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Ilhamiddin Ikramovich Nazarov; Naeem Suleman Dhiraj

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Human beings are naturally inclined towards safeguarding and protecting themselves from future misfortunes. This natural tendency of risk mitigation has given rise to the concept of insurance which existed thousands of years ago and was fervently practiced by many ancient tribes. Over time, the concept of insurance has changed since it is now being commercialized and have been transformed into a profit-oriented business. To revive the legacy of the real concept of insurance, the takāful (Islamic insurance) scheme was introduced in the second half of the 20th century differentiating itself from conventional insurance practices. The takāful scheme is strictly based on Islamic law known as Shari'ah. This paper thus expounds on the concept of takāful assimilating a holistic overview of this emerging industry while sorting the differences between the takāful scheme and the conventional insurance mechanisms. It concludes that the takāful (Islamic insurance) scheme is a robustly viable and sustainable alternative to conventional insurance.

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A Conceptual Understanding and Significance of *Takaful* (Islamic Insurance): History, Concept, Models and Products

Ilhamiddin Ikramovich Nazarov

International Islamic University Malaysia (IIUM)

Ph.: +60 11 283 41200

Email: ilhamiddinn@gmail.com

Naeem Suleman Dhiraj

Corresponding author

International Islamic University Malaysia (IIUM)

Ph.: +60 12 431 7861

Email: dhirajnaeem@gmail.com

Mailing address: IIUM Institute of Islamic and Finance (IiBF)

International Islamic University Malaysia (IIUM)

53100, Selangor, Malaysia

Abstract

Human beings are naturally inclined towards safeguarding and protecting themselves from future misfortunes. This natural tendency of risk mitigation has given rise to the concept of insurance which existed thousands of years ago and was fervently practiced by many ancient tribes. Over time, the concept of insurance has changed since it is now being commercialized and have been transformed into a profit-oriented business. To revive the legacy of the real concept of insurance, the takāful (Islamic insurance) scheme was introduced in the second half of the 20th century differentiating itself from conventional insurance practices. The takāful scheme is strictly based on Islamic law known as Shari'ah. This paper thus expounds on the concept of takāful assimilating a holistic overview of this emerging industry while sorting the differences between the takāful scheme and the conventional insurance mechanisms. It concludes that the takāful (Islamic insurance) scheme is a robustly viable and sustainable alternative to conventional insurance.

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1. Introduction

The modern forms of insurance are relatively new, but the concept is not. Thousands of years ago, transferring the risks and losses were practiced among individuals and groups. For example, in many societies, when a house burned down, the entire community contributed to rebuilding it. These benevolent

practices still exist among some primitive tribes (Raynes, 1948). Around 3000 B.C., marine insurance was used by Chinese merchants where the concept of protection and insurance was practiced against trade losses. They distributed their cargoes in several boats, and if one of the boats sank, the merchant lost only a part of his cargo (Abdul Rahman & Redzuan, 2009). A different kind of insurance was developed by the Indians and Greeks against sinking ships. Ship-owners financed their commercial voyages by borrowing money from creditors with placing their ships as collateral. If profit were gained, they would repay their debts with high rates of interest. In the event, if the loss was incurred or the ship sank, they were free from repaying the debts (Al-Hanis, 1979). Ancient Romans had benevolent societies with developed life and health insurance where aged and sick individuals were helped financially, and funeral insurance was provided. Also, their soldiers were subscribed to health and disability plans (Khorshid, 2004).

2. Pre-Islamic Practices

Before the advent of Islam, ancient Arab tribes had practiced the concept of “*kafālah*”, where they were loyal to their tribes and had developed a strong tribal system to protect their members against any hazards. For instance, if any of the tribal members committed a crime such as murder, a war would break out amongst them which at times even lead to more deaths and tragedies. These grievances were mitigated by paying what is known as blood money in order to avoid further revenge and tribal bloodsheds. All of the members of the tribe contributed in the form of a donation to meet the compensation funds for the victim's family. Such donations were collected to settle compensation for any tribal disputes. This kind of cooperation and practices were known as “*Aqilah*”, where the members of the tribe shared burdens of each other. The entire community guaranteed each other against any losses or hazards that could occur to them which is identical to the concept of contemporary mutual insurance (Alhabshi & Shaikh Abdul Razak, 2009).

Ibn Khaldun had written in *The Preface (Al-Muqaddimah)* that the Arabs have practiced some methods to compensate and indemnify the voyage members of the group against any losses in their business ventures, which were known as winter and summer voyages. They paid a percentage of their profit or capital to compensate for any losses or damages faced by any of the voyage members (Khorshid, 2004). The same practices of “*Aqilah*” continued even after the advent of Islam due to its obvious benefits which are clearly emphasized and supported in the Holy Qur’an.

The Prophet (pbuh) reinforced “*Diyah*”, compensation paid to the victim’s heirs in the case of murder. The value and quantum of compensation were agreed upon between the families. One who committed the murder/crime was individually liable for the payment or compensation, but the common practice was that “*Aqilah*” (close kin of the murderer) or the tribe was supposed to pay the compensation as well (Alhabshi & Shaikh Abdul Razak, 2009). The second caliph of Islam, Umar ibn al-Khattab (May Allah be pleased with him), had formed a similar scheme known as “*Qasamah*” to pay the compensation to the victims of the one who was murdered, in the event the murderer could not be identified (Abdul Rahman & Redzuan, 2009). At the end of the eighth century, Muslims had built a powerful naval force and developed marine navigation and science. Merchants realized the necessity of insurance to cover the losses from the hazards of the sea. Based on the ethical norm of helping one another, they contributed to the fund to compensate

one who suffered any losses (Alhabshi & Shaikh Abdul Razak, 2009). Commercial insurance contracts are relatively new in the Islamic world. It was initially examined by Hanafi jurist (*Ibn Abidin 1783-1836 A.D.*), that some Muslim merchants have sought his opinion about marine insurance under the principles of *Shari'ah*. He opined about marine insurance that, "I see that it is not permitted to any merchant to get indemnity for his damaged property against the payment of a certain sum of money known as insurance premium; because this is a commitment for what should not be committed to". The discussion continued after *Ibn Abidin* for a century regarding the legitimacy of commercial insurance based on the Islamic standpoint, where it was subjected to deep revisions among the Islamic jurists (Ahmad, 2007; Anwar, 1994; Khan, 2005).

