

Disaster Risk Financing  
& Insurance Program



SUPPORTED BY  
WORLD BANK GROUP



Global Shield  
Financing Facility



# Horn of Africa DRIVE Takaful

FAQ

DECEMBER 2023

© [2024] International Bank for Reconstruction and Development / The World Bank  
1818 H Street NW  
Washington DC 20433  
Telephone: 202-473-1000  
Internet: [www.worldbank.org](http://www.worldbank.org)

This work is a product of the staff of The World Bank with external contributions. The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of The World Bank, its Board of Executive Directors, or the governments they represent.

The World Bank does not guarantee the accuracy, completeness, or currency of the data included in this work and does not assume responsibility for any errors, omissions, or discrepancies in the information, or liability with respect to the use of or failure to use the information, methods, processes, or conclusions set forth. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Nothing herein shall constitute or be construed or considered to be a limitation upon or waiver of the privileges and immunities of The World Bank, all of which are specifically reserved.

## RIGHTS AND PERMISSIONS

The material in this work is subject to copyright. Because The World Bank encourages dissemination of its knowledge, this work may be reproduced, in whole or in part, for non-commercial purposes as long as full attribution to this work is given.

Any queries on rights and licenses, including subsidiary rights, should be addressed to World Bank Publications, The World Bank Group, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2625; e-mail: [pubrights@worldbank.org](mailto:pubrights@worldbank.org).

### Cover Photos Credits

Photo by Curt Carnemark, World Bank (Top)

Photo by Dominic Chavez, World Bank (Middle)

Photo by Arne Hoel, World Bank (Bottom)

# CONTENTS

- A** Acknowledgements
- B** Introduction
- 01** What is Takaful?
- 02** What is Sharia Compliance?
- 03** What makes Takaful Sharia compliant?
- 04** How does Takaful differ from insurance?
- 05** Is payment of surplus to participants mandatory under a takaful contract?
- 06** What is Retakaful?
- 07** How does index-based livestock Takaful (IBLT) work in practice?
- 08** What Takaful model does the DRIVE product adopt?
- 09** What is the status of the Takaful market in Somalia?
- 10** Is the local Takaful market holding the risk under DRIVE?
- 11** How is Sharia compliance established in Takaful?
- 12** Why is there a need for a Supreme Sharia Supervisory Board (SSSB) or National Sharia Council?

## ACKNOWLEDGMENTS

This note was produced by a core team led by Qhelile Ndlovu (Financial Sector Specialist). The team included Dr. Younes Soualhi and Zainal Kassim (Senior consultants). The note benefited from review and editorial inputs provided by Abdirahman Shariff (ZEP-RE DRIVE Country Manager for Somalia) and Simeon Abel (World Bank Consultant).

The takaful market development work is financed through the Financial Resilience Program (FRP), which is sponsored by USAID and the DRIVE project which is supported by the Global Shield Financing Facility (GSFF).

## INTRODUCTION

The De-risking, Inclusion and Value Enhancement of Pastoral Economies in the Horn of Africa (DRIVE) project is being implemented across HoA countries with support from the World Bank and in partnership with the private sector. DRIVE aims to enhance the financial resilience of pastoralists to drought through supporting the scale up of a financial services package including index-based livestock insurance (IBLI), and index-based livestock takaful (IBLT) to meet the needs of the majority Muslim population in Somalia and the Somali region of Ethiopia.

The takaful market in HoA is small but growing, with Somalia being the most nascent. Somalia is home to six takaful operators, each with varying durations of operation, spanning from two to nine years. In Ethiopia there are two insurers with registered takaful windows, while Kenya has just one takaful operator. There are no retakaful operators in Somalia or Ethiopia, while in Kenya there are three reinsurance companies that operate retakaful windows. Between 2019 and 2022 total contributions in Somalia increased by 50 percent from US\$6.5 million to US\$9.2 million. However, the bulk is for expatriate medical cover. In Kenya, takaful contributions are estimated to have reached US\$21 million in 2020.

