

Assessing ‘Takaful’ Insurance Business Regulation in Ethiopia against Sharia Norms: A Comparative Analysis

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Abstract

Muslim communities are not beneficiaries of conventional insurance schemes due to the perceived absence of Insurance scheme that complies with Islamic principles and Sharia laws. While insurance plays an important role in compensating and mitigating risks related to unpredictable loss of life and property, it needs to accommodate Islamic law to make Muslim communities on board. This article seeks to examine the reasons behind Muslim communities are left out of conventional insurance schemes. Then, the article asks whether or not the Islamic insurance scheme introduced by Ethiopian insurance business regulation complies with sharia standards. By employing doctrinal and comparative research methods, the article has found that conventional insurance is prohibited because it violates Islamic principles by involving elements of Riba (Usury), Gharar (peril), and Maysir (gambling). Moreover, while the Ethiopian insurance regulation introduces the Islamic insurance scheme, it falls short of assuring the fulfillment of Sharia standards provided by Islamic scholars and international non-profit organizations. Finally, the article suggests the insurance business regulation in Ethiopia should be overhauled by considering the Sharia standards.

Keywords: Islamic Insurance, Conventional Insurance, Sharia standard, Regulation, Ethiopia.

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Introduction

The realization of modern trade and commerce is unimaginable without the involvement of the financial institution in general and the insurance business in particular.¹ The role played by the insurance business in reducing the effect of several perils, like illness, accident, loss of property due to theft or fire, agricultural losses, and other natural and artificial risks is profound in that it will reimburse the losses.²

Consequently, countries around the world established insurance businesses and their legal frameworks. However, the establishment, as well as the legal framework of conventional insurance (hereinafter referred to as Insurance), is contrary to the Sharia principles as they involve elements of *Gharar* (aleatory nature of the insurance contract)³, *Riba* (Usury)⁴, and Maysir (gambling)^{5,6}. This has become an obstacle to the needs of Muslim communities to enhance their lives by covering life, health, property, motor, and liability risk without going beyond the teaching of their religion.⁷

Hence, Muslim scholars were searching for an alternative institution as an answer to the quest of Muslim communities until they met at the conference in Mecca in the name of the Council of Islamic scholars⁸ in 1985.⁹ At the end of the conference, they came to a consensus on the non-

¹Anwar, Habiba, *Islamic Finance: A Guide for International Business and Investment*. GMB Publishing Ltd., United Kingdom. 2008.

²Birritu, a quarterly magazine, *The National Bank of Ethiopia*, No. 112, 2012. [http://www. Birritu@ethionet.et](http://www.Birritu@ethionet.et). (April 15, 2020).

³Gharar (refers to peril, speculation, deception or uncertainty) is its origin from Arabic verb ‘gharra’, to mean literally to deceive. Gharar refers deceit, uncertainty, and hazard. <http://www.investopedia.com/terms/g/gharar.asp> (accessed on April June, 2020). However, gharar refers to the feature of Insurance as aleatory transaction in this case.

⁴The term ‘riba’ is an Arabic word which means an increase, an additions or excess. (Takaful (Islamic Insurance) Practices: Challenges and Prospects in Nigeria, *Journal of Insurance Law & Practice*, Vol. 4, No. 2, 2015. P.14.

⁵Is a type of business where financial gain results from mere chance, speculation and conjuncture; apart from work. Instances of Maysir activities include horse racing, lottery, and crossword puzzles. Id. P. 15.

⁶There are several publication on the prohibition of conventional insurance in line with Islamic laws-includes Abu-Hussain, M. F., Muhamad, N. H. N., & Hussain, M. Y. M. (2014) compiled these fatwas as (1) Fiqh Council of the Muslim World League (2) Islamic Research Institute of Al-Azhar University in 1965 (3) Grand Council of ‘Ulama of Saudi Arabia (4) Majlis Taḥqīqāt al-Sharia Lucknow, India (5) Al Majma’ al-Fiqhi al-Islami of OIC in 1975 (6) Council of Islamic Ideology, Pakistan (7) International conference on Islamic Economic in 1976, and (9) European Council for Fatwa. See: Abu-Hussain, M. F., Muhamad, N. H. N. & Hussain, M. Y. M., ‘Takāful (Islamic Insurance) Industry in Malaysia and the Arab Gulf States: Challenges and Future Direction,’ *Asian Social Science*, 10/21 (2014): 26-34.

⁷Zainal Abidin Mohd Kassim, *Takaful and Mutual Insurance: Alternative Approaches to Managing Risks*, world bank report on direction in development finance, Washington D.C. 2013. P. 88.

⁸This council known as International Islamic Fiqh Academy which is head quartered in Jeddah, it consists of Islamic scholar (Ulama) all over the world. <http://www.iifa.aifi.org> (accessed on April 10,2020).

⁹Muhamad Badri Bin Othman, *Development and Shariah issues of the Takaful industry in Malaysia: effects of the regulatory framework on the implementation and growth*, 2012 p.8.

compliance of conventional insurance with Sharia principles, which is followed by approval of ‘*Takaful*’ insurance (used interchangeably Islamic insurance throughout the writing) as an alternative for Muslim communities. Subject to its Sharia compliance, non-Muslims are at liberty to participate in Islamic insurance. Since then, Islamic insurance (*Takaful*) has been expanding in Muslim majority countries; countries with diverse religions as well as counties with a Muslim minority. As such, *Takaful* is growing at an average of 20% annually.¹⁰

Domestically, Insurance Business Proclamation No.1163/2019 (as amended)¹¹ comes up with a provision that allows the establishment of Islamic insurance operators and/or the opening of the *Takaful* window in the existing conventional insurance companies.¹² Moreover, the Proclamation authorizes the National Bank of Ethiopia (NBE) to issue a directive regulating the licensing and operation of Islamic insurance. In line with this law, the NBE issued Directive No. STB/1/2020 seeks to provide additional conditions for licensing and Supervision of the Islamic insurance scheme.¹³

The overall objective of this article is to address the following questions: - the rationale for the introduction of Islamic insurance? what are the elements involved in conventional insurance that are against Islamic financial principles? And how far do Ethiopia’s insurance business proclamation and NBE directive give assurance of Islamic insurance’s compliance to sharia principles? To put it in another way, are the aforementioned proclamation and directive help us realize *Takaful insurance* in Ethiopia which is ultimately consistent with sharia standards?

The article proceeds in seven sections, including the introduction. The first section deals with the general overview of Islamic insurance. Section two is a comparison and contrasts between Conventional insurance and Islamic insurance. The third section is a discussion on the background of the Ethiopian insurance business. Section four as the main component of the article examines the Ethiopian Islamic insurance legal framework that gives the green light for the Islamic insurance business with its sharia compliance requirement. Then, the need for revision of the Ethiopian

¹⁰Redzuan, H., Rahman, Z. A., and Aidid, S. S. (2009). *Economic determinants of family takaful consumption: Evidence from Malaysia*. International Review of Business Research Papers, 5(5), p. 194.

¹¹ Federal Democratic Republic of Ethiopia, amendment insurance business proclamation No. 1163/2019, *Federal Negarit Gazette*, 26th years, No. 6.

¹²Id. Article 60(2).

¹³Licensing and Supervision of insurance Business Directives to License *Takaful* business operator and authorize *takaful* window operator Directives No. SBB/1/2020.

Islamic insurance legal framework is discussed in section five. The final part of this article is the conclusion.

1. General Overview

Insurance is crucial in solving some problems that bring uncertainty to human life and build people's confidence in business activities. In addition to this, some types of insurance like vehicle insurance against third parties and health insurance coverage become compulsory for the owner of the vehicle and every citizen, respectively.¹⁴ However, the question of conventional insurance's compliance with Sharia principles was frequently asked by Muslim scholars. Initially, Muslim scholars were divided over the answer as to whether Conventional insurance is sharia-compliant or not.¹⁵ Indeed, the Organization of Islamic Cooperation (is the second largest inter-governmental organization after the United Nations and the collective voice of the Muslim world to ensure and safeguard their interest in economic, social, and political areas)¹⁶, come up with two Fatwas (legal opinion of Islamic Scholars) at the Conference of Mecca in 1985.¹⁷ The first of these 'Fatwa'¹⁸ is a decision on the impermissibility of Insurance with Sharia principles. As a result of this decision, the argument on the permissibility or otherwise of conventional insurance schemes for Muslims is solved as the Muslim community has to respect the rules made by a majority of the Islamic scholars as a fourth source of the sharia principle (Ijma which literally to mean, consensus by a majority of Muslim Jurist).¹⁹

The scholars backed their decision basically on the involvements of three things into Insurance is provided as the rationale for its Sharia non-compliance. These are: (i) *Riba* (Usury), (ii) *Gharar*(uncertainty), and (iii) *Maysir* (Gambling).²⁰ *Riba* (Usury) is prohibited as trading money for money by the verses of the Holy Quran and Hadith of the Holy Prophet. Under conventional

¹⁴Spencer L. Kimball, *The Purpose of Insurance Regulation: A Preliminary Inquiry in the Theory of Insurance Law*, Minnesota Law Review. 2324. Vol. 45. No. 471. 1961. In Ethiopia vehicle insurance is compulsory on a person who owns a vehicle buy an insurance policy according to vehicle insurance proclamation No.

