

MICROTAKAFUL-ISLAMIC INSURANCE FOR DEPRIVED: INNOVATION, SUSTAINABILITY AND INCLUSIVE GROWTH

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ABSTRACT

Takaful (joint guarantee) follows 'The Tabarru' system. To cover defined loss from the contribution fund is the key objective of Takaful. Microtakaful- Islamic Insurance for Deprived, is a new concept in name but provided by many mutuals and cooperatives since long. Above one billion people are living in underdeveloped countries out of which 54% are Muslims. 20 countries have a Muslim majority out of the 41 lowest human development countries. Even in Muslim countries with high human development insurance penetration is very low as compared to others. All these shows Microtakaful has a huge market to cover across globe predominantly in African and South Asian countries. There are few Takaful providers came forward in different countries to provide microtakaful but still a long way to go to make a real impact on people's livelihood and share the concept of brotherhood and solidarity. Main challenges faced by microtakaful providers are sustainable microtakaful product and proper delivery channels for inclusion of huge numbers of people. This study is expected to suggest different sustainable microtakaful products for life insurance (credit, term and endowment), non-life insurance (primary health and hospitalization), livestock insurance and group insurance along with innovative and feasible delivery channels which will cost effectively increase reach of the takaful providers to the huge population under poverty. In addition this study will also provide an overview of currently available microtakaful products in different countries, difficulty in further penetration of the same and current situation and future market potential for microtakaful products across different countries in Africa and South Asia. Microtakaful-Takaful due to its virtuous approach, risk sharing concept, transparency and distribution of surplus gaining popularity in non-Muslim countries. This paper will also provide glimpse about implementation of the same concept in India (as non-Muslim country).

Keywords: *Microtakaful, sustainable microtakaful products, delivery channels, potential market.*

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INTRODUCTION

Shariah compliant finance has grown at a brisk pace over past few decades. Nowadays it is considered as vital part of global financial markets. Major products contributing to growth are from different areas like banking, asset management, capital markets and insurance (Takaful). Takaful as a concept is not widely understood and always neglected as compared to Islamic Banking.

Takaful is a unique concept and one of the important social institution to counter poverty and deprivation. Takaful as a concept is in practice for more than 1400 years now, but officially as general insurance it was launched in Sudan in 1979. The use of takaful as an alternative to conventional insurance started in 1985 when the Grand Council of Islamic Scholars of the Organization of the Islamic Conference formally gave the required permission. Ever since 1985 takaful has grown rapidly in terms of number of lives covered under it and the type of products offered under takaful. Currently there are around 190 takaful service providers across 34 countries with an estimated premium income of \$9 billion¹.

Takaful works on concepts similar to mutual insurance, allows for sharing of risk transparently by pooling contributions of individuals for the benefit of all subscribers. According to the takaful act of Malaysia, takaful is defined as "A scheme based on brotherhood, solidarity and mutual assistance, which provides for mutual financial aid and assistance to participants in case of need whereby the participants mutually agree to contribute for that purpose". Basically a takaful contract is amalgamation of tabarru (gifting), agency and profit sharing contract between the pool created and the policy holders.

According to a study conducted by the World Bank in 2012, approximately around 30% of total Muslim population across the world is living under the poverty line. Most of the people in countries like Kenya, Nigeria, Indonesia etc. are below the poverty line. Microtakaful is a concept developed for deprived people in Muslim countries. Unlike takaful, it covers high risk. Products of microtakaful developed in such a way that they are affordable for people at the bottom of the income and social pyramid. Many a times microtakaful requires subsidies from governments, donor agencies and zakat funds for sustainability. Microtakaful can be defined as "A mechanism to provide Shariah-based protection to the under-privileged Muslims at an affordable rate".

¹ ICMIF Takaful, Takaful Operators

CURRENT SCENARIO

Starting with Indonesia, the home of largest Muslim population in the world. Islamic finance is growing at 35-40% per annum in the economy that expands around 5-6% annually. Even though Indonesia has the highest market potential for takaful, there are only six companies providing takaful-microtakaful across country. According to report of WHO, 2008 total public expenditure on health is just 1.1% of total GDP and total insurance penetration of 1.7%² shows there is significant demand of insurance/takaful as major population is still not insured.

As compared to Indonesia, Malaysia is a much smaller country. Malaysia has as much as 13 takaful providers and has comparatively good insurance penetration. Saudi Arabia has the highest number of takaful providers across the world. Even if as many as 40 takaful providers (Saudi Arabia and other gulf countries) insurance penetration is as low as 0.8 with an insurance density (\$US) as low as \$ 188³.

