Issues and Challenges in Developing Microtakaful in Muslim Country

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ABSTRACT

Microtakaful is a mechanism to provide shari’ah-based protection to the poor and under-privileged individuals at affordable costs. The objective of this paper is to discuss the issues and challenges in developing microtakaful in Malaysia by using library study based method, which is a kind of qualitative research approach. The outcome of the review suggests that the Islamic financial industry must have to focus on microfinance and microtakaful for overall development of the community and not only in Muslim countries as the number of Muslims living under poverty outside Muslim countries are also high.

Key Words: Microtakaful, Microfinance, Poverty

INTRODUCTION

International agencies such as the World Bank and United Nations use internationally defined poverty as living on less than US$2 a day on average. According to this measure, people earning less than US$1.25 per day are living in extreme poverty, and people who earn less than US$2 a day are in moderate poverty (Hasim, 2014). According to the most recent estimates, in 2013, over one billion people in the world lived in extreme poverty, earning less than $1.25 a day; and 2.2 billion people lived in moderate poverty, earning less than US $2 a day (World Bank, 2017). Apart from that, it have been found that, most of the Muslim-majority countries are generally poorer than other countries on average (Shaikh, Ismail & Shafiai, 2017).
In those Muslim-majority countries such as Indonesia, Pakistan and Bangladesh, around 2% of their GDP are currently spent for insurance compared to a global average of around 7% (Swiss Re, 2007). Prior research has found that insurance consumption in general is less in predominantly Islamic countries (Wasaw, 1986; Browne and Kim, 1993; Enz, 2000; Beck and Webb, 2003). Two main reasons contribute to a lower insurance take-up. First of all, conventional insurance products like there are known in the western-hemisphere are not accepted in Islam. Secondly, those conventional products are not available to or adapted to the needs of the majority population who lives on a low income close to the poverty line. In fact, The non-poor confront essentially the same risks (death, illness or injury, loss of property and natural disaster) faced by the poor, but they have access to formal insurance schemes and often have less financial impact (Hasim, 2014).

For Malaysia cases, in September 2010, the central bank namely, Bank Negara Malaysia has urged Takaful operators to design micro-takaful policies, medical and retirement products, to penetrate the untapped population; the low income market (Mohd Rom & Abdul Rahman, 2012). Low income and poor who represent the rural and urban poverty groups are the most neglected people in insurance mainstream and are unprotected (Bank Negara Malaysia, 2010). The Tenth Malaysia Plan (2011) stating that a fair and socially just society is where all people, with no exception, have the rights, freedom, and capacity to access services and resources to enhance their well being, and where the most disadvantaged are given extra support to ensure such success. One of the four principles to support Malaysia’s growth objectives is a needs-based principle; to alleviate the livelihoods of bottom 40% households and disadvantaged groups.

According to Erlbeck et al. (2012), there are emergence for insurance schemes to cater the need for for low income people that based on Islamic principles. These so called Microtakaful schemes are based on the experience of conventional microinsurance services, and complement Islamic microcredit and microsavings products. The first Microtakaful scheme was established in 1997 in Lebanon. Approximately eight providers in Lebanon, Indonesia, Malaysia, Sri Lanka, Bahrain and Pakistan exist by January 2010 (Patel, n.a.; ICMIF takaful, 2010). The infant stage of Microtakaful is also attested by Kwon (2010). Thus, based on the above situation, this study will discuss on the issues and challenges of developing microtakaful in Muslim country. This is a conceptual paper that will highlight the discussion from the previous study.

LITERATURE REVIEW
Definition of microinsurance and macro-takaful
Microinsurance is based on the same principles as regular insurance. But despite similar risk coverage, insurance products and their relevance are different, whether they are in regular insurance or microinsurance. Simply downsizing regular insurance products is not an efficient way of approaching this low-income environment, which is what many first-movers in the marketplace did. It is far more effective to design specific products for this market, based on a deep understanding of the particular needs of the customers (Biener & Eling, 2012). The Consultative Group to Assist the Poor (2003) defines microinsurance as “The protection of low-income people against specific perils in exchange for monetary payments (premiums) proportionate to the likelihood and cost of the risk involved. As with all insurance, risk pooling allows many individuals or groups to share the costs of a risky event. To serve poor people,
microinsurance must respond to their priority needs for risk protection, be easy to understand, and affordable.”

