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Strategies to Shape the Future of Islamic Financial risk Management and Takaful Insurance

Prof. Saad Darwish[1]

Abstract

This paper highlights the contemporary issues related to credit risk in Islamic banking and Takaful (insurance). These two areas of the Islamic finance are facing several challenges that need to be highlighted. Both are witnessing a global and regional increase in demand and have bright future. In order to secure proper growth, it is essential to adopt proper strategies regarding credit risk management and to expand insurance policies. Conventional finance has been solid competition for these Islamic finance products. Several topics were discussed such as; Islamic credit concept, types, factors, and tools. On the other hand, the Islamic insurance concept, mechanism, challenges, and modern thoughts and strategies are considered. The major conclusion is that religious legislation pertaining to the framework of the Islamic financial institutions will play a critical role in shaping the future of credit and insurance management strategies.

Keywords: Islamic Finance, Takaful, Risk Management, Islamic Banking

1- Introduction

Since its inception in 1970 Islamic finance has become a rapidly growing industry. Islamic finance constituents are the Islamic banking system, services, investment, housing and such other economic activities. The biggest challenge for Islamic finance is to balance the innovations of conventional finance, Muslim financial needs under shariah requirements. Islamic financial system is facing two dimensional challenges from the scholars of finance and economics and the scholars of sharia and economic finance legislations to expand the sharia compliant to Islamic financial products. Studies reveal that the Islamic banking system has performed well and has maintained its efficiency during the recent economic crisis. Islamic banks have obtained higher loan deposit ratios, high cost-income ratios, lower non-performing loans, higher capital ratios and higher overhead costs as compared to conventional banks during the crisis (Beck, 2013). The core responsibility of Islamic banking managers is to safeguard risk management as the unique risks for Islamic banks are shariah noncompliance risk, rate of return risk, displaced commercial risk and equity investment risks and other risks are same as that of conventional banks which are credit risk, market risk, liquidity risk and operational risks. That's why Islamic financial institutions are under the same pressure of risk as is the conventional financial system but in a different environment due to the nature of contracts that are related to the transactions of the Islamic finance. According to the nature of contracts Islamic financial institutions share the risk with the investors while conventional financial institutions pass on the burden of credit risk to the third party. The uniqueness of Islamic finance has also been contained in the insurance industry under the guidance of Takaful (cooperation). Takaful is the economic activity that refers to a pool of contributions managed by the insurer. The insurer reimburses the insured in case of financial or materialistic loss. Takaful is a fast growing Islamic insurance industry which has begun to compete with conventional financial companies all around the world.

[1] Professor of Business Administation, Department of Business Administration, College of Administrative Sciences, Applied Science University, Kingdom of Bahrain. E-mail: saad_darwish51@yahoo.co.uk