In 1965, The Congress of Islamic Research in Cairo discussed the validity of conventional insurance in the Islamic world. In 1976, after 11 years, the first International Conference on Islamic Economics was held in Makkah, Saudi Arabia. More than 200 Islamic jurists and economists attended this big event where they reached a consensus announcing all types of conventional insurance as unlawful since it was in contradiction with the principles of the *Shari'ah*. This decision was approved by the Organization of Islamic Cooperation (OIC) in 1985 in Jeddah in which it was stated that "The contract of commercial insurance with periodical fixed premium provided by the present-day insurance companies is a contract which is void and therefore *harām* in accordance with the requirements of the *Shari'ah*". Mutual insurance or *Takāful* scheme was approved by OIC to replace the system of insurance as it is moral and structured on mutual help and cooperation for the sake of the society (ISRA, 2016).

The first *takāful* insurance was introduced in Sudan in 1979. The industry was stimulated by the growth of Muslim's need for Shariah-compliant insurance. The Shari'ah board of the Faisal Islamic Bank in Sudan issued a fatwa with regards to the *Takāful* scheme, and the first *Takāful* Company was founded by the bank under the Company's Act 1925 to become a public company. Thus, the concept of *Takāful* has spread to other parts of the Islamic world as well. In Malaysia, the first Act of *Takāful* was enacted in 1984, where the company was launched as a private limited company. Nowadays, there are many *Takāful* operators around the globe in Muslim and non-Muslim countries (Obaidullah, 2005; Ochieng, 2013; Sharifuddin, Kasmoen, Taha, Talaat, & Talaat, 2016; Solomon, 2014).

3. Methodology

This research delves into the conceptual understanding of the *takaful* industry in Malaysia since its awareness, outside of Malaysia, is not as comprehensive as it ought to be. The researchers believe that for a robust fathoming of the subject matter, the qualitative research analysis tends to be the best approach. To carve out a comprehensive structure which not only provides a detailed understanding of the concept of *takaful* to its audience but advertently, it also draws a baseline for the differences between the conventional and the Islamic insurance practices. This distinction is crucial for a broader audience to clarify many of the pre-existing misconceptions about *takaful*. The research primarily contains data from the available literature, library research, case studies, and document analysis.

4. Findings and Discussion

The term *takāful* is an Arabic word derived from the word “*Kafala*”, which means “warrant”, “bail”, or “guarantee” (Engku & Odierno, 2008; Ismail, 2011). *Takāful* refers to an arrangement for mutual solidarity and indemnity that protects members who face defined risks and dangers. *The takāful* scheme needs to be in line with Islamic ethics and norms in order to be acceptable among the Muslims where the existence of principles such as cooperation (*Ta’āwun*) and donation (*Tabarru’*) is necessary (Redzuan, Abdul Rahman, & Aidid, 2009).

The AAOIFI's *Shari’ah* Standard No. 26 of November 2017 defined the *Takāful* scheme as "Islamic Insurance (which) is a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability. The resources of this fund are used to indemnify any participant who encounters an injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of policyholders or a joint stock company that manages the insurance operations and invests the assets of the fund, against a specific fee." The International Association of Insurance Supervisors (IAIS) and Islamic Financial Services Board (IFSB) defined the *Takāful* scheme as “*Takāful* is the Islamic counterpart of conventional insurance and exists in life, family and general forms. It is based on concepts of mutual solidarity, and a typical *Takāful* undertaking will consist of a two-tier structure that is a hybrid of a mutual and a commercial form of company”.

4.1 Concept and Significance

The essence and idea of *takāful* revolve around mutual assistance, protection, indemnity, solidarity, and sharing liabilities among the participants (Engku & Odierno, 2008). Facing risks or dangers as a group and working collectively makes the burden of loss much lighter and affordable. If any of the members are afflicted with harm, the entire group feels responsible for assisting the afflicted member. It is significant since it creates harmony and brotherhood among the participants. As mentioned above, similar features were perceived under the Arab’s tribal customs and practices in the form of ‘*Aqilah*’ regarding the fulfilment of blood money, which was approved and adopted by Prophet Muhammad (PBUH).

Basically, in the *Takāful* scheme, groups of people facing the same peril and harm will be willing to make contributions in the form of a certain sum of money to a common fund, which can be used for the compensation to those members who suffer from a defined loss. For instance, in the case of modern motor policy, a vehicle driver faces many risks daily while driving. These motor-cycle drivers may form a group and make contributions to a particular sum of money to compensate any participant that may suffer an accident. A similar concept of insurance can also be applied to marine and fire. Islamic teachings highly emphasize such fervent arrangements of indemnity and solidarity emphasized by Islamic teachings while similar injunctions are also found in many Holy Qur’anic verses and the sayings of the Prophet Muhammad (PBUH).

Profit maximization is not the primary objective of the *Takāful* scheme. If any of the customers decide to exit from the fund, they receive a full refund of the premium they have paid after deducting the operations

costs; this is however not the case in the conventional insurance (Solomon, 2014). In conventional insurance, the nature of the relationship between the insurance company and the policyholders is of a vendor and vendee, which is undoubtedly different from the *Takāful* scheme. *Takāful* promotes sharing responsibilities to protect policyholders against misfortunes and risks according to the policy (Alhabshi & Shaikh Abdul Razak, 2009).

4.2 Shari'ah Basis

The basis of *Takāful* can be deduced from the *Shari'ah* teachings and the injunctions of the Holy Qur'an, the Sunnah and the legal maxims. Allah (SWT) commands Muslims to be involved and contribute to good deeds as it is mentioned in Surat Al-Maidah:

"Help ye one another in righteousness and piety, but help ye not one another in sin and rancour, fear Allah, for Allah is strict in punishment" (Qur'an, 5:2).

