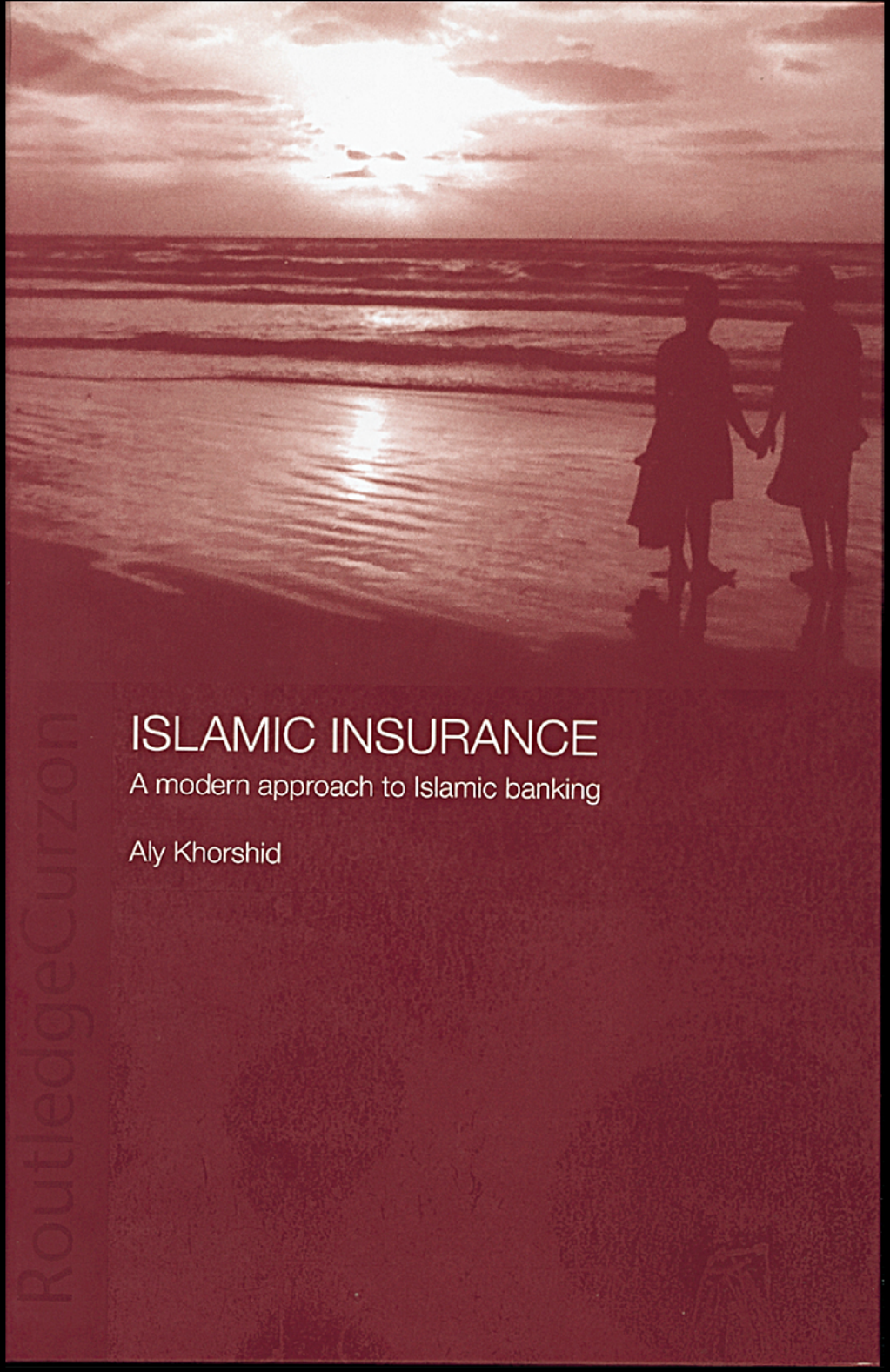

ISLAMIC INSURANCE

A modern approach to Islamic banking

Aly Khorshid

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ISLAMIC INSURANCE

Some Muslims believe insurance is unnecessary, as society should help its victims. 'Insurance', however, need not be a commercial venture. In its purest sense, it is assistance with the adverse effects of inevitable afflictions, an arrangement beneficial to all. Schemes to ensure the livelihoods of traders and communities have been in existence for millennia. Commercial insurance, on the other hand, was invented ostensibly for the same ends but with the chief beneficiaries being the shareholders and directors. Among the countless revelations Islam passed on, two prohibitions, namely *riba* (usury) and *gharar* (risk), have been used by legislators as grounds for the prohibition of insurance. Islam is not against making money, and there is no inherent conflict between the material and the spiritual. Islamic law allows *ijtehad* (initiative) to the benefit of the people as long as there is no harm to other people. Muslims can no longer ignore the fact that they live, trade and communicate with open global systems, and they can no longer ignore the need for banking and insurance. There is no prohibition in Islamic law against banking or insurance, similarly, Muslims can create insurance schemes that use their faith as the immutable basis for a working model.

Aly Khorshid demonstrates how initial clerical apprehensions were overcome to create pioneering Muslim-friendly banking systems, and applies the lessons learnt to a workable insurance framework by which Muslims can compete with non-Muslims in business and have cover in daily life. The book uses relevant Quranic and *Sunna* extracts, and the arguments of pro- and anti-insurance *jurists* to arrive at its conclusion that Muslims can enjoy the peace of mind and equity of an Islamic insurance scheme.

Aly Khorshid, born in Egypt, received his PhD from the University of Leeds in 2001. He is a researcher in Islamic economics, and a consultant to Islamic banks and Islamic institutions in both the Middle East and Europe. Besides being a company director, he is also on the board of management of several companies. Dr Khorshid has published various articles on Islamic economics.

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To my late parents
who would have been pleased
to see this book published
and to my wife Noha, and my children

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INTRODUCTION

What is it about insurance that is so divisive and emotive to modern Muslims? Is it not that Islam is a religion based on peaceful coexistence with fellow man, with the maintenance of stable and constructive societies? This second question is perhaps the most germane; the answer is yes, Islam is a society that cares for its most unfortunate members, the result of which is a community that can thrive, free from crime, bitterness and sorrow. And if this is the case, if communities and nations pull together to assist those most in need, there is a distribution of wealth and resources unrestricted by a nadir of charitability. The gains of the rich and comfortable, be they from skill or fortune, will help the poor with their losses, be they foolish or calamitous. Under a system such as this, why bother getting personal insurance?

There is another reason why insurance is frowned upon and outlawed in Islamic States and among Islamic communities: interpretation of many Quranic edicts brings the conclusion that insurance is not only unnecessary but highly unlawful Islamically. Chief among these are the outlawing of *riba* (usury) and *gharar* (risk). The lending of money at high rates of interest, or the payment of money for nothing are both linked with commercial insurance and contribute to its proscription. *Riba* is considered extremely anti-Islamic, and references to it pepper the Quran, each mention adding to its significance. Insurance is a risk. People in the West willingly pay money to insurance companies in order to buy peace of mind, with no guarantee of return. In one sense, never having to make a claim is a good thing as it suggests mishaps or tragedies have been avoided. In another, this means that the insurance company has literally been given the money, and the insured is out of pocket. Even the most generous no-claims bonus will not square this circle. To the Muslim, things that happen on earth are the will of God, and so to insure against them could be construed as questioning his actions.

Insurance is, however, something that the Muslim participates in five times a day; what is prayer if not a form of insurance premium in the hope of a divine dividend at the end of life? Faith itself is insurance, and the Quran states many examples of how worldly insurance is as sensible and as beneficial to community as is faith. This book methodically explores many of these

examples, and the conclusion that insurance is intrinsically bad begins to look unfounded.

An additional reason for Islamic proscription is that insurance companies can (indeed, need to) accumulate vast sums of money, much of which is invested. To be suitable for a Muslim to be the insurance company's customer, these investments must not be involved with forbidden aspects of Islamic life: things like pork and alcohol. Few insurance companies can give this assurance.

If the history of insurance is taken as a whole, commercial insurance is a relatively recent invention. This book details several historical insurance schemes where no money changes hands and several where it does. It is concluded that insurance, when applied Islamically and equitably, need not invoke anathema among Muslims, and can be used to the greater good of the community. Mutual insurance and Social Security systems are looked into to provide a basis on which a model can be founded.

Similar apprehensions have been experienced by Islamic States and organizations attempting to create Western-style banking systems for government and the populace. Two case studies – those of the Malaysian *Takaful* Act and Saudi Arabian systems – are used to demonstrate ways in which Islam and finance can, by focused and careful readings of *Sunna* and application of business sense, combine to create a system that is as acceptable to Muslims as it is to the financial world. Assurances that the bank does not partake in any transactions or decisions that would contravene the requirements of a truly Islamic life are given to investors, who can go on to benefit from a stable banking system safe in the knowledge that they are not infringing their devotion to God by proxy. While this book does not pretend that banking and insurance are one and the same, the two industries have undeniable parallels and banking can provide insurance with precedents. First, the physicality of the structures of the institutions is in many ways similar, and there are similarities between interest payments and overdraft charges and dividends and premiums. Second, the example of the *Takaful* Act in particular demonstrates how a desired end can be reached by inclusive intellectual, clerical and financial discussion with the beneficiaries being the general public and, therefore, community, nation and faith.

The fact that there is no mention of what we today would call insurance in the Quran is used as sufficient evidence that it is fundamentally wrong. Considering that the Quran is over a thousand years old, it is little wonder that there is no mention. There is also no mention of computers, aircraft or steam trains, but their introduction can largely be described as beneficial. Supporters of insurance consider the way in which insurance was introduced to the Islamic world (by Christian traders and sailors) and the timing of it (at a time of mutual mistrust between the two worlds) to be the sparks of the anti-insurance blaze, rather than any inherent wrong in an Islamically-designed and wholly beneficial system. Often, the result of the debate is conceived before Quranic interpretation is used to justify it – and interpretation can provide powerful arguments both ways when used by influential parties.

This book describes the Western approach to insurance in some detail. If nothing else it shows what a complex business insurance is, and will ensure that anyone attempting to formulate an Islamic insurance system takes a deep breath and is fully informed before embarking on a journey that will have to deal with prohibitions, legislation and financial perplexities. But at its heart, this description shows in no uncertain terms that problems and opposing interests can be overcome by time, conciliation, openmindedness and intellectual and governmental application.

Eventually, we must conclude that insurance is as natural a part of today's financial and societal framework as are banking and transportation, and that any individual, nation or religion that refuses to use it is at an immediate disadvantage, and the gulf between the Islamic and non-Islamic worlds can only widen. Islam is not anti-business – indeed, its Prophet Mohammed was himself a businessman of repute – so the principles of a fair system must be in place in order to thrive. By blocking a mechanism that allows business to experiment and cover losses, the world of Islam will ever be at a disadvantage – and there are many *jurists* who agree. Insurance does not have to contradict a single law of the Quran – these laws are unbreakable – but by careful consideration and cooperation, insurance can become a part of the Muslim's life.

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1

THE MEANING OF INSURANCE IN ISLAM

Introduction

To Muslims, Islam is a complete way of life that endeavours to construct the entire fabric of human life and culture in the light of values and principles revealed by God for man's guidance. The basis of Islamic belief is included below as a guide to readers unfamiliar with the details of the religion. In essence, Islam revolves around Mohammed's Revelation of the word of God, Allah, and a Muslim must adhere to His teachings, which are covered by the 'Five Pillars' of Islam.

The world of early medieval times, when Islam was young and starting its spread, was of course a very different place than the world of today or, indeed, of any period in the interim. Like any revealed faith, it has had to reinterpret – and then justify or forbid – trappings of an ever-changing human environment (the discoveries of lands hitherto unknown to adherents, new inventions, scientific discoveries, changing mercantile and financial methods, the migration and merging of civilizations and peoples, to name but a few). It was up to *Imams*, scholars and clerics to debate and decide whether an innovation or discovery could be circumscribed by Islamic teachings; their weighty opinions were and are hard to contradict, versed as they are in the technicalities and implied messages behind every passage of the Quran, just as a solicitor's knowledge of the minutiae of a legal Act is essential in fighting a legal case. In banking and insurance schemes that were benefiting Western traders and businesses, many of the scholars saw contradictions with Quranic teaching should their application spread to Muslim lands. The second part of this chapter explores Islamically legitimate banking as an example of how careful and fastidious interpretation, not the mere search for loopholes, can find practicable and beneficial solutions.

Islamic revelation

Just as Christianity is an updated version of Judaism, Islam is a more modern interpretation of Christianity. The three major religions of the world share many common points but jar on many others, the fundamental areas of disagreement

being the veracity of the two Prophets, Jesus Christ and Mohammed; Jews believe in the revelations of neither and Christians dismiss Mohammed's teachings. Muslims see the rapid spread of Islamic teaching and faith as proof that Mohammed's word is indeed the teaching of Allah himself, but since belief in revelation often has more to do with the personality and the miraculous deeds of its bearer than the truth in the teachings themselves, the Christian and pagan world of contemporaneous Europe checked Islam's growth, limiting its footholds to what are now Spain, Turkey and the Balkans. Its rise throughout the Middle East was, however, unstoppable, and European crusaders found anti-Islamic propaganda a sharper sword in the battle to retain power bases and sustain Christianity. This resulted in a deep-rooted scepticism of Islam in Europe that, despite starting to erode thanks to the works of non-Muslim scholars in the nineteenth and twentieth century, is still very strong.

The most absurd myths that historians have ever repeated are the legends of fanatical Muslims sweeping through the world and forcing Islam upon conquered races at the point of the sword. This contradicts the sense of justice that is one of the most wonderful ideals of Islam (DeLacy: (n.d.:8). As Naidu (n.d.:167) states, 'A sense of justice is one of the most wonderful ideals of Islam, because as I read in the Quran, I find these dynamic principles of life not mystical, but practical, ethics for the daily conduct of life suited to the whole world.'

But Islam has a still further service to render to the cause of humanity. It stands, after all, nearer to the real East than Europe does and it possesses a magnificent tradition of inter-racial understanding and cooperation. No other society has such a record of success in uniting in an equality of status, of opportunity, and of endeavours, so many and so various races of mankind. Islam still has the power to reconcile apparently irreconcilable elements of race and tradition. If ever the opposition of the great societies of East and West is to be replaced by cooperation, the mediation of Islam is an indispensable condition. In its hands lies the solution to the problems that Europe faces in its relations with the East. If they work together the hope of a peaceful issue is immeasurably enhanced. But if Europe, by rejecting the cooperation of Islam, throws it into the arms of its rivals, the outcome can only be disastrous for both (Gibb: 379).

Many Muslim economists believe that a re-orientation of this approach and a reconstruction of the entire framework of economic analysis and policy are needed if Muslims are not to be disadvantaged.

The Muslim economist starts from the assumption that economics neither is, nor can be, totally value-free; nor is it totally value-neutral. What is important is that this is hardly a desirable state of affairs.

By studying the way Islamic banking has overcome the restrictions placed upon it by the religion, restrictions that limit investors as much as the banks themselves, we can recognize ways in which insurance can become legitimized while remaining within a strict Islamic framework.

The concept of God in Islam

Every language in the world has one or more words to refer to God and to other lesser deities. Muslims maintain that Allah is the sacred and unique name of the one true God. The term has no plural or gender, in contrast to 'gods', or 'goddesses' of other religions. It is interesting to note that Allah is the personal name of God in Aramaic ('A branch of the Semitic group of languages spoken in parts of Syria and the Lebanon' (*Chambers Twentieth Century Dictionary*)), the language spoken by the ancient Jews and Jesus, and the sister language of Arabic.

To a Muslim, Allah is the Almighty, the Creator and the sustainer of the universe, with whom nothing can compare. The essential monotheism of Islam is summed up by a famous passage from the Quran:

> In the name of God, the Merciful, the Compassionate. Say (O Mohammed) He is God the One God, the everlasting refuge, who has not begotten, nor has been begotten, and equal to Him is not anyone.
>
> (112:1–4)

This passage introduces the idea of refuge, which earthly insurance caters for but is here provided forever by God.

God's attributes

According to Islam, if the Creator is eternal and everlasting, then it follows that his attributes must also be eternal and everlasting. God can neither lose any of these qualities nor acquire new ones. According to the Quran:

> God has not taken to Himself any son, nor is there any god with Him: for then each god would have taken off that which he created and some of them would have risen up over others. And why, were their gods in earth and heaven other than God, they (heaven and earth) would surely go to ruin.
>
> (23:91)

In Islam, as in other monotheistic religions, the concept of God is constantly equated with his oneness. There are innumerable Quranic verses that attest to this attribute, refuting the existence of other gods as false, for example:

> For ye do worship idols besides God and ye invent falsehood. The things that ye worship besides God have no power to give you sustenance; then seek ye sustenance from God, serve Him and be grateful to Him: to Him will be your return.
>
> (29:17)

The Prophet

The inspired man who founded Islam was born about AD 570 into an idol-worshipping Arabian tribe, the *Quraysh*. Mohammed's father died before Mohammed was born and, because he was orphaned at birth, he was always particularly sympathetic towards the poor, the widowed and the orphaned, as well as to slaves and downtrodden people. By his twentieth birthday Mohammed was already a successful businessman and became a director of camel caravans for a wealthy widow (Khadija). When he reached the age of 25 his employer, recognizing Mohammed's merit, proposed marriage. Despite her older years, he married her, and remained a devoted husband as long as she lived (Rahman 1981: 21). At Mohammed's own death, an attempt was made to deify him by some hysterical Arabs who thought that worshipping Mohammed was worshipping God, but the man who succeeded him (Abu Baker) resisted the hysteria, claiming the eternity of Allah.

Prophethood is not unknown among revealed religions, but in Islam it has a special status and significance. According to Islam, Allah created man for a noble purpose – to worship Him and lead a virtuous life based on His teachings and guidance. The Prophet was there to let humans know the role and purpose of their existence through clear and practical instructions from Allah. The Quran states that Allah has chosen from every nation a Prophet to convey the message to the people:

> We send not a messenger except [to teach] in the language of his [own] people, in order to [make] things clear to them. So Allah leads astray those whom he pleases and he is exalted in power, full of wisdom.
>
> (14:4)

The Prophet is the best in his community, morally and intellectually. This is fundamental, as a Prophet's life serves as a model for his followers. His personality should attract followers to his message rather than driving them away by an imperfect character. Once he has received the message he is infallible. Minor mistakes are usually corrected by further revelation (Iqbal 1987: 583).

The content of the Islamic Prophet's message to mankind not only defines a clear concept of God and His attributes, the Creation, the unseen world, Paradise and Hell but also God's purpose for human beings, the rewards for obedience and punishments for disobedience. Furthermore it lays out how to organize society according to God's will – clear instructions and laws that, when justly applied, will result in a happy and ideal society (Rahman 1981: 22).

The role of the Quran

Islam asserts that humanity has received divine guidance through only two channels: first, the word of Allah and, second, the Prophets who were chosen by

Allah to communicate his will to human beings. These two concepts of God and Prophet go hand in hand and any attempt to understand one without the other is doomed to failure (Amin 1985: 22).

In the tradition of major monotheistic world religions, Islam is unique in that its scripture, i.e. the Quran, was revealed during the lifetime of its last Prophet, Mohammed. The Prophet himself was also responsible for its revelation, a divine manifestation, and after his death the task of compiling and preserving the Quran fell to the companions of the Prophet and, later, the Caliphs. The preservation and maintenance of the original manuscript (*Hafiza*) is well documented. Eventually, once copies were made, the holy work left Arabia to have a huge impact on what were to become Muslim territories beyond Arabia (Al-Sharawi 1988: 109).

Muslims believe that, as the last revealed book of God, the Quran was preserved, as it was to become the book of guidance for all humanity. As evidence of this they point to the universality of its address in that it speaks to all mankind: 'O Man! What has seduced you from the Lord?' (4:1), and:

> O Mankind! Fear your Guardian Lord who created you from a single person, created out of it his mate and from them twain scattered like seeds, countless men and women.
>
> (4:1)

The concept of worship in Islam

The concept of worship in Islam is commonly held to mean performing ritualistic acts such as prayer, fasting and charity. This somewhat limited concept of worship is only a small part of its significance in Islam. The traditional definition of worship in Islam is a comprehensive one that includes almost everything in an individual's daily activities. Everything, in fact, that one says or does to please Allah (Al-Sharawi 1988: 2:128).

Islam looks at the individual as a whole. He or she is required to submit completely to Allah, as the Quran instructed God's prophet Mohammed:

> Say [O Mohammed] my prayer, my sacrifice, my life and my death belong to Allah; He has no partner and I am ordered to be among those who submit [i.e. Muslims].
>
> (6:162)

The natural outcome of such submission is that all aspects of life are organized according to the instruction of God. Islam, as a way of life, requires that its followers model their life according to its teachings in every aspect, religious or otherwise.

It is worth emphasizing that even performing one's social duties and responsibilities is considered a form of worship. The Prophet deemed that acts

done for the benefit of the family are considered acts of charity. Familial duties such as feeding and clothing members of one's family and kin also constitute worship. Even enjoyable, pleasurable activities, providing they are performed according to the instructions of the Prophet, are considered acts of worship. The key here would appear to be conforming to Islamic norms. If an activity conforms to the guidelines laid down by God through his Prophet, all actions related to its performance can be considered to be worship.[1]

Although the non-ritual aspects of worship are many, and embrace all aspects of life, this should not detract from the importance of ritual worship. Such acts, if performed in true spirit, elevate people morally and spiritually, enabling them to carry on their daily activities according to the guidance of God. The ritual aspects of worship are referred to as the Five Pillars of Islam.

The five Pillars of Islam

Islamic faith is built on five 'Pillars'. The irreducible Pillar is a state of faith, a belief in the oneness of Allah. Branching from this belief (which is volitional and could be described as an action) are four other activities of faith, each of which is a vital part of Islam. The ritualistic Pillars are well known to the non-Muslim world, the frequency of their being carried out ranging from daily to at least once in a lifetime. Their respective relevance to insurance will become clearer; as a guide to readers with little knowledge of Islam, the Five Pillars are a good starting point from where to explore the ethos of the religion.

A discussion of the ritual and non-ritual aspects of Islamic worship reveals that although the ritual aspect is more clearly defined, Muslims believe that all activities, provided they conform to Islamic norms, promote love of God as He alone is the provider of this code of life. It is clear that the concept of worship in Islam is a comprehensive one that regulates human life on all levels – individual, social, economic, political and spiritual – providing guidance in every detail. In theory at least, Muslims believe that this complete code of life leaves a believer in no doubt as to how to live and work, encouraging all Muslims to strive to please their God who knows and sees everything (Ghazali 1990).

The first Pillar: Shahada (witnessing)

Shahada is a state of faith and reflects a genuine belief in Allah and testifies his oneness and, consequently, the rejection of any other deity. Of the Five Pillars, this is the one that encompasses all others, the tip of the pyramid. Adherence to the other four is irrelevant without this fundamental belief.

The second Pillar: Salah (prayer)

Salah is the verbal testification that there is but one God and that Mohammed is His messenger. It is a ritual prayer that occupies a key position for two reasons:

first because it is the distinctive mark of the believer, and second because it precludes, in theory, an individual from all sorts of sin and temptation by providing him with direct communion with his Creator five times a day, and allows him access to correct behaviour. Regarding Allah, the Quran states: 'You alone we worship and You alone we turn to for help. Guide us to the straight path' (1:5,6).

The third Pillar: Zakat (poor-dues)

Zakat (poor-dues) is an important pillar of Islam. In the Quran, *Salah* and *Zakat* are generally mentioned together. Like *Salah*, *Zakat* is a manifestation of faith that affirms that God is the sole owner of everything in the universe, and that what men possess is merely entrusted to them. God ultimately makes trustees of His believers. This is illustrated by the verse: 'Believe in Allah and His messenger and spend of that which He made you trustees' (57:7). In this respect, *Zakat* is an act of devotion which, like prayer, brings the believer nearer to his Lord.

Aside from its spiritual significance, *Zakat* is, in practice, a means of redistribution of wealth in a manner that narrows the gap between classes and groups, thereby contributing to social stability. Muslims believe that the practice of giving alms to the poor purges the souls of the rich of selfishness and the souls of the poor of envy and resentment against society. *Zakat* is therefore not always a personal act of worship. Where it is not given freely it can, if necessary, be exacted by force.

The fourth Pillar: Seyam (fasting)

Seyam (fasting during the daytime during the month of Ramadan) is a well-known pillar of Islam. The main function of fasting is to make the Muslim pure 'from within', just as the other aspects of the *Shari'a* make him pure 'from without'. Muslims hold that by fasting, and engaging in the spiritual purity fasting brings, they are able to respond to what is true and good and shun what is false and evil. This principle is outlined in the Quranic verse: 'O you who believe, fasting is prescribed for you as it was prescribed for those before you, that may gain piety' (2:183). In a well-authenticated tradition, the Prophet reported Allah as saying (of the Muslim): 'He suspends eating, drinking, and gratification of his sexual passion for my sake.'[2]

The fifth Pillar: Al-Hajj (the pilgrimage)

Every year on the ninth day of *Zou al-Haja* there is a pilgrimage to Mount Arafat and Mecca. It is the duty of each Muslim to take part in this pilgrimage at least once in his lifetime, provided he is financially and physically able. It is a very important pillar of Islam, and displays a unity unique to the religion. Muslims

from all corners of the world, wearing the same dress (to signify equality regardless of wealth, colour, language, etc.) respond to the call of *Hajj* in one voice and language: '*Labbaikah allahumma labbaik!* [Here I am at your service, O Lord!].' Muslims performing the *Hajj* are required to exercise strict self-discipline and control, not least because Mecca is a holy place where sacred things are revered. Even the life of plants and birds is made inviolable so that all elements are in harmony: 'And he that venerates the sacred things of God, it shall be better for him with his Lord' (22:30). The pilgrimage is in response to the call made by the Prophet Abraham (the Father of the Prophets) on this day.

Islam's moral system

Islam has laid down some universal fundamental rights for humanity as a whole, which act in the same way as insurance cover. Such rights and obligations are to be observed and respected in all circumstances. To achieve these rights, Islam provides not only legal safeguards but also a moral system. Thus, whatever leads to the welfare of the individual or society is morally justified and promoted. Whatever is injurious to either is morally bad. Islam attaches great importance to the love of God and to the love of man but warns against too much familiarity. The Quran states:

> It is not righteousness that ye turn your faces towards East or West; but it is righteousness to believe in God and the last day and the Angels, and the book and the messengers; to spend of your substance, out of love for Him, for your kin, for orphans, for the needy, for the wayfarer, for those who ask, and for the ransom of slaves; to be steadfast in prayers, and practise regular charity; to fulfil the contracts which ye made and to be firm and patient, in pain [or suffering] and adversity and throughout all periods of panic. Such are the people of truth, the God-fearing.[3]
>
> (2:177)

This verse provides a Muslim with a picture of a righteous, God-fearing man. Such a man should be firm and adhere to such beneficial regulations, but he should also not neglect love of God or his fellow human beings. This is the standard by which a particular mode of conduct is judged and classified as good or bad. Such guidelines provide the nucleus around which a system of moral conduct should revolve. Before laying down any moral injunctions, Islam seeks to plant firmly in the human heart the conviction that human dealings are with God, who sees everything at all times and in all places. The human being may hide from the whole world but cannot hide from God; he or she may deceive everyone but cannot deceive God; he or she can flee from the clutches of everyone but God. Islam, therefore, makes God's pleasure the objective of human life and by this it has established a system and standards of morality which pave the way for the moral evolution of humanity.

By making divine revelation the primary source of knowledge, Islam gives a permanent anchor to its moral system with some scope for adaptation and innovations. This scope does not, however, allow for moral fluidity. It provides a sanction to morality in the love and fear of God, which impels humanity to obey the moral law even without external pressure being exerted. Through belief in God and the Day of Judgement it provides a powerful persuasive force for a person to adopt moral conduct.

Islam's moral system lays down a way of life which is based on promoting good and preventing evil. Through this system, conscience and virtue should prevail. Those who respond to this call are gathered together into a community and given the name 'Muslims'. The singular object underlying the formation of this community (*Umma)* is that it is commanded to embrace goodness and eradicate evil. The basic moral teachings of Islam cover the various aspects of a Muslim's life – the broad spectrum of personal moral conduct through to social responsibilities.

The consciousness of God

The Quran specifically mentions the consciousness of God as the highest level a Muslim should aspire to: 'The most honourable among you in the sight of God is the one who is most God-conscious'[4] (49:13).

Humility, modesty, control of passions and desires, truthfulness, integrity, patience, steadfastness, and the fulfilment of one's promises are all moral values that are emphasized throughout the entire Quran, as in the following verses:

> And God loves those who are firm and steadfast.
>
> (3:146)

> . . . and vie with one another to attain to your sustainer's forgiveness and to a Paradise as vast as the heavens and earth, which awaits the God-conscious, who spend for charity in time of plenty and in time of hardship and restrain their anger, and pardon their fellow men, for God loves those who do good.
>
> (3:133–4)

In a way that summarizes the moral behaviour of a Muslim, the Prophet said:

> My sustainer has given me nine commands: to remain conscious of God, whether in private or in public; to speak justly, whether angry or pleased; to show moderation both when poor and when rich; to re-unite friendship with those who have broken it off with me; to give to him who refuses me; that my silence should be occupied with thought; that my looking should be an admonition; and that I should command what is right.

The gratitude and fear of the Muslim believer

Islam requires its followers to surrender themselves to God and to believe in the oneness of God, in the sense of His being the only Creator, the only one worthy of worship whom no craven images can replace. In addition to this a Muslim is also required to have faith in God, the evidence and proof of which lie in his actions. The Prophet is quoted as saying: 'None of you [truly] believes until his inclination is in accordance with what I have brought.'[5] The whole concept of Muslim faith is bound with the idea that a Muslim is grateful to God for the feelings of euphoria his faith gives him. This gratitude is, in fact, the essence of *ibadah* (worship). A non-believer is called *kafir*' which means 'one who denies a truth' and also 'one who is ungrateful'.[6] A believer loves, and is grateful to God for the bounties bestowed upon him, but is aware of the fact that his actions, whether mental or physical, are far from godly. A Muslim, in theory, should always be aware that he will have to atone for his sins, either in this life or the hereafter. He, therefore, fears God, surrenders himself to him and serves him with great humility. Such a mental state means that Muslims should, at all times, be mindful of God. Such awareness of God is therefore the life force of faith, without which it would fade and wither away.[7]

Social responsibilities of the Muslim

Islam's main assertions concerning social responsibilities are based on kindness and consideration for others. Since a broad injunction to be kind is likely to be ignored in specific situations, Islam lays emphasis on specific acts of kindness and defines the responsibilities and rights of various relationships. In relationships, a Muslim's first obligation is to immediate family, parents, husband or wife and children, then to other relatives, neighbours, friends and acquaintances, orphans and widows, the needy of the community, fellow Muslims and, finally, fellow man and animals.

Respect and care of parents is stressed in Islamic teaching and is a very important part of a Muslim's expression of faith.

> Your sustainer has decreed that you worship none but him, and that you be kind to parents, whether one or both of them attain old age in your lifetime. Do not say to them a word of contempt nor repel them, but address them in terms of honour. And, out of kindness, lower to them the wing of humility and say: 'My sustainer!' Bestow on them your mercy, even as they cherished me in childhood (17:23–4).[8] And render to the relatives their due rights, as also to those in need, and to the traveller; and do not squander your wealth in the manner of a spendthrift.[9]
>
> (17:26)

On the subject of neighbours, the Prophet Mohammed is reported to have said:

> He is not a believer who eats his fill when his neighbour beside him is hungry; and does not believe whose neighbours are not safe from his injurious conduct.[10]

According to the Quran and *Sunna*, a Muslim has to discharge his moral responsibilities not only to his parents, relatives and neighbours, but also to the whole of mankind and animals, trees and plants – to life itself. So, on the level of essential moral characteristics, Islam builds a comprehensive system of morality which aims to realize the potential of humanity.

Traditional Islamic financial instruments

For great periods of post-classical history, the Middle East has been the hub of trade for the known world. Its geographical location made it a stop-off, a warehouse, and a stock exchange for traders from every part of the known world. Spices, minerals, foodstuffs, fabrics, luxurious and essential from all its surrounding regions passed through its ports. Of course, different regions, with their own prevalent belief systems, also had their own financial instruments. To some lawmakers of what is now known as the Middle East and, therefore, of Islam, these transactional devices breached a fundamental prohibition of the Quran, namely *riba*. It has been used as the main factor in prohibition since the insurance industry's introduction, and deserves close attention. Indeed, the use of the word 'industry' is in itself telling: the implications are obvious yet, as will be seen, it is overcoming this element of insurance that offers the very solution for an Islamic system.

Approximations (meanings) of insurance – *Aman* and *Ta'min*

The noun *Aman* denotes security, peace, safety, protection. *Ta'min*, the word which one usually associates with insurance in Islam, is the *masdar* of the second form, *ammana*, to re-assure, safeguard, guarantee. The derivative noun, *amin*, denotes a guard or a secure place. *Amin*, for example, constitutes one of the designations for Mecca.

Imana is the *masdar* of the fourth form *amana* (to believe), and denotes fidelity, loyalty, confidence, trust. The noun *Iman* denotes faith, belief in. The tenth form, *istaamanah*, denotes a request for protection or for indemnity. These are some of the derivatives of *Amina*, all of which combine to produce a common meaning of peace of mind, trust and lack of fear (*Al Mujmaa al Wasit*, 1964: 1:38).

References to *Aman* in the Quran

There are said to be 879 instances of the word *Aman* or its derivatives in the Quran (Al-Baqi 1958: 81–93), the majority in the form of the noun *Iman*. In *surat al Nisa* (Quranic chapter), for example, there is the following:

> And if one of you deposits a thing on trust [*Amina*] with another, let the trustee faithfully discharge his trust [*u timana amanatahu*] and let him fear his Lord.
>
> (4:58)

and in *surat Yusuf* (Quranic chapter) we read that:

> God commands you to render back your trusts [*ammanat*] to those to whom they are due.
>
> (12:64)

Furthermore in *surat al Qassas* (a Quranic chapter) one reads:

> He said 'Shall I trust you (*Amina*) with him with any result other than when I trusted with his brother's aforetime?'
>
> (28:26)

And finally, in *Surat Al Umran* there is a telling homily:

> Among the People of the Book are some who, if entrusted [*Ta'min*] with a hoard of gold will readily pay it back [whilst] others, who if entrusted with a single silver coin, will repay only on demand.
>
> (3:75)

Peace of mind, absence of fear, protection of the self, protection of one's wealth and one's offspring, protection against the vicissitudes of fate, poverty and disease, protection during travel and protection of one's residence are all encompassed within the Islamic understanding of insurance, under the following three classifications:

1 Faith as insurance (*al-Ta'min al Imani*).
2 Insuring the Hereafter (*al-Ta'min al Akharuwi*).
3 Worldly insurance (*al-Ta'min al Dunyawi*).

Pre-modern *jurists'* standing on insurance

Ibn Abdin's strictures on marine insurance

Having completed a survey of Islamic financial instruments in practice, these will now be evaluated in the light of the *juristic* interpretations of *Shari'a* prescriptions on insurance. However, the current system of insurance, with its structure and rules, is a modern invention, reflecting the absence of any guidelines or provisions for Islamic *jurists* in the past. It is considered both modern and alien, part of the influx of foreign laws and rules brought to

Muslims from the West during the latter part of the nineteenth century. Ibn Abdin[11] was the pioneer *jurist* who wrote about insurance; he was followed by many modern Islamic *jurists* and scholars in this field. This chapter will review, analyse and contest their views.

Ibn Abdin wrote about marine insurance only because it was the first of its kind that came into existence in Islamic countries. The reason for that was the extensive commercial activity between East and West during the booming industrial revolution in Europe, as the foreign traders who used to visit Muslim countries required some kind of insurance to guarantee their import deals.[12]

Ibn Abdin referred to the issue of marine insurance in his treaties entitled 'Scrutinized Answers for Dispersed Questions', particularly in a chapter titled 'The Trust of the Unbeliever' in the section on 'Al jihad' (The Holy War) in a postscript. There he wrote:

> It was customary that if traders wanted to hire a boat from a non-Muslim owner, they made their payment of rent to that man, as well as depositing a certain amount of money with another non-Muslim agent who lived elsewhere on Islamic territory. They used to call that deposit the 'sowkra' which was proposed against all kinds of risks that might occur to the boat or its contents during the journey, such as fire, sinking or piracy, etc. The agent was paid for his services as a warrantor and his appointed proxy, who lived in the coastal area of Islamic territory, collected the Sawkara from the traders, with permission from the Sultan, and accordingly repaid them the equivalent of the damage done to their goods at sea, if any.

Having given that vivid account, Ibn Abdin added that 'It seems to me that the traders have no right for any money to be returned to them in lieu of their perished goods, as that would be a commitment to offer something non-committable.' Hence, he believed, such a kind of insurance was illegal from the point of view of the *Shari'a*. It would be a void and groundless contract as it was based on the guarantee of an uncontrollable event. Ultimately, no Muslim living on Islamic territory could be allowed to have a contract with an insurer in an Islamic region, unless the contract was totally compatible with the revelation and teachings of Islam. Under such a financial deal, from an Islamic point of view, it would not be compulsory for the insurer to repay the insured any money for any unforeseen risk. The trader should also be involved only in the payment of the necessary minimum, such as normal fees and charges collected from visitors to Jerusalem.[13]

Ibn Abdin, in defending his viewpoint against any possible disputation that might arise, referred to the depositee who would charge the depositor for keeping the deposit. In such a case, the element of guarantee had to be intact, as the depositee was responsible for the safekeeping of the deposit whilst in his possession. That is unlike the case of insurance where the money was not in the

possession of the Sawkara payer, but always in the possession of the boat owner. But, if the Sawkara payer were the same boat owner, then he would be a hireling responsible for both labouring and safekeeping. However, neither party could guarantee the avoidance of natural risks such as death or drowning.

He also referred to some other kinds of pledge that differ from insurance. If a guarantor pledged the safety of somebody by tempting him to travel a certain route for his own security, then any money taken against that pledge should not be in the form of insurance. In that case, the guarantor, owing to ignorance of the real degree of danger, would not actually be in a position to guarantee the real safety of the traveller. But, if he were able to ascertain how dangerous the travel paths were, then he would be legally entitled to a commission, just as the depositee was. However, the rule would be that 'The tempter should not guarantee unless he is in firm knowledge of the danger ahead.'

Ibn Abdin was trying to clarify the difference between insurance in the case of a boat's sinking and in the case of highway robbery. Both cases appear to be incompatible with 'the rule of guarantee'. However, in the case of the recipient of Sawkara, there is no intention to tempt traders while being ignorant of the potential dangers. The condition for the guarantee is that the danger has to be known to the tempter but not the tempted. On the other hand, in the case of robbery, both parties have to know the volume of danger to the same degree, otherwise the condition of guarantee would not be fulfilled.

The goal Ibn Abdin wanted to achieve was to highlight the conflict between insurance and a pledge. He wanted to prove, at one and the same time, the absence of temptation on the part of 'the insurer', and ignorance of the expected danger on the part of 'the insured'. Thus, any commitment by the insurer would be illegitimate, and the insurance could never be a legal pledge, as in the case of the deposit.

Ibn Abdin differentiated between the insurance contract concluded in a non-Islamic territory and that concluded in an Islamic territory. He suggested the following views:

1 If a Muslim trader, having a non-Muslim partner, had an insurance contract with a 'Sawkara' recipient in an Islamic land, who collected the insurance deposit in lieu of the perishable goods, it would be legal for the trader to regain the money, as the contract was conducted between two non-Muslim parties on Islamic territory, if the money was restored to the trader with his consent.
2 If that trader was living in a non-Muslim territory, where he had made the insurance contract, it would be legal for him to collect the insurance money in the Muslim territory because of the imperfection of a contract issued in a non-Muslim territory. It would be allowed as he would be in receipt of money from a non-Muslim, although insurance is illegitimate and unjust if it rewards unforeseeable risks, but the injustice is being done to non-Muslims with his consent.

3 If the contract was signed in an Islamic region, but the settlement of the contract occurred in a non-Islamic region, the trader would not be allowed to receive any insurance money in lieu of the perished goods even with the consent of the non-Muslim party. That is because the void contract was issued in an Islamic region.

From this set of arguments, we can first conclude that marine insurance, which used to exist in Ibn Abdin's time, was taboo as it entailed a commitment in relation to the unforeseeable on the part of the non-Muslim insurer. Nor was it a legitimate form of pledge based on specialist knowledge imparted to the traveller or trader to enhance his security in return for a commission. As such it had to be an illegal contract to be avoided in Islamic territories. Second, Ibn Abdin makes clear that Islamic rules and provisions should only be implemented in Islamic territories. According to the Abu Hanifa school of Islamic law, Muslims should not be liable for their deeds outside Islamic territories, even if they are responsible for the same deeds inside Islamic territory. The justification for this is that the *Imam* of Islam would not be capable of executing the restrictions that God has placed on man's freedom of action outside of his jurisdiction.

However, Ibn Abdin also argued that 'A Muslim is allowed to commit in the non-Islamic region only what he is allowed to commit in the Islamic region.' In the same way, the *Imams* Shaf'i, Malik and Ibn Hanbal decided that Muslims should be liable and loyal to Islamic regulations wherever they are. Eventually the matter was decided by the interpretation and application of the *Ulama* (the ruling of Islamic *jurists*). The predominant trend calls for Muslims' thorough devotion and commitment to the restrictions imposed by Allah, and the principles and values of Islam at all times and in all places. Nonetheless, the Abu Hanifa school of Islamic law considers the power of Islam, which enables the *Imams* to apply Islamic provisions as conditional in circumstances of war, especially for Muslim prisoners in non-Muslim countries. However, it is not credible that *Imam* Abu Hanifa intended to appeal to Muslims who move to non-Islamic countries to renounce the religious rules and conduct of the *Shari'a*.

Islamic banking in the West

Conventional banks and their regulatory authorities were initially sceptical about a system of banking whose guiding principles were based on religious values and ethics. But the 1990s have seen several Western banks considering establishing their own Islamic banking units. Attracted by the enormous growth potential, they hope to use their expertise to create sophisticated deals to generate innovative solutions to the problems facing Islamic investors.

London is already fast becoming a centre for handling Islamic financial instruments, where deals are arranged by established banks such as: ANZ Grindlays, Citibank International, Kleinwort Benson, Saudi International Bank

and the Al-Rajhi Banking & Investment Corporation (ARABIC). The Dallah Al Baraka group and the United Bank of Kuwait (UBK) also have a number of investment companies in London (ibid.: 56).

Cooperation and integration

Eddie George, the Governor of the Bank of England, told the Arab Bankers Association (ABA) in London in 1994 that he welcomed the presence of well-run Arab banks in Europe's largest financial centre, although he recognized the difficulties in finding satisfactory means of accommodating the principles of both Western and Islamic banking within a single regulatory structure. He argued that these problems will have to be solved if institutions are to be permitted to offer more general Islamic banking facilities in the UK:

> One such problem is how to classify Islamic funds in terms of the British legal framework. To what extent, and in what precise forms, are funds placed with an Islamic institution 'capital-certain', thus falling within the UK's Banking Act definition of deposits or to what extent are they participating in a collective investment scheme, falling under the Financial Services Act? My understanding is that Islamic funds may fall into either of these categories or indeed others, but we certainly need to deepen our understanding of the developing principles and practices in this area. But whatever form they take, I think it is likely that the concepts will be familiar to the supervisors and regulators here; and that we can find satisfactory answers to these questions, perhaps through the organizational structure.
>
> (Ibid.: 1997: 57)

With the exception of Denmark, the rest of Europe has, as yet, shown little interest in Islamic banking. But growing EU trade with the Muslim world, and an increasing Muslim population in Europe, mean that there is an untapped demand for Islamic banking services. The real competition tends to be between Western institutions themselves, which have developed strong Islamic trade finance departments. They are structuring deals in cooperation with Islamic investors and banks. Some such banks have their own *Shari'a* advisers.

At the retail banking level in the Arab world, the major conventional banks have made few developments of their own in offering Islamic banking services. But the growth of private Islamic companies and the subsequent collapse of the largest investment company, Al-Rayan, has encouraged Egypt's four big banks to reconsider. These banks, which include the National Bank of Egypt, now accept deposits for *Mudaraba* profit-sharing and offer Islamic financing for small-business clients. With their deposits growing steadily, conventional Arab banks can now offer a secure environment for Muslim depositors and investors.

Insurance and the Islamic contractual framework

The contenders for arguing the validity of insurance, along with the advocates of its permissibility, generally try to assimilate the insurance contract into one of the Islamic nominate transactions. The advocates insist on this assimilation in order to provide evidence that insurance is totally in breach of Islamic law, as it does not comply with the regulations of the contract that it is deemed to correspond to. The contenders assert that insurance is equivalent to an Islamic contract, and therefore is valid being within the provisions of the *Shari'a* and indirectly acknowledged by it (Moghaizel 1990: 162).

Insurance and Mudaraba

Mudaraba, one of the major Islamic concepts, is referred to in the context of insurance[14] and it is often evoked to provide an 'Islamic' insurance scheme.[15] *Mudaraba orgirad* is a major exception to the prohibition of *gharar*. It is a contract whereby one party (*rabb al-mal*) entrusts a sum of money to another party (*Mudarib*) to trade with for an agreed percentage of the profits (Ibn Qaduma 1972: 5:22). The latter is deemed to be the agent to the provider of the capital.

It is essential that the respective shares of the profits are fixed on a proportional basis, and do not consist of a lump sum. The profits are allocated after the return of the capital to the investor. There may even be a multiplicity of investors entrusting capital to a *Mudarib* (ibid.: 46–8). The agent is free to conduct his trading according to commercial practice if no particular restrictions have been stipulated by the investor. He can deduct the expenses that he incurred from the capital handed to him and the contract can be terminated at will, by either party, even if a duration has been fixed for the contract.[16]

A hire contract is considered as an invalid *Mudaraba* (*Ijra*) and in this case the agent is remunerated by a wage and does not share the profits and is entitled to his business expenses only (Al-Sharkhasi 1913: 22:67).

Conventional insurance, as it is practised today, is not a *Mudaraba* contract. Firstly, the intention of the parties to form a *Mudaraba* contract is non-existent.[17] What the insured is seeking is security and an eventual return. The insurer invests the premiums as his own funds and he alone gets the profits (except in mutual insurance and with-profit life policies). Obviously, in non-life policies, the premiums paid by the insured, which some identify with the capital of the investor in a *Mudaraba* being paid by instalment, are not returned to the policyholder. The payment of the sum insured, if it takes place, is not equivalent to the sum of the premiums paid by the insured plus profits. If it were so, the insured would then only get the sum of his savings invested, and the concepts of distribution of risk and pooling of premiums, which are at the heart of insurance, would be missing.

Therefore, a *Mudaraba* contract in which the capital invested must be returned with any eventual profits, and where there is a possibility of loss which will be subtracted from the invested capital, is not in any respect close to the established idea of insurance. In relation to with-profit life insurance policies, the intention of the parties to *Mudaraba* (that the share of the profit allocated to the investor is a proportion of total profits and not a lump sum) is lacking.

In with-profit policies the returns that the insured benefits from are essentially different from the *Mudaraba* returns. While addendum found in policies state that 'It should be clearly understood that the amounts payable on policies taken out now may be more or less than those shown', this does not render the contract a *Mudaraba*.

In fact, under a with-profit policy, the death benefits, in case the life-insured dies before the due date of his returns under the policy, will usually be equal to a lump sum computed on the basis of the monthly premium (e.g. 250 times the monthly payment).

This is clearly in conflict with *Mudaraba* rules, which include, as a requirement of utmost importance, the determination of the profits on a proportional basis. The sanction of the contradiction of this rule invalidates *Mudaraba*.

If the insured does not die before the policy matures, the returns that he or she will obtain are initially fixed as lump sums, with the clause mentioned above included in the policy and warning the insured that the returns cannot be precisely forecast, since rates of interest and inflation, which affect investments made by the insurer, may vary. Such returns, even if they are not precise pre-determined lump sums, do not consist of a proportion of the profits made by the insurer on the investment of the total of the premiums paid by the insured, as is the case in a true *Mudaraba* contract.

It is fair to surmise that today's established concepts of insurance are not *Mudaraba* contracts. It may be possible to change such policies in such a way that would put them in the ambit of *Mudaraba* contracts without depriving them of their main function – providing financial security to the insured. There seem to be no affirmative answers to the question: 'Can the mechanism of *Mudaraba* contracts as regulated by the *Shari'a* be a convenient support for an insurance scheme?'(Uways 1970: 102–4).[18]

The first mechanisms to be excluded are all indemnity policies. Obviously, the sum insured should always be a lump sum, equal to the contingency faced by the insured. Any amendment to this aspect would upset the basic principle underlying such policies. As far as the adaptability of life insurance (with profit) to *Mudaraba* contracts is concerned,[19] the following objections leave little doubt that such an enterprise would be pointless.

First, the *Mudarib* or agent is not held liable if the capital handed to him is lost while in his trust if he was not responsible for the loss. This means that in case of unsuccessful investment, an investor could lose all his capital without having any claim against the agent. Any clause to the contrary would invalidate the *Mudaraba*[20] and however remote and improbable the chances of actual loss

may be, such potentialities, which should be stated in the contract, would certainly not be suitable for a person seeking financial security and contemplating a considerable return on precious savings. In this regard current life policies undoubtedly contain less *gharar* than the contract of *Mudaraba* (Ibn Qaduma 1972: 5:44).

Second, the *Mudaraba* is primarily a contract between two parties and not a collective contract. The mixing of capital, provided by various investors at different stages, is subject to a number of restrictions such as the prerequisite condition that no subsequent *Mudaraba* is valid if it is liable to prejudice the previous one (ibid.: 46). Such potential prejudice is, in each individual case, inescapable.

The third objection is that the *Mudaraba* can be terminated at will by any of the parties to it (Ibn Rushid 595 AH: 2:240), even if the duration has been laid down in the contract. Any clause to the contrary would be null and void.[21] Thus the insured would be able, at any moment, to rescind the contract and insist on having his capital returned to him (Al-Mardawi 1986: 5:448). This permanent facility to rescind, to which the insured is entitled, is yet another major impediment to the use of *Mudaraba* in the creation of an 'Islamic' insurance scheme, since the insurer will not be able to invest in any venture in which money is not available on demand.

A fourth point is that in a *Mudaraba* the agent cannot entrust the capital of the investor to another person or institution for investment without the express authorization of the investor. It is obvious that the insistence of such authorization or any other requisite express authorization, consistent with the rules governing the *Mudaraba*, can easily be made in the contract between the 'insured' and 'insurer'. However, the need for express authorization is yet another confirmation that the *Mudaraba* contract is only intended to be a transaction between two persons whereby an owner of capital can trade with it by retaining the services of an agent, bound to abide by the instructions of the provider of capital, as the agent is working for him even though the agent is not considered an employee.

It is the concepts of intent and context, under which the *Mudaraba* contract is regulated, that prevent it being adaptable to a collective project like insurance. The very nature of *Mudaraba* necessitates the absence of even the most elemental principles of an insurance contract.

Fifth, it should also be noted that the profits of *Mudaraba* cannot be stipulated for the benefit of a third party (Ibn Qaduma 1972: 5:64–5). In the case of the death of the investor, the returns under the contract will be distributed to the legal heirs in accordance with the Islamic inheritance rules and cannot be paid specifically to the spouse and/or children of the investor whom he may wish to benefit. In the case of a life policy, the sum insured, being paid out of the estate of the insurer, is not subject to the inheritance rules applicable to the distribution of the properties which form the estate of the insured, who as a result can designate any beneficiary he wishes.

While *Mudaraba* may be a useful mechanism for Islamic banking,[22] the situation is markedly different in insurance. Each contract has a different role and is therefore regulated in a dissimilar, and even irreconcilable way, even if it is presumed that the investor had relinquished some of his rights (such as the right to impose restrictions on the agent as to the country and field invested in). However, as this concept is one of the most 'daring' Islamic contracts, the temptation to try to introduce it as a support for new transactions was great.

The introduction of insurance through *Mudaraba* has been achieved through combining it with other concepts, such as the principles of solidarity and mutual help amongst Muslims which are completely alien to a genuine *Mudaraba* contract. This resulted, in many respects, in the misconstruing and misapplication of *Mudaraba*.[23] The fact is that the original *Mudaraba* was undermined by being taken out of context and put into a totally different one.

We can conclude that capitalism cannot be 'Islamicized' by introducing *Mudaraba* in all economic transactions (Moghaizel 1990: 172).

Insurance and waqf

Waqf is the retention of a property that cannot be sold, and assignment of the usufruct (Ibn Qadumah 1972: 5:544) for the benefit of a charitable or humanitarian objective, or for a specified group of people, such as the members of the donor's family.[24] The profits and returns produced by the property subject to the *waqf* belong to its beneficiaries and, if they are succeeded, it then goes to the closest relatives of the stipulant or, according to another Hanbali opinion, to the poor (ibid: 569). *Waqf* is a contract, despite the fact that it is constituted by a unilateral act and does not need the consent of the beneficiaries,[25] who in many cases are a category of people such as the poor or destitute.

Waqf must be perpetual and cannot be temporary. The founder of each one states: 'This property is a *waqf* for one year for the benefit of X'.[26] The founder of a *waqf* is motivated by humanitarian considerations. He strives to aid the community and thereby be rewarded, after death, for his charitable act. Although, *waqf* of movables is not generally prohibited, *waqf* of money is not allowed under Hanbali law.[27] Furthermore, a *waqf* dependent upon a contingency is not valid except where such a contingency is the death of the founder of the *waqf* (ibid.: 571).

Waqf must not contain any stipulation which contradicts its object; for example, the entitlement of the stipulant to revoke the *waqf* at will (ibid.: 551–2). The founder cannot designate himself as a sole beneficiary of the *waqf*. He can, however, provide for his right to spend the products of the *waqf* in a manner benefiting others (ibid.: 550–2; Ibn Rhajab 1970: 131).[28] He can also devote the *waqf* to a category of people to which he belongs (Al-Khafif 1941: 2:463).

Waqf is administered and managed by a *Mutawalli* or a *nazir* for a remuneration. He is appointed by the founder who may appoint himself as a

Mutawalli when constituting a *waqf*. The *Mutawalli* has the powers to carry out all acts which are advantageous to the *waqf* and its beneficiaries in compliance with the stipulations defined by the founder and recognized by the *Shari'a*. The use of the *waqf* mechanism in order to set up a valid insurance scheme has been advocated by Muslim *jurists*.[29] However, no such scheme seems to have so far materialized because the insurmountable obstacles inherent in the rules regulating *waqf* damage the feasibility of this sort of project.[30] Some of these obstacles follow.

1 *Waqf* is a kind of *Sadaqa*, that is, a charitable and pious donation, aimed at obtaining a reward after death. The motive of the founder is to get closer to God by disposing of a part of his property for the benefit of others who are in need of it. By contrast, in conventional insurance, the insurer is not motivated by a pious and charitable intention when he insures his property or liability. He is motivated not by a feeling of responsibility towards the community but by the wish to preserve his assets. A *waqf*, initiated by any motivation other than piety, is not a true *waqf*. As far as life insurance is concerned, where the beneficiaries are clearly third parties, the motivation of the founder to provide for his heirs and secure for them a decent life might be seen as a valid basis for constituting a *waqf*.[31] However, other fundamental impediments still exist in relation to the nature of the property which is the subject of the *waqf* and its beneficiaries.

2 One of the conditions pertaining to the subject matter of *waqf* is its perpetuity[32] so that any property which cannot be benefited from except by being disposed of or consumed cannot form the subject matter of a valid *waqf* (Ibn Qaduma 1972: 5:585). This means that as far as money is concerned, the sums payable in compensation of a loss sustained by a beneficiary of the *waqf* must proceed solely from the profits made out of the lawful investment of the money subject of the *waqf*, without deducting any amount from the capital raised and pooled by the founders of the common *waqf*. Thus, in order to secure the payment of all compensations from the returns obtained on the investment of the capital of the *waqf*, such capital must be substantial and would be beyond the *waqf* of the average person. In addition during the first years the insurers would have to wait until a fund is constituted out of the capital raised and invested in order to provide for the payment of compensation to the prejudiced beneficiaries.

   It is evident that such a scheme is not practical, or even feasible, because of the nature of *waqf* as a retention of property and allocation of the returns it produces to designated beneficiaries.

3 It might be said that in the context of an insurance scheme, each founder will designate as beneficiaries the group, or those insured, participating in the scheme. The fact is that a number of people will leave the group of beneficiaries when they wish to put an end to their participation in the scheme. On the other hand, new contributors will be taking part in the

scheme. The consequence is that the beneficiaries of the common *waqf* will constantly change. This is strictly prohibited by Hanbali law and leads to the invalidity of the *waqf* itself (ibid.: 552).

