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Takaful, microtakaful, and the foundations of inclusion

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Roughly one quarter of the world's population is Muslim.[1] However, conventional financial services – including insurance – do not comply with some of the fundamental tenets of Islam.[2] Islamic finance in its modern commercial form emerged in the Gulf countries in the 1970s,[3] although the principles upon which it is based date back some 1,400 years.

Takaful, which provides a Sharia-compliant alternative to conventional insurance, is said to have emerged in Sudan in the late 1970s[4] and was estimated to be a USD 24 billion industry in 2019, growing at a massive 18% per year. Microtakaful – takaful that specifically targets low-income individuals, households, and businesses – is still very much in its infancy but we believe it can play a significant role in inclusion for vulnerable populations.

With this in mind, we have produced this briefing note aiming to stimulate discussion on the topic. Our focus will naturally be on Muslim customers – takaful's core target group – but it is important to note that there is no reason that non-Muslim customers could not also benefit from takaful products (indeed, this may be useful for providers to consider as part of their business cases). In this note, we briefly describe the major principles and models of takaful and give an overview of the global takaful market. We then consider the role of microtakaful in financial inclusion, with reference to existing research, and then use four case studies to examine the development of microtakaful in different contexts. Finally, we conclude by highlighting some key issues that need to be addressed to support the development of microtakaful.

[1] https://www.pewresearch.org/fact-tank/2017/08/09/muslims-and-islam-key-findings-in-the-u-s-and-around-the-world/

[2] https://www.islamic-banking.com/explore/islamic-finance

[3] Critical Overview of the History of Islamic Economics: Formation, Transformation, and New Horizons – https://core.ac.uk/download/pdf/39283104.pdf

[4] https://www.emerald.com/insight/content/doi/10.1108/JIMA-04-2018-0078/full/html

Principles and models

Takaful cover is an aspect of Islamic finance wherein instead of paying premiums as one would in traditional insurance, participants contribute money into a pool system to protect each other against loss or damage, thus creating a takaful fund.

Conventional insurance's life and non-life categories have approximate equivalents in family and general takaful and, indeed, takaful products were introduced as an alternative to this conventional insurance, which does not comply with the riba (interest) and al-gharar (uncertainty) principles of Sharia law. In takaful, the fund operates according to Islamic cooperative principles and a portion (100% in general takaful) of the contributions made by the participants is treated as tabarru (donations). Furthermore, any claims made by participants are paid out of the takaful fund and the remaining surplus in the fund (after accounting for the cost of potential claims, the cost of retakaful, and other reserves) is distributed back to participants as cash dividends or as a reduction in future contributions. The main purpose of takaful is not to generate profits but to distribute the risk amongst participants. Takaful operators manage funds on behalf of the participants and are differentiated by the way they implement takaful's principles. In brief, these approaches can be classified into the following models:[5]

MODEL	DESCRIPTION
Al Ta'awuni model (Non-profit model)	This model seeks to achieve the welfare of takaful participants and the community at large. The takaful operator acts as a trustee on behalf of participants with no intention of making profit. Hence, this is also known as the non-profit model. The profit and underwriting surplus are distributed back in their entirety to the participants.
Al Mudharabah model	This model is a profit-sharing contract where participants provide capital in the form of contributions and the takaful operator acts as a mudarib who provides his management expertise to efficiently utilise the takaful fund. The takaful operator shares the profit and underwriting surplus of the takaful fund according to pre-determined ratios and is responsible for all management expenses.
Al Wakalah model	In this model, participants provide capital in the form of contributions and the takaful operator manages the funds and charges a fixed fee (called a Wakalah fee) for providing services. Some takaful operators charge an additional fee on surplus as an incentive to efficiently manage the funds.
Mixed model (Al Mudharabah + Al Wakalah)[6]	This model is a combination of Al-Mudharabah and Al-Wakalah models where an Al-Wakalah contract is used for underwriting activities while an Al-Mudharabah contract is adopted for investment activities.
Wakalah model with Waqf fund	This model is a modified version of the Wakalah model where a Waqf fund is created by the initial donations of participants. The takaful operator deducts its fees from the Waqf fund. Profit resulting from investment is shared between the takaful operator and participants according to agreed ratios. 100% net surplus belongs to participants who have no prior claims and is distributed to them according to proportion of their contributions.

