84	Algeria	0.7	0.1	0.6
85	Pakistan	0.7	0.4	0.3
86	Nigeria	0.6	0.2	0.5
87	Kuwait	0.5	0.1	0.4
88	Qatar	0.5	0.0	0.5
	World	6.6	3.8	2.8

Source: World Insurance in 2011, Swiss Re, Sigma, No 3/2012, p 39

From the above table of insurance density values all over the world it can be seen that:

- The insurance penetration of the world market on average was 6.6% in 2011 (it is lower than the previous years because the impact of the global financial crisis on the insurance sector that started in 2008) while the insurance penetration of the Islamic countries in 2011, was much lower than the world average. The highest are for Lebanon and Morocco 2.9 while the lowest are 0.5 for Kuwait and Qatar.
- The Ranking of the Lebanon was 46 at the global level, but was the first among the Islamic countries, where the insurance penetration was 2.9%. (if Lebanon considered as an Islamic State).
- – - In terms of the continents, North America comes in first place with an insurance penetration of 7.9%, followed in the second place by Europe 7.1%, Oceania in the third place by 5.9%, Asia in the fourth place by 5.8%, Africa in the fifth place by 3.6 and Latin America & Caribbean in the last place by 2.8%.
- The highest penetration of Life Insurance was 13.9% existed in Taiwan, which represents 3.7 times of the world percentage which was 3.8% & the highest penetration of non-Life Insurance was 9.5% existed in Netherlands, which represents 3.4 times of the world percentage which was 2.8%.

what can be concluded from aforementioned tables is that penetration of conventional insurance in Islamic Countries are very low and on the other hand insurance can play a major role in poverty reduction, so we need some alternative to be acceptable for Islamic societies and that is takaful and micro takaful

5- Takaful and Microtakaful, Istruments to Assist the Poor

Takaful is a kind of cooperative Insurance based on Islamic law for enhancing social solidarity amongst policy holders. It is not purely profit oriented, but seeks protection against risks in the first place. And to absorb material consequences of any loss and damage to insured person or his properties. All participants in Takaful (Policy holders) cooperate on such a principle, to compensate anyone of them exposed to damage due to any of the risks covered by the policy. Since those policy holders are the owners of such an insurance process, they are entitled to retrieve surplus of operations in cash, each according to his premium amount, after allocation of overhead charges and expenses.

According to Billah (2001), “the objective of *takaful* is to diversify the risk among the members. In a practical sense, *takaful* can be visualized as a method of joint guarantee among participants against loss and damage that may be inflicted upon any of them. The members of the group agree to guarantee jointly any of them who suffer a catastrophe to receive a certain amount of money to meet the loss and damage incurred.”

According to Khan (2006), **“**micro*takaful* is defined as a mechanism to provide *Shariah*-based protection to the blue collared, under-privileged individuals at affordable costs. Micro*takaful* is the *Takaful* scheme for low-income people. All the *Takaful* products like *Takaful* financing, *takaful* education, fire, pension and so forth can be delivered to poor people with some modification, such as low premium contribution.”

The microinsurance and micro*takaful* movement is one of such innovation strategies in reducing poverty; however, it faces a number of challenges to meet its full potential.

According to Billah (2001), Islamic insurance transaction, named *Takaful* is a policy of mutual cooperation, solidarity, and brotherhood against unpredicted risk and catastrophe, where participants contribute (donate) to help one another in times of hardship. He mentions that“the objective of *takaful* is to diversify the risk among the members. In a practical sense, *takaful* can be visualized as a method of joint guarantee among participants against loss and damage that may be inflicted upon any of them. The members of the group agree to guarantee jointly any of them who suffer a catastrophe to receive a certain amount of money to meet the loss and damage incurred.”

micro*takaful* is one of the mechanisms to fulfil the needs of the lower income, with the concept of providing affordable protection to the poor. *Takaful* operators should come up with this kind of product, as the alternative to those offered in the conventional market (Swartz and Coetzer 2010).

Establishing “micro*takaful*” schemes enables takaful become much more acceptable and accessible to the poor whilst still maintaining the benefits (Patel 2002). The needs of the poor in Islamic countries are no different from the poor in other societies except that these are conditioned and influenced by their faith and culture in a significant way (Obaidullah, 2008).

There are several key differences between Takaful and conventional insurance systems. some of these differences are:

1) Conventional insurance is a risk transfer mechanism whereby risk is transferred from the policy holder (the Insured) to the Insurance Company (the Insurer) in consideration of “insurance premium” paid by the Insured. While takaful is based on mutuality; hence the risk is not transferred but shared by the participants who form a common pool. The Company acts only as the manager of the pool (Takaful Operator).

2) Takaful does not include the three elements of interest, uncertainty and gambling which many Islamic scholars believe that conventional insurance, has these elements but forbidden under Shariah. All funds invested under Takaful must be free of interest whilst conventional insurance can invest in interest based investments.

3) Conventional insurance operates as a commercial business with individuals purchasing policies to insure against risk. Premiums paid will vary between individuals dependent on the company’s assessment of their risk. If no claims are made the premiums paid will be retained by the company as profit.

In comparison contributions made to Takaful insurance are divided between two funds: one to be considered as a charitable fund and the other intended for profit and loss sharing. The custodian of the Takaful funds splits any profits between the contributors and the custodian, with the percentage of the division determined in advance.

4) Takaful means to share amongst each other. Those who contribute to the fund are known as participants and they are guaranteeing each other. If there are needs to be met through the fund, those

who receive from it are considered beneficiaries rather than claimants. Individual rights to the funds are waived in favor of the collective need. The Takaful system is thus based on mutual co-operation rather than individual premiums and claims.

5) Takaful insurance has a fixed minimum contribution which disregards the idea that someone may be more of a risk to insure. Contributions are not affected by credit scores which most conventional insurance companies take into consideration.

Models of Takaul

There are 3 main Takaful models and several variations on how takaful can be implemented.

1. Mudharabah (profit sharing) Model
2. Wakalah (agency) Model
3. Combination of both

The takaful operator is the administrator of the fund and manages the fund in trust on behalf of the participants, and the contract between participants and the operator is governed under the contract of Wakalah or Mudharabah.

The wakalah concept is essentially an agent-principal relationship, where the takaful operator acts as an agent on behalf of the participants and earns a fee for services rendered. The fee can be a fixed amount or based on an agreed ratio of investment profit or surplus of the takaful funds.

Under the mudharabah contract, the takaful operator acts as a mudharib (entrepreneur) and the participants as rabbul mal (capital providers). The contract specifies how the surplus from the takaful operations is to be shared between the takaful operator and the participants. Losses are borne by the participants as the capital providers. However, to protect the interest of the participants, the takaful operator is required to observe prudential rules including provision of financing rate-free loans by the operator to the takaful risk funds in the event that there is a deficiency in the takaful risk funds.

Of course a detailed discussion of different types of takaful, other variations, problems and challenge are out of scope of the present paper.

6- Concluding remarks

Since poor people are typically more exposed to different risk, and vulnerability to risk is a key aspect of poverty. In other words, risk may cause poverty, and poverty may causes exposure to risks.

Microinsurance can assist the poor to maintain a sense of financial confidence even in the face of significant vulnerability. Microinsurance represents a key tool for poverty reduction with tremendous potential for mitigating risk factors to low-income households.

Since the majority of people who are living in Islamic countries are poor and they consider the conventional insurance as unislamic phenomena, so it seems that there is a need for a kind of acceptable insurance program for low income sectors of these countries. Since takaful and microtakaful schemes are based on cooperative/mutual principles and acceptable for all Mslims from different sects, they should consider as alternatives for insurance and microinsurance.

Microtakaful will be an effective solution for the low income Islamic population, and expected to become more popular in the Middle East and North Africa region and in certain Asian economies with huge Islamic population such as Indonesia and Malaysia.

Takaful and Microtakaful is predicted to be a growth area in insurance, appealing not only to Muslims but to others who are attracted to the mutual element. People who are concerned about the type of businesses which their funds are invested in, may also consider Takaful insurance to be a more ethical choice. Although the success of Takaful largely depends on how Islamic Financial Institutions could work on a global basis.

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MEDIEVAL JEWISH AND ISLAMIC PAYMENT INSTRUMENTS: THEIR INTERACTION AND LASTING HERITAGE

by

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Based on chapters

4. Deriving History from Law: Are Cheques Traceable to the Talmud?

6. The Medieval *Hawale*: The Legal Nature of the *Suftaj* and Other Islamic Payment Instruments

7. Funds Transfers Under Talmudic Law: Orthodoxy and Adaptation

of

B.Geva

The Payment Order of Antiquity and the Middle Ages: A Legal History

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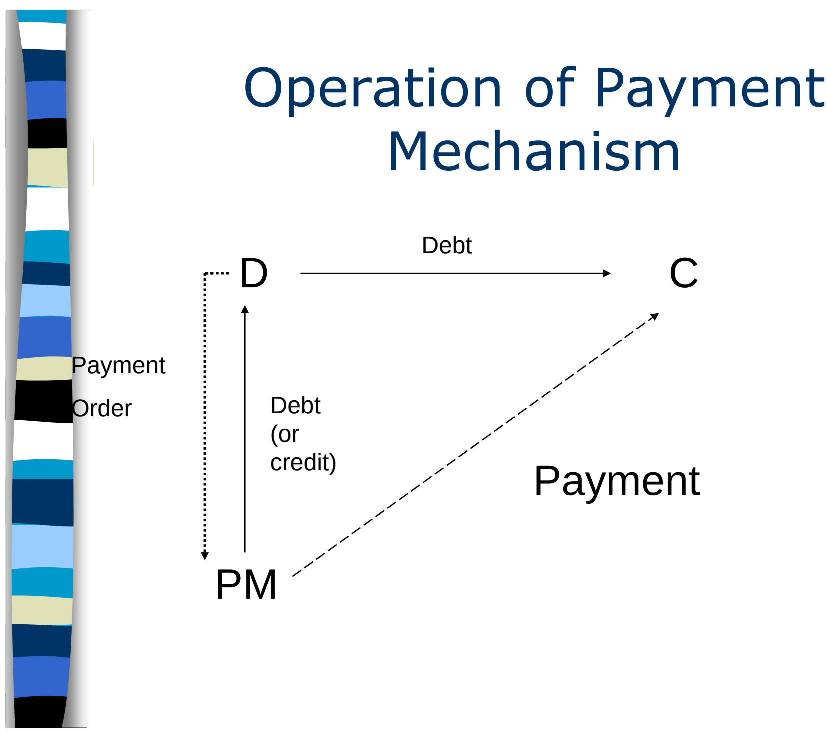
I. Introduction

A payment mechanism can be broadly described as any method involving a third party other than the debtor and creditor ('Paymaster'), facilitating the transmission of monetary value in the payment of a debt, which enables the debtor to avoid the transportation of money in specie and its physical delivery to the creditor in the discharge of the debt.

A payment mechanism does not involve the physical delivery of a bag of money from the debtor to the creditor via a third party carrier. Rather, its operation is premised on the discharge of a debt by virtue of an authorized payment made by the paymaster, frequently a debtor's debtor. Besides discharging the original debt (owed by Debtor to Creditor), this payment discharges the debt of the paymaster. Alternatively, where there is no such pre-existing debt owed by the paymaster to the debtor, this payment, besides discharging the original debt, creates a new debt owed by the original debtor to the paymaster.

The operation of payment mechanism is premised on Creditor getting either a substituted debtor [Paymaster] on original Debtor's Debt to Creditor or a substituted debt [of Paymaster to Debtor]- to replace Debtor's original debt to Creditor.



A payment mechanism can also be created by the circulating a ‘payment instrument’, meaning a document under which a paymaster under a payment mechanism is bound to pay the creditor or the creditor’s creditor to whom the original creditor transferred the instrument.

There were primary three hurdles in Antiquity for the emergence of a legal doctrine facilitating the effective operation of a payment mechanism:

•Formal contract requirements;

•Strict privity – even in informal contracts; and

•Debt is not an asset but a personal relationship so as to preclude debtor substitution as well as debt transfer

When these hurdles were overcome, four legal issues arose:

1. Does Paymaster become liable directly to Creditor?
2. On what theory does Debtor discharge, and does Creditor have recourse against Debtor upon the default by Paymaster?
3. What if any defences available to Paymaster against Creditor’s claim?
4. Is Creditor’s claim against Paymaster transferable – and if so by the mere delivery of the payment instrument? Is it transferable free of defences?

A classic example for a ‘perfect’ payment mechanism is the post-Medieval English bill of exchange, currently codified worldwide under national bills of exchange statutes. The bill of exchange contains an order by a ‘drawer’ addressed to a drawee to pay a payee or bearer. In a typical example, the drawer is Debtor (e.g. textile country manufacturer) instructing his debtor (e.g. city retailer of textile products), i.e. Paymaster, to pay to the Debtor’s Creditor (e.g. country wool supplier). Drawee-retailer expects to pay out of proceeds of the sale of the textile products to the public. He became liable on the instrument by signing it as an ‘acceptor’. As years passed by, it became possible for the payee to effectively have payment to him ‘accelerated’ by having the instrument discounted with a transferee who then became entitled either to do the same or to recover from the drawee when the instrument fell due. In short, having thus become ‘negotiable’, the paper could circulate from hand to hand, or from one ‘holder’ to another. Alternatively, the payee or any subsequent ‘holder’ could have discharged his own debt owed to his own creditor by properly transferring the instrument to that creditor. Other than when it was payable to the bearer each transfer required also the ‘endorsement’ of the transferor. Finally, the drwaee could not meet the holder’s action by asserting defences to liability.

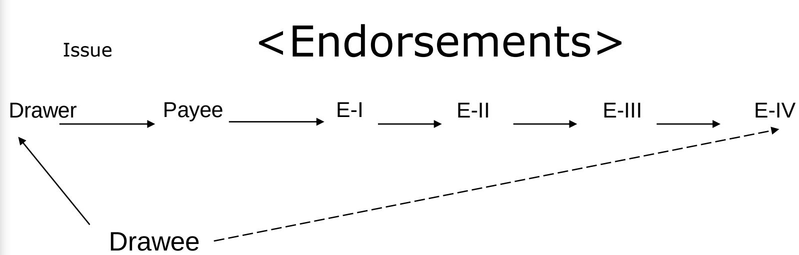
7

Modern Bill of Exchange – Basic Form

Drawer is Debtor
Payee is Creditor
Drawee is PM

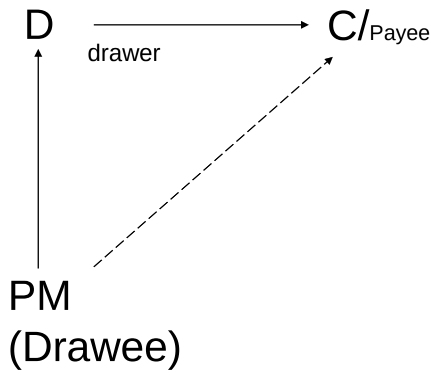
To: Drawee
Pay Payee
(-) Drawer

Bill Discounting under Modern Law and Practice – Circulation free of defences

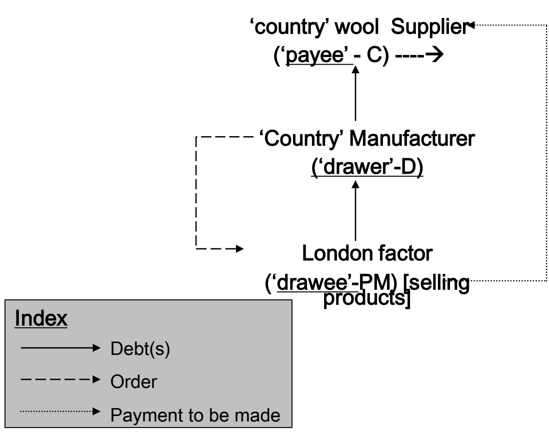


Addendum I:
The Modern Bill of Exchange

conditional payment; recourse;
transferable by delivery free of defences



A 17th -Century Inland Bill of Exchange in England [Transferable by Delivery- possibly with endorsement - since 18th century]



It is very unusual for commercial instruments and legal principles governing them to come abruptly and from nowhere. Rather, they are typically the result of an evolutionary process having roots in more than one place and in one period of time. The English bill of exchange as a model payment mechanism is no exception. This paper examines the contribution of early Medieval Islamic and Jewish payment instruments and laws, as existed mainly in the Near East, to the development of payment mechanisms and legal doctrine governing them. It endeavours to show the interaction among these two religious laws and practices and point out their everlasting heritage.

II. Islamic Law

Documentation of Islamic payment instruments is quite rich; this is particularly true for the period of the Fatimid Caliphate, which was in power between the 10th and 12th centuries. Approximately from that period, or more specifically, between the 11th and 13th centuries, plenty of documents originate from the Jewish *Geniza* of Cairo. Typical instruments were the *ruq'a* and the *sakk*, both being payment order, as well as the *hawale*, the latter being a withdrawal out of an account with a *sarraf* (private money changer).

Islamic payment instruments have not always acquired distinct names. Thus, the withdrawal out of an account with a *sarraf* in the execution of a non-cash payment made by a small retailer to his wholesaler may be treated simply as a *hawale*. In turn, more specialized terminology, though not necessarily uniform or precise, has also developed. Thus, the *ruq'a* has a few meanings. First, it means an order for the delivery of goods. Second, it is a payment order, issued to the payee, instructing the paymaster to make payment against its presentment by the person entitled to obtain payment. Third, it denotes the paymaster's own obligation to pay, or in fact, any promissor's debt or acknowledgement of debt instrument. The first sense is outside the scope of the present paper; in both the second and third senses, which are of interest in the context of the present paper, the *ruq'a* overlaps with the *sakk*, from which, linguistically, the modern word 'cheque' may be derived. In fact the second and third meanings may converge; this is so, since the paymaster's obligation to pay on a *ruq'a* or *sakk* is typically in pursuance to the payment order directed to the paymaster which is at least implicit on the instrument. The express terms of the document may however reflect the debtor's order, the paymaster's promise, or both. A payment instrument to be further discussed is the *suftaj*; it contains an obligation of a paymaster or his correspondent to pay at a place other than that of the issue of the document.

This part of the paper focuses on the *hawale* as a legal doctrine facilitating the operation of all these mechanisms. Having recognized informal contracts, to overcome also the other difficulties, Islamic jurisprudence came up with the *hawale*. Its operation relied on a Koranic passage, stating that "Whenever a person transfers his debt upon a rich man and the creditor assents to the same, then let the claim be made upon the rich man." It operated as the transference of an obligation from one person to another, and was constituted by an agreement by which a debtor is freed from a debt by another becoming responsible for it.

Participants in a *hawale* transaction are the original debtor ('transferor'), the paymaster ('transferee'), and the creditor. However, under each of the major Islamic schools the *hawale* agreement is an informal one between two parties which binds the third party. It is universally agreed that the creditor is one of the parties to the agreement. Schools nevertheless vary as to the other contracting party. Thus, under the Hanafi school (ultimately codified in the Mejelle) the parties are the paymaster and the creditor (and not the debtor). Under the Maliki school parties to the *hawale* are the debtor and creditor (and not the paymaster). Hence, in Hanafi legal doctrine, the *hawale* operates to give the creditor a substituted debt (owed by the paymaster to the debtor). At the same time, Maliki doctrine, gives the creditor a new debtor (paymaster) on the original debt owed to the creditor by the original debtor.

The following table summarizes and compares between the features of the hawale under each of the major Islamic schools:

Hanafi v. Maliki *Hawale*

D=Debtor

C=Creditor

PM=Paymaster

Hanafi *Hawale*

[substituted debt by new debtor]

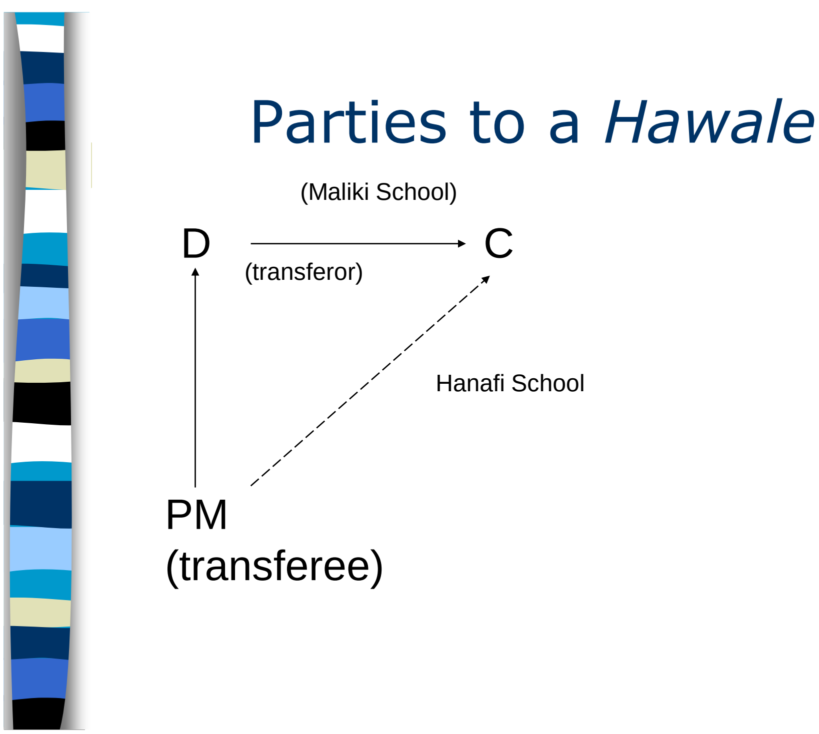
- **PM must consent.**
- **PM need not have owed D.**
- Usually D gets absolute discharge: no recourse to C.
- C's claim against PM is subject to D's defences.

Maliki *Hawale*

[substituted debtor on D's debt]

- **PM need not consent.**
- **PM is to have owed D.**
- Usually D gets absolute discharge: no recourse to C.
- C's claim against PM is subject to PM's defences.

Under each school C gets a new debtor, except that under the Hanafi school it is on a new debt and under the Maliki school it is on the original D's debt to C.



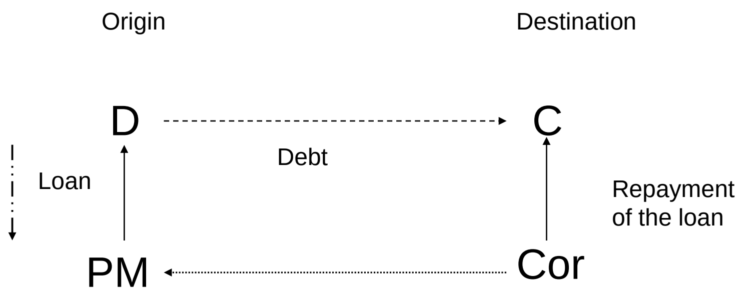
A mechanism facilitating payment between distant parties premised on the Islamic *hawale is* the *suftaj*. The latter could be used e.g. by Debtor in point of origin who wishes to pay to Creditor in point of destination without risking the physical delivery of the money. In such a case the underlying operation of the *suftaj* is as follows: Debtor 'lends' money to Paymaster at point of origin. Document issued by Paymaster may include Paymaster's obligation to pay Creditor at the point of destination as well as Debtor's instruction to do so. Debtor sends the document to Creditor who then presents it for payment to Paymaster's Correspondent at the point of destination. Correspondent ('Cor') may effectively be same as Paymaster or someone in an ongoing relationship with Paymaster who will settle with Paymaster periodically on a balance resulting from payment activities in both directions.

Being a loan of money to avoid the risk of transport the *suftaj* has been suspected as conferring a gain on the Debtor-'lender' in violation of prohibitions against interest. Overall, it was nevertheless tolerated. Its operation can be explained as two *hawales*. Participants in the first hawale are Debtor, Creditor, and Paymaster. In the second *hawale* Debtor drops out. Instead, Paymaster acts ad debtor while Correspondent acts as the paymaster.

Under the Hanafi school, the agreement between PM and C discharges D. This agreement is created by the acceptance of the *suftaj* document by C. Correspondent becomes indebted to C (so as to discharge PM) under the second hawale only upon Correspondent's agreement to honour D's order when the *suftaj* is presented by C to Correspondent.

Under the Maliki school, the agreement between D and C, created by the acceptance of C of the *suftaj* document, constitutes the first *hawale*, so as to replace D by PM as the one indebted to C. However, acceptance of the *suftaj* document by C, also constitutes an agreement between C and PM (C's new debtor under the first *hawale*) so as create a second *hawale,* under which Correspondent (as the new paymaster) becomes directly liable to C. Stated otherwise, under the Maliki school, paymaster's agreement is dispensed with so that Correspondent, as the paymaster under the second *hawale*, becomes automatically liable to C upon C's acceptance of the *suftaj* document. Hence, in dispensing with Correspondent ('Cor')'s agreement, the Maliki school conferred on C a right against Correspondent by the mere receipt of the *suftaj* document from D. This is a substantial improvement compared to the Hanafi school which still required Correspondent's agreement in order to entitle C.

Islamic *Suftaj*: C v Cor
by means of 2 *hawales*
[in 2nd hawale – PM is debtor and Cor is paymaster]



■Hanafi: PM/C; Cor/C;

By means of *Suftaj* document sent by D to C – ***and C's presentment to Cor.***

■Maliki: D/C; PM/C;

By means of *Suftaj* document sent by D to C — ***alone.***

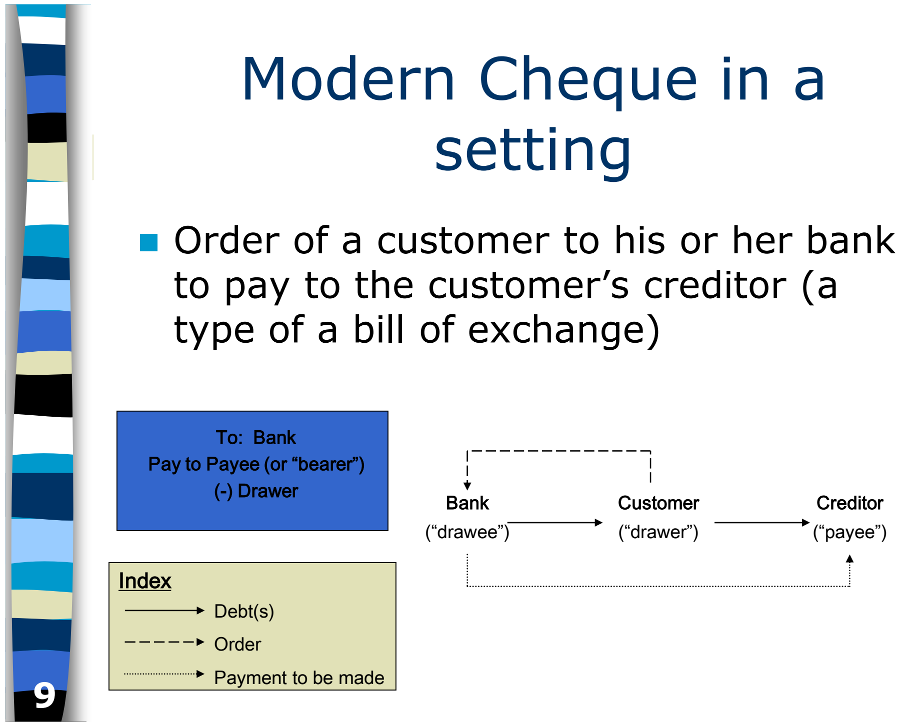
III. Jewish Law

The Jewish Talmud, of which substantial part was written in what is now modern Iraq contains substantial discussions on variety of topics relevant to payments, including:

- Monetary legal theory ('metalism');
- Doctrinal issues relating to cheques;
- No debt transfer (presence of all three is required)– *except for*:
- **Transfer of debt instruments by delivery;** and
- Particular payment mechanisms: *oditta*; *zechi; urcheta*; and the *dyokani*.

Discussion as to the monetary legal theory is included in the book but is not part of the present paper.

The modern cheque is a species of a bill of exchange. A cheque is drawn on a drawee bank, usually against funds available to the drawer with the drawee. It is an order by a drawer to a drawee bank to pay the payee or bearer. It is transferable by delivery (plus endorsement where applicable). Its issue to the payee constitutes a conditional discharge to the drawer. Stated otherwise, a payee who takes a cheque is taken to implicitly renounce his rights against Creditor, on the condition that payment will be received from the drawee. On his part, the drawee does not incur liability on a cheque so that the debt owed by the payee to the drawer is absolutely discharged only upon payment by the drawee.



