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Problems and Prospects of Islamic Banking: a case Study of Takaful

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Abstract

The paper is an attempt to analyse the working of Takaul in the world and its popularity in the insurance sector in the world. Keeping in view of Sharia we have also tried all possible aspects of insurance system popular in the world and tried to look at its possibility to familiarize more amongst Muslims of the world. It is observed that customer awareness remain low, however this is often attributed to a limited understanding of Islamic finance in the banking and insurance world. We wish to have a proper salesmanship and advertisement of Islamic banking system in India and all around the world.

Introduction

The paper is an attempt to analyse the working of Takaul in the world and its popularity in the insurance sector in the world. Keeping in view of Sharia we have also tried all possible aspects of insurance system popular in the world and tried to look at its possibility to familiarize more amongst Muslims of the world.

Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (*Sharia*) and its practical application through the development of Islamic economics. Sharia prohibits the payment or acceptance of interest fees for the lending and accepting of money respectively,[(Riba, usury) for specific terms, as well as investing in businesses that provide goods or services considered contrary to its principles (Haraam, forbidden). While these principles were used as the basis for a flourishing economy in earlier times, it is only in the late 20th century that a number of Islamic banks were formed to apply these principles to private or semi-private commercial institutions around the world. These banks have grown in Muslim world, but are a very small share of the global world.

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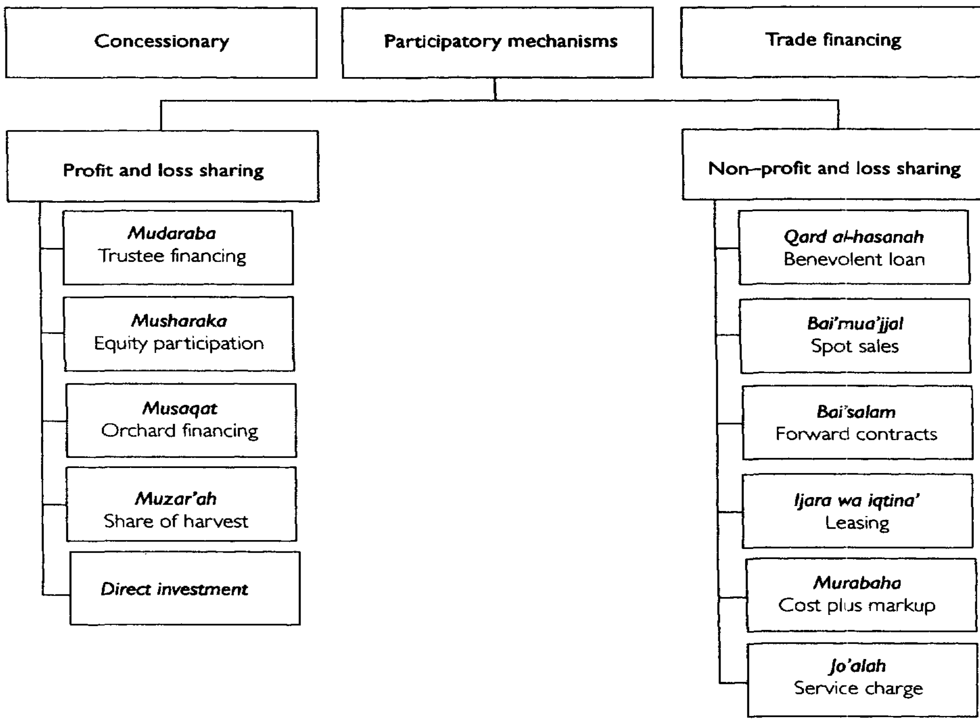
The first modern experiment with Islamic banking was undertaken in Egypt under cover without projecting an Islamic image—for fear of being seen as a manifestation of Islamic fundamentalism that was anathema to the political regime.

Islamic Banking is growing at a rate of 10-15% per year and with signs of consistent future growth. Islamic banks have more than 300 institutions spread over 51 countries, including the United States through companies such as the Michigan-based University Bank, as well as an additional 250 mutual funds that comply with Islamic principles. Conservative estimates suggest that over US$500 billion of assets are managed according to Islamic investment principles.

Principles

Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shariah, known as *Fiqh al-Muamalat* (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of profit and loss and the prohibition of *riba* (usury). Common terms used in Islamic banking include profit sharing (*Mudharabah*), safekeeping (*Wadiah*), joint venture (*Musharakah*), cost plus (*Murabahah*), and leasing (*Ijarah*).