[5] Performance Indicators for Microinsurance KPI Handbook v.2 – https://microinsurancenetwork.org/resources/resource-7185

[6] Takaful models and Global Practices – https://mpra.ub.uni-muenchen.de/40010/1/Takaful_models_n_global_practices.pdf

These models are applied differently by operators across the world. Takaful policies were initially typically designed for affluent customers, but based on the experiences of conventional microinsurance, takaful was later adapted for low-income customers and branded 'microtakaful'. The first microtakaful scheme was reportedly introduced in Lebanon as early as 1997, and by 2010 there were schemes in Lebanon, Indonesia, Malaysia, Sri Lanka, Bahrain, and Pakistan.

The global takaful insurance market grew at an 18% CAGR between 2007 and 2012.[7] By 2019, although still fragmented, it had reached a value of USD 23.7 billion and was forecast to exceed USD 40 billion by 2023. Presently, the core takaful markets are concentrated in the Middle East Gulf Cooperation Council (GCC) countries, South Asia, and Southeast Asia (SEA). Growth is expected to be accelerated by factors such as an expanding Muslim customer base in the Middle East (GCC) and Asia-Pacific, an increase in ethical investment policies, and regulatory innovations that incorporate takaful businesses.[8] Additionally, though the African takaful industry is smaller than in other regions, it is also poised to grow: there are a range of players across North and West Africa in particular who are passionately working on expanding takaful cover. According to Pew Research, the global Muslim population is expected to increase by approximately 35% in the next 20 years, rising from 1.6 billion to 2.2 billion by 2030.[9]

Furthermore, if these population trends persist, 79 countries will have a million or more Muslim inhabitants in 2030. Most of these countries are currently classified as low- or middle-income and have low insurance penetration rates, hinting at the potential for both takaful and microtakaful to grow during the coming decade.

To realise this potential, increasing the supply of Sharia-compliant protection products, improving customers' awareness of them, and encouraging regulatory inclusion (particularly of microtakaful) will all be impactful. Furthermore, as the microtakaful industry develops, a more tailored approach to product design will become increasingly important. Bank Negara Malaysia findings[10] indicate a tendency towards a simple cut-and-paste approach that replicates products from Malaysia in the Middle East and other regions. While this may work in certain instances, it is not a sustainable approach to meeting specific customer needs in each country. Customers in Ethiopia, for example, will differ in important ways from those in Malaysia. However, to get this more local approach to product development right, investment in human capital and skills development will be required.

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[7] CAGR=Compound Annual Growth Rate. Sourced from the global takaful insurance market report – The Deloitte ME Islamic Finance Knowledge Center – https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-advisory/1947_global-takaful-insurance-market_AAM.pdf

[8] Ibid

[9] Pew Research Center's forum on Religion and Public Life: The Future of the Global Muslim Population – January 2011

[10] Bank Negara Malaysia (2016). Discussion paper on micro-insurance and microtakaful. Kuala Lumpur – BNM

Microtakaful as a tool for inclusion

Although nascent, the microtakaful industry has already been identified as having a (still mostly latent) role to play in inclusion. Among others, Bank Negara Malaysia has highlighted microtakaful's potential to contribute to poverty reduction and the promotion of social mobility for underserved segments.[11]

It could serve as an alternative coping strategy for low-income households (Muslim and – potentially – non-Muslim too) that are excluded from existing social protection schemes and/or Sharia-uncompliant financial services. Furthermore, some have suggested that microtakaful can be an effective scheme for protection of the poor even in active takaful markets with little experience of designing and distributing it.[12]

Although several empirical studies investigating the effect of the insurance sector on economic growth find a positive relationship, a study of microinsurance markets indicates that microfinance institutions in Muslim-majority countries are less likely than non-Muslim countries to offer insurance services.[13] Conversely, research suggests that the sustainability of microfinance institutions in low- or middle-income Muslim countries can be boosted through microtakaful schemes.[14] Once again, this suggests that the microtakaful market could align the incentives of various ecosystem players through product delivery.