This Frequently Asked Questions (FAQ) note was prepared to improve understanding on takaful and the process of sharia compliance by pastoralists and other stakeholders. The FAQ also clarifies the nature of the DRIVE IBLT product and its status of sharia compliance as of December 2023. The index-based livestock takaful (IBLT) product under DRIVE is the first parametric takaful solution globally.

## 1. What is Takaful<sup>1</sup>?

Takaful is a mutual insurance concept that operates in accordance with Islamic principles, which are based on fairness, transparency, and social responsibility. It is designed to help people protect themselves against risks and losses, while remaining true to their religious values and principles.

## 2. What is Sharia Compliance?

Shariah<sup>2</sup> compliance is the adherence to the Shariah rulings and principles found in the main sources of the Holy Qurán and the Prophetic traditions. The five overriding objectives of Shariah<sup>3</sup> law can be summarized as safeguarding one's Religion, Selves, Minds, Progeny and Wealth.

Such rulings can either be based on *ijtihad*<sup>4</sup>, *tawil*<sup>5</sup>, or *qiyas*<sup>6</sup>. The bulk of shariah rulings and principles is firm and intact over time and are unchangeable. However, the status of the compliance can change over time, depending on circumstances at the time of the ruling. This is particularly true of finance, e.g. both banking and insurance.

## 3. What makes Takaful Sharia compliant?

The key principles of Shariah compliance in the context of Takaful are:

i. The prohibition of *gharar*, which refers to uncertainty or ambiguity. This means that **Takaful is based on a contract of *tabarru'* (donation) and not a contract of exchange like conventional insurance.** According to Shariah, *gharar*, can affect contracts of exchange but not

contracts of donations such as Takaful. Further, Takaful products must be designed in a way that is transparent, fair, and avoids ambiguity. The terms and conditions of the Takaful contract must be clearly defined, and the risks and benefits of the product must be clearly understood by the policyholder (termed 'participant' in Takaful).

ii. The prohibition of the practice of *maysir*, or gambling. This means that **Takaful is a mechanism of risk sharing (akin to mutual insurance) rather than transferring risk.** Participants contribute funds to a common Fund to protect against losses. These contributions are termed *tabarru* or donations. The takaful Fund is managed on behalf of the participants by a Takaful Operator in exchange for a fee (the *wakala* or agency fee). Participants of a Takaful scheme are considered co-owners of the Fund and share in the surpluses and deficits of the Fund. This approach encourages members to take an active role in managing risks and helps to create a sense of community and mutual support.

iii. The prohibition of *riba*, which refers to interest or usury. This means Takaful operators invest a portion of the Takaful Fund in Shariah compliant investments only. Takaful Operators cannot invest in interest(*riba*)-based financial instruments, such as bonds or fixed deposits. Instead, Takaful Operators invest in Shariah-compliant assets, such as equities (of companies that exclusively engage in shariah-compliant businesses), real estate, and other non-interest-based financial instruments.

iv. The prohibition of *riba* also means that if the takaful Fund falls into a deficit the Takaful Operator provides a *qard* (an interest free loan), which would be a first charge on any future surpluses arising from the common Fund.

1 - Takaful is an Arabic word that means guaranteeing each other.

2 - Shariah (an Arabic word loosely interpreted as "the way" or "the way to water") law is derived from the teachings of the Quran and from the hadith (the sayings) and sunnah (the actions) of Prophet Muhammad (peace be upon him). It is basically a set of principles on all aspects of life, including marriage, divorce, finance and religious rituals (such as fasting and prayer).

3 - Shariah (an Arabic word loosely interpreted as "the way" or "the way to water") law is derived from the teachings of the Quran and from the hadith (the sayings) and sunnah (the actions) of Prophet Muhammad (peace be upon him). It is basically a set of principles on all aspects of life, including marriage, divorce, finance and religious rituals (such as fasting and prayer).

