MICROTAKAFUL: FIELD STUDY EVIDENCE AND CONCEPTUAL ISSUES

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ABSTRACT

This research examines microinsurance schemes based on the Islamic law (Shariah), so called Microtakaful schemes. We conduct a field study of two Microtakaful insurance providers in Indonesia. One of the two companies studied is owned in majority by Muslim shareholders, whereas the other company is owned by a large international commercial insurance company. We document the forms and characteristics of their Microtakaful credit life insurance products as well as the organizational structure of these two companies. We then discuss the Microtakaful schemes in the light of best practices in microinsurance and socio-cultural Islamic principles. The results suggest that both companies have a similar product design and business operations, and that best practice microinsurance services can be offered in a Shariah-compliant way. Our findings also demonstrate that an international commercial insurer can successfully offer Microtakaful schemes and, hence, participate in this untapped market segment.

JEL Classifications: G22, G15, D20

Key words: Takaful, Microinsurance, Microtakaful, Shariah-compliant insurance operations, Indonesian insurance market
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**INTRODUCTION**

Around 25% of the world’s population is Muslim. Most of them live in the low-income or lower-middle income countries of Indonesia (207 million), Pakistan (160 million), India (151 million) and Bangladesh (132 million) (Central Intelligence Agency, 2010). Studies indicate that the population of these countries will increase 36.9% by 2050, while the population growth for the same period in industrialized countries like USA, Japan, Germany and France is only 9.2% (United Nations Population Fund, 2010).

In those major Muslim countries around 2% of GDP are currently spent for insurance compared to a global average of around 7% (Swiss Re, 2007). Prior research has found that insurance consumption in general is less in predominantly Islamic countries (Wasaw, 1986; Browne and Kim, 1993; Enz, 2000; Beck and Webb, 2003). Two main reasons contribute to a lower insurance take-up. First of all, conventional insurance products like there are known in the western-hemisphere are not accepted in Islam. Secondly, those conventional products are not available to or adapted to the needs of the majority population who lives on a low income close to the poverty line.

The first take-up barrier of insurance is addressed by an Islamic form of insurance termed takaful which evolved in the late seventies in Sudan and Egypt. Takaful is a cooperative insurance mechanism based on the principles of solidarity and reciprocity (Billah, 2007). In January

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1 The Islamic law (Shariah) sets the framework for insurance operations. It legitimates the existence of insurance practices and gives prohibitions as well as recommendations for the operation of insurance undertakings. According to Sharia conventional insurance contains three prohibitions. Firstly, insurance business involves riba (interest), secondly, gharar (uncertainty), and thirdly, maisir or qimar (speculation or gambling). Additionally, insurance companies are not permitted to be involved in transactions or subjects that are prohibited (haram) in Islam, e.g. alcohol, pork, gambling, illegal drugs and pornography.
2009, 124 full-fledged takaful operators existed globally (Ernst & Young, 2010). The largest markets currently include the Middle East and Malaysia with a takaful premium of USD 3.7 billion and USD 889 million, respectively (Ernst & Young, 2010). Future growth is expected as the Muslim population and its income rises and the concept of Islamic finance gains popularity.

Next to takaful products for affluent customers, insurance schemes for low income people (microinsurance) based on Islamic principles have emerged. These so called Microtakaful schemes are based on the experience of conventional microinsurance services, and complement Islamic microcredit and microsavings products. The first Microtakaful scheme was established in 1997 in Lebanon. Approximately eight providers in Lebanon, Indonesia, Malaysia, Sri Lanka, Bahrain and Pakistan exist by January 2010 (Patel, n.a.; ICMIF takaful, 2010). The infant stage of Microtakaful is also attested by Kwon (2010). In an investigation of microinsurance markets he finds that microfinance institutions in Muslim populous countries are less likely to offer insurance services.

Despite its growing importance, only few academic studies focus on takaful insurance in general (Kader, 2010; Kwon, 2008; Maysami and Kwon 1999), and we are not aware of any study examining Microtakaful schemes specifically. In his discussion of takaful insurance, Kwon (2007) identifies Microtakaful as a “new trend”. However, he only provides a brief definition of Microtakaful, but no in-depth analysis.

Microtakaful though, can play a significant role in the economic development of major Muslim countries. Several empirical studies that investigate the effect of the insurance sector as a provider of risk transfer on economic growth find a rather positive relationship (Browne and Kim, 1993; Outreville, 1996; Beck and Webb, 2003; Lim and Haberman, 2003). For nonlife insurance, Beenstock et al. (1988), Outreville (1990), Esho et al. (2004) and Zou and Adams
(2004) provide evidence. Thus, Islamic emerging market countries can facilitate economic growth by creating incentives for insurers to offer Microtakaful insurance schemes in these countries.

