

Strengthening the role of Wakeel to enhance takaful value chain

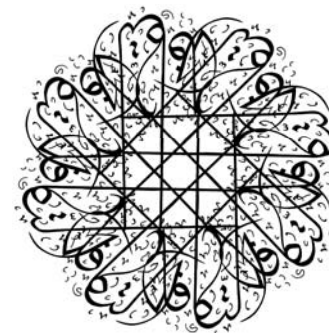
Presented by *Ajmal Bhatty*

Session 6: Regulators' Forum
11am to 12.30pm, 27th October 2010

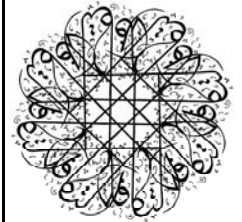
Global Islamic Finance Forum
Kuala Lumpur



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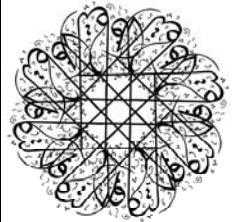


Creating 'enabling' conditions for the Wakeel



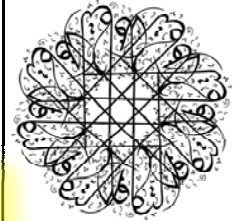
- Still huge gaps exist
- Not entirely the Wakeel's fault
- Several issues that make it difficult to do what is essential in enhancing this 'takaful value chain'.
- Concerted effort needed at the level of regulators, scholars, academia and the governments to create enabling conditions to enhance the 'takaful value chain'.
- Our customers entrust us with their hard earned cash to be applied towards the takaful value chain but is the Wakeel able to follow this through in keeping these values?

Departure from what it should be to what it is in practice



- We build structures that have the promise of complying with the delivery of takaful value chain. In practice how much of this promise is kept?
- We go to the customers with a proposition of insurance that is distinct and unique.
- There are no issues in meeting the claims and providing the service. But how much is there a departure between what the takaful proposition should be and what it turns out to be in practice?
- Without adherence to the takaful value chain, a takaful company and a takaful product would look like, feel like and be like conventional insurance

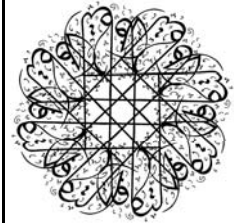
The takaful value chain



The takaful value chain is a system of mutual and co-operative help that enables channelling wealth and capital with social conscience and responsibility, in fairness to others for risk shared and undertaken, providing just reward, encouraging distribution of wealth through savings and insurance protection based on equity, justice and fair-play, helping to enlarge the system as a caring and transparent system,

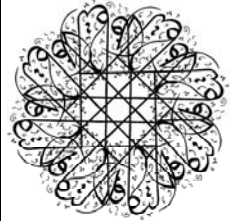
towards the welfare of society, free from exploitation, utilising wealth for generating economic activity in businesses that are socially responsible and eco-friendly. It discourages creating money from money and hence prohibits interest, linking deposits and investments to real underlying assets for a sustainable takaful proposition.

Key issues confronting us in implementing and enhancing the takaful value chain



- 1. Takaful System has a Reputational Risk at its current state of evolution**
- 2. What about Universality of Takaful?**
- 3. There is lack of enabling conditions impacting entrepreneurial drive**
- 4. To compete, takaful standards need to be at par with international standards**
- 5. Is there mutuality between participants and shareholders?**
- 6. How do we enable the industry to practice what we preach?**

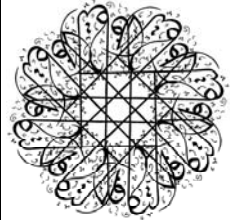
The Reputational Risks



- To what degree is the customer aware of the benefits of takaful value chain?
- Do the customers have any feel of what is meant by mutual and co-operative principles or why takaful is a fairer system except for the explanation of surplus sharing?
- Building the expectations of takaful value chain and then cutting corners outside the principles of Zarurah.
- Let alone the customers, many times there is low awareness of the principles amongst the staff of takaful companies. Malaysia scores better on this aspect.

Universality of Takaful

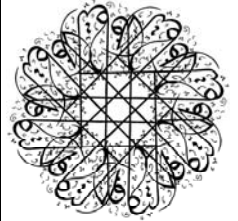
Is Takaful for Muslims only?



If certain principles are good for one, they are good for all

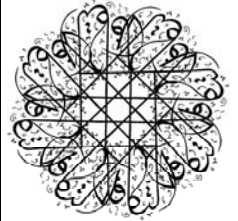
- To what extent does the takaful material and publications talk about the universality of takaful?
- This aspect is of paramount concern
- We need a concerted effort to promote the real value chain of takaful and to demonstrate why it is good for everyone

Web definitions of takaful



- ④ Takaful is an Islamic insurance concept which is grounded in Islamic muamalat (banking transactions), observing the rules and regulations of Islamic law. This concept has been practiced in various forms for over 1400 years. ... en.wikipedia.org/wiki/Takaful
- ④ Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. The concept of takaful is not a new concept; in fact, it had been practiced by the Muhajrin of Mecca and the Ansar of Medina following the hijra of the Prophet over 1,400 years ago. ... www.moneyscience.com

Web definitions of takaful



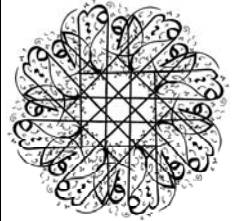
- Ⓢ Takaful is an Islamic alternative to traditional insurance, providing similar protection without violating the principles of Shariah. A group of participants mutually agrees to pool donations in a fund that is used to indemnify each of the participants against certain losses.

www.islamicinvestingguide.com

- Ⓢ Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance, takaful schemes are designed to avoid the elements of conventional insurance (i.e., interest and gambling) that are problematic for Muslims.

