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Microtakaful as an Islamic Financial Instrument, for Poverty Alleviation in Iraq

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Abstract: Poverty is still prevailing in Iraq despite the Government's efforts to implement programs to fight poverty in the country. Many researchers suggest that access to insurance services is an important strategy for poverty reduction. However, the poor and low-income households are often ignored or inadequately serviced by the private insurance market and social insurance schemes because the premiums are unaffordable. A specific type of insurance particularly developed to protect the poor and low-income households is microinsurance, or a *shari'ah*-compliant form of microinsurance known as microtakaful. Therefore, this paper considers microtakaful as an Islamic financial instrument for poverty alleviation to protect the poor and low-income households in Iraq. The objective of this paper is to propose a microtakaful model integrating the microtakaful scheme with the financial supports from the Government, Islamic institutions of *zakat* and *waqf*,contributions from the international *zakat* organisations and donationsinto a cooperative common pool of funds managed by the takaful operator or a microtakaful institution, which will be used to compensate participants in the event of loss.

Key words: Microinsurance · Microtakaful · Microtakaful model · Poverty alleviation

INTRODUCTION

Iraq has historically been one of the most prosperous Arab nations. It is a country that is blessed with a wealth of natural resources. Iraq, with 144.2 billion barrels of proven oil reserves [1], has the fifth largest oil reserves in the world and the third largest in the Middle East. The country produces 3.6 billion barrels of oil per day. The economic growth has steadily increased and Iraq is now an Upper Middle Income Country based on World Bank ranking of economies.

Nevertheless, poverty is still prevailing in Iraq and is rampant in rural areas. Although the statistics released by the Iraqi Ministry of Planning indicated that the rate of poverty in Iraq has recently decreased to 11-percent, however the Iraq Household Socio-Economic Survey II (IHSES 2012) by the World Bankfound that 18.9-percent of Iraqi families live below the poverty line of 105,500 Dinars per capita per month. Rural poverty is consistently higher than urban poverty – 30.6-percent of the rural population lives below the national poverty line compared to 14.8-percent of the urban population [2].

While 18.9-percent is the official figure by the World Bank, but according to Layth Mahdi [3], the real number exceeds 35-percent. The Iraqi people have endured a lot of hardship and suffering during the last four decades of war, in addition to crippling sanctions. As reported by Amal Sakr [4] in Al-Monitor, the Governor of Baghdad, Ali al-Tamimi affirmed that the poverty rate in Iraq is very high and the Iraqi government is not able to provide genuine solutions to deal with the poverty crisis in the country.

The Ministry of Planning has implemented several programs aimed to reduce poverty in Iraq. In 2010, it started a five-year program (2010 to 2014) in hopes to bring the poverty level down to 10-percent. However, the Ministry has admitted that its plans have failed to achieve their objectives [3].

According to Bakhtiari [5], access to insurance is an important strategy for poverty reduction. However, the poor and low-income households are often ignored or inadequately serviced by the private insurance market and social insurance schemes because the premiums are unaffordable. Furthermore, Cohen and Sebstad [6] suggested that providing aid in the form of insurance is

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Table 1: Differences between takaful and microtakaful

	Takaful	Microtakaful
Market	Policyholders are from middle and high-income households.	Policyholders are the poor and low-income households, often working in the informal economy and outside of the social insurance coverage with irregular incomestreams.
Market awareness	Market is largely familiar with insurance.	Market is largely unfamiliar with insurance
Contributions (premiums)	Based on age or other specific risk characteristics.	Low contributions and affordable.
Affordability considerations	Contributions are paid by policyholders.	Contributions may be paid in full or partly by a subsidy from *zakat* funds, *waqf* funds or the Government.
Sums Insured	Large sums insured.	Small sums insured.
Policy Document	Complex policy document with many exclusions.	Simple and easy to understand policy document with a few or no exclusions.
Claims handling	Claims process for large sums insured may be quite complicated.	Simple and fast procedures to small sums, yet still controls fraud.

far better off in providing social protection rather than allotment in cash. A specific type of insurance particularly developed to protect the poor and low-income households is microinsurance. Microinsurance is like any other traditional insurance is a risk-sharing mechanism in which premiums are paid by all members of the insurance scheme and this pool of premiums is used to reimburse those members of the scheme who suffer losses caused by risks such as natural catastrophes, illness, injuries and death. The difference between microinsurance and traditional insurance is that microinsurance provides affordable and accessible insurance to the poor and low-income households who cannot gain access to traditional forms of insurance.