4 It might also be said that it is acknowledged by the *Shari'a* that the payment of benefits must be dependent upon certain qualifications which would, in this case, be the condition that payment be made only to those who have suffered prejudice due to a loss or damage sustained (ibid.).[33] While this point of view may be useful in setting up an insurance scheme in the form of *waqf*, it should be pointed out that a stipulation making the payment of benefits conditional upon an uncertain event's happening[34] may meet objection stemming from the position of Hanbali law with regard to additional stipulations in a *waqf*, an area in which their interpretation is not flexible.

Any valid clause must contribute to increasing the charitable and pious nature of the *waqf*. The principle here is not the validity of clauses, in contradiction with the object of the *waqf*, but rather the irrelevance of all clauses inserted by the founder of the *waqf* if they are not of the essence of the *waqf*.

In addition to the foregoing, other rules governing *waqf* form obstacles to its introduction into an insurance plan. An example of such obstacles is the requirement that the beneficiaries be determined.[35] In the case of insurance the beneficiaries (the other insured persons) are not known to the founder and they change continually.

So, as a result of its specific nature, it is evident that *waqf* cannot serve as a vehicle to set up an insurance scheme.

Other Islamic financial instruments

Insurance and onerous donation

The onerous donation, *hiba bi shart al-awad*, whereby a recipient commits himself to perform an obligation in return for a gift, is an accepted Islamic principle (Al-Khafif 1941: 2:468). It is, however, considered a sale (Yusuf 1969 2:330) and is therefore subject to the provisions applicable to such a contract.[36] Many commentators have argued that a transaction such as this is indeed an onerous donation, or at least a rudiment of it (Qardawi 1978: 226; Izz al-Din Bahr al-Ulum 1979: 37–9). Others argue that it is difficult to agree with this view, as one of the conditions of a valid *hiba bi shart al-awad* is the determination of compensation to be awarded by the recipient (Al-Khafif 1941: 2:468; Yusuf 1969: 2:330) and such a transaction is not possible in insurance, since the sum insured, payable by the insurer (recipient), depends upon the extent of the prejudice suffered by the insured (as is the case of indemnity insurance) and is thus impossible to determine in advance. Moreover, the application of the rules relating to sales renders the contract invalid because of *riba*, among other

things, caused by the disparities between the sum of the premiums and the sum insured in both life and non-life insurance.

Other Islamic laws used to 'legitimize' insurance

Comparisons drawn between insurance and Islamic contracts are aimed mainly at legitimating insurance by demonstrating that similar practices are acknowledged by Islamic law. In the latter case, it is not a question of identifying insurance in terms that appear to validate it in Islamic law, for while this may be an interesting academic exercise, the similarities are purely accidental. Many proscribed transactions appear to have similar principles to insurance but it must be borne in mind that these contracts were designed for completely different contexts. Many contractual mechanisms have been subject to such analogies. The principal ones are touched upon in the following paragraphs.

Kafala (guarantee)

The validity of *Kafala*, which usually involves an undefined subject matter, is often cited. An example of this would be if one says: 'I stand as surety for all debts of X' (Ibn Qaduma 1972: 4:536). This has been seen as a commitment, comparable to the duty of the insurer to pay the sum insured, as is the case of liability insurance (Al-Zarqa 1962: 57; Al-Muhmud 1986: 68–9).

The idea of a similarity between *Kafala* and general insurance practices has been rightly dismissed (Bakhit 1906: 4). Their only common feature, the transfer of liability, cannot alone justify such comparison, as the disparities between the two are too numerous.[37]

Diyya (blood money)

Insurance, in general, has also been compared to *diyya* – a sum of money paid as a compensation by a group of people (often the tribe) on behalf of a person who unintentionally killed or injured someone, often to prevent any retaliation on the part of the victim's family. Such comparison, however, is flawed, as in this latter case there is no contract between the group of people paying the *diyya* and the person who committed the unintentional crime.

Ji'ala

This is a contract whereby one person promises to reward another unspecified person in exchange for carrying out a specified task. This contract is deemed exceptionally valid because of the need for it (Ibn Qadumah 1972; Al-Khafif 1941: 2:332–3; Ibn al-Qayyim 1968: 2:5), in spite of the considerable amount of uncertainty involved in it. *Ji'ala* is evidently far from being similar to the insurance contract.

Muwalat

Muwalat is the contract whereby one party agrees to bequeath his estate to the latter, on the understanding that the benefactor will pay any *diyya* that may eventually be due by the former. This contract is invalid in Hanbali law, which rejects contractual inheritance (Ibn Qadumah 1972: 6:381). *Muwalat* has often been described as a kind of liability insurance (Al-Zarqa 1984b: 1:560; *a contrario* Muslehuddin 1966: 179).

Comments on Islamic insurance loopholes

It is clear that the insurance contract *per se* cannot be reduced to one of the above-mentioned transactions, and therefore cannot be seen as indirectly legitimated by Islamic law. However, some conclusions can be drawn from the existence of such mechanisms. For example, the *Shari'a* embodies a number of contracts which, like insurance, are inherently aleatory (e.g. *Kafala*, *Ji'ala*) albeit in exceptional situations. Such practices were allowed because of the demand for them and because they did not involve potential iniquities leading to unjustified gain and advantage for one party, with corresponding disadvantage and unfair loss for the other. In this manner, *gharar* should not be seen as a paramount prohibition applicable without regard to its consequences and context. It is not forbidden.[38]

Other considerations come into play where *gharar* is concerned, such as the role of the transaction in question, the rationality of the need for it, and the eventual causes of unlawful gain that would result from it. These elements are the determinant factors in the validity of the principles of 'exceptional contracts', that is, contracts which do not fall within the limits of the major transactions (such as sale, gift or hire) regulated by Islamic law. None of these exceptional transactions would apply normally if the principles regulating contracts were applied without consideration to specific situations.

It should also be acknowledged that insurance has often been compared to other Islamic contracts and, as a result, has been held to be invalid. It has been equated, for example, as a contract of *sarf* (exchange money) and thus been declared invalid, due to the disparity between the sums paid by each party (because of the existence of *riba* in the contract) (Muslehuddin 1966: 177). This may be fine in theory, but in practice insurance is certainly much more complex than a contract of *sarf* involving a mere exchange of commodities. First, an insurance contract involves payment of the sum insured, which will not be paid out if the event insured against does not occur. The possibility of this is made clear for both parties at the time of the conclusion of the contract. A contract of *sarf*, on the other hand, contains by its very definition an exchange of values which is certain to take place, otherwise it ceases to be a *sarf* contract.

Additionally, one cannot disregard the elements inherent in insurance, such as the pooling of premiums, the determination of the sum insured according to

the prejudice suffered in indemnity insurance, and other such insurance mechanisms which bear little relation to a simple contract of barter.

To reiterate, it would appear that methods which merely study the validity of new contracts and attempt to fit them forcibly into nominate Islamic contracts spring from a prejudiced view of the *Shari'a* and have been proven to be unwarranted. A more appropriate route to follow is to make use of the contractual freedom afforded by Islamic law, rather than insisting on an obsolete scheme of basic nominate transactions, acknowledged, at the time they were devised and recognized by the *Shari'a*, as highly sophisticated and able to serve the needs of that time. As far as insurance is concerned, it is obvious that as a concept it does not correspond to any of the nominate contracts of Islamic law and, more importantly, it cannot be adapted to fit these, whatever modifications are devised, without being deprived of its major features.

Insurance and Zakat

Zakat is one of the five pillars of Islam, which is liable to be a source of gain. It represents the solidarity of the rich with the needy prescribed by Islam. The purpose of *Zakat* is to provide assistance to those who lack the basic necessities of life. It is often thought that, in relation to insurance, *Zakat* could be considered as an Islamic alternative to insurance. The beneficiaries of *Zakat* are enumerated in the Quran:

> The alms are only for the poor and the needy, and those who collect them, and those whose hearts are to be reconciled, and to free the captives and the debtors, and for the cause of Allah, and [for] the wayfarer.
>
> (Surat al-Tawba (Repentance): 9:60)

It is worth noting that the phrases 'In the way' or 'cause of Allah', are very flexible notions that could be extended to an unlimited number of situations, where there is a justified need for financial help, such as medical aid and scholarships (Al-Sha'rani 1975: 49–58). *Zakat* and other such wealth distribution practices sanctioned and demanded by Islam play an important role in alleviating the prejudicial consequences of supervening risks (Abd al-Rasul 1968: 115). However, *Zakat* cannot replace insurance, as in many respects it is a profoundly different concept.[39] *Zakat* is paid in order to please God and is a compulsory Islamic duty. Insurance is, in most cases, voluntary. The payment of *Zakat* aims at providing for the needy, whereas the insured's intention is to secure for himself financial assistance in case of misfortune. As for social security, risks covered by *Zakat* are mainly social risks. *Zakat* is based on the solidarity of the community's members and the duty of the State to promote social justice. *Zakat* is therefore akin to social security, as noted earlier (ibid.: 49) and is considered part of the Islamic social security system.

It is precisely for this reason that *Zakat* cannot be considered as providing an alternative to insurance. Insurance mainly covers non-social risks, and *Zakat* has no provision for this. In any case, *Zakat* funds would not be technically applicable to insurance, as its contributions are proportional to taxable property and bear no relation to the indemnity payable in cases of misfortune. Consequently, *Zakat* funds would not adequately protect against risks other than social risks, and were such a modification forged it would negate the essence of *Zakat*, which would be unthinkable from an Islamic point of view (Moghaizel 1990: 189).

The evolution of Islamic financial institutions – some examples of implementation

The practice of many modern Islamic scholars to put forward Islamic alternative economic theories and the emergence of 'Islamic' financial institutions is a relatively recent phenomenon and is still in a formative phase. The Islamic banks are well known today as the very first 'Islamic' firms to be set up. Over 45 Islamic banks and other financial institutions currently operate according to the 'Islamic' interest-free profit-and-loss system (PLS) (Wilson 1987: 10).

Four principal legal techniques used by Islamic banks are the contracts of *Mudaraba*, *Musharaka* (whereby both the customer and the bank contribute to providing capital dedicated to a specific venture), *Ijara* (lease financing) and *Murabaha* (cost plus trade financing) (Al-Ashkar 1987: 32–5). The achievements of Islamic banks have been judged by many as very successful (Parker 1987: 23–6), while other less enthusiastic commentators have expressed more cautious opinions because, in the end, the success of these institutions depends to a great extent on their competitiveness and their performance in the international markets (Delwin 1986: 8, 16–20).

A problem faced by 'Islamic' financial institutions in general, and Islamic banks in particular, has been the lack of an appropriate legislative framework to support their establishment and promote their growth. This problem has, to a considerable extent, been eased by the enactment of special regulations, sensitive and applicable to the nascent Islamic financial structure.

One example of this new legislative trend is the Pakistani *Mudaraba* Ordinance,[40] which arose from the Islamicization of commercial laws in Pakistan. *Mudaraba* is defined as 'Business in which one person participates with money, and another with efforts or skills or both his efforts and skills, and shall include Unit Trusts and Mutual Funds.' The establishment and the control of the scheme is the duty of a registrar, especially appointed, as well as a tribunal created for this purpose. The *Mudaraba* is either a multi-purpose or a specific-purpose *Mudaraba* and it can be either for a fixed period or for an indefinite period; *Murabaha* is used to fund trade-related transactions on a cost-plus funding basis (Parker 1994: 14).

What is specific to the Pakistani *Mudaraba* Ordinance, as compared with the Malaysian Islamic legislation, is that the religious supervisory board, charged

with checking the lawfulness of the operations conducted, is constituted by the government, and not by the company concerned, by virtue of a clause in its articles of association. The religious board, which has the power to order modifications, is required to give a certificate in writing, stating that the *Mudaraba* is not contrary to the *Shari'a*. This certificate is a prerequisite of the authorization which allows the floatation of the *Mudaraba*.

Section 18 of the Ordinance requires that the apportionment of the profits between the company and the investor be computed in such a manner that the former's portion does not exceed 10 per cent of the net annual profits. When 90 per cent or more of the annual profits are distributed to the investors, the income of the *Mudaraba* is exempted from income tax. The final notable point of the *Mudaraba* Ordinance is that, by virtue of Section 14, the company is required to circulate to all investors its annual balance sheet and profit and loss account, the auditors' report and a general report on the *Mudaraba*'s activities and prospects.

Another example of recent Islamic legislation is the Islamic Banking Act of 1983 and the *Takaful* Act (1984) of Malaysia.[41] Under the Islamic Banking Act of 1983, Islamic Banking has to be transacted by an Islamic bank (which cannot be a foreign bank) specially licensed for that purpose. The bank's activities must be subject to the control of a religious advisory body in charge of ensuring that the bank is not carrying out its business in a manner contrary to Islamic law.[42]

The Central Bank of Malaysia is granted wide supervisory powers over Islamic banks. It can demand that the bank hold a minimum amount of liquid assets at all times,[43] can also impose restrictions on credits granted to a single customer,[44] and enjoys the conventional investigatory powers of Central Banks under conditions of secrecy. Section 34–1 provides for banking secrecy. This ideal is somewhat compromised by a qualification exempting from secrecy the Central Bank and a competent minister, whose task it is to direct the Central Bank to investigate books, accounts and transactions of the bank if he 'has reason to believe the bank is carrying on its business in a manner detrimental to the interests of its depositors', in which case the Central Bank may also assume control of the business of the bank.[45] Finally, it should be noted that the implementation of the Islamic Banking Act 1983 led to consequential amendments of a number of other Malaysian laws.[46]

Another example of Islamic legislation which is relevant is the Turkish Decree No. 83/7406, dated 16 December 1983, concerning the foundation of Special Financing Institutions allowing Islamic banking in Turkey.[47] As Turkey is formally a secular State, the Decree does not expressly cite Islamic financial institutions and does not mention the *Shari'a* or any religious supervisory board, but it does establish profit-and-loss sharing financial institutions, which are services offered by Islamic banks.

These Special Financing Institutions administer current accounts on which no return is paid, as well as participation accounts, whereby the funds are deposited against a 'contract to participate in the profit and loss of operations'.

The Special Institutions, which are submitted to the control of the Central Bank and the Prime Minister's office[48] may finance commercial and agricultural activities, give letters of guarantee for projects abroad, and procure and sell in instalments or lease to firms the relevant equipment to secure investment. The new regulations are laid down in a manner which ensures an advanced and profitable integration in the economy. The Special Financing Institutions are regarded as ventures leading to beneficial financial results for the economy by mobilizing deposits through various investment channels, rather than as an opportunity for Muslims to invest their money in a manner sanctioned by the *Shari'a*, as is the case with certain 'Islamic' commercial legislation in force in other countries. This is hardly surprising given that, in Turkey, the introduction of the new Islamic regulations provoked opposition from those deeply committed to the secular character of Turkish law. Accounts may be opened by Turkish citizens working abroad in a foreign currency[49] and a special procedure has been established enabling those depositors to transfer abroad the profits earned on their account (although the Prime Minister may order that these profits be invested in a specific enterprise and field).

It is evident from this legislation that structures permissible in a *Shari'a* framework are being transplanted into existing conventional economic systems. Without qualifying, for the moment, the success of such structures, it might safely be said that the concept of an Islamic enterprise has arisen in practice, and efforts are being made to elaborate this concept in legal terms. However, it is too early to pass a definitive judgement on the viability of the new institutions and how competitive and lucrative they are likely to be.

The main feature of an 'Islamic' enterprise is that it must be acceptable to Islam and the *Shari'a*. Therefore, it has to adhere to a set of rules which embody Islamic restrictions as to the nature of the contracts entered into by the firm, and the investments made, stemming from the prohibition of *riba* and prejudicial *gharar*.

Prospects for the future

The marketplace became increasingly crowded with Islamic institutions in the 1990s. In June 1991 Saudi Arabia's largest bank, the National Commercial Bank, started its own Islamic banking division and hopes to become the market leader within five years. Kuwait's International Investor, which opened in 1992, has already established itself as one of the most innovative institutions in Islamic capital markets, having negotiated a KD143m deal to lease seven Airbuses to Kuwait Airways.

However, Islamic commercial banks in the Gulf and elsewhere have continued to suffer from short-term losses as a result of the difficult financial climate faced by their clients, and profits are generally low. The Faisal Islamic Bank of Egypt lost US$54m in 1991 and Al-Baraka lost US$13m in 1990 in London, although Al-Rajhi has maintained its position as the strongest and

most profitable of the Islamic commercial institutions, largely thanks to the stability and resilience of the Saudi economy (Wilson 1997: 61).

The future lies in the continued development of Islamic banking instruments, by Islamic bankers, economists and *Shari'a* scholars. Although the *Shari'a* sets out key principles to be observed in business, it does not provide a detailed, codified body of financial law. The development of new financial products is therefore a complex issue, as Islamic financiers seek to apply Islamic ideals to transactions, while accommodating contemporary commercial needs and the demands of a sophisticated business environment.

Methods of accounting which currently vary between Islamic banks and countries will need to be harmonized for the better comparison of statistics and the successful development of international banking relationships. Basic monetary management principles will also need to be agreed on and standardized to increase inter-bank cooperation.

The general public, who often think of Islamic banking principles as consisting solely in prohibiting interest on savings, will need to be better informed about the services available. If Islamic banking is to attain its market potential, small depositors need to be attracted by accurate information about a broad range of financial products. Banks will need to reduce their current dependence on *Ijara* (leasing) and *Murabaha* (cost-plus) – often popular because of the low risk associated with the practice – and be forced to develop genuine profit-and-loss (PLS) investments (Siddiqi 1985: 112).

Conclusion

God revealed the Quran to his messenger Mohammed, whose life and teaching (*Sunna*) has been donated to Islam according to God's guidance. Muslims believe that the Quran, revealed to Mohammed and preserved by God, became the book of guidance for all humanity, and is furthermore the final message from God to all people and completes the doctrines of Judaism and Christianity. Muslim worship is a gratitude to God in the form of testifying to God, praying, paying *Zakat*, fasting and pilgrimage. The Muslim argument against material insurance posits that since society has an obligation to care for its weak and unfortunate, the self-protection granted by an insurance policy has no place in society.

Modern authors are trying to devise an economic system which would be consistent with Islam yet differ from capitalist consumer society, whilst acknowledging the principle of private property. One prerequisite of such a system is that contractual and economic public policies must be strictly and precisely framed by positive legislation, so that the supervisory body, in charge of controlling the conformity of transactions with Islamic rules, does not act with full authority. This is particularly relevant in those cases where the supervisory body is appointed and remunerated by the company (and would then tend to be complaisant with its policy), as well as when this body does not

come under the company's remit (where it would then be inclined to follow a restrictive pattern according to each situation). The whole issue depends upon the consistency of the economic alternative structure proposed by modern *jurists*, such as whether it proves to be a real alternative rather than a formal amendment of the capitalist system. This is far from being the norm, as 'Islamic' economic methods generally materialize in isolated ventures and not as part of a radical reform of existing models.

The implementation of the concept of 'Islamic' insurance did not coincide with the emergence of Islamic banking. The formation of insurance companies proposing Islamically lawful insurance policies started no earlier than 1983, and, unlike Islamic banking, the field has so far remained unregulated except in rare cases, the most significant being Malaysia. It is surprising that Saudi Arabia has so far achieved very little in this regard.

2

RIBA (USURY) AND *GHARAR* (RISK)

Riba

A principal argument against insurance, one whose case is strong and deserves careful analysis, is that of the Quran's and *Shari'a*'s banning of usury and other forms of economic transaction which are deemed to be unproductive or to give unfair advantage to one party at the expense of the other. The history of insurance as it developed in the Arab world has traditionally been limited to joint sharing of common risk. This is a slight deviation from the purely societal interpretation of the mutually caring community, as particular interest groups could individualize risk to their collective advantage, even when it could benefit their competitors. The Islamic concept of insurance is, we recall, not primarily an economic or material concept, but one based on faith in God and the daily following of Islamic moral law which, under the protection of God, enhances security, well-being and prosperity in this life, and ensures a heavenly life hereafter. This chapter details those Islamic legal, *juristic* and Quranic codes that have a bearing on insurance. As will be seen, the whole concept is interwoven with the principles of the faith.

Usury (*riba*) in the *Shari'a*

Modern definitions

At the root of the anti-insurance argument is the Islamic objection to *riba*, lending at interest. The literal translation of the Arabic verb *riba* is derived from the Arabic root *raba* and means 'increase' and refers to the practice of lending money at an exorbitant (and therefore unlawfully high) rate of interest. The noun *riba* literally means surplus excess. Some English definitions of the word 'usury' are: 'the practice of loaning money at an exorbitant rate of interest' (*Collins Dictionary*) and 'an addition to the principal of a loan, usually interpreted as interest payments or receipts for both commercial and private loans' (Wilson 1987). The word has unsavoury connotations (being connected, for example, with Hitler's anti-Semitic reasoning) and, since the level at which

'exorbitant' is reached is less than clear, accusations of it can be levelled against money-lenders of any kind at the whim of those in power. The word *riba* is applied where there is a perceived additional increase in an object of transaction over and above its original value, size or amount (Wilson 1985: 24). As a technical term, *riba* means usury and interest, and in general any unjustifiable increase in capital for which no compensation is given.

Traditional usage

In the pre-Islamic era *riba* – as it was then practised – was generally held to be the increase of money in consideration for an extension of the term of maturity of a loan. Pre-Islamic Arabs would pay premiums on loans and would receive a certain amount, leaving the principal sum untouched. When the maturity date expired they would claim the principal sum from the debtor. If it was not possible for the debtor to repay this sum they would increase the principal sum and extend the term. It was transactions like these with a fixed time limit and payment of interest, as well as speculation on the part of the lender, that formed an essential element in the trading system of the pre-Islamic era (Al-Tabari 1978: vol. 4). A debtor who could not repay the capital, either in money or in goods, with its accumulated interest when it fell due, was given an extension of time during which to pay. However, the sum due was then doubled. Such practices are clearly referred to in the Quran (Kurashi 1945: 89).

Quranic injunctions concerning *riba*

In the Quran, the first verse dealing with *riba* is in *Surat al-Rum*:

> That which ye do for increase through the property of other people, will have no increase with God: but that which ye lay out for charity, seeking the countenance face of God will increase. It is these who will get a recompense multiplied.
>
> (30:9)

According to Quranic exegesis,[1] this was revealed in Mecca before the emigration (*Hijra*) to Madina, that is, before the prohibition of *riba* which the verse heralds. Another verse which mentions *riba* prior to its formal prohibition is:

> For the iniquity of the Jews we made unlawful for them certain food goods and wholesome things which had been lawful for them, in that they hindered many from God's way. That they took usury, though they were forbidden, and that they devoured Man's substance wrongfully. We have prepared for those among them who reject a grievous punishment.
>
> (4:160,161)

The first express prohibition which mentions *riba* and bans it for the first time is: 'Oh ye who believe! Devour not usury, doubled and multiplied; But fear God; that ye may really prosper' (3:130). This was the first verse directly to impose a ban on usury. In interpreting this verse, the exegesis agrees that the expression 'multiples' does not ban the practice of charging interest in general but rather describes the usury practices of the day. In this they assume that the concept of multiples of multiples is no more than a description of a state of affairs, which was a precursor to the imposition of the ban (Kotb 1978: part 1:130).

Later verses, however, reveal an intensification of this prohibition:

> Those who devour usury will not stand except as stands one whom the Evil one by touch hath driven to madness. That is because, they said, trade is like usury; but God hath permitted trade, and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past, their case is for God to judge; but those who repeat the offence are companions of the fire: they will abide therein for ever.
>
> God will deprive usury of all blessing, but will give increase for deeds of charity: for he loveth not creatures ungrateful and wicked. Those who believe, and do deeds of righteousness and establish regular prayers and regular charity, will have their rewards with their Lord: On them shall be no fear, nor shall they grieve.
>
> Ye who believe! Fear God and give up what remains of your demand for usury, if you are indeed believers. If ye do it not, take notice of war from God and his Apostle: but if ye turn back, ye shall have your capital sum; deal not unjustly, and ye shall not be dealt with unjustly.
>
> (2:275–9)

In these verses *riba* is both condemned and prohibited in the strongest possible language, whilst trade or industry which increase the prosperity and stability of individuals and nations is considered legitimate. Dependence on usury is seen as facilitating unproductive activity. The Quran also advocates further concessions on behalf of debtors (2:280). Creditors are asked: 1 to relinquish past claims arising out of the practice of usury; 2 to give time for payment of capital if a debtor is in financial difficulty; or 3 to write off the debt altogether as an act of charity. The Quranic verses condemning *riba* clearly prohibit any unlawful acquisition of wealth at the expense of others. This condemnation is applied to different practices, either by individuals or by nations, the principle being that any profit that a person acquires should be through his own exertions and not through exploiting others (Yousuf 1938: 1062). The Quran regards *riba* as a practice of non-believers. It demands, as a test of belief, that it should be abandoned.

The Quran does not prohibit all forms of profit derived from business transactions. The usury mentioned therein applies to debts and is not related to

sales and purchases. Usury in sales is not subject to the stipulations of the Quranic verses (Al-Masri 1987a: 52). Here the use of the term usury, although a general one, is intended to give a specific meaning: that of the practices of usury in the pre-Islamic era, which involved doubling and multiplying of debt.

The Prophet's sayings on Riba

The Prophet's authenticated sayings (*Hadith*) that deal with the subject of *riba* are numerous, so only a small number of them will be mentioned here. The usury condemned by the Quran is 'debt usury' whereas the *Sunna* mainly deals with the concept of 'sale usury'. Although debt usury is mentioned in *Hadith* literature, the *Sunna*'s contribution to the subject confines itself merely to enforcing the Quranic injunctions against *riba* and outlining in detail exactly what is banned. It is generally understood that *riba*, as forbidden in the Quran, refers to interest on loans. Anything that goes beyond this is regarded as a later development. According to Issa (1974), the study of economics did not begin until the eighteenth century, although the idea of economic thought came much earlier (also documented by Al-Najjar (1974), who agrees with Issa's differentiation between science and ideas).

The first example of the Prophet dealing with debt usury was when a tribe, the *Thaqeef*, claimed repayment of its debt from another tribe, the *Bani Muqeera*. This was a past debt remaining from pre-Islamic usury practice. The Prophet told the *Thaqeef* that the Quran ordered the abandonment of such practices. The second time the Prophet encountered the old problem was when he spoke in his last sermon (on the occasion of the farewell pilgrimage). The Prophet is quoted as condemning usury among members of his family:

> Every usury is disparaged, and the first usury I disparage is ours [Abbas Bin Abd Al-Muttalib's usury – i.e. the Prophet's relatives' usury]. It is all disparaged.
>
> (Salus 1990)

The *Sunna* serves to underline and clarify the prohibition of debt usury as originally outlined in the Quran. This example illustrates the way in which the *Sunna* confirms the prohibition of debt usury and prescribes and bans sale usury. The *Hadith*'s view on sale usury is illustrated by a group of traditions. There are a considerable number of *Hadith*s which deal with this subject, but the most famous and generally accepted is:

> Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, the like for the like, hand to hand [*yad-in-bi-yad*, i.e. immediate sale]. But if the kinds differ, then sell as you may like it from hand to hand.
>
> (Bukhari and Muslim (repr.) 1990: book 9:5854)

Another *Hadith* is that narrated by Abu Sa'id Al-Khdry on the Prophet; he says:

> Do not sell gold unless an equivalent for an equivalent; do not prefer one and not the other [i.e. no discrimination between equivalents]. Do not sell what is available now for what is not available at the place of sale.
> (Abu Saaid Al-Khdry 1985: 1967)

By interpreting these traditions, Muslim *Fuqaha* (*jurists*) distinguish two types of sales usury (Al-Khadri 1958):

1 Increase Usury (*riba al-fadl*), which occurs when there is a transaction where items of the same kind of commodity capable of *riba* (*mal ribawi*) are exchanged or where there is an increase in either item over the other, even if they differ in quality. Therefore, when items of the same type are exchanged in sale, if either of them carries an increase over the other, this increase is considered *riba* (Sayoti 1980: 1:365).
2 Delayed Payment Usury (*riba an Nasi'ah*), a form of sale usury that occurs if there is a sale where both items are properties subject to usury (*mal ribawi*) but only one of the items is received at the time and place of the sale and the other item is received at a later date. Therefore, delayed payment usury occurs when an item, available at the place of sale, is sold for an item which is not available at the place of sale, even if the two items exchanged are equal in quantity in order to avoid increase usury. Equality of exchange of both items does not hold here, as there is a time difference in their exchange (Al-Tabari 1978: 4:63).

This issue is, however, one on which not all Islamic *jurists* are united. A close examination of all the different views postulated reveals great divergence in both interpretation of the Quranic verses and of the Prophet's *Hadith* on the subject of *riba* (ibid.: 66). Though such divergences are classic examples of the ever fluid and ongoing debates in the realm of Islamic jurisprudence, they should be seen as differences of detail rather than major disagreements. It is worth noting that in spite of such differences on the finer details, the opinion of the majority is in favour of the Quranic call for cancellation of a debt if the debtor is in financial difficulties. All are agreed that this stipulation follows the verses that prohibit *riba* (Issa 1974):

If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only know (2:280).

Unlike its precursor – medieval Christianity – which allowed the offer of interest as a gift (even though this was regarded as a dangerous exception), Islam does not allow even voluntary interest in the form of a gift to the lender. However, the post-Reformation Christian standpoint on this is very different from Islamic thought, as it is now far removed from its origin (Taylor and Evans 1987: 19).

Mudaraba (trust financing)

The principles of *Mudaraba* are based on the bank investing its depositor/investor funds in an enterprise, for which the bank provides the necessary working capital. The management of the enterprise remains independent. The managers receive an agreed percentage of any profit from the venture as a fee. The net profits after deduction of bank and managerial fees is then payable to the depositors/investors. This dividend may be fixed or may be a percentage of the profits. If no profit is made, the bank is not entitled to a fee (Siddiqi 1985: 112).

Murabaha (cost-plus financing)

In a *Murabaha* transaction the bank acts as an agent for its depositors and investors in the purchase of a commodity. The bank then sells on the commodity to the end user, although the depositors and investors must initially take title to the goods to ensure that they are accepting the risk in the financed commodity. The rate of profit is agreed in advance and represents the difference between the prices at which the bank buys and sells the commodity (Khan and Mirakar 1989: 41).

Musharaka (profit sharing)

This concept is similar to *Mudaraba*, except that the managers of the venture are allowed to contribute to part of the capital. Managers and depositors/investors share the profits or losses of the enterprise in direct proportion to their initial capital contribution. The bank then receives its fee from the depositors/investors (ibid.: 43).

Ijara (leasing)

Under an *Ijara* contract the bank uses the funds of its depositors/investors to purchase an asset which is then leased to a third party for a specified amount. The lease income is then passed on to the depositors/investors after deduction of the management fee. Lease payments may be adjusted from time to time in order to remain in line with the prevailing market rates. Lease payments, under an *Ijara* contract, are designed to reflect the cost to the lessor, of funding leased assets and therefore generally approximates payments made under a conventional lease contract (Siddiqi 1985: 109).

Ijara wa Iktina (lease purchase)

An *Ijara* contract does not permit the lessee the option of purchasing the leased asset, because the granting of such an option would involve uncertainty, which is prohibited in Islamic finance. Under *Ijara wa Iktina*, the lessee undertakes to purchase the leased asset, while making payments into an Islamic investment

account on top of the regular lease payments. At the end of the lease the investment account funds – together with any accumulated profits – are used to purchase the leased asset (ibid.: 111).

Qard Hassan (interest-free loan)

Islamic institutions are often prepared to grant interest-free loans to clients for humanitarian and welfare reasons. Repayments are made over a period agreed by both parties, with the financing institution making no profit from the transaction (Waqar 1989: 223).

Christian and Islamic views on usury in medieval times

What we can deduce from the pre-Reformation Christian and Islamic viewpoints on usury is that both prohibited usury outright. The only thing that was clearly permissible was a return from a partnership, provided the partner making the investment genuinely shared the risk. That is, both doctrines called for a share of risk between the lender and the borrower with no one party being allowed to acquire extra advantage at the expense of the other. Both rejected deferment as a justification for the payment of interest, and held that when gain is sought from an activity which is not in itself productive (i.e. which does not require labour, expenditure or risk-taking on the part of the lender), it is illegitimate and reprehensible. According to both doctrines, the essence of usury is that whether the borrower gains or loses, it is certain that the lender always takes his pound of flesh. They call, therefore, for an equitable bargain from which both parties might derive fair advantage according to the amount of risk they run.

However, in spite of the fact that the positions of the two religions were almost identical on usury, there was a discrepancy over compensation. Classical Christian thought maintained that the borrower who fails to pay his creditor at the appointed date should submit to a penalty (Taylor and Evans 1987: 20), and that the creditor who loses an opportunity of gain (by laying out his money) should receive compensation. The Islamic view was, and is, that the borrower is not liable for punishment if he fails to pay up on the maturity date. Islam is very emphatic on the point that the lender should postpone the date of payment without taking interest from the borrower or, preferably, cancel the whole amount of debt as gratis.

The discussion on usury has thus far centred on a comparison between Christianity and Islam. There is, however, an extensive economic theory literature which will be examined later.

Riba and *gharar*: fundamental prohibitions

The two prohibitions contained in the *Shari'a* that fundamentally impact on the entirety of Islamic law of contracts are the prohibition of unjustified increase of

capital (*riba*) (Moghaizel 1990: 131) and the prohibition of risk (*gharar*). The prohibition of *riba* is certainly the most burdensome ethical prescription imposed by the *Shari'a* on contemporary profit-oriented ventures and enterprises since it prescribes that in all transactions where the exchange of counter-values takes place, no increase must accrue to either party without corresponding compensation (Qurayshi 1982).

Riba

Although the prohibition of *riba* is mentioned in different sections of the Quran, the extent of its definition and the scope of its application were not defined. The whole doctrine of the prohibition of *riba* was subsequently elaborated by Muslim scholars on the basis of the *Hadith* which dealt with *riba*.[2] The ensuing doctrine was to form a considerable impediment to the free development of legal transactions.

Of the two forms of *riba* outlined in this chapter, the first, *Riba al-Fadl*, occurs when goods of similar kinds are exchanged with a disparity between them. The second, *Riba al-Nasi'ah*, arises when there is a delay in performance. The various schools of law have agreed upon the prohibition of *riba* because it is one of the seven prohibitions mentioned by the Prophet.[3] However, each school interpreted the nature of the prohibition inferred from these substances in a different manner. It is with *Riba al-Fadl* that the traditions have been interpreted differently by each school of law (Al-Jaziri 1969: 2:249ff). As regards the second, *Riba al-Nasi'ah*, there is no controversy. All schools agree that delay in payment in an onerous contract is forbidden and time alone does not produce money. Consequently, all interest payments are uncompromisingly prohibited, whether in the form of interest granted on money entrusted to the other party as a deposit, or for investment. The prohibition of *riba* is relevant to the subject of insurance because it bars any disparity between sums of money exchanged and bans all sorts of interest.

The Islamic concepts of equity and fraternity which are binding on those belonging to the Islamic *Umma* in essence and by definition abhor any kind of transaction involving a gain which is not justified by a thing remitted or a service rendered. All transactions which could result in speculative investment and monopoly are thus precluded and rejected (Al-Qardawi 1978). It is stipulations such as these which place stringent and burdensome limits on the freedom of the parties involved in creating contracts.

Gharar

The prohibition of risk (*gharar*) is the second major element in the Islamic law of contracts. To avoid unfair dealing resulting from an ambiguous understanding of the rights and duties, not just of the parties involved, but also of the object of the contract (which must be precisely ascertained and susceptible to immediate

delivery), the *Shari'a* requires a clear and certain determination of the rights and obligations of each party to the contract. Many Muslim *jurists* have defined *gharar*, some treating it more strictly than others.

A general definition was offered by the Hanbali *jurist* Ibn Taymiyya, who defined *gharar* as something of unknown outcome or result (Ibn Taymiyya 1970: 29:22).[4] *Gharar* thus resides in the uncertainty affecting the occurrence of the contract or of one of the obligations under it. This is to be seen as separate from *juhala* – ignorance or uncertainty as to the outcome of the contract. The concept of *juhala* means that the commodity or the price to be paid is unknown, whereas in the case of *gharar* the contract and the obligations of the parties under it are certain to take place but one of the elements of the contract is not defined.[5] An example of a sale involving *juhala* is the classical case of a sale of what is hidden up one's sleeve (Al-Qarafi 1927: 3:265). Here the uncertainty affects the subject matter of the contract. Scholars have given numerous examples of contracts involving *gharar* transactions in which the nature or quantity of the commodity and price were unknown (Ibn Rushid 595 AH: 2:147; Ibn Taymiyyah 1985: 29:25).[6]

Not being expressly mentioned or forbidden as such in the Quran, *gharar* is not as strongly and as strictly prohibited as *riba*. However, its prohibition can be deduced from other verses forbidding all unlawful and unfair transfer of wealth between Muslims: 'And eat not up your property among yourselves in vanity' (2:188). The prohibition is repeated in the Quran in verses 4:29,161 and 9:34.[7]

However, prohibition of *gharar* is expressly mentioned in the *Sunna* in a number of sayings attributed to the Prophet where he unequivocally condemns transactions with aspects of *gharar*: 'The Prophet peace be upon him has forbidden sales by throwing stones and sales involving uncertainty' (Muslim 1513: *Hadith* 4).[8] Owing to this condemnation, it is incumbent upon all Muslims to ensure that the subject of the contract be precisely determined and available for immediate delivery. Conditional contracts, because of the uncertainty that they involve, are widely considered invalid as the parties do not know if or when the contract will be concluded (Al-Qarafi 1927: 1:228–9). This prohibition, which initially concerned contracts of sale, was extended by analogy to other contracts in differing degrees by the various schools of law.[9]

The prohibition of conditional contracts led, among other things, to the invalidity of transactions containing two different contracts; for example, if one says, 'I will sell you my house if you sell me yours.' In this case the contract cannot be concluded because it contains two sales. Since the first sale is conditional upon the second one, the deal involves uncertainty. The reported sayings of the Prophet do not limit this prohibition to sales only, but mention transactions in general ('The Prophet peace be upon him prohibited two deals in one' (Ibn Hanbal 1986: 1:398)). Also, transactions cannot involve more than one proposed contract (as in the case of a sale coupled with a lease). The scope of this rule has been differently construed by the various schools. For some, only contracts which are in contradiction cannot be joined together (Ibn al-Qayyim 1972a: 3:142).

The four schools of law acknowledge the prohibition of contracts involving *gharar*, but the scope of *gharar* itself varies from school to school and there are various exceptions to its proscription. The majority of these exemptions are specific rather than general in operation. The Maliki School alone stipulates as a general rule that *gharar* does not affect acts of charity or gratuity. A donation which involves uncertainty or risk is nevertheless valid as it does not lead to prejudice if it fails to take place. Since the donor has not provided anything in this transaction, he will not suffer loss by virtue of any contingency affecting the donation (Ibn Rushid 595 AH: 2:324).[10]

The other schools do not uphold such views (except Ibn Taymiyyah who favours the Maliki position concerning *gharar* (Ibn Taymiyyah 1985: 29:33)) and consider that *gharar* does affect the validity of charitable acts subject to a number of exceptions. One such exception is the validity of wills notwithstanding the undefined nature of their subject matter or their indeterminacy (Al-Khafif 1972: 2:481).

Given the controversy surrounding the issue of *gharar*, it is remarkable that a number of agricultural tenancies contain elements of *gharar* but are nonetheless deemed valid; an example is contracts such as *muzara* and *muswagat*, where one party cultivates the land owned by the other party for a fixed share of the produce and thus for an undetermined remuneration (Ibn Qaduma 1972: 5:382–3,360–1; Ibn Abdin 1966: 6:274–5).

The concept of *Ji'ala* is also worthy of mention in this context as it involves considerable uncertainty. It consists of a reward offered for a service to be rendered, such as the recovery of lost property where the effort involved cannot be ascertained beforehand (Al-Mardawi 1986: 6:389–90).

The long list of exceptions to unlawful transaction where *gharar* is concerned illustrates that *gharar* is not rejected in the same manner as *riba* whose prohibition is undeniably related to the potential harmful consequences that it may have. In a contract of sale, for example its prohibition is motivated by the likelihood that one of the parties has struck an unfair bargain if the uncertainty involved leads to one of them being disadvantaged. *Gharar* is particularly relevant in such cases as it can lead to an unjust outcome for one of the parties. The position of the Maliki and Hanbali *jurist*, Ibn Taymiyya, illustrates this point. Ibn Taymiyya expressly said that a sale involving *gharar* leads to injustice, enmity and hatred (Ibn Taymiyyah 1985: 29:23). As a result of his position, *jurists* acknowledge that *gharar* not involving potential inequality (as in the case of gifts) is permitted. *Gharar* inherent to the mechanism of a specific contract which does not involve prejudice is also admitted, as in the cases of *Kafala* (guarantee) and *Ji'ala* (reward).

Need (*haja*) alone can justify a departure from the general rule prohibiting *gharar*, as expressed by Ibn Qayyimma in a statement about a contract of *Ijara* containing elements of uncertainty: 'If you plant this piece of land with wheat, I will lease it to you for one hundred; if you plant it with barley, I will lease it to you for fifty' (Ibn al-Qayyim 1968: 3:400).

This opinion is reinforced by the distinction made by scholars between excessive *gharar* and light *gharar*. Only excessive *gharar* can invalidate the act to which the prohibition of *gharar* applies (Al-Qarafi 1927: 3:365–6). The measure of *gharar* necessarily varies from one situation to another and it is impossible to fix a precise criterion for it. What is obvious is that the notion of *gharar* is indeed very relative and does not constitute a general prohibition applicable in all situations quite as *riba* does. The prohibition of *gharar* applies where uncertainty or indeterminacy introduce the possibilities of an unjust outcome.

The concept of Islamic insurance meets a huge stumbling block when it encounters the notion of *gharar*. Theoretically, however, the application of *gharar* to principles of insurance depends on two elements. The first lies in whether the insurance contract amounts to a transaction categorized as *Mu'awada* or whether it corresponds to another class of contract devised by Islamic law, or indeed whether it can be considered to fall in an Islamic scheme of contracts at all. The second determinant element is whether the uncertainty inherent in insurance can be allowed, either by virtue of necessity or the fact that it does not lead to unfair prejudice.

Need (*haja*) and necessity (*darura*) In Islamic law

The *Shari'a* expressly delivers Muslims from hardship as shown by the following verses of the Quran:

> Allah desireth for you ease; He desireth not hardship for you.
>
> (2:185)

> Allah would make the burden light for you, for man was created weak.
>
> (4:28)

The interests of Muslims are a prime and determinant concern for Islamic law (Ibn Qayyim 1968: 3:14) and it is on this account that the rule of necessity and need has been invoked. According to this rule it is possible to diverge from a prohibition when a person is in a situation of need, hardship or necessity. The concept of necessity allows departure from prohibitions when the life or entire property of the person concerned would otherwise be lost (Ibn Nujaym 1983: 91–2, 94).

However, these rules of need and necessity cannot be indeterminately and freely applied. The need must be pressing enough and the necessity actual and unavoidable (ibid.). If relief can be obtained by any means other than breaking the prohibition in question, then the principle is not applicable. The role of need and necessity comes into play when there is a genuine problem for which no Islamic alternative is available. The measure of the allowed departure from the rules of prohibition depends upon the extent of the necessity involved, and

once the cause of the derogation has lapsed the prohibitions come into force once again (ibid.: 95).

The concepts of need and necessity allow for circumstances to be examined and weighed in every case to ascertain whether a rule is applicable or not. The rule of need and necessity has been qualified as being a proper source of law (Abu Solayman and Ali 1992: 25),[11] although one that should only be invoked when circumstances justify it.

Summary of financial activities proscribed by Islam

Riba (charging interest)

The charging of interest associated with the use of money is prohibited. Returns on invested money should be calculated in proportion to the profits (or loss), generated by the enterprise in which it is invested. A pre-determined or guaranteed rate of return is usually prohibited (Wilson 1985: 48).

Gharar (uncertainty)

An element of uncertainty in contractual transactions is forbidden. A contract cannot rely on the future occurrence of an event that is uncertain. Thus, instruments which require one party to insure another or grant another an option to buy or sell an asset are not usually permitted.

Maisir (gambling)

Gambling or speculation is prohibited. This means that futures or options transactions may be unacceptable if undertaken for speculative purposes (Nejatullah 1985: 85).

A recent history of Islamic banking

Since the early 1980s, Islamic banking has developed into a multi-billion dollar business. The Western world is realizing that, even in its own cities, it is no longer a 'fringe' business. The creation of the Islamic Development Bank (IDB) in Jeddah in 1975 was a landmark for Islamic banking. The IDB was the first development institution dedicated to the financial requirements of Muslim countries. The bank's articles of association stipulate that all its business should be conducted in accordance with Islamic *Shari'a* law (Wilson 1985: 39). Its success can be measured by the Saudi government's decision in 1992 to double the subscribed capital of the IDB to $5.7bn, making it the largest inter-government agency in the Muslim world (ibid.: 40).

Commercial Islamic banking took off in the 1970s when a number of new institutions were established in the Gulf, including the Dubai Islamic Bank

(1975), the Kuwait Finance House (1977) and the Bahrain Islamic Bank (1979). However, the most significant developments took place in Saudi Arabia, aided by its huge economic infrastructure. One of the prime movers of such developments was Prince Mohammad Al-Faisal, whose ambition was to create a network of Islamic banks across the Muslim world – a process which saw the founding of the Faisal Islamic Bank in Egypt in 1977 and the Faisal Islamic Bank in Sudan in 1978. But it was Prince Al Faisal's Geneva-based Dar Al Mal Al Islami, founded in 1981, that brought Islamic banking to the attention of those Western bankers who, previously, had little or no knowledge of Islam or Middle Eastern countries. The Geneva office of Dar Al Mal is now the centre of a network of 43 branches in 20 countries with assets under management in excess of $3bn (Shirazi 1990: 85).

The assets of Islamic banks incorporated in the Middle East rose from $4.4bn in 1985 to $15.7bn in 1994, although total assets controlled by Islamic financial institutions, including assets under management and the activities of banks based outside the Middle East, are estimated to be in the order of $80–$100bn (Wilson 1997: 55). Compared with conventional banking this is a relatively small sum, but the overall demand for Islamic banking products is probably much greater than banks have so far been able to tap.

3

PRE-MODERN AND MODERN *JURISTS'* STANDING ON INSURANCE

Introduction

This chapter begins with a brief history of insurance, showing that it has surfaced throughout history and geography in many guises, even if few of them, it must be noted, are not as much profit-oriented as they are measures towards damage limitation. Then, the chapter starts to concentrate on the implications and applications of insurance where the *Shari'a* is concerned, before discussing the views of pre-modern *jurists* who had to form opinions of a type of *Mu'amalat* (dealing) which were known at their time as *Sawkara* (insurance). As we will see, the first scholar to give an opinion was Ibn Abdin, then Sheikh Mohammed Abdu, who was followed by a number of honourable scholars such as Mustafa Al Zarqa, known to approve of all kinds of insurance. Modern *jurists'* opinions were drawn from those of the pre-modern *jurists* in the light of modern *Mu'amalat*, and their arguments are about its permissibility within *Shari'a* law.

A history of insurance

Although the insurance policy as we know it is a relatively recent development, the concept is by no means new. The idea of transferring the risk of loss from an individual to his group began thousands of years ago. When a family's hut burned down, for instance, the entire tribe would rebuild it. Traces of rudimentary insurance practices are still seen among the few primitive tribes that exist today (Raynes 1948: 71).

About 2500 BC, Chinese merchants were using primitive forms of marine insurance (Ibid.: 32). When boat operators reached river rapids they waited for other boats to arrive, before redistributing the cargo so that each boat carried some of the contents of the others. If one boat was lost navigating the rapids, all the operators shared a small loss but nobody had their entire cargo wiped out (Rahman and Gad 1978: 32).

Benevolent societies were developed in Egypt as early as 2500 BC. There is evidence that the ancient Egyptians had writings on the walls of some of the temples in Luxor (Upper Egypt) and that they formed committees for burying

the dead. They believed that life after death was inevitable and therefore the body should be preserved for the spirit when they were reunited at the time of reincarnation. That led them to spend prodigiously when death occurred and even before that to build tombs suitable for the preservation of the body. Therefore the committee spent the money needed to preserve the body after death for as long as that person or his relatives paid an annual fee. This annual fee could either be in the form of agricultural produce or manufactured goods and clothes, sufficient to ensure that the body would be preserved in a well-sealed tomb (organized primarily for religious and social purposes in the hereafter). However, members contributed to funds that paid burial expenses and gave aid for those seriously ill or injured by accident (ibid.: 32).

By 1500 BC, these same societies provided fire insurance. The biblical story of the Prophet Yusuf (Joseph) is another early illustration of insurance principles. Around 1700–1500 BC, according to the authorities (ibid.: 33), Yusuf interpreted a dream of the Pharaoh to mean that there would be seven years of plenty and seven years of famine. At Yusuf's suggestion, the Egyptians set aside grain during the years of plenty to prepare for the years of famine. Although this was cooperative (and, owing to Yusuf's certainty, could possibly be described as acting on foreknowledge rather than preparing for risk), it is an indication that human societies have been involved in insurance as far back as the ancient Egyptians. Today, people set aside a little to protect themselves against possible future emergency or loss (ibid.: 35).

The Phoenicians, Greeks and Indians took another major step in laying the foundations for today's insurance industry when they developed insurance against a ship's sinking. When a group of shipowners financed a commercial voyage, they borrowed money from a lender, using the ship as collateral. If the voyage was successful, the shipowner repaid the loan at a high rate of interest. If the ship was lost, the shipowner was free of the debt (Al-Hanis 1979: 66).

Ancient Romans had both life and health insurance. The Collegia, Roman benevolent societies, provided burial insurance and financial help for the sick and aged. Roman guilds issued life insurance contracts for members and by AD 200, the Romans had a rough mortality table. The Roman military also had health and disability plans (ibid.).

When guilds arose in Flanders and Holland, among the services they provided were sickness benefits and burial fees. Some guilds made efforts to reimburse members for fire losses. Although their methods of operation were unsophisticated by today's standards, they popularized insurance (ibid.). During this period, insurance was underwritten mainly by individuals and guilds. Benefits were relatively low; one person or a small group could have enough capital to conduct insurance business. The person selling insurance was called an underwriter, signing his name and the amounts of liability at the bottom of the page (Rahman and Gad 1978: 35).

Ibn-Khaldon, in his *Muqaddimma* (Preface) has written about Arab business ventures which were then known as Winter and Summer Voyages. The voyage

members indemnified any member of the group against loss of either their stock or their profit. All members of the voyage paid a percentage either of their profit or capital as compensation for the loss or damage sustained by any member of the voyage.

The objectives of insurance in Islamic law (*Al-Shari'a*)

The idea of insurance (*Ta'min*) in Islam is inexorably bound up with, and must be in harmony with, the objectives (*maqsad*) of the *Shari'a* with regard to securing benefit for the Muslim or preventing him harm, not only in this world but also in the hereafter. These objectives are religion, life, intellect, lineage and property (Al-Atar 1983: 68). It is in this context that we must discuss the idea of insurance and its practice in Islam. To this end, the discussion of insurance will consider both the concept of insurance in Islam and its relationship to the objectives of the *Shari'a*.

The *Fuqaha* (*jurists*) tended to neglect the idea of insurance in Islam, principally because they were concerned with the practical daily conduct of the Muslim in society and not with the uncertainties of insecurity and fear, which are very much bound up with the idea of insurance. Besides, insurance itself has a history that has seen its applications and popularity vary widely over the centuries, and commercial insurance has not always had a part to play.

The general significance of Islamic insurance outlined so far pertains to protection, in this world and in the hereafter, of a person's needs, beliefs, life, wealth and descendants from what is unknown. Such protection also involves the provision of a means of subsistence (material and spiritual), livelihood, nourishment, property, wealth, fortune and, above all, God's blessing during this life, protection from Hell, and the promise of everlasting Heaven.

The important objectives in Islamic law (*Shari'a*) are to provide advantages that bring about security, ward off evil doings and prevent hardship to all people, regardless of their faith. Such advantages have essential benefits for the hereafter, and secondary benefits which are operative in the here and now. The performance of good deeds is both a worldly and a 'hereafter' benefit (Al-Qubaysi 1977).

The worldly and hereafter benefits are essential to the spirit of life. Without spirituality, life is meaningless, and has no purpose. Human life, conceived as created by God, has meaning whether in the present or in the hereafter. In such a scheme of life one's necessities are to protect faith, descendants, life itself and wealth. Islam asserts that this is what protects life and people from defection (Al-Qardawi 1962).

The secondary benefits are mainly worldly ones that are essential for life, such as relationships formed around common interests which hold people together, the authorities and laws of the land, the relationships between people, animals and vegetation – in essence, the interaction between human beings and

their environment (Al-Shatbi 1986 (970 AH): 2:176). Islamic law (*Shari'a*) recognizes the importance of these essential and secondary benefits and gives clear guidance on the way to behave, on how to deal with these issues with respect and acceptance in an intelligent manner (ibid.: 178).

Some of the issues on which guidance is given are concerned with the Islamic faith in general (*Ibadat*). Much of this guidance deals with the details of ritual such as the Five Pillars of Islam: shortening prayer when travelling; exemption or postponement of fasting for the sick (or women at a ritually impure period); dry wash (*Tayamum)* before prayers; protecting the genitals; women's adornment (and general women's issues (veil, etc.)); and respect for the elderly, scholastic traditions. The guides also make pronouncements of a less religious and practical nature: eating the necessary foods; enjoying one's life and wealth; looking after relations; common laws to promote justice; security; investing and protecting wealth; punishing wrongdoers; keeping the peace (*Salaam*); borrowing and lending; forgiveness and forgetting; money exchange; contracts; usury (*riba*); negligence; medical care and medicine; caring for the old and young; protecting the wealth of the young until maturity; education and learning; scholars and their responsibilities; duties towards neighbours and the needy; modes of behaviour in private and in public; and the relationship between man and son. All this guidance is to benefit human beings and provide them with happiness. As individuals, or collectively, it is people's duty to protect these benefits (ibid.: 178).

Original objectives

Because mankind has instincts higher than those of animals it is essential for the good of humanity to define and hold to certain guiding principles and objectives, but because of the frailty of human nature these goals can often become confused. The essential objectives as perceived and outlined in the *Shari'a* are: protecting human life; faith; the cultivation of intellect and the spread of knowledge; protecting one's descendants by keeping them from bad deeds which provoke God's wrath; and protecting wealth by avoiding waste.

These are the major requirements, not merely for the livelihood and material needs of the people, but, more importantly, for their spiritual needs and the life hereafter. A Muslim's life will be disorientated and confused in the absence of any one of these main five elements (i.e. the protection of human life; faith; the mind; dependants and wealth) (ibid.: 179).

Sheikh Mohammed Abdu's legitimation of life insurance

A *fatwa* (formal legal prescription) was attributed to *Imam* Mohammed Abdu that allegedly proclaimed the admissibility of life insurance.[1] According to the *fatwa*, life insurance is admissible, as an agreement entered into between the insured and the insurance company, which is considered a legal *Mudaraba*.

The US Mutual Life Company's general manager posed the question of the legality of a deal between a contracting party who agreed to give a company a certain amount of money, paid in instalments over a certain period of time, for the purposes of investment. Under the terms of such an agreement, if he remained alive at the end of the period, he would regain his money with any interest accruing from the investment, but if he died before the end of the proposed term of the contract, the money and any interest would go to his successors. The answer to this question in the *fatwa* was as follows:

> [T]he agreement between the man and the company would be a kind of *Mudaraba* which is legal. The man had every right to collect his money at the end of the period with any interest produced by that investment. In the case of the man dying during the term of the deal, his successors would be entitled to receive the benefit of that money in his place.
>
> (Lewaa al-Islam, al-Azahar University, Egypt)

Another *fatwa* published in the magazine *Nor-el-Islam* by Sheikh Ibrahim Elgabbali and attributed to Sheikh Mohammed Abdu, dealt with the question of the legality of someone entering into a contract with a group of people to finance them out of his own resources to trade for a certain period of time, on condition that at the end of that period, if he remained alive, he would have the right for his money to be repaid with an agreed rate of interest added. This raised the question of whether, if he died before the end of the term of the contract, his successors were fully entitled to his stake from the deal. The *fatwa* declared that such a contract was a thoroughly legal act. The man would be fully entitled to collect his money at the end of the contract with the agreed rare of interest. If he died, then his successors would be fully entitled to inherit the capital and proceeds in his place. It is noteworthy that what was published in *Nor-el-Islam* magazine about how a *Mudaraba* differs from that in *Almuhamah* magazine in several aspects.