¹⁵Rejda E. G. (2011). Principles of Risk Management and Insurance, eleventh edition, Prentice Hall, United States. Sahih al-Muslim, Kitab al-Birr, 59. See also Ma'sum Billah Mohd, Dispute among the Ulama on the Validity of life Insurance & Possible Refutation to the Misconception, 2011.

¹⁶ A brief on the Organization of Islamic Cooperation (OIC) and its institution. <https://www.sesric.org/about-oic.php>.

¹⁷ See Anwar supra note. 1.

¹⁸ Fatwa refers to a legal opinion or decree issued down by an Islamic expert in sharia laws. In order to come to this conclusion. Islamic scholars critically assess the theories and operations of the conventional insurance and attempted to formulate an alternative system based on Islamic values and principles.

¹⁹See Anwar. supra note, 1.

²⁰Nasser, Y. & Jamil, R., *Takāful: A Study Guide* (Kuala Lumpur: IBFIM, 2011), 81-84.

insurance, the insured pays a premium in exchange for the insurer's undertaking to pay the sum much higher than the policyholder paid, on the realization of the specific event clearly outlined in the policy. This unjustified increase leads to *riba*. Further, *riba* would also involve in the case of non-occurrence of the defined event in the policy. When the specified event in the policy is not realized, the insured loses the money and unjustified increases of capital for the insurance company.²¹ *Gharar*(uncertainty), Sharia exemplifies it with a fisherman's sale of fish that one will catch tomorrow because of the uncertainty on whether one will catch the fish or not. In Islam, engaging in indeterminate events whose occurrence is uncertain is prohibited.²² The periodical premium payment by the policyholder without being certain on the payment for the payment is upon the occurrence of a defined event in the policy.²³ Its involvement is a result of inequality of the premium payable by the policyholder with the reimbursement that will be payable by the insurer in case the risk is materialized.²⁴

Thus, it is against the core Islamic economic principle of equitable distribution of wealth, and lack of transparency in the common insurance regarding its profit and expenses.²⁵ The Second ruling of the council is the approval of Takaful as a Sharia-compliant alternative to Insurance.²⁶ By the same token, the Muslim Scholars cite the following verses from the Holy Quran and Hadith of the Holy Prophet for approval of Takaful respectively.

(The Quran says under vol.5: verses 2)

“Help ye one another in righteousness and piety, but help ye not one another in sin and rancor”.²⁷

²¹ Aly Khorshid, *Islamic Insurance: A modern approach to Islamic banking*, RoutledgeCurzon is an imprint of the Taylor & Francis Group, New York, 2004, p. 63.

²² See: “*Sharh Al-'Inayah Ma'a Fath Al-Qadir*” “*Sharh Al-'Inayah Ma'a Fath Al-Qadir*” [5: 192]; [5: 192]; “*Tabyin Al-Haqa`iq*” “*Tabyin Al-Haqa`iq*” [4: 46]; [4: 46]; “*Al-Taj*” “*Al-Taj Wa Al-Iklil*” “*Wa Al-Iklil*” [4: 362]; [4: 362]; “*Fath Al-'Aziz Bi-Hamish Al-Majmu*” “*Fath Al-'Aziz Bi-Hamish Al-Majmu*” [8: 127]; [8: 127]; “*Matalib Uli Al-'Matalib Uli AlNuha*” “*Nuha*” [3: 25]; [3: 25]; “*Al-Qawa'id Al-Nuraniyyah*” “*Al-Qawa'id Al-Nuraniyyah*” (P. 116); (P. 116); “*Nazariyyat Al-'Aqd*” “*Nazariyyat Al-'Aqd*” (P. 224). See: (P. 224). See: “*Al-Gharar Wa Atharahu Fi Al-'Uqud*” “*Al-Gharar Wa Atharahu Fi Al-'Uqud*” by Al-Siddiq Al-Amin Al-Darir (published by Al-Siddiq Al-Amin Al-Darir (published by Saleh Kamil Center for University Thesis), (P. 54). Saleh Kamil Center for University Thesis), (P. 54).

²³ See Aly Khorshid, *supra* note 21, P.61.

²⁴ Mohd Fadzli, Y., Wan Zamri, W.I. & Abdul Khudus, M.N., *Fundamentals of Takāful*, 18.

²⁵ Mohammed, J. A. (2007). *Corporate Social Responsibility in Islam*. Unpublished doctoral thesis, Auckland University of Technology. Retrieved September 14, 2008.

²⁶ See Anwar. *Supra* note 1.

²⁷ Holy Quran, vol. 5:2.

The Prophet Muhammad said: “The believers, in their affection, mercy, and sympathy to each other, are like the body, if one of its organs suffers and complains, the entire body responds with insomnia and fever” (Muslim).²⁸

In addition, they cited *Aqilah* and *Diya* which were seen as arrangements customarily used for sharing responsibility, mutual help, and solidarity in some tribes during the time of Prophet Mohammed.²⁹

The word *Takaful* is derived from the Arabic root word ‘*Kafala*’ which is defined as taking care of each other in the time of need and guarantying for one another.³⁰ *Takaful* is the way of providing mutual help and assistance for the member who suffers loss from the money contribution already made by all participants.³¹ It is the agreement for cooperation voluntarily whereby the members contribute money to a fund for helping and indemnifying each other in case of loss/losses and invest and/or distribute its surplus under the model adopted.³² Preceded to Fatwa given by the Organization of Islamic Cooperation, the first Islamic Insurance (Takaful) is established in Sudan by Faisal Islamic banks in 1979.³³

The Islamic insurance is categorized as Family and General *Takaful*. Like life insurance, family *Takaful* is long-term insurance and it covers all risks related to danger to human life. In contrast, general insurance covers non-family insurance including property, marine, motor, and other risks.³⁴

²⁸ Sahih Al-Muslim, Kitabul Birr Wa’s-salat-wa’l-Adab, Book 32 No. 59.

²⁹ Ibn Hajar al-‘Asqalanī, Fath al-Bārī bi Sharḥ Ṣaḥīḥ al-Bukhārī, vol. 12 (Cairo, Egypt: Dār al-Ḥadīth, 2004), 289, 290, no. hadīth 6910. Manjoo, Faizal . Why Different Takaful Models in the World? No. 10. 2007 <http://www.sabbir@icmif.org>. www.takaful.coop. (accessed on 28 May, 2020).

³⁰ Stagg-Macey, Catherine (2007). *An Overview of Islamic Insurance*. No. 8. <http://www.sabbir@icmif.org>. (accessed on 28 May, 2020) Engku Rabiah Adawiah, E.A., & Hassan Scott, P.O., Essential Guide to Takāful, 3.

³¹ Takāful is derived from an Arabic word which means “solidarity”, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks. In a Takāful arrangement, the participants contribute a sum of money as Tabarru’ commitment into a common fund, which will be used for mutual assistance of the members against specified loss or damage. See Islamic financial service board, guidance on the recognition of ratings by external credit assessment institutions on takaful and retakaful undertaking, IFSB standard No.5, 2011. <http://www.ifsb.org>. (accessed on May 20, 2020)

³² See Anwar, supra note No. 1.

³³ Hamid, M. A., and Othman M. S. (2009). A study on the level of knowledge and understanding among Muslims towards the concepts, Arabic and Sharia terms in Islamic Insurance (takaful). *European Journal of Social Sciences*, 10(3), p. 470.

³⁴ Id.

