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Developing a Conceptual Framework of Microtakaful as a Strategy towards Poverty Alleviation

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Abstract
Many researchers suggest that access to insurance services is an important strategy for poverty alleviation. However, the poor 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 is microinsurance, or a *shari'ah*-compliant form of microinsurance known as microtakaful. In essence, microtakaful has the same technical apparatus as takaful but it focusing on providing the poor with opportunities to protect themselves against specific risks in exchange for affordable premiums. Therefore, this paper considers microtakaful as an effective tool to provide protection for the poor and enable achievement of sustainable poverty alleviation. The objective of this paper is to propose a conceptual framework of microtakaful integrating the scheme with financial supports form the government, Islamic institutions of *zakat* and *waqf*, contributions from the international zakat organisations, donations and grants from Non-Governmental Organisations (NGOs) and donor agencies. This paper is expected to provide a basis for further study on designing microtakaful products and pricing modeling based on cooperative principles as a means of poverty alleviation.
Keywords: Microinsurance, microtakaful, microtakaful model, poverty alleviation

1. Introduction

International agencies such as the World Bank and United Nations use internationally defined poverty as living on less than US$2 a day on average. According to this measure, people earning less than US$1.25 per day are living in extreme poverty, and people who earn less than US$2 a day are in moderate poverty. According to the most recent estimates, in 2011, over one billion people in the world lived in extreme poverty, earning less than $1.25 a day; and 2.2 billion people lived in moderate poverty, earning less than US $2 a day (World Bank, 2014). Approximately 23-percent of the world's population is Muslim, according to the Global Religious Landscape Report from the Pew Research Center's Forum on Religion and Public Life (2012). The report, which drew from 2010 census data claims that there were 1.6 billion Muslims worldwide, a number that is anticipated to rise to over 2.2 billion by 2030. Poverty is rampant and common in the Muslim countries except for a handful of countries in Southeast Asia and the Middle East. In Indonesia alone, the home of the largest Muslim population in the world, almost half or 43.3-percent of the population live in poverty (World Bank, 2010), struggling to survive on less than US$2 a day. A study undertaken by Mohammed Obaidullah and Tariqullah (2008) has some shocking revelations. Just five of its 56 Islamic Development Bank (IDB) member countries – Indonesia, Bangladesh, Pakistan, Nigeria and Egypt account for over half a billion (528 million) of the world's poor with incomes below $2 a day or below their national poverty lines. All these countries except Nigeria have Muslims constituting over 95-percent of their respective population.

The non-poor confront essentially the same risks (death, illness or injury, loss of property and natural disaster) faced by the poor, but they have access to formal insurance schemes and often have less financial impact. However, the significant majority of people living in poverty have very limited or absolutely no access to basic financial services including insurance. Without access to formal insurance schemes, most poor people manage risk with their own means by using informal mechanisms – selling assets, making out-of-pocket payments or borrowing. This could leave the poor even more vulnerable to future risks.

According to Bakhtiari (2013), access to insurance is an important strategy for poverty alleviation. A research by Cohen and Sebstad (2005) shows that not only are poor households aware of their vulnerability to risk, but they are willing to pay to protect against these risks. However, the poor are often ignored or inadequately serviced by the private insurance market and social insurance schemes because the premiums are unaffordable. Furthermore, Cohen and Sebstad (2006) suggested that providing aid in the form of insurance is far better off in providing social protection rather than allotment in cash. Improving access to insurance enables people living in poverty to improve their livelihoods and uplift themselves out of poverty.

A specific type of insurance particularly developed to protect the poor generally excluded from public and private insurance schemes 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 who cannot gain access to traditional forms of insurance.

However, this type of conventional insurance (and microinsurance) is not permissible in Islam. Numerous empirical researches (Swiss Re, 2008; AIG, 2013) have shown that insurance ownership rates are very low in countries with a predominantly Muslim population. Lack of *shari'ah*-compliant insurance products is cited as a main reason for this. The emergence of Islamic insurance or known as takaful that fully adheres to *shari'ah* laws may help to boost the demand for insurance in Muslim countries.

