

SALAMA INSURANCE: THE NEED OF AN ISLAMIC LEGAL FRAMEWORK

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ABSTRACT

Many Muslims, for religious convictions are reluctant to take up conventional insurance as it is deemed to have uncertainty, gambling and interest, which are prohibited by religion. The purpose of this paper is to examine Islamic Insurance in Algeria and analyse a suitable regulatory framework.

One can argue that the trend towards Islamic insurance in Algeria contributes to raising the level of insurance culture, which will help to mobilize more savings. After studying the topic, we can provide a road map to better regulating the Islamic insurance market because the Islamic companies could not function in the absence of an Islamic insurance act. In the absence of such a framework, regulators often treat Islamic insurance companies similarly to conventional insurance companies, which hinders the development of Islamic Insurance Industry.

Keyword: Insurance, Islamic finance, Salama Insurance, Takaful

JEL Code: G22,G23

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1. INTRODUCTION

The Islamic insurance or *Takaful* is a relatively recent trend in Algerian insurance sector and is based on the principles of Islamic law in all its various operations. It is the outcome of specialists who have worked for years for an insurance solution that is compatible with the values and principles of Muslim community.

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This type of insurance has been first implemented in Sudan then moved to the rest of the world (Asif, 2011), supported by continuous regulatory reforms in compliance with the specificity of Islamic principles and sometimes also with the specificity of each country. These reforms have conducted a disparity in growth and development of Takaful market, given the different economic and social factors of each country.

Algeria, like any other Islamic country, could not remain far from this trend which might contribute to the development of its financial sector in general and the insurance sector in particular. This strategy would participate to achieve the objectives of economic development and accompany all parties involved in this trend. However, the insurance sector in Algeria is characterized by some specificities compared to other Muslim dominated countries (novelty of the Takaful experience) which remains less regulated and is based solely on the experience of Salama Insurance Company.

The traditional insurance market in Algeria is characterized by a very weak insurance culture. Most of the insurance products are compulsory, such as civil liability insurance of motor vehicles, fire insurance for institutions and natural disaster insurance started from 2003 after Bab El Oued's flood in Algiers in 2001 and Boumerdes's earthquake in 2003.

The trend towards Takaful insurance in Algeria will contribute to raising the level of insurance culture, which will help to mobilize more savings.

In this study we will attempt to address the following question:

What is the reality of Takaful insurance market in Algeria and what are the main legal conditions for its development?

This study helps to provide some insight about the Takaful and insurance environment in Algeria. It also clarifies the most necessary axes and requirements for the success of the process of transformation towards Takaful insurance in Algeria, which is suitable for the specificity of the sector. The importance of this study stems from the importance of the insurance system in contributing to the mobilization of savings and the protection of economic actors in order to support economic development in Algeria.

In order to understand and analyze the most important elements of the study, we diagnose the situation of the Takaful insurance market in the world and use a comparison between models close to the Algerian insurance market and provide some suitable proposals for the insurance environment in Algeria.

The remaining of this paper is organized in four sections. The second section examines some indicators of the insurance market in Algeria. Section three addresses a study of the experience of Takaful insurance in Algeria, after the introduction of financial liberalization. In section four, we discuss the requirements of Takaful insurance in Algeria. In the last section, we produce some concluding remarks.