The objective of this paper is twofold. First, we define Microtakaful in terms of product design and business operation by identifying fundamental principles of takaful and microinsurance from the literature. Those principles are than used as a benchmark for current Microtakaful practices. Second, based on information gathered in a field study, we provide an analysis of two Microtakaful schemes. We discuss our cases in the light of best practices in microinsurance and socio-cultural Islamic principles and compare the products and business operations of the two Microtakaful schemes studied. We find that insurance supply in form of takaful is well suited to serve the low-income people in majority Muslim countries. Most notably, we document the case that an international insurance corporation can offer microinsurance that complies with socio-cultural Islamic principles. Thus, it is possible for international companies to enter the promising Microtakaful insurance market.

The remainder of this article is organized as follows. The next section discusses the principles of microinsurance. The third section explains our research design, before we provide a detailed analysis of the companies studied in the field. The “Discussion and Implications” section presents the major findings and conclusion.

**INSURANCE FOR THE LOW-INCOME GROUP**

In the late nineties of the last century the institutional arrangement of microinsurance evolved to complete risk mitigation instruments for low-income people in developing countries.
Microinsurance is a risk protection for low-income people based on actuarial and economic principles (Churchill, 2006).

In 2006, 78 million people worldwide owned a microinsurance policy (Roth et al., 2007) in contrast to a market potential of 3 billion customers (Lloyds, 2009), leaving more than 97% uncovered. Hence, most low-income people still have to use alternative, mostly re-active risk management strategies, like out-of-pocket payments, lending, or selling of assets. Those strategies heavily affect the possession and accumulation of assets as well as future income flows as people might fall back under the poverty line if they are hit by a loss or damage (Cohen and Sebstad, 2006). Microinsurance in contrast is an ex-ante risk coping strategy which can cover those shocks exceeding an individuals’ or a communities’ financial capacity. It minimizes the vulnerability of the low-income people and provides a safety net. The most notable and significant difference between insurance and microinsurance is its target group. Microinsurance serves the low income people, who are living slightly above the poverty line and usually work in the informal sector. Due to their employment status they are neither part of the social security system nor recognized as insurable by market-based insurance companies (Churchill, 2006). Covered risks are identical to formal retail-sector insurance: There is microinsurance for health, death, education, housing, agricultural risks and others with a major focus on credit life insurance. Premium payments and insured amounts are relatively small. Products usually offer basic coverage based on the needs of the population. Their design, documentation and processing is simple and easy to understand as (financial) literacy is low. An understanding of insurance and its benefits still has to be established in the target markets (Churchill, 2006). Like in formal insurance, microinsurance is delivered with the help of agents and financial institutions. To reach the poor, additional innovative distribution channels are used. For example, health insurance is provided
by hospitals or even by dairy cooperatives. Risk carriers of microinsurance vary in their size and legal status. They range from small mutuals to multinational insurance companies. Three major suppliers can be identified though: Firstly, community-based mutuals or cooperatives, secondly non-governmental organizations (NGOs) or government-subsidized programs, and thirdly commercial insurer of the formal market (Dercon and Kirchberger, 2008). Most of the time those schemes operate independently of religious principles. Only a few schemes have started operations yet that take Islamic values into account. Those Microtakaful schemes are the subject of our empirical field study.

RESEARCH DESIGN

The objective of our field study is to empirically explore major characteristics of Microtakaful and to identify best practices in regard to application of microinsurance best practices and socio-cultural Islamic principles. For this purpose we have chosen the Indonesian market because of its first in-depth experience in Microtakaful, well-grounded history of successful microfinance activities, and large potential for Microtakaful.

Case selection is not random but focuses on theoretical useful cases (Eisenhardt, 1989). We have limited the case studies to one country to control for variations in business environment and regulatory framework. The studied companies are one of the primer Microtakaful insurer worldwide, major stakeholders in the Indonesian Shariah insurance market and the only two supplier of Microtakaful in Indonesia. Both insurers differ in their insurance conduct, cultural background of ownership and experience with microinsurance. Hence, both companies provide a fertile ground for exploring a relatively young phenomenon and bringing key characteristics of Microtakaful to light.
The first organization studied (henceforth referred to as Asuransi A) was established in 1994 as the first full-fledged Shariah-conform insurer in Indonesia. Its founding fathers are actors of the Indonesian financial sector, including the Ministry of Finance, as well as a Malaysian takaful operator and local Muslim entrepreneurs. The set-up received full support of the Indonesian Moslem Scholars Association. By the end of 2009 the majority shareholders were a Malaysian takaful operator as well as an Islamic Bank which had joined the insurer in 2004. The insurer operates two subsidiaries. One subsidiary offers life insurance products since the inception whereas a second subsidiary operates since 2005 and focuses on general insurance. The introduction of Shariah-compliant credit life microinsurance in corporation with a local NGO was its first experience to access the low income segment.