A further challenge for the microtakaful industry is that it has historically been overshadowed by both the takaful industry and the microinsurance industry. This impacts discussions on the design, documentation, and processing of microtakaful products as is evinced by the scarcity of data available on microtakaful schemes and the relatively limited focus on the relevance of these schemes to financial inclusion. However, this could also be an advantage: not only can microtakaful providers benefit from lessons learned by takaful providers, but they can also benefit from microinsurance's experience with customer-centric designs tailored to serve vulnerable individuals and households and their businesses.

[11] Ibid

[12] Mokhtar, M., Sulaiman, R. and Ismail, A. (2012) 'Towards developing a sustainable microtakaful program in Malaysia', in 2nd Isra Colloquium: Islamic Finance in a Challenging Economy: Moving Forward.

[13] Erlbeck, A., Altuntas, M., & Berry-Stölzle, T. R. (2011). Microtakaful: Field study evidence and conceptual issues. *Department of Risk Management and Insurance, University of Cologne*.

[14] Ismail, A. G. (2014) IRTI Policy Paper A Framework for Regulating Islamic Microfinance Institutions.

Case Studies

To better understand the state of the global microtakaful industry, we have collected data for three Islamic countries (Morocco, Indonesia, and Malaysia) and one Muslim-majority country (Nigeria). These countries have been selected because they are at different stages in the development of microtakaful, both in terms of regulatory interventions and microtakaful product development.

We were also interested in representing both African and south-east Asian countries. The case studies have been consolidated using primary data via interviews and conference notes complemented with secondary data collected from government publications, newspaper articles, takaful operators' websites, and academic papers. They progress from least developed microtakaful markets (Morocco and Nigeria) to most developed (Indonesia and Malaysia).

Morocco

Takaful regulation was introduced in Morocco in 2019 and many insurance companies have shown an interest in learning more about takaful products and the experiences of takaful providers in other active takaful markets.[15] The regulation was introduced to encourage the diversity of products provided by the newly-created Islamic banks (also known as the 'participative banks') in 2017.[16] Most of the existing commercial banks (including three foreign banks) had already set up operations to provide Islamic banking services. However, these provided only one type of loan product – for either real estate or car financing – and there was no additional cover component to limit the risk of non-payment in case of death or disability. There was therefore a need to develop life and disability products for the benefit of participative banks as well as individual borrowers.

Although the takaful industry in Morocco is still nascent, as the above dates reflect, it has been developing rapidly and Morocco is increasingly becoming one of the more advanced takaful countries in North Africa. For example, recognising that takaful providers need access to appropriate capital markets to thrive, the Moroccan Capital Market Authority (AMMC) has been approached to facilitate Sharia-compliant investments for these insurers.

These developments are not yet, however, being replicated for microtakaful and discussions about microtakaful and its role in supporting financial inclusion and poverty reduction have been limited. This is partly because there is currently limited incentive to develop and pilot these products as the market potential is still unclear. Indeed, the demand for microtakaful products relative to traditional insurance/microinsurance products among low-income consumers in Morocco has not been established. Furthermore, customer perception for microtakaful is yet to be investigated and it is expected that the supply-side issues of pricing and distribution will have a notable impact on scaling microtakaful.[17]

[15] Morocco approves law on sharia-compliant insurance – https://www.reuters.com/article/morocco-bank-insurance-idUSL8N24B5HK

[16] Morocco's Islamic 'Participatory' Banks: 71 Agencies and MAD 1.1 Billion in Loans – https://www.moroccoworldnews.com/2018/06/249015/islamic-participatory-banks-71-agencies/

