

Prospectus & problem of Takaful in Bangladesh

Background: We are exposed to some sort of risk in our lives. These risks may be expected or unexpected, and may occur to our life, our assets or businesses etc. These risks affect us to the extent that we may become destitute. Our religion, Islam encourages us to take effective measures against these unexpected incidences. These measures are called Ikhtiar. Its historic evidence is found when Hazrat Yousaf A.S. asked his fellow men to build reserves of grain for seven years so that during the draught years these could be made available.

The word "Takaful" has come from the Arabic word Kafalah, which literally means "guaranteeing each other" or "joint guarantee". Takaful is commonly referred to as Islamic insurance even some people claim it as not an insurance contract. Takaful, as practiced nowadays, is near to investment contract compared to insurance or pooled fund contract.

1.2 The Prohibition of insurance in Islam

Insurance in its present form is not acceptable under Islamic Shariah. Following are some of the factors for its prohibition:-

1.2.1 Gharar: A transaction should be free from uncertainty i-e Gharar. This restriction in Islam is made to stop the exploitation of common man. This element is present in conventional system of insurance as the insured party is liable to pay the premium but its outcome or claim is uncertain to happen and also is the quantum of loss. Similarly the insurance company is unaware of the future claim payments under the specific policy / plan etc.

1.2.2 Maiser: Maiser or gambling is also strictly prohibited in Islamic Shariah. This element is present in insurance system when the insured person wants to get a big claim against the small premium. In this scenario the insurer company is at loss. However, the specific event doesn't happen than the policy holder loses his amount and the company is in benefit. Similarly we observe that in case of cancelation or termination/ surrender of insurance contract the policy holder is at loss.

1.2.3 Riba/ Interest: In the insurance context, a fixed amount of profit given by the insurer company to the policy holder and also to its share holders is called interest or Riba, which is strictly prohibited. The investment portfolio of the companies is also consisted of those areas which involve interest income.

1.3 Need of an insurance system based on Islamic Shariah:

As we have elaborated the basic reasons of prohibition of insurance system in Shariah, naturally the question arises for its alternative based upon Islamic economic principles. This need gives rise to development of Takaful Insurance system based upon Islamic Shariah. Some of the basic elements that laid the foundations of Islamic insurance system are following:-

1.3.1 Insurance with conventional form is an integral part of market economy, so it also contains economic evils of interest, gambling and uncertainty. However, the Islamic insurance system is based upon the universal principles of Takaful and Ta'awun i.e. granting & cooperating with each other. Under this arrangement, a group of people agree to protect each other from a specific event of loss. Participants of the group willingly help and protect each other with sincerity.

1.3.2 Brotherhood and solidarity with each other are cornerstones of this system. The participants of the group achieve collective rights and benefits for each other, whereas the operator of this system who is called Takaful operator manages the takaful fund which is created through the contributions of its participants. This contract is based upon the universally accepted Islamic principle of Tabarru and Modarbah.

1.3.3 In the case of conventional insurance, the company income also includes underwriting surplus. An underwriting surplus is basically the difference between total amount of premium earned and total claims paid to the policyholders whereas, investment income is also part of it. The company has the discretion over the profit distribution, due to which there arises a conflict of interest between the policy holders and company share holders. In contrast, under Islamic mode of insurance the operating company has no rights to claim the underwriting surplus. The Takaful contract specifies it in advance about the distribution of profit share.

1.3.4 Insurance in conventional form is basically profit oriented and company's primary objective is to earn maximum revenue and profit for the owners / share holders. Conversely, the Islamic mode of insurance is running on principles of collective welfare and brother hood. It is basically a nonprofit oriented concept. The operator of the company receives Wakalah fee or service charges etc only.

1.3.5 Under insurance contract, if no claim arises during the time period then the premiums are lost. But in the case of Islamic insurance, if no claim arises then the surplus of underwriting income is distributed to the policy holders, or with consent of policy holders it is given to the charity.