Figure 1. Types of Islamic banking contracts



Shariah Advisory Council/Consultant

Islamic banks and banking institutions that offer Islamic banking products and services (IBS banks) are required to establish a Shariah Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the bank comply with

Shariah principles. On the other hand, there are also those who believe that no form of banking can ever comply with the Shariah.

A number of Shariah advisory firms (either standalone or subsidiaries of larger financial groups) have now emerged to offer Shariah advisory services to the institutions offering Islamic financial services. Issue of independence, impartiality and conflicts of interest have also been recently voiced.

Islamic financial transaction terminology

- Bai' al-inah (sale and buy-back agreement)
- Bai' bithaman ajil (deferred payment sale)
- Bai muajjal (credit sale)
- Mudarabah (profit sharing)
- Mudarabah
- Musawamah
- Bai salam
- Hibah (gift)
- Ijarah
- Ijarah thumma al bai' (hire purchase)
- Ijarah-wal-iqtina
- Musharakah (joint venture)
- Qard hassan/ Qardul hassan (good loan/benevolent loan)
- Sukuk (Islamic bonds)
- Wadiah (safekeeping)
- Wakalah (power of attorney)
- Islamic equity funds
- Takaful (Islamic insurance)

Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the law of large numbers.

Key features of takaful

- The customers (policyholders) of the takaful business agree to pool their contributions and share the liability of each policyholder. So if one policyholder has to be paid a claim, this is paid out of the combined pool of the policyholders' contributions.
- As with mutual insurance, the policyholders share in the profit and loss of the takaful business, i.e. the policyholders all share the insurance risk – they do not give the risk to the takaful company (as occurs in a conventional shareholder insurance company). Consequently, if at the end of a financial year, the takaful business makes a surplus, this is shared between the takaful policyholders.

- If at the end of the financial year the policyholders' fund makes a loss, this deficit is funded by an interest-free loan from the shareholders' fund. The shareholders' fund is then repaid the loan from any future surpluses of the policyholders' fund. The shareholders cannot access the capital from the policyholders' fund except when the interest-free loan is being repaid.
- The assets of the takaful business have to be invested in Shariah compliant assets. For example, investments can't be made in gambling institutions, businesses that make alcohol, businesses that sell weapons or assets that pay interest.
- The operators of the business are paid explicit fees for setting up and running the company on behalf of the policyholders. These fees should cover all the setting-up costs, running costs and profit loading of the shareholders and are the only way that the shareholders are remunerated. After the fees are deducted, any surplus arising from the takaful business is shared amongst the policyholders only. These explicit fees are in the takaful contract that each policyholder signs with the takaful company and are fully transparent.

Overview of takaful

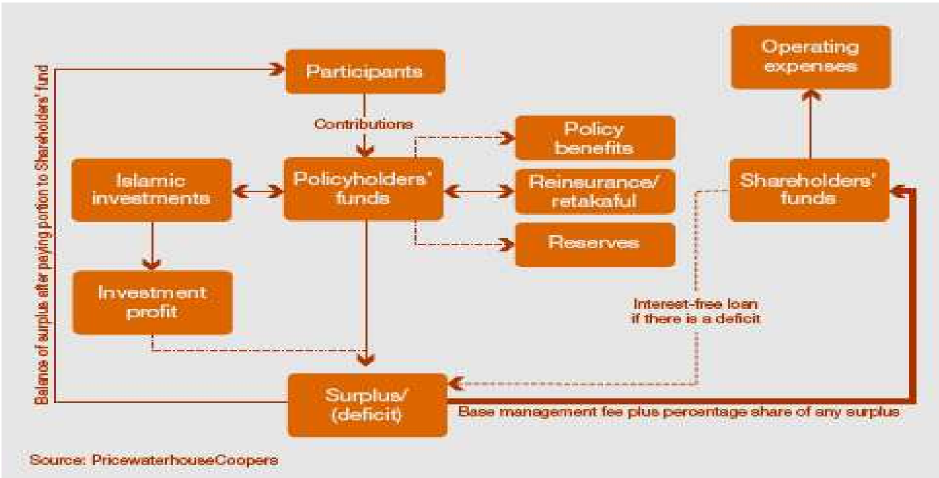
The takaful brand of insurance is a classic example of consumer-driven response to their needs. For generations, Muslims around the world have grown with a mind set that insurance (especially life insurance) is taboo because it contravenes some of the Islamic tenets. Life insurance as sold in conventional way was declared unacceptable in 1903 by some prominent Islamic scholars in the Arab countries. The search was on for an acceptable alternative ever since, and not until the 1970's the debate took sufficient momentum to reach a consensus. In 1985, the Grand Counsel of Islamic scholars in Makkah, Saudi Arabia, Majma al-Fiqh, approved takaful system as the alternative form of insurance written in compliance with Islamic Sharia. It is outside the scope of this presentation to explain how the takaful system works except to say that it is a concept of protection for the good of society, a concept that was never an issue in Islam in the first place. The Grand Counsel approved this system as a system of co-operation and mutual help but the exact method and operation was left to Islamic scholars and insurance practitioners to resolve develop and implement.