[17] Consolidated from interview notes with Pierre Bonzom

Nigeria

More than 50% of the Nigerian population is Muslim, suggesting a potential takaful market of ~80 million customers.[18] New regulations on microinsurance were announced in 2014, which coincided with the introduction of operational guidelines for takaful. While there are no specific microtakaful guidelines, NAICOM (the regulatory authority) has taken a proactive approach to promoting microtakaful as a platform for financial inclusion – especially in the impoverished north, which is predominantly Muslim. For example, in November 2020, NAICOM announced the introduction of a new microtakaful product for the largely Muslim population in Kano state.[19] In Kano, more than 60% of the adult population is comprised of entrepreneurs. In this context, providing microtakaful products for MSMEs could be viable for providers and help ensure the sustainability of these businesses, thereby supporting the local economy. Furthermore, the Federal Government of Nigeria also supports the adoption of microtakaful to complement the expanding Social Intervention Programs (SIP) for lower-income households and the country is working on creating an environment conducive to the development and distribution of microtakaful.[20] Supporting this, in a recent interview, Aisha Bashir – the head of the microinsurance unit of NAICOM – expressed the regulator's intention to develop microtakaful regulations/guidelines and support the design of microtakaful products. This evidence of microtakaful benefiting from expertise gained from microinsurance is an encouraging sign and will be an important example – especially for countries like Nigeria which have two or more major religious groups.

Approximately 85% of Indonesia's population is Muslim and the market potential for microtakaful is therefore immense.

Indonesia

Approximately 85% of Indonesia's population is Muslim and the market potential for microtakaful is therefore immense. The development of microtakaful in Indonesia has been ongoing since 2011[21] and as of 2013, there were seven takaful operators[22] providing products in the following categories: personal accident, credit life, and property. Research indicates that 41 takaful operators (85% of the total) still do not provide microtakaful.[23]

To encourage takaful providers to work on microtakaful products that address low-income customers, the Financial Services Authority of Indonesia (OJK) has been developing a standard microtakaful product that can be sold by all takaful operators. Furthermore, OJK has included microtakaful development in its financial inclusion programmes, noting that it should be interconnected with other, complementary initiatives such as digital payments and branchless banking. To help drive this, OJK urges coordination via forums between associations, takaful operators, distribution channels, and communities to better support product design, knowledge sharing, and awareness campaigns. Despite these efforts, three main challenges have emerged that could pose as hurdles to developing microtakaful: lack of regulatory intervention, low public awareness, and limited availability of human resources. These will need to be addressed to enable the microtakaful market to develop further.[24]

[18] Oxford Business Group Nigeria economy analysis – https://oxfordbusinessgroup.com/analysis/emergence-microinsurance-and-takaful-boost-market-penetration

[19] NAICOM to introduce micro takaful insurance in Kano – https://www.vanguardngr.com/2020/11/naicom-to-introduce-micro-takaful-insurance-in-kano/

[20] Adoption of Micro-Takaful Will Support Nigeria's SIPs 2021 – http://www.globalethicalbanking.com/adoption-micro-takaful-will-support-nigerias-sips/

[21] Islamic Financial Services Board (ISFB) and International Association of Insurance Supervisors (IAIS)

[22] The 11th Harvard University Forum on Islamic Finance – https://www.researchgate.net/publication/270284881_Challenges_and_Opportunities_in_Developing_Microtakaful_in_Muslim_Majority_Country_A_Case_Study_of_Indonesia/link/54a6de280cf267bdb909fa4e/download

[23] OJK workshop presentation – https://www.inclusiveinsuranceasia.com/docs/landscape-study-2013/session6/MLSAO_S6_Takaful_OJK_Muchlas.pdf

[24] OJK Technical workshop presentation 2017 – http://asuransimikroindonesia.org/official/asmik/uploads/materi-pasmina-2017/TechnicalWorkshop/Session1/Workshop_Session1_AASI_SiBijak_July2017.pdf

