

Takaful (Islamic Insurance): Historical, Shari'ah and Operational Perspectives

Sheila Nu NuHtay, Mustapha Hamat, Wan Zamri Wan Ismail and Syed Ahmed Salman
Institute of Islamic Banking and Finance,
International Islamic University Malaysia, Selangor, Malaysia

Abstract: Insurance is used, as one of the risk management tools and it becomes more important in the daily lives due to the complicated business activities. However, the non-Shari'ah compliant elements such as interest, gambling and uncertainty involved in the insurance make the insurance prohibited from the Islamic perspective. As an alternative, Shari'ah scholars have introduced Takaful (Islamic insurance). The purpose of this study is to highlight the history, Shari'ah and operational aspect of Takaful. Secondary data is collected from the articles, books and internet resources and then library research is used to get the secondary data. This study highlights the Shari'ah background and validity of Takaful, its models and management of the Takaful Risk Funds. It is expected that this study will be the interest of industrial players, consumers, regulators and investors.

Key words: Takaful, Islamic insurance and Shari'ah, gambling, uncertainty, Malaysia

INTRODUCTION

By nature, human being is weak and there is a tendency that they will try to find a mean to protect and secure them in the misfortune. Common types of risks faced at the individual levels are related to risks to the property owned, for instance car and house, health, permanent disablement and personal accidents. Risks related to the property involve fire and flood. In the case of health, the cost of medical expenses is a burden for the individuals. Moreover when someone is suffering from permanent disablement, the continuation and survival of the life is not easy, since it needs strong financial support. Similarly, the personal accidents might be difficult to avoid in the daily lives, since most of us have experience ranging from the minor to the major accidents. Common current practice to claim the expenses incurred in the case of misfortune is buying the insurance. In most of the cases, parents want the kids to be secured, especially in the case of education and they will start engaging in the insurance product, i.e., child education plan. Salary earners are, also interested to have sufficient amount of money when they retired and hence, they prefer to buy the insurance products, for instance investment linked products and retirement products. In addition, the government policy makes the people unavoidable from insurance. For instance, road tax can be renewed if the owner buys the car insurance and it is widely practiced in many developed countries such as Canada, United States of America and United Kingdom and in many developing countries such as Malaysia. In some countries like the

United States of America if the people do not have health insurance, they cannot be admitted to the hospital. Therefore, insurance cannot be avoided due to the living style of the daily life now-a-days.

The main purpose of existence of the business entities is to earn profit and it cannot be attained without taking risk. According to the Capital Asset Pricing Model, risk and return are highly and positively correlated. This means that the higher the risk is the more return will be and the lower the risk is the lesser the return will be. Global risk management survey 2013 mentions the top 10 risks faced by the business entities worldwide and they are related to economic slowdown and slow recovery, regulatory or legislative changes, increasing competition, damage to reputation and brand, failure to attract or retain top talent, failure to innovate to meet customer needs, business interruption, commodity price risk, cash flow or liquidity risk and political risk and uncertainties. One of the ways to manage the risk is buying the insurance.

It could be summed that both individual and business levels need insurance to seek the compensation and coverage in the case of loss and it has been found to be a useful tool. However from the Islamic perspective, there are prohibited elements in the insurance practice and they are interest, gambling and uncertainty. Thus, muslim scholars have introduced with Takaful, as an alternative to the insurance. However, the concept of Takaful has been practiced before pre-Islamic period. The objective of this study is to re-emphasize on the historical development of Takaful and its Shari'ah aspect and operational models.

HISTORICAL PERSPECTIVE OF TAKAFUL

Some form of insurance and mutual help schemes have been practiced by the tribal Arabs since the pre-Islamic period, some of which were later approved by the Prophet (PBUH). Billah (2003), Khorshid (2004) and Obaidullah (2005) have identified the systems such as al-Diyat (blood money), al-Aqilah, Ma'qil, al-Qasamah, al-Tahanud, al-Diwan and Dhaman Khatar, al-Tariq briefly explained after:

The legal ruling on the subject of blood-money was extensively discussed by Imam Malik in his al-Muwatta under the chapter, Kitabal Uqul. This system was introduced to replace the primitive custom of blood called for blood and to curb the fury of war among the various warring tribes. This covers unintentional murder where the entire tribe mutually agrees to provide financial compensation as blood money.

