A Call for Mutuality in Islamic Finance
Corporate Form in Islamic Financial Intermediation

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Insurance Without \textit{Gharar} : Takāful

Remove The Profit Motive – Mutual Insurance

\textbf{Islamic constraint:} Prohibition of \textit{gharar} – (trading risk for-profit)

\textbf{Consequence:} Jurists forbid conventional insurance

\textbf{Juristic solution:} Make the contract non-commutative

\textbf{Reality:} Stockholders own for-profit “Takaful” companies

\textbf{Fiction:} Owners provide insurance as voluntary \textit{tabarru‘}

\textbf{Economic solution:} Align rhetoric with facts – \textit{takāful} mutuals

\textbf{Economic method:} Shift focus in risk intermediation from \textit{contract} (\textit{tabarru‘} fiction) to \textit{corporate form} (mutuality)

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Credit Without *Ribā* (an extreme form of *gharar*): *I’timān*

Remove The Profit Motive – Mutual Thrifts

**Islamic constraint:** Prohibition of *ribā* – (trading credit for-profit)

**Consequence:** Jurists forbid interest-based loans, deposits, bonds

**Juristic solution:** Use other contracts to synthesize interest rate

**Reality:** Profits $\Leftarrow$ synthetic-interest income $-$ cost of funds

**Fiction:** Contract based – bank’s business is trade, leasing

**Islamic Economic solution:** *Also contract based* – equity-based intermediation

**Economic method:** Shift focus in credit intermediation from *contract* (bay‘ fiction) to *corporate form* (mutuality)
Al-Qarāfi on Loans, Sales, Leases and Ribā
Anwāʿu Al-Burūqi fī Anwāʿi Al-Furūq (Dār Al-Kutub Al-‘Ilmiyya, Beirut, 1998, vol.4)
Difference #201 – between the Juristic Rules of Qarḍ and Bay‘

- “Know that in the juristic rule of loans, three other juristic rules were violated: The rule of ribā . . . The reason for [allowing] those violations is the charitable (maʿrūf) component therein. If charity is absent, it would no longer be permitted

“(Question:) Simple loans (al-ʿāriya) are also charitable . . . but allowed for a known term with known compensation, even if no longer charitable. . . . (His answer:) When simple loans are compensated, they become leases, and it is not foreseen that ribā can exist in leases . . ., whereas a compensated loan is a sale”

- This logic fails if (as done currently in structured finance) leases are used to extend credit in a manner similar to loans

- Can one extend the analysis to say that the credit component should be non-commutative (minimal net interest income)?
Focus on contracts inadequate to regulate financial intermediaries
  - This is equally true for Sharī‘a and secular regulations
  - Regulators protect the system, Sharī‘a also protects individuals

Profit motive + focus on contracts ⇒ Sharī‘a-arbitrage
  - **Religiously:** may squander objectives of Sharī‘a
  - **Materially:** Muslim customers pay more for less

Advantages of mutual Islamic financial intermediaries:
  - **Nonprofit** ⇒ limited scope for Sharī‘a-arbitrage
  - Savers are in fact partners (match profit-sharing rhetoric with reality)
  - Pay higher returns to partners, charge lower rates to customers
  - Provide better “loss-ratios” to insured shareholders
  - Noncommutative *takāful* (match *takāful* rhetoric with reality)