Takaful and microtakaful are the Islamic alternatives to conventional insurance and microinsurance. The 1985 Fiqh Academy of the Organisation of the Islamic Conference (OIC) issued its *fatwa* declaring that the conventional insurance contract is *haram* due to the presence of the elements of *gharar* (excessive uncertainty), *riba* (interest) and and *maisir* (gambling). Insurance is only permissible in Islam when undertaken in the framework of *takaful* (mutual guarantee) and *ta'awun* (mutual cooperation). In order to eliminate the element of *gharar* and *maisir* in the takaful contract, the concept of *tabarru'* (donation) is incorporated in it. As with conventional microinsurance, microtakaful is a mechanism to provide *Shari'ah*-based protection to the poor and low-income households at an affordable cost. Table 1 illustrates the distinct differences between takaful and microtakaful.

The Need for Microtakaful in Iraq: Approximately 23-percent of the world's population is Muslim. Current estimates conclude that the number of Muslims in the world is around 1.6 billion. Numerous researches [7, 8] have shown that insurance[1] and takaful ownership rates in countries with majority Muslim populations are still very low.

A report released by [8] indicated that the average insurance and takaful penetration of Middle East-North Africa (MENA[2]) countries is 1.06-percent of gross domestic product (GDP) compared to a global average of about 6.50-percent. This is in contrast to the economic prosperity of some Middle East countries such as Saudi Arabia and United Arab Emirates (UAE) where the GDP per capita is among the highest worldwide and yet insurance and takaful penetration is not commensurate with the high GDP. In Iraq, the insurance and takaful penetration rate is estimated at only 0.08-percent, one of the lowest in MENA countries. Table 2 shows the insurance penetration rates in MENA countries as measured by premiums as a percentage of GDP.

The reasons for low insurance and takaful penetration in Muslim countries are mainly due to underdeveloped insurance market, attitude towards risk, consumer scepticism, lack of awareness and non-availability of disposable income. Some people may be aware of insurance and takaful needs but cannot afford to purchase the required protection.

[1] While conventional insurance companies operate in Islamic countries, their services are limited to commercial needs and to the elite sector of the population.

[2] All countries in the MENA region have populations with a high percentage of Muslims.

Table 2: Insurance and Takaful Penetration Rates in MENA Countries for the Year 2012

MENA Countries	Insurance and Takaful Penetration (%) (Premiums as a Percentage of GDP)
Morocco	2.95
Lebanon	2.85
Jordan	2.13
United Arab Emirates (UAE)	1.98
Bahrain	1.97
Tunisia	1.80
Iran	1.65
Palestine	1.45
Turkey	1.37
Oman	1.01
Saudi Arabia	0.75
Egypt	0.73
Syria	0.69
Algeria	0.67
Qatar	0.63
Kuwait	0.50
Sudan	0.50
Libya	0.27
Yemen	0.23
Iraq	0.08
Average (MENA)	1.06
Asia	5.73
Europe	6.73
World	6.50

Source: AIG, 2013. MENA Insurance markets: A mini guide. Singapore: Middle East Insurance Review

Although Iraq is an upper-middle income country, but more than 35-percent of the population lives in poverty. Some Iraqi families are still struggling to afford food[3] and their basic needs. Those in the middle and high-income groups who can afford, are either not convinced or are not interested because lack of awareness about the insurance and coverage. As a result, most Iraqis are unable to participate in insurance or takaful schemes. Therefore, one of the solutions to tackle low insurance penetration in the country especially among the poor and low-income households is to embrace microtakaful.

Another reason to establish a microtakaful scheme in Iraq is to provide some social protection needs to those with low-income and excluded from formal social security schemes. Of particular interest, it is the provision of cover to persons working in the informal economy who do not have access to social protection benefits provided by employers directly, or by the Government through employers [9].

El-Mekkaoui and Johnson [10] studied the formal and informal social protection system in Iraq using empirical data from a household survey. They examined the access for Iraqis to social security schemes, health insurance and retirement benefits. The research found that only wage-earning employees in the formal sector are able to receive some form of formal and informal insurance. However, less than half of these individuals are covered.

Before discussing microtakaful as a mechanism to extend coverage of the existing social protection system, it is useful to understand the social security schemes in Iraq. Basically, there are three different categories of formal social protection system provided by the Government of Iraq: the Public Distribution System (PDS), the Social Protection Net (SPN) and job-related benefits such as pension scheme. For many years, Iraq spends a great deal on its social security, for instance 8.8-percent of GDP for the combined budgets of the PDS and SPN in 2008 [11]. Likewise, Iraq spends a large percentage of its budget on pensions, for example in 2010 more than 4-percent of GDP went to pensions [12].