1 Almuhamah magazine (Vol. 5: 460:563) states that life insurance companies would act legally as though they were *Mudarabas*, which are legal. In accordance with that premise, the life insurance system was also considered to be legal. However, that contradicts the position which Nor-el-Islam put forward, whereby:
2 The successors, or whomsoever authorized, have the ultimate right to benefit from the whole sum of that money, including the interest resulting from the deal.
3 This means that if the insured party died before the end of the payment of instalments he owed to the insurer, the successors would be allowed to collect the total sum of money agreed on, with any interest accruing from the instalments paid by the insured during his lifetime.
4 In *Nor-el-Islam* the position outlined was different. It said:

5 If the insured died before the end of the proposed term, the successors or whomsoever are authorized to benefit from that money after his death, are allowed to collect only the instalments he had paid in practice with the interest resulting from the deal.

What was published in *Nor-el-Islam* does not comply with the modern system of insurance. It was a kind of *Mudaraba* in which the distribution of profit and loss was unclear. What *Almuhamah* magazine published was just the bare outline of insurance in the sense of how to regain the sum of money agreed on, even if the instalments had not been paid in full.

However, there was no clear evidence in the published material of either magazine of the legitimacy of the prevailing insurance system. What was published in *Nor-el-Islam* had no connection with insurance. It was just a *Mudaraba*, which has no similarity with life insurance (as we shall clarify later). On the other hand, what *Almuhamah* showed could be used as evidence of the legitimacy of life insurance as it was proven to be a legal kind of *Mudaraba*. Yet, saying that life insurance is a kind of *Mudaraba* would not be true because the *jurists* have identified it as a profit-sharing contract, if the capital is provided by one of the parties and the effort is provided by the other and both parties can be clearly identified. The most important condition is the determination of the percentage of profit for both parties. In the case of loss, unless proven to be the result of speculator incompetence, the owner of the capital has to be held individually responsible (Al-Khafif 1970: 252).

Following this argument, could the insurance system thus outlined not be a true kind of *Mudaraba*? And should the owner of capital pay the instalments to the speculator to invest, provided they share the profits while bearing the burden of any unforeseen loss separately? It is acknowledged that the company (or capital owner) would provide the speculator with the required money to invest however they chose to. That speculator, in return, should accept all the consequences of any prospected danger that might affect the capital owner's future. If the latter collapsed after the payment of one instalment, then the speculator might be able to keep the rest of the instalments for himself. It could be possible as well that the capital owner might pay all instalments to the speculator without any damage. That would not give a clear picture of the Islamic *Mudaraba* which calls for cooperation and offers the decent honourable life by the exchange of benefits between people.

It seems that Sheikh Mohammed Abdu was the pioneer of (or, at least, was attributed as being the first to acknowledge that life insurance could be a contract of) *Mudaraba*. In fact, the word 'insurance' was never referred to in the *fatwa*, nor was it mentioned in the inquiry by the questioner. However, some modernists have already accepted that viewpoint.

Abdel-Wahab Khallaf[2] has described the life insurance contract as compliant with the terms of *Mudaraba*. He added that if there is an objection that the interest in a *Mudaraba* contract is unlimited, while that in an insurance

contract is limited, or that the speculator might invest the money illegally through usury or other unlawful methods, there is an answer to that. There has never been a common judgement that the interest in a *Mudaraba* should not be fixed in advance and would be proportionally divided between the parties. In that case, his views conflicted with those of many diligent scholars. However, borrowing with interest remained outlawed to eliminate any doubts, but the *jurists* admitted that what was forbidden to keep suspicions at bay may be admissible in cases of necessity. So long as insurance can be shown to have become a necessity of daily life, rather than having established cooperation and created savings for the benefit of the community, and does not actively harm anybody, it could be considered legitimate.

Mohammed Kamil el-Banna, Sheikh Abdelhalim Bassioni, Mustafa Zeid and Sheikh Mohammed Abu Zahra made clear their disagreement about treating insurance contracts as equivalent to *Mudaraba*, and continued to consider insurance as a thoroughly illegitimate act.

Mohammed Kamil el-Banna wrote:

> The obvious difference that makes it impossible for *juristic* reasoning to accept the insurance contract as the equivalent of a *Mudaraba* concerns the burden of loss which would be assumed by the owner of capital individually in a *Mudaraba*, while the matter would be different in the case of an insurance contract. Furthermore, if the owner of capital died in the case of a *Mudaraba*, his successors would regain only what their testator had paid, without any excess, while in the case of insurance, if the insurer died, the insured would collect a lot of money, which makes it an absolutely inadmissible risk, as the outcome would depend purely on accident or chance, without reasonable control measures.
>
> (Al-Dasuqi 1976: 79)

Sheikh Abdelhalim Bassioni mentions, however, that the non-determination of the percentage of interest in a *Mudaraba* is derived from the nature of the deal itself as a purely commercial relationship, based on profit and loss. The *jurists* did not determine the ratio of interest simply because they wanted to enhance the nature of *Mudaraba*. Therefore, the insurance contract could not be the same as the *Mudaraba* contract. For that reason, it would not be acceptable to ignore the opinions of the *jurists* in favour of the opinion of Sheikh Mohammed Abdu.

Mustafa Zeid stated that had it not been for two reasons, the insurance contract could have been a form of *Mudaraba* contract. The first concerns the nature of the *Mudaraba* requiring the sharing of both parties in both profit and loss, while the insurance contract does not mention anything about the loss. The second reason demonstrates why the profit in a *Mudaraba* should be proportionally, and not fixedly, rated. He then declared that the insurance companies normally take the necessary precautions to protect their interests,

which is why they rarely experience any loss or damage while the insured suffer because of biased laws regarding payment of instalments.

Sheikh Mohammed Abu Zahra adamantly denied any connection between insurance and *Mudaraba*. In his opinion, the benefits of insurance should not be considered as the fruits of usury, but as a kind of deferred or postponed usury. It is referred to as *Riba Al-Nasiaa* or *Riba al-Jahiliya* credit (of the pre-Islamic era). It is absolutely taboo under the unanimous consensus of *Ulama*. Thus, the conclusion had to be that life insurance is totally different from the legal *Mudaraba*.

In his *fatwa*, Sheikh Mohammed Abdu determined the legality of taking all the insurance money including the interest produced during the term of the contract. What evidence did he give? Was it a kind of donation or voluntary contribution of alms? Or the fulfilment of a personal legal commitment? This commitment could not definitely be considered a donation, as insurance companies acted on commercial grounds, aimed only at achieving high profits for their shareholders, without much consideration for the insured, other than keeping to the legal terms of the contract. Then what these companies paid for their customers could not be considered as a form of contribution or donation, or any other kind of help for the needy and disabled, as these good causes did not form part of the company objectives. Moreover, as long as the insurance contract could be described as a 'commutative contract', in which each party ultimately regained an amount of money equal to the effort they had put in, there was no chance of calling what they paid to the insured a donation or cooperation. Hence, if the money paid to the insured were not a donation, then the commitment of repaying the whole premium at the end of the term – despite non-payment of all instalments – was not just illegal, it was a form of gambling. That is because the collection of all the money – without being paid in instalments – would be suspended on the occurrence of an unforeseen incident for both parties, which injects the element of gambling.

The *fatwa* issued by Sheikh Mohammed Abdu has been used by foreign non-Muslim insurance companies to attract Muslim customers on the grounds that life insurance was legal. However, this *fatwa*, with the approval of its perfection, did not provide evidence for the legitimacy of life insurance, which was wrongly considered in the *fatwa* as legal on the same basis as a *Mudaraba*. Although modern insurance is totally different from the *Mudaraba*, some *jurists* have supported Sheikh Mohammed Abdu in his call for approving life insurance, owing to acknowledgement of its benefits and advantages in confronting the complexities of life.

Sheikh Mohammed Bakheit El-Muteiay[3] answered a question from the *Ulama* living in Slanik about the legality of a Muslim's depositing money with an investment company for a fixed commission for a certain period of time, then receiving the capital sum and any interest accruing. Sheikh El-Muteiay answered that 'The only legal paths for a money guarantee are either by pledge, or by voluntary agreement. Otherwise they would be illegal.' The only

condition that had to be met was that the money had to be deposited as a proper loan to be returned in full in any case, or it would become a gambling-like action.

In 1917, the *Shari'a* High Court issued a verdict against an heir who claimed the right to obtain a prescribed amount of money from an insurance company, after the pledge of the company manager for a lump sum payment in the case of the insured's death, provided his heir would settle the monthly instalments against the lump sum. The High Court justified that, by saying the claim had contained what should not be claimable (as the insurance money should not count as a part of the deceased's estate), and Sheikh Abdel Rahman Quraa[4] was requested to give a Formal Legal Opinion on how fire insurance companies should perform. He replied that they were not doing their job in compliance with Islamic *Shari'a*. He meticulously discussed the tasks of these companies compared to the methods of legal guarantee outlined in the opinion of Sheikh El-Muteiay, before he finally came to the same conclusion about how unforeseen their action would be. Accordingly, the whole task could not get away from the taboo of gambling (*Al-Muhamah* magazine Vol. 5 (394): 460).

Sheikh Ahmed Ibrahim,[5] some of whose views are summarized here, had his own opinions about life insurance, chiefly surrounding his assertion that no comparison could be drawn between the life insurance contract and the legitimate *Mudaraba*. Accordingly, the insurance contract is illegal because it is open to usury. Furthermore, if the successors received the insurance money before the full settlement of the instalments, it would be risky and therefore a form of gambling. In such a case there would be no return on what the company had, rather than both parties to the deal's abilities to predict future prospects. They would be dealing with each other on an unknown basis, which would contradict the customary and fixed system of dealing (*Al-Shubban al-Muslimoon* (*Muslim Youth*) Magazine 1941 (November): Vol. 13, issue 3: 7).

Sheikh Mohammad El-Molky[6] holds the opinion that the investment of money is not gambling according to the Quran. The gambling that *is* forbidden, is specifically the well-known game in which two parties play against each other, with a certain stake in the pot from each of them, and the winner takes all – not the way investment works. Insurance cannot, by any means, be compared with gambling, particularly when it is taken as a collective cooperative effort of social use to humanity in confronting natural catastrophes. However, the obscurity of gambling would only be evident if it were viewed as a mere commercial contract between two parties.

Ahmed Taha el-Sanousi, a contemporary Islamic scholar, in his comparative research entitled 'The Insurance Contract in Islamic Legitimacy',[7] makes a comparison between insurance contracts from the angle of liability and 'the fidelity'. He came to the conclusion that there was no reason why an Islamic form of insurance should not exist since its components resembled the 'fidelity' of a contract. If they really are alike, we would be able to depend on that similarity for the legitimization of insurance.

The fidelity of contract forms a link between two parties to an optional contract, provided that each party divulges to the other any previous offences regarding money, and that the first of them to die leaves his estate to the other. One of them may be more influential and powerful than the other and should accordingly be responsible for all the other affairs of the weaker party, including the payment of *diyya* (blood money) in the case of committing murder. Eventually, the stronger party would have the right to inherit from the weaker party in cases where no other heir can be found.

This fidelity in *Jahilia* (the pre-Islamic era) was one of the fundamental ways to inherit from someone to whom one was not related. The harsh and hazardous conditions of life during that era facilitated this kind of alliance. When Islam emerged, this situation was acknowledged and allowed to continue for some time until the religion was refined. As a great religion, it outlawed unjust support of one person by another, and called for equality and justice in relationships between all people, as revealed in the Quran:

> O ye who believe! Stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be [against] rich or poor: For Allah can best protect both. Follow not the lusts [Of your hearts].
>
> (3:135)

The *jurists* and *Imams* hold very diverse opinions about the 'fidelity of contract for the clientele', and whether or not it was a reason to inherit. The Quran states that the next of kin should have the highest priority to inherit over other relatives:

> . . . but kindred by blood have prior rights against each other in the Book of Allah. Verily Allah is well acquainted with all things.
>
> (8:75)

Also, the Prophet Mohammed instructed mankind clearly that: 'Fidelity should be for the one who frees a human being from slavery' (*Hadith* 2517).

Insurance of liability is a contract in which the insurer pledges to guarantee indemnity for any loss that might occur to the insured, in the case of any mistake made in his business dealings that are incurred at another's expense. Such a guarantee would only be applicable to civil liability, and has nothing to do with criminal responsibility, even with regard to consequences such as fines.

It does seem, from the formal point of view, that the components of 'fidelity of the contract for the clientele' complies with insurance of liability, or may at least resemble it. On the other hand, the deep and genuine basis of comparison lies in the following two differences between these types of contract:

1 'Fidelity of the contract of clientele' is a contract between two parties. If the insurance of responsibility were considered a dual contract, it would be a form of illegal gambling. Jurists have commonly agreed that the transfer of dangerous liabilities from one individual to another would lead to the erosion of the social fabric. At the same time, the 'fidelity of contract of the clientele' would not be considered to be gambling, even if it were between two parties, because it is based on the links between relatives as well as on moral support. Thus, the financial outcome of this contract would be derived from those values.
2 No connection exists between the two contracts; while the 'fidelity of contract for the clientele' has been based mainly on defending and supporting the weak and oppressed fellow members of a tribe, 'insurance of liability' has been based mainly on the notion of the reciprocal financial exchange on grounds of probabilities, for commercial purposes.

Sheikh Abdel Rahman Issa[8] opines that insurance should be divided into two parts. First, he considered reciprocal insurance to be legal and desirable, being cooperative in nature and useful in confronting social problems and natural disasters, seeing the value of this kind of insurance as a contract between two parties in which the owner of capital paid a wage or commission to the other party. Eventually, however, in view of the fact that the Maliki school of Islamic law ideology contested his argument (supporting the conception of a contract from which the contractor would not gain), he concluded that it would be legal if both parties to reciprocal insurance took commission in the case of a disaster, even if it affected a third party. Second, he judged as legally admissible commercial insurance against risks to property and civil liability, as it would provide many benefits to the public by saving people's financial resources, protecting them from damaging financial ruin, and, more importantly, bringing profits to the insurance company. He treated it as an economic transaction for the benefit of the two parties who voluntarily agreed to contract with one another (Issa, Sheikh Abdul El-Rahman 1996: 90).

However, we can see that the issuing of such an unqualified judgement is not acceptable, as it ignores (or omits) a number of important facts about this kind of insurance. The judgement was made on the basis of non-equality between the contracting parties in a contract based on submission, in which the stronger party dictated the terms and conditions to the weaker party. It would also be a contract based on tempting the insured, which is not permissible, as it would be a potential contract.

Finally, the insurance company would collect the funds from all the insured parties, to invest them in different ways which would produce large profits for the company. This attitude would definitely count – in the opinion of economic *jurists* – as the defence of a monopolistic position and economic risk which could cause a lot of damage to the community. So what is the nature of the commitment to commercial insurance? Would it comply with *Shari'a* rules and

general principles? Would the consent of the two parties always be sufficient evidence to judge whether their position was legal? Sheikh Issa also recognized the benefits that would accrue from social and cooperative forms of insurance, as well as showing the disadvantages of being a merely commercial activity.

Mohammed Yursuf Musa[9] acknowledged that insurance of all kinds is based on a cooperative enterprise from which society benefits, and thought that it would be legal if it were free from usury. In his opinion, if the insured lived for the whole term of the life insurance contract, he should be entitled to regain only what he has already paid, without any interest. But if the insured died before the term of the contract was up, his successors should receive the full amount of insurance, as that would be absolutely legitimate (*Alahram aliqtisadi*, issue 132: 20).

It is understandable that insurance as a cooperative enterprise applies to reciprocal insurance. Thus, the illegitimacy of usury should not be an issue. In the case of the death of the insured, Musa cites no evidence as to how the full collection of the insurance premiums would be assured and legal. Writing about life insurance in his book *Al-Islam Wal Hayat* (*Islam and Life*), he maintained that insurance in general is legitimate if conducted by ethical companies, free of usury both in their own investments and in reimbursing the premiums to the insured at the end of the term of the contract (Musa 1986: 216). Hence, in his conclusion on the illegality of insurance he referred only to the relationship between insurance and usury, and can be considered to stop short of declaring the legality of usury-free insurance.

Musa refutes this point by giving the example of insurance which, in some of its particulars, resembled the Cooperative Pilgrimage Society law which imposes 240 points per annual instalment on each member. If the member died before it was his turn to travel, then his successors would regain nothing from the instalments he had paid. If he discontinued payment of his prescribed instalments, he could regain only what he had already paid. Eventually, if he had the chance to travel on a pilgrimage, he would be paid around 40 points by the Society, provided he was responsible for the settlement of the remaining instalments. If he died before fulfilling this commitment, nobody after his death would be obliged to take legal action (Musa 1986: 217).

The comparison between commercial insurance and the Cooperative Pilgrimage Society is not valid as they differ in essence as well as in details. Such subscriptions to non-profit societies are purely benevolent with the main aim of helping their members and the community. They run an ideal financial system which aims neither to make any sort of profit nor to gain from usury. Insurance, on the other hand, is a bare-faced commercial activity, for the express purpose of making profits from customers. The characteristics of the insurance contract are totally different from those of charitable organizations, which are cooperative contracts, rather than ones based on obligation, probability and temptation. As long as it gives wide scope to deceiving and misleading customers (Issa, Sheikh Abdul El-Rahman 1996: 24), the insurance *jurist*

admitted that it could not form a part of the group of 'good faith contracts'. Because of this, there is no way of comparing commercial insurance with the operation of the Cooperative Pilgrimage Society.

It is true that insurance, if it were of a cooperative nature, would be different from any kind of gambling or mortgaging, but if it were not, it would be risky, tainted and outlawed. That is mainly because of a lack of equality and proportionality between profit and loss, with the total absence of fairness in the division of profits. The allegation that card-playing is the only act of gambling is ingenuous. The ancient Arabs used to hold raffles (like the Lottery) with their arrows, using them as a source of good fortune in a way that controlled their daily lives. Later, with the spread of enlightenment from Islam, that came to be considered gambling and, along with other practices such as drinking, was banned. The Quran is unequivocal: 'Forbidden also is the division of meat by raffling with arrows: that is impiety' (4:3); and 'O ye who believe! Intoxicants and gambling, sacrificing to stones, and [divination by] arrows, are an abomination – of Satan's handiwork: eschew such [abominations], that ye may prosper' (4:90).

The assessment of compensation in life insurance is based on a forecast of how long the insured will live. It differs in this respect from the assessment of perished goods. Therefore, as long as it is utterly predictable it would be very hard to achieve justice that would give insurance the nature of gambling. Insurance also contains some kind of temptation, which is prohibited, as well as ignorance about how to insure somebody's life, and this ignorance is what makes the contract imperfect, leading as it does to legal disputes and the wasting of people's resources.

It is understandable that life insurance companies normally invest their reserves for usurious purposes. From this angle, it is hard to separate the rules and regulations of the insurance systems which govern the treatment of their customers from the illegal pay-out of consequently tainted money to the insured at the end of the term.

Al-Maliki school of law

Mustafa Ahmed El-Zarqa's views

Mustafa Ahmed El-Zarqa[10] came to the conclusion that the rule of commitment operated if somebody promised another party a loan – which did not form part of their duty – or took on any financial burden on their behalf. The *jurists* of the Maliki school of Islamic law held different conceptions of how obligatory the maintenance of the original promise was. Some of them supported the fulfilment of the promise unequivocally, irrespective of its nature, while others held the opposite view. One group put forward the idea that the lender was obliged by his promise when the purpose for which the money was required was specifically defined, even if the person to whom the promise was made did not

achieve the goal. However, some *jurists* did not agree with this latter point, and made it conditional on the person to whom the money had been promised achieving the set task.

El-Zarqa continued to maintain that the insurance contract should be an obligation on the insurer towards the insured, bearing, on his behalf, all the harmful consequences of any dangerous accident to which the insured might be subject. That obligation was inherent in the promise, whatever the possible outcome.

The differences between the *jurists* of the Maliki school of Islamic law on this issue leads us to the core of the dispute about the implementation of obligatory promises. According to this school, the opinion closest to reality is the one that is called for. Thus, the promise should not be obligatory unless there is a reason to let the person who has been promised be actively involved. The lender who makes the promise should not make any promise before being fully confident that he is capable of carrying it out.

The idea of treating the insurance contract – even without a return – as an obligatory promise is not valid as the nature of the contract conflicts with obligatory promises. It would not be possible to accept this idea as evidence for the issuing of an insurance contract, as this contract is not just a promise, but is also a formal commitment by the insured to pay the proposed instalments, in return for repayment of the insurance premiums at the end of the term of the contract. If the insured fails to fulfil his commitment, then the insurer would naturally be absolved of any responsibility towards him.

The Aqila system

The *Aqila* is a clan committed, by an unwritten law of the Bedouins originating in the early stages of Islam, to pay blood money for each of its members. If somebody unintentionally commits a murder (manslaughter), and the granting of blood money became the clan's final verdict, then that blood money would be spread across his *Aqila* (the supportive clan).

The *Imams* and *jurists* have different ideas as to who the members of *Aqila* should be. *Imam* Abu Hanifa suggested they should be the administrators in his area, while *Imam* Malik argued they should be the killer's clan, who normally live with him in the urban centre and not those who live in the rural area. *Imam* Shaf'i stated that they should be the next of kin on the father's side (Ibn Hazm 1980: 11:47). *Imam* Ibn Hazm backed *Imam* Shaf'i's opinion in that the blood money should be collected by the clan members in a cooperative way to maintain good ties with the killer, provided the killing itself happened unintentionally. The *jurists* justified that as a kind of punishment of the clan members for their deficiencies in neglecting their kinsman to the point where he was pushed to kill someone, albeit by accident (Ibn Abdin (repr.) 1966: 5:47).

What, then, are the points of similarity between the insurance system and the *Aqila* system that was basically established on firm foundations of

cooperation and mutual support? The delinquent would gain no personal benefit in complying with the *Shari'a*, on grounds of cooperation and family solidarity (Abu Zahra 1989: 517). Comparing *Aquila* with commercial insurance reveals fundamental differences. The latter is a purely commercial activity, based on a bilateral commitment between an investor (the company) and a customer (the insured). These commitments represent the payment of prescribed monthly or annual instalments by the insured against the return of a financial benefit to him at the end of the contractual term. Although El-Zarqa insisted that the dual responsibility in the systems could deem them acceptable, the *jurists* refuted this by pointing to the lack of dual responsibility in commercial insurance.

The *Aqila* system is similar to the pensions scheme for State employees which is founded on cooperation between the State and its employees for their eventual benefit. Under this system, the State deducts from employees' salaries regular monthly amounts which are give as pension payments at the end of their working life. These payments should continue for the rest of their lives and are then passed on to their dependant successors after death until they become independent. On the face of it, the process is similar to the commercial insurance system in respect of paying monthly instalments, but closer examination reveals differences between them. The commercial insurance system is based on certain financial rules, the ultimate goal of which is profit, while State-designed pension schemes exist for the sole benefit of its employees. The State, by so doing, aims to express its appreciation of its employees' lifetimes of public service and show their care and responsibility towards all civil servants, irrespective of their religion or gender, ensuring that they and their families can live a decent and honourable life after retirement. The small percentage, deducted from employees' monthly salaries while in service, is not equivalent to an insurance premium but is a form of tax designed to provide good administration and an appropriate standard of public welfare.

Despite some abuses of pension schemes, it does not signify that a commercial insurance system could act as a legal counterpart.[11] There is a big difference between a cooperative and benevolent social security system under the direct supervision and control of the State and a private system designed by the private sector that aims to profit from the financial resources of the public by exploiting suspicions. Muslims believe that Islam, as a broad-minded and final religion, has been revealed to all mankind and has proven useful for every generation everywhere. As a tolerant religion, it would not reject a foreign or modern system because of its origin, unless it contradicted the provisions of *Shari'a* and the general principles of Islam. However, El-Zarqa's opinion, giving formal approval to commercial insurance by comparing it to 'fidelity of contract for clientele', 'obligatory promise' for the Maliki school of Islamic law, the *Aqila* system, or public employees' pension schemes, is not valid, nor is his opinion about the legality of commercial insurance.

Mohammed Abu Zahra put forward significant opinions about insurance, summed up in three main points:

1 Abu Zahra argued that the *jurists* should not be rigid in trying to interpret modern contracts in the light of the *Shari'a*. That means more flexibility and understanding are required, unless those contracts conflict with the basic rules of Islam. Some understand that the insurance contract has become acceptable according to the beneficence which is taken in some Islamic countries as a considerable argument (particularly in the Hanafi school of Islamic law) regarding issues which used to be proven by discovery and not by the general text. Abu Zahra would agree that the genuine and true beneficence could be an argument. Then he made an inquiry as to whether commercial insurance has become a public or private beneficence; his answer for this inquiry would be that only a very small proportion of people currently use that sort of insurance. At the same time the alleged beneficence would normally confront some issues being derived from the texts.
2 The insurance contract has come to be accepted in some Islamic countries on the basis of its beneficial effects which are considered a substantive argument in its favour, particularly by the Hanafi school of Islamic law. Professor Abu Zahra would agree that the genuine and true beneficence could be an argument in its favour. He inquired into whether commercial insurance is of public or private benefit, concluding that very few people currently benefit from that sort of insurance. At the same time, any alleged benefit would normally have to be measured by its conformity to the texts.
3 Abdel Rahman Issa has pointed out a real benefit from the insurance contract, one that can be considered independently of jurisprudence, namely that the insurance contract has now become an economic necessity and a fact of daily life. However, it is pertinent to ask whether commercial insurance is the only option. Whatever necessity there might be, the doors of cooperative insurance are wide open. If it did not exist, it would have to be invented.[12]

Eventually, he concluded that a cooperative, social insurance scheme is completely legitimate and that non-cooperative insurance is unacceptable because it contains the taints of gambling, temptation and usury that would nullify the contract. It represented a waste of financial resources through payment of money against future receipts and, therefore, such kind of insurance should not be considered an economic necessity.

The importance and impact of insurance upon current daily life in terms of economy and social welfare are quite distinct from its commercial aspects. It has become a daily fact of life as well as a reality affecting everybody. By and large, this effect on daily life has been due to colonial domination of the Islamic world's political and economic affairs, whereby Western laws, traditions and policies were (and are) imposed on Islamic countries, leaving the doors wide open for their companies to arrive and exploit the human and natural resources of Islamic countries. Islamic life needs to be reorganized with its acquired

heritage and, most importantly, with the rejection of what is not *Shari'a*. Insurance is definitely one of the legacies we should adjust to, but in accordance with Islamic culture and religion.

Modern *jurists'* standing on insurance

Introduction

Modern Islamic *jurists* have expressed their views on insurance, individually in their own publications, collectively during conferences on the subject, or in papers presented at them. Examining their views adds to the long-standing confusion and difficulties of interpretation. There are several reasons for this confusion but the main one is the lack of any references to insurance in the Quran and *Sunna*. This precluded initiatives by respected scholars and explains the absence of classical Islamic law treatises on the subject (Khalaf 1974: Vol. 11). This has led to opinions being given by scholars who lack understanding of the nature of the insurance contract and its terms, and therefore cannot be objective in assessing the core mechanisms of insurance.

Several opinions have been expressed on the validity and permissibility of insurance and these can be grouped in the following way:

1 A group that prohibits all kinds of insurance without exception.[13]
2 A group that only approves of commercial insurance organized on a mutual or cooperative basis.[14]
3 A group that approves all kinds of insurance.[15]
4 A group that prohibits only life insurance with a commercial or mutual contract.[16]
5 A group that stresses that insurance *per se* is unlawful, although necessity makes it permissible (Khalaf 1974: Vol. 2).
6 A group that allows only some indemnity insurance, such as motor insurance.[17]

It must be noted that these groups often overlap, as some *jurists* approve of certain aspects of insurance but disapprove of certain practices at the present time. An attempt to harmonize and reconcile these views is being made in this work.

The first group's opinion is based on moral, political, religious and economic arguments. The second group's views derive from the legal standpoint of traditional teachings on *gharar* and *riba*. Some of the *jurists* insist on non-legal arguments, whilst others insist on the contractual basis of insurance. Both views are indiscriminately employed and expressed fairly, as far as insurance is concerned. The view of the majority of contemporary Muslim *jurists* and scholars that insurance is prohibited when persons or organizations profit from the misfortune of others has been stated by the Committee of *Ulama' Al-Majma*

al-Fiqhi al Islami,[18] while insurance is acceptable if conducted on a mutual or cooperative basis.

The legitimate bases of insurance

The application of a number of prohibitions in Islamic law differs according to whether the contract is an onerous one (*mu'awada*) or one without consideration, (*Tabarru*). This distinction is essentially relevant in Maliki law, where the prohibitions of *riba* and *gharar* apply only to *mu'awadah*, but, as noted earlier, similar positions in the Hanbali school of Islamic law were developed by Ibn Taymiyyah.

Insurance falls within the category of *mu'awadah*, as both the insurer and insured conclude the contract knowing that it involves mutual obligations and is subject to the conditions contained in the policy, namely that the insurer is not bound to pay the sum insured if the insured fails to pay the due premiums.[19]

Prohibition of gharar and the validity of insurance

The prohibition of *gharar* in Islamic law has been the major argument put forward against the validity of insurance. Those who argue that insurance cannot be accepted under Islamic law argue that uncertainty is a prominent feature of insurance. Firstly, these proponents argue that there is uncertainty as to the payment of the sum insured. The insured pays periodical premiums without knowing whether the sum insured will ever be received, as its payment is dependent upon the occurrence of a contingent event (Al Masri 1987b).

Additionally, when payment is made, there is uncertainty as to the amount payable to the insured as such payment is measured according to loss sustained, at least as far as indemnity insurance is concerned. Therefore, insurance manifestly involves uncertainty, and this uncertainty is equivalent to the element of *gharar* expressly prohibited in sales contracts in Islamic law (as mentioned in the *Sunna* and in the Quran (2:188)) and, by analogy, other contracts. Thus, insurance in Islamic terms cannot be permissible (Al-Hafiz 1984: 2: 426–31).

The position of the *Shari'a* towards conditional and uncertain sales is that risk, where it is involved, is forbidden because of the likelihood that it will result in disadvantage to some party (Khater 1985). However, such an interpretation of the *Shari'a* is far from being an accurate reflection of its position in this regard. There are various elements which form the basis of different views. One view considers the existence in Islamic law of a category of contract involving uncertainty, which includes wills, guarantees, and other similar contracts. Another viewpoint, supported by Ibn Taymiyyah, accepts the Maliki doctrine which confines *gharar* to circumstances where uncertainty may have prejudicial effects and upset the balance between the mutual rights and duties of the contracting parties (Shalaby 1960). Apart from this, there is the fact that *gharar*

is, itself, applicable to contracts involving an actual exchange of counter-values and is subject to the requirement of equivalence rather than being a transaction containing a binding promise of financial assistance through a contribution to a fund created for the purpose.

For this reason the sale of unripe fruit was forbidden by the Prophet. If the fruit did not ripen, the calculated equivalence would be upset and the result would be an unjustified increase of capital to the benefit of the seller.[20] Though the insurance contract has incorrectly been compared to the sale contract, it is not a conventional contract whereby goods or services are exchanged for money, in which case the comparison would have been well-founded. Each insurance transaction containing risk has to be considered fully to evaluate the eventual prejudice it entails. As for insurance, it has been specifically designed in order to counter the effects of risk and this function cannot be set aside when studying its legitimacy within Islamic law. It must be the determinant in this respect.

Uncertainty is inherent to insurance. It aims to provide financial security in exchange for a premium which is appropriately justified, as no one would expect to receive financial assistance from a fund without contributing to it. Insurance without uncertainty is inconceivable, as is the case with other such contracts containing a functional contingency, such as wills, guarantees and *Mudaraba*. The performance of the obligation of a surety is necessarily uncertain, as it is deemed to materialize only in case of default of the principal debtor, which is a contingent event. The same principle occurs in insurance where the uncertainty is fully justified and legitimate. It should be noted that the concepts of State pension schemes and mutual insurance are not refuted when commercial insurance is rejected because of the existence of *gharar*, as the same principle of functional contingency applies.

Uncertainty is present in mutual and State insurance schemes as much as in commercial insurance and the argument that *gharar* does not invalidate mutual and State schemes because the premium is deemed to be a donation is unconvincing (El-Atar 1978: 112). In fact the Islamic opinion supporting such an argument implicitly admits that *gharar* is not by itself prohibited *per se*, and is only deemed to invalidate insurance when there is a possibility of unjust advantage, as is the case in commercial insurance. Therefore insurance contains *gharar* because its aim is to cater for prejudicial uncertainty. It is not, as is the case with some Islamic contracts, rendered invalid by it. As required by the *Shari'a*, the rights and obligations of the parties are, to a great extent, precisely determined. The contract stipulates exactly what each party is enjoined to do or abstain from. What remains undetermined in indemnity insurance is the sum insured, as it will be measured according to the loss sustained and covered under the policy's terms.

This factor (along with the indeterminacy of the date of payment of the indemnity) is dependent upon the occurrence of the risk covered and does not fall within the arena of the prohibition of *gharar*, which forbids functional

uncertainties pertaining to the essence and role of the contract. It is considered by Mustafa Al Zarqa that insurance falls not within the scope of the application of the prohibition of *gharar* by *Shari'a* but within the kind that is acceptable: '. . . and for those who say that peace [*Ammn*] has no value, I [Mustafa al-Zarqa] say that peace [*Ammn*] is the greatest life gain as that peace God has gifted *Quraysh* with it. "Let them adore the Lord of this house [House indicate the *Ka'ba*]"' (106:3). All people work hard, collect wealth, build houses or palaces, invest and trade all these for gaining peace and security for themselves and their families for their present and future, and there is no evidence in the Sorat that obtaining peace does not have a price, and any claim that peace does not have a price contradicts to God's principles (Al-Zarqa 1984: 47). Therefore, insurance does not fall within the scope of the prohibition of *gharar*, as it is a collective scheme which cannot be reduced to a one-off bilateral contract: *gharar* invalidates a contract when it results in unfair profit to one party, as in the case of the sale of unripened fruit. The prohibition of *gharar* is founded either on *riba* or on gambling, as expressed by Ibn Qayyim (1972b) (*Al Tariq al hukmya fi al Syasa al Ta-Shri'iya*: 2:7).

Similarly, the *Sorat* contract of hiring guards is a contract of employing guard to protect one's properties or goods of any kind. The guard employed is paid wages for the service provided, which amounts to paying fees for peace of mind.

Insurance contracts have no such unjust profit because, with the exception of life insurance, if the event insured against occurs, the insured will not make a profit but will simply be indemnified from the collective fund set up and administered by the insuring body. If the event insured against does not take place, the premiums do not become the property of the insured. The transfer of the premium occurs only once they have been paid, and is independent of the occurrence of an uncertain event. Therefore *gharar* does not arise in this case. In addition to this it should be specified again that insurance lessens social and economic risks (Shouki 1984).

Invalid bases of insurance

Implication of riba in insurance

Under a conventional insurance contract the insured pays to the insurer a sum, usually by instalment, in exchange for the insurer's undertaking to pay, on the occurrence of a specific event defined in the policy, a sum which is normally largely superior to the premiums paid. The insured (or the beneficiary) may consequently obtain a sum much higher than the one he has paid. This difference has been seen by Muslim *jurists* as amounting to an unjustified increase of capital, resulting in *riba*. *Riba* would also be involved when the risk insured against does not take place, only this time to the benefit of the insurer. The premiums paid are seen as a 'mere loss' to the insured and an unqualified profit for the insurer, which amounts to an unjustified increase of capital

prohibited by the *Shari'a* (Qadi 1984: 2:499). This concept of *riba* has been introduced into the argument on the invalidity of Islamic insurance as a result of an unfounded analogy made between insurance and a number of contracts sanctioned by Islamic law. One such example is the analogy made between insurance and *sarf* (Muslehuddin 1966: 177). When the insurance contract is seen as *sarf*, the difference between the premiums paid and the sum insured cannot but be described as *riba* as the insured receives a sum exceeding by far the instalments that he paid (Al-Dasuqi 1967: 177).

On examination of its lawfulness, the insurance contract cannot be reduced to, or made to fit into, one of the Islamic nominate contracts. The sum insured paid to the policyholder is not the repayment or refund of the premiums paid by him increased by a certain amount, as is alleged by those who oppose insurance (Al-Hafiz 1984: 2:499). It is true that the premium paid by the insured varies with the amount and extent of the cover required. This is necessary for the common fund to provide sufficient cover for the risks transferred from the insured to the insurer. Insurance is the participation in a common scheme, aimed at providing financial assistance according to the terms of the contract entered into between the insured and the body to which the risk is transferred. The premium paid represents the necessary contribution to the common fund, without which no reserves could be formed to provide assistance, and no remuneration for the service provided by the insuring body could be made (Moghaizel 1990: 202).[21]

Gambling versus insurance

It has been claimed by many that insurance should be rejected because it is a form of gambling. The payment of the sum insured depends upon pure chance, as is the case with gambling profits (Uways 1970: 98). But as we have already established in detail (Uthman 1969), the requirement of insurable interest removes insurance from the ambit of gambling and the argument disqualifying insurance on this ground is invalid.

Another view is that bidding is another kind of risk which is not a necessary part of everyday living and working; on the contrary, it is a voluntary choice. Regardless of whether one is the bidding process's initiator or someone who joins in, it is volitional. Such a process entails both loss and gain. The hope of gain motivates the taking of risk which is a game involving money stakes. This is considered gambling and insurance does not differ from this (Nejatullah 1985: 15).

Other arguments on the invalidity of insurance

In addition to the arguments citing the existence of *gharar* and *riba*, other grounds have been put forward for the rejection of insurance by those who argue insurance's invalidity:

1 The insurance contract is not recognized by the *Shari'a*. According to this argument, insurance should be rejected because it does not correspond with the nominated contracts regulated and expressly validated by the *Shari'a*. The counter-argument is that Islamic law does not reject all contracts that do not comply with established nominate contracts. It recognizes the concept of contractual freedom and allows the introduction of new transactions, provided that they do not violate Islamic contractual public policy.

2 The 'inheritance rules and insurance' argument concerns life insurance, where the sum insured is paid to a beneficiary designated by the insured, and is not passed on at the death of the insured to his legal heirs. It is said that this constitutes a breach of Islamic inheritance rules concerning the distribution of the deceased's estate among his legal heirs. This argument has its origins in a distorted view of the insurance contract, as the sum insured paid to the beneficiary does not originate from the estate of the life insured, but from the fund constituted and administered by the insurer. As a result it is not subject to the inheritance rules applicable to the estate of the life insured. It might be argued that by its means life insurance allows the life insured to defraud the inheritance rules, and takes advantage of heirs to the detriment of the others. In fact, according to the *Shari'a*, a Muslim may donate freely during his lifetime to any person he wishes,[22] so he does not need to resort to life insurance for this purpose.

3 The third party contract is illegal in Islamic law. Contracts for the benefit of third parties would not be allowed in Islamic law, because the clause stipulating that the benefit from the contract is to be given to a third party would amount to an additional clause in the contract prohibited by the *Shari'a* (Al-Sanhuri 1934: 2:159–61). As a result, given that insurance is often a contract for the benefit of a third party (Issa 1978), it should be rejected. While this statement might be pertinent in Hanafi law, the position of Hanbali law in this respect is very different. This latter doctrine allows additional stipulations to the contract, provided that they do not contravene the provisions of the *Shari'a*, so that contracts for the benefit of third parties are valid and do not constitute an impediment for the permissibility of insurance under the *Shari'a*.

4 According to views on the will of God, man's destiny is decided by God, and insurance and life insurance contracts would upset the course, because it aims to change the natural consequences of adverse events. This extra-legal argument was refuted very early on (Uthman 1969: 478; Mahmoud (n.d.): 159). It is obvious that the *Shari'a*, which has Muslim interests in mind at all times, is not violated by measures of precaution and security which are aimed at providing financial assistance in the event of prejudicial events.

5 Regarding reinvestment of the insurance premium, the investment policy of the insurer is important since, while it is not properly part of it, it has a consistent bearing on the insurance contract, forbidding as it does elements

such as *riba*. It is evident that insurance companies invest the funds raised in ventures involving interest in violation of the *Shari'a*, but the invalidity is due to the investment behaviour of the insurer, not to an inherent defect in the insurance contract. It disqualifies the insurance contract only inasmuch as it is inconsistent with Islamic law, and there is a considerable latitude for manoeuvre in this respect.

6 Insurance is not based on genuine cooperation. The supporters of the validity of insurance quote in its favour the verse of the Quran calling for mutual help and cooperation among Muslims: 'And the believers, men and women, are protecting friends of one and another; they enjoin the right and forbid the wrong, and they pay the poor-due and they obey Allah and His messenger' (9:71). Such arguments must be refuted on the grounds that there is no intention of cooperation and mutual help among the group of the insured. Whether the intention of mutual help exists or not among those insured in commercial insurance, the fact is that the loss sustained by one of them is borne by the others collectively, since the sum insured is paid from a fund constituted by the collection of premiums from all those insured. Consequently, the mutual help enjoined by the Quran is in force on a *de facto* basis, but, as will be submitted later, mutual insurance does not embody genuine cooperation among the insured any more than commercial insurance does. However, even if the insurance contract is not a realization of the principles prescribed by the *Shari'a*, it is, nevertheless, valid so long as it does not contravene the rules of Islamic law.

7 Besides the arguments rejecting commercial insurance cited above, there are many other arguments that fall into two main categories:

a The first concerns stipulations in the insurance contract, often seen as draconian clauses towards the insured, such as charging interest for a delay in payment of the premium (al-Mammal: 354). Here the blame is directed at the stipulations, which are in themselves too burdensome and contrary to the *Shari'a*. It is not the insurance contract *per se* that is subject to controversy, but certain terms contained within it which are judged unfair. The issue here is how these clauses can be modified to make them acceptable to Islamic law.

b The second category of positions includes extra-legal arguments which are entirely subjective and unfounded. Amongst such arguments are allegations that insurance leads to negligence, as insurance companies strive solely to make profits at the expense of the community (Khorshid 1994), and to exert control of governments (Issa 1978: 118–19). This undermines all legal reasoning as it demonstrates a preconceived hostility towards insurance, which proceeds from a profound misconception and limited understanding of its mechanisms. These arguments reveal the underlying reasons for the rejection of insurance by the majority of its proponents which will be explained

later. One remarkable example is the allegation that insurance leads to negligence because the insured, knowing that he will be indemnified by the insurer in case of damage to or loss of his property or in case of liability incurred, will act recklessly and without prudence. It is also said that the insured will intentionally commit acts causing him to be indemnified under the insurance contract (ibid.: 12). While insurance is subject to abuses and fraud, as any other contract, effective measures have been taken to counter this. Insurance policies generally contain a deductible or excess clause making the insured liable to contribute a certain proportion of the loss sustained. In addition, policies often impose on the insured the adoption of preventive measures to minimize the occurrence of an insured risk. These are promissory warranties to maintain alarms or sprinkler systems in commercial fire policies or to install new locks or maintain new brakes in motor policies.[23] As far as intentional acts committed by the insured are concerned, there is a standard practice whereby policies do not cover losses intentionally caused by the insured.

It is widely agreed among Islamic scholars and *jurists* that the insurance contract can never be free of gambling, temptation and usury. As long as there is no compelling economic necessity, it should be replaced by a lawful, cooperative insurance system, which is free from usury and any other taint. With regard to the criticism that the insurance contract is a waste of resources, it is important to qualify this. It is not necessarily the case, as sometimes the insured party may not receive the full insurance entitlement owing to the non-occurrence of the accident covered by the transaction. In such a case, the insured party might pay their money without any return. In many cases, the insurance companies may also prefer to repair the damage without paying the insured any actual money. That mostly happens in cases of insured objects which can be repaired or replaced.

Sheikh Abdullah El-Galgeily's *The Mufti of Jordan* already set out his judgement of all kinds of insurance as illegal according to *Shari'a* for several reasons, specifically that insurance:

1 is incompatible with natural and familiar methods of earning money, such as buying and selling;
2 is not free of the taint of gambling;
3 is not free of temptation and cheating; and
4 involves an element of usury.

In addition, the insurance companies issue the terms and conditions in their contracts in an ambiguous, unclear way that protects only their own interests, while ignoring those of their customers, a situation with the potential to lead to corruption.

Muslim *jurist* Siddik Mohammed El-Amin El-Dareir, author of *Hokm Aqd Al-Ta'min fi al-Shari'a al-Islamiya*, was of the opinion that the current insurance system is not legal, as it is not appropriate to decide on the basis of necessity unless there are no other alternatives. In the case of insurance, it would be possible to take the essence of the insurance contract and make the best of it, while firmly upholding the doctrines of Islamic jurisprudence. That could be achieved by moving from commutative to contributory insurance contracts. It would be possible to remove the intermediaries who solely make profits from insurance and convert to a cooperative insurance system. That kind of insurance could be run by the participants themselves or under government supervision. El-Darir came to his conclusions mainly because the current insurance contract contains an element of temptation which is utterly unlawful.

Other views on insurance

It is now clear that a distinction has to be made between life and non-life insurance. Life insurance contracts do not have the indemnity character of other policies, and are not considered as compensation for a loss suffered. The sum insured is paid without reference to any financial prejudice sustained, although the idea of compensation may be inferred if the sum insured is paid to the breadwinner's dependant after the insured's death, something that is not the case when the sum insured is paid to the insured himself at the maturity date of an endowment policy. In the latter, and in spite of the insurable interest requirement, it remains, from an Islamic point of view, immoral gambling. This is why positions towards life insurance generally differ and are extremely restrictive. Therefore, life insurance must be considered separately in any insurance scheme, and as being not in harmony with the *Shari'a*.

Inconsistencies in arguments prohibiting insurance

Insurance is criticized for involving elements forbidden by Islamic law, such as *riba* and *gharar*. Other non-legal considerations are cited incidentally (Al-Hafiz 1984: 2:365–6). On the other hand, the insurance schemes accepted by Islamic opinion, such as mutual insurance, do not necessarily eliminate the forbidden elements that exist in commercial insurance. A contract which, on the one hand, is rejected for contravening the Islamic law of contracts is accepted; on the other hand, in a different context and while still containing the principal causes of its rejection, a contradiction advises that weakens the reasoning of the arguments against commercial insurance. Amongst those opposing the validity of commercial insurance, there is almost unanimity that mutual insurance is the only acceptable insurance scheme under the *Shari'a*, with the exception of State insurance. The argument is that the mutual structure does not involve forbidden elements (Sha'ban 1978: 13; Al-Hafiz 1984: 2:508–9; Rahman 1979: 228), and that mutual insurance embodies the Islamic conception of solidarity

and mutual help, as premiums paid are donated by the insured who are free of any profit-making intention (Al-Darir 1987: 646). According to this view, the only aim of the participants in the scheme is to provide relief for its other members in the event of financial loss. The premiums and the sum insured are seen as gifts and therefore exempted from the prohibitions of *riba* and *gharar* as there is no exchange of counter-values (Al-Hafiz 1984: 2:504).[24]

Armed with the above opinions, the mutual scheme can be considered valid for the following reasons:[25]

1 the intention of the members is to help each other and to bear one another's burdens;
2 the intention of the members is to donate the premium and not to pay a contribution in return for financial cover;
3 the insuring body is owned by all those insured;
4 the company is managed by the insured and not by a distinct entity; and
5 the profits are distributed to the members and not to shareholders owning the business.

It should be pointed out that the members of a mutual insurance company do not have to know each other, and deal solely with the business of the company in matters relating to their policy.

In commercial insurance the intentions of the policyholders cannot be guessed at, and would not affect the judgement of the promoters of, and participants in, the scheme. It is more than evident that the incentives of the insured are to seek the best financial cover with the most favourable terms available. All policyholders pay a premium in exchange for cover. That is the promise of the insurer: to secure them financial assistance according to the conditions of the policy. There is no doubt that in the mind of the insured, were his intentions revealed, the idea of interdependent and mutual obligations between him and the insuring body would always be manifest.

We conclude that if *riba*, prejudicial *gharar* and gambling exist in commercial insurance, they will not be present in mutual insurance, because mutual insurance eradicates the alleged causes of the forbidden elements, according to the reasoning of the opinion which invalidates insurance on the grounds of *gharar*. Therefore, mutual insurance should be strongly recommended and the insured may, at least theoretically, be asked to pay an additional premium to enable the company to meet its financial obligations towards members entitled to an indemnity. This additional premium cannot be pre-determined, so that excessive uncertainty is involved in this operation. Advocates of mutual insurance often fail to mention this point. As far as ownership and management of the mutual insurance company is concerned, actual practice demonstrates that the policyholders own and manage the company only in formal terms. Evidence of this is that in a case of insolvency, the policyholder will lose only his premium as would any other insured person who had contracted with a commercial

insurer. The control of the directors by the members is virtually imaginary, due *inter alia* to the extremely low rate of participation in the election of directors and owing to the quorum requirement and proxy system.[26]

The policyholder in a mutual insurance company is buying a service like any other insured person. He does not play the role of owner, even were he given the opportunity to do so. The main feature of mutual insurance is that policyholders have a proprietary right to profits. The insured have, in this case, a proportional interest in the surpluses while, in commercial insurance, the surpluses go to the owners of the enterprise who are the shareholders. This is the only relevant difference between commercial and mutual insurance. In commercial insurance, a mutual company might contravene the *Shari'a* by adopting an investment plan involving forbidden elements. On the other hand, a proprietary company may be following an investment programme in compliance with Islamic law. Many large proprietary companies compete successfully with mutual companies in that they pay benefits to policyholders and still pay dividends to their shareholders.[27] The large volume of business transacted by some proprietary companies results in considerable savings in administrative costs to policyholders and the larger investment income generated from greater reserves allows them to pay out part of those benefits to policyholders. In reality, the issue is determined by how equitable the company's policy and practices are rather than in the form the company takes, or in the supposed altruistic intentions of the insured.

If the insurance market were not subject to restriction and regulation, it would certainly be open to abuse and wrongful practices, whatever form the insurance companies, whether proprietary or mutual, took if the management were unprofessional. The attitude and expectations of the insured are the same in each case. A commercial insurer may or may not be of greater benefit to the insured than a mutual entity depending upon the company's policy, the terms of the contracts issued and other considerations such as State supervision and investment strategy (Carter 1973). Even if, in terms of lower premiums or higher bonuses, mutual insurance were to prove more profitable for the insured, this would not imply that commercial insurance is invalid under Islamic law (Al-Fangari 1984: 55).

This prospective advantage, which might render the bargain struck with a mutual insurance company more profitable and rewarding to the policyholder, does not invalidate commercial insurance as a lawful business activity from an Islamic point of view. The fact that the persons who set up and run an insurance enterprise make gains out of the service rendered does not invalidate insurance. Criteria other than the company's structure determine whether it is permissible or not under Islamic law.

Main reasons for Muslim jurists' *prohibition of insurance*

The mutual structure does not eliminate from insurance the elements that were put forward as reasons for disallowing commercial insurance. It does not

transform the contract into a gratuitous act (*Tabarru'*) as has been claimed. It is claimed that the contract of insurance was rejected because its subject matter and constitutive elements were unlawful, whereas mutual insurance is allowed because it is based on genuine solidarity (Sha'ban 1978: 13). The only difference between mutual and commercial insurance is in the structure of the insuring body, a consequence of which surpluses, if any, are apportioned among policyholders instead of shareholders. This might be more advantageous to the insured and appears more equitable since the mutual structure does not present itself as an exploitative entity. The contractual obstacles put forward against the validity of insurance in fact constitute a means to support and strengthen the real causes for commercial insurance, and the decisive evidence in this concern is precisely the acceptance of mutual insurance and State insurance. Those real causes are of origins alien to the concept of insurance in Islam and the Islamically unlawful practices of insurers.

The insurance concept was originally an alien idea introduced by foreign companies (Al-Fangari 1984). Seen as such, it aroused the mistrust of Muslim *jurists*, especially at a time when no legislation existed which could regulate the practice of insurers to guarantee to the insured fairness of transactions.[28] The insurer appeared to be a foreign capitalistic entity exploiting Muslims by selling them a then unknown, and somewhat elusive, service. The fact that the majority of insurance business was effected by foreign companies had, and still has, a substantial influence on the prohibition of commercial insurance, as insurance has been perceived as a means to extract money unjustly from Muslims for the benefit of Western exploitative interests.

The opposition to insurance was a reaction to the introduction of a foreign concept which was totally new. Maxine Rodinson describes the reluctance of Muslim entrepreneurs to engage in modern industrial undertakings as a 'normal reaction at that period of transition towards the sudden introduction by foreigners of an economic behaviour which was radically new and heterogeneous to the network of traditional social relations and to the attitudes and behaviour which were correlative to them' (Rodinson 1988: 181).[29]

Another fundamental consideration that led to the prohibition of commercial insurance was the investment of funds by insurance entities in interest-bearing activities. Such considerations have always been associated with commercial insurance despite the fact that they are unrelated to the proprietary or mutual structure of the insuring body. In addition to this, the terms of insurance policies have frequently been judged as unfair towards the insured, even in Western jurisdictions where contractual public policy is less stringent than that laid down in the *Shari'a* and where the legislation is less paternalistic and protective of the individual's interests. Such would be the case, for example, of ambiguous exclusions which can be construed in different ways, thus allowing the insurer to adopt the most convenient interpretation in order to avoid payment (Al-Dasuqi 1976). Another example of a clause which could be seen as unfair is the stipulation, under which interest is charged for delay in the remittance of

the premium. As a result, Muslim *jurists* regard commercial insurance as an enterprise which aims to exploit people in need of security and out of this need to maximize profits without reference to the interests of the insured (Moghaizel 1990). It is viewed as a tool in the hands of the rich who get richer by making those in need of financial security poorer (Akhafif 1967).

These positions obviously do not reflect reality and betray their proponents' philosophical stances, since they normally lead to the conclusion that any insurance scheme, even if commercial, would be acceptable if subjected to adequate safeguards to free it from forbidden elements. That is why mutual insurance was advocated by Muslim *jurists*.

Another factor which fuelled opposition to insurance is that Muslim *jurists* wrongly viewed insurance as a charitable institution designed to help the needy (Al-Jammal 1978: 343).[30] While this might be the case for social security and *Zakat*, it is not the case for insurance. Insurance was initially devised to meet the requirements of international commerce and, as David M. Walter (1986) maintains, insurance 'developed first as a means of spreading the huge risks attendant on early maritime enterprises'.

Principally, insurance is linked to business activity, and to view insurance companies as relief organizations, as a number of Muslim *jurists* did, is a fundamental misconception. The result will inevitably be the rejection of insurance because it fails to satisfy the conditions required from a charitable establishment. This groundless view contributed to the rejection of insurance by those who held that insurance was used as a profit-oriented activity.

It should be emphasized that the majority of arguments submitted against the validity of insurance are based on a misapprehension of its nature and mechanisms, as well as on a restrictive construction placed on Islamic contractual freedom. The opinion condemning commercial insurance puts forward two sets of impediments. The first pertains to the contractual mechanism itself, the second to accompanying terms and practices. Insurance is purportedly dismissed because it radically offends the Islamic law of contracts, although other forms of insurance are endorsed and even recommended.

In the second conference of the Islamic Research Forum held in Cairo at *Muharram* 1385 *Hijri* (1961), Sheikh Ali el-Khafif launched a detailed research on insurance. He stressed the need for the establishment of an Islamic insurance scheme based on *Shari'a*. He mentioned the differing opinions of the *Ulama* and *jurists* about its validity. He concluded by defending commercial insurance as a humane cooperative system, describing it as one of the fundamental components of current life which produces social stability. Moreover, he argued it was a modern contract unaffected by any text either banning or permitting it, and was devoid of any sort of temptation or usury. It would bring benefits to both parties and establish a tradition of supporting the public interest that would help it acquire the power of necessity so that everybody would get used to it. It produces a stronger commitment than the obligatory promise which the Maliki school of Islamic law defined as a duty to fulfil.

Later, the conference members who held different views, the majority of whom were lawyers, discussed the research. They acknowledged that commercial insurance was a lawful process as a precautionary necessity based on cooperation. Others did not agree with that view. They stood firmly by the view that Islam would not admit such transactions that are based on temptation and usury. However, the conference did not come to any definite decisions, except that:

1 cooperative insurance run by benevolent societies and groups, for the provision of social and financial services to their members, was a lawful form of insurance;
2 the pension scheme and other social security systems established in some countries under government control were lawful and desirable;
3 other kinds of commercial insurance should be subject to further study and extensive discussion by a committee comprised of the *Shari'a Ulama*, lawyers and economic and social experts. It was recommended that the committee should study the different opinions and views of economists, lawyers and social security specialists to reach an understanding and, as far as possible, enlighten the *Shari'a Ulama* worldwide (*Al-Azhar* Magazine, Muharram 1385 Hijri: 125).