Another issue worth discussing here is the *Takaful* insurance model. The *takaful* model is the method of governing the relationship between the *Takaful* operator and participant. The three frequently adopted models of *Takaful* insurance include - *Mudharaba*, *Wakala*, and *Wakala-Mudharaba*. In the *Mudharaba* model, the participants are considered the owner of the money contributed, and the *Takaful* operator/window is the administrator of the fund/money. In this case, the funds contributed by participants are categorized as participants' risk fund (PRF) and participants' investment fund (PIF). Participants' risk fund is a portion of the fund paid for the claims of the member participant in case the defined event is realized. Whereas participants' investment fund is the portion contribution of the participant allocated for investment.³⁵ This investment is based on sharing of both profit and loss between participants and *Mudarib*(*Takaful* operator/window) and should be on permissible investment.³⁶ While, in the case of the *Wakala* model, the operator/window carries on the investment as a mere agent on behalf of participants for commission.³⁷ The third one, the *Wakala-Mudharaba* model includes the elements of the two models above. The operator/window is entitled to a commission as an agent for the management of the participants' fund and the service they provide. In addition, they have also entitled to the share of profit or loss for investing participant's investment funds.³⁸

Currently, *Takaful* is developing faster than Insurance in both Muslim and **non-Muslim countries**.³⁹ However, this development is not free of institutional, operational, and regulatory challenges. To put it differently, challenges identified by scholars, include lack of awareness among the communities, absence of *Takaful* scholars and experts, and lack of standard setter and supporting Sharia-based institutions. Moreover, the lack of appropriate external regulatory frameworks at international, regional, as well as national levels are the challenges that are facing *Takaful* insurance.⁴⁰

³⁵ Islamic financial service board, guiding principles on the governance of *Takaful* undertaking, December 2009.

³⁶ Mohd Fauzi Abu-Hussin, Nasrul Hisyam Nor Muhamad & Mohd. Yahya Mohd. Hussin, *Takaful (Islamic Insurance) Industry in Malaysia and the Arab Gulf States: Challenges and Future Direction*, Asian Social Science; Vol. 10, No. 21; 2014 p.29.

³⁷ See Islamic financial service board, supra note 41.

³⁸ Odierno, Hassan Scott P., and Muhaimin Iqbal. "Takaful Windows: An Initial Stepping Stone to Bigger Islamic Insurance Market." Middle East Insurance Review. Dec. 2006 p. 65–66.

³⁹

⁴⁰ See Mohd Fauzi Abu-Hussin, Nasrul Hisyam Nor Muhamad & Mohd. Yahya Mohd. Hussin, supra note 42.

As the basic and underlining rationale for the introduction of Islamic insurance as an independent entity from conventional insurance is strict adherence to the Sharia principles. Therefore, the regulatory requirements of *Takaful* insurance's sharia compliance by the government regulatory and supervisory authority through different methods- including but not limited to imposing the establishment of a qualified sharia board/council with clear mandate and duties in the formation and operation(as to ensure the products, services, and operations of Islamic insurance comply with sharia) as well as regular monitoring and supervision by government's supervisory authority plays a crucial role for the success of the business and protection of the stakeholders in Islamic insurance.⁴¹

2. Conventional Insurance Vis-à-vis Islamic Insurance

As far the reason why Islamic insurance was introduced as a distinct engagement is directly related to the non-compliance of common insurance with the sharia principles. This incompliance leads to the search for the alternative by Muslim scholars to solve the unpredictable problems and enable Muslim communities' participation in economic activities in line with the teachings of sharia. Given that, they come up with an institution that is an alternative to the mainstream insurance called *Takaful* (Islamic insurance)⁴². Having identified the areas of incompliance with the sharia principle in conventional insurance above, the discrepancy between Islamic insurance and commercial insurance in line with AAOIFI standards and scholarly literature will be elaborated on

⁴¹ Hasan, Zulkifli. (2010). *Regulatory framework of Sharia governance system in Malaysia, GCC Countries and the UK*. Kyoto Bulletin of Islamic Area Studies, 3-2, p. 90.

⁴² "Islamic Insurance is a process of agreement among a group of persons to Islamic Insurance is a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability. The resources of this fund are used to indemnify any participant who encounters injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of policyholders, or a joint stock company that manages the insurance operations and invests the assets of the fund, against a specific fee." See *Accounting and Auditing organization of Islamic financial institution(AAOIFI), Islamic insurance, sharia standard No. 26. May 2005, p. 678.*

in this part of the discussion. Accordingly, the following can be said about the difference between insurance and Islamic insurance:

Firstly, the contract in conventional insurance is a contract between an insurer and the insured. In this contract, the insurance company undertakes an insurance policy (for reimbursing the policyholder in case of materialization of specific events in the policy) in return for the premium paid by the insured.⁴³ The goal of the company selling this insurance policy is the maximization of profit for its shareholders.⁴⁴ While the main purpose of takaful insurance is for solidarity and mutual help among members in every legislation including ours.⁴⁵ Thus, the contribution made by the participant is in the form of a donation (*tabarru*). The main objective of Takaful is the protection of the well-being of the members through cooperation and solidarity by joint-guarantying the participants in case of losses or injury and achieving pleasure with minimum profit. This is aimed at consisting with Islamic financial principles that prohibit an exchange contract because it involved uncertainty on the occurrence or otherwise of the event (i.e., *Gharar*) which is forbidden in Islam.⁴⁶

Secondly, the insurance company is one of a party that undertakes a contract with the insured in its name. The insured bought the policy from the insurer as a product from the marketplace and the company is entitled to the ownership of the premium paid in exchange for indemnity for the insured only in case of the fulfillment of the specified risk in the policy. In other words, the policyholder has no right to the premium paid unless the event specified in the policy brought is materialized.⁴⁷ Whereas, the role of the Takaful operator is an agent of the participant (principal) to manage the affairs of the undertaking and the funds contributed. The participant in turn pays a commission to the operator for the service according to the underlying agreement on the takaful

⁴³ Federal democratic republic of Ethiopia, insurance business proclamation No. 746/2012, federal negarit gazetta, article 2(17), 18th year, No. 57.

⁴⁴Id. P.692.

⁴⁵ See amended insurance business proclamation No. 1163/2019, supra note 11, article 2(39). See also AAOIFI standard No. 26 supra note 18. And see also IFSB supra note 19.

⁴⁶Seyed Mohamed Mohamed Mazahir, Asmak Ab Rahman, Mohammad Ismath Ramzy, *an analysis of policy compatibility between conventional insurance and Islamic insurance policy: a case study of conceptual and operational difference*, Shariah Journal, Vol. 25, No. 3, 2017 p. 496.

⁴⁷See AAOIFI standard No.26, supra note No. 45.

model. The participant is entitled to the ownership of their contribution and the fruit of investments.⁴⁸

Thirdly, the policyholder exchanged the premium they paid for the insurance company in return for the transfer of risk to the company in normal insurance. Thus, insurance is based on the transfer of the future risk (if any) from the policyholders to the insurer once the premium is paid.⁴⁹ However, the money payments of the participant are not premium rather, it is a contribution in the form of donation which is used for the joint guarantees of each other. Moreover, neither transfer ownership of money contributed to the takaful operator nor transfer risk from the participants to the operator. Thus, the contribution is deposited to the segregated account (interest-free account) from the operator's account.⁵⁰

Fourthly, the surplus of the contribution left (if any) after the following payment including - payment of claims, payment of the agreed-upon commission for the *Takaful* operator/window, and *Retakaful* (reinsurance) expense can be either invested or distributed to the participant according to the model adopted by the Islamic insurance. Not only is the surplus that is shared among the members, but also the loss is shared between them as one feature of Islamic investments.⁵¹ In contrast to this, the premium paid by the policyholder is the asset of the company once the policy document is signed. The insured has no right either on the surplus or loss of the insurance company. Thus, both the surplus and loss go to the insurer's accounts to be shared among the shareholders.⁵²

Fifthly, the participants are insured as well as insurers at the same time in Islamic insurance. It is to mean that, the contribution payable by a participant is deposited in their name to indemnify the loss of the member specified according to the agreement among them and the surplus can also be invested in sharia compliance investment by their name.⁵³ In the case of Conventional insurance, the insurance fund is owned and managed in the name of the company. The payment of

⁴⁸ Id.

⁴⁹Seyed Mohamed Mohamed Mazahir et al, supranote 46 p. 493.

⁵⁰ Id.

⁵¹See AAOIFI, supra note No.45. The policyholders of takāful share any surplus or loss from the pool collectively. Due to surplus money in addition to premium contribution, takāful system has a built-in mechanism to counter any over-pricing policies of the insurance companies, see also Farooq, S.U., Chaudry, T.S., Fakhr-e-Alam & Ahmad, G., 'An Analytical Study of the Potential of Takāful Companies', p. 58.

⁵²Seyed Mohamed Mohamed Mazahir et al, supra note 46 p. 497.