In a similar manner, a system called al-Aqilah (which literally means, slayer's paternal relative who undertakes to pay blood money) was introduced as a covenant of mutuality formed between the Meccan immigrants (Muhajirin) and the Medinans (Ansars) whereby members pay their annual contributions through a fund called al Kanz. This fund will be used to pay compensation on behalf of a member who is liable to pay a diyat. This doctrine was approved by the Prophet (PBUH) and later made mandatory by the second caliph, Umar Al Khattab, based on the following Hadith:

Narrated by Abu Hurairah (RA), he said that: Once 2 women from the tribe of Huzail clashed when one of them hit the other with a stone which killed her and also the fetus in the victim's womb. The heirs of the victim brought an action to the court of the Holy Prophet (PBUH) who gave a verdict that the compensation for the infanticide is freeing of a male or female slave while the compensation for the killing of the woman is the blood money (diyat) to be paid by the Aqilah (the paternal relatives) of the accused (al-Muwatta Chapter 474)

Besides the system of al-Aqilah, a number of similar systems were practiced during the Islamic civilization, such as Ma'qil which was provided under the constitution of the city-state of Medina whereby each member of a tribe contribute to a fund to be used for payment of ransom money for someone who was made a prisoner of war by an enemy. If the fund is insufficient, other related or neighboring tribes will assist.

al-Qasamah another system is called al-Qasamah which is a fund jointly contributed by the community to help the family of murdered victims where the murderer could not be found.

al-Muwalah is a scheme between 2 parties with the intention that either one of the two will be responsible in the event where something should occur to his counterpart.

al-Tahanud is basically food sharing and rationing scheme for those travelling where all travelling members contribute their food to be pooled together to be shared later.

al-Diwan which is a register, the persons whose names contained in the Diwan owed one another mutual assistance and have to contribute to the payment of compensation. This system was institutionalized during the second Caliph Umar Al Khattab.

Khorshid (2004) who cited IbnuKhalidun in his monumental book the Muqaddimah (Prolegomena), describes that Arab business ventures known, as the Winter and Summer Voyages practiced the concept of insurance where members of such trade Voyages participated in a scheme to indemnify any member of the group against loss of their stock or profit, financed through the collection of contributions from members. This is reiterated by Rispler-Chaim (1985) who cited Rahman (1979) that the merchants of Mecca used to form a mutual fund called Dhaman Khatar al Tariq to help the victims or survivors of natural hazards during their commercial ventures and the Prophet (PBUH) who traded with the capital provided by Sayyidah Khadijah (RA), contributed to such fund.

Among the classical jurist who first recorded the legal basis, meaning and concept of insurance as we know today was a Hanafite jurist, IbnuAbidin who termed insurance premium as sukra (security) (IbnuAbidin's ruling on insurance is with regards to a merchant who chartered a ship from a shipowner with a mutual understanding that the charterer would pay an additional amount known as sukra (premium) if the ship faces any form of risk to reasonably indemnify the charterer) followed by the fatwa of Sheikh Muhammad Abduh legalizing insurance practices (Billah, 2001; Klingmuller, 1969).

Buoyed by the fervent Islamic revival (al-Sahwah al-Islamiyyah) among the Muslim Ummah during the last 50 years or so where muslims who seeks to return to their Islamic roots in their lives, the world view of Islam in the economic, political, social and personal spheres begin to germinate interest in the Islamic intelligentsia as narrated by Esposito (1999) as:

The indices of Islamic reawakening in personal life are many: Increased attention to religious observances (mosque attendance, prayer, fasting), proliferation of religious programming and publications more emphasis on Islamic dress and values, the revitalization of Sufism (mysticism). This broader-based renewal has also been accompanied by Islam's reassertion in public life: An increase in Islamic oriented governments, organizations, laws, banks, social welfare services and educational institutions

The culmination of these renewed and re-energized efforts to practice Islam in the financial sphere has resulted in the setting-up Islamic banks and followed by Takaful companies in various parts of the Islamic world.

As a measure to ensure an orderly development of Takaful which is premised on a different legal and philosophical framework and the need to nurture Takaful into a strong and well developed business on par with its conventional counterpart, the Malaysian government enacted the first dedicated Takaful Act 1984 in the world to regulate the Takaful and retakaful industry. Other countries too have at least amended or endorsed their respective insurance regulations to cater for the unique requirements of the business. BNM have initiated the Financial Sector Master Plan (2000-2010) which targeted the Takaful industry and Islamic banking to contribute at least 20% of the total market share of the financial sector and followed by Financial Sector Blueprint (2011-2020) which targets Islamic banking and finance in Malaysia to account for at least 40% of the total market share by 2020.