The Al-Majma' al-Fiqhi (Egypt) view of insurance

In addition to the various structures put in place to provide an insurance scheme in compliance with Islamic law, many other projects have been suggested. One of them is outlined in the decision of *Al-Majma' al-Fiqhi* (part of *Rabetat Ulama' al-Islamyah*, Headquarters in Mecca, Saudi Arabia), which rejected commercial insurance and presented mutual insurance (cooperative insurance) as the only acceptable scheme under the *Shari'a*, on the basis that this latter form constitutes a gratuitous act, free from *gharar* and *riba*.[31] While important points are stressed by *Al-Majma' al-Fiqhi*, such as the investment of the premiums in activities Islamically permissible, as well as the necessity of the establishment of a supervisory body in the company, the scheme presented raises serious doubts about its feasibility, since it recommends the application of elusive requirements such as 'the true co-operative insurance doctrine by virtue of which the participants alone manage the whole scheme' and 'the training of people to engage in cooperative insurance' (see Appendix 1).

In addition to the fact that, practically speaking, such dispositions have no real significance, the non-feasibility of such projects has best been illustrated by the dual structure of the Saudi National Co-operative Insurance Company (Lasheen 1981), which was supposed to embody the view advocated by *Al-Majma' al-Fiqhi* and others, who see in mutual or cooperative insurance a solution to the problem of insurance under Islamic law. As demonstrated earlier, the cooperative character remains purely formal in this insurance company, which contains, in reality, just a single mutual insurance principle – the

eventual redistribution of surpluses to the insured – and which operates neither as a fully cooperative entity nor as a mutual insurance company.

Another practical scheme, regulating re-insurance companies,[32] is worthy of mention as, unlike many other schemes, it consists of operative principles of 'Islamic' re-insurance devised by a committee of experts and considered as being functional and in conformity with the *Shari'a*. As in 'Islamic' insurance schemes, the drafters applied mutual insurance principles (distribution of surpluses to the insured) to an entity with a proprietary structure (a joint stock company). Again, the same device, which consists of setting up two different funds, is used. The first one, called the Participating Companies Fund, is used for the running of the re-insurance business proper and the expenses related to it (Al-Hakim 1969: 79). Premiums paid by participating companies are allocated to that fund and claims paid to them come from it. The second fund, called the Shareholders' Fund, comprises the paid-up capital, in addition to profits made on its investment, plus a proportion of the profits generated by the investment of the first fund. This last operation is designated as *Mudaraba*, whereby the re-insurance company is deemed to be the agent and the ceding companies the investors.

As in the case of insurance, *Mudaraba* mechanisms are not appropriate as a vehicle for a re-insurance agreement and, although the same arguments apply in this regard, an important point as to the ownership of the Participating Companies Fund, should be stressed here. According to conventional re-insurance principles (Wilson 1997: 49), such a fund should be the re-insurer's property. But under the project in question, and by application of *Mudaraba* principles invoked by the drafters, this fund is supposedly owned by the ceding companies acting as investor and the fund is deemed to represent the capital entrusted to the agent (*Mudarib*) to trade with. Leaving aside the 'enigmatic' status of indemnities received by the re-insurer from the retrocessionaire and allocated to the Participating Companies Fund, the right of the investors (here the ceding companies) to terminate the contract and recover their funds when they wish is excluded from the re-insurance scheme since, if put into effect, it would undermine the whole system.

As a result, the *Mudaraba* contract is simply formulated to legitimize the proportion of profits on investments of the Participating Companies Fund given to the shareholders. Without it, there would be no incentive for those shareholders to form a re-insurance company if the only returns to which they were entitled were profits generated by the investment of capital.

The contention that the assets of the Participating Companies Fund are the property of the re-insurer and thus cannot be invested in the context of a *Mudaraba* is strengthened by Clause 1 of Paragraph III of the draft which stipulates (applying conventional re-insurance practices relating to premium reserve deposits) that part of the premiums payable to the re-insurer may be retained by the ceding companies and are then considered as free loans made to them by the re-insurer. This clause indicates that the premiums payable are the property of the re-insurer, especially since the same provision, Clause 1 (ii),

states that the retained sums are, in their turn, invested by the ceding companies acting as agent on the basis of *Mudaraba*. Thus it is irrefutable that the premiums paid cannot be considered as the capital of a *Mudaraba* contract whereby the ceding company is the investor and the re-insurer is the agent (*Mudarib*) as it is provided by Clause 8 (b) of Paragraph IV.

As for the distribution of surpluses meant to render the scheme 'cooperative', it should be noted that these distributions are made at the discretion of the re-insurance company's Board of Directors and General Assembly, which is entitled to allocate the surplus to reserve funds 'as may be deemed necessary in the interest of the participating companies'. This eventual and much-qualified distribution of surpluses is not, in reality, any more Islamic than the commonly used profit commission stipulated in re-insurance treatises, whereby a percentage of the profit made by the re-insurer out of the treaty is refunded to the re-insured at the end of each treaty year, and which can as well be termed *Mudaraba* if one applies the ill-founded and modern opinions seeing a *Mudaraba* in all operations involving a proportional profit-sharing arrangement.

When considering all the evidence, one is justified in stating that the truly relevant issue in insurance, from the Islamic point of view, is the question of the existence of interest-bearing operations, as the main differences between the proposed scheme and the conventional one relate to points where interest is involved (for example, investment of funds in sources Islamically, with no interest on retained premiums).

Shari'a jurists and insurance

This section deals with an elaboration of the position taken by Muslim *jurists* on insurance in general, and on commercial insurance in particular. It will also outline a proposal for the development of an insurance system that will function in compliance with Islamic law.

It does seem from the argument reviewed earlier that the insurance *jurists* consider commercial insurance as a humane cooperative system that would achieve security and peace of mind of the public, rather than offer a raft of services in the field of economics without being suspected of any sort of gambling. Insurance has become an essential matter in view of today's complications of life. Thus, it has imposed itself as a daily life issue that is unavoidable by any developing nation.

Shari'a jurists hold diverse conceptions about insurance, taking it not as a humane, cooperative and social idea, but as a commercial business and a modern kind of contract. Some of them have agreed that such a business is a cooperative deal, as Islam encourages this sort of activity that produces many benefits to individuals and to society as a whole. Wherever there is a benefit, it should be sustained by *Shari'a*. Others have denied that principle. They consider insurance as noting more than an illegitimate deal based on the understanding that it is founded on something unknown, which is against *Shari'a*'s provisions that admit

any dealing should be dependent on a specific well-known matter. Moreover, it contains suspicions that it is risky and unpredictable. The Prophet Mohammed was reported as saying: 'Leave that which cause you to doubt, and betake yourself to that which will not cause you to doubt' (Ibn Hanbal 1986: 3:153).

Although the *Shari'a jurists* have disagreed about commercial insurance, they virtually agree that this kind of insurance has been wrapped up by suspicions, doubts and deeds that were considered taboo by *Shari'a*. Those who support the legitimacy of insurance admit their denial of how the insurance companies invest their funds and how they pay the insurance money to their customers. Other *jurists* see no economic emergency that would necessitate this kind of insurance, but the majority of them would agree that insurance has currently become one of the most important requirements of life. That naturally would need in-depth consideration, but on different new bases and rules that stay within the spirit and overall principles of the *Shari'a*.

An opinion on commercial insurance

Confirming that the commercial insurance contract has been based on cooperative ideas, and talking about the benefits and characterization of the insurance contract to society, insurance *jurists* actually contradict themselves. They claim that if the contract was profitable for the insurer, it would be of loss to the insured, and vice versa. They also confirm that it is a financially competitive contract in which every instalment is like the monthly rent in the normal rental contract, or that it appears to be a direct selling and buying deal. Eventually they call it a cooperative humane contract. To take both notions at the same time in the same contract is contradictory. It is becoming obvious that the insurance contract has nothing to do with cooperation. More evidence for this is shown in the legislative interference of some countries for the protection of the insured interests (the submissive party) against the exploitation of the insurer (the stronger party).

As Islamic *Shari'a* encourages and calls for cooperation of all kinds, the *jurists* in general would naturally believe in every cooperative relationship. It is revealed in the Holy Quran: 'Help ye one another in righteousness and piety, but help ye not another in sin and rancour' (5:2). Nu'man Bin Bashir reported Allah's Messenger as saying, 'The similitude of believers in regard to mutual love, affection and fellow feeling is that of one body; when any limb of it aches, the whole body aches, because of sleeplessness and fever (*Sahih Muslim* part 4). Despite the Divine call for cooperation in general, it would seem that both the insurance *jurists* and the *Shari'a* scholars have understood differently this meaning. According to the Conventional Law Cogitation (Murad: 112), cooperation is the reciprocal of assistance between members of the society, without exploitation by an individual to another, or a group of another. To review the history of the cooperative movements in the world, it would be noticeable that all leaders of those movements were highly concerned about the

exploitation of mankind, and hence adopted the necessary campaigns for freeing human beings from any type of abuse, blackmailing or exploitation. However, the concept of cooperation in Islam is even deeper, and is comprehensively honourable. It is based on the understanding of brotherhood in the Faith. It is revealed in the Holy Quran: 'The believers are but a single Brotherhood: so make peace and reconciliation between your two [contending] brothers . . .' (49:10).

The declaration of brotherhood between members of any society is just an assurance of the solidarity and collaboration between the members of that society in the daily routine of life: in the feelings, the needs, the social status and dignity (Al-Sibaai: 109). Cooperation in Islam is material as well as spiritual, as the Muslim individual is supposed to be not only linked with his Muslim brother by a material tie and interest, but by the bond of faith which is stronger and more exalted than the family relationship.

Muslim individuals in their society believe beyond doubt that money in their hands does not morally belong to them, and that ultimately it belongs to Allah. Relying on this understanding, they consider themselves merely trustees to take care of that money. Thus they do not know avarice, greed or any kind of money loving. They live in a self-contented situation. They would spend their wealth and money on the help of the needy and poor in obedience of what they have been instructed in the Holy Quran and the *Sunna*. These are the real features of solidarity, collaboration and support that characterize ideal Muslim society.

Insurance *jurists* have not taken the right interpretation of cooperation in the Foreign Conventional Beneficence when they claim that insurance is a cooperative contract. This beneficence would totally contradict the idea of the cooperative nature of insurance, as the insurance companies normally utilize and invest the insured money from which they would make profit without giving the insured any significant portion of these gains.

Insurance *jurists* consider the insured as a group of people seeking the cooperation of the insurers to keep them from risks and dangers they might be subject to. Unfortunately, this betrays a misunderstanding of the precise meaning of cooperation. The condition for any task to become cooperative is that the business itself should be owned by the group to which all the benefits and revenues would return. In the case of commercial insurance, which is a profit-making business, the revenues go to the real beneficiary (the insurers) and the services go to the group of insured. That could never be called a cooperative project. It is accepted that insurance did start as a cooperative service before being converted to a commercial system by Jewish traders and currency merchants. It is very likely that Jewish propaganda and international capitalism have used the media to promote commercial insurance as cooperative and humanitarian. With passing time, that idea has become well established in people's minds, supported by elaboration from law experts, and has been carried into Muslim countries on waves of foreign rule and systems early in the twentieth century.

On the other hand, *Shari'a jurists* have got their understanding of cooperation from the Holy Quran and the *Sunna* of the Prophet Mohammed. However, if some of them have supported the insurance *jurists* in their allegation about the cooperative nature of commercial insurance, that might be attributed to their incompetence in understanding of the hidden reality of commercial insurance. Having previously referred to the fact of Muslim insurance *jurists* have been affected by foreign thoughts, I should declare that our *jurists*, when they write about insurance, only differ in quantity rather than quality. Another point that I have noticed is their collective agreement about specific cases prohibited by the *Shari'a*, such as 'insurance for the benefit of a girl friend'. This would confirm that our insurance jurisprudence could not be the same as the foreign one, particularly the French system. It should not be a problem to acquire other experience and knowledge, provided that we have desperate need for what we take, and that there is no conflict with our Islamic *Shari'a*. I have also noticed that the *jurists* of law and economy – including insurance *jurists* – may believe in the foreign economic systems more than they do in the Islamic *Shari'a*. They think that the *Shari'a* should be more flexible towards compatibility with prevailing trends, as if they want to yield the *Shari'a* for imported modern notions (*Liwaa Al-Islam* Magazine, Vol. 8, issue 11: 720).

Any development in life should take place under the power of the Holy Quran and *Sunna*, as the Islamic *Shari'a* is the real overlord of the system, and should never be submissive to any other power. Therefore, the economists and the law *jurists* should do their utmost to surrender every modern imported issue to the *Shari'a* instead of trying to implement otherwise. It would be a shame within a Muslim nation to undermine the *Shari'a* by applying some conventional or man-made laws.

A proposal of an insurance system in compliance with Islamic Shari'a

All Islamic *jurists*, whether in favour of or opposed to commercial insurance, naturally abide by the provisions of the *Shari'a*. Nonetheless, it would be admissible to adopt different opinions and conceptions about modern issues as long as they were not originally stipulated, each scenario becoming subject to theoretical research and independent judgement in a legal or theological sense. Each *jurist* has his own views to believe in, based on sufficient and relevant evidence. However, the main point, which has been abandoned by the *jurists* in their assessment of insurance legitimacy, has always been the economic point of view and how much effect would it have on the general economy of the State. The insurance system from this viewpoint would cause greater economic danger to the general economy as a group of individuals control huge amounts of money, and then utilize and invest that money in an uneconomical way which might damage the public interest. That is exactly what economic *jurists* have confirmed. Hence, some provident countries would go for the nationalization of

the banking system and the major influential companies that have a direct impact upon the financial and productive systems of the State.

Shari'a jurists from both sides of the argument have been endeavouring to give insurance-related examples of financial dealings that appeared in Islamic jurisprudence. Those who admitted the legality of the insurance contract have relied on its similarity to the Islamic contract of *Mudaraba* or, perhaps, the contract of 'Fidelity Contract of Clientele', for example. This is an indirect judgement that no modern dealing would be accepted unless a counterpart was found in the Islamic *Shari'a*, as if we should have to stick only within the limits of the *Shari'a*'s contents without giving ourselves any chance of flexibility to manoeuvre. This would inflict us with rigidity and petrifaction. Yet, by any means, adherence to *Shari'a* should never mean that our juridical heritage, in terms of financial dealings, is rigidly confined to a specific period of time. It is a great scripture highly enriched with statutory theories and unparalleled legislative provisions and principles, many of which guide the modern legislator in the making of conventional laws.

Some *Shari'a jurists* have set opinions that represent a specific historical era, opinions that can not be applicable to the current system of commercial insurance with its modern applications. One example is that of Ibn Abdin, who declared his opinion about insurance when colonizers were dominating Muslim lands, when there were no specific rules for running an insurance system. Ibn Abdin lodged his opinion in the chapter 'The Insured' in his book *Aljihad*. He wrote about the rights and duties of the insured in the Islamic countries at that ancient time, which are hardly appropriate or executable today.

If insurance is a new system or a modern kind of contract, then the *Shari'a* has no determined limit to contracts between people in specific committing issues, as there is nothing in its provisions and conditions to do with the limitation of contracts or the confinement of their subjects, unless there is a clear contradiction to the *Shari'a*'s provisions and rules (*The Islamic Jurisprudence* 1981: 1:584).

The Islamic *Shari'a* is considered the final revelation, which is valid and useful anywhere, and for every generation. It is also designed to exist suitably and compatibly with any further human development that might occur in life. It will remain qualified to provide Mankind with any legislation that will help all people to live in peace and prosperity. This was acknowledged and confirmed by 'The International Conference for the Comparative Law of Islamic *Shari'a*' held in Paris on 17 July 1951.

The *Shari'a* creates solidarity between Muslim individuals as a duty for everyone. It should be applied as much within small family units as within the regions and the whole Islamic nation.

The family

In the family arena, the *Shari'a* has decreed the statutory portion for a wife and her children. It is also a responsibility for every financially able person to offer

his or her help to the disabled and needy (Musa 1960: 126). The *Shari'a* also decreed the *Aqila* system. Also, 'The Will' that has to be issued by the testator should not be accepted for one inheritor without the approval and consent of the rest of the inheritors, and should not cover more than one-third of the estate inheritance.

The region

As far as the region is concerned, the *Shari'a* declares that it is the duty of everybody to care for others who need help within the network of the locality. It is narrated that Allah's Messenger said, '. . . and any residents of a quarter have among them a hungry person by reason of poverty, Allah is quit of any obligation towards them' (Ibn Hanbal 1986: 2:33). This *Hadith* is a clear order for every Muslim to be helpful to his or her fellow member of the nation to the extent that the entire region should be as one unit.

The Muslim nation

Solidarity within the whole nation is dealt with through a system of *Zakat* that has to be taken at the rate of 2.5 per cent annually from:

1 the saved funds in the country;
2 the circulated commercial capital;
3 the agricultural production at 5 or 10 per cent;
4 the mining production at the rate of 20 per cent; and
5 the cattle at a special percentage in special conditions.

This *Zakat* is not an individual act of benevolence according to their discretional payment, but it is the right of the State to collect it by the power of law, provided that it in turn distributes the proceeds to the needy in accordance with the *Shari'a*. It is only one base of many social solidarity bases (Al-Sibaai: 126). The *Imam* (head of State) has the right through the *Shoura* (consultative council) to impose the levy of a specific share of money from the rich to support the poor and needy, in terms of feeding, clothing and shelter. It is revealed in the Holy Quran that Muslims must '. . . render to the kindred their due rights, as [also] to those in want, and to the wayfarer' (17:26), and that they should '. . . do good to parents, kinsfolk, orphans, those in need, neighbours who are strangers, the companion by your side, the wayfarer [ye meet] . . .' (4:36).

The Islamic economy has shown great concern for the welfare of illegitimate babies and children in general. Islam established a pioneering social security system 14 centuries ago, when Caliph Omar Bin El-Khattab (the second successor of the Prophet Mohammed) ensured the payment of 100 Dirham (the currency unit in early Islam) for every new-born child, and if he grew up the money would be doubled. Also, every illegitimate baby had to be paid

100 Dirham, with a monthly income support for his guardian. If he grew up, then he would be made equal to his contemporaries. Islam also offered orphans a considerable level of care, a policy revealed in the Holy Quran: 'Seest thou one who denies the judgement [to come]? Then such is the one who repulses the orphan, and encourages not the feeding of the indigent' (107:1,2,3); also, 'Those who unjustly eat up the property of orphans eat up a fire into their own bodies: they will soon be enduring a blazing fire' (4:10). There are more verses about caring for the orphan.

Islam has never excluded other categories of society in its offer of the chance to live a good life, irrespective of status or religion. There is no doubt that Islam has arranged every possible facility to offer all the citizens an honourable life with full peace of mind. The presence of the fair *Imam* and the availability of all causes of perfect solidarity should create a life of good quality. That remains one of Islam's fundamental principles, one with a genuine base in *Shari'a*.

A number of Islamic economists call for commercial insurance to be under the control of government, structured according to Islamic principals. These insurance companies should practise and offer services to people for a period of time to establish credibility, to provide jobs and prosperity and to help the economy flourish. After it is well established, commercial insurance should be implemented nationwide, and any insurance business should be regulated according to the experiences gained.

Although this opinion seems genuine and acceptable, assuming that the application of Islamic laws would lead to the perfect and healthy society with rigid solidarity and cooperation, some still believe in the establishment of insurance companies on new bases, but with an Islamic foundation. These Islamic companies would definitely be a part of the means to achieve complete social solidarity in Islamic society. Moreover, the current social conditions make the establishment of such companies inevitable.

Having said that, the conclusions of the arguments for commercial insurance are as follows:

1 unlike the allegations of insurance *jurists* supported by a few *Shari'a jurists*, commercial insurance has never been established on cooperative bases;
2 the commercial insurance contract is one based on impermissible temptation, which would make it a potentially illegitimate contract;
3 the doubt of gambling and risk would be inherent in this contract, as meeting the commitment would be indefinite rather than predictable for both parties;
4 usury is part of the fabric of the insurance contract, either in the settlement of the insured instalments or in the way the insurance companies reinvest their money;
5 some economists believe that commercial insurance would represent an economic hazard upon the State as few people possess sufficient wealth collectively to avoid its domination of all means of production in the State.

That is why necessary laws and rules, which could limit the power of such companies, would need to be set. Despite the effort governments make for the protection of their economies, the major companies still perform tricks to avoid penalization. For that reason, some States have opted for the nationalization plan against insurance and other similar companies for the sake of the welfare of society and to protect the economy; and

6 in commercial insurance, the participating companies do not consider that there is equality between the insurer and the insured. They have set their rules for their own favour, caring little for the insured. These companies make enormous profits at the expense of the insured, which can be interpreted as being usury.

Aside from commercial insurance, there are other kinds of insurance, such as social security and reciprocal insurance. Not only are they legal, they are also highly desirable and often required. The idea that there are similarities between individual insurance and social security, that they have allegedly been established on the same base and under similar conditions (exception that the State plays the role of the insurer in case of the social security) is not true. However, social security is not a contract in the same sense as that of the commercial insurance contract; it is a system set by the State to help certain individuals and groups whose financial resources are not sufficient for the confrontation of daily life risks. The beneficiary of this type of insurance would not normally pay the instalments themselves; indeed, they often pay nothing, at least until the situation improves and a payment threshold is reached. Thus, the gap is very wide between social collaborative systems and commercial profit-making systems, with the latter's oppressive conditions.

In view of that, we believe beyond doubt that the cooperative system should replace the commercial system, as the cooperative system is the one that complies with Muslim teachings. Additionally, it would achieve the genuine purpose of insurance, the protection of society's weak and unfortunate. Some researchers have tried to create a new system of insurance that replaces the current system and complies with the spirit and principles of Islamic *Shari'a*. One of these scholars was Zaki M. Shibana, Professor of Agricultural Economies at Alexandria University, in his article, 'Fundamental Islamic economic features to encounter the current economic problems' (*Al-Shubban al-Muslimoon*, Magazine, Issues 2–6, Vol. 3). He proposed the establishment of a proper governmental insurance company funded by *Zakat*, which then takes responsibility of every aspect of general social solidarity for the whole nation. Such a company, if established with decentralization of its activities, would achieve the correct aim of social solidarity, provided that it functions to secure the living of those mentioned as beneficiary in the verses of *Zakat* are met.

Another suggestion from Sheikh Mohib El-Din El-Khatib,[33] who called for the formation, by working groups and other categories in their place of work, of insurance cooperative societies on similar bases. Every society should collect

monthly contributions from each member according to his or her salary, and the sum should be invested in ways prescribed legal by Islamic law and kept for the help of any member afflicted with disability, sickness or death, or even to help in cases such as bearing the costs of children's marriages. This could prove the most provident idea for cooperative insurance if it was well controlled by an official body in the State.

In the light of the above arguments and proposals, the following suggestions are compatible with the overall spirit of Islamic *Shari'l*:

1 A public institution for *Zakat*, with different branches nationwide, has to be established. Every branch should be responsible for both the collection of the *Zakat* within its jurisdiction and the distribution of its proceeds to those who are entitled in the same area. The overseeing institution should control the collection, distribution and investment process, and it should be responsible for saving the surplus funds for emergencies. A part of these funds will be used for insurance.
2 A public institution for cooperative insurance has to be established with the main function of overseeing cooperative societies' activities around the country. Those societies should be established according to a binding law, made and enforced by the government.
3 A public institution for the insurance of government utilities should be established, in a way that every department has to pay a monthly or annual contribution in instalments. The main institution should be in charge of investing these funds, and saving them for any risks that might occur, or for damages to the government departments.

Some insurance *jurists* still have the conception of keeping insurance companies even after the nationalization, on the grounds that benefits could be found from re-insurance in terms of hard currency revenues from foreign companies, for overstaffing of employees, and the availability of the well-maintained technical equipment. However, we see that these justifications are not sufficient for the existence of commercial insurance, as staffing and technical equipment could be dealt with in the cooperative insurance system. As far as hard currency is concerned, it would be very risky, since we might not be sure of earning the expected revenue in the light of bilateral business forecasts and currency exchange fluctuations.

The meaning of 'insurance' to Muslims

This chapter opened with examples of insurance that have replenished people through hard times and provided them with peace of mind in times of stability (an ever-retrospective State if ever there was one). An average Westerner, asked what is meant by insurance, will probably respond with something to do with motoring, life/holiday insurance or National/medical Insurance. In other words,

commercial insurance, or the buying of security. To a Muslim, insurance has particular connotations. Since everything is provided by God, they look to God for their insurance and, just like worldly insurance, it surfaces in many guises.

Faith as insurance – *Al-Ta'min Al Imani*

In common with other monotheistic religions, faith is the basis of the Muslim's sense of well-being – the source of his peace of mind (*itmanan*). With faith the Muslim is cherished and lives a fulfilled life; without faith he feels lowly and defeated. With faith the Muslim feels contented; without faith the Muslim feels uneasy. With faith, the Muslim feels secure (*ammana*); without faith Muslim experiences fear, sadness and pain. To be without faith is to experience oppression and loss of guidance, but the true Muslim is guided along the right path and is rewarded for his loyalty to God, both in this world and in the next.

The man without faith meets only with indignation and wretchedness and, ultimately, chastisement from God. Faith, in short, is insurance against the negative values which are attributed to the faithless (Ibn al-Arabi 1972: 2:917).

With this in mind, God reprimands those who turn away from His religion:

> If the people of the towns had but believed (*ammana*) and feared God,[34] we should indeed have opened out to them all kinds of blessings from heaven and earth, but they rejected the truth and We brought them to book for their misdeeds.
>
> (7:96)

> Did the people of the town feel secure (*ammana*) against the coming of our Wrath by night, while they were asleep? Or else did they feel secure against the plan of God? But no one can feel secure against the plan of God, except those doomed to ruin.
>
> (7:96–9)

The above verses chastise those who, despite the revelation of Islam and the manifest blessings bestowed upon them, refuse to believe in God (*Al-Naysaburi* 1967: 9: 111).

Religion is thus seen as the gift of faith (*iman*) securing the Muslim's happiness in this world and in the next:

> Whosoever works righteousness, man or woman, and has faith, verily to him We will give a new life, a life that is good and pure, and We will bestow on such their reward, according to the best of their actions.
>
> (16:97)

God, through his messenger Mohammed, established a contract of religion with the Muslim, whereby the latter, for the reward of security and a livelihood

bestowed on him by God, must perform his religious duties as laid down in the Quran (and the *Sunna* of the Prophet). Should he deviate from these duties then in place of God's blessings he will be visited with punishment and afflicted by strife (*Al-Manar* 1980: 6:346).

As for the believers, they will (continue to) receive the blessings and benefaction of God, experiencing unalloyed joy, avoiding evil and degradation, enjoying peace and comfort in this world and recompense in the next (ibid.: 347).

In an aside to the people of Mecca who spurned the message of God and who abandoned themselves to frivolous pastimes, bringing down upon themselves the chastisement of God (ibid.: 9:24–5), God asked if they felt secure in their existence (Al-Tabari 1978: 9:8).

> There were those who were able to know the warnings from God and took refuge under His wing and as a consequence received His blessing, and there were those who ignored it and as a consequence were divested for their unbelief.
>
> (*Al-Manar* 1980: 17:27).

Thus, if the Muslim does not keep to the terms of the contract laid down by God, God will forfeit His protection (insurance) against fear, poverty, sadness and ill health:

> God has promised to those among you who believe and work righteous deeds, that He will, of surety, grant them in the land inheritance of power as He granted it to those before them; that He will establish in authority their religion – the one which He has chosen for them; and that He will change [their state] after the fear in which they lived, to one of security and peace [*aminan*].
>
> (24:55)

In an address of one of the Prophet's companions to Him on the question of security in exchange for fear, he asked:

> 'When will the time come when we feel so secure we can lay down our arms?' And the Prophet replied 'Security is now upon us [because God has granted it to us] so that all the traveller has to fear now, as he guides his sheep from one place to another, is the ravenous wolf.'
>
> (Muslim, Al Bukhari 1966)

Again it is made clear in the Quran that the continuance of this security is conditional on the people (of Mecca) performing good works:

> God sets forth a parable, a city enjoying security [*aminatun*] and quiet, abundantly supplied with sustenance from every place. Yet it was

> ungrateful for the favours of God, so He made it taste hunger and terror [closing in on it] like a garment [from every side] because of the evil [its people] wrought.
>
> (16:112)

This turning away from God by the people of Mecca through the rejection of Mohammed ensured their punishment instead of God's blessings, hunger instead of sustenance, unease instead of security (Al-Tabari 1978: 4:125; *Al-Jalalin* 1980: 231; Ibn Kathir 1981: 2:349).

> Which of us [two] parties has more right to security [*aman*]? Tell me if you know. It is those who believe and confuse not their beliefs with wrong that are truly in security, for they are in receipt of the right guidance.
>
> (6:81–2)

The above verses highlight the recourse to polytheism at a time of burgeoning Islam (Al-Tabari 1978: 4:227). Abd Allah Ibn Masud recounted that on learning such verses Muslims trembled, and asked Mohammed for an explanation, whereupon he repeated the words of Luqman to his son: 'Do not worship false idols for that is the greatest abomination' (31:13).

Therefore, in Islamic belief, to worship false idols incurs the wrath of God and disaster, but to follow the righteous path leads to deliverance and safety.

Faith as insurance against fear and sadness

Pain, sadness and fear are the antithesis of security (*aman*) (Al-Saboni 1981:607), an axiom which endures for the Muslim not only in this world but also in the next. These negative states of mind can only lead to the deterioration of the sinner's stability and henceforth his or her future becomes unbearable and his or her past rendered devoid of happy memories (Al-Qurtabi 1952: 1:329). Being in a constant state of fear and sadness is to experience deprivation and loss (*Al-Manar* 1980: 1:237).

The spectre of sadness and fear is invoked many times in the Quran, in which it is made clear that the believer, so long as he or she continues to perform good acts and abide by the religious duties of Islam, will avoid such afflictions:

> Those who believe and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord. On them shall be no fear, nor shall they grieve.
>
> (2:277)

Thus, the Muslim, on account of his faith, is protected against loss, fear and sadness, and his obtaining of the good things in life is facilitated by his faith in God (*Al-Manar* 1980: 1:237, 352; Al-Saboni 1981: 1:169).

Likewise, faithful observance of Islam removes fear of the resurrection assuring the protection of the believer. This is insurance (*Ta'min*) for the faithful:

> Resurrection, the sound of trumpets, is heard by all living on earth and those of other galaxies and sky except those who will be relieved from the trumpet sound and those who died in war for God [the Martyr]. The mountains will be flattened, the earth will shake, the pregnant will deliver prematurely, the children will age, the people will run lost calling each other for direction; only those God will exempt will be relieved from that fear and terror.
>
> (Al-Qurtabi 1952: 13:344)

In other words, those who do not fear the resurrection are insured against fear.

Prayer as insurance

Time and time again in Islamic messages to the people, prayer is presented as a form of insurance, i.e. a commitment to prayer is rewarded by God's protection. According to Islamic principles, Man's instinct is to avoid danger and escape from fear and sadness, blights which can be alleviated only by taking refuge in God. When God sends down floods, famine, pestilence, earthquakes and storms as a warning, man is powerless to prevent them (ibid.):

> Say, He has power to send calamities on you from above and below, or cover you with confusion in party strife, giving you a taste of mutual vengeance, each from the other. See how We explain the signs by various [symbols], that they may understand.
>
> (6:65)

It is in the power of God alone to offer his people protection (Al-Saboni 1981: 1:397):

> Say: who is it that delivers you from the darkest recesses of land and sea, when you call [*tadu*] upon Him in humility and silent terror. If He only delivers us from these [dangers] we vow we shall truly show our gratitude. Say: It is God that delivers you from these and all [other] distresses, and yet you worship false gods.
>
> (6:63–4)

Thus God is all powerful, providing sustenance and protection where merited, and punishment where called for.

The good Muslim who observes his religious duties and who supplicates (*yadu*) himself before God, will in turn receive an answer: 'And your Lord says

"Call on Me. I will answer your prayers'" (40:60). On this point, Ibn al-Abbas remarks:

> Each Muslim who prays receives an answer from his Lord. If he asks for sustenance he receives it, providing his daily acts are in accordance with the *Shari'a*.
>
> (Al-Qurtabi 1952: 2:311)

Thus we note here the link between commitment to prayer on the part of the Muslim and his protection (*Ta'min*) under God's wing:

> For who listens to the distressed [soul] when it calls on Him, and who relieves its suffering?
>
> (27:62)

God answers the calls of distressed travellers and seafarers enabling them to reach safe ground (Al-Qurtabi 1952: 13:233):

> He it is who enables you to travel the land and sea, so that you even board ships, then sail with them, with a favourable wind and they rejoice thereat.
>
> (10:22)

When they think they are being overwhelmed by storms, they cry to God, begging for their deliverance in return for carrying out their duty to Him:

> '. . . If you deliver us from this, we shall truly show our gratitude.' But when He delivers them, Behold, they transgress insolently through the earth in defiance of right.
>
> (10:22–3)

The Muslim not only prays to God for protection and his livelihood in the present world, but in the next world also, so as to ensure he enters Paradise.

> If any do wish for the Hereafter and strive therefore, with all due striving, and have faith, they are the ones whose striving is acceptable to God.
>
> (17:18–19)

Thus to pray to God is to secure the protection (*Ta'min*) of God from misery in this world and Hellfire in the next, but the supplication in the material world must be genuine, supported by lawful (*halal*) conduct befitting a Muslim:

> There are men who say 'Our Lord, give us your bounties in this world.' But they will have no portion in the Hereafter.
>
> (2:200)

Thus, according to the Muslim faith, prayer is an insurance against fear and sadness on the one hand, and against damnation and suffering in the next life on the other.

In relation to this concept of *Ta'min* in Islam, on the authority of Aiysha it is told that the Prophet said, 'If the Jew envies the Muslim for anything, it is surely for the security and protection he enjoys under Islam' (Al-Qurtabi 152: 1:130–1).

To sum up the argument about the role of *Ta'min* in Islam, we can see from the Quranic verses and *Hadith* that pious Muslims secure God's protection in the material world against fear, poverty and sadness (and against Hellfire in the next world) through their good deeds and their performance of religious duties, whilst the neglectful Muslim or the unbeliever forfeits this protection.

Insuring the hereafter (*Al-Ta'min Al-Akhrawi*)

The origin of the Islamic principle is the belief in life after death and the resurrection of the body and soul. Life after death is thus everlasting – the end of death. Human performance during our existing life will determine our fate in the afterlife, whether in Heaven or in Hell.

The only insurance against going to Hell is living everyday life according to Islamic principles:

> The ultimate aim for man is to avoid Hell; those who obeyed God's requests and obeyed God's forbidding are the ones insured not to end up in Hell. The link between man's day to day work and his relationship with others, and his faith in God, is the route away from Hell.
>
> (Al-Tabari 1978: 24:276)

Heaven is visualized as a beautiful and peaceful place where security is guaranteed:

> The righteous [will be] amid gardens and fountains [of clear-flowing water]. [Their greeting will be]: enter ye here in peace and security. And we shall remove from their hearts any lurking sense of injury. [They will be] brothers [joyfully] facing each other on thrones [of dignity]. There no sense of fatigue shall touch them, nor shall they [ever] be asked to leave.
>
> (15:45–8)

However, Heaven is the destination only of:

> Those who obeyed God's rules [those having accepted God's blessing and his beneficence, having been wary of God's revenge, and having avoided God's prohibitions are in the light of God's grace, which protects them not only from active wrong but also from straying into paths of temptation or carelessness], who did good things towards each other, those people will receive God's blessings, utmost peace, no fear of death as their judgement

> will be light [who showed], no hatred nor malice neither malevolent nor ill will towards others, theirs will be love, friendliness, brotherhood, bosom friends, quintessence, sincerity. There will be no illness, tiredness, boredom – all happiness in the everlasting Heaven.
> (Al-Tabari 1978: 14:25; Al-Qurtabi 1952: 10:32; Al-Saboni 1981: 2:110)

Assurance of the higher levels in Heaven

> It is not your wealth nor your sons that will bring you nearer to us in degree; but only those who believe and work righteousness, these are the ones for whom there is a multiplied reward for their deeds, while secure they [reside] in the dwellings on high.
>
> (34:37)

> All worldly goods are but a shadow that will pass away. Their intrinsic and eternal value is small, but those who work righteousness in faith are on the true path of self development, the reward they will get, infinitely more than their merits entitle to them, for they will partake of the boundless bounties of God.
> (Al-Qurtabi 1952: 14:306; Al-Tabari 1978: 22:68, Al-Saboni 1981: 2:557)

There will be no uncertainty as there is living on earth, no danger of discontinuity, no possibility of their satisfaction being terminated; everything will be open and in social companionship. All the petty feelings of jealousy or exclusiveness will have passed away and the purity, beauty, truth and goodwill will pertain. As in the Buddha's doctrine, the highest object of this life is to obtain salvation for sorrow, pain and the other incidents which make of it a constant struggle. Islam teaches that this is not possible by unaided efforts. Certainly, striving is an indispensable condition, but it is the mercy of God which comes to the aid of Muslims and keeps them from the fire of eternal punishment. This is mentioned last as the foundation on which eternal felicity and positive spiritual joys are built (Al-Tabari 1978: 25:83).

Given the above extracts and opinions, it can be considered that Muslims view good deeds in life as the insurance premium for everlasting life in the hereafter and at a higher level in Heaven. Human beings are in need of this type of insurance to protect themselves from terror at the day of resurrection, the day of judgement and humiliation and suffering in Hell (Al-Qurtabi 1952: 16:150). The real insurance is the grace of God for everlasting life, the only profitable investment human beings can enjoy forever.

Worldly insurance (*Al-Ta'min Al-Dunyawi*)

The basis of worldly or material insurance and its principle in Islam is the insurance given by faith. Insuring the Muslim during his life is a constituent of

his faith, his work, his good deeds, his relationship with others, his worship of God. To embrace good deeds, God made faith available to human beings to give them peace of mind, and to remove fear of the unknown. This type of insurance is connected to the 'insurance for the hereafter', as both lead to the same fate – Heaven (Al-Qurtabi 1952: 16:151–5). The need for peace, security and peace of mind in life are universal ambitions (ibid.: 81–3). They are fulfilled in Islam by faith, which brings its own, non-financial, rewards, and its means of compensation for life's vicissitudes.

Insuring livelihood

The Quran states:

> God sets forth a parable: a city enjoying security and quiet, abundantly supplied with sustenance from every place, yet was it ungrateful of the favours of God, so God made it taste hunger and terror [in extremes], like a garment [from every side], because of the [evil] which [its people] wrought.
> (16:112)

The reference could be made to any of the cities or populations of ancient or modern times, which were favoured with security and other blessings by God, but which rebelled against God's law and were therefore punished. There are several metaphors: the experience of hunger and terror after abundant supplies and the full security which it had enjoyed, and the complete enfolding of the city as with a garment by the two scourges of hunger and a state of subjective alarm. If the reference is to Mecca shortly before its fall to the Muslims, the hunger was the seven years of severe famine which afflicted it, and the alarm was the constant fear in the pagans' minds that their day was nearing an end. Peace and prosperity were restored only after the re-entry of the Prophet.

Insuring against fear and poverty: the Quraysh

In the Quran we read:

> For the covenants [of security enjoyed] by the *Quraysh*, their covenants [covering] journeys by winter and summer, let them adore the Lord of his house, who provides them with food against hunger, and with security against fear [of danger].
> (106:1–4)

The *Quraysh* were an important tribe of Arabia, who had the custody of the *Ka'ba*, the central shrine of Arabia. They had a commanding influence over other tribes, their central position facilitating trade and profit. The Mecca territory being by Arabian custom inviolable from the ravages of war and

private feuds, they had a secure position, free from fear of danger. The honour and advantage from their position as servants of the sacred shrine of the *Ka'ba* they owed to God. In those days of general insecurity, their prestige as custodians of Mecca enabled them to obtain covenants of security and safeguard from the rulers of neighbouring countries on all sides – Syria, Persia, Yemen, and Abyssinia – protecting their trade journeys in all seasons.

Their journeys to the warmth of Yemen in the winter and the cooler regions of Syria and the North in the summer made them practised travellers and merchants, who acquired much knowledge of the world and many arts, and perfected their language as a polished medium of literary expression. Those experiences compensated the unfortunate losers for their losses. The *Quraysh* did not appreciate that God preferred them, particularly as he had chosen his Prophet from amongst them. They witnessed how God protected the *Ka'ba* from invasion by Abraha (Quran: 'Surat El-Fil': 105:1–5) and his elephants, even though they ran away and did not have the courage to stand up and defend their families, homes or wealth. The *Quraysh* tribe believed that God was the only insurance they could ever have, but they defied the injunction to worship the one God and continued to worship a man-made god of stones and clay (Al-Qurtabi 1952: 2:504; Al-Tabari 1978: 3:198).

Insuring against sadness and grief

We are reminded of two Quranic verses:

> After [the excitement] of the distress, He sent down calm on a band of you overcome with slumber while another band was stirred to anxiety.
>
> (3:154)

and

> Remember he covered you with a sort of drowsiness, to give you calm as from himself.
>
> (8:11)

Calm (peace of mind) is essential in battle and in all situations of danger. If the mind is in a state of overexcitement, it cannot carry out a well-considered or concerted plan of action. This spirit of calm confidence on the part of Muslims won against the blustering violence of the *Quraysh* (Al-Qurtabi 1952: 3:242).

When a mother's eyes had become scalded with tears at the separation from her baby, they were 'cooled' – her heart was comforted:

> So We brought thee back to thy mother, that her eye might be cooled and she should not grieve.
>
> (20:40)

Avoiding sadness and grief is an intention to embrace the logic of God's guidance (Ibn Al-Arabi **1957**: 1:125).

Insuring against illness (Al-Marad)

> And when ye are in peaceful conditions [again] if anyone wishes to continue *Umrah* [visit *Ka'ba* not at the time of *Hajj*] on to the *Hajj*, it is permissible.
>
> (2:196)

The peaceful condition is either free from illness or from enemies. The Prophet Mohammed said, 'Cold symptoms are an insurance from Leprosy' (Al-Qurtabi 1952: 2:372).

Insuring protection (Himaya) and asylum

The Quran offers asylum to those who are drawn to religious belief

> If one amongst the pagans ask thee for asylum, so that he may hear the words of God; and then escort him to where he can be secure, that is because they are men without knowledge.
>
> (9:6)

Even those who are in battle with Islamic forces are entitled to seek asylum and to gain protection, even if they do not convert and accept the word of Allah:

> Even among the enemies of Islam, actively fighting against Islam, there may be individuals who may be in a position to require protection, full asylum to be given to them and opportunities provided for hearing the words of God. If they accept the words, they become Muslims and brothers, if they do not see their way to accept Islam, they will require double protection either from Islamic forces openly fighting against their people, or from their own people, as they detached themselves from them; both kinds of protection should be ensured for them from any harm (*Moaman*).
>
> (Al-Qurtabi 1952: 8:75)

Insuring the path (Ta'min Al-Tariq) – free passage

> Between them and the cities on which We had poured Our blessings, We had placed cities in prominent positions, and between them We had appointed stages of journey in due proportion: travel therein, secure by night and day.
>
> (34:18)

The old frankincense route was the great highway between Arabia and Syria (Al-Tabari 1978: 22:58). Through Syria it connected with the great and flourishing kingdoms of the Euphrates and Tigris valleys on the one hand, and Egypt on the other – and with the great Roman Empire around the Mediterranean. At the other end, through the Yemen coast, the road connected by sea transport with India, Malaya and China. The Yemen–Syria road was much frequented. Syria was the land on which God 'had poured His blessings', being a rich, fertile country where Abraham had lived, and including the Holy Land of Jerusalem in Palestine. The route, on which merchants could travel with ease and safety by night and by day, was in the days of its prosperity studded by many closely-situated stations, or cities. The close proximity of stations prevented the encroachment of highwaymen (Al-Qurtabi 1952: 14:289).

Insuring against God's punishment during Worldly Life (Al-Dunya)

> God has promised, to those among you who believe and work righteous deeds, that He will, of a surety, grant them in the land inheritance of power as He granted it to those before them; that He will establish in authority their religion, the one which He has chosen for them; and that He will change [their state], after the fear in which they [lived], to one of security and peace.
>
> (24:55)

Three things are promised here to those who have faith and obey God's law: 1 that they will inherit power and authority in the land, not for any selfish purposes of theirs, nor by way of favouritism, but in order that they may maintain God's law; 2 that the religion of right, which God has chosen for them, will be openly established, and will suppress all wrong and oppression; and 3 that the righteous will live in peace and security, instead of having to suffer persecution, or leave their homes for the cause of God, or practise the rites of their faith in secret (Yousuf 1938: 914). The verse was revealed about the time of the battle of the Ditch (*Khandaq)*, also called the Battle of the Confederates (*Ahzab*) AH 4–5. We can imagine the comfort it gave to the Muslims who were besieged in Madina by a force ten times their number (ibid.: 914).

To those who do not follow Islamic law and are defined as evil, there is no security or peace, only the unpredictable threat of divine punishment, although God is just and merciful:

> Do then those who devise evil feel secure that God will not cause the earth to swallow them up? Or that the wrath will not seize them from directions they little perceive? Or that he may not call them to account in the midst of their goings to and fro, without a chance of their frustrating him? Or that he may not call them to account by a process of slow wastage? For thy Lord is indeed full of kindness and mercy.
>
> (16:45–7)

Pilgrim insurance in Mecca (Ta'min Al Bayt al-Haram)

Islamic writings elaborate on the concepts of insurance or performance of the pilgrimage. It is an Islamic requirement to attempt, if possible, one pilgrimage in a lifetime. The Prophet Abraham asked God to make Mecca a secure and peaceful place, and God acceded to his request and it is therefore Abraham's shrine (Ibn Al-Arabi 1972: 1:38, 39). These verses from the Quran remind Muslims of the function of Mecca (ibid.: 73):

> Remember, We made the house a place of assembly for men and a place for safety.
>
> (2:127)

> The first house [of worship] appointed for men was that at Bocca: full of blessing and of guidance for all kinds of beings. In it are signs manifest: [for example], the station of Abraham; whoever enters it attains security (*Amn*).
>
> (3:96, 97)

It is in another form, as *Amn* from God's revenge in the hereafter, that Prophet Mohammed said:

> Who went for pilgrimage to Mecca and did not do obscenity nor act unlawfully, returned home as he was just born.
>
> (Ibn Al-Arabi 1972: 1:39)

Insuring peace and salutation to strangers

The humble who had sincere faith were not sent away to humour the wealthy, but were honoured and given a special salutation, which has become the characteristic salutation in Islam: '*Salaam*' ('Peace be on you'). The word *Salaam* has a special affinity with the word 'Islam'. In words people are given the salutation, and in life they are promised mercy by the special grace of God (*Al-Manar* 1980: 5:282). When a courteous greeting is offered, it is met with a still more courteous greeting, or one of at least equal courtesy. This is considered important as all creatures derive from the one God, and are brought together before him (ibid.: 374).

> Ye who believe! When ye go abroad in the cause of God, investigate carefully, and say not to anyone who offers you a salutation: 'Thou are none of a believer.'
>
> (4:94)

> When those come to thee who believe in our signs, say: 'Peace be on you'.
>
> (6:54)

The attributes of God, summed up in the human concept of the 'Sovereign', imply the one undisputed authority who is entitled to give commands and receive obedience – the power that enforces law and justice. *Salaam* embodies not only the idea of peace as opposed to conflict, but also wholeness as opposed to defects, hence the paraphrase 'source of peace and perfection' (Yousuf 1938).

Conclusions

Insurance is by no means a new concept, nor is it exclusively commercial. It has altruistic uses beyond the boardroom and the stockbroker, providing social bonding and collaborative environment in which whole societies can prosper. Few Muslims would disagree with insurance in its purest sense, as in its own way it reinforces the social responsibilities laid down to Muslims in the Quran. The majority of its detractors cite the commercial aspects of 'modern' insurance as reason enough to disallow it; many of their views are indeed justified and Islamically valid, while some choose to err on the side of caution because of the lack of specific mention of insurance in Mohammed's teachings, written of course when the industry was not extant anywhere in the world.

The Quran's and *Shari'a*'s prohibition of usury is similar to that of pre-reformation Christianity, except that the only permissible form of financial risks involves gaining returns from a partnership and allowing a penalty if a borrower fails to pay a debt in time. Insurance seems to have a place in a generic human solidarity, and forms of it have been traced back to 2500 BC; it was practised by the Chinese, the ancient Egyptians, the Greeks and the Romans. Insurance to Muslims is not a financial transaction, but is an everyday act, performed whether at work or at home. Worship can be considered as insurance for the ultimate place in Heaven, the destination for those who obey God's rules and avoid God's prohibitions. Muslims believe that Islam provides a legal safeguard, a moral system, and love of God. In return, God has promised Heaven and peace forever.

Apart from commercial insurance, there are other kinds of insurance such as State-established social security, where the State plays the role of the insurer. However, the social security is not a normal contract and cannot be directly compared with commercial insurance; it is a system set by the State for the help of certain categories whose financial resources are not sufficient for the confrontation of daily life risks. Many *Shari'a jurists* are in favour of insurance contracts as long as they are free from *riba*, gambling and *gharar*. Their opinions are generally in favour of cooperative or mutual insurance. In view of that, it is believed beyond doubt that the cooperative system should replace the commercial system, as the cooperative system is the only one that complies with Muslim teachings while satisfying the genuine purpose of insurance.

4

THE DEVELOPMENT OF MUTUAL INSURANCE IN THE WEST

Introduction

Insurance has a crucial role to play in social and economic development of Muslim countries, which is why it is necessary to study relevant insurance schemes that have been developed and practised with a history of success. The application of mutual insurance, the most successful form of insurance in the West and, as discussed in earlier chapters, acceptable to most Muslim scholars, is suitable to Muslim countries. This chapter outlines the mutual insurance structure and practice in several Western countries, each of which has a different structure, approach, and framework of legislation. From selected components of all the Western countries' insurance schemes compared in this chapter, we are able to construct an acceptable mutual form.

It is noted that all Muslim countries are also developing countries that suffer from an excessive growth of population relative to economic capacity and, as a result, national income dose not rise at rates commensurate with growth. Also, since capital formation is a very slow process, developing markets are usually small, being based on a relatively undiversified economy and lacking both financial and technical experience, particularly in mutual insurance activity.

As insurance expands with industrial and economic growth, the problem of insurance will differ from one country to another, according to each country's economic stage of development and political environment. It is known that establishing a mutual insurance market in developing countries often suffers from a lack of sufficient numbers of similar risks, and more time is required to develop the insurance market.

The organization of mutual insurance

The concept of mutual insurance can be traced back in history to the eighteenth century when shipowners' dissatisfaction with the terms available from the underwriters at Lloyd's led them to form mutual insurance associations to meet their needs at lower cost. 'Mutual' appears in the names of those associations, now known as 'protecting and indemnity clubs'. Since the start,

mutual insurance has steadily been developed in all countries, whether industrial or agricultural, and in all social and economic strata, whether urban or rural (Raynes 1948: 71). Mutual insurance is organized either by large companies and international organizations or by small firms. Its policyholders can be from one or several countries or from a single region or town. There are also mutual insurance companies that cater solely for members of a single profession (Carter 1973: 11). Mutual insurance occupies a strong position and even dominates the market of some countries, often grouped at a national level into a specific professional organization (Insurance Annual Report 1991: appendix 1).

Insurance is by its nature a mutual activity. It serves to compensate a group of persons, organized in accordance with statistical laws, from a hazard, so it is in no way surprising to find that people who incur the same risks create mutual insurance companies in order to be able to control the organization and functioning of their group. Members of such a company compose the social body and determine its powers. They constitute the General Meeting of the company, appointing from amongst themselves the directors. A mutual insurance company is a company that belongs to its insured members and is owned by its policyholders or their representatives – professionals or trade associations. An example of such a group at a national level is the UK's national association (Mutual Insurance Companies Association). This comprises a group of mutual insurance companies, together some nine company members and eight company associate members.

At an international level, another example is the International Association of Mutual Insurance Companies, AISAM (*Association Internationale des Sociétés d'Assurance Mutuelle*), which covers over 220 companies from 26 countries from its principal office in Amsterdam. The corporate purposes of the AISAM are defined in its by-laws:

1 to establish relations and links of confraternity between its members and to watch over the general interests of private insurance organizations based on the mutual principle of non-profit making;
2 to facilitate the exchange of information and experience between members, in matters of legal, fiscal, economic, political or other problems affecting mutual insurance in the different countries;
3 to draw its members' attention to problems of a general nature which arise in one or more countries and which seem to warrant study in the general interest of mutual insurance companies;
4 to study the origins of mutuality and investigate future possibilities of disseminating its principles;
5 to obtain recognition as a representative of insurance institutions based on the mutual principle in all international organizations; and
6 to maintain regular contact with the national federations of mutual insurance companies.

Mutual value

The value of insurance is implicitly acknowledged but rarely made explicit. In practice, insurance eliminates uncertainty and risk and so allows commercial risk-taking. It helps place small groups on a more competitive footing with larger rivals, so stimulating new growth. Insurance develops financial security and reduces economic wastage.

The value of non-life insurance premiums rose from some US$38.5 billion in 1965 to some US$265.1 billion in 1985 throughout the OECD (Organization for Economic Co-operation and Development) countries (Sanders 1987: 3), matching the growth in GNP over the same period. The insurance industry was thus able to consolidate its overall economic position worldwide and occupy a position of growth. But like all commercial markets, the non-life insurance industry is not perfect. It suffers from alternate oversupply of its capacity, and volatility in current risk creates disequilibrium in pricing. When premiums become almost as unpredictable as losses, the insurance buyer is forced to turn to risk-financing solutions that are not based on conventional insurance. Thus, today no organization can depend solely on commercial insurance and the development of mutual dependence, and indemnification by means of a private pooling of risks is also a growth sector, receiving encouragement from national and world trade authorities.

Some US$10 billion of annual premiums have been identified in insurance organizations, which are the subject of this study. This sum received a considerable boost in 1986, when major US corporations sought liability insurance capacity to the value of some $1 billion, the subject of cyclical withdrawal by established American and European insurers and re-insurers (ibid.).

Mutual stock

Mutual stock insurance organizations operate on an advance premium basis and are generally capitalized on the lines of a stock corporation. The stockholders or shareholders enjoy a return on their investment represented by the capital stock. Some of these may issue assessable or non-assessable contracts (where they have a system of 'calls' for premium post loss), but the assessment liability is typically limited (Klock 1974: 379). These mutual practices have in the past been designed to serve the requirements of a particular class of insured persons in the same trade or profession, frequently under the aegis of a trade or professional body. More recently hybrid mutual operations have emerged as a matter of necessity to replace insurance capacity vacated by commercial insurers after a buyers' market in the insurance trade cycle.

Mutual assessment

There are mutual insurance organizations that operate on an assessment basis. For the smaller mutual of this class, contributions may be sought from the policyholders, in most cases, after a loss has occurred. Frequently for the larger and more established mutual, sufficient funds and expertise will have been accumulated to make advance calls that will generally be sufficient to cater for all losses in that financial year. These mutuals are usually non-profit making, without share capital, and are used by insurers of a particular class, with or without the involvement of the trade or professional body concerned (ibid.).

An example of this kind of mutual is the 'Protection and Indemnity Club' (Carter 1973: 59). This largely owes its origin to the reluctance of London underwriters to associate themselves with the liability risks that emerged in shipping around the turn of the nineteenth century. The clubs, as they became known (*The National Mutual Life with Profits Guide* August 1993: 5) also provided advice and services. Some have become involved in physical damage insurance to the hulls, others in war and strike risks. More recently, they have been used to solve professional liability problems.

Other registered societies and clubs

Called 'fraternal' in the US, certain organizations provide mutual aid and self-help (Peffer 1974: 411). Examples are:

1 friendly societies, which began over 200 years ago, performing functions largely taken over by the Welfare State, but which still provide for those areas where the services of the State or other agencies are either non-existent, inadequate or need supplementing. In addition to life assurance and relief or maintenance during sickness, unemployment and retirement, friendly societies are able to provide other insurance that is of a more personal nature;
2 non-profit-making organizations helping with private health care and the effects of hospitalization;
3 the insurance cooperative which is most frequently used for agricultural insurance; and
4 in Third World countries, 'reciprocals'. Reciprocal exchanges operate in the areas of property damage and liability protection. They are unincorporated associations of the insured, each insured person, in effect, being a part owner of the enterprise and assuming a definitely established underwriting liability, which is shared. Reciprocal exchanges have also been used in the US as a way of providing insurance capacity where commercial insurance may not exist, for example, malpractice insurance for physicians.