A similar mechanism under the Talmud did not require a written instrument. Nor was the order to pay out of funds available to the drawer with the drawee -- but rather against credit extended by the drawee to the drawer. Payee was not allowed to transfer his claim and presumably all three, drawer, payee and drawee were required to be present at the same time at the same place to give any efficacy to the arrangement. As well, Talmudic law looked for an obligation of the drawee towards the payee and was reluctant to confer upon the drawer conditional discharge. It was agreed that drawer/Debtor was fully discharged if payee/Creditor expressly and unconditionally renounced his rights against drawer/Debtor. At the same time it was thought that without drawee/Paymaster's guarantee there cannot be an implied renunciation by payee/Creditor against drawer/Debtor. In turn, express renunciation by payee/Creditor, conditional upon drawee/Paymaster, was considered ineffective since under such circumstances drawee/Paymaster's obligation was revocable.

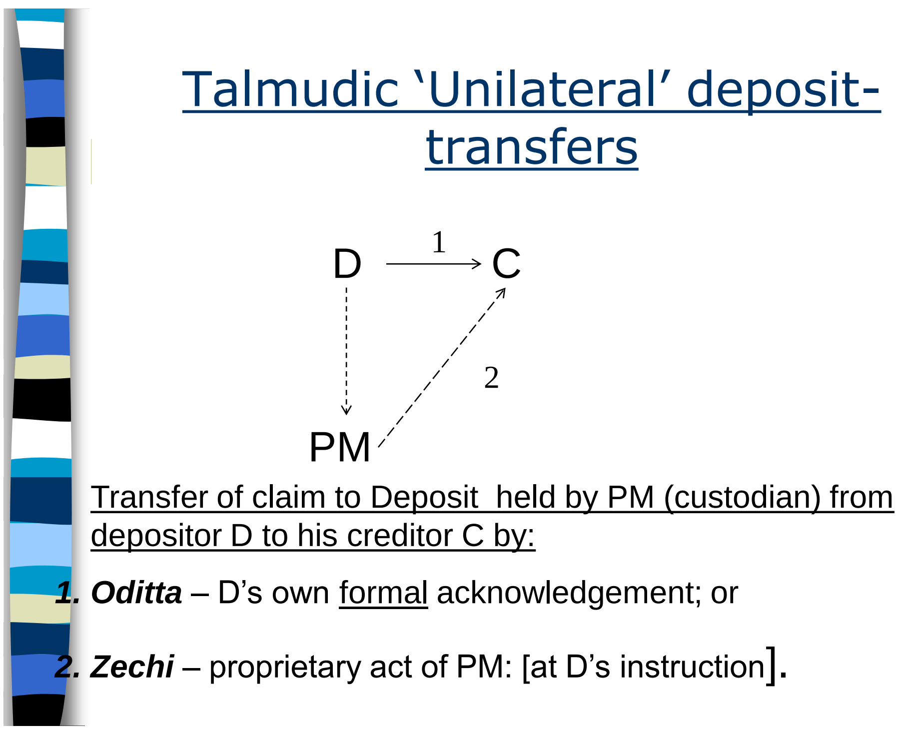
Hence, this mechanism is not a cheque; and yet, the discussion around it, as to the nature of the discharge, heralded a discussion on the nature of payment by bill of exchange or cheque, that surfaced in England around 12 centuries later.

An important doctrine under the Talmud is that a monetary debt is not transferable. However, an instruction by Debtor to Paymaster to pay Creditor money owed by Paymaster to Debtor binds Paymaster and inures to the benefit of Creditor when given by means of a declaration made by Debtor in the presence of all three. As under the *hawale*, it is disputed whether Paymaster becomes liable to Creditor on Paymaster's debt to Debtor or on Debtor's Debt to Creditor.

And yet, the Talmud pioneered the concept of a transferable debt document. Under the Talmud, to be transferable, a documentary note of indebtedness must be a *shetar*; it thus has to comply with formality requirements, even if only as to adequate witnessing. Furthermore, there may be formalities to be observed as for the transfer itself. However, it was agreed that Debtor may pay Creditor, or borrows money from him so as to become obligated to him, by physically transferring to Creditor a debt instrument reflecting Paymaster's obligation to pay debtor. Two disputations nevertheless existed:

- Does transfer occur by the mere delivery (by Debtor to Creditor) of debt document (relating to debt owed by Paymaster to Debtor) or does transfer require also the execution of an accompanying formal bill of sale?
- Does the transfer forfeit altogether the power of Debtor to release Paymaster?

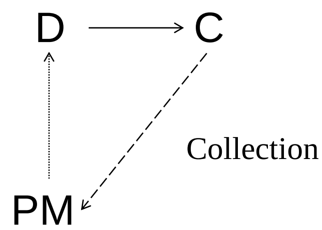
The Talmud further allowed payment from Debtor to Creditor by the unilateral transfer of Debtor's claim to deposited money with Paymaster. These two methods were the *Oditta* and *Zechi*. The former is a formal 'acknowledgement' by Debtor that the deposit actually belongs to the Creditor. The latter is a proprietary act by Paymaster, as instructed by Debtor, that he, i.e. Paymaster, holds the money on deposit for Creditor.



Another Talmudic payment mechanism is that of the *Urcheta*. Thereunder, Debtor, being Creditor's debtor and Paymaster creditor, issues to Creditor the *Urcheta* document. This document gives Creditor the power to collect from Paymaster the debt owed by Paymaster to Debtor, with the view of applying the proceeds to Debtor's debt to Creditor.

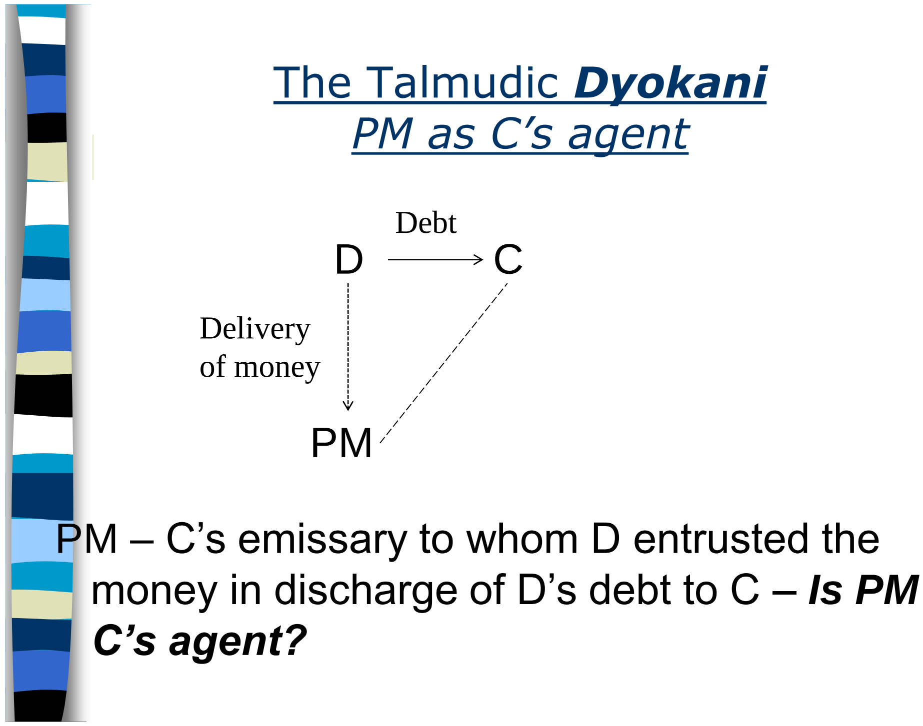
The Talmudic ***Urcheta***
C as D's agent

Urcheta



1. D: [C's debtor and PM's creditor] — ***Urcheta*** issuer
2. C: Emissary with authority to collect from PM [PM's debt to D with the view of applying the proceeds to D's debt to him]
3. PM: D's debtor

The last Talmudic payment mechanism to be discussed here is that of the *Dyokani*. Thereunder, Debtor delivers money to Paymaster with the view of paying Debtor's debt to Creditor. Paymaster is however Creditor's emissary. The circumstances under which payment by Debtor to Paymaster is considered as payment to Creditor's agent, so as to discharge Debtor's debt to Creditor, are disputed. In effect, the issue is who bears the risk of embezzlement or loss on the way between Paymaster and Creditor.



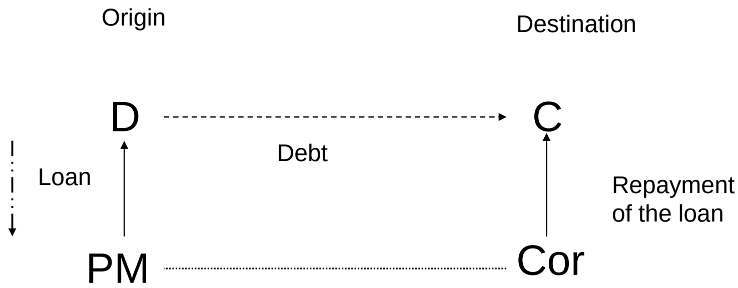
IV. Convergence

Unsurprisingly, the convergences between the Talmudic *Dyokani* and the Islamic *Suftaj*, as mechanisms for payment between distant parties, did not go unnoticed. The following is the question addressed to post-Talmudic Rabbis in what is now Iraq in Gaonic Resposne No. 423:

> Reuven wrote to Shimon a *suftaj from one place to another and Shimon delivered it to* Levy who received from him and after that denied. And the one who delivered and he [the second receiver] admits that he did not give. <u>May Shimon go back to Reuven and claim the *suftaj money since he got nothing from Levy?*.</u>

[Emphasis added].

<u>Talmudic *Dyokani* Turns *Suftaj*</u>
D delivered money to PM who became bound to C -- but defaulted
[May Shimon (C) go after Reuven (D)?]



D: **either *Reuven* [or unknown debtor [of Shimon]}**

***C:* *Shimon* [in both scenarios]**

PM:* either *Levy* [or *Reuven]

***Cor:* *Levy* [in both scenarios]**

Effectively then, the question concerns Debtor (let assume it is Reuven) who owes money to Creditor (Shimon). They are located in two different places. The Paymaster is Levy, who operates in both Reuven's and Shimon's places. Levy issued a *suftaj* to Rueven who sent it to Shimon. Shimon presented the suftaj document to Levy who ultimately declined to pay. The question addressed to the Rabbis was whether upon Paymaster Levy's default Creditor Shimon has recourse against Debtor Reuven .

Adhering to the view that Paymaster Levy did not become Creditor-Shimon's agent under the Talmudic *Dyokani* (which would have allowed Shimon to recover from Reuven) the Gaonite Rabbis nevertheless answered in the negative:

> *We have seen that there is* nothing in the roots of our laws to permit [to send] the ***suftaj***. *This is so since our* Rabbis said that you may not remit coins by means of a ***dyokani*** *even when signed by* witnesses. Nevertheless, having seen that people actually use the *suftaj we recognized* it so as not to hinder commerce. And we accepted upon ourselves to admit the *suftaj* under the law of the merchants and neither add nor subtract. And so is the law and it ought not to be changed.

[Emphasis added].

Stated otherwise, fully submitting themselves to commercial usage that prevailed in the market, the Rabbis departed from the law and applied rules that governed the Islamic *suftaj*. They did not even attempt to 'bend' Talmudic legal principles with the view of adapting them so as to reach the 'desired' result in their framework.

Amazing as it is, this Response remained limited to the circumstances that existed in what is now Iraq at the end of the first millennium. It did not affect subsequent developments in Jewish law.

V. Conclusion

In his monumental work on the history of English law, Holdsworth is skeptical as to whether the modern bill of exchange is a true derivation from the business practices of the Arabs. He nevertheless speaks (vol. VIII, 2^{nd} ed. at 133) of the Arabs using "something very much like the modern bill of exchange" that as early as the 8^{th} century CE:

> [C]ould pass from hand to hand by something very much like an indorsement; and, to use modern terms, the payee [thereof] had a right of recourse against the drawer in the event of non-payment by the acceptor.

My research does not support this specific observation. First, 8^{th} century may be too early a milestone, at least for a solid record of Medieval Islamic payment instruments. Second, there is no indication that at any time Medieval Islamic payment instruments were endorsable, that is, that their transfer was accomplished by the delivery plus the endorsement signature by the transferor of the instrument. Third, in the case of default by the drawee (being either the correspondent or paymaster), both Hanafi and Maliki rules permit recourse by Creditor-payee against Debtor-drawer only under narrow circumstances. Rather, in principle, debtor-drawer's discharge is absolute.

Holdsworth's observation appears to be exaggerated also in another respect. Transferability of a debt in association with the physical transfer of the debt instrument is not an Islamic innovation. Thus, as was already indicated, the transferability by delivery of a loan document payable by the borrower to his lender, almost as if it were an ordinary chattel, goes back to the Jewish Talmud and thus preceded Islam.

At the same time, unlike any earlier legal doctrine or institution, Maliki principles governing the *hawale* provided for solid rules to govern a simplified procedure for the transfer by delivery of informal debt instruments by the simple delivery of an informal debt instrument.

While the transferability by delivery feature is the forerunner of circulation by negotiation, the creditor's direct entitlement from the paymaster and correspondent is the precursor of the acceptor's liability to the payee on a bill of exchange. Indeed, Islamic practice did not encourage the circulation of the *suftaj*, and Islamic doctrine was hostile to the paymaster's obligation on the *suftaj*. In the final analysis, however, fundamental elements of the bill of exchange, both as a negotiable instrument and machinery for the transfer of funds, are traceable to Islamic instruments and legal doctrine.

Besides introducing the circulation of debt instruments, Jewish law provided for important discussion on the effect of the use of a payment mechanism on the debt which is paid with it. As Islamic law, it struggled with applying relatively rigid legal rules to new circumstances evolving in commerce. In some way it introduced the otherwise controversial 'law merchant' as permitting mercantile custom to supersede rules of law.

Neither Islamic nor Jewish law facilitates the accrual in the hands of a creditor of an 'abstract' right, namely an entitlement by the credtior from the paymaster (or his correspondent) to the sum of the money to which the obligation relates, free of defences available to the parties in their bilateral relationships. This aspect is the contribution of Roman law and is outside the present discussion.

Cooperative Insurance Market in Saudi Arabia

Challenges, Growth Opportunities & Suggestions for Development "An Empirical Study"

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Abstract

Insurance activity is one of the main pillars of economic theory & as Saudi Arabia is the most influential & biggest economy in the Middle East. I decided to study the Saudi insurance market as it is considered an emerging market, especially in light of the economic liberalization policy. Saudi insurance market can be described as a fiercely competitive market between foreign & national companies, a very low insurance penetration & a very low insurance density. Therefore, I offer the officials who are responsible for supervising & controlling the insurance sector some elements which I see their inevitability to be discussed in a theoretical & practical manner. The purpose of this research is to find feasible, applicable, and viable solutions; so that we can avoid any severe, adverse, and harmful disruption on the insurance sector & consequently on the policy holders. This study aims to achieve the following objectives: determining the main features of the Saudi insurance market, clarifying the most important challenges that face the insurance sector under the GATT & determining the most important & valuable suggestions on how to prepare the insurance sector to face future challenges. The Importance of the Study is: studying the reality of the insurance market in this particular period is crucial due to its exposure to the global economy's vulnerability which has affected all sectors. It represents a special & a particular importance in the current phase with respect to the effects of the GATT agreement on the insurance sector & to reach the most important policies and procedures to be followed for the development of the insurance sector and facing the side effects of globalization on the other hand so we wouldn't be surprised by its negative impacts.

Study Plan:

The objective of this study will be achieved through the following sections:

Section One: The most important features of the Saudi insurance market.

Section Two: The challenges facing the insurance sector, especially in light of GATT.

Section Three: The most important actions and policies to be followed for the development of the insurance sector.

Results and Recommendations

Introduction:

Insurance activity is one of the main pillars of economic theory, and not only is it difficult but also impossible to isolate it from the prevailing economic activity in any society because both affect each other (and vice versa). It is impossible to find a developing or a developed country without an insurance activity that plays an essential role in providing insurance protection for individuals or enterprises against the risks that they might be exposed to. At the same time, insurance contributes to the financing and investment needed for development plans ***(Ahmed, Mamdouh, Risk Management and Insurance, 2004, p 68)* [(2)].**

Given the reality of the Saudi market, especially in light of economic successive variables that need to be traced continuously, we found that there are many challenges which are located in the insurance sector that has to be faced and to find the optimal methods to deal with it, especially in light of economic liberalization policy which need the cooperation of all national operating insurance companies: public, private or joint venture. They have to search for a way out specially under: the sever competition from foreign companies, a very low insurance penetration (the ratio of the total insurance premiums to gross domestic product), a very low insurance density (the ratio of total insurance premiums to total population) and to a higher goal that must be achieved which is preserving the rights of policyholders.

The Importance of the Study:
Undoubtedly there are many problems that face the insurance sector in Saudi Arabia as an emerging market. Therefore I offer the officials who are responsible for supervising & controlling the insurance sector some elements which I see the inevitability to be discussed in a scientific & practical manner. The purpose of this is to find feasible, applicable ,and viable solutions for it so that we can avoid any sever, adverse, and harmful shake on the insurance sector & consequently on the policy holders. These elements are ***(Ahmed, Mamdouh, GATT and the Insurance Sector: Current Reality - the Effects of the Agreement - Methods of Confrontation, 2005, pp 87-91)* [(4)]:**

First: Technical Skills: There are many challenges which face the insurance sector with respect to technical skills, the toughest ones are:

1. Production
2. Investment
3. Managerial & technical expertise

Second: Very Poor Public Awareness of Insurance: There is no doubt that there is a severe lack of Insurance public awareness, which is evident through the very low ratio of insurance penetration & insurance density in Saudi Arabia (will be demonstrated later).

Third: Competition: Competition is the most important feature and condition of open markets, which relies mainly on the idea of survival of the fittest and strongest. But this would happen in the insurance sector under the policy of economic liberalization, as competition will be intensified either between national companies and foreign companies, or between national companies among themselves.

We can’t deny that the client would prefer to deal with an insurance company that: offer a distinctive insurance service, meet their own needs, sell for lower prices, and has strong financial solvency. In addition, we can’t ignore that the competition will be intense given that foreign companies enjoy advanced information technology, huge capital & reserves and low production costs. Furthermore, there is another great challenge that can be represented by its reliance on technical rates that are much lower than the rates applied in national companies in most insurance branches.

Fourth: Supervision and Control: The insurance sector is subject to supervision and control in every country, with different forms and degrees that suit its economic doctrine which the state embraces. And despite the supervision and control in the Saudi market - (represented in the Saudi Arabian Monetary Agency, SAMA) and the presence of corresponding bodies in countries that embrace the free economic doctrine, there are many types of risks & obstacles that face the insurance sector in light of the economic liberalization policy which must be noted.

The objective of the study:

This study aims to achieve the following:

1. Determine the main features of the Saudi insurance market.
2. Clarify the most important challenges that face the insurance sector under the GATT.
3. Determine the most important & valuable suggestions on how to prepare the insurance sector to face future challenges.

The Importance of the Study:

1. The study of the reality of the insurance market in this particular period is important due to its exposure to the global economy's vulnerability which has affected all sectors.
2. This study represents a special & particular importance in the current phase with respect to the effects resulting from the currency of GATT on the insurance sector.
3. To address the most important policies and procedures to be followed for the development of the insurance sector on one hand and facing the side effects of globalization on the other hand so we wouldn't be surprised by its negative effects.

Study Plan:

The objective of this study will be achieved through the following sections:

Section One: The most important features of the Saudi insurance market.

Section Two: The challenges facing the insurance sector, especially in light of the GATT.

Section Three: The most important actions and policies to be followed for the development of the insurance sector.

Results and Recommendations

Bibliography

Chapter I: The Main Features of the Saudi Insurance Market

The Historical Background of the Insurance Industry in Saudi Arabia:

The insurance market is relatively new in Saudi Arabia, where there were nearly 100 companies registered abroad & were acting as intermediaries, agents or branches of foreign insurance companies since the beginning of the 1970s. In 1986 the National Company for Cooperative Insurance (NCCI) - which is now called TAWUNIYA - was formed by Royal Decree as a Saudi Arabian joint stock company, with the Public Investment Fund, the Pension Fund and the General Organization for Social Insurance as its shareholders. It was established to provide insurance services to the private sector and large governmental projects and to ensure the retaining of a large portion of the insurance premiums inside Saudi Arabia ***(IOB, Principles & Practices of Insurance (Insurance Foundation Certificate Exam: IFCE, Version 4), Feb. 2012, pp 123-125)*** [(15)]**.**

The Council of Senior Scholars in Saudi Arabia issued a decision number 51 on 23 \ 3 \ 1977 which considered cooperative insurance contract as a donation contract & accordingly approved by the Islamic law (in coincide with Shariah Laws). By the end of 2003, the Law on Supervision of Cooperative Insurance Companies, **promulgated by Royal Decree (M/32) dated 31/07/2003,** was enacted, followed shortly by the Implementing Regulation, early in 2004 ***(ibid, p 124)***.

The law in its first article states that: "Insurance in Saudi Arabia should be cooperative insurance which does not conflict with the provisions of Islamic Shariah, & cooperative insurance comprise of: Health Insurance, Auto Insurance, Fire Insurance and Compulsory Contractors Insurance. The life insurance is the prerogative of banks as instructed by the Saudi Arabian Monetary Agency (SAMA), which is the government regulator of the Saudi insurance sector.

The Control & Supervision of Cooperative Insurance Companies Regulation was the first Saudi Arabian legislation regulating insurance sector. While there were over 75 insurance operators writing insurance business estimated in excess of SAR 2.7 billion in Saudi Arabia, without virtually any regulation at all. Now, this has changed completely, as what used to be an unregulated, free-for-all has become one of the most powerful & closely regulated insurance markets in the Gulf region ***(ibid, p 124)***.

The lack of regulation before the Royal Decree on August 1, 2003, does not mean that the Saudi Arabian government took a non-interventionist approach to the insurance industry, but the status of insurance was uncertain under Shariah Law. In Saudi Arabia, the debate of whether or not contracts of insurance are legitimate under Shariah law was narrowed down to the key issue that "to profit from an insurance transaction is against Islamic law, while collective risk sharing is acceptable and in the community's interest". This is based on Decision No 51 of March 23, 1977 of the Supreme Council of the Senior Al'Ommah, a Saudi Arabian government body of religious scholars, who ruled that cooperative (or mutual) insurance is "a form of donation contract", and because no one is supposed to profit from cooperative insurance transactions, the Senior Al'Ommah considered insurance in this form to be acceptable under Islamic Law ***(ibid, p 124)***. That is why the National Company for Cooperative Insurance (NCCI) has been established in 1986- in response to the Senior Al'Ommah's recommendations that a cooperative insurance company should be established in Saudi Arabia to offer an alternative to commercial insurance.

In keeping with NCCI's articles of association, the company maintains separate accounts for both its policyholders and for its shareholders. Therefore, it is actually a hybrid between a true mutual insurer, which is wholly owned by its policyholders and not traded on the stock market, and a commercial insurer, but nevertheless sufficiently mutual to meet the Senior Al'Ommah's recommendation that it should conduct its business on a cooperative basis.

Although there was never a statutory prohibition of commercial insurance in Saudi Arabia, the Saudi Arabian Ministry of Commerce did not issue commercial registrations to any person or company, other than NCCI, to conduct insurance business in the country. Nevertheless, a fair number of foreign-registered insurance organizations operated in Saudi Arabia (through a local agent), most of these were Bahraini-exempt companies, i.e., companies registered in Bahrain with the express purpose of not conducting business there.

In accordance with the strict letter of the law, conducting any kind of business in Saudi Arabia without holding the prerequisite commercial registration is unlawful. Notwithstanding this, the Ministry of Commerce exercised a loose supervisory function over foreign insurers who conducted business in the country, (all government construction contracts contain a proviso that the contractor must have a Contractor's All-Risks Insurance with an insurer who is represented in Saudi Arabia, and it was quite acceptable to insure such risks with Bahraini-based, Saudi-operating insurers other than NCCI). So, having an insurance industry which is essentially offshore and not subject to strict local supervision naturally created problems.

While a few numbers of foreign insurers who wrote business in Saudi Arabia have had a good reputation & solid financially, there were many who were financially unsound and sometimes unscrupulous.

Unsurprisingly, there were incidents of insurers collecting premiums and disappearing overnight. Furthermore, because the business was essentially foreign, local retention of risk and reinsurance within the Saudi market was low, with over 70% of the premiums generated in Saudi Arabia left the country.

The current reforms for allowing & regulating insurance were driven by the following two important changes that took place within Saudi Arabia *(ibid, p 126)*:

1. The medical compulsory Insurance.
2. Joining the World Trade Organization.

For many years, all health-care in Saudi Arabia has been free to all citizens and foreign residents. Since there were an estimated six million foreign workers and their dependents in Saudi Arabia (in 1999), this clearly imposes a considerable burden on the nation's healthcare system and on the economy as a whole. To alleviate the problem, the government introduced the Cooperative Health Insurance Act through the Royal Decree No M/10 on August 13, 1999, which makes it mandatory for employers to buy private medical insurance for their foreign employees and their dependents. In principle, the government could have just made private health insurance for foreigners obligatory and left the Saudi insurance market in its existing, disorganized state.

However, the Regulation requires that insurers providing cover under the scheme must be Saudi registered cooperative insurance companies. Because there was only one entity which fulfills this requirement, namely the NCCI, the effect of the legislation could have been the introduction of a state-owned monopoly. Rather, the Saudi government has been working to encourage an increase in the private sector's role in the economy as a whole not to decrease it. Additionally, setting up the provision of health insurance to an estimated 6 million persons within a relatively short period would have been a logistical exercise well beyond the capacity of any single entity.

The second key driver to the introduction of insurance regulation in Saudi Arabia was the determination to accede the World Trade Organization (WTO). A part of the agreement to join the WTO was the opening up of insurance sector to foreign companies.

In truth, this is a paradox, because in its past unregulated state, the Saudi insurance market was open to all comers, albeit not in any official basis. If one viewed the opening up of the Saudi insurance market solely from the perspective of being able to establish a licensed Saudi Arabian insurer, it was closed to both foreigners and Saudis alike, since there was no framework for setting up such entities, other than NCCI, of course. So, the Control of Cooperative Insurance Companies Regulation came into force on November 20, 2003. With the issue of the Implementing Rules on April 23, 2004, a new industry in Saudi Arabia was born.

Insurance Regulation in Saudi Arabia:

When the decision was made in Saudi Arabia to open its doors to insurance, it was done to improving the consumers' welfare, to be in the public interest, to enable the nation to deal with its healthcare insurance problem, and to bring about an open market, fairness and a level-playing field between foreign and domestic insurance companies to be in line with the WTO agreements.

On July 30, 2003, the Saudi Council of Ministers passed a historic legislation opening Saudi Arabia's insurance sector to foreign investment & the Control of Cooperative Insurance Companies Law came into force on November 20, 2003. The Implementing Rules was published on April 23, 2004. The objectives of the law and the implementing Regulations were expressed in the Article two of the Regulations ***(ibid,***

p 128):

Objectives of the Law and its Implementing Regulations:

1. Protection of policyholders and shareholders.
2. Encouraging fair and effective competition.
3. Enhancing the stability of the insurance market.
4. Enhancing the insurance sector and provide training and employment to Saudi nationals.

When viewed broadly, SAMA's insurance regulatory powers in Saudi Arabia includes *(ibid, p 128)*:

1. Regulating the establishment of insurance and reinsurance companies in Saudi Arabia;
2. Supervising the technical aspects of insurance and reinsurance companies' operations;
3. Regulating the distribution of surplus funds to shareholders and policyholders;
4. Determining the minimum capital and solvency requirements for each class of insurance;
5. Setting the rules of regulating the companies' investments inside & outside KSA;
6. Actuarial and rating approval.
7. Determining the educational and qualification requirements of insurance company personnel, brokers and agents.
8. Approving the insurance forms & documents.
9. Setting standards and rules governing the practice of salesmen and related disclosure of information and protection (code of conduct).
10. Interpreting the contract and its enforcement.
11. Determining, organizing and supervising the mandatory (compulsory) coverage.

