University of Mohamed Lamine Debaghine Setif2

Faculty of law and Political Sciences

ESSENTIAL TERMINOLOGIES OF FINANCIAL INSTITUTIONS

Pedagogical publication designed to master students, option Financial Institutions Law

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INTRODUCTION

The financial system is the backbone of any economic system; it is linked to all the economy’s components, including individuals, households active in different sectors, and the government. Therefore, the progress and backwardness of a country's economy are attributable to the effectiveness of its financial system, which provides the financial resources necessary for economic activity.

The financial system enables lenders and borrowers to exchange funds and includes different types of financial institutions. To ensure that it plays its role, the financial system includes providing effective markets that use different instruments to collect the savings necessary for investment; in other words, financial institutions channel the savings from surplus units to others with financial deficits that have investment opportunities and need funds to finance them. This crucial role in intermediating between the two different units is due to the abilities of these institutions, which create an excellent reputation that qualifies them to have the exclusive practice of the financial intermediation function to transfer passive funds in the form of savings or hoarded funds to active ones circulated in all sectors.

This pedagogical publication deals with financial institutions in all their forms and types, including banking intuitions and non-banking financial institutions, in addition to financial markets, by addressing the most important points related to these institutions and markets. To do so, the pedagogical publication includes a series of lessons delivered to students in the second-year master's option Financial Institutions Law to expand and deepen the concepts of the financial system, including its institutions and its instruments, and provide students with legal financial terminologies to boost their knowledge in this broad and important field in order to familiarize them with them.

CHAPTER 01:

BANKING FINANCIAL INSTITUTIONS

Preview

Banks are the most important components of the financial systems due to their influential roles on the overall financial system, including all the financial institutions. Thus, banks affect the course of economic development through their intermediary role in collecting savings and converting them from inert capita into productive one in the form of loans to the real sector sectors. Since banks are the oldest financial institutions to emerge, the accumulated experience over centuries has enabled them to acquire the abilities to adapt, grow, and develop. Their activities have expanded to include the provision of a wide variety of innovative services that meet the requirements of economic organizations. Banks have deepened their financial and development roles by establishing different types of banks that provide various facilities that can advance the growth of economic sectors.

1. Types of banks

A bank is a financial institution that is licensed to accept checking and savings deposits and make loans. Deposits play a key role in determining the nature and type of banks specifically and the institutions in general, so banks strive to compete to attract more deposits to improve their performance by providing several types of deposits.[1] There are many types of banks operating and interacting within a system that serves development purposes by providing operational or expansive loans as well as a wide and innovative variety of facilities and services. Generally speaking, the type of bank depends on the way in which resources (deposits) are linked to uses (assets). In their activities, banks allocate their financial resources to certain uses depending on a particular philosophy, which places them under a particular classification. Accordingly, banks are classified as follows:

1.1. Central banks (bank of banks)

The central banks first emerged as commercial banks given the power to issue banknote by their governments, as in the Netherlands in 1814, England in 1844, and France in 1848, followed by Germany, Sweden, the United States, Australia, Italy, Canada, and Ireland in 1875, 1897, 1914, 1924, 1926, 1935, and 1942, respectively. After the First World War, the world experienced chaos in the area of monetary issuance and control, resulting in record fluctuations in prices and exchange rates that threatened economic and monetary wars between countries. In order to regulate and develop economic transactions, countries have quickly accredited central banks,

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[1] Adam Barone, How Banking Works, Types of Banks, and How To Choose the Best Bank for You, 28/03/2023, Consulted on 26/06/2023 at https://www.investopedia.com/terms/b/bank.asp

whether by setting up central banks or giving exclusive concessions to one of the commercial banks, concerning issuance the banknotes, the receipt of government deposits, and the monitoring of economic and monetary conditions in order to achieve internal and external economic stability.

Central bank is an extraordinary public monetary institution with the ability to create and control legal money through its monopoly on the power to issue banknotes. It is also exclusively competent to monitor, intervene, and direct the various components of the banking and financial apparatus. The meeting of these characteristics makes central bank the real designer of monetary policy and the only qualification for its activation and correction if it is necessary.

To ensure the effective implementation of its policies in order to contribute to financial and economic stability and improve the welfare of citizens, countries prevent their central banks from deviating from their objectives and seeking profits that may lead them to employ their liabilities in risky assets in addition to entering into competition with other banks. Instead, central banks seek to hold liquid assets or easy-liquefied assets to use them at a time of necessity in maintaining the stability of the financial and economic system. To maintain the stability of the central banks, most countries have sought to investigate its neutralization and isolation from all political influences with close cooperation with the governments to achieve harmony and avoid conflict between fiscal and monetary policies coordination. [1] In this regard, harmonization between fiscal and monetary policies helps to achieve short-term pricing and the long-term sustainability of economic activity, but avoiding spillover effects for both is difficult owing to the independence of the authorities in charge of their own initiative (governments and central banks). For example, the high proportion of public debt affects the credibility of monetary policy by increasing pressure to raise real interest rates and crowding out private investment if the government raises taxes to service public debt. Rising public debt also increases government securities and increases demand for real cash balances.

On the other hand, monetary policy affects the real; for example, monetary policy's quest to curb inflation and stabilize prices has expanded effects on the short-term genaral budget deficit (Dahan model), and the adoption of currency supervision arrangements (under fixed exchange regulations) reduces the huge fiscal deficit and avoids the use of a deficit financing tax. The problem of coordination in many countries is compounded by the absence of sophisticated financial markets, which

[1] Samir Hassoun, ***Political Economy of Money and Banking***, Second Edition, Edition Majd, Lebanon, 2004, p. 169.

leads the governments to resort to borrowing from the central banks, which may reject the government's request for consideration of maintaining a stable inflation rate. In order to harmonize the two policies, many countries have strengthened the independence of central banks due to the impact on fiscal discipline, the inflation rate, and economic performance because of the close correlation between money and the sustainability of economic activity, with central banks being given the task of maintaining economic stability.[1] To achieve this, central banks have assumed functions that lead to the achievement of the objective, the most important of which are:

- Designing, implementing, and managing the monetary policy.[2]
- Managing the countries' foreign reserves.[3]
- Issuing the banknotes (paper money).
- Determining the legal reserve that other banks must keep with the central bank and its administration, where the offending banks are subject to penalties ranging from payment of additional interest to denial of loans leading to a temporary or final stop (close).
- Lending to banks operating in the form of discounts on commercial papers or loans at a discount rate against the mortgage of government bonds or real estate, and sometimes in the form of a pledge to buy government bonds. The discount rate and the purchase and sale of government bonds (open market operations), as well as the legal reserve ratio and the mandatory additional deposits whose counterpart pays interest, are the main tools used by central banks to control the supply of money in case the banks do not respond to the friendly persuasion method.
- Facilitating and encouraging interbank borrowing (for one night) for interest below the central banks' discount rate. The interbank lending mechanism optimizes the utilization of unemployed resources and increases the turnover of cash to the benefit of the economy.

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[1] Bahaa Al-Din Touil, ***The Role of Fiscal and Monetary Policies in Economic Growth: The Case of Algeria: 1990-2010***, Ph.D diss, Batna University, Algeria, 2015/2016, pp. 71-78.

[2] The main objectives of monetary policy are: (1) increase the level of employment, (2) improving the economic growth rate, (3) maintaining price stability, (4) stabilizing interest rates, (5) stabilizing financial markets, and (6) stabilizing exchange rate.

[3] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p. 29.

- Collecting the outstanding cheques from banks to other ones, the process is done by deducting amounts due from bank balances at the central bank (clearing) without the need to transfer money or the costs and time involved.[1]
- Supervising the banks in the field of credit (size, type, price, and destination) and controlling their responsiveness to laws and regulations are necessary in order to achieve the integrity of their financial position, protect depositors' funds, and ensure the continued flow of financing for development.
- Managing governments' deposits and regulating their bond issuances.
- Providing advices and suggestions to the governments on financial and economic matters.
- Participating in economic planning, represent financial institutions, and defend their interests.

1.2. Commercial banks (deposit Banks)

Like other active banks, commercial banks intermediate between surplus holders (savers) do not have any investment opportunities and deficit holders (investors) who are in need of financing investment opportunities they have, using deposits deposited with them on investment aspects that yield an appropriate return that ensures acceptable profits. However, what differentiates commercial banks from other banks is the general nature of their activities and the absence of specialization in a particular activity or sector. In their financial intermediation, they accept various deposits to employ them in various aspects of investment. Therefore, commercial banks are well known as ***deposit banks***, because deposits are the main source of their invested funds. They accept deposits in all their forms, and since their investments are the largest compared to the rest of the banks, contrary to self-resources which their contribute usually represent the minority, so they unable commercial banks to contribute significantly in the financing of their investments.

1.3. Non-commercial banks

In banking systems, there are other types of banks in addition to commercial banks; these banks become known as non-commercial banks, which play an important role in channeling funds from savers to investors and then contributing to finance investments. Therefore, non-commercial banks include:

1.3.1. Specialized banks: They are banks that specialize in servicing a particular economic sector with the aim of developing it and accelerating its growth by

[1] Munir Ibrahim Hindi, ***Commercial Bank Management: An Entry for Decision Making***, op.cit, p. 79.

providing different-term services and loans at competitive interest rates. It is worth mentioning that the decision to establish it determines the bank's activity and its specialization. On the part of the resources, and unlike commercial banks, demand deposits in specialized banks are not important; they depend primarily on both their own resources (capital and reserves held), the proceeds of issuing bonds, and then term deposits of a stable nature and government assistance if possible.[1]

- **Agricultural banks**: This type specialized banks satisfy the needs of financing of the agricultural sector, so they specialize in the provision of loans and banking services to enable the agricultural activities to expand vertically and horizontally and to obtain the largest possible agricultural production. Given the characteristics of agricultural activity and its different financing requirements, agricultural banks have absorbed this, and they attempt to vary their services and loans appropriately.[2] Therefore, Agricultural banks' loans are divided into:

✓ **Consumer loans**: They are loans to landowners and agricultural workers to fill their deficits or temporary interruptions in their income resulting from temporary unemployment, agricultural pests, and sometimes social commitments Also, the imperatives of meeting the renewed time period between harvest dates and consumer expenditure prompt agricultural banks to provide seasonal consumer loans.

✓ **Short-term loans**: These loans normally do not exceed 18 months, to meet current expenditures such as the acquisition of production requirements from seeds and fertilizer and the payment of workers' wages.

✓ **Medium-term loans**: The maturities of these loans range from two to five years, and are used to purchasing livestock, machinery, and production equipment, as well as to make small real estate improvements.

✓ **Long-term loans**: All these loans are over the five-year maturity date directed to finance irrigation, drainage, major repairs, the construction of some necessary buildings, and all agricultural expansion.[3]

- **Industrial Banks**: These banks attempt to satisfy the financing needs of industrial businesses for either operational or expansive purposes. The industrial sector has always attracted the attention of different countries in view of the vital roles they can play, which has led them to encourage the development and expansion

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[1] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, pp. 29, 35.

[2] Samir Hassoun, op.cit, p. 153.

[3] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, ***Financial Markets and Institutions***, Hariry Print, Egypt, 2006, p. 332.

of specialized banks through the provision of services and loans that meet certain purposes:

- ✓ **Short-term loans**: These loans do not exceed a year, allocated to finance working capital, export operations, ongoing purchases of production supplies from raw materials and half-manufactured, in addition to workers' wages.
- ✓ **Medium-term loans**: The maturity of these loans are up to five years granted to finance the acquisition of production equipment.
- ✓ **Long-term loans**: These loans are up to 20 years maturity, directed to buy factory land and create industrial buildings.[1]

The role of industrial banks do not only stop when they make loans but it extends to other operations and services, the most important of which are:

- ✓ Participation in the capital of industrial enterprises.
- ✓ Provide all available banking services.
- ✓ Feasibility studies for projects expected to be completed.
- ✓ Technical and administrative assistance by placing experts and specialists at the disposal of industrial enterprises and providing for their expenses.
- ✓ Develop and introduce new production methods.
- ✓ Financing workers' training programs.

- **Real estate banks**: Real estate banks are competent to provide loans for the purchase of land and real estate and finance various construction projects with mortgages. Due to the characteristics of the real estate sector, the majority of the loans provided are medium- and long-term (ranging from ten to thirty years) and associated with completion plans. In addition, the decision to grant credit is made longer than the rest of the loans, owing to the long procedures it takes to verify the mortgage, estimate its value, and pass through the publicity and mortgage registration processes. Real estate banks' credit policy is characterized by weak resilience to economic events that may emerge due to long-term loans they provide as they have a high-risk slow turnover rate, which places real estate banks under the imperative of raising interest rates and withholding a greater margin than the credit value of the mortgaged asset than commercial banks. The proportion of the margin retained is positively correlated with the loan's term.[2]
- **Foreign trade banks**: These banks aim at financing foreign trade operations in order to promote this vital sector by making all banking facilities available to sector actors, including exporters and importers. To this end, banks grant loans of different

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[1] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p. 38.

[2] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 333.

maturities and open documentary credits for export and import to enable businesses to export their outputs and import their inputs.[1]

1.3.2. Business and Investment banks: In England, these banks are called ***Merchants Banks,*** and in France, ***Banques d'Affaires***, but in the United States, ***investment banks***. These banks have been established to serve investment by providing financing and contributing to investment management, pooling resources from clients' deposits to employ them in different investment aspects. In this context, business and investment banks are effective contributors to facilitating the establishment and growth of businesses; they undertake the task of managing the necessary financial resources and issue securities to companies. They may cover the whole or part of the issuance process to later be made public to make a capital profit from the difference between the purchase and sale price. To drive and stimulate investment, these banks contribute to the establishment of different companies and continue to support them by providing loans and issuing bonds for them. Like other commercial banks, business and investment banks rely on deposits in its activities, but their deposits are usually long-term and large, enabling them to set up companies in different economic sectors.[2]

1.3.3. Savings banks: These banks occupy special importance as a savings pot that accommodates different categories of society and is characterized by their spread, as they are active in small banking units usually followed by the postal authority. These banks are distinct from commercial banks in that they issue low minimum deposit investment certificates, which qualify them to attract small savers and gain great popularity. They depend on their attraction of savings on investment certificates issued in different values that give their owners several benefits, such as counting interest for the savers from the month of purchase while counting from the month following in other banks. In addition to the competitiveness of interest rates, investment certificates also give their owners the right to borrow on concessional terms by guaranteeing them. The combined financial resources of savings banks contribute to the establishment of new companies and the provide loans to other project. Savings banks may also invest in the establishment of investment funds, the purchase of first-class securities, and deposits with other banks with special interest.[3]

1.3.4. Internet Banks: As it is known the need is the mother of the invention, which applies to Internet banks or electronic banks. The expansion of trade and business has increased the need for low-cost means of payment, paving the way for

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[1] Samir Hassoun, op.cit, p. 154.

[2] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p. 39.

[3] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 342.

the emergence of electronic banks in conjunction with the acceleration of the information and communication revolution and the resulting expansion of the Internet, as well as lower money transfer costs and the settlement of payments arising from transactions in an electronic and fast manner. Electronic banks began to emerge in 1995, offering their various services to their customers anywhere via a specialized website and then evolving to make the services provided through the network compete with the services provided by other banks.

1.3.5. Islamic banks: These banks are relatively newly established since their first appearance dates back to 1970s. The philosophy of Islamic banks is based on avoiding dealing with interest (Reba) on lending and borrowing, and replacing them with what accords with the principles of the *Islamic Shariah* by entering into processes of murabahat, mudarabat (speculation), and mucharakat (participation) instead of lending.[1] The sources of Islamic banks come from paid capital, retained profits, current and savings accounts, deposits of various timings, zakat, and funds deposited to invest with the authorization of their owners. The Islamic banks employ funds available in various areas of direct investment by establishing projects, contributing to the capital of enterprises (buying shares), and providing interest-free lending, in addition to using *zakat* funds to achieve social solidarity (*Takaful*). In its activities, Islamic bank avoid anything contrary to Islamic laws, the most important of which are:

- **Mucharakat (participatory financing):** Islamic banks can engage is full participation until the redemption solution or participation ending in ownership,
- **Mudaraba (speculative financing)**: Islamic bank (speculator) uses the funds of the owners of investment deposits in their investment activities, provided that the profit will be shared between the parties in an advance agreement.
- **Murabahat (finance in profit)**: At the request of a client to purchase a particular commodity with specific specifications, Islamic bank shall agree on the sale price, payment terms, and profits earned by the bank.[2]
- **Istisna'a**: It is a contract between the Islamic bank (mustana'a) and the customer (sanaa or manufacturer) whereby the bank is obliged to supply certain tools and materials to the manufacturer for the manufacture and delivery of a product manufactured to certain specifications for an agreed amount of money.
- **Salam:** This Islamic funding formula is a contract between the Islamic bank and the customer under which one of the parties to the contract is obliged to deliver products to the other party to certain specifications later for an amount of money

[1] Samir Hassoun, op.cit, p. 159.

[2] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p. 41.

agreed upon.[1] Salam is a short-term financing formula to finance agricultural products for a single cycle of less than one year to allow farmers to purchase production supplies such as materials, machinery, equipment, and others. The Islamic bank can widely apply the salam method, especially in agriculture, where the bank purchases the agricultural crop before harvesting and pays the price in advance, allowing farmers to improve their production. Salam is used to finance the previous stages of the production and export of goods and products that are in high demand by purchasing them via salam contract and re-marketing them. Salam is applied to the bank's financing of artisans and small producers by supplying them with production supplies in exchange for obtaining and re-marketing their products in the future.[2]

- **Muzara:** Due to the importance of agriculture, Islamic banks have allocated some kind of financing to them, namely, muzara (farmers). Muzara is a partnership contract whereby one of the partners provides funds or one of the elements of production, namely land, while the other partner provides work on the land. The validity of the Muzara contract requires the land to be arable with some specifications and the method of distribution of the return.

- **Musaka:** It is one of the contracts used to provide funding for the care and watering of trees. It is a kind of participant based on the worker's effort to care for fruitful trees and his commitment to water, pollination, and cleaning care, with the result of distributing the fruits between them in an agreed proportion. Thus, Musaka is a partnership between two people: one owner of trees who seeks to develop them and another who has the effort to distribute the output between them according to the agreement.[3]

- **Mugharasa:** Mugharasa is that the Islamic bank purchases land from its funds to give it to those who want to plant them a particular tree from its own funds, on the understanding that they are partners in the lands and trees in a proportion of information after the trees reach the stage of production and fruit.[4]

- **Takaful financing (Al-Qard al -Hassan):** This type of Islamic finance is defined as a contract that entitles the borrower to own the money for a period of

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[1] Omar Hamza, ***Participatory Banks and Traditional Banks: what a path?,*** The International Journal of Research and Scientific Meditation, Vol 02, N° 02, 2017, pp. 95, 96.

[2] Hind Mahdaoui, ***Islamic Banking, an Alternative Solution to Global Financial Crises***, Ph.D diss in Economics, Tlemcen University, Algeria, 2015/2016, p. 44.

[3] Mechri Walid, ***The Role of Islamic Financial Instruments in Financing Islamic Banks in the light of the Global Financial Crisis***, Ph.D diss in Economics, Biskra University, Algeria, 2016/2017, p. 30.

[4] Ben Mostafa Abdelkader, ***Islamic Banks and their Responsiveness to Basel 3 Standards: An Applied Study on the GCC (Saudi Arabia, Kuwait, and the UAE) during 2013–2016***, Ph.D diss in Economics, Tlemcen University, Algeria, 2017/2018, p. 60.

time, to be received with a view to helping the borrower fulfill the need. Al-qard al-hassan is a loan free of interest generally granted in small amounts (micro-loans) to combat poverty within societies.[1] Islamic banks have adopted **Al-Qard al-Hassan** to promote social solidarity in Islamic societies. Islamic banks provide financing to meet personal and family consumer needs for housing, clothing, and other necessities of life, as well as the investment needs of traders, farmers, craft owners, and other professions in order to meet their production needs for hardware, equipment, raw materials, and others. Thus, al-qard **al-hassan** is one way of enabling individuals to benefit from the money, where the loan is refunded after the end of the agreed period without any interest or share in the profits or losses. The bank only recovers the principal of the loan, with the possibility of being taken for the costs and administrative expenses spent against the loan's grant, provided that they do not exceed actual expenses and are not related to the term.[2]

1.3.6. Universal or all-purpose banks: With the establishment of the World Trade Organization (WTO) in April 1995, the world has witnessed an unprecedented movement of economic and financial liberalization. This movement was characterized by privatization, the introduction of profound structural reforms that included the liberalization of the financial sector, and the removal of most of the constraints and barriers to capital flows as prerequisites imposed by globalization and its institutions to attract multinational corporations and to transfer technology. Concurrently, the world has seen a communications and information revolution that has contributed to the effective and low-cost transfer of information and funds, facilitating the offering and trading of some of the financial instruments developed, such as financial derivatives and securitized debts, and increased the importance of capital markets and exchange rates.

To adapt to new developments and maintain their position and share in finance market, banks have had the opportunity to take advantage of the economic and technological momentum to modernize their activities and services and expand them into new areas of balance between profitability, liquidity, and safety, which can only be achieved by moving towards a universal banking system. Universal or all-purpose banks are keen to do all the traditional and non-traditional functions of banks; they combine the functions of commercial banks, investment banks, businesses, and specialized banks at the same time, relying on diversification as a strategy by which to diversify their resources and investment channels. With regard to sources of funds, universal banks seek to develop their deposits by launching a range of diversified

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[1] Khaldi Khadidja, ***Justice and Efficiency of Islamic Banks: Theoretical and Mathematical Analysis***, Ph.D diss in Economics, Tlmecen University, Algeria, 2007/2008, p. 37.
[2] Hind Mahdaoui, op.cit, pp. 58,59.

and innovative services that have the effect of attracting new age groups. They also try as much as possible to maintain the stability of deposits by installing deposits, securing deposits, launching investment certificates and negotiable deposits, and establishing investment funds to allow small savers to subscribe to them. In order to raise sources of financing, universal banks may resort to securitize their loans and long-term borrowing from banks and financial institutions, and they may take the form of a holding company that manages a group of companies in all fields to obtain more financial resources.

In employing their funds, universal banks seek to diversify, both in banking and non-banking areas. Employment of funds includes diversification in the investment portfolio, diversification of loans to all sectors and regions, as well as entering new investment areas such as investment banking, which includes buying newly issued shares, marketing and selling them, and advising companies on any new issuance.

Universal banks also play an important role in the success of the privatization process. They provide long-term loans to shareholder workers' unions, provided that the loan is paid back from the dividend proceeds, or by replacing the loan with equity stakes to ensure that the bank interferes in the management of the company in order to eliminate any misconduct that may lead to the bankruptcy of the company and the loss of creditors' rights.

Besides banking fields, universal banks attempt to diversify their activities as much as possible. This can be reached by breaking into non-banking areas that achieve profitability and the desired return with low liquidity risk, such as carrying out leasing financing activities, trading the currencies to complete international deals for some companies in exchange for commissions, ensuring equity and bond issuance, providing insurance services, establishing investment funds, and others. To reach as many clients as possible, some universal banks offer some activities at major malls and shops and offer ATM service anywhere, 24/7.[1] At last, the following figure conclude the structure of the banking system, which may vary from country to another.

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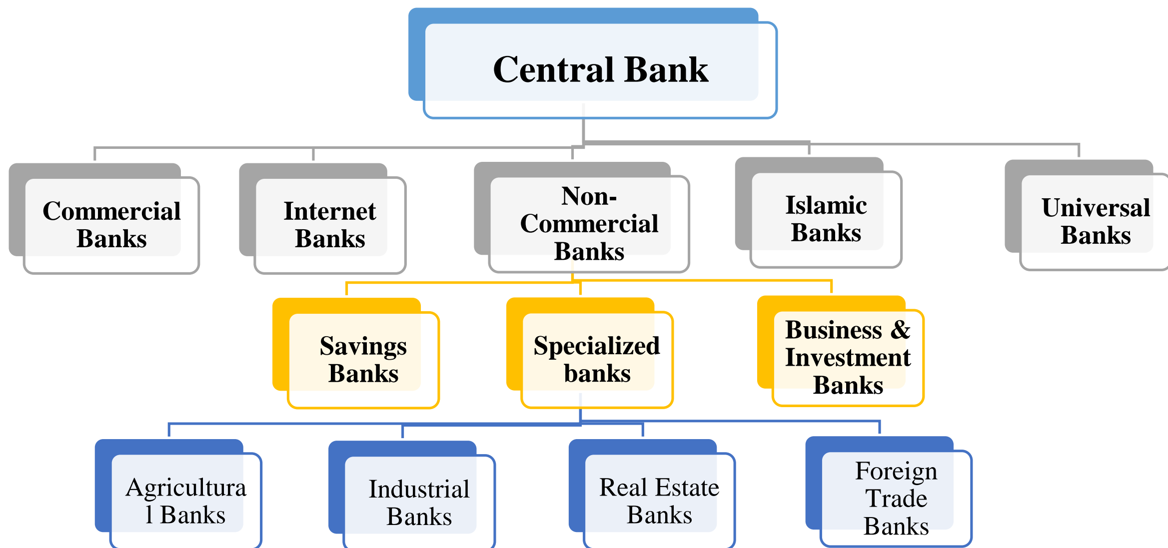
[1] Abdulmutalib Abdulhamid, ***Universal Banks: Their Operations and Management***, Eldar El Gamaya, Alexandria, Egypt, 2000, p. 17.

Figure 01: Banking System Structure



Source: Author's preparation

2. Roles of banks

Banks have received great attention from specialists and decision-makers, and are considered the most important financial intermediaries and most active actors in the financial and economic arenas due to the roles they play. Qualified leadership and strict oversight will enable banks to lead the development and success of monetary and economic policies. Among the roles expected of banks, there are the stereotypical roles that almost all banks in the world perform, in addition to modern roles that require special competencies and an environment that not all banks can capture.