To provide an indication of what microtakaful products in Indonesia look like, the table below summarises the product information of three products available as of 2017.[25]

	MICRO TAKAFUL INSURANCE "SI BIJAK"[26]	SI ABANG 1	ASURANSIKU SYARIAH
Type of insurance	Sharia insurance consists of the Life Insurance and General Insurance **Life Insurance Sharia:** Term Insurance (died other than by accident - natural death) Funeral (compensation for funeral) **General Insurance Sharia:** Personal Accident Business interruption	Anti-bankruptcy due to due to loss of income of participant caused by fire, explosion, accident, lightning, smoke, eruption, tsunami, and earthquake which meet Sharia principles	Accidental death benefit and total permanent disability due to accident.
Period of insurance	12 months – not automatically renewed	12 months	12 months
Payment contribution	IDR 50,000 (USD 3.47) Consists of IDR 25,000 (USD 1.73) for life insurance Sharia benefits and IDR 25,000 (USD 1.73) for general insurance Sharia	IDR 40,000 (USD 2.76)	N/A
Compensation benefits	**Life insurance Sharia** 1. Term Insurance – IDR 2.5 million (USD 173.25) 2. Funeral - IDR 500,000 (USD 34.65) **General insurance Sharia** 1. Personal Accident – IDR 2.5 million (USD 173.25) 2. Participants' loss of income due to fire, natural disaster, robbery of a dwelling house, or vehicle, or a kiosk or cart business insured – IDR 500,000 (USD 34.65)	IDR 5 million (USD 346.50)	IDR 30 million (USD 2,079)
Distribution channel	Marketed only through the mechanism of the Consortium under the coordination of AASI (Insurance Association of Indonesia) Members of the association are required to register with the AASI for its involvement in the marketing of the product.	Consortium market to Ministry of Cooperatives and SMEs	Member of Sharia Insurance Association of Indonesia

[25] All amounts represented in Indonesian Rupiah (IDR) to US Dollar (USD)

[26] Si Bijak product information document 2014 – https://www.inclusiveinsuranceasia.com/docs/Polis-Asuransi-Syariah-untuk-Peserta-v5-ENG.pdf

Malaysia

Malaysia's microtakaful sector has exhibited steady development since the launch of Takaful Ikhlas's government-funded microtakaful scheme for farmers in 2013. This scheme was distributed to 100,000 members in conjunction with the Farmers Welfare Federation of Malaysia to assist low-income farmers by providing for funeral expenses. In 2017, the Perlindungan Tenang initiative was launched by Bank Negara Malaysia to encourage takaful operators to offer microtakaful products to underserved segments of the population – specifically to the bottom 40% of households[27] – in the form of simple, affordable, takaful protection using multiple agent networks and selected agencies for distribution. It was designed to provide short-term financial protection against death, fire, or other unforeseen events with a yearly renewable microtakaful plan.

To increase awareness and demand for these plans, the policy document was simplified and claims payment was to be processed within five working days, provided the prerequisite documentation of the participants or beneficiaries was complete. And in 2019, the initiative extended the distribution channel to include direct online sales of Perlindungan Tenang products from participating takaful operators. The table below highlights takaful operators and microtakaful schemes provided under the Perlindungan Tenang initiative.[28]