The global Takaful industry with its modest beginnings in the early eighties with <10 players worldwide is now churning a multi-billion dollar business spanning across South-East Asia, Middle East, Africa, Central Asia and Europe with >200 players. Global Takaful contributions according to projections from Ernst and Young (2011) are expected to reach USD 12 billion in 2012 and growing at an average annual rate of 20-30%. However, this is still a very small fraction of the global insurance contributions which recorded US\$4,597 billion in 2011 (Sigma, 2011).

SHARI'AH BACKGROUND AND MODELS OF TAKAFUL

Whilst fully appreciating the great service and importance of insurance as a risk management tool for individuals, businesses and society, contemporary Islamic scholars are not in agreement with the contractual nature of insurance which are deemed not in

line with the precepts of Shari'ah. They have identified a number of traits of an insurance contract and its practices which are not permissible under Shariah principles and practices namely: Elements of gambling (maisir/qimar), elements of uncertainty (gharar fahish), elements of interest (riba) in addition to elements of fraud and cheating (ghish wa ghabn) and ignorance (al-jahala) (Al-Zuhaili, 2002).

This is supported by a number of edicts (fatawas) such as: First International Conference on Islamic Economics (Makkah) 1976, Resolution of the Fiqhi Academy of OIC 1985, Resolution 12/11 of Al Barakah Group Symposium, Resolution 42 of Al-Rajhi Bank-Saudi Arabia, Resolution of National Fatwa Committee of Malaysia 1972, Resolution of Dewan Syariah Nasional Indonesia, 2001 and Resolution of Fiqh Council of Muslim World League, 1978. From the various fatawas and research from scholars on the subject, the alternative form of insurance which is permissible under Shariah should be based on the contract of donation (uqudtabarruat), instead of the conventional commercial contract of exchange (uqudmuawadhah) as it contains major elements of riba, maisir and gharar which invalidates the conventional insurance contract.

Takaful is derived from the root word kafala which means responsibility, guarantee, amenability or surety. In practice, Takaful takes the meaning of joint guarantee, shared responsibility, mutual undertaking among Takaful participants against certain financial loss from specific risks where they agree to contribute to a defined fund. It is an effort to remove damage or harm when it occurs, through the payment of compensation from the Takaful participation (as described in the Islamic legal maxim *al dararyuzal* (damage or harm is removed) (Ali *et al.*, 2008).

In short, a Takaful scheme is an undertaking involving defined participants, making defined contributions to a defined fund, covering defined risks in a defined period of time. Takaful as a system, manifest a sense of brotherhood and solidarity among the participants where they agree to help one another as enjoined by Allah (SWT) in the Holy Quran: And cooperate you one another in righteousness and piety (Surah al-Maidah Verse 2). And on the advice of the Prophet (PBUH):

Narrated by Abu Harairah (RA) from the Prophet (PBUH) whosoever removes a worldly hardship from a believer, Allah (SWT) will remove from him one of the hardships of the hereafter. Whosoever alleviates the needy person, Allah (SWT) will alleviate from him in this world and the next (Sahih Muslim, Kitab al-Birr, Book 32 No.6250)

In this respect, the Islamic Financial Services Act 2013 (Malaysia) defines Takaful as: Takaful means an arrangement based on mutual assistance under which Takaful participants agree to contribute to a common fund providing for mutual financial benefits payable to the Takaful participants or their beneficiaries on the occurrence of pre-agreed events.

For this purpose, unlike conventional insurance practice, the Takaful Risk Fund (tabarru fund) is managed and accounted separately from the shareholders fund. The Takaful operator only acts, as the manager and trustee of the Takaful Risk Fund on behalf of the Takaful participants.

Contemporary Islamic scholars have recommended that the most suitable contracts to be applied in the management of a Takaful business are generally based on 3 concepts, namely al-Mudharabah or al-Wakalah or al-Waqf or a combination of the 3 contracts. There are studies by jurists and researchers to employ other contracts such as al-Wadiah, etc., which has yet to be fully explored. The 3 models are briefly explained after:

Takaful based on al-Mudharabah Model: al-Mudharabah (trustee profit-sharing) may be defined as a contractual agreement between the provider of capital (sahibul mal) and the entrepreneur (mudharib) for the purpose of a business venture whereby both parties agree on a pre-determined profit-sharing ratio whereas losses of the venture will be the sole responsibility of the capital provider except for losses due to the negligence, misconduct, violation of conditions by the entrepreneur (Usmani, 2007).

The principle of al-Mudharabah when applied to atakaful contract defines the Takaful operator as the entrepreneur who undertakes the Takaful business activities (of basically managing the Takaful fund collected from participants based on tabarru who agree to jointly guarantee each other against losses defined in the Takaful contract) and the participants who entrust funds to the Takaful operator by means of Takaful contributions. The Takaful contract may specify (in some model) the proportion of profit (surplus) to be shared between the participants and the Takaful operator (Hasan, 2011).