According to Ingram and McCord (2011), the first definition of microinsurance appears to have been published in 1999 by Dror and Jacquier (1999) as part of an article titled Microinsurance: Extending Health Insurance to the Excluded. They defined ‘micro’ as the level of society where the interaction is located, that is smaller than national schemes, and ‘insurance’ refers to the economic instrument. Nowadays, the term micro-insurance is a combination of all previous definitions. The features are as follows; transactions are low-cost; clients are generally low net worth; communities are involved in important phases of the process, such as product cover design and rationing of benefits and lastly the essential role of micro-insurance is risk management of the whole group over and above what is possible at the level of the individual.

Micro-insurance fills many financial gaps. They are financial gaps of immediacy, such as expenses related to a funeral event (e.g. the coffin and catering); financial gaps that are related to the culture of the deceased (e.g. repatriation, and the unveiling of the headstone); and the longer term survival gaps for dependents, such as schooling and expenses associated with housing (Howard, n.d).

On the other hand, microtakaful is the shariah compliance of microinsurance. Micro Takaful is a contract whereby the operator (insurer) undertakes as an agent of the participants (insured/policy holders) to pay the participant (insured) of the beneficiary a given sum of money or any other indemnity when the risk insured against occurs. The participant (insured) pays the contribution (premium) to the insurer on a donation basis (Ahmed, 2016).

Microtakaful is widely known in the industry as Takaful for low-income populations. In general Takāful terms, “low-income” means that section of the population that is customarily not eligible and not invited to participate in any of the Takaful plans of any Takaful Operator (TO) (IFSB, 2015). This group’s ineligibility is attributed to members’ inability to meet the basic financial and underwriting requirements set forth by Takaful regulation, for reasons relating to medical history, hazardous occupation, irregular income, insurable interest, and various other considerations that fall within the purview of prudential regulation of exclusive finance. Various definitions of Microtakāful have been applied to categorise this group of low-income participants. For example, jurisdictions may categorise these participants based on their minimum annual income, product features, the location of potential participants, or their distribution channels.

The comprehensive definition stated by IFSB(2015) is “Microtakāful is the Islamic counterpart of microinsurance, and exists in both Family and General forms. It is a joint-guarantee initiative, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks, under the core principles of Tabarru’ (donation), Taawun (mutual assistance) and Prohibition of Riba (usury). Microtakaful is generally offered to [the] low-income and under-privileged segment of the population (which is usually excluded from the general Takaful terms and conditions) by various entities which are regulated and supervised by regulatory and supervisory authorities of Takaful/insurance or any other competent regulatory and supervisory authority under the national laws of any jurisdiction.”
Bank Negara Malaysia (2016) has defined macrotakaful as, takaful product that is designed to respond to the financial protection needs of low-income households. In this respect:
(a) “financial protection” means being able to access timely and adequate financial resources to:
   (i) cope with major expenses; or
   (ii) provide temporary or partial relief from financial difficulties arising from unexpected adverse events; and
(b) “low-income households” refers to poor, vulnerable or lower middleincome households, particularly groups that have been previously excluded from access to insurance/takaful.

The main differences between Microtakaful and microinsurance are the same as the differences between Takāful and insurance. The absence of shariah non-compliant elements – namely, Riba, Maysir and Gharar in Takaful. This makes Microtakaful products more appealing to those sections of the population that are conscious of the religious implications of their participation in the financial services offered by various types of financial institutions. (Khan, 2013).

Roles of microtakaful
As been highlighted by BNM(2016), among the roles of microtakaful is to reduce poverty and promote social mobility predominantly reside within the realm of structural economic policies and public social protection schemes. However, the availability of microtakaful products is highly important as an additional or alternative coping strategy for the household, as some households may not be covered by existing social protection schemes or may need additional protection beyond the scope of such schemes.

Micro-takaful is one of the mechanisms to fulfil the needs of the lower income, with the concept of providing affordable protection to the poor (Abdul Rahman & Mohd Rom,2012). Takaful operators should come up with this kind of product, as the alternative to those offered in the conventional market (Swartz and Coetzer 2010). Establishing “micro-takaful” schemes enables insurance to become much more acceptable and accessible to the poor whilst still maintaining the benefits (Patel 2002).

According to Ahmed (2016) in his study, among the main benefits of Micro Takaful Insurance are helping guaranteeing loans to financiers, reducing the cost of insurance and therefore low income people can afford its premiums, benefiting from the advantage of other insurance services (risk control and loss reduction) , policyholders would participate in surplus in the event of it accomplished,limits the wasted economic energy of a large segment of society, spreading the culture of social responsibility and contributes to the reduction of poverty and even improve the standard of living for the poor and low-income people.

