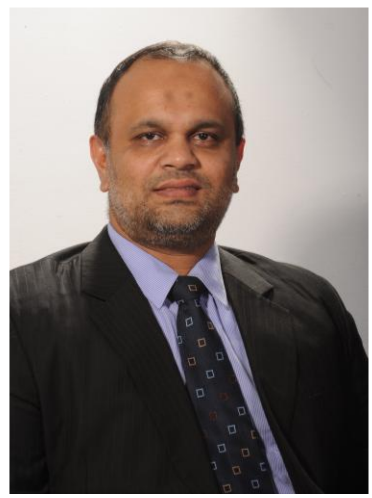
Takaful and its relevance to Sri Lanka

The concept provides a more ethical option for risk mitigation but lacks awareness in the country and is misconceived to be religion-based

By Ehsan Zaheed

The need for greater penetration of life and health insurance in Sri Lanka is a subject which has come under much discussion over the years. According the Insurance Board of Sri Lanka's (IBSL's) Statistical Review 2015, only about 2.8 million citizens of the country have life insurance policies. The number of life policies in force as a percentage of the total population only amounted to 13.4%, as per the document.

This means that 86.6% of the country's population has no life insurance – which is a cause for concern.



Globally, the insurance market is dominated by life insurance – which accounted for 63% of total insurance industry premiums globally in 2015 – according to a report by a multinational insurer. The same report says, "Leaving Laos and Sri Lanka out of the equation, the life insurance segment dominates the insurance market in all of the Asian countries included in our analysis."

Contrary to the global trend, in the case of Sri Lanka, considering the figures in IBSL's Statistical Review 2015, the total premiums of the general business were approximately 28% greater than that of the long term insurance sector (total general premiums were Rs. 68,815 million compared with long-term premiums of Rs. 53,575 million.)

This asymmetry clearly shows the critical need to improve life insurance penetration in the country.

The role of Takaful

In attempting to improve this situation and provide protection to a greater segment of the population one must not forget the other options for risk mitigation besides conventional insurance.

In this scenario, the 'Takaful concept' is particularly important as an alternative option for risk mitigation – especially considering its greater consideration of ethical factors. While unfortunately there is still lack of awareness of the concept in the country and it is misconceived to be religion-based, Takaful offers a useful alternative risk mitigation option due to its participatory and collective features. These features enable anyone to participate in a pool within the Takaful model to secure the interests of relevant groups. Such groups could be even composed of low income earners, working executives, self-employed individuals and others in need of life, medical and general insurance.

The concept can be extended to mitigate risks associated with varying situations – ranging from houses to airplanes. Therefore it would be useful to explore the concept of Takaful in brief and understand its relevance in providing risk mitigation/protection to people.

What is Takaful?

Takaful is an insurance concept of risk management based on guidelines that embody principles of reciprocity and participation. Its roots date back 1,400 years and it has inherited financial principles practiced under the observance of the guiding principles of Islam.

Takaful means 'joint guarantee' in which several parties ensure the safety of their collective partners. The model creates a financial community in an effort to safeguard the interests of each individual through a collective fund that does not 'transfer' risk but 'share risk'.

In the case of an ill-fated event, the affected party may benefit from the contributions of his fellow participants, thus becoming joint owners of the fund and providers of relief to cover the loss of each other. The emergence of Takaful can be traced to the perennial need for a scheme of insurance, void of interest and uncertainty. 'Takaful insurance' fills this void with transparency, equity and mutual benefit.

The difference between Takaful products and conventional insurance products

There are certain characteristics of conventional insurance that does not allow the Muslim community to obtain insurance – which is a necessity in planning ones finances.

The first of these is the earning of interest, referred to in Islam as Riba. Traditionally viewed from the perspective of a loan, Riba is considered unfair and inequitable to the borrowing party and therefore earning interest is not allowed in financial transactions.

The second element is the presence of uncertainty embedded in the design of conventional insurance products. This arises due to the 'transfer of risk' for a premium (price) that deals in the probability of occurrence or the 'chance' that the event would not occur. This trading of risk is not allowed to protect participants from unfair, unjust or 'uncertain' transactions.

Takaful is a risk management system and an alternative to the way risk is managed in insurance. With consideration to the above mentioned tenets, it operates on cooperative principles and incorporates the concept of 'Tabarru' (donation, gift).

Instead of paying an insurance premium, Takaful participants (policyholders) donate their Takaful contribution to a common pool with the intention of mutually assisting members against a defined loss or damage. It is a one-way transaction, which does not expect a definite return on the donation, unlike the more traditional bilateral conventional insurance contract where a premium is paid in return for an insurance benefit. Here, it should be noted that the participants of a Takaful fund share the fund/pool, its risks and its rewards making it distinctively different.

The impact of the difference on the customer

As the fund is collectively owned, any surplus that remains after meeting the losses of the participants are also rightfully owned by the members. This is what is referred to as the Refund of SURPLUS contribution (premium) to a customer. It is a by-product of the concept of participating in mutual wellbeing of the community, that serves an emotional or spiritual need, and at the same time protects ones wellbeing whilst also being void of interest.

In addition to this, participants are given the assurance of 100% guilt free transactions based on the fact that the fund operates on Islamic principles that prohibit aiding social vices and other harmful activities against mankind and the environment.

The misconceptions regarding Takaful in Sri Lanka

Unfortunately, the knowledge and awareness of Takaful is insufficient, although an improvement has been witnessed in this regard in recent years. Today Takaful is offered by four operators operating in the country. However it has been perceived as religion based and only for one community. In light of its inherent benefits, Takaful can make a significant positive impact – which extends far beyond one community.

It should however be noted that demand for Takaful is growing with the growth of Islamic/alternate finance. There is growing acceptance of Takaful by a wider segment in Sri Lanka at present – however the potential is far greater.

The future of Takaful

While Takaful clearly can play a far more significant role in terms of risk mitigation and protection, to optimize the impact Takaful has to be innovative in its offerings. The challenge for the providers of Takaful is be aggressive innovators of risk management products that would address the risk management/protection needs of Sri Lankans, without attempting to follow the business model of the conventional insurers.

Considering the changing insurance industry landscape – particularly with regard to regulation – Takaful being a stakeholder in the global finance industry faces many challenges. Such a key challenge is to further enhance its own identity and have regulators fully understand the concept and operations of Takaful entities. Takaful must stay relevant especially with evolving regulations.

The need for avenues and method of risk mitigation has increased in the wake of increasing natural disasters and other challenges. Takaful is well poised to deliver on this and thereby contribute and add value to the many uninsured citizens of the country.

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