

Takaful in Belgium

Shari'ah compliant life insurances within the Belgian legal & regulatory framework



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Preface

I selected the subject for this master paper end of October 2014. Already after “Syria fighters” was a frequent subject in Belgian national newspapers, but before Charlie Hebdo and the (renewed?) aloofness and distrust towards Muslims. Nevertheless, studying the subject increased not only my understanding of but also respect and appreciation for this religion.

The insurance value chain covers many areas: underwriting, claims, distribution, policy administration, investments, reinsurance, risk management, compliance, audit, ... and operates in a legal, tax and regulatory framework that is becoming more and more European and global, but also more complex. To cover all these areas is an enormous challenge and sometimes leads to a more superficial approach than desired, unable to discuss all these topics in depth. Not only time and space have limited the depth of research and assessment in these areas, also the lack of being able to discuss a whole domain fully in depth has sometimes kept me from elaborating on a specific element within one domain.

As wide the area of insurance, as numerous almost the number of websites, consultants and papers that cover many of those different topics for Takaful. Each paper leading to new ones has forced me to decide at a certain moment not to further explore existing literature but to focus on writing. For several topics, papers do not provide an answer. Not only because the area of Takaful is still to be further explored, posing even challenges to the countries in which Takaful is a developed industry (to the extent that this can be realised in less than 30 years), but because ethics, co-operation and “doing the right thing” are often captured more truly in a story or a discussion than in scientific research.

Combining a full time job as Head of Markets & Strategy in a life insurance company, being a father of three wonderful kids and the husband of a loving and understanding spouse, a semi-professional musician and substantially engaged in a number of local organisations, associations and co-operations, leads to a constant prioritisation of tasks and a continuous confrontation with the concept “choosing is loosing”. I am extremely grateful for the support of my family - especially my wife Nele and my three children Dirk, Bert and Mare - who have supported me and allowed me in the passed months to spend (too) much time on this paper and (too) little on them. They give me the

strength to push my boundaries and walk the extra mile time and again. I am also very grateful to my promotor, Jan Dhaene, who has supported me to explore this topic from the very start, always prepared to read drafts of the paper at odd hours or last minute and has supported me with many contacts and connections he has around the world to explore the topic of Takaful. Finally a word of thanks goes to Moustapha Kharbouch, a Muslim and an insurance professional who I have learned to appreciate very much. A conversation with him on a terrace in Brussels was one of the elements that lead me to proposing this topic. Further conversations throughout the year and the support in launching a small survey have made a substantial contribution to this paper.

If one thing, I hope this paper will be read by many individuals. I have chosen to be active in the insurance industry because it is an industry that, if executed properly, does the “right” things and has a positive contribution to society. Softening the shocks of existence, pooling resources for the unfortunate few, allowing communities to recover from natural catastrophes are all examples of this. It is this philosophy that I also found in Takaful. The current underflow in society - an increased attention to peer-to-peer initiatives, revival of co-operations and of (also online) communities, participatory democracy, etc. - all support the basic concepts of insurance and Takaful. Mutual insurance, insurance in the form of co-operations, Takaful: all go or stay away from high-tech finance and support the basic honourable profession of insurance. If this paper can make even the slightest contribution to this, it was worth it.

Leuven, 19/08/2015.

Chapter 1

Shari'ah, islamic finance and insurance

1.1 Shari'ah

1.1.1 Definition

Family Takaful (Islamic life insurance) is insurance that complies with the Shari'ah. Few words soak as many and as strong emotions as the word *Shari'ah*. By many Westerners (non-Muslims) it is equal to the frequent abuses which are executed in its name and are not acceptable in their view of a modern democracy (e.g. corporal punishment, stoning of women). But based on the same concept, modern and broad-minded Muslims defend democracy and equal rights for men and women. This supports an attempt to clarify the Shari'ah and to approach it in an unbiased way.

The Shari'ah is not a readily available corpus. In fact, three definitions could be identified [3]:

- Shari'ah as a set of divine rules for an ideal society
- Shari'ah as a science and a system of rules developed by (Islam) jurists
- Shari'ah as it is applied today in daily life

Shari'ah could be literally translated as 'The Path': the path that God has laid to develop and realise an ideal relationship between a Muslim and God as well as his fellow creatures. In this way it could be translated as *fairness* or *justiceship*. This means Shari'ah deals with many topics also addressed in secular law, including crime, politics, and economics, as well as personal matters such as hygiene, diet, prayer and everyday etiquette.

Within the context of this master paper, Shari'ah is defined as the moral code and religious law of a prophetic religion, Islam.

1.1.2 Sources

There are two primary sources of Shari'ah law: the *Qur'an* (more specifically, Quranic verses or *ayahs*) and the example set by the prophet Mohammad (PBUH¹) in the *Sunnah*². Where it has official status, sharia is interpreted by Islamic judges (*qadis*) with varying responsibilities for the religious leaders (*imams*).

The Qur'an is the book containing the speech of God revealed to the Prophet Mohammed (PBUH) in Arabic, conveyed by the angel Gabriel, and transmitted to us by continuous testimony. It is *the* main source of Shari'ah and some scholars even consider it the only source.

Sunnah literally means a way or rule or manner of acting, or a mode of life. On some matters, the Qur'an says nothing and in such case the obvious thing to do is following the custom of the prophet Mohammed (PBUH), referred to as Sunnah.

One of the differences is that the Qur'an was recorded in writing from the beginning, while the Prophet Mohammed (PBUH) discouraged his Companions to write down the Sunnah in order not to have it confused with the Qur'an.

Still these sources reveal little on modern social or political problems, nor on life insurances. Therefore, the application of Sharia is extended through consensus of the religious scholars (*ulama*), thought to embody the consensus of the Muslim Community (*Ijma*). Islamic jurisprudence will also sometimes incorporate analogies from the Quran and Sunnah through *Qiyas*, though many scholars also prefer reasoning (*'aql*) to analogy.

Ijma refers to the consensus of juristic opinions after the death of the Prophet Mohammed (PBUH) and the agreement reached on the decisions taken by the learned Muftis, or jurists, on various topics.

Qiyas or analogical reasoning, suggesting equality or similarity between two things and thus allowing the extension of Shari'ah to a new case.

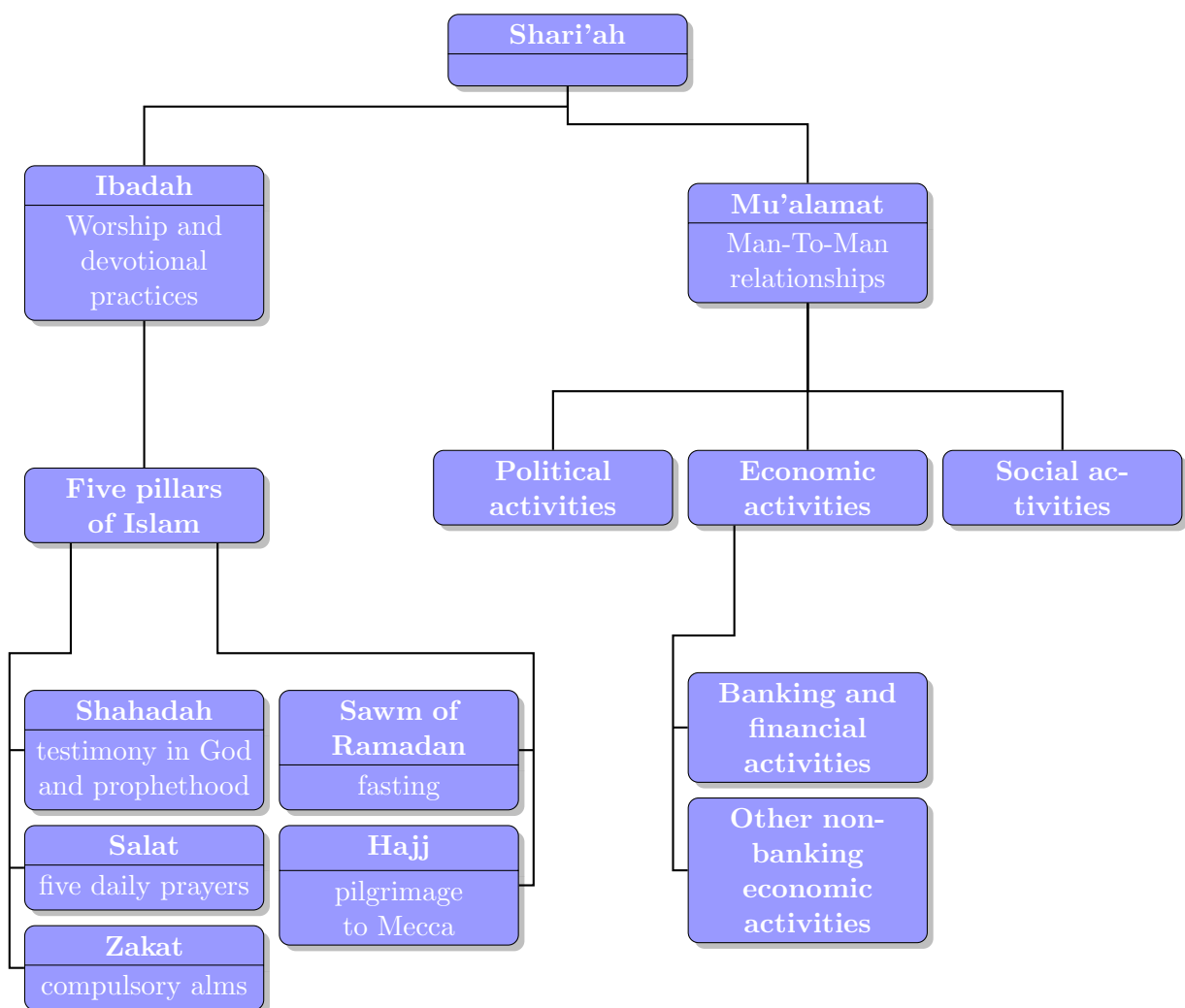
¹PBUH is the abbreviation for "Peace Be Upon Him". It is a 'durood' or conventionally complimentary phrase attached to the names of the prophets in Islam. Although the author of this paper is not a Muslim, it is added out of respect for the prophets, for the Islamic religion and for the many Muslims encountered both before and during writing this paper as well as those who will read it.

²The word Sunnah is derived from 'root', meaning smooth and easy flow or direct flow path. Sunnah is the way of life prescribed as normative for Muslims on the basis of the teachings and practices of the Islamic prophet Muhammad and interpretations of the Qur'an.

Ijtihad or logical reasoning, using one's own judgement, allows for the further extension or application in day to day topics. Any form of Ijtihad must have its starting point in a principle of the Qur'an, Sunnah or Ijma and cannot be used to achieve a result which contradicts with a rule from one of these three fundamental sources.

1.1.3 Scope

As a religion, Islam encompasses the total lifestyle: both man-to-man (Mu'alamat) and man-to-god (Ibadah) relationships. This is why the Shari'ah forms the basis not only for worship and devotional practice but also for the political, social and economic (including banking and finance) activities.



The extensiveness of the aspects covered by Islam and Shari'ah is often strange to non-muslims, as other religions often focus on man-to-god interaction as well as ethics

(‘just’ actions, doing well vs. doing wrong). The fact that economy and business transactions (mainly trade) are such a relatively important aspect of the Shari’ah can be related to the fact that Mohammed (PBUH) was a trader himself.

1.1.4 Schools

The largest denomination in Islam is Sunni Islam, which makes up up to 90% of all Muslims³. Next to the Sunni Islam, Around 10% are Shia Muslim, and of these roughly 80% live in just four countries: Iran, Pakistan, India and Iraq. Different interpretations on topics of Shari’ah law in general and Takaful specifically, often correspond with the differences between these schools (leading to differences in Fiqh⁴). More information on the background and historical development of these schools can be found in many different books and papers, such as [19].

Hanafi is named after the scholar Abū Hanīfa an-Nu’mān ibn Thābit, a Tabi’i⁵ whose legal views were preserved primarily by his two most important disciples, Abu Yusuf and Muhammad al-Shaybani. Hanafi is the fiqh with the largest followers among Sunni Muslims. It is predominant in the countries that were once part of the historic Ottoman Empire.

Maliki was founded by Malik bin Anas in the 8th century. Unlike other Islamic fiqhs, Maliki fiqh also considers the consensus of the people of Medina to be a valid source of Islamic law. It is one of the larger groups of Sunni Muslims, comparable to the Shafi’i, but smaller than the Hanafi. Sharia based on Maliki doctrine is predominantly found in North Africa (excluding northern and eastern Egypt), West Africa, Chad, Sudan, Kuwait, Bahrain, the Emirates of Dubai and Abu Dhabi (UAE), and in northeastern parts of Saudi Arabia.

Shafi’i was founded by the Arab scholar Al-Shafi’i in the early 9th century. Where passages of Qur’an and Hadiths are ambiguous, the school first seeks religious law guidance from Ijma - the consensus of Sahabah (Muhammad’s companions). If there was no consensus, Shafi’i school relies on individual opinion (Ijtihad) of the companions of Muhammad, followed by analogy. One of the main differences with the Hanafi school is that it does not consider Istihsan (personal preference of Islamic legal scholars) as an acceptable source of religious law. It is prevalent in the following regions: the Balkans,

³<https://en.wikipedia.org/wiki/Islam#Denominations>, statement based on 15 different sources, and <http://www.pewforum.org/2009/10/07/mapping-the-global-muslim-population/>, indicating 87% to 90%.

⁴Fiqh is Islamic jurisprudence, the human understanding of the Qur’an and Sunnah by Islamic jurists that is implemented via rulings or Fatwa

⁵Tabi’un or follower: the generation of Muslims born after the passing of Mohammed (PBUH)

Syria, Lebanon, Jordan, Palestine, Egypt, parts of Iraq, Turkey, the Caucasus, parts of Russia, Turkmenistan, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Afghanistan, Pakistan, parts of India and China, and Bangladesh.

Hanbali is named after the Iraqi scholar Ahmad ibn Hanbal (d. 855), and was institutionalised by his students. It is the smallest of the four major Sunni schools. The Hanbali school does not accept jurist discretion or customs of a community as a sound basis to derive Islamic law (in contrast with Hanafi and Maliki). Instead, it relies on weaker Hadiths, individual opinions of Muhammad's companions or analogy. It is considered to be the most strict and conservative school and found primarily in Saudi Arabia and Qatar.

Belgium In Belgium, most muslims of Turkish origin follow the Hanafi school, while those of Maghrib origin follow the Maliki school [20].

1.2 Islamic economics

1.2.1 Basis

A number of basic concepts from Islam are essential in order to understand Islamic Finance.

“Our Economy[4]” (Arabic: *Iqtisaduna*) is an important work of reference by Muhammad Baqir al-Sadr on Islamic economics, demonstrating the incompatibility of both Marxism and capitalism with Islam. As later synthesised by Wilson [5], it rejects the class categorisation of Marxism as simplistic, as capitalists and workers are not just products of a system of production, but also human beings with moral responsibilities. While material consumption and having power over resources are the ends for many Marxists, for Muslims these are more the means and the ends are spiritual. Other authors [7] suggest that communism is in conflict with the basic requirement of human personality - which is translated in the economic sphere requiring private property and freedom of enterprise.

Since both recognise private property and the legitimacy of markets, it might appear that Islam has more in common with Capitalism. Mawdudi considered Capitalism to put an extreme, excessive accent on the rights of individual ownership and freedom of enterprise, hence inflicting suffering and privation of people who own little. Human character, brotherhood, sympathy and co-operation are lacking in such a society [8].

1.2.2 (Life) Insurance

A special word on insurance is in order here. In the time of the prophet Mohammed (PBUH), insurance as such did not exist. Initially it was hence treated suspiciously, since it was considered to go against *Tawakkul* (trusting in God's plan)⁶. However, nowadays scholars accept insurance as such is not Haram. First of all, no human actions will change the Will of Allah (SWT⁷), also not if a person has insurance or not. Further, a Hadith narrated by Anas bin Malik⁸, tells the following. One day prophet Muhammad (PBUH) noticed a Bedouin leaving his camel without tying it. He asked the Bedouin: "Why don't you tie down your camel?" The Bedouin answered: "I put my trust in Allah (SWT)". The prophet then said: "Tie your camel first, then put your trust in Allah (SWT)". This story according to muslim scholars clearly reflects the acceptance, and even the recommendation of proper risk management. Insurance, which is actually considered as risk management, is thus deemed acceptable.

Still questions remained on the acceptability of life insurance. Since it is Allah (SWT) who 'decides' on life and death, how can Muslims create something where the mere occurrence of death would trigger beneficial payments? Here scholars refer to verse 4:92 of the Qur'an, introducing the concept of *Dijah* or blood money. It is a financial compensation that is paid if another person is killed unintentionally and in that way forms, for most Muslim scholars, the basis for the permissibility of life insurance.

Takaful

The term *Takaful* originates from the root verb *kafala*: to guarantee, to secure or to be responsible for others. In the literal sense, *Takaful* thus means joint responsibility or guarantee based on mutual agreement. It implies collective assurance and mutual undertaking among members: mutual responsibility and mutual protection from losses.

Conventional insurance

There has been a lot of debate and different opinions on the fact if conventional insurance is Haram. Most scholars agree that *Riba* or interest is not permissible (cfr. section 1.3.6). A second prohibited element, uncertainty or *Gharar* and gambling or *Maysir* is accepted by some based on the fact that statistics and actuarial calculations support a form of objectivity (e.g. Sheikh Mustafa Al-Zarka is often referred to for this opinion). Still, also Sheikh Mustafa Al-Zarka acknowledges that if a mutual or co-operative insurance exists, it is preferable to profit motivated insurance. Also in case no alternative exists

⁶The Qur'an speaks of the fact that success is only achieved when trust is in God and the believer is steadfast and obeys God's commands.

⁷These letters stand for the Arabic words "Subhanahu Wa Ta'ala", or "Glory to Him, the Exalted".

⁸As quoted in Sunan At-Tirmidhi, 1981

and if the insurance is legally mandatory (e.g. liability car insurance), one must do it and one is excused from the Shari'ah point of view (see section 1.3.4).

The Fiqh Council of World Muslim League (1978) resolution and The Fiqh Council of Organization of Islamic Conference (1985) in Jeddah resolved that conventional insurance as presently practiced is Haram, and that co-operative insurance (Takaful) is permissible and fully consistent with Shari'ah principles. Since this paper focusses on Takaful, it follows the more strict interpretation and discusses the different elements that feed objections to conventional insurance. One could also consider that the more Shari'ah compliant a product is, the broader the potential group of customers (it doesn't harm to be more Shari'ah compliant than certain groups aim for or find acceptable).

1.3 Sharia and Islamic Finance

When entering the keywords "Islamic Finance" on amazon.co.uk, a list of 2.410 results (category: books) appear. The literature on this topic is extensive, covering a wide area of topics, and profound with many books on specific elements in each area. This chapter merely aims to provide an introduction, outlining a number of general concepts and terminology that will be used further in the paper. It by no means wants to be extensive nor complete on any of the aspects treated.

1.3.1 Pillars of Shari'ah Contracts

Underlying all commercial transactions is contract law. Following pillars can be defined [23]:

Form (sighah) : The form of any contract in Islamic law is offer and acceptance. For a contract to be valid, there should be an offer followed by its acceptance, made by use of words or indications that are commonly used in the particular locality.

Parties to the contract (al-aqidan) : The parties should have the ability or capacity to enter into a valid contract. Subject to certain principles, impediments or incapacity to enter into a valid contract include being a minor, insanity, forgetfulness, sleep and terminal illness.

Subject matter and price (al-ma'qud alaih) : The subject matter of a contract must have commercial value, must exist and must be legally owned by the seller at the time of the contract. The subject matter should also be Halal (see 1.3.3). Finally, also the price (value) should be fixed.

Intention to create legal relations : The parties must have the intention to create legal obligations, which involves the meeting of minds based on mutual satisfaction (cfr. Qur'an 4:29).

1.3.2 Making profit - Profit & loss sharing

It is important to note that making profit by trade is actually stimulated by Islam (Qur'an, 2:275 & 4:275): it encourages and promotes the right of individuals to pursue personal economic prosperity - as long as higher values stay intact. It is encouraged above lending money (cfr. subsection 1.3.6) to invest and share in both profits and losses arising out of the enterprise. Within conventional banking and lending, the focus is on the creditworthiness and repayment capacity, often leading to guarantee requirements. Whether a project succeeds and generates a profit or a loss, is only secondary to that. The entrepreneur invests his time and in many cases also bares (too often even personally) the loss of taking (new) initiatives. In islam, this kind of distribution is considered unjust. Both the investor (financial institution: bank or insurer) and entrepreneur share in the profit and in the loss of an undertaking. The entrepreneur invests time and, in case of an unsuccessful venture, is not rewarded for this (no remuneration). The investor provides capital and fully takes the financial loss. In case of a successful venture, the entrepreneur is rewarded for his time investment and the capital provider for the capital that was provided. The profit sharing is open for discussion between those parties who can make arrangements at their sole discretion. Losses are however (per definition) shared equally (proportionally) among all capital providers - no exceptions to this rule are allowed.

1.3.3 Halal transactions

Muslims are prohibited to engage in activities that are not allowed under the Shari'ah. All activities in a transaction should thus be permissible or 'Halal'. This does not correspond with activities (and as a consequence also investments in activities) which are forbidden or 'Haram', such as alcohol, pork, pornography,

Riba (usury or interest), as explained further, is also Haram. In practice, this would mean Islamic Financial Institutions (IFIs) would not be able to invest in the majority of businesses (since most of them have regular commercial loans on which they pay interest). Therefor a number of prominent Shari'ah scholars have advanced the view that it is permissible to invest in these businesses as long as following conditions are met [25]:

- The principal business activity is Halal. This means not investing in:
 - Alcoholic drinks and related activities
 - Pork, ham, bacon and related by-products
 - Dead animals (not slaughtered according to Shari'ah rules)
 - Products associated with gambling such as gambling machines, casinos, ...
 - Tobacco, drugs, etc.

- Activities associated with pornography
- Gold and silver except for spot cash
- Armaments and destructive weapons
- Income derived from prohibited activities should be limited (limits vary between scholars from 5% to 20%)
- Aggregate amount of interest the company pays should not exceed its total asset value by more than x percent (25% - 40%)

In case of doubt regarding whether an investment is fulfilling the above conditions, it is considered judicious to abstain from investing in it.

1.3.4 Necessity makes the prohibited permissible

That necessity removes restriction is an important juridical rule. It shows that the Shari'ah is not inconsiderate of the exigencies of life, nor to human weakness and the ability to face them. It allows Muslims, under the compulsion of necessity, to do things which would otherwise be Haram, in order to meet the necessity and save himself from harm.

It should not be applied lightly, and in this case necessity should be read as harm. When a person undergoes an excessive situation that could hurt him or destroy his body, part of his body, his mind, his family, his money or his religion, he can engage in Haram activities or contracts in case no Halal alternative is available. It is also used as a valid reason for Muslims to take a mortgage, car insurance, ... from a conventional financial institution if no Takaful alternatives are available.

The basis for this can once again be found in the Qur'an. Verse 2:173 on eating Haram food to prevent starvation and verse 2:185 on 'skipping' some days of Ramadan but catching them up later in case of being ill or traveling ("Allah (SWT) intends for your ease, and He does not want to make things difficult for you") are often referred to for this topic.