2.1. Savings mobilization

As they seek to attract as many funds as possible, banks offer a variety of deposits consistent with the preferences and desires of their target clients, and for this reason, banks are known as depository institutions. In this regard, the most prominent deposit types that the banks offer to their clients are:

2.1.1. Current deposits (call deposits) and Non-current deposits (time deposits): Current deposits (call deposits) are deposits that give their owners (depositors) the right to withdraw or transfer them at anytime and anywhere without

having to notify the bank in advance. Traders are usually targeted by issuing a checkbook used to complete business operations by enabling them to complete overdrafts from all branches of the bank, provided that the balance of transactions remains credited. However, some banks may offer the possibility of withdrawing additional amounts, resulting in the generation of a debit balance that their clients are required to settle it with interest and commissions. Non-current deposits (time deposits) are amounts of cash deposited by their owners, in advance agreement with the bank that are not withdrawn before a specified date (maturity date). In the event that the client renews his obligation to withdraw all or part of his deposit before the due date, the bank usually deprives the depositor of the benefit of all or part of the interest due. Unlike current deposits, which are considered inexpensive resources due to the absence of an obligation to pay any interest on them, banks pay interest on term deposits that vary in proportion to their maturity.

To satisfy some clients' willingness to take advantage of the features of both previous types of deposits, banks have launched **savings deposits**, which are non-negotiable term deposits that enable their owners to deposit cash in a savings book that is entitled to the benefits of term deposits while allowing withdrawal and transfer without prior notification to the bank. In order to avoid substantial interest, most banks refrain from opening savings accounts for business enterprises in order to avoid the latter's possibility of converting their current accounts into savings to take advantage of the interest they entail, thereby deterring the risk of the high cost of financing that would raise the cost of lending and then investment.

In addition to non-tradable term deposits, financial engineering has invented a new financial product called **certificates of deposits.** The new products aims to meet banks' aspirations to attract more liquidity to raise their turnover against competing financial institutions while at the same time satisfying the desires of some customers to obtain bonds against their deposits that are tradable in financial markets.

2.1.2. Stable and unstable deposits: Through careful consideration of the movement of existing deposits, the bank's management can recognize the degree of stability of its deposits, which is reflected in the bank's investment strategy, both short- and long-term. The nature of the deposits determine the type of investment assets available to the bank for acquisition. The deposits that the historical data[1] demonstrate their behavior and stable nature as a result of the withdrawal and deposit

[1] Historical data is compiled and prepared from the bank's records over a period of time ranging from five to ten years and may extend further at the bank's disposal.

of their owners or their refusal to withdraw for a period of time will direct the bank to acquire long-term investment assets with low liquidity. Unstable or volatile deposits are those that are likely to be withdrawn so that their balance cannot be credited after a period, which does not make them a priority in the bank's long-term investment policy; therefore, the bank can employ them in the acquisition of high-liquidity, low-yield assets.

2.1.3. Private and public deposits: In addition to the previous types of deposits, deposits can also be divided into private deposits involving individuals (personal deposits), business deposits, and public deposits held by public enterprises.

Individual deposits constitute the largest share of the number of accounts but do not occupy the forefront in terms of value. However, their relative stability and the credit balance that characterizes them (due to the savings tendencies of their owners) make personal deposits of utmost importance to the bank. Business deposits may not be the same as personal deposits, but they are usually important values, and because they are unstable and exposed to large withdrawals depending on the economic situation of economic activity (economic cycles), the bank's management does not rely on them to plan the bank's long-term investments.

In terms of public deposits, they are of great value, but they are also unstable because of their economic and political linkages, which make public deposits more vulnerable to abrupt withdrawals affecting the bank's financial balances.

2.1.4. Deposits in local and foreign currencies: Banks offer deposits in either local currency or foreign currencies, or both of them, to satisfy the desires of individuals and institutions, which in turn contributes to attracting savings and curbing compactness.

2.1.5. Permanent and semi-permanent deposits: Permanent deposits are savings deposits, while semi-permanent deposits include temporary deposits such as employees' salaries, incidental deposits such as subscription proceeds in new projects introduced by the bank, and seasonal deposits such as the sale of products or seasonal crops, and so on.[1]

Since banks stem their activity from the collection of deposits in various forms, banks started in the early 1960s [2] to seek to explore and invent sophisticated tools.

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[1] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, Arab Nile Group, Egypt, 2011, p. 122

[2] Liability management, including deposits, was of little interest prior to the 1960s; it was considered as a difficult external variable to control, and the largest share of deposits were current deposits (60% of deposits) do not pay any interest, which thwarts competition. At that time, the

These tools were to ensure flexibility in deposit management so that they could expand investments and loans in order to reduce costs and increase profits while maintaining their financial solvency by ensuring their abilities to deal with any deposit withdrawals. To that end, banks had to take into account two main considerations in their deposit management:

- **Liquidity**: Banks started to diversify deposit sources and not rely on current deposits of an unstable nature, in addition to studying the movement of deposits for proper and rapid forecasting of depositors' behaviors during a given period. In this area, the importance of acquiring modern software and equipment is highlighted in the guidance of the Banks' management to develop accurate estimates of the liquidity required to avoid any emergency that may affect the banks' reputation and trust in it.
- **Cost**: Banks have sought to reduce costs by trying to obtain greater financial resources at the lowest possible cost.[1]

2.2. Meeting the financing needs of different economic sectors

By attracting funds from surplus units and collecting it in savings receptacles in addition to their own funds, banks have the potential to start its main activity by allocating funds to finance individuals and economic units with a wide range of services through three main forms, namely:

2.2.1. Contribution to project capital: Banks' contribution to project capital usually has a positive and stimulating impact, especially during the early stages of venture activity, allowing them to implement many investment opportunities and overcome many obstacles and problems due to the bank's expertise and highly qualified staff. Thanks to the good reputation of banks, businesses have greater opportunities to attract domestic and foreign capital. The extensive network of communications and relations between banks and foreign markets allows for better promotion of companies and their economic viability, motivating foreign investors to contribute to companies' capital and opening up broader prospects for domestic and external expansion. In order to preserve their current and future interests (by contributing to future projects), banks usually take into account the ownership of a minimum share and prevent any shareholder from acquiring a certain

interbank lending market was at the beginning of its development, so bank administrations focused only on asset management. In the 1960s, the largest banks began to pay attention to liabilities, and as their activities grew and expanded, their interest in precautions and in providing liquidity to finance lending activities increased.

[1] Mahmoud Younes & Kamel Amine El-Wassal, ***The Economics of Money, Banking, and Financial Markets***, Eldar El Gamaya, Alexandria, Egypt, 2005, pp. 239, 250.

percentage of the project's capital (more than 49%). This precaution is to avoid the risks that may result from a party's control over the management of the project and to influence its orientation. Taking into account the goal of profitability in their investment activities, banks, after a period, may resort to selling their share of the venture stocks to provide additional resources to finance other new projects[1] and expand the list of beneficiaries of the bank's services.[2]

2.2.2. Providing loans to finance projects: With the evolution of banking activities, banks gain the ability to create a wide range of loans that differ in terms of their liquidity, maturities, and guarantees offered to their counterparts aimed at creating new projects or developing existing ones. Thus, by providing loans and services, banks provide the most appropriate conditions (financing) for achieving economic take-off, which serve the economic and social development plans and achieve the established objectives. In this context, we can divide loans into several categories based on several criteria, which are:

- **Division of loans according to their liquidity:** This division includes:

✓ **Permanent loans (with a slow or no turnover rate):** These loans are usually renewed from time to time without any perceived reduction are low-flexibility loans, including in particular loans to individuals and then loans with mortgages and loans with securities in addition to doubtful debts.

✓ **Semi-permanent loans (with a moderate turnover rate):** These loans are more flexible and include loans to guarantee goods and loans conditional on contractors' concessions.

✓ **Seasonal and temporary loans (with rapid turnover):** These loans are highly flexible or more adequate to liquidity, including loans for the export of agricultural, and commercial products, as well as loans to exporters and importers and any loans secured by commercial paperwork.[3]

- **Division of loans according to the guarantees provided by their counterparts**: These loans include:

✓ Loans with merchandise guarantees.[4]

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[1] Some banking laws prohibit banks from contributing to enterprise capital, while others prohibit banks from acquiring more than a certain percentage of companies' shares.

[2] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, ***Banking Risks Management from Banking and Legal Viewpoints***, Monchaat Almaref, Egypt, 2002, p. 387.

[3] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, pp 16, 140.

[4] Mortgaged goods are required to be disposable without damage, have stable prices, and have a stable market in which demand is not subject to severe fluctuations because of changing tastes or replacing others within a short period.

- ✓ Loans with trust receipts as a guarantee.[1]
- ✓ Loans guaranteed by commercial papers (instead of discounted).[2]
- ✓ Loans guaranteed by Securities.[3]
- ✓ **Loans guaranteed by deposits and credit balances with others in various currencies**: Banks provide these loans to spare their clients from having to transfer their foreign currencies or liquidate their deposits and lose interest on them that exceeds the interest paid on the loan.
- ✓ **Loans with a commercial mortgage guarantee**: In addition to the acquisition mortgage, in which the acquisition of the encumbered asset is transferred to the creditor bank, legislation has allowed specialized private banks to lend to some of their clients in exchange for an official mortgage in which machinery and equipment remain in their possession. In the case of loans granted for the import of machines, the latter are mortgaged directly upon arrival and then allowed to be customs cleared to install them at the borrower's plant.
- ✓ Loans with mortgage guarantees.
- ✓ Loans by a personal guarantee.[4]
- ✓ Loans without guarantees.[5]
- ✓ Loans in exchange for debt or contracts, such as construction operations contracts or supply contracts to government agencies.
- ✓ Loans guaranteed by agricultural crops. [6]

- **Division of loans according to their duration:** These loans include:

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[1] Instead of mortgaging the goods and bearing the burden of storing them, the bank may, under a trust receipt, abandon the mortgaged goods in favor of the client, who desperately needs them for export, or use them as a feedstock or intermediary in an industry.

[2] One of the most popular commercial papers is the bill of exchange, promissory note and the check (cheque), which are securities traded by traders among themselves instead of cash payment and include payment of a specific amount within a specified period. Commercial papers have the potential to be directly transferred when they are shown or delivered.

[3] In accepting securities, banks take into account the fact that the client's ownership of the securities is proven, that the securities are included in the exchange's price schedule, and that their prices and handling are stable, as well as the stability of the financial position of the company exporting them. These conditions serve to facilitate the process of fast, low-cost liquidation. Diversification of securities is also taken into account in order to avoid concentration risks.

[4] Banks may accept lending their clients by guaranteeing a personal guarantee from a third party (the guarantor) based on a serious credit study of both the client and the guarantor in order to determine their financial position and their ability to pay the borrower's debts in the event of the latter's inability to pay.

[5] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 596.

[6] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1,op.cit, p. 145.

- ✓ **Short-term loans**: these loans are not exceeding two years' repayment, usually directed at financing enterprises' exploitation activities and the acquisition of consumer durables for households (families). These loans are used to help facing financial insolvency in the treasury resulting from the time difference between expenses and revenues, such as seasonal crop campaigns, commodity stepping, pre-financing on exports, public transactions, and administrative debt.
- ✓ **Medium-term loans**: These loans intends to finance investments with a maximum maturity of seven years. These investments consist of establishment and expansion projects in addition to the refurbishment of equipment and means of production.
- ✓ **Long-term loans**: These loans are for longer than seven years and less than 15 years and are aimed at financing important investment projects.[1]

– **Division of loans according to the purpose of financing:** These loans include:

- ✓ **Exploitation loans**: these loans intend to help enterprises cope with expenditures related to the operation of productive capacity from inputs
- ✓ **Investment loans:** Those loans create new productive capacity or expand the capacities in enterprises.[2]

2.2.3. Providing guarantees for the benefit of projects: Banks provide a strong boost to the completion of projects through their intervention, at the request of the contractor client. Therefore, banks issue an initial or final letter of guarantee in which they undertake to refund the cash insurance[3] in the event of the contractor's failure to perform the transaction, and any advance to the contractor is received on the project entrusted to it (Advance Payment Letter of Guarantee). Banks also issue a letter of guarantee of items loaned to the contractor in case the project owner lends the contractor machinery, equipment, or forms for the completion of the operation.

Thus, the letters of guarantee offer several economic advantages. They contribute to the completion of many large projects thanks to the large financial liquidity they provide instead of depositing it with the owner of the project. They also contribute to stimulating many contractors to enter the tenders (biddings), allowing the owner to obtain better prices. In addition, letters of guarantee avoid

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[1] Tijani Najeh, ***Monnaie, Institutions Financières et Politique Monétaire : Théorie et Pratique en Tunisie***, Imprimerie Officielle de la République Tunisienne, 2001, p. 39.

[2] Hamrit Rachid, ***The Role of Agricultural Investment in Supporting State Revenues - Desert Farms - * * * Biskra State Model * *,*** Ph.D diss in Economics, Biskra University, 2013/2014, p. 76.

[3] Government departments and companies require contractors wishing to implement the projects tendered to provide cash deposit as a guarantee to be confiscated if the contractor decides to retreat from the completion of the project for any reason.

transferring the funds required as collateral from one country to another and then returning them, along with the costs and losses they entail because of changing exchange rates.[1] Letters of guarantee are considered indirect financing of projects in exchange for the borrower's acquiring assets or providing other guarantees.[2]

2.3. Financing foreign trade

In addition to their developmental role in financing economic projects, banks contribute to the development of various sectors by financing a highly important sector, namely foreign trade (exports and imports). On the one hand, financing imports contributes to providing economic development requirements for capital goods to start production and intermediate goods to increase the volume and quality of production, as well as other consumer goods. On the other hand, the provision of export facilities stimulates the development of domestic industries by creating external channels for the discharge of production and the provision of foreign exchange resources to the country. Banks exercise their role in financing foreign trade by issuing letters of guarantee and documentary credits using their existing network of relationships with their external branches or correspondents (foreign banks) in other countries.[3]

Under a joint guarantee, large banks issue an external guarantee letter[4] whereby the businesses can obtain medium- or long-term loans from an external bank to acquire and import the necessary machinery and equipment without incurring additional charges and commissions or exposure to the risks of changing exchange rates resulting from the transfer and import of different currencies. In addition, in the context of facilitating the flow of foreign trade, banks issue a letter of guarantee to facilitate procedures with Customs by taking the goods out until they finish assessing the duty payable to the public treasury. Banks issue nautical letters of guarantee in the event of the goods arrival prior to shipping documents. banks undertake to settle the amount instead of waiting until the documents arrive and the risks they entail for its importing clients, such as changing the price of the goods on the local market, incurring guard expenses, storing the goods, and potentially

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[1] Salah al-Din Hassan El-Sissi, ***Theoretical and Applied Studies: Documentary Credits and Bank Guarantees in Economic, Accounting and Legal Terms*,** Dar El-Wesad, Lebanon, 1998, p. 75.

[2] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 389.

[3] Salah al-Din Hassan El-Sissi, ***Theoretical and Applied Studies: Documentary Credits and Bank Guarantees in Economic, Accounting and Legal Terms***, op.cit, p. 04.

[4] External guarantee letters include external letters of guarantee received from correspondents abroad for beneficiaries of the country and external letters of guarantee issued at the request of a resident of the country for beneficiaries abroad.

damaging them, as well as the possibility that the importer may be bound by delivery or operation dates.[1]

In addition to the various forms of letters of guarantee, banks offer an important opportunity to facilitate and develop international trade by opening documentary credit at the request of their exporters and importers. Documentary credit[2] provides safety for both the exporter and the importer by overcoming the possibility of a party breaching its obligations regarding the settlement of the price of the goods or the date of delivery and quality of the goods .[3] Entering banks as intermediaries between the two sides of the transaction as a reputable institution has helped to overcome several obstacles, including its seriousness and ability to fulfill its obligations and the resulting losses to the other party,[4] Documentary credits help avoid freezing part of the capital until the goods arrive and complete the transaction. Once the shipping documents are submitted to the correspondent bank, the exporter can receive the amount of his goods without having to wait for them to arrive in the importer's country. Exporter can obtain a loan guaranteed by a documentary credit, but the importer can avoid freezing his capital between sending and receiving the goods and then selling them.[5]

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[1] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 389.

[2] Documentary credits are divided into export and import credits and include many different types in terms of the strength of the undertaking (cancellable and irrevocable), in form (Transferable credit to another party and non-transferable), in implementation ('at sight' credit, acceptance credit, and provision under external credit facilities), and finally in terms of the shipping method (a credit allowed for partial shipment, a credit not permitted, a credit allowing for recharging, and a credit not permitted).

[3] One of the parties to the contract may resort to defaulting on its obligations by not paying for shipped goods because of lower prices in the country of origin or because of changing exchange rates, thereby raising its prices in the country of import.

[4] In the case of the exporter, he may be obliged by the importer's refusal to receive the goods to sell the goods at any price, sue in the importer's country, or recover the goods, with the consequent increased costs of transportation, insurance, and storage. If the exporter defaults on his obligations to deliver the goods at the agreed time, price, and quality, the importer will have to sue in the importer's country, which will increase costs.

[5] Salah al-Din Hassan El-Sissi, ***Theoretical and Applied Studies: Documentary Credits and Bank Guarantees in Economic, Accounting and Legal Terms***, op.cit, p. 07.

2.4. Contributing to establish financial markets and develop their performance

Banks play a pivotal role in the establishment and development of financial markets by undertaking several tasks, such as the revitalization of financial markets, the most important of which are:

- **Establishment of investment funds**: Some legislation allows banks to establish investment funds due to their experience in dealing with the requirements of the investment climate and their role in boosting investments.[1]
- **Establishment of deposit funds**: The Banks' purpose is to manage the funds of their depositors in the purchase and sale of securities based on their orders for specific fees and commissions.
- **Loans to brokers and securities dealers**: They are called short-term loans and are aimed at financing the brokers to purchase securities for their customers' accounts, as well as financing the dealers to purchase securities for their own accounts, which contributes to the revitalization of the financial market and increases liquidity in it.
- **Issuing and promoting government and private securities**: Some countries allow banks to establish brokerage houses that play the role of investment bankers, which manage, cover, and market all issuance of government and private securities in an individual or collective manner (in solidarity with a group of banks).[2]
- **Investing in securities**: Safety controls require banks to move away from investing in assets whose returns are subject to severe volatility, which exposes the banks to financial insolvency that could lead to bankruptcy. Thus, most laws have prevented banks from holding a large proportion of shares in their portfolio, encouraging banks to invest in the purchase of private first-class bonds, mainly government bonds and treasury bills, that provide liquidity and security to the bank and its depositors from market risk.[3]
- **Offering bonds to trade**: Besides offering shares to raise their capital, specialized banks issue bonds to expand their activity. Commercial banks are one of

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[1] Safwat Abdulsalam Awadallah, ***Investment Funds: Study and Analysis from the Perspective of the Islamic Economy***, Dar Alnahda, Egypt, 2005, p. 41.

[2] Abdulghafar Hanafi, ***Investing in Securities: Stocks-Bonds-Investment Documents-Options***, Elder Elgamaya, Egypt, 2000, p. 43.

[3] Munir Ibrahim Hindi, ***Commercial Bank Management: An Entry for Decision Making***, third Edition, Modern Arab Office, Egypt, 1996, p. 143.

the largest buyers of such bonds in pursuit of a guaranteed return, which contributes to the expansion of specialized banks in financing important economic activities.[1]

- **Establishment of investment companies**: Banks can establish investment companies with fixed and variable capital.
- **Establishment of mutual debt funds**: In some countries, banks are allowed to establish mutual debt funds that are active in the field of debt securitization and sale to the public.[2]

2.5. Contribution to public expenditure

Banks have a role to play in financing government expenditures. In addition to paying direct and indirect taxes owed to the governments, banks have the burden of lending to governments (public loans), especially in the event of weak or absent financial markets. In countries with a policy of financial repression, various banks and financial institutions are forced to buy government bonds. Internal public loans are the best tools available to governments for obtaining funding to implement development schemes, especially in light of the difficulties in obtaining external loans.[3]

2.6. Assistance in the implementation of public enterprise privatization programs

Many developed and developing countries have introduced programs to privatize their economic sectors in order to eliminate economic distortions, raise their efficiency and competitiveness, redistribute wealth among segments of society, alleviate public debt, and reduce their public budget deficits by creating temporary additional resources. These programs also target encouraging domestic and foreign private investment by allowing the private sector to play an effective development role. To achieve effective privatization, banks play important roles, notably:

- **Consultancy role**: The consultancy role of banks is reflected in the preparation of feasibility studies for projects to be privatized to determine benefits and costs, identify the potential effects on the national economy, assess the assets of such projects, determine the optimum number and value of the shares to be offered and the way they are sold, as well as provide a set of options for the best way to privatize and the right time.

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[1] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 119.

[2] Shakir Atallah, ***Financial Market: Tunisian Experience***, Imprimerie Cartage Tunis, Tunisia, 2007, p. 54.

[3] Said Abdullaziz Atman, ***Introduction to the Public Economy (Public Finances)***, Eldar Elgamaya, Egypt, 2003, p. 351.

- **Financing role**: Banks may invest in buying some or all of the shares offered and including them in their investments portfolio, or they may merely promote and market those shares among their clients. In both cases, it will free the economy from government control and encourage an active and effective private sector.

After the implementation of privatization and the transfer of ownership to the private sector, banks continue to support privatized projects by investigating their financial, administrative, and investment conditions, providing technical advice and financial information periodically, and providing financing in the form of working capital or to finance expansion projects through joint lending or the issuance of negotiable bonds.

2.7. Attracting foreign direct investments

Foreign direct investments FDIs are usually referred to as one of the most effective means of overcoming the problem of limited financing, especially when external loans decline and are not available. Consequently, countries, particularly developing ones, are often advised to pay attention to FDIs by providing attractive conditions. This is considered the ideal alternative to relieving pressure on limited funding resources, reducing the technological gap, increasing productive capacity, providing foreign cash resources, expanding the tax base, and alleviating the problem of unemployment. In doing so, countries desiring to attract FDIs have improved the investment climate by providing important legal and tax incentives[1] in conjunction with financial incentives to urge local banks to provide loans for investments at low interest rates and to harness their technical and advisory capabilities to accompany them. These procedures aimed at serving them in the hope that they will stabilize and continue to operate in the local markets.[2] In order to improve the banking sector's efficiency and reduce the costs of financial intermediation, liberalization has begun by removing all restrictions on its activity and establishing a framework that allows for the promotion of competition and the launching of initiatives and innovations, as well as substantial improvements in legal and regulatory structures.[3]

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[1] Menouer Ousrir & Aliane Nadir, ***Incentives for Direct Private Investment***, Journal of North African Economies, Chlef University, Algeria, N°02, May 2005, p. 97.

[2] Zidan Mohamed, ***FDI in Countries in Transition - An Analytical View of Gains and Risks***, Journal of North African Economies, Chlef University, Algeria, N°01, 2004, p. 120.

[3] Hariri Abdelghani, ***Financial Liberalization Policies in Arab Countries and Their Implications for the Financial Sector***, Journal of North African Economies, Chlef University, Algeria, N°15, 2016, p. 34.

2.8. Combating money laundering

Money laundering operations are defined as a series of successive operations aimed at camouflaging and concealing the illegal source of funds to show them as legitimate funds obtained from legal projects and then employing them in the formal economy.

Money laundering operations are considered one of the most serious organized economic crimes owing to the negative economic impacts they have on the national economy. In addition to their effects on national income as a result of capital smuggling abroad and the fact that some individuals benefit from large illegal incomes in the form of bribes and commissions and others are deprived of productive categories, money laundering operations affect the important economic indicators. The smuggling of funds absorbs part of the savings directed at productive investment, as well as the misallocation of resources and distortion of competition between legitimate projects and projects established with laundered funds.

Owing to increasing flows of laundered funds, inflation, unemployment, and interest rates in the receiving countries are expected to rise, while the exporting country's currency is expected to depreciate.[1] Owing to money launderers' reliance on banks to transfer and launder money, banks have a great responsibility to tackle these operations and to trap them in order to preserve their reputation and financial integrity. By checking the selection of their clients and monitoring their behaviors, processes, and activities related to them. This can only be reached by training employees under the supervision of experts to use modern methods to detect and deal with suspicious transactions and establishing an internal system for exchanging information with other banks.[2] It should be noted that due to the banking position on money laundering operations, the Basel Committee and the United Nations have provided a set of guidelines to banks and financial institutions to address them. In addition, Vienna Treaty which was concluded on December 19, 1989, urging countries to take effective action against such operations; one of the most important is the abolishing the banking secrecy system for any operations related to illicit business. Financial institutions should contribute to efforts to combat the phenomenon by scrutinizing their clients' operations and reporting suspicious and other transactions.

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[1] Safwat Abdulsalam Awadallah, ***The Economic Effects of Money Laundering and the Role of Banks in Combating it,*** Dar Alnahda, Egypt, 2003, p. 73.

[2] Mahmoud Mohamed Saif, ***Analysis and Evaluation of Banks' Role in Combating Money Laundering***, Dar Athaqafa, Jordan, 2008, p. 134.

2.9. Other services

In addition to the above, banks make available to their clients a variety of advisory and other services that contribute in one way or another to facilitating economic transactions and completing investment transactions at the lowest cost, namely:

- **Provision of Private Banking Service**: With increasing competition and countries' trend to open their banking markets in accordance with the GATS Agreement and its implications and the diversity of banking risks, banks have sought to keep abreast of developments and meet the growing demand for private banking service and its privacy in dealing with high-net-worth people. Banks have diversified their list of services to include innovative ones, such as the services of trust[1] and the provision of advisory services for the acquisition of special items such as artistic works and other services.[2] Private banking contributes to generating additional returns for banks, mobilizing and employing important savings to serve investment purposes in all its forms.[3]
- Discount of commercial papers and grant accreditation, and realizing commercial papers.
- Mortgage securities and keep securities as deposits.
- Rent cupboards to save stuff and securities.[4]
- Provide bank guarantee to its customers.[5]

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[1] The Trust service includes the purchase and sale of securities for clients owning wealth, investing funds in global investment funds, debt securitization, property management, and comprehensive account services by investing funds in excess of the balance specified in investment alternatives.

