Takaful: strong growth perspectives in Europe

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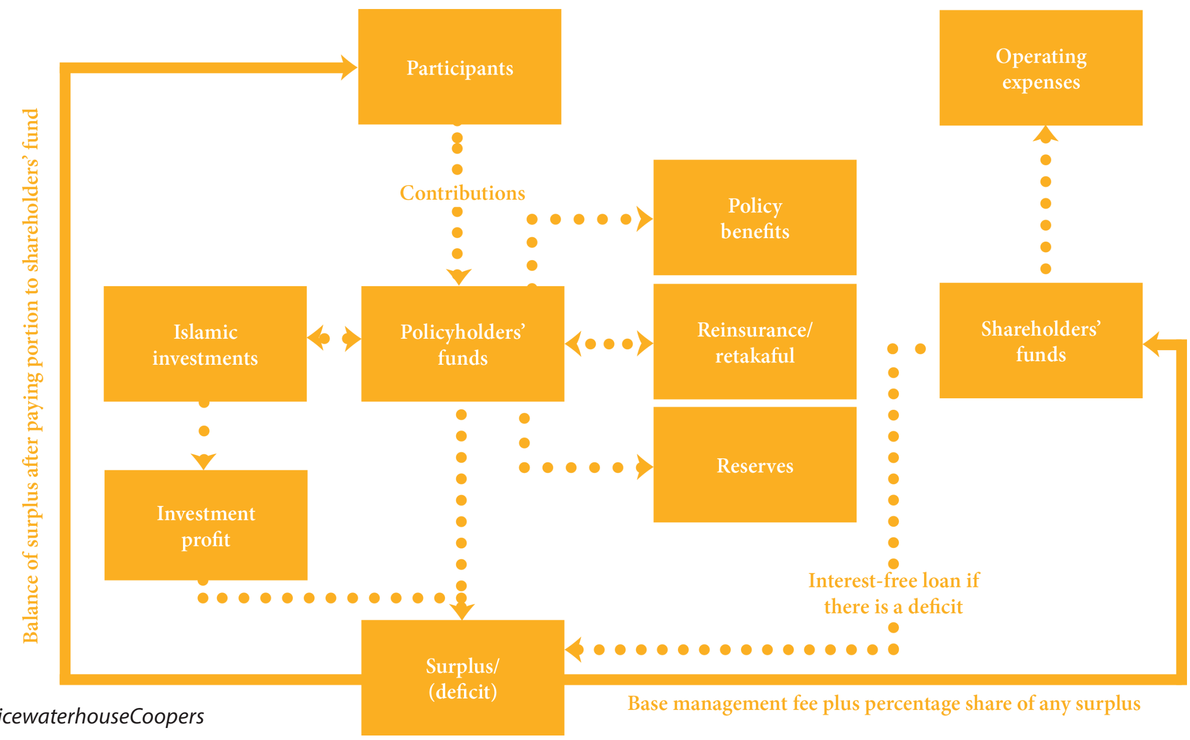
The universe of risks is expanding. Globalization and new economic and technological activities mean new risks for the future, and with these new risks come more development opportunities for the insurance industry.

Historically, there have been three basic corporate models to deliver insurance: conventional, mutual, and cooperative. A fourth model has emerged three decades ago and has evolved quickly reaching phenomenal growth rates and expanding across the world. Takaful, is simply a form of insurance, that is shariah-compliant, this means it follows Islamic tenets as well as is deemed fair, transparent and ethical. Takaful companies have to follow Islamic finance principles, and appoint a board of shariah scholars to ensure that both the products and the operations of the company comply with shariah law.

Takaful rests on several basic principles: a participant-owned fund, mutual guarantee, shared risk, no uncertainty nor speculation, no charging of interest, and investments must be screened and confirmed shariah-compliant and finally, operational models (Wakalah and Mudarabah) must be transparent and fair. Takaful arrangements can be used to pool either general insurance risks or life (known as family takaful) risks, covering the same spectrum as conventional insurance.

The aim of the shareholders is not trade or profit from other people's money; their goal is solely to distribute risk among themselves, there is a clear segregation between 'participant' and 'operator'. In the Wakalah model, the takaful operator acts as an agent for the policyholders. In this model, the shareholders' fund is paid a pre-agreed proportion of the contributions paid by the policyholders from the takaful fund in return for running the takaful operations on their behalf (wakeel fees). In the Mudharabah model, the operational structure is similar except the shareholders' fund receives a share of the profit (or loss as the case might be) from the policyholders' takaful fund. Mudarabah is known as the profit-sharing model. Today, wakalah has become the model of choice with most Takaful operators, as the fees are pre-determined.

Mudharabah Model



Source: PricewaterhouseCoopers

There is a clear convergence between mutual insurance, cooperative and takaful. Takaful in principle is 'mutual,' based on solidarity and risk-sharing principles, and 'co-operative' insurance in principle is mutual, the cooperative insurance values are defined as : self reliance, self responsibility, equality, equity and solidarity.