1.3.5 Zakat

One of the five pillars of Islam, the five duties incumbent on every Muslim, is Zakat: giving x% of one's savings to the poor and needy (the other 4 are *Shahadah*: there is no god except God and Mohammed (Peace Be Upon Him) is God's Messenger, *Salat*: ritual prayer 5 times a day, *Sawm*: fasting and self-control during the holy month of Ramadan, *Hajj*, pilgrimage to Mecca at least once in a lifetime if one is able). The principle underlying Zakat is that if an owner sees the value of his property increase, he should share some of this growing prosperity in this world to gain favour in the next.

As with many of the Islam concepts mentioned in the paper, a whole chapter could be easily devoted to each one of them.

Other items worthwhile mentioning on Zakat are:

- Through Fiqh, Zakat is also the basis for governmental taxation of the income (a minor part of scholars expand this to capital or wealth in general) in Muslim states. This way Zakat is a form of social security system [17], which can be considered as a form of mutual insurance as well.
- In the United Kingdom, according to a self-reported poll of 4000 people, three out of ten U.K. Muslims gave to charity. British Muslims, on average, gave \$567, compared to \$412 for Jews, \$308 for Protestants, \$272 for Catholics and \$177 for atheists in Britain⁹.

1.3.6 Riba

Definition

Riba can be roughly translated as “Usury”, or unjust, exploitive gains made in trade or business. Riba is condemned in the Qur’an (see for example 2:275-2:281 in Appendix A.1), forbidden in Islamic economic jurisprudence (Fiqh) and considered as a major sin.

Origin

The basis for this prohibition is that Muslims are encouraged to undertake action in order to gain wealth. As mentioned earlier, entrepreneurship and making profit (this way) is stimulated. But when giving a loan and asking interest, this form of income you would acquire without doing anything, without ‘working’. Money (and other similar things which often have no intrinsic value but as a mean of exchange such as e.g. gold or silver) has no value in itself, and therefore should not be allowed to generate more money. Many Muslim jurist consider money as potential capital rather than capital, meaning that money becomes capital only when it is invested in a business. This also implicitly denies a time value of money¹⁰: Muslims are encouraged to spend money and/or invest in productive investments and are discouraged from keeping money idle.

There are two related aspects to Riba referred to by the prophet Mohammed (PBUH) and the Qur’an that make it unjust [11]:

1. Punishing someone for default is unjust.

⁹“Muslims give more to charity than others, UK poll says”. nbcnews.com. 22 July 2013.

¹⁰Although many Muslim scholars agree on this topic, a group of scholars does acknowledge a certain time value limited to inflation, hence allowing for an interest rate equal to inflation.

2. It should be a judge that determines which compensation (if any) is appropriate in case of default, not the party to whom the debt is owed.

In Sura 30, Ar-Rum, interest is linked to Fasad, loosely translated as the corruption of society. In Sura 4, Al-Nisa, Jews are admonished for taking usury (while it is forbidden) and hence devouring people's wealth by false pretences. It translates to the fact that interest on money is regarded as representing an unjustified creation of instantaneous property rights.

Finally, the ultimate effect of interest on society is considered to be leading to negative growth and to an inefficient allocation of society's resources. This is related to the above mentioned topic on the most credit-worthy party receiving the loan versus the most promising project receiving the required capital.

Special case(s)

A special case of Riba is the late payment interest. Blankly abolishing every incentive to make payments in time (although it is the duty of every Muslim to execute the contract he has engaged himself in, thus including the timely payments) also seems not a good idea. The solution provided is that a fine could be imposed on those that do not pay in time. To conform with the Shari'ah, this fine should then be given to charity (cfr. Zakat, section 1.3.5).

1.3.7 Gharar

Gharar (uncertainty, risk of speculation) should be excluded from contracts, meaning there should be no uncertainty to the subject-matter of a contract¹¹: its sale price, deliverability, quantity, quality, existence, This is an important aspect for insurance, since by definition there is uncertainty if and/or when the insured risk occurs and thus in many cases the timing, height, ... of the amount the insurance will provide.

The rationales for prohibiting Gharar include mitigating disputes over the interpretation of contracts and mitigating problems arising from asymmetric information so that injustice and inequity doesn't fall on the ill-advised contracting party from the outset [10].

Asymmetric information can be defined as information that is known to one party in a transaction but not to the other. Islam upholds the disclosure of information as a

¹¹The prohibition of Gharar appears in several verses of the Qur'an, e.g. 4:29. Next to these, Ahmad and Ibn-e-Majah narrated on the authority of Abu-said Al-khudriy: Mohammed (PBUH) has forbidden the purchase of the unborn animal in its mother's womb, the sale of the milk in the udder without measurement, the purchase of spoils of war prior to their distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver.

sacred duty. Asymmetric information is an issue because, due to the fact that Riba is considered Haram, many contracts are set up on a 'PLS' basis (PLS = Profit and Loss Sharing). In case one party knows the asset/company/investment is of 'poor' quality but does not inform the buyer/investor, this is known as the lemon market problem in valuation. It leads to the effect that shareholders demand a premium to purchase shares to offset losses arising from funding lemons. This premium raises the cost also for equity finance for good or high quality firms [11]. In insurance, asymmetric information is also linked to moral hazard and adverse selection risks. Next, it means that depositors (family Takaful clients) are to some extent burdened with gathering information about the safety, soundness, riskiness and profitability of the projects the bank (or insurer) invests their money (family Takaful contribution) in. This topic will be further addressed in the governance section, where customer representation and Shari'ah Supervisory Boards are discussed.

1.3.8 Maysir

Linked to uncertainty (Gharar) is Maysir or Qimar, meaning games of chance or gambling. The prohibition of Maysir arises from the premise that the agreement between parties involves certain immoral and undue benefits based on false hopes in the contract. It involves the lucky chance of obtaining something valuable without actually earning it. The prohibition is based on Qur'an verses 5:90-91 and 2:219. Since the outcome of any game of chance is uncertain, Maysir is closely related to Gharar.

1.4 Islamic Financial contracts and structures

This section is in first instance more closely related to Islamic finance and Islamic banking than it is to Islamic insurance. Also, the technicalities of the investment part of life insurances are not the main scope of this master paper. However, since it is required to better understand acceptable contracts and terms and conditions in general, and the investment part also baring specific challenges for family Takaful in Belgium, the main concepts are listed and briefly explained in this section.

1.4.1 Overview

Islamic financial contracts can be grouped in two categories: Deferred Sales Contracts (DSC) and Profit-and-Loss Sharing (PLS) based contracts.

Each of the contracts will be explained more in detail in the next sections, where their definition, Shari'ah compliance, applications and difference with conventional finance products are discussed. The definitions of the contracts, as applied within a financial

Table 1.1: Deferred Sales Contracts

Name	Description	Use	Shari'ah compliance
Murabaha	Sale with a known profit: object delivered at contract time but price due as debt in future	Mortgage, working capital facility	Yes if cost+
Salam	Price paid immediately but object delivered later (debt in kind)	Commodity financing	Only ok under specific conditions
Ijarah	Transfer of usufruct of an object in exchange for a rent claim	Leasing	Yes
Istina'a	Purchaser asks seller to manufacture specifically defined product, using seller's raw materials, at a given price.	Project Finance	Generally not

Table 1.2: Profit-and-Loss Sharing contracts

Name	Description	Use	Shari'ah compliance
Mudarabah	Partnership in profit between capital and work	Current and savings accounts, investments	Yes
Musharakah	Partnership whereby each party contributes to the partnership capital	Investments, working capital facility	Yes

institution, are standardised by the AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions).

The Shari'ah compliance mostly draws from Usmani (1998, [6]). Mufti Muhammad Taqi Usmani (born in 1943) is a Hanafi Islamic scholar from Pakistan. He served as a judge on the Federal Shariat Court of Pakistan in 1981 and 1982, and the Shariat Appellate Bench of the Supreme Court of Pakistan between 1982 and 2002. He is an expert on the field of Islamic Jurisprudence (fiqh), economics and Hadith. He wrote a book on Islamic Finance in 1998 to which many authors of books and papers on Islamic finance (including now this one) later refer.

1.4.2 Murabaha

Definition

Murabaha refers to the sale of goods with a pre-agreed mark-up on the cost. The contract consists of four elements:

1. An order by a prospective buyer to buy a specific commodity promising to buy it for a cost plus profit (margin) price. The promise is an invitation to do business and not a commitment.
2. If the seller accepts, he is bound to ensure he can locate the commodity, buy it and thus own it via a legitimate contract.
3. The seller consequently makes an offer to the prospective buyer (so at the moment he actually owns it).
4. Next, the buyer has the option to either buy it or to revoke his offer.

Shari'ah compliance

The basic ingredient for Shari'ah compliance is that the seller discloses the actual cost he has incurred in acquiring the commodity. The mark-up might seem to resemble a classical interest charge. But therefore it is important that the sellers first acquires and owns the object and subsequently the buyer can still revoke his offer. The markup thus does not reflect the time value of money, but reflects the risk born by the seller. For example, the commodity price might have declined and the buyer no longer accepts the higher price.

Islam treats money and commodities differently: money has no intrinsic utility, commodities can be of different qualities and traded commodities should thus fulfil certain specifications. When money is traded for money it can only be traded on the spot and for the same value (no excess value allowed). This is different for commodities, where all four schools of Shari'ah law and the majority of the Muslim jurist accept that two different prices can be used for cash and credit sales.

Since Murabaha is not considered a loan or debt but a sale, specific conditions regarding the sale of goods in Shari'ah should be met:

1. The subject of the sale must exist at the time of the sale.
2. The subject of the sale must be owned by the seller at the time of sale

This explains why the first step in Murabaha only encompasses a promise to buy and not an actual buy/sale: the object is not yet in the possession of the seller and hence no valid sale can take place.

Applications

A vast number of applications exist for the Murabaha contract:

- Mortgages
- Working Capital
- Letter of credit
- Car purchase

In case of a mortgage for example, the bank purchases a property designated residence at a specified price. After the bank has acquired the property, it is sold to the customer who pays the purchase price plus a profit component in instalments over time.

Difference with conventional finance

From the above description, following differences can be identified:

- No interest (Riba) is involved.
- The bank acquires the object and the client is not obliged to buy it.
- The cost price of the item and the markup for the bank are communicated transparently.
- The seller cannot contractually be bound to buy-back the commodity (so the bank cannot require a kind of repayment once the commodities are harvested).
- A penalty can be agreed for late delivery, in which case it must be donated to charity.

1.4.3 Salam

Definition

Salam is a contract involving the purchase of a commodity for deferred delivery in exchange for immediate payment.

Shari'ah compliance

Salam involves selling something that does not already exist and would normally not be Shari'ah compliant. It was however allowed by the prophet Mohammed (PBUH) under certain conditions: to meet the needs of small farmers who needed finance to grow their

crops, to feed their families up to the time of harvest. Specific conditions for permissible Salam involve:

- It should only be applied to fungible commodities, and the quality and quantity need to be exactly specified.
- Date and place of exchange should be specified.
- The full amount needs to be paid in advance.

Applications

Salam is used only under the conditions set out above, so to specifically finance farmers. A Salam contract is a debt obligation, albeit in goods and not in money. In this specific setting, the bank is also allowed to establish security, to be used in case of default in delivery.

Difference with conventional finance

First of all no interest is charged, albeit a monetary compensation can be included in determining the (in this case lower) price for the commodity. The second major difference is that the bank is not repaid but actually acquires the commodity once harvested. The bank in this case often enters into a parallel Salam with a buyer of this commodity.

1.4.4 Ijara

Definition

Lexically, Ijara means “to give something for rent”. It is used for two different situations:

Lease is the most common type of Ijara, relating to the usage (usufructs) of assets. The lessor is called *Mu'jir* and the lessee *musta'jir*.

Wages : employing services of a person for wages paid. The employer is called *musta'jir* and the employee *ajir*.

For Takaful, the lease type is the most important. It involves transfer of usufruct, which is defined as the right of enjoying a thing, of which the property is vested in another.

Within the lease type of contract, a subtype exists called Ijara wa Iqtina, where at the end of the agreed lease period, the lessee becomes the owner of the object. In normal cases, ownership stays with the lessor who can sell or re-lease it to the same or another party.

Shari'ah compliance

Shari'ah allows a fixed charge relating to tangible assets (as opposed to financial assets), since by converting capital into these assets the lessor has assumed risks for which compensation is allowed (for example the risk of a recession or reduced demand for the asset).

The usage of the asset by the lessee can of course not be Haram (for example, leasing a machine to produce alcohol). A purpose of use can be stipulated in the contract, in which case the lessee should adhere to it.

Since ownership stays with the lessor, he of course (re)possesses the object in case of default (including if the lessee gives notice of its intention to redeem - in which case the lessee should bare related costs). It also means that liabilities emerging from the ownership should be born by the lessor - liabilities relevant to the direct use should be born by the lessee.

In general, terms and conditions should be fixed at contract conclusion (this holds for all types of contracts: eliminating Gharar as discussed in section 1.3.7). It also means that the lessor cannot change the rent unilaterally.

Finally, the lease terminates in case the asset has totally lost the function for which it was leased. Only in case of misuse or negligence, the lessee is liable to compensate the lessor.

Applications

Ijara is used for many lease-like contracts. The Islamic Development Bank (IDB) uses Ijara as medium-term mode of financing, involving purchasing and subsequently transferring the right of use of equipment and machinery to the beneficiary for a specific period of time.

Difference with conventional finance

Since Shari'ah law does not object to paying for the usufruct, Ijara contracts are relatively similar to normal lease contracts. Shari'ah compliance is in this case more a moral than a legal issue. Still, strictly speaking following differences can be noted:

- No interest: rental payments for an assets is not capital + interest payments for a loan, although one could argue that the difference is partly grammatical.
- No penalty interest for late payments (see section 1.3.6 on Riba).
- Insurance and maintenance issues: in contrast with conventional lease, responsibility for maintaining and insuring the asset remains at the lessor. Since a large

part of these aspects are also beneficial for the use of the asset (cfr. subsection Shari'ah compliance), both can be transferred to a large extent to the lessee within the framework of the Ijara contract.

- Monitoring by the Shari'ah board (cfr. section 1.5.2).

1.4.5 Istina'a

Definition

Istina'a is derived from the term Sina'a, which means to manufacture a specific commodity. It is an agreement where one party pays for goods to be manufactured or something to be constructed. The bank as intermediary often creates separate contracts with the buyer and the producer, allowing for the purchaser to also pay on a longer-term schedule. The bank makes profit by adding a mark-up on the price.

Shari'ah compliance

The majority of religious schools find Istina'a not permissible under the Shari'ah. There is no basis for it in the Qur'an or Sunnah. It involves a sale of something that is not yet in the possession of the seller (it should still be constructed), which is not allowed.

Applications

Project finance, construction of capital equipment such as airplanes and ferries.

Difference with conventional finance

The main difference consists of applying a mark-up on the price versus interest based financing.

1.4.6 Mudarabah

Definition

Mudarabah refers to a business contract in which one party brings capital and the other brings personal effort and time. The proportionate share of profit for both parties is determined by mutual agreement. But a financial loss, if any (and if not due to negligence or violation of the terms of the contract), is fully born by the capital provider - while the other party in this case is not remunerated for this effort and time. The financier

is called *Rab-ul-Maal* and the entrepreneur is called *Mudarib*. Applied within a bank, account holders can be the capital providers and the bank invests the capital in various businesses. As a matter of principle, the owner of the capital does not have a right to interfere in the management of the business and Mudarabah is therefore sometimes also referred to as a sleeping partnership.

Two subtypes of this contract are often used:

Mudarabah Al Muqayyadah or restricted Mudarabah: the Rab-ul-Maal can specify a particular line or place of business.

Mudarabah Al Mutlaqah or unrestricted Mudarabah: full freedom is given to the Mudarib (within normal course of business).

This leads to a two-tier setup within the bank: the account holders / depositor provide their funds on the basis of unrestricted Mudarabah. The bank invests in different businesses via the restricted Mudarabah. In case of profits, the bank withholds part of the profit to cover its operations (administrative cost, capital depreciation, ...) and gives the remainder as a return to the depositors. In case of a loss, the depositors bare the loss and the bank makes no money.

Finally, it is important to know that the bank cannot demand any guarantee from the Mudarib such as security or collateral.

Shari'ah compliance

The origin of profit and loss sharing was already discussed in section 1.3.2. More specifically for Mudarabah contracts, jurists rely on the contract the prophet Mohammed (PBUH) with Khadija prior to his marriage to her. The legal evidence lies thus both in the Qur'an as well as the Sunnah.

As set out by Usmani, 15 rules should be taken into account for a valid Mudarabah contract, of which the most important ones are:

- The amount of capital should be known at the outset of the contract.
- Capital should be in the normal currency in circulation.
- The capital must not be a liability or debt to the Mudarib: the Mudarib is a trustee. Therefore also no security should be stated in the Mudaraba contract.
- If there are multiple capital providers, profits should be divided proportionate to the amount of capital provided.
- Profit should be defined in the contract and profit distribution should be percentage wise. The Mudarib collects its share of the profit only after obtaining permission from the Rab-ul-Maal.

Applications

Mudarabah is considered to be the essential mode for Islamic banks in their relationship to depositors. Its application for depositors and a bank's basic operations is already explained within the definition.

Difference with conventional finance

Mudarabah touches the basic difference between interest based banking and profit and loss sharing agreements.

- No interest (Riba) is involved.
- No guarantees / collateral is allowed.
- Income for the financial institution depends on the amount of profit made by the companies it provides capital to.

1.4.7 Musharakah

Definition

Musharakah implies a partnership in a venture: two or more parties combine their capital or labour to share profits, enjoying similar rights and liabilities. The parties share profits in an agreed manner and losses in proportion to the capital contribution.

Also for Musharakah two subtypes exist:

Mufawada entails an unrestricted and equal partnership with complete equality regarding capital, management and right of disposition. In this system, each partner is also the guarantor of the other.

'inan where parties contribute with either capital, in kind or labour (or a combination of those). It is limited in scope to a specific undertaking and each partner is only the agent and not the guarantor of the other.

Shari'ah compliance

Like with Mudarabah, the basis for Profit and Loss Sharing contracts is reflected in section 1.3.2.

Also on this topic Shari'ah rules were clarified by Usmani, of which following attention points arise:

- It is not a condition that partners have equal shares in capital.

- It is not permitted to forbid one of the partners from work, but one can mandate the other to singly work in the company.
- It is permitted to take a mortgage or guarantee, but only against negligence (so not against losses).
- In principle, profit should be divided among partners in ratios proportionate to their shares in the capital.

Applications

Similar to the Mudarabah, Musharakah is used for carrying on ordinary commercial activities. The concept is however also applied to structure a working capital facility. Diminishing Musharakah has been successfully applied by Jordan Islamic Bank for real estate financing.

Difference with conventional finance

Like Mudarabah, Musharakah touches the basic difference between interest based banking and profit and loss sharing agreements.

- No interest (Riba) is involved.
- No guarantees / collateral is allowed (except for protection against negligence).
- Income for the financial institution depends on the amount of profit made by the companies it provides capital to.

1.5 Family Takaful

1.5.1 Intermediate conclusion

What does all the above mean for the family Takaful (Islamic life insurance) industry?

Basically, two elements of life insurances are to be addressed further.

The first element is defined as the *savings component*. For this component the elimination of Riba (cfr. 1.3.6) is important. This component is also referred to as an insurance-based investment product. In Belgium the savings component mainly consists of

- A fixed interest rate (Branch 21), mostly heavily invested in bonds and thus based on Riba, which is prohibited. On top of that, the promise of a fixed return is inconsistent with PLS based contracts (see 1.3.2).

- An investment in assets (unit-linked, Branch 23) which are commonly either bonds (Riba once again) or stock (Halal equity, see 1.3.3).

An important difference between Branch 21 and Branch 23, is that the Branch 21 savings component is protected by a Deposit Guarantee Scheme, reimbursing up to 100.000 € in case the insurer goes bankrupt. This is not the case for Branch 23.

The second component is the *risk (death, disability) cover* component which foresees an amount to be paid at the time of death of the insured. This component conflicts with the prohibition of Gharar (cfr. 1.3.7) and Maysir (cfr. 1.3.8). The actuarial calculations on which the tariffs for this component are based are considered inappropriate because it contains of course a large 'uncertainty' component which, in traditional life insurance companies, leads (or should lead) to a profit for the insurer and no (/little/limited) profit sharing with the policy holders. Even worse: in case the risk does not occur, there is no 'return' at all for the insured.

1.5.2 Shari'ah supervisory board

Definition

Most Islamic financial institutions appoint a board or committee of religious scholars (Shari'ah Supervisory Board (SSB) / Shari'ah Review Board (SRB)) to ensure their operations and activities comply with Shari'ah principles, as well as that transactions comply with the Fiqh al-Mu'amalat [9].

The International Association of Islamic Banks (IAIB) clarifies the duties of the SSB in article 2 of its Statute:

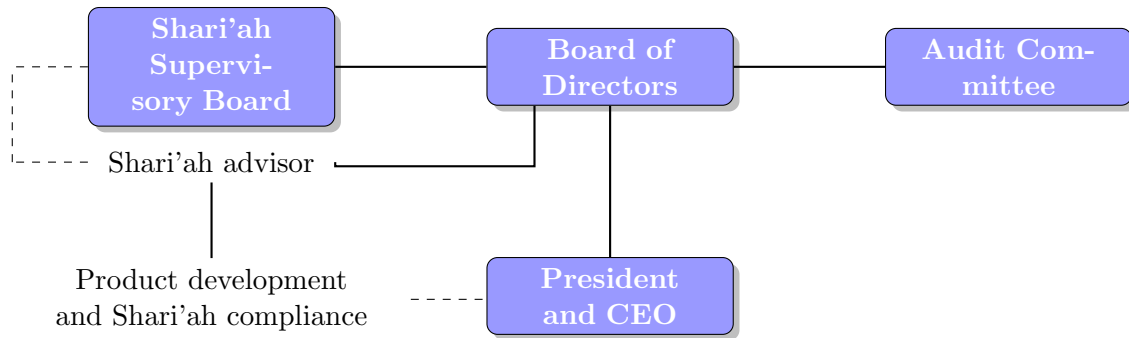
1. To study Fatwas previously issued, assess its constituency with the Shari'ah and, when appropriate, base its own rulings on these decisions;
2. To supervise the activities of the bank in order to guarantee conformity with the Islamic law;
3. To issue religious opinions on banking and financial questions; and
4. To clarify legal religious rulings on new economic issues.

A Fatwa, or approval report, contains the argumentation of the review board and describes which Shari'ah rules underly the contract form. This judgement can be based on diverse Islamic schools of thought, so that a Fatwa of one board is not per se endorsed by other boards.

The SSB also prepares an annual Shari'ah Compliance Review report to be presented to the Islamic Financial Institution's (IFI's) annual general meeting.

Organisation

The corporate governance structure of Meezan Bank (primary Islamic bank in Pakistan) is a good example of how this effects the organisation and governance within a typical Islamic Financial Institution (IFI). This modern practice of corporate governance is reflected schematically below.



A high level of independence is maintained among the major governance organs. The Shari'ah governance organs consist of the Shari'ah Supervisory Board, the Shari'ah advisor (who interacts between the board of directors and the Shari'ah Supervisory Board), and both Product Development as well as a Shari'ah Compliance Unit (SCU).

Shari'ah scholars

The increasingly complex and sophisticated world of modern and dynamic Islamic finance, Shari'ah scholars are not only expected to answer any issues or concerns for a particular transaction or product, but are also deemed to provide constructive and creative alternative recommendations. They are thus not only asked as a member of an SSB, but are often involved in product development, document review, investment supervision, and providing training and education.