[2] These include: providing personal services such as booking tickets, making hotel bookings, sending packages, paying various installments, providing consultations in the field of real estate, financial, and tax planning, providing loans and facilities in various currencies, as well as guarantees and foreign exchange operations, trading in foreign currencies, and providing modern electronic banking services and life insurance.

[3] Abdelbaset Wafa, ***The Private Banking Industry and Its Role in Savings Mobilization***, Dar Alnahda, Egypt, 2005, p. 111.

[4] Mustafa Kamal Taha, ***Banks' Operations***, Dar Elfker Egamie, Egypt, 2005, p. 111.

[5] The bank guarantee differs from the letter of guarantee in several points, highlighting that the bank, in the case of its guarantee, is obliged to notify its client that it will pay the value of the guarantee, unlike the letter, in which the bank is not obliged to notify its client to meet the value of the letter of guarantee. Likewise, the Bank's commitment in the letter of guarantee is final and does not have the right to retreat after the issuance of the letter, as the bank pays its value upon the request of the beneficiary, unlike the bank guarantee, whose implementation depends on the confirmation of the order for which the guarantee was issued.

- Make bank transfers.[1]

- Issuance of Credit cards and debit cards, which benefit the banks as they increase their revenues from subscription and issuance fees and the use of ATMs, is a very motivating tool to attract and increase deposits at a lower cost.

- ATM service.

- Availability of banking and electronic checks.

- Provide the opportunity to use a mobile phone to complete banking transactions.[2]

- Setting up point-of-sale services to pay the bills by using terminals in shops.

- Issuing and trading electronic money (E-Cash)[3] to allow the completion of sales and purchases via the Internet and transferring it to another party through a special program on computers that issues electronic money units and sends them to the bank that deducts the equivalent value from the client's account.

- Offering certificates of deposit and savings in their negatiable and non-negotiable categories to allow small savers to receive rewarding returns for long periods.

- Managing the depositors' accounts.

- Providing investment trustee services to manage client investments by providing a non-traditional range of services with profitability and economic returns, such as the establishment of companies, preparation of feasibility studies and evaluation of investment opportunities, subscription in securities, and ensuring the offering of shares, management of acting companies, sale and liquidation of companies, marketing and management of real estate, money management; marketing business, and management and liquidation of estates

- Provide services to clients wishing to travel, such as travelers' checks, foreign currencies, and bank transfers.

- Provide Insurance services through specialized management for this purpose, or within the framework of the insurance company tracking the bank, or by contracting with other insurance companies.

- Perform foreign exchange or campio transactions by buying and selling foreign currencies.

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[1] Mahmoud Al-Kilani, ***Commercial and Banking Encyclopedia: Bank Operations***, Dar Althaqafa, Jordan, 2008, p. 231.

[2] By inserting a smart card into the phone, a WAP (Wireless Application Protocol) app allows connecting the phone to the Internet.

[3] One of the most popular companies issuing electronic money is DIGICASH , which issues Blind Signature; MONDEX, which offers Off-Line; and CYBER CASHATT, which offers Cyber Cash Wallet.

- Provide insurance service against the risks of exchange rate fluctuations and interest rates, whether for clients or the bank's own management, through the use or innovation of financial instruments, perhaps the most famous of which are derivatives.[1]

- **Securitization**: As part of lending risk management, banks allocate them by securitizing their loans (assets) and converting them into negotiable bonds that they market to banks and other institutions by relying on special-purpose agencies. Securitization provide financial resources to banks, which can reuse them for loans and other financial investments.[2] The basic principle of securitization is to balance return and risk by segmenting cash flows to meet investors' needs. The securitized securities is backed by an asset or a group of financial assets called "securitized assets" that represent the guarantee and source of cash flows, and the securitized assets are transferred and gathered in negotiable liquid securities (a diversified asset pool). The debtor company (originator or seller) sells assets it owns to special-purpose agencies that issue securities backed by assets, sometimes called chips or bond categories, to sell to investors in exchange for transferring cash flows to them.

There are several reasons that push financial and non-financial institutions, as well as governments, to use securitization, namely (1) to reduce the cost of financing and overcome the problem of high-risk credit rating by hiring special purpose companies, (2) diversify funding resources and provide liquidity without the need to increase the capital, (3) improve the capital structure by balancing the capital and risk, (4) improve risk management and overcome the problem of different asset and liability timelines, and (5) avoid capital requirements for entities requiring to meet the risk-weighted capital requirements (meeting the criterion of capital adequacy).

Securitization also contributes to achieve extrabudgetary funding and increase credit strength by reducing financial leverage from access to finance without increasing the financial leverage burden while allowing the possibility of removing leveraged assets wholly or partly from the balance sheet, which is positively reflected in its credit rating and facilitating access to finance from more efficient capital markets rather than financial intermediaries. Securitization help to create income for the originator of loans from the fees and securities of loan management services in the event the originator establishes and manages companies of special purpose. Securitization offers the possibility to convert illiquid and unattractive

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[1] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p.722.

[2] Badiaa Lachab, ***The global financial crisis: an attempt to understand and overcome***, The Arab Journal of Economic Research, N°52, Autumn 2010, p. 68.

financial assets into liquid and negotiable financial assets suited to investors' needs, at lower costs, would increase the efficiency of financial markets and reduce liquidity risks in the financial system. Securitization process allows banks to improve their competitiveness, as they have the opportunity to get rid of junk and doubtful loans and the consequent reduction of capital and reserves allocated to them, permitting the banks' management to focus on strategic functions, and form a better-yielding and lower-risk investment portfolio.[1]

- **Finance leasing**: Financial leasing emerged in the mid-nineteenth century in the mining sectors and then evolved in the twentieth century when it widespread in the United States. In Britain, this type of funding spread in the 1950s by establishing several homes offering financial leasing.

Under the pressure of insufficient financial resources to meet funding requests, banks may turn to finance seekers to lease productive assets for a certain period while opening up the possibility of owning them instead of resorting to borrowing and bearing related risks. Finance leasing is characterized by lower costs; the cost of renting is less than the cost of purchasing and sometimes less than borrowing costs. Finance leasing allows the lessor to reduce the costs of bankruptcy by recovering the leased asset, unlike the bank, whose financial position is affected by the borrower's insolvency. Financial leasing gives the tenant greater flexibility; it gives him the right to return the asset during periods when he does not exploit it in return for maintenance throughout the exploitation period. The lessor and tenant also have a tax advantage by deducting the premium of the depreciation and lease costs, respectively. As a result of the leased asset's failure to appear in the leased company's budget, the market value of the company is expected to be unaffected.[2] The resort of companies to finance leasing is the ideal solution if their financial resources are unable to cover the costs of purchasing assets, giving the company the opportunity to utilize those resources for other purposes, and allowing for the lifting of many of the restrictions that banks usually place on their borrowers that could reach to the acquisition of management decisions on future investments, financing methods, distribution of profits, and others.[3]

[1] Abdelkader Beltas, ***La titrisation***, Edition Légende, 2007, p. 14.

[2] The real value of the assets equals the value of the assets in the budget plus the capitalization of the rent installments.

[3] Munir Ibrahim Hindi, ***Commercial Bank Management: An Entry for Decision Making***, op.cit, p. 182.

3. Banking: its effects, risks and lending controls

In their way of providing their critical services, banks are affected by many factors and risks, which they must manage carefully. In the following, we shed light on factors affecting banks, the risks they encounter, and the controls on their lending.

3.1. Factors affecting banks

Due to the importance of banks and their close relationship with economic sectors, banks face a wide range of factors that restrict their activities, the most important of which are:

3.1.1. Legislations and laws: like other institutions, applicable legislation and laws affect banks, so banks are required to adjust their operations to comply with laws in the country in which they are active.[1]

3.1.2. Investment climate and economic development: The reciprocal relationship between banks, investment climate, and economic development has made the latter an important factor affecting banks. As they are the main engine of economic activity, banks are required to pay great attention to the changeability of the investment climate, as it contains many types of risks that banks must deal with carefully to allow them to play their roles in improving the country's economic level.[2]

3.1.3. Monetary and Credit policy requirements: Based on its objectives, central banks exercise their powers over the components of the banking system using the tools available to influence the size and types of credit. In addition, central banks usually inspect banks and conduct a comprehensive and partial inspection to ascertain the financial integrity of the banking system and the application of their instructions in order to preserve depositors' and creditors' funds.[3] In this regard, monetary policy has the ultimate objectives of stabilizing the overall price level to remove uncertainty, accelerate economic growth, and achieve a positive balance of payments. However, achieving these goals is not guaranteed, so monetary authorities are targeting variables that are highly responsive to monetary policy instruments called operational or initial targets (cash reserves, non-borrowed reserves, bank

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[1] Salah al-Din Hassan El-Sissi***, Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p.154.

[2] Asaad Mohamed Ali Wahab Elawad & Hasan Abdulkareem Elebrahimi, ***Employing Sustainability Accounting standards "FNO1 Employing Sustainability Accounting standards "FNO101 in the 01 in the Commercial Commercial Banking to enhance Investors' Confidence***, Namaa Economy and Trade Journal, Algeria, Vol 05, N°01, 2021, p. 02.

[3] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p.154.

accounts rate, and interest rates in money market). These variables are highly influential on intermediate and intermediate targets (cash pools, interest rate and exchange rate) and in a close relationship with the ultimate goals by using quantitative tools (indirect tools). These tools involve the discount rate, required reserve ratio, open market policy, and qualitative tools (direct tools) in the form of framing or roofing of credit and determining the minimum ratios of liquidity and moral suasion of banks. In order to achieve the desired results of monetary policy on economic activity, the policy has channels that are divided by literature into four channels: (1) interest rate channel, (2) exchange rate channel, (3) asset price channel (expected returns), and (4) bank credit channel.[1]

3.1.4. Sound banking policy requirements: The trends in the bank's management of liabilities (in particular deposits) depend on several considerations:

- Reconciling return, liquidity, and security in lending activity, by promoting the acquisition of assets with a low level of risk and high liquidity that can meet its obligations while maximizing its return.[2] Banks usually seek to create a secondary reserve added to the base reserve consisting mainly of fast-liquidating securities at low costs.[3]
- The extent to which the loans made comply with the bank's objectives.
- The compatibility of the bank's financial structure with lending policy, as the high volume of self-resources, deposits and capital are critical factors in increasing lending activity.
- The extent to which the structural composition and stability of deposits are commensurate with the structural composition of loans and financial investments of the bank in terms of the term, size and concentration.
- Human potential in terms of expertise and competencies is a critical factor in guiding lending activity, as some loans require careful and forward-looking studies that are not possible for all banks.[4]

3.2. Banking risks

Banking industry is one of the most vulnerable industries; banks funding the creation and expansion of projects, whether by lending or sharing capital, but dealing

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[1] Warda Chiban, ***The Causation Between the Quantity of Money and GDP in Algeria: An Econometric Study (1990-2011)***, Ph.D diss in Economics, Batna 1 University, Algeria, 2015/2016, pp. 88-103.

[2] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p.154.

[3] Munir Ibrahim Hindi, ***Commercial Bank Management: An Entry for Decision Making***, op.cit, p. 295.

[4] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 96.

with an uncertain future may expose the bank to unexpected losses or fluctuations in the expected return on particular assets.

3.2.1. Financial risks: Liquidity risks include withdrawal of deposits and market risks (fluctuation of revenues as a result of changing interest rates, securities prices, and prices of goods and services), as well as credit risks (debtors default), which, if not managed, can lead the bank to bankruptcy.

3.2.2. Operational Risks (Activity Risks): These risks arise as a result of defects and inefficiencies in the bank's internal systems and information systems or arises as a result of external events (including legal risks) resulting in the absence of management from current events at the bank and the erosion of its control. Then, operational risks open the way for the spread of financial fraud, mismanagement, embezzlements, cybercrime, interference and overreach of powers, and delays in the timely preparation and submission of reports.[1]

3.2.3. Business risks: Business risks include all external risks that the Bank has no capacity to control, such as economic conditions, financial sector structure, changing legislation, etc.

3.2.4. The risks of events: These risks include political risks, financial crises, natural disasters, civil wars, etc.

3.2.5. Other risks: Banks face other risks including countries' risks (international lending), reputational risks (decreasing client confidence), and compliance risks (financial penalties and prohibition from engaging in an activity as a result of wrongdoing).[2]

Therefore, banks must be ready for all these risks by establishing policies and procedures for risk management that ensure that risks are identified, measured, and tracked to avoid or reduce them at minimum levels so that they do not affect money flows and disposal (trade-offs between return and risk).

To ensure the banks' sustainability, monetary authorities, including central banks, have paid great importance to managing bank risks by subjecting banks operating under their tutelage_to strict and continuous supervision to ensure their efficiency, integrity, and respect for banking laws and legislation. This can be reached by improving control on banking system to maintain the integrity of banks'

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[1] Zitouni Kamel, ***Impact of Economic Shocks on the Analysis of Indicators of Banking Crises during 1980-2015: A Comparative Study between Algeria and Saudi Arabia,*** Ph.D diss in Economics, M'Sila University, Algeria, 2016/2017, pp. 69-70.

[2] Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume1, op.cit, p.621.

financial positions and depositors' and creditors' funds by improving the predictability and readiness of deviations and preparing various possible solutions. In this regard, countries have sought to improve banking control systems to prevent crises. Among the most acceptable and used systems by bank supervisory authorities the CAMELS system, which is an American early warning system permits to evaluate the performance and health of banks. It consists of six criteria that allow the assessment of banks' financial situation quickly and continuously, which are (1) adequacy of capital, (2) Asset Quality, (3) Management Risk for Day-to-Day Activities, (4) Earnings, (5) Liquidity, and (6) Sensitivity to market risks.

As countries move to accelerate financial liberalization and interconnect financial relations between countries, in addition to the financial crises that have invaded many financial systems, the effectiveness and efficiency of banking controls have become linked to coordination between different regulatory authorities. Accordingly, the governors of 10 central banks in developed countries agreed to establish the Basel Committee in 1975. Since 1988, the Basel Committee has been working on the development of norms and standards aimed at strengthening the supervision of banks and ensuring their financial integrity and has urged monetary authorities to apply them in order to avoid the possible impact of different levels of bank control on some banks' competitive advantage over others. The Basel 1 Criteria dealt with credit risk by focusing on the adequacy criterion (basic and supplementary), so the size of the standard (Capital to Assets) has been sat at 8% (COOKE ratio), and it was recommended for its application as of the end of 1992.[1] Owing to the failure of this standard to capture all risks as well as the prevalence of innovative financial instruments, especially after the 1997 Southeast Asian crisis, the Basel 2 Convention expanded in 2004 the standard of capital adequacy [2] to include credit, market, and operating risks. Thereby, the amount of capital is linked to those risks while maintaining the same ratio and allowing the issuance of short-term unsubordinated debt[3]. Overall, the new criteria are based on three main themes:

- Adequacy of the capital. It includes minimum capital requirements, credit risk by applying for the standard entry, credit risk by applying the input based on the internal classification, credit risk under securitization, operational risk, and banking book risk in relation to investment price fluctuations.
- Supervisory audit on banks.

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[1]Zitouni Kamel, op.cit, pp. 74-99.

[2] According to Basel 2, **capital adequacy ratio** = private funds/(credit risk + market risk + operating risk)≥8%.

[3] It is a debt precedes others in rank.

- Market discipline by publishing information and provide transparency to alleviate the problem of asymmetric information.

Basel2 has tried to provide a set of criteria by which to measure different risks, but it is noticeable that it focuses on credit risks, providing three methods for measuring those risks:

- The standard method focuses on giving different hazard weights depending on the class of customers (governments, banks, companies, etc.).
- The basic internal classification method assesses the risk of customers failing to pay their debts (default risk), while the rest of the credit risk remains covered by the central bank.
- Advanced internal classification method based on the assessment of all credit risks without central bank intervention.[1]

The minimum adequacy of the capital ratios is comprised of three segments; the seed capital (the paid up capital, reported reserves, and retained earnings), supplementary (unreported reserves and recalibration reserves), and short-term unsubordinated debt (less than two years and not more than 250% of the seed capital). As soon as the 2008 global financial crisis erupted, Basel2 failed to maintain the financial position of banks in the face of external risks and shocks emerged, this paved the way to launch Basel3 in September 2010, with a timeline for the application up to 2019. The concept of liquidity and private funds has been readjusted to include ordinary shares. The risk was expanded to include derivative contracts and pressure tests, and leverage ratios were introduced to raise the adequacy of the capital to absorb losses and shocks; the capital's adequacy rate was raised to 10.5%.[2]

Developments in financial markets in recent years that have generated multiple risks and increased their seriousness and their spread have led to increase the importance of paying attention to applying the principles of governance in banks. This step is to ensure the commitment of governing councils (boards of directors) to achieving the prevailing goals and safeguarding the rights of stakeholders, including shareholders and depositors.[3]

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[1]Salah al-Din Hassan El-Sissi, ***Scientific and Practical Banking Encyclopedia***, Volume2, Arab Nile Group, Egypt, 2011, p.188.

[2] Hayat Nedjar, ***The Basel 3 Convention and its Possible Implications for the Algerian Banking System,*** Journal of Economics and Management, Setif 1 University, Algeria, N°13, 2013, p. 280.

[3]Zitouni Kamel, op.cit, pp. 105-108.

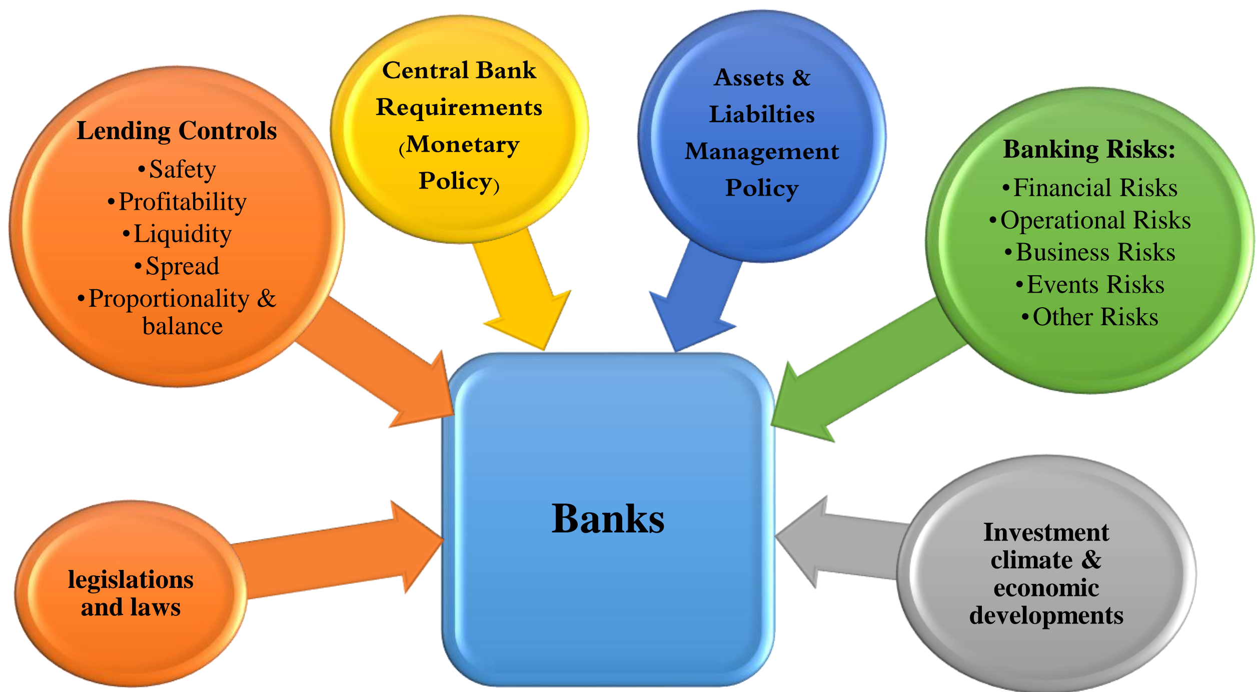
3.3. Lending controls

Credit creation is one of the most important and dangerous tasks associated with banks, considering that loans are merely an employment of depositors' funds. So, banks are required to set a sound credit policy that has a set of elements that may sometimes conflict:

- **Safety**: In its functions, the bank is keen to protect the funds of its depositors. It seeks to provide efficiency and effectiveness in its employment with an acceptable return in light of the risk management associated with the banking business.
- **Profitability**: It includes all returns from financial hiring and commissions on services provided, and profitability is positively correlated with risk.
- **Liquidity component**: To respond to any possible withdrawal requests in every way, banks employ their resources in a variety of assets that can be liquidated quickly and at low costs. In turn, the bank's liquidity is affected by the level of stability of its resources, whether they are subjective (capital, reserves, and withheld profits) or external (deposits), and the level of liquidity of its assets, especially with regard to financial client positions.
- **Spreading**: To diversify and distribute risks, banks avoid concentration through the spread of their activities and clients and between markets, in addition to geographical spread.
- **Proportionality and balance (Equilibrium):** Banks face imbalance between different activities due to the high share of certain activities at the expense of others, which may limit growth opportunities and diminish the margin of maneuver. To avoid this imbalance, banks are constantly trying to adjust their activities and balance between the loans granted, financial assets, and the bank's resources (liabilities) on the one hand and between various financed activities and services on the other.[1]

[1] Abdul Hamid Mohammed Al-Sharbi & Mohammed Abdul Hamid Al-Sharbi, op.cit, p. 85.

Figure 02: Banking Conditions



Source: Author's preparation

CHAPTER 02:

NON-BANKING FINANCIAL INSTITUTIONS

Preview

Banking institutions have enjoyed great attention, but that does not mean that they have a monopoly over the financial intermediation function or the financial markets. In fact, there are other financial institutions that do not possess the characteristics of banking institutions (receipt of deposits), but they play an important role in channeling and directing financial resources from savings lenders (holders of surpluses) to investors borrowers (holders of deficits). The evolution of the financial environment in the early 1980s and the erosion of some of the boundaries between banking and non-banking institutions made the latter a direct competitor and an important player in the financial system.

1. Insurance companies

Insurance companies are a financial institution and an important component of financial system due to the important services they offer, which enable them to collect funds from insured parties to reinvest them. In the following, we shed light on the most important aspects of insurance companies.

1.1. Insurance definition

Insurance is one of the most important and renowned tools of risk management because it can transfer the risks from one party to another who is willing to bear the burden of losses if they are realized. Thus, insurance is one of the effective systems that reduces the insured person's uncertainty about all or part of the financial losses that can occur. Insurance is an economic tool that can replace a significant potential loss with a confirmed small one. Insurance is a process that allows individuals and businesses (insured) the possibility of protecting them from potential losses by paying periodic installments to the insurer who is willing to bear the consequences of the risk by means of the large numbers law, which requires a large number of similar risks to be pooled and cleared. The law helps to improve the accuracy of the estimate between actual and expected losses and helps to determine the value of the advance fixed premium.[1]

1.2. Insurance contract information

In order to establish both parties' obligations, they are required to sign a contract called an insurance policy, which includes the following information:

[1] Falag Saliha, ***The Requirements for the Development of the Takaful Insurance System - Arab Experiences***, Ph.D diss in Economics, Chlef University, Algeria, 2014/2015, pp. 16-17.

1.2.1. Contracting parties: To be valid, an insurance contract usually includes different parties, who are:

- **The insurer (insurance company)**: The first party to the contract is the insurer who agrees to indemnify another upon the occurrence of a specified contingency and is often the insurance company.

- **The insured**: It is the second party in the contract. The insured is the party to be compensated in case of a loss in exchange for an obligation to pay periodic insurance premiums during a certain period.

- **The beneficiary**: In addition to the previous parties to the contract, the insurance contract may include other parties, such as the beneficiary. The latter is the person who receives the benefits of an insurance policy upon its maturity. In other words, he is the person for whom the insurance contract is entered into and who receives the compensation when the insured risk is ascertained. The beneficiary may be the insured person himself and maybe another person, such as the employer insure his or her workers against the risks of labor injury, in which case the employer is the insured person while the beneficiary is the workers. It should be noted that in some life insurance contracts, the insured person may be another person, such as the husband insuring his wife's life for the benefit of his children; here, the husband is the insured person while the children are the beneficiaries.

1.2.2. Parties' obligations: The obligations of the parties to the insurance contract are represented in the amount of insurance or premium paid by the insured person. Concerning the obligations of the insurer, the amount of the insurance shall be determined in advance and confirmed in the insurance policy. In the insurance of the property, the value of the subject matter shall be equal to that of the matter insured, thereby constituting the maximum amount of the insured's obligations. With regard to life insurance, the insured person is obliged to pay the full amount of the insurance without estimating the amount of compensation for the loss in the event of the occurrence of the incident insured against since the loss cannot be estimated precisely.

For the insured person's obligations, they are the insurance premium or periodic installments that are paid in advance and are determined as a proportion of the amount of the insurance.

1.2.3. The insured incident: The incident insured against is the occurrence of the insured risk that causes the insured to lose property or get hurt, which can cause him to lose his life.

1.2.4. Duration of the insurance: The beginning and end of the duration of insurance are usually determined by a specific hour and day, which helps to

determine precisely the duration of the insured's responsibility. If the risk is found to occur outside that duration, the insured person's obligation is to pay any compensation for the loss being outside the coverage. The duration of insurance in the case of property and responsibility is often one year, which may exceed more in special cases, such as insurance on cars in the case of sale by installment. Life insurance is always longer than one year and not less than five years, sometimes extending to the life of the insured person.[1]

1.3. Types of insurance

Insurance is a vital service for both natural persons (individuals) and legal ones (institutions), so it includes many types that will be shown below.

1.3.1. Insurance by insured risk position: This includes:

- **Insurance for persons**: It is an insurance policy in which the risk insured against is concerned with the insured person, who insures himself against various threats to his life, health, or ability to work. In this regard, to cover all these risks, many types of insurance have been designed for individuals, the most important of which are:

✓ **Death insurance**: Death insurance is a contract that will inter into effect if the insured person dies.

✓ **Insurance in the case of life only**: The subject of this insurance contract is to provide insurance protection to the insured until the insured person reaches an age for which a pension is required.

