Revista de Științe Politice. Revue des Sciences Politiques • No. 81 • 2024: 145 – 153

ORIGINAL PAPER

Takaful Islamic insurance for life: Appraisal on the relevance of takaful models on financial markets behaviour

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Abstract:
The purpose of this study is to identify and describe the relevance of the takaful sector in terms of demographic features and geographical conditions. This study employs a qualitative, descriptive, literature-based approach to explore the significance and growth tactics used in this sector. The method is useful for reviewing specific situations and phenomena by assessing information and data from current literature. The study deliberates the elements that influence the efficiency level of the Takaful sector in terms of the benefits it delivers to investors, as well as the effects of Takaful insurance firms' special factors that make it a superior investment option. The findings testifies Takaful as a thriving insurance industry with enormous potential and a bright future in the global market. Industrial players, Sharia experts, and Takaful insurance businesses should work together to overcome inadequacies and loopholes that hinder the global evolution of this sector. The study supports the growth trajectory and advises Takaful operators to create more creative Takaful products and make them more accessible to consumers.

Keywords: *Takaful, Islamic insurance, Takaful models, Islamic finance, Sharia law, investor, global market.*

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1. Introduction

The phenomenon of an ageing population is attributed to the retirement of baby boomers, contributing to an increase in the old population (Rogers et al., 1999) affecting the future productivity and economic growth in countries (Cheng, 2007). According to the United Nations, all countries around the world are experiencing an increase in the number of elderly people in their populations, which has an impact on all societal sectors such as labour and financial markets, goods and services such as housing, transportation, and social protection, and changes in family structures (Mahmud, et al., 2019). There is no denying that old age will cause a decline in our overall health no matter how fit an individual is. Old age certainly comes with increased health risks, tendency of developing dementia and Alzheimer's disease, depression. Adequate planning for the security of financial outcomes can be rightly predicted by sound financial knowledge and clarity of the post-retirement goals. Mindful financial management and strategic planning for retirement will ensure a stable post-retirement life (Frank et al., 2023) and Takaful plays a vital role in bridging the gap between conventional plans and financial instruments based on Sharia law.

1.1 Overview of Islamic financial market

The Islamic Finance Market (IFM) is a vibrant and quickly growing sector that principally includes Islamic Banking, Sukuk (Islamic Bonds), Takaful (Islamic Insurance), and Islamic Mutual Funds. Liberalisation and globalisation have resulted in a homogenised financial system with the same set of incentives and motivations, contributing to global instability. The diversity in structure brought about by the financial instruments employed in Islamic Financial Markets contributed to the stability of the financial system (Ali & Nisar, 2016) by giving an alternative to existing financial services. According to Scott Schmith (2005), an international trade specialist at the International Trade Administration, Department of Commerce in the United States, the growth of Islamic finance has helped to diversify markets and institutional structures, particularly in oil-rich Muslim countries and countries with significant Muslim minorities. The International Monetary Fund (IMF) reports that cooperative banks, including local credit unions, and Islamic banks were among the financial institutions that survived the 2007-2008 economic crisis. They were somewhat isolated from the 'speculative' financial market, making them more resilient to any financial shocks. Both entities differ from commercial banks in that they share risk with depositors (Al-Muharrami, 2014). During financial crises, Islamic banks were less prone to deposit withdrawals, but their lending remains less responsive to changes in deposits. Samartha et al. (2022) explored the benefits of adopting technology to improve financial services in the banking sector.

1.2 Takaful – Islamic insurance

Takaful or Islamic insurance is a type of financial instrument that serves as a mutual guarantee for modern Muslim cultures in times of economic insecurity, illness, unemployment, widowhood, and old age.Its Islamic insurance businesses offer a variety of Islamic insurance products, including life and family (education funds), medical, maritime and aviation, property and accident, and auto insurance. Islamic insurance has been utilised to increase insurance penetration in various Muslim-majority countries.