Takaful industry is still not past its formative years and there are many areas unresolved, especially in life insurance. The key areas to resolve are the global standardization of takaful terminology, the development of an acceptable form of life insurance (family takaful) especially for countries in the Arab regions and a common consensus for a system to determine profits (or surplus) distributable to participants and shareholders.

There is no unique operating model for takaful companies, as each country has its preferred model. However the most widely used models are mudharaba, wakala and the hybrid model. Mudharaba (Figure 1) is known as the profit-sharing model. The shareholders share in the profit or loss with the policyholder. In this model, the shareholders are paid:

- A pre-agreed proportion of any surplus generated by the policyholders' fund in return for running the insurance operations of the takaful business on behalf of the policyholders. If the policyholders' fund makes a loss, the operator provides an interest-free loan as explained above; and
- A pre-agreed proportion of any investment income from investing the policyholders' fund's assets on behalf of the policyholders.

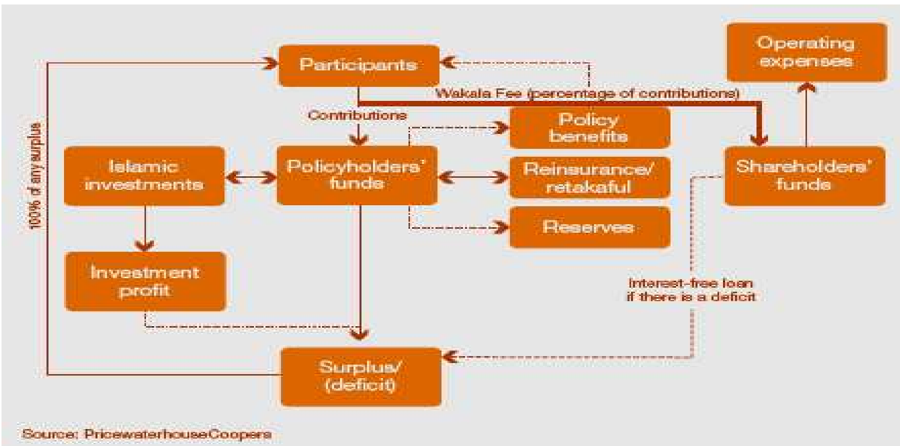
Mudharaba model



Source: PricewaterhouseCoopers

In the wakala (Figure 2) model, the operator acts as an agent of the participants. In this model, shareholders are paid a pre-agreed proportion of the contributions paid by the policyholders in return for running the insurance operations of the takaful business on behalf of the policyholders. If the policyholders' fund makes a loss, the operator provides an interest-free loan to the policyholders' fund that is repaid out of future surpluses in the fund.

Wakala model



Source: PricewaterhouseCoopers

Market potential

The takaful market is currently concentrated in Malaysia and the Middle East and has been experiencing significant growth rates. There are currently more than 130 takaful companies in operation worldwide, of which nearly half are to be found in the GCC countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. The takaful growth rate in these countries is well ahead of the conventional insurance market in the region. With regard to takaful, the market is expected to be worth $4 billion in the next few years at the present rate of expansion, compared with about $170 million today.

In some countries with majority Muslim populations, such as Nigeria, Pakistan, Egypt and Bangladesh, the takaful market can be considered very much in the embryonic stage. These are almost totally untapped markets, in which insurance penetration hovers somewhere below 2% of GDP.7 Globally, some estimate that the global takaful industry is growing at 20% per year, far outstripping the 2.5% annual growth for conventional insurance premiums.8 Moody's has predicted that global takaful premiums will rise to $7bn by 2015.