4 - Decisions of Shariah authorities and Scholars based on independent legal reasoning (Islamic law)

5 - Based on interpretation, 6 - Based on analogy

## 4. How does Takaful differ from insurance?

Takaful is a system whereby participants share risk by making specific contributions into a Fund that is used to pay for losses suffered by its members. Takaful is premised on mutual co-operation and solidarity, therefore entails risk sharing.

Insurance (other than mutual insurance) involves the transfer of risk from individuals to an insurance company in exchange for a specific premium payment. The insurance company takes on speculative risk wherein it expects that the

total premiums it collects would exceed the sum of the expenses it incurs and total claims it pays out. This is akin to the practice of maysir, or gambling, which is forbidden under Shariah law. Takaful is a Shariah-compliant alternative to insurance.

such as equities (of companies that exclusively engage in shariah-compliant businesses), real estate, and other non-interest-based financial instruments.

iv. The prohibition of riba also means that if the takaful Fund falls into a deficit the Takaful Operator provides a qard (an interest free loan), which would be a first charge on any future surpluses arising from the common Fund.

Table 1 : Compares the key features of insurance and Takaful.

Feature	Insurance/reinsurance	Takaful/Retakaful
Contract	Contract of exchange	Contract of donation
Shareholders & insurance funds	Not separated	Separated
Insurance/risk fund	Belongs to the shareholders	Collective ownership of participants
Investment fund	Belongs to the shareholders	Takaful participants owns the capital, and thus the Investment fund. The Takaful operator owns its share of profit.
The participants	Independent from each other <sup>57</sup>	Cooperate with each other
The insurer	Manager of its own insurance fund	Agent on behalf of the participants
Claims	Paid from Shareholders fund	Paid from General Takaful Fund
Investment	No Shariah compliance restrictions	Only Shariah compliant investments
Gharar (uncertainty)	Exists	Exists but tolerated due to tabarru'
Surplus	Normally not distributed	Normally not distributed
Liquidation	As per market practices	For the benefit of charities

Source: Authors

## 5. Is payment of surplus to participants mandatory under a takaful contract?

Payment of surplus to participants is not mandatory. The decision to pay surplus is based on actuarial assessment of the sustainability of the Takaful Fund. It is made when the total amount of the Fund is sufficient to cover losses in the foreseeable future.

## 6. What is Retakaful?

Retakaful is a Shariah-compliant form of reinsurance. In contrast to reinsurance, where the insurer (to whom the risk has been transferred by the insured) offloads a portion of the risk to the reinsurer, the Takaful pool actively shares risks with the Retakaful pool. This sharing is facilitated through the payment of a contribution from the Takaful pool to the Retakaful pool.

The Retakaful Operator takes a wakala fee from this Retakaful contribution in return for managing the Retakaful Fund. The Retakaful Operator meets its expenses of managing the Retakaful Fund from this fee. Similar to the Takaful Operator, the Retakaful Operator is obliged to make a qard payment to the Retakaful pool should a deficit arise. This is subsequently repaid from future surpluses from the Retakaful Fund.

## 7. How does index-based livestock Takaful (IBLT) work in practice?

IBLT is designed to **prevent** the loss of livestock due to drought by providing funds for pastoralists to purchase feed for their livestock when there is inadequate pasture. It is not meant for restocking after livestock loss.

The payout is based on an index that measures the level of pasture in an area. If the pasture available for livestock is too low (i.e. the vegetation index falls below a minimum level of greenness) the contract pays out a sum of money which is enough to keep a unit of livestock alive. The payout is therefore less than the total value of a livestock and is unlikely to cover the cost of replacing a lost livestock, illustrating the preventive intention of this intervention.

## 8. What Takaful model does the DRIVE product adopt?

Figure 1 summarizes how the Takaful scheme for pastoralists in Somalia operates based on a hybrid Wakalah and Mudarabah model.<sup>7</sup> Total contributions from the Government and pastoralists are first split between a wakala fee and a tabarru'.

The Takaful Operator uses the wakala fee to cover its own expenses.