Just like mutual insurance, the takaful fund is not owned by shareholders but by the policyholders, which eliminates the conflict of interest that can occur for conventional insurance companies. For cooperative insurance companies, the shareholder and the policyholder are the one and same person. The policyholder, through his or her role as part owner of the fund therefore the company, has the right to elect members of the management, hence have a say as to the strategic decision process of the 'mutuelle'.

The corporate structure fort is similar, but integrates another element into the mix: the Shariah Board, which is made of three Islamic scholars who are involved in the development of products as well as in the issue of fatwa, (ruling on a point of Islamic law ie: approval of the Board regarding the shariah compliance of a given product). The Shariah Board ensures that the products to be issued on the market do not contain any elements which could be considered 'haram' (forbidden). As an example, if the takaful fund plans to invest in a certain stock, the Shariah Board makes sure that the stock has been properly vetted ie: that it doesn't invest in the financial sector, alcohol, the entertainment industry armament or tobacco. Once the stock gets the approval of the Shariah Board, a fatwa (a formal certificate of authenticity) is issued, deeming it fit to be invested in. The takaful operator can do so, safe in the knowledge that the policyholders will subscribe an insurance policy, whose underlying assets are compliant with their religious and ethical beliefs. Operator is expected to provide an interest free loan (qard al hasan) in case of a deficit in the fund which will be repaid out of future surplus arising.

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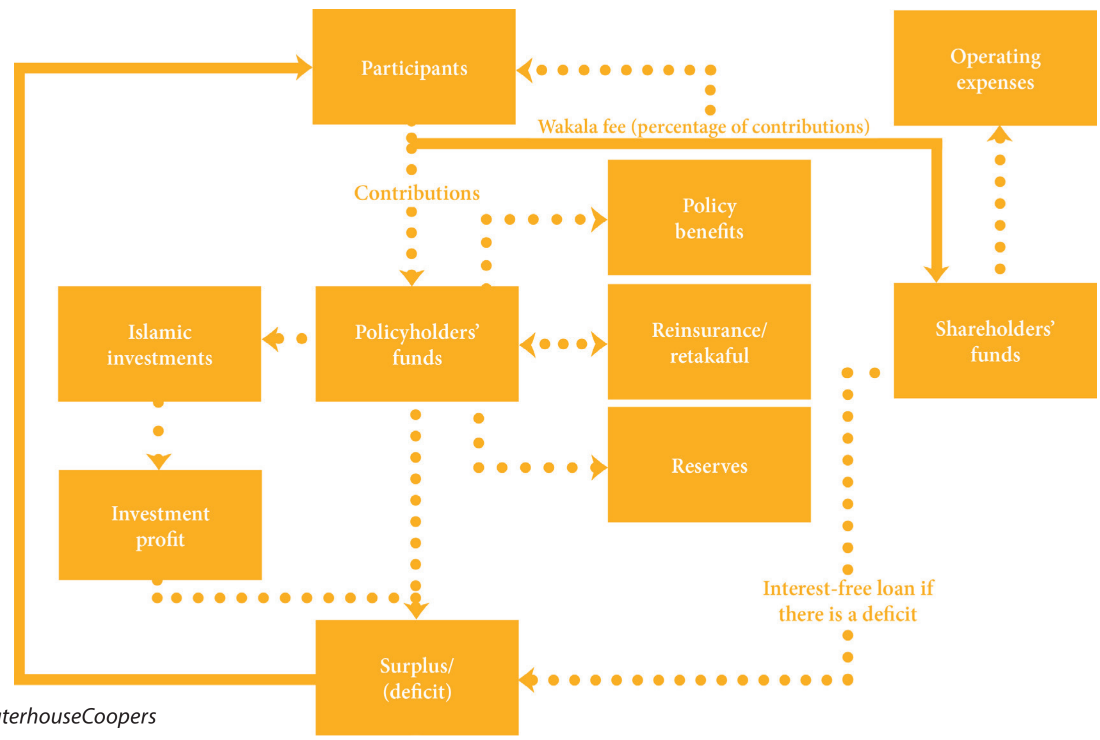
Opportunities for takaful in Europe

The focus in providing Islamic financial services in Europe has been primarily in the area of banking. But as the retail Islamic banking share grows, demand for shariah-compliant insurance will have to follow especially when the awareness and tendency to purchase insurance is undeniably much greater in western jurisdictions than in developing countries. Hence, takaful would seemingly target a much more informed market segment, including the 53 million Muslims residing in Europe where coverage is viewed as something necessary rather than exotic.

The largest volumes of takaful contributions may still be in the Middle East and South East Asia but its dramatic growth has enticed major conventional insurers to buy into the concept. Axa, Allianz, Aviva, UK Prudential all have entered the takaful fold with shariah-compliant operations.

Re-insurance giants such as Munich-re, Hannover-re, Swiss-re and Scor have also followed by setting up suitable re-takaful solutions. Although outside of their home markets, these European players are well equipped to transfer their takaful expertise, as the call for alternative offerings is growing, opening up western markets for takaful in its next phase of development.