The above Qur'anic verse refers to the form of mutual help, spreading good deeds, and practicing virtue. The essence of *Takāful* is to help each other in difficult circumstances wherein removing the perils and hazards from the participants is an excellent form of cooperation which is in line with the commands of Allah (SWT). There are several Ahadith where the Prophet (PBUH) encourages believers to help each other and overcome hazards:

- (i) "Allah (SWT) will always help His servant for as long as he helps his brother [in need]" (Narrated by Imam Ahmad and Imam Abu Daud).
- (ii) "The believers are like the body; when one of its parts is afflicted with pain, the rest of the body will also be affected" (Narrated by Imam Bukhari and Imam Muslim).
- (iii) "One true believer and another true believer are like a building, whereby every part in it strengthens the other part" (Narrated by Imam Bukhari and Imam Muslim).
- (iv) "By my life, which is in Allah's power, nobody will enter Paradise if he does not protect his neighbour who is in distress" (Narrated by Imam Ahmad).
- (v) "Whosoever removes a worldly hardship from a believer, Allah will remove from him one of the hardships of the hereafter. Whosoever alleviates the needy person, Allah will alleviate from him in this world and the next" (Narrated by Imam Muslim).

Preceding *Ahadith* inspires and urges Muslims to take care of each other, work collectively, and think about the needy. With *Takāful* strategy and risk mitigation, hazards and unpleasant events can be alleviated and disbursed over all participants rather than leaving the heirs and the properties to the chance. If the hazard was to be borne individually, it may damage the person and cause him/her severe harm. Hence, it can be perceived that the concept of *Takāful* is highly encouraged in *Shari'ah*. Muslims are responsible for one another and their community. True believers never harm or leave the needy (Alhabshi & Shaikh Abdul Razak, 2009; Engku & Odierno, 2008).

4.3 Objectives

Essentially, the objective and the purpose of the *Takāful* scheme is not only about gaining profits but also to support and bear the loss of other participants. The basic concept of *Takāful* revolves around sharing

risks among participants, providing protection, solidarity, cooperation, and mutual help to all participating members in order to overcome unpleasant events and inflictions (Abdullah, 2015). Participants jointly agree to guarantee proper help and monetary compensation to the members of the group for any catastrophe or disaster that may potentially put them in a worse-off situation (Yousof, 1990). As such, the dilemma becomes lighter, and the financial burden of the needy alleviates while preventing them from falling into the debt pit.

The concept of *Takāful* reflects the goals of *Shari'ah* as perceived from the Holy Qur'an and the Sunnah (Abdullah, 2015). Initially, the idea of insurance was altogether neglected by the Islamic jurists since it contained prohibited elements such as uncertainty, gambling, and usury. Notwithstanding, with the introduction of *Takāful* however, these elements were abolished hence revitalizing the concept insurance by implementing the *Takāful* scheme (Khorshid, 2004).

4.4 Risk Management

Some Muslims have a common misunderstanding about the concept of *Takāful*. They assume that by subscribing to *Takāful* one involves into risk mitigation –which in Arabic is known as “*Qada' val Qadar*” (predestination) –and that it is against Allah's (SWT) will; however, it is not. Neither *Takāful* scheme denies predestination nor does it attempt to prevent it. The role of *Takāful* is to merely reduce the impact of the event of hardship after its occurrence.

Preparing to protect oneself from the future catastrophes is evident from the following *Ahadith* and occasions described below.

- (i) It is evident from the Holy Qur'an that Prophet Ya'qub (PBUH), father of Prophet Yusuf (PBUH), resorted to risk management method when he ordered his sons to enter Egypt from different gates (Yasin & Ramly, 2011). The Holy Qur'an states that "And he said, "O my sons, do not enter from one gate but enter from different gates; and I cannot avail you against [the decree of] Allah at all. The decision is only for Allah; upon Him I have relied, and upon Him let those who would rely [indeed] rely" (*Surat Al-Yusuf, Verse 67*).
- (ii) When Prophet Muhammad (PBUH) saw a *Bedouin* leaving his camel untied, he questioned the *Bedouin* saying, "Why don't you tie down your camel?" The *Bedouin* replied, "I put my trust in Allah". The Prophet (PBUH) said, "Tie your camel first, then put your trust in Allah" (Narrated by Imam Tirmizi & Ibn Majah).
- (iii) Saa'd ibn Abi Waqqās (May Allah be pleased with him), one of the companions of the Prophet (PBUH), before his dying had enquired from the Prophet (PBUH) about donating two-thirds of his wealth to charity, the Prophet (PBUH) replied to him that, "it will be better to leave your heirs wealthy rather than leaving them in poverty begging from others".
- (iv) In the era of the second caliph, Umar ibn al-Khattab (May Allah be pleased with him), similar occasions had occurred for instance when a cholera epidemic had wide-spread in some territories, he withheld from entering those areas and justified saying that, "We run from one divine destiny to another".

According to the preceding Qur'anic verse and the Prophetic narrations, Muslims are obliged to safeguard themselves, preserve their properties, and undertake necessary precautions to mitigate risks or losses instead of waiting to be saved miraculously. It is essential to manage *Takāful*'s risks properly according to the principles of the *Shari'ah* and provide a solution when conducting business.

4.5 Prohibited Elements and Proposed Solution

From an Islamic standpoint, none of the aspects of the contract should violate the *Shari'ah* principles. Investments and activities based on *riba* (interest) and gaining profit without bearing risk are prohibited in *Shari'ah* due to its oppressive nature and unfair distribution of risk and return. In order to make it valid, *Shari'ah* requires that all transactions must be free from prohibited elements such as *riba* (interest), *gharar* (uncertainty), and *maysir* (gambling).

4.5.1 Usury (*riba*)

The term *riba* means expansion, growth, increase, usury, interest, or any predetermined excess on loan based on time value of money or for deferred payments when the debtor is unable to settle his debt after a fixed period (BISC Group, 2008; Engku & Odierno, 2008). The reason why *Shari'ah* condemns conventional insurance products is that they are involved in interest-bearing transactions. In the modern financial system, conventional insurance companies rarely keep their collected premiums in cash; usually, it is invested in interest-bearing fixed income instruments. Based on Islamic laws, charging or paying interest is not allowed, regardless of the interest amount or the purpose of the contract (Hachemi et al., 2014). Dealings based on *riba* is a form of injustice leading to manipulation and exploitation where the rich get richer, and the poor becomes poorer. Allah (SWT) prohibits *riba* in the Holy Qur'an gradually in four stages.

In the first stage, Allah (SWT) compares *riba* (interest) with *zakat* (obligatory financial contribution) and *sadaqa* (voluntary charity). Not only that, Allah (SWT) in fact praises *zakat* and *sadaqa* to remind people to think about the repercussions of *riba*.