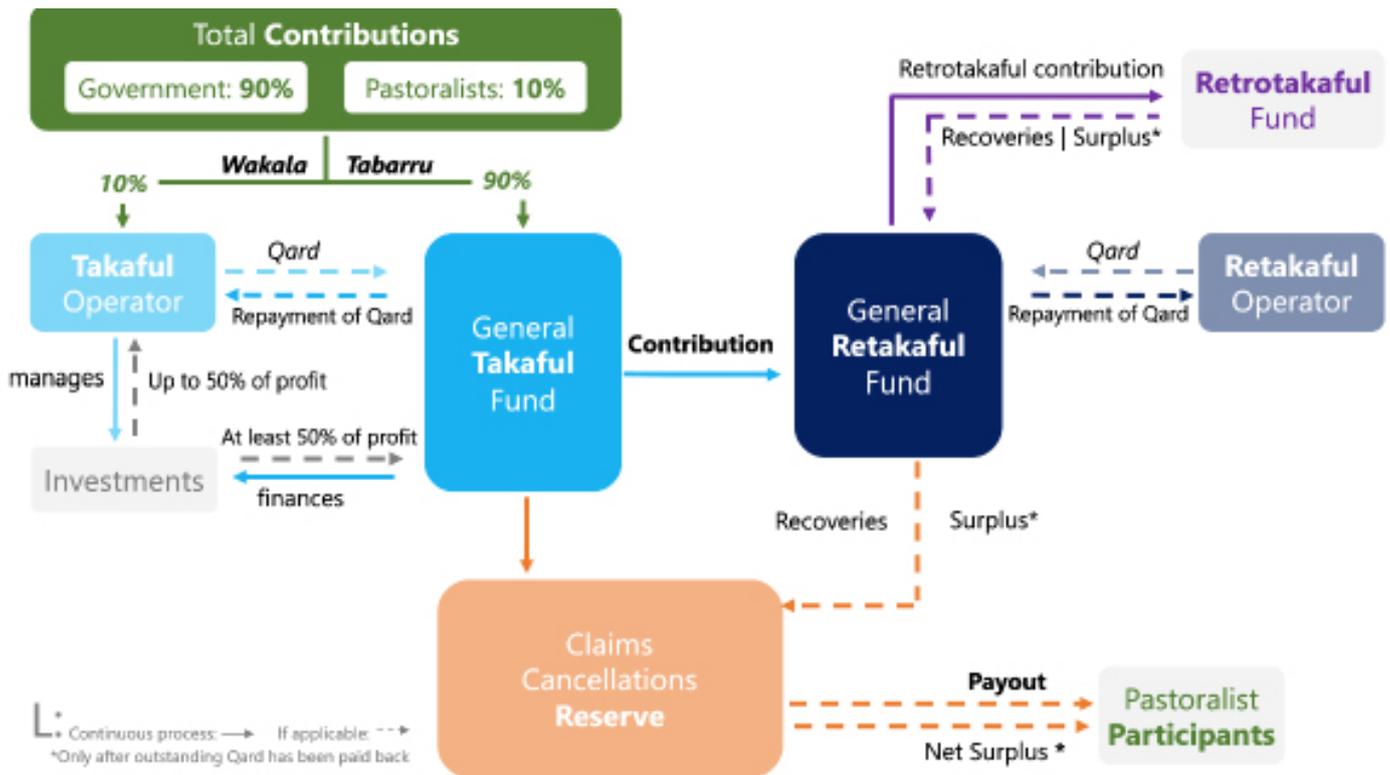
The General Takaful Fund pays a retakaful contribution into a General Retakaful Fund, which is to manage the risk of the General Takaful Fund being inadequate to cover all the members' losses.

A portion of the General Takaful Fund is not used to pay claims but to invest in sharia-compliant investments, which increases the total amount of funds available in the General Takaful Fund to cover members' losses. The Takaful Operator manages the investment on behalf of the participants. The proceeds from investments are shared equally by the Takaful Operator and the General Takaful Fund.