Microtakaful is the Islamic alternatives to conventional microinsurance. As with conventional microinsurance, microtakaful is a mechanism to provide *shari'ah*-based protection against the financial consequences of death and illness to the poor at an affordable cost. The objective of this paper is to propose a conceptual framework of microtakaful integrating the scheme with financial supports form the government, Islamic institutions of *zakat* and *waqf*, contributions from the international zakat institutions, donations and grants from Non-Governmental Organisations (NGOs) and donor agencies. This paper considers microinsurance as a poverty alleviation tool, with particular emphasis on life insurance that helps mitigate risk and enables the poor to cope with various risks and vulnerabilities they are faced with. It should also be noted here that microtakaful is not the sole solution for reducing poverty in Muslim countries, but one of the universal poverty alleviation tools or even provide effective social protection to the poor in the absence of appropriate government schemes.

2. Defining Microinsurance and Microtakaful

Microinsurance concept has emerged as a subset of financial tools from the microfinance. The concept has evolved over the years within microfinance and then developed into a sector of its own.

According to Ingram and McCord (2011), the first definition of microinsurance appears to have been published in 1999 by Dror and Jacquier (1999) 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 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, there is an element of a social protection system, similar to social insurances and national health insurance schemes. A study by Ramm and Ankolekar (2014) addresses the potential and roles of microinsurance within a broader social protection framework in a country.

Warren Brown and Craig Churchill in their two-volume research report, *Providing Insurance to Low-Income Households* comprehensively discussed on microinsurance as insurance that is intended for the poor. 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 principles involved in offering insurance to the low-income market (Brown and Churchill, 1999). The second volume of the report, *Part II: Initial Lessons from Microinsurance Experiments for the Poor* analysed practice in relation to these principles (Brown and Churchill, 2000). This report discovered three insurance products to protect against three of the major risks facing poor communities – death risks, health risks and property risks. Within 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. Moreover, poor households consistently identify the loss of a breadwinner or sickness of a family member as their greatest concerns (Cohen and Sebstad, 2006). 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 poor.

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 (Akhtar Khan, 2006).

As mentioned above, microinsurance (or microtakaful) is a type of insurance (or takaful) aimed at protecting the poor and vulnerable. Therefore, all takaful products, for example family takaful and general takaful can be delivered to the poor with some modifications to fit the needs of the poor – the product has to be simple, easy to understand and affordable premiums. Microtakaful also requires the involvement of takaful operators, government subsidies, *zakat* funds, Non-Governmental Organisations (NGOs) and donor agencies for sustainability. Support from the mainstream takaful operators could come in the form of technical expertise and financial assistance. Some consider microtakaful as a part of corporate social responsibility (CSR) programmes of takaful industry.

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 (Brugnoni, 2013).

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.

3. Structure and Business Models for Microtakaful

As it has been mentioned earlier, the products of microtakaful are actually similar to takaful but these would need to be modified to fit the needs of the poor. In general, there are two forms of Islamic insurance models – takaful *tijari* (business) and takaful *ta'awuni* (mutual cooperative insurance).

The operational model of microtakaful also is similar to takaful scheme. 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. 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. On the other hand, 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 a pre-agreed fee, referred to as *wakalah* fee to cover the operating expenses and record a profit.

Another model prevalent in practice is the hybrid model (Htay and Syed, 2013) – a combination of *mudarabah* and *wakalah* models. In this model, the takaful operator receives a *wakalah* fee for managing the takaful fund and share of the underwriting surplus and investment profit.

The other model and most recent model gaining popularity is an extension of the *wakalah* model known as 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. 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, hybrid 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 supposed a prime consideration. For example, according to Develtere et al., (2004), microinsurance institutions providing health care in developing countries should be 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. Therefore, this paper proposes a conceptual framework for microtakaful model that provides protection for the poor and enables achievement of sustainable poverty alleviation. In order to achieve this objective, the model should be developed based on takaful *ta'awuni* (cooperative insurance) principles, integrating the microtakaful scheme with financial supports form the government, Islamic institutions of *zakat* and *waqf*, contributions from the international zakat organisations, donations and grants from NGOs and donor agencies. In practice, the cooperative model is not common as it does not allow profit for the takaful operator. However, takaful operators should view microtakaful as part of their corporate social responsibility (CSR) programmes rather than a serious driver of premium income. To encourage takaful operators to be involved in microtakaful schemes based on *ta'awuni* (cooperative), the government should provide tax incentives to companies who practice CSR. It also would be an excellent choice for a government interested in helping segments of the population to help them to be insured in an Islamic manner (Zainal Abidin et al., 2013).