“And whatever you give for interest to increase within the wealth of people will not increase with Allah. However, what you give in zakah, desiring the countenance of Allah – those are the multipliers” (*Surat Ar-Rum, Verse 39*).

In the second stage, Allah (SWT) condemns Jews' practices of *riba* considering it as *dhulm* (injustice/oppression) since it wrongfully devours people's rights and properties.

"For wrongdoing on the part of the Jews, We made unlawful for them [certain] good foods which had been lawful to them, and for their averting from the way of Allah many [people]. And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And we have prepared for the disbelievers among them a painful punishment” (*Surat An-Nisa, Verses 160-161*).

In the third stage, Allah (SWT) prohibits the method of usury, charging double and multiple.

“O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful” (*Surat Ale-Imran, Verse 130*).

In the fourth stage, Allah (SWT) finally prohibits all kinds of *riba*, forbidding charging or gaining any excess over the capital.

“Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein” (*Surat Al-Baqarah, Verse 275*).

Immediately in the succeeding Verse, Allah (SWT) says,

“Allah destroys interest and gives increase for charities. And Allah does not like every sinning disbeliever” (*Surat Al-Baqarah, Verse 276*).

Generally, a conventional insurance company deposits and invests its funds in conventional banks and investment instruments or portfolios in which their income is based on interest (*riba*). Additionally, imposing interest against late payment towards premium of the policyholders. Interest-based activity is prevalent in conventional insurance companies. Thus, in order to be compliant with the rulings of *Shari'ah*, *riba* must be excluded from all operations and transactions in *Takāful* business (Billah, 2013).

4.5.2 Uncertainty (*gharar*)

The term *gharar* means ‘deficit in clarity’, ‘deceit’, ‘ignorance’, or ‘uncertainty’ in a business transaction over the terms, substance or attributes of the contract (Abdul Rahman & Redzuan, 2009). Transactions must be devoid of *gharar* since it is a crucial requirement for a contract to be valid in Islam. Prohibition of *gharar* can be deduced from the verse in *Surat-An Nisa* in the Holy Qur'an:

“O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful” (*Surat An-Nisa, Verse 29*).

According to a *hadith* reported by Said ibn al-Musayyib (May Allah be pleased with him), the Prophet (pbuh) “Forbade from an uncertain transaction” (Narrated by Imam Malik). Hence, from the above verse and the narration, uncertainty is prohibited in transactions. In order to protect rights and obligations, to ensure equal power in dealing and provide full consent for involved parties in the contract, it is necessary to eliminate all factors that lead to *gharar*. Contracts will be rendered void due to the existence of extreme uncertainty (*gharar faahish*) which affects the validity of the contract. Minor uncertainty (*gharar yasir*) is generally tolerated and does not affect the validity of the contract. In charitable and unilateral contracts, the existence of *gharar* does not have any adverse effect on the validity, and it is generally tolerated since in the charitable and unilateral contracts nothing is expected in return (Engku & Odierno, 2008).

Furthermore, all terms and conditions must be clearly stated and defined for the parties involved in the business venture. In conventional insurance, policyholders are unaware as to how the profit is generated, realized, distributed and how the funds are invested, which renders the entire agreement as *Shari'ah* non-

compliant. If losses occur, policyholders are compensated; however, if there are no losses, policyholders' premiums are not reimbursed. Additionally, conventional insurance does not practice profit and loss sharing between the participants and the company. However, in a *takāful* scheme, rules and conditions are pre-defined, and the income distribution is transparent in the agreement. *The takāful* scheme is not meant for maximizing profit; instead, it is built based on mutual cooperation, indemnity, and solidarity providing financial assistance as well as moral support against losses and hazards to the participants or their properties.

4.5.3 Gambling (*maysir*)

The term *maysir* means 'betting', 'gambling' or 'wagering'. It may exist in the form of *gharar* since they are intertwined. *Maysir* occurs in the conventional insurance contracts where policyholders give a lesser amount of premium to the insurance company in a hope to get more substantial sum if hazards were to occur. The policyholder may lose all contributed premium if a defined event does not happen, there is always one party that wins, and another loss, which is contrary to the *takāful* scheme (Abdul Rahman & Redzuan, 2009; Hachemi et al., 2014).

Transactions between policyholders and conventional insurance company resemble a game of chance since at the end of the contract there is always one party that loses. To further clarify, if the customer makes a claim, the insurance company loses; and if there is no claim, the customer loses the premium he/she has paid. Majority Islamic jurists consider conventional insurance products to be *Shari'ah* non-compliant as it involves gambling. In *takāful* however, all terms and conditions are precisely defined. Those who suffer from any hazard will be compensated for their contributed premium plus from other participants' donations. Game of chance and gambling are condemned by *Allah* (SWT) in the following verses:

- (i) "...They ask you concerning wine and gambling. In them is a great sin and some profit for man, but the sin is greater than the profit" (*Surat Al-Baqarah, Verse 219*).
- (ii) "O you who believe! Intoxicants and gambling, (dedication of) stones, and (divination by) arrows are an abomination of Satan's handwork: eschew such (abomination), that you may prosper" (*Surat Al-Ma'idah, Verse 90*).

In the above verses, *Allah* (SWT) advised and warned against gambling while prohibiting it in the Holy Qur'an. Islam prohibits all activities that involve uncertainty, and excessive risks where gaining or losing money is based on chances and speculations.

5. The Solution

Generally, the idea of insurance does not contradict the *Shari'ah* laws because the essence is noble, which is to help members to overcome troubles and provide protection against potential losses. It is impossible to reject the idea of insurance in modern life due to people's need for financial support from perils or hazards. In order to make it *Shari'ah* compliant, there was a need to "Islamize" the idea of insurance by modifying and removing prohibited elements that harm policyholders and the society at large. Albeit, the idea of insurance in Islam is as follows:

"Islam is not against the concept of insurance itself but against some of the means and methods that are currently used in conventional insurance. The concept of mitigation of risks by adopting the law of large numbers was widely used in Islam and especially in the practice of "Al-Aqilah" (the practice from ancient Arab tribal custom). However, to be acceptable in Islam, any form of insurance should avoid the elements of *riba*, *maysir* and *gharar*, although elements of *gharar* may be forgivable depending on the circumstances" (IFSB & IAIS, 2006).