✓ **Mixed Insurance**: In this contract, the insurer is obliged to pay the amount of insurance to the beneficiaries in the event of the death of the insured during a certain period, while it pays the insured the same if he stays alive at the expiration of the agreed period.

✓ **Insurance against personal or physical injuries**: The subject of this insurance is to insure the insured against the risks of personal or physical injuries that can happen to him .

✓ **Children's insurance and others**: As they are the most vulnerable social groups, insurance companies offer the possibility to insure the children and others against any risk.[2]

Life insurance companies take care of these forms of insurance and others. They are organized into two types: joint-stock companies and mutual societies. The

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[1] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, ***Management of Financial Institutions***, Dar Alayam, Jordan, 2015, p. 135.

[2] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 135.

ownership of the joint-stock companies is attributable to their shareholders, and the holders of insurance policies are mutually reinforcing. Unlike banks, insurance companies are the least bankrupt financial institutions, persuading central banks to exempt them from the strict regulations to which banks are usually subject. Since mortality rates are generally predictable and largely certain, life insurance companies can accurately predict the size of future shareholders' payments, enabling them to acquire low-liquidity and long-term assets such as private bonds and commercial mortgages as well as stocks. The issuance of insurance policies is the main activity of life insurance companies, and it takes two main forms:

✓ **Life insurance**: The amount of the insurance is paid to the beneficiaries in the event of the insured person's death and in the form of decreasing periodic installments over life, where the amount of the insurance required for the risk of death is exceeded as the probability of death is minimal.

✓ **Provisional death insurance**: The amount of insurance is due if the death occurs within a certain agreed-upon period called the period of insurance. Unlike the previous form of insurance, the insurance premium is positively correlated with the risk of death, and premiums are increased by the higher probability of death as the insured person ages.[1]

- **Property Insurance**: This type of insurance covers risks to property (machinery, buildings, and crops) and material losses resulting therefrom. The most important types of property insurance are against the risks of natural disasters, fires, and terrorism; against burglary and theft; and against the risks of all type of transport, as well as misuse of leased property, fraud, and manipulation.

- **Civil responsibility insurance**: It is also known as third-party responsibility (liability) insurance, and it covers the civil responsibility of the insured person arising from a professional or contractual error causing compensable injury.[2] In civil responsibility insurance, it is difficult to identify a specific object or person to be the subject of insurance, which prompted the insurance companies to protect themselves by setting a maximum amount of insurance in the insurance contract that they are obliged to pay as their maximum responsibility.[3] The most important forms of civil liability covered by insurance are:

✓ Insurance for the self-employed against financial damages to others resulting from professional activity such as that of doctors, engineers, and others.

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[1] Frederic S.Mishkin, ***The Economics of Money, Banking, and Financial Markets***, Sixth edition, Addison Wesley Longman, USA, 2001, p. 314.

[2] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 142.

[3] Frederic S.Mishkin, op.cit, p. 321.

- ✓ Insurance for the employer against damages caused to others during work, whether the employer or one of his employees caused harm resulting from the use of working tools.
- ✓ Automotive accident insurance.
- ✓ Insurance from private civil responsibility or what is known as the responsibility of the follower for the harm caused by his dependents to others, whether the follower is a head of the family or an employer.
- ✓ Insurance against the dangers of riots, civil unrest, and labor strikes.[1]

Since it is extremely difficult to estimate losses to property compared to death, the amount of compensation that may be paid to insurance policyholders is unpredictable and may exceed a company's ability to cover losses if they occur, which requires it to acquire more high-liquid assets than life insurance companies. It should be noted that insurance companies for injuries and property are the most commonly used companies for reinsurance, as many of the risks they are exposed to are high-cost and, at the same time, have a high return. Therefore, these companies accept to keep to themselves the part that suits their capabilities and reinsure the rest of the process with another insurance company or several other insurance companies.[2]

1.3.2. Insurance by activity objective: This includes:

- **Commercial Insurance (Profit):** In order to achieve profitability in its activities, insurance companies invests the revenue of the accumulated insurance policies in the financial markets in order to achieve returns and profits.
- **Cooperative insurance (non-profit):** The parties exposed to a particular risk may form solidarity to face potential losses through the establishment of an insurance company in which profitability is excluded from its activities and its objective is to achieve solidarity in the face of risks.

1.3.3. Insurance according to the body responsible for the insurance: This type of insurance is divided into private insurance and public one.

1.3.4. Insurance according to compulsory contracting: This type of insurance can be mandatory and optional.[3]

[1] Insurance Federation of Egypt, ***Annual Report***, 2011, p. 21.

[2] Frederic S.Mishkin, op.cit, p. 315.

[3] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 138.

1.4. Sources of funds of insurance companies and their investment areas

Insurance companies are profitable companies that provide insurance services for various kinds of risks and act as intermediaries (financial institutions) by collecting premiums (funds) from the insured to invest them in multiple areas permitted by law to achieve sufficient returns to cover the insured person's compensation when the insured risk occurs and other expenses in addition to profits. Insurance companies may take a number of legal forms, such as joint stock companies, fund companies, mutual societies, or even cooperative associations. They may also resort to reinsure the risk through contracts in the event of risks insured against them whose compensation amounts exceed their financial capabilities in order to satisfy clients and maintain their market share.[1]

1.4.1. Sources of funds of insurance companies: Sources of financing for any economic project consist of equity (capital, reserves) and debt, but this is different for insurance companies depending on the nature of the insurance activity on the one hand and the restrictions governing the business of these companies on the other. The sources of funds for insurance companies are concentrated in the following components:

- **Self-resources:** It consists of capital, reserves of profits, and some other allocations. The capital is the main guarantor of the obligations that insurance may face at the beginning of its activity, but later, the combined reserves perform this role efficiently. The reserves represent long-term liabilities, so the insurance companies take into account that they employ them to make long-term investments. Allocations are reserves retained to meet negative outcomes and any obligations (compensation) arising from the expired insurance year. They therefore reflect short-term obligations imposed on insurance companies to invest rationally in short-term financial instruments that can be easily and quickly liquidated without incurring significant costs.
- **Rights of policyholders (insured):** These are technical allocations, constituting the largest share of the sources of financing of insurance companies,[2] which are deductions from unexpired premiums at the end of the insurance year, including what are considered to be short-term sources of financing, including long-term sources of funding.[3] In this regard, insurance companies in the world achieved

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[1] Melakhssou Belal, ***The Impact of Insurance on Algeria's Economic Growth: 1990-2010***, Ph.D diss in Economics, 2015/2016, pp. 16-18.

[2] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 391.

[3] Tarfah Shariki & Rafid Mohammed, ***Role of Insurance Sector in the Economic Activity***, Tishreen University Journal- Economic and Legal Sciences Series, Vol 30, N°4, 2008, p. 161.

record revenues from insurance premiums of $6,292,600 billion by the end of 2021.[1] Table 01 sets out the total premiums from the insurance companies in the world in 2011, 2012, and 2013.

Table 01: World's Total Insurance Premiums 2017-2019 ($ Millions)

Year	Life Insurance	Nonlife Insurance	Total Insurance
2017	2,723,040	3,066,759	5,789,799
2018	2,882.179	3,266,841	6,149,020
2019	2,916,267	3,376,333	6,292,600

Source: International Insurance fact Book, Insurance Information Institute III, 2021, p. 02.

Following 2.9% real growth in 2019, total global insurance premiums were estimated to fall 1.4% in real terms in 2020 due to the COVID-19 pandemic and forecast 3.4% rebound growth in 2021. Regarding the types of insurance, after 2.2% growth in 2019, in 2020 global life premiums were estimated to fall 4.5% and to grow 3% in 2021. Nonlife premiums will fare better: following 3.5 percent real growth in 2019, premiums were estimated to grow 1.1% in 2020 and to rebound with 3.6% growth in 2021 and 2022.

- **Short-term loans:** To perform well and ensure the continuity of their services, insurance companies may resort to borrowing from other financial institutions in the form of short-term loans since their services are characterized by their short-term nature.

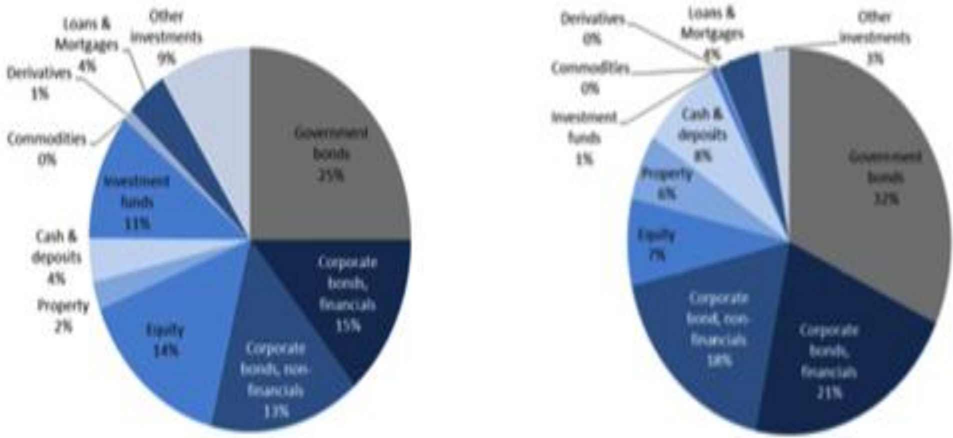
1.4.2. Fields of employment of insurance companies' funds: In order to meet their insurance obligations, insurance companies must maintain their ability to meet their obligations during the period of insurance. During that period, insurance companies invest their funds, especially insurance premiums, in investment channels determined by national laws, while maintaining sound foundations for investment in terms of liquidity, profitability, security of invested funds, and diversification.[2] One of the most important investment channels that absorbs the funds of insurance companies comes in the form of government securities (government and municipal bonds, treasury bills, and any government-guaranteed instruments), followed by bonds of reputable companies, and then shares and subscriptions to investment funds and companies, as well as direct investment in some economic companies.

[1] ***Insurance Information Institute III***, International insurance fact book, 2015, p. 3.

[2] Frederic S.Mishkin, op.cit, p. 318.

Moreover, insurance companies employ some of their funds in the acquisition of real estate by providing provide loans with mortgage guarantee or insurance documents, as well as deposits in banks in current accounts.[1] Since the majority of insurance companies' employment, including the life insurance is in long-term assets, they are more vulnerable, especially to the risk of changing interest rates, which have become more volatile, threatening to lower the prices of these companies' assets and affecting their role as conduits for channeling savings towards different investments. Thus insurance companies are required to impose the strengthening of precautionary measures to avoid reducing their investments and funding for the rest of the economic system.[2] Figure 03 shows the investment portfolio of insurance companies in the Eurozone by the end of 2015.

Figure 03: Investment Portfolio of Insurance Companies in the Eurozone by the End of 2015



Source: European Insurance and Occupational Pensions Authority EIOPA, Financial Stability Report, 2015

1.5. Role of insurance companies

Insurance companies have been able to keep such a great importance within the financial systems thanks to the economic roles they can play and contribute to the channeling of savings for financing purposes, allowing the implementation of

[1] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 391.

[2] ***The insurance sector contributes to increasing the risks facing the financial system since the global crisis***, IMF Bulletin, 4 April 2016, p. 1.

investment projects, and increasing the competitiveness of economies in order to improve the welfare of societies. Therefore, Insurance companies can contribute to:

1.5.1. Reduce the financing costs of project: Economic projects in different sectors (agriculture, industry, and services) can in no case rely only on self-financing resources but often need external financing that requires the participation of others in the project or may be limited to loans at certain periods. The contributor to financing projects may retreat from participating if he estimates that different risks may threaten his investment by disappearing, and therefore he may set conditions and impose additional costs. To eliminate fears and uncertainty and bring the parties closer, insurance companies provide adequate guarantees to protect them from different risks, which contributes to encouraging the attraction and employment of capital at lower costs.[1]

1.5.2. Balancing reserves and obligations: Insurance companies rely on correct information, statistics, and accurate data that they can easily obtain due to their long experience, specialization, and deep knowledge of the nature of the risks; therefore, insurance premiums are appropriate to meet the risk and are affordable. The estimation of project owner who does not have insurance coverage usually comes off as personal and inaccurate, either exaggerated or much lower. Therefore, the insurance comes to prevent the allocation of unnecessary cash reserves to meet the risks, thereby providing liquid funds for use in employment in other areas.[2]

1.5.3. Providing safety, economic stability, and increasing production: The effects of insurance extend to the economic behavior of both businesses and workers. Insurance provides everyone with stability and tranquility that allows for full-time production, increased productive efficiency, and entry into good investment areas without distracting and wasting time in assessing the risk of loss by reducing uncertainty, in addition to providing advice at the request of clients before and during projects.[3] The insurance allows businesses to determine in advance what needs to be reserved to meet the risk, allowing them to continue operating their units on a regular basis without disruption. The insurance prevents projects owners from facing a sudden loss that obliges them to raise the prices of goods and services produced, which affects their competitiveness. Compensation provided by the insurance companies for losses will help to resume work and restart economic units. The effect of insurance extends to consumers, where the stability of production prompts the

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[1] Raid Abdulkhalek Abdullah al-Obaid & Khaled Ahmed Farhan al-Mashhadani, ***Management of Financial and Banking Institutions***, Dar Alayam, Jordan, 2013, p. 105.

[2] Tarfah Shariki & Rafid Mohammed, op.cit, p. 160.

[3] Melakhssou Belal, op.cit, pp. 36-37.

consumer to refrain from storing goods that may be damaged later, thereby losing a portion of the income rather than saving or investing it.

1.5.4. Developing national savings and revitalizing investments: Life insurance is a distinct savings device that competes with other savings devices in view of its unique advantages, which increase its effectiveness in attracting savers from all categories. Small savings accumulated through normal savings cannot lead to large capital formation during the early years, while savings through life insurance can create a direct and immediate right to access, in the event of death, to large amounts that are payable immediately in the early years of savings sufficient to make investments.[1] Insurance companies invest a large part of the combined premium returns in different aspects of investment, including stocks and bonds, which contributes to the revitalization of financial markets in particular and the national economy in general.[2]

1.5.5. Curbing inflationary pressures: Insurance has a role in reducing inflationary pressures. The turnout for insurance allows the withdrawal of a mass of cash from trading that would have led to higher demand for consumer goods and services. After collecting insurance premiums, insurance companies tend to use their accumulated funds to finance productive investment projects that raise national production, are commensurate with the amount of cash traded in the market, and lead to a balance of supply and demand.[3]

1.5.6. Developing the international trade: Insurance covers the risks to which the goods are exposed to during their transport, both between countries and within them. Thus, insurance has a facilitating effect and is a catalyst for commercial transactions, which highlights its results in increasing their size. The continued flow of goods to various markets will create demand for them (supply creates demand)

The marine or aviation insurance policy on goods in the case of import and export is a guarantee to traders. Therefore, these policies reassure and encourage them to raise the volume of international exchanges, enabling them to implement obligations with ease if the goods are exposed to sudden events during their transport and before the moment of receipt of documents and the transfer of ownership of the goods to the buyer. In addition, export insurance protects the exporter against the risk of the importer's failure to meet its payment obligations (default) for reasons that may be due to political turmoil that hampers the transfer of funds, thus

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[1]Abdulwahab Yusuf Ahmed, ***Finance and Management of Financial Institutions***, First Edition, Dar Alhamed, Jordan, 2008, p. 198.

[2] Frederic S.Mishkin, op.cit, p. 318.

[3] Raid Abdulkhalek Abdullah al-Obaid & Khaled Ahmed Farhan al-Mashhadani, op.cit, p. 105.

protecting the importer against the risk of non-performance of the contract. Subsequently, insurance stimulates international trade and provide goods in markets at appropriate prices as a result of the guarantee provided by the insurance document to banks when opening documentary credits.[1]

1.5.7. Improving the balance of payments: Insurance is one of the items of balance of payment, where insurance services provided by residents to non-residents are recorded in export items, in addition to the services of managing the portfolio of assets of insurance companies and the operations associated with investments made by reinsurance companies abroad, which affect money flows to and from abroad.[2]

1.5.8. Facilitation of the expansion of credit and increased confidence: Insurance helps businesses access more credit facilities, especially for small and modern ones that need access to finance for expansion purposes. The effect of insurance is highlighted by encouraging banks to provide financing where it provides adequate coverage of the risks to the assets offered as collateral, thereby avoiding borrowers' insolvency risks if their insured businesses stumble into trouble or bankruptcy. In most cases, banks require the provision of insurance documents for project approval and individual lending.

1.5.9. Prevention and loss reduction: Work in insurance requires attention to the study and dissemination of various risk prevention methods in various production projects. In factories and warehouses, insurance companies focus on the provision of tolls against theft and fire exposure, so they encourage the use of alarms, automatic fire extinguishers, and tools that prevent labor accidents. Because of their expertise in the area of insurance and their availability to qualified personnel, insurance companies make recommendations on accident-proof precautions, which help reduce the risk of car accidents and the risk of transporting dangerous goods and materials.[3] Therefore, insurance companies are in one way or another promoting the use of risk prevention tools that reduce losses, and they may refrain from paying compensation if the requirements of preventive action are found to be inconsistent. To encourage this, insurance companies reduce the value of the premium on projects certified to comply with public safety rules and refrain from securing or raising the value of the insurance premium on projects found to be failing to follow the safety rules for various risks.[4]

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[1] Yousef Masadawi, ***The Role of the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) in Promoting Exports and Investments of Member Countries***, Damascus university journal for the economic and legal sciences, Vol 24, N° 01, 2011, p. 25.

[2] Falag Saliha, op.cit, p. 25.

[3] Abdulwahab Yusuf Ahmed, op.cit, p. 198.

[4] Frederic S.Mishkin, op.cit, p. 319.

1.5.10. Attracting capital: Insurance contributes to attracting domestic and foreign capital by opening the way to participate in the establishment of insurance companies or enter into the capital of existing companies.

1.5.11. Contributing to the development of economic sectors: Insurance companies have an important contribution to make in developing the performance of economic sectors. In addition to investing in the acquisition of shares and corporate bonds, insurance companies have a catalytic effect on production projects by introducing modern production methods. The contribution of insurance companies to the imposition of preventive measures and the reduction of uncertainty against the risks of damage or decline in production raises the burden on producers to allocate additional precautions to deal with the risks that motivate the introduction of modern and large-scale technology.[1]

1.5.12. Job creation: Insurance sector is one of the employment sectors where the insurance companies absorb a large number of job applicants from various disciplines and competencies, which has a positive impact on reducing unemployment rates and poverty and raising production rates.[2]

1.5.13. Achieving social stability: Insurance has an important contribution to avoiding falling into poverty through the service of compensation for loss of sickness, disability, or referral to unemployment, or commercial compensation when the property is exposed to the risk of theft or fire, which would return the insured (the loser) to the activity.

1.5.14. Developing a sense of responsibility and contributing to reducing accidents: The requirements made by insurance companies, such as refusal of compensation if the insured's will is to achieve the risk insured against, refraining from compensation if the loss does not exceed a certain threshold, or compensation as a percentage of the cost of the loss, would spread in the insured the sense of responsibility and make him more careful to avoid danger. Moreover, the pension guaranteed by the insured's family after his death reflects the spirit of responsibility and develops it in societies.[3]

2. Mutual and pension funds

In addition to insurance companies, investment and retirement funds are considered financial vessels that accumulate funds to invest them in a variety of

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[1] Tarfah Shariki & Rafid Mohammed, op.cit, p. 162.

[2] Abdulwahab Yusuf Ahmed, op.cit, p. 198.

[3] Falag Saliha, op.cit, pp. 25-26.

securities, allowing businesses to obtain the required funding to implement their investment projects that benefit the economy as a whole. Thus, mutual and pension funds are a method of managing individuals' savings in a collective manner consistent with their needs, desires, and risk acceptance to the benefit of all participating parties represented in the funds and savers.

2.1. Mutual funds

To take note of the most important aspects of investment funds, the following will be addressed:

2.1.1. Mutual funds concept: Mutual funds are intermediate financial institutions that accumulate funds from small investors in exchange for stocks whose proceeds are used to purchase various securities from different financial markets, thus opening up broad prospects for these small savers to invest in financial markets and take advantage of the opportunities and returns they offer. By issuing shares, mutual funds employ small collected funds to hold a large volume of securities, thereby placing them in a good negotiating position that enables them to reduce brokerage commissions and create a diversified investment portfolio to effectively manage liquidity risks. In exchange for depositing their funds, the investor in mutual funds, who is in fact a small saver, receives shares proving his share in that portfolio. Thus, investors get involved in the potential for profit and loss, but the funds' reliance on a diversification strategy for their purchase and sale of securities, in addition to their experience, allow for investment risk reduction and provide an acceptable level of liquidity. The strategy of diversifying the investments of mutual funds enables investors to maximize their return, which cannot be achieved in the absence of investment funds.

The purpose of establishing mutual funds is to link small savers to financial markets. By attracting small savings and employing them in the purchase and sale of securities, i.e., employing these funds in the formation and management of large and diversified investment portfolios. Thus, mutual funds contribute to preventing the flight of national savings abroad and stimulating financial markets, as well as

reducing speculation in them due to the preference of many funds not to venture into speculation on securities.[1]

It should be noted that the first mutual fund was established in the United States in Boston in 1924. Since then, the number of funds have increased, reaching 8120 funds in 2006 with total assets of $10413.6 billion. (Larger than insurance companies and fewer banks). Moreover, the number of accounts reached 289977, interacting with the pulse of financial markets, especially in the early 1990s, when financial markets experienced an unprecedented recovery that contributed significantly to the growth of the mutual fund sector, and non-bank financial institutions in general.

2.1.2. Types of mutual funds: There are many types of mutual funds that can satisfy the economic agents' preferences. Mutual funds can be classified according to many criteria, as follows:

- **Classification of mutual funds according to the duration of assets owned:** This includes:

✓ **Short-term mutual funds**: These funds invest in the purchase and sale of short-term securities traded in money markets.

✓ **Long-term mutual funds**: They include bond funds (investing in fixed-income securities with maturities beyond the year), equity funds (whose investments consist of ordinary and preferred shares), and hybrid funds (investing in all shared and bonds).[2]

- **Classification of mutual funds according to the share trading:** This classification includes many types of mutual funds, which are:

✓ **Open-end mutual funds**: Funds whose shareholders (investors savers) can recover their value (buy back) at any time, either directly by selling the shares recovered to the public or by resorting to broker who charges them a commission. The value of the share is linked to the value of the fund's assets and activities;[3] thus, the fund is open and allows other investors to invest in as long as the fund remains active.[4]

✓ **Closed-end mutual funds**: Unlike previous funds, these funds allow a specific number of their shares to be subscribed to the first issue, which is not redeemable. In other words, the number of shareholders in closed-end mutual funds is limited. Thus, the shareholders only have the financial markets (organized and

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[1] Safwat Abdulsalam Awadallah, op.cit, p. 41.

[2] Anthony Saunders and Marcia Million Cornett, op.cit, p. 122.

[3] Frederic S.Mishkin, op.cit, p. 326.

[4] Safwat Abdulsalam Awadallah, op.cit, p. 39.

unorganized) to sell and recover their value, where the shares are treated as ordinary shares. At the end of each period, the fund's Management distributes the returns on its investments and profits to its shareholders according to the conditions previously specified.[1]

- **Classification of mutual funds according to the fund objectives:** There are other types of mutual funds, according to fund objectives:

✓ **Growth mutual funds:** These funds aim to achieve long-term growth and a significant future return on their financial portfolios. Therefore, their portfolios consist of shares of companies that achieve high growth rates. It should be noted that these funds are appropriate for investors who look for achieving significant returns.

✓ **Income mutual funds**: These funds aim at preserving their assets as well as achieving an appropriate periodic return on their assets. Therefore, they invest their funds in the acquisition of shares and bonds belonging to large and stable companies. These funds fit investors who seek returns sufficient to cover their living expenses, regardless of the substantial taxes owed.

✓ **Income and growth mutual funds**: The managers of these funds aim to preserve their assets and achieve an appropriate short-term periodic return with a significant long-term return by constantly improving the market value of owned assets.

✓ **Tax management mutual funds**: These funds aim at avoiding the taxation of investors by avoiding any distributions of returns to them and instead reinvesting their profits in exchange for investors obtaining additional shares. These funds fit the category of investors avoiding the payment of substantial taxes and wishing to defer their payment to subsequent years.

✓ **Dual-Purpose Mutual Funds**: These funds emerged to satisfy the preferences of two categories of investors: investors who seek to achieve stable income from their investments and investors who seek to achieve steady growth on their investments. To satisfy both needs, the managers of these funds deliver the first category income stocks and the second category growth stocks.

- **Classification of mutual funds according to the owner:** The type and nature of the owner affect the types of mutual funds.

✓ **Mutual funds in the form of a joint stock company**: The shareholders who own them appoint the board of directors as stipulated in the funds' statute, allowing the shareholders to determine their investment policies and other matters.[2] The reality shows that the shareholders have contracted with a bank, insurance

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[1] Frederic S.Mishkin, op.cit, p. 326.

[2] Safwat Abdulsalam Awadallah, op.cit, p. 18.

companies, exchange brokers, a consulting institution, or even an investment fund to manage the fund's activity.

✓ **Mutual funds owned by banks and companies**: Following the broad success of mutual funds, some financial institutions, such as banks and insurance companies, have begun to invest in these promising funds through the establishment of mutual funds or the acquisition of existing funds. Some banks and insurance companies have more than one fund that acquire a significant proportion of the total assets of mutual funds.[1] For example, in the United States, insurance companies hold 10% of the mutual funds' assets in 2006, compared to the banks that acquired 11% of them. In recent years, mutual funds have been concentrated, with some 25 companies sponsoring mutual funds acquiring 71% of the overall funds' assets.

- **Classification of mutual funds according to the components of their assets:** The collection of assets that mutual funds own determines the type of mutual fund, so mutual funds can be:

✓ **Common equity funds**: These funds invest in the acquisition of all kinds of ordinary shares.

✓ **Bond funds**: The assets of these funds consist of bonds of all kinds.