Public Distribution System (PDS) is a primary social protection system in Iraq. The entire population of Iraq is eligible to receive the food ration. Every Iraqi, irrespective of income level, is entitled to a monthly food ration for a small nominal fee. Because the PDS is available to all Iraqis and not only to the poor, it is very inefficient as a social security scheme [11]. First, asitis universal, it does not target the poor or vulnerable households. Because of its size, it has caused some distortions in the food market that have depressed food prices and thus hurt rural farmers. Farmers are of particular concern because they comprise such a large fraction of the rural poor [11].

In order to better target social protection to the poor and reduce poverty, a cash-based program known as the Social Protection Net (SPN) was introduced in 2004 by the Ministry of Labour and Social Affairs (MOLSA).SPN targets individuals belonging to particular groups that are believed to be vulnerable including the disabled, or phaned children, divorced or widowed women, married male university students, families of the imprisoned and missing persons, those unable to work due to terrorism and the internally displaced. A report by [11] shows that these categories are not good predictors of poverty. The program does not effectively target the poor and low-income households and only reached less than 10% of the poor. In fact, two-thirds of those who receive

[3]The United Nations has estimated that 6-percent of the Iraqi population are food deprived and a further 14-percent are vulnerable in terms of food security.

benefits live above the poverty line. For this reason, a mechanism to provide social and risk protection should be available to lower the vulnerability of the poor population of Iraq.

While workers in both formal and informal economy are eligible for the PDS and the SPN, other formal social protection schemes such as pension and healthcare benefits are only limited to workers in the formal economy. According to [12], only around 25-percent of the total workers in Iraq are covered by a mandatory pension system. Most of them are public sector workers and only around two-percent of the workers in the private sector are covered. Pension benefits are relatively generous, but they primarily assist those living above the poverty line. In most cases, the working poor in the informal economy are excluded to receive pension and retirement benefits. In this case, microinsurance (and microtakaful) can be a substitute for pension benefits in contexts where the Government does not have the capacity to extend the coverage to those in the informal economy [13].

In order to reduce the risk of poverty traps, El-Mekkaoui and Johnson [10] suggested that policy makers could try to increase the options of both formal and informal social protection mechanisms available to the poor in Iraq. Therefore, microtakaful can be an effective mechanism to protect the poor and low-income households against the financial consequences of death and illness. Microtakaful scheme enable takaful to become much more acceptable and accessible to the poor.

Defining Microinsurance and Microtakaful: Micro insurance is a relatively new concept and appeared very recently. The word 'microinsurance' itself being used for the first time about 15 years ago even though the concept of insurance have been found as far back as the Iraq's ancient law code, Code of Hammurabi, created by the Babylonian King Hammurabi (1792–1750 BC).

According to Ingram and McCord [14], the first definition of microinsurance appears to have been published in 1999 by Dror and Jacquier [15] as part of an article titled *Microinsurance: Extending Health Insurance to the Excluded*. They defined 'micro' as the level of society where the interaction is located, that is smaller than national schemes and 'insurance' refers to the economic instrument.

It is important to be clear that microinsurance is insurance and more simply is a special category of insurance and not a new category of insurance. As such it is defined as either life microinsurance or non-life microinsurance policies that provide protection to the poor and low-income households against specific risks in exchange for a regular payment of premiums that are calculated proportional to the likelihood and cost of the relevant risk. This pool of premiums is used to reimburse those members of the microinsurance scheme who suffer losses from a pre-defined set of perils.

As the microinsurance aims at protecting the poor and low-income households, there is an element of a social protection system, similar to social insurances and national health insurance schemes. A study commissioned by the Social Protection Working Group of the Microinsurance Network addresses the potential and roles of microinsurance within a broader social protection framework in a country.

Warren Brown and Craig Churchill [16, 17] in their two-volume research report, *Providing Insurance to Low-Income Households* comprehensively discussed on microinsurance as insurance that is intended for the poor and low-income households. The first volume of the report, *Part I: A Primer on Insurance Principles and Products* provided a framework for thinking about microinsurance and identified the principals involved in offering insurance to the low-income market [16]. The second volume of the report, *Part II: Initial Lessons from Microinsurance Experiments for the Poor* analysed practice in relation to these principles [17]. This report discovered three insurance products to protect against three of the major risks facing low-income communities-death risks, health risks and property risks. With in each type of insurance for the risks, that is life insurance, health insurance and property insurance; the research suggested that life insurance is the most widely available and proven type of insurance in low-income markets. The lower frequency of death risks and the reduced administrative complexity in managing life insurance make it a safer, easier form of coverage than health and property insurance.Health and property insurance have proven much more difficult than life insurance to provide on a fully sustainable basis.