The world's 1.5 billion Muslims11 represent a potential customer base that no insurer can afford to ignore. Unlike most Western countries, the bulk of the world's Muslim population is youthful. In fact, 60% of the global Muslim population is under 25 years of age.11 This youthful population is starting to achieve a certain level of affluence and if it can be captured early, has the potential to be a customer base to be retained for 40 years or more. The under-insured status of most Muslims is also a significant enticement to potential takaful operators. Taken as a percentage of GDP, premiums in the developed world, including Japan and the Asian 'Tiger Economies', average 9.3%. In the Middle East, Africa, South and East Asia, premiums amount to only 3% of GDP. Growth forecasts for takaful vary, but the consensus amongst most market forecasters is for the current level of worldwide contributions written by takaful insurers, estimated at roughly $2.0 to $2.6 billion as of 2006, to soar to $7.0 billion or more by 2015.12 This is well on its way to becoming a reality, for the forecast of $2.1 billion12 in contributions by 2010, which was published by *Asian Insurance Review* a decade ago,13 has already been surpassed. However, when compared with the $3.7 trillion level of global premiums for conventional insurance, the enormous growth potential for takaful becomes obvious.

Insurers and customers are starting to realise that:

• There is a significant market for takaful;

• takaful products can be price competitive with conventional insurance products; and

• takaful is inherently ethical and is obliged to invest in ethical products. Further if the takaful business makes money, it gives a share of this surplus back to the policyholders.

This combination of ethical investment policy, significant growth potential and price competitiveness makes for a compelling business proposition to non- Muslims as well, in the UK, the rest of Europe and the US. This is a strong driver in markets where the majority of the population is not Muslim. There are two million Muslims in the UK and 20 million in Europe, while in the US the estimates range from 2 million to 6 million. 14 but if non-Muslims seeking an ethical investment come in as takaful customers, the market then becomes one of almost 60 million in Britain and some 450 million in Europe.

Growth in Takaful

Growth in the Islamic insurance industry, or takaful, has slowed slightly as a result of the global economic crisis but is still outpacing the Islamic finance sector as a whole, it is growing faster than the Islamic finance sector and 30, 40 or 50 percent growth in premiums is not unheard of."

A recent report by HSBC estimated the global takaful market at $14.4 billion by 2010.

"It is only an emerging industry, so as people do it more and more, they get more experience about what is acceptable and what is not,"

Under takaful, the risk and reward are shared between the customer and insurer, while in conventional insurance the insurer takes on all the risk for a premium.

Major European insurers eyeing a move into the market for Islamic insurance, or takaful, face a tough decision whether to use diminished resources to secure an upper hand or risk losing ground to niche providers.

Takaful is a Sharia law-compliant insurance structure in which members agree to provide insurance for each other by contributing to a pool of funds which are used to indemnify participants who suffer a loss.

Many Muslims would likely be willing to pay a reasonable premium for Sharia compliant products, but so far have not had the choice.

The very first Takaful company was established in 1979 - the Islamic Insurance Company of Sudan. Today there are some 28 registered Takaful companies worldwide writing takaful directly and 10 more as Islamic windows or marketing agencies placing insurance risk with conventional and takaful companies. In fact the number of takaful companies is higher as all insurance companies in Sudan are deemed to operate in accordance with Islamic Sharia principles. In addition, new takaful companies have been established recently in Sri Lanka and Tunisia. At least four more Takaful companies are under formation in the Middle East (viz. Kuwait, UAE and Egypt). Several other Takaful companies are being contemplated in various countries such as Pakistan, Australia and Lebanon. It is also understood that interest is shown in Takaful in South Africa, Nigeria, and some of the former states of the Soviet Union.

Takaful industry in the Middle East is under-developed compared to other markets such as Malaysia. The more successful companies in the Middle East have grown at 10% p.a. whereas in Malaysia the rate of growth has been 60% p.a.

A broad estimate of the total Takaful industry in 2000 is approximately US$550m for both life and non-life business, of which around $193m pertains to Asia Pacific. Malaysia is one of the largest markets outside the Arab region for Takaful, writing 72% of the non-Arab takaful business. A geographical spread of takaful business is as follows.