Wakala Model



Source: PricewaterhouseCoopers

Many industry experts argue that the maturity of the insurance industry in Europe could make the expansion of takaful more dramatic in Europe than in the traditional markets of Middle East and South East Asia, provided the right products and regulatory balance can be found. Given the maturity of life market in Europe, family takaful is forecast to have vast opportunities to develop especially with the growth predicted for private pension plans. Mutual insurance which is a popular protection product especially in some European countries such as France, has outperformed the conventional insurance in the past few years, in a number of European countries, reflecting that value based insurers are attracting more customers than their conventional peers.

The transparency of contracts used in takaful and the avoidance of industries such as alcohol, gambling and tobacco in the investment portfolios of takaful companies potentially appeals to customers looking for ethical financial services especially with the increasing interest in SRI (socially responsible investments). Takaful has still not seen major developments in Europe although, the first takaful company found home in Luxembourg more than a decade ago in 2002, followed by the UK further in 2008 when Britain's first shariah-compliant insurance company was launched.

No additional dedicated takaful companies have been established but few products have been introduced, such as the recent initiative by Swiss Life which has launched what is believed to be Europe's first family takaful product, primarily aimed at French customers looking for Islamic finance or ethical investment solutions. Salam Epargne & Placement, a life insurance product aimed at French residents, enables policyholders to invest in the various UCITS of the Salam-Pax Sicav, a 'shariah-compliant' fund of funds. It has been

Exhibit 1

	Takaful	Cooperative insurance	Mutual insurance
Contracts utilised	• Donation and mutual undertaking based on non-renumerative/ non-commutative contract • Not an exchange/commutative contract	• Mutual contract	• Mutual contract - considered to be an exchange contract on principles of mutuality
Company's responsibility	• Manage the participants' fund • Pay claims from underwriting fund • Provide interest free loan to underwriting fund in case of deficit	• Pay claims with underwriting fund • Pay for deficits if any	• Pay claims with underwriting fund
Participants' responsibility	• Pay contributions	• Pay contributions (and pay for deficits in some models)	• Pay premiums (and pay for deficits in some models)
Capital utilised for underwriting business	• Participants fund and in case of shortfall, temporary access to shareholders' equity on a qard al hasan basis	• Participating capital and accumulated surplus	• Participating capital, accumulated surplus and guarantee capital (if applicable)
Investment considerations	• Shariah-compliance and prudential	• No restrictions except prudential	• No restrictions except prudential

Source: EYs The World Takaful Report 2012

	Mutual insurance	Takaful	Conventional insurance
Contract forms	Bilateral contract	Donation and mutual contract	Exchange contract
Company's responsibility	Pay claims with underwriting fund	Pay claims with underwriting fund, and interest free loans in case of shortfall	Pay claims with underwriting fund and shareholders' equity
Participants' responsibility	Pay contributions	Pay contributions	Pay premiums
Capital utilised	Participating capital	Participants' funds	Share capital
Investment considerations	No restrictions except prudential	Shariah-compliant	No restrictions except prudential

Source: Clyde & Co

certified by the European Independent Committee of Islamic Finance (CIFIE).

In Germany, FWU, the Munich based financial group has also launched in 2012 a Family Takaful Savings plan distributed through financial intermediaries.

Major opportunities for Islamic financial services remain in the UK, France and Germany due to the concentration of Muslim communities in these countries. France in particular has been very proactive in integrating the alternative finance with major tax and regulatory reforms in favour of facilitating the introduction of shariah-compliant products to the market.

Community banks such as Chaabi Bank, the long-established French subsidiary of Moroccan Groupe Banque Populaire., has already launched the first shariah-compliant deposit account in France last year, and plans to roll out a full set of alternative financial products in the near future.

Germany has also witnessed some recent action in terms of welcoming shariah-compliant finance. The first bank to operate under shariah principles was issued a license in 2010, and in the same year, Meridio, an asset management company headquartered in Cologne, the first actively managed Islamic fund.

Conclusion

It seems that takaful, which knows outstanding growth in more mature markets such as the GCC and South East Asia, has the opportunity to grow in Europe, should the right conditions such as regulation, distribution, cross-border selling and marketing be put together. We have seen that locally, especially in France and Luxembourg, governments have embraced the idea of developing takaful in their respective countries. And the target market should not necessarily faith-based, takaful has the attributes to appeal to a larger customer base including non-Muslims. Product innovation, with a customer centric approach, consumer education, easy access to fair and ethical investment vehicles, as well as corporate governance, are key factors that can contribute to takaful gaining critical mass in Europe, the experience and skills gained by European major insurers, reinsures and banks will play a major role in facilitating the inclusion of takaful in the western market.

The various regulatory reforms that were conducted across Europe to integrate shariah-compliant finance, coupled with mandatory insurance and European passport instituted in 2002 that allows insurance providers registered in a member of the EU to provide their services to the whole European market, will speed up the expansion of takaful products further.

If the several attributes of mutual and cooperative insurance that takaful has will facilitate its inclusion within the European insurance market in general, some markets such as France can also benefit from the few differences that should help accessing another customer community within the country, and also in Francophone Africa where French banks and insurance companies have a footprint like Morocco, Tunisia, West Africa etc. ■