✓ **Balanced funds**: They are also called miscellaneous funds, meaning funds consisting of a combination of ordinary stock and other fixed-income securities.

✓ **Cash Market Funds**: The assets of these funds consist of short-term securities usually traded in money market.[2]

2.1.3. Sources of mutual funds: Stocks are the primary source of investment to mutual funds as well as paid-up capital, allowing their shareholders to receive returns in three ways:

- Obtaining periodic returns from dividends and interest on bonds purchased by the funds.
- Capital gains from the sale of securities in which the funds invested.
- An improvement in the market value of the portfolio leads to a rise in the funds' shares, enabling shareholders to take advantage of this and sell shares at an appropriate price.

The advantages offered by mutual funds, such as the right to transfer funds from one fund to another within the single fund group and tax credits, are what have

[1] Anthony Saunders and Marcia Million Cornett, op.cit, p. 122.
[2] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 359.

made these funds a very important savings attraction tool, as in recent years they have occupied an important place within financial systems.[1]

2.1.4. Mutual fund assets: Managers of mutual funds employ their pool of equity sales (the savings of investors) to buy and sell securities from various financial markets (local and foreign) and to form a diversified investment portfolio in line with the fund's objectives. To preserve the constituent assets of the portfolio, managers of mutual funds have the burden of monitoring the evolution and modification of the components of the portfolio as required by interest by disposing of some assets and purchasing others in a balance between return and risk.[2] Overall, the investment portfolio's constituent assets vary depending on the type of fund, with two main distinguishable categories:

- **Short-term securities**: These securities make up the short-term portfolio of mutual fund, which includes foreign deposits, local current deposits and currencies, savings and term deposits, repurchase agreements, commercial papers, short-term municipal bonds, short-term government bonds. To maintain the integrity of assets, managers of funds are required to deal wisely with the risks of both credit, interest rate, exchange rate, and market.
- **Long-term securities**: The portfolio of long-term mutual funds consists of company shares (constituting the majority of assets), followed by credit market instruments such as long-term commercial papers (exceeding the year), long-term municipal bonds, and long-term government bonds.[3]

2.2. Pension funds

Pension funds are one of the most developed financial institutions, having achieved an annual growth rate of approximately 14% since 1960.[4] Like other financial institutions, pension funds play an important role in financial intermediation by consistently accumulating savings in the form of contributions

[1] Abdulrahman Mare, ***The Role of Investment Funds in Activating the Securities Market in Syria (Field Study)***, Damascus university journal for the economic and legal sciences, Vol 29, N° 01, 2013, p. 290.
[2] Safwat Abdulsalam Awadallah, op.cit, p. 41.
[3] Anthony Saunders and Marcia Million Cornett, op.cit, p. 134.
[4] Ayman El Mahgoub, ***New Strategies for Trusteed pension Funds (One Global Macro-Approach),*** Arab Economic journal, Egypt, N° 23, 2001, p. 40.

over the years and converting them into long-term investment aspects, especially in financial markets and real estate sector.[1]

2.2.1. Types of pension funds: In response to varied preferences, pension funds take many forms, including:

- **Division according to the managing body:** This includes:

✓ **Private pension funds**: In some countries, laws allow companies, businesses, private sector federations, and professional associations to establish pension funds that collect contributions from their workers. An entity that manages the fund's affairs and determines its investment policy to maximize the return sufficient to cover future commitments. These funds offer beneficiaries payments for long years of contribution in their programs, falling under three categories:

- **Regular payments**: These payments are the most widespread among pension systems, where beneficiaries are offered periodic payments with biometric hazard insurance, such as high age, with the possibility of protection in case of death.
- **One installment**: Fund can offer Contributors all pensions in one installment that is sufficient to ensure an adequate income during the period of retirement. In addition, pension funds in many countries allow citizens to choose between receiving all pension income in the form of a one payment or a large proportion thereof when the date of retirement comes.
- **Gradual withdrawal**: Instalments are made periodically but without any insurance against the risk of a higher rate of life, as the amount of payments is gradually reduced with the longevity of contributors.[2]

✓ **Public pension funds**: These funds are established by the governments and run by one of their agencies, with the opening of the opportunity to contribute in their programs for workers from various public and private sectors, civil and military. These funds provide their contributors with several benefits, the most important of which is to ensure the provision of pensions regardless of the funds' financial position, since the government guarantees the financing of the fund in the event of financial difficulties that may affect its ability to meet its obligations (pension).[3]

- **Division according to the form of advances:** This division includes:

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[1] Frederic S.Mishkin, op.cit, p. 321.

[2] European Commission, ***Private Pension Schemes: Their Role in Adequate and Sustainable Pensions***, 2010, p. 14.

[3] Richard Kohl and Paul O'Brien,***The Macroeconomics of Ageing, Pensions and Savings : A Survey, Economics,*** Working papers N°200, OECD Publishing, 1998, p. 08.

- ✓ **Funds with specific contributions**: These funds pledge to their contributors (subscribers) to pay the pension, the amount of which shall be determined later on the basis of their contributors' income and years of service.
- ✓ **Funds with specific benefits**: In these funds, future income (pension) is determined in advance. These funds are divided into:

- **Fully funded funds**: These funds are fully funded if contributions paid over the years are sufficient to cover the benefits when they fall due (maturity).
- **Wholly unfunded funds**: by contrast, funds are wholly unfunded if contributions are insufficient to cover benefits, in which case most governments intervene to cover deficits, allowing funds to meet their obligations and continue to fulfill their economic role.

2.2.2. Pension fund resources: The resources of pension funds are made up of workers' and employers' contributions. Most laws require them to pay periodic contributions according to Pay-As-You-Go rule (the contribution deduction from the source) within a retirement program whose laws are designed by the government with the task of managing to a government body or agency in order to protect the rights of contributors and the permanence of the program. The program ensures the determination of rights, responsibilities, relationships, and duties for both the fund's managing body, the contributors to the program (workers and employers), and the beneficiaries of the program.

To encourage pension funds to grow and develop to enable them to perform their economic and social functions, they have benefited from many advantages, namely:

- Tax incentives in the form of tax deductions on contributions from employers and exemptions for workers' contributions.
- Cover all workforce.
- Transferability of the contribution amount from one company to another and from one sector to another, which gives flexibility and ease to pension funds in pooling workers' contributions in the event of a change of activity.
- Interdependence between different sectors. Contributions paid to pension schemes by large companies and major sectors contribute to closing the financing gap arising from the inability of small companies or those experiencing financial difficulties to pay outstanding contributions, which benefits all workers.
- Because of their economic and social importance, governments set minimum standards for pension funds to comply with and intervene with their agencies to ensure their sustainability and ability to meet their obligations, especially in times of crisis when contributing companies face the threat of bankruptcy.

- Including social protection in the payment of pension income.[1]
- Harmonized between different groups of society, where the male and female sexes are differentiated when the age of benefiting from the pension income is calculated.

Notwithstanding the benefits provided, pension funds, and in particular private ones, suffer from a deficit that affects their ability to meet their future obligations as a result of the widening gap between contributions and payments made. The difficulties that pension funds encounter push them to choose between several scenarios for addressing the problem and raising the amount of contributions, such as raising the proportion of the deduction of income intended to contribute to retirement programs; extending the years of service to benefit from retirement; increasing the number of contributing workforce; and lowering the legal age of entry into the labor market. These possible scenarios may collide with the rejection of syndicates, which puts governments in direct confrontation with them.[2]

2.2.3. Pension fund investments: Pension funds seek to invest the proceeds of contributions in investments with sufficient returns to fund payments to beneficiaries and achieve the fund's financial balance and program sustainability. With the majority of funds having successive losses, governments have introduced reforms to pension systems, enabling them to enter new investment areas that permit them to employ their resources in the acquisition of assets that until recently were prohibited from being traded.[3]

Since the size and flow date of pension fund payments can be expected with great certainty, pension funds tend to invest in long-term financial instruments by acquiring bonds, stocks, and long-term mortgages. In order to maintain the fund's liquidity and solvency, the fund's management seeks to acquire and diversify high-liquidity and low-risk assets. In line with changes in the investment environment, the investment strategy of pension funds underwent dramatic changes. After World War I, the majority of pension funds' assets consisted of only government bonds, and the ratio fell then to 77% in 1960 and gradually to 47% in 1974 and so on.[4]

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[1] Max Horlick, ***The Relationship between Public and Private Pension Schemes: an Introductory Overview,*** Social security bulletin, Social Security Administration, USA, Vol 50, N°07, July 1987, p. 20.

[2] Willi Leibfritz and others, ***Ageing Populations, Pension Systems and Government Budget: How do they Affect Saving?*** Working papers N°156, OECD Publishing, 1995, p. 17.

[3] Ayman El Mahgoub, op.cit, p. 50.

[4] Frederic S.Mishkin, op.cit, p. 322

As a result of the tax advantage of municipal bonds as they are tax-exempted, pension funds have been tend to the acquisition of them, and their share in the portfolio of these funds has risen, yet they have not been equally important. Later, the boom in equity markets in the early 1950s and higher returns have persuaded pension funds, like other financial and non-financial institutions, to enter this promising market and then their share of the total owned-assets reached 39% for private and 34% for public funds. During the 1980s, pension funds continued to interact with the economic environment in order to exploit opportunities to maximize their investment returns. Real estate market has experienced an unprecedented boom due to the widespread and growing demand from the local or foreign markets, thus, pension funds increased their investments in the real estate market. Public funds captured three-quarters of the retirement sector's real estate assets. Yet the demand of pension funds for real estate market were not at the same level as the insurance companies; they acquire only 4% of total assets in 1994.[1]

3. Other non-banking financial institutions

Despite the importance of the non-banking financial institutions discussed above, other institutions occupy an important place in the financial system due to their role in attracting funds from surplus savers and channeling them in different forms to deficit investors who possess investment opportunities. In the following, we will address the most prominent non-banking financial institutions.

3.1. Finance companies

Finance companies have become one of the most important savings vessels, especially in open financial markets. Finance companies have emerged to meet the financing needs of small and emerging businesses that lack guarantees capable of facilitating their access to adequate financing through the classic channels represented, especially banks.

3.1.1. Finance companies concept: Finance companies are non-depository financial institutions that are active in lending to both small businesses and consumers who lack good credit status or sufficient guarantees that enable them to obtain bank loans. Newly established businesses encounter considerable difficulties in obtaining funding from traditional financing channels from banks and financial markets in order to launch their projects and then manage them due to a lack of experience, which puts them in a fragile negotiating position with financial institutions. Given that need is the mother of invention, finance companies have

[1] Ayman El Mahgoub, op.cit, p. 51.

emerged to assist these enterprises by providing them with funding at certain interest rates and with technical assistance to create businesses and make profits. Finance companies also provide consumer loans to individuals to satisfy their consumer needs by financing purchases of furniture and durable goods and the acquisition and improvement of various properties.[1] Due to the privacy of their customers, financing companies' loans are considered high-yield and high-risk loans, making their interest rates high. As non-depositary enterprises, finance companies are less vulnerable to central banks' requirements, such as legal and other reserves, allowing them to expand and grow.

Historically, Finance companies date back to the beginning of the last century, when automobile corporations set up subsidiaries at the beginning of 1900 to provide financing to customers willing to buy cars. At that time, requests for financing were met with banks' refusal to consider them unproductive loans. These subsidiaries were a great success that contributed to the revitalization of the automotive industry, motivating other corporations such as General Electric Corp, to finance purchases by customers wishing to acquire its equipment and later expanding the idea to include stores.[2]

3.1.2. Types of finance companies: Given the complexity of economic life and the expansion of the financial system, finance companies take several types due to many criteria.

- **Sales Finance Companies:** They are financial institutions belonging to an industrial company or retailer, specializing in providing loans to consumers for the acquisition of equipment and goods belonging to the company or trader, such as Ford Motor Credit and Sears Roebuck Acceptance Corp. The lending process in sales finance institutions is faster than in banks, which puts them in intense competition with them to acquire a larger share of the finance market.[3]
- **Consumer Finance Companies:** These companies specialize in lending to individuals to finance their purchases of various goods, equipment, and brands. They also lend for the purpose of home repairs and renovations, as well as refinancing small debts and granting loans to cover the expenses of treatment, study, and holiday trips.[4] These may be either completely independent, as Household Finance Corp., or maybe a subsidiary of a bank, as Person-to-Person Finance Company, a company

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[1] Anthony Saunders and Marcia Million Cornett, ***Financial Institutions Management: A Risk Management Approach***, Sixth Edition, McGraw-Hill/Irwin, 2008, p. 153.

[2] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 120.

[3] Anthony Saunders and Marcia Million Cornett, op.cit, p. 153.

[4] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 121.

owned by City Group Bank.[1] Due to the high risk of lending to individuals that banks refuse to lend to, consumer finance companies usually offset this by raising interest rates and accepting guarantees that banks refuse to accept.

- **Business finance companies:** These companies provide loans to businesses through the leasing of equipment and the sale of debts. They allow to purchase outstanding accounts (bills, invoices, bonds, etc.) of the business borrower in exchange for the latter benefiting from a loan to acquire new machines or benefiting from the leasing of equipment (Rail cars, aircraft, and computers), which finance companies, at the request of businesses, buy and lease for certain years.

3.1.3. Sources of finance companies: Finance companies differ from banks in that they do not accept deposits; instead, they receive funds (liabilities) from other sources, the most important of which are:

- **Commercial papers:** Commercial papers are one of the sources of financing for short-term finance companies, making them the most suitable for short-term loan financing and the most important source of financing since interest rates are usually at lower levels than those charged by banks on loans. Commercial papers are very attractive because they are sold directly without intermediaries and thus avoid paying commissions to mutual funds and other investment companies. Their maturity dates range from 30 days or less to 270 days, and they are the largest short-term trade issuers.

- **Other sources:** Finance companies may resort to other sources to ensure the proper functioning of their operations and the fulfillment of their clients' wishes. These sources include:

✓ short- and long-term bonds.
✓ Loans from banks.
✓ Loans and subsidies from the parent company if it exists.[2]

3.1.4. Assets of finance companies: Finance companies can hold different forms of assets, including:

- **Consumer loans:** Finance companies grant consumer loans that include loans for the purchase and rental of cars, the purchase of movables such as durable goods, household appliances, furniture, etc., which puts them in strong competition with commercial banks in the consumer loan market.[3]

- **Mortgages:** Residential and commercial mortgages have become important components of finance companies' portfolios. Their contribution to the United States, for example, rose from 10.5% in 1977 to 30.3% in 2006, owing to a number

[1] Frederic S.Mishkin, op.cit, p. 325.
[2] Anthony Saunders and Marcia Million Cornett, op.cit, p. 155.
[3] Alaa Farhan Talab & Hader Younes Al-Moussaoui & Mohamed Fayez Hassan, op.cit, p. 120.

of factors, including high-risk lenders due to the absence of restrictions normally imposed on banks. Finance companies offset higher risk by raising interest rates and commissions, in addition to the tendency of some countries, such as the United States, to reduce the tax on mortgage-secured loans and lower interest rates on such loans, which has resulted in the recovery of the real estate market. Mortgages include concessional loans (seizure rights) and any form of property.

- **Loans to businesses:** Business loans account for the largest share of the business portfolio of finance companies. Business loans include two main types:

✓ **Rental**: it involves either finance companies purchasing cars, equipment, and other items to rent to businesses while retaining ownership or they conceding when the transaction is made or after.

✓ **Lending**: Finance companies lend to businesses to enable them to purchase tools, equipment, and cars.

Finance companies usually prefer the first type of financing due to many considerations, the most important of which is the possibility of easily recovering leased equipment in the event of bankruptcy or failure of leased companies, in contrast to financing with lending, which is more difficult and takes longer.

✓ **Purchase indebted accounts (debts):** Finance companies can purchase indebted accounts at discounted rates, hopefully getting a return when the debtor repays its debts.

✓ **Bank deposits**: Finance companies usually employ a portion of their funds in deposits in banks to benefit from the interest rate paid on the deposits.

✓ **Securities of different duration and liquidity**: Finance companies prefer to invest in securities traded in financial markets to take advantage of the returns gained in these markets.

✓ **Reserves to meet losses or no gains**: To protect themselves from shocks and strengthen their financial position, finance companies hold a portion of their funds in the form of reserves that generate no returns.[1]

3.2. Hedge funds

Hedge funds are an important component of the financial system due to their role in financial intermediation.

3.2.1. Hedge funds concept: Hedge funds are intermediate financial institutions that raise funds from wealthy individuals and other investors, such as banks, to invest on their behalf. These funds intersect with mutual funds in that they invest the funds collected on their behalf. However, there are several points of difference between

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[1] Anthony Saunders and Marcia Million Cornett, op.cit, p. 160.

the two types of funds; hedge funds require investors to invest large amounts over a long period of time, which may extend for years. For example, in the United States, hedge funds stipulate that the investor must provide at least $100,000.

Thus, these funds usually have a very limited number of wealthy investors, not exceeding 100 members, and earn fees from them of up to 2% of the assets managed annually, and the percentage of the profits earned may be up to 25%.[1]

Given that these funds are not subject to the requirements and restrictions imposed by monetary authorities on mutual funds, the governing body usually uses a high-risk offensive strategy in its investment of available funds, through short-selling, electronic trading, arbitrage between markets, derivatives trading, and securitized debts, to generate significant returns. To manage those risks and achieve expected returns, hedge funds rely on a neutral market strategy by acquiring a wide variety of financial instruments, where they buy cheap instruments, and they are expected to go up in price, and sell at what appears to be exaggerated levels. However, those expectations may not be accurate at times, which exposes the fund's investments to financial losses.

3.2.2. Types of hedge funds: hedge funds are classified as highly specialized institutions whose management depends on experienced and highly qualified managers for significant profits. In order to attain the established objectives, manager of funds rely on diverse investment strategies, some of which are highly hazardous and some of which are moderately risky or risk-averse. Therefore, hedge funds can be classified into three categories:

- **High-risk funds:** Managers of these funds pursue an offensive strategy in search of significant returns on their assets to maximize their profits. These funds invest in buying shares of companies whose distributing profits (dividend) are expected to grow steadily in the coming years and usually invest in unstable emerging markets (startups) due to the large returns they provide as well as the high risk. Fund investments expand from stocks to bonds, currencies, commodities, and others to take advantage of spreads.
- **Moderate degree of risk funds:** Managers of these funds adopt long-term strategies based on investing in distressed financial instruments such as shares, debts, and any claims on companies facing bankruptcy or disorganization. However, they are assumed to possess opportunities that allow them to exit their positions, improve their condition, and thus increase their market value in the future, according to the managers of the funds.

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[1] Frederic S.Mishkin, op.cit, p. 329.

- **Risk-averse funds:** In their strategy, managers of these funds focus on current income rather than capital gains by buying shares, bonds, fixed-income derivatives, and low-risk.[1]

3.3. Credit unions

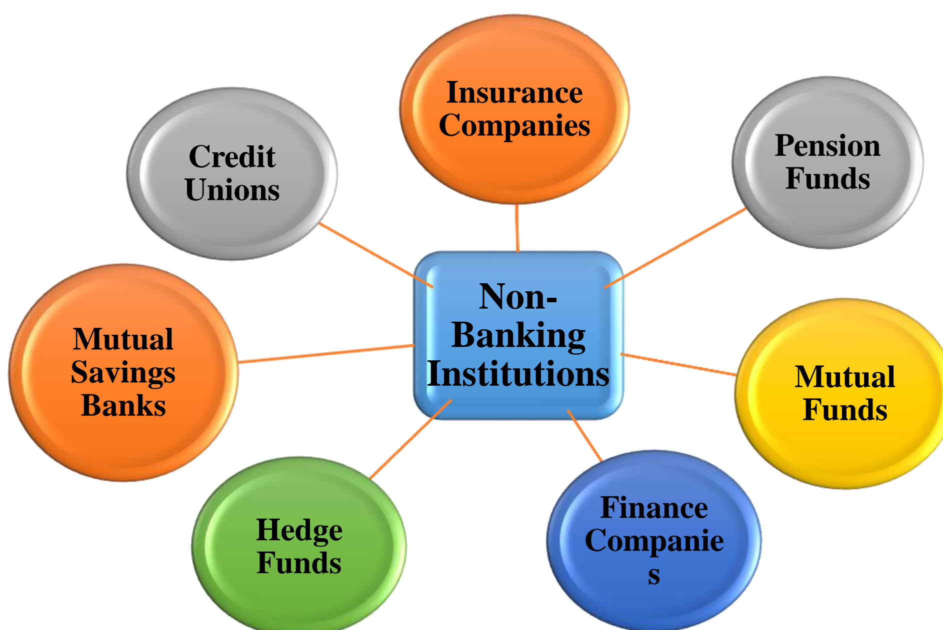
Credit unions are financial institutions organized as small cooperative enterprises established by a particular group of workers of a particular enterprise, such as the workers union of that enterprise. These associations mobilize resources from their founders' contributions in the form of deposits (current and term) for use in providing consumer and real estate loans.

3.4. Mutual savings banks

These institutions interfere with savings banks in that both receive funds from individuals' savings deposits that are subsequently employed in mortgages and consumer loans, but mutual savings banks are characterized by the fact that they take the form of cooperatives owned by their depositors.[2]

Lastly, we can conclude the most important non-financial institutions discussed in the following figure.

Figure 04: Types of Non-Banking Financial Institution



Source: Author's Preparation

[1] Anthony Saunders and Marcia Million Cornett, op.cit, p. 143.
[2] Mahmoud Younes & Kamel Amine El-Wassal, op.cit, p. 103.

CHAPTER 03:

FINANCIAL MARKETS

Preview

Financial markets are an important component of the financial system; they are not only an effective financial intermediation institution that connects savers and investors directly, but they are also a very important means of enhancing the resilience and efficiency of the financial system. Therefore, financial markets link the various depository and non-depository financial institutions together, increasing their interaction and opening the way for their pooled funds to be invested in investments with an appropriate return to sustain their activity.

1. Financial markets: their concept, functions, and types

As it is said before, financial markets are the most popular financial institutions, and many consider them to be the most effective and capable mean of channeling funds from people who do not have productive uses or opportunities to those who do, which in turn contributes to greater economic efficiency. Therefore, financial markets are reliable tools to have direct effects on personal wealth, the behavior of businessmen and consumers, and the overall performance of the economy and well-being.

1.1. Concept and functions of financial markets

Given the importance of financial markets, several efforts have emerged to give them a concept and define their functions.

1.1.1. Financial markets concepts: Given the complexity of financial markets' roles, and the evolution of their functions, many definitions have been addressed, perhaps the most important of which are:

- Financial markets are defined as an automatic communication tool between savers and investors; that is, they represent the link between savings and investment through several specialized technical tools and institutions that create the opportunity for the surplus funds (savings) to be within the reach of the investors (individuals, institutions, or governments) who own investment opportunities and need finance for both.[1]
- Some see financial market as a system whereby sellers and buyers are combined for a certain type of securities or financial assets so that investors can sell and buy a number of shares and bonds within the market, either through brokers or companies working in this field. As telecommunications companies grew as

[1] Tijani Najeh, op.cit, p. 67.

information and communication technologies developed, the importance of being in the headquarters of financial markets decreased, allowing for intensified off-market interaction with brokerage companies that are widely spread, so that transactions take place in both official or organization markets (exchanges) and parallel or unorganized markets (over-of-the-counter).[1]

1.1.2. Financial markets functions: Financial markets have a variety of roles. With all economic or technological progress, some new needs emerge, and then new functions for the financial market arise to satisfy them and stimulate economic development. The most important of these functions are:

- Attracting savings, especially those of small investors, which benefit development and reduce inflation.[2] Thanks to economies of scale and the experience of financial brokerages, savers have the potential to achieve higher returns at low costs.[3]
- Reducing inactive savings and hoarding (compactness) by opening channels to employ them in investments with encouraging returns, which reduces banks' dominance in relation to national savings and their different employment.[4]
- Contributing to direct financing by providing governments and institutions (public and private) with the opportunity to obtain the necessary funding by harnessing their potential to issue and market bonds and shares, thereby contributing to productive investments leading to an increase in production and national income and the consequent improvement of economic development. Since the investor's goal is to maximize profit, this can only be done by covering the costs of obtaining funding, which will therefore motivate him to direct investments to the best and most efficient uses.[5] Advanced financial markets provide long-term liquidity for productive investments, so providing the possibility of fast and low-cost securities liquidation will eliminate the hesitancy of savers to cede their savings for a long time to the purchase of financial instruments, thereby linking savers to long-term investments.

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[1]Abdul Ghafar Hanafi, op.cit, p. 37.

[2] Ziad Ramadan & Marwan Shmout, ***Financial Markets***, United Arab Company for Marketing & Supply, Egypt, 2008, p. 09.

[3] Mohamed Kamal Abu Amcha, ***Investing in Gulf Capital Markets and Their Role in Attracting Foreign Investments***, The Arab Journal of Economic Research, N° 61-62, Spring 2013, p. 79.

[4] Panicos O.Demetriades, ***Financial Markets and Economic Development***, ECES, working paper N°27, June 1998, p. 12.

[5] Chaker Atallah, ***Financial Market: the Tunisian Experience***, Imprimerie Tunis Carthage, Tunisia, 2007, p. 13.

- Alleviating the Principle/Agent problem by linking the performance of corporate managers to the movement of prices of their stock in the market, which prompts them to make greater efforts to improve their performance and realize the best results.[1]

- Give a valuation of companies and projects where financial markets play an important role in reducing the Asymetric Information problem and taking advantage of Free Riders by publishing all information, reports, and indicators. This will allow investors to realize the real status of companies, which will have a reflection on equity prices, and thus urge the company to adjust its policies to benefit from further financing.

- Attracting foreign investments. The availability of an appropriate investment climate will contribute to reducing the use of external borrowing. On the one hand, financial markets largely guarantee the necessary financing to expand domestic and foreign investment activities. On the other hand, financial markets provide adequate safeguards to maintain the stability and development of investments, including foreign indirect investments seeking to form secure and profitable investment portfolios, by ensuring the liquidity of traded securities, as well as adequate supervision of listed companies by obliging them to publish periodic and structured reports.[2]

- Reducing the leakage of national capital abroad by providing a secure and profitable instrument capable of absorbing capital.[3]

- Contributing to the sustainability of companies' activities, financial markets play a role in improving their competitiveness by persuading them to introduce improvements in their financial structure by increasing the importance of self-financing and permanent and stable financing to integrate with bank financing, which has a positive impact on alleviating external debt burdens and achieving long-term financial balance.