2- Islamic Finance Management

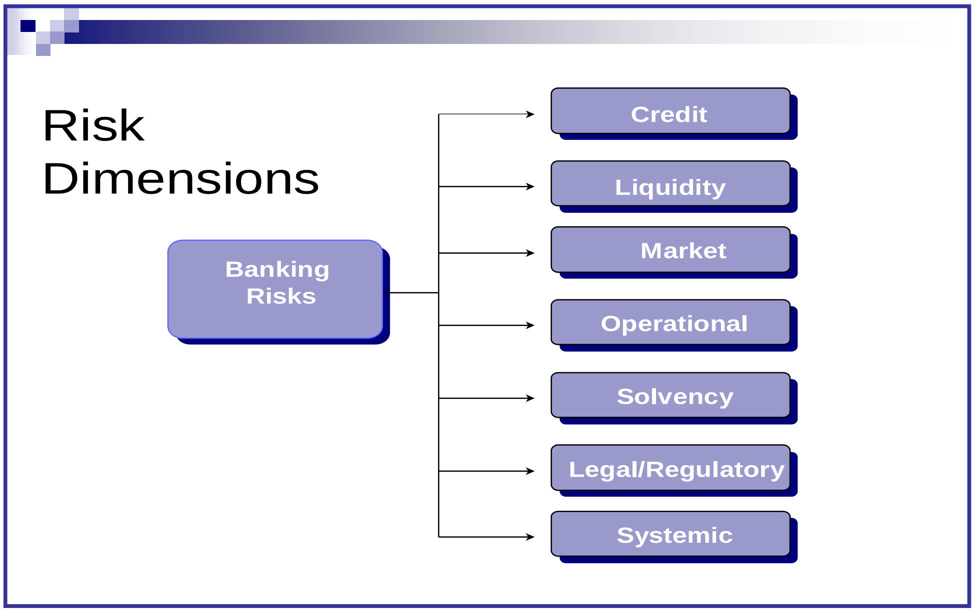
2-1- Concept

As a main component of the Islamic financial system, the Islamic financial institutions are obliged to work in an environment of risk existence. In a broad sense the risk implies the exposure to uncertainty. Risk management is a process of identifying, measuring, monitoring, reporting and hence controlling the risk (Dorfman, 2007). Changing financial market trends have posed various risks to financial institutions including the Islamic banking system. In the banking operations risks are not unavoidable, same as that of conventional banks Islamic banks also have to face the risks but of different nature due to its shariah compliance assets and liability structure. Islamic banks products are based on profit and loss sharing and conventional banks don't do so (Bhatti, 2010) The Islamic finance system does not reject risk but it denies the two extremes of risk behaviors; risk avoidance and excessive risk. Since Islamic finance is based on real production oriented ideology, it encourages the risk taking approach in economic activity but it is against the extreme side of uncertainty and hence the returns and risks are balanced. Islamic finance is purely based on the cooperative approach and prohibits Riba (interest or Usury) of any kind as it jeopardizes the livelihood of the people in a society. The other main principal of Islamic finance is based on ethical standards as depends upon religious concern of parties, the investor and the debtor to ensure serious consideration of the nature of business and its products. Islamic finance integrity lies in liability and the inevitable risk that both parties have to share (Chintaman, 2014). Through cooperative arrangements many of financial and economic objectives can easily be achieved rather than for profit gaining arrangements. Muslim investors and Islamic financial institutions jointly can share the risks they are facing by making non for profit arrangements which are flexible and can accommodate any type of risk (Al-Suwailem, 2006)

The Islamic financial system is the brainchild of the Islamic economic philosophy based on Quran and Hadith and follows halal or permissible financial practices. These practices are based on Profit and loss risk sharing, avoidance of Riba (interest or usury), avoidance of investment in haram (unlawful) business or its products, shunning investment in Gharar (excessive uncertainty), payment of Zakat, existence of 'real' economy, and observance of all the matters described by shariah compliant fiqah and economic scholars (Abraham, 2010). There are significant difference between the Islamic banking system and the conventional banking system regarding risk management and risk predictions. Management efficiency, risk weighted assets and size of total assets, casts an influence on credit risk of Islamic banking (Ahmed & Ahmed, 2004). Various types of risks are faced by financial institutions among which credit risk and operational risk are the most important risks in certain economic activities of conventional and Islamic baking sysytem. It refers to the ability of the debtor to pay back the money in accordance with the conditions stipulated in the contract (Elgari, 2003). Prohibition of Riba (interest, usury), Maisir (Gambling), Gharar (excessive uncertainty) and the requirement of equity profit and loss sharing are the basic principles of Islamic finance. Islamic risk management is based on equitable risk sharing and transactions in tangible assets. Islamic finance has now become a fast growing financial sector in the world (Alsharmani, 2014). Conventional finance and banking uses hedging as main mechanism to face credit risk whereas Islamic finance cannot use this mechanism due to shariah compliant requirements. Islamic financial institutions do not transfer the risk to the third party to retain profits which is a major component of conventional economics and is used to retain profits.

2-2-Types and Factors

There are several types of threats which hinder the performance of Islamic institutions such as banking and finance. Shafaqat 2008as shown in (Figure 1) illustrates the types of risks according to their importance in Islamic banking. As shown below, credit risk is the most important source of risk exposure to the Islamic banking system.



Source: Shafaqat 2008

The extent of exposure to this risk is determined by several factors such as:

1. Management efficiency: this is the ability of a certain bank to evaluate the financial position of the client to whom the bank is dealing with.
2. Size of the total assets: the larger size of assets lowers the risk exposure.
3. Invested sectors: loans should be minimized in risky sectors.
4. Regulatory capital: larger size of capital implies stronger ability to face default impacts.
5. Loan loss provision: Islamic banks should build and expand these provisions to minimize the credit risks.
6. Leverages: Reducing adverse selection and strengthening internal contracts.
7. Funding cost: the cost should be profitable and competitive.