<u>Takaful Insurance:</u>

THE WORD 'TAKAFUL' HAS BEEN DERIVED FROM THE ARABIC ROOT WORD 'KAFALA' MEANING 'MUTUAL PROTECTION AND JOINT GUARANTEE. IT IS RISK-SHARING INSTEAD OF RISK-TRANSFERRING. OPERATIONALLY, TAKAFUL REFERS TO PARTICIPANTS MUTUALLY CONTRIBUTING TO A COMMON FUND WITH THE PURPOSE OF HAVING MUTUAL INDEMNITY IN THE CASE OF PERIL OR LOSS. THE BASIC ELEMENTS OF TAKAFUL ARE:

- **MUTUALITY AND COOPERATION.**
- **PAYMENTS MADE WITH THE INTENTION OF CONTRIBUTION.**
- **JOINT GUARANTEE / INDEMNITY AMONGST PARTICIPANTS.**
- **SHARED RESPONSIBILITY.**
- **CONSTITUTION OF SEPARATE "PARTICIPANTS' TAKAFUL FUND".**
- **INVESTMENTS AS PER SHARIAH.**

A TAKAFUL FUND IS BASICALLY A POOL OF MONEY THAT PARTICIPANTS CREATE TO HELP EACH OTHER. BUT SUCH FUNDS CAN'T SURVIVE IF A COUNTRY'S REGULATIONS DON'T ALLOW FOR A COOPERATIVE LEGAL FORM OF BUSINESS ORGANIZATION OR FOR COMPANIES THAT LACK SHARE CAPITAL (CAPITAL STOCK).

For practical reasons, takaful operators (which are usually limited liability companies and may be Islamic banks) exist to manage these pools of funds, and shareholders exist to support a fund's startup and ongoing administrative expenses.

EACH TAKAFUL COMPANY MUST KEEP ITS PARTICIPANTS' CONTRIBUTIONS SEPARATE FROM ITS SHAREHOLDER FUNDS; THE TWO SOURCES OF MONEY CAN'T BE MIXED. THEREFORE, EACH TAKAFUL OPERATOR MANAGES TWO SEPARATE FUNDS *(FALEEL JAMALDEEN, 2012)* [12]*:*

- **The takaful fund:** This fund is the participants' (policyholders') money.
- **The shareholders fund (also called the operating fund):** this account holds the seed money (the paid-up capital) provided by the company's shareholders. The shareholder fund pays startup administrative expenses, and remaining capital is invested. Any profits from those investments go back into this fund. In addition, takaful participants pay ongoing management fees that are placed in the shareholders fund to support continuing administrative expenses.

  Shareholders are rewarded for their investment with explicit fees that are paid out of this fund periodically. In addition, when a takaful fund earns investment profits, shareholders may receive a share of those profits.

An important point to keep in mind is that any takaful fund (regardless of its particular structure) that experiences a deficit during its operation requires underwriting or capital backing; otherwise, the fund can become insolvent. Takaful shareholders underwrite the funds when deficits exist. They do so by giving the fund a qard hasan (interest-free loan).

Later, when the deficit disappears and a surplus accrues, the shareholders deduct the loan amount from fund surpluses.

Takaful Insurance' Models:

There are three main takaful models:

1-Wakala (Agency) Model: The Principal-Agent Relationship

In the case of a wakala-based takaful product, the takaful operator works as an agent on behalf of the takaful participants, who are called the principals. (The operator, or agent, is the wakil.)

The takaful operator manages the fund and receives a pre-agreed percentage of the participants' fund or fixed fee; this management fee is called a wakala (agency) fee. In addition, the takaful operator may charge a performance-based fee, which is its incentive to manage the fund as well as possible. The takaful operator determines what fee(s) to charge after consulting with the shariah board. Any fees it collects are placed in the shareholders fund and are used to reward the shareholders as well.

Note that any surplus that the takaful fund or the shariah-compliant investments generate goes back to the participant contributions.

2-Mudaraba (partnership or venture) Model: Partnership

Mudaraba is an Islamic contract based on a financial partnership in which one party (an investor) gives money to another (a fund manager) for the purpose of investing it in a business or economic activity. The investor puts up all the capital, and the fund manager provides expertise and knowledge to help the activity be successful. Both parties share the profits based on an agreed-upon ratio, but only the investor can lose the initial capital if the activity isn't successful.

When a takaful product is based on this contract, the shareholders of the takaful company share the profit of the fund with the policyholders. The policyholders are the investing partner (silent partner), called the rab al mal.

The takaful company (the takaful operator and shareholders) is the working partner or fund manager, called the mudarib (speculator). The takaful company isn't liable for any loss (unless the loss stems from the company's own negligence or misconduct). Instead, the participants' fund bears the loss. (The participants stand to lose money; the company stands to lose the value of its time and efforts). The takaful company receives a percentage of the fund's surplus (if one exists) and a percentage of any profit from investments made by the fund.

Note that the key difference between the mudaraba and wakala model is that a portion of the surpluses from both the takaful fund and the sharia-compliant investments goes into the shareholders fund in a mudaraba-based takaful. The wakala contract rewards shareholders with only a management fee and possibly an incentive fee.

3-Combination Model: Principal-Agent Relationship and Partnership

This structure is the most widely used in the takaful industry and alleviates most criticisms leveled against the pure mudaraba model. Here's how the combination model works:

- Using the wakala contract, the takaful company acts as the agent for the fund management and receives a fee for underwriting the fund.
- Using the mudaraba contract, the takaful company acts as the fund manager for managing investments and shares the profit for the investment of the takaful fund.

Note that the company doesn't receive any portion of a surplus in the participants fund in the combination takaful structure.

The Applied Model of Cooperative Insurance in Saudi Arabia:

The insurance companies in Saudi Arabia are stock companies. The Implementing Regulations of the Cooperative Insurance Companies Control Law that has been issued on Apr 4, 2004 by SAMA (Saudi Arabia Monetary Agency) in Article Seventy regarding Distribution of Surplus stated that:

2. The following shall be regarded by the Company upon preparation of the statements of insurance operations:

a) Determine earned premiums, and income generated from reinsurance commissions, and other insurance operations revenues.

b) Determine the incurred indemnification.

c) At the end of each year, the total surplus representing the difference between (a) and (b), less any marketing, administrative expenses, the necessary technical provisions, and other general expenses related to the operation of insurance shall be specified.

d) Company's net surplus shall be determined by adding or subtracting the investment return of the policyholder's invested funds, and subtracting the general expenses related to the policyholder's portion of the investment activities.

e) 10% of the net surplus shall be distributed to the policyholders directly, or in the form of reduction in premiums for the next year. The remaining 90% of the net surplus shall be transferred to the shareholders' income statement.

f) The shareholder's net income shall be transferred to the statement of shareholders' equity.

g) Twenty percent (20%) of the net shareholders' income shall be set aside as a statutory reserve until this reserve amounts to 100% of the paid capital, and

3. The Agency's written approval must be obtained for policyholders' net surplus distribution and timing.

So, from the mentioned above, we conclude that the Cooperative insurance model that is applies in Saudi Arabia is not Wakala, Mudaraba, nor Mixed Model as it doesn't separate policyholders (participants)' fund from shareholders' fund & also, it distribute 10% of the surplus to the policyholders & 90% to the shareholders which means that it is the same as the conventional insurance.

Previous Studies about the Saudi Arabia Insurance Market:

The previous studies of the Saudi Arabia insurance market are limited, but we will give a brief summary of these studies as follows:

First study: ***"Mutual insurance companies operating in Saudi Arabia (An analysis and assessment from the Islamic Economy point of view) ", (Abdul Moeti, Ayman, 1999*** **[1]** :

This research aims to provide an empirical study of the Saudi insurance market & the operating Mutual Insurance Companies, and evaluating the activity of these companies either legally or economically. The main findings of this study were:

1 - The magnitude of the demand for insurance in the Saudi market, which comes first among Arab countries in terms of reinsured premiums.

2 - There is no control, supervision or legal regulation of insurance companies in Saudi market.

3- Most studied companies have achieved relative success in economic evaluation.

4 – There is no unified standard accounting system that can be used to organize the insurance companies in the Saudi market.

5 – The permitted Islamic insurance model has only a theoretical framework which lacks details from a practical prospective.

6 – There isn't any kind of independent Shariah committee to control the mutual insurance companies in the Saudi market.

7 - THERE ARE NO UNIFIED LEGITIMATE OVERSIGHT BODIES (SHARIAH COMMITTEE) AT THE LEVEL OF THE ISLAMIC WORLD, TO CHECK THE COMPLIANCE OF THE INSURANCE COMPANIES' TRANSACTIONS WITH SHARIAH.

8 - The insurance policies issued by the Cooperative Insurance Companies are the same as the insurance policies issued by the conventional insurance companies as they are aleatory contract.

9 - The difficulty of adopting in practice the donation basis as a vent for the cooperative insurance to be religiously permitted in light of the inevitable presence of corresponding obligations (consideration) which are not applied practically.

10 – The applied Mutual Cooperative Insurance Model took a compromise model between the Mutual Insurance Model (the western model) & the joint stock companies for conventional insurance.

The most important recommendations reached by the researcher are:

1 – The need for reconsidering the donation basis as a vent for the cooperative insurance to be religiously permitted.

2 – The need for detailed religiously permitted insurance model.

3 - The need for a regulatory accounting system and a uniform standard regulating the operation of the insurance companies and reconsidering the drafting of the statute and insurance policies.

The second study: ***"Saudi Insurance Market," (Shaalan, Ahmed, 2005)*** **[7]:**

The main findings of this study were: Saudi Arabia has witnessed significant developments with regards to the insurance market legislation and the most important ones are: the Cooperative Insurance Law that issued by Royal Decree in 2003 and the Cooperative Health Insurance Law (which its Implementing Regulation has been issued in 2002), and the Compulsory Insurance on the driver's license in 2002, who was replaced by Auto Insurance, in addition to the issuance of the Supervision of the Cooperative Insurance Companies Law in 2003.
The opinion of the researcher was that the system of auto insurance is one of the most important legislations where it is estimated that the written premiums of auto insurance would be SR 4,963 million & 6,350 million SR of Health Insurance in 2009. Also, the study predicted that the Saudi insurance market total written premiums in 2009 will be about SR 15 billion & the Average per capita spending on insurance (insurance density) in Saudi Arabia will increase from SR 150 per year to 750 Saudi Riyals in 2009, and the contribution of the insurance sector to Saudi Arabia's GDP (insurance penetration) will reach 5% in 2009. Add to that the implementation of cooperative insurance law in 2003 has led to reducing the existence of non-eligible insurance companies from 100 to 15 companies.

The third study: ***"Insurance Fraud in the Saudi Market" (Zureiqat, Murad, 2008)*** **[8]:**

The researcher pointed out that the phenomenon of fraud is all over the world & does not exclude any country or activity: financial or economical, but it much spread particularly in the insurance business, as insurance fraud exceeds 60% of the total cases of fraud in all activities, because insurance scammers see the insurance sector as fertile soil & favorable climate.
The study focused on the risk of insurance fraud, and warned of its negative effects on society. and estimated the size of claims involving fraud by 3% -11% of the total claims globally, and what insurance companies pay each year due to fraudulent claims is about US 4.1 billion.

The study showed that the phenomenon of fraud forced insurance companies to raise insurance rates to compensate for losses and to increase the financial reserves & at the same time suspended certain types of insurance policies because of their inflated claims.

The study also demonstrated that there are several social factors prompted the sample members to commit insurance fraud including: deliberately doing accident (auto collision) as a show in front of a group of friends, forging reports to the insurance company to get paid as result of these reports, forging medical reports & bills through a family member, make the same claim for an insurance company several times, using a medical card of someone else, negligence of the insurance companies staffs.

The study also showed that the organizational factors represented in: concealment of material facts that affect claims, the staff of the insurance companies who handle claims are negligent in accepting the reports and tolerate potential fraud from their relatives, the insurance policies in the Saudi market constitute an outlet for fraud because of the lack of clarity in its conditions. As well as the lack of qualified & trained personnel in the insurance companies who have the ability to detect the counterfeit transactions. Also, the failure of the insurance companies to exchange information with each other about the insured is an outlet for fraud because it has become so easy to get an insurance policy from any company.

The study showed that the most important ways to circumvent the insurance companies include the following: reporting inaccurate claims many times which constitutes 23.6%, giving the policy to another person which constitutes 23.3%, forging some paperwork and make up 7.6%.

The majority of individuals' who committed fraud are: students who represent 24.3% of respondents, drivers 16.7%, insurance representatives 6.2%.

The insurance branches which were exposed to the highest proportion of fraud are: auto insurance 52.4%, medical insurance 35.7%, work-related accidents 10.7% & transit insurance 1.2%.

Fourth study: ***The Impediments of the Cooperative Insurance Industry in Saudi Arabia, (Al-Anzi, Fahd, 2009)*** **(6)*****:***

The findings of this study were as follow:

1 - Lack of clarity of Shariah is still bogging for those who are working in the cooperative & Takaful insurance industry. So, there is a desperate need for standardization & unification of Shariah legislations & setting a legal regulation to accommodate the legitimate insurance standards.
2 – The number of cooperative reinsurance companies are small.
3 - The lack of an effective jurisdictional system for Cooperative Insurance to protect them from circumvents.
4 – The increasing numbers of insurance fraud cases.

5 - The presence of technical obstacles relating to the cooperative insurance policy.

6 - Blurred supervision & control mechanisms so that there are two bodies sharing control over the cooperative insurance companies: Saudi Arabian Monetary Agency (SAMA) and the Cooperative Health Insurance Council.
7 - Weakness of trained manpower and poor educational outcomes for insurance specialty in the Saudi Universities and the reluctance of young people to study & work in insurance for religious & social reasons.
8 - Non-interest of the insurance companies for scientific, technical and professional standards that is necessary for the practice of insurance activities.

The study recommended the need to activate the role of supervision & control over the cooperative insurance market and the need to assess the market need for new insurance companies and to encourage existing reinsurance companies to be repositioned to conform with the requirements of the cooperative insurance and to benefit from the unique experiences of the Cooperative Insurance markets such as the Malaysian market.

Fifth Study: ***"The Saudi Insurance Market Report, 2012" (Saudi Arabian Monetary Agency, General Insurance Supervision Department)*** **(27)*****:***

This report presented the data of the Saudi Arabia insurance sector & based on its data we can figure out the following information:

1-Insurance Penetration: Insurance penetration is defined as Gross Written Premiums divided by the total Gross Domestic Product (GDP).

Remarks:

(1) Total GDP is: SR 1,786 SR, 1,413 SR, 1,690, SR 2,163 and SR 2.727 Billion in 2008, 2009, 2010, 2011 and 2012, respectively.

(2) Non-oil GDP is: SR 690, SR 738, SR 792, SR 919, SR and SR 1.353 Million in 2008, 2009, 2010, 2011 and 2012 respectively.

(3)Insurance penetration of non-oil GDP is defined as Gross Written Premiums divided by non-oil GDP.

(4)Insurance penetration of non-oil GDP has slightly decreased at an average annual growth rate of 1%.

(5)Insurance penetration of non-oil GDP decreased to 1.56% in 2012 from 2.02% in 2011.

The following table shows the insurance penetration in Saudi Arabia during the period: 2008-2012:

Tables 1: Insurance Penetration (2008 to 2012)

Line of Business	2008 %	2009 %	2010 %	2011 %	2012 %	% Change
Total General Insurance	0.31%	0.45%	0.40%	0.36%	0.33%	-9.5%
Total Health Insurance	0.27%	0.52%	0.51%	0.45%	0.41%	-7.8%
Total P&S Insurance	0.03%	0.07%	0.06%	0.04%	0.03%	-22.1%
Total	0.92%	1.03%	0.97%	0.86%	0.78%	-9.2%

The Saudi Insurance Market Report, 2012, p 38 [28].

From the above table we find that:

-Insurance penetration is very low: 0.92%, 1.03%, 97%, 0.86% & 0.78% during the period: 2008-2012 (which is the first indicator to measure the insurance awareness).

-Over the past five years, insurance penetration has decreased by an average annual rate of 3.5%.

-In 2009, insurance penetration increased from 0.92% to 1.03%, in 2008. This is mainly due to a decrease of the total GDP (-20.77% in 2009) because of the oil price.

-In 2012, insurance penetration decreased to 0.78%, down from 0.86% in 2011. This is mainly due to a continuously strong growth of the total GDP (26.07% in 2012). The oil sector accounted for a significant part of this growth.

2-Insurance Density: Insurance density is defined as Gross Written Premiums divided by the total population (or Gross Written Premiums per Capita).

Saudi population was: 24.0, 24.8, 25.4, 27.1, 27.1 and 29.19 Million in 2008, 2009, 2010, 2011 and 2012, respectively [1].

Tables 2: Insurance Density [*] (2008 to 2012)

Line of Business	2008 SR	2009 SR	2010 SR	2011 SR	2012 SR	% Change 2012:2011
Total General Insurance	222.5	248.9	247.8	290.8	308.3	6.0%
Total Health Insurance	193.7	287.4	320.2	357.8	386.5	8.0%
Total P & S Insurance	23.9	39.5	35.8	33.4	30.4	-8.8%
Total	440.1	575.8	603.8	682.0	725.2	6.3%

The Saudi Insurance Market Report, 2012, p 38 [28].

From the table above, we find that:

-Insurance density has increased from SR 682 per Capita in 2011 to SR 725 per capita in 2012, which represents a 6.33% increase.

- Insurance density has increased by an average annual rate of 16.2% between 2008 and 2012.

-Insurance density of Protection and Savings insurance remained very low (SR 30 per Capita) when compared to General and Health insurance.

- Insurance density of Protection & Saving insurance products is decreasing each year during the period 2009-2012 & has decreased by an average annual rate of 7.68%.

-The insurance density is very weak (which is the second indicator to measure the insurance awareness) where it reached US 117.36 , 153.55, 161.01 , 181.87 & 193.39 during the period 2008-2012, and if we take into account the rate of inflation during this period, we find that these values would be less .

We have to take into consideration that most of these premiums comes from Compulsory insurance (auto, health and liability), as solely auto & health insurance are accounted for 75.4% of the GWP & if we eliminated them, the insurance density becomes extremely low, especially in light of the rising income average in Saudi Arabia over the past two decades. So, based on the values of the above insurance density & insurance penetration we can say that the level of insurance awareness in Saudi Arabia is very low.

To complete the picture, we have displayed the values of insurance penetration & insurance density of some other countries & compared it with the values of Saudi Arabia during the same period through the following tables:

Tables 3: Insurance Penetration: Premiums as a % of GDP All over the world in 2011(*)

Ranking	*Country*	*Total Premiums*	*Life Premiums*	*Non-life Premiums*
1	***Taiwan***	17.0	13.9	3.1
2	***Netherlands***	13.2	3.7	9.5
30	***Israel***	5.2	2.8	2.4
62	***United Arab Emirate***	1.8	0.3	1.5
81	***Saudi Arabia***	**0.9**	**0.1**	**0.8**
1	***North America***	**7.9**	**3.5**	**4.4**
2	***Europe***	**7.1**	**4.1**	**3.0**
4	***Asia***	**5.8**	**4.3**	**1.6**
	World	**6.6**	**3.8**	**2.8**

(World Insurance in 2011, Swiss Re, Sigma, No 3/2012, p 39) (27)

From the above table of insurance density values all over the world we find that:

1 - The insurance penetration of the world market on average was 6.6% in 2011 (it is lower than the previous years because the impact of the global financial crisis on the insurance sector that started in 2008) while the insurance penetration of the Saudi market has reached 0.9% in 2011, which was much lower than the world average (about 13.64% of the world average).

2 - The insurance penetration of the Asian market was 5.8% during the year 2011 while the insurance penetration of the Saudi market has reached 0.9% in 2011, which was much lower than the Asian average (about 15.52% of the Asian average).

3 - The ranking of Saudi Arabia with regard to insurance penetration of the insurance market was 81 at the global level and 23 at the level of the continent of Asia.

4 - It is difficult to compare insurance penetration in Taiwan (17.0%) and Netherlands (13.2%) with the most other country, but impossible to compare insurance penetration in these two countries with Saudi Arabia (0.9%).

5 - The Ranking of the Lebanon was 46 at the global level, but was the first among the Arab countries, where the insurance penetration was 2.9%.

6 – The ranking of Israel was the 30th at the global level, but its ranking was the 6th among the Asian countries where its insurance penetration was 5.2%.

7 - In terms of the continents, North America comes in first place with an insurance penetration of 7.9%, followed in the second place by Europe 7.1%, Oceania in the third place by 5.9%, Asia in the fourth place by 5.8%, Africa in the fifth place by 3.6 and Latin America & Caribbean in the last place by 2.8%.

8 – The insurance penetration of Saudi Arabia with regard to life insurance is very low as it reached 0.1% of GDP while the world average is 3.8% (which represents 2.63%) and in Asia is 5.8% (which

represents 2.33%).

9 - The insurance penetration of the Saudi Arabia with regard to non-life insurance (property & Liability insurance) was 0.8% which is very low as it represents 28.57% of the world average (2.8%) but higher than the average in Asia which was 1.6% (as it represents 50%).

10 - The highest penetration of Life Insurance was 13.9% existed in Taiwan, which represents 365.79% of the world percentage which was 3.8% & the highest penetration of non-Life Insurance was 9.5% existed in Netherlands, which represents 339.29% of the world percentage which was 2.8%.

Tables 4: Insurance Density: Premium Per Capita in USD All over the world in 2011 (*)

Ranking	*Country*	*Per Capita of Total Premiums*	*Per Capita of Life Premiums*	*Per Capita of Non life Premiums*
1	***Switzerland***	8012	4421	3591
2	***Netherlands***	6647	1870	4777
26	***Israel***	1650	885	765
30	***United Arab Emirate***	1380	255	1126
59	***Saudi Arabia***	**177**	**10**	**167**
1	***North America***	**3815**	**1697**	**2118**
4	***Asia***	**314**	**229**	**85**
	World	**661**	**378**	**283**

(World Insurance in 2011, Swiss Re, Sigma, No 3/2012, p 38) (27)

From the above table of insurance density values all over the world we find that:

1 - The insurance density of the global market, on average, amounted to $ 661 in 2011, while the insurance density in the Saudi insurance market amounted to $ 177 in 2011, which is much lower than the global average (about 26.78% of the world average).

2 - The insurance density of the Asian market, on average were $ 314 in 2011, while the insurance density in the Saudi insurance market amounted to $ 177 in 2011, which is lower than the average in Asia (about 56.37% of the Asian average).

3 - The Saudi Arabia global ranking with respect to insurance density is 59 **th** & 16 **th** with respect to the ranking in Asia.

4 - It is difficult to compare insurance density in Switzerland ($ 8012) and Netherlands ($ 6674) with most of the other countries, but impossible to compare insurance density in these two countries with Saudi Arabia ($ 177).

5 - The Ranking of the United Arab Emirates is 30 at the global level, but is ranked first among the Arab countries, where the insurance density is $ 1380.

6 – The ranking of Israel is the 26th at the global level, but its ranking is the 5th among the Asian countries where its insurance density is $ 1650.

7 - In terms of the continents, North America comes first with an insurance density of $3815, followed by Oceania in second place ($ 2759), Europe in third place ($1886), Asia in fourth place ($ 314), Latin America & Caribbean in fifth place ($ 261) & Africa in last place ($ 65).

8 – The insurance density of Saudi Arabia with regard to life insurance was very low as it reached $ 10 per capita while the world average was $ 378 (which represents 2.65%) and in Asia was $ 229 (which

represents 4.37%).

9 - The insurance density of the Saudi Arabia market with regard to non-life insurance (property & Liability insurance) was $167 which is also low as it represents 59.01% of the world average ($283) dollars but higher than the average in Asia ($ 85) as it represented 196.47%).

With regard to life insurance, the insurance density was $ 10 which is very low as it represents 2.65% of the world average ($ 378) & represents 4.37% of the Asian average ($ 229). This decrease in the insurance density of life insurance can be justified for religious reasons, but the decrease in general insurance is not justified, especially if we take into consideration that the average of income is somewhat high in Saudi Arabia & there are huge amount of property.

10 - The highest density of Life Insurance exist in Switzerland with an average per capita $4,421, which represents 1169.58% of the world average & the highest density of non-Life insurance exist in Netherland with an average per capita $4,777 , which represents 1687.99% of the world average.

All of the above confirm the low level of awareness of insurance in Saudi Arabia.

In general it can be said that the insurance markets in the Arab world in general and not only in Saudi Arabia are weak in terms of insurance density & insurance penetration, compared with the rest of the world as shown in table (5):

Table (5) Arab Insurance Market Review
Key Economic & Demographic Indicators in 2011

Ranking	Country	GPI[1] in Millions USD	Premium Per Capita in USD	GDP Per Capita in USD	Premium as a % of GDP	Population in Millions	GDP in Millions USD
1	Algeria	1,154.9	32.08	4,917	0.7%	36.00	177,000
2	Bahrain	546.1	413.71	19,697	2.1%	1.32	26,000
3	Egypt	1,592.7	19.03	2,820	0.7%	83.70	236,000
4	Jordan	598.3	94.97	4,444	2.1%	6.30	28,000
5	Kuwait	698.2	193.94	46,667	0.4%	3.60	168,000
6	Lebanon	1,221.0	283.95	9,767	2.9%	4.30	42,000
7	Libya	140.7	21.65	12,262	0.2%	6.50	79,700
8	Mauritania	n/a	n/a	1,158	n/a	3.54	4,100
9	Morocco	2,920.4	90.41	3,065	2.9%	32.30	99,000
10	Oman	733.0	244.33	24,333	1.0%	3.00	73,000
11	Palestine	n/a	n/a	1,549	n/a	4.17	6,460
12	Qatar	974.0	541.11	96,111	0.6%	1.80	173,000
13	Saudi Arabia	4,934.4	176.23	21,321	0.8%	28.00	597,000
14	Sudan	289.1	124.6	1,537	0.4%	42.30	65,000
15	Syria	n/a	n/a	2,814	n/a	21.00	59,100
16	Tunisia	900.7	84.18	4,299	2.0%	10.70	46,000
17	UAE	6,513.8	1,357.04	70,625	1.9%	4.80	339,000
18	Yemen	80.6	3.25	1,452	0.2%	24.80	36,000
19	Iraq [2]	98,686	n/a	n/a	n/a	32.96	115,500

Source: Arab Insurance Group (ARIG), Annual report 2012, pp18-19 [23].

(1)GPI: *Gross Premium Income, which includes direct and reinsurance inward premiums received in the year, net of cancellations but before deduction of commissions or reinsurance premiums ceded.*

(2)The premium figures are in local currency for Iraq.

From the above table of Arab Insurance Market we find that:

1-Regarding GPI, UAE comes first, Saudi Arabia second & Morocco third ($6,513.80, $4,934.40 & $2,920.40) & Yemen comes last ($80.60).

2-Regarding insurance penetration, UAE comes first, Qatar second & Bahrain third ($1,357.04, $541.11 & $413.71) & Yemen comes last ($3.25).

3-Regarding insurance density, Lebanon & Morocco comes first & second with the same value (2.9%) & Libya & Yemen comes last with the same value (0.2%).

4-Even though Qatar & Kuwait comes first & third regarding GDP Per Capita, their insurance penetration & insurance density are very low (insurance penetration: $541.11 & 193.94 , insurance density: 0.6 & 0.4 respectively) .

5-Libya comes just before the last one (Yemen) regarding all the above economic & demographic key indicators (GPI, insurance penetration & insurance density) even though its ranking is six regarding GPD Per Capita ($12,262).

<u>Insurance Market Performance – Overall:</u>

Table 6: Gross Written Premiums * (2008 to 2012)

Line of Business	2008		2009		2010		2011		2012	
	SR Million	%	SR Million	%	SR Million	%	SR Million	%	SR Million	%
Protection & Savings	594	5.44%	1,003	6.87%	972	5.93%	905	4.89%	889	4.20%
Health	4,805	44.01%	7,292	49.91%	8,690	53.03%	9,708	52.46%	11,285	53.30%
General	5,520	50.55%	6,315	43.22%	6,625	40.43%	7,890	42.64%	9,000	42.50%
Total	**10,919**	**100%**	**14,610**	**100%**	**16,387**	**100%**	**18,505**	**100%**	**21,174**	**100%**

The Saudi Insurance Market Report, 2012, p 7 (28).

<u>Remark:</u> The Gross Written Premiums (GWP) are the total of accounted premiums. There may be double counting of reinsurance premiums accepted from other Saudi Arabian insurers or reinsurers.

From the above table we find that:

1-The overall insurance Gross Written Premiums (GWP) increased by SR 2.7 Billion to reach SR 21.174 Billion in 2012, compared to SR 18.505 Billion in 2011, which represents a growth rate of 14.42%.

2-Health insurance remained the biggest line of business in 2012. Its contribution to total GWP slightly increased from 52.46% in 2011 to 53.30% in 2012, while General insurance's contribution to total business volume remains at 42.50% in 2012.

3-Health insurance accounted for SR 1.6 Billion of the SR 2.7 Billion increase of GWP, which represents a 59.30% contribution to the market's GWP increase.