Table 1: Geographical spread of Takaful business - 2000

These are estimated figures	Takaful	% of total
Malaysia	$143m	27%
Other Asia Pacific	$50m	9%
Europe, USA	$6m	1%
Arab Countries	$340m	63%
Total	$538m	100%

The growth in Takaful business in Malaysia has been impressive. Starting from a low base in 1994, the annualized average growth used to be in the order of 92% in Family Takaful and 34% in General. Since 1998, the growth rate has slowed down to around 30% in Family Takaful and 17% in General. In Family Takaful the products sold were individual and group term and savings products, mortgage policies and pension plans. In General takaful all classes of business were sold.

Table 2: Growth of Takaful in Malaysia

US$m	Family Takaful	% Increase	General Takaful	% Increase	Total Takaful	% Increase
1998	55.0		36.6		91.6	
1999	70.0	27%	42.7	17%	112.7	23%
2000	93.2	33%	49.8	17%	143.0	27%

Note: Exchange rate RM2.43 to $ (1997 prices)

Takaful in Arab Countries

To illustrate the penetration of takaful in the private sector, the following table provides a picture of business written by companies in the Arab countries excluding NCCI in Saudi Arabia. This company's business is mainly generated from government sources and its exclusion from the figures provide a better measure of how takaful companies are doing in the market place where they compete with conventional insurance companies.

Table 3: Takaful business in the Arab Region - 1999

US$m	LIfe Takaful	General Takaful	Total Takaful	Total Market	Takaful Share of Market
Saudi Arabia	1.3	60	61	781	* 8%
UAE	1.1	12	13	815	2%
Qatar	-	6	6	153	4%
Bahrain	-	5	5	134	4%
Sudan	0.4	27	27	33	83%
Jordan	0.3	6.3	7	141	5%
Total	3.1	116	119	2,057	6%

Takaful figures estimated, Market figures from Sigma SwissRe & Ari

* Takaful share for Saudi Arabia increases from 8% to 36% if NCCI's premium is included above.

Takaful business has generally grown at a higher rate than the total insurance business in each of these countries. Growth rates reflect the increasing market share of Takaful business over the same period, 1995 to 1999 for these countries:

Reinsurance or Retakaful

Reinsurance of takaful business on Islamic principles has been an area of much debate. Reinsurance on Islamic principles is known as retakaful. The problem has been one of lack of retakaful companies in the market. This has left the takaful companies with a dilemma of having to reinsure on conventional basis, contrary to the customer's preference of seeking cover on Islamic principles. The Sharia scholars have allowed dispensation to takaful operators to reinsure on conventional basis so long as there was no retakaful alternative available. Takaful companies therefore actively promote co-insurance. A number of large conventional reinsurance companies from Muslim countries take on retrocession. Still there is a lack of capacity within the Takaful industry worldwide. A certain proportion of risk is placed with international reinsurance companies that operate on conventional basis. The retrocession from Takaful companies ranges from some 10% in the Far East where Takaful companies have relatively smaller commercial risks (so far), to the Middle East where up to 80% of risk is reinsured on conventional basis.

Market characteristics

The market characteristics of the Arab region are quite different from other regions. The main differences are in terms of the attitude to risk and lack of insurance awareness. The level of awareness is very low about financial protection amongst individuals. This is not the case for Malaysia, Indonesia and Brunei, certainly not to the same extent. This is illustrated by comparing insurance density and penetration of conventional insurance and Takaful aggregated.

The average ratio of capital to premiums for many Arab insurers is around 1 whereas the ratio should be in the region of 2.5 times.

The Middle East and indeed many of the Muslim countries are a mixture of some rich and some poorer economies. Insurance density and penetration in some of these countries show the low expenditure in life insurance in Saudi Arabia of $1 per head and UAE of $68. In comparison, the world average life premium per capita was $235, the UK $2,503, USA $1,447 and Switzerland $2,914 (highest). The GDP in many of these countries is high, such as Kuwait, Saudi Arabia and UAE, and yet insurance penetration is not commensurate with the high GDP. This reflects the indifferent attitude to risk in these countries.

The insurance penetration in the UK was 13.35% (life 10.30%), USA 8.55% (life 4.23%), and South Africa 16.54% (life 13.92%) the highest. Insurance penetration for the Middle East is very low at 1.6%.

Traditionally the reasons for low penetration for insurance in the Middle East, particularly in life insurance, used to be:

- lower disposable incomes, except for the Arabian Gulf countries.
- greater reliance on social welfare provisions
- extended family system
- attitude to personal risk

Nevertheless many of the classic parameters of old are changing, such as the extended family system. The pace of change has increased manifold due to urbanisation and industrialisation and the recent phenomenon of liberalisation and globalisation. Moreover, populations of many developing Muslim countries are skewed towards younger age groups, which has put greater pressure on limited resources and employment.