By pooling risk through a mutual, the members of these organizations obtain considerable advantages in their attempts to finance their fortuitous risks. Principally, they will be able to achieve the ability to insure and manage risks in circumstances and at times when commercial insurance is neither available nor affordable (Klock 1974: 379).

The use of a wide and homogeneous database enables such organizations to create a rating structure more accurate than might otherwise have been the case. Also, the element of self-interest enables the members to discipline themselves in a way that does not obtain in the commercial insurance market. This, in turn, will allow reductions in loss costs to be made and broader covers to be granted. Smaller members may also enjoy the possibility of purchasing insurance with discounts similar to those that larger companies enjoy in the commercial market. This way, all the values of insurance are further enhanced.

The ultimate purpose of mutual insurance companies is to serve the objectives of risk management, by providing a mechanism to reduce losses (Housell 1987: 4). The opportunities for reductions in the cost of financing insurable losses through the mutual are considerable and, in some instances, this route is the only one available. However, in seeking to minimize the overall risk for the organization looking to establish a mutual, the insurance, legal and tax implications are considerable.

Risk management

Organizations today undertake such a wide variety of tasks that their corporate objectives differ greatly. For any commercial organization the financial objectives can be simple, expressed as: *revenue – costs = profit* (*or loss*) (Sanders 1987).

This equation states the obvious, but it helps to emphasize that any decision, which affects one variable must affect at least one of the others. Thus, if a corporation wishes to improve its profits, it can do so by increasing its revenue, reducing its costs or by doing both (Lalley 1992: 37). Some organizations do not have the freedom to alter every one of these variables.

The cost of risk to any organization must represent a significant part of the total costs and it can vary drastically from year to year. The object of risk management is to plan, organize and control, to bring down the cost of risk to the lowest possible level tempered only by other corporate objectives voluntarily adopted or imposed by legislation.

Applications of mutual insurance to risk management

Many insurable risks are in fact difficult to insure. This is particularly true of the kind of risks emerging from today's economic and political uncertainties. For example, negligence has become a wholly abstract and uncertain concept. Judgement is frequently based on the insurance principle of 'which can pay?'

As a result, in some cases and at certain times, conventional insurance is very restricted and may disappear completely at short notice. Conventional insurance for professional indemnity, in particular, is becoming increasingly expensive. However, the commercial insurance market is not to blame for this unsatisfactory situation. Fundamentally, any risk is insurable (Handsell 1987: 7) and at stable premiums, if it is static, clearly identified, precisely defined and quantified in terms of probability of incidence and severity of costs.

There are other requirements, which enable the insurer to apply 'the law of large numbers', namely that there must be a sufficient 'spread' of risk, over which to make a 'book' of underwriting probabilities, and thus secure the average and expected result. Apart from the unpredictability of many of today's risks, the insurance market is also faced with unpredictability of demand from their customers from year to year (Wise 1993: 4).

It becomes very difficult for an insurance underwriter to obtain the broad spread of risk he needs, both in terms of good and bad risks, as well as in terms of geographical spread, without some kind of group scheme to which members voluntarily commit themselves for a reasonable period of time.

How can the insurance industry succeed in the quantification of probability and severity? Too much uncertainty produces volatility in terms of insurance and many of the risks that threaten the trade or the current insurance market are not catered for by professional association members. As soon as volatility enters the scene, insurability disappears in the eyes of the insurers (Lalley 1992: 42).

Volatile risk comes to be equated with business risk, and insurance can therefore only perform with the greatest difficulty, as insurance premiums will always be volatile. Much of the volatility described can be controlled, if not entirely eliminated, by measures that recognize the problems encountered. Many trade and professional associations have attempted to reward their members for the cost of the administration and management. To a large extent, such schemes can help to establish the acceptance of uniformity and make the cost of risk reduction worthwhile. There is also the problem that commercial underwriters can never know as much about the risks of any given group of organizations as the people within those organizations.

Outside life assurance, insurance is a trading market and, in common with other commodity markets, is subject to trade cycles. The fluctuations in the insurance trade cycle are of a similar nature. Capital flows into the industry in times of profitability, pushing down insurance rates. This leads to some forms of insurance, particularly the more volatile risks, at any time becoming affordable or unavailable, or only available at inadequate levels of indemnity, as investors leave the market.

After a period of shortage, the rates rise, tempting capital back into the industry. This eventually leads to competition for market share, and the whole process repeats itself. Over recent years the fluctuations have become more acute. In the ten-year cycle leading to the turn of the twenty-first century, the downturn in the market was delayed by high interest rates, and in the previous

cycle it was precipitated by a 'bear' market, which depressed insurance funds. Thus, interaction with general economic developments may distort the insurance cycle further (Volkswagebwerk 1972: 12).

An example of how self-interest and self-help can operate in mutual trading in insurance is that of the lawyers' mutual for professional negligence risks (Yorrow 1990: 37). This is one of the most volatile of risks to insure against. Often, and depending on the state of the insurance cycle, this form of cover is difficult or unavailable to buy and there are massive price fluctuations. Yet the members of this mutual have enjoyed consistent cover at reasonable premiums for many years. Furthermore, if one is paying for one's own claims, the essential elements of risk management are reinforced, through the principle of mutuality. There is a very strong incentive to make sure that claims are kept to a minimum.

There is also a systematic method of dealing with all circumstances that might lead to a claim. Once these are notified, a full-time lawyer retained for the purpose constantly monitors individual members' claims experience and suggests remedial action. In such situations, a return to the more primitive forms of mutual protection may not only be a better alternative to conventional insurance; it may be the only form of insurance available.

In the case of difficult risks, and when the commercial insurance market is not able to provide affordable protection (ibid.: 48), the ability of an adversely affected organization to manage its risks better is the key to regaining the advantages of protection by combination. A return to the original principle of sharing the risk, inherent in the mutual form, is the key to improved risk management.

At present, there are over 500 mutuals in the USA and their number is growing (American Insurance Association 1992: 2:33). The members, certainly from the most successful operations, will find it beneficial to draw up their own 'rules of the club', in the form of a members' agreement (ibid.). The agreement spells out the terms of acceptance into, and continuing membership of, 'the club'. The vital elements of self-interest and consequent insurability at affordable terms are restored via the incorporation of beneficial codes of conduct, risk management procedures, loss reduction (pre- and post-claim), disciplinary codes and the methods of transacting business, policy terms and rates, re-insurance procedures and requirements, method of cost, premium and surplus allocation.

Re-insurance and foreign exchange

Insurance markets in developing markets often lack a sufficient number of similar risks. The risks insured are generally few, but they are larger relative to the total exposure and cannot be balanced in the same market; therefore, it will require re-insurance in another market or foreign country, leaving a relatively small and manageable risk for the local market. Hence the outflow of re-insurance

remittance constitutes a substantial amount of foreign exchange, which may have an effect on the cash flow and balance of payment.

In addition, the technical reserve funds (savings by insurance for the policyholders) can be effected, and immediate payment of these funds represents a further drain of cash flow. The excessive dependence by the developing countries on foreign re-insurance facilities is likely to lead to unfavourable terms and conditions.

The establishment of national and regional re-insurance schemes has embraced a number of mutual insurance companies, as is the case in Great Britain (ibid.:35). National Insurance institutions are beneficial both to mutual insurance companies in the local and national markets and to the economy of the country, particularly in the area of foreign exchange requirements.

Investment of mutual insurance

Investment of mutual insurance funds constitutes an important issue of paramount importance; such funds need spread in diversity of investments as well as an adequacy of safety and yield. Stock exchange investments combine these advantages, and accordingly a large portion of mutual insurance reserve funds is usually invested in stock exchange bonds. Obtaining the maximum economic progress, notably when the market is restricted in developing countries, is a particularly sensitive issue.

Another area of investment is real estate, which can also be restricted if an imposition of rent control by the government is in force. However difficult the investment problems seem, there will always be a determination on the part of the mutual insurance company to provide an adequate formulation to help growth.

State regulation of insurance and re-insurance

The British regulatory philosophy used to be one of voluntary disclosure, under which successive governments relied very much on the publication by insurance companies of accounting information to assist in the operation of the self-regulatory pressures of a competitive market. The American tradition, which mirrored European principles, is highly regulated and codified by statute. It extends, beyond concerns that the insurance company can pay its claims, to other consumer protection matters, such as policy wording and the control of premium rates.

In 1977 the United Nations Conference on Trade and Development encouraged developing countries[1] to establish insurance cooperatives in order to provide better insurance protection. At least 20 developing countries, and most developed countries implemented this. The EU also introduced the concept of the minimum guarantee fund, in place of earlier minimum capital requirements. This provides a new inner benchmark of solvency. This fund must be

maintained at a specified amount, depending on the class of business transacted, or one-third of the calculated solvency margin, whichever is greater.

The EU's approach to the calculation of the non-life solvency margin in fact requires two calculations, the first on a premium basis and the second on a claims basis, whereas traditionally only the premiums were used. Sole use of premiums as a means to calculate the solvency margin can result in the margin being reduced by inadequate premium levels. A second calculation using the claims results overcomes this potential flaw by substituting the claims basis for the premiums if the claims ratio exceeds 69.6 per cent. An insurance organization's current growth in written premiums would run the risk of being overlooked if the claims result were the only method used.[2]

Another innovation is a system whereby the amount by which gross premiums in the calculation are reduced to the net retained is measured by the relationship of re-insurance losses recovered to total losses suffered. This compares with the traditional method that uses amounts of re-insurance premiums paid out, but which might not reflect the end result. Moreover, the calculation gives a maximum credit for re-insurance of 50 per cent, which materially affects the smaller organization that may re-insure a substantial proportion of its risks.

In the case of mutual or mutual-type associations, which may seek to assess premium contributions from members after the loss is incurred, that is, with variable contributions, there are two important concessions under the EU regulations that are being used as models elsewhere.[3]

First, it is possible to reduce the appropriate minimum guarantee fund by 25 per cent, thereby allowing relatively low initial funding. Second, it is possible to include in the solvency margin calculation up to 50 per cent as an 'unmade call'. Any claim that the mutual has against its members by way of a call for supplementary contribution within the financial year can be allowed. This can be up to one-half of the difference between the maximum contributions and the contributions actually called in, provided that the limits of liability are kept to a reasonable level. But whilst the EU regulations pertaining to mutuals are held to be an improvement on the more traditional methods of control, defects remain.

The solvency margin calculation treats all re-insurers alike, and does not discriminate against the less fortunate (Anderson and Thompson 1921: 333). Neither does the solvency margin guard against potential ruin from investment depreciation: foreign exchange and claims are somewhat arbitrary, and no evaluation is made of the profitability of any given line of business, or adequacy of loss reserves.

The EU regulations provide the manager of a mutual with a better set of 'ground rules' than previously existed in law. The EU has yet to harmonize accounting standards within the Community and relies upon the existing accounting standards of the individual member States. Whilst this remains a weakness, the Community has recognized the need for special accounting rules for insurance enterprises, and is preparing a separate insurance accounting directive.

The mutual structure is, in fact, intended to contain substantial elements of equity having regard to the members of each policy-year (Cooper 1995: 35), although the directors of the mutual retain the power to move reserves or parts of reserves from one year to the next. Thus, a mutual can involve capital, although it may not have to provide immediate paid-up capital at the commencement of trading. In such cases the capital is, in effect, with the members of the mutual to be provided where necessary. Most on-shore and offshore supervisory authorities will control a mutual in a most flexible manner.

Although rarely put into practice, the form of incorporation may be on the purest mutual basis, where claims are apportioned and collected from members without any deposit or advance payment. Alternatively, they could go to the other extreme, whereby advance deposits are unlikely to be exceeded, or a ceiling is placed on supplementary calls. For budgeting purposes, a supplementary possible call may be indicated at the beginning of the policy year, to be called or not as circumstances dictate with the progress of the year. Initial funding may consist of gifts, loans, bank guarantees, premiums in advance (that is, more than one year's premium is paid in at the start), or part equity. Ongoing funding can be supplied by drawing on accumulated reserves, advance calls, supplementary calls, and equity raising or loan capital. Whilst unusual, it has been found possible to mitigate supplementary calls for new, non-marine mutual, by the use of re-insurance.

For the modern mutual, flexibility of cover can be given to pay claims excluded or not covered, or to provide for additional insurance to be underwritten beyond that contemplated at the inception of the mutual. Equity is achieved by matching calls against claims payments and the cost of providing services over a period of years. That is, there is self-insurance at cost. Service to members has always been a strong feature of mutual operations with the provision of claims mitigation and loss prevention as well as general risk management.

Whilst the operation of the mutual has followed a specialized path, recently this structure has been used, successfully, to solve risk-financing problems in such diverse areas as professional indemnity insurance, workmen's compensation, social security, employee benefits, and space satellite insurance.

Mutual insurance in the USA

All insurance companies in the 50 States of the United States are subject to the General Corporation and Insurance laws of the States in which they are authorized to operate. With limited exceptions, all companies writing property are regulated under Department of Insurance casualty, life and marine insurance regulations, according to the local State needs.

Unlike a stock company, a mutual insurance company is a corporation owned and operated by its policyholders (Mason 1992). It is a form of insurance whereby each insured person, by payment of a specified amount into a common fund, engages collectively with other insured persons in indemnifying all others

against loss. An insured person is entitled to attend policyholders' meetings and to vote on all questions that arise including the election of members of the company's board of directors.

The first successful mutual insurance company in the USA was a fire insurance company organized in Philadelphia, Pennsylvania, in 1752. It continues in operation to this day as an exceptionally strong institution (Noniewicz 1986). At that time insurance premiums were paid by insured persons in the form of periodic assessments, calculated to cover the actual amount of losses and expenses incurred by the company. Some of the small mutual companies continue to operate today on the assessment basis. Most mutual companies in the country, however, now charge a fixed premium, usually payable in advance. Rates are classified by type of structure, construction, protection and occupancy, or use. Each mutual insurance company is authorized, under a charter issued by the State in which it is domiciled, to provide insurance against various and specific hazards as set out in the company's articles of incorporation. Mutual life insurance companies are limited to classes of cover they can underwrite, namely, life, medical and hospital insurance. They cannot issue policies covering property (National Association of Independent Insurers 1993).

Likewise, mutual property and casualty insurance companies cannot issue life insurance policies, but are specifically limited by their articles to underwriting insurance against damage from such perils as fire, lightning, wind, hail, etc. Additional perils insured against are explosion, riot or civil commotion, aircraft, vehicles, vandalism or malicious mischief, theft and numerous extensions of such basic coverage.

As a mutual insurance company improves its financial position, it may gain the authorization to underwrite additional lines of insurance. Many of these companies have now become 'multiple line' writers, although there are still 'speciality' companies underwriting insurance against such single hazards as hail damage, growing crops or damage to property caused solely by hurricanes, tornadoes, cyclones, windstorms or hail (Holtom 1973).

Regulation by a State Department of Insurance can be extensive. Insurance departments approve rates, forms and policy wordings that are filed by each company. They license agents and supervise their activities; they supervise mandatory deposits of assets by companies operating within the State's boundaries, holding such deposits as a protection for the policyholders in the State. Each department maintains a staff of qualified accountants who periodically examine all records of companies doing business in its jurisdiction. The laws governing insurance company operations are established by the legislature of each State and are administered by the Insurance Department (Shilberg 1987). Although this procedure may result in variations from State to State, little difficulty is experienced by the companies.

Almost all mutual insurance companies are required to file an annual statement each year-end with the Department of Insurance in each State where

they are authorized to issue policies (Noniewicz 1986). Whilst certain small companies submit simple forms containing limited information, most insurance companies, mutual and stock, are required to file an annual statement form designed and approved by the National Association of Insurance Commissioners (NAIC), which is made up of each State's Commissioner of Insurance.

The NAIC is a powerful organization that strives for uniformity in regulatory decisions and forms, as well as in laws governing the insurance industry in the United States. The 'convention form' annual statement is a complex 55-page document requiring detailed information relative to a company's premium income, losses, expenses, investments, reserves and assets during the year for which it is filed (Mason 1992). The annual statement is useful in determining the success or failure of a company and its financial condition and forms the basis for the periodically scheduled examinations conducted by the Insurance Departments.

Currently the United States government does little in the way of regulating the insurance industry. Instead, federal guidelines governing many areas of the insurance business have been established. It is ordinarily up to the various State governments to follow these guidelines. In order to maintain State control and regulation of insurance, each legislature establishes procedures in accordance with federal directives (National Association of Insurance Commissioners 1992).

Feeling that its insurance is unable to provide adequate facilities, the federal government does not offer insurance cover in catastrophic areas such as flood, crime, all risk damage to crops, medical protection for the aged or life insurance for members of the armed services. In addition, all insurance companies are subject to the rules and regulations of the Internal Revenue Service, which has certain specific procedures applicable to the payment of federal income by mutual insurance companies.

The 'farm mutual' comprises an important segment of the mutual insurance industry in the United States today. These companies were organized by groups of farmers striving to protect themselves in their rural environment, mostly during the latter part of the nineteenth century. Such companies usually operate in the limited area of a political sub-division, such as a township (36 square miles). They originally provided insurance to farm dwellings and out-buildings, rural churches and meeting halls and, later on to chattels against only two hazards: fire and lightning. In many States insurance departments did not regulate such companies under federal corporate laws, but received authority under the corporate laws of that State. They operated strictly upon an assessment basis with the number and amount of assessments being limited only by the amount of loss suffered by company members (Noniewicz 1986). Many farm mutuals still operate on this basis. Thus limitations have been established, and they continue to insure only against the hazards of fire, lightning and offer limited extended coverage. These companies, through arrangements with larger mutuals underwriting windstorm and hail, third party liability and other extensions, are able to continue serving their rural policyholders.

Over the years, however, other mutual companies, once classified as farm mutuals and providing insurance in rural areas only, have grown and now underwrite most property and casualty lines. The insurance laws of many States are still quite limited in regard to regulation of small, rural underwriters (Mason 1992). As a given mutual company's assets increased it became necessary for it to operate under a different chapter of the insurance law and then submit to departmental regulation.

All mutual insurance companies operating in the United States, with some definitive exceptions, produce business under the system of independent agents or 'captive' agents (Shilberg 1987). The exceptions are:

1 direct underwriters that sell insurance through their employees direct to the public and not, therefore, through independent agents or brokers;
2 those farm mutual companies that depend upon the members of their boards of directors for the production and service of the business; and
3 in those cases where the manager underwrites all the policies for the company.

As the various States enact laws requiring licensing of agents, however, these exceptions become fewer and fewer, resulting in more knowledgeable professional agents.

As the needs of the insuring public become greater it becomes more difficult for the smaller mutual insurance company to provide the necessary coverage. In some areas the powers of the regulatory agencies, the insurance departments, have waned, but in other areas of the business they are more extensive. Through mergers, re-insurance and assurance of combination policies, mutual insurance has maintained a strong position in the United States. Currently there are approximately 1,800 mutual insurance companies operating in the United States, many of which are more than 100 years old (Noniewicz 1986).

Mutual insurance: the European approach

In the UK and in Europe generally, the conventional market and the insurance brokers are less conversant with the concept of 'self-insurance', and less obliged to seek that route. Thus other criteria for mutual insurance success can be examined, namely the ability to launch the mutual or association captive, without upsetting the conventional insurers or the brokers (Britten 1989).[4] A typical approach in the difficult market of professional indemnity insurance, for example, might be as follows (Akhurst and Watson 1990):

1 To exert influence against current market trends to narrow cover by imposing aggregate limits and excluding broader elements of cover currently available.
2 To improve negligence defence techniques by involvement in 'underwriting' and 'risk bearing' (with profit potential) – pre- and post-loss.

3 To become involved in claims settlement.
4 To 'capture' any excess profits that might be made by the conventional insurance market.
5 To provide a smoothing mechanism to even out the peaks and troughs of the traditional insurance trade cycle.

A purely funding approach may be made that relies on actuarial projections, and does not seek any support from the conventional insurance industry. Such an approach would be based on a company limited by guarantee and the fund would be structured so as not to constitute an insurance contract requiring statutory approval.

The mechanics of such an approach are demonstrated by the first proposals of the Law Society, in the Law Society's Gazette, and Bacon and Woodrow Consulting Actuaries, who made the projections. These proposals were made possible by the following special features (European Commission 1989: 29–39).

1 Under the Solicitors Act 1974, lawyers can establish a fund and grant statutory indemnity to solicitors, employees, etc. (past and present) and oblige solicitors to make contributions to the fund. Thus obligations to make payments into the fund and rights to recover from that fund are established without any contract of insurance ever being in force.
2 Claimants against a solicitor would have statutory rights (under the Solicitors Act) to be compensated by the fund for any claim sustainable against a solicitor. To give the Council some idea of the financial consequences of self-insurance, a limited number of products are set out below (Philips and Drew 1990). When considering them a number of facts must be borne in mind, namely that:

   a actuaries have assumed that the Department of Trade and Industry would not demand that the fund meet the EU solvency margin. Even if it is desired that the fund should be able to operate within the EU solvency margin in the longer term, that margin could be built up over a number of years and, moreover, any incidental losses could be recovered over a period;
   b the projections take into account a 15 per cent year-on-year increase in premiums and claims settlement. The figures take into account increases in the size of the number of claims and the amount of claims, which tend to run ahead of the general level of inflation in the economy;
   c tax is allowed at a rate of 35 per cent and interest at 10 per cent shown at a net rate of 6.5 per cent;
   d reserves are discounted to a figure which, including the additional interest credited thereto, would amount to the sum necessary on settlement, at the projected time that the settlement would be made;
   e claims incurred are claims reserved;

f management expenses are the costs of setting up the venture. Costs of defence are included in the claims and claims reserve figures. Costs of underwriting, claims handling, etc. would be met, from a sum equal to current brokerage;
g the total net investment income is split between net discounted reserves and the profit and loss account;
h the results of each projection can most readily be seen from the balance sheet. The liabilities are made up as follows:
  i insurance funds – the total of discounted reserves carried forward for prior years and the current year;
  ii accumulated profits – the profit carried each year to the profit and loss account accumulated to the end of the balance sheet year;
  iii total liabilities – the sum of insurance funds and accumulated profits.

Under total liabilities is shown the solvency of the fund. The minimum EU solvency margin is compared with the net assets available to cover that margin, where 'net assets' are equal to 'accumulated profits', since no capital contribution is required.

The Law Society Council has approved the Solicitors Indemnity Rules 1987 (Laheac 1993), which will bring into effect a statutory fund providing the same indemnity as was previously given by the master policies, placed earlier in the insurance market.

Technical personnel and exchange of information

Established mutual insurance needs adequate trained personnel, who are of utmost importance in managing successful mutual insurance. Recruitment of knowledgeable staff in a new mutual insurance scheme can be a difficult task, as the recruitment of experienced staff will need help from larger insurance companies and cooperation between other mutuals. As in the case of the AISM, the aim is to:

1 establish relations between members and to watch over the general interests of private insurance organizations based on the mutual principle of non-profit making;
2 facilitate the exchange of information in legal, fiscal, economic and political matters affecting mutual insurance in different countries;
3 draw members' attention to problems that arise of a general nature in one or more countries, for other members' interests;
4 obtain recognition as a representative of insurance institutions in all international organizations; and
5 keep its members updated on changes and relevant information from around the globe.

Conclusion

Mutual insurance practised in the West has been established for many years and operates within the framework of the insurance industry. Insurance is based on statistical experience, the main difference between mutual insurance and commercial insurance being that the owner of the mutual insurance is the policyholder, whereas in commercial insurance the owners are normally the shareholders, and are not necessarily policyholders. In mutual insurance, a non-profit making organization, the management loyalty is focused on the policyholders; in commercial insurance, a profit making organization, the management are loyal to the shareholders.

Taking into account the highly technical and complex nature of insurance, mutual insurance requires to be in cooperation with other similar mutual insurance schemes either in the same country or abroad. This cooperation brings the law of large numbers to the small company, and information, problems encountered and up-to-date knowledge become available to mutual organizations large and small.

In developing countries, where the volume of insurance transactions is still small, international corporations can provide practical opportunities for development of the insurance industry. National, or international, re-insurance in these emerging countries is an important backup to mutual insurance; it is a good sign that an efficient service is provided to the mutual insurance organization. The goodwill that is traditionally associated with mutual insurance brings the benefits of security and prosperity.

5

THE DEVELOPMENT OF ISLAMIC BANKING AND INSURANCE IN MALAYSIA

A case study

Introduction

Malaysia is a relatively small country of Southeast Asia, whose population is mainly Muslim. Natural resources such as crude oil and gas are the main sources of income, and the economy is dependent on private and foreign investment. With the *Takaful* Act, 1984, the government of Malaysia is considered to be one of the first to adopt Islamic banking and insurance systems parallel to their conventional counterparts.

The development of Islamic banking in Malaysia

Since the 1970s, Islamic banking has emerged as a new reality on the international financial scene. Its philosophy and principles are, however, not new, having been outlined in the Quran and the *Sunna* of the Prophet Mohammed. The emergence of Islamic banking is often related to a revival of Islam and a desire of Muslims to live all aspects of their lives in accordance with the teachings of Islam.

In Malaysia, separate Islamic legal provisions and banking regulations exist side by side with those for the conventional banking system. The legal basis for the introduction of banking products along Islamic principles was the Islamic Banking Act, 1983, which came into effect on 7 April 1987. The Act provides the Central Bank with powers to supervise and regulate Islamic banks, similar to the cases of other licensed banks. The Government Investment Act, 1983 was also enacted at the same time to empower the government to issue Government Investment Certificates, (GICs) which are government bonds issued on an Islamic basis. As the Certificates are regarded as liquid assets, Islamic banks could invest in them to comply with the prescribed liquidity requirements as well as to park their temporary idle funds. Malaysia was the first country in the world to issue government bonds of an Islamic character.

The first Islamic bank established in the country, namely the Bank Islam Malaysia Berhard, commenced operations on 1 July 1983, with a branch in Kuala Lumpur. Bank Islam was listed on the Main Board of the Kuala Lumpur Stock Exchange on 17 January 1992 and by the end of 1993 it had a network of 52 branches. In line with its aims, the activities of the bank are based on Islamic principles of banking and credit conforming to the *Shari'a*. On the basis of these principles, Bank Islam offers all the conventional banking services, such as accepting deposits, granting credit facilities, providing safekeeping facilities and fund transfers. The bank accepts savings and demand deposits from members of the public under the principles of *wadi'ah* (deposits). It also accepts term deposits in the form of general investment deposits and special investment deposits under the principles of *Mudaraba*. General investment deposits and special investment deposits are similar to the fixed deposits commonly accepted by commercial banks, merchant banks and finance companies. However, the special investment deposits allow the depositors to specify the manner in which the deposits are to be utilized by the bank.

Service charges are levied on demand deposits, which do not bring any return to the depositors, and savings account holders are not entitled to a share of any return to the depositors or to a share of the bank's profits; but the bank, at its absolute discretion, may reward such savers as a token of its appreciation for the deposit of money with the bank. Profits are paid to the general investment account holders out of the bank's revenue from its financing and investment activities, while the special investment account holders are paid profits or made to bear losses from the manner in which their deposits are utilized.

The bank grants financing facilities such as project finance under the principles of *Mudaraba* and *Musharaka*, lease financing under the principles of *al ijara* and *tatinaa*, hire purchase financing under the principles of *al bai bithaman ajil*, trade financing (including bill financing and letter of credit) under such principles as *murabaha*, *Musharaka* and *wakalah*, guarantees under the principles of *al-kafala* and benevolent loans under the principles of *qard hassan*. In 1991, two new Islamic instruments were introduced, namely Islamic Accepted Bills and Islamic Export Credit Refinancing. Another important development in the evolution of Islamic banking is the securitization of debts and the trading of such debt instruments. After more than a decade in operation, Bank Islam Malaysia Berhard has proved to be a viable banking institution with its activity expanding rapidly throughout the country.

On the prudential front, Bank Islam has to adhere to the same regulatory rules as other banks offering conventional banking products. It is also required to maintain a statutory reserve account with the Central Bank. The long-term objective of the Central Bank has been to create an Islamic banking system which functions on a parallel basis with the conventional system. A single Islamic bank does not constitute a system. A banking system, whether Islamic or conventional, requires three vital ingredients to qualify as a system. These are:

1 a large number of players (there must be an adequate number of different types of institutions participating in the system. This is required to provide depth to the system);
2 a broad variety of instruments (a large variety and range of different types of instruments must be available to meet the various needs of financial institutions and customers); and
3 an Islamic inter-bank market (there must be an efficient and effective inter-bank money market to link the players (institutions) and the instruments).

In addition to the above requirements, which apply to all systems, it must be Islamic in substance and not merely in name (You 1991: Vol. 6: No. 1).

A wide variety of instruments

By the beginning of 1993, a total of 21 Islamic banking products were successfully developed by the Central Bank and, therefore, one of the three requirements for a fully fledged Islamic financial system was achieved, namely the requirement for a large number and wide variety of Islamic financial instruments to meet the various needs of financial institutions and customers. This section deals with each instrument.

Al-wadi'ah yad dhamanah (safekeeping with guarantee)

Al-wadi'ah yad dhamanah refers to deposits which have been deposited with another person who is not the owner for safekeeping. As a *wadi'ah* is a trust, the depositee becomes the guarantor and therefore guarantees repayment of the whole amount of deposits, or any part thereof, outstanding in the account of the depositors when demanded. The depositors are not entitled to any share of the profits but the depositee may provide returns as a gift (*al-hiba*) to the depositors as a token of appreciation.

Al-mudaraba (profit-sharing)

Profit-sharing, or *al-mudaraba*, refers to an agreement made between two parties: one who provides the capital and the other, the entrepreneur, to effect business projects on a profit-sharing basis, according to pre-agreed ratios. In the case of losses, these are borne by the provider of the funds.

Al-musharaka (joint venture)

A partnership or joint venture for a specific business with a profit motive, whereby the distribution of profits is apportioned according to an agreed ratio is termed *al-musharaka*. In the event of losses, both parties will share the losses on the basis of their equity participation.

Al-murabaha (cost-plus financing)

Al-murabaha refers to the sale of goods at a price which includes a profit margin as agreed by both parties. In *al-murabaha* contracts, the price, other costs and the profit margin of the seller must be stated at the time of the agreement of sale.

Bai' bithaman ajil (deferred payment sale)

The concept of *bai'bithaman ajil* is similar to that of *al-murabaha*, except that in this case the sale of goods is on a deferred payment basis.

Bai' al-dayn (debt-trading)

Debt financing, *bai' al-dayn*, is the provision of financial resources required for production, commerce and services by way of sale, or purchase, of trade documents and papers. It is a short-term facility with a maturity of not more than a year. Only documents evidencing debts arising from bona fide commercial transactions can be traded.

Al-ijara (leasing)

An arrangement under which the lessor leases equipment, building or other facilities to a client at an agreed rental is referred to as *al-ijara*.

Al-ijara thumma al-bai' (hiring followed by sale and purchase)

Al-ijara thumma al-bai' refers to two contracts undertaken separately and consequentially, as follows.

1 *Al ijara* contract (hiring or renting).
2 *Al bai'* contract (sale and purchase).

Under the first contract, the hirer hires the goods from the owner at an agreed rental over a specified period. Upon expiry of the hiring period, the hirer enters into a second contract to purchase the goods from the owner at an agreed price. This concept is applicable to financing the purchase of consumer goods and durables.

Al-qard al-hassan (benevolent loan)

Al-qard al-hassan is an interest-free loan given mainly for welfare purposes. The borrower is only required to repay the principal sum borrowed, but may pay an extra amount as a gift (*al-hiba*) at his or her absolute discretion, as a token of appreciation.

Al-wakala (agency)

The system of *al-wakala* refers to a situation where a person nominates another person to act on his or her behalf.

Al-kafala (guarantee)

The guarantee provided by a person to the owner of goods who had placed or deposited goods with a third party is covered by *al-kafala*. Any subsequent claim by the owner with regard to these goods must be met by the guarantor if it is not met by the third party.

Al-rahn (borrowing with collateral)

The concept of *al-rahn* refers to an arrangement whereby a valuable asset is placed as a collateral for a debt. The collateral may be disposed in the event of default.

Al-hiwala (remittance)

Al-hiwala refers to a transfer-of-funds debt from the depositor's or the debtor's account to the receiver's or the creditor's account where a commission or fee (*al-ujr*) may be charged for such service.

Al-ujr (fee)

Al-ujr is the commissions or fee charged for services.

Malaysia and the *Takaful* Act

The Malaysian *Takaful* Act (1984)[1] is certainly one of the most (if not *the* most) developed and comprehensive legislative frameworks aimed at establishing an insurance scheme in compliance with the *Shari'a*. The Act does not prejudice conventional insurance legislation, in that commercial insurance is still allowed and is governed by its own regulations. The *Takaful* Act exists concurrently with conventional insurance laws and offers an insurance scheme in which Muslims can take part.

Takaful (Arabic for 'mutual guarantee') is defined in Section 2 of the Act as meaning 'a scheme based on brotherhood, solidarity and mutual assistance, providing for mutual financial aid and assistance to the participants, in cases of need, where the participants mutually agree to contribute for that purpose'. The same section states that the aims and operations of *Takaful* 'do not involve elements which are not approved by the *Shari'a*'.

The Malaysian *Takaful* system can be summarized as follows. *Takaful* business which includes life insurance ('family solidarity business') and non-life

insurance ('general business') can be undertaken by a Malaysian company as defined by the Companies Act 1965, or by a society constituted under the Co-operative Societies Act. There is, therefore, no specific company form devised or required to undertake *Takaful* business. Premiums are called contributions in order to imply the notion of gratuitous payment made in order to contribute towards a mutual help scheme. Therefore, the premium is, legally speaking, a donation which is supposed to be to a certain extent disinterested and directed to other insured persons (called participants).

Life insurance companies offer three main types of policy:

1 whole life policy, which involves payment of a fixed sum by the insurance company on death or permanent disability of the policyholder. The premium charged is based on the age and health of the policyholder. On death a lump sum equivalent to the sum insured plus the profits or bonuses accrued is paid to the beneficiary of the policyholder;
2 endowment policy which, in addition to its function of providing death coverage within stipulated periods, also acts as a means of savings for the policyholder. The policy involves the purchase of a policy with a fixed lump sum, or annuity, payable on maturity or death of the policyholder. Part of the premium on this policy constitutes the payment for protection, while the balance constitutes savings; and
3 'term assurance', where the sum insured of the term policy is payable only in the event of the death or permanent disability of the life insured within the stipulated term. This type of policy does not have surrender value. The premium payable is relatively lower than with whole life, or endowment, assurance.

The office of the Director General was established for implementing the *Takaful* Act. The latter, who is appointed by the Minister of Finance, enjoys very extensive powers and is attached to the general administration of the *Takaful* Act.[2] In particular, the Director General is responsible for whether the operator is carrying out business in a manner 'which is not approved' by the *Shari'a*. The powers of the Director General include the right to refuse to register an operator, or to cancel its registration – thus putting it out of business, where there is evidence of breaches of the *Shari'a*.[3]

Two of the 13 grounds available to the Director General to cancel the registration of an operator are very broad indeed. Because of the very nature of his or her authority, the Director General is given great power of discretion. There are cases where the Director General concludes that the *Takaful* activities of the operator are possibly detrimental to the interests of its participants and where public interest requires the cancellation of the registration.[4] The Director General exercises control on the forms of proposals, policies and brochures (issued by the operator) and may order that a form be discontinued if it is considered in contravention of the *Takaful* Act, or if it appears to be misleading.

In Sections 33, 46(1)(g) and 47, all books, accounts, other documents and information held by the operator may be inspected or investigated at will by the Director General who can also issue directions to the operator if there is suspicion that the latter is carrying out business 'in a manner likely to be detrimental to the public interest, the interests of the participants or the interests of the operator'. In this respect the operator may be asked by the Director to cease the category of business conducted.

The Director General is the licensing authority for *Takaful* brokers and adjusters.[5] The *Takaful* Act also imposes the establishment of a *Shari'a* supervisory council, to control the legality of the business conducted by the operator.[6] Such control would affect the business on many levels, be it investment,[7] or the terms of the policies, or other levels. Such supervisory organs have already been set up by the 'Islamic' insurance companies operating at the time of the enactment of the *Takaful* Act. They represent the only guarantee of the legality of the operations effected by the insuring body.

The Act enjoins the operator to make a deposit, determined by the Minister, with the Accountant General of Malaysia. What is of importance here is that such deposits are to be invested in compliance with Islamic law. The importance of this point highlights the fact, expressed earlier, that in countries where no appropriate legislation is enacted for 'Islamic' institutions, the latter may be obliged to contravene the *Shari'a* in order to comply with the legal prescriptions applicable to them, which are intended to regulate conventional commercial entities. The above-mentioned prescription constitutes an example of remedy in this respect.

Section 18 of the Act places restrictions on the payment of dividends to the shareholders. No dividend shall be paid until all the capitalized expenditure of the operator has been written off. Capitalized expenditure, according to the Act, is meant to include 'preliminary expenses, organizational expenses, share selling commission, brokerage, amounts of losses incurred and any other items of expenditure not represented by tangible assets'. From this section it appears that the insuring body, under the *Takaful* Act, is normally a company with shareholders, and thus the mutual concept is not adopted. As will be argued later, in practice insurance remains, under the Act, an activity promoted and conducted for profit, but being a form of commercial insurance does not automatically make the scheme unlawful in the light of Islamic law.

The *Takaful*, or indemnity fund, is maintained by operators in respect of each of the classes of business engaged in.[8] *Takaful* guarantee scheme funds are established by the Director General, by means of levies paid by the operator.[9] Such funds, if available for investment, must be fully in compliance with Islamic law. Re-insurance, named Re-*Takaful*, is compulsory, by virtue of Section 23 of the Act.

The insurance industry is regulated by analysing periodic returns as well as by on-site inspection. The primary objectives of on-site inspections are to ensure that insurance companies and insurance intermediaries are solvent, that they operate in accordance with the requirements of the Insurance Act, 1963 (and

other relevant regulations) and that they adopt sound business practices and are managed by competent persons.

The *Takaful* Act is a set of protective measures to benefit those insured. The rules in this regard are not new or particular to *Takaful*, for example the deposit requirement, the lodging of statements of accounts with the relevant authority,[10] licensing of brokers,[11] actuarial investigation[12] and other such measures aimed at regulating the business and safeguarding, as efficiently as possible, the interests of those in weaker bargaining positions.

It should be emphasized that the *Takaful* Act has, in many respects, been inspired by, and is framed according to, the Malaysian Insurance Act, 1963[13] and the UK Insurance Companies Act of 1982.[14] A significant part of the protective measures adopted by the *Takaful* Act has been adapted from the above: for example, the powers and prerogatives of the Minister in charge of *Takaful* supervision and of the Director General of *Takaful*, which is borrowed from the UK Insurance Companies Act, 1982, as regards the duties of the Secretary of State. From those powers come:

- the duty of the insurer to deposit accounts and other statements with the Director General/Secretary of State;[15]
- the power to obtain information and require production of documents;[16]
- the power of the Minister/Secretary of State to require an insurer not to make investments of a specified class or description and to realize the whole or a specified proportion of investments of a specified class or description;[17]
- the entitlement of the Director General/Secretary of State to petition to wind up the company;[18] and
- the duty to notify change of director, controller or manager to the Director General/Secretary of State.[19]

Such safeguards for the protection of policyholders are more extensive in the case of the Director General under the *Takaful* Act: for example, the power to direct the insurance company, restricting its freedom to dispose of its assets, is much wider in the *Takaful* Act than in the UK Insurance Companies Act, 1982.[20] There are other similar prescriptions in the two Acts, such as the right of policyholders to receive copies of documents and statements deposited with the Director General/Secretary of State, periodic actuarial investigation for life insurance business and establishment of a separate insurance fund for assets and liabilities attributable to long-term business, or to industrial assurance business under the 1982 Act and to all classes of business according to the *Takaful* Act.[21]

The margin of solvency condition placed on payment of dividends in Section 18 of the *Takaful* Act is restricted to long-term business in the 1982 Act,[22] but in all cases there is a requirement of permanent solvency margin in both Acts.[23] Finally, two identical provisions, which should be underlined, are the prescriptions pertaining to misleading statements and to intermediaries. Section 28 of the *Takaful* Act, which adopts exactly the same wording as Section 73 of

the 1982 Act, renders any person who misleadingly induces persons to enter into a contract of insurance guilty of an offence. Section 36-1 of the *Takaful* Act, also similar to Section 74 of the 1982 Act,[24] requires any person connected with an insurer to 'give the prescribed information with respect to his connection with the operator insurer to the person to whom the invitation is issued'. A comparison of the two Acts demonstrates that the *Takaful* Act contains major provisions which are similar to other legislation dealing mainly with commercial insurance.

The safeguards introduced by the *Takaful* Act in order to afford protection to the insured are not restricted to 'Islamic' insurance. Indeed, there are many regulations in force in the context of commercial insurance that are interventionist in favour of the insured, where commercial insurance presents no more likelihood of inequality than the *Takaful* system.[25] It remains, therefore, to question the rationale behind rendering the *Takaful* Islamically permissible, whilst rejecting conventional insurance unacceptable under the *Shari'a*. It is particularly remarkable that the *Takaful* Act has no special structure imposed on the insuring body. Moreover, there has been no attempt to introduce the mutual concept, much acclaimed by those opposing conventional insurance, as the only lawful structure. This cannot but be approved, since it was concluded earlier.

The mutual form does not, by itself, validate insurance since it has no bearing on the forbidden elements supposedly involved in commercial insurance. The *Takaful* Act, by allowing *Takaful* to be conducted by 'a company, as defined in the Companies Act 1965, or by a society registered under the Co-operative Societies Act'[26] acknowledges the commercial character of *Takaful*. *Takaful* is viewed as a commercial activity operated by the insuring body as a business, that is, as an activity generating profit. Yet, despite the fact that this source of profit is implicitly viewed as such, the *Takaful* Act presents *Takaful* as a scheme based on brotherhood, solidarity and other disinterested moral values,[27] and it colours its terminology in that vein, using words and expressions such as 'family solidarity' for life insurance and 'contribution' for premiums.

The Act presumes that the insured persons are animated by a will to assist each other financially and also that, by virtue of the *Takaful* scheme, financial aid and assistance will be available 'to the participants in case of need'.[28] This feature, which is meant to be the basis of the distinction between *Takaful* and conventional insurance, is more an idealistic supposition than a fact. The reality is that the participant usually has the same motivations as any other insured contracting conventional insurance. The sum insured is payable in compliance with the conditions contained in the policy (*Takaful* certificate) when the event insured against occurs without regard to the need of the participant. As a result, there is an evident contradiction between the intrinsically commercial nature of the scheme and the charitable and benevolent aspect of it.

This inconsistency stems from the desire to give to the scheme a humanitarian character which, it is thought, would bring it in line with the requirements of the *Shari'a*. The fact is that this dressing up of the scheme

carries no real significance, since it lacks a genuine basis. In addition to this, the majority of protective measures contained in the Act are, as has been demonstrated, common to all kinds of insurance. However, there are no grounds on which to infer that *Takaful* is identical to commercial insurance due to the specific requirement that *Takaful* operations be in compliance with the *Shari'a*. Consequently there are provisions in the Act which require that the investment of deposits and *Takaful* guarantee scheme funds be carried out in a way not contrary to the *Shari'a*.[29]

This characteristic forms the distinction between *Takaful* and other insurance schemes. The rest is a matter of terminology and theoretical assumptions, so that in reality the *Takaful* Act, in view of its similarities with commercial insurance, is an implied acknowledgment of the validity of this latter provided that the investment policies adopted are not in breach of Islamic law.[30]

This latter issue falls within the competence of the Islamic supervisory board appointed by the insuring body. The Islamic and moral nature of the Act is also apparent in the proposal forms and policies circulated by *Takaful* companies. One example is the following explanatory paragraph contained in the 'Proposal for Participation in the Family *Takaful* Plan and *Takaful* Mortgage Plan':[31]

> In essence therefore the operation of *Takaful* can be summarized as a venture which embodies the virtues of co-operation, mutual help and shared responsibility among the participants. The embodiment of the principles among members of the community is in line with the injunction of the religion of Islam.

While such an interpretation may be applicable to most insurance operations, it contradicts other clauses of the same document, serving to negate the presumed disinterested and charitable elements in the scheme. One example of such clauses is that fixing the maximum maturity date for any participant to their 60th birthday is something that would normally be found in a conventional life insurance policy, but not in a scheme aimed at supporting humanitarian considerations. These, and other, contradictions are caused by an attempt to find in the *Shari'a* positive justification for insurance whilst, in reality, the contractual freedom afforded by Islamic law is sufficient to validate insurance and renders this unrealistic exercise superfluous.

The use of *Mudaraba* comes as a striking illustration of the endeavour to 'Islamicize' the insurance contract at the expense of applying *Mudaraba* rules incorrectly. In the proposal cited above, *Mudaraba* is reduced to a mere method of apportioning profits. The surplus remaining in the indemnity funds after payment of compensation and deduction of operational and re-insurance costs is shared between the participants and the company, provided the participants have not incurred any claims and no *Takaful* benefits have been paid to them. This sharing of the surplus is in a ratio agreed to, in accordance with the principle of *Al Mudaraba*.

Despite the inconsistencies cited above, the *Takaful* system set up in Malaysia has the merit of being both comprehensive and properly regulated by law. It constitutes an undeniable step towards freeing insurance from elements contravening Islamic law pertaining to the investment policies followed by insurance companies.

With the introduction of the Islamic inter-bank money market on 3 January 1994, all the three vital ingredients that are required for a comprehensive, vigorous and vibrant Islamic banking system were set in place which enabled the Islamic banking system in Malaysia to take off on a path of sustained growth.

Overview of Islamic banking in Malaysia (BNM report)[32]

Since the 1970s, Islamic banking has emerged as a new reality in the international financial scene. Its philosophies and principles are, however, not new, having been outlined in the Holy Quran and the *Sunna* of Prophet Mohammed more than 1,400 years ago. The emergence of Islamic banking is often related to the revival of Islam and the desire of Muslims to live all aspects of their lives in accordance with the teachings of Islam.

In Malaysia, separate Islamic legislation and banking regulations exist side-by-side with those for the conventional banking system. The legal basis for the establishment of Islamic banks was the Islamic Banking Act (IBA) which came into effect on 7 April 1983. The IBA provides BNM with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks. The Government Investment Act 1983 was also enacted at the same time to empower the government of Malaysia to issue Government Investment Certificates (GIC), which are government securities issued based on *Shari'a* principles. As the GIC are regarded as liquid assets, the Islamic banks could invest in the GIC to meet the prescribed liquidity requirements as well as to invent their surplus funds.

The first Islamic bank established in the country was Bank Islam Malaysia Berhard (BIMB) which commenced operations on 1 July 1983. In line with its objectives, the banking activities of the bank are based on *Shari'a* principles. After more than a decade in operations, BIMB has proved to be a viable banking institution with its activity expanding rapidly throughout the country with a network of 80 branches and 1,200 employees. The bank was listed on the Main Board of the Kuala Lumpur Stock Exchange on 17 January 1992.

The long-term objective of BNM is to create an Islamic banking system operating on a parallel basis with the conventional banking system. However, similar to any banking system, an Islamic banking system requires three vital elements to qualify as a viable system, i.e.:

- a large number of players;
- a broad variety of instruments; and
- an Islamic money market.

In addition, an Islamic banking system must also reflect the socio-economic values in Islam, and must be Islamic in both substance and form.

Recognizing the above, BNM adopted a step-by-step approach to achieve the above objective. The first step to spread the virtues of Islamic banking was to disseminate Islamic banking on a nation-wide basis, with as many players as possible and to be able to reach all Malaysians. After a careful consideration of various factors, BNM decided to allow the existing banking institutions to offer Islamic banking services using their existing infrastructure and branches. The option was seen as the most effective and efficient mode of increasing the number of institutions offering Islamic banking services at the lowest cost and within the shortest time frame. Following from the above, on 4 March 1993 BNM introduced a scheme known as *Skim Perbankan Tanpa Faedah* (Interest-free Banking Scheme) or SPTF in short.

In terms of products and services, there are more than 40 Islamic financial products and services that may be offered by the banks using various Islamic concepts such as *Mudaraba*, *Musharaka*, *Murabaha*, *Bai' Bithaman Ajil* (*Bai' Muajjal*), *Ijara*, *Qardhul Hasan*, *Istisna'* and *Ijara Thumma Al-Bai'*. To link the institutions and the instruments, the Islamic Inter-bank Money Market (IIMM) was introduced on 4 January 1994.

In October 1996, BNM issued a model financial statement for the banking institutions participating in the SPI requiring the banks to disclose the Islamic banking operations (balance sheet and profit and loss account) as an additional item under the Notes to the Accounts.

As part of the effort to streamline and harmonize the *Shari'a* interpretations among banks and *Takaful* companies, BNM established the National *Shari'a* Advisory Council on Islamic Banking and *Takaful* (NSAC) on 1 May 1997 as the highest *Shari'a* authority on Islamic banking and *Takaful* in Malaysia.

On 1 October 1999, a second Islamic bank, namely Bank Muamalat Malaysia Berhard (BMMB), commenced operations. The establishment of BMMB was the effect of the spin-off following the merger between Bank Bumiputra Malaysia Berhard (BBMB) and Bank of Commerce (Malaysia) Berhard (BOCB). Under the merger arrangement, the Islamic banking assets and liabilities of BBMB, BOCB and BBMB Kewangan Berhard (BBMBK) were transferred to BBMB, while the conventional operations of BBMB, BOCB and BBMBK were transferred to BOCB accordingly. In addition, BMMB was given 40 branches of BBMB and BBMBK in various locations throughout Malaysia and a staff workforce of 1,000, migrated from BBMB, BOCB and BBMBK.

Islamic Inter-bank Money Market

The Islamic Inter-bank Money Market (IIMM) was introduced on 3 January 1994 as a short-term intermediary to provide a ready source of short-term investment outlets based on *Shari'a* principles. Through the IIMM, the Islamic banks and banks participating in the SPI would be able to match their funding

requirements effectively and efficiently. BNM issued the Guidelines on the IIMM on 18 December 1993 to facilitate proper implementation of the IIMM.

The IIMM covers the following aspects:

- Inter-bank trading of Islamic financial instruments; and
- *Mudaraba* Inter-bank Investments (MII).

Only Islamic banks, commercial banks, merchant banks and eligible finance companies and discount houses are allowed to participate in the IIMM.

Inter-bank trading

Eligible banking institutions are allowed to trade in the designated Islamic financial instruments, such as Islamic accepted bills, Islamic 'green' bankers' acceptances and Islamic debt securities among themselves. GIC are non-tradable but the players may exchange the papers among themselves based on the price issued by BNM.

Mudaraba Interbank Investments (MII)

MII refers to a mechanism whereby a deficit Islamic banking institution ('investee bank') can obtain investment from a surplus Islamic banking institution ('investor bank') based on *Mudaraba* (profit-sharing). The period of investment is from overnight to 12 months, while the rate of return is based on the rate of gross profit before distribution for investments of one-year of the investee bank. The profit-sharing ratio is negotiable among both parties. The investor bank at the time of negotiation would not know what the return would be, as the actual return will be crystallized towards the end of the investment period. The principal invested shall be repaid at the end of the period, together with a share of the profit arising from the use of the fund by the investee bank. Beginning 2 February 1996, BNM introduced the minimum benchmark rate for the MII, i.e. the prevailing rate of the Government Investment Issues plus a spread of 0.5 per cent. The purpose of the benchmark rate is to ensure that only banks with reasonable rate returns participate in the MII.

Government Investment Issue

When the first Islamic bank in Malaysia began its operations in 1983, the bank could not, among other things, purchase or trade in Malaysian Government Securities (MGSs), Malaysian Treasury Bills (MTBs) or other interest-bearing instruments. However, there was a serious need for the Islamic bank to hold such liquid papers to meet the statutory liquidity requirements as well as to park its idle funds. To satisfy both requirements, the Malaysian Parliament passed the Government Investment Act in 1983 to enable the government of Malaysia to

issue non-interest bearing certificates known as Government Investment Certficates (GICs) (since replaced with Government Investment Issues (GIIs)). GIIs were introduced in July 1983.

The GII represent borrowings by the government for its development expenditure. However, unlike the borrowings by way of the MGS or MTB, the GII do not have a pre-determined rate of interest. It is issued based on the concept of *Qardhul Hasan* (benevolent loan). Under this principle, the purchase of GII by any institution or individuals will be considered as a benevolent loan to the government to enable the government to undertake developmental projects for the benefit of the nation. The providers of the funds (institution or individuals) would not expect any return on their loans but would expect the principal amount to be returned at maturity. The rate of return, if any, would be at the absolute discretion of the borrower, that is, the government. If the government decided to give a return to the GII holders, the Dividend Committee comprising representatives from the Ministry of Finance, BNM, and the Economic Planning Unit and the Religious Affairs Section, both of the Prime Minister's Department, will recommend the rate of return for the GII. Normally, the rate of return is determined by a number of factors such as the economic conditions of the country, existing yield levels for similar instruments, and inflation rate.

The concept of *Qardhul Hasan* does not satisfy the GII as tradable instruments in the secondary market. To address this shortfall, BNM opens a window to facilitate the players to sell and purchase the papers with the Central Bank. The price sold or purchased by the players is determined by BNM which maintain a system to record any movement in the GII. As at the end of 1999, the outstanding amount of the GII issued is RM2 billion.

Financial institutions offering Islamic banking services

The Islamic banks are not the only financial institutions involved in Islamic banking. Other financial institutions also offer Islamic banking services through the 'Islamic Banking Scheme'.

Islamic banks

1 Bank Islam Malaysia Berhard.
2 Bank Muamalat Malaysia Berhard.

Commercial banks

1 Affin Bank Berhard.
2 Alliance Bank Malaysia Berhard.
3 AmBank Berhard.
4 Bank Utama (Malaysia) Berhard.
5 Citibank Berhard.

6 EON Bank Berhard.
7 Hong Leong Bank Berhard.
8 HSBC Bank Malaysia Berhard.
9 Malayan Banking Berhard
10 OCBC Bank (Malaysia) Berhard.
11 Public Bank Berhard.
12 RHB Bank Berhard.
13 Southern Bank Berhard.
14 Standard Chartered Bank Malaysia Berhard.

Finance companies

1 Affin-ACF Finance Berhard.
2 AmFinance Berhard.
3 EON Finance Berhard.
4 Hong Leong Finance Berhard.
5 Kewangan Bersatu Berhard.
6 Mayban Finance Berhard.
7 Public Finance Berhard.
8 RHB Delta Finance Berhard.
9 Southern Finance Berhard.

Merchant banks

1 Affin Merchant Bank Berhard.
2 Alliance Merchant Bank Berhard.
3 AmMerchant Bank Berhard.
4 Aseambankers Malaysia Berhard.
5 Malaysian International Merchant Bankers Berhard.

Discount houses

1 Abrar Discounts Berhard.
2 Affin Discount Berhard.
3 Amanah Short Deposits Berhard.
4 CIMB Discount House Berhard.
5 KAF Discounts Berhard.
6 Malaysia Discount Berhard.
7 Mayban Discount Berhard.

Conclusion

Malaysia has emerged as the first country to implement a dual banking system, that is, an Islamic banking system on a basis parallel with the conventional

system in countries with a free market economic system. It has thus emerged as the first country to have a fully fledged Islamic banking system. The Malaysian model has been recognized by many Islamic countries as the model of the future and they have shown keen interest in studying it in order to implement a similar system in their respective countries.

The 'Mudaraba Contract for Investment, Savings and Takaful among Moslems' could be seen as a valuable and Islamically valid investment opportunity but, coupled with life cover, its adequacy in non-life insurance is doubtful. In a non-life insurance policy, one cannot be expected to enter into a *Mudaraba* contract each time one needs to insure some form of property, and if the insurance aspect alone is applied the scheme becomes a variation of with-profit policies and is, therefore, not an Islamic alternative to commercial insurance, as is intended.