4-Protection and Savings insurance remained the smallest line of business accounting for 4.20% of total GWP, with a decrease in its written premiums by 1.77% in 2012.

Table 7: Gross Written Premiums by Line of Business (2008 to 2012)

In SR Million	2008		2009		2010		2011		2012		Growth
	SR M	% Total	SR M	% Total	SR M	% Total	SR M	% Total	SR M	% Total	%
Aviation	139	1%	174	1%	305	2%	272	1%	67	0.3%	**-75.4%**
Energy	208	2%	302	2%	329	2%	361	2%	385	1.8%	**6.6%**
A & L * & Other	531	5%	544	4%	507	3%	632	3%	691	3.3%	**9.4%**
Marine	620	6%	525	4%	518	3%	634	3%	743	3.5%	**17.2%**
Engineering	682	6%	810	6%	869	5%	913	5%	1,077	5.1%	**18.0%**
Property/ Fire	798	7%	905	6%	959	6%	1,157	6%	1,348	6.4%	**16.6%**
Motor	2,542	23%	3,055	21%	3,239	20%	3,922	21%	4,689	22.1%	**19.6%**
Total General Insurance	**5,520.1**	**50.6%**	**6,315.3**	**43.2%**	**6,725.1**	**40.7%**	**7,890.3**	**42.6%**	**8,999.9**	**42.5%**	**14.1%**
Health	4,805	44%	7,292	50%	8,690	53%	9,708	52%	11,285	53.3%	**16.2%**
Protection & Saving	594	5%	1,003	7%	972	6%	905	5%	889	4.2%	**-1.8%**
Total	**10,919**	**100%**	**14,610**	**100%**	**16,387**	**100%**	**18,504**	**100%**	**21,174**	**100%**	**14.4%**

The Saudi Insurance Market Report, 2012, p 37 [28].

** A & L stands for Accidents and Liabilities insurance throughout the document.*

From the above table we find that:

1-Motor and Health insurance accounted for around 75.4% of total GWP in 2012.

2-The third line of business was Property/Fire with a 6.4% share of total GWP in 2012.

3-All lines of business grew in 2012 except Protection & Saving and Aviation.

<u>Health Insurance:</u>

1-Health insurance, which includes both compulsory and non-compulsory lines, accounted for 53.3% of the 2012 total market GWP with SR 11.29 Billion in underwritten premiums.

2-Health insurance accounted for 61.9% of the market's NWP as insurance companies retained SR 9.95 Billion of their Health insurance GWP, which represents an 88.2% retention ratio.

3-Health insurance's NEP registered SR 9.08 Billion.

4-Health insurance's NCI (Net Claims Incurred) amounted to SR 7.39 Billion, which translates into an 81.4% loss ratio for the year 2012.

<u>Motor Insurance:</u>

1-Motor compulsory and non-compulsory lines of business stood in second place with a 22.1% share of total GWP in 2012.

2-Motor insurance's GWP totaled SR 4.69 Billion in 2012, which represents a 22.1% share of total market GWP.

3-Motor insurance's retention ratio of 94% was the highest of all business lines. Motor insurance NWP totaled SR 4.41 Billion.

4-Motor insurance's NEP amounted to SR 4.1 Billion and accounted for 27.5% of the insurance market's NEP.

5-Insurance companies recorded SR 3.22 Billion in Motor insurance's NCI which resulted into a 78.5% loss ratio.

<u>Property/ Fire insurance:</u>

1-Property/ Fire insurance's GWP totaled SR 1.35 Billion in 2012, which represents a 6.4% share of total market GWP.

2-Insurance companies retained only 15.1% of their Property/ Fire insurance premiums as the business line's NWP amounted to 203 Million. Property/ Fire insurance contributed only1.3% to total market NWP in 2012.

3-Property/ Fire insurance's NEP registered SR 181 Million.

4-Insurance companies recorded SR 91 Million in Property/ Fire insurance's NCI which translates into a 50.5% loss ratio.

<u>Engineering insurance:</u>

1-Engineering insurance's GWP totaled SR 1.08 Million in 2012, a 5.1% contribution to total market GWP.

2-Insurance companies retained 15.4% of their Engineering underwritten premiums. Engineering insurance NWP registered SR 166 Million.

3-Engineering insurance NEP amounted to SR 154 Million and accounted for 1.1% of the insurance market's NEP.

4-Engineering insurance recorded a loss ratio of 31%, with NCI, totaling SR 48 Million.

<u>Accident and Liability (A&L) & other insurance:</u>

-Accident and Liability (A&L) & other insurance (which refers to all other business lines in general insurance) includes the following lines of business: personal accident, work related, employer's liability, third party liability, general liability, product liability, medical liability, professional liability, theft & burglary, safe burglary, fidelity and any other liability.

1-Insurance companies underwrote SR 691 Million in A & L and other general insurance premiums in 2012.

2-Insurance companies retained SR 329 Million of A & L and other general insurance underwritten premiums, a 47.6% retention ratio.

3-A & L and other general insurance NEP totaled SR 324 Million, which represents a 2.2% contribution to total NEP.

4-Insurance companies recorded SR 82 Million in A & L and other general insurance's NCI which translates into a 25.3% loss ratio.

<u>Marine insurance:</u>

-The Marine insurance line of business includes both cargo and hull insurance.

1-Marine insurance GWP totaled SR 743 Million in 2012, which represents a 3.5% contribution to total market GWP.

2-Insurance companies retained 30.9% of their Marine insurance underwritten premiums as the business line's NWP amounted to SR 230 Million.

3-Marine insurance's NEP recorded SR 226 Million, which -represents a 1.5% share of total NEP for

2012.

4-Marine insurance’s NCI amounted to SR 94 Million. This resulted in a loss ratio of 41.8%.

Energy insurance:

1-In 2012, Energy insurance GWP totaled SR 385 Million, which represents a 1.8% share of total market GWP.

2-Insurance companies ceded 98.1% of their Energy insurance underwritten premiums. Energy insurance NWP amounted to SR 7 Million.

3-Energy insurance’s NEP amounted to SR 7 Million, accounting for only 0.05% of the insurance market’s NEP.

4-Energy insurance’s NCI amounted to SR 1 Million. This resulted in a loss ratio of 9.3%.

Aviation insurance:

1-Aviation insurance GWP reached SR 67 Million in 2012, a 0.3% contribution to total market GWP.

2-NWP for Aviation insurance reached SR 2.4 Million resulting in a retention ratio of 3.6%.

3-Aviation insurance’s NEP totaled SR 1.9 Million and NCI amounted to SR 15 Million resulting in a loss ratio of 22% for 2012.

Protection and Savings insurance:

1-Protection and Savings insurance’s GWP totaled SR 889 Million in 2012, which represents a 4.2% contribution to the market’s total business volume.

2-Protection and Savings insurance accounted for 4.8% of the market’s NWP as insurance companies retained SR 767 Million of GWP.

3-Protection and Savings insurance’s NEP registered SR 809 Million, which represents a share of 5.4% of the total insurance market’s NEP.

4-Protection and Savings insurance’s NCI amounted to SR 137 Million.

Table (8) Net Written Premiums (*) by Line of Business (2008 to 2012)

Line of Business	2008		2009		2010		2011		2012		% Change
	SR Million	%	SR Million	%	SR Million	%	SR Million	%	SR Million	%	
A&L and Other	217.3	3.0	244.3	2.4	275.9	2.3	279.8	2.1	329.0	2.0	17.6
Motor	2,458.7	33.6	2,944.1	29.2	3,098.8	26.1	3,710.6	27.4	4,408.2	27.4	18.8
Property/ Fire	95.4	1.3	105.1	1.0	126.5	1.0	135.5	1.0	203.2	1.3	49.9
Marine	201.5	2.8	183.2	1.8	175.4	1.5	204.9	1.5	229.5	1.4	12.0
Aviation	5.5	0.1	1.1	0.0	4.8	0.0	1.2	0.01	2.4	0.01	92.8
Energy	0.9	0.0	5.2	0.1	7.6	0.1	7.4	0.1	7.3	0.0	(1.2)
Engineering	122.2	1.7	125.3	1.2	113.9	0.9	131.2	1.0	165.9	1.0	26.5
Total General Insurance	**3,102**	**42.4**	**3,608**	**35.8**	**3,803**	**31.9**	**4,471**	**33.0**	**5,346**	**33**	**19.6**
Total Health Insurance	**3,751**	**51.2**	**5,557**	**55.2**	**7,120**	**60.6**	**8,225**	**60.8**	**9,951**	**61.9**	**21.0**
Total P&S Insurance	**468.2**	**6.4**	**908.0**	**9.0**	**876.8**	**7.5**	**841.2**	**6.2**	**767.0**	**4.8**	**(8.8)**
Total	**7,321**	**100**	**10,073**	**100**	**11,800**	**100**	**13,537**	**100**	**16,064**	**100**	**18.7**

The Saudi Insurance Market Report, 2012, p 39 (28).

(*) Net Written Premiums (NWP) is defined as the premiums retained by the insurance company, after the subtraction of the premiums ceded to local or international reinsurers from GWP by line of business.

From the above table we find that:

1-Total NWP increased from SR 13.5 Billion in 2011 to SR 16.1 Billion in 2012, with an 18.7% increase.

2-Around 89.3% of total NWP in 2012 was generated by Motor and Health insurance.

3-Health insurance remained the largest line of business accounting for 61.9% of total NWP in 2012.

4-Motor insurance share of total NWP remained in second place. Motor insurance accounted for 27.4% of NWP in 2012.

Table (9) Retention Ratio by Line of Business period (2008-20012)

Line of Business	2008	2009	2010	2011	2012	% Change
	%	%	%	%	%	
A&L and Other	40.9	44.9	54.4	44.30	47.61	**7.5**
Motor	96.7	96.4	95.7	94.60	94.01	**(0.6)**
Property/ Fire	11.9	11.6	13.2	11.72	15.07	**28.6**
Marine	32.5	34.9	33.8	32.32	30.89	**(4.4)**
Aviation	2.9	0.6	1.6	0.46	3.57	**682.3**
Energy	0.4	1.7	2.3	2.05	1.90	**(7.3)**
Engineering	17.9	15.5	13.1	14.38	15.41	**7.2**
Total General Insurance	56.2	57.1	56.5	56.7	59.4	**4.8**
Total Health Insurance	78.1	76.2	81.9	84.7	88.2	**4.1**
Total P&S Insurance	78.9	90.5	90.2	92.9	86.3	**(7.1)**
Total	60.9	62.4	72.0	73.2	75.9	**3.7**
Total Without life	66.4	67.4	70.9	72.1	75.4	**4.5**

The Saudi Insurance Market Report, 2012, p 40 [28]**.**

Remark: Retention ratios are not shown for Protection & Savings in this table as the savings element of the contract must be retained in the Saudi Arabian company, so retentions are not directly comparable with other insurance contracts.

-The retention ratio measures the written premiums retained by the insurance company. It is calculated by dividing the NWP by the GWP.

From the above table we find that:

1-The overall retention ratio of insurance companies in the Saudi market increased to 75.8% in 2012 from 73.2% in 2011. This ratio is largely skewed due to the high retention ratio of Motor and Health insurance which collectively account for around 75.4% of total GWP. In 2012, the retention ratios for Motor and Health insurance were 94% and 88%, respectively.

2-The weighted average retention ratio of other insurance lines of business (i.e., excluding Motor and Health insurance) unchanged at 20% in 2012 compared to 2011

Notes:

- Newly licensed companies are required to adhere to a minimum retention ratio of 30% (as per Article 40 of the Implementing Regulations).

Table 10: Commissions Incurred by Line of Business (2008 to 2012)

Line of Business	2008		2009		2010		2011		2012		% Change
	SR Million	%	SR Million	%	SR Million	%	SR Million	%	SR Million	%	
A&L & Other	52.8	6.9	44.1	5.2	41.8	4.1	46.5	4.2	49.7	5.8	6.8
Motor	281.6	36.6	285.1	33.5	341.4	34.5	421.6	38.0	280.1	32.7	(33.6)
Property/ Fire	59.5	7.7	66.4	7.8	74.1	7.2	74.4	6.7	74.7	8.7	0.5
Marine	54.9	7.1	42.3	5.0	41.6	4.1	46.8	4.2	47.4	5.5	1.3
Aviation	2.4	0.3	2.5	0.3	3.2	0.3	2.4	0.2	0.3	0.0	(86.1)
Energy	3.0	0.4	0.6	0.1	7.0	0.7	0.7	0.1	0.0	0.0	(99.7)
Engineering	44.3	5.8	48.0	5.6	56.3	5.5	56.0	5.1	49.4	5.8	(11.9)
Total General Insurance	**498.7**	**64.8**	**488.9**	**57.5**	**565.5**	**56.6**	**648.4**	**58.5**	**501.7**	**58.5**	(22.6)
Total Health Insurance	**238.9**	**31.0**	**320.7**	**37.7**	**405.9**	**41.2**	**430.7**	**38.8**	**330.6**	**38.6**	(23.2)
Total P&S Insurance	**32.0**	**4.2**	**40.4**	**4.7**	**20.9**	**2.1**	**29.6**	**2.7**	**24.8**	**2.9**	(16.2)
Total	**770**	**100**	**850**	**100**	**992**	**100**	**1,109**	**100**	**857**	**100**	(22.7)

The Saudi Insurance Market Report, 2012, p 42 [28].

From the above table we find that:

1-Total commissions incurred amounted to SR 857 Million in 2012, compared to SR 1.12 Billion in 2011, which represents a decrease of 22.7%.

2-General insurance related commissions accounted for 58.5% of total commissions incurred in 2012.

3-Health insurance's share of total commissions incurred represented 38.5% in 2012.

4-Protection and Savings insurance's commissions incurred was 2.9% of total commissions incurred in 2012.

Table 11: Gross Claims Paid by Line of Business (2008 to 2012)

Line of Business	2008		2009		2010		2011		2012		% Change
	SR Million	%	SR Million	%	SR Million	%	SR Million	%	SR Million	%	
A&L and Other	92.0	2	98.4	1	57.8	1	92.5	1	105.0	1%	13.5
Motor	1,492.4	29	1,621.4	22	1,881.5	22	2,730.0	24	3,464.8	25	26.9
Property/ Fire	314.9	6	456.1	6	397.3	4	527.4	5	773.6	6	46.7
Marine	195.1	4	166.7	2	276.5	3	205.8	2	257.3	2	25.0
Aviation	11.5	0	17.8	0	26.5	0	31.3	0	15.5	0	(50.6)
Energy	26.5	1	570.1	8	138.5	2	82.2	1	58.5	0	(28.8)
Engineering	111.7	2	145.6	2	159.2	2	226.1	2	239.7	2	6.0
Total General	**2,244**	**43**	**3,076**	**42**	**2,937**	**34**	**3,895**	**34**	**4,914**	**36**	**26.2**
Total Health	**2,839**	**54**	**4,010**	**55**	**5,440**	**64**	**7,297**	**64**	**8,511**	**63**	**16.6**
Total P&S	**140**	**3**	**169**	**2**	**136**	**2**	**292**	**3**	**189**	**1**	**(35.3)**
Total	**5,224**	**100**	**7,255**	**100**	**8,514**	**100**	**11,485**	**100**	**13,615**	**100**	**18.5**

The Saudi Insurance Market Report, 2012, p 42 [(28)].

From the above table we find that:

1-Total gross claims paid increased by 18.5% from SR 11.5 Billion in 2011 to SR 13.6 Billion in 2012.

2- In 2012, Health and Motor gross claims paid grew by 16.6% and 26.9%, respectively compared to 2011 figures.

3- In 2012, Property/Fire insurance recorded the highest growth rate in gross claims paid, after increasing by 46.7% from SR 527 Million to SR 774 Million.

Table (12) Net Earned Premiums vs. Net Claims Incurred (2008 to 2012, SR Million)

Loss Ratio (% NEP)	2008	2009	2010	2011	2012
	68.3%	**70.9%**	**68.2%**	**71.8%**	**77.6%**

The Saudi Insurance Market Report, 2012, p 15 [(28)].

Remark: Net Earned Premiums (NEP) is equal to NWP minus the change in net unearned premiums reserve, while, Net Claims Incurred (NCI) is the total claims paid plus the change in outstanding and IBNR claims reserve.

From the above table we find that:

1-The insurance market's General and Health NEP totaled SR 14.1 Billion in 2012, up from SR 11.7 Billion in 2011, which represents a 21% increase.

2-General and Health Net Claims Incurred NCI increased by 30% for the year 2012 to reach SR 10.9 Billion.

3-The loss ratio is equal to NCI divided by NEP.

-In 2012, General and Health net claims ratio increased to reach 77.6%.

<u>Insurance Market Profitability (2011-2012, SR Million)</u>

Source: The Saudi Insurance Market Report (2012), SAMA – General Insurance Supervision Department, p 16.

1-Insurance underwriting result is the outcome of subtracting all insurance related expenses from insurance related revenues.

2-The net result equal to the sum of insurance operation revenues minus the sum of insurance operation expenses.

3-Investment result is the total of insurance operation investment income minus total of insurance operation investment expense.

4-In 2012, the insurance underwriting result totaled SR 1.13 Billion, which represents a 22% increase from 2011 figures.

5-Investment result increased to SR 123 Million in 2012 from SR 70 Million in 2011, which represents a 76% increase from 2011 figures.

6-The insurance market's net result increased to 972 Billion in 2012 from SR 890 Billion in 2011, which represents a 9% increase.

7-Return on Assets (ROA) is the ratio of net result to total assets. In 2012, insurance market's ROA was 2.8%.

8-Return on Equity (ROE) is the ratio of net result to total equity. In 2012, Insurance market's ROE was 9.6%.

<u>Policyholders' Balance Sheet:</u>

From the balance sheet of the policyholders' assets we find that *(The Saudi Insurance Market Report (2012), P 17* [28] :

1-At the end of 2012 insurance companies held SR 3.1 Billion in cash and cash equivalents in their policyholders' accounts.

2-Investment accounted for the biggest share of policyholders' assets, with a value of SR 6.3 Billion, followed by receivables (net) with a value of SR 6 Billion.

3-Total Policyholders' (operation) assets amounted to SR 23.3 Billion.

<u>Shareholders' Balance Sheet:</u>

From the balance sheet of the shareholders' assets we find that *(The Saudi Insurance Market Report (2012), P 18* [28] :

1-At the end of 2012, insurance companies' shareholders held SR 2.4 Billion in cash and cash equivalents.

2-Investments accounted for the biggest share of shareholders' assets, with a value of SR 7.3 Billion.

3-Shareholders' assets amounted to SR 11.4 Billion.

4-Insurance companies' total assets amounted to SR 34.73 Billion.

Policyholders Liabilities & Equity' Balance Sheet:

From the balance sheet of the policyholders & equity we find that *(The Saudi Insurance Market Report (2012), P 19 [28])* :

1-At the end of 2012, insurance companies held SR 15.8 Billion in technical reserves, which consist of unearned premiums, outstanding claims, IBNR and adjustment expense reserves.

2-Mathematical reserves amounted to SR 1.9 Billion.

3-Policyholders' liabilities and equity amounted to SR 23.3 Billion.

Shareholders Liabilities & Equity' Balance Sheet:

From the balance sheet of the shareholders & equity we find that *(The Saudi Insurance Market Report (2012), P 20 [28])*:

1-At the end of 2012, shareholders' liabilities amounted to SR 1.3 Billion, while shareholders' equity totaled SR 10.2 Billion.

2-Share capital constituted the biggest share of shareholders' equity with a value of SR 9.1 Billion.

3-Shareholders' liabilities and equity registered SR 11.4 Billion.

4-Insurance companies' total liabilities and equity amounted to SR 34.73 Billion.

Employees Breakdown by Nationality:

Table (13) Employees Breakdown by Nationality (2008 to 2012)

Nationality	No. of Managerial		Employees		Total No. of Employees	
	2011	2012	2011	2012	2011	2012
Other Arab	1,222	1,381	309	305	1,531	1,686
Other Non– Arab	1,643	1,823	321	330	1,964	2,153
Saudi	3,542	4,276	420	404	3,962	4,680
Total	**6,407**	**7,480**	**1,050**	**1,039**	**7,457**	**8,519**
Saudization Ratio	**55%**	**57%**	**40%**	**39%**	**53%**	**55%**

The Saudi Insurance Market Report, 2012, p 34 [28].

From the above table we find that:

1-The total number of insurance companies' employees in Saudi Arabia reached 8,519 in 2012, up from 7,457 in 2011.

2-Saudi nationals employed by insurance companies account for 55% of the total workforce, increased by 18% from 2011 Saudi nationals employees.

3-In 2012, the Saudization ratio for non-managerial positions increased to 57%, while the Saudization ratio for managerial positions slightly decreased to 39% from 40% in 2011.

4-Note: Newly licensed insurance companies are required to adhere to a Saudization ratio of 30% during the first year of operations (as per Article 79 of the Implementing Regulations).

Insurance Market Structure:

Table (14) Gross Written Premiums by Company 2010-2012, SR Million (Market Share)

Item Name	2010		2011		2012	
	SR Million	%	SR Million	%	SR Million	%
Highest 8 Companies	11,088	71.1	12,733	68.7	14,601	69
Remaining 27 companies	4,507	28.9	5,801	31.3	6,560	31

The Saudi Insurance Market Report, 2012, p 35 (28).

From the above table we find that:

1-In 2012, the top 8 insurance companies generated 69% of the insurance market's GWP.

2-The remaining 27 insurance companies included in the report accounted for the remaining 31% of total market premiums.

Chapter II: The Challenges facing the Insurance Sector under GATT

There are many common challenges facing the insurance sector in general in any state in addition to the challenges it faces in some countries due to the circumstances of each country. The following explanations elaborate on the most important general implications that affect the insurance sector in most countries of the world, including Saudi Arabia:

GATT agreement and areas of impact on the insurance sector:

If we read the GATT with respect to financial services, which include insurance, we find that there are a range of areas that must be studied, taking into account the discussions and negotiations that took place in this respect among the countries that have already signed the Convention, and the most important of these areas that raise fears and controversy in this regard are as follows ***(Ahmed, Mamdouh, GATT and the Insurance Sector: the Current Reality - the Effects of the Convention & Confrontation Methods, 2005)*** (4):

1- Confining insurance to state-owned companies only:

The agreement provides in this regard that the local private sector and foreign capital not only have the right to exercise insurance activity but also have the same opportunities that is given to the public sector (in the countries where there are state-owned companies), without distinction or discrimination, whether in terms of the conditions of the establishment of new insurance companies, in terms of activity practice conditions, privileges, supervision or the rights & duties.

2 - Confining insurance to companies wholly owned by nationals:

The agreement does not prevent entry of foreign insurance companies and also does not impose entry without restrictions or controls, i.e. there is no objection of its entry but with partnership with a local capital, but the percentage of the local-domestic capital could be higher. At the same time, I think that the agreement does not prohibit states from exercising their right to limit the practice of insurance activity for foreigners on stock public companies only, with maximum percentage, without allowing agencies or foreign branches.

3 - Confining local property and Liability insurance at local insurance companies only:

It is logical that the agreement is not opposing this situation, provided that the insurance is not limited to a specific company as this would be inconsistent with the objective of the Convention which is the liberalization of trade and services.

4 - Confining Governmental Property & liability insurance at specific companies:

This situation does not represent any problem, so it makes sense to choose the state company that owns or that have interests with, however, the same privilege should be given to the foreign companies to choose the insurance companies that it owns or in which it has particular interests.

5 - Imposing a specific percentage of reinsurance for local companies in favor of National Reinsurance Companies:

The Convention is not opposing this situation (in the case of a national reinsurance company) provided that it is not limited to a specific company where this would be inconsistent with the objective of the Convention-trade & services liberalization- but all the companies operating in the country must be dealt in the same manner, regardless of the nationality of capital ownership.

6 - Imposing imports insurance at the importing country's companies:

This contradicts with the objectives of the agreement but in the case of countries where there is a foreign currency procurement problem, there is no problem for the state to insure internally at the national insurance companies, but for the private sector, this situation would not be acceptable.

7 - Imposing insurance of contractors' all risks at the implementation country's companies:

There is no problem in this regard, as all projects that are implemented in the country are treated as a local project.

8 - Freeing access of reinsurance companies to the local market:

This point does not represent any problem where the reinsurance companies practice its activity on an international scale and do business in many countries before the introduction of GATT.

9 - Ancillary insurance services such as: actuarial experience, loss adjusting & survey & insurance consultations:

There is no doubt that any country has the right to regulate its insurance market but without inconsistence with the objective of the Convention. Also, the rules that are set to regulate the market should be applied to the whole players in the market regardless of their nationality as long as they meet the requirements of the citizens of the state.

There is no doubt that there are many problems that face the insurance sector in Saudi Arabia, being an emerging market, and based on that I present in front of the officials, some of the factors that I see the inevitability of discussing them in a scientific manner to reach a viable & applicable solutions to prevent any devastating shakes from happening to the insurance sector that could have harmful and negative consequences on the policyholders.

<u>The most important challenges that face the insurance sector in Saudi Arabia:</u>

<u>First: Technical personnel:</u>

Insurance activities require special qualifications of management and practice, where it differs from other types of economic activities - production, commercial or service - for being a future service if it has any defect this leads to determining the rights of others - the policyholders ***(Saunders, Anthony & Cornett, Marcla Millon, 2003)*** [(21)]. Therefore, it needs to a special technical and managerial expertise engaged in multiple directions and variety in their work & depends on predictability, expectation and is characterized by flexibility and a fast decision-making and thus have to face several challenges including but not limited to:

A – Production:

Production in insurance companies, state-owned under the previous circumstances, was depending on the administrative decisions to insure the risks that face public & governmental companies, but the policy of economic liberalization will affect these decisions and thus the management of insurance companies will face a big problem in production.

If we look at the current marketing strategy, we find that it mainly depends on the producers (insurance agents) who work as employees and get salary plus commission on their production, or they rely on insurance brokers who are self-employed and have no loyalty to a particular company and they are all interested in completing the process to obtaining the commission.

Also, the insurance market lacks to the production & brokerage companies, either in number or qualification, that provide the best service and the lowest rate to the customer and works primarily for his interest and has no affiliation to a specific company. In addition, the brokerage companies do all stages of the insurance process starting from risk assessment, premium calculation and ending with loss settlement- if it happens.

Also, the cultural and professional level of the producers is very low, which leads to the difficulty of marketing, then they tend to rely on giving a reduction in the premium without relying on persuasion of applicants through the benefit differences between the policies & insurers, and therefore they limit the comparison to be just on the price only.

Therefore, there is a great need for raising the cultural and professional level of the producers through requiring minimum educational levels (higher than what is currently required) as well as the necessity of passing tests from a specialized institute, syndicate or association that should be established for this purpose. Every insurance intermediary (producer, agent, broker, …) has to be licensed through this association before he can practice. Also, as many types of insurance need special expertise & education, so we have to apply the principle of specialization as it is not acceptable for any intermediary to sell all types of insurance.

Therefore, insurance companies should change their production policy through using other methods of marketing and paying more attention to the issue of selecting, training and preparing qualified personnel in addition to relying on the specialized agencies in production- as the Saudi Insurance market is in desperate need of these things and the foreign companies and their affiliates have an extraordinary advantage in this matter at the expense of national companies.

Also, the national insurance companies must change their production methods in dealing with the client through team work- not like what is happening right now as one producer does all the process alone. Through the team work one agent prepares the applicant for insurance, the second agent identifies risks & hazards, the third presents the alternatives and the fourth delivers the offer, ... etc., until the job is done & the commission will be collective.

Finally, commission should be tied to the technical results (loss ratio) of each producer(s) or each group to differentiate between them based on their results & for sure this method will be reflected on their selection of risks ***(Erik, Banks, 2003)*** [(11)].

B-Investment:

The insurance sector is characterized by accumulation of funds and reserves specially life insurance, so the management of these funds needs to a distinct technical staff, specialized and able to identify the most appropriate areas of investment and the amount that should be invested in each area - within the constraints imposed by the supervisory authority - in order to achieve the basic principles generally accepted in the investment of insurance funds, namely: security, liquidity and profitability ***(Rejda, George E., 2013)*** [20]. So, an independent, professional & specialized investment management companies should be established to manage these funds, albeit the size of these investments are limited at the moment, but it will increase dramatically in the light of the expected spread and expansion of protection and savings insurance, which includes huge technical provisions that invested for long periods.

Because the investment process lacks talented & specialized staffs in the light of successive changes, here we find that foreign companies entrusted its investment to specialized companies to manage it which leads to maximizing its return to the maximum possible degree, and therefore they have a competitive advantage over national companies ***(Philippe Jorion, 2007)*** [16].