In contrast, the second organization studied (henceforth referred to as Asuransi B) belongs to a large western commercial insurance company. Asuransi B is not a full-fledged takaful company but operates its Shariah business as a window. Asuransi B is present in Indonesia since 1981. The insurer operates a life and a general subsidiary. Since 2006, insurance in accordance with the Islamic law is offered. In the same year, the insurer introduced conventional credit life microinsurance in partnership with a donor from the field of development cooperation. After the successful launch of the conventional microinsurance service, a Shariah version of the product was introduced in early 2008. The product, termed Mikro Dua, is very similar to the credit life insurance offered by Asuransi A. Microinsurance services are also distributed by microfinance institutions. However, unlike operator A, no further intermediary is involved.

It was expected that Asuransi A performs better in terms of Shariah compliance due to its majority Muslim ownership, whereas Asuransi B stronger adheres to best practices in microin-

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2 In that case Takaful business is delivered by a conventional insurer via the same distribution channels as his conventional insurance products. Operations and accounting, on the contrary, are separated (Schoon, 2009, p. 53).
surance owing to its prior learning experience. Our analysis is based on a field study in which we applied the concept of triangulation. Triangulation in general means the multiple employment of various sources of data, observers, methods, and/or theories in investigations of the same phenomenon (Bruns and Kaplan, 1987). Hence, we collected qualitative and quantitative data from multiple sources (Eisenhardt, 1989; Yin, 2009). Qualitative data dominates though, because of the young age of the two insurance schemes. The primary source of data is five in-depth, semi-structured interviews. Interviews have been conducted in September and October 2009 with key staff of the insurance companies as well as with one NGO acting as an intermediary for Microtakaful services of Asuransi A. The interview guidelines are based on findings from literature survey on rulings of Islamic jurisprudence in regard to insurance undertakings as well as on microinsurance best practices. Our secondary source is annual reports and company profiles, evaluation reports as well as press releases. Results of Asuransi A are validated by an advisor to the company. Our multiple data sources allow us to cross-check for internal consistency and enhance reliability (Jick, 1979; Yin, 2009). The field study report is then the result of the patterning of the field material.

To construct external validity (Yin, 2009) and to structure our discussion of the Microtakaful schemes in the light of microinsurance best practices, we use six dimensions capturing microinsurance best practices. Those are briefly discussed below, before we turn to another eight dimensions operationalizing the socio-cultural principles of the Islamic law.

**Microinsurance Best Practices**

The compatibility of Microtakaful practices in Indonesia with international best practices on microinsurance has been tested by six variables. The latter are based on the findings of 22 extensive case studies conducted by the Consultative Group to Assist the Poor (CGAP) working
group on microinsurance, which is part of the World Bank, and further experience from 40 microinsurance providers.

**Market needs:** Insurance companies are not yet familiar with the microinsurance market. They need to gain knowledge and to understand the needs of the market to be able to design demand-driven products. Demand oriented products are a prerequisite to be successful in this market segments as financial resources of the target group are very limited (Churchill, 2006; Wohlner, 2008).

**Product design:** Only major insurable risks should be covered by a small benefit package to keep premiums affordable (Wipf et al., 2006; Churchill, 2006). Policy language is simple. There are either no or only few exclusions. To reduce administrative costs and risk of adverse selection group insurance policies are most recommendable (Wohlner, 2008).

**Premiums:** Premium amounts and payments are to be adapted to the cash-flows of the customers; in best cases premiums are linked to an existing financial service. Group pricing is applied (Wipf et al., 2006; Wohlner, 2008).

**Processes:** Policy application and claims documentation is reduced to a minimum. Claims are settled quickly (Dercon et al., 2004; Churchill, 2006).

**Distribution:** Microinsurance is distributed by partners who know the target market well and have an established relationship with potential customers (Dercon et al., 2004).

**Market education:** In most developing countries an insurance culture does not exist. People are not familiar with insurance and sometimes neither with other financial services. The target group does not know how insurance works or how they can personally benefit from it. In addition, insurance benefits are intangible which requires trust from the policyholders. Therefore,
staff and potential customers need to be educated on how insurance works (Wipf et al., 2006; CGAP Working Group on Microinsurance, 2008).

**Socio-Cultural Islamic Principles**

Takaful as a concept is similar to conventional mutual risk mitigation, in which risk-sharing is based on the concept of ta’awuni (mutual protection). The difference between takaful and conventional insurance rests in the way the risk is assessed and handled as well as in the ownership of the takaful fund and how it is managed. Further differences are present in the relationship between the insurer (operator) and insured (participant). In the following we focus on the socio-cultural principles of Shariah to highlight the differences more clearly.

**Vision and mission:** According to Islamic jurisprudence an insurer should operate on the principles of solidarity and mutual cooperation (El-Gamal, 2007). Its initial objective is not to gain profit but to mutually assist each another (Islamic Financial Services Board, 2009).

