

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

<i>State</i>	<i>No. of national insurance companies</i>	<i>No. of foreign insurance companies</i>	<i>Total</i>
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)

<i>Insurance class</i>	<i>Premiums 1997</i>	<i>Premiums 1998</i>	<i>Growth rate (%)</i>
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 occurrence⁶ of a future and uncertain event⁷ (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
<i>Policyholders' liabilities</i>		
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
<i>Policyholders' surplus</i>		
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
<i>Shareholders' liabilities</i>		
Accrued expenses and other liabilities	363	447
Total shareholders' liabilities	363	447
<i>Shareholders' equity</i>		
Share capital (authorized and issued five million shares, paid up 50%)	250,000	250,000
Unrealized investment losses	(13,155)	(3,239)
<i>Reserves</i>		
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

ISLAMIC BANKING AND INSURANCE IN SAUDI ARABIA

Table 6.8 NCCI financial highlights for 5 years (1997–2001) SR million

<i>Description</i>	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
<i>Policyholders' assets</i>		
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

ISLAMIC BANKING AND INSURANCE IN SAUDI ARABIA

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
<i>Policyholders' liabilities</i>		
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
<i>Policyholders' surplus</i>		
Accumulated policyholders' surplus	371,722	318,402
Unrealized investment gains	61,039	42,766
Total policyholders' liabilities and surplus	1,181,125	995,950

ISLAMIC BANKING AND INSURANCE IN SAUDI ARABIA

Table 6.12 Shareholders' liability and equity

	2001 SR '000	2000 SR '000
<i>Shareholders' liabilities</i>		
Accrued expenses and other liabilities	363	447
Total shareholders' liabilities	363	447
<i>Shareholders' equity</i>		
Share capital ^a	250,000	250,000
Unrealized investment losses	(13,155)	(3,239)
<i>Reserves</i>		
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 ^aAuthorized 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
<i>Revenues</i>		
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

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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

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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
<i>Cash flows from operating activities</i>		
Net surplus from insurance operation	63,064	85,148
<i>Adjustments to reconcile net surplus from insurance operations to net cash provided by operating activities</i>		
Depreciation and amortization	3,840	4,575
Gain on sale of investments	–	(7,156)
Income from investments in associates	(2,543)	–
<i>Changes in operating assets and liabilities</i>		
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)

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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

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 (Muslehuiddin 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.

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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

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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

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judgment by using analogy, discretion, 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;

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- 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?

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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 aimed 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;

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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.