1.5.3 Standardization

AAOIFI

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and Shari'ah standards for IFIs. As an independent international organization, AAOIFI is supported by institutional members (200 members from 40 countries currently) including central banks, IFIs and other participants from the international Islamic banking and finance industry, worldwide. (See www.aaofi.com for more information.)

IFSB

The Islamic Financial Services Board (IFSB), created in 2002, serves as an international standard-setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and insurance. To this end, the work of the IFSB complements that of the Basel Committee on Banking Supervision, International Organisation of Securities Commissions and the International Association of Insurance Supervisors. In April 2015, the 188 members of the IFSB comprise 61 regulatory and supervisory authorities, eight international inter-governmental organisations, and 119 market players (financial institutions, professional firms and industry associations) operating in 45 jurisdictions. (See www.ifsb.org for more information.)

1.5.4 Summary of main differences between conventional and Takaful

<i>Conventional Insurance</i>	<i>Takaful</i>
Risk transfer	Risk sharing
Losses and gains managed by insurer (target: create profit)	Gift (Tabarru') to the risk pool, sharing the losses and gains between participants
Funds are mostly invested in fixed interest instruments	Funds are only invested in halal instruments
Saving and risk can be intermingled	Strict separate approach between individual savings and risk pooling

Chapter 2

Family Takaful (Islamic Life Insurance)

In this chapter different aspects of the setup or implementation of family Takaful (Islamic Life Insurance), are worked out. Often different options exist or different interpretations of Shari'ah law lead to sometimes even contradicting opinions. It also highlights issues or challenges that are present in the way Takaful is setup in different regions of the world.

The next chapter will elaborate those aspects and challenges considering family Takaful in Belgium.

2.1 Market

2.1.1 Islamic Finance Market

The global islamic finance market is estimated to cover roughly USD 2 trillion in assets [24]. Figure 2.1 from the Global Islamic Finance Report 2013 [26] shows the evolution of the market from 2008 to 2012. From the same report, based on 2012 figures, the top 5 countries (each over 100 billion in assets) are Iran (USD 416 b), Saudi Arabia (USD 215 b), Malaysia (USD 155 b), UAE (USD 120 b) and Kuwait (USD 103 b).

2.1.2 Global development of Takaful

The development of Takaful in modern times started in Sudan in 1979 and Malaysia in 1984. It developed further as a the result of the 1985 fiqh Academy ruling declaring that conventional insurance was Haram, while insurance based on co-operative principles, Shari'ah compliance, and charitable donations are acceptable [27]. The birth of Takaful industry in Malaysia lies in the Takaful act of November 1984. However, Takaful only

took momentum in early 2000 when the Malaysian government promoted it [29]. Growth varied significantly from country to country and its success, or otherwise, has been largely dependent on the awareness and affluence of the local population, as well as on the robustness of the local regulatory framework.

The global Takaful market is estimated to continue its double-digit growth momentum of about 14% and may reach over USD 20 billion in 2017 [24]. Saudi Arabia is the largest Takaful market, while also the GCC¹ region is an important Takaful market. Figure 2.2 shows the evolution from 2009 to 2014 (2014 = forecast).

Malaysia was and still is an important country for Takaful, given the important regulatory actions such as the initial Takaful act in 1984 and the recent concept paper by the Bank Negara Malaysia (Malaysia's central bank) on Life Insurance and Family Takaful for Everyone (LIFE). It also attracted a lot of M&A activity recently (in 2013 Malaysia's insurance industry attracted new players from Canada and the US who were keen to acquire local operators and grow their regional business further [24]). While Indonesia showed important growth in Takaful due to advances in regulatory reforms, Turkey has become a new frontier market for Takaful (either for full fledged Takaful Operators or Takaful products by the growing number of participation banks).

Limiting market potential to muslims

One of the obvious prejudices is that Takaful potential is limited to the muslim community. A 2013 research on Takaful potential in India [42] shows that over 40% of both muslims as well as non-muslims agree that Takaful products are not only offered to muslims but also to non-muslims (on the other hand, roughly 5% of muslims versus 20% of non-muslims disagree with the statement). Various other papers (e.g. [43]) and articles (e.g. "Islamic finance: Attractive for non-muslims?" by Dr. Zulkifli Hassan) stress the potential of a Takaful offering for non-muslims. In practice, over 40% of the customers of Prudential BSN Takaful Berhad (PruBSN) in 2007 were non-muslims [28].

2.1.3 Takaful in Europe

One of the reasons why expansion of Takaful to Europe could be beneficial, is its different market dynamics. The average life insurance premium per capita in Europe was 1.124 € in 2013 (source: Insurance Europe statistical publications), while below 50 Euro in the Middle East (source: Swiss Re sigma study on world insurance in 2013). After Asia-Pacific, Middle-East and Africa, Europe is the region with the largest Muslim population (source: Pew Research Centre, estimated number of Muslims in Europe to grow from 43

¹The Co-operation Council for the Arab States of the Gulf, originally (and still colloquially) known as the Gulf Co-operation Council (GCC), was a regional intergovernmental political and economic union consisting of all Arab states of the Persian Gulf, except for Iraq. It currently still points to its original member states: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

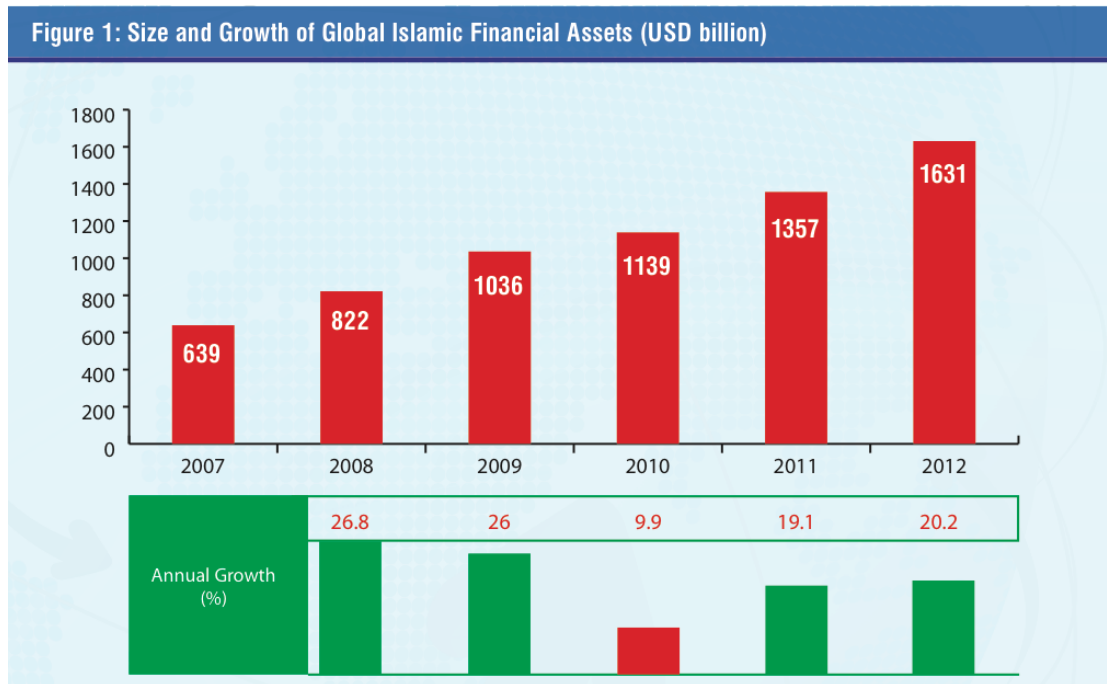


Figure 2.1: Islamic Finance Market - source: [26]

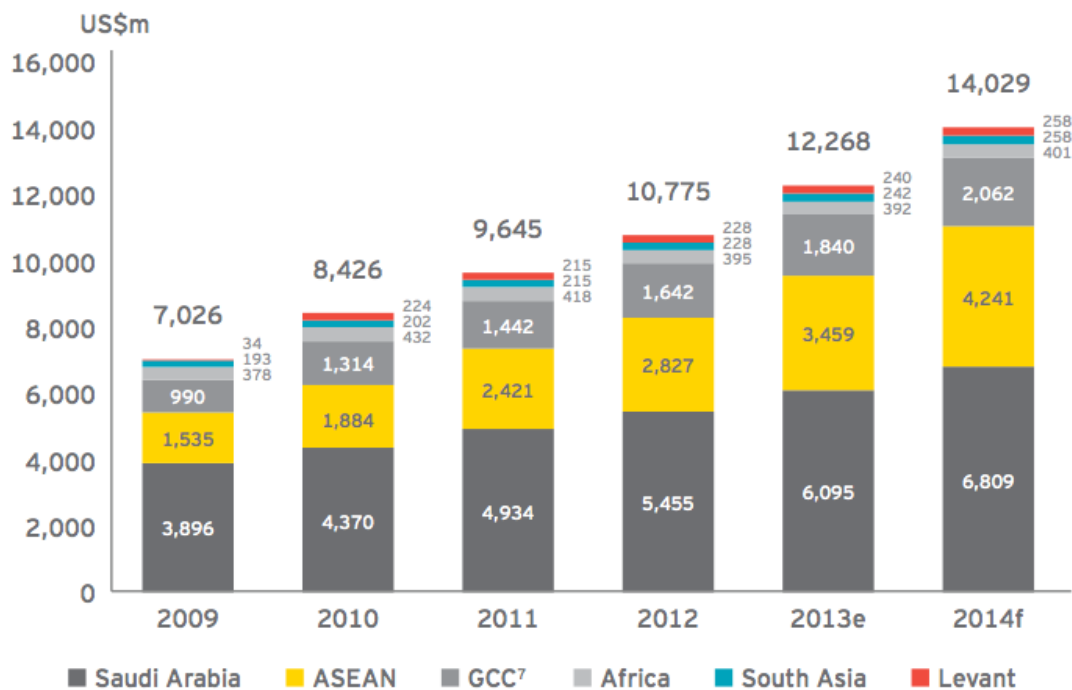


Figure 2.2: Global Takaful Market 2009-2014(f) - source: [24]

million in 2010 to 71 million in 2050). Despite the fact that Europe still represents only 2,7% of the total Muslim population in the world, it thus still represents a significant GWP (gross written premium) potential. In an article by Mr. Ridwan Abbas [16], Ms. Dingwall (currently partner at Norton Rose Fulbright) advises to choose a host regulator that understands Takaful such as the UK regulator, since this would obviously streamline the process of authorisation.

Despite initial positive vibes, a 2012 article in the Middle East Insurance Review magazine [31] speaks of “Takaful in Europe showing signs of life again” with the introduction of a family Takaful product by Swiss Life in France. Based on this article as well as [32] and [33], following overview was composed. The overview concerns Islamic Finance in general, and Islamic Investments as well as Takaful in more detail. Given the fact that insurers are also large institutional investors, development of investment and insurance market can be considered as related.

UK : The leading role of the UK (5 Islamic bank licences) was a bit tempered by HSBC pulling out of the Islamic banking market and its announcement after investigating Sukuk in the late 2000s to scrap its corresponding plans due to a ‘lack of value’. In the Takaful domain, Salam Halal Insurance went into runoff in 2010 (after one year), but in 2011 a Shariah-compliant broker (GNL Insurance) was approved by FSA. Finally, the UK hosts around 25 major law firms, making the UK a major global provider of the specialist legal expertise required for Islamic finance.

France : In an attempt to become a European hub for Islamic finance, building on the highest muslim population in the EU and a high trade flow with Muslim countries, France regulated Sukuk investments in 2007 and guaranteed parity of tax treatment shortly after that.

Germany was the first country to tap into the Islamic capital market (Saxony-Anhalt Sukuk, 2004) and accepted a Shari’ah compliant banking operation in 2009. It has the second largest Muslim population in the EU, a strong economy and a trading partnership with Turkey. German financial institutions actively participate in the Islamic finance industry via their subsidiaries in London, Dubai and Kuala Lumpur.

Italy is geographically close(r) to Northern Africa and the Middle East and plans to launch a Mediterranean Partnership Fund. Multiple Italian banks are also active in the GCC region.

Ireland focusses mainly on investment funds. It has set up a dedicated FSA team to deal with the establishment of Islamic investment funds and hosts up to 20% of the Islamic funds outside the Middle East.

Luxembourg was the first European country to list a Sukuk (2002). There is a strong government promotion to attract Islamic funds (currently 16 are listed) and it was the first EU country to adopt UCITS IV. Regulated Islamic funds have reached USD 5 billion AuM (Assets under Management). Moreover, the Central Bank

of Luxembourg is the only EU country that is an active member of the Islamic Financial Services Board. With over 669 Double Tax Treaties in force and 25 pending (March 2014), it is well positioned to serve as a hub for Islamic finance products to Europe.

The above overview clearly shows that, despite potential being recognised, Takaful in Europe is still in its infancy. Most countries seem to have been attracted by the large volume of Islamic investments, trying to get ‘a piece of the cake’ of this business which has an important B2B aspect. Takaful can in this view more be considered as having a focus on consumers, and only a few countries have embraced Takaful until now. On the other hand, major European financial institutions such as Axa, Allianz, Aviva and UK Prudential all have entered the Takaful domain with Shari’ah compliant operations in non-European markets².

Ethical investments

Closely linked to halal investments and also appealing to non-muslims, European countries having a strong culture of ethical investments are seen as a relevant indicator of favourable market conditions for Takaful ([32], [33]). The top 3 countries are France, UK and the Netherlands (AuM based, source: Islamic Finance in Europe) while Belgium ranks 5th in this overview and has after France the second largest number of funds.

Co-operation, sharing economy

The rise of the sharing economy (well known examples are Airbnb and Uber) as well as some initiatives in the financial (e.g. Zopa offering peer to peer lending) and insurance sector (the German friendsurance and the French insPeer), and an increasing interest in social responsibility and ethical investments all support the basic philosophy of Takaful and seem to create a more interesting or suitable environment to launch these products in the future.

2.2 Business Model

Given the above elements, what could be an acceptable business model for Shari’ah compliant life insurance?

The Islamic Financial Services Board (IFSB) defined Takaful in its paper on governance in December 2009 as follows [14]: “*Takaful is the Islamic counterpart of conventional insurance, and exists in both Family (or ‘life’) and General forms. Takaful*

²Cfr. <http://www.worldcommercereview.com/publications/article.pdf/790>

is derived from an Arabic word that means joint guarantee, whereby a group of participants agree among themselves to support one another jointly for the losses arising from specified risks. In a Takaful arrangement the participants contribute a sum of money as a Tabarru' commitment into a common fund that will be used mutually to assist the members against a specified type of loss or damage. The underwriting in a Takaful is thus undertaken on a mutual basis, similar in some respects to conventional mutual insurance. A typical Takaful undertaking consists of a two-tier structure that is a hybrid of a mutual and a commercial form of company - which is the Takaful Operator (TO) - although in principle it could be a pure mutual structure."

Takaful can be seen as the Islamic counterpart of conventional mutual insurance and is sometimes defined as not being a type of but rather an alternative to insurance. The description of Takaful business models is nicely summarized in [29] but can be found more extensively in [37], [34], [14], [23], [38], [35] and many other books and papers on (family) Takaful.

2.2.1 Components

Personal Investment Account (PIA)

The savings part is set up as a personal investment account (PIA) for the policy holder. It is invested in a halal way, e.g. via Mudarabah (cfr. 1.4.6) and similar to savings or investment accounts in Islamic banks. Once the contract reaches maturity or if the policyholder terminates his policy, he will get all the money (including profits and losses made) in the account. The investments are managed by the Takaful Operator and the total of assets managed for the savings part is called the Participants' Investment Fund (PIF).

Risk pool: Tabarru' and Ta'awun

Tabarru' is Arabic for a donation or gift. Instead of paying an insurance premium, Takaful participants (clients or policyholders) donate their Takaful contribution to a common pool to mutually assist the 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.

The pooling as such doesn't eliminate Gharar, as the uncertainty about future claim events still exists. However, it is considered to be acceptable as the donation (Tabarru') is meant for mutual assistance and not for gambling for a(n undue) profit. By doing this, all participants mutually share the risk in Takaful, which is an important fundamental difference with conventional insurance. In conventional insurance indeed the risk is transferred from the insured to the insurer.

Ta'awun means mutual co-operation, underlining the risk and profit and loss sharing between the participants in the risk pool. The pool of money composed by all the donations from the policyholder to the shared risk pool is called the Shared Risk Fund or SRF. A record is kept of each participant's donations: the Personal Risk Account (PRA)³. The Takaful Operator just manages underwriting and investments on behalf of the participants.

Qard Hasan

In practice, an issue can arise when at a certain moment the SRF is insufficient to pay for all risks that occur. Given the statistical based calculation and uncertainty that risks occur and almost independent of the height of the contributions (unless the full amount to be paid upon death is contributed by each policyholder up front, in which case the mechanism actually becomes useless), the probability of this happening is larger than 0%. Due to the nature of the risk sharing and the risk pool, policyholders are (at least morally) obliged to continue contributing to (slowly or quickly, depending on how this is set up) cover the losses. Asking for an extra contribution at the moment the SRF becomes zero is rather impractical and might trigger a lot of administration. More importantly however, taking this up as an explicit obligation undermines the concept of *Tabarru'*. Therefore, in many countries the Takaful Operator - although intrinsically not bearing the risk (which is born by the pool of participant) and only a manager of underwriting and investments - is obliged to foresee a *Qard Hassan*: a benevolent (interest free) loan to the SRF in case of deficits. The *Qard Hassan* is paid back by the (whether or not increased) subsequent premiums the policyholders pay.

Takaful Operator

As set out above, the Takaful Operator is essentially the manager of the diverse funds and executes a lot of administrative processes a conventional insurer does as well. Because it is a separate commercial company, since it has (depending on the remuneration model - see next section) insecure income streams and due to the fact that the Takaful Operator in many cases is expected to provide a *Qard Hassan* in case of a deficit in the SRF, the equity of the Takaful Operator also plays an important role and is referred to as the ShareHolder Fund or SHF.

The Takaful Operator can outsource part of the tasks assigned to him. For the SRF this can be done via reTakaful (Takaful reinsurance). For the investment part this can be done explicitly to another (asset management) company or implicitly by placing parts of the PIF in investment accounts with Islamic banks [35].

³In Malaysia this is called the Participant's Special Account or PSA

Summary

The table below summarises the key concept discussed above:

Takaful Operator (TO)	Participants			
ShareHolder Fund (SHF)	Shared Risk Fund (SRF)			Participants' Investment Fund (PIF)
	Personal Risk Account (PRA)			Personal Investment Account (PSA)

2.2.2 Remuneration Models

Given the business model sketched above, with a personal investment account and a risk pool in which risks and profit and loss is shared with other participants, how is the TO who organises such business model rewarded for the efforts of drawing up the contracts, setting up the risk pools, taking care of distribution, doing the administration, managing the investments?

Wakalah model

Wakalah is the process of assigning or entrusting another person with a certain task. The Takaful Operator acts as an agent for the policyholder (=principal) and is paid a fixed fee (mostly a fixed percentage of the amount paid by the policyholder). The Takaful Operator thus shares neither the risk, nor the profit of the two types of fund that are managed (neither for the PIF, nor for the SRF). Since the majority of costs of the Takaful Operator (TO) are of a fixed nature and evolve (stepwise or continuously) together with the number of participants or premium payments, the Wakalah model matches the nature of the costs the TO incurs. One of the disadvantages of the model is that the TO is not incentivised or rewarded for good (risk/)return management of the PIF. In fact, the Takaful Operator could just as easily put it in a low risk (low attention/management) Sukuk (see section 2.5.1) and after the initial investment ignore the further evolution of it.

Wakalah model with performance fees Since only paying Wakalah fees focusses the TO's attention on turnover, fees sometimes include 'performance' elements in relation to underwriting surplus or investment profit [35]. This brings the model closer to the Mudarabah model (certainly in case performance fees form a large part of the (potential) remuneration of the Takaful Operator).

Mudarabah model

In the Mudarabah model, the Takaful Operator acts as Mudarib (or entrepreneur) and the policyholders as Rab-el-mal (capital provider). The Takaful Operator shares in the investment profits of the funds and is thus only rewarded if an investment profit is made. This obviously heavily incentivises the TO to manage the funds to the best of its ability. This model leads to a significant risk for the Takaful Operator. In case of adverse market conditions (mainly for the personal investment accounts) or higher risk occurrence (depleting the SRF), the Takaful Operator makes a loss which is largely beyond his control.

Profit and Loss sharing for the SRF assumes also sharing of underwriting shortfall and surplus. This is however prohibited by most scholars⁴. It takes away the essence of risk and profit and loss sharing among the participants in the risk pool and makes part of the Tabarru' go to the Takaful Operator. Although this seems to take away the incentive for the Takaful Operator for a good performance in underwriting, the Takaful Operator is still incentivised by the fact that, in case of insufficient means in the SRF, he needs to foresee a Qard Hassan.

Modified Mudarabah Model Especially when setting up a new Takaful undertaking, a pure Mudarabah model implies a high risk for the Takaful Operator: next to carrying startup losses, if claims exceed Tabarru' the TO not only has no income from its activities at all, he should on top of that foresee a Qard to the SRF. This may well threaten the existence of the TO itself. Therefore, some models allow the TO to not only charge the direct cost of claims handling but also the management expenses to the SRF [35], although many consider it to be not Shari'ah compliant. This Modified Mudarabah model is very similar to the Wakalah model with performance fees.

Mixed Wakalah Mudarabah model

Given the advantages and disadvantages listed above, a mixed Wakalah Mudarabah model has become increasingly popular. A Wakalah fee is charged for the part that goes to the risk pool (SRF) and profit sharing (Mudarabah) is applied for managing the PIF. It takes away most disadvantages and assumes that the risk of needing to provide a Qard Hassan (next to the pressure on competitive pricing, and the review and follow-up by the Board of Directors as well as the Shari'ah Supervisory Board) are sufficient to promote prudent underwriting.

⁴In an interview by Azman Mohd Noor with Sheikh Abd al-Sattar Abu Ghuddah at International Islamic University Malaysia, 6 March 2008, it was described permissible by regarding it as ju'alah for the management's good performance in handling underwriting [38]. However, the AAOFI standards do not allow it.

Waqf model

Mainly being applied in Pakistan and South-Africa, the model requires the setup of a Waqf (endowment-trust⁵ or independent pool) that is responsible to collect the donations and give protection to the policyholders on behalf of themselves. All contributions thus belong to the Waqf fund. The Takaful Operator is the manager of the Waqf fund.

For third parties, Takaful undertakings might seem to be identical with the TO. The separate SRF does not need to have a separate legal personality. The Waqf model in fact does transform the SRF into a legal entity. It also means that an initial equity, required for its operations, needs to be provided by the initial participants. This reduces ambiguity (relationship between all participants managed via the Waqf), the donations are unconditional and the TO is the Mudarib (or manager) of this fund. It takes away one aspect which was considered to be ambiguous in the other models (and certainly a Mudarabah model where also underwriting surplus is shared): that the underwriting surplus could be (fully or partially) given back to the policyholders which makes the contribution not longer an unconditional gift. On the other hand, ownership of the donated funds is transferred from the participants to the waqf. This establishes claims of the participants against the waqf, while they lose those rights that are substantiated by their ownership of funds in the other Takaful models. Also the (at least conceptual or moral) obligation to make further contributions when the risk pools runs into deficit, is less clear in the waqf model⁶.