3.1 Microtakaful Based on Ta'awuni (Cooperative Insurance) Principles

In theory, discounted premiums, perhaps with the help of government or donor subsidies can stimulate demand for microinsurance and microtakaful. Without government intervention in the form of subsidy, donations from various funding organisations or likewise, it is unlikely microtakaful schemes will be successful. 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 operator or a microtakaful institution. This cooperative common pool provides a mechanism for sharing all claims to compensate participants in the event of loss, pay retakaful contributions and to build contingency reserve.

The concept of *zakat* could be expanded to provide a sustainable source of income for the poor through microtakaful. According to Brugnoni (2013), *zakat* could be used to pay the contributions of the microtakaful policy. This is important in order to reduce the cost of premiums to an affordable level for the poor to purchase. Participants in the microtakaful scheme will of course eligible to receive *zakat* themselves. As many microtakaful institutions raise their funding from *zakat*, zakat institutions can also improve the redistribution efficiency and provide a financially sustainable approach to benefit the Islamic society at large (Mahmoud Mohieldin, 2012). For instance, 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.

Another possible external source of funding for microtakaful is from international zakat organisations that are professionally and efficiently run. 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 fund initial expenses, research and development of the microtakaful scheme.

In addition to *zakat*, which is mandatory on every Muslim who possesses the minimum *nisab* (*nisab* means the minimum amount of wealth upon which *zakat* is payable), *waqf* as a voluntary charitable donation is also capable of playing important role in alleviating poverty through microtakaful. As *waqf* are generally in the form of fixed assets, such assets are often under-utilised. AbdulHasan Sadeq (2002) presents an integrated approach on how traditional *waqf* institutions can be revitalised through innovations. Cash 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 of projects including microtakaful schemes.

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 the low-income market (McCord, 2008).

4. The Conceptual Framework for Microtakaful

The proposed conceptual framework for microtakaful as a strategy towards poverty alleviation comprises of the participation of four parties.

1. Participation of the Government: The government should play an important role in encouraging takaful

operators to design microtakaful schemes to the poor. In addition, the government should also facilitate links to appropriate support organisations such as zakat and waqf institutions, as well as international donors and grant providers.

The microtakaful schemes also should have a social protection element, in which the government to provide premium (contribution) subsidies to the poor who cannot afford to buy the policy. The government needs to establish an intervention fund where it is directly funded from government's annual budget. Although the government supported insurance and takaful schemes often look similar to the social security schemes, but fundamentally they are different. While in traditional social security schemes the government underwrites the risks and pays for the services, in microtakaful schemes the government pays the full or partially subsidising premiums, while the risk is underwritten by takaful operator or microtakaful institution.

It is also important that the government develop and implement a supportive regulatory and supervisory framework suitable for microtakaful market. A successful microtakaful regulatory scheme will protect policyholders while supporting market development and enhance social welfare. Cost-efficient distribution channels are particularly important in microtakaful because of the low premium value per policy that are affordable to the poor. Therefore, alternatives to traditional methods of distribution such as selling insurance through brokers and sales representative, which incurs large commission fees, are needed in order to keep the costs low. More innovative distribution channels including mobile phone providers, post-offices and retailers that have the potential to reach the poor at low cost should be established. Sometimes these innovative mechanisms and partnerships, however, are not permitted by the regulator. Therefore, the government should reconsider licensing requirements, particularly in utilisation of some of the more innovative distribution channels.

2. Microtakaful operators or microtakaful institutions: Microtakaful operators or microtakaful institutions play a significant role in developing microtakaful products that are affordable to the poor, simple and easy to understand. Takaful operators should be able to provide actuarial and technical expertise in designing and developing microtakaful schemes. Microtakaful requires specialised actuarial capacity, which uses mathematics to place a monetary value on future risks. Actuarial and statistical analysis for microtakaful is complicated by claim volatility and lack of reliable data characteristic of the poor population.