Table 5.1 Number of financial institutions

	As at end				*March*
	1998	*1999*	*2000*	*2001*	*2002*
Islamic banks	1	2	2	2	2
Commercial banks	25	23	21	14	14
Finance companies	18	16	14	10	10
Merchant banks	5	5	5	5	5
Discount houses	–	7	7	7	7

Table 5.2 Number of branches/Islamic banking scheme counters

	As at end				*March*
	1998	*1999*	*2000*	*2001*	*2002*
Islamic banks	80	120	122	122	122
Commercial banks					
Full-fledged branch	7	6	7	8	8
SPI counters	1,553	1,366	1,338	1,335	1,335
Finance companies					
Full-fledged branch	3	2	2	2	2
SPI counters	823	735	745	730	730
Merchant banks					
SPI counters	6	6	4	–	0

Table 5.3 Financing deposit ratio (%)

	As at end				*March*
	1998	*1999*	*2000*	*2001*	*2002*
Islamic banks	90.3	51.9	56.8	52.6	48.8
Commercial banks	52.3	46.5	53.5	55.6	57.2
Finance companies	78.7	98.8	94.4	99.3	100.2
Merchant banks	69.4	194.0	88.7	114.6	103.1

Table 5.4 Total assets 1994–March 2002 (RM'000)

Year	*IB*	*CB*	*FC*	*MB*	*DH*	*SPI*	*Total*
1994	3,046,310	1,397,457	347,961	93,318	–	1,838,736	4,885,046
1995	3,248,000	2,038,916	651,277	259,230	–	2,949,423	6,197,423
1996	3,962,000	3,652,757	1,852,937	664,767	–	6,170,461	10,132,461
1997	5,202,104	9,077,980	2,924,381	676,839	–	12,679,200	17,881,304
1998	5,698,378	11,385,159	3,321,390	778,134	–	15,484,683	21,183,061
1999	11,724,223	15,589,065	4,806,146	1,439,347	2,577,707	24,412,265	36,136,488
2000	14,008,934	20,058,475	7,149,872	1,507,952	4,288,350	33,004,649	47,013,583
2001	17,404,759	27,026,076	9,768,572	1,352,925	3,748,697	41,896,270	59,301,029
Mar 02	19,095,123	27,282,770	11,246,057	1,358,258	3,898,289	43,785,374	62,880,497

Table 5.5 Total deposits 1994–March 2002 (thousands of RM)

Year	*IB*	*CB*	*FC*	*MB*	*DH*	*SPI*	*Total*
1994	2,891,920	1,463,139	246,710	53,944	–	1,763,793	4,655,713
1995	2,745,335	1,744,940	378,931	56,581	–	2,180,452	4,925,787
1996	3,283,289	2,666,432	966,439	347,986	–	3,980,857	7,264,146
1997	3,223,440	5,153,239	1,170,227	348,487	–	6,671,953	9,895,393
1998	4,039,747	8,415,160	2,110,717	606,456	–	11,132,333	15,172,080
1999	9,685,166	10,576,042	3,033,083	401,401	1,109,163	15,119,689	24,804,855
2000	11,301,587	16,089,422	5,392,597	867,143	2,267,652	24,616,814	35,918,401
2001	14,375,617	22,030,963	7,663,718	673,451	2,362,757	32,730,889	47,106,506
Mar 02	16,103,320	22,809,608	8,384,778	745,437	3,019,222	34,959,045	51,062,365

Table 5.6 Total financing 1994–March 2002 (thousands of RM)

Year	*IB*	*CB*	*FC*	*MB*	*DH*	*SPI*	*Total*
1994	1,274,929	274,069	163,460	25,310	–	462,839	1,737,768
1995	1,966,597	842,557	452,872	229,986	–	1,525,415	3,492,012
1996	2,259,069	2,125,213	1,224,931	392,518	–	3,742,662	6,001,731
1997	3,350,689	4,705,766	2,189,934	502,962	–	7,398,662	10,749,351
1998	3,471,438	4,702,815	1,878,449	408,521	–	6,989,785	10,461,223
1999	5,029,537	4,920,513	2,995,546	778,202	27,773	8,722,034	13,751,571
2000	6,423,392	8,533,577	5,089,803	769,320	–	14,392,700	20,816,092
2001	7,671,016	12,257,576	7,612,937	771,608	–	20,642,121	28,313,137
Mar 02	7,852,286	13,045,324	8,401,775	768,719	–	22,215,818	30,068,104

Table 5.7 Deposit services

Products/Services	*Applicable concepts*
Savings deposit	*Wadiah Yad Dhamana/Mudaraba*
Current deposit	*Wadiah Yad Dhamana/Mudaraba*
General investment deposit	*Mudaraba*
Special investment deposit	*Mudaraba*
Specific investment deposit	*Mudaraba*
Negotiable Islamic Deposit Certificate	*Bai' Bithaman Ajil* (BBA)
Islamic Negotiable Instrument of deposit	*Mudaraba*

Table 5.8 Retail/Consumer banking

Products/Services	*Applicable concepts*
House financing	BBA/*Al-Ijara wa Iqtina* (AIWI)
Commercial property financing	BBA
Hire purchase	*Al-Ijarah Thumma Al-Bai'* (AITAB)
Overdraft	*Murabaha*
Share financing/unit trust financing	BBA/*Mudhara/Musharaka*
Factoring	*Bai' Al-Dayn* (BAD)
Working capital financing	*Murabaha*
Credit card	BBA
Charge card	*Qardhul Hasan*
Umrah financing	BBA

Table 5.9 Corporate banking

Products/Services	*Applicable concepts*
Project financing	*Mudaraba/Musharaka*/BBA/*Istisna'*/AIWI
Bridging finance	*Istisna'*/BBA/*Musharaka*
Financing syndication	BBA/*Musharaka/Istisna'/Ijara*
Revolving financing	BBA/*Murabaha*
Bonds	BBA/*Musharaka/Istisna'/Qardhul Hasan/Ijara*
Commercial papers	*Murabaha*
Leasing	*Ijara*
Industrial hire purchase	AITAB
Underwriting, lead arranging/advisory	*Ujr*

Table 5.10 Treasury/Money market investment products

Products/Services	*Applicable concepts*
Sell & buy-back agreements	*Murabaha*
Sanadat (bonds) Mudharabah Cagamas	*Mudaraba/Musharaka*/BBA/*Istisna'/Ijara wa Iqtina*
Foreign exchange	*Ujr*
Government Investment Issues	*Qardhul Hasan*
Forward rate agreements	*Ujr*

Table 5.11 Trade financing

Products/Services	*Applicable concepts*
Letters of credit	*Wakala/Murabaha/Musharaka*
Islamic accepted bills	*Murabaha/Bai' Al-Dayn*
Export credit financing	*Murabaha/Bai' Al-Dayn*
Bank guarantee	*Ujr*
Shipping guarantee	*Ujr*

Table 5.12 Other products and services

Products/Services	*Applicable concepts*
Stockbroking services	*Ujr*
TT/Funds Transfer	*Ujr*
Travellers' cheques	*Ujr*
Demand draft	*Ujr*
Cashiers' order	*Ujr*
Standing Instruction	*Ujr*
ATM Service	*Ujr*
Telebanking	*Ujr*

6

THE DEVELOPMENT OF ISLAMIC BANKING AND INSURANCE IN SAUDI ARABIA

A case study

Introduction

As the stronghold of Islam where the *Shari'a* is the supreme law of the land, Saudi Arabia would have been expected to tackle the problem of insurance by establishing a scheme of 'Islamic' insurance following in the footsteps of countries like Malaysia. In actual fact, commercial insurance companies cannot be set up and registered in Saudi Arabia, and no insurance regulations have been enacted – except certain provisions concerning marine insurance in the Commercial Court Regulations[1] from which the validity of insurance transactions in the Kingdom are inferred.

The case remains that a Saudi Arabian insurance market has not officially been recognized by the State (Faris 1983: 114), although in practice it is largely composed of segments similar to those constituting the insurance market in the States of the Gulf Co-operative Council. However, in Saudi Arabia all insurance business is transacted under the umbrella of commercial firms (ibid.: 113). Being not yet officially legalized, the insurance companies are not practically accepted or licensed to perform in isolation from other commercial activities of the agent, who is usually a merchant or a trader. This wide gap between legal theory and practice is a common feature of many of the States of the Gulf Co-operative Council. In the last two decades very many new insurance companies with a majority of Saudi interests have been established and registered outside Saudi Arabia (ibid.: 114), although almost all of their operations are within the territories of Saudi Arabia. These companies are subsequently referred to as 'national' companies. Foreign insurance companies are still operating side-by-side with the newly formed 'National Insurance Companies'.

Due to the absence of any official statistical data in connection with the Saudi Insurance Market, as well as the absence of any official record for the number of insurance companies in Saudi Arabia, and since various foreign insurance offices are accustomed to entering and leaving the market without any governmental supervision, the real scale of insurance activity within the

Saudi economy would be unknowable. Judged, however, by the whole structure of the economic scope therein, it is estimated to be the largest market not only within the States of the Gulf Co-operative Council, but also in the whole Arab world.

While the *Shari'a* is proclaimed constitutionally to be the supreme and unquestionable source of legislation, the practice diverges in many respects from this governing principle, as various pieces of legislation contain dispositions that are contrary to Islamic law. This contradiction reflects the failure to harmonize a capitalistic economic structure and environment with the *Shari'a* as the majority of the actual religious authorities conventionally interpret it.

Saudi Arabian draft decree regulating insurance, still being modified, and currently in the final stage to be approved by the Shari'a council,[2] widens the gap between theory and practice. It stipulates that no insurance company may be allowed to be constituted in Saudi Arabia, and that all insurance business will have to be transacted through an agent, whose position is regulated in detail by the draft decree. Provisions are made concerning the form and minimum capital of the insurance company to be represented by the agent. The insurance company must be a *joint-stock company* with a paid up capital of a sum equivalent to ten million Saudi Riyals (emphasis added) (Shahab el-Din 1990).

Once adopted, this decree will further substantiate the contradiction that insurance companies may not be constituted in Saudi Arabia because of the controversy concerning the validity of insurance and the opposition of the majority of religious authorities to it. But commercial insurance may freely be undertaken from other countries through Saudi agents. This situation illustrates perfectly the dictum that there is a confrontation between an irresistible force (the economic and social necessity) and an immovable object (the *Shari'a*) (Ballantyne 1990: 121). The acceptance of insurance is imposed by economic reality and restrictions put to it are dictated by considerations pertaining to the *Shari'a*.

The National Co-operative Insurance Company

The pessimists that prevailed with regard to the official recognition of insurance activities in 1960s' and 1970s' Saudi Arabia have lost ground and support. It has been superseded by much optimism due to many reasons. In practice, the country's economy showed a considerable boom during the final 20 years of the twentieth century. Almost all government, and private sector projects are currently insured in compliance with the requirements of the contract conditions between the owner and the contractor, to insure the works, constructional plants and the liabilities. However, it should be noted that the situation in Saudi Arabia regarding insurance is not restricted to the case outlined above. One more tangible and effective turning point in the official attitude towards insurance was the announcement made by the government early in 1985 that resulted in the Royal Decree sanctioning the licensing and the

establishment of a State-owned insurance company with an authorized capital of SR500 million (approx. US$143 million) and the 'National Co-operative Insurance Company'[3] commenced operation in 1986.[4] Whatever the future of this newly established company, it was a clear indication of a remarkable change in official concern towards the encouragement of insurance activities in the future of the State economy.

The possibility of allowing other cooperative insurance companies to be established and to operate in the Kingdom was also acknowledged by a decision of the Council of Ministers, but at the time of writing no other insurance company has been formed in pursuance of this decision.

The duty of adherence to the Islamic *Shari'a* is mentioned in various sections of the articles of association of the National Co-operative Insurance Company. What is particularly interesting is the mechanism adopted by the company in order to confer a cooperative character. First, it must be pointed out that the company is not mutual, because the insured do not become members of it. It is a company, with capital and shareholders. However, what is in the spirit of the articles, beside the duty of adherence to the *Shari'a*, is that the surplus held by the company, if any, is distributed to the insured if not reinvested or added to the provisional reserves – after making the customary deductions and deduction of a certain percentage (not exceeding 10 per cent of net profit of investments) for the company and its staff. This last deduction operates similarly to *Mudaraba* contracts, whereby the profits are realized on the investment of the capital and the investor. The returns on the investment of shareholders' funds are distributed to them after the deduction of customary expenses.

The main feature of this company is that it embodies certain mutual insurance rules (such as the redistribution of surpluses) and it applies them to a company structure designed to carry out commercial insurance. Such a company would have been a real cooperative but for the following:

- The customers of a cooperative company are usually shareholders in it and even when cooperatives offer services to non-shareholders, they do not lose their cooperative nature as they were initially constituted by a group of people in application of cooperative principles; and
- The National Co-operative Insurance Company (NCIC) was not formed as a genuine cooperative one. Its legal structure is in the form of a joint stock company constituted between three government agencies There is no condition that the insured be a shareholder in the company and no such condition has been imposed even at the inception of the company's activities, so that the fundamental principle of cooperative entities – that the customer be a shareholder – is lacking.

Another basic cooperative principle that is deficient is the rule that each shareholder be entitled to one vote at company meetings, whatever the number of shares held. In the National Co-operative Insurance Company, a shareholder

must have 20 shares to obtain one vote and every block of additional 20 shares means an additional vote.

It might be said that the term 'cooperative' used for the NCIC is more an attribute designating the eventual redistribution of surpluses, if any, among the insured (provided such surpluses are not allocated to the provisional reserves). This difference between the NCIC and conventional commercial insurance companies has justified, in the mind of the draftsman, the use of the term 'cooperative', thus rendering the scheme Islamically permissible, since it is considered by many modern Muslim authors that the cooperative or mutual structure validates insurance.

A question that one may ask is: 'what is the likelihood of a surplus being distributed to the insured after the deductions prescribed in the articles of association?' In the absence of the right of the insuring body to make supplementary calls for premiums (to address an eventual deficit) there will be a need for significant annual reserve allocations, thus rendering remote the likelihood of any substantial apportionment of profits among the insured.

As a result of the absence of a genuine and significant cooperative or mutual structure, the only truly relevant feature of this scheme is the general requirement of abidance to the *Shari'a* for investments made by the insurance company. In practice, investment of the collected premiums (in addition to the fairness of the company policy) is the major issue regarding the validity of the scheme. The lawful investment of premiums and the equity of an insurance scheme are not functions chosen for the insuring body and it is in those fields that the NCIC or other companies aiming to abide by the *Shari'a* will have to perform successfully.

On the other hand, it is interesting to note that Saudi Arabian law contains the legal framework required for the establishment of mutual insurance companies. This could be achieved by resorting to the cooperative companies' regulations, embodied in the Saudi Companies Law, which provide for the constitution of cooperative companies with a variable capital in the sense that the increase or writing down of capital is not subject to the strict formalities usually imposed for such operations in conventional joint-stock companies. As a result, this may enable a cooperative company to have shareholders coming into and leaving the company: this would allow the introduction of a membership scheme for all policyholders so that each insured is allocated a certain number of shares, and mutual insurance could be brought in through this medium. However, it seems that there are no practical prospects for such a scheme in the near future and the only insurance company registered in Saudi Arabia is the NCIC, whose policyholders are not integrated into the company as a genuine mutual body would have required.

Table 6.1 overleaf shows the number of foreign and national insurance companies in the States of the Gulf Co-operative Council as at 31 December 1985.

During the last 13 years of its existence in 1980, the NCCI has managed to perform in the range of total gross revenue to SR339.5 million in 1999 (from SR289.2 million in 1998). The company's activities include all sectors of the

Table 6.1 Number of national and foreign insurance companies in the States of the Gulf Co-operative Council as at 31 December 1985

State	*No. of national insurance companies*	*No. of foreign insurance companies*	*Total*
Kuwait	4[a]	15[a]	19
UAE	8	139	147
Bahrain[b]	5	11	16
Saudi Arabia[c]	34	unknown	unknown
Oman	1	16	17
Qatar	3	4	7

Source: Faris 1983: 113.

Notes
[a] Not including national re-insurance companies;
[b] Not including offshore companies;
[c] All insurance companies operating in Saudi Arabia are registered in foreign countries. Companies with a majority of Saudi interests in their capital are referred to as National Companies. Due to the lack of an official record of the number of foreign insurance companies operating in the country, the exact number of these offices is unknown. Estimates place the number at over 100.

Table 6.2 Financial situation of the NCCI, 1993–9 (figures in millions Saudi Riyals)

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Total assets	747.5	800.9	932.1	896.5	1025.3	1190.2	1252.1
Technical reserves	227.0	266.0	303.5	345.0	419.4	485.0	562.0
Written premiums	619.3	752.3	771.7	664.8	672.7	683.7	628.7
Net premiums earned	127.8	127.9	124.4	137.7	186.6	196.4	204.1

Source: NCCI Annual Report, 1999.

economy that affect people in their daily lives. Table 6.2 shows the financial situation of the company from 1993 to 1999.

The gross premium written in the Saudi insurance market grew by 4.1 per cent from SR2852 million in 1997 to SR2968 million in 1998 despite the international market trend of a continuous softening in insurance rates. The growth in the Saudi insurance market reflects the remarkable growth witnessed by medical, motor and engineering sectors. The growth was evenly distributed among the different types as shown in Table 6.3 opposite.

A proposed Islamic insurance organization

Two types of 'Islamic' insurance company can be found. They form either a division, or an organ, of an Islamic bank, or constitute independent legal entities with a separate *juristic* personality, whilst at the same time being subsidiaries of

Table 6.3 Growth (or fall) in Saudi insurance market by category (figures in millions of Saudi Riyals)

Insurance class	*Premiums 1997*	*Premiums 1998*	*Growth rate (%)*
Medical	510.4	665.1	30.3
Engineering	245.5	268.7	9.5
Motor	662.9	718.9	8.5
Fire	410.8	391.0	−4.8
Miscellaneous accidents	152.8	142.7	−6.6
Aviation	64.2	59.2	−7.8
Marine			
cargo	381.1	349.6	−8.3
hull	87.8	79.2	−9.8
Energy	240.8	208.8	−13.3
Other	95.7	84.8	−11.4
Total	2852	2968	4.1

Source: NCCI Annual Report, 1999.

an Islamic bank. There are more than 15 insurance organizations claiming to be 'Islamic'.[5] The term, widely used by these companies to designate the Islamic substitute to insurance, is *Takaful* (as in the case in the Malaysian legislation). This term is an Arabic word meaning 'guaranteeing each other'. It expresses the idea of mutual assistance and solidarity between Muslim people and implies an objective body interested in establishing a scheme of mutual financial support. The concept introduced by *Takaful* is similar to that of conventional commercial insurance. Basically, both systems are financial instruments that assist the unfortunate who have been confronted with financial predicaments. Despite the basic similarity, Islamic (*Ulama*) scholars have agreed that commercial insurance is not permissible in Islam because it contains the elements of *gharar* (temptation), *maisar* (gambling) and *riba* (usury), which are contradictory to Islamic *Shari'a*.

Such a theoretical ideal is, to a great extent, at variance with the prevailing practice, as has been shown in the context of the Malaysian *Takaful* system. Among the existing 'Islamic' insurance schemes, the one that has attracted particular attention is the service launched by the *Dar al-Mal al-Islami* Trust, the 'Mudaraba for Investment, Savings and Takaful Among Moslems'. Under this scheme, the participant enters into a *Mudaraba* contract with the company, whereby all instalments are split into two parts. The first goes to an investment fund, the second to a *Takaful* fund, and both funds are supposed to yield profits in accordance with *Mudaraba* principles. After deducting management expenses, one-fifth of monthly profits is allocated to the company and the remaining

four-fifths are reinvested into the respective funds from which they originate. On the maturity date the participant receives the due portion from the investment funds expressed in units, plus profits, in addition to the portion of any existing surplus from the *Takaful* fund. In the event of death of a participant before the maturity date, the company will pay surviving heirs the unpaid instalments that correspond to the sum insured in a conventional insurance policy, plus the value of the instalments paid by the deceased and the profits accrued.

The supervision of this plan is the responsibility of the Religious Supervisory Board of the *Dar al-Mal al-Islami* Trust. What appears obvious is that this scheme is not a mutual one. The participants transact with a joint-stock company and do not become members of the insuring entity. Thus the ideal of mutual or cooperative insurance, as the only acceptable alternative to commercial insurance, appears to have been discarded. In order to 'Islamize' the plan, the insurance operation is joined to *Mudaraba* and is presented as being an application of Islamic principles embodied in the Quran and *Sunna* and calling for solidarity between Muslims. It is called a 'silent partnership' in Islamic law, putting aside the investment aspect and the wording of the contract, which does not in practice affect its substance. The fact remains that the elements put forward to disqualify commercial insurance are clearly present in the contract issued by *Dar al-Mal al-Islami* subsidiaries. The participant's heirs receive *Takaful* benefits on the occurrence[6] of a future and uncertain event[7] (the death of the participant) and the amount that they receive is greater than the sum of the instalments paid by the participants. Therefore, according to Islamic opinion forbidding commercial insurance, this scheme should be considered invalid, as it involves both *gharar* and *riba*. In addition, many terms of the contract, which could have been tempered in accordance with the assumed charitable basis of the assistance scheme, have been inserted, as they figure in commercial insurance policies. An example is the non-payment of the duly paid instalment which would forfeit the right to gain *Takaful* benefits and lead to the termination of the contract. Another example is the clause that invokes the force of warranties in the event of untrue or incorrect statements, and releases the company from the obligation to pay the *Takaful* benefits.

There are also limits on the age of participants of the sort one would find in any life insurance plan. The major significant feature of the plan launched by the *Dar al-Mal al-Islami* Trust is that the instalments paid by the participants are invested in non-interest bearing activities in compliance with the *Shari'a*.

NCCI (Saudi Arabia)

Annual report, data and chairman's statements for the year 2001[8]

It gives me immense pleasure to present the Company's 15th annual report. It includes the most significant results realized by the Company during 2001, the insurance activities undertaken and the services provided to our customers.

The Saudi insurance market has received a significant boost to future development prospects in the form of the Resolution of the Council of Ministers No. 222 dated 13/8/1422H. The Resolution addresses mandatory insurance for in-country transit vehicles and drivers' licence insurance for Saudis and expatriates within the Kingdom. Coupled with the Resolution of the Council of Ministers No. 71 dated 1420H, concerning mandatory cooperative health insurance applicable to residents in the Kingdom, considerable growth is anticipated.

From a different perspective, the Saudi insurance market, as with other insurance markets worldwide, has been affected directly and indirectly by the tremendous loss incurred as a result of the 11th September 2001 incident in the United States of America.

Recognizing the interaction of local and international factors, gross premiums written grew from SR716.9 million in 2000 to SR1.02 billion in 2001. This represented an increase of 42.7 per cent and resulted in the highest volume of annual gross written premiums in the company's lifetime. In contrast, paid claims rose sharply by 104.1 per cent from SR355.2 million in 2000 to SR724.8 million in 2001.

Total revenues also increased to SR385.8 million by virtue of the escalation in net premiums earned and re-insurance commissions. Simultaneously, the total costs and expenses during 2001 increased by 18.3 per cent to SR322.7 million, as a result of a rise in net claims incurred, policy acquisition costs, excess of loss expenses, selling and marketing expenses, operating salaries and general and administrative expenses. During 2001, the company succeeded in consolidating its financial position by increasing technical reserves to SR340.7 million and total assets rose to SR1.53 billion. Additionally, policyholders' investments increased by 4.1 per cent during 2001 reaching SR584.8 million, while its income decreased by 29 per cent. Shareholders' investment income realized a loss of SR2.8 million, despite an increase in these investments by 15.9 per cent. Such mixed fortunes are attributable to the recession in the worldwide economy.

As a result of 2001 insurance operations realizing a net surplus of SR63.1 million, the Board of Directors, in compliance with the cooperative concept and in accordance with article (43) of the Articles of Association, has decided to return to the policyholders a proportion of the surplus equivalent to SR15.8 million after allocating the necessary provisions. The Board also recommended the distribution of SR18 million profits to the company's shareholders.

The year 2001 witnessed structural changes in the company's operational set up to focus on our customer needs. We also further expanded our office network throughout the Kingdom, and introduced technological changes to facilitate dealing with the customers using modern information applications. NCCI has made significant progress with its objective of Saudization of positions within the company. Currently, Saudi staff form 67 per cent of the total company workforce.

During 2001, Saudization programmes were reinforced by the introduction of the Insurance Diploma, in collaboration with the Institute of Banking. To facilitate the provision of health care services for medical insurance customers, and to avoid administrative obstacles between the parties involved (insurance companies, medical providers, and customers), NCCI led considerable efforts in discussions with the major medical insurance companies and medical care providers. The aim has been to unify the criteria applied in providing health care to the insured persons, obtain approvals for special medical services, amend accounting systems applied in payments, and establish a medical coding system. The Board of Directors' Report provides details of the financial outcomes, activities and services provided by NCCI during 2001. I feel honoured to express my appreciation and sincere thanks to The Custodian of The Two Holy Mosques, HRH The Crown Prince, HRH The Second Deputy Premier and to the learned members of our government for their unwavering support and encouragement. I would also like to express my appreciation to our valued customers for the confidence they entrust in us, which we consider as a source of pride and empowerment. Finally, I would also like to extend my appreciation to the Members of the Board of Directors and to all NCCI staff for their tremendous and sincere efforts.

Annual report for the year 2001

In 2001 numerous local and worldwide factors interacted and impacted directly on the activities of NCCI. The majority of these had a positive influence, as reflected in the increase of gross written premiums, which for the first time in the company's lifetime exceeded the one billion Saudi Riyals mark. On a less positive note we experienced an increase in total paid claims by 104 per cent and a decrease in the net surplus from insurance operations by 25.9 per cent.

On a local scale, the Saudi insurance market witnessed another step towards increased government activity in insurance. Resolution of the Council of Ministers No. 222 dated 13/8/1422H addressed mandatory insurance for in-country transit vehicles and drivers' licence insurance for Saudis and expatriates within the Kingdom.

The significance of this Resolution means that, coupled with the Resolution of the Council of Ministers No. 71 for the year 1420H, concerning mandatory cooperative health insurance applicable to residents in the Kingdom, it anticipates a broader perspective of the insurance market growth. From an international perspective, the insurance industry encountered the worst catastrophe in its lifetime following the attack on the World Trade Center in New York on the 11th September. Consequently, current estimations of the likely losses incurred are put at as much as US$70 billion. The magnitude of this event has caused tremendous confusion in all insurance markets worldwide. Many insurance companies have discontinued their activities. Other companies denied insurance coverage, particularly against terrorism and similar perils.

Rates have escalated rapidly, most notably in the areas of aviation and property insurance. Simultaneously, recession in the world economy has become more evident with inactivity and deceleration in the growth averages, decline in performance of the main stock markets in the world and consequently, a decline in local and worldwide investment revenues. Hereunder is a presentation and analysis of the major results and activities of NCCI during 2001.

Major financial results

Written insurance premiums

During 2001, the gross premiums written increased by 42.7 per cent and produced the highest growth rate throughout NCCI's lifetime. The total amount was SR1023.2 million, compared to SR716.9 million in 2000. Much of this increase can be attributed to the increase in insurance prices throughout the world markets as a result of increased loss ratios in the re-insurance markets and to the incidents of the 11th September in the USA. The insurance types which are directly affected by the world market situations include aviation insurance whose premiums escalated by 233 per cent, marine (hull) insurance by 46.9 per cent and energy insurance by 28.9 per cent. On the other hand, engineering insurance increased by 65.4 per cent.

Claims paid to clients

Countering premium growth, the gross claims paid also escalated during the year by 104.1 per cent. It increased from SR355.2 million in 2000 to SR724.8 million in 2001. The majority of this increase emanates from medical, aviation, and motor insurance claims. Medical claims alone formed 43.4 per cent of the gross claims paid, aviation claims formed 27.9 per cent and motor claims formed 11 per cent.

Revenues and expenses

Impacted by a 19 per cent increase in the net premiums earned and 9.7 per cent re-insurance commissions, total revenues rose to SR385.8 million by the end of 2001, compared to SR358 million in 2000, i.e. an increase of 7.8 per cent. This percentage is higher than last year's 5.4 per cent, irrespective of the decline in other underwriting income, investment income, and management fees. The total costs and expenses also rose from SR272.9 million in 2000 to SR322.7 million in 2001, i.e. an average of 18.3 per cent. This is attributable to the increase in net claims incurred by 17.6 per cent, which accelerated from SR139.9 million in 2000 to SR164.5 million in 2001. Additionally, the policy acquisition costs, excess of loss expenses, selling and marketing expenses, operating salaries and general and administrative expenses contributed to the

increase. General and administrative expenses were used by the company for expanding and establishing sales offices, developing of products, recruitment, training and marketing and upgrading the quality of our services and operation techniques.

Technical reserves and assets

To reinforce its potential to satisfy its commitments, to keep abreast of annual expansion in volume of activity and to broaden the customer base, NCCI raised its technical reserves to SR340.7 million in 2001 from SR331.2 million in 2000. As a result of the company's investments, locally and abroad, the total assets increased from SR1381.7 million in 2000 to SR1534.9 million in 2001. This 11.1 per cent increase in assets reinforced NCCI's financial position.

Policyholders' investments and shareholders' investments

NCCI maintains both policyholders' accounts and shareholders' accounts separately. Therefore, by necessity it plots separate investment policies for each. The total policyholders' investments reached SR584.8 million in 2001, realizing an increase of 4.1 per cent over that of 2000. Policyholders' investment income decreased by 29 per cent, from SR31 million in 2000 to SR22 million in 2001. This is attributable to the share of certain investments in 2000, and to realizing an increase in the capital assets. Investments of the shareholders' funds registered losses totalling SR2.8 million in 2001, compared to SR28.9 million profit realized in 2000; this is despite the total of such investments rising by 15.9 per cent to SR348.6 million in 2001, compared to SR300.9 million in 2000. Mainly, the losses recorded are the result of the decline in stock prices around the world following the 11th September incidents. Another contributing factor has been the global recession, which involved the economies of the majority of the world's countries.

Net surplus from insurance operations

The insurance operations realized a net surplus of SR63.1 million in 2001 showing a decline of 25.9 per cent (SR85.1 million in 2000). This has been due to the reduction in investment income and the decrease in the medical insurance revenue, coupled with an increase in claims paid and expenses. Pursuant to the cooperative principal under which NCCI operates, and in accordance with article (43) of the Articles of Association, the Board of Directors has decided, after allocating the necessary allowances, to return to the policyholders a share of the surplus equivalent to SR15.8 million for the 2001 operations (SR22 million was returned in 2000). Hence, the total amount returned to the policyholders by the company since its establishment is SR239.3 million.

Shareholders' profits

In line with NCCI's Articles of Association, the shareholders are allowed to keep accounts separate from those of the policyholders. Therefore, the shareholders are entitled to fees equivalent to only 10 per cent of the policyholders' investment revenues. The total of such fees amounted to SR2.4 million in 2001 compared to SR3.4 million obtained by the shareholders in 2000. In accordance with the Articles of Association, and based on resolutions of the General Assembly, the total profits suggested for distribution to shareholders by the Board of Directors is SR18 million in 2001 (SR19 million in 2000).

Remuneration to the Board of Directors

As the shareholders' operations realized losses of SR2.8 million, the Board of Directors were not paid any rewards during 2001. Members of the Board were paid SR255 thousand as an allowance for attendance at the Board meetings and committees and for the additional responsibilities with which they were entrusted. The total payments made to the Managing Director/General Manager were SR 1 million in terms of salaries and allowances.

Activities and accomplishments

Marketing and sales activities

The challenges encountered by NCCI within the Saudi market have emphasized the importance of the company's marketing and sales strategies. NCCI divided its activity into four segments: Major Accounts, Corporate Accounts, Commercial Accounts and Retail Accounts. The company devised specific marketing and selling policies for each segment. The regional offices were restructured within the framework of this segmentation so that the activities were allocated accordingly. In 2001, the Major Accounts segment was developed to lead the various sectors in terms of the volume of business. The company conducted seminars and training programmes, internally and externally for customers of this segment. It organized periodical meetings with clients, and provided explanations about market changes. Under Corporate Accounts and Commercial Accounts, NCCI launched various insurance products, including corporate *rukhsa* insurance, travel insurance, shop owners insurance and the *Manasek* Programme for *Umrah* performers. While professional marketing representatives were assigned to promote these programmes, the company expanded its efforts in contracting with agents and brokers, and planned for opening new marketing channels. The Retail Accounts were given particular attention to broaden the customers' base in 2001. NCCI expanded the sales programmes for customers and implemented a variety of marketing plans. The company also diversified the sales channels, and

inaugurated sales offices in Al Ahsa, Dammam, Al Kharj and Makka to reinforce sales efforts on all products. The company addressed the *Takaful* insurance product, which included (AFAQ) Saving Programme, Higher Education, and short-term protection. These were given priority within its marketing programme. It is anticipated that these products will constitute a quality jump in the company's activities within the coming years.

Information systems and electronic services

In 2001 NCCI implemented a variety of modern information applications. These included systems for *Umra* insurance, corporate *rukhsa*, annual international travel, and an individual travel insurance renewal system, as well as certain administrative applications. All computer units were replaced and updated to cope with the new products. Additionally, operating systems (HP) were updated, whereby transition was made from the Novel system to Windows 2000. NCCI also is considered one of the pioneering companies in Saudi Arabia in the application of the (DHCP) system during 2001. Through its site on the Internet NCCI provided several new services, including the Customer Internet Call Request. It also provided all types of application forms on the Intranet and on the Internet including job applications. NCCI also conducted an experiment which allows certain major clients access to their insurance policies through the company's site on the Internet. Thus, enabling the customers access to conduct amendments, additions, or make inquiries by direct contact.

Customer services

NCCI provided several new services, including the development of medical malpractice insurance and individual personal accidents insurance to be sold through the Toll Free call facility. The company also commenced a centralized system for issuing insurance policies through the Customers' Service Center (CSC) during 2001, starting with the policies of the Central Regional Office (CRO) and its branches. The auto update system was developed to further include document renewals for travel, home, and medical malpractice insurances.

Claims services

NCCI implemented various procedures to prevent and minimize losses, especially those emanating from industrial risks. Coordination was made with customers to follow procedures plotted by the company to improve the quality of protections, minimize the probability of losses occurring and prevent large losses. The company, in collaboration with the General Traffic Department, provided several services to facilitate and expedite the handling of vehicle claims. It enhanced its presence at the Traffic Sections to assist customers in finalizing

accident procedures encompassing traffic reports and repair permissions. The number of company offices at Traffic Sections totalled 8, split between 4 in Riyadh, 2 in Jeddah, and 1 each in Dammam and Al Khobar. NCCI also signed an agreement with a specialized company in the field of loss assessment, which will handle settlements of marine cargo insurance claims at Central Regional Office. This will help reduce administration procedures and any undesirable delays. In the meantime, the company applied the concept of connecting aviation insurance claims and marine hull insurance claims to the central claims system during 2001. Claim Administration Units were established at the Regional Offices with a Claim Team to handle settlements of claims specific to each region. The total number of claims paid by NCCI exceeded 21,000 in 2001, of which the majority related to motor vehicle insurance.

Recruitment and human resources development

By the end of 2001, the company workforce had increased to 590, compared to 529 in 2000. This comprised 421 employees, 78 trainees, and 91 marketing representatives. The number of Saudi nationals within the company workforce also rose to 345, which represents 67 per cent of the total number of the employees and marketing representatives. Saudization programmes were reinforced during 2001 through the two year Insurance Diploma Programme applied in collaboration with the Institute of Banking. The company participated in Career Days conducted at King Fahd University for Petroleum and Minerals, King Saud University and the Institute of Public Administration. The purpose was to acquaint young Saudi nationals with work opportunities in the field of insurance. At the same time, NCCI established a 'Development and Assessment Centre' to identify and develop its Saudi employees possessing high levels of competence and with the potential to satisfy the future requirements for middle and higher administration personnel. NCCI conducted training programmes at its own training centre for the development of its workforce. Such programmes included topics relevant to insurance, computer skills, management, personal and financial skills, and English Language teaching. Additionally, the company provided training programmes outside the Kingdom for selected employees and major clients. It also accepted trainees from abroad at its training centre. As one of its objectives to develop a recruitment programme, the company developed criteria to benefit from the National Regulating Project for Common Training in collaboration with The Human Resources Fund and The General Corporation for Technical Education and Vocational Training.

TAJ medical insurance activities

In 2001, NCCI led efforts with the major medical insurance companies and medical providers to establish criteria for providing optional medical insurance

services, and the application of those provided within the framework of the Cooperative Health Insurance Ordinance. Such efforts aimed at standardizing criteria to be applied in the procedures for providing health care to the Insureds, obtaining approvals for special medical services, amending accounting systems pertinent to payments, and establishing a medical coding system. TAJ activities included the assignment of specialized, experienced and competent physicians. Also included were the development of information technology systems relevant to medical insurance practice, contracting with the largest possible number of qualified medical providers, reaching agreements with worldwide medical centres for the development of tele-medical services, and attracting additional major clients. The ultimate purpose of these efforts has been to upgrade the medical insurance service to achieve the highest customer satisfaction.

Technical activities and insurance market challenges

The technical development process for insurance coverage continued during the year 2001 with emphasis on medical insurance programmes for individuals (AFAQ) Programmes for protection and savings, international travel insurance and *Umrah* (*Manasek*) insurance. The development process encompasses aspects such as the conditions, coverage, and prices. The Technical Division, however, encountered many problems during the year.

These resulted from the recession in the international re-insurance markets, the incidents of 11th September 2001, collapse of the worldwide stock markets, and the dissipation of hopes of the re-insurers in realizing satisfactory investment revenues to assist them in encountering their losses. NCCI entered into prolonged negotiations with re-insurers to restrict the sharp escalation of insurance prices being imposed by these international circumstances to a level acceptable to local market customers. Assurances have been sought that insurance coverage, most notably in aviation and property insurances, whether new arrangements or renewals, will be honoured. In consideration of these contingent variations, NCCI had to reconsider its underwriting policy and to apply an increase in pricing on certain types of insurance, ranging from 10 per cent to 40 per cent. Despite this the company succeeded in devising insurance arrangements for its clients, which helped maintain the prices at a reasonable level.

Finally, the Board of Directors takes this opportunity to express sincere thanks and gratefulness to the Custodian of The Two Holy Mosques, King Fahd bin Abdulaziz, and to congratulate him on the twentieth anniversary of his prosperous tenure. Thanks and gratefulness are extended to HRH The Crown Prince, HRH The Second Deputy Premier, and to the Saudi Government for their continued support and encouragement. The Board also expands its thankfulness and appreciation to our esteemed customers for the invaluable confidence which they have bestowed on the company. Such

confidence has been a consistent incentive towards upgrading the company and, consequently, the quality of its services. Also, the Board expresses its appreciation to the NCCI's Management and Staff for their sincere efforts made during the year, that have resulted in the realization of these accomplishments.

Table 6.4 Policyholders' assets

	2001 SR '000	*2000 SR '000*
Cash at banks	38,355	50,353
Receivables, net	494,250	328,095
Deferred policy acquisition costs	11,846	9,147
Prepaid expenses and other assets	29,475	27,713
Available for sale investments	143,304	124,247
Investments held to maturity	343,346	338,172
Investments in associates	98,138	99,595
Fixed assets, net	22,411	18,628
Total policyholders' assets	1,181,125	995,950

Table 6.5 Shareholders' assets

	2001 SR '000	*2000 SR '000*
Placements with banks	–	78,000
Available for sale investments	245,208	243,908
Investments held to maturity	88,161	43,595
Investments in associates	15,252	13,397
Accrued investment income	2,810	3,137
Due from policyholders	2,324	3,674
Total shareholders' assets	353,755	385,711
Total assets	1,534,880	1,381,661

Table 6.6 Policyholders' liabilities and surplus

	2001 SR '000	*2000 SR '000*
Policyholders' liabilities		
Re-insurer balances payable	232,629	173,490
Unearned premium income	151,362	109,470
Unearned commission income	52,634	53,387
Outstanding claims, net	67,424	77,281
Reserve for discontinued operations	81,121	100,219
Accrued expenses and other liabilities	145,070	95,261
Due to shareholders	2,324	3,674
Surplus distribution payable	15,800	22,000
Total policyholders' liabilities	748,364	634,782
Policyholders' surplus		
Accumulated policyholders' surplus	371,722	318,402
Unrealized investment gains	61,039	42,766
Total policyholders' liabilities and surplus	1,181,125	995,950

Table 6.7 Shareholders' liability and equity

	2001 SR '000	*2000 SR '000*
Shareholders' liabilities		
Accrued expenses and other liabilities	363	447
Total shareholders' liabilities	363	447
Shareholders' equity		
Share capital (authorized and issued five million shares, paid up 50%)	250,000	250,000
Unrealized investment losses	(13,155)	(3,239)
Reserves		
Legal	35,478	35,478
Consensual	17,739	17,739
General	44,700	44,700
Retained earnings	18,630	40,586
Total shareholders' equity	353,392	385,264
Total shareholders' liabilities and equity	353,755	385,711
Total shareholders' liability and equity	1,534,880	1,381,661

Table 6.8 NCCI financial highlights for 5 years (1997–2001) SR million

Description	*1997*	*1998*	*1999*	*2000*	*2001*
Gross premiums written	672.7	683.8	628.7	717.0	1023.2
Gross claims paid	398.0	440.8	357.4	355.2	724.8
Net surplus from insurance operations	66.6	45.0	6.8	85.1	63.1
Total revenues	277.6	289.2	339.5	358.0	385.8
Technical reserves	215.8	267.2	333.8	331.2	340.7
Total asset	1025.3	1190.2	1252.1	1381.7	1534.9

Table 6.9 Annual report – financial statements – balance sheet as of 31 December 2000 and 2001

	2001 SR '000	*2000 SR '000*
Policyholders' assets		
Cash at banks	38,355	50,353
Receivables, net	494,250	328,095
Deferred policy acquisition costs	11,846	9,147
Prepaid expenses and other assets	29,475	27,713
Available for sale investments	143,304	124,247
Investments held to maturity	343,346	338,172
Investments in associates	98,138	99,595
Fixed assets, net	22,411	18,628
Total policyholders' assets	1,181,125	995,950

Table 6.10 Shareholders' assets

	2001 SR '000	*2000 SR '000*
Placements with banks	–	78,000
Available for sale investments	245,208	243,908
Investments held to maturity	88,161	43,595
Investments in associates	15,252	13,397
Accrued investment income	2,810	3,137
Due from policyholders	2,324	3,674
Total shareholders' assets	353,755	385,711
Total assets	1,534,880	1,381,661

Table 6.11 Policyholders' liabilities and surplus

	2001 SR '000	*2000 SR '000*
Policyholders' liabilities		
Re-insurer balances payable	232,629	173,490
Unearned premium income	151,362	109,470
Unearned commission income	52,634	53,387
Outstanding claims, net	67,424	77,281
Reserve for discontinued operations	81,121	100,219
Accrued expenses and other liabilities	145,070	95,261
Due to shareholders	2,324	3,674
Surplus distribution payable	15,800	22,000
Total policyholders' liabilities	748,364	634,782
Policyholders' surplus		
Accumulated policyholders' surplus	371,722	318,402
Unrealized investment gains	61,039	42,766
Total policyholders' liabilities and surplus	1,181,125	995,950

Table 6.12 Shareholders' liability and equity

	2001 SR '000	*2000 SR '000*
Shareholders' liabilities		
Accrued expenses and other liabilities	363	447
Total shareholders' liabilities	363	447
Shareholders' equity		
Share capital[a]	250,000	250,000
Unrealized investment losses	(13,155)	(3,239)
Reserves		
Legal	35,478	35,478
Consensual	17,739	17,739
General	44,700	44,700
Retained earnings	18,630	40,586
Total shareholders' equity	353,392	385,264
Total shareholders' liabilities and equity	353,755	385,711
Total shareholders' liability and equity	1,534,880	1,381,661

Note [a]Authorized and issued five million shares, paid up 50%.

Table 6.13 Annual report – statements of insurance operations and accumulated policyholders' surplus for the years ended 31 December 2000 and 2001

	2001 SR '000	*2000 SR '000*
Revenues		
Gross premiums written	1,023,206	716,983
Less: Re-insurance ceded	(735,552)	(498,845)
Net premiums written	287,654	218,138
Changes in unearned premiums	(40,112)	(10,285)
Net premiums earned	247,542	207,853
Re-insurance commission	57,023	51,965
Other underwriting income	31,115	34,244
Investment income, net of management fee	21,969	31,013
Administration fee and other income	28,144	32,945
Total revenues	385,793	358,020

Table 6.14 Costs and expenses

	2001 SR '000	*2000 SR '000*
Gross claims paid	724,815	355,220
Less: Re-insurance share	(556,662)	(229,713)
Net claims	168,153	125,507
Changes in outstanding claims	(3,647)	14,419
Net claims incurred	164,506	139,926
Policy acquisition costs	30,026	21,920
Excess of loss expenses	8,487	5,274
Selling and marketing expenses	51,334	43,559
Operating and administrative salaries	47,856	41,532
Other general and administrative expenses	20,520	20,661
Total costs and expenses	322,729	272,872

Table 6.15 Accumulated policyholders' surplus

	2001 SR '000	*2000 SR '000*
Net surplus from insurance operations	63,064	85,148
Accumulated policyholders' surplus, beginning of year	318,402	276,870
Unusual item	–	(22,000)
Surplus distribution declared	(15,800)	(22,000)
Surplus reserve restored	6,056	384
Accumulated policyholders' surplus, end of year	371,722	318,402

Table 6.16 Annual report – statements of shareholders' income for the years ended 31 December 2000 and 2001

	2001 SR '000	*2000 SR '000*
Loss on sale of investments	(20,174)	(4,535)
Investment income	10,421	3,076
Income from investments in associates	4,839	5,375
Management fee income	2,441	3,446
General and administrative expenses	(453)	(406)
Net (loss) income for the year before unusual item	(2,926)	6,956
Unusual item	–	22,000
Net (loss) income for the year	(2,926)	28,956

Table 6.17 Annual report – statements of policyholders' cash flows for the years ended 31 December 2000 and 2001

	2001 SR '000	*2000 SR '000*
Cash flows from operating activities		
Net surplus from insurance operation	63,064	85,148
Adjustments to reconcile net surplus from insurance operations to net cash provided by operating activities		
Depreciation and amortization	3,840	4,575
Gain on sale of investments	–	(7,156)
Income from investments in associates	(2,543)	–
Changes in operating assets and liabilities		
Receivables	(166,155)	(3,244)
Deferred policy acquisition costs	(2,699)	715
Prepaid expenses and other assets	(1,762)	(11,700)
Re-insurer balances payable	59,139	13,398
Unearned premium income	41,892	9,840
Unearned commission income	(753)	(5,280)
Outstanding claims, net	(9,857)	11,988
Reserve for discontinued operations	(19,098)	(19,881)
Accrued expenses and other liabilities	49,809	29,801
Due to shareholders	(1,350)	202
Net cash provided by operating activities	13,527	108,406

Table 6.18 Cash flows from investing activities

	2001 SR '000	*2000 SR '000*
Proceeds from matured investments	133,768	236,713
Purchase of investments	(139,726)	(313,091)
Movement in fixed assets, net	(7,623)	(4,855)
Dividends received from investments in associates	4,000	–
Net cash used in investing activities	(9,581)	(81,233)

Table 6.19 Cash flows from financing activities

	2001 SR '000	*2000 SR '000*
Surplus (paid) restored, net	(15,944)	384
Net cash (used in) provided by financing activities	(15,944)	384
Net (decrease) increase in cash at banks	(11,998)	27,557
Cash at banks – beginning of year	50,353	22,796
Cash at banks – end of year	38,355	50,353

7

BASIC PRINCIPLES FOR AN INSURANCE SCHEME ACCEPTABLE TO THE ISLAMIC FAITH

Introduction

This study has shown that insurance is not completely forbidden by the *Shari'a*. Islamic finance is becoming a major force in the Islamic world and is beginning to play a significant role in the West, one that will increase in extent and influence. Islamic contracts, as construed and expounded by the *Shari'a*, are neither understood nor ignored by Western scholars. Modern Islamic authors and legislators have endeavoured to build a systematic Islamic law of contract similar to Western law but benefiting from the flexibility of the general principles contained in the *Shari'a* (Moghaizel 1990: 270). In addition to this, and as part of the same trend, efforts have been made to establish an all-embracing 'Islamic' economic doctrine, comprising modern concepts and practices such as insurance, presented as an alternative to available economic systems. As far as the concept of insurance is concerned, the existence of an economic system based on the *Shari'a* is tangible and specialist in nature.

Indemnity and non-indemnity insurance

Muslim *jurists* generally treat life insurance and non-indemnity insurance with more caution than other forms of insurance since the sum insured is paid independently of the injury suffered – the contract is not seen as a contract aimed at compensation. The payment of the sum insured is a conditional obligation, and the compensation is considered inequitable in that it involves gaining unjustified financial rewards.

The life insurance contract is open to criticism from an Islamic point of view, as the concept of insurance is not free from the prohibitions of *riba* and *gharar*. Therefore, non-indemnity insurance is regarded by a number of Islamic financial institutions as both justified and well-founded. One such example is the *Mudaraba* contract of the *Dar al-Mal al-Islami* Trust. Leaving aside the misapplication of *Mudaraba* principles (ibid.: 271–2) as discussed earlier, it might be considered that whilst the more conventional life insurance industry favours introducing investment devices in most life insurance schemes and that

the insurance aspect is becoming secondary (ibid.: 39–40), a particular feature of the Islamic form is that all non-indemnity insurance can be incorporated into an investment contract whereby the sum insured consists of the amount paid by the insured in instalments along with any profits made out of its investment in accordance with the stipulations of the contract in question.

The beneficiary would be entitled to the returns, which, by virtue of the 'life insurance contract' complying with the *Shari'a*, cannot freely be designated by the insured or the investor, as the money entrusted to the insurer is simply invested on behalf of (and thus remains the property and part of the estate of) the contracting party, to be distributed on death to his legal heirs in conformity with Islamic inheritance rules (Al-Bahi 1973: 89).

Professional insurance

There are two different types of insurance scheme in keeping with Islamic law. The author would agree with Moghaizel Fadi in his argument regarding professional insurance; he, together with other researchers, is of the opinion that professional insured have no option but to accept the terms of the contract imposed on them.

Each of the two schemes is aimed at one category of insured persons:

1 The first concerns professional groups such as engineers, contractors or physicians, that is, people without professional or specific knowledge of insurance; these insured persons (those who are in a weak bargaining position and have no choice but to accept all the conditions imposed by the insurer) are both in need of financial cover and lacking full awareness of the importance of, and legal refinement involved in, the contract.
2 The second scheme relates to groups or companies with detailed knowledge of the industry; this group of insured persons includes those who, by virtue of their standing and profession, are expected to be in a better position to evaluate and comprehend the terms of the insurance contract and its legal significance.

The above distinctions are relevant in Islamic law in order to apply a different system for each category, so affording adequate protection for those in need of it. The association between insurer and well-advised persons and entities would not be subject to stringent regulation as it would be unlikely that the insured would be misled in this case.

The scope and content of the protection for persons who fall victim to an unequal bargaining position would still have to be determined, but the guiding principle would be a dual system, of the aforementioned kind, which would accord with the *Shari'a* (Al-Fangari 1984), whereas the current policies and practice of insurance companies do not: this has been the prime reason for their rejection in Islamic economic practice.

Applied to an Islamically acceptable insurance scheme, a dual system such as that detailed here would not be a system specifically designed to meet the requirements of the *Shari'a* as such, but would make a valuable contribution to all insurance schemes. Regulations that take into account the personal position of the insured have already been considered in Western legal systems, most notably in the United Kingdom by the Law Commission (Clark 1989).

Thus a distinction between the 'professional' and the 'non-professional' insured (or between individual insured persons and companies in respect of unfair or unfavourable practices on the part of the insurers) has already been made as far as conventional insurance is concerned. If such a system were adopted as part of an Islamically permissible system, it would constitute a special feature.

State supervision and control

Without interfering with the freedom of the individual, one of the State's obligations to its citizens is to protect the economy and maintain a balance between the State economy and the private market economy, such that private individuals and companies enjoy the greatest possible freedom in their dealings. In an Islamic State where the majority are Muslims, governmental intervention varies from simple and unobtrusive control to a more paternalistic and close supervision of insurance business, coupled with power to impose regulations and restrictions considered appropriate by the government to guarantee a sound insurance sector.

As far as Islamic law is concerned, some argue that if insurance is undertaken by the State, it will be clear of all forbidden elements (Muslehuddin 1966: 165). But the role the State should play in economic activities has not been sufficiently defined by the classical Islamic authorities. It is, however, acknowledged by modern authorities (as expressed by *al-Majma' al-Fiqhi*) that 'Islamic economic doctrine' admits the principle of private initiative and enterprise in all economic fields and projects and that the State intervenes only to ensure the success of economic ventures and the soundness of their operations (Moghaizel 1990: 279).

In the USA, where State control is limited to the mutual insurance organizations, regulation by the State Department of Insurance can be extensive. The department approves rates, forms of policy wordings, management of mutual companies, mandatory deposits of assets and the handling of deposits of policyholders. The laws governing insurance company operations are established by the legislature of each State and are administered by the Insurance Department. Regulations may differ from one State to another but little difficulty is experienced.[1]

In Europe the EU regulations on insurance, including conventional insurance and mutual insurance, demonstrate a comprehensive control for all EU countries. The regulations are updated regularly for the benefit of policyholders

and go as far as giving the Council of Regulators the right to inspect the financial consequences of self-insurance in relation to conventional and mutual insurance. This allows the assessment of the benefits to the insurer and policyholders (whether financial or of another kind), and enables the Council to report to the EU countries' members, who in turn report back to the insurers and policyholders, giving them the freedom to select the most appropriate form for their business.[2]

In Australia, the government appoints an insurance commissioner who cooperates with the Commonwealth Commissioner of Insurance in all matters relating to life and non-life insurance. The Commissioner receives advice from individual official bodies such as the Institute of Actuaries and the Institute of Chartered Insurers. There are regular consultations and meetings between the Commissioner and mutual organizations; this includes attendance at Annual General Meetings. In Canada (which was under the rule and supervision of the United Kingdom until 1931) and Quebec (under the influence of France), the federal government abrogated insurance legislation and enacted three laws for extra-State control of the insurance business in conventional and mutual insurance. These were: a law relating to the Department of Insurance; a law relating to foreign insurance companies; and a law relating to Canadian and British insurance companies. Quebec has not adopted this standard law, the insurance legislation of that province setting out its own insurance law. The civil codes and laws relating to husbands and parents are being modified and amended in a continuous process and the federal laws of Canada are gradually becoming effective in the Quebec province.[3] The experience of Canada indicates that even where there are differences in loyalties within one country, State control is essential and a formula can be negotiated to the satisfaction of all sects and groups.

In Japan, the Minister of Finance and his office is the direct controller of the mutual insurance business. All mutual insurance companies without exception or delay must produce for the Minister of Finance an inventory, a balance sheet, a business report, profit and loss accounts and minutes of resolutions relating to the amortization of the federal fund and payment of interest thereon, the reserve and the distribution of profits or surplus. These documents are presented to the Minister of Finance, policyholders and insured persons or beneficiaries within three months of the end of the financial year.[4]

Both Finland and Sweden have always been closely associated with mutuality. In fact, in Sweden some banks are experimenting and succeeding in adopting the principles of Islamic banking in light of *Mudaraba* and *Musharaka*, under the initiative of economic support to industry. Finland, which introduced insurance legislation in 1933, amended in 1952, particularly protected mutual insurance companies against loss or damage. The supervisory authority is vested in the Department of Health and Social Welfare. The mutual companies are granted government-made concessions to be able to meet their liabilities if in difficulties. Mutual insurance companies are limited either to life or property

business, so that the ministry regulators are able to supervise and control mutual insurance on a yearly basis. The law regulates the amount of capital, fixing the premium rate, election of management, mergers with other mutuals and changes from mutual to stock companies.[5]

The above examples illustrate that supervision of insurance by the governments and its agents can keep a healthy balance between insurance companies and the insured, contributing to a steady economic environment and reducing the legal claims between insurer and insurance companies. This in turn saves governments time and resources.

In view of State control, in order to have insurance schemes that are Islamically acceptable, the schemes must show fairness between the insurance companies and the insurers to avoid the advantages insurance companies have over their customers and policyholders.

The insurance contract

As far as an insurance policy is concerned, the main issue for consideration is the failure to uphold the policy by the insurer, that is, non-payment of the sum insured, either on the grounds that the insured has committed some breach of duty or that the event that took place was excluded as a risk from the cover of the policy by virtue of its wording.

The author concurs with Moghaizel Fadi in his argument regarding insurance contracts in that he, together with other researchers, is of the opinion that insurance contracts must be acceptable to Muslim *jurists*. Insurance has been rejected by many Muslim *jurists* by virtue of the avoidance of payment by the insurer. Many opinions expressed on this subject describe insurers as dishonest tradesmen who, once in receipt of their premiums, will try to discharge themselves from the liability to pay the sum insured by any means. Although the holders of these opinions lack the legal rigour required when criticizing repudiation of liability, it is necessary to investigate in some detail the actual grounds on which insurers most commonly repudiate liability in order to assess whether they really enjoy substantial arbitrary power to this effect. From the Islamic point of view, the legality of the company's investment policy, demonstrated by its marketing and handling of claims, is the main issue. This principally concerns the limiting provisions and the insurer's repudiation for breach of warranty or for non-disclosure or concealment. Thus an insurer 'will not be permitted an unconscionable advantage in an insurance transaction, even though the policyholder, or other person whose interests are affected, has manifested fully informed consent' (Keeton 1985).

