

# Prospective of Realizing Islamic Insurance Model in Russia

## *(presentation of Takaful project in Russia)*

As the practice of the *takaful* business around the world has shown, its success does not always solely depend on the role played by Islam in a particular country. For example, such country as Iran, whose economy has been in the process of islamization for the last twenty years, still have no pure *takaful* companies. At the same time, in South-East Asia where Islam has less influence on public life than in Iran, the Islamic insurance business is widely developed.

While studying the characteristics and advantages of *takaful* over conventional insurance, a Russian researcher may consider whether it would make sense to establish *takaful* companies in Russia.

In the last few years, Russia has been actively trying to build bridges with many Orient countries. This is due to changes in the priorities of Russia's foreign policy and to normal economic interest in mutually beneficial economic cooperation with potential partners in developing countries.

More emphasis is currently being placed on scientific, technical and financial cooperation. Some Russian banks are trying to find experts in interest-free financing, which shows that they have serious intentions to further develop partnership relations with Islamic corresponding banks abroad.

As for the prospects of establishing an Islamic insurance company in Russia, the situation is even more complicated. On the one hand, creating a *takaful* operator in this country appears problematic due to the lack of experience in this kind of operations in the Russian insurance business, and a number of other negative factors.

In Russia, development of Islamic insurance will take much more time than in non-Muslim countries (at least several decades) and will face all those difficulties that are in store for anything new and never tried before. But it would be wrong to regard the appearance of a *takaful* operator in the Russian Federation as a fad or as a dubious economic experiment with unpredictable results. In the opinion of the author, the establishment of a *takaful* company in Russia is desirable for the following reasons:

- 1) Islamic insurance, as opposed to the conventional one, is fully compliant with *Shariah*. The potential customers of a *takaful* company in Russia are approximately 15 million Muslims who live in the country. One may argue that making a contract with a non-Muslim insurer is not a big sin<sup>1</sup>. One of the principles of *Shariah* included in *Majallat*

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<sup>1</sup> As it is well known Islam requires the believers to follow the teachings of the Holy *Quran* and the *Sunnah* not only

teaches that the lesser of two evils should be chosen. However, if it is possible to avoid what is doubtful from the point of view of *Shariah*, one should choose what is more in line with the *Shariah* principles: “Leave what is doubtful for that which is not!”;

- 2) many commercial and financial partners of Russia in the Middle East hesitate to invest into various lucrative projects, fearing economic instability and bad faith on the part of the Russian colleagues. Under such circumstances, it would make sense to establish a *takaful* company that would secure the risks of Muslim investors<sup>2</sup>;
- 3) the Russian insurance market should encourage competition. Offerings from *takaful* companies would help to diversify the market, and that would benefit the development of insurance in Russia;
- 4) *takaful* companies in Russia will, among other things, invest their funds into projects connected with Islam and Muslims, this will help to improve the wealth of the Muslim community, which makes up a significant portion of the country’s population<sup>3</sup>.

So, taking into account the current situation in Russia, the creation of an Islamic insurance company would be desirable, mainly for the development of competition in the insurance market. And it is much easier to do now, after the Federal Law of the Russian Federation “On the Organization of Insurance Business in the Russian Federation (with the Amendments and Additions of November 20, 1999)”.

In accordance with this Act, foreign insurers were allowed to establish 100-percent foreign-owned subsidiaries in Russia. This lifted the 1992 restriction that set a 49-percent limit for the share of foreign capital in Russian insurance companies.

At the same time, the new Act applied certain restrictions to foreign insurers establishing companies or subsidiaries in Russia with a share of foreign participation exceeding 49%. Such companies were not allowed to engage in the following operations: life insurance; compulsory insurance; compulsory state insurance; property insurance involving supply of goods or provision of services to the government; insurance of governmental or municipal property. The new edition of the Federal Law of the Russian Federation “On the Organization of Insurance Business in the Russian Federation (with the Amendments and Additions of December 10,

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in religious practice but also in the worldly life. Thus, for example, the prohibition of *Riba* (usury) is stated on multiple occasions in the Holy *Quran* and the *Sunnah* of the Prophet. Consequently, the conduct of Muslims in trading or when making financial and other deals must be in full compliance with the requirements of *Shariah*, as the violation of prohibitions imposed by Allah is a sign of disbelief.