If *takāful* companies avoid depositing collected funds in conventional banks and interest-based investments, *riba* and other prohibited elements will be wiped out automatically. Since the essence of *takāful* is indemnity, solidarity, sharing responsibility, and mutual cooperation, the element of gambling (*maysir*) does not exist. There is no winner or loser; in fact, all members may benefit from the *takāful* scheme. Islamic jurists have suggested avoiding the elements of *gharar* by bringing the conventional insurance scheme closer to the *Shari'ah* principles. It is mandatory to modify conventional insurance to donation (*tabarru'*) and mutual cooperation (*ta'āwun*) contract with a condition of compensation. Experts acknowledge that the elements of *gharar* remain (to a certain extent) in *takāful* because the occurrence of hazard is unpredictable. Due to the benevolent and charitable essence of *takāful*, such uncertainty is acceptable and tolerated (Engku & Odierno, 2008).

The essential difference between Islamic and conventional insurance is the feature of donation. The relation between the conventional insurance company and its clients is a relation of vendor and purchaser of an insurance policy. On the contrary, in the *takāful* scheme, there is no purchasing or selling of the policy, only contributing money based the spirit of donation which is then to be used for compensation to the participant, in the event of a claim.

6. Operational Models

The primary requirement for *takāful* products is to adhere to the *Shari'ah* laws. A *takāful* scheme comprises of two parties, the participants and the operator. The scheme is not profit-oriented, and the nature of contract among members is based on donation whereby all participants agree to donate a sum of money to the fund. The donation is utilized to compensate members in case they face defined perils or hazards. A few commonly used models are listed below.

6.1 Mudārabah Model

The structure of this model is designed based on the principles of *mudārabah*. It is essentially a profit-sharing contract between the capital provider (*rabb-ul-maal*) and the entrepreneur (*mudarib*). *Takāful* operators offer their skills and experiences in managing collected funds and act as a fund manager (*mudārib*). Participants provide the required capital and act as a capital provider *rabb-ul-maal*. Derived profits are shared between parties based on the pre-agreed profit-sharing ratio. However, in case of financial loss, participants are to bear all the losses while the *mudārib*, in this case, does not get compensated (Archer, Karim, & Nienhaus, 2009; Serap, 2013).

There is no salary or periodic payments for the operator except the pre-agreed shares of profit. In the *mudārabah* model of the *takāful* scheme, the capital is owned by the participants (*rabb-ul-maal*); whereas

in the conventional insurance, the capital is owned by the company and the insurer is the sole beneficiary of realized profits (Al-Salih, 2004; Attar, 1983). Figure 1 below illustrates the flow of basic *mudārabah* operational model of the *takāful* scheme.

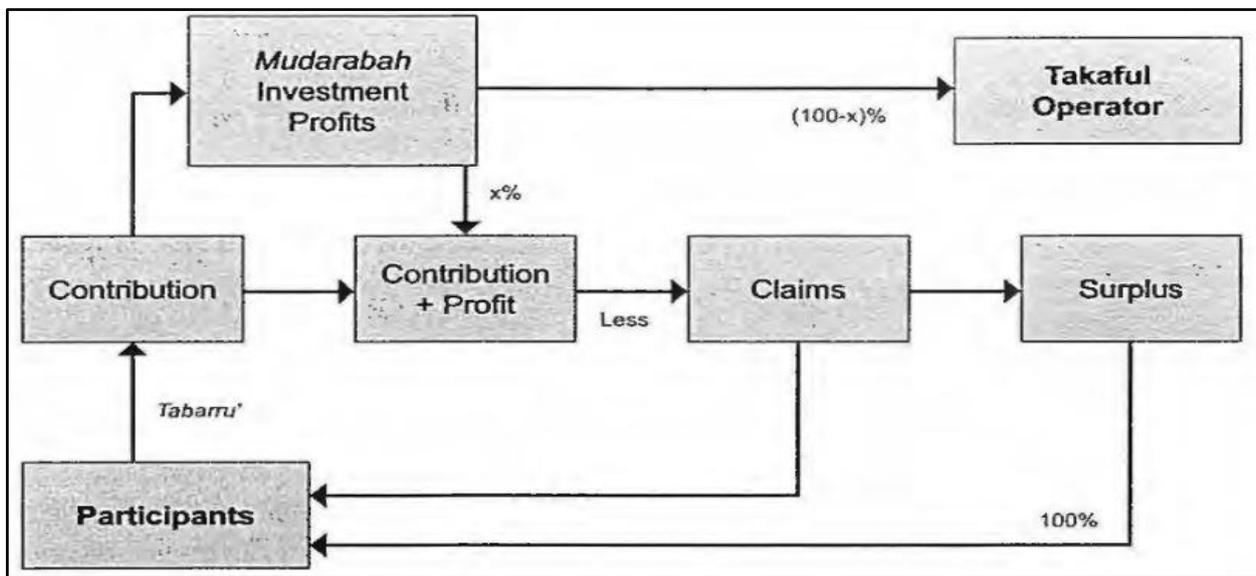


Figure 1: *Mudārabah* operational model in a *takāful* scheme (Engku & Odierno, 2008).

6.2 Wakālah Model

The structure of this model is designed based on an agency contract (*wakālah*). This contract entails an authorization from the participants by the operator to represent and execute permissible dealings. The *takāful* operator acts as an agent of the participants to manage and invest collected funds (Hassan, Abbas, & Zainab, n.d.; Tolefat & Asutay, 2013). The realized profits and losses from investments and *takāful* operation solely belong to the participants. The *takāful* operator, as an agent of the members, is responsible for distributing shares of profits to the participants as per their contribution to the fund and is compensated based on a pre-agreed service fee which is deducted from the collected funds (Andrew, 2007). Figure 2 below illustrates the flow of basic *wakālah* operational model in a *takāful* scheme.