Consultative Group to Assist the Poor (CGAP) [18] in the *Preliminary Donor Guidelines for Supporting Microinsurance Insurance* explained that insurance products for the low-income must satisfy the specific needs of the poor, be easy to understand and efficient to administer. The more complicated the product, the less likely that it will succeed. The report summarised common insurance products with an indicator of their complexity as shown in Figure 1

Type of Insurance	Protection Provided	Complexity of Product
Crop Insurance	Poor crop yields due to specified causes, natural disaster recovery.	Highly Complex
Health	Medical costs for illnesses and injuries	
Annuities, Endowment and Whole Life	Savings accumulation, retirement and premature death	Complex
Property	Damage, destruction and theft of household assets	
Term Life	Loan principal and interest paid, benefit paid to beneficiaries, burial costs	Moderate
Disability (for loans)	On-going loan payments if borrower becomes seriously disables	
Credit Life	Loan principal and interest paid on death of borrower	Simple

Source: Consultative Group to Assist the Poor (CGAP), 2003. Preliminary donor guidelines for supporting microinsurance. CGAP Working Group on Microinsurance, Washington, DC: Consultative Group to Assist the Poor.

Fig. 1: Relative Complexity of Different Types of Insurance Products

The differences in complexity are related to the ability to efficiency and effectively manage the controls on the product. Moreover, low-income households consistently identify the loss of a breadwinner or sickness of a family member as their greatest concerns. Disability is also important but often subsumed under health. Therefore, this paper focuses on life microinsurance, particularly the term life and credit life as a social protection mechanism for the low-income market in Iraq.

A type of microinsurance that is compliance with *Shari'ah* principles is called microtakaful. By definition, microtakaful is a mechanism to provide *Shari'ah*-based protection to the poor and under-privileged individuals at affordable costs [19]. As mentioned above, microinsurance (or microtakaful) is a type of insurance (or takaful) aimed at protecting the poor and low-income households. Therefore, all takaful products, for example family takaful and general takaful can be delivered to the poor with some modifications-affordable premiums and it may need additional funds, such as institutionalised *zakat* funds and Government subsidies to provide effective and comprehensive financial protection to the poor.

The first microtakaful scheme was established in 1997 in Lebanon by the Lebanon Agricultural Mutual Fund, which provides health insurance coverage and meets costs not covered by the Government Social Security Fund, which usually covers 85-percent of hospital fees. The fund covers more than 5,000 families (23,000 beneficiaries) with premium of US$10 per month for each family. Those who cannot afford the premiums are sponsored by local villagers or other policyholders [20].

Though less prevalent than conventional microinsurance, microtakaful products have developed in countries such as Bahrain, Bangladesh, Indonesia, Jordan, Malaysia, Morocco, Pakistan, Sri Lanka, Trinidad and Tobago, Somalia and Sudan-countries where the takaful sector is already well-established.

Developing a Microtakaful Model for Iraq: The insurance industry in Iraq is dominated by three state-owned companies that benefit from being the sole provider of insurance services to the Government. The largest state-owned company is the National Insurance Company, which is one of the oldest insurance companies in the Middle East. The second largest state-owned is the Iraq Insurance Company, which was writing exclusively life before 1998. The reinsurance business is written by the state-owned Iraq Reinsurance Company, acting as the main reinsurer of the market. Apart from these three state-owned insurance companies, there are 19 privately-owned insurance companies in Iraq.Some of the private-owned insurance companies are very small and have a low capital base, which limit their ability to underwrite large risks. The operation of insurance in Iraq is governed by the Insurance Business Regulation Act 2005. This act applies to all insurance companies, reinsurance companies and intermediaries practicing insurance business in Iraq whether state-owned, private-owned or foreign companies.

Although there are numbers of insurance companies in Iraq, the insurance industry in Iraq is still underdeveloped. The insurance density and penetration is very low and ranked the lowest among MENA countries. Despite Iraq is a Muslim country with 97-percent Muslims, takaful has not been able to grow substantially in Iraq. This should not be a reason not to introduce microtakaful in protecting the poor and low-income households. It is necessary to develop an insurance culture among the low-income market and introduce products that, at least provide life and accident protection. Microtakaful can be effective even in markets with little experience of takaful, as long as products, procedures and policies are simple, the premiums are low, the administration is efficient and distribution channels are innovative [21].