<sup>2</sup> Even if the investors are from countries where Islamic insurance is not yet widespread, they will readily use the services of people of their own faith, providing that these have a good name and are financially sound.

<sup>3</sup> Islam is ranking first among Russia’s religious denominations in terms of the number of young believers. Thus, the share of young people among Muslims (48.4 %) is higher than among Orthodox believers (39.2 %)// tolerance.ngo.ru

2003)” canceled such restrictions for the insurance organizations from the EU countries – the members of the Agreement on Partnership and Cooperation of 24 June 1994.

Consequently, once the limit of foreign investments in the authorized capital of Russian organizations set at 25% (according to the above-mentioned Federal Law), is reached, the Insurance Supervision Body will stop issuing licenses to subsidiaries of foreign insurers and to Russian companies with a share of foreign capital exceeding 49%. This quota is calculated as the ratio between the total amount of stakes owned by foreign insurers and their subsidiaries in the authorized capitals of insurance companies, and the aggregate authorized capital of all insurance companies.

The new Law (with the Amendments and Additions of December 10, 2003) also provides a strict specialization of insurance organizations. The division between organizations engaged in life insurance and ones engaged in non-life insurance is set. There are 23 types of insurance, which are allowed to be realized in practice of insurance organizations in Russia. Among *takaful* operators, there is no strict division between life insurance companies and those specializing in other types of insurance services, and if life insurance (as part of Family *Takaful*) plays an important role in the business of many Islamic insurers, other services offered by *takaful* companies are also popular among Muslim and non-Muslim population in different countries.

At the same time, the author believes that despite the invaluable experience of foreign Islamic insurers, a more acceptable option for Russia would be establishing a Russian *takaful* company, majority-owned by Russian capital. As was discussed above, in many countries the issue of establishing an Islamic insurance company was considered first of all a political issue, and only then an economic one. We cannot rule out the possibility that the establishment of a *takaful* company in Russia may face problems due to the unwillingness of certain authoritative circles to let foreign insurers (especially Islamic ones<sup>4</sup>) enter the domestic market. And establishing a Russian company would eliminate such needless complications. Certainly, the new company will need to use experience of foreign experts in training qualified staff for the *takaful* business.

When studying the prospects of establishing an Islamic insurance company in Russia, we cannot bypass the issue of possible collision between the principles of Islamic law and the provisions of the legislation of the Russian Federation, which is a secular state pursuant to Article 14, item 1 of the Constitution.

The experience of *takaful* operators in non-Muslim countries shows that their status can be successfully regulated within the framework of conventional insurance legislation. The principles of Islamic law only apply to the internal relations within the company, without

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<sup>4</sup> It would be preferable to use the word “*Takaful*” rather than “Islamic insurance” in the name of such a company.

violating the laws of the country where the company is registered or conducts its business. If an Islamic insurance company is established in Russia, its operations will be compliant with the requirements of the Act “On the Organization of Insurance in the Russian Federation” and other Russian regulatory Acts. Passing a special *Takaful* Act in Russia is hardly necessary.

According to majority of Islamic scholars, only Muslims should head an Islamic insurance company. This provision may be considered as a violation of the principle of publicity of contract (Article 426 of the Civil Code of the Russian Federation). In accordance with the Russian law, a person of any faith is free to engage in any kind of business that does not violate the legislation. This author believes that this problem can be resolved in the following way. After all, only potential customers will decide whether they prefer to use an insurance company that is run by a non-Muslim or a company headed by someone of their own faith. Therefore, an Islamic insurance company established and managed by non-Muslims has the right to exist and compete for the premiums of the insureds, provided that its operations are in compliance with the Russian legislation and the principles of Islamic law. In any case, it will be under the oversight of the *Shariah* Supervisory Board consisting of Muslim experts<sup>5</sup>. As for the *Shariah* Supervisory Board itself, it will evaluate all transactions in terms of their compliance with *Shariah* before the contract is made.