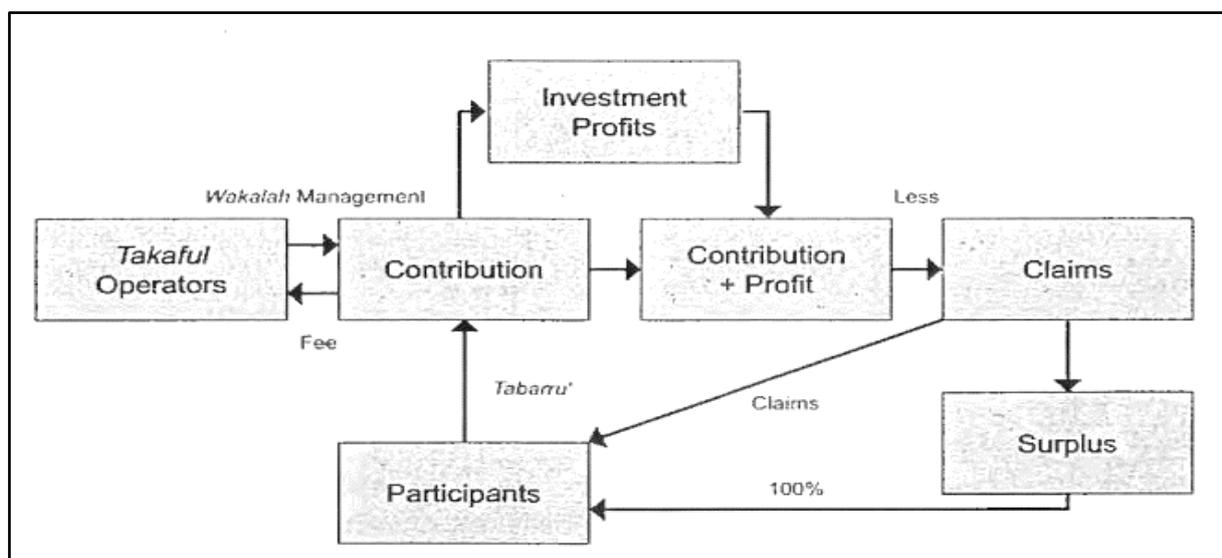


Figure 2: *Wakālah* operational model in a *takāful* scheme (Engku & Odierno, 2008).

6.3 Waqf Model

The structure of this model is designed based on the concept of charity (waqf). It means a "religious endowment" bestowed for the sake of Allah (SWT), which is done by donating permanent assets such as buildings, books, agricultural machinery, livestock, shares stocks and even cash. It is acceptable based on the condition that the physical asset itself is not depleted with the flow of the benefits from such assets (Kahf, 2003). Therefore, the participants of the *takāful* fund have no right to it since the ownership of the *waqf* fund solely belongs to Allah (SWT). They are not entitled to receive any profit or surplus from the fund but are permitted to only claim for compensation in case of occurrence of a misfortune (Tolefat & Asutay, 2013). Figure 3 below illustrates the flow of basic *waqf* operational model in the *takāful* scheme.

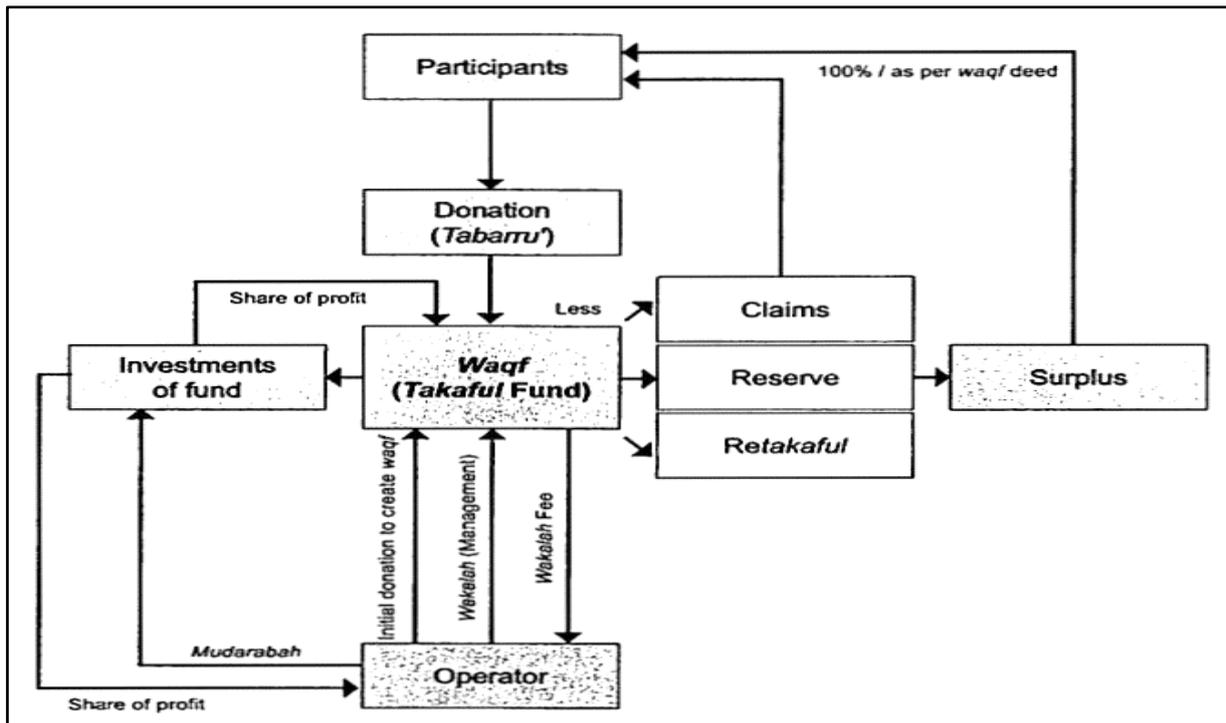


Figure 3: *Waqf* operational model in a *takāful* scheme (Engku & Odierno, 2008).

6.4 Hybrid Model

The structure of this model is designed by combining *mudārabah* and *wakālah* contracts. *Takāful* fund operator and participants sign two contracts simultaneously; *mudārabah* for investment and *wakālah* for underwriting (Tolefat & Asutay, 2013). Enables the operator to act as an agent as well as an entrepreneur at the same time. It receives a fee on *wakālah* basis plus a share from the derived profit based on a pre-agreed *mudārabah* contract. The operator has no right to reserved amounts that remain after redeeming all claims. All losses are entirely borne by the *takāful* participants provided that the *takāful* operator did not act negligently. If proven otherwise, the *takāful* operator bears the losses. Figure 4 below illustrates the flow of transactions in the hybrid (*mudārabah –wakālah*) operational model in the *takāful* scheme.

