The need for insurance for the low income segment of the population is well documented. In this segment, an unexpected event resulting in a loss of income can have a catastrophic effect on the family unit. The problem with insurance is that it is usually run as a business and as such may be an inappropriate vehicle to service the low income segment of the market. Think about it this way, there are significant business risks in micro insurance and insurers in the developing world (where the low income segment of the market is probably the largest) see better business opportunities tapping the growing affluent middle income segment of the market. The risk-return story for this growing middle class in developing countries, where insurance penetration itself is still below that of more developed markets, is more compelling than for the lower income segment of the market. Thus, without government intervention in the form of subsidy or likewise, it is unlikely that the problem of underinsurance for the poor will be resolved anytime soon if we were to depend entirely on insurance companies to lead the way.

The Insurance Landscape:-

Insurance is one alternative to managing risks. For insurance this involves paying a premium for a transfer of risk from the insured to the insurance company. For most individuals who buy insurance it is for the purpose of protecting assets. These assets can be property (casualty or general insurance) or future income (life insurance). Insurance, like banking, is heavily regulated as this involves collecting money from the public and providing custodial services until claims are paid. Although there can be many forms of insurance (e.g. direct and re insurers) in most countries one set of regulations cover all insurers. Successful insurance companies are those that have attained critical size (defined as when expense loading exceeds expenses incurred) and underwrite profitably. As a consequence of this the insurer is able to provide a good return to shareholders. The yardstick of profitability from the shareholders perspective is the unit return per dollar capital invested. Thus, the optimal position is to write the most profitable business for the least amount of capital employed.

The Curse of being Micro:-

In most countries insurers serving the “micro” market also serve the “mainstream” market. Thus, maximizing profits to shareholders remains an important consideration for the “micro” market. In certain countries, like India, the regulator regulates that a minimum target of gross written premium should be from the “micro” market to ensure that the insurance industry contributes to the national agenda of financial inclusion. Insurance is normally SOLD not BOUGHT and the level of financial literacy among buyers of micro insurance is probably low. The cost of providing financial advice is high as a percentage of the micro premium. Where then can micro policyholders afford to source financial advice on insurance? In the absence of personalized financial advice, the micro market should only serve simple and standardized protection products where minimal financial advice is necessary.

The Spirit of Takaful:-

Islam is not only about belief in God and how God should be worshiped. Islam provides guidance on all aspects of life, from resolving family matters, to crime and punishment and to the conduct of business. Insurance, as a business therefore needs to satisfy the conditions placed by Sharia for it to be considered halal (permissible). Islam is not against profiting from trade and services but Sharia principles require that such transactions should avoid exploitation of the individual. This means avoiding riba (interest), gharar (uncertainty in the contract) and maysir (gambling). This applies to both the insurance contract and how insurance funds are invested. The 1985 Fiqh Academy in Makkah concluded that the conventional for profit insurance contract has elements of gharar and maysir making it not Sharia compliant. For insurance to be halal it must satisfy two conditions; (1) It is cooperative in nature (this means that insurance must follow the cooperative or Mutual model). (2) The insurance risk pool has to be established on the basis of charity and cooperation (the opposite of charity and cooperation would be an institution driven by profit).

The Fiqh Academy reasoned that a more acceptable form of insurance is the cooperative or Mutual model where the intention is to foster solidarity, all members in the group lending a helping hand to those in the group who are unfortunate. The gharar element it would seem is offset by the intention of mutual assistance among the participants in the cooperative, while the maysir element is removed by removing the emphasis on profiting from the program.

While Takaful itself is in a relative stage of infancy in Pakistan (4% percent of the overall insurance industry’s gross written premium1 ), microinsurance is also struggling to break through its embryonic shell and carve a niche for itself with the growing number of policyholders (currently 4 million approx.2 ). Similarly, microtakaful in Pakistan is also allowed as an offshoot of the microinsurance regulatory framework as envisaged in the recent Takaful Rules of 2012. Pakistan, which is a country with a predominant majority Muslim population (98 percent3 ), has historically witnessed a lower insurance penetration and density as compared to its regional peers. A slight improvement, however, has been witnessed during the last five years when the penetration had an upsurge from 0.74 to 0.92 percent of GDP, whereas the density has jumped from USD 5.38 to USD 7.64 per capita4 , without incorporating the inflationary as well as currency devaluation factors.