The development of microtakaful in Iraq requires financial support from the Government and other contributors. The Government should urge insurance companies, both state-owned and private-owned to design microtakaful schemes to the poor. These microtakaful schemes also should have a social protection element, in which the Government subsidies the premium contributions for the poor and low-income who cannot afford to buy the policy. Therefore, without Government intervention in the form of subsidy or like wise, it is unlikely microtakaful schemes will be successful. The Government subsidies could be financed out of general taxation revenues. It is also important to integrate microtakaful schemes with *zakat, waqf* and donations from various funding organisations and Non-Governmental Organisations (NGOs), as well as charitable and benevolent bodies.

Islam establishes *zakat* as a compulsory for all financially able Muslims. *Zakat* is an annual tax put on idle assets, which have not been put to productive use for a period of one year. It is a unique instrument for poverty alleviation. *Zakat* does not refer to donations given out of kindness or generosity, but to the systematic giving of 2.5-percent[4] of person's wealth each year to benefit the poor[5]. *Zakat* fund institutions in every province in Iraq are legal entities that enjoy financial and administrative autonomy. These *zakat* fund institutions comprise of clerics, local Government representatives and social activists. However, these institutions are supervised by the Ministry of Religious Endowment and Affairs. According to [20], *zakat* could be used to pay the premiums of the microtakaful policies. This is the path chosen by the Selangor Zakat Centre in Malaysia, which has set up the Collective and Intensive Takaful Fund, funded by a monthly deposit deducted from the payments made to the poor. Therefore, in the proposed microtakaful model for Iraq, I suggest that the local *zakat* fund institution to subside fully or partly the contributions (premium) on behalf of the poor and low-income participants in themicro takaful scheme.

Another possible way is to explore international *zakat* organisations that professionally and efficiently run and leverage on the wealthy into the microtakaful arrangement. Some of the international *zakat* organisations are the International Zakat Organisation (IZO), which is an international *zakat* body under the Organisation of the Islamic Conference (OIC), International Waqf and Zakat Foundation and Zakat Foundation of America. It is recommended that the microtakaful provider seeks partnership with the international *zakat* organisations to utilise *zakat* fund in order to subsidise the contributions on behalf of the poor and low-income participants. This is important in order to reduce the cost of premiums to an affordable level for the poor to purchase.

In addition to *zakat*, which is obligatory, *waqf* as a voluntary charitable donation is also capable of playing important role in alleviating poverty through microtakaful. It refers to the dedication of some valuable goods, for example a building, a plot of land or even cash, such that it no longer belongs to anybody and cannot be bought or sold to fund projects for the long-term benefit of the community and the poor. The profits which are then generated from projects funded by *waqf* are given away

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[4]The 2.5-percent rate only applies to cash, gold and silver, and commercial items. There are other rates for farm and mining produce and animals.

[5]Another type of zakat is zakat-ul-fitr, which is obligatory for every person including any children or elderly persons, to pay in the Islamic holy month of Ramadan. The purpose of the zakat-ul-fitr is to help the poor to celebrate the festival of breaking the fast (eid-al-fitr) along with the rest of the Muslims. Therefore, I exclude zakat-ul-fitr in the model.

as charity. In Iraq, *waqf* is administered by the Ministry of Religious Endowment and Affairs. Presently, the Government of Iraq maintains *waqf* funds for religious purposes, for instance to fund the construction and maintenance of religious sites and pay the salaries or imams.

As *waqfs* are generally in the form of fixed assets, such assets are often under-utilised. Abdul Hasan [22] presents an integrated approach on how traditional *waqf* institutions can be revitalised through innovations. *Waqf* certificates of different denominations could be issued to raise the cash, so that a number of individuals or institutions may buy them and finance the development projects.Funds accumulated through the cash *waqf* can be used as an initial fund for a microtakaful scheme. Therefore, it is important to integrate *waqf* into the microtakaful model.

At the same time, many donors started to fund microinsurance (and microtakaful) and this have increased significantly in recent years. Some organisations and NGOs are offering grants in order to help takaful operators and microinsurance (and microtakaful) institutions develop new microinsurance products and models by covering their start-up costs. Donors and grant providers include World Bank, International Labour Organization (ILO), Government funded initiatives such as the *Deutsche Gesellschaft für Internationale Zusammenarbeit* (German Federal Enterprise for International Cooperation) and State Secretariat for Economic Affairs (SECO) of Switzerland; development banks such as Asian Development Bank and Inter-American Development Bank; insurance and reinsurance companies' charitable organisations such as Z Zurich Foundation and Munich Re Foundation; as well as NGOs like Humanist Institute for Cooperation with Developing Countries (HIVOS), Cooperative for Assistance and Relief Everywhere (CARE) International and Oxfam International.