The economic factors have kept insurance low in many of these countries. People may be aware of insurance needs but cannot afford to buy the required protection. The minority, who can afford, are either not convinced or are not interested. Poor marketing has been one of the contributory

Takaful Potential

The world population in 1999 is estimated to be around 6 billion as per the Global Population Project based in the United States. The data on Muslim population is not readily available. It was estimated by using information contained in a publication entitled Islamic Beliefs and Teachings from India. Accordingly there may be around 1.5 billion Muslims making up for 25% of the total world population in 1999. As we look around throughout the Muslim world it is quite evident that people have not taken to life insurance in the same way as in most other countries.

The growth of insurance in Muslim countries was examined by looking at the past trends and taking a conservative view on future growth. This provided a consistent pattern of slower growth in mature markets and higher growth in many of the developing countries. Most of the Muslim countries have potential to at least double their insurance volumes.

One of the main reasons for low penetration of insurance in these countries is the under-development of life insurance. As stated earlier, decades of misunderstandings created a mind-set amongst Muslims that did not help to develop life insurance to any great extent. And yet life insurance is so essential in providing the vital protection to the family. The insurance industry globally was US$ 2.3 trillion in 1999 (up by 7.3% on 1998), with life insurance 61% of total. The size of the Middle East insurance market was US$ 7.9 billion or 2.4% of world premium, and life insurance 31% of the market. Iran experienced strong growth at 25.2% for 1999, compared to average for the region of 5.2%. Life insurance in the region increased by around 3% in 1999 compared to 12.5% in Iran and 5.3% in Kuwait.

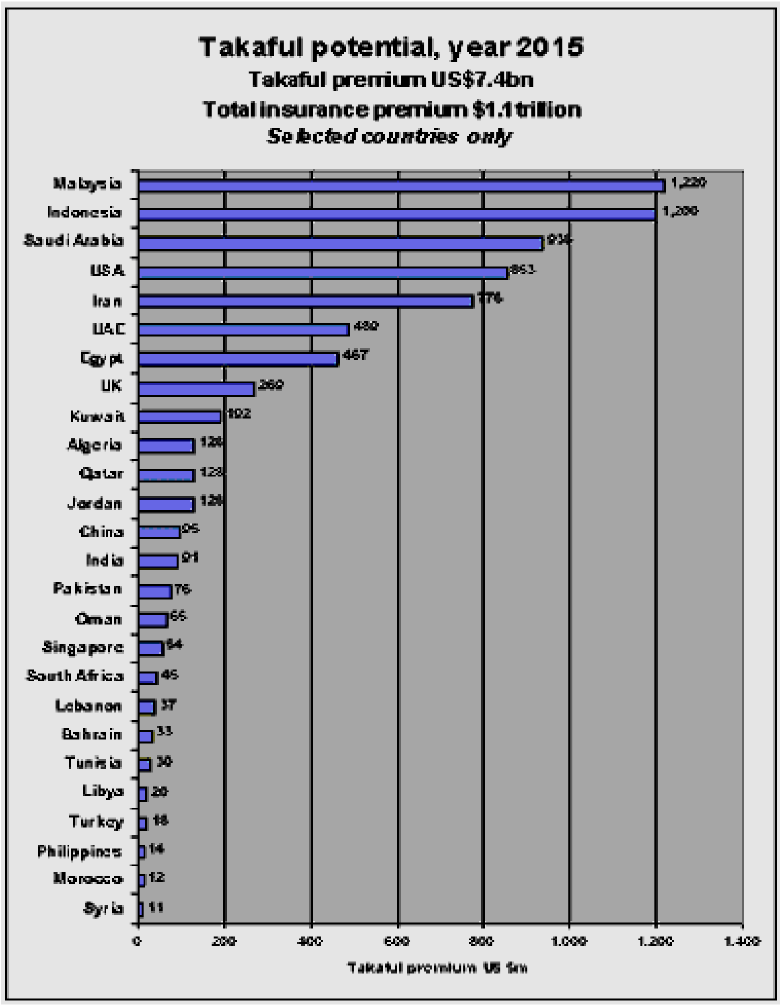
The takaful industry holds the key to unlocking this potential where life insurance can actually be provided through "family takaful" naturally acceptable to the masses. The demand for Islamic products is evident from the success of Islamic finance and banking that has now firmly established itself with a total of more than $7 billion of capital, $4.1 trillion of assets and more than $120 billion of deposits.