- Contributing to the success of privatization programs. The existence of efficient financial markets is central to any process aimed at privatizing public enterprises and improving their performance. Sharp competition in financial markets will enable

[1] Mohamed Kamal Abu Amcha, ***Investing in Gulf Capital Markets and Their Role in Attracting Foreign Investments***, op.cit, p. 79.

[2] Chaker Atallah, op.cit, p. 13.

[3] Mohamed Kamal Abu Amcha, ***The Importance of Developing Financial Markets in Member States of the Cooperation Council of the Gulf***, The Arab Journal of Economic Research, N° 55-56, Autumn 2011, p. 135**.**

a real valuation of the companies' assets to be privatized and bring the shares to a level of real and realistic prices.[1]

- Contributing to the preservation and development of wealth, like cash money, securities available for trading are usually held and retained as a tool of preservation of wealth until they are liquidated at the time of necessity. Due to their distinctive characteristics, securities traded in financial markets are neither depreciated (worn out) nor eroded over time, but some generate profits that increase their value and grow the wealth of their holders.

- Facilitating access to the borrowing market. Financial instruments are stocks and bonds that allow their owners to borrow from financial institutions against their mortgage.

- Facilitating the payments and development of exchanges. Financial instruments usually enjoy broad acceptance among customers in different markets, which makes the clearance of them easy and smooth and encourages the development of internal and external transactions.

- In addition to their role in facilitating access to financing channels, financial markets play another role that is positively reflected in investment by reducing investment risk through financial derivatives that allow diversification and hedging. The multiplicity of financial markets and financial instruments traded in them allows the investor to diversify his or her areas of investment, avoiding the risk of investing in a particular instrument or market. The development of financial markets and their openness to each other, on the one hand, and the development of financial engineering outputs from innovative financial instruments such as derivatives, on the other hand, have given investors the opportunity to hedge against the risk of declining returns in the future.[2]

- High-liquidity financial markets reduce investment risk by allowing the saver to adjust his investment portfolio by selling and buying such securities quickly and at low costs, which accelerate the turnover of financial assets in the markets and increase the markets efficiency.

- Improving the functioning of financial markets has a positive impact on other financial institutions because financial markets provide services and investment opportunities that increase the return on their assets, thereby increasing profits and market value.

- Increasing the effectiveness of listed companies. The access of companies listed financing by stock offering will stimulate them to increase the effectiveness

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[1] Chaker Atallah, op.cit, p. 13.

[2] Ziad Ramadan & Marwan Shmout, op.cit, p. 10.

of the use of resources and increase the productivity of their human resources, with a view to increasing their market value and allowing them to obtain additional financing easily in the future.[1]

- Assisting in the implementation of monetary policies, financial markets allow central banks to implement their policies effectively. Open market operations, which are an important tool in the functioning of these banks, cannot be carried out with the required effectiveness in the absence of financial markets.[2] Most central banks use financial market indicators in their models to foresee activity and inflation rates in the future and to anticipate economic shocks, avoiding financial crises. Financial markets are preferred places to measure market expectations and reactions to monetary policies, allowing them to adjust these policies quickly.[3]
- Measuring companies' performance through the movement of equity prices and giving a fair assessment of their performance and real value.[4]
- Contributing to raising the level of financial awareness and sense of savings and investment among individuals and institutions, and improve the transparency of information about the performance of listed companies and the economy as a whole.
- Through economic openness and the development of media and communication, economies with financial markets have the opportunity to benefit from international finance by establishing international relations with various financial and business centers around the world.[5]

1.2. Types of financial markets

Multiple needs for investment opportunities and finance, as well as the urgent need to improve the efficiency of the overall economy, have prompted the emergence of different types of financial markets. We cannot address financial markets without shedding light on the different types of them, which can be divided according to many criteria.

1.2.1. Division according to the securities dealt with: This includes:

- **Money Market**: This market offers short-term credit instruments with a maturity of less than a year. It is characterized by a low degree of risk as it offers the

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[1] Panicos o.demetriades, op.cit, p. 12.

[2] Paul Mylonas and Sebastian Schich, ***The Use of Financial Markets Indicators by Monetary Authorities,*** OECD publishing , working paper N°223, 1999, p. 13.

[3] Mohamed Kamal Abu Amcha, ***The Importance of Developing Financial Markets in Member States of the Cooperation Council of the Gulf***, op.cit, p. 141.

[4] Nazhan Mohamed Su, ***Securities Markets in the Wake of the Current Global Economic Crisis***, Damascus university journal for the economic and legal sciences, Vol 26, N°02, 2010, p. 658.

[5] Mohamed Kamal Abu Amcha, ***The Importance of Developing Financial Markets in Member States of the Cooperation Council of the Gulf***, op.cit, p. 141.

possibility to liquidate the assets without high costs. In the money market, liquidity and flexibility are high due to the short investment period and low levels of both money risk (the likelihood of a sudden and sharp decline in securities prices) and credit risk (the likelihood of the debtor's inability to pay). In turn, money markets are divided into three main types:

- ✓ **Open markets:** Central banks rely on these markets to manage their monetary policy.
- ✓ **Discount markets**: These markets are primarily designed for dealing with discountable securities, the central bank charges banks a discount rate for these securities.
- ✓ **On-demand money markets**: These markets bring together commercial and specialized banks willing to lend and borrow in between for a short time and in various currencies.

- **Capital market**: Financial transactions are carried out in this market on medium- and long-term financial assets (instruments) with maturities exceed a year. Capital market is of the utmost importance in view of its advantages for both parties in financial transactions (seller and buyer). It allows for the creation of suitable canals for the investment of funds and the gaining of rewarding returns, ultimately in the interest of the national economy, as well as for the seller and buyer to obtain the real value of the securities. Managers of capital markets are constantly working to achieve liquidity for the invested funds at any time and in any form (shares, bonds, and others) with ease.[1]

1.2.2. Division according to issue type: This includes:

- **Primary market (initial issues market or subscription):** This market deals with new securities that are put up for subscription (before being traded). Companies and governments seeking to finance their investment operations rely on this market to introduce new issues of securities. In order to ensure the success of the issuance process, companies must take certain conditions into account when choosing the appropriate size of the issuance, the timing of the issuance, the type of security, as well as the methods of issuing and marketing the new issuance. In this regard, there are three ways in which issuers can manage their securities:

- ✓ **Resorting to an investment bank[2] as a broker**: it provides advice to the issuer company. The investment bank engages in issuing and marketing the company's securities, starting with all the operational procedures for issuing the paper, such as contacting the competent market management committee, through the

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[1] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 16.

[2] An investment bank is a specialized financial institution, most notably Merril Lynch, First Boston Corporation, Morgan Stanley, and the Salomon Brothers.

pledge to make efforts to dispose of a minimum amount to be issued and to reach the possibility of covering the issue for subsequent resale to the public. In order to choose the optimal investment bank, companies can negotiate directly with a group of specialized banks or resort to the bidding method by launching a competition between banks to choose the best offer (competitive bidding). The selected bank charges the company a commission based on a contract.

✓ **Direct interaction**: Companies willing to issue new securities can contact major investors directly in the form of major financial institutions to convince them to purchase all the exported quantities.

✓ **Auctions**: Companies can call investors for a bid to offer the price and quantity of securities they are willing to purchase. The priority is given to the best price and then the lowest.[1]

- **The secondary market (trading market or stock exchange):** The secondary market is the market where securities can be exchanged from one party to another in specific places called trading floors that deal with securities previously issued in the first market. In this market, there are major motives that persuade investors to come. The first motive is liquidity, which drives investors to employ excess liquidity they hold by purchasing securities and then selling them in case of a liquidity shortage. The second motive is information. By using the information available to the investors about certain securities that they believe are exclusive (not available to other investors), they can make extraordinary profits or avoid losses.[2]

1.2.3. Division according to market transaction regulation: This includes:

- **Organized markets:** These markets are subject to supervision by a higher authority (the market authority). The latter is charged with the management of trading operations and ensures that they conform to the regulations governing fair competition, preventing any fraud that has adversely affected the rights of traders and the market's reputation, and thus their ability to perform their economic functions.[3] Therefore, most legislation and laws stipulate that the organized markets must possess a set of conditions that are characteristic of them, such as the existence of conditions for the trading of securities, providing a specific place where trades take place (the stock exchange hall), setting working times, and the presence of

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[1] Munir Ibrahim Hindi, ***Securities and Capital Markets, Securities and Capital Markets***, Monchaat Al Maaref, Egypt, 1999, p. 92.

[2] Ziad Ramadan & Marwan Shmout, op.cit, p. 88.

[3] Issam Abdelghani Ali, ***Principles of Finance, Facilities Management, and Financial Markets***, Nas Law Company, Egypt, 2004, p. 351.

intermediaries who are responsible for carrying out trades and are subject to the terms and laws of the exchange.[1]

- **Unorganized markets:** They are called over-the-counter markets or parallel markets. In these markets, unrestricted securities in organized markets are traded in short selling, mostly bonds, because they cannot meet the conditions of listing in organized markets. Therefore, transactions take place outside the stock exchange (inside and outside the country), relying on a modern and fast communications network connecting investors, financial intermediaries, and traders who hold quantities of such securities, so there is no specific place to conduct them or specific rules that frame operations.[2] The unorganized markets provide important services to their customers and largely ensure the marketing of new issuances of securities due to the simplicity of the procedures. Their large liquidity offers the possibility for the securities to be liquidated very quickly and in any quantity, and in this way, they outperform the organized markets. Unorganized markets have two main types:

- **Third market**: This is an unorganized market in which transactions are done on securities restricted in organized markets. The third market arose to remedy the shortcomings of organized markets as it allows large investment companies such as pension funds and mutual funds to benefit from rewarding commissions in the form of deductions on commissions, unlike organized markets, and allows large operations to be carried out at the required speed.

- **Forth market**: This market links large companies and wealthy individuals. The role of the broker in this market is very limited, as it is limited to connecting the parties directly, so its commission has come down. The fourth market has come to respond to the need of those companies to execute deals in large volumes and at a low cost.[3]

1.2.4. Division according to the time of execution of transactions: This includes:

- **Spot markets**: In these markets, the transaction is liquidated directly; the sellers receive the price of the securities from the buyers immediately after the latter deliver the securities.

- **Forward markets**: Unlike the spot markets, transactions in forward markets are liquidated later, thus postponing the delivery and payment of securities to a later date to be agreed upon between the transaction parties. In order to ensure the execution of the transaction, financial market authorities require the traders in

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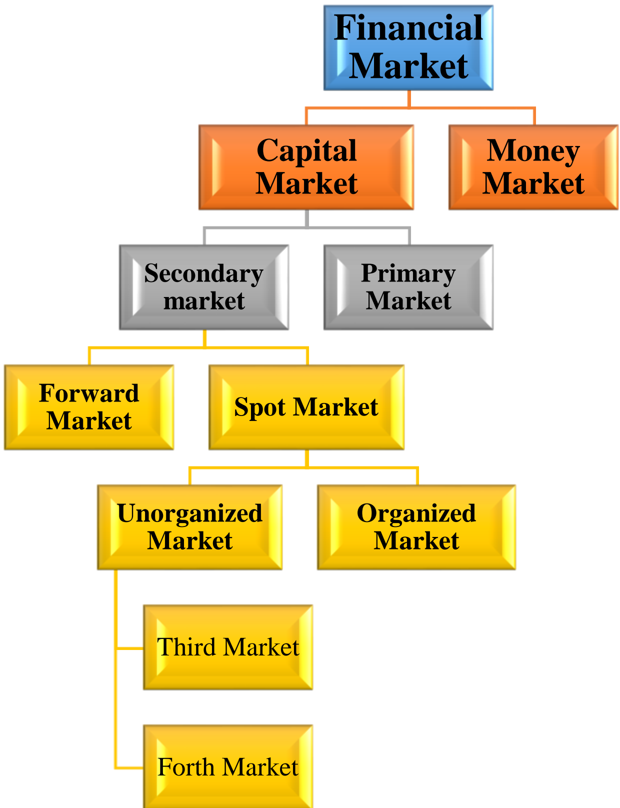
[1] Ziad Ramadan & Marwan Shmout, op.cit, p. 16.

[2] Munir Ibrahim Hindi, ***Securities and Capital Markets, Securities and Capital Markets***, op.cit, p. 106.

[3] Ziad Ramadan & Marwan Shmout, op.cit, p. 93.

forward markets to pay an insurance amount as coverage, depending on the type of transaction.[1] Most financial systems have created forward markets as a hedging method that gives buyers and sellers a cover to reduce the risk of future price changes that cause losses to their savings and investments. In this regard, derivatives are the most prominent financial instruments in the forward markets.[2] The following figure demonstrates the structure of the financial market in its various markets.

Figure 05: Financial Market Structure



Source: the Author's preparation

2. Conditions of operation of the financial market and types of financial instruments traded

To ensure the well-functioning of financial markets and the trading of financial instruments, financial market authorities set several conditions. In the following, we

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[1] Salah al-Din Hassan El-Sissi, ***Theoretical and Applied Studies: Arab and International Securities Exchanges and Establishment of the UAE Stock Exchange***, First Edition, Dar El Wissam, Lebanon, 1998, p. 15.

[2] Ziad Ramadan & Marwan Shmout, op.cit, p. 19.

shed light on these conditions and the prominent instruments traded in financial markets.

2.1. Conditions of operation of the financial market

To enable financial markets to perform their mandated functions, they must meet conditions and criteria that determine their value and efficiency, notably:

- **Openness and transparency**: To alleviate the asymmetric information problem that negatively affects the efficiency of the market, market authorities are charged with the responsibility of periodically publishing market-related data and information, including restricted and traded securities, indices, and their prices, to all market parties without exception or discrimination. Stock exchanges are required to provide a monthly publication in more than one language through many means of publication. One of the methods recommended by international bodies to improve corporate transparency and performance is governance, defined by the Organization for Economic Cooperation and Development (OECD) as the set of relationships between the company's managers, the board of directors, and shareholders. Therefore, governance aims at establishing control over the work of corporate management in order to prevent any action that harms the interests of shareholders and then damages the reputation of the financial market in which the company is listed.
- **Liquidity**: Managers of financial markets are required to work to permanently provide liquidity in the market, enabling traders to perform transactions to sell and buy securities quickly and without high costs.
- **Low cost of exchanges and mediation**: It is seen as one of the most attractive factors for traders to sell and buy different securities, which then contributes to increasing liquidity in financial markets.
- **Market depth**: Market depth increases as a large number of sellers and buyers are permanently and continuously available at prices that may exceed or fall short of current prices.
- **Market flexibility**: Securities must be tradable and flexible enough to facilitate a smooth transfer of ownership from one party to another.
- **Free and fair competition**: They enable securities to reach real prices and balance the market.[1]
- **Diversity and abundance of financial instruments**: To achieve the efficiency desired, market authorities need to work to provide the traders with diverse securities

[1] Mohamed Kamal Abu Amcha, ***The Importance of Developing Financial Markets in Member States of the Cooperation Council of the Gulf***, op.cit, p. 143.

in nature, terms, and prices in permanent abundance to avoid a shortage of securities that leads to unreasonable increases in prices, which harm the sustainability of financial markets and affect their capabilities to function efficiently.

- **Financial market efficiency**: Efficiency, especially operational efficiency, is the ultimate goal that market authorities work to achieve; it is the principal way to bring prices closer to real prices and then avoid exacerbate the asymmetric information problem.
- **Protecting investors' rights**: Preserving the rights of investors is among the responsibilities of market authorities that are required to improve the methods of disclosure and publication of information and deter any fraud in markets. So, they contribute to providing sound securities and reducing the risk of investing in the financial market.
- **Internal and external promotion of the financial market**: Among the missions of market authorities is to promote markets in the country where the market is active and abroad, which can attract more investors and surely increase market liquidity.[1]
- **Availability of sophisticated and diversified banks and non-bank financial institutions**: It is crucial to have sophisticated and diversified banks and non-banking institutions in financial markets due to their role in collecting savings and investing them in the financial market, which helps to achieve a balance in the market between supply of securities and demand for them.
- **The existence of active brokers and dealers:** Having many active financial intermediaries, including dealers and brokers, is essential for the market to operate since they connect sellers and buyers.
- **Economic freedom**: Market authorities must provide economic freedom by authorizing trading in securities at any amount.
- **Fast performance**: Brokers are required to execute their client's orders (delivery or receipt of securities at agreed prices) within a short time and compensate clients with other securities.
- **Availability of adequate experts**: To perform well without any serious deviations, financial markets must have adequate experts who can manage trading and transactions within the markets.
- **Acquiring fast and modern communications network**: A fast and modern communications network is crucial to improving the performance of financial

[1] Mohamed Kamal Abu Amcha, ***Investing in Gulf Capital Markets and Their Role in Attracting Foreign Investments***, op.cit, p. 82.

markets since this network connects various financial markets, ensuring a fast and accurate flow of information.

- **Enabling investors to get a suitable return on their investments:** To improve the attraction of financial markets, which is the only way to increase market liquidity, market authorities must work to enable investors to gain an encouraging return on their investments, by setting a minimum price for securities that they should not exceed while activating a catalytic tax system.
- **Opening the opportunity for small savers and investors to access and take advantage of the financial market:** To improve liquidity by attracting more savers, market authorities are called upon to encourage the issuance of shares and bonds with nominal values commensurate with their potential. Thereby, these efforts will increase the popularity and liquidity of the market, supporting its ability to attract savings and financial investments.
- **Openness**: To deal with globalization and financial liberalization, financial market authorities are required to open the market to foreign companies that operate in the domestic market but have their headquarters abroad, opening up broad prospects for communication and interaction between domestic and foreign markets and then attracting more liquidity.
- **Modern infrastructure**: To improve the competitiveness of the financial market with other markets in attracting liquidity, market authorities are required to modernize the market infrastructure in terms of systems, procedures, institutions, and committees that facilitate the execution of transactions, the transfer of ownership of assets, and the settlement of the resulting payments.

The above requirements cannot serve their purpose in the absence of a stable economic and political environment that encourages the attraction and stability of domestic and foreign investments and, in addition to the availability of a legal and regulatory framework framing the functioning of the market and the relations between its parties in order to safeguard their interests, taking into account the flexibility and alignment of innovations in financial instruments and domestic and foreign economic developments.[1]

2.2. Instruments traded in the financial markets

To respond to the development of economic life, many instruments have been invented and introduced in financial markets to satisfy the needs of all parties in the market. The most prominent instruments are:

[1] Mohamed Kamal Abu Amcha, ***The Importance of Developing Financial Markets in Member States of the Cooperation Council of the Gulf***, op.cit, p. 143.

2.2.1. Instruments traded in money markets: Money markets include many instruments traded whose maturity does not exceed a year, which are:

- **Negotiable certificates of deposit (CDs):** CDs are the most important and famous security traded in the money market. Commercial banks release CDs into circulation for sale to their depositors for annual interest to attract additional funds and raise their liquidity volume.[1] CDs are issued in different values and with different maturities of less than one year for the bank to keep the deposit for a certain period. CDs offer the investor in them (the deposit holder) attractive benefits such as a higher interest rate than the interest of savings accounts and the opportunity to obtain liquidity before maturity by selling them in secondary markets (including banks, investors, and brokers who deal with them), in addition to their guarantee from the central bank.[2]

- **Commercial papers:** They are such fixed-income investment instruments, usually issued by major banks and reputable companies with discounts like treasury bills, and are only guaranteed by the issuing company's reputation.[3] The value of commercial papers has grown steadily in the United States since the 1970s, surpassing 3000% in 1970–1999, as financial intermediaries and companies are among the largest holders of commercial papers.[4]

- **Treasury bills:** Treasury bills are a government debt instrument that is subject to subscription in order to balance its public finances, with periods ranging from three months to one year. As government banks, central banks, on behalf of their governments, offer treasury bills for sale (issuance) at discounted prices in auctions that may be electronic. Companies, governments, and financial institutions are among the most prominent investors in Treasury bills because they are highly liquid and without the risk of default.[5]

- **Private short-term bonds**: These bonds are considered a short-term financing tool traded in the monetary market. These bonds are issued by private companies and corporations and have a higher degree of default risk relative to government bonds. These bonds are issued at relatively high interest rates.[6]

- **Banker's acceptances**: Banker's acceptances emerged in the context of traders' international trade transactions hundreds of years ago. They are negotiable bank withdrawals, issued by companies and individuals and guaranteed by banks at

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[1] Frederic S.Mishkin, op.cit, p. 26.

[2] Aouadi Naceur, ***Les marches de capitaux en Tunisie,*** Editions C.L.E, Tunisie, 2002, p. 59.

[3]Ziad Ramadan & Marwan Shmout, op.cit, p. 55.

[4] Frederic S.Mishkin, op.cit, p. 26.

[5] AouadiNaceur, op.cit, p. 63.

[6] Chaker Atallah, op.cit, p. 133.

the stamp of "accepted", under which they undertake to pay a specified amount at a given date if the original issuer fails to meet its obligations within the agreed deadlines. Banker’s acceptances address the lack of liquidity among individuals and institutions, and thanks to the strength and good reputation of banks, banker’s acceptances are widely accepted by traders to settle transactions between them without the need to transfer funds. They can also be kept and receive their nominal value when the due date comes, or put up for sale on the secondary market at a discount, which is similar to treasury bills.

- **Repurchase Agreements (Repo agreements):** Repo agreements are considered short-term loans (usually with a maturity period of less than two weeks), in which treasury bills are a guarantee that the lender is entitled to acquire in the case of the borrower's default.[1] Repo agreements include the sale by the borrower (mostly banks) of a quantity of treasury bills to the lending buyer (mostly companies), with the undertaking to buy them back at a later date at a price higher than the sale price. Because of their effectiveness, central banks usually use these agreements to adjust interest rates and provide liquidity in the market, or vice versa.[2]

- **Federal Funds**: Central banks have introduced a one-night interbank lending and borrowing market to help banks meet their obligations regarding the reserve limits to be deposited with them (required reserve), so banks borrow from other banks using an electronic money transfer system between operating banks. This market is a strong indicator of the state (situation) of the banking system in the country; its high interest rates indicate the need for large banks to borrow to meet financing needs, and on the contrary, lower prices indicate a decline in banks' need for funds as a result of reduced economic activity.[3]

- **Short-term bills:** these bills are a negotiable short-term credit tool whereby a person (the editor) undertakes to pay back the amount borrowed with interest at a particular date to the bank, which he may hold or sell to a third party (the undertaking holder) at a particular discount.

- **Eurodollars:** Given the position of dollar in international transactions and its relative stability, banks outside the United States and foreign banks active in the United States have attempted to attract this currency by allowing their clients to open dollar deposit accounts on which they pay interest and are obliged to refund them when they are due in the same currency. U.S. banks have also often resorted to borrowing dollars from other banks or their offshore branches to finance their

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[1] Frederic S.Mishkin, op.cit, p. 27.

[2] Issam Abdelghani Ali, op.cit, p. 298.

[3] Frederic S.Mishkin, op.cit, p. 27.

lending activities,[1] trading in the currency market both inside and outside the U.S. market.

- **Short-term Eurobonds**: These bonds are issued in the form of a negotiable bearer's bond for a period of one week to one year.[2]

2.2.2. Instruments traded in the capital markets: Capital markets include instruments with maturities exceeding a year; these instruments are:

- **Long-term Bonds**: Long-term bonds are a contractual agreement between two parties for a fixed period of more than one year, with the first borrower paying the second lender interest for the duration of the contract period, ending with the depreciation of the bond at the end of the period. The holder (lender) may receive periodic interest for the duration of the bond's life plus the nominal value (original value) on the last day of the bond, or may receive fixed and periodic installments including interest and part of the nominal value of the bond. The holder of a bond may also get equal shares of the bond's asset and not interest that is concessional during the bond period. Bonds are divided into several types and on different grounds, including:

✓ **Government bonds (sold at a discount) and corporate bonds**: Government bonds are a type of sovereign bond. Government bonds usually have medium or long maturities, ranging from a few years to several contracts. The government issues these bonds to finance economic development operations or to meet a budget deficit or other emergency. Issuance is done either by direct public offering (DPO), offering on the stock exchange, or using banks to sell it. These bonds are free of risk because of the government's ability to meet its obligations. Low interest rates are awarded on this type of bond because of their low risk since the government undertakes to pay the value of the bonds and the interest due. These bonds enjoy a high degree of liquidity while being exempt from taxes. They also vary into various types of state bonds that are issued to finance public expenditure or bonds of international bodies such as the International Bank for Reconstruction and Development, which it issues to finance its projects. Then there are bonds that public institutions export to finance their expenses and projects, and they vary according to the type and nature of the enterprise. Corporate bonds are issued by financial institutions, shareholding companies (joint-stock companies) operating in the private sector, or commercial, industrial, and service companies to finance their projects, and they are mostly guaranteed. Corporates issue bonds at higher interest

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[1] Mahmoud Younes & Kamel Amine El-Wassal, op.cit, p. 91.

[2] Ziad Ramadan & Marwan Shmout, op.cit, p. 57.

rates, but it is more exposed to the risks of the issuers' inability to meet the debt and its annual interest.[1]

✓ **Bearer bonds and nominal bonds**: A bearer bond is a fixed-income security that is owned by the holder, or bearer, rather than by a registered owner. Bearer bonds are offered with coupons for interest payments that are physically attached to the security. The bondholder is required to submit the coupons to a bank for payment and then redeem the physical certificate when the bond reaches the maturity date. For example, when the bond is stolen, the bondholder is the owner of the bond can obtain its value or interest.[2] Nominal bond also referred to as a conventional bond in some countries like Canada and the U.K. makes payments of a fixed amount, rather than a fixed real (inflation-adjusted) value. Most bonds are nominal.[3]

✓ **Secured bonds and unsecured bonds**: Secured bonds are guaranteed by the mortgage of some of the issuing company's assets or securities of another company, or even by an external body, and unsecured bonds. Secured bond gives the holder the right to claim the specific guarantee when the issuing company is unable to satisfy the nominal value of the bond and its interests or when the company is liquidated. Theoretically: bondholders can dispose of these assets and fulfill their rights (1) If the sale value of these assets is greater than their debts, they meet their rights and pay the rest to the company, or (2) If the value derived from the sale is lower, the bondholders become ordinary creditors in the amount of the remaining amount. Secured bond differ from unsecured ones, the latter are bonds without any mortgage to their owner other than the pledge and obligation of the issuer to pay. Unsecured bonds are called ordinary bonds; the actual guarantees of these bonds are the total assets of the issuer and its financial position (its ability to meet its obligations to its creditors).