One of the main purposes of State control has been to ensure that the insurer will be able to fulfil his obligations when the sum insured is due. Another concern is the possibility that insurers could dodge their legal obligations by drafting provisions in a way that smallprint (which is rarely read in full) or complicated wording could be used to invalidate claims and avoid payment.

Muslim *jurists* warn against unethical activity, whereby insurers, once they have collected their premiums, can arbitrarily avoid payment of the sum insured. This is unfounded, as insurers do not enjoy unrestricted power to disavow their engagements and victimize helpless individual policyholders. The law regulating insurance contracts puts important limits on the insurer's freedom in this respect and, even though additional reform is still required to increase the protective measures established in favour of the insured, any future change will protect the insured further. Regulations adopted in this respect will obviously vary from one system to another but not so fundamentally as to justify the characterization of a system as 'Islamic' or 'non-Islamic', for the basic mechanisms of insurance are universal, as is the concern about limiting unfair advantages of the insurer.[6]

The system of the Malaysian *Takaful* Act, 1984, apart from some particular points, is not essentially innovative; it is interesting to note that even the most daring protective clauses of the *Takaful* Act are not exclusive to it. For example, Section 26 of the Act (stating that a *Takaful* certificate shall not be called into question by reason only of a mis-statement of the age of the participant in the case of the family solidarity business) has an equivalent in the Australian Insurance Contracts Act, 1984. By virtue of Section 30 of this Act the insurer may not avoid the contract, even if the mis-statement of the age of the insured was fraudulent.

It must be acknowledged, however, that insurance as it is practised today cannot be considered totally free from essential elements which definitely contravene Islamic law. Were this the case, it would be due to the investment policy the company engages in.

Investment policies of insurance companies

A major challenge confronting the world of Islam is that of constructing its economy and investment in a way commensurate with its world role in ideological, political and economic relations and, above all, in its dealings with other countries, be they underdeveloped countries or those in the developed West. This demands economic development to 'catch up' with the industrialized countries in the West, whilst at the same time maintaining the Islamic ideology and framework.

The type of investment available to insurance companies is limited, especially where the *riba* element is involved. From an Islamic angle, what must be determined is the validity of investment policies followed by insurance companies and the bearing of the prohibition of interest on such policies. The prohibition of interest leads to the invalidity of numerous investment outlets. Government and corporate bonds are not permissible because they bear interest; the same applies to debentures, loans, interest-bearing mortgages and all fixed interest securities. All interest-bearing deposits would also be unlawful.

The result is that the remaining valid investment opportunities consist of shares and real estate. Non-life insurance companies' need for liquid assets renders real estate an unattractive investment, so the only significant and valid investment outlet is company shares. In developing Islamic countries, these do not represent an appropriate market opportunity because of the lack of advanced organization of capital markets in such countries. In non-life insurance, the transactions are short-term contracts. They combine savings and insurance, as is the case with life policies.

High liquidity is necessary in order to meet claim requirements, which are often unpredictably heavy. The marketability requirement for securities in general business explains the high proportion of government and other public authority securities. Corporate bonds and debentures are also favoured because they offer a relatively safe investment opportunity from the repayment point of view. Other major investment outlets for non-life insurance companies are stocks and shares, short-term investments, cash and bank deposits (Moghaizel 1990: 291).

In life insurance, liquidity is not a major concern since maturity of claims is long-term, and more or less predictable – it is a question of finding adequate investment channels for the large funds constituted by life offices. Investment is more directed towards non-liquid assets, such as real estate and mortgages, so that the main assets of life insurance companies are channelled into long-term investments and only a small proportion is kept in liquid form (Faris 1983: 118). If liquidity is unexpectedly needed, it can be obtained on the security of long-term investments.

Investment in company shares may be Islamically restricted for other reasons. If the company whose shares are bought engages in unlawful trade, such as transactions relating to pork, alcohol, or other prohibited goods, or if the company itself engages in interest-bearing activities, then it might be said that the participation in such a company is contrary to Islamic law. In view of these restrictions, the range of conventional investments is considerably reduced.

Other forms of lawful profit-orientated activities are *Mudaraba* and *Musharaka* contracts, so long as interest is not involved; alternative forms of investment have also been suggested as being Islamically acceptable (Nejatullah 1985: 55), but it still remains to be seen whether they can offer an adequate field for insurance companies' investment strategies. This applies in particular to non-life insurance companies which, as has already been observed, have a requirement of high liquidity in assets.

Insurance schemes acceptable to Islam

Investment is the main concern of the *Shari'a*. When it is related to insurance, the assets should be invested lawfully, to the benefit of the insured, by participating in projects and organizations acceptable to Islam that are not involved in prohibited activities.

Distinction between lawful and unlawful business conduct is rather difficult, requiring knowledge, skill and experience. Some *jurists* go so far as to invalidate an insurance contract if the fund is invested in unlawful activities, on the grounds that *riba* is not eliminated. Other *jurists* insist that insurance companies should not invest in shares in companies which engage in dealings contrary to the *Shari'a* or which own shares in other companies involved in unlawful activities or dealing in alcohol, distilling, pig-farming or the like, which are forbidden by Islam.

Islamic economic structures have gradually implemented Islamic law, and have progressively substituted conventional institutions. This gradualist approach of 'stages' is seen as appropriate as it is essentially Islamic, and was adopted by Islam in its early days to eradicate highly reprehensible practices. The Quranic method proceeded stage by stage until complete proscription was achieved (Al-Khafif 1941), rather than by issuing an abrupt decree for total prohibition. This is particularly true in relation to the banning of alcohol and interest. As far as the alcohol prohibition is concerned, the following verses illustrate the 'stages' approach resorted to in the Quran.

> And of the fruits of the date-palm, and grapes, whence ye derive strong drink and [also] good nourishment. Lo! therein is indeed a portent for people who have sense.
>
> (16:67)

> They question thee about strong drink and games of chance. Say: In both is great sin, and [some] utility for men; but the sin of them is greater than their usefulness.
>
> (2:219)

> O ye who believe! Draw not near unto prayer when ye are drunken, till ye know that which ye utter.
>
> (4:43)

Islamic banks and cooperative insurance, and other Islamic financial institutions, have proved popular with depositors in their Islamic investment activities. In their investments on a *Mudaraba* basis (with depositors sharing in the bank's profits), the profit sharing ratio is related to the minimum notice required for withdrawal; deposits with Islamic banks tend to be more stable than those with conventional banks because most holders of investment accounts make few and infrequent withdrawals (Wilson 1990).

Islamic investment institutions, particularly the larger retailers, are represented in the West. Examples are Dar al-Mal al Islami in Geneva, and Al Baraka and Al Rajhi investment, with offices in London. The Islamic banks and other Islamic financial institutions act upon the significance of the returns obtained on Islamic investment operations designed to replace conventional interest, opposed by Muslim *jurists*.

Today, interest rates constitute an international basis for placing capital on the free market. As a reflection of the availability of such capital, they equilibrate supply and demand and facilitate the integration of divergent international monetary policies. It is well known that interest is considered the price of money and that a considerable number of rules applicable to the determination of value of goods and services apply to money. Clearly, money has an important role.

Closed economic systems cannot be of advantage to an adopted Islamic system. If a banking or insurance company intends to be isolated from the international monetary economy, it can in theory achieve this isolation by adopting a closed economic system. Such a system cannot have an advantage, however, as an Islamic institution. Until the market recognizes Islamic institutions, it may be unable to give a return on deposits competitive with conventional institutions, especially if the return is higher or lower than that offered by a conventional institution. The Islamic investment may result in loss, either from lack of liquidity or lack of investment. The survival of an Islamic system cannot be ensured if it is not maintained by a continuous flow of constantly renewed funds, guaranteeing the financing of losses until the re-emergence of more favourable conditions enables profit-making to resume. The skill, and experience, of managers is critical to keeping this balance.

Insurance is not in itself invalid under Islamic law; its periphery activities, which might not always conform to Islamic law, are factors that can constitute unlawful operation. The invalidity of investment patterns results from Islamically unlawful practices, common in the capitalist economy where interest plays a fundamental role at all levels. But the invalidity is not the essence of insurance – it results from the insurance *mechanisms*. When permissible means of investment are available and workable from the insurance angle, insurance will be totally free from forbidden elements, making insurance valid under Islamic law. The invalidity of certain investments does not invalidate insurance itself, as it is not specific to the nature of insurance, but rather the prevailing economic environment. Al-Sharkhasi (1913), in the context of *Mudaraba*, did not invalidate the dealings between Muslim and non-Muslim in any contractual transaction:

> Even though it is judicially permissible, it is reprehensible for a Muslim to entrust capital as a command [*Mudaraba*] to a Christian, just as it is reprehensible for a Muslim to mandate a Christian to work with his capital. This is so, because, in the latter case, the person directly overseeing the transaction is the Christian who will not guard against usury, nor will he be aware of the factors which invalidate the contract, nor will he, because of his faith, guard against them. Similarly, he will deal in wine and pork and it is reprehensible for a Muslim to deputize another person to deal in these commodities. However, this disapproval does not affect the essence of the command or of the mandate, nor does it obviate its judicial validity.
>
> (ibid.: 22:125 (trans. Udovitch 1970: 228))

Applied to insurance, this *Hanafi* principle would conclude that the invalidity involved in investment operations operated by the insurance company would not necessarily affect the validity of an insurance contract itself. The contract would not be declared null and void under Islamic law.

Management skill on the part of the lending or controlling body should ensure that appropriate levels of service are delivered when basic principles are met, such as:

- long-term commitment to the organization;
- prudent re-insurance funding;
- protection of investment;
- sound actuary loss and payout forecast;
- experience of underwriting policies;
- an acceptable level of organization remuneration and expenses;
- risk-sharing between all members;
- risk management;
- risk assessment and control;
- profit allocation policy;
- attitudes towards problem solving;
- ability to analyse technical data;
- sound investment programme complying with the *Shari'a*;
- political prudence (for example, having influential leaders who favour a particular political party could have an adverse effect when the political environment changes); and
- compliance with legal regulations.

Successful management of an insurance scheme calls for experience and knowledge of basic Islamic prohibitions. It is essential to have direct access to advice on Islamic matters. Management of funds requires exceptional skill and experience and conformity with a number of basic principles in order to ensure the successful management of a financing entity. It should be stressed that, taking into account the highly technical and complex nature of insurance operations, Islamic and developing countries are the first to acknowledge the real benefits of international cooperation. International cooperation brings the law of large numbers into play in the developing market, despite its limited size. It also helps to make re-insurance available to these markets on advantageous terms. Besides, international cooperation provides practical opportunities for insurance growth in emerging countries where the volume of insurance transactions is still small and the ratio of insurance premium receipts to national income is generally low (Al-Hakim 1971: 12).

The international market can also contribute to the insurance business in the way it organizes economic development and growth in the capacity of the world market, acting either individually, regionally or in groups. Such contributions continue to press the limits of capacity of the world market,

a fact that adds to the present problem of the contracted re-insurance market.

Conclusion

Interest can be considered 'the price of money' as money itself has an important role in the market, and interest rates constitute an international basis for placing capital in the free market. The invalidity of certain types of investment does not invalidate the whole insurance industry as these investments are not specific to insurance, but are merely results of the prevailing economic environment. So long as the structure and procedures of insurers are in line with Islamic law, there is no reason why insurance should arbitrarily be made invalid.

8

CONCLUSIONS

The conflict between Islam and today's financial institutions

Technological and sociological progress tend not to follow a linear path, a phenomenon repeated throughout history. Single developments can inspire, facilitate or allow multitudinous others and humanity generally benefits. We can use the Agricultural and Industrial Revolution as examples of practical, visible changes, and few would deny that we are experiencing similar phenomena today, those of information technology, finance and communications. Developments in computer technology, satellites, the Internet, and the immense speed of communication between nations means that the globe has effectively become one large country. Growing international trade has increased the need for forms of commercial insurance which are acceptable internationally.

Insurance is one of the cornerstones of competition. Covered risks are more likely to be taken, particularly in the fields of shipping and air travel, where random natural events can cause massive loss. Add to this the fact that most developed countries have compulsory employee insurance and we see a lack of insurance as a severe hindrance on international development and expansion. The principle of insurance and its permissibility in Islam has become a maze of contradictions, confusion and ambivalence, and a comprehensive, thorough understanding of the relevant Islamic principles and of the *Shari'a* is essential if this problem is to be resolved. After all, insurance protects people's livelihoods, communities and well-being – this does not sound much like a contradiction of Islam. The articulation of insurance to Muslims is not in antithesis with the principles of Islam. It is an axiom which endures for Muslims, with analogies in prayers and good deeds, associated with worldly life and categorized in the Quran and *Sunna* – these deeds can be considered the 'premium' Muslims pay for ensuring peace and salutation in both worldly life and in the hereafter.

We have two guiding principles: we have a pressing insurance, and we cannot contravene the *Shari'a*. There is no reason why the two requirements have to contradict one another. The forms of insurance developed in Islam have never been precisely regulated by Islamic law and, as already noted, were practised for purposes wider than financial gain. Legislative and contractual

developments have occurred which cannot be reconciled with the restrictive classical conceptions of the Islamic *Shari'a*. The confusion has been compounded by allowing for a legislative contractual framework for all.

Prohibition of *riba* does not constitute negative constraint on investment. It is mainly concerned with economic justice and moral justification, subjects that must be considered on a case-by-case basis; it is wrong to consider every transaction with the slightest hint of *riba* as being bad, and worse to throw a blanket over the whole world of business in order to be sure of condemning the 'guilty', when the 'innocent' are severely disadvantaged as a result. The Islamic *Shari'a* encourages making money, as long as it is legitimate and not at the expense of the poor. Making money from money is regarded as wealth created by the lender without any effort or work. The main tool of monetary policy adopted by Western institutions is the system of interest rates, which is not welcomed by the Islamic *Shari'a*. The borrower alone is the one creating the wealth and taking considerable risk, something regarded as unjust under the *Shari'a*.

Scholastic debate

The debate about insurance has only been entered by Muslim *jurists* in the last five decades (with remarkably little change in opinion considering the unimaginable societal changes that have taken place over that time). There has been much confusion and contradiction, as the majority of those who have expressed opinions on the *Shari'a* and Islamic *mu'amalat* have lacked knowledge of insurance principles and practice, and many of those who have expressed negative opinions on insurance have been ignorant of Islamic principles and *mu'amalat*. There has, therefore, been a gap of understanding between the *jurists* of Islam and insurance, which has created confusion in the mind of the average Muslim over the permissibility of insurance. It is the kind of conflict of opinion that always results when the result is not arrived at, but is worked towards, with the path taken being influenced by the safest route or by the satisfaction of preconceived ideals. This study has sought to address these problems and to give precise answers to the questions raised.

One of the reasons Islamic scholars did not consider the issue of insurance to be a priority is that insurance was not developed by Muslims within Islamic law – largely because of its innovative and foreign nature. Several attempts were made to disqualify insurance on legal grounds by attempting to fit it into a contractual system not devised for the purpose. Although, since the birth of Islam, Islamic principles have approved of much wider forms of insurance than the merely financial, some scholars have remained sceptical. The same can, of course, be said of many financial instruments that have been introduced *to* Muslims rather than developed piece by piece *by* them with the religion as the guiding laws on which they are based.

Islamic law is not restricted to the roles mentioned in the Quran and the Sunna. Islamic principles encourage initiatives – exercise of independent

judgment by using analogy, descretion, and maintaining public good – on the part of qualified scholars of Islam to benefit and comfort the people. Some objectors and literalists take a very restrictive approach to Islamic law, insisting that all rules must be expressly mentioned or fully governed by the *Shari'a*. Such an unrealistic view can lead to great distress to Muslims who wish to abide by Islamic rulings and who will inevitably be compelled under the pressure of the legitimate necessities of their daily activities to depart from the strict application of the *Shari'a*. Above all, these pedantic attitudes lead to misrepresentation of Islamic principles to the non-Muslim world. Opinion outside the Muslim world is often that Muslims are anti-Western and anti-progress, despite the evidence to the contrary that comes from walking through almost any Middle Eastern city.

Islamic banking

Islamic banking started in the 1970s and has since grown considerably. The depositors expected the banks to manage their deposits according to the Islamic *Shari'a* and to develop financial products parallel to Western fund management. Conforming with *Shari'a* law, and at the same time providing a service comparable with conventional institutions, was helped by the Muslim clients' willingness to accept lower returns than conventional institutions would award, at least during the initial development of the Islamic services. The challenge to Islamic banks comes from clients comparing rates with those of conventional institutions dealing in *riba*, when long-term investment is involved, or to new small businesses or farmers. The basic principle of Islamic finance is cooperation under the *mudaraba* contract, where the bank purchases the goods and retains responsibility for them until they are sold on behalf of the client, and the profit is then shared between the bank and the client. The ownership responsibility borne by the bank justifies the mark-up on resale of the goods. Other forms of Islamic finance includes *mudaraba*, *Musharaka*, *ijara* and *qard al-Hasan*.

Mutual insurance – the way forward

Mutual insurance was established in 1752 in the Western industrialized countries (including the USA). It developed solidly and now has a considerable share of the insurance market. Mutual organizations operate profitably and successfully for the benefit of the policyholders, not the shareholders, and in all the countries included in this study which operate mutual insurance schemes, the basic principles are the same:

- all mutual insurance possesses its own specific identity;
- mutual ownership of policyholders;
- investment of assets to the benefit of policyholders;
- long-term commitment to policyholders;
- profit allocation to policyholders;

- transparency of all dealings with policyholders;
- election of management and key officers;
- careful underwriting;
- regular actuaries statistical update;
- annual accounting;
- high standards of risk control;
- re-insurance is available with other mutual or non-mutual organization to share the risks; and
- government regulation to ensure the protection of policyholders.

Policyholders of mutual insurance are the shareholders, therefore the benefits, decision-making, management of assets and profits are shared by the policyholders. The surplus resulting from premium income exceeding claims can be paid out to policyholders, but policyholders also have responsibilities for any losses.

As we have seen, the principles of mutual insurance harmonize with the Islamic principle, *mo'amalat*. Insurance itself is not the issue – the issue is how Islamic insurance companies should be organized and controlled according to the principles. These matters were agreed at the first international conference on Islamic economics held in Mecca in 1396 AH (1976), and confirmed by a *fatwa* issued by the higher council of Saudi Arabian *Ulamas* in 1397 AH (1977), as well as by an international *fatwa* of the *Fiqh* Council of the World Muslim League in the following year and by a *fatwa* issued by the Organization of Islamic Conferences in 1405 AH (1985).

Most Islamic scholars approve of cooperative and mutual insurance principles; in Saudi Arabia, cooperative insurance (NCCI) operates as a major mutual company and as an indigenous insurance operation. Islamic insurance companies are often offshoots of Islamic banks, provided as an additional service for the banks' clients and some cross-subsidy may occur, particularly in the early days of setting up; but the banks, in practice, are able to underwrite losses as part of the overall services.

Malaysia has emerged as the first country to implement a dual banking system, with Islamic and conventional services operating parallel to each other. Although the Islamic Banking Act of 1983 enabled the Central Bank to issue and control the new Islamic banks, the Finance Minister has the ultimate power of decision-making. Bank Islam Malaysia has become the sixth largest bank and appeals to Muslims as it deducts tax and *Zakat* at source, and pays an acceptable dividend to its shareholders. The Malaysian model has been recognized by many Islamic countries as the model of the future and leaders are keen to learn to implement a similar system in their own countries. As insurance is relatively new, Islamic insurance companies are at the development stage, and are small. In relatively advanced Islamic countries, such as Malaysia, insurance runs on conventional rather than Islamic lines.

It is now clear that Islamic insurance would be able to develop growth in an equity market, as an Islamic insurance company cannot hold bonds but can hold

equity products because of the lack of the *riba* element. Another advantage of Islamic insurance, affiliated with Islamic banks, is that it ensures availability of liquidity and can contract in *murabaha* with Islamic banks rather than on the open market.

Life business is relatively small in Islamic countries. Government employees enjoy some degree of protection, with compensation in the event of workplace accidents, and retirement-linked financial rewards plus a continuance pension. These benefits are now spreading to the private sector, which will inevitably result in the growth of life and pension-linked policies. Re-insurance is also new. At present Islamic insurance companies insure with conventional providers in the absence of re-insurance provided by Islamic insurance companies. Currently, aircraft, shipping, oil production and large institutions under the ownership of the Muslim private sector or Islamic governments are insured with Western insurance companies. Islamic principles offer no grounds for objection to re-insurance in the same way as with mutual insurance, on a profit-sharing basis – the difference is the number and scale of operations.

New challenges facing the world

Large, terrifying and implication-heavy events sharpen media focus at the expense of concentration on root causes and analysis. At the time of writing this book, the focus of world news is on the fresh rounds of international terror; dominating the media are the devastating September 2001 hijackings in the USA and their aftermath, suicide attacks in Russia, Kenya, Israel and Bali. Often glossed over is the terrorism by the Israeli government, with its huge stock of modern weapons and the support of the US government, against unarmed Palestinians whose only weapons are their own lives, cornered into being suicide bombers. These depressing circumstances and the unjust treatment by the West of the Muslim world has created terrorist groups such as *Al Qaida*. If we broaden our focus a little, we see the opinions of Muslims who see all these actions as reprehensible, dangerous and misguided.

However, the feeling of dispossession and disillusionment is an often-cited cause of the problems facing the Muslim world. Western commerce is seen as imposing itself on people; the phrase 'Western imperialism' is heard, where imperialism is not in the tradition of conquering empires (of which Islam has had its fair share), but of a creeping and increasingly unavoidable system that permeates every life. In truth, it is not a problem that is limited to the Islamic people, but one that affects ordinary folk, especially the poor, throughout the West and beyond. The interest-based system creates inescapable debt burdens and has widened the gap between the rich and the poor – the lenders and the borrowers – that can create the conditions for riots, and cause feelings of religious righteousness and fervour to boil over into the sickening acts we have seen perpetrated in the name of religion over the past decades. Could these be the conditions to which Allah was referring when the Prophet Mohammed delivered his decree on usury?

It is possible that the time is right for the world to rethink its attitude to world commerce, something which has itself become subject to immutable laws and dogma that could put any religion in the shadow. A need to satisfy shareholders and continue growth trends in a world of finite resources cannot go on for ever. An interest-free approach to investment does not rule out making a profit on sales – wages, materials and transportation costs all come into play – but taking a step back and asking 'Why?' can cause no harm and can often produce surprising answers. Looking at past successes of interest-free commerce will add ammunition to the argument. There are many examples of how interest-free loans can bring back their value plus much more, tangible or otherwise, without forcing the policyholder to embark on a journey of risk and debt.

Government agencies can invest in schemes aided at creating jobs – the repayments of policyholders become the long-term financial health of the nation, not only from the direct taxation and the reduction of social security, but also in the inevitable drop in crime that accompanies social inclusion. With interest-free loans, individuals can embark on small enterprises that have much the same effects as those of employment under another body. Communities, particularly rural ones, can respond to the unique needs that are often overlooked with blanket policies made by central government.

Over the course of the twenty-first century, many economists and humanitarian agencies have predicted the step between the rich and the poor is set to increase even wider than the pitiful stride that is observed now. Such predictions are based on prevailing conditions – there is no reason to believe that conscientious administrations will not come up with just means to provide the poor with financial assistance that come with no strings attached. The Jubilee 2000 campaign succeeded in at least drawing attention to the problem of spiralling Third-World debt, and in some cases has forced governments to stop the accruing of interest or even writing off the debts altogether, with little or no adverse effect to the lender State. The benefits that are not immediately obvious come in the shapes of fewer wars, less hatred and more freedom.

Health care investment is an area, like employment, where an immediate lack of observable benefit is balanced by long-term stability. The figures for working days lost through sickness in developed countries make for nauseous reading. But the problems of poor health in the developing world, exemplified AIDS/HIV, cholera, tuberculosis and malaria among countless other blights, make the West's sickness problems look trifling. Even a little investment can eliminate this immense burden and allow the 'developing' world to live up to its name.

Health care and education often occupy the same agendas – much ill-health is down to a lack of understanding, although the problems are deeper than this might suggest. However, education of children in the basic necessities of reading, writing and arithmetic bring untold benefits to any society. Loans provided for education repay themselves many times over thanks to the societal benefits they bring, and any interest that has to be paid is a denial of education to more children. Ongoing adult education should not be neglected;

breakthroughs in technology mean that today's skills are tomorrow's quaint oddities, and workers can find themselves on the scrap-heap just as they have mastered the latest skill. Any investment in education is an investment in the future from the society up to the level of mankind as a whole.

In many communities, half the population lives under a 'glass ceiling' or has absolutely no say in society's progress. Yet this group is trusted with the vitally important tasks of rearing children and usually gives them their first exposure to any kind of education. In many regions the rights and opportunities given to females are out of proportion with their value to society, and have no parallels with those offered to males. This subject can cover all of those mentioned above, particularly education, health and employment; their benefits to society have been illustrated, so their denial to women and girls can only disadvantage any society. This, of course, does not take into account women's basic rights as human beings, which are and have been neglected so often in humankind's history that one wonders how we succeeded in dominating the planet.

Investing in the rights of women, or in any of the subjects touched on above, should not be an attempt to earn interest to benefit shareholders and directors. These investments are for everyone – a redistribution of unbalanced wealth that can make whole nations feel the benefit. When societies start to feel stable and populations can see a brighter future, the dispossessed classes start to fade away. A popular feeling of dispossession has been the cause of virtually every war in modern times and fuels the furnace of oppression and terrorism.

Nobody is pretending that abandoning Western influence – or imposing strict Islamic interpretation – will bring a peace for which humankind has yearned for millennia. But if adherents of both sides of the argument could start to see each other's views, understanding can result – even a shift of a token degree is a shift in the right direction.

General conclusion

This work has sought to evaluate and discuss the position of Islamic insurance in a new light. Its originality lies in its discussion of the theoretical foundation from an Islamic system, and its conclusion that Islamic insurance, particularly mutual insurance, is a concept that Islam can permit and reconcile with the general framework of modern Islamic law and mutual insurance. When *jurists* accept that insurance is not inherently anti-Muslim, and that traditionally it has been they who have been anti-insurance, progress can possibly be made. The principle of *ijtihad* should arm them with the moral and legal justification to be open-minded and to be prepared to work around one of the economic world's largest problems with an eye firmly on the future and not on the past.

Perhaps the most fitting justification comes from the lips of the Prophet Mohammed himself when he said:

> There should be neither harming nor reciprocating harm.[1]

Appendix 1

MUDARABA FOR INVESTMENT AND SAVINGS AND *TAKAFUL* AMONG MUSLIMS (SHAHAB EL-DIN 1990)

Islamic *Mudaraba*

This contract is a *Mudaraba* or *qirad* contract constituted pursuant to the rulings of Islamic *Shari'a* among subscribers to *Mudaraba* certificates as beneficial owners of *Mudaraba* assets (as Rabb Al Maal) ('Participant') on the one hand, and Islamic *Takaful* Company (I.T.C.) Société anonyme (Luxembourg) (*as mudarib*) (the 'Manager') on the other.

Section I Objectives and Legal Form

1 The objectives of this *Mudaraba* are:

   a the collective investment of private savings over the participation period specified on the face of *Mudaraba* certificate in accordance with the rulings of Islamic *Shari'a*;
   b systematic saving throughout the participation period with investment of the savings in accordance with the rulings of Islamic *Shari'a*;
   c Islamic solidarity among participants in case of death of any participant prior to the end of his participation period as specified in the following conditions.

2 The annual instalment appearing on the face of the *Mudaraba* certificate of each participant is divided into the following two portions:

   a an amount allocated for the purchase of investment units in the managed fund for the account of the participant. No *Takaful* benefits are deducted from this amount or the profits generated therefrom;
   b an amount specified in the contract is paid for the purpose of investment in the *Takaful* Fund. Each participant has accepted in good faith and consents to relinquish a portion or all of his profits on this amount for payment of *Takaful* benefits to its recipients in a similar type of *Takaful*. The participant also has to donate, if such profits are insufficient, part or all of the amount specified in this paragraph to the

Takaful Account, if necessary. The participant who continues until maturity of the contract would receive whatever remains to him from this account and its profits. However, the participant whose heirs have received *Takaful* payments, and/or the participant who withdraws or is considered to have withdrawn, has donated whatever may be his credit to support the *Takaful* fund, referred to in the declarations and donations attested to on the application form, duly signed by the participant.

3 All the effective expenses necessary for the management and investment of the *Mudaraba* will be deducted from the two portions (a) and (b) above-mentioned of the *Mudaraba* assets.

4 The participant shall pay at the time of subscription the issue fee determined by the Manager.

5 The Manager deals exclusively with the management and investment of the assets of the *Mudaraba* and the profits generated therefrom. The Manager undertakes to invest these assets separately from his own assets and free from any lien with his own creditors.

6 The Manager shall respect, in all his dealings, the rulings of the Islamic *Shari'a*. The participant and the Manager shall, while interpreting Islamic *Shari'a*, abide by the decision of the Religious Supervisory Board of *Dar Al-Maal Al-Islami* Trust (Religious Supervisory Board).

Section II Guarantee of performance

7 In conformity with the *Shari'a*, the Manager is liable for any proven loss to the assets of the *Mudaraba* if such loss is due to his failure to respect the conditions of this *Mudaraba* contract or negligence in the discharge of his functions. Payment of such proven loss is guaranteed by *Dar Al-Maal Al-Islami* Trust.

Section III Participation in the Mudaraba

8 An individual can become a participant by completing an application form and remitting the first instalment subject to the following:

a participation is effective upon acceptance of the application by the Manager and collection of the remittance at the date on the 'commencement date';

b participation is limited to Muslims who have attained their twentieth birthday but not their fiftieth on the commencement date, provided the age at the maturity date does not exceed sixty-five;

c payment of any instalment is effective only on the date of collection by the Manager;

d the participation period is indicated on the face of the certificate and commences for each participant from the commencement date shown on the face of the certificate to the date of maturity.

Section IV Investment of Mudaraba assets

9 The Manager shall invest the *Mudaraba* assets – representing the amounts paid by participants pursuant to paragraph (a), Article 2 – and what Allah bestows as profit for the benefit of participants in the managed fund, in conformity with the Islamic *Shari'a*, under the supervision of the Religious Supervisory Board.

10 The Manager shall also invest the assets of the *Takaful* Fund referred to in paragraph (b) of Article 2. All, or a portion of, such amounts may be transferred to *Takaful al Umma Mudaraba* (*Takaful* fund).

Section V Mudaraba units

11 The share of each participant in *Mudaraba* assets is represented, at any time, by the number of *Mudaraba* units or fractions thereof, owned by the participant. The Manager shall continue allocating *Mudaraba* units to the incoming participants.

12 The initial value of a unit on the participation date and the number of the units acquired by the first instalment are shown on the face of the certificate. The participant shall be notified of the number of units credited for each subsequent instalment.

13 The number of units acquired by the participant is determined by the division of the invested amount under paragraph (a) Article 2, by the value of the unit on the valuation date preceding collection of the investment.

14 The value of the unit is determined by dividing the value of *Mudaraba* assets as of the last valuation date by the number of existing units. Units will be valued on the last day of each calendar month (valuation day).

15 The Manager shall maintain a register of the names and addresses of participants and the number of *Mudaraba* units owned.

Section VI Valuation of Mudaraba assets and profit allocation

16 *Mudaraba* assets shall be valued by the Manager at each valuation date in the same currency appearing on the face of the certificate. The *Mudaraba* profit in connection with paragraph (a) of Article 2, if any, increases the value of units owned by the participant according to the results shown by the valuation. The Manager shall publish the annual balance sheet and profit and loss account. These should be audited by an independent auditor appointed by the Manager.

17 What Allah bestows as investment income (profit) during each month on the *Mudaraba* Assets, mentioned in paragraph (a) Article 2, shall be allocated as follows:

a one-fifth of the profit to the Manager;
b four-fifths of the profit to be reinvested for the benefit of all participants as assets of the *Mudaraba* or the *Takaful* Fund.

18 What Allah bestows as investment income (profit) with respect to the amounts specified in paragraph (b) Article 2 shall be allocated as follows:

a one-fifth of the profit to the Manager;
b four-fifths to be reinvested for the benefit of the *Takaful* Fund.

Section VII Withdrawal from Mudaraba

Participant deemed to have withdrawn and termination of participation

19 The participant may elect to withdraw from the *Mudaraba*, provided at least two years have elapsed from the commencement date stated on the face of the certificate. The withdrawing participant has consented to relinquish as a donation to the *Takaful* Fund the amount paid in accordance with paragraph (b) of Article 2, together with the profit thereto in order to enable the *Mudaraba* to fulfil its obligations with respect to the *Takaful* benefits between Muslims in accordance with the undertaking made by the participant in the application form signed by him.

In such case the withdrawing participant is entitled to the value of units owned by him according to the last valuation preceding withdrawal. Withdrawal shall be effected on completion of forms provided by the Manager. After processing, payment is made by cheque payable to the participant within 30 days.

20 The value of all *Mudaraba* units owned by the participant shall be paid to him on the date of maturity, according to the last valuation preceding the maturity date and, in addition, the participant's share in the surplus, if any, of the *Takaful* Fund as referred to in paragraph (b), Article 2 and Article 10. This sum shall be paid to the participant by cheque which will be sent to the address registered with the Manager after receiving an application on the forms supplied by the Manager and with due consideration to Article 30 of this contract.

21 A participant who fails to pay the annual payment when due shall be deprived of the *Takaful* benefits and be considered as having withdrawn. The value of all *Mudaraba* units shall be paid to him and he will be treated as a withdrawing participant under the provisions of Article 19 hereof, which he approved in the subscription application signed by him.

Section VIII Takaful Fund

The example of believers in their affection, mercy and sympathy is like the example of the human body; if any one of its limbs complain, all other parts complain with vigilance and fever.

22 As the Islamic *Shari'a* encourages solidarity, unity and cooperation among Muslims, the participants have agreed among themselves to apply part of their instalments to finance the *Takaful* Fund in order to achieve cooperation and solidarity among themselves, according to their need under the conditions of this contract. Therefore, participants have accepted in good faith and consent to relinquish part, or all, of their payments to the *Takaful* Fund and its profit, as provided in paragraph (b) of Article 2, as a donation to effect payment of the investment portion of the instalments remaining, until the maturity date for any deceased participant who dies before completion of what he undertook to pay as instalments and as provided by Section IX.

Section IX Payment of Takaful benefits

23 In the event of a participant's dying before completion of what he undertook to pay as instalments as stipulated in paragraph (a) Article 2, the Manager shall pay to the heirs of the deceased the amount of instalments remaining as from the date of his death to maturity date as described in paragraph (a) referred to, in addition to the value of *Mudaraba* units by the deceased and the assets according to the last valuation preceding the date of his death.

24 The right of the heirs to *Takaful* benefits is subject to the following conditions:

a the information submitted by the deceased participant in his application form is true and correct;
b the death of the participant occurred for reasons other than suicide, which Islam has prohibited;
c the death of the participant did not occur by execution or wilful homicide;
d the deceased participant was not murdered by the heirs, but if the participant was murdered by one of the heirs, only that heir shall be deprived of the *Takaful* benefit;
e payment of all instalments due before death was duly made;
f death has not been preceded by a request for withdrawal signed by the participant.

When the above *Takaful* conditions are met, *Takaful* benefits mentioned in Article 23 shall be paid out from the *Takaful* Fund, after presentation of

proof of death of the participant and the identification of heirs as described in Article 25.

25 All sums payable on the death of the participant are inheritance funds (*Tarekat*) and shall be payable by the Manager to the legal heirs as provided by the *Shari'a* after submission of the following:

a the heir of the deceased shall complete a form provided by the Manager enclosing documents supporting the information contained in the form;
b the heirs shall submit an inheritance declaration issued by an official authority proving death and indicating the identity of heirs and shares due to each of them. In the case that they fail to do so, they shall submit other documents satisfactory to the Manager establishing the number of heirs and the Religious Supervisory Board shall decide the share of each heir accordingly;
c after completion of the above, the Manager shall pay, within a maximum of two months, to the heirs of the deceased the amounts indicated in Article 23 by a bank cheque to be delivered to the heirs or their authorized representative.

26 The participant has declared that the information contained in the application signed by him to subscribe to this certificate is true and correct and that he accepts the conditions of this *Mudaraba* contract. In the event that this information proves to be untrue or incorrect, the heirs of the deceased participant shall have no right to the *Takaful* benefit, but shall only receive the value of the units acquired under paragraph (a) of Article 2, together with whatever amount that may remain for his heirs in connection with the amounts or profits thereto paid, in accordance with paragraph b of Article 2.

Section X General

27 The owner is the person whose name is printed on the face of the *Mudaraba* certificate and is the one who is addressed for all purposes, and title to the certificate may not be transferred in any manner whatsoever.

28 The liability of a participant is limited to his equity participation in the *Mudaraba*.

29 A participant shall pay, personally and from his own funds, every year the *Zakat* due according to *Shari'a*, for this certificate as per the annual financial valuation together with his other assets on which *Zakat* is due.

30 If the participant has not submitted a claim for payment within 30 days in the case of withdrawal, or if he is deemed to have withdrawn pursuant to Articles 19 and 21, or in the case of death of the participant, or at the maturity date, the participant or his heirs authorizes the Manager to invest

such sums, until the date of effective payment, for his benefit or that of his heirs.

If such a claim is thereafter submitted at any time, such sums shall be paid according to the value of *Mudaraba* units at the most recent valuation date with what Allah bestows as income (profit) according to Article 16 hereof. Payment shall be made within 30 days of this claim.

31 The contract shall be interpreted according to Islamic *Shari'a* and is enforceable, pursuant to the prevailing laws of the country where the Manager is located, and in conformity with the provisions of Islamic *Shari'a*.

32 Any dispute arising between the two parties of the *Mudaraba* contract (the Manager and the participant) and not settled amicably shall be settled by arbitration, according to the rulings of Islamic *Shari'a*. Each party shall nominate an arbitrator and the two so nominated shall nominate a third who chairs the arbitration panel. If they fail to so nominate a third party, or if any party fails to nominate his own arbitrator within the period prescribed by the arbitration regulations, such arbitrator shall be nominated by the Religious Supervisory Board of DMI in accordance with the periods and measures provided by the arbitration regulations of the Group of DMI. The judgement rendered by the Arbitration Board in this respect is final and binding on both parties.

33 The Arabic text of this contract is the binding version.

34 A notice to the participant shall be deemed to be given 14 days after posting by airmail to the participant at his registered address.

35 The application for subscription and the declarations are deemed to be an integral part of this contract.

Appendix 2

ARABIAN INSURANCE GUIDE

Islamic re-insurance operating principles

According to the rulings of the Religious (*Shari'a*) Supervisory Board, an Islamic re-insurance company must function in accordance with Islamic cooperative principles as detailed below.

I Premiums

1 An Islamic re-insurance company shall not receive any re-insurance commission from a commercial re-insurance or insurance company but may pay or receive such a 'fee' from Islamic insurance or re-insurance companies. However, in order to develop a distinctively Islamic re-insurance system, the Islamic re-insurance company should transact business on a net premium basis.
2 The Islamic re-insurance company may enter into profit-sharing arrangements with its participating (ceding) companies.
3 The Islamic re-insurance company may also enter into profit-sharing arrangements with its re-insuring companies (retrocessionaires) both Islamic and commercial.

II Retrocession protection (further re-insurance)

In order to protect the interests of its participating companies and shareholders, an Islamic re-insurance company may secure adequate retrocession protection from commercial re-insurance companies when necessary, subject to the provisions of paragraph I above and other conditions stipulated hereafter.

III Premium and loss reserves

1 An Islamic re-insurance company may retain a part of the premium payable to its re-insurers (retrocessionaires) as a premium deposit/reserve (and also a loss reserve where required under local laws or practices) and permit its participating companies to retain such reserves/deposits which shall be dealt by:

i considering them as free loans. The re-insuring company shall not receive any share of the profits from the investment of these reserves, subject to the condition that the insurance or re-insurance company holding the reserves/deposits is alone responsible for any investment losses.

ii investing such reserves on the basis of the Islamic *Mudaraba* in consultation with the re-insurance company concerned, and in this case, the re-insured company shall not bear any investment loss unless it is due to a faulty decision or lack of care by the company retaining and investing the reserves. The re-insuring company shall be paid an agreed percentage of profits net of taxes, if any, and the balance shall be retained by the company investing the deposits to cover its administrative expenses.

2 Alternatively, the condition of retention of deposits could be waived altogether – a trend which is rapidly gaining ground. Furthermore, a participating company should accept a suitable reduction in the re-insurance commission payable to it in lieu of the profit payable on such deposits.

IV Accounts, reserves and appropriation of surpluses

1 An Islamic re-insurance company shall maintain and administer two funds – one known as Participating (Ceding) Companies' Fund and the other as Shareholders' Fund.

2 Assets of the Participating Companies' Fund shall consist of:

a re-insurance premium received;
b claims received from retrocessionaires;
c such proportion of the investment profits generated by the investment of funds and other reserves, attributable to participating companies as may be allocated to them by the General Assembly on the recommendation of the Board of Directors of the company.

3 All claims payable to the participating companies – retrocession costs, technical reserves and administrative expenses of the re-insurance company excluding expenses of the investment department – shall be met from the Participating Companies' Fund.

4 The balance outstanding to the credit of the Participating Companies' Fund at the end of the year would represent their surplus.

5 The General Assembly may on the recommendation of the Board of Directors allocate the whole or part of the surplus to the Participating Companies' Special Reserve or such other reserves as may be deemed necessary in the interest of the said companies.

6 In case all the surplus is not allocated to the reserves, the balance will be distributed amongst the participating companies in proportion to the re-insurance premium paid by each company during the year.

7 If the Participating Companies' Fund produces a loss, the same shall be met out of their special reserves and in case the same is not available or is insufficient such deficit shall be met through a loan from the Shareholder's Fund, to be repaid from future surpluses.
8 Assets of the Shareholders' Fund shall consist of:

   a paid-up capital, and reserves attributable to the shareholders;
   b profit on the investment of capital and shareholders' reserves;
   c such proportion of the investment profit generated by the investment of the participating companies' funds and technical and other reserves attributable to participating companies as may be allocated by the General Assembly of the company, on the recommendation of their Board of Directors, in their capacity as managing trustee (*Mudarib*) of such funds.

9 All administrative expenses of the Investment Department and other expenses attributable to the shareholders shall be debited to the Shareholders' Fund.
10 The General Assembly may, on the recommendation of the Board of Directors, determine the shareholders' surplus after the deduction of all their expenses.
11 The General Assembly may, on the recommendation of the Directors, allocate such amounts to the Shareholders' General and other Reserves as may be deemed fit by them.
12 The balance of the shareholders' surplus, if any, shall be distributed amongst them.

V Investment of funds

An Islamic re-insurance company must invest its funds in sources permissible by the Islamic *Shari'a* only.

Appendix 3

GLOSSARY OF MUTUAL INSURANCE USING CASE STUDIES FROM THE USA, AUSTRALIA, CANADA, JAPAN AND FINLAND

Introduction

This Appendix attempts to point out how legislation is used to level the playing field of insurance under varying governmental administrations, and serves to demonstrate the stringency and level of technicality required. An Islamic insurance scheme would be no different in its dependence upon official and voluntary bodies.

USA

American Insurance Association (AIA) This important association started as an organization of top fire and casualty executives who met, informally, to discuss important phases of the business. Its headquarters is in New York.

American Mutual Insurance Alliance (AMIA) An organization of mutual insurance companies similar to the American Insurance Association in the stock company field. The resumé of an insurance company's assets, liabilities and details of its business are filed at the close of each calendar year with the insurance department of each State in which it is permitted to do business. This is usually distributed to members and published (in condensed form).

Assets All the wealth of a company. Some assets are 'non-admitted' in that while they may be of value, they do not comply with the requirements of a State, and therefore cannot be used in determining the worth of a company in its published statement or its advertisements.

Best's Key Rating Guide Annual report on property and liability insurance companies. Headquarters in Morristown, New Jersey.

Captive Agent An agent who, by contract, represents only one company and its affiliates.

Co-insurer Where two or more companies share a risk they are 'co-insurers' of it. Also, when a claimant is required to stand part of his own loss because of the operation of a co-insurance clause, he is a 'co-insurer'.

Commissioner of Insurance The official of a State, charged with the duty of enforcing the insurance laws. Also sometimes called the 'Insurance Superintendent' or 'Director of Insurance'.

Compulsory Insurance Some States require that specific forms of insurance be carried by people in certain circumstances, such as workmen's compensation and, in the States of Florida, Massachusetts, New York, Puerto Rico and North Carolina, automobile liability.

Contractual Liability Liability as set forth by agreements between people, as distinguished from legal liability which is imposed by law.

Crop–hail Insurance Insurance against hail damage to growing crops. Although hail is the basic peril in these policies, cover is often granted for crop damage resulting from additional perils such as fire, windstorm, lightning, etc.

Direct Underwriters Companies selling insurance through their employees direct to the public and not therefore through independent agents or brokers.

Directors' and Officers' Liability Insurance Protection given to officers and directors of a corporation against damages from claims resulting from negligent or wrongful acts in the course of their duties. It also covers the corporation for expenses incurred in defending lawsuits arising from alleged wrongful acts of officers or directors. These policies always require the insured to retain part of the risk uninsured.

Dividend In capital stock corporations, it is the distribution of the profits or a part of them to the stockholders. In mutual companies, the dividends go to the policyholders.

Errors and Omissions A type of insurance which will step in to take the place of insurance that has not been effected due to a mistake or forgetfulness. Issued to concerns such as mortgage companies or others engaged in the routine insurance of a number of properties. This term also describes a clause in certain policies whereby the company agrees to waive its defences when an honest error has been committed, provided it is corrected when discovered.

Fair Plan A programme recommended by the President's Advisory Panel on Insurance in riot-affected areas which provides fair access to insurance requirements for property owners who experience difficulty in buying insurance on property located in blighted or deteriorating urban areas. Basically, the Plan assures a property owner of a physical inspection of his property and a promise to provide fire and allied lines of insurance if the property is adequately maintained and if recommended improvements, necessary to make the property

insurable, have been made. Many of these Plans have been extended to cover property State-wide.

Federal Insurance Administration A government office, part of the Department of Housing and Urban Development (HUD), handling insurance programmes such as Federal Riot and Civil Commotion Reinsurance Contract which backs up policies provided by Fair Plans in a number of States, and Federal Crime Insurance.

Financial Responsibility Laws Laws enacted by most States to keep reckless and financially irresponsible drivers off the highways. These acts vary from State to State, but in general they suspend the driving licence of any person who cannot pay a judgement arising out of an automobile accident or who has been involved in any automobile accident causing bodily injury or property damage or who has been convicted of a serious traffic violation. In the latter two cases, the operator recovers his licence if he files proof of his ability to pay claims up to certain fixed amounts for injury he may subsequently inflict on others, but in the first case, in many States, he cannot drive again until he has paid the outstanding judgment and filed proof of financial responsibility for future accidents. The required proof is usually supplied by a certificate filed by an insurance company or sometimes by a bond, or deposit of cash or securities. Sometimes referred to as 'Safety Responsibility' laws.

Independent Agency System An insurance distribution system within which independent contractors, known as agents, sell and service property liability insurance solely on a commission or fee basis under contract, with one or more insurers that recognize the agent's ownership, use, and control of policy records and expiration data.

Insurance Department The department of a State government which has charge of enforcing the laws governing insurance.

Insurance Information Institute (III) An organization with headquarters in New York, composed of the principal stock company associations for all classes of business other than accident, health and life insurance. It was formed to control and coordinate the public relations activities of each. Basically, the aim of the Institute is to attain a better public understanding and acceptance of the insurance business.

Insurance Services Office (ISO) A voluntary non-profit association of property and casualty insurance companies, with headquarters in New York, and providing a great variety of services on a national basis. Among its operations are rating, statistical, actuarial and policy form services for all classes of property and casualty business. The association also functions, as provided by law, as an insurance rating organization. In addition, where applicable, the ISO acts as an advisory organization or as a statistical agent. Established in 1971 by the consolidation of numerous associations and bureaux performing these services for separate classes of business and in various parts of the country.

Liability An amount for which the insurer is obligated by law. Also, the amount required by statute to be reported as a liability (money owed) in the insurer's annual statement.

Mass Merchandising A general marketing technique which, applied to insurance, is a programme where a group of persons insure with one company, usually at lower than standard premiums, because of the expense economy to the insurer. Until recently such plans were principally used in life, accident and health insurance but now are extended to other classes such as automobile and homeowners' policies.

Mutual Insurance Insurance in mutual companies, that is, companies without stockholders or capital stock. All risks and all profits are the property of the policyholders. They are sometimes classed as cooperative insurance companies.

National Association of Independent Insurers (NAII) A body, formed to work together and exchange ideas, of companies that do not belong to a rating bureau unless legally required to do so, preferring to act independently. Membership of the association includes fire, casualty and surety companies of all types. It acts as an advisory body and statistical agent for its members and has headquarters in Chicago.

National Association of Mutual Insurance Companies (NAMIC) This is the world's largest insurance company trade association, comprising more than 1,000 member companies located throughout the US and Canada. NAMIC is the channel through which all mutual fire and casualty companies, working together, can express views on common problems and take concerted action toward the solution for the immediate and long-term good of the mutual insurance business. The headquarters are in Indianapolis, Indiana.

National Flood Insurers Association A voluntary pool of property insurers, formed to provide flood insurance for dwellings in specified areas in collaboration with the US Department of Housing and Urban Development (HUD). This joint venture produces a market for flood coverage. The association was formed in 1968 and has headquarters in New York.

Rating Bureau An organization that fixes the rates that companies charge for their policies. In most States rating bureaux are established in conformity with rating laws.

Re-insurance The process whereby a company may share its risk with another, paying to such a sharing company a portion of the premium it receives. Conducted in different ways, re-insurance contracts pay only the company which re-insures, not the policyholder.

Surplus After a company's liabilities are deducted from its assets, what remains is the surplus.

Umbrella Liability A form of excess liability insurance available to corporations and individuals, protecting them against claims in excess of the limits of their primary policies or claims not covered by their insurance programme. This latter coverage requires the insured to be a self-insurer for a substantial amount ($10,000–25,000).

Australia

Commonwealth Government Actuary A Commonwealth official giving actuarial advice to government departments and the Life Insurance Commissioner on matters coming under the Life Insurance Act. At the time of writing the offices of Commonwealth Government Actuary and Commonwealth Life Insurance Commissioner are held by the same person.

Commonwealth Life Insurance Commissioner An official of the Treasury designated by the Commonwealth Life Insurance Act to administer the provisions of the Act regarding the conduct of life assurance business in Australia. Under this Act, life assurance includes both industrial insurance and superannuation business conducted by life offices.

Compound Bonus In life assurance, a bonus to the amount related to the sum assured and existing bonuses.

Conversion of Policy An alteration of a policy from one type to another, which can involve movement from the with-profit class to the non-profit class, or vice versa. This can mean that the policyholder becomes, or in the reverse case ceases to be, a member of a society.

Faculty of Actuaries Similar to the Institute of Actuaries based in Scotland.

Friendly Societies A specific type of mutual insurance society usually concerned with life and sickness insurance and governed by special legislation. Societies are often local in scope or limited to members of a particular trade or profession. Some societies have entered the field of health benefits in connection with the National Health Scheme. Some of the larger ones also offer benefits similar to those offered by life assurance offices, although usually on a somewhat restricted scale.

Funds The accumulation of excess of income over outgoings. In fire and accident insurance, this normally applies to the amount provided in respect of unearned premiums and for additional departmental reserves.

General Meeting A meeting attended by the members and governed by the Companies Act as regards convening, notice and business. Matters such as the accounts, the directors' and auditors' report, election of directors and appointment and remuneration of auditors are dealt with at Annual General Meetings and any other business is dealt with at Extraordinary Meetings. In today's world, where most companies have large memberships, only a very small proportion of members attend these meetings.

Industrial Assurance Life assurance, conducted by assurance companies, which is subject to special provisions in the Commonwealth Life Insurance Act, 1945–1973. The significant feature of such business is that premiums are received by collectors. Contracts are normally for somewhat smaller sums assured than are funds in non-industrial business and premiums are payable weekly or monthly. A simplified range of policies is offered.

Institute of Actuaries of Australia and New Zealand A professional association of actuaries based in Australia and New Zealand. This is a non-examining body whose members would normally also be members of one or other of two United Kingdom bodies, the Institute or Faculty. The functions of this Institute include the surveillance of professional conduct and practice and providing a forum for discussion of matters of mutual interest.

Insurance Office The general description of a body conducting insurance business, whose title, amongst others, can be Company, Society, Association or Institution. It may coincide, although this is not always the case, with the description 'mutual'.

Letter of Acceptance The document whereby the offer of a contract is made to a proposer by the Life Office. The payment of the first premium constitutes the agreement by the proposer to this contract.

Liabilities The present value of the obligation to the policyholders, that is, technical reserves, determined on a basis decided by the Actuary of the office. In fire and accident insurance, liabilities comprise mainly provision for unearned premiums, outstanding claims and miscellaneous creditors.

Life Insurance Act 1945–1973 A Commonwealth Act of Parliament which stipulates the conditions under which companies and societies transact life insurance business.

Life Offices' Association for Australia A voluntary association of companies or other institutions transacting life assurance business in Australia. The mutual life offices are all members of this association.

Members Persons entitled to vote at a general meeting of the mutual insurance office, normally those participating in profits. In fire and accident insurance, the policyholders of a Society are, *ipso facto*, also its members. Persons or classes of persons eligible for membership are defined in the society's Articles of Association.

Memorandum and Articles of Association The legal document establishing the company and setting out the objects for which it has been established (the Memorandum) and details of its system of operation and administration (the Articles). Alterations can be made only by Members in General Meeting and in conformity with the provisions of the Companies Act.

Mutual Insurance Insurance provided by funds of which share capital forms no part.

Mutual Insurance Society A voluntary association of persons or companies to establish a formal organization for the purpose of providing themselves with a specialized insurance service in either a particular class of business (such as life assurance, employer's liability insurance, etc.) or a particular industry (such as agriculture, etc.).

Non-forfeiture A provision frequently included in a life assurance policy whereby in the event of non-payment of a premium, cover is maintained until arrears of premium and interest exceed the technical reserve, at which time the policy is terminated.

Non-profit Policyholders Policyholders who do not share in the profits of the office. Their relationship to the assurer is no different from that of policyholders in a proprietary company.

Officers Staff appointed by the directors for executive duty, normally full-time.

Participation in Profits The right to share in periodic distribution of surplus.

Policy of Assurance The document prepared by the Life Office setting out the details of the contract between the office and the client.

Reserves Arbitrary additions to the liabilities or writing down of the assets to add to the stability of the office.

Reversionary Bonus In life assurance, a bonus expressed as an amount payable when a policy becomes a claim.

Simple Bonus In life assurance, a bonus the amount of which is related only to the sum assured.

Surplus The excess of funds over liabilities determined at a valuation. In fire and accident insurance, it is synonymous with profit, that is, the balance remaining for the benefit of members after payment of claims, commission and expenses and after provision for outstanding claims and unearned premiums.

Terminal Bonus In life assurance, a final allocation of bonus payable when the policy becomes a claim.

With-profit Policyholders Those who have the right to a share in profits. Usually synonymous with membership of the Society.

Canada

Accidental Death Insurance Insurance accepted by the insurer which is an additional insurance to a life contract and obliges the insurer to make an additional payment of compensation if the person insured meets with a fatal accident.

Accumulation of Capital Creation of a capital by regular payments into an interest bearing fund to accumulate surplus for increasing future reserves.

Actuary Expert in risk calculation of probabilities in life and accident insurance, etc. According to the wording of the new law, this term also describes a Fellow of the Canadian Institute of Actuaries.

Agency A term with three distinct meanings:

1 an organism that, within a definite area, acts as an intermediary between the insurer and the insured and is responsible for insurance production and, to some extent, administration;
2 the method of acquisition, in contrast to the system of general agents; and
3 the office in which this activity is performed.

Aggravated Risk *See* 'Substandard Risk'.

Annuitant A person drawing a pension from a natural person or a corporate body on the ground of an annuity contract or a judgment of a court of law in connection with annuity contracts; this expression is preferred to the term 'insured'.

Applicant The one who signs the policy form. He becomes the contracting partner when the policy is issued by the insurer.