The most important challenges facing the investment in the insurance sector under the GATT are:

1) Limitations of the domestic insurance market:

As the scientific and practical fundamentals to build a robust insurance market is having a broad base of insurance clients to achieves the law of large numbers, we find that in the face of the limited domestic market, opening of the insurance markets and the entry of foreign companies would be counterproductive unless accompanied by the development & raising of insurance awareness and increasing the number and size of insurance operations, which affects the size of the domestic insurance sector's investments and on the followed investment policy.

2) The Capital Values of the Local Insurance Companies are small:

There is no doubt that the decrease in the capital of the national insurance & reinsurance companies compared to global companies does not make it in the same level of competition with the big & giant companies coming to the domestic insurance market, which affects the size of the assigned operations and thus affect the amount of money available for investment in the national insurance companies.

The following table shows the values of the capital of the insurance companies in Saudi Arabia:

Table No. (15) Capitalization of the Insurance Companies in the Saudi Arabia market in the year 2012 (in SR Million)

Shareholders' Equity	Number of Ins. Co.
< 50	5
50-100	5
100-150	5
150-200	7
200-500	9
≥ 500	4
Total	**35**

The Saudi Insurance Market Report, 2013, p 35 [28]

From the above table & the attached data, we find that:

a-The Insurance companies' equity increased form SR 9.2 Billion at the end of 2011 up to SR 10.15 Billion at the end of 2012, with 25 companies exceeding SR 100 Million.

b-The largest company by total equity is Tawuniya, with total equity of SR 2.14 Billion at the end of 2012 following an increase from SR 2.05 Billion at the end of 2011.

c-The amount of all insurance companies' equity that totaled SR 10.15 billion equals 2.7 billion U.S. dollars), and this figure is a very small amount for the 35 operated insurance companies, where there are hundreds of insurance companies over the globe where the equity of any of them- even its capital- is more than all the insurance companies in Saudi Arabia collectively.

<u>Note</u>: the Law of Cooperative Insurance Companies Supervision stipulates a minimum capital of SR 100 Million for insurance companies and SR 200 Million for companies that will undertake insurance and reinsurance activities.

3) Low Retention Rates:

The retention ratio measures the written premiums retained by the insurance company. It is calculated by dividing the NWP by the GWP.

1-The overall retention ratio of insurance companies in the Saudi market increased to 75.8% in 2012 from 73.2% in 2011. This ratio is largely skewed due to the high retention ratio of Motor and Health Insurance which collectively account for around 75.4% of total GWP. In 2012, the retention ratios for Motor and Health Insurance were 94% and 88%, respectively.

2-The weighted average retention ratio of other insurance lines of business (i.e., excluding Motor and Health Insurance) unchanged at 20% in 2012 compared to 2011

Notes:

1-Newly licensed companies are required to adhere to a minimum retention ratio of 30% (as per Article 40 of the Implementing Regulations).

2-Retention ratios are not shown for Protection & Savings insurance as the savings element of the contract must be retained in the Saudi Arabian company. Therefore retentions for Protection & Savings insurance are not directly comparable with other insurance lines of business.

Saudi market's retention in general is very low (see Table 9 and the comment on it), especially in the branches of aviation, property and energy, and the vast majority of the companies retained a small ratio of the GRP & the big ratio is reinsured in the international market.

The Saudi insurance companies have become dependent on the income from the commissions and not on the insurance premiums unlike the case for foreign insurance companies, where this affects the size of the investments portfolio of local insurance companies.

4) Capacity Utilization Rate:

The average utilized capacity for insurance companies in the Saudi market is very low as a percentage of the market available capacity. This may be due to the continued increase in the available capacity to these companies because of the continued increase in shareholders' equity, the entry of many new companies to the market, and also the low insurance public awareness. All these have a negative impact on attracting additional funds for investment and development of the national insurance companies' investment funds to commensurate with the market size.

In accordance with Article 48 of the Rules of the Implementing Regulations that stipulate that: "The Company's gross written premium shall not exceed Ten times the paid capital and reserves without the Agency's written approval", from the data of the annual report of Saudi Arabian Monetary Agency for the year 2012 we find that the total paid capital & reserves of the 35 insurance companies (and not equity rights) until the end of 2012 is SR 10,069 million (about USD 2,685 million) & the Gross Written Premiums is SR 21,174 million. Then, the utilized capacity ratio is 21% and if we take into consideration that the insurance companies can write up to 10 times the paid capital and reserves, i.e. it can write up to SR 100,069 million, this means that the unutilized capacity is about SR 80,000 million.

From the above analysis we conclude that not only there is no need for any more new insurance companies, but the number of working insurance companies in the Saudi Market is more than enough & we will (and should) see many mergers & acquisitions.

5) Method of Marketing Insurance Services and Lack of Attention to the Concepts of Measuring Consumer Trends and Customer Satisfaction:

Despite the importance of the marketing insurance service and its provided phases integration and its association with the methods of modern marketing, it did not take adequate attention from the insurance companies in the Saudi market, where there are many indicators (as we explained before) that showed that the volume of the insurance premiums is not relevant to the development of economic activity or the size of the available demand in the market, as well as with the number of operating insurance companies and their underwriting capacity.

Since the insurance companies rely mainly in their marketing operations on production department employees who work based on salaries and commissions, and level of educational, cultural & technical capability for many of them is not up to the required standard, which greatly affect the level of services they provide and the level of competition in this area because of the weak technical background which is crucial to marketing. All this ultimately leads to limiting competition to price discounts that is not based on a technical basis & harmful competition which affects the results of the insurance companies operations & in the long term on their investment activity.

6) Weakness of the Investment Department at the Local Insurance Companies:

There is a tendency toward the least risky projects with more liquidity and therefore most of the insurance investments tend to go to bank deposits and government bonds, which lead to a gap between the returns of investment achieved by insurance companies and what can be achieved by international companies.

7) Lack of Expertise and Technical Cadres in the Field of Fund Investment of National Insurance Companies:

The expansion of the insurance market and entering the competition led to increasing the need for large numbers of technical personnel to manage the investment portfolios of the local insurance companies & this is not available both in terms of numbers and quality, which would affects the results of the investments ***(S. Travis Pritchett et. al., 2000)* [17].**

8) Lack of Active Participation of the Insurance Companies to Spread Public Insurance Awareness and educating them about their insurance rights. Also, some methods of dealing of insurers with the insureds have left a bad impression toward the insurance industry, which made it difficult either to maintain the current clients of the insurance companies or to attract new customers under the competition with the foreign companies. All this will be reflected in the end, on the size of the investment portfolios of the national insurance companies.

C- Technical and Managerial Expertise:

The UNCTAD's Secretarial report in its assessment of the insurance activity of the Arab insurance markets and North Africa mentioned repeatedly that the insurance sector is suffering from a lack of noticeable specialized expertise at all levels, both in terms of numbers and quality, where we find that ***(Ahmed, Mamdouh, Merger between the Insurance Companies: Motives, Methods & Effects, 2000)*** [5]:

1 - There is a clear lack at the senior management level in terms of skill and experience.

2 - There is a clear lack in the area of underwriting, loss adjusting, investment and reinsurance.

3 - An apparent lack of actuaries.

At the same time, we have to pay more attention to the issue of continuous training, and we have in the Malaysian experience a good example where the instructions were issued for insurance companies to spend at least 1% of the total salaries of the previous year in training of their employees, & if not fully spent, the balance will be converted to a special account that has been established for training the whole market i.e. all insurance companies would benefit from it.

Second: Poor Insurance Awareness:

There is no doubt that there are a severe weakness insurance awareness (that has been measured previously by the insurance penetration and insurance density in Saudi Arabia during the period of 2008 – 2012. This means that a major effort has to be done through the Department of Insurance Supervision, as one of the duties of the Insurance Supervision and Control Authority in any state to raise insurance awareness. Also, it is the responsibility of the insurance companies (through the formation of an insurance union or federation) to spend more effort & a large portion of their profits and the amounts allocated for marketing to raise the insurance awareness for all citizens and residents. This is because it is not only their responsibility to do so, but they are the primary beneficiary of raising the insurance awareness and thereby increase the insurance penetration & density of the insurance market.

Third: Competition:

Competition is considered as one of the most important features and conditions of open markets, which rely primarily on the idea of survival of the fittest and strongest which is what happened in all countries that have followed an economic liberalization policy and what is happening right now in the insurance sector in Saudi Arabia where competition sparks between national and foreign companies & between national companies among themselves.

Also, the competition will be very strong given that the foreign companies are having advanced information technology, large capital and low cost of production. Another big challenge which is its reliance on technical rates that is much lower than the applied rates in the national companies in most insurance branches.

We can't deny that the customer would prefer to deal with the company that: offers a distinguished insurance service, delivers insurance policies that meet their own needs, offers lower prices, and has a high solvency margin.

If the competition in any economic activity depends on attracting customers on prices reduction on one hand and on improving service method on the other hand, however, one of the established fundamentals of insurance is refusing the destructive competition, which relies on prices reduction unless it is based on a logical and acceptable justification, i.e. the prices should be adequate & equitable ***(Alexander, Carol, 2003)*** **[10]**. Then, the insurance companies should move in the following directions during the coming period:

1-Conducting the necessary studies about loadings for production commissions & general and administrative expenses to finding ways to reduce them & the profits to increase them.

2-Improving and developing method of delivering the service and using the modern methods of marketing in addition to relying on the specialized production agencies.

3-Paying more attention to the training, selection and preparation of qualified personnel as well as setting aside a proportion of the annual salaries of the employees for this purpose.

4-Implementing a market study dedicated to identifying customer needs accurately in order to provide new insurance coverage which are consistent with the rapid development in all areas, where the foreign companies have many competitive advantages based on their research capacity in developing its services and meeting the needs of customers.

5-Paying more attention to raising the level of insurance awareness and setting aside an annual budget for this purpose shared by all insurance companies.

6-Paying more attention to the insurance policies both in terms of form and contents & as well as phrasing which still contains strange and incomprehensible phrases that occur due to the literal translation of foreign policies.

7-Reconsidering the current prices to be homogeneous with the world prices that the foreign companies are using for the same risks.

8-The national companies should understand that the time has come to work as an integrated team not to fight bitterly, as all companies, big or small is exposed to the same risks even in varying degrees and therefore it is inevitable for them to cooperate.

9-The national companies during the initial entry of foreign companies may try to reduce prices but this should be based on technical basis otherwise it would result in depletion of reserves and provisions or even bankruptcy. But the giant foreign companies can reduce their prices due to their financial strength (capital, provisions, reserves, the volume of business, etc...), and its ability to absorb & compensate for the losses that may be exposed to in a particular country from other countries due to the international geographical spread. So, it is inevitable for national companies to merge - especially small and medium-sized ones - to reduce competition among themselves in one hand and conglomerate in the face of foreign companies on the other hand.

10-It should be clear to all companies that the collapse of even one national company at the beginning will lead to a loss of confidence in all national companies and consequently the policyholders will turn to the foreign companies.

11-All national insurance companies should pay more attention during this period to the underwriting process and rate making as most of the current generations have originated under the tariff regime (rates from schedules) and therefore their experience to pricing risk is very limited. So they must train a new generation who are qualified and capable of pricing risks. The issue is very serious because the lack of qualified underwriter would result in either assessing the risk more than it should be and thus leads to losing the customer who would search for another insurance company and this decrease the size of the portfolio, then the law of large numbers will not be met and therefore the actual results will deviate from expected results, or assessing the risk less than it should be and this leads to an insufficient premium and, consequently, the inability to pay the claims, and both cases lead to the collapse of the company.

12-Establishing insurance pools in many branches such as: energy, fire, marine, aviation, etc. which helps to take advantage of the total capacity of the market - rather than the capacity of each individual company - and thereby reducing the percentage of premiums that go outside.

13-Expanding the use of information technology for planning and budgeting, which helps make the rational decision.

Fourth: Supervision and Control:

The insurance sector is subject to the supervision and control by the state even in different forms and shapes no matter what the economic doctrine embraced by the state. With the existence of the department of insurance that belongs to SAMA and the presence of similar supervisory authority bodies in countries that embrace the free economic doctrine - there are many risks that the insurance sector's faces under the liberalization economic policy.

We note here an important point which is some people see that no need for supervision and control over the insurance under the liberalization economic policy and the freeing of prices. But we feel that the role of the insurance supervision has been intensified and the need for it has been increased than before albeit with a different shape. We mean that the supervision & control have been changed from prices controlling & preventing harmful competition between the national companies to monitoring the financial solvency and verify the adequacy of the financial & technical provisions and reserves. Also, the availability of the necessary conditions for establishing of new companies, as well as to check the availability of technical & administrative personnel, either at the time of formation or during practice, especially top & technical management positions. Besides, setting the necessary legislations to regulate the market and the qualifications of actuaries, brokers and insurance agents & solving any dispute between the insurance companies with each other or with insureds ***(Vaughan, Emmett j,.2007)***[21]

Chapter III: The Most Important Policies and Procedures to be followed for the Development of the Insurance Sector.

Based on the study of the insurance sector in Saudi Arabia in the first chapter, and the challenges that the sector is facing in the second chapter, I propose the following suggestions regarding the procedures and policies to be followed for the development of the insurance sector in Saudi Arabia:

First: Conducting the Necessary Studies to increase the Productivity of the Existing Insurance Companies:

In this regard, we need to carry out studies and researches that contribute to increasing the productivity of the existing insurance companies through:

1-Developing and modernizing the current traditional coverage and searching for new & more productive alternatives that are compatible with the requirements of the current market.

2-Developing the marketing methods and introducing new ones that fit with market conditions and the quality of the Saudi consumer.

3-Conducting the necessary studies to reduce the premium loadings, especially general and administrative expenses and production commission.

4-Paying attention to training, whether internally or externally that should be done through specialized centers & qualified experts at the highest level in terms of academic and practical experience.

5-Increasing the insurance companies' capacity operating in the country through the establishment of specialized pools in different branches of insurance such as: fire, marine, aviation, engineering, etc., in order to use the available capacity in the national market before going outside.

6-Relying on the expansion of the reciprocal agreements between local markets and foreign markets, so that the local insurance companies can get a quota share or a balanced agreements either in premiums or profits from the foreign insurance companies that is tied to what local insurance companies cedes to the foreign companies.

Second: Studying the Idea of Merger between Existing Companies and Stopping Licensing New Insurance Companies for a specific period:

Merging between insurance companies on the international level represents a phenomenon and a clear trend in the last two decade of the last century and the first decade of the present century. Until we can make a decision regarding the need for new insurance companies, satisfying with the existing ones, or merger of some of them, an analytical study of the available capacity & the utilized capacity has to be done to the data of the premiums and their relationship to the shareholders net equity to determine whether the existing insurance companies have fully utilized (exploited) their available capacity or not ***(Ahmed, Mamdouh, the Need of the Insurance Market in the Sultanate of Oman for new Insurance Companies, 1995)*** **[3]**.

Third: Paying More Attention to increasing the Utilized Capacity of the National Insurance Companies:

We already explained in numbers in the second chapter that the insurance companies did not fully utilize its available capacity, where the percentage of utilized capacity of the available capacity is 21%, and this means that the insurance companies should make every effort to take advantage of this unutilized capacity, and at the same time, this result confirms the need of the current operating companies in the market to cooperate to confront foreign companies, as their entry to the market will be at the expense of the national companies, and therefore no way for them but to merge.

Fourth: Legislative Role:

There is no doubt that the Saudi Arabian Monetary Agency (SAMA) and its right arm the Department of Insurance Supervision have played a great role during the previous period that led to remarkable results that the practice of insurance or the continuation of the old situation would not have been able to function without it.

The following are the Most Important Steps that have been done & the regulations that have been issued in this area so far by the Saudi Arabian Monetary Agency (SAMA), according to the Cooperative Insurance Companies Control Law:

1. Regulations for the establishment of insurance and reinsurance companies in Saudi Arabia;
2. The supervision of the technical aspects of insurance and reinsurance companies' operations;
3. Regulation of the distribution of surplus funds to shareholders and policyholders;

4. Determining the capital and solvency requirements for each class of insurance business required by companies;
5. Regulation of the companies' investments both inside and outside Saudi Arabia;
6. Actuarial and rating approval.
7. Education and qualification requirements of insurance company personnel, brokers and agents.
8. Content of policy forms.
9. Code of Conduct, insurance sales and information disclosure.
10. Contract interpretation and enforcement.
11. Compulsory purchase of insurance coverage.
12. Risk Management Regulations.
13. Types and proportions of ownership of insurance companies.
14. Regulations of the cooperative health insurance system in Saudi Arabia.
15. Outsourcing Regulation for Insurance and Reinsurance Companies and Insurance Service Providers.
16. The Unified Compulsory Motor Insurance Policy.
17. Anti-money Laundering & Combating Terrorism Financing Rules.
18. Online Insurance Activities Regulation.
19. Insurance Intermediaries Regulation.
20. The Regulation of Reinsurance Activities.
21. Anti-Fraud Regulation for the insurance companies.
22. Implementing Regulations.

Results and recommendations:

First: Results:

The following are the most important results that have been reached in this research:

1-Insurance penetration in Saudi Arabia is very low: 0.92%, 1.03%, 97%, 0.86% & 0.78% during the period: 2008-2012 (the first indicator of the insurance awareness). During the past five years, it has decreased by an average annual rate of 3.5%.

2-Insurance density is very weak (the second indicator of the insurance awareness) where it reached US 117.36 , 153.55, 161.01 , 181.87 & 193.39 during the period 2008-2012, and these values would be less if we take into account the rate of inflation during this period.

3-Insurance density of Protection and Savings insurance remained very low (SR 30 per Capita in 2012) when compared to General and Health insurance. It has decreased during the period 2009-2012 by an average annual rate of 7.68%.

4-Most of the premiums comes from Compulsory insurance as auto & health insurance accounted for 75.4% of the GWP & based on the values of the above insurance density & penetration we can say that the level of insurance awareness in Saudi Arabia is very low.

5-If we compare the values of insurance penetration & insurance density of some other countries with the values of Saudi Arabia during the same period we find that:

-The insurance penetration of the world market on average was 6.6% in 2011 while in the Saudi market it has reached 0.9% in 2011, (about 13.64% of the world average).

-The insurance penetration of the Asian market was 5.8% during the year 2011 while in the Saudi market it has reached 0.9% in 2011, (about 15.52% of the Asian average).

-The ranking of Saudi Arabia with regard to insurance penetration at the global level in 2011 was 81 and

23 at the level of the continent of Asia.

-The insurance penetration of Saudi Arabia with regards to life insurance has reached 0.1% of GDP while the world average is 3.8% (which represents 2.63%) and in Asia is 5.8% (which represents 2.33%).

-The insurance density of the global market, on average, amounted to $ 661 in 2011, while in the Saudi market amounted to $ 177 in 2011, which is much lower than the global average (about 26.78% of the world average).

-The insurance density of the Asian market, on average was $ 314 in 2011, while in the Saudi market amounted to $ 177 in 2011, which is lower than the average in Asia (about 56.37% of the Asian average).

-The Saudi Arabia global ranking with respect to insurance density is 59**th** & 16**th** with respect to the ranking in Asia.

-The insurance density of Saudi Arabia with regards to life insurance has reached $ 10 per capita while the world average is $ 378 (which represents 2.65%) and in Asia was $ 229 (which represents 4.37%).

-The insurance density of the Saudi Arabia market with regards to non-life insurance (property & Liability insurance) was $167 which is low as it represents 59.01% of the world average, which was $283 dollars but higher than the average in Asia ($ 85) as it represents 196.47%). With regard to life insurance, the insurance density was $ 10 which is very low as it represents 2.65% of the world average ($ 378) & represents 4.37% of the Asian average ($ 229). If this decrease in the insurance density of life insurance can be justified for religious reasons, the decrease in general insurance is not justified, especially if we take into consideration that the average of income is somewhat high in Saudi Arabia & there are huge values of property.

All of the above confirms the low level of awareness of insurance in Saudi Arabia.

6-The overall insurance Gross Written Premiums (GWP) increased by SR 2.7 Billion to reach SR 21.174 Billion in 2012, compared to SR 18.505 Billion in 2011, which represents a growth rate of 14.42%. Health insurance remained the biggest line of business in 2012. Its contribution to total GWP slightly increased from 52.46% in 2011 to 53.30% in 2012, while General insurance’s contribution to total business volume remains at 42.50% in 2012. Protection and Savings insurance remained the smallest line of business accounting for 4.20% of total GWP, with a decrease in its written premiums by 1.77% in 2012.

7-Around 89.3% of total NWP in 2012 was generated by Auto and Health insurance.

8-The overall retention ratio of insurance companies in the Saudi market increased to 75.8% in 2012 from 73.2% in 2011. This ratio is largely skewed due to the high retention ratio of Auto and Health insurance which collectively accounted for around 75.4% of total GWP. In 2012, the retention ratios for Auto and Health insurance were 94% and 88%, respectively. But the weighted average retention ratio of other insurance lines of business (i.e., excluding Auto and Health insurance) remained unchanged at 20% in 2012 compared to 2011

9-Total gross claims paid increased by 18.5% from SR 11.5 Billion in 2011 to SR 13.6 Billion in 2012 where Health and Auto gross claims paid grew by 16.6% and 26.9%, respectively compared to 2011 figures. Property/Fire insurance recorded the highest growth rate in gross claims paid, after increasing by 46.7% in 2012 from SR 527 Million to SR 774 Million in 2011.

10-General and Health Net Claims Incurred NCI increased by 30% for the year 2012 to reach SR 10.9 Billion while General and Health net claims ratio increased to reach 77.6%.

11-In 2012, the insurance underwriting result totaled SR 1.13 Billion, which represents a 22% increase from 2011 figures. Investment result increased to SR 123 Million in 2012 from SR 70 Million in 2011, which represents a 76% increase from 2011 figures. The insurance market’s net result increased to 972 Billion in 2012 from SR 890 Billion in 2011, which represents a 9% increase. Return on assets (ROA) in 2012 was 2.8% & return on equity (ROE) was 9.6%.

12-In 2012, the top 8 insurance companies generated 69% of the insurance market’s GWP while the remaining 27 insurance companies included in the report accounted for the remaining 31% of market total premiums.

13-The most important challenges that face the insurance sector in Saudi Arabia are:

-**In the area of production:** the insurance companies rely mainly in their marketing operations on production department employees who work based on salaries and commissions, and the level of educational, cultural & technical expertise for many of them is not up to the required standards, which greatly affect the level of services they provide and the level of competition in this area because of the weak technical background which is crucial in marketing. Also, the insurance market lacks in term of production & brokerage companies, either in number or qualification that provide the best service and the lowest rate to the customer.

-**In the area of investment:** there is a great need for a distinct technical staff, specialized and able to identify the most appropriate areas of investment and the amount that should be invested in each area in order to achieve the basic principles generally accepted in the investment of insurance funds, namely: security, liquidity and profitability. The most important challenges facing the investment in the insurance sector under the GATT are: limitation of the domestic insurance market, the capital values of the local insurance companies are small, low retention & capacity utilization rate, lack of using the new methods of marketing insurance services and lack of attention to the concepts of measuring consumer trends and customer satisfaction & weakness of the investment department at national insurance companies.

-**In the area of technical and managerial expertise:** there is a clear lack at the senior management level in terms of skill and experience, a clear inadequacy in the area of underwriting, loss adjusting, investment and reinsurance & an apparent insufficiency in the number of actuaries.

-**In the area of insurance awareness:** there is no doubt that there are a severe weakness of insurance awareness which was clear when we calculated the insurance density & insurance penetration in Saudi Arabia during the period of 2008 – 2012.

-**In the area of competition:** competition sparks between national and foreign companies & between national companies among themselves as a result of the open market policy. Competition will be very strong given that foreign companies are having an advanced information technology, large capital, low cost of production & its reliance on technical rates that is much lower than the applied rates in the national companies in most branches. Then the national companies would lose their customers.

-**In the area of supervision and control:** after liberalizing the insurance market, we feel that the role of insurance supervision has been intensified and the need for it has been increased albeit in different shapes. It has been changed from price controlling & preventing harmful competition between the national companies to monitoring the financial solvency and verifying the adequacy of the financial & technical provisions and reserves. Also, setting up the necessary legislations to regulate the market and the qualifications of actuaries, brokers and insurance agents & solving any dispute between the insurance companies with each other or with insured.

14-The Cooperative insurance model that is applies in Saudi Arabia is neither Wakala, Mudaraba, nor Mixed Model as it doesn't separate policyholders (participants)' fund from shareholders' fund & also, it distribute only 10% of the surplus to the policyholders & 90% to the shareholders which means that it is the same as the conventional insurance.

Secondly: Recommendations:

1-Under the obligations of the GATT that has been signed by Saudi Arabia, regarding the insurance sector, it must amend the provisions of the laws to cope with the new changes and the anticipated climate of competition & pay much attention to three key elements, namely: Liberalizing the structure of the insurance market, liberalization of rates, & strengthen the supervisory role of the supervisory authority over insurance.

2-Regarding the most important challenges that face the insurance sector in Saudi Arabia we can consider the following recommendations:

-In the area of production: there is a great need for raising the cultural and professional level of the producers through requiring minimum educational levels & passing tests from a specialized organization that should be established for this purpose to take care of the interests of this important category to organize its business. Also, we have to apply the principle of specialization as it is not acceptable for any intermediary to sell all types of insurance. We recommend SAMA to encourage the production & brokerage companies to enter the market & facilitating their formation & registration.

Insurance companies should change their production policy through using other methods of marketing and paying more attention to the issue of selecting, training and preparing qualified personnel in addition to relying on the specialized agencies in production & dealing with the client through team work- not like what is happening right now as it does all the process alone. Finally, commission should be tied to the technical results (loss ratio) of each producer(s) or each group & for sure this method will be reflected on their selection of risks.

-In the area of investment: an independent, professional & specialized investment management companies should be established to manage the insurance companies' fund besides hiring a distinct & specialized technical staff & entrust its investment to specialized companies. Also, they have to: expand the domestic insurance market, increase the capital values of the national insurance companies, increase the retention rates, increase the capacity utilization rate, using the new methods of marketing insurance services and paying more attention to the concepts of measuring consumer trends and customer satisfaction:

-In the area of technical and managerial expertise: as we have seen that there is a clear deficiency at the senior management level in terms of skill and experience, in the area of underwriting, loss adjusting, investment and reinsurance & an apparent deficiency at the number of actuaries, then SAMA & the insurance companies have to pay more attention to the issue of continuous training & applying the Malaysian model in this matter (that we talked about before).

-In the area of insurance awareness: as there is a severe lack of insurance public awareness, the Department of Insurance Supervision has to raise insurance awareness levels, as it is one of its duties. Also, it is the responsibility of the insurance companies to spend more effort & a large proportion of their profits to raise the insurance awareness for all citizens and residents (it is their responsibility & they are the primary beneficiaries of raising the insurance awareness).

-Insurance companies have to change the bad impression regarding dealing with insureds toward insurance industry, which made it difficult either to maintain the current clients or to attract new customers under the competition with the foreign companies.

-In the area of competition: the insurance companies should move in the following directions during the coming period to face the competition that results from opening its market:

-Conducting the necessary studies about loadings to find ways to reduce them.

-Improving and developing methods of delivering the service and using the modern methods of marketing in addition to relying on the specialized production agencies.

-Paying more attention to the training, selection and preparing qualified personnel.

-Implementing a market study to identifying customer needs accurately to providing new insurance coverage which are consistent with the rapid development in all areas.

-Paying more attention to raise the level of insurance awareness and setting aside an annual budget for this purpose & to be shared by all insurance companies.

-Paying more attention to the insurance policies both in terms of form or contents & phrasing which still contains strange and incomprehensible phrases.

-Reconsidering the current prices to be congruent with the world prices that the foreign companies are using for the same risks.

-The national companies should understand that the time has come to work as an integrated team not to fight bitterly, as all companies are exposed to the same risks even in different degrees.

-The national companies during the initial entry of foreign companies may try to reduce prices, this should be based on technical basis otherwise it would result in depletion of reserves and provisions or even bankruptcy. But the giant foreign companies can reduce their prices due to their financial strength and its ability to absorb & compensate for the losses that may be exposed to in a particular country from other countries. So, it is inevitable for national companies to merge - especially small and medium-sized ones - to reduce competition among themselves and conglomerate in the face of foreign companies.

-It should be clear to all companies that the collapse of even one national company at the beginning will lead to a loss of confidence in all national companies and consequently the policyholders will turn to the foreign companies.

