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# An Overview of Islamic Non-Banking Institutions (INBFI) in Iran

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## ABSTRACT

The financial system in Iran constitutes two major types of financial institutions: Islamic banks and Islamic non-bank financial intermediaries (INBFIs). Nevertheless, the INBFI in Iran, similar to other Islamic countries, forms a small segment of the Islamic finance industry. The interest-free banking law passed in 1983 applies to the country's entire financial system, including the non-banking sector. This paper studies the emergence and current practices of INBFI in Iran and the challenges faced in realizing these divine objectives. For this purpose, the non-bank Islamic financial intermediaries are broadly divided into three groups. First, Islamic Non-bank monetary financial intermediaries whose services are similar to those provided by banks, including Credit institutions, Savings, and Housing institutions. Second, Islamic social Microfinance Institutions are development and poverty eradication institutions. These institutions, which have grown significantly over time, provide services to disadvantaged and needy people. These include Gardul Hassan (QH), charities, Waqf, and Zakat that provide financial services to the poorest people to transform them from a beggar into an entrepreneur. Third, other financial intermediaries that provide Islamic banking services include Islamic leasing companies and Takaful.

The type of Islamic contract used depends on the type of activity of the financial institution. For example, leasing companies use Lease contracts or hire purchases, while investment institutions use a civil partnership or Vekale. This article focuses on two goals. First, the pathology of individual INBFI in Iran is discussed. Second, given that the Shia legal system in Iran differs in some respects from countries operating under Sunni Sharia, an attempt has been made to point out this difference wherever it exists. This study shows that the efficiency of these institutions is low, and their total capacity is not exploited. Finally, this Article provides policy implications and solutions to increase efficiency and optimal capacity to achieve poverty alleviation and development goals.



**Keywords:** Islamic non-banking, Iran, microfinance, takaful, leasing, waqf.



## ÖZET

İran'daki finansal sistem, İslami bankalar ve bankacılık dışı İslami finans kurumları olmak üzere iki temel finansal kurumdan oluşmaktadır. Bununla birlikte, İran'daki bankacılık dışı İslami finansal kurumlar diğer İslam ülkelerinde de olduğu gibi İslami finans sektörünün küçük bir bölümünü oluşturmaktadır. 1983 yılında çıkarılan faizsiz bankacılık kanunu, bankacılık dışı finans sektörü de dahil olmak üzere ülkenin tüm finansal sistemi için geçerlidir. Bu rapor, bankacılık dışı İslami finans kurumlarının İran'da ortaya çıkışını, mevcut uygulamalarını ve hedeflerini gerçekleştirme noktasında karşılaşılan zorlukları incelemektedir. Bu doğrultuda, bankacılık dışı İslami finansal kurumlar genel olarak üç gruba ayrılmaktadır. Birincisi, kredi kurumları, tasarruf ve konut kurumları dahil olmak üzere bankalar tarafından sağlanan hizmetlere benzeyen bankacılık dışı islami parasal ve finansal kurumlar bulunmaktadır. İkincisi ise kalkınma ve yoksulluğu ortadan kaldırma hedefi doğrultusunda faaliyet gösteren kurumlar olarak İslami mikrofinans kurumlarıdır. Zamanla önemli ölçüde büyüyen bu kurumlar, dezavantajlı ve ihtiyaç sahibi insanlara hizmet vermektedir. Bunlar arasında, en yoksul insanları bir dilenciden girişimciye dönüştürmek için finansal hizmetler sağlayan karz-ı hasen, vakıf ve zekât gibi hayır kurumları bulunmaktadır. Bu kurumların üçüncüsü ise İslami bankacılık hizmetleri sunan diğer finansal aracılar arasında İslami kiralama ve tekafül şirketleri bulunmaktadır. Kullanılan İslami sözleşmenin türü, finans kuruluşlarının faaliyet türüne bağlıdır. Örneğin, kiralama şirketleri, kira sözleşmelerini veya kiralama satın alımlarını kullanırken yatırım kuruluşları sivil ortaklık veya mali sorumluluk yöntemini kullanmaktadır. Bu rapor temel olarak iki noktaya odaklanmaktadır. İlk olarak, İran'daki islami Bankacılık Dışı Kurumlarda bireyin patolojisi tartışılmaktadır. İkinci olarak, İran'daki Şii hukuk sisteminin bazı açılardan Sünni Şeriat öğretisi çerçevesinde faaliyet gösteren ülkelerden farklı olduğu göz önüne alındığından dolayı mevcut farka birçok yerde vurgu yapılmıştır. Bu çalışma, kurumların verimliliğinin düşük olduğunu ve toplam kapasitelerinden yararlanılamadığını göstermektedir. Son olarak, bu çalışma, yoksulluğu azaltma ve kalkınma hedeflerine ulaşmak için verimliliği ve en uygun kapasiteyi artırmak için politik çıkarımlar ve çözümler sunmaktadır.



**Anahtar Kelimeler:** İslami banka dışı sektörler, İran, mikrofinans, tekafül, kiralama, vakıf.

**Reference:** Afshari, Z. (2022). *An Overview of Islamic Non-Banking Institutions (INBFI) in Iran* (Research Report No. 24). Istanbul: Research Center for Islamic Economics (IKAM).


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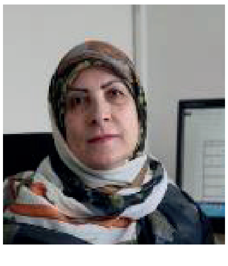


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# Introduction

It is well acknowledged in the academic literature that an efficient and well-developed financial system is vital for influencing economic growth. The financial system plays an important role, particularly in mobilizing and allocating resources. Theoretical literature argued that the availability of financial instruments and institutions significantly reduces transaction and information costs in the economy, influencing savings rates, investment decisions, and technological innovations. Financial intermediaries play an equally crucial role in capital transfer from lenders to borrowers during economic reform and banking institutions, widely known as non-bank financial institutions (NBFIs). NBFIs consist of securities companies, insurance companies, leasing companies, and investment funds (Chien, et al., 2021). In reality, the coexistence of banks and NBFIs by creating competition between these two increases these institutions' efficiency and helps promote economic development (Hossain & Shahiduzzaman, 2005; Dang & Pham, 2020). While banks remain the dominant financial intermediaries in most economies, non-bank financial institutions (NBFIs) complement banking activities by providing various services that banks do not typically perform, increasing financial sector diversification and facilitating growth and development. Therefore, NBFIs in an economy add to the development of a diverse financial sector that expands the menu of products to serve society's dynamic needs better. A diverse financial sector also increases the stability of the financial system. NBFIs can serve as backup institutions that may help stabilize the financial sector when adverse shocks adversely affect the dominant financial institutions, notably banks. Moreover, a well-developed NBFI sector can provide services to those segments of the society that are not adequately served by the formal banking sector. In this way, NBFIs have great potential to promote shared prosperity more effectively.

Poverty eradication, socio-economic justice, and the equitable distribution of income acknowledged since WWII as a global responsibility and recognized as core features of an Islamic economic system. Although Microcredit's success in alleviating poverty has now been recognized worldwide, it has two main weaknesses - First, there is a growing discomfort among Muslim clients about the program being interest-based and sharia non-compliance. Second, the cost of the loan is high. It has led us to look for an Islamic alternative. A new alternative is the creation of Islamic micro-financing institutions, which are strictly based on Sharia. It led to establishing Islamic non-bank financial institutions (INBFI). The main goal of the INBFI is to transform the poor from a status of perpetual charity dependent to self-respected entrepreneurship. In other words, the aim is to help the poor become owners of some productive assets and help them jump out of poverty. In other words, these institutions can eradicate poverty and improve income distribution without harming economic growth.

It is crucial to establish institutions to meet these objectives. Accordingly, Islamic financial institutions should pay more attention to the methods of financial risk-sharing that provide growth and meet the social needs of society. Since Islamic banks do not reflect these features, INBFIs can provide supplemental services to fulfill far-reaching goals and effectively promote social welfare. Despite the low levels of development in most countries with a high Muslim population, Islamic NBFIs have gained momentum. A case can be made to exploit the synergies between socially responsible investments and Sukuk as an alternative tool for mobilizing financing that could attract Islamic and socially responsible investors to make a visible contribution to sustainable development. Islamic

NBFIs include Islamic credit unions, house financing, Takaful, and leasing companies that can improve financial inclusion in most OIC developing markets when adequately implemented.

Furthermore, Islamic social financing can play a role in achieving the dual development goals of ending extreme poverty worldwide and promoting shared prosperity. Islamic social finance could play a significant role in helping achieve the twin development objectives of ending extreme poverty globally and promoting shared prosperity by raising the incomes of the bottom 40 percent of the population. Such intervention, involving Zakat and Sadaghat (charity), Waqf can potentially address the basic needs of the needy and create a social safety net. Islamic social financing institutions and tools, which are rooted in redistribution and charity and include Zakat and charity, can meet the basic needs of the very poor and create a social safety net.

Islamic Microfinance can integrate the poorest by savings schemes via wadiah and mudarabah deposits, money transfers through Zakat and sadaqat, and insurance via the takaful concept. Muslim countries have established various microfinance models based on interest-free banking. Iran established several microfinance schemes compatible with Sharia in line with other Islamic countries.

After the Iranian Islamic Revolution of 1979, many laws and regulations were changed and harmonized with Shari'ah law (Hosseini, 2015). On 7 June 1979, the government nationalized all banking and insurance systems. The Law of Establishment of Non-Government Banks was passed in 2008-2009 to reform and restructure the economy. During 2000-2010, a significant improvement in bank intermediation was observed (IMF, 2011). Now, the financial system in Iran constitutes two major types of financial institutions: Islamic banks and Islamic non-bank financial intermediaries (INBFIs).

Nevertheless, similar to other countries, the share of INBFI in comparison to the banking system is not considerable. Iran is the only Islamic country in which all financial institutions, both banking and non-banking, are required to enforce interest-free banking. While in other Islamic countries, the dual system is implemented, i.e., part of the financial system operates under the conventional interest-based method, and the other operates under interest-free banking.

In Iran, the financial sector consists of two major components: a large public sector and a limited private sector that started in the new millennium. The second type consists of a large number of INBFIs. INBFIs consist of two major types: first, Islamic non-bank monetary institutions, which collect the surplus funds in the society through Qardhul Hassan (QH) savings deposits, term investment deposits, bond issuance, Participation bonds, and allocating through interest-free banking operations. The use of Islamic contracts varies according to the type of institution and activity. For example, leasing companies use lease contracts or hire purchases, while investment institutions use a civil partnership or Vekale, etc. (Shamsuddin, 2017). The paper concluded that when they are adequately implemented, they can improve financial inclusion in Iran.

Second, Islamic social financing institute: They can play a significant role in achieving the dual development goals of ending extreme poverty worldwide and promoting shared prosperity. Islamic social finance could play a significant role in helping achieve the twin development objectives of ending extreme poverty globally and promoting shared prosperity by raising the incomes of the bottom 20 percent of the population. Such intervention, involving zakat, sadaqat (charity), and

Waqf, can potentially address the basic needs of the needy and create a social safety net. Islamic social financing institutions and tools, which are rooted in redistribution and charity and include Zakat and charity, can meet the basic needs of the very poor and create a social safety net. Iranian experiments using these institutes demonstrate this potential, but they require policies to support the efficient mobilization of Islamic social resources, the efficient use and management of these resources, and their integration with microfinance for a more inclusive and cost-effective approach.

Iran's Shia Islamic-based legal system is partially different from other Islamic countries that operate under Sunni jurisdictions. The critical analysis of INBFI experiences in the selected environment provides a better picture of practices systematically and comparably. Two perspectives are considered for the analysis. First, it deals with the pathology of implementation of Islamic non-banking financial institutions. The second offers a comparative perspective with other Islamic countries. This study shows that the efficiency of these institutions is not acceptable, and they have a long distance to achieve their potential capacity. Finally, this Article provides implications for increasing the efficiency of INBFI and back on its course to achieve its optimal condition.

