

Takaful Windows: An Initial Stepping Stone to Bigger Islamic Insurance Market

In this two-part piece, we present the views of two takaful experts – **Mr Hassan Scott Odierno** of Mercer Zainal Consulting and **Mr Muhaimin Iqbal**, Chairman of Islamic Insurance Society and President of Takaful Institute of Indonesia – on the plus-es and minus-es of operating Islamic insurance windows.

Wherever Islamic insurance is mentioned, there is considerable debate about whether or not windows are favourable for the development of the takaful sector. Some jurisdictions frown on or are silent about them, but other countries, such as Indonesia, for the time being at least, tolerate or welcome this mode of offering Islamic insurance. In Malaysia, where there is a developed regulatory framework for licensing and supervising takaful companies, windows are not allowed.

Mr Hassan Scott Odierno of Mercer Zainal Consulting, says:

Before deciding whether windows are a good or bad thing, we need to define exactly what a takaful window is.

For instance, each of these situations which could be considered window solutions:

- A conventional insurer which has set up takaful pooled accounts as a sublet of its conventional accounts;
- A conventional insurer which sells takaful unit-linked funds;
- A conventional insurer with a separate subsidiary or sister company set up for takaful (with or without the sharing of services).

In each of these situations, an insurer or insurance group has made the decision to sell both conventional insurance and takaful.

Advantages of Windows

One major advantage of windows is the spreading of management expenses. In markets where Muslims are a minority in purchasing insurance, setting up an insurance company to cater strictly for Muslims would result in high management expenses as there are numerous expenses that do not depend on the size of the insurer. Therefore, assuming that non-Muslims cannot be convinced to buy takaful, having conventional operations alongside takaful reduces costs for the Muslims, which is good.

In countries where there is insufficient demand for takaful, the use of windows will allow takaful to be brought to the people, which is better than nothing at all. Whenever starting insurance operations, the key to success will be in attaining critical size. In these markets, allowing takaful to develop while only incurring marginal costs is a tremendous advantage.

Another advantage is in countries where there are conventional insurance regulations instead of takaful-specific regulations. Here, there can be issues such as having a certain percentage of total investible assets in conventional mandatory investments which are not Shariah-compliant.

By having conventional operations, these mandated assets can be allocated there, thus the insurer can avoid more difficult discussions with regulators to provide for

exceptions or accepting these assets for takaful products on the basis of dharurat (emergency or necessity).

Furthermore, discounting Shariah issues of the desirability of selling conventional insurance to Muslims, having both conventional insurance and takaful allows the insurer to choose the most profitable places to sell each.

For instance, in Malaysia and from the purely profit perspective, it may be desirable to sell general insurance via conventional means, and single premium mortgages via takaful, as general insurance does not normally share in underwriting surplus on a conventional basis, and takaful single premium mortgage reducing term plan can be designed without having to finance new business strains.



Disadvantages

Contingent Component

One issue with takaful windows is that, unlike Islamic banking windows, there is a contingent component (ie the payment of death and other benefits possibly many years into the future) which must be dealt with. How will the funds for this purpose be segregated? Will there be sufficient internal audit to ensure that all aspects of the operations are Islamic? How can the Shariah Council be certain of this?

Infighting

Other questions raised in this regard are: What will be done if Muslims wish to purchase conventional plans? Will this be allowed? What are the Shariah Council's views on whether conventional plans can be marketed to Muslims when takaful exists within the company or group?

If this is allowed, there is the issue of infighting between agents selling conventional insurance and those selling takaful. A solution could be agents selling both takaful and conventional products but this could be a problem for Muslim agents.

Anti-Selection

The issue of anti-selection can also arise with a window

solution. This may occur in a situation where premium rates are regulated by class of insurance (tariff-based) such as certain classes of general insurance in Malaysia. Here, the existence of basic structural differences between takaful and conventional insurance may make one favoured over the other.

Suppose that surplus sharing is set up such that motor insurance and fire share in surplus on a separate basis (ie not pooled with each other), and that motor is not profitable whereas fire is very profitable. In this case, motor policyholders may choose conventional insurance whereas fire policyholders pick takaful. This would not work out well for the insurer as it must now share profits with the profitable portions and take all the losses on the unprofit-

able portions.

Dilution

A distinct disadvantage is one of branding. Will it be difficult to convince Muslim policyholders that takaful is more than a name change, considering that similar conventional insurance is also being sold? Policyholders may well look at the agents and management as to whether they are committed to takaful. This may be difficult to demonstrate if takaful is a product rather than a different way of sharing risk. In short, Muslim agents and management must be convinced of the uniqueness and purity of takaful over conventional insurance. Can this be done with a window? ■

Mr Muhaimin Iqbal of the Takaful Institute of Indonesia says:

Where Windows are a Good Solution

Despite the disadvantages of windows, there are situations where such a mode of operation actually favours Islamic insurance. Windows are a good solution where takaful is still new to the market.

By allowing windows, the insurance company can learn the concept without necessarily having to put in a huge investment, which is needed to set up a new company. Indonesia is a good case where windows are allowed. Now, most of the takaful growth in the market is driven by window operations.

Others say though that since the takaful industry is market-driven, windows should be allowed so that there will be more players in the market who will have established best practices that in turn will help the industry grow and innovate. This is how it should be done in the initial stage at least.

Takaful windows should be encouraged in the beginning so as to have a vast number of players entering the takaful market around the same period. With this, the much-needed capacity could grow within a relatively short period. Otherwise, it will take time to grow the market to an adequate capacity.

But takaful windows are only a temporary solution. There must eventually be total separation because the nature of takaful is actually totally different from that of conventional insurance.

There must be a real intention – with a certain target date – for full conversion.

Criticism

Some critics denounce takaful windows on the grounds that they are lax about or lack understanding of proper Shariah compliance. However, my view is that if the Shariah Supervisory Board of the company is really functioning well, then there is no reason for takaful windows not to operate with full Shariah compliance.

Despite the increasing number of players in the market, existing takaful companies should not be overly concerned if more established conventional companies operate windows for takaful products.

More windows coming to the market will indirectly

promote full-fledged takaful because the pure takaful companies will be giving “a perfect image” of Islamic insurance compared to windows.

The fact that global insurers and reinsurers such as AIG and Hannover Re are starting their own takaful and retakaful units, is a very positive indication that the takaful market is a real thing and that more and more players with a strong commitment, and capacity, are coming.

Phased Development of Takaful

We should not be arguing about whether or not takaful windows ought to be allowed or not, because such arguments are counter-productive to the development of the takaful market. In Islam, changes can always be made in stages – so let's not create difficulties for ourselves. ■

