

Shariah Compliant Insurance Products – Takaful in the UK

By Benjamin Macfarlane

Introduction

“Takaful” is an Arabic word meaning “guaranteeing each other” or “joint guarantee.” The fundamentals underlying the concept of Takaful are very similar to co-operative and mutual principles, which are accepted under Islamic law.

Takaful is a form of co-operative insurance, where members contribute a certain sum of money to a common pool. The purpose of this system is not to create profits, but to uphold the principle of “bear ye one another’s burden.” The concept of Takaful or Islamic insurance, where resources are pooled to help the needy, does not contradict Shariah.

This concept is in accordance with the principles of compensation and shared responsibilities among the community. It is not a new concept, and has been practised by the Muhajrin (emigrants) of Mecca and the Ansar (supporters or followers) of Medina following the hijra of the Prophet Muhammad over 1,400 years ago. It is generally accepted by Muslim jurists that the operation of conventional insurance does not conform to the rules and requirements of Shariah. The elements of uncertainty or gambling in the contract of insurance and interest on the investment activities of conventional insurance companies contravene the rules of Shariah.

Takaful is an alternative form of cover by which a Muslim can avail himself against the risk of loss due to disasters. The European Council for Fatwa and Research has stated:

“Commercial insurance is originally haram as agreed upon by most contemporary scholars. It is well known that in most non-Islamic countries there are co-operative and mutual insurance companies. There is no harm from the Shariah point of view to participate in these services.”

The basic principles of Takaful insurance are as follows:

1. Policyholders co-operate among themselves for their common good.
2. Every policyholder pays his subscription to help those that need assistance.
3. Losses are divided and liabilities spread according to the community pooling system.
4. Uncertainty is eliminated in respect of subscription and compensation.
5. No one member of the scheme derives advantage at the cost of others.

Growth and development of Takaful

Muslims around the world have for generations grown up with the mindset that insurance is forbidden because it contravenes some of the Islamic doctrines. Conventional life insurance was declared to be unacceptable in 1903 by prominent scholars in the Arab countries. In 1974, the National Religious Council issued a legal opinion that conventional life insurance is not permissible because it contains elements of: (1) risk and uncertainty; (2) gambling; and (3) interest.

In 1985, the Grand Counsel of Islamic Scholars in Saudi Arabia named the Majma al-Fiqh approved Takaful system as the alternative form of insurance written in compliance with Islamic Shariah. This system was approved as a system of co-operation and mutual help for the good of society by the Grand Counsel.

However, the exact method and operation of the system was left up to Islamic scholars and insurance practitioners to resolve, develop and implement. The Takaful industry is still in its formative stages and there are many unresolved areas. The key issues that need to be resolved are the global standardization of Takaful terminology, the development of an acceptable form of life insurance especially for countries in the Arab regions, and a common consensus for a system to determine profits distributable to participants and shareholders.

The first ever Takaful company, established in 1979, was the Islamic Insurance Company of Sudan. Recently, new Takaful companies have been established in Sri Lanka and Tunisia and there are several Takaful companies under formation in the Middle East. Takaful companies are also being contemplated in Pakistan, Australia and Lebanon. There are signs of interest shown in Takaful in South Africa, Nigeria and some former states of the Soviet Union.

A broad estimate of the total amount of risk underwritten by the Takaful industry in 2000 is approximately US\$550 million for both Life and non-Life business, of which around US\$193 million relates to risk in the Asia Pacific region. Malaysia is one of the largest Takaful markets outside the Arab region. It writes about 72% of the non-Arab Takaful business. The following table shows the geographical spread of Takaful business.

| Estimated figures | Takaful | % of total |
|--------------------|----------|------------|
| Arab countries | US\$340m | 63% |
| Malaysia | US\$143m | 27% |
| Other Asia Pacific | US\$50m | 9% |
| Europe, USA | US\$6m | 1% |
| Total | US\$538m | 100% |

Re-Takaful

Reinsurance of Takaful business on Islamic principles has been an area of much debate. Reinsurance on Islamic principles is known as re-Takaful. The problem has been one of a lack of re-Takaful companies in the market. This has left the Takaful companies with the predicament of having to reinsure on conventional basis, contrary to the customer’s preference of seeking cover on Islamic principles. The Shariah scholars have allowed a dispensation to Takaful operators to reinsure on a conventional basis if there is no re-Takaful alternative available. Therefore Takaful companies actively promote co-insurance. A number of large conventional reinsurance companies from Muslim countries take on retrocession.