⁵³ Nico P. Swartz & Pieter Coetzer, 'Takāful: An Islamic Insurance Instrument,' Journal of Development and Agricultural Economics, 2010: p.334

compensation by the insurer is based on the policy document when the specified events in policy is materialized. Apart from this, the insured is the policyholder who signs the policy document and pays the premium to the insurance company. Therefore, insured and insurer are different in the case of conventional insurance.⁵⁴

Sixthly, there are two distinct agreements in Islamic insurance. One is the agreement between the participant and the operator/window. This agreement is an agency relationship to administer the participant's fund, payment of the claim in case of materialization of a defined event in the policy, invest the surplus in the sharia-compliant business, and carry out other day-to-day activities in return for a commission.⁵⁵ The other agreement is undertaken among the member participants as a partnership (*Musharaka*) for solidarity and mutual help among themselves.⁵⁶ Seventh, Islamic insurance needs the establishment of a supervisory committee named as sharia advisory board/council for monitoring its daily activities in the eyes of Islamic principles. In the case of Insurance, no needs to establish such a committee apart from the board and other management.⁵⁷

To conclude, the commercial insurance scheme is contrary to Islamic finance. The implication is that; it is impermissible (*haram*) for Muslims to enter into the concession contract with insurers according to the sharia principle. Having discussed how insurance violates Islamic financial rules, the next question will be whether or not the Muslim community have an alternative option? The answer is positive thanks to the effort made by Muslim scholars and Jurists by taking into account the crucial nature of insurance schemes in individual life as well as business to come up with an alternative for Muslims called *Takaful* (Islamic insurance) in place of conventional insurance.

⁵⁴See Seyed Mohamed Mohamed Mazahir et al, supra note 52.

⁵⁵ See AAOIFI standard No. 26, p. 670. "*The Musharakah (partnership) among the participants, which leads 4/1 The Musharakah (partnership) among the participants, which leads to the establishment of a company that has articles of association and to the establishment of a company that has articles of association and all other documents. The relationship between the participants may all other documents. The relationship between the participants may be confined to a Musharakah contract if a company manages the be confined to a Musharakah contract if a company manages the fund. [see Shari'ah Standard No. (12), on Sharikah (Musharakah) fund. [see Shari'ah Standard No. (12), on Sharikah (Musharakah) and Modern Corporations]*".

⁵⁶ See AAOIFI standard No. 26, p. 670. "*The Musharakah (partnership) among the participants, which leads 4/1 The Musharakah (partnership) among the participants, which leads to the establishment of a company that has articles of association and to the establishment of a company that has articles of association and all other documents. The relationship between the participants may all other documents. The relationship between the participants may be confined to a Musharakah contract if a company manages the be confined to a Musharakah contract if a company manages the fund. [see Shari'ah Standard No. (12), on Sharikah (Musharakah) fund. [see Shari'ah Standard No. (12), on Sharikah (Musharakah) and Modern Corporations]*".

⁵⁷Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), Sharia Standards for Islamic Financial Institutions, Bahrain, 2008, 473.

3. Background of insurance in Ethiopia

The developments of the insurance business legal regime in Ethiopia pass through different stages. Before the establishment of the Imperial insurance company in 1951, the modern history of the Insurance business in Ethiopia was occupied by foreign investors, especially from Italy, Great Britain, and France.⁵⁸ The insurance policy issued by both imperial insurance companies(domestic) and foreign insurance agents were fire, marine, life, and general accident insurance policy.⁵⁹ As to the regulation of the then growth of insurance business in Ethiopia, the 1960 Commercial and Maritime codes had provided a minimum standard for operation of inland, river, air, and maritime insurance in book III title III and title VII, respectively.⁶⁰ Added to this, the regime issued legal notice 393/1971 to regulate licensing, renewal, and other supplementary provisions.⁶¹

The nationalization of private property which the insurance companies were not an exception followed during the Derg regime. Proclamation No. 68/1975 was used as a green light for the monopolization of the insurance industry by the government which had a negative consequence for the industry as a whole.⁶² post-1991, the transitional government's shift to a free-market economy paved the way for the establishment of the domestic private insurance company and competition in the industry through licensing and supervision of insurance business proclamation No.86/1994.⁶³

This proclamation is more comprehensive than the preceding insurance legislations and it re-establishes the National Bank of Ethiopia as a central bank with a regulatory and supervisory role in the financial institution and opens the business for the private where some new developments by the proclamation are made.⁶⁴ With the development of the insurance business, proclamation

⁵⁸Hailu Zeleke, *Insurance in Ethiopia: Historical Development, Present Status and Future Challenges*. Addis Ababa: Master Printing Press. 2007.

⁵⁹Id.

⁶⁰Abay Yimer,S. *Financial Market Development, Policy and Regulation, the international experience and Ethiopia's need for further reform* (PHD theses, University of Amsterdam, 2011), p.13.

⁶¹IGE(MI), 1960, *Ethiopia Facts and Figures* (Ministry of Information of Imperial Government of Ethiopia, Addis Ababa, 1960). As Cited by Abay Yimer,S.

⁶² Abay Yimer,S. *supra* note.70.

⁶³TGE, 1994, *Ethiopian Insurance Corporation Establishment Council of Ministers Regulation No. 201/1994*, *Negarit Gazeta*, Year 53, No. 110, Addis Ababa, 19th September, 1994.

⁶⁴Itana Ayana, 1994, "Credit Policy, Financial Institutions and Private Investment In Ethiopia," in Getachew Yoseph And Abdulhamid Bedrikello, (eds.), *The Ethiopian Economy: Problems And Prospects Of Private Sector Development, Proceedings Of The Third Annual Conference On The Ethiopian Economy* (Addis Ababa University Press, Addis Ababa, 1994).As Cited by Abay Yimer,S.

No. 86/1994 is repealed after almost two decades in order to ensure stability and reliability and replaced by insurance business proclamation No. 743/2012.⁶⁵ Thus, there are about 18 insurance companies are operating in Ethiopia currently.⁶⁶

However, none of the above legal regimes allows the establishment and operation of either the *Takaful* window under a conventional insurance company or a full-fledged Islamic insurance business until the insurance business amendment proclamation No. 1163/2019 comes up with a provision that allows the licensing of both full-fledged Islamic insurance business undertaking and opening a *takaful* window under the existing insurance company. Moreover, the proclamation authorizes the NBE to issue a directive that provides additional criteria specific to *Takaful*. As per this authorization, the NBE issued directive No. STB/1/2020 in order to provide an additional condition that is unique to *Takaful* in licensing and supervision.

4. Assessment of Sharia Compliance Requirement of Islamic Insurance in Ethiopia

4.1. Insurance Business Law

The FDRE constitution of 1995 attempted to secular arrangements that accommodate cultural and religious diversity in the country. As part of legal pluralism, the adjudication of disputes related to personal matters through customary and religious courts is recognized.⁶⁷

Most importantly, the main reason for the evolvement of *Takaful* is conventional insurance's odds with the sharia principles on the presence of *Riba* (interest, Usury), *Gharar* (uncertainty), and *Maysir* (gambling) as it is discussed elsewhere above.⁶⁸ The 1995 FDRE constitution establishes the separation of state and religion under article 11.⁶⁹ This shows the absence of state religion and the legislation that outlaws or favors one religion over another is void. The FDRE constitution recognizes freedom of religion to be freely exercised individually and/or in a group. Furthermore, individuals have the freedom to advance their religious values in social organizations and establish religious-based institutions so long as the public advancement of these beliefs does not impinge

⁶⁵Federal Democratic Republic of Ethiopia, Insurance Business Proclamation No. 746/2012, *Negarit Gazeta*, Year 18, No. 57, Addis Ababa, 22st Aug., 2012.

⁶⁶NBE, 2007/2008 (4), *Quarterly Bulletin Fiscal Year 2020/21 Vol. 37 No. 1* [of the National Bank of Ethiopia] First Quarter 2020/21 (Ethiopian Fiscal Year 2013), Addis Ababa, 2020/21.

⁶⁷FDRE, 1995, *Constitution of the Federal Democratic Republic of Ethiopia Proclamation No 1/1995*, *Federal Negarit Gazeta*, Year 1, No 1 Addis Ababa, 21st August 1995.

⁶⁸Nasser, Y. & Jamil, R., *Takāful: A Study Guide* (Kuala Lumpur: IBFIM, 2011), p. 81-84.

⁶⁹ See FDRE constitution, *supra* note 78. Article. 11.

negatively on the liberty of other citizens, or violate democracy and the law through violence or illegal means.⁷⁰ Given that, Sharia rules forbid the conventional insurance scheme on one hand and the importance of the insurance scheme for a considerable number of the Muslim population of Ethiopia on the other hand needs to be reconciled. That's why amended insurance business proclamation No. 1163/2019 provides for the establishment of the Islamic insurance scheme.

Additionally, the establishment of takaful insurance promotes the participation of Muslims in commercial activities and entrepreneurship.⁷¹ International instruments in which Ethiopia is a party guarantees freedom of religion.⁷² As such, once ratified they become an integral part of the law of the country to respect, protect, fulfilling the same.⁷³ Religious freedom entitles everyone to follow the religion of his choice, including the freedom to respect the principles of the religion he chooses to follow, advancing its values in social organization, and forming religious-based institutions as long as the right of others is respected.

