

## Takaful, an optimal model that remains to be built



### TAKAFUL & RE-TAKAFUL (EUROPE)

By Ezzedine Ghlamallah

**The question of the optimal structure of the Takaful model is an unresolved issue. Takaful operators often face a double dilemma with investors looking to see profitability in line with conventional insurers, while consumers expect to find a product that fully embraces the ideals of solidarity.**

The most-used models are those of companies whose management is entrusted to a Takaful operator that can be found in the Wakalah, Mudarabah and hybrid models. With the pure mutual model, there are also cooperative societies for which the Takaful fund is fully managed and controlled by the company. It is possible to classify Takaful societies into two large subsets that determine the management model used: companies whose management is entrusted to an operator and cooperative or purely mutual societies.

The model used has an impact on the management, redistribution of surpluses and remuneration of the operator. An

agency problem exists with models whose management is entrusted to an operator. There are two principals, subscribers and shareholders, who do not share the same goals. Asymmetric information can lead to anti-selection and moral hazard phenomena. Anti-selection can be shown by the participants in the selection of the operator regarding the content and quality of the guarantee due to imperfect information, while a moral hazard can occur because of the discretionary power available to the operator regarding the amount of contributions as well as investment income.

On the operator's side, a moral hazard may involve a false statement of risk or risk behavior of participants once the guarantee is granted, while the risk of anti-selection may materialize in the event of guarantees granted automatically to third parties. Industry players have developed a new model combining Mudarabah and Wakalah called the 'hybrid model'. The Mudarabah-Wakalah hybrid model is today the most used in Takaful family companies. The Wakalah contract is used for underwriting and the Mudarabah contract is used for Takaful fund investments.

On the other hand, the purely mutual companies are managed on a purely cooperative or mutual basis by and on behalf of Takaful participants. The company belongs to the participants. It manages the activity on the participants' behalf and there is no separate entity in charge of managing the activity.

The Takaful industry faces its own set of institutional, legal and regulatory issues with a central dilemma. Firstly, although the purely mutual model is closest to the spirit of solidarity and mutual aid pronounced by Shariah, some legal systems in many countries do not accept the mutual or cooperative form with a solidarity goal and this is the first reason why this type of structure is rare in the industry. Secondly, and more fundamentally, a new mutual insurance company would hardly be able to meet the capital requirements now essential for any insurance company creation. (2)

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