Islamic banking system has gaining momentum among Muslims as it satisfies their social and religious needs in accordance with shariah. This system has huge potential which still needs to be explored for Islamic finance marketing (Khan, 2011). Interest or usury (Riba) is prohibited in Islamic finance system. In conventional banking system money is a medium of exchange and has no intrinsic value. Islamic banking system deals in assets and hence, is the asset based banking and adhere shariah law of contract. There is prohibition of Interest (Riba), Gharar (uncertainty) and Maisir (gambling) in this financial system (Mansoori, 2011). Islamic banking is expected to flourish in the coming years due to its Shariah compliant system and suitability to the Muslim communities in particular and non-Muslim communities in general around the world. However; there are still many problems and hindrances which this economic system is facing and these are as under:-

1. Absence of a legal framework in most of the Islamic countries around the world.
2. Shortage of a trained workforce for conducting business in accordance to shariah compliance rules.
3. Lack of shariah based securities.
4. Shortage of supporting institutions.
5. Lack of good relationship among the management, the entrepreneurs and the legislative authorities.
6. Lack of public awareness and poor marketing.
7. Ignorance of people at large about shariah compliant principles in business and commerce.
8. Predominance of conventional economic system in most of the Muslim economies of the world.
9. Lack of support from government mechanism in most of the Islamic countries.

If these problems are addressed properly with sincere efforts, Islamic banking is expected to prosper more rapidly. A present Islamic banking is increasing at 20% to 25% per annum (Ali, 2006). In analyzing the factors of credit risk exposure, the role of effective management is vital in regulating the risks and risk control. The credit decision should de decentralized from headquarters to smaller units.

The lending cost must be lowered to become more competitive in the financial system especially for those with solid financial positions in the market. There is a need to reform the risk factors and less provision to increase the elasticity of the Islamic financial institution to defaults. There are several types of variations between the debt held by Islamic banks and the conventional banks, primarily there is no possibility of increase in the debt after it has been established between the parties. The next important factor is the large impact of the form of contract on the level of risk; this is followed by the prohibition of trading in debt, finally, permissibility of conditional discounting should be emphasized (Zafar, 2009). Islamic financial institutions are facing greater exposure to credit risk because they are forced to operate under shariah rules and regulations, and on the other hand they have to compete with conventional financial institutions in the Islamic world as well as in the entire world for its growth.

2-3 Strategies and Means

Earlier it has been stated that credit risk management is the process by which risk exposure is identified, measured, mitigated, controlled, reported and monitored. In the conventional financial institutions' context, there are many risk management standards that have been devised in order to control the risks in USA such as the Project Management Institute, the National Institute of Science and Technology, actuarial societies and ISO standards. These standards aim to transfer risk to a third party so as to avoid risk, this in turn reduces the negative impact of risk and accepts some or all of the consequences of a particular risk (Hubbard, 2009).

The method for dealing with risk in most models of conventional institutions simply consists of the following order:

1. Identify, characterize and assess threats.
2. Assess the vulnerability of critical assets to specific threats.
3. Determine the risk.
4. Identify ways to reduce those risks.
5. Prioritize risk reduction measures based on strategy.

The international organization for standardization (ISO) identifies the following principles of risk management which are as follow:

