SHARED RISK & REWARD

Issue 109 – August 5, 2012

Takaful & Mutual Insurance

A recent report from Dome Advisory, a UK-based Shari'ah and legal advisory firm, included a detailed legal overview of the takaful industry (with some elements of Shari'ah-compliance included). One of the most interesting ideas raised by the two co-authors is that the current takaful models may be overly complex and reverting to a simpler, tried-and-true structure comparable to friendly societies and mutual insurance, with modifications to ensure Shari'ah-compliance, may be a better way to build the takaful industry.

This may be beneficial in growing takaful within the European Economic Area since a UK-based Friendly Society could 'passport' across the EEA with fewer hurdles than a firm from outside the EEA. It is less clear from their study whether this would provide benefit for the GCC countries where foreign insurers and takaful operators are restricted by regulations that favor domestic companies (outside of the financial centers like Qatar Financial Center, DIFC, etc).

The primary difficulty they identify is that a *de novo* friendly society, which must meet minimum capital requirements, is limited in its ability to raise capital to meet them outside of the voluntary contributions from members. The solution proposed in the report is to find established friendly societies that have excess capital that could be used for 'bolt-on' takaful units alongside, or supplanting, the conventional business of the friendly societies.

This is an interesting idea because it idea that demonstrates how many of the requirements in Islamic finance are already met in large part by established company structures with no connection to Islamic finance. In the past decades, conventional insurance companies have largely de-mutualized and turned into corporate forms which are more problematic from a Shari'ah-perspective.

These companies have demutualized in part because it is easier to grow and raise capital for expansion if shareholders, rather than policyholders, receive the underwriting surpluses and the profits on the invested premiums.

This has in some cases caused problems where insurance companies have under-estimated their ability to withstand losses on policies they have written (notably with AIG and its massive portfolio of CDS contracts). Perhaps there is some common reason why mutual insurance was more widespread until recently and has more in common with takaful than conventional insurance does now.

Until next week,
Blake Goud

My Reading List

- Dome Advisory International Takaful Report, 2012-2013 (link)

Blog Posts This Week

- Malaysian banks, ITFC working to open up more Islamic trade finance
- Should the Indonesian hajj funds invest in project-based sukuk or deposit the funds with Islamic banks?
- Where is the Islamic ETF growth?
- Are tax incentives good for Islamic finance?

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