Remuneration of the TO can be similar to the Wakalah (or Wakalah Mudarabah) model.

Determination and distribution of surpluses

Closely linked to the operating models outlined above, the determination and distribution of surpluses differs significantly between different players and countries. As the insurance risk is in principle not transferred, the logical consequence would be that surpluses are distributed to the policyholders. Another interpretation is that the surplus arises from sound risk management and that thus the Takaful Operator, in a mixed model, should receive a proportion of these surpluses. Finally, often linked to the Waqf model, policy holders do not receive any surpluses because the Tabarru' is unconditional and the surpluses are donated to charity.

⁵In countries that adopt a common law system (such as Malaysia, Pakistan and the UK), a waqf is likely to be governed by trust laws, namely in the form of a Trustee Act.

⁶Although some argue that, since the deficit is initially covered by the Qard Hassan, paid back by later contributions of participants (and the set of participant can differ from the one when the deficit occurred), it is already the case that the SRF in the end repays the Qard and the Waqf model just makes this more clear / transparant.

Conclusion

Milliman [29] indicates the choice between the models set out above, depends on many factors: target population, regional acceptance, Shari'ah Supervisory Board view, regulatory framework,

The Mudarabah model is less accepted globally, while the Wakalah model is by far the most recognised and has the positive effect of a steady income stream for the Takaful Operator. As already mentioned, a growing number of Takaful Operators select a mixed Wakalah Mudarabah model and is widely practiced in Middle East and Malaysia and accepted by the majority of scholars. AAOFI has endorsed hybrid versions of the Wakalah model.

2.3 Legal (Company) Framework

2.3.1 Mutual Insurance Company

The concept of mutual insurance could be tracked back to the origin of insurance itself. It is argued [18] that in the so-called "laws of Hammurabi" (founder of Babylon), arrangements are included which result in the participants in a caravan settling among themselves to make good damage that one or more of them suffered due to theft. These arrangements were actually a form of risk sharing and therefore an initial sign of insurance.

More recent history leads to eighteenth century shipowners' dissatisfaction with the terms available from the underwriters at Lloyd's, which led them to form mutual insurance associations to meet their needs at low(er) costs.

Mutual and co-operative insurance is provided by societies that are formed and governed and, in most cases, owned by their members for their members. It follows the principles of solidarity and sustainability. The business model of mutual and co-operative insurance focuses on using surpluses exclusively for the benefit of policyholder-members and of society [22]. In Europe, the market share of mutual and co-operative insurers amounts to 28,4%, of which 32,5% in non-life and 25,3% in life insurance, while in Belgium it is relatively low⁷ (15,5%, resulting from 21,2% in non-life and 12,5% in

⁷It is not clear to what extent Ethias is included in these figures. Ethias started as mutual insurance company - and this part of the company still provides occupational accident insurance - but this actual mutual insurance part currently holds only 25% - 3 shares of the commercial insurance company Ethias NV. Although Ethias still claims to follow the philosophy of a mutual insurance company, it is strictly speaking (legally) not a mutual insurer anymore. P&V, another registered member of Amice, is a co-operation and not a mutual insurance association. Although they do implement some important elements, such as an advice committee that represents their customers, it are not the customers but other co-operations and mutualities who form their co-operative shareholders (which is defined as a 'second order co-operation').

life), certainly compared to its neighbouring countries: over 40% in the Netherlands, France and Germany (source: Market Insights Europe 2012, <http://www.amice-eu.org/Download.ashx?ID=45709>, produced by ICMIF).

2.3.2 Windowed Approach

Despite the argumentation set out above, another concept which is regularly applied, is the windowed or ‘firm within a firm’ approach. One of the reasons is that in some countries where Takaful Operators are present, there is no appropriate legal framework for establishing mutuals or co-operative undertakings - or if such a framework is present, it is not always allowed or considered within the financial services industry (governed by the financial regulatory authority). For regulators, a proprietorship can often be easier regulated and supervised, in a more direct manner. It clearly separates the ‘regulated party’ (management, BoD, shareholders) from the ‘protected party’ (policyholders).

Given the proprietary setup, the Takaful Operator manages the contributions and SRF almost at its full discretion - which is not in line with the Takaful philosophy. Also from a regulatory point of view, it is the Takaful Operator that receives a license, based on the form of proprietary ownership and the SHF. The Takaful philosophy is challenged in two ways or situations [36]:

- In case of deficit in the SRF, who should actually make up for it? The regulator, from a proprietary ownership and conventional insurance environment, could point to the Takaful Operator and its shareholders. They might provide a Qard Hassan, but would argue that it are the participants, who are the owners of the SRF as for as the TO is concerned, who bare this responsibility.
- Since it are the participants that own the SRF, they should be able to appoint another TO to manage their SRF. Both how to organise themselves to do so as how to (en)force the decision pose a real challenge in the windowed approach

2.3.3 Preferred approach

Many factors can play a role in the (possibility of) choice between the two models:

- Pace at which a regulator wants to promote Takaful
- Viewpoint of local Shari’ah scholars (or e.g. the Shari’ah Supervisory Council - see section 2.6.4)
- Interest of new insurance and Takaful companies in starting operations
- Maturity of the conventional insurance business
- Availability of skilled human resources

In Pakistan, windowed operations are allowed because the regulator's primary aim was the growth of Takaful business. The life insurance penetration in the country was very low (0,28% of GDP in 2005) and hence the choice was made to limit entry barriers as much as possible. The regulator however did set rules to maximise the Shari'ah compliance for the windowed approach. Qatar and Pakistan reconfirmed allowing both approaches in 2012.

SAMA, the Saudi Arabian Monetary Agency, obliged all insurers to operate within the co-operative model it defined (which is very similar to the mutual insurance model), or to exit the market by March 2008 [40]. Indonesia proposed a new Act to phase-out Takaful windows in three years time.

As a conclusion, most movements indicate that a full-fledged mutual insurance approach is generally preferred to a windowed approach for Takaful. However, given the more limited number of these players, the presence of global or regional conventional insurers, the support for market growth in many of these countries where life insurance is still a very limited portion of GDP compared to Europe or the US, most countries - at least initially - allow both models to exist next to eachother.

2.4 Distribution

This section handles the distribution of Takaful life insurance. First it sketches the current state of distribution of Takaful. Next it briefly addresses the different types of distribution channels.

2.4.1 Global development of Takaful distribution

The main distribution channels used for Takaful are brokers, bancassurance (appositely called *bancaTakaful*) and (retail and to a lesser extent also corporate) agencies, as shown in figure 2.3 [24].

2.4.2 Distribution Channels

As with conventional insurance, the importance of each type of distribution channel differs substantially from country to country. This is due to both historical reasons, customs in a certain country as well as local regulation and legislation. Therefore, the following sections will briefly define the categories of distribution channels and give the current status in a number of countries where Takaful plays a substantial role [30].

For any of the types of distribution, it is important that the intermediary, next to a sufficiently thorough knowledge on life insurance products, is knowledgeable on the concepts of family Takaful. They should be able to explain the operating model of the

insurer, the Shari'ah compliance of this model and of the product, ... to the customer. Finally, intermediaries should not undermine the noble objectives of Takaful by pursuing their personal interest, but instead be honest, responsible, wise, patient and dedicated [58].

Agents

The Concise Oxford Thesaurus (2007) defines agent as a “representative” who acts on behalf of another who appoints him/her to conduct a certain transaction.

In the UAE, conventional insurance is sold substantially through agents, but Takaful (with less than 300 agents) was not able to replicate its success. The channel is more popular in Malaysia, with over 60.000 registered Takaful agents, and is considered the most suitable channel for regular contribution products. Also in Indonesia this is an important channel, mainly due to the population being spread over many islands.

Direct Writing

Direct Writing covers all type of insurance sale where there is no face to face contact between a sales person and the client. This can be via mail, outbound calling or online.

Two leading Takaful Operators in UAE have had a relative success in selling products online. In KSA⁸ the channel is non existing, since ‘Protection and Savings’ (P&S) products are mandatory sold face to face. In Malaysia, with an estimated 30% of business (2008, declining in later years) the penetration of direct marketing is substantially higher for Takaful than for conventional insurance. In Indonesia, a similar situation can be found where it was the most important distribution channel in the past, but is currently declining.

Brokers

Brokers are intermediaries who sell insurances for multiple insurance companies. It also means they can sell both conventional as well as Takaful insurance. Although one can raise questions on the mixed (Halal and Haram) income streams that support the broker and his infrastructure, it is a distribution channel that is also used frequently for distributing Takaful products. In those countries where many Takaful players are present, brokers can offer exclusively Takaful products and not sell conventional insurance, but in case only one or a limited number of Takaful players are present, the broker is almost obliged to also offer conventional insurance products. In any case, when offering Takaful products and similar to the other distribution channels, a broker should be aware of the specifics of Takaful and be able to explain these to his clients. This might pose

⁸Kingdom of Saudi Arabia

a threshold for brokers who are already selling conventional insurances to also cover Takaful.

BancaTakaful

With bancaTakaful, family Takaful is sold via the (mostly widespread) distribution channel of a(n Islamic) bank. It is the dominant distribution channel in the UAE and KSA and is on the rise in Malaysia and Indonesia.

In practice, three bancaTakaful arrangements can be distinguished:

- Islamic bank sells products from an independent third party Takaful Operator and they are recognisable as such by a customer.
- The bank sells Takaful products under its own brand name, but the product is provided by a third party, known as a White Label Service Provider. Since the product, for the customer, seems to be provided by the bank, it challenges governance and transparency aspects of Takaful.
- The Islamic bank sells Takaful products under its own brand name and the Takaful product is provided by a Takaful Operator which is a subsidiary of the bank⁹. Since both institutions are driven by the same shareholders, management rules, disclosure policies, Sharia'ah interpretations etc. can be expected to be in line with each other.

Other

Other distribution channels often entail partnerships, such as work side offering.

Women's-only products are a unique innovation that has demonstrated success in the KSA and is sold almost exclusively via female agents.

Muslim affinity groups are generally seen as a promising distribution opportunity. It is considered to be one of the key success factors in Indonesia and selected parts of Malaysia. Mosques and the Imams act as 'benevolent' agents, creating pools of affinity groups, and providing 'group' protection for the muslims in their particular mosques.

2.4.3 Legal framework for distribution

The legal framework for distribution often contains country-specific elements. The legislation and regulation normally cover the mandate of the agent (and breaches of it). In

⁹Many jurisdictions require the Takaful Operator to be legally and commercially independent of the bank.

Malaysia, for example, the relevant legislation consists of the Contracts Act 1950 (section 181) as well as the Takaful Act 1984 (section 25, 28 and 66). Next to the legislation and regulation, often also a code of ethics applies (in Malaysia, this code of ethics is issued by the Malaysian Takaful Association).

Since distribution is often performed by another party (agent, bank, ...), it adds another layer of complexity on the Principal-Agent issue (see section 2.6.1). This can be linked with the remuneration of these agents, which is mostly an up-front commission, while the Takaful Operator (and the participant) only benefit more gradually / on a longer term.

2.5 Operations

2.5.1 Investments

Investments should be strictly limited to Shari'ah compliant assets. Please refer to the section on Halal transactions (1.3.3) and Riba (1.3.6) for more details. Still different asset types can be identified, which will be briefly discussed below.

Regular income assets: Sukuk

Sukuk is an Arabic term for financial certificate. They are a Shari'ah compliant version of corporate or government bonds. Sukuk are issued via the creation of a Special Purpose Vehicle (SPV) when the issuing bank finances a project (e.g. of a company or government, such as a new plant, school, infrastructure, ...). The client makes regular fixed payments in return. The SPV issues certificates for the bank and/or other investors, ranking alongside each other as senior, unsecured debt¹⁰.

Although Sukuk is or seems very similar to bonds, Hassan et al [23] composed an overview of the key differences:

	<i>Sukuk</i>	<i>Bond</i>
Definition	Ownership stake in asset	Issuer's pure debt
Certificates	Trust certificate	Debt certificate
Return earned	Profit	Principal and interests
Asset	Physical asset	Receivables, financial assets
Ownership	Asset or its usufruct	Debt, no ownership
Relationship	Partner	Creditor

¹⁰As discussed in the sections on Shari'ah compliant contracts, losses are always distributed evenly pro rata the amount of capital foreseen and the bank is not allowed to negotiate securities or guarantees.

Sukuk are investment products used in both Islamic banking as well as in Takaful. They were already standardized in a Resolution of the International Islamic Fiqh Academy (IIFA)¹¹ in 1988 and also make part of the AAOIFI standards. The most common types of Sukuk are Mudarabah Sukuk (trust investment bonds, cfr. 1.4.6), Musharakah Sukuk (partnership investment bonds, cfr. 1.4.7) and Ijarah Sukuk (leased asset bonds, cfr. 1.4.4).

Equity

Equity investments are allowed under the conditions set out in section 1.3.3.

Purification of Income Distribution As indicated in section 1.3.3, a (limited) part of income from investments can be related to interest. Most scholars accept investing in these stocks (within the given limits) on the precondition that ‘contaminated’ earnings are cleansed or purified. The Islamic fund (manager) should as accurately as possible screen those earnings and disburse that portion of the fund’s income through charity in order to purify these earnings (cfr. also section 1.3.5 on Zakat). Although cleansing of dividend earnings is an established practice, there is no consensus among Muslim jurists on the cleansing of capital gains.

Risk management for Islamic Investment Funds Each of the common financial instruments (cfr. section 1.4) has a unique risk-reward profile. Figure 2.4 shows a table with specific risks for each type of contract. Fund managers are expected to proactively discharge their fiduciary duty to potential investors by guiding them to the best product according to the prevailing market indices. In order to reduce market risk, portfolio diversification is the most straightforward technique which can also be applied by Islamic Investment Funds. Portfolio Protection via derivatives is less straightforward: most derivatives are by nature not Shari’ah compliant. Alternatives have been developed by Shari’ah scholars, but are not as sophisticated and as readily available as their conventional counterparts. Finally, since the Islamic Investment Instruments are traded less (and thus less liquid) compared to conventional instruments, the investment (fund) manager should carefully consider liquidity issues in case of exits.

Stability of returns Some financial institutions of investment fund managers setup a Profit Equalization Reserve (PER). It is a mechanism to set aside ‘excess profits’ in order to mitigate fluctuating returns as well as securing the capital against future unexpected losses. Although questions can be raised towards its Shari’ah compliance, since part of the profit is set aside without following normal profit distribution rules. Despite

¹¹The IIFA is a subsidiary organ of the Organisation of the Islamic Co-operation (OIC), created by the Third Islamic Summit Conference in 1981. It is the highest Shari’ah body among the OIC countries and it is based in Jeddah, Saudi Arabia.

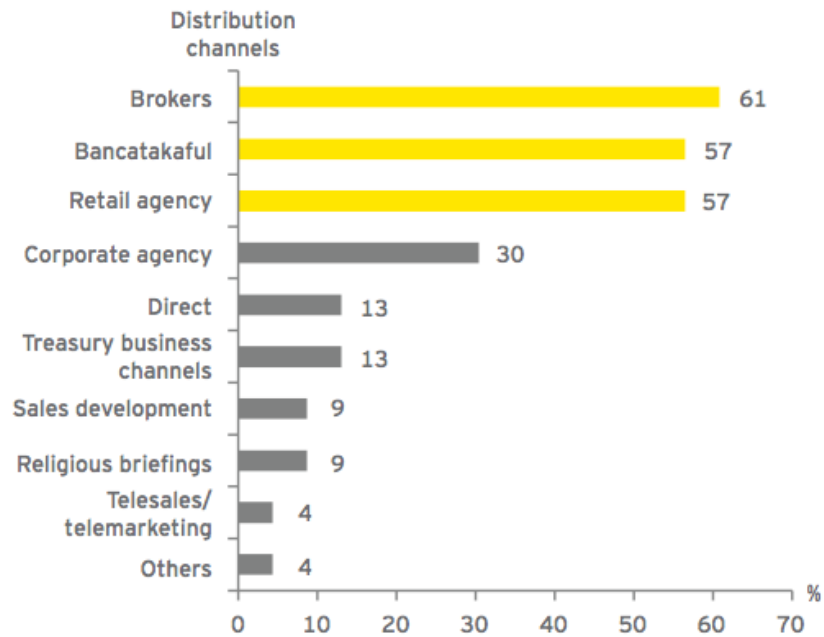


Figure 2.3: Global Takaful Distribution - source: [24]

Table 3 Examples of Islamic financial contracts and their underlying characteristics				
Contract	Type	Underlying contract type	Inherent risk	Type of product
Ijarah	Debt-based	Lease		
Murabahah	Debt-based	Cost-plus mark up	Credit risk	
Salam	Debt-based	Future contract	Market risk	
Istisna'	Debt-based	Manufacturing contract	Operational risk	Financing
Musharakah	Equity-based	Profit and loss sharing	Credit risk	
			Operational risk	
Mudarabah	Equity-based	Profit-sharing and loss-bearing	Displaced commercial risk	
			Operational risk	
Wadiah	Trust Contract	Safe custody of assets	Credit risk	Deposit
Qard	Debt-based	Interest free financing	Displaced commercial risk	

Sources: Islamic banks, KFH Research.

Figure 2.4: Inherent Risks of Islamic Contracts - source: [33]

discussions among scholars from which part of the profit the PER should be created (total return or from the part of the fund manager), the technique is generally accepted and included in the AAOIFI standards (standard no. 11: Provisions and reserves) as long as it is clearly communicated and agreed to by the account holders [38].

Ratings Takaful companies themselves are rated by the major rating agencies. A.M. Best publishes transparently both its rating methodology [39] and a regular Takaful review [40]. Also Standard & Poor's apply their insurance rating methodology to Takaful Operators [41]. Both parties also indicate the difficulties and challenges that clearly exist and are often related to the regulatory and solvency topics discussed further. Related to the above mentioned risk management, these rating agencies also rate Shari'ah compliant investment instruments. Standard & Poor's for example has defined three broad categories they use when rating Sukuk [41] and they issued their first rating for an established Shari'ah fund in May 2010¹². One can see from those items that rating agencies in the more recent years have paid more attention to the Islamic Finance market in general and Takaful Operators particularly. Still coverage is not to the same level as in conventional finance and insurance. Moody's for example explicitly focusses on rating Sukuk, Islamic Banks and Takaful Operators, not explicitly mentioning Shari'ah compliant investment funds [44].

Mortgages and leasing

Section 1.4 introduced Shari'ah compliant alternatives for mortgages and leasing (e.g. Ijara, cfr. 1.4.4). Similar to savings or investment accounts (but without the same flexibility in withdrawals) the money on the personal investment account of policyholders, as well as the reserves in the risk pool, could be invested in those instruments.

Conclusion

The market of Islamic investment products is growing rapidly. Islamic participation banking assets rose to USD 778 billion¹³ in 2013, expecting to reach 1.8 trillion in 2019. Global outstanding Sukuk assets have reached USD 300 billion¹⁴. Although these numbers may seem impressive, they are still a very small fraction of the overall global investment market - even ignoring the whole derivatives market. Moreover, the issuance of these assets is concentrated mainly in the Middle East, Malaysia and other emerging East Asian markets, together representing 94% of the global Sukuk market.

¹²The fund rated was EFH Funds SCA SICAV-SIF-Liquidity Subfund, domiciled in Luxembourg and managed by European Finance House, the European financial arm of Qatar Islamic Bank.

¹³Source: EY World Islamic Banking report, 2014. The figure excludes assets in Iran which has a unique domestic industry.

¹⁴Source: KFH research database, cfr. <https://www.islamicfinance.com/2015/01/global-growth-trends-in-sukuk/>

The availability of investment assets outside this region is therefore very limited. This gives rise to two related issues: concentration risk and FX hedging.

Concentration Risk This is the most difficult issue to overcome. Only a substantial increase in Islamic funds / assets would allow for better spread of the investments. The concentration mainly concerns the region and the issuer. As listed before, multiple types of instruments (mortgages, leasing, working capital financing, ...) exist almost to an extent similar to conventional banking (but excluding loans/bonds/Riba of course). Mainly growth outside the original region would help to lower the concentration risk, and it might be an opportunity for both governments and companies to tap into this potential.

FX Hedging Since instruments are mainly issued in the region outlined above, either in USD or in local currency, a EUR/USD FX risk arises which should be hedged (see also section 3.2.2). FX forward contracts or hedges however violate the principle that, from a Shari'ah point of view, it should be spot transactions. Although this has been circumvented by developing FX forward instruments based on the principle of wa'd (unilateral promise) or wa'dan (two unilateral promises), some opined this is merely mimicking conventional products and labelling them as 'Islamic' only in form. A more detailed discussion can be found in [47], but given the fact that it is used mainly for protection and not speculation, that EUR instruments are insufficiently available (also taking into account concentration risk) and taking into account the legal framework, one can assume that a setup as discussed is at least less Haram than a conventional FX hedge and under the given circumstances would therefore be permissible.

2.5.2 Underwriting

In the end, most underwriting and claim-related issues are similar to conventional insurance. However, some differences do exist.

First of all, Shari'ah scholars differ in opinion on how to deal with selection issues and discrimination based on gender and medical evidence. Typically, Takaful Operators would apply the same techniques as in conventional insurance. Surprisingly, not that many Shari'ah scholars are familiar with the underwriting subject and the topic is not frequently treated on Shari'ah Supervisory Boards [60].

Occupational classification might be an issue, as to the extent that a Takaful Operator would in principle need to exclude people working in alcohol, tobacco, pornography or gambling-related industries.

Policy exclusions (suicide, HIV, self-inflicted injuries, ...) mostly mimic conventional insurance but it is expected that exclusions will become less evident as the Takaful indus-

try matures [29]. Varying levels of religious conservatism by region will likely influence these aspects, but exclusion goes against the nature of mutuality and co-operativeness.

For a more thorough discussion of the subject, including a review on related past literature, please refer to [60]. Some topics of this paper will be addressed further in section 3.5.2.

2.5.3 Claims

Mirath (succession or inheritance) and *Wasiyah* (will or bequest) are the sets of Shari'ah law that govern these topics. The Qur'an explicitly stipulates the categories of heirs and their entitlement to the estate (cfr. 4:11-12 and 4:176). A nomination clause, pointing out the beneficiary (or beneficiaries) of a life insurance, potentially violates these rules. Two specific aspects are to be analysed. First of all, some scholars argue that *Mirath* does not apply, since the amount paid from a life insurance is based on gifts (not only of the deceased, but also of the other participants in the risk pool) and the money was never part of the estate. Another aspect is how the beneficiary is taken up in the policy: it can also be that this person is nothing more than an agent or executor who receives the benefit on behalf of the heirs and who will subsequently divide it corresponding to Shari'ah. For these type of matters, it is important to verify the viewpoint of the SSB or even the Shari'ah Supervisory Council of the country of operation, since for example in Pakistan - after court case of Karim v. Hanifa, 1970 - and the National Shari'ah Advisory Council (NSAC) of Malaysia settled the way it should be handled in these countries.

A specific point of attention are ex-gratia claims. Since the risk fund pool is a shared fund with contributions of all policyholders and an ex-gratia claim directly affects this fund and the underwriting surplus, in theory the consent of all policyholders would be required. In practice a more pragmatic solution is often adopted and permission is asked from the Shari'ah Supervisory Board.