Even in the most developed Muslim-majority countries, insurance markets in this sector are largely in their early stages of development, with relatively low insurance density (Farooq & Zaheer, 2015). Islamic insurance has grown significantly over the world, yet it has developed unevenly between countries. Some countries, such as Iran, Malaysia, and Saudi Arabia, are Islamic insurance elites due to their relatively large number of Islamic insurance operators and houses, as well as the sustained growth of Islamic insurance sales within their borders, whereas others, such as Indonesia, Pakistan, and Sudan, have seen limited development. Moreover, Karbassi Yazdi et al. (2022) investigated the dynamics of the banking system in Iran considering the conditions of an uncertain environment.

While Islam believes that increasing income and riches through development is vital for meeting fundamental necessities and achieving equitable income and wealth distribution, this alone cannot realise its comprehensive goal of human well-being. It is also vital to meet both spiritual and non-material demands in order to promote true well-being and long-term economic progress. If all of these requirements are not met, there will be a fall in well-being, eventually leading to the demise of society and civilization (Abdou, 2014). Takaful markets have attempted to create a Sharia-compliant annuity product that achieves the same goal as a conventional annuity: guaranteeing a stream of payments at retirement age with optional riders to secure death benefits (Ismail, 2017). Some institutions provided a Shariah-compliant Public Mutual Private Retirement Scheme (PRS) that invested contributions in both sukuk and equities as a way to diversify profits given the volatility of the stock market. The International Shariah Research Academy for Islamic Finance collaborated with Prudential BSN Takaful to develop the conceptual framework and structure for a Shariah-compliant retirement annuity plan (Ali et al. 2014).

2. Conceptual Analysis

The preservation of wealth is critical in Islam for human well-being. The primary goal of Sharia (also known as Shariah - Islamic law) is to promote people's well-being by protecting their faith (din), self (nafs), intellect (aql), posterity (nasl), and riches (mal). Whatever protects these five pillars is in the public interest and desirable, whereas everything that harms these pillars is against the public interest and should be removed." (Chapra 2012). The preservation of wealth would also be considered one of the five crucial parts in Maqasid al-Shariah that designated it as daruriyyat, despite being put at the end of the book (Kamali, 2017). Further, Islamic wealth management essentially stems from the core notion of Islamic wealth in guaranteeing the sustainability and well-being, which extends towards Islamic financial products, asset allocation, portfolio management and financial planning (Alam et al., 2017). A comprehensive service of Islamic wealth management should include wealth generation, wealth protection, wealth accumulation, wealth distribution, and wealth purifying.

2.1 General and Family Takaful

Takaful products are divided into two categories: general Takaful and family Takaful (Alhabshi& Razak 2011; Htayet al., 2012). According to the IFSB, generic Takaful is a plan that consists mostly of short-term joint guarantee contracts (often one year) that provide mutual reimbursement in the case of a particular sort of loss. The schemes are intended to address the needs of individuals and corporate bodies seeking protection against material loss or damage caused by a catastrophe or disaster affecting participants' real estate, assets, or belongings. The Takaful contribution paid is pooled into the Participant Risk Fund under the idea of Tabarru (Fadzli, 2011) to match the risk elements of the business that are inherent in its underwriting activities.

Family Takaful is Shariah-compliant coverage based on the principles of mutual aid and risk sharing (Salman et al., 2015). In the event of an unexpected event affecting Takaful participants, financial assistance will be drawn from the Takaful fund provided by the participants under the notion of 'Tabarru', which signifies giving. In comparison to conventional life insurance, conventional insurance provides a death benefit in exchange for paying a premium (Fadzli, 2011). Thus, the risk is transferred from the individual to a traditional insurance provider. Having adequate retirement funds is crucial to ensure financial security in old age. Furthermore, Wanke et al. (2022) did a research study to analyse the banking performance of ASEAN countries based on the CAMELS Rating System, employing a unique framework based on MCDM / Z numbers. Spulbar et al. (2020), on the other hand, analysed important components of European Union member states' banking systems.