1.3.6 Under the conventional life insurance contract, either the policy holder gets maturity payment or the nominees of policy holder get the insurance claim in case of his death, but in the life takaful policy there are two types of accounts, the participant special account called PSA, and participant account called PA. In case of maturity of policy contract, the takaful policy holder only receives the amount earned under the participant's account (PA) and in case of death of policy holder; the beneficiary receives the claim value from the participant special account (PSA) and also the accumulated value of participant account (PA).

1.3.7 The investment portfolio is entirely the discretion of company in conventional insurance but in the case of Islamic insurance the takaful contract specify in advance about the mode of investment of the premium contribution which are strictly Shariah compliant only.

1.3.8 The conventional insurance company has no obligation to pay Zakat but the Islamic insurance company pays the Zakat on annual basis.

Principles, Types & Shariah Issues of Takaful System:

Takaful is an alternative insurance system based on the Islamic Shariah principles. Investopedia defines takaful as “The type of Islamic insurance in which the members called participants contribute their money into a common pool called takaful fund with the aim to compensate each other against a specific and predetermined loss”.

The participants also contribute a certain amount in the Tabarru or donation fund which is also managed by the takaful operator.

Takaful insurance is based upon the Islamic principles of Akhuwat, Ta’awun and Tabarru, with the sole purpose to extend financial assistance to the participants of fund in case of need and hardship.

The contributions are used to help the needy participants in the case of any unfortunate incidence and the takaful operator acts on behalf of the participants. After meeting all the obligations the surplus i.e. the underwriting surplus is paid back to the participants as the takaful operator is only liable to charge its administration /Wakalah fee.

1.5.1: Principles of Takaful

These are two basic principles:

Ta’awun, which is called mutual assistance among the people, &

Tabarru, the willingly donation/contribution for the benefits of weaker/poor.

Some of the Ayyatts and Ahadith in their context are presented for reference:-

“Help ye one another in righteousness and piety but help ye not one another in sin and rancor” (Al- Maidah: 2).

“Allah will always help His servant for as long as he helps others”. (Narrated by Imam Ahmad and Imam Abu Daud).

“The place of relationships and feelings of people with faith, between each other, is just like the body; when one of its parts is afflicted with pain, then the rest of the body will be affected”. (Narrated by Imam Al-Bukhari and Imam Muslim).

“One true Muslim and another true Muslim is just like a building whereby every part in it strengthens the other part.” (Narrated by Imam Al-Bukhari and Imam Muslim).

1.5.2: The Key Elements:

The key elements which make takaful system a successful and feasible alternative insurance system are following:-

Elimination of Gharar: The element of Gharar or uncertainty is avoided the tabarru or voluntary donations that aim to mutually assist the participants in case of an unfortunate incidence or loss.

Takaful Fund: A takaful fund is created by contributing donations of participants and claim liability is spread among them.

Participants as Owner of Fund: This fund is owned by the participants and not by the company as the company only acts as a takaful operator, not the owner.

Management: The fund is managed by the competent takaful management as per Shariah allowed principles of Modarbah and Wakalah business model.

Investments: The investments are strictly made as per Shariah principles and avoiding the elements of Riba/ interest income.

1.5.3: Types

Takaful products are basically of two types known as General Takaful and Family Takaful.

General Takaful: General takaful is similar to conventional general insurance and covers all aspects of life except life and health coverage. It is a short term in nature usually from some days like Travel Takaful to a year like fire, home, car takaful etc.

Family Takaful: Family Takaful is an alternative savings scheme of life insurance in accordance with Shariah with long term financial objectives. It gives protection to the beneficiaries of the participant financially if any calamity or death happens in the future. The main concern of the family Takaful plan is the distribution of Takaful benefits in the event of the participant's death. It is the alternative of the conventional life insurance having long contract term of ten years or more. Some of the common & popular takaful products are; Family Takaful; Health Benefit Takaful; Critical Illness Coverage; Education Benefit takaful & Savings Benefit takaful.