Looking at the current scenario of the insurance industry at African countries, among 20 countries with lowest HDI 19 are from the African continent. Takaful contributions in Africa are detailed in the table.

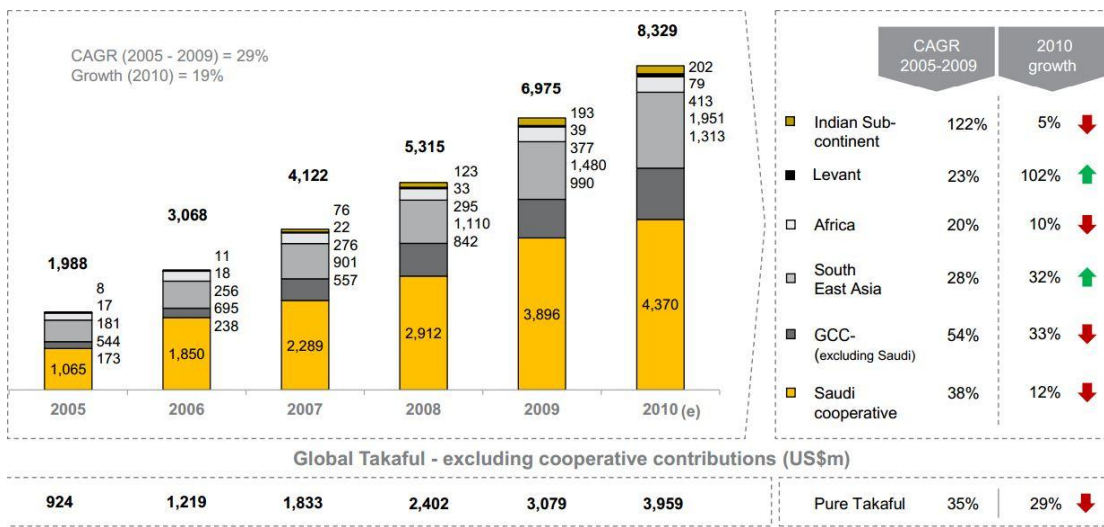
Table 1: Gross Takaful premiums

Country	GWP in USD Million		
	2008	2009	2010
Egypt	6.2	29.3	41.9
Mauritania	0.4	0.4	0.4
Senegal	8.0	8.0	8.0
Sudan	280.7	339.6	363.4
Kenya	n/a	n/a	n/a

(Source: 39th AIO conference report)

Global contributions to takaful premiums are as mentioned below.

Figure 1: Global Gross Takaful Contributions



(Source: The World Takaful Report 2012, EY)

GCC has the highest number of operators but very low average contributions per operator while Malaysia has the highest average contribution per operator. Premiums collected per operator for major regions are as follows,

Table 2: Takaful Contribution Concentration Centers

Region	Average Contribution Per Operator	Growth 2010
Malaysia	US\$ 141 Million	24%
Saudi Arabia	US\$ 141 Million	12%
GCC	US\$ 74 Million	16%
Indian Sub-Continent	US\$ 17 Million	10%
Africa	US\$ 13 Million	5%
Levant	US\$ 9 Million	102%

(Source: World Islamic Insurance Directory, 2012)

² Swiss Re sigma report

³ Swiss Re, IMF, Alpen Capital

MARKET POTENTIAL

At the global level it was being noted that out of 41 countries with lowest human development 20 are with the majority of Muslim population and another 9 countries have a Muslim population above 20%. Insurance density and penetration is very low in these countries. So takaful has very high potential to grow at a rapid pace. The only concern for growth is properly priced policies and efficient delivery channels.

African and South Asian countries have the highest market potential, as still around 60% of total Muslim population is not insured. Takaful/Micro Takaful industry has been growing at an average of 35% (CAGR) over the last 5 years across the world. This industry potential to grow at the same rate for the next 15 years if it gets supportive regulations across the world. The below mentioned 12 countries have around 1.113 billion Muslim population, which is more than 70% of total Muslim population across the world. Here along with total Muslim population expected in 2010, per capita income and insurance penetration is also mentioned. Insurance penetration in those countries is very low as compared to developed countries like USA, UK etc. So we can estimate very high growth in those markets.