For this purpose, the non-bank Islamic financial intermediaries are broadly divided into three groups of institutions: 1) Islamic Non-bank monetary financial intermediaries, which, in many ways, services are similar to those provided by banks. For example, Credit institution Savings and Housing institutions. 2) Islamic Social Microfinance institutions (ISMF) which include QH and other voluntary charities (Sadaqat), Waqf, and Zakat dedicated to providing services to the poorest people and needy. 3) Other financial intermediaries that provide Islamic banking services include Islamic leasing companies and Takaful. The analysis began with four main elements of INBFI, namely: history, legal, current practices, and management practices in post-revolutionary Iran, and ended up with a critical evaluation. In addition, a comparative study of selected Islamic countries' experiences can help design the optimal model of non-banking financial institutions. In the subsequent sections, we study the evolution, organization and performance, and shortcoming of these institutions in Iran. Each section ends up with a critical discussion. The final part is devoted to the discussion and policy implications.

## Non-Bank Monetary Islamic Financial Intermediary in Iran

The non-bank credit institutions were established in Iran at the beginning of the new millennium, providing micro-finance under Central Bank supervision. The operations of non-bank financial institutions authorized by the CBI. According to Article 16, credit institutions cannot carry out usurious operations. To direct funds to production and meet the financial needs of vulnerable groups, financial and credit institutions form their services under the executive regulations and the law of interest-free banking operations. Credit institutions can provide the required financial resources in the following way:

1. Accepting savings loan deposits;
2. Accepting investment deposits;
3. Issuing participation bonds ;
4. Issuing QH bonds;

5. Receiving facilities from actual and legal persons (Article 17 approved by the Monetary and Credit Council).

To accurately implement the monetary and credit policy, credit institutions are obliged to:

1. Pay Legal deposits concerning the types of deposits to the CBI

2. Types of interest rates on deposits, facilities, commissions, and prizes are determined under the criteria approved by the Monetary and Credit Council (Article 29 approved by the Monetary and Credit Council).

Credit institutions can open a current account with the approval of the CBI; the maximum balance of this account is Up to 3% of the remaining deposits subject to the required deposit (Article 30 approved by the Monetary and Credit Council). Granting credit facilities in these institutions is within the framework of laws, regulations, and Executive instructions of the law on interest-free banking operations and following each institution's field and type of activity (Article 19 of the Regulations of Non-Banking Institutions) (CBI, 2015a).

The essential services and activities offered by non-bank financial institutions are to finance investment to promote the production sector. It happened through: financing in exchange for collateral of receivables, financing through lending Commercial, financing to start production activities in the pre-purchase products, and investment activities include providing brokerage services, Securities, direct participation in investments, and formation of mutual funds .

**Capital requirement:** At first, the capital of a non-bank credit institution is set at least five billion rials at the time of the establishment. It is noticeable that if the total annual losses exceed 2% of the capital, the institution will provide the difference within a maximum period of two years. Regulations governing the establishment and mode of operation of Non-bank credit institutions are subject to the approvals of the Money and Credit Council dated 1992-1994(CBI, 2015b).

The regulations governing the determination of capital are related to the Monetary and Credit Council meeting dated 21/2/2010, in which the minimum capital for the establishment of a non-bank credit institution changed to 3,000 billion rials. Table 1 shows that the minimum capital required to establish QH Funds and staff credit unions reach.5 billion rials. In contrast, the minimum capital required for establishing a Credit institution increased to 50 billion rials. Moreover, this amount for leasing companies increased to 100 billion rials.

**Table 1:** The Minimum Capital Required to Establish Various Types of INBFI in Iran (Billion Rials)

| | Mainland | abroad |
|---|---|---|
| QH Banked | 500 | 500 |
| non-bank credit institution | 3,000 | 6,000 |
| QH Funds | .5 | .5 |
| Credit institution | 50 | 50 |
| staff credit unions | .5 | .5 |
| Leasing | 100 | 100 |

**Source:** CBI (2010a, 2010b).

Despite the increase in the risk of financial activities and assets, capital has not increased proportionally. As a result, the capital adequacy ratio had sharply decreased. Many non-governmental banks and non-bank credit institutions have a shortage of capital, and this is considered a warning sign of a crisis in the banking system. To improve the health of institutions and prevent financial instability, a new capital requirement was established. The minimum capital required for establishing and operating a non-bank credit institution increased to 15000 billion rials in 2016. Existing non-bank credit institutions, within a maximum period of three years after approval, are required to increase their capital to the minimum set within the framework of a program approved by the Central Bank. Suppose non-bank credit institutions do not increase their capital within the set deadline. In that case, the Central Bank is obliged to impose fines, prohibit the payment of dividends to shareholders, prohibit the receipt of new types of deposits, prohibit the granting of new types of small facilities, requirement. Establish and merge with other banks and revoke the license to establish and operate the bank. Non-bank credit institutions must hold 3% of their total deposit balances in the form of tradable Islamic securities in the capital market (CBI, 2017). The Non-bank monetary institutions in Iran may be classified as Credit Unions, Savings, and Housing institutions as follows:

## Islamic Credit Unions

The purpose of forming an Islamic credit union is to provide an alternative and assist Muslims who wish to organize and run their financial institution according to the financial principles of Islam and share the benefits of this model with the community. In general, Muslims, as well as others, need to keep their savings, need credit for housing, consumer goods, medical care, business, education, etc., but they want to obtain them from a financial institution according to their faith. Two types of Credit unions are operating in Iran, i.e., Employee / Labor Credit unions (The members include employees, retirees, pensioners, and pensioners) and Trade Credit unions : (Its members are Holders of licenses from the country's trade union) which receive their business license from the country's trade union.

According to the Executive instructions for the establishment, operation, and supervision of credit cooperatives (2004), credit unions were licensed by the Ministry of Cooperatives but not supervised effectively. Based on Article 11, the minimum capital for establishing and operating credit unions with less than 50 employees is 500 million rials. The amount of capital ten million rials is added for each additional member. The 5th FYDP of 2010 (article 96) assigns a new regulatory framework for credit unions and makes the CBI solely responsible for licensing and supervising non-bank credit institutions. Since then, 900 credit unions have applied for a CBI bank license, and the many small and medium-sized ones will operate under the umbrella of a new Cooperative Bank of Iran. The CBI closed 50 credit unions and merged the remainder into six new entities. Therefore, the consolidation is expected to result in 12 new banks and the Cooperative Bank of Iran.

According to Article 37, the receipt of loan fees must be within the framework of the rules and regulations of the Central Bank. The company's investments are limited to only the purchase of participation paper, treasury bonds, Sukuk, Islamic bonds, and other similar bonds guaranteed by the government, CBI, and Banks, or deposit within Bank and non-bank affiliated institutions purchasing shares of the credible credit cooperative union. In any case, the sum of the investments in question should not exceed 20% of the available resources (Article 38). According to Article 40, legal reserves and precautionary reserves are calculated on the base of company regulation (CBI, 2016).

According to the CBI, in 2015, the minimum capital requirements for credit institutions were established in 300 billion rials. Upon the laws approved by the State Board, 4 February 2015, credit institution after getting Central Bank agreements must be in a three-step of the Bank license (the primary license, certificate, permit (established but in practice a large number of these institutions without having the license of the Central Bank. Currently, 2,489 credit unions have been identified in Iran, of which 1,889 are inactive or in liquidation, 257 are licensed, and 343 are being reorganized (parliament Research center, 2018).

Examples of credit unions in other countries are MCCA Islamic Finance and Investments (Australia), Islamic Investment and Finance Cooperatives Group (IFCG) in Afghanistan, Baitul Mal WA Tamwil (BMT) in Indonesia. WOCCU has undertaken a project to set up Islamic Investment and Finance Cooperatives (IIFCs) in Afghanistan. These IIFCs are the only credit unions within the WOCCU system with Islamic financing features. WOCCU has developed several Shari'ah-compliant products for the IIFCs, including al-wadiah safekeeping accounts; working capital loans (*Murabahah*) for the purchase of inputs on a mark-up basis, financial investment (*mudarabah*) on a passive partnership basis; financial lease (*ijara*) for equipment; and hybrid loans (*Ijarah* paired with *Murabahah*).

## Savings and Housing Institutions

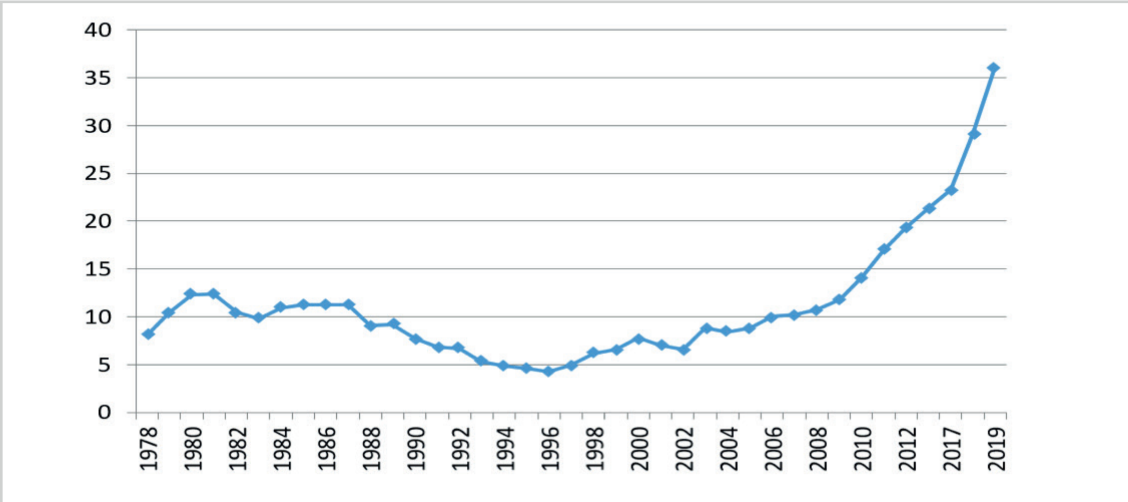
According to Executive instructions for the establishment, operation, and supervision of Savings and Housing Facilities (2020) : Savings and Housing Facilities in addition to receiving facilities from credit institutions, government, state-owned companies, public, non-governmental organizations, and municipalities, these institutions can also receive loans from international financial institutions to provide the desired liquidity. Also, with the establishment of savings institutions and housing facilities, mortgage payments will be made in each province on a regional basis and with particular criteria of the same province.

Monetary and Credit Council provides a sufficient facility for financing the housing sector by attracting micro-savings and granting housing facilities and citing the administrative regulations of Note 2 of Article 7 of the Law on Support for Rehabilitation, Improvement, and Renovation Dilapidated and Inefficient Urban Structures approved by the Cabinet. The Executive has approved the establishment, operation, and supervision of savings institutions and housing facilities "in articles and four notes. The minimum capital required for establishing and operating the Institute in Iran, amounting to 500 billion rials, other antiquities, and centers of the province, is determined to be 400 billion. The CBI may change and increase the minimum capital subject to this Article every two years. Upon the proposal of these institutions are required to adjust within a year (Article 5). The minimum capital adequacy ratio of the institution following the rules and regulations approved by the Ministry of Finance and. Credit depends on the capital adequacy ratio (Article 9). The institution is authorized to invest in the stock market and its suburbs (Article 11). The ratio of legal deposits for different types of deposits of the Resurrection Institute was set at 2 %( Article 13).

## The Performances

The total assets of non-governmental banks and Non-Bank credit Institutions had an increasing pattern, as shown in figure1.

**Figure 1:** The Value of Assets of the Non-Public and Non-Bank Credit Institution (Billion Rials)



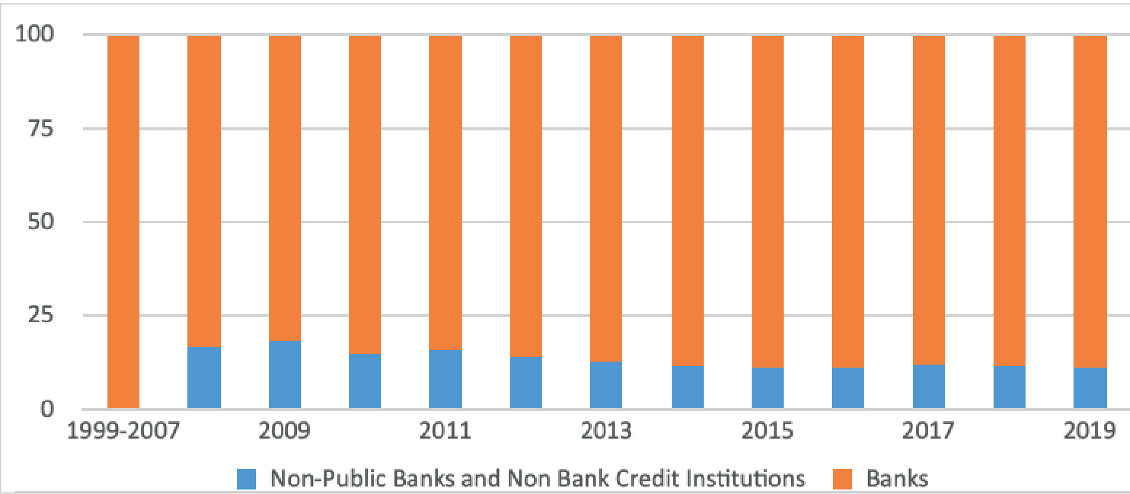

**Source:** Author calculation on the base of CBI (2021).

The value of assets as a percentage of GDP was 3.42 percent and 21.36 percent in 1962 and

2013respectively. The non-bank financial institutions form a small segment of the Islamic finance industry in Iran.