3. Model Fitness

The Takaful Models folow the teachings of the holy law of Islam called Sharia (or Shariah). The cooperative (Taa'wuni) model requires participants to make contributions, which are then accumulated in the participant risk fund (PRF), from which claims, Re-Takaful contributions, and running expenditures are paid. In addition, a percentage of PRF will be invested to produce revenue. Any PRF surplus will be divided among shareholders and participants (Frenz & Soualhi, 2010). The principal-agent relationship exists between Takaful operators (TOs) and participants under the Pure Wakalah (Agency) Model. TOs operate as agents for participants, making investments and managing assets (Sherif and Shaairi 2013). The contributions received from participants will be divided into three categories: Wakalah fee, PRF, and PIF. TOs do not share the investment profit or surplus from PRF. Claims will be reimbursed out of the PRF. In the event of maturity, the participant will receive his respective amount (portion of the contribution that has been invested and profit from the investment) from the PIF (if any) and the maturity value from the PRF.

The Modified Wakalah Model (Wakalah with Incentive Compensation) treats the relationship between TOs and participants as principal-agent; however, TOs are permitted to share the PRF surplus. The donations made by participants will be divided into three categories: Wakalah fee, PRF, and PIF. TOs divided the PRF surplus and investment gains. Claims will be reimbursed from the PRF. In the event of maturity, the participant will receive his respective amount (portion of contribution invested and profit earned) from the PIF (if applicable) and the maturity value from the PRF (Mohamed et al., 2015).Profit sharing is the foundation of the Pure Mudarabah (Investment Profit-Sharing) Model, which governs the contractual relationship between participants and TOs. Participants are capital providers, and TOs manage the funds provided by the participants. The TOs' income is entirely decided by their share of the profits from the PIF. There is no Wakalah fee for TOs. Claims will be reimbursed from the PRF. In the event of maturity, the participant will receive his or her appropriate amount (portion of the contribution deposited and profit from the investment) from the PIF (if applicable) as well as the maturity value from the PRF.

The Modified Mudarabah Model allows TOs to charge the direct cost of handling claims and administrative fees before calculating surplus or deficit. At the same time, TOs might split the PRF surplus and PIF profit. The contribution received from participants will be divided into three categories: monitoring charge (the direct cost of handling claims and administration fee), PRF, and PIF. In the event of maturity (Yusof& Majid 2020), the participant will receive his respective amount (percentage of contribution invested and profit earned) from the PIF (if any) and the maturity value from the PRF. The Hybrid Wakalah-Mudarabah Model combines the principles of Wakalah and Mudarabah. The Wakalah idea is utilised for underwriting, while Mudarabah is used for investment. When compared to the Pure Mudarabah model, TOs enjoy a more constant income, i.e. the Wakalah fee (Safdar2023).At the same time, TOs might split the PRF surplus and PIF profit. Claims will be reimbursed out of the PRF. In the event of maturity, the participant will receive his respective amount (portion of the contribution that has been invested and profit from the investment) from the PIF (if any) and the maturity value from the PRF. Waqf Model This model has more features than the Hybrid Wakalah Mudarabah model (Khairi et al. 2020). The additional requirement is that owners contribute an equal amount of money in the PRF to establish the waqf. Aside from the first waqf donation, the remainder will follow the Hybrid Wakalah-Mudarabah model.

4. Relevance of Takaful Islamic insurance in contemporary financial market

Finance and Takaful are becoming increasingly popular worldwide, contributing significantly to the global economy. The overall asset value of global Islamic finance markets was around 3.95 trillion US dollars in 2021, representing a 17% increase as compared to 2020. By 2026, the worldwide Islamic financial markets are expected to have a total asset value of $5.9 trillion. The Islamic banks use several asset arrangements, including Murabahah (profit margin sales), Ijarah (lease), Musharakah and Muḍarabah (profit-sharing), and Wakalah (service charge) to counter the cabalistic growth of the financial markets. Al Rajhi Bank, situated in Saudi Arabia, led the list of the world's largest Islamic banks, with total assets rising 22% to $125 billion in 2020. The challenge for the Takaful sector is to develop and align the Takaful criteria to be consistent with insurance standards established by IAIS, IRS, and others. Overcoming the problems is critical since takaful is an essential component of the global insurance sector, the fastest expanding and most likely to expand the overall size of the industry.