-All national insurance companies should pay more attention during this period to the underwriting process and rate making, so, they must train a new generation who are qualified and capable of pricing risks. The issue is very serious because the lack of availability of qualified underwriter would result in the collapse of the company.

-Establishing insurance pools in many branches such as: energy, fire, marine, aviation, etc. which helps to take advantage of the total capacity of the market - rather than the capacity of each individual company - and thereby reducing the percentage of premiums that go outside.

-Expanding the use of information technology for planning and budgeting, which helps to make the rational decision.

-In the area of supervision and control: we must realize that the role of the insurance supervision in Saudi Arabia after liberalizing the insurance market has to be intensified and increases more than before albeit with a different shape. It has to be changed from controlling prices & preventing harmful competition between the national companies to monitoring the financial solvency and verifying the adequacy of the financial & technical provisions and reserves. Also, setting the necessary conditions for establishing new companies & checking the availability of technical & administrative personnel. In addition, setting up the necessary legislations to regulate the market and the qualifications of actuaries, brokers and insurance agents & solving any dispute between the insurance companies with each other or with the insured**.**

3-The insurance companies in Saudi Arabia should change their practice through separating policyholders (participants)' fund from shareholders' fund & also, it should distribute at least 50% of the surplus to the policyholders otherwise they should declare that they are conventional insurance companies.

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CONCEPTS ANALYSIS I-MQ’S AS STANDARD OF APPLICATION TO CREATE *TAKAFUL IJTIMA’I* TO CONSTRUCT WELFARE SOCIETY

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ABSTRACT

State as the highest institution has its own responsibilities in prospering or increasing society welfare. In the Islamic view, a country pretended to be prosperous and abundant blessings when the people has *iman* (faith) and being *taqwa* (Al-A'raf: 96). Therefore, state through the government has an obligation to keep the faith and *taqwa* of its community by implementing *takaful ijtima’i* (public security) which are complete and integrated (comprehensive), where the five basics of human needs are summarized in *maqashid al-shari'ah* can be fulfilled. In preparing this paper, the authors use the method approach to the study of literature and study of arguments or *dalil* of Al-Quran (*tadabbur*). Both methods are based on the reference of *dalil*, theories and recent data from the research to formulate solutions. Results of the analysis will be used for the preparation of the concept of *takaful ijtima’i* which based on *maqashid al-shari'ah*. It is expected that the resulting concept can be applied in the implementation of public guarantees to create prosperity for the nation and the state.

Keywords: faith, *maqashid al-shari'ah*, takaful ijtima'i, welfare

1. INTRODUCTION

1.1.Background

Welfare is a goal to be achieved by each country. Various parties were eventually described in terms of well-being or ‘welfare’ itself, to which they understand. In Falah Islamic welfare is expressed with a victory in the world and in the hereafter. To accomplish this, God expressly and clearly says in the Qur'an:

وَلَوْ أَنَّ أَهْلَ ٱلْقُرَىٰٓ ءَامَنُوا۟ وَٱتَّقَوْا۟ لَفَتَحْنَا عَلَيْهِم بَرَكَـٰتٍ مِّنَ
ٱلسَّمَآءِ وَٱلْأَرْضِ وَلَـٰكِن كَذَّبُوا۟ فَأَخَذْنَـٰهُم بِمَا كَانُوا۟
يَكْسِبُونَ ﴿٩٦﴾

> *"And if only the people of the cities had believed and feared Allah , We would have opened upon them blessings from the heaven and the earth; but they denied [the messengers], so We seized them for what they were earning."*

Welfare in the Islamic faith reflected by citizens' faith and *taqwa* in the aggregate. As one of the world's largest community, muslim certainly has the potential to emerge as rulers of civilization. But in fact, today, most Muslim countries are poor countries. Even sometimes the world pretends a Muslim country to be third world countries synonymous with poverty and underdevelopment. Though, Islam has clearly encourages us to advance in the field of the economy, as evidenced by the success of the companions of the Prophet Muhammad.

Backwardness of Islamic countries is motivated by the lack of public insurance (*takaful ijtima'i*) in ensuring the basic needs of the community. So that it can create social inequalities that can lead to crime and immorality nationally. Then in the end the immorality accumulate in each country, which can slowly degrade the faith and *taqwa* in the aggregate.

As the statement in a hadith, "faith will rise along with the increase of *taqwa*, and will go down with increasing immorality". If this problem is left unchecked and not being solved, it is not impossible for the Islamic countries will become increasingly worse. So, it is necessary for formulating and finding a solution to the problem of *takaful ijtima'i* in increasing faith and taqwa in Muslim communities aggregately.

1.2.Identification and Problem Formulation

To solve the welfare problem as described in the background section, the authors identify the problems that, the condition of faith and *taqwa* of today's society in a state which is not in good condition triggered by the public security system that is not comprehensive. Then, it takes the concept of a complete and integrated *takaful ijtima'i*. Based on the identification of the problem, the authors also determine the formulation of the problem as follows: How does the concept of *takaful ijtima'i* able to keep the faith and *taqwa* of society?

1.3.Purpose

From the description of the problem formulation above, then this paper has the following objectives: define the concept of *takaful ijtima'i* which is capable in keeping the faith and *taqwa* of society.

1.4.Benefit

As a result of scientific analysis, this paper is able to provide benefits to various parties including, the results of this paper can be used as a reference for government policy-making related to issues of public policy and the welfare state. Besides this paper can provide benefits for academics and researchers in the development of science and further research. Also expected recommendations given by the author is able to be applied to each individual in the program formulating and formatting prosperous society.

2. LITERATURE REVIEW

To support scientific papers, the authors conducted literature review with documentation methods. This is done so that the authors can obtain data and balanced information based on the theories that exist today, so that the resulting solution is objective and realistic. In preparing this paper, used theories based on the following description.

> *“And if only the people of the cities had believed and feared Allah, We would have opened upon them blessings from the heaven and the earth; but they denied [the messengers], so We seized them for what they were earning."* (Al-A’raf : 96)

In the verse above clearly illustrated that Allah SWT will give blessing to a country if the people believe and fear Allah. Based on the arguments of the Qur'an to the verse, it is clear that the welfare of the Islamic perspective is condition where the community has a good faith and being *taqwa*. To confirm this Nejatullah Muhammad Siddiqi stated that, The road to spiritualism of Islam barged straight through the frenzied atmosphere of practical life. There is nothing that separates and cut the road of life. He is the only way of life special. And when we say that the kindness and pietiness should be our goal we are proclaiming that this is a particular way of life (Some Aspects of the Islamic Economy: 1972).

To achieve prosperity God intended, state through the government has an obligation to fulfill its responsibilities to the public, as the Prophet SAW said:

> *"Each of you is a leader and each of you is responsible for the lead. Imam is a leader and responsible to the people they lead.* " (Narrated by Bukhari and Muslim from Ibn Umar)

In fulfilling its responsibilities, the state has its own function. According to Dr. Yusuf Qardawi, the state serves the people and assuring the minimum requirement. This function is essentially aimed at maintaining public faith in general. With the fulfillment of basic needs, it is expected that human transcendental relationship with God is maintained (Fiqh Daulah: 1997).

According to Ali Sakti’s statement on his book, functions of the state is to maintain and increase the faith of the nation. Thus indirectly it can be said that the parameters of the economic success in the perspective of Islam is not dominated by the progress of physical development, but rather is determined by how much of the state collective closeness to Allah (Islamic Economics Theoretical Analysis of the answers to the chaos of modern economics: 2007).

Furthermore Ali Sakti also added that the country has a social-moral functioning, which is the core of the government's work program is learning and understanding of Islam itself. In this respect Islam is not just a religion or ideology but also to be a comprehensive reference for all human activity, whether it is a horizontal relationship with fellow human beings and the environment, as well as a vertical relationship with the Creator is Allah SWT.

According to Al-Mawardi primary function of the state is to continue the prophetic role of religion in maintaining and managing the mundane things (Al-Ahkam Al-Sulthaniah: 1973). This is reinforced by Ibn Taymiyyah which states that the function of the state is made religion belongs to Allah and there is no more fitnah on earth (Al-Islam fil hisbah: 1997).

Monzer Kahf also expressed the same opinion by stating that the function of the state is bringing Muslim communities become closer to Allah SWT (Economic Role of State in Islam: 1999).

The function and role of the state must continue under any circumstances. This is what the state requires a mechanism *takaful ijtima'i* (public security) as a form of protection to meet the basic needs of its people, as the following hadith:

> *"Each of you is the giver of protection and are responsible for what you give protection (on the Day of Resurrection)"* (Narrated by muttafaq 'Alaih)
>
> *"Verily, those who believe are those who can provide safety and protection of life and property of others"* (Narrated by Ibn Majah)

At-Takaful ijtima'i does not only apply to fellow Muslims, but also to the people than Islam. This practice is exemplified by the Prophet Muhammad in Medina, which still provide protection of life and belongings to faiths besides Islam, such as the Jewish and Christian. (Khairul Anwar: 2007). In Islam, faith is an important variable that should be improved in the community. Existence of *takaful ijtima'i* has no other aims there beside to keep the faith and *taqwa* (piety) in the citizens.

On the other hand, Imam As-Syaitibi (709 H) formulate *maqashid al-shari'ah* that includes the need for faith, life, intellect, lineage, and property. These five requirements must met by all individuals. *Takaful ijtima'i* concept forcing the state should possessed five points were able to meet the basic needs level daruriyat (primary).

More specifically Imam Al-Ghazali (1111 AD) the view that the first step to improve the condition of a country is through coaching that is intended to maintain the faith. Of course, to increase faith, it is necessary to do operational government program, through the guidance of Islam and other public security. Faith plays an important role in determining the welfare state; one of them; because faith is able to influence the consumption patterns of society as a whole.

With one's faith can act as an Islamic man, where consumption behavior always put righteous deeds and remained consistent at a certain level of basic needs (Ali Sakti: 2011). Consumption behavior is called *taqwa* piety human consumption behaviors that ultimately capable on delivering to the welfare state. In addition, faith also can help formation of *rabbaniyah shalih personality* (Godliness personality) which is applied in society as a whole in every aspect of life (I-ZISWAF: 2012).

3. METHODOLOGY

3.1.Writing Methods

This paper is prepared using descriptive analysis techniques, namely the method of writing that is focused on the study of the problem by collecting data and information related to the problem being studied. Results of a descriptive analysis of qualitative statements are strung in the description of the non-numbers explanation. This research method is quite flexible, because the research procedures used not mathematically strict, so the authors can easily make changes or adjustments to a new analysis found.

3.2.Data Type

In preparing this paper, the authors use secondary data types. Secondary data used in the form of evidence, records, or historical reports that have been arranged in the archive (documentaries data). More specifically, the authors use the source, Al-Quran, Al-Hadith, scholarly books, statistical data agency (BPS), and information obtained through the media.

3.3.Data Collection Techniques

The data collection techniques used in the preparation of this paper is as follows:

1. Literature study, which are the data collection activities, reading and recording and interpreting the data obtained.
2. Documentary, in the form of documentation studies done by reading the reports and articles that are accessible from the Internet, books and journals that fit the problem. In this method, the authors only move the relevant data in, from a source or document required.
3. Experience survey, which is taking shape through discussions with practitioners and experts of Islamic economics. Questions groove in the discussion tends to loose and not bound by systematic inquiry.
4. Subjective-intuitive is to involve the author's opinion on the issue being discussed.

3.4.Method of Analysis

The methods of analysis used by the authors are of two types, namely the study of literature and argument approaches *istishab*. Arguments of *istishab* approach used is the analysis by drawing conclusions based on the arguments that have been there before, the argument used is Al-Quran and Al-Hadith. While the method of literature study conducted by analyzing various theories as well as data related to the problem being studied, to produce a relevant and realistic conclusion. Results of analysis of the two methods are a non-mathematical descriptive report. The analytical framework in this paper is as follows:

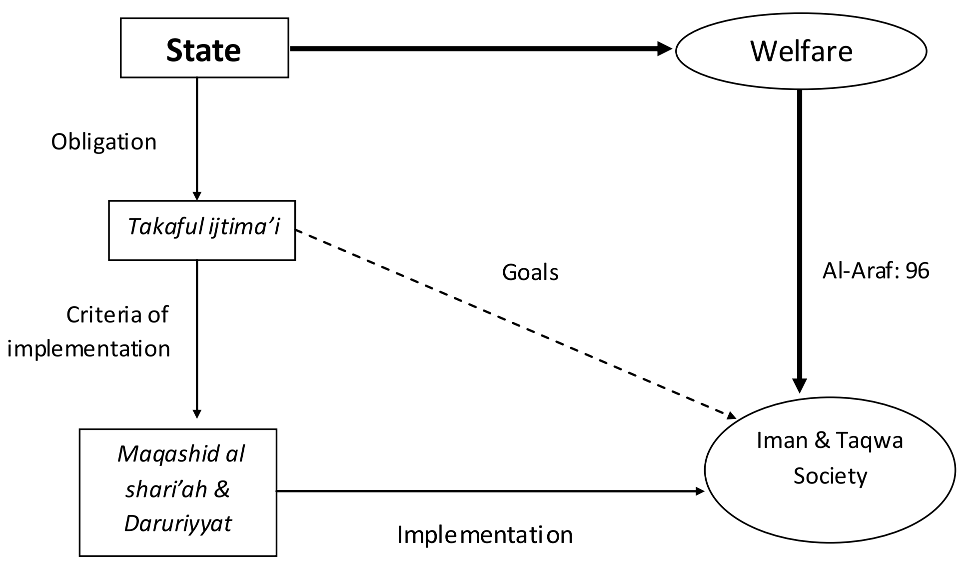

Figure 1. Analytical framework
Source: Rizma Riyandi Rahman

In the framework of the above analysis it is clear that there are two main directions of thinking the object of analysis (countries) that ultimately converge at a single destination. Direction of thinking with bold arrows shows that in this part of the analysis process used arguments approach the *istishab* with the main argument of the Quran (Al-A'raf: 96). While the direction of thinking with thin arrows used methods of literature study, which ultimately think this two-way meet at the same point. The several stages of activity that writers go through in preparing this paper are:

1. Stage of Affirmation of the idea, the stage in which the authors define the notion to be studied deeply. At this stage, the authors also measure the sharpness as well as the usefulness of the idea, that idea was formed to provide power for good and wide for the life of Muslims.
2. Stage of Data collection, the activity of collecting theories and current data related to the problem being studied. This activity is done so that the results are relevant and applicable to the analysis carried out in real life.
3. Stage of analysis of the data, analyze the data and an activity theory based on the method of analysis used. At this stage, *filtration* (sort out) the data to form concepts and ideas that are tailored for the demands of the public and in accordance with the Shari'ah (*maqashid al-shari'ah* meet) in the implementation of *takaful ijtima'i*.
4. Stage of Concluding is the preparation of the concept of I-Mq'S as a standard implementation of *takaful ijtima'i* after a series of analytical processes.

4. FINDINGS AND ANALYSIS

4.1.Application of *maqashid al-shari'ah* in Takaful Ijtima'i

Takaful ijtima'i a public security provided by the state to the citizen either Muslim or non-Muslim. In practice, *takaful ijtima'i* should be able to meet basic needs (*daruriyyat*) citizens through public facilities. This is done so a state through government could fulfill its responsibility to the community.

> *"An imam (head of state) is the preserver and regulatory affairs (of the people) and he will be held accountable for the affairs of the people".* (Narrated by Bukhari and Muslim)

Based on the arguments of Al-Quran from surah Al-A'raf verse 96, the Islamic view that a country is said to be prosper if its people believe and fear Allah, in other words the people have faith and being *taqwa*. It is necessary to guarantee that the state is able to support the faith and devotion of the country. To achieve this, the state must have a concept that is both complete and integrated (comprehensive) *takaful ijtima'i*. The comprehensive nature of the public security must be able to meet the basic needs of born-spiritual, physical-spiritual, material-nonmaterial and various outside-in on the needs of human beings. To eliminate the dichotomy between inner and outer, spiritual and physical, as well as material and non-material, Imam As-Syatibi has redefined human needs into five forms which includes: faith, life, intellect, lineage, and property. Currently we are familiar with the needs *maqashid al-shari'ah*. The application of *maqashid al-shari'ah* in the implementation *takaful ijtima'i* is as follows:

Table1. Applications *Maqashid al-Shari'ah* for Takaful ijtimai
Source: Riyandi Rahman

Daruriyyat	Program
Faith/religion (*Ad-Din*)	• Assurance of worship • Development of Islamic understanding
Life/Soul (nafs)	• Provision of health facilities: hospitals, health centers. • Assurance of food and residence. • Security and peace (police, national army)
Intellect (Al-Aql)	Assurance of education without boundaries (elementary, junior high school, high school, university)
Lineage (Nasl)	• Warranty to childbirth -means of delivery- • Guarantee thoroughbred indefinitely (annihilation program of contraceptive *device*) • Eradication of adultery/prostitution activities
Property (Al-Mal)	Ensure availability of jobs and business opportunities
Note: all form *takaful ijtima'i* must be provided by the government (state) on the citizens who are in poverty.	

1. Faith/Religion (Ad-Din)

   Religion in this case Islam, is the need of ruhiyah. Its presence may affect patterns of living, thinking, and behavior. Even the goal of human life is often defined by his religion. On the other hand, religion has a strong influence on the belief that we often refer to as *aqidah*. Furthermore *aqidah* provide important influences on human behavior and charity, as Muhammad Sholahuddin explained that,

   > *"if a person consistently associate each decision as a choice by certain ideological based, it will form a certain mindset. This mindset will then be used effects a person's behavior patterns. Similarly, to make Islam as a benchmark will bear Islamic mindset and if practiced will create Islamic behavior patterns."*

   This is confirmed by the word of Allah,

أَلَمْ تَرَ كَيْفَ ضَرَبَ ٱللَّهُ مَثَلًا كَلِمَةً طَيِّبَةً كَشَجَرَةٍ طَيِّبَةٍ
أَصْلُهَا ثَابِتٌ وَفَرْعُهَا فِي ٱلسَّمَآءِ ﴿٢٤﴾
تُؤْتِيٓ أُكُلَهَا كُلَّ حِينِۭ بِإِذْنِ رَبِّهَا ۗ وَيَضْرِبُ ٱللَّهُ ٱلْأَمْثَالَ لِلنَّاسِ
لَعَلَّهُمْ يَتَذَكَّرُونَ ﴿٢٥﴾

> *"Have you not considered how Allah presents an example, [making] a good word like a good tree, whose root is firmly fixed and its branches [high] in the sky? It produces its fruit all the time, by permission of its Lord. And Allah presents examples for the people that perhaps they will be reminded."* (Ibrahim: 24-25)

What is meant by 'good word' in the above verse is the creed or connotative refer to *aqidah*. With a straight and right aqidah then someone else would be better. In takaful ijtima'i application, the fulfillment of religious needs lowered into two public policy, namely:

• **Assurance of worship**, where the government must ensure that religious facilities are accessible to every citizen. Besides security and freedom in the use of religious facilities is the responsibility of the government. This guarantee is not only given to Muslims, but should be offered to people of other faiths, as the Prophet Muhammad gave the example of when the state ruled Medina.

• **Development of Islamic understanding**, is one form state responsibility in exercising Islamic proselytizing. Coaching can be done with a model of mentoring which is made into small groups, consisting of 5 to 12 people assisted by a person of Trustees. As God in the Qur'an to imply activities coaching through the following verse:

ٱدْعُ إِلَىٰ سَبِيلِ رَبِّكَ بِٱلْحِكْمَةِ وَٱلْمَوْعِظَةِ ٱلْحَسَنَةِ ۖ وَجَٰدِلْهُم
بِٱلَّتِي هِيَ أَحْسَنُ ۚ إِنَّ رَبَّكَ هُوَ أَعْلَمُ بِمَن ضَلَّ عَن سَبِيلِهِۦ ۖ وَهُوَ
أَعْلَمُ بِٱلْمُهْتَدِينَ ﴿١٢٥﴾

> *"Invite to the way of your Lord with wisdom and good instruction, and argue with them in a way that is best. Indeed, your Lord is most knowing of who has strayed from His way, and He is most knowing of who is [rightly] guided."* (An-Nahl: 125)

Coaching is done in order that faith and devotion of every individual Muslim maintained its stability, so that the individual is able to perform well against the Shari'ah compliance. That way faith can effectively control the patterns of behavior of people to keep away from immoral activity, because in Islam there are coaching two main mechanisms that work to maintain stability of faith, which is the mechanism *mutaba'ah yaumi'ah* (evaluate the charity) and *tarbiyah dzatiyah* (independently self-coaching).

2. Soul (an-nafs)
   The soul is an important aspect in human being. These aspects include the body and mind, if the balance is disrupted can lead to madness or even death. Application of social security schemes to meet the needs of the soul, namely:

   • **Provision of health facilities**, community health centers by providing facilities, and hospitals. The government must ensure that people who are in poverty are able to access health facilities for free.

   • **Assurance of food and shelter**, this warranty is given specifically for people who are in poverty, as mandated by the laws of the Republic of Indonesia. In addition, the government should ensure availability of raw materials in the food market to make sure that people's needs always be fulfilled.

   • **Security and peace** absolutely must be met by the government in order to create a strong state sovereignty in the region. Real acts of the government in this case are to establish and carry out a national police force and army.

3. Intellect (Al-Aql)

Allah has glorified humanity with intellect, until a man with her degree exalted.

يَٰٓأَيُّهَا ٱلَّذِينَ ءَامَنُوٓاْ إِذَا قِيلَ لَكُمۡ تَفَسَّحُواْ فِي ٱلۡمَجَٰلِسِ فَٱفۡسَحُواْ
يَفۡسَحِ ٱللَّهُ لَكُمۡۖ وَإِذَا قِيلَ ٱنشُزُواْ فَٱنشُزُواْ يَرۡفَعِ ٱللَّهُ ٱلَّذِينَ ءَامَنُواْ
مِنكُمۡ وَٱلَّذِينَ أُوتُواْ ٱلۡعِلۡمَ دَرَجَٰتٖۚ وَٱللَّهُ بِمَا تَعۡمَلُونَ خَبِيرٞ ١١

" O you who have believed, when you are told, "Space yourselves" in assemblies, then make space; Allah will make space for you. And when you are told, "Arise," then arise; Allah will raise those who have believed among you and those who were given knowledge, by degrees. And Allah is acquainted with what you do." (Al-Mujadalah: 11)

Thus the reason to be guarded, the need for maintaining a sense a form of public security shall be borne by the state. Forms to meet the needs of *takaful ijtima'i* reasonable public security program are through education. Government must be able to ensure that every citizen can have access to education at all levels including elementary, junior high school, high school, and college. In addition to guaranteed-related educational institutions, the government must facilitate citizens with educational infrastructure (books) which are affordable by the various circles of society.

4. Descendants (An-Nasl)

Every living thing has an instinct to have children, and one of the goals of *munakahat* done by the Prophet Muhammad is to maintain descent. To facilitate descent are three public policy that can be applied in *takaful ijtima'i* namely; guarantee childbirth/delivery means, including the freeing mothers from labor costs, and collateral descent, where the government may not restrict its citizens to descent, as Allah SWT says in surah An-Nur verse 32, and Al-Maidah verse 87. In addition to the above two main policies, the government should ensure state free of adultery in other words there’s no prostitution which can damage *nasl*. As Allah says in the Qur'an:

وَلَا تَقْرَبُوا۟ ٱلزِّنَىٰٓ ۖ إِنَّهُۥ كَانَ فَٰحِشَةً وَسَآءَ سَبِيلًا ﴿٣٢﴾

"*And do not approach unlawful sexual intercourse. Indeed, it is ever an immorality and is evil as a way."*(Al-Isra ': 32)

5. Property (Al-Mal)

Needs which is often being focus of discussion in economic matters is a property/wealth. Because the position is as a means of wealth are able to convey human needs and as a necessity of life itself. In Islam the property must be sought by way of working for the grace of God Almighty, as following word.

فَإِذَا قُضِيَتِ ٱلصَّلَوٰةُ فَٱنتَشِرُوا۟ فِى ٱلْأَرْضِ وَٱبْتَغُوا۟ مِن فَضْلِ ٱللَّهِ
وَٱذْكُرُوا۟ ٱللَّهَ كَثِيرًا لَّعَلَّكُمْ تُفْلِحُونَ ﴿١٠﴾

“And when the prayer has been concluded, disperse within the land and seek from the bounty of Allah , and remember Allah often that you may succeed." (Al-Jumu'ah: 10)

Because of this, the government should ensure the availability of jobs and businesses. Cannot being justified when the government's efforts to displace people’s business without *shar’i* reason. Even the government should be able to provide information services businesses, and enterprises in facilitating community land. Public policy can have a concrete impact if implemented fully. It means that the government must run a 10 *takaful ijtima'i* (public security) simultaneously. A form of this *Takaful ijtima'i* is I-Mq’S (Iman, *maqashid al-shari'ah*) concept, which is a standard concept of public security applications aimed to improve society with *iman* -or faith- and *taqwa* -or devotion- *maqashid al-shari'ah* basis.

4.2.Analysis of the concept of I-Mq'S (Iman-M*aqashid al-Shari'ah)* **in Achieving Welfare**

The existence of a public policy that is provided by the government are supposed to be able to support the community of faith that creates charity aggregately. The explanation of the correlation between I-Mq'S and well-being are as follows:

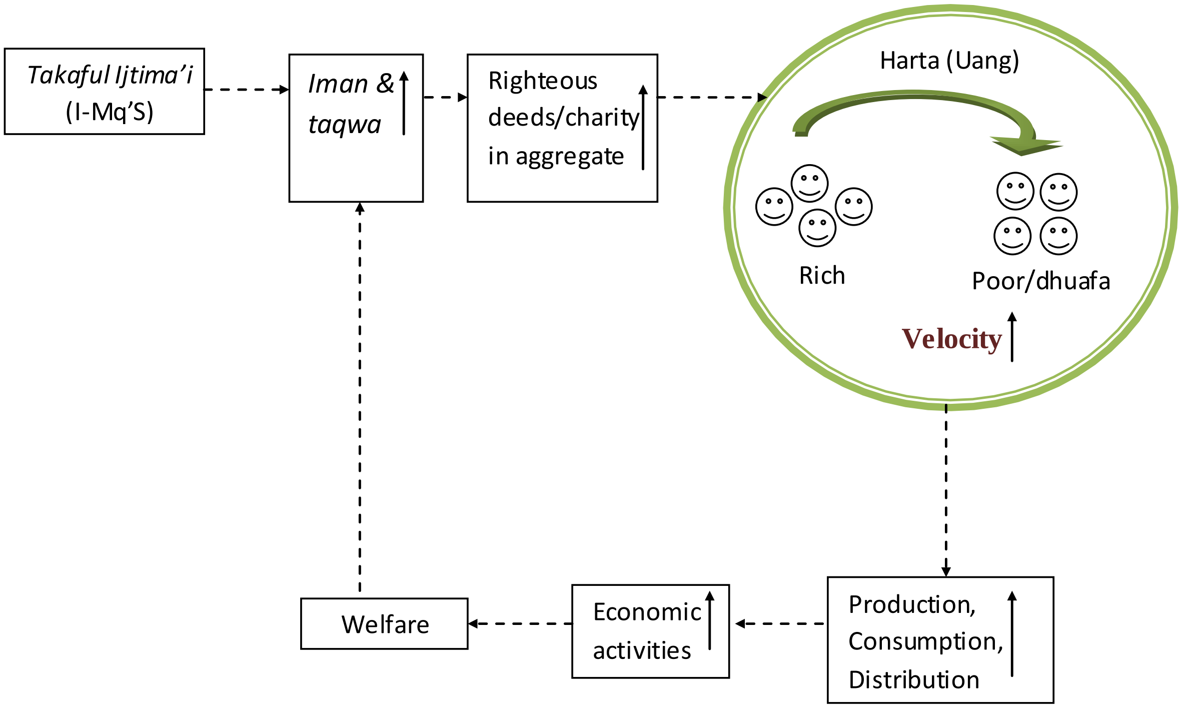

Figure 2. Correlation analysis I-Mq'S to the welfare
Source: Rizma Riyandi Rahman

When the concept of takaful ijtima'i I-Mq'S implemented, and is able to maintain and increase the faith and *taqwa* (piety) of the people, then the charity/righteous deeds in the aggregate will increase. Righteous deeds referred to in this discussion is the good deeds in the broadest sense, including the spirit of endeavor (work), *Ta'awun* spirit, and the spirit of worship *mahdhah* implement. The phenomenon will create economic interaction between the upper class and lower class communities. The position is initially trigger wealth in the hands of rich people will move into the hands of the poor (*dhuafa)*, so the consumption activity of the poor (*dhuafa)* increases. This condition causes the rotation (velocity) property/wealth/money is so fast, because on the other side of the market will respond to an increase in the consumption of the *dhuafa*, so that production and distribution activities were increased (Ali Sakti: 2013). Likewise turnaround this property is highly recommended by Allah SWT.