In Iran, the amount of Facilities Extended by Banks and Credit Institutions changed from 206 billion rials in 2002 to 16096.8 billion rials in 2019. As figure 2. Shows the number of facilities extended by non – bank and non-public institutions accounted for 16.6% in 2008 and decreased to 11.1% in 2019. The ratio range was between 11 %( 2015) and 18.3 %( 2009). The percentage share of External loans and deposits of reporting banks vis-à-vis the non-banking sectors (% of domestic bank deposits) decreased drastically from15.4% in 1995 to 0.739 in 2016 ( CBI, 2021)

**Figure 2:** Facilities Extended by Banks and Non-Banks Credit Institutions in Iran

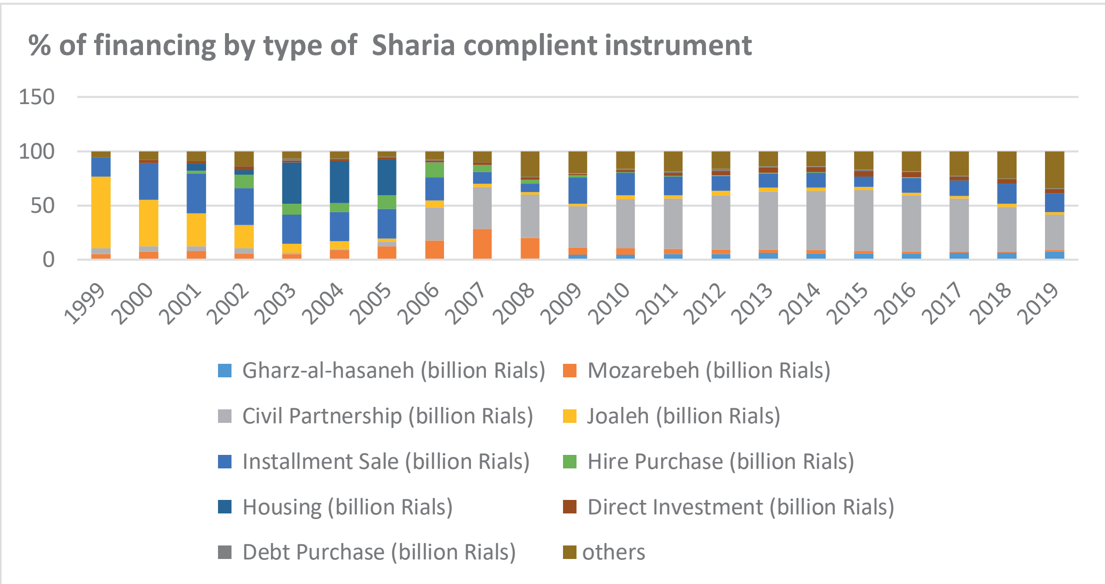



**Source:** Afshari (2020).

As figure 3, shows in 2007-2019, the percentage of civil partnership and Installment Sale were the dominant form of facilities extended by Non –bank and non - public institutions, and in 2007-2019 which accounted for about half of the facilities extended by Non –bank and non-public institutions. With the installment sales application, the financial institution can purchase or resell instruments such as raw materials, machinery equipment, and housing. Installment sales are the most crucial financing method in Iran. "Leasing and purchasing" is a tool that allows banks to purchase and rent buildings, machinery, and equipment. Direct investment is the activities of a bank for economic development or social purposes.

While the percentage share of QH and direct investment in total facilities revealed a decreasing pattern and in 2019 accounted for 7.7 % and 4.3%, respectively. The share of other facilities extended by the non-bank institution is not considerable. With mozaraah (*mudarabah*), they are used for short-term commercial activities and provide funds for private projects of individuals and firms.

**Figure 3:** % of Financing by Type of Sharia Compliant Instrument by Banks and Non-Bank Institutions

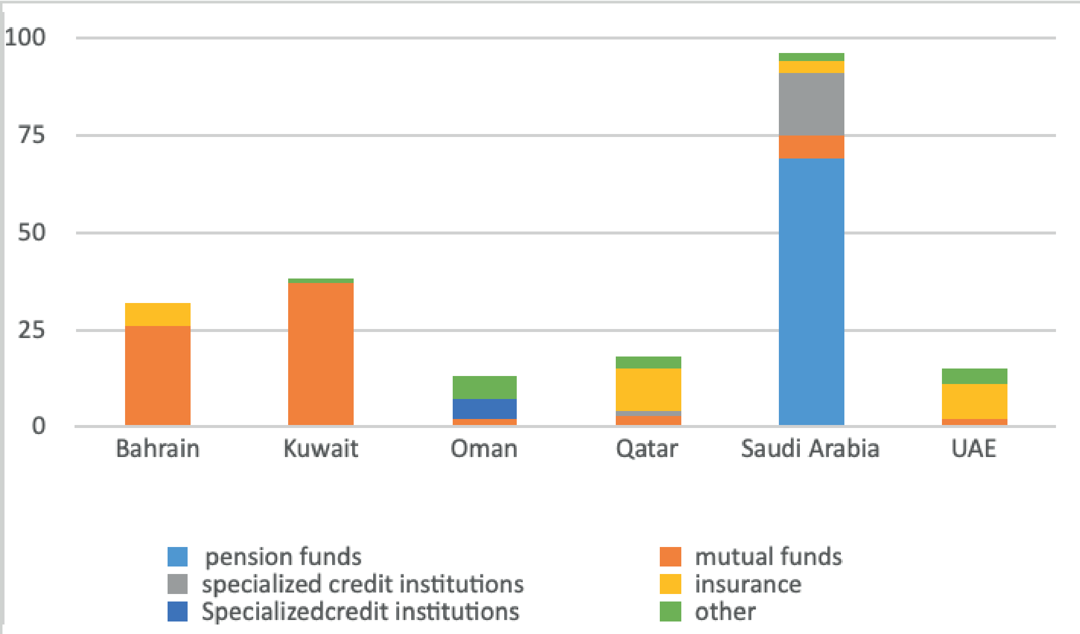



**Source:** Afshari & Soleymanimovahed (2020).

Currently, there are four categories of banks in Iran: public commercial, public specialized, privatized, and private. Thirty-two banks and financial/credit institutions now operate in Iran, including ten state-owned banks, 20 private banks, and two other financial institutions. All of these banks are governed by the central bank. In addition, a large number of unlicensed (and unregulated) financial institutions (shadow banks), which are connected to public sector entities, the armed forces, and charities, included 2,489 credit cooperatives and 3,525 religious charity funds(Erdogan, S. and Gedikli, A. 2020). While there are about seven thousand non-bank credit institutions, only five thousand are active; 3500 specialize in microfinance, and the other 1500 are big credit unions.

While, in 2017, the number of Islamic non –bank financial sector Saudi Arabia was 97. Moreover, this number in Bahrain is 32, Kuwait 32, Qatar with 17 Oman, and UAE is 14. Figure 1. Depict the non-bank institutions in GIC members by kind of activity. The INBFIs in Saudi Arabia consist of two significant pension funds and four Specialized Credit Institutions. Investment companies dominate the INBFIs in Kuwait, while funds management firms dominate in Bahrain. The insurance sector remains limited, while investment companies and mutual funds have more prominent activity, mainly in Kuwait and Saudi Arabia.

**Figure 4:** The Non-Bank Institutions in GIC Members by Types of Activity




**Source:** IMF- FSAP.

## Pathology of Islamic Monetary Finance

Non – bank credit institutions spread rapidly all over the country. Only a few of them work officially, while the others work independently away from the supervision of the Central Bank. The Ministry of Cooperatives licensed credit unions but was not supervised effectively. While most institutions provided banking services purely to their members, some progressively engaged in regular banking in violation of the license. To attract deposits away from established banks, some institutions promised to remunerate term deposits much above the CBI-regulated rates offered by banks.

Consequently, they became independent institutions and worked without the supervision of the Central Bank. The small credit institutions have limited power than the larger institutions in Iran, linked to state institutions such as the Iranian Revolutionary Guards Corps. Caspian, linked to the latter, offers about a 35% interest rate (compared to 18 to 22%) and attracts many clients.

In 2011, Iran had 7,000 registered nonbank credit institutions, of which 5,000 were active (3,500 microfinance entities; 1700 credit cooperatives of which 1,500 credit unions and 200 cooperatives), with total assets of $600 billion (more than 15 percent of GDP) in 2010. Six entities account for ninety percent of the credit union's total assets. By the end of 2011, the deposits absorbed by these institutions jumped to 600 thousand trillion rials. 300 Thousand billion rials of liquidity are under the authority of credit cooperatives (Niavand, Nia, 2017), According to the Central Bank. By the end of 2011, it is estimated that the total amount of funds deposited in these institutions approximated 19% of the total liquidity. (CBI, 2015). The deposits absorbed by financial and credit institutions increased to 850 trillion rials, 27% of the banking system deposits (Delegation of ministers, 2014). It is estimated that the total amount of funds deposited in these institutions 11220 thousand trillion rials equivalent to $295 billion) approximated 15-20% of the total liquidity. Most of the clients of these institutions were small depositors ( Shamsuddin & Ahmad, 2017). It amounts to less than $10 billion deposits for more than 450 thousand clients. Mostly, they are laborers and small depositors, with a dark cloud of poverty hanging over them if these institutions were to shut down.

Paying high deposit rates required credit unions to engage in riskier lending, and, in 2010, one million depositors were affected by the bankruptcy of two medium-sized credit unions. Some institutions went bankrupt, like 'Mizan' in 2013. In 2016, 12 financial institutions acknowledged bankruptcy. Still, the government kept quiet, while the closure of 'Caspian' and 'Arman' because of bankruptcy led to protests by clients asking for their funds to be repaid.

***Causes of Frequent Bankruptcy Cases***

The main reason for the bankruptcy of non-bank credit institutions can be linked to the provision of high-interest rates that amounted to 20-35% and the consideration of loans without sufficient collateral. There are other undeclared reasons such as weak central management, the failure to follow regulation, the lack of competent professionals in managing such institutions, and successive Iranian governments undertaking irrational behavior. We can classify the reasons behind the bankruptcy of these institutions as follows

**The Interest Rate Discrepancies:** 35% interest rate in compare to18 to 22% of official banks, i.e., the interest rate discrepancies between official banks and non-bank credit institutions was 10%. Paying high deposit rates required credit unions to engage in riskier lending, and, in 2010, one million depositors were affected by the bankruptcy of two medium-sized credit unions. Causes of frequent bankruptcy cases in Iran The main reason for the bankruptcy of non-bank credit institutions can be linked to the provision of high-interest rates that amounted to 20-35% and the consideration of loans without sufficient collateral. Until 2007, Iran's CBI did not have a defined interest rate for private banks and non-bank credit institutions which entrenched competition between these institutions until most of them went bankrupt

**The Multiplicity of Institutions:** The multiplicity of institutions made monitoring difficult for Central Bank. Because of Spreading thousands of these institutions all over the Iranian provinces, CBI lost control of them. Only a small number of them work officially, while the others work independently away from the supervision of the Iranian Central Bank. The licenses of these institutions are issued by ministries that have nothing to do with the authorized financial institution in the country. Most of these licenses were issued during President Mahmoud Ahmadinejad's government.