Apart from microtakaful operators, a large number of institutions such as microfinance institutions (MFIs), cooperatives, NGOs and community-based insurance organisations offer microinsurance and microtakaful products. Some of the inherent problems of these microtakaful institutions are lack of expertise ranging from actuarial science, product development, underwriting, risk management and claims management. As microtakaful institutions often do not have the appropriate expertise, they should find alternative mechanisms by seeking support from microtakaful or microinsurance consultants to supply the required assistance. There are a number of microtakaful and microinsurance consultants such as the International Cooperative and Mutual Insurance Federation (ICMIF) Microtakaful Support Centre, MicroInsurance Centre, Micro Insurance Academy, the Centre for Financial Regulation and Inclusion (Cenfri) and the Centre for Insurance and Risk Management (CIRM). The actuarial organisation is also becoming actively engaged, with the International Actuarial Association setting up a microinsurance committee to organise support for microinsurance development. Donations and grants from international organisations and NGOs may be able to support initial research and development phase as well as consultation fees for technical expertise. If consultant services are too expensive or not readily available, partnerships with local takaful operators are particularly effective strategy.

Kamaruddin (2012) proposes that various takaful operators should make their contribution into a microtakaful fund through the mechanism of cash *waqf*. Funds accumulated through the cash *waqf* can be used as an initial fund for a microtakaful scheme. Thus, the microtakaful efforts by takaful operators can be viewed as corporate social responsibility (CSR) strategies. The company's management need to educate shareholders that as takaful operators they have a responsibility to provide access to protection for the most vulnerable in society. This also could positively increase the image and reputation of the takaful operators in the eyes of customers, government and regulatory bodies. In addition, the social impact of helping to alleviate poverty can attract new investors which build further value to their business line.

3. Zakat funds, donor organisations and NGOs: The basic fundamentals underlying the microtakaful concept are very similar to cooperative principles of social responsibility and care for others especially those who are vulnerable. Like governments, zakat institutions, donor organisations and NGOs provide assistance, sometimes in the form of cash payments, or technical assistance.

The institution of zakat plays a significant role as an instrument of poverty alleviation in a sustainable way. The utilisation of the zakat fund through co-funding of microtakaful premium (contribution) subsidies could be a program to redistribute the wealth among the rightful beneficiaries of zakat.

The involvement of donors (international organisations and NGOs) in funding microtakaful should be prioritised to fund initial expenses, research and development, rather than subsidising premiums. In theory, subsidies help the poor to receive protection through microtakaful that they would not otherwise have. In this paper, we stressed that only the government or zakat institutions that are established or approved by the government are the most effective and sustainable options of subsidies for microtakaful scheme. Donor subsidies, while useful, do not sustain microtakaful programs over the long term.

Local organisations like community-based NGOs are providing an effective channel in reaching deeply into local communities. The success of a microtakaful scheme depends on a thorough understanding of the needs and risk profiles of the target group, as well as high penetration of microtakaful products among the poor. Therefore, NGOs could play a more collaborative role by assisting in market research and to conduct awareness campaign on microtakaful at the local level.

4. Microtakaful Participants*:* Takaful participants contribute to a common pool from which claims are paid, and any surplus from the pool is later returned to members in some form of sharing device. Microtakaful adopts the concept of *tabarru'* (donation) with the intention to help other participants faced with difficulties, whereas in the conventional microinsurance, policyholders pay premiums to protect themselves or their families should something unexpected happen.

4.1 The Proposed Microtakaful Model

As we mentioned earlier, the proposed microtakaful model is a non-profit insurance program based on cooperative principles, where profit is not an operational goal. It is an integrated model involving participation by the government, takaful operators or microtakaful institutions, zakat funds, donor organisations and NGOs. Figure 1 provides a proposed conceptual framework for the operations of microtakaful.