> *"... so that it will not be a perpetual distribution among the rich from among you. And whatever the Messenger has given you - take; and what he has forbidden you - refrain from. And fear Allah ; indeed, Allah is severe in penalty."* (Al-Hashr: 7)

Gradually, this property/wealth turnover will continue to increase the movement of the country's economic activity. Activity has increased production and will create a lot of demand for labor, and unfold a wide-open private employment opportunities. This condition, either directly or indirectly, can cause changes in a person's social status from being unemployed workers, from poor to rich, and from misery to prosperity.

But not quite up here, I-Mq'S still have to be implemented sustainably so that faith and *taqwa* (piety) citizens always awake. If faith and *taqwa* (piety) citizens back down, then the country's economic activity would be decreased. It will certainly leave and getting away from effort in reaching welfare of the state.

So, it a must if it appears the statement that the welfare of the country depends on the faith and *taqwa* (devotion) of its citizens. Therefore, the government should continue to strive to increase the faith and devotion through the implementation of I-Mq'S, especially on the activity of Islamic coaching. Because the activity of Islamic coaching will be essential in shaping the character of *Rabbaniyah* through two mechanisms that have been previously described. Islamic coaching must be sustainable, because people have a dynamic mindset and feelings, constantly changing all the time. Then it needed a mechanism to keep the mindset of piety and sense of faith in each individual in society. Essentially, humans are always faced with two choices, namely *haq* and *bathil* (vanity), wickedness and piety, kufr and faith. But the lucky ones are those who remain consistent to choose the path of good to cleanse his soul. As Allah SWT,

> *"And [by] the soul and He who proportioned it. And inspired it [with discernment of] its wickedness and its righteousness, He has succeeded who purifies it, and he has failed who instills it [with corruption].Thamud denied [their prophet] by reason of their transgression,"* (Ash-Shams: 7-10)

Many things can be done to purify one's soul, starting with implementing *mahdhah* worship, keeping away from vices/misconduct, and so on. Furthermore, appropriate mechanisms for maintaining the sanctity of life is advising each other, because basically people have to be reminded.

> *"By time,Indeed, mankind is in loss,Except for those who have believed and done righteous deeds and advised each other to truth and advised each other to patience."* (Al-Asr: 1-3)

Remind each other mechanism can be accommodated through the activity of Islamic sustainable development that is brought in the concept ofs I-Mq'S. With the application of I-Mq'S which are summarized in the 10 *takaful ijtima'i* application, then welfare can be achieved, and the predicate *baldatun thayyibatun wa rabbun ghafur* be realized well.

5. CLOSING

5.1.Conclusion

Welfare in Islam is a condition in which society as a whole faith and fear. To achieve this application of a comprehensive public security is required. *Takaful ijtima'i* ultimately adopted and implemented to support the improvement and stability of faith and piety.

Basically *takaful ijtima'i* good shape is a public security to meet human needs as a whole, namely faith, life, intellect, lineage and property. Because with that patterns and concepts such as faith and piety that society can be maintained. The 10 *maqashid al-shari'ah* applications in *Takaful ijtima'i* (I-Mq'S) are:

1. Guarantee religious facilities
2. Islamic Guidance (coaching)
3. Provision of health facilities
4. Food security and shelter
5. Security and peace
6. Assurance education
7. Guarantees maternity facilities
8. Guarantee of thoroughbred
9. Guarantee eradication of prostitution
10. Guarantee of employment and business

Implementation of I-Mq'S should run continuously and persistently, so this program should not be done only in cases incidental. And its implementation must be carried out thoroughly. Therefore, by applying the *maqashid al-shari'ah*, welfare –is reflected by the faith and piety– can be achieved, because the focus of I-Mq'S is the spiritual and physical needs are intended to maintain the stability of the faith and piety.

5.2.Recommendation

As for some suggestions to be presented in this paper, namely:

1. State through government are expected to renew their welfare objectives of the course material in the form of goal attainment purely economic aspects, with the *iman* (faith) and *taqwa* (fear).
2. Government is expected to not only focus on the material aspects in determining public policy. Especially in the implementation of public security, the government should ensure the basic needs of society as a whole (faith, life, intellect, lineage, property).
3. This paper presents a discussion of new forms of *takaful ijtima'i* only conceptually, and has not been discussed in the technical level. Thus, the authors suggest for very hopeful and fellow researchers or *civitas academica* who want to write a similar topic, to continue the discussion of this topic to the level of the mechanism of alternative forms of employment programs that can be implemented by various parties in order to achieve the welfare state.

Expected some suggestions above can be applied well and was able to bring the benefits of the blessings of Allah SWT. Therefore, the usefulness of a science will only appear when the supporting parties have wholeheartedly appreciate and manifest in a series of personality that is reflected through real charity. Be assured that God will be pleased with us.

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Etude comparative sur les facteurs influençant le risque de crédit : cas des banques islamiques et des banques classiques

Ahmadi Aymen

Résumé :

A partir d'une analyse de la littérature sur le sujet de la gestion du risque de crédit, et notamment celle sur la finance islamique, cette étude a comme objectif : mesurer l'influence de plusieurs facteurs (ratios financiers) sur le risque de crédit au sein des institutions financières islamiques et faire une comparaison avec les banques classiques. Et enfin, faire une analyse afin de déterminer les avantages et les difficultés qui peuvent rencontrer ce type de financement parallèle notamment en matière de gestion du risque de crédit. Ce qui va nous permettre de voire si le caractère islamique de ces banques permet de limiter ce risque ou c'est simplement un faux-fuyant qui permet juste d'appliquer les règles de la « Charia » sans aucune contribution concrète en matière de gestion de risque.

Mots clés : risque de crédit, banques islamiques, banques classiques, ratio financiers.

Introduction :

A partir des années 70 et depuis la création de la « Dubaï Islamic Bank » en 1975, (première banque privée du monde avec des produits sans intérêt bancaire), la croissance de la finance islamique dans le monde entier a été phénoménale avec un taux annuel moyen de 10% à 15%.

En Iran, au Pakistan et au Soudan, l'industrie bancaire locale dans son ensemble est devenue islamique. Et dans d'autres pays, plusieurs grandes banques internationales (HSBC, BNP Paribas, Commerzbank, Citicorp…) ont introduit des divisions islamiques qui offrent différents produits conformes à la loi islamique « La charia ».Cette loi qui exige le partage des risques et interdit le paiement ou la réception d'intérêts (riba).

Selon Olsen et Taisier (2008), Les différences entre les deux types de banques ne sont pas seulement sémantiques (comme l'affirment certains critiques de la finance islamique). Les banques islamiques et classiques se distinguent les unes des autres sur la base des informations financières tirées du bilan des entreprises et des états des résultats.

Ainsi, à l'actif du bilan de la banque islamique on trouve : les investissements qui sont basés sur les règles de la Charia, tel que la Moucharaka et la Moudaraba qui peuvent être considérés comme mode de financement avec la participation aux bénéfices, ou la Mourabaha, comme mode de financement à revenu fixe. On trouve aussi les ventes à crédit, tel que le Salam et l'Isitisna. En revanche, du côté du passif, on trouve les dépôts qui peuvent être conservés sous forme de comptes courants (Quard Hassan) ou comptes de placement (voire Annexes).

Cependant, comme toutes les banques opèrent dans le même environnement concurrentiel et sont réglementées de la même façon dans la plupart des pays, il est possible que les banques islamiques et classiques affichent les mêmes caractéristiques financières. Notamment certaine homogénéité pourrait être observée en matière de gestion des différents risques qui peuvent toucher ces institutions financières.

Dans cet article nous nous proposons (i) d'étudier les facteurs qui ont une influence sur le risque de crédit dans les banques islamiques et (ii) d'identifier s'il existe une différence entre les déterminants du risque de crédit des banques islamiques et des banques classiques, dans un cadre géographique et règlementaire identique.

En examinant de près la relation entre les ratios financiers, le risque de crédit des banques islamiques et celui des banques classiques, cet article vise à contribuer à la littérature existante à plusieurs égards.

Tout d'abord, fournir une étude statistique basée sur les facteurs de risque sur un ensemble de banques islamiques et classiques dans des différents pays, après, utiliser une analyse de régression afin de déterminer les facteurs sous-jacents qui ont une influence sur le risque de crédit des banques islamiques et celles classiques dont la plupart de leurs opérations sont basées sur l'intérêt.

L'analyse mettra le point sur les principaux facteurs qui ont un effet direct ou indirect le risque de crédit dans le système bancaire islamique. L'identification de ces facteurs suivie d'une étude comparative va nous permettre de fournir plus d'idées afin d'améliorer la gestion des risques dans le secteur bancaire islamique.

Ce papier est organisé comme suit : la section 2 définit les différences en matière des risques de crédit dans les deux types de banques. Dans la section 3 nous exposons une revue de littérature sur les variables qui peuvent influencer le risque de crédit dans les deux types d'institutions financières. La section 4 décrit la méthodologie suivie par l'analyse des résultats dans la section 5. La section 6 conclut le papier avec la contribution de l'étude et les horizons de recherches.

2. Le risque de crédit:

Selon Hans et Kang (2007), le risque de crédit ou le risque de défaut de contrepartie, représente une grande importance dans la gestion des risques et d'évaluation des actifs financiers. Les exemples spectaculaires des pertes découlant des récentes faillites d'entreprises, tel qu'Enron, WorldCom et Kmart, illustrent son importance. Cependant, le risque de défaut de paiement, par sa nature même, est difficile à quantifier, et les notes traditionnelles fournies par des agences telles que Moody et Standard & Poor's sont loin d'être idéales.

Pour cela, dans une logique de maximisation de profit, les banques cherchent à appliquer un taux d'intérêt optimum afin de réduire au maximum le risque. Tel n'est pas le cas en finance islamique en raison de l'absence de taux d'intérêt dans les opérations bancaires. La principale source de revenus dans les opérations de crédit sont les gains des différents contrats basés sur le principe du partage des pertes et des profits (PPP). Ce principe, d'après Elmelki (2011), a été présenté comme une alternative à l'élimination de la variable taux d'intérêt du processus de l'intermédiation financière bancaire. Les parties prenantes à l'activité bancaire sont dans l'obligation de partager les risques et par conséquent les profits ou les pertes. C'est ce degré de risque qui légitime la rémunération issue du projet d'investissement. En référence à ce principe, la finance islamique est appelée également « finance participative ». Ce principe signifie qu'un contrat ne doit pas être conclu de façon à ce que l'ensemble de ses clauses soient en faveur d'une seule des parties contractantes. Les termes contractuels doivent être équitables afin d'éviter les positions d'abus de force de l'une des parties contractuelles pour parvenir à la réalisation de la cohésion de la communauté.

Les deux formes les plus populaires sont Moudaraba et Moucharaka, en général dans ce type de contrats les banques islamiques reçoivent des fonds d'investissement sur la base de Moudaraba (participation aux bénéfices). Dans ce cas la banque n'est autorisée à utiliser les fonds que dans le cas des activités jugées appropriées par les gestionnaires, et que les activités ne sont pas interdites par les lois islamiques.

Selon l'IFSB, les actifs de la banque islamique, dont la transaction a été réalisée avec le principe du partage des pertes et des profits, présentent des risques plus importants que les autres transactions. Par conséquent, il n'est pas surprenant de voir que les suggestions d'adéquation en capital de l'IFSB pour les produits Moucharaka et moudaraba soient plus élevées que les autres produits financiers islamiques.

Les banques doivent trouver les emprunteurs qui utiliseront les fonds pour les investissements qui sont approuvés par la banque (Moucharaka), et enfin ces entrepreneurs partagent les profits et les pertes avec la banque selon un accord sur un ratio fixé en avance. Enfin les banques rassemblent tous les profits et pertes sur les différents placements et partagent les bénéfices avec les déposants de fonds selon une formule prédéterminée. Donc nous pouvons constater que les banques islamiques sont des partenaires à la fois avec les déposants et les entrepreneurs en partageant les risques avec les deux.

Selon, Karim et Ali (1989), les banques classiques utilisent à la fois la dette et les capitaux propres pour financer leurs investissements, tandis que les banques islamiques sont censées dépendre principalement du financement par actions et les comptes de dépôt, et les comptes d'épargne et d'investissement. En finance islamique le compte courant (de dépôt) est très similaire à ces comptes dans les banques classiques et aucun intérêt n'est payé aux déposants des comptes courants. Les déposants ont un accès instantané à ces comptes et sont en mesure de retirer de l'argent chaque fois qu'ils le souhaitent. Les dépôts d'épargne sont à durée déterminée accords d'intéressement qui ne peuvent pas être encaissés avant l'échéance sans pénalité importante. Le taux de participation aux bénéfices des dépôts d'épargne dépend de bénéfices futurs, mais les rendements attendus sont similaires à ceux des dépôts d'épargne

Les banques islamiques remplacent les prêts avec des investissements qui sont généralement plus risqués que les prêts à intérêt qui sont garanties. Pour cela, les types de contrats tels que Moucharaka et Moudaraba aident à réduire le risque dans le secteur bancaire islamique car les entrepreneurs qui souhaitent profiter de ces dispositions doivent documenter la faisabilité des projets à entreprendre.

Olsen et Taisier (2008) ont montré que le coût du capital dans les banques classiques représente les dettes et les fonds propres, mais dans les banques islamiques il est remplacé par les profits et les pertes partagés par les déposants et les détenteurs de participations dans le capital. Le rendement des capitaux propres dans les banques islamiques est plus variable que pour les banques classiques, mais le risque de défaut de ne pas payer un retour aux déposants est éliminé selon le modèle de la finance islamique car le fait de ne pas récompenser les déposants pourrait conduire à un retrait substantiel des dépôts et donc générer un risque de faillite pour les banques.

En finance islamique, le risque de crédit est lié au défaut de paiement se manifestant lorsqu'une partie du contrat avance des fonds (Salam ou Istisnaâ) ou délivre une marchandise (Mourabaha) avant de recevoir la contrepartie de son financement et s'expose, donc, à des pertes potentielles. Dans le cas des modes de financement participatifs (Moucharaka ou Moudharaba), le risque de crédit se manifeste par le non-paiement par l'entrepreneur de la part revenant à la banque lorsque celle-ci devient exigible. Ce problème devient encore pertinent en cas d'asymétrie d'information liée à la méconnaissance des profits réels réalisés par l'entreprise. Concernant les contrats Mourabaha, le risque de crédit prend la forme d'un risque de contrepartie dû à la mauvaise performance du partenaire. Cette mauvaise performance peut être d'origine externe due à des causes systématiques.

Nous savons que le risque de crédit est l'un des principaux risques qui affectent gravement la viabilité des banques comme en témoigne les crises financière de 1997 et de 2008. Dans cette mesure, Sarker (1999) a constaté que le montant des créances douteuses dans le secteur bancaire islamique est en pleine croissance ce qui renforce le risque de crédit encouru par ces organisations.

Donc afin de faire face à ce risque et d'autre risques qui touchent ces institutions financières et malgré les nombreuses différences entre les institutions financières islamiques et classiques, que ce soit au niveau du système même ou plus spécifiquement, dans les produits et services qu'elles offrent, induisent des risques différents et donc une gestion des risques distincts, et dans le but d'harmoniser la gestion des risques, l'Islamic Financial Service Board (IFSB), qui représente l'organisme de la réglementation bancaire comme le cas du Comité de Bâle en finance conventionnelle, a rédigé des normes concernant les risques de crédits pour les institutions financières islamiques (IFI).Nous citons ci-dessous les principales normes qui concerne le risque de crédit :

Norme 2.1 : « En raison des particularités de chaque instrument financier, le risque de crédit doit être analysé pour chacun d'eux. Ceci facilitera la mise en place d'un système de contrôle interne et de gestion des risques »

Norme 2.2 : « La majorité des juridictions interdit l'application de pénalités en cas de défaut, sauf en cas de mauvaise gestion délibérée de la part du cocontractant, ce qui augmente la probabilité de défaut. De plus, l'amende prélevée ne peut être au bénéfice de la banque mais doit être versée à une œuvre caritative ou au fond Zakat ce qui a pour conséquence d'augmenter le coût de la perte en cas de défaut ».

Norme 2.3 : « Chaque IFI est censée mettre en place un système de gestion des risques permettant l'identification, la mesure, le suivi, le reporting et le contrôle du risque de crédit »

Norme 2.4: « Les IFIs doivent considérer le risque de crédit de manière holistique et s'assurer que la gestion du risque de crédit prenne part à une approche intégrée de la gestion de l'ensemble des risques financiers. Étant donné la nature des instruments financiers islamiques, les sources des risques de crédits peuvent être les mêmes que les risques de marché ou opérationnel. Par exemple, dans un contrat Salam, un changement des variables affectant le risque de marché comme le prix des matières premières ou un climat désavantageux peut devenir des déterminants clés influençant le risque de crédit ».

Norme 3.0 : « Les IFIs mettent en place des procédures définissant les contreparties éligibles (consommateur, entreprise ou État), la nature des financements approuvés ainsi que le type d'instruments appropriés. Elles doivent obtenir suffisamment d'informations pour permettre une évaluation complète du profil de risque de la contrepartie avant l'octroi du financement».

Norme 3.1 : « Les IFIs doivent mettre en place une politique de due diligence permettant l'évaluation des contreparties, en particulier pour les transactions impliquant : d'une part, des partenariats incluant de multiples modes de financements. L'IFI doit mettre en place des processus de contrôle lors d'opérations avec des particuliers ou des États afin de répondre à des objectifs spécifiques financiers conçu pour résoudre les problèmes d'adéquation avec la Chariaa, les problèmes légaux et les problèmes fiscaux des clients. D'autre part ,une solvabilité qui pourrait être influencé par des facteurs externes : lorsque de graves risques sont présents dans des produits de participations, particulièrement dans le cas des *financements Moudaraba, d'autres contrôles et évaluations seront portées sur la finalité économique du projet, la capacité d'exploitation ainsi l'évaluation des cash-flow prévisionnels. La stratégie de diminution du risque doit être aussi précise que possible».*

Par ailleurs, selon l'IFSB, les indicateurs de mesure du risque dans le processus de due diligence incluent notamment la VaR, des stress testing, le RAROC ainsi que des analyses de sensibilités des variables. Ces mesures de risque ne diffèrent pas des institutions financières classiques.

Aussi un certain nombre de méthodes d'atténuation du risque de crédit emprunté à la finance conventionnelle sont applicables à la finance islamique. Les plus significatives sont les réserves pour pertes de prêt, le nantissement, les techniques de netting du bilan et les ratings internes.

3. Revue de la littérature :

Des études antérieures ont largement traité des risque et des facteurs contribuant à ces risques au sein des institutions financières dans le système bancaire classique (Rosen et Saunders 2010, Lopez et Saidenberg 2000, Carey et Hrycay 2001,Berger et DeYoung, 1997; Angbazo et al, 1998). Or malgré leur importance, ces facteurs n'ont pas été largement étudiés et documentés en finance islamique. La majorité des travaux sur la finance islamique sont principalement focaliser sur des questions conceptuelles qui sous-tendent le système sans intérêt (Hassan et Bashir, 2002).

Néanmoins une étude sur les institutions financières islamiques dans 28 pays élaboré par Khan et Ahmed (2001) a montré que le risque de crédit est plus élevé dans les contrats Moucharakah (3,69 sur d'un score de1 à 5) suivie par Moudarabah (3,25). Ils ont conclu que les banquiers ont pu constater que les contrats de partage des pertes et des profits présentent le risque de crédit le plus élevé par apport aux contrats de vente avec marge bénéficiaire de comme la Mourabaha (mark-up).

Dans cette logique, Sundararajan et Errico (2002) ont déduit que tandis que les contrats de partage des pertes et des profits peuvent déplacer le risque de crédit directement des banques islamiques à leurs déposants, ils peuvent également accroître le degré du risque global lié à l'actif du bilan des banques puisque les actifs sous ce type de contrats sont sans garantie. D'après leur déduction, le ratio des actifs les plus risqués par apport au total des actifs est généralement plus élevé dans une banque islamique que dans une banque classique.

Une étude faite par Samad et Hasan (1999) sur le système bancaire islamique en Malaisie, ils ont pu révéler que la performance du risque des banques islamiques entre 1984 et 1997 dans les affaires risquées a augmenté au cours des années. Et que suite à une comparaison entre une banque islamique « Islam bank » avec deux banques classiques : « Pertanian Bank » et « Perwira Affin Bank », les indicateurs de risque de l'Islam Bank sont les plus faibles. Ils considèrent que la raison de ce faible risque de la banque islamique est que son investissement dans les titres d'État est beaucoup plus élevé que les deux banques classiques. Dans une autre étude Samad (2004) sur la mesure de la performance du risque de crédit deux ratios financiers ont été utilisé l'Equity to Asset ratio (**EQTA**) et l'Equity to Net Loan ratio (**EQL**), et il a pu constater que plus ces ratios sont élevés, plus la banque à la capacité d'absorber les pertes d'actifs donc le risque de crédit sera réduit.

Berger et DeYoung (1997) ont trouvé que les actifs à risques pondérés retardés (**Lagged RWA**) sont significativement et positivement liés au risque de crédit mesuré par NPLs au total des prêts. Ils ont rationalisé qu'un portefeuille de prêts à risque relativement élevé entraînera une hausse des prêts non performants(NPLs). Le capital retardé (lagged capital), mesuré par les capitaux propres par apport à l'actif total, présente des résultats mitigés ; Pour les petites banques avec un capital limité, le coefficient du capital retardé estimé est significative mais négativement liée au risque, Cette constatation confirme l'hypothèse de l'aléa moral, et suggère que, en moyenne, les banques faiblement capitalisées prennent des prêts plus risqués, ce qui pourrait potentiellement entraîner une augmentation des créances douteuses(NPLs).

Selon Rose (1996), les provisions pour pertes sur prêts par apport aux encours moyens des prêts **(LLP to average loans outstanding**) ont été identifiées dans la littérature bancaire comme un indicateur de risque de crédit avec une corrélation positive avec ce risque.

Ahmed (1998) a constaté que les provisions pour pertes sur prêts (LLP) sont positives et associées de façon significative avec les créances douteuses (NPLs). Par conséquent, si on a des provisions pour pertes sur prêts plus élevées cela indique une augmentation du risque de détérioration de la qualité du prêt. Fisher, Gueyie et Ortiz (2000) ont trouvé des résultats similaires et ont montré que les provisions pour pertes sur prêts par apport au total des prêts (REGAP) sont positivement lié au risque. Aussi, Amarjit (2011) et King et Mohamed (2011) ont également constaté que la taille de la banque mesurée par le logarithme naturel du total des actifs est fortement négativement liée au risque.

4. Méthodologie :

4.1. Les Données:

La base de données utilisé pour faire les testes empirique est Bankscope : il s'agit d'un outil d'information et d'analyse sur les banques et les institutions financières dans le monde, avec notamment un historique des données financières pouvant atteindre 16 ans et qui couvre 30.000 banques et institutions financières, dont les banques islamiques.

Afin de constitué notre échantillon à partir de cette base de données, nous avons suivi plusieurs étapes : tout d'abord, nous avons procédé à l'extraction des donnés comptables et financières et notamment les rapports annuels des différentes banques islamiques dans le monde. Après nous avons sélectionné les banques qui possèdent des informations relatives à nos facteurs recherchés, cet étapes a réduit notre échantillon.

Enfin, vu le manque d'information sur ce type de banque nous avons choisi, l'ensemble de banques qui possèdent les informations recherchées entre 2006 et 2009 et nous avons pris pour chaque banque islamique, une banque classiques dans le même pays et qui possède les même caractéristiques, afin de nous permettre de faire la comparaison entre les deux types de banques.

4.2. Les Déterminants du modèle :

Basé sur une étude de la littérature sur les déterminants liés au risque de crédit (Ahmad, 2003; Hassan, 1992,1993, Hassan et al, 1994, Shrieves et Dahl, 1997, Angbazo et al, 1998), plusieurs variables ont été identifiés pour former notre modèle de régression.

Afin de faire nos mesures et vu la diversité des banques selon leurs origines et leurs natures, nos calcules seront faites sur la bases des ratios financiers. L'utilisation des mesures de ratio n'est pas une nouvelle méthode dans la littérature vu qu'O'Connor (1973) et Libby (1975) ont utilisé cette méthode dans les années 1970. Et depuis de nombreuses études ont été basé sur cette méthode comme, Chen et Shimerda (1981), Sabi (1996) et Samad (1999). L'utilisation de la méthode des ratios présente de nombreux avantages. L'avantage le plus important est qu'elle compense les disparités bancaires. Aussi, si les banques ne sont pas égales en matière de tailles, l'utilisation des ratios élimine les disparités dans les tailles et les amène à égalité.

Notre modèle sera basé sur les variables suivantes :

- <u>La variable endogène :</u>

- **CR** : (Credit risk) : selon les variables exogènes, nous allons mesurer le risque de crédit qui sera une variable continue calculée sur la base des NPLs: (NPLs to total loans) Le ratio des prêts bancaires non productifs (créances douteuses) par rapport au total brut des prêts est la valeur des prêts non productifs divisée par la valeur totale du portefeuille de prêts (y compris les prêts non productifs avant la déduction de provisions pour pertes sur prêts). Le montant du prêt enregistré comme non productifs devrait être la valeur brute de l'emprunt tel qu'elle est inscrite sur le bilan, non seulement le montant encore impayé. Selon (Rose, 1996; Berger et DeYoung, 1997; Corsetti, Persenti et Roubini, 1998), le ratio des prêts bancaires non productifs par rapport au total brut des prêts est considéré comme un indicateur de risque de crédit.

- <u>Les variables exogènes :</u>

- **MGT** (management efficiency : earning assets to total assets) : ratio des actifs productifs / total des actifs : C'est le rapport entre les actifs qui génèrent des revenus pour la banque par apport à l'actif total détenues. Ce ratio mesure l'efficacité de la gestion bancaire dont les actifs productifs comprennent les prêts, les titres de placement et des actifs du marché monétaire.

- **REGCAP** (regulatory capital : tier 1 capital to total assets): Tier 1/ total des actifs : Le ratio rapportant le Tier 1 au total des actifs ajustés du risque est un indicateur largement utilisé par les régulateurs afin de mesurer le degré de capitalisation des institutions financières ; le minimum requis selon les accords de Bâle est de 4%. Dans la pratique, la plupart des banques visent au moins 7 %.

- LLP : (loan loss provision to average loans outstanding): provision pour pertes sur prêts / les encours moyen des prêts

- **RWA** : Les Risk-Weighted Assets (RWA/ total assets), ou actifs à risques pondérés ou encore actifs pondérés par le risque par apport au total des actifs, le RWA correspondent au montant minimum de capital requis au sein d'une banque ou d'autres institutions financières en fonction de leur niveau de risque. Ce montant se calcule sur la base d'un pourcentage des actifs, pondérés par le risque.

À chaque actif est assigné un risque pondéré déterminé en fonction du montant du risque attaché. L'idée du RWA est d'éviter de déterminer un montant fixe de capital à détenir, sans distinction et sans modularité. Par exemple, des prêts garantis par une lettre de crédit seront davantage pondérés par le risque qu'un crédit hypothécaire, peu risqué puisque garanti par l'hypothèque. Ce système aide à prévenir les banques de ne pas prendre plus de risques (notamment de crédit) qu'elles ne sont en mesure de supporter. Dans notre modèle et afin de faciliter les calculs on va utiliser le rapport du RWA/ total des actifs.

- **LNTA** : **Natural log of total assets (LNTA)** : LNTA est le logarithme du total actif de la banque et est une mesure de la taille de la banque. Elle peut avoir un effet sur les niveaux visés en raison de la possibilité de diversification de la banque, de la nature de l'ensemble des opportunités d'investissement, des caractéristiques de la propriété ou encore de l'accès aux fonds propres.

- LD (Proportion of loan to deposit ou LTD ratio) : Le loan to deposit ratio est tout simplement la masse des crédits que consent une banque divisée par la masse de ses dépôts. Suivant que le ratio est supérieur à 100% ou pas, elle aura à se refinancer ou non sur le marché.

- EQTA (Equity to Asset ratio): Mesure les capitaux propres en pourcentage du total des actifs. Il offre une protection de pourcentage accordé par les banques pour son investissement dans l'actif. Donc c'est une mesure de la capacité d'absorption des chocs globale d'une banque pour les pertes potentielles des actifs de prêts.