2. INDICATORS OF THE ALGERIAN INSURANCE MARKET

2-1. Development of insurance market in Algeria

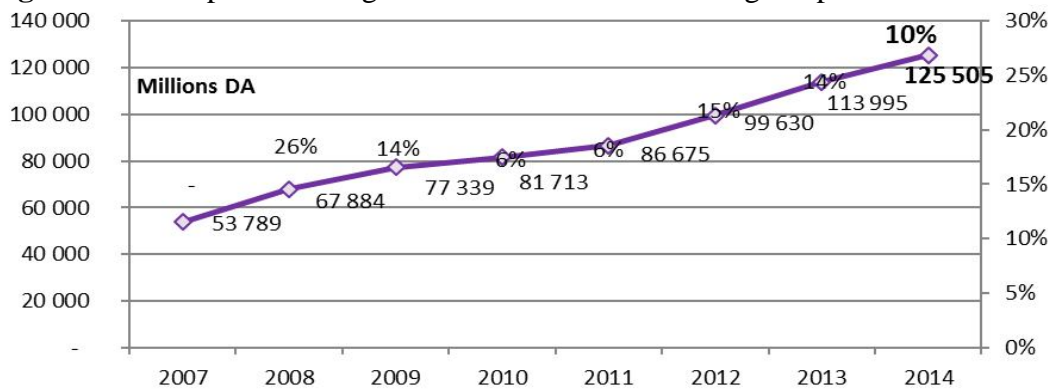
Algeria is situated on the northern coast of Africa. Following the partition of Sudan in 2011, it became the largest country on the continent of Africa. Algeria shares borders with a number of countries including Mali, Morocco, Niger, Libya and Tunisia. The Current population of Algeria is about 41 million people. However, its economy remained heavily reliant on the production of oil and natural gas, both of which account for over 93 percent of the country's exports.

The Article 619 of the Algerian Civil Code states that insurance is a contract under which the insurer is obliged to pay the policyholder an amount of money or income or

any other financial performance in case of a specified risk in the contract in return for the agreed premium.

Although the reduction of growth rate from 10% in 2014¹ to 2.2% in 2015, the insurance market in Algeria had been increasing till 2014. The turnover value of 53 billion dinars recorded during 2007, has grown to 130 billion dinars in 2015 with a growth rate of 10% in most cases. The maximum rate of 26% was reached in 2008. In fact, the insurance market in Algeria has grown continuously over the last years. This growth was mainly due to the increase of car insurance premiums by about 20% annually after the increasing number of cars in Algeria. The figure below summarizes the evolution of turnovers for the insurance sector in Algeria during the period 2007-2014.

Figure1: Development of Algerian insurance market during the period 2007-2014

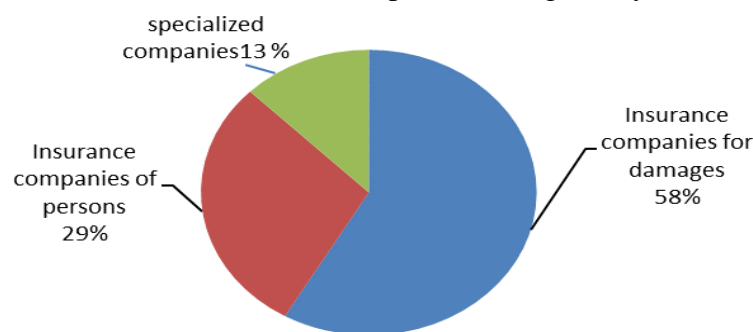


Source: Reports of Algerian Ministry of Finance for the years concerned

2.2. The reality of insurance sector in Algeria

The increasing growth of Algerian insurance sector is partly due to the radical reforms undertaken since 1996, following the issuance of the order 95/07, by which the insurance industry was liberalized and the monopoly state abolished (because there were 8 public companies) by opening the market for local private and foreign investments. Therefore, we can notice the rise of insurance companies from 14 to 24 between 2000 and 2015. These companies are divided between : insurance companies for damages, insurance companies of persons and specialized companies (including the reinsurance company and some cooperatives) as shown in the figure below:

Figure 2. Distribution of insurance companies in Algeria by nature of activity



Source: report of the Ministry of Finance for 2014.

¹ Insurance activity report for Algeria 2014, Direction of Insurance, General Direction of Treasury, Ministry of Finance, Algeria.

3. TAKAFUL INSURANCE EXPERIENCE

Takaful is an Arabic word stemming from the verb “kafal”, which means to take care of one another’s needs. Takaful insurance is defined as the Islamic alternative to traditional insurance with a difference in the fact that the customers of Islamic insurance get an investment return plus the surplus (Khan et al, 2011).

Takaful has an explicit ethical structure which can be marketed to both Muslims and non-Muslims (Swartz and Coetzer, 2010). The potential for Takaful is also important for Western countries which have large Muslim communities.