**Operational model:** In Shariah-compliant insurance contracts between the policyholders and insurer eliminate uncertainty (gharar) and game of chance (maisir). Accepted contractual relationships are either based on mudarabah or wakalah. In those models policyholders are donating a contribution for a cooperative risk-sharing. As a consequence, policyholders are entitled to underwriting as well as investment surpluses (Islamic Financial Services Board, 2009).

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3 Under a mudarabah contract a capital provider (rabb al-mal) and an entrepreneur (mudharib) conduct a joint venture (Wahab et al., 2007). In takaful, the policyholders provide the capital by paying their contributions in form of a donation to the tabarru fund. Within a pure mudarabah model the insurance operator is solely responsible for investing the tabarru fund. However, today mostly a modified mudarabah model is practiced. In that case the operator manages the investment and underwriting of risk (Wahab et al., 2007).

The pure wakalah model is a contract of agency and mainly practiced in the Middle East (Ayub, 2007). On the principle of tabarru, the insured contribute to a common risk pool and assign an agent, the wakil, for managing the fund. The wakil as a fiduciary is responsible for investment and underwriting activities of the tabarru fund. For his services he receives a pre-agreed wakalah fee upfront which is normally a percentage of the contributions. Out of this fee he has to cover his management and administration expenses as well as a profit margin for his shareholders. The wakil invests the funds in accordance with Islamic financial instruments according to Shariah. Returns are fully attributed to tabarru fund.
Sales and distribution: According to a majority of scholars, sales targets are not desirable. Agents should not sell policies that are not in the customers’ interest but rather serve their sales target. Therewith, the agent benefits at the expenses of the policyholder which is prohibited in Islam. Furthermore, all delivery channels should operate according to Shariah. Otherwise, the insurers’ funds are mingled with financial means from haram (prohibited) business. Those prohibited business are conventional financial transactions, alcohol, tobacco, drugs, prostitution, weapons, gambling, and pork (Hassan and Lewis, 2007).

Underwriting: In addition, insurers should not underwrite risks stemming from prohibited businesses either.

Investments: In Islamic finance, investments need to be free from interest (riba) and like underwriting investment categories need to adhere to Islamic law (Bekkin, 2007).

Reinsurance: Primary Shariah conform insurer have to reinsure with a retakaful company. They operate on the same principles as primary takaful insurer and fulfill the same function like a conventional reinsurer (Arbouna, 2000).

Shariah Supervisory Board: Every Islamic Financial Institutions has to implement an independent body of the company who monitors the Shariah compliance of the institution and its transactions (Islamic Financial Services Board, 2009).

Zakat: Every Muslim is obliged to share 2.5% of his assets held for one year above a certain threshold (nisab) with the needy (Lewis, 2001). In many countries this obligation also applies to companies. Hence, Islamic insurers have to either contribute to a Zakat fund or distribute their Zakat directly to the needy.
To illustrate the design and application of Microtakaful in Indonesia the next section first describes the current Microtakaful practices of the two studied insurer. Secondly, those practices are discussed with respect to Shariah compliance and microinsurance best practices. Therefore, the case studies give an answer to the question whether fundamentals of Islamic jurisprudence on insurance are compatible with the basic principles of microinsurance. Furthermore, it highlights implications for the future operation of Microtakaful and prospective market participants.

FIELD STUDY

In 2006, a demand study on microinsurance in Indonesia has been conducted with the support of the United Nations Development Program (McCord et al. 2006). It revealed that the low income people in Indonesia rely on informal risk management strategies. Insurance, neither conventional nor Shariah-conform, was available to the low income households and formal insurers were reluctant to enter the market. In several focus group discussions across the country, participants identified the death of a relative as the fourth most perilous risk. Furthermore, an estimated number of 40,000 microfinance institutions are operating in Indonesia, around 3,000 of them in accordance with the Islamic law (Seibel, 2008). These institutions manage their risk of non-performing micro-loans mostly by an increase in interest rates. A Shariah-conform credit life insurance for the low-income people was not available and only some Islamic microfinance institutions opted to insure with a conventional insurer. The introduction of a credit life insurance therefore increased risk management strategies of the microfinance institutions and the policyholders as they are not burdened by the deceased’s debt.
The Case of Asuransi A - Majority Shareholders of Muslim Origin

The first credit life Microtakaful policy was sold by Asuransi A in January 2007 after a close collaboration had been established with a domestic NGO in 2006. The NGO supports Islamic microfinance institutions who offer microcredits and savings. To develop a Microtakaful product the NGO had already formed a working group in 2005. Asuransi A and the NGO still work closely together as the NGO supports sales and services the policies.

Microtakaful in Practice: Microinsurance Best Practices

Asuransi A distributes and services its Microtakaful product with the help of:

“[…] cooperatives, community-based microfinance institutions and rural banks”.

Contact to microfinance institutions is either directly or with support of the partnering NGO who acts as an intermediary. Collaborating microfinance institutions are well established actors in the local microfinance business. They are close to the target group and generally well perceived by the poor.