**Inefficient and Insufficient Supervision:** Monetary policy aims to manage the interest rates, liquidity ratios to promote economic growth. It needs complete supervision by the CBI over banks and credit institutions involved in financial activities; otherwise, the monetary policy would fail. The failure of the CBI to regulate credit institutions led to the violation of its monetary policy. The noncertified institutions do not deposit the required capital ratios in the CBI (usually 10% of the total deposits in any bank), which increases risk in times of crisis, leading to bankruptcy.

Not only did the government and the CBI fail to register such institutions, but they were also unsuccessful in spreading awareness amongst people of the necessity to avoid investing in such unofficial credit institutions. They could not convert these assets into funds to pay back clients' savings during crises and panic. As a result, they were paralyzed. In addition, the government's permission for non-compliance with central bank supervision by financial institutions is responsible for the severe financial crises and crises of 2005-2013.

Inexperienced managers: Most of the managers in these institutions come from non-banking backgrounds and are not specialists in credit operations. The affiliation of most of these institutions with the centers of power, wealth, and confidante relationships was one of the main grounds for their financial dilemmas. The non-banking institutions control savings; however, they possess low experience in administration and banking. As a result of professional and administrative inexperience, these institutions bought assets that were hard to realize .in the short run, like purchasing real estate and entering contracts for commercial and industrial enterprises. It tended to reduce savings into high-risk speculations in the exchange, gold, and real estate markets. And they enter contracts for commercial and industrial enterprises, leading to economic instability in the country. They were paralyzed as they could not convert these assets into funds to pay back clients' savings during crises and panic.

**A Lack of Transparency:** If credit or financial institution works away from the supervision of the CBI will result in the collapse of the financial system, leading to the loss of rights, public mistrust, financial corruption, and, most importantly, a negative consequence on people's lives. Credit institutions have contributed to Iran's financial instability risks because, in the absence of adequate supervision and internal controls, many have faced difficulties, partly due to fraud. After all, the CBI had no control over their ability to add to liquidity through deposit creation. Recurring bankruptcy in Iran threatens the trust and stability of the financial system. When bankruptcy recurs after debt accumulation by the non-banking institutions one after another, they are paralyzed from being able to pay back customer deposits, and clients lose confidence in the whole financial system, bank, and non-bank. As a result, panic prevails amongst clients who might rush to withdraw their money at any given time, leading to bankruptcy and, ultimately, exposing the economy to a severe financial crisis and a downward turn in investments. Prevailed bankruptcy has threatened the financial and economic stability of Iran.

***Cover Up the Bankruptcy***

The Central Bank's involvement, in certain situations, came too late. To avoid transmitting panic to other banks. In August 2016, Iran closed about fifty million unknown bank accounts- with no names or addresses- referring to the possibility of using them in illegal operations. The government tried to cover up the bankruptcy of credit institutions. Some bankrupt institutions like 'Mizan' in 2013, even though it had obtained an operating license, as debt accumulation forced the CBI to dissolve it officially in May 2015. The client protests shut down the branches of credit institutions, and the media covered the bankruptcy of 'Caspian,' 'Arman,' 'Thamin Hijaj,' 'Josar,' and 'Thamin Ala'imah' in 2017. Finally, the CBI did intervene to save key credit institutions from bankruptcy, preventing a similar fate for others and averting alarming clients in the country. Also, the CBI set up a credit supply to 'Caspian' to prevent the recurrence of its bankruptcy and avert clients' panic, as it had gone bankrupt in 2016 (Shamsuddin, 2017).

Moreover, Efforts have been made since 2017 to address the rising risks of credit institutions following runs on two of them; the CBI intervened, paid depositors, and provided liquidity support, de facto establishing deposit insurance for these institutions. The steps have been taken to improve the CBI's regulatory oversight over them and allay social concerns about the safety of deposits by merging or trying to close several of them, including a few owned by the armed and security forces, and transferring their assets and liabilities to regulated banks. These steps reduced the assets held by unlicensed funds from 25 percent of total financial system assets to 10 percent (Islamic Parliament Research Center 2018). As a result, risks from credit institutions are partially eliminated.

Although INBFIs are now in part closed or under greater CBI oversight, they harmed the profitability and balance sheets of regulated banks and weakened public confidence in the financial system and the CBI's regulatory abilities. In addition, because of INBFIs, Iranians experienced bank runs for the first time. Iran Has a Slow Motion Banking Crisis If there is a silver lining to the experience with INBFIs, it is that depositors are more aware of financial risk and regulatory problems, especially whether or not the CBI supervises a financial institution (Mazarei, 2019).

There is no doubt that any credit or financial institution that works away from the supervision of the CBI will result in the financial system withering away, leading to financial corruption and a negative impact on people's lives. The interest rate discrepancies between official banks and non-bank credit institutions threaten investment. It was difficult for the CBI to manage inflation rates by adjusting the policy rate and monetary base. Today, the CBI has decided to design its monetary policy to reduce interest rates and encourage investment, reactivation of industrial sectors, in order to deal with high interest rates. (CBI, 2011).

## Islamic Social Microfinance Institutions in Iran

### Legal and Conceptual Framework

Islamic micro-financing provides an alternative to conventional micro-financing to meet the financial needs of the poor and disadvantaged. Conventional IMFIs follow the well-known example of the Grameen Bank of Bangladesh, which is considered a pioneer in microfinance. . The model used by this bank is interest-based. Islamic microfinance represents the confluence of two rapidly growing sectors: microfinance and Islamic finance (Nabi, 2013). As the Islamic finance sector refers to the financial system based on Sharia, 'The proposed and currently used models for IMFIs are based on the Grameen model; with the main difference that Islamic instruments or modes of financing eliminate riba. Obaidullah and Salma (2008) reviewed various microfinance models and their acceptability among Muslim countries. They concluded that already established microfinance models are successfully copied in providing noninterest-based financing. For example, Islamic Bank Bangladesh Limited follows the Grameen Bank Model, FINCA in Afghanistan, and UNDP in Syria follows the Village Bank Model. Muslim Community Cooperative (Australia) Ltd. uses the Credit Union Model. The Self Help Group Model is quite famous among Islamic NGOs in Indonesia. Although both mobilize external funds and savings as their source of funds, Islamic charities such as Zakat and Waqf are the specific source for funding Islamic microfinance. However, we can highlight the differences between Islamic IMFIs and conventional IMFIs at least in the following areas:

**Modes of Financing:** Conventional IMFIs are interest-based, while Islamic IMFIs are interest-free. Islamic IMFIs operate through several Islamic modes of financing such as Ijarah, Murabahah, Istisna, Mudarabah, Musharakah, Bai Bithaman Ajil, etc.

**Sources of Funds:** Conventional IMFIs usually get the funds from external donors and the clients' savings and external funds (Habib, 2002). Islamic IMFIs, however, in addition to these sources, can catch the funds from religious institutions such as Waqf, Zakat, Anfal, etc., which are prevalent in most Islamic countries.

**Target Group:** Although the microfinance movement is meant to help the poor run out of poverty, the poorest segment of the population is left out by conventional IMFIs (Choudhury, 2002). However, this is not the case with Islamic IMFIs. Islamic IMFIs can integrate the poverty eradication institutions in an Islamic economic system by using *QH* and other voluntary charities (*Sadaqat*) to provide the poorest people with financial services. In contrast to conventional MFIs s, the IMFI staff approach to the job is a part of religious duty (Arabi & Meisami, 2013).

Equity instruments are relatively uncommon. Mudaraba and, Musharakah products are issued by 17.2 % of Islamic MFIs, and 22.6 percent of Islamic MFI clients use these products. This preference might reflect the high risk associated with equity products and the difficulties associated with determining a project's yield, which would imply the need for costly monitoring. Instead, debt instruments, Murabahah and QH particular, are substantially more common than equity instruments. 75.8 percent of Islamic MFIs provide Murabahah, 58.6 percent provide QH, and 20.7 %. On average, 47.6 percent of Islamic microfinance clients use Murabahah, 23.1 percent use QH, and18.2 percent use salaam. Thus, our results establish that Islamic MFIs and their clients mainly rely on Murabahah and QH (Ahmad et al., 2021).

More than 1500 Islamic financial institutions are functioning globally, out of which about 300 institutions provide Islamic microfinance services in 32 countries of the world (Mughal, 2017). The size of the Islamic microfinance industry is about 1 billion USD which contributes about 1 percent of the market share to the total Islamic finance market in the world (Dar & Azmi, 2017). Moreover, Most of the Islamic IMFI are concentrated in the East Asia and Pacific region (64 %), followed by the Middle East and North Africa region (28 %) (Karim et al., 2008; Dar & Azmi, 2017). South Asia accounts for the most significant number of Islamic MFIs, with 30 in Pakistan, 9 in Bangladesh). The Middle East and North Africa also feature many Islamic MFIs, with 29 providers, and sub-Saharan Africa accounts for 23 Islamic MFIs.In Iran, the number of microfinance institutes was 7000 in 2017.

Murabahah, a debt-based financing product, is the most widespread, and 64.7 percent of Islamic MFIs provide it in terms of the availability of different types of Islamic financial products. Due to the high risk associated with equity-based products such as Musharakah, relatively less exploited by MFIs.

Islamic IMFI has been growing at a rate of around 20 percent. (Ahmad et al., 2021). For instance, the performance of FINCA in Afghanistan, IBBL in Bangladesh, Akhawat and Wasil foundations in Pakistan are remarkable.

**Islamic Microfinance**

Microfinance programs in Iran began at the end of the 1990s with the cooperation of the local government and international organizations' efforts for poverty eradication. Today microfinance is a growing sector in the country and has been officially recognized by the Iranian government (Di Pucchio, 2015).

CBI Bank Circular No. 41932/94 dated May 2015, which implicitly places facilities up to 200 million Rials under micro-facilities. Meanwhile, some banking network institutions have included facilities up to one billion Rials in the category of micro facilities. At present, micro and macro facilities are distinguished by differences in the facility's location, the length of the repayment period, and the amount of collateral required. Their licensed Microfinance institute based on the Interest-Free Banking Act allows charging a 4 percent commission on lending.

In general, micro-facilities are used to purchase goods and services such as housing, cars, education, medical treatment, marriage, dowry, and travel, or to finance small and medium-sized industries and production units, with fewer repayment periods than ten years. Lighter collateral is used. In Iran, there is no clear line between micro and macro facilities; as a result, separate and reliable statistical information on the ratio of micro and macro facilities is not available.

Although Agricultural Bank is identified as a pioneer bank in microfinance, this bank has conducted several special efficient projects to support poor and vulnerable people. According to available statistics, 72% of grants of this bank go to borrowers in the form of microcredits (Bakhtiari, 2009).

**Islamic Social Micro Finance (ISMF)**

Islamic social finance could play a significant role in helping achieve the twin development objectives of ending extreme poverty globally and promoting shared prosperity by raising the incomes of excluded. Such intervention, involving Zakat and sadaqat (charity), Waqf can potentially address the basic needs of the needy and create a social safety net. Islamic social financing institutions and tools, which are rooted in redistribution and charity and include Zakat, Waqf, and charity, can meet the basic needs of the very poor and create a social safety net.

It requires policies to support the efficient mobilization of Islamic social resources, the efficient use and management of these resources, and their integration with microfinance for a more inclusive and cost-effective approach. These include policies to build legal, regulatory, and financial frameworks at the macro and medium levels and build supportive infrastructure. At the micro-level, these policies include increasing the accountability and transparency of institutions, improving their governance, and diversifying their products while turning poor people into literate and responsible customers. This section reports several creative experiments using Zakat and Waqf, including creating an interest-free credit provided by Zakat and charity. They support community-based development by using zakat and truth funds, creating a guarantee fund with Zakat, providing affordable medical services through corporate endowments and endowment engineering for relief and rehabilitation. Policies are needed to support the efficient mobilization of Islamic social resources, the efficient use and management of these resources, and their integration with microfinance, for greater and more cost-effective participation. These include policies to build legal, regulatory, and financial frameworks at the macro and medium levels and build supportive infrastructure. At the micro-level, these include policies to increase the accountability and transparency of institutions, improve their governance structures, and diversify their product offerings while turning poor people into more literate and responsible customers.

Furthermore, several microfinance schemes compatible with Islamic social finance have been established in Iran. They are primarily based on institutions such as Zakat (almsgiving), khums (alternative Sharia financial obligations), waqf (endowment), and *QH* (Quaiyum, et al., 2008). Therefore, ISMF should mobilize resources by accepting savings deposits or obtaining funds. This commercial approach entails charging and sharing profits and is relatively consistent with Islamic Sharia'. Besides providing alternatives to exploitable lending via mudarabah and Musharakah, Islamic Microfinance can integrate the poorest by savings schemes via wadiah and mudarabah deposits, money transfers through Zakat, and sadaqat, and insurance via takaful concept.