Takaful and Micro Takaful in Malaysia:-

In Malaysia, takaful is a hybrid, a combination of proprietary (the operator’s fund) and mutual (the participants’ fund) operations. The ‘insurance’ is conducted in the participants’ fund. All takaful operators are from 2014 subject to a Risk based approach to solvency capital requirements. The Regulation places the onus on the operator to guarantee that takaful benefits are paid. The operator provides a temporary qard (interest free loan) to cover any deficits in the participant’s fund which is then repaid from future surpluses in the participants’ fund. Micro takaful products in Malaysia are primarily designed as “small size” regular takaful products subject to the same considerations with regard to profitability/sustainability as other takaful products. Usually takaful is packaged with small loans to save on distribution costs. In Malaysia therefore, it is more “mini” takaful rather than “micro” takaful.

What about Takaful Product:-

The need to ensure transparency means the deduction for expenses and commissions must be clearly set out. This deduction, called the agency or wakala fees, is paid to the takaful operator to meet its distribution and management expenses. Currently the wakala fee charged by the operator is expressed as a percentage of the contributions (i.e. premium) not a fixed dollar amount. Whether the policy is ‘regular’ or ‘mini’ the wakala fee as a percentage of contribution is unchanged. Thus the percentage of contribution paid out as claims (which is total contribution less the wakala fee) is independent of the size of the contribution. In the example for the conventional term and endowment policies given earlier we saw that the percentage that actually goes towards paying claims vary by size of premium. The existing Takaful Model can be considered as Takaful Tijari (Business).

Should we use this same Takaful Model for the “micro” segment of the insurance market? The Islamic economic system is anchored on the needs of the community over the needs of the individual. Indeed for a Muslim his wealth is not his but has been given by God to be held in trust for the benefit of the community. It is said that only that part of his wealth that he gives away as charity is his. Apart from sadakah (charity), the other two means of achieving the objective of an equitable society are through the payment of zakat (tithe) and waqf (endowment). Zakat is an annual ‘tax’ put on idle capital (assets which have not been put to productive use for a period of one complete lunar year) while waqf is an endowment made by the individual for the use of the public good. How can the resources obtained through zakat and waqf be used to support the micro takaful industry? an alternative model to the Tijari model, one where one stakeholder is removed from the equation (the shareholders) and replaced with another, the trustees. We term this alternative model Takaful Ta’awuni (or the cooperative model). The proposed model is not immune to the other problems besetting micro insurance. While the need to satisfy shareholders’ profit expectations is removed there are expenses to control and processes that need to be optimized to ensure the model is workable.

Summary:-

Given the level of transparency practiced in takaful it is proposed that micro takaful rather than micro insurance is more suited for the micro segment of the market. The micro takaful organization would be based on a cooperative model rather than the hybrid takaful model. Furthermore where possible, consideration should be given to the use of waqf money to provide for the capital necessary to establish the micro takaful operation. Consistent with the concept of a waqf, these funds should be managed with the intention that it will be preserved over time notwithstanding that these funds may be temporarily drawn down by the participants’ fund to meet temporary deficits due to fluctuating claims experience. Indeed it should grow as it is ‘fed’ by surpluses from the micro takaful operation. This waqf would be managed by suitably qualified trustees in place of a Board of Directors. Expenses for the operation can be minimized by standardization of benefits and contributions and the use of a third party administrator. To ensure that the poorest are covered and instalment premiums are paid on time, consideration should be given to utilize zakat money to subsidize the contributions on behalf of the poorer participants. This would mitigate the effect of the uncertain income flow experienced by the poor which in many instances means that the lapse experience among micro insurance policyholders may be exceptionally high.

Finally, to avoid being labelled as an insurance operation, benefits should not be guaranteed (i.e. similar to a discretionary mutual). This will avoid punitive solvency requirements and expensive regulatory oversight. Nonetheless, on a voluntary basis the Trustees must ensure that best practices in corporate governance are maintained. A holistic approach with the support from the government, particularly in terms of legislation and the appropriate capital requirement, is essential for the successful development of a micro takaful market.