Application Also called a 'proposal'. A document filled in and signed by the applicant which contains the application and gives the insurer information about the circumstances that have to be known for the evaluation of the risk to be covered.

Assets The total values which a company must possess to be able to meet its obligations to the insured persons. The law prescribes both the types of possible investments and the maximum percentage of holdings in each class of investment. The most important classes include: mortgage loans, State and private bonds, real estate, equity shares of industrial companies, loans on policies.

Auditor A person charged with the annual audit of the books and accounts of an insurance company and nominated according to the laws referring to the insurer or by the Annual General Meeting. The auditor has to be an accountant and a member of an established accountants' association and must not be a shareholder, a board member, a manager, or an employee of the insurer. The auditor draws up the annual report and this report, together with one of the board of directors, is presented to both the annual general meeting and the insurance office.

Beneficiary Person who, in the event of a claim covered by contract, shall receive the sum insured. The beneficiary may be designated so that the sum insured is payable to the policyholder, to his legal successors, or to a nominated beneficiary. If it is to be paid to the policyholder's legal successors, heirs, executors, or trustees, it forms a part of his inheritance.

Board of Directors At the general meeting, the board members are elected. If it is a joint stock company, they are elected by the shareholders and normally are shareholders themselves. In the case of a mutual society, the members elect the board of directors, all of whom must themselves be members entitled to vote. In the event of a joint stock, life insurance company issuing with-profits policies, the holders of such policies who are present at the general meeting elect at least one-third of the board members. Every board member elected in this way has to be himself a holder of a with-profits policy. The members of a mutual life insurance company, a mutual assistance society, or a fire insurance mutual are entitled to vote. An individual has to be of age. Regardless of the number or the sum of contracts, every member has only one vote, and can vote in person or appoint a proxy.

Bonus System According to this system, additional insurance can be included into a with-profits policy during the term of the contract. In such cases the share in the profits is used as a single premium for the purchase of supplementary insurance.

Certificate of Deposit Certificate to be presented by every member of a fire insurance mutual before a policy is handed over to him. The amount is fixed by the board of directors according to the regulations of the company, relative to the risk to be covered by the insurance. The term 'certificate of deposit' has to be indicated at the head of the form in a conspicuous way.

Certificate of Participation Instead of indicating all the rights and obligations of its members in the contracts, a mutual assistance society can make reference to its rules and by-laws in the certificates of participation. This method implies that the associate can claim his right to demand a copy of those rules.

Claim The happening of the event specified in the policy, as a result of which the insurer is bound to indemnify: (i) the insured in his person or in his belongings, or, in case of death; and (ii) the nominated beneficiary according to the contractual terms.

Claims Inspector A person employed directly by an insurance company or contracting with an insurance company to examine and estimate the damage and establish the allowable claim payment.

Contracting Partner Person or corporate body effecting insurance. Where a third person's life is insured and the policyholder is not identified, in the case of a group insurance contract, the contracting partner is the employer. (*See also* 'Applicant' and 'Policy Applicant'.)

Contribution Premium paid by the member of a fire insurance mutual or a mutual assistance society. The rate of contribution is fixed by the board of directors. The amount of every contribution is deducted from the one indicated in the certificate of deposit signed by the member. This term is also used for the share to be paid by a member participating in a pension or group insurance contract.

Conversion into a Mutual Insurance Company The transformation of a life insurance company issuing shares into a life insurance mutual by means of stock redemption. The plan referring to this has to be set down in special regulations approved by the majority of shareholders summoned to a meeting for this purpose. It can be carried out if it meets the requirements of the authorities controlling the company. However, the Minister has to be convinced that the conversion into a mutual society is feasible, that the capital to be raised for the redemption of stock presents no risk to the protection of the insured persons, that a certain percentage of shares is offered for sale and that the prices are fair and reasonable.

Conversion Privilege According to this privilege, which is granted under a term insurance contract, the insured, if he has paid all the outstanding premiums, may assign his policy to the insurer in exchange for a new life endowment insurance contract of which the sum insured may be equal to or smaller than the existing contract. Another examination of his insurability is not necessary and he can choose between: (i) paying the difference between the premiums paid according to the original contract and those which would have been stipulated by the new contract for the same period of time (consequently making the dates of issue of the new and the original contract identical); or (ii) concluding a new contract. In this case, the age of entry is that at the time of conversion, and the rate of premium is the one fixed by the insurer for the new type of contract.

Deposit Amount prescribed by law which has to be paid to the Ministry of Finance by every insurer requesting the granting or renewal of the concession. It has been established with a view to guaranteeing the performance of contractual obligations.

Disability Insurance Additional insurance to a life insurance contract. It binds the insurer to compensate an insured disabled through illness or injury by premium waiver or by cash indemnity.

Discharge Some industrial life insurance contracts contain the so-called 'discharge' clause. If no beneficiary is nominated, the insurer is entitled to decide in favour of certain persons such as those who have given the insured financial support or who have borne the expenses of his funeral. In this way the insurer is in a position to pay benefits without any delay and with a minimum of administration cost.

Distraint, Immunity from The proceeds of the policy do not belong to the estate of the insured. Hence his creditors do not have a legitimate claim to them if a beneficiary is nominated. In Quebec, this particular protection is to the advantage of the preferential beneficiaries, namely the insured's spouse and children. In the case of a mutual assistance society, the benefits to which the insured, the widow(er), the heirs, or the legal successors have a rightful claim are not subject to distraint.

Dividend Share of profits paid to every shareholder of a joint-stock company. According to the profit-sharing system, the contracting parties have a share in the profits realized by the company.

Extra Premium Also called 'Loading'. An additional charge imposed by the insurer in case of substandard risk. Chiefly claimed for occupational reasons, in case the insured person performs an activity that is dangerous or injurious to health or for reasons of health, if the insured is afflicted with some infirmity or disease, or because of the insured, or the insured's family's, antecedents.

Fidelity Guarantee Guarantee for every person who has responsibility for any aspect of the funds of an insurer. It assures the company and its policyholders against unfaithful performance of the obligations stated in the regulations of the company. The guarantee amount is fixed by the board of directors or a minimum amount is prescribed by law.

Funds Every mutual assistance society is bound to keep the books so that separate funds exist for the various kinds of aids and indemnities. In addition, a special fund exists for the purpose of meeting general expenses. Once a year, all these funds are balanced with the inclusion of the respective premiums and contributions.

General Manager, Officers Cadres of high rank authorized by the Board of Directors. Their rights and obligations are described in the company regulations relative to the business purposes.

General Meeting A meeting of shareholders of a joint stock company or of members of a mutual society, where the motions on the agenda are put to the vote, the annual reports of the board members are received, the board members are elected, and other items such as selection and remuneration details of an auditor may be discussed and acted upon. The general meeting is convened according to the legal rules or the by-laws of the company.

General Provisions In addition to the conditions described under 'Insurance Policy', insurance of persons has to contain the following provisions:

1 the time fixed for premium payment;
2 a table for the calculation of the surrender value;
3 a policyholder's rights regarding:
   i participation in profits;
   ii the surrender value and loans on the policy; and
   iii the transformation of the contract;
4 the terms of reinstatement;
5 the modalities of paying sums due; and
6 the term during which payments have to be effected.

Guaranteed Values Values reached by the policy after a certain period of time. They vary with the age, currency, and type of the contract, and include:

1 prolongation value, or temporary insurance of the same capital as the original insurance;
2 surrender value, or the sum reimbursed to the insured on the cancellation of his contract; and
3 reduction value, or reduced insurance of the same nature as the original insurance.

Industrial Life Insurance A life insurance contract of which the sum insured amounts to a maximum of $2,000. No participation in profits and no bonus or dividend payment. Premiums become due every fortnight or at shorter intervals, also monthly, if collected at the insured person's residence.

Insurability Determination by the insurance company as to whether insurance may be issued, modified or declined based upon individual risk factors of the applicant. Future insurability guarantees to the insured by contract an opportunity to effect an additional insurance at future specified times. Future examination of his insurability is not necessary and following increased optional insured amounts are fixed at the conclusion of the original contract.

Insurable Interest In life insurance, Insurable Interest can be defined as the policyholder's legitimate interest in the continuation of the insured life for economic reasons or family. In property insurance, it becomes relevant if a person suffers damage through the loss or destruction of property. The Civil Code says that the insurable interest must exist when loss to property occurs. In life insurance, however, it is only necessary that the insurable interest existed when the contract was issued. The degree of people's interest in their own lives is not limited. Between the creditor and debtor the life insurance interest is limited to the debt, and for property insurance against loss or damage; the interest shall not exceed the real value of the property insured.

Insurance Contract Contract by virtue of which the insurer obtains a premium or contribution and is bound to pay benefits to the policyholder or to a third party in case of an insured loss. The text of a contract is usually recorded in a document called the Policy.

Insurance Policy The document that attests the insurance contract, indicates the commencement and the term of the contract, the names of the parties and of any person to whom the sum insured is to be paid, the premium amount, the type of risk, the subject-matter of the contract, the sum insured, and contains the general provisions.

Insured An individual or a corporate body participating in the insurance by signing an insurance contract accepted by the insurer. In life insurance the insured is the person whose life is insured and who is also the applicant or

contracting party and policyholder. In a contract on the life of a third party the insured is the third party. In this case the person who contracts for coverage is called applicant, contracting party and policyholder but not the insured. In a group contract the employer negotiates with the insurer, and is generally called the policyholder. The insured persons are the employees covered.

Insurer Term which defines:

1 the insurance company; and
2 every person professionally competent in the domain of insurance. A person who, directly or indirectly, offers services as an insurer or assumes this title, effects or is bound to effect insurance, collects premiums, contributions, or other sums due by virtue of such contracts, and is bound to make the payment of insurance benefits or mutual aids.

Lapse Cancellation of a life insurance contract for non-payment of premiums at the expiration of the time fixed for payment, which is 30 days from the due date.

Liabilities Total debts, charges, and obligations of a company. The reserves provided by the articles form the principal item and are used for covering the obligations to the insured persons. The following items should be mentioned also:

1 the reserve for amounts deposited with the company;
2 the reserve for the payment of profit shares (or dividends);
3 the reserve for payments falling due;
4 the employees' pension fund; and
5 unpaid bills, etc.

The excess of assets over liabilities forms the net property of the shareholders (if such exists) and of the insured persons.

Licence
Authorization a corporate body has to obtain from the Superintendent so as to act as an insurer. The same term describes the authorization that entitles a person to bear the title of an insurance agent and to act as such. The Superintendent grants it by virtue of a special examination. Finally, a corporate body can obtain this licence, if all the persons through the intermediary of whom it acts or intends to act are authorized in such a way.

Life Insurance Agent The person charged by a life insurance company with contacting and keeping in touch with clients. A distinction is made between:

1 the full-time professional agent, whose sole occupation is the production and maintenance of life insurance; and
2 the part-time agent, who dedicates only part of his time to his pursuit.

Loading *See* 'Extra Premium'.

Member One of the founders of a fire insurance mutual or any other person who subscribes a certificate of deposit so as to obtain a policy. In case of a mutual assistance society, too, this term describes a founder or a person who subscribes an application for admission and undertakes to pay the premiums, contributions, and donations prescribed in the regulation and is willing to comply with the regulations. The term also describes a company, association, or other organized group insurance, whereas the person insured by such a contract is called a participating member.

Mutual Assistance Society According to the wording of the Insurance Law of Quebec, a mutual assistance society is an association founded with a view to using the contributions of its members for supporting those members who suffer misfortune caused by sickness, accident, and financial reverses or through the death of their children or wards. In case a member dies, the widow(er), orphans, or legal representative are supported in the same manner.

Mutual Life Insurance Company Also called a Mutual Life Insurance Society, an Insurance company that has used its surplus for the redemption of stock or originates in the transformation of a mutual assistance society. In both cases, the insured persons are the owners of the company and are entitled to elect the board members.

Participation in Profits The clause of an insurance contract according to which the insurer is bound to give the policyholder of a participating contract a share in the profits made by the company. The insured persons are obliged to accept the distribution of the profits arranged by the board, as it is stated in their contracts. While it would be expected that joint stock companies issued non-participating policies and mutual societies with-profits policies, the majority of joint stock companies issue with-profits policies. Hence they are bound by law to distribute at least 90 per cent of the profits gained from this category of business to the insured persons. On the other hand, mutual societies also issue non-participating policies.

Policy *See* 'Insurance Policy'.

Rating This term has two distinct meanings:

1 a general statement of the premium rates applicable to all age groups and arranged according to the various combinations of contracts offered by the company or, in property insurance, according to the types of construction, isolation, fire, etc.; and
2 the fixing of the premium for a given contract.

Reinstatement Also called 'Revival'. Restitution of a life insurance contract that has been cancelled for non-payment of the premium. Within two years

after the cancellation, the policyholder has to make an application, which is granted on the condition that the insured complies with the terms of insurability, makes payment of the overdue premiums and reimburses the advances plus interest.

Re-insurance Process according to which an insurer (assignor) transfers part of the risk to be covered to a re-insurer (assignee).

Re-insurer Insurance or re-insurance company that shares the risk with the insurer by underwriting the excess of the insured limit or a part of the risk assumed by the insurer for the purpose of setting a limit to the insurer's loss of property. The insurer pays a premium adequate to the risk assigned to the re-insurer.

Reserve Fund Fund established by the board of directors of a fire insurance mutual when the contributions are fixed. It is built up with the surplus remaining to the company after deduction of the ordinary expenses and losses and may be used for balancing the annual contribution and for the adjustment of damages. The annual contribution levied for this fund amounts to 10 per cent of the amount fixed in the certificate of deposit.

Revival *See* 'Reinstatement'.

Substandard Risk Also called Aggravated Risk. Risk not acceptable at normal or ordinary conditions because of the occupation, previous history of the person insured or poor health of the person. Risks of this kind entail additional premiums and may even be rejected by the insurer.

Sum Insured Sum guaranteed by contract, exclusive of supplementary insurance benefits (such as double indemnity in case of death by accident). This amount is usually indicated on the first page of the policy.

Superintendent of Insurance The Superintendent directs an insurance office, under the control of the Minister of Financial Institutions, Companies, and Cooperatives. In Québec, the Superintendent and his or her staff are treated in accordance with the civil service law. Charged with the control of the insurance transactions, the Superintendent has access to all the documents relative to insurance transactions and in possession of a person acting as an insurer or insurance agent. It is this office that licenses an insurance company or insurance agent.

Japan

Financial structure

A mutual (insurance) company has no capital. For establishing a mutual company, it is necessary, however, to raise a certain amount of money, called a foundation fund. It serves for starting up business activity and as a guarantee to

the policyholders. This fund is a kind of debt from a third party to be paid off in the future. It is prescribed by the Insurance Business Law that a certain amount of money necessary for the repayment should be appropriated as a redemption each business year. A mutual company is required to set aside a reserve that is used for making up the general losses which may occur in the future.

Management

The bodies of a mutual company are subject to the provisions of the Insurance Business Law but many sections of Commercial Law are binding on a mutual company by virtue of statutory references (Kogawa 1992). The company is managed by the bodies detailed below.

General assembly of members

The Insurance Business Law provides that every mutual company must have, as a rule, a general assembly of members, but that it may, in its articles of incorporation, provide itself with a body to take the place of the general assembly of members. In practice, a mutual company has determined that the general meeting of representatives of members is almost the same as that of the general assembly of members. This body decides all questions of special importance relating to the constitution and existence of the mutual company, such as amendment of the articles of incorporation, winding-up of the company, transfer of contracts and amalgamation. This general meeting of representatives of members elects members of the board of directors.

Board of directors

This board has the exclusive right to decide the conduct of the business, but has no title to represent the company in dealing with third parties. The representative(s) of the company are elected from the directors by the board. Directors are called to keep the articles of incorporation, the proceedings at the general assembly and of the directors' meeting at the office, and a list of members and inventory, a balance sheet, a business report, a profit and loss account, and minutes of resolutions relating to the amortization of the foundation fund, the payment of interest thereon, the reserve and the distribution of surplus at the head office.

Auditors

Auditors are elected by the general meeting of representatives of members and are entitled to scrutinize the accounts of the company. Every auditor or the committee of the auditors has a right of access at all times to the books and papers relating to the accounting of the company and is entitled to require from

the directors explanations concerning the accounts. Auditors must submit to the general meeting of representatives of members a report on the accounts presented by directors and examined by themselves.

Glossary of legal and contractual terms and procedures

Action calling the director to responsibility The members representing not less than 300 members may, in writing, demand the company to bring an action to call the director to account.

Actuary A life insurance company shall appoint an actuary to be in charge of matters relating to insurance calculations such as the basis of calculating premiums and liability reserve. The actuary shall acknowledge and confirm the correctness of the accounts in the documents to be filed with the Minister of Finance by the company.

Advisory Council Council, consisting of business leaders, professors and representatives of consumers chosen from outside the company, and which may be set up to consider constructive comments regarding the management.

Amalgamation A mutual insurance company may amalgamate with another mutual insurance company. In this case, the surviving company after amalgamation or the new company shall be a mutual company. In the case of an amalgamation of a mutual company with a stock company, the surviving company or new company may be a stock company.

Auditor Every auditor has a right of access at all times to the accounting books of a company and is entitled to require explanations concerning the accounts from the directors. The accounts, examined by auditors, must be presented to the general meeting of representatives of members.

Board of Directors A body elected by the general meeting of representatives of members and having the exclusive right to decide the conduct of the business. Representative directors elected by the board of directors represent the association when dealing with third parties.

Cause of Termination of Membership Membership is terminated for any cause specified in the articles of incorporation or by the extinction of the relationship of insurance.

Claim for Repayment The withdrawing member may, in accordance with the provisions of the articles of incorporation, or of the insurance policy conditions, demand the repayment of the sum to which he or she is entitled.

Deposit The persons filing an application for a licence to transact insurance business may be required to deposit a proper amount when the Minister of Finance deems it necessary. And, when considered necessary, in view of the

situation of affairs or assets of an existing insurance company, he may order the deposit of assets, or may issue other orders necessary for its supervision.

Dissolution Winding up of a mutual company can take place on expiration of the term in the articles of incorporation, by resolution of a general assembly of members, amalgamation of the company, by transfer of all insurance contracts, by bankruptcy of the company, by cancellation of the licence, or by judgment of a court ordering dissolution.

Distribution of Remaining Assets Except as otherwise provided for in the articles of incorporation of the company, the remaining assets after liquidation shall be distributed among the members at the time of the company's winding up, in the same ratio as the distribution of surplus.

Distribution of Surplus Surplus may be distributed among the members qualifying under the articles of incorporation at the end of each business year, according to the decision of the general meeting of representatives of members.

Documents to be Produced to the Minister of Finance An insurance company shall close its books as on the last day of March each year, and shall, without delay after the conclusion of the general assembly, produce an inventory, a balance sheet, a business report, a profit and loss account and minutes of resolutions relating to the amortization of the foundation fund, the payment of interest thereon, the reserve and the distribution of profits or surplus for the Minister of Finance. These documents should be offered to the policyholders, insured persons or beneficiaries, for inspection.

Exception in Valuation of Shares If the market price of a share listed on the securities exchange market, which is held by an insurance company, exceeds its acquisition cost, the company, with the approval of the Minister of Finance, may mark its price ranging from more than its acquisition cost to less than its market price. This valuation profit (unrealized capital gain) must be funded as a reserve for policyholders of the company. (See 'Principle of Assets Valuation' and 'Reserve Provided for in Article 86 of the IBL'.)

Founder Members To incorporate a mutual company, at least seven founder members are necessary. They must make out articles of incorporation and make available the fund necessary for the company and assemble initial members (policyholders) of more than 100 in number.

Foundation Fund The amount of money provided by founders and contributors towards the foundation fund upon the formation of a mutual company and designed to serve as a guarantee and operating fund; this fund is in the nature of a loan rather than a capital and must be amortized in the future. The IBL provides that a mutual company must have a foundation fund of 30 million yen or more.

General Assembly of Members and **General Meeting of Representatives of Members** A mutual company has a general assembly of members as a final

decision-making organ, comparable to a joint stock company's general meeting. The general meeting of representatives of members may be substituted for that of members.

Incorporation of a Mutual Company A mutual company may be organized by the following procedures:

1 making out the articles of incorporation by founders;
2 drawing original members, more than 100 in number;
3 setting out of the foundation fund;
4 convening the constituent general assembly; and finally,
5 registration of incorporation.

Insurance Business Law (Law No. 41, 1939) The Insurance Business Law consists of two main parts:

1 insurance supervision articles; and
2 articles relating to rights and obligations of members and to formation, management, and winding-up of a mutual company.

Insurance Company In the Insurance Business Law (IBL) it is stipulated that insurance business may be carried on only by joint stock or mutual companies with a capital or foundation fund of 30 million yen or more.

Interdiction of Carrying On Any Other Business An insurance company is, as a rule, prohibited from carrying on any other business. But a life insurance company may be authorized by the Minister of Finance to grant a policyholder a loan on his policy up to the amount of the surrender value.

Liability or Mathematical Reserve An insurance company must calculate a liability reserve according to the type of its insurance contracts every financial year and shall make entries in the books specially provided for this purpose.

Licence to Insurance Business Only companies licensed by the Minister of Finance may carry on insurance business. In applying for a licence, an insurance company must offer to the Minister of Finance such documents as articles of incorporation, a document showing the method of carrying on the business, etc.

Limited Liabilities of the Members of a Mutual Company Members of a mutual insurance company are not personally liable for the debts of the company and have no obligation to pay supplementary amounts over and above the premiums already paid.

Liquidation Bringing to an end the outstanding business of a company being wound up. It is carried out in the following order:

1 collection of debts;
2 realization of the remaining assets;
3 setting of claims of the company's creditors;
4 repayment of the foundation fund; and finally
5 distribution of remaining assets to the then members.

Mutual Insurance Company A legal person or body which is incorporated according to the IBL and grants insurance cover to its members against contributions. It is called an 'in-between corporation', neither a public service corporation nor a commercial company.

Mutualization of a Stock Company Alteration of a company's structure from a joint stock insurance company into a mutual company in accordance with a certain procedure, such as the passing of a resolution of the general meeting of shareholders or the approval of the Minister of Finance, is provided in Articles 19–31 of the IBL.

Particulars to be entered into the Register of Members In the register of members, the following particulars must be entered:

1 the names and domiciles of the members; and
2 the class of insurance, the amount insured and the corresponding premium for the insurance of each member.

Principle of Assets Valuation In cases of assets valuation, an insurance company must, as a general rule, be based on the cost principle provided in the Commercial Law and also the principle of conservatism (not conservation?) in order to ensure the solvency. (*See* 'Exception in Valuation of Shares'.)

Prohibition of Composite Management of Life and Non-life Business An insurance company is prohibited from doing life and non-life business concurrently. A life insurance company, however, may carry on *re-insuring* life insurance.

Reduction of the Amount Insured A mutual company shall have provisions in its articles of incorporation regarding a reduction of the amount insured. Most articles of incorporation describe that a reduction of the amount insured shall be the last resort in the event of an abnormally high loss.

Reserve Provided for in Article 86 of the IBL A legal reserve is provided for in Article 86 of the IBL. It was originally established for keeping the income and outgoings of the company from the influence of accidental profit and loss caused by the selling and buying or valuation of the assets. Hence, the profits should be allocated to this reserve, whereas the losses should be made up by withdrawals from it. With the sanction of the Minister of Finance, the profits may be used for other purposes wholly or in part.

Reserve to Make Up for Losses For the purpose of making up for losses, a mutual company shall set aside a reserve out of surplus for each business year. The total amount and the minimum amount thereof to be laid aside each year shall be determined by the articles of incorporation.

Selection of Representatives of Members A selection committee nominates the candidates for the representatives. Those nominated take up the posts of representatives, unless more than a certain portion object to the nomination within one month.

Finland

Actuary Every life insurance company must employ an actuary who is charged with mathematical calculations. The Ministry of Social Welfare stipulates the conditions with which the actuary must comply so as to be able to exercise his functions.

Articles The articles contain provisions such as those which lay down the title, field of activity, organization and representation of the company, as well as the rights and obligations of the members. The articles have to be ratified by the supervisory authority (the Ministry of Social Welfare and Health).

Auditor The general meeting elects at least two auditors (and their deputies), who are charged with checking the books and the balance sheet.

Board of Directors of an Insurance Company The board of directors must consist of at least three members and is elected by the general meeting or the board of administrators.

Bonus All surplus of life insurance has to be paid back to the policyholders. The repayment is effected according to certain rules laid down in the articles or in the general policy conditions.

Chairman of the Board of Directors The Finnish legislation permits the Chief Officer (General Manager) to be also chairman of the board of directors.

Company Report For each financial year the board of directors has to draw up a company report that covers the activities of the company and comments on the closing of accounts.

Concession Permission by the government to make insurance transactions. In connection with the grant of the concession, the articles of the company are ratified.

Control Office Organ established for the annual checking of the management, the books, and the balance sheet.

Establishment, Institution In earlier legislation this term was synonymous with the (insurance) company. It is no longer used in this sense.

General Manager of an Insurance Company The General Manager is nominated by the board of directors or administrators. The articles normally contain provisions relating to the obligations and liability of the General Manager, who may be a member of the board of directors or a person not affiliated with this organ.

General Meeting The supreme organ of an insurance company where, in case of a mutual society, the members exercise their rights to vote. The powers of the general meeting can be delegated to a special meeting of sub-committee elected by the policyholders.

Guarantee Fund According to the law of 30 December 1952, a guarantee fund is required for the establishment of a mutual. In circumstances defined in the articles, the holder of a share in the guarantee fund (guarantor) may be entitled to vote.

Insurance Business According to the law of 30 December 1952, insurance can only be transacted by joint-stock or mutual companies. A concession has to be granted by the supervisory authority. The law contains separate rules of company law for stock companies and for mutuals as well as some types common to both.

Insurance Company The insurance company law in force at present was promulgated on 30 December 1952. An insurance company is either a mutual or a joint-stock company. The law contains provisions that specifically apply to the mutual or the joint-stock type as well as others common to both of them.

Insurance Supervisory Authority Official organ charged with the supervision of private insurance. According to the law of 30 December 1952, every insurance company is subject to supervision. The Ministry of Social Welfare acts as supervisory authority.

Meeting of Sub-committee Body elected by the members of a mutual insurance company entitled to vote; the members of the sub-committee must be members of the company (*Yhtiokokous* and *Edustaja*).

Member The individual or corporate body taking out an insurance policy and, thereby, becoming a member of a mutual society.

Merger The assets and liabilities are transferred from one company that is generally to be dissolved into another.

Mutual Insurance Company Also called a mutual insurance society. In principle, the policyholders of a mutual insurance company are its owners and are usually held responsible for its liabilities. Both the mutuals and the stock companies are subject to the control of the supervisory authority, that is to say, they are State-controlled.

Obligation to Pay an Additional Contribution A kind of extra payment of a supplementary amount over and above the premiums already paid. It has to be

laid down in the articles of a mutual whether and to what extent the policyholders are responsible for the liabilities of the company. If necessary, the articles must contain the principle according to which the personal liability of a member can be claimed.

Outstanding Claims Reserve Reserve for pending claims (damage) which has to be indicated as a special item on the balance sheet. The supervisory authority gives directions about the calculation of the outstanding claims reserve.

Parent Company The company that owns more than half the shares (or votes) of another stock company. The two companies form a combine. A combine-like arrangement can also occur between two mutuals if, in accordance with the articles, one of them assigns to the other a decisive number of voting rights at its general meeting.

Perpetual Insurance Fire insurance on house property, in a contract without specified expiration dates. Since 1967, insurance of this type has no longer been effected. A single premium or premiums for a limited period of time is charged.

Principle of Adequacy According to the law of 30 December 1952, the amount paid for the insurance, that is to say the premium (reduced by possible surplus amounts), shall be in adequate proportion to the insurance benefits.

Proxy It has to be stated in the articles of a mutual whose policyholders employ their rights to vote directly to what extent the voter may appoint a representative in his or her place. In a meeting of the sub-committee representing the members, the right to vote has to be exercised personally.

Representative In principle, the mutual insurance company policyholders are entitled to vote at the general meeting. However, in accordance with the articles, the powers of the general meeting can be delegated to a meeting of a sub-committee whose members are elected by the members of the company, a customary practice for a large mutual.

Reserve Fund Reserves that form part of the company's own capital. According to the law in force at present, the reserve fund is no longer compulsory.

Supervision The insurance companies are subject to the control of the Insurance Department of the Ministry of Social Welfare and Health. The powers of the supervisory authority are regulated by the law of 30 December 1952.

Supervising Authority Insurance Department of the Ministry of Social Welfare and Health.

Transfer of Insurance Portfolio According to the law of 30 December 1952, an insurance portfolio can be entirely or partly transferred from one company to another. This cession depends on the permission of the supervisory authority.

Appendix 4

GLOSSARY OF ISLAMIC FINANCIAL TERMS

bai bithaman ajil Contract of sale of goods on deferred payment, either lump sum or instalment.

fatwa A religious decree.

fiqh Islamic jurisprudence, interpretation of the *Shari'a* religious law.

gharar Deception involving deliberate creation of, or exploitation of, uncertainty as with gambling.

halal Permissible under the *Shari'a* religious law.

ijara Leasing contracts whereby a bank purchases equipment on behalf of a client.

ijara wa iqtina As *ijara* but the purchaser owns the equipment at the end of the contract.

jahala Ignorance.

Mudaraba Trust financing where there is an agreement between two parties, one of whom is the *rab-al-maal* (financier), the other the *mudarib* (entrepreneur). The profit is shared out in accordance with the contract, the entrepreneur being rewarded for his efforts and the financier (who can be the bank or an individual) for the use of his capital and the risk in providing the capital.

Murabaha Cost-plus financing involving a contract between a bank and its client for the resale of goods at a price which includes a profit margin agreed by both parties, as owner the bank retains responsibility for the goods until they are resold.

Musharaka A partnership agreement between two or more parties whereby they jointly finance a project with profit shared according to a pre-agreed ratio, and losses shared in relation to the equity holding in the project. An entrepreneur's share of the profit may exceed his liability for losses, reflecting the effort he puts into the project. A method of Islamic venture capital funding.

qard al hassan An interest-free loan.

rabb-al-maal Financier or investor.

riba An addition to the principal of a loan, usually interpreted as interest payment or receipts for both commercial and private loan.

riba al-fadl Interest involved in barter.

Shari'a Islamic religious law derived from the Quran and the *Hadith* (sayings of the Prophet Mohammed).

Sunna Practice and traditions of the Prophet Mohammed.

ta'min Insurance.

Takaful Islamic insurance provided under the principle of mutual support.

waqf Property the income from which is used to help the poor and needy. *Waqf* property cannot be bought or sold, and is usually administered by a religious foundation.

Zakat A religious tax applied annually to wealth in the form of liquid assets at the rate of one-fortieth of the value of the assets. The revenue can only be used for charitable purposes such as helping the poor or the needy.

NOTES

1 THE MEANING OF INSURANCE IN ISLAM

1 Al-Ghazali, Ihya' Ulum el-Din (Revival of Religious Sciences) has devoted one of four volumes to worship. He discusses the knowledge, articles of faith, secrets of purity, prayer, fasting, pilgrimage, the rules of reading the Quran, invocations and supplications and observation of daily duties according to fixed times.

2 On the authority of Abu-Hurairah, *Hadith* No. 158 of Al Ahadith al-Kodsi'a, Dar al Toras, Cairo, 1980.

3 As if to emphasize again a warning against deadening familiarism, we are given a beautiful description of the righteous and God-fearing man. He should obey salutary regulations, but he should fix his gaze on the love of God and the love of his fellow man. We are given four heads: 1 Our faith should be true and sincere; 2 We must be prepared to show it in deeds of charity to our fellow man; 3 We must be good citizens, supporting social organization; 4 Our own individual soul must be firm and unshaken in all circumstances. Although they are interconnected, they can be viewed separately. Faith is not merely a matter of words. We must realize the presence and goodness of God. When we do so, the scales fall from our eyes. All the falsified and fleeting nature of the present cease to enslave us: His power (angels), His messengers and His message are no longer remote from us, but come within our experience. Practical deeds of charity are of value when they proceed from love, and from no other motive. In this respect, our duties also take various forms, which are shown in reasonable gradation, our kith and kin, orphans (including any persons who are without support or help), people who are in real need but who never ask (it is our duty to find them out, and they come before those who ask), the stranger, who is entitled to laws of hospitality, the people who ask and are entitled to ask, i.e. not merely lazy beggars, but those who seek our assistance in some form or another (it is our duty to respond to them), and the slaves (we must do all we can to give or buy their freedom). Slavery has many insidious forms, and all are included. Charity and piety in individual cases do not complete our duties. In prayer and charity we must also look to our organized efforts: where there is a Muslim State, these are made through the State, in facilities for public prayer, and public assistance and for maintenance of contracts and fair dealing in all matters. Then come the Muslim virtues and patience. They are to preserve the dignity of man (Yousuf 1938: 69–70).

4 This is addressed to all mankind and not only to the Muslim brotherhood, although it is understood that in a perfect world the two would be synonymous. As it is, mankind is descended from one pair of parents. Their tribes, races and nations are a convenient label by which we may know certain differing characteristics. Before God they are all one, and He gives most honour to who is most righteous (Yousuf 1938).

5 On the authority of Abu-Mohammed Abdullah, the son of Omar ibn al-As, *Forty Hadith No. 41*.
6 Al-Tabari: Jaffar Mohammed Jarier, *Tafsir al-Tabari, Jamaa al-bayan fi Tafsir al-Qurán*.
7 Ibid.
8 The spiritual and moral duties are now brought into juxtaposition. We are to worship none but God, because none but God is worthy of worship, not because 'the Lord thy God is a jealous God, visiting the iniquity of the fathers upon the children unto the third and fourth generation of them that hate me . . .' (Exod. 5). Note that the act of worship may be collective as well as individual, hence the plural (*ta'budu*). The kindness to parents is an individual act of piety, hence the singular (*taqul*, *qul*, etc.). The metaphor is that of a high-flying bird which lowers her wing out of tenderness to her offspring. There is a double aptness: 1 When the parent was strong and the child was helpless, parental affection was showered on the child. When the child grows up and is strong, and the parent is helpless, can he do less than bestow similar tender care on the parent? 2 But more: he must approach the matter with gentle humility: for does not parental love remind him of the great love with which God cherishes his creature? There is something here more than simple human gratitude: it goes up into the highest spiritual region (Yousuf 1938).
9 In the Jewish Decalogue, which was given to a primitive and hard-headed people, this refinement of kindness, to those in want and to wayfarers (i.e. total strangers whom you come across) finds no place. Nor was there much danger of their wasting their substance out of exuberance. Even the command 'to honour thy father and mother' comes after the ceremonial observance of the Sabbath. With us the worship of God is linked up with kindness to parents, kindred, those in want, those who are far from their homes though they may be total strangers to us. It is not mere verbal kindness. They have certain rights which must be fulfilled (Yousuf 1938).
10 *Hadith* related by al-Bukhari (author unable to find page reference).
11 Abdeen, Mohammed Amin Bin Omer Bin Abdel Aziz Aldemashqy (1784–1836) was born and died in Damascus. He was the most influential jurist of his time (Rad Al-Muhtar ala Al-dar Al-mukhtar (repr. 1966)).
12 See *Hadarat al-Islam Magazine*, Vol. 2, 1st Issue: 37.
13 Postscript, part 3, line 273, published by Dar el-Kutub Al-Arabia al-Kubra, Egypt.
14 Mohammad Al-Bahi (1967: 192, 203) sees in the insurance contract a juxtaposition of a solidarity contract and a *Mudaraba* contract, 97–98 concerning the draft of the new Egyptian Civil Code.
15 *Mudaraba* contracts issued by *Dar al-Mal al-Islami* Trust – Geneva under which the heirs of the contractant obtain, in case of death of this latter before his 60th birthday, the returns that the contractant was entitled to receive and the sum of the contributions that the insured would have paid had he lived to the age of 60. See Appendix 1.
16 Only Hanafi and Hanbali allow the *Mudaraba* with a fixed duration (Ibn Qadumah 1972: 5:69–70).
17 The contract of *Mudaraba* is concluded by using *Mudaraba*, *girad* or similar words (Ibn Qadumah 1972: 5:22).
18 Uways cites the decisions of the *al-Majaal-Fiqhi* forbidding commercial insurance and stating that insurance cannot be considered a *Mudaraba* contract. See also Bakhit (1906: 4–5) and Sayyed (1981a: 194–6).
19 Attempted by a number of 'Islamic' insurance schemes (e.g. Dar al-Mal al-Islami Trust).
20 In Hanbali law, only the clause would be invalid (Ibn Qadumah 1972: 5:64–5).
21 Art. 19 of the ITC: *Mudaraba* deprives the 'insured' from his right of contracting out during the first two years of the *Mudaraba*.
22 Even this has been contested (Homoud 1985: 214).

23 The Malaysian Islamic insurance company (*Takaful* Company – *Syarikat Takaful Malaysia Sendrian Berhard*), operating under the Malaysian *Takaful* Act 1984 aiming at regulating Islamic insurance companies (see above) mentions in its 'Family Takaful Plan and Takaful Mortgage Plan' that the plan is 'run on the basis of the principle of *al-Mudaraba*'. One can also read: 'I hereby agree that on the basis of the principle of *al-Mudaraba* and other related principles of *Shari'ah* . . .'. Apart from such allusions to *Mudaraba* the whole contract contains a life insurance policy with the specific feature that the investment of the premiums is done in a manner not contrary to the *Shari'a* and that the benefits are payable to the heirs of the insured, although one of the incentives for saving under the scheme is to secure a sum of money specifically for the dependants of the insured.
24 See the *Shorter Encyclopedia of Islam*; the English synonym used is 'endowment'.
25 This point is subject to a controversy in Hanbali law where some scholars required such a consent (Ibn Qadumah 1972: 546).
26 Except for the Maliki; see Al-Khafif (1941: 397).
27 Ibn Qadumah (1972: 5:585).
28 'If one offers *badana* [i.e. a camel for sacrifice] or something else in Allah's cause he is allowed to benefit from it in the same way as others benefit from it even if he did not stipulate that' (Sahih Al-Bukhari: Book of Wills and Testaments: 4:13).
29 Opinion of Mohammad Shafi (Jurisconsult, Dar al-Ulum, Karachi) cited in the thesis of Mohammad Muslehuddin (1966: 163–4).
30 The idea would be to constitute a common *waqf* administered for a remuneration by a *mutawalli* (the insurer) responsible for managing the *waqf* in a profitable way. The beneficiaries designated by each founder (the other insureds) would receive from the *waqf* an amount of money in compensation for a loss that they eventually suffer.
31 In application of the *Hadith* 'It is better for you to leave your inheritors wealthy than to leave them poor begging others' (Al-Bukhari 1386 AH, Book of Wills and Testaments: 4:3; Chapter II, *Sahih Muslim*: 3:1251, Book 25 *Hadith* 5 (1628); and Ibn Hanbal 1986: 1:173).
32 Except in Maliki law, (*Al Musnad*: 173).
33 The clause enabling the *nazir* (manager) to give from the *waqf* to the beneficiary that he chooses is valid because this does not constitute an exclusion of a beneficiary from the *waqf*. It only makes his entitlement to receive from the *waqf* conditional upon a qualification.
34 In the context of an eventual insurance scheme the *waqf* is not in itself conditional, which would have rendered it void (according to all Sunni schools except for Maliki). Only the payment of benefits is conditional upon an uncertain event.
35 Except for *waqf* for charitable purposes (Ibn Qadumah 1972: 5:587).
36 For the *Hanafi* the onerous donation is a donation in respect of its formation and a sale in respect of its effects.
37 For a detailed discussion see Muslehuddin (1966: 272–4).
38 Ibn Qayyim considers that the aleatory sales prohibited by the Prophet fall either under the heading of *riba* or gambling (Ibn Qayyim 1968: 2:7).
39 See Yusuf al-Qardawi (1962: 12(6):51), where the author compares *Bayt al-Mal*, i.e. the Islamic public treasury, to a national insurance company.
40 *Mudaraba* companies and *Mudaraba* (Floatation and Control) Ordinance, 1980. Source: *Islamic Studies*, Vol. 24, No. 1–1985, pp. 67–85, also in *The Gazette of Pakistan, Extraordinary* (26.6.1980) pp. 388–400.
41 Respectively Act No. 276, and Act No. 312. This latter enactment will be discussed later.
42 *Malaysian Takaful Act*, S. 3–5 (b).
43 Ibid., S. 16–1.

44 Ibid., S. 27–1.
45 Ibid., S. 37–1.
46 Namely the Banking Act 1973 (Act No. 102), the Companies Act 1965 (Act No. 125), and The Central Bank of Malaysia Ordinance 1958 (No. 61).
47 *The Official Gazette of Turkey*, Dec. 1984: 58–9.
48 Ibid., Jan. 1985: 56.
49 Ibid., Dec. 1983: 19.

2 *RIBA* (USURY) AND *GHARAR* (RISK)

1 Al-Naysaburi, Abu Hassan Ali Ahmed al-Wahdi, *Asbab al-Nazoul fi al-Quran*.
2 The Quranic verses forbidding *riba* are: II / 275, 276, 278, 279, III / 130, 131, 132, 133, 134, 135, 136, 137, 138, 139, IV / 161. These are in addition to the following fundamental *Hadith*: 'Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, measure for measure and hand to hand. If the articles are of different species, exchange them as you wish, the exchange being made hand to hand' (Muslim, Sahih, *Book of Musaqat*, *Hadith* 81).
3 These are: 1 Not submitting to the oneness of God; 2 Making magic; 3 Killing another person for no valid reason; 4 *Riba*; 5 Stealing orphans' wealth or inheritance; 6 Avoiding going to war when called for for the faith; and 7 Avoiding malicious scandal against unchaste women.
4 A narrower definition is given by Ibn Abidin who sees *gharar* as the uncertainty of the existence of the subject matter of a sale (Ibn Abdin 1966: 4:147).
5 No differentiation in detail will be made between *gharar* and *juhala* in this work and it is the broad meaning of *gharar* comprising *juhala* which will be considered, so that *gharar* will be contemplated not only as the uncertainty affecting the existence of a contract or an obligation included in it but also the ignorance of one of its essential elements, like the nature of the subject matter of the contract or its quantity. (See al-Sanhuri 1934: 2:49.)
6 Ibn Taymiyyah expressly cites lack of knowledge of the nature or kind or quantity of the subject matter as a sort of *gharar*.
7 See also Ibn Taymiyyah 1985: 29:22.
8 This saying has also been reported by Abu Dawud (*Al-Bukhari*, *Hadith* 3376). 'Sales by throwing stones' refers to a pre-Islamic transaction whereby the sale is concluded on the throwing of a stone.
9 See also the following *Hadith*: 'The Prophet peace be upon him has prohibited two sales in one' (Ibn Hanbal 1986: 2:174–5).
10 See also Al-Qarafi 1927: 150–1; Al-Hattab 1938: 6:51.
11 See also Muslehuddin (1975): 59.

3 PRE-MODERN AND MODERN *JURISTS'* STANDING ON INSURANCE

1 This *fatwa* was issued in Safar of 1319 Hijri, and published in the magazine *Almuhamah*, Volume 5, Issue 460: 563.
2 Distinguished scholar, one well known for his views on Islamic *muamalat*.
3 Sheikh Mohammed Bakheit bin Hussein el-Muteiay el-Hanafi, the Grand Mufti of Egypt and one of the greatest jurists, lived 1854–1935. An author of many important books.
4 An Egyptian erudite, graduate of al-Azhar. The Grand Mufti of Egypt 1925.
5 An Egyptian scholar born 1874. Studied in al-Azhar and Dar el-Ulum; formerly a member of the Linguistic Academy. Author of many books.

6 Sheik Mohammad el-Molky, Islamist scholar, died 1956; one of his books is *al-Arowat al-Wosqah*.
7 Published in *Al-Azhar* Magazine, Vol. 25, Part 2: 23.
8 An Egyptian erudite, graduate of al-Azhar, formerly manager of the Arabic and Religion Inspection department of al-Azhar.
9 Egyptian jurist, 1899–1963; graduate of al-Azhar. He gained a PhD in Philosophy from France.
10 A lecturer in Islamic Jury and Civil Law at the Faculty of Law, Damascus University.
11 Section 11 of the Pension Scheme specifies that the Insurance money should be sent to the legal inheritors, unless the beneficiary has appointed other beneficiaries before his death to whom the money should be sent. That would conflict with the inheritance system of *Shari'a*. If the employee were allowed to do that, he would be depriving the legal inheritors from their rights, accordingly hindering the implementation of *Shari'a*.
12 The source of these points is *The Islamic Jurisprudent Week*, page 511. However, the author is unable to find the year or volume number.
13 Al-Dasuqi (1967: 83) listed the scholars who prohibit all kinds of insurance: 1 Al Motayy, Mohammad Bakhit, Mufti of Egypt, 1910; 2 Quraa, Abdul Rahman, Mufti of Egypt, 1925; 3 Ibrahim (1941: 3:8); 4 Egyptian High Islamic (*Shari'a*) Court, Judgment date 28 December 1907; see Issa (1978: 125) and Al-Sanhuri (1934: 1:158); 5 Tagg (1972); 6 Al-Qulqaly 1978: 110; 7 Makhloof, Mohammad *Abdel Hadi*; 8 Alyan (1987); 9 Gamal (1930); 10 Issa (1978); 11 Prince Al-Saud, Mohammad Al-Fisul, Chairman of Dar al Hal al-Islami; 12 Shaarawi (1977); 13 Al-Khali (1987); 14 Ali, Mohammad, Banna (1974), *Lewaa al-Islam*, issue 11; 15 Al-Naqar (1973); 16 Committee of *fatwa*, Al-Azhar, Egypt, *fatwa* date 24 April 1958; and 17 Al-Zarqa (1962).
14 1 Abu Zahra (1982); 2 Al-Darir (1987); 3 Kassem; 4 Hasan (1976); 5 Al-Dasuqi (1967); 6 *Al-Najd, Ahmed, Abdul Sattar Zohow*, Aqd al Ta'min baynal Shaí'ah a wal Qanon, 1972; 7 Saad (1983); 8 Majm'a al Abahath al Islamiyya, Committee for Islamic Research Conference, June 1965; 9 Al-Gharib (1979); 10 Al-Fangari (1984); 11 Lasheen (1981); 12 Nasser (1974); 13 Sharaf al-Din (1982); 14 Nadwat al Tashiaa, Conference for Legislations, Libya, 1972; 15 Al-Almi, Al Toatomar (1976), *Ill iktisad al Islami*, International Conference for Islamic Economics, Mecca; 16 Hayat Kabar al Olmaa (1977), The Association for Prominent Jurists in Saudi Arabia; see Appendix 1; 17 *Magmaa Al Fiqhi al Islami wa Rabatad al Alam al Islami*, Islamic League (1978).
15 In *Mejalat Al Fikr al Islami* (March 1988: 16), there was a survey containing the following scholars who approved all kinds of insurance: 1 Al- Mohammad, Abdullah Sayam, 1932 (he was the first scholar to allow all kinds of insurance); 2 Al-Zarqa (1962); 3 Khafif, whose opinion was presented to the 1967 International Conference for Islamic Economics in Mecca; 4 Al-Sayeh, Abdel Hamid, President of the Jordanian Court. His opinion was submitted to *Majma al Bohuth al Islamiyya*; 5 Al-Bahi (1967); 6 Al-Sanhuri (1964: Vol. 7); 7 Awad (1962).
16 1 Al-Thaalby, Mohammad Bisr Al Hassan; 2 Al-Hilar, Taki al Din; 3 Malik, Ramzi, Mufti Lebanon; 4 Mabrook, Mohammad; 5 Al-Sanhuri, Mohammad Faraq.
17 Al-Nadwa, Mohammad Ishaq, reported on: Ala al Islami, Vol. 10, No. 7, pp. 61–6. Resolution of the Lucknow Conference, 15–16 December.
18 Position of Mohammad Abu Zahra reported in *Mesrati* (1984).
19 The only exception to this principle are *ex gratia* payments made by the insurer, which are a matter of company policy and do not have any impact on the nature of the insurance contract from a legal point of view.
20 Prophet Mohammed said, 'Do not sell the fruit until their good condition becomes evident', *Hadith* 3675, book 9, Sahih Muslim.

21 Moghaizel states that *riba* is not applicable to the insurance contract. Such a conclusion is not quite right. Although *riba* was prohibited not with insurance in mind, we cannot be certain that an insurance contract is free from the element of *riba*, as in most insurance the premium is reinvested and the difference between the premium paid and claims (if made) has an element of *riba*.
22 With the exception of gifts made during the death or sickness (*marad*) of the donor, which are treated as a will. See Al-Kasani (1986): 7:98).
23 Breach of a promissory warranty entitles the insurer to repudiate the contract from the date of the breach. Section 38–1 of the Marine Insurance Act, 1906 states: 'In a voyage policy there is an implied warranty that at the commencement of the voyage the ship shall be seaworthy for the purpose of the particular adventure.' Section 55-2-a of the Marine Insurance Act, 1906 provides that 'The insurer is not liable for any loss attributable to the wilful misconduct of the issued.'
24 The author adds that the intention of the policyholders to donate the premium must be expressed in the articles of association of the insurance company.
25 See *Majma' al Buhuth al Islamiyya* (1965), Conference of Islamic Economics. The conference covered cooperative and, particularly, mutual insurance. Contributors to the conference and researchers following the conference supported their views. Some of these were: 1 Al-Dasuqi Mohammad (1966); 2 Al-Gorff, Mohammad Makky Sadi (1973); 3 Al-Kamal, Cahoreb (1977); 4 Hassn, Mohammad Deltogi (1988); 5 Hassan Hamed (1967); 6 Yousef Kassem (1986); 7 Mohammad Shawki Al-Fangari (1984); 8 Fathy Al-Said Lasheen (1981); 9 Abdul Nasser Tawfiq Al-Atar (1974); 10 The Conference of Islamic Economics (1980). Researchers concluded and the conference recommended cooperative (including mutual) insurance.
26 Officers and staff of the company can often secure the required quorum. See Hetherington 1969: 1068). The author reaches the conclusion that 'The practice in both property-liability and life companies plainly rejects the almost total non-participation of policyholders in the selection of management (ibid.: 1083).
27 Scandinavian life offices make *ex gratia* payments in situations where the life insured died before the risk attached. Such payments purport to repair injustice by having their sources in the terms of the contract (Sellmer 1972: 33:502–20).
28 See Mohammad Bakhit, *Risalatan*, and the opinions of Mohammad Abdu quoted and discussed in *Rashid rida al Manar*, Vol. 27, 1926, pp. 344–6. The Lucknow Conference classified insurance under the head of foreign transactions (foreign in the sense of non-Islamic).
29 Writing about the history of the insurance contract indicated that in Europe during the Middle Ages, every innovation was suspect due to the absolute supremacy of tradition. Acknowledged operations were used as shields for new contracts. The insurance contracts were hidden under the cover of a charter agreement.
30 The author states that 'Insurance was initially a favour'.
31 All members of *Al Majma al Fiqhi*, except Sheikh Mustafa Al Zarqa (Dean of Law and Islamic *Shar'iah*, University of Damascus, one of the scholars who has strong views and arguments in favour of insurance; not all his views are accepted by other jurists).
32 A re-insurance contract is one where the insurance company is obliged to share the burden of risks insured by another company.
33 A jurist of a Syrian origin, he lived in Egypt as an author and translator. He established the magazine *Al-Zahar*.
34 This is a contractual idea. Good deeds or faith result in God's blessing.

4 THE DEVELOPMENT OF MUTUAL INSURANCE IN THE WEST

1 European Union Publications, ref. 92/49/EEC.

2 Ibid., ref. 92/99/EEC.
3 Ibid.
4 Sir Leon Britten, then Vice President of EU.

5 THE DEVELOPMENT OF ISLAMIC BANKING AND INSURANCE IN MALAYSIA

1 Law of Malaysia, Act 312, as amended by the Economics Department, *Money and Banking in Malaysia*, Bank Negara Malaysia, 1994.
2 Malaysian *Takaful* (Amendment) Act A620, 1985, Section 54-1.
3 Ibid., Sections 8 and 11-1(a).
4 Ibid., Section 11-1(g) and 11-1(m).
5 Ibid., Sections 37 and 38.
6 Ibid., Section 8-5.
7 The investment policy of the operator is also subject to the control of the competent Minister who may require an operator to abstain from a specified kind of investment (S.17-6).
8 Malaysian *Takaful* (Amendment) Act, Section 17-1 requires that *Takaful* funds be kept separate from all other assets of the operator.
9 Ibid., Section 21.
10 Ibid., A. 41.
11 Ibid., Section 37.
12 Ibid., Section 42.
13 Laws of Malaysia Act 89 (revised 1972) and subsequently subjected to various amendments.
14 1982 C 50.
15 The *Takaful* Act, Section 41 and Section 22 of the 1982 Act.
16 Ibid., Section 33 and Section 44 of the 1982 Act.
17 In this respect, Section 38 of the 1982 Insurance Companies Act and Section 17-4 of the *Takaful* Act are similar except for a slight difference of terminology.
18 The *Takaful* Act, Section 48-1 and Section 54 of the 1982 Act.
19 Ibid., Section 32 of the *Takaful* Act and Section 62 of the 1982 Act.
20 Respectively, Section 47-1(b) and Section 45.
21 The *Takaful* Act, Sections 16 and 17, and Section 28 of the 1982 Act. By virtue of Schedule 1 of the 1982 Act, long-term business comprises life and annuity, marriage and birth, linked long-term, permanent health, tontines, capital redemption and pension fund management.
22 Ibid., Section 29-7.
23 Ibid., Sections 4-2(b) and 32.
24 Applied by Regulation 68 of the Insurance Companies Regulations 1981 (SI 1981 No. 1654).
25 For example, The Policyholders Protection Act 1975 (1975 C.75): 'An Act to make provision for indemnifying (in whole or in part) or otherwise assisting or protecting policyholders and others who have been or may be prejudiced in consequence of the inability of the Kingdom to meet their liabilities . . .'
26 The *Takaful* Act, Section 4-1.
27 Ibid., Section 2, interpretation of the word '*Takaful*'.
28 Ibid.
29 Ibid., Sections 13-2 and 21-7.
30 Ibid. In that context the definition of *Takaful* business given by Section 2 of the Act seems most appropriate: '*Takaful* business means business of *Takaful* whose aims and operations do not involve any element which is not approved by the *Shari'a*.'

31 Issued by the Malaysian *Takaful* Company, *Syarikat Takaful Malaysia Sendirian Berhard*.
32 Bank Negara Malaysia (BNM) Website http://www.bnm.gov.my

6 THE DEVELOPMENT OF ISLAMIC BANKING AND INSURANCE IN SAUDI ARABIA

1 Issued by Royal Order No. 32 of 15/1/1350 AH (1930) (Articles 324–89).
2 See '*Saudi Arabia Draft Insurance Law*', Middle East Executive Reports, April 1988: 6 and May 1988: 7.
3 Royal Decree No. M/5, dated 17/4/1405 AH (8/1/1985).
4 National Company for Co-operative Insurance, Saudi Arabia, Annual Accounts, 1999.
5 Arab 'Islamic' insurance companies are listed in the Annual Arabian Insurance Guide.
6 See advertising of The Scheme in Arabia, February 1985: 68. Clause 22 of the contract states: 'As the Glorious Islamic *Shari'a* encourages unity and co-operation among Muslims, the Participants have agreed among themselves'.
7 Thomson v. Weems, The relevant case in English law is (1884) 9 App. Cas. 671, HL.
8 Soliman Saad Al-Humayyd, Chairman, NCCI, This information is taken from the NCCI Website (http://www.ncci.com), and outlines their experiences of Islamic Banking in Saudi Arabia.

7 BASIC PRINCIPLES FOR AN INSURANCE SCHEME ACCEPTABLE TO THE ISLAMIC FAITH

1 See Chapter 4, p. 202, 'Mutual insurance in the USA'.
2 See Chapter 4, p. 207, 'Insurance in Europe'.
3 See Appendix 3, 'Mutual insurance in Canada'.
4 See ibid., 'Mutual insurance in Japan'.
5 See ibid., 'Mutual insurance in Finland'.
6 The Malaysian *Takaful* Act, 1984.

8 CONCLUSIONS

1 *Hadith* related by Ibn Majid, included in the 40 *Hadith* 1977.

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Many of the works cited in this book are timeless and have been reproduced by numerous authors down the ages. Where they have been used, the author has given as much information as it was possible to glean from the publications; this often misses out dates, publishers, etc. Many citations are little more than pamphlets in Arabic; in such cases transliteration difficulties and a lack of authorship information has led to seemingly incomplete or inaccurate entries, or entries with authors in reality being citations from within them. All of the sources have, however, been published to some degree.

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