1.6: Shariah issues in Takaful industry:

Although Takaful mechanism is derived from two primary sources i.e. the Holy Quran and Sunnah of Hazrat Muhammad (SAW), no one can guarantee that its implementation is fault-free. There are still certain Shariah issues surrounding the implementation and operations of Takaful which have yet to be resolved. This is because, Quranic verses and the Sunnah of Hazrat Muhammad (SAW), are interpreted in different ways. The main issues surrounding takaful operational mechanism are as follows:

1.6.1: Issues of Nomination and Hiba:

Nomination is the process of appointing a person or persons who are entitled to receive the policy benefits in case of policyholder's death during policy tenure. Nomination is an important process that ensures that benefits to the nominated person are paid promptly. There are two major views regarding the status of nominee. One view holds that the takaful benefits are the wealth of the deceased and only his legal heirs can be nominated. The other view holds that the participant can gift the takaful benefits to anybody as a hiba and hence can

nominate anybody. Hiba can be defined as “a voluntary contract that results in uncompensated ownership transfer between living individuals”. In other words, it can be referred to as giving ownership of one’s property to another without any rewards in return. Some takaful operators also use the Hiba concept for the nomination. Usually application of hiba in Takaful products leads to an issue. The issue arises between the legal heirs and the donee regarding the Takaful benefit. The reason may be due to lack of knowledge on the application of the concept of hiba. There are different opinions regarding the application of hiba in nomination. It can be best understood by looking into some of the issues in hiba. According to Islamic concept of hiba, gifts can be given during the lifetime of an individual. But in family Takaful, the Takaful benefits are given as a gift if the policy holder dies before the maturity. Thus, it goes against the nature of hiba itself. Another point to be noted is that if Takaful benefit is distributed after the death of the participant, it must be done with following preconditions: First, the estate of policyholder should be distributed in a manner that it should not exceed one third of estate excluding the expense & debts. It should also be regarded as Wasiyah and not as Hiba. The Islamic financial institutions including takaful industry are working over the concept of Hiba to customize it in the structural framework.

1.6.2: Issues of distribution of surplus:

Mudrabah is the first operational model in the earlier day of takaful. Under the Mudrabah contract, the distribution of surplus income between participants of takaful fund and takaful operator is specifies. Participants of takaful fund are regarded as Rab ul Maal(Fund provider) so any loss is to be borne by them only. There are two different views for the surplus distribution. The first one categorically prohibits the sharing of the underwriting surplus, & other view validates the surplus sharing.

1.6.3: Issues related to Tabarru:

The Takaful industry is simply a mutual insurance. The takaful contract shows the spirit of cooperation called Tabarru in Islam. Tabarru literally means Donation, grant or contribution etc. in the takaful context; a voluntary amount donated by the participants in the takaful fund is called Tabarru. This fund is then used to support the unfortunate. There are two main Shariah issues related to Tabarru contract.

First, As the fund participants are owner of Tabarru fund, the company not entitled for any profit derived from the fund. Thus, any surplus from the fund must be return back to the fund, for the mutual benefit of the participants in the future. What is happening right now is that, the Takaful operator also share the portion of the profit derived from the fund.

Second, Under the Tabarru concept, a person is not entitled to get back what he has contributed to Tabarru as it already belongs to the mutual fund of all participants. The issue arises when the Takaful participants are entitled for the surplus derived from the fund.

For the first issue, some scholars permit the Takaful operator to take portion of the surplus as administration charge. On the second issue, some scholars permit the participants to take surplus distribution as the Tabarru fund is meant to benefit the contributors themselves. In

addition, the practitioners argue that, the surplus must be distributed to the participants in order to be competitive to insurance counterparts. If Takaful operators do not distribute the surplus to the participants, they may run away and subscribe insurance policy.

3.1 TAKAFUL BUSINESS MODELS

Commonly known business models are following:

Modarbah Model

Wakalah Model

Mixed Model

- **Modarbah Model:**

Courtesy: Insuranceinfo.com

Modarbah is a contract between two parties, one is called Rabul Maal (investor) and the second is called Modarib (the manager). There is contract agreement regarding the share and profit and losses etc between them. Two separate funds are created by takaful operator, called Participant account and Participant special account. As the above model describes, Participant account is related with the investment portfolio of participant, whereas Participant special account deals with the claims and other expenses plus any profit / loss arising out of investment fund.