2.5.4 Actuarial

Although there is no fixed rate of return due to the lack of fixed interest rate instruments in which the reserves can be invested, one can argue that also in conventional insurance the reserves are not invested in a single type of instrument. Therefore it is common that a (prudent) expected rate of return is used within the actuarial calculations. An alternative approach is using a zero percent interest rate, but on the one hand this would lead to higher (less competitive) premiums and increasing surpluses, while on the other hand the reserves would most probably still not be put on a cash account and be invested in diverse instruments. Within the non interest bearing investments, losses on an instrument can always occur (theoretically even more than with fixed interest instruments) and thus a zero percent interest rate would also still implicitly be an assumption on the return.

2.5.5 Accounting

Islamic financial accounting can be defined as *“the accounting process that provides appropriate information (not necessarily limited to financial data) to stakeholders of an entity that will enable them to ensure that the entity is continuously operating within the bounds of the Islamic Shari’ah and delivering on its socioeconomic objectives”* [12]. Islamic accounting does not exclude normal financial accounting, but can potentially be seen as more broad and is closely linked to accountability. From AAOIFI’s Statement of Financial Accounting (SFA) No 1 paragraphs 37-42, following items support this more broader definition:

- Information on the institution’s compliance with the Shari’ah, information establishing the separation of prohibited earnings and expenditures (if any) and the manner in which these were disposed.
- Information to assist the concerned party in determining Zakat on its funds and the purpose for which it will be disbursed.
- Information about the Islamic bank’s discharge of its social responsibilities.

Even within the normal, basic financial statements (FAS 1 also defines Balance sheet, Income statement, Cash flow statement and Statement of retained earnings or shareholders’ equity), specific items may arise. For example, on the asset side, the total investments are generally split up per type (Mudarabah financing, Musharakah investments, Istina, ... - cfr. section 1.4).

The applicability of IFRS to Islamic financial institutions has created certain problems because its standards are intended for conventional forms of business. This goes both ways: some issues in Islamic finance are not covered by IFRS and some existing IFRS are not applicable to Islamic banks.

The Bahrain based AAOIFI (see section 1.5.2) has issued a total of 88 standards: including 48 on Shari’ah, 26 accounting, 5 auditing standards, 7 governance standards and 2 codes of ethics. Already in 2009 (April 21 2009, Accounting Today) IASB board member Robert Garnett indicated “We have to embrace all financial products so we will need to change our standards”. IASB and AAOIFI have subsequently exchanged opinions on the convergence of their standards.

2.5.6 reinsurance

Takaful reinsurance is called reTakaful and is offered by many of the well known reinsurers (e.g. Munich Re, Swiss Re, ...) as well as by specific reTakaful players. It serves the same purpose as within conventional reinsurance and is an advisable risk measure to cover for example excess loss. In order to protect the initial policyholders it is also considered almost a must for Takaful Operators in their first years of existence. A more thorough assessment of reTakaful is outside the scope of this paper.

2.6 Governance, Solvency and Supervision

2.6.1 Corporate Governance

The OECD defines Corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined [13]. The slight difference between conventional governance and the governance in Islamic financial institutions, lies in the inclusion of Shari'ah governance within the corporate governance structure of Islamic Financial Institutions (IFIs). The Islamic Financial Stability Board (IFSB) defined it in the following way [14]. A defined set of relationships between a company's management, its board of directors, shareholders and other stakeholders, that provides the structure through which:

1. the objectives of the company are set; and
2. the means of attaining those objectives and monitoring performance are determined.

In the context of Takaful Operators (TOs), good corporate governance should encompass:

1. a set of organisational arrangements whereby the actions of the management of the TO are aligned, as far as possible, with the interests of its stakeholders;
2. provision of proper incentives for the organs of governance such as the Board of Directors, the Shari'ah Supervisory Board and management to pursue objectives that are in the interests of the stakeholders and facilitate effective monitoring, thereby encouraging TOs to use resources more efficiently; and
3. compliance with the Shari'ah rules and principles.

Next to the Shari'ah compliance the IFSB thus, specifically for Takaful Operators, emphasises aligning the interests of the Management, BoD and SSB with those of the stakeholders (including the customers).

The underlying premise of corporate governance from the Islamic perspective is the concept of Tawhid (unity of God) and the principle of *Shura* (mutual consultation). These are complemented by the Islamic legal rules on harmonious relationships and mutual benefits in commercial transactions.

The IFSB guiding principles on governance for Takaful undertakings consists of three parts.

Part I: Adaption of existing good governance standards The two core principles in this part are to manage a comprehensive governance framework appropriate for their business model, in which independence and integrity of each organ of governance is well

defined and preserved (preferably in the articles of association of the firm at inception) and to adopt an appropriate code of ethics and conduct to be complied with by their officials at all levels.

Part II: Balanced approach: consideration of the interests of all stakeholders

The two major stakeholders for a Takaful Operator are the shareholders and the participants. Both should be duly represented in the board as well as in all general meetings. Therefore two key principles of this part are to have in place an appropriate governance structure that represents the rights and interests of Takaful participants and to adopt and implement procedures for appropriate disclosures that provide Takaful participants with fair access to material and relevant information. According to the same guiding principles, a recognized specialist and professional should be appointed to evaluate and analyze risks, insurance and annuity premiums, reserves and dividends. This person is known as an actuary. To resolve conflicts of interest, the IFSB proposes a governance committee responsible for implementing the governance framework. For instance, the committee can consist of an independent non-executive director, a Shari'ah scholar and an actuary.

Part III: A comprehensive prudential framework for Takaful Undertakings

Part III's two core principles are that TO's shall ensure that they have in place appropriate mechanisms to properly sustain the solvency of the Takaful Undertaking and that they shall adopt and implement a sound investment strategy and prudently manage the assets and liabilities of their Undertaking. As a consequence of the first principle, Takaful Undertakings are encouraged to subscribe to a reTakaful scheme that suits its primary requirements to avoid unnecessary loss.

Transparency

AAOIFI's Statement of Financial Accounting (SFA) No. 1 paragraph 26 gives a list of the main categories of users of external financial reports for Islamic financial institutions. Next to the well-known equity holders and regulatory agencies, they list following users of those reports:

- Holders of investment accounts
- Holders of current and saving accounts
- Other depositors (e.g. also PIA account holders)
- Zakat agencies

Actuary

The role and autonomy of the actuary is in this respect crucial as well. The actuary is the one who determines the risk-adequate contributions, the desirable level of reserves, et cetera. Since the level of contributions will also determine the TO's remuneration, a conflict of interest clearly arises and one can wonder if a formally strengthened autonomy is sufficient as mitigation.

The definition of the tasks of the actuarial function is part of the governance framework of the Solvency II directive (mainly Article 48). Eiopa guidelines further describe these (https://eiopa.europa.eu/Publications/Guidelines/Final_EN_SoG_Clean.pdf):

- Guideline 38: Conflict of interest should be avoided when appointing extra tasks to the actuary (Article 48) and the actuarial function should give an opinion on the reinsurance policy (Article 246).
- Guideline 39: The actuary should identify any inconsistencies with the requirements set out for technical provisions cfr. Articles 76 to 85 and should explain any material effect of changes in data, methodologies or assumptions between valuation dates on the amount of technical provisions if already calculated on a Solvency II basis (Article 48).
- Guideline 40: The actuary should assess the consistency of the internal and external data, used in the calculation of external provisions, with reference to the data quality standards set in the Solvency II Directive. Where relevant, the actuary can also provide recommendations on internal procedures to improve the data quality (Article 48).
- Guideline 41: When providing its opinion on the underwriting policy and the reinsurance arrangements, the actuary should take into consideration the interrelations between these and the technical provisions (Article 48).
- Guideline 42 relates to undertakings with an internal model (under pre-application).
- Guideline 43: The actuary should report in writing at least annually to the administrative, management or supervisory body. The reporting should document all material tasks that have been undertaken by the actuarial functions, their results, clearly identifying any deficiencies and giving recommendations as to how such deficiencies could be remedied (Article 48).

Customer representation

The principle of Shura, addressed above, also envisages consultation with customers, specifically acknowledging depositors or PIA account holders as well as participants in the SRF as key players in the governance process. According to professor Volker Nienhaus, adjunct professor at the International Centre for Education and Islamic Finance

(Kuala Lumpur), corporate law usually sees only shareholders as risk-bearers and ignores the special status of investment account holders and Takaful participants, which originates from the underlying Shari'ah contracts [23]. Despite specific legislative requirements however, IFIs may voluntarily disclose relevant data to their customers.

One of the more promising suggestions is the creation of a specific Governance Committee (GC), set up by the BoD, to give policyholders' interests sufficient attention in management decisions (see [14], item 49 to 54).

Another example of customer representation was introduced in Sudan with the Takaful Act in 2003¹⁵. Here, policyholders have the right to monitor management performance through the policyholders' general assembly, which has the right to:

- approve the final accounts and the directors' report
- recommend to the BoD the surplus to be allocated
- appoint one or two representatives in the BoD
- comment on the performance of the undertaking and all relevant matters, and make recommendations to the shareholders as well as the BoD

Finally, the seven principles set forth by ICA (the International Co-operative Alliance) can also be referred to as guidelines or best practices:

1. Voluntary and open membership (open to all who accept the responsibilities of the membership, non-discriminating)
2. Democratic member control (members participate actively in policy making and decisions of the co-operative)
3. Member economic participation (equitable contribution, democratic control)
4. Autonomy and independence (autonomous, self-help organisations)
5. Education, training and information (providing education and training for its members so they can contribute effectively)
6. Co-operation among co-operatives (working together with other co-operatives - one could consider reTakaful also in this respect)
7. Concern for community (sustainable development)

Conclusion on governance

The hybrid nature of Takaful undertakings implies complex Principal-Agent issues. The management of the Takaful Operator is the agent for two principles: the shareholders of

¹⁵The Act gives policyholders more rights and stronger governance than the shareholders compared to what is practiced elsewhere.

the Takaful undertaking (owners of the SHF) and the participants in the risk pool ('owners' of the SRF). This gives a multitude of conflicts of interests that should at least be addressed by competent governance structures and enhanced transparency requirements that are often different from (or additive to those of) conventional insurance.

2.6.2 Shari'ah Supervisory Board

The basics on the Shari'ah supervisory board were already addressed in section 1.5.2.

Required qualifications

The qualifications to become a Shari'ah scholar being eligible for an SSB position are not established in any formalised manner. The State Bank of Pakistan (SBP) however has listed its criteria for the appointment of Shari'ah advisors. A number of these criteria are reflected below, to show the breadth and depth of required qualifications:

1. Minimum qualifications and experience
 - more than 5 years of experience of giving religious rulings
 - knowledgeable of financial services industry (e.g. preferably master in banking and finance)
2. Track record: impeccable track record
3. Solvency and financial integrity (not been in default of payment, having sufficient means to discharge his/her financial obligations)
4. Integrity, honesty and reputation

Conflict of interest

Shari'ah scholars have both supervisory and consultancy functions. Given only a limited group (currently roughly 30 to 40) of scholars has the required knowledge and skills, it happens that the same scholar is member of one (or more) SSBs and also provides consultancy to the regulator(s) on Shari'ah topics. A 2010 survey of Shari'ah board membership by Zawya Shari'ah scholars in partnership with Funds@Work (<http://www.shariascholars.com/>) shows a high concentration of board membership. The database focusses on the GCC region and shows the top ten scholars hold 39 percent (450 of a total of 1.141) board positions, with the two top scholars both occupying 85 board positions each. Retainers by individual banks range from USD 20.000 to USD 100.000, leading to USD 1 million-plus incomes. Perhaps of greater concern however is the excessive workload of the favoured scholars. Some countries are taking regulatory action to limit the total number of board positions held in their jurisdiction. Professor

Nienhaus proposes to recommend or stipulate that each Shari'ah Board should include at least one 'junior scholar' in order to facilitate transfer of knowledge and skills between generations (and for the number of experienced scholars to increase substantially in the near future) - [23]. Another action might be to move from individually extensive fit & proper criteria to a multidisciplinary composition of the Shari'ah Supervisory Board.

Internal Shari'ah Compliance Unit

The ISCU is responsible for verifying processes, services and transactions to ensure that the relevant departments have complied with the resolutions/pronouncements of the SSB. It enjoys a high level of independence to ensure accountability and transparency in its verifications process.

2.6.3 Solvency

Solvency of the Shared Risk Fund

Takaful implies that all claims are settled from the Shared Risk Fund (SRF). The most straight forward ways to guard the solvency of such a shared fund, would be either to limit the claims or accept an obligation to pay additional contributions in case of deficit (or a combination of both). A third option is to limitedly increase the premiums above the calculated level in order to build up reserves that can be used in case of extraordinary claims.

Qard and the ShareHolder Fund Since it takes time to build up these reserves (and still a situation could occur in which those are depleted), the concept of a Qard Hassan was introduced in section 2.2.1. This means that initially the SHF (Share Holder Fund) should have a sufficient level to provide for the Qard Hassan, but this capital requirement will lower as the reserves in the SRF build up. Eventually, the requirement for the SHF could reduce to zero from the moment the reserves in the SRF are sufficiently high.

Risk diversification Until now, the SRF was treated as a single fund. However, in case diverse risks are covered (death, accident, disability, ...), separate Shared Risk Funds might be set up. In this case, these risk funds (and their reserves) could cover for each other. As with any type of risk diversification, the underlying assumption is that due to a more limited correlation, the risk funds will not all be stressed (and hence depleted) at once.

TO remuneration The question raises if the Takaful Operator should be remunerated for foreseeing the Qard facility and/or for the risk diversification, both contributing to

the solvency of its operations. There is no straight answer to this questions. The Qard Hassan is a benevolent loan and no interest is due. Also, the fact that multiple risk covers are offered and are subscribed to, is no intrinsic quality of the TO or its management. At least the participants should be aware of the remuneration structure of the TO and if and how these aspects are covered in order to comply with transparency and disclosure requirements as well as to stimulate competition on or via this aspect.

Solvency & Qard Hassan

Although Shari'ah doesn't explicitly mandate or require it, these is an expectation that the operator will inject an interest-free loan in the event of a deficit of the Shared Risk Fund. There is also uncertainty about the timing and the repayment of the loan. Due to the fact that the Takaful Operator needs to recover this loan via future contributions, it is not clear how this should be done with exiting participants (except when this could be done via surrender penalties).

Different regulators have developed different approaches on this issue. The Central Bank of Bahrein (CBB) allows cross-subsidy between various pools (the individual life pool could subsidise the group life pool for example), while other regulators do not allow this.

In adverse cases with multiple subsequent losses, it is unclear if the Qard can be written off. The risk in this scenario could substantially increase because future entrants might no longer be willing to pay for losses from the past, continuously reducing the number of participants. In this case a strategy to write off the loan might be the better option, but it is one that is mostly not foreseen.

Finally there is uncertainty in many cases as to how the Qard can be treated (as a notional debt/asset) for solvency purposes.

Contingency Reserve

Instead of distributing the full surpluses, the question raises if they cannot be used by the Takaful Operator to set up a contingency reserve. Certainly during the first years of operations, such reserves might be even critical in order to have a buffer against potential adverse claim experience in the future and to allow the pool to build self-sustaining capital in the future. A contingency reserve would reduce the (probability of a) need for a Qard by the Takaful Operator. As this reserve is built up mainly in the first years of operations (and still increases if the pool grows), it creates a type of generational equity issue where the initial policyholders experience a lower benefit of surpluses than those who joined later.

What portion of surpluses to put into such a contingency reserve? One could argue that the full surpluses are initially attributed to the contingency reserve, as long as it is

clear to - and meets the expectations of - the participants. After all, the primary goal of the risk pool is to meet claims when risks occur.

Risk Based Capital (RBC) requirements

Regulators realise already for some time that ratio-based solvency requirements are relatively unreliable as measure for the appropriate level of capital requirements. Risk-based approaches are instead used for a relatively long time by rating agencies to assess the financial stability (and/or claims-paying ability) of insurers. While the EU has developed Solvency II which will finally come into force on 1/1/2016, also other countries developed an RBC approach (many earlier than the Solvency II framework): the US has a risk-based capital model, the UK has foreshadowed the EU in 2004, Australia was a regional pioneer on RBC and several Asian countries were developing or introducing RBC approaches in 2009 already, such as Singapore, Korea, Malaysia, Indonesia and Japan.

RBC frameworks often also introduce the notion of regulatory versus owners' and policyholders' equity. Here the difference with Takaful might increase, related to what is accepted as eligible capital including the differential ability of these categories to absorb losses. For example, if the SHF and SRF are considered both separately and jointly, the treatment of a Qard Hassan should be detailed. If it is correctly set up and has a subordinated nature in the SRF, it should be part of the (regulatory) capital for this SRF. But in that case, it cannot be categorised as an asset in the SHF, to avoid double counting.

The Islamic Financial Services Board (IFSB) and the International Association of Insurance Supervisors (IAIS) established a Joint Working Group (JWG) which produced the paper "Issues in Regulation and Supervision of Takaful (Islamic Insurance)", published in August 2006. One of the results was the IFSB standard on governance already mentioned [14]. As a successor of this paper, in 2010 IFSB published the "Standard on Solvency Requirements for Takaful Undertakings" [15]. It is based on the IAIS standards and guidance papers on solvency requirements from October 2007 and 2008 and applies the necessary modifications and adaptations to cater for the specificities and characteristics of Takaful undertakings. The four main objectives of the paper are therefore very similar to those of Solvency in conventional insurance:

- Increase the likelihood that a Takaful undertaking can meet its contractual obligations and commitments
- Act as an early warning system for regulatory intervention and corrective action
- To provide a buffer so that, even in case of failure of a Takaful undertaking, the impact on Takaful participants can be limited or reduced
- To foster confidence in the financial stability of the Takaful sector amongst the general public, and in particular to the Takaful participants.

Scope of application The standard focusses on the Shared Risk Fund (SRF) which is (/are) the underwriting fund(s). This is logical, since the savings element (Participants Investment Fund or PIF) and its surplus are normally not used to meet deficiencies in the SRF. The risk of losses in the PIF is fully born by the participants themselves. Following important differences are indicated in the IFSB paper:

The solvency of the SRF and SHF should be considered separately. As set out in sections 2.2 and 2.3, a typical Takaful undertaking consists of a two-tier structure that is a hybrid of a mutual (the SRF) and a proprietorship company (the Takaful Operator). It hence requires a clear segregation between the SRF and the SHF. This segregation is not only required from the regulatory point of view in calculating solvency requirements, but also operationally, both in going concern as well as under any form of insolvency. The SRF has little means - except by gradually building up reserves, as set out above in the section 2.6.3 on contingency reserves.

Qard Hassan as eligible capital. One of the mechanisms for providing capital to the SRF is via the Qard Hassan (cfr. section 2.6.3). Depending on the conditions under which the Qard is provided and should be repaid, it should be part of the eligible capital of the SRF. Amongst others, it requires that the participants' claim to the SRF would rank above any outstanding Qard.

Treatment of Qard in the SHF. In order to be able to provide a Qard to the SRF, the SHF should mark certain assets as 'available for transfer' (ensuring sufficient liquidity and, if possible, limited volatility). This increases the probability that the funds are available when a deficit in the SRF occurs and the Qard is drawn.

Valuation of assets and liabilities. The paper acknowledges that still substantial differences occur between different jurisdictions, resulting in different regulatory capital and solvency requirements. This is however the domain of the IASC and IAIS. It puts forward a market consistent approach for both assets and liabilities. For the liabilities, the Technical Provisions should comprise two components: the current central best estimate of Takaful underwriting obligations (discounted to net present value) and a risk margin. The risk margin could be based on what a willing third party (at arms length) would be prepared to accept those liabilities through a hypothetical portfolio transfer.

. Finally, the paper proposes following key features for solvency requirements:

1. The solvency requirements for Takaful Undertakings must adopt a total balance sheet approach, which also addresses a clear separation of the SRF (and taking into account transferability between SRFs in case of multiple SRFs) and the SHF.
2. The solvency requirements should be established at a level such that the respective amounts of solvency resources in the Takaful and shareholders' funds are adequate to meet their respective financial obligations (bearing in mind that part of the shareholders' funds may be 'earmarked' to cover a Qard facility).

3. The solvency requirements should establish solvency control levels at the respective Takaful and shareholders' funds, that trigger proper interventions by TO and the supervisory authority when the available solvency is less than the solvency control level.
4. The solvency requirements should establish criteria for assessing the quality and suitability of solvency resources in the Takaful and shareholders' funds to absorb losses in different financial stages of the respective funds (for example, also in these cases¹⁶ there is a difference between equity and the Qard facility).
5. The solvency requirements for Takaful undertakings must have separate risk adjusted computation and assessment. The risk management framework must be comprehensive and cover all risks to which the PRFs and the shareholders' funds are exposed. Although the risks of a Takaful undertaking are not that different from that of a conventional insurer, other sections have already pointed out specific risks such as those linked to Shari'ah compliant investments and the potential conflict of interest between the risks of the participants (related to the SRF) and those of the shareholders of the TO.
6. An essential part of the supervisory review process is to assess for each undertaking that adequate risk management arrangements are in place through which the TO can, and does, monitor, measure, report and control the management of the assets and liabilities in a coherent and integrated manner.
7. Information regarding the solvency requirements for a Takaful undertaking that is material and relevant to the market participants should be publicly disclosed to enhance market discipline and the accountability of the TO.

More extensive information can be found in [15] and an example of such a Risk-based capital regime can be found in Malaysia [49].

Solvency II

During the International Finance Magazine's EU Islamic Finance and Banking Summit that took place in London on November 18-19 2014, solvency II and solvency requirements were pointed out as the biggest challenge to Takaful (and to mutual insurance)¹⁷.

At a European level, articles, papers or other sources are very scarce. One of the very few articles addressing Solvency II and Takaful dates back to 2010 [46]. In it, Mr. Khan highlights some similarities between the Solvency II regulations & IFRS II standards on the one hand, and the IFSB guideline on capital requirements [15]: "These include

¹⁶Consider for example run off. In normal circumstances the Qard is repaid by future premiums / surpluses. In a run off case, the level of future premiums are either decreasing or non-existent.

¹⁷Cfr. <http://www.internationalfinancemagazine.com/article/Market-for-Takaful-in-Europe-is-looking-brighter.html>

total balance sheet approach, adequate solvency resources, solvency control levels, quality and suitability of solvency resources, comprehensive risk management framework, supervisory review of risk management framework and public disclosure of solvency information.”. He also indicates that Solvency II appears to focus on combined accounts and a single Own Risk and Self Assessment (ORSA) covering both the Shareholder Fund (SHF) and the shared risk fund (SRF). This differs from the IFSB standard which makes separate allowances for SHF and SRF.

Based on EU directives, supplementary contributions can only be taken into account in case of non-life mutuals - provided that the supplementary contribution can be claimed within the financial year and limited on the one hand to half of the difference between the maximum contributions and the contributions actually called in already, and subject to a limit of 50% of the lesser of the available solvency margin and the required solvency margin. For non-life mutuals, this supplementary members’ call can thus be recognised as Tier 2 capital.

In its press release on Solvency II on March 11, 2010, Amice warns that mutual and co-operative insurers are more often SMEs and mono-liners that cannot take advantage of full diversification benefits. Their need for capital could hence force them to consolidate.

2.6.4 Regulatory environment and Supervision

Shari’ah Supervisory Council

While the SSB ensures Shari’ah compliance at the level of (a group of) an insurer(s), the central bank - as the supervisory and regulatory body for the banking and financial system of a country, often established its own standing Shari’ah Supervisory Council (as is the case for example in Malaysia and Sudan). All resolutions of IFT’s SSB should then comply with the general standards established by the supreme SSC of the central bank.