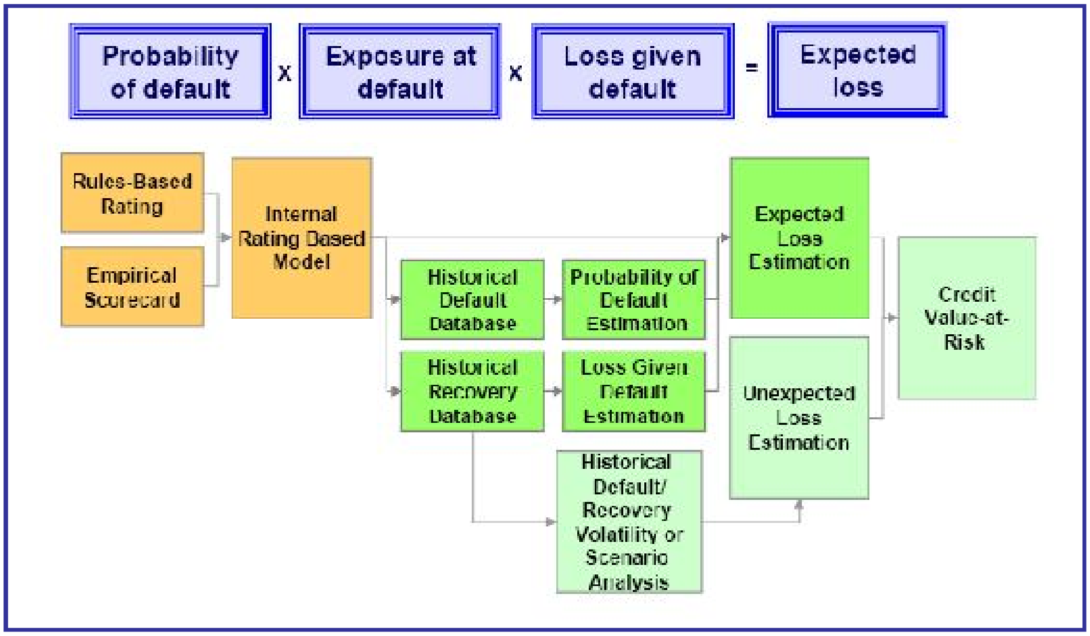
1. Create value.
2. Be an integral part of organization process.
3. Be part of decision making.
4. Explicitly address uncertainty.
5. Be systematic and structured.
6. Be based on the best available information.
7. Be tailored.
8. Take into account human factors.
9. Be transparent and inclusive.
10. Be dynamic, iterative and responsive to change.
11. Be capable of continual improvement and enhancement.

On the other hand, in the Islamic finance context, risk management should comply with certain principles which imply that corporations raise additional funds through equity not through bonds (debt proliferation is minimized in this concern). Risks are shared between the financer and producers. Regulations should not allow purchase of business or financial risk by outsiders who are not involved in the business or supply of investable funds for the business but are only taking chances on the outcome.

Islamic finance system risk management depends mainly on three methods that contain different products and mechanisms (Zafar, 2009):

a. The instructions that are formally being standardized such as ISD and IIFM. Tahawud (hedging) master agreement.
b. Risk management methods directly based on the well organized Islamic financing methods and rules.
c. The possibility of using sharia complaint mechanisms to replicate conventional risk management products and methods.

The above mentioned methods provide the Islamic financial institutions with the ability to use them in a flexible manner that complies with their business environment. The fundamental formula for calculating the risk (as seen below) is the same for both insurance regimes which means that they both are vulnerable to risk but the nature of risk differs.



Source: Ken Dorph 2009

There are several strategies and mechanisms to counteract the Islamic credit risk management system. The first strategy to control risk is proposed as an equation. The principle of this mechanism is very simple and effective by allowing the risk managers to set limits for the credit and debts then monitoring exposure against these limits in a dynamic environment, guarantees, collateral and netting agreements helps mitigate risk (Misys, 2010). In this equation, the limit categories are flexible in nature and easy to adopt by the debtor and the financer. Exposure can be calculated in various ways and each limit can be weighted and then adjusted by mutual agreement.

- Debt value = Risk Exposure
- Net value of debts and credits = Risk Exposure
- Gross value of debts and credits = Risk Exposure

The credit risk mitigating technique is yet another strategy for Islamic institutions to face risk. Mitigation is a systematic methodology for setting markup rates according to risk rating of the counterparties; therefore this can serve as a primary strategy to protect against the risk problems in financial markets in the Islamic banking system (Risk Institute, 2010). Mitigation of risk requires the use of the following tools by the risk managers of the Islamic institutions:

1. Pricing: should be determined as per expected risks.
2. Permissible and enforceable collateral and guarantees: by third party, redemption and for default payments.
3. Clear documentation: whether orders are cancelable.
4. Clear procedures: laws and transactions.
5. Situational actions: customers cancel.
6. Profit equalization reserves: smooth earnings across the cycle.
7. Investment risk reserves: absorb negative shocks on assets value.
8. Fees on Mudarata, charges on assets and deposits, Hamish Jiddiya and Urbun.
9. Qurd-ul-Hassan (non-interest loan): from shareholders to profit sharing depositors.