One major characteristics of Shariah compliant insurance is that both parties be sincere and the policy is for the sake of the hereafter and that there is nothing illegal in its aim and operations (Chua, 2000).

It takes three models: speculative model, agency model and mixed model². The main purpose of Takaful under the Islamic system is to bring equity to all parties involved, and the objective of the contract is to help the policy holder through bad times (Hussain and Pasha, 2011). That is why the profit is not the main goal of Takaful company.

Takaful insurance takes two forms: general Takaful (corresponds to damage insurance in the traditional insurance) and family Takaful (corresponds to life insurance in the traditional insurance).

3.1. History of Takaful insurance

Faisal Islamic Bank of Sudan was the first to introduce reforms to his insurance system by establishing Islamic Insurance Company Limited in Khartoum in 1979 (Anwar, 2008). The project shift into a complete Islamic financial system in Sudan was done by a formal decision in 1984. The supervision and control law of insurance operations in Sudan was issued in 1992. It obliged all commercial insurance companies to convert into Islamic companies.

In Malaysia, the first Takaful act was issued in 1984, and in the same year, the first Takaful company was established. Takaful has been supported by the Central Bank of Malaysia. This support is reflected in the Government's development of the basic plans for Islamic financial industry during the period 2001-2010 (Bouhrawa, 2013). In fact, Malaysia is the most popular in the promotion of Takaful industry and is likely to be the most competitive in terms of insurance for damages and persons. To be preserved, these results are now supported by the issuance of the Islamic financial services act in 2013 (IFSB, 2013).

Despite that Malaysia is the world's number one family Takaful market, it has been experiencing a decline due to the growth of family Takaful in other two countries: Pakistan and the UAE during last years. The general trend shows that these countries would join Malaysia in the next 05 years (IFSB, 2013).

On the other hand, some Asian countries such as Afghanistan, Azerbaijan, the Maldives, Singapore, Sri Lanka and Thailand have also reviewed their legal system to develop Takaful insurance services in the hope of providing more support to Islamic finance. Moreover, some African countries also such as Kenya, Morocco, Nigeria, South Africa and Tunisia, issued laws to frame Takaful industry in their markets.

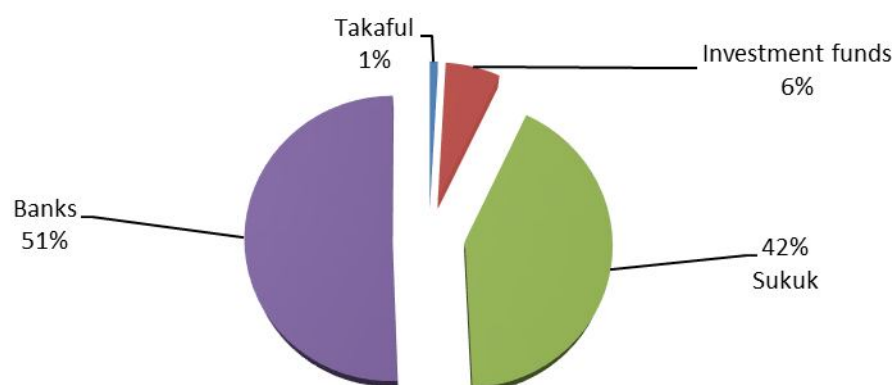
Clearly, Takaful industry has grown rapidly in the last decades. The growth rate has reached 15% during the period 2008-2014. In this context, the contribution to

² The Islamic Financial Services Board (IFSB) has conducted extensive studies in order to understand Takaful models used internationally.

the global insurance market was estimated at more than \$ 21.4 billion in 2013 and \$ 22.1 billion in 2014, supported mainly by the growth in regions known for their Takaful industry namely the GCC countries, Central Asian countries and South East Asia³. The number of Takaful companies in the world has therefore exceeded 200 companies in 2014 against 133 companies in 2006.

