

TAKAFUL AS ALTERNATIVE TO CONVENTIONAL INSURANCE

1. Introduction

All human beings are invariably exposed to the likelihood of meeting catastrophes and disasters giving rise to misfortunes and sufferings such as death, loss of limbs, accident, destruction of business or wealth, etc. Notwithstanding belief of all Muslims in Allah and *Qadha-o-Qadr*, Islam provides that one must find ways and means to avoid such catastrophe and disaster wherever possible, and to lighten his or his family's burden should such event occur. One possible resort in this contest is insurance cover as available in the conventional system.

Different views have been expressed about the status of conventional insurance from the point of view of Islam. An overwhelming majority of the Shariah scholars believe that it is unlawful due to involvement of *Riba* (interest), *Maisir* (gambling) and *Gharar* (uncertainty).[@] As such, a consensus has been evolved about its prohibition in the light of the principles of the Shariah.

Takaful, Islamic alternative to insurance, is based on the concept of social solidarity, cooperation and mutual indemnification of losses of members. It is a pact among a group of members who agree to jointly indemnify the loss or damage that may inflict upon any of them out of the funds they donate collectively. As per practice of the *Takaful* companies, a part of contributions (premiums) under *Takaful* system falls under the category of donation in order to spread liability with the objective of common good. The remaining part of the premium is given on the basis of *Mudaraba*. Therefore, structure of *Takaful* that comprises the contracts of *Mudarabah*, *Tabarru'* (to donate for benefit of others) and mutual sharing of losses, is made so as to eliminate the element of absolute uncertainty so far as determination of contributions is concerned. There would be some uncertainty in even *Takaful* system but that would be of commercial nature pertaining to the result of the business conducted by the company. As such there could be only *Gharar-e-Yaseer* - greatly minimized and, therefore, acceptable from Shariah standard.

Takaful is not a new concept in Islamic commercial law. Islam accepts the right of human beings to protect their religion (belief), life, dignity and honour, property and the talent. The contemporary jurists acknowledge that the principle of shared responsibility in the system of 'Aaqilah' (kins or the persons of relationship) laid the foundation of *Takaful*. Mutual help and indemnification was a custom in some tribes at the time of the Holy Prophet (pbuh). In case of any natural calamity, every body used to contribute something until the disaster was relieved. Similarly, the idea of *Aaqilah* in respect of blood money was based on the concept of *Takaful* wherein payments by the whole tribe distributed the burden and the losses. Islam accepted this principle of reciprocal compensation and joint responsibility.

[@] *Maisir* means any forms of business in which monetary gains come from mere chance, speculation and conjecture and not from work or real sector business. *Gharar* means any major uncertainty about the subject matter or rights & liabilities of parties to the contract.

On the basis of the above principles, Islamic system of insurance embodies the elements of shared responsibility, joint indemnity, common interest and solidarity. According to the jurists, this concept of insurance is acceptable in Islam because the policyholders would cooperate among themselves for their common good; every policyholder would pay his subscription in order to assist those of them who need assistance; it falls under the donation contract which is intended to divide losses and spread liability according to the community pooling system; the element of uncertainty will be eliminated in so far as subscription and compensation are concerned; it does not aim at deriving advantage at the cost of other individuals.

2. Main Objective of Takaful

Having a Family Takaful or Islamic life insurance policy does not mean that one has insured one's own life, but it is a fair financial transaction catering for the benefits of certain helpless people in the society. The rationale behind having a life insurance policy could be summed up as hereunder:

It is one of the means of providing a material safeguard for offspring and is thus in line with the saying of the holy prophet SAW. He (SAW) spoke to this effect: "it is better for you to leave your off-spring wealthy than to leave them poor, asking others for help". The Holy Prophet (SAW) also encouraged the providing of security for the widows and poor persons as he highlighted in one of his traditions: "The one who looks after and works for a widow and for a poor person (dependent), is like a warrior fighting for The Cause of Allah (SWT), or like a person who fasts during the day and prays throughout the night".

3. Tabarru' and Takaful

In order to eliminate the element of uncertainty in the Takaful contract, the concept of "tabarru" (to donate or give away) is incorporated in it. In relation to this, a participant agrees to relinquish as tabarru certain proportion of his Takaful installments or contributions that he agrees or undertakes to pay thus enabling him to fulfill his obligation of mutual help and joint guarantee, should any of his fellow participants suffer a defined loss.

In essence, tabarru' would enable the participants to perform their deeds sincerely in assisting fellow participants who might suffer a loss or damage due to a catastrophe or disaster. The sharing of profit or surplus that may emerge from the operations of Takaful, is made only after the obligation of assisting the fellow participants has been fulfilled.

It is imperative, therefore, for a Takaful operator to maintain adequate assets of the defined funds under its care whilst simultaneously striving prudently to ensure that funds are sufficiently protected against undue overexposure.