The contract specifies the ratio of surplus and profits distribution and between participant and takaful company. The Shariah principle of profit loss sharing is foundation of the modarbah model. Predetermined share of under writing surplus and profit on the investments is given to the takaful operator as it runs all core activities. Profit is earned by investing the participant account funds in halal and Shariah compliant business activities and surplus or profit is then shared in predetermined ratio.

The takaful operator is also entitled for service charges for doing all the activities to run the company, but it does not share loss as it works as modarib only. These losses are born by primarily the investment surplus and then by participants contributions (i.e. tabarru) to meet the claims for general takaful fund.

- **Wakalah Model:**

Courtesy: Insuranceinfo.com

It is a different model from modarbah as the takaful company charges a wakalah fee as service charges. The Shariah advisory board of the company determines the amount of fee. In this model the takaful fund the operator is considered a separate entity and the company is considered as wakeel. The company charges a fee as service charges and it is not sharing in

any of the underwriting results. The operator provides services against pre agreed wakalah fee. The net income of underwriting results and investments profits pooled in participant special account after deduction of wakalah fee. This profit is then distributed to all the participant policy holders proportionally after all claim liabilities are paid. Besides that, a contingency reserve fund is also maintained.

The participant also has rights over the tabarru or donations so it is conditional donation and not mandatory for the participants.

- **Mixed Model**

Courtesy: Takaful growth opportunities- pricewatercoopers inc.

The GCC countries have mostly adopted the mixed model of Wakalah / Modarbah, but it is also used by some operators in other countries. In principle, the takaful contribution funds are segregated in two funds namely shareholder's fund and participant fund.

In the case of mixed Wakalah/ Modarbah model the company operates two separate funds. The Wakalah contract is used for underwriting activities while Mudarbah contract is used for investment portfolio. The shareholders takaful company become wakeel or agent of participants/ policyholders and manage the activities of company, and the operator charges a fee from each participant. This fee is normally a percentage of the contributions of participant and is a major income source of company. It is a fixed fee and it is already disclosed in the contract to the participants.

Under the Modarbah contract the company invests contributions of participants in Shariah compliant investment avenues. A profit share is also allowed from the investment income for the company.

3.2 Performance of Different Sectors of Takaful Industry

Although insurance sector in general has globally experienced a solid growth of 11% in the last decade, the takaful industry growth is restricted to mainly in some parts of the Muslim world. Insurance culture is not prevalent in Muslim world, so takaful growth is also at a low pace. However it has a great potential being a large size of Muslim population and it is expected that takaful growth and penetration may surpass conventional insurance in future in Muslim countries. Key takaful markets are Malaysia and Saudi Arabia. In other parts of world, takaful operators lack of scale. The main business segments are following: Motor takaful, Property and Accident takaful, Marine and Aviation takaful, Medical and Family takaful. Family and medical takaful are the most popular segments in all the markets

- **Takaful Industry Financial performance:**

Size and growth of life insurance

Source: Ali (2017)

Category	Gross premium		Market share		Growth rate (%)
	2009-2010	2011-2012	2009-2010 (%)	2011-2012 (%)	
BDT million					
Islamic Insurance	8637.59	5669.30	33.02	25.95	-34.36
Insurance	17,520.09	16,178.85	66.98	74.05	-7.66
Total	26,157.68	21,848.14			

Size and growth of non- life insurance

Source: Ali (2017)

Category	Gross premium		Market share		Growth rate (%)
	2009-2010	2011-2012	2009-2010 (%)	2011-2012 (%)	
BDT million					
Islamic Insurance	1185.18	2326.40	5.19	4.55	96.29
Insurance	21,659.95	48,769.80	94.81	95.45	125.16
Total	22,845.13	51,096.21			

- **Takaful Industry Products and Services:**

Product development is the core of the Takaful industry survival. Customers are knowledgeable and demand those products which are Shariah compliant and have innovative features. These products should be of the level to compete with conventional companies these should also be compatible for individual customers and corporate sector clients. The Takaful operators need to develop products that follow the Shariah principles. It shouldn't be done by renaming the conventional products as takaful products without really following the Shariah principles as it will also cause customers to lose faith in Takaful. Although takaful is a young industry and a lot of conventional practices are still used, it is time to phase it out and become more Shariah compliant. Basically the market for Takaful products is vast and there is great potential. To market the products to the potential clients needs to benchmark against successful companies to look into their business model and marketing techniques.