***QH Funds***

QH Funds are a form of ISMF with a long history in Iran. From ancient times, benevolent people gave some of their money to needy persons. Under Islamic thoughts and to support the poor, the Muslims followed this doctrine through history by providing QH to cover the financial needs of the poor. Over time the quality and quantity of QH improved. In addition, IMFI provides financial services to needy entrepreneurs to confront their financial problems. ISMF merged microfinance and Islamic finance based on the principles of Sharia.

QH and micro credits provide finances for the poor and those groups who do not have access to financial resources. QH Funds are a kind of ISMF that proposes financial services to its members. The main difference between Microcredit and QH is that Microcredit is an interest rate-based loan, while QH is a loan without interest. The other difference between these two is that Microcredit allocates for any purpose. At the same time, QH pays solely to the needy and generally alleviates their primary needs for God's sake. Therefore QH is a more potent instrument than Microcredit to alleviate poverty.

In Iran, QH funds were originated before the Islamic revolution. Mainly, they were established in mosques, among families, or employees of an organization. Thus, they did not need an office or to be registered. Therefore it is not easy to trace them. However, in 1969, the first fund was registered in Tehran with the capital of 140 thousand rials (about $ 2000). Their activity extended by absorbing deposits and facilitating zero interest-bearing loans. It took four years until the other fund with working capital of 1200 thousand Rials ($ 17143) and 120 shareholders were registered in Tehran. This new fund was registered as a financial (commercial) unit and was eligible to collect deposits and extend non-interest-bearing loans. It is noticeable that before the Islamic Revolution, all banks were interest-based institutions; this new fund served as a model for an Islamic financial institution.

It was followed by the establishment of several similar institutions in other cities. Therefore, two types of QH organizations were developed before the revolution: the voluntary funds to collect QH, Deposits, and extend loans, and the second as a non-interest-bearing financial organization. Until 1979 at least 200 QH funds operate in Iran.

After the nationalization of banks, Islamic Economic Organization (IEO) was established. IEQ offers QH funds several services, including QH loans, managerial instructions, accounting, and deposit-loan management. In return, the QH funds should open a deposit account and keep the required reserve in the IEO. Membership in IEO was optional. As a result, most QH's were not a member of IEO.

Moreover, QH funds were neither under the supervision of the CBI nor the government. QH's have formed on a regional basis. The QH funds provide loans for the following purposes: marriages, home repairs, residential rents, and mortgages, hospital and illness expense, business working capital, education, agricultural activities, small industries, home appliances, rehabilitation of damages caused by natural disasters, pilgrimage, supporting other QH funds, supporting private and state organizations, repairs of mosques, and shrines and library construction.

After the Revolution, funds grew both in cities and villages. In 1980, 1984, and 1985 the funds reached 800, 1400, 1650, and 2250. The main reason for the rapid growth of these institutions is the ambiguity about the Islamic nature of the banking system before the implementation of the Interest-Free Banking law in 1984. Moreover, there was no opportunity for the new private financial institutions to be established. Therefore the only feasible way was the establishment of QH funds. It required the CBI to gain supervision over the QH funds as of 1989. The law of the "Unorganized Money Market" act was approved by the Parliament in 2005. In 2012 QH funds increased to 5000. Currently, 3,525 registered funds are working in Iran, of which 1,028 are either inactive or in liquidation. 71% of the funds are under the supervision of the Central Bank (Parliament Research Center, 2018).

***Charities (Sadaqat)***

Charities are non-profit organizations that are not based on personal profitability and pursue charitable and public goals. Non-governmental, non-profit, non-political, voluntary, and independent are common characteristics of charities. In 1994, more than 1300 charities were active in Iran. The number of charities has grown from 2000 units in 1997 to about 10,250 in 2005 and exceeded 17,000 charities in 2011.

The 2007 "law on the regulation of nonbank money markets" imposed limits on charities' operations: deposits became subject to CBI reserve requirement; lending was restricted to interest-free loans. Further, Articles 95, 97, 104, 140, and 163 of the Law of the Fourth Economic, Social, and Cultural Development Plan of Iran and the Horizon of Iran 1404 have been enacted to support public organizations and charities.

The Imam Khomeini Relief Committee (IKRF) is an Iranian charitable organization founded in March 1979 to support the poor through providing services and relief (pension, loans, and grants). The formation of the IKRF was part of the expansion of government social security. IKRF defines its goal as "providing livelihoods and educational and health support to people in need at mainland

and abroad to achieve self-reliance, strengthen and increase piety and maintain human dignity." IKRF provides basic needs for the lowest class and meets the needs of the middle class. The aim is to help such families regain financial stability by increasing the penetration rate of support services.

The IKRF Provides the required resources from three sources, The Supreme Leader Donations, the Iranian government, religious taxes and donations (Alms, Zakat, and Zakat al-Fitr) from individuals, and Income from investing its vast resources (IKRF annual reports, 2008-2013). Moreover, IKRF installs charity boxes all over the country to collect donations. 75% of the organization's funding comes from the government. As of December 2008, 8.6 million poor people have received aid from IKRF. Six hundred ninety-eight thousand families were covered in the Rajaei plan, which provides social security coverage for senior villagers and uninsured nomads. 1.5 million people below the poverty line received free insurance from IKRF, and 843 thousand students received an education allowance (Nicknam, MH, 2009). In 2013 the number of needy households under the IKRF umbrella increased to 222813 households (621299 people). In 2019 2636540 households (4 287 609 people) were covered by IKRF. By adopting strategies to improve the governance of the charities and building charitable networking, the IKRF can improve its efficiency (Hosseini & kazeminajaf abadi, 2020).

According to the 2013 CGAP focus note, 255 financial service providers offer Sharia-compliant microfinance products worldwide. Approximately 28 percent of these providers are concentrated in the Middle East and North Africa, which is one of the two regions representing almost 92 percent of all providers

***Zakat***

Zakat is a form of alms-giving to the Muslim Ummah treated in Islam as a religious obligation, which, by Qur'anic ranking, is next after prayer in importance. (Mesbahi, 2018). Zakat is a religious duty for all Muslims who meet the necessary wealth criteria to help the needy. It is a mandatory charitable contribution, often considered to be a tax. Zakat is an expressly designed economic instrument to redistribute wealth from the rich to the poor to eradicate inequality and poverty. The payment and disputes on Zakat have played a significant role in the history of Islam.

Nevertheless, except for a few countries (Saudi Arabia, Iran, Pakistan, and Malaysia), this powerful tool has not put enough attention on the socio-economic development plans of the majority of the Islamic countries. Zakat acts as a core of the ISMF. Zakat was mandatory in Libya, Malaysia, Pakistan, Saudi Arabia, Sudan, and Yemen. There were government-run voluntary zakat contribution programs in Bahrain, Bangladesh, Egypt, Indonesia, Iran, Jordan, Kuwait, Lebanon, Maldives, and the United Arab. The states where Zakat is compulsory differ in their definition of the base for zakat computation

Zakat is divided into Zakat of property and Zakat of bodies. Zakat of bodies is a tax which Every Muslim who can afford it must pay either 3kg of their usual nutrition (such as wheat, barley, maize, rice, bread) or its monetary equivalent to the poor. Based on juridical bases, Zakat on wealth is paid based on the person's entire property. It is 2.5% (or 1⁄40) of a Muslim's total savings and wealth above a minimum amount known as nisab. Zakat is additionally payable on agricultural goods (wheat, barley, dates, and raisin), precious metals (gold and silver), minerals, and livestock at a rate varying between 2.5% and 20% (1/5) depending on the type of goods.

Zakat is generally levied on livestock (except in Pakistan) and agricultural produce, although the types of taxable livestock and produce differ from country to country. Zakat is imposed on cash and precious metals in four countries with different assessment methods. Income is subject to Zakat in Saudi Arabia and Malaysia, while only Sudan imposes Zakat on "wealth that yields income." In Pakistan, the property is exempt from the zakat calculation, and the compulsory Zakat is primarily collected from the agriculture sector. In six of the 47 Muslim-majority countries—Libya, Malaysia, Pakistan, Saudi Arabia, Sudan, and Yemen—Zakat is obligatory and collected. In Jordan, Bahrain, Kuwait, Lebanon, and Bangladesh, Zakat regulates the Zakat. Under compulsory systems of zakat tax collection, such as Malaysia and Pakistan, evasion is widespread, and the alms tax is regressive. Many Muslims accept their duty to pay Zakat but deny that the state has a right to levy it, and they may pay Zakat voluntarily while evading official collection. Involuntary collection systems, studies show that Zakat is paid only by a fraction of the Muslim population who can pay (Powell, 2009).

Shias, unlike Sunnis, traditionally regarded Zakat as private and voluntary action, and they give Zakat to imam-sponsored rather than state-sponsored collectors. (Keviani, et al., 2013). There are differences in the interpretation and scope of Zakat and other related taxes in various sects of Islam. For example, khums is interpreted differently by Sunnis and Shias, with Shia expected to pay one-fifth of their excess income after expenses as khums, and Sunni doesn't. According to the doctrine of the Niaba, at least one-tenth of Zakat and khums collected by the Imam and religious deputies spent for the hierarchical system of the Shiite clergy (Momen, 1987)

**Zakat Collection Organizations in Iran:** Iran is the only Shi'a jurisdiction. Shi'a rules for alms (Zakat and the related tax of khums in Shi'as) require Zakat on certain goods and a donation of 20% of income distributed by the Imam or his deputy (the ulema in the case of modem Imami Shi'as found in Iran). Zakat (referring to Zakat and khums, in Shi'as) consider as a moral rather than a legal obligation in Iran (Medani, 2005).

After abolishing it for being un-Islamic, the late Ayatollah Khomeini reintroduced the Iranian income tax during the Iran-Iraq War. During the war, income tax was justified based on necessity( Powell, 2010). Thus Zakat remains a pious, though legally unenforced duty. In Iran, like other Islamic countries, paying Zakat is based on jurisprudential views. Alms are generally received by "bonyads," religious or charitable foundations. The largest Bonyad-e Mostazafin, supports the family members of martyrs and has $12 billion in assets and 400,000 employees." Bonyads in Iran are estimated to control about 40% of the non-oil wealth of the country (Omid, 1998). Since 1989, Imam Khomeini's relief committee (IKRF) started collecting and spending Zakat.

In 1996, the Zakat Rehabilitation Headquarters in the Plan and Budget Organization was formed. In 2004, this task was handed over to IKRF. The Zakat Law was approved and implemented in 2011. Duties of the Central Zakat Council consist of: A. Determining the basic policies regarding the collection and consumption of Zakat and determining the relevant laws and criteria; B. Policy-making in propaganda and educational affairs to acquaint and guide people to pay Zakat; c. They planned to establish coordination, supervision, and effective participation of governors, city and village councils, and Friday prayer imams and congregations to implement this law. Collection and consumption priorities of Zakat were carried out according to the opinion and permission of the Supreme Leader (Article 3).

State involvement in the collection and distribution of Zakat varies widely. Citizens can pay income tax as either a secular tax or Zakat about Malaysia's religiously pluralistic population. Saudi Arabia mandates zakat contributions. Zakat is private and voluntary in Bangladesh, although subject to social pressure. The high-income Islamic countries have implemented a centralized zakat system. Except for Saudi Arabia and Kuwait, all the other zakat governance bodies are administered by the Ministry of Islamic Affairs. Saudi Arabia recognized Zakat as a tax; hence it is governed under the General Authority of Zakat and Tax.

In comparison, zakat governance in Kuwait is shared by two ministries – the Ministry of Islamic Affairs and Finance. Kuwait and Saudi Arabia implemented the compulsory zakat payment law from the seven countries. It is mandatory for public and closed listed shareholding companies in Kuwait to pay Zakat at 1 percent on annual net profit. In Saudi Arabia, all Saudi individuals and companies except for several exempted companies must pay Zakat at the rate of 2.5 percent from the assessable amount. (Muhammad, 2019). The Ministry of Justice and Islamic Affairs manages Zakat in Bahrain. Other than Zakat, MJIA also collects sadaqat (donation) from the public.

