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# The USP of ethical finance and insurance

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# A short history

## Two origins of insurance

- A hedge against misfortune...
  - Chinese traders travelling rivers (2000 BC) limited losses by distributing wares over many ships
  - Code of Hammurabi (1750 BC) a loan to fund shipment of goods included coverage of the risk that shipment would be stolen
  - Achaemenian monarchs registered 'insurance' contracts. Involved a 'central banking system' which allowed one to take money out in case of 'risk' e.g. construct a building, set up a feast or have your daughter married
  - Athenian Maritime loan: advance money for ship travelling; the price of the loan varied with perceived riskiness of ship travelling

# Two origins of insurance

- A cooperative endeavour...
  - ‘Friendly societies’; cooperative ventures stood at the origin of generalised insurance in the 19<sup>th</sup> century. They are still largely present today
  - Returns today in micro-insurance markets (parallel to micro-credit)
  - Takaful itself originated from Ta’awun, a form of mutual assistance with its origins in pre-Islamic tribal practices of solidarity and reciprocity
- Insurance has evolved into a \$4.3 trillion market (7% of global GDP) but insurance is far from generalised. Industrialised countries hold 88% of global premiums and spend around 9% of GDP to insurance. It is only 2.7% for emerging markets.

# The challenge of global markets

- Close parallel with the experience of cooperative banking and insurance in (continental) Europe
- Globalisation is testing the limits of cooperative insurance/banking. The 'group' becomes very abstract and we do not see the element of mutual help and solidarity anymore
- Cooperative banks e.g. Credit Agricole (France) or Rabobank (Netherlands); difficult to see the difference with non-cooperative banks
- Takaful is still local but its success (and regulation) pushes it to a global level (certainly at the investment side). *How to retain your identity?*

# How to retain your identity?

- Two specific parts to Takaful: *Religious* and *community based*
- Strengthen these identity markers
  - A cooperative enterprise takes a closer look at its members compared to a non-cooperative. Member service matters!
  - Create member identity through communication e.g. a newsletter distributed out to all the members and other types of activities
  - How do you pay your staff? What with bonuses? Suppose there are losses what happens at that moment with the bonus? Can give a strong signal that this is really a community effort; we are all in the same boat

# How to retain identity?

- Pass on the message of religion and community in the type of product you design and in the way you invest your money
- Invest in local communities e.g. municipalities, regional development banks etc.(importance of Sukuk market) and communicate about this
- Micro-Takaful is a very strong signal that community support has a meaning for you; it equals going back to the roots
- Your religious identity is highly connected to the functioning of the Sharia board. Do your customers know about this board? How does your Sharia board communicate to the outside world?
- Don't play with your religious identity, its is highly delicate and once lost all is lost; this implies care and due diligence when selling products and investing funds

# How to retain identity?

- Financial products are speech acts
  - Careful control of the conversation process in which products are sold. Is the Takaful message being passed on?
  - Are you distributors sufficiently trained to pass on the Takaful message?
  - Experience with SRI products; biggest challenge was to convince the bank personnel in the different branches that this is a serious product with excellent financial characteristics while at the same time delivering an ethical surplus. Once the banking personnel was convinced customers followed (customer follows 90% of the time advice of his banker/insurer)

# Conclusion

- Takaful has found its USP, otherwise it would not be growing at the speed we witness, the challenge is to guard the identity markers on the road to success



# Economic theory

## Insurance and economic development

- The impact of insurance runs closely parallel to the impact of the financial system on economic development see the work of Levine (1993, 2001, 2005)
- Levine sees five basic functions of the financial system:
  - Savings mobilization
  - Resource allocation
  - Liquidity creation
  - Risk management (diversification)
  - Monitoring of firms and managers
- Extensive discussion on the causality of the relationship between development and deepness of financial markets (Lucas 1988; Krugman 1993; Zingales 1998)

# Economic theory

## Insurance and economic development

- Stylised facts:
  - It is not the amount of capital that counts but how it is used
  - Mature financial systems come in different forms e.g. banking systems or private capital markets. Both forms can be equally successful.
  - Deepness of the financial system is necessary but not sufficient condition for economic development
  - Lack of a serious financial system is sufficient condition for prevention of economic development
  - Mature insurance markets are an essential part of a well developed financial system

# Economic theory

## Insurance and economic development

- Without insurance:
  - Business activities become too risky
  - Entrepreneurial spirit is dampened
  - Less forward planning because of increased uncertainty
- Through insurance:
  - Provoking risk transparency
  - Speeding up transfer of new technologies
  - Creditworthiness and access to loans enhanced
  - Internalisation of risk costs
  - Monitoring of risk factors and tackling them (e.g. safety belt, climate change)
  - Insurers hold 11% of worldwide assets, tend to invest more long term

# Back to the roots

- Yet financial markets and insurance markets tend to forget their functional role in favour of pure return
- Globalisation is testing the limits of cooperative insurance. The 'group' becomes very abstract and we do not see the element of mutual help and solidarity anymore
- Takaful takes you back to the roots of the financial system and the insurance system in particular: its functional role in the growth of communities
- The cooperative element implies much closer attention to the effect on the people involved. It is the community taking care of the community. Helping yourself by helping others and that is its USP