3- Islamic Insurance (Takaful)

3-1- The Concept

The conventional insurance system provides the means for people to transfer the burden of financial loss or financial uncertainty to the insurer, for the agreed financial consideration generally known as the premium (Ahmed, 2004). Islamic insurance practice is in accordance with the Islamic code of life and possesses the fundamental characteristics of sincerity, absolute observance of shariah principles, moral attributes and the elements of an insurance contract (Billah, 1998). In the exchange, the insurer promises and is bound to provide financial compensation to the insured in case of occurrence of loss. In contrast to this insurance system, Takaful (Islamic Insurance) is a concept based in Islamic banking and banking transactions. “Takaful is a financial transaction of a mutual cooperation between two parties to protect them from unexpected future material and financial risk. The insured pays a particular amount of money (contribution) to the insurer (Takaful operator) with a mutual agreement that the insurer is under a legal responsibility to provide material and financial protection to the insured party” (Hamid, 2009). It is very clear from the observances that conventional insurance system does not follow shariah principles whereas there is an overall perception that Takaful is insurance system compliant with shariah rules and regulations. It is very much needed that Islamic finance scholars should devise such insurance policies that attract Muslims towards Takaful in contrast to the conventional insurance system (Hussain, 2011)

By its concept, Takaful primarily relies on three main principles that represent the virtues of Islam:

a. Cooperation: it is one among the most important virtues of Islam that has been mentioned in the Holy Quran and sayings of Prophet Mohammed (PBUH) that encourages Muslims to apply it on their behaviors and transactions in all walks of their lives.
b. Responsibility: it is an obligation from the insurer towards the insured in financial and material loss in addition to the sympathy exhibited a person for another which is yet another virtue of Islam.
c. Mutual protection: this principle is considered to be the basis of Takaful and the main reason for the need for insurance in Islam.

There are certain valid examples in Islamic history relating to Takaful insurance base on mutual cooperation which are as follow:-

a) The Merchants of Makkah contributed in a fund to assist the victims of hazards of trade journeys and natural disasters which they have to face during trade journeys.
b) Other type of surety was Daman khatr al-tariq that was used to impose on the business authorities against the losses suffered on hazardous routes during a trade journey.
c) A'qila was a type of assistance which was provided to the family of victims and captives during the trade journeys. This was a mutual cooperation between the traders to deal with the dangers they have to face in their trade journeys.
d) To resolve or end the mutual enmity or revenge, contracts of ‘aqdmuwalat’ were entered into force by the authorities.
e) The other model of mutual cooperation was known as ‘Hilf’ a means of confederations or agreements done for mutual assistance among the people in the early days of Islam.

Four fundamental elements are important in a Takaful insurance which are the Nea’a (Utmost Sincerity), integration of shariah conditions in risk protection sharing, presence of ethics and moral values, avoidance of unlawful elements and strict adherence to Islamic rules (Fisher, 2001)

1. Utmost sincerity of intention while intentionally following the guidelines and adhering to the rules of Takaful system.
2. Integration of shariah conditions, namely risk protection sharing, coincidence of ownership, participation in management by policy holders, avoidance of Riba and prohibited investment and inclusion of Mudarabah or Wakalah principles of Takaful management.
3. Presence of moral values and ethics, business is conducted openly while in accordance with the principles of utmost good faith, honesty, full disclosure, truthfulness and fairness in all dealings.

4. No unlawful element that contravenes shariah and strict adherence to Islamic rules with reference to commercial contracts.

The above mentioned factors aim to bring the insurance industry within the compliance of Islam. Gharar (uncertainty) plays a vital role in Islamic insurance. Gharar is an Islamic finance term describing risky or hazardous sales behavior, where details concerning the sale item are unknown or uncertain (invest podia, 2010). It is necessary to forbid transactions with excessive risk due to uncertainty. This principle is found in the derivative market of the finance industry such as forwards, futures and options which are forbidden in Islam due to Gharar. Islamic banking has been introduced in South Africa in 2010 with incorporation of legal definitions of Musharaka, Mudarabah, and Murabha in its taxation laws amendment bill to eliminate interest and utilization of Islamic contracts to make it compliant with shariah laws in Islamic banking (Qasaymeh, 2011).