Kuwait, Jordan, Bangladesh, Bahrain, and Oman enacted laws of Zakat and established zakat organizations supported by the government operating voluntarily. Some Muslim majority countries, i.e., Turkey, Tunisia, and Azerbaijan, are governed by secular regimes. The complete accomplishment of the fruits of Zakat is to be achieved under an Islamic economy with a zakat institution supervised by an official state control rather than leaving it only to private charitable initiatives, the NGOs. The intermediary role of the Presidency of Religious Affairs between payers and recipients of Zakat and charitable organizations is to lead an increased zakat base and awareness and concern for the needy among the whole society (Zagrali, 2017).

**Performances:** According to 1998 survey information, 44% of Iranians paid Zakat. The total income of IKRF in nine years from 2004 to 2011 was more than 2723 billion rials. The amount reached 980 billion Rials in 2020. Based on available statistics, more than 60% of the value of Zakat was collected from wheat and barley zakat. Zakat collected from gold and silver is less than two-thousandth of the total value of Zakat. Each of the Raisin zakat and livestock zakat was less than 20% of the value of Zakat. In 2020, the amount of Zakat paid in the country had exceeded 1180 billion rials. The Supreme Zakat Council spent 60% of the collected Zakat on the affairs of the poor, and the rest will be spent on the civil affairs of the area where the collected Zakat was collected. (Irna, 2021). More than 80 percent of the collected Zakat is spent on the living of the needy, and the remaining money is spent on dowry and civil works such as helping to build 9,000 mosques, building a bathhouse, and building a road.

To evaluate the performance of Zakat collectors in Iran by the IKRF, we compare the performance of IKRF with similar organizations responsible for Zakat in other countries. In 2010 the percentage of Zakat to GDP in Iran was .0000014.0%. In comparison, the IKRF total revenue was about ten times

Zakat. The percentage of Zakat to GDP in some countries where Zakat is not mandatory (Egypt, Jordan, and Kuwait) remain between .02.0%. 08.0%.The exact ratio in some countries where Zakat is mandatory (Pakistan, Saudi Arabia, and Yemen) was 3.0% to 1%.

The Zakat collected by the IKRF in Iran was less than in other countries. It is noticeable that this ratio was less than one-thousandth of the lowest ratio and less than one hundred thousandths of the highest ratio (Estate & Hariri, 2012). Although the IKRF has been collecting Zakat and spending it for more than 20 years, the performance shows that the collected Zakat is much less than the capacity of Zakat in the country. In terms of the services provided to zakat payers and beneficiaries, Oman and UAE are the most advanced and transparent in their governance. They recognized the importance of the internet in reaching societies from various parts of a country.

***Waqf***

Waqf is a voluntary charitable act with broad economic implications and can play an essential role in increasing sources of welfare. While the principal endowment in creating Waqf was usually immovable assets, such as land and real estate, moveable assets, such as cash, grain to use as seeds, etc., were also used for its creation. Besides providing support in religious matters, Waqf can be established to provide socio-economic relief to the needy and the poor, including education, health care, and other social purposes (Kahn, 1999). Two kinds of Waqf have been recognized, i.e., Cash waqfs and real estate waqfs. Cash waqfs are charitable endowments established with cash capital (Cizakca, 2004). What distinguishes these from the standard real estate endowments is the nature of their capital, corpus, which is in cash. The corpus of the real estate waqfs, by contrast, is in real estate. Thus, while a wealthy Muslim usually dedicates his property and directs its rental income to charity, in the case of cash endowment, not real estate but cash is deducted, and the money from investing this money is spent on charity (Lahsasna, 2010).

The funds of cash waqf can be invested according to a professional business plan provided by the trustee based on the need and requirements of the society. Therefore, the trustee who manages the fund must act as a financial organization with a commercial identity and be profitable. However, to ensure investment security, it is recommended to invest in low-risk investments. (Kahf, 1999) A novel form of corporate ownership has emerged in Turkey, Pakistan, India, and Bangladesh and refers to a charitable endowment whose asset base consists of shares in a company. The corporate waqf arrangement enables an individual to transfer their ownership share in a company to a charitable foundation in perpetuity. The corporate Waqf provides a base for the development of industrial foundations and foundation-owned-firms in countries where a waqf system is legalized, including Turkey, Malaysia, and India, among others

**Waqf Management in Iran:** The Iranian parliament passed the first Waqf law about a hundred years ago. The Waqf law and its administration have changed considerably by demanding social and economic conditions over the past decades. During the monarchy regime, some endowed lands were sold out, and public trust in the preservation and security of endowed properties was subsequently diminished (Auqaf, 2002).

After the Islamic revolution, Ayatollah Khomeini issued a fatwa that all previously endowed properties privatized properties should resume their original status. Consequently, the first bill for the revival of endowed estates was approved by the Revolution Council in 1979. The new law specifies the property rights of the endowed properties and the type of organizations managing or supervising them.

The first Article of the new law states that all endowments for public benefits do not have a trustee, and all family Waqfs or those devoted to specific groups, but have lost their trustee or are under dispute by the beneficiaries, should be managed by the ACO. It implies that all family or public Waqfs that have a trustee according to the benefactor's will (Waqf) will be independent and run by their designated trustees. There are three different institutions in charge of Waqf properties in Iran as follows:

The first public organization is the ACO which takes care of all endowed properties that have missed or have no trustee. The income generated by the endowed properties shall be used for research, propagation, and publication of Islamic teachings if the categories of expenditures are not specified in the deed or are for general public benefit. The trustee's compensation, being a specified person by the deed or by the ACO, will be paid according to the deed. In case it is insufficient, the ACO will pay up the difference. Article 33 determines the compensation for the trustee and the supervisor. If the deed does not specify it, it would be ten and five percent of the endowment's net income, respectively. When this remuneration is not adequate or excessive, it will be adjusted with the consent of the ACO supervisor (Sadr, 2016).

The prerevolutionary method was not a dependable source of income. To reach a reliable source of income and to increase efficiency, the ACO has formed a Development and Rehabilitation Fund to survey the Waqf properties all over the country.ACO diversified financing tools for investment projects by resorting to issuing Waqf certificates, Musharakah Sukuk, QH certificates, and Waqf shares. In addition, ACO initiates the "Endowment Investment Fund" by allocating part of the income gained from down payments of the rented properties, available liquidity, and other small income receipts to participate in income-generating projects and investing the Fund's resources. As a result, old Waqf projects will be revived, and the Fund's income will be sustained. In addition, The ACO is reviewing stock exchanges and auctions for physical real estate and endowment securities (Sorush, 2013; Musavian et al., 2009).

The second Waqf administration is the holy shrines of the Prophet's progeny members. They are autonomous, and their mission is to advance Islamic Sharia and provide service to pilgrims. The most prominent among them are the Astan Quds Razavi of Imam Reza, Hazrat Ma'soumeh, and The Prophet's progenies members in Shiraz. The endowed properties include cultural, agricultural, medical, and commercial estates. To increase the productivity of the endowed properties and extend the cultural activities, they established a research center devoted to Qur'anic studies. The remaining are commercial projects that have been established through participatory contracts with private investors. The trustee share is 50% or more, reflecting the trustee's successful efforts to increase receivables and invest more in renovating old endowment properties .

The third type of administration is private trustees or joint private-public custodians. There are two conspicuous examples of this sort: Namazi Hospital Foundation and Afshar Cultural Foundation. Both were founded by scholars who devoted their wealth to piped purified water, medical services, and cultural studies. A relatively new initiative to financing endowment activities is that a portion of non-government shares is paid for by issuing an "endowment certificate." (Sorush, 2013). People's trust in the excellent performance of this charity has made people with different income levels willing to participate in this new endowment project. This new method of financing endowment projects has been approved by Sharia and legal authorities (Sorush, 2013).

The management of waqf institutions varies from one country to another. For instance, Singapore developed waqf properties into real estate, generating millions of Singapore dollars annually. Another example is Kuwait, and the practice is to spend more on charity which is on social development. In fact, in Malaysia, the waqf management practices differ from one state to another. For certain states, the practices share scheme, and some states do not practice such. However, there are also some similarities; for example, most of the waqf properties are developed for everyday purposes, for instance, mosques, educational development, and social welfare (Harun et al., 2012).

**Performances:** According to surveys conducted by the Research Center of the Islamic Consultative Assembly, in 2010, more than 110,000 waqf endowments were operating in Iran. These endowments have more than 7400 thousand real estate units. Moreover, the revenue of the ACO is 580 billion rials. In 2019, the endowments registered include 1.3 million rivals, 72,000 mosques, 8,000 holy shrines, 1,400 medical endowments, 133 hospitals, 12,000 schools and 19 clinics. In 2020 the ACO revenue was 17000 billion, which accounted for about 1.17% of GDP (Young journalist Club, 2021).

In Iran, the law on endowments and administered endowments have changed significantly over the past two decades. The new laws helped establish endowment property rights and investment security. In addition, a new perspective has emerged on the potential contribution of endowed property to social and economic development. In general, Iran seems to have overcome the problems caused by the illegal occupation or misuse of endowed property. Iran has succeeded in enacting new laws to ensure the implementation of endowment property rights, more effective organizations, and innovative financing instruments. As mentioned, waqf is potentially used to support some infrastructure projects. New types of endowments that use cash have been created in the form of endowments that can be a source of investment in sustainable infrastructure. In addition, endowments can be made for social, health, and educational infrastructure (Ahmed, 2017).

It is worthily noting that the practices of waqf in the Muslim minority communities are more dynamic and responsive to the community's needs than the majority of Muslim countries. For example, the Singapore endowment experience was extremely excellent because it had strict legal requirements and could meet all legal requirements and could also gain public trust in endowment management and instead of strict donations receiver, it became an income generator. On the other hand, Kuwait's experience records outstanding performance due to the less interruption by the government and establishment of good governance, internal control, and accountability tools. In Kuwait, Awqaf Public Foundation (KAPF) manages waqf to allocate funds for activities and investment of the assets. In addition, KAPF coordinates with the governmental and non-governmental bodies to establish Sharia-compliant waqf projects to achieve waqf objectives. This coordination includes specifically managing specialized funds in the waqf sector, regional institutions for the waqf development, and the management of family waqf.

In Indonesia, term managing waqf, affairs are the responsibility of the Islamic Religious Council of each state. The courts recognized Sharia as the governing law of property for Muslims, including waqf. The government of Malaysia has formed a department for zakat, waqf, and hajj on the 27th March 2004 to make the administration systematic and practical. However, this department does not have the authority to administer and manage waqf properties but instead plays a role as a planning coordinator and observes. An independent internal organization carries out waqf management in Turkey that the courts treat as legal entities. A board mutually manages the modern waqf s instead of an individual. The legal infrastructure is modified to give broader operational powers to the mutawalli boards (Kamarubahrin & Ayedh, 2018).

**Pathology of Islamic Social Microfinance**

Social finance institutions (zakat, waqf, charities, and QH) are powerful tools for poverty alleviation. Although the implementation of ISMF in Iran has a long history, evaluations show that many of these programs have been implemented inefficiently and have faced structural problems. Pathology of microfinance shows that these institutions are confronted with several damages like moral hazards, High costs of supervision, Lack of appropriate collateral, diversion of credits, Strategic default, Low yields, Lack of resources (Ahmad, 2002; Shahidinasab et al., 2017). The shortcoming can be classified as follows:

First: 4 percent commission on lending was insufficient to cover operating costs in times of higher inflation. As a result, sub-optimal entities started to take on credit risk by granting non-interest-free facilities.

Second, the lack of an integrated and systematic monitoring system has led to the possibility of some financial abuses and violations through institutions. Since many charities are not registered, how to monitor the activities of these organizations, especially in charities that have extensive financial activities, has provided a good platform for fraudsters. (Asghari & Farajiha, 2011). Because of the nature of charitable activities, numerous studies have shown that criminal activity and economic corruption take many forms in charities. The most important of them took the form of crimes such as fraud, betrayal of trust, money laundering, and tax evasion (Asghari, 2011). Third, Iran's income tax system exempts them from taxation to encourage charitable donations (GilakHakimabadi, 2011). They may be exploited if they do not have enough oversight. One of these corruptions is tax evasion (Ebadi, 2007).