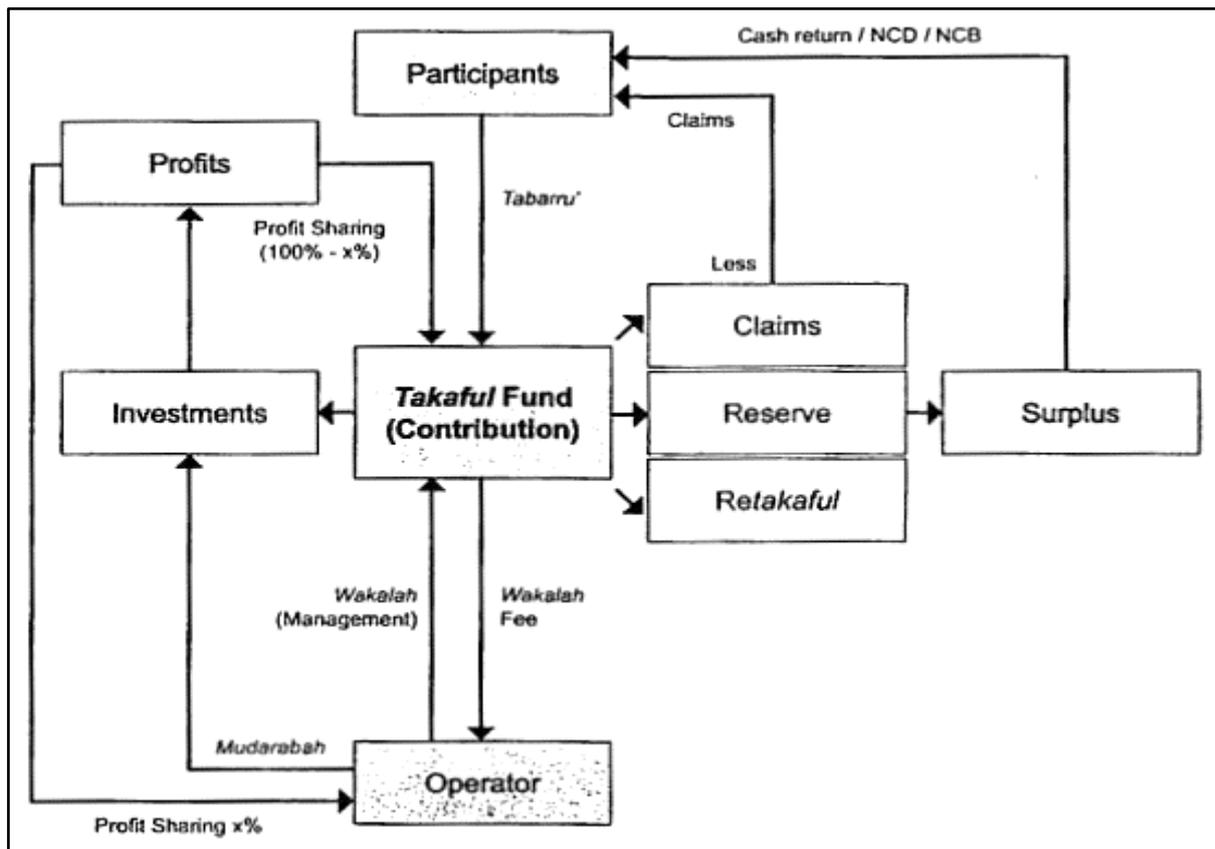


Figure 4: Hybrid (mudārabah-wakālah) operational model in a takāful scheme (Engku & Odierno, 2008).

In all of the above discussed takāful models, the operator allocates the contributed funds in two separate accounts: 1) Participants' Account (PA) where funds are invested in a Shari'ah-compliant business. 2) Participants' Special Account (PSA) where members are compensated if there are any losses. After realizing the profit, the surplus is then distributed between members based on their contribution except in the case of waqf model, where the realized profit from investments remains in the takāful fund without any distribution among the participants (Marifa Academy Team, 2014).

7. Products of Takāful

7.1 General Takāful

General takāful products are typically designed to provide a form of Shari'ah-compliant risk-sharing and risk management mechanisms on an annual renewal basis. In this scheme, the relationship among the participants is based on ta'awun and tabarru'; whereas the relationship between takāful operator and participants, it is based on mudārabah, wakālah, or waqf (Yasin & Ramly, 2011). Several general takāful products are designed, and a few of them are as mentioned below.

- (a) Motor takāful: This type of policy protects the participant against any losses or damages to the insured vehicle due to theft, accident, fire or third-party property damage or bodily injury.

- (b) Fire *takāful*: This type of policy protects the participant against any losses or damages caused by fire, lightning, or explosion to their properties. It includes but not limited to buildings, machinery, plant, furniture, and accessories. The fire takaful scheme usually excludes damages caused by earthquake, volcanic eruption, or typhoon scheme.
- (c) Engineering *takāful*: This type of policy protects the contractor's interest against any losses, damages, or liability due to different causes to the construction of bridges, buildings, dams, and towers.
- (d) Marine *takāful*: This type of policy protects the participant against any perils or damages to the property while it is in transit. It includes sea peril, collision, stranding, fire, and severe weather. Such coverage may be provided to marine transport or road and aviation. Moreover., it can also be a combination of all (Marifa Academy Team, 2014; Yasin & Ramly, 2011).

7.2 Family Takāful

Family *takāful* products are typically designed to offer protection against the risks of death or permanent disability. Under this scheme, the participant may benefit from long-term savings and investment returns according to a pre-agreed ratio based on *mudarabah*. Also, the participants in a family *takāful* scheme entrust their money to the *takāful* operator and conduct a *wakālah* contract which enables the operator to act as their agent.

The participants' contribution in the form of a donation to the *takāful* fund is deposited in PSA. The funds are used to compensate claimant's family in case of the claimant's demise or permanent disability. The contribution in the form of savings is deposited in PA for investment in *Shariah*-compliant businesses. *The takāful* operator is responsible for distributing the surplus based on participants' contribution to the fund. There are several types of family *takāful* products offered by various operators which are primarily divided into two categories; 1) Individual family *Takāful*: In this type of product, the member of the fund has policy protection against any defined risks, including mortgage, education, or health. 2) Group family *Takāful*: In this type of product, the members have policy protection for themselves and their families against any defined risks, including mortgage, group health, and education. Their families are entitled to receive financial benefits in case of illness, death or permanent disability (Marifa Academy Team, 2014; Yasin & Ramly, 2011).