Consumer protection

Next to solvency, governance (incl. risk management) and transparency requirements¹⁸, regulators can develop additional instruments for consumer protection. Consumer protection has been given increasing attention in different parts of the world¹⁹. For Takaful, it was already mentioned several times that Malaysia is one of the frontrunners and the Bank Negara Malaysia (BNM) plays an active role within all of these domains [52]. As part of their Financial Sector Assessment Program, the IMF and the World Bank have published a “Detailed assessment of observance” on the insurance core principles

¹⁸These domains mostly relate to prudential supervision and also correspond to the three pillars of Solvency II

¹⁹EU directives within this domain are MIFID (Markets In Financial Instruments Directive), IDD (Insurance Distribution Directive) or IMD2 (Insurance Mediation Directive 2) and PRIIPS.

of Malaysia in February 2013 [48]. It indicates that the Malaysian government has set up a Takaful and Insurance Benefits Protection System (TIPS) to protect participants in Takaful and owners of insurance policies from the loss of their eligible benefits in the unlikely event of an insurer member failure. TIPS is funded by annual premiums of its member institutions. In 2013, BNM published a concept paper on the future framework for life insurance and family Takaful [50]. The goal was to increase the insurance and Takaful penetration rate while at the same time ensuring that consumers continue to receive proper advice. It discusses how to increase operational flexibility and promote product innovation (while preserving policy value), diversify distribution channels and strengthen market conduct, enhancing consumer protection. After receiving feedback, the framework will be translated stepwise in legislation / regulation from 2015 onwards. As one of the next steps, a revised framework for the introduction of new products by insurers and Takaful Operators was proposed end of 2014 and translated into a new policy in May 2015 [51].

2.7 Challenges

Although this paper will further focus on family Takaful in Belgium, it does not mean that there aren't any challenges to Takaful in the area where it originated and is currently most developed. Most of these challenges will hold consequently for family Takaful in Belgium as well.

In its 2010 report, Milliman [29] stipulates the following challenges (some specific technical challenges are discussed in the corresponding sections and are hence not included in this overview):

- *Lack of consumer awareness.* Despite the introduction of Takaful in several markets, the level of penetration is still below levels that are assumed realistic. Many consumers are not aware of the Takaful alternative, some reject the notion that it is a Shari'ah compliant instrument and just see it as conventional insurance.
- *Scarcity of Human Resources with both Shari'ah and insurance expertise.* This clearly impedes future growth. Moreover, since it are mostly conventional (ly trained) insurers, learning about Shari'ah compliance to enter the Takaful market, it is assumed that this puts the focus on translating conventional insurance products to Shari'ah compliant products. This results in limited original thinking on product development and innovation within the Takaful industry.
- *Shortage of Shari'ah scholars with appropriate expertise.* This was already addressed in section 2.6.2 on governance and the Shari'ah Supervisory Board when discussing Conflict of Interest.
- *Lack of standardization in the industry due to Shari'ah interpretation.* Different interpretations lead to regional differences, differences in choice of the Takaful

model, difficulties with Wakalah fees and the cost of capital. Despite a number of organisations that were created to develop standards (AAOFI, IFSB), they have no legislative or regulatory power nor represent or are accepted by all Takaful Operators that exist.

- *Diverging regulatory approaches and the lack of centralised regulations.* Non-muslim countries try to develop a level playing field approach. Malaysia has opted for a pragmatic middle ground, having a parallel system for conventional insurance and Takaful. Others such as the Central Bank of Bahrein (CBB) opt for a tailor-made approach taking into account the unique characteristics of Takaful companies.
- *Solvency and capital requirements* where specific challenges exist as discussed in the previous section.
- *Corporate governance*, where the relationship between the SSB and BoD is one of deep trust and integrity. Compliance standards however still do not include the SSB specifically or Shari'ah compliance in general.
- *Shortage of Sharia-compliant assets:* even in countries with an Islamic banking infrastructure, suitable Shari'ah compliant investments - particularly those with a longer investment duration - are often lacking or insufficiently available. If these assets are available, the range is often limited resulting in concentration risk.

Chapter 3

Family Takaful in Belgium

Belgium is not an island, nor politically, nor economically. Several of the challenges outlined in the previous chapter hence also apply to Takaful in Belgium. Therefore, several themes will be addressed again within the Belgian (or sometimes also European) context and specifics within the Belgian framework will be highlighted.

As already stated before, the breadth of areas covered gives no room (nor expertise) to cover each area in depth. The goal is to highlight areas of attention and sometimes suggest potential solutions. The chapter ends with an overview of different scenarios to introduce Takaful in Belgium.

3.1 Market

3.1.1 Muslims in Belgium

The European muslim population is expected to grow from 5.9% in 2010 to 10.2% in 2050, growing from 43 to 71 million individuals (Pew institute, 2015: <http://www.pewforum.org/2015/04/02/muslims/>). Underlying factors are a higher fertility rate, a younger population (different age distribution) as well as religious switching and migration.

The Muslim population in Belgium is expected to grow from +/- 623.000 in 2010 to 1.149.000 in 2030 according to PewResearch, 2011. Roughly one fourth of the Brussels population is Muslim, but also other cities or areas have a relatively high concentration of Muslim inhabitants (e.g. Antwerp, Charleroi, ...).

3.1.2 Belgian Islamic finance market

The Islamic finance market in Belgium is close to non-existing. From an Islamic banking side, the most noteworthy event in recent years has been the launch of a halal investment

fund by Fortis. It did not seem to have a lot of success (not only was it not followed by new halal funds later on, Fortis also stated that religion did not seem to influence the choice of investment in a substantial way).

Despite research conducted by master of business administration student Robin Roose in 2009 [53], showing a substantial preference by Muslims for Islamic banking products, the supply side for these products has not substantially developed until now. In the same paper, legal and fiscal hurdles (e.g. for providing Halal mortgages) are discussed and as recently stated in an interview by Mohamed Boulif¹, also on this topic little to no progress has been made.

3.1.3 Takaful

At the start of this paper, Takaful products were not offered in Belgium². Also within Assuralia, the professional association of Belgian insurers, the topic has not yet been mentioned (feedback Assuralia dd 10/10/2014).

In general, Takaful is younger and less well-known than Islamic banking. In the research mentioned in the previous section, 25% of respondents had actively searched for Islamic Banking products in Belgium, but none did so for Takaful.

In order to quickly check how the Muslim community nowadays thinks about Takaful, one interview was done and a simple survey was launched.

Survey results

The goal of the survey was not to conduct an in-depth research with a representative sample of the Belgian Muslim population, but merely to get an impression if results would substantially differ from the previous research done, or from research in other countries. It is thus not intended to estimate market size.

Questions Five questions were asked relating to Takaful. Since information on Takaful was indirectly available in some of the questions, the questions were posed in a specific sequence without the possibility to review the answer on a previous question. The questions were posed in Dutch. The answers were provided in a random sequence (different for each respondent) as to eliminate bias based on the sequence of answers.

¹March 14, 2014: <http://www.dewereldmorgen.be/artikels/2014/03/14/anders-ondernemen-islamitisch-bankieren>. Mr. Mohamed Boulif is CEO of the Brussels based Al Maalya Islamic Finance Consulting and former president of the Executive Council of Muslims in Belgium (EMB, or 'moslim executieve')

²Recently, a new website, takaful.be, has started offering Takaful funeral insurance. However, the website does not seem to be set up by a registered insurer, nor by a registered intermediary. The information provided is limited and the legality of this initiative thus seems questionable. Other similar initiatives in the past have proven to be scams. A contact request has been not responded to.

Results In total, 36 muslims responded to the questionnaire, of which 16 male and 20 female. Table 3.1 gives an overview of their answers to the survey. The results are in line with other surveys mentioned: Takaful is known only to a limited part³ of the muslim population. Most have heard of the prohibition of Riba which indicates a more widespread knowledge of Islamic banking, but the majority is ignorant on the other aspects of Takaful. In general, people are interested in Takaful (from the questions in between, it could be derived that conventional insurance is Haram while Takaful is Halal, so even those ignorant on Takaful before would be able to provide a well-founded answer to this question), but only a minority (other studies indicate 20%, which is fairly close to the 25% of this survey) would be prepared to pay a slightly higher price than conventional insurance⁴.

3.2 Legal Framework

An insurance company is generally referred to as an ‘undertaking’. The legal forms in which such an undertaking can be established in Belgium are threefold: a (joint) stock company, a co-operation or a mutual insurance association.

3.2.1 Company setup

Mutual Insurance Association

With 15 individual players (source: FSMA, <http://www.fsma.be/nl/supervision/finbem/vohvo/article/lijsten/vo/vo1.aspx>) and the largest (Federale Verzekeringen) in the last part of the top 15 of Belgian insurers, with a market share of 1,38% (Ethias⁵ being the third largest with close to 10%), the Belgian market is rather fragmented and limited.

Probably linked to the relatively low importance of mutual insurance in the total insurance industry, papers, articles and books on this topic are scarce. A recent article [21] of Lieve Lowet, Partner at ICODA European Affairs, describes how to create a new mutual insurance company in Belgium. In it, she points out several inconsistencies and open issues in the current Belgian legislative framework.

In order to start a new insurance company offering life insurances, a minimum capital of 3,7 million Euro is required⁶. Of course, also solvency capital requirements should be

³Given the fact that respondents include some with which this topic has been explicitly discussed, the results (27,78% that heard of Takaful) should even assumed to be an overestimation.

⁴Although there is no need for Takaful insurance to be more expensive than conventional insurance (except maybe for the SSB), the question assesses an increased likelihood to switch from a conventional insurance policy to a Takaful one.

⁵Please refer to the footnote / remarks on Ethias and P&V in section 2.3.1.

⁶Cfr. article 19 in the Royal Decree on the Supervision of Insurance Undertakings (rd 1991, unofficial coordination of April 2014 (<https://www.nbb.be/doc/cp/nl/vo/wg/pdf/rd.22-02-1991.04-2014.pdf>) and

met.

Viable Size Given an average yearly expenditure on life insurance products per capita in the Belgian market of 1.500 € (source: Insurance Europe, 2013), this would require roughly 2.500 people to bring together the required minimum capital. It is not the intention of this paper to create a business plan for setting up a new Takaful Operator in Belgium. However, related to capital requirements, the starting capital of such a company should - additionally to the minimum required funds - be sufficient to cover the losses in the first years. Taking diverse rough assumptions on expenses (minimum 15 employees to ‘run’ an insurance company: actuary, risk, accounting, management, administration, legal (or external legal advice), IT, IT systems, building (rent), ... and a budget of 600.000 Euro for IT and operational expenses), income (entry fee on risk and savings, profit share on the savings part) and portfolio evolution (retention rate of 95%), a customer base of 100.000 customers would be required to run the company break-even. Suppose this could be reached over a time period of 10 years, it would require an additional capital of almost 9 million Euro.

All this leads to the conclusion that this is not an evident thing to do. Two (mitigating) options:

- Find a foreign Takaful mutual insurer to (help) start the Takaful mutual insurance company in Belgium or
- Find an existing mutual insurer in Belgium to start Takaful life insurances

An alternative would be to start as a conventional joint stock company and convert to a mutual insurance association once the size allows for it.

Existing mutual insurers in Belgium As mentioned, a limited number of mutual insurance associations exist in Belgium, and most of them focus on specific customer segments or specific (types of) products (= Branches).

- AMMA and Curalia focus on professionals in the healthcare sector. Precura focusses on disability insurance for professions (lawyers, notary, bailiffs, ...).
- Two associations focus on the Nuclear Industry: ELINI and EMANI
- Following players focus on a specific (non-life) branch: Algemene Vervoerverzekering only offers Branch 7 (goods in transit), Amifor only offers Branch 8 (fire and natural forces), Ethias Gemeen Recht only Branches 1 (accident) and 2 (sickness), Garantiefonds reizen: Branches 16 (miscellaneous financial loss) and 18 (assistance), L’Alliance Batelire de la Sambre belge offers Branch 6 (ships).

the “Circulaire NBB.2011.07 dd 14 november 2011”.

- Koninklijke Sint-Donatusgilde Nazareth is a player with local agents (Ghent area) who started in 1906 and offers mutual fire and natural forces (Branch 8) as well as other damage to property (Branch 9)
- “Onderlinge Interprofessioneel Verzekeringsfonds Leven SECUREX” and “Securex-Vereniging voor Onderlinge Verzekering, Allerlei Risico’s” are tied to the HR services company SECUREX and focusses on independents (group life insurance or occupational pensions). Xerius Onderlinge Verzekeringsvereniging has a similar focus.
- Federale Verzekeringen does offer life insurance to the general public.

Windowed Approach

No specific legal framework for a windowed approach exists. The management activities, investments, policy conditions, ... should all be set up separately and as independent as possible from the conventional insurance business. Reporting and transparency are both key in such a setup. One of the apparent advantages in the legal insurance framework, is that the (mathematical) reserves are anyhow considered to be owned by the policyholders. They even have a specific priority in case of liquidation or bankruptcy, ranking them higher than any other creditors.

Profit participation A windowed approach can only work if the mortality profit is given back to the Takaful participants. Article 12bis (of Royal Decree on supervision of insurance undertakings) stipulates the conditions under which profit participation can be given. The profit shared cannot be higher than the net technical profit before endowment (§2 B.1). Although an exception can be asked in case of an important increase in production, it is debatable if this would hold in subsequent years for a starting operator or fund. The net technical profit is calculated per product category, namely per Branch (for the definition of product category, reference is made to Article 11bis which points to the required statistical reporting of FSMA, which in its regulation states that statistical data should be made available per branch).

Confined / segregated fund One of the options to strengthen the windowed approach, is the use of a confined or segregated fund⁷. It is primarily targeted and used for the savings component of conventional Branch 21 life insurances, and the application for risk covers is not evident.

⁷Cfr. Chapter XI of the RD life insurance, articles 57 - 61

3.2.2 Insurance Legislation

The most important legislation consists of the Law on Insurances dd April 4th 2014 (and related Royal Decrees / regulations), the Royal Decree Life and the Law on the Supervision of Insurance Undertakings (and corresponding Royal Decree).

Law on Insurances

Manadatory law First of all it is important to notice that article 56 of this law declares the entire part, consisting of articles 54 until 223, to be ‘mandatory law’, and could as such be argued to form a ‘general good’ exception to the freedom of operation of foreign Insurance companies (or Takaful Operators) in Belgium (see also [56] and [57]). Though it is not certain all elements will uphold in court, it at least forms a hurdle for new entrants from both a legal and a marketing⁸ side.

Uberrimae Fidei The principle of utmost good faith is a well known basic principle of insurance and also corresponds well to the philosophy and ethics of doing business in Islam in general and within Takaful specifically. Where the initial Belgian insurance legislation (1874) aimed primarily at defending the ‘weaker’ position of the insurance company (since the insured had a lot more knowledge about his situation than the insurer), the current legislation (see for example article 3) primarily focusses on defending the interests of / protecting the client.

Mutual Insurance The law is applicable to mutual insurers as well. Although article 4 §5 allows for the specificities of mutual insurers to be taken into account⁹, no action has been taken until today.

Unit-linked life insurance Article 19 stipulates that the unit-linked investments need to invest in assets that the insured can understand and for which he can assess the corresponding risks. Article 20 explicitly limits the range of assets that can be invested in (please refer to section 3.5.1 for more details).

Transparency The second title of part 4, consisting of articles 28 to 38, elaborate on transparency requirements, which can be further amended or specified in a Royal Decree. Takaful undertakings can only welcome these requirements since they create a

⁸One could expect the Belgian regulator to defend the fact that it is mandatory law, at least initially. By going to court, this can lead to reputational damage and could be used by competitors as a warning not to do business with the new entrant

⁹Via a Royal Decree, certain provisions or clauses can be either considered not to be applicable for mutual insurers, or the way they should be applied by mutual insurers can be adjusted

level playing field for all players (where transparency is part of the philosophy of Takaful, it has not always be done to the same extent by conventional insurers).

Segmentation Article 43 declares articles 44 to 46 applicable to individual life insurance, and thus to Takaful. Article 44 states: *Any segmentation in terms of underwriting (acceptance), pricing and / or the scope of coverage must be objectively justified by a legitimate goal and the means of achieving that must be appropriate and necessary.* Articles 45 and 46 require those to be published on the website and communicated to the (potential) clients, but also allow for the FSMA to forbid the use of certain segmentation criteria. Further discussion on (the impact on) underwriting can be found in section 3.5.2.

Cancellation Within the first 30 days, the insured has the option to cancel his newly acquired insurance (article 57 §3). This is not fully in line with the concept of Tabarru' (you do not reclaim or cancel a gift) but does not seem to be a major issue.

Duty of disclosure As indicated the duty of disclosure (article 58 - 61) is consistent with the concept of transparency in Takaful. Also the following articles describing the consequences of non-disclosure (unintentional as well as intentional, fraud, ...) can generally be considered to be in line.

Premium as debt, to be requested by insurer Article 67 stipulates that the premium is a debt of the insured to the insurer, which the insurer should request from the insured. This is at least from a philosophical point not in line with the principles of mutual insurance, of continuing to pay in case of deficit if the SRF, and of the fact that the contribution to the SRF is a gift (Tabarru'). However, one can question if this is not more a semantical discussion.

Arbitrage Arbitrage is in general not allowed (article 90) and thus any kind of clause referring to Shari'ah based arbitrage would be void.

Excluded risks Unless stipulated otherwise, suicide of the insured is not covered within the first year after underwriting the policy (article 164). Also, unless stipulated otherwise, death as a consequence of the death penalty or a direct consequence of a criminal act (by the insured) is not covered. Suicide and criminal acts are a specific case on which different opinions and applications within Takaful exist. Death is considered to be determined by Allah (SWT). As a result, some exclude suicide and criminal acts (for example in Malaysia, <http://www.malaysiantakaful.com.my/Consumer-Zone/FAQs/Family-Takaful/What-are-the-exceptions-in-the-Family-Takaful-plan.aspx>). However, others follow the reasoning that the person committing suicide or the criminal act

is himself accountable and answerable to Allah (SWT) and the beneficiary is still entitled to receive the death benefit.

Beneficiary Article 169 stipulates that the policyholder (and only the policyholder) is entitled to designate a beneficiary. Please refer to the sections on claims (2.5.3 and 3.5.3), but inheritance law is not in scope of this paper.

Insured benefits Creditors are not entitled to any of the insured benefits. For Muslims, debt is a serious matter. Islam warns against it and urges the Muslim to avoid it as much as possible. It is considered to have negative consequences both on an individual level (disgrace and humiliation because it preoccupies the mind and makes one worried about paying it off) as on a community level (e.g. lack of responsibility and self-reliance). Therefore, when taking on debt, a Muslim should be determined to repay it and it should be known or thought most likely that he is able to repay it. Often the family of a deceased will therefore try to repay his debts, or this can be also done via family Takaful (one example is a mortgage insurance). So, although there is no legal claim from debtors to the insured benefit, it will most probably be often used to repay the debtors anyhow.

Qualified intermediaries Article 270 §4 introduced a new way of verifying a new intermediary has sufficient knowledge to be recognised and registered with the FSMA. Where in former times it was required to follow a training, certified by FSMA, now a new intermediary needs to successfully pass a FSMA certified exam. This has increased the entry barrier to become an intermediary, and supports a further professionalisation of the profession of insurance mediation.

Royal Decree on Life Insurances

This section describes elements in the “Royal Decree of November 14th 2003 concerning life insurance activity¹⁰” that are of particular interest for family Takaful.

Categorisation Article 3 defines the difference between two main categories: those that are not linked to an investment fund (Branch 21) versus those that are (Branch 23). Product classification and the different ‘Branches’ is discussed in more detail in section 3.3.1.

¹⁰Royal Decree of November 14, 2003 regarding the life insurance activity, of which an unofficial coordination (04/2014) can be found on the website of the NBB, unfortunately only in Dutch (https://www.nbb.be/doc/cp/nl/vo/wg/pdf/rd_14-11-2003_04-2014.pdf)

Information requirements Specific information requirements for Branch 23 (the investment part of a family Takaful) are set out in article 7 §6.

Excluded risks Risk exclusion is already discussed in the previous section on the Law on Insurances. Article 12 §2 stipulates the surrender value in case such excluded risk occurs. It is not fully compatible with the principle of Tabarru': the contribution to the risk pool is a gift, where risks that occur (and are covered) receive a compensation from the mutual pool. Paying any kind of benefit for excluded risks is not in line with this philosophy. Given the legal requirements however, the principle 'necessity makes the prohibited permissible' would apply here.

Component interaction The strict separation between savings (even if it is unit-linked) and risk covers is not reflected in Belgian legislation. In fact, Article 13 of the Royal Decree states that a policyholder has the right to reduce his contract at any moment. The second paragraph of the same article states that in this case, the insured death benefit should be upheld by using the theoretical surrender value of the policy (so including the life benefit)¹¹.

Information requirements Articles 19 and 20 further address information that should be communicated to the policyholder on a yearly basis.

Law and Royal Decree on the Supervision of Insurance Undertakings

The basic Law on the Supervision of Insurance Undertakings¹² was published in the Belgian Official Gazette on July 29th, 1975. The latest update was published on June 17th, 2014. An unofficial coordinated version can be found on the website of the NBB. When discussing the setup of a new insurance undertaking in Belgium, multiple references were already made to either the law or the royal decree on the supervision of insurance undertakings.

3.2.3 Other legislation

As stated in section 3.2.1 on the windowed approach, the reserves are considered to stay the ownership of the policyholder. This supports his right to surrender. In this case, the policyholder is entitled to the mathematical reserves of the death cover (next to those in

¹¹Only in case of a term life with levelled premiums, the insurance is cancelled in this case, cfr. article 14.

¹²Law of July 9th 1975 on the supervision of insurance companies, of which an unofficial consolidated version of 06/2014 can be found on the website of the Belgian National Bank (NBB): https://www.nbb.be/doc/cp/eng/2015/20150211.be_19750709.pdf (consulted on 07/27/2015).

the personal investment account). This somehow contradicts the principle of Tabarru', because he would re-claim part of the risk fund where he made a donation to and which normally only pays out in case of death.

As mentioned in section 2.5.3, differences in inheritance law may also exist. The discussion on Belgian inheritance law and the appointment of an executor goes beyond the scope of this paper.

3.3 Product

3.3.1 Product Classification

Belgian legislation follows the Solvency II product classification (cfr. Annex I of the Solvency II directive as well as Annex I of the Belgian law on the Supervision of Insurance Undertakings). Solvency II distinguishes 9 types of life insurance contracts, referred to within Belgium as Branch 21 to Branch 29:

I (Branch 21): *The life insurance referred to in points (a)(i); (ii) and (iii) of Article 2(3), excluding II and III.* Article 2(3) stipulates:

- (i) life insurance which comprises assurance on survival to a stipulated age only, assurance on death only, assurance on survival to a stipulated age or on earlier death, life assurance with return of premiums, marriage assurance, birth assurance;
- (ii) annuities;
- (iii) supplementary insurance underwritten in addition to life insurance, in particular, insurance against personal injury including incapacity for employment, insurance against death resulting from an accident and insurance against disability resulting from an accident or sickness

The risk covers of Family Takaful fit this definition. The savings part, since it is most likely linked to investment products, is not.

II (Branch 22): *Marriage assurance and birth assurance.* These specific products are not in scope of this paper.

