

CSR governance, contributions and investments management optimization for Takaful operators



TAKAFUL &
RE-TAKAFUL (EUROPE)

By Ezzedine Ghlamallah

The Islamic financial system with its moral and ethical foundations is today a reliable and concrete innovation in order to remedy the various hazards that are shaking up the current economy and to ensure financial stability. However, the Islamic financial sector must question its corporate social responsibility (CSR). The performance and accountability of boards and the effectiveness of governance mechanisms continue to be a concern.

Scientific research has shown that Shariah supervisory boards have a positive impact on performance when they play a supervisory role, but this impact is negligible when they have only an advisory role.

It may, therefore, be relevant to combine CSR with the specific governance of Takaful operators. This is why some authors have tried to bring the concepts of Islam and CSR closer together and explain to what extent CSR conforms to Islamic principles. Takaful, an important emerging sector of Islamic finance, has experienced remarkable growth worldwide in recent decades. Nevertheless, the sector continues to face a multitude of problems in its business models.

Dr Hayat Khan from Alfaisal University, a director of undergraduate business programs and an assistant professor of economics, states that the relationship between policyholders and a Takaful operator is in essence a principal-agent relationship.

To alleviate the problems related to this relationship, Dr Hayat believes that all incentives offered to Takaful operators must include surplus sharing and that offering Mudarabah in the presence of surplus sharing is optimal only when the risk-adjusted return on investing technical reserves outweighs a similar return on efforts exerted in underwriting risks.

A Wakalah hybrid is also recommended as it induces the operator to increase



the size of the pool that, in turn, reduces the average risk to the benefit of policyholders. In addition, there is an urgent need to develop a fair and equitable participant contribution calculation model because inefficiencies in investment management are mainly due to the inability to manage all resources at an optimal level.

“ The ultimate goal is to evolve toward a consensus-based Takaful model where compliance issues with Muslim law can be minimized or even eliminated so that consumers have greater confidence in the Takaful model ”

At the same time, operating systems and investment-related products improve the efficiency of Takaful operator

investment management. In addition, research has shown that the size of the operator has no significant effect on the effectiveness of the investment management of insurers and Takaful operators.

As an extension of current research, it is important to develop a CSR and consensus-based model to ensure full Shariah compliance. In addition to compliance issues, it is difficult to align all stakeholder interests.

Unless appropriate regulations and proper corporate governance are settled, the management of a commercial enterprise always tends to favor the profits of its shareholders and to relegate the interests of customers to the second rank. This conflict has not yet been resolved and practitioners have to develop a model that will allow it.

The ultimate goal is to evolve toward a consensus-based Takaful model where compliance issues with Muslim law can be minimized or even eliminated so that consumers have greater confidence in the Takaful model. This model will have to include a formula for calculating contributions and investment optimization tools to improve competitiveness. (2)

Ezzedine Ghlamallah is a senior consultant at SAAFI which specializes in Islamic finance and Takaful solutions. He can be contacted at ezzedine.ghlamallah@saafi.fr.