Old wine in new casks

The case of Takaful: an interest-free participation-based insurance system

By Florence de Vries

It is difficult to believe that in this modern world, with all the technology at its disposal, financial product providers sometimes reverts to antiquated financial principles in designing new products.

Global alternative financing systems like Islamic finance is not a new concept. The Financial Times explains that the main principle of Islamic finance is its adherence to interest-free financial transactions. Other principles include the prohibition of fixed returns, profit and loss sharing (or risk sharing) and participatory financing. This model has been around since the early 1960s and has at the heart of it, the objective of developing and providing alternative financial contracts in conformity with Sharia principles as necessitated by Islam.

This form of banking was introduced by banks the world over, with a variety of South African banks such as alBaraka Bank and Absa having climbed on board. Financial analysts have written about this form of alternative financing systems extensively with Turkish analysts recently arguing that these financing systems present a viable alternative to the conventional banking system as we understand it.

In Turkey, specifically, the concept of interest-free financial instruments has taken off over the past twenty years – all to the benefit of its participants.

The latest development is the establishment of an interest-free participatory insurance system – also known as 'Takaful' – which is a system of insurance based on Islamic principles of mutual assistance and donation.

The word 'Takaful' means "joint guarantee" and sees a group of participants contribute toward a pool of money and mutually agree to protect each other by compensating those who suffer a loss or damage. This is very much in line with where insurance started so many ages ago. Wikipedia provides the following examples:

"The first methods of transferring or distributing risk in a monetary economy were practised by Chinese and Babylonian traders in the 3rd and 2nd millennia BC, respectively. Chinese merchants travelling treacherous river rapids would redistribute their wares across many vessels to limit the loss due to any single vessel's capsizing. The Babylonians developed a system that was

recorded in the famous Code of Hammurabi, c. 1750 BC, and practised by
early Mediterranean sailing merchants. If a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the shipment be stolen or lost at sea.

Broadly speaking, there are two primary stakeholders in the “interest-free” insurance system: The policyholder and the insurance business who manages the insurance scheme on behalf of policyholders. The latter is typically backed by larger shareholders with specific duties, including underwriting and investing the pool of funds.

In this system, policyholders – rather than shareholders - benefit from profits generated by the sale of insurance products and services and moreover, premiums are collected in a risk fund which belongs to all the participants. Any surplus left in the fund at the end of the year is paid out to those participants (as opposed to being retained for profit by the insurance company). This principle in particular presents an interesting alternative to the conventional insurance company’s ‘cash bonus’ which is paid out at the end of a specified period within which the insured person did not register a claim.

The regulatory and legal infrastructure of interest-free participation banks in Turkey has already been set up and completed and the new insurance system was introduced to provide an alternative model for citizens who don’t like traditional insurance products due to interest and the participation principle sensitivities.

Intended to be a solution to mobilise better financial inclusion, the ‘Takaful’ insurance model presents an interesting and innovative example of how traditional religious principles can be applied to modern financial systems. Turkish interest free financial services has really taken off over the past two decades and is said to be one of the most advanced systems in the world.

With so much attention being given to financial inclusion in the new regulations being introduced, this may very well be another way of achieving it.

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