Table 3: Estimated Muslim Population in 2010

Country	Muslim Population	Per Capita Income	Insurance Penetration
Indonesia	213 M	\$4,094	1.50%
Pakistan	178 M	\$1,250	0.70%
India	177 M	\$3,194	5.10%
Bangladesh	148 M	\$3,125	0.90%
Egypt	80 M	\$5,598	0.70%
Turkey	75 M	\$12,390	1.30%
Nigeria	75 M	\$2,241	0.50%
CIS Region	61 M	\$10,715	NA
Algeria	35 M	\$7,100	0.80%
Morocco	32 M	\$7,360	2.80%
China	23 M	\$7,503	3.80%
Russia	16 M	\$15,756	2.30%

(Source: Global Insights, Pew Forum)

Microtakaful industry is currently established few countries and in very limited business lines and segments. Still it has immense potential to grow at a high rate if providers tap following markets,

- Potential Market Share in countries where takaful is already established:
 - Share of Islamic finance in Malaysia and GCC is 22% and 25% respectively, while takaful market share is only 10% and 15% respectively.
 - So there is at least 10% growth potential in those already captured market. As those markets are already captured there will be less investment in delivery channels.
- Most of the premiums for takaful are collected as general takaful insurance. Family takaful is as little as 5% in many markets, so there is enormous potential for family takaful.
- As one can infer from the above table, conventional insurance has very low penetration across 1.6 billion Muslims populations for many reasons starting from religious reasons to financial reason. If microtakaful insurance companies properly position it across the world, there is a huge market waiting for it.
- Large Muslim countries like Indonesia, Bangladesh, Pakistan etc. are opening up for takaful/microtakaful. Given proper technical and financial assistance from the IDB and separate regulatory framework microtakaful will grow in these countries.
- China, Russia, India, Turkey and CIS countries have a great number of Muslim population, so given the proper encouragement and support from governments and regulators to local insurance, microtakaful can be established in these countries.

Microtakaful can allow tapping into a large number of lower middle and lower income segments in most of the Muslim countries.

CHALLENGES

Takaful operators globally are very excited by growth statistics of the industry and future potential growth, in many countries operators facing numerous challenges which provide interruptions at the growth of the industry.

Challenges in Islamic countries,

- Lack of proper regulatory framework
 - More consistent regulatory framework is needed in the key markets for microtakaful.
 - Separate regulator will provide better growth opportunity for the industry.

- Appropriate internal controls and risk management is big challenge.
 - As Sharia's compliance risk should be rooted in all parts of operations, at a time of expansion appropriate risk management is very vital.
 - Strategy for microtakaful providers should be such as product of microtakaful provides value to all stakeholders within permissible limit of risk.
- Shortage of expertise
 - As this field is relatively new, most of the operators didn't have enough experience of business.
 - There is also shortage of human resource with requisite expertise in this industry.
- Rising Competition
 - Even though there is high growth expected in the industry, competition is rising in leaps and bounds in this industry.
 - This industry is working on thin margins but to gain market share quickly young microtakaful operators price products in such a way that it will become tougher to be profitable. For e.g. three newly added takaful operators in Malaysia will increase competition.
- Reinsurance is also one of the major issues.
 - Lower reinsurance ratios restrict operators to aggressively penetrate untapped markets.

Table 4: Reinsurance Ratios

Year	GCC		Malaysia	
	Conventional Insurance	Takaful	Conventional Insurance	Takaful
2007	52%	42%	18%	6%
2008	50%	45%	22%	9%
2009	47%	47%	23%	8%
2010	52%	34%	23%	12%
2011	50%	34%	25%	20%

(Source: EY analysis, report 2012)

- Operational and Business Excellence is required, increase in capital investment
 - As insurance business is becoming digital, takaful service providers should also include technology in all aspects of business like strategy, marketing and operations.
- Need to evolve such a product which can compete with general Microinsurance products.
- Develop products which provide sustainable cash flows over a period of time.
- Develop cost effective and efficient delivery channels, so that operators can make enough margins to stay in the business.
- Overall weaker economy of world is forcing takaful operators to hire high level talent at management level to develop proper strategy, so that company can sustain in adverse conditions.

Challenges in non-Islamic countries,

- Licensing from regulators
 - Microtakaful is not recognized most of the regulators as sustainable insurance, so many regulators of non-Islamic countries do not give license to microtakaful operators.
- Availability of human resource with proper knowledge of Islamic finance and Shariah compliance.
- Discrepancy in Shariah law
 - As shariah law is based on religious texts and some rules needs to be interpreted, there are differences between different interpreters.
- Shariah compliant investments of the fund collected under takaful.
- Reinsurance.
- Awareness and education of microtakaful products and Islamic finance.
- Dispute resolution
 - It is one of the major challenges in non-Islamic countries as they do not have proper Islamic courts running on Shariah Law.