3-2- Challenges and Opportunities

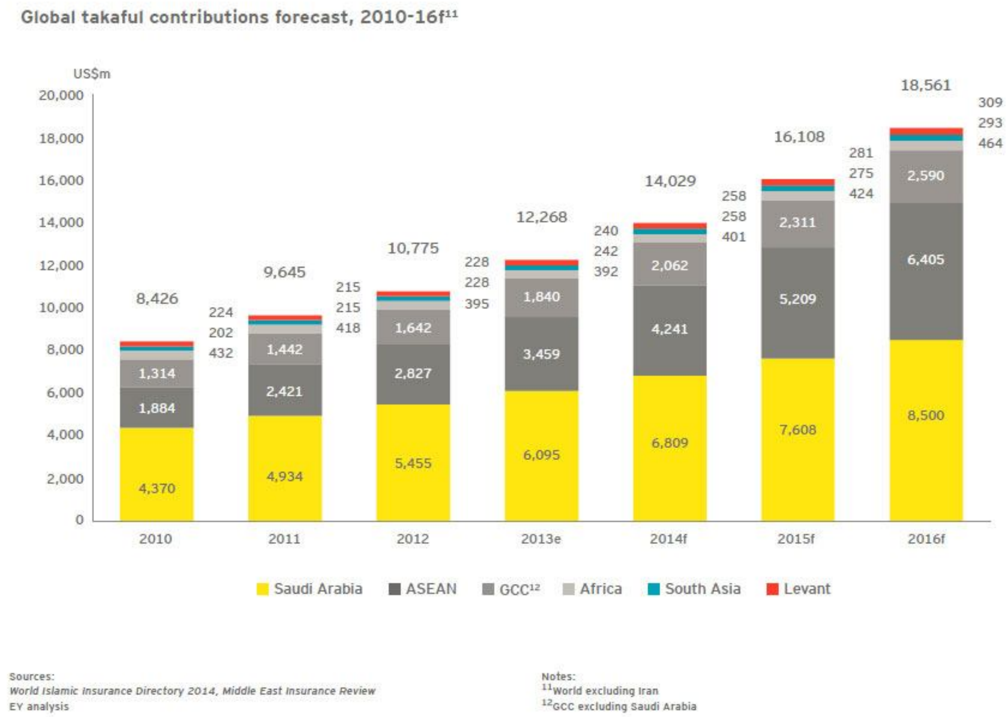
There are several challenges Takaful is facing in the insurance industry as an Islamic alternative model of insurance against conventional insurance system. The major threat to the Islamic insurance system is the lack of awareness among Muslims about Takaful due to common belief that "God will protect" in all the matters of life, their social, economic and personal matters. This belief needs to be resolved through the spread of insurance culture among Muslims and this awareness can be promulgated through education, community activities through mosques about Muslim finance by shariah compliance economic scholars (Makiyan, 2008). The compulsory vehicles insurance (Takaful) is another venue for its growth among Muslims in the entire world; it is the shariah compliant solution for insurance for every one. Motor Takaful is constituent of two types of insurance plans; motor all risk (comprehensive) and motor third party liability. Motor all risk covers the losses incurred due to accidents whereas motor third party liability covers losses due to accidents and deaths or bodily injuries of third party like passengers, spouses and the children except the driver and the insured (Riaz, 2009). There are various misconceptions about Takaful which need to be addressed by Islamic fiqah and Islamic Finance scholars and the resolutions need to be propagated through electronic media, expert marketing teams and entrepreneurs involved in the Takaful insurance business. These individuals can also propagate the solutions through publishing their success stories.

The general misconceptions are as following:-

1. "Risk Protection (insurance) is against Tawakkul". Human actions cannot change Allah Almighty's Will regarding the destiny as we are unknown to the unforeseen events occurring in future; however many a times we have been advised by Quran and Hadith to take precautionary measures and after these actions depend and trust on the creator of all the universe. HadhratAnas bin Malik narrates an Arab Bedouin's question to Prophet Muhammad (PBUH), "Shall I leave my camel untied and seek Allah's protection for it, or should I tie it?" The Holy Prophet replied, "Tie your camel and then depend upon Allah (swt)." {As quoted by Sunan Al Tarmizi, 1981,}.
2. "All Risk protection (Insurance) is Haram". "The World Muslim League Fiqah Council (1398/1978) resolution and Fiqah Council of Organization of Islamic Conference (1405/1978) in Jeddah resolved that, "conventional insurance as presently practiced is Haram". And that, "cooperative insurance (Takaful) is permissible and fully consistent with Shariah principles". "Hence, conventional insurance is prohibited for Muslims because it contains elements of Riba, Al Maisir, and Al Gharar. By contrast, Takaful provides risk protection in accordance with Shariah using principles of Ta'awun (mutual assistance), brotherhood, piety and ethical operations".
3. "Insurance is similar to gambling and hence forbidden (Haram) in Islam"; "Insurance is similar to gambling is also a misconception about Takaful insurance. Risk or uncertainty is of two types,a'qila; pure risk and speculative risk. Pure risk is based on loss or no loss. Pure loss falls under insurance risk protection and is lawful. However speculative risks involve loss, no loss or gain. Setting up a new business comes under speculative risk because there are chances of loss, no loss or gain. Speculative risk that includes potential gain is forbidden and cannot be insured under Takaful".
4. "All insurance seeks to maximize profits" it is also a misconception that all types of insurances seek to maximize profits that take benefits away from policyholders. "Takaful operators, by contrast, are mutual or cooperative entities. The goal of Takaful insurance is community well-being and self-sustaining operations - not high profits; Under the Takaful Mudarabah Model, surplus is shared fairly between shareholders and policyholders, under the Takaful Wakalah Model, surplus is owned by the policyholders and may be reduced by a performance fee incentive for the operator before distribution to the policyholders".
5. "All Takaful holders are the same". Islam is the religion which preaches unity in diversity. There are several Takaful insurance models, introduced by shariah and financial scholars. These models include Sudani model of Hebbah or Tabarru, Bahraini and Malaysian model of Mudarabah, and Saudi Arabian Al Wakalah model.