Theoretically, the *takaful* business can exist in Russia in the form of both commercial and mutual insurance, depending on the level of economic development of the region where the Islamic insurer will operate, on the income level of the local populations, on their awareness of the various insurance services, etc. However, a number of important principles underlying the operations of *takaful* companies and related primarily to the system of profit and loss sharing and to the investment of premiums, are not completely in line with the Russian legislation. As a result, an Islamic insurer conducting its business in Russia risks violating the principles of *Shariah*.

We see the following solution to the problem. Obviously, changing the insurance law to accommodate the needs of *takaful* companies would require much more effort than changing the provisions regulating mutual insurance. The task is made even easier by the fact that this legislation is now in the preparatory stage. Therefore, a constructive and appropriate compromise would be to establish a Russian *takaful* company on the principles of mutual insurance,

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<sup>5</sup> This problem can also be viewed in a historical context. For example, in the years of the NEP [Lenin’s New Economic Policy in the 1920-s, marked by a limited economic liberalization], there was a restaurant in Moscow named “Lurye”, which served only kosher food in accordance with the Jewish traditions. However, this did not make Jewish religious laws non-compliant with Soviet law, because the restaurant was established in accordance with the requirements of the Soviet legislation. Both Jews and people of other faith were allowed to eat Jewish food, but the chef had to be a Jew, otherwise the food would not be kosher. So, why not an Islamic insurance company, established in accordance with the Russian laws and offering services that are necessary to Muslims can’t be allowed to exist?

considering that virtually all Muslim scholars are unanimous in finding mutual insurance to be compliant with *Shariah*.

According to the currently in force federal law, mutual insurance societies in a form of non-commercial organizations that are membership based can be established as: a) non-commercial partnerships; b) consumers' co-operatives (consumers' unions). A mutual insurance society in a form of a non-commercial partnership should be set up and function under the Federal Act "On the Organization of Insurance in the Russian Federation". A mutual insurance society in a form of a consumers' co-operative (consumers' union) should be established and function in conformity with the Civil Code of the Russian Federation, in particular, under Article 116 of this Code.

If a mutual insurance society is set up in a form of a commercial organization than it should obtain a license given by the insurance supervisory board. The above-mentioned Federal Act does not extend to a mutual insurance society set up in a form of a non-commercial organization. Therefore, a mutual insurance society:

- a) is free to determine rules of mutual insurance;
- b) independently determines its tariff policy;
- c) determines types, forms and rates of technical and other forms of insurance;
- d) with regard for the requirements fixed for non-commercial organizations it determines the content of the forms and accounting on insurance operations.

A mutual insurance society in a form of a non-commercial organization is not a subject to insurance supervision.

According to the data of the National Association of Mutual Insurance Societies there are nearly 200 mutual insurance societies in Russia, however many of them still remain on paper<sup>6</sup>. This can be proved by statistics: according to the Association, last year mutual insurance societies collected only 15 mln rubles of insurance premium. The total amount of their funds does not exceed 2 mln USD. Approximately  $\frac{3}{4}$  of the total turnover falls on large cities, first of all, on Moscow and St. Petersburg.

Practice shows that mutual insurance is in popular demand in Russia mostly in a small business and agricultural sectors i.e. such spheres, which are not a matter of interest for big insurance companies. For example among farmers the demand for mutual insurance services is very high, but defects of legislation make farmers use services of conventional joint-stock companies which actually begin to work on mutuality principles. However such situation excludes profit orientation but does not give a company any privileges.

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<sup>6</sup> Conception of Establishing and Functioning of Mutual Insurance Societies// [www.ovsk.ru](http://www.ovsk.ru)

In addition to insurance services intended solely to Muslims (insurance of mosques, Islamic educational institutions, Islamic business centers etc), it would make sense for a Russian *takaful* operator to enter sectors where competition of conventional insurers is less strong.