PRODUCTS

Currently there is no specific limit of premium/sum assured given for products to be considered under microtakaful. There is about 8-10 takaful providers claims that they launched microtakaful product. The main characteristic of microtakaful product is lower premiums so that it can be accessed by population below the poverty line.

Currently there are many microtakaful products available for life microtakaful, whole life microtakaful, health microtakaful, agriculture microtakaful, livestock microtakaful. Most of the products are priced aptly to target large number of population under poverty.

Keeping few facts like sharing of profit, growing retakaful and increasing technical and financial support from different international organization and government, following product is suggested to capture higher market.

- **Endowment Microtakaful**

Nowadays in most of the countries either government or international welfare organizations are spending a good amount for financial inclusion. Governments can give money as a part of the premium and another part will be paid by the policy holder. Through a survey done in India, it has been come out that poor people are willing to pay premiums for such a policy where they get back the amount they paid as survival benefits.

- Government/Donors Contribution: Required up to 40-50% (for better benefits)
- Term : Around 15-20 years
- Payment Mode: Monthly
- Approximate premium: \$2-\$15 / month (excluding contribution)
- Sum Assured: 10-25 times (depending on the risk associated)
- Repayment amount: Net premium collected at the end of tenure

Companies should arrange their workings from the return they are getting on the investment. Contribution of the government/donor should be directly added to premiums paid by the policyholder. For the interest of microtakaful providers, premium paid by government should be excluded at the time of calculation of sum assured but included at the time of repayment at the end of tenure.

Pros:

- As policy holder is getting entire amount back at the end of tenure (if no claim made), there is a higher probability of people accepting the policy.
- The amount government is spending will be saved by end person and in terms invested back into the economy, this will help the economy to grow by availing high investments.

Cons:

- As insurance company has to make earnings and pay claims through the interest they earned on investments, in the adverse situation company can stuck in the liquidity crunch. So retakaful is very important for this product.
- End users are not getting instant benefit from the government so they may not support a government which may create political danger for government.

There is immense potential in livestock microtakaful and health microtakaful market, so to capture those markets companies can launch some products specifically catering to livestock and health microtakaful.

RETAKAFUL

Retakaful is an Islamic alternative to reinsurance. There are about 35 retakaful companies across the world including two reinsurance giants Munich Re retakaful and Swiss Re retakaful having offices in Malaysia. Retakaful operates on the same line as takaful/microtakaful. The only difference between retakaful and microtakaful is microtakaful individuals are contributors, where in retakaful, takaful operators or fund operators are contributors. Retakaful companies also bounds to follow Shariah law and must make any investment under that limit.

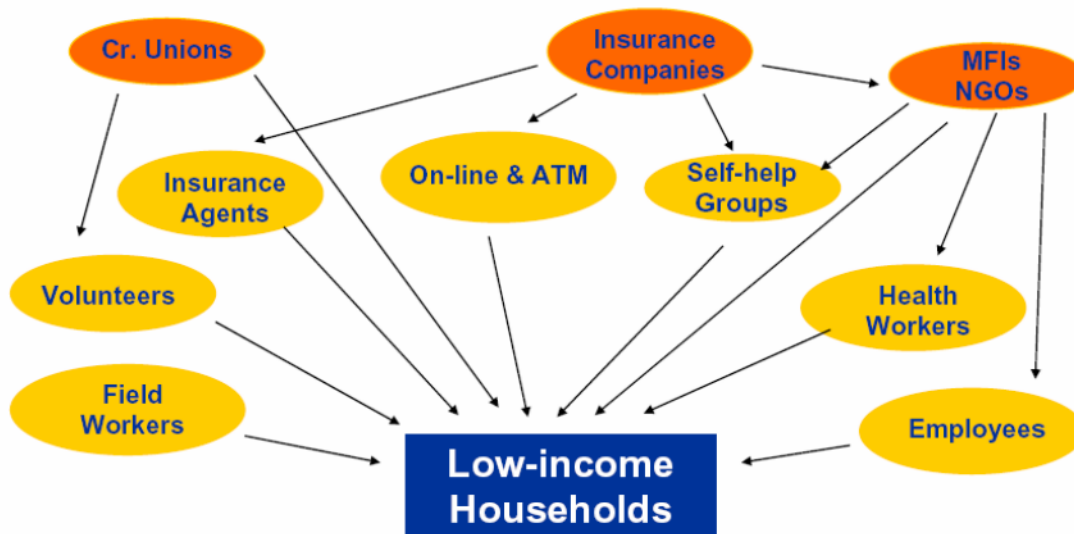
Ratio of retakaful is very low because of differences between Muslim scholars regarding the concept of retakaful. As this industry is in initial stage and there is high growth opportunity ahead, it is required for each takaful operator to have retakaful for financial stability and sustainability for longer terms.