✓ **Callable bonds and non-callable bonds**: The issuing company of the callable bond has the right to recover its bond before the expiration of the bond period. These bonds are usually issued with a recall premium, and the bondholder receive the band value in addition to all interest due. Conversely, the issuer of the bonds cannot claim the bonds back before the date of their postponement, as these bonds constitute the majority of the bonds issued and traded in the markets.

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[1] Ziad Ramadan & Marwan Shmout, op.cit, p. 112.

[2] James Chen,***Bearer Bond: Definition, How It Works, and Why They're Valuable***, 20/07/2021, Consulted on 18/07/2023 at https://www.investopedia.com/terms/b/bearer_bond.asp

[3] Akhilesh Ganti, ***Nominal Value: What It Means, Formulas for Calculating It***, 19/05/2023, Consulted on 10/08/2023 at https://www.investopedia.com/terms/n/nominalvalue.asp

✓ **Convertible bonds and non-convertible bonds**: Convertible bonds give their holder or issuer the right to convert the bond into shares. Bonds are converted into ordinary shares either at a fixed rate, where they are normally issued at an interest rate lower than the interest rate on non-convertible bonds, or the share price is calculated through its market value and gives the investor a number of shares corresponding to the value and interest of the bond at the time of the transfer, which can be converted into shares of the company itself or of a second company in which the issuer has a share.

Convertible bonds are the most popular type of bond that investors are interested in because they explicitly state that the bondholder can convert the value of the bond and its returns into ordinary shares in the issuing company. The owner of the bond, when he notes that the profits earned by shareholders are much higher than the nominal annual interest, can ask the issuer to transfer his bond to a stock. Convertible bonds provide different advantages to all parties (issuer, investor, and broker) in the financial market. The issuer, investor, and broker can get the money they need at a relatively low cost because the interest rates on convertible bonds are lower than the interest rates on ordinary bonds. This advantage benefits companies that are at the beginning of their operating life, i.e., in what is known as the growth phase. On the other hand, the issuance of convertible bonds by companies will avoid the risk of the impact of dumping. As for the investor, it gives him the opportunity to obtain capital gains resulting from the expected increase in the market value of the share over the transfer price and protects him from capital losses due to the security provided by the bond to the investor. That is, no matter how low the market value of the common share, the acquisition of the convertible bond guarantees him at least the opportunity to obtain the interest rate of the bond, which is the same market rate as a common bond without the condition of convertibility. The advantages of convertible bonds for the intermediary offer opportunities for all intermediaries to do a great deal of trading in ownership, which is achieved because of the low margin required for speculation in the financial market, which is usually less than the margin required for speculation in equities, thus providing them with the opportunity to achieve significant capital gains by dealing with them in the secondary market. Conversely, non-convertible bonds are the most common form of lending bonds; originally, the bonds are non-convertible, although given a special advantage, they are convertible.

✓ **Fixed-rate bonds and floating-rate bonds:** The rate of interest granted on the fixed-rate bond is fixed and consistent over the length of the bond, and this type of bond is usually invested in and purchased due to the bond's resistance to

changes in interest rates and inflation during the period. On the contrary, the interest rate on floating-rate bonds is changed based on interest rates on interbank loans for a given country, for example, or on another indicator, especially inflation, and the interest rate is usually adjusted on a monthly basis or on a quarterly or annual basis.

- ✓ **International bonds**: These bonds are issued in different currencies for acquiring foreign currencies.[1]
- ✓ **Perpetual bonds**: These bonds are issued with no maturity dates; buyers who purchase this type of bond receive interest all the time, whether on a semi-annual, annual, or as specified in the bond.[2]
- ✓ **Zero Coupon Bonds and coupon bonds**: Among the most prominent of zero coupon bonds are U.S. treasury bills that are offered for sale at a value below the nominal value, the holder shall recover the nominal value only upon maturity. So, zero coupon bonds don't pay interest for lending money, but issue a discount on the bond's face value. On the contrary, coupon bonds are Bearer's bonds that are accompanied by with vouchers (coupons) used to claim interest.
- ✓ **Income bonds**: These bonds link the holder's interest to the condition that the issuing enterprise makes a profit, so the bondholder cannot claim interest in years when the issuing company does not earn a profit. In other words, income bonds guarantee the investor's (the bondholder's) interest only in the case of yields, and income bonds are not offered for sale as new financing, but their issuance takes place at the official restoration of the exchange of securities. However, some prospectus may allow the bondholders to earn profits despite the lack of profits, as the interest distributed is deducted from the dividend of subsequent years.
- ✓ **Junk bonds (high-yield bonds) and investment grade bonds**: These bonds are famous for the high risk they contain, making them low-quality bonds. They have been created to finance board members' ownership of a large share in the capital of the company by issuing bonds that use their proceeds to buy a large part of their traded shares in the market. However, this procedure would result in a significant increase in the proportion of money borrowed to money owned; making investment risky that would require a high coupon rate to offset those risks. Therefore, these bonds called high interest rate bonds, high interest is awarded on these bonds due to the client's higher risk of investing in this type of bond, such as default risks, etc.[3] Unlike junk bonds, investment grade bonds have low interest rates. This type of bond is issued by entities with a high credit rating present a

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[1]Ziad Ramadan & Marwan Shmout, op.cit, p. 112.

[2] Frederic S.Mishkin, op.cit, p. 74.

[3] Munir Ibrahim Hindi, ***Financial Management,*** fourth Edition, Modern Arab Center, Egypt, 1999, p. 557.

relatively low risk due to the liquidity or profits earned annually and the company's ability to pay the value of the bond and the interest resulting therefrom. Individuals who want to buy this type of bond bear low risks.[1]

✓ **Participating bonds**: These bonds are hybrid bonds that have some equity qualities, allowing the holder to earn an additional profit if the exporting company makes a profit.[2]

✓ **Electronic bonds**: unlike other bonds, electronic bonds are intangible bonds offered, traded, and registered electronically.[3]

✓ **War bonds**: Bonds issued by government agencies in order to finance the military sector in equipment, salaries, and materials needed in cases of war.[4]

✓ **Climate bonds (green bonds)**: They are bonds launched by the official authority authorized by the government to deal with volatile climate situations in the country or to finance projects that reduce carbon emissions or alleviate the effects of climate change. When the state faces changes in climate and adverse conditions, the agency is financed to deal with climate change through this type of bond.[5]

✓ **Serial bonds:** This type of bond is based on a clear sequence of repayment of the asset over fixed periods of time before the expiration of the bond period, so as to reduce the bond's value to zero at the last payment.[6]

✓ **Extendable bonds:** They are Another type of bond gives the buyer the right to extend the bond's term when the maturity period is exceeded or before it is exceeded.[7]

✓ **Traditional bonds and subordinated bonds:** The nominal value of the traditional bond shall be paid in a single payment at the expiration of the term of the bond, and interest shall be paid on periods prior to its expiration. Interest shall normally be paid on semi-annual or annual periods.[8] Subsidiary bonds possess a

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[1] ***Investment-grade Bond (or High-grade Bond)***, 2023, Consulted on 10/07/2023 at https://www.investor.gov/introduction-investing/investing-basics/glossary/investment-grade-bond-or-high-grade-bond

[2] Chaker Atallah, op.cit, p. 144.

[3] Issam Abdelghani Ali, op.cit, p. 194.

[4] Andrew Ancheta, ***War Bonds***, 27/03/2022, Consulted on 15/07/2023 at https://www.investopedia.com/terms/w/warbonds.asp

[5] ***Understanding Climate Bonds***, 2023, Consulted on 15/07/2023 at https://www.climatebonds.net/resources/understanding

[6] James Chen, ***Serial Bond: What it is, How it Works, Example***, 29/04/2022, Consulted on 15/07/2023 at https://www.investopedia.com/terms/s/serialbond.asp

[7] James Chen, ***Extendable Bond Definition***, 30/03/2023, Consulted on 15/07/2023 at https://www.investopedia.com/terms/e/extendablebond.asp

[8] LCX Team, ***Tokenized Bonds vs Traditional Bonds***, 20/02/2023, Consulted on 15/07/2023 at https://www.lcx.com/tokenized-bonds-vs-traditional-

lower priority in repayment than other bonds to be paid to the issuer and are different from ordinary bonds in the event of the issuer's bankruptcy, where the bonds are paid to the holders of ordinary bonds first, followed by the payment of the holder of subordinated bonds through the remaining amount, which are bonds at high interest rates because they contain high risks.[1]

- **Stocks (shares)**: Shares are participating security, giving the holder the right to receive a share of assets and realized profits. The shares are divided into ordinary and preferred, which in turn are divided into several forms of shares, the most famous of which are:

✓ **Ordinary shares**: These shares constitute the largest category of shares issued whose holders have the right to participate in the profits of the company after paying the dividend but before paying the deferred dividend.

✓ **Preferred shares**: These shares enjoy certain privileges in voting, profits, liquidation products, or other rights, provided that shares of the same type are equal in rights and privileges. The preferred share differs from ordinary one in that it enables the shareholder to concede a fixed return before making any dividend received by the holders of the common stock. In the event that the company does not make a profit covering the amount of dividend the holder must receive, the right does not fall but may be deferred.[2]

✓ **Nominal shares**: These shares are registered in the name of their owners in the issuing company records and requires that the name of the new owners be re-registered in the event of any transfer of ownership.

✓ **Bearer shares**: The ownership of these shares is transferred once they are required, so the holder of this type of share shall not be entitled to vote in public associations.

✓ **Order shares (promissory notes)**: This type of shares resembles ordinary shares in that the name of its owner is mentioned on the instrument, but the transfer of its ownership depends on its mere manifestation and does not require its return to the company; it is accompanied by the requirement of permission or order.[3]

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bonds/#:~:text=Traditional%20bonds%20are%20debt%20securities,investors%20at%20a%20fixed%20rate.

[1] Konstantine Vasilev, ***Subordinated Bond***, 06/08/ 2023, Consulted on 15/07/2023 at https://cbonds.com/glossary/subordinated-bond/

[2] Real Business Rescue, ***Understanding Preference and Ordinary Shares***, 2023, Consulted on 18/07/2023, at http://bitly.ws/Sob9

[3] Ziad Ramadan & Marwan Shmout, op.cit, p. 98.

✓ **Free shares**: These shares are distributed free of charge to shareholders in the company that uses them as a strategy to increase its capital, using profits that were held in the form of reserves.

✓ Shares listed on the stock exchange and unlisted shares.

✓ **Preferred blue shares of high quality**: These shares are of interest to investors seeking to build a low-risk financial portfolio, as they relate to large companies with excellent reputation that generate profits and distribute them continuously and regularly.

✓ **Buy-and-hold shares**: Investors accept the acquisition and long-term retention of these shares as part of their long-term strategy to generate rewarding returns because of the widespread belief that their exporting companies can achieve significant profits in the future.

✓ **Income shares**: They are the shares of large and long-standing companies active in important sectors such as industry and services and have a long tradition of distributing profits regularly, which attracts investors, especially older ones looking for regular income.

✓ **Speculative shares**: Investors use speculative shares to speculate to gain greater profits. Speculative stock is highly risky and traded at a relatively low price because its fundamentals do not look strong or have a sustainable business plan, yet the trader is optimistic that the share price will improve in the future.

✓ **Cyclical shares**: These shares are due to companies whose activity revenues are linked to a close relationship with the overall economic situation. The share prices rebounded during the economic boom and decline, one of the most prominent shares of automotive.

✓ **Growth shares**: They are the shares of emerging and modern companies active in promising sectors that supposedly possess significant opportunities for expansion and growth, reflected in their future market value and their expected distribution of significant profits.

✓ **Quality shares**: These shares belong to companies that are famous for having quality and distinct management, which creates security and guarantees for investments in their shares.

✓ **Value shares**: They are shares whose market prices are usually undervalued as a result of difficult conditions that the company suffers from, but they are expected to surpass and make significant profits in the future.[1]

✓ **Ordinary shares of the productive divisions**: These are shares whose distributions are linked to the activities of one of the productive divisions and the profits that they make. In the 1980s, the corporation GMC introduced several

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[1] Chaker Atallah, op.cit, p. 126.

innovative categories of stocks, each one associated with the dividend of a production department: the category E Class associated with the electronic information systems division and the class H Class associated with the aircraft parts division.

✓ **Ordinary shares with deductible distributions**: In order to alleviate the problem of Principal-Agent and encourage employees to participate in the ownership of their companies and expand the ownership base in them, some governments have introduced incentive legislation that exempts companies from interest taxes if they provide loans to their employees to finance the purchase of their shares. It also allows them to include dividends on shares in expenses deducted prior to tax calculation if they sell a share of their shares to their employees.

✓ **Blue-chip shares**: Unlike familiar shares, companies may issue shares that give their holder the right to obtain compensation from the issuing company if the market value falls to a certain extent within a period of time that is declared in the prospectus.

✓ **Preferred shares in which distributions are associated with the return on treasury bills and government bonds**: The issuing company of these shares links the dividends with the returns on treasury bills and government bonds. The companies issue thee shares to attract more investors seeking to own securities with stable real values, as treasury bills and government bonds enjoy great demand due to the absence of default risk. [1]

✓ **Defensive shares**: They are the shares of companies active in vital sectors that are not affected by business cycles or emergency conditions, such as essential goods and services companies, which gives them relatively better security and stability.[2]

✓ **Convertible shares into bonds**: These shares are corporate securities that allow their holders to choose to turn them into a certain number of bonds within an agreed period to benefit from the fixed income of bonds.[3]

✓ **Convertible preferred shares into ordinary shares:** These shares are corporate securities that the investor can have the option to turn into a certain number of ordinary shares of the same company after a predetermined time span or on a specific date.[4]

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[1] Munir Ibrahim Hindi, Financial Management, op.cit, p. 542.

[2] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 26.

[3] Chaker Atallah, op.cit, p. 146.

[4] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 84.

✓ **Callable shares**: These shares are shares belong to a company that can buy back. Callable shares may be issued in order to have the option of retaining tighter control over a business or to avoid paying interest on preferred stock.[1]

- **Investment certificate & voting trust certificate:** Investment and voting trust certificates are tradable securities that are usually offered at a nominal value equivalent to the share. These certificates are distributed free of charge to shareholders on the occasion of an existing stock fragmentation or to increase the company's capital. The owners of investment certificates are responsible for the same financial rights as shareholders, as a priority of subscription bonds and shares issuing (initial public offering IPO) and participating in profits and losses without participating in management. The owners of voting trust certificates are entitled to non-financial rights, such as voting on the company's decisions, participating in its management, and so on.[2]

- **Structured Finance:** Structured finance is one of the innovative financing methods (one of the instruments of financial engineering) that has become popular with financial and non-financial institutions in the money and capital markets. Structured finance enjoys great demand from financial institutions to dispense with traditional brokerage and overcome liquidity problems and traditional financing risks.

Structured finance includes a wide range of activities and products that have been included to attract appropriate funding according to the desires of clients of all forms of organizations while reducing risk through the use of complex techniques and structures. In structured finance, a range of highly diverse assets are assembled in terms of quality and nature (loans, bonds, mortgages, and rights issues). These assets, which are in most cases illiquid and can be structurally isolated in the interest of investors and lenders, form a capital structure in the form of tranches or segments based on the revenue flows generated from securing (collateral) assets against those collateral pools. Through this process, risks are identified, allocated, and hedged in new safe negotiable assets (products), which are therefore accepted by credit rating agencies so that they can use them as a base of financing independent from the risks of the asset originator's bankruptcy. The asset isolation process allows the asset creator (asset originator) to easily access the capital markets by creating returns on the debt issued at a lower cost and thereby reducing the cost of financing.

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[1] Accounting tools, ***Callable Stock Definition***, 10/03/2023, Consulted on 18/08/2023 at https://www.accountingtools.com/articles/what-is-callable-stock.html

[2] Aouadi Naceur, op.cit, p. 201.

Among the most prominent structured products are Asset-Backed Securities (ABS), Commercial Mortgage-Backed Securities (CMBS), Residential Mortgage-Backed Securities (RMBS), and Collateralized Debt Obligations (CDO). Thus, structured finance involves derivatives, securitization, and special-purpose entities independent and far from bankruptcy[1] that receive funds, secure receipts and payments produced, and entities transferring ownership[2] to avoid double taxation of entities performing the roles of borrowers or holders of loans, as well as the use of risk mitigation techniques. The issuer, which is a structured finance operating company (SFOC)[3], raises funds through the issuance of two categories of securities: bills of category I and bills of Category II after the purchase of securities, the issuer pledges to secure cash or future flows (returns) that come from the financial asset investment pool. This process generates increased liquidity for the issuer without increasing the capital base, either by selling these assets to a special purpose entity that subsequently issues debt bonds to investors in order to finance the purchase. It should be noted that structured finance differs from securitization in that the first is granted to a special purpose company that is secured by a series of contractual agreements from the principal counterparts (contractors, buyers, suppliers, speculators, and others), where their assets constitute a guarantee of improved stability of cash flows and mitigation of volatility, while securitized bonds are based on assets isolated from the instrument itself (a special purpose securitization

[1] Special-purpose entities are structured in a way that eliminates the incentive to initiate financial insolvency proceedings voluntarily, and it is unlikely that a third party of creditors will commence insolvency proceedings voluntarily. Sponsoring companies (referred to as guarantors, originators, sellers, or managers) are usually a large bank, finance company, investment bank, or insurance company, establishing these entities that take the form of a limited liability company or a joint liability company by contributing an asset or set of assets in exchange for monetary returns from the funding to be granted, while investors contribute to the remainder of the shares of the capital (assets), where the assets act as security and insurance. Thereby, the sponsoring company secures the debt of the entity for the particular purpose of the lender.

[2] Entities transferring ownership distribute their income to their owners or investors, thus requiring income taxes at the individual level of their owners or investors.

[3] Among the types of structured finance companies, there are: (1) Structured Investment Vehicles (SIVs) that issue structured financial assets The investor receives returns from: (1) Structured Lending Vehicles (SLVs), which differs from its precedent in that it purchases securities to enter into a repurchase agreement or total return exchange; (2) Financing Agreements where the affiliate investor pays a predetermined interest in exchange for returns; and (3) Credit Derivatives Product Companies (CDPCs), which sell credit protection on the names of one company or portfolio of companies as well as structured assets and issue equity and debt categories.

company), so that the source of repayment of the capital and interest is the pool of assets generating cash flows.

Structured finance offers several advantages to issuing company in terms of flexibility in the payment structure, securities design, and asset types to meet investors' needs, obtaining a better credit rating, reducing financing costs, and the possibility of converting liquid assets into illiquid ones, as well as transferring and allocating risks.[1]

- **Financial derivatives**: These innovative financial instruments are financial contracts relating to off-balance sheet items that have been devised to meet clients' needs in managing the risk of changing interest rates, prices, and exchange rates by hedging them. The derivatives first appeared in 1937 to meet the needs of merchandise market dealers when some sales contracts on the London Stock Exchange were contracted on Dutch mercury follicles. The first futures contract took place on the rice exchange in Osaka, Japan, in 1950. The Chicago Grain Exchange approved those contracts in 1965, and a clearing house was established in the same year.

Financial derivatives became popular and widespread in financial markets as early as the 1970s, so they became commonly used in financial markets for managing and hedging risks. Yet, developments in the use of these contracts revealed their misuse by directing them to speculate to take advantage of price spreads like stocks.[2] Derivatives contracts vary depending on their nature, risks, and duration and are valued at one or more assets, instruments, or financial indicators. They are a contract between the parties whereby the price of assets or indices is determined at the present time, with this fixed rate to be delivered at a later date.[3] Derivatives are divided into:

✓ **Options**: These derivatives are contractual agreements whereby the issuer of the option (the seller) grants the right rather than the obligation to the subscriber of the option (the buyer) to sell and purchase one or more financial instruments at a predetermined price (strike) at a future date. Financial options are divided into:

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[1] Omar Taleb, ***The Impact of Mortgage Debt Securitization on the Performance of the Secondary Real Estate Market - A Comparative Study of the Countries of North Africa-***, Ph.D diss in Economics, Biskra University, Algeria, 2014/2015, pp. 3-28.

[2] Anthony Saunders and Marcia Million Cornett, op.cit, p. 691.

[3] Issam Abdelghani Ali, op.cit, p. 299.

- **Call option**: This option gives the buyer who subscribes to it is right to exercise the contract if not.
- **Put option**: In this option, the seller of the option has the right to exercise the contract or not.

By combining call and put options, a variety of strategies can be achieved that can yield limitless profits, while the maximum risk volume remains limited to up to the price of the option contract paid for the purchase of the contract, which is called the premium (allowance). It should be noted that the U.S option gives the parties the freedom to exercise or cancel the contract before the time limits for its exercise are reached, whereas the European option does not allow this before the date of its exercise. In general, the buyer of the option at the time of writing pays the costs of coverage received by the seller of the option, representing a small proportion of the contract's value; this has allowed options markets to be the most developed in recent years. The option buyers always make gains even in the worst cases, If their expectations are not met, they remain under no obligation to perform the contract (which may be substantial in value) and incur losses, paying only for coverage costs.

✓ **Futures**: These derivatives are also known as futures contracts; they are contracts concluded between two parties, one with a long position and the other with a short position, through which the delivery and receipt of one or more financial assets are agreed at a specified time in the future at a price and conditions specified at the time of signing the contract. Unlike options contracts, futures contracts are an obligation to receive and deliver on the agreed date, so the execution of the contract requires the placement of purchase orders with a securities company active in futures markets, which passes the order to a stockbroker who executes the transaction with other brokers who are willing to sell futures contracts.

In order to maintain the attractiveness of the futures market and overcome the risk of substitution arising from defaulting due to the breach of obligations by the parties to the contract, either because of the bankruptcy of one of them or the desire of one of them to avoid the contract before it matures, the world's stock exchanges obliged all parties to pay a financial guarantee, which is a margin, to the clearance houses that register the contract. The margin includes a fixed portion of the amount if the contract paid when the contract is concluded. The margin includes a variable part required by the exchange commission to attitude adjustment (situation settlement) if the margin account falls to a certain extent.

✓ **Swaps**: Swaps are the most recent financial derivatives[1] and represent commitments (obligations) to exchange a range of cash flows. Swaps are undertaken to achieve certain objectives, including making profit and facing future commitments. Companies use swaps to benefit from the financial benefits of each other to reduce borrowing costs and gain an advantage. In this context, company may have the advantage of a good reputation or a good credit rating for bank borrowing at a relatively low interest rate, while other company devotes its direct borrowing advantage by offering bonds at a relatively low interest rate, so both can make better gains and agree to swap interest rates. The swap extends to other types such as currency, commodity, and equity swaps.

- **Investment certificates**: Mutual funds issue investment certificates against investment funds securities in the form of nominal investment certificates of one value.[2] In this regard, Investment certificates are investment products created to gather investors' capital and invest them collectively through a portfolio of financial instruments such as shares, bonds, and other securities. Therefore, Investment certificates are crucial as they facilitate the accumulation of personal savings, whether for major investments or for retirement. They are an important component of the financial market due to their role in making institutional and personal savings available as loans to companies and projects that contribute to growth and jobs.[3]

- **Foreign currencies**: Foreign exchange markets trade foreign currencies, and financial instruments denominated in different currencies are sold and purchased by individuals, companies, banks, and governments. Exchanges in this market are carried out by major commercial banks (financial brokers), which are linked to a global and sophisticated telecommunications network, mostly in major financial centers in London, New York, Tokyo, Singapore, Hong Kong, Frankfurt, and Zurich. Like other markets, investment in the foreign exchange market is affected by risk and return, and given the freedom in which these markets operate, government restrictions are usually unaffected.

- **Physical (tangible) assets**: Among the physical assets are such as real estate, where they are mortgaged as collateral to obtain a physical asset, such as loans, or are securitized in bonds backed by mortgage loans, where they create a debt used to finance investment in real estate. The mortgage market contributes to economic

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[1] The first swap took place in 1985 on the currency between MBI and the World Bank.