Donations should be used on research and product development of the microtakaful scheme. The remaining fund balance should be used to sustain the microtakaful scheme and should not be channelled to the participants as subsidies. This creates financial independence on external assistance. Otherwise, the microtakaful scheme may find itself in severe difficulty or having to raise premiums beyond the reach of its policyholders, if the donor decides to reduce or cease the funding. For example, the GLICO life policy with an endowment rider in Ghana had significant donor input through CARE International in its research and development phase. This collaboration produced a product that was well received, though marketing requires invigoration. Without donor input, GLICO would probably not have entered thelow-income market.

Therefore, the objective of this paper is to propose a microtakaful model integrating the microtakaful scheme with the financial supports from the Government, Islamic institutions of *zakat* and *waqf*, contributions from the international *zakat* organisations, donations and grants.

A Microtakaful Model: Takaful *Tijari* or Takaful *Ta'awuni*?: In general, there are two forms of Islamic insurance models-takaful *tijari* (business) and takaful *ta'awuni* (mutual cooperative insurance).

The operation of takaful within the takaful *tijari* model can be structured on a number of models. At a global level, there are two standard takaful models applied, namely the *mudarabah* model and the *wakalah* model. Another model prevalent in practice is the hybrid model-combination of these two models. The other model and most recent model gaining popularity constitutes the *waqf* model.

The *mudarabah* model is based on profit-sharing principles between participants and the takaful operator. The takaful operator manages the operation of the takaful fund in return for a share of the surplus on underwriting and a share of profit from investment. It was introduced in the Malaysian market in 1984 and is now mainly applied in the Asia-Pacific region. Figure 2 illustrates the *mudarabah* model in family takaful.

The *wakalah* model, generally practised in the Middle East, is essentially an agent-principal relationship, where the takaful operator acts as an agent on behalf of the participants and manages the takaful fund in return for apre-agreed fee, referred to as *wakalah* fee. The takaful operator manages the operations [6]entirely with in the disclosed *wakalah* fee. In addition, the takaful operator may charge a performance-based fee, which is its incentive to manage the fund as well as possible. Thus, the *wakalah* model can be viewed as transparent as fees are clearly related to operator's operational costs. Figure 3 illustrates the *wakalah* model in family takaful.

An extension of the *wakalah* model is the *wakalah-waqf* model (also frequently referred to as *waqf* model), in which the risk related component of the takaful contributions is pooled in a separately formed *waqf* fund.

[6] Operating expenses may include salaries, overhead, agent's commissions and marketing expenses.