However, this rapid development of Takaful insurance industry still represents a very small part of the total Islamic financial services. Indeed, the percentage of the collected assets by Takaful insurance companies did not exceed 0.9% in 2015, which is very weak compared for example to the activity of Islamic banks (50.8%), Islamic Sukuk (42%) or Investment Funds (6.2%)⁴. As shown in the figure below:

Figure 3. The size of Islamic financial services in 2015



Source: from <http://www.meinsurancereview.com>, seen in June 05,2016

Although the insurance penetration rate in the GCC and South-East Asia is on average 1% of GDP, excepting for Malaysia where it is 5%, the Takaful industry can expand rapidly, there are large sectors of Takaful insurance markets untapped because of the lack of legal frameworks as well as the dominance of traditional insurance companies. We observe that Takaful companies have recently extended their activities by including unusual products, new also for traditional insurance. They are sectors such as: wealth management, study financing and pensions.

3.2. Regulation of Takaful Insurance

In terms of solvency, Takaful companies are limited in their financial resources compared to traditional insurance companies. Retakaful is therefore necessary to support the growth and solvency of these companies. So, retakaful companies can play an important role in expanding the Takaful portfolio by increasing the subscription capacity despite the difficulties facing this orientation.

The relationship between the insured and the insurance company differs from conventional insurance and Takaful. The latter has many models that regulate this relationship. Takaful insurance companies have focused on controlling this relationship in order to give a clear picture of the rights and duties of each party. That is why, the area of shariah compliant products was the most important issue at the

³ The Gulf Cooperation Council. Its member states are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

⁴ from <http://www.meinsurancereview.com>, seen in June 05,2016.

beginning. The control and supervisory issues concerning Takaful were determined by the Islamic Financial Services Board in August 2006⁵, urging the need for takaful insurance to be Shariah compliant.

In reality, most international organizations agree that there is no single model that regulates the management of Takaful companies. Each country must issue a law regulating its Takaful industry.

As insurance is risky, every Takaful company must show its capacity to meet its obligations in a certain period, very often is one year. The companies are requested to applying an estimate of technical provisions without recourse to loans. It means that the fund solvency level must correspond to the nature of the overall risks, allow early intervention and determine the terms of recourse to loan facilities.

If the solvency estimates are insufficient with respect to Takaful risk management, the Takaful supervisors should develop effective risk management systems consistent with Takaful principles and internal controls in particular with regard to actuarial issues and internal audit, with emphasis on the respect of general rules concerning the presentation of information in financial statements as well as the disclosure requirements in those lists in order to achieve accounting objectives⁶.

The Algerian insurance law 06/04⁷ knows a legal vacuum in takaful insurance industry, as the insurance companies in Algeria have to take the form of cooperatives as being (not for profit purpose) represented by the participants' fund or the form of traditional insurance companies (profit purpose) represented by shareholders. This situation required more reconsideration in favor of takaful companies in Algeria either by modifying some laws which are not comply with the nature and principles of takaful or by the adoption of a separate law which would govern the takaful industry and ultimately promote the investment in takaful, like the Malaysian and Sudanese experiences.

4. TAKAFUL INSURANCE IN ALGERIA

4.1. The reality of Islamic insurance

Salama Insurance is the only company that applies Takaful insurance in Algeria. It is one of the main branches of Salama Group (Arab Islamic Insurance Company) which is a leading provider of insurance solutions in the world that complies with Islamic Sharia since its establishment in 1979 in the Emirate of Dubai, United Arab Emirates. Salama Group has six Takaful companies in the World: Algeria, United Arab Emirates, Saudi Arabia, Egypt, Senegal, and Jordan. Salama Insurance was created in 2000, then acquired Al Baraka and Al Aman Insurance and Reinsurance Company in 2006.

Salama's part is estimated at 3% of the total Algerian market and at 22% of the private sector. Even though this ratio appears very weak, it is interesting in the way that the turnover is annually evolving, the average rate during the period 2004/2015 is 46% as shown in the table below.

⁵ The Islamic Financial Services Board (IFSB) is an international standard-setting organization that promotes and enhances the soundness and stability of the Islamic financial services industry.

⁶ Financial Accounting Standard No 12 relating to presentation and general disclosure can be relied upon in the financial statements of Islamic insurance companies.

⁷ The insurance law 06/04 was published in February 20, 2006.