In the event of a loss by a participant, the Takaful Operator pays using money from the General Takaful Fund as well as from recoveries from the General Retakaful Fund.

7 - The participants and Takaful Operator share in any operating surplus. This is to reward the Operator for effectively managing the Fund on behalf of Participants.

Figure 1: The Takaful operational model adopted by DRIVE



Note: The General Takaful Funds in Somalia are not yet being used to pay losses because this is a new product and will require time for the Funds to accumulate sufficient capital and reserves. Takaful funds in Ethiopia cover 10% of the losses and the Retakaful and retrotakaful Fund cover the balance.

If the total amount available in the General Takaful Fund and the General Retakaful Fund is not enough to cover the losses, the Takaful Operator provides an interest free loan (Qard) to the General Takaful Fund. In the event of an annual surplus, the fund first pays back any outstanding Qard provided by the Takaful Operator, if applicable. Once the Qard is completely paid back, participants may receive a share of the remaining surplus.

## 9. What is the status of the Takaful market in Somalia?

The Somali market is nascent, comprising 6 Takaful Operators and 1 broker, each with two to nine years of existence. There is no Retakaful Operator. Between 2019 and 2022, total contributions increased by over 40% from US\$6.5 million to US\$9.2 million. However, the bulk is from medical cover for expatriates.

## 10. Is the local Takaful market holding the risk under DRIVE?

Given the nascent nature of the Takaful Operators in Somalia, their Takaful Funds are not being used to underwrite the losses (underwriting here refers to a source of qard to cover any excess of claims over contributions). Instead, the losses are being met from the Retakaful Funds of participating Retakaful Operators through ZEP-RE. In time, it is expected that local

Takaful Operators will retain a portion of the risks in their respective takaful funds. This temporary arrangement has been considered shariah compliant on an exemption basis by the ZEP-RE sharia advisor.

The ZEP-RE Retakaful Fund in turn is not expected to retain all the risks and thus require (conventional) retrocession support as currently there is no capacity to retrocede to another retakaful fund. Again, this is considered as Shariah compliant by the ZEP-RE Shariah advisor on a temporary dispensation basis.

## 11. How is Sharia compliance established in Takaful?

A Takaful Operator establishes a Shariah Supervisory Board (SSB) to provide guidance and oversight to management to ensure that all Takaful operations are in line with the values and principles of Shariah. The SSB is made up of experts in Islamic law and finance.

The SSB is responsible for ensuring that the Takaful Operator manages the operations in an ethical and socially responsible manner. The SSB reviews the full range of operations including:

- i. The design, operation, and management of Takaful products and services.
- ii. All operations, including investments, contracts, risk management, and governance.
- iii. The social and environmental impact of the Takaful Operator's investments.

## 12. Why is there a need for a Supreme Sharia Supervisory Board (SSSB) or National Sharia Council?

In summary, while insurance is not Shariah compliant, Takaful is, based on opinion of the appointed Shariah scholar. As the interpretation of Shariah law can vary even within a jurisdiction (depending on the teachings and understanding of the subject matter by the Shariah scholar involved) it is vital to have a common understanding of what is considered Shariah compliant and what is not within the regulated jurisdiction. This would avoid confusion to the public and allows the regulator to issue takaful regulations that applies consistently across the industry. Thus, there is a need for a

Supreme Sharia Supervisory Board (SSSB) at the regulator level whose fatwas (a ruling or point in Islamic law) are generally accepted by those governed by the laws of the country. The SSSB provides guidance and oversight by issuing operating standards and guidelines that ensures that all Takaful operations in the country are in compliance with Shariah principles as interpreted by the SSSB. By following these principles, Takaful operators can provide a socially responsible alternative to conventional insurance, while remaining true to their religious values and principles.

# Disaster Risk Financing & Insurance Program

---



**Global Shield**  
Financing Facility

[WWW.FINANCIALPROTECTIONFORUM.ORG/GSFF](http://WWW.FINANCIALPROTECTIONFORUM.ORG/GSFF)