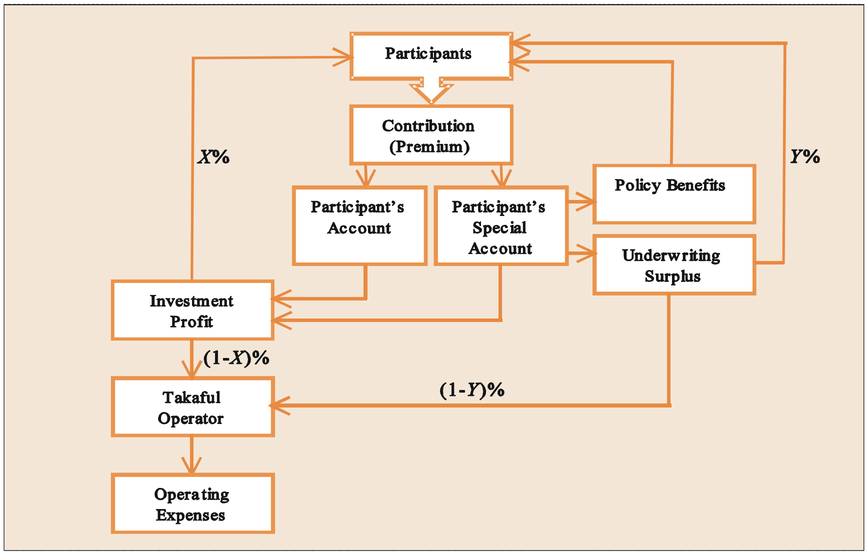

Fig. 2: The Mudarabah Model

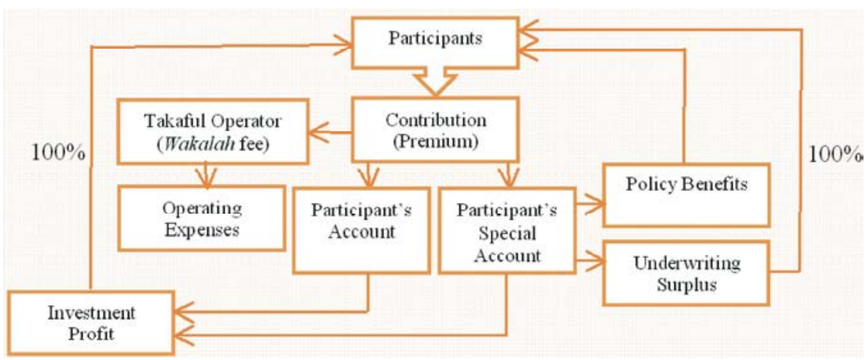

Fig. 3: The Wakalah Model

This model has been implemented by takaful operators in Pakistan, South Africa and some other countries.Under the *waqf* model, the takaful operator initially makes a donation to establish the *waqf* fund. After creation of the fund, the takaful operator loses their ownership rights on the *waqf* fund. However, they have the right to administer the operations of the *waqf* fund in return for a *wakala* fee. The contributions received from the participants will also be deposited into this *waqf* fund and the combined amount will be used for investment. To comply with the concept of *waqf*, the initial donation may not be used to settle claims. The *waqf* fund may accumulate reserves from both contributions and the profit earned on their investment and these remain assets of the *waqf*. Unlike the *mudarabah* or *wakalah* models, the *waqf* fund in this model is not owned directly by either the takaful operator or the participants and there is no mechanism to distribute any surplus fund.

Now, the question is, should we use the same takaful *tijari* model such as the *mudarabah* model, *wakalah* model or *waqf* model for microtakaful?

Theoretically, takaful is perceived as cooperative insurance. The purpose of takaful is to uphold the principles of brotherhood and solidarity, which provides mutual financial aid and assistance to its participants in the event of mishap and difficulties.In microinsurance and microtakaful, profit is not a prime consideration. For example, microinsurance institutions providing health care in developing countries are focusing on service provision and not to make profits. However, any profits are used to build up a reserve, improve the quality of service or to reduce its members' contributions [23].

Therefore I propose the microtakaful model for Iraq should be developed based on takaful *ta'awuni* (cooperative insurance) principles. In practice, the cooperative model is not common as it does not allow profit for the takaful operator. However, it would be an excellent choice for a Government interested in helping segments of the population to help themselves to be insured in an Islamic manner [24].

Under *mudarabah* and *wakalah* models as shown in figures 2 and 3, the participant pays a contribution to the takaful operator, who splits this into two accounts-Participant's Account for the purpose of savings and investment; and Participant's Special Account as *tabarru'* (donation) for the purpose of mutual help. The funds in the Participant's Account belong to the individual participant, where as amounts in the Participants' Special Account become a community pool of money for assistance against the covered risks. This community-pooled account operates in a manner similar to cooperative insurance. In this paper, I propose a non-profit cooperative insurance model where contributions are made from participants, as well as contributions from the Government and society[7]. These contributions from the Government, *zakat* funds, *waqf* and donations should be managed by trustees.

A Proposed Microtakaful Model for Iraq: In theory, discounted premium, perhaps with the help of Government or donor subsidies can stimulate demand for microinsurance. The proposed microtakaful model contains the element of contribution (premium) subsidies. This is important to ensure that the poor are covered and contributions are paid on time; and hence to reduce lapse rate which in many instances that the lapse experience among microinsurance policyholders and microtakaful participants are exceptionally high.

Mutual cooperation (*ta'awun*) is achieved through contributions from participants to a cooperative common pool of funds managed by the takaful operat or or a microtakaful institution. This cooperative common pool provides a mechanism for sharing all claimsto compensate participants in the event of loss, pay retakaful contributions and to build contingency reserve.

The proposed microtakaful model also should have a social protection element, in which the Government subsidies the contributions for the poor and low-income who cannot afford to buy the coverage. As suggested by Brugnoni [20], *zakat* also could be used to pay the contributions of the microtakaful policy. Participants in the microtakaful scheme will of course eligible to receive *zakat* themselves. However, in order to achieve this in the context of Iraq, *zakat* fund should be properly collected and managed by the Government of Iraq through the Ministry of Religious Endowment and Affairs. It isimportant to create a separate fund to provide subsidy resources to the poor and low-income, I name it as a subsidy fund that will be made up from the Government contributions and *zakat* fund.