- **Takaful Industry Regulations:**

There is a need for standardized regulations for the takaful industry worldwide. These regulations can help consumers decide which practices and models are acceptable to them. There is also need for regulations to protect consumers against the bankruptcy of established operators. In most countries, there is currently only limited Takaful specific regulation. At the same time, there have been some initiatives launched recently to expand the regulatory framework. One particular challenge is to take into consideration the specifics of Islamic

Takaful and Retakaful. An adequate regulatory framework will have a positive effect on Takaful industry growth. Only Malaysia, Pakistan and Bahrain have issued specific laws on takaful. Qatar issued Islamic Finance Amendments Rules in 2012, whereas in Pakistan these rules were introduced in 2005. The other markets suffer lack of regulations. The Industry suffers from absence of standardization that affects their business especially companies with cross-border selling.

- **Takaful Industry Marketing:**

Despite an increasing Islamic consciousness, awareness about Takaful is still low. There have been cases of takaful companies that had to limit their customers and merge with other takaful companies as they could not get enough funds to be able to compensate the claims. Muslim & Non Muslim population should be offered with customized needs. As takaful companies have been established few years back so they have tough competition with conventional insurance companies and they have to differentiate on the value proposition from other in the market. An equitable and transparent marketing approach complying the Shariah rules and regulation should be adopted. For this, it is paramount to have a distinctive branding strategy by the Takaful industry highlighting the benefits of Takaful.

- **Takaful Industry Distribution channels:**

Takaful companies are using a variety of distribution channels. The takaful business is retail-based, and it has lack of identification of most effective forms of distribution. In fact, the commonly used channels are branches, agents and Islamic Banks known as Bancatakaful. In Malaysia takaful companies use following distribution channels: Retail and corporate agencies, Bancatakaful, Corporate direct channels, Brokers & direct marketing channels. Technology has been increasingly used in distribution of Takaful products. Bancatakaful is considered the best instrument to distribute takaful products in markets with very low penetration rate.

- **Takaful Industry Customer Service:**

Most of business in Takaful or insurance sector comes through agents who have personal contact with customers. Providing good customer service is highly important to survive in the industry. The Takaful industry needs to build customer service levels and develop best strategies to achieve higher service standards. Takaful companies need to differentiate themselves by offering value added services that conventional insurance cannot, that are widely accepted and with the potential to be developed further and to be enhanced within the industry.

- **Takaful Industry Human Resource:**

The Takaful industry needs Shariah scholars who have expertise in both Islamic finance and Fiqah. Due to shortage of these talents, many scholars sit in various boards. There is a need to establish full time national Shariah boards which look after the Shariah issues of all Takaful and re-Takaful operators. This will be an important step towards the harmonization of practices. For Takaful and retakaful operators, it is also difficult to find suitable employees with at least some background in Islamic finance especially if they want to expand into new business.

- **Takaful Industry & Retakaful:**

Reinsurance sector plays a pivotal role in the survival of insurance industry and retakaful is basically an Islamic form of reinsurance. The conventional insurance company manages its risk portfolio of big amount claim payment by ceding a portion of its risk with another insurance company called reinsurer. In case of any loss like natural disaster, riots or incidence like 9/11, due to which a large number of policy holders are affected, only way of survival of an insurer is to transfer the risk portion to a reinsurer.

A takaful operator also transfers risk and pays a portion of premium to retakaful company and in return the retakaful company shares the risk. A takaful operator is unable to bear the whole risk as in case of catastrophic loss, all reserves may be depleted and company may become insolvent. All the share holders and participant policy holders will be at loss in this situation. A retakaful arrangement gives stability to the takaful industry. Operational mechanism of a retakaful company is same like a takaful company with a difference that customers of retakaful company are fund operators and others takaful companies, whereas customers of a takaful company are general public, business owners and commercial entities.

It is mandatory for a retakaful company to operate business as per Shariah rules especially in its investment portfolio. A retakaful contract is made for this purpose between takaful operator and the retakaful company. The participant policy holders of takaful are not involved in this agreement.