6. “Insurance schemes are an invention of the modern times”. It is a reality that “social arrangements for pooling of risks existed since many centuries ago. The Takaful system evolved from ancient methods of risk protection in Arabia about 14 centuries ago called; (a) daman Khtr-al-tariq-surety for traders; (b) a'qila - payment to the family of a victim by the accuser’s relatives (c) hilf - confederation for mutual assistance”. In the history of insurance 1706 is the year indicates the first ever emergence of insurance in England and it was named as the first ‘perpetual assurance scheme’. In USA during 1740, first insurance company was established which was the merchant's cooperative founded by Ben Franklin. In the modern era these old cooperatives have converted them to stock companies in pursuance for high profits.
7. “I have no need of Takaful insurance”. Takaful insurance provides us an opportunity to practice the virtues of Islam, including self-purification according to Quran and Hadith of Prophet Muhammad (PBUH). Allah Almighty says in Surah Al Maidah (Verse No. 2): “Help one another in furthering virtue and Taqwa (God-consciousness), and do not help one another in evil and transgression”. “In a Hadith of Ahmad and Abu Daud: “Whosoever fulfils the intention of his brother, Allah will fulfill his intentions”. And “Always help those who help their brother(s)”. In Madinah the very first constitution drafted by Prophet Muhammad (PBUH) in 622CE has three aspects which related to protection and social insurance for the Jews, the Ansar, and the Christians by Prophet Muhammad (PBUH). Article 3 of this constitution concerning ‘wergild’ or ‘blood money’, which is a provision of Fidyah (ransom) and A’qila. These concerns testify the fact that Islam provides ample opportunities of risk protection to the Muslims for their economic uplift and growth.

Takaful provides an opportunity of self discipline in terms of savings and financial planning in order to take care of one’s self and needs of family and dependants. A Hadith of SahihBokhari, described by HadhratAamir bin Sa’ad bin Abi Waqas, describes Prophet Muhammad (PBUH) saying: “Verily, it is better for you to leave your heirs wealthy than to leave them poor asking for help to the others” and “The one who looks after and works for a widow and for the poor is like a warrior fighting for Almighty Allah's cause”. Also, a Hadith in Sahih Muslim narrated by Abu Hurairah describes Holy Prophet (PBUH) saying: “Whosoever removes a worldly hardship from a believer (Muslim), Allah (swt) will remove his hardships on the Day of Judgment”. The biggest challenge for Takaful is unavailability of experienced and trained personnel that can effectively manage and spread Takaful especially in infant insurance markets in the developing Muslim countries. Takaful companies should establish and expand their training programs in order to train the Takaful staff and to raise awareness among general Muslims. The trained human resources should not be influenced by conventional insurance marketing and policies in order to build loyalty and innovation skills amongst themselves. Poor market and customer segmentation in addition to lack of customer focused services standards represent another pathetical situation to the performance of Takaful companies (Hamid, 2011). To deal with these problems there should be development of need-based products and better penetration policy levels should be implemented in order to grasp the market share. Additionally, if investment in technological and human resources need to be expanded this will lead to improvement of the service standards and will boost the image of the overall industry of Takaful insurance. Takaful industry growth is the force behind the conversion decision of several insurance companies to the Islamic insurance system. International insurance companies have initiated Islamic insurance system which complements their own conventional insurance practices. Table 1 represents the spread of Takaful operators around the world which makes it clear that future of Islamic insurance system is very bright if it is marketed properly in the Muslim world in particular and in the entire world in general. Initially the majority of these companies were operating in Arabian countries. In 2006 the market of Takaful reached $1.7 billion and is expected to reach to $7.4 billion by 2015.