The product, Mikro Satu, protects against the risk death of a loan taker. Heirs are relieved from the deceased’s debt and microfinance institutions from non-performing loans if heirs are without means. Mikro Satu covers the outstanding balance at the time a debtor dies. The product does not involve additional riders. Therewith, the benefit package is small and easy to understand for all participants. Conditions are rather simple but several causes of death are excluded and age limitations apply.

“Those exclusions are: suicide, perpetration of a crime, political risk, war, riot, invasion, terrorism, sabotage, contagious diseases, HIV, AIDS. Credit users above 65 years cannot be insured”.

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4 Manager Actuary, Asuransi A.
The insurance term matches the loan period which is usually between six month and one year. Hence, the product is short-term. Mikro Satu is offered as a mandatory group policy to microfinance institutions.

“Premiums are calculated monthly on the individual balance outstanding and paid with each installment”.

Therefore, insurance costs are diminishing and spread over a longer period which further disburdens the households. Premium rate is 0.5‰ of monthly amount outstanding and with an average loan sum of one million IDR (70.32 EUR) premium payment amounts to 5,000 IDR (0.35 EUR) which is equal to one can of soda. Pricing is identical for all microfinance institutions which are associated to the NGO but varies for microfinance institutions that are directly linked to Asuransi A.

Loan applicants simultaneously apply for insurance cover as insurance cover is mandatory for each loan taker. For loans up to 20 million IDR (1,406.28 EUR) there are no underwriting requirements. Otherwise a statement of good health is needed. For claims application microfinance institutions need a death certificate issued from local authorities. After microfinance institutions received claims notification and complete documentation 80% of the claims are settled within seven days.

The Manager Actuary of Asuransi A explained that the insurer does not train the staff of the microfinance institutions or conduct awareness campaigns for the general public. Instead its cooperation partner is doing so called “sosialisasi” activities which are a kind of road show. During informational presentations benefits of Mikro Satu and microinsurance in general are explained to potential partner microfinance institutions and their staff.

5 Head of Microtakaful Working Group, NGO of Asuransi A.
6 Head of Microtakaful Working Group, NGO of Asuransi A.
Microtakaful in Practice: Adherence to Socio-cultural Islamic principles

The company’s primary objective is to provide risk mitigation based on mutual assistance and solidarity. Asuransi A explained their vision and mission as a takaful company as follows:

“As a syariah-compliant insurance company, […] operates on the concept of cooperation, helping one another in righteousness and piety as outlined in the Qur’an. In this respect, […] considers all its participants as one big family who will protect one another and collectively shoulder the financial risks that might befall on any one member of the family.”.⁷

The insurer’s objective to provide Microtakaful is to empower microentrepreneurs. Microtakaful is an inherent part of the company’s social obligation of supporting the needy. Legally, Microtakaful operations of Asuransi A are based on a wakalah bil ujrah contract which is mandatory for Shariah approved insurances in Indonesia (Dewan Syari’ah Nasional, Majelis Ulama Indonesia, 2006). Wakala bil ujrah as illustrated below is a combination of a modified mudarabah and wakalah model. The operator receives a wakalah fee (ujrah) as well as a share of investment and underwriting surpluses.

Asuransi A distributes their retail product by conventional microfinance institutions and Islamic microfinance institutions. The insurer opted to cooperate with conventional microfinance institutions to raise awareness for the concept of Shariah compliant microinsurance. Referring to sales activities of the Microtakaful business the actuarial manager explained:

“We do not have any sales targets”.⁸

Asuransi A does not aggressively approach new microfinance institutions. Rather microfinance institutions had to approach the insurer. Underwriting is largely outsourced to the micro-

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⁷ Annual Report, Asuransi A.
⁸ Manager Actuary, Asuransi A.
finance institutions. The head of Microtakaful working group said that underwriting goes along with the loan application process and if a loan is approved the customer simultaneously receives insurance cover. Consequently, Asuransi A relies on a Shariah analysis conducted by their partnering microfinance institutions.

With respect to the companies investment and reinsurance strategy, the Head of Underwriting explained that all funds of the tabarru fund are invested in line with Islamic principles and all risk of Microtakaful is retained with Asuransi A. Microinsurance claims are small and do not exceed 20 million IDR (1,406.28 EUR). Therefore, the directive to solely reinsure with retakaful companies does not apply to Microtakaful activities of the operator.

Shariah compliance of Asuransi A is supervised by the company’s Shariah supervisory board. The board is responsible for overseeing the implementation of Shariah principles and edicts of the National Shariah Board in regard to the operational activities of the company:

“The Shariah supervisory board consists of five members. It is approved by the National Shariah Board”.

Asuransi A continuously met its Zakat obligation and established a social charity organization to manage its Zakat funds. The funds are channeled in areas of education, community healthcare, economic empowerment, and disaster relief effort. Parts of the fund have been used to introduce the product Mikro Satu.