The potential takaful volumes were estimated by taking into account the growth inertia that can be achieved through the introduction of family takaful and the following factors:

A greater awareness of Takaful system is achieved

- More Takaful companies are set up and run professionally
- More global coverage is secured through international companies' network and the use of modern IT technology
- Sale through banks
- Companies are well capitalized and demonstrate secure haven for the funds
- Retakaful capacity with triple A rating is available

Other factors were also taken into account such as literacy levels in each country and the take up rates for takaful products as opposed to conventional products.



Twenty-seven countries were selected where most of the demographic and insurance statistics was available. It was estimated that the global takaful premium could be in the region of US$7.4 billion in 15 years' time, growing at nearly 20% per annum. This is not an unachievable task when we have Malaysian takaful business growing at 60% pa and the Middle East at 10%. With concerted effort on part of the Takaful operators worldwide, a growth of 20% pa should be very much possible.

The principle of risk-sharing can have far reaching implications. For risks to be shared, borrowers have to be willing to provide much more information about their situation than normal banks would seek for lending against collateral or guarantees. It will include confirmation that the funds are to be deployed in permissible activities, as well as transparency in reporting financial information about the progress of the business or project for which the money has been borrowed.

Present day Islamic financial institutions also invariably have a Shari'a (Islamic Law) Supervisory Board of Advisors. This is usually a body of qualified Muslim jurists well versed in commercial transactions. All new transactions and structuring of deals are vetted by these Boards for compliance with Islamic Law.

The incremental growth of Islamic financial institutions also shows how Muslim societies will begin to incorporate the spirit justice and equity. Emerging from the colonial interlude, Muslim societies have begun to reflect on the basic precepts of their economic organisation. Understandably, there are a host of external and internal realities which impinge upon the way these societies are organised. However, as the move towards more representative societies gathers pace, the underlying thrust of the Islamic quest for equity and justice is likely to manifest itself in developments in Muslim societies over time.

In these endeavours Muslims will be in good company. Together with the growing protest against the growth of global inequity, the quest for ethical financial intermediation, will provide platforms for like minded players from across faith and ideological boundaries to come together.

Challenges for takaful operators

The potential for takaful is beyond question. But there are many hurdles to overcome if this market is to realise its potential. Human resources pose a major obstacle to growth, as the market is facing a severe shortage of qualified staff who understand both technical insurance principles and have an adequate awareness of Shariah finance.

One of the biggest challenges is creating customer awareness. Many Muslims live under the misconception that insurance is contrary to the principles of Islam, particularly with regard to life insurance. People have to be made aware that takaful provides an acceptable religiously validated solution. Similarly, non-Muslims need to be made aware of why takaful is ethical.

Countries where takaful is new also need to set out clear principles on how takaful business should be taxed, and to create a regulatory regime that does not treat takaful less favourably than conventional insurance. In the UK, Europe and the US, there is also limited experience of how takaful can be accounted for and how to run takaful businesses not only to be Shariah compliant but also to comply with local national regulatory insurance rules.

The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has created a standard that is the default accounting standard for takaful businesses in some Middle East countries. Takaful businesses in other countries account for takaful under International Financial Reporting Standards (IFRS). Applying IFRS to takaful is a complex area and will be the subject of a separate PricewaterhouseCoopers' paper.

The limited availability of short-term non-equity financial instruments such as sukuk and Shariah-compliant money market instruments equivalent to treasury bills represent a further challenge for takaful companies, making managing their investment portfolio more challenging than for conventional insurers who can simply invest in bonds and cash assets.

Takaful companies that grow rapidly (as has been seen in Malaysia and is currently being seen in the Middle East) face the challenge of ensuring that the systems that they have in place can cope with such rapid growth. Along with these challenges, takaful providers must enhance their product innovation and continue to offer a high level of customer service. They must be able to understand evolving customer and market-specific needs and be willing to renew or re-engineer product design and consumer benefit packages, as well as expand customer reach across various distribution channels.

Challenges ahead

Despite this vast market potential, Takaful operators have some significant challenges to overcome before these products enter the mainstream in European markets. First and foremost is the lack of a standardised interpretation of what constitutes Takaful. "Currently," says Jaffer, "each market has its own set of rules and regulations for Takaful and industry experts recognise the need to make them more uniform. The Islamic Financial Services Board has recently published an exposure draft in which it makes recommendations for common governance of the Takaful industry worldwide."