The ratio of retakaful to takaful companies is very low. So it is becoming difficult for retakaful companies to cater more takaful companies when they have to follow guidelines of Shariah law for investment of funds. Apart from Malaysia there is a retakaful operator against 18-20 takaful operator. So there is enough scope for different reinsurers of the world to enter into Islamic countries as retakaful player.

DELIVERY CHANNELS

Currently most of the providers are using traditional delivery channels for microtakaful. Conventional delivery channels can be any one of many shown below,

Figure 2: Conventional Delivery Channels



(Source: Dr. B Helms, CGAP)

Distributing all the countries providing microtakaful into four categories, depending on the level of financial inclusion and insurance penetration, one can formulate strategy for innovating delivery channels.

Probable framework for distribution for different countries:

Category A: Insurance Company Dependent Microtakaful

Countries in category A are countries with

- Highly developed insurance market.
- High level of financial inclusion.

In these countries government can choose either insurance service providers or banks/MFIs as the main delivery channel for microtakaful, but insurance service providers have better expertise in insurance. So the government/regulator should design framework in such a way that takaful providers get enough rewards for providing microtakaful.

Category B: Microfinance Dependent Microtakaful

Countries in category B are countries with

- High level of financial inclusion.
- Under developed insurance market.

As level of financial inclusion is high in these countries, banks and MFIs have higher reach in rural areas. So in these countries if government/regulator goes with MFIs and banks as major microtakaful providers they will able to capture market faster as compared to depending on traditional insurance service providers.

Category C: Regulation Dependent Microinsurance

Countries in category C are countries with

- Low level of financial inclusion.
- Less developed insurance market.

In this category, both insurance and microfinance market are in the developing stage. So in these countries most of the markets are untapped. Government/regulator should develop a framework in such a way that microtakaful can be delivered through both. Being in developing stage it is important to have supportive regulations along with monetary help from government to implement microtakaful faster.

Category D: Confused Trajectory

Countries in category D are countries with

- Low level of financial inclusion.
- Highly developed insurance market.

Here insurance market is highly developed without proper financial inclusion, which indicates highly subsidized insurance market. In such countries government/regulator should focus on FI also along with microtakaful penetration. This will bring overall growth in the financial sector which in turn will make insurance sector self-sustainable.

POOL MICROTAKAFUL-INNOVATION IN DELIVERY CHANNEL AND PRODUCT:

Apart from the traditional way to implement microtakaful, providers can give microtakaful in the pool especially where the population is scattered in small groups. Rather than providing microtakaful to each individual, providers can provide it for the entire group. Here, providers can appoint one person as the head of the group who is responsible for collecting premiums and distribution of money in case of any claim made from that group. This strategy will help company to gain higher market share at very low infrastructural investment and low administration cost.

TAKAFUL IN NON-MUSLIM COUNTRIES

The transparency in contract and evasion of industries deteriorating human life for investments (alcohol, tobacco, gambling etc.) are the main reasons behind takaful/microtakaful getting popularity into non-Muslim countries. The main aim of microtakaful is not earning profits but to provide help to the poor, so microtakaful/takaful products are competitively priced against conventional insurance providers in non-Muslim countries.

The combination of ethical investment policies, price attractiveness and immense potential of growth makes very good opportunity for takaful/microtakaful providers to capture markets across the world.

The major challenges in implementing microtakaful/takaful in non-Muslim countries like USA, UK, Germany, India etc. are mentioned above. As concept wise microtakaful is very similar to the concept of Mutuals in non-Muslim countries. The only major difference is there is no restrictions on investments in Mutuals.⁴

CONCLUSION

The challenge in successful implementation of microtakaful lies in developing products which fulfill needs and efficient delivery channels which covers the majority of the population. On the top of that how to contain costs while providing all the things needed by customers is also one of the major hurdles at the time of implementation of different strategies.

The Islamic financial industry must have to focus on microfinance and microtakaful for overall development of the community and not only in Muslim countries as the number of Muslims living under poverty outside Muslim countries are also high.

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⁴ Mutual is organization based on principle of mutuality. Here also people from organization make a continuation pool of investment for benefit of all in the organization.