Summary of Major Findings

Microtakaful activities of Asuransi A display a wide range of microinsurance best practices and a strong adherence to the Islamic law. The product Mikro Satu is based on market

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9 Head of Underwriting, Asuransi A.
10 Annual Report, Asuransi A.
needs as it was introduced in response to a request by an apex organization of Islamic microfinance organizations. Product design and premiums are adapted to the target group. One weakness in product design is the number of exclusions. This measure to control for moral hazard and adverse selection increases the complexity of the product and decreases its level of inclusiveness. Premiums are affordable and financial burden of households is reduced to a minimum. Administrative processes and documentation requirements are manageable for the target group which is attested by prompt claim disbursements. Mikro Satu is distributed within a strong partnership of different actors. Asuransi A provides a well-calculated product and underwriting capacities but neglects its responsibility for awareness raising campaigns or agent trainings. The latter are taken over by a local NGO who serves as an intermediary to the target market. Last actors of the insurance supply chain are microfinance institutions who are strong and well-suited retailers for a credit-life product. On the one hand the choice of distribution partners of Asuransi A increases its outreach and its outsourcing of standard underwriting activities ensures efficient operations. On the other hand those actions conflict with Islamic rulings. Most likely Asuransi A underwrites prohibited (haram) risks. Otherwise, Microtakaful practices very well adhere to the Islamic law. Practices reflect the fundamental principles of solidarity and mutual cooperation as demand fulfillment is of major concern. In contrast to formal sector takaful practices Mikro Satu is not restricted by limited retakaful or investment capacities as volume is comparatively low. An interesting fact is that Asuransi A finances its Microtakaful activities by means of the Zakat fund. This course of action is legitimate as financial resources of the Zakat fund have to be spent for the poor and needy. Microinsurance policyholders clearly belong to this category. Thus, Asuranssi A fulfills its obligation of social charity by offering its primer business services to the needy.
Microinsurance Best Practices

Micro Dua is an adaptation of a conventional credit-life microinsurance product Asuransi B had introduced eight month before. Design and delivery of the conventional products relied on the results of the demand study for the Indonesian microinsurance market. Due to this extensive market research and its prior experience Asuransi B was familiar with the specific needs of the households and their cash-flows. Micro Dua was then a response to Islamic microfinance institutions that still lacked access to insurance cover in accordance with Shariah. Hence, the product is distributed by Islamic microfinance institutions. Those are rather large and well-established microfinance institutions as a minimum annual premium of 40 million IDR (2,812.56 EUR) for one group policy is required.

Micro Dua covers the major insurable risk death of a relative. In general, the Microtakaful product covers a loan taker’s debt in case he dies. Only suicide and insurance related crimes are excluded. Eligible for credit-life insurance are all loan takers between 15 and 60, if their loan term is of maximum five years and the loan sum does not exceed 200 million IDR (14,062.80 EUR). Average loan amount is 7.3 million IDR (513.29 EUR). Therewith, common microcredits are covered. People between 61 and 65 years can be covered for an extra premium. The product is designed as a mandatory group policy. Asuransi B offers several benefit options to the microfinance institutions: Firstly, Islamic microfinance institutions can choose to either cover the outstanding balance or the initial loan amount. Secondly, the Islamic microfinance institutions can opt for an additional benefit. In that case, heirs receive twice the original loan amount. This additional benefit intends to especially support dependents in case the breadwinner of the family dies. Heirs are enabled to pay for productive assets, educational expenses or consumption needs.
Thirdly, microfinance institutions can choose for a payout in case the spouses die. The insurance term matches the credit period which is in average 20 month.11

Pricing is based on the insured group. Depending on the choice of benefit package the premium is calculated and varies between 0.24% p.a. and 0.70% p.a. Average premium per person is around 4,000 IDR (0.28 EUR) which is the price of three liters of good quality drinking water.

“Partnering Islamic microfinance institutions are responsible for premium collection and premiums are deducted at the time of loan disbursement”.12

Hence, premium payment reduces the initial loan payout but charges households at the time of additional income.

In general, coverage is directly approved by the Islamic microfinance institution:

“Underwriting requirements are kept at minimum. For loans below ten million IDR (703.14 EUR) no specific documentation is needed. Above ten million and up to 50 million IDR (3,515.70 EUR) a simple health questionnaire is needed”.13

Only loans above 50 million IDR (3,515.70 EUR), which exceed national microcredit standards, need approval by Asuransi B.