Operator Name	AIA Public Takaful	Prudential BSN Takaful	Takaful Ikhlas
Product Name	AIA i-Starter Plan	Lindungi	Agro Mabrur-i
Distribution channel	Online	Online	AgroBank branches nationwide
Sum covered	MYR 10k (USD 2,410) MYR 15k (USD 3,615) MYR 20k (USD 4,820) MYR 25k (USD 6,025) MYR 30k (USD 7,230)	MYR 20k (USD 4,820) MYR 30k (USD 7,230)	Plan 1: MYR 13k (USD 3,133) Plan 2: MYR 26k (USD 6,266) Plan 3: MYR 40k (USD 9,640)
Contribution	As low as MYR 39 (USD 9) yearly (Depends on Age/Gender)	As low as MYR 50 (USD 12.50) yearly (Depends on Age/Gender/Health Status/Occupation)	Plan 1: MYR 75 (USD 18.70) Plan 2: MYR 135 (USD 30.13) Plan 3: MYR 195 (USD 46.99) yearly
Coverage	Starter plan coverage of one year – death benefit and a choice of additional coverage. Family takaful plan	Death coverage and total and permanent disability benefit depending on the criteria mentioned above.	Comprehensive microtakaful protection package. 3 plans – death or total and permanent disability, hajj by proxy, endowment, and funeral expenses.

[27] 10 affordable insurance plans rolled under perlindungan Tenang – Borneo Post Online 2017 – https://www.theborneopost.com/2017/11/25/10-affordable-insurance-plans-rolled-out-under-perlindungan-tenang/

[28] All amounts represented in Malaysian Ringgit (RM) and US Dollar (USD) Malaysian Takaful Association – https://www.malaysiantakaful.com.my/family-takaful/perlindungan-tenang

There are also a few free microtakaful protection plans in the market, designed for eligible low-income households. For example, 'My Salam' is a free takaful income assistance scheme provided by the Government for individuals earning less than MYR 24,000 per annum (USD 5,839). The coverage includes a one-time MYR 8,000 cash payout (USD 1,946) upon diagnosis of one of 45 critical illnesses as categorised by the health department and MYR 50 (USD 12) daily hospitalisation income replacement up to MYR 700 per annum (USD 170) at any government, military, or university hospitals.[29]

The growth of microtakaful in Malaysia has been greatly enhanced by these microtakaful protection plans, along with the initiatives mentioned earlier. However, despite this growth, the level of understanding and awareness of microtakaful in the country remain low.[30] Thus, developing the microtakaful sector in Malaysia will require efforts to increase this awareness, to encourage investment in demand-side studies, and look for opportunities to counter the ongoing challenges of affordability and product design.