In case a takaful company becomes insolvent due to large no of catastrophic claims then a Qard-e-Hasna is given by Retakaful Company to pay these claims. This qard-e-hasna is interest free in nature, which is to be paid in coming years or it is deducted from the surplus results of that company in following years.

The collections of Retakaful Company are invested as per Shariah laws and on Mudarbah basis and profits etc are distributed as per retakaful contract. These companies are developing innovative strategies & products for new markets and investment avenues.

10.1 Challenges for Takaful Operators

The potential of Takaful is beyond question. But there are many hurdles to overcome if this market is to realize its potential.

Human resource

Human resources pose a major obstacle to growth, as the market is facing a severe shortage of qualified staff who understand both technical insurance principles and have an adequate awareness of Shariah finance.

Customer awareness

One of the biggest challenges is creating customer awareness. Many Muslims live under the misconception that insurance is contrary to the principles of Islam, particularly with regard to

life insurance. People have to be made aware that Takaful provides an acceptable religiously validated solution. Similarly, non-Muslims need to be made aware of why Takaful is ethical.

Lack of unified rules

In Bangladesh Takaful business operation is almost new. It has started in the year 2000. So it is needed to set out clear principles on how Takaful business should be taxed, and to create a regulatory regime that does not treat Takaful less favorably than conventional insurance.

Financial instrument

The limited availability of short-term non-equity financial instruments such as sukuk and Shariah-compliant money market instruments equivalent to treasury bills represent a further challenge for Takaful companies, making managing their investment portfolio more challenging than for conventional insurers who can simply invest in bonds and cash assets.

Lack of Islamic Law

Takaful business operation is different from the conventional insurance companies. But all the Islamic insurance companies need to follow the insurance act for conventional insurance. At least government can take the steps to amend the insurance act 1938 for Islamic insurance operation.

Product innovation and after sale service

Along with these challenges, Takaful providers must enhance their product innovation and continue to offer a high level of customer service. They must be able to understand evolving customer and market-specific needs and be willing to renew or re-engineer product design and consumer benefit packages, as well as expand customer reach across various distribution channels.

Lack of commitment by the company

The members of the Islamic life insurance business do not follow Islamic rules and Shariah in each operational activity strictly. This discourages the customers to take Islamic insurance in some cases.

Lack of professionalism

There is lack of professionalism in Takaful insurance operation. There are a few numbers of insurance professionals and actuaries in our country. The market research and other financial

research for Takaful business is also in insignificant magnitude. Because of all those problems there is no dynamic change in the Takaful business operation in Bangladesh.

10.2 Prospects for Takaful Operators

Takaful insurance has bright prospect in Bangladesh. Besides the conventional insurance Islamic insurance can flourish in our country. The prospect of Takaful business in Bangladesh is given below:

Religious sentiment

The people of Bangladesh have strong religious belief. As Takaful insurance is based on Islamic Shariah, it can take the place of conventional life insurance more easily.

Literacy rate

The literacy rate of country is in increasing trend. People understand the need of insurance for savings and to protect family and him from unwanted contingencies. Takaful business can take this opportunity by following the Islamic Shariah and by offering diversified products, services to the people.

Business development

The prosperity of business and per capita income of the country people is the another opportunity for Takaful business.

Group Insurance

Takaful life insurance companies in Bangladesh have introduced group insurance policies for the business and other institution. It will cover a lot of people in a single policy. And most of the Islamic financial institutions are now taking Islamic insurance from the Takaful life insurance.

Micro Insurance

The Takaful life insurance companies are now offering micro insurance. It enables the poor people to take insurance for future savings and for unwanted contingencies. And it increases the efficiency of economy.

Hajj bima

Takaful business offer hajj bima. It is an important policy for the Muslim people. If the insurance company make this product more attractive by providing additional services it will attract more people.

Lower rate of premium

In abroad people who want to take policy need to pay a handsome amount as installment. But the Takaful insurance has offer product like Islamic DPS and other micro insurance policy in which the policyholder need to pay only a minimum amount. So more people can buy policy if the insurance company can successfully aware the people regarding policy.