Ce ratio est l'un des nombreux ratios financiers utilisés pour déterminer la santé financière et la rentabilité à long terme d'une société. Il est souvent utilisé par les investisseurs pour déterminer si les actions de la société sont un investissement sûr. Plus ce ratio est élevé plus la banque à la capacité de supporter les pertes d'actifs. Donc le risque de crédit sera diminué.

- EQL (Equity to Net Loan ratio): Mesure les capitaux propres en pourcentage du montant net du total des prêts. Il fournit l'équité comme une protection afin d'absorber les pertes sur prêts. Plus le ratio de EQL est élevé, plus la banque a la capacité à absorber les pertes sur prêts. Ce rapport s'inscrit dans le cadre des ratios de fonds propres et le financement d'une banque, et les mesures de levier financier de l'entreprise en calculant la proportion de fonds propres et de la dette de l'entreprise utilisent pour financer ses actifs.

4.3. Question de recherches et hypothèses:

L'objectif de cette étude est de mesurer l'influence de plusieurs facteurs sur le risque de crédit au sein des institutions financières islamiques et faire une comparaison avec les banques classiques. Enfin faire une analyse de cette comparaison ce qui va nous permettre de déterminer les avantages et les difficultés qui peuvent rencontrer ce type de financement parallèle notamment en matière de gestion du risque de crédit, et aussi les différences et les similarités entre les deux types de financement.

Comme première démarche nous allons étudier l'impacte des différents ratios financiers choisis sur le risque de crédit, après nous procèderons à faire la comparaison de cet impacte entre les banques islamiques et les banque classiques.

Donc, selon la littérature les hypothèses suivants sont à vérifier :

H1 : le risque de crédit a une relation négative avec les variables MGT, LNTA, REGCAP, EQTA et EQL.

H 2 : le risque de crédit a une relation positive avec les variables LLP, RWA et LD,

Et nous allons essayer de répondre aux interrogations suivantes :

I1 : Suite à l'absence de l'intérêt, les banques islamiques prennent-t-elles moins de risque au niveau de leurs crédits ?

I2 : le risque de crédit au sein des banques islamiques, varie-t-il de la même façon au sein des banques classiques

4.4. Le modèle:

Nous allons travailler avec un modèle de régression linéaire multiple et l'équation du model utilisé pour cette étude est la suivante :

CR= (NPLs to total loans)= Le ratio des prêts bancaires non productifs (créances douteuses) par rapport au total brut des prêts

$$\boldsymbol{CR_{it} = \lambda_0 + \lambda_1\, LLPs + \lambda_2\, MGT_{it} + \lambda_3\, REGCAP_{it} + \lambda_4\, RWA_{it} + \lambda_5\, LNTA_{it} + \lambda_6\, LD_{it} + \lambda_7\, EQTA_{it} + \lambda_8\, EQL_{it} + \varepsilon_{i,t}}$$

Avec :

- i: la banque choisi
- t: l'année
- $\lambda_0 \rightarrow \lambda_8$: les paramètres estimés
- **ε**: le terme d'erreur

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Définitions:

- **La Charia :** Le terme « Charia », qui littéralement signifie en arabe « Le chemin à suivre », désigne un système légal basé sur l’éthique musulmane. Ce système fait figure de référence juridique et indique la ligne de conduite dans tous les domaines de la vie des musulmans, y compris le domaine économique. La charia comprend des éléments invariants qui sont les règles canoniques immuables dans le temps et dans l’espace et des éléments variants que les juristes musulmans sont capables d’édicter, selon l’analyse des situations particulières et évolutives.
  Les deux principales sources de la Sharia sont : Le Coran : Le livre saint de l’Islam et La Sounna : le terme englobe l’ensemble des enseignements transmis par le Prophète Mohammed (SAWS) via ses paroles, ses expressions, ses actes, et son approbation tacite.

- **Riba:** tout avantage ou surplus qui sera perçu par l'un des contractants sans aucune contrepartie acceptable et légitime du point de vue du droit musulman, dans le cadre d’un prêt ou d’une vente à terme des monnaies ou d’un troc déséquilibré des produits alimentaires de même nature
- **Moucharaka:** est une association entre deux parties (ou plus) dans le capital d'une entreprise, projet ou opération moyennant une répartition des résultats (pertes ou profits) dans des proportions convenues. Elle est basée sur la moralité du client, la relation de confiance et la rentabilité du projet ou de l'opération. La Moucharaka, telle que pratiquée par les Banques Islamiques nouvelles telle que la nôtre, se présente le plus souvent sous forme d'une contribution au financement de projets ou d'opérations ponctuelles proposés

par la clientèle. Comme dans la Mourabaha, ce financement peut se faire avec ou sans décaissement.

- **Moudaraba:** est une technique de financement utilisée par les banques islamiques. Il s'agit d'un partenariat d'investissement où la banque joue le rôle de l'investisseur (Rab el Mal), en s'engageant à financer intégralement le projet. En contrepartie, l'entrepreneur (Moudarib) doit assurer la gestion du projet. La rémunération est fondée sur une clé de répartition fixée au préalable sous forme de pourcentage de bénéfices de l'entrepreneur. Les pertes éventuelles doivent être supportées par le seul bailleur de capitaux. Le chef d'entreprise renonce à une rémunération variable de son travail.
- **Mourabaha:** La Mourabaha (ou Murabaha) est contrat de vente, entre un vendeur et un acheteur, par lequel ce dernier achète les biens requis par un acheteur et les lui revend à un prix majoré d'une marge clairement et explicitement déterminée. Les bénéfices (marge bénéficiaire) et la période de remboursement (versements échelonnés en général) sont précisés dans un contrat initial. Cela permet à un client d'acquérir un bien sans contracter un emprunt avec intérêt. Et à la différence du système du système conventionnel, le Mourabaha prévoit un double cession, avec un financier propriétaire du bien financé. Les conditions de vente telles que la marge bénéficiaire pour le vendeur ou les détails de remboursement des échéances sont prédéfinies entre les différentes parties.
- **Salam:** peut être défini comme un contrat de vente avec livraison différée de la marchandise. Ainsi, contrairement à la Mourabaha, la Banque n'intervient pas comme vendeur à crédit de la marchandise acquise sur commande de sa relation, mais comme acquéreur, avec paiement comptant d'une marchandise qui lui sera livrée à terme par son partenaire.
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- **Istisna:** c'est un contrat d'entreprise en vertu duquel une partie (MOUSTASNI'I) demande à une autre (SANI'I) de lui fabriquer ou construire un ouvrage moyennant une rémunération payable d'avance, de manière fractionnée ou à terme. Il s'agit d'une variante qui s'apparente au contrat Salam à la différence que l'objet de la transaction porte sur la livraison, non pas de marchandises achetées en l'état, mais de produits finis ayant subi un processus de transformation
- **Quard Hassan:** Prêt de bienveillance que l'on rembourse à l'échéance agréée sans intérêt ni part de profit ou perte dans l'affaire. Disponible de manière limitée et pour des périodes courtes, généralement pour le financement de petites affaires ou pour le soulagement de difficultés personnelles telles qu'un décès, des études …
- **IFSB:** Basée à Kuala Lumpur depuis 2002, l'IFSB est un organisme regroupant des Banques centrales, des autorités monétaires ainsi que diverses organisations actives dans le domaine de la régulation et la supervision des institutions agissant dans la sphère de la finance islamique. L'ISFB a pour rôle de mettre en place un corpus de standards et de bonnes pratiques qui viendraient en complément des règles de surveillance édictées par le Comité de Bâle, les organisations internationales de contrôles des activités de marchés (IOSC) et d'assurance (IAIS).

- **Annexes:**

- Bilan d'une banque islamique:

Banque Conventionnelle	Actif	Banque Islamique
<u>Actif Circulant</u>		<u>Actif circulant</u>
Titres négociables **Prêt standard** **Découverts** **Autres avances**		**Cash** **Investissement** Financement Musharaka Financement Mudaraba **Murabaha interbancaires de CT** **Vente à crédit** Salam Istisna'a Murabaha **Investissement actions, immobiliers**
<u>Actif immobilisé</u> **Participation** **Immeubles**		<u>Actif immobilisé</u> **Participation (musharaka)** **Immeubles** **Diminishing Musharka**
Banque Conventionnelle	**Passif**	**Banque Islamique**
<u>Dette CT</u>		<u>Dette CT</u>
Dépôts **Emprunts et dettes financières diverses**		**Compte courant (Qard Hassan)** **Compte d'investissement (PSIA)** Restreint Non-restreint **Compte d'épargne** **Zakat et impôt anticipé** **Murabaha interbancaire de CT** **Provision (IRR)**
<u>Dette LT</u>		<u>Dette LT / Fonds propres</u>
Capital action **Bénéfice** **Réserves**		**Fonds islamiques** **Capital action** **Bénéfice** **Bénéfice à purifier** **Réserves (PER)**

Source : Sunil K. et Ioannis A, (2008).

Free Services Provided by Saudi Banks to Current Account Holders. Is it Usury?

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Abstract

I have addressed in the paper Islam's emphasis on making all the Muslim's consumable items (food, clothes..etc) good and pure, and the purification of sources of livelihood from suspicions and prohibitions. One of the most important factors which help the Moslem today to achieve this is the rectification of banking transactions according to the principles of Islam. Unfortunately, this aspect did not receive the attention it deserves, neither from government entities nor from civil society organizations.

To promote the role of researchers in bridging this gap, I have selected some of the most common transactions, namely services provided to current account holders. I have selected some, if not all, of those services which are provided by most Islamic banks in Saudi Arabia, and subjected them to observation and scrutiny. I have concluded that some of the services under study are prohibited, such as waiver of certain charges, while others involve a high degree of suspicion, which may even amount to prohibition, such as the free issue of ATM cards and cheque books.

In the conclusion, I have recommended the issue of certain provisions which allow the Saudi Arabian Monetary Agency (SAMA) to regulate *Shari'a* compliance of the activities of Islamic banks in Saudi Arabia, and urged volunteer organizations to establish an independent entity to conduct *Shari'a* reviews of the activities of Islamic banks.

Introduction

Islam commands that the food is made good and pure, and made that as a condition for the acceptance of the prayers that Muslims made to Allah, as stated in the Hadith narrated by Abu Huraira. He said: The Messenger of Allah (PBUH) said: "O People, Allah is good and pure, He only accepts what is good and pure. Allah commanded the believers as He commanded the messengers, for He said: {O Messengers, eat from the good foods and work righteousness. Indeed I, of what you do, am Knowing} [*Al-Mu'minoon: 51*], and He said: {O you who have believed, eat from the good things which We have provided for you} [*Al-Baqarah: 172*]; he then mentioned the man who travels extensively, shaggy and untidy, extending his hands to the heavens and calling unto God, O' Allah, O' Allah, but his food is ill-gotten, his drink is ill-gotten, his clothes are ill-gotten, and he is nourished with ill-gotten food, how can the call of such a man be answered?"[4]

People nowadays can hardly do without banking transactions. Some laws and regulations are now tending to make financial transactions through banks obligatory, either for economic reasons with the aim of holding funds as much as possible within financial institutions, or for security reasons because "Cash funds are the optimal and most common way in carrying out criminal activities, including money laundering and financing of terrorism, because they simply come from unknown and untraceable sources, and carrying out those transactions does not require any mediator".[5]

Islamic banks have presented themselves as an aid to the Moslem individual to achieve his objective to make his food good and pure, and provided him with contracts and services which they claim are *Shari'a* compliant. They based the integrity of their transactions on approvals by their respective *Shari'a* boards. The *Shari'a* board at each bank reviews every contract or action and approves what it finds to be valid and acceptable from a *Shari'a* point of view, and rejects or amends what it finds to be invalid or non-compliant. Although the efforts of these boards are appreciated and commended, their affiliations with banks and the obvious conflict of interest in their decisions, as they are nominated by the Board of the bank and funded out of the bank's budget, undermine their credibility and weaken reliance on their decisions.

In seeking a neutral regulator or supervisor, one can only find the Saudi Arabian Monetary Agency (SAMA). One of SAMA's objectives as stipulated in Article 1 of its Charter is "To regulate commercial banks and exchange dealers, and to issue instructions to them when required."[6] This regulation unfortunately is confined to the professional banking aspect, and does not cover the *Shari'a* aspect. That is to say, SAMA approves transactions which are compliant with regulations from a banking point of

[4] **Abdul Baqi, Mohammed Fouad.** "Sahih Moslem." Dar Iyha' Al-Turath Al-Arabi. 2/703.
[5] **Anti-Money Laundering and Counter-Terrorism Financing Rules.** 46.
[6] **Charter of the Saudi Arabian Monetary Agency.**

view, even if they involve a *Shari'a* violation, since there are no provisions on Islamic banks in relevant regulations[7].

With the absence of a neutral regulator, as aforementioned, it was necessary for researchers and independent scientific organizations to intervene to mend this discrepancy and bridge this gap with serious research and unbiased serious studies which show aspects of discrepancy – if any – and present remedial proposals and legitimate alternatives for contracts which are found to be prohibited under *Shari'a.* On that basis, this brief research was prepared as a humble effort and modest contribution in this respect.

The Current Account and its Adaptation

Definition and Characteristics of the Current Account

The current account is one of the most important and widespread contracts between the bank and its clients. Although it has been long known in the banking law, it cannot be analyzed, and its provisions cannot be addressed, from a *Shari'a* point of view unless this contract is adapted to *Shari'a*, and subject to its compliance as a contract defined in Islamic jurisprudence.

The Legal Definition of the Current Account

The current account was defined by Dr. Ali Jamaluddin Awad as: "An amount of money placed by individuals or institutions in the bank, on condition that the bank undertakes to return it or a sum equal to it to those individuals or institutions or to any other named person upon demand, or subject to conditions as agreed"[8].

Jurisprudence Definition of the "Deposit" Contract

"The deposit is the money placed with others for safekeeping". The *Hanbali* Sect added "without compensation"[9].

Jurisprudence Definition of the "Loan" Contract

"The loan is the payment of money to a person to benefit from it, and to be repaid"[10].

The Islamic Jurisprudence Adaptation of the Current Account

When considering the foregoing definitions, and upon review of current account opening agreements entered into between banks and their clients, we find that this contract is in general, a loan contract, whereby the client provides a sum of money to the bank to be repaid at a later time. Although some specialists have adapted it as a deposit contract, this adaptation is however warded off and opposed with two objections as follows:

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[7] See for example: **Palestinian Banking Law of 2002,** which contains articles to regulate Islamic banks in Palestine.
[8] **Banking Transactions from a Legal Prospective.** 35.
[9] **Kuwaiti Jurisprudence Encyclopedia.** 43/5.
[10] **Al-rawdh Al-Murabba'.** 361.

- Firstly – The borrower may use the loan as he deems fit without the permission of the lender. This is why the definition says "repaid" by other funds, and not "returned" using the same funds. In the deposit however, the depositee may not use the money except with the permission of the depositor[11]. When considering the foregoing definition of the current account, we find that it corresponds to the definition of the loan, in that the bank has the option of either returning the same funds or repaying by other funds. This demonstrates that the bank has the right to use the funds deposited in the current account without the permission of the client.

- Secondly – The bank is obliged to pay a sum equal to the sum deposited by the client irrespective of what happens to the bank or to the funds received from clients. For example: if the bank is robbed, or if its safe is burnt, such events do not affect the client's right to receive his funds, without consideration of the causes of loss of the funds, and without any differentiation between the loss resulting from the bank's negligence, breach or otherwise.

When considering the loan and deposit contracts, we find that the loan contract satisfies this definition in the current account agreement. The borrower is obliged to return the funds in all circumstances, while in the case of the deposit, the depositee is not obliged to replace the deposit if destroyed, if such loss is not a result of negligence or breach on the depositee's part[12].

Does the affluent borrow from the less affluent?

Some may say that it is logical and reasonable that the person who has a higher net worth is the lender, and the person who has a lower net worth is the borrower. However, based on the foregoing adaptation of the current account, the bank, which has a higher net worth, borrows from the client. This is incomprehensible. The answer to that is that it is customary and acceptable. As the scholars of Fundamentals of *Fiqh* say, the occurrence is evidence of possiblity. Al-Zubair bin Al-Awam (may Allah be pleased with him), was rich. People used to come to him with funds to deposit, and he would say: "No, it is a loan, for I fear it may be lost"[13]. Clients are less affluent than the bank as individuals. However, when considering the total sums deposited by clients, they are much larger than the bank's funds. Moreover, most of the bank's funds take the form of client deposits.

"Every Loan Yielding Benefit is Usury"

This expression is widely known when studying benefits related to loans and concluding relevant rulings. Following is a brief overview of the most significant aspects related to this expression.

Is it Valid as a Hadith?

Dia' Al-Mouselli said: "There is not valid Hadith narrated quoting the Prophet (PBUH) on this"[14]. Al-Hafiz Ibn Hajar said: "It was narrated in a book by Al-Harith bin Abi Osama, but the chain of narrators

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[11] **Usuray in Banking Transactions.** 246
[12] **Al-Shirazi.** Al-Muhathab. 1/395.
[13] **Narrated by Al-Bukhari.** 4/87. Hadith No. 3129.
[14] **Al-Moghni a'an Al-Hifth wal Kitab.** 2/403.

includes Siwar bin Mosaab, who is unauthentic"[15]. Al-Imam Al-Ajlouni said: "Its chain of narrators is not valid"[16].

The Ummah Embraced It

Although the expression "Every loan yielding benefit is usury", is not proven to be a valid Hadith of the Prophet (PBUH), as aforementioned, scholars have unanimously agreed to its meaning that every loan which involves an added benefit condition or collusion to add benefit, is usury[17]. Jurisprudence books continue to cite this rule as evidence of the prohibition of this added benefit or other benefits, as they relate to loan contract.

Is Every Benefit Prohibited?

The expression is general, as it starts with "every" denoting generalization. The absolute expression states that any benefit arising from the loan is a prohibited benefit. However, none of the scholars have stated this. Benefit is prohibited if made conditional and to the sole benefit of the lender, or joint between the lender and the borrower but the lender receives greater benefit as compared to the benefit of the borrower.[18]

Following this theoretical introduction which is essential for addressing this issue, we now proceed to address some of the services or benefits provided by Saudi banks to current account holders, and weigh them on a scale of *Shari'a* to ascertain their compliance or non-compliance.

Automated Teller Machine (ATM) Card and Cheque Book

Is it conditioned?

Bank clients holders of current accounts are entitled to receive an ATM card and a cheque book, in accordance with the account opening instructions issued by SAMA in its capacity as the regulator of banks, as well as in accordance with the ATM card application and cheque book application, which form part of the documents required to open a bank account with Saudi banks[19]. Moreover SAMA has recently issued a circular on the tariff of banking services charges which banks are entitled to receive from clients, stipulating that the bank shall issue the client's ATM card at the time of account opening, and shall renew the ATM card, free of charge. It also stipulated that the bank shall provide a free cheque book (25 cheques)[20]. Therefore, it is clear that the card and cheque book benefits are imposed as conditions upon the bank, and the bank must provide them free of charge, by law and contract.

Nature of Benefit to Both Parties

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[15] **Al-Talkhees Al-Habeer**. 3/90.
[16] **Kashf Al-Khafa.** 2/148.
[17] **Majmoo Fatawa Al-Shaikh Abdul-Aziz bin Baz** (Allah have mercy on him)**.** 19/249.
[18] **Benefit of the Laon.** 411.
[19] **Rules for Opening and Operating Bank Accounts.** 33.
[20] **Saudi Arabian Monetary Agency.** Circular on Banking Tariff. Circular No. 341000134319 dated 25.11.1434H.

Contemporary scholars differ in the Islamic ruling on this benefit, where some see it permissible[21], and other believe it is less favorable (*Makrooh*)[22]. However, what is evident from their writings is that they all agree that the bank benefits from the provisions of these services. This perspective is an essential pillar on which they base their decision not to consider this benefit prohibited.

When considering this claim (the bank benefits from the free of charge issue of cards and cheque books to clients), we find that it is not a foregone conclusion, and is not free from objections which I believe are sufficient to at least warrant reconsideration. This includes:

- All those who have decided that the bank benefits from the free of charge issue of cards and cheques are *Shari'a* scholars. I did not find in their statements any reference to any financial or accounting studies. It is known that judging something stems from its perception. In order to reach a *Shari'a* ruling based on accounting information, specialists should study this matter and decide on the part related to their field of specialty, such that the *Shari'a* ruling reached is realistic.

- Even if we assume that there was a study by a bank based on which its *Shari'a* Board had built its ruling to accept the provision of this service, other banks may not build upon that study because of differing circumstances and conditions which may make the bank benefit and therefore may provide them, or not benefit and therefore should be prohibited from providing them free of charge. This is taking into consideration that – as aforementioned – what is applied is theoretical studies conducted by all, but not supported by any study and analysis of data and figures.

- All banks - before the issue of the aforementioned Banking Tariff Circular-differentiated in treatment between small and big clients, and would ask depositors of small funds to pay fees for such services, while providing them free of charge to holders of high balances. If, as they claimed, the bank benefits from their issue, logic dictates that they issue them free of charge to all clients. However, the differentiation in treatment between clients is clear evidence that this benefit arises from the loan and is intended to attract client funds.

Waiver of Certain Charges (Issue of Remittances, Printing of Statement of Account, etc.)

Some banks waive charges from some services to a certain category of clients, or provide it to them at a lower rate. This is usually linked to the size of the client's balance with the bank. The higher the balance, the lower, or total waiver of, the service charges.

Is it conditioned?

Usually, there is no express condition in the account opening agreement to grant such service charge waivers. This however does not mean a breach of one of the conditions of the prohibited benefit – that is this benefit is stipulated as a condition in the contract – and therefore this service may be provided to current account holders free of charge, for the following reasons:

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[21] See for example: **Al-Qari, Dr. Mohamed.** Bank Accounts and Deposits. See also **Al-Rajhi Bank Shari'a Board Ruling** No. 345 dated 24.7.1420H.

[22] See for example: **Transformation of the Usury Bank into an Islamic Bank**. 1/200.

- Firstly – It is known that contracts and conditions do not require as evidence to be written in the contract and signed by both parties. They may be proven in any manner and by any means which show their existence or occurrence. In our subject, marketing offers aimed at attracting clients focus on such benefits and promise them to the client.

- Secondly – Scholars have agreed on a rule which states "what is commonly practiced has equal weight to what is stipulated as a condition"[23]. If what is common practice is evidenced by simple recurrence, this should also be applied to banking transactions. When a client applies for opening an account, he sees before him thousands of other clients who were granted those benefits in a regular and continuing behavior which had not made a single exception. It is also known that such services are not performed manually, but through an electronic system used by the bank and programmed to grant those services to the client, either automatically upon account opening, or when the client's balance or average balance of account reaches a certain amount.

- Thirdly – Even if we accept that this benefit is unconditional, it cannot be free from objections. What is most evident from the statements of scholars is the prohibition of unconditional benefits if such benefits are provided before the obligation is fulfilled, unless the benefits are not for, or in compensation for the loan[24], as stipulated by the *Malki* Sect[25] and the *Hanbali* Sect[26]. It was also stated by some of the Companions, such as Ibn Abass and Abdullah bin Sallam, (Allah be pleased with them)[27]. Some of the evidence to this is the Hadith narrated by Anas bin Malik (Allah be pleased with him), he said: The Messenger of Allah (PBUH) said: (If one of you grants a loan, and is offered by the borrower a present or a ride, he must not take the ride or accept the present, unless it was customary for him to receive them from the borrower before the loan was granted)[28]. In the matter at hand, the provision of the benefit from the bank was solely for the purpose of the loan, and hence is considered a prohibited benefit.

Nature of Benefit to Both Parties

If the discussion of the subject of the ATM card and cheque book were on whether the bank benefits from such services, the services under review here obviously do not realize any material benefit to the bank. If the bank's goal was not to attract and hold client funds, it would not have provided such services.

Recommendations

- To establish a Shari'a banking Board at the government's level, or an integrated Shari'a Board independent of Islamic banks to achieve a higher degree of regulation and control over compliance with Shari'a principles in Islamic banking transactions.

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[23] See the explanation of the rule: **Al-Ashbah wal Natha'ir.** 1/84.
[24] As in the case where the lender and the borrower had previously exchanged gifts, or were related by blood or marriage, in which case a present is made not for the sake of the loan.
[25] **Mawahib Al-Jaleel.** 6/529.
[26] **Al-Moghni.** 6/437.
[27] **Ibn Hazm.** Al-Muhalla. 8/86.
[28] **Sunan Ibn Majah.** 2/61. **Al-Baihaqi.** Al-Sunan Al-Kubra. 5/350.

- To involve financial, accounting and legal professionals in the study of Shari'a banking subjects, as it is known that judging something stems from its perception. Total perception dictates that the subject must be studied by experts in all related fields before a *Shari'a* ruling is rendered.

- To encourage scientific research in these subjects, and to organize dedicated conferences attended by experts to deliberate this subject.

With these recommendations, we reach the objective of this paper, thanks to Allah. Allah is more Knowing, and Peace and Blessing Upon Prophet Mohammed, his Family and all of his Companions.

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Islamic Economics & Islamic Finance: Confusion Concepts

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It is very important to emphasize on main concepts of the subject before proceedings for exploration and analysis. Islamic Economics as a field of study suffers in my opinion from the lack of conceptual foundation resulted from the translation from Arabic to other languages worldwide. Islamic Economics derives its principles from the holy Quran, the Sunnah; Prophet Mohamed's words; and the Ejtihad; primitive recognized Muslim scholars' diligence. Accordingly the whole literature that builds the foundation of Islamic Economics have been derived from Arabic sources. I have realized that some English translations of the main concepts of Islamic Economics don't give the same meaning as it's in Arabic which can create confusion in understanding those main concepts. Moreover; many concepts are pronounced completely wrong and the problem here is that the wrong pronunciation of those concepts became as they are the original utterance. It is also important to know that the diligence schools in Islam have some differences in interpretations and intuitive approaches that affected the methodology of scientific papers Islamic economists adopt.

On the other hand; the term of "Islamic Economics" is a very controversial terminology because embedding a divine religion's principles into external scientific framework may lead to adopting surrealistic methodologies by scholars to avoid debatable arguments. Economics is science and all its theories are subject to the proof. Yet; creeds' theories are taken as beliefs and they are not subject to the test hence we cannot describe their abstracts as scientific ones. This can give an explanation of why some scholars of Islamic Economics – if we can use this term "Islamic Economics" as a conventional term – utilize Islamic transactions' principles as external ethical variables and embed them in existing framework of the existing literature. This type of manipulation in the adopted methodology cannot provide new implications to the existing economic literature because ethical variables have been already addressed throughout the humanitarian history in general and they were the premise of the whole classical economic theories. Other scholars of Islamic Economics are more practical and they try to address instead Islamic principles of financial transactions as regulations and rules must be adopted by Muslims. Therefore; they may use the term of 'Islamic Economics" or "Islamic Finance" as a mere expression to "Islam's principles of financial transactions". Those principles have been extracted from the holy Quran, the Sunnah, and the Ejtehad as mentioned above. The main rule that classifies the Islamic transactions from other conventional transactions is the rule of "Halal" and "Haram"; the "good" and the "bad". The good is good because God said it is good and the bad is bad because God said it is bad so in the foreground it's all God's word. Hence; nothing should be described as "Islamic Economics" because divine principles are not subject to the "scientific controversies" – We may call it "Muslims' economy" or "Muslims' economic life". However; we may use the term "Islamic Economics" as a conventional term as a simple classification to an economic system from the Islamic perspectives.

I also realized that some information regarding the history of Islamic economics and Islamic finance in some recent literatures are not accurate and I believe that this resulted from the lack of the mastery of the Arabic language by many scholars who attain their knowledge from translated versions where errors in translations were accumulated over the history. Regulations of financial transactions had been set by Prophet Muhammad himself since his migration with his followers from Mecca to Al-Madina the city. In Al- Madina the first Islamic bank has been established in addition to a comprehensive insurance system that aimed to maximize the social welfare of its people.

Nowadays some serious attempts are taken worldwide to organize, expurgate, and band together that literature by recognized international institutions mostly financed by Saudi Arabia, Bahrain, Qatar, and United Arab Emirates where they found United Kingdom a friendly haven for their adventures followed by USA.

Because Islamic transactions worth trillions of dollars in the present day the world is racing in its investment. Islamic stocks and Islamic bonds are traded internationally in almost all international financial markets and fundamental movements that counter the invasion of the Islamic transactions in international financial markets are tailing beside the lure of money.

"The religion may make money but the money has no religion."

Ghada Mohamed

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