Apart from the general problems faced by any conventional insurer in the Russian market, *takaful* operators will have to deal with additional difficulties. These are due to the total lack of public awareness of what is Islamic insurance. *Takaful* companies will need to invest heavily into promotion and market education, explanation the nature of the services they provide in order for potential customers to understand the difference between *takaful* and conventional insurance.

Below are shown the results of surveys conducted in St. Petersburg and Kazan (Republic of Tatarstan). These two cities have been chosen due to the presence of typical potential groups of the *Takaful* services customers in both of them.

The research targeted to reveal the potential market segment representatives attitude to the *Takaful* insurance services and to some programmes; to find out the key factors of the consumer's choice of the insurance company; to obtain the attitude of the market potential representatives to the various methods of the insurance products promotion.

The respondents have been chosen among the Muslims 25 to 45 years old having the monthly income over USD 250.00 per family member, i.e. among those who are able to pay for the insurance services.

St. Petersburg and Kazan *takaful* market analysis results are as follows:

- There are over 100,000 Muslims living in St. Petersburg and over 500,000 Muslims living in Kazan.
- About 7 % of the total number of the Muslims are religious. Much more (22%) represent those who try to adhere to their 'roots' and follow *Shariah*. 73% haven't determined themselves.
- The total number of potential *takaful* service customers at the initial stage of the company operation can be 29,000 in St. Petersburg and 145,000 in Kazan.
- At present each third Muslim uses the insurance services. Mostly those services cover the vehicles (CASCO) insurance and the mandatory vehicle-related third party legal liability insurance.

- About half of the Muslims using the insurance services spend over USD 50.00 per month for the insurance-related purposes. The most popular is the car (CASCO) insurance.
- The *takaful* principles knowledge level among the population is quite low. Only 1 % of the Muslim respondents are fully aware of the *takaful* principles. About 7 % of the respondents have heard some general information on those principles. 92 % of the respondents do not have any idea on the subject.
- Among non-religious people the interest to *takaful* can emerge as an alternative to the conventional life insurance or as alternative investment tool which reliability and profitability has been proved by their friends.
- Over 19 % of the Muslims are likely to get interested in this kind of insurance.
- The majority of the Muslims, especially the religious people will be likely to take *takaful* as a means of their well being protection, their property protection, their children care.
- Insurance is a trust-based service. In order to get the above-mentioned market segment customers trust the insurer should operate in accordance with the principles as follows:
  - Transparency of the company; free access to the information on the company, its staff, policy, partners etc. (via press, web-site, conferences etc.).
  - Support and active position of the religious leaders which have obtained relevant information and brochures. This is the most important element, especially for the religious people.
  - High quality supporting printed materials describing the *takaful* principles, the company, its partners, the insurance rules, the insurance policies, notice letter envelopes.
  - Direct communication with the customers, especially at the initial stage must be held by the Muslim staff.
  - There must be a strategic partner (either a bank or an insurance company) coming from the Islamic country and the company must position itself in the market together with that partner.

- The image of *takaful* company is very important to the religious customers. On the contrary, such attributes as the ‘wide range of services provided’, ‘suitable office location’ are not important at all.
- The most demanded services in the field of *takaful* can be: private property insurance; life insurance; children insurance.
- The average annual premium affordable to *takaful* insurance company customers ranges from USD 180.00 to USD 240.00 (or USD 15.00 to USD 20.00 per month).

The basic concept of “*Takaful*” project of “Itil” insurance company is an establishment of the ever first *takaful* company in Russia. The project is initiated by a team of specialists from Kazan-based “Itil” insurance company. The team members have got a managerial and organizational experience while running Russian insurance companies since 1992.

The purpose of establishing a *takaful* company is to meet the needs of the Russian population in the field of insurance protection of their property and personal interests based on the Islamic principles.

The first steps of realizing of the project were made in January 2004. Since that time the initiative group has obtained support from the Muslim public organizations and Muslim religious leaders.