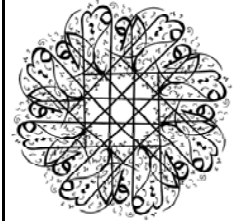
www.firstglobal-group.com

Web definitions of insurance



“Insurance is a promise of reimbursement in the case of loss; paid to people or companies so concerned about hazards that they have made prepayments to an insurance company.”

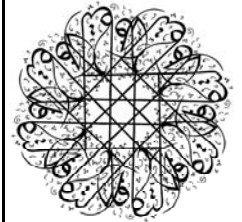
A definition of takaful akin to insurance plus more



“Takaful is a system that enables people and companies concerned about hazards to mutually help each other to reimburse in the case of loss, out of a fund built by their contributions and managed on their behalf by a takaful company. Unlike an insurance company, a takaful company invests all its funds in assets and businesses under defined principles that are good for society and environment at large and when the fund is in surplus, part of the surplus is set aside to be shared with the contributing people and companies within certain rules and conditions.”

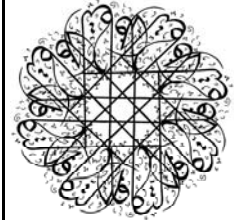
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Lack of enabling conditions impacting entrepreneurial drive



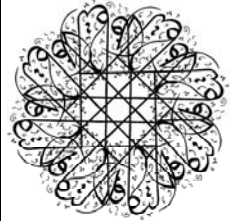
- What is the attraction to an entrepreneur to start a takaful venture? It must make business sensebut with social conscience
- Impediments for a takaful shareholder in getting a decent return?
- Wakala model: Open to abuse and exploitation as wakala fees can be increased to generate higher returns for the shareholders.
- Mudaraba model: It forces shareholder to bear heavy expense burden until surplus arises after a time lag.
- Sticky issues: Sharing in surplus of participants' fund and benevolent loan or Qard.
- The Qard exposes the shareholder to financial risks and puts a dent in the return on his capital.
- For the Wakeel, Qard does not have a legal backing under the statutory regulations of a country and yet it is needed but is non obligatory under Shariah

To compete, takaful standards need to be at par with international standards



- This is essential for takaful companies to compete domestically and internationally
- AAOIFI and IFSB are working hard to achieve standardizations
- There are big gaps between new standards of IASB / IFRS and takaful accounting.
- There is the basic difference between Risk Transfer and Risk Sharing. How does one reconcile this fundamental difference?
- .. requirements for separate accounting for participants and shareholders,
 - .. the impact of surplus distribution on long term reserving
 - .. calls on shareholders equity through deficit funding / Qard that depletes capital in conventional but stays as an asset to be returned under takaful.

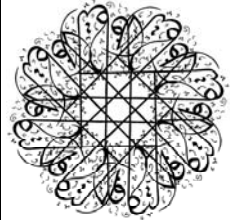
Is there mutuality between participants and shareholders?



- The co-operative structure is the main pillar of takaful.
- The shareholders bring in the enabling capital
- Should the co-operative spirit not be broader than just applying to the participants?
- Takaful is possible only because the shareholders' capital enables the mutual risk sharing to take place.
- The shareholders expose their capital to the very risks the participants are mutually protecting against except the risk is of different nature. Their capital is undeniably and inescapably exposed to the financial risks emanating from the outcome of insured events that may or may not occur.
- This is an aspect of Shariah consideration to see the spirit of co-operative principles in this manner. The shareholders are not to benefit from the participants' fund. But they need to be compensated for the financial risk they are obliged to take, there is no escaping this fact.

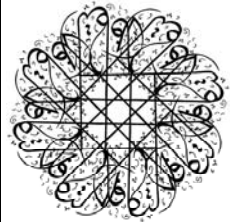
No
Shareholders
No
Takaful

How do we enable the industry to practice what we preach



- This is the biggest gap ... here is one solution to remove it.
- **This is what we preach:** Takaful built on the spirit of mutual help and co-operation between a community of people who bring their money together to help each other.
- How do we make sure that the holder of a takaful certificate gets this real sense of community belonging, of the mutuality aspects?

Demonstrating the spirit and the essence of takaful



- **A practical solution:** An annual gathering of the community of participants, employees, shareholders to build and strengthen the co-operative bond.
- To impart better understanding of what it means to donate through tabarru concept, get to know directly from Shariah scholars what it means to be Shariah compliant, from the management of how the company ensures all contracts, operations, transactions are devoid of interest, speculation and uncertainty (*Riba, Gharar, Maysir*), how retakaful works with minimum of conventional reinsurance on the basis of Zarurah.
- This will not work where takaful value chain is weak or suspect.
- For others, this would increase the awareness of takaful hugely and give takaful customer a tangible feel of what it means to be a takaful customer compared to being an insurance customer.

**Strengthening the role of Wakeel to
enhance takaful value chain**

Presented by Ajmal Bhatti

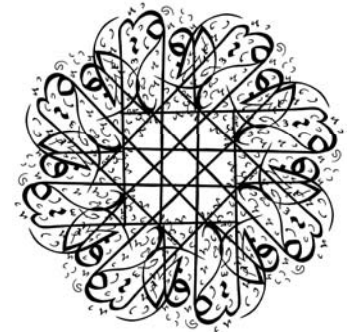


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Terima Kasih



Thank you