Finally and The most important of these shortcomings and challenges are lack of sustainable access to financial services; Populist goals without sufficient professional and financial support; granting subsidy facilities based on government resources without emphasizing on savings of target groups; Lack of correct diagnosis or selection of the target group and mismatch between the loan amount and the needs of the borrower. Because of the problem mentioned earlier and the lack of supervision, the transparency and accountability of these institutions are very low. These losses led to a run on a microfinance charity in Isfahan in 2003. The panic threatens social stability. The case of fraud and betrayal in the trust of Kowsar Altar Institute that  had tax evasion (Ashournejad et al., 2011). As a result, public trust in charity institutions is decreased over time.

It requires policies to support the efficient mobilization of Islamic social resources, the efficient use and management of these resources, and their integration with microfinance for a more inclusive and cost-effective approach.

These include policies to build legal, regulatory, and financial frameworks at the macro and medium levels and build supportive infrastructure. One way to improve the present Islamic financial system is to reform zakat and waqf institutions. It can be facilitated by transforming old and unproductive waqf properties into modern waqf buildings, which have become income-generating assets and affected Iran's economic and social development. Innovative methods of finance like Corporate Waqf, cash waqf, and Partnership Bonds may increase the efficiency of Waqf properties.

At the micro-level, these policies include increasing the accountability and transparency of institutions, improving their governance, and diversifying their products while turning poor into literate and responsible customers. They are supporting community-based development by using zakat and truth funds. Creating a guarantee fund with zakat; providing affordable medical services through corporate endowments; and endowment engineering for relief and rehabilitation. Policies are needed to support the efficient mobilization of Islamic social resources, the efficient use and management of these resources, and their integration with microfinance, for greater and more cost-effective participation.

Besides the size of Islamic funds, the issue of quality is also crucial for sustainable investments. As mentioned before, the efficiency and effectiveness of these institutions is the main problem, but it is less costly in the economic and physical labor context to fix the issues with the waqf institutions rather than designing and regulating new institutions (Sadr, 2016).

## Other Financial Intermediaries

Other financial intermediaries offering Islamic non-banking services include Takaful and Islamic leasing companies.

**Takaful (Islamic Insurance)**

One of the essential Islamic tools with insurance function in the contemporary era is Takaful, which is based on Islamic jurisprudence. Despite its short life, it has gained a good position in the insurance market in Islamic countries. Takaful in different jurisdictions is defined as a Sharia-compliant mutual assurance contractual structure, where participants contribute their resources to mitigate against future risks based on agreed terms (OIC Fiqh Academy, 2016, Albarrak, & El-Halaby,2019) .Social Takaful is based upon two principles: the unity and risk-sharing principles. This Islamic approach can financially support citizens and is somewhat similar to conventional insurance. The difference between Takaful and Conventional Insurance is as follows:

1- Conventional Insurance follows a bilateral contract, which means the contract between Insured and Insurer. But Takaful means the contract between all the group members, and it is a multilateral contract.

2- The motive of Takaful is mutual help among the members (i.e.) loss sharing among the members equally.

3- The premium in conventional insurance belongs to the company, but the premium of Takaful insurance belongs to its members.

4- In conventional insurance, the customers transfer their risk to the Insurance Company, whereas in the Takaful system, members share their risk among the group. Profit from the operations of Conventional Insurance belongs to the company, but a surplus in Takaful is shared among its member groups. Profit from Takaful Investments is members' income, but the investment return belongs to the Insurance Company in conventional insurance.

Takaful Insurance offers many benefits and services, such as regular insurance. Faith-based consumers who have a capital surplus to invest and hedge risk can choose takaful jobs. Takaful is a form of cooperative insurance involving allocating and spreading the risk .Takaful insurance is based on three fundamental prohibitions in Islam: gambling, interest, and uncertainty. Therefore, companies resort to a "free" contract to eliminate any idea of gambling or uncertainty in their contracts. More precisely, it means that subscribers "donate," not pay premiums to the operator. To exclude any notion of interest, the amount of this "donation" only covers the management costs of the contract; any profits must be shared between the policyholders and the operator. It means that any participants' claims will be paid from the Takaful fund, and the remaining surplus after securing the possible cost of future claims and other reserves will belong to the participants in the fund and not the Takaful operator. These funds may be distributed as cash dividends or distributed or by reducing future contributions to participants. In addition, investing funds in "haram" or illegal sectors such as alcohol, drugs, gambling, pornography, halal food, tobacco, non-sponsored banks, insurance, and the arms industry (excluding the state industry) is prohibited. Islamic contracts have been used in the structure of Takaful. This institution in the insurance market is inevitable. Cooperation, uniform interest, and shared responsibility are the main features of the Takaful model.

***Takaful Models***

Takaful Insurance works in four different models:

1. Moradabad model: In this model, the profit and loss of the Takaful fund are divided between customers (insurer) and shareholders. In the Mudaraba model, mainly used in Asia-Pacific, insurers only receive available profits from their funds. The ، Takaful committee of a single-member company approves the share ratio for each year in advance; the shareholders bear most of the costs. It was first used in the Far East, especially in Malaysia(Ramaswam, 2021).

2. Wakulla model: In this model, commissions and agency fees are invested in Takaful shares in the owner's capital. In the wakalah model, the insured's investment surplus - net or management cost - goes to the insured. Shareholders receive wakalah fees from the partnership, covering most trading costs. This annual fee is determined in advance in consultation with the company's Sharia Supervisory Board. Management cost is related to performance (The Middle East model).

3. Hybrid model: A mix of Mudaraba and Wakulla models is called the Hybrid model of Takaful Insurance. Some Bahrain and UAE companies follow this model in their business operations (Used in Bahrain, UAE, and the Middle East countries).

4. Waqf model: Part of the member's participation in this model is irreparable. Companies in Pakistan and South Africa are following this system (Mainly used in Pakistan and South Afri).

***Types of Takaful Companies***

There are three types of Takaful companies in Islamic countries as follows:

1) Takaful Operators are actual Takaful Companies that work on Takaful exclusively. They are Takaful Funds with legal personality. In article 2 of Malaysian Law, Takaful operator introduces all companies and institutions necessary for Takaful operators because of their legal personality. Due to company-specific rules, Malaysia Central Insurance cannot supervise if they have an actual person. In Iran, it can be said that only joint-stock companies and stock cooperatives have the right to conduct insurance activities. Therefore, not all companies can operate Takaful in the insurance industry.

2) The Window of Takaful Operators: in the case of Takaful companies, it can be said that according to the Takaful Law of Pakistan, Takaful Company is an insured company that is allowed to conduct commercial activities of Takaful and traditional insurance. Although this is only enshrined in Pakistani law, it exists in other countries with this type of insurance. These companies are just a window to Takaful, and one of their activities is Takaful. However, their difference with Bancatakaful is that the main operation is banking in the latter, while in this type of company, the main operation is insurance. In Iran, all insurance companies can use the capability of such operations. Out of total 308Takaful companies, 93 are Takaful windows. However, these Takaful windows own only 2.5% of the total Takaful assets.

3) Bank Takaful. These companies operate in banking, and because of their similarity to joint venture managers, they move towards such operations. There are two reasons for their insurance licenses: (1) In countries such as Malaysia, where banking operations cover insurance activities, the entry of banks into such operations is predictable, (2) less possibility of borrowing from Takaful Company (Elahi, 2021).

Iran's Shia Islamic-based legal system is significantly different from takaful models. Unlike other Islamic economies, it is stated that insurers in Iran do not need a Sharia council and do not operate as traditional Takaful operators because the Iranian government does not have a strict division with conventional insurance. The reason is that the entire Iranian financial system, including the insurance industry, is based on Shiite Islam, in contrast to the predominantly Sunni economies, which have a dual system. As a result, Iranian insurers throughout the industry mostly have conventional operating structures with the everyday use of Takaful-functioned "windows." This trend is similar to Malaysia's primary Takaful industry. In contrast, large parts of the Mena and Asian markets have historically retained full Takaful models due to Sunni criticism of conventional insurance (Kortbawi, 2016).

***Performances***

Social Takaful has become increasingly popular in Islamic and non-Islamic countries during the past four decades. It should be claimed that the various methods of social Takaful, which currently consists of the youngest and most dynamic insurance markets around the world, refer back to nearly 14 centuries ago(Bidabad, 2003). Most Muslims refused conventional insurance because it did not follow Islamic principles. The world's first Islamic insurance company was established in 1979 in Sudan. Following the passage of the Insurance Act of 1992 (revised in 2003), all insurance companies in Sudan were required to conduct insurance and reinsurance transactions only in Islamic ways, mainly based on the Wakala Takaful model on a large scale. Takaful is offered on a large scale in Islamic countries such as Malaysia, Bahrain, Pakistan, Saudi Arabia, United Arab Emirates (UAE), Indonesia, Egypt, Brunei, Sudan, and Iran. Takaful was introduced to Oman in 2014, and Morocco adopted the Takaful Regulations in 2015) and has expanded into existing markets, most notably in the GCC and Africa. New laws were enacted in 2014 in Indonesia and Pakistan to help the Takaful industry . The Takaful market has a small share in Islamic finance. Its share increased from 1.1% in 2019 to 2% in 2021 (Al-Amri & Hossain, 2015).

The growth of the global market is mainly driven by the three main markets of Saudi Arabia, Iran, and Malaysia, which account for nearly 80% of total global assets. Moreover, the top three Takaful markets – Saudi Arabia, Iran, and Malaysia - made up 79% of the market's share of total Takaful assets in 2017. According to Thomson Reuters (2018), Saudi Arabia is the most significant market that contributed US$ 15 billion in total assets for Takaful markets with 35 Takaful (Operator and Takaful windows. Similarly, Malaysia contributed more than US$ 9 billion in total assets with 20 Takaful companies. Globally, there are an estimated 324 Takaful operators in the world. In 2019, Gulf countries were the major contributors (74%) of the Takaful insurance. Iran, like Saudi Arabia and Sudan, is 100% Takaful. However, while growth rates declined in Saudi Arabia and Iran, Iran's share decreased from 13.7% in 2015 to 8.8% in 2020, primarily due to currency depreciation (DCIBF, 2020). Although Turkey has been establishing Islamic financial institutions since the 1980s, development in the Takaful business has lagged behind Malaysia due to weak harmonized sharia law and public awareness of Islamic financial products (Aslan et al., 2017).

Takaful companies' assets to GDP in 2005 and 2015 were 0.94% and 3.08%, respectively. Meanwhile, the world average in 2015 based on 125 countries is 19.68%. In 2017, this ratio in Lebanon and Saudi Arabia were 8.77% and 2.29%, respectively. The average for 2017 in 63 countries was 19.87%. However, Takaful is the minor contributor to the Islamic financial industry (2% in 2014). The average value of additional life insurance premium as a percentage of GDP in Iran in the period 1993-2014 was 0.1% (minimum 0.02% in 1993, maximum 0.27% in 2014). The minimum amount of non-legal life insurance premiums to GDP was 0.29% in 1991 (the maximum was 1.27% in 2012(Economic Research, 2021). Except for motor and health insurance, demand for insurance products appears low in GCC countries. The GCC countries are taking various steps to establish regulatory frameworks to address capital needs and deal with Takaful.

Two criteria were used: TAKAFUL industry development score (IFDI score) and economic freedom to evaluate Takaful performance. Countries are classified into three groups based on IFDI scores: 70 and above, 40-60, and 20-30). Saudi Arabia is a leader in developing the Takaful industry, the only country in the first group. Next, Iran, Bangladesh, Malaysia, and Indonesia fall under the second group. In addition, seven countries - Jordan, Kuwait, Oman, Pakistan, Turkey, Bahrain, and Sudan - make up the third group. According to the second criterion (economic freedom score), Malaysia in 2019 was the leader of the group with the highest score of economic freedom (100/74). Jordan and Bahrain have slightly higher economic scores than Turkey (66.5, 66.4, and 64.6, respectively). Meanwhile, the Takaful industry is more advanced in Saudi Arabia [92/92], followed by Malaysia [41.63], Turkey [21.71], and the United Kingdom [0.21]. Except for the United Kingdom, sample countries have higher development scores than the average global Takaful [5.29] (COMCEC, 2019).