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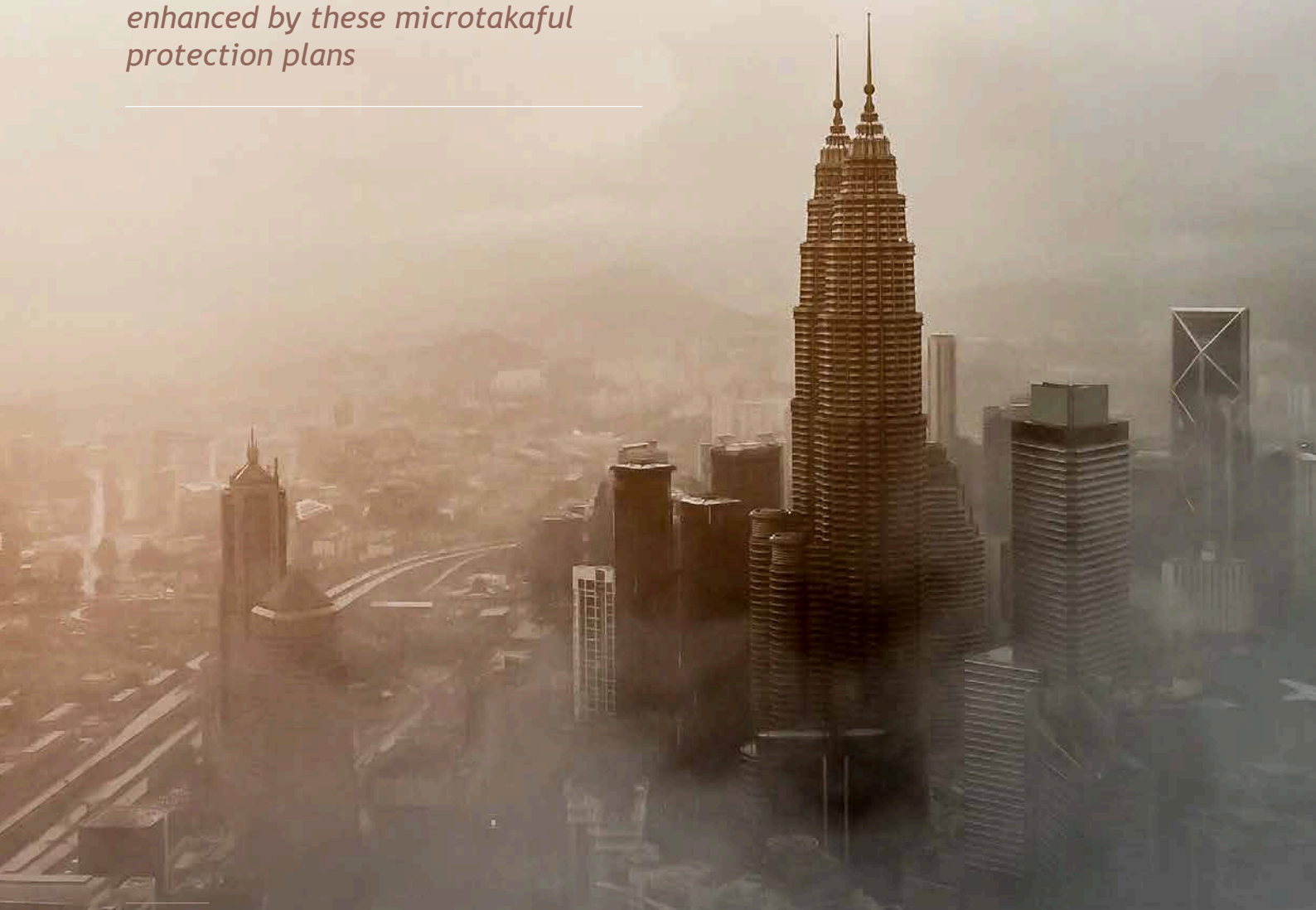

[29] *MySalam* National Health protection plan official website – https://www.mysalam.com.my/b40/info/?url=FAQ-EN

[30] Salleh, M. and Padzim, F. Z. (2018) 'The prevalence of micro Takaful products in the eyes of Malaysian SMEs', International Academic Journal of Business Management, 5(3), pp. 49-65. https://www.researchgate.net/publication/325141499_The_prevalence_of_Micro_Takaful_Products_in_the_Eyes_of_Malaysian_SMEs

Conclusion

Emerging microtakaful markets show immense growth potential but are faced with many challenges, several which are similar to the challenges faced by the global microinsurance industry. Furthermore, the principles at the foundation of takaful and microtakaful suggest scope for inclusion by their very design.

For microtakaful to play a significant role in financial inclusion and poverty alleviation, regulatory interventions that facilitate a conducive ecosystem for product development and distribution will be required. Most active takaful markets are still developing these guidelines for microtakaful, which is a challenge: the 2015 IFSB-IAIS Joint Paper on Issues in Regulation and Supervision of Microtakaful notes that regulators have little experience or empirical data to support the development of microtakaful-specific guidelines. Additionally, interpretation of Sharia[27] differs – impacting regulation, governance, and products, and making coordinated efforts more difficult – and the role of entities like the Sharia Supervisory Board in promoting microtakaful have not yet been fully defined. This is compounded by the current lack of robust microtakaful literature in general – and information on global best practices in particular – for the industry to leverage.

Finally, as our case studies suggest, there is a lack of awareness on microtakaful (compared to takaful and traditional insurance/microinsurance) among the target segments that must be addressed to enable the industry to grow. This will be a challenge due to the lack of in-depth analysis of marketing approaches and the behavioural economics of customers engaging with microtakaful products but is a critical next step. Increasing the information available throughout the ecosystem can only help with the design of customer-centric solutions and is key to developing the global industry and enabling microtakaful to play its role in driving inclusion.

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