In our county, the insurance business proclamation No.1163/2019 (as amended) come up with the provision that allows the licensing of both independent operators of *Takaful* insurance/window under the operational insurance company. The regulatory and supervisory authority of the financial institutions (NBE) is authorized to issue a directive for additional conditions unique to Takaful insurance information and operation.⁷⁴ The first step of the amended proclamation is inserting the definition of *Takaful* under the definitional part. Accordingly, *Takaful* is defined as community cooperation in which members contribute a fixed amount of money to mutually compensate each other in the case specified risk is materialized.⁷⁵ The element of the definition is:- Takaful insurance is community cooperation rather than an agreement between the insurer and policyholder; the money payable by the member is a contribution, not a premium; and the money is contributed for mutual assistance not as a premium to the company payable in exchange of

⁷⁰Id. Article 27(1).

⁷¹Kazi Md. Mortuza Ali, *Present Scenario and Future Potentials of Takaful, Prime Islami Life Insurance Limited, Bangladesh*, V. 2 No. 2. P. 7.

⁷²UN General Assembly, International Covenant on Civil and Political Rights, 16 December 1966, United Nations Treaty Series(UNTS), vol. 999, p. 171, Art 18(1)

⁷³Article 9(4) provides that international treaties ratified by Ethiopia are the integral part of the law of the land. Furthermore, Article 13(2) of the Constitution requires the provisions on human rights to be construed in conformity "to the principles of the Universal Declaration of Human Rights, International Covenants on Human Rights and international instruments adopted by Ethiopia." Mohammed Abdo, *legal pluralism, sharia courts, and constitutional issues in Ethiopia*, Mizan law review, Vol. 5 No.1, 2011. P.80.

⁷⁴Abay Yimer, S. supra note 70 p.14-15

⁷⁵ Amended insurance business proclamation, supra note 11, art. 2(39)

transferring the risk.⁷⁶ Furthermore, the proclamation stipulates the application of the provisions of the insurance business proclamation with its amendment and relevant directives issued by the NBE for conventional insurance businesses.⁷⁷ In contrast, not only *Takaful* is defined as a cooperation of the community, but also not included in the lists provided under the definition of financial institution by the same proclamation.⁷⁸ Nevertheless, this proclamation leaves the following question without a proper answer. These are: - firstly, the amendment proclamation lacks a proper definition for *Takaful* insurance *per se* apart from defining the word *Takaful*. Indeed, the definition given for '*Takaful*' seems to include *Takaful* insurance (Islamic insurance). If it is assumed according to the formula provided for the application of insurance legislation and directives under article 60 of the amendment on applying the definition provided for insurance business on *Takaful* insurance, issuance of the directive by NBE apart from the conventional one become meaningless.⁷⁹ However, *Takaful* has its salient features that are distinct from ordinary insurance which is the reason for the additional condition and specific authorization to commence its undertaking.

More broadly, the above definition falls short of including the following main elements of *Takaful* insurance by AAOIFI standard on Islamic insurance No. 26.⁸⁰ AAOIFI defines *Takaful* insurance as a process of the agreement by a group of people to mutually handle a specific risk by payment of contribution as a donation under the specialized management of the company adheres to rules and principles of sharia to manage its affairs and invest the fund.⁸¹ Comparative to this definition, the amended proclamation failed to include the following: - First, the definition is not comprehensive enough to include the specification of contributions by the participant as *Tabarru* (donation) which, *inter alia*, is the main element of *Takaful* insurance provided by the council of Islamic scholars. In a nutshell, *Takaful* insurance is based on two basic principles regarding participants namely: (i) *Tabarru*(donation) and (ii) *Ta'awun*(cooperation) according to the IFSB.⁸² Perhaps, the second principle (i.e., *Ta'awun*) is included in the definition of the phrase

⁷⁶ Id.

⁷⁷ Id. Art. 60(1&2).

⁷⁸ Id. Art. 2(12) & art. 2(39).

⁷⁹ It is sound to make the applicability of the provision of the proclamation and other directives of NBE on *Takaful* only in case it doesn't go against the nature and principles of sharia law.

⁸⁰ See AAOIFI standard No. 26. Supra note 70.

⁸¹ Id.

⁸²Zainal Abidin Mohd Kassim Hassan Scott Odierno Sabbir Patel, *hybrid insurance structure: reciprocal, hybrid mutual insurer, and Takaful*, world Bank, Washington D.C. 2013. P.74.

“*cooperation of community*” and the element missed out is the contribution of the member in the form of donation (*Tabarru*).⁸³

The rationale for contributing as a donation (*Tabarru*) is for the protection of the scheme from the involvement of the aforementioned sharia prohibited elements mainly *Gharar* (uncertainty) and *Maysir* (gambling).⁸⁴ Failure to contribute the money as a donation makes the contract/transaction similar to a commercial insurance business against the Islamic Law of Contracts principle.⁸⁵ This is supported by a popular statement among Maliki schools⁸⁶ that read as *Gharar*(uncertainty) has no impact on donation contract. Moreover, it exonerated *Takaful* insurance from the involvement of gambling as every participant agrees his/her contribution as a donation to help one another as means of cooperation.

Secondly, unlike insurance companies that are only entitled to give insurance service with the license mainly (apart from ancillary activities permitted for long-term insurance and general insurance under article 6 of insurance business proclamation No.746/2012), the license and authorization of Islamic insurance include the permission to invest from participants’ investment fund and in the name of the participants’ subject to the model adopted. The difference is that ancillary activities permitted as per the above provision by conventional insurance are in the name of the shareholders of the said company.⁸⁷ The NBE issued directive No. SIB/52/2020 (as amended) for licensing and supervision of insurance business investment of their funds. The preamble of this directive stated that income-earning for the sake of profit maximization by the insurance company is a source of financial risk unless it is practiced prudently.⁸⁸ As per this directive, the investment of insurance funds in both general insurance and long-term insurance is limited. In general insurance, the area of investment highly encouraged is treasury bills and bank

⁸³Id.

⁸⁴Id.

⁸⁵“*Sahih Muslim*” “*Sahih Muslim*”, , *Kitab: Al-Buyu’ Kitab: Al-Buyu’* [3: 1153]; [3: 1153]; “*Sunan Abu Dawud*” “*Sunan Abu Dawud*” [2: 228] (H: 3367); [2: 228] (H: 3367); “*Sunan Al Nasa’i*” “*Sunan Al Nasa’i*” [2: 217]; [2: 217]; “*Sunan Ibn Majah*” “*Sunan Ibn Majah*” [2: 739]; [2: 739]; “*Sunan Al-Tirmidhi*” “*Sunan Al-Tirmidhi*” [3: 532]; [3: 532]; “*Sunan Al-Darimi*” “*Sunan Al-Darimi*” [2: 167]; [2: 167]; “*Al-Muwatta’*” “*Al-Muwatta’*” [2: 664]; [2: 664]; “*Musnad Al-Imam*” “*Musnad Al-Imam Ahmad*” *Ahmad*” [1: 203] and [2: 367 and 439]; [1: 203] and [2: 367 and 439]; “*Sunan Al-Bayhaqi*” “*Sunan Al-Bayhaqi*” [5: 226]; and [5: 226]; and “*Musannaf*” “*Musannaf Ibn Abu Shaybah*” *Ibn Abu Shaybah*” [8: 194], Section (2).

⁸⁶“*Bidayat Al-Mujtahid*” “*Bidayat Al-Mujtahid*” [2: 534].

⁸⁷ See insurance business proclamation No. 746/2012, supra note 88, article 6.

⁸⁸ Licensing and supervision of Insurance Business a directive on the investment of insurance fund, directive No. SIB/52/2020.

deposits with at least 60% of the total asset of the company. Moreover, investment in the purchase or construction of building for rent and company shares are to the maximum of 10% and 20% of total assets respectively. Coming to the long-term insurance business, investment in treasury bills and bank deposits should not be less than 50% of the total asset of the company, up to 25% of the investment on purchase construction of building or rent, and, 15% on the company share. Therefore, only 10% of the total asset of the companies are allowed to be invested in the areas of their choice in both general and long-term insurance.⁸⁹ The provision of the directive limits the maximum percentage of the sectors to be invested by the insurance company and at the same time, the restriction applies to *Takaful* insurance as it mentioned the applicability of other insurance directives on *Takaful* insurance above. The problem in the application above directive can be seen from a different angle, but for the objective of this study, let's see the requirement of investing the maximum percentage of the fund on treasury bills and bank deposits. The reason for the argument against this requirement in Islamic insurance is derived from the source of profit in such investments which is mainly from collecting interest on treasury bills or the money deposited in banks. Such investment is prohibited according to the teachings of Islam and is also one of the main reasons for the emergence of *Takaful* insurance.⁹⁰ Nevertheless, neither the investment permission nor its sharia adherence to the types of investment is included as an element of the definition. Therefore, the non-inclusion of mandatory sharia compliance in the investment of *Takaful* insurance is another great flaw of the same proclamation.