III (Branch 23): *The insurance referred to in points (a)(i) and (ii) of Article 2(3), which are linked to investment products.* This might seem the most obvious choice for the savings part. However, in principle the amount in the investment account, since it is and stays the personal property of the insured, becomes part of the legacy after his death. While classically, this means that the amount does not depend on survival nor death and is in a puritan view not an 'insurance' as such. The qualification of this type of life insurance (payment equal in case of life or death), amongst others important for fiscal treatment (premium tax, tax deduction, fiscal treatment of

payment: see section 3.5.6), has been much debated and was the subject of multiple court decisions between 2000 and 2010 ([45], section 1.3.1). The discussion involves the difference between investment instruments and insurance contracts. Given the strict separation between the SRF and the PIA, the same arguments could (even more strongly) be made for the PIA in family Takaful. Current consensus is that the contract can still be treated as life insurance contract, amongst others since the aleatory character consists of the fact that it is not clear who will receive the payment (in case the participant still lives at 65: the participant, in case the participant dies: the beneficiary). It implies that at least this aspect - qualifying the PIA in the contract as a life insurance and administrating the beneficiary in case of death of the participant - to be explicitly taken up.

- IV** (Branch 24): *Permanent health insurance, referred to in point (a)(iv) of Article 2(3)*. Although family Takaful covers a wide range of products, including health insurance, this is not taken up within the scope of this paper. Also, Branch 24 explicitly mentions the current products existing in the UK and Ireland.
- V** (Branch 25): *Tonines, referred to in point (b)(i) of Article 2(3)*. The definition of this type of products is “operations whereby associations of subscribers are set up with a view to capitalising their contributions jointly and subsequently distributing the assets thus accumulated among the survivors or among the beneficiaries of the deceased (tontines)”. The scope differs from family Takaful since it encompasses a joint savings (investments) pool of which the assets are distributed, where in Takaful risk is shared but investments are in the PIA.
- VI** (Branch 26): *Capital redemption operations, referred to in point (b)(ii) of Article 2(3)*. The definition of this type of product is as follows: “capital redemption operations based on actuarial calculation whereby, in return for single or periodic payments agreed in advance, commitments of specified duration and amount are undertaken”. To start with, Branch 26 is a clear investment or savings product and not so much a life insurance product (cfr. discussion on Branch 23). Therefore it does not offer the same (potentially) beneficial tax treatment as Branch 23. A more important factor however is that the definition contains a commitment of a specified amount, which is closely linked to the Branch21 product type. It is therefore not withheld for family Takaful, since no commitment of savings / investment return is allowed.
- VII** (Branch 27): *Management of Group pension funds, referred to in point (b)(ii) and (iv) of Article 2(3)*. Group insurance is not in scope of this paper.
- VIII** (Branch 28): *The operations referred to in point (b)(v) of Article 2(3)*. Similar to Branch 24, this points to a specific product available in France: “the operations carried out by life insurance undertakings such as those referred to in Chapter 1, Title 4 of Book IV of the French ‘Code des assurances’”. This is not in scope of this paper.

IX (Branch 29): *The operations referred to in article 2(3) (c).* The definition of Branch 29 is the following: “Operations relating to the length of human life which are prescribed by or provided for in social insurance legislation, in so far as they are effected or managed by life insurance undertakings at their own risk in accordance with the laws of a Member State”. This supports the single European insurance market, but is not specific for Belgium or the Belgian market.

Given the above analysis, the risk cover and SHF would fall under Branch 21, the savings component would fall under Branch 23. It should be noted that accident and health insurances are classified under Branches 1(a) and 2.

3.3.2 Risk cover(s)

Earlier sections define the risk cover as being part of the mutual insurance via the Shared Risk Fund and classifiable as Branch 21. It is not the purpose of this paper to discuss the range of risk covers that can be offered, since basic death and disability would as such not differ substantially from conventional insurance. However, the product classification also influences the costs that can be charged. For Branch 21 products, article 25 of the Royal Decree Life Insurance allows for following cost loadings (tariff components):

- Mortality and survival laws and (for temporary death cover with levelled regular premiums without the option for reduction or surrender) lapse tables
- For those transactions / services not linked to investment funds (non unit-linked type): acquisition, collection and inventory fees of surcharges.

The acquisition fee and collection fee are both a Wakalah type of remuneration. In general, these Wakalah fees are expected to cover both the commissions and management expenses of the Takaful Operator. In this case, the TO is expected to prudently estimate the expected management expenses (payable from the SHF, which is fed by the Wakalah fees). The definitions section of the Royal Decree on Life Insurance stipulates the acquisition cost is related to costs triggered by the acquisition, (initial) contract closure or increase(s) in insured benefits - while the collection cost covers the costs related to the collection of the premium (or in this case, Tabarru’).

Although it is not explicitly mentioned that these (up front) fees can also cover the expected future management expenses for the contract, it is also not explicitly prohibited. In Wakalah or Wakalah Mudarabah contracts, sometimes a performance fee is also permissible¹³. However, it is not clear if this type of fee can be regarded as an inventory fee. Article 27 §2 states that the inventory surcharge is consumed continuously and as a

¹³For example, the Shariah Advisory Council of Bank Negara Malaysia resolved that distribution of surplus from PRF to the participants and Takaful Operator is permissible based on the premise that Takaful contract is generally established on the principles of tabarru’ and ta’awun (mutual co-operation), apart from the agreement among the contracting parties. The resolution is also based on the permissibility of performance fee for the Takaful company. (Press statement dated 25 September 2007)

function of risk capital and surrender value. The definition of inventory fee indicates its purpose is to cover the management of the contracts by the insurance company (Takaful Operator in this case). These definitions do not match a performance fee paid to the TO out of surpluses on the SRF.

Based on the analysis above, it seems advisable to use the Wakalah model for the risk cover and not to foresee a performance fee, although the latter could be investigated in more detail.

3.3.3 Savings component

The conclusion for the savings part of family Takaful was classification as Branch 23. For this type of product, the Royal Decree on Life Insurance allows (article 27 §1):

- For those transaction / services linked to investment funds (unit-linked type): management, entry and exit fees

The exit fee is limited to 5% (article 65 §4). The profits (and/or losses) made should be reflected in the value of the fund¹⁴. The regulations for the fund, as set out in the fund prospectus, describe how the management fee is calculated.

The entrance fee can be regarded as a Wakalah fee.

The management fee in practice is often a fixed fee on the Assets under Management (AuM). The Royal Decree itself does not contain any specific rules, besides the fact that it should be charged by reflecting it in the unit price.

Many additional requirements concerning the unit-linked fund are taken up in the Royal Decree Life Insurance or in various other legislation. A detailed discussion of all these elements is beyond the scope of this paper. Specific items will be addressed in case important differences with or objections to Takaful are present. Article 72 and 73 of the Royal Decree contain detailed transparency requirements, which can only be welcomed by Takaful Operators.

Market practice is to have a daily (on trading days) unit price, but this is also not strictly required. The investment part, investing the clients' premiums in Shari'ah compliant instruments and how the PLS (Profit and Loss Sharing) basis of these contracts is then reflected in the daily list price of e.g. Sukuk is the subject of many detailed studies¹⁵ and the setup of Sukuk in the Netherlands was the subject of a doctoral study by Dr. Omar Salah [59]. The fact that UCITS compliant Sukuk funds are available¹⁶, supports

¹⁴Also implying that profits are kept within the fund and not paid to the participant as profit share, as explicitly stated in article 65 .5

¹⁵For example. "Sukuk Structure: An International Comparison" by Abdul GhafarIsmail and "Screening of Sukuk bonds as islamic interbank and investment tool" by Shahid Ghauri & Prof Dr Omar Masood

¹⁶Franklin Templeton Investment launched a UCITS compliant Sukuk fund in Luxembourg in March 2013

the assumption that the main characteristics for unit-linked Branch 23 investments will be fulfilled (cfr. also section 3.5.1).

3.4 Distribution

This section discusses the pros and cons on the distribution channels defined in section 2.4.2.

It is required that every intermediary is registered with the FSMA (article 262, Law on Insurance), who upholds a registry of insurance intermediaries divided in three categories: brokers, agents and subagents. Numerous aspects in this Law are a reflection of the European Insurance Mediation Directive (IMD), of which a new version is to be adapted shortly¹⁷.

The main distribution channel for individual life insurance in Belgium is bancassurance (56,5%), followed by brokers or non-exclusive distributors (36,7%), direct (4,1%) and exclusive agents (2,7%)¹⁸. These figures also depend on the type of product (e.g. for pension savings, the share of exclusive agents is 27,9% - please refer to section 3.5.6 for the definition of pension savings).

3.4.1 Agents

Tied vs. untied agents

Tied agents only sell insurances of and for one insurer (which can be different per Branch), untied agents sell insurances for a specific set of insurers (which is the main difference with brokers, who give independent advice as they are not linked to a specific insurance company). Agents represent or act on behalf of the insurer. Therefore most of the AssurMIFID regulation (see section 3.6.4) is the responsibility of the insurer and not of the intermediary.

Special case: mosques and imams

Given the increased level of professionalism and enhanced education or examination requirements, executing insurance mediation as a side business is less and less obvious.

¹⁷It is also referred to as the Insurance Distribution Directive, and a final compromise text was published on July 16, 2015. After adoption by the European Parliament, member states will have two years to transpose it into national laws and regulations.

¹⁸source: Assuralia, 2013: http://www.assuralia.be/fileadmin/content/stats/02_Overige_Assuraliastudies/Distributiekanelen/NL.Distributie.2013.pdf

Although exceptions on these requirements exist, they are set up particularly for providing an insurance additionally to a product and do not hold for life insurances. A tied agent statute would probably not be in line with a more independent position of imams.

Still, the function of mosques has evolved in the past decades¹⁹. Where their primary initial function was almost purely religious (house of prayer, religious education), mosques have expanded to cover sports, social and cultural activities. They are a place where Muslims meet and discuss various topics, be it religious, social or cultural. They have also often expanded for that reason physically and contain multiple rooms or buildings for these activities, sometimes even a supermarket with Halal goods. Presenting Takaful in general, providing education on Islamic finance and insurance, organising events on this topic could all fit into this new function. Even offering the opportunity to talk to an insurance agent or direct writer providing Takaful insurance could be a part of Takaful distribution.

3.4.2 Direct Writing

Direct writing has overall a limited market share in the distribution of individual life insurance (4,1%). No pure online players in life insurance are active in Belgium today. With the global development of online (increase expected for life insurance from 8% now to 15% in the next three to five years [61], an entrance and/or increase in this channel can be expected in the foreseeable future. The current insurance client is more a hybrid customer, also referred to as ROPO (Research Online, Purchase Offline). Pure online channels do exist in non-life, the most well-known example being the car insurance of Corona Direct (a subsidiary of Belfius). Several companies therefore offer online tools for, for example, premium calculation and/or return simulation.

Ethias is an example of a direct insurer, although during the financial crisis they were forced to stop their own (life insurance) product and currently act as an intermediary for Integrale. Nevertheless they still support these sales in a similar way, with online tools and offer request subsequently handled by their own personnel.

Direct insurance is often accompanied by either a substantial marketing effort, affiliate branding and/or community building. Together with a system of collaborating with mosques and Muslim organisations, this could be a successful distribution channel. Given the AssurMIFID requirements (see section 3.6.4), a pure online offer is less evident - unless a transaction only service is offered.

¹⁹The information in this paragraph is derived from interviews with Muslims. It is also supported by for example the booklet on Islamic organisation in Limbourg, 2007 ("Islamitische organisaties in Limburg", 2007, Provinciaal Integratiecentrum, Provincie Limburg, <http://www.embnet.be/Portals/0/IslamorganisatiesLimburg.pdf>)

3.4.3 Brokers

Given the lack of existing Takaful Operators in Belgium, brokers seem to be a less evident distribution channel. Not only would additional training be required for the existing brokers to understand Takaful (and be able to explain it to their customers), part of the added value - analysing and providing advice on product offerings from different players - would make less sense if only one Takaful player would be available. Only after Takaful demand would increase, brokers would be more likely to come into play as a distribution channel for Takaful.

3.4.4 Bancassurance

One of the issues (cfr. section 2.5.1 and 3.5.1) is finding sufficient assets to invest in. An advantage of combining both an Islamic bank and Takaful is that the investments made by the bank (mortgages, leasing, SME working capital, ...) could be used as an investment for not only the savings accounts but also the family Takaful participants' personal investments (PIA) as well as the reserves for the Shared Risk Fund (SRF). An additional advantage is that investments in the distribution channel can then be born by both Islamic banking and insurance products. It is however also clear that starting both an Islamic bank and a Takaful company together adds substantial complexity.

3.4.5 Commission

Life insurance commissions in Belgium

Entry fee The commission on life insurance products in Belgium generally depend on the fiscal pillar of the product (cfr. section 3.5.6). In the 2nd and 3rd pillar, those where the client has a fiscal advantage, the intermediary (broker or agent) usually receives the entry fee that is charged to the client, either on a yearly basis or partly prefinanced (the latter occurring less and less). The height of this commission is hence directly related to the entry fee charged (mostly expressed as a percentage of the premium) and is generally higher (in percentage, for example 4% to 6%) for lower level premiums (e.g. pension savings) and lower (e.g. 1% to 3%) for higher premium products (e.g. second pillar). For family Takaful, the prefinancing of the commission is not evident. It can be seen as a type of debt, since it is only acquired if the policyholder continues contributing in the next years.

Rappel Next to this, the intermediary usually receives a “rappel commission” in the second year that the policy is active. This is an out of tariff commission that thus applies to portfolio growth. It goes up to half of one annual premium (differences also exist based on the product composition, where it is lower when products have a large

savings component and higher where no savings component exists). Often minimum levels of in force portfolio are required before rappel is paid. The out of tariff character and (currently at least) lack of transparency is already a first hurdle for Takaful. But the main issue with rappel, is the way it is financed. Since it is not based on a tariff / cost component, the payment by the insurer should come from other tariff sources such as investment profit, mortality profit. But mortality profit in Takaful is shared with the policyholders and the investment profit is distributed according to a predefined ratio (although the Takaful Operator could still use part of this income to pay the rappel to the intermediary).

Portfolio commission Finally, for 4th pillar products (those without a tax advantage), where no rappel commission is paid, the intermediary often receives a portfolio commission. This is a small percentage (e.g. 0,10%) of the Assets under Management (AuM, in sometimes Branch 21 and mostly Branch 23, so on the savings part). The entry fee and portfolio commission are paid so that the intermediary is able to also service the client after the policy has been sold. As part of the value chain of the Takaful insurance, this part could be set up under profit sharing on the Branch 23 part in Takaful. Where portfolio commission is normally paid independent on the fund performance, in this setup it would be only paid if the fund makes profit and the level should thus be set so that, on average, a similar commission can be expected.

Commissions for family Takaful in Belgium

The different aspects have been outlined above. If the issues with prefinancing entry fees / acquisition commission on the one hand and rappel on the other hand would lead to not applying these, it potentially becomes unattractive for an insurance intermediary to distribute Takaful compared to conventional insurance. In other countries, entry fees are often variable and large entry fees (of 20% or 30%) are charged in the first year(s) (after which the entry fee reduces to close to 0%). This has the advantage of a reasonable remuneration for the intermediary to acquire new customers, which is fully transparent. It would also be allowed / feasible under a Takaful regime. The Belgian market has developed differently and it takes many years to gather this type of amounts. Maybe to compensate for this, rappel has been introduced - which due to the initial lack of transparency happened outside the knowledge of the customer. With the announced increases in transparency on costs and commissions, these will become more clear in the future. Meanwhile, a solution should be found to provide a competitive remuneration for the intermediaries of Takaful.

Future evolution

Both MIFID (II) and IDD (IMD2) promote more transparency on the remuneration of the intermediary selling insurance-based investment product (or, on the banking side, funds). Article 24 of IDD, for example, stipulates that the full distribution cost (intermediary remuneration) needs to be disclosed, and upon customer request, detailed²⁰. Some supervisors, also looking at this way forward in a banking environment, are even considering a ban on commissions, switching to pure fee based products. This might have an important impact on the distribution of this type of product in Belgium (and Europe), but would also support the transparency and comparability of Takaful products, taking away a potential competitive disadvantage.

3.5 Operations

3.5.1 Investments

One of the challenges for the investment activities, is to find sufficient assets / instruments to invest in. Although Islamic funds and Sukuk are available in Europe, the number of funds, their risk profile, available durations and geographical spread are still limited compared to conventional investments. This increases concentration risk and the risk of asset-liability mismatch (amongst others a duration gap). Foreign investments and hedging are not as straightforward as with conventional investment instruments neither (see section 2.5.1).

Section 3.5.6 on tax treatment and requirements will elaborate further on challenges these pose towards the investments allowed.

3.5.2 Underwriting

As explained in section 3.2, certain legal boundaries are set for the segmentation that can be done. For example, it is not allowed to differentiate the tariff based on the gender of the participant. For this specific item, it corresponds with the opinion of multiple Sharia'ah scholars [60]. Another element that could evoke debate, is a participant's occupation. Although, as mentioned, the topic is less debated and some scholars differ in opinion, most scholars are of the opinion that a Takaful Operator should consider providing coverage to applicants who are deemed to have risky occupations but who provide halal services to the community. Most agree as well that it is permissible to give Takaful coverage to an individual working in a Haram environment. However, most of them state that it is not permissible to give coverage to a person having a Haram

²⁰See article 24 of the final IDD proposal, <http://data.consilium.europa.eu/doc/document/ST-10747-2015-INIT/en/pdf>

occupation. The latter might pose a problem under Belgian legislation. First of all, it is questionable if this would be considered as appropriate and necessary to reach a legitimate goal. One could argue that this would unnecessarily discriminate between people with different occupations. Either FSMA would consider this not acceptable, and could within the framework of the law put it on a list of not accepted segmentation criteria (to which appeal is not clear), or potential customers or anti-discrimination movements could take it to court.

The basic philosophy of ta'awun, of mutual co-operation, solidarity and brotherhood steer in a direction of limited segmentation. In general, limits on segmentation should thus not be considered as an issue for Takaful. In that respect, only the potential requirement of accepting persons with a Haram occupation seem to potentially evoke discussions.

3.5.3 Claims

The issue on inheritance law was touched upon in sections 2.5.3 and 3.2.3 and will not further be addressed.

3.5.4 Actuarial

No specific requirements exist in Belgium on top of those discussed in section 2.5.4.

3.5.5 Accounting

In Belgium, despite the adoption of IFRS for the consolidated financial statements of several types of companies, Belgian GAAP (Generally Accepted Accounting Principles) remains the required accounting framework for stand-alone financial statements, mainly due to the impact on tax and company laws. It is not the purpose of this paper to discuss the differences between Belgian GAAP and IFRS, but it is something to take into account when creating a Belgian entity for Takaful (and to a lesser extent insurance distribution). Some (more) important differences relate to the (market vs. book) valuation of certain assets²¹ and deferred acquisition costs in case of prefinanced commissions. Belgian GAAP however is mandatory to implement, which is not different for Takaful vs. conventional insurance.

3.5.6 Tax

Several tax regimes exist, often referred to as different (fiscal) pillars. The Belgian tax regime contains multiple challenges for family Takaful.

²¹Although one of the major differences concerns bonds, which should not be part of Takaful assets.

2nd Pillar - Occupational pension

Group Insurance The most well-known subset is group insurance, regulated via the Law on Supplementary Pensions (“Wet Aanvullende Pensioenen” or “WAP”) and the related Royal Decree. The minimum guarantee it sets forth (currently still 3,25% for contributions made by the employer and 3,75% for contributions made by the employee) is not in line with the principles of Takaful²². Branch 23 products are therefore seldom used within this category. A pension fund investing in Islamic assets combined with a Takaful death cover might be an option, but given the specifics of this type of insurances and the fact that it should be set up for all the employees in the company are barriers for developing and commercialising a Takaful offer.

Self-employed For the self-employed, the most important products are the (s)VAPZ (“Vrij Aanvullend Pensioen voor Zelfstandigen” or free supplementary pension for self-employed) and IPT (“Individuele PensioenToezegging” or individual pension promise). For the first one, the insurance undertaking is required to guarantee that the policyholder gets back his (savings) premium, including cost (sometimes referred to as 0% guarantee). This is not in line with the Takaful principles. Even in case of Sukuk, guaranteeing this would mean the Takaful Operator needs to cover the difference in case of bankruptcy of the business the Sukuk has invested in, where in case of investments (according to Shari’ah principles), these losses need to be born by the investor (the policyholder in this case). Since there is no way around this, and reducing the probability to a minimum by for instance investing in government Sukuk, a Takaful Operator might still consider to offer this product. The higher level of premiums, mostly recurring, reduce the number of policyholders required to form the minimum guarantee fund and often lead to higher (product / customer) profitability. For the IPT, no such obligation exists. IPT is more often done in the form of a large(r) single premium. There thus seem to be no issues for offering a Takaful IPT. For both products, the 80% rule²³ determines the maximum tax deductible premium.

3rd Pillar - Tax deductible individual savings

Pension savings Pension savings is a popular product in Belgium (average equipment rate of over 50%). A premium of currently max. 940 € gives a tax benefit of 30% of the premium paid. It is regulated in articles 145/8 to 145/16 of the WIB (“Wetboek InkomstenBelasting” or income tax code). An important challenge for Takaful is that article 145/11 stipulates in which assets the money should be invested:

²²The minimum guarantee should be provided by the employer, not by the insurer. However, on the one hand it leads to employers expecting insurers to perform at least close to this minimum requirement and on the other hand the statement is a more general one: any type of fixed minimum return in a product is violating Shari’ah principles

²³The pension amount the premiums lead to, plus the state pension the person receives, should not be more than 80% of the gross wage in the last year of his career.

- Maximum 20% can be invested in assets denoted in a foreign currency. This poses an important threat for the investment part, since the availability of Islamic assets in Euro is relatively limited (and hence would trigger concentration risk).
- Maximum 75% can be invested in bonds (and other debt instruments), in mortgages and in term deposits (with more detailed requirements specified in this article). Since no debt instruments are allowed in Takaful, the maximum percentage is not an issue.
- Maximum 75% can be invested in equity, with following additional requirements:
 - Maximum 70% of this can be invested in companies, hosted in the EEA (European Economic Area)²⁴, with a market capitalization of over 1 billion Euro.
 - Maximum 30% of this shares can be invested in companies, hosted in the EEA, with a market capitalization of less than 1 billion Euro.
 - Maximum 20% of this share can be invested in companies hosted outside the EEA.

These conditions pose a real challenge to the family Takaful investment side. Not only are the investments in the EEA limited, more importantly it means that a minimum of 15% to 25% (depending on the amount of cash held, see next item) should be invested in debt instruments. One option would be to apply for a tax ruling, explaining the issue at hand and maybe even arguing based on freedom of religion, to allow Shari'ah alternatives of bonds and mortgages (e.g. Sukuk) to be categorised under the second item (bonds and other debt instruments, mortgages).

- Maximum 10% can be held in cash (either in Euro or a currency of an EEA member)

Long term savings The tax deductibility of individual life insurances under the long term savings regime, originated²⁵ from the deductibility of both a mortgage (loan) and a mortgage insurance (decreasing term insurance linked to a mortgage). The maximum deductible amount depends on the income level but is capped at currently 2.260 €. The tax benefit is also 30% of the premium paid. Since it is still the same fiscal basket as mortgage loans and insurances, it is only used before and mainly after a mortgage loan has been taken and repaid. Therefore the equipment rate is relatively low. Similar to IPT, no specific additional conditions are defined and a family Takaful Long term savings product would be viable.