Table1. Development of the Salama Insurance's turnover (Unity: 1 million dinars)

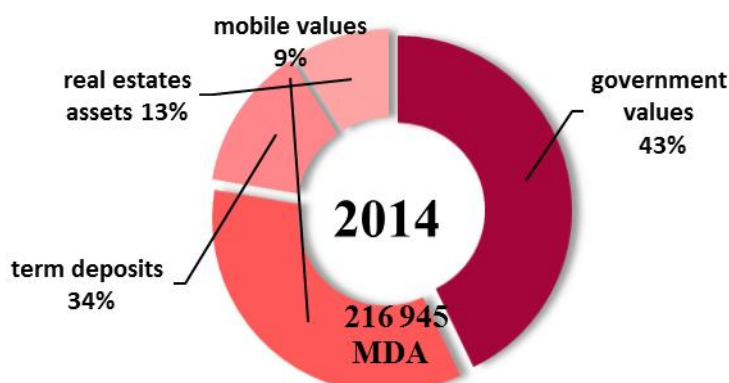
Years	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Turnover	238	481	497	524	658	728	2540	2797	3277	4015	4491	5987

Source: Insurance Direction reports 2004-2015, Ministry of Finance -Algeria.

The particularity in the Algerian insurance law is the fact that it directs the investment deposits in the form of technical provisions⁸. According to the law, insurance companies are obliged to invest in a specific selected destination in order to maintain their solvency regardless of their specificities (Islamic or not Islamic).

The figure 4 illustrates that the state investment values (treasury values) and the term deposits represent the most important investments required by the current legislation for the insurance companies. Certainly, the legal constraints of investments fixed by law pose a big challenge to Takaful companies because they are related to interest rate. Islam has prohibited interest rate and so many Muslims avoid using this kind of investment.

Figure 4. Financial employment of insurance companies in Algeria in 2014



Source: Insurance direction's report 2014, Ministry of Finance -Algeria.

The other channels which are not linked to interest rate such as real estate and land owned in Algeria, and other real estate rights, are not or less profitable. The reason why they are not attractive investment destinations.

Another obstacle is about re-takaful. The reinsurance activity in Algeria is mainly controlled by the Central Reinsurance Company (CRC), whose activity does not comply with the principles of takaful (Islamic law), because the Algerian legislator obliges all insurance companies operating in Algeria to reinsure at least 50% of their risks in it. Furthermore, insurance companies have also the obligation to trade first with the CRC in the case of having risks involved in the voluntary agreement, especially when the Central Reinsurance Company offers equal to or better conditions than those provided by foreign reinsurers. The rate of total premiums reinsured annually by insurance companies over the period 2004-2014 are shown in the following table.

⁸ Executive Decree n°13-115 Concerning codified obligations, Official Journal of Algeria No. 18,2013.

Table 2. Development of reinsurance in Algeria for the period 2004/2014

<i>Year</i>	<i>Insurance companies production</i>	<i>Reinsurance rate (%)</i>
2004	35 758	34%
2005	41 620	32%
2006	46 474	33%
2007	53 789	32%
2008	67 884	36%
2009	77 339	33%
2010	81 713	34%
2011	86 675	30%
2012	99 630	32%
2013	113 995	28%
2014	125 505	29%

Source: Insurance Direction reports 2004-2015, Ministry of Finance -Algeria.

4.2. *Some requirements for Takaful industry in Algeria*

Following the experience of some countries that have been first practiced Takaful insurance on the one hand, and the specificity of Algerian insurance market, on the other hand, we will discuss some amendments that might be introduced to the legal framework of Takaful in Algeria.

The relationship between the insured and the insurance company differs between traditional insurance and Takaful. There are many models that regulate this relationship in Takaful companies. In order to give a clear picture of the rights and duties of each party, Shariah rules have been identified as an essential issue in Takaful, that why, we put emphasis on the need of board's supervision through the enactment of a Takaful act that would be very clear in terms of licensing, identifying the rights and duties of all Takaful operators. Algerian companies could not continue to function in the absence of a takaful act .