By having Microtakaful products, the burden of premium is comparatively less on the poor population that is affordable to them( Abdullah & Rashid,2014). But the inconsistent support of Government would be an important element for the success of Micro-Takaful Scheme. As Akhter, Akhtar, and Jaffri (2009) stated in their study:
“Integrating Islamic microfinance with NGOs, NPOs, Zakah, Awqaf and with Takaful as well as with professional training and capacity building institutions will be helpful to achieving their aim of providing micro financial services to the poorest of the poor under one roof”

METHODOLOGY
This study using library study based method, which is a kind of qualitative research approach.

EMPIRICAL RESULTS
Challenges in developing microtakaful
Patel and Bhatti (2008) study as cited by Rashid and Abdullah (2014) listed some of the difficulties in penetration of Takaful among poor population. Fully trained and skilled staff to promote Takaful is nearly unavailable, ii. Knowledge of Takaful Permissibility is lacking in general public, iii. In many regions of Muslim world, concept of insurance to deal with risk is not popular, iv. Efforts of Governments of Muslim countries are not so appreciable, v. Takaful industry is still in infancy stage to meet the demands of public, vi. Distribution and marketing channels are not working effectively to create awareness on benefits of Takaful program, vii. There is a lack of trust among the general public about insurance and Takaful programs.

In Indonesia the establishment of the microtakaful is relatively new (Ingram and Mc Cord, 2011). As a subset of the takaful, the development of microtakaful always follows the development of the takaful industry. While the takaful industry is known in a limited society, the microtakaful is even much less known (Hidayat and Sukmana, 2014). The challenges can be categorized into:

1. Regulation
   The proper regulation may reduce the uncertainty (Ingram et al., 2011). Conversely, regulation which is not comprehensive may not interest investor to enter the takaful industry. As the takaful is different from conventional insurance, the basis of the conventional insurance cannot be applied for takaful. For example: takaful is using the concept of risk sharing, whereby the risk is divided among the takaful customers whereas the conventional insurance runs on the basis of risk transfer whereby the risk is transferred to the insurance company. Forcing the conventional basis to takaful concept would not be suitable.

2. Public awareness
   In practice, the microtakaful concept is very limited to be adopted by Islamic microfinance institutions. In most cases, it is adopted by cooperatives. This is due to low level of public awareness on microtakaful concept.

3. Availability of human resources.
   One of the important factors to develop the microtakaful is the human resource (Ascarya and Yumanita, 2005). In order for the microtakaful to grow fast, it has to be supported by a large number of the proffesional human resources which focus in this particular sector, otherwise, the growth will be slow. In fact, the number of the expected human resource is still far from the existence
Gor (2013) summarized several challenges in developing microtakaful as below:

i. Lack of proper regulatory framework. Because of that, more consistent regulatory framework is needed in the key markets for microtakaful. Separate regulator will provide better growth opportunity for the industry.

ii. Appropriate internal controls and risk management is big challenge. As Sharia’s compliance risk should be rooted in all parts of operations, at a time of expansion appropriate risk management is very vital. Strategy for microtakaful providers should be such as product of microtakaful provides value to all stakeholders within permissible limit of risk.

iii. Shortage of expertise. As this field is relatively new, most of the operators didn’t have enough experience of business. There is also shortage of human resource with requisite expertise in this industry.

iv. Rising Competition. Even though there is high growth expected in the industry, competition is rising in leaps and bounds in this Industry. This industry is working on thin margins but to gain market share quickly young microtakaful operators price products in such a way that it will become tougher to be profitable. For e.g. three newly added takaful operators in Malaysia will increase competition.

CONCLUSION
As the conclusion, the Islamic financial industry must have to focus on microfinance and microtakaful for overall development of the community and not only in Muslim countries as the number of Muslims living under poverty outside Muslim countries are also high. This microtakaful products which based on cooperative principles play a role as a mechanism to provide shari’ah-based protection against the financial consequences of death and illness to the poor in exchange for affordable premiums. Here it is important to note that Takaful and Insurance both can be one of helpful tools to reduce poverty but cannot totally eliminate poverty from its roots. To reduce the burden of poor population Micro-Takaful schemes with small premium amount can be beneficial. The discussion of the challenges will help in analyzing the possible solutions for future study.

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