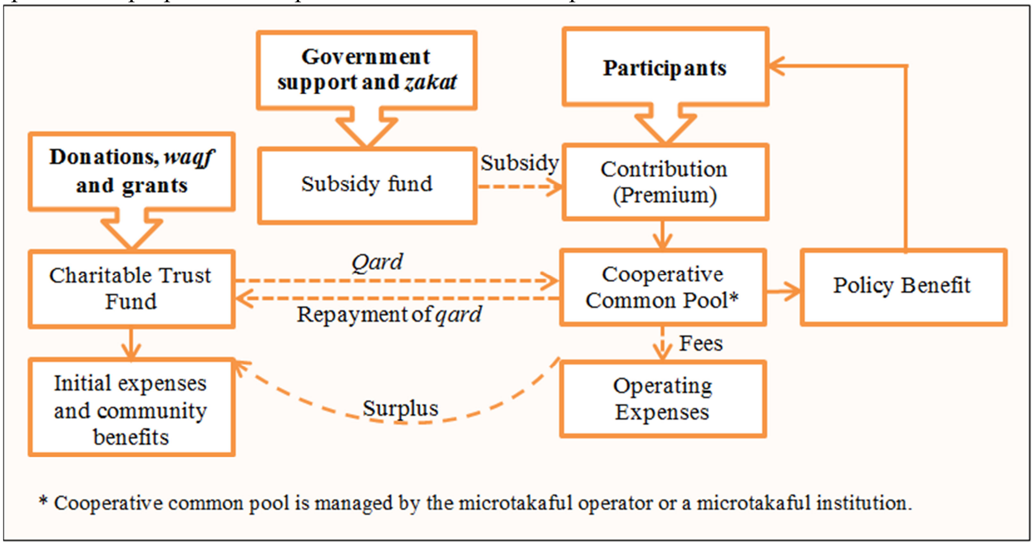

Figure 1: The Proposed Conceptual Framework for Microtakaful Based on Cooperative Principles

Under current practice of *mudarabah* or *wakalah* model in takaful contract, the participant pays a contribution to the takaful operator, who splits this into two accounts – Participant's Account (PA) for the purpose of savings and investment; and Participant's Special Account (PSA) as *tabarru'* (donation) for the purpose of mutual help. The funds in the PA belong to the individual participant, whereas amounts in the PSA become a community pool of money for assistance against the covered risks. This community-pooled account in takaful contract operates in a manner similar to cooperative insurance model that we adopted in this paper as shown in figure 1 – a fund that we name 'Cooperative Common Pool'. Amount in Cooperative Common Pool, after deducting operating expenses, will be used to pay claims and retakaful. End of year surplus in the Cooperative Common Pool will be channelled to the Charitable Trust Fund.

It is important to create a separate fund to provide subsidy resources to the poor; we term this fund as a 'Subsidy Fund' that will be made up from government contributions and *zakat* funds from zakat institutions that are established or approved by the government. This fund should be managed by a Board of Trustees.

Another fund in this proposed microtakaful model that should be created is a 'Charitable Trust Fund'. Contributions from the international zakat organisations, *waqf* funds, donations and grants from NGOs could be used to provide the initial capital of a fund, which can be nominal. The purpose of the Charitable Trust Fund is divided into two parts – to cover initial expenses and community benefits, and the second part is to provide *qard hassan* (interest-free loan).

The first part of the Charitable Trust Fund 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 microtakaful to the target market. 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 (2013) 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 *waqf* model in takaful contracts; the other part of the Charitable Trust Fund should be managed with the intention that it will be preserved over time notwithstanding that it may be temporarily use by the participants' fund to meet temporary deficits due to fluctuating claims experience (Zainal Abidin, 2013). In this context, the participants' fund is the Cooperative Common Pool. When the Cooperative Common Pool fund runs into a deficit, the Charitable Trust Fund provides *qard hassan* (interest-free loan) to the Cooperative Common Pool fund to cover the deficit. The *qard hassan* will be repaid when the pool returns to profitability with no extra charge.

5. Conclusion

Recently microinsurance has captured the attention of policy makers, international development agencies, NGOs and donor agencies. The International Labour Organisation (ILO) and a number of governments around the world have endorsed microinsurance as an instrument for poverty reduction and social development. This paper proposes Islamic microinsurance (where it is known as microtakaful) based on cooperative principles as a mechanism to provide *shari'ah*-based protection against the financial consequences of death and illness to the poor in exchange for affordable premiums. However, microtakaful schemes require well-developed institutional arrangements at least between four participants – government, microtakaful operators or microtakaful institutions, zakat funds, donor organisations and NGOs, and microtakaful participants – in order to run in an efficient and effective manner. In addition, this paper will also provide a conceptual basis for designing microtakaful products and developing models for pricing life microtakaful.

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