The absence of an organisation to regulate Takaful also makes its implementation more challenging in European countries, where regulations form the backbone of the financial industry. Takaful's adherence to Shari'ah laws and its different approach to accounting practices such as the distribution of surplus, will require analysis within both the legal and tax structures of each jurisdiction.

One help in this process is the number of major European insurance companies and banks that have a high degree of familiarity with Islamic financing practices and the cultural mandates behind them as a consequence of having large operations in predominantly Muslim countries. AXA in France, Zurich in Switzerland and Allianz in Germany all have high Takaful exposure, and banks such as HSBC, Crédit Agricole or BNP Paribas understand the huge potential of Islamic finance, as they all have operations in the Middle East and Asia.

However, in the majority of cases, Takaful remains deeply embedded within the overall financial operations of these global financial institutions, which typically offer the full range of conventional as well as Islamic banking services in non-Muslim regions. "Conflicts arise because very few of the leaders in the Bancatakaful sector have stand-alone sales forces able or willing to dedicate all their resources to the promotion and distribution of Takaful," notes Jaffer. "Instead, we see distribution of Takaful through generalist sales teams that may also be promoting credit cards and current accounts, or Takaful-linked products through investment teams that are also responsible for the sale of mutual funds and other structured investments. In those situations, we need to level the playing field by offering sales incentives that are similar to those offered for conventional products."

Takaful continues to suffer from a shortage of human resources with the requisite expertise." Progress is being made in some regions: the Islamic Banking and Finance

Institute Malaysia offers a comprehensive training programme which looks at Islamic banking, Takaful and Islamic capital markets; and Bahrain’s Islamic Finance and Banking Training offers courses targeted at financial industry experts, which cover the applications of key Islamic banking and financial instruments.

Conclusion

In Muslim societies, the injunction of Zakat provides a vital mechanism for addressing social welfare issues. All Muslims are required to give away at least two and a half percent of their income to the poor and the needy as Zakat. As the principle is well established in Muslim societies, Muslim economists have argued for its institutionalisation with even higher levels of giving. A social welfare state is thus not alien to Muslim thinking at all.

As for national borrowing, Muslims are expected to have risk-sharing contracts rather than fixed rate loans. Translated into practice this would imply that lenders to Muslim countries would need to be convinced of the viability of the projects financed as their return would depend on the success of these ventures. This would have a mitigating effect on spurious debt build ups and repayment crisis as has become common.

Thus in theory Muslim societies should have a much more equitable ethos than they do at present. This discrepancy is there for a variety of reasons, but developments in banking and finance show that a slow evolution reflecting this basic ethos is taking place.

Islamic finance has a similar rationale. Indeed in some respects it goes further, being concerned not just with what kind of activities are being financed but also with the way in which they are funded. Thus Muslims are encouraged to invest in “permissible” (Halal) activities, via “permissible” means.

That means that while Islamic financial institutions will not invest in corporations dealing with forbidden items like alcohol and gambling, neither will they deal with organisations involved in riba, or usury, transactions. Indeed, the lending of money for a predetermined return (riba) is expressly prohibited in the Qur’an. Many Muslim jurists consider any form of interest as riba (usury) and thus do not allow dealing with or investing in banks per se.

Insurance, especially life insurance is an essential part of the social protection needed for any society. It has its rightful place in Islam but years of misunderstanding and misconception have created mental blocks against insurance in the Muslim culture. I believe Takaful or Co-operative Insurance is the right way forward towards the breakdown and removal of such mental blocks. This type of insurance has great deal to offer in Muslim countries where the spread of insurance per person and per cent of GDP can increase manifold if the system of takaful is projected correctly and understood properly. It can genuinely enlarge the insurance market in areas where traditional insurance has not been able to grow, as it should have done. This is true of personal lines, especially of life insurance or family takaful.

In order to create the essential trust and confidence, which is needed to remove the mental blocks just mentioned, the efforts to develop and manage takaful business must be genuine. Investors, entrepreneurs and insurers have good opportunity to take up the challenge of developing insurance business on Islamic principles. After all Takaful is intrinsically in accordance with the indigenous consumer needs.

Customer awareness remain low, however this is often attributed to a limited understanding of Islamic finance in the banking and insurance world. We wish to have a proper salesmanship and advertisement of Islamic banking system in India and all around the world.

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