## Islamic Leasing (*Ijara*) in Iran

Ijara has been used by Muslims for over 1400 years and can be considered the oldest form of Islamic finance. The advantages of lease financing in development are well known: leases provide access to finance not otherwise available. Borrower credit and collateral requirements and transaction costs are all relatively low. The ijara contracts are similar to a conventional lease, i.e., the owner leases his property to a lessee for a specified number of periods for a fee. Islamic leasing consists of an indirect financing facility involving a Muslim lessor and a Muslim lessee who enter into an agreement whereby a lessor leases a good or service to a lessee for a price agreed in advance for an agreed period in compliance with the Islamic law. For example, the lessee is responsible for regular maintenance, and the lessor is responsible for major maintenance, just as with many conventional lease contracts. Islamic leasing is preferably used by Muslim lessees and lessors who want to operate this type of financial transaction following Islamic Finance. In the case of Islamic leasing, there are differences between Ijarah and conventional leasing, despite the many similarities, such as the fact that in terms of late payment, the lessor can claim compensation for charitable projects, and Ijara does not allow the leasing of perishable goods

However, the following features of ijara differentiate it from a conventional lease: first: The lessor must own the assets for the whole lease period. Second: If the lessee defaults on payments or delays payments, the lessor can't charge compound interest. Third: The use of the leased asset is specified in the contract; three types of ijara arrangements can exist according to sharia principles:

**Lease-Ending Ownership:**In this type of ijara contract, the lessee owns the leased asset at the end of the lease term. This lease contract doesn't contain any promise to buy or sell the assets. But the bank may make a unilateral (verbal) promise to transfer ownership or offer a purchase plan for the assets. The lessee can also make a (verbal) unilateral promise to buy the property. The purchase price is ultimately determined by the asset's market value or the agreed price.

**Operating Lease:** This type of ijara contract doesn't include a promise to purchase the asset at the end of the contract. This arrangement is a lease agreement with the lessor.

**Forward Lease:** This contract combines construction finance (*istisna*) and a redeemable leasing agreement. Because this lease is for future dates, it is called future leasing. The forward leasing contract is generally purchased at its completion or in the section (section) of the project. There are many ijara products in the market with different contracts. Malaysia, for example, offers car financing through a combination of the ijara contract and the Bai (purchase) contract. The ADCB (Abu Dhabi Commercial Bank) and the British Bank of Saudi Arabia Amanah provide financing for ijara (Jamaldin, 2016; Akhtar, 2021). Iran restricts leasing operations to various methods of installment sales and hires purchases.

### *Rules Governing Leasing in Iran*

CBI included leasing companies after establishing non-bank credit institutions ( CBI, 2016). CBI has set out and issued the directions and rules for the establishment, activities guidelines, and the relevant regulations for the leasing companies. A summary of these regulations and directions are as follows:

1- Leasing both movable and immovable properties (Articles 1 and 14 of Iran Central Bank's regulations) are carried out via two agreements, including installment sale and hire purchase. The inclusion, however, of the phrase "through different methods" can lead to the conclusion that the different methods of installment sale and hire purchase like sale and leaseback are allowed by law according to the principle of willpower.

2- To obtain a license from the CBI for the leasing company to comply with the provisions of the above instructions and regulations, they must submit the completed form to the Central Bank. (Following the Articles 4, 10, and 11). The fact is that other activities such as factoring and futures contracts are also mentioned and allowed in the leasing company's memorandum.

3- According to Article 2, the minimum capital for the activities of leasing companies is as follows: First, companies that operate only in the field of durable consumer goods, home appliances, equipment, computers, and similar items, at least 20 billion rials. Second, companies are active in automobiles, passenger cars, vans, buses, trucks, machinery, road construction equipment, machinery required by factories. People like them pay at least 60 billion rials. Third, companies that use low-cost capital goods such as aircraft. Buses, trailers, heavy trucks, heavy machinery required by factories and. According to paragraph C of article 5, companies should pay at least 100 billion rials minimum capital required for establishing and operating a leasing company for 100 billion rials (CBI,2017).

4- According to article 34: The interest rate of the facilities granted by the leasing company can be up to a maximum of 3 percentage points more than the interest rate for the facility granted by the Monetary and Credit Council for credit institutions. Out of 300 companies operating at this time, only 20 met the conditions. As a result of the new conditions, many smaller private companies ceased trading in the industry, and banks and automakers monopolized leasing. In the following decade, from 2010 to 2020, the CBI was concerned that shareholders of private sector banks were using affiliated leasing companies to take out loans. As a result, strict regulations for banks were extended to leasing companies. The CBI now supervises all banking and non-banking leasing companies with the same regulations.

### *The Structure of Leasing Companies in Iran*

Leasing companies receive their funds and financial resources from various sources. Funding sources can be divided into four categories:

1- Equity-based financing is the money that the company's shareholders provide to form the company's capital.

2- Debt-based financing through the issuance of participation papers or obtaining loans

3- Derivative-based financing results from the sale of derivative products

4- Embedded Based Financing: These types of financing can be obtained through traditional markets, i.e., stock market, or informal markets, inside or outside the country. The primary sources of financing for Iranian leasing companies are equity-based financing and banking facilities (Miri, 2007).

In Iran, leasing companies are classified into three groups in terms of affiliation (Miri & Habibi, 2009): First, bank leasing companies: Bank leasing companies are owned and controlled by the public and private banks. These companies include Industry and Mining Leasing, Iran Leasing, Parsian Leasing, Egghead Novin Bank Leasing. These companies have completed the range of banking services of their parent companies.

Second, Captive Leasing Companies: These lessors are owned by the producers/manufacturers of the leased assets. The main goal of marketing and sales of the parent company was to create these companies. Some examples are Iran Khodro Leasing Company, Rayan Saipa Leasing Company, and Bahman Leasing Company. Third, Independent Leasing Companies: These independent companies, any parent company or significant shareholders, do not regulate.

In the Iranian leasing market, asset items are divided into micro tickets, small tickets, medium tickets, and big tickets in terms of asset type. Only a few leases are intended for large industrial companies. It seems that leasing companies are operating with big tickets and expanding financial facilities based on the instructions and requirements of the CBI to establish a leasing company and its related regulations. In Iran, leasing companies are mainly active in micro, small, and medium ticket items for households and small and large scale economic institutions. It is estimated that 40 percent of the leases in Iran have been arranged for private cars and 25 percent for commercial vehicles (Miri, 2009).

### *Performance*

The first leasing company operating in Iran was the Iran Leasing Company, established in 1975 by the French bank Credit Lyonnais in cooperation with the Credit Bank of Iran. Shortly after Aria Leasing Company was established, the two companies ceased operations in 1978, and after 15 years, a private leasing company (Pars Leasing) started operating. The years 2001 to 2010 were decisive decades in the Iranian leasing industry. After 2002, large automotive companies and banks established leasing companies, and these new companies became members of the association.

Just after 2004, carmakers started getting into leasing to increase their sales. Iran Khodro and Saipa are leading the way. In all, there were estimated to be around 300 leasing companies set up in just a few years. The number of Registered Leasing Companies in Iran increased to 142 in 2004 and then 73 in 2005. Another hurdle the industry faced was new conditions set by the CBI for leasing companies that they needed to comply with within a month to obtain an operating license. Minimum capital, adequate credit records, business plans, and the introduction of qualified managers were among the requirements that had to be met to obtain an operating license. Out of 300 companies operating at this time, only 20 met the conditions. As a result of the new conditions, many smaller private companies ceased trading in the industry, and banks and automakers monopolized leasing (Country Focus, 2021).

From 2010 to 2020, the CBI was concerned that shareholders in private-sector banks would use affiliated leasing companies to obtain loans in the next decade. As a result, strict regulations for banks were extended to leasing companies. The CBI currently oversees all banking and non-banking leasing companies under the same rules. In recent decades, the industry has faced many obstacles, including monetary and financial repression policies and disputes between the club and the association. The leasing industry violates these rules due to the strict rules of the central bank, which are not compatible with the mechanisms of supervision of the leasing industry.

As a result of these challenges, there is a call to build a robust national organization to address the needs of lessors with a single voice. The new umbrella organization, the National Leasing Association of Iran, was established in March 2016. Immediately, the association adopted policies to formulate a strategy for the leasing industry in Iran, and the first effect of implementing this strategy was the unity and cohesion of all leasing companies. In that year, 28 leasing companies attended the founding meeting of the National Association. Currently, this number has increased to more than 43 companies. All official and licensed leasing companies are members of this association, and this was the first strategic achievement to bring about change (Country Focus, 2021).

In 2018, there are 50 leasing companies under the supervision of the Central Bank, whose operations are inspected periodically to regulate the money market. About 86% of leases are unlicensed, inactive, or liquidated by the central bank) parliament Research center, 2018). The share of lease volume to GDP increased from 0.65 in 2004 to 1.07 in 2007. Iran leasing volume to GDP (%) grew from 0.020 in 2005 to 0.490 in 2015. And to 0.490, .0.3 in 2015.The global share of the lease to GDP was .57. Moreover, leasing market penetration for Iranian private cars in 2005 was 13.8 %, and that for commercial vehicles and building equipment was 22.6 % and 4.9 %, respectively. The highest penetration rate was 40% for Australia (Glesson, 2020) .In 2018, the Annual Volume of leasing in Iran was 0.85 US $bn. According to the White Clarke Global Leasing Report 2021, which ranks countries by leasing volume, Iran is ranked 45th, compared to its neighbor Turkey, 30th, and further away Egypt, 46th (White Clarke Group, 2021).

## Discussion (Evaluation and Suggestions)

International financial systems recognize the growing importance of non-bank financial institutions (NBFIs), particularly their potential contribution to economic development. The nature of risk and asset sharing of Islamic financial products is more appropriate for providing financial services through NBFI.

However, in Iran, Islamic banking and assets, due to the inevitable need to compete with the conventional financial system and the force of convergence between the two, have generally confused the concept of social welfare and the conventional ideology of wealth maximization. As mentioned, non-bank financial institutions in Iran and other Islamic countries constitute a small part of the Islamic financial industry. Although no specific information is available on the extent of non-banking participation in infrastructure-related sectors, the small amount of Islamic funds indicates that investment in these sectors will be below. This sector is underdeveloped, and Islamic financial resources are underutilized, so policymakers should prioritize it. Since most of the infrastructure financing is financed through INBFI, the scale of Islamic infrastructure financing can be increased if the industry becomes more diverse and efficient. In addition, the Islamic non-banking industry is not a sustainable source to achieve the goal. Therefore, INBFI does not reach its potential (not optimal).

The lack of asymmetric information (moral hazard) is one of the most common problems of microfinance in Iran and other Islamic countries (Ahmad, 2002, Shahidinasab et al., 2017). Moreover, the efficiency of microfinance institutions has diminished by contaminating micro-financing with the quasi-interest-based conventional system. 3- The lack of theoretical or conceptual coherence and harmony in INBFI emerged due to the lack of attention to the aforementioned vital points. 4- Lack of relationships between Islamic microfinance and digital tools that could easily promote product and platform innovation and aid service provision. There is still a considerable need for well-versed professionals in Islam's principles and conventional finance.

Following steps are required to increase both sustainability and efficiency.

1- It is necessary to theoretically and practically develop the INBFI system. 2- For a robust Islamic INBFI sector to enhance shared prosperity, it needs supportive institutions and public policy, responsible governance and leadership, and a robust regulatory framework promoting risk-sharing and entrepreneurship. 3- Restructuring the products and instruments to serve the objectives set by Islamic economics is required. 4- Creating legal frameworks and technological platforms to digitally and transparently channel corporate and individual zakat, sadaqat, and waqf into liquidity pools for QH, providing a dependable source of Sharia-compliant funds. The requirements for a direct link between the zakat collector and its recipient can be accommodated through client pre-screening and selection processes and decreasing the administrative costs through improving the governance. And finally, the growth of Islamic non-bank financial institutions is also contingent on a robust Islamic capital market that creates Sharia-compliant investment opportunities. In this regard, infrastructure projects provide new investment opportunities and create synergies that allow Islamic non-bank financial institutions and capital markets to grow together. 5- An excellent place to start is with Islamic insurance. Takaful protecting against risk and uncertainty could play a critical role in enhancing financial inclusion, reducing poverty, achieving inclusive economic growth, and boosting shared prosperity. Takaful can provide essential benefits to households and firms. Greater access to financial services for households and firms may help reduce income inequality and accelerate economic growth. Protection against unexpected shocks to income and enhanced productivity through better health for the poor and the vulnerable segment of the society through micro Takaful could become an effective tool for combating poverty.

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