²⁴The EEA consists of all member countries of the European Union, Liechtenstein, Norway and Iceland

²⁵The Law of May 17th 2004, published in the Belgian Official Gazette on June 16th, broke the fiscal link between the mortgage loan and life insurance. Article 145/4 of the WIB determines the conditions.

4th Pillar - Non tax-deductible individual savings

Without tax deductibility, the savings part of a life insurance contract is primarily an investment instrument. Compared to other investment products (e.g. buying a similar fund with a bank), a premium tax of 2% is due on life insurances. For Branch 21 products, a fiscal advantage still exists since no withholding tax is due²⁶ on the return (which is different from a term deposit, where 25%²⁷ withholding tax on the return is due). However, no withholding tax is due on Branch 23 investments, which for its investment fund counterpart only holds if it is fully invested in equity. For Islamic investments however, where this is the case, the insurance tax of 2% would be a competitive disadvantage for family Takaful versus an Islamic investment product.

3.6 Governance, Solvency and Supervision

3.6.1 Corporate Governance

Transparency

Multiple legislative initiatives (Solvency II, IDD / IMD2, AssurMIFID, ...) support an increased transparency on product characteristics and costs, on intermediaries and commissions, and on the operations and risks of an insurance undertaking (an example of the latter being the Solvency II Pillar III requirements, describing Quantitative Reporting Templates that will be publicly disclosed on an annual basis). The transparency requirements do not tackle specific Takaful items such as the Shari'ah Supervisory Board. It would be advisable to publish the SSB report (cfr. section 1.5.2) as well and ideally minimum requirements for this report would also be defined.

Customer representation

One example of customer representation in Belgium can be found at P&V. They have a user advisory board where representatives of the co-operatives advise the Board of Directors on Corporate Social Responsibility topics and on the way the co-operative principles are applied within P&V Group. Based on the information on their website, Federale Verzekeringen does not have such an organ and focusses its marketing on "The insurer that shares its profit with you", prominently positioning the rebates and profit sharing over the past years.

²⁶Some additional conditions need to be fulfilled: the contract should have a minimum duration of 8 years (and the money is left in the contract during this time) or the death cover should be 130% or more of the invested amount

²⁷The recently announced Tax Shift contains an increase of the withholding tax to 27%.

3.6.2 Shari'ah Supervisory Board

Based on the composition of most Shari'ah Supervisory Boards and the characteristics of its members, it is unlikely to find (sufficient) Belgian scholars that would fit these requirements. Hence, the involvement of foreign scholars would be required. This poses potential language issues, since the translation from English to a native language (Dutch/French) version could incorrectly reflect certain language specifics or sensitivities. Supplying a second version in either English or Arabic might be a proper way to limit this risk. It also implies an increased cost compared to conventional insurers.

3.6.3 Solvency and prudential supervision by the NBB

The Belgian solvency regime will be following the European Solvency II legislation.

3.6.4 AssurMIFID & intermediaries: FSMA

Markets: MIFID

The law²⁸ of July 30th, 2013, expands the MIFID rules in Belgium to the insurance sector. It is followed by several Royal Decrees to clarify its application in the insurance sector. This is also often referred to as "AssurMIFID". Several memo's and overviews are available on the website of the FSMA (www.fsma.be). It covers a wide set of topics, that will not all be discussed (e.g. client file, reporting, data retention but also conflict of interest and inducements are not substantially different with Takaful vis a vis conventional insurance).

Pre-contractual information Supplying pre-contractual information supports the transparency principles of Takaful.

Duty of care: advice AssurMIFID introduces the concept of 'advice', where advice is defined as giving a personalised recommendation to a client (on his request or upon initiative of the intermediary or insurer), concerning one or more insurance agreements. Personalised recommendation means that the recommendation is presented as being suited for the client or is based on consideration of his personal circumstances. As FSMA indicates in its memo FSMA_2014_02 dd. 16/04/2014 (page 32), the number of cases in which a policy is sold where no advice is given, should be rather limited. In most scenario's, this will also be the case for Takaful (primarily a direct online offer could be pure transaction based).

²⁸Law of July 30, 2013 to strengthen the protection of consumers of financial products and services and the powers of the FSMA and laying down miscellaneous provisions.

Duty of care: needs analysis, knowledge & experience Before offering a specific insurance policy, the intermediary should identify the client's desires and needs. The knowledge and experience of the client concerning savings- or investment components of his insurance should be verified. Knowledge and experience should clearly be identified as two independent areas. The impact on Takaful is that the client should understand the Islamic investment concepts and the risks attached to those. With a standard conventional insurance or banking questionnaire, many clients are attributed a defensive profile, leading to investments primarily in Branch 21 / Branch 44²⁹ (insurer) or in bond funds / mixed funds with low volatility (bank). Since bonds and Branch 21 are not available in family Takaful, a clear description of the risks is mandatory. Still, also in family Takaful, less (e.g. government Sukuk) and more risky funds are available, enabling composing an offer that can fit to the desires, needs, knowledge and experience of most clients. When starting offering family Takaful in Belgium, the experience in family Takaful and Islamic investment products will of course be very limited to non existing.

Suitability and Appropriateness Appropriateness is applicable if no advice is given, or if the client decides not to follow the advice. It is still important to verify in this case that the client has the required level of knowledge and experience to buy the product. In case advice is given to the client (the majority of the cases as stated above), the suitability test verifies if the product(s) offered corresponds to the knowledge and experience, financial situation and investment goals of the clients. Again on these topics the experience of clients on Takaful or Islamic investment products will be limited. Before executing these tests however, the insurance intermediary is allowed to explain concepts to the client. It is fair to assume that this explanatory phase will be an important phase in family Takaful, given the limited knowledge among the Belgian Muslim population. As indicated in section 3.4, also Muslim organisations and mosques may play a role in this educational aspect.

Intermediaries

As set out in section 3.2.2 and 3.4, intermediaries need to be registered with the FSMA, and to obtain such a registration they (in case they do not have specific educational degree) need to pass an FSMA certified exam. FSMA also verifies how well the intermediary executes his profession with reference to MIFID guidelines and insurance legislation (amongst others, using mystery shopping). Intermediaries are also required to follow regular trainings in order to keep their knowledge up to date.

²⁹Branch 44 means a combination of Branch 21 and Branch 23, where in the case of a defensive profile Branch 21 would probably be the largest component

3.7 Market entry

Introducing family Takaful in Belgium can be done in several ways. This section lists different options and highlights a number of advantages and disadvantages.

3.7.1 Factors considered

Customer segmentation

“All generalisations are dangerous, even this one.” (Alexandre Dumas-fils). The main target group for Takaful is the muslim community, and its relative size within the total population is a good indicator for successfully launching Takaful. The key differentiator between Islamic and conventional insurance in the Shari’ah compliance. Certain customer segments are willing to pay a premium for the most compliant Shari’ah products, while others will be more attracted to products that are only part Shari’ah compliant but offer a more competitive rate [11].

Brand and marketing

Brand recognition is also addressed. This can be approached in several ways: a well known Belgian insurer will also be known by the Belgian Muslim population. On the other hand, a known foreign Takaful provider might also have (country of origin) brand recognition and could have an increased credibility in the Shari’ah compliance of their products and operations. “The new or upcoming middle class often encompasses ethnic minorities and is until today largely ignored by retailers in Flanders”, according to Rachiid Lamrabat (expert in etnomarketing) in a recent edition of the Belgian magazine “Trends”.

Time to market - Takaful / Product

In order to start offering family Takaful, the relevant knowledge and procedures need to be present or developed. In this case companies that have the relevant knowledge and processes already in-house, offering family Takaful in other countries, could have a head start. If in-house knowledge is not present and thus needs to be developed, this has a negative influence on time to market. It could be partially mitigated via specific consulting on this topic. Despite the limited presence of Takaful in Europe, various global consultants with local presence (e.g. Milliman, who recently³⁰ won the Best Advisory Firm Award for Takaful Consulting, or Towers Watson, see for example [52]) or European consultants with experience in the subject (e.g. FWU Group who assisted in creating a

³⁰Press release on March 19, 2015 - see <http://www.milliman.com/WorkArea/DownloadAsset.aspx?id=74298>

‘white label’ family Takaful product winning the Euromoney Islamic Finance Award for ‘Best White Label Provider’ in 2005 - see also [54]).

Time to market - Company / Distribution

Finally, some form of presence in the Belgian market is required to be able to legitimately offer products. Despite the legal possibilities and the efforts of the EU to come to a single insurance market, a recent study of the European Consumer Center in Germany [62] shows disappointing results in reality: online only 14 out of 144 insurance companies allowed for cross border insurance contracting, while the offline study showed that after contacting 567 of which only 32 replied to the questionnaire, only 3 of them offered cross-border insurance contracts. This at least indicates (perceived) hurdles to offer insurance in another country and would give a time to market advantage for companies already active in Belgium. Besides a direct (online) channel, already available and used by the company, the setup of an distribution channel generally requires an extensive period as well.

3.7.2 Greenfield

Starting a greenfield operation might seem a self-evident option. As discussed in previous sections, it would ideally be set up as a mutual insurance company.

Advantages	Disadvantages
No existing structures nor ‘history’ to take into account, so as clean and as Shari’ah compliant as possible	Relatively high capital requirement: both due to initial capital requirement and ‘burning’ capital in the startup phase
Can be set up in the ‘ideal’ mutual insurance operating model	Probably the longest time to market: setup of a new company, development of products, creation of a distribution channel, ...
Possibility to market the brand to fully match the target group	Recent initiatives such as New Bank clearly show how difficult it is to start a new financial institution in Belgium

In 2007, the NBB (at that time CBFA) published a memo on how to obtain the authorisation to operate as an insurance company under Belgian law [55]. The memo itself as well as the 16 annexes are a good starting point to develop this greenfield option. It however contains little to no information specific for mutual insurers. As indicated in the previous sections, though still foreseen as a legal form in the relevant legislation, the presence of mutual insurers in Belgium is limited compared to other neighbouring countries.

3.7.3 Market entrance by a foreign Takaful player

Foreign Takaful player from within Europe

The cross-border business of insurance could be taken-up and pursued pursuant to two freedoms of the internal market of the European Union - freedom of establishment and freedom to provide services. Despite previous efforts of the European Union on a single European insurance market, cross border insurance distribution is still limited. Still, Solvency II, the new EU Insurance Mediation Directive, PRIIPs³¹, ... focus on further supporting these.

The freedom to provide services, the single European insurance license and home country control allow for a foreign (EU) Takaful player to enter the Belgian market by offering its existing products through Belgian intermediaries. Many challenges outlined in this chapter would still remain, and the list of legislation that NBB ([56] and [57]) or FSMA (<http://www.fsma.be/en/Supervision/finbem/vohvo/bepalingen.aspx>) publish, containing provisions of general good in Belgium, is quite extensive.

A scenario within the freedom of establishment, establishing a Belgian Branch / subsidiary of the foreign Takaful player, thus seems as likely. It increases the options to tackle challenges set out in this chapter.

Foreign Takaful player from outside Europe

Solvency II allows third countries to be recognised as having an equivalent Solvency regime. It also foresees transition periods. On June 5th, the European Commission adopted the first package of third country equivalence decisions under Solvency II³². In it, Switzerland is granted full equivalence, other countries are granted equivalence within a transition period of 10 years (Australia, Bermuda, Brazil, Canada, Mexico and the USA). None of these however are important Takaful markets. This makes that the market entry for such a player would pose more challenges, would be more difficult, than for a European player - and the establishment of local presence (e.g. a subsidiary) in Europe seems advisable.

³¹PRIIPs stands for the regulation on Packaged Retail Insurance-based Investment Products, which composes amongst others a standardised KID or Key Information Document.

³²See http://europa.eu/rapid/press-release_IP-15-5126_en.htm for more details.

Advantages	Disadvantages
Shari'ah compliant products already available	Products need to be adapted to local legal, tax and regulatory framework
Operations, governance, investments, ... already Shari'ah compliant	Locally unknown brand
Sufficient size already for mutual setup and meeting solvency requirements	Local distribution channel to be developed

3.7.4 Starting Takaful operations from within an existing insurance company

Addressing some of the disadvantages of the previous options, one could start to offer Takaful life insurance from within an existing (life) insurance company in Belgium. In general, following advantages and disadvantages can be listed:

Advantages	Disadvantages
Relatively fast go to market since life insurance license is already present	Windowed approach most evident, but arguably less Shari'ah compliant
Known brand within the Belgian market	Limited expertise on Takaful and Shari'ah present in (most) existing life insurance companies
Existing distribution channel might be used to market Takaful products as well	Effort required on transparency, customer representation, Shari'ah Supervisory Board and compliance

Within this option, several sub-options can be evaluated depending on the type of life insurance company:

- Mutual insurance company: e.g. Federale, Securex. The advantage of this approach is that, despite that a windowed approach might still be used, the mutual insurance aspect is in the genes of a mutual insurance company and they are acquainted with the related setup, procedures and governance.
- Player with focus on sustainability. Albeit financial institutions such as Triodos Bank profile themselves specifically on this topic, no life insurers currently seem to do so. As stipulated in section 2.1.2, also non-muslims can be considered as potential client - mainly those with a specific interest in (and often willing to pay a premium for) ethical investments and sustainability. This is a close match with Takaful and the obvious advantage would be a (partial) target segment and brand fit.
- Belgian branch of an international player already offering family Takaful in other countries. Those players combine both market presence and brand awareness with

product know-how (be it in other countries / markets, with a different regulatory and legal environment). The time to market for this type of company would most probably be the fastest one and the investment would most probably be the most limited.

3.8 Conclusion

Following the analysis above, every type of market entry has both advantages and disadvantages. The selection of “the best” alternative heavily depends on the selection or evaluation criteria used. If and how Takaful will be introduced in Belgium, is a combination of many factors - and as often pure coincidence being one of them. Though probably large enough for one, maybe two fully independent Belgian players, a larger scaled approach - be it combining Takaful with existing mutual or co-operative insurance or following a European approach to also cover (larger) populations in other (neighbouring) countries - seems to make the most sense or at least increases the probability of success.

Table 3.1: Survey Results

Question	Answer
Have you ever heard of Takaful (Islamic insurance)?	
Yes	10 (27,78%)
No	26 (72,22%)
Are the insurance policies currently sold in Belgium (= conventional insurance) halal?	
Yes	0 (0%)
No	11 (30,56%)
Don't know	23 (63,89%)
Other	2 (5,56%)
How does Takaful (Islamic insurance) differ from conventional insurance (multiple answers can apply)	
No use of interests	15 (41,67%)
Risk sharing between the policy holders vs. risk transfer to the insurer	7 (19,44%)
Not all types of insurance exist in Islamic or Takaful form	6 (16,67%)
Takaful products have arabic names	3 (8,33%)
Takaful insurance can only be bought by Muslims	1 (2,78%)
Takaful insurance can only be sold by Muslims	1 (2,78%)
There is no difference	0 (0%)
Don't know	19 (52,78%)
Other	1 (2,78%)
Do you think non-muslims would be interested in Takaful?	
Yes	24
No	12
If Takaful would be offered in Belgium, would you be interested?	
Yes, if the conditions are similar to conventional insurance	20 (55,56%)
Yes, even if the price would be slightly higher than conventional insurance	9 (25%)
No	4 (11,11%)
Other	3 (8,33%)
I am a	
Male	16 (44,44%)
Female	20 (55,56%)
Age category	
Younger than 18	2 (5,56%)
18 to 24	2 (5,56%)
25 to 29	3 (8,33%)
30 to 39	23 (63,89%)
40 to 49	6 (16,67%)
50 to 64	0 (0%)
65+	0 (0%)

Chapter 4

Next Steps

As described in the preface, this paper aims for a broad assessment of (family) Takaful in Belgium. It also means that in each of the mentioned areas where challenges appear, a more in depth analysis of this topic is preferred.

4.1 Market research

No (substantial) market research has been performed within the scope of this master paper. In order to better underpin a potential business case for entering (or creating) the family (or general) Takaful market in Belgium, market research towards the Belgian Muslim (and non-muslim) population would be advisable.

4.2 Capital requirements

Solvency II (together with the legal setup of Takaful) poses a challenge to Takaful since some of its specifics are not addressed. However, either national supervisors or EIOPA could address this topic within the existing Solvency II framework. The Directive after all also does not forbid more detailed or specific approaches, as long as they reside within the framework set out in the Directive. A proposal for such a framework, a specific approach towards Takaful within Solvency II, could also be the subject of further research.

4.3 Product / legal

It is clear that a number of legal topics were only briefly touched upon within this master paper. Mr. Omar Salah obtained his PhD by examining and providing solutions for the legal setup of Sukuk in the Netherlands [59]. Similar to such a more in depth

analysis on this single item, further research can be done towards different types of investments, their Shari'ah framework as set out in section 1.4. One example can be how to provide Islamic mortgages within the Belgian legislative environment. For a Takaful market to fully develop and prosper, these type of instruments (for example specifically mortgages, which can be considered as a relatively long term, relatively low risk investment with relatively stable cash flows) are preferably present. Also inheritance law and the beneficiary of a death cover are not addressed in detail in this paper.

4.4 Business Case

Finally, after potentially clarifying additional issues listed above and after selecting an option from the alternatives provided in this paper, in combination with results from (further) market research, a business case could be made to enter the Belgian (or European) Takaful market.

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Appendix A

Appendix A - Qur'an verses

Mohsin Khan English translation

A.1 2: Al-Baqarah ("The Cow"), 173, 219 and 275-281

173. *He has forbidden you only the Maitah (dead animals), and blood, and the flesh of swine, and that which is slaughtered as a sacrifice for others than Allah (or has been slaughtered for idols, on which Allah's Name has not been mentioned while slaughtering). But if one is forced by necessity without wilful disobedience nor transgressing due limits, then there is no sin on him. Truly, Allah is Oft-Forgiving, Most Merciful.*

185. *The month of Ramadan in which was revealed the Qur'an, a guidance for mankind and clear proofs for the guidance and the criterion (between right and wrong). So whoever of you sights (the crescent on the first night of) the month (of Ramadan i.e. is present at his home), he must observe Saum (fasts) that month, and whoever is ill or on a journey, the same number [of days which one did not observe Saum (fasts) must be made up] from other days. Allah intends for you ease, and He does not want to make things difficult for you. (He wants that you) must complete the same number (of days), and that you must magnify Allah [i.e. to say Takbir (Allahu Akbar; Allah is the Most Great] for having guided you so that you may be grateful to Him.*

219. *They ask you (O Mohammed - PBUH) concerning alcoholic drink and gambling. Say: "In them is a great sin, and (some) benefit for men, but the sin of them is greater than their benefit." And they ask you what they ought to spend. Say: "That which is beyond your needs." Thus Allah makes clear to you His Laws in order that you may give thought.*

275. *Those who eat Riba (usury) will not stand (on the Day of Resurrection) except like the standing of a person beaten by Shaitan (Satan) leading him to insanity. That is because they say: "Trading is only like Riba (usury)," whereas Allah has permitted*

trading and forbidden Riba (usury). So whosoever receives an admonition from his Lord and stops eating Riba (usury) shall not be punished for the past; his case is for Allah (to judge); but whoever returns [to Riba (usury)], such are the dwellers of the Fire - they will abide therein.

276. Allah will destroy Riba (usury) and will give increase for Sadaqat (deeds of charity, alms, etc.) And Allah likes not the disbelievers, sinners.

277. Truly those who believe, and do deeds of righteousness, and perform As-Salat (Iqamat-as-Salat), and give Zakat, they will have their reward with their Lord. On them shall be no fear, nor shall they grieve.

278. O you who believe! Be afraid of Allah and give up what remains (due to you) from Riba (usury) (from now onward), if you are (really) believers.

279. And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums).

280. And if the debtor is in a hard time (has no money), then grant him time till it is easy for him to repay, but if you remit it by way of charity, that is better for you if you did but know.

281. And be afraid of the Day when you shall be brought back to Allah. Then every person shall be paid what he earned, and they shall not be dealt with unjustly.

A.2 4: sūrat I-nisāa ("The Woman"), 11-12, 29, 92 and 176

11. Allah commands you as regards your children's (inheritance); to the male, a portion equal to that of two females; if (there are) only daughters, two or more, their share is two thirds of the inheritance; if only one, her share is half. For parents, a sixth share of inheritance to each if the deceased left children; if no children, and the parents are the (only) heirs, the mother has a third; if the deceased left brothers or (sisters), the mother has a sixth. (The distribution in all cases is) after the payment of legacies he may have bequeathed or debts. You know not which of them, whether your parents or your children, are nearest to you in benefit, (these fixed shares) are ordained by Allah. And Allah is Ever All-Knower, All-Wise.

12. In that which your wives leave, your share is a half if they have no child; but if they leave a child, you get a fourth of that which they leave after payment of legacies that they may have bequeathed or debts. In that which you leave, their (your wives) share is a fourth if you leave no child; but if you leave a child, they get an eighth of that which you leave after payment of legacies that you may have bequeathed or debts. If the man or

A.3. 5: SURAH AL-MA'IDAH ("THE TABLE SPREAD WITH FOOD"), 3, 90-92101

woman whose inheritance is in question has left neither ascendants nor descendants, but has left a brother or a sister, each one of the two gets a sixth; but if more than two, they share in a third; after payment of legacies he (or she) may have bequeathed or debts, so that no loss is caused (to anyone). This is a Commandment from Allah; and Allah is Ever All-Knowing, Most-Forbearing.

29. O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is Most Merciful to you.

92. It is not for a believer to kill a believer except (that it be) by mistake, and whosoever kills a believer by mistake, (it is ordained that) he must set free a believing slave and a compensation (blood money, i.e. Diya) be given to the deceased's family, unless they remit it. If the deceased belonged to a people at war with you and he was a believer; the freeing of a believing slave (is prescribed), and if he belonged to a people with whom you have a treaty of mutual alliance, compensation (blood money - Diya) must be paid to his family, and a believing slave must be freed. And whoso finds this (the penance of freeing a slave) beyond his means, he must fast for two consecutive months in order to seek repentance from Allah. And Allah is Ever All-Knowing, All-Wise.

176. They ask you for a legal verdict. Say: "Allah directs (thus) about Al-Kalalah (those who leave neither descendants nor ascendants as heirs). If it is a man that dies, leaving a sister, but no child, she shall have half the inheritance. If (such a deceased was) a woman, who left no child, her brother takes her inheritance. If there are two sisters, they shall have two-thirds of the inheritance; if there are brothers and sisters, the male will have twice the share of the female. (Thus) does Allah makes clear to you (His Law) lest you go astray. And Allah is the All-Knower of everything."

A.3 5: Surah Al-Ma'idah ("The Table Spread with Food"), 3, 90-92

90. O you who believe! Intoxicants (all kinds of alcoholic drinks), gambling, Al-Ansab, and Al-Azlam (arrows for seeking luck or decision) are an abomination of Shaitan's (Satan) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful.

91. Shaitan (Satan) wants only to excite enmity and hatred between you with intoxicants (alcoholic drinks) and gambling, and hinder you from the remembrance of Allah and from As-Salat (the prayer). So, will you not then abstain?

92. And obey Allah and the Messenger (Mohammad - PBUH), and beware (of even coming near to drinking or gambling or Al-Ansab, or Al-Azlam, etc.) and fear Allah. Then if you turn away, you should know that it is Our Messenger's duty to convey (the Message) in the clearest way.

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