Source: World Islamic Insurance Directory 2014.

3-3- Mechanism

The main principle of Takaful is not to generate profit but to help the stakeholders. There are four parties involved in the Takaful operations (Billah, 2007):

1. Participant: the party who pays premium or the contribution.
2. Operator: Takaful operations Management (the company).
3. Insured: the entity that enjoys the services.
4. Beneficiary: the party who receives help at the time of loss.

The contributions are divided into two accounts; first, the investment account that follows the contract of Mudarabah (profit and loss sharing) and is considered to be the main stream of profit for Takaful companies. The second is the Tabarru (charity) account which is used for covering the loss of the insured parties. At the international level there are three models of Takaful being followed and each company selects one of these models accordingly; either in accordance with the regulations of the country in which it is operating or in keeping with the model that is optimally suited for the company:

- Ta'awni model (cooperative insurance): "The main characteristic of this model is simply the profit-sharing principle which allows the participants (contributors) to receive profits according to the agreed formula within the operation. This model represents the cooperative and brotherhood spirit of Islam".
- Wakalah model (Agency): Wakalah model requires three parties; Takaful Operator, the agency, and the participants or the policyholders. In this model the Takaful operator delegates management rights to the agent who employs his knowledge and skills in collecting contributions from the policyholders and investing them in shariah compliant techniques within the contract of agency.
- Tijari model (commercial): Commercial Takaful is of two types, one is the general insurance where the entire surplus is distributed between the commercial insurance participants and the insurance operators. The second is the life or family Takaful where the participants become eligible for the whole surplus with no deductions because of its nature of life insurance coverage.

4- Conclusions

The major conclusion of this research paper is that Islamic finance has proved itself to be a very strong competitor in the fields of credit and insurance industries of conventional finance. In order to enhance its competitiveness, Muslim finance scholars should expand risk management products since the sensibility of Islamic financial institution are at a higher risk as compared to conventional financial institutions. Credit risk is the most important risk that is being faced by the Islamic institutions so the role of management is very critical and vital in smoothing the impact of the exposures of such risks. Equation has been proved to be one of the most effective credit risk management techniques for Islamic finance due to its nature of flexibility, accuracy, and applicability. Mitigation, decentralizing the credit risk decisions, increasing risk provisions, raising funds from equity and not from the bank, and in adopting the ISO model of risk management in dealing with risk exposures which all are supporting techniques in managing credit risk in the Islamic finance system. Islamic Takaful industry is in its infancy and is a fast growing branch of Islamic Finance. Its principles are summarized by the company on three different models, cooperative, agency and commercial management. The main difference between these models is the distribution of surpluses which give more flexibility to management in Takaful companies. Takaful is regulated by acts passed by the parliaments in various countries, or by the decrees issued by executive offices under the provisions of the Holy Quran and Hadith of the Prophet Muhammad (PBUH). Takaful companies comfortably work better in Shariah based economic system. Sudan the only country which truly offers an Islamic economic system whereas in other countries where shariah based economic system do not exist Takaful companies are competitively competing with conventional insurance companies (Bekkin, 2007).

The future for both credit risk management and Takaful is very bright and promising as western scholars and investors are paying more interest to them, especially to counterfeit problems associated with the conventional financing system. In 1990, the establishment of the Institute of Islamic banking and Insurance (IIBI) in UK is an important indicator of the importance and rise of this vital economic activity around the world. In USA the situation is more favorable for Islamic finance system as we see a list of conventional commercial banks that are operating Islamic banking and insurance system i.e. HSBC, Devon Bank of Chicago, Deutsche Bank, JP Morgan Chase, and University Bank -Ann Arbor. These banks along with their conventional banking are offering Islamic banking system to its clients. Mortgages from Islamic Banking units of these conventional banks have been purchased by Freddie Mac and Fannie Mae companies. Also, many universities are keen to develop this topic due to its high demand in world job market. We should expect shariah compliance Islamic finance scholars to educate the common to abolish the myths which hinder the large Muslim community about Islamic finance products and play a progressive role in assisting economic and financial experts in order to widen the use of these Islamic techniques to cope with the conventional financial products.

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