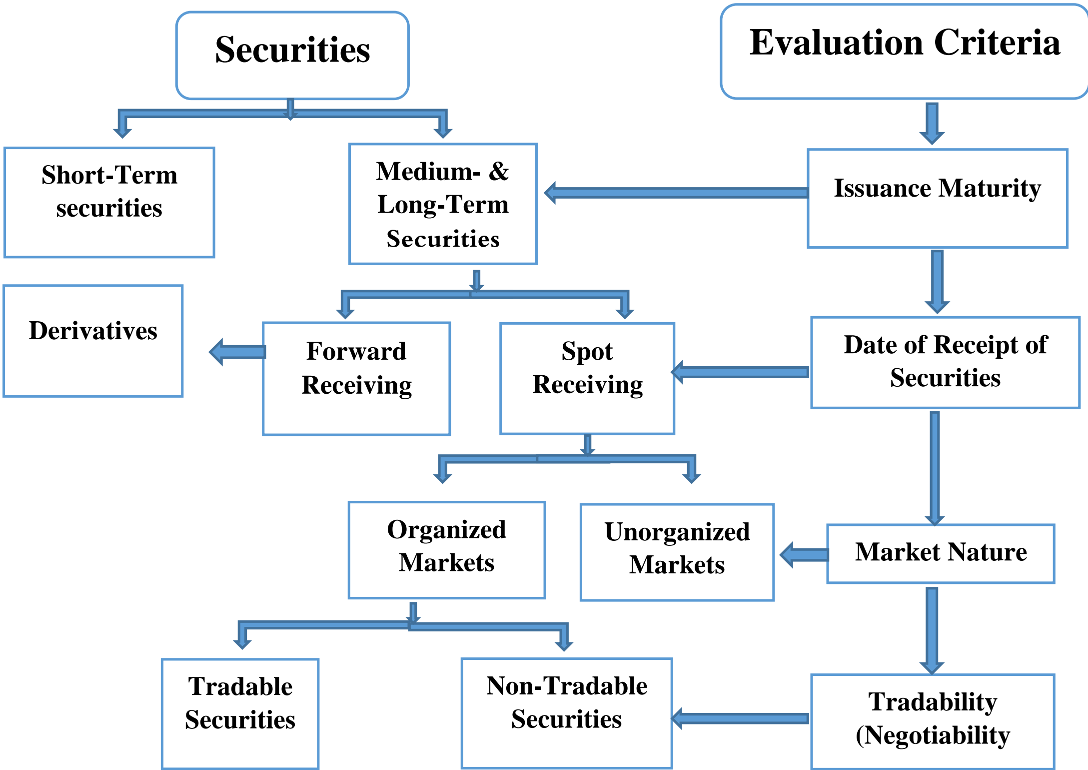
[2] Meir Cohen, ***Markets and Financial Institutions: Opportunities and Challenges***, Translated by Abdulhakam Ahmad Al-Khozami, Dar Al Fajr, Egypt, p. 324.

[3] European Commission, ***Investment Funds***, Consulted on 12/07/2023, at https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/financial-markets/investment-funds_en

growth, with mortgage markets financing the acquisition of households and businesses from homes and commercial properties.[1]

At last, we can list the securities types according to different valuations.

Figure 06: Types of Securities



Source: the author's preparation

3. Financial markets traders

Like other markets, many traders (agents) are active in the financial markets, operating to ensure the good functioning of the financial markets and reach the desired efficiency.

3.1. Types of traders

The traders operating in financial markets can be divided into several types:

3.1.1. Lending Investors: This category of traders includes individuals and institutions active in the financial sector (banks and non-depository financial institutions) and non-financial sectors, as well as governments and their agencies

[1] Omar Taleb, op.cit, pp. 138-140.

that have the desire to invest their savings in financial markets and obtain adequate returns sufficient to cover their obligations and make profits. Central banks also intervene as lenders to implement their monetary policy and influence the amount of money and interest rates.

3.1.2. Borrowing issuers: This category of traders includes individuals and institutions from all sectors and governments that suffer from a money deficit obstructing the financing of their projects, as well as central banks that need to achieve monetary policy goals by offering bonds to influence interest rates, the amount of money in circulation (money supply), and the inflation rate. In order to plug the deficit, borrowing issuers resort to issuing securities in the primary market that can be traded later in secondary markets.[1]

3.1.3. Market institutions: To ensure the security and clearance (settlement) of transactions, the financial markets authorities has established several institutions, including:

- **Supervisory institutions**: These crucial institutions are usually represented by the ministry of finance, which enacts laws and legislation to regulate the markets and ensure the proper functioning of the financial market.[2]
- **Regulatory and operational institutions:** The market committee is charged with managing and preserving the interests of the financial market and the traded instruments. The committee is responsible for monitoring the market and settlement and clearing houses, examining the operations of intermediaries, and imposing disciplinary sanctions on them in case of violation of the regulations and laws governing their profession and the market in order to safeguard the interests of investors and the economy as a whole. This committee is usually composed of representatives of intermediaries registered on the exchange and of the guardianship authorities (supervisory authorities), as well as expert people.[3] The market committee is assisted by operational institutions that set technical and administrative structures to establish the market, accelerate its operations, decide which securities and financial instruments are accepted to be listed and traded, record transactions and prices, disclose information, suspend trading, and ensure the application of laws and regulations.
- **Technical institutions:** These institutions, such as clearing and reconciliation companies, strive to ensure the completion of settlements and the delivery of securities and contracts, as well as the market operations guarantee fund, which, in

[1]Ziad Ramadan & Marwan Shmout, op.cit, p. 132.
[2] Chaker Atallah, op.cit, p. 38.
[3] Nazhan Mohamed Su, op.cit, p. 658.

the event of the inability of intermediaries to meet the payment or delivery, intervenes in a guarantee as a result of market operations.[1]

3.1.4. Financial intermediaries: Financial intermediaries are seen as the drivers of the financial market. In their absence, a lending investor cannot be linked to the borrowing issuer; therefore, financial surpluses are not channeled to finance the projects, which means that the financial market fails to perform its functions. A financial intermediary, who may be a natural or moral person, is required to be licensed by the market committee and is obliged to respect market laws and the committee's instructions and directives. Overall, financial intermediaries are divided into three categories:

- **Hall dealer**: The mission of the hall dealer is to execute specific orders from his/its clients to sell and buy securities for their benefit, charging them for this commission as determined by the market authority.
- **Dealer agent**: He/it is a person who works for a brokerage house that gives him/it orders to be executed.[2]
- **Market maker**: He/it is an exchange trader who has capital to use in the sale and purchase of securities for the benefit of his/its investment portfolio after obtaining a special license. Because he/it deals with great values, the maker can influence the market, move the prices, and make it happen.[3] Market makers are divided into:

✓ **Hall brokers (speculators):** They look like hall dealers but work for their own interests (self-employed) and do not carry out any operations for the public or other brokers.

✓ **Specialists**: They are financial intermediaries specializing in dealing in a particular type of security; they may be self-employed or work for other brokers.

✓ **Small order brokers**: They are traders who deal in small quantities of securities for sale and purchase on their own account, earning a commission representing the difference between the purchase price and the sale.

✓ **Large order brokers**: They are traders who deal in large quantities of securities on their own accounts in order to selling them to the requesting person.[4]

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[1] Chaker Atallah, op.cit, p. 42.
[2] Munir Ibrahim Hindi, Securities and Capital Markets, op.cit, p. 115.
[3] Ziad Ramadan & Marwan Shmout, op.cit, p. 138.
[4] Munir Ibrahim Hindi, Securities and Capital Markets, op.cit, p. 116.

- **Initial Issuances coverage underwriters:** The intermediary can underwrite new issuances of securities in exchange for a commission set out in the underwriting agreement, thus performing the role of the agent, who is responsible for marketing and connecting the public to the issuers of securities. However, the underwriter's role may be limited to selling and marketing publications without undertaking to underwrite them completely or in part.
- **Investment companies**: An intermediary can be an investment company if it has the necessary qualifications.[1] The investment company acts on its own account or on behalf of others (clients) in the building and management of a portfolio of securities. With respect to clients, investment companies, on the basis of a joint agreement, manage clients' investments, provide advice and counselling, and may go further beyond their role to act freely and make decisions to sell and buy securities without referring to the client for a commission paid by sellers, buyers, or both.[2]
- **Independent (autonomous) research institutions**: Although they do not engage in brokering or intermediation activities, independent research institutions contribute to stimulating the market by conducting, on request, studies and analyses of information in order to reach the best investment decision, especially since financial intermediaries are the category the most widely using information. Research institutions charge a commission from their service applicants, whether clients or brokerage houses, which in the United States is called hard or tough dollars. The following figure illustrates the various financing methods for which financial markets are available.

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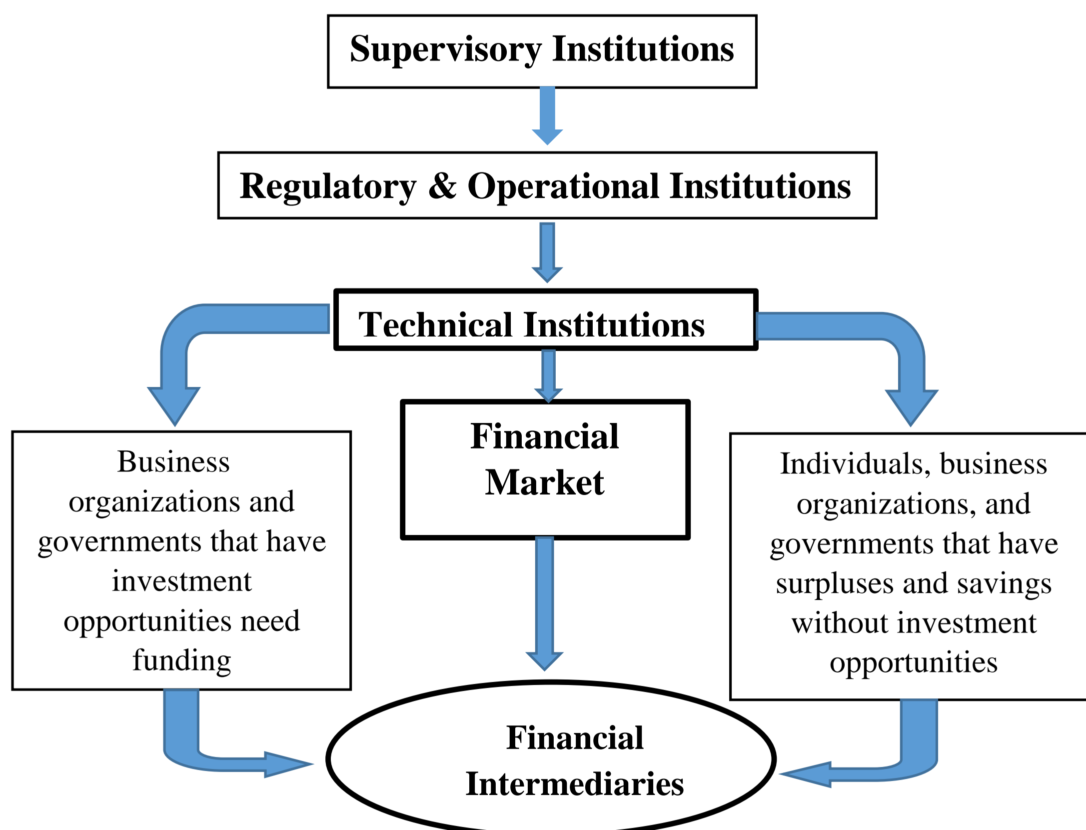
[1] Most local laws require investment companies to have financial resources represented in the capital, reserves, and other self-financing.

[2] Ziad Ramadan & Marwan Shmout, op.cit, p. 138.

Figure 07: Direct and Indirect Financing Methods in the Financial Market



Source: the author's preparation

3.2. Importance of financial intermediaries

Financial intermediaries have pivotal roles to play, as they are the engine of the markets, reflecting positively on the performance of financial markets, including:

- Increasing market efficiency by providing clients with up-to-date information and analysis on the assets listed or traded in the market.
- Rationalizing investment decisions, given their great experience, financial intermediary companies, along with their key work of selling and purchasing securities, advise their clients on optimal investment decisions and may manage their portfolios on their behalf.
- To maintain price stability and transaction volume, some intermediary, such as market makers, intervene using their stock of securities in sales or purchases, as well as encouraging clients to buy and sell by reducing and raising the profit margin,

which will lead to a balance in the demand and supply of securities, thereby stabilizing prices and the volume of trading.[1]

- Activating the financial market, some intermediaries lend to investors and clients who want to buy securities, allowing continued market demand and high liquidity.
- Maintaining market stability by choosing the right times for offering securities for subscription or covering issuances due to the constant presence of intermediaries in the market, their knowledge of its conditions, and their ability to foresee its orientation.
- Working to provide indirect financing, as they are the effective element in intermediating between savers and borrowers (through intermediation, intermediaries make profits), thus allowing the market to obtain the necessary liquidity.
- Availability of funding commensurate with different timelines by funding long-term operations from short-term sources. [2]
- Risk reduction and diversification through the building of investment portfolios in various fields and activities.
- Makin it easier for the clients to use special financial services.[3]
- Reducing costs by offering the feature of economies of scale to investors seeking to build a sound portfolio.
- Helping corporations optimize the capital structure by obtaining an appropriate mix of equity and debt.
- Stimulating economic development.
- Linking households to the financial market.
- Safeguarding the hard-earned money of clients.
- Providing financial advisory services, provide financial information, and engage in credit rating.[4]

3.3. Market orders

The financial intermediaries' work is based on the execution of orders received from clients, the most prominent of which are most commonly used in global markets:

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[1] Munir Ibrahim Hindi, Securities and Capital Markets, op.cit, p. 115 .

[2] Nadia Abu Fakhra & Mahmoud Sobh & Shamel Al-Hamoui, op.cit, p. 62.

[3] Nirmalarajah Asokan, ***What are Financial Intermediaries Used for?***, on 09/10/2022, Consulted on 28/07/2023, at https://agicap.com/en/article/financial-intermediaries/

[4] Wallstreetmoj Team, ***Financial Intermediary***, Consulted on 30/07/2023, at https://www.wallstreetmojo.com/financial-intermediary/

3.3.1. Specific (limit) orders for execution price: These are the orders based on the price, namely:

- **Market order**: Where the order is executed as soon as it is received from the client and at the best prices at the date of execution.
- **Specific or limit order**: It is based on the type of condition or restriction set by the client, who may require the order to be executed as soon as the price reaches the execution price only, or may only be executed at the best prices present at the moment of the fixed execution deadline, or may be limited to the execution of both.[1]
- **Order at the first price**: The broker executes the order at the first price.
- **Order the last price**: The order is executed at the end of the transactions. (the closure).[2]

3.3.2. Specific (limit) orders for execution time: These execution of these orders depends on the duration, namely:

- **A day-specific order**: These orders are valid for only one day, hoping to meet expectations.
- A week- or month-specific order: These orders are valid for a day, hoping to reach the expected price.
- **Open order**: This order shall be valid until the client has issued his decision to execute or cancel it.
- **Instant order or market order**: Whereby the dealer execute the order immediately and at the best current prices.

3.3.3. Orders with price and execution time: These orders include:

- **Limit price order within a specified period**: This order is issued at a certain price to be implemented within a specified period.
- **Open order within a certain price**: This order is executed as soon as market prices reach the desired level or better, without specifying which time period.

3.3.4. Special order: This type of orders include:

- **Stop order**: The dealer is obliged to execute his/its client's order to sell his securities at a certain price (stop loss order) if the prices are expected to continue to fall or buy securities at a certain price (stop by order) if the prices will hopefully rebound.

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[1] Munir Ibrahim Hindi, Securities and Capital Markets, op.cit, p. 128.

[2] Salah al-Din Hassan El-Sissi, ***Theoretical and Applied Studies: Arab and International Securities Exchanges and Establishment of the UAE Stock Exchange***, op.cit, p. 16.

- **Stop limit order (pre-arranged stop order):** This order is used in cases of uncertainty about the price at which the stop order is executed. The client sets a minimum sale price and a maximum purchase price, only that price or better is dealt with.
- **Order of execution as appropriate**: in this type of orders, the clients leaves his dealer full freedom to choose the securities to purchase or by and the time and price of execution, which gives greater flexibility to the dealer.

3.4. Transactions repayment (deals clearance)

After receiving the orders, the financial intermediary proceeds with the execution of the transactions, which is required to complete (liquidate) the settlement of the payments arising therefrom. There are three methods of payment for transaction, which are:

- **Full monetary method**: In this method, the investor pays the value of the securities to the intermediary or banker in cash after issuing the order.
- **Partial monetary method**: This method is also known as margin style, and it is the most commonly used method. The investor pays part of the transaction in cash (margin) at the time of issuing the order, while the rest is settled by a loan and secured securities in the place of the transaction.
- **Short-selling (over-the-counter)**: Unlike ordinary investment based on the sale of securities after a period of time, in practice, another method of transaction is highlighted in which investors, especially speculators, sell securities without holding them, where they are purchased at the time of their price decline. Short selling is widely used for speculating on the decline in the price of the security, investor orders the intermediary to sell the securities whose prices are expected to decrease. Accordingly, the intermediary executes the order and finds a buyer to deliver the securities from the intermediary inventory or borrows them from another broker. When prices fall, the investor receives the difference between the two prices, while the intermediary uses the proceeds of the sale in other investment areas that may be more useful than holding shares.

Besides speculation, the investor can use short selling for other purposes, the most important of which are:

- Hedging from the risks of price decreasing.
- Arbitrage by buying securities in the low-price market and selling them in the high-price market.
- Delayed payment of taxes.

- Facilitate the delivery of securities in the event of a spatial difference that prevents the investor from delivering the securities.[1]

4. Efficiency of financial markets

The ultimate goal of financial market workers is to reach the maximum level of efficiency, where efficiency reflects the ideal of financial markets. Below, we will try to address this efficiency in some detail.

4.1. Efficiency Concept

The efficiency of financial markets has occupied a large place in the interests of specialists and decision-makers because of its great importance in achieving the optimal allocation of financial resources available to economic units that have the best investment opportunities at the lowest possible time and cost. Under an efficient market, securities prices reflect all available information, both about the issuing entity and about others, without an interval, which may result in unfair benefits (extraordinary profits) to some parties at the expense of others, which is incompatible with fair competition. In order for financial markets to be efficient, certain conditions must be met, including:

- Ensuring full competition by removing all the transaction restrictions that limit the number of sellers, buyers, and quantities dealt with.
- Market liquidity is affordable and timely, as a corollary of the preceding requirement.
- Make accurate and up-to-date information about securities and listed companies available to all market traders at any time and at no cost. This is can be achieved by providing modern and effective means of communication, such as publication on the Internet, in newspapers, and in periodical reports.
- Providing rationality in investors' actions, which can lead to maximizing and sustaining the benefit of exploiting their wealth.[2]
- The market has management that ensures its proper functioning. This management is to be unbias and competent, composed of experienced persons assisted by a specialized committee. This committee derives its powers from legislation and laws aimed at protecting investors' interests.[3]

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[1] Munir Ibrahim Hindi, ***Securities and Capital Markets***, op.cit, p. 125.

[2] Abdul Ghafar Hanafi, op.cit, p. 205.

[3] Ziad Ramadan & Marwan Shmout, op.cit, p. 199.

It should be noted in this regard that full efficiency is impossible to achieve, so it is impossible to meet all the above conditions. This necessitates replacing it with economic efficiency, which is based on the assumption that some time has elapsed since the information is received until it is analyzed and then reflected in the stock price. The functioning of the market and its intermediaries cannot be done in the absence of certain costs and taxes incurred by investors, enabling some investors and brokers to earn at least extraordinary profits in the long run. Overall, in order to achieve its objective and function efficiently, the market should have two main characteristics:

- **Internal efficiency**: It is called operational efficiency, and it is the ability of the market to use savings in the best investments, i.e., to direct available resources to the most profitable securities from active sectors at the lowest possible cost, which is the cost of transactions from brokerage commission expenses and fees paid by the buyer, seller, or both to the intermediary and market authority when making transactions. Higher operational efficiency contributes to higher market attractiveness and high demand, which have a profound impact on the market and the liquidity of the securities dealt with in it.[1]
- **External efficiency**: It is called price efficiency, which means that securities prices reflect all available information without a significant interval, so that market value expresses fair real value, enabling no party to predict future prices or adopt a strategy that may yield extraordinary returns.

4.2. Levels of efficiency

According to several factors to be explained, three levels of efficiency in financial markets are determined, which are:

4.2.1. Poor level: At this level of efficiency, market prices reflect historical information about prices and transaction volume, allowing information to be accessible to all. Thus, the possibility of extraordinary profits is diminished by analyzing historical prices or using them to predict future prices because these prices are available to everyone, which corresponds to *the random walk theory* of the conduct of stock prices. This theory suggests that stock prices in financial markets do not always follow a certain trend but are in random motion, which makes it difficult to predict future price behavior.[2] In other words, random walk theory claims that stock prices move randomly and are not influenced by their history. Because of

[1] Abdul Ghafar Hanafi, op.cit, p. 209.

[2] Suleiman Mosli & Hazem al-Saman, ***Price Efficiency Study for Damascus Securities Market***, Damascus university journal for the economic and legal sciences, Vol 29, N°02, 2013, p. 155

this, it is impossible to use past price action or fundamental analysis to predict future trends or price action. If markets are indeed random, then markets are efficient, reflecting all available information.[1] It should be noted that most developing financial markets are poorly efficient.

4.2.2. Semi-strong level (near-strong level): At this level of efficiency, prices are supposed to reflect not only historical information but also information that is usually publicly available and published, such as international conditions, economic conditions, industrial conditions, and entities, in the form of publicly available reports and analyses. The timing here is a key and vital factor, as prices may not respond to any changes quickly, and therefore some investors can make extraordinary profits. In this regard, it can be pointed out that this level of efficiency is the closest to practical realities, as all advanced financial markets have not yet exceeded the semi-strong level of efficiency.

4.2.3. Strong level: The prices of securities under a strong level of efficiency reflect all kinds of information, including historical and publicly published information, in addition to unpublished or private information that is available only to a particular category, such as the managers of the entity and its decision-makers and financial institutions specialized in investment and securities analysis. Given the speed with which prices respond to information received, it is difficult for a particular group to take advantage of it or monopolize it to achieve additional (unusual) profits. The development and low costs of means of communication have greatly improved the efficiency of financial markets and allowed investors to respond quickly and take advantage of information that can be easily traded, thereby helping to bring prices to a fair level.[2]

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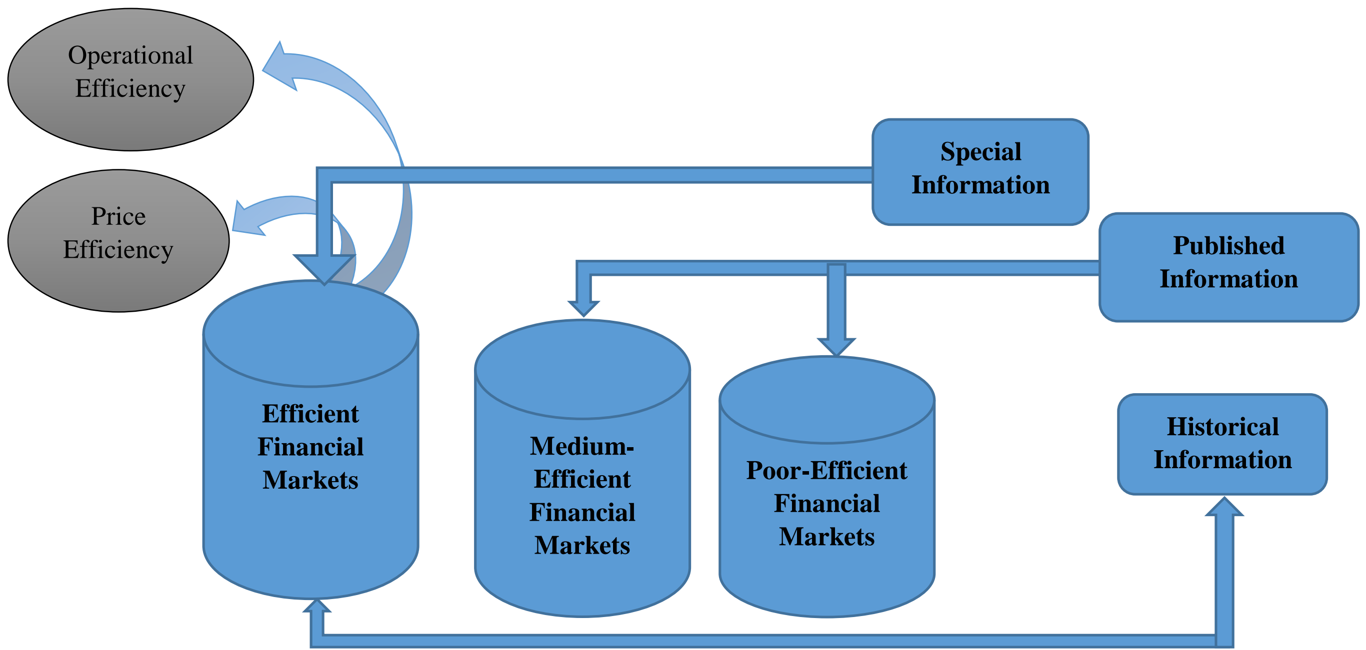
[1] Tim Smith, ***Random Walk Theory: Definition, How It's Used, and Example***, 23/02/2023, Consulted on 08/08/2023 at https://www.investopedia.com/terms/r/randomwalktheory.asp

[2] Suleiman Mosli & Hazem al-Saman, op.cit, p. 155.

Figure 08: Financial Markets Efficiency Levels



Source: the author's preparation

CONCLUSION

Financial institutions are entities and establishments engaged in the field of dealing with financial and monetary transactions such as deposits, loans, investments, and currency exchange. Financial institutions consist of a broad range of institutions, including banks, non-banking institutions, and financial markets, that together form the financial system and determine its shape, nature, characteristics, and features.

The primary objective of the financial institutions is to provide effective channels that can transfer funds quickly and securely at low costs and to offer financial instruments that permit investors to diversify their portfolios and manage the risk by allocating them. In other words, due to their experience in financial intermediation, financial institutions have the capability to match savers' or investors' funds with those seeking funds, using products such as loans and markets such as a stock exchange. So, they mobilize the savings and direct them to the most productive investment opportunities (profitability) that serve the purposes of economic growth and lead to a better standard of living for members of society. The good functioning of the economy requires financial institutions capable of allocating the resources of society efficiently. Through financial intermediation between lending savers and borrowing investors, productive entities have access to untapped liquidity and financing from direct and indirect channels to satisfy their financial needs and make investments at the lowest time and cost, thereby raising income and national output and optimizing savings employment.

Financial institutions also have a role in promoting the efficiency of markets by providing the necessary information about companies, contracts, and financial instruments so that investors can make correct choices and by providing information about the current market so that investors can assess the performance of their investments and meet consumers' and companies' financial needs.

We can conclude that financial institutions are essential for improving the efficiency and competition of economies due to their role in channeling savings and investments where it is most useful between suppliers, people or institutions owning capital to lend or invest, and those in need seeking capital, including businesses, governments, and individuals.

Sophisticated and effective financial institutions are prerequisites for sound and sustainable economic growth. Therefore, monetary authorities are pivotal for the better performance of financial institutions by permitting them to play their crucial roles and removing any problems or obstacles affecting the performance of financial markets.

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