In this model, I propose the integration of microtakaful scheme with contributions from the international *zakat* organisations, *waqf* fund, donations and grants from NGOs, as well as charitable and benevolent bodies. These contributions provide the initial capital of a fund, which can be nominal – a fund that I name as charitable trust fund, which should be managed by trustees. The purpose of the charitable trust fund is divided into two parts. The first part is to cover expenses for initial administrative, research and product development of the microtakaful scheme, to explore potential distribution channels and to create a roadmap to promote microinsurance in Iraq. Since some donations and grants are one-off financial contributions, some recurring and others spread over two or three years; thus to create financial independence on external assistance, this fund should only cover the start-up costs.

Any recurring donations, together with any surpluses from the cooperative common pool will be kept in the charitable trust fund. Zainal Abidin [25] proposes to spend the surplus for the benefit of the community as means of promoting solidarity, for example to be used for the purpose of creating awareness of the benefits of the microtakaful scheme.

Operate on the same principle as the *waqf* fund of the takaful *waqf* model; the other part of the fund should be managed with the intention that it will be preserved over time not with standing that it may be temporarily use by the participants' fund to meet temporary deficits due to fluctuating claims experience [25]. In this context, the participants' fund is the cooperative common pool. When the cooperative common fund runs into a deficit, the charitable trust fund provides *qard hassan*(interest-free loan) to the cooperative common fund to cover the deficit. The *qard hassan* will be repaid when the pool returns to profitability with no extra charge.

As I mentioned earlier, the proposed microtakaful model is a non-profit cooperative insurance program where profit is not an operational goal. However, this program could positively increase the image and reputation of the microtakaful operatorand the microtakaful institution in the eyes of customers as well

[4] As mentioned in the previous sub-section, in the proposed microtakaful model, I integrate financial supports from the Government, Iraqi zakat funds, contributions from the international zakat organisations, waqf, donations and grants.

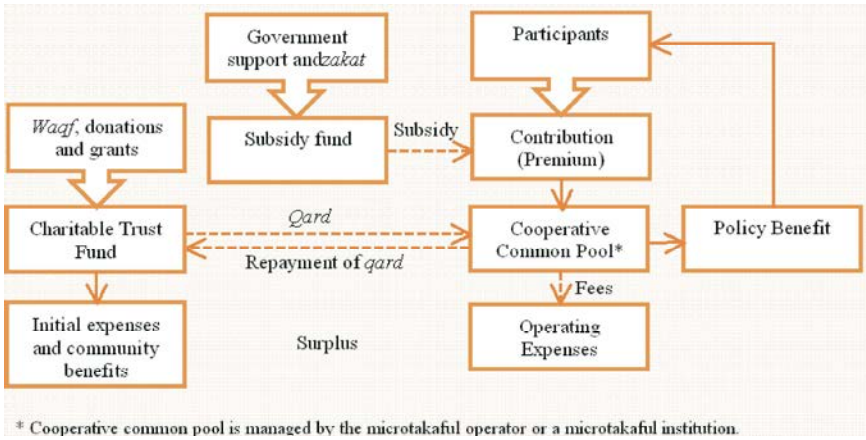

Fig. 4: The Proposed Microtakaful Model

as the Government and regulatory bodies. In addition, the social impact of helping to alleviate poverty can attract new investors as well as talent, which build further value to their business line.

CONCLUSION

Recently microinsurance has captured the attention of policy makers, international development agencies, Non-Governmental Organisations (NGOs) and donor agencies. The International Labour Organisation (ILO) and a number of Governments have endorsed microinsurance as an instrument for poverty reduction and social development. This paper proposes Islamic microinsurance, where it is known as Microtakaful as a mechanism to provide *Shari'ah*-based protection to the poor and low-income Iraqis against specific perils in exchange for low premiums. However, protection for the entire population is only possible if the proposed microtakaful scheme is integrated into existing social security systems in Iraq.

For microinsurance to succeed in Iraq, a partnership or collaboration is needed between the Government, NGOs, community organisations and microtakaful operators. The development of microtakaful schemes in Iraq requires financial support from the Government, *zakat* funds, contributions from the international *zakat* organisations, *waqf*, donations and grants from organisations and NGOs, as well as charitable and benevolent bodies. Once these microtakaful schemes become available, the poor and lower-income households would need to be educated on the benefits of microtakaful, which the local community organisations may be able to provide a means of distribution.

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