However, there is still a lack of capacity within the Takaful industry worldwide. A certain proportion of risk is placed with international reinsurance companies that operate on a conventional basis. The retrocession from Takaful companies ranges from some 10% in the Far East – where Takaful companies so far have relatively smaller commercial risks – to the Middle East where up to 80% of risk is reinsured on conventional basis.

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Shariah Compliant Insurance Products – Takaful in the UK (continued...)

Takaful in the UK

The global Islamic finance market has grown to over US\$200 billion. London is one of the main wholesale transacting centers outside the Middle East for this market. The irony is that there are very few Islamic financial products available to Muslims in the UK. However, a community of some 1.5 million–2 million Muslims and some 350,000 households is a sizeable market and is unlikely to be ignored for long. There have been recent developments that suggest that the lack of Shariah compliant financial products for the resident UK Muslim community may be about to change dramatically. A small Takaful operation looking after the insurance needs of Muslims has been in operation for some years.

Indications have emerged from the UK regulators that they do not have any objections in principle to Shariah compliant financial products. As a result of this, major players like HSBC and some building societies are entering the market with a range of products. They have teamed up with Muslim institutions to try to address the regulatory issues that have so far discouraged the launch of Islamic housing finance and other products. A working party, comprising the Muslim Council of Britain (MCB) and the Union of Muslim Organizations (UMO) has been formed with the approval of the governor of the Bank of England.

The market in the UK can grow significantly with a range of Takaful insurances and Shariah compliant bank/mortgage products. Each relies on the other for real growth. These products and services are ethically based and therefore should also appeal to non-Muslims.

In the UK, Datamonitor has forecast that gross advances on Islamic mortgages will grow from £164 million (US\$306.99 million) in 2004 to almost £1.5 billion (US\$2.8 billion) by 2009. In the past 12 months alone a number of UK financial services providers, such as Lloyds TSB, HSBC and Lloyd's of London have launched Shariah compliant products.

The Financial Services Authority (FSA) and Takaful

The Financial Services and Markets Act (FSMA) 2000, which came into force in December 2001, governs the regulatory regime in the UK. FSMA provides that carrying on a regulated activity, or purporting to do so, in respect of a specified investment by way of business in the UK, requires authorization by the FSA, unless the person carrying on such activity is exempt. Effecting or carrying out contracts of insurance is included in regulatory activities.

Takaful does not involve the payment of a premium, but the payment of a "donation." However, none of the essential elements of an insurance contract are inconsistent with the Shariah principles governing Takaful.

It is a criminal offence to carry on a regulated activity in the UK without being authorized by the FSA. Also, any agreement entered into by a person in contravention of the requirement to be authorized will be unenforceable against the other party, who will be able to recover any money or other property paid or transferred by him under the relevant agreement.

In order to become authorized by the FSA there are certain "threshold conditions" that need to be satisfied by the applicant. An applicant also needs to satisfy the FSA's risk assessment process, which involves an assessment of the risk posed by an applicant against a number

of probability and impact factors. A number of specific threshold conditions are:

1. There must be sufficient financial resources to meet claims as they fall due. In particular, there should be a solvency margin as determined and agreed with the FSA. The margin represents the excess of assets over liabilities and provides a "cushion" against any unexpected claims.
2. There must be adequate resources.
3. Adequate systems and controls need to be in place to ensure that risk is managed properly.

However, certain Takaful insurers may have some difficulty in technically meeting their solvency margin. This is because the FSA solvency rules are based on encouraging a spread of investments. However, given the present limited size of the Islamic investment market, there is not the same investment scope for a Takaful insurer as there is for a conventional insurer.

In order to satisfy the "adequate resources" threshold, there must be competent and prudent management, which will be responsible for managing the various risks involved in the Takaful operation. Those persons who occupy certain so-called "controlled functions" must be "fit and proper." In addition, there must be sufficient expertise, such as in respect of legal, accounting and underwriting matters. There also needs to be in place an efficient and reliable IT system to process applications, handle claims and deal with general administration.

The FSA, in discharging its general functions, must have regard to the desirability of facilitating innovation in connection with regulated activities, the international character of financial services and markets, and the desirability of maintaining the competitive position of the UK. Therefore, it can be assumed that although the FSA may be relatively unfamiliar with Takaful as a product, it will welcome any application for authorization to conduct Takaful business in the UK.

Conclusion

Insurance, especially life insurance, is an essential part of the social protection necessary for any society and can also have its rightful place among Muslim societies. However, years of misunderstanding and misconception have created mental blocks against insurance in the Muslim culture. It is believed that Takaful or co-operative insurance is the right way forward towards the breakdown and removal of such blocks. If the system of Takaful is projected correctly and understood properly it could lead to a manifold increase in take-up of insurance products in Islamic countries and amongst Muslims in other countries.

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