Administrative processes for the Islamic microfinance institutions are minimized:

“Once a month they transfer collected premiums to our company and up-to-date information about current policyholders. If claims have to be settled in between, Islamic microfinance institutions can

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11 Company presentation, Asuransi B.
12 Head of Micro Business Development, Asuransi B.
13 Head of Micro Business Development, Asuransi B.
deduct the claim amounts from the collected premiums and transfer the remaining balance to our company".14

Islamic microfinance institutions can directly disburse benefits up to 50 million IDR (3,515.70 EUR) to guarantee fast claims settlement. In all other cases approval by Asuransi B is required. For claims documentation the heirs have to present a death certificate as well as a claim form which has to be signed by local authorities. In addition, Asuransi B requires their Islamic microfinance institutions to disburse funds at the earliest ten days after the day of death. The intention is to influence spending behavior. If the sum insured is paid out directly after death money is rather spend for funeral celebrations than for productive means or school tuition. Asuransi B, like Asuransi A, does not invest in general awareness campaigns to socialize the concept of insurance among the public. They do

“support our cooperating Islamic microfinance institutions and our agents with trainings and marketing material. If needed we give further administrative assistance”.15

Microtakaful in Practice: Adherence to Socio-cultural Islamic principles

Asuransi B entered into the low-income market out of three motivations:

“Firstly, the insurer would like to test a new market segment that can greatly enhance its customer base. Secondly, the government’s drive to provide access to insurance for a much wider range of people in Indonesia is supported. Thirdly, microinsurance combines corporate social responsibility with a business opportunity”.16

14 Head of Micro Business Development, Asuransi B.  
15 Head of Micro Business Development, Asuransi B.  
16 Corporate website, Asuransi B.
Therewith, the insurer’s objective of microinsurance supply is business oriented. Involvement in *Microtakaful* is intended to yield profit in the short and long-term. However, to achieve profits in the *Microtakaful* market, Asuransi B serves its policyholders and facilitates the creation and operation of a risk pool based on the notions of solidarity and mutual assistance:

“According to national regulations we operate our Shariah business in form of a wakalah bil ujrah”.\(^{17}\)

To enhance the outreach of Micro Dua, sales staff has individual sales targets to fulfill. Those targets are challenging but not leading to miss-selling.

“Micro Dua is only distributed by Islamic microfinance institutions. Conventional microfinance institutions can opt for non-Shariah version of the product”.\(^{18}\)

A separated Shariah analysis of the distributors is not conducted as their Shariah compliance is assumed due to their legal status.

Like Asuransi A, Asuransi B partly outsourced underwriting. Underwriting authority for a sum insured up to 50 million IDR (3,515.70 EUR), which is the national upper bound for microcredits, is with the Islamic microfinance institutions. Consequently, Asuransi B can only partly control for Shariah compliance of underwritten risks. As insurance is only offered to Islamic microfinance institutions their business percentage of unlawful risks is assumed to be minimal. Assets of the tabarru fund are invested in Shariah deposits with Islamic financial institutions that are approved by the company’s Shariah supervisory board. Some investments with Islamic banks are interest-bearing. Reason for investment decision is a risk-return strategy and those investments are chosen that offer best return with the lowest risk.\(^{19}\)

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\(^{17}\) Vice-Head of Shariah Insurance, Asuransi B.

\(^{18}\) Head of Micro Business Development, Asuransi B.

\(^{19}\) Head of Investments, Asuransi B.
Like Asuransi A, Asuransi B does not need retakaful cover for its Microtakaful operations. The Shariah unit of the insurer is regularly monitored by its Shariah supervisory board. The independent board consists of three members:

“They supervise the performance of the company. They report the development of products and operations to the National Shariah Board”.

Until 2009, Asuransi B company did not contribute Zakat which is in line with national regulations. According to Indonesian National Council of Ulama, Zakat only has to be paid by individuals but not by companies (Adnan and Bakar, 2009). However, Asuransi B does regularly support victims of national natural catastrophes.

**Summary of Major Findings**

The characteristic feature of Micro Dua is its strong demand-orientation embodied in its flexibility in benefit options. Premium payments are adapted to the irregular cash-flows of the policyholders and administrative processes are reduced to a minimum for all parties. Partnering Islamic microfinance institutions have extensive authorities in underwriting as well as in claim settlement which enhances settlement time. Agents are trained by the insurer and suitable marketing material is provided. However, Asuransi B does not invest in education activities on insurance principles for the general public. In sum, Micro Dua comes close to microinsurance best practices. Thus, the case of Asuransi B demonstrates that an international commercial insurer can indeed successfully operate a Microtakaful program. Profit-orientation does not violate the Shariah as long as the insurer serves its policyholders by facilitating the creation and operation of a risk pool based on the notions of solidarity and mutual assistance.

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20 Vice-Head of Shariah Insurance, Asuransi B.
DISCUSSION AND IMPLICATIONS

The objective of our study is to identify an insurance mechanism for low-income Muslims in developing countries. Therefore, we highlighted fundamental principles of takaful and of microinsurance as both forms of insurance either resolve religious or economic take-up barriers of the target segment. We conducted a field study of two Microtakaful schemes in Indonesia and evaluated those practices against our theoretical benchmark. In sum, we found empirical evidence for an insurance supply that is suited for low-income Muslims. Quality of services is independent of religious background of the insurers’ shareholders.