The project leader is Dr. Renat I. Bekkin who is an Islamic insurance expert from the Moscow State Institute of International Relations (Ministry of Foreign Affairs of the Russian Federation). In 2003 he got a Ph.D. in Law degree. The title of his research paper “Insurance in Islamic Law: Theory and Practices”.

### **Basic mission and aims of a *takaful* company establishment in Russia**

A *takaful* company general mission is to provide promotion of the Islamic principles of economy within the territory of the Russian Federation and thus to support Russia’s integration in the world economic community.

This *takaful* company is being established in order to achieve the following aims:

1. To provide the Russian citizens with the Islamic principles-based insurance services aiming at securing their property and personal interests.

2. To provide the Russian citizens with financial services aiming at letting them invest their funds in various projects based on the Islamic principles.

#### *Expected results*

The expected result of this project implementation is the Russia's ever first Islamic principles-based effectively run insurance company establishment.

#### *Project unique features*

This project has the following unique features:

1. None of the insurance companies presently operating in Russia has ever focused on the religion-determined customer segment.
2. Detailed research of the *takaful* principles and their further adaptation to the Russian legislation has revealed in the Russian financial services market the free niche for the Islamic principles-based financial operations.

Preliminary estimations prove this project to be profitable in the long term period, due to the following reasons:

1. Information sources indicate that *takaful* companies are more profitable than western commercial insurance companies.
2. Due to the Russian people well-being gradual growth the long term accumulating insurance programs are likely to become much more attractive for the population.
3. The Russian legislative and executive powers activities are aimed at the increase of the role the insurance companies play in the economic and social spheres.
4. The Muslim religious leaders and Russian Muslim communities heads are ready to support the project implementation.

The information obtained via the Internet shows that various financial institutions express their interest in the *takaful* subject.

## Company's internal environment strengths and weaknesses

Strengths	Weaknesses
<p>1. <i>Takaful</i> products allow the Russian Muslim entrepreneurs and other persons to perform financial transactions in accordance with Islamic law.</p> <p>2. A <i>takaful</i> company's tariff policy is attractive because it is based on the leading risk management technologies and low tariffs of its partners - re-insurers.</p> <p>3. An insurance company operating in accordance with the Islamic principles will attract various businesses top managers being Muslims.</p> <p>4. The brand is original because of <i>takaful</i> products exclusive positioning in the Russian insurance market.</p> <p>5. <i>Takaful</i> products quality is based on a constant monitoring of the insurance market demand.</p> <p>6. <i>Takaful</i> products are designed on the basis of the standards and experiences of the world leading <i>takaful</i> companies.</p> <p>7. The company's business processes are</p>	<p>1. At the initial stage of the company's operation the tariff policy is determined by the company's insurance portfolio scope. The insurance market leaders offer low insurance tariffs according to their high insurance portfolios due to their customers network formed during the previous period of operation.</p> <p>2. To promote the company's new brand in the insurance market big investments are required.</p> <p>3. Due to absence of the prototype products in the Russian insurance market it is not possible to make a precise forecast of the new products of <i>takaful</i></p> <p>4. Lack of qualified top and medium level managers in the field of insurance in the Russian labor market.</p> <p>5. Time required to hire agents and to train them will cause a delay of active sales at the start-up period.</p> <p>6. The brand unawareness will negatively impact <i>takaful</i> products sales at the start-up period.</p>

<p>oriented to the quality servicing of the customers.</p> <p>8. Complex approach used at the pre-operation period makes it possible to optimize the company's structural units.</p> <p>9. <i>Takaful</i> products sale to the corporate customers is supposed to be held using complex risk management principles.</p> <p>10. Well-designed advertising policy, positioning the company at specialized industry exhibitions and the insurance agents' activity will provide <i>takaful</i> company with the required products sales volume.</p> <p>11. The strategic investor presence will provide the guaranteed funding of the company's operation at the start-up period.</p> <p>12. <i>Takaful</i> products sales methods will include modern Internet technologies.</p>	
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**Company's external environment opportunities and threats**