Now, the legal framework in Algeria needs additional paragraphs within the Insurance Law 06/04 to enable Takaful Insurance contracts to cover all risks that do not conflict with Islamic principles as well to define the relationship between the insurer and the insured as a speculative or an agency relationship or both.

The resources and liabilities of cooperative funds are not enough defined in the law, therefore they must be separated from the private capital of Takaful insurance company. Procedures linked to reducing the warranty also have to be redefined and the canceling of contracts must be Shariah compliant as well.

It is also worth introducing premium donation clause in favor of cooperative's fund and determining the manner to keep its accounts. Moreover, it is also necessary to determine how to deal with the surplus and deficit situations that may occur with this type of fund.

Within the current Algerian insurance act, the new Takaful companies have to choose one of the two legal forms: the stock company or the mutual company⁹. However, the necessity here is to frame Takaful insurance operations within every Takaful company by establishing a Shari'a Supervisory Board, which will be responsible for monitoring, following up all operations and specifying their qualifications and tasks.

It is also essential to exempt Takaful insurance companies from the application of the article 14 of the law which is related to the right of the insured to ask for a compensation when delays occur in his payment.

On the other hand, there is a need to review the bases of determining the mathematical provisions specifically those related to the interest rates contained in the articles 73, 74 and 75 of the Insurance Law 06/04 so that they would be more adapted to Takaful companies as well as the need to review the loading system for reducing the value of compensation in Takaful companies as stated in the article 30.

Furthermore, the explanation of the surplus distribution in Takaful has to be introduced in the insurance law. This distribution is always the subject of redistribution to the insured.

Following the same idea of sharia compliance, it is expected from the legislator to amend the article 85 concerning the reduction of guarantees and equivalent premiums in order to comply with the specificity of the Takaful insurance contract.

Also, the existing interest and discount rates that are stipulated in the article 90 in the case of annulment of takaful insurance contracts should be excluded. They are in opposition with the principals of Takaful system.

In the same context, Algeria needs also to amend the article 203 which is related the definition of the insurance company. This definition does not include Takaful and Retakaful companies.

The legislator has to reconsider also the modalities of employing the legal duties to make sure that they will become in line with the specificity of Takaful insurance and change the pricing mechanisms of insurance products, especially those related to interest rate by replacing them with Takaful compliant elements.

We may add also the possibility of revising the Takaful accounting system due to the existence of two separate accounts, one belongs to the company and the other belongs to the participants.

Given the weakness of the reinsurance market at the local level represented by the Central Reinsurance Company (CCR) as the only reinsurance company in Algeria, or at the international level, the problem of retakaful remains a major constraint to any development of the Takaful insurance in Algeria, therefore it is important to open A retakaful fund at the (CCR) at first stage pending the development of retakaful.

Finally, the supervision of Takaful insurance activity is carried out by the supervisory commission for insurance in accordance with a the articles 209 to 213 of the Algerian Insurance act. This commission is competent to supervise Takaful insurance with qualified employees in the field, but, in the future it would be essential to establish a competent legitimate body to follow Takaful insurance issues.

5. CONCLUSION

Most of the global indicators confirm a promising future for the Islamic finance with its rules and assets both for banking and insurance sectors, especially after the successive crises affected the international financial system and various financial institutions. Takaful insurance is considered one of the main approaches to play the

⁹ Article 215.

role of financial stabilizer because Islamic Finance is interested in managing the risks of various economic agents on the basis of ethics inspired from Islamic principles.

The development of Islamic insurance in Algeria appears to have lagged behind. However, the existing insurance should not be neglected but the both systems would work together and offer divers products to satisfy the various needs . The introduction of Islamic insurance in Algeria would gain more subscribers who are looking for Islamic products. It is appropriate to mention that the current legal framework of Algerian insurance market which is based on many elements inspired from French laws seems to be inappropriate in many of its axes with the nature and specificity of Algerian society (beliefs and customs).

The necessity is to offer the opportunity to Takaful insurance as an integral part of supporting national development by enriching its appropriate legislative, regulatory and institutional framework as well as by the preparation of an appropriate environment for the success of Takaful insurance, especially with regard to the development of the financial market and various financial aids that are Sharia compliant.

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