Both Indonesian insurers, Asuransi A and Asuransi B, entered the low-income market with a Shariah compliant credit life microinsurance. The products are based on best practices of conventional microinsurance as well as on the insurers’ practice of Shariah-conform insurance. In contrast to conventional microinsurance, in Microtakaful the relationship between the policyholder and the insurer is based on the Islamic concepts of ta’awun (mutuality) and tabarru (donation). Donations given in the intention of mutual assistance in emergencies are in the collective ownership of the policyholders and managed by a commercial entity. The funds of the tabarru are invested according to Islamic investment rules. The distribution of the product is generally limited to Islamic microfinance institutions. Shariah conformity is supervised by an independent Shariah supervisory board.

Since one of insurers studied (Asuransi A) is owned by Muslim shareholders, whereas the other insurer studied (Asuransi B) belongs to an international conventional insurance company,
we are able to provide an answer to the questions whether international commercial insurers can successfully offer Microtakaful programs. The answer is “Yes” because our findings document that practices of Asuransi B adhere to socio-cultural Islamic principles as well as to microinsurance best practices. Thus, it is possible for international insurance corporations to enter an untapped Microtakaful insurance market. This finding has important implications.

First, from the point of view of the insurance industry, the emerging market for Microtakaful insurance products offers strategic growth opportunities in underserved insurance markets. Second, since there is evidence of a positive causal relationship between insurance penetration and economic growth (Outreville, 1990; Ward and Zurbruegg, 2002; Beck et al., 2007; Arena, 2008) emerging markets that are in majority Muslim can facilitate economic growth by creating incentives for international insurers to offer Microtakaful insurance schemes in their countries.

Overall, the two concepts of takaful and microinsurance complement each other well. Microtakaful provides a promising perspective for the future development of Islamic emerging insurance markets and eventually contributes to a country’s economic growth.
REFERENCES


Patel, S. Takaful and poverty alleviation.


Table 1. Comparison of Field Study Results

<table>
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<th>Panel A: Microinsurance Best Practices</th>
<th>Asuransi A – Majority Shareholders of Islamic Origin</th>
<th>Asuransi B – International Commercial insurer as Majority Shareholder</th>
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<td><strong>Distribution</strong></td>
<td>Conventional and Islamic microfinance institutions</td>
<td>Islamic microfinance institutions who can contribute a minimum annual premium of 40 million IDR</td>
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<tr>
<td><strong>Market needs</strong></td>
<td>Cover of major insurable risk</td>
<td>Cover of major insurable risk Supply is based on extensive market research and experience with conventional microinsurance</td>
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<td><strong>Product Design</strong></td>
<td>Small benefit package</td>
<td>Flexible benefit options</td>
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<td><strong>Premiums and Pricing</strong></td>
<td>Low premiums</td>
<td>Low premiums</td>
</tr>
<tr>
<td><strong>Processes</strong></td>
<td>Application together with loan application</td>
<td>Application together with loan application</td>
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<tr>
<td><strong>Market education</strong></td>
<td>No education for general public</td>
<td>No education for general public</td>
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<tr>
<th>Panel B: Socio-Cultural Islamic Principles</th>
<th>Asuransi A – Majority Shareholders of Islamic Origin</th>
<th>Asuransi B – International Commercial insurer as Majority Shareholder</th>
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<tr>
<td><strong>Vision and Mission</strong></td>
<td>Protection based on solidarity and mutual assistance; Microtakaful to support the needy</td>
<td>Commercial interest; Microtakaful to test a new market, social responsibility</td>
</tr>
<tr>
<td><strong>Operational Model</strong></td>
<td>Wakalah bil ujrah</td>
<td>Wakalah bil ujrah</td>
</tr>
<tr>
<td><strong>Sales and Distribution</strong></td>
<td>No sales targets implemented</td>
<td>Moderate sales targets Distribution via Islamic microfinance institutions</td>
</tr>
<tr>
<td><strong>Underwriting</strong></td>
<td>Largely outsourced to microfinance institutions, in case of conventional microfinance institution no conduct of Shariah analysis</td>
<td>Largely outsourced to microfinance institutions</td>
</tr>
<tr>
<td><strong>Investments</strong></td>
<td>In accordance with Islamic investment principles</td>
<td>Shariah deposits with Islamic financial institutions including interest-bearing assets</td>
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<tr>
<td><strong>Retakaful</strong></td>
<td>No need of retakaful cover</td>
<td>No need of retakaful cover</td>
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<td>Implemented and supervised by National Shariah Board</td>
<td>Implemented and supervised by National Shariah Board</td>
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<td><strong>Zakat Contribution</strong></td>
<td>Establishment of own Zakat fund and continuous contribution</td>
<td>No payment of Zakat</td>
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