The contract of *Takaful* provides solidarity in respect of any tragedy in human life and loss to the business or property. The policyholders (*Takaful* partners) pay subscription to assist and indemnify each other and share the profits earned from business conducted by the Company with the subscribed funds. It can envisage the profit sharing business between the Takaful operator and the individual members of a

group of participants who desire to reciprocally guarantee each other against a certain loss or damage that may be inflicted upon any one of them.

Takaful companies divide the contributions into two parts i.e. donation for meeting mortality liability or losses of the fellow policyholders and the other part for investment. Accordingly, the clause of *Tabarru'* is incorporated in the contract. How much of the contribution is meant for mortality liability and how much for investment account is based on a sound technical basis of mortality tables and other actuarial requirements. Both the accounts are invested and returns thereof distributed on *Mudarabah* principle between the participants and the *Takaful* operators. The profit attributable to the participants is credited into the two accounts respectively.

To describe from another angle, a *Takaful* contract may comprise clauses for either protection or savings/investments or both the benefits of protection as well as savings and investment. Contributions of the policyholders are used to jointly indemnify individual losses as a part of 'protection'. The Protection part of *Takaful* works on donation principle according to which individual rights are given up to indemnify the losses reciprocally. In the Savings part, individual rights remain intact under *Mudarabah* principle and the contributions alongwith profit (net of expenses) are paid to the policyholder at the end of policy term or before, if required by him.

The distinction between the conventional insurance and *Takaful* business is more visible with respect to investment of funds. While insurance companies invest their funds in interest-based avenues and without any regard for the concept of *Halal-o-Haram*, *Takaful* companies undertake only Shariah compliant business and the profits are distributed in accordance with the pre-agreed ratios in the *Takaful* Agreement. Likewise they share in any surplus or loss* from the pool collectively. *Takaful* system has a built-in mechanism to counter any over-pricing policies of the insurance companies because whatever may be the premium charged, the surplus would normally go back to the participants in proportion to their contributions.

The terms 'Family *Takaful*', '*Takaful Ta'awani*' or just '*Takaful*' are generally used for family solidarity in place of conventional life insurances. Other products available in various countries are General *Takaful*, Education/Medical *Takaful*, etc.

4. Models of Takaful

Based on the nature of relationship between the Company and the participants, there are various models like *Wakalah* (agency) Model, *Mudarabah* Model and the combination of Agency and *Mudarabah* models. In the Sudanese *Takaful* Model that is preferable to majority of the contemporary Shariah experts, every policyholder is also the shareholder of the *Takaful* Company. There is a Board that runs the business on behalf of all the participants and there is no separate entity managing the business. The legal framework in other Islamic countries normally does not allow this arrangement and *Takaful* Companies work as separate entity on the basis of *Mudarabah* (as in Malaysia) and on the basis of *Wakalah* (as in the Middle East region).

* Losses, if any, are first absorbed by reserves known as Participants Equity, then from interest free loans from shareholders of *Takaful* Company and then by a general increase in pricing by the Company.

In Mudarabah model that is practised mainly in the Asia Pacific region, the policyholders get profit on their part of funds only if Takaful Company earns profit. The sharing basis is determined in advance and is a function of the developmental stage and earnings of the Company. The Shariah committee of Takaful Company approves the sharing ratio for each year in advance. Most of the expenses are charged to the shareholders.

In *Wakalah* Model, the surplus of policyholders' funds investments – net of the management fee or expenses - goes to the policyholders. The shareholders charge *Wakalah* fee from contributions that covers most of the expenses of business. The fee rate is fixed annually in advance in consultation with Shariah committee of the company. In order to give incentive for good governance, management fee is related to the level of performance.

5. Development of Takaful Business

The Takaful business has proved its viability in a period of only two decades. It has been growing at the rate of 10-20% p.a. compared to the global average growth of insurance 5% p.a. A large number of Takaful Companies exist in the Middle East, Far East, and even in some non-Islamic countries. There are over 60 companies offering Takaful services (including Windows- 5%) in 23 countries around the world. These countries are: Malaysia, Singapore, Indonesia, Sri Lanka, Bangladesh, Turkey, Luxembourg, Senegal, Tunisia, Bahrain, Brunei, Kuwait, Jordan, Qatar, UAE, Egypt, Saudi Arabia, Sudan, Nigeria and Iran; In Pakistan, one Takaful company has been incorporated that is expected to launch the Takaful business as and when bye laws are finalized by the Security and Exchange Commission of Pakistan. Malaysia has developed *Retakaful* business as well. Takaful products are available to meet the needs of all sectors of the economy, both at individual as well as corporate levels, to cater for short and long term financial needs of various groups of the society.

Takaful business has a large potential as there is increasing demand for Shariah compliant system particularly in the perspective of development of Islamic banking system. Up till now there had been low insurance density (premium per capita and penetration premium % of GDP) in Islamic countries mainly because of belief of the Muslims that insurance was un Islamic. Development of this system would require awareness and education of the public at large, developing human resources and expertise, legal framework for Takaful industry, harmonization of practices, developing new instruments for Shariah compliant investments, accounting standards for Takaful operations and solid arrangements for Retakaful (arrangements being finalized for ASEAN Retakaful International Limited).