<b>Opportunities</b>	<b>Threats</b>
<p>1. The revival of the Russian population's national self-determination.</p>	<p>1. Due to the high degree of a terror danger the Russian population is concerned about</p>

<p>2. The Russian both legislative and executive powers aim to increase the role insurance play in the economical and social spheres.</p> <p>3. The Muslim religious leaders and Muslim communities leaders agree to support the project implementation.</p> <p>4. The project is supported by the Russian public Muslim organizations.</p> <p>5. Gradual well-being growth of the Russian population.</p> <p>6. The insurance culture growth among the Russian population.</p> <p>7. Total number of computer and Internet users growth in Russia.</p>	<p>the Islamic structures being established. This can relate to the Islamic financial institutions too.</p> <p>2. The competitors' prototype products emergence in the market discrediting principles of <i>takaful</i>.</p> <p>3. Difficulties of obtaining approval by the Russian Ministry of Finance Federal Insurance Supervision Board.</p>
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**Conclusions:**

**1. Takaful company operational results depend upon complex and qualified internal processes structuring at the company design stage.**

**2. The competitive environment and formulated goals require the company all level managers professionalism in the field of insurance and management.**

It is possible that *takaful* will be even more successful in Russia than for example in the USA, even though the financial means of American and Russian Muslims are incomparable. In the US, mosques<sup>7</sup> alone own property worth between \$500 mln and 1 bln. And if we consider the businesses controlled by Muslims, these will total another \$1 bln<sup>8</sup>. US Muslims own about

<sup>7</sup> The USA have about 2,000 mosques, 200 full-course Islamic schools and 3 Islamic universities.

<sup>8</sup> Takaful Targets US \$ 10 bn US Market (Interview with Omar Clark Fisher)// Islamic Banker. – 1997. – December. – P. 14.

400,000 homes (worth approximately \$4 bln). In total, according to different calculations, potential objects of Islamic insurance are worth \$6 and 10 bln<sup>9</sup>.

Such statistical data do not exist in Russia, but it is obvious that Russian Muslims do not possess such assets. However, Russia has enough wealthy Muslims that are ready to support various Islam-related projects, such as sponsoring the construction of a mosque or assistance in financing educational projects. For such people, these acts of charity mean fulfilling their duty before Allah. Support from these people will be forthcoming once they understand that the *takaful* business will be lucrative not only for themselves but also for other Muslims who, if Islamic insurance becomes successful in Russia, will choose to enter in a *takaful* contract.

Apart from recruiting qualified personnel with a good knowledge of the technical issues of the Islamic insurance business, a *takaful* company will need to pay much attention to the training of insurance agents. These will be central to the success of *takaful* in Russia. The help of imams will also be required. In Russia, Muslims know very little of their religion, what is allowed and what is prohibited by *Shariah*. Therefore, if the imams explain when speaking to believers that Islamic insurance, as opposed to conventional one, is fully compliant with the teachings of Islam, this will help Muslims to understand and embrace *takaful*<sup>10</sup>.

The business of *takaful* operators in a non-Muslim environment has both positive and negative aspects. The latter are due to the popular distrust among non-Muslim Russians toward Islam and everything that appears to be related to it, especially in the light of such events as the war in Chechnya and the rise of extremism around the world under Islamic slogans. But if agents conduct the necessary work and non-Muslim population becomes aware of the benefits and advantages of Islamic insurance, it is possible that the concept of *takaful* will be successful also among the followers of other religions: "...Allah will rise up, to (suitable) ranks (and degrees), those of you who believe and who have been granted Knowledge..." (58: 11).

**Renat I. Bekkin,**  
**Ph.D. in Law,**  
**“Itil” Insurance Company,**  
**Deputy General Manager,**  
**Director of Islamic Insurance Division,**  
[www.takaful.ru](http://www.takaful.ru)

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<sup>9</sup> Ibid. – P. 14.

<sup>10</sup> Today, Russia has no authoritative Islamic scholars who could issue rulings on the legal aspects of *Shariah*, which will pose serious problems when forming *Shariah* supervisory councils.