Takaful based on al-Wakalah Model: The term wakalah means performing tasks on behalf of others, delegation of a task or job to another and in English it generally means agency. The AACIFI Shariah Standard No. 23 defines wakalah as: The act of one party delegating the other to act on its behalf in what can be the subject matter of delegation.

Under Takaful, this model entails the operator (the wakeel) to manage the Takaful Risk Fund (muwakkalbihi) as an agent of the participants (the muwakkil) and is paid a fee (the ujah) for its services. Profit and losses from the management of the Takaful Risk Fund belong entirely to the participants, unless the losses were due to the negligence or misconduct of the Takaful operator (The SAC of BNM approved this model at its 24th meeting dated 24 April, 2002).

Takaful based on al-Waqf Model: Waqf literary means, detention but its legal meaning is the dedication of a property or giving it away in charity for a good purpose and other religious, pious or charitable purposes. The establishment of waqf, according to Doi (2007) extinguishes the right of the dedicator (waqif) and transfer its ownership to Allah (SWT). For Takaful under this model, a waqf account has to be established by the operator within the Takaful Risk Fund. To this effect the operator is required to relinquish some kind of seed money, as waqf to operationalize the said waqf fund. The waqf fund shall work to achieve the following objectives:

- To extend financial assistance to its members in the event of losses
- To extend benefits to its members strictly in accordance with the waqf deed

All the expenses related to the under writing and operational cost of Takaful shall be charged to the waqf fund. As manager, the Takaful operator will perform all functions necessary for the operations of the waqf fund against a wakalah fee to be deducted from the contribution paid by the participants (The SAC of BNM at its 87th meeting dated 23rd June, 2009 approved the waqf model for Takaful).

Takaful based on Hybrid Model: This business model is a combination of the 2 principles of al-Mudharabah and al-Wakalah. Under this model, a relationship between the operator which combines the role of entrepreneur or mudharib, as well as the agent or wakeel of the participant whilst the latter in the capacity as both provider of capital or sahibul-mal and principal to the agent. By this arrangement on the part of the operator, an agency fee can be remunerated as upfront charges from the Takaful Risk Fund whilst at the same time will have the right to profit-sharing on returns on the investment of the Takaful Risk Fund in accordance with the al-Mudharabah contract.

A summary of the key features of the various Takaful models was formulated by Ernst and Young (2011) as follows (Table 1).

Table 1: Features of Takaful Models

Items	Mudharabah	Wakalah	Hybrid	Wakalah waqf
Share of technical results	None	Percentage of upfront contribution	Percentage of upfront contribution	Percentage of upfront contribution
Share of investment result	None	None	Agreed profit-sharing ratio	Agreed profit-sharing ratio
Share of surplus (technical and investment results)	Pre-agreed percentage of surplus	None	None	None
Loss on investments	Borne solely by participants	Borne solely by participants	Borne solely by participants	Borne solely by participants
Operating expenses	Borne solely by shareholders' fund except for direct expenses of the Takaful Risk Fund	Borne solely by shareholders' fund except for direct expenses of the Takaful Risk Fund	Borne solely by shareholders' fund except for direct expenses of the Takaful Risk Fund	Borne solely by shareholders' fund except for direct expenses of the Takaful Risk Fund
Deficit in Takaful Risk Fund	Qard al hassan from shareholder's fund	Qard al hassan from shareholder's fund	Qard al Hassan from shareholder's fund	Qard al hassan from shareholder's fund
Creation of Takaful Risk Fund	Participants' Takaful contributions	Participants' Takaful contributions	Participants' Takaful contributions	Participants' Takaful contributions and initial waqf fund from shareholders' fund
Liquidation of Takaful Risk Fund	Accrue to participant's only	Accrue to participant's only	Accrue to participant's only	Waqf amount must go to another existing Waqf Fund and cannot be disbursed among participants

CONCLUSION

In sum, this study tries to highlight again the history of Takaful, its Shari'ah aspect and operational models since Takaful becomes part of the lives now-a-days. Literature provides the evidence that the concept of Takaful has been practiced since pre-Islam period and the intention is to help. In addition, the prohibition of insurance due to the involvement of interest, gambling and uncertainty from the Islamic perspective is discussed. This study further, elaborates the dominant Takaful operational models, such as al-Mudharabah, al-Wakalah and al-Waqf Model. It is expected that this study will be the interest of regulators, industrial players, customers, Shari'ah scholars and public as well.

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