Thirdly, it fails to articulate the objective that necessitates the emergency of *Takaful* insurance which is the involvement of things contrary to Islamic sharia in insurance for serving the Muslim community. To put it differently, the proclamation should have required *Takaful* insurance operators/window's strict compliance with sharia principles to protect and assure the client from misleading acts and fraud and then show the green light for the participant that it is an optional alternative to insurance. This demand is not without good reason, it is aimed at removing obstacles that can hinder the proper operation of *Takaful* insurance under other laws. For example, Vehicle insurance against third party risk proclamation No.799/2013 prohibited everyone from driving the

⁸⁹ Licensing and supervision of Insurance Business a directive on the investment of insurance fund, directive No. SIB/25/2004.

⁹⁰ Even according to the new circular issued by the NBE in November 2020, the insurer needs to invest at least 40% of the insurance fund on the treasure bill to support the monetary policy.

vehicle without entering into valid vehicle insurance against third party risk.⁹¹ The nature of the obligation under this proclamation is ‘obligation to do’ on the person who owns the vehicle or sanction in case of failure.⁹² The question that can be raised here is; how the participant in *Takaful* insurance is excluded from the valid insurance mentioned above? In this case, the proclamation answers the question by defining insurance company as a company registered to undertake general insurance only.⁹³ Thus, forwarding *Takaful* insurance as an option to insurance by revising this proclamation will be a solution to such a problem by respecting the legislation on compulsory insurance as well as fulfilling the teaching of the religion. For instance, Christian Health-sharing arrangements are a grouping of people organized to help each other in paying major health care costs from the contributions made by members voluntarily. Hence, the US health care bill exempts members of this group from buying compulsory insurance bills.⁹⁴ Likewise, this proclamation should have to include such provision or gives an alternative option between insurance and *Takaful* insurance in case of compulsory insurance by requiring the owner of the vehicle either to enter into insurance or *Takaful* insurance. The reason is that NBE has no power to issue a contrasting directive to such a law because of the principle of hierarchy law.

Finally, the requirement of the proclamation for compliance of *Takaful* insurance to all other insurance legislation and regulation without providing exception in case it goes beyond the Islamic financial principle is another flow.⁹⁵ There is no problem with this provision in case the two legal frameworks are complementary. However, the problem is in case of contradiction between the two. According to articles 60(1&2) of the amended insurance business proclamation, the insurance business legal framework prevails in case of contradiction with *Takaful* insurance.⁹⁶ This put the permission to establish *Takaful* insurance questionable for the area of contradiction between the two is when the insurance legal framework goes against sharia principles.

4.2. The National Bank Directive

⁹¹ Federal democratic republic of Ethiopia, vehicle insurance against third party risk proclamation, No. 799/2013, Federal Negarit Gazette, year 19th, No.53, article 3(1).

⁹² The same proclamation provides sanction for the violation of its provision to be a fine of 3000(three thousand birr) to 5000(five thousand birr) or up to one-year imprisonment. Id. Article 30.

⁹³ Id. Article 2(2).

⁹⁴ See NBE Directives No. SBB/1/2020, *supra* note 15.

⁹⁵ See amended insurance business proclamation, *supra* note 95.

⁹⁶ Id.

In Ethiopia, NBE is the regulator of the financial institutions through licensing and supervision.⁹⁷ Up on the authorization of the amended proclamation, NBE issued directive No. STB/1/2020 provides for additional criteria for licensing and authorizing Takaful insurance.⁹⁸ Based on the preamble of this directive, ensuring the safety and soundness of the insurance sector; regulation of Takaful by setting minimum requirements, and protection of participant's interests are the general objectives.⁹⁹ The former two objectives are not an exception from the objectives of regulating financial institutions in which the insurance business is a subset.¹⁰⁰ Whereas, the latter resemble to Takaful insurance as the term *participant* is only employed on Islamic insurance.

It is understandable from the title of the directive that, both full-fledged Takaful insurance and Takaful insurance window inside the licensed conventional insurance is permitted to undertake by obtaining license and authorization from the NBE, respectively. Apart from licensing and authorization requirements from the NBE, the directive lists several special conditions for licensing and operation of Takaful operator or window.¹⁰¹ The first and basic requirement is the establishment of an advisory council consisting of three members on Sharia issues on the operation of Takaful called sharia advisory council.¹⁰² Regarding the qualification of the member of the council, one member needs to be a sharia scholar as indicated in the nomenclature of the council to advise on the sharia principle. And the other two are required to be insurance and financial expertise.¹⁰³

The other special conditions required from Takaful insurance or window to license and operations are: - submission of detailed policies and procedures on the sharia oversight, adoption of an operating model¹⁰⁴, maintenance of relevant documentation on contract governing the relationship between participant and takaful operator/window and the relationship between the participant themselves, policies on fund segregation, investment, recognition of surplus, a deficit of fund,

⁹⁷ Federal democratic republic of Ethiopia, Amended National Bank of Ethiopia Establishment Proclamation No. 591/2008, federal negarit gazetta, 14th year No. 50, article 5(7).

⁹⁸ See licensing and authorization of takaful insurance No. STB/1/2020. Supra note 13.

⁹⁹ Id.

¹⁰⁰ Id.

¹⁰¹ Id. Article 4.

¹⁰² Id. Article 4.2.

¹⁰³ Id. Article 4.4.

¹⁰⁴ Operating model is defined under the definitional part of the directive as a model that identifies the relationship and fiduciary duties takaful operator/window towards participant.

commission for takaful operator/window, separation of shareholders asset from the fund of the participant as well as separation of family takaful account from general takaful.¹⁰⁵

Unlike the feature of conventional insurance whereby the policyholders have no right to the premium paid, the participant of the takaful operator/window has the right to the funds as a whole and the surplus after the payment of a claim in case of materialization risk. Thus, the NBE directive requires effective and efficient management of funds to cover loss against the participant and develop a policy on the distribution of surplus as well as profit obtained from the participant's investment fund.¹⁰⁶

According to this directive, most of the mandates related to the Takaful operator and window to regulate themselves by submitting the policies on their regulation to the NBE.¹⁰⁷ This is aimed at giving more freedom for them by requiring only minimum standards. Moreover, the whole directive lacks detailed regulation with only general terms on the special requirement for establishment and operation. The regulator takes into account the nature of Islamic insurance which should be in line with the principles of sharia to be acceptable in the eyes of the public by imposing mandatory conditions on Takaful operators and takaful window operators. However, more regulation is expected from the regulatory authority for protecting the interest of the participant and ensuring the product's compliance with sharia principles and building public confidence on the business.

Besides the pitfall we discussed above, the proclamation authorizes the NBE to issue directive for additional conditions to be fulfilled. Accordingly, the NBE issued directive require sharia advisory council consisting of three members in addition to the board as an indication of *Takaful* operations in line with sharia principles.¹⁰⁸ Despite requiring the establishment of sharia advisory council, the establishment doesn't guarantee for meeting its purpose genuinely rather than a mere formality. The directive's failure in providing proper composition, qualification and mandate of the council in addition to its being silent on the time of establishing the council. A question may be raised as to why it needs to specify the time of its establishment. The answer is for its importance compliance of *Takaful* operator and window on every act and step to the principles. The pre-incorporation of

¹⁰⁵ See NBE directive No. STB/1/2020, supra notes 110, art. 4.

¹⁰⁶ Id. Article 5.

¹⁰⁷ Id.

¹⁰⁸ Id.

Takaful insurance also needs to be conducted in line with the sharia principles. The other thing requiring the documents that need to be deposited by the *Takaful* operator or windows like a contract that governs the relationship between participants and the *Takaful* operator and window, a contract between participants, segregation of funds, investments policy, a commission of the operator or window, and auditing requirement and risk management, a deficit of participant's risk funds have to comply to sharia principles. Therefore, the establishment of a sharia advisory council should be at a very initial stage of pre-incorporation to ensure compliance in every activity. Yet, the problem goes deep in the following:

- a) **Composition:** - is the about the member of individuals consists in the council having sharia knowledge. The name of the council and members included are not complimentary. The reason is that its name is indicated as sharia advisory council, but the sharia scholar is a minority in the establishment.¹⁰⁹ The difficulty is that, in case they are asked for advice or approval by the board as the decision needs to be supported by the majority, however, the sharia scholar is a minority (only one person) as per the directive. According to the experience of Nigeria's National Insurance commission guidelines for Islamic insurance, the sharia advisory board must consist of at least three members whereby two of them are required to be qualified and experienced in Islamic law. Furthermore, the sharia scholar needs to be majority according to the Islamic insurance guideline issued by the Nigerian insurance commission.¹¹⁰ To meet the desired objective, entitling sharia scholar members of the council to have veto power on the other two members in cases the decision needs sharia approval. This is enough to solve the problem and for a suitable response to customers' demand for Islamic insurance products. The requirements of the council's members to be three in the directive are important even from the experience of the other jurisdictions for decision making by the majority on two to one(2:1).¹¹¹ Added to this, the inclusion of interdisciplinary financial experts in the council is important to enable them to giving solid and concrete decisions.¹¹² However, making the sharia scholar minority

¹⁰⁹ Id. Article 4(3).