8. Differences between Takāful Scheme and Conventional Insurance

The common objective of all insurance schemes is the alleviation of the financial burden when peril, hazard or catastrophe occurs to the participants. Nevertheless, there are some differences between the *takāful* scheme and conventional insurance. *The takāful* scheme is designed on mutual cooperation, solidarity, and indemnity while guaranteeing one another against any future losses or catastrophe. Participants jointly agree to share the financial burden and support members of the group in overcoming the defined incident. Collectively donated money to the fund is managed and invested by the *takāful* operator while being utilized to compensate the participants (Maysami, Golriz, & Hedayati, 1997; Muhammad, 2013).

In conventional insurance, the risk and hazards are transferred from the insured party to the insurer company (Pfeffer, 1956). Conventional insurance scheme comprises prohibited elements, which

contradicts the basic principles of Islamic laws (Siddiqi, 1985). *The takāful* company does not act as an insurer; instead its role revolves around managing and investing the contributed funds. The operator is neither selling the risk coverage nor are the participants purchasing it. Additionally, it must be emphasized at this juncture that unlike the conventional insurance, the risk (of having to compensate participants for claims), for the *takāful* operator, is not an exchange for the contributed amount to the fund; instead, the risk is shared among the members (Yousof, 1990). Nevertheless, conventional insurance company acts as an insurer, and its framework is structured based on "risk assumption", while it may pay less (or more) than the actual value of the insured property (Ali, 1989).

In *Takāful* scheme, the sources of funds are from the policyholders wherein the *takāful* operator manages the business activities through *mudārabah*, *wakālah* or *waqf* models. Meanwhile, in conventional insurance, the sources of funds are from the shareholders, and the business activities are solely managed by the insurer (the company) without any participation of the policyholders. In *Takāful* scheme, collected funds are invested in *Shari'ah*-compliant businesses. *Takāful* increases the moral values of the society and offers suitable approaches for abolishing the dilemmas being faced due to the unique risks (Hachemi et al., 2014). When a conventional insurance company sells the policy to the clients, the company agrees to undertake and compensate the clients if they suffer from a defined loss. The inclusions and exclusions of the type of coverage in policy is determined. When an insured event occurs, the company compensates the client; whereas if the defined event does not occur during the period, the company possesses all of the paid premiums and the insured receives nothing.

Although the objectives of an insurance scheme are good, such practices are not compliant with Islamic laws. The existence of the elements of chance and uncertainty creates an ambiguity in the contract, which is not acceptable according to the *Shari'ah* rulings. There is always a winner, and a loser in such a contract where gaining more than the premium paid based on a chance is akin to gambling. The other prohibited instrument in a conventional insurance company is investments in interest-based activities (Alhabshi & Shaikh Abdul Razak, 2009).

Table -1 Comparison between *Takāful* and Conventional Insurance

	<i>Takāful</i>	Conventional Insurance
Contract type	A combination of <i>tabarru'</i> contract and an agency and/or profit-sharing contract.	Contract of exchange (sale and purchase) between insurer and insured.
The obligation of participants/policy holders	Participants are duty-bound to contribute to the scheme and are expected to share the surplus mutually.	Policyholders are duty-bound to pay the premium to the insurer.
The obligation of the operator/insurer	The <i>takāful</i> operator acts as the administrator of the <i>takāful</i> fund and is thus benefited from it. If there is any deficiency in the fund, the <i>takāful</i>	The insurer is liable to pay benefits as promised from the insurance fund and/or shareholder's fund.

	operator must provide interest-free loans (<i>qard al-hasan</i>).	
Returns of the operator/insurer	The <i>takāful</i> operator earns a return for rendering services for managing the <i>takāful</i> funds from <i>mudārabah</i> profit-sharing scheme as <i>mudārib</i> and as an agency fee from <i>wakālah</i> contract.	The insurance company makes a profit when there is an underwriting surplus.
Counter value	Counter-value (<i>'iwad</i>) is the effort and/or undertaking of risk.	No explicit or valid counter-value. Source of profit is anticipating (hoping) that the uncertain future will be in their favour.
Indemnification component	The indemnifications component is based on mutual contribution (<i>ta'awun</i>) reciprocal donation (<i>tabarru</i>).	The indemnification component is a commercial relationship between the insurance company and the insured.
Insurer-insured relationship	There is no insurer-insured relationship between <i>takāful</i> operator and participants. Participants act as both the insured and the insurer simultaneously.	There is a clear insurer-insured relationship.
Investment fund	<i>Takāful</i> funds must be invested in <i>Shari'ah</i> -compliant instruments.	There is no restriction in investing the funds.

(ISRA, 2016)

As the Prophet (pbuh) said, "There shall come upon the people a time in which the one who is patient upon his religion will be like the one holding onto a burning ember." (Narrated by Imam Al-Tirmizi, No. 2260). In another narration, he stated: "A time will come upon people when they will consume usury". The companions asked him "Is that all of the people?" The Prophet (PBUH) said, "Whoever does not take from it will be [at least] afflicted by its dust" (Narrated by Imam Ahmad, No. 10191).

9. Conclusion

In so far, it is apparent that conventional insurance is designed to be profit-driven rather than being a rescuing tool for its subscribers. Although the subscribers are compensated in the event of the occurrence of the damage in the current insurance practices, they are however deprived of retrieving any of their contribution (paid premium) in the event of the absence of hazard occurrence. Moreover, the insurance company fully benefits financially from the chance of not having to pay its subscribers. In a *takāful* scheme, however, the participants are reimbursed a pro-rated amount of their paid premium in the event if the misfortune does not occur. Thus, the *takāful* scheme is based on an ethical and a just mechanism; the central concept is seen by many as a sustainable alternative to the existing insurance practices.

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Abbreviations

SWT = “*Subhanau Wa Ta’ala*”. An acronym used for praising the one true God the Almighty.

pbuh = *Peace be upon him*. An acronym used in the praise for Prophet Muhammad, the last and final messenger

of God the Almighty.

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