Islamic finance and Takaful have mostly spread throughout the Middle East, as well as sections of Asia, Africa, and Europe. The global Takaful market size is predicted to increase from $26.50 billion in 2022 to $29.73 billion in 2023 at a compound annual growth rate (CAR) of 12.2%. The global takaful market is estimated to reach $45.95 billion in 2027, with a CAR of 11.5%. The Russia-Ukraine war hampered the possibilities of global economic recovery from the COVID-19 epidemic, at least in the medium term. The battle between these two countries has resulted in economic sanctions against many countries, an increase in commodity prices, and supply chain interruptions, generating inflation in goods and services and hurting various markets throughout the world. Takaful is founded on the Islamic principle of shared responsibility towards one another, and as a result, it is frequently practiced among Muslims. For example, according to the Muslim Population by Country 2023 Report shared by the World Population Review, a US-based sophisticated demographics data supplier, Islam would be the world's second-largest religion after Christianity, with more than two billion followers.

Technological developments are a major trend gaining traction in the Takaful business. Major players in the industry are introducing technologically improved solutions to maintain their market position. Cyber Village Sdn Bhd (CBV), a Malaysia-based provider of digital engagement technology solutions, has created the industry's first peer-to-peer community-based family takaful app.The platform is built upon CV's Insurtech P2P technology. It integrates Takaful, mutual help, and the peer-to-peer concept into a single platform, allowing a group of people to pool their funds to insure against a risky event. Through the platform, the Takaful Operator may meet members' requests for mobile capabilities, self-service options, and proactive messaging, such as speedy and effective digital customer onboarding. Dar Al Takaful, a UAE-based Takaful insurance firm, merged with the National Takaful firm, strengthening both companies' standing in the insurance market and allowing them to develop technologies to improve their products.

5. Conclusions

The Takaful market has grown significantly, driven by increased demand from both Muslim-majority and non-Muslim-majority countries. This growth is fuelled by Takaful insurance's ethical and Shariah-compliant nature, which appeals to a wide range of consumers. Takaful providers have increased their product offerings to reach a larger market. This includes, among others, investment-linked Takaful, general Takaful, family Takaful, and health Takaful. Diversification has led to a larger client base. Furthermore, Takaful operators are expanding into markets beyond their own countries. They are reaching out to Muslims all across the world, as well as non-Muslims seeking inclusive and moral insurance options. Collaborations and mergers with overseas insurance businesses are also on the increase. Furthermore, the landscape of Takaful is changing due to digital technologies. Online distribution channels, smartphone apps, and digital underwriting procedures all contribute to increased accessibility and client involvement. Takaful providers can streamline operations and improve consumer experiences as insurance technology evolves.

The rise in demand for Takaful insurance in Muslim-majority countries is due to the fact that conventional insurance is sometimes rejected by Islamic Sharia law because factors such as uncertainty of business losses, medical conditions, hospitalisation, and others are against Islamic teachings. Takaful insurance distributes investment earnings across both participants. Because the premium is considered a donation by the members, a tiny portion of the surplus is provided to the Takaful organiser to manage the insurance procedure. The remaining cash is divided equally among the participants. The lack of standardisation in Takaful insurance due to regional differences is substantial, making the Takaful process difficult to standardise. In comparison to the traditional insurance industry in the region, Takaful insurance has seen significant adoption and penetration. Takaful insurance's prospective customer base includes the world's 1.5 billion Muslims. The target demographic is the young people, as they have the potential to become customers. The Takaful insurance industry should select the type of innovation that best suits the characteristics of communities and environmental conditions, taking into account customers' demographic and geographical conditions, in order to achieve the Takaful industry's goal of introducing Takaful and encouraging participation in Takaful activities.

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Article Info

Received: December 23 2024
Accepted: April 4 2024

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How to cite this article:
Frank, D., Sudhir Prabhu K, Vidya Bai G, Birau, R., Filip, R.D., Nioata (Chireac), R.M., Lupu (Filip), G.A.M. (2024). Takaful Islamic insurance for life: Appraisal on the relevance of takaful models on financial markets behaviour. *Revista de Științe Politice. Revue des Sciences Politiques,* no. 81, pp. 145 – 153.