¹¹⁰ Federal Republic of Nigeria, national insurance commission, operational guidelines of *takaful* insurance, section 3(6), 2013.

¹¹¹ Negara bank of Malaysia, Central Bank of Malaysia, policy on the sharia governance BNM/RH/PD 028-100, 2019, section 13.1.

¹¹² Hasen, Zulkifli (2010). Supra note 46.

without granting veto power and giving mere advice may undermine its main objective which in turn decreases the public confidence in the product. Therefore, the establishment of the sharia advisory council seems symbolic without practical significance as the directive neither requires the sharia scholar to be the majority nor veto power is given to overrule the decision of the two non-sharia scholars on sharia issues.

- b) **Qualification:** - the NBE directive No. SIB/32/2015 provides requirements of persons with significant influences on insurer stipulated detailed qualification that is required for the appointments of director, chief executive officer and senior executive officer which includes character and building knowledge, experience, and age as to fulfill the objectives stated under its preamble among others - ensuring public confidence and enhancing effective governance in insurance.¹¹³ The same detailed criteria for the appointment of the members of the sharia advisory council are required for the same objectives mentioned above. Nevertheless, the Takaful licensing and authorization directive No. STB/1/2020 doesn't provide the qualification, competency, ineligibility, and ethics of the proposed membership sharia council. Sharia advisory council needs to be competent, and independent to approve Islamic insurance products with sharia principles.¹¹⁴ The directive stated only one of the members to be a scholar in sharia principles which is more general without reference to the specific specialization in *Fiqh al Mu'amalat* (Islamic commercial jurisprudence) which is more preferable for ensuring sharia compliance of its operation.¹¹⁵ One can question the existence of such scholars in our country, however, due to the role they are called upon, it is mandatory to fulfill such qualifications at least through training by the institution themselves before and after they are selected for the role as well as regular training by the NBE on *Fiqh-ul Mu'amalat* as the supervisory authority. Furthermore, there

¹¹³ Licensing and supervision of insurance business directives on requirements for persons with significant influence in an insurer directive No. SIB/32/2012, article 5.

¹¹⁴Hussain G. Rammal, *the importance of shari'ah supervisory in Islamic financial institutions, Corporate Ownership and Control/* Volume 3, Issue 3, 2006. P. 205. See also World Bank paper deals with CG arrangements that address issues of Shariah compliance. Grais and Pellegrini (2006a) provides an overview of the issues and challenges of CG for IIFS. Grais and Pellegrini (2006b) deals with IIFS' CG that address stakeholders' financial interests.

¹¹⁵ See Islamic insurance guidelines of national insurance commission of Nigeria, supra note 134. See also Nawal Hussein Abbas El Hussein, *The Sharia Supervisory Board: Does it Influence Corporate Social Responsibility Disclosure by Islamic Banks? A Review*, Journal of Islamic Studies and Culture, Published by American Research Institute for Policy Development, USA, Vol. 6, No. 1, 2018 p. 124. See also AAOIFI (Governance Standard 1) which recommends to include jurists of *Fiqh Al-Muamalat* in the sharia advisory board/council.

is no way to ascertain the credibility of the qualification of the proposed sharia scholar as the provision is silent about the way how the knowledge is obtained and the credibility of the organization where the knowledge is gathered for the successful operation of *Takaful* insurance in line with sharia principles.¹¹⁶

Besides, NBE directive No. SIB/42/2015 require the election of a Nomination committee from shareholders at their general meeting who are independent of the insurer.¹¹⁷ The mandate of the committee is for specifying/nominating candidates for the board members which is aimed at ensuring sound and prudent corporate governance in the insurance company.¹¹⁸ It is equally important for the nomination of a member of the council for the same purpose. Unfortunately, nothing is said even whether the said sharia knowledge needs to be proved and how can it be proved in the directive. For instance, the aforementioned Islamic insurance guidelines of Nigeria which are issued by the insurance regulatory authority in the country; require the proposed members of the sharia advisory council needs to provide curriculum vitae, and the takaful operators/window is also required to have formal assessment mechanism for ensuring appropriate knowledge and experience of the proposed members. Moreover, it requires the approval of the insurance commission (supervisory authority) at the final stages. And the commission can approve or otherwise the proposed members of the sharia advisory council.¹¹⁹ Likewise, it is sounder to impose provision of the certificate as evidence of having the said knowledge, formal assessment of their competency of having experience and training, and approval of the proposed appointment of the members of the sharia advisory council by the National Bank of Ethiopia (NBE) to ensure operational independence of the council.¹²⁰

c) Power and responsibilities: - the aforementioned two NBE directives No. SIB/ 32/2012 and directive No. SIB/42/2015, clearly identified the power and responsibility of the persons with significant influence in an insurer such as the director, chief executive officer, senior officer, and nomination committee, respectively. In Malaysia, the Islamic financial service act of 2013 authorizes Negara Bank which is the central bank as well as the regulatory body of the financial institution to issue duties and mandates of the sharia

¹¹⁶Grais and Pellegrini, supra note, 95.

¹¹⁷ Licensing and supervision of insurance business, insurance corporate directive No. SIB/42/2015,

¹¹⁸ Id.

¹¹⁹ See Islamic insurance guidelines of national insurance commission of Nigeria, supra note 134, section 3.9.

¹²⁰ Gafoor, A.L.M. *Interest-Free Commercial Banking*. Malaysia: A.S. Noordeen. 1996.

board.¹²¹ Likewise, the Negara bank of Malaysia issued the sharia governance policy with detailed responsibility and power for the sharia board.¹²² Coming to the NBE directive, some provisions look like the responsibility of the sharia advisory council without any indication of the provision that deals with another matter including- endorsement of operating mode, advising the board on distribution and management of surplus, and approval of direct payment.¹²³ Establishing the council without stating its power and duty makes its establishment a mere formality without tangible roles in *Takaful* insurance operator or window.¹²⁴ In case of the nature of the council's ruling, Malaysia Islamic financial service act No. 759/2013 stated that:- compliance with any rulings of the sharia advisory council by Islamic financial institution is a duty for its deemed compliance with sharia principles.¹²⁵ Identifying the nature of their decision as binding is basic for the protection of the interest of the participant and its credibility in eyes of the public, the participants, and other stakeholders. Added to this, it assures them that, they apply for the correct product whereby their activities are supervised by the authority according to sharia. The status of the council's ruling and the decision should be the core criteria that indicate the activities as complementary to Islamic principles.¹²⁶ Reducing the ruling to mere advice negatively affects the credibility and reliability of the institution in the eyes of the participant and it also practically puts the decision of the board superior to the council even on the issues that need sharia rulings.¹²⁷

The responsibility of the sharia board/councils includes, but is not limited to the following: Reviewing the guidelines and policies of *Takaful* operators or window in the eyes of sharia principles and approving or rejecting the same; following the day-to-day activities and reporting the compliance or otherwise of the activity to the board; providing remedies in case of non-compliance; disclosure of accurate information for the participant on activities and product of *Takaful* operator or window's sharia compliance; reporting to the supervisory authority on

¹²¹ Law of Malaysia, Islamic financial act N. 759/2013, article 32.

¹²² See policy on the sharia governance of Negara bank of Malaysia BNM/RH/PD 028-100, 2019, section 10.

¹²³ See a directive to license and authorize takaful insurance No. STB/1/2020, article 4.8. and 5.3.1.

¹²⁴ Warde, I. (1998). *The Role of Shari'ah Boards: A Survey*. San Francisco: IBPC Working Papers.

¹²⁵ See Islamic financial service act of Malaysia No.759/2013 supra notes 128, article 28.

¹²⁶ Grais and Pellegrini, supra note, 95.

¹²⁷ See Warde,(1998), supra note 99.

compliance in regular bases and approving the business to be undertaken by the *Takaful* operator or window.¹²⁸

- d) **Conflict of interest:** - According to Malaysia's experience, let alone the proposed member of the sharia advisory council himself, his immediate family should not be a member of the executive, substantial shareholder, senior officer, or its affiliate and other contractual relationship with the financial institution to qualify as a candidate. Contrary to this, our NBE directive is silent on the neutrality of the proposed member of the council. This will lead to a conflict of interest especially if the member of the council is a member of the management or a significant shareholder of the operator/window. The requirement of Ineligibility to be a member of the council is crucial to avoid conflict of interest and ensure its independence.¹²⁹ Conflict of interest can be avoided by restricting members of the *Takaful* operator/window from being members of the management such as director, management staff, or senior officers, or having a relationship with one of them that can reasonably be perceived to interfere in the independent judgments of the council, being a shareholder, membership to sharia council or equivalent in another similar establishment, and holding beneficial interest or investment with *Takaful* operator/window to be a member of sharia advisory council at the same time.¹³⁰ The other thing worthy discussion regarding conflict of interest is members' eligibility to be elected in another Takaful operator/windows and/or financial institution which is prohibited in other jurisdictions.¹³¹ Furthermore, the ethical code of conduct of a member of the council is also not provided. Ethical code is an important part in the sight of Sharia and to avoid controversy on whether a criminal, accused, fraudulent, bankrupt, unethical, partier, or dishonest individual can be

¹²⁸The sharia advisory council will derive consensus on its recommendations and conclusions using the appropriate, standard, and accepted methodology including interpretation or analogy from the Qur'an (Holy Book of Islam) and Sunnah(Custom of the Prophet Muhammad). See Grais and Pellegrini identified five main roles of the Sharia board/council as “*certifying permissible financial instruments through fatwas (ex-ante Shariah audit), verifying that transactions comply with issued fatwas (ex-post Shariah audit), calculating and paying Zakat, disposing of non-Shariah compliant earnings, and advising on the distribution of income or expenses among shareholders and investment account holders*”.

¹²⁹ Id. members' dual relationship with the institution as providers of remunerated services and as assessors of the nature of operations could be seen as creating a possible conflict of interest.

¹³⁰Moini, Y., (2015). IBD, Circular No. 01; *Shari'ah Governance Framework for Islamic Banking Institutions (IBIs)* of SBP. Retrieved from <http://sbp.org.pk/2015/C1.htm> (accessed February 1st 2020)

¹³¹ See guidelines of Islamic insurance in Nigeria, supra note 134, section 3.17.

appointed to the council or not. In the same fashion, no requirement for diligence, and good faith in performing their duty in line with sharia principles in the directive.

- e) **Liability and term of office:** - Providing the office term of a member of the council with the possibility of limiting re-election to encourage expansion of knowledge; a rewarding member who works hard; also avoids permanency of members and adding new workforce is crucial for its success. Additionally, it is short of providing liability provision in case of breach of sharia principle, duties for the member of the sharia council, tenure, Takaful window, and/or takaful operator.¹³²

Apart from the limitation of the directive regarding the sharia advisory council, there is also another gap that should be filled for protecting Islamic insurance under the sharia principle. These are: - first, in investing in Takaful funds, one of the main criteria is investing the sharia-compliant businesses. The reason is that not all type of business is permissible in Islam. However, the directive neither limits the type of investments undertaken by takaful insurance operators/windows nor requires the investment to be in line with the underlying Islamic investment whereby both profit and loss are shared.¹³³

Second, as the main party for whom Islamic insurance is established, the participants are not given the right to question the queries of sharia compliance in the operation for themselves. Likewise, the relationship of the sharia advisory council with the participant and the council's answerability to the participant is absent. Moreover, no requirement for transparency which is the main element of the Islamic insurance on all activities of Takaful provided.¹³⁴ In the case of duties for the council, the lesson from the two national jurisdictions discussed above, the sharia advisory council is duty-bound to report sharia in compliance to the participant and the regulatory body if the Takaful operator/window failed to follow their advice adequately.¹³⁵ Therefore, the Ethiopian Islamic insurance legal framework fails in providing a guarantee for the Muslim community in requiring Islamic insurance operators and window strict compliance with sharia standards.

¹³² Usmani, M.T. (2001). *The Historic Judgement On Interest: Delivered in The Supreme Court Of Pakistan*. Karachi, Pakistan: Idaratul Ma'arif.

¹³³ Dar HA. *Lack of Profit Loss Sharing in Islamic Banking, Management and Control Imbalances International*, Journal of Islamic Financial Services Vol. 2 No.2.

¹³⁴ Banaga, A., Ray, G.H. and Tomkins, C.R. *External Audit and Corporate Governance In Islamic Banks*. Aldershot: Avebury. 1994.

¹³⁵ See sharia governance policy of Islamic financial institution, Negara bank of Malaysia BNM/RH/PD 028-100, 2019, section 10. And also see Islamic insurance guideline, insurance commission of Nigeria, 2013, section 3.31.

5. The need for Revision

The inclusion of the permission to establish Islamic insurance in the amended insurance business proclamation is important development for recognition of religious equality and accommodation of religious diversity in our country in addition to the interest-free banking service by the Banking Proclamation 592/2008. Moreover, non-Muslims can also be members/participants. Non-Muslims are also interested in Islamic insurance as it is characterized by solidarity and fairness. This increases the culture of tolerance among different religious groups of the country; social justice; economic prosperity of the whole community; and reduces the concentration of wealth in few peoples.¹³⁶

However, to serve the true intention of the Muslim community and meet the goal of its establishment, the amended insurance business proclamation No.1163/2019, Vehicle insurance against third party proclamation No. 799/2013 as well as takaful licensing and authorization directive of NBE needs to be revised to include the following to fulfill genuine sharia compliance and protection of the public from fraud in the name of Islamic insurance. Firstly, it needs to clearly define Islamic insurance with clear objectives. The definition needs to be comprehensive enough to include sharia compliance as the main criteria for the establishment of an Islamic insurance operator/window. Secondly, the Islamic insurance so established should be specified as an alternative/option, especially in the case of compulsory insurance like vehicle insurance against a third party which imposes an obligation to enter into insurance coverage on every owner of the vehicle.

Thirdly, detailed and broad regulation on the sharia advisory council needs to be included. To put it in a more precise way, the detailed regulation should deal with the composition; qualification; character and ethical conduct; conflict of interest; exhaustive power and responsibilities; and liability provision of the personnel who is a member of the council. The provision should also regulate the mandate of the board of takaful insurance operators/window and duty towards implementation of the advice of the council. Moreover, the requirement of every decision of the board to be approved sharia advisory council should be included; in transparency and disclosure for the protection of stakeholders. Finally, the regulation of the relationship between participants

¹³⁶ Michael Ainley, Ali Mashayekhi, Robert Hicks, Arshadur Rahman, Ali Ravalia, Islamic Finance in the UK: Regulation and Challenges, Financial Services Authority, November 2007, p. 7.

and the sharia advisory council should be added. The council's transparency with the participant regarding the activities of the operator/window compliance with Islamic finance and the council's answerability to the participant's questions and doubts would also help the development of Islamic insurance by increasing the reliability among stakeholders.

6. Conclusion

Insurance is an important institution that reimburses the policyholder commonly known as the insured in cases of materialization of losses to life/body or property according to the underlying policy entered into between the insurer and the insured. This article has demonstrated how the non-compliance of conventional insurance with Sharia Law Principles prompted Islamic insurance as a viable substitute for Muslim communities in the form of solidarity in case of risk/loss. Yet, while Islamic Scholars have advocated for widespread use of Islamic insurance, its e is a recent phenomenon in Ethiopia that was introduced under the amended insurance business proclamation. Further, the NBE Directive is issued to provide additional conditions regarding the formation and operation of *Takaful* insurance operator and/or window in the existing conventional insurance. However, it is not comprehensive enough to regulate let alone several important aspects of Islamic insurance; at least its strict compliance to sharia principles to meet the goal of its establishment.

Specifically, both the proclamation and the authorization of the directive of the National Bank failed to clearly define Islamic insurance and the objective of its establishment. Moreover, even though it requires the establishment of a sharia advisory council for the compliance of the undertaking to the sharia principles, it does not provide their duties. Added to this, the directive is silent on most of the basic things that should be fulfilled to serve the purpose of its establishment and increase the confidence of the people to participate in Islamic insurance for solidarity and mutual assistance; monitor and supervise the Islamic insurance from fraud and invest the surplus in compliance with the norms and teachings of Sharia.

This article suggests that Ethiopia needs to revise the *Takaful* regulation to include a clear definition and objective by ensuring compliance with *Takaful* insurance. These among other things include broad regulation regarding the established sharia advisory with clear power, responsibility, liability on the member, and accountability on the *Takaful* operator/window's board and management to make the Islamic insurance effective and efficient